"CAN I TELL YOU SOMETHING IN CONFIDENCE?" LEGAL PRIVILEGE IN M&A TRANSACTIONS

Posted on January 22, 2020

Categories: Insights, Publications

Legal privilege can be a tricky subject in business transactions. A situation that arises frequently in corporate M&A deals is especially challenging. A lawyer or law firm represents the sellers of a target company in a sale transaction. The lawyers may represent the target company as well, either for ordinary course business law matters or specifically in connection with the sale. In the course of the transaction, the lawyers provide legal advice to both the sellers and the company. A similar situation involves the individuals receiving legal advice wearing two hats: they are sellers of the target company and also members of its management team. It can be difficult to keep track of which hat the recipients of legal advice are wearing at any given time. It gets even more complicated when the sellers need information from the company in order to give representations and warranties in a sale agreement.

The parties assume that any communications with their lawyers are privileged. But what happens after the deal closes, and the target company belongs to the purchaser (and often amalgamates with the purchaser)? Does legal privilege travel with the target company into potentially adverse hands? To an extent, this question pits the underlying purpose of legal privilege against principles of corporate identity, amalgamation and succession. There does not appear to be any authority in Ontario that answers this question directly. However, case law and emerging practices in other jurisdictions provide some guidance for how the parties to M&A deals might protect themselves from unintentionally waiving privilege.

Privilege basics:

Privilege is a rule of evidence in Canada and elsewhere, though it has evolved into a substantive legal right as well.[1] It protects communications between clients and lawyers where certain requirements are met. Privileged communications are protected from disclosure during litigation and are not admissible as evidence. Different types of privilege exist. Two of the most common types are 'solicitor-client privilege' and 'litigation privilege'.

Solicitor-client privilege protects communications between a lawyer and their client made for the purpose of seeking or providing legal advice. In order to be privileged, the communication must be made with the

expectation that it will be kept in confidence. Importantly, privilege is waived if the communication is disclosed to a third party. Solicitor-client privilege does not expire. It continues to attach to communications so long as it is not waived.

Litigation privilege attaches to documents created for the dominant purpose of existing or contemplated litigation. A document need not be created by a lawyer in order to be privileged. Litigation privilege ends once the underlying litigation (and any related litigation involving common issues) ends. Like solicitor-client privilege, it is waived by disclosure to a third party.

There is also a concept in Canadian law called 'common interest privilege'. It is a misnomer, however, because 'common interest' is not actually a freestanding source of privilege. Rather, it acts as an exception to the usual rule that parties waive privilege where a communication or document is disclosed to a third party. The common interest exception has its roots in 'joint retainer privilege', which protects two defendants who use the same lawyer to defend litigation. Where two parties share a sufficiently common interest in a matter, they may share legal opinions and information with one another without waiving privilege. Importantly, 'common interest privilege' protects the parties sharing a common interest against the rest of the world; but *no privilege exists as between the parties sharing a common interest* in respect of the information or documents that are shared.[2] In Canada, the common interest exception applies to solicitor-client privilege in the context of business transactions.[3] In other jurisdictions, including the state of New York, the common interest exception applies only to litigation privilege.[4]

Privilege in M&A transactions: Lessons from other jurisdictions

The rules governing privilege pose a challenge in M&A deals. These transactions necessarily involve multiple business parties and a change of ownership. The cardinal rule that 'privilege is waived by disclosure' fits awkwardly into the changing matrix of parties and their lawyers. If communications involve both the seller and the target company (which are distinct legal entities), does that amount to a third party disclosure that waives privilege? Even if a common interest exists between the seller and the target company in the transaction, the law says that *no privilege exists between the parties to a common interest*. So what protection does the seller have when the target moves into the hands of a purchaser? Assessing privilege can be further complicated where the computers, emails and business records of a target company containing privileged communications fall into the purchaser's control. While these issues do not appear to have been considered by courts in Ontario, they have been addressed squarely in other jurisdictions.

The New York Court of Appeals addressed privilege relating to deal advice in 1996 in *Tekni-Plex Inc. v. Meyner & Landis*.[5] The sole shareholder of a packaging company sold his business to a purchaser. He made various representations in the parties' purchase agreement about the company's compliance with government

regulations. As is common practice, the purchaser was a special purpose corporation that later merged with the target company after the sale closed. The surviving entity from the merger commenced an arbitration against the seller, alleging fraud and misrepresentation. It also brought an application before the Court to, among other things, compel the law firm that historically represented the company to turn over privileged documents on the basis that they belonged to the target. The Court of Appeals held that privilege *related to the sale transactions* remained with the seller. It distinguished between privilege over legal advice received in the ordinary course of the target company's business (which travelled along with the target after it was sold) and privilege over legal advice connected to the sale transaction itself (which remained with the seller, notwithstanding the sale of the target). The Court drew a distinction between the 'old' and 'new' target company. It concluded that the seller retained privilege over communications between his lawyer and the target from the time "*when [the seller and target company] were joined in an adversarial relationship to [the purchaser]*" (i.e., before the sale). The Court of Appeals reached this conclusion mostly on the basis of first principles, including the need to protect the expectations of confidentiality that facilitate frank legal advice: privilege is a "*prophylactic measure that frees clients from apprehension that information imparted in confidence might later be used to their detriment*". That purpose would be thwarted if the 'new' company were granted control over the privileged communications regarding the merger transaction.

The Alberta Court of Queen's Bench reached a different conclusion in 2013 in *NEP Canada ULC v. MEC OP LLC*.[6] That case followed the sale of an oil and gas operating subsidiary of the seller to a strategic purchaser. Before and during the sale, the seller's legal counsel provided advice to the target company, including advice regarding the target's disclosure obligations in the sale transaction. The purchaser amalgamated with the target following the sale. The amalgamated company inherited emails and other materials containing privileged communications with the seller's lawyers. It sued the seller for various misrepresentations regarding the company's compliance with environmental regulations. It took the position that the emails and records were its property (by virtue of the post-closing amalgamation) and should be disclosed in the litigation. The defendant seller argued that the communications were subject to a privilege belonging to it alone, and that the materials should be returned to it without disclosure in the litigation. The Court of Queen's Bench agreed with the plaintiff that the communications had been shared with the target company by the seller in a common interest during the sale transaction, and that there can be *no privilege as between the target and the seller*.[7] In reaching this conclusion, the Court declined to follow the approach in *Tekni-plex*. Instead, it cited the decision of the US Supreme Court in *Commodity Futures Trading Commission v. Weintraub* for the proposition that "*when control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well*." The Alberta Court noted that the parties could have included a provision in their share purchase agreement extinguishing any rights of the target to waive privilege over the documents, but they did not.[8]

Shortly after *NEP v. MEC* was released, the Delaware Court of Chancery reached a similar conclusion in *Great Hill Equity Partners IV LP, et. al. v. SIG Growth Equity Funds I, LLLP, et. al.*[9] The case involved the sale of an online payments company to a special purpose corporation created by a private equity fund sponsor. The target company's value was largely a function of its existing relationships with other industry participants, including PayPal. After the sale closed, the purchaser sued the seller for fraudulent misrepresentation for failing to disclose that key contractual relationships had been terminated. The Court of Chancery considered and rejected the approach in *Tekni-plex*. It held that such approach ignored the Delaware General Corporations Law governing mergers, which provides that "*all property, rights, privileges, powers and franchises, and every other interest shall be thereafter as effectually the property of the surviving or resulting corporation*".[10] Just like the Court in *NEP v. MEC*, the Court of Chancery cited *Weintraub* for the proposition that displaced managers of a target company may not assert privilege over the wishes of its current managers. It also emphasized that matters of privilege can be addressed contractually:

"the answer to any parties worried about facing this predicament in the future is to use their contractual freedom … to exclude from the transferred assets the attorney-client communications they wish to retain as their own"

Following the *Tekni-Plex* and *Great Hill* decisions, a practice has developed in the United States to address privilege through contractual provisions in share purchase agreements and merger agreements (often referred to as '*Great Hill* clauses'). According to a 2019 study by the American Bar Association, 70 per cent of private M&A deals reviewed included provisions deeming deal-related privileged communications to be the property of the seller.[11] In 2019, the Delaware Court of Chancery enforced such a clause in *Shareholder Representative Services LLC v. RSI Holdco, LLC*.[12] The parties to a merger agreement included a provision preserving privilege for the seller over pre-merger communication in connection with the sale. It also required that the buyer take necessary steps to maintain the effectiveness of the privilege and prevented the buyer from relying on privileged communications in any subsequent litigation. The Court noted that the sellers "*heeded the Great Hill court's advice – they used their contractual freedom*".

The path forward in Ontario?

It is notable that Section 179 of the *Ontario Business Corporations Act* includes very similar language to the provision of the Delaware General Corporate Law that drove the Court's analysis in Great Hill. Section 179 provides that upon amalgamation, "*the amalgamated corporation possesses all the property, rights, privileges and franchises … of each of the amalgamating corporations*".[13]

While there does not appear to be any judicial guidance on the issue from Ontario, the authorities from other jurisdictions highlight the tension that exists between two sets of legal principles: the need to protect parties'

ability to receive frank legal advice on the one hand, and the rules of distinct corporate identity and succession on the other.

While the use of '*Great Hill* clauses' in share purchase agreements may provide a practical solution to that tension, it is not clear that they will be given effect in all circumstances. At its core, privilege is a rule of evidence. It prevents *courts* (not just contracting parties) from reviewing evidence that is otherwise relevant and might assist courts to do justice. In this sense, privilege is different from private rights that can be bought, sold, created, extinguished or alienated by contract. Arguably, parties are not entitled to create privilege by agreement where it would not otherwise exist. Privilege that was waived by disclosure before a transaction closes (or that did not exist in the first place because the requisite expectation of confidentiality is missing), cannot be manufactured contractually.

As the use of *Great Hill* provisions expands in the Canadian market, Ontario courts may have to resolve the tension between the different principles at play, and decide the extent to which matters of privilege can be determined by agreement.

Lessons for sellers (and their lawyers):

Notwithstanding the lack of guidance in Ontario, parties to M&A transactions can take some lessons from the experience of other jurisdictions. They and their lawyers should turn their minds to the following questions:

1. **Where could litigation happen?** As we have learned, the law of privilege has evolved differently in different jurisdictions. Even among English-speaking common law jurisdictions in North America, there are important differences in approach. Courts will often apply their own rules of privilege, even where the underlying facts in a dispute occurred elsewhere.[14] Many M&A deals in Canada involve parties and lawyers in different jurisdictions. Before a transaction gets underway, it is wise to discuss the contours of privilege with counsel in the jurisdictions where litigation might ensue.

2. **Who is the client?** Ask this question early and often. It is common for one law firm to represent both the sellers and the target company in a sale transaction, or for the transaction to proceed with some ambiguity as to which party is the client for what purposes. There are risks to such an arrangement.

- In the course of a sale transaction, there are good reasons that the sellers' lawyer might speak to employees and officers of the target company (especially where the sellers are required to make representations about the state of the company). The sellers also frequently wear two hats, as selling shareholders and as management of the target company. For each communication, consider whether the purpose is to give or receive legal advice, and whether any individual's participation might constitute a waiver of privilege.

- When sellers are also members of the target's management, be aware of the email accounts that are used to seek and receive legal advice (and where those emails might end up when the transaction is done).
- Where a lawyer is advising both the seller and target company, consider whether a 'common interest' exists that will prevent waiver of privilege. It should not be taken for granted that the target company shares the same interest as the seller in closing the transaction. The target may have an interest in avoiding any misrepresentations, which departs from the seller's interest in completing the transaction on the most favourable terms. Consider when it becomes essential that the target company retain separate counsel, and what matters should not be discussed between the sellers and the target.
- Finally, keep in mind that, generally, no privilege exists between the parties to a common interest. Until an Ontario court decides otherwise, sellers should assume that a common interest with the target company will not protect privilege if that target becomes an adversary after the deal closes.

3. **What can we agree on?** Consider whether it is practical and desirable to address ownership and control over privileged communications by including a 'Great Hill clause' in the parties' agreement. Where the purchaser is likely to come into possession of privileged communications after the deal closes, the seller may wish to require the purchaser and its affiliates to take steps to preserve the seller's privilege. Conversely, the purchaser may wish to limit the extent of seller protections if it subsequently discovers actionable conduct by sellers.

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[1] *Blood Tribe Department of Health v. Canada (Privacy Commissioner)*, 2008 SCC 44 AT 10.[ps2id id='1' target='/]
[2] *R. Manes and M. Silver, Solicitor-Client Privilege in Canadian Law*, (Toronto: Butterworths, 1993 at p. 45). See also *NEP Canada ULC v. MEC OP LLC*, 2013 ABQB 540 [*NEP v. MEC*] at 12.[ps2id id='2' target='/]
[3] *Iggillis Holdings Inc. v. Canada (Minister of National Revenue)*, 2018 FCA 51 at 42.[ps2id id='3' target='/]
[4] *Ambac Assurance Corp. v. Countrywide Home Loans*, 27 NY3d 616 (NY Court of Appeals, 2016).[ps2id id='4' target='/]
[5] 89 NY2d 123 (1996) [*Tekni-plex*].[ps2id id='5' target='/]
[6] *NEP v. MEC*.[ps2id id='6' target='/]
[7] *NEP v. MEC* at 30.[ps2id id='7' target='/]
[8] The *NEP v. MEC* decision might be criticized on a couple grounds. It takes for granted that the seller and target company shared a common interest in the success of the transaction. Arguably, the target company should have been agnostic as to its ownership, and had no particular interest in closing the transaction. Also, the Court's conclusion is premised on the *existence* of a common interest and the *absence* of a joint retainer. It

ignores that the common interest exception grew out of the joint retainer exception to waiver; the two concepts should have the same effect on the existence of privilege, not opposite effects. However, neither of these errors were necessary for the Court to reach the same result. If there simply was no common interest and no joint retainer in the first place, then there should simply be no privilege to fight over.[ps2id id='8' target=''/]
[9] 80 A.3d 155 (Del. Ch. 2013) [*Great Hill*].[ps2id id='9' target=''/]
[10] Emphasis added.[ps2id id='10' target=''/]
[11] American Bar Association, Business Law Section: *Private Target Mergers & Acquisitions Deal Points Study (including transactions from 2018 and Q1 2019)* https://www.americanbar.org/digital-asset-abstract.html/content/dam/aba/administrative/business_law/deal_points/2019_private_study.pdf, page 123.[ps2id id='11' target=''/]
[12] CA No 2018-0517-KSJM (Del Ch May 29, 2019).[ps2id id='12' target=''/]
[13] R.S.O. 1990, c. B.16, s. 179(b), emphasis added.[ps2id id='13' target=''/]
[14] For a discussion of this issue see B. Kain, "*Solicitor-Client Privilege and the Conflict of Law*" in *The Canadian Bar Review*, Vol. 90, No. 2 (2011).[ps2id id='14' target=''/]

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.