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# Ownership of Privileged Communications in M&A Transactions: Practical Takeaways and Recent Case Law

Authors: Jonathan Bilyk, Michel Gélinas and Kevin Greenspoon

Can the buyer in a M&A transaction who takes possession of the seller's or target company's privileged communications on closing use those communications in a post-closing dispute against the seller? Can the seller assert privilege and demand return of the documents? In *Dente v Delta Plus Group* the Ontario Superior Court of Justice validated the use in M&A agreements of contractual provisions that preserve a seller's ownership over privileged materials, such as pre-closing deal communications with counsel. The decision is also a reminder for sellers to exercise caution regarding the use of target company email accounts to communicate with counsel during the course of a deal and after closing.

In this bulletin we start with some practical takeaways to consider for M&A transactions (Part I), then review the *Dente* decision (Part II) and discuss recent Delaware case law on these issues (Part III).[1]

## Part I: Practical Takeaways

**The purchase agreement should address what happens to privileged communications at closing.**

- *Dente* confirms that parties to a share purchase agreement may contract to override the default principle that the buyer will effectively assume ownership and control of the target company's solicitor-client privileged communications at closing. While there are no Canadian decisions considering these issues in an asset sale transaction, clear contractual language in the purchase agreement addressing the parties intentions' regarding the transfer and retention of privileged communications should govern the outcome in that context as well.
- When drafting the provision, the parties should consider whose privileged communications (seller and/or target) and which privileged communications (deal communications and/or other pre-closing communications) should be preserved. The parties may also include a "no use" clause that further articulates their understanding as to which documents cannot be used in any post-closing litigation, including non-privileged communications. The parties should, however, be sure that they own and control the privilege necessary to manage the operations, assets and liabilities they will inherit or retain on closing.

**Where possible, privileged documents should be removed from the target company's servers and other records before closing.**

- Even where a seller has contracted to retain privilege over certain communications, it is recommended that the seller still excise those communications from any data systems or other records that will transfer to the buyer at closing. Generally, the protection of solicitor-client privilege will attach to communications between a lawyer and client that occur along the continuum of seeking and giving legal advice and that are made with a reasonable expectation that those communications are confidential. If documents are left behind by the seller for the buyer to access, the buyer may claim that the seller has waived privilege over them on the grounds that the seller has abandoned any reasonable expectation of confidentiality. Documents inadvertently left behind are more likely to withstand a claim that privilege has been waived if the seller can demonstrate that it undertook reasonable efforts to remove privileged communications from the target company's records before closing.

- The seller may include covenants in the purchase agreement that the buyer will not (i) claim privilege has been waived over any documents left behind or (ii) use such communications in any post-closing dispute with the sellers regarding the transaction. While such covenants should prove helpful in the event of a dispute, a seller may not always want to rely on them as an alternative to document removal; a buyer who stumbles upon such documents cannot "unsee" what it has seen, and buyer's counsel may take the leaving behind of such documents as an invitation to claim that privilege has been waived. Of course, any document removal should be undertaken in accordance with the purchase agreement.

**Use of confidential email accounts and corporate email policy.**

- An employee's use of their work email account for personal communications with their counsel may not satisfy the requisite level of confidentiality for privilege to attach to the emails. This may be the case if the employee does not have a reasonable expectation of privacy regarding their emails, such as when the employer has a policy restricting the use of company email for personal matters, monitors emails and/or warns that any emails sent through work accounts will not be confidential vis-à-vis the company.
- The seller and target company management should consider how they will communicate with counsel at the outset of a transaction. Where a seller is using a target company or other corporate email account (such as a work account with another employer that has access to the emails) to communicate in the seller's personal capacities with their counsel about the deal, privilege may be waived where the seller does not have a reasonable expectation that their communications will be confidential vis-à-vis third parties (including the target company, to the extent it is not a joint client with the seller). In some cases, a seller might use an independent, secure email account to avoid these issues, which has the added benefit of simplifying the task of excising documents from the target company servers at closing (see above). Avoiding the use of a target company email account, however, may be less relevant when the seller and target are joint clients of counsel for purposes of the transaction. In this case, the seller and target company will generally share privilege over deal communications, making it all the more important for the parties to specify in the transaction documents who retains and controls the privilege on closing (see above).
- While the purchase agreement may specify who has control over pre-closing privileged communications, the buyer will typically have control over any target company emails generated after closing. Accordingly, a seller should generally avoid using target company email accounts for deal-related communications with counsel after closing to avoid any claim by the buyer that privilege over such communications has been waived.

**Consent for seller to use deal counsel post-closing.**

- Where the seller and the target company are joint clients of counsel or where the seller has a relationship with target company counsel, the parties may want to address in the purchase agreement whether the seller may use such counsel in any post-closing dispute against the buyer to avoid any claims that counsel is conflicted from acting against the target company or its affiliates (including the buyer) post-closing.

**Understanding who the client is.**

- Whether a solicitor-client relationship exists is a fact-driven analysis. In most cases, the answer will be clear. In other cases, such as in *Dente* where counsel had historically acted for both the sellers and the target company, it may be prudent to set out clearly in the legal retainer for a M&A transaction who counsel is representing in the deal. However, the retainer is but one indicia of a solicitor-client relationship. Other factors, including which party receives the legal invoice, gives instructions or receives advice, may be relevant to determine who counsel is representing for the matter. Clarity can be important because, as *Dente* illustrates, where the seller and target company are joint clients, neither can claim confidentiality or privilege against the other over any counsel communications relating to the joint representation.

## Part II: Dente et al v Delta Plus Group et al

***Background***

*Dente* arose as a privilege motion in a civil dispute involving two individual plaintiffs (father and son) who sold the outstanding shares in a pair of companies, Degil Safety Products (1989) Inc. (Degil) and Ontario Glove and Safety Inc. (OGS), to Delta Plus Group (Delta). The transaction was effected by way of a share purchase agreement. To assist Delta with post-closing integration, the sellers entered into consulting agreements pursuant to which they continued working with the target companies after the sale. Those agreements came to an early end following the sellers' resignations or the termination of the agreements, with the specifics of the demise forming part of the larger dispute regarding the purchase agreement, the consulting agreements, earn-out payments and related matters. Two years after the sale, the sellers sued Delta and the target companies, Degil and OGS.

The plaintiffs retained as litigation counsel the same law firm and lawyer that had represented them in the Delta transaction (Seller Counsel). Dating from 2010 onward, Seller Counsel had acted for the plaintiffs individually regarding various matters, including estate and family matters and their interests in Degil and OGS. Occasionally Seller Counsel also represented Degil and OGS.

During document review for production, the defendants' counsel identified (but did not review) 387 documents in their possession as potentially containing solicitor-client communications between the sellers and Seller Counsel. The documents included both deal communications for the Delta transaction and pre-deal communications unrelated to the transaction. The sellers asserted privilege and brought a motion for the return of the documents. The parties agreed on a protocol and engaged neutral counsel to review the documents at first instance. Neutral counsel narrowed down the subject documents to just 135, which were delivered to the Court for review under seal.

***Joint clients and successors to privilege***

Generally, the protection of solicitor-client privilege will attach to confidential communications between a lawyer and client that occur in the continuum of seeking and giving legal advice. The privilege belongs to the client and, while judicially protected as near absolute, can be lost in certain circumstances, including where the communications have been disclosed to third parties other than by way of inadvertence (see discussion below).

In *Dente,* the sellers' ability to assert solicitor-client privilege over the subject documents turned on whether they and the target companies were joint clients of Seller Counsel. Rules of evidence and lawyers' professional codes of conduct dictate that as between joint clients "no information received in connection with the matter from one client can be treated as confidential so far as any of the [other clients] are concerned" (see the Law Society of Ontario's *Rules of Professional Conduct*, Section 3.4-5). The defendants argued that Degil, OGS and the sellers were jointly represented by Seller Counsel in the Delta transaction and, as a result, that no communications between the sellers and Seller Counsel regarding the transaction could be confidential or privileged vis-à-vis Degil and OGS. As the court put it, as joint clients, the sellers and target companies would hold joint privilege over the communications.

Whether the target companies held rights over the privilege attaching to the subject documents was relevant to the dispute because, as the Court affirmed, "solicitor-client privilege that is held by an original owner passes to a successor-in-title to the business, and is then held by the subsequent owner". Delta, as the buyer of the outstanding shares of the target companies, effectively assumed ownership over Degil's and OGS's rights of privilege as they existed at closing. The Court was by no means breaking new ground in applying this principle. What is notable about the decision, however, is that the Court adopted an important qualification to the successor rule that has seldom been considered in Canadian case law: following the position adopted by the Alberta Court of Queen's Bench in its 2013 decision *NEP Canada ULC v MEC OP LLC*, the Court held that parties to a share purchase transaction are free to contract, by way of the inclusion of a clause in the purchase agreement, for the seller to retain the rights to privileged communications.

While the *NEP* decision may be read strictly as standing for the proposition that a contractual provision allocating privilege may be used only in respect of solicitor-client communications pertaining to the transaction to which the clause relates, this is perhaps too narrow of an interpretation. The reasoning in *Dente* suggests that parties are generally free to contract to allocate privilege as they see fit, whether that be privileged deal communications or other materials.

***The target companies were not joint clients with the sellers and did not assume rights over the privileged communications***

The purchase agreement for the Delta transaction did not contain a clause preserving the sellers' ownership in the target companies' privileged communications. If the sellers and target companies were joint clients of Seller Counsel for purposes of the transaction then the sellers' privileged deal communications would be available to the defendants because Degil's and OGS's rights in the joint privilege would have passed to Delta at closing.

The Court noted that whether a solicitor-client relationship exists is a fact-driven analysis. The question is whether a reasonable person in the circumstances would reasonably believe that the lawyer was acting for a particular party. Based on certain indicia, such as the fact that the purchase agreement stated that Seller Counsel was acting for the sellers and testimony from Seller Counsel and the sellers that they both believed Seller Counsel was acting only for the sellers, the Court held that Seller Counsel did not represent the target companies in the transaction. There was no joint privilege over the deal communications relating to the transaction and, accordingly, Delta did not acquire ownership over the privileged deal communications. However, the Court also found that there were pre-deal communications with Seller Counsel to which both the sellers and the target companies held joint privilege.

***Pre-closing communications left behind on target companies' servers***

Historically the sellers used the target companies' email accounts to communicate in their individual capacities with Seller Counsel regarding personal retainers. They continued to do so for the Delta transaction and during the tenure of their post-closing consulting arrangement.

The sellers claimed that they had taken steps to remove all privileged documents from the target companies' servers and that they believed no privileged documents remained on the servers by the time they were integrated into Delta's systems. The defendants nonetheless located on their network pre-closing seller-counsel communications and argued that, by virtue of leaving these materials behind, the sellers had waived any privilege attaching to them. For their part, the sellers claimed that they inadvertently left those documents on the servers.

Generally, the court may exercise its discretion in favour of maintaining privilege notwithstanding alleged inadvertent disclosure. In determining whether disclosure amounts to waiver, the court will consider various factors, including whether the disclosure was actually inadvertent and excusable and whether, upon discovery of the disclosure, an immediate attempt was made to retrieve the documents. Accepting the sellers' assertion that they dutifully sought to remove the subject documents from the target companies' servers and believed they had all been deleted (assertions that the defendants were unable to contradict with competing evidence), the Court held that the left behind documents had been disclosed by the sellers inadvertently and that accordingly privilege had not been waived.

This result may have been different if the target companies had a corporate email policy that restricted employees' rights to privacy and confidentiality regarding their personal communications (see discussion below). If that were the case, from the outset privilege may not have attached to the sellers' deal communications with counsel.

It also remains unclear whether a seller that contracts for the retention of privileged communications arising before closing will still need to take steps to remove those communications from the target company servers at the time of closing. While the sellers in *Dente* owned the privilege attaching to the deal communications, the Court nonetheless considered whether the sellers had waived that privilege by leaving documents in the hands of the buyer after closing. Prudence suggests that sellers seeking to retain privilege over communications should undertake reasonable efforts to excise such materials from the servers and other records transferred to the buyer at closing. While it may be impracticable or impossible in some cases to capture every document, *Dente* suggests that careful pre-closing excision of documents will be an important factor considered by the court when determining if there has been a waiver of privilege.

***Post-closing communications on buyer's servers***

Regarding the sellers' use of target company email accounts during their post-closing consulting tenure, the Court considered existing case law on whether an employee's use of an employer's computer system to send emails compromises solicitor-client privilege. The Court focussed on the general principle that an employee's ability to assert privilege over their emails depends on whether they have a reasonable expectation regarding the privacy of those communications. In so doing, it highlighted the relevance of, among other things,

whether the employer had a policy that warned its employees about such use or that limited employees rights of privacy, privilege or confidentiality regarding their emails, including any personal emails sent or received on the company's servers.

In this case, it was relevant to the Court that the defendants did not have a policy that restricted the use of email for personal communications or that stated confidentiality or privilege could not attach to any such communications, and that the sellers had not been warned by the defendants about their personal usage. Also relevant were the efforts by the sellers to delete all such emails from the system before the termination of their consulting services. The Court concluded that the sellers maintained a reasonable expectation of privacy in the emails generated during the consulting period, and, in reaching this conclusion, looked favourably upon the sellers' efforts to delete the emails and seek their immediate return after discovering that some remained on the defendants' servers.

## Part III: Recent Delaware Case Law

### *Contractual protections in M&A agreements: the Great Hill clause*

The Canadian decisions in *NEP* and *Dente* are closely aligned with the case law in Delaware, one of the preeminent business law jurisdictions that has had opportunity to consider these issues in the last decade.

In the 2013 decision *Great Hill Equity IV, LP v. SIG Growth Equity Fund I, LLLP*, Delaware's Court of Chancery held that in a merger effected under Section 259 of the *Delaware General Corporation Law* (DGCL), all privilege attaching to pre-merger communications of the target company (including those relating to the negotiation of the merger itself) passes to the surviving corporation in the merger by plain operation of Section 259 of the DGCL, unless the parties contract otherwise in the acquisition agreement. While later decisions have questioned the precise reasoning deployed in *Great Hill* (specifically, the court's interpretation of the meaning of "privilege" in Section 259 (see *Hyde Park Venture v. FairXchange, LLC*)), the substantive principle and effect of the decision remains intact. Indeed, as a pioneering decision in Delaware on this issue, the phrase "Great Hill clause" is often used to refer to the provision in a purchase agreement that preserves the seller's rights in privileged communications.

Analogous to *Great Hill*'s consideration of the legal effect of a Section 259 merger under the DGCL, we note that the target company in *NEP* had amalgamated with the buyer immediately post-closing under the *Alberta Business Corporations Act*. Consistent with the legal effect of Canadian statutory amalgamations, the Court in *NEP* confirmed that the target company's rights to pre-merger privileged communications were preserved and maintained in the amalgamated entity.

In *Dlo Enterprises, Inc. v. Innovative Chemical Products Group, LLC* the Delaware Court of Chancery held that, in an asset sale (i.e., where the seller is not extinguished or subsumed by the buyer at closing), the seller will retain the privilege related to all excluded assets reserved for the seller under the asset purchase agreement, unless the parties agree otherwise. Where the excluded assets include the seller's rights under the acquisition agreement (a customary excluded asset) the seller will by default retain all pre-closing privilege related to the acquisition agreement and negotiations. While there is no Canadian case law that considers these issues in the context of an asset purchase agreement, clear contractual language addressing the parties intentions' regarding the transfer and retention of privileged communications, including specifying which privileged communications relating to the business and the deal are to be retained by the seller as an excluded asset, should govern the outcome.

### *Inadvertent waiver*

As is the case in Canada, it is not entirely clear in Delaware whether a seller who contracts for the retention of privileged pre-transaction communications will be found to have waived this privilege if the communications are left in the possession of the buyer post-closing, such as in emails or other electronic files left on the servers acquired by the buyer.

In *Great Hill*, for example, the buyer highlighted that the seller not taken any steps to segregate privileged communications or excise them from the target company's computer systems either before the merger or in the year following closing. Because the Court held that privilege over such documents passed to the buyer by operation of Section 259 of the DGCL, it declined to consider the waiver issues. Nonetheless, the Court included strong words to suggest that it would regard unfavourably defences against waiver that are proffered by sellers who did not undertake reasonable efforts to protect the privilege in dispute.

In *Shareholder Representative Services LLC v. RSI Holdco, LLC*, the Court of Chancery had the opportunity to again consider a similar scenario, with a seller leaving privileged communications on computers and email servers over which the buyer took possession after the merger. In this case, the agreement included a Great Hill clause, which included a "no use" covenant that precluded the buyer from using any privileged communications in a post-closing dispute with the seller and a provision requiring the buyer to take steps necessary to ensure that the seller's privilege would survive and remain in effect after closing. The Court enforced the "no use" covenant and, on that basis, declined to consider whether the seller had waived privilege and vitiated the protections of the Great Hill clause. The Court commented that to the extent any privilege had been waived, such waiver would have arguably been in part due to the buyer's own breach of its covenant to use necessary efforts to preserve the privilege. Leaving a door open for further litigation on the question of waiver, the Court clarified that "Great Hill did not resolve the waiver issue".

***Post-closing use of target company/buyer email accounts***

A similar approach to determining privilege regarding employee emails used in *Dente* is followed in Delaware, where corporate policies and employee expectations as to privacy and confidentiality are key factors in the determination of whether privilege has been waived. (for example, see *Dlo, In re WeWork Litigation, Consol* and *Twitter, Inc. v. Elon R Musk, X Holdings I, Inc., and X Holdings II, Inc.*

[1] As of this bulletin's original publication date, a motion for leave to appeal has been commenced in Divisional Court.

Key Contacts: Michel Gélinas, Kevin Greenspoon and Seann D. McAleese