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You've sold your business. Did you also sell all the e-mails with the lawyers about the sale?

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One of the most important points on which lawyers educate their clients is the attorney-client privilege. Usually it is simple, but occasionally it isn't. If you are a business owner, one important question you may have is: What happens to the attorney-client privilege after I sell the business?

A recent appellate decision in New York demonstrates that the answer to this question can depend not just on which law is applied, but on which court you ask. In those cases where Delaware and New York courts would apply different rules and where jurisdiction could be established in either state, the really important question is, *Who was first to go to court?*

The elements of the attorney-client privilege

The basic elements of the attorney-client privilege are straightforward. For any document or potential testimony, we ask whether it reflects a communication between lawyer and client, whether the purpose of that communication was to enable the lawyer's rendering legal advice to the client, and, lastly, whether the communication has been deliberately kept confidential. If the answer is *yes*, *yes* and *yes*, then the attorney-client privilege applies.[1] In litigation, privileged material can be carved out from what normally must be disclosed to adversaries.

The importance of the privilege

It is hard to overstate the importance of the privilege. One way a lawyer can highlight its importance is by reminding the client of how broad the sweep for documents is in a court proceeding. It is not just e-mails that must be preserved and produced: Every kind of record counts.

Consider the plight of a chancellor of the University of Illinois some years ago. A professor sued her and other university officials. The chancellor was advised to take care when writing e-mails. So far so good. But unfortunately the lesson she took from this advice was that, going forward, she should write e-mails from a non-university account and, after hitting "send," promptly delete them from her sent-mail folder. In one of those e-mails, the chancellor even wrote this damning admission: "Robin has warned me and others not to use email since we are now in litigation phase. We are doing virtually nothing over our Illinois email addresses. I am even being careful with this

[1] *See* In re Cty. of Erie, 473 F.3d 413, 419 (2d Cir. 2007) ("A party invoking the attorney-client privilege must show (1) a communication between client and counsel that (2) was intended to be and was in fact kept confidential, and (3) was made for the purpose of obtaining or providing legal advice.").

email address and deleting after sending."[2] This university chancellor now serves as a cautionary tale of exactly what *not* to do. All documents, created in whatever medium, are fair game and must be preserved once litigation looms.

If a relevant document is to be withheld from adversaries, one of the principal ways to do it is by invoking the attorney-client privilege. Clients must, therefore, understand the privilege and remember it. And they should keep in mind how easily the privilege is waived by sharing an otherwise confidential document with an outsider.

Corporate clients

Often it is important to understand to whom, exactly, the privilege belongs. When the lawyer's client is an organization – whether a corporation, a limited liability company, or any other kind of association – then the privilege belongs to the organization – that is, the client. Indeed, New York's Rules of Professional Conduct have a special rule for lawyers engaged by an organization whose interests start to diverge from the interests of its "constituents" – that is, its "directors, officers, employees, members, shareholders or other constituents": The lawyer must "explain" to them "that the lawyer is the lawyer for the organization and not for any of the constituents."[3] Unless they have engagements of their own, the privilege does not belong to the organization's shareholders or members. And it does not belong to the organization's agents, even if the agent's title is "President" or "CEO."

Delaware's default rule when the lawyer's client is sold

Now what happens when ownership or control of the organization changes hands? If a corporate merger or consolidation resulted in a Delaware entity as the surviving or new entity, then Delaware courts have a rigid response to this question. Finding themselves bound by the command of the Delaware legislature, the Delaware courts have a "default rule" that they necessarily will apply unless the seller and buyer agreed otherwise.[4] The default rule, according to a Delaware statute, is that "all property, rights, *privileges*, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the surviving or resulting corporation."[5] Any selling shareholders who want to avoid this default rule must "use their contractual freedom … to exclude from the transferred assets the attorney-client communications they wish to retain as their own."[6]

So this is one answer to the question, What happens to the attorney-client privilege after I sell the business? According to this answer: Unless you specifically provided otherwise, you sold it.

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[2] *See* Jodi S. Cohen & Christy Gutowski, *Hidden U. of I. emails cast light on disputes*, CHI. TRIB. (Aug. 8, 2015), https://www.chicagotribune.com/politics/ct-university-of-illinois-emails-0809-20150807-story.html.
[3] Rule 1.13(a).
[4] Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 80 A.3d 155, 159 (Del. Ch. 2013).
[5] Del. Code Ann. tit. 8, § 259 (emphasis added); *accord* Del. Code Ann. tit. 6, § 18-214 ("Conversion of certain entities to a limited liability company").
[6] *Great Hill Equity Partners*, 80 A.3d at 161.

New York's refusal to apply Delaware's default rule

And yet, if you have sold your business, and the business merged into or became a Delaware entity, but you did not use your "contractual freedom" as advised by the Delaware Court of Chancery, you may have another option. If you are in New York, you might ask a New York court to award you possession of the pre-sale communications between you and your former corporation's lawyer. The recent case of *Askari v. McDermott, Will & Emery, LLP*, decided by the Appellate Division, Second Department, on November 27, 2019, demonstrates that New York courts will defy the Delaware rule even when the outcome of the sale transaction was a Delaware entity.[7]

In *Askari*, the sellers were two individuals, Kevin Askari and Burt Zweigenhaft. Their business provided pharmacy and clinical services to cancer patients. The business operated through three corporations formed under, respectively, New York, Massachusetts and New Jersey law. Between the two shareholders, Askari had control, because he held 68% of the shares of each of the three corporations.

Askari and Zweigenhaft found a buyer who was willing to keep them on as co-owners of the business but to whom they transferred control over the business. This buyer was a California corporation named "Pharmacy Corporation of America." Askari and Zweigenhaft's three corporations went through a chain of transactions, of which the final outcome was a new Delaware limited liability company that owned the entire business and that was itself, in turn, co-owned by Askari, Zweigenhaft and Pharmacy Corporation of America. Although Pharmacy Corporation of America's stake in the new Delaware entity was only 37.5%, all the members of the new Delaware entity entered an operating agreement putting management in the hands of Pharmacy Corporation of America's representatives.

Part of the overall plan was for Askari to be employed by the reorganized business. But that, it seems, was not to last. Askari joined a new, separate business. And then he asked his former business's lawyers to give him all the old, attorney-client privileged communications between him and them about the reorganization.

The lawyers balked. After all, the new entity was a Delaware limited liability company. And there was no provision in the sale agreement displacing Delaware's default rule that the attorney-client privilege passed to the new Delaware entity. That sale agreement even had a Delaware choice-of-law clause. The law firm, McDermott, Will & Emery, LLP, therefore reasoned that the attorney-client privilege over all the old documents belonged now to the new Delaware company. Accordingly, McDermott asked the new company's managers – representatives of the buyer, Pharmacy Corporation of America – whether it could give Askari his old e-mails with McDermott. The answer was, no.

[7] 114 N.Y.S.3d 412 (N.Y. App. Div., 2d Dep't 2019).

That might have been the end result, had a Delaware court been asked to weigh in. But Askari sued in New York for possession of the documents. And although the New York trial court, finding that it was bound to apply Delaware law, sided with the buyer, the Appellate Division reversed.

It did not matter to the Appellate Division that the new entity was a Delaware company – a fact that in Delaware would likely have been deemed to tie the court's hands. Nor did it matter to the Appellate Division that the purchase agreement had a Delaware choice-of-law clause. This was not an action to enforce any rights under the purchase agreement, and, according to the Appellate Division, this simply was not a Delaware dispute. Askari had previously owned a New York corporation that was advised by New York lawyers. Driving home its New York-centric view of the case, the Appellate Division noted: "The sole nexus that Delaware has to this action is that [the new company] is a limited liability company formed under the laws of that state."[8]

So much, then, for Delaware's default rule, which the Appellate Division declared "is contrary to New York public policy."[9]

The court applies New York's different rule

McDermott insisted that, in handling the corporate transactions, it had been counsel to Askari's corporate entities but not to Askari himself. The old New York corporation did not even exist anymore, so who was in a position to demand the return of the old corporation's documents? To that question, the Appellate Division answered that the old New York corporation still had the capacity to bring a civil action. "Here, [New York] Business Corporation Law § 1006 specifically provides that a dissolved corporation, like [Askari's old New York corporation], may commence an action in any court under its corporate name."[10] And Askari, as a former director of that old New York corporation, "had the right to request McDermott's files on behalf of" the now-defunct entity.[11]

Finally, McDermott had to comply with Askari's demand for the documents because, in a corporate sale, New York, unlike Delaware, automatically carves out from the sold assets the attorney-client communications that "relat[e] to the merger transaction."[12] Judgment was granted in Askari's favor.

Takeaway

The Delaware Court of Chancery has faulted New York courts for failing to recognize that "the [Delaware] General Assembly's statutory determination leaves no room for judicial

[8] 114 N.Y.S.3d at 432.
[9] *Id.* at 433.
[10] *Id.*
[11] *Id.* In addition, the Appellate Division saw grounds to discredit McDermott's insistence that it was solely the corporate entities' lawyer, not Askari's lawyer. But that was superfluous. This interpretation of New York Business Corporation Law § 1006 sufficed to put McDermott's argument to rest.
[12] *See* Tekni-Plex, Inc. v. Meyner & Landis, 674 N.E.2d 663, 671 (N.Y. 1996).

improvisation."[13] A Delaware court should not be expected to apply New York law in a case like *Askari*. For their part, the New York courts have made clear that they might refuse to apply Delaware's statutory rule even after a New York entity has become a Delaware entity. Many cases that are similar to *Askari* can just as well be brought in Delaware as in New York.[14] In such cases, parties need to recognize quickly that they are in a race to the courthouse. Because whichever court rules first – whether a Delaware court or a New York court – will likely make all the difference.

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About Pavia & Harcourt LLP

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[13] *Great Hill Equity Partners*, 80 A.3d at 159.

[14] Under § 18-111 of the Delaware Limited Company Act, the Delaware Court of Chancery has jurisdiction over any action to enforce the Act, and under § 18-109, any current or former "manager" of a Delaware limited liability company is subject to personal jurisdiction in Delaware for actions "relating to the business of the limited liability company." *See* Del. Code Ann. tit. 6, §§ 18-109, 18-111. The Delaware General Corporation Law has similar provisions. *See, e.g.*, Del. Code Ann. tit. 10, § 3114 ("Service of process on nonresident directors, trustees, members of the governing body or officers of Delaware corporations"). Considering the facts of this particular case, if Askari had spent any amount of time as a manager or an officer of the post-sale Delaware entity before his falling out with Pharmacy Corporation of America, then he might have had to defend his position in Delaware.