The Wheels Are Falling Off the Privilege Bus: What Deal Lawyers Need to Know to Avoid the Crash

*By Erik J. Olson, Gregory V. Varallo, and Rudolf Koch** | Author Bios

Over the last several years, the rise of electronic discovery, the increasing focus of in-house counsel on business roles, and the increasing complexity of mergers and acquisitions have expanded significantly the volume and type of potentially privileged documents created in connection with mergers and acquisitions. Despite the commonly held perceptions of clients and deal lawyers alike, many communications sent to or from lawyers are not privileged. In addition, courts—and, in particular, the Delaware Court of Chancery—are taking a closer look at the privilege determinations being made by litigants before them. These shifts have important practical impacts on lawyers and clients. This article examines these circumstances and recent decisions in the courts to provide practical advice for deal lawyers.

When parties execute a merger agreement involving a public company, there is a good chance of attracting litigation. Often, but unpredictably, such litigation will develop into fully contested motions and efforts to enjoin the transaction. Once the litigation process starts, it is the evidence, as opposed to the facts in the abstract, that matters, and cases frequently turn on evidence rather than hornbook law.[1]

One of the most important evidentiary issues is privilege, particularly the attorney-client privilege. Deal lawyers create a large amount of potentially privileged information, and cases can be won or lost based on whether such documents are successfully withheld as privileged. However, the rules of the litigation game are changing, and it is important that deal lawyers adapt accordingly.

Although the black-letter law regarding what type of advice is privileged has not changed, electronic discovery, the shifting focus of in-house counsel to more

* Gregory V. Varallo is a director and Rudolf Koch is an associate at Richards, Layton & Finger, P.A., in Wilmington, Delaware. Erik J. Olson is a partner at Morrison & Foerster LLP in Palo Alto, California. Richards, Layton & Finger and Morrison & Foerster have been involved in some of the cases discussed herein, but the opinions expressed in this article are those of the authors and not necessarily those of Richards, Layton & Finger, Morrison & Foerster, or their clients. Specifically, Mr. Varallo represented Broadcom Corp., Teleglobe Communications, and Western Refining Yorktown, Inc. Mr. Koch represented Western Refining Yorktown, Inc. and NVIDIA Corp.

1. The working outline of this article was drawn from a presentation given by Messrs. Olson and Varallo to the Mergers & Acquisitions Subcommittee of the Negotiated Acquisitions Committee of the Business Law Section of the American Bar Association at its meeting in August 2010 in San Francisco. The authors wish to thank Diane Frankle, Esq., the Chair of the Subcommittee, for the invitation to speak and Chief Justice Myron T. Steele of the Delaware Supreme Court for his encouragement and suggestion that the oral presentation be turned into a written article.

business matters, and the greater complexity of deals have vastly changed the volume and type of potentially privileged documents that are responsive to discovery requests. In that regard, a large number of e-mails often include numerous recipients, e.g., lawyers, employees, and bankers, and these e-mails are often then forwarded to additional individuals. In addition, lawyers often act as negotiators. The result is that many communications that deal lawyers and their clients may think are privileged are not in fact privileged.

The expansion of electronic communication has also multiplied geometrically the number of conversations that have been preserved. The end result is that blunt or "colorful" communications that were initially thought to be private often become public. This problem is magnified when clients believe, based on a mistaken understanding of the attorney-client privilege, that the communications are both private and protected from later disclosure.

Because litigators have been incentivized to err on the side of caution and broadly designate documents to or from an attorney as privileged, many such documents never see the light of day. Those incentives, however, are changing. In fact, the Delaware Court of Chancery, the nation's premiere business court, is actively changing them—and deal lawyers need to be aware of these developments.

Further, the oft-ignored issue of what state's privilege law applies is slowly coming to the forefront. This is an issue with potentially broad practical implications for deals and deal lawyers. In Delaware, as in many jurisdictions, parties traditionally have assumed that Delaware privilege law applies; absent challenge, the Delaware courts generally will apply Delaware law.[2] Alternatively, lawyers sometimes assume that the laws of the state in which they work will apply if litigation arises there. However, as the nature of discovery changes, instances of parties pressing for a non-forum state's privilege law to apply in particular cases may increase, and few will relish the prospect of multiple jurisdictions applying their own separate laws with respect to the same communications. For example, the Delaware Court of Chancery recently was faced with determining whether Massachusetts or Delaware privilege law applied to particular communications.[3] If the correct law to apply was that of Delaware, an investment banker being copied on certain communications likely would not waive privilege. If, on the other hand, Massachusetts law applied, those documents would have to be produced. In determining which state's law applied, the court utilized the complicated and multi-factored test from the *Restatement (Second) of Conflict of Laws* section 139—a test that deal lawyers should at least be aware of when rendering advice.

This article reexamines privilege based on this recent shift in the courts' and parties' focus and provides practical advice for deal lawyers.[4] Because a substan-

2. *See, e.g.*, *In re* Teleglobe Commc'ns, 493 F.3d 345, 358–59 (3d Cir. 2007).

3. *See infra* notes 78–82 and accompanying text (discussing 3Com Corp. v. Diamond II Holdings, Inc., C.A. No. 2292-VCN, 2010 WL 2280734 (Del. Ch. May 31, 2010)).

4. The purpose of this article is to provide a survey of the current state of privilege law relating to negotiated transactions and to provide practical advice to deal lawyers. Privilege law is complex, and each of the topics discussed herein could be the subject of its own article.

tial portion of merger litigation is brought in Delaware, this article focuses on Delaware law. However, the principles can be applied universally.

I. What Documents Are Privileged?

The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law.[5] Although there are many similarities, each state has its own privilege rules, as do the federal courts. In Delaware, Uniform Rule of Evidence 502(b) defines the scope of the attorney-client privilege. Rule 502(b) states, in pertinent part:

> A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client (1) between the client or the client's representative and the client's lawyer or the lawyer's representative, (2) between the lawyer and the lawyer's representative, (3) by the client or the client's representative or the client's lawyer or a representative of the lawyer to a lawyer or a representative of a lawyer representing another in a matter of common interest, (4) between representatives of the client or between the client and a representative of the client, or (5) among lawyers and their representatives representing the same client.[6]

In addition to applying to communications between an attorney and her client, in Delaware, the rule also protects confidential communications involving counsel for separate clients so long as the clients share a common interest sufficient to justify invocation of the privilege.[7] Similarly, the privilege recognized in Rule 502(b) applies to communications among non-lawyer representatives, provided that such communications are confidential and "for the purpose of facilitating the rendition of professional legal services to the client."[8]

Other jurisdictions, such as California, apply similar but somewhat different tests. Thus, in California, Evidence Code section 952 protects the information if the communication "discloses the information to no third person other than those who are present to further the interest of the client in the [legal] consultation or those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted."[9] The determination of when the participation of a non-client in an otherwise protected communication falls within or outside of these two circumstances

5. Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

6. Del. Unif. R. Evid. 502(b) (West 2010). In California, the privilege derives from the Evidence Code, particularly sections 950 to 954. It protects confidential communications between a lawyer and a client who "consults a lawyer for the purpose of retaining the lawyer or securing legal service or advice from him in his professional capacity." Cal. Evid. Code § 951 (West 2009).

7. U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C., Civ. A. No. 112-N, 2005 WL 2037353, at *1 (Del. Ch. rev. Aug. 16, 2005).

8. Del. Unif. R. Evid. 502(b) (West 2010).

9. Cal. Evid. Code § 952 (West 2009); *see also* Oxy Res. Cal. LLC v. Superior Court, 9 Cal. Rptr. 3d 621, 635–39 (Ct. App. 2004) (setting out the basic principles that trial courts should use to determine when disclosure to a third party waives or destroys the privilege).

is intensely factual.[10] Often disclosures made while investment bankers or other advisors are present will fall within the protected zone, but the outcome may vary based on where, when, and how the communication occurs and the context in which the issue arises in litigation.

Importantly, there is no state in which a statement made to or by an attorney is automatically subject to the privilege. This issue has particular importance in the context of negotiated transactions. As the Court of Chancery has stressed, "just because you use a lawyer as a negotiator doesn't make something privileged. The lawyer actually has to be operating as a lawyer."[11] The critical distinction is that the "privilege protects legal advice, as opposed to business or personal advice."[12] However, those lines are becoming blurred, and are not drawn where many deal lawyers and their clients think they are.[13] In this regard, Chancellor Strine has explained that "[t]he fact that much of the legal advice in this country is now sought and rendered by thumbs on fruit devices [Blackberries] . . . that's something that's going to lead to, frankly, more things people think" are "privileged that are not. And the mixing of lawyer roles with business roles is a danger. And I think this Court hews to, we want to know what's the capacity"—business or legal?[14]

While there are no Delaware cases setting forth bright-line rules as to which parts of the contract-negotiation process are privileged and which are not, there are transcript rulings that provide valuable insight into this issue. "[T]he fact that a lawyer, for example, bargains over an economic term with a third party doesn't mean that everything the lawyer did is subject to attorney-client privilege when he reports on a factual matter. . . . And it doesn't mean it's attorney work product."[15] The key is that "the lawyer has to be plying her trade in some way that's genuinely lawyerly, has to be looking at a context and applying legal acumen to it that's different[] than simply being a skilled negotiator or skilled linguist."[16]

10. Cal. Evid. Code § 952.

11. Transcript of Record at 41–42, *In re* Loral Space & Commc'ns Inc. Consol. Litig., C.A. No. 2808-VCS, 2004 WL 376442 (Del. Ch. Feb. 15, 2008) [hereinafter *Loral* Transcript]; *see also* SICPA Holdings S.A. v. Optical Coating Lab., Inc., C.A. No. 15129, 1996 Del. Ch. LEXIS 118, at *6 (Del. Ch. Sept. 23, 1996) ("What are protected are communications *to a lawyer by or on behalf of a client for the purpose of the rendition of legal services or lawyer statements constituting legal services*.").

12. Lee v. Engle, Civ. A. Nos. 13323 & 13284, 1995 WL 761222, at *1 (Del. Ch. Dec. 15, 1995).

13. *See SICPA*, 1996 Del. Ch. LEXIS 118, at *6 (noting that the mere "presence of a lawyer at a business meeting called to consider a problem that has legal implications does not itself shield the communications that occur at that meeting from discovery").

14. Transcript of Record at 11, Intel Corp. v. NVIDIA Corp., C.A. No. 4373-VCS (Del. Ch. Apr. 5, 2010) [hereinafter *NVIDIA* Transcript]. California courts ask equivalent questions and will not protect communications that are intended to provide purely business advice or circumstances in which the attorney acts merely as the negotiator. *Cf*. Montebello Rose Co. v. Agric. Labor Relations Bd., 173 Cal. Rptr. 856, 874 (Ct. App. 1981); Aetna Cas. & Sur. Co. v. Superior Court, 200 Cal. Rptr. 471, 475 (Ct. App. 1984). Thus, a report on communications with the other side may not be deemed privileged even though it is made by an attorney to a client, even if no one else is copied. *See Montebello Rose*, 173 Cal. Rptr. at 874 (permitting disclosure of communications concerning strategy between an attorney who was acting as a negotiator and his principal in labor negotiations).

15. *See* Transcript of Record at 195, Nokia Corp. v. Qualcomm Inc., C.A. No. 2330-VCS (Del. Ch. Apr. 28, 2008) [hereinafter *Nokia* Transcript].

16. *NVIDIA* Transcript, *supra* note 14, at 12.

"[R]eporting back what happened at the negotiating table and just saying factually what happened, the fact that a lawyer is saying it to the client and then the client and lawyer deliberate about what to go back with," does not alone make any of these communications privileged.[17] For example,

> [The lawyer states,] "I was there. They wouldn't give for this business reason.["] . . . The client says, "Well, our business reason why we can't do this is X, and you better go and do Y." That's the sort of thing that . . . is largely not going to be privileged."[18]

With respect to drafts of contracts, drafts that are shared with a counterparty are generally not privileged. Internal drafts, on the other hand, *may* be privileged. In describing when such drafts may be privileged, Chancellor Strine has explained that

> sometimes there is the sort of deep idea that drafts of documents can reveal attorney/client communications. I think that is so, particularly if there are interpolations like somebody—particularly if a non-lawyer is taking a first cut at something, . . . and they put a question mark to the lawyer. That might very well be a request for some sort of legal advice. . . . It can't be there is [sic] just peers talking about a deal, you know, because that is not fair. That is just not—that is not the way the world works. The fact that somebody happens to have a law degree versus MBA, or a law degree versus an M.A. in economics, and as a result, the communications with them about non-legal issues are somehow privileged, that is not the law.[19]

In addition, a party cannot shield business-related documents by sending them to its general counsel. The Court of Chancery has explained: "Imagine a firm that decides to run all of its communications through counsel. The first part of the document's privileged, general counsel is answering questions. Then it says 'By the way, boss, here's a report from the sales unit.' That's not privileged."[20]

For documents that contain both legal and business advice, parties must produce the business advice with only the legal advice redacted. Chancellor Strine has summarized this rule as follows:

> [E]specially at the period of time before litigation broke out between the two companies, I would expect that the communications were more of a mixed nature on both sides and that—that's where I expect lawyers to use redaction. . . .—if there's a discussion of business issues or other things that are not privileged, I expect that part of the document to be disclosed, okay? [W]here the first two paragraphs are about legal advice and the next two are about business advice, the only thing that's being redacted are the first two paragraphs . . . to me, that's really what is required in these things.[21]

Thus, although the Delaware courts have provided guidance, they have not set forth bright-line rules regarding the distinction between what is "business" advice

17. *Id*. at 5.
18. *Id*. at 13.
19. *Loral* Transcript, *supra* note 11, at 42–43.
20. *Nokia* Transcript, *supra* note 15, at 197.
21. *Id*. at 192.

and what is "legal" advice with respect to a lawyer who has handled negotiations. The issue is necessarily factual, and, despite impressions to the contrary among some practitioners, it cannot be determined in advance with certainty. Nevertheless, a party involved in contract negotiations may not shield behind the attorney-client privilege all of its internal discussions regarding those negotiations merely because a lawyer was handling the negotiations—and many documents that deal lawyers and their clients may assume are privileged are not in fact privileged under Delaware law. The key from a Delaware law perspective (and most other states) is the capacity in which the attorney is acting.

Further, even if privileged in the first instance, privilege may be waived, or a court may order production pursuant to what is known as the *Garner* exception. The court in *Garner v. Wolfinbarger* explained that in the face of an assertion of the attorney-client privilege by a corporation, a stockholder who is bringing a derivative action may be able to demonstrate good cause why that privilege should not apply.[22] *Garner* identified a nonexclusive list of factors that a court should consider in this analysis.[23] Importantly, it is impossible for a deal lawyer to know how these factors would be applied in a particular case at the time advice is being rendered. Even if *Garner* does not apply, clients may find it in their interest during negotiations or for other reasons to disclose the legal advice that they have obtained to those sitting on the opposite side of the table. Once legal advice or some other attorney-client communication is intentionally disclosed to an adversary, the privilege is waived and both the disclosed communications and others relating to the same subject matter may be subject to later disclosure.[24]

II. The Work Product Doctrine Does Not Provide a Safe Harbor

Many deal lawyers wrongly assume that even if not protected by the attorney-client privilege, their work (or the work of other advisors) is protected by the work product doctrine. However, this doctrine does not act as a catch-all. Rather,

22. 430 F.2d 1093, 1103–04 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971). Delaware has adopted the test set forth in *Garner*. *See, e.g.*, Deutsch v. Cogan, 580 A.2d 100, 106 (Del. Ch. 1990).

23. These factors are: (1) "the number of shareholders and the percentage of stock they represent"; (2) "the bona fides of the shareholders"; (3) "the nature of the shareholders' claim and whether it is obviously colorable"; (4) "the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources"; (5) "whether, if the stockholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality"; (6) "whether the communication related to past or to prospective actions"; (7) "whether the communication is of advice concerning the litigation itself"; (8) "the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing"; and (9) "the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons." *Garner*, 430 F.2d at 1104.

24. For example, in California a waiver occurs whenever the client "without coercion, has disclosed a significant part of the communication or has consented to disclosure made by anyone." Cal. Evid. Code § 912(a) (West 2009). While the language used differs from state to state, the rule is essentially the same nearly everywhere. Once a previously privileged communication is voluntarily disclosed to an adversary, the privilege is lost and disclosure may be compelled not just as to the party to whom the initial disclosure was made but to others that may seek the same information later.

it only protects the narrow subset of documents that were "written specifically in preparation for threatened or anticipated litigation."[25]

Under Delaware law, as under federal law, to qualify for work product immunity, material must be "(1) documents and tangible things; (2) prepared in anticipation of litigation or for trial; and (3) prepared by or for another party or by or for that other party's representative."[26] Substantively, the work product doctrine protects fact gathering in anticipation of litigation and strategy or tactical advice concerning pending or anticipated litigation.[27] Determining precisely when litigation is anticipated is fact intensive and often difficult.[28] Although many mergers involving Delaware public companies result in litigation, without something more, documents prepared in connection with negotiating merger agreements are *not* considered to be created in anticipation of litigation.[29] Thus, it is a mistake for lawyers, who advise clients regarding transactions in which litigation has not already been filed, to rely on a commonly held belief that their work will remain immune from discovery if litigation is later filed.

Further, even where a document qualifies for protection, the qualified immunity provided by the work product doctrine may be overcome if the party seeking to obtain the discovery makes a showing of (1) a substantial need for the materials, and (2) an inability to obtain substantially equivalent materials without undue hardship.[30]

III. What Are the Traditional Incentives with Respect to Claiming Privilege?

The Court of Chancery also understands that once in litigation, attorneys face strong incentives to over-designate documents as privileged. Vice Chancellor Laster has recently described these incentives succinctly as follows:

25. Zirn v. VLI Corp., 621 A.2d 773, 782 (Del. 1993) (quoting Riggs Nat'l Bank of Wash., D.C. v. Zimmer, 355 A.2d 709, 715 (Del. Ch. 1976)).

26. Atkins v. Hiram, Civ. A. No. 12,887, 1993 WL 545416, at *3 (Del. Ch. Dec. 23, 1993); Del. Ct. Ch. R. 26(b)(3).

27. Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc., Civ. A. No. 13590, 1996 WL 535407, at *2 (Del. Ch. Sept. 17, 1996).

28. The federal courts are split on how to determine whether a document was created in anticipation of litigation. For example, some courts hold that a document must have been prepared under a "substantial and imminent" or "fairly foreseeable" threat of ligation. *See, e.g.*, Kidwiler v. Progressive PaloVerde Ins. Co., 192 F.R.D. 536, 542 (N.D. W. Va. 2000). Others require that a document must have been created "because of" anticipated litigation. *See, e.g.*, United States v. Torf (*In re* Grand Jury Subpoena), 357 F.3d 900, 909–10 (9th Cir. 2004). At least one court attempts to determine whether the "primary motivating purpose" behind the creation of a document is to "aid in possible future litigation." *See* United States v. El Paso Co., 682 F.2d 530, 542 (5th Cir. 1982).

29. *See, e.g.*, Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co., 967 F.2d 980, 984 (4th Cir. 1992) ("[B]ecause litigation is an ever-present possibility in American life, it is more often the case than not that events are documented with the general possibility of litigation in mind. Yet, 'the mere fact that litigation does eventually ensue does not, by itself, cloak materials' with work product immunity." (quoting Binks Mfg. Co. v. Nat'l Presto Indus., Inc., 709 F.2d 1109, 1118 (7th Cir. 1983))); *In re* Gabapentin Patent Litig., 214 F.R.D. 178, 183 (D.N.J. 2003) ("In general . . . a party must show more than a 'remote prospect,' and 'inchoate possibility,' or a 'likely chance of litigation.'" (quoting Harper v. Auto-Owners Ins. Co., 138 F.R.D. 655, 660 (S.D. Ind. 1991))).

30. Del. Ct. Ch. R. 26(b)(3). Special protection is given to a lawyer's "mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation." *Id.*

> Lawyers know they rarely will be second-guessed by their clients for taking an expansive view of privilege and withholding borderline documents. . . . Too frequently counsel default to a rule of invoking privilege whenever an attorney appears on a document. For there to be downside from this strategy, an adversary first must challenge the privilege calls. With all that needs doing in litigation, the opposing party may never do so. Or they may raise the issue but never follow up. Or they might follow up but not move to compel. And if the opposing party actually decides to file, the motion may be poorly pressed, and a cross-motion can muddy the waters and prompt a busy judge to declare a pox on both houses and deny all relief. If nothing else, every step takes time. With many a slip 'twixt cup and lip, the aggressive privilege call becomes second nature.[31]

Not only will lawyers rarely be second-guessed by counsel, but younger associates, who often are tasked with creating a privilege log, face only the downside risk of being underinclusive. In this regard, Vice Chancellor Laster has recognized that

> [t]here is no reward for doing a good privilege log. It's painful. It results in these huge documents. No one has any incentive to be responsible [on] a privilege log as opposed to [being] overinclusive. Junior associates or paralegals get tasked with it. They screw up if they don't log a document, not if they come to the partner and say, "Really, this one shouldn't be logged."[32]

With electronic discovery, these incentives have only increased as the volume of potentially privileged documents has increased, the number of communications that are recorded and retained has dramatically expanded, and the difficulty of drawing clear lines with respect to legal and business advice has been amplified.

IV. How Are the Incentives Changing?

Recognizing that these incentives and the resulting practices undermine Delaware's "well established policy of pretrial disclosure which is based on a rationale that a trial decision should result from all the available evidence rather than tactical maneuvers based on the calculated manipulation of evidence and its production,"[33] the Delaware Court of Chancery has begun taking affirmative steps to alter the calculus attorneys face when initially withholding documents as privileged.

First, there have been several recent occasions where, after a motion to compel is filed, Chancellor Strine has required a Delaware lawyer representing each party to certify that she has reviewed each document on her client's privilege log and that she believes in good faith that each document is in fact privileged.[34] In his

31. Klig v. Deloitte LLP, Civ. A. No. 4993-VCL, 2010 WL 3489735, at *6 (Del. Ch. Sept. 7, 2010).
32. *Id*. at *5.
33. *Id*. at *6 (quoting Hoey v. Hawkins, 332 A.2d 403, 405 (Del. 1975)).
34. *See, e.g.*, *NVIDIA* Transcript, *supra* note 14, at 97–103; Transcript of Record at 13, Broadcom Corp. v. Cox, C.A. No. 4519-VCS (Del. Ch. June 10, 2009) [hereinafter *Broadcom* Transcript]. In *Broadcom*, which was expedited litigation, the court gave the defendants only twenty-four hours to complete the certification.

experience, if the law firm designating privilege is "outside Delaware, they will have overdesignated."[35] The Chancellor has explained that "that's a signal, frankly, to the business and legal community that maybe there has to be a little more old school . . . people used to be pretty darn careful and persnickety about what they did to request legal advice."[36] The certification process can be very costly, as partners are required personally to review each document on a privilege log. Moreover, and not surprisingly, such certifications usually result in the production of numerous documents that originally were listed as privileged. When "there's somebody responsible . . . from each Delaware firm . . . it's amazing how . . . privilege logs shrink."[37] Of course, with such supplemental productions comes the risk that the court may draw an inference that the producing party tactically withheld such documents in the first instance.[38]

Second, some judges may be trending toward reviewing all challenged documents *in camera*. The new business division of the Delaware Superior Court and the Delaware federal courts have also been active in this regard.[39] Such a practice often leads to documents that were initially withheld as privileged being produced and may result in broad waiver. In *Teleglobe Communications Corp. v. BCE, Inc.*,[40] for example, Special Master Colin J. Seitz, Jr. asked the plaintiffs to select fifty documents from the defendant's challenged privilege log for *in camera* review.[41] After having fought the plaintiffs' initial challenge to privilege, the defendant immediately produced several of the selected documents.[42] After *in camera* review, Special Master Seitz determined that numerous documents were not in fact privileged and noted that he would have been justified in ordering the production of *all* documents on the defendant's privilege log.[43] Parties may also want to avoid such reviews because

35. *Broadcom* Transcript, *supra* note 34, at 13.

36. *Id*. at 11.

37. *Id*. at 16. Delaware's call for increased oversight by senior attorneys familiar with the rules and practices in the local jurisdiction is part of a broader trend by courts to require more active consideration by senior attorneys *before* courts will step in to resolve discovery disputes. For example, the two largest federal courts in California and many of the complex litigation divisions set up in the state courts in California's largest counties (such as Los Angeles, San Francisco, and San Jose) have increasingly interpreted the existing meet-and-confer obligations to require that senior attorneys meet in person to review each discovery issue before the parties can seek a ruling from the court.

38. The Court of Chancery also expects attorneys to be involved in the document collection process, particularly when determining what documents are responsive to requests from opposing counsel. For example, in a recent bench ruling, Vice Chancellor Laster made clear that "you do not rely on a defendant to search their own e-mail system. . . . There needs to be a lawyer who goes and makes sure the collection is done properly . . . . [W]e don't rely on people who are defendants to decide what documents are responsive, at least not in this Court." Transcript of Record at 10, Roffe v. Eagle Rock Energy GP, C.A. No. 5258-VCL (Del. Ch. Apr. 8, 2010).

39. In one recent large contract case, Commissioner Lynne Parker called for *in camera* review of all challenged documents. *See* Transcript of Record at 57–67, Statoil Mktg. & Trading (US) Inc. v. W. Ref. Yorktown, Inc., C.A. No. 08C-03-170 RRC (Del. Super. Ct. Feb. 1, 2010).

40. C.A. No. 04-CV-1266 (SLR), 2006 WL 2568371 (D. Del. Feb. 22, 2006).

41. *Id*. at *4.

42. *Id*.

43. *Id*. at *8–9; Teleglobe Commc'ns Corp. v. BCE, Inc., C.A. No. 04-CV-1266 (SLR), slip op. at 29 (Del. Ch. Feb. 22, 2006).

in many courts, such as the Court of Chancery, the judge is also the finder of fact—and the judge may see even privileged documents during any such review.[44]

Third, parties that tactically provide privilege logs that do not contain adequate information to test the privilege run the risk that the court will find that they have waived the privilege.[45] For example, in *Klig v. Deloitte LLP*,[46] Vice Chancellor Laster ordered production of more than 300 documents listed on a privilege log because the court determined that the attorneys had made a tactical decision not to disclose adequate information describing those documents.[47] That privilege log contained virtually identical descriptions with respect to each of these documents such as "Communication reflecting legal advice of counsel regarding the [litigation name] matter."[48] Further, that log failed to identify which individuals were attorneys.[49] Importantly, the court did not review the documents *in camera* or otherwise to determine whether absent such a waiver the documents would be privileged.

The court's remedy was fashioned in large part to alter the incentives litigators face in designating documents as privileged. After describing these incentives (referenced above), the court recognized that "in the past this Court has shown remarkable willingness to allow practitioners who provide an inadequate log to get a do-over and do it right. I think that's a terrible idea."[50] And in declining to certify an interlocutory appeal, the court made clear that:

> The remedies imposed by the Court play a significant role in the producing party's calculus. If the only consequence of losing a motion to compel is an order requiring the party to prepare the log it should have prepared in the first place, then a [deficient] log offers considerable upside without meaningful downside. If parties know that a motion to compel can result in the immediate production of inadequately described documents, then the upfront incentives change.[51]

In its decision declining to certify an interlocutory appeal, the court also clarified that this case did not involve a party's good-faith attempt to comply with Delaware law and that "[i]t takes conscious effort to render a log so devoid of content."[52] In contrast, explained the court, a party that has attempted in good faith to comply with its obligations should not be penalized for falling short, and in such circumstances, an order requiring supplementation may be appropriate.[53]

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44. The authors do not mean to suggest that judges would actively utilize such evidence when making judicial determinations. Rather, the point is simply that judges are human and, despite best efforts, may be unable to remain completely uninfluenced by such materials.

45. Parties must also consider the flip side: if privilege is not properly asserted, parties run the risk of broad waiver. With electronic discovery, the risk that parties waive privilege through inadvertent disclosure has increased significantly, largely because of the way information is stored and disseminated.

46. C.A. No. 4993-VCL, 2010 WL 3489735 (Del. Ch. Aug. 6, 2010).

47. *Id*. at *1–2.

48. *Id*. at *2.

49. After the motion to compel was filed, and before the hearing, a list of attorneys was provided. *Id*. at *3.

50. *Id*. (quoting Discovery Ruling at 7–8).

51. *Id*. at *7.

52. *Id*. at *5. The Delaware Supreme Court refused to hear the interlocutory appeal. Deloitte LLP v. Klig, No. 596, 2010, 2010 WL 3736141 (Del. Sept. 27, 2010).

53. *Klig*, 2010 WL 3489735, at *7.

Nevertheless, the risk of waiver remains, and the Court of Chancery is focused on the incentives to over-designate documents as privileged.

Fourth, Delaware courts are also not reluctant to award attorney's fees where parties have been prejudiced by over-designation.[54] Recently, the Delaware Superior Court (Delaware's law court) ordered production of numerous documents in the middle of a jury trial and awarded $850,000 in attorney's fees, even though it recognized that the penalized party had *inadvertently* withheld certain nonprivileged documents as privileged.[55] In that case, the privilege issues unfolded before the jury after a witness for the defendant testified about an e-mail that had been withheld as privileged.[56] Although that e-mail had properly been withheld, it was ordered produced because the witness's testimony put it "at issue."[57] Certain references in that e-mail led to the realization that certain additional documents that had been withheld as privileged (1) were not privileged or (2) were not identified as privileged on the privilege log provided to opposing counsel.[58] This additional evidence was ordered produced in the middle of trial.[59] Further, some of this evidence contradicted testimony that already had been given by defense witnesses; possibly influenced by these inconsistencies, the jury ultimately awarded a $15.5 million verdict in the plaintiff's favor.[60] The facts of this case provide a good example of the difficulty of keeping track of privileged material in the age of electronic discovery, the risk that such material may be ordered produced even after discovery is completed, and the unintended consequences that may result therefrom.

Finally, the Court of Chancery has begun to embrace the practice commonly referred to as quick-peek discovery. In *ACS State Healthcare, LLC v. Wipro Inc.*,[61] the Court of Chancery, for the first time, granted a stipulated order that permits the parties to produce certain documents without first conducting a document-by-document privilege review, and confirms that producing documents pursuant to the order will not constitute a waiver of applicable privileges under Delaware law.[62] In lieu of a document-by-document privilege review, the order permits the parties to rely upon keyword search terms, analytical software tools, and/or other reasonable means to locate and exclude potentially privileged materials prior to production, and deems the foregoing as "adequate precautions" to prevent inadvertent disclosure of privileged material.[63] As such, the order is a blend of what are colloquially

54. If such overdesignation is found to have been in bad faith, a Delaware court may impose sanctions.

55. M&G Polymers USA, LLC v. Carestream Health, Inc., C.A. No. 07C-11-242 PLA, 2010 WL 1611042 (Del. Super. Ct. Apr. 21, 2010).

56. *Id*. at 64. Privilege issues began to unravel when a witness testified that he did not anticipate litigation as of a certain date. *Id*. at 67. Accordingly, the court ordered production of all documents withheld solely on the grounds of work product that were created prior to that date. *Id*.

57. *Id*. at 65.

58. *Id*. at 65–67.

59. *Id*. at 67.

60. *Id*. at 69–70.

61. C.A. No. 4385-VCP (Del. Ch. July 23, 2009) (Order), *available at* http://www.delawarelitigation.com/uploads/file/int1E.PDF.

62. *Id*. at 3–6.

63. *Id*. at 3.

referred to as "clawback" and "quick-peek" arrangements.[64] As most litigators know, the federal rules of civil procedure have also embraced quick-peek discovery.[65] Although the decision to engage in such arrangements is within the parties' control, the quick-peek option provides additional incentives, i.e., significantly lower discovery costs, to share information with opposing counsel. Under a quick-peek arrangement, although truly privileged documents may never be produced, they will be seen by opposing counsel and may influence how any litigation proceeds.

In short, the rules of the game are changing, and many documents that deal lawyers and their clients may think are privileged are more likely to be produced (or at least seen by opposing counsel or judges) than ever before.[66]

V. Whose Privilege Applies?

With the changing nature of discovery also comes a renewed impetus to consider the question of which state's privilege law applies. While the attorney-client

64. Generally speaking, a clawback agreement provides that the production of privileged information in discovery is presumed to be inadvertent, does not waive any privilege, and requires the receiving party to return any material that is claimed to have been inadvertently produced. A quick-peek agreement permits counsel to review an opposing parties' documents prior to production (or review for privilege) and identify documents believed to be relevant to the litigation. The producing party then has the opportunity to review the identified documents and withhold any on the basis of applicable privileges (which are not waived).

65. *See* Fed. R. Civ. P. 502. The federal protections against waiver, however, are not binding on the states. It is possible (but unlikely) that a particular state may consider quick-peek discovery in another state as having waived the privilege with respect to any documents reviewed by opposing counsel. In this regard, when entering the order in *Wipro*, Vice Chancellor Parsons noted:

> I think that the procedure that we're putting in place is sufficient to preserve everybody's expectations in terms of handling of attorney-client material so that there would not be a waiver if—if persons adhere to these procedures. But then, of course, that obviously just applies to Delaware. And you know, if the next case is in West Virginia and they're asking for the same documents, I would hope that the Court there would be convinced of the reasonableness of the approach we've used and reach the same conclusion, but obviously they're not bound by it.

Transcript of Record at 24, ACS State Healthcare, LLC v. Wipro, C.A. No. 4385-VCP (Del. Ch. July 16, 2009).

66. When reviewing documents for production, it still likely makes sense to err on the side of protecting privilege, at least during initial reviews. Secondary reviews should take a more exacting approach. Also, when drafting privilege logs, attorneys should thoroughly consider whether documents originally designated as privileged should be produced and assume that they will need to defend any claims of privilege. The *Klig* opinion provides a good description of the content that the Court of Chancery expects privilege logs to contain:

> The party asserting the protection of the attorney-client privilege has the burden of establishing its application. To meet this burden, defendants must include greater detail in their privilege log. Specifically, defendants must identify (a) the date of the communication, (b) the parties to the communication (including their names and corporate positions), (c) the names of the attorneys who were parties to the communication, and (d) the subject [matter] of the communication sufficient to show why the privilege applies, as well as [what topic it pertains to]. With regard to this last requirement, the privilege log must show sufficient facts as to bring the identified and described document within the narrow confines of the privilege.

Deloitte LLP v. Klig, No. 596, 2010, 2010 WL 3736141, at *5 (Del. Sept. 27, 2010) (quoting UniSuper Ltd. v. News Corp., C.A. No. 1699-N, slip op. at 1–2 (Del. Ch. Mar. 9, 2006)) (last alteration added).

privilege itself is largely the same across jurisdictions, states vary widely with respect to waiver of privilege, including, for example, whether copying bankers or other individuals on communications waives the privilege.[67] Some of the issues most likely to arise in the case of litigation over a merger or acquisition, such as when a lawyer is treated as a mere negotiator or business advisor and when and how a common interest may arise, are among the areas in which state laws vary most significantly.

Although a rule of evidence, the attorney-client privilege is considered substantive law,[68] and Delaware courts will not always apply Delaware privilege law.[69] Rather, Delaware courts, like many state courts, have adopted the "most significant relationship" test of the Restatement (Second) of Conflict of Laws section 139 to determine which state's law applies to questions of privilege.[70] The Restatement provides, in pertinent part:

> (1) Evidence that is not privileged under the local law of the state which has the most significant relationship with the communication will be admitted, even though it would be privileged under the local law of the forum, unless the admission of such evidence would be contrary to the strong public policy of the forum.
>
> (2) Evidence that is privileged under the local law of the state which has the most significant relationship with the communication but which is not privileged under the local law of the forum will be admitted unless there is some special reason why the forum policy favoring admission should not be given effect.[71]

The Restatement explains that "[t]he state which has the most significant relationship to a communication will usually be the state where the communication took place."[72] The state where a communication took place means "the state where an oral interchange between persons occurred, where a written statement was received or where an inspection was made of a person or thing."[73] However, if there was a "prior relationship" between the parties to the communication, the state with the most significant relationship will usually be the state where the prior relationship was "centered."[74]

Once a court determines the state with the most significant relationship, the analysis turns on whether the evidence is privileged under the law of that state. Under subsection (1) of section 139, if the evidence is *not* privileged under the

67. States also vary widely on nonlawyer privileges. For example, many states have an accountant privilege—Delaware and California do not.

68. *See* Republic Gear Co. v. Borg-Warner Corp., 381 F.2d 551, 555 n.2 (2d Cir. 1967).

69. This article does not attempt to deal with transnational choice-of-law issues, which also are becoming more prevalent.

70. *See, e.g., In re* Best Lock Corp. S'holder Litig., Civ. A. No. 16281, 2000 WL 1876460, at *6 (Del. Ch. Dec. 18, 2000); Lee v. Engle, Civ. A. Nos. 13323 & 13284, 1995 WL 761222, at *7 n.3 (Del. Ch. Dec. 15, 1995); Danklef v. Wilmington Med. Ctr., 429 A.2d 509, 512–13 (Del. 1981).

71. Restatement (Second) of Conflict of Laws § 139 (1971).

72. *Id.* § 139 cmt. e.

73. *Id.*

74. *Id.*

law of the state with the most significant relationship, the forum should admit the evidence, except "in those rare instances where its admission would be contrary to the strong public policy of the forum."[75] Subsection (2) provides that if the evidence *is* privileged under the law of the state with the most significant relationship, but not privileged under the law of the forum, the forum should admit the evidence unless there is some "special reason" why the forum's policy of admission should not be given effect.[76] To guide the forum in determining whether to apply the laws of the state with the most significant relationship, the Restatement provides the following four factors: "(1) the number and nature of the contacts that the forum state has with the parties and with the transaction involved, (2) the relative materiality of the evidence that is sought to be excluded, (3) the kind of privilege involved and (4) fairness to the parties."[77]

Whether a given state's privilege law applies can be outcome-determinative with respect to whether particular documents retain privileged status. For example, in *3Com Corp. v. Diamond II Holdings, Inc.*,[78] the Court of Chancery was recently faced with a motion to compel production that turned on whether the court was to apply Delaware or Massachusetts privilege law. The dispute specifically involved whether privilege was waived by copying an investment banker on certain communications. If Massachusetts law applied, the answer would be yes. Under Delaware law, however,

> where a client seeks legal advice as to the proper structuring of a corporate transaction and it is also prudent to seek professional guidance from an investment banker, it would hardly waive the lawyer-client privilege for a client to disclose facts at a meeting concerning such transaction at which both his lawyer and his investment banker were present.[79]

The court applied the Restatement and concluded that Delaware has a

> considerable interest in the communications that take place among a client, its attorneys, and its investment bankers when those parties are discussing the merits of

75. *Id.* § 139(1).

76. *Id.* § 139(2) & cmt. d. Comment d explains the rationale of the second prong of the Restatement as follows:

> The state of the forum will wish to reach correct results in domestic litigation. It will therefore have a strong policy favoring disclosure of all relevant facts that are not privileged under its local law. On the other hand, the state which has the most significant relationship with the communication has a substantial interest in determining whether the evidence of the communication should be privileged. It is also the state to whose local law a person might be expected to look for guidance in determining whether to make a certain statement or to make a certain [*sic*] information available.
>
> The forum will admit evidence that is not privileged under its local law but is privileged under the local law of the state which has the most significant relationship with the communication, unless it finds that its local policy favoring admission of the evidence is outweighed by countervailing considerations.

77. *Id.* § 139 cmt. d.

78. C.A. No. 2292-VCN, 2010 WL 2280734 (Del. Ch. May 31, 2010).

79. *Id.* at *4 (quoting Jedwab v. MGM Grand Hotels, Inc., No. 8077, 1986 WL 3426, at *2 (Del. Ch. 1986)).

> a complex transaction, such as a merger, for which they have selected Delaware law and Delaware as a forum for resolution of any disputes that might arise.[80]

Further, applying Delaware law in this context would "avoid the uncertainty generated by the varying loci of communications involved both in this case and others like it. This, in turn, would foster predictability for parties to major corporate transactions that have availed themselves of Delaware law."[81] For these reasons, the court found that Delaware has a more significant relationship to the challenged communications than Massachusetts and applied Delaware privilege law—even though most of the challenged communications took place in Massachusetts.[82] Of course, had a similar case—such as a class action—been brought in another jurisdiction, there is no guarantee that, even under precisely the same facts, that the court would apply Delaware privilege law, particularly given that the Restatement explains that the state with the most significant relationship with a communication will usually be the state where the communication took place. Moreover, the Delaware court may have reached a different conclusion in this case had the parties not included a Delaware choice-of-forum provision in the contract.

VI. Practical Steps Deal Lawyers Can Take to Preserve Privilege

In addition to remaining informed as privilege issues develop, deal lawyers can take practical steps when rendering advice to manage privilege issues. For example, deal lawyers should

- Assume that any communication may appear before a court and opposing counsel, even if it is clearly privileged.
- Understand that the attorney work product doctrine only protects documents created in anticipation of litigation and may not act as a safe harbor to protect drafts, internal law firm communications, or communications regarding negotiations or negotiating strategy.
- Take care to document the legal nature of communications where possible.
- Inform clients at the beginning of an engagement or at the beginning of the merger process that the mere fact that a communication is to or from an attorney does not make that communication privileged. To be privileged, a communication must be genuinely for the purpose of facilitating legal services. Particular attention should be focused on these issues:
    - During the pendency of negotiations, communications to or from, or reflecting a communication with, a lawyer-negotiator that do not involve analysis of the law or advice regarding legal issues or requests

80. *Id.* at *1.
81. *Id.* at *5 (footnote omitted).
82. *Id.* at *6.

for the same, but instead involve business or negotiating strategies or issues, are likely not privileged.

- Documents that contain both privileged and non-privileged material must be produced, with the privileged material redacted.

- Remind clients and other members of a client's engagement team that e-mail and other electronic communications are routinely retained by computer systems or other recipients and are poor locations in which to use "colorful" analogies or language because such communications are frequently the primary target of discovery by a company's adversaries.

- Explain to in-house counsel that their business advice is not privileged, including when they are acting simply to collect documents to facilitate business meetings.

- Be aware of which states' privilege law may apply. If multiple states' privilege law may apply (as is almost always the case), a conservative approach would dictate erring on the side of the most restrictive of those states' rules of privilege.

- Understand the Restatement factors and, where appropriate, try to make clear that parties are acting with the expectation that a particular state's privilege law will apply. Take other affirmative steps to affect any choice-of-law analysis, such as determining where a meeting should be located.

- Be careful regarding who is copied on communications, as certain individuals may waive privilege—and such rules vary from state to state.
  - Do not just press "reply to all" when rendering legal advice without knowing the identity of everyone on the e-mail chain and whether anyone may render any privilege waived.
  - Make sure that you know the identity of every person in the room during a meeting.
  - Pay specific attention to circumstances in which attorneys are including or excluding investment bankers, other financial advisors, accountants, or experts in a communication, with specific reference to whether they are a necessary part of the implementation of any legal advice that will be given.

- Inform clients not to forward communications that may be privileged outside of the company or to other parties to gain a perceived strategic advantage, as privilege may be waived.

- Caution outside directors of a company you are advising that using an e-mail account provided by a different company—such as an outside director's full-time employer—can lead to waiver. For example, if the

company whose e-mail address is being used has access to that individual's e-mails or is served a subpoena, waiver may result in some jurisdictions.

* * *

In sum, electronic discovery, shifting in-house counsel focus, and increased complexity of deals are creating a large volume of communications to or from attorneys that are not privileged. In addition, courts are beginning to focus on the incentives litigators face to over-designate documents as privileged, which is changing the calculus for litigators. The bottom line is that going forward, many documents that deal lawyers and their clients may think are privileged will be produced in litigation. It is imperative that deal lawyers remain informed and coordinate with litigators about these issues (and others that may arise in litigation) when negotiating complex transactions.

Author Biographies for The Business Lawyer, Volume 66, Issue 4, August 2011

The Wheels Are Falling Off the Privilege Bus: What Deal Lawyers Need to Know to Avoid the Crash

Erik J. Olson is a litigation partner in the Palo Alto office of Morrison Foerster LLP. Mr. Olson practices in the Securities Litigation, Enforcement and White Collar practice group and has extensive experience in all forms of securities litigation, including merger and corporate governance litigation. He represents buyers, sellers, and financial advisors in the Delaware Court of Chancery and in state and federal courts across the country. Mr. Olson is a former Chair of the Litigation Section of the State Bar of California.

Gregory V. Varallo is a director of Richards, Layton & Finger and vice chair of the firm's Corporate Department. His practice is concentrated in the area of complex corporate and business litigation, corporate governance, and corporate transactions. Mr. Varallo has litigated numerous complex business disputes in the Delaware courts and has also appeared on behalf of the firm's clients in state and federal courts throughout the United States. Mr. Varallo is a frequent author and speaker at various seminars and institutes. He is a co-author of *Fundamentals of Corporate Governance A Guide for Directors and Corporate Counsel* (ABA, 2d Ed. 2010), and *Special Committees: Law and Practice* (Oxford 2011) as well as numerous articles and has served as a member of the Editorial Advisory Board of *The Business Lawyer*, as well as on various ABA committees.

Rudolf Koch is an associate at Richards, Layton & Finger. He focuses on representing corporations, members of boards of directors, special board committees, substantial stockholders, limited liability companies and partnerships in litigation in Delaware's state and federal courts, and provides non-litigation advice and counseling to his clients with respect to corporate governance and fiduciary duties. He received his B.S. from Cornell University, and his J.D. from Cornell Law School, where he was an editor of the *Cornell Law Review*. Upon graduation, he served as a law clerk for the Honorable Maryanne Trump Barry, U.S. Court of Appeals for the Third Circuit.