

Preserving the Corporate Attorney-Client Privilege as Against Investors

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In *Hyde Park Venture Partners Fund III, L.P. v. FairXchange, LLC*,^[1] the Delaware Court of Chancery provided a valuable reminder to corporations and their directors and officers that a corporation cannot assert a privilege, such as the attorney-client privilege, against its directors or the investors that appointed those directors in litigation unless one of three exceptions are met: (1) the parties agree by way of contract, such as a confidentiality agreement, that the corporation may assert privilege against certain directors and the investors that appointed that director; (2) the board of directors forms a special committee that excludes the director after which the committee can consult with counsel confidentially and retain the privilege against the director and the investor that appointed the director; or (3) sufficient adversity of interests has arisen and becomes known to the director, thus impacting the director's ability to rely on corporate counsel for matters where the director or the investor that appointed the director and corporation's interests are adverse.

Background

The plaintiffs, stockholders of an acquisition target, brought suit seeking statutory appraisal of their shares, following the target company's acquisition by a nonparty. The plaintiffs' designee served on the target's board, but was excluded from board meetings after he expressed a desire to obtain a market check to understand the target's value after receiving a surprise offer from the acquirer. One day after the designee demanded information in his capacity as a director, other stockholders removed him from the board by written consent, and the transaction was approved. During discovery of the appraisal proceeding, the company asserted attorney-client privilege over materials prepared during the designee's tenure as a director as against the plaintiff stockholder.

Court's Analysis

Delaware law treats the corporation and the members of its board of directors as joint clients for purposes of privileged material created during a director's tenure. Joint clients have no expectation of confidentiality as to each other, and one joint client cannot assert privilege against another for purposes of communications made during the period of joint representation. In addition, a Delaware corporation cannot invoke privilege against the director to withhold information generated during the director's tenure. Delaware law has also recognized that when a director represents an investor, there is an implicit expectation that the director can share information with the investor.

In this case, the board designee and other board members were joint clients, and therefore, inside the circle of confidentiality during the designee's tenure as a director. During the board designee's tenure as a director, he

received numerous communications from the company and its counsel. The company, therefore, had no expectation of confidentiality from the board designee and cannot assert privilege against him or his affiliates. The company also failed to implement any of the three exceptions to asserting privilege against directors. First, there was no contract governing confidentiality of discussions between the company, its counsel, and the board. Second, the board did not form a transaction committee. Third, the board designee did not become adverse to the company until after he sent his books-and-records request at which point the company was able to exclude the director and the investor that appointed the director from the privileged materials.

Takeaways

To assert privilege against certain directors or the investors that appointed those directors, a corporation should follow one of the three recognized exceptions to the joint client rule: (1) address privilege and/or confidentiality via contract; (2) have the board of directors form a committee that excludes the director; or (3) put the director on notice of the facts creating sufficient adversity of interests.

[1] 2023 WL 2417273, at *1 (Del. Ch. Mar. 9, 2023).

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