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Asset Purchase Agreements in Section 363 Sales Should Address Who Controls the Attorney-Client Privilege and Whether the Privilege Is Waived Post-Sale

By Russell C. Silberglied[*]

It has been eleven years since a leading bankruptcy journal published an article entitled "Who Owns Privileged E-Mails in a § 363 Sale Case? Is Ownership Waived When the Debtor's Computer Servers are Sold?" (the "2009 Article").[1] The 2009 Article suggested that parties should carefully address in the asset purchase agreement (a) who owns the attorney-client privilege after a bankruptcy sale—the buyer or the seller—and (b) how to avoid waiver of the privilege if the answer is the seller but the buyer has physical possession of the Seller's email and document server. A few years later, then Chancellor (and later Delaware Supreme Court Chief Justice) Leo Strine cited the 2009 Article with approval in a merger case, holding that parties should exercise their freedom of contract to alter state law default rules if so desired.[2]

Since then, M&A lawyers outside of bankruptcy have taken heed. Numerous subsequent articles have noted the trend of including such terms in merger agreements and asset purchase agreements,[3] and have even suggested specific model language.[4]

Yet surprisingly, eleven years later, the same cannot be said in the world of Chapter 11 practice. No reported bankruptcy court opinion in the last eleven years appears to have ruled on or even discussed the issue. Moreover, a random sampling of asset purchase agreements from Section 363 sales seems to indicate that parties more often than not do not address the issue of who owns the privilege after the closing of the sale, or if they do, frequently do so in a fairly perfunctory manner. Very few of the asset purchase agreements reviewed in this random sample attempt to grapple with the waiver issue in any meaningful manner.

Below, after briefly summarizing the state of the law, I argue that the bankruptcy world should heed the warning and start addressing the issue of who owns the privilege post-sale and how to avoid a finding of waiver when a server is one of the assets sold. Indeed, it could be argued that it frequently is

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[*]Russell C. Silberglied is a director at Richards, Layton & Finger, PA in Wilmington, DE ("RL&F"). RL&F represented a party in certain of the opinions and deals referred to in this article. Mr. Silberglied is the author of the 2009 Article. The views contained in this article are those of Mr. Silberglied and not necessarily of RL&F or its clients. The author would like to thank J. Zachary Noble of RL&F for his extensive research in support of this article.

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more important to do so in the context of a sale under Bankruptcy Code Section 363 than in a typical M&A transaction outside of bankruptcy. After all, after a merger or a sale of substantially all of a solvent company's assets, there often is little for the seller or target to do (in the case of a merger, the target no longer even exists). In contrast, following a Section 363 bankruptcy sale, the selling debtor or its estate almost always has to object to proofs of claim and frequently files avoidance actions and many other types of adversary proceedings, so it may be crucial for the seller to retain control over the privilege. Thus, debtor-sellers have every incentive to contract for the right to retain the privilege and guard against its waiver, and should follow the lead of their M&A colleagues in negotiating such provisions. Some applicable sample provisions from court approved Section 363 asset purchase agreements are included below

In addition, while the Delaware and New York courts (and certain other courts) have been clear that parties may and should exercise their freedom of contract to address who owns the privilege post-closing, at least certain commentators[5] and courts[6] have disagreed and argued that privilege should not be alienable. Below, I argue that the Delaware and New York courts are correct, and that contractual freedom should be permitted. Indeed, if the law were otherwise, debtor-sellers would be unable to retain the privilege in aid of post-sale litigation and claim objections, which would erode creditor recoveries. Public policy therefore favors the ability of debtor-sellers to contract to retain and control the privilege.

A. Ownership of the Privilege

The initial question that must be addressed seems straightforward: if an asset purchase agreement or merger agreement is silent on the subject, who controls the privilege after the transaction—buyer or seller? While seeming to be a straightforward question, there are wrinkles, so the answer is not uniform.

First, what set of communications are we talking about? Consider the following categories of communications between the seller and its attorneys: (a) communications about standard business operations; (b) communications about litigation that the seller is or may be engaged in with third parties, which will be an included asset or liability in the purchase or merger; (c) the same as (b), but the litigation will be an excluded asset or liability in the purchase or merger; (d) communications about the auction or sale process run by the seller that results in the purchase; and (e) communications concerning the negotiations of the deal and of the APA or merger agreement itself.

From a policy perspective, one could argue that the answer should be different for the various categories. Take, for example, categories (b) and (c). It is very difficult to litigate a claim without control of the privilege. Thus, it makes intuitive sense that the answer should be different for these two categories; from a policy perspective, one might expect the buyer to control privilege as to (b) and the seller as to (c). Now contrast categories (a) and (e). Certainly the privilege concerning communications relating to business

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operations should be owned by whoever currently is operating the business; indeed, the U.S. Supreme Court so indicated long ago in *Commodities Futures Trading Comm'n v. Weintraub.*[7] But some might be uneasy with the same result for communications over the very agreement that gave rise to the sale; after all, that would put control of the privilege into the hands of the very party that was *adverse* to those communications at the time they were made. If that were the rule, transactional attorneys who regularly represent sellers would come to believe that they essentially do not enjoy an attorney-client privilege (or at least one that survives closing) and would caution clients to assume that communications will not, in the long term, be privileged. This would undercut the very purpose of the attorney-client privilege, which is to facilitate candid conversations between clients and their attorneys, thereby promoting legal compliance.[8] Thus, there may be good reason to have opposite default rules for category (a) on the one hand and (e) on the other.[9]

However, there also is a counter argument in favor of uniformity. Certainly, determining who owns the privilege is most predictable if the answer is uniform in all circumstances. And to be sure, determining precisely which category a communication falls within can be gray. Consider, for example, an attorney-client communication about how CAD and CAM charges are calculated under a long-term commercial lease. If the term of the lease continues post-sale or merger, that is squarely within the preview of operations (i.e., category (a)), and therefore one would expect the privilege would be controlled by the buyer. However, what if the landlord disagrees with the calculation, sues the seller, and the buyer demands that lawsuit be an excluded liability, making this same communication fall within category (c)? The seller certainly would want to control the privilege for purposes of that lawsuit.

Second, does the *type* of transaction matter? Is or should the result be different if the transaction at issue is an asset purchase on the one hand or a merger on the other?

In the absence of contractual provisions to the contrary, courts have considered some of these issues. Due to the ultimate holding of the cases, some have concluded that state law in two states whose choice of law often is invoked—New York and Delaware—differ.[10] And indeed, in *Tekni-Plex, Inc. v. Meyner & Tandis,* the New York Court of Appeals held that while in general the privilege passes to the buyer if the buyer can be characterized as continuing the seller's business, an exception exists for "discrete communications. . . concerning the acquisition" itself because at the time the seller and its counsel had "an adversarial relationship" to the buyer; for those communications, the privilege stays with the seller.[11] Applying New York law, a Delaware Court of Chancery opinion called *Postorivo* held that the privilege related to excluded assets and liabilities also stays with the seller.[12] In contrast, in *Great Hill Equity Partners*, the Delaware Court of Chancery applied a blanket rule that the privilege passed to the surviving entity in a merger.[13]

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But is there really a distinction between *Tekni-Plex* (New York) and *Great Hill* (Delaware)? *Tekni-Plex,* as well as *Postorivo* (a Delaware case applying New York law), involved a sale of substantially all of a company's assets and liabilities and essentially continuation of the business through the buyer. In contrast, *Great Hill* involved a merger. The Delaware Court of Chancery's opinion turned on the specific wording of Delaware's merger statute. Section 259 of the Delaware General Corporation Law ("DGCL") provides, in relevant part, 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. . ."[14] The seller argued that the statute's use of the word "privileges" was not intended to mean evidentiary privileges, but rather privileges akin to property rights. The Court of Chancery rejected the argument, noting that the seller cited no authority and read the word "all" out of the statute.[15]

Thus, it is clear that the holding of *Great Hill* rested entirely on the plain meaning of the merger statute. Because *Tekni-Plex* involved a purchase of assets and liabilities rather than a merger, and there is no similar statutory dictate in Delaware or New York for asset and liability purchases as opposed to mergers, it is not at all clear whether the default laws of the two states in fact differ.[16]

B. Waiver

Assuming that the seller retains control over some portion of the privilege, the next question to consider is: what happens to that privilege when the communications are contained on an email or document server that the buyer physically possesses and used post-closing? I pointed out in the 2009 Article,

> turning over a document to a third party typically *does* constitute a waiver.[17] Privilege law is based on confidentiality; if an otherwise privileged communications is not made in confidence, the privilege does not attach.[18] "The disclosure rule operates as a corollary to this principle: If a client subsequently shares a privileged communication with a third party, then it is no longer confidential, and the privilege ceases to protect it."[19] Thus, under the traditional approach to waiver of the attorney-client privilege, even the inadvertent production of documents waives the privilege and, taken to its logical extreme, even a document in a stolen car would lose its privilege.[20] Other courts, have rejected this extreme view, holding that the "mere inadvertent production of documents. . . does not waive the privilege."[21] Under this contemporary view, courts engage in a fact-specific inquiry to determine whether there was an intention to disclose the documents or communications, whether such disclosure was merely inadvertent and even if the disclosure was unintentional, whether it was "so negligent or reckless that the court should deem it intentional."[22,23]

As part of the sale of an operating business, debtors frequently turn over their entire document and email servers to the buyer. While the debtor likely will retain a complete copy, for use in claims objections, avoidance actions and other litigation, the buyer's personnel can access pre-sale privileged communications at any time inadvertently or intentionally. Under the "traditional approach," this would be a clear waiver of the privilege. Even

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under the "modern approach," it might be difficult to refer to the wholesale turnover of privileged documents to the buyer as "inadvertent" unless other steps are taken. Then Chancellor Strine, while not deciding the issue because it was unnecessary to do so, implied that he would find a waiver after the seller's "lengthy failure to take any reasonable steps to ensure the Buyer did not have access to the allegedly privileged communications."[24]

Other courts have held that there was a waiver in similar circumstances. For example, in *Goldstein v. Colborne Acquisition Co., LLC*,[25] the court held that privilege was waived due to the sale of email servers: "[R3, one of the sellers,] knew, or should have known, that the sale included the company's servers and its e-mails, including his own personal e-mails. . . That R3 may not have realized the import of his actions is immaterial. . . R3 deliberately disclosed, by sale, his e-mails to a third party. . . and waived the privilege."[26] In *Soc'y of Prof'l Eng'g Emps. in Aerospace v. The Boeing Co.*,[27] the court found waiver of privilege in an email chain after Boeing allowed another airline company access to its emails through a complex sale and service-provision transaction.[28] The court noted that the parties failed to negotiate a provision in their agreement to guard against privilege waiver.[29] And in *Lynx Services*, the court held that "[b]y transferring the email communications to Accella, the defendants voluntarily disclosed privileged information to a third party and, as a result, waived the attorney-client privilege as to those communications."[30]

On the other hand, in *Postorivo*, the court held that no "reasonable inference" could be drawn that NPS and Postorivo "deliberately and voluntarily" surrendered attorney-client privilege.[31] To support this finding, the court pointed to the way the sellers and their counsel "conducted their affairs after the APA closed,"[32] without describing what conduct led the court to conclude they did not intend to waive privilege. The 2009 Article questioned whether the court had reached the correct result.[33]

C. <u>Contracting for a Different Result</u>

The 2009 Article noted that the Court of Chancery (applying New York law) indicated, in *Postorivo,* a willingness to honor the parties' attempt to contract for a different result; it suggested that "debtor's counsel should strongly consider addressing these points in the asset-purchase agreement" and indeed, "how to deal with privileged e-mails and other documents on servers. . . being sold should be a part of most 'checklists' in negotiating an asset purchase agreement."[34]

Since then, the case law has mostly embraced the concept of freedom of contract. The Court of Chancery stated in *Great Hill*:

> Of course, parties in commerce can—and have—negotiated special contractual agreements to protect themselves and prevent certain aspects of the privilege from transferring to the surviving corporation in the merger. . . [T]he answer to any parties worried about facing this predicament in the future is to use their contractual freedom in the manner shown in prior deals to exclude from the transferred assets the attorney-client communications they wish to retain as their own.[35]

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The seller did not do so, and therefore its attempt to assert continued control of the privilege post-merger failed, even though the communications related to the negotiation of the merger—one of the categories for which *Tekni-Plex* and *Postorivo* held that the privilege remains with the seller. Because Section 259 of the DGCL applied, if the seller wanted to retain the privilege it needed to contract for that result.

More recently, the Court of Chancery held in *Shareholder Representative Servs., LLC v. RSI Holdco, LLC*[36] that the seller had indeed contracted to retain the privilege post-merger. The court upheld the seller's assertion of privilege, establishing conclusively (rather than arguably in *dicta*, as was the case in *Great Hill*) that Delaware law upholds freedom of contract over control of the privilege.

Delaware is not alone. *Tekni-Plex* itself noted that the seller "expressly provided [in the APA] that. . . [the privilege] be preserved in any subsequent acquisition."[37] Relying on *Tekni-Plex*, the New York Appellate Division recently ruled that privilege was retained in part because the purchase and sale agreement so provided.[38] Moreover, the "waiver" cases cited in Section B above (*Goldstein* and *Society of Professional Engineering Employees in Aerospace*) find a waiver for, among other reasons, a failure to contract around the issue—thereby also implying acceptance of the concept that the parties may choose by contract who controls the privilege.

But this view is not universally held. At least one Federal District Court, in the *Zenith* case, has rejected the parties' attempt to provide for a transfer of privilege in an asset purchase agreement.[39] And the thesis of the Giesel Article (see note 5 supra.) is that privilege is not alienable, and parties should not be able to engineer through a contract who controls it.

Unless and until the views expressed by *Zenith* and the Giesel Article become more widespread (which they should not, as described below in Section D), most Chapter 11 debtors engaged in a Section 363 sale should attempt to negotiate to retain the privilege for the benefit of the estate and for what it needs to accomplish post-closing.

Indeed, in a very real sense, the estate typically will have a greater need to control certain privileged communications than does the target of a solvent company merger or a seller outside of bankruptcy. In the latter situations, there typically is little if anything left for the target company to do post-merger, since, for example, as a matter of law all of the target's assets, claims and liabilities vest with the surviving company to the merger.[40] Post-merger litigation frequently focuses on an earn out or a fraud claim, in which case the litigant frequently will not be the target company itself (given the merger) but rather pre-merger stockholders or management. Unless there is a common interest privilege between the target and the pre-merger stockholders or management,[41] there might be little need to retain privilege.

The opposite is true of debtors after a Section 363 sale. Debtors almost always defer claims objections and avoidance actions until they have monetized the operating business in a sale. Other types of litigation, such as fiduciary duty claims and commercial disputes, frequently are delayed as

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well. Moreover, Plan confirmation usually proceeds post-sale and if any party objects to the debtor's Plan, the proceeding becomes a contested matter under Fed. R. Bankr. Proc. 9014. If the debtor does not retain control of the privilege, there are several risks. First, in depositions and at trial, the debtor (or whoever is prosecuting claims on behalf of the estate) will not be able to invoke the privilege. Second, in responding to document requests (assuming that the debtor retained a full back up or copy of its email and document servers as well as paper), the debtor also will not be able to invoke the privilege, albeit the non-party buyer could, and the debtor and the buyer would have to coordinate a response (the result of which the debtor might not desire). Third, if the non-debtor party to the litigation subpoenas the non-party buyer, which has no interest in the litigation, the buyer might simply waive privilege because it wants to expend as little money as possible responding to discovery in a case in which it has no financial interest. That, too, typically will be unfavorable to the debtor and its estate and creditors. Finally, the reverse can happen: the debtor might want to waive privilege, perhaps because it needs to introduce evidence of the privileged conversation to bolster its claim, and it knows that it cannot simultaneously claim privilege on related communications because the "sword and shield" rule will be invoked.[42] But if the buyer controls the privilege, waiver is not the debtor's call to make, and the buyer might not agree for fear that the waiver will cut broadly and harm it in the future. All of these scenarios make litigation at best unwieldly and possibly unworkable for the post-sale debtor and its estate.

As a result, a debtor/seller should seek a provision in the asset purchase agreement that mirrors the result of *Postorivo*: privilege related to operation of the business will be controlled by the buyer, but privilege related to (a) excluded assets or liabilities, including litigation over excluded assets or liabilities, and (b) the negotiation of the APA or the deal points with the buyer remain with the debtor/seller (or the estate). Because buyers in asset sales very infrequently assume any liabilities other than those of vendors that they must keep happy, such a provision will cover nearly all claims objections. Likewise, avoidance actions and breach of fiduciary duty suits typically are excluded assets. And if any dispute arises with the buyer over, e.g., an earn out or fraud, communications relating to those issues would be covered as well.

However, care needs to be taken in defining the scope of what privilege is being retained and what is passing to the buyer. Suppose general counsel emailed with a member of the debtor's sales force pre-petition concerning its relationship with a key customer. The customer buys its products from the company by individual purchase orders (not a contract that has to be assumed and cured). The relationship has continued post-petition and the buyer is continuing the relationship post-sale. Thus, the general counsel's email relates to "operations," and one would assume that under the structure outlined in the previous paragraph, the buyer would succeed to the privilege. But what happens if the customer also files a proof of claim and the debtor

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objects, on a basis directly related to the email communication? The buyer did not assume the liability, and the debtor, not the buyer, is litigating with the customer. The debtor would expect to have retained the privilege since the liability is excluded. Because both the buyer and seller would have an expectation that they control the privilege in this type of scenario, the parties should consider and negotiate language to address precisely what result they intend. No reported case has ever considered whether it would enforce the buyer and seller's agreement that they *both* hold the privilege in such a scenario, so debtors should exercise caution before trying and relying on the effectiveness of such a solution.

The M&A world outside of bankruptcy has taken heed of these privilege issues and typically attempts to address them. The fulsome privilege provisions contained in the merger agreement at issue in the *Shareholder Representative Services LLC* litigation is a good example.[43] There, the parties not only negotiated specific language providing that privileged communications concerning the merger itself remain under the control of the target; the agreement also provided that the surviving company and its affiliates "agree that no party may use or rely on any of the Privileged Communications in any action or claim against or involving any of the parties hereto after the Closing."[44] When the merged company attempted to do exactly that—rely on the privileged communications in ensuing litigation—the Court of Chancery enforced the provision and prevented it from doing so.[45] This, in essence, helped to blunt the waiver argument.

The Giesel Article collects other corporate control transaction agreements with such provisions and articles advocating for them.[46] One such provision addresses the waiver point the following way:

> [N]either the buyer nor the acquired entity "will seek to obtain such communications, whether by seeking a waiver of the attorney-client privilege or through other means." . . .[N]either the buyer nor the acquired entity "may use or rely on any such Privileged Communications. . ." In addition . . ."Acquiror waives and will not assert, and agrees to cause its Affiliates (including any Acquired Entity) to waive and not to assert, any attorney-client privilege with respect to such Privileged Communication."[47]

In addition, a recent article noted that most M&A lawyers address the issue, and large law firms train their associates to address it in their deals.[48]

But this does not necessarily appear to be the case in bankruptcy transactions. In preparation for this article, we reviewed the asset purchase agreements for recent Section 363 sales from EDGAR (thus, companies with publicly traded debt) and a random sampling of larger 363 sales that we could locate. Many of these asset purchase agreements had either no privilege provision at all or a perfunctory provision about privilege—sometimes one sentence (or a portion of a sentence) simply saying that privilege is an excluded asset. That level of specificity usually is insufficient.[49]

Moreover, even fewer of the asset purchase agreements that we reviewed contain a provision that could be argued to protect the waiver concern when the seller purports to retain privilege but transfers its email and document

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servers to the buyer (a provision, for example, like the one contained in the Chancery Court's *Shareholder Representative Services LLC* opinion). The Destination Maternity asset purchase agreement, after defining privilege as an "Excluded Asset," provides that if the purchaser or any affiliate receives Excluded Assets, "Purchaser shall promptly transfer or cause such of its Affiliates to transfer such asset. . . to the Company [Destination Maternity], and such asset will be deemed the property of the Company held in trust by Purchaser for the Company until so transferred."[50] Similarly, the Chieftain Sand and Proppant, LLC asset purchase agreement lists privileged communications as excluded assets and then states:

> To the extent that any Acquired Documents include materials or other information that may be subject to attorney-client privilege, work product doctrine, or any other applicable privilege or doctrine concerning any pending, threatened, or prospective suit, action, inquiry, dispute, proceeding, investigation, or arbitration, the parties agree that it is their mutual desire, intention, and understanding that the sale by Sellers, and acquisition by Purchaser, of such Acquired Documents is not intended to, and shall not, waive or diminish the continued protection of any such materials or other information under the attorney-client privilege, work product doctrine, or other applicable privilege or doctrine.[51]

A third Section 363 sale that addresses the issue (albeit in the sale order rather than the asset purchase agreement itself) is Synergy Pharmaceuticals. After a typical provision providing that the parties do not intend to transfer "Privileged Retained Books and Records," it goes on to provide:

> (b) any such sale, assignment, transfer, conveyance, disclosure, or delivery is entirely inadvertent and unintentional and shall neither be construed as, nor constitute, a waiver, modification, limitation, or impairment of the privileged or protected nature of the Privileged Retained Books and Records; and (c) any Privileged Retained Books and Records inadvertently held by the Purchaser shall, at the request of the Debtors, be transferred to the Debtors. . .[52]

Other asset purchase agreements have touched on the issue, without ultimately fully addressing it. The Avaya, Inc. agreement provides that "the parties shall use commercially reasonable efforts and cooperate in good faith with each other to provide such Books and Records without causing violation or loss of attorney-client work product and other legal privileges of Avaya and its subsidiaries."[53] While this is a helpful start and indicates the parties' intentions (which may be important because, as set forth above, waiver arguably requires a finding of a knowing and intentional act), this provision arguably could be considered more of an agreement to cooperate in the future than a commitment to a specific forbearance at the time of the transfer. The Bumble Bee transaction has the following provision:

> Each Buyer. . . hereby. . . acknowledges and agrees that. . . other than in the case of. . . fraud. . ., all attorney-client privileged communications between or among any Seller, any Transferred Subsidiary and their respective current or former Affiliates or Representatives and their counsel. . . made before the consummation of the Closing in connection with the negotiation, preparation, execution, delivery and Closing. . . shall continue after the Closing to be privileged communications with such counsel and none of Buyers,

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> their respective Affiliates and any Person purporting to act on behalf of or through any Buyer or any of such Buyer's current of former Affiliates, shall seek to obtain the same by any process on the grounds that the privilege attaching to such communications belongs to such Buyer, any of its Subsidiaries (including the Transferred Subsidiaries) or the Business. . .[54]

This provision directionally seems to touch on the waiver issue where it says that the buyer "shall [not] seek to obtain the [privileged documents] by any process," because "any process" could include accessing or calling up emails and Word documents in its physical possession. However, the next phrase is "on the grounds that the privilege attaching to such communications *belongs* to such Buyer" (emphasis supplied). So, putting the two phrases together, this clause might only be limited to not permitting the buyer to argue that it may access the documents because it owns the privilege, rather than preventing it from arguing that such provision is waived because the buyer physically possesses the documents.

Ultimately, a few of the purchase agreements we surveyed in the random sample of APAs addressed the issue. But given how few did so, it appears that the bankruptcy community simply has not caught up with this issue. It should.

D. Contracting Should Be Permitted

As described above, most courts not only permit but seem to actively encourage parties to address who controls the privilege in an asset purchase agreement or merger agreement. For example, the Delaware Court of Chancery stated in *Great Hill* that "the answer to any parties worried about facing this predicament in the future is to use their contractual freedom in the manner shown in prior deals to exclude from the transferred assets the attorney-client communications they wish to retain as their own."[55] But since at least one court[56] as well as a law review article[57] disagree, it is worth considering the arguments against the parties being able to decide for themselves who will control the privilege.

The central thesis of the Giesel Article is:

> The attorney-client privilege is a careful balance of public goals and policy. Courts and legislatures have set the precise bounds of the privilege by determining the right balance of society's interest in a justice system that effectively and efficiently finds the truth and the secondary but important interest behind the privilege in assuring that clients fully disclose all matters to their attorneys so that they can have the best possible representation and abide within the law. When private parties contract to allocate control of the privilege, those parties are contracting to maximize their collective good, but in doing so they are resetting the bounds of the privilege in a way that circumvents the balance set so carefully by courts and legislatures. When dealing with claims of privilege based on common interest, courts have not allowed parties to dictate the existence of a common interest if, in fact, no common interest as determined by the court existed. Courts have not allowed parties to reshape the privilege by contract. Similarly, control of the privilege for an entity should not be contractually alienable apart from control of an entity. As courts refuse to honor contractual extensions of statutes of limitations before a cause of action accrues because of the public interest at issue, so, too, courts should refuse to enforce contractual privilege allocation provisions. Control of the privilege for

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> an entity should not be contractually alienable apart from control of the entity.[58]
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> * * *
>
> [P]arties motivated by their own self-interest but with no consideration of the public interest, should not be allowed to allocate control of the privilege by contract. The parameters of the privilege should not be dictated by private parties. Not only is nonalienability by contract dictated by the values and policies the privilege represents, but also its own structure demands this result. . . Recognizing that control of the privilege can be transferred by contract also creates a practical nightmare as parties follow the logical slippery slope to parsing control of the privilege in pieces and parts. . .[59]

The thought-provoking Giesel Article makes some valid points. For example, it is certainly the case that anything other than a blanket rule that the privilege remains with one party can lead to logistical problems. The hypotheticals described in Sections A and C, *supra,* of a single communication that arguably falls into two different "privilege buckets," one of which is controlled by the seller and the other by the buyer, is one such problem. A related issue is a fight over which bucket a particular privilege properly belongs in. A third problem is the interpretation of a specific contractual provision, and a fourth is whether that provision should or should not be enforced. This does not purport to be an exclusive list; there surely are other logistical issues with the current system.

But the central concern expressed in *Zenith* and the Giesel Article is that privilege should not be something that can be bought and sold. Of course, in the typical situation, no one is attempting to sell the privilege on a standalone basis; rather, the issue is that a change of control transaction is occurring, and one of many issues being negotiated as part of the transaction is who should control the privilege after the transaction closes. But Giesel argues that private litigants should not be able to provide for a result different than the default rules because there is a public policy at play—the "concern of the public at large" for "justice by a system that reliably ferrets out the truth in the adversarial arena of the courts. It is in the public interest that the court system achieves that overarching public benefit."[60] Privilege hinders that goal but is permitted because of its own public interest: facilitating maximum, honest communication between attorney and client so that attorney can provide advice within this system.[61] Thus, Giesel contends, "control of the privilege should not be the creature of a contractual allocation but rather should be fully-recognized as a policy decision, which should be the result of careful judicial or legislative contemplation."[62]

There are several problems with this argument. First and perhaps most fundamentally, it is not correct that there are no other public policies at play when private litigants decide who should control the privilege post-sale. Freedom of contract itself is a public policy.[63] Typically, it takes a countervailing interest much stronger than a hypothetical possibility of impeding a future evidentiary hearing to impede parties' freedom of contract.[64] Moreover, in bankruptcy cases, a very significant public interest would be severely hampered if the *Zenith* and Giesel Article argument were to become the law:

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the interest of the many creditors who are not a party to the asset purchase agreement. After all, if the default rule is that most privileged communications will be controlled solely by the buyer, that means that the seller/debtor and its estate will not control the privilege when they object to proofs of claim, litigate preference cases, litigate against directors and officers, insurance companies or commercial parties, etc. Given how difficult it is to litigate without control of the privilege,[65] this would frequently result in materially lower recoveries for creditors. The theoretical concern over the effect on the adversarial process pales by way of comparison to the direct impact that such a rule would have on creditor recoveries in bankruptcy cases.

Second, despite the aspirational goal of "Courts and legislatures set[ting] the precise bounds of the privilege by determining the right balance. . ."[66] the reality is that, other than the law in Delaware related to mergers and federal law related to bankruptcy trustees, the law is less precise than one would hope. This provides uncertainty that can be cleared up with a well-drafted contractual provision, for the benefit of the parties and, presumably, the public as well. For example, consider the *Tekni-Plex/Postorivo/Orbit One* standard: when a successor entity continues to operate a predecessor, the successor "stands in the shoes of prior management and holds the privilege with respect to communications regarding the company's operations."[67] This is far from a blanket rule that every time there is a sale of substantially all of a company's assets, the privilege belongs to the buyer. Indeed, in *Lynx Services Ltd. v. Horstman*, the court held that as a matter of law the privilege was retained by the seller of substantially all of its assets[68]—the opposite result of *Tekni-Plex* and its progeny. *Lynx Services* primarily cited opinions where certain assets, but not substantially all of a company's assets, were sold.[69] There might be something to the notion that a buyer of less than all of a company's assets typically doesn't "continue the business," as opposed to merely utilizing the asset,[70] but that does not appear to be the analysis typically used by the courts. If the standard is whether use of the seller's assets is so substantial that it amounts to continuing the business, that inquiry is fact specific and there often will be substantial uncertainty over who controls the privilege—unless the parties are permitted to clarify the answer with a contractual provision.

A second example is the recent case of *Askari v. McDermott, Will & Emery, LLP*.[71] There, because of a series of related transactions, multiple relevant parties, and a claim of malpractice as well as claims between the buyer and seller, a dispute arose as to which state's law applied, Delaware or New York. If Delaware law applied, under *Great Hill* the privilege would lie with the merged entity; if New York law applied, then under the *Tekni-Plex* exception for litigation about the transaction itself, the privilege would be controlled by plaintiff. The trial court ruled that Delaware law applied, but the Appellate Division reversed, demonstrating just how complex the law itself (absent contracting for clarity) can be. It is difficult to see how there could be a public interest in adding layers of satellite litigation to numerous cases concerning who owns the privilege.

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Third, the Giesel Article's argument by analogy to the common interest privilege misses its mark. The argument is that "courts do not find a legally sufficient common interest solely because the parties, by contract, agree that they share a common interest. The agreement of the parties is but one reference point courts consider when deciding whether, in fact, the parties share a legally sufficient common interest."[72] The problem with this analogy is that letting private parties simply agree that they have a common interest, even if objectively they do not, would *create* a privilege where one otherwise does not exist. In contrast, allowing parties to an asset purchase agreement to agree *which party* controls the privilege does not create a new privilege, but rather allocates which of two parties controls an existing privilege.[73]

Accordingly, the policy concerns do not weigh against permitting transacting parties to determine who will control the privilege. To the contrary, then Chancellor Strine was correct to encourage such contracting in *Great Hill*, and it is time for more bankruptcy practitioners to follow suit.

Conclusion

Most of this article will not come as news to non-bankruptcy M&A practitioners. But, for whatever reason, the bankruptcy world as a whole has not yet caught up. Many asset purchase agreements in Section 363 sales do not address who controls the privilege at all. Others do so in a conclusory way, which is bound to give rise to issues in the future. And only a very few of the surveyed asset purchase agreements grapple with the issue of possible waiver if the privilege remains with the seller but the document and email servers are assets included in the purchase and thus in the physical possession of the buyer.

Given how important control of the privilege often is in litigating claims objections, avoidance actions, D&O insurance claims, fiduciary duty claims and other commercial litigation, bankruptcy practitioners should in the future pay close attention to these issues. As stated in the 2009 Article, it should be on every "checklist" of items to address in a Section 363 sale.

NOTES:

[1]American Bankruptcy Institute Journal, Vol. XXVII, No. 1 (Feb. 2009).

[2]Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 80 A. 3d 155 (Del. Ch. 2013).

[3]See, e.g., Roxanne L. Houtman, Delaware Insider: Great Hill: To the Survivor Goes the Privilege?, Bus. L. Today 1, 2 (Mar. 2014); Edna Selan Epstein, Acquisition and Merger: Whose Privilege Is It Now?, 42 Litigation, No. 2,8 (Winter 2016); W. Brantley Phillips, Jr. & Joseph B. Crace, Jr., Preserving the Attorney-Client Privilege in Change-of-Control Transactions, 19 No. 9 M&A Lawyer 2 (Oct. 2015).

[4]See, e.g., Henry Sill Bryans, Business Successors and the Transpositional Attorney-Client Relationship, 64 Bus. Law. 1039, 1085 (2009).

[5]See, e.g., Grace Giesel, "Control of the Attorney Client Privilege After Mergers and Other Transformational Transactions: Should Control of Their Privilege Be Alienable By

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Contract?", 48 Seton Hall L. Rev. 309 (2018) (hereinafter, "Giesel Article"). See also Edward J. Imwinkelried, "The Alienability of Evidentiary Privileges: Of Property and Evidence, Burden and Benefit, Hearsay and Privilege," 80 St. Johns L. Rev. 497 (2006) (arguing against alienability of privilege belonging to natural persons, but distinguishing privileges held by entities).

[6]See Zenith Electronics Corp. v. WH-TV Broadcasting Corp., 2003 WL 21911066 (N.D. Ill. 2003).

[7]Commodity Futures Trading Com'n v. Weintraub, 471 U.S. 343, 105 S. Ct. 1986, 85 L. Ed. 2d 372, 12 Bankr. Ct. Dec. (CRR) 1247, 12 Collier Bankr. Cas. 2d (MB) 651, Bankr. L. Rep. (CCH) P 70360, 17 Fed. R. Evid. Serv. 529, 1 Fed. R. Serv. 3d 417 (1985). *Commodities Futures Trading* concerned whether a bankruptcy trustee or pre-bankruptcy management controls the privilege; it held in favor of the trustee. But it used sweeping language going beyond just a trustee scenario: "[W]hen control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well. New managers installed as a result of a takeover, merger, loss of confidence by shareholders, or simply normal succession, may waive the attorney-client privilege with respect to communications made by former officers and directors." 471 U.S. at 349.

[8]See Tekni-Plex, Inc. v. Meyner and Landis, 89 N.Y.2d 123, 651 N.Y.S.2d 954, 674 N.E.2d 663, 671–72 (1996). The court stated:

> [T]o grant new *Tekni-Plex* control over the attorney-client privilege as to communications concerning the merger transaction would thwart, rather than promote, the purposes underlying the privilege. The attorney-client privilege encourages "full and frank communication between attorneys and their clients and thereby promote[s] broader public interests in the observance of law and administration of justice" (Upjohn Co. v. United States, 449 U.S. 383, 389, 101 S.Ct. 677, 682, 66 L.Ed.2d 584; see also, People v. Mitchell, 58 N.Y.2d 368, 373, 461 N.Y.S.2d 267, 448 N.E.2d 121)). Where the parties to a corporate acquisition agree that in any subsequent dispute arising out of the transaction the interests of the buyer will be pitted against the interests of the sold corporation, corporate actors should not have to worry that their privileged communications with counsel concerning the negotiations might be available to the buyer for use against the sold corporation in any ensuing litigation. Such concern would significantly chill attorney-client communication during the transaction.

[9]*Commodities Futures Trading* of course did not address this issue because the new controller was a Chapter 7 trustee, not a party that entered into a transaction with prior management. Because Chapter 7 trustees are appointed automatically without negotiations, issue "(8)" simply is not present.

[10]See, e.g., Askari v. McDermott, Will & Emery, LLP, 179 A.D. 3d 127 (N.Y. App. Div. 2019); Giesel Article, 48 Seton Hall L. Rev. at 331–37 (describing and contrasting "the New York Approach" and "the Delaware approach").

[11]674 N.E. 2d at 666; see also Orbit One Communications, Inc. v. Numerex Corp., 255 F.R.D. 98 (S.D. N.Y. 2008) (holding that privilege transferred to a purchaser of substantially all of a company's assets that was continuing the business, but an exception existed for communications related to the acquisition itself).

[12]Postorivo v. AG Paintball Holdings, Inc., 2008 WL 343856 (Del. Ch. 2008).

[13]80 A.3d at 158–60.

[14]80 A.3d at 156 (quoting 8 Del. C. § 259) (emphasis supplied).

[15]80 A.3d at 157.

[16]See also Lynx Services Ltd. v. Horstman, 2016 WL 4565895 (N.D. Ohio 2016) (distinguishing, for purposes of determining whether privilege passed, between a sale of substantially all of a company's assets and a merger); but see Askari, 179 A.D.3d at 145–147 (discussed in Section D, infra; case turned on whether *Great Hill* or *Tekni-Plex* applied).

[17]See, e.g., In re Teleglobe Communications Corp., 493 F.3d 345, 361 (3d Cir. 2007), as

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amended, (Oct. 12, 2007) ("Disclosing a communication to a third party unquestionably waives the [attorney-client] privilege.").

[18]493 F.3d at 361 (citing Restatement (Third) of the Law Governing Lawyers § 68 (2000)).

[19]493 F.3d at 361.

[20]See, e.g., Berg Electronics, Inc. v. Molex, Inc., 875 F. Supp. 261, 262, 34 U.S.P.Q.2d 1315 (D. Del. 1995) (explaining that under the traditional approach, "[t]he privilege for confidential communications can be lost if papers are in a car that is stolen, a briefcase that is lost, a letter that is misdelivered, or in a facsimile that is missent"); 8 John H. Wigmore, Evidence § 2325, at 633 (McNaughton rev. 1961) ("All involuntary disclosures, in particular, through the loss or theft of documents from the attorney's possession, are not protected by the privilege, on the principle. . . that, since the law has granted secrecy so far as its own process goes, it leaves to the client and attorney to take measures of caution sufficient to prevent being overheard by third persons. The risk of insufficient precautions is upon the client. This principle applies equally to documents.").

[21]Berg Elecs., Inc., 875 F. Supp. at 263 (citing Helman v. Murry's Steaks, Inc., 728 F. Supp. 1099, 1104 (D. Del. 1990)); Fidelity Bank, N.A. v. Bass, 1989 WL 9354 (E.D. Pa. 1989); Mendenhall v. Barber-Greene Co., 531 F. Supp. 951, 954–55, 217 U.S.P.Q. 786, 9 Fed. R. Evid. Serv. 1613, 33 Fed. R. Serv. 2d 921 (N.D. Ill. 1982).

[22]531 F. Supp. at 954–55.

[23]2009 Article at 47 (footnotes and citations in original).

[24]Great Hill, 80 A. 3d at 162.

[25]Goldstein v. Colborne Acquisition Co., LLC, 873 F. Supp. 2d 932 (N.D. Ill. 2012).

[26]873 F.Supp.2d at 936.

[27]Soc'y of Prof'l Eng'g Emps. in Society of Professional Engineering Employees in Aerospace v. Boeing Co., 2010 WL 3083536 (D. Kan. 2010).

[28]2010 WL 3083536 at *4.

[29]2010 WL 3083536 at *4. ("[T]his court will grant no greater protection than Boeing's own precautions warrant. Based on the facts in this case, the court does not believe that Boeing has 'jealously guarded' its privileged documents.").

[30]Lynx Services Ltd. v. Horstman, 2016 WL 4565895 (N.D. Ohio 2016).

[31]Postorivo v. AG Paintball Holdings, Inc., 2008 WL 343856 (Del. Ch. 2008).

[32]2008 WL 343856 at n.13.

[33]2009 Article, at 47, 77.

[34]2009 Article at 77.

[35]Great Hill, 80 A.3d at 160–61.

[36]Shareholder Representative Services LLC v. RSI Holdco, 2019 WL 2290916 (Del. Ch. 2019).

[37]Tekni-Plex, 674 N.E. 2d at 671.

[38]Spicer v. GardaWorld Consulting (UK) Limited, 181 A.D.3d 413, 120 N.Y.S.3d 34 (1st Dep't 2020).

[39]See Zenith Electronics Corp. v. WH-TV Broadcasting Corp., 2003 WL 21911066 (N.D. Ill. 2003).

[40]See 8 Del. C. § 259.

[41]If pre-merger shareholders or management share a common interest privilege with the target, the target might wish to retain the privilege in the merger because, in any subsequent

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litigation between stockholders/management and the merged entity, the privilege only can be asserted against the merged entity if it is not a party to the privilege; if the merged entity succeeds to the privilege, common interest communications will be privileged against third parties but not against the parties to the common interest. See In re Teleglobe Commc'ns, Inc., 493 F.3d at 359, 364–65.

[42]See, e.g., U.S. v. Bilzerian, 926 F.2d 1285, 1291–94, Fed. Sec. L. Rep. (CCH) P 95701, 31 Fed. R. Evid. Serv. 1185 (2d Cir. 1991) (prohibiting a party from introducing evidence of certain privileged communications and invoking privilege with respect to similar communications).

[43]See Shareholder Representative Services LLC v. RSI Holdco, 2019 WL 2290916 (Del. Ch. 2019).

[44]2019 WL 2290916 at * 2.

[45]2019 WL 2290916 at *3–5.

[46]Giesel Article, 48 Seton Hall L. Rev. at 338–40.

[47]48 Seton Hall L. Rev. at 340 (quoting a transaction with Equinix, Inc.).

[48]Benjamin Horney, "How to Protect Atty-Client Communications After a Merger," Law360 (Sept. 26, 2019).

[49]See Horney, at 2. ("The provisions should be more than just a single sentence denoting that certain communications are privileged and do not belong to the buyer once the deal is complete.").

[50]In re Destination Maternity Corp., Case No. 19-12256 (BLS), D.I. 493 at Ex. 1, § 6.9 (Bankr. D. Del. Dec. 13, 2019).

[51]See In re Chieftain Sand and Proppant, LLC, Case No. 17-10064 (KG), D.I. 178 at Ex. A, § 9.13 (Bankr. D. Del. Mar. 27, 2017).

[52]In re Synergy Pharmaceuticals, Case No. 18-14010 (JLG), D.I. 484 at ¶ 26 (Bankr. S.D.N.Y. Mar. 1, 2019).

[53]In re Avaya Inc., Case No. 17-10089 (SMB), D.I. 684 at Ex. A, § 1.03(a)(v) (Bankr. S.D.N.Y. May 31, 2017).

[54]See In re Bumble Bee Parent, Inc., Case No. 19-12502 (LSS), D.I. 326 at Ex. A, § 10.22 (Bankr. D. Del. Jan. 24, 2020).

[55]Great Hill, 80 A.3d at 160–61.

[56]See Zenith Electronics Corp. v. WH-TV Broadcasting Corp., 2003 WL 21911066 (N.D. Ill. 2003).

[57]Giesel Article, 48 Seton Hall L. Rev. 309.

[58]Giesel Article, 48 Seton Hall L. Rev. at 311–12.

[59]48 Seton Hall L. Rev. at 316.

[60]48 Seton Hall L. Rev. at 341.

[61]48 Seton Hall L. Rev. at 342.

[62]48 Seton Hall L. Rev. at 342.

[63]See, e.g., ev3, Inc. v. Lesh, 114 A.3d 527, 529 n.3 (Del. 2014), as revised, (Apr. 30, 2015) ("Delaware courts seek to ensure freedom of contract and promote clarity in the law in order to facilitate commerce."); Libeau v. Fox, 880 A.2d 1049, 1056–57 (Del. Ch. 2005), judgment entered, 2005 WL 5783306 (Del. Ch. 2005), judgment aff'd in part, rev'd in part on other grounds, 892 A.2d 1068 (Del. 2006).

[64]See Libbeau, 880 A.2d at 1056–57 ("When parties have ordered their affairs voluntarily through a binding contract, Delaware law is strongly inclined to respect their agreement,

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and will only interfere upon a strong showing that dishonoring the contract is required to vindicate a public policy interest even stronger than freedom of contract. Such public policy interests are not to be lightly found, as the wealth-creating and peace-inducing effects of civil contracts are undercut if citizens cannot rely on the law to enforce their voluntarily-undertaken mutual obligations.").

[65]See supra § C.

[66]Giesel Article, 48 Seton Hall L. Rev. at 311.

[67]Postorivo v. AG Paintball Holdings, Inc., 2008 WL 343856 (Del. Ch. 2008).

[68]2016 WL 4565895 at *2.

[69]See 2016 WL 4565895 at *2–3 (citing In re In-Store Advertising Securities Litigation, 163 F.R.D. 452 (S.D. N.Y. 1995) and In re Grand Jury Subpoenas 89-3 and 89-4, 734 F. Supp. 1207 (E.D. Va. 1990), order aff'd in part, vacated in part on other grounds, 902 F.2d 244, 30 Fed. R. Evid. Serv. 273, 28 A.L.R.5th 775 (4th Cir. 1990)).

[70]The *Lynx Services* court appears to have applied a different standard altogether, focusing not on whether the buyer continues to operate the seller's business, but rather on whether the sale "involve[d] a transfer of control or management." 2016 WL 4565895 at 2. However, somewhat oddly, *Lynx Services* also cites *Orbit One*, which is a sale of substantially all of the company's assets and applies *Tekni-Plex*. See Orbit One, 255 F.R.D. at 106–07.

[71]Askari v. McDermott, Will & Emery, LLP, 179 A.D.3d 127, 114 N.Y.S.3d 412 (2d Dep't 2019).

[72]Giesel Article, 48 Seton Hall L. Rev. at 347.

[73]The Giesel Article also draws an analogy to the prohibition on parties agreeing to extend a statute of limitations before the cause of action accrues. 48 Seton Hall L. Rev. at 349–52. This argument omits that tolling of a statute of limitations after the cause of action accrues is not only permitted but common practice. It is not clear why the policy concerns of the former are more analogous than the latter.