

# ETHICAL ISSUES IN M&A TRANSACTIONS

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**14<sup>th</sup> Annual  
Mergers & Acquisitions Institute**

Dallas, TX –October 4-5, 2018

Sponsored by: UT Law CLE

# ETHICAL ISSUES IN M&A TRANSACTIONS

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Business lawyers generally do not pay a lot of attention to the ethical rules that impact a merger and acquisition (“*M&A*”) transaction. Other than the widely accepted principle that an attorney shouldn’t contact the principal of the other side if he or she knows them to be represented by counsel, M&A lawyers may not pay attention to the other rules that might be applicable in a given situation. This paper analyzes three of the more common areas where an attorney may face ethical issues in an M&A transaction: (i) determining when conflicts of interest exist among clients and potential clients; (ii) preserving the attorney-client privilege during and after the transaction; and (iii) balancing the need to be an advocate for the client versus obligations of candor to opposing counsel.

## I. WHO IS MY CLIENT? – CONFLICTS OF INTEREST IN M&A TRANSACTIONS

**Introduction.** Resolving conflicts of interest among parties in an M&A transaction is a very easy process, provided that your client is an entity with one owner who is also the sole employee of the business. Anything beyond that fact pattern is complicated and requires you to determine the identity of your client. Rule 1.06 of the Texas Disciplinary Rules of Professional Conduct (the “*Texas Rules*”) tells the M&A practitioner right up front that not much help will be forthcoming:

### **RULE 1.06 Conflict of Interest: General Rule**

- (a) A lawyer shall not represent opposing parties to the same litigation.

The Texas Rules were obviously written by litigators for litigators. The rest of Texas Rule 1.06 provides marginally more help.

- (b) In other situations and except to the extent permitted by paragraph (c), a lawyer shall not represent a person if the representation of that person:

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- (1) Involves a substantially related matter in which that person's interests are materially and directly adverse to the interests of another client of the lawyer or the lawyer's firm; or
- (2) Reasonably appears to be or become adversely limited by the lawyer's or law firm's responsibilities to another client or to a third person or by the lawyers' or law firm's own interests.
- (c) A lawyer may represent a client in the circumstances described in (b) if:
  - (1) The lawyer reasonably believes the representation of each client will not be materially affected; and
  - (2) Each affected or potentially affected client consents to such representation after full disclosure of the existence, nature, implications, and possible advance consequences of the common representation and the advantages involved, if any.

The commentary to Texas Rule 1.06 at least mentions the problems caused by the standards set in 1.06(b) and (c) in a non-litigation context.

#### **Non-litigation Conflict Situations**

13. Conflicts of interest in contexts other than litigation sometimes may be difficult to assess. Relevant factors in determining whether there is potential for adverse effect include the duration and intimacy of the lawyer's relationship with the client or clients involved, the functions being performed by the lawyer, the likelihood that actual conflict will arise and the likely prejudice to the client from the conflict if it does arise. The question is often one of proximity and degree.

14. For example, a lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation may be permissible where the clients are generally aligned in interest even though there is some difference of interest among them.

After working through those rules and commentary, the only definitive take-away is that a practitioner cannot represent the buyer and the seller in the same M&A transaction. This applies to lawyers within the same firm—so one partner cannot represent the seller and another partner, even if from another office, cannot represent the buyer.<sup>1</sup>

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<sup>1</sup> See Texas Rule 1.06(f).

When dealing with a selling entity client that has multiple constituencies, whether it be multiple owners with differing economic interests, owners and employees who will be involved in the business post-transaction, owners with third parties who own a significant asset related to the business (such as real estate occupied by the business) or otherwise, the attorney has to understand from the outset the interests and roles of the various constituencies and to determine whether it will be permissible to represent the different parties in the deal. After that determination is made, the lawyer should make it clear to everyone involved, preferably in writing, who the lawyer represents (and, just as importantly, who the lawyer does not represent). If a joint representation is permissible, the attorney should explain the nature of the joint representation, and set forth in a written engagement/conflict waiver agreement the ground rules for dealing with multiple parties. Finally, the lawyer must pay attention during the negotiation of the transaction to changing fact patterns that could alter the analysis as to whether joint representation is possible.

**Joint Representation Analysis.** In a sell-side representation, the lawyer may be approached to represent all of the constituents to the transaction under the theory that it is more efficient from both a cost and transactional perspective for one lawyer to represent all of those on the seller's side. Some of the more common joint representations include representing all of the owners of a selling entity, representing the entity/owners and one or more key employees of the entity, or representing the entity/owners and the owners (often an affiliate of one of the owners) of an asset used by the company, such as real estate. The multiple owners may be receiving different consideration or are being treated differently after the sale. It may be a condition to closing that a key employee enter into an employment agreement or the real estate owner enter into a lease with the buyer. The fundamental issue in determining if an attorney can represent multiple parties on the same side of an M&A transaction is whether the attorney's representation of one client's interest in the transaction could adversely impact the interest of another client in the transaction. In other words, if representing one client's interests could kill the deal for another client, then the attorney needs to forego the representation of one of the parties or determine if the representation would be possible with a conflict waiver.

This very situation was at issue in a recent Delaware case,<sup>2</sup> where a law firm that represented the majority owner of the company purported to represent the company in connection with a potential acquisition that did not go forward, as per the wishes of the majority owner. The minority owners sued, claiming that the majority owner breached a duty in the company agreement to use reasonable efforts to sell the company. In addition to relief for the failed sale, the court awarded the minority owners a pro rata share of the attorneys' fees incurred by the company, stating that the company and its counsel "should not have been picking sides" in the members' dispute.

Set forth below are some examples of multi-client situations that an attorney might encounter in M&A transactions.

**EXAMPLE 1:** Joe Moneybags (75%) and Jim Workingman (25%) own Success, LLC and a buyer has offered to buy their interests in the company. The proposed deal is that

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<sup>2</sup> *In re Oxbow Carbon LLC Unitholder Litig.*, 2018 WL 3655257 (Del. Ch. Aug. 1, 2018).

Moneybags will receive 75% of the consideration and Workingman will receive 25% of the consideration. Both parties will enter into non-compete agreements with the buyer, but neither will be involved with the business after closing. Attorney A has represented Moneybags for years, and has also represented Success, LLC on various transactions and litigation since its inception. Moneybags and Workingman come to Attorney A and ask her to represent both of them in the sale. Can she do so?

ANSWER: The interests of Moneybags and Workingman are generally aligned in this scenario, so Attorney A could represent both parties. However, she would be wise to get an engagement agreement with joint representation language (see Attachment 1).

EXAMPLE 2: Same facts, except Moneybags will receive 90% of the cash paid at closing, and Workingman will receive 10% of the cash, plus a 10% interest in Buyer LLC. Workingman will enter into a 5 year employment agreement with non-solicitation and non-competition provisions to be determined.

ANSWER: Attorney A has a conflict under Texas Rule 1.06(b). Her representation of Workingman in connection with the negotiation of the employment agreement and ownership interest could be adverse to her representation of Moneybags with respect to the overall transaction. Attorney A could only take on this representation if she can satisfy the requirements of Rule 1.06(c)—she reasonably believes that her representation of each client will not be materially affected by the conflict and each client consents to the representation after full disclosure of the existence, nature, implications, and possible advance consequences of the common representation and the advantages involved, if any. In this instance, Attorney A should get a waiver letter from the clients that profiles the relationships between the parties, and the implications and the pitfalls of the joint representation, including an acknowledgement from Workingman that her work on his behalf could be impacted because of her relationship with Moneybags, and an acknowledgement from Moneybags that her representation of Workingman on his matters could result in the termination entire transaction. Even then, Attorney A would be well advised to pass on the joint representation if possible.

EXAMPLE 3: Moneybags is the sole owner of the company, and Workingman is only an employee. The purchase agreement says it is a condition to closing that Workingman enter into an employment agreement with the buyer with a non-competition agreement. Can Attorney A represent Workingman as well as Moneybags?

ANSWER: This is really the same situation as Example 2. Attorney A's ability to represent Workingman's interests in negotiating his employment agreement conflict with her duties to Moneybags in connection with the acquisition. Attorney A should not represent Workingman without the detailed waiver from both parties described above.

EXAMPLE 4: Same situation, except that it is not a condition to closing for Workingman to enter into the employment agreement—Moneybags is just to use commercially reasonable efforts to get Workingman to enter into an agreement.

ANSWER: Attorney A should be able to represent Moneybags and Workingman in this situation. She still should get a written engagement letter from Workingman that acknowledges the representation and the relationships of the parties.

EXAMPLE 5: In Example 2 or Example 3 above, the parties decide that Workingman will hire Attorney B to represent his interests in the transaction. Can Moneybags pay Workingman’s legal fees to Attorney B?

ANSWER: Yes. See comment 12 to Rule 1.06 of the Texas Rules:

12. A lawyer may be paid from a source other than the client, if the client is informed of that fact and consents and the arrangement does not compromise the lawyer’s duty of loyalty to the client. . . .

EXAMPLE 6: Moneybags is the sole owner of the company, but real estate owned by the company is owned by a partnership consisting of Moneybags and his brothers. It is a condition to closing the deal that the partnership enter into a lease with the buyer. Can Attorney A represent both Moneybags and the partnership?

ANSWER: This is really the same situation as Example 2. Attorney A would have to get a detailed waiver from Moneybags and the partnership in order to proceed with the representation.

**Conflict of Interest Waivers.** If an attorney does decide to proceed with a representation under a waiver when a conflict exists, a considerable amount of thought and effort needs to go into the drafting of that waiver. As mentioned in Texas Rule 1.06(c), the conflict can only be waived “after full disclosure of the existence, nature, implications, and possible advance consequences of the common representation and the advantages involved, if any.” This is obviously not a “one size fits all” document. While the language regarding joint representation in Attachment 1 should be included, the attorney should go to great lengths to explain the situation to the clients and to spell out the adverse consequences that could result from the joint representation. The clients should acknowledge that they understand these consequences and make an express representation of their belief that the potential cost savings and efficiencies gained by the joint representation outweigh the potential adverse consequences.

## **Conflict of Interest Takeaways.**

1. The first step in a multiple constituency M&A representation is to determine who the attorney represents, who the attorney could represent with a waiver, and who the attorney cannot represent.
2. Generally, an attorney should avoid situations where loyalty to one constituent party would put the attorney at odds with the interests of another constituent party.
3. The findings should be communicated to all of the constituent parties in writing, so that everyone knows who the attorney represents (and does not represent). Joint representation language should be used if the attorney is to represent multiple constituencies.
4. Conflict waivers should be used when a potential conflict exists, and that waiver must be detailed in terms of the conflict and potential adverse consequences that could arise from that conflict.

## **II. ATTORNEY-CLIENT PRIVILEGE**

**Introduction.** One of the more troublesome problems related to the disclosure of confidential information during the due diligence process is how to disclose certain information to the recipient to facilitate a meaningful evaluation of litigation-related confidential information without waiving any work-product protections, attorney-client privileges, and similar protections and privileges. The language set forth below to go in an acquisition agreement constitutes an attempt to allow the seller to furnish to the buyer confidential information without waiving the seller's work product, protection, attorney-client privilege and similar protections by demonstrating that the buyer and seller have or should be presumed to have common legal and commercial interests, or are or may become joint defendants in litigation:

**Section 12.6. Privileges Not Waived.** The disclosing party is not waiving, and will not be deemed to have waived or diminished, any of its attorney work product protections, attorney-client privileges, or similar protections and privileges as a result of disclosing its confidential information (including confidential information related to pending or threatened litigation) to the receiving party, regardless of whether the disclosing party has asserted, or is or may be entitled to assert, such privileges and protections. The parties (a) share a common legal and commercial interest in all of the disclosing party's confidential information that is subject to such privileges and protections, (b) are or may become joint defendants in Proceedings to which the disclosing party's confidential information covered by such protections and privileges relates, (c) intend that such privileges and protections remain intact should either party become subject to any actual or threatened Proceeding to which the disclosing party's confidential information covered by such protections and privileges relates, and (d) intend that after the Closing the receiving party shall have the right to assert such

protections and privileges. No receiving party shall admit, claim or contend, in Proceedings involving either party or otherwise, that any disclosing party waived any of its attorney work product protections, attorney-client privileges, or similar protections and privileges with respect to any information, documents or other material not disclosed to a receiving party due to the disclosing party disclosing its confidential information (including confidential information related to pending or threatened litigation) to the receiving party.<sup>3</sup>

The language set forth above, however, may be disregarded by a court, and may even “flag” the issue of privilege waiver for adverse parties which obtain the agreement. Further, there may be instances when the receiving party is an actual or potentially adverse party in litigation with the disclosing party (e.g., when litigation is the driving force behind an acquisition). In those cases, the language of the foregoing provision is intended to bolster a claim by the disclosing party that the recipient is later precluded from using disclosure as a basis for asserting that the privilege was waived.

Whether work product protections and attorney-client privileges will be deemed to be waived as a result of disclosures in connection with a consummated or unconsummated asset purchase depends on the law applied by the forum jurisdiction and the forum jurisdiction’s approach to the joint defendant and common interest doctrines (these doctrines are discussed below). In most jurisdictions, work product protection will be waived only if the party discloses the protected documents in a manner which substantially increases the opportunities for its potential adversaries to obtain the information. By contrast, the attorney-client privilege will be waived as a result of voluntary disclosure to any third party, unless the forum jurisdiction applies a form of the joint defense or common interest doctrines.<sup>4</sup>

**Work Product Doctrine.** The work product doctrine protects documents prepared by an attorney in anticipation of litigation or for trial.<sup>5</sup> The work product doctrine focuses on the adversary system and attorney’s freedom in preparing for trial.<sup>6</sup> The threshold determination in a work product case is whether the material sought to be protected was prepared in anticipation of litigation or for trial.<sup>7</sup> Work product protection, codified by FED. R. CIV. P. 26(b)(3), allows protected material to be obtained by the opposing party only upon a showing of substantial need and undue hardship.<sup>8</sup> This form of protection relates strictly to documents prepared in anticipation of litigation or for trial.<sup>9</sup> Therefore, in absence of any anticipated or pending litigation, documents prepared for the purposes of a specific business transaction are not protected by the work product doctrine.

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<sup>3</sup> ABA Mergers and Acquisition Committee, *Model Asset Purchase Agreement* (2001).

<sup>4</sup> See Henry Still Bryans, *Business Successors and the Transpositional Attorney-Client Relationship*, 64 *Bus. Law.* 1039 (2009); cf. Charles L. “Chip” Babcock and Crystal J. Parker, *How to Protect Privilege with Respect to Communications with Litigation-Related Public-Relations Consultants*, 31 *Corp. Couns. Rev.* 47 (2012).

<sup>5</sup> See *Hickman v. Taylor*, 329 U.S. 495, 511 (1947).

<sup>6</sup> See *Union Carbide Corp. v. Dow Chem.*, 619 F. Supp. 1036, 1050 (D. Del. 1985).

<sup>7</sup> *Binks Mfg. Co. v. National Presto Indus., Inc.*, 709 F.2d 1109, 1118 (7th Cir. 1983).

<sup>8</sup> FED. R. CIV. P. 26(b)(3).

<sup>9</sup> See *Hickman v. Taylor*, 329 U.S. at 512.



In most jurisdictions, a waiver of the work-product protection can occur where the protected communications are disclosed in a manner which “substantially increases the opportunity for potential adversaries to obtain the information.”<sup>10</sup> Waiver of work product protection by sharing the work product with one adversary can result in waiver as to other unrelated adversaries.<sup>11</sup> The question is whether the particular disclosure was of such a nature as to enable an adversary to gain access to the information.<sup>12</sup> Disclosure under a confidentiality agreement militates against a finding of waiver, for it is evidence the party took steps to insure that its work product did not land in the hands of its adversaries.<sup>13</sup> In a minority of jurisdictions, the waiver of work product protection depends on whether the parties share a common legal interest.<sup>14</sup> In such jurisdictions, the courts will apply the same analysis as for the waiver of attorney-client privilege.<sup>15</sup>

**Attorney-Client Privilege.** The attorney-client privilege protects communications of legal advice between attorneys and clients, including communications between corporate employees and a corporation’s attorneys to promote the flow of information between clients and their attorneys.<sup>16</sup> The requirements for the protection of the attorney client privilege can be summarized as follows:

“The privilege applies only if (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.”<sup>17</sup>

Although the attorney-client privilege does not require ongoing or threatened litigation, it is more narrow than the work product doctrine because it covers only “communications” between the lawyer and his client for the purposes of legal aid.<sup>18</sup>

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<sup>10</sup> See *Behnia v. Shapiro*, 176 F.R.D. 277, 279 (N.D. Ill. 1997); see also 8 WRIGHT, MILLER & MARCUS, FEDERAL PRACTICE AND PROCEDURE: CIVIL, § 2024, at 369 (1994).

<sup>11</sup> See *In re Stone Energy Corp.*, Fed. Sec. L. Rep. (CCH) ¶94,809 (W.D. La. August 14, 2008) (Plaintiff in securities fraud class action entitled to review attorney internal investigation report prepared for audit committee in anticipation of litigation because defendant company provided it to SEC which was held to be adversary even though no action was pending).

<sup>12</sup> See *Behnia*, 176 F.R.D. at 279-80; *U.S. v. Amer. Tel. & Tel.*, 642 F.2d 1285, 1299 (D.C. Cir. 1980).

<sup>13</sup> *Blanchard v. EdgeMark Financial Corp.*, 192 F.R.D., 233, 237 (N.D. Ill. 2000).

<sup>14</sup> *Id.*; See *In re Grand Jury Subpoenas*, 89-3 & 89-4, *John Doe* 89-129, 902 F.2d 244, 248 (4th Cir. 1990).

<sup>15</sup> *Id.*

<sup>16</sup> See *Upjohn Co. v. U.S.*, 449 U.S. 383, 389 (1981).

<sup>17</sup> *U.S. v. United Shoe Mach. Corp.*, 89 F. Supp. 357, 358-59 (D. Mass. 1950).

<sup>18</sup> See *Upjohn*, 449 U.S. at 389.

The core requirement of the attorney-client privilege is that the confidentiality of the privileged information be maintained. Therefore, the privilege is typically waived when the privilege holder discloses the protected information to a third party.<sup>19</sup> A waiver of attorney-client privilege destroys the attorney-client privilege with respect to all future opposing parties and for the entire subject matter of the item disclosed.<sup>20</sup>

The courts have developed two doctrines of exceptions to the waiver of the privilege through voluntary disclosure. The joint defendant rule, embodied in UNIF. R. EVID. 502(b)(5), protects communications relevant to a matter of common interest between two or more clients of the same lawyer from disclosure.<sup>21</sup> This widely accepted doctrine applies strictly to clients of the same lawyer who are joint defendants in litigation. Several courts have expanded the joint defense doctrine in order to create another exception to the waiver of attorney-client privilege: the doctrine of common-interest. Under the common interest doctrine, privileged information can be disclosed to a separate entity that has a common legal interest with the privilege holder, whether or not the third party is a co-defendant.

Federal circuit courts and state courts diverge in their interpretation and application of the common interest and joint defendant doctrine.<sup>22</sup> Some Federal courts have extended the common interest exception to communications in furtherance of any common legal interest and do not require that shared communications relate to pending or anticipated litigation.<sup>23</sup> They allow “attorneys representing different clients with similar legal interests to share information without having to disclose it to others . . . in civil and criminal litigation, and even in purely transactional contexts”<sup>24</sup> and consider that “[a]pplying the common interest doctrine to the full range of communications otherwise protected by the attorney-client privilege encourages parties with a shared legal interest to seek legal assistance in order to meet legal requirements and to plan their conduct accordingly.”<sup>25</sup>

Delaware has codified the common-interest privilege, extending the attorney-client privilege to certain communications by clients, their representatives or their lawyers to a lawyer “representing another in a matter of common interest”,<sup>26</sup> and recognizes that disclosure may be confidential even when made between lawyers representing different clients if those clients have a common interest — that is, an interest that is “so parallel and non-adverse that, at least with

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<sup>19</sup> Cf. *In re Information Management Services, Inc. Derivative Litigation*, C.A. No. 8168-VCL (Del. Ch. Sept. 5, 2013) (*communications between executives and their individual counsel made using company email accounts were not privileged because there was no reasonable expectation of privacy*).

<sup>20</sup> See *In re Grand Jury Proceedings*, 78 F.3d 251, 255 (6th Cir. 1996).

<sup>21</sup> UNIF. R. EVID. 502 (d)(5).

<sup>22</sup> *U.S. v. Weissman*, No. SI 94 Cr. 760 (CSH), 1996 WL 737042 \*7 (S.D.N.Y. 1996).

<sup>23</sup> See *Restatement (Third) of The Law Governing Lawyers § 76(1) (1997)*; *Teleglobe Communications Corp. v. BCE, Inc.*, 493 F.3d 345; *United States v. BDO Seidman, LLP*, 492 F.3d 806, 816 [7th Cir 2007]; *In re Regents of the Univ. of Calif.*, 101 F.3d 1386, 1390-1391 [Fed. Cir. 1996].

<sup>24</sup> *Teleglobe*, 493 F.3d at 36.

<sup>25</sup> *BDO Seidman*, 492 F.3d at 816 [internal quotations and citation omitted].

<sup>26</sup> Del. Uniform R. of Ev. 502[b].

respect to the transaction involved, they may be regarded as acting as joint venturers.”<sup>27</sup> More restrictive courts require that the parties share an identical legal, as opposed to purely commercial, interest.<sup>28</sup>

Finally, some courts persist in rejecting the common interest theory absent actual or pending litigation in which both parties are or will be joint defendants. In *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*,<sup>29</sup> the New York Court of Appeals held that the attorney-client privilege is waived when privileged information is shared between two entities in process of merging because, for the common interest doctrine to apply in New York, the communication must also relate to litigation, either pending or anticipated, even though the attorney-client privilege itself is not tied to litigation. In so holding the Court of Appeals refused to (i) apply the common interest doctrine to communications between parties to a merger after the merger agreement was signed but before closing or (ii) explain when a communication is qualified as being related to pending or anticipated litigation.<sup>30</sup>

The Texas law is comparable to New York in requiring actual or pending litigation to be involved for the communication to be privileged:

Texas requires that the communications be made in the context of a pending action. See Tex. R. Evid. 503(b)(1)(C) (protecting from disclosure communications between a client “to a lawyer . . . representing another party in a pending action and concerning a matter of common interest therein”) (emphasis added). \* \* \* Thus, in jurisdictions like Texas, which have a pending action requirement, no commonality of interest exists absent actual litigation. Accordingly, our privilege is not a “common interest” privilege that extends beyond litigation. Nor is it a “joint defense” privilege, as it applies not just to defendants but to any parties to a pending action. Rule 503(b)(1)(C)’s privilege is more appropriately termed an “allied litigant” privilege. The allied litigant doctrine protects communications made between a client, or the client’s lawyer, to another party’s lawyer, not to the other party itself. \* \* \* This attorney-sharing requirement makes clear that the privilege applies only when the parties have separate counsel.<sup>31</sup>

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<sup>27</sup> *3Com Corp. v. Diamond II Holdings, Inc.*, 2010 WL 2280734, \*7, 2010 Del. Ch. LEXIS 126, \*32 [May 31, 2010], quoting *Jedwab v. MGM Grand Hotels, Inc.*, 1986 WL 3426, \*2, 1986 Del. Ch. LEXIS 383, \*5 [Del. Ch. Mar. 20, 1986].

<sup>28</sup> See *Duplan Corp. v. Deering Milliken*, 397 F. Supp. 1146, 1172 (D.S.C. 1974).

<sup>29</sup> 57 N.E. 3d 30 (N.Y. 2016).

<sup>30</sup> See ABA Mergers and Acquisitions Committee, *Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions*, 72 Bus. Law. 449-451 (2017); cf. *Int’l Ins. v. Newmont Mining Corp.*, 800 F. Supp. 1195, 1196 (S.D.N.Y. 1992).

<sup>31</sup> *In re XL Specialty Ins. Co.*, 373 S.W.3d 46 (Tex. 2012).

In the Fifth Circuit, “two types of communications are protected under the [common legal interest] privilege . . . (1) communications between co-defendants in actual litigation and their counsel; and (2) communications between potential co-defendants and their counsel.”<sup>32</sup>.

Although there is no uniform test for application of the common interest doctrine, courts have consistently examined three elements when applying the doctrine: (1) whether the confidentiality of the privileged information is preserved despite disclosure; (2) whether, at the time that the disclosures were made, the parties were joint defendants in litigation or reasonably anticipated litigation; and (3) whether the legal interests of the parties are identical or at least closely aligned at the time of disclosure.<sup>33</sup>

**Waiver in M&A Transactions.** The core requirement of the common interest doctrine is the existence of a shared legal interest. Courts will have less difficulty in finding an exception to a waiver when the parties to the purchase agreement actively pursue common legal goals.<sup>34</sup> An agreement in which the buyer does not assume the litigation liability of the seller does not demonstrate an alignment of the parties’ interests. A common business enterprise, such as the sale of assets, or a potential merger, will not suffice unless the parties’ legal interests are at least parallel and non-adverse.<sup>35</sup> Disclosures by a corporation and its counsel to the corporation’s investment banking firm during merger discussions have resulted in a waiver of the attorney-client privilege because the common interest rule did not apply.<sup>36</sup> The court said the common-interest rule protects from disclosure those communications between one party and an attorney for another party “where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel,” noting that the common interest must be a legal one, not commercial or financial.<sup>37</sup> The court concluded, however, that the common interest rule did not apply because the defendants did not demonstrate that the investment banking firm’s legal interest in the threatened litigation was anything more than peripheral.<sup>38</sup>

Although the consummation of a transaction is not determinative of the existence of a waiver, the interests of the parties may become closely aligned as a result of the closing. As a result, there is a higher probability that information will remain protected in a transaction that closes and in which the buyer assumes liability for the seller’s litigation, than in a transaction that does not close and in which the buyer does not assume liability for the seller’s litigation.<sup>39</sup> Generally, (i) in a statutory merger the surviving corporation can assert the attorney-client privilege, (ii) in a stock-for-stock deal the privilege goes with the corporation, although in some

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<sup>32</sup> See *Advanced Neuromodulation Sys. v. Advanced Bionics Corp.*, 2005 U.S. Dist. LEXIS 47692 (E.D. Tex. Oct. 26, 2005).

<sup>33</sup> See, e.g. *U.S. v. Gulf Oil Corp.*, 760 F.2d 292, 296 (Temp. Emer. Ct. App. 1985).

<sup>34</sup> See *U.S. v. Schwimmer*, 892 F.2d 237, 244 (2d Cir. 1989).

<sup>35</sup> *Jedwab v. MGM Grand Hotels*, 509 A.2d 584, 586 (Del. Ch. 1986).

<sup>36</sup> See *Blanchard v. EdgeMark Financial Corp.*, 192 F.R.D. 233, 235 (N.D. Ill. 2000).

<sup>37</sup> *Id.* at 236.

<sup>38</sup> *Id.* at 237.

<sup>39</sup> See Hundley, “White Knights, Pre-Nuptial Confidences, and the Morning After: The Effect of Transaction-Related Disclosures on the Attorney-Client and Related Privileges,” 5 DEPAUL BUS. L.J. 59 (Fall/Winter, 1992/1993); cf. *Cheeves v. Southern Clays, Inc.*, 128 F.R.D. 128, 130 (M.D. Ga. 1989) (“Courts have found a community of interest where one party owes a duty to defend another, or where both consult the same attorney”).

cases the buyer and seller may share the privilege, and (iii) in the case of an asset sale some cases hold no privilege passes to the buyer because the corporate holder of the privilege has not been sold while others hold that a transfer of all of seller's right, title and interest in the assets of a business effectively transfers the right to assert or waive the privilege.<sup>40</sup>

In *Tekni-Plex, Inc. v. Meyner and Landis*,<sup>41</sup> the New York Court of Appeals held that in a triangular merger the purchaser could not preclude long-time counsel for the seller and its sole shareholder from representing the shareholder in an indemnification claim arising out of the merger, and that the purchaser controlled the attorney-client privilege as to pre-merger communications with the seller, other than those relating to the merger negotiations. Responding to an argument that the transaction was really an asset acquisition, the court said in dictum: "When ownership of a corporation changes hands, whether the attorney-client relationship transfers . . . to the new owners turns on the practical consequences rather than the formalities of the particular transaction."<sup>42</sup>

*Postorivo v. AG Paintball Holdings, Inc.*,<sup>43</sup> arose in the context of a contract indemnity action brought by the buyer under an asset purchase agreement against the seller over seller's representations, warranties and covenants. The Delaware Chancery Court (applying New York law and relying on *Tekni-Plex, Inc. v. Meyner & Landis, supra*) held that, under the asset purchase agreement, the seller retained the attorney-client privilege with respect to communications regarding the excluded assets and liabilities. The court confirmed the agreement of the parties that buyer holds the attorney-client privilege with respect to communications regarding the operation of the business before and after the asset purchase agreement, and seller holds the privilege as to communications regarding the negotiation of the asset purchase agreement. In so holding, the court cited with approval the *Tekni-Plex* approach that practical consequences trump the form of the transaction, and rejected buyer's argument that the attorney-client privilege is "an incident of control and cannot be split among several different entities, even if a written contract among the parties provides to the contrary".

Considering but declining to follow the *Tekni-Plex* and *Postorivo* cases discussed above, the Delaware Court of Chancery in *Great Hill Equity Partners IV, LP v. SIG Growth Equity*

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<sup>40</sup> *Id.*; *Louisiana Municipal Police Employees' Retirement System v. Sealed Air Corp.*, *Fed. Sec. L. Rep. (CCH)* ¶94,807 (D.N.J. August 11, 2008) (*In rejecting plaintiff's assertion of both attorney work product and attorney-client privilege waivers because buyer and seller were on opposite sides of a negotiated transaction, the Court wrote, "The weight of case law suggests that, as a general matter, privileged information exchanged during a merger between two unaffiliated business would fall within the common-interest doctrine," quoting from Cavallaro v. U.S.*, 153 F. Supp. 2d 52, 61 (D. Mass. 2001), *aff'd on other grounds* 284 F.3d 236 (1st Cir. 2002), and citing *Rayman v. Am. Charter Fed. Sav. & Loan Ass'n*, 148 F.R.D. 647, 655 (D. Neb. 1993)); *Coffin v. Bowater Incorporated*, Civ. No. 03-227-P-C, 2005 U.S. Dist. LEXIS 9395 (D. Me. May 13, 2005); *Soverain Software LLC v. Gap, Inc.*, 340 F. Supp. 2d 760, 762 (E.D. Tex. 2004); *Cheeves v. Southern Clays*, 128 F.R.D. 128, 130 (M.D. Ga. 1989); *In re Cap Rock Elec. Coop., Inc.*, 35 S.W.3d 222, 224 (Tex. App.—Texarkana 2000, *no pet.*); see *Simon M. Lorne, Losing the Privilege When the Subsidiary is Sold*, *Bus. Law Today* (Jan. 2014); Subcommittee on Recent Judicial Developments, ABA Negotiated Acquisitions Committee, *Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions*, 61 BUS. LAW. 1007-1009 (2006).

<sup>41</sup> 89 N.Y.2d 123, 674 N.E. 2d 663 (1996).

<sup>42</sup> 89 N.Y.2d at 133.

<sup>43</sup> C.A. No. 2991-VCP, 3111-VCP, 2008 WL 343856 (*Del. Ch.* 2008).

*Fund I, LLLP*,<sup>44</sup> held that under DGCL § 259, all privileges—including the attorney-client privilege—pass from the acquired corporation to the surviving corporation in a merger, absent a provision in the merger agreement to the contrary. The case arose when the acquirer sued the seller over a year after consummation of the merger alleging it had been fraudulently induced to enter into the merger and notified the seller that among the computer files it received in the merger were pre-merger communications between the acquired company and its deal counsel. Even though the seller had not taken the steps of protecting the privileged communications by a merger agreement provision or the physical removal of the communications from the computer files received by the buyer, the sellers asserted continuing privileged control of the attorney client communications.

The opinion by Chancellor Leo Strine (now Chief Justice of the Delaware Supreme Court) in *Great Hill* literally applied DGCL § 259, which provides that in a merger “all . . . privileges” become the property of the surviving corporation in explaining his holding that the target’s attorney-client privilege vested in the surviving corporation in the merger. The Chancellor wrote that “*all* means *all*.” The court emphasized, however, that parties can modify the statutory default rule by including in the merger agreement a provision specifying who retains control over privileges, including privileged communications relating to the negotiation of the merger. *Great Hill* also highlights the need to take practical steps to ensure that the parties’ agreements over who maintains control over privilege are given effect, such as by taking steps to remove communications as to which the seller wants to continue to control privilege from the computer systems transferred to the buyer.

Because the court decided that the privilege belonged to the surviving corporation, the court did not decide whether the sellers had waived any privilege by allowing the buyer to have access to the communications. The court, however, commented that the sellers’ “lengthy failure to take any reasonable steps to ensure the [b]uyer did not have access to the allegedly privileged communications” presented a “substantial issue.” *Id.* at 162.

**Privilege Related Provisions Related to Legal Counsel.** To address questions regarding who will control the attorney-client privilege after a merger in view of the *Great Hill* case and also the ability of counsel to the seller continue to represent seller after the acquisition, an acquisition agreement could contain a provision such as the following:

**Section 12. Representation** It is acknowledged by each of the parties hereto that the Company (until the Closing) and Seller (until and after the Closing) have retained \_\_\_\_\_ LLP (the “**Law Firm**”) to act as their counsel in connection with the transactions contemplated hereby and that the Law Firm has not acted as counsel for any other Person in connection with the transactions contemplated hereby and that no other party to this Agreement or Person has the status of a client of the Law Firm for conflict of interest or any other purposes as a result thereof. Parent hereby agrees that, in the event that a dispute arises between Buyer

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<sup>44</sup> 80 A.3d 155, 155 (Del. Ch. 2013).

or any of its and Seller or any of their Affiliates, the Law Firm may represent Seller or any such Affiliate in such dispute even though the interests of Seller or such Affiliate may be directly adverse to Buyer or any of its Affiliates, and even though the Law Firm may have represented the Company in a matter substantially related to such dispute or may be handling ongoing matters for the Seller, and Buyer hereby waives, on behalf of itself and each of its Affiliates, (a) any claim that any of them have or may have that any of the Law Firm has a conflict of interest in connection with or is otherwise prohibited from engaging in such representation, (b) agree that, in the event that a dispute arises after the Closing between Buyer or any of its Affiliates (including after the Closing, the Company) on the one hand, and Seller on the other hand, the Law Firm may represent Seller in such dispute even though the interest of any such party may be directly adverse to Buyer or any of its Affiliates (including after the Closing, the Company) and even though the Law Firm may have represented Seller or the Company in a matter substantially related to such dispute or may be handling ongoing matters for the Company. Buyer further agrees that, (i) as to all communications between the Law Firm and Seller that relate in any way to the transactions contemplated by this Agreement, the attorney-client privilege, the expectation of client confidence and all other rights to any evidentiary privilege belong to the Seller and may be controlled by Seller and shall not pass to or be claimed by Buyer or the Company, and (ii) as to all communications between the Law Firm and the Company, or among the Law Firm, the Company or Seller prior to the Closing that relate in any way to the transactions contemplated by this Agreement, the attorney-client privilege, the expectation of client confidence and all other rights to evidentiary privilege belongs to Seller and may be controlled by the Seller and shall not pass to or be claimed by Buyer or the Company. The parties hereto further agree that the Law Firm and their respective partners and employees are third party beneficiaries of this Section 12.6.

An alternative provision dealing with the attorney-client privilege and the ability of Seller's counsel to represent Seller in post-closing disputes with Buyer follows:

#### **Section 12.6. Attorney-Client and Privilege Matters**

(a) Each of the parties to this Agreement, on its own behalf and on behalf of its directors, members, partners, officers, employees and Affiliates, hereby agrees that \_\_\_\_\_ LLP (the "*Law Firm*") may serve as counsel to the Stockholders and the Company in connection with the negotiation, preparation, execution and delivery of this Agreement and

the consummation of the transactions contemplated hereby (the “**Existing Representation**”).

(b) Notwithstanding the Existing Representation, each of the parties to this Agreement, on its own behalf and on behalf of its directors, members, partners, officers, employees and Affiliates (including, after the Closing, the Company) (collectively, the “**Company Parties**”), hereby:

(i) Consents to the Law Firm’s representation of the Stockholders and any director, member, partner, officer, employee or Affiliate of a Stockholder (collectively, the “**Stockholder Parties**”) in connection with any matters or disputes arising out of or relating to this Agreement and the transactions contemplated hereby;

(ii) Waives, and agrees not to assert, any claim such party may have that the Law Firm has a conflict of interest or is otherwise prohibited from representing any Stockholder Party based upon the Law Firm’s representation of the Company prior to the Closing; and

(iii) Agrees that, if a dispute arises between any Stockholder Party and a Company Party, the Law Firm may represent such Stockholder Party notwithstanding the fact that the interests of such Stockholder Party and the Company Party may be directly adverse and that the Law Firm may have represented the Company in a substantially related manner.

(c) Buyer waives and agrees not to assert, and agrees after the Closing to cause its Affiliates (including, after the Closing, the Company) (collectively, the “**Buyer Parties**”) to waive and to not assert, any attorney-client privilege, attorney work product protection or expectation of client confidence with respect to any communications prior to the Closing that relate in any way to the Existing Representation and that are (i) privileged communications between the Law Firm or another legal advisor, on the one hand, and any Stockholder Party and/or the Company, on the other hand, or (ii) communications that refer to or relate to such privileged communications (collectively, the “**Confidential Communications**”). Buyer (on its behalf and on behalf of its Affiliates) and the Company agree that:

(i) the attorney-client privilege with respect to the Confidential Communications belongs to the applicable Stockholder Party, may be controlled by such Stockholder Party, and will not pass to or be claimed by Buyer Party; and



(ii) the Confidential Communications shall not be subject to any joint privilege (whether or not the Company also received such advice or communication) and shall be owned solely by the applicable Stockholder Party.

(d) Notwithstanding anything to the contrary contained in this Section 12.6:

(i) the ownership of, and the right to assert or waive the attorney-client privilege, work product protection or any other applicable privileges or protections with respect to all other pre-Closing communications between the Company and any director, officer or employee of any of the Company and the Company's internal or external counsel (including the Law Firm), except to the extent relating to the Existing Representation, shall remain with the Company upon consummation of the transactions contemplated hereby ;

(ii) the Buyer and its Affiliates do not waive any right arising from any actions of a Stockholder Party after the Closing that results in a waiver of the attorney-client privilege; and

(iii) any attorney-client privilege, work product protection or other applicable privilege referred to in this Section XX whether or not relating to the Existing Representation, shall also belong to the Company and shall be deemed passed to and may be claimed by it after the Closing to the extent any such attorney-client privilege, work product protection or other applicable privilege is required to be waived or otherwise required to be similarly released by any Governmental Authority, under Applicable Law or pursuant to any order, and in any such case, the Company and its Affiliates shall not be in breach or violation of any provision of this Agreement for providing any information, documents, communications or client confidences to any Governmental Authority in response to and subject to the requirements of, and limitation in, the foregoing.

**Contractual Provisions to Reduce Waiver Risk.** The parties may provide contractually for the buyer to have the benefit of the privilege, the sample provisions quoted above, and by analogy, to joint defense and common interest cases, the privilege agreement should be upheld.<sup>45</sup>

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<sup>45</sup> *Id.*; see Subcommittee on Recent Judicial Developments, ABA Negotiated Acquisitions Committee, *Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions*, 60 *BUS. LAW.* 843, 861-63 (2005)

Further, by analogy to those cases and the principle that the privilege attaches to communications between an attorney and prospective client prior to engagement, parties should be able to provide that due diligence information provided is protected by the attorney-client privilege.<sup>46</sup>

Courts may also maintain the attorney-client privilege when the interests of both parties are aligned through specific contractual relationships.<sup>47</sup> Therefore, the parties may find some comfort in provisions that align their legal interests and burdens, such as provisions pursuant to which buyer assumes the litigation liability of seller, indemnification provisions or assistance provisions which may facilitate a court's application of the common interest doctrine. If appropriate, the parties also should consider signing a "common interest agreement" or a "joint defense plan" that evidences their common legal interests and stipulates a common plan for litigation.

### III. ADVOCACY VERSUS CANDOR IN THE M&A CONTEXT

In negotiating an M&A transaction, an attorney has to balance the conflicting principles of getting the most advantageous result for the client against the obligation to deal honestly with the opposition. The first place to start is Rule 4.01 of the Texas Rules, which reads as follows:

#### **Rule 4.01 Truthfulness in Statements to Others**

In the course of representing a client a lawyer shall not knowingly:

- (a) Make a false statement of material fact or law to a third person; or
- (b) Fail to disclose a material fact to a third person when disclosure is necessary to avoid making the lawyer a party to a criminal act or knowingly assisting a fraudulent act perpetrated by a client.

On its face, this rule seems very simple: "Thou shalt not lie." However, in practice this can get complicated. The terminology and the commentary in the Texas Rules can help add clarity to what is and is not permissible in the negotiation process.

The Texas Rules provide that "'Knowingly,' 'Known,' or 'Knows' denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances." This does not appear to be a "should have known" standard. For example, in *Brown v. County of Genesee*,<sup>48</sup> the court failed to find a mutual mistake of fact in a situation where counsel did not

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(discussing *Venture Law Group v. Superior Court*, 12 Cal. Rptr. 3d 656 (Cal. Ct. App. 2004) which held that the surviving corporation in a merger is the holder of the attorney-client privileges of both constituent corporations post merger and an attorney for the non-surviving corporation has a duty to exercise the privilege unless instructed not to do so by the surviving corporation).

<sup>46</sup> *Cap Rock*, 35 S.W.3d at 222; cf. *Cheeves v. Southern Clays*, 128 F.R.D. 128, 130 (M.D. Ga. 1989) ("Courts have found a community of interest where one party owes a duty to defend another, or where both consult the same attorney.").

<sup>47</sup> See *In re Regents of Univ. of Cal.*, 101 F.3d 1386, 1390 (Fed. Cir. 1996), cert. denied, 520 U.S. 1193 (1997) (holding that parties to an exclusive license agreement have a substantially identical legal interest).

<sup>48</sup> 872 F.2d 169 (6<sup>th</sup> Cir. 1989)

know, but believed it probable, that plaintiff and her lawyer were mistaken concerning the computation of damages in an employment discrimination case. There is an argument to be made that the definition of knowledge encourages an attorney to put his or her head in the sand. However, a diligent attorney will still want to prevent the client from committing fraud or creating more problems after the transaction closes, so it generally would be best to ask the hard questions, even if the answer isn't the desired one.

One other important standard in Rule 4.01 is the concept that the facts involved must be "material." The commentary to the Texas Rules helps shed light on what would be considered "material" in a particular context. The commentary admits that whether a particular statement would be material "can depend on the circumstances." The commentary to the comparable ABA Model Rule adds further clarity—a statement is material under the Model Rules if it could have influenced the recipient.<sup>49</sup> If a client ever says something to the effect that "I can't disclose that to the buyer—they will never do the deal.", then you probably have a material fact involved.

The commentary to the Texas Rules further describes types of statements that are not taken as statements of material fact because they are viewed as matter of opinion or conjecture. Estimates of price or value placed on the subject of a transaction fall into this category. Furthermore, the commentary acknowledges that statements regarding a client's supposed intentions as to an acceptable resolution of an issue may be viewed as negotiation positions rather than recitations of fact. The commentary also makes it clear that, while an attorney has to be truthful, there is no duty to inform a third person of relevant or material facts.

Finally, the commentary makes it clear that the fact that a particular transaction is being undertaken on behalf of an unknown principal doesn't need to be disclosed unless the non-disclosure constitutes fraud. The commentary states that these situations fall under "generally accepted" conventions or are considered as "ordinarily" acceptable behavior. The possibility remains, given this language, that counsel could take a situation too far and fail to adhere to the generally accepted ordinary standards.

The Texas Rules and the commentary acknowledge that some degree of "puffing" is permissible in the negotiation process. As a general rule, puffery, or making a hyperbolic statement(s) during the course of negotiation, is acceptable. What constitutes puffery versus what constitutes an actionable claim under the Texas Rules depends on the context in which the statement is made, how the statement is made, and whether the statement is objectively untrue. Set forth below are some relevant examples of situations that an attorney might encounter in an M&A context.

**EXAMPLE 1:** Your seller client has posted all of their material contracts in an electronic data room. The buyer has placed a high value on the contracts. One of the contracts may be terminated by either party with 30 days' prior notice. Your client is worried that they buyer will read that contract and either seek a purchase price reduction or terminate the deal. The buyer has been given full access to the data room and has completed due diligence, but says nothing about the 30 day provision. Do you have a duty to tell the other side about the provision?

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<sup>49</sup> See *In re Merkel*, 138 P.3d 847 (Or. 2006) (information is material if it "would or could have influenced the decision-making process significantly.")

Answer: An attorney has no duty to tell the other side about relevant facts. If asked, the attorney cannot lie, but there is no duty to make the other side aware of contractual provisions, assuming the contract has been made available to the buyer. Since the client is not committing any form of fraud here (the provision has been made available for all to see), this is not a failure to disclose a material fact.

EXAMPLE 2: Seller client tells her attorney that she will not accept less than \$100 million for her business. The attorney then tells opposing counsel that the client “Will not accept less than \$125 million. Is this actionable?”

Answer: This should generally be considered puffery, with the attorney trying to get the best deal for the client.

EXAMPLE 3: Seller client has marketed her business for months, with the help of her attorney, and only received one offer from a potential purchaser. In the course of negotiations, the attorney tells opposing counsel: “Your client needs to act quickly in agreeing to a contract. We have multiple offers on the table for this business.” Is this actionable?

Answer: Yes, because the statement is false.

EXAMPLE 4: Same facts, but there was one other person who expressed interest in the business. The attorney tells opposing counsel: “Other people have shown interest in the business, so your client needs to act quickly in agreeing to a contract.” Is this actionable?

Answer: This statement is probably permissible as puffery. It may be an exaggeration of the interest, but there is some basis in truth to the statement.

## Attachment 1 -- -- Language Regarding Joint Representation

***Note: This is meant for sample purposes only. Counsel should consider whether the actual fact situation at hand requires some or all of this language.***

We acknowledge that different members of the Client Group may communicate with and direct the Firm in its representation of the Client Group during the course of the Matter. In order to avoid not only actual conflicts of interest, but also the appearance of impropriety, the members of the Client Group (each acting individually), has instructed the Firm as follows:

1. *No Member of the Client Group to be Favored* – Should an opportunity arise in connection with the Matter to favor one or more members of the Client Group over others, the Firm should not do so without disclosure to the other members of the Client Group, and the Firm may inform all members of the Client Group if there is ever any question in this regard;
2. *Conflicting or Detrimental Instructions* – If any member of the Client Group instructs us to take action on behalf of the Client Group that other members of the Client Group instruct us not to take, or which we would regard as potentially or actually detrimental to some members of the Client Group, we will not act unless and until the members of the Client Group resolve the issue between themselves, and should they fail or refuse to resolve the issue to our satisfaction within a period of time that is reasonable in our judgment, the Firm will resign from the representation;
3. *No Secrets* – We may, in our discretion, or we may be required to, share with members of the Client Group the substance of any communications we have with other members of the Client Group; and
4. *Disputes* – Should a dispute arise between members of the Client Group related to the Matter, whether before or after conclusion of the Matter, the Firm would be prohibited from representing any member of the Client Group in connection with such dispute.

In addition to the foregoing, the attorney/client privilege may not bar disclosure to members of the Client Group the substance of communications with other members of the Client Group, even if unrelated to the Matter. Indeed, if the information is significant, we may have a duty to disclose information from or about some members of the Client Group with all other members of the Client Group.

By their signature below, and consistent with Sections 1.06 and 1.07 of the Texas Disciplinary Rules of Professional Conduct, each member of the Client Group affirms and agrees that the Firm has consulted with them or offered the opportunity to consult (at no charge) concerning the implications of the Firm's representation of the members of the Client Group in the Matter, including the advantages and risks involved, and the effect on the attorney-client privilege, and they each agree and consent to the representation. Further, all members of the Client Group agree that if the Firm is required to withdraw as counsel in the representation of the Client Group, no such member of the Client Group will contest the withdrawal.