



## *Postorivo v. AG Paintball Holdings, Inc.*, C.A. Nos. 2991-VCP, 3111-VCP (Del. Ch. Feb. 7, 2008) (V.C. Parsons)

In the course of resolving a discovery dispute, the Court of Chancery addressed which entity properly holds the attorney-client privilege in connection with certain categories of communications in view of the sale to defendants of substantially all of the assets of National Paintball Supply Inc. ("NPS"). Plaintiff Eugenio Postorivo ("Postorivo"), was the founder and sole owner of National Paintball Supply Inc. ("NPS"). NPS had sold substantially all its assets to defendants pursuant to the terms of an asset purchase agreement ("APA"). Defendants formed Kee Action Sports Holdings, Inc. ("KEE Action"), which utilized the assets to continue to operate the NPS's former business. Pursuant to the terms of the APA, Postorivo and NPS retained certain assets and liabilities, including rights arising out of certain litigation (the "Procaps Litigation"). The Court addressed which entity held the attorney-client privilege in connection with the following categories of communications: "(1) communications, pre- and post-APA, that impact the ongoing business of the post-acquisition entity; (2) communications regarding the APA; and (3) communications concerning excluded assets and liabilities, e.g., the Procaps Litigation." The parties agreed, and the Court confirmed, that KEE Action held the attorney-client privilege for communications impacting the ongoing business of the post-acquisition entity, including pre-APA communications, because "KEE Action stands in the shoes of the former NPS management and holds the attorney-client privilege that NPS formerly held." The parties also agreed (and the Court confirmed) that Postorivo and NPS retained the attorney-client privilege for communications that Postorivo and NPS had with in-house and outside counsel regarding the negotiation of the APA because the rights of NPS arising from the APA "were independent from, and adverse to," the rights of KEE Action. The parties disputed, however, which entity held the attorney-client privilege in connection with communications concerning the assets and liabilities excluded by the terms of the APA. Postorivo and NPS argued that the privilege belonged to them pursuant to the explicit terms of the APA. The defendants argued that "[a] corporation's attorney-client privilege cannot be split among several different entities, even if there is a written contract" purporting to do so. The Court, considering the "practical consequences rather than the formalities" of the asset sale, determined that NPS and Postorivo would continue to hold the privilege in connection with the excluded assets and liabilities. The Court noted that NPS would have to prosecute the Procaps Litigation and should be able to assert or waive the attorney-client privilege in connection with such prosecution. Moreover, the Court noted that it "generally eschews mandating actions contrary to the intent explicitly reflected in freely negotiated contracts among sophisticated, well-represented parties."

The full opinion is available [here](http://www.potteranderson.com).



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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

EUGENIO POSTORIVO, )  
for himself and derivatively on behalf of )  
KEE ACTION HOLDINGS, INC., )  
a Delaware corporation, et al. )  
)  
Plaintiffs, )  
)  
v. ) Consolidated  
) Civil Action No. 2991-VCP  
AG PAINTBALL HOLDINGS, INC., )  
a Delaware corporation, et al., )  
)  
Defendants. )  
\_\_\_\_\_)  
)  
KEE ACTION SPORTS HOLDINGS, )  
INC., et al., )  
)  
Plaintiffs, ) Civil Action No. 3111-VCP  
)  
v. ) Transferred Pursuant  
) to 10 *Del. C.* § 1902  
EUGENIO POSTORIVO, et al., )  
)  
Defendants. )

**MEMORANDUM OPINION**

Submitted: January 31, 2008

Decided: February 7, 2008

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**PARSONS, Vice Chancellor.**

This action concerns disputes arising out of an asset purchase agreement. Plaintiffs sold substantially all of their assets in a predecessor company to Defendants in an asset purchase agreement (the “APA” or “Agreement”). Plaintiffs also retained certain excluded assets and liabilities. Defendants employed the assets to continue to operate the same business in a successor company. Soon after the execution of the APA, significant disputes arose regarding, among other things, Plaintiffs’ representations, warranties, and covenants under the APA. When efforts to resolve the disputes failed, Defendants filed a contract indemnity action against Plaintiffs in the Superior Court. Subsequently, Plaintiffs commenced this action in the Court of Chancery asserting direct and derivative claims for fraud, waste, breach of fiduciary duty, conversion, breach of contract, and declaratory and injunctive relief. On June 30, 2007, I granted the parties’ proposed stipulation and order consolidating the Indemnity Action with this action.

The consolidated action is presently before me on a discovery dispute over competing attorney-client privilege claims. Initially, the parties sought a determination of which entity holds the attorney-client privilege as to documents or communications regarding the operation of Plaintiffs’ business before the APA, the operation of the business after the APA, communications regarding the APA, and the excluded assets and liabilities. During the pendency of this and other pretrial motions, the parties reached agreement on each of these categories of privilege claims except the last one – the excluded assets and liabilities.

For the reasons stated in this memorandum opinion, I conclude that Plaintiffs hold the attorney-client privilege with respect to communications regarding the excluded

assets and liabilities.<sup>1</sup> I also confirm the parties' agreement, consistent with the pertinent case law, that Defendants hold the attorney-client privilege with respect to communications regarding the operation of the business before and after the APA, and Plaintiffs hold the privilege as to communications regarding the negotiation of the APA.

## **I. BACKGROUND AND PROCEDURAL HISTORY<sup>2</sup>**

### **A. Pre-APA**

National Paintball Supply, Inc. ("NPS") is a corporation founded and wholly-owned by Eugenio Postorivo. NPS was in the business of selling equipment and supplies, including guns, paintballs, protective goggles, clothing, and other gear related to the paintball gaming industry.

Beginning in early 2000, years before the APA, attorney John Campo served as general counsel for NPS, and represented Postorivo personally as the majority shareholder of NPS. While serving as in-house counsel for NPS, Campo maintained an office in the NPS headquarters, and was privy to, and advised Postorivo regarding, all aspects of the Company's operations. In 2006, NPS experienced a market downturn and

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<sup>1</sup> Under the terms of the APA, Defendants appear to have significant rights of access to documents in Plaintiffs' possession, custody, or control regarding the Procaps Litigation, which constitutes a major part of the excluded assets and liabilities. Defendants' rights would appear to encompass access to Plaintiffs' attorney-client privileged material regarding those assets and liabilities. For purposes of the current dispute, however, I need not attempt to delineate the extent of those rights.

<sup>2</sup> I generally summarize some of the background facts here, but attempt to focus on the facts necessary to resolve this discovery dispute.

entered into discussions regarding an asset sale. During those negotiations, Campo and Blank Rome LLP represented NPS and Postorivo, as the sole shareholder of NPS.

## **B. Execution of the APA and Related Transactions**

In the APA, initially signed September 29, 2006, amended, and subsequently closed on or about November 17, 2006, Postorivo sold substantially all of the assets of NPS to AJ Intermediate Holdings, Inc. (“AJI”). AJI formed a new company, KEE Action Sports Holdings, Inc. (KEE Action),<sup>3</sup> to receive these assets and combine them with assets from another company, Pursuit Marketing, Inc. (“PMI”). PMI was a competitor of NPS. Pursuant to the APA, Postorivo and PBS Holding Group, Inc. (“PBS”) (formerly known as NPS) retained defined excluded assets (*e.g.*, the Procaps Litigation) and excluded liabilities, and associated rights and privileges derivative from such excluded assets and liabilities.

Section 1.1 of the APA defines the acquired assets as follows:

[E]xcept for Permitted Liens (as such term is defined herein), all right, title and interest in all properties, assets, privileges, rights, interests and claims, real and personal, tangible and intangible, of every type and description, wherever located, including the Business as a going concern and goodwill, which right, title and interest are owned, used or held for use by each Seller in connection with the Business (except for those assets that are expressly excluded pursuant to Section 1.2 hereof) (collectively, the “Acquired Assets”).<sup>4</sup>

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<sup>3</sup> For simplicity, when referring to KEE Action Sports Holdings, Inc., KEE Action LLC, or AJI Intermediate Holdings, Inc., separately or collectively, I will use KEE Action.

<sup>4</sup> Aff. of James G. McMillan, Exs. 1-2, (the APA) § 1.1. “Business” is defined in the Recitals as follows: “The Sellers own and operate a business in the paintball

The Acquired Assets constitute substantially all of the assets of NPS, including real property, inventory, machinery, equipment, contracts, intellectual property, files and records, security deposits, claims, goodwill, cash, and investments.

APA § 1.2 provides that certain assets shall be excluded from the Acquired Assets and retained by the Sellers, the “Excluded Assets.” For purposes of this opinion, an important Excluded Asset is the Procaps Litigation. Pursuant to Section 1.2(e), and subject to an option described in Section 1.6, “any proceeds of or other rights in respect to the Procaps Litigation” are excluded assets.<sup>5</sup> Under the Agreement, Excluded Assets also include the following retained rights: “[a]ny property, right, or asset arising from and directly related to the defense, release, compromise, discharge or satisfaction of any of the Excluded Liabilities (as such term is defined herein).”<sup>6</sup>

Pursuant to Section 1.6, the “Option in Respect of Procaps Litigation,” NPS granted KEE Action the option to purchase “all of NPS’s rights in and to the Procaps

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industry, including the manufacture and distribution of paintball game equipment, supplies, and accessories and the publication of industry magazines.” APA Recitals, §1.

<sup>5</sup> APA § 1.2(e). Section 1.3(b)(viii) defines “Procaps Litigation” as “any liability relating to: (A) National Paintball Supply, Inc. v. Paintball, L.P., AAA No. 50 181 T 000252 05; and (B) National Paintball Supply, Inc. v. Imperial Capital Corporation (U.S.D.C. District of New Jersey) Civil Action No. 1:06-cv-1544 (JBS).” Under Section 1.2(h), Excluded Assets also include “[a]ll rights of the Sellers under this Agreement and all agreements and other documentation relating to the transactions contemplated hereby . . . .”

<sup>6</sup> APA § 1.2(d). Sellers retained both excluded assets and excluded liabilities.

Settlement for a purchase price equal to the Procaps FMV.”<sup>7</sup> Section 1.6(b) defines the “Procaps FMV” as “the fair market value of the Procaps Settlement, as determined by the board of directors of [KEE Action], using generally accepted valuation methodologies.” If Postorivo disputes the KEE Action board of directors’ valuation, the APA requires Postorivo to provide written notice to and work together with KEE Action in good faith to agree upon an independent third party appraiser to determine the Procaps FMV.<sup>8</sup> In the calculation of the Procaps FMV, NPS and Postorivo shall:

[C]ooperate with and provide any information requested by [KEE Action] or the Independent Appraiser in connection with the assessment of the Procaps FMV. Further, the Sellers (including NPS) and [Postorivo] shall take any such actions as are requested by [KEE Action] or the Independent Appraiser to seek to relieve any confidentiality orders applicable to the requested information or to otherwise facilitate the acquisition of the requested information.<sup>9</sup>

Under § 1.6(e), the APA further provides that:

NPS shall promptly forward to [KEE Action] all filings served or made by any party to the Procaps Litigation and all other information relating to the Procaps Litigation that is reasonably requested by [KEE Action], subject to such restrictions as may be reasonably requested by NPS upon advice of its outside counsel that such restrictions are required in order to preserve attorney-client privilege.

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<sup>7</sup> *Id.* § 1.6(a).

<sup>8</sup> The APA anticipates the possibility of additional disagreement and provides for contingencies, but the details of the process are not germane to the pending motion.

<sup>9</sup> APA § 1.6(b).

Additionally, § 12.8 of the APA provides that the Agreement is governed by New York law.

### **C. Procedural History**

Plaintiff Postorivo filed this action on May 29, 2007, directly and derivatively on behalf of KEE Action, PBS (formerly known as NPS), and other entities affiliated with Postorivo (the “Chancery Action”) seeking declaratory and equitable relief and damages. The named defendants are Brent Leffel and Raymond Dombrowski, along with the following entities, KEE Action Inc., AG Paintball Holdings, Inc., KEE Action Sports, LLC (collectively the “Defendants”), and other affiliated entities arising out of Defendants’ conduct towards Postorivo in conjunction with his sale of substantially all of the assets of NPS to Defendants pursuant to the APA and related transactions.

On June 27, 2007, Plaintiffs moved to preclude Defendants’ alleged violation of the attorney-client privilege and improper contact with employees. Plaintiffs’ motion sought: (1) a declaration Postorivo retained certain attorney-client privileges, notwithstanding the sale of assets in the APA; (2) a determination as to the appropriate parameters for contacts with former NPS and current KEE Action employees in discovery in this action, in light of concerns about attorney-client privilege; and (3) a determination, after discovery, of the appropriate remedy if Defendants or their counsel irreparably violated attorney-client privilege. After extensive briefing the Court heard argument on Plaintiffs’ motion on August 8, 2007. At that time, the Court provided guidance to the parties regarding various issues related to the second and third aspects of the motion. That guidance included directions for the conduct of certain discovery

related to those matters. This opinion addresses an unresolved privilege issue raised by the first aspect of Plaintiffs' motion.

## II. ANALYSIS

The open question involves who holds the attorney-client privilege regarding various categories of communications in the wake of an asset sale. KEE Action has a colorable claim of attorney-client privilege to the following three types of communications: (1) communications, pre- and post-APA, that impact the ongoing business of the post-acquisition entity; (2) communications regarding the APA; and (3) communications concerning excluded assets and liabilities, *e.g.*, the Procaps Litigation. While the parties previously advanced divergent positions, they now agree KEE Action holds the attorney-client privilege for communications that impact the ongoing business of the post-acquisition entity, including pre-APA communications, and Postorivo and NPS hold the attorney-client privilege for their communications regarding the APA. The parties still dispute, however, who holds the privilege for communications concerning the excluded assets and liabilities.

As a preliminary matter, the Court must determine which state's substantive law governs the dispute. Delaware applies the most significant relationship test from the Restatement (Second) of Conflicts of Laws.<sup>10</sup> Delaware courts also generally honor

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<sup>10</sup> See *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 47 (Del. 1991). "As the forum state, Delaware must apply its own choice of law rule." *Nat'l Acceptance Co. of Cal. v. Mark S. Hurm, M.D., P.A.*, 1989 WL 70953, at \*2 (Del. Super. June 16, 1989). Under the most significant relationship test, courts consider seven broad policy considerations: (1) the needs of the interstate and international systems; (2) the relevant policies of the forum; (3) the relevant policies of other interested

contractually-designated choice of law provisions so long as the jurisdiction selected bears some material relationship to the transaction.<sup>11</sup> Here, the APA, in § 12.8, designates New York law. Consistent with the Restatement and well-settled Delaware precedent, because the APA designates New York law and neither party challenges the applicability of that designation, I analyze the issues presented under New York law.

**A. Communications Impacting the Ongoing Business of the Post-Acquisition Entity and Communications Regarding the APA**

While the parties previously disputed these issues, both sides now agree that KEE Action holds the attorney-client privilege for communications impacting the ongoing business of the post-acquisition entity, including pre-APA documents and communications.<sup>12</sup> The parties also agree that Postorivo and NPS hold the attorney-client privilege for communications they had with counsel (including in-house counsel Campo and outside counsel Blank Rome) regarding the negotiation of the APA, related contracts, and the acquisition transaction in general.<sup>13</sup>

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states and the relevant interests of those states in the determination of the particular issue; (4) the protection of justified expectations; (5) the basic policies underlying the particular field of law; (6) certainty, predictability, and uniformity of result; and (7) ease in the determination and application of the law to be applied. RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 145(1) (1997).

<sup>11</sup> See *J.S. Alberici Const. Co. v. Mid-West Conveyor Co.*, 750 A.2d 518, 520 (Del. 2000) (citing *Annan v. Wilm. Trust Co.*, 559 A.2d 1289, 1293 (Del. 1989)).

<sup>12</sup> Pls.’ Op. Br. (“POB”) at 11 (noting that Postorivo does not assert privilege with regard to such communications); Defs.’ Ans. Br. (“DAB”) at 13-14.

<sup>13</sup> POB at 14-20; DAB at 14. Defendants do argue, however, that to the extent any such privileged communications and documents continue to reside on KEE Action computers and servers, Plaintiffs have waived the privilege. As I stated at argument, there has been no waiver of privilege here. Specifically, the

The *Tekni-Plex, Inc. v. Meyner & Landis* case from New York supports both conclusions.<sup>14</sup> Because the reasoning of that case bears importantly on my decision regarding the disputed issues currently before me, the *Tekni-Plex* opinion warrants discussion even as to the issues on which the parties agree. In *Tekni-Plex*, a successor company (“new Tekni-Plex”) acquired a predecessor company (“old Tekni-Plex”). By way of background, old Tekni-Plex was a corporation wholly-owned by Tom Tang, its sole shareholder, president, chief executive officer, and sole director. In March 1994, Tang and Tekni-Plex entered an agreement of merger with TP Acquisition Company (“TP Acquisition”) through which TP Acquisition purchased all of old Tekni-Plex’s tangible and intangible assets, rights, and liabilities (the “Merger Agreement”) and, contemporaneously therewith, old Tekni-Plex ceased doing business in any form.<sup>15</sup> In addition, TP Acquisition purchased and then cancelled all of Tang’s shares in Tekni-Plex, the only outstanding shares of the corporation.

Following the merger, TP Acquisition changed its name to Tekni-Plex, Inc. (“new Tekni-Plex”). In June 1994, new Tekni-Plex began arbitration proceedings against Tang arising out of certain representations and warranties contained in the Merger Agreement. Tang retained the law firm of Meyner and Landis (“M&L”), the same law firm that had

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circumstances do not support a reasonable inference that Plaintiffs deliberately and voluntarily relinquish the right to assert their claims of privilege by virtue of the way Campo and others conducted their affairs after the APA closed. *See* D.R.E. 510.

<sup>14</sup> 674 N.E.2d 663 (N.Y. 1996).

<sup>15</sup> *Id.* at 665.

represented old Tekni-Plex in several pre-merger matters as well as the negotiations leading up to the Merger Agreement. M&L also had represented Tang individually on several personal matters. During the arbitration, new Tekni-Plex moved to disqualify M&L from representing Tang on the basis that, through the merger, new Tekni-Plex had acquired control of the attorney-client privilege of old Tekni-Plex. By a separate motion new Tekni-Plex also sought an injunction prohibiting M&L from representing the prior owner in any action against new Tekni-Plex and from disclosing to Tang any information obtained from old Tekni-Plex, and an order directing M&L to return to new Tekni-Plex all files in M&L's possession concerning its prior legal representation of old Tekni-Plex.<sup>16</sup>

The New York Court of Appeals dealt with several issues related to new Tekni-Plex's claim of control over the attorney-client privilege, first determining whether the privilege passed from old Tekni-Plex to new Tekni-Plex. The Court of Appeals concluded that when a corporation changes ownership, "whether the attorney-client relationship transfers as well to the new owners turns on the practical consequences rather than the formalities of the particular transaction."<sup>17</sup> When the successor merely purchases assets and does not attempt to continue the pre-existing operation, generally the attorney-client privilege does not transfer. By contrast, when the successor continues the operations of the predecessor company, the successor company stands in the shoes of

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<sup>16</sup> *Id.* at 666.

<sup>17</sup> *Id.* at 668.

prior management and holds the privilege with respect to communications regarding the company's operations.<sup>18</sup>

The court found that following the merger, new Tekni-Plex continued the business of old Tekni-Plex, with the same products, clients, suppliers, and nonmanagement personnel. Further, under the Merger Agreement, new Tekni-Plex possessed all of the rights, privileges, liabilities, and obligations of old Tekni-Plex. Therefore, the Court of Appeals held that, as a practical matter “old Tekni-Plex did not die. To the contrary, the business operations of old Tekni-Plex continued under the new managers. Consequently, control of the attorney-client privilege with respect to any confidential communications between M&L and corporate actors of old Tekni-Plex concerning these operations passed to the management of new Tekni-Plex.”<sup>19</sup>

Next, the Court of Appeals determined whether new Tekni-Plex or old Tekni-Plex held the attorney-client privilege for pre-Merger Agreement representation. The court concluded that when management of new Tekni-Plex continued the business operations of the pre-merger entity, control of the attorney-client privilege arising out of those operations, including pre-merger communications between old Tekni-Plex and M&L, passed to new Tekni-Plex.<sup>20</sup> The court explained that its “conclusion comports with new Tekni-Plex's right to invoke the pre-merger attorney-client relationship should it have to

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<sup>18</sup> *Id.*

<sup>19</sup> *Tekni-Plex*, 674 N.E.2d at 669.

<sup>20</sup> *Id.* at 670 (citing *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 349 (1985)).

prosecute or defend against third-party suits involving the assets, rights or liabilities that it assumed from old Tekni-Plex.”<sup>21</sup>

Similarly, here KEE Action acquired substantially all of the assets of NPS. Further, KEE Action now controls and operates the business NPS formerly operated. Therefore, as a practical matter, the business operations of NPS continue under the management of KEE Action. Consequently, *Tekni-Plex* supports the parties’ joint position that KEE Action stands in the shoes of the former NPS management and holds the attorney-client privilege that NPS formerly held, including pre-APA representation.

The court in *Tekni-Plex* also addressed the new company’s claim that it controlled the privilege as it related to old Tekni-Plex’s and Tang’s communications with M&L regarding the merger transaction. The court held that new Tekni-Plex “[did] not control the attorney-client privilege with regard to discrete communications made by either old Tekni-Plex or Tang individually to M&L concerning the acquisition - a time when old Tekni-Plex and Tang were joined in an adversarial relationship to [new Tekni-Plex].”<sup>22</sup> Further, the court held that new Tekni-Plex was not entitled to the law firm’s confidential communications concerning its representation of old Tekni-Plex with regard to the acquisition.<sup>23</sup> The rights of old Tekni-Plex as to disputes arising from the merger transaction were independent from, and adverse to, the rights of new Tekni-Plex. The

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<sup>21</sup> *Id.* at 670.

<sup>22</sup> *Id.* at 666.

<sup>23</sup> *Id.*

New York Court of Appeals reasoned that new Tekni-Plex’s claims did not derive from any rights that it may have inherited from old Tekni-Plex; rather, they emanated exclusively from the Merger Agreement. Therefore, the court determined that no privilege pertaining to such claims had been conveyed to new Tekni-Plex, stating: “During this dispute stemming from the merger transaction, then, new Tekni-Plex cannot both pursue the rights of the buyer (Acquisition) and simultaneously assume the attorney-client rights that the buyer’s adversary (old Tekni-Plex) retained regarding the transaction.”<sup>24</sup>

Similarly, Postorivo and NPS were in an adversarial relationship to KEE Action when the parties negotiated the APA. Consequently, the rights of Postorivo and NPS with regard to disputes arising from the APA are independent from, and adverse to, the rights of KEE Action. Moreover, no provision of the APA provides that Postorivo and NPS sold or transferred their respective privileges and rights concerning communications with counsel related to the APA or the negotiations associated with the Agreement.<sup>25</sup> Therefore, *Tekni-Plex* supports the parties’ joint position that Postorivo and NPS hold the attorney-client privilege for their communications with counsel relating to the APA.

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<sup>24</sup> *Id.* at 671.

<sup>25</sup> Indeed, the language of the APA is to the contrary. Section 1.2(h) provides that the “Excluded Assets” from the sale include “[a]ll rights of the Sellers under this Agreement and all agreements and other documentation relating to the transactions contemplated hereby . . . .”

## B. Excluded Assets and Liabilities

The parties also agree that, pursuant to §§ 1.2(e) and 1.6 of the APA, NPS retained and did not transfer to KEE Action the right to pursue a cause of action defined as the “Procaps Litigation.”<sup>26</sup> Plaintiffs assert that because NPS retained, and did not sell, the excluded assets, it holds the attorney-client privilege relating to legal advice sought or obtained by NPS related to the excluded assets or liabilities, including the Procaps Litigation. Defendants respond that in an asset transfer or sale, the selling company’s attorney-client privilege passes as a whole to the entity that acquired substantially all of the assets and the control of the ongoing business operations.<sup>27</sup> Furthermore, relying on a case from a federal district court in Illinois, *American International Specialty Lines Insurance Co. v. NWI-I, Inc.*,<sup>28</sup> Defendants contend that 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.

To evaluate NPS’s claim of attorney-client privilege over communications pertaining to the Procaps Litigation, I begin with the APA. Under New York law, “a written contract is to be interpreted so as to give effect to the intention of the parties as expressed in the unequivocal language that they have employed.”<sup>29</sup>

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<sup>26</sup> POB at 20; DAB at 16.

<sup>27</sup> DAB at 16.

<sup>28</sup> 240 F.R.D. 401 (N.D. Ill. 2007).

<sup>29</sup> *Cruden v. Bank of New York*, 957 F.2d 961, 976 (2d Cir. 1992). This principle is consistent with Delaware law. See *Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1195-96 (Del. 1992).

Under the terms of the APA, KEE Action explicitly recognized that Postorivo and NPS retained the attorney-client privilege regarding the excluded assets (such as the Procaps Litigation) and the excluded liabilities.<sup>30</sup> Section 1.1 specifically excepts from the definition of the Acquired Assets those assets excluded in Section 1.2. Section 1.2 provides that the Procaps Litigation and certain other assets are excluded from the APA. The Agreement also provides, however, that the Procaps Litigation is subject to an option whereby KEE Action can purchase all of NPS's rights in a judgment or settlement of the Procaps Litigation (the "Procaps Settlement") for its fair market value or FMV. To facilitate calculation of the Procaps FMV, the APA requires NPS and Postorivo to cooperate with and provide information to KEE Action or an independent appraiser and to seek relief from any confidentiality orders applicable to the requested information. In addition, NPS must forward to KEE Action all filings served or made by any party to the Procaps Litigation and all other information reasonably requested by KEE Action. Pursuant to § 1.6(e) of the APA, however, the information supplied may be "subject to such restrictions as may be reasonably requested by NPS upon advice of its outside counsel that such restrictions are required in order to preserve attorney-client privilege."<sup>31</sup> These provisions reflect the parties' intention to have NPS retain the rights to privileged information relating to the Procaps Litigation, subject to KEE Action's right of access to that information in certain circumstances.

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<sup>30</sup> See APA §§ 1.2(d), 1.6(e).

<sup>31</sup> APA § 1.6(e).

KEE Action does not deny that the APA indicates NPS retained the attorney-client privilege rights related to the Procaps Litigation. Instead, they argue that:

A corporations' attorney-client privilege cannot be split among several different entities, even if there is a written contract among the parties purporting to split up the privilege among several entities. Rather, in an asset transfer or sale, the corporation's attorney-client privilege passes as a whole to the entity that acquired substantially all of the assets and the control of the ongoing business operations [in this case KEE Action].<sup>32</sup>

In support of that proposition, KEE Action relies exclusively on the decision in *American International*, so I now turn to that precedent.<sup>33</sup>

In *American International*, Fruit of the Loom, Inc. ("Old FTL") entered Chapter 11 bankruptcy proceedings, as a result of which its assets were transferred to multiple

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<sup>32</sup> DAB at 16. In briefing another motion in this action, Defendants recently stated, "in the context of the ongoing document review, should the Postorivo Parties identify and remove documents related to retained [*i.e.*, excluded from the APA] assets and liabilities, the KEE Parties will not object on the ground that they do not retain the attorney-client privilege (although this is not a concession that NPS in fact has any legitimate claim to this privilege.)" KEE Parties' Suppl. Br. in Opp'n to the Postorivo Parties Mot. to Preclude Defs.' Alleged Violation of the Attorney-Client Privilege and Alleged Improper Contact with Employees, filed Jan. 24, 2008, at 17 n.11. Although one might argue that this "concession" moots the issue of who owns the privilege as to the Procaps Litigation, I do not believe that is correct. As explained *infra*, Plaintiffs contend that, notwithstanding the "concession," Defendants' earlier actions in contesting this issue constitute bad faith litigation practices warranting an award of attorneys' fees.

<sup>33</sup> To the extent my ruling in this case is viewed as inconsistent with *American International*, I note that in applying either New York or Delaware law, I am not required to follow Illinois case law. That is, the *American International* case may provide guidance, but it is not controlling in this case.

successor entities.<sup>34</sup> Substantially all of Old FTL's assets, as well as control of its former business operations were transferred to a new entity, "New FTL." However, certain of Old FTL's assets and liabilities, including certain potential environmental remediation liabilities, were transferred to a separate entity, SLT, and certain insurance policies that potentially provided coverage for those environmental liabilities were either transferred to SLT or remained with Old FTL (which changed its name to NWI-I). The written agreements among the parties provided that, in connection with the assets transferred to SLT, SLT also received any attorney-client privileges relating to those assets.

Litigation over the environmental liabilities ensued, and during discovery, it became necessary for the presiding U.S. Magistrate Judge to determine which entities had the authority to invoke or waive any attorney-client privileges. The court held that only New FTL acquired the right, after the bankruptcy and the various transfers of assets, to assert attorney-client privileges that were owned by Old FTL before the bankruptcy. Because "New FTL purchased substantially all of Old FTL's business operations and continues to operate Old FTL's business, . . . the authority to assert or waive the attorney-client privilege transferred to New FTL."<sup>35</sup>

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<sup>34</sup> The successors after the bankruptcy included: "(1) the FTL Liquidation Trust, a/k/a the FOL Liquidation Trust; (2) the Unsecured Creditors Trust; (3) the NWI Successor, now known as the Successor Liquidation Trust ("SLT"); (4) the Custodial Trust ("CT"); (5) Reorganized Fruit of the Loom, which consisted of Reorganized Debtors, Newco and any successor; and (6) Newco, to which Apparel Business Assets were transferred (referred to herein as "New FTL")." *American Int'l*, 240 F.R.D. at 403.

<sup>35</sup> *Id.* at 407.

Quoting from a case that cited *Tekni-Plex*, the federal district court in *American International* stated that, in the asset transfer context, the appropriate rule for determining whether the attorney-client privilege also transfers “turns on the practical consequences rather than the formalities of the particular transaction.”<sup>36</sup> Looking to the transactions at issue in *American International*, the court concluded that “because the practical consequence of the Asset Purchase Agreement resulted in the transfer of control of Old FTL’s business and the continuation of that business under new management, the authority to assert or waive the attorney-client privilege transferred to New FTL.”<sup>37</sup> Moreover, the court held that, absent control of the corporation, the privilege does not pass to a successor entity even with respect to assets that were transferred to a successor.<sup>38</sup> The court made that ruling, however, in a context in which the debtor’s assets had been conveyed to several different successors and three different companies claimed jointly to hold the attorney-client privilege as it pertained to certain assets. The court also applied the same principle regarding a claim that NWI-I retained an insurance policy and the right to assert privilege as to documents and communications relating to it. In doing so, the court noted that defendants had not provided the court “with any case law

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<sup>36</sup> *Id.* at 406.

<sup>37</sup> *Id.* at 407.

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

that supports allocating the attorney-client privilege based on the division of a debtor's assets to multiple successor entities.”<sup>39</sup>

The general legal principle enunciated in *American International* arguably could support KEE Action's claim here to control the privilege as to the Procaps Litigation. Several considerations convince me otherwise, however. First, the context of the two cases is quite different. Unlike *American International*, this case does not involve either a bankruptcy or a situation in which NPS's assets have been conveyed to multiple successors. Second, as the Magistrate Judge recognized in citing the decision of the New York court in *Tekni-Plex*, it is important in resolving privilege issues like the one presented in this case to consider the practical consequences rather than the formalities of the particular transaction.

Here, as a practical matter, it makes more sense for NPS and Postorivo to hold the attorney-client privilege for the discrete and segregable assets and liabilities explicitly reserved for them under the APA. Imagine the impracticality of a contrary result: NPS would have to prosecute the Procaps Litigation, for example, and defend an excluded liability without the ability to assert or waive the attorney-client privilege for communications related to those matters. Instead, KEE Action would be the only entity with that authority, and it foreseeably could have interests adverse to NPS. And third, the language of the APA reflects a clear recognition by KEE Action that NPS would retain the privilege as to the Procaps Litigation. This Court generally eschews mandating

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<sup>39</sup> *Id.* at 408.

actions contrary to the intent explicitly reflected in freely negotiated contracts among sophisticated, well-represented parties. I therefore conclude that NPS and Postorivo hold the attorney-client privilege for communications regarding the Procaps Litigation and any other similar assets and liabilities excluded from the APA. To the extent this result is inconsistent with the reasoning of the *American International* case, I find that reasoning unpersuasive in the current context and decline to follow it.

At the same time, I am mindful that the parties cited, and my own research revealed, very little case law directly addressing the issue presented here. The *American International* case involved the most nearly analogous factual circumstances, even though I found it distinguishable in important respects. The decision in that case arguably supported KEE Action's position. In these circumstances, I reject the arguments in NPS and Postorivo's co-pending motion to preclude Defendants' alleged violation of the attorney-client privilege that Defendants' pursuit of its claim of privilege as to the Procaps Litigation constituted bad faith litigation conduct justifying fee shifting.<sup>40</sup>

### **III. CONCLUSION**

For the reasons stated, I conclude NPS and Postorivo hold the attorney-client privilege for communications regarding the excluded assets and liabilities under the APA, including the Procaps Litigation.

**IT IS SO ORDERED.**

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<sup>40</sup> See Reply Br., after Discovery, in Support of Pls.' Mot. To Preclude Defs.' Violation of the Attorney-Client Privilege, filed Jan. 31, 2008, at 24-28.