Another Court Adopts the "Practical Consequences" Test in Analyzing the Sale of Corporate Assets

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In his July 18, 2012 “Privilege Points” release, Tom discusses the impact of a sale of corporate assets on the privilege:

Courts have traditionally recognized what was called the "bright-line" test in assessing whether a corporate transaction conveyed the benefits of an attorney-client relationship (including the privilege). Under that standard, selling the stock of a subsidiary to a third party normally transferred the privilege, while selling assets did not.

Courts increasingly use a more subtle analysis when analyzing asset sales – called the "practical consequences" test. This approach sometimes results in the asset purchaser's ownership of the privilege relating to those assets. In John Crane Production Solutions, Inc. v. R2R & D, LLC, Civ. A. No. 3:11-CV-3237-D, 2012 U.S. Dist. LEXIS 67457 (N.D. Tex. May 15, 2012), the court dealt with a disqualification motion which focused on whether an asset sale conveyed the elements of an attorney-client relationship. The court asked for more evidence, but noted that applying the "practical consequences" test involves "such factors as the extent of the assets acquired, including whether stock was sold, and whether the purchasing entity continues to sell the same product or service, whether the old customers and employees are retained, and whether the same patents and trademarks are used." Id. at *5.

Most transactional lawyers are familiar with the old "bright-line" test, but should realize that many courts now take a more subtle approach.