CHANCERY BAR ASSOCIATION BERMUDA CONFERENCE

SHAREHOLDER DISPUTES PANEL

PRIVILEGE: SOME KNOTTY ISSUES

Albert Sampson

4 Stone Buildings

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1. This note addresses 3 questions relating to discovery and privilege in the context of shareholder and board disputes: **(i)** can a shareholder see the legal advice given to a company; **(ii)** is it possible to share advice without waiving privilege; and **(iii)** what discovery should a company give in the context of a shareholder dispute, and how does a shareholder obtain disclosure from a company?

I. Can a shareholder see the legal advice given to the company?

2. The basic common law position is that a shareholder is entitled to see any advice taken by the company, subject to one exception: where that advice concerns litigation between the company and the shareholder, the shareholder may not see it - ***Woodhouse & Co Ltd v Woodhouse*** **(1914) 30 TLR 559**:

> "*The principle was that if people had a common interest in property, an opinion having regard to that property, paid for out of the common fund, i.e., company's money or trust fund, was the common property of the shareholders, or cestuis que trust. But where the parties were sundered by litigation such an opinion obtained by one of them was privileged*" (*per* Phillimore LJ, at 560).

3. The general rule is based on an analogy drawn with the law of trusts. This was recently analysed by the English High Court in ***Sharp v Blank*** **[2015] EWHC 2681 (Ch)**:

> "*Just as a trustee who takes advice as to his duties in relation to the running of a trust, and pays for it out of the trust assets cannot assert privilege against the beneficiaries who have, indirectly, paid for that advice, so too a company taking advice on the running of the company's affairs and paying for it out of the company's assets cannot assert a privilege against the shareholders who, similarly, have indirectly paid for it*" (*per* Nugee J, at [9]).

4. However, this general rule does not apply where there is a dispute. In other words, "*the essential distinction is between the advice to the company in connection with the*

administration of its affairs on behalf of all of its shareholders, and advice to the company in defence of an action, actual, threatened or in contemplation, by a shareholder against the company" (***Arrow Trading & Investments Est 1920 v Edwardian Group Ltd*** **[2004] BCC 955**, *per* Blackburne J at [24]).

(1) Therefore, shareholders are entitled to see legal advice in relation to the general management of the company.

(2) However, once there is a dispute between the company and the shareholder, or a sufficiently strong possibility of such a dispute, the shareholder cannot see advice in relation to that dispute.

5. This principle has been applied in the Cayman Islands (see e.g. ***In re Fortuna Development Corporation*** **[2004-05] CILR 197** and ***In re Torchlight Fund LP*** **[2016] CILR Note 9**).

6. However, in practice, there are some nuances to this general rule.

(1) **First**, for the exception to apply, the litigation must genuinely be between the shareholder and the company. Where the substance of the litigation is between rival factions of shareholders, or between shareholders and the board (e.g. unfair prejudice proceedings), the company is usually joined as a nominal defendant and does not play an active role in proceedings. In such a case, the litigation does not bring the company within the exception to the rule in ***Woodhouse*** and the board cannot assert privilege over advice given to the company against shareholders (see ***Re Hydrosan*** **[1991] BCC 19**, *per* Harman J at 21G-H).

(2) **Second**, is the claim to privilege made in respect of documents concerning the litigation only, or is a wider claim being made? The exception only applies to advice in relation to litigation between a company and a member (or members). If the advice concerns the general administration of the company's affairs, shareholders are entitled to see it.

(3) **Third**, when is the advice given? The exception is basically an application of litigation privilege – so litigation must be "*threatened or in contemplation*". If the possibility of litigation is merely foreseen as the possible outcome of a transaction, that will not entitle the company to assert privilege against shareholders in subsequent litigation (***CAS (Nominees) Ltd v Nottingham Forest plc*** **[2002] BCC 145**, *per* Hart J at [19]).

(4) **Fourth**, do the documents actually contain advice given to the company? Directors might have taken their own advice as to their potential liabilities arising out of a transaction. In that case, the privilege will be theirs, not the company's, and they will be entitled to assert it against the company and its members. However, this is worth scrutinising closely:

(a) who gave the advice – was it an independent firm, or the same firm that acts for the company, or same firm but different fee-earners;

(b) who paid for the advice – the company or the directors;

(c) does the advice clearly deal with the company's position or the directors' position separately?

II. Can you share advice without waiving privilege?

7. The common law recognises that waiver of privilege can be limited. Thus:

(1) sharing it with some parties does not necessarily mean that privilege is lost against others (***Gotha City v Sothebys (No 1)*** **[1998] 1 WLR 114**, at 118G-121H and 122H); or

(2) privileged material can be shared with others on terms or under circumstances where privilege is preserved (***B v Auckland District Law Society*** **[2003] 2 AC 736**, at [66]-[70]).

8. The principle has been applied abroad – see ***Citic Pacific Ltd v Secretary of State for Justice*** **[2012] HKCA 153** and **[2015] HKCA 293** (Hong Kong) and ***Primeo Fund v Bank of Bermuda (Cayman) Limited*** **[2016] (2) CILR 353** (Cayman Islands).

9. If the advice is shared, control of what then happens to it may be lost. ***Berezovsky v Hine*** **[2011] EWCA Civ 1089**, (see [42]-[43], and also [34]) concerned a case where one party shared privileged material (draft witness statements) with another, and those parties then became involved in hostile litigation with one another and with a third party.

10. The question before the court was the extent to which the recipient of the privileged material could rely on it in other proceedings. In that case, the Court of Appeal found that the sharing of the material was subject to implied restrictions that prevented such use. However, the

case shows the danger of sharing privileged material on an informal basis; the claim to privilege is at the mercy of the courts finding an implied limitation on the waiver:

> "*The possibility of Mr Patarkatsishvili deploying the draft statements against Mr Berezovsky was not in the parties' minds at the time* […] *it does highlight the fact that there would have been possible uses to which Mr Patarkatsishvili might wish to put the draft statements to which neither party would have put his mind. On the facts of this case, I think that supports the notion that Mr Berezovsky would have intended a very limited waiver, and that Mr Patarkatsishvili would have appreciated that*" (at [43]).

11. Sharing privileged material potentially opens up costly satellite litigation about waiver, reliance and the limits of the use of the material. Best practice is to identify the basis on which advice is being shared and to restrict the third party's usage of it in writing (either by clear communications, or through a formal confidentiality agreement). This maximises the sharing party's chances to prevent any inadvertent waiver or unauthorised use by the recipient. This could be very important in the context where the third party becomes hostile in the same or subsequent litigation.

III. <u>What discovery should the company give? How does a shareholder obtain the company's documents?</u>

12. Outside of the context of proceedings:

    (1) **Section 82 Companies Act 1981** ("**CA 1981**") enables members: **(i)** to inspect minutes of general meetings (which are to be kept pursuant to s. 81[1]) free of charge; or **(ii)** to request copies of minutes for a reasonable fee.

    (2) **Section 87 CA 1981** entitles members to receive financial statements of a company.

    (3) **Section 110 CA 1981** enables members to instigate an investigation into the affairs of the company by inspectors appointed by the Minister of Finance, which results in the production of a report that is sent to the company and may be sent (at the Minister's discretion) to the applicants.

13. In the case of litigation, the answer to this question depends on the nature of the litigation.

[1] Section 81 also requires minutes of board meetings to be kept, however these are not available for inspection under s. 82.

(1) **Dispute between a member and the company / company and the board**: In such cases, the company plays an active part in the litigation and is likely to be required to give discovery in the usual way.

(2) **Disputes between shareholders**: In such cases, the company is usually merely a nominal defendant and is unlikely to be required to give discovery to the same extent as other parties to the proceedings.

(3) The general common law position is that the company should not become involved in shareholder disputes because the expenditure is not in the ordinary course of its business. However, there is no hard and fast rule on this and it will depend on the circumstances of the case, and the company would have to justify its participation in a shareholder dispute (for a summary of the principles, see ***Arrow Trading v Edwardian Group Ltd***, *per* Ferris J at [11]). This approach has been followed in the Commercial Court of Bermuda: ***Westport Trust Company Ltd v Paragon Trust Ltd* [2010] Bda LR 35**, *per* Kawaley J at [17].

14. Alternatively, the parties might consider that disclosure from the company is necessary. It will be a matter for the court to decide whether it is necessary for the company to give discovery (**Bermuda RSC, Order 24, rr 3, 7 and 8**). This might be relevant where:

(1) there are gaps in discovery given by members or directors that are joined to proceedings;

(2) the board took advice on behalf of the company in relation to a particular transaction, which the members are entitled to see;

(3) the company's financial information is required for the purposes of determining the dispute (or quantifying any relief); or

(4) there are suspicions that the respondents to the litigation are being funded by the company (which is potentially improper).

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