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Privilege in Corporate Investigations

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Introduction

- Corporate Investigations: Why Care About Privilege
- Legal Professional Privilege: Overview
- *Director of the Serious Fraud Office v Eurasian National Resources Corporation* [2018] EWCA CIV 2006
- *Al Sadeq v Dechert LLP* [2023] EWHC 795 (KB)
- Practical Tips for Clients and their Solicitors

Corporate Investigations: Why Care About Privilege?

- Investigations focus on fact finding
- Potential scenarios:
  - Internal allegations
  - External allegations
  - External interventions
- Material generation
  - Interviews
  - Documents
- Reputation management

Legal Professional Privilege: Overview (1)

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- Single Concept – 2 Subheads
  - Legal Advice Privilege
    - *Three Rivers District Council v Governor and Company of Bank of England (No 6)*
      - i) it arises out of a relationship of confidence between lawyer and client, so unless the communication or document for which privilege is sought is a confidential one, legal advice privilege does not arise;
      - ii) when it applies, it is absolute and cannot be overridden by some supposedly greater public interest, but it can be waived by the person entitled to the privilege, it can be overridden by statute or abrogated under crime/fraud/iniquity exception (*); and
      - iii) it gives the person entitled to it the right to decline to disclose or to allow to be disclosed the confidential communication or document in question.
    - *Three Rivers District Council v Governor and Company of Bank of England (No 5)*
      - Only communications passing between a lawyer and a person at the client who is authorised, expressly or impliedly, by the client to give instructions to obtain legal advice and/or to receive and/or act on legal advice will attract legal advice privilege.
      - Criticised but not overruled

Legal Professional Privilege: Overview (2)

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- Litigation Privilege

    - Communication between lawyer (acting in professional capacity) and client, or between either & a third party
    - Includes documents created by or on behalf of lawyer/client
    - Dominant purpose is litigation
    - Litigation must exist, be pending or be reasonably contemplated

Starbev GP Ltd v Interbrew Central European Holding BV [2013] EWHC 4038 (Comm) [11] – [13]

- Burden of proof for litigation privilege is on the establishing party
- Assertion of privilege is not determinative; court will scrutinise basis carefully
- Reasonable contemplation is more than (a) "*mere possibility*", (b) "*distinct possibility… someone might at some stage bring proceedings*", or "*general apprehension of future litigation*"
- If there is "another purpose" the dominant purpose test will not be satisfied.

Director of the Serious Fraud Office v Eurasian National Resources Corporation [2018] EWCA CIV 2006

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- ENRC instructed solicitors and forensic accountants to carry out investigations into foreign subsidiaries.
- ENRC communicated with SFO pursuant to Self-Reporting Guidelines.
- SFO commenced criminal investigation and issued notices under Criminal Justice Act 1987 to compel production of documents generated during ENRC's own investigations.
- ENRC resisted on the basis that documents were subject to either litigation privilege or legal advice privilege.
- Andrews J granted declaration that documents were not privileged.
- Reversed in part on appeal.

Director of the Serious Fraud Office v Eurasian National Resources Corporation (cont'd)

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- Were legal proceedings in contemplation?
  - Question of fact.
  - Prospect of prosecution made clear, legal advisers engaged, litigation in reasonable contemplation.
  - Subtext of relationship between SFO and ENRC.

- Clear threat of criminal investigation, the reason for investigation – within the zone of dominant purpose of preventing or dealing with litigation.

- *Obiter* comments on legal advice privilege issues:
  - *Three Rivers (No 5*) criticised but remains good law pending Supreme Court reconsideration. No legal advice privilege over interview notes.
  - Had legal advice privilege been all that had been claimed then no privilege. Documents did not contain information communicated to ENRC's solicitor by anyone authorised to see or receive legal advice on behalf of ENRC.
  - Interviews with ex-employees would not be subject to legal advice privilege.
  - Lawyers' working papers issue not decided.

Al Sadeq v Dechert LLP [2023] EWHC 795 (KB)

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- Claimant ("**C**") was former general counsel of RAK - UAE sovereign wealth fund.
- Defendants ("**D**") instructed by RAK Government to investigate C's fraud & misappropriated assets during tenure at the fund.
- C alleges D complicit in unlawful arrest, detainment and denial of legal representation.
- 4 issues: (i) does LAP apply to investigatory work; (ii) can non-parties rely on litigation privilege; (iii) does crime/fraud/iniquity exception apply, and (iv) redaction of privileged materials.

- **Issue 1** – C argued D were merely gathering factual information, not advising
  - Rejected.
  - Court focused on terms of engagement and nature of work undertaken.
  - D engaged to advise and assist as lawyers, to determine what had occurred for the purpose of exploring legal options to recover losses. Artificial to separate investigatory work from role as lawyers.
  - "*Where lawyers are engaged to conduct an investigation, it is a reasonable and fair assumption that the engagement encompasses the investigatory work and related legal advice and assistance as part of a continuum of legal service. It would take strong evidence to rebut this.*"

Al Sadeq v Dechert LLP (cont'd)

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- **Issue 2** – C alleged D claimed litigation privilege over documents created for proceedings that their clients were not party to (criminal proceedings).
  - In majority of cases, a non-party will not be able to meet dominant purpose tests.
  - But if they have a sufficient interest in litigation so as to create documents for the dominant purpose of that litigation, litigation privilege applies. Fraud victim example.

- **Issue 3** – C alleged D should disclose any documents which had been generated by, or reported on, allegedly iniquitous conduct.
  - D submission was this was overbroad, the test is whether document was brought into existence for furthering a criminal or fraudulent purpose.
  - Court agreed with D. Iniquity exception will only apply in exceptional cases.
  - Touchstone is whether the communication arises in conduct in which the solicitor is acting in the ordinary course of their professional engagement as a solicitor.

- **Issue 4** – C argued redactions suggested dominant purpose test had not been properly applied.
  - Rejected.
  - No authority for proposition that it is only permissible to redact a part of a document on the grounds of privilege if it severable from the unredacted parts.
  - "*if privileged and non-privileged information are so intertwined that redacting the privileged parts of a document becomes impracticable or unfeasible, then the balance will have to fall in favour of withholding the entire document on the basis of privilege*."

Practical Tips

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- Correct preparation for an investigation is critical
  - Define the client and who is authorised to seek legal advice on the client's behalf.
  - Document the purpose and scope of the investigation (incl. next steps) in the engagement letter.
  - Consider who you will be communicating with inside the client organisation and why.
  - Brief the client's employees on privilege issues.

- Keep purpose and scope under review.
  - Consider if litigation is a possibility and when the likelihood increases.
  - Is your goal to ultimately provide legal advice?
  - Ensure in-house and external views on litigation risk are clearly documented.
  - Be mindful of the use of non-lawyer investigators.

- Manage paper trail
  - Keep privileged and non-privileged materials separate.
  - Limit audience for privileged documents.
  - Be mindful of notes (opinion/views vs. factual summaries).
  - Risk of waiver when sharing documents.

- Liaise with relevant advisors and stakeholders
  - Client data monitoring policies.
  - Consider ACAS Guidance where employee misconduct (but no automatic right to representation).
  - Waiver risk in providing investigation outcomes.

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Navigating knowledge – *Establishing knowledge in directors' duties cases*

17 October 2023

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The importance of knowledge

- Actual and deemed/constructive knowledge
- E.g. *Duke of Sussex v News Group Newspapers Limited* [2023] EWHC 1944

Directors' Duties –

- Engagement of duty?
- Breach of duty by director – objective or dual test

E.g. s.172 - duty to promote the success of a company for the benefit of its members
Evidence director actually considered the best interests of the company > subjective test
No evidence > whether a reasonable director in the position of the director in question could reasonably have thought that the matter in issue was for the benefit of the company - *Re HLC Environmental Projects Limited* [2013] EWHC 2876 Ch at 92

Sequana – is there a knowledge requirement?

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BTI 2014 LLC v Sequana [2022] UKSC 25

- Distribution by solvent company
- Existence of the 'rule in West Mercia' / the 'creditor duty' - in certain circumstances when a company is financially distressed the directors' fiduciary duty to the company to act in its interests (s.172) is modified to include a duty to act in the interests of creditors as a whole
- Rule does not apply just because there was a real and not a remote risk of insolvency at some point in the future
- Actual test? Open to debate…

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When is the 'creditor duty' triggered?

- Lord Briggs at §208 - preferred "*a formulation in which either imminent insolvency (i.e. an insolvency which **directors know or ought to know** is just around the corner and going to happen) or the probability of an insolvent liquidation (or administration) about which **the directors know or ought to know**, are sufficient triggers for the engagement of the creditor duty*."

- Lord Hodge **agreed with Lord Briggs** and at §207 - was "*satisfied that the directors of a company which is insolvent or bordering on insolvency owe a duty to the company to have proper regard to the interests of its creditors and prospective creditors*".

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When is the 'creditor duty' triggered?

- Lord Reed at §88 - "*inclined to agree*" with (a) the view it is sufficient for the creditor duty to arise where the company "*is insolvent or bordering on insolvency*", and (b) with Lord Briggs and Lord Hodge that the probability of an insolvent liquidation or administration was also sufficient.

  §90, he was "***less certain than Lord Briggs JSC and Lord Hodge DPSC … that it is essential that the directors "know or ought to know" that the company is insolvent or bordering on insolvency***".

- Lady Arden agreed with Lord Reed's test and at §281- "*Like Lord Reed PSC, I would* ***leave the question of knowledge open for full submissions***".

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Hunt v Singh

[2023] EWHC 1784 (Ch)

Question - when does a director's duty to take into account the interests of creditors arise, in circumstances where the company is at the relevant time insolvent, but its insolvency is due to a tax liability which the directors (wrongly, as it later turned out) believed at the relevant time had been avoided by a valid tax avoidance scheme entered into by the company?

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The Scheme

"*It initially operated as follows:*

- *(1) The Company set up an employee benefit trust ("EBT") for the benefit of employees of the group;*
- *(2) A shell BVI company, Moorston Holdings Limited ("Moorston") was incorporated, with Mr Singh and another of the directors of the Company as directors;*
- *(3) The Company made payments in excess of £3 million to the EBT trustee, and the directors of Moorston resolved to allot two ordinary shares of £1 to the EBT trustee;*
- *(4) The EBT trustee subscribed for £3,143,169 1p preference shares in Moorston at a premium of 99p per share;*
- *(5) The EBT trustee issued Moorston shares to the head office staff members, according to the Company's wishes to award them, as employees of the Company, non-contractual gratuitous bonuses;*
- *(6) Moorston then declared and paid dividends on those shares to the head office staff members.*

7. From 2003 onwards, the scheme was modified slightly, in that the Company subscribed for a 1p D redeemable share in Moorston at a substantial premium (constituting the amount the Company had resolved to pay out in gratuitous bouses), and the Company then resolved to award shares in Moorston to the head office staff, pursuant to "incentive arrangements" for senior executives and employees.

8. This process was then repeated at regular intervals over the following eight years, resulting in 34 subscriptions and declarations of dividends in favour of the directors of the Company (and certain other recipients) in a sum totalling over £54 million over the eight years during which the Scheme operated."

The Facts

- 2002 - tax avoidance scheme – ‘non-contractual gratuitous bonuses’
- Advised ”robust” and avoided PAYE and NIC
- 2004 – Paymaster General announces crackdown
- Sept 2005 – HMRC market-wide offer; -£3.5 net assets
- Advice continues
- Early 2006 – HMRC reference litigation
- July 2008 – assessment issued - £11,376,566 for PAYE and £4,776,592 for NIC
- May 2009 – similar scheme challenged – Tax Chamber of First-Tier
- July 2010 – success in Upper Tribunal Tax and Chancery Chamber
- November 2011 – success in Court of Appeal
- Advised Company’s scheme cannot be distinguished
- May 2013 – CVL
- Dissolution and restoration

The Appealed Decision

First Instance (ICCJ Prentis – 6/4/2022)

- Duty not engaged - directors had acted reasonably in taking and acting upon professional advice as to the Scheme and to the merits of HMRC's claim and as to what provision, if any, should be made in the Company's accounts

- If engaged, no breach

Appeal (Zacaroli J – 17/7/2023)

- Agreed duty engaged "when the directors know or should know that the company is or is likely to become insolvent… In this context 'likely' means probable" [25]

- Tax liability is not contingent debt - *Integral Memory PLC v Haines Watts* [2012] EWHC 342 (Ch) at [32]

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The Proper Test

"*Where a company was faced with a claim to current liability of such a size that its solvency depends on challenging that claim, then the creditor duty arises if the* ***directors know or ought to know*** *that there is* ***at least a real prospect*** *of the challenge failing*" at [51]

By (a) Sept 2005 when HMRC made the market-wide offer, if not by; (b) Oct 2005, when HMRC made it clear it would pursue litigation if no settlement reached; (c) July 2008, when HMRC issued formal assessments; (d) May 2009 when the FTT decision was released; (e) July 2010 when the Upper Tribunal Decision was released

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The ”economic shift”

“52. I recognise that the language of "real risk" of insolvency was specifically rejected by the Supreme Court in Sequana , but that was in the different context of the possibility that a company, that was undoubtedly solvent at the relevant time, might become insolvent at some point in the future.

53. There is an important difference between the two contexts, particularly in light of the rationale for the creditor duty in the first place: i.e. that there is a shift in economic interest from shareholders to creditors (either alongside or to the exclusion of shareholders depending on the depth of the insolvency): see, for example, Lord Reed at §83 of Sequana . ***If it turns out that the company was in fact insolvent at the relevant time, then this shift in economic interest had already occurred, and had occurred irrespective of whether the directors appreciated it.”***

Where does this leave us?

- Is knowledge a pre-requisite?
- *Hunt v Singh* – no full argument
- Assuming knowledge is required – what level and how do you prove it?

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Actual and deemed knowledge

- Actual knowledge – subjective enquiry, question of fact, to be assessed on balance of probabilities

- Deemed knowledge – how do you decide what the directors ought to have known but did not know?

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Actual and deemed knowledge

"…Taking this case as an example, the question whether the Company was subject to existing tax liabilities to HMRC was a binary one: it either was, or it was not. ***It is a binary question, however, on which reasonable directors, advisors and tribunals, may reasonably differ.*** *Identifying where, on the sliding scale between high probability of success and high probability of failure, the duty to consider the interests of creditors cuts in is inherently difficult. A conclusion that the duty to have regard to creditors' interests is triggered by actual or constructive knowledge of a real risk that the liability may exist, with questions of degree of probability of success or failure being factored into the content of the duty and whether it was breached in the particular case, is more consistent in my view with the approach suggested, for example, by Lord Reed in Sequana . At §82* ***he advocated an approach which is:"…sufficiently fact-specific to take account of differences, according to particular circumstances, in what it may be reasonable and responsible for directors*** *to do when they find that the company is in a sufficiently weak financial situation that a conflict of interest between its creditors and its shareholders appears to arise"* - Zacaroli J in *Hunt v Singh* at [59]

Actual and deemed knowledge

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Wrongful Trading – s.214(4) IA86

4. For the purpose of subsections (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—
(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and
(b) the general knowledge, skill and experience that that director has.

Duty to exercise reasonable care, skill and diligence – s.174 CA06

(1)A director of a company must exercise reasonable care, skill and diligence.
(2)This means the care, skill and diligence that would be exercised by a reasonably diligent person with—
(a)the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
(b)the general knowledge, skill and experience that the director has.

Practical steps for building a case

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- Focus on establishing knowledge by a certain date
- Alternative dates
- Thorough appraisal of key events against the backdrop of the company's financial status
- Looking at the individual director
- All directors are under a duty to inform themselves about the company's affairs - *In re Westmid Packing Services Ltd* (No 3) [1998] 2 BCLC 646, 653
- Appropriate to rely on another? See *Equitable Life Assurance Society v Bowley* [2004] 1 B.C.L.C. 180 at [41] regarding NEDs
- Finance director vs. sales director
- Size of business?
- How sophisticated are the accounting procedures?

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