CHECK YOUR PRIVILEGE: THE IMPACT OF *SHLOSBERG* AND *LEMOS* ON OFFICEHOLDERS

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Introduction

1. This paper supports the talk which the authors will deliver on Tuesday 8 May 2018 at the Guildhall Chambers Insolvency Seminar at the Watershed. By means of a case study, the talk will consider the recent decisions in *Avonwick Holdings Ltd v Shlosberg*[1] and *Re Lemos*[2], which concern the effect which bankruptcy has on the bankrupt's right to legal professional privilege, and explore the impact which those decisions have on the trustee's ability to carry out their function of getting in and realising the bankrupt's estate for the benefit of the bankrupt's creditors.

2. At the outset, it is important to observe that the decisions have taken the profession somewhat by surprise, given that they effectively reverse well-established law and practice. As such, those decisions throw up a multitude of questions as to the ambit of the trustee's powers to deploy privileged material on behalf of the estate, the answers to which are by no means clear. There is therefore likely to be the need for further caselaw to clarify the position. In the meantime, the case study is designed to stimulate intellectual debate as to the current state of the law and the possible availability of solutions to the issues raised.

What is privilege?

3. Privilege is a right to resist the compulsory disclosure of information, and in particular documents which contain legal advice or were created for the dominant purpose of obtaining information or advice in connection with actual or contemplated litigation[3]. The right exists because it is in the public interest that a person is able to consult their lawyer in confidence in the knowledge that what is told to the lawyer will never be revealed without their consent

4. The right to privilege is a fundamental human right and a necessary corollary of the right of any person to obtain skilled advice about the law, which advice cannot be effectively obtained unless the client is able to put all the facts before the adviser without fear that they may afterwards be disclosed and used to his prejudice[4].

5. Whilst the right to privilege (as with any fundamental human right) can be overridden by Statute (in exercise of Parliamentary Sovereignty), any intention by Parliament to do so must be either expressly stated in the Statute or appear by necessary implication[5].

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[1] [2016] EWHC 2001 (Ch); [2016] EWCA Civ 1138, [2017] Ch 210
[2] [2017] EWHC 1825 (Ch); [2018] Ch 81
[3] *B v Auckland District Law Society* [2003] 2 AC 736, para 67 (Lord Millett) and *Three Rivers District Council v Governor and Company of the Bank of England (No 6*) [2005] 1 AC 610, para 26 (Lord Scott of Foscote).
[4] *R v Derby Magistrates' Court, Ex p B* [1996] AC 487 and *R (Morgan Grenfell & Co Ltd) v Special Comr of Income Tax* [2003] 1 AC 563
[5] R v Secretary of State for the Home Department, Ex p Simms [2000] 2 AC 115; *R (Morgan Grenfell & Co Ltd) v Special Comr of Income Tax* [2003] 1 AC 563

The limits of privilege

6. There are three specific cases in which the right to assert privilege in communications which would otherwise be covered by legal professional privilege does not apply[6]:

    a. when the communications are made for the purpose of effecting "iniquity";
    b. when the client waives the privilege and permits disclosure; or
    c. when the communications are made for the purpose of being repeated to the other party (such as an instruction to settle a claim for a specified sum).

Iniquity

7. The iniquity exception was considered by the Court of Appeal in *Barclays Bank Plc v Eustice*[7] in the context of a claim under s.423 of the Insolvency Act 1986 ("**IA**"). In that case, there was a strong prima facie case that the defendant had entered into a transaction at an undervalue for the purpose of prejudicing the interests of a secured creditor. The Court of Appeal held that such purpose was *"sufficiently iniquitous for public policy to require that communications between him and his solicitor in relation to the setting up of these transactions be discoverable"*.[8]

Waiver

8. There are various ways in which the right to privilege may be waived. Most obviously, these include deploying the privileged material in court or disclosing it to another party (either voluntarily or inadvertently). However, privilege may also be waived if there is a loss in confidentiality in the material. In *Shepherd v Fox Williams LLP*[9], Simler J observed:

    > *"It is well established that a document which would otherwise be privileged does not lose the quality of confidentiality necessary to attract privilege simply because it has been seen by someone other than the lawyer and client. The critical question is whether the document and its information remain confidential in the sense that it is not properly available for use. If a document has been made generally available, confidence and therefore privilege will be completely lost. However documents communicated to a third party in circumstances expressly or impliedly preserving confidentiality against the rest of the world are unlikely to lead to the privilege being lost."*

9. In that case, the claimant forwarded privileged material to his girlfriend's personal email address and she then forwarded that email to her work email address. The court rejected the contention that this amounted to a waiver of the material in favour of her employer.

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[6] *Conlon v Conlons Ltd* [1952] 2 All ER 462
[7] [1995] 1 WLR 1238
[8] In *McE v Prison Service of Northern Ireland* [2009] UKHL 15; [2009] 1 AC 908 at [109], Lord Neuberger expressly left open the question of whether *Eustice* was correctly decided.
[9] [2014] EWHC 1224 (QB) at [50]

Joint privilege

10. Where legal advice is given to joint clients, those clients will be entitled to joint privilege. It is well-established that: (i) joint privilege cannot be waived by one joint client without the other's consent; but (ii) one joint client cannot claim privilege against another joint client in respect of communications which are subject to joint privilege[10].

Successors in title: the *Crescent Farm* principle

11. In *Crescent Farm (Sidcup) Sports Ltd v Sterling Offices Ltd*[11], A sold a piece of land to B subject to a right of pre-emption. B wished to sell the land to C free from A's right of pre-emption. B therefore sought legal advice as to the validity of A's right. B subsequently conveyed the land to C and, at the same time, provided them with a copy of the advice. Goff J held that C, as successor in title to the property conveyed, succeeded to and was entitled to assert B's privilege as predecessor in title. That proposition has since become known as "the *Crescent Farm* principle".

The trustee in bankruptcy

12. By s.305(2) IA, the function of a trustee in bankruptcy is to get in, realise and distribute the bankrupt's estate in accordance with the provisions of Chapter IV of Part IX IA (i.e. ss.305-335 IA). The relevant provisions of that Chapter are as follows:
    a. by s.306, the bankrupt's estate (which, by s.283 IA, includes all property belonging to or vested in the bankrupt at the commencement of the bankruptcy and any power exercisable by him over or in respect of that property) automatically vests in the trustee on his appointment taking effect;
    b. by s.311(1) and s.312(1), the trustee has an obligation to take possession of all books, papers and other records which relate to the bankrupt's estate or affairs and which belong to him or are in his possession or under his control (including any which would be privileged from disclosure in any proceedings) and the bankrupt has a corresponding obligation to deliver up those documents to the trustee;
    c. by s.314(1), the trustee is given the powers set out in Parts 1 and 2 of Sch.5, which include the power to bring legal proceedings relating to the property comprised in the bankrupt's estate or under ss.339, 340 and 423;
    d. s.333 imposes a wide obligation on the bankrupt to co-operate with the trustee in the exercise of his function.

***Konigsberg*: the previous prevailing view**

13. The interaction between a bankrupt's right to privilege and the effect of the making of a bankruptcy order was considered by the court in *Re Konigsberg (a Bankrupt)*[12] (a case decided under the provisions of the Bankruptcy Act 1914). In that case, a firm of solicitors provided advice to a married couple in relation to the transfer of their jointly owned matrimonial home into the wife' sole name. The husband was subsequently adjudged bankrupt and his trustee in bankruptcy sought a declaration that the transfer of the matrimonial home into was void by virtue of s.42 of the Bankruptcy Act 1914. The wife sought to exclude evidence of the communications with the solicitors on the basis that those communications were the subject of joint privilege which had not been waived.

14. The issue for determination was whether the trustee in bankruptcy should be treated as standing in the bankrupt's shoes (such that the wife could not assert joint privilege against him) or as a third

[10] Shore v Bedford (1843) 5 M. & G. 271
[1111] [1972] Ch 553
[12] [1989] 1 WLR 1257

party (such that she could insist on the maintenance of privilege even if the bankrupt was prepared to waive it).

15. Peter Gibson J (as he then was) concluded that the wife was not entitled to assert privilege against the Trustee, stating:

> *"Important and desirable though I recognise it is to maintain the principle of legal professional privilege I can see no sufficient reason to treat the trustee as a third party for that purpose. The rule recognises that joint clients cannot maintain privilege against each other and as the privilege of the bankrupt had devolved on to the trustee who is entitled to obtain the privileged information from the bankrupt, in my judgment it is appropriate to treat the trustee as being in the shoes of the bankrupt for the purpose of privilege in proceedings against the joint client. It would be very odd if the trustee, entitled as he is to, and possessing, the information, cannot use it in the performance of his duties in seeking to recover the bankrupt's property."*

16. In reaching that decision, he expressly referred to the *Crescent Farm* principle (i.e. that a successor in title to property succeeds to and is entitled to assert the privilege of a predecessor in title). It is important to note that *Crescent Farm* was not an insolvency case.

17. The decision in *Konigsberg* was expressly followed by Stanley Burnton QC (as he then was) in *Re Cook*[13], which held that the power and right to waive legal professional privilege in relation to the estate and affairs of a bankrupt pass to the trustee in bankruptcy in the same way as the bankrupt's assets and the right to possession of books, papers and records. In reaching that decision, the court did not draw any distinction between s.306 (the effect of which is to transfer the beneficial ownership of assets from the bankrupt to the trustee) and s.311(1) (which entitles the trustee to take possession of certain documents).

18. Thus, following *Konigsberg*, it was taken as settled law that a trustee succeeds to the bankrupt's right to privilege and is thus free to deploy privileged material in the exercise of his functions.

Shlosberg **at first instance: a turning point**

19. In *Shlosberg,* the bankrupt was adjudged bankrupt on a creditors' petition based on a substantial judgment debt. Following the making of the bankruptcy order, the solicitors who acted for the petitioner were also instructed to act on behalf of his trustees in bankruptcy. The trustees exercised their power under s.311(1) IA to take possession of his books, papers and other records, which were then passed to, and reviewed by, the solicitors. When he discovered this, the bankrupt applied for an order directing the solicitors to cease to act for both the petitioner and the trustees. The key issue for determination was whether the benefit of the bankrupt's privilege vested in his trustees as part of his estate.

20. There were three categories of documents with which the court was concerned. The first, related to an asset of the bankrupt (earlier litigation which had resulted in a county court judgment in his favour) and were subject to the sole privilege of the bankrupt. It was common ground between the parties that the privilege in the documents vested in the trustee as successor to title in the assets under the *Crescent Farm* principle. At first instance, Arnold J expressed doubt as to whether this was correct but accepted the proposition on the basis that it was not disputed. The issue was not considered further by the Court of Appeal.

21. The second and third categories of documents related to liabilities of the bankrupt. In both cases, the documents were subject to the joint privilege of the bankrupt and his company. At first instance, the trustees' primary argument was that they were entitled to privilege in those documents because

[13] [1999] BPIR 881

the documents themselves formed part of his estate (as they fell within the definition of property in s.436(1)) and they had acquired the privilege therein as successors in title under the *Crescent Farm* principle. That argument was rejected by Arnold J on the basis that the right to exercise privilege does not depend on the ownership of the paper on which the privileged information is recorded.

22. The trustees' secondary argument was that the privilege in those documents was itself property of the bankrupt which formed part of his estate, being either: (i) an interest arising out of, or incidental to, property (within the definition of "property" in s.436(1)); or (ii) a power exercisable over or in respect of property (within the extended definition in s.283(4)). Having closely scrutinised the earlier authorities (including *Konigsberg* and *Cook*), Arnold J also rejected that argument.

Shlosberg in the Court of Appeal

23. The trustees appealed to the Court of Appeal. In addition to reasserting that the documents and any privilege attaching to the information contained therein were "property" which vested in them on their appointment taking effect, they further argued that it is a necessary implication of s.311 IA that trustees are entitled to use privileged documents for the purpose of their functions and powers. The Court of Appeal rejected those arguments, holding that:
    a. privilege is not property of a bankrupt which automatically vests in the trustee in bankruptcy. The bankrupt could only be deprived of privilege if the IA expressly so provides or it is a necessary implication of the express language of its provisions. The relevant provisions (ss. 283, 306 and 436) do not expressly treat privilege as property of the bankrupt which automatically transfers from the bankrupt to the trustee and that is not a necessary implication of those provisions;
    b. the decision in *Konigsberg* was incorrect insofar as it was considered that privilege devolved on the trustee in bankruptcy;
    c. whilst s.311(1) IA entitles the trustee in bankruptcy to take possession of documents which include privileged information for the overriding function of getting in, realising and distributing the bankrupt's estate, and to look at the documents to obtain information relevant to those matters, the provision does not entitle the trustee to waive the bankrupt's legal professional privilege in taking steps against third parties for the benefit of the bankrupt's estate.

24. In consequence, the Court upheld Arnold J's decision to grant an injunction requiring the solicitors to cease to act for the petitioners.

Re Lemos: the nail in the coffin?

25. The Court of Appeal's decision in *Shlosberg* inevitably led to concern as to the use that could be made by trustees of privileged material and it did not take long for the issue to return to court.

26. In *Lemos*, trustees in bankruptcy were in possession of privileged documents which were likely to be useful as evidence for the purposes of a s.423 claim in respect of a property worth approximately £16.5m which had been transferred to an offshore trust. The bankrupt and his wife refused to waive privilege in those documents. The trustees applied for directions and the issues for determination were as follows:
    a. were the trustees entitled to deploy the privileged documents in s.423 proceedings without the consent of the bankrupt and/or his wife?
    b. if not, could the bankrupt be ordered to waive his privilege pursuant to s.333 and 363 IA?

27. As to the first issue, the trustees argued (somewhat courageously) that the decision in *Shlosberg* confirms that a bankrupt's privilege in documents that relate to assets (but not liabilities) of the bankrupt's estate devolves upon the trustee. In doing so, they relied on the decision of Arnold J in relation to the first category of documents which (it was said) was not challenged on appeal. As

noted above, that decision had not been the subject of adversarial argument and Arnold J had expressly recorded his reservations in relation thereto.

28. Having carefully analysed the decisions in *Shlosberg*, HHJ Hodge QC (sitting as a Judge of the High Court) concluded that the Court of Appeal had overruled *Konigsberg* for all purposes, that the *Crescent Farm* principle has no continuing application in bankruptcy cases and, accordingly, that a trustee in bankruptcy does not automatically step into the shoes of a bankrupt in relation to privileged documents even if they affect assets of the bankrupt. He further held that the *Crescent Farm* principle could not, in any event, have any application to documents relating to property which is the subject of a s.423 claim. This is because such property cannot property be characterised as forming part of the bankrupt's estate.

29. As to the second issue, the trustees argued that since: (i) s.333 imposes an obligation upon a bankrupt to co-operate with his trustees in the fulfilment of their functions to the extent that the trustees may reasonably require; and (ii) s.363(2) enables the court with supervisory jurisdiction over the bankruptcy to compel such compliance, the Bankruptcy Court can compel a bankrupt to waive his privilege. HHJ Hodge QC rejected that argument. He noted that in *Horton v Henry*[14] the Court of Appeal had rejected the argument that these provisions enabled the court to compel a bankrupt to exercise the right (which, by operation of the relevant pension legislation, remain vested in the bankrupt) to elect to drawdown a pension to enable the trustee to obtain an income payments order against him. He held that the right to privilege is such a fundamental principle that only an express power in s.363(2) itself would confer jurisdiction to order waiver of privilege and that even if the court did have such jurisdiction, it was difficult to envisage any circumstances in which the court would exercise it.

30. Thus, the trustees' generic application was dismissed. However, it is important to note that they were not precluded from subsequently making a more focussed application in respect of specific identified documents on the grounds that those documents fell within the iniquity exception.

Practical consequences for Trustees

31. In *Lemos,* the trustee argued in portentous terms that if (as HHJ Hodge QC ultimately found) the decision in *Shlosberg* prevented him from using privileged documents without the consent of the bankrupt (which consent was unlikely to be forthcoming) this would have "far-reaching consequences for the insolvency industry as a whole". He gave the following five practical examples of ways in which he alleged that the proper administration of bankruptcy estates would be hampered:
    a. trustees will be unable to disclose details of their investigations to any creditors who are funding the bankruptcy process where such details would reveal information contained within privileged documents. That would naturally lead them to question the status of investigations, the benefit of such investigations and why such creditors should continue funding the process and the trustees' role within it;
    b. when interviewing any third party, trustees will be unable to refer to any information contained in privileged documents. This will make such an interview process much more difficult and could ultimately render it useless to the bankruptcy process;
    c. trustees might also be unable to disclose relevant privileged information to third party funders who might otherwise be interested in funding a claim in relation to the bankrupt's estate. Without such information, which might be key to the basis for a claim, such funders might be likely to lose interest;
    d. if asked to adjudicate on a creditor claim, and the trustees have seen privileged documentation which proves that a creditors' claim is wholly or partly without basis, they

[14] [2016] EWCA Civ 989, [2017] 1 WLR 391

might be unable to evidence the reasons why they are rejecting that claim, and in defending any appeal against their decision;

e. if a privileged document reveals an asset in the bankruptcy estate, trustees will be unable to use that document to further their investigations into that asset, and accordingly that could prevent that asset from being realised for the benefit of the bankrupt's creditors.

32. Whilst the decisions in *Shlosberg* and *Lemos* are unhelpful and will undoubtedly increase the need for trustees to seek guidance from the court before exercising their powers in order to avoid inadvertently breaching the bankrupt's human rights, the authors do not necessarily consider that the position is as bleak as the submissions in *Lemos* suggest.

33. This is because whilst trustees are prima facie prevented from taking any steps which would have the effect of waiving the bankrupt's right (solely or jointly) to privilege that does not mean that the trustees cannot derive any useful benefit from the privileged information. For example, if a privileged communication recorded in a document reveals the existence of a previously unknown bankruptcy asset, the trustee may be able to seek further information about that asset from other sources using the extensive investigatory powers conferred by the Insolvency Act without needing to allude to the privileged communication.

34. Nevertheless, it is arguable that trustees are not permitted to share privileged material with any third parties, even on confidential terms, because this would clearly amount to a waiver of privilege as between the trustees and those parties unless it is possible to rely on common interest privilege[15] and it will therefore be necessary to find pragmatic solutions to this problem which do not infringe the bankrupt's fundamental rights.

35. These problems and solutions will be explored in detail at the Seminar through the case study.

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[15] See *Buttes Gas and Oil Co -v- Hammer (No. 3)* [1981] QB 223.