

Dispute Resolution Bulletin

Winter 2008/2009



Welcome to the latest edition of our bulletin.

Our lead article reports on the concept of privilege and the impact this can have on litigation proceedings. In the current financial climate, we are seeing an increasing number of director and shareholder disputes and questions as to what documents can be protected by privilege is a complex one in such disputes.

Elsewhere we look at the issue of full and final settlement of a claim and what measures can be taken to ensure a payment really does finalise a dispute. Joshy Thomas also provides an update on matters recently dealt with by our intellectual property dispute resolution team.

If you would like advice on any of the issues covered in this newsletter or another aspect of dispute resolution please contact Victoria Brackett on 01293 742818 or victoria.brackett@thomaseggar.com

Privilege... is nothing sacred?

As the current financial climate worsens companies are revisiting decisions with the benefit of hindsight.

Directors or shareholders who often failed to receive any benefit (and may in fact have been prejudiced) are taking action against those who may have taken those decisions in good faith when the financial outlook was looking better.

In addition to this, the new Companies Act 2006, in pursuance of the government policy of "enlightened shareholder value" has enhanced the ability of shareholders to question the management of the company and obtain greater access to information. There is now less of a bar to a person bringing an action, either as a shareholder in his or her own right or in the shoes of the company.

As a result we have seen over the course of the last few months a steady increase in internal company disputes and litigation taking place between directors, shareholders and the companies.

In circumstances where the likelihood of internal company litigation is increasing and the duties with which directors are bound to comply are becoming stricter it is worth considering the issues of what may and may not be produced in proceedings involving directors, shareholders and the company itself.

Basic Privilege principles

During Court proceedings there is a stage in the process called "disclosure". At this point the parties are under an obligation

to provide or "disclose" to the other parties all documents relevant to the issues in dispute. In particular: all documents on which the party relies; all documents which adversely affect the party's case; all documents which adversely affect the other party's case; and all documents which support the other party's case.

On this definition all legal advice could be discloseable to the other party, including advice on what actions to take, merits of the claim and so on. The difficulties that could arise in this situation are obvious, no party would ever set out in writing any information that conflicted with its case and so the principle of privilege exists where documents which are considered "privileged" do not have to be disclosed to the other parties in the litigation proceedings.

There are two main categories of privilege:

- (a) legal advice privilege; and
- (b) litigation privilege.

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Legal advice privilege covers correspondence between a lawyer and their client for the purpose of obtaining legal advice. Litigation privilege is more restrictive in that it covers the legal advice given to a client by their lawyer in circumstances where proceedings are being contemplated or the purpose for which the documents are prepared is used in litigation proceedings.

Waiver of Privilege

It is also important to remember that the duty to disclose non-privileged documentation is a continuing one. Whilst a document may start out life as privileged there are circumstances under which that privilege may be waived, for instance if a client chose to share their legal advice with a third party there is a real risk that privilege in that legal advice has been waived (and must therefore be provided to the other side in the proceedings).

The “Client” under Three Rivers

In the case of *Three Rivers v BCCI* the definition of “the client” came under close scrutiny. In smaller, owner managed companies a lawyer’s “client” is quite easy to define. Generally the person dealing with the lawyer, providing the instructions, the information required, receiving the advice and taking the decisions in the litigation is often one and the same.

However, in larger companies it was argued that “the client” did not constitute the whole company entity, its employees and its legal counsel. Instead it was argued that “the client” is a strictly defined, contained group within the company, the “inner circle”. It was held that between the lawyer and the inner circle; and between the company in-house legal counsel and the inner circle; privilege would be upheld. However, where documents had passed between the inner circle and the rest of the company (i.e. within the company) either no privilege existed or privilege had been waived. Further, communication

between the rest of the company (i.e. not the inner circle) and either the in-house counsel or the company’s lawyers would also be unlikely to be privileged although privilege in this regard would depend on the facts in the case of each document.

Intra-company proceedings

With the introduction of codified directors’ duties and the strengthened principles of enlightened shareholder value under the Companies Act 2006 there has been an increase in intra-company proceedings such as disputes within the board, disputes between the board and shareholders and disputes between shareholders.

Privilege in intra-company disputes is construed more strictly by the Courts and as such documents that in proceedings between unrelated parties would not be discloseable may in fact be provided to the other side.

The main categories of intra-company litigation are:

- (i) shareholder disputes;
- (ii) derivative actions; or
- (iii) claims in which the claim is made against the company itself, such as employment claims.

Shareholder disputes are typically brought by a shareholder or a group of shareholders because they have been prejudiced in some way. Typically these claims are brought under the provisions of either s994 Companies Act 2006: that the company is being run in a manner which is unfairly prejudicial to the members (or a group of members) interests; or s122 (g) Insolvency Act 1986: a petition for the winding up of the company on the grounds that it is just and reasonable for the Court to make that order.

Derivative actions are brought by a shareholder on behalf of the company (often against the company’s management) because the management that control the company will not direct the company to bring a claim. The Companies Act 2006 has brought in a

new two-step derivative action procedure. The shareholder must first obtain the permission of the Court to bring the proceedings on the behalf of the company. Once the shareholder has shown it has a valid claim the Court will allow the claim to proceed and the shareholder must show whether the company should now take over the claim or the shareholder should continue to pursue the claim on the company’s behalf.

The claims made directly by or against the company are more straightforward (such as debt claims and employment claims) and bear greater resemblance to normal contractual disputes between non-related parties, however due to the relationship these are considered to be an intra-company proceeding.

In order to determine whether documents, which may ordinarily be classified as privileged, should be disclosed in intra-company proceedings the context of the litigation contemplated must be considered. If a claim is considered “non-hostile” from the perspective of the company then the claimants are entitled to sight of usually privileged company documents. If the proceedings are considered “hostile” then the company is entitled to withhold the documents from disclosure under the privilege principles.

Hostile litigation

Claims made directly by or against the company are considered “hostile” because the company is actively





participating in proceedings. As such it should be afforded the same level of entitlement to legal protection as the party with whom it is engaging and normal privilege principles should apply.

Non-hostile litigation

Shareholder disputes and derivative actions are both considered to be “non-hostile”. In these types of claim, although involved by necessity of procedure, the company will effectively take a neutral position.

As such the normal privilege principles do not necessarily apply. In derivative claims it is in the company’s interest (although not necessarily the management’s) for a claim to succeed. In a shareholder dispute the company should not take sides and the doctrine is that if the legal advice relating to a company’s property was paid for out of company funds it is the common property of shareholders. They are therefore entitled to sight of these documents.

In such wide circumstances even advice prepared in contemplation of litigation may not be privileged and a number of recent decisions by the Courts have upheld this position.

Why is this relevant?

Due to the relatively recent enactment of the Companies Act 2006, the impact of the provisions regarding directors’ duties which have been brought in under this legislation are yet to be fully realised.

Notwithstanding the lack of Court decisions, it is clear that with the first codification of directors’ duties there is, at least in theory, a greater risk that a director’s actions may be a breach or potential breach of duty. At the same time the Companies Act 2006 has created a procedure under which it is easier to bring a claim against that director.

The advice the directors are being provided with in relation to compliance with their duties is to seek advice on potential issues of conflict as soon as possible in order to minimise risk. In such grey areas it is unlikely that any advice will be unequivocal. The risk is therefore that the advice the company (and thereby the directors, although see below paragraph) receive throughout this process to the issue of proceedings are not privileged and must be disclosed to the other side.

In some circumstances where the directors (perhaps as well as the company) are the recipient of the legal advice they may also be considered the solicitor’s clients for the purposes of privilege. In this situation it is possible to argue that normal privilege principles are re-applied as the claim becomes “hostile” since the directors are unlikely to take up a neutral position in relation to proceedings or agree to privilege being waived.

Therefore, in order to avoid disclosure of documents in subsequent proceedings where the documents created were believed or intended to be privileged, practitioners and clients alike need to carefully consider when dealing with potentially contentious issues of company law:

- The areas of potential conflict and the parties involved;
- Who is the client?
- To whom the advice is being provided? and
- In what circumstances or for what purpose is the advice being prepared?

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Newsbrief

Intellectual property update

The intellectual property dispute resolution team have been working for a number of different clients in relation to disputes arising from the ownership of intellectual property rights, including:-

1. Advising a website owner on copyright infringement of their website by a local competitor, and writing a letter for action to that competitor that resulted in the immediate “taking down” of the infringing site and a full apology.
2. Advising a patentee (owner of the patent) on their rights under a patent licence including dealing with the issue of whether a product infringed the patent, and with wider issues of registered design right infringement and know-how.
3. Advising on copyright infringement relating to a magazine publication.
4. Advising the owner of a database regarding the infringement of its database, and dealing with breaches of the Computer Misuse Act 1990.
5. Dealing commercially with a potential entitlement before grant action before the Comptroller at the UK Intellectual Property Office by negotiating a settlement involving a Co-development Agreement between the parties.

For further information please contact Joshy Thomas (023 8083 1231) joshy.thomas@thomaseggar.com

Full and final settlement – is it really the end of the matter?

In the current economic climate more and more businesses are turning to litigation, or other forms of dispute resolution, to pursue money they are owed.

In many cases claims can be settled by offering less than the full value of the claim as businesses facing cashflow problems may be happier to accept less than the full amount claimed if it means that they will receive it sooner and it removes the risk of their taking the matter to Court. An important consideration, however, is whether a party on receiving and banking monies purportedly paid to them in full and final settlement is obliged to treat it as such.

In *Stour Valley Builders v Stuart*, the Court of Appeal held that where a Claimant accepts and banks a payment by cheque (although the same applies to other methods of payment) and only after it has cleared informs the Defendant that they will not accept the money in full and final settlement, it may be allowed to pursue the remainder of the amount owed. This is in direct contrast

with the position in the United States whereby if one party banks a cheque sent on the understanding that it is in full and final settlement it cannot then continue to pursue a claim for the remainder.

What therefore do you need to do to ensure that your payment made in full and final settlement really does finalise the dispute? Alternatively, as a recipient, what should you be on the lookout for?

The Court of Appeal in *Stour Valley Builders v Stuart* held that the key factor in deciding whether a payment is made in full and final settlement is the intention of the receiving party. The intention must be to accept the payment in satisfaction of the dispute for there to be a binding contractual settlement. When sending payment intended as full and final settlement although there is a

presumption that the cashing of this payment gives effect to this intention, this presumption is easily rebutted.

The presumption is more difficult to rebut where the payment is made by the payor:

- Addressing the letter to a specific person and indicating on the envelope it is to be opened by the addressee only
- Marking on the envelope that it contains a payment in full and final settlement of a dispute and that the payment should not be cashed until the contents of the accompanying letter have been considered
- Forewarning the addressee that the letter and payment are being sent.

If, as recipient, you receive payment by this means you should ensure that you respond promptly, if possible before banking the payment, stating that you accept the payment but that you consider it sent on account only.

For further information please contact Louise Ervin (023 8083 1232) louise.ervin@thomaseggar.com

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