The Shareholder Rule and privilege in company disputes

Briefing Summary: In this briefing, Guernsey partner Tim Corfield and counsel Elliot Aron look at the latest developments in relation to the Shareholder Rule, practical implications, and disputes concerning former directors.

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The application of the rules in relation to legal advice privilege, in the context of company disputes, has long given rise to interesting questions. Companies do, of course, have separate legal personality and the privilege in legal advice obtained by a company vests in the company itself. At the same time, however, companies must always act through human agents, i.e. the directors; and companies with shares will have shareholders with rights in relation to, and an interest in, the company. Whilst it is clear that companies can assert privilege in their legal advice as against the outside world, there has been historic uncertainty in relation to a company's ability to assert privilege as against: (1) the company's shareholders; and (2) a company's former directors.

In relation to the former scenario, for over a century, the "Shareholder Rule" has meant that companies could not assert legal advice privilege as against the shareholders in disputes with them. Put simply, that was because shareholders are the owners of the company; as owners, they could be regarded as having effectively paid for the advice and, accordingly, should be entitled to see it on that basis. The Privy Council in *Jardine Strategic Limited v Oasis Investments II Master Fund Ltd and 80 others (No 2) (Bermuda) [2025] UKPC34* has, however, recently held that the Shareholder Rule is unjustifiable and should no longer be applied by the courts of England and Wales.

Whilst Guernsey companies' law has certain differences from the law of England and Wales, and the courts of Guernsey are always free to forge their own path in a principled way, it is highly likely that the Guernsey courts will adopt the Privy Council's rationale for abolishing the Shareholder Rule.

So far as the latter scenario is concerned, there is only limited – and conflicting – authority on how the courts should deal with documents privileged in the company's hands in circumstances where the company is in dispute with former directors who claim an entitlement to see the advice in question. Uncertainty in this area will, therefore, continue for the foreseeable future.

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The Shareholder Rule

In ***Jardine,*** the Privy Council examined the origins of the Shareholder Rule, analysing early case law from the nineteenth century, and found the original justification for the Shareholder Rule to be that the shareholders, as the owners of the company's funds, had paid for the legal advice and were therefore entitled to see it (in other words, they had a proprietary interest in it). However, that rationale was given short shrift by the Privy Council, given it was "***wholly inconsistent***" with the separate legal personality of companies also established in the nineteenth century (the so-called rule in ***Foss v Harbottle***).

In addition to the categoric rejection of the notion of shareholders having a proprietary interest in a company's legal advice, the Privy Council also had to consider submissions from the dissenting shareholders to the effect that a joint interest privilege between shareholders and the company should be found to apply in circumstances where the interests of a company and its shareholders are aligned. The submissions placed a particular emphasis on solvent companies, where it was argued that there will usually be alignment between companies and the shareholders, since improving a company's share price is good for both the company and its shareholders. Perhaps unsurprisingly, the Privy Council rejected those submissions as a gross over-simplification; both as between different shareholder camps, as well as the company's position, with companies having a far-wider group of stakeholders and objectives to consider – especially in litigation. In addition, any rule based on a fact-sensitive test of whether there was, in the particular circumstances in question, an alignment of interests between the company and its shareholders would be entirely unsatisfactory so far as legal certainty is concerned. Put simply, no company would ever be able to obtain legal advice in the certainty that it would not need to be disclosed to shareholders.

Accordingly, the Privy Council has now decisively rejected the Shareholder Rule (or alternative concepts), likening the existence of the doctrine to "***the emperor wearing no clothes in the folktale***". It is now confirmed that the Shareholder Rule no longer forms part of Bermuda law and "***ought not to continue to be recognised in England and Wales***". By extension, and given the same underlying rationale would apply equally to Guernsey companies, it is highly likely that the Guernsey courts would follow the same approach.

Practical implications

The decision matters for all parties involved in a corporate dispute:

- directors can now engage in frank discussions with legal advisers, knowing that privilege will be protected;
- there is certainty for shareholders too, who will no longer be able to seek to rely on the Shareholder Rule to access privileged advice. Shareholders may need to alter their litigation strategies in order to overcome the information disadvantage, and should consider framing the issues in a way which maximises pressure on companies who are unwilling to waive privilege in their legal advice in the context of such disputes; and
- there is greater coherence to this area of the law, consistent with a company's separate legal personality.

Disputes concerning former directors

A related issue arises in the context of disputes between companies and former directors. It is not unusual, particularly for companies in liquidation, to pursue claims against former directors for breaches of duties or other misfeasance in office. In that situation, any legal advice previously obtained by a company, that remains privileged in the company's hands, may be relevant to the issues in dispute. Moreover, the former director, on account of being the company's (human) agent at the time the relevant advice was obtained, may not only be aware of the advice in question and/or its contents, but may also continue to hold a copy of the advice in question.

In this situation, from the company's perspective, it is likely to seek to argue that the legal advice in question was obtained by the company; that privilege in the advice has not been waived; and therefore that any former directors, irrespective of whether they are aware of the advice and/or continue to hold a copy of it, are not entitled to breach confidentiality or waive the company's privilege in the advice. From the former director's perspective, she will likely argue that it is wholly artificial and improper to deny her the ability to rely upon the advice in question where relevant to the issues in dispute, in circumstances where she is aware of its existence and/or contents.

Contrary to the jurisprudence concerning the Shareholder Rule, there has been remarkably little judicial consideration given to this situation, including in Guernsey. There is first instance authority in ***Derby & Co Ltd v Weldon (No.10) [1991] 1 W.L.R. 660*** to the effect that privilege cannot be claimed by a company, C, against a former director, D, in circumstances where D has seen B's privileged advice whilst acting as B's director. There is also some Australian authority to the effect that former directors in litigation against a company were entitled to disclosure of privileged documents of the company to which they would have been entitled to access in the course of their tenure as directors.

The settled position is, however, far from clear. As ***Documentary Evidence by Hollander*** suggests, one analysis that could be made in the light of ***Berezovsky v Hine & Ors [2011] EWCA Civ 1089*** is that a disclosure by a company, C, to its employee or director, D, is a form of limited waiver such that D was shown the privileged document for the purposes of her employment or directorship only. If that is the correct analysis, it may follow that it would be unfair to let D use the document for a different purpose from that for which the disclosure was made by C. In addition, there will be other considerations for the court to grapple with in this context: for example, if the effect of a former director being able to rely upon company advice in proceedings is that the privileged advice enters the public domain, the consequences may be far-reaching indeed.

It has taken many years for clarity to be obtained in relation to the Shareholder Rule. There may yet be a long wait for further clarity in relation to the disputes with former directors. Companies should always proceed carefully when obtaining legal advice and seeking to preserve privilege in it, and in connection with any corporate disputes.