LEGAL PROFESSIONAL PRIVILEGE UPDATE

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Two recent decisions of the NSW Supreme Court on legal professional privilege illustrate the application of sections 118 and 119 of the Evidence Act 1995 (NSW) and highlight some steps that should be taken to increase the prospect of attracting privilege for audit letters and for expert reports.

SOLICITOR'S AUDIT LETTERS HELD NOT TO ATTRACT PRIVILEGE

In 789TEN Pty Ltd v Westpac Banking Corporation [2005] NSWSC 123, Westpac Banking Corporation ('the bank') sought an order preventing 789TEN Pty Ltd ('the company') from having access to certain documents produced on subpoena by accounting firm KPMG on the basis that those documents were privileged.

There was a dispute concerning some correspondence and a report prepared by KPMG which largely turned on its facts, but the most significant aspects of the decision are Justice Bergin's findings in relation to the audit letters. The documents produced by KPMG included:

- a letter dated September 2004 from the bank to its solicitors, Henry Davis York (HDY), requesting it to communicate directly with the bank's auditors (PwC) ('the audit query letter'); and
- a letter from HDY to PwC dated October 2004 ('the audit response letter').

The bank maintained that the audit query letter and audit response letter attracted the litigation privilege under s119 of the Act. In the audit query letter, the bank asked HDY to provide certain information to PwC in connection with the bank's audit, including details of the company's claim. The audit response letter provided the information requested.

The parts of the letters at the heart of the claim for privilege were standard audit queries referring to the directors' 'estimate' of 'any financial settlement (including costs and disbursements)' that 'might be incurred' in relation to the company's claim and HDY's opinion as to whether that estimate is reasonable. The bank submitted that the estimation by HDY of the bank's potential liability, having regard to the estimation made by the directors, was fundamentally connected to the proceedings. It submitted that the process of confirming whether the directors' estimate was reasonable was the provision of a professional legal service and that such service was 'relating to' the proceedings.

Justice Bergin accepted that the provision of a legal opinion as to whether the estimate of a possible settlement is reasonable in all the circumstances is the provision of 'professional legal services'. However, the real question is whether the letters were prepared for the dominant purpose of providing legal services relating to the proceedings. She looked at the letters as a whole and concluded that the dominant purpose of the letters was to provide information to the auditor for the purpose of assisting the auditor and the bank with the audit process. The claim for privilege under s119 in relation to the audit query letter and audit response letter failed.

Justice Bergin also considered the application of s118 in relation to the audit letters. Section 118 prevents disclosure of a confidential communication made between a client and his lawyer, between two or more lawyers acting for the client or a confidential document prepared

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by the client or lawyer, for the dominant purpose of the lawyer providing legal advice to the client.

Section 117 of the Act defines 'client' for the purposes of the Act as including 'an agent of the client'. The bank submitted that PwC was its agent and that agency should be implied from the contents of the letters and the surrounding circumstances. Justice Bergin considered the duties and function of an auditor and held that

... the fact that the Corporations Act requires an auditor to be independent of the audited company weighs against the implication that an auditor stands in the shoes of the audited company as its agent in receiving information from third parties about the company.

She concluded that PwC was not acting as the bank's agent when it received the audit response letter; rather PwC received the audit response letter as an independent auditor.

It followed that the legal advice privilege did not apply to the audit query letter, as it was not prepared for the dominant purpose of HDY providing legal advice to the bank.

IMPLICATIONS

This main significance of this decision is that it shows that, when audit queries are raised in relation to contingent liabilities in the financial accounts of a company (generally relating to actual or threatened proceedings), a company is at risk if it allows its solicitors to deal directly with the auditors. The better course, for the protection of any privileged communications, as suggested by Justice Bergin in her judgment, is for the solicitors to advise the client and for the client to prepare the letter excluding privileged material and ensuring its protection. However, this may not always be practicable or acceptable to the auditors. At the very least, the solicitor's letter should be provided primarily to the client and copied to the auditor. It cannot be certain that this will ensure protection of the privilege.

One issue that was not raised in this decision was whether disclosure to the auditor is a disclosure under compulsion of law. That is a possible further basis for protecting audit letters.

EXPERT RETAINED BY SOLICITORS ON BEHALF OF INSURER—REPORT HELD NOT TO ATTRACT PRIVILEGE

In Re Southland Coal Pty Ltd [2005] NSWSC 259, there was an application to set aside summonses for examination issued under s596B of the Corporations Act, including orders for production, which were served on various officers of the QBE insurance group and expert consultants retained by them.

QBE was the insurer of Southland Coal Pty Ltd (Southland) in respect of a coal mine in the Hunter Valley, NSW. A spontaneous combustion incident at the coal mine in December 2003 led to Southland and its joint venture partner, Thiess Pty Ltd (Thiess), making various claims against QBE under the relevant policies. In January 2004, on becoming aware of the incident, and before formal claims had been lodged, QBE's solicitors retained the consultants against whom summonses had been issued to report on the incident and alleged loss. Since that time, there had been negotiations between QBE and the insured and no litigation had been commenced by Southland, although Thiess commenced proceedings against QBE in December 2004.

The applicants (the persons summonsed) argued that the summonses should be set aside on the basis that they were an abuse of process and oppressive, and the material sought to be obtained was protected by privilege. Chief Justice Young considered that, leaving aside the privilege question, the summonses were not an abuse of process and there was no oppression. Chief Justice Young went on to consider the question of privilege.

THE DECISION

The documents sought included documents prepared by two of the experts retained by QBE's solicitors for Southland's claims. The question was whether s118 (legal advice) and s119 (litigation) of the Act applies to these documents.

The applicants argued that the nature of the functions of the experts after the December 2003 incident was an integral part of the process of QBE obtaining legal advice as to its position. QBE needed to supply its lawyers with the facts in order to gain appropriate advice.

However, Chief Justice Young observed that it was the solicitors, not QBE itself, who commissioned the expert report and the solicitors asked the experts to report direct to them so that they could provide advice to QBE.

Chief Justice Young considered that, as QBE's solicitors merely obtained general instructions to do what was in their view required to protect QBE, and they retained loss assessors and other experts on their own initiative based on previous experience with such incidents, the documents were not privileged under s118. Chief Justice Young refused to extend the s118 legal advice privilege to situations 'where the solicitor, acting within general instructions, of his or her own initiative seeks a report from an expert'.

Chief Justice Young then considered whether the experts' documents or their evidence would attract litigation privilege under s119 of the Act. This depended on whether the documents were created or evidence was communicated for the dominant purpose of use in, or in relation to, litigation that was either in existence or at least anticipated or in reasonable contemplation. At the time the documents were created or evidence was communicated, there was litigation on foot between Thiess and QBE but not between Southland and QBE. The question was whether there is a 'real prospect' that litigation will occur. This meant more than just a mere possibility of litigation. In January 2004, when the experts were retained, it was unlikely that there was a real prospect of litigation.

Chief Justice Young accepted that the probabilities were that, even if some documents in the hands of the proposed examinees were privileged, there will be some documents not in that category about which examinees may be questioned. He held that, in those circumstances, 'the appropriate course is for the examination to proceed and for the person before whom the examination is held to rule on privilege question by question, document by document'.

IMPLICATIONS

While each case must turn on it facts, this decision shows that in cases where the solicitor, acting within general instructions, of his or her own initiative seeks a report from an expert, that report may fall outside legal advice privilege. In order to assist in attracting privilege, in circumstances where an expert's report is required by solicitors in order to advise their client, the client should retain the expert itself for the express purpose of providing assistance in relation to the provision of legal advice, or specifically instruct the solicitor to retain the expert for that purpose.

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