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Protecting Client Privilege During UK Regulatory Investigations: A Cautionary Tale from the UK's Audit Regulator

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On June 10, 2020, Mr Justice Trower, sitting in the English High Court, handed down his judgment in *A v B [2020] EWHC 1491 (Ch).* The judgment addressed the treatment of privileged documents that had been disclosed to an auditor by their clients under a limited waiver, with a finding that it was for the auditors (and not their clients) to decide, objectively, if the relevant materials could be withheld on the grounds of privilege, or should be disclosed to the Financial Reporting Council.

The judgment has implications for communications between clients and their auditors, and the practicalities associated with the sharing of privileged information in connection with audits and audit procedures performed in the United Kingdom.

Overview of the decision

These proceedings arose out of an investigation conducted by the Financial Reporting Council (the "**FRC**") into the 2018 audit of a company, 'A', carried out by its former auditor, 'B' (the "**Audit**"). The FRC's investigation was conducted pursuant to its powers under the UK's *Statutory Auditors and Third Country Auditors Regulations 2016* ("**SATCAR**"). As part of the investigation, the FRC required the provision of documents held by B, relating to the Audit. While non-compliance with an FRC production request is an offence, under the provisions of SATCAR, there is no failure to comply if a relevant document is withheld on the grounds of legal professional privilege.[1]

In response to the FRC's instruction to B, company A asserted privilege in respect of some of the requested documents, claiming that these materials were only in B's possession for the purpose of the Audit, on the basis of a limited waiver of privilege (meaning that the privileged information had been shared with the auditor for the limited purpose of the Audit, under strict confidentiality requirements, such that any privilege was preserved, as is permitted by English law). B disagreed with A's assertion of privilege in respect of six documents. A sought a declaration from the Court that B was bound to withhold production of the documents on the basis of A's assertion of privilege alone. Both B and the FRC disagreed, arguing that an auditor is entitled to make its own assessment of privilege in respect of documents that it holds.

Trower J refused to make the declaration sought by A[2] and held that whether a document is protected by privilege is a matter of fact and law that is unaffected by any assertions made by the parties.[3] As B was the party under the obligation to provide the requested documents, it was for B to determine whether or not it was entitled to withhold any or all of them on the basis of privilege.[4] Moreover, the declaration sought by A was incapable of resolving the dispute; only a decision on the privilege status of the six specific disputed documents could do that. As such, a declaration was deemed an inappropriate remedy.[5]

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Additionally, the Court offered guidance on the proper approach to resolving a dispute between an auditor and client (or indeed the FRC) as to the privileged nature of documents:

- If the client disagrees with the auditor's privilege decisions, it remains open to the client to issue proceedings to restrain the use of the privileged documents in the usual way.[6]
- In the event that an auditor discloses client documents to a regulator that are in fact privileged, and depending on the arrangements between the parties, the auditor could be exposed to risk of liability to its client for breach of its right to privilege.[7]
- If the FRC disagrees with a privilege assertion by the auditor, then it can proceed against the auditor for non-compliance with the request, under the SATCAR enforcement regime.[8]

It remains to be seen if this decision will be appealed, and/or if this approach will be upheld in a broader regulatory context, beyond the confines of an FRC investigation.

Implications

For a company's in-house counsel, the challenge of ensuring cooperation and transparency with auditors as they fulfil their day to day role, while at the same time seeking to protect and preserve legal professional privilege over the company's sensitive legal material, will not be new.[9] This decision underscores the importance of how clients and their auditors navigate this delicate balance, particularly in the context of regulatory investigations.

Despite the objective nature of legal professional privilege, Trower J acknowledged in his judgment the existence of a potential tension between the interests of an auditor and its client in the context of a regulatory investigation. Rejecting the principle that an auditor should unquestioningly accept its client's view on privilege when responding to its regulator's request, it was noted that an auditor "*has interests of its own to protect*"[10] and as such may "*wish to ensure that the FRC has access to the maximum amount of information*".[11] Against that backdrop, the following considerations are relevant.

Firstly, the importance, when sharing information pursuant to the English doctrine of limited waiver, of ensuring only clearly privileged documents are physically shared with auditors during day to day interactions. The likelihood of auditor-client disagreements over privilege will be reduced if the documents shared are indisputably privileged. Where alternative means of sharing information are acceptable (for example, through briefings or in person review of documents), these should be considered.

Secondly, the significance of a constructive and pre-emptive dialogue between auditors and their clients on questions of privilege. The parties should seek to reach a common understanding as to the privileged status of materials as early as possible, before such materials are passed over to the auditor, and it may be appropriate to document this understanding in a memo. As this decision makes clear, the independent obligation of the auditor to produce documents during a regulatory investigation should motivate the client to seek to protect its claims to legal professional privilege from the outset of the engagement. Similarly, it would seem beneficial for the auditor to seek to understand at the outset the client's perspective on the privileged status of their materials. Parties may also wish to consider the extent to which the terms of any limited waiver of privilege, and arrangements for notice of disclosure to regulators, could be addressed in their terms of engagement. However, the English courts may be hesitant to construe the terms of an engagement letter as requiring an auditor to be bound by its client's views on privilege. As noted by Trower J, such an agreement would need to be expressed in "*clear words*".[12]

Thirdly, the ramifications for audits of multi-national companies which include a UK

component. Audit work papers are generally retained by each firm that performs audit procedures, including by UK auditors performing work on the UK-based subsidiaries of international clients. Such clients may be used to different legal rules concerning the assertion of privilege in audit work papers, such as the common practice in the United States of auditors deferring to the legal assertions of their clients. Non-UK companies whose legally privileged information may appear in the work papers of their UK-based auditors that perform audit work on subsidiaries of those non-UK companies should be mindful of how this decision may impact assertions of privilege over relevant material in the UK.

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[1] *SATCAR*, Schedule 2, paragraph 1(8).

[2] *A v B* [2020] EWHC 1491 (Ch), paragraph 60.

[3] *Ibid*., paragraph 67.

[4] *Ibid.*

[5] *Ibid*., paragraph 63.

[6] *Ibid*., paragraph 72.

[7] *Ibid*.

[8] *Ibid*., paragraph 71.

[9] See, by way of illustration, the obligation to cooperate with auditors in *SUP 3.6.1 R, FCA Handbook* and the protections afforded to privileged documents by Section 413, *Financial Services and Markets Act 2000*.

[10] *Ibid*., paragraph 70.

[11] *Ibid*.

[12] *A v B* [2020] EWHC 1491 (Ch), paragraph 69.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these developments. For additional information, please contact the Gibson Dunn lawyer with whom you usually work, or the following authors:

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