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A privileged position? The extent to which privileged documents held by a bankrupt transfer to his trustee in bankruptcy: *Shlosberg v Avonwick*

KEY POINTS

- Privilege does not always automatically transfer to the trustee in bankruptcy.
- Ownership of a document does not necessarily entitle the holder to the privilege recorded within the document.
- Privilege is likely to pass where the privilege relates to assets which pass to the trustee in bankruptcy.

INTRODUCTION

This article examines the recent judgment of Mr Justice Arnold in the case of *Shlosberg v Avonwick Holdings & Ors* [2016] EWHC 1001 (Ch) which represents a shift in the law as to whether a trustee in bankruptcy ('TIB') is entitled to documents in the hands of a bankrupt which are subject to legal professional privilege.

An application was brought by Mikhail Shlosberg, a bankrupt, against his main creditor Avonwick Holdings Ltd ('Avonwick'), his joint TIBs ('the Trustees') and his former legal representatives Dechert LLP ('Dechert'). Mr Shlosberg sought an order that, as his former solicitors, Dechert should cease acting for both Avonwick and the Trustees on the basis that they held documents in relation to which Mr Shlosberg was entitled to assert legal professional privilege.

BACKGROUND FACTS

Mr Shlosberg is a Russian businessman who held the beneficial interest in Webinvest Limited ('Webinvest'). In early 2010 Mr Shlosberg wished to invest in a company called Vimetco NV ('Vimetco') whose shares would be de-listed in London and re-listed in Hong Kong to increase their value. To achieve this Mr Shlosberg required US\$200m to repay borrowings and secure releases of shares which had been charged

as security. Mr Shlosberg lent US\$100m for this purpose. Avonwick provided a further loan in the amount of US\$100m to Webinvest and Mr Shlosberg personally guaranteed that loan. The total amount of US\$200m was used to finance the Vimetco project by making a loan to a company called Globoid Finance Establishment ('Globoid'). Webinvest failed to repay the loan due to a default by Globoid.

Webinvest settled with Globoid by way of a series of agreements reached during arbitration proceedings, but shortly thereafter Globoid went into liquidation and Webinvest was left as an empty shell.

Subsequently, Avonwick brought proceedings and obtained a judgment against Webinvest and Mr Shlosberg for approximately US\$195m. Neither Webinvest nor Mr Shlosberg paid any sum in respect of this judgment and as a result statutory demands were served on them. They applied for an injunction to restrain Avonwick from presenting a winding-up petition and to set aside the statutory demand. These applications were unsuccessful with the result that a bankruptcy order was made against Mr Shlosberg.

Dechert held much documentation which Mr Shlosberg asserted was privileged. As a result, he applied for Dechert to be removed from the record as the solicitors for Avonwick and the Trustees. In this regard, it became

apparent that no barrier had been put in place between the legal teams advising Avonwick and those advising the Trustees.

Mr Shlosberg claimed privilege over three main categories of documents. The first category related to litigation in the County Court which was unrelated to the affairs described above ('Category A'). The second category related to the statutory demands served on Mr Shlosberg and Webinvest by Avonwick and the attempts to restrain Avonwick from presenting the petitions ('Category B'). The third category was the documents arising out of the claim brought by Avonwick against Mr Shlosberg and Webinvest ('Category C').

THE ISSUES ARISING

The key issue in dispute was whether the benefit of privilege in respect of these documents remained with Mr Shlosberg or whether it had transferred to the Trustees upon his bankruptcy.

Prior to this judgment it was unclear whether, upon the declaration of bankruptcy, the TIB would 'step into the shoes' of the bankrupt and automatically acquire any privilege the bankrupt formerly held in relation to documents relating to his estate or affairs.

At the outset Arnold J highlighted that the function of a TIB is to take control of the bankrupt's assets, realise those assets and distribute them in accordance with the Insolvency Act 1986 (IA 1986). He directed that the burden of proof was on the Respondents to prove the benefit of Mr Shlosberg's privilege had vested in the Trustees.

Biog box

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THE GROUNDS RELIED UPON BY THE RESPONDENTS AND ARNOLD J'S ANALYSIS

The Respondents put forward four grounds in support of their argument.

The first was that the title to the physical documents which recorded the privileged information vested in the Trustees as part of the bankrupt's estate and hence the benefit of the privilege was acquired with the title to the documents.

This was rejected by Arnold J who held that 'it is not ownership of the paper which matters, but the right to control the dissemination and use of the information recorded on the paper.' In this regard he relied upon the example of a piece of paper owned by a solicitor recording privileged information – the client does not lose their right to claim privilege because the piece of paper is owned by the solicitor and further he does not lose the right of privilege if the solicitor destroys, gives away or sells the file.

The second ground was that privilege is either 'property within s 436(1) or a power over, or in respect of, property within s 283(4)' such that privilege would pass to the Trustees.

Section 436(1) of the IA 1986 defines the scope of the property which will pass to a TIB, as including '... money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property...'

Section 283(4) of the IA 1986 further provides that references '... to property, in relation to a bankrupt, include references to any power exercisable by him over or in respect of property...'

This argument was also rejected by Arnold J. Dealing with s 436(1) he held that:

'Although privilege is enforceable in a court of law, its only effect is to enable the beneficiary of the privilege to resist compulsory disclosure of information in proceedings. It is not a marketable right, it has no commercial value and it cannot be realised or distributed to creditors. Moreover, it does not arise out of, nor is it incidental to, property in the documents

containing the privileged information. It is a right in respect of the information which arises out of the confidential relationship between the client and the lawyer, and it has nothing to do with the status of the documents as chattels.'

In deciding whether privilege is a power exercisable over or in respect of property within the meaning of s 283(4) Arnold J held that privilege is not a power exercisable over documents as chattels but is a power over the information contained within the documents. He explained that privilege 'is not a power which would assist the trustee to realise the value of the documents recording the privileged information or to distribute the proceeds.'

The third ground was that the Trustees are the successors in title to the County Court judgment. Mr Shlosberg did not argue to the contrary presumably as the County Court judgment gave rise to a debt in his favour and any privilege relating thereto would become vested in the Trustees.

The fourth ground was that, in relation to Category B and C documents, the Trustees were the successors in title to the judgment of the High Court obtained against Mr Shlosberg prior to the date of his bankruptcy and the judgment was an 'obligation' within the meaning of s 436(1) which vested in the Trustees. Arnold J found that a judgment against a bankrupt is not 'property' or an 'obligation' within the meaning of s 436(1) as judgment debts cannot be realised for the benefit of creditors.

The judge therefore found that the Trustees acquired the benefit of Mr Shlosberg's privilege with respect to the Category A documents but not the documents in Category B and Category C. He also granted an injunction requiring Dechert to cease acting for Avonwick.

ANALYSIS

The decision in *Shlosberg* illustrates that a bankrupt would not be able to assert privilege in respect of communications solely on the basis that the TIB would step into the bankrupt's shoes upon a declaration of bankruptcy. The effect of Arnold J's decision is that it is necessary to focus on

the underlying nature of the document in respect of which privilege is asserted. If the privilege is being asserted over documents which record the requesting and giving of legal advice relating to, or documents created for the dominant purpose of proceedings concerning, property which passes to the TIB then the benefit of that privilege will pass to the TIB. The TIB will not be entitled to access privileged material which does not concern property passing to the TIB as such material would remain vested in the bankrupt.

This is certainly a logical approach, although in practice it may give rise to disputes where a bankrupt relies upon privilege in order to withhold documentation from the TIB. An unscrupulous bankrupt may seek to use this to his advantage in order to conceal assets from his TIB.

Furthermore, whilst a bankrupt may be able to deny a TIB access to privileged documentation following the decision in *Shlosberg*, the question arises as to whether he would have to provide disclosure in any event pursuant to ss 333 and 366 of the IA 1986 which require the bankrupt to provide information to the TIB. It is unclear as to why the position under these sections should be any different from the outcome of the *Shlosberg* decision. This is a matter which is likely to come before the courts in the future.

In the light of the potential for future litigation in this area, and the fact that the Respondents are seeking to appeal the decision, no doubt the Official Receiver, insolvency practitioners and insolvency lawyers will continue to follow the developments in this area with interest. ■

Further reading

- LexisPSL Dispute resolution: Practice notes: Privilege – general principles
- LexisPSL Restructuring and Insolvency: Practice notes: Roles, powers, functions and duties of a trustee in bankruptcy
- RANDI Blog: Trustees in bankruptcy and privilege – a spanner in the works? (*Shlosberg v Avonwick Holdings*) by Eleanor Stephens, 9 June 2016