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LEGAL PRIVILEGE – THE KING HAS BEEN ADVISED – THE SHAREHOLDER RULE NO LONGER APPLIES UNDER ENGLISH LAW

Jul 25, 2025

SUMMARY

Yesterday in a landmark decision, *Jardine Strategic Limited v Oasis Investments II Master Fund Ltd and others,* the Privy Council, on appeal from Bermuda's Court of Appeal, has changed the law.

"*The status-based automatic Shareholder Rule is therefore now, and in truth has always been, a rule without justification. Like the emperor wearing no clothes in the folktale, it is time to recognise and declare that the Rule is altogether unclothed*" [para 82].

Under English and Bermudian law, shareholders (and former shareholders) are no longer entitled to legally privileged communications belonging to the company during a dispute with them.

HEADLINE – SPEED READ

Before yesterday (albeit questioned very recently by the High Court which refused to apply the Rule in *Aabar v Glencore*), English law notionally accepted for the last 140 years or so that shareholders could access legal advice obtained by the company, (i) if they were shareholders at the time the communication was created, and (ii) unless the advice related to the dispute between the company and its shareholders (the 'Shareholder Rule').

From yesterday, and unless shareholders have already received a copy of legal advice received by the company before a dispute arose, they are no longer entitled to receive such advice as part of disclosure in litigation or arbitration.

In deciding this, the Court acknowledged that "*directors of a large modern sophisticated company have the constant and difficult task of finding their way to a reliable perception of their company's best interests while paying appropriate attention to the interests and wishes of their many different classes of stakeholders, when making decisions, large and small, about the management and*

direction of the company's business. Many of those decisions will need, or at least benefit from, candid, confidential, legal advice."

Abolishing the Shareholder Rule means that directors can now have reasonable certainty that confidence will be maintained in legal advice at the time they decide to seek such advice. And, not worry that it could be used against the company in a subsequent dispute. In short, the decision puts shareholders in the same position as other stakeholders who may litigate against companies (employees, lenders, insurers etc.) in terms of accessing a company's privileged material.

JUDGMENT - WHAT DID THE PRIVY COUNCIL DECIDE IN *JARDINE*?

The so-called 'Shareholder Rule' forms no part of Bermuda or English law. Companies can now assert privilege - where it exists in communications - against their shareholders (or former shareholders) when they are in dispute with them.

In finding that the Shareholder Rule forms no part of Bermuda or English law, the Privy Council made the following key findings:

1. The original justification for the Shareholder Rule was proprietary, but this basis is wholly inconsistent with the proper analysis of a registered company as a legal person separate from its shareholders such that the shareholders have no proprietary interest in the funds of the company used to pay for the advice. The shareholder respondents' arguments in this case did not justify the proprietary basis for the rule and it had not been supported for some time in reported cases or academic writings as a valid basis for the Rule.

2. Joint interest privilege is not assumed and cannot be used as an automatic status-based denial of legal professional privilege between every company and all its shareholders. A broadly based exception from legal advice privilege, founded upon a supposed joint interest between company and shareholders would discourage companies from obtaining candid legal advice in confidence. It would ignore the separate personality of the company and it would wrongly assume a simple coincidence of interests between the company and the shareholders (or even between the shareholders themselves) contrary to the typical commercial reality.

3. However, the Court was clear that nothing in this judgment should be taken as laying down the law about joint interest privilege. The Privy Council did not review or otherwise decide the scope and applicability of joint interest privilege. It simply decided that the company shareholder relationship does not fall within any general principle of joint interest privilege. As the facts of this case vividly demonstrate, there may be sharply divided views and interests between shareholders supporting, and opposing, a particular step such as a merger or an amalgamation. Shareholders are simply not a homogeneous block with a single shared interest which may coincide with, or diverge from, the interests of the company.

4. The relationship between a company and its shareholders is essentially contractual, and the terms of that relationship typically (as in this case) greatly restrict what a shareholder is entitled to see of, or be told about, the company's documents. So it would be strange that an exception to that same privilege could be mounted on the basis of a special relationship (company and shareholder) when the express contractual terms of that relationship point clearly in the opposite direction.

IMPACT

WHAT DOES THIS MEAN FOR DIRECTORS AND INHOUSE LAWYERS?

- Directors of companies, especially those with numerous and diverse shareholders, can have a tough job making decisions in the context of (i) complex statutory and fiduciary obligations (ii) often highly regulated environments and (iii) where shareholder activism and class actions are on the rise. As the Privy Council identified, the Shareholder Rule risked deterring directors from either taking much-needed legal advice to assist them in properly carrying out their duties to their company or being frank when doing so.
- *Jardine* has now removed what many corporates perceived to be an anachronistic rule and potentially eliminates or reduces risk in company disputes for corporate clients and directors in any shareholder disputes, be that unfair prejudice petitions, FSMA claims, climate-related claims, or joint venture disputes.
- Even if there is no anticipated dispute with its shareholders, companies can more confidently reject shareholder requests for a copy of company legal advice.
- Where the Company wishes to share legal advice with its shareholders, it does not necessarily mean privilege protection will be lost as against anyone else if a dispute arises. The court would likely recognise that such sharing was done on a limited waiver basis (provided confidence is maintained and it was provided for a limited purpose). However, it may hinder a company from preventing shareholders from utilising such advice in any future dispute against the company.

BACKGROUND AND CONTEXT

WHAT ARE LEGALLY PRIVILEGED COMMUNICATIONS?

Under English law, confidential communications between a lawyer (including company employee lawyers working 'in-house') and their client, made for the dominant purpose of giving or seeking legal advice, are protected from disclosure in disputes by legal advice privilege: the client has the right to decline to disclose the confidential communication and it cannot be obtained, or relied on, by the "client's" opposing party. This is called legal advice privilege.

In addition to certain statutory privileges, and a joint privilege belonging to parties seeking to settle a dispute (without prejudice privilege), English law also recognises 'litigation privilege' which attaches to communications between lawyer and/or client with third parties for the dominant purpose of actual or contemplated litigation.

Legal privilege is regarded as a fundamental human right. It encourages full and frank communication between lawyers and their clients, without fear that such communications might be later used against the client or otherwise disclosed to an opposing party or enforcement authority/regulator.

WHAT WAS THE SHAREHOLDER RULE?

Previously, a company could not, in the course of a dispute between it and shareholders (or former shareholders) (where they were shareholders at the time the communication was created), withhold otherwise privileged documents from inspection on the ground that the documents were covered by legal advice privilege, unless the advice related to hostile proceedings between the company and its shareholders.

The Shareholder Rule was initially justified on the basis of an analogy with the relationship between trustees and beneficiaries. The Trustee Rule is founded upon the twin propositions that beneficiaries collectively have an interest in the due administration of the trust, and collectively own the trust fund out of which the trustees pay for legal advice.

There was said to be analogy as between a company and its shareholders, on the basis that the shareholders could be said to be the beneficial owners of the company's property, so as to have paid for the legal advice of which they were seeking disclosure, even though the company was a separate entity, and because the directors could therefore be said to be trustees for the shareholders. Parallels were also drawn, as late as 2002, between companies and trusts by saying that company directors owe fiduciary duties to their shareholders.

The case law then developed to recognise the Shareholder Rule (i.e. privilege could not be claimed) where there was a joint interest between the company and the shareholders.

WHAT WERE THE FACTS IN *JARDINE*?

- The appellant company, Jardine Strategic Limited (the "Company") was formed from the amalgamation of Jardine Strategic Holdings Ltd ("Jardine Strategic") and JMH Bermuda Ltd resulting in all the shares in Jardine Strategic being cancelled. Under the (Bermuda) Companies Act 1981, the Company was required to pay fair value for those cancelled shares to shareholders who voted against the proposed transaction. Some of those shareholders, the respondents, were not satisfied with the figure offered to them so they triggered the statutory mechanism under which the court determines the fair value for the Company to pay.

- The issue was whether the claimants now litigating against the Company were entitled to see the legal advice that was given to the Jardine Matheson group when it was setting the value which it offered as fair value to dissenting shareholders who had their shares cancelled.
- The Company asserted that the documents, which it had listed in its discovery but not made available for inspection, were covered by legal professional privilege, in particular by legal advice privilege.
- The plaintiffs accepted that the advice received by the pre-amalgamation companies was of a type which would ordinarily be protected by legal advice privilege from production to the other party to the litigation but they relied on the Shareholder Rule which they said overrode that privilege when the party seeking access to the documents is a shareholder in the company or at least was a shareholder at the time that the advice was sought or received.
- The Bermuda Chief Justice held that the Company was not entitled to maintain legal advice privilege in respect of legal advice received by Jardine Strategic because the plaintiffs had been shareholders in that company. The Court of Appeal dismissed the Company's appeal.

RELATED CAPABILITIES

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