

The High Court in Sports Direct has ruled that the fundamental protections afforded by legal privilege can be sidestepped by the FRC in the course of its regulatory investigations into auditors

Legal professional privilege has long been recognised as a “fundamental human right” which ensures that individuals (and companies) can confidentially access legal services. However, a recent High Court decision in *The Financial Reporting Council (FRC) v Sports Direct* severely erodes that protection for auditors and audit clients.

What is legal professional privilege and why is it important?

Legal professional privilege broadly divides into two heads: legal advice privilege and litigation privilege. Legal advice privilege covers communications with a lawyer for the purpose of obtaining legal advice. Litigation privilege covers material prepared for the purpose of litigation or anticipated litigation.

Privilege has long been recognised as a necessary protection to ensure that clients are able to communicate frankly and confidentially with their lawyers, without risk of those frank communications getting into the hands of the state or an opposing party, or entering the public domain.

It is generally considered an absolute right which no court or public body can override without clear statutory authority (which is rarely given).

What has the Court decided?

In the Sports Direct case, the High Court surprisingly ruled that the fundamental protections afforded by legal privilege can be sidestepped by the FRC in the course of its regulatory investigations into auditors.

Since 2016 the FRC has had the statutory powers to demand that auditors and audit clients hand over documents which are relevant to its audit investigations. However, these powers are subject to an important qualification: a person (or company) cannot be required to hand over any documents if they are protected by privilege.

Sports Direct was required by the FRC to hand over documents relating to its auditor, Grant Thornton. The material requested included a document containing legal advice which Sports Direct had shown to Grant Thornton during the course of the audit, but which Grant Thornton had not retained. Sports Direct resisted the request on the grounds that the material was protected by privilege.

The High Court held that the fact that Sports Direct had shared the document with its auditor did not mean that the document was no longer privileged.

However, the Court also found that had Grant Thornton kept a copy of the document it would not have breached Sports Direct’s privilege by sharing it with the FRC (or that it would merely have been a ‘technical breach’), as its provision would be solely for the purpose of the FRC’s confidential investigation into Grant Thornton. The Court reasoned that the position should be no different simply because the document was not in Grant Thornton’s possession.

The Court therefore concluded that, despite the clear wording of the statute, Sports Direct was not entitled to rely upon privilege as a reason for refusing to hand over the documents to the FRC.

Even more surprisingly, as Grant Thornton was only able to describe the document it saw in general terms, and Sports Direct was unable to identify precisely which document it was, Sports Direct was required to hand over all documents which were capable of being the one described.

What are the consequences for auditors and audit clients?

This decision is significant for any auditor who needs to see material that may be subject to the audit client's legal privilege. Sports Direct have been granted permission to appeal the decision so it remains to be seen whether the High Court's 'technical breach' test will survive the Court of Appeal. However, whatever the eventual decision, audit clients may be more cautious about sharing such material than they have been in the past. Where material is shared, it may be advisable to keep a clear record of precisely which documents were seen.

Audit clients need to be aware that, at present, any privileged material in their possession (whether previously shared with their auditor or not) could potentially be the subject of a statutory notice from the FRC requiring its production. Although the Court reasoned that the material would be provided solely for the purpose of the FRC's confidential investigation into the auditor, audit clients may wish to take steps to ensure that it is not passed on by the FRC to third parties, and that it does not enter the public domain in the event that the FRC subsequently brings enforcement action against the auditor.

Audit clients will wish to be particularly careful where their senior financial directors are also subject to investigation by the FRC. This will be especially so where those directors were authorised to seek and receive legal advice on behalf of the company, and so may have seen privileged material.

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