BUDDLE FINDLAY

# Legal update - The unintentional waiver

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*28 July 2014*

A recent decision from the Federal Court of Australia reminds those taking out warranty and indemnity (W&I) insurance for transactions that they must keep in mind the true nature of their relationship with the insurer. Failure to do so can have significant consequences.

Asahi Holdings (Australia) Pty Ltd discovered that one of these consequences was the loss of legal privilege attaching to sensitive information that they had voluntarily provided to the insurer in connection with a warranty claim.

W&I insurance provides cover for losses arising from a breach of warranty (and in certain cases under an indemnity) in connection with a merger or acquisition. The use of the insurer's balance sheet effectively facilitates a transaction by transferring some transaction risk from a seller or a buyer to the insurer.

The appetite for W&I insurance has increased over the past several years on both sides of the Tasman, partly as attitudes to risk changed during the global financial crisis. Over the past year or so as deal flow has increased, the use of W&I insurance has also increased.

W&I insurance has also become popular as a means to enable a seller to distribute sale proceeds promptly following completion of a sale. Having said that, this recent case featuring Asahi and Pacific Equity Partners (PEP) provides three key warnings:

- Once the policy holder alleges a breach of warranty and claims under the policy, the interests of the insurer will generally be more closely aligned with those of the party said to be in breach than the policy holder's
- The policy holder will likely lose any legal privilege over information they disclose to the insurer, unless they take protective steps
- When disclosing information to the insurer the policy holder must take positive steps, addressed specifically to the insurer, to retain their privilege – it will be difficult to establish that confidentiality was implied.

## The facts of Asahi Holdings (Australia) Pty Ltd v Pacific Equity Partners Pty Ltd (No2) [2014] FCA481

Asahi acting through its nominee Independent Liquor (NZ) Ltd, bought Flavoured Beverages Group Holdings Limited (FBG) (the Independent Liquor business). As part of the agreement for sale and purchase, the Seller (PEP) provided certain warranties and Asahi took out insurance for any breach of those warranties. The Seller was indemnified in respect of any liability up to the policy limit of NZ$150m.

FBG's performance failed to live up to Asahi's expectations. After receiving a report compiled by its solicitors as to the true financial position of FBG (which report included information that had been sourced from Asahi's accounting advisers and also from another law firm), Asahi brought a claim of misleading and deceptive conduct against PEP in respect of certain of the warranties and statements made. The full report was provided by Asahi's lawyers to its insurers, and a version with up to 69 redactions was subsequently provided to the Seller.

The Seller sought access to the redacted passages, which Asahi resisted on the ground that the redacted parts of the report were protected by legal professional privilege. The Seller conceded that the report had been privileged, but argued that Asahi had voluntarily waived their privilege by providing the report to its insurer.

## The insurer's interest is more closely aligned with the party allegedly in breach than with the claimant

There is always the potential for the interests of an insurer and those of a claimant to conflict. The key lesson of this case is that, in the context of a claim under a W&I policy, the insurer (a potential adversary) will share interests with an existing adversary (the seller alleged to have breached a warranty). Put simply, both the seller and the insurer will want to establish that no warranties have been breached, so as to avoid incurring liability.

The conflict of interests between policy holder and insurer, coupled with the alignment of interests between insurer and seller, proved lethal to Asahi's arguments in this case.

## Disclosure to the insurer waives privilege as against the counterparty

The purpose of litigation privilege *"is to keep hidden from one's opponent or adversary (whether actual or potential) material that may prejudice the privilege holder or advantage his or her opponent."* Voluntary conduct which is inconsistent with that purpose – the maintenance of confidentiality – will be taken as a waiver of the privilege.

The Judge held that Asahi had waived its privilege over the report by voluntarily disclosing it to its insurer. The objective purpose of the disclosure was to enable the insurer to assess Asahi's claim. In the Judge's view, Asahi must have objectively appreciated that the insurer could reject the claim, and that if it did, the insurer could then use the full report in any resultant court proceedings, and could thereby bring the redacted information into the public domain.

The disclosure of the information for use by the insurer was therefore "entirely antithetical" to the claimed confidentiality, and so *"inconsistent with the maintenance of the confidentiality which the privilege is designed to protect"*. The privilege was waived.

## Maintaining privilege despite disclosure

Asahi could have preserved its privilege and confidentiality by getting the insurer to agree, expressly or impliedly, that disclosure was on a limited basis only. The test for a limitation on waiver is objective (*Berezovsky v Hine*, [2011] EWCA Civ 1089):

*… where privilege is waived, the question whether the waiver was limited, and, if so, the parameters of the limitation, must be determined by reference to all the circumstances of the alleged waiver, and, in particular, what was expressly or impliedly communicated between the person sending, and the person receiving the documents in question, and what they must or ought reasonably have understood.*

In an ideal world Asahi would have obtained an express agreement as to the uses to which the insurer could put the information. But it did not, and the case illustrates the lengths that parties must go to in order to establish an implied agreement that the waiver of privilege is limited.

Asahi (or its solicitors) had marked several pages of the report either "Privileged and Confidential" or "Confidential and Privileged". Asahi took no other steps to maintain confidentiality, apparently assuming that confidentiality was implied from their own duty to disclose information, the insurer's duty of utmost good faith, and the commonality of interests they wrongly believed they shared with the insurer. All this was not enough.

Bromberg J assessed the facts from the insurer's point of view. The "Privileged and Confidential" or "Confidential and Privileged" could well have been "a hangover from a prior use of the memo".

All other factors told against an implied limitation, which factors will be common in the context of a transaction involving this kind of insurance. These were:

- The insurance policy included a special process by which privileged information could be provided to the insurer
- The parties were potential adversaries
- Both parties to the deal had obtained legal advice.

In these circumstances, the failure to expressly seek confidentiality was fatal. The Judge ordered Asahi to hand over to PEP the redacted parts of the report.

*This article was written by David Thomson (Partner) and Jeremy Wilson (Law Clerk) and first published in NewLaw Magazine on Friday 11 July 2014.*


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