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Bloomberg BNA regularly spotlights the insights of state and local tax attorneys at Alston & Bird LLP. In this installment, Zachry Gladney, Richard Kariss, Charles Wakefield, and Kathleen Cornett discuss the importance of protecting privileged communications in large and complex transactions with tax exposure.

Privileged & Confidential: A Primer on the Work-Product Doctrine for State Tax Professionals




BY ZACHRY GLADNEY, RICHARD KARISS, CHARLES WAKEFIELD AND KATHLEEN CORNETT

When evaluating and negotiating large transactions, it is important to keep the entire team – lawyers, accountants, consultants, etc. – on the same page. But this vital information sharing can also lead companies to inadvertently waive protection for privileged communications.

Zachry Gladney and Richard Kariss are partners in the State and Local Tax Group in Alston & Bird LLP's New York office. Charles Wakefield is a senior associate in the State and Local Tax Group in Alston & Bird LLP's New York office. Kathleen Cornett is an associate in the State and Local Tax Group in Alston & Bird LLP's Atlanta office.

There are two kinds of privileges that protect communications between clients and attorneys: the attorney-client privilege and the work-product doctrine. While attorney-client privilege provides broad protection, in general, a client waives this privilege by disclosing the communication to a third party. The *Kovel* doctrine, named after the Second Circuit decision first recognizing it, extends attorney-client privilege to communications with third parties, but only in the limited circumstances where they are necessary to facilitate effective legal representation. This narrow exception generally does not apply to accountants and consultants hired by a company to provide non-legal advice and services.

But if the work-product doctrine applies, companies have more flexibility to share attorney-client communications, including legal advice and analysis, with third parties without waiving privilege.

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What's covered?

The purpose of work-product protection is to promote the adversarial nature of litigation by shielding an attorney's preparations from discovery. First established by the Supreme Court in *Hickman v. Taylor*, 329 U.S. 495 (1947), and now codified in Federal Rule of Civil Procedure 23(b)(3), the work-product doctrine protects from disclosure during discovery or at trial ''documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative,'' unless the opposing party shows a ''substantial need'' for the documents and cannot obtain the material by other means ''without undue hardship.'' Opinion work product, which includes documents that show the ''mental impressions, conclusions, opinions or legal theories of an attorney or other representative,'' requires ''a highly persuasive showing'' to justify disclosure to an opposing party. [*United States v. Adlman*, 134 F.3d 1194, 1204 (2d Cir. 1998).]

The work-product doctrine protects opinions, memoranda and other types of attorney work product if a court concludes that they were prepared in anticipation of litigation. The doctrine does not protect documents ''prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'' [*Id.* at 1202.] The majority view among federal courts is that a document was prepared in anticipation of litigation if the attorney prepared the document ''because of'' the prospect of litigation. [*See, e.g., United States v. Deloitte LLP*, 610 F.3d 129, 137 (D.C. Cir. 2010).] The minority view is that the privilege applies to a document if the ''primary motivating purpose'' for creating the document is anticipation of litigation. [*See U.S. v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982).] The doctrine does not require that litigation have been filed at the time the attorney prepares the documents, rather the protection applies even ''when litigation is merely a contingency.'' [*Burlington Indus. v. Exxon Corp.*, 65 F.R.D. 26, 42 (D. Md. 1974).]

In an influential decision, the Second Circuit held in *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998), that the privilege protects ''documents which, although prepared because of expected litigation, are intended to inform a business decision influenced by the prospects of litigation.'' [*Id.* at 1197-98.] While contemplating a merger, a corporation requested that its outside accountant and attorney at Arthur Andersen prepare a memo evaluating the tax implications of the restructuring. The corporation expected the restructuring to produce a significant federal tax refund (around $35 million), which it knew the IRS would challenge. The Arthur Andersen memo analyzed the IRS' likely legal challenges to the future tax refund claim and proposed possible legal theories to defend the refund claim during litigation.

The IRS argued that the memo was not protected work product because the attorney prepared it to help his client make a business decision. The court rejected this distinction and concluded that the work-product doctrine applied ''where a party faces the choice of whether to engage in a particular course of conduct virtually certain to result in litigation and prepares documents analyzing whether to engage in the conduct based on its assessment of the likely result of the anticipated litigation.'' [*Id.* at 1196.] When an attorney prepares a document in part to inform a business decision, the test ''really turns on whether it would have been prepared irrespective of the expected litigation with the IRS.'' [*Id.* at 1204.]

Applying *Adlman's* reasoning, courts have also held that a legal opinion memorandum prepared by an attorney that analyzed the partnership tax issues from the client's sale of stock was prepared in anticipation of litigation. [*See Long-Term Capital Holdings v. United States*, 2002 U.S. Dist. LEXIS 23224 (D. Conn. Oct. 30, 2002).] In contrast, tax audit work papers created to calculate tax reserves for audited financial statements have been found to be prepared in the ordinary course of business and not in anticipation of litigation, and thus were not protected by the privilege. [*See United States v. Textron*, 577 F.3d 21 (1st Cir. 2009).]

Waiver: Proceed with Caution!

As demonstrated above, the standard for determining whether the work-product privilege applies has been somewhat generously construed by the courts, but the scope of documents covered by the work-product privilege is not infinite. The privilege is also easily waived without careful attention. This is particularly true in the context of complex business transactions where the transacting parties often engage multiple law firms, accounting firms, and business consultants who all want access to the same relevant legal analysis. As the number of players involved grows, the more likely it is that the privilege will be waived. Losing control of a document by sharing it freely frequently results in the privilege being waived.

While Circuit courts disagree over whether disclosure of attorney work product to third parties creates the presumption that the privilege was waived, most lower courts have held that a waiver of work-product protection occurs only when either: (1) a party discloses the work product to adversaries; or (2) a disclosure to a third party substantially increases the likelihood that an adversary will come into possession of the material. [*See, e.g., United States v. Johnson*, 378 F. Supp. 2d 1041, 1047 (N.D. Iowa 2005)]

As an example, in *United States v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010), the court held that Dow Chemical did not waive work-product protection when it disclosed legal opinion memos prepared by in-house and outside counsel to its independent auditors at Deloitte. First, the court held that Deloitte was not an adversary for purposes of waiver because the anticipated dispute was with the IRS, not Deloitte. [*See id.* at 140.] Second, the court analyzed whether Deloitte ''was a conduit'' to the IRS such that disclosure substantially increased the likelihood that the IRS would possess the memos. [*Id.* at 141.] The court concluded that Dow had a ''reasonable expectation of confidentiality'' when it provided Deloitte the memos because an independent auditor ''has an obligation to refrain from disclosing confidential client information.'' [*Id.* at 142 (referencing Rule 301 of the American Institute of Certified Public Accountants Code of Professional Conduct).] Thus, there was no waiver as long as the disclosing party had a ''reasonable basis for believing that the recipient would keep the disclosed material confidential.''

Conclusion

To preserve a strong claim of work-product protection, we recommend taking appropriate steps to main-

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tain confidentiality. In the event a document covered by the work-product privilege must be shared with a third party, it should be emphasized to the intended recipient the confidential nature of the document and require the recipient to limit access to only those necessary for review.