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Maintaining Client Confidences: Developments at the Supreme Judicial Court and First Circuit in 2009

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- *Comm'r of Revenue v. Comcast Corp.*, 453 Mass. 293 (Mar. 3, 2009)
- *U.S. v. Textron*, 557 F.3d 87 (1st Cir. Jan. 21, 2009) *withdrawn, vacated and rehearing en banc granted by* 560 F.3d 513 (1st Cir. Mar 25, 2009), *superseded by* — F.3d —, 2009 WL 2476475 (1st Cir. Aug. 13, 2009)

In 2009, the Massachusetts Supreme Judicial Court (SJC) and the United States Court of Appeals for the First Circuit both issued important decisions addressing the reach of the work product doctrine to protect from discovery documents prepared for business purposes, but with litigation also in mind. The SJC also ruled on the scope of the so-called derivative attorney-client privilege that has been used to protect communications with non-attorneys, such as accountants and consultants, who assist the legal team.

In *Textron*, the First Circuit initially issued its opinion in January 2009, holding that Textron's tax accrual work papers justifying its reported tax reserves, to be drawn upon should the IRS dispute (as it had) the company's tax reporting, constituted protected work product. *U.S. v. Textron*, 557 F.3d 87 (1st Cir. 2009) *subsequently withdrawn and vacated.*

In *Comcast*, the SJC followed federal precedent and similarly ruled that memoranda prepared by an accounting firm retained by in-house counsel to advise it on how to structure a large stock sale for tax purposes constituted attorney work product that need not be produced in the state tax authority's suit against Comcast. *Comm'r of Revenue v. Comcast Corp.*, 453 Mass. 293 (2009). While it interpreted the work product doctrine broadly, the *Comcast* court strictly construed the attorney-client privilege and narrowed the scope of the derivative privilege articulated in *U.S. v. Kovel*, 296 F.2d 918 (2d Cir. 1961), whereunder communications involving non-lawyers (such as accountants) employed to assist an attorney in rendering legal advice may qualify as privileged attorney-client communications. Interestingly, after *Comcast* was decided, the First Circuit withdrew its first *Textron* decision, granted rehearing *en banc* (560 F.3d 513 (1st Cir. Mar 25, 2009)) and then, in a sharply-split *en banc* decision, reversed its earlier ruling. *U.S. v. Textron*, — F.3d —, 2009 WL 2476475 (1st Cir. Aug. 13, 2009). In the second *Textron* decision, the First Circuit ruled that the company's tax accrual papers were subject to production, as they had been created in the ordinary course of business, not for litigation, and thus were not protected work product.

The *Comcast* and *Textron* decisions illustrate the inherent difficulty in delineating between business materials and documents prepared in anticipation of litigation in a world where

business decisions often anticipate the prospect of litigation and build that consideration into the deliberative process. Accordingly, business lawyers and litigators alike in Massachusetts, as well as accountants, tax advisers and others who work with attorneys, would do well to understand both the *Comcast* and *Textron* decisions.

Just the Comcast Facts

The principal player in the *Comcast* case was U.S. West, a Comcast predecessor. After it acquired Continental Cablevision, antitrust considerations mandated that U.S. West should sell its stock in another one of its Massachusetts companies. The sale would have significant tax consequences, notably a $500 million capital gain. Not surprisingly, U.S. West sought to structure the transaction with taxes in mind and retained Arthur Andersen LLP for tax advice. The Andersen partners, including a lawyer precluded from practicing law while employed by the accounting firm, prepared a series of draft memoranda and then a final memorandum outlining alternative methods for structuring the transaction from a tax perspective. The Andersen memoranda included tax pros and cons of each proposed method and the relative litigation risks attendant to each.

Thereafter, U.S. West structured the sale in such a way that it paid no Massachusetts taxes on account of the capital gain realized and taxed at the federal level. Following a tax return audit, Massachusetts charged that U.S. West owed more than $50 million in state taxes. It issued an administrative summons requiring U.S. West to produce all documents relating to its divestiture of the stock. The company resisted production of the Andersen tax memoranda, claiming they constituted protected attorney-client communications and work product prepared in anticipation of litigation.

The Massachusetts Commissioner of Revenue requested the documents in superior court, but it was denied relief. The Massachusetts Supreme Judicial Court then took direct review.

Comcast Attorney-Client Privilege Analysis

Addressing the attorney-client privilege issue first, the SJC in *Comcast* observed that, although the attorney-client privilege serves fundamental societal interests in allowing free consultation between attorney and client, the privilege is subject to narrow construction because it impedes fact finding. Citing *U.S. v. Arthur Young*, 465 U.S. 805 (1984), the court stated that a narrow construction is particularly appropriate where information is withheld from the government in a tax enforcement proceeding. Further, the court noted the obvious: the attorney-client privilege applies only to communications between attorney and client. Comcast argued, however, that the Andersen partners had assisted in-house counsel who served his corporate client (U.S. West) and thus enjoyed the derivative privilege recognized in *U.S. v. Kovel*, 296 F.2d 918 (2d Cir. 1961). Earlier jurisprudence under *Kovel* might have allowed the attorney-client umbrella to cover non-attorneys assisting counsel rendering legal advice in this manner. Nevertheless, although it acknowledged the "logic" of *Kovel* and "its continuing vitality," the SJC disagreed. True, as the Second Circuit had stated in *Kovel*, the attorney-client privilege may apply if "the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit." But, just as the First Circuit had in *Cavallaro v. United States*, 284 F.3d 236, 249 (1st Cir. 2002), the SJC observed that the "necessity" element means more than "just useful and convenient."

In the end, the *Comcast* court gave the derivative privilege a narrow interpretation. It ruled that the *Kovel* doctrine is limited to instances in which the accountant or other non-lawyer truly facilitates or translates communications between the attorney and client serving essentially as "interpreter" or "translator." That could be the case where an accountant prepares a client's net worth statement or analyzes a complex financial transaction to aid a lawyer in defending a client charged with financial crimes. Where, however, the non-attorney is retained to provide advice, such as state tax advice in the case of Comcast's advisers, the attorney-client privilege does not attach. In rejecting the suggestion that its decision reduces the attorney-client privilege to a "meaningless protection," the court observed that the U.S. West attorney "was free to seek advice on Massachusetts tax law from a Massachusetts attorney, where the privilege would apply."

Mindful of *Comcast*, practitioners should now realize that *Kovel*, if it ever did, no longer provides support for a broad derivative attorney-client privilege in Massachusetts. While not outright rejected by the SJC, the derivative privilege appears at best to be a thin reed in Massachusetts, assuredly protecting only the facilitation or translation of information flow between client and attorney necessary for effective consultation.

Comcast Work Product Analysis

Although the *Comcast* court concluded that the attorney-client privilege should be narrowly construed, the court nevertheless gave a broad reading to the work product doctrine and held the Andersen memoranda were protected. The fact that the memoranda were prepared by a non-attorney was of no moment. Even though it is commonly referred to as the "attorney" work product doctrine and the seminal Supreme Court case, *Hickman v. Taylor*, 329 U.S. 495 (1947), involved an attorney's work (in the form of witness interview memoranda), the Massachusetts Rules of Civil Procedure, like the federal counterpart, expressly extend work product to non-lawyers. By its terms, Mass. R. Civ. P. 26(b)(3) protects from discovery (absent a showing of substantial need) documents "prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative (including his attorney, consultant, surety, indemnitor, insurer, or agent)."[1]

The *Comcast* court noted that two divergent tests have developed to determine whether documents are "prepared in anticipation of litigation." The first test limits the reach of work product protection to documents prepared "primarily or exclusively" to assist in litigation. Under this test, documents prepared in order to inform a business decision, even if litigation may be a consideration or possible consequence, do not constitute protected work product. Were this test to apply, the Andersen memoranda at issue would likely not constitute protected work product because they were prepared primarily to inform a business decision.[2]

The second test, and the one adopted by the SJC in *Comcast*, extends the reach of work product protection to documents created "because of" considerations of potential litigation, even if the documents were prepared for a business purpose and not to assist in litigation. Viewing the Andersen memoranda as an analysis of the litigation consequences of particular tax structures, the court explained that, under the test, a litigation analysis prepared so that a party can make an informed business decision nevertheless can be said to be prepared because of the possibility of litigation and thus can constitute protected work product.

The *Comcast* court adopted the looser "because of" test without much analysis. Rather than develop the argument for its own acceptance of the "because of" test, the SJC cited *United States v. Adlman*, 134 F.3d 1194 (2d. Cir. 1998), a leading "because of" case, and announced Massachusetts would follow suit:

> We need not repeat here the court's exploration of the contours of the two tests. It is sufficient to say that we agree with both the reasoning and the conclusion [of *U.S. v Adlman*] that the latter formulation ("because of" existing or expected litigation) is the correct test.

In so ruling, the *Comcast* court also noted that *Adlman* has been followed in several federal circuit courts including the First Circuit in *State of Maine v. U.S. Dept. of the Interior*, 298 F.3d 60 (2002) ("*Maine*") and the initial *Textron* decision. In giving weight to these federal cases and its adoption of the "because of" test, the SJC explained that Massachusetts Rule 26(b)(3) on work product is identical to its federal counterpart and it is therefore appropriate to look to federal case law for guidance.

Turning to the facts of the case, the SJC concluded that, as set forth in the affidavit of Comcast's in-house counsel, when Comcast commissioned the tax advice its concern focused on the reasonable possibility that the tax authority would challenge any non-payment of state taxes in light of the significant capital gain realized. It rejected the commissioner of revenue's argument that the Andersen memoranda were designed, if anything, to avoid litigation and not in anticipation of it. Instead, the court found the memoranda were prepared to inform a business decision that turned on the assessment of the likely outcome of litigation. The court accordingly held that the memoranda were prepared in anticipation of litigation and therefore constituted protected work product.

Textron and Work Product

Textron raises the question whether the work product doctrine protects tax accrual work papers prepared by a tax payer. Tax accrual work papers list the questionable positions the tax payer takes on its tax returns, estimate the likelihood that those positions will withstand scrutiny by the IRS or state taxing authority, and calculate the amount of additional tax liability that would result if an IRS assessment had to be paid. In contrast to the circumstances in *Comcast* where the Andersen tax memoranda anticipated and helped structure a transaction that was potentially taxable, tax accrual work papers consider the tax impact of completed transactions. The First Circuit, which had already adopted the "because of" test, held in January 2009 in a split decision authored by Judge Torruella that Textron's tax accrual work papers were created because of the prospect of IRS litigation and, therefore, constituted protected work product. *U.S. v. Textron*, 553 F.3d 87 (1st Cir. 2009) ("*Textron I*").

Shortly after the issuance of the *Comcast* decision, which cited *Textron I*, the First Circuit withdrew the opinion and reheard the case *en banc*. On August 13, 2009, the full *en banc* First Circuit ruled. *U.S. v. Textron*, — F.3d — (1st Cir. Aug. 13, 2009) ("*Textron II*"). This time the court took the opposite position and held that the tax accrual work papers were not protected work product and must be produced. First Circuit Judges Torruella and Boudin now found their roles reversed with Judge Boudin writing the majority (joined by Chief Judge Lynch and Judge Howard) and Judge Torruella writing a blistering dissent (joined by Judge Lipez). The new majority focused on certain "exception" language in the Second Circuit *Adlman* case that had been recited in the First Circuit's prior *Maine* decision to the effect that the "because of" test does not protect from disclosure "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation," "even if the documents aid in the preparation of litigation."

Thus, tax accrual documents protected by the work product doctrine in *Textron I* were no longer protected because they should be seen as prepared in the ordinary course of business to support statutorily required financial statements filed with the SEC. Bolstering its case for disclosure, the majority further observed that "how far work product protection extends turns on a balancing of policy concerns rather than application of abstract logic," adding later that "underpaying taxes threatens the essential public interest in revenue collection." Also interesting is that the *en banc* majority seemed to employ an "I know it when I see it" test, explaining that "every lawyer who tries a case knows the touch and feel of materials prepared for a current or possible…law suit" and that "any experienced litigator would describe the tax accrual work papers as tax documents and not as case preparation materials."

In dissent, Judge Torruella charged that the "simply stunning" majority opinion had effectively overruled the "because of" test in favor of a "prepared for" test that asks whether a contested document was "prepared for use in possible litigation." This, Judge Torruella asserted, is even narrower than the primary purpose test and ignores both *Adlman* and the First Circuit *Maine* case that expressly adopted it, as well as the plain language of Rule 26(b)(3) of the Federal Rules of Civil Procedure, which, like Massachusetts Rule 26(b)(3), provides qualified protection for documents "prepared in anticipation of litigation *or* for trial." Judge Torruella ended his dissent by stating that "the majority has thrown the law of work-product protection into disarray," and suggested that it is time for the Supreme Court to intervene and "set the circuits straight on this issue which is essential to the daily practice of litigators across the country."

The *Comcast* and *Textron* decisions highlight the difficulty delineating between work prepared solely for business purposes and that prepared in anticipation of litigation. Indeed, the First Circuit articulated different approaches and opposite results in its two *Textron* decisions. It is possible that courts may begin to move away from the dual purpose "because of" test in favor of blanket rules that certain types of materials, tax accrual work papers, for example, categorically are not (or are) protected work product. It will also be interesting to see whether the SJC revisits its *Comcast* decision in light of *Textron II* to provide uniformity across state and federal courts in Massachusetts on the important issue of the scope of work product protection. In all events, practitioners and their service providers should remain mindful of the holdings in both cases as they create materials for business purposes that arguably anticipate litigation. ■

Endnotes

1. The work product doctrine is qualified, at least with respect to facts contained in a document that do not reveal the mental impressions of the attorney or other representative of the party. With respect to fact work product, the protection may be overcome if the party seeking discovery demonstrates "substantial need" of the materials and inability to obtain them elsewhere. The *Comcast* court noted, however, that the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning litigation, so-called "opinion" work product, are afforded greater protection than fact work product and that it is an open question, at least in Massachusetts, as to whether the protection for opinion work product is absolute or whether it can be overcome by some extraordinary showing.

2. A line of Massachusetts Superior Court decisions, following *Shotwell v. Winthrop Community Hosp.*, 26 Mass. App. Ct. 1014, 1016 (1988), have applied the "primary purpose" test. *See Shipley Co. v. E.I. du Pont de Nemours & Co.*, 1994 WL 902955 (Mass. Super. Ct. Nov. 10, 1994) (McHugh, J.); *Harris v. Steinberg,* 6 Mass. L. Rptr. 417, 1997 WL 89164 (Mass. Super. Ct. Feb. 10, 1997) (Doerfer, J.); *Torossian v. Peerless Ins. Co.*, 1996 WL 1744608 (Mass. Super. Ct. Apr. 22, 1996) (Houston, J.); *Meszar v. Horan,* 10 Mass. L. Rptr. 682 (Mass. Super. Ct. Nov. 16, 1999) (Toomey, J.); *Abramian v. President and Fellows of Harvard College,* 14 Mass. L. Rptr. 230, 2001 WL 1771985 (Mass. Super. Ct. Dec. 04, 2001) (Lauriat, J.); *Vasquez v. Elco Administrative Services,* 14 Mass. L. Rptr. 173, 2001 WL 1631535 (Mass. Super. Ct. Dec. 17, 2001) (Agnes, J.). Similarly, the Superior Court in *Comcast* ruled that "the determinative question is whether the prospect of litigation was the primary motivating purpose behind the creation of the document."