OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL
DISTRICT COUNSEL, CONNECTICUT-RHODE ISLAND
CC:NER:CTR:HAR

FROM: Richard G. Goldman
Special Counsel (Tax Practice and Procedure)
CC:PA:APJP:B3

SUBJECT: Request for Chief Counsel Advice
Waiver of Privilege

This Chief Counsel Advice responds to your undated memorandum. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

A=
B=
C=
D=
E=
F=
G=
H=
I=
J=
Date 1=
Date 2=
Date 3=
Date 4=
Date 5=
Date 6=
Date 7=
Date 8=

Date 9=
Date 10=
Tax Year 1=

ISSUE:

Whether A and B waived the attorney client privilege and work product protection when E turned over five file drawer sized boxes of documents to the revenue agents or by allowing the revenue agents unrestricted access to these documents for approximately 18 months.

CONCLUSION:

A and B waived the attorney client privilege and work product protection when E turned over five file drawer sized boxes of documents to the revenue agents.

FACTS:

The Internal Revenue Service (Service) began the audit of A and B on Date 1 for Tax Year 1. Revenue agents C and D were assigned to conduct the audit. A conducts A's various businesses in an office suite which has a small conference room. The audit was conducted in this small conference room. E has handled numerous tax matters for A over the years. In fact, E maintains an office in A's office suite. Both A and E have law degrees and are accountants. A and B executed a Form 2848, Power of Attorney and Declaration or Representative, on Date 2, authorizing E to, among other things, perform any and all acts that A and B can perform with respect to their income tax matters for Tax Year 1.

The revenue agents made several information document requests concerning certain tax issues. In response, E provided the revenue agents with an unsigned memorandum dated Date 3 from F's law firm to A setting out the law firm's position concerning one of the tax issues. Although this memorandum is addressed to A, it was created to advise the revenue agents of A and B's position with respect to that particular tax issue. The memorandum referred to three documents prepared by attorneys but did not include these writings as attachments. Since the information provided was insufficient, another information document request was issued by the revenue agents. In response to this information document request, E obtained five drawer size boxes of information. These five boxes were provided by E to C and D in the small conference room for their use in the audit. Apparently, E obtained five drawer size boxes of information from A's in-house counsel, G, who works in the suite next to A.

On Date 4, C and D began to skim through the boxes. The revenue agents noticed that certain documents were marked as being protected by the attorney client

privilege. The revenue agents read only some of the information that was marked as being protected by the attorney client privilege. On Date 5, D spoke with District Counsel Attorney H. D's notes reflect that H advised D that since A's employee/representative brought the five boxes to the revenue agents, A had, in effect, waived A and B's attorney client privilege. The notes also reflect that H advised that A may counter with the statement that the information was inadvertently disclosed; however, the Service's position was strong concerning the waiver issue.

The revenue agents were allowed approximately 18 months of unrestricted access to the five boxes commencing from Date 4. The revenue agents usually scheduled two-day appointments about once a month. The five boxes were of a size where they were conspicuous to anyone using the conference room. The revenue agents brought their own copy paper and used the office copier to make their own copies of materials from the five boxes in full view of A, E, the secretaries, and other office personnel. The revenue agents did not take any original documents with them. At no time during this 18 month period was the attorney-client privilege or work product protection raised.

In one meeting in this small conference room prior to the review of the five boxes by C and D (prior to Date 4), A advised C that C should resolve certain procedural tax matters with E. A was aware that the revenue agents were in the office suite conducting the audit. A used the small conference room for meetings when the five boxes were in the conference room. E told the revenue agents that everything they needed to know about one of the tax issues was in the five boxes and that, if they needed something, they should go through the materials themselves. On many occasions, E and/or G entered the small conference room to specifically discuss the case with the revenue agents. The revenue agents often posited questions to E concerning information derived from the five boxes. On several occasions, E had G respond to these questions. Sometimes the boxes were opened with materials spread out when E and G were in the room. G never raised any concerns with the revenue agents about the privileged nature of the material they were reviewing

On Date 6, E provided the revenue agents with a signed copy of the memorandum dated Date 3 from F's law firm which was previously provided in unsigned form to the revenue agents. This time, the three documents prepared by the attorneys referred to in the memorandum were provided as attachments. None of the three documents were marked as being protected from disclosure.

On Date 7, the Service issued a very detailed 30-day letter to the A and B, containing many references to the materials from the five boxes. On Date 8, F wrote a letter to Group Manager I advising that certain privileged documents were inadvertently provided by E and were not as a result of a voluntary act by A and B. F claimed that A and B did not waive the attorney client privilege and would have

asserted the privilege prior to E's disclosure. F advised that A and B were claiming the attorney client privilege and demanded return of all documents wrongfully in the Service's possession without specifically describing the documents for which they sought return.

On Date 9, I sent F a letter advising that A and B had waived the attorney client privilege when the documents were voluntarily turned over to the revenue agents at A's place of business. I noted that F had not provided a privilege log of documents nor had F demonstrated that the attorney client privilege applied to each of the unidentified documents. This response to F was coordinated with District Counsel Attorney J. On Date 10, F, on behalf of A and B, filed a protest with respect to the 30-day letter objecting to the revenue agents' use of documents marked privileged.

On Date 11, F sent another letter to I, which attached a privilege log for the documents. The privilege log contains a list of 641 documents, categorized by date, document type, author, recipient, subject, and the claimed privilege or protection. The privilege log fails to articulate any rationale for why the documents might be protected by the attorney client privilege or work product. Furthermore, F does not indicate whether each document should be entirely or partially withheld. F asserts the attorney client privilege as the basis for withholding all of these documents and asserts work product as a separate basis for withholding three of those documents. F contends in this letter that E did not have authority to turn over documents. F indicates that E received the boxes from the G's office and was granted limited access to the files for the purpose of responding to the Service's request for all documents regarding one of the tax issues. F further contends that the privileged documents that E gave to revenue agents were irrelevant to the Service's request. Finally, F contends that the Service was not blameless, because the revenue agents accepted many documents marked as privileged.

Two of the three documents provided by E on Date 6 with the signed memorandum were listed in the privilege log. As previously stated, these documents were not marked as being privileged. It appears that the revenue agents only copied about forty-two documents (other than the two provided by E on Date 6) which have been listed in the privilege log. Only about nineteen of these documents have some sort of indication that they may be protected from disclosure. This case and the documents are now in Appeals.

LAW AND ANALYSIS

The attorney client privilege is waived by any voluntary disclosure. Chubb Integrated Systems v. National Bank of Washington, 103 F.R.D. 52, 63 (D.D.C. 1984). However, the standards for waiver of the attorney client privilege differ to a degree from waiver of work product with work product afforded greater protection. Bowne of New York City, Inc. v. AmBase Corp.,150 F.R.D. 465, 478 (S.D.N.Y.

1993).[1] The distinction lies in their differing purposes. The purpose of the attorney client privilege is to protect the confidential relationship between the client and the attorney while the purpose of work product protection is to promote the adversary system by safeguarding the fruits of an attorney's trial preparation from discovery. Edwards v. Whitaker, 868 F. Supp. 226, 229 (M.D. Tenn. 1994). Voluntary disclosure to third parties does not automatically waive work product protection. In re Sealed Case, 676 F.2d 793, 809 (D.C. Cir. 1982). However, where a party discloses work product for reasons not related to the facilitation of its trial preparation, the work product protection may be waived. Waiver is found where the disclosure substantially increases the opportunity for potential adversaries to obtain information. Thus, the protection is forfeited by disclosures in circumstances where the attorney cannot reasonably expect to limit the future use of the otherwise protected material. Grifith v. Davis,161 F.R.D. 687, 699 (C.D. Cal. 1995); see also Westinghouse Electric Corporation v. Republic of the Phillippines, 951 F.2d 1414, 1428 (3d Cir. 1991) (in order to waive the work product doctrine, the disclosure must enable an adversary to gain access to the protected information). Since it is clear that the Service would be considered an adversary, a voluntary disclosure would waive both the attorney client privilege and work product protection.

E voluntarily turned over the five boxes to the revenue agents. F now argues that E lacked authority to turn over the information in the boxes and that the disclosures were inadvertent. This argument is misplaced. A and B executed the Form 2848 giving E a power of attorney over all income tax matters for Tax Year 1. Furthermore, A indicated that the Service should resolve matters directly with E. Clearly, E had the authority to waive the attorney client privilege and work product protection. United States v. Miller, 660 F.2d 563, 571-572 (5th Cir. 1981), vacated as moot, 685 F.2d123 (5th Cir. 1982) (turning over privileged information was within the scope of accountant's implied authority where accountant was given power of attorney and negotiated with the revenue agent on behalf of the taxpayers); Jonathan Corp. v. Prime Computer, Inc., 114 F.R.D. 693, 670 (E.D. Va. 1987) (voluntary production of memorandum by employee-agent during the ordinary course of business negotiations waived attorney client privilege with respect to that document). Even if a court found that there was not an actual grant of authority, clearly, A ratified E's actions by A's silence or other inaction. Lyon v. Commissioner, T.C. Memo. 1994-351. A used the conference room where the boxes were in full view. A did not question the revenue agents' use of this material over the 18 month span they were using the conference room.

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[1] The attorney client privilege also differs from work product protection in that the privilege belongs solely to the client while work product belongs to both the lawyer and the client. American Standard Inc. v. Pfizer, Inc., 828 F.2d 734, 745 (Fed. Cir. 1987); In re Sealed Case, 676 F.2d 793, 812 n.75 (D.C. Cir. 1982).

F claims the documents were inadvertently provided by E and were not as a result of a voluntary act by A and B. Courts have generally followed one of three distinct approaches to claims based on inadvertent disclosures: (1) the lenient approach, (2) the "middle of the road" approach, which is also called the Hydraflow approach, and (3) the strict approach. The standards governing waiver of the attorney client and work product through inadvertent disclosure are essentially the same and courts use these approaches when analyzing inadvertent disclosures of both attorney client and work product protected information. Westinghouse v. Republic of the Philippines, 951 F.2d 1414, 1429 (3d Cir. 1991) ("the standard for waiving the work-product doctrine should be no more stringent than the standard for waiving the attorney-client privilege"); Carter v. Gibbs, 909 F.2d 1450, 1451 (Fed. Cir. 1990) (for inadvertent disclosures, the criteria for waiver of work product and attorney client privilege are equivalent); see also Wright, Miller & Marcus, Federal Practice and Procedure: Civil 2d §§ 2016.2.

Under the lenient approach, waiver must be made knowingly. The determination of inadvertence is the end of the analysis. This approach reasons that inadvertent disclosure of a protected document is insufficient by itself to constitute a waiver because important rights may only be relinquished intentionally by the client. In re Southeast Banking Corp. Securities and Loan Loss Reserves Litigation, 212 B.R. 386 (S.D. Fla. 1996); Smith v. Armour Pharmaceutical Co., 838 F. Supp. 1573, 1576 (S.D. Fla. 1993). Georgetown Manor, Inc. v. Ethan Allen, Inc., 753 F. Supp. 936, 938 (S.D. Fla. 1991); see also Mendenhall v. Barber-Greene Co., 531 F. Supp. 951, 954 (N.D. Ill. 1982) (holding that the better rule is that mere inadvertent production does not waive attorney client privilege).

The lenient test has been criticized as creating little incentive for lawyers to maintain tight control over privileged material. The lenient test also can be said to minimize the importance of confidentiality since the lack of confidentiality becomes meaningless so long as it occurred inadvertently. A and B will not be able to avail themselves of the lenient approach because this case would not be litigated in a forum following this approach.

If this case is tried in the Tax Court, the rules of evidence applicable to trials without a jury in the United States District Court for the District of Columbia should apply. I.R.C. § 7453; T.C. Rule 143(a). The D.C. Circuit has adopted a strict approach with respect to waiver. Under the strict approach, any document voluntarily produced, whether intentionally or not, loses its privileged status with the possible exception of situations where all precautions were taken. In re Sealed Case, 877 F.2d 976 (D.C. Cir. 1989); In re Mine Workers of America Employee Benefits Plan Litigation, 1156 F.R.D. 507, 512 (D.D.C. 1994) (the holder of the privilege bears the burden of maintaining the confidentiality of privileged information and absent "extraordinary circumstances," disclosure waives the privilege with respect to the privileged documents, regardless of whether the disclosure is

voluntary or inadvertent); see also Carter v. Gibbs, 909 F.2d 1450, 1451 (Fed. Cir. 1990) (the court in adopting a strict approach with respect to the disclosure of attorney work product document, ruled that it was "irrelevant" whether the disclosure was inadvertent).

In re Sealed Case creates a strong incentive for careful document management, stating that "the courts will grant no greater protection to those who assert the privilege than their own precautions warrant." Id. at 980. Under the strict test, any document produced, either intentionally or otherwise, loses its privileged status with the possible exception of situations where all precautions were taken. The strict test makes attorneys and clients accountable for their carelessness in handling privileged matters and creates certainty with respect to whether there has been a waiver. Even if A and B could show their disclosures were inadvertent, there would be waiver under this approach.

Finally, there is the middle test, sometimes called the Hydraflow test. Hydraflow, Inc. v. Enidine Inc., 145 F.R.D. 626, 637 (W.D.N.Y. 1993). Although the Second Circuit has not directly ruled on the issue, district courts within the circuit seem to follow the Hydraflow approach. Laquila Construction, Inc. v. Travelers Idemnification Co., 1999 U.S. Dis. LEXIS 5567 (S.D.N.Y. 1999); United States v. United Techs Corp., 979 F. Supp. 108 (D. Conn. 1997); Aramony v. United Way of America, 969 F. Supp. 226, 235 (S.D.N.Y. 1997); Lois Sportswear, U.S.A., Inc. v. Levi Strauss & Co., 104 F.R.D. 103, 105 (S.D.N.Y. 1985).

Under the Hydraflow test, the court undertakes a five-step analysis of the unintentionally disclosed document to determine the proper range of privilege to extend. These considerations are (1) the reasonableness of the precautions taken to prevent inadvertent disclosure in view of the extent of document production, (2) the number of inadvertent disclosures, (3) the extent of the disclosures, (4) the promptness of measures taken to rectify the disclosure, and (5) whether the overriding interest of justice would be served by relieving the party of its error. Id.; see also Alldread v. City of Grenada, 988 F.2d 1425, 1433 (5th Cir. 1993). If, after completing this analysis, the court determines that waiver occurred, then those documents are no longer privileged.

There would also be waiver under this middle approach for the following reasons (again, assuming the disclosures were inadvertent). A and B took no precautions to prevent inadvertent disclosure to C and D. To the extent this was not a voluntary disclosure, there was such extreme carelessness as to suggest that A and B were not concerned with protecting the information. The number of documents disclosed (641 documents) was significantly high. C and D were allowed free access to this material for about 18 months. Although it can be argued that F acted promptly to rectify the disclosure, it is significant that A's in-house counsel, G, was aware of the use of the material and took no action to rectify the disclosure. A and E also failed

to take action to rectify the disclosure. As for the fifth factor, the revenue agents relied on the access to these materials for about 18 months in order to conduct their audit. They have already relied on the documents obtained during the period they had access to the materials. Additionally, granting the proposed protection of the documents would tend to condone the taxpayers' extreme carelessness. These considerations of fairness would weigh in favor of a finding of waiver.

Finally, it should be noted that the privilege log F provided was deficient to establish that any of the 641 documents are protected from disclosure. The log failed to articulate any rationale for why documents would be protected by the attorney client privilege or work product.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We suggest that in the event this case goes to litigation, Appeals remove the forty-four documents in the Service's possession which F asserts are protected by attorney client privilege and work product and not forward them along to Counsel with the administrative file. Appeals should instead forward to Counsel a list of these documents indicating which documents have been specifically delineated as being protected from disclosure (along with the specific assertion marked on the document) and which documents have not been delineated. Counsel in turn may specifically request these documents in discovery. This process will enable a court to scrutinize F's claims of attorney client privilege and work product protection with respect to the documents in the Service's possession.

If you have any further questions, please call the branch telephone number.