Protecting Confidential Communications Between Counsel and Accountant

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It is not uncommon that there is a cross-over between legal work and accounting work. Lawyers and accountants often work hand-in-hand, and it is essential that they share information to allow the client to receive the best advice possible. However, it is well established that there is no accountant/client privilege in Massachusetts which protects confidential communications between an attorney and an accountant. And, the attorney-client privilege generally extends only to communications between the attorney and the client, and not to communications between the accountant and the attorney or the accountant and the client. How then, if at all, can one protect these communications in the event of litigation

Attorney-Client Privilege

We are all familiar with the attorney-client privilege. The classic formulation is that it protects (1) communications between and attorney and a client; (2) which were intended to be and, in fact were kept, confidential; (3) for the purpose of obtaining or providing legal advice. The privilege belongs to the client though it can be waived expressly by the client or by disclosure to third parties. Is there a way to extend protections afforded by the privilege to communications with an accountant working with the lawyer to provide service to the client?

The Kovel Doctrine

United States of America v. Kovel, 296 F.2d 918 (2d Cir. 1961). Kovel was a former IRS agent. He was employed by a law firm specializing in tax law. Kovel was subpoenaed to testify before a grand jury regarding a client of the firm. The law firm took the position that because Kovel was an employee under the direct supervision of the lawyers, any communications that he had with or regarding the client were privileged. At the grand jury, Kovel refused to testify, and the

Court held him in contempt. On appeal, the Court considered under what circumstances, if any, the attorney-client privilege might also protect communications between a non-lawyer and a lawyer or the client.

The Kovel court recognized that the complexities of law often require lawyers to utilize others to assist them, and that this does not typically waive the privilege. For example, lawyers use secretaries, file clerks, messengers, etc. The Court determined this was no meaningful difference between this type of assistance and "a case where the attorney sends a client speaking a foreign language to an interpreter to make a literal translation of the client's story; a second where the attorney, himself having some little knowledge of the foreign tongue, has a more knowledgeable non-lawyer employee in the room help out; a third where someone to perform that same function has been brought along by the client; ..." It then analogized Kovel's communications with the accountant to those where a lawyer relies on the services of an interpreter. As explained by the Kovel court, the privilege should extend to situations "where the attorney, ignorant of the foreign language, sends the client to a non-lawyer proficient in it, with instructions to interview the client on the attorney's behalf and then renders his own summary of the situation, perhaps drawing on his own knowledge in the process, so that the attorney can give the client proper legal advice." In other words, the Kovel court thought "accountant-ese" was akin to a foreign language for many attorneys and extending the privilege to this narrow area was consistent with established law.

As explained by the Court, "the presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated tax story to the lawyer, ought not destroy the privilege, any more than would that of the linguist in the second or third variations of the foreign language theme discussed above; the presence of 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." The lynchpin for the Kovel court was that **"the communication be made in *confidence* for the purpose of obtaining *legal* advice from the lawyer. If what is sought is not legal advice but only accounting service ... or if the advice sought is the accountant's rather than the lawyer's, no privilege exists."** This language has become the basis for what has become known as the "Kovel Doctrine."

The leading Massachusetts federal decision (USDC) adopting the rationale of Kovel is Cavallaro v. United States, 153 F. Supp. 2d 52 (D. Mass. 2001). Cavallaro involved an attempt by the IRS to verify the tax implications of a merger between two closely held corporations, one owned by the parents and the other by their children. The parents' company acted as a manufacturer and the children's company acted as the manufacturer's rep. At issue were the valuations ascribed to each of the companies.

Prior to the merger, the parents engaged a law firm to assist them with estate planning and potential transfer tax issues. Their company engaged EY to provide tax advice, described in the EY engagement letter, "solely for the benefit of [the children's company] and not for the benefit of anyone other than the corporation and its shareholders." After the merger, the IRS subpoenaed EY, and the parents moved to quash the subpoena on privilege grounds. Their position was that because EY also aided their lawyers in providing legal advice to their company and the parents, the communications were privileged.

Relying on Kovel, which the Cavallaro court recognized as the "leading" case regarding extending the attorney-client privilege to accountants, the Court rejected the attempt to protect the EY communications. It noted that there was no evidence that the parents' lawyers hired EY. To the contrary, the engagement letter specified that EY worked for the childrens company.

Moreover, although the parents argued that EY also provided tax advice to them, the court drew a distinction between the provision of "tax advice" by EY to the parents and situations where "the accountant was acting as agent of the [parents] or their lawyers to assist in securing *legal* advice." Tax advice given directly by the accountant is not protected.

The takeaway from Cavallaro is that Massachusetts courts are hesitant to extend the attorney-client privilege to accountants unless the services performed are narrowly focused on assisting the lawyer in providing legal services as contrasted to providing direct business advice or accounting services. The description of services described in the accountant engagement letter is, therefore, a crucial piece of evidence.

Massachusetts state courts have also adopted the holdings of Kovel and Cavallaro. The seminal Massachusetts state court decision is Commissioner of Revenue v. Comcast Corp., 453 Mass. 293 (2009). In Comcast, the SJC rejected an effort to shield communications between in-house counsel and outside tax consultants (Arthur Anderson) regarding the structuring of a sale of stock. Relying on both Kovel and Cavallaro, the Court determined that whether classified as tax advice or legal advice, the services were not "necessary" for the effective consultation with the attorney. The Court further noted that merely showing that the information provided assisted the attorney in providing better advice, is not enough. The Court focused on the fact that the accountants were expressly engaged to assist the attorney in interpreting Massachusetts law and held that "the privilege does not apply where the accountant provides 'additional legal advice about complying with the tax code even where doing so would assist the attorney in advising the client.'" In responding to the argument that the Comcast decision essentially renders the privilege meaningless, the Comcast court stated that the in-house lawyer was "free to seek advice on Massachusetts tax law from a Massachusetts attorney, where the privilege would apply.

Instead, he sought advice on Massachusetts tax law from Massachusetts accountants, where no privilege applies. If his actions left his client potentially at risk, that is 'the inevitable consequence of having to reconcile the absence of a privilege for accountants and the effective operation of the privilege of client and lawyer under conditions where the lawyer needs outside help'" (citing Kovel).

Kovel, Cavallaro and Comcast provide guidance in efforts to expand the reach of the attorney-client privilege to communications with an accountant. The key is to make it clear that the accountant is not being engaged to provide business or accounting services to the client but rather is being engaged to help the lawyer communicate advice to his/her client.

Kovel Letters

To increase the likelihood of falling within the Kovel protections, before speaking with the accountant, the parties should execute a so-called "Kovel Letter" which describes exactly what services are being provided by the accountant and makes it clear that the accountant is not being engaged to render business advice or to provide any independent analysis, but rather to merely assist the attorney in providing legal advice. To be an effective Kovel Letter, the following tips should help:

- Counsel, not the client, should be the one to engage the accountant for the limited purpose of providing information and analysis to assist the lawyer in providing legal advice.
- There should be a dedicated engagement letter that clearly outlines the limited purpose of the engagement towards assisting the lawyer in communicating legal advice to his/her client;

- Communications should, if possible, go directly to the attorney instead of to the client (which allows you to argue that the attorney is the actual client).
- Hire the lawyer first, then the accountant.
- Document how the accountant's work will assist the lawyer.
- If possible, the accountant utilized should not be the client's existing accountant (unless absolutely necessary). If there is overlap, the two roles must be clearly segregated.
- Consider having outside counsel engage the accountant instead of in-house counsel. (Courts sometimes view in-house counsel's role as largely business and not legal).
- If engaged in anticipation of litigation, the engagement letter should so state.
- In the engagement letter state that all communications between the attorney, client and accountant are incidental to the provision of legal services and are intended to be confidential.
- The accountant's work papers should be marked "prepared at the request of counsel" and be segregated from other accounting documents.
- The accountant's work papers should be deemed part of the lawyer's file, not the accountant's, as would be true in the typical engagement.
- All documents should be kept confidential (so as to not destroy the privilege by having a third-party come into possession)
- The accountant's bill should be sent to and paid for by the attorney (and then billed back to the client as an expense)

Work-Product Doctrine

In Comcast, despite losing the battle on the basis of attorney-client privilege, Comcast won the battle on its second argument: work-product doctrine.

The work-product doctrine has its genesis in Hickman v. Taylor, 329 U.S. 495 (1947). Hickman involved a wrongful death case of a seaman who died when a tugboat sank. The plaintiff sought to discover statements of the crew members taken by defendants' counsel who had been engaged to conduct an investigation in anticipation of the inevitable lawsuit. Under the work-product doctrine, now codified in Massachusetts Rules of Civil Procedure, Rule 26(b)(3), documents "prepared in anticipation of litigation or for trial by or for another party of by or for that other party's representative" are not discoverable absent "a showing that the party seeking discovery has substantial need of the materials in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means."

Federal Rule 26(b)(3) contains similar protections, though the protections afforded to communications between an attorney and one who has been engaged as an expert go a bit further. The Federal rule expressly protects those communications (FRCP 26(b)(4)(C)) except to the extent that the communications relate to compensation of the expert, the facts or data provided or relied upon, and the assumptions that the expert relied upon which were provided by the attorney. This express carve out is not present in the Massachusetts state rules.

Thus, you should always have a Kovel Letter and, if you are anticipating litigation, make it clear that your accountant is being engaged in anticipation of litigation so that you also have the work-product fall back argument if your request for Kovel extension of the privilege does not prevail.

Non-Disclosure Agreements

It is essential under both Kovel and the work-product doctrine that the protected communications be kept confidential. If the information is shared with a third-party, whatever protections you might have had, will have been lost. Generally, Non-Disclosure Agreements are enforceable as long as they are reasonable. Similarly, confidentiality clauses in your engagement letters are also upheld. Having those in place, underscores that your intention is to keep information confidential, provides you with an opportunity to "call back" inadvertent disclosures provided that you act promptly.

Responding to Subpoenas

A subpoena is a court order, carrying with it all the powers of the legal system, such as contempt, if you do not comply with it. When receiving a subpoena, whether for documents or not, note the day it was served as well as the day specified for compliance. (Often you can get an extension unless there is a firm trial date or something of that nature). If you believe that the information sought is broad enough to require production of documentation or information discussed with an accountant which may be protected by the Kovel Doctrine, Work-Product Doctrine, or some other basis (i.e. confidentiality), you need to assert those objections timely.

Rule 45(d)(2) of the Massachusetts Rules of Civil Procedure allows you to assert an objection within 10 days of service or at any time prior to the date for production if it is less than 10 days, in writing. At that point, the burden falls on the party requesting the material to file a motion to compel the production. If your objection is based on privilege, you should include a privilege log identifying the material with sufficient detail such that the privilege can be assessed.

Rule 45(d)(2)(B) of the Federal Rules of Civil Procedure is similar, but the time frame is 14 days instead of 10. The federal rule also mandates that the requesting party must make reasonable efforts to avoid undue expense and burden.

Inadvertant Disclosures

Care must be taken not to inadvertently produce information that you believe is protected, especially as the inadvertent production could be deemed a waiver of the attorney-client privilege that you have worked so hard to protect. Accidents to happen, however. If you do inadvertently disclose, both the Massachusetts and Federal rules have a procedure by which you can try to call back the information and prevent the other side from using it. See FRCP 26(b)(5)(ii)(B) and MRCP 26(b)(5)(B). Both rules require that you act promptly upon learning of inadvertent disclosures and be prepared to explain the procedures you had in place to prevent the inadvertent disclosures. Both rules describe the process of how to obtain court intervention if the other side does not voluntarily agree (which is usually the position taken), with the Massachusetts rule referring directly to Rule VIII of the Trial Court Rules, Uniform Rules of Impoundment Procedure.