

Cost-Efficient Alternatives for Document Production Gaining Traction

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Tax controversies often involve voluminous document production and extensive privilege logs from multiple parties. The privilege issues can be complex and involve advice from multiple advisers potentially covering several different types of privilege protections, including attorney-client, work product and Section 7525 tax practitioner. Even when the number of documents and privilege claims remains relatively small, litigants may worry about the risk of subject-matter waiver if they do not vigorously assert privilege over otherwise innocuous documents. Given this backdrop, taxpayers, the courts and the government have begun to adopt new methods for minimizing the cost and burden of document production and resolving the privilege concerns often associated with document-intensive tax disputes.

Taxpayers should consider whether these alternative approaches can be used in the administrative process and tax litigation as a way to save time and money and lead to more efficient resolution of privilege disputes. Indeed, recent litigation has demonstrated that the Department of Justice (DOJ) and Internal Revenue Service (IRS) are now more willing than they were just several years ago to engage in practices that can potentially streamline discovery and limit drawn-out privilege fights. Two examples of such practices are the use of predictive coding and the negotiation of customized “quick peek” agreements.

Predictive Coding

In *Dynamo Holdings Ltd. P’ship v. Comm’r*, 143 T.C. No. 9 (Sept. 17, 2014), the U.S. Tax Court embraced a process already blessed by some district courts, holding that taxpayers can use predictive coding to more efficiently identify documents responsive to a discovery request issued by the IRS. Predictive coding is a form of computer-assisted review in which the producing party selects and codes a sample set of documents drawn from the larger universe of documents to be searched. A computer program then “predicts” the responsiveness of the remaining documents based on the coding performed on the sample set. The approach can significantly decrease the amount of documents to be reviewed, which leads to substantial cost savings for the taxpayer.

Expert testimony in *Dynamo* established that the use of predictive coding would reduce the taxpayer’s cost of responding to the discovery request from \$500,000 to approximately \$85,000. *Id.* at p. 19. The decision reflects the current judicial trend in cases involving significant document review of seeking cost efficiencies in advance of production and any resulting privilege disputes.

Customized “Quick Peek”

A second important cost-saving strategy that litigants and the courts recently have employed (and that the IRS suggested be used in *Dynamo* instead of the predictive coding the court ultimately allowed) involves the use of “quick peek” agreements. The customized quick peek, in which the parties jointly develop a quick peek agreement tailored to their needs and the circumstances of the case, can and has been

used as a way of efficiently allowing IRS/DOJ to review documents despite obstacles such as voluminous amounts of privileged information or situations where the assertions of privilege require verification.¹

It is important to note that, as described below, quick peek review does *not* require a party to allow the adversary's trial or exam team to see privileged materials.² Taxpayers and the IRS/DOJ can craft ways to enhance efficiency while not giving the adversary a window into all privileged communications, such as selecting an independent or third-party reviewer or limiting the amount of contact the reviewer can have with those directly involved in the dispute. Two recent, significant tax cases involving Skadden clients utilized customized quick peek procedures. Although the specifics of the procedures substantially differed, the fact that both cases used customized agreements demonstrates the flexibility afforded to taxpayers via this approach.

Key potential advantages of the customized quick peek include:

- **Flexibility:** The parties can negotiate a carefully tailored agreement addressing the scope of the documents subject to review and whether the review will include all of the documents or just a particular subset.
- **Neutral, Third-Party Review:** The agreement can be drafted to appoint a specially selected, neutral third-party to review the documents. Using a neutral party avoids tainting the trier of fact (*i.e.*, the judge) during *in camera* review of the documents and avoids allowing the government access to privileged documents. While an independent mediator may be ideal from the taxpayer's perspective, potential reviewers also could include a DOJ employee not involved in the litigation. The taxpayer also could negotiate the opportunity to participate in the review process and provide the reviewer with the appropriate context for the privileged documents.

Prior to the recent litigation in which the IRS and DOJ were willing to enter into customized quick peek arrangements, the government appeared to disfavor such arrangements. On August 3, 2009, the Office of the Chief Counsel of the IRS issued Notice CC-2009-023 (approximately one year after the effective date of Fed. R. Evid. 502), expressing its disfavor with the use of quick peek agreements in the administrative process. The notice cited concerns about the binding nature of such audit-stage agreements on IRS counsel and the DOJ in later proceedings, as well as the potential overuse by taxpayers of such agreements. However, the recent trend in the use of quick peek arrangements in tax disputes may signal a shift in the government's willingness to engage in a customized quick peek process.

¹ The basic concept underlying quick peek review is contemplated in the 2006 Advisory Committee Notes to Fed. R. Civil. P. 26 (though the term "quick peek" is not used) and is expressly mentioned in the Advisory Committee Notes to Fed. R. Evid. 502(d). See also *In re Delphi*, 2007 WL 518626 at *8 (E.D. Mich 2007) (court encouraged parties to agree upon a "quick peek" procedure as a preliminary step in order to reduce the number of documents that would be subject to *in camera* review). Under a standard, "uncustomized" quick peek agreement, the producing party makes the entire universe of documents at issue available to the requesting party prior to undertaking any privilege review. The requesting party then reviews the documents and selects the subset it wants the producing party to produce in the litigation or administrative proceeding. The requesting party's review does not result in a waiver of any privilege. The producing party then performs a privilege review of the documents selected by the requesting party.

² Any quick peek agreement should contain language expressly recognizing that no subject-matter waiver has occurred and ask the court to adopt that language as a condition of the agreement, in order to provide confidence that the government cannot later argue that a waiver has occurred. Fed. R. Evid. 502(d) explicitly provides that a court order declaring that there is no waiver also precludes the government from arguing for waiver in any later proceeding. See Fed. R. Evid. 502(d)-(f); *Hopson v. City of Baltimore*, 232 FRD 228 (D. Md. 2005). Note that Rule 502(d) expressly applies to the attorney-client privilege and work product protection, but it does not apply to the Section 7525 tax practitioner privilege.

Conclusion

Predictive coding and customized quick peek agreements can allow taxpayers and the government to resolve difficult privilege disputes efficiently and with finality. Acceptance of such customized procedures in three recent complex tax cases reflects the courts' increasing support of cost-effective solutions in cases involving the potential for significant document review. Taxpayers should consider the application of such agreements to their particular tax controversies and work with their advisers to establish parameters that increase efficiencies while still protecting sensitive information.