

B. THE DISTRICT COURT ERRED IN CONCLUDING THAT THE DOCUMENTS LISTED AS FTB 100139, FTB 100218, FTB 100288 & 100289-100292, FTB 100401, FTB 100908-100909, FTB 101634-101645, FTB 101656, FTB 104117-FTB 104122 (DUPLICATED AT FTB 100288 & 100289-100292) AND FTB 07381 WERE NOT PRIVILEGED AND HAD TO BE DISCLOSED TO HYATT.

1) The Attorney-Client Privilege Bars Disclosure of Confidential Communications Between Client and Lawyer

The FTB has asserted that many of the documents requested by Hyatt are protected from discovery under the attorney-client privilege because they involve confidential communications with FTB's Tax Counsel. The specific documents at issue are listed as FTB 100139, FTB 100218, FTB 100288 & 100289-100292, FTB 100401, FTB 100908-100909, FTB 101634-101645, and FTB 07381.

The attorney-client privilege allows a client to refuse to disclose and prevent another from disclosing confidential communications between the client or his representative and his attorney or his attorney's representative, which communications were made for the purpose of facilitating the rendition of legal services to the client. N.R.S. 49.095. It is the oldest of the privileges for confidential communications known to the common law. The privilege rests on the theory that encouraging clients to make full disclosure to their attorneys enables the latter to act more effectively, justly and expeditiously, a benefit outweighing the risks posed to truth finding. Haynes v. State, 103 Nev. 309, 317, 739 P.2d 497, 502 (1987).

The privilege exists to protect "not only the giving of professional advice to those who can act on it but also the giving of information to the lawyer to enable him to give sound and informed advice." Upjohn Co. v. United States, 449 U.S. 383, 390 (1981) (citations omitted); see also First Chicago Intern. v. United Exchange Co., Ltd., 125 FRD 55, 58 (S.D.N.Y. 1989) (documents

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2 created at corporate counsel's request to provide counsel with facts necessary to render legal
3 opinion protected by attorney-client privilege). While the privilege does not extend to mere facts,
4 "[a] fact is one thing and a communication concerning that fact is an entirely different thing."
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6 Upjohn, 449 U.S. at 395-396. Hyatt is entitled to discover the relevant facts, but not to discover
7 documents that reflect or constitute confidential legal communications regarding those facts. Id.

8 The FTB, as a public entity of the State of California, fits the definition of "client" under
9 Nevada law. N.R.S. §49.045. The attorney-client privilege applies where there is a confidential
10 legal communication between an FTB lawyer and a "representative of the client," which means "a
11 person having authority to obtain professional legal services, or to act on advice rendered pursuant
12 thereto, on behalf of the client." N.R.S. §49.075. The attorney-client privilege applies with equal
13 force to confidential legal communications involving in-house and outside counsel. Upjohn, 449
14 U.S. at 394-397; American Optical Corp. v. Medtronic, Inc., 56 FRD 426, 430 (D. Mass. 1972).
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16 Nevada and California law are in harmony in the confidential treatment accorded attorney-
17 client communications. See California Evidence Code §§ 175 and 951. In California and Nevada,
18 the attorney-client privilege applies to client communications in the course of professional
19 employment that are intended to be confidential. In California and Nevada, client communications
20 with public lawyers are accorded the same scope of protection as client communications with
21 private lawyers. Under California law, FTB's Tax Counsel are public lawyers appointed by the
22 FTB and acting under legislative authority. See California Revenue & Taxation Code section
23 17023. The FTB's Tax Counsel is required to have been admitted as a member of the California
24 State Bar as a term of employment. See California Franchise Tax Board Tax Counsel Job
25 Description, attached hereto as Exhibit 13. The FTB's Tax Counsel is a separate operational
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2 branch within the Franchise Tax Board. See Franchise Tax Board Organizational Chart, attached
3 hereto as Exhibit 14.

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5 Moreover, based on the principles of comity and choice of law grounds, the confidential
6 communications involving FTB's Tax Counsel and FTB's employees are attorney-client
7 communications and protected by the privilege of confidentiality. All these confidential
8 communications with FTB's Tax Counsel occurred outside of Nevada and inside of California or
9 deal with the application of California tax law to Hyatt. In California, communications between a
10 public lawyer and the client are treated as confidential communications within the ambit of the
11 attorney-client communication privilege. See California Evidence Code section 950 et. seq.,
12 Roberts v. City of Palmdale 5 Cal.4th 363, 371-72, 20 Cal.Rptr.2d 330, 334 (Cal. 1993); People
13 ex rel. Deukmejian v. Brown 29 Cal.3d 150, 159, 172 Cal.Rptr. 478, 482 (Cal. 1981) Ward v.
14 Superior Court 70 Cal.App.3d 23, 138 Cal.Rptr. 532 (Ct. App. 1977); People ex rel. Department
15 of Public Works v. Glen Arms Estae, Inc. 230 Cal.App.2d 841, 41 Cal.Rptr. 303 (Ct. App. 1964).
16 Moreover, in California, where the public lawyer's advice pertains to a matter as to which the
17 agency possesses independent authority, a distinct attorney-client relationship with the agency is
18 created. Civil Service Commission v. Superior Court 163 Cal.App.3d 70, 78, 290 Cal.Rptr. 159,
19 164.
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22 Moreover, in California, the Legislature has provided additional protections to shield the
23 disclosure of attorney-client communications under the California Public Records Act, Cal. Govt.
24 Code section 6254 (a), (b), and (k) (West Supp. 1999), when public lawyers and public employees
25 communicate in writing. See Roberts v. City of Palmdale 5 Cal.4th 363, 373, 20 Cal.Rptr.2d 330,
26 335 (Cal. 1993). Thus, in addition to the general attorney-client communications that fall within
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the ambit of California Evidence Code sections 950 et. seq., the California Supreme Court has extended the preclusion against disclosing confidential communications involving attorney and client to: (1) preliminary drafts, notes, or interagency or intra-agency memoranda which are not retained by the public agency in the ordinary course of business; (2) records pertaining to pending litigation to which the public agency is a party; and (3) records the disclosure of which is exempted or prohibited pursuant to federal or state law. See Roberts v. City of Palmdale 5 Cal.4th 363, 373, 20 Cal.Rptr.2d 330, 335 (Cal. 1993); California Public Records Act, Cal. Govt. Code section 6254 (a), (b), and (k) (West Supp. 1999).

The District Court below, and the Discovery Commissioner, made an erroneous determination by concluding that confidential communications between the FTB's Tax Counsel and FTB employees are not within the protections of the attorney-client communication privilege. Under both California and Nevada law, FTB Tax Counsel are lawyers, and any confidential communication between a lawyer and client is privileged from disclosure unless the confidential communication falls within narrowly prescribed exceptions to the rule. Under both Nevada and California law, confidential communications made between lawyer and client during the course of an lawyer-client relationship are not subject to discovery. With both states, there are limited exceptions in which the lawyer-client relationship does not apply. The only exception to the lawyer-client privilege sought by plaintiff was under the crime-fraud exception, and the Discovery Commissioner specifically found that the crime-fraud exception did not apply. See Transcript of Discovery Commissioner's November 9, 1999 hearing, Exhibit 4, at p. 75. Accordingly, the lawyer-client privilege of both California and Nevada should act to bar disclosure and discovery of confidential communications between FTB Tax Counsel and FTB employees.

1. FTB 100139

This document is an internal FTB communication between Anna Jovanovich and Sheila Cox. At the time the document was drafted, Ms. Jovanovich was an FTB attorney and Ms. Cox was the auditor on the Hyatt file. The redactions relate to conversations that Ms. Cox had with Ms. Jovanovich, an FTB attorney, about the Hyatt case. The redaction reflects that legal advice, not business advice, was offered by Ms. Jovanovich, because the advice concerns a recommendation about what additional information might be necessary in order to make an appropriate residency determination under California's tax laws.

The Discovery Commissioner determined that the document was not privileged based on Finding Four and Finding Six. However, these findings are erroneous. In Finding Four, the Discovery Commissioner stated that the "entire process of the FTB audits of Hyatt, including the FTB assessments of taxes and the protests, is at issue in this case" and that Hyatt "is alleging fraud, among other torts, by the FTB in the manner it audited him and assessed and attempted to collect taxes and penalties from him [and that] Hyatt's claim of fraud against the FTB entitles him to discovery on the entire audit and assessment process performed by the FTB." Exhibit 3, p. 3. However, just because the Discovery Commissioner concluded that Hyatt had alleged fraud and was therefore entitled to discover the entire process of the FTB's audit, does not mean that Hyatt is entitled to discover documents covered by the attorney-client privilege.

Hyatt argued to the Discovery Commissioner, in a separate appendix to the motion, that the FTB auditors and attorneys engaged in fraudulent activity such that the Discovery Commissioner should invoke the "crime-fraud" doctrine to permit inspection of documents which otherwise would be protected by the privilege. However, Hyatt was unsuccessful, and the

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2 Discovery Commissioner stated that he "was not going to embrace [the crime-fraud exception] as
3 a reason for the recommendation on the production" of documents which FTB claimed were
4 protected by the attorney client privilege. See Exhibit 4, p. 75. Therefore, the crime-fraud
5 doctrine does not apply in this case.
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7 Even a court intent on discarding the attorney-client privilege and permitting a review of
8 documents based on the fact that crime or fraud has occurred has an obligation to hear testimony
9 and, if warranted, conduct an *in camera* review of the documents. Courts have adopted a two-
10 pronged test in making such a determination. First, the court must find "'a factual basis adequate
11 to support a good faith belief by a reasonable person' that an *in camera* review of the materials
12 reveals evidence to establish the claim that the crime-fraud exception applies." United States v.
13 Zolin, 491 U.S. 554, 572 (1989) (quoting Caldwell v. District Court, 644 P.2d 26, 33 (1982)); see
14 also Seattle N.W. Securities v. SDG Holding, 812 P.2d 488, 497 (Wash. Ct. App. 1991); Central
15 Construction Co. v. Home Indem. Co., 794 P.2d 595, 598 (Alaska 1990). Second, once such a
16 showing is made, the judge has discretion to conduct the *in camera* review based on the facts and
17 circumstances of the particular case. Zolin, 491 U.S. at 572.
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20 The Discovery Commissioner, presumably, considered the foregoing crime-fraud exception
21 analysis and concluded that Hyatt had not proven that the crime-fraud exception applied, by stating
22 that he "was not going to embrace [the crime-fraud exception] as a reason for the recommendation
23 on the production" of documents which FTB claimed were protected by the attorney client
24 privilege. See Exhibit 4, p.75. As such, the crime-fraud exception has not been established by
25 Hyatt and did not serve as a basis for the Discovery Commissioner's ruling. Hyatt did not
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2 challenge the Discovery Commissioner's conclusion on this point. Absent such a finding, the
3 attorney-client privilege still attaches to the relevant documents.

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5 Furthermore, Finding Six is erroneous because it disregards and ignores the fact that
6 Jovanovich at all times acted as an FTB attorney, engaged in communications with her client —
7 the FTB — regarding legal advice on the Hyatt audit.

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9 Specifically, with regard to FTB 100139, Ms. Jovanovich was an FTB attorney at the time
10 the document was drafted, and the document reflects legal advice from Ms. Jovanovich to Ms.
11 Cox regarding what information would be required to make a legal determination that Hyatt was a
12 resident of California and owed California income tax. Therefore, the document is clearly a
13 communication between an attorney and client regarding legal advice and should be privileged.

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15 At a May 5, 1999, hearing on the attorney-client privilege issue, the Discovery
16 Commissioner commented that FTB 100139 presented the same factual situation as FTB 100216
17 (which was duplicated in typewritten form in FTB 100209), which was produced only in redacted
18 form. See Transcript of Discovery Commissioner's May 5, 1999 hearing, pg. 49, line 22-23,
19 attached hereto as Exhibit 15. The redacted portion of FTB 100216 includes a recitation of a legal
20 communication that Richard Gould, FTB Tax Counsel, had with Mark Shayer, a former FTB
21 employee auditor who was the auditor of Hyatt before Sheila Cox. The redacted entry reflects Mr.
22 Gould's legal advice to Mr. Shayer about certain California tax statutes and decisions that might
23 apply to the Hyatt audit. The Discovery Commissioner concluded that the redactions were
24 privileged because they constituted attorney-client communications. See Discovery
25 Commissioner's Report and Recommendation, Exhibit 3, p. 4; Exhibit 15, pp. 42-45.
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3 Despite the fact that the Discovery Commissioner concluded that the FTB 100216 was
4 privileged, and that FTB 100139 presented the same circumstances as the FTB 100216, only with
5 Anna Jovanovich as the FTB in-house lawyer and Sheila Cox as the auditor on the Hyatt matter,
6 the Discovery Commissioner concluded that the redactions on FTB 100139 were discoverable,
7 based solely on the Findings Four and Six. There should be no difference between the analysis that
8 is applied to FTB 100216 and that applied to FTB 100139 — both Gould and Jovanovich were
9 attorneys providing legal advice to FTB employees. The comparison between FTB 100216 and
10 FTB 100319 shows the fallacy of the Discovery Commissioner's findings.
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12 Findings Four and Six are erroneous. The Discovery Commissioner concluded that the
13 crime-fraud exception does not apply in this case and, therefore, there is no justification for a
14 conclusion that Hyatt is entitled to inspect FTB documents which are otherwise protected by the
15 attorney-client privilege. Furthermore, in the audit of Hyatt, Jovanovich acted solely as a legal
16 advisor to the audit staff and this conduct in no way extinguishes the attorney-client privilege. The
17 Discovery Commissioner's conclusions in Finding Six are erroneous because so long as Jovanovich
18 was acting in her capacity as an attorney and giving legal advice to her client — the FTB — the
19 communications are protected from disclosure by the attorney-client privilege, especially in light of
20 the Discovery Commissioner's conclusion that the crime-fraud exception did not apply in this case.
21 Moreover, the finding that Anna Jovanovich was an integral part of the audit is a distortion of fact.
22 The audit extended over a six year period. It consumed over six hundred hours of auditor time.
23 Over this six year period, Anna Jovanovich consulted with the auditor on the Hyatt matter seven
24 times and contributed less than fifteen hours of her time during this period.
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2. FTB 100218 & FTB 100401

The redacted portion of FTB 100218⁴ reflects a question from Sheila Cox, the FTB auditor at the time, to in-house FTB lawyer Anna Jovanovich. The question constitutes an internal FTB communication, and the document expressly states what an FTB client representative said to an FTB attorney in order to obtain legal guidance as to how to proceed with the Hyatt audit. As such, Hyatt's demand for production is the equivalent of asking Ms. Cox "What did you say to the attorney?" — a question which Ms. Cox could not be compelled to answer:

"A fact is one thing and a communication concerning that fact is an entirely different thing. The client cannot be compelled to answer the question, 'What did you say or write to the attorney?' but may not refuse to disclose any relevant fact within his knowledge merely because he incorporated a statement of such fact into his communication to this attorney." Upjohn, 449 U.S. at 395-396 (quoting Philadelphia v. Westinghouse Electric Corp., 205 F.Supp. 830, 831 (E.D. Pa. 1962).)

The remaining analysis of this document is identical to that presented in conjunction with FTB 100319. Ms. Jovanovich was acting as an FTB attorney at the time of the communication, Ms. Cox was seeking legal advice from Ms. Jovanovich, and the crime-fraud doctrine does not apply. As a result, the communication is protected from discovery.

3. FTB 100288 & FTB 100289-92

FTB 100288 is a cover memo for FTB 111289-92, which is a memorandum that is prominently marked "Not for Public Distribution, Confidential, Attorney-Client Privileges." The Discovery Commissioner suggested that no attorney-client privilege applies based on Findings Four and Six because the documents were distributed to five people. However, these documents

⁴FTB 100401 is a duplicate document of FTB 100218. The same arguments regarding privilege stated under FTB 100218 apply with equal force to this document.

on their face indicate that the distribution was simply to the five FTB employee attendees of a meeting in California, where FTB attorney Richard Gould discussed legal issues with all of them. As a reminder, the Discovery Commissioner concluded that Richard Gould was an FTB attorney who was not involved in the Hyatt audit in any other capacity, and that communications with Gould wherein he offers legal advice are privileged.

To hold that this distribution waives the attorney-client privilege is to hold that in-house attorneys cannot give legal advice to more than one client representative at a time, and it suggests that a corporation cannot disseminate legal advice to all of the people who need to know it. The memorandum provides analysis of a method of taxation, the legal requirements to invoke that method, and the possible application of that method to the Hyatt audit. The memorandum contains citations to tax codes and court cases, and unquestionably constitutes legal advice from the FTB attorney. Moreover, the issues discussed in memorandum may become relevant in the Hyatt protest, which is an ongoing administrative proceeding.

4. FTB 100908-909

This document is an internal memorandum from Mark Shayer, a former FTB employee, to Anna Jovanovich, FTB's Tax Counsel. The second page contains several specific legal questions for Ms. Jovanovich, based on the case summary on the first page. Mr. Shayer, as the auditor in October 1993, had the power to request advice from Ms. Jovanovich on behalf of the FTB, and was thus a client representative for purposes of Nevada privilege law. N.R.S. §49.075. Since the privilege protects "not only the giving of professional advice to those who can act on it but also the giving of information to the lawyer to enable him to give sound and informed advice," the entire document is privileged. Upjohn, 449 U.S. at 390 (citations omitted). Moreover, the confidential

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2 communication occurred in California where it is protected by the attorney-client communication
3 privilege.

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5 While the Discovery Commissioner concluded that FTB 100216 -- a communication from
6 My. Shayer to Mr. Gould requesting legal advice -- was privileged, the Discovery Commissioner
7 concluded that FTB 100908-99 was not protected by the attorney-client privilege based on
8 Findings Four and Six, which are erroneous. The letter is addressed to Ms. Jovanovich as "Lead
9 Technical Counsel," and Mr. Shayer was requesting specific legal advice regarding the imposition
10 of taxes. This document is clearly covered by the attorney-client privilege and must not be
11 disclosed.

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13 **5. FTB 101634-101645 & FTB 101646-101656**

14 These documents are two versions of a memorandum from Sheila Cox to Anna Jovanovich
15 in the FTB Legal Department. They discuss the factual history of the case and the potential bases
16 for application of the civil fraud penalty to Mr. Hyatt. The Discovery Commissioner concluded
17 that the documents were not privileged based on Findings Four and Six.

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19 As stated before, the fact is that Ms. Jovanovich was acting as an FTB attorney, and the
20 document was directed to her from her "client," Ms. Cox, an FTB auditor. The documents contain
21 a summary of the factual history of the case, and while it is true that the facts in the memo are not
22 privileged, "[a] fact is one thing and a communication concerning that fact is an entirely different
23 thing." Upjohn, 449 U.S. at 395-396, these memos show exactly what Ms. Cox said to an FTB
24 lawyer, and are privileged in their entirety.

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26 The Court should not operate under the assumption that these facts have been hidden from
27 Hyatt. To the contrary, the audit narrative for the 1991 Hyatt audit describes all of the factual
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2 matters in these memoranda, as part of the proof that Hyatt tried to perpetrate an amateurish tax
3 fraud on the State of California. This audit narrative was produced to Hyatt. See Hyatt's
4 Appendix of Exhibits, attached hereto as Exhibit 16. This is not a case in which Ms. Cox told facts
5 to Ms. Jovanovich in an attempt to cloak them with privilege. Rather, Ms. Cox laid all these
6 matters out as part of her exhaustive narratives which have already been made available to Mr.
7 Hyatt together with referenced back up materials, facts either considered or relied on, as well as
8 the entire audit file. Furthermore, Hyatt has extensively reviewed all the facts of the audit by
9 examining Ms. Cox for nine days in deposition.
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12 **6. FTB 07381**

13 This document reflects a conversation between Anna Jovanovich and Richard Gould
14 regarding tax sourcing issues. At the time of the conversation, Gould and Jovanovich were FTB's
15 Tax Counsel discussing the protest of Hyatt. This document reflects Gould's legal opinions
16 regarding the availability of using the sourcing method to assess California income taxes on Hyatt,
17 and is unquestionably a privileged communication between two staff attorneys and is entitled to
18 protection under the attorney-client privilege. The Discovery Commissioner order FTB to disclose
19 these documents based on Findings Four and Six.
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21 This document is no different than FTB 100216 in that it is a communication from Gould
22 to another FTB employee regarding legal advice on a method of taxation. Because this is a
23 situation where Gould was the party giving the advice, it should be privileged regardless of what
24 capacity Jovanovich was acting in at the time of the communication.
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2) Attorney Work-Product Is Not Subject To Discovery.

FTB also claims that one document listed on the privilege log that was ordered disclosed by the Discovery Commissioner is protected from disclosure by the attorney work product doctrine. N.R.C.P. 26(b)(3) limits the discovery of documents and tangible things prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative. The doctrine protects an attorney's mental impressions, conclusions, or legal theories concerning the litigation, as reflected in memoranda, correspondence, interviews briefs, or in other tangible and intangible ways. Wardleigh v. Second Judicial Dist. Court, 111 Nev. 345, 357, 891 P.2d 1180, 1188 (1995).

1. FTB 07381

This document has been discussed in the section regarding attorney-client privilege. It is also protected from disclosure because it reflects the mental impressions, conclusions and legal theories of FTB attorneys. As such, this document is clearly privileged and protected from disclosure. Furthermore, despite the Discovery Commissioner's Finding Four, there has been no ruling that the crime-fraud exception applies, and therefore, there is no exception to the work-product privilege available to Hyatt

3) Some of the documents are protected by the Deliberative Process privilege.

The FTB is claiming the deliberative process privilege with respect to six documents, totaling ten pages, including FTB 104117 through 104122 and FTB 100289 through FTB 100292.

Hyatt is barred from discovering the mental and deliberative processes of an administrative agency. This is commonly referred to as the deliberative process privilege, which has a basis in

both state and federal law. This prohibition against examination of the mental and deliberative processes of the FTB as a substitute for examination of the facts themselves is recognized as the Morgan/Fairfield rule (313 U.S. 409, 422; 14 Cal.3d 768, 779) in U.S. and California courts. See County of San Diego v. Superior Court, 176 Cal.App.3d 1009, 1024 (1986). The oldest case establishing this principal is Martin v. Mott (1872) 12 Wheat. 19, 31, 6 L.Ed. 527. Mr. Justice Story stated there:

Whenever a statute gives a discretionary power to any person, to be exercised by him upon his own opinion of certain facts, it is a sound rule of construction, that the statute constitutes the sole and exclusive judge of the existence of those facts.

The leading case on the subject is United States v. Morgan, 313 U.S. 409, 421-422 (referred to as the "Fourth Morgan" case) where the United States Supreme Court stated:

But, finally, a matter not touching the validity of the order requires consideration over the Government's objection the district court authorized the market agencies to take the deposition of the Secretary. The secretary thereupon appeared in person at the trial. He was questioned at length regarding the process by which he reached the conclusions of his order, including the manner and extent of this study of the record and his consultation with subordinates. His testimony shows that he dealt with the enormous record in a manner not unlike the practice of judges in similar situations, and that he held various conferences with the examiner who heard the evidence. Much was made of his disregard of a memorandum from one of his officials who, on reading the proposed order urged considerations favorable to the market agencies. But the short of the business is that the Secretary should never have been subjected to this examination. (Emphasis added.)

In ISI Corporation v. United States, 503 F.2d 558 (9th Cir. 1974), the court held that opinions, conclusions and reasoning of governmental officials are not subject to discovery. There, the Ninth Circuit affirmed the trial court's denial of the corporation's motion to compel answers from an Internal Revenue Service auditor and noted, "Relying on other district court opinions [citation] the district judge held that 'the opinions, conclusions and reasoning of governmental

officials are not subject to discovery.' We accept this statement as a correct rule of law" *Id.* at 559 (citation omitted).

In *Green v. Internal Revenue Service*, 556 F.Supp. 79, 84-85 (N.D. Ind. 1982), *aff'd*, 734 F.2d 18 (1984), the court discussed at length the policy and rationale behind the privilege which protects the deliberative process⁵ of a governmental agency:

The governmental privilege protects material reflecting the decisions or policy making process of Governmental agencies ... The Courts in the above cases denied production of documents on the ground that internal agency documents containing the opinions, conclusions and reasoning reached by governmental officials in connection with their official duties are entitled to a qualified protection from disclosure.

The governmental privilege is based upon two important policy considerations. First, it was developed to promote frank discussion among those upon whom rests the responsibility for making the determinations that enable the Government to operate ... Second, the privilege is designed to shield from disclosure the mental processes of executive and administrative personnel.

The privilege applies to intra-governmental documents reflecting advisory opinions, recommendations and deliberations which comprise part of the process by which governmental decisions are formulated. Once claimed, the privilege protects material relating to the methods by which a decision is reached, as well as the matters considered, the contributing influences, and the rule played by the word of others The privilege has also been held to apply to '[o]pinions, legal analysis and recommendations, ".... 'opinions, conclusions and reasoning of Governmental officials, 'conclusions or opinions,'... material reflecting deliberative or policy-making processes, ... and documents which are part of the 'administrative reasoning process.'....

Id. at 84-85 (citation omitted).

⁵The deliberative process privilege is really the well established rule which exempts from disclosure intergovernmental communications containing conclusions, opinions and reasoning. (*United States v. Leggett and Platt, Inc.* 542 F.2d 655 (6th Cir. 1976).) The discussion of the privilege is clouded because the disclosure statutes, such as Freedom of Information Act, the California Public Records Act and the Information Practices Act, have often adopted this common law privilege as the basis for exemption from disclosure. The release of information under the disclosure acts is different than litigation; however, the cases which discuss deliberative process in this light may be helpful in the understanding of the common law privilege.

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2 The privilege to preserve the confidentiality of the governmental decision making process
3 also has been applied in numerous other cases involving the Internal Revenue Service. For
4 example, in Bank of America v. U.S., U.S. District Court, No. Dist. Calif., May 24, 1979, 78-2
5 USTC (CCH ¶ 9493), the court stated, "[i]f disclosure of the requested IRS files would inhibit free
6 and open discussion between governmental officials or unduly embarrass the government, the files
7 may be subject to a qualified privilege for the opinions and views of government officials."
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9 Similarly, in Furman v. U.S., U.S. District Court, South Carolina, Greenville Div., Nov. 25,
10 1983, 83-2 USTC (CCH ¶ 9739), the court denied the taxpayer's discovery requests upon the
11 Internal Revenue Service for all reports, correspondence and internal documents prepared by the
12 Internal Revenue Service audits agents in anticipation of the case. The Court, in denying the
13 discovery requests, stated: "[t]he Government has a well established privilege with exempts from
14 disclosure intra governmental communications containing conclusions, opinions and reasoning. . . .
15 This is especially true in tax cases where the taxpayer must rely on the validity of its own position
16 under the applicable taxing provisions."
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18 California courts which have considered these same issues have reached the same
19 conclusion - a litigant may not probe the deliberative processes of the administrative agency. He is
20 limited to a review of the administrative record.
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22 For the most part, the form of deliberative process discussed above is designed for cases
23 which attack a decision made by the agency. However, in this case, Hyatt is not, theoretically,
24 attacking the FTB's Notice of Proposed Assessment. If he were, he would be prohibited by the
25 cases cited above from discovering the Review Notes and the internal memorandum discussing
26 sourcing. However, it must be considered that Hyatt is protesting his proposed assessment in
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2 California via the administrative proceeding and there is no doubt that Hyatt will litigate if the
3 proposed assessment is upheld. Therefore, Hyatt must be denied access to these documents since
4 he would not be entitled to them in California court and the interest that California has in
5 maintaining the integrity of its administrative system and taxing authority outweighs any interest
6 Hyatt may have in these particular documents. Hyatt cannot be allowed to undermine the statutory
7 privileges the State of California has in protecting its decision-making process by bringing suit in a
8 sister state. Comity requires this result.
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10 From the vein of deliberative process discussed above, which is founded upon the
11 separation of powers principle and limits judicial review of an executive agency decision-making
12 process, a second vein has developed. Instead of focusing on high-level policy or regulatory acts,
13 this second vein is founded upon the judicial acknowledgment of the importance and usefulness of
14 free-flowing ideas and opinions in government agencies. This form pertains to agency decisions
15 and the flow of information, including personal opinions from a subordinate to a superior. It is
16 upon this second version of the privilege that the FTB primarily relies.
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19 Several cases support the application of the "self-critical analysis" version of the privilege in
20 a variety of situations, outside the review of the adoption of a policy. Most notably and most
21 on-point, in Maricopa Audubon Society v. US Forest Service, 108 F.3d 1089 (9th Cir 1997), the
22 Ninth Circuit upheld the deliberative process privilege in this context. In that case the government
23 was allowed to withhold portions of "an internal investigation report on allegedly illegal and
24 unethical management" of a region of the Forest Service. The Court held that in order to invoke
25 the privilege, 1) the materials must be predecisional in nature and form part of the agency's
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deliberative process; and 2) the agency must identify a specific decision to which the document is pre-decisional (which avoids creation of "secret, working law."). Id. at 1093-1094.

The Maricopa Court went on to define a "predecisional" document as one "prepared in order to assist an agency decisionmaker in arriving at his decision," which may include "recommendation ... and other subjective documents which reflect the personal opinions of the writer rather than the policy of the agency." Id. at 1093. The Court stated that a predecisional document is part of the "deliberative process" if disclosure would expose an agency's decisionmaking process in such a way as to "discourage candid discussion within the agency and thereby undermine the agency's ability to perform its functions." Id. at 1093.

1. FTB 104117 - 104122 (Duplicated at FTB 03091-03096)

Five of the documents (six pages) being claimed as privileged under the deliberative process privilege are FTB 104117 through FTB 104122. These comprise "review comments" prepared by Carol Ford, a residency audit case reviewer. Upon completion of an audit, the auditor (or her supervisor) forwards the file to the FTB's "central office" for the issuance of the Notice of Proposed Assessment. In the case at bar, Penelope Bauche was the employee responsible for the final decision of whether or not to release the Notice.

To assist Ms. Bauche in her decision-making process, a member of her staff, in this case Carol Ford, reviews the file prepared by the auditor for completeness and sustainability. The reviewer documents her comments and Ms. Bauche may use those comments to determine if a Notice of Proposed Assessment should be issued or if the file should be returned to audit for further development. The review comments are not deemed to be part of the "audit file" since they are merely the memorialization of the department's final critical analysis of the sufficiency of the

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2 audit. When Ms. Bauche completes her use of the comments, they are often forwarded to the
3 auditor's supervisor for the second use of auditor evaluation.

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5 These documents must be protected from discovery because the review comments were
6 prepared by Ms. Ford, Ms. Bauche's subordinate, to assist Ms. Bauche in her decision to issue the
7 Notice of Proposed Assessment. Indeed, the comments did or may have reflected Ms. Ford's
8 personal opinions and not the views of the agency. The review comments were prepared in the
9 confidential environment of the FTB review unit with the only possible release being to that of a
10 supervisor in connection with personnel review. California State Personnel records are
11 confidential. California Government Code §18934.

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13 If review comments became available to taxpayers in their contests to dispute taxes, the
14 candid review and disclosure of the sufficiency of the supporting audit would be jeopardized. A
15 subordinate would no longer be able to express her opinions candidly for fear that such opinions
16 would be attributed to the department or that she would "take the blame" if her "opinions" were
17 not accurate statements under the law. Hyatt's aggressive discovery in this case makes these fears
18 well founded. Hyatt has already subjected the auditors and reviewers to days of depositions.

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20 The FTB has satisfied the procedural requirements to assert the privilege. First, the claim
21 of privilege must be lodged by the head of the agency cognizant of the matter, after personal
22 consideration of the allegedly privileged nature of the information. Coastal Corp. v. Duncan, 86
23 FRD 514, 517 (D. Del. 1980). In the FTB's briefing to the Discovery Commissioner, it included a
24 Declaration executed by Paul Usedom, Chief of the Audit Division, supporting the FTB's assertion
25 of privilege. See Affidavit of Paul Usedom, attached hereto as Exhibit 17. Mr. Usedom's
26 declaration is not very specific since any further discussion of the documents or their use in the
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2 audit would disclose the deliberative process which the FTB seeks to protect. United States of
3 America v. Board of Education of the City of Chicago, 610 F. Supp. 695 (1985).

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5 After the threshold requirements are met, the Court must weigh the competing interests for
6 and against disclosure. Villaume v. United States of America, 616 F.Supp 185 (1985). The
7 Discovery Commissioner abused his discretion by not considering California's interest in not
8 producing the documents. See Exhibit 4, pp. 53--58. The FTB has produced over 3,500 pages of
9 audit workpapers, over 70 pages of Narrative Reports, two Notices of Proposed Assessment and
10 several witnesses for exhaustive deposition. With respect to the FTB's disclosure, the FTB has
11 been consistent and discriminating in its claim of privilege. As a public agency, the FTB has been
12 as forthcoming as it can be, while protecting its sovereign interests.

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14 The review comments do not contain the reasoning behind the conduct in carrying out the
15 audit. It is only that conduct which is at issue in this case. Indeed, Ms. Ford's review occurred
16 after the audit was virtually complete and never had any contact whatsoever with the State of
17 Nevada. Hyatt is trying to discover the review notes to support his imminent tax battle in
18 California. Thus, plaintiff's demand for discovery of what and how the FTB evaluated the factual
19 record in the audit case violates the prohibition against discovery of the agency's deliberative
20 process. Accordingly, further discovery should be denied.

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22 **2. FTB 100288 & FTB 100289-92**

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24 The memo at issue is the memorialization of a meeting between the auditors on this case,
25 Monica Embry of the Policy Section and Richard Gould of the Legal Branch. The GTA Policy
26 Section exists to provide policy analysis to auditors, similar to the legal advice provided by the
27 attorneys in the legal branch. The meeting was held to discuss the viability of a sourcing theory for
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2 the taxation of patent royalties. Ms. Embry served as the "secretary" of the meeting, and therefore
3 wrote up the memo. This document should be protected not only under the attorney-client
4 privilege, but also under the deliberative process privilege.
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6 When a Notice of Proposed Assessment is issued, the proposed tax is merely tentative until
7 the expiration of the protest period or the completion of the protest administrative process. If the
8 proposed assessment is upheld, the FTB issues a Notice of Action, at which time the tax is due and
9 payable and no longer tentative. The Notice of Action does not need to be based on the same
10 theory as the Notice of Proposed Assessment. Since the protest procedure is in essence a de novo
11 review of the audit, the hearing officer may change the tax due or revise the tax theory upon which
12 the tax is based. To allow a memo which discusses an alternative theory of taxation to be
13 disclosed to a taxpayer before the protest procedure is complete and before the Notice of Action
14 has been issued would jeopardize the purpose and usefulness of such meetings and
15 memorializations. As discussed above, Hyatt is involved in an ongoing dispute over the proposed
16 tax assessment. His further litigation in California, should the assessment be upheld, is almost
17 certain.
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20 According to Coastal States Gas Corp. v Department of Energy, 617 F.2d 854 (D.C. Cir.
21 1980), the three major purposes of the deliberative process privilege are: "(1) to assure that
22 pre-decisional opinions and recommendations will flow freely from subordinates to
23 decisionmakers, without fear of public ridicule or criticism, (2) to protect prematurely disclosed
24 policies or opinions before they are officially adopted as agency policy, and (3) to protect from
25 misleading the public with opinions and recommendations that may have played a minor role in the
26 policy decision, but were not actually the ultimate deciding factor."
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Since the decisionmaking process with respect to the assessment of tax is ongoing and the Notice of Action has not yet been issued, the release of this memo, which discusses an alternative taxing theory, would be premature. The FTB may eventually adopt or reject the position reflected in the memorandum and its disclosure to the taxpayer would hamper the department's ability to freely discuss theories and, especially, memorialize them in writing. Further, the taxpayer may be misled by the memo or the defense of the FTB's position may be hindered, should the FTB decide to follow a contradictory course to that outlined in the memo. The Discovery Commissioner again abused his discretion by not considering the FTB's interest in maintaining the confidentiality of that memo. Further, the interests of comity require that the ruling to produce this memorandum be vacated.

B. THE DISTRICT COURT ABUSED ITS DISCRETION IN ENTERING THE PROTECTIVE ORDER

The District Court abused its discretion in entering the protective order because it unfairly limits FTB's ability to prepare for trial, prepare witnesses for deposition, and use the confidential documents in its parallel administrative proceeding in California. In sum, the protective order interferes with and prevents the FTB from having access to and use of relevant information secured through permissible discovery under the Nevada Rules of Civil Procedure without the imposition of special restrictions and sanctions against the FTB and its employees. The Protective Order denies the State of California due process under the Nevada, California, and United States Constitutions because it is one-sided, oppressive, burdensome, and unjustified. The purpose and design of the Protective Order is to control and, in some instances, to prevent, the State of California from using discovery secured in this Nevada lawsuit in administrative proceedings in

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2 California. The Protective Order is lengthy, complicated, builds in lengthy delays in discovery,
3 gives Hyatt arbitrary and total control of the "confidential" process, precipitates unnecessary
4 motion practice, drastically limits the State of California's use of discovery materials, greatly
5 reduces defense counsel's ability to use discovery materials with its client, prevents preparation of
6 witnesses, gives the plaintiff automatic discovery as to defense witnesses, consultants and work
7 product, reverses the burden of justifying discovery of relevant materials, unnecessarily increases
8 the expense of discovery, unnecessarily burdens the defense, witnesses, experts, court reporters,
9 and the court, and gives unnecessary protection to documents and information which have no
10 value or is already public information.
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13 The Protective Order is unfair because it imposes terms and conditions on the use of
14 evidence secured through discovery on the State of California that are not imposed on the plaintiff.
15 The State of California is barred from using an entire class of evidence in administrative
16 proceedings involving the plaintiff without first complying with an involved, complicated, and
17 burdensome process, which gives the plaintiff veto power, while the same terms and conditions are
18 not imposed on plaintiff. Exhibit 6, ¶¶ 3 and 4. The Protective Order interferes with the State of
19 California's ability to candidly and freely discuss the merits of the plaintiff's lawsuit, prepare
20 defenses to plaintiff's claims, and interferes with the ability of the State of California and its
21 attorneys to prepare witnesses and other evidence with evidence secured through permissible
22 discovery. Id. at ¶ 2.
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25 Most importantly, FTB cannot show the documents to an entire class of witnesses — those
26 who did not draft the document, receive the document, or previously see the document — unless
27 they get specific permission from Hyatt. Id. at ¶¶ 2(a), 3, 7, and 12. Such restriction limits the
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FTB's ability to discuss the documents with witnesses without first identifying those witnesses to Hyatt. This provides Hyatt with the unfair advantage of knowing the identity of every witness that the FTB consults, and Hyatt has the ability to refuse to permit the FTB from showing the confidential documents to the witness. Id. at ¶ 2(a). The FTB is faced with a situation where the first time it can show the confidential documents to a witness is at that witness's deposition. Such a situation limits FTB's ability to prepare witnesses for depositions or otherwise discuss the documents with those witnesses. Therefore, the entry of such an order is an abuse of discretion.

However, FTB's proposed stipulation and protective order still requires the FTB to maintain the confidentiality of documents and information produced by the Hyatt in this litigation, but it permits the FTB to discuss the documents with witnesses (conditioned upon them signing an agreement to keep the materials confidential) without having to seek Hyatt's prior permission to do so. This permits FTB to adequately prepare for trial and depositions. Furthermore, the FTB's protective order permits the FTB and Hyatt to use the discovered documents only in this case and the parallel California proceedings. This allows for the practice already prevailing between the parties. Mr. Hyatt has repeatedly used discovery materials obtained in this litigation to support his tax case in California. These include the following correspondence submitted by Hyatt's representatives which reference matters acquired by Hyatt from the FTB in discovery and referencing Sheila Cox' or Julie Meyer's deposition testimony:

1/19/99	Letter from Kern to Julie Meyer re correcting audit record re royalty income
1/22/99	Letter from Kern to Julie Meyer re correcting audit record re check assignment errors
1/22/99	Letter from Kern to Julie Meyer re correcting audit record re credit card assignment errors

- 1/25/99 Letter from Kern to Julie Meyer re correcting audit record re check assignment errors
- 1/26/99 Letter from Kern to Julie Meyer re correcting audit record re LV addressed envelopes submitted to FTB on 1/8/99
- 1/26/99 Letter from Kern to Julie Meyer re correcting audit record re check and credit card assignment errors and LV addressed envelopes submitted to FTB
- 1/26/99 Letter from Kern to Julie Meyer re correcting audit record re check and credit card assignment errors and LV addressed envelopes submitted to FTB (Duplicate of H 06891-907 with additional schedules page attached re checks to credit card companies)
- 2/3/99 Letter from Kern to FTB, Julie Meyer transmitting LV addressed envelopes and demanding record correction
- References:
- PO Box 81230, zip 89180 (4/22/92-1/4/93)
- PO Box 60028, zip 89160 (2/1/92-10/26/92)
- 3225 S. Pecos, 89121 (12/16/91-4/13/92)
- 4012 S. Rainbow #469 89129 (7/31/92-11/24/92)
- 3/10/99 Letter from Kern to Julie Meyer responding to Meyer's 2/22/99 letter which responded to Kern's seven letters to correct errors and demand for "proper" answer pursuant to CCC Sec. 1798 and referencing her deposition and designation as compliance person re Information Practices Act

The FTB should be permitted to consider evidence discovered in this case which might bear one way or another on Mr. Hyatt's claim of Nevada residency which is presently being considered in the parallel California proceeding. This comports with the practice already being employed by Hyatt. This Court should strike the protective order entered by the district court and enter the protective order proposed by the FTB.

IV. Conclusion

The FTB has demonstrated that the Discovery Commissioner's rulings regarding the privilege issues, and the District Court's affirmation of those rulings, were incorrect. The FTB has