UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No.	SA CV 16-02277-CJC (DFMx)	Date:	December 20, 2019
Title	ChromaDex, Inc. v. Elysium Health, Inc.		

Present: The Honorable	Douglas F. McCormick, United States Magistrate Judge
Nancy Boehme	Court Reporter
Deputy Clerk	Not Present
Attorney(s) for Plaintiff(s):	Attorney(s) for Defendant(s):
Not Present	Not Present
Proceedings:	**(IN CHAMBERS) Order re Defendant's Motion to Compel**

On December 5, 2019, the parties submitted letter briefs under the Court's informal telephone conference procedure about a discovery dispute involving Plaintiff's refusal to reproduce in unredacted form two documents that Plaintiff contends are protected by the attorney-client privilege. The documents are versions of an accounting memorandum (the "Reserve Memo") drafted by Plaintiff's Controller and sent to Plaintiff's outside accountant for use in preparing the company's 10-Q. The Reserve Memo included legal analysis from Plaintiff's outside counsel that pertains to this case.

On December 6, the Court held an informal discovery conference. During the discussion, the Court ordered the parties to submit supplemental letter briefs regarding (1) whether state or federal law applied and (2) whether the Reserve Memo is privileged. The Court having read and considered the supplemental briefs now rules as follows:

I. Federal Privilege Law Applies

Under Federal Rule of Evidence 501, federal common law generally governs claims of privilege. "But in a civil case, state law governs privilege regarding a claim or defense for which state law supplies the rule of decision." Fed. R. Evid. 501.

There is no dispute that state law applies in a pure diversity case, and that federal common law applies in a pure federal question case. Additionally, "[w]here there are federal question claims and pendent state law claims present, the federal law of privilege applies." Agster v. Maricopa County, 422 F.3d 836, 839 (9th Cir. 2005). However, the Ninth Circuit has not spoken as to what privilege law applies to a case, such as this, that arose out of diversity jurisdiction but later included a federal question. Plaintiff's initial Complaint alleged only state law claims.

Defendant's Counterclaim alleges only state law claims. Plaintiff's First Amended Complaint included a claim for violation of the federal Defend Trade Secrets Act ("DTSA"), 18 U.S.C. § 1836, which was dismissed with leave to amend, re-alleged in the Second Amended Complaint, withdrawn in the Third Amended Complaint, and then re-alleged in the Fourth Amended Complaint and the now-operative Fifth Amended Complaint.

Plaintiff argues that because the original and only uninterrupted jurisdictional basis of this action has been diversity, state privilege law applies. The cases cited by Plaintiff are unhelpful because they involve pure diversity jurisdiction. See Kandel v. Brother Int'l Corp., 683 F. Supp. 2d 1076, 1078, 1081 (C.D. Cal. 2010) (diversity jurisdiction with no federal claims); Star Editorial, Inc. v. U.S. Dist. Court for the Cent. Dist. of Cal., 7 F.3d 856, 858-59 (9th Cir. 1993) (same); Oakes v. Halvorsen Marine Ltd., 179 F.R.D. 281, 282, 284 (C.D. Cal. 1998) (same).

Defendant argues that because the Reserve Memo is relevant to both the federal and state claims, federal privilege law applies. On this point, Defendant cites two recent Ninth Circuit cases: Wilcox v. Arpaio, 753 F.3d 872 (9th Cir. 2014) and In re TFT-LCD (Flat Panel) Antitrust Litig., 835 F.3d 1155 (9th Cir. 2016).

In Wilcox, plaintiffs filed federal claims and supplemental state law claims. See 753 F.3d at 874. In support of their motion to enforce a purported settlement, plaintiffs submitted an email from the county mediator. See id. The county argued that the emails were inadmissible under state privilege law, whereas plaintiffs claimed that federal privilege law applied. See id. at 875. The Ninth Circuit agreed with plaintiffs: "The contested evidence . . . concerns all of [the] claims for relief-federal and state law claims alike. Where, as here, the same evidence relates to both federal and state law claims, 'we are not bound by Arizona law' on privilege. Rather, federal privilege law governs." Id. at 876 (citing Agster, 422 F.3d at 839).

In TFT-LCD, plaintiff initially filed suit under both federal and state law, but ultimately dismissed the federal claims. See 835 F.3d at 1157-58. Nevertheless, the Ninth Circuit held that federal law applied to the admission of emails and the resulting settlement contract: "[T]he eventual dismissal of federal claims does not govern whether the evidence related to federal law. Because, here, at the time the parties engaged in mediation, their negotiations concerned (and the mediated settlement settled) both federal and state law claims, the federal law of privilege applies." Id. at 1158-59.

Although not cited by either party, in Platypus Wear, Inc. v. K.D. Co., 905 F. Supp. 808 (S.D. Cal. 1995), the court was tasked with deciding whether state or federal privilege law applied to an action based on diversity with one federal counterclaim. Noting that the "need for consistency" required federal courts to apply federal privilege policies where evidence goes to both federal and state law claims, the court held that "consistency cannot be used to justify ignoring . . . Rule 501 where evidence can be relevant only to state law claims." Id. at 812. Because the disputed evidence went only to a state law issue, the court applied state law. See id.

In light of the above, the Court concludes that federal privilege law applies. Although this case began as a pure diversity action (unlike Wilcox and TFT-LCD), it included a federal claim by the time the instant privilege dispute arose. More significantly, the Reserve Memo appears to relate to Plaintiff's federal DTSA claims as well as Defendant's state law counterclaims. In this situation, federal privilege law governs. See Wilcox, 753 F.3d at 877.

II. The Reserve Memo is Not Privileged

The remaining question is whether the Reserve Memo is privileged. Plaintiff argues that it did not waive privilege over the legal advice in the Reserve Memo because it was necessarily disclosed as part of outside counsel's preparation of the 10-Q.[1] Defendant responds that Plaintiff waived any privilege when it disclosed the legal advice to third party accountants.

There is no accountant-client privilege. See United States v. Arthur Young & Co., 465 U.S. 805, 817-19 (1984). However, under what has been called the "Kovel doctrine," material transmitted to accountants may fall under the attorney-client privilege if the accountant is acting as an agent of an attorney for the purpose of assisting with the provision of legal advice. See United States v. Kovel, 296 F.2d 918, 922 (2d Cir. 1961) (accountant hired by tax counsel to assist in interpreting client conversations was considered privileged agent); see also United States v. Judson, 322 F.2d 460, 462-63 (9th Cir. 1963) (adopting Kovel). "What is vital to the privilege is that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer." United States v. Gurtner, 474 F.2d 297, 299 (9th Cir. 1973) (quoting Kovel, 296 F.2d at 922).

The third-party communications must be "necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit." Cavallaro v. United States, 284 F.3d 236, 247-48 (1st Cir. 2002) (quoting Kovel, 296 F.2d at 922). "[T]he 'necessity' element means more than just useful and convenient." Id. at 249. The privilege does not apply if the attorney's ability to represent the client is merely improved; instead, "the involvement of the third party must be nearly indispensable or serve some specialized purpose in facilitating the attorney-client communications." Id. ("[T]hat . . . [accountant] double-checked [lawyers'] legal advice to make sure 'it was consistent with the accounting records' . . . is not enough to show that [accountant] was necessary, or at least highly useful, in facilitating [lawyers'] provision of legal advice."); see also United States v. Ackert, 169 F.3d 136, 139 (2d Cir. 1999) (communications found not to be privileged even though investment banker "significantly assisted the attorney in giving his client legal advice about its tax situation").

[1] It is not clear whether the 10-Q was prepared by outside counsel, the accounting firm, or some combination thereof. In its letter brief, Plaintiff stated that it engaged its accounting advisor and outside counsel to draft the company's 10-Q. In the supplemental brief, Plaintiff implies that outside counsel prepared the 10-Q.

In a similar situation to the one now before the Court, the court in United States v. ChevronTexaco Corp., 241 F. Supp. 2d 1065 (N.D. Cal. 2002), held that accounting advice provided to in-house counsel did not fall within the privilege. Chevron sought to protect documents that pertained to a business transaction being investigated by the IRS. Chevon asserted the privilege over communications between Chevron employees, including in-house lawyers, and its outside accounting firm. Chevron argued that the accounting firm fell within the Kovel relationship because the communications were for the purpose of securing legal advice.

The court explained that Kovel, as construed by the Second Circuit's decision in Ackert, did not extend the privilege to instances where accountants were consulted for the purpose of the accountant, not an attorney, providing legal advice. See ChevronTexaco, 241 F. Supp. 2d at 1072. The court looked to Kovel's statement that "[i]f 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" and held that it was clear that Chevron had retained the accountant to "assist Chevron in analyzing the tax legal issues." Id. The privilege did not apply because the accountant provided the advice directly to Chevron, and not to assist Chevron's lawyers in rendering legal advice. The court pointed to a declaration by a Chevron employee that the accounting firm was retained "to assist my attorneys and me in evaluating the legal merits of the transaction."

Plaintiff offers a single sentence as to how the Reserve Memo fits within Kovel: "[The accounting firm] was necessary because it translated the Reserve Memo (among other things) into an analysis about whether the 10-Q met generally accepted accounting principles."[2] But in camera review of the communications do not show Plaintiff's accountant interpreting or translating otherwise privileged information to enable the attorney to understand that information. To the contrary, the legal advice in the Reserve Memo communicates Plaintiff's lawyers' conclusion to its outside accountant, in order to obtain "accounting advice from [the] accountant," i.e., prepare the 10-Q. United States v. Richey, 632 F.3d 559, 566 (9th Cir. 2011) (communications between attorney and appraiser hired by counsel not privileged where purpose of communications was to prepare a valuation report for submission to the IRS, which was a business purpose, and not for the purpose of providing legal advice). This situation falls outside the orbit of Kovel. Cf. Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., 244 F.R.D. 412, 420 (N.D. Ill. 2006) (concluding that company's retention of accounting firm was necessary and indispensable to counsel's ability to render legal advice given the "complex quantitative analyses and extensive information-gathering that was beyond . . . counsel's resources and abilities, but was uniquely within [accountant's] qualifications").

[2] Counsel and the accountant often enter into a "Kovel agreement," which is sometimes submitted alongside the privileged materials for in camera review. See, e.g., United States v. Burga, No. 18-1633, 2019 WL 3859157, at *6-7 (N.D. Cal. Aug. 16, 2019). No agreement was submitted in this case.

As far as the Court can tell, the accounting firm's role was to provide financial expertise in preparing a required SEC filing, which is more within the realm of business advice rather than legal advice. See Dahl v. Bain Capital Partners, LLC, 714 F. Supp. 2d 225, 228-29 (D. Mass. 2010) (communications between client's investment bankers and counsel not privileged where investment bankers acted in business capacity and were not necessary or indispensable for counsel to provide legal advice).

Accordingly, within fourteen (14) days of this Order, Plaintiff is ORDERED to reproduce in unredacted form the versions of the Reserve Memo over which it claimed attorney-client privilege.