No.

In the Supreme Court of the United States

TEXTRON INC. AND SUBSIDIARIES, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the work-product privilege in Federal Rule of Civil Procedure 26(b)(3), which protects documents that are "prepared in anticipation of litigation or for trial," is limited to documents that are prepared for use in litigation.

CORPORATE DISCLOSURE STATEMENT

Textron Inc. has no parent corporation, and no publicly held company owns 10% or more of Textron's stock.

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PETITION FOR A WRIT OF CERTIORARI

Textron Inc., together with its subsidiaries, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the en banc court of appeals (App., *infra*, 1a-46a) is reported at 577 F.3d 21. The opinion of the court of appeals panel (App., *infra*, 47a-88a) is reported at 553 F.3d 87. The district court's order denying respondent's petition to enforce administrative summons (App., *infra*, 89a-118a) is reported at 507 F. Supp. 2d 138.

JURISDICTION

The judgment of the court of appeals was entered on August 13, 2009. On October 20, 2009, Justice Breyer extended the time within which to file a petition for a writ of certiorari until December 24, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

RULE INVOLVED

In relevant part, Federal Rule of Civil Procedure 26(b)(3)(A) provides:

> Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent).

STATEMENT

In 2003, the Internal Revenue Service (IRS) commenced an audit of petitioner's tax returns for tax years 1998 to 2001. In connection with that audit, the IRS issued an administrative summons for petitioner's workpapers relating to its potential tax liabilities for tax year 2001. Citing, *inter alia*, the work-product privilege, petitioner withheld certain documents, including a spreadsheet prepared by petitioner's lawyers that listed items on its return whose treatment was uncertain (and, as to each item, estimated the likelihood of success in the event of a dispute). The government then filed a petition to enforce the summons in the United States District Court for the District of Rhode Island. The district court denied the petition. App., *infra*, 89a-118a. A panel of the court of appeals initially affirmed. *Id.* at 47a-88a. After granting rehearing en banc, however, the court of appeals reversed. *Id.* at 1a-46a.

1. This case presents a substantial circuit conflict on an issue of immense practical importance: the scope of the work-product privilege. The Court first recognized that privilege in *Hickman* v. *Taylor*, 329 U.S. 495 (1947).[1] In the course of discovery, the plaintiff in *Hickman* had sought materials "secured by an adverse party's counsel in the course of preparation for possible litigation after a claim ha[d] arisen." *Id.* at 497. Although the then-recent Federal Rules of Civil Procedure took a "broad and liberal" approach to discovery, *id.* at 507, and by their terms seemingly permitted the plaintiff to obtain the materials in question, see *id.* at 505-506, the Court held that the "work product" privilege protected "written materials obtained or prepared by an adversary's counsel with an eye toward litigation." *Id.* at 511. The Court explained that the work-product privilege was justified by historical practice, see *id.* at 510 n.9, and that a contrary rule would lead to "[i]nefficiency, unfairness and sharp practices," with the result that "the legal profession would be demoraliz[ed]" and "the interests of the clients and the cause of justice * * * poorly served," *id.* at 511.

In 1970, the Federal Rules of Civil Procedure were amended to codify the work-product privilege. Rule 26(b)(3) provides that the work-product privilege covers "documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party

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[1] *Hickman* has variously been described as giving rise to a "doctrine," "protection," or "privilege." In keeping with the terminology of the Court's more recent decisions, we refer here to the "work-product privilege." See, *e.g.*, *Department of Interior* v. *Klamath Water Users Protective Ass'n*, 532 U.S. 1, 7 (2001); *United States* v. *Hubbell*, 530 U.S. 27, 31 (2000); *Swidler & Berlin* v. *United States*, 524 U.S. 399, 402-403 (1998).

or its representative." The privilege is qualified rather than absolute: where a party to litigation can show that it "has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means," the party can obtain production of otherwise protected materials. Fed. R. Civ. P. 26(b)(3)(A)(ii). Even upon such a showing, however, the party may not obtain production of so-called "opinion work product": that is, materials that would "disclos[e] * * * the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation." Fed. R. Civ. P. 26(b)(3)(B). This case concerns the issue of when a document has been prepared "in anticipation of litigation," and is therefore protected by the work-product privilege, under Rule 26(b)(3).

2. Textron Inc. is a multi-industry corporation whose subsidiaries and operating units include such well-known businesses as Cessna Aircraft and Bell Helicopter. Textron and its subsidiaries file consolidated tax returns; they are collectively the petitioner before this Court. Because Textron is one of the Nation's largest corporations, petitioner's tax returns are routinely audited; in fact, the IRS has audit staff permanently based onsite at Textron, and, during the relevant period, had approximately 20 employees assigned to audit petitioner's returns. In 2003, the IRS commenced a scheduled audit of petitioner's tax returns for tax years 1998 to 2001. As part of that audit, the IRS issued more than 500 formal requests for information; petitioner produced "many file cabinets" worth of material in response to those requests. App., *infra*, 4a, 90a-91a; C.A. App. 184, 194-195, 227.

In tax year 2001, one of Textron's subsidiaries had engaged in several "sale-in, lease-out" transactions in-

volving telecommunications and rail equipment. In 2002, the IRS adopted a policy under which, where a taxpayer claims benefits from two or more similar "listed transactions" (*i.e.*, transactions whose tax treatment was, in the IRS's view, open to question), the IRS would seek *all* of the taxpayer's "tax accrual workpapers" (*i.e.*, workpapers relating to potential tax liabilities) for the tax year in question, regardless whether those workpapers pertained to the transactions at issue. See I.R.S. Announcement 2002-63, 2002-2 C.B. 72. Although the "sale-in, lease-out" transactions were not classified as "listed transactions" at the time Textron's subsidiary engaged in them, they were so classified several years later, and petitioner duly informed the IRS of the transactions. See I.R.S. Notice 2005-13, 2005-1 C.B. 630; App., *infra*, 4a, 91a; C.A. App. 252-255.

Based on those transactions, and notwithstanding the fact that the subsidiary had received legal advice that its tax treatment of those transactions was appropriate, the IRS issued a request, followed by an administrative summons, for petitioner's 2001 workpapers. In response, petitioner expressed its willingness to produce documents relating to the transactions at issue. But it withheld other documents relating to its return as a whole, including, most notably, a spreadsheet prepared by its in-house lawyers that listed items on its return whose treatment was uncertain (and, as to each item, estimated the likelihood of success in the event of a dispute),[2] and background memorandums that set out the legal analysis behind those estimates. By its own admis-

[2] A redacted version of a comparable spreadsheet from a prior tax year was introduced as an exhibit in the district court and is reproduced in the appendix to this petition at pages 121a to 122a.

sion, the IRS sought those documents in order to obtain a "roadmap" to petitioner's tax return, because those documents would "provid[e] guidance" in reviewing petitioner's tax return and "disclos[e] unidentified issues." App., *infra*, 5a, 31a, 91a-93a; Gov't C.A. Br. 7, 19; Gov't C.A. Reply Br. 16 n.7.

3. Pursuant to 26 U.S.C. 7604, the government then filed a petition to enforce the summons in the United States District Court for the District of Rhode Island. As is relevant here, petitioner contended that the withheld documents were protected by the work-product privilege. In support of that contention, petitioner submitted affidavits regarding the method by which the documents were prepared, and also presented testimony at an evidentiary hearing concerning the documents' purposes. Specifically, the head of petitioner's tax department testified that, although one purpose of the documents was to assist petitioner's independent auditor in reviewing the amount set aside in reserve for potential tax liabilities in the event of disputes, another purpose was to guide petitioner in making litigation or settlement decisions concerning the tax treatment of the specified items. See C.A. App. 200 (testimony of Norman Richter).

After the evidentiary hearing, the district court denied the government's petition. App., *infra*, 89a-118a. As is relevant here, the district court held that the documents at issue were covered by the work-product privilege. *Id.* at 105a-110a. The district court noted that, although courts had "applied * * * different tests in determining whether a document was prepared 'in anticipation of litigation,'" *id.* at 107a, "the relevant inquiry is whether the document was prepared or obtained 'because of' the prospect of litigation." *Ibid.* Applying that standard, the court determined that the documents

"would not have been prepared at all 'but for' the fact that [petitioner] anticipated the possibility of litigation with the IRS." *Id.* at 108a. The court explained that, "[i]f [petitioner] had not anticipated a dispute with the IRS, there would have been no reason for it to establish any reserve or to prepare the workpapers used to calculate the reserve." *Ibid.* The court added that, "even if the workpapers were needed to satisfy [petitioner's auditor] that [petitioner's] reserves complied with [generally accepted accounting principles], that would not alter the fact that the workpapers were prepared 'because of' anticipated litigation with the IRS." *Id.* at 109a.[3]

4. The government appealed. A divided panel of the court of appeals initially affirmed in relevant part, agreeing with the district court that the documents at issue were covered by the work-product privilege. App., *infra*, 47a-88a. After granting the government's petition for rehearing en banc, however, the court of appeals reversed by a 3-2 vote. *Id.* at 1a-46a.

a. The en banc court of appeals first noted that, under Federal Rule of Civil Procedure 26(b)(3), the work-product privilege extends to documents that are "prepared in anticipation of litigation or for trial." App., *infra*, 11a. At the same time, the court reasoned that "how far work product protection extends turns on a balancing of policy concerns rather than application of abstract logic." *Id.* at 9a. The court of appeals also observed that "the Supreme Court has not ruled on the issue before us,

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[3] The district court determined that the documents at issue were also covered by the attorney-client privilege, App., *infra*, 99a-102a, but that petitioner had waived that privilege by disclosing the documents to its auditor, *id.* at 110a-112a. Petitioner did not challenge the latter determination on appeal.

namely, one in which a document is not in any way prepared 'for' litigation but relates to a subject that might or might not occasion litigation." *Ibid.*

Although the court of appeals acknowledged that it had previously suggested that the relevant inquiry was whether the documents were prepared "because of" the prospect of litigation, App., *infra*, 9a, it ultimately held that the work-product privilege reached only documents that were "prepared *for use* in possible litigation." *Id.* at 11a. In adopting that standard, the court explained that "[i]t is not enough to trigger work product protection that the *subject matter* of a document relates to a subject that might conceivably be litigated," *id.* at 16a, "[n]or is it enough that the materials were prepared by lawyers or represent legal thinking," *id.* at 17a. The court added, without elaboration, that "[e]very lawyer who tries cases knows the touch and feel of materials prepared for a current or possible * * * law suit." *Ibid.*

Applying the "for use" standard, the court of appeals determined that the documents at issue were not covered by the work-product privilege, reasoning that "[a]ny experienced litigator would describe the tax accrual work papers as tax documents and not as case preparation materials." App., *infra*, 15a. The court noted that one purpose of the documents was to assist petitioner's auditor in reviewing the amount set aside in reserve for potential tax liabilities in the event of disputed, *id.* at 11a, and summarily discounted petitioner's evidence that another purpose was to guide petitioner in making litigation or settlement decisions concerning the tax treatment of the specified items, *id.* at 14a-15a. The court concluded that "[t]here is no evidence in this case that the work papers were prepared for * * * use [in litigation] or would in fact serve any useful purpose for [petitioner] in conducting litigation if it arose." *Id.* at

18a-19a. In so concluding, the court conceded that "[o]ther circuits have not passed on tax audit work papers and some might take a different view." *Id.* at 18a.

b. Judge Torruella, joined by Judge Lipez, dissented. App., *infra*, 21a-46a. He criticized the majority for "abandon[ing] our 'because of' test"; "ignor[ing] a tome of precedents from the circuit courts"; "brush[ing] aside the actual text of Rule 26(b)(3)"; and "contraven[ing] m[any] of the principles underlying the work-product doctrine." *Id.* at 21a-22a.

At the outset, Judge Torruella noted that, while the majority had "claim[ed] allegiance" to the court of appeals' earlier decision applying the "because of" standard, App., *infra*, 22a, the majority in fact adopted a narrower standard by concluding that documents must be prepared "for use" in litigation in order to be protected by the work-product privilege. *Id.* at 23a. He explained that "no court * * * has so ruled," *id.* at 24a, and that the "for use" standard could not be reconciled either with the "because of" standard applied by the majority of the circuits or even with the narrower standard of the Fifth Circuit, which turns on whether the "primary purpose" for which the document was prepared was to assist in future litigation. *Id.* at 24a-27a. And as to the majority's application of the "for use" standard, Judge Torruella noted that "[l]ower courts deserve more guidance than a simple reassurance that a bare majority of the en banc court knows work product when it sees it." *Id.* at 27a.

Judge Torruella then contended that the majority's "for use" standard was incorrect, primarily because it was inconsistent with the language of Rule 26(b)(3), which protects not only documents prepared "for trial" but also documents prepared "in anticipation of litigation." App., *infra*, 28a. He explained that "the term 'an-

ticipation of litigation' should not be read out of the rule by requiring a showing that documents be prepared for trial." *Ibid.* Judge Torruella also contended that this case "squarely implicated" the policy rationales for the work-product privilege articulated in *Hickman*, because the documents at issue "contain counsel's ultimate impression of the value of the case" and thus "contain exactly the sort of mental impressions about the case that *Hickman* sought to protect." *Id.* at 31a. He added that, "if attorneys who identify good faith questions and uncertainties in their clients' tax returns know that putting such information in writing will result in discovery by the IRS, they will be more likely to avoid [doing so], thus diminishing the quality of representation." *Id.* at 32a. And he noted that the majority's approach would have significant ramifications beyond the specific context of this case, because it would allow parties to access documents assessing litigation risks more generally. *Id.* at 33a-34a.

Judge Torruella next determined that, under the "because of" standard, the documents at issue in this case would be covered by the work-product privilege. App., *infra*, 34a-45a. He noted that the district court had found both that "anticipation of litigation was the 'but for' cause of the documents' creation," *id.* at 36a, and that the documents were created for a litigation-related purpose as well as a business purpose, *id.* at 35a-36a. Judge Torruella contended that "[t]he majority ma[de] no effort to reject these factual findings," *id.* at 36a, but instead ignored them as irrelevant "without any finding of clear error," *id.* at 38a. Because the documents "were not prepared irrespective of the prospect of litigation," he reasoned, they would be protected under the correct standard. *Id.* at 43a (internal quotation marks omitted).

Judge Torruella concluded that the majority's decision "throw[s] the law of work-product protection into disarray," App., *infra*, 45a, and "will be viewed as a dangerous aberration in the law of a well-established and important evidentiary doctrine," *ibid.* He added that the majority's decision "further[s] the split" in the circuits concerning the meaning of Rule 26(b)(3), *ibid.*, and that "[t]he time is ripe for the Supreme Court to intervene and set the circuits straight on this issue which is essential to the daily practice of litigators across the country," *ibid.*

5. The court of appeals subsequently granted a stay pending the filing of a petition for certiorari. App., *infra*, 119a-120a. In so doing, the court of appeals acknowledged that "the work product privilege finds its origin in a Supreme Court decision that has not often been revisited by the Court," *id.* at 120a, and that "there is some difference in the interpretations adopted in different circuits," *ibid.*

REASONS FOR GRANTING THE PETITION

When measured in terms of its practical significance for civil litigants, this is one of the more important cases to come before the Court in some time. In the decision below, the en banc First Circuit adopted an unprecedentedly narrow interpretation of the work-product privilege in Federal Rule of Civil Procedure 26(b)(3), holding that the privilege is limited to documents that are prepared "for use" in litigation. That holding deepens a preexisting and longstanding circuit conflict: nine other courts of appeals have adopted inconsistent (but uniformly broader) views of the privilege's scope. The First Circuit's analysis, moreover, was deeply flawed, because its "for use" standard cannot be reconciled either with the language of Rule 26(b)(3) or with the poli-

cies underlying the work-product privilege. As the enormous amount of attention that this case has garnered reflects, the scope of the privilege is a recurring issue of obvious practical significance, and this case is an optimal vehicle in which to consider the issue. In sum, because this case is a compelling candidate for further review in every respect, certiorari should be granted.

A. The Decision Below Deepens A Circuit Conflict Concerning The Scope Of The Work-Product Privilege

1. As the First Circuit seemingly recognized, see, *e.g.*, App., *infra*, 18a, 120a, its decision conflicts with the decisions of nine other courts of appeals concerning the scope of the work-product privilege. That conflict warrants this Court's review.

a. Eight courts of appeals have held that, for purposes of determining whether a document was prepared "in anticipation of litigation" under Rule 26(b)(3), the relevant inquiry is whether the document was prepared or obtained "because of" the prospect of litigation. See, *e.g.*, *In re Sealed Case*, 146 F.3d 881, 884 (D.C. Cir. 1998); *United States* v. *Adlman*, 134 F.3d 1194, 1202-1203 (2d Cir. 1998); *Martin* v. *Bally's Park Place Hotel & Casino*, 983 F.2d 1252, 1260 (3d Cir. 1993); *National Union Fire Ins. Co.* v. *Murray Sheet Metal Co.*, 967 F.2d 980, 984 (4th Cir. 1992); *United States* v. *Roxworthy*, 457 F.3d 590, 593 (6th Cir. 2006); *Binks Mfg. Co.* v. *National Presto Indus., Inc.*, 709 F.2d 1109, 1118-1119 (7th Cir. 1983); *Simon* v. *G.D. Searle & Co.*, 816 F.2d 397, 401 (8th Cir.), cert. denied, 484 U.S. 917 (1987); *In re Grand Jury Subpoena*, 357 F.3d 900, 907 (9th Cir. 2004). That standard appears to have originated in the leading treatise on civil procedure, which states that, for purposes of the "in anticipation of litigation" requirement, "the test should be whether, in light of the nature of the document and the

factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation." 8 Charles Alan Wright, Arthur R. Miller & Richard L. Marcus, *Federal Practice and Procedure* § 2024, at 343 (2d ed. 1994) (Wright & Miller).

In applying the "because of" standard, courts of appeals have focused on whether the document at issue would not have been prepared but for the prospect of litigation—or whether the document was prepared for a litigation-related purpose, even if it was prepared for another purpose as well. For example, in *Adlman*—perhaps the most influential lower-court decision on the scope of the work-product privilege—the Second Circuit held that the privilege covered a document that, *inter alia*, made "predictions about the likely outcome of litigation" with the IRS that could result from a company's planned merger. 134 F.3d at 1195. The court concluded that, "[w]here a document was created because of anticipated litigation, and would not have been prepared in substantially similar form but for the prospect of that litigation, it falls within Rule 26(b)(3)." *Ibid.* In so concluding, the court determined that "[t]he fact that [the] document's purpose [was] business-related"—*viz.*, to assist the company in deciding whether to proceed with the merger in the first place—"appears irrelevant to the question whether it should be protected under Rule 26(b)(3)." *Id.* at 1200.

Similarly, in *Grand Jury Subpoena*, the Ninth Circuit held that the work-product privilege extended to documents that were created not only to assess a company's potential liability, but also to comply with certain regulatory requirements. 357 F.3d at 909-910. In adopting the "because of" standard, the court explained that the standard "does not consider whether litigation was a

primary or secondary motive behind the creation of a document," but rather "affords protection" when the document "would not have been created in substantially similar form but for the prospect of that litigation." *Id.* at 908 (quoting *Adlman*, 134 F.3d at 1195).

And in *Sealed Case*, the District of Columbia Circuit held that certain documents could be privileged despite the fact that no "specific claim" had arisen at the time the documents were prepared. 146 F.3d at 882. In the course of doing so, the court reaffirmed its adoption of the "because of" standard, reiterating that "the 'testing question' for the work-product privilege" is whether a document "can fairly be said to have been prepared or obtained because of the prospect of litigation." *Id.* at 884 (internal quotation marks omitted) (quoting *Senate of the Commonwealth of Puerto Rico ex rel. Judiciary Committee* v. *United States Dep't of Justice*, 823 F.2d 574, 586 n.42 (D.C. Cir. 1987) (R.B. Ginsburg, J.)). The court noted that lawyers often prepared documents "prior to the emergence of specific claims," such as when lawyers "consider whether business decisions might result in antitrust or securities lawsuits" or "assess the possibility that new products might give rise to tort actions." *Id.* at 886. The court reasoned that, if the work-product privilege were not available in those situations, lawyers "would not likely risk taking notes about such matters or communicating in writing with colleagues, thus severely limiting their ability to advise clients effectively." *Ibid.*

b. Even before the First Circuit's decision in this case, there was a longstanding circuit conflict between the foregoing circuits and the Fifth Circuit, which has repeatedly held that, for purposes of determining whether a document was prepared "in anticipation of litigation" under Rule 26(b)(3), the relevant inquiry is whether the "primary motivating purpose" for which the docu-

ment was prepared was to assist in litigation. *United States* v. *Davis*, 636 F.2d 1028, 1040 (5th Cir. Unit A Feb. 1981), cert. denied, 454 U.S. 862 (1981). Perhaps most significantly, in *United States* v. *El Paso Co.*, 682 F.2d 530 (1982), cert. denied, 466 U.S. 944 (1984), the Fifth Circuit held that the work-product privilege did not cover workpapers like those at issue in this case, on the ground that, even though the workpapers "forecast[] the ultimate likelihood of sustaining [the company's] position in court," the "primary motivating force" behind their preparation was "not to ready [the company] for litigation over its tax returns," but rather "to anticipate, for financial reporting purposes, what the impact of litigation might be on the company's tax liability." 682 F.2d at 543.

Notably, in adopting the "because of" standard, numerous courts have expressly rejected the Fifth Circuit's more stringent "primary purpose" standard. See, *e.g.*, *Adlman*, 134 F.3d at 1198-1199 (noting, after citing *Davis* and *El Paso*, that "a requirement that documents be produced primarily or exclusively to assist in litigation in order to be protected is at odds with the text and the policies of [Rule 26(b)(3)]"). Commentators have criticized the Fifth Circuit's standard as well. See, *e.g.*, Claudine Pease-Wingenter, *Prophetic or Misguided? The Fifth Circuit's (Increasingly) Unpopular Approach to the Work Product Doctrine*, 29 Rev. Litig. 121, 161 (2009) (contending that "[t]he Fifth Circuit's 'primary purpose' test is clearly at odds with the plain meaning of the text of Rule 26(b)(3) and undercuts the policy goals of the work product doctrine"). In the face of mounting criticism, however, the Fifth Circuit has adhered to its standard. See, *e.g.*, *In re Kaiser Aluminum & Chem. Co.*,

214 F.3d 586, 593 (2000), cert. denied, 532 U.S. 919 (2001).[4]

c. Although a panel of the First Circuit had previously suggested that it would follow the prevailing "because of" standard, see *Maine* v. *United States Dep't of Interior*, 298 F.3d 60, 68 (2002), the en banc First Circuit took a different approach in this case and held that, for purposes of determining whether a document was prepared "in anticipation of litigation" under Rule 26(b)(3), the relevant inquiry was whether the documents were "prepared *for use* in possible litigation." App., *infra*, 11a. While the First Circuit at one point purported to reaffirm its earlier decision in *Maine*, *id.* at 9a, it did not otherwise refer to the "because of" standard (on which the district court and the court of appeals panel had relied, see, *e.g.*, *id.* at 55a-57a, 107a-108a), but instead repeatedly reiterated the novel requirement that a document must possess a litigation-related *use* in order to be protected. See, *e.g.*, *id.* at 14a ("could be useful" in litigation); *id.* at 15a ("prepared for use in litigation"); *id.* at 18a ("prepared for potential use in litigation"). And in applying that standard to the facts of this case, the court concluded that "[t]here is no evidence in this case that

[4] The remaining three circuits—the Tenth, Eleventh, and Federal Circuits—have not addressed the issue. A district court recently predicted that the Eleventh Circuit would "align itself with the majority of the other courts of appeal[s] and adopt the 'because of litigation' test." *Regions Fin. Corp.* v. *United States*, No. 06-895, 2008 WL 2139008, at *5 (N.D. Ala. May 8, 2008), appeal dismissed, No. 08-13866 (11th Cir. Dec. 30, 2008). By contrast, several district courts in the Tenth Circuit have adopted the Fifth Circuit's "primary purpose" standard. See, *e.g.*, *United States Fire Ins. Co.* v. *Bunge North America, Inc.*, 247 F.R.D. 656, 658-659 (D. Kan. 2007); *McEwen* v. *Digitran Sys., Inc.*, 155 F.R.D. 678, 682 (D. Utah 1994); *Gottlieb* v. *Wiles*, 143 F.R.D. 241, 253 (D. Colo. 1992).

the work papers were prepared for * * * use [in litigation] or would in fact serve any useful purpose for [petitioner] in conducting litigation if it arose." *Id.* at 18a-19a. As the dissent below explained, the First Circuit thus adopted a standard that is narrower than either the "because of" standard applied by eight other circuits or the "primary purpose" standard applied by the Fifth Circuit, neither of which requires a litigation-related use. See *id.* at 23a-27a (opinion of Torruella, J.). The First Circuit thereby deepened a circuit conflict that merits this Court's review.[5]

2. This case constitutes an ideal vehicle for the Court to resolve the well-entrenched circuit conflict concerning the scope of the work-product privilege, because the choice of the appropriate standard would plainly be dispositive of whether the privilege covers the documents at issue here.

a. As the district court and the court of appeals panel correctly determined, the documents at issue would be covered under the "because of" standard. See App., *infra*, 55a-74a (court of appeals panel); *id.* at 105a-110a (district court). To begin with, as the district court

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[5] In addition, numerous States have rules codifying the work-product privilege in materially identical terms to Federal Rule 26(b)(3), and many state courts of last resort (including courts within the First Circuit) have applied the "because of" standard in determining whether a document was prepared "in anticipation of litigation" under the applicable state rule. See, *e.g.*, *Commissioner of Revenue* v. *Comcast Corp.*, 901 N.E.2d 1185, 1203-1204 (Mass. 2009); *Springfield Terminal Ry. Co.* v. *Department of Transp.*, 754 A.2d 353, 357-358 (Me. 2000); *Henderson* v. *Newport County Regional YMCA*, 966 A.2d 1242, 1247 (R.I. 2009). In many cases, therefore, the practical effect of the decision below will be to render the availability of the work-product privilege in the First Circuit dependent on whether the case is being litigated in federal or state court.

found, "it is clear" that the documents "would not have been prepared at all 'but for'" the prospect of litigation with the IRS concerning the specified items from petitioner's tax return. *Id.* at 108a; see, *e.g.*, *Adlman*, 134 F.3d at 1195. That is true for the simple reason that, "[i]f [petitioner] had not anticipated a dispute with the IRS, there would have been no reason for it to establish any reserve or to prepare the workpapers used to calculate the reserve." App., *infra*, 108a. Petitioner, moreover, presented ample evidence that there was a reasonable prospect of litigation with the IRS: all but one of its eight previous audits had resulted in at least some form of adversarial proceedings, with three resulting in litigation in federal court (including one proceeding that was still ongoing at the time the documents at issue were being prepared). See *id.* at 109a; *Textron Inc.* v. *Commissioner*, 336 F.3d 26, 28-30 (1st Cir. 2003).

In addition, to the extent that courts applying the "because of" standard have focused more specifically on whether the documents at issue were prepared for a litigation-related purpose (even if they were prepared for another purpose as well), see, *e.g.*, *Roxworthy*, 457 F.3d at 598-599; *Grand Jury Subpoena*, 357 F.3d at 907-908, it is clear that the "because of" standard would still be satisfied, because petitioner presented uncontroverted testimony to the district court that the documents were prepared not simply to assist petitioner's auditor in reviewing the amount set aside in reserve for potential tax liabilities, but also to guide petitioner in making litigation or settlement decisions concerning the tax treatment of the specified items. See C.A. App. 200. Although the en banc majority appeared to discount that testimony in applying its "for use" standard, see App., *infra*, 14a, the district court seemingly credited it in reaching a contrary result under the "because of" standard, see, *e.g.*, *id.*

at 93a-94a, and the government did not challenge the credibility of that testimony on appeal, see Gov't C.A. Br. 52 n.16. In sum, because the documents at issue would not have been prepared but for the prospect of litigation and were in fact prepared for a litigation-related purpose, they would be covered under the "because of" standard.

b. Lower-court decisions applying the "because of" standard confirm that conclusion. At least one district court has extended work-product protection to similar documents under the "because of" standard, reasoning that, "[w]ere it not for anticipated litigation, [the company] would not have to worry about contingent liabilities and would have no need to elicit opinions regarding the likely results of litigation." *Regions Fin. Corp.* v. *United States*, No. 06-895, 2008 WL 2139008, at *5-*6 (N.D. Ala. May 8, 2008), appeal dismissed, No. 08-13866 (11th Cir. Dec. 30, 2008). And although no court of appeals applying the "because of" standard has specifically considered documents provided to a company's auditor for the purpose of reviewing the amount set aside in reserve for potential tax liabilities, courts of appeals applying that standard have suggested that the privilege would reach documents that assess potential tax liabilities, see, *e.g.*, *Roxworthy*, 457 F.3d at 592; *Adlman*, 134 F.3d at 1195,[6] and documents provided to a company's auditor for the purpose of reviewing the amount set aside for potential litigation liabilities more generally, see, *e.g.*, *Adlman*, 134 F.3d at 1200. Because the documents at issue here do not meaningfully differ from the documents discussed

[6] The government contended below that the Sixth Circuit's decision in *Roxworthy* was "incorrect[]." Gov't C.A. Reply Br. 48 n.19.

in those cases, they would surely be covered under the "because of" standard applied by the majority of circuits.

By contrast, the only lower courts to hold that documents of the type at issue here would not be subject to the work-product privilege are the en banc First Circuit, applying its newly minted "for use" standard, and the Fifth Circuit, applying its distinct "primary purpose" standard. See *El Paso*, 682 F.2d at 542-544. The choice of the appropriate standard would therefore be dispositive of whether the documents at issue are covered by the privilege—and, for that reason, this case constitutes a suitable vehicle for resolution of the circuit conflict on the privilege's scope.

B. The Court Of Appeals' Decision Is Erroneous

The en banc First Circuit erred in holding that the work-product privilege in Federal Rule of Civil Procedure 26(b)(3) is limited to documents that are prepared for use in litigation.

1. Most importantly, the First Circuit's novel "for use" standard cannot be reconciled with the plain language of Rule 26(b)(3). By its terms, that provision reaches not only documents prepared "for trial," but also documents prepared "in anticipation of litigation": *i.e.*, documents prepared "in *contemplation* of litigation." *Senate of the Commonwealth of Puerto Rico*, 823 F.2d at 586 (emphasis added) (quoting *NLRB* v. *Sears, Roebuck & Co.*, 421 U.S. 132, 154 (1975)). The First Circuit's standard, however, seemingly writes the "broader category" of documents prepared "in anticipation of litigation" out of the rule altogether, because a document that is prepared for use in litigation would presumably always qualify as a document prepared "for trial." *Adlman*, 134 F.3d at 1198; see *ibid.* (noting that, "[i]f the drafters of the Rule intended to limit its protection to documents

made to assist in preparation for litigation, this would have been adequately conveyed by the phrase 'prepared * * * for trial'") (second alteration in original). The First Circuit's interpretation would therefore apparently contravene the familiar canon of construction that a court should "give effect, if possible, to every word [the provision] used." *Carcieri* v. *Salazar*, 129 S. Ct. 1058, 1066 (2009) (citation omitted). And even if some independent meaning could be attributed to the phrase "in anticipation of litigation," the First Circuit's "for use" standard would at best engraft a substantial limitation on the scope of the work-product privilege that is nowhere to be found in the language of Rule 26(b)(3)—as the en banc majority implicitly acknowledged. See App., *infra*, 16a; *Adlman*, 134 F.3d at 1198 (noting that "[n]owhere does Rule 26(b)(3) state that a document must have been prepared *to aid* in the conduct of litigation in order to constitute work product").[7]

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[7] In adopting the "for use" standard, the First Circuit cited two of this Court's decisions, neither of which is apposite. The First Circuit first quoted *FTC* v. *Grolier, Inc.*, 462 U.S. 19 (1983), for the proposition that "the literal language of [Rule 26(b)(3)] protects materials *prepared for* any litigation or trial as long as they were prepared by or for a party to the subsequent litigation." App., *infra*, 16a (emphasis in First Circuit's opinion) (quoting *Grolier*, 462 U.S. at 25). In *Grolier*, however, the Court was addressing only the discrete question whether the work-product privilege "extended beyond the litigation for which the documents at issue were prepared," 462 U.S. at 24—as the original emphasis in *the Court's* opinion makes clear. See *id.* at 25 (stating that "the literal language of [Rule 26(b)(3)] protects materials prepared for *any* litigation or trial as long as they were prepared by or for a party to the subsequent litigation"). The First Circuit also cited *Sears*. App., *infra*, 17a. That opinion, however, stands only for the proposition that documents prepared "in contemplation of" litigation "fall squarely" with the definition of protected work product—a proposition that is more

2. The First Circuit's standard is irreconcilable not only with the language of Rule 26(b)(3), but also with the policies animating the work-product privilege. In first recognizing the privilege in *Hickman*, this Court explained that the privilege was necessary because "it is essential that a lawyer work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel." 329 U.S. at 510. And the Court expressed a particular solicitude for an attorney's "thoughts," "mental impressions," and "personal beliefs," which, the Court noted, had previously been viewed as "inviolate." *Id.* at 511, 512. Notwithstanding the government's contention that the work-product privilege "hamper[s] the search for the truth," Gov't C.A. Reply Br. 4, this Court has repeatedly reaffirmed the "strong public polic[ies]" underlying the privilege, *e.g.*, *United States* v. *Nobles*, 422 U.S. 225, 236 (1975) (internal quotation marks omitted), and those policies were "substantially incorporated" in Rule 26(b)(3), *Upjohn Co.* v. *United States*, 449 U.S. 383, 398 (1981).

The First Circuit's standard would strip protection from documents embodying an attorney's opinion as to the "likelihood of success in litigation," *Adlman*, 134 F.3d at 1200—documents that most directly implicate the policies underlying the work-product privilege (and therefore lie at the "core" of the privilege). See *Nobles*, 422 U.S. at 238; cf. *Hickman*, 329 U.S. at 516 (Jackson, J., concurring) (explaining that "[d]iscovery was hardly intended to enable a learned profession to perform its functions * * * on wits borrowed from the adver-

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consistent with other circuits' "because of" standard than with the First Circuit's "for use" standard. See p. 20, *supra*.

sary").[8] If such documents are not covered by the privilege, it would have a chilling effect on lawyers, who would be loath to commit their opinions to paper if the resulting documents were "open[] to the free scrutiny" of the IRS and other litigants. *Hickman*, 329 U.S. at 514. An approach that permitted discovery of such documents would therefore lead to the "inefficiency" of which *Hickman* warned, with the result that "the legal profession would be demoraliz[ed]" and "the interests of the clients and the cause of justice * * * poorly served." *Id.* at 511.

3. In support of its "for use" standard, the First Circuit cited an advisory committee note to Rule 26(b)(3), which indicates that "[m]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes" are not protected by the privilege. Fed. R. Civ. P. 26(b)(3) advisory committee's note (1970). That note, however, speaks only to situations in which a document has *only* a non-litigation-related purpose—not, as here, a non-litigation-related purpose *and* a litigation-related purpose as well. See, *e.g.*, 8 Wright & Miller § 2024, at 346 (citing the advisory committee note for the proposition that, "even though litigation is already in prospect, there is no work-product immunity for documents prepared in the regular course of business *rather than* for purposes of litigation") (emphasis added); *id.* at 198 (Supp. 2009) (adding that "'[d]ual purpose' docu-

[8] Indeed, the government has not disputed in this case that, if the documents at issue are subject to the privilege in the first place, they would qualify as "opinion work product" and would therefore be protected from disclosure even upon a showing of substantial necessity. See Fed. R. Civ. P. 26(b)(3)(B).

ments created because of the prospect of litigation are protected even though they were also prepared for a business purpose"). As the dissent below noted, a contrary understanding of the advisory committee note would create an atextual exception to Rule 26(b)(3), by excluding documents that would otherwise fall within the scope of the rule whenever the documents possessed an additional purpose beyond a litigation-related purpose. See App., *infra*, 42a-43a (opinion of Torruella, J.).[9]

In sum, there is no valid justification for the First Circuit's novel limitation on the scope of the work-product privilege. This Court should grant review in order to eliminate the circuit conflict and correct the First Circuit's seriously flawed approach.

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[9] Before the First Circuit, the government argued that the documents at issue should not be covered by the work-product privilege because petitioner was legally required to generate them. See Gov't C.A. Supp. Br. 2-4. The First Circuit did not rely on that argument, and for good reason. That is because, at most, the law "requires that [petitioner] prepare audited financial statements reporting total reserves based on contingent tax liabilities" and does not "require the form and detail of the documents prepared here." App., *infra*, 32a (Torruella, J., dissenting). To be sure, petitioner prepared the documents for the purpose, *inter alia*, of assisting petitioner's auditor in reviewing the amount set aside in reserve for potential tax liabilities (and thus in performing its obligation to review petitioner's financial statements for compliance with generally accepted accounting principles). The salient point, however, is that, but for the prospect of litigation with the IRS, petitioner would not have needed to prepare the documents at all. See, *e.g.*, C.A. App. 200 (testimony of Norman Richter) (explaining that, if petitioner had not anticipated litigation with the IRS, the documents "would be blank" and "[w]e would have nothing there").

C. The Question Presented Is An Exceptionally Important And Recurring One That Merits The Court's Review In This Case

Finally, the question presented in this case is an exceptionally important one because it concerns the scope of the work-product privilege—an issue that is "essential to the daily practice of litigators across the country." App., *infra*, 45a (Torruella, J., dissenting). If the First Circuit's unprecedented interpretation of the work-product privilege is allowed to stand, it will have profound consequences for civil litigants in a variety of different contexts.

1. As a preliminary matter, the factual context in which this case arises—*i.e.*, whether the work-product privilege extends to documents assessing risks in tax litigation for the purpose, *inter alia*, of assisting a company's auditor in reviewing the amount set aside in reserve—is important in its own right. Because of the size and complexity of their operations, publicly held companies inevitably find themselves taking positions on their tax returns that fall into "gray areas" as to which there is legal uncertainty (because the relevant statutory or regulatory language is unclear and the IRS has provided no guidance on point). For that reason, virtually all publicly held companies generate so-called "tax accrual workpapers" in some form. If a company is required to disclose such documents to the IRS, it will give the IRS a "blueprint" to the company's thinking in preparing its tax return (as the en banc majority acknowledged, see App., *infra*, 20a); indeed, the IRS has freely admitted that it sought the documents at issue here for that reason. See pp. 5-6, *supra*. But that kind of disclosure would contravene the fundamental principle, established in *Hickman*, that a party is not entitled to an opposing attorney's "assessment of * * * legal vulnerabilities in order to

make sure it does not miss anything in crafting its legal case." *Delaney, Migdail & Young, Chartered* v. *IRS*, 826 F.2d 124, 127 (D.C. Cir. 1987).[10]

Not surprisingly, the decision below has already emboldened the IRS—which, before 2002, had only rarely sought workpapers from taxpayers, see C.A. App. 238; *United States* v. *Arthur Young & Co.*, 465 U.S. 805, 820-821 (1984)—to declare that it will aggressively pursue such workpapers in future. See Kim Dixon, *U.S. IRS Could Seek More in Company Audits—Official*, Reuters, Nov. 19, 2009 (quoting comments by William Wilkins, IRS Chief Counsel). And because disclosure to an adverse party waives the work-product privilege, see 8 Wright & Miller § 2024, at 369, a company that is required to disclose its workpapers to the IRS will likely be obligated to turn over those workpapers to *state* taxation authorities (even if a state court would construe the privilege more broadly, see p. 17, n.5, *supra*) and even to private litigants, thereby compounding the consequences of the First Circuit's approach.

2. The practical significance of the First Circuit's approach, however, sweeps far beyond the particular context of this case. The First Circuit's "for use" standard is in no way cabined to that context—nor could it logically be, as the government seemingly recognized at oral argument below. See C.A. En Banc Tr. 4-5, 16

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[10] Ironically, in *Delaney*, the IRS argued that the work-product privilege covered documents *it* had prepared to analyze the legal vulnerability of a particular auditing method, and the District of Columbia Circuit agreed. See 826 F.2d at 126-128; cf. C.A. Panel Tr. 20 (Sept. 5, 2008) (stating that the government "spend[s] a lot more time defending our documents from requests on the grounds of work product than we do * * * seek[ing] them [from other parties]").

(June 2, 2009) (conceding that the "work product test" adopted by the court "will apply" both "to the IRS" and "to everyone else," including "outside the tax realm").

Under the First Circuit's standard, work-product protection would no longer extend to *any* documents prepared by counsel that assess the risks of ongoing or potential litigation, because such documents could not meaningfully be said to have been prepared "for use" in litigation. For example, the work-product privilege would not cover a document that a company prepares in order to inform a potential merger partner of the litigation risks that the company faces—risks that the partner would assume in the event the merger is consummated. See, *e.g.*, *Adlman*, 134 F.3d at 1195. Nor would it cover so-called "audit response letters": that is, letters routinely prepared by outside counsel at their corporate clients' request assessing pending or threatened litigation against the company for the purpose of assisting the company's auditor in performing its duties. See, *e.g.*, *Lawrence E. Jaffe Pension Plan* v. *Household Int'l, Inc.*, 237 F.R.D. 176, 179-181 (N.D. Ill. 2006) (holding that work-product privilege covers audit response letters); *In re Honeywell Int'l, Inc., Sec. Litig.*, 230 F.R.D. 293, 300 (S.D.N.Y. 2003) (same); *Tronitech, Inc.* v. *NCR Corp.*, 108 F.R.D. 655, 656 (S.D. Ind. 1985) (same).[11] In those and other similar contexts, the documents at issue contain information that would be enormously valuable to adverse parties in litigation, and the work-product privilege would provide the only potential source of protec-

[11] The government conceded below that, if the documents at issue in this case were not protected by the work-product privilege, audit response letters would not be protected either. See C.A. En Banc Tr. 19 (June 2, 2009).

tion against disclosure (because the attorney-client privilege is waived by disclosure to *any* third party, even a potential merger partner or auditor). See 8 Wright & Miller § 2024, at 367-368.[12]

Perhaps for that reason, the First Circuit's decision has received an enormous amount of attention from the news media and commentators—and, belying the First Circuit's belief that "[n]o one with experience of law suits" would reach a contrary conclusion, App., *infra*, 17a, the decision has also been greeted with widespread consternation by practitioners. See, *e.g.*, Nancy T. Bowen, William S. Lee & Robert C. Morris, *Newly Minted 'For Use in Possible Litigation' Test of 'Textron' May Have Far-Reaching Implications for Companies*, 78 U.S.L.W. 2199, 2199 (2009) (stating that the decision below is "highly controversial"; "may have far-reaching implications, particularly for publicly traded companies"; and "adds further uncertainty to [an] already confused legal arena"); Amir Efrati, *Ruling in Tax-Auditing Case Puts Corporations on Edge*, Wall St. J., Aug. 20, 2009, at A9 (suggesting that the decision below "is causing lawyers for big companies some sleepless nights" and has been seen as "signal[ing] an attack by the courts on the 'work-product doctrine'"); Michelle M. Henkel, *'Textron' Eviscerates the 60-Year-Old Work Product Privilege*, 125 Tax Notes 237, 237 (2009) (contending that, "[b]ecause of the widespread impact of [the decision below],

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[12] In fact, relying on the decision below, the Director of the SEC's Division of Enforcement recently made the unqualified assertion that "audit documentation * * * relied on by an auditor in connection with an audit report" is not covered by the work-product privilege. See Robert Khuzami, Remarks at AICPA National Conference on Current SEC and PCAOB Developments (Dec. 8, 2009) <www.sec.gov/news/speech/2009/spch120809rsk.htm>.

the entire legal profession and all corporations should be in a state of disbelief").

In addition, in the wake of the First Circuit's decision, practitioners have already begun recommending that companies take steps to avoid the disclosure to adverse parties of their litigation risk assessments. See, *e.g.*, Scott Novick, *What In-House Tax Professionals Should Do in Light of 'Textron,'* Global Tax Blog (Aug. 31, 2009) <tinyurl.com/scottnovick> (contending that "tax departments can and should * * * [l]imit[] tax accrual work papers to numerical analysis with minimal supporting narrative"); Robert W. Pommer III, *First Circuit Reverses Course in Closely Watched Work Product Case; Establishes Broad New Standard That Could Extend Outside Tax Area*, 41 Sec. Reg. & Law Report 2050, 2053 (2009) (recommending that companies "exercise greater caution when sharing documents with the[ir] outside auditors"); cf. Stuart J. Bassin, *Managing Tax Accrual Workpapers After 'Textron,'* 123 Tax Notes 571, 580 (2009) (suggesting, while this case was still pending below, that the drafters of workpapers "should choose their words carefully"). Those recommendations amply support the prediction that the First Circuit's decision will have a broad chilling effect if it is allowed to stand.

3. Although issues concerning the applicability of the work-product privilege arise in courts around the Nation on a daily basis, this Court has not directly addressed the scope of the privilege since its decision more than sixty years ago in *Hickman*. See App., *infra*, 120a.[13] But notwithstanding the frequent recurrence in

[13] In *Arthur Young*, the Court refused to recognize an "accountant work-product privilege" for workpapers generated by a compa-

lower courts of issues concerning the privilege, if the Court does not grant review in this case, it is far from clear when the Court will have the opportunity to do so again. In ordinary civil litigation, a party that wishes to appeal a determination that a document is not covered by the work-product privilege may not be able to do so immediately, cf. *Mohawk Indus., Inc.* v. *Carpenter*, No. 08-678 (Dec. 8, 2009), slip op. 9-10 (explaining options for appeal of denial of attorney-client privilege), and, even if it can, the party will have to bear the expense of litigating what is an inherently collateral issue all the way to this Court.

At all events, there is simply no reason for the Court to wait to address the scope of the work-product privilege. Ten circuits have now spoken on the issue, taking three different (and irreconcilable) positions on the privilege's scope. This case, moreover, is an optimal vehicle for consideration of that issue. As the dissent below observed, "[t]he time is ripe for the Supreme Court to intervene and set the circuits straight." App., *infra*, 45a (opinion of Torruella, J.). The Court should grant review in this extraordinarily important case and correct the First Circuit's excessively narrow interpretation of the work-product privilege.

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ny's *auditor*. See 465 U.S. at 815-821. In some respects, this case presents the flipside of the issue in *Arthur Young*, because it involves workpapers generated by the company's *own lawyers*.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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DECEMBER 2009

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 07-2631

UNITED STATES OF AMERICA, Petitioner,
Appellant,

v.

TEXTRON INC. AND SUBSIDIARIES, Respondent,
Appellee.

August 13, 2009

Before: LYNCH, Chief Judge, TORRUELLA, BOUDIN, LIPEZ and HOWARD, Circuit Judges.

BOUDIN, Circuit Judge.

The question for the *en banc* court is whether the attorney work product doctrine shields from an IRS summons "tax accrual work papers" prepared by lawyers and others in Textron's Tax Department to support Textron's calculation of tax reserves for its audited corporate financial statements. Textron is a major aerospace and defense conglomerate, with well over a hundred subsidiaries, whose consolidated tax return is audited by the IRS on a regular basis. To understand the dispute, some

background is required concerning financial statements, contingent tax reserves and tax audit work papers.

As a publicly traded corporation, Textron is required by federal securities law to have public financial statements certified by an independent auditor. *See* 15 U.S.C. §§ 781, 78m (2006); 17 C.F.R. § 210 *et seq.* (2009). To prepare such financial statements, Textron must calculate reserves to be entered on the company books to account for contingent tax liabilities. Such liabilities, which affect the portrayal of assets and earnings, include estimates of potential liability if the IRS decides to challenge debatable positions taken by the taxpayer in its return.

The calculation of such reserves entails preparing work papers describing Textron's potential liabilities for further taxes; these underpin the tax reserve entries in its financial statement and explain the figures chosen to the independent auditor who certifies that statement as correct. By examining the work papers the accountant discharges its own duty to determine "the adequacy and reasonableness of the corporation's reserve account for contingent tax liabilities." *United States v. Arthur Young & Co.,* 465 U.S. 805, 812 (1984) (rejecting claim of accountant work product privilege protecting such work papers).[1] The work papers are thus one step in a process whose outcome is a certified financial statement for the company.

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[1] The procedural requirement that auditors examine tax accrual work papers is based on a combination of Statement on Auditing Standards No. 96, Audit Documentation (2002), *superseded by* Auditing Standards No. 3, Audit Documentation (2004); Statement on Auditing Standards No. 326, Evidential Matter (1980); and Auditing Interpretation No. 9326, Evidential Matter: Auditing Interpretations of Section 326 (2003).

In Textron's case, its Tax Department lists items in the tax return that, if identified and challenged by the IRS, could result in additional taxes being assessed. The final spreadsheets list each debatable item, including in each instance the dollar amount subject to possible dispute and a percentage estimate of the IRS' chances of success. Multiplying the amount by the percentage fixes the reserve entered on the books for that item. The spreadsheets reflecting these calculations may be supported by backup emails or notes.

A company's published financial statements do not normally identify the specific tax items on the return that may be debatable but incorporate or reflect only the total reserve figure. As the Supreme Court explained in *Arthur Young,* tax accrual work papers provide a resource for the IRS, if the IRS can get access to them, by "pinpoint[ing] the 'soft spots' on a corporation's tax return by highlighting those areas in which the corporate taxpayer has taken a position that may, at some later date, require the payment of additional taxes" and providing "an item-by-item analysis of the corporation's potential exposure to additional liability." 465 U.S. at 813.

The IRS does not automatically request tax accrual work papers from taxpayers; rather, in the wake of Enron and other corporate scandals, the IRS began to seek companies' tax accrual work papers only where it concluded that the taxpayer had engaged in certain listed transactions "that [are] the same as or substantially similar to one of the types of transactions that the [IRS] has determined to be a tax avoidance transaction."

26 C.F.R. § 1.6011-4(b)(2) (2009). Only a limited number of transactions are so designated.[2]

The present case began with a 2003 IRS audit of Textron's corporate income tax liability for the years 1998-2001. In reviewing Textron's 2001 return, the IRS determined that a Textron subsidiary—Textron Financial Corp. ("Textron Financial")—had engaged in nine listed transactions. In each of the nine instances, Textron Financial had purchased equipment from a foreign utility or transit operator and leased it back to the seller on the same day. Although such transactions can be legitimate, the IRS determined that they were sale-in, lease-out ("SILO") transactions, which are listed as a potential tax shelter subject to abuse by taxpayers.

SILOs allow tax-exempt or tax-indifferent organizations—for example, a tax-exempt charity or a city-owned transit authority—to transfer depreciation and interest deductions, from which they cannot benefit, to other taxpayers who use them to shelter income from tax. Where the only motive of a sale and lease back is tax avoidance, it can be disregarded by the IRS and taxes assessed on the wrongly sheltered income.[3]

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[2] A current list of such transaction types, amounting to less than three dozen, appears at Internal Revenue Service, Recognized Abusive and Listed Transactions-LMSB Tier I Issues, http://www.irs.gov/businesses/corporations/article/0,id=120633,00.html (visited July 7, 2009).

[3] *See AWG Leasing Trust v. United States,* 592 F. Supp. 2d 953, 958 (N.D. Ohio 2008) (upholding denial of depreciation and interest deductions for SILO transaction); I.R.S. Notice 2005-13, 2005-9 I.R.B. 630 (Feb. 11, 2005); Shvedov, *Tax Implications of SILOs, QTEs, and Other Leasing Transactions with Tax-Exempt Entities* 10-12, CRS Report for Congress (Nov. 30, 2004).

Textron had shown the spreadsheets to its outside accountant, Ernst & Young, but refused to show them to the IRS. The IRS issued an administrative summons pursuant to 26 U.S.C. § 7602 (2006), which allows the IRS, in determining the accuracy of any return, to "examine any books, papers, records, or other data which may be relevant or material to such inquiry." *Id.* § 7602(a)(1). According to IRS policy, where the taxpayer claims benefits from only a single listed transaction, the IRS seeks only the workpapers for that transaction; but where (as in Textron's case) the taxpayer claims benefits from multiple listed transactions, the IRS seeks all of the workpapers for the tax year in question. I.R.S. Announcement 2002-63, 2002-27 I.R.B. 72 (July 8, 2002). The summons also sought related work papers created by Ernst & Young in determining the adequacy of Textron's reserves that Textron might possess or could obtain. Textron again refused.

The IRS brought an enforcement action in federal district court in Rhode Island. *See* 26 U.S.C. § 7604(a) (2006). Textron challenged the summons as lacking legitimate purpose and also asserted, as bars to the demand, the attorney-client and tax practitioner privileges and the qualified privilege available for litigation materials under the work product doctrine. The IRS contested all of the privilege claims. Both the IRS and Textron filed affidavits and, in addition, the district court heard witnesses from both sides.[4]

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[4] Textron's evidence came from Norman Richter, chief tax counsel and manager of Textron's Tax Department; Roxanne Cassidy, director of tax reporting; Edward Andrews, director of tax audits; Debra Raymond, vice president, taxes, of Textron Financial; and Mark Weston, a partner in Ernst & Young. IRS evidence was provided by Internal Revenue Agent Edward Vasconcellos; Professor

Textron agreed that it usually settled disputes with the IRS through negotiation or concession or at worst through the formal IRS administrative process; but it testified that sometimes it had litigated disputed tax issues in federal court. Its evidence also showed that the estimates for tax reserves and the supporting work papers were generated within its Tax Department but that tax lawyers in that department were centrally involved in their preparation and that Textron Financial also used an outside counsel to advise it on tax reserve requirements.

Textron described generically the contents of the work papers in question: these included (1) summary spreadsheets showing for each disputable item the amount in controversy, estimated probability of a successful challenge by the IRS, and resulting reserve amounts; and (2) back up e-mail and notes. In some instances the spreadsheet entries estimated the probability of IRS success at 100 percent. Textron said that the spreadsheets had been shown to and discussed with its independent auditor but physically retained by Textron.

Neither side disputed that the immediate purpose of the work papers was to establish and support the tax reserve figures for the audited financial statements. Textron's evidence was to the effect that litigation over specific items was always a possibility; the IRS did not deny that in certain cases litigation could result although it said that this was often unlikely. Whether Textron's evi-

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Douglas Carmichael, former chief auditor of the regulatory body for auditors of public companies (the Public Company Accounting Oversight Board); and Gary Kane, an IRS expert on tax accrual work papers.

dence is materially different than that of the IRS remains to be considered.

Ultimately, the district court denied the petition for enforcement. *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 150, 155 (D.R.I. 2007). The court agreed with the IRS that the agency had a legitimate purpose for seeking the work papers. *Id.* at 145. It also ruled that insofar as the Textron-prepared work papers might otherwise be protected by attorney-client privilege, or the counterpart tax practitioner privilege for non-lawyers engaged in tax practice, *see* 26 U.S.C. § 7525 (2006), those privileges had been waived when Textron disclosed the work papers' content to Ernst & Young. *Id.* at 152.

However, the district court concluded that the papers were protected by the work product privilege, which derived from *Hickman v. Taylor,* 329 U.S. 495 (1947), and is now embodied in Rule 26(b)(3) of the Federal Rules of Civil Procedure. This privilege, the district court held, had not been waived by disclosure of the work papers to the accountant. *Textron,* 507 F. Supp. 2d at 152-53. The district court's decision that the work papers were protected work product involved both a description of factual premises and a legal interpretation of applicable doctrine.

The district court first said (paraphrasing a Textron witness) the work papers were prepared to assure that Textron was "adequately reserved with respect to any potential disputes or litigation" over its returns; the court also said that, by fair inference, the work papers served "to satisfy an independent auditor that Textron's reserve for contingent liabilities satisfied the requirements of generally accepted accounting principles (GAAP) so that a 'clean' opinion would be given" for Tex-

tron financial statements. *Textron,* 507 F. Supp. 2d at 143.

Then, in its discussion of legal doctrine, the district court stated:

> As the IRS correctly observes, the work product privilege does not apply to "'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'" *Maine,* 298 F.3d at 70 (quoting [*United States v. Adlman,* 134 F.3d 1194, 1202 (2d Cir. 1998)]). However, it is clear that the opinions of Textron's counsel and accountants regarding items that might be challenged by the IRS, their estimated hazards of litigation percentages and their calculation of tax reserve amounts would not have been prepared at all "but for" the fact that Textron anticipated the possibility of litigation with the IRS . . . . Thus, while it may be accurate to say that the workpapers helped Textron determine what amount should be reserved to cover any potential tax liabilities and that the workpapers were useful in obtaining a "clean" opinion from E&Y regarding the adequacy of the reserve amount, there would have been no need to create a reserve in the first place, if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding.

Textron, 507 F. Supp. 2d at 150.

The court concluded that the work papers were therefore prepared "because of" the prospect of litigation, *Textron,* 507 F. Supp. 2d at 150, a phrase used in *Maine v. United States Dep't of Interior,* 298 F.3d 60, 68 (1st Cir. 2002). The court rejected the IRS' reliance on a Fifth Circuit decision rejecting work product protection for tax accrual work papers on the ground that the Fifth Circuit followed a different "primary purpose" test for work protect. *Textron,* 507 F. Supp. 2d at 150 (discussing *United States v. El Paso Co.,* 682 F.2d 530, 543 (5th Cir. 1982), *cert. denied,* 466 U.S. 944 (1984)).

On appeal, a divided panel upheld the district court's decision. The *en banc* court then granted the government's petition for rehearing *en banc,* vacated the panel decision, and obtained additional briefs from the parties and interested amici. We now conclude that under our own prior *Maine* precedent—which we reaffirm *en banc*—the Textron work papers were independently required by statutory and audit requirements and that the work product privilege does not apply.

The case presents two difficulties. One, which can readily be dispelled, stems from the mutability of language used in the governing rules and a confusion between issues of fact and issues of legal characterization. The other problem is more basic: how far work product protection extends turns on a balancing of policy concerns rather than application of abstract logic; here, two circuits have addressed tax accrual work papers in the work product context, but, apart from whatever light is cast by *Arthur Young,* the Supreme Court has not ruled on the issue before us, namely, one in which a document is not in any way prepared "for" litigation but relates to a subject that might or might not occasion litigation.

In origin, the work product privilege derives from the Supreme Court's decision in *Hickman v. Taylor*, 329 U.S. at 510-11, and focused at the outset on the materials that lawyers typically prepare for the purpose of litigating cases. *Hickman v. Taylor* concerned ongoing litigation in which one side filed interrogatories seeking from opposing counsel memoranda recording witness interviews that the latter had conducted after receiving notice of possible claims. Often such material and other items designed for use at trial (*e.g.*, draft briefs, outlines of cross examination) are not obtained from or shared with clients and are unprotected by the traditional attorney-client privilege.

Hickman v. Taylor addressed "the extent to which a party may inquire into oral and written statements of witnesses, or other information, secured by an adverse party's counsel in the course of preparation for possible litigation after a claim has arisen." 329 U.S. at 497. The Court cited a privilege in English courts protecting

> [a]ll documents which are called into existence for the purpose-but not necessarily the sole purpose-of assisting the deponent or his legal advisers in any actual or anticipated litigation . . . . Reports . . . if made in the ordinary course of routine, are not privileged . . . .

Id. at 510 n. 9.

This history led the Court to practical considerations:

> Proper preparation of a client's case demands that he assemble information, sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy without undue

> and needless interference . . . . This work is reflected, of course, in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways—aptly though roughly termed . . . as the "work product of the lawyer."

Id. at 511.

On this basis the Court declared that the interrogatories, which sought witness interviews conducted by opponent counsel in preparation for litigation, were protected by a qualified privilege. *See id.* at 511-12. When in 1970 the Supreme Court through the rule-making process codified the work product privilege in Rule 26(b)(3), it described the privilege as extending to documents and other tangible things that "are prepared in anticipation of litigation or for trial." This phrase, as illuminated by *Hickman v. Taylor*'s reasoning, is the one to be applied in this case.

Turning back to the present case, the IRS is unquestionably right that the immediate motive of Textron in preparing the tax accrual work papers was to fix the amount of the tax reserve on Textron's books and to obtain a clean financial opinion from its auditor. And Textron may be correct that unless the IRS might dispute an item in the return, no reserve for that item might be necessary, so perhaps some of the items might be litigated. But in saying that Textron wanted to be "adequately reserved," the district judge did not say that the work papers were prepared *for use* in possible litigation—only that the reserves would cover liabilities that might be determined in litigation. If the judge had made

a "for use" finding—which he did not—that finding would have been clearly erroneous.

That the purpose of the work papers was to make book entries, prepare financial statements and obtain a clean audit cannot be disputed. This was the testimony of IRS expert and former Chief Auditor of the Public Company Accounting Oversight Board Douglas Carmichael:

> Q. . . . Would you please explain what tax accrual workpapers are?
>
> A. . . . Tax accrual workpapers really include all the support for the tax assets and liabilities shown in the financial statements . . . .
>
> A. Well, from the company's perspective, they're created because, for example, for a public company, the key officers of the company sign a certification saying that those financial statements are fairly presented, and they need support for that.
>
> From the auditor's perspective, it's the same thing, the auditor needs to record in the workpapers what the auditor did to comply with generally accepted auditing standards. So the workpapers are the principal support for the auditor's opinion.
>
> Q. And why do public companies prepare financial statements?
>
> A. Usually, to meet requirements for raising capital. If they're a public company, they need to file annual financial statements on a form 10K with the SEC and quarterly information on a 10Q.

The Textron witnesses, while using the word "litigation" as often as possible in their testimony, said the same thing. Textron's testimony differed from that of the IRS expert only in its further assertion that, without the possibility of litigation, no tax reserves or audit papers would have been necessary. For example, Roxanne Cassidy, Textron's director of tax reporting, testified as follows:

> Q. . . . [W]hat was Textron's purpose in preparing those tax reserve papers?
>
> A. The purpose primarily was to determine whether Textron was adequately reserved with respect to any potential disputes or litigations that would happen in the future. We would need to ensure that we were adequately reserved in the current year on Textron's financial statements.
>
> . . .
>
> Q. And as a publicly traded company, is Textron required to file its financial statements with the Securities and Exchange Commission?
>
> A. Yes.
>
> Q. And do those financial statements include tax reserves?
>
> A. Yes . . . .
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> . . .
>
> Q. And in having its tax reserves audited by an independent auditor, must Textron be able to support the determinations it

> has made regarding the adequacy of its tax reserves with some type of evidence?
>
> A. Yes, the support needs to be to the satisfaction of the auditors.

As the IRS expert stated, even if litigation were "remote," the company would still have to prepare work papers to support its judgment. Textron's own witness acknowledged that it would "have to include in its . . . tax accrual work papers any new transactions that the company entered into that year that there might be some tax exposure on" regardless of whether it anticipated likely litigation. Judged by Textron's own experience, most—certainly those with high percentage estimates of IRS success—would never be litigated.

To complete the story, we note *one* suggestion by one Textron witness that, if litigation did occur, the work papers could be useful to Textron in that litigation.[5] This assertion was not supported by any detailed explanation, was *not* adopted by the district judge and is more than dubious: the main aim of audit work papers is to estimate the amount potentially in dispute and the percentage chance of winning or losing. Even an academic supporter of Textron's legal position conceded that "it is doubtful that tax accrual workpapers, which typically just identify and quantify vulnerable return positions, would be useful in the litigation anticipated with respect to those posi-

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[5] Textron Vice President of Taxes Norman Richter said that Textron would still prepare tax accrual workpapers absent GAAP requirements "[b]ecause it guides us—it's—the analysis is still—it would guide us in making litigation and settlement decisions later in the process." This assertion was not contained in Richter's affidavit, which instead said that Textron prepared the work papers "to comply with GAAP" as required for reporting taxes to the SEC, and was not supported by detail or explanation in the record.

tions." Pease-Wingenter, *The Application of the Attorney-Client Privilege to Tax Accrual Workpapers: The Real Legacy of United States v. Textron*, 8 Houston Bus. & Tax L.J. 337, 346 (2008).

Any experienced litigator would describe the tax accrual work papers as tax documents and not as case preparation materials. *Whether* work product protection should apply to such documents is a *legal* question informed by the language of rules and Supreme Court doctrine, direct precedent, and policy judgments. The first of these sources—Supreme Court doctrine and the wording of the rules—is helpful to the IRS; direct circuit precedent and the underlying policy of the doctrine and other prudential considerations are more helpful still. Legal commentators can be found on each side; the most persuasive of them favors the IRS.[6]

From the outset, the focus of work product protection has been on materials prepared for use in litigation, whether the litigation was underway or merely anticipated. Thus, *Hickman v. Taylor* addressed "the extent to which a party may inquire into oral and written statements of witnesses, or other information, secured by an adverse party's counsel *in the course of preparation for possible litigation* after a claim has arisen." 329 U.S. at 497 (emphasis added). Similarly, the English privilege, invoked by *Hickman v. Taylor,* privileged "documents which are called into existence for *the purpose—but not necessarily the sole purpose—of assisting the*

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[6] *See* Ventry, *Protecting Abusive Tax Avoidance,* 120 Tax Notes 857, 870-83 (2008); Johnson, *The Work Product Doctrine and Tax Accrual Workpapers,* 124 Tax Notes 155, 160-68 (2009). The Pease-Wingenter article, *supra,* identifies many weaknesses in the Textron argument, *id.* at 343-48, although Pease now says her own ultimate view favors Textron.

deponent or his legal advisers in any actual or anticipated litigation." *Id.* at 510 n. 9 (emphasis added) (internal quotation marks omitted).

The phrase used in the codified rule—"prepared in anticipation of litigation or for trial" did not, in the reference to anticipation, mean prepared for some purpose other than litigation: it meant only that the work might be done *for* litigation but *in advance of* its institution. The English precedent, doubtless the source of the language in Rule 26, specified the purpose "of assisting the deponent or his legal advisers in any actual or anticipated litigation . . . ." The Advisory Committee's Note cited with approval a decision denying work product protection to a driver's accident report, made pursuant to Interstate Commerce Commission rules, even though it might well have become the subject of litigation. Fed. R. Civ. P. 26 advisory committee's note (1970).[7]

It is not enough to trigger work product protection that the *subject matter* of a document relates to a subject that might conceivably be litigated. Rather, as the Supreme Court explained, "the literal language of [Rule 26(b)(3)] protects materials *prepared for* any litigation or trial as long as they were prepared by or for a party to the subsequent litigation." *Federal Trade Commission v. Grolier Inc.,* 462 U.S. 19, 25 (1983) (emphasis added).

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[7] *Goosman v. A. Duie Pyle, Inc.,* 320 F.2d 45 (4th Cir. 1963). In *Goosman,* the Fourth Circuit denied work product protection to reports a truck driver made to the lessee and owner of the truck following an accident. The court explained that the reports "were made in the ordinary course of business under ICC regulations and do not represent the lawyer's work product within the holding in *Hickman v. Taylor.*" *Id.* at 52. *See also, e.g., Calabro v. Stone,* 225 F.R.D. 96, 99 (E.D.N.Y. 2004); *In re Raytheon Securities Litigation,* 218 F.R.D. 354, 359 (D. Mass. 2003).

This distinction is well established in the case law. *See, e.g., NLRB v. Sears, Roebuck & Co.,* 421 U.S. 132, 138 (1975).[8]

Nor is it enough that the materials were prepared by lawyers or represent legal thinking. Much corporate material prepared in law offices or reviewed by lawyers falls in that vast category. It is only work done in anticipation of or for trial that is protected. Even if prepared by lawyers and reflecting legal thinking, "[m]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes are not under the qualified immunity provided by this subdivision." Fed. R. Civ. P. 26 advisory committee's note (1970). *Accord Hickman v. Taylor,* 329 U.S. at 510 n. 9 (quoting English precedent that "[r]eports . . . if made in the ordinary course of routine, are not privileged").

Every lawyer who tries cases knows the touch and feel of materials prepared for a current or possible (*i.e.,* "in anticipation of") law suit. They are the very materials catalogued in *Hickman v. Taylor* and the English precedent with which the decision began. No one with experience of law suits would talk about tax accrual work papers in those terms. A set of tax reserve figures, calculated for purposes of accurately stating a company's financial figures, has in ordinary parlance only that pur-

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[8] *Accord United States v. Roxworthy,* 457 F.3d 590, 595 (6th Cir. 2006) ("Nevertheless, the key issue in determining whether a document should be withheld is the function that the document serves."); *Coastal States Gas Corp. v. Dep't of Energy,* 617 F.2d 854, 858 (D.C. Cir. 1980) (same); *Church of Scientology Int'l v. IRS,* 845 F. Supp. 714, 723 (C.D. Cal. 1993) ("The Ninth Circuit test focuses on the function of a document as part of the deliberative process rather than on the contents of the document.").

pose: to support a financial statement and the independent audit of it.

Focusing next on direct precedent, work product protection for tax audit work papers has been squarely addressed only in two circuits: this one and the Fifth. In *Maine,* we said that work product protection does not extend to "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation." *Maine,* 298 F.3d at 70 (quoting *United States v. Adlman,* 134 F.3d 1194, 1202 (2d Cir. 1998)) (internal quotation marks omitted). *Maine* applies straightforwardly to Textron's tax audit work papers—which were prepared in the ordinary course of business—and it supports the IRS position.

Similarly, the Fifth Circuit in *El Paso* denied protection for the work papers because the court recognized that the company in question was conducting the relevant analysis because of a need to "bring its financial books into conformity with generally accepted auditing principles." 682 F.2d at 543. The Fifth Circuit, which employs a "primary purpose" test, found that the work papers' "sole function" was to back up financial statements. *Id.* at 543-44. Here, too, the only purpose of Textron's papers was to prepare financial statements.

Other circuits have not passed on tax audit work papers and some might take a different view. But many of the debatable cases affording work product protection involve documents unquestionably prepared for potential use in litigation if and when it should arise.[9] There is no

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[9] *See, e.g., Delaney, Migdail & Young, Chartered v. IRS,* 826 F.2d 124, 127 (D.C. Cir. 1987) (protection for "attorneys' assessment of . . . legal vulnerabilities in order to make sure it does not miss any-

evidence in this case that the work papers were prepared for such a use or would in fact serve any useful purpose for Textron in conducting litigation if it arose.

Finally, the underlying prudential considerations squarely support the IRS' position in this case, and such considerations have special force because *Hickman v. Taylor* was the child of such considerations, as the quotations above make clear. The privilege aimed centrally at protecting the *litigation process, Coastal States Gas Corp. v. Department of Energy,* 617 F.2d 854, 864 (D.C. Cir. 1980), specifically, work done by counsel to help him or her in *litigating* a case. It is not a privilege designed to help the lawyer prepare corporate documents or other materials prepared in the ordinary course of business. Where the rationale for a rule stops, so ordinarily does the rule.

Nor is there present here the concern that *Hickman v. Taylor* stressed about discouraging sound preparation for a law suit. That danger may exist in other kinds of cases, but it cannot be present where, as here, there is in substance a legal obligation to prepare such papers: the tax audit work papers not only have a different purpose but *have* to be prepared by exchange-listed companies to comply with the securities laws and accounting principles for certified financial statements. *Arthur Young* made this point in refusing to create an accountant's work product privilege for tax audit papers:

> [T]he auditor is ethically and professionally obligated to ascertain for himself as far as possible whether the corporation's con-

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thing in crafting its legal case"); *see also In re Sealed Case,* 146 F.3d 881, 885 (D.C. Cir. 1998) (protection for documents to "protect the client from future litigation about a particular transaction").

> tingent tax liabilities have been accurately stated. . . . Responsible corporate management would not risk a qualified evaluation of a corporate taxpayer's financial posture to afford cover for questionable positions reflected in a prior tax return.

465 U.S. at 818-19; *see also* Johnson, *supra,* at 160-61.

Textron apparently thinks it is "unfair" for the government to have access to its spreadsheets, but tax collection is not a game. Underpaying taxes threatens the essential public interest in revenue collection. If a blueprint to Textron's possible improper deductions can be found in Textron's files, it is properly available to the government *unless* privileged. Virtually all discovery against a party *aims* at securing information that may assist an opponent in uncovering the truth. Unprivileged IRS information is equally subject to discovery.[10]

The practical problems confronting the IRS in discovering under-reporting of corporate taxes, which is likely endemic, are serious. Textron's return is massive—constituting more than 4,000 pages—and the IRS requested the work papers only after finding a specific type of transaction that had been shown to be abused by taxpayers. It is because the collection of revenues is essential to government that administrative discovery, along with many other comparatively unusual tools, are furnished to the IRS.

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[10] *See Abel Inv. Co. v. United States,* 53 F.R.D. 485, 488 (D. Neb. 1971) (holding that IRS documents created during an audit were not protected work product, despite containing attorneys' mental impression and legal theories, because an IRS audit is not litigation).

As Bentham explained, all privileges limit access to the truth in aid of other objectives, 8 Wigmore, *Evidence* § 2291 (McNaughton Rev. 1961), but virtually all privileges are restricted—either (as here) by definition or (in many cases) through explicit exceptions—by countervailing limitations. The Fifth Amendment privilege against self-incrimination is qualified, among other doctrines, by the required records exception, *see Grosso v. United States,* 390 U.S. 62, 67-68 (1968), and the attorney client privilege, along with other limitations, by the crime-fraud exception, *see Clark v. United States,* 289 U.S. 1, 15 (1933).

To sum up, the work product privilege is aimed at protecting work done for litigation, not in preparing financial statements. Textron's work papers were prepared to support financial filings and gain auditor approval; the compulsion of the securities laws and auditing requirements assure that they will be carefully prepared, in their present form, even though not protected; and IRS access serves the legitimate, and important, function of detecting and disallowing abusive tax shelters.

The judgment of the district court is *vacated* and the case is *remanded* for further proceedings consistent with this decision.

It is so ordered.

TORRUELLA, Circuit Judge, with whom LIPEZ, Circuit Judge, joins, dissenting.

To assist the IRS in its quest to compel taxpayers to reveal their own assessments of their tax returns, the majority abandons our "because of" test, which asks whether "'in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained *because*

of the prospect of litigation.'" *Maine v. United States Dep't of the Interior*, 298 F.3d 60, 68 (1st Cir. 2002) (emphasis in original) (quoting *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998)). The majority purports to follow this test, but never even cites it. Rather, in its place, the majority imposes a "prepared for" test, asking if the documents were "prepared for use in possible litigation." Maj. Op. at 13. This test is an even narrower variant of the widely rejected "primary motivating purpose" test used in the Fifth Circuit and specifically repudiated by this court. In adopting its test, the majority ignores a tome of precedents from the circuit courts and contravenes much of the principles underlying the work-product doctrine. It also brushes aside the actual text of Rule 26(b)(3), which "[n]owhere . . . state[s] that a document must have been prepared *to aid* in the conduct of litigation in order to constitute work product." *Adlman*, 134 F.3d at 1198. Further, the majority misrepresents and ignores the findings of the district court. All while purporting to do just the opposite of what it actually does.

I. The Majority Quietly Rejects Circuit Precedent

The majority claims allegiance to our prior decision in *Maine*, 298 F.3d at 70. Specifically, the majority seizes upon a single line from that decision: "the 'because of' standard does not protect from disclosure 'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'" *Id.* (quoting *Adlman*, 134 F.3d at 1202). This qualification is important to be sure, and I will address it *infra*, Section III.B.2. But I must start by addressing the rest of the *Maine* decision, which the majority is careful to ignore.

In that decision, Maine sought documents prepared by the Department of the Interior regarding its decision, made during pending related litigation, to classify salmon as a protected species. *Id.* at 64. The district court found some of these administrative documents unprotected as the Department had not shown that litigation preparation was "'the primary motivating factor for the preparation of the documents.'" *Id.* at 66-67. This formulation of the test for "anticipation of litigation" was based on the Fifth Circuit rule that the work-product doctrine did not protect documents that were "not primarily motivated *to assist in* future litigation." *United States v. El Paso,* 682 F.2d 530, 542-43 (5th Cir. 1982) (emphasis added) (citing *United States v. Davis,* 636 F.2d 1028, 1040 (5th Cir. 1981)). On appeal in *Maine,* we specifically repudiated this test and adopted the broader "because of" test, which had been thoughtfully and carefully explained by Judge Leval in the Second Circuit decision in *Adlman,* 134 F.3d at 1202-03. *See Maine,* 298 F.3d at 68 ("In light of the decisions of the Supreme Court, we therefore agree with the formulation of the work-product rule adopted in *Adlman* and by five other courts of appeals.").

In the present case, the majority purports to follow *Maine,* but really conducts a new analysis of the history of the work-product doctrine and concludes that documents must be "'*prepared for* any litigation or trial.'" Maj. Op. at 18 (emphasis in original) (quoting *FTC v. Grolier Inc.,* 462 U.S. 19, 25 (1983)). Similarly, at another point, the majority suggests that documents must be "for use" in litigation in order to be protected. *Id.* at 13. *Grolier* did not establish such a test and the majority can

point to no court that has so ruled.[11] Rather, the majority of circuit courts, led by the Second Circuit's decision in *Adlman*, have rejected such a rule.

Adlman's articulation of the "because of" test is fatal to the majority's position. In that case, Judge Leval discussed the application of the work-product doctrine "to a litigation analysis prepared by a party or its representative in order to inform a business decision which turns on the party's assessment of the likely outcome of litigation expected to result from the transaction." *Adlman*, 134 F.3d at 1197. In other words, *Adlman* asked whether the work-product doctrine applies where a dual purpose exists for preparing the legal analysis, that is, where the dual purpose of anticipating litigation and a business

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[11] To support its conclusion, the majority commits a plain logical error. The majority states that work-product protection must not be judged solely on its subject matter, but rather whether the documents's purpose is *for use* in litigation. In support of this proposition, the majority cites a number of cases that propound the uncontroversial proposition that a document must be judged according to its purpose, not solely its content. Maj. Op. at 18 n.8. But those cases do not establish the majority's rule that the documents' purpose *must be limited to use in litigation.* Rather, one of the cases the majority cites adopts the test that the document must have been created "because of" litigation, which, as *Adlman* describes, is antithetical to the majority's new requirement. *United States v. Roxworthy,* 457 F.3d 590, 593-94 (6th Cir. 2006) (adopting *Adlman*'s "because of" test). Another of the majority's citations is from the D.C. Circuit, which has also since adopted the "because of" test. *Senate of Puerto Rico v. United States Dep't of Justice,* 823 F.2d 574, 587 n.42 (D.C. Cir. 1987). The final decision cited by the majority, from the Northern District of California, deals with the deliberative process privilege, not the work-product doctrine. *Church of Scientology Int'l v. IRS,* 845 F. Supp. 714, 723 (C.D. Cal. 1993). In any event, the Ninth Circuit also applies the "because of" test. *In re Grand Jury Subpoena,* 357 F.3d 900, 907-08 (9th Cir. 2004) (praising and following *Adlman*).

purpose co-exist. To answer that question, the *Adlman* court examined and rejected the "primary purpose" test adopted by the Fifth Circuit in *El Paso,* 682 F.2d at 542-43, which only grants work-product immunity to work-papers prepared "primarily motivated to assist in future litigation over the return," *id.* at 543:

> [Protection] is less clear, however, as to documents which, although prepared because of expected litigation, are intended to inform a business decision influenced by the prospects of the litigation. The formulation applied by some courts in determining whether documents are protected by work-product privilege is whether they are prepared "primarily or exclusively to assist in litigation"—a formulation that would potentially exclude documents containing analysis of expected litigation, if their primary, ultimate, or exclusive purpose is to assist in making the business decision. Others ask whether the documents were prepared "because of" existing or expected litigation—a formulation that would include such documents, despite the fact that their purpose is not to "assist in" litigation. Because we believe that protection of documents of this type is more consistent with both the literal terms and the purposes of the Rule, we adopt the latter formulation.

Adlman, 134 F.3d at 1197-98, *quoted in part in Maine,* 298 F.3d at 68. And if it needs to be spelled out any more clearly, *Adlman* makes it explicitly clear that the broader "because of" formulation is not limited to documents prepared *for use* in litigation:

We believe that a requirement that documents be produced primarily or exclusively to assist in litigation in order to be protected is at odds with the text and the policies of the Rule. Nowhere does Rule 26(b)(3) state that a document must have been prepared *to aid* in the conduct of litigation in order to constitute work product, much less *primarily or exclusively* to aid in litigation. Preparing a document "in anticipation of litigation" is sufficient.

The text of Rule 26(b)(3) does not limit its protection to materials prepared to assist at trial. To the contrary, the text of the Rule clearly sweeps more broadly. It expressly states that work-product privilege applies not only to documents "prepared . . . for trial" but also to those prepared "in anticipation of litigation." If the drafters of the Rule intended to limit its protection to documents made to assist in preparation for litigation, this would have been adequately conveyed by the phrase "prepared . . . for trial." The fact that documents prepared "in anticipation of litigation" were also included confirms that the drafters considered this to be a different, and broader category. Nothing in the Rule states or suggests that documents prepared "in anticipation of litigation" with the purpose of assisting in the making of a business decision do not fall within its scope.

Id. at 1198-99 (emphasis and alterations in original). Rather than confront this language, the majority resorts to simplistic generalizations. Using its novel "prepared for" test, the majority unhelpfully explains that "[e]very lawyer who tries cases knows the touch and feel of materials prepared for a current or possible . . . law suit." Maj. Op. at 19. Once the majority ignores decades of controlling precedent, the matter becomes so clear that "[n]o one with experience of law suits" could disagree. *Id.*

I need say little else; the majority's new "prepared for" rule is blatantly contrary to *Adlman*, a leading case interpreting the work-product doctrine that we specifically adopted in *Maine*. The majority's opinion is simply stunning in its failure to even acknowledge this language and its suggestion that it is respecting rather than overruling *Maine*.

II. The Majority Announces a Bad Rule

The majority acts as if it is left to this court to draw a line from *Hickman* to the present case. In so doing, the majority ignores a host of cases which grapple with tough work product questions that go beyond the stuff that "[e]very lawyer who tries cases" would know is work product. Lower courts deserve more guidance than a simple reassurance that a bare majority of the en banc court knows work product when it sees it.[12] Of course,

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[12] This test is reminiscent of Justice Stewart's famously unhelpful test for identifying obscenity:

> [C]riminal laws in this area are constitutionally limited to hard-core pornography. I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it

since this is an en banc proceeding, the majority is free to create a new rule for the circuit—though it would be better if it admitted that it was doing so. But our new circuit rule is not even a good rule.

First, as Judge Leval observed in *Adlman*, a "prepared for" requirement is not consistent with the plain language of Federal Rule of Civil Procedure 26, which provides protection for documents "prepared in anticipation of litigation *or* for trial." Fed. R. Civ. P. 26(b)(3)(A) (emphasis added); *see also Adlman*, 134 F.3d at 1198-99. There is no reason to believe that "anticipation of litigation" was meant as a synonym for "for trial." Claudine Pease-Wingenter, *Prophetic or Misguided? The Fifth Circuit's (Increasingly) Unpopular Approach to the Work Product Doctrine*, 29 Rev. Litig. (forthcoming 2009) (analyzing and rejecting many of the arguments advanced by the majority in favor of a narrow construction of the phrase "anticipation of litigation"). Since the terms are not synonymous, the term "anticipation of litigation" should not be read out of the rule by requiring a showing that documents be prepared for trial. *See Carcieri v. Salazar*, 129 S. Ct. 1058, 1066 (2009) (discussing the basic principle that statutes should be construed to give effect to each word).

Second, though the majority goes into some depth describing the foundational case of *Hickman v. Taylor*, 329 U.S. 495 (1947), it misses the fundamental concern of that decision with protecting an attorney's "privacy, free from unnecessary intrusion by opposing parties and their counsel." *Id.* at 510. Without such privacy, litigants

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> when I see it, and the motion picture involved in this case is not that.

Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

would seek unfair advantage by free-riding off another's work, thus reducing lawyers' ability to write down their thoughts:

> Were the attorney's work accessible to an adversary, the *Hickman* court cautioned, "much of what is now put down in writing would remain unwritten" for fear that the attorney's work would redound to the benefit of the opposing party. Legal advice might be marred by "inefficiency, unfairness and sharp practices," and the "effect on the legal profession would be demoralizing." Neither the interests of clients nor the cause of justice would be served, the court observed, if work product were freely discoverable.

Adlman, 134 F.3d at 1197 (quoting *Hickman*, 329 U.S. at 511) (citations omitted). The majority posits that these rationales do not apply to documents containing a lawyer's legal analysis of a potential litigation, if that analysis was prepared for a business purpose. Maj. Op. at 21. This is both unpersuasive and directly contrary to the policy analysis in *Adlman*, which we adopted in *Maine*. *Adlman* identified an example of a protected document:

> A business entity prepares financial statements to assist its executives, stockholders, prospective investors, business partners, and others in evaluating future courses of action. Financial statements include reserves for projected litigation. The company's independent auditor requests a memorandum prepared by the company's attorneys estimating the likelihood of success in litigation and an accompanying

> analysis of the company's legal strategies and options to assist it in estimating what should be reserved for litigation losses.

Id. at 1200. Discussing this example, the court concluded that in this scenario "the company involved would require legal analysis that falls squarely within *Hickman*'s area of primary concern—analysis that candidly discusses the attorney's litigation strategies, appraisal of likelihood of success, and perhaps the feasibility of reasonable settlement." *Id.* Further, there is "no basis for adopting a test under which an attorney's assessment of the likely outcome of litigation is freely available to his litigation adversary merely because the document was created for a business purpose rather than for litigation assistance." *Id.* In other words,

> [i]n addition to the plain language of the Rule, the policies underlying the work-product doctrine suggest strongly that work-product protection should not be denied to a document that analyzes expected litigation merely because it is prepared to assist in a business decision. Framing the inquiry as whether the primary or exclusive purpose of the document was to assist in litigation threatens to deny protection to documents that implicate key concerns underlying the work-product doctrine.

Id. at 1199; *see also Roxworthy,* 457 F.3d at 595 (stating "the IRS would appear to obtain an unfair advantage by gaining access to KPMG's detailed legal analysis of the strengths and weaknesses of [the taxpayer's] position. This factor weighs in favor of recognizing the documents as privileged.").

The majority offers no response to this sound policy analysis and no reason to doubt that inefficiency and "sharp practices" will result from its new rule allowing discovery of such dual purpose documents, which contain confidential assessments of litigation strategies and chances. Instead of addressing these concerns, the majority's policy analysis relies instead on case-specific rationales—namely the need to assist the IRS in its difficult task of reviewing Textron's complex return. *See* Maj. Op. at 22-23. Such outcome determinative reasoning is plainly unacceptable. Thus, properly framed, it is clear that the rationales underlying the work-product doctrine apply to documents prepared in anticipation of litigation, even if they are not also for use at trial.[13]

And these policy rationales are squarely implicated in this case. First, Textron's litigation hazard percentages contain exactly the sort of mental impressions about the case that *Hickman* sought to protect. In fact, these percentages contain counsel's ultimate impression of the value of the case. Revealing such impressions would have clear free-riding consequences. With this information, the IRS will be able to immediately identify weak spots and know exactly how much Textron should be willing to spend to settle each item. Indeed, the IRS explicitly admits that this is its purpose in seeking the documents.

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[13] Perhaps because of these very same concerns about privacy and fairness, the IRS itself argued for the protection of its documents prepared for the dual purposes of helping the IRS understand the litigation risks that might result if the IRS made the administrative decision to adopt a new program. *Delaney, Migdail & Young, Chartered v. IRS,* 826 F.2d 124 (D.C. Cir. 1987). This point was also noted by the *Adlman* court when it observed that "the IRS successfully argued against the very position it here advocates." *Adlman,* 134 F.3d at 1201.

Second, as argued to us by amici, the Chamber of Commerce of the United States and the Association of Corporate Counsel, if attorneys who identify good faith questions and uncertainties in their clients' tax returns know that putting such information in writing will result in discovery by the IRS, they will be more likely to avoid putting it in writing, thus diminishing the quality of representation. The majority dismisses such concerns, concluding that tax accrual workpapers are required by law. Maj. Op. at 21. But the majority fails to cite the record for this conclusion, likely because the majority is simply wrong. As the majority opinion earlier admits, Maj. Op. at 2-3, the law only requires that Textron prepare audited financial statements reporting total reserves based on contingent tax liabilities. Accounting standards require some evidential support before such statements can be certified, but do not explicitly require the form and detail of the documents prepared here by Textron's attorneys with respect to each potentially challenged tax item. *See also* Michelle M. Henkel, *Textron: The Debate Continues as to Whether Auditor Transparency Waives the Work Product Privilege*, 50 Tax Management Memorandum 251, 260 (2009) (distinguishing auditor's workpapers and corporate workpapers and explaining that the latter are not mandatory but serve to evaluate a company's litigation risks). Rather, all that must be actually reported is the final tax reserve liability amount. Thus, as amici worry, the majority's new rule will have ramifications that will affect the form and detail of documents attorneys prepare when working to convince auditors of the soundness of a corporation's reserves.

These concerns are even more clearly implicated in this case because the majority's decision will remove protection for Textron's "backup materials" as well as its

actual workpapers. The district court found that these materials included "notes and memoranda written by Textron's in-house tax attorneys reflecting their opinions as to which items should be included on the spreadsheet and the hazard of litigation percentage that should apply to each item." *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 143 (D.R.I. 2007). Thus, these documents thus go beyond the numbers used to compute a total reserve. Rather, they explain the legal rationale underpinning Textron's views of its litigation chances. The majority fails to acknowledge this subtlety, explain why it views such documents as required by regulatory rules, or explain why such mental impressions should go unprotected. Exposing such documentation to discovery is a significant expansion of the IRS's power and will likely reveal information far beyond the basic numbers that the IRS could discover through production of Textron's auditor's workpapers.

But more important are the ramifications beyond this case and beyond even the case of tax accrual workpapers in general. The scope of the work-product doctrine should not depend on what party is asserting it. Rather, the rule announced in this case will, if applied fairly, have wide ramifications that the majority fails to address.

For example, as the IRS explicitly conceded at oral argument, under the majority's rule one party in a litigation will be able to discover an opposing party's analysis of the business risks of the instant litigation, including the amount of money set aside in a litigation reserve fund, created in accordance with similar requirements as Textron's tax reserve fund. Though this consequence was a major concern of the argument in this case, the majority does not even consider this "sharp practice," which its new rule will surely permit.

And there are plenty more examples. Under the majority's rule, there is no protection for the kind of documents at issue in *Adlman*, namely "documents analyzing anticipated litigation, but prepared to assist in a business decision rather than to assist in the conduct of the litigation." 134 F.3d at 1201-02. Nearly every major business decision by a public company has a legal dimension that will require such analysis. Corporate attorneys preparing such analyses should now be aware that their work product is not protected in this circuit.

III. The Workpapers Are Protected Under the Right Test

Applying the "because of" test thoughtfully adopted in *Adlman* and *Maine*, the majority should have concluded that Textron's workpapers are protected by the work-product doctrine. The proper starting point in reaching this legal conclusion should be the factual findings of the district court, which held an evidentiary hearing to understand the nature of the documents sought here by the IRS.

A. Factual findings

After considering affidavits and testimony, the district court found that the tax accrual workpapers are:

> 1. A spreadsheet that contains:
>
> (a) lists of items on Textron's tax returns, which, in the opinion of Textron's counsel, involve issues on which the tax laws are unclear, and, therefore, may be challenged by the IRS;
>
> (b) *estimates by Textron's counsel expressing, in percentage terms, their judgments regarding Textron's chances of prevailing*

> *in any litigation over those issues (the "hazards of litigation percentages");* and
>
> (c) the dollar amounts reserved to reflect the possibility that Textron might not prevail in such litigation (the "tax reserve amounts").

Textron, 507 F. Supp. 2d at 142-143 (emphasis added). These workpapers do not contain any facts about the transactions that concerned the IRS. *Id.* at 143.

The district court also found, "[a]s stated by Norman Richter, Vice President of Taxes at Textron and Roxanne Cassidy, Director, Tax Reporting at Textron, Textron's ultimate purpose in preparing the tax accrual workpapers was to ensure that Textron was 'adequately reserved with respect to any potential disputes or litigation that would happen in the future.'" *Id.* at 143. Further, "there would have been no need to create a reserve in the first place, if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding." *Id.* at 150.

In addition to recognizing these litigation purposes, the district court also recognized the dual purposes driving the creation of these documents and found that the workpapers' creation "also was prompted, in part" by the need to satisfy Textron's auditors and get a "clean" opinion letter. *Id.* at 143. The district court later clarified:

> Thus, while it may be accurate to say that the workpapers helped Textron determine what amount should be reserved to cover any potential tax liabilities and that the workpapers were useful in obtaining a "clean" opinion from [the auditor] regarding the adequacy of the reserve amount,

> there would have been no need to create a reserve in the first place, if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding.

Id. at 150. Relatedly, the district court found that anticipation of litigation was the "but for" cause of the documents' creation. *Id.* Thus, the district court clearly found two purposes leading to the creation of the workpapers.

The majority makes no effort to reject these factual findings, but simply recharacterizes the facts as suits its purposes. For example, the majority declares, without reference to the district court's more nuanced findings, that the "the IRS is unquestionably right that the immediate motive of Textron in preparing the tax accrual work papers was to fix the amount of the tax reserve on Textron's books and to obtain a clean financial opinion from its auditor." Maj. Op. at 12-13. At another point, the majority boldly pronounces, "the only purpose of Textron's papers was to prepare financial statements." *Id.* at 20. Of course, as explained above, the district court's factual findings about Textron's "ultimate purpose" were directly contrary to these pronouncements. Discarding a district court's factual finding on causation without any demonstration of clear error is not within this court's proper appellate function. *See* Fed. R. Civ. P. 52(a) ("Findings of fact, whether based on oral or other evidence, must not be set aside unless clearly erroneous, and the reviewing court must give due regard to the trial court's opportunity to judge the witnesses' credibility."); *see also Constructora Maza, Inc. v. Banco de Ponce,* 616 F.2d 573, 576 (1st Cir. 1980) (noting that clear error review applies even when "much of the evidence is docu-

mentary and the challenged findings are factual inferences drawn from undisputed facts").

Instead, the majority exalts in the fact that the district court made no finding that the documents were "*for use* in possible litigation." Maj. Op. at 13. That proposition is true. But, as described above, "for use" (i.e. "prepared for") is not and has never been the law of this circuit.

The majority does suggest that the documents business purpose "cannot be disputed." *Id.* This is also uncontroversial. The district court found both a litigation and a business purpose. But, in straining to ignore the documents' litigation purposes, the majority proceeds to rely heavily on the IRS's expert. In so doing, the majority makes no effort to explain why the district court should have been required to adopt the view that the workpapers existed only for a non-litigation purpose. The majority claims that Textron's witnesses agreed with the IRS expert, but the majority fails to reconcile this proclamation with the competing view of Textron's witnesses, which the district court explicitly relied upon in its factual findings regarding Textron's "ultimate purpose." *Textron,* 507 F. Supp. 2d at 143. This is another corruption of the proper role of an appellate court. *See Anderson v. Bessemer City,* 470 U.S. 564, 574 (1985) ("Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous.").

The majority does suggest that the district court's findings regarding the cause of the workpapers' creation was only stated in its legal analysis section. Maj. Op. at 9. But the actual purpose of the documents' creators, or, in the words of the district court, "but-for" causation, is a

factual issue, and the majority makes no effort to explain why such issue should be reviewed as a legal conclusion.

The majority also proclaims, without record support, that "[a]ny experienced litigator would describe the tax accrual work papers as tax documents and not as case preparation materials." Maj. Op. at 15. As described above, this conclusion reverses, without any finding of clear error, the district court's factual findings. Further, this language dangerously suggests that this court can, from its general knowledge, offer an expert opinion as to how such documents are always seen by "experienced litigators." Another of the many errors of this approach is revealed by reference to undisputed record testimony. Namely, the majority's assumption that tax accrual workpapers are a uniform class from corporation to corporation is simply wrong. When the district court carefully and specifically defined what documents were actually at issue in this case, it explained that "there is no immutable definition of the term 'tax accrual papers,'" and that their content varies from case to case, *Textron*, 507 F. Supp. 2d at 142, a conclusion that is consonant with the testimony of the government's expert. *Id.* at 142 n.2. Thus, even were it not our rule that we defer to the district court's factfinding, such a rule would make good sense in handling the wide range of workpapers likely to confront district courts in the future as the IRS increasingly seeks their discovery.

Even if we looked at the purpose of tax accrual workpapers as a general matter, the district court's conclusion that Textron's anticipation of litigation drove its reporting obligations is not so outrageous as to leave us with a firm conviction of error. Rather, other courts reviewing similar kinds of documents have reached similar conclusions. *Regions Fin. Corp. & Subsidiaries v. Unit-*

ed States, No. 2:06-CV-00895-RDP, 2008 WL 2139008, at *6 (N.D. Ala. May 8, 2008) (concluding, in examining another company's workpapers that "[w]ere it not for anticipated litigation, Regions would not have to worry about contingent liabilities and would have no need to elicit opinions regarding the likely results of litigation"); *Comm'r of Revenue v. Comcast Corp.,* 453 Mass. 293, 901 N.E.2d 1185, 1191, 1205 (2009) (affirming a finding of work-product protection for a business memorandum analyzing the "pros and cons of the various planning opportunities and the attendant litigation risks" since the author "had 'the prospect of litigation in mind when it directed the preparation of the memorandum'" and would not have been prepared irrespective of that litigation (quoting *Adlman,* 134 F.3d at 1204)).

B. Analysis

This court should accept the district court's factual conclusion that Textron created these documents for the purpose of assessing its chances of prevailing in potential litigation over its tax return in order to assess risks and reserve funds. Under these facts, work-product protection should apply.

1. The "because of" test

First, the majority does not develop any analysis contesting the proposition that disputes with the IRS in an audit can constitute litigation, within the meaning of Fed. R. Civ. P. 26(b)(3)(A). Indeed, such a conclusion is clear. For these purposes, the touchstone of "litigation" is that it is adversarial. *See* Restatement (Third) of the Law Governing Lawyers § 87 cmt. h (2000). Though the initial stages of a tax audit may not be adversarial, the disputes themselves are essentially adversarial; the sub-

ject of these disputes will become the subject of litigation unless the dispute is resolved.

Applying the "because of" test as articulated in *Adlman* and *Maine,* the workpapers are protected. Under these precedents, a document is protected if, "'in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained *because of* the prospect of litigation.'" *Maine,* 298 F.3d at 68 (emphasis in original) (quoting *Adlman,* 134 F.3d at 1202). The "because of" test "really turns on whether [the document] would have been prepared irrespective of the expected litigation with the IRS." *Adlman,* 134 F.3d at 1204. As the district court found, the driving force behind the preparation of the documents was the need to reserve money in anticipation of disputes with the IRS. *Textron,* 507 F. Supp. 2d at 143. Though other business needs also contributed to Textron's need to create the documents, those needs depended on Textron's anticipating litigation with the IRS. In other words, without the anticipation of litigation, there would be no need to estimate a reserve to fund payment of tax disputes. *Id.* at 150. In this way, the dual purposes leading to the documents' creation were intertwined, and work-product protection should apply. *See In re Grand Jury Subpoena,* 357 F.3d at 910 ("The documents are entitled to work product protection because, taking into account the facts surrounding their creation, their litigation purpose so permeates any non-litigation purpose that the two purposes cannot be discretely separated from the factual nexus as a whole."); *see also* Andrew Golodny, *Note: Lawyers versus Auditors: Disclosure to Auditors and Potential Waiver of Work-Product Privilege in United States v. Textron,* 61 Tax Law. 621, 629 (2008) ("As a commentator noted, 'in the case of tax contingency reserves, the prospect of fu-

ture litigation and the business need for the documents are so intertwined that the prospect of future litigation itself creates the business need for the document.'" (quoting Terrence G. Perris, *Court Applies Work Product Privilege to Tax Accrual Workpapers*, 80 Prac. Tax. Strategies 4 (2008))).

The majority simply refuses to accept the district court's finding that the documents would not exist but for Textron's need to anticipate litigation. This rejection is essential to the majority's erroneous conclusion. Accepting the district court's findings regarding purpose compels a finding of work-product protection, since the precedents are clear that under the "because of" test, dual purpose documents are protected. In fact, that is one of the very reasons some courts have adopted the test. 8 Charles Alan Wright, Arthur R. Miller & Richard L. Marcus, *Federal Practice and Procedure*, § 2024 (2d ed. 2009) ("'Dual purpose' documents created because of the prospect of litigation are protected even though they were also prepared for a business purpose."); *see also Roxworthy*, 457 F.3d at 598-99 ("[D]ocuments do not lose their work product privilege 'merely because [they were] created in order to assist with a business decision,' unless the documents 'would have been created in essentially similar form irrespective of the litigation.'" (quoting *Adlman*, 134 F.3d at 1202)); *In re Grand Jury Subpoena*, 357 F.3d at 907 (adopting Wright and Miller's "because of" test in order to handle "dual purpose" documents); *Maine*, 298 F.3d at 68 (adopting *Adlman* after recounting the distinction between the "because of" test and the "primary purpose" test in their handling of dual purpose documents); *Adlman*, 134 F.3d at 1197-98, 1202 ("Where a document is created because of the prospect of litigation, analyzing the likely outcome of that litigation, it does not lose pro-

tection under this formulation merely because it is created in order to assist with a business decision."); *In re Special Sept. 1978 Grand Jury (II),* 640 F.2d 49, 61 (7th Cir. 1980) ("We conclude that the materials . . . were indeed prepared in anticipation of litigation, even though they were prepared as well for the filing of the Board of Elections reports.").

2. The exception to the "because of" test

The majority reads too much into one sentence from *Maine* and *Adlman.* Specifically, it is true that "the 'because of' standard does not protect from disclosure 'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'" *Maine,* 298 F.3d at 70 (quoting *Adlman,* 134 F.3d at 1202). This proviso relates to the advisory notes to the rule, which excludes from protection "[m]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes." Fed. R. Civ. P. 26 advisory committee's note (1970). Understood in light of the fact that the "because of" test unequivocally protects "dual purpose" documents, this proviso does not strip protection for dual purpose documents that have one business or regulatory purpose. Rather, the best reading of the advisory committee's note is simply that preparation for business or for public requirements is preparation for a nonlitigation purpose insufficient in itself to warrant protection. The note states that there is no protection for documents created for business, regulatory, or "other nonlitigation purposes." This language suggests the note is considering business and regulatory purposes as nonlitigation purposes, but does not suggest that the presence of such a purpose should somehow override a litigation purpose, should one

exist. Thus, correctly formulated, this exception should be understood as simply clarifying the rule that dual purpose documents are protected, though "there is no work-product immunity for documents prepared in the regular course of business *rather than* for purposes of the litigation." Wright & Miller, *supra*, § 2024 (emphasis added); *see also Roxworthy*, 457 F.3d at 599 ("[A] document can be created for both use in the ordinary course of business and in anticipation of litigation without losing its work-product privilege."). Under the majority's interpretation, the exception swallows the rule protecting dual purpose documents.

So understood, the exception does not control this case. After citing this exception, the district court concluded that the documents were not created irrespective of litigation because Textron would not have prepared the documents but for the anticipation of litigation. *Textron*, 507 F. Supp. 2d at 150. The majority makes no effort to label this finding clearly erroneous. To the contrary, the finding is correct. The tax accrual workpapers identify specific tax line items, and then anticipate the likelihood that litigation over those items will result in Textron having to pay the IRS more money. That Textron will not ultimately litigate each position does not change the fact that when it prepared the documents, Textron was acting to anticipate and analyze the consequences of possible litigation, just like the memorandum example in *Adlman*, 134 F.3d at 1200. The documents would not be the same at all had Textron not anticipated litigation. So, under the "because of" test, as applied in *Adlman* and the many circuit courts that have followed it, these documents were not prepared "irrespective" of the prospect of litigation. They should be protected.

3. *Arthur Young* and *El Paso* do not control

Neither the Supreme Court's decision in *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984), nor the Fifth Circuit's decision in *El Paso,* 682 F.2d at 530, support a different result.

In *Arthur Young,* the Court declined to recognize an accountant's work-product doctrine, thus holding that tax accrual workpapers created by an independent auditor were not protected. *Arthur Young,* 465 U.S. at 815-21. But unlike the Court in *Arthur Young,* we are not now confronted with the question of whether to recognize a new privilege. Here, the doctrinal decision we face is how to apply existing work-product doctrine to the present facts, in other words whether the "because of" test protects dual purpose documents, as the *Maine* and *Adlman* courts so held. This question was not at all presented in *Arthur Young.*

On the other hand, *El Paso* is clearly factually on point—there the Fifth circuit rejected work-product protection for similar tax accrual workpapers. *El Paso,* 682 F.2d at 542. But, as explained above, that court applied a different definition of the work-product doctrine, asking whether the "primary motivating purpose behind the creation of the document was to aid in possible future litigation." *Id.* at 542-44 (concluding that the document should not be protected as it "carries much more the aura of daily business than it does of courtroom combat"). Finding Textron's workpapers protected would not *create* a circuit split, but be merely an application of a widely acknowledged existing difference between our law and the law of the Fifth Circuit. It is precisely in these "dual purpose" situations that the "because of" test used in this circuit is meant to distinguish itself from the "primary purpose" test used in the Fifth Circuit. *Maine,*

298 F.3d at 68 (citing *Adlman* for the proposition that the primary purpose test "is at odds with the text and the policies of Rule 26 because nothing in it suggests that documents prepared for dual purposes of litigation and business or agency decisions do not fall within its scope"). Thus, unlike the Fifth Circuit, we need not assess whether the tax accrual workpapers carry more of one "aura" than another.

IV. Conclusion

The majority's decision may please the IRS and some tax scholars who understandably see discovery of tax accrual workpapers as an important tool in combating fraud. But this decision will be viewed as a dangerous aberration in the law of a well-established and important evidentiary doctrine. Whatever else one may think about this case, the majority's assertion that it is following *Maine* is plainly erroneous. Rather, the majority's "prepared for" test is directly contrary to *Adlman,* a decision we explicitly adopted in *Maine.*

In straining to craft a rule favorable to the IRS as a matter of tax law, the majority has thrown the law of work-product protection into disarray. Circuits have already split interpreting the meaning of "anticipation of litigation," between the "primary purpose" and "because of" tests. Now this court has proceeded to further the split by purporting to apply the "because of" test while rejecting that test's protection for dual purpose documents. In reality, the majority applied a new test that requires that documents be actually "prepared for" use in litigation. The time is ripe for the Supreme Court to intervene and set the circuits straight on this issue which is essential to the daily practice of litigators across the country.

The correct test is that spelled out in *Adlman,* and adopted by most circuit courts. Applying that test to the facts actually found by the district court, these tax accrual workpapers should be protected. For these reasons, I respectfully dissent.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 07-2631

UNITED STATES OF AMERICA, Petitioner,
Appellant,

v.

TEXTRON INC. AND SUBSIDIARIES, Respondent,
Appellee.

January 21, 2009

Before TORRUELLA, BOUDIN, Circuit Judges, and SCHWARZER,[*] District Judge.

TORRUELLA, Circuit Judge.

The question presented by this appeal is whether the work-product doctrine protects documents prepared by Textron Inc. for the purpose of calculating tax reserve liability from production to the IRS pursuant to an investigative subpoena. Like other companies, Textron prepares "tax accrual workpapers" which, generally speaking, list the questionable positions Textron took on its

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[*]Of the Northern District of California, sitting by designation.

tax returns, estimate the likelihood that those positions will not withstand scrutiny, and calculate the amount of additional tax liability that would result from revision of those positions. Textron prepares these estimates so that it can maintain an adequate reserve fund, properly report its assets and liabilities, and obtain independent certification of its financial statements. As part of the auditing process, Textron showed these tax accrual workpapers to Ernst & Young ("E&Y") an independent auditor.

This case arose when the Internal Revenue Service ("IRS"), after noticing potential tax shelter transactions, issued an administrative summons to Textron pursuant to I.R.C. § 7602 seeking tax accrual workpapers for Textron's 2001 tax returns. Textron refused to comply and asserted a number of defenses. The IRS sued to enforce the subpoena. After an evidentiary hearing, the district court ruled for Textron on its work-product protection claim, but rejected its other defenses. The district court also found that Textron's disclosure to E&Y did not constitute waiver. The IRS appeals. After careful review,[1] we affirm in part, vacate in part, and remand.

I. Background

The IRS subpoena sought "Tax Accrual Workpapers," defined as:

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[1] Textron was joined by amici curiae Committee on Taxation and Committee on Corporate Reporting of Financial Executives International, Chamber of Commerce of the United States of America, and Association of Corporate Counsel. The IRS has submitted two scholarly articles which we have considered: Dennis J. Ventry, Jr., *Protecting Abusive Tax Avoidance*, 120 Tax Notes 857 (2008); and Claudine Pease-Wingenter, *The Application of the Attorney-Client Privilege to Tax Accrual Workpapers: The Real Legacy of United States v. Textron*, 8 Houston Bus. & Tax L.J. 337 (2008).

> [A]ll accrual and other financial workpapers or documents created or assembled by the Taxpayer, an accountant for the Taxpayer, or the Taxpayer's independent auditor relating to any tax reserve for current, deferred, and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to any footnotes disclosing reserves or contingent liabilities on audited financial statements. They include, but are not limited to, any and all analyses, computations, opinions, notes, summaries, discussions, and other documents relating to such reserves and any footnotes.

The subpoena sought all documents in the actual or constructive possession, custody, or control of Textron or its accountants. The district court held oral arguments where the government reiterated that it was seeking tax accrual documents prepared by Textron or E&Y. Textron argued that it had created the documents in anticipation of a dispute with the IRS regarding its tax returns.

The district court then held an evidentiary hearing on the types of documents included in the definition of "tax accrual workpapers" and the basis for Textron's work product claim. At the evidentiary hearing, the IRS's expert witness, Professor Douglas Carmichael, testified that securities law requires that public companies obtain a letter from an independent auditor approving the company's financial statements, and that part of that audit was an analysis of the company's reserves for covering tax loss. Textron's former Director of Tax Reporting, Roxanne Cassidy, countered that the tax accrual work-

papers were created "to determine whether Textron was adequately reserved with respect to any potential disputes or litigations that would happen in the future." Cassidy and Norman Richter, Textron tax counsel, explained that the tax accrual workpapers listed positions Textron was taking on its tax returns that might require that a reserve be set aside. These positions were then analyzed by Textron attorneys who estimated a percentage likelihood that the position would not prevail if challenged by the IRS. Textron calls this the "hazards of litigation percentage." The reserve requirement was calculated by multiplying this percentage times the tax benefit claimed.

In response, Carmichael, the IRS expert witness, contended that public companies prepare these papers every year to comply with securities law regardless of whether they expect litigation. But, Richter testified that the tax accrual workpapers were prepared under the assumption that issues identified would be challenged by the IRS and would need to be defended. He further testified that if Textron did not anticipate any disputes, the tax accrual workpapers would be blank. The IRS disagreed, arguing that some workpapers would nevertheless be necessary to handle deferred taxes or to justify setting aside no tax reserve.

It was undisputed that the IRS audits every Textron return in multi-year cycles. Testimony also showed that in each audit cycle hundreds of IRS adjustments to Textron's returns were simply accepted by Textron. Where Textron and the IRS do dispute tax liability, their dispute could be resolved through a conference with the audit team, by presentation of arguments to the IRS Office of Appeals, or, ultimately, federal court litigation. In seven of the last eight audit cycles, Textron and the IRS

have brought at least one issue to the IRS Office of Appeals. Between 1959 and present, Textron and the IRS have litigated three disputes in federal court. Textron admitted that it expected to concede several issues identified in the workpapers, and that the percentage for those issues was listed as "100%." Textron explained that those items were due to instances where legal developments rendered a prior position undefendable.

IRS agents explained that access to the workpapers would help them navigate Textron's 4000 page tax return which was accompanied by "9 four-drawer file cabinets" of paper. The IRS witnesses explained that the tax accrual workpapers would help the IRS understand the substance of a transaction and could help the IRS identify potential issues with Textron's return. An agent testified that in 2006 the IRS adopted the policy of seeking tax accrual workpapers when the audit team becomes aware (sometime through self-reporting) of certain transactions by the taxpayer which potentially constitute abusive tax shelters.

As to the waiver issue, the IRS's expert, Carmichael, testified that companies create these tax accrual workpapers, knowing that they will be shared with an auditor. Evidence also showed that the auditor's code of ethics requires information be kept confidential unless required to be produced in response to a subpoena or other legal obligation. Mark Weston, a partner at E&Y, submitted an affidavit explaining these confidentiality obligations and further stating that E&Y had not in fact disclosed any information regarding Textron's 2001 tax accrual computations. But the IRS expert opined that auditors ultimately owe an allegiance to the investing public and have legal obligations of disclosure in some instances.

Textron countered that it let E&Y look at its tax accrual workpapers, but did not allow E&Y to retain a copy of them. Debra Raymond, a Textron tax manager, averred that she had reviewed E&Y's files and that E&Y did not in fact retain a copy of Textron's workpapers.

The IRS subpoena also requested any tax-accrual documents prepared by E&Y regarding Textron. After the evidentiary hearing, the district court found that the "tax accrual workpapers" at issue did not include facts about the issues they identified, and could be described as follows:

> 1. A spreadsheet that contains:
>
> (a) lists of items on Textron's tax returns, which, in the opinion of Textron's counsel, involve issues on which the tax laws are unclear, and, therefore, may be challenged by the IRS;
>
> (b) estimates by Textron's counsel expressing, in percentage terms, their judgments regarding Textron's chances of prevailing in any litigation over those issues (the "hazards of litigation percentages"); and
>
> (c) the dollar amounts reserved to reflect the possibility that Textron might not prevail in such litigation (the "tax reserve amounts").
>
> 2. Backup workpapers consisting of the previous year's spreadsheet and earlier drafts of the spreadsheet together with notes and memoranda written by Textron's in-house tax attorneys reflecting their opinions as to which items should be included on the spreadsheet and the hazard of liti-

> gation percentage that should apply to each item.

United States v. Textron Inc., 507 F. Supp. 2d 138, 142-143 (D.R.I. 2007). The government objects on appeal that the district court did not include in this definition any tax accrual workpaper that E&Y prepared in its audit of Textron.

The district court then found that the subpoenaed documents were relevant, requested for a proper purpose, and were privileged attorney-client communications. *Id.* at 143-48. But, the district court found that the attorney-client privilege was waived by disclosure to E&Y. *Id.* at 151-52.

As to the work-product protection claim, the district court credited Textron's testimony that its ultimate purpose in preparing the tax accrual workpapers was to ensure that it was "'adequately reserved with respect to any potential disputes or litigation that would happen in the future.'" *Id.* at 143 (quoting the testimony of Norman Richter). The court found that this desire to ensure adequate reserves was also prompted, in part, by its wish to satisfy independent auditors that Textron had properly reported its financial information. *Id.* at 150. The court acknowledged the First Circuit's "because of" test for determining whether documents were prepared in anticipation of litigation and recognized that under that test there is no protection for "'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'" *Id.* (quoting *Maine v. United States Dep't of the Interior,* 298 F.3d 60, 70 (1st Cir. 2002)). The district court then held that the tax accrual workpapers "would not have been prepared at all 'but for' the fact that Textron anticipated the possibility of litigation with

the IRS." *Id.* The district court reasoned that while the papers were used to obtain a favorable opinion letter from E&Y regarding Textron's reserves, there would have been no need for such reserves "if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding." *Id.* The IRS appeals the conclusion that the work-product doctrine protects the tax accrual workpapers.

The district court then noted that the standard for waiver of the work-product protection was different than for attorney-client privilege. *Id.* at 152. The district court concluded that disclosure of Textron's tax accrual workpapers to E&Y did not effect a waiver since disclosure "did not substantially increase the IRS's opportunity to obtain the information contained in them." *Id.* at 153. The district court based its decision on E&Y's professional confidentiality obligations and the fact that E&Y averred that it had not actually disclosed the information. *Id.*[2] The IRS also appeals this conclusion.

The district court then ruled that the government could not make the showing needed to overcome work-product protection since the government sought Textron's "mental impressions, conclusions, opinions or legal theories." *Id.* at 154 (internal quotations omitted). The IRS does not appeal this conclusion.

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[2] The district court also found that E&Y had promised to keep the documents confidential. The IRS contends that this fact is not supported in the record. As explained infra n.10, we need not decide this dispute.

II. Discussion

Three issues are thus presented for appeal: (1) whether the work-product doctrine protects Textron's workpapers; (2) whether any such work-product protection was waived through disclosure to E&Y; and (3) whether the district court erred in not considering the IRS's request for E&Y's workpapers.

On these evidentiary issues, we "review district court rulings on questions of law de novo; we review district court fact findings for clear error; and we review 'discretionary judgments such as evidentiary rulings' for abuse of discretion." *Cavallaro v. United States,* 284 F.3d 236, 245 (1st Cir. 2002) (quoting *United States v. Mass. Inst. of Tech.* ("*MIT*"), 129 F.3d 681, 683 (1st Cir. 1997)).

"[T]he party who invokes the privilege bears the burden of establishing that it applies to the communications at issue and that it has not been waived." *XYZ Corp. v. United States,* 348 F.3d 16, 22 (1st Cir. 2003).

A. Work-Product Protection

1. Applicable law

"[T]he work-product doctrine does apply in tax summons enforcement proceedings." *Upjohn Co. v. United States,* 449 U.S. 383, 386 (1981). The work-product doctrine protects "documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative." Fed. R. Civ. P. 26(b)(3)(A). In assessing whether a document was prepared in anticipation of litigation, this circuit uses the "because of" test. *Maine,* 298 F.3d at 68. Under this test, a document is protected "if, 'in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or

obtained because of the prospect of litigation.'" *Id.* at 70 (quoting *United States v. Adlman,* 134 F.3d 1194, 1202 (2d Cir. 1998)) (emphasis in original). It is also our law that, "the 'because of' standard does not protect from disclosure 'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'" *Id.* (quoting *Adlman,* 134 F.3d at 1202). As discussed below, we hold in this case that the presence of a business purpose does not defeat work-product protection.

The work-product doctrine originates in *Hickman v. Taylor*, where the Supreme Court laid out the problems with allowing the discovery of work product:

> Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten. An attorney's thoughts, heretofore inviolate, would not be his own. Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial. The effect on the legal profession would be demoralizing. And the interests of the clients and the cause of justice would be poorly served.

Hickman v. Taylor, 329 U.S. 495, 511 (1947). The doctrine is rightly seen as a protection for the adversary system, not simply the attorney. *Coastal States Gas Corp. v. Department of Energy,* 617 F.2d 854, 864 (D.C. Cir. 1980) (noting the doctrine does not protect all documents prepared by a lawyer and instead "focuses on the integrity of the adversary trial process itself" (quotation omitted)).

The Restatement has offered a definition of litigation in the work product context:

> "Litigation" includes civil and criminal trial proceedings, as well as adversarial proceedings before an administrative agency, an arbitration panel or a claims commission, and alternative-dispute-resolution proceedings such as mediation or mini-trial. It also includes a proceeding such as a grand jury or a coroner's inquiry or an investigative legislative hearing. In general, a proceeding is adversarial when evidence or legal argument is presented by parties contending against each other with respect to legally significant factual issues.

Restatement (Third) of the Law Governing Lawyers § 87 cmt. h (2000). "'Adversarialness' is the touchstone of this approach to the 'litigation' question . . . ." *In re Grand Jury Subpoena*, 220 F.R.D. 130, 147 (D. Mass. 2004).

2. Are tax disputes "litigation?"

The IRS argues that preparation of tax returns is not meant to be an adversary process, but rather is a self-reporting regime that relies on the good faith of taxpayers. The IRS reasons that it is not seeking to gain unfair litigation advantage but rather to verify self-assessment in an environment where the taxpayer holds all the relevant information. Textron responds that it routinely engages in administrative disputes and even federal court litigation with the IRS.

Citing *Roxworthy*, Textron argues that anticipation of audit disputes can constitute anticipation of litigation. *United States v. Roxworthy,* 457 F.3d 590, 600-01 (6th Cir. 2006) (finding memos prepared analyzing legal ar-

guments supporting and opposing specific tax positions to be protected work product). But, *Roxworthy* cites another case, *Hodges*, for the proposition that "a document prepared 'in anticipation of dealing with the IRS . . . *may* well have been prepared in anticipation of an administrative dispute and this *may* constitute litigation within the meaning of Rule 26.'" *Id.* at 600 (quoting *Hodges, Grant & Kaufmann v. IRS*, 768 F.2d 719, 719-22 (5th Cir. 1985)) (emphasis added). *Hodges*, however, was not expressing a holding, but simply remanding to the district court to consider a work-product claim. Considering that *Roxworthy* dealt with anticipation of litigation with respect to specific transactions, *Roxworthy* does not establish that all documents prepared analyzing tax returns are protected. Instead, *Roxworthy* holds that documents created to analyze specific areas of likely dispute *may* be protected.

Nonetheless, after considering the applicable test, we conclude that, while not all "dealing with the IRS" during an audit is "litigation," the resolution of disputes through adversary administrative processes, including proceedings before the IRS Appeals Board, meets the definition of litigation. The IRS is correct that preparation and filing of returns relies on good faith self-reporting. But, good-faith disputes regarding the proper application of tax law also arise during the audit process. Thus, though the initial processing of these disputes in the audit process may not be adversarial, the disputes themselves are essentially adversarial; the subject of these disputes will become the subject of litigation unless the dispute is resolved.[3]

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[3] Thus, we do not hold that filing tax returns or participating in audits is itself adversarial. Our holding does not and should not

3. Were the tax accrual workpapers prepared in anticipation of litigation?

In addition to the question of whether audit disputes with the IRS are litigation, we must confront the question of whether Textron's tax accrual workpapers are prepared in anticipation of such disputes. The district court reasoned that the business need to cover potential liabilities arose out of the anticipation of potential disputes, and thus would not occur "but for" those disputes. *Textron,* 507 F. Supp. 2d at 150. The IRS argues that the district court's conclusion is factually and legally wrong.

a. Analysis

The IRS argues that, as a legal matter, the documents were not prepared in anticipation of litigation and that the district court misapplied the "because of" test when it reasoned that the documents would not have been created "but for" the prospect of litigation.

We agree with the district court's finding that one of the purposes behind the creation of the documents was anticipation of litigation. As the district court explained, the need to estimate the likelihood of success in litigation was a result of the need to set up a reserve fund to cover tax positions for which Textron could foresee disputes with the IRS.

Of course, simple relation to litigation is insufficient to trigger work-product protection. *Maine,* 298 F.3d at

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change the essentiality of good faith self-assessment. The IRS retains many enforcement tools to ensure compliance with that system. Thus, we do not share in the IRS's negative conclusions about the policy effects of our judgment, which concerns tax accrual workpapers, documents which the IRS admits it seeks only in limited circumstances.

69. Further, work-product protection must be assessed in reference to a "the function that the document serves," not its content. *Roxworthy,* 457 F.3d at 595. And it is not enough that the preparer "had the prospect of litigation in mind when it" created the documents. *Adlman,* 134 F.3d at 1204. Rather, the "because of" test "really turns on whether it would have been prepared irrespective of the expected litigation with the IRS." *Id.*

But, here, the function of the documents was to analyze litigation for the purpose of creating and auditing a reserve fund. It can be fairly said that "'the driving force behind the preparation'" of the documents, *Roxworthy,* 457 F.3d at 595 (quoting *Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co.,* 967 F.2d 980, 984 (4th Cir. 1992)), was the need to reserve money in anticipation of disputes with the IRS. The district court so found, and we find no clear error. *See Cavallaro,* 284 F.3d at 245 (clear error standard applied to findings of fact of district court in privilege case).[4] In this way, we read the

[4] The dissent challenges this factual conclusion of the district court, but utterly fails to explain why the district court's acceptance of the testimony of Textron's witnesses was clear error. Specifically, the district court found that Textron would have no need to compute reserves if it had not anticipated litigation. *Textron,* 507 F. Supp. 2d at 150 (recognizing that though "it may be accurate to say that the workpapers helped Textron determine what amount should be reserved to cover any potential tax liabilities," anticipation of disputes drove that very need). Contrary to the dissent's intimations, the district court did find that Textron's tax accrual workpapers were prepared with dual purposes in mind. *Id.* at 143 (finding Textron's "ultimate purpose" in preparing the workpapers was to ensure Textron was adequately reserved with respect to disputes or potential litigation, but acknowledging that the desire to establish adequate reserves "also was prompted, in part, by its wish to satisfy an independent auditor" and obtain a clean opinion). These findings were based on testimony from Textron's witnesses. The testimony of the

district court's "but for" reasoning as a way of expressing its conclusion that the documents would not have been prepared irrespective of the prospect of litigation, but rather were prepared "because of" the risk of disputes and litigation which gave rise to a need to compute and report tax reserves.[5]

The IRS next argues that the district court found that the "workpapers helped Textron determine what amount should be reserved to cover any potential tax liabilities and that the workpapers were useful in obtaining a 'clean' opinion from E&Y regarding the adequacy of the reserve amount." *Textron*, 507 F. Supp. 2d at 150. The IRS argues that this finding legally compels a ruling that the tax accrual workpapers are not protected, since documents prepared in the ordinary course of business receive no protection. *Maine*, 298 F.3d at 70. The IRS further reasons that since the documents were required to comply with reporting and securities obligations, the tax accrual workpapers were prepared pursuant to "regulatory requirements" and are therefore not protected.

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government's expert, cited by the dissent, does not contradict the conclusion that Textron was motivated by dual purposes, especially considering that it is not clear that the expert is using the same definition of "anticipation of litigation" that we adopt. *See infra*. Thus, the district court's fact finding was not clearly erroneous. Rather, it is accurate to say that Textron's tax accrual workpapers would not have been prepared in a similar form irrespective of the potential for litigation.

[5] The IRS also argues that some form of workpaper would have been prepared even if no disputes were anticipated in order to justify setting aside no reserve. But that is not the context in which the workpapers at issue in this case were created. Rather, the evidence shows that these workpapers project the risks of litigation over specific tax positions and were created in the context of anticipating disputes (and therefore possible litigation) over those positions.

See Nat'l Union, 967 F.2d at 984. The IRS reasons that, as a simple matter of law, Rule 26 does not apply to "[m]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes." Fed. R. Civ. P. 26 Notes of Advisory Committee on 1970 amendments.

We reject the IRS's contention that the mere presence of a business or regulatory purpose defeats work-product protection. To be sure, "there is no work-product immunity for documents prepared in the regular course of business *rather than* for purposes of the litigation," even though "litigation is already in prospect." 8 Charles Alan Wright, Arthur R. Miller & Richard L. Marcus, *Federal Practice and Procedure*, § 2024 (2008) (emphasis added). But, it is also true that "'[d]ual purpose' documents created because of the prospect of litigation are protected even though they were also prepared for a business purpose." *Id.*; *see also In re Grand Jury Subpoena,* 357 F.3d 900, 907 (9th Cir. 2004) (adopting Wright and Miller's "because of" test in order to handle "dual purpose" documents).

Thus, the best reading of the advisory committee's note is simply that preparation for business or for public requirements is preparation for a nonlitigation purpose insufficient in itself to warrant protection. The note states that there is no protection for documents created for business, regulatory, or "other nonlitigation purposes." This language suggests the note is considering business and regulatory purposes as nonlitigation purposes, but does not suggest that the presence of such a purpose should somehow override a litigation purpose, should one exist. To the contrary, the language of the note does not suggest that the advisory committee was considering the

problem of dual purpose documents. Thus, we do not read the note as stating that there should be no protection where a document is prepared because of the possibility of litigation but also for a business or regulatory purpose.[6]

Like in the case where a company analyzes pending litigation for the purpose of setting aside a reserve, *cf. Adlman*, 134 F.3d at 1200 (describing hypothetical examples where work-product protection applies), here the business purpose derives from and is inextricably related to anticipating litigation. That the anticipation of such disputes (and corresponding potential litigation) also

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[6] One district court in this circuit has reached an opposite conclusion. *In re Raytheon Secs. Litig.*, 218 F.R.D. 354, 359 (D. Mass. 2003) ("However, even when documents were created 'because of' litigation, documents that are required to be prepared to comply with the law may not be protected."). This approach refuses to protect documents prepared because of the possibility of litigation simply because another possible purpose is present. As explained *infra*, such an approach ignores the primary distinction between the "because of" and the "primary purpose" test.

The IRS also points to another decision in this circuit where the district court analyzed opinion letters regarding investment vehicles alleged to be tax shelters. *Fidelity Intern. Currency Advisor A Fund, L.L.C., ex rel. Tax Matters Partner v. United States*, No. 05-40151, 2008 WL 4809032, at *13 (D. Mass. April 18, 2008). The court found those letters' "purpose was not to analyze pending or imminent claims; instead, it was to induce the taxpayers to invest in the strategy (or, put differently, to provide comfort to those investors, particularly with respect to the possible imposition of future tax penalties)." *Id*. But that court did not hold "dual purpose" documents unprotected. Rather, it essentially made a factual call, which we do not now judge, that the possibility of litigation was too remote. *Id*. As explained, *infra* Section II.A.4, in the present case the context surrounding the creation of the documents, namely the need to estimate reserve funds, made it reasonable for Textron to foresee and analyze litigation.

triggered certain business and accounting obligations does not bar the protection of the work-product doctrine. *See id.* at 1202 ("Where a document is created because of the prospect of litigation, analyzing the likely outcome of that litigation, it does not lose protection under this formulation merely because it is created in order to assist with a business decision."); *In re Special September 1978 Grand Jury (II),* 640 F.2d 49, 61 (7th Cir. 1980) ("We conclude that the materials . . . were indeed prepared in anticipation of litigation, even though they were prepared as well for the filing of the Board of Elections reports."). In arguing against this conclusion, the IRS points to a Third Circuit case where that court instructed the district court on remand to assess whether a tax reserve file was prepared to assist in litigation or to comply with securities requirements. *United States v. Rockwell Int'l,* 897 F.2d 1255, 1266 (3d Cir. 1990). In the present case, however, the district court has already conducted such analysis and has concluded that the workpapers were created because of both purposes.

The dissent disagrees with this legal conclusion and relies primarily on the language in *Maine* that "the 'because of' standard does not protect from disclosure 'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'" *Maine,* 298 F.3d at 70 (quoting *Adlman,* 134 F.3d at 1202). Based on this language, the dissent charges we are going against established circuit precedent. But, for the reasons described above, it is error to read this "ordinary course of business" language as implying that all documents prepared with some business purpose in mind are necessarily unprotected. The court in *Maine* was not confronted with dual purpose documents like those at issue here. Rather, that court recited the above quoted language in

the course of holding that there was insufficient information to see if the documents at issue were prepared for litigation *or* rather in the ordinary course of business. *Id.* Thus, *Maine's* "ordinary course of business" language should not be read as barring protection for dual purpose documents where one business purpose is present. This conclusion is all the more clear when one consider's *Adlman's* reason for adopting the "because of" test:

> The issue is less clear, however, as to documents which, although prepared because of expected litigation, are intended to inform a business decision influenced by the prospects of the litigation. The formulation applied by some courts in determining whether documents are protected by work-product privilege is whether they are prepared "primarily or exclusively to assist in litigation" — a formulation that would potentially exclude documents containing analysis of expected litigation, if their primary, ultimate, or exclusive purpose is to assist in making the business decision. Others ask whether the documents were prepared "because of" existing or expected litigation — a formulation that would include such documents, despite the fact that their purpose is not to "assist in" litigation. Because we believe that protection of documents of this type is more consistent with both the literal terms and the purposes of the Rule, we adopt the latter formulation.

Adlman, 134 F.3d at 1197-98, *quoted in part in Maine*, 298 F.3d at 68.

Further, a contrary holding would lead to undesirable results in other cases. Consider a document prepared to analyze a specific litigation in order to compute for an auditor how much must be retained in a litigation reserve fund. Were we to adopt the IRS position that documents created to satisfy audit reporting responsibilities were not protected, opposing counsel in the litigation might be able to discover such a memo, effectively disclosing counsel's ultimate mental impression of the case. In fact, in similar circumstances, the Sixth and Second circuits have suggested that memoranda analyzing a transaction or position to be protected by the work-product doctrine. *Roxworthy,* 457 F.3d at 600; *Adlman,* 134 F.3d at 1200-04 (remanding for the district court to apply the correct standard).

b. Countervailing concerns

Having explained why application of the work-product doctrine leads us to the conclusion that Textron's tax accrual workpapers are protected, we pause to address the IRS's arguments against such a conclusion.

i. *Arthur Young*

The IRS asserts our decision will run afoul of Supreme Court precedent. In *Arthur Young*, the Court declined to recognize an accountant's work-product doctrine, thus holding that tax accrual workpapers created by an independent auditor were not protected. *United States v. Arthur Young & Co.,* 465 U.S. 805, 815-21, (1984). The Court recognized that the auditor's papers necessarily included the taxpayer's own thinking about tax "soft spots." *Id.* at 813. The Court also rejected some of the fairness concerns implicated in that case. *Id.* at 820 (rejecting argument that "enforcement of an IRS summons for accountants' tax accrual workpapers per-

mits the Government to probe the thought processes of its taxpayer citizens, thereby giving the IRS an unfair advantage in negotiating and litigating tax controversies"). Further, the Court rejected policy concerns that, without a new privilege, companies would be tempted to withhold information from auditors. *Id.* at 818-19 (finding that "[r]esponsible corporate management would not risk a qualified evaluation of a corporate taxpayer's financial posture to afford cover for questionable positions reflected in a prior tax return" and concluding that "the independent auditor's obligation to serve the public interest assures that the integrity of the securities markets will be preserved, without the need for a work-product immunity for accountants' tax accrual workpapers").

Following this precedent, we have recognized that "the doctrine of construing the [attorney-client] privilege narrowly . . . has particular force in the context of IRS investigations given the 'congressional policy choice in favor of disclosure of all information relevant to a legitimate IRS inquiry.'" *Cavallaro,* 284 F.3d at 245-46 (quoting *Arthur Young,* 465 U.S. at 816). But unlike the Court in *Arthur Young*, we are not now confronted with the question of whether to recognize a new privilege. Here, the doctrinal decision we face is whether to afford protection to documents created because of both business and litigation — a question not presented in *Arthur Young*.[7] Since this question has broader implications, the

[7] The IRS also suggests that the Supreme Court was comfortable with discovery of taxpayer tax accrual workpapers because it "affirmatively encouraged the IRS's seeking tax-accrual workpapers from the company prior to pursuing such workpapers from the auditor." IRS Reply Brief at 22-23 (citing *Arthur Young,* 465 U.S. at 820-21 & n.17). But the cited provisions of *Arthur Young* do not consider the question of work-product protection, and do not endorse

Supreme Court's policy judgment that a new privilege is not necessary for the accurate preparation of accountants' tax accrual workpapers is not controlling. Further, our prior analysis of this issue does not rely on the policy considerations rejected in *Arthur Young*. That case is not an obstacle to our conclusion that protection of dual-purpose documents is consistent with the purpose and doctrine of the work-product doctrine.

ii. *El Paso*

Because of a contrary outcome in a Fifth Circuit case, the IRS argues that our decision will create a circuit split. *See United States v. El Paso Co.,* 682 F.2d 530, 542 (5th Cir. 1982), *cert. denied*, 466 U.S. 94 (1984). In *El Paso*, the Fifth Circuit found that a company's own tax accrual workpapers were not protected as they were created for purposes of complying with securities law:

> In sum, we believe that the tax pool analysis does not contemplate litigation in the sense required to bring it within the work product doctrine. The tax pool analysis concocts theories about the results of possible litigation; such analyses are not designed to prepare a specific case for trial or negotiation. Their sole function, from all that appears in the record, is to back up a figure on a financial balance sheet. Written

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any particular method, but rather simply take note that the IRS "has demonstrated administrative sensitivity" by adopting a policy to "take all reasonable means to secure the information from the corporation itself before issuing a summons to the independent auditor." *Arthur Young,* 465 U.S. at 821 n.17. Whether such "reasonable means" can include summons of a taxpayer's own tax accrual workpapers was not considered by the Supreme Court.

> ultimately to comply with SEC regulations, the tax pool analysis carries much more the aura of daily business than it does of courtroom combat. We hold, therefore, that the tax pool analysis and backup memoranda are not protected work product materials.

Id. at 543-44. However, in *El Paso* the Fifth Circuit applied a different definition of the work-product doctrine, asking whether the "primary motivating purpose behind the creation of the document was to aid in possible future litigation." *Id.* at 542 (internal quotation marks omitted). Thus, the result here does not create a circuit split with *El Paso*, but is merely the application of an existing split in the definition of the "anticipation of litigation." It is precisely in these "dual purpose" situations that the "because of" test used in this circuit distinguishes itself from the "primary purpose" test used in the Fifth Circuit. *Maine,* 298 F.3d at 68 (citing *Adlman* for the proposition that the primary purpose test "is at odds with the text and the policies of Rule 26 because nothing in it suggests that documents prepared for dual purposes of litigation and business or agency decisions do not fall within its scope"). Thus, unlike the Fifth Circuit, we need not assess whether the tax accrual workpapers carry more of one aura than another. We need only conclude that since the analysis was undertaken "because of" the anticipation of litigation, work-product protection applies.

iii. Factual argument

Since some tax positions in the accrual papers carry a 100 percent chance of failing, the IRS argues, as a factual matter, that Textron could not have been anticipating litigation. But, Textron explained that those entries were the result of identifying positions that were incor-

rect as a result of subsequent legal developments. The IRS also argues that most disputes are resolved informally. But the fact that most disputes are resolved before litigation commences does not mean that analysis of those disputes could not have been in anticipation of "the prospect of litigation" over those disputes. To the contrary, assessing the likelihood that a tax position will not withstand scrutiny necessarily entails analysis which anticipates how litigation of that position would be resolved.

4. Has Textron adequately identified the specific litigation for which the workpapers were prepared?

Adlman and *Roxworthy*, cases we relied on above, are also not directly on point as they involved documents analyzing the consequences of a specific litigation or specific transaction. The IRS argues that this distinction is controlling, that to protect Textron's tax accrual workpapers is in effect to afford a "blanket" protection — a work-product doctrine that is so broad it will "swallow" the attorney-client privilege. It is true that we have required proponents of a work-product protection claim to "'identify the litigation for which the document was created . . . and explain why the work-product privilege applies to all portions of the document.'" *Maine,* 298 F.3d at 69 (quoting *Church of Scientology Int'l v. United States Dep't of Justice,* 30 F.3d 224, 237 (1st Cir. 1994)). These "identification and explanation requirements are not to be given a hypertechnical construction," but "they can neither be brushed aside nor satisfied by vague generalities." *Id.*

Here, Textron has met its burden. The tax accrual workpapers identify and numerically evaluate a number of tax positions Textron took on its 2001 returns. As de-

scribed above, Textron has shown that its analysis of each position was prepared by anticipating the possibility of litigation with the IRS arising over a dispute regarding that position. Thus, the tax accrual workpapers identify specific positions, and the litigation projections were created in anticipation of disputes and possible litigation over those positions.[8]

The IRS again argues that Textron could not have consistently had specific litigation in mind since most tax disputes were resolved before litigation and since Textron could not reasonably intend to litigate every challenged position. But these facts do not change our analysis. As the district court found, the spreadsheet at issue assessed the likelihood of succeeding in litigation over each specific position. Thus, the function served by creating this analysis is to assess what funds must be set aside in anticipation of litigation over each of the positions identified. That Textron might ultimately decide not to dispute a specific position does not contradict the conclusion that when it estimated its litigation success, it was anticipating specific litigation.

Again, we note that a contrary result would lead to an undesirable result. If we were only to afford work product protection over documents of this sort by requiring a showing, as the IRS suggests, that there was some specific quantum of expectation that the position at issue

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[8] The IRS posits that some entries in the tax accrual workpapers may refer to reserves held for deferred taxes over which no litigation is to be expected. That some reserves may not be based on disputes does not change our conclusion regarding computation of reserves that are based on potential disputes. Further, the IRS has not requested that we order the production of only the papers regarding deferred tax reserves, which in any event, would not appear to be relevant to assisting the IRS.

would mature into full-fledged litigation, we would essentially be offering protection only to the cantankerous and combative taxpayer who intends to thoroughly litigate every position.

Precedent does suggest that a party claiming work-product protection must "'have had a subjective belief that litigation was a real possibility, and that belief must have been objectively reasonable.'" *Roxworthy,* 457 F.3d at 594 (quoting *In re Sealed Case,* 146 F.3d 881, 888 (D.C. Cir. 1998)). The district court found that, considering its history, it was reasonable for Textron to conclude that litigation with the IRS was likely. We see the matter differently but reach the same result.

In the context of these facts, we do not think that a history of litigation with the IRS should be the deciding factor. A company with a history of challenging the IRS creates these documents "because of" the same reason as another company without such a history: the possibility of a dispute compels them to anticipate litigation so as to prepare and assess their tax reserve funds. In this case, the anticipation of litigation coupled with securities and reporting requirements forced Textron to analyze and project its likelihood of success in litigation. Thus, Textron was effectively forced to operate under the hypothetical belief that litigation would occur. For this reason, regardless of its specific history with the IRS, it was objectively reasonable for Textron to forecast litigation.

The IRS argues that this holding will "immunize nearly every document generated by lawyers because clients can always be said to be aware of possible litigation." The IRS worries that work-product protection would "encompass essentially all legal advice," since any lawyer analyzing the risks inherent in a legal transaction or position will be able to gain work-product protection

by saying that the analysis was prepared in anticipation of litigation regarding that transaction or position. We disagree. As we have just explained, in the case of tax accrual workpapers, the dual purposes — financial reporting and anticipating litigation — are necessarily intertwined; the function of preparing adequate financial reports inherently requires Textron to anticipate and analyze litigation. The anticipation of litigation may be similarly intertwined in other cases. *See, e.g.*, *Delaney, Migdail & Young, Chartered v. IRS*, 826 F.2d 124, 127 (D.C. Cir. 1987) (distinguishing case law requiring a "specific claim" to uphold a claim of work-product protection to certain IRS memoranda analyzing potential legal vulnerabilities). But in many cases, there will not be an obvious objectively reasonable need to foresee litigation.[9] Of course, each case will depend on its facts. *See,*

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[9] For example, the IRS argues that protecting Textron's tax accrual papers would lead to protection of documents prepared by a bank to estimate loan failure rates. We disagree. A loan may fail for all sorts of reasons. Tax positions would ultimately succeed or fall based on their legal merit, assessed through litigation. In this case, the combination of the possibility of litigation and reporting requirements required Textron to anticipate litigation. Legal analysis of other transactions and positions may not entail such specific consideration of litigation.

The IRS also fears our holding will somehow lead companies to use lawyers to conduct performance reviews, then seek work-product protection for such documents. We think such a hypothetical is distinguishable. In such a case, the employer may be evaluating the employee's performance for business purposes, regardless of the possibility of litigation. Here, Textron evaluates its tax positions for business purposes precisely because of the possibility those positions will be challenged in litigation. Thus, the business context makes it reasonable for Textron to anticipate and foresee litigation. While such a question is a factual matter for another case, it seems less likely that the function of employee evaluations would similarly make it reasonable for an employer to anticipate litigation.

e.g., *Adlman,* 134 F.3d at 1204 (remanding for further fact finding applying the correct standard). But, in the present case, we conclude that Textron's need to consider the possibility of litigation with respect to each disputed position adequately satisfies this requirement.

B. Waiver of Work-Product Protection

Unlike attorney-client privilege, "work product protection is provided against 'adversaries,' so only disclosing material in a way inconsistent with keeping it from an adversary waives work product protection." *MIT,* 129 F.3d at 687. Specifically, "disclosure to an adversary, real or potential, forfeits work product protection." *Id.*

We must decide whether Textron waived work-product protection by showing its tax accrual workpapers to E&Y, its independent auditor. A number of district court cases have concluded that disclosure to independent auditors does not waive work-product protection. *See, e.g.*, *Regions Fin. Corp. & Subsidiaries v. United States,* No. 06-00895, 2008 U.S. Dist. LEXIS 41940, at *27-28 (N.D. Ala. May 8, 2008); *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.,* 237 F.R.D. 176, 183 (N.D. Ill. 2006) ("Disclosing documents to an auditor does not substantially increase the opportunity for potential adversaries to obtain the information."); *Merrill Lynch & Co. v. Allegheny Energy, Inc.,* 229 F.R.D. 441, 448 (S.D.N.Y. 2004) ("A business and its auditor can and should be aligned insofar as they both seek to prevent, detect, and root out corporate fraud."). *But see Medinol v. Boston Sci. Corp.*, 214 F.R.D. 113, 116-17 (S.D.N.Y. 2002) ("Boston Scientific and its outside auditor Ernst & Young did not share 'common interests' in litigation, and disclosures to Ernst & Young as independent auditors did not therefore serve the privacy interests that the work product doctrine was intended to pro-

tect."). It is undisputed that Textron and E&Y were not actual adversaries. The IRS argues by analogy to *MIT* that they were potential adversaries. In *MIT*, we found work-product privilege waived when MIT disclosed documents to a Defense Department auditing agency. 129 F.3d at 687. The audit agency was reviewing MIT's expense submissions. *Id.* We found MIT and the agency to be potential adversaries as, "MIT doubtless hoped that there would be no actual controversy between it and the Department of Defense, but the potential for dispute and even litigation was certainly there." *Id.*

The facts here are different. While the Defense Department auditing agency was reviewing expenses to determine if it would challenge those expenses, E&Y was not auditing Textron in order to identify disputes it would have with Textron, but rather, to decide if it could issue a letter certifying Textron's financial statements. This is a cooperative not adversarial relationship. *See Jaffe Pension Plan*, 237 F.R.D. at 183 ("[T]he fact that an independent auditor must remain independent from the company it audits does not establish that the auditor also has an adversarial relationship with the client as contemplated by the work product doctrine."). While it is possible to imagine circumstances where E&Y's professional obligations could cause E&Y and Textron to come into conflict on some legal question, the IRS can point to no "conceivable scenario in which E&Y would file a lawsuit against [Textron] because of something E&Y learned from [Textron's] disclosures." *Regions*, 2008 U.S. Dist. LEXIS 41940, at *27-28 (citing *MIT* and the district court's opinion in this case to conclude that there was no waiver in similar circumstances). Whereas MIT's disclosure to the Defense Department auditing agency had the potential to directly trigger a dispute with that agency, no such potential adversity existed here.

Disclosure to a conduit to a potential adversary can also waive work-product protection. *Raytheon*, 218 F.R.D. at 360 (collecting cases). In other words, waiver occurs upon disclosure to a third party that "substantially increased the opportunities for potential adversaries to obtain the information." 8 Wright, Miller, & Marcus, *supra*, § 2024 (2008). Though E&Y has professional confidentiality obligations limiting disclosure, the IRS argues that it may be required to turn documents over to the SEC and may, in some circumstances, have a duty to disclose information to protect stockholders. *See Arthur Young,* 465 U.S. at 817-18 ("The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public.").

The IRS also argues that E&Y may be required to disclose this information in response to a valid subpoena. At first glance, this argument seems circular: a subpoena would only be valid if the protection did not survive. But, on further examination, the question is more complicated. The record establishes that E&Y did not retain a copy of Textron's tax accrual workpapers. Thus, at first we would see little likelihood that E&Y would have to disclose those papers. But, E&Y used those papers, together with its own expertise, in preparing its own assessment of Textron's reserve tax liability. Therefore, the only remaining documents which could be subjected to a risk of discovery are E&Y's own assessments, which incorporate Textron's analysis.

Though we hold Textron's tax accrual workpapers are protected, *Arthur Young* suggests that E&Y's work-

papers may be discoverable. 465 U.S. at 815-821.[10] In fact, as we find *infra*, Textron itself may be required to produce E&Y's workpapers on remand.

Since E&Y's workpapers may be discoverable, the question we must ask is whether disclosure of those workpapers substantially increased the risk that the contents of Textron's workpapers would be disclosed to an adversary. As the Supreme Court has recognized, independent auditors "obtain and assess the opinions, speculations, and projections of management with regard to unclear, aggressive, or questionable tax positions that may have been taken on prior tax returns." *Arthur Young,* 465 U.S. at 812. Further the auditor's workpapers "*may* document the auditor's interviews with corporate personnel." *Id.* (emphasis added). Thus, disclosure of E&Y's workpapers *might* reveal Textron's own analysis. On the other hand, E&Y's affiant, Weston, suggested that E&Y "did not rely solely upon the conclusions of [Textron's] tax counsel" but instead "applied its own professional knowledge and judgment." Because the district court did not address the question of whether the IRS can gain discovery of E&Y's tax workpapers through a subpoena to Textron, it made no factual findings regarding the actual contents of E&Y's workpapers or the extent to which disclosure of such workpapers would effectively constitute disclosure of Textron's own assessment. Rather than rely on vague language suggesting what might be in E&Y's workpapers, we think that this is a question the district court must develop on remand

[10] Though the parties debate the extent of confidentiality agreements and expectations of privacy between Textron and E&Y, we find such expectations irrelevant here, since a bilateral confidentiality agreement regarding Textron's workpapers would not defeat a valid IRS subpoena for E&Y's workpapers.

through *in camera* inspection, if feasible, or through testimony.

C. E&Y's Workpapers

The IRS's subpoena also sought tax accrual workpapers prepared by E&Y that were within the possession, custody, or control of Textron or its accountants. The district court did not include such workpapers in its definition of the documents sought and so did not rule on their discoverability. The IRS asserts that such failure to rule is error.

Textron argues that this omission is the fault of the IRS. When convening the evidentiary hearing, the district court called on the parties to present evidence on the question of "[w]hat specific types of documents are included in the 'Tax Accrual Workpapers' and 'backup' documentation" sought by the summons. But the evidence at the evidentiary hearing simply concerned Textron's workpapers, and the IRS did not bring up E&Y's workpapers. Textron thus argues that the IRS should not be permitted to now challenge the scope of the district court's construction of the summons. We disagree.

The summons explicitly sought these documents and the record indicates that the government reiterated its request in its briefing and at the initial oral arguments held before the evidentiary hearing was scheduled. The district court was fairly put on notice of this request, and in fact, when discussing the applicability of I.R.C. § 7525, stated at the oral arguments, "I think you've made your case as far as the Ernst & Young papers." That the evidentiary hearing focused on developing evidence regarding the nature of Textron's tax accrual workpapers does not show that the IRS had abandoned its clearly made request for E&Y's workpapers. In other words, since the

IRS "squarely and distinctly" requested E&Y's workpapers, and the district court was on notice of the issue, the argument is not waived. *Cf. B&T Masonry Constr. Co. v. Pub. Serv. Mut. Ins. Co.*, 382 F.3d 36, 40 (1st Cir. 2004) ("To preserve a point for appeal, some developed argumentation must be put forward in the nisi prius court — and a veiled reference to a legal theory is not enough to satisfy this requirement.").

Turning to the merits, as noted above, *Arthur Young* suggests such documents are not protected and Textron has not argued otherwise. Textron also does not meaningfully dispute the government's prima facie showing of relevance. Instead, Textron contends that we may nevertheless affirm the district court because Textron, the only defendant in this action, does not have possession, custody, or control of these documents.

In the normal discovery context, "so long as the party has the legal right or ability to obtain the documents from another source upon demand, that party is deemed to have control." *Mercy Catholic Med. Ctr. v. Thompson,* 380 F.3d 142, 160 (3d Cir. 2004); *see also* 8A Wright, Miller, & Marcus, *supra*, § 2210 ("Inspection can be had if the party to whom the request is made has the legal right to obtain the document, even though in fact it has no copy."). Textron has provided us with no argument why that test should not apply in the IRS subpoena context.

Textron argues that its witness testified that Textron could not access the documents. But Textron mischaracterizes the record. Textron's witness simply testified that E&Y did not give Textron its workpapers, not that Textron could not obtain copies of the documents upon request. Thus Textron has no evidence showing that it did not have the ability to demand the documents. Textron

argues that R.I. Gen. Laws § 5-3.1-22 establishes an independent auditor owns its own workpapers. But, again, it does not establish that Textron does not have the ability or contractual right to request the documents.

The IRS has some evidence to suggest that Textron may have had the right to demand E&Y's workpapers. Raymond, a Textron witness, stated that she had reviewed E&Y's files to confirm that E&Y did not retain Textron's workpapers. The IRS argues that this shows Textron has the right to obtain the documents. Textron argues it shows only a right to temporary access. We need not parse this testimony, since even adopting Textron's interpretation, we could not affirm on this basis. Textron has the burden of showing a lack of control and has produced no evidence to meet this burden. *United States v. Lawn Builders of New England*, 856 F.2d 388, 392 (1st Cir. 1988) ("'Once the district court has reason to believe that the requested documents exist, the burden then shifts to the summonee to show that he is not in possession of them.'" (quoting *United States v. Freedom Church*, 613 F.2d 316, 322 (1st Cir. 1979))). Thus, we remand for the district court to determine the factual question of whether Textron can obtain E&Y's workpapers.

III. Conclusion

For the foregoing reasons, we affirm the district court's determination that Textron's tax accrual workpapers are protected, affirm that Textron and E&Y were not potential adversaries, but vacate the ultimate determination that work-product protection was not waived, and remand for the district court to reassess, in a manner consistent with this opinion, the question of whether disclosure of E&Y's workpapers would reveal the information contained in Textron's own workpapers. On remand the district court should also assess the discovera-

bility of E&Y's workpapers by determining whether Textron has the legal right or ability to obtain these documents.

Affirmed in part, Vacated in part, and Remanded. No Costs are imposed.

BOUDIN, Circuit Judge, concurring in part and dissenting in part.

The central issue is whether Textron's tax-accrual work papers are protected from IRS summons because they are attorney work product. Any lawyer might be unnerved to find that his potential adversary could obtain the lawyer's own estimate of his chances of success. But under our own precedent and consistent with other circuits, tax-accrual work papers are not protected because they are prepared for reasons independent of the need to prepare for or conduct litigation.

Federal securities laws require publicly traded corporations like Textron to have their financial statements certified by an independent auditor. *See* 15 U.S.C. §§ 78l, 78m; 17 C.F.R. § 210 *et seq*. Key to the audit is evaluating "the adequacy and reasonableness of the corporation's reserve account for contingent tax liabilities." *United States v. Arthur Young & Co.,* 465 U.S. 805, 812 (1983). Tax accrual work papers aid by *inter alia*

> pinpoint[ing] the 'soft spots' on a corporation's tax return by highlighting those areas in which the corporate taxpayer has taken a position that may, at some later date, require the payment of additional taxes" [and also include] "an item-by-item analysis of the corporation's potential exposure to additional liability.

Id. at 813.

In the wake of Enron and other corporate scandals, the IRS began to seek taxpayers' tax-accrual work papers for certain transactions "that [are] the same as or substantially similar to one of the types of transactions that the [IRS] . . . has determined to be a tax avoidance transaction." Treas. Reg. § 1.6011-4(b)(2) (2002) (codified at 26 C.F.R. § 1.6011-4(b)(2)). Here, the IRS' request for Textron's tax accrual work papers was made after an IRS team found that Textron had entered into nine separate "Sale-In, Lease-Out" ("SILO") transactions.[11]

A qualified privilege exists for attorney work product, but the phrase does not mean any and all work by an attorney that happens to refer to litigation; it means work connected to preparing for or managing litigation. *Hickman v. Taylor,* 329 U.S. 495, 510-12 (1947). The attorney-client privilege is not in any way confined to advice given for use in litigation, *Mead Data Central, Inc. v. U.S. Dep't. of the Air Force,* 566 F.2d 242, 252-53 (D.C. Cir. 1977), but the latter privilege was held to be waived by Textron and is not at issue on this appeal.

In our circuit and in others, documents are said to be created "in anticipation of litigation," and thus eligible for work product protection if, "in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained because of the prospect of litigation."

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[11] SILO transactions are "a combination of a sale of an asset by a tax-exempt entity" followed by a "lease back to the same entity." Shvedov, *Tax Implications of SILOs, QTEs, and Other Leasing Transactions with Tax-Exempt Entities* 1, CRS Report for Congress (Nov. 30, 2004). These transactions benefit private entities by allowing them to "deduct depreciation" and "interest." *Id.* at 10.

Maine v. U.S. Dep't. of the Interior, 298 F.3d 60, 68 (1st Cir. 2002) (quoting *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998)) (internal quotation marks omitted). The "because of" phrase, standing alone, does not answer the question what happens if the document is created to satisfy some requirement imposed *independently* of the need to litigate, but our precedent squarely answers the question.

We have held that work-product protection does not extend to "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation." *Maine*, 298 F.3d at 70 (*quoting Adlman*, 134 F.3d at 1202) (internal quotation marks omitted). This caveat applies "even though litigation is already in prospect," *Adlman*, 134 F.3d at 1202 (citing 8 Wright, Miller & Cooper, *Federal Practice and Procedure* § 2024, at 346 (3d ed. 1998)), and even if "the documents aid in the preparation of litigation." *Maine*, 298 F.3d at 70.

The district court held that the work papers "would not have been prepared 'but for' the fact that Textron anticipated the possibility of litigation with the IRS" and that if "Textron had not anticipated a dispute with the IRS, there would have been no reason for it to establish any reserve or to prepare the work papers used to calculate the reserve." *U.S. v. Textron Inc.*, 507 F. Supp. 2d 138, 150 (D.R.I. 2007). But this misreads *Maine*: *Maine* holds that it is not the subject matter discussed in the materials that controls but whether documents are prepared "in the ordinary course of business" or were otherwise independently required, which are both the case with tax accrual work papers mandated by accounting requirements.

The decisions in other circuits bear out this legal interpretation. In *Adlman* itself, the company in question had "the prospect of litigation [with the IRS] in mind" when it asked for the preparation of a memorandum studying the tax implications of a contemplated restructuring; nonetheless, the Second Circuit allowed that if the memorandum would have been prepared in a similar form without expected litigation with the IRS, then it was not created "because of" litigation. *Adlman,* 134 F.3d at 1203-04; *accord United States v. Roxworthy,* 457 F.3d 590, 598-99 (6th Cir. 2006).[12]

Conversely, in cases finding documents to be protected, it is because the documents were created in order to be useful in litigation. *See, e.g.*, *Delaney, Migdail & Young, Chartered v. IRS,* 826 F.2d 124, 127 (D.C. Cir. 1987) (protection for "attorneys' assessment of . . . legal vulnerabilities in order to make sure it does not *miss anything in crafting its legal case*") (emphasis added); *see also In re Sealed Case,* 146 F.3d 881, 885 (D.C. Cir. 1998) (protection for documents to "protect the client from future litigation about a particular transaction").

To the extent the panel majority rests on the district court's legal interpretation, that interpretation is simply at odds with our decision in *Maine* and with *Adlman* on which *Maine* relied. Nor can the district court's outcome

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[12] *See also In re Royal Ahold N.V. Sec. & ERISA Litig.,* 230 F.R.D. 433, 435 (D. Md. 2005) (no protection for notes and memoranda detailing witness interviews where "principal reason" for documents was "to satisfy the requirement of . . . outside accountants"); *Fidelity Int'l Currency Advisor A Fund, LLC v. United States,* No. 05-40151-FDS, 2008 WL 4809032, at *12-14 (D. Mass. Apr. 18, 2008) (no protection for opinion letters analyzing "likely tax consequences" of certain transactions where purpose was "to induce the taxpayers to invest in the strategy").

be defended by treating the district court's decision as a *factual* finding that *in this instance* Textron prepared these documents *both* to satisfy the accounting requirements and for possible use in litigation. This is not what the district court found and, given the legal rule adopted in *Maine* and *Adlman*, it would not matter if it had so found.

The government offered compelling evidence that the sole reason for the creation of Textron's estimates of risk with respect to individual tax positions was to prepare the reserve figures for the company books and statements and to satisfy the auditors that the reserves were adequate. No contrary evidence was offered by Textron. The district court made no contrary finding and any such finding would have been clearly erroneous. The government's expert witness—the former chief auditor of the Public Company Accounting Oversight Board—testified:

> Q: Does a public company prepare tax accrual work papers only when it anticipates litigation over the issues identified in the work papers?
>
> A: No. They have to prepare them to support the representations in the financial statements.
>
> Q: So if a public company believes the chances of litigation over the issues in the work papers are remote, it would still prepare those work papers?
>
> A: Yes. because they'd have to be able to support that judgment [to the independent auditor].
>
> Q: And would those work papers be prepared in the same form as work papers in-

> volving issues for which the company actually anticipates litigation?
>
> A: Certainly, the basics would be the same. . . .
>
> . . .
>
> Q: Would the tax accrual work papers ever be blank?
>
> A: I can't think of a circumstance where they would, no.

Textron's own witness acknowledged that it would "have to include in its . . . tax accrual work papers any new transactions that the company entered into that year that there might be some tax exposure on" regardless of whether it anticipated litigation with the IRS. Textron offered no testimony purporting to show that its lawyers had any intention of utilizing its assessment in the conduct of any litigation that might ensue (although it did offer speculation as to how such documents *might* conceivably be helpful), and such a use is not even arguably the driving purpose behind the document's creation.

The only circuit precedent that directly involves tax accrual work papers held that they were not protected attorney work product. *United States v. El Paso Co.*, 682 F.2d 530, 543 (5th Cir. 1982) (noting that in tax accrual work papers legal analysis is only a "means to a business end").[13] The Fifth Circuit looked to the primary purpose

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[13] *El Paso* denied protection for the work papers because the court recognized that the company in question was conducting the relevant analysis because of a need to "bring its financial books into conformity with generally accepted auditing principles." *Id.* at 543. And, it saw the need to satisfy independent auditors as being "compelled by the securities laws." *Id.*

of the documents in deciding whether they were created "in anticipation of litigation"; but the "because of" test, as construed in *Maine*, is certainly no more protective here because it denies protection so long as the papers would have been prepared regardless of litigation.

The government's position is also supported by two scholarly articles that analyzed, and roundly condemned, the lower court's decision. Pease-Wingenter, *The Application of the Attorney-Client Privilege to Tax Accrual Workpapers: The Real Legacy of United States v. Textron*, 8 Hous. Bus. & Tax L.J. 337 (2008); Ventry, *Protecting Abusive Tax Avoidance*, 120 Tax Notes 857 (2008). Without endorsing everything in the articles, it is fair to say that they make scholarly mince-meat of Textron's position.

In most matters of privilege, there is a certain arbitrariness as to where to draw the line or, to put it differently, even the most sacrosanct of privileges represents a sacrifice of other interests—usually, as Bentham classically explained, the interest of truth. 8 Wigmore, *Evidence* § 2291 (McNaughton Rev. 1961). Here, the matter is not open to a panel for re-examination on policy grounds, but no one should think that the policy arguments are all on one side.

Precisely because the work papers in this instance are required by the financial statement obligations and accounting rules, there is little risk of the chilling effect so often paraded in privilege cases. The Supreme Court in rejecting an accountant's privilege for the preparation of tax accrual work papers pointed out that large companies effectively have to comply with the accounting requirements and would do so with or without a privilege for the accountant. *Arthur Young,* 465 U.S. at 818-19.

And, while it may seem one-sided to give the government Textron's blue print to weaknesses in Textron's tax returns, the return is massive—constituting more than 4000 pages; the government has an important interest in collecting taxes that are owed; and its inquiries into work papers were focused on a specific type of transaction that had been shown to be open to abuse. So context should be kept in mind before shedding too many tears for Textron.

In all events, it is important for us to adhere to the existing rules of the road. Parties can generally adjust their behavior so long as they know what privilege rules apply. Here, the governing rubric in *Maine* (First Circuit) and *Adlman* (Second Circuit) and a precise precedent in *El Paso* (Fifth Circuit) govern this case. An *en banc* court could change the rule; a panel majority cannot.

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

C.A. No. 06-198T

UNITED STATES OF AMERICA, Petitioner,

v.

TEXTRON INC. AND SUBSIDIARIES, Respondent.

Aug. 28, 2007

TORRES, Senior District Judge.

Pursuant to 26 U.S.C. §§ 7402(b) and 7604, the United States has filed a petition to enforce an Internal Revenue Service (IRS) summons served on Textron Inc. and its subsidiaries ("Textron") in connection with the IRS's examination of Textron's tax liability for tax years 1998-2001. The summons seeks Textron's "tax accrual workpapers" for its 2001 tax year. Textron has refused to produce the requested documents on the grounds that (1) the summons was not issued for a legitimate purpose and (2) the tax accrual workpapers are privileged.

Because this Court finds that the requested documents are protected by the work product privilege, the petition for enforcement is denied.

Facts

Based on the pleadings, affidavits submitted by the parties, and the evidence presented at a hearing conducted on June 26, 2007, this Court finds the relevant facts to be as follows.

Textron, Inc. is a publicly traded conglomerate with approximately 190 subsidiaries. One of its subsidiaries is Textron Financial Corporation (TFC), a company that provides commercial lending and financial services. In 2001 and 2002, Textron had six tax attorneys and a number of CPAs in its tax department but TFC's tax department consisted only of CPAs. Consequently, TFC relied on attorneys in Textron's tax department, private law firms, and outside accounting firms for additional assistance and advice regarding tax matters.

Like other large corporations, Textron's federal tax returns are audited periodically at which time the IRS examines the returns for the tax years that are part of the audit cycle. In conducting its audits, the IRS, typically, gathers relevant information by issuing "information document requests" (IDRs) to the taxpayer. If the IRS disagrees with a position taken by the taxpayer on its return, the IRS issues a Notice of Proposed Adjustments to the taxpayer. A taxpayer that disputes the proposed adjustments has several options to resolve the dispute within the agency. Those options range from an informal conference with the IRS team manager to a formal appeal to the IRS Appeals Board. If the dispute is not resolved within the agency, the taxpayer may file suit in

federal court. In seven of its past eight audit cycles covering the period between 1980 and the present, Textron appealed disputed matters to the IRS Appeals Board; and three of these disputes resulted in litigation.[1]

During the 1998-2001 audit cycle, the IRS learned, from examining Textron's 2001 return, that TFC had engaged in nine "sale-in, lease-out" (SILO) transactions involving telecommunications equipment and rail equipment. The IRS has classified such transactions as "listed transactions" because it considers them to be of a type engaged in for the purpose of tax avoidance. *See* 26 C.F.R. § 1.6011-4(b)(2). The IRS issued more than 500 IDRs in connection with the 1998-2001 audit cycle, and Textron complied with all of them, except for the ones seeking its "tax accrual workpapers."

The Summons

On June 2, 2005, Revenue Agent Vasconcellos, the manager of the IRS team examining Textron's return, issued an administrative summons for "all of the Tax Accrual Workpapers" for Textron's tax year ending on December 29, 2001. The summons defined the "Tax Accrual Workpapers" to include:

> [A]ll accrual and other financial workpapers or documents created or assembled by the Taxpayer, an accountant for the Taxpayer, or the Taxpayer's independent auditor relating to any tax reserve for cur-

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[1] *See Textron, Inc. v. Comm'r,* 117 T.C. 67 (2001) (relating to federal income tax liability for tax years 1987 through 1992); *Textron, Inc. v. Comm'r,* 336 F.3d 26 (1st Cir. 2003) (appeal regarding a different issue raised in the tax court); *Textron, Inc. v. United States,* 418 F. Supp. 39 (D.R.I. 1976) (relating to tax years 1959 through 1962).

> rent, deferred, and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to any footnotes disclosing reserves or contingent liabilities on audited financial statements. They include, but are not limited to, any and all analyses, computations, opinions, notes, summaries, discussions, and other documents relating to such reserves and any footnotes. . . .

Textron refused to produce its tax accrual workpapers, asserting that they are privileged and that the summons was issued for an improper purpose.

The Tax Accrual Workpapers

Because there is no immutable definition of the term "tax accrual workpapers," the documents that make up a corporation's "tax accrual workpapers" may vary from case to case.[2] In this case, the evidence shows that Textron's "tax accrual workpapers" for the years in question consist, entirely, of:

1. A spreadsheet that contains:

   (a) lists of items on Textron's tax returns, which, in the opinion of Textron's counsel, involve issues on which the tax laws are unclear, and, therefore, may be challenged by the IRS;

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[2] Professor Douglas Carmichael, the government's expert, explained that the content of tax accrual workpaper files "does vary" because "Companies organize their records in different ways." Transcript of June 26, 2007 Evidentiary Hearing at 132. *See also United States v. El Paso Co.,* 682 F.2d 530, 533 (5th Cir. 1982) (noting the many names for tax accrual workpapers).

(b) estimates by Textron's counsel expressing, in percentage terms, their judgments regarding Textron's chances of prevailing in any litigation over those issues (the "hazards of litigation percentages"); and

(c) the dollar amounts reserved to reflect the possibility that Textron might not prevail in such litigation (the "tax reserve amounts").

2. Backup workpapers consisting of the previous year's spreadsheet and earlier drafts of the spreadsheet together with notes and memoranda written by Textron's in-house tax attorneys reflecting their opinions as to which items should be included on the spreadsheet and the hazard of litigation percentage that should apply to each item.

The evidence shows that while Textron may possess documents, such as leases, that contain factual information regarding the SILO transactions and other items that may be listed on the spreadsheet, its tax accrual workpaper files do not include any such documents.

As stated by Norman Richter, Vice President of Taxes at Textron and Roxanne Cassidy, Director, Tax Reporting at Textron, Textron's ultimate purpose in preparing the tax accrual workpapers was to ensure that Textron was "adequately reserved with respect to any potential disputes or litigation that would happen in the future." It seems reasonable to infer that Textron's desire to establish adequate reserves also was prompted, in part, by its wish to satisfy an independent auditor that Textron's reserve for contingent liabilities satisfied the requirements of generally accepted accounting principles (GAAP) so that a "clean" opinion would be given

with respect to the financial statements filed by Textron with the SEC.

Each year, Textron's tax accrual workpapers are prepared shortly after the corporation's tax return is filed. The first step in preparing the workpapers is that Textron's accountants circulate to Textron's attorneys a copy of the previous year's tax accrual workpapers together with recommendations regarding their proposed changes and/or additions for the current year. Textron's attorneys, then, review those materials, propose further changes to the spreadsheets and hazard litigation percentages which are returned to the accountants who compile the information and perform the mathematical calculations necessary to compute the tax reserve amounts. The attorneys and accountants, then, meet to give their approval so that the accountants may finalize the workpapers.

TFC goes through a similar process in preparing its tax accrual workpapers but, since TFC does not have any in-house attorneys, its accountants rely on tax advice obtained from outside accounting and law firms, before meeting with a Textron tax attorney to finalize the workpapers.

Once the tax reserve amounts for each item on the worksheets are established, those amounts are aggregated with other contingent liabilities and the total is reported as "other liabilities" on Textron's financial statements.

During the course of an audit conducted by Ernst & Young (E&Y), Textron's independent auditor, Textron permitted E&Y to examine the final tax accrual workpapers at issue in this case with the understanding that the information was to be treated as confidential.

Analysis

I. *The Summons*

A. *Scope and Enforceability, in General*

Section 7602 authorizes the IRS to issue administrative summonses for the production of "any books, papers, records, or other data which may be relevant or material" in "ascertaining the correctness of any return, . . . , determining the liability of any person for any internal revenue tax . . ., or collecting any such liability. . . ." 26 U.S.C. § 7602(a). The Supreme Court has described § 7602 as a "broad summons authority" reflecting a "congressional policy choice *in favor of disclosure* of all information relevant to a legitimate IRS inquiry." *United States v. Arthur Young & Co.,* 465 U.S. 805, 816, 104 S. Ct. 1495, 1502, 79 L. Ed. 2d 826 (1984).

When documents requested in a summons are not produced, the United States may petition a federal district court for an order compelling compliance. 26 U.S.C. § 7604. To obtain such an order, the IRS must show: (1) that there is a legitimate purpose for the investigation pursuant to which the summons is being sought, (2) that the inquiry or the materials sought may be relevant to that purpose, (3) that the information sought is not already within the Commissioner's possession, and (4) that the administrative steps required by the Code have been followed. *United States v. Powell,* 379 U.S. 48, 57-58, 85 S. Ct. 248, 255, 13 L. Ed. 2d 112 (1964).

The government may make a prima facie showing that those requirements have been satisfied "on the face of the summons and by supporting affidavits." *United States v. Freedom Church,* 613 F.2d 316, 321 (1st Cir. 1979). *See also United States v. Lawn Builders of New*

England, Inc., 856 F.2d 388, 392 (1st Cir. 1988) ("Assertions by affidavit of the investigating agent that the requirements are satisfied are sufficient to make the prima facie case.") (quoting *Liberty Financial Servs. v. United States,* 778 F.2d 1390, 1392 (9th Cir. 1985)). When the requisite showing has been made, the burden shifts to the party summoned to present evidence that the *Powell* requirements have not been satisfied or that there is some other reason why the summons should not be enforced. *Freedom Church,* 613 F.2d at 319 (citing, *inter alia, United States v. LaSalle Nat. Bank,* 437 U.S. 298, 316, 98 S. Ct. 2357, 57 L. Ed. 2d 221 (1978)).

In this case, Textron does not dispute that the documents sought may be relevant[3] or that the IRS has followed the necessary administrative steps in issuing the summons. Rather, Textron argues that the IRS seeks the documents for the purpose of using them as leverage in settlement negotiations and that the documents are privileged.

B. *The Legitimate Purpose Requirement*

Whether the purpose for issuing a summons is legitimate depends on the circumstances. Section 7602(a) makes it clear that "ascertaining the correctness of any return" and "determining the liability of any person for any internal revenue tax" are legitimate purposes for is-

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[3] In *United States v. Arthur Young & Co.,* 465 U.S. 805, 104 S. Ct. 1495, 79 L. Ed. 2d 826 (1984), the Supreme Court held that an IRS summons satisfies the *relevance* prong of the *Powell* test if the documents sought "'might have thrown light upon' the correctness of [the taxpayer's] return," *Arthur Young,* 465 U.S. at 813-14 and that the "tax accrual workpapers" involved in that case, which were prepared by the taxpayer's outside auditor, satisfied that relevance standard. 465 U.S. at 815.

suing a summons. On the other hand, it is improper to "us[e] a civil summons to gather evidence to be used solely in a criminal prosecution," *United States v. Kis*, 658 F.2d 526, 535 (7th Cir. 1981), or to issue a summons "to harass the taxpayer or to put pressure on him to settle a collateral dispute, or for any other purpose reflecting on the good faith of the particular investigation." *Powell*, 379 U.S. at 58.

In this case, the statements on the face of the summons, itself, and the supporting declaration of Agent Vasconcellos that the purpose of the summons is to "ascertain the correctness of the tax returns filed by the taxpayer" for the years in question, constitute a *prima facie* showing that the purpose is legitimate. Consequently, the burden is on Textron to "create a 'substantial question in the court's mind regarding the validity of the government's purpose.'" *United States v. Gertner*, 65 F.3d 963, 967 (1st Cir. 1995) (quoting *United States v. Salter*, 432 F.2d 697, 700 (1st Cir. 1970)). In order to carry its burden, Textron "must articulate specific allegations of bad faith and, if necessary, produce reasonably particularized evidence in support of those allegations." *Id.*

In arguing that the government's stated purpose is pretextual and that the IRS's real objective is to use the opinions of Textron's counsel and tax advisers with respect to the SILO transactions as a bargaining lever, Textron alleges that the 2001 examination was substantially completed when the summons was issued; that Textron already had provided numerous documents requested by the IRS regarding the SILO transactions; and that the IRS could have requested any additional documents regarding the facts underlying those transac-

tions. However, those allegations are insufficient to establish a bad faith purpose.

As a factual matter, the IRS disputes the assertion that the 2001 examination had been substantially completed when the summons was issued and the only evidence offered by Textron on this point was an IRS agenda for a March 22, 2005 meeting between the parties which stated, simply, that the purpose of the meeting was to determine what steps were needed to bring the examination to completion. Nor does Textron's production of other documents relating to the SILO transactions or the fact that the IRS could have requested additional documents by issuing IDRs raise a substantial question as to bad faith. The IRS has discretion to determine the manner in which its investigation should be conducted. *See United States v. Norwest Corp.,* 116 F.3d 1227, 1233 (8th Cir. 1997) ("[I]t is for the agency, and not the taxpayer, to determine the course and conduct of an audit"). Accordingly, the IRS is not required to obtain relevant documents by the least formal means possible. *See Tiffany Fine Arts, Inc. v. United States,* 469 U.S. 310, 323, 105 S. Ct. 725, 732, 83 L. Ed. 2d 678 (1985) (the IRS is not required to "conduct its investigations in the least intrusive way possible.").

Textron also argues that the summons is overbroad because it seeks not only TFC's tax accrual workpapers but, also, the tax accrual workpapers for Textron and all of its subsidiaries. However, the request for Textron's workpapers does not establish bad faith because TFC is a subsidiary of Textron and the IRS asserts that it is seeking to determine Textron's overall tax liability, not just any tax due from the SILO transactions.

In short, the IRS has made a prima facie showing that the *Powell* requirements have been satisfied and Textron has failed to rebut that showing.

II. *Applicability of Privilege*

Satisfaction of the *Powell* requirements is not sufficient to warrant enforcement of an IRS summons if the documents sought are privileged. *Upjohn Co. v. United States,* 449 U.S. 383, 386, 101 S. Ct. 677, 681, 66 L. Ed. 2d 584 (1981) (refusing to enforce IRS summons because documents sought contained communications protected by the attorney-client privilege and also recognizing that "the work-product doctrine does apply in tax summons enforcement proceedings."). In general, when a claim of privilege is made, the party asserting the privilege "has the burden of establishing not only the existence of that privilege, but also that the privilege was not waived." *In re Raytheon Sec. Litig.,* 218 F.R.D. 354, 357 (D. Mass. 2003).

In this case, Textron argues that its tax accrual workpapers are protected by the attorney-client privilege, the tax practitioner-client privilege created by 26 U.S.C. § 7525, and the work product privilege.

A. *Attorney-Client Privilege*

The attorney-client privilege protects confidential communications between an attorney and client relating to legal advice sought from the attorney. *See United States v. Bisanti,* 414 F.3d 168, 171 (1st Cir. 2005); *Cavallaro v. United States,* 284 F.3d 236, 245 (1st Cir. 2002). Since the privilege may hamper the search for truth by preventing the disclosure of relevant evidence, it is narrowly construed. *In re Keeper of Records (XYZ Corp.),* 348 F.3d 16, 22 (1st Cir. 2003) ("the attorney-client privilege must be narrowly construed because it

comes with substantial costs and stands as an obstacle of sorts to the search for truth."). Narrow construction of the privilege is especially called for in the case of tax investigations because of "the 'congressional policy choice *in favor of disclosure* of all information relevant to a legitimate IRS inquiry.'" *Cavallaro,* 284 F.3d at 245 (quoting *Arthur Young,* 465 U.S. at 816).

Textron's affidavits state that its tax accrual workpapers are privileged because they were prepared by counsel and reflect counsel's legal conclusions in identifying items on Textron's return that may be challenged and assessing Textron's prospects of prevailing in any ensuing litigation. (Richter Aff. ¶¶ 13, 22.) The IRS argues that the workpapers are not privileged because, in preparing them, Textron's attorneys were not providing legal advice but, rather, were performing an accounting function by reconciling the company's tax records and financial statements.

It is true that, generally, the mere preparation of a tax return is viewed as accounting work and a taxpayer may not cloak the documents generated in that process with a privilege simply "by hiring a lawyer to do the work that an accountant, or other tax preparer, or the taxpayer himself . . . normally would do." *United States v. Frederick,* 182 F.3d 496, 500 (7th Cir. 1999). *See* E.S. Epstein, *The Attorney-Client Privilege and the Work-Product Doctrine* 246 (4th ed. 2001). On the other hand, it is equally true that communications containing legal advice provided by an attorney may be privileged even though they are made in connection with the preparation of a return.

> Determining the tax consequences of a particular transaction is rooted entirely in the law. . . . [Therefore] [c]ommunications

> offering tax advice or discussing tax planning . . . are 'legal' communications.

U.S. v. Chevron Texaco Corp., 241 F. Supp. 2d 1065, 1076 (N.D. Cal. 2002). *See* Epstein, at 249; Louis F. Lobenhoffer, *The New Tax Practitioner Privilege: Limited Privilege and Significant Disruption,* 26 Ohio N.U. L. Rev. 243, 252 (2000) (the attorney-client privilege should not be lost when true legal advice or lawyer's work is performed, albeit in support of an accounting or financial reporting function).

The Seventh Circuit explained the distinction, in the context of an IRS audit, by stating that where representation during an audit consists of "merely verifying the accuracy of a return," it is "accountants' work"; but, if the attorney participates in the audit "to deal with issues of statutory interpretation or case law" that may have been raised in connection with examination of the taxpayer's return, "the lawyer is doing lawyer's work and the attorney-client privilege may attach." *Frederick,* 182 F.3d at 502. Furthermore, in *United States v. El Paso Co.,* the Fifth Circuit addressed the distinction as it applies specifically to tax accrual workpapers by observing that, while preparation of tax accrual work papers might be considered an accounting function, "we would be reluctant to hold that a lawyer's analysis of the soft spots in a tax return and his judgment on the outcome of the litigation on it are not legal advice." *United States v. El Paso Co.,* 682 F.2d 530, 539 (5th Cir. 1982).

Here, since the tax accrual workpapers of Textron and TFC essentially consist of nothing more than counsel's opinions regarding items that might be challenged because they involve areas in which the law is uncertain and counsel's assessment regarding Textron's chances of

prevailing in any ensuing litigation, they are protected by the attorney-client privilege.

The IRS's reliance on *Arthur Young* is misplaced because, although *Arthur Young* deemed tax accrual workpapers pinpointing the "soft spots" on a corporation's tax return *relevant* to examination of the corporation's return, it did not hold the attorney-client privilege inapplicable to legal conclusions of counsel contained in the workpapers. On the contrary, *Arthur Young* expressly recognized that "§ 7602 is 'subject to the traditional privileges and limitations.'" *Arthur Young,* 465 U.S. at 816 (citation omitted). *Arthur Young* also is distinguishable on the ground that, there, the workpapers had been prepared by the corporation's independent auditor whose "obligation to serve the public interest assures that the integrity of the securities markets will be preserved." *Arthur Young,* 465 U.S. at 819. By contrast, Textron's workpapers were prepared by its counsel whose function was to provide legal advice to Textron.

B. *Tax Practitioner-Client Privilege—§ 7525*

Section 7525, which created a tax practitioner privilege, was enacted after the Supreme Court's decision in *Arthur Young,* which declined to create a new "accountant-client privilege" between a corporation and its independent auditor. *Arthur Young,* 465 U.S. at 817. Section 7525 confers a privilege on tax advice in the form of confidential communications "between a taxpayer and any federally authorized tax practitioner" to the same extent that such communications would be protected between a taxpayer and an attorney. 26 U.S.C. § 7525(a)(1).

In the case of a corporation, the privilege does not apply to written communications between the tax practitioner and the corporation "in connection with the pro-

motion of the direct or indirect participation of such corporation in any tax shelter (as defined in section 6662(d)(2)(C)(iii))." 26 U.S.C. § 7525(b) (2001). Nor does the privilege extend to a tax practitioner's "work product" in *preparing* a return or to "communications between a tax practitioner and a client simply for the preparation of a tax return." *United States v. KPMG, LLP*, 316 F. Supp. 2d 30, 35 (D.D.C. 2004) ("nothing in the statute 'suggests that these nonlawyer practitioners are entitled to privilege *when they are doing other than lawyers' work*'") (emphasis in original) (citation omitted).

Textron argues that, to the extent that the workpapers in question reflect the advice that TFC received from CPAs in its tax department, they are privileged under § 7525. The IRS argues that the opinions of TFC's tax accountants do not qualify for protection under § 7525(a); and, even if they did, they fall within the exception contained in § 7525(b).

Since TFC's tax accountants participated in advising Textron regarding its tax liability with respect to matters on which the law is uncertain and/or estimating the hazards of litigation percentages, they were performing "lawyers' work." Accordingly, that advice would qualify for the privilege conferred by § 7525(a). *See* 26 U.S.C. 7525(a) (tax advice communications protected "to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.").

In support of its argument that the written communications from TFC's tax accountants fall within the "promotion" of a tax shelter exception created by § 7525(b), the IRS points out that 26 U.S.C. § 6662(d)(2)(C)(ii) defines "tax shelter" to include any arrangement "a significant purpose" of which "is the avoidance or evasion of

Federal income tax" and that an IRS notice identifies SILO transactions as a type of tax avoidance arrangement. *See* 26 C.F.R. § 1.6011-4(b)(2); IRS Notice 2005-13 (February 11, 2005), 2005-9 I.R.B. 630. That argument is not persuasive because even if the SILO transactions in which TFC engaged are characterized as "tax avoidance" transactions the communications were not made "in connection with the *promotion*" of TFC's participation in them. 26 U.S.C. § 7525(b) (emphasis added).

Section 7525(b) is aimed at communications by outside tax practitioners attempting to sell tax shelters to a corporate client. *See* 144 Cong. Rec. S7643-02, S7667 (July 8, 1998) (statement of Sen. Mack) ("[section 7525(b)] was meant to target written promotional and solicitation materials used by the peddlers of corporate tax shelters"). As the Conference Report relating to § 7525(b) stated "[t]he Conferees do not understand the promotion of tax shelters to be part of the routine relationship between a tax practitioner and a client. Accordingly, the Conferees do not anticipate that the tax shelter limitation will adversely affect such routine relationships." H.R. Rep. No. 105-599 (Conf. Report to Accompany HR 2676) (June 24, 1998).

Here, TFC's accountants were not "peddlers of corporate tax shelters" or outside promoters soliciting TFC's participation in the SILO transactions. Rather, they were acting as tax advisers and the workpapers reflect their opinions regarding the foreseeable tax consequences of transactions that, already, had taken place, not future transactions they were seeking to promote.

C. *The Work Product Privilege*

1. The Nature of the Privilege

The work product privilege applies to materials prepared or gathered by an attorney in anticipation of litigation or preparation for trial. The purpose of the privilege is "to preserve a zone of privacy in which a lawyer can prepare and develop legal theories and strategy 'with an eye toward litigation' free from unnecessary intrusion by his adversaries," *United States v. Adlman*, 134 F.3d 1194, 1196 (2d Cir. 1998) (citing *Hickman v. Taylor*, 329 U.S. 495, 510-11, 67 S. Ct. 685, 393-94, 91 L. Ed. 451 (1947)), "to prevent a litigant from taking a free ride on the research and thinking of his opponent's lawyer and to avoid the resulting deterrent to a lawyer's committing his thoughts to paper." *Frederick*, 182 F.3d at 500.

The privilege first was articulated by the Supreme Court in *Hickman v. Taylor*, 329 U.S. 495, 67 S. Ct. 685, 91 L. Ed. 451 (1947), and, later, was codified in Federal Rule of Civil Procedure 26(b)(3) which provides:

> (3) Trial Preparation Materials . . . . a party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (b)(1) of this rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative . . . *only* upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required

> showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.

Fed. R. Civ. P. 26(b)(3) (emphasis added).

As the rule indicates, unlike the attorney-client privilege, the work product privilege is a qualified privilege which may be overcome by a showing of "substantial need." Fed. R. Civ. P. 26(b)(3). The burden of establishing "substantial need" rests on the party seeking to overcome the privilege; and, when "opinion work product" consisting of "mental impressions, conclusions, opinions or legal theories" of attorneys is involved, the burden of establishing "substantial need" is greater than it is with respect to documents that are merely obtained by a party. *Upjohn*, 449 U.S. at 401-2 ("we think a far stronger showing of necessity and unavailability by other means . . . would be necessary to compel disclosure" of opinion work-product.). Indeed, some courts have accorded "nearly absolute" protection to work product consisting of opinions or theories. *In re Grand Jury Subpoena*, 220 F.R.D. 130, 145 (D. Mass. 2004) (collecting cases).

In *Upjohn*, the Supreme Court made it clear that the work product privilege may be invoked in response to IRS summonses.

> [T]he obligation imposed by a tax summons remains 'subject to the traditional privileges and limitations.' . . . Nothing in the language of the IRS summons provisions or their legislative history suggests an intent on the part of Congress to prec-

> lude application of the work-product doctrine. Rule 26(b)(3) codifies the work-product doctrine, and the Federal Rules of Civil Procedure are made applicable to summons enforcement proceedings by Rule 81(a)(3).

Upjohn, 449 U.S. at 398-99 (citation omitted).

2. The "In Anticipation of Litigation" Requirement

Courts have applied two different tests in determining whether a document was prepared "in anticipation of litigation." Under the "primary purpose" test, documents are held to be prepared in anticipation of litigation "as long as the primary motivating purpose behind the creation of a document was to aid in possible future litigation." *El Paso,* 682 F.2d at 542. Under the more inclusive "because of" test, the relevant inquiry is whether the document was prepared or obtained "because of" the prospect of litigation. *United States v. Adlman,* 134 F.3d 1194 (2d Cir. 1998). In *Adlman,* after making a detailed analysis of the two tests, the Second Circuit found the "because of" test "more consistent with both the literal terms and the purposes of [Rule 26(b)(3)]" and the Court stated:

> In short, the enforceability of the IRS summons for the Memorandum will turn on whether it (or substantially the same document) would have been prepared irrespective of the anticipated litigation and therefore was not prepared because of it.

Adlman, 134 F.3d at 1198, 1205.

The First Circuit has adopted the "because of" test articulated in *Adlman. Maine v. Dept. of the Interior*, 298 F.3d 60, 68 (1st Cir. 2002).

Textron asserts that its tax accrual workpapers were prepared because it anticipated the possibility of litigation with the IRS regarding various items on its return and it points to the hazards of litigation percentages as evidence that the possibility of such litigation was the reason for preparing the workpapers. The IRS asserts that the workpapers were prepared in the ordinary course of business and in order to satisfy the requirements of the securities laws that financial statements filed by publicly traded companies comply with GAAP (which mandate the creation of reserves to meet contingent liabilities). The IRS contends that Textron had to provide its independent auditor with the kind of information contained in the workpapers in order to obtain a "clean" opinion that the reserves satisfy GAAP's requirements.

As the IRS correctly observes, the work product privilege does not apply to "'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'" *Maine,* 298 F.3d at 70 (quoting *Adlman,* 134 F.3d at 1202). However, it is clear that the opinions of Textron's counsel and accountants regarding items that might be challenged by the IRS, their estimated hazards of litigation percentages and their calculation of tax reserve amounts would not have been prepared at all "but for" the fact that Textron anticipated the possibility of litigation with the IRS. If Textron had not anticipated a dispute with the IRS, there would have been no reason for it to establish any reserve or to prepare the workpapers used to calculate the reserve. Thus, while it may be

accurate to say that the workpapers helped Textron determine what amount should be reserved to cover any potential tax liabilities and that the workpapers were useful in obtaining a "clean" opinion from E&Y regarding the adequacy of the reserve amount, there would have been no need to create a reserve in the first place, if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding.

Nor can there be any doubt that Textron's belief in the likelihood of litigation with the IRS was well-founded. As already noted, the matters identified in the workpapers dealt with issues on which the law was unclear. Moreover, in seven of Textron's eight previous audit cycles, "unagreed" issues had been appealed to the IRS Appeals Board, and three of those issues were litigated in federal court.

The IRS relies on *El Paso* for the proposition that tax accrual workpapers are prepared in the ordinary course of business; and, therefore, are not protected by the work product privilege. However, *El Paso* is not persuasive because it applied the "primary purpose" test for determining whether documents are prepared "in anticipation of litigation" and not the "because of" test adopted by the First Circuit.

Moreover, even if the workpapers were needed to satisfy E&Y that Textron's reserves complied with GAAP, that would not alter the fact that the workpapers were prepared "because of" anticipated litigation with the IRS. *See Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, 237 F.R.D. 176 (N.D. Ill. 2006). In *Jaffe Pension Plan*, letters obtained by a corporation's shareholders containing an assessment by the corporation's attorney of pending litigation against the corporation

were held to be protected by the work product privilege even though the securities laws required that the letters be provided to the corporation's independent auditor. As the *Jaffe Pension Plan* court stated:

> Plaintiffs insist that "[t]he documents at issue here were created 'pursuant to public requirements unrelated to litigation,' and in fact, would have been created regardless of the litigation." . . . The court disagrees. In the absence of any pending or threatened litigation, Household's counsel would have had no need to advise [the independent auditor] regarding such non-existent matters. Thus, the Opinion Letters were prepared "because of" pending or threatened litigation and are protected by the work product doctrine.

Jaffe Pension Plan, 237 F.R.D. at 181. *See Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401 (8th Cir. 1987) (holding that individual case litigation reserves prepared by company's attorney were protected opinion work product).

III. Waiver or Loss of Privilege

A. The Attorney-Client and Tax Practitioner-Client Privileges

It is well established that "voluntary disclosure to a third party waives the attorney-client privilege even if the third party agrees not to disclose the communications to anyone else." *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1427 (3d Cir. 1991). That principle has been applied specifically to disclosures made to independent auditors. *First Fed. Sav. Bank of Hegewisch v. United States*, 55 Fed. Cl. 263,

268-69 (Fed. Cl. 2003) (attorney-client privilege was waived when board minutes containing confidential communications between board members and outside counsel were disclosed to outside auditors who were auditing company's financial statements); *Gutter v. E.I. Dupont de Nemours & Co.*, 1998 WL 2017926 *5 (S.D. Fla. 1998) (attorney-client privilege for legal opinion letters and litigation reports to the board of directors was waived when disclosed to independent auditor); *In re Pfizer Inc. Sec. Litig.*, 1993 WL 561125 *7 (S.D.N.Y. 1993) ("Pfizer cannot assert attorney-client privilege for any documents that were provided to its independent auditor. Disclosure of documents to an outside accountant destroys the confidentiality seal required of communications protected by the attorney-client privilege"); *see also Cavallaro*, 284 F.3d at 247-49 (attorney-client privilege was waived when communications were disclosed to outside accountants who were not retained to facilitate legal advice by attorneys).

Since the tax practitioner privilege created by § 7525 mirrors the attorney-client privilege, it, too, may be waived by disclosure to a third party. *See United States v. BDO Seidman*, 337 F.3d 802, 810 (7th Cir. 2003) ("the § 7525 privilege is no broader than that of the attorney-client privilege"); *Doe v. KPMG, LLP*, 325 F. Supp. 2d 746, 752 (N.D. Tex. 2004) (Court must "look to the law of attorney-client privilege to inform its interpretation of the taxpayer-federally authorized tax practitioner privilege.").

Textron argues that providing the tax accrual workpapers to E&Y did not waive the protection of either privilege and it seeks to distinguish the cases holding that disclosure to an outside auditor waives the attorney-client privilege on the ground that those cases were de-

cided prior to the enactment of § 7525. More specifically, Textron argues that, because it occasionally revises its reserves based on the opinions of the independent auditor, the auditor's review of Textron's workpapers should be viewed as performed in connection with providing "tax advice" to Textron and, therefore, it is privileged under § 7525. That argument is creative but not persuasive because it ignores reality to describe an independent auditor responsible for reporting to the investing public whether a company's financial statements fairly and accurately reflect its financial condition, as providing "tax advice" to the company when the auditor seeks to determine the adequacy of amounts reserved by the company for contingent tax liabilities.

In short, any attorney-client privilege or tax practitioner privilege that attached under § 7525 was waived when Textron provided its workpapers to E&Y.

B. The Work Product Privilege

1. Waiver

Since the work product privilege serves a purpose different from the attorney-client or tax practitioner privileges, the kind of conduct that waives the privilege also differs.

The purpose of the attorney-client and tax practitioner privileges is to encourage the full and frank discussion necessary for providing the client with sound advice. That purpose is achieved by guaranteeing that confidential communications between the client and the advisor will remain confidential. Since disclosure to a third party is inconsistent with a claim of confidentiality, such disclosure waives the privilege.

By contrast, the purpose of the work product privilege is to prevent a potential adversary from gaining an

unfair advantage over a party by obtaining documents prepared by the party or its counsel in anticipation of litigation which may reveal the party's strategy or the party's own assessment of the strengths and weaknesses of its case. Accordingly, only disclosures that are inconsistent with keeping the information from an adversary constitute a waiver of the work product privilege. *Gutter,* 1998 WL 2017926 *3 (S.D. Fl. 1998) ("While disclosure to outside auditors may waive the attorney-client privilege, it does not waive the work product privilege"). As the First Circuit stated in *United States v. Massachusetts Institute of Technology,* ("*MIT*"), 129 F.3d 681 (1st Cir. 1997):

> The [attorney-client] privilege . . . is designed to protect confidentiality, so that any disclosure outside the magic circle is inconsistent with the privilege; by contrast, work product protection is provided against "adversaries," so only disclosing material in a way inconsistent with keeping it from an adversary waives work product protection.

129 F.3d at 687 (collecting cases). *See Jaffe Pension Plan,* 237 F.R.D. at 183 ("[T]he work product privilege may be waived by disclosures to third parties 'in a manner which substantially increases the opportunity for potential adversaries to obtain the information.' ") (citation omitted); *In re Raytheon Sec. Litig.,* 218 F.R.D. at 360 (D. Mass. 2003) ("[D]isclosure of a document to third persons does not waive the protection unless it has substantially increased the opportunity for potential adversaries to obtain the information.").

Most courts considering the question have held that disclosure of information to an independent auditor does

not waive the work product privilege because it does not substantially increase the opportunity for potential adversaries to obtain the information. *In re JDS Uniphase Corp. Sec. Litig.,* 2006 WL 2850049 (N.D. Cal. 2006) (work product protection not waived when protected board minutes were disclosed to the independent auditor); *Jaffe Pension Plan,* 237 F.R.D. at 183 (Because an independent auditor does not have an adversarial relationship with the client, "[d]isclosing documents to an auditor does not substantially increase the opportunity for potential adversaries to obtain the information."); *Frank Betz Assocs., Inc. v. Jim Walter Homes Inc.,* 226 F.R.D. 533, 535 (D.S.C. 2005) (disclosure to independent auditor of documents supporting reserve for copyright infringement litigation did not waive work product protection); *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.,* 229 F.R.D. 441 (S.D.N.Y. 2004) (even though an auditor "must maintain an independent role," disclosure to auditor not a waiver of work product privilege because no likelihood that the independent auditors were a conduit to an adversary . . . or that accounting rules would "mandate public disclosure" of the documents); *Gutter,* 1998 WL 2017926 *5, *3 (S.D. Fl. 1998) (work product privilege not waived by disclosure to auditor of letters estimating cost of litigation "since the accountants are not considered a conduit to a potential adversary" and "there is an expectation that confidentiality of such information will be maintained by the recipient."); *In re Pfizer Inc. Sec. Litig.,* 1993 WL 561125 *6 (S.D.N.Y. 2003) (no waiver of work product privilege because auditor "not reasonably viewed as a conduit to a potential adversary.").

In this case, too, the disclosure of Textron's tax accrual workpapers to E&Y did not substantially increase the IRS's opportunity to obtain the information con-

tained in them. Under AICPA Code of Professional Conduct Section 301 *Confidential Client Information*, E&Y had a professional obligation "not [to] disclos[e] any confidential client information without the specific consent of the client." Furthermore, E&Y expressly agreed not to provide the information to any other party, and confirms that it has adhered to its promise. (Weston Aff. ¶ 3; Raymond Aff. ¶ 20.) Even if the AICPA Code coupled with E&Y's promise did not establish an absolute guarantee of confidentiality, they made it very unlikely that E&Y would provide Textron's "tax accrual workpapers" to the IRS and they negate any inference that Textron waived the work product privilege.[4]

The IRS cites *MIT* for the proposition that disclosure to an independent auditor waives work product protection but that reliance is misplaced because *MIT* is factually distinguishable from this case. The documents at issue in *MIT* were minutes of meetings of the MIT Corporation and some of its committees relating to bills submitted by MIT for services rendered pursuant to a contract with the Department of Defense (DOD). The documents were requested by the Defense Contract Audit Agency (DCAA) in order to confirm that the bills were justified and MIT provided the minutes due, in part, to the fact that DCAA "regulations and practices offered MIT some reason to think that indiscriminate disclosure was unlikely." *MIT*, 129 F.3d at 683. The First Circuit assumed, without deciding, that the documents were protected work product, but held that the docu-

[4] The IRS points out that Rule 301 provides that it shall not be construed to relieve an auditor of its obligation to adhere to applicable accounting standards set forth by GAAP or auditing standards set forth by GAAS, but there is no indication that compliance with those standards would have required disclosure in this case.

ments had to be produced in response to an IRS summons because disclosure had been made to the DCAA, "a potential adversary." *Id.* at 687.

The difference between this case and *MIT* is that, in *MIT,* DOD was MIT's potential litigation adversary and DCAA, as DOD's audit agency, had both an obligation to DOD to determine whether the amounts charged by MIT to DOD were correct, and the authority to sue MIT in order to recover any overcharges. By contrast, in this case, E&Y was a truly independent auditor that had no obligation to the IRS to determine whether Textron's tax return was correct and no authority to challenge the return. In this instance, E&Y was seeking, only, to determine whether the reserve established by Textron to cover the corporation's contingent tax liabilities satisfied the requirements of GAAP. Since E&Y was not a potential Textron adversary or acting on behalf of a potential adversary, and, since E&Y agreed to treat the workpapers as confidential, disclosure to E&Y did not substantially increase the likelihood that the workpapers would be disclosed to the IRS or other potential Textron adversaries. *See Merrill Lynch,* 229 F.R.D. at 447 (finding no waiver where company shared internal investigative report of executive's theft with independent auditor, and distinguishing *MIT:* "The First Circuit, for example, found that the DOD's audit agency was an adversary because it could potentially dispute a billing charge and file suit against MIT, not because of its duty to review MIT's accounts."); *see also In re Pfizer Inc. Sec. Litig.,* 1993 WL 561125 *6 (finding Pfizer's disclosure to an independent auditor not a waiver of work product protection because "[Pfizer's independent auditor] is not reasonably viewed as a conduit to a potential adversary.").

2. Overcoming the Privilege

As already noted, the work product doctrine creates only a qualified privilege that may be overcome by a showing of (1) "substantial need" for the protected documents, and (2) an inability to otherwise obtain the information contained therein or its substantial equivalent without "undue hardship." Fed. R. Civ. P. 26(b)(3).

While establishing that protected documents relate to a legitimate IRS investigation may satisfy the "relevancy" requirement of § 7602, it is insufficient to establish the "substantial need" showing necessary to overcome the work product privilege. *See Davis v. Emery Air Freight Corp.*, 212 F.R.D. 432, 436 (D. Me. 2003) ("the fact that the documents sought might be relevant to [plaintiff's] claims is not enough under Rule 26(b)(3)."). That is especially true in the case of opinion work product, which consists of the "mental impressions, conclusions, opinions or legal theories" of attorneys, where the party seeking the materials must meet a heightened burden. *See Upjohn*, 449 U.S. at 401-2 ("a far stronger showing of necessity and unavailability by other means . . . would be necessary to compel disclosure" of attorneys' notes and memoranda regarding oral statements of witnesses which "reveal the attorneys' mental processes in evaluating the communications"); *see also* Fed. R. Civ. P. 26(b)(3) ("In ordering discovery . . . the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.").

Here, the IRS has failed to carry the burden of demonstrating a "substantial need" for ordinary work product, let alone the heightened burden applicable to Textron's tax accrual workpapers, which constitute opi-

nion work product. While the opinions and conclusions of Textron's counsel and tax advisers might provide the IRS with insight into Textron's negotiating position and/or litigation strategy, they have little bearing on the determination of Textron's tax liability.[5] The determination of any tax owed by Textron must be based on *factual* information, none of which is contained in the workpapers and all of which is readily available to the IRS through the issuance of IDRs and by other means. The opinions of Textron's counsel, either favorable or unfavorable, would have little to do with that determination, and forced disclosure of those opinions would put Textron at an unfair disadvantage in any dispute that might arise with the IRS, just as requiring the IRS to disclose the opinions of its counsel regarding areas of uncertainty in the law or the likely outcome of any litigation with Textron would place the IRS at an unfair disadvantage. *See e.g. Delaney, Migdail & Young, Chartered v. IRS,* 826 F.2d 124, 127 (D.C. Cir. 1987) (upholding IRS assertion of work product privilege over "IRS memos advis[ing] the agency of the types of legal challenges likely to be mounted against a proposed program, potential defenses available to the agency, and the likely outcome.").

Conclusion

For all of the foregoing reasons, the government's petition to enforce the summons is denied.

It is so Ordered.

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[5] At the evidentiary hearing, the IRS argued that it is entitled to the tax accrual workpapers because the hazards of litigation percentages would assist in determining whether Textron owes a penalty for underpayment of taxes. Since the IRS has not even asserted that Textron owes any further tax, this argument is premature, at best.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 07-2631

UNITED STATES OF AMERICA, Petitioner,
Appellant,

v.

TEXTRON INC. AND SUBSIDIARIES, Respondent,
Appellant

Sept. 16, 2009

Before: LYNCH, Chief Judge, TORRUELLA, BOUDIN, LIPEZ and HOWARD, Circuit Judges.

Textron, Inc. and Subsidiaries have filed a petition to stay mandate pending the timely filing and resolution of a petition for *certiorari*. Such petitions are not granted as a matter of course but require a judgment about likelihood of a grant and a showing of "good cause."

Textron suggests that the likelihood of a grant of *certiorari* is high and that irreparable injury will result in its absence. The likelihood of *certiorari* is difficult to predict: although the case is certainly important to the IRS and companies that file audited financial statements and are thereafter engaged in tax controversies, the rul-

ing in favor of the IRS is limited to materials prepared in the ordinary course of business and disclosed to auditors, since undisclosed materials generated by lawyers within the corporation are normally protected by the attorney client privilege regardless of whether prepared in anticipation of litigation. Nevertheless, the work product privilege finds its origins in a Supreme Court decision that has not often been revisited by the Court and there is some difference in the interpretations adopted in different circuits even though the two that have addressed tax audit work papers both favor the IRS. Since *certiorari* is at least a possibility and in the present circumstances disclosure pendente lite could deprive Textron of the most effective protection as to the documents at issue, we grant the stay on the customary terms.

On motion of appellee Textron Inc. and Subsidiaries for an order staying mandate, the issuance of the mandate is hereby stayed pending the filing of a timely petition for *certiorari* and, if a timely petition for *certiorari* is filed within 90 days of the date of this order, pending a resolution of the petition by the Supreme Court. If the petition for *certiorari* is denied, the mandate shall issue forthwith. If the petition is granted, the stay of mandate shall continue until disposition of the case by the Supreme Court. Counsel for appellee Textron Inc. and Subsidiaries is directed to promptly notify the Clerk of this court both of the filing of any such petition for *certiorari* and its disposition.

It is so ordered.

By the Court:

/s/ Richard Cushing Donovan, Clerk

APPENDIX E