Blurred Vision: Courts, Corporations Don't See Eye to Eye on Attorney Work Product Protection

Do you think you know protected work product when you see it? The First Circuit Court of Appeals says it does. In a recent novel interpretation of attorney work product, the First Circuit enunciates a new view of the time-honored doctrine, which could signal big headaches ahead for corporations in the tax arena and beyond.

First Circuit Creates "For Use" Test

In *United States v. Textron, Inc*., 1st Cir. (*en banc*), No. 07-2631 8/13/09, the Court of Appeals held that the tax accrual work papers prepared by lawyers and others were not protected by the attorney work product doctrine. Textron, known for making Cessna planes and Bell Helicopters, is a publically-traded company and is required to have financial statements certified by an independent auditor. In the financial statements, Textron calculates reserves for contingent tax liabilities including estimates of potential liability if the IRS challenges the company's tax return. The final spreadsheets list each debatable item including the dollar amount subject to possible dispute and a percentage estimate of the IRS' chances of success. These calculations are also supported by backup e-mails and notes. The IRS audited Textron's returns for the years 1998–2001 and questioned nine 2001 transactions. The IRS issued an administrative summons demanding the tax accrual work papers. Textron refused to turn the papers over to the IRS, arguing that the work papers were protected by the work product doctrine because they were prepared in anticipation of litigation, such as a potential tax dispute with the IRS.

In August 2007, the U.S. District Court for the District of Rhode Island refused to enforce the summons on the basis that the work papers were protected work product. In January 2009, a panel for the First Circuit affirmed. The panel rejected the government's argument that "the mere presence of a business or regulatory purpose defeats work product protection." The panel observed that the papers were created for the dual purpose of preparing financial statements to obtain a clean audit and for estimating the likelihood of success in litigation and set reserves to cover tax positions for which Textron could foresee disputes with the IRS. As such, the panel held the papers were protected work product.

The IRS petitioned for an *en banc* rehearing. The case was argued in early June and the First Circuit issued its decision on August 13, 2009.

In a deeply divided 3-2 decision, the First Circuit held that the workpapers were not protected by the work product doctrine. "We now conclude ... that the Textron work papers were independently required by statutory and audit requirements and that the work product privilege does not apply." In justifying its decision, the First Circuit declared that work product protection is focused on materials prepared *for use* in actual or anticipated litigation. "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." The Court addressed the disparity in its novel "for use" test with the phrase in Rule 26 (b)(3) of the Federal Rules of Civil Procedure — "prepared in anticipation of litigation or for trial" and reconciled that the phrase meant that the work might be *used for* litigation but done *in advance* of its institution.

Employing a "you know it when you see it" approach, the Court chided "[a]ny experienced litigator would describe the tax accrual work papers as tax documents and not as case preparation materials." [E]very lawyer who tries cases knows the touch and feel of materials prepared for a current or possible lawsuit ... [n]o one with experience of lawsuits would talk about tax accrual work papers in those terms." In Textron's case, the Court found "the only purpose of Textron's papers was to prepare financial statements." "There is no evidence in this case that the work papers ... would ... serve any useful purpose for Textron in conducting litigation if it arose."

Dissent Warns Decision Reaches Beyond Tax Papers

An impassioned dissent warned that the ramifications of the majority's decision reached "beyond this case and beyond the case of tax accrual work papers in general." In fact, legal advice used to make business decisions about any potential liability that might be litigated could be discoverable under the *Textron* ruling. For example, the dissent explained "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 ...." The dissent continued, "these percentages contain counsel's ultimate impression of the value of the case ... [r]evealing such impression would have clear free-riding consequences."

The dissent forewarned that under the majority's interpretation "there would be no protection for documents analyzing anticipated litigation, but prepared to assist in a business decision rather than to assist in the conduct of the litigation .... Nearly every major business decision by a public company has a legal dimension that will require such analysis. Corporate attorneys preparing such analysis should now be aware that their work product is not protected in this circuit."

There is a Split of Authority

The *Textron* decision is a departure from the Second Circuit's decision in *U.S. v. Adlman* 134 F.3d 1194 (2nd Cir. 1998), where the taxpayers claim of work product protection was upheld. In *Adlman* the Court held that Rule 26(b)(3) does not limit its protection "to materials prepared to assist at trial .... Nothing in the Rule states or suggests that documents prepared 'in anticipation' of litigation with the purpose of assisting the making of a business decision do not fall within its scope." In other words, in *Adlman*, a document does not lose work product protection merely because it is intended to assist in the making of a business decision as well as analyze the likely outcome of anticipated litigation. Nor must the litigant prove that the document was prepared primarily or exclusively for use at trial. The *Adlman* Court explained it believed the drafters of the Rule had a broader intent when articulating the words "prepared *in anticipation* of litigation or for trial." As noted by the dissent in *Textron*, there is now a decided split in the Circuits.

Calling for ultimate resolution, the Textron dissent concluded, "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." Legal analysts believe there is a strong likelihood the Court will take the case, considering the split in the Circuits and the implications for a litigant's ability to obtain his adversary's litigation assessments and financial reserves. The *Textron* decision makes it unclear what documents attorneys can or should create in the non-tax civil litigation arena.

The First Circuit has issued a stay of its mandate while Textron petitions for writ of *certiorari* to the Supreme Court. Textron's cert petition is due to be filed November 12, 2009.

Companies Must Proceed Cautiously

In the meantime, prudent litigators should take care in these very uncertain times. It is not uncommon for litigation assessments to include a detailed discussion of the company's facts and legal arguments in favor of or against a certain position. In addition, legal advice regarding how the litigation might be resolved and the attendant financial risks are also commonly discussed in internal documents, and often shared with decision-makers beyond the legal department. Until *Textron*, most attorneys likely assumed that these candid risk assessments were protected work product, employing a "know it when you see it" approach. Now, however, the *Textron* decision has "thrown the law of work-product protection into disarray." Unless the Supreme Court elects to resolve this important issue, the internal documents businesses have long believed were protected are at greater risk for exposure.

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