

Client Advisory | August 2009

En Banc First Circuit Decision Erodes Scope of the Work Product Doctrine

A recent First Circuit decision significantly narrows the scope of the attorney work product doctrine and raises concerns that legal analysis conducted by corporate attorneys is not necessarily protected from discovery. In *United States v. Textron Inc.*, the First Circuit held that Textron's tax accrual work papers were not protected by the work product doctrine because the work papers were mandated by statutory and audit requirements and therefore not prepared in anticipation of litigation. No. 07-2631 (1st Cir. Aug. 13, 2009) (*en banc*). The First Circuit's controversial decision applies to more than the preparation of tax accrual work papers, however, and removes much of the protection previously afforded by the work product doctrine.



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The *Textron* Facts

Tax accrual work papers provide support for the amount of a corporate taxpayer's tax reserves, which must be included on a corporation's financial statements. Typically, work papers describe a company's potential liability for additional taxes if the IRS successfully challenges the company's position on a return. Textron's work papers went beyond identifying the numbers used to determine its tax reserve, however. Textron's tax department, in-house attorneys, and outside counsel drafted spreadsheets that identified each debatable item, the amount subject to possible dispute, and a percentage estimate of Textron's chance of success if the IRS challenged the debatable item. Textron also kept backup e-mails and memoranda drafted by its attorneys regarding which items should be included on the spreadsheet and why.

In connection with its 2003 tax audit of Textron, the IRS issued a summons to Textron requesting its tax accrual work papers. Textron challenged the summons on several grounds, including that its work papers were protected by the attorney work product doctrine. Textron argued that it would not have created the documents but for the fact

that it anticipated litigation over items in its work papers. Moreover, Textron asserted that its in-house attorneys were "centrally involved" in preparing the work papers and that the spreadsheets contained legal analysis and opinion regarding Textron's tax reserve requirements.

The District Court Held that the Work Papers are Protected Work Product

In August 2007, the U.S. District Court for the District of Rhode Island denied the IRS' petition for enforcement of the summons and held that the work papers were protected by the work product doctrine. The district court found that Textron created the documents in anticipation of litigation and for a business purpose, but that Textron's "ultimate purpose" behind preparing the documents was its anticipation of future disputes with the IRS. The Court concluded that the work papers would not exist but for Textron's anticipation of litigation and classified the work papers as protected work product.

After a divided three-judge panel of the First Circuit upheld the district court's decision, the First Circuit granted the government's motion for rehearing *en banc*.

The *En Banc* Majority Reversed the Ruling of the District Court

In a 3-2 decision issued on August 13, 2009, the First Circuit reversed the district court's decision and held that Textron's tax accrual work papers were not protected work product because they were created to satisfy audit and statutory requirements. In support of its holding, the First Circuit reaffirmed the work product test set forth in its precedent, 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. U.S. Dep't of Interior*, 298 F.3d 60, 68 (1st Cir. 2002) (citation omitted).

Although the First Circuit affirmed the "because of" work product standard, it restated the test so that work product is limited only to documents that "were prepared for use in possible litigation." The First Circuit advised that the work product doctrine cannot be invoked simply because the subject matter of a document may be litigated in the future. More importantly, a corporation cannot shield documents prepared by an attorney or documents that reflect "legal thinking" if the documents were prepared in "the ordinary course of business, or pursuant to public requirements unrelated to litigation."

Pursuant to its narrow interpretation of work product, the First Circuit concluded that Textron's work papers were prepared in the ordinary course of business because financial reporting requirements mandated support for the tax reserve listed in Textron's financial statement. The majority dismissed Textron's claim that the documents were prepared in anticipation of litigation and claimed that "[a]ny experienced litigator would describe the tax accrual work papers as tax documents and not as case preparation materials." Interestingly, the First Circuit did not refer to the district court's factual finding that the documents had a dual purpose; instead, the First Circuit stated that the "only purpose" of the work papers was to assist Textron in obtaining audited financial statements. The Court emphasized that the work product doctrine "is not a privilege designed to help the lawyer prepare corporate documents or other materials prepared in the ordinary course

of business." Accordingly, Textron's tax accrual papers were not protected work product.

The First Circuit further justified its decision by stressing the importance of tax collection by the government. The Court stated that tax collection "is not a game" and that the "practical problems confronting the IRS in discovering under-reporting of corporate taxes, which is likely endemic, are serious." The Court noted that the IRS sought Textron's work papers only after finding questionable transactions in its financial statements. Thus, the First Circuit based its holding on two grounds: the work product privilege protects only work done for litigation, and IRS access to the work papers serves the "legitimate, and important, function of detecting and disallowing abusive tax shelters."

The Dissent Argued that the Majority Rejected Precedent and Adopted a Rule with Wide-Ranging and Detrimental Implications for Corporations

The dissent sharply criticized the First Circuit's ruling, as well as the reasoning applied to reach its ruling. The dissent accused the majority of tailoring its decision to obtain a favorable ruling for the IRS. It argued that the majority adopted a narrow definition of work product that only includes documents "prepared for use in possible litigation" and abandoned a "tome of precedent" in doing so. The dissent asserted that the majority's new rule also ignores the underlying purposes of the work product doctrine.

The dissent first questioned the First Circuit's ruling regarding the scope and applicability of the work product doctrine in light of its own precedent. The dissent cited to the Second Circuit's decision in *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998), which the First Circuit expressly adopted in *Maine*. In *Adlman*, the Second Circuit considered the application of the work product doctrine to documents prepared with the dual purpose of anticipating litigation and making a business decision. The Second Circuit concluded that a document created because of anticipated litigation does not forfeit work product protection simply because it is also intended to assist a company in making a business decision. Therefore, *Adlman* refused to limit the work

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product doctrine to documents prepared “for use” in litigation. The majority’s decision to adopt such a standard creates a circuit split that should be resolved by the Supreme Court, suggested the dissent.

Under the proper work product test, the dissent agreed with the district court and found that Textron’s work papers constitute work product. The dissent discussed the district court’s findings of fact, which concluded that the documents would not exist but for Textron’s need to anticipate litigation with the IRS. The dissent emphasized that Textron would not have created the documents in the same form and substance if it had not anticipated litigation. The dissent highlighted the majority’s disregard for the district court’s factual findings, which also makes the ruling ripe for appeal.

Most importantly, the dissent criticized the First Circuit’s ruling because it ignores the principles underlying the work product doctrine, as well as established precedent. Pursuant to the First Circuit’s ruling, the dissent contended that a civil litigant could discover an opposing party’s litigation

strategy and analysis of the risks of the potential litigation, including the amount of money set aside in a litigation fund; even the IRS conceded this possible result at oral argument. The dissent cautioned that the First Circuit’s ruling will impact the quality of legal advice provided to corporations in a variety of contexts, as well as the form and detail of company documents used to provide evidentiary support for tax reserves. The dissent warned that attorneys preparing documents analyzing anticipated litigation that assist in a business decision “should now be aware that their work product is not protected in this circuit.”

The First Circuit’s Decision May Be Reviewed by the Supreme Court

Given the far reaching implications of the First Circuit’s decision, as well as the split with the Second Circuit, the Supreme Court may grant a petition for *certiorari*. Indeed, the dissent encourages 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.”

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