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Textron Loses Work Product Case in 3-2 *En Banc* Decision

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In a 3-2 *en banc* decision issued August 13, the First Circuit rejected Textron Inc.'s argument that its internal tax accrual workpapers were protected by the work product doctrine. The decision is unremarkable on one level, given the relative simplicity of the majority analysis, and quite remarkable in other ways, given (i) the majority's avoidance of any discussion of leading circuit court opinions and its embrace of what is known as the dual purpose doctrine and (ii) the extensive 26-page dissent which describes the majority decision as misleading and corruptive of proper appellate jurisprudence. The dissent's forceful critique considered together with a continuing circuit split on the correct interpretation of the work product rule could provide a sufficient basis for review by the Supreme Court.

We have previously described the facts of this case in our earlier updates. *See* http://www.mofo.com/news/updates/files/15174.html and http://www.mofo.com/news/updates/files/12716.html. As a high-level summary, Textron created internal risk analyses regarding each position on its tax return for the 2001 tax year. These tax accrual workpapers were prepared by in-house counsel or in-house accountants under the supervision of in-house counsel. Accompanying the risk analyses were estimates of the litigation risks on each arguable position and a statement regarding reserves for the position. The IRS sought all of Textron's workpapers under its modified policy regarding requests for all tax accrual workpapers from taxpayers in audit when the taxpayers have engaged in certain transactions. The district court found that the workpapers were protected work product. On appeal in a 2-1 decision, the First Circuit affirmed the district court but remanded on the question of whether there was a waiver of work product. Textron thereafter sought a rehearing on the question of waiver, while the Government sought a rehearing *en banc*. The First Circuit vacated its earlier decision,

solicited supplemental briefing and held oral argument on June 2.

The First Circuit's decision boils down to the following syllogism: (i) Textron's workpapers were created in order to obtain a clean financial statement from its outside auditors; (ii) documents that are created for non-litigation, regulatory or business purposes are not protected work product; and (iii) therefore, Textron's workpapers are not protected work product. This is the basic approach argued by the Government. Regarding the first premise, the majority was on sound footing because both parties agreed that Textron created the internal workpapers to assist with its financial audit. However, the majority did not agree with Textron that an additional purpose, that of evaluating litigation risk, was also involved in the creation of the workpapers. The second premise is hardly disputable so long as there is, again, no litigation-related purpose which informed the creation of the document. And the conclusion of course is only as good as the two supporting premises. The majority reached its conclusion by determining that (i) there is no factual support for Textron's claim that it had a litigation-related purpose when it created the workpapers and (ii) that the work product protection applies only to documents created for "use" in litigation.

1. The Majority Rejected Textron's Factual Claims that its Workpapers Served Litigation Purposes

In formulating its core argument, the majority discounted evidence that Textron was, in fact, motivated in part by litigation concerns when it created its internal risk analyses. The majority summed up its dim view of the testimonial evidence in a footnote:

> 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.

Slip op. at 16-17, n. 5. This critique of the evidence is illustrative of the majority's implicit rejection of what is known as the "dual-purpose" interpretation of work product. Under that interpretation, a document created for non-litigation and litigation-related purposes can still be protected as work product by virtue of the litigation-related aspect of the document. *See*, *e.g.*,*United States v. Roxworthy*,457 F.3d 590 (6th Cir. 2006) (acknowledging that accountant's tax analysis memo had both a business, *i.e.*, penalty protection, purpose and litigation-related purpose). Mr. Richter's two statements are not only reconcilable, they fit within the framework of this widely accepted interpretation of work product. Moreover, though Mr. Richter's first statement may not have appeared in his affidavit, it was submitted under oath during the evidentiary hearing held by the district court. The majority gave no explanation as to why a statement under oath at a hearing should be treated any differently than the testimony contained in an affidavit. The majority's unstated view must be that the testimony given by Mr. Richter during the hearing was not credible, although the appeals court was not in a position itself to judge the credibility of the witness. And what does this suggest for future litigation on this issue, even in the First Circuit? If an affidavit clearly asserts that workpapers are used in evaluating a potential litigation position apart from any GAAP requirement, does that mean the taxpayer proffering such an affidavit would win?

The dissent raises a wholly separate but supportive critique of the majority opinion on this point. In short, it argues that there is no GAAP requirement that a public company must create internal risk analyses such as Textron's workpapers: "The law only requires that Textron prepare audited financial statements reporting total reserves based on contingent tax liabilities. Accounting standards require some evidential support . . . but do not explicitly require the form and detail of [Textron's workpapers]." Slip op. at 37. Thus, the particular form of Textron's workpapers suggests that Textron's factual claim regarding the use of workpapers for litigation purposes and not merely to satisfy GAAP requirements is correct.

The majority also apparently treated as irrelevant the fact that no workpapers would have been created with respect to a tax return position unless Textron believed there was a litigation risk with respect to that position. Both the district court and the original reviewing panel found this to be a crucial fact and concluded that this showed that the workpapers were in fact quintessential work product. Though the district court and the panel did not attempt to explain which came first (GAAP reporting requirements or potential litigation) as a cause in the creation of the workpapers, both courts acknowledged that the litigation risk which existed with respect to each arguable position was a factor in the creation of the workpapers in the first instance. Thus, by what appears to be more judicial fiat than thorough consideration, the majority was able to reject any factual basis for the claim that Textron's workpapers were created in part with litigation purposes in mind.

2. The Court Suggests a New "Anticipation of Litigation" Standard

Work product as codified in Rule 26(b)(3) of the Federal Rules of Civil Procedure applies to documents "prepared in anticipation of litigation or for trial." Courts which address the question of whether work product applies to documents which are not clearly trial materials routinely consider whether to adopt the majority "because of" test or the minority view's "primary motivating purpose" test of work product. *See*, *e.g.*, *United States v. Roxworthy*, 457 F.3d 590 (6th Cir. 2006); *Regions Financial Corp. v. United States*, 101 AFTR 2d 2008-2179 (D. Ala. 2008). The minority view, perennially advocated by the IRS, is that the primary motivating purpose for the creation of the document must be to assist in pending or impending litigation. *See United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982). The majority view is that the document must be created because of the prospect of litigation. *See United States v. Adlman*, 134 F.3d 1194 (1998). The majority view thus extends the protection of work product to documents that have been created earlier in time than actual commencement or threat of litigation and to documents that may have a dual purpose in their creation. In *Roxworthy*, for example, the Sixth Circuit recognized work product protection for a tax opinion from an outside accounting firm even though the document may have served both a litigation preparation and penalty protection purpose. The First Circuit, in *Maine v. United States Dep't of the Interior*, in fact embraced the majority view:

> 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)).

Slip op. at 26 (dissent). Instead of discussing these two conflicting views, the First Circuit here fashioned an interpretation of the rule which, while using somewhat different

language from the minority view and claiming support from *Maine*, seems to have the same practical effect as the minority view. Under the court's approach, documents which are not prepared for pending or impending litigation or trial are not protected work product:

> 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 . . . ."

Slip op. at 18. The majority elaborated its view by appealing to a trial lawyer's sensibilities: "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." Slip op. at 20. Using this standard, the majority decides that trial lawyers would not describe tax accrual workpapers as protected work product. *Id. See also* slip op. at 17: "Any experienced litigator would describe the tax accrual work papers as tax documents and not as *case preparation materials*." (Emphasis added). The majority's resort to what are plainly litigation or trial-oriented materials reveals that its approach, though nominally following the analysis in *Maine*, is in fact much closer to the minority view noted above.

There is a possible narrow reading of the majority opinion. Given that the majority claimed it was following *Maine*, its holding might be interpreted as consistent with that decision inasmuch as it decided that Textron's workpapers were not created "because of" litigation, either actual or potential. In other words, the majority concluded that the *sole* purpose for the creation of Textron's workpapers was not litigation-related, and therefore, the workpapers could not meet the *Maine* test.

3. IRS Need for Information is Irrelevant to Work Product Determination

The minority criticized the majority opinion for its apparent concern regarding the IRS's need to obtain information about complex income tax returns: "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." Slip op. at 35. The majority cites the Government's need to collect revenue, to identify "improper deductions," and to "uncover the truth," and notes the serious problems of the IRS in determining underreporting with regard to a 4,000 page return. However, these concerns are irrelevant to the question of whether a document is work product in the first instance. That question depends upon whether a document has been prepared in anticipation of litigation, not whether the party seeking the information has a substantial need for the information. Indeed, when it comes to risk analysis of the sort contained in Textron's workpapers, this is the precisely the sort of information that the work product was created to protect. Rule 26(b)(3) provides for circumstances in which the party seeking discovery can obtain work product upon a showing of substantial need. Most courts have held that for opinion work product that showing can almost never be made because such work product has near absolute immunity. Textron's work papers contain classic opinion work product.

4. State Tax Considerations

This decision by the First Circuit may also have implications for the litigation of state and local tax disputes, where state departments of revenue, like the IRS, have been seeking

to discover tax accrual workpapers and other documents as to which taxpayers have claimed attorney-client and work product privilege. For example, in March of this year, the Massachusetts Supreme Judicial Court upheld the application of the work product doctrine to protect memoranda prepared by an accounting firm, at the request of in-house counsel, in planning for a transaction. *Commissioner of Revenue v. Comcast Corp.*, 901 N.E.2d 1185 (Mass. 2009). *See* http://www.mofo.com/news/updates/files/15322.html. The Court in *Comcast* applied the majority test discussed above, finding that the documents were prepared because of the "prospect of litigation," would not have been prepared but for that prospect, and were protected under the dual purpose rule even though they may have prepared in part to assist in a business decision. The state court cited, among other cases, the decision in *Textron* that has now been reversed by the *en banc* panel. Nonetheless, the rule in Massachusetts state courts, at least, would still be that announced by the Supreme Judicial Court in *Comcast*, and would still provide protection to documents that have been created with a dual purpose. That same rule applies in many other federal circuits, and similarly broad protection is often provided by state rules of evidence. Therefore, in state and local tax disputes, as in many other federal circuits, the work product doctrine may still protect documents that have been prepared, at least in part, in anticipation of litigation.
