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## *United States v. Textron, Inc.:* The First Circuit *En Banc* Eviscerates the Work Product Doctrine and Creates a New “Prepared For” Test

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The Court of Appeals for the First Circuit on rehearing *en banc* has held, in a 3-2 decision, that tax accrual workpapers prepared by Textron, Inc. (Textron) are not protected by the work product privilege.<sup>2</sup> This decision reverses the district court’s decision finding the workpapers were privileged because they were prepared in anticipation of litigation.<sup>3</sup> As a result of this decision, “the majority has thrown the law of work product protection into disarray.”<sup>4</sup>

### Background

In June 2005, the Internal Revenue Service (IRS) issued a summons to Textron seeking its tax accrual workpapers for 2001. Textron refused to produce these workpapers, asserting that they were privileged and that the IRS issued the summons for an improper purpose. The government then sought to enforce its summons in the United States District Court for the District of Rhode Island. The district court held that the work product privilege protected Textron’s workpapers because they were prepared in anticipation of possible litigation on an unsettled area of the law. The court therefore denied the government’s petition to enforce the IRS summons seeking Textron’s workpapers.<sup>5</sup>

In January 2009, the Court of Appeals for the First Circuit, in a 2-1 panel, affirmed in part, vacated in part, and remanded, holding that: (1) Textron’s tax accrual workpapers were protected from an IRS administrative subpoena by the work product doctrine; (2) Textron did not waive its work product protection by showing its tax accrual workpapers to its independent auditor, even though the court remanded the question of whether disclosure of Ernst & Young’s (E&Y)

workpapers would reveal the information contained in Textron’s own workpapers; and (3) the district court should assess on remand the discoverability of E&Y’s workpapers by determining whether Textron had the legal right or ability to obtain these documents.<sup>6</sup>

In dissent, Judge Boudin (who wrote for the majority in the *en banc* decision) argued that precedent established that tax accrual workpapers are not protected because they are prepared for reasons independent of the need to prepare for or conduct litigation. In Judge Boudin’s view, the subject matter should not control; instead, whether the documents at issue were prepared in the ordinary course of business or were otherwise independently required should determine whether such documents receive work product protection. In this case, he noted, the tax accrual workpapers were mandated by accounting requirements.

Subsequent to the January decision, both Textron and the government petitioned the court to rehear the case *en banc*. In requesting the court to rehear the case, Textron asserted that the court’s decision could result in a waiver of the work product doctrine if (a) E&Y incorporated Textron’s work product into its workpapers and (b) E&Y’s workpapers could be subpoenaed by the government from either Textron or E&Y.

The government requested *en banc* review because, agreeing with Judge Boudin, it viewed the panel decision as conflicting with prior First Circuit precedent, *Maine v. Dep’t of Interior*,<sup>7</sup> which held that documents generated in the ordinary course of business, or that would have been generated irrespective of litigation, are not protected work product. In addition, the government argued that *United States v. El Paso Co.*,<sup>8</sup> which held that a taxpayer’s tax-accrual workpapers were not work product because they are “compelled by the securities laws,” created a conflict with the Fifth Circuit (where tax accrual workpapers are not work product) and supported a rehearing.

On March 24, 2009, the First Circuit denied Textron’s petition for rehearing, but on the following day granted the

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government's petition, agreeing to hear the *Textron* work product privilege ruling *en banc*.<sup>9</sup> The court thus withdrew the panel opinion and the dissent, and vacated the judgment entered on January 21, 2009.

### **The *En Banc* Decision**

The question for the *en banc* court on rehearing was whether the attorney work product doctrine protects tax accrual workpapers prepared by *Textron*'s lawyers to support the company's determination of its tax reserves for financial statement purposes.<sup>10</sup> In a 3-2 decision, the court held that because statutory and audit rules independently required *Textron* to prepare its workpapers, work product protection is not available.<sup>11</sup> The majority concluded that "the work product privilege is aimed at protecting work done for litigation, not in preparing financial statements. *Textron*'s workpapers were prepared to support financial filings and gain auditor approval. . ."<sup>12</sup>

In reaching its conclusion, the court found that *Textron*'s workpapers were "one step in a process whose outcome is a certified financial statement for the company."<sup>13</sup> The court noted that both parties had agreed that the immediate purpose of the workpapers was to establish and support *Textron*'s tax reserves.<sup>14</sup> At the same time, however, the court quoted the district court's factual findings that *Textron*'s counsel had also prepared the workpapers to analyze "items that might be challenged by the IRS [and] their estimated hazards of litigation percentages" and that this analysis "would not have been prepared at all "but for" the fact that *Textron* anticipated the possibility of litigation with the IRS."<sup>15</sup> The *en banc* court therefore noted that, based on these facts, the district court had concluded that the workpapers were prepared "because of" the prospect of litigation.<sup>16</sup>

Despite the district court's factual findings, the majority of the First Circuit opined that "how far work product protection extends turns on a balancing of policy concerns"<sup>17</sup> and there is no precedent for the present case "in which a document is not in any way prepared "for" litigation but relates to a subject that might or might not occasion litigation."<sup>18</sup> The majority then fashioned a new test for determining if documents are entitled to work product protection by requiring an inquiry into whether the documents were "prepared for" use in possible litigation.<sup>19</sup> According to the court, work product protection only applies to documents "prepared for" litigation or trial, but does not apply to the subject matter of a document "that might conceivably be litigated."<sup>20</sup> In applying this new test, it is not "enough that the materials were prepared by lawyers or represent legal thinking . . . It is only work done in anticipation of or for trial that is protected."<sup>21</sup>

Applying this "prepared for" test to the facts of the present case, the *en banc* court found that no evidence existed that *Textron*'s workpapers were prepared for use in litigation "or would in fact serve any useful purpose for *Textron* in conducting litigation if it arose."<sup>22</sup> Accordingly, the court held

that *Textron*'s workpapers were not entitled to protection under the work product doctrine. Furthermore, the court observed that, from a policy perspective, "IRS access [to the workpapers] serves the legitimate, and important, function of detecting and disallowing abusive tax shelters."<sup>23</sup>

In a strongly worded dissent, Judge Torruella (who wrote the majority opinion in the panel decision), joined by Judge Lipez, argued that this narrower "prepared for" test "ignores a tome of precedents from the circuit courts and contravenes much of the principles underlying the work product doctrine."<sup>24</sup> Furthermore, the dissent concluded that this new rule "is not even a good rule."<sup>25</sup> In addition, the dissent emphasized that the majority's disregard of the district court's factual findings that there were two purposes for the creation of *Textron*'s workpapers is not within the court's proper appellate function.<sup>26</sup> Indeed, the dissent noted that the district court's factual findings about *Textron*'s purpose for creating the workpapers were directly contrary to the majority's bold pronouncement that "the only purpose of *Textron*'s papers was to prepare financial statements."<sup>27</sup> In short, based on the facts and the *Maine* decision, the dissent firmly asserted that "the majority should have concluded that *Textron*'s workpapers are protected by the work product doctrine."<sup>28</sup>

### **Analysis**

In *Maine v. Dep't of Interior*,<sup>29</sup> the First Circuit Court of Appeals articulated the work product test by stating that a document is work product 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."<sup>30</sup> A document would not be work product, however, if it is "prepared in the ordinary course of business or . . . would have been created in essentially similar form irrespective of the litigation,"<sup>31</sup> even if the document "relat[es] . . . to litigation."<sup>32</sup> Thus, prior to its recent *en banc* decision in *Textron*, the First Circuit (like other courts) focused on the document's function, not its subject matter, to determine whether a document is work product. That framework furthered the aim of the work product doctrine, which is "to protect the adversary trial process, not to protect any interest of the attorney."<sup>33</sup>

In *Maine*, the First Circuit was presented with the opportunity to adopt either the "primary purpose" test (approved by the Fifth Circuit in *El Paso*<sup>34</sup>), or the "because of" test (first articulated by the Second Circuit in *United States v. Adlman*<sup>35</sup>) to guide its consideration of whether documents were created in anticipation of litigation.<sup>36</sup> The "primary purpose" test restricts work product protection to those documents that were prepared primarily to assist in litigation.<sup>37</sup> Conversely, the broader "because of" test affords work product protection to documents that were prepared "because of" existing or anticipated litigation.<sup>38</sup> The court adopted the "because of" test and held that "documents should be deemed prepared for litigation 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."<sup>39</sup>

The *Maine* court recognized the need to protect documents that "although prepared because of expected litigation, are intended to inform a business decision influenced by the prospects of the litigation."<sup>40</sup> Furthermore, *Maine* acknowledged that documents can have dual purposes. Although dual-purpose documents can lose work product protection, they do so only if they would have been created in a substantially similar form irrespective of litigation.<sup>41</sup> Therefore, dual-purpose documents—those prepared for both litigation and business purposes—should be protected under the "because of" test. In rejecting the "primary purpose" test, the court recognized that its adoption "would potentially exclude documents containing analysis of expected litigation, if their primary, ultimate, or exclusive purpose is to assist in making the business decision."<sup>42</sup>

In *Textron*, the *en banc* court held that tax-accrual workpapers do not qualify for work product protection under *Maine* because they are mandatory business documents, created annually by public companies to satisfy federal securities law requirements. According to the court, *Textron* had to create its tax accrual workpapers incident to its financial reporting requirements, whether it actually anticipated litigation or not. Furthermore, because *Textron* (like all public companies) must generate tax accrual workpapers—whether or not it anticipates litigation over any specific issue—such workpapers should not qualify for work product protection. Even where tax accrual workpapers analyze hypothetical litigation, the *en banc* court concluded that this does not mean they were generated to assist litigation or otherwise merit work product protection.<sup>43</sup>

As previously noted, both the lower court and a majority of the First Circuit three-judge panel correctly rejected these views and held that the *Textron* workpapers were work product and entitled to protection because they "would not have been prepared at all "but for" the fact that *Textron* anticipated the possibility of litigation with the IRS."<sup>44</sup> As the district court found, *Textron's* workpapers were created because of anticipated litigation with the IRS, even though the documents could also assist with a business purpose, e.g., to justify the reasonableness of an aggregate loss reserve contingency set forth in *Textron's* financial statements. The panel majority saw no reason to part with the district court's findings and likewise concluded that "but for" its anticipation of litigation with the IRS, *Textron* would not have prepared the workpapers.<sup>45</sup> The panel majority also noted that "financial reporting and anticipating litigation—are necessarily intertwined; the function of preparing adequate financial reports inherently requires *Textron* to anticipate and analyze litigation."<sup>46</sup>

Further, despite the *en banc* court's assertion to the contrary, *Textron* was under no legal obligation to prepare

workpapers that reflected the judgments of its attorneys regarding litigation hazards, nor did any law or regulation require *Textron* to calculate or document its loss contingency reserve in any particular manner. The *en banc* court has cited no such legal obligation because there was none. The district court correctly recognized, "while it may be accurate to say that the workpapers helped *Textron* determine what amount should be reserved to cover any potential tax liabilities," there was no legal obligation to create such documents.<sup>47</sup> In fact, the district court found that, in the absence of attorney judgments that uncertain tax positions might come into dispute, there would not have been tax reserves, and therefore no underlying documentation.<sup>48</sup> These findings demonstrate that the *en banc* court's decision is "a dangerous aberration in the law of well-established and important evidentiary doctrine [and] the majority's assertion that it is following *Maine* is clearly erroneous."<sup>49</sup>

### Implications of Decision

The severe restriction on work product protection advanced by the *en banc* court is inconsistent with (1) the holding and the "dual purpose" rationale of *Maine* and (2) the long-recognized policies underlying work product protection.<sup>50</sup> As a result of this decision, taxpayers in the First Circuit should now conclude that corporate lawyers' analyses of their clients' exposures, in litigation with adversaries, must be turned over to adversaries whenever these analyses are for the clients' use in preparing their financial statements and related disclosures. Unlike the *en banc* court, the district court and a panel majority correctly recognized that application of the work product doctrine precluded this result. Now, as a result of the *en banc* court's conclusion that *Textron's* counsel prepared the analysis in the workpapers to assist *Textron* in making its financial statement disclosures, tax accrual workpapers prepared by corporate counsel to assess their clients' potential tax liabilities in challenges by the IRS or state tax authorities, as well as backup materials reflecting counsels' evaluations, are no longer protected under the work product doctrine in the First Circuit.<sup>51</sup>

In this decision, the First Circuit has undermined the financial statement disclosure process, the corporate counsel/client relationship and the policies behind the work product doctrine itself. Corporate lawyers today, more than ever, should be assisting their clients with complex issues that address financial reporting obligations, legal compliance and potential litigation exposure. The work product doctrine exists to provide a zone of privacy around such assistance. The law should support, not penalize, companies that rely on their counsel in such situations.

The court's new "prepared for" test sets a troubling precedent that could hinder in-house counsel from preparing analyses that are of the greatest importance to corporations and their investors.<sup>52</sup> Under this "prepared for" test, every party (not only the IRS or state tax authorities) in commercial litigation whose opponent files GAAP financial statements

that report contingent liabilities for litigation exposure will be able to obtain in discovery the hazards of litigation analysis of its opponent’s lawyers. The First Circuit’s decision has eviscerated the work product protection that exists to protect exactly the type of attorney analysis that was present in this case.

Given the complexity and multi-faceted nature of the challenges facing companies today, those companies must be able to rely upon counsel to evaluate these challenges from all angles—ensuring corporate compliance with the law while considering practical business implications of various courses of action. The ability of attorneys to conduct these evaluations depends upon the certainty that the clients’ adversaries will not have unfettered access to the evaluations. As the Supreme Court stated in *Hickman v. Taylor*, without work product protection, “much of what is now put down in writing would remain unwritten . . . Inefficiency, unfairness and sharp practices would inevitably develop . . .”<sup>53</sup>

In conclusion, the Supreme Court should take this case if presented with the opportunity.<sup>54</sup> The *en banc* court’s decision “has thrown the law of work product protection into disarray.”<sup>55</sup> There is already a split in the circuits between the “primary purpose” and the “because of” tests and the court’s creation of the new “prepared for” test, which is contrary to the holding in *Adlman*, creates a further split. Companies and their corporate counsel must now look to the high court to “intervene and set the circuits straight on this issue which is essential to the daily practice of litigators across the country.”<sup>56</sup>

<sup>1</sup>The author acknowledges and thanks the following Sullivan & Worcester attorneys for their helpful comments: David Nagle, Paul Decker, and Jonathan Dubitzky.

<sup>2</sup>*United States v. Textron*, No. 07-2631 (1st Cir. Aug. 13, 2009) (*en banc*).

<sup>3</sup>*United States v. Textron, Inc.*, 507 F. Supp. 2d 138 (D. R.I. 2007).

<sup>4</sup>*Textron*, slip op. at 53 (Torruella, J., dissenting).

<sup>5</sup>*Textron*, 507 F. Supp. 2d at 155.

<sup>6</sup>*Textron v. United States*, 553 F.3d 87 (1st Cir. 2009) (vacated). For further discussion of the panel decision, see Douglas S. Stransky, “*United States v. Textron, Inc.: A Hollow Taxpayer Victory for Privilege in the First Circuit*,” *Practical U.S./Domestic Tax Strategies* (January 2009).

<sup>7</sup>298 F.3d 60, 70 (1st Cir. 2002).

<sup>8</sup>682 F.2d 530, 543 (5th Cir. 1982).

<sup>9</sup>506 F.3d 513 (1st Cir. 2009). For further discussion of this decision, see Douglas S. Stransky, “*First Circuit Vacates Textron Work-Product Privilege Ruling and Grants Petition for Rehearing En Banc*,” *Practical U.S./Domestic Tax Strategies* (March 2009).

<sup>10</sup>Federal securities law requires Textron to have public financial statements certified by an independent auditor. See, e.g., 15 U.S.C. §§ 781, 78m (2006).

<sup>11</sup>*Textron*, slip op. at 11.

<sup>12</sup>*Id.* at 24.

<sup>13</sup>*Id.* at 4.

<sup>14</sup>*Id.* at 8.

<sup>15</sup>*Id.* at 10 (quoting *Textron*, 507 F. Supp. 2d at 150).

<sup>16</sup>*Id.* at 11 (citation omitted).

<sup>17</sup>*Id.*

<sup>18</sup>*Id.* at 12.

<sup>19</sup>*Id.* at 13, 14.

<sup>20</sup>*Id.* at 19 (citing *Federal Trade Commission v. Grolier, Inc.*, 462 U.S. 19, 25 (1983)).

<sup>21</sup>*Id.* at 20.

<sup>22</sup>*Id.* at 22.

<sup>23</sup>*Id.* at 24.

<sup>24</sup>*Id.* at 26.

<sup>25</sup>*Id.* at 32. In fact, the dissent’s heading for this section is entitled: “The Majority Announces a Bad Rule.” *Id.* at 31.

<sup>26</sup>*Id.* at 42 (citation omitted).

<sup>27</sup>*Id.* (citing *Textron*, slip op. at 20).

<sup>28</sup>*Id.* at 53.

<sup>29</sup>298 F.3d 60 (1st Cir. 2002).

<sup>30</sup>*Id.* at 68 (citing *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998)).

<sup>31</sup>*Id.* at 70 (citing *Adlman*, 134 F.3d at 1202).

<sup>32</sup>*Id.* at 69.

<sup>33</sup>*Coastal Sts. Gas Corp. v. Dep’t of Energy*, 617 F.2d 854, 864 (D.C. Cir. 1980); e.g., *Abel Inv. Co. v. United States*, 53 F.R.D. 485, 488 (D. Neb. 1971) (IRS documents created during an audit were not work product, even though they “contain mental impressions, legal theories, and assessments of the strengths and weaknesses of the government’s case,” because an IRS audit is not litigation).

<sup>34</sup>*United States v. El Paso*, 682 F.2d 530 (5th Cir. 1982). The Fifth Circuit is the only circuit that has adopted the “primary purpose” test.

<sup>35</sup>134 F.3d 1194 (2d Cir. 1998).

<sup>36</sup>*Maine*, 298 F.3d at 68.

<sup>37</sup>*Id.*

<sup>38</sup>*Id.*

<sup>39</sup>*Id.* (quoting *Adlman*, 134 F.3d at 1202).

<sup>40</sup>*Id.* (quoting *Adlman*, 134 F.3d at 1197-98).

<sup>41</sup>*Id.* (citing *Adlman*, 134 F.3d at 1202).

<sup>42</sup>*Id.* (quoting *Adlman*, 134 F.3d at 1197- 98). As the dissent notes, “[i]t is precisely in these “dual purpose” situations that the “because of” test is meant to distinguish itself from the “primary purpose” test. . .” *Textron*, slip op. at 52 (quoting *Maine*, 298 F.3d at 68).

<sup>43</sup>Although the majority purports to be following *Maine* in its holdings, its erroneous characterizations of the facts and the law in this case undermine the Second Circuit’s decision in *Adlman*, which first articulated the “because of” test. Indeed, as Judge Torruella in his dissent noted, “*Adlman’s* articulation of the “because of” test is fatal to the majority’s position [because] *Adlman* makes it explicitly clear that the broader “because of” formulation is not limited to documents prepared for use in litigation.” *Textron*, slip op. at 29, 30.

<sup>44</sup>See, e.g., *Textron*, 507 F. Supp. 2d at 150. This is also the view of the dissent in the *en banc* decision. See, e.g., *Textron*, slip op. at 47 (“[T]he precedents are clear that under the “because of” test, dual

purpose documents are protected.”).

<sup>45</sup>*Textron*, 553 F.3d at 97.

<sup>46</sup>*Id.*

<sup>47</sup>*Textron*, 507 F. Supp. 2d at 150.

<sup>48</sup>*Id.*

<sup>49</sup>*Textron*, slip op. at 53.

<sup>50</sup>The work product doctrine was adopted, in part, to enable attorneys to best serve their clients without fear that their mental processes would be subject to disclosure to their opponent. See *Hickman v. Taylor*, 329 U.S. 495, 511(1947).

<sup>51</sup>*But cf. Comm’r of Revenue v. Comcast Corp.*, 901 N.E.2d 1185 (Mass. 2009) (affirming a finding of work product protection for documents prepared by accountants “because of” litigation, and also to enable the taxpayer to make business decisions about the outcome of that litigation).

<sup>52</sup>In addition, the majority’s opinion is troubling because of its attempt to “hide the ball” in its analysis. As the dissent notes, the *en*

*banc* court had the power to overturn prior First Circuit precedent, “though it would be better if it admitted that it was doing so,” rather than purporting to follow *Maine. Textron*, slip op. at 32.

<sup>53</sup>329 U.S. 495, 511 (1947).

<sup>54</sup>*Textron* has 90 days to petition the Supreme Court to review the *en banc* decision. Whether *Textron* will file such a petition or, if filed, whether the Supreme Court will agree to hear the case is not known at this time.

<sup>55</sup>*Textron*, slip op. at 53.

<sup>56</sup>*Id.* □

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