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U.S. v. Textron Inc. and the Changing Landscape of the Work Product Doctrine

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In the wake of the First Circuit's recent decision in *United States v. Textron Inc.*, 577 F.3d 21 (1st Cir. Aug. 13, 2009) — holding that the work product doctrine does not protect "tax accrual workpapers" from disclosure — corporations and their attorneys may find themselves wondering how this surprising shift in work product jurisprudence will shape the way in which they do business.

The highly anticipated opinion from the *en banc* court appears to abandon the test previously adopted by the First Circuit — and other circuits — for determining what documents constitute work product, *i.e.*, whether the documents were prepared "because of" litigation, and establishes a new test (albeit without expressly characterizing it as such) looking to see whether the documents were prepared "for use" in litigation. The implications of the *Textron* decision will no doubt reach far beyond the jurisdictional borders of the First Circuit and may cause the U.S. Supreme Court to weigh in on the extent to which counsel's candid assessment of litigation risk will be protected from discovery.

The Work Product Doctrine: Pre-Textron

Hickman *and Rule 26(b)(3)*

The work product doctrine derives from the Supreme Court's decision in *Hickman v. Taylor*, 329 U.S. 495 (1947). In *Hickman*, the plaintiff sought production of memoranda memorializing witness interviews the defendant's counsel conducted after having received notice of the potential claims. The defendant refused to produce the memoranda claiming that they constituted "privileged matter obtained in preparation for litigation." The Supreme Court sided with the defendant on the ground that:

> the general policy against invading the privacy of an attorney's course of preparation is so well recognized and so essential to an orderly working of our system of legal procedure that a burden rests on the one who would invade that privacy to establish adequate reasons to justify production through a subpoena or court order.

In 1970, the work product doctrine was codified by Fed. R. Civ. P. 26(b)(3), which prohibits the discovery of materials "prepared in anticipation of litigation or for trial by or for another party or its party's representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent)." Pursuant to this rule,

such materials are discoverable only upon a showing that the party seeking discovery "has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means."

Since the Supreme Court's decision in *Hickman* and the codification of Rule 26(b)(3), courts have continually reaffirmed the work product doctrine and the public policy rationale on which it is grounded. While unified in their support for the doctrine, however, courts have adopted two distinct approaches to its application: the "primary motivating purpose" test, adopted by the Fifth Circuit in *U.S. v. El Paso*, 682 F.2d 530 (5th Cir. 1982), and the "because of" test, articulated by the Second Circuit in *U.S. v. Adlman*, 134 F.3d 1194 (2d Cir. 1998) and adopted by a majority of courts, including the First Circuit in *Maine v. U.S. Dep't of the Interior*, 298 F.3d 60 (1st Cir. 2002).[1]

The "Primary Motivating Purpose Test" v. The "Because Of" Test

In *El Paso*, the IRS brought an action against the defendant to enforce two summonses seeking production of documents in connection with a tax audit. One of the summons sought El Paso's "tax pool analysis," which summarized the impact of potential litigation on the company's tax liability. The Fifth Circuit held that the "tax pool analysis" did not constitute work product because "the work was not primarily motivated to assist in future litigation over the [tax] return." "Litigation need not be imminent," the court explained, "as long as the primary motivating purpose behind the creation of the document was to aid in possible future litigation."

In *Adlman*, like in *El Paso*, the IRS brought an action against the defendant to enforce a subpoena seeking documents in connection with an audit. Among other things, the subpoena sought a study prepared for the defendant's attorney assessing the likely result of expected litigation. Rejecting the "primary motivating purpose" standard articulated in El Paso, the court adopted the "because of" test, which holds that the work product doctrine applies where "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."

Prior to *Textron*, courts analyzing the work product doctrine have applied either the "primary motivating purpose" test or the "because of" test to determine whether a particular document is protected from disclosure. With the First Circuit's decision in *Textron*, a third test — the "for use" test — seems to have emerged, further blurring an already unsettled area of the law.

Textron *Background*

Textron is a major aerospace and defense conglomerate. As a publicly traded company, Textron is required to file audited financial statements. In connection with the preparation of such statements, Textron must calculate reserves to account for contingent tax liabilities, *i.e.*, estimates of potential liability if the IRS decides to challenge questionable positions taken by Textron in its returns. In so doing, Textron

prepares tax accrual workpapers listing each debatable item, including the dollar amount at issue and a percentage estimate of the IRS's chances of success. Only the reserve amount is included in Textron's published financial statements.

In 2003, the IRS conducted an audit of Textron for the period between 1998 and 2001. After reviewing Textron's 2001 tax returns, the IRS issued an administrative summons seeking production of its underlying tax accrual workpapers. Textron declined to turn over the workpapers — primarily prepared by lawyers and others in the company's tax department — on the grounds that, among other things, they constituted protected work product.

The IRS initiated an action in federal district court in Rhode Island to enforce the summons. Following an evidentiary hearing, the district court denied the IRS's petition for enforcement, concluding that the workpapers were prepared "because of" litigation and, therefore, constituted work product. On appeal, a divided panel affirmed the lower court's decision. Thereafter, the *en banc* court granted the IRS's petition for rehearing. On August 13, 2009, in a 3-2 decision, the court held that the work product doctrine did not protect the tax accrual workpapers from disclosure.

Majority Opinion

Framing the issue as whether the work product doctrine applies to "a document [that] is not in any way prepared 'for' litigation but relates to a subject that might or might not occasion litigation," the court concluded that the workpapers were not protected from disclosure. Although the court stated that its conclusion was consistent with the principles established in *Maine* (which adopted the "because of" test), the decision does not appear to apply the "because of" test but instead relies upon a new, unannounced test based on whether the materials were "prepared for use in litigation [and] whether the litigation was underway or merely anticipated." Textron's workpapers, according to the court, were prepared "to fix the amount of the tax reserve on Textron's books and to obtain a clean financial opinion from its auditor" and would not "serve any useful purpose for Textron in conducting litigation if it arose." Accordingly, the court held that they did not constitute work product.

Dissent

In a strongly worded dissent, Judge Juan Torruella stated that under the "because of" test, articulated by the Second Circuit in *AdIman* and adopted by the First Circuit in *Maine*, Textron's workpapers were protected by the work product doctrine since they were created in connection with the calculation of a reserve fund needed in case litigation arose at some later date. Although the creation of the workpapers may have stemmed in part from other business needs, "without the anticipation of litigation, there would be no need to estimate a reserve to fund payment of tax disputes."

In so stating, Judge Torruella attacked the majority for "ignor[ing] a tome of precedents from the circuit courts" and "contraven[ing] much of the principles

underlying the work-product doctrine." Judge Torruella harshly criticized the majority for essentially rejecting the established "because of" test and adopting a new test for determining whether the work product doctrine applies. Characterizing the majority opinion as an effort to "assist the IRS in its quest to compel taxpayers to reveal their own assessments of their tax returns," the dissent termed the majority's "for use" test "blatantly contrary" to earlier precedent and its opinion "simply stunning" in its "suggestion that it is respecting rather than overruling *Maine*."

Judge Torruella expressed deep concern that the majority decision would have broad, negative consequences that would go well beyond the discoverability of tax accrual workpapers. For example, he pointed out that under the court's new rule documents analyzing the prospects and business risks of litigation, traditionally protected by the work product doctrine, would be discoverable. In particular, "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 . . . ." Judge Torruella warned: "Corporate attorneys preparing such analyses should now be aware that their work product is not protected in this circuit."

Appeal

On August 21, 2009, Textron filed a motion with the First Circuit to stay issuance of the Court's mandate pending the filing and resolution of a petition for *certiorari* with the U.S. Supreme Court. On September 16, 2009, the First Circuit granted the motion, recognizing that *certiorari* "is at least a possibility" because, among other things, "there is some difference in the interpretations [of the work product privilege] adopted in different circuits." Because issuance of the First Circuit's mandate has been stayed, for now the "for use" test is not yet the governing standard in the First Circuit.

On December 24, 2009, Textron filed a Petition For A Writ Of Certiorari with the Supreme Court. The petition advances three principal arguments: first, that the First Circuit's decision deepens a longstanding conflict among the circuits as to which test applies when determining whether a document is protected by the work product doctrine; second, that the First Circuit's decision was erroneous because its "for use" test is irreconcilable with Rule 26(b)(3) and the policy rationale underlying the work-product privilege; and, third, that the applicability of the work product doctrine is an issue of the utmost importance that directly impacts the daily practice of law nationwide.

Work Product Doctrine: Post-Textron

Whether the work product doctrine protects a particular document from disclosure is a question trial lawyers and their clients grapple with on a daily basis. With the First Circuit's decision in *Textron*, the answer has become less clear. For example, will *Textron* have a chilling effect on companies asking their attorneys to assess the risk of litigation? Will attorneys be reluctant to offer candid, useful opinions on potential

litigation risk for fear that their advice will have to be turned over to an adversary in discovery?

Recognizing the need for clarity, Judge Torruella urged in his dissent that "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."

Whether the Supreme Court will grant Textron's petition remains to be seen (currently, the response to the petition is due on January 27, 2010). In the meantime, companies should be mindful of Judge Torruella's warning and consider *Textron*'s implications when consulting with their attorneys to prepare analyses of the risks associated with litigation both in the tax context and beyond.

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[1] Other courts that have adopted the "because of" test include: *National Union Fire Ins. Corp. v. Murray Sheet Metal Co., Inc.*, 967 F.2d 980 (4th Cir. 1992); *Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987); *Senate of Puerto Rico v. DOJ*, 823 F.2d 574(D.C. Cir. 1987); *Binks Mfg. Co. v. Nat'l Presto Indus., Inc.*, 709 F.2d 1109 (7th Cir. 1983); *In re Grand Jury Proceedings*, 604 F.2d 798 (3d Cir. 1979).