IN THE

United States Court of Appeals

FOR THE FIRST CIRCUIT

UNITED STATES,

Petitioner-Appellant,

—v.—

TEXTRON INC. AND SUBSIDIARIES,

Respondent-Appellee.

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

BRIEF FOR *AMICI CURIAE* THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND ASSOCIATION OF CORPORATE COUNSEL SUPPORTING TEXTRON INC. AND IN FAVOR OF AFFIRMANCE

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

RULES

TREATISES

OTHER AUTHORITIES

STATEMENT OF IDENTITY

The Chamber of Commerce of the United States of America (the "Chamber") is the nation's largest federation of business companies and associations, with underlying membership of more than 3,000,000 businesses and professional organizations of every size and in every sector and geographic region of the country. A significant number of the Chamber's members conduct business in the First Circuit. An important function of the Chamber is to represent the interests of its members by filing briefs as an *amicus curiae* in cases involving issues of national concern to American business.

The Association of Corporate Counsel ("ACC") is a bar association of over 23,000 in-house counsel worldwide who practice in the legal departments of more than 10,000 corporations (public, private, for- and non-profit). As an *amicus curiae*, ACC offers the Court the perspective of in-house lawyers who provide the majority of corporate legal counseling on a day-to-day basis for their clients; accordingly, the advice of these lawyers is integral to the integrity of corporate financial processes and crucial to their clients' ability to cooperate fully in the audit process (internal controls and external auditing). As ACC is recognized as the standard-bearer for promoting and protecting the ability of lawyers to protect their clients' right to confidential counsel, it is deeply concerned about the precedent at

stake in this case, and its impact on the delivery and viability of legal advice provided in the corporate context.

ACC's and the Chamber's members are interested in the impact of this case on both corporate legal practice and the rights of corporate clients to legal counsel. Both groups' members have a direct interest in the outcome of this appeal because the IRS' arguments, if accepted, would set a troubling precedent that actually could deter in-house counsel from creating written analyses of corporate actions in the course of advising and helping to ensure corporate compliance with law, and thus frustrate the ability of corporate clients to receive robust, timely, engaged and carefully considered legal advice to which they are entitled. As the Supreme Court stated in its seminal decision in *Hickman v. Taylor*, without work product protection, particularly for the kind of attorney analysis at issue in this case, "much of what is now put down in writing would remain unwritten. . . . Inefficiency, unfairness and sharp practices would inevitably develop." 329 U.S. 495, 511 (1947). ACC and the Chamber also represent the interests of clients in this decision, as work product protection—while maintained by lawyers—is a long-standing right expected by corporate clients, and its limitation or erosion is their loss, dramatically impacting corporations' ability to seek legal counsel without fear that the counsel's candid opinions and analyses will be disclosed to adversaries.

BRIEF STATEMENT OF FACTS

I. THE TAX ACCRUAL WORKPAPERS AT ISSUE CONTAIN THE LITIGATION ANALYSES OF TEXTRON'S ATTORNEYS

A full recitation of the facts underlying this appeal is included in Textron Inc.'s ("Textron") brief and will not be repeated here. ACC and the Chamber submit that the following are the narrow and salient facts on appeal:

1. The documents at issue in this appeal are specific "tax accrual workpapers" (the "Workpapers") sought by an IRS summons issued pursuant to 26 U.S.C. § 7602 in connection with its audit of Textron's tax returns. *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 142 (D.R.I. 2007). Although the IRS suggests that "tax accrual workpapers" is a broad category of documents that may include, in some cases, documents created by a company's managers, employees and accountants, in this case the Workpapers were prepared by Textron's tax attorneys for the 2001 tax year. *Id.* at 143.

2. The Workpapers consist of a spreadsheet that contains:

   a. "lists of items on Textron's tax returns, which, in the opinion of Textron's counsel, involve issues on which the tax laws are unclear, and therefore may be challenged by the IRS;"

   b. "estimates by Textron's counsel expressing, in percentage terms, their judgment regarding Textron's chances of prevailing in any

litigation over those issues (the 'hazards of litigation percentages')" and

c. "the dollar amounts reserved to reflect the possibility that Textron might not prevail in such litigation," calculated based on counsel's "hazards of litigation percentages." *Id.* at 142-43.

Additionally, the Workpapers include certain "backup," consisting of the previous year's spreadsheet and prior drafts of the spreadsheets with notes and memoranda written by Textron's counsel, "reflecting their opinions as to which items should be included on the spreadsheet and the hazard of litigation percentage that should be applied to each item." *Id.* at 143.

3. The District Court found that the Workpapers were created for two reasons:

a. Textron's "ultimate purpose" for creating the Workpapers in the form in which they were created was to ensure that it was "adequately reserved with respect to any potential disputes or litigation that would happen in the future."

b. Furthermore, the District Court stated that "it seems reasonable to infer" that Textron desired to satisfy its independent auditor Ernst & Young LLP ("EY") that Textron's reserves for contingent tax liabilities satisfied the requirements of generally accepted accounting

principles (GAAP), so that EY would be in a position to issue an unqualified opinion with respect to Textron's financial statements. *Id.*

4. The IRS audits every tax return filed by Textron, in groups, every several years. During the course of its audits, the IRS gathers information through information document requests, or "IDRs." In the audit cycle at issue, for tax years 1998-2001, the IRS served over 500 IDRs on Textron. If the IRS disagrees with a taxpayer's tax position, as it has done many times with Textron, it issues a Notice of Proposed Adjustments. The taxpayer may then proceed to dispute the adjustments through informal negotiations or, if the dispute is not resolved through negotiation, by filing a formal administrative appeal to the IRS Office of Appeals. (*See* Br. of IRS at 54 n.17.) If this process does not resolve the dispute, the taxpayer may file suit in federal court. *Textron*, 507 F. Supp. 2d at 141-42.

5. In all but one of Textron's eight audit cycles between 1980 and 2007, Textron disputed the IRS audit results through the IRS administrative appeals process. On three occasions during this period, Textron filed suit against the IRS in federal court. *Id.*

6. All of the factual information underlying the analysis of Textron's tax liability is available to the IRS through means other than production of the Workpapers. *Id.* at 155. The IRS does not appeal this finding.

II. TEXTRON DISCLOSED THE WORKPAPERS TO ITS INDEPENDENT AUDITOR WITH AN EXPECTATION OF CONFIDENTIALITY

7. After Textron filed its tax return, Textron showed the Workpapers to its independent auditor, EY, upon EY's request, as part of the audit of Textron's financial statements. *Id.* at 143.

8. The purpose of Textron's disclosure was to support EY's audit of Textron's financial statements—specifically, to assist EY in determining whether Textron's contingent tax liability reserves satisfied the requirements of GAAP. *Id.* at 154.

9. Textron showed the Workpapers to EY with an expectation of confidentiality:

a. First, as the District Court found, EY was and is expected to adhere to the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct Rule 301.01, which provides: "A member in public practice shall not disclose any confidential client information without the specific consent of the client." *See id.* at 152-54. In fact, the Public Company Accounting Oversight Board (PCAOB), which oversees independent auditors, 15 U.S.C. § 7213, supports the obligation of auditors to maintain the confidentiality of information received from clients, as directed by AICPA rules. *See* PCAOB Rule

3100 ("A registered public accounting firm and its associated persons shall comply with all applicable auditing and related professional practice standards.").

b. Textron, in fact, acted at all times in a manner intended to safeguard the confidentiality of the information shared with EY. *Textron*, 507 F. Supp. 2d at 143, 152-54.

ARGUMENT

I. THE DISTRICT COURT CORRECTLY CONCLUDED THAT TEXTRON'S TAX ACCRUAL WORKPAPERS AT ISSUE ARE PROTECTED BY THE ATTORNEY WORK PRODUCT DOCTRINE

The attorney work product doctrine protects "from disclosure materials prepared by attorneys 'in anticipation of litigation,'" and this protection is grounded in "strong public policy." *Maine v. Dep't of Interior*, 298 F.3d 60, 66 (1st Cir. 2002). The rationale for the doctrine, as stated by Justice Jackson in his concurring opinion in *Hickman v. Taylor*, is to enable parties to prepare adequately in an adversarial process: "Discovery was hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary." 329 U.S. at 516. And yet, the IRS' appeal seeks to turn fundamental notions regarding the work product doctrine on their head by allowing it access to Textron's lawyers' thoughts and analyses, which the IRS would

"borrow" for what it acknowledges would be to further its own litigation purposes against Textron.

Here, the IRS unquestionably is Textron's adversary, given that the IRS is auditing Textron's tax positions, routinely disputes those positions (which the IRS calls "questionable" in its Brief, at 23-24) through administrative proceedings against Textron and sometimes even in court, and has sued Textron to force it to turn over certain documents regarding its tax positions. What the IRS is after, however, is not the *factual* documents underlying Textron's tax positions—*e.g.*, leases and other documents on which Textron's tax positions are based—and there is no question on appeal regarding those documents, to which the IRS has access. Rather, the IRS openly states that it seeks the analysis of Textron's *lawyers* regarding those tax positions, an analysis that identifies the *lawyers' opinions* regarding the strengths and weaknesses of those positions, as well as Textron's potential financial exposure as to each. The IRS even lists for this Court all the ways in which IRS agents hope to make use of such an analysis by Textron's lawyers, including:

- the analysis "could assist them in determining Textron's tax liability by providing guidance for navigating the voluminous raw data produced by Textron and by disclosing unidentified issues;" and

- the analysis "of an uncertain issue's reserve percentage could assist the IRS agents in determining whether to use their limited resources to develop that issue." (Br. of IRS at 19-20.)

Moreover, the IRS does not want such analyses just in this case. It wants them as a matter of policy. *See, e.g., Tax Accrual Work Papers Protected by Work-Product*, BNA Corporate Counsel Weekly, Sept. 12, 2007 (quoting IRS Chief Counsel Donald Korb as stating, the day after the District Court's decision, that Textron's "victory could be short-lived," and that "[a]s far as we're concerned, we're not going to change [IRS policy] as a result of this decision").

In other words, the IRS believes it would be convenient to have a roadmap prepared by an audited taxpayer's attorneys that identifies their views of the "soft spots" in their client's tax positions. (Br. of IRS at 31-32.) The IRS wants to examine and selectively use what are equivalent to Textron's internal legal "admissions" of its litigation weaknesses. The IRS, in fact, suggests that its convenience in auditing taxpayers should be where this Court's analysis begins, and that the IRS' interest *per se* trumps any interest in preserving work product protection. The IRS' argument mocks Justice Jackson's oft-quoted rationale for recognizing the work product doctrine in the first place. *Compare* Br. of IRS at 31-32, *with Hickman*, 329 U.S. at 516 (rejecting argument of party's counsel that

he should be able to obtain his adversary's work product "to make sure he overlooked nothing") (Jackson, J., concurring).

As discussed *infra*, however, there is no support for the IRS' argument that its audit responsibilities—however important they are—automatically trump the work product doctrine. The Supreme Court, in fact, has recognized that "[n]othing in the language of the IRS summons provisions or in the legislative history suggests an intent on the part of Congress to preclude application of the work-product doctrine." *See Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981). The analysis in this case thus does not begin with what the IRS believes is convenient for it. It begins with the underpinning of the work product doctrine itself.

A. The IRS Audit Process Does Not Take Precedence Over the Importance of the Attorney-Client Privilege and the Work Product Doctrine

1. The Protections Preserve Fundamental Interests of American Jurisprudence

The attorney-client privilege and the work product doctrine have been defined in response to the "difficult and delicate task" of balancing the adversarial system's competing interests in safeguarding the attorney-client relationship and the conduct of the legal profession, on the one hand, and the need for reasonable and necessary factual inquiries, on the other. *See Hickman*, 329 U.S. at 497. The attorney-client privilege is the oldest privilege under common law, and it enshrines

the fundamental interest in the free flow of information and advice between attorneys and their clients, thereby promoting the "broader public interests in the observance of law and administration of justice." *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981). This privilege, however, is limited to protecting communications between attorneys and clients; the privilege historically has not protected internal documents prepared by an attorney to assist in representing a client in an adversarial process, where the documents are not communicated to the client.

In *Hickman*, the Supreme Court was faced with a litigant's attempt to obtain just such documents, memoranda prepared by an adversary's counsel documenting witness interviews conducted by that counsel. *Hickman*, 329 U.S. at 498-501. The memoranda were acknowledged not to be protected by the attorney-client privilege. *Id.* at 508. While recognizing that "discovery rules are to be accorded a broad and liberal treatment," *id.* at 507, the Supreme Court recognized the work product doctrine to safeguard "the historical and necessary way in which lawyers act within the framework of our system of jurisprudence to promote justice and to protect their clients' interests." *Id.* at 511. Proper conduct of the legal profession requires that a lawyer be permitted to "assemble information, sift what he considers to be the relevant facts, prepare his legal theories and plan his legal strategy without undue and needless interference." *Id.* If such protection were not

extended to attorney work product, "[t]he effect on the legal profession would be demoralizing. And the interests of the clients and the cause of justice would be poorly served." *Id.* Weighing the need for full and complete discovery against the beneficial role served by lawyers in American society, the Supreme Court found: "Not even the most liberal of discovery theories can justify unwarranted inquiries into the files and the mental impressions of an attorney." *Id.* at 510. This rule was codified in 1970 in Federal Rule of Civil Procedure 26(b)(3).

In *Upjohn*, the Supreme Court held that the work product doctrine must be available to corporations: "In light of the vast and complicated array of regulatory legislation confronting the modern corporation, corporations, unlike most individuals, constantly go to lawyers to find out how to obey the law, particularly since compliance with the law in this area is hardly an instinctive matter." *Upjohn*, 449 U.S. at 395 (citations omitted). Thus, any impairment of the traditional attorney-client protections "not only makes it difficult for corporate attorneys to formulate sound advice when their client is faced with a specific legal problem but also threatens to limit the valuable efforts of corporate counsel to ensure their client's compliance with the law." *Id; see also United States v. Nobles*, 422 U.S. 225, 238-39 (1975) ("At its core, the work-product doctrine shelters the mental processes of the attorney, providing a privileged area within which he can analyze and prepare his client's case. But the doctrine is an intensely practical one,

grounded in the realities of litigation in our adversary system."). Therefore, although the attorney-client privilege and work product doctrine by their nature limit discovery by adversaries (a point which the IRS acknowledges but laments), this limitation—grounded in the societal benefits recognized in the attorney-client relationship itself—has long been regarded as a necessary institution in our system of jurisprudence.

2. The Traditional Protections *Limit* the IRS' Subpoena Power Under 26 U.S.C. § 7602

This same balancing test has been applied to affirm the benefits and application of the attorney-client protections as against inquiries by government agencies, including the IRS. The IRS' interest in "administering the self-reporting tax system" (Br. of IRS at 39), is indisputably important, as is its interest in obtaining documents pursuant to a § 7602 summons from taxpayers to assist in its oversight responsibilities. There is no basis, however, for the IRS to claim that its desire to review a taxpayer's tax accrual workpapers, even when those workpapers include attorney-client protected information, necessarily overrides those protections. The IRS knows this. In *Upjohn*, the Supreme Court commented that the IRS "wisely" conceded that the work product doctrine does apply to limit IRS summonses. *Upjohn*, 449 U.S. at 397. In that case, the Court reversed the Sixth Circuit's finding that the work product doctrine does not apply to IRS summonses, holding that the importance of the IRS' responsibilities does not override

"application of the work-product doctrine." *Id.* at 397-98. As the Supreme Court later confirmed, "§ 7602 is 'subject to the traditional privileges and limitations.'" *United States v. Arthur Young & Co.*, 465 U.S. 805, 816 (1984) (quoting *United States v. Bisceglia*, 420 U.S. 141, 150 (1975)).

In earlier Administrations, the IRS itself acknowledged that it should tread with caution when seeking "tax accrual workpapers," even as a category broader than documents containing attorney work product. In *Arthur Young*, the Supreme Court approved of the IRS "tightening its internal requirements for" summonses of tax accrual workpapers. 465 U.S. at 820. Following *Arthur Young*, the IRS recognized that the Supreme Court credited such "sensitivity" and that "the Supreme Court . . . reaffirmed the traditional privileges and limitations upon the Service's summons power." Announcement 84-46, 1984-18 I.R.B. 18.

The IRS, therefore, is flat wrong by now suggesting that its desire for convenience in obtaining the legal analysis of Textron's lawyers is inherently more important than the interests served by the attorney work product doctrine. There simply is no authority for the proposition that the IRS must be given the right it seeks in this case—namely, to "perform its functions . . . on wits borrowed from the adversary." ACC and the Chamber submit that this Court, in assessing the IRS' attempted intrusion into the mental impressions of Textron's counsel, should

reject the IRS' request for approval of such a blanket new power, and instead the Court should apply its traditional work product analysis in this case.

B. Textron's Workpapers Were Prepared Because Of the Prospect of Litigation

1. Under the Standard Applied by the First Circuit (and Most Circuits), the Workpapers Are Entitled to Work Product Protection

This Court has held that a document is prepared "in anticipation of litigation," and thus protected by the attorney work product doctrine, 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." *Maine*, 298 F.3d at 68. In *Maine*, the First Court joined the majority of Circuit Courts of Appeals in holding that the work product doctrine applies where a document is created "because of" existing or expected litigation, and rejected the Fifth Circuit's "primary purpose" test, which "would potentially exclude documents containing analysis of expected litigation, if their primary, ultimate, or exclusive purpose is to assist in making [a] business decision." *Id.* (following *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998)).[1]

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[1] The First, Second, Third, Fourth, Sixth, Seventh, Eighth, Ninth and D.C. Circuit Courts and the Court of Federal Claims have expressly adopted the "because of" standard. *See Maine*, 298 F.3d at 69; *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998); *In re Grand Jury Proceedings*, 604 F.2d 798, 803 (3d Cir. 1979); *Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co., Inc.*, 967 F.2d 980, 984 (4th Cir. 1992); *United States v.*

Applying *Maine*, the District Court concluded that the Workpapers were created based on Textron's reasonable "belief in the likelihood of litigation with the IRS." Indeed, the District Court found:

> it is clear that the opinions of Textron's counsel and accountants regarding items that might be challenged by the IRS, their estimated hazards of litigation percentages and their calculation of tax reserve amounts would not have been prepared at all "but for" the fact that Textron anticipated the possibility of litigation with the IRS.

Textron, 507 F. Supp. 2d at 150.

The District Court's "but for" analysis is the logical equivalent of the "because of" test, and its findings recognize the practical realities of reserve analyses prepared by companies and their counsel. In the process of determining whether to establish a reserve to account for the uncertainty of litigation (and if so, how much to reserve)—whether the litigation is with private parties on any issue, or with the IRS on tax issues—a company is likely to turn to its attorneys. Indeed, it is this very conduct that ACC and the Chamber seek to encourage by their arguments in this brief. Often, it is the internal business attorneys who are ideally situated to conduct such analyses and develop opinions on the relevant issues—*i.e.*,

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Roxworthy, 457 F.3d 590, 600 (6th Cir. 2006); *Binks Mfg. Co. v. Nat'l Presto Indus., Inc.*, 709 F.2d 1109, 1118-19 (7th Cir. 1983); *Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401 (8th Cir. 1987); *In re Grand Jury Subpoena*, 350 F.3d 1010, 1015-16 (9th Cir. 2003); *Senate of Puerto Rico v. Dep't of Justice*, 823 F.2d 574, 586 n.42 (D.C. Cir. 1987); *Evergreen Trading, LLC ex rel. Nussdorf v. United States*, 80 Fed. Cl. 122, 132 (2007). It appears that only the Fifth Circuit has adopted the "primary purpose" test. *See United States v. El Paso Co.*, 682 F.2d 530, 542-44 (5th Cir. 1982).

identifying issues of potential dispute; and if challenged, the chance the client will lose; and if so, the client's potential liability. The "anticipation of litigation" is inherent in the reserve analysis itself. In fact, many courts (even beyond those cited by the District Court) analyzing this issue have concluded that reserve analyses, "by their very nature," are prepared "because of" litigation and thus deserve work product protection.[2]

The Workpapers prepared by Textron's counsel contain exactly the kind of "mental processes of the attorney, providing a privileged area within which he can analyze and prepare his client's case." *Nobles*, 422 U.S. at 238-39. Moreover, the reason advanced by the IRS for wanting these Workpapers—*i.e.*, that they "are

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[2] *See, e.g., Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401-02 (8th Cir. 1987) ("By their very nature [the litigation reserve analyses] are prepared in anticipation of litigation and, consequently, they are protected from discovery as opinion work product."); *United States v. Roxworthy*, 457 F.3d 590, 598-600 (6th Cir. 2006) (finding analysis of tax consequences of particular transactions to be entitled to work product protection); *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, 237 F.R.D. 176, 184-85 (N.D. Ill. 2006) (extending work product protection to so called "audit letters"—letters sent by a company's counsel to the company's auditors analyzing litigation loss contingencies for the purpose of an audit of the company's reserves); *In re Honeywell Int'l, Inc. Sec. Litig.*, 230 F.R.D. 293, 300 (S.D.N.Y. 2003) (same as to audit workpapers); *S. Scrap Material Co. v. Fleming*, No. 01-2554, 2003 WL 21474516, at *9 (E.D. La. Jun. 18, 2003) (same as to audit letters); *In re Pfizer Inc. Sec. Litig.*, No. 90-1260, 1993 WL 561125, at *3-5 (S.D.N.Y. Dec. 23, 1993) (same); *Vanguard Sav. and Loan Assoc. v. Banks*, No. 93-4627, 1995 WL 555871, at *4 (E.D. Pa. Sept. 18, 1995) (same); *Tronitech, Inc. v. NCR Corp.*, 108 F.R.D. 655, 656 (S.D. Ind. 1985) (same); *see also Laguna Beach Cty. Water Dist. v. Superior Ct.*, 22 Cal. Rptr. 3d 387, 391 (Cal. Ct. App. 2004) (same).

relevant because they focus the IRS on the 'soft spots' on a taxpayer's return" (Br. of IRS at 31-32)—is the quintessential reason the work product doctrine exists in the first place. If the IRS were to obtain this information, it would gain the outline of Textron's lawyers of the strengths and weakness of Textron's tax positions, which the IRS seeks unabashedly to exploit in its audit of Textron, in negotiations, through the IRS appeals process and in court, if necessary. Such a result would undermine the purpose of the work product doctrine, and ACC and the Chamber urge the First Circuit not to so erode the doctrine.[3]

2. That Textron Also Used the Workpapers to Support its Public Reporting Requirements Does Not Eliminate Work Product Protection

The IRS argues that the Workpapers would have been created in "substantially the same form" because of Textron's need to comply with securities regulations regarding public reporting. (Br. of IRS at 48-49.) According to the

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[3] Under Fed. R. Civ. P. 26(b)(3), ordinary work product is not discoverable by an opposing party absent a showing of "substantial need," but even on this showing, courts "must protect against disclosure of the mental impressions, conclusions, opinions or legal theories of an attorney or other representative of a party." The IRS does not appear to dispute that it is seeking the "opinions, speculations, and projections" of Textron's attorneys (Br. of IRS at 40), but instead seems to argue only that such analyses, when part of "tax accrual workpapers" generally, never are entitled to work product protection. Thus, the IRS does not feign to make a showing of "substantial need" for the analysis at issue in this case, let alone the more compelling showing that possibly could overcome the protection afforded opinion work product. *See Upjohn*, 449 U.S. at 401 (Opinion work product "cannot be disclosed simply on a showing of substantial need and inability to obtain the equivalent without undue hardship.").

IRS' reasoning: A public company's financial statements include its tax reserves; it periodically must file with the SEC its financial statements together with an unqualified opinion by an independent auditor that the financial statements comply in all material respects with GAAP; the auditor may review company documents supporting the company's tax reserves before completion of the audit; therefore, a significant reason for preparing such documents must be to obtain an unqualified audit opinion, so the documents never may be protected work product prepared "in anticipation of litigation." The IRS' argument, in effect, would create a bright-line rule that *all analyses* used as part of a public company's financial reporting process are not entitled to work product protection, even when they contain the mental impressions and judgments of attorneys concerning prospective litigation. There are two principal flaws in the IRS' argument.

First, the IRS' real argument is that the First Circuit should apply the "primary purpose" test adopted by the Fifth Circuit. As the IRS puts it, the District Court should have been "following a decision directly on point," *United States v. El Paso*, 682 F.2d 530, 544 (5th Cir. 1982), which held under the Fifth Circuit's primary purpose test that certain tax accrual workpapers were "[w]ritten ultimately to comply with SEC regulations," and that the documents at issue were not prepared in anticipation of litigation at all. (*See* IRS Br. at 57.) The First Circuit, however, has *rejected* the primary purpose test, criticizing it in *Maine* because it

inappropriately "would potentially exclude documents containing analysis of expected litigation, if their primary, ultimate, or exclusive purpose is to assist in making [a] business decision." *Maine*, 298 F.3d at 68 (quoting *Adlman*, 134 F.3d at 1197-98). This panel is bound to follow First Circuit precedent. *See Lacy v. Gardino*, 791 F.2d 980, 985 (1st Cir. 1986) ("Uniformity of decisions within a multi-panel circuit can only be achieved by strict adherence to prior circuit precedent, with the error-correcting function reserved to the court sitting en banc."). Furthermore, the IRS has not provided any compelling rationale for this Court to adopt the "primary purpose" test that the First Circuit and most other Circuit Courts of Appeals already rejected.[4]

Second, this Court and others have recognized that "dual purpose" documents merit work product protection. *Maine*, 298 F.3d at 68-69; *see also In re Grand Jury Subpoena*, 350 F.3d 1010, 1016 (9th Cir. 2003) (holding that application of the work product doctrine cannot be resolved "simply by looking at one motive that contributed to a document's preparation"); *In re Raytheon Sec. Litig.*, 218 F.R.D. 354, 359 (D. Mass. 2003) (finding that audit opinion letters may be entitled to work product protection depending on the facts of the case and

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[4] In fact, the "primary purpose" test places too heavy a burden on courts to determine the most significant rationale for preparation of a document—a determination fraught with ambiguity. The "because of" test, by contract, is simpler to apply as a factual matter and is "more consistent with the literal terms and purposes of [Rule 26(b)(3)]." *Adlman*, 134 F.3d at 1198.

contents of the letters); *Laguna Beach Cty. Water Dist. v. Superior Ct.*, 22 Cal. Rptr. 3d 387, 391 (Cal. Ct. App. 2004) (same). The IRS ignores the reality of the public company reporting process and the many legal authorities recognizing that the attorney work product doctrine can coexist harmoniously with that process.

To be sure, public companies must satisfy SEC reporting requirements by filing audited financial statements, but there is no requirement that they support all of their financial positions with the opinions of counsel. When they do—prudently—they should not be penalized. When corporate counsel prepares a litigation reserve analysis (which, as discussed *supra*, inherently is prepared because of the prospect of litigation), and the analysis also is used to support the company's financial statements or tax positions, courts thus have recognized that this "dual purpose" does not jeopardize its work product protection. *See, e.g.*, *Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401-02 (8th Cir. 1987) ("By their very nature [the litigation reserve analyses] are prepared in anticipation of litigation and, consequently, they are protected from discovery as opinion work product."); *United States v. Roxworthy*, 457 F.3d 590, 598-600 (6th Cir. 2006) (finding analysis of tax consequences of particular transactions to be entitled to work product protection). As cited *supra* at footnote 2, courts in fact extend work product protection to lawyers' litigation analyses prepared at the client's request and *sent directly to the auditor for purposes of auditing the company's reserves.*

Indeed, when crafting the work product doctrine, the Supreme Court recognized that English courts had applied it to "[a]ll documents which are called into existence for the purpose—*but not necessarily the sole purpose*—of assisting the deponent or his legal advisors in any actual or anticipated litigation." *Hickman*, 329 U.S. at 510 n.9 (quoting Odgers on Pleading and Practice (12th ed., 1939), p. 264) (emphasis added). As the Second Circuit has held, while it is true that work product protection does not extend to "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation," *Adlman*, 134 F.3d at 1202, the fact that a document's purpose is "business-related" is "irrelevant" to the "because of" test. *Id.* at 1200. As long as the document is prepared "because of" litigation, it is protected. The Second Circuit thus has determined that documents created in the following scenario are "squarely" entitled to work product protection:

> A business entity prepares financial statements to assist its executives, stockholders, prospective investors, business partners, and others in evaluating future courses of action. Financial statements include reserves for projected litigation. The company's independent auditor requests a memorandum prepared by the company's attorneys estimating the likelihood of success in litigation and an accompanying analysis of the company's legal strategies and options to assist it in estimating what should be reserved for litigation losses.

Id. The same conclusion applies here, on the analogous facts before this Court. By definition, the kind of attorney's litigation reserve analysis in this case is

prepared "because of" litigation; indeed, it is impossible to separate the "litigation" from the "analysis" in the first place.

In sum, the IRS invites this Court to create a proposed *per se* rule that any documents, including an attorney's opinions and mental impressions, never are entitled to work product protection "as a matter of law" whenever the documents are used to support a company's financial statements. (Br. of IRS at 49-51.) Such a rule would force corporations into a no-win situation. A company should feel free to engage counsel to provide precisely the sort of analysis at issue here—consideration of the company's tax positions where the law is unsettled—and to use that analysis to support reserves based on potential litigation with the IRS. And yet, these otherwise-prudent measures, under the IRS' proposed approach, would be used freely by the IRS against the company, thereby potentially chilling the company's use of counsel in the first place, or forcing the company to place impractical limitations on its counsel's ability to work. *See Hickman*, 329 U.S. at 511 ("Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten.").

3. The District Court Was Correct in Concluding that Textron Reasonably Anticipated "Litigation" With the IRS

The IRS argues that even if the District Court correctly concluded Textron's attorneys would not have created the Workpapers "but for" the potential for dispute with the IRS, the District Court erred as a matter of law by extending work

product protection to the Workpapers without "identifying the specific litigation" anticipated as to each of the "specific issues listed" in the Workpapers. (IRS Br. at 53-54.) The IRS seems to argue that the "specific litigation" anticipated must be guaranteed litigation *in court*. *See id.* at 54 n.17 (arguing that even where taxpayers, like Textron, appeal issues to the IRS Office of Appeals, this constitutes an attempt "to resolve disputed tax issues within the agency so that the parties need not resort to litigation"). The IRS misstates the law and fails to comprehend both the adversarial nature of the IRS audit process and the nature of the Workpapers created by Textron's counsel.

As the District Court found, the purpose of the Workpapers was "to ensure that Textron was 'adequately reserved with respect to *any potential disputes or litigation* that would happen in the future,'" and Textron would have had no need to create the Workpapers if it "had not anticipated a dispute with the IRS that was likely to result in *litigation or some other adversarial proceeding*." *Textron*, 507 F. Supp. 2d at 143, 150 (emphasis added). As courts within the First Circuit applying this Court's decision in *Maine* have concluded, this finding satisfies the requirement that "litigation," under Fed. R. Civ. P. 26(b)(3), is anticipated. In *In re Grand Jury Subpoena*, 220 F.R.D. 130, 147 (D. Mass. 2004), the District of Massachusetts held that "'[a]dversarialness' is the touchstone of this approach to the 'litigation' question," and cited with approval the definition of "litigation" in

the Restatement (Third) of the Law Governing Lawyers § 89 cmt. H (2000), which includes "adversarial proceedings before an administrative agency, an arbitration panel or a claims commission, and alternative-dispute-resolution proceedings such as mediation or mini-trial," or any proceeding in which "evidence or legal argument is presented by parties contending against each other with respect to legally significant factual issues."

In *Roxworthy*, on facts closely analogous to those before this Court, the Sixth Circuit held that where a taxpayer is audited by the IRS, "a document prepared 'in anticipation of *dealing with the IRS* . . . may well have been prepared in anticipation of an administrative dispute and this may constitute 'litigation' within the meaning of Rule 26." 457 F.3d at 600 (quoting *Hodges, Grant & Kaufmann v. Internal Rev. Serv.*, 768 F.2d 719, 719-22 (5th Cir. 1985)) (emphasis added). In *Roxworthy*, the court held that, particularly given a taxpayer's history of litigation with the IRS, an analysis by the taxpayer's attorney of "a specific transaction that could precipitate litigation" was protected work product. *Id.* at 600. Moreover, as the Supreme Court has explained, given that the work product doctrine is "an intensely practical one, grounded in the realities of litigation in our adversary system," *Nobles*, 422 U.S. at 238-39, even allowing an adversary to gain documents prepared to assist in negotiating a settlement would be an "intolerable intrusion on the [settlement] bargaining process," because this would "allow[] one

party to take advantage of the other's assessment of his prospects for victory and an acceptable settlement figure." *Adlman*, 134 F.3d at 1202 (quoting Edward H. Cooper, *Work Product of the Rulesmakers*, 53 Min. L. Rev. 1269, 1283 (1969)).

Here, the adversity between Textron and the IRS is apparent from the IRS' posture vis-à-vis Textron's tax returns and the history between Textron and the IRS. The IRS audits each of Textron's tax returns in the course of periodic audits, seeks voluminous discovery from Textron by way of IDRs and frequently issues Notices of Proposed Adjustments to Textron's tax positions. *Textron*, 507 F. Supp. 2d at 141-42. Textron, with the assistance of counsel and others, and the IRS, through its counsel and staff, generally meet to attempt to mediate their disputes. *See id.*; *see also* Br. of Textron at 3-4. Since 1980, all but one of the IRS' audits of Textron resulted in Textron filing formal administrative appeals. *Textron*, 507 F. Supp. 2d at 141-42. Three of these disputes ended up in court, but as the authorities above demonstrate, the administrative proceedings before the IRS themselves—the audits, the Notices of Proposed Adjustments, the negotiations, the appeals process—all constitute "litigation" in modern practice. *See, e.g.*, *Roxworthy*, 457 F.3d at 600 (finding company reasonably believed that a controversy with the IRS was a "virtual certainty" where "company's tax returns were routinely examined by the IRS, the company was engaged in a transaction involving 'a very substantial amount of tax dollars,' and the IRS 'had previously

questioned similar transactions'") (quoting *United States v. ChevronTexaco Corp.*, 241 F. Supp. 2d 1065, 1082 (N.D. Cal. 2002).

It is irrelevant to the analysis whether Textron's attorneys believed Textron ultimately may concede or lose some items identified in the Workpapers (as the IRS suggests), if those items were challenged by the IRS. (In fact, that belief supports the policy behind the work product doctrine to keep such candid assessments from one's adversary.) There also is no requirement that Textron's attorneys be prepared to cite an action pending in court for work product protection to apply and serve its expected purpose. It is enough that when Textron's attorneys prepared the Workpapers, each tax item they identified and analyzed was prepared with the history and context described above—*i.e.*, the potential IRS challenge and any further adversarial process—firmly in mind.[5] This is the adversity necessary

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[5] The IRS cites *Coastal States Gas Corp. v. Department of Energy*, 617 F.2d 854, 865 (D.C. Cir. 1980), as requiring a rigid requirement that documents must have been "prepared with a specific claim supported by concrete facts which would likely lead to litigation in mind." As the IRS well knows, in *Delaney, Migdail & Young, Chartered v. Internal Revenue Service*, the IRS later prevailed on its assertion of work product protection because the D.C. Circuit agreed that *Coastal States* requires no such rigid or "blanket rule." 826 F.2d 124, 127 (D.C. Cir. 1987). Requiring a "specific claim" to be identified in all instances, the court held in *Delaney*, "would ignore the function performed by the withheld material" in the first place. *Id.* Thus, work product protection may apply "in the absence of a specific claim where an attorney 'rendered legal advice in order to protect the client from future litigation about a particular transaction.'" *Roxworthy*, 547 F.3d at 599 (quoting *In re Sealed Case*, 676 F.2d 793, 817 (D.C. Cir. 1982)). Here, the

to satisfy the "anticipation of litigation" standard.[6] Taken literally, the IRS' proposed rule would encourage taxpayers to turn to court *more frequently*, rather than attempt to resolve differences outside of court, because work product protection would be unavailable in any context short of initiating court proceedings. That certainly is neither the law nor a common sense approach to the issues before this Court.

C. *Arthur Young* Does Not Compel a Different Result

In the IRS' view, the District Court's ruling conflicts with *Arthur Young*. (Br. of IRS at 36.) The IRS misapprehends the facts and holding of *Arthur Young*. There, the IRS issued a summons to an independent auditor for the "tax accrual workpapers" the auditor prepared in connection with auditing a corporate client. The Second Circuit denied enforcement of the summons based upon what it crafted

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function of the Workpapers prepared by Textron's attorneys was to assess tax litigation risk against the IRS as to specific items.

6 Even in its brief, the IRS takes an adversarial posture towards Textron's currently-audited tax positions, calling them "questionable positions." (Br. of IRS at 23-24.) The IRS, moreover, states that it is targeting certain of Textron's transactions which the IRS has "listed." As various courts and authorities have noted, the IRS' listing notices are announcements of the IRS' "litigating positions." *See, e.g., ABA Section of Taxation Report of the Task Force on Judicial Deference*, 2004 TNT 178-26 (Aug. 1, 2004) ("Neither should most notices qualify for full *Skidmore* deference since they are little more than an announcement of a litigating position . . . [and] litigating positions should receive no deference."); *see also Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 213 (1988) ("Deference to what appears to be nothing more than an agency's convenient litigating position would be entirely inappropriate.").

as a new accountant-client privilege. *Arthur Young*, 465 U.S. at 808-10. The Supreme Court refused to adopt the judicially-created privilege, but—as is critical to the current case—the workpapers at issue in *Arthur Young* were *not* analyses prepared by the company's attorneys. *Id.* at 808, 812. In fact, the Supreme Court did not address the attorney work product doctrine at all, except to state that IRS summonses issued under § 7602 are "subject to the traditional privileges and limitations." *Id.* at 816, 817 (even suggesting that result in case could be different if attorney work product were at issue). Thus, the IRS—which neglects to mention these facts in its seven-page discussion of *Arthur Young*—can find no support from this decision.

II. THE DISTRICT COURT CORRECTLY CONCLUDED THAT ATTORNEY WORK PRODUCT PROTECTION WAS NOT WAIVED BY TEXTRON'S DISCLOSURE OF THE WORKPAPERS TO ITS AUDITORS

The IRS argues that Textron waived work product protection by disclosing the Workpapers to EY. But the work product protection is not waived automatically by any disclosure to a third person; rather, the protection is only waived by "disclosing material in a way inconsistent with keeping it from an adversary." *Mass. Inst. of Tech.*, 129 F.3d at 687 (finding waiver where party disclosed work product relating to contract payments to the counter-party's auditor in support of party's position that there was no breach of contract). This test stems from the underpinning of the work product doctrine: "The work product privilege

does not exist to protect a confidential relationship, but rather to promote the adversary system by safeguarding the fruits of an attorney's trial preparation from the discovery attempts of an opponent." *United States v. Am. Tel. & Telegraph*, 642 F.2d 1285, 1299 (D.C. Cir. 1980). Whether the party receiving the disclosure is sufficiently "adversarial" to the party sharing work product depends on an analysis of the facts and policies at issue in a particular case. *See In re Subpoenas Duces Tecum*, 738 F.2d 1367, 1372 (D.C. Cir. 1984) (resolving waiver analysis on three factors: (1) whether disclosing party acted consistently with the purpose of the doctrine, (2) whether disclosing party had reasonable expectation of confidentiality and (3) whether waiver would support policy interests behind the doctrine); *Mass. Inst. of Tech.*, 129 F.3d at 687-88 (finding waiver where documents were disclosed to "potential adversary" in the sense that the recipient of documents might bring a claim against the disclosing party).

Even though the inquiry is a fact-intensive one, the IRS submits that as a blanket rule, an "independent auditor" is "both a potential adversary and a potential conduit to its client's adversaries." (Br. of IRS at 61.) The District Court appropriately rejected the IRS' arguments, *Textron*, 507 F. Supp. 2d at 152-54, as have a long line of courts that have considered these very issues. *See, e.g., Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 447-49 (S.D.N.Y.

2004) (rejecting argument of waiver based on company's disclosure to its auditors of attorney work product).[7]

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[7] *See also In re JDS Uniphase Corp. Sec. Litig.*, No. 02-1486, 2006 WL 2850049, at *2 (N.D. Cal. Oct. 5, 2006) (same); *S. Scrap Material Co. v. Fleming*, No. 01-2554, 2003 WL 21474516, at *9 (E.D. La. Jun. 18, 2003) (finding no waiver because disclosure of legal analysis to auditors was not like "one of those cases where a party deliberately disclosed work product in order to obtain a tactical advantage or where a party made testimonial use of work product and then attempted to invoke the work product doctrine to avoid cross-examination"); *Lawrence E. Jaffe Pension Plan*, 237 F.R.D. at 183 (same); *Frank Betz Assoc., Inc. v. Jim Walter Homes Inc.*, 226 F.R.D. 533, 535 (D.S.C. 2005) (finding no waiver upon company's disclosure to auditors, based on common interests between them); *In re Raytheon Sec. Litig.*, 218 F.R.D 354, 360 (D. Mass. 2003) (rejecting rule of waiver based on disclosure to auditors and finding that waiver must be resolved on the facts of the case); *In re Pfizer, Inc. Sec. Litig.*, 1993 WL 561125, at *6 (finding no waiver because auditor not reasonably viewed as a conduit to a potential adversary); *Gutter v. E.I. Dupont de Nemours & Co.*, No. 95-2152, 1998 WL 2017926, at *5 (S.D. Fla. May 18, 1998) ("[t]ransmittal of documents to a company's outside auditors does not waive the work product privilege because such a disclosure 'cannot be said to have posed a substantial danger at the time that the document would be disclosed to plaintiffs'"); *Vanguard Sav. and Loan Assoc. v. Banks*, No. 93-4627, 1995 WL 555871, at *4 (E.D. Pa. Sept. 18, 1995) (finding no waiver because company did not make disclosure to auditors with "conscious disregard of the possibility that an adversary might obtain the protected materials"); *Gramm v. Horsehead Indus., Inc.*, No. 87-5122, 1990 WL 142404, at *5 (S.D.N.Y. Jan. 25, 1990) (finding no waiver upon disclosure to auditors because "disclosure to another person who has an interest in the information but who is not reasonably viewed as a conduit to a potential adversary will not be deemed a waiver of protection of the rule"); *Tronitech, Inc. v. NCR Corp.*, 108 F.R.D. 655, 656 (S.D. Ind. 1985) (no waiver upon disclosure of work product to auditors because "audit letters are produced under assurances of strictest confidentiality").

A. Ernst & Young is Not Textron's Adversary

An independent auditor, the IRS claims, is by definition its client's adversary because an auditor is a public "watchdog." (Br. of IRS at 62.) While it is true that a public company's auditors must remain "independent" of their clients, this role does not, as the IRS argues, make them adverse to their clients, nor should the relationship be interpreted in any way that could *discourage* open communication between a company and its auditor. Indeed, the vast majority of courts to address the issue, as listed *supra*, have recognized that disclosures by companies to their independent auditors in connection with financial statement audits does *not* waive work product protection. *See, e.g., Merrill Lynch*, 229 F.R.D. at 447 (the waiver analysis "must not end with the mere fact of a disclosure to the independent auditors") (collecting cases).

In *Merrill Lynch*, the Southern District of New York examined the body of authority on the issue and concluded that disclosure of work product to independent auditors is not the kind of disclosure to "adversaries" required to effect a waiver. It found, in fact, that:

> any tension between an auditor and a corporation that arises from an auditor's need to scrutinize and investigate a corporation's records and book-keeping practices simply is not the equivalent of an adversarial relationship contemplated by the work product doctrine. Nor should it be. A business and its auditor can and should be aligned insofar as they both seek to prevent, detect, and root out corporate fraud. Indeed, this is precisely the type of limited alliance that courts should encourage.

Merrill Lynch, 229 F.R.D. at 448. Looking to the "intensely practical" nature of the work product doctrine, the court in *Merrill Lynch* found that corporations and auditors share "common interests" in conducting thorough inquiries of corporate affairs and promoting compliance with the law. *Id.* at 447-49.[8] An auditor's "independence" from its clients does not rise to the level of an adversarial litigation relationship. *Id.*; *see also Am. Steamship Owners Mut. Prot. and Indem. Assoc. v. Alcoa Steamship Co., Inc.*, No. 04-4309, 2006 WL 278131, at *2 (S.D.N.Y. Feb. 2, 2006) (applying *Adlman* to reject argument that disclosure of legal opinions to actuary, which as a "public watchdog" might be required to turn opinions over to insurance regulators, constituted a waiver).

The "common interest" analysis has been adopted by other courts following the "because of" test, including courts within the First Circuit. *See, e.g., Mass. Inst. of Tech*, 129 F.3d at 687-88 (finding waiver where the parties did not share a common interest); *In re Raytheon Sec. Litig.*, 218 F.R.D at 360 (applying common interest analysis and holding that question of waiver upon disclosure of documents to a company's auditor must be resolved on facts). As recognized in *Merrill Lynch*, this "common interest" between public company and auditor encourages,

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[8] For example, under the Sarbanes-Oxley Act, management is required to report annually on its internal controls, and auditors must report on management's assessment of such controls, s*ee* 15 U.S.C. § 7262, but they both share a common interest in ensuring that the company's internal controls satisfy management's and the public's joint need for accurate and reliable information about corporate operations.

rather than chills, the sharing of information between them, thus enhancing the availability and accuracy of information to the investing public. *Id.* at 449.[9]

Tracking the reasoned analysis of *Merrill Lynch*, and consistent with these other authorities, the District Court appropriately found that EY is not Textron's adversary. *Textron*, 507 F. Supp. 2d at 152-54. There was no prospect of litigation between EY and Textron with regard to Textron's tax reserves. *See also Merrill Lynch*, 229 F.R.D. at 447-49 (finding no waiver where the "worst case scenario" between company and its auditor would have been the auditor's release of an

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[9] Some courts even have refused to apply a *per se* rule that disclosure by a public company to government enforcement agencies waives work product protection, because a contrary rule would chill voluntary cooperation with these regulators, even though there is potential adversity built into the very nature of the relationship. *See In re Steinhardt Partners*, 9 F.3d 230, 236 (2d Cir. 1993) ("[W]e decline to adopt a per se rule that all voluntary disclosures to the government waive work product protection."); *In re Cardinal Health, Inc. Sec. Litig.*, No. 04-575, 2007 WL 495150, at *8 (S.D.N.Y. Jan. 26, 2007) ("Establishing a rigid rule would fail to anticipate situations in which the disclosing party and the government may share a common interest in developing legal theories and analyzing information, or situations in which the SEC and the disclosing party have entered into an explicit agreement that the SEC will maintain the confidentiality of the disclosed materials.") (citing *In re Sealed Case*, 676 F.2d 793, 817 (D.C. Cir. 1982); *Saito v. McKesson HBOC, Inc.*, 2002 WL 31657622, at *6, 11 (Del. Ch. Ct. Nov. 13, 2002) ("[P]ublic policy seems to mandate that courts continue to protect the confidentially disclosed work product in order to encourage corporations to comply with law enforcement agencies."); *Maruzen Co., Ltd. v. HSBC USA, Inc.*, 2002 WL 1628782, at *2 (S.D.N.Y. June 23, 2002) (denying motion to compel because defendants had confidentiality agreements with U.S. Attorney's Office to whom documents were disclosed (citing *Steinhardt*); *In re LTV Sec. Litig.*, 89 F.R.D. 595, 614-22 (N.D. Tex. 1981) (maintaining confidentiality of a company's internal investigation ordered by and shared with the government).

opinion stating its inability to accurately evaluate the company's financial statements). Nor could there be. Under AICPA rules, "independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness" to all those affected by a business, including management, owners and creditors. AICPA, AU § 220.02. Independent auditors thus are not expected to have an *adversarial* relationship with the companies they audit; indeed, the AICPA Code of Conduct recognizes that even the threat of adversity between an auditor and client can raise questions about the auditor's independence. *See* AICPA, ET § 101.08. The PCAOB, in fact, mandates that independent auditors "comply" with AICPA rules. *See* PCAOB Rule 3100.

Textron and EY, like other public companies and their auditors, share an interest in the filing of reliable financial statements. The blanket rule advocated by the IRS that would waive work product protection whenever corporations disclose documents to their auditors is not justified by the law, nor would it provide rational incentives to companies engaged in a meaningful public reporting process. As the District Court recognized, a minority of courts have concluded that, on the facts before them, a company's disclosure of work product to its auditors constituted a waiver. However, the overwhelming majority of cases and the current trend

support the conclusion that an auditor is not its client's adversary for purposes of the work product doctrine.[10]

B. Ernst & Young Is Not a Conduit to Textron's Adversaries

Nor, as the District Court found, could Textron reasonably expect that EY would be a conduit to Textron's adversaries—here, the IRS. EY is not an agent or fiduciary of the IRS. As the District Court found, Textron went to great lengths to preserve the confidentiality of the Workpapers, *e.g.*, showing them to (but not leaving a copy with) EY. *See Textron*, 507 F. Supp. 2d at 143, 152-54. As courts have held, actions consistent with an expectation of confidentiality support the preservation of work product protection. *See, e.g., Merrill Lynch*, 229 F.R.D. at 448-49 (applying similar reasoning in evaluating impact of audit standards on waiver analysis); *Am. Steamship Owners Mut. Prot. And Indem. Assoc., Inc.*, 2006 WL 278131, at *2 (company's disclosure to independent actuary did not waive

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[10] Indeed, subsequent decisions by two courts finding a waiver have disagreed with that position, holding that disclosure to an auditor is not a waiver. *Compare Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113, 115-17 (S.D.N.Y. 2002) (finding waiver based on auditors' "public watchdog" function), *with Merrill Lynch*, 229 F.R.D. at 446-49 (rejecting reasoning of *Medinol* and holding that, based on the underlying facts of their relationship, auditors are not their clients' adversaries); *and In re Diasonics Sec. Litig.*, No. 83-4584, 1986 WL 53402, at *1 (N.D. Cal. June 15, 1986) (finding wavier because auditors' duties to the investing public "transcend the relationship with the client"), *with In re JDS Uniphase Corp. Sec. Litig.*, 2006 WL 2850049, at *2 (adopting reasoning of *Merrill Lynch* over *Medinol*).

work product protection where actuary in fact maintained confidentiality of the documents); *see also* citations *supra* at n.7.

Moreover, as the District Court recognized, AICPA Code of Professional Conduct Rule 301.01 requires accountants to maintain the confidences of their clients: "A member in public practice shall not disclose any confidential client information without the specific consent of the client."[11] The IRS argues that the District Court clearly erred in finding that Textron reasonably expected confidentiality on this basis because the requirements of Rule 301 are subject to valid summonses. In so doing, the IRS presents a succinctly circular argument. The IRS suggests that the mere *serving* of a summons unilaterally overrides all traditional privileges and protections, and thus that an IRS summons requesting documents protected by the work product doctrine *sua sponte* eliminates confidentiality under Rule 301. That is not the law, nor does the IRS cite any authority for the proposition. Rather, as discussed *supra*, an IRS summons is limited by all applicable privileges and protections, and even if the summons is served upon a company's auditors, the company has standing to ensure application of the privilege or protection to its own documents. *See, e.g., Arthur Young*, 465

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[11] In addition, when conducting business in Rhode Island, as in its audits of Textron, EY is obligated to maintain the confidentiality of its clients' information. R.I. Gen. Laws 1956 § 5-3.1-23.

U.S. at 808 (independent auditor followed its client's instructions not to comply with an IRS summons, and both parties contested the summons).

The IRS also argues that, because auditors may be required by law to turn over client information to government regulators such as the SEC, auditors are mere conduits to their clients' adversaries. The IRS is mistaken. As stated above, the PCAOB has not disturbed auditors' obligations regarding confidentiality pursuant to Rule 301, but rather directs them to "comply" with AICPA rules. *See* PCAOB Rule 3100. Moreover, when Congress created the PCAOB—the body that directly oversees independent auditors—it provided that all documents it collects from auditors regarding their clients "shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure," and that if the PCAOB shares any such document with the SEC or other federal or state regulators, this will be "without the loss of its status as confidential and privileged." 15 U.S.C. § 7215.

Thus, the District Court did not commit a clear error in finding that Textron reasonably expected confidentiality from its auditors, and there is no basis on this record to conclude that EY served as a mere conduit of information to the IRS (or any other Textron adversary).

C. The IRS' Position Would Discourage Prudent Corporate Governance

Any erosion of the traditional privileges and protections "not only makes it difficult for corporate attorneys to formulate sound advice when their client is faced with a specific legal problem but also threatens to limit the valuable efforts of corporate counsel to ensure their client's compliance with the law." *See Upjohn,* 449 U.S. at 392. Yet this is the result encouraged by the IRS. Again, the IRS advocates a catch-22, whereby companies that seek the benefit of their lawyers' litigation analyses and provide those analyses to their auditors, when necessary to the audit—a practice that should be encouraged—would be punished for doing so by thereafter being forced to turn that work product over to the IRS.

By urging this Court to adopt a blanket rule of waiver whenever companies share documents with their independent auditors, the IRS' request is particularly dangerous. "A business and its auditor can and should be aligned insofar as they both seek to prevent, detect, and root out corporate fraud." *See Merrill Lynch*, 229 F.R.D. at 448; *see also In re JDS Uniphase Corp. Sec. Litig.*, 2006 WL 2850049, at *1-2 (following the reasoning of *Merrill Lynch*). Any authority that threatens to weaken that common interest runs contrary to the goals of encouraging good corporate governance and transparency that Congress sought to achieve by enacting the Sarbanes-Oxley Act, *i.e.*, "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities

laws." H.R. Rep. No. 107-610, at 1 (2002), *as reprinted in* 2002 U.S.C.C.A.N. 542, 542. A *per se* rule of waiver in that context, as the court described in *Merrill Lynch*, "could very well discourage corporations from conducting a critical self-analysis and sharing the fruits of such an inquiry with the appropriate actors." *Merrill Lynch*, 229 F.R.D. at 441 (citing *United States v. Arthur Young*, 677 F.2d 211, 220 (2d Cir. 1982), *aff'd in part, rev'd in part*, 465 U.S. 805 (1984)). Any ambiguity on this issue, in fact, would be harmful to the process of good corporate governance, because "[a]n uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all." *Upjohn*, 449 U.S. at 393.

Perhaps most importantly, should the IRS succeed in its request that this Court craft such sweeping new rules—*i.e.*, that a company's litigation reserve analysis prepared by its counsel is never work product, and even if it is, that the company's disclosure of the work product to its auditors waives all protections—the effects on Textron *and all other companies preparing financial statements in accordance with GAAP* would be draconian and the precedent would devastate the work product doctrine itself. In a post-Sarbanes Oxley world that places a premium on corporate accountability, companies sensibly turn to their attorneys to provide legal counsel, conduct internal investigations and prepare analyses in order to assist the company on an increasingly-wide array of complex issues—all while

companies consider their (also widening) public disclosure obligations. In this context, the legal work performed by corporate counsel benefits the company's compliance with the law and its business decision-making, and the two are interrelated. Were this Court to hold that Textron—having taken the sensible approach of requesting that its lawyers prepare a litigation reserve analysis—must give that analysis to its adversary merely because Textron used it for the additional purpose of assessing and supporting its public financial disclosures, it would set a dangerous precedent:

- First, the IRS' lawyers would win the opportunity to use this work product to outline their positions adverse to Textron, and (as promised) will pursue this strategy as a matter of policy against all other similarly situated corporate taxpayers.
- Second, companies that produce attorney work product to the government whenever the government asks certainly must expect—under the current state of the law—that this will be considered a *universal* waiver (rather than a waiver selectively made just as to the government), *see In re Qwest Comm'ns Int'l, Inc. Sec. Litig.*, 450 F.3d 1179, 1192-97 (10th Cir. 2006 (joining line of cases to reject selective waiver, and ordering company that produced work product to government to produce documents to litigation adversaries); *United*

States v. Mass. Inst. of Tech., 129 F.3d 681, 686 (1st Cir. 1997) (expressing "reluctance" regarding theory of selective waiver).[12] Thus, companies should expect that private litigants and shareholders will seek such litigation analyses turned over to the IRS as a matter of course to support actions second-guessing the companies' financial statements and positions supporting them.

- Third, should the Court hold that disclosure to auditors constitutes a waiver of work product protection, litigants likely would argue that such a waiver constitutes a subject matter waiver, entitling them to obtain all privileged communications and confidential information regarding the litigation or subject at issue. *See, e.g., In re Echostar Comm'ns Corp.*, 448 F.3d 1294, 1303-04 (Fed. Cir. 2006) (whether disclosure of work product results in subject matter waiver is a fact-intensive inquiry based on the context of disclosure).
- Fourth, if this Court were to hold that the litigation analysis prepared by Textron's counsel is not attorney work product and thus is available to Textron's adversaries, then whether or not such analyses are produced to the government or the auditors in any given case, *all*

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12 *But see* cases cited in n.9, *supra*. With such ambiguity regarding the theory of selective waiver, companies can have no confidence that disclosure made to one will avoid a waiver as to all.

private litigants will be emboldened to seek such analyses in suits against companies.

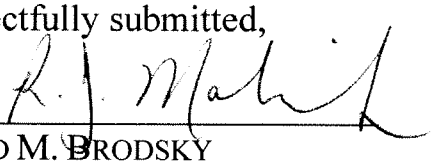
This Court should decline the IRS' invitation to *discourage* prudent corporate conduct and to *punish* companies that turn to their lawyers for assistance in the realities of running a modern business.

CONCLUSION

For the reasons stated herein, ACC and the Chamber request affirmance of the District Court's decision.

Dated: April 8, 2008

Respectfully submitted,



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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B), as extended by this Court should it grant the Chamber and ACC's Motion for Leave to File and Motion for an Extension, because this brief contains 10,834 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). Those excluded are the Table of Contents, the Table of Authorities and Certifications of Counsel.

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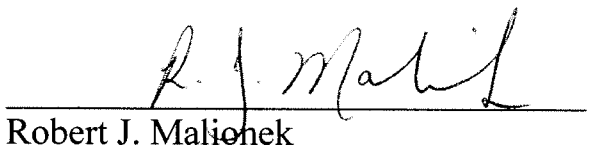

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