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FIRST CIRCUIT HOLDS THAT TAX ACCRUAL WORK PAPERS ARE NOT PROTECTED UNDER THE ATTORNEY WORK PRODUCT DOCTRINE

In *United States v. Textron Inc.*, 2009 WL 2476475 (1st Cir. Aug. 13, 2009), the United States Court of Appeal for the First Circuit held that the attorney work product doctrine only protects documents "prepared for use in possible litigation." This arguably marks a significant modification of the previous rule in that Circuit and elsewhere that documents that were prepared "because of" possible litigation were protected under the work product doctrine. The consequences of this decision may be far-reaching. At the very least, corporate and tax counsel assisting in the preparation of documents that have both a business purpose and a possible litigation purpose should be aware that, unless those documents were "prepared for use" in litigation, they may be subject to discovery.

In 2003, the Internal Revenue Service ("IRS") audited Textron's corporate taxes from 1998 to 2001. During the course of the audit, the IRS concluded that Textron had engaged in a number of transactions that were designed to evade taxation. Pursuant to its statutory authority, the IRS issued an administrative summons to "examine any books, papers, records, or other data which may be relevant or material" to the IRS' audit. Because the IRS argued that Textron's accounting claimed benefits for multiple listed transactions, the IRS sought "all workpapers for the tax year in question." The IRS also sought work papers created by Textron's auditors, including tax accrual work papers prepared in part by Textron's corporate tax counsel.

In Textron's case, its tax accrual work papers listed items in its tax return "that, if identified, and challenged by the IRS, could result in additional taxes being assessed." Textron's tax accrual work papers listed "each debatable item, including in each instance the dollar amount subject to possible dispute and a percentage estimate of the IRS' chances of success." Based on these calculations, Textron calculated the amount of money it would need to reserve in case of additional tax liability. Textron asserted that these work papers were protected under the attorney work product doctrine and, as such, were not discoverable.

The district court agreed, concluding that "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 'but for' the fact that Textron anticipated the possibility of litigation with the IRS." On appeal to the First Circuit, a divided panel agreed. However, the *en banc* court granted the IRS' petition for rehearing, reversing the district court and First Circuit panel in concluding that such documents were not protected under the work-product doctrine.

In reversing the district court and the panel's decisions, the court noted that under Federal Rule of Civil Procedure 26(b)(3), only documents that are "prepared in anticipation for litigation or for trial" are protected by the work product doctrine. Under the First Circuit's earlier decision in *Maine v. United States Department of Interior*, 298 F.3d 60 (1st Cir. 2002), the standard for making such a determination was whether the documents were prepared "because of" possible litigation. While stating that it was not expressly overruling the precedent announced in *Maine*, the First Circuit appeared to modify this standard, holding that to determine whether the work product privilege applied a court must look to see if there was "evidence" that the work papers were "unquestionably *prepared for potential use in litigation* if and when it should arise." The court concluded that the tax accrual work papers were not prepared for such a use, holding that "the work product privilege is aimed at protecting work done for litigation, not in preparing financial statements."

The court noted that documents, such as Textron's tax accrual work papers, did not have "the touch and feel of material prepared for a current or possible (*i.e.*, "in anticipation of") law suit." "No one with experience of law suits," the court further held, "would talk about tax accrual work papers" as documents prepared in anticipation of litigation. Rather, a "set of tax reserve figures, calculated for purposes of accurately stating a company's financial figures, has in ordinary parlance only that purpose: to support a financial statement and the independent audit of it."

Two judges dissented. Judge Toruella, writing for the minority, noted that the majority had "abandoned" the First Circuit's previous "because of" test in favor of what he called a "bad rule." Citing concerns about "free-riding off another's work" -- that is, the fear that an attorney's work "would redound to the benefit of the opposing party" -- the dissent argued that corporate tax attorneys are now incentivized to avoid writing down their thoughts because of a "new rule allowing discovery of . . . dual purpose documents, which contain confidential assessments of litigation strategies and chances." In light of the majority's decision, the dissent argues, "the IRS will now be able to immediately identify weak spots and know exactly how much" companies such as Textron "should be willing to spend to settle."

As a consequence, the dissent argues, attorneys who prepare "documents analyzing anticipated litigation, but prepared to assist in a business decision rather than to assist in the conduct of litigation," should be wary. "Nearly every major business decision by a public company," the dissent notes, "has a legal dimension that will require such analysis." As such, "[c]orporate attorneys preparing such analyses should now be aware that their work product is not protected in this circuit."

In many respects, the dissent lays out the potential consequences of *Textron*. *Textron* potentially limits the scope of the work product doctrine to those documents prepared solely for actual *use* in litigation. Consequently, in light of *Textron*, attorneys preparing "dual purpose documents" -- documents

that have both a purpose of anticipating litigation and a business purpose --are now potentially discoverable in the First Circuit.

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