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Caveat Corporate Litigator: The First Circuit Sets Back the Attorney Work Product Doctrine

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I have been writing articles about the attorney work product doctrine since 1987.[1] After Judge Pierre Leval delivered his thoughtful and eminently correct decision on that doctrine in *U.S. v. Adlman*[2] on behalf of the Second Circuit, however, I thought that much of the disinformation, misunderstanding, and mischief regarding work product would cease.[3] I was wrong.

ADLMAN

Judge Leval's opinion on *Adlman* is a necessary predicate to understand where we now find ourselves. In *Adlman*, an in-house lawyer for the Sequa Corporation (Monroe Adlman) asked the company's outside accounting firm to evaluate the tax consequences of a proposed corporate reorganization. The accounting firm did so in a detailed memorandum, setting forth among other things an analysis of the likely bases of an IRS challenge to a large tax refund claim the company was likely to interpose as a result of the reorganization.

After Sequa went through with the transaction and claimed the hefty refund, the IRS did indeed bring on an audit, which led to a subpoena for documents that included the accounting firm's memorandum. When Sequa and Mr. Adlman declined to produce the document, the IRS sought to enforce the subpoena before Judge Knapp in the Southern District of New York.

Sequa and Mr. Adlman claimed the protections of the attorney-client privilege and the work-product doctrine. Judge Knapp rejected both, however. With respect to the attorney-client privilege, he found that Mr. Adlman had not consulted the accounting firm to receive legal advice. And as to work-product, Judge Knapp ruled that that doctrine was not applicable because the memorandum was prepared for litigation that was based on events purely prospective in nature.

In 1995, the Second Circuit partially affirmed the rulings of Judge Knapp (*Adlman I*[4]). In rejecting the claim of attorney-client privilege, the

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1. *See*, *e.g.*, C. E. Stewart, "The Attorney Work Product Doctrine," 92 *Case & Comment* (1987); C. E. Stewart, "Corporate Counsel and Attorney Work Product," *New York Law Journal* (November 8, 1993); C. E. Stewart, "Corporate Counsel and Privileges: Going, Going,…," *New York Law Journal* (July 11, 1996).
2. 134 F.3d 1194 (2d Cir. 1998).
3. *See*, *e.g.*, C. E. Stewart, "The Attorney-Client Privilege: The Best of Times, the Worst of Times," *The Professional Lawyer* (1999); C. E. Stewart, "*Hickman v. Taylor* Reinvigorated by the Second Circuit, with Important Benefits for Litigants," *ABA Pretrial Practice & Discovery* (July 1998).
4. 68 F.3d 1495 (3d Cir. 1995).

court found that "the evidence supports the conclusion that Sequa consulted an accounting firm for tax advice, rather than that Mr. Adlman, as Sequa's counsel, consulted [the accounting firm] to help him reach the understanding he needed to furnish legal advice." At the same time, however, the court remanded the case on the work-product issue. The court ruled that whether or not the events had not yet occurred was immaterial to an analysis under Fed. R. Civ. P. 26(b)(3); the proper standard to be applied was whether the memorandum was prepared in anticipation of litigation that could result from engaging in the proposed conduct.

Judge Knapp, with the foregoing guidance, still was not moved. On remand, he again rejected the claim of work-product, and the issue once more went back to the Second Circuit.

In *Adlman II*[5], a Second Circuit panel headed by Judge Leval ruled in 1998 that the requisite showing under Rule 26(b)(3) to protect attorney work-product materials prepared "in anticipation of litigation" was just that—whether the materials had been, in fact, prepared "in anticipation of litigation." Judge Leval's decision rejected a growing number of decisions which imposed a gloss on the language of Rule 26(b)(3), requiring a showing that the sought-after materials had been generated "primarily," "principally," or "exclusively" in anticipation of litigation.[6] After a review of the policies underscored by the Supreme Court in *Upjohn* and *Hickman v. Taylor*,[7] Judge Leval termed the IRS's position that it should be entitled to the documents as "untenable":

> "If the company declines to make [a candid analysis of litigation risks] or scrimps on candor and completeness to avoid prejudicing its litigation prospects, it subjects itself and its co-venturers to ill-informed decision making. On the other hand, a study reflecting the company's litigation strategy and its assessment of its strengths and weaknesses cannot be turned over to litigation adversaries without serious prejudice to the company's prospects in the litigation.[8]

Consequently, Judge Leval determined that, for purposes of determining whether a document was prepared "in anticipation of litigation," the relevant standard would be to ascertain whether the document was created "because of" the prospect of litigation. On the heels of *Adlman II*,

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5. 134 F.2d 1194 (2d Cir. 1998).
6. *E.g.*, *In re Woolworth Corporation Securities Class Action Litigation*, 1996 WL 306576 (S.D.N.Y. June 7, 1996); *In re Leslie Fay Companies Inc. Securities Litigation*, 161 F.R.D. 274 (S.D.N.Y. 1995); *In re Kidder Peabody Securities Litigation*, 1996 WL 263030 (S.D.N.Y. May 17, 1996); *Garrett v. Metropolitan Life Ins. Co.*, 1996 WL 325725 (S.D.N.Y. June 12, 1996); *In re Wilkie Farr & Gallagher*, 1997 U.S. Dist. LEXIS 2927, 1997 WL 118369 (S.D.N.Y. March 14, 1997).
7. *U.S. v. Upjohn*, 449 U.S. 383 (1981); *Hickman v. Taylor*, 329 U.S. 497 (1947).
8. 134 F.3d at 1200.

most other courts followed Judge Leval's "because of" standard; it thus seemed that practicing lawyers could predict with some certainty where the work product goal posts were.[9] That all changed, however, when the First Circuit decided to change the rules.

TEXTRON

In connection with an audit of Textron's tax returns, the IRS discovered that a Textron subsidiary had utilized a number of tax shelters about which the IRS had questions. That led to the IRS issuing an administrative summons, seeking all of Textron's tax related work-papers for one of the years under audit. Textron partially resisted the summons, withholding certain documents, including spreadsheets prepared by Textron's lawyers; those spreadsheets (i) listed reserve items for which the ultimate tax treatment was uncertain, and (ii) estimated the likelihood of success with respect to each item in the event of a dispute with the IRS. Textron cited the attorney-client privilege and the work product doctrine as reasons for its non-compliance with the summons.

The district court ultimately denied the IRS's request for enforcement of its summons.[10] While the court acknowledged that the IRS had a legitimate reason for seeking the materials,[11] and while it rejected the claim of attorney-client privilege because Textron had shown the materials to its outside auditors,[12] the court nonetheless ruled that the materials were protected under the work product doctrine and thus not discoverable.[13]

Unlike the attorney-client privilege, disclosure of attorney work product to a non-adverse party (e.g., a company's auditor) does not automatically waive attorney work product protections.[14] Having disposed of the waiver issue, the court then looked to Judge Leval's analysis in *Adlman*

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9. *See*, *e.g.*, *In re Sealed Case*, 146 F.3d 881 (D.C. Cir. 1998); *In re Grand Jury Subpoena*, 357 F.3d 900 (9th Cir. 2004); *U.S. v. Roxworthy*, 457 F.3d 590 (6th Cir. 2006). Prior to the First Circuit's recent decision, the Fifth Circuit had been the principal outlier. *See In re Kaiser Aluminum & Chem. Co.*, 219 F.3d 586 (2000), *cert. denied*, 532 U.S. 919 (2001) (applying a "primary purpose" test).
10. *U.S. v. Textron, Inc.*, 507 F. Supp. 2d 138 (D.R.I. 2007).
11. *Id*. at 145.
12. *Id*. at 152. It is black letter law that disclosure of privileged materials to a third party waives the privilege. *See*, *e.g.*, *In re Subpoena Duces Tecum*, 738 F.2d 1367 (D.C. Cir. 1984).
13. *Id*. at 150.
14. *Id*. at 152-53.

(which had subsequently been adopted by the First Circuit[15]) in resolving the matter:

> "[I]t 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 revenue amounts would not have been prepared at all "but for" the fact that Textron anticipated the probability of litigation with the IRS."[16]

On appeal to the First Circuit, a divided three judge panel affirmed the district court. The First Circuit *en banc*, however, agreed with the IRS's petition for a rehearing *en banc* and vacated the earlier appellate affirmance.

After oral argument before the entire First Circuit, the court, by a three to two vote, reversed the district court and ruled that the work product doctrine did not shield the spreadsheets from disclosure to the IRS.[17] The three judge majority endorsed a new test for evaluating work product: were the documents created "for use" in litigation—i.e., would the materials "in fact serve any useful purpose for Textron in conducting litigation if it arose."[18] Because tax accrual work papers are prepared in the normal course for a public company seeking a "clean" opinion from its auditors, the majority opined that "[a]ny experienced litigator" would not describe such documents "as case preparation materials."[19] To Textron's argument that it would be "unfair" for the IRS to have access to the spreadsheets because it would give the IRS a huge advantage in its litigation with Textron, the majority was not impressed, observing that "the essential public interest in revenue collection" trumped any notions that litigation should be a relatively fair fight.[20]

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15. *Maine v. United States Department of the Interior*, 298 F.3d 60 (1st Cir. 2002).
16. 507 F. Supp. 2d at 150. That the documents were useful in getting a "clear" opinion from Textron's auditors was beside the point insofar as "there would have been no need to create a reserve in the first place, if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding." *Id*.
17. 577 F.3d 21 (1st Cir. 2009) (*en banc*).
18. *Id*. at 27 & 30.
19. *Id*. at 28. *See also id*. at 31. *See generally U.S. v. Arthur Young & Co.*, 465 U.S. 805 (1984) (rejecting accountant work product privilege).
20. *Id*. at 31.

THE DISSENT

The two judge dissent right off noted that the majority decision was in the face of the First Circuit's own precedent.[21] It next observed (correctly) that the majority's "prepared for" test "is an even narrower variant of the widely rejected 'primary motivating purpose' test used in the Fifth Circuit."[22] The majority's test, moreover, "ignores a tome of precedents from the circuit courts and contravenes much of the principles underlying the work-product doctrine"; indeed, it even "brushes aside the actual text of Rule 26(b)(3)."[23]

The dissent then went through a careful recitation of the analysis articulated by Judge Leval in *Adlman*; and how that analysis (and the "because of" test) were consistent with the text of Rule 26(b)(3) and the underlying goals and policies of the work product doctrine (as originally articulated by the Supreme Court in *Hickman v. Taylor*[24]). In fact, as the dissent observed, under the "because of" standard, the spreadsheets "contain exactly the sort of mental impressions" that the work product doctrine was designed to protect.[25] And as the dissent conversely observed, under the majority's "prepared for" test, there would be no protection for attorney documents analyzing anticipated litigation; the judges thus warned lawyers going forward "that their work product is not protected in this circuit."[26]

The dissent concluded by acknowledging that the IRS would surely be happy about this sharp change in the law, thus allowing the agency to have a new and "important tool in combating [tax] fraud."[27] But given the fact that the majority's decision "has thrown the law of work-product into disarray,"[28] the dissent called upon 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.[29]

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21. *See supra* note 15. Bizarrely, the majority argued that the "prepared for" test is not inconsistent with the "because of" test; that is obvious sophistry and clearly wrong. 577 F.3d at 32-34.
22. 577 F.3d at 32. *See supra* note 9.
23. 577 F.3d at 32.
24. *See supra* note 7.
25. 577 F.3d at 36.
26. *Id.* at 38.
27. *Id*. at 43.
28. *Id*.
29. *Id*.

THE SUPREME COURT

Textron asked for certiorari review by the Supreme Court.[30] The Court declined to exercise its jurisdiction, however. With the Court's decision not to weigh in, it is clear that the majority's ruling in *Textron* unleashes (like Pandora's Box) wide-spread mischief into the lives of corporate litigators. First, if only documents "prepared for" litigation are covered, then the universe of protected materials has shrunk enormously; conversely, the amount of motion practice to get access to this increased universe of materials will surely rise commensurately. Careful lawyers will undoubtedly react by reducing their litigation analyses to writing (or eliminating them all together); as Judge Leval (and others—e.g., the Supreme Court) have observed, such a result would be hard to reconcile with good corporate decision making.[31] Other foreseen (and unforeseen) consequences also lurk. As the dissent in *Textron* noted, for example, under the majority's approach litigation reserve decisions and specific amounts thereof are likely fair game under the "prepared for" test.[32]

CONCLUSION

At bottom, the majority's decision in *Textron* is wrongly decided and will have many bad results flowing from it—especially now that the Supreme Court has decided not to weigh in and overrule it. As the Eighth Circuit made clear over three decades ago in one of the truly seminal decisions on work product, the doctrine protects litigation **analysis**, wholly without regard to "use" in the litigation at issue; indeed, the analysis can be for litigation that is terminated or unrelated to the litigation at issue.[33] Furthermore, the type of litigation analysis done by the Textron lawyers

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30. *See* J. Finet & A. Bennett, "Textron Seeks Supreme Court Review of Ruling on Tax Accrual Work Papers," *ABA/BNA Lawyer's Manual on Professional Conduct* 20 (January 6, 2010).
31. *See supra* notes 7 & 8.
32. 577 F.3d at 37. The dissent noted its concern with this "sharp practice" becoming the norm. *Id*. Even before the *Textron* decision, the issue of disclosure of litigation reserves was on the radar screen of corporate litigators as being fraught with dangers to the attorney-client privilege and the work product doctrine. *See* August 8, 2008 letter from the Litigation Advisory Committee of the Securities Industry and Financial Markets Association to R. Hartz, Chairman, Financial Accounting Standards Board, regarding an amendment of FASB Statements Nos. 5 and 141(R). [This letter (and others commenting on the FASB proposals) can be found at http://www.fasb.org/home.].
33. *See In re Murphy*, 560 F.2d 326 (8th Cir. 1977). *See also* C. E. Stewart, "Jumping on a Hand Grenade for a Client," *Federal Bar Council Quarterly* (November 2009).

is/was clearly *opinion* work product, attorney materials which "enjoy[ ] a nearly absolute immunity and can be discovered only in very rare and extraordinary circumstances."[34] Such "very rare and extraordinary circumstances" were clearly not shown by the IRS in *Textron*—the agency only wanted the litigation materials to ensure that it would not have to be engaged in a fair fight. That should never be the governing principle. But until the Supreme Court sets the law back to its *Adlman* days, the cautions of the *Textron* dissent must be carefully heeded.

34. 560 F.2d at 336.

NOTES