TEXTRON: THE FALSE CHOICE BETWEEN FINANCIAL TRANSPARENCY AND LITIGANT CONFIDENTIALITY

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Corporate fraud has rampaged through the American economy for the past ten years. Enron crashed into bankruptcy in 2001 after an investigation uncovered an elaborate conspiracy to disguise $11 billion in losses with deceptive accounting practices and convoluted self-dealings.[1] In 2002, WorldCom admitted to misleading investors by improperly accounting for $3.8 billion in expenses.[2] That same year, Tyco International shareholders learned that their CEO used company money to buy $6,000 shower curtains, a $17,000 traveling toilet box and other extravagant personal items.[3] In 2008, Bernie Madoff confessed to orchestrating the largest Ponzi scheme in American history, costing investors $65 billion.[4]

Amidst the growing flurry of scandals, Congress passed the Sarbanes-Oxley Act, a broad piece of legislation that provided new regulation for the financial sector.[5] Congress emphasized financial transparency by requiring public companies

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1. Skilling v. United States, 130 S. Ct. 2896 (2010); George Benston, *The Quality of Corporate Financial Statements and Their Auditors Before and After Enron*, 497 POLICY ANALYSIS 1 (2003).

2. WorldCom Inc., Current Report (Form 8-K) at Exhibit 99.1 (June 25, 2005).

3. Tyco Int'l Ltd., Current Report (Form 8-K) at 6-7 (Sept. 10, 2002) (detailing other expenditures including $2,900 coat hangers, a $6,300 sewing basket and a $15,000 dog umbrella stand).

4. Dan Margolies, *U.S. Task Force Targets 4 Types of Financial Crimes*, REUTERS, Jan. 8, 2008, http://in.reuters.com/article/idINIndia-4526022010 0108.

5. STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 39 (2d ed. 2008).

to disclose more information to regulators and the general investing public.[6]

Transparency may be essential for effective corporate governance, but confidentiality is an integral component of the American adversarial system. A well-functioning adversarial system requires litigants to possess "a certain degree of privacy, free from unnecessary intrusion by opposing parties."[7] To preserve the integrity of the adversarial system, the Supreme Court created the work product doctrine: work product prepared in anticipation of litigation is shielded from discovery by opposing litigants.[8]

The work product doctrine implicates a delicate balance between transparency and confidentiality: companies need to be transparent enough to promote efficient financial markets, but they also need to preserve enough confidentiality to prepare effectively for litigation. Work product protection allows companies to meet both of these competing needs: companies can freely share litigation-related information with regulators without fear that the information may later be used against them by opposing litigants.[9] Financial transparency and litigant confidentiality need not be mutually exclusive.

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6. *See* Brent J. Horton, *How Corporate Lawyers Escape Sarbanes-Oxley: Disparate Treatment in the Legislative Process*, 60 S.C. L. REV. 149, 200 n.272 (2008) (stating that financial transparency was the "cornerstone" of Sarbanes-Oxley). Many commentators agree that financial transparency is important for the capital markets. *See generally* Gill North, *Efficiency, Fairness & Irrationality: Incompatible or Complementary?*, 24 BANKING & FIN. L. REV. CAN. 311, 312 (2009) (arguing that investor confidence in the integrity of the markets is necessary for long-term efficiency); Jill E. Fisch, *Top Cop or Regulatory Flop? The SEC at 75*, 95 VA. L. REV. 785 (2009) ("Ensuring appropriate financial transparency is at the core of the SEC's traditional expertise."); Louis Lowenstein, Essay, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335, 1361 (1996) ("[G]ood financial accounting is important to the integrity of our markets . . . [and] an important corporate governance tool.").

7. Hickman v. Taylor, 329 U.S. 495, 510-12 (1947).

8. *See id.* at 510-11; *see also* Duplan Corp. v. Moulinage et Retorderie de Chavanoz, 509 F.2d 730, 734 (4th Cir. 1974) (stating that the *Hickman* Court "was concerned with protecting the thought processes of lawyers and thus the very adversary system"); Jeff A. Anderson et al., *The Work Product Doctrine*, 68 CORNELL L. REV. 760, 785 (1983).

9. *See* United States v. Adlman, 134 F.3d 1194, 1200 (2d Cir. 1998) (stating that an attorney's mental impressions should not be available to oppos-

In *United States v. Textron*, the First Circuit upset this functional balance by creating a new standard for the work product doctrine: only documents created "for use" in litigation are shielded from discovery.[10] Under this standard, litigation-related documents that also fulfill a regulatory purpose may no longer be protected by the work product doctrine. One of the most significant regulatory requirements for public companies is the annual independent audit, which requires companies to disclose sensitive legal information to its independent auditors.[11] Under a reasonable interpretation of *Textron*, any information shared with independent auditors would be discoverable by opposing litigants. Thus, while *Textron* appears to promote transparency – by giving litigants access to information traditionally protected by the work product doctrine – the decision actually discourages transparency by disincentivizing companies from communicating freely with their independent auditors.

This Note analyzes *Textron* in the context of independent audits and submits that the First Circuit decision is a dangerous aberration from Supreme Court precedent that should not be followed. *Textron* discourages financial transparency, undermines the adversarial system and creates a perverse informational asymmetry that benefits a company's opponents at the expense of the company's shareholders and the general investing public. Part I of this Note describes the independent audit. Part II discusses the work product doctrine. Part III analyzes *Textron* and its novel "for use" standard. Finally, Part IV discusses the public policy concerns raised by the *Textron* decision.

I.
THE INDEPENDENT AUDIT

Publicly-traded companies in the United States must file annual financial statements with the Securities & Exchange Commission ("SEC").[12] The Supreme Court described finan-

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ing litigants merely because the document was created for a business purpose).

10. 577 F.3d 21 (1st Cir. 2009).

11. *See* discusssion *infra* Part I.

12. Securities and Exchange Act of 1934, 15 U.S.C. § 78m(a)(2); United States v. Arthur Young & Co., 465 U.S. 805, 810-811 (1984) (stating that

cial statements as "one of the primary sources of information available to guide the decisions of the investing public."[13] Public confidence in financial statement accuracy is vital for the nation's legal, political, and economic systems.[14] Shareholders, creditors, and the general investing public rely on them to make informed business decisions.[15]

Financial statements provide both quantitative and qualitative information. The balance sheet, income statement and statement of cash flows provide quantitative information about the company's current and historical financial health.[16] The notes to the financial statements include management's qualitative discussion and analysis of the company's long-term health.[17]

Financial statements must comply with two important requirements. First, the financial statements must be prepared by company management in accordance with the accounting rules set out in the Generally Accepted Accounting Principles ("GAAP").[18] Second, an independent auditor must review the financial statements.[19]

A company is free to select its own independent auditor.[20] But once the audit begins, the auditor owes no allegiance to

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federal securities laws require public companies to file financial statements with the SEC).

13. *Arthur Young*, 465 U.S. at 810.

14. INQUIRY OF A CLIENT'S LAWYER CONCERNING LITIGATION, CLAIMS AND ASSESSMENTS, Statement on Auditing Standards No. 12, § 337C (Am. Inst. of Certified Pub. Accountants 1976).

15. *See* Ricardo Colon, *Caution: Disclosures of Attorney Work Product to Independent Auditors May Waive the Privilege*, 52 LOY. L. REV. 115, 120 (2006).

16. 17 C.F.R. § 210.3-01 (2010) (balance sheet); 17 C.F.R. § 210.3-02 (2010) (income statement and statement of cash flows).

17. 17 C.F.R. § 229.303(a) (2008).

18. RESPONSIBILITIES AND FUNCTIONS OF THE INDEPENDENT AUDITOR, Statement on Auditing Standards No. 1, § 110.03 (Am. Inst. of Certified Pub. Accountants 1972); 15 U.S.C. § 78j-1(a)(1) (2006).

19. 15 U.S.C. § 78j-1(a)(1) (2002); 15 U.S.C. § 7201(2) (2002). The profession was largely self-governed until 2001. Congress enacted Sarbanes-Oxley in the wake of the Enron scandal and created the Public Accounting Oversight Board ("PCAOB") to regulate the accounting profession. *See* 15 U.S.C. § 7211 (2002).

20. To emphasize the independent nature of the auditors, management may allow the auditors to be selected by the board of directors or by a shareholder vote. *See* INDEPENDENCE, Statement on Auditing Standards No. 1, § 220.07 (Am. Inst. of Certified Pub. Accountants 1972). The audit selection

the company. "This public watchdog function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust."[21] The auditor has a "*public* responsibility transcending any employment with the client."[22]

At year-end, company management prepares a draft of the financial statements. The auditor takes the draft and conducts various audit procedures to test the accuracy and completeness of the financial statements. The auditor's ultimate goal is to provide an opinion on whether the financial statements are in conformity with GAAP.[23] The auditor must collect and retain evidence in support of the opinion.[24]

The best opinion a company can receive is an unqualified opinion.[25] Anything less can be catastrophic – potential consequences include decreased investor confidence, lower share prices and restricted access to capital.[26] Hence, companies

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process is also governed by independence requirements set out by the PCAOB and the SEC. SEC Release No. 34-53677, 71 Fed. Reg. 23,971 (Apr. 19, 2006) (codifying Professional Standard Rule 3).

21. United States v. Arthur Young, 465 U.S. 810, 818 (1984) (internal quotations omitted).

22. *Id.* at 806 (emphasis in original).

23. *See* RESPONSIBILITIES AND FUNCTIONS OF THE INDEPENDENT AUDITOR, Statement on Auditing Standards No. 1, § 110.01 (Am. Inst. of Certified Pub. Accountants 1972) (stating that the auditor opines on "the fairness with which [the financial statements] present, in all material respects, financial position, results of operations, and its cash flows in conformity with generally accepted accounting principles").

24. AUDIT EVIDENCE, Statement on Auditing Standards No. 106, § 326.01 (Am. Inst. of Certified Pub. Accountants 2006). The quantum of evidence necessary to support the opinion is within the professional judgment of the auditor. *Id.* § 326.22.

25. There are several less favorable opinions available to the auditor: a qualified opinion, an adverse opinion or a disclaimer of opinion. *See* REPORTS ON AUDITED FINANCIAL STATEMENTS, Statement on Auditing Standards No. 58, § 508.10 (Am. Inst. of Certified Pub. Accountants 1998) (providing guidance for when these opinions are justified).

26. *See* Jagan Krishnan, Jayanthi Krishnan & Ray G. Stephens, *The Simultaneous Relation Between Auditor Switching and Audit Opinion: An Empirical Analysis*, 26 ACCT. & BUS. RES. 224 (1996); Colon, *supra* note 15, at 116; Andrew B. Jackson, Michael Moldrich & Peter Robuck, *Mandatory Audit Firm Rotation and Audit Quality*, 23 MANAGERIAL AUDITING J. 5, (2008) ("A qualified report may signal to investors that managers are poor stewards of the company's affairs, or that managers have attempted to present an over-favourable view of the company's performance . . . .").

have a strong incentive to cooperate with the auditor and disclose the information necessary to obtain an unqualified opinion. "Independent auditors have significant leverage . . . . An auditor can essentially compel disclosure by refusing to provide an unqualified opinion otherwise."[27]

A. *Litigation Information Provided to Auditors*

During the course of an audit, the auditor has a duty to investigate the company's potential legal liabilities.[28] Company management is the primary source for this information.[29] Management provides the auditor with a description and evaluation of all significant claims in a document commonly called a *litigation reserve workpaper*.[30] Each enumerated claim is usually accompanied by a short description of the litigation, an evaluation of the claim and an estimate of liability that management reasonably expects the company to incur.[31]

The auditor then attempts to corroborate management's information with the company's outside counsel. The lawyer must provide a document called a *legal letter*.[32] The legal letter describes the nature and progress of each case on which the lawyer worked a significant amount of hours, as well as any future legal action the company intends to take.[33] In the letter, the lawyer assesses the likelihood of an unfavorable outcome for each case and, if possible, provides an estimate of the loss.[34] The lawyer should also disclose and identify any pending or threatened litigation that management did not already

27. United States v. Deloitte LLP, 610 F.3d 129, 143 (D.C. Cir. 2010).

28. INQUIRY OF A CLIENT'S LAWYER CONCERNING LITIGATION, CLAIMS, AND ASSESSMENTS, Statement on Auditing Standards No. 12, § 337.04 (Am. Inst. of Certified Pub. Accountants 1976).

29. *Id.* § 337.05.

30. *See id.* §§ 337.05-337.07 (providing guidance on other audit procedures, which include an examination of litigation-related documentation such as legal invoices, correspondence with lawyers and board minutes).

31. *See* United States v. Aldman, 134 F.3d 1194, 1199-1200 (providing an example of litigation reserve work papers); United States v. Textron, 577 F.3d 21, 23 (1st Cir. 2009) (describing tax accrual work papers, a similar type of document required by auditors).

32. INQUIRY OF A CLIENT'S LAWYER CONCERNING LITIGATION, CLAIMS, AND ASSESSMENTS, Statement on Auditing Standards No. 12, § 337.08-337.09 (Am. Inst. of Certified Pub. Accountants 1976).

33. *Id.* § 337.09d(1).

34. *Id.* § 337.09d(2).

disclose to the auditor.[35] If the lawyer refuses to provide the necessary information in the legal letter, the auditor has grounds to give the company an unfavorable audit opinion.[36]

The concept of the legal letter was created by the *Treaty*, a formal agreement that created a cooperative framework for the accounting and legal professions.[37] Before the Treaty, auditors and lawyers often clashed because of their inherently different capacities. Auditors owe fidelity to the public whereas lawyers owe fidelity to the client. Auditors must be "without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be."[38] Lawyers, on the other hand, are anything but independent – they serve as the company's advocates.[39]

Confidentiality is a key weapon in the attorney's arsenal: confidential communications between lawyer and client are protected by the attorney-client privilege.[40] The privilege is "founded upon the necessity, in the interest and administration of justice," of allowing clients to speak to attorneys without fear that the communications will be disclosed to others.[41]

When information is shared with an independent auditor, the attorney-client privilege is waived.[42] Unsurprisingly, the

35. *Id.* § 337.09d(3).

36. *Id.* § 337.13.

37. *See* EXHIBIT II—AMERICAN BAR ASSOCIATION STATEMENT OF POLICY REGARDING LAWYERS' RESPONSES TO AUDITORS' REQUESTS FOR INFORMATION, Statement on Auditing Standards No. 12, § 337C (Am. Inst. of Certified Pub. Accountants 1976) [hereinafter *Treaty*].

38. INDEPENDENCE, Statement on Auditing Standards No. 1, § 220.02 (Am. Inst. of Certified Pub. Accountants 1972).

39. *See* MODEL RULES OF PROF'L CONDUCT pmbl. (2002).

40. Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) (describing the privilege as the oldest privilege for confidential communications known to the common law).

41. Hunt v. Blackburn, 128 U.S. 464, 470 (1888); *see also Upjohn*, 449 U.S. at 389 (stating that the privilege's purpose is to encourage clients to make full disclosure to their attorneys).

42. Colon, *supra* note 15, at 116 (stating that "it is well settled that companies waive the attorney-client privilege by disclosing documents to independent auditors"); *In re* Pfizer Sec. Litig., No. 90 Civ. 1260 (SS), 1993 WL 561125 at *6, *7 (S.D.N.Y. Dec. 23, 1993) (stating that "Pfizer cannot assert attorney-client privilege for any documents that were provided to its independent auditor"); Westinghouse Elec. Corp. v. Republic of the Philippines, 951 F.2d 1414, 1427 (3d Cir. 1991).

threat of waiver made attorneys extremely reluctant to share litigation-related information with auditors. Auditors would often respond to an attorney's reluctance by issuing unfavorable audit opinions.[43]

In 1975, the two professions agreed to enter into the Treaty by compromising on several key issues. First, both professions agreed to use legal letters as the standard form of communication between lawyers and auditors. Second, both professions agreed that lawyers, in most circumstances, should not be forced to predict the outcome of a case, "except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either 'probable' or 'remote.'"[44] Finally, both professions agreed that attorney-client confidentiality must be preserved.[45] To minimize concerns regarding the waiver of attorney-client confidentiality, the auditor must exercise professional judgment so as to reduce the risk of jeopardizing the attorney-client privilege.[46] The Treaty warned that the agreement would not be viable if case law evolved in a way that compromised attorney-client confidentiality.[47]

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43. *See generally* Richard E. Deer, *Lawyers' Responses to Auditors' Requests for Information*, 28 BUS. LAW. 947 (1973).

44. *Treaty*, *supra* note 37.

45. *Id.* (stating that "the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and encouraging its readiness to seek advice of counsel and to act in accordance with client's counsel").

46. INQUIRY OF A CLIENT'S LAWYER CONCERNING LITIGATION, CLAIMS, AND ASSESSMENTS: AUDITING INTERPRETATIONS OF SECTION 337, Statement on Auditing Standards No. 12, § 9337.09 (Am. Inst. of Certified Pub. Accountants 1976); *but see* AUDIT EVIDENCE: AUDITING INTERPRETATIONS OF SECTION 326, Statement on Auditing Standards No. 106, § 9326 (Am. Inst. of Certified Pub. Accountants 2006) (providing a scenario in which audit concerns would outweigh privilege concerns).

47. *Treaty*, *supra* note 37 ("The Statement of Policy has been prepared in the expectation that judicial development of the law in the foregoing areas will be such that useful communication between lawyers and auditors in the manner envisaged in the Statement will not prove prejudicial to clients engaged in or threatened with adversary proceedings. If developments occur contrary to this expectation, appropriate review and revision of the Statement of Policy may be necessary.").

B. *Litigation Information in the Financial Statements*

The auditor receives far more information than what is ultimately presented on the face of the financial statements. FAS 5 is the accounting standard that describes how potential litigation losses should be disclosed in the financial statements.[48] According to FAS 5, company management must evaluate the likelihood of loss for each litigation claim under three possibilities: (1) probable; (2) reasonably possible; and (3) remote.[49]

FAS 5 provides little guidance about how companies should distinguish between the three categories.[50] Instead, it provides a list of qualitative factors to consider when assessing the likelihood of loss: (a) the opinions or view of legal counsel and other advisers; (b) the experience of the company in similar cases; (c) the experience of other companies in similar cases and (d) any decision of company management as to how the company intends to respond to the lawsuit (for example, a decision to contest the case vigorously or a decision to seek settlement).[51]

A potential litigation loss is recorded on the financial statements only if two conditions are met: the loss is probable and the loss can be reasonably estimated.[52] For example, Company X is sued by a consumer for a potential product de-

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48. FAS 5 governs the treatment of all loss contingencies, including potential litigation losses. A loss contingency is defined as "an existing condition, situation or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future events occur or fail to occur." ACCOUNTING FOR CONTINGENCIES, Statement of Fin. Accounting Standards No. 5, ¶ 1 (Fin. Accounting Standards Bd. 1975) [hereinafter *FAS 5*].

49. Under FAS 5, a loss is "probable" if the future event is likely to occur. A loss is "reasonably possible" if the chance of the event occurring is more than remote but less than likely. A loss is "remote" if the chance of the future event occurring is slight. *Id.* ¶ 3.

50. FAS 5 does caution companies that "probable" does not mean virtual certainty. *Id.* ¶ 84. Accounting experts have tried to provide quantitative estimates, but the estimates vary widely. Some argue for a percentage slightly greater than 50%, while others estimate 70-80%. *See* Matthew J. Barrett, *Opportunities for Obtaining and Using Litigation Reserves and Disclosures*, 63 OHIO ST. L.J. 1017, 1036 (2002) (expressing his personal belief that the percentage should be approximately 70.7%).

51. *FAS 5*, *supra* note 48, ¶ 35.

52. *Id.*

fect. If the company knows it will probably lose in litigation and can reasonably estimate its liability, the litigation loss must be recorded in the financial statements. It is important to note, however, that even if the loss is recorded, a reader of the financial statements does not have access to individual reserve amounts because the amounts are aggregated into a general account. Hence, the legal letters and litigation reserve workpapers provided to auditors contain far more detailed information than what is ultimately reflected on the face of the financial statements.

Even if a potential litigation loss does not have to be recorded on the financial statements, FAS 5 may require the company to disclose information in the notes to the financial statements. A potential litigation loss is disclosed in the notes when there is at least a reasonable possibility that the loss may be incurred.[53] The company must describe the nature of the litigation as well as an estimate of possible loss, a range of potential loss or an assertion that such an estimate cannot be made.[54]

A company is not required to disclose a litigation claim on the financial statements if the possibility of loss is remote.[55] FAS 5 also does not require disclosure of any claims that have yet to be asserted by potential litigants unless it is probable that a claim will be asserted and there is a reasonable likelihood that the outcome will be unfavorable.

For example, Company Y suffers a workplace accident that injures several employees. None of the employees have expressed an intent to file a lawsuit and it is unclear whether Company Y was responsible for the accident. If Company Y believes that the risk of litigation loss is remote, the potential litigation does not have to be disclosed. On the other hand, if Company Y believes that it is probable that an employee will eventually file a claim and there is a reasonable possibility that Company Y will lose in litigation, the contingency should be disclosed.

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53. *Id.*

54. *Id.* However, the Treaty contemplated that, in most circumstances, lawyers would not be able to provide an estimate. *Treaty, supra* note 37.

55. *FAS 5, supra* note 48, ¶ 35.

II.
THE WORK PRODUCT DOCTRINE

The work product doctrine provides an attorney with the privacy necessary to prepare effectively for litigation. The Supreme Court stated that the doctrine "shelters the mental processes of the attorney, providing a privileged area within which he can analyze and prepare his client's case."[56] The work product doctrine fundamentally differs from the attorney-client privilege. While the attorney-client privilege protects confidential communications from the client to the attorney,[57] the work product doctrine is broader in scope: the doctrine preserves the integrity of the adversarial system[58] by preventing a litigant from taking a free ride on the work performed by his opponent's lawyer.[59]

A. *The Supreme Court Creates the Work Product Doctrine in* Hickman

The Supreme Court created the work product doctrine in *Hickman v. Taylor*.[60] In *Hickman*, tug boat owners hired a lawyer after a boating accident killed five of the nine crew members aboard. The lawyer privately interviewed the four survivors and took statements from them with an eye towards litigation. Opposing counsel filed interrogatories seeking the witness statements.[61] The Court held that the witness statements were not discoverable. "Not even the most liberal of discovery theories can justify unwarranted inquiries into the files and the mental impressions of an attorney."[62]

The work product doctrine protects both tangible and intangible work. "This work is reflected, of course, in interviews, statements, memoranda, correspondence, briefs, mental im-

56. United States v. Nobles, 422 U.S. 225, 238 (1975).

57. Anderson, *supra* note 8, at 882.

58. *Id.* at 881.

59. United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999).

60. 329 U.S. 495 (1947). Ten years before *Hickman*, the Supreme Court had adopted the Federal Rules of Civil Procedure, creating the pretrial discovery process in 1937. The newly created discovery process created an inherent tension between an attorney's obligation to his client and his duty to respond to discovery requests. The work product doctrine was the Supreme Court's solution to ease this conflict. *See* Anderson, *supra* note 8, at 765.

61. *Hickman*, 329 U.S. at 498-99.

62. *Id.* at 510.

pressions, personal beliefs, and *countless other tangible and intangible ways. . . .*"[63] The underlying facts of a case, however, remain open to discovery.[64]

The work product doctrine protects the vitality of the adversarial system and preserves the integrity of the legal profession. "Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten . . . inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial."[65] The discovery process was "hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary."[66]

B. *Rule 26 Partially Codifies the Work Product Doctrine*

The general principles set out in *Hickman* were codified in Rule 26(b)(3) of the Federal Rules of Civil Procedure.[67] Rule 26 sets out a two-tiered scheme for work product protection. "Documents and tangible things that are prepared in anticipation of litigation or for trial" are shielded from discovery unless the opposing litigant can demonstrate "substantial need" for the materials.[68] Any intangible work product contained within the documents, however, is always protected regardless of substantial need. "If the court orders discovery . . . it must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation."[69]

Hickman and Rule 26 differ in two significant ways. First, Rule 26 expressly protects work product created by non-attorneys: the Rule mentions consultants, sureties, indemnitors, in-

63. *Id.* at 511 (emphasis added).

64. *Id.* ("Where relevant and non-privileged facts remain hidden in an attorney's file and where production of those facts is essential to the preparation of one's case, discovery may properly be had.").

65. *Id.* at 511.

66. *Id.* at 516 (Jackson, J., concurring).

67. United States v. Adlman, 134 F.3d 1194, 1197 (2d Cir. 1998); Tronitech, Inc. v. NCR Corp., 108 F.R.D. 655, 656 (S.D. Ind. 1985).

68. FED. R. CIV. P. 26(b)(3).

69. *Id.*

surers and agents as persons whose work may be protected.[70] Conversely, the Court in *Hickman* only provided explicit protection for work product created by attorneys.[71] The facts in *Hickman* only implicated attorney work product, thus the Court did not have an opportunity to reach the issue of non-attorney work product.[72]

Second, Rule 26 is only a partial codification of the work product doctrine because *Hickman* remains the proper standard for the protection of intangible work product.[73] Rule 26 only provides work product protection for "documents and other tangible things" and the intangible work product contained within them.[74] However, the Rule is silent on what protection, if any, is provided for intangible work product not contained within a document prepared in anticipation of litigation. *Hickman*, on the other hand, protects both tangible and intangible work product. The Court provided a non-exhaustive list of work product examples that included intangible items such as mental impressions and personal beliefs.[75]

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70. *Id.*; *see* Rhone-Poulenc Rorer, Inc. v. Home Indem. Co, 139 F.R.D. 609, 615 (E.D. Pa. 1991) (stating that Rule 26 "is not confined to information or materials gathered or assembled by a lawyer. Instead, it includes materials gathered by any consultant, surety, indemnitor, insurer, agent, or even the party itself.").

71. *Hickman*, 329 U.S. at 511.

72. According to the D.C. Circuit, *Hickman* may protect non-attorney work product. *See* United States v. Deloitte LLP, 610 F.3d 129, 136 (D.C. Cir. 2010) ("Under *Hickman*, however, the question is not who created the document or how they are related to the party asserting work-product protection, but whether the document contains work product – the thoughts and opinions of counsel developed in anticipation of litigation.").

73. *Deloitte*, 610 F.3d at 135 ("The work-product doctrine announced in *Hickman* was subsequently partially codified in Federal Rule of Civil Procedure 26(b)(3). . ."); United States v. 266 Tonawanda Trail, 95 F.3d 422, n.10 (6th Cir. 1996); *In re* Seagate Tech., LLC, 497 F.3d 1360, 1376 (Fed. Cir. 2007) ("[T]he work product doctrine was partially codified in Rule 26(b)(3), which applies work product protection to 'documents and tangible things.' Courts continue to apply [*Hickman*] to 'nontangible' work product."); Maynard v. Whilrpool Corp., 160 F.R.D. 85, 87 (S.D. W. Va. 1995) (stating that the *Hickman* formulation protects the mental impressions of an attorney even if Rule 26 does not); *In re* Grand Jury Subpoena, 220 F.R.D. 130, 141 (D. Mass. 2004); Anderson, *supra* note 8, at 841 (stating that *Hickman* continues to govern intangible work product protection).

74. FED. R. CIV. P. 26(b)(3).

75. *Hickman*, 329 U.S. at 511.

C. *Circuit Split Interpreting "in Anticipation of Litigation"*

Rule 26 requires that eligible work product be prepared "in anticipation of litigation."[76] Most courts have interpreted this language to require documents to be created "because of" litigation. This standard broadly protects any document prepared with an eye towards litigation, even if the document may also be used for other non-litigation purposes.[77] The Fifth Circuit utilizes a narrower standard, requiring that work product be prepared with impending litigation as the "primary motivating purpose" of the work product.[78]

1. *Majority Standard: "Because Of" Test*

Under the majority standard, a document is protected if it is created "because of" litigation.[79] "Litigation" is defined to cover a wide range of work product, including documents created before litigation commences and even documents created for litigation that never actually comes to pass.[80] Courts engage in a fact-specific inquiry to determine whether the materials in question were created "because of" litigation. "Prudent parties anticipate litigation and begin preparation prior to the time suit is formally commenced. Thus the test should be whether, in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation."[81]

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76. FED. R. CIV. P. 26(b)(3).

77. *See* Adlman v. United States, 134 F.3d, 1194, 1197 (2d Cir. 1998).

78. *See* United States v. El Paso Co., 682 F.2d 530 (5th Cir. 1982).

79. This standard has been adopted by all circuits except for the 5th, 10th and 11th circuits. *See* United States v. Deloitte LLP, 610 F.3d 129, 136 (D.C. Cir. 2010); Michelle M. Henkel, *Textron: The Debate Continues as to Whether Auditor Transparency Waives the Work Product Privilege*, BNA TAX MGMT. MEMORANDUM, June 22, 2009, at 251; Philip N. Jones, *First Circuit in Textron Gives IRS Access to Tax Accrual Workpapers*, J. TAX'N, Oct. 2009, at 201.

80. Anderson, *supra* note 8, at 885 ("It is often prior to the emergence of specific claims that lawyers are best equipped either to help clients avoid litigation or to strengthen available defenses should litigation occur."); *In re* Sealed Case, 146 F.3d 881, 887 (D.C. Cir. 1998) (holding that the absence of a specific claim is only a single factor in considering work product protection).

81. 8 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, FEDERAL PRACTICE AND PROCEDURE, § 2024 (2d ed. 2009).

According to the Rule 26 advisory committee notes, the work product doctrine does not apply to materials assembled in the ordinary course of business.[82] Courts have interpreted the notes to create an "ordinary course of business" exception to the work product doctrine.[83]

However, some documents created in the ordinary course of business also serve litigation purposes ("dual purpose documents"). Many courts and commentators agree that dual purpose documents should be protected.[84] Only business documents wholly unrelated to litigation should fall under the exception.[85] If any document created during the ordinary course of business is necessarily barred from protection, "the exception does not acknowledge that materials might be prepared in the ordinary course of business so that the company will be prepared adequately for trial."[86]

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82. FED. R. CIV. P. 26 advisory committee's note ("Materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes are not under the qualified immunity provided by this subdivision.").

83. *See* Adlman v. United States, 134 F.3d, 1194, 1202 (2d Cir. 1998) (withholding "protection from documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of litigation").

84. 8 WRIGHT, MILLER & MARCUS, *supra* note 81, § 2024 ("Dual purpose documents created because of the prospect of litigation are protected even though they were also prepared for a business purpose."); *Adlman*, 134 F.3d at 1200 (finding "no basis for adopting a test under which an attorney's assessment of the likely outcome of litigation is freely available to his litigation adversary merely because the document was created for a business purpose rather than for litigation assistance"); *see also* Regions Fin. Corp. & Subsidiaries v. United States, No. 2:06-CV-00895-RDP, 2008 WL 2139008, at *6 (N.D. Ala. May 8, 2008) (stating that the court found "no support for the conclusion that a party must show that it was motivated by preparation for litigation and nothing else in order to claim that a document is protected work product"); Caremark, Inc. v. Affiliated Computer Servs., Inc., 195 F.R.D. 610, 614 (N.D. Ill. 2000); Anderson, *supra* note 8.

85. *See* Anderson, *supra* note 8, at 852 (stating that "a court should treat the ordinary course of business criterion as merely one factor among many when applying the anticipation-of-litigation test"); Thomas Wilson, *The Work Product Doctrine: Why Have an Ordinary Course of Business Exception?*, 1988 COLUM. BUS. L. REV. 587, 595 (1988) (stating that the exception "contravenes the policies of Rule 26(b)(3) and the *Hickman* case").

86. Wilson, *supra* note 85, at 600.

One of the most frequently cited cases for the "because of" standard is *United States v. Adlman*.[87] In *Adlman*, the Second Circuit held that a study assessing the likely outcome of litigation is protected from discovery.[88] A document created because of litigation does not lose work product protection merely because it is also helpful in making a business decision.[89] The Second Circuit stated that analysis of a case in anticipation of litigation is a "classic example of work product" and receives heightened protection under Rule 26(b)(3).[90] The court also used litigation reserve workpapers as an example of protected work product.[91]

The Second Circuit rejected the proposition that documents must be useful at trial to receive work product protection. "Nowhere does Rule 26(b)(3) state that a document must have been prepared to aid in the conduct of litigation in order to constitute work product, much less primarily or exclusively to aid in litigation. Preparing a document 'in anticipation of litigation' is sufficient."[92] The court utilized a textualist argument by looking at the broad language used in Rule 26. "If the drafters of the Rule intended to limit its protection to documents made to assist in preparation for litigation, this would have been adequately conveyed by the phrase 'prepared for trial.' The fact that documents prepared 'in anticipation of litigation' were also included confirms that the drafters considered this to be a different, and broader category."[93]

2. *Minority Standard: "Primary Purpose" Test*

The Fifth Circuit has been the only circuit to reject the "because of" standard.[94] In the Fifth Circuit, a document is

87. *Adlman*, 134 F.3d at 1195.

88. *Id.* at 1195.

89. *Id.*

90. *Id.* at 1196-97.

91. *Id.* at 1120. (stating that litigation reserve workpapers fall "squarely within *Hickman*'s area of primary concern" because they contain "litigation strategies, appraisal of likelihood of success and perhaps the feasibility of reasonable settlement").

92. *Id.* at 1198.

93. *Id.*

94. *See* United States v. El Paso Co., 682 F.2d 530 (5th Cir. 1982); Michelle M. Henkel, *Textron: The Debate Continues as to Whether Auditor Transparency Waives the Work Product Privilege*, BNA TAX MGMT. MEMORANDUM, June

protected work product only if its "primary motivating purpose" is to aid in possible future litigation. This interpretation of Rule 26 significantly restricts the scope of the work product doctrine.[95]

In *United States v. El Paso Co.*, the IRS requested the company's tax accrual workpapers during the course of an audit.[96] The workpapers listed questionable items on the company's tax returns that the company believed could result in future additional tax liabilities if the IRS challenged it in court. The company refused to provide the documents, arguing that the workpapers were protected by the work product doctrine.

The Fifth Circuit held that the workpapers were not protected by the work product doctrine because their primary purpose was not litigation-related. "The legal analysis is not an end in itself . . . Business imperatives, not the press of litigation, call these documents into being."[97] Because the "primary purpose" of the workpapers was to ensure that the company was in conformity with GAAP, the workpapers were not protected.[98]

D. *Work Product Protection Can Be Waived*

Work product protection is not absolute. The protection is waived when the work product is disclosed in a manner that substantially increases the opportunity for a potential adversary to obtain the information.[99] Most courts have held that

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22, 2009, at 253 (stating that the Fifth Circuit is the only circuit to have adopted a stricter "primary motivating purpose" standard).

95. Andrew Golodny, Note, *Lawyers Versus Auditors: Disclosure to Auditors and Potential Waiver of Work-Product Privilege, in* United States v. Textron, 61 TAX LAW. 621, 623 (2008).

96. *El Paso Co.*, 682 F.2d at 533.

97. *Id.* at 543.

98. *Id.* ("El Paso establishes its non-current tax account to bring its financial books into conformity with generally accepted auditing principles. The desire to please the accountant, in turn, is compelled by the securities laws. The primary motivating force behind the analysis, therefore, is not to ready El Paso for litigation. . . rather, the primary motivation is to anticipate, for financial reporting purposes, what the impact of litigation might be on the company's tax liability.").

99. *In re* Pfizer Sec. Litig., No. 90 Civ. 1260 (SS), 1993 WL 561125, at *6 (S.D.N.Y. Dec. 23, 1993); Merrill Lynch & Co., Inc. v. Allegheny Energy, 229 F.R.D. 441, 445 (S.D.N.Y. 2004); 8 WRIGHT, MILLER & MARCUS, *supra* note 81, § 2024. Work product waiver differs from attorney-client privilege waiver –

disclosing work product to independent auditors does not constitute waiver.[100] "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."[101]

A few cases have held that a litigant waives work product protection when the documents are shared with auditors, but these opinions are rare exceptions to the majority line of cases. In *United States v. MIT*, the university provided documents to the Defense Contract Audit Agency ("DCAA"), the auditing arm of the Department of Defense.[102] When MIT claimed that the documents were protected by the work product doctrine, the First Circuit held that the protection was waived because the documents were provided to the DCAA, a potential adversary.[103]

The *MIT* decision should be limited to its specific facts. The DCAA auditors sought to promote a specific government interest: preventing contractors like MIT from overcharging the government. The school was aware that the DCAA could use information gathered by its auditors to bring a lawsuit. In contrast, independent auditors are not agents for any government interest – they must be independent and neutral.[104] Independent auditors also have a professional duty to keep client information confidential.[105] The DCAA has no such obli-

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which occurs when information is disclosed to any third party – because "disclosure to third parties will often strengthen a client's case." Anderson, *supra* note 8, at 883. Work product protection exists "to protect information against opposing parties, rather than against all others." United States v. Am. Tel. & Tel. Co., 642 F.2d 1285, 1299 (D.C. Cir. 1980).

100. *See* United States v. Deloitte, 610 F.3d 129, 139 (D.C. Cir. 2010) (stating that no other circuit court has addressed the issue and that most district courts have not found waiver); Westerbank P.R., v. Kachkar, 2009 WL 530131, at *7 (D.P.R. Feb. 9, 2009); *see also* Tronitech, Inc. v. NCR Corp., 108 F.R.D. 655 (S.D. Ind. 1985); *Merrill Lynch & Co.*, 229 F.R.D. 441; Regions Fin. Corp. & Subsidiaries v. United States, No. 2:06-CV-00895-RDP, 2008 WL 2139008 (N.D. Ala. May 8, 2008); *In re Pfizer*, 1993 WL 561125, at * 4.

101. *Merrill Lynch*, 229 F.R.D. at 448.

102. United States v. Mass. Inst. of Tech. ("MIT"), 129 F.3d 681 (1st Cir. 1997).

103. *Id.* at 687.

104. *See* discussion *infra* Part I.

105. Under the professional guidelines set forth by the American Institute of Certified Public Accountants ("AICPA"), an independent auditor should

gation and is free to use its information-gathering authority to promote the government's interests.[106]

In *Medinol v. Boston Scientific Corp.*, the defendant provided documents to its independent auditors.[107] The district court held that the company waived work product protection because the independent auditors and the defendant did not share "common interests in litigation" and their relationship "did not therefore serve the privacy interests that the work product doctrine was intended to protect."[108] The *Medinol* court was heavily influenced by the recent corporate scandals. "As has become crystal clear in the face of the many accounting scandals that have arisen as of late, in order for auditors to properly do their job, they *must* not share common interests with the company they audit. Good auditing requires adversarial tension between the auditor and the client."[109]

Medinol has been heavily criticized and "has been almost uniformly rejected as adopting far too restrictive of a view."[110] *Medinol* fundamentally misunderstood the relationship between a company and its independent auditors. The Public Company Accounting Oversight Board ("PCAOB"), created by Sarbanes-Oxley in direct response to the scandals alluded to in *Medinol*, expressly rejected the idea that auditors should have an adversarial relationship with clients. "Independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness."[111] Independence does not require an adversarial relationship. "The fact that an independent auditor must remain independent from the company it audits does not establish that the auditor has an adversarial relationship with the client as contemplated

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not disclose any confidential client information without the specific consent of the client. AICPA, CODE OF PROF'L CONDUCT § 301 (1992).

106. *MIT*, 129 F.3d at 683.

107. 214 F.R.D. 113 (S.D.N.Y. 2002).

108. *Id.* at 117.

109. *Id.* at 116 (emphasis in original).

110. Vacco v. Harrah's Operating Co., Inc., No. 1:07-CV-0663, 2008 WL 4793719, at *7 (N.D.N.Y. Oct. 28, 2008); *see also* Westernbank P.R. v. Kachkar, No. 07-1606, 2009 U.S. Dist. LEXIS 16356, at *10 (D.P.R. Feb. 9, 2009).

111. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 1, § 220.02 (Am. Inst. of Certified Pub. Accountants 1972).

by the work product doctrine."[112] According to audit regulations, the auditor should not assume that management is dishonest.[113] Instead, the audit should be conducted with "an attitude that includes a questioning mind and a critical assessment of audit evidence."[114]

A recent decision from the same district as *Medinol* distanced itself from *Medinol*, holding that disclosure to independent auditors does not constitute waiver of work product protection.[115] The court recognized that a decrease in work product protection does not lead to an increase in financial transparency. The work product doctrine "exists to safeguard other values no less precious, those of our adversary system of litigation. We should not sacrifice one to save another, particularly when . . . no such savings will be made."[116]

III.
TEXTRON

The controversy in *United States v. Textron* began when the Internal Revenue Service (IRS) audited Textron's prior tax returns in 2003.[117] The IRS flagged nine suspicious transactions and demanded that the company provide supporting documentation.[118] Textron refused to provide relevant documents, including tax accrual workpapers prepared by lawyers and employees in its tax department. The workpapers listed questionable items on the company's tax return that the IRS could challenge in court, resulting in additional taxes and penalties. For each item, the workpapers included the amount in controversy as well as a percentage estimate of the company's

112. Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., 237 F.R.D. 176, 183 (N.D. Ill. 2006).

113. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, § 230A.09.

114. *Id.* § 230A.07 (stressing the need for objective evaluation of evidence).

115. *See* Merrill Lynch & Co., Inc. v. Allegheny Energy, 229 F.R.D. 441, 449 (S.D.N.Y. 2004).

116. *Id.*

117. 577 F.3d 21, 23 (1st Cir. 2009).

118. *Id.* at 23-24. The IRS seeks additional documentation when it suspects that the taxpayer is using illegal tax shelters. *See id.* at 23. The agency is empowered to "examine any books, papers, records or other data which may be relevant or material to determining the accuracy of any return." 26 U.S.C. § 7602(a)(1) (2010).

probability of success during potential litigation. Relevant emails and documents were also appended to the workpapers.

In 2007, the district court held in favor of Textron.[119] Applying the "because of" standard that had been adopted by the First Circuit in *Maine v. United States Dep't of Interior*,[120] the court held that the workpapers were prepared "because of" the prospect of litigation with the IRS.[121] On appeal, a divided panel of the First Circuit upheld the district court's decision.[122] The First Circuit then granted the government's petition for a rehearing en banc.[123]

The en banc court reversed the panel decision and held that Textron's workpapers were not protected by the work product doctrine. According to the majority, the documents were prepared because of the company's need to receive an unqualified audit opinion. "Any experienced litigator would describe the tax accrual workpapers as tax documents and not as case preparation materials."[124] Because the workpapers were prepared to comply with audit requirements and not for impending litigation, the work product doctrine did not apply.[125] The court also stressed the public policy concerns underlying the public duty of the IRS. "[T]ax collection is not a game. Underpaying taxes threatens the essential public interest in revenue collection."[126]

The *Textron* majority purported to apply the "because of" standard, but it instead appeared to create a new "for use" standard.[127] The court emphasized that Textron's "immediate

119. United States v. Textron, 507 F. Supp. 2d 138 (D.R.I. 2007).

120. *See* Maine v. United States Dep't of Interior, 298 F.3d 60, 68 (1st Cir. 2002) (stating that the First Circuit "agree[s] with the formulation of the work-product rule adopted in *Adlman*").

121. *Textron*, 507 F. Supp. 2d at 149-51.

122. United States v. Textron, 553 F.3d 87 (1st Cir. 2009) (depublished).

123. United States v. Textron, 577 F.3d 21 (1st Cir. 2009).

124. *Id.* at 28.

125. *Id.* at 30-31 ("The [work product doctrine] aimed centrally at protecting the litigation process, specifically, work done by counsel to help him or her in litigating a case. It is not a privilege designed to help the lawyer prepare corporate documents or other materials prepared in the ordinary course of business.").

126. *Id.* at 31.

127. *See id.* at 27 ("The district judge did not say that the work papers were prepared *for use* in possible litigation – only that the reserves would cover liabilities that might be determined in litigation. If the judge had made a

motive" for preparing the workpapers was not related to litigation.[128] Although the documents would not have been created if not for potential litigation with the IRS, the workpapers were not "for use" in litigation.[129] "From the outset, the focus of work product protection has been on materials prepared *for use* in litigation, whether the litigation was underway or merely anticipated."[130]

The impact of the First Circuit's new "for use" standard extends far beyond IRS discovery of tax accrual workpapers. Both legal letters and litigation reserve workpapers are not created "for use" in litigation – they are created in order to obtain an unqualified audit opinion. As a result, both litigation reserve workpapers and legal letters could be available for discovery by opposing litigants if *Textron*'s new standard is applied.

This Note submits that *Textron* is a dangerous misinterpretation of the work product doctrine. First, *Textron* is inconsistent with prior work product doctrine precedent, including the Supreme Court *Hickman* decision. Second, *Textron* ignores the scope of the work product doctrine as defined by *Hickman* and Rule 26. Finally, *Textron* is unpersuasive in light of other well-reasoned decisions that have protected legal letters and litigation reserve workpapers.

A. Textron *Misinterprets Prior Work Product Cases*

The First Circuit, sitting en banc, was free to set new circuit precedent.[131] However, the *Textron* majority attempted to frame its opinion as being consistent with the prior decisions in *Hickman*, *Adlman* and *Maine*. First, the court stated that its "for use" standard was based on the Supreme Court's analysis

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"for use" finding – which he did not – that finding would have been clearly erroneous.") (emphasis in original); *see id.* at 30 ("There is no evidence in this case that the work papers were prepared *for such a use* or would in fact serve any useful purpose for Textron in conducting litigation if it arose.") (emphasis added); *see id.* at 32 (Torruella, J., dissenting) (stating that the majority ignored the "because of" standard and applied a novel "prepared for" standard).

128. *See id.* at 27.

129. *Id.*

130. *Id.* at 29 (emphasis added).

131. *See, e.g., id.* at 34-35 (Torruella, J., dissenting)

in *Hickman*.[132] However, *Hickman* did not limit the work product doctrine to materials prepared for use at trial. Instead, the *Hickman* Court provided a broad, open-ended list of protectable work product: "interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways . . . ."[133] *Hickman* created a work product doctrine that encompasses much more than documents created "for use" at trial.

The First Circuit then stated that *Textron* was consistent with *Maine* because Textron's workpapers were prepared in the ordinary course of business.[134] In *Maine*, the First Circuit adopted the "because of" standard established in the Second Circuit *Adlman* decision.[135] *Adlman* used litigation reserve workpapers as an example of work product that should be protected under the "because of" standard.[136] Had the *Textron* court applied *Adlman* and *Maine* faithfully, this example would have controlled and led to a contrary decision. Instead, the *Textron* court cited to *El Paso*, a Fifth Circuit decision based on the minority "primary purpose" standard.[137]

The *Textron* majority misunderstood litigation reserve workpapers to be documents created "in the ordinary course of business."[138] Litigation reserve workpapers are only prepared when potential litigation arises: if there is no prospect of litigation, public companies would have no need to provide

132. *Id.* ("Every lawyer who tries cases knows the touch and feel of materials prepared for a current or possible . . . lawsuit. They are the very materials catalogued in *Hickman v. Taylor*.").

133. Hickman v. Taylor, 329 U.S. 495, 511 (1947).

134. *Textron*, 577 F.3d at 30 (1st Cir. 2009) (stating that "*Maine* applies straightforwardly to Textron's tax audit work papers").

135. *See* Maine v. U.S. Dep't of Interior, 298 F.3d 60, 68 (1st Cir. 2002) (stating that the First Circuit "agree[s] with the formulation of the work-product rule adopted in *Adlman*").

136. United States v. Adlman, 134 F.3d 1194, 1200 (2d Cir. 1998) ("A business entity prepares financial statements. . . [which] include reserves for protected 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.").

137. *Textron*, 577 F.3d at 30.

138. *Id.* at 30-31.

documentation to their auditors.[139] "Were it not for anticipated litigation, [the defendant] would not have to worry about contingent liabilities and would have no need to elicit opinions regarding the likely result of litigation."[140] Theoretically, audit documents could fall within the "ordinary course of business" exception if the prospect of litigation is considered to be in a company's ordinary course of business. However, such a broad reading of the exception would eviscerate the work product doctrine.

The *Textron* majority emphasized that Textron's documents fulfilled a regulatory requirement – the mere existence of this regulatory requirement appeared to be dispositive of the workpaper's purpose.[141] However, this type of reasoning was flatly rejected in *Adlman*, which recognized that dual-purpose documents deserve protection. "We see no basis for adopting a test under which an attorney's assessment of the likely outcome of litigation is freely available to his litigation adversary merely because the document was created for a business purpose rather than for litigation assistance."[142]

B. Textron *Misinterprets the Scope of the Work Product Doctrine*

Rule 26 provides protection for documents and other tangible items prepared in anticipation of litigation.[143] Materials assembled pursuant to public regulatory requirements unrelated to litigation should not receive work product protec-

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139. *See, e.g.*, Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., 237 F.R.D. 176, 181 (N.D. Ill. 2006) ("[I]n the absence of any pending or threatened litigation, [defendant's] counsel would have had no need to advise [the auditors] regarding such non-existent matters. Thus, the opinion letters were prepared 'because of' pending or threatened litigation and are protected by the work product doctrine.").

140. Regions Fin. Corp. v. United States, No. 2:06-CV-00895-RDP, 2008 WL 2139008, at * 6 (N.D. Ala. May 8, 2008).

141. *Textron*, 577 F.3d at 31 ("Nor is there present the concern that *Hickman v. Taylor* stressed about discouraging sound preparation for a lawsuit . . . it cannot be present where, as here, there is in substance a legal obligation to prepare such papers: the tax audit work papers not only have a different purpose but have to be prepared by exchange-listed companies to comply with the securities laws and accounting principles for certified financial statements.").

142. United States v. Adlman, 134 F.3d 1194, 1200 (2d Cir. 1998).

143. FED. R. CIV. P. 26.

tion.[144] As a result, Rule 26 may not protect workpapers prepared to comply with an independent audit.

However, the work product doctrine is only partially codified in Rule 26 because *Hickman* remains the standard to apply to intangible work product.[145] Rule 26 protects tangible work product, but is silent on intangible work product.[146] *Hickman*, on the other hand, expressly protects intangible work product – the Supreme Court included mental impressions, personal beliefs and "countless" other intangible materials as examples of protected work product.[147]

In most cases, intangible work product is contained within tangible work product already protected by Rule 26. For example, a lawyer's intangible legal strategies are contained within a legal memorandum protected by Rule 26. In these situations, a court can apply either Rule 26 or *Hickman* to reach the same result, which may be why courts (like the First Circuit in *Textron*) often discuss the work product doctrine without differentiating between the two standards. However, audit documents present the anomalous situation in which a document is ineligible for work product protection under Rule 26, but the intangible work product contained therein remains protected by *Hickman*. The *Textron* court failed to account for this possibility.

Intangible work product should be protected, regardless of the type of document into which it is incorporated. A lawyer's mental impressions of impending litigation can be expressed in two different documents: a legal letter provided to auditors and a legal memorandum prepared for use in trial. Under *Textron*'s "for use" standard, the legal memorandum would supposedly receive protection but the legal letter would not. However, in actuality, neither document is protected – the very same mental impressions contained within the "protected" legal memorandum are open to discovery via the legal letter.

144. *Id.* advisory committee's note.

145. *See* discussion *supra* Part II.B.

146. FED. R. CIV. P. 26(b)(3) (protecting "documents and tangible things"); *see* discussion *supra* Part II.B.

147. Hickman v. Taylor, 329 U.S. 495, 511 (1947).

C. Textron *Is an Outlier Among Other Work Product Cases Involving Audit Documents*

Courts before and after *Textron* have persuasively argued that audit documents should be protected.[148] Legal letters were protected by courts before *Textron.* In *Tronitech, Inc. v. NCR Corp.*, the district court held that legal letters are protected and that the "ordinary course of business" exception does not apply.[149] Legal letters are "prepared because of the litigation, and it is comprised of the sum total of the attorney's conclusions and legal theories concerning that litigation."[150] A more recent district court decision found *Tronitech* persuasive, holding that legal letters are protected because "the documents were generated at the request of general counsel . . . and set forth a summary of all ongoing litigation, as well as counsel's mental impressions, opinions, and litigation strategy."[151]

Courts before *Textron* also protected litigation reserve workpapers.[152] In *Simon v. G.D. Searle & Co.*, a drug manufacturer's risk management documents contained the legal department's individual case reserve estimates.[153] The Eighth Circuit held that the documents were protected. "The individual case reserve figures reveal the mental impressions, thoughts, and conclusions of an attorney in evaluating a legal claim. By their very nature they are prepared in anticipation of litigation and, consequently, they are protected . . . ."[154] Although workpapers reflecting individual reserves are pro-

148. *See, e.g.*, Tronitech, Inc. v. NCR Corp., 108 F.R.D. 655 (S.D. Ind. 1985); Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., 237 F.R.D. 176 (N.D. Ill. 2006); S. Scrap Material Co. v. Fleming, No. 01-2554, 2003 U.S. Dist. LEXIS 10815 (E.D. La. June 18, 2003).

149. *Tronitech*, 108 F.R.D. at 655.

150. *Id.* at 656.

151. *S. Scrap Material Co.*, 2003 U.S. Dist. LEXIS 10815, at *34-35.

152. Simon v. G.D. Searle & Co. 816 F.2d 397, 401-02 (8th Cir. 1987); GE Capital Corp. v. DirecTV, Inc., 184 F.R.D. 32, 36 (D. Conn. 1998); *Jaffe*, 237 F.R.D. at 181 (N.D. Ill. 2006); Frank Betz Assocs., Inc. v. Jim Walter Homes, Inc., 226 F.R.D. 533, 535 (D.S.C. 2005); *In re* Pfizer Sec. Litig., No. 90 Civ. 1260 (SS), 1993 WL 561125 at *4 (S.D.N.Y. Dec. 23, 1993).

153. *Simon*, 816 F.2d at 401.

154. *Id.*

tected, courts are split as to whether documents containing aggregate reserve estimates receive protection.[155]

The D.C. Circuit, the only federal court of appeals to discuss the work product doctrine since *Textron*, expressly stated that audit documents are eligible for work product protection. In *United States v. Deloitte LLP*, the IRS audited the tax returns of Dow Chemical Company ("Dow").[156] The IRS sought to discover a memorandum prepared by Dow's independent auditors, Deloitte.[157] The memorandum summarized a meeting between Dow, Dow's outside counsel, and Deloitte about the possibility of litigation over a specific tax item.[158] The IRS argued that the memorandum could not be work product because it was generated during an annual audit, rather than in anticipation of litigation.[159] The IRS asserted that "a document's function, not its content, determines whether it is work product" and cited *Textron* for support.[160]

The D.C. Circuit flatly rejected the IRS's arguments and held that "material developed in anticipation of litigation can be incorporated into a document produced during an audit without ceasing to be work product."[161] Work product protection does not depend upon a document's ostensible function – instead, the court should examine the document's contents to determine whether the work product doctrine applies.[162]

The D.C. Circuit chose to distinguish *Textron* on the facts. The D.C. Circuit stated that the decision in *Textron* turned on the particular documents at issue in that case and that the First Circuit never excluded the possibility that other documents prepared during an audit might warrant work product protec-

155. *Compare Simon*, 816 F.2d at, 401-02 (8th Cir. 1987) (arguing that aggregate reserves do not deserve protection because the individual reserves lose their identity when combined), *and In re* Pfizer Sec. Litig., 1993 WL 561125, at * 4 (describing individual reserve figures as "typical examples of work product" but aggregate reserves are not), *with* Rhone-Poulenc Rorer, Inc. v. Home Indem. Co, 139 F.R.D. 609, 615 (E.D. Pa. 1991) ("[I]t is impossible to protect the mental impressions underlying the specific reserves without also protecting the aggregate figures.").

156. United States v. Deloitte LLP, 610 F.3d 129, 133 (D.C. Cir. 2010).

157. *Id.*

158. *Id.*

159. *Id.* at 136.

160. *Id.* at 137-38.

161. *Id.* at 138.

162. *Id.* at 137.

tion.[163] But the D.C. Circuit's attempt to distinguish *Textron* appeared disingenuous and its disagreement with the First Circuit was apparent when it stated that Judge Torruella's *Textron* dissent made "a strong argument that while the [First Circuit] said it was applying the 'because of' test, it actually asked whether the documents were 'prepared for use in possible litigation,' a much more exacting standard."[164]

IV.
POLICY CONCERNS

Textron creates alarming public policy concerns. First, the "for use" standard unnecessarily places two important priorities at odds with each other: financial transparency and litigant confidentiality. Second, *Textron* destabilizes the important working relationship between independent auditors and attorneys. Third, *Textron* undermines the adversarial system and creates arbitrary distinctions between litigants. Finally, *Textron* creates a perverse informational asymmetry that benefits a company's opponents at the expense of the company's shareholders and the general investing public.

A. Textron *Forces Companies To Choose Between Financial Transparency & Litigant Confidentiality*

A company should be able to communicate freely with its auditors without sacrificing its ability to prepare effectively for litigation. The "because of" standard encourages open communication: because audit documents are protected, companies can cooperate with independent auditors without fear that opposing litigants can use those documents against them in future litigation.[165] *Textron*, on the other hand, leaves a company's audit documents vulnerable to discovery because they are not created "for use" in litigation.[166]

Under *Textron*, companies are faced with a nearly impossible task: provide auditors with just enough information to receive an unqualified opinion but without providing any extra

163. *Id.* at 138.
164. *Id.*
165. *See* discussion *supra* Part II.C.1.
166. *See* discussion *supra* Part III.

information that could be used by opposing litigants.[167] If it provides too little information to auditors, the company may receive an unfavorable audit opinion.[168] On the other hand, if the company provides detailed legal letters and litigation reserve workpapers to auditors, opposing litigants would be armed with valuable litigation information that can be used against the company during litigation and settlement negotiations.[169]

Companies should not be forced to tiptoe between financial transparency and effective trial preparation. When a company's confidentiality is properly protected, both priorities can be accommodated. Confidentiality allows attorneys to develop the facts necessary for effective client representation.[170] Furthermore, confidentiality promotes financial transparency by enabling companies to communicate freely with auditors. As a recent district court stated,

"[T]he aim should be for corporations to share information with their auditors to facilitate a meaningful review and, ultimately, the availability of more accurate information for the investing public. It is also important to encourage complete disclosure between a company and its auditor, so that auditors are not inadvertently shielded from complete frankness by corporate management."[171]

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167. Because the quantum of evidence necessary for an unqualified opinion is largely within the discretion of the independent auditor, companies cannot predict ex-ante how much information will be necessary to satisfy the auditor. "The amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine in the exercise of his or her professional judgment after a careful study of the circumstances in the particular case." AUDIT EVIDENCE, Statement on Auditing Standards No. 106, § 326.22 (Am. Inst. of Certified Pub. Accountants 2006).

168. *See* discussion *supra* Part I.

169. *See* discussion *supra* Part I.

170. *See* Upjohn v. United States, 449 U.S. 383, 391 (stating that confidentiality "facilitates the full development of facts essential to proper representation of the client") (quoting MODEL CODE OF PRF'L RESPONSIBILITY EC 4-1 (1980)); *see also* United States v. Chen, 99 F.3d 1495, 1500 (9th Cir. 1996) (stating that the "valuable social service of counseling clients and bringing them into compliance with the law cannot be performed effectively if clients are scared to tell their lawyers what they are doing, for fear that their lawyers will be turned into . . . informants").

171. Merrill Lynch & Co. v. Allegheny Energy, 229 F.R.D. 441, 449 (S.D.N.Y. 2004).

B. Textron *Destabilizes Important Relationships*

Auditors have been criticized in recent years for their lack of success in ferreting out corporate fraud.[172] In response, auditors have aggressively demanded more information from companies, "increasingly insist[ing] that corporations disclose documents protected by the attorney-client privilege and/or attorney work product privilege."[173]

Textron exacerbates the recent tension between independent auditors and attorneys by dramatically narrowing the scope of work product protection. The Treaty expressly cautioned that a change in the scope of work product protection could undermine the vitality of the agreement between the two professions.[174] Both professions emphasized the importance of confidentiality in the Treaty. "The objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client."[175]

C. Textron *Undermines the Adversarial System*

The adversarial system requires each party to present its own arguments. "By placing the burden of representation on the parties themselves, the adversarial system fosters a competitive relationship that motivates each party to marshall all the law and facts beneficial to its case."[176] The work product doctrine encourages effective legal service in the adversarial system[177] and "revitalizes the competitive relationship by creating a zone of privacy within which the attorney or investigator may work relatively free of the fear that his efforts will be discoverable."[178]

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172. *See, e.g.*, Gideon Mark & Thomas C. Pearson, *Corporate Cooperation During Investigations and Audits*, 13 STAN. J. L. BUS. & FIN. 1, 22 (2007) (stating that auditors are "under pressure from the SEC and the PCAOB post-SOX [i.e. the Sarbanes-Oxley Act], and chastened by the demise of Arthur Andersen and the recent wave of securities fraud class action suits").

173. *Id.* at 22 (stating that companies acquiesce to the auditors' demands "seeking to avoid the prospect of receiving qualified audit opinions or no opinion at all").

174. *See Treaty*, *supra* note 37.

175. *See Treaty*, *supra* note 37.

176. Anderson, *supra* note 8, at 786.

177. *See In re* Sealed Case, 107 F.3d 46, 51 (D.C. Cir. 1997).

178. Anderson, *supra* note 8, at 785.

Textron discourages litigants from relying on the work product doctrine and encourages them to engage in the type of "sharp practices" that the Supreme Court sought to avoid when it created the work product doctrine in *Hickman*.[179] The Court feared that if attorney work product were easily discoverable, "much of what is now put down in writing would remain unwritten . . . inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial . . . the cause of justice would be poorly served."[180]

Litigants will only rely on the work product doctrine for protection if courts consistently and predictably apply the doctrine.[181] As the Supreme Court warned, "An 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."[182] *Textron* creates confusion for both the courts and litigants. *Textron*'s definition of work product is cryptic, merely stating that, "Every lawyer who tries cases knows the touch and feel of materials prepared for a current or possible . . . lawsuit."[183] Judge Torruella's scathing dissent criticized the majority's unhelpful definition, stating that "lower courts

179. *See In re* Sealed Case, 146 F.3d 881, 884 (D.C. Cir. 1998) ("Without a strong work product privilege, lawyers would keep their thoughts to themselves, avoid communicating with other lawyers, and hesitate to take notes."); *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 135 cmt. b (Proposed Final Draft No. 1, 1996) ("A lawyer whose work product would be open to the other side might forgo useful preparatory procedures, for example, note-taking.").

180. Hickman v. Taylor, 329 U.S. 495, 511 (1947); *see also* Rhone-Poulenc Rorer, Inc. v. Home Indem. Co., 139 F.R.D. 609, 615 (E.D. Pa. 1991) (stating that a restrictive view of work product "would make it extremely hazardous for a business to finance and plan for its defense. The incidental effect of such a decision could be the failure of litigants to properly document and consider all the factors that bear upon the decision to try or settle lawsuits.").

181. Consistent application of the work product doctrine at the district court level is crucial, especially in light of the Supreme Court's recent decision that a court's discovery order that is adverse to the attorney-client privilege does not qualify for immediate appeal under the collateral order doctrine. *See* Mohawk Indus. v. Carpenter, 130 S. Ct. 599, 606 (2009) (stating that courts "routinely require litigants to wait until after final judgment to vindicate valuable rights, including rights central to our adversarial system"). At least one circuit court has applied *Mohawk* to the work product doctrine. *See* Hernandez v. Tanninen, 604 F.3d 1095, 1098-99 (9th Cir. 2010).

182. Upjohn Co. v. United States, 449 U.S. 383, 392 (1981).

183. United States v. Textron, 577 F.3d 21, 30 (1st Cir. 2009).

deserve more guidance than a simple reassurance that a bare majority of the en banc court knows work product when it sees it."[184]

Textron creates an arbitrary disadvantage for public companies during litigation. If a private company sues a public company, the private company has access to its opponent's legal strategies, mental impressions and settlement considerations because the public company's audit documents are discoverable. But private companies are not required to undergo independent audits, so the public company does not have reciprocal access to the private company's legal information.

Textron also creates arbitrary distinctions amongst private litigants. A private company in merger negotiations may provide the other company with an assessment of its ongoing litigation. A company may hire consultants for long-term strategic planning and provide the consultants with litigation reserve assessments to help project future cash flows. A growing business looking to increase its line of credit may provide its bank with an evaluation of its ongoing claims. None of these documents are created "for use" in litigation and may be discoverable by opposing litigants under *Textron.*

D. Textron *Creates a Perverse Informational Asymmetry*

Financial statements are an important source of information for a company's shareholders as well as the general investing public.[185] Although the financial statements need to contain enough information to facilitate informed investment decisions, shareholders do not want too much information to be disclosed. If information such as a company's trade secrets and future design concepts were available to the public and the company's competitors, the company's profitability would obviously suffer. Hence, the amount of information contained within the financial statements reflects a careful balance of considerations: the financial statements contain enough information so that investors can make informed decisions but not so much information that the company's competitiveness is compromised by the disclosures.[186]

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184. *Id.* at 34 (Torruella, J., dissenting).

185. *See* discussion *supra* Part I.

186. *See generally* Louis Lowenstein, Essay, *Financial Transparency and Corporate Governance: You Manage What You Measure,* 96 COLUM. L. REV. 1335, 1357

Textron obliterates this careful balance and creates a perverse informational asymmetry. While shareholders and the general investing public are limited to the information contained in the financial statements, *Textron* provides litigating opponents with unfettered access to audit documents containing confidential company information. For example, Company Z is sued for copyright infringement. During an audit, Company Z provides a legal letter and litigation reserve workpapers to its independent auditors.[187] The company and the auditors agree that a loss at litigation is reasonably possible, but an estimate of loss cannot be made. Hence, in accordance with FAS 5, Company Z's financial statements would include a disclosure in the notes to the financial statements providing general information about the pending litigation.[188]

When the "because of" standard is applied, the plaintiff in the copyright infringement suit cannot obtain Company Z's legal letter or litigation reserve workpapers.[189] As a result, the plaintiff is limited to the information available in the financial statements, which puts the plaintiff in the same position as Company Z's shareholders and the general investing public. But, under the "for use" standard, the audit documents are available – the plaintiff has access to the company's legal strategies, settlement considerations and other vital litigation information that even the company's shareholders are not privy to.[190]

Textron forces a company's shareholders to subsidize the legal costs of the company's litigating opponent. An opponent is allowed to take a free ride on the work product created by the company, a situation which the Supreme Court intended to prevent when it created the work product doctrine.[191] The opposing litigant is also more likely to prevail

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(1996) (stating that the SEC has always been sensitive to a company's potential concern about revealing proprietary information). FAS 5 is also an example of an accounting regulation that recognizes that full disclosure of sensitive information is not the goal of the financial statements. *See* discussion *supra* Part I.B.

187. *See* discussion *supra* Part I.A.

188. *See* discussion *supra* Part I.B.

189. *See* discussion *supra* Part II.C.1.

190. *See* discussion *supra* Part III.

191. Hickman v. Taylor, 329 U.S. 495, 516 (Jackson, J., concurring) (stating that the discovery process was not intended to allow lawyers to perform

during litigation or to negotiate a more favorable settlement, especially when audit documents reveal that the defendant company is not confident about winning at trial. The advantages enjoyed by the opposing litigant directly translate into a reduction in the company's value and a resulting loss to the company's shareholders.

V.
CONCLUSION

Textron is a misguided interpretation of the work product doctrine and should not be followed. The "because of" test set out in *Adlman* is the correct standard for the work product doctrine. Documents created in anticipation of litigation should be protected even if they serve business-related purposes and are not strictly "for use" in litigation. This standard is faithful to Supreme Court precedent, encourages financial transparency and protects the vitality of the adversarial system.

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their work "on wits borrowed from the adversary); *see also* United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999) (stating that the work product doctrine "intended to prevent a litigant from taking a free ride . . .").