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On the Road Again: The D.C. Circuit Reinvigorates the Work-Product Doctrine in United States v. Deloitte & Touche

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ON THE ROAD AGAIN: THE D.C. CIRCUIT REINVIGORATES THE WORK-PRODUCT DOCTRINE IN *UNITED STATES V. DELOITTE & TOUCHE*

*Christopher R. Wray**

INTRODUCTION

In 2009, the United States Court of Appeals for the First Circuit, sitting en banc, found that tax accrual workpapers prepared by in-house tax attorneys did not constitute work product.[1] The decision was widely panned. One prominent law firm described the *Textron* decision as "merrily roll[ing] over established notions of work-product,"[2] while a representative for the Association of Corporate Counsel—an organization for in-house attorneys—described the case as "eviscerat[ing] the work-product doctrine."[3]

Only months later, the United States Court of Appeals for the District of Columbia Circuit revived the work-product doctrine and found that audit workpapers can receive protection.[4] Unlike *Textron*,

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1 *See generally* United States v. Textron Inc., 577 F.3d 21 (1st Cir. 2009) (holding that tax accrual workpapers used in a financial statement audit did not qualify for work-product protection).

2 Edward L. Froelich & Hollis L. Hyans, United States v. Deloitte LLP*: Work Product Redeemed,* Textron *Rebuffed,* Client Alert (Morrison & Foerster LLP, San Francisco, CA.), July 29, 2010, at 1, *available at* http://www.mofo.com/files/Uploads/Images/100729WorkProduct.pdf.

3 Amir Efrati, *Ruling in Tax-Auditing Case Puts Corporations on Edge,* WALL ST. J., Aug. 20, 2009, at A9.

4 *See generally* United States v. Deloitte LLP, 610 F.3d 129 (D.C. Cir. 2010) (holding that tax accrual workpapers used in a financial statement audit could qualify for work-product protection).

the *United States v. Deloitte LLP* decision was well reasoned and well received: one prominent law firm described the decision as "redeem[ing]" the work-product doctrine and "rebuff[ing]" *Textron*.[5] Public companies—particularly their general counsels—breathed a sigh of relief.

The *Deloitte* decision contributes to work-product case law in three respects: (1) it is the first federal circuit court decision on the work-product doctrine as applied to audit workpapers following the First Circuit's much maligned *Textron* decision; (2) it is the first federal appellate court decision to comment on the waiver of work product in the context of financial statement audits; and (3) it affects the rules of evidence in the United States Tax Court.

This Note will analyze the current status of the work-product doctrine and review positively *Deloitte*'s impact on the law, arguing that the opinion, unlike *Textron*, provides a sound legal framework rooted in statute and longstanding case law.

Part I of this Note provides a foundational background of the work-product doctrine as applied to audit workpapers. Part II analyzes the *Deloitte* decision's effect on what constitutes work product, and Part III discusses the decision's effect on work-product waiver. Finally, in Part IV, this Note analyzes the policy and legal arguments for and against the discoverability of audit workpapers and positively critiques the *Deloitte* decision.

I. THE WINDING ROAD FROM *HICKMAN* TO *TEXTRON*: THE WORK-PRODUCT DOCTRINE AND TAX ACCRUAL WORKPAPERS

A. *The Journey Begins:* Hickman *and Rule 26(b)(3)*

The Supreme Court established the work-product doctrine in 1947 in *Hickman v. Taylor*.[6] In *Hickman*, the Court held that an attorney's notes taken during interviews with witnesses in anticipation of litigation are not discoverable.[7] To prepare for litigation, the Court said, our system must enable an attorney to "sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy without undue and needless interference."[8]

5 Froelich & Hyans, *supra* note 2, at 1.

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

7 *Id.* at 514. A single document may contain both discoverable work product (such as a witness statement) and nondiscoverable work product (such as a conclusion of counsel that the witness seems trustworthy and would be good to use at trial). In this case, courts will generally order production with the nondiscoverable material redacted. *See* RICHARD D. FREER, CIVIL PROCEDURE § 8.3 (2d ed. 2009).

8 *Id.* at 511.

Such "work is reflected . . . in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways" that are undiscoverable.[9] The work-product doctrine, as envisioned in *Hickman*, precludes opposing counsel from gaining access to an attorney's thoughts, trial strategies, and legal theories.

The Supreme Court based its decision primarily on public policy concerns. Asserting that lawyers would be less likely to put their thoughts in writing if they were discoverable, the Court said the "effect on the legal profession [of permitting discovery] would be demoralizing" and the "interests of the clients and the cause of justice would be poorly served."[10] Work-product protection would encourage robust legal analysis by disallowing parties from litigating "on wits borrowed from the adversary."[11]

The *Hickman* decision became partially codified by Federal Rule of Civil Procedure 26(b)(3), which provides that "a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative" unless a substantial need can be shown.[12] The Advisory Committee's notes reflected the public policy sentiments of the Court in *Hickman*: "[E]ach side's informal evaluation of its case should be protected . . . each side should be encouraged to prepare independently, and . . . one side should not automatically have the benefit of the detailed preparatory work of the other side."[13]

As the *Deloitte* majority would later point out, *Hickman* was only partially codified by Federal Rule of Civil Procedure 26(b)(3).[14] The Rule does not contain an exhaustive list of what is work product, and any document containing the "mental impressions" of an attorney—as well as intangible items—can qualify for work-product protection.[15]

B. A Necessary Detour: Audit Workpapers and Tax Accruals

All public companies in the United States are required to provide an annual financial report to the Securities and Exchange Commis-

9 *Id.*

10 *See id.*

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

12 FED. R. CIV. P. 26(b)(3). Protection does not apply to "materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes." FED. R. CIV. P. 26(b)(3) advisory committee's note (1970 amendment).

13 *Id.*

14 United States v. Deloitte LLP, 610 F.3d 129, 135 (D.C. Cir. 2010).

15 *Id.* at 136 (citations omitted).

sion (SEC).[16] The report must include financial statements prepared in accordance with generally accepted accounting principles (GAAP), and the financial statements must be audited by an independent public accountant under generally accepted auditing standards (GAAS).[17] GAAP is promulgated exclusively by the Financial Accounting Standards Board (FASB), and GAAS is established chiefly by the American Institute of Certified Public Accountants (AICPA).[18] Under GAAS, an auditor must state in the audit report "whether the financial statements are presented in accordance with [GAAP]."[19] Material departures from GAAP require either a qualified or an adverse opinion in the auditor's report.[20]

GAAS also mandates that the auditor prepare and maintain "audit documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed[,] . . . the audit evidence obtained and its source, and the conclusions reached."[21] The documentation "[p]rovides the principal support for the opinion expressed regarding the financial information or the assertion to the effect that an opinion cannot be

16 *See* 15 U.S.C. § 78m(a)(2) (2006) (permitting the Securities and Exchange Commission to require audited annual reports); *see also* 17 C.F.R. § 249.310 (2005) (requiring that Form 10-K be used to file annual reports with the SEC).

17 17 C.F.R. § 210.1–02 (2005) (defining an audit to be an "examination of the financial statements by an independent accountant in accordance with generally accepted auditing standards").

18 DAVID R. HERWITZ & MATTHEW J. BARRETT, ACCOUNTING FOR LAWYERS 150 (Concise 4th ed. 2006) ("To date . . . the SEC has only occasionally established auditing standards, so it has been mostly the accounting profession, through the AICPA's Auditing Standards Board, which has determined 'generally accepted auditing standards' or 'GAAS.'"). The Public Company Accounting Oversight Board (PCAOB) has the ability to "establish or adopt . . . auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for" public companies. 15 U.S.C. § 7211(c)(2) (2006). However, to date, the PCAOB has issued only fifteen such auditing standards, and they have adopted many of the AICPA's standards as interim standards. *See Auditing*, PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, http://pcaobus.org/Standards/Auditing/Pages/default.aspx (last visited Mar. 22, 2012).

19 *See* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Adherence to Generally Accepted Accounting Principles § 410[.01] (Am. Inst. of Certified Pub. Accountants 2011).

20 *See* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Lack of Conformity With Generally Accepted Accounting Principles § 544 (Am. Inst. of Certified Pub. Accountants 2011); *see also* HERWITZ & BARRETT, *supra* note 18, at 175–78 (discussing the difference between a qualified, unqualified, and adverse opinion).

21 CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Audit Documentation § 339.03 (Am. Inst. of Certified Pub. Accountants 2011) (parenthetical omitted).

expressed."[22] Audit documentation is commonly known as workpapers or working papers.[23]

GAAP has long required public companies to "accrue" a "reserve"[24] for contingent tax liabilities, now usually referred to as uncertain tax positions (UTPs).[25] Contingent tax liabilities include estimates of potential losses if certain tax positions are not sustained.[26] While various documents are used to analyze tax accruals, a common format was spotlighted in the *Textron* dispute: a spreadsheet listing "each debatable item, including in each instance the dollar amount subject to possible dispute and a percentage estimate of the IRS's chances of success. Multiplying the amount by the percentage fixes the reserve entered on the books for that item."[27] These documents are routinely given to independent auditors to provide support for the contingent tax liabilities and UTPs, and auditors are required to keep such documents in the workpapers to support their opinion.

Thus, "tax accrual work papers provide a resource for the IRS, if the [government] can get access to them."[28] These workpapers

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22 *Id.*

23 *See id.*

24 *See* ACCOUNTING FOR CONTINGENCIES, Statement of Fin. Accounting Standards No. 5 ¶ 61 (Fin. Accounting Standards Bd. 1975), *available at* http://www.fasb.org/pdf/fas5.pdf ("Accounting accruals are simply a method of allocating costs among accounting periods and have no effect on an enterprise's cash flow.") (now superseded by and codified in various sections of the FASB Accounting Standards Codification). A "reserve" for purposes of this Note is the liability associated with an accrued expense and does not indicate that any cash or other assets have been set aside for a particular purpose. *See* HERWITZ & BARRETT, *supra* note 18, at 420–23 (discussing the various uses of the term "reserve" in financial accounting).

25 *See* HERWITZ & BARRETT, *supra* note 18, at 455.

26 United States v. Textron Inc., 577 F.3d 21, 22–23 (1st Cir. 2009).

27 *Id.* at 23.

28 *Id.* Starting with tax year 2010, certain companies are required to file the newly released Schedule UTP with their tax return. The IRS designed the schedule to gather a description of each uncertain tax position for which the company has booked a reserve in their financial statements, although specific amounts of each reserve need not be disclosed. The stated goals of the schedule include a reduction in "the time it takes to find issues and complete an audit." Douglas H. Shulman, Commissioner of Internal Revenue, Remarks Before the Tax Executives Institute 60th Mid-Year Meeting (Apr. 12, 2010), *available at* http://www.irs.gov/newsroom/article/0,,id=221280,00.html. The IRS, however, has updated and expanded the "policy of restraint" with the implementation of Schedule UTP. Under the policy of restraint, the IRS will not, during an examination, assert waiver of the work-product doctrine for any document given to an independent auditor as part of an audit of the taxpayer's financial statements. Additionally, a taxpayer may redact from tax workpapers any "working drafts, revisions, or comments concerning the concise description of tax positions reported on Schedule UTP" as well as "the amount of any reserve related to

"pinpoint the 'soft spots' on a corporation's tax return by highlighting those areas in which the corporate taxpayer has taken a position that may, at some later date, require the payment of additional taxes" and by providing "an item-by-item analysis of the corporation's potential exposure to additional liability."[29]

C. *A Bump in the Road:* Arthur Young

The Supreme Court considered whether work-product protection would extend to audit workpapers in *United States v. Arthur Young*.[30] In *Arthur Young*, the Supreme Court considered whether "tax accrual workpapers prepared by a corporation's independent certified public accountant in the course of regular financial audits are protected from disclosure in response to an Internal Revenue Service summons."[31]

During a routine audit of Arthur Young's client, Amerada Hess Corp., the IRS learned that Amerada had made questionable payments from a special disbursement account.[32] The IRS initiated a criminal investigation and issued an administrative summons to Arthur Young for its Amerada files, including the tax accrual workpapers.[33] Amerada ordered Arthur Young not to comply with the summons.[34]

The IRS instituted an enforcement action in the United States District Court for the Southern District of New York, and the District Court declined to recognize an accountant-client privilege.[35] The United States Court of Appeals for the Second Circuit reversed, finding it necessary "that some form of privilege be carved out to protect the independent auditing process."[36] Relying on *Hickman*, the Second Circuit said that promoting full disclosure to public accountants

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a tax position reported" on the schedule. *See* I.R.S. Announcement 2010-76, 2010-41 I.R.B. 432–33. It is not clear whether this policy of restraint applies to litigation. For additional information, see generally Julia Ushakova, *Seeking Privileged Information Under Schedule UTP: Protections and Privileges for Taxpayers*, 9 DEPAUL BUS. & COM. L.J. 445 (2011) (discussing the requirements of Schedule UTP, the policy of restraint, and the impact on the work-product doctrine).

29 United States v. Arthur Young & Co., 465 U.S. 805, 813 (1984).

30 *See id.*

31 *Id.* at 807.

32 *Id.* at 808.

33 *Id.* at 808–09.

34 *Id.* at 809.

35 United States v. Arthur Young & Co., 496 F.Supp. 1152, 1157 (S.D.N.Y. 1980).

36 United States v. Arthur Young & Co., 677 F.2d 211, 221 (2d Cir. 1982).

would ensure the accuracy and trustworthiness of data available in securities markets. [37]

The Supreme Court reversed the Second Circuit and declined to recognize either an accountant-client privilege or work-product immunity for auditor's workpapers.[38] Reasoning that independent auditors have a "*public* responsibility transcending any employment relationship with the client," the Court said that to "insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations."[39]

D. Forks in the Road: Interpreting "In Anticipation of Litigation"

While *Arthur Young* declined to extend privilege to accountants or recognize work-product immunity for auditors' workpapers, traditional notions of work product, including attorney-client work product, remained intact after the decision. Under *Hickman* and Federal Rule of Civil Procedure 26(b)(3), if a document is "prepared in anticipation of litigation," it is generally not discoverable until after the producing party redacts any attorney opinions or impressions. But soon after *Arthur Young*, the federal circuits began to disagree about what meets the "in anticipation" standard. The Fifth Circuit applies the stringent "primary purpose" test, while most other Circuit Courts use the less rigorous "because of" test.[40]

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37 *See id.*

38 *Arthur Young*, 465 U.S. at 821.

39 *Id.* at 817–18.

40 The "because of" test has been adopted in at least nine circuits, including the D.C. Circuit. *See, e.g.*, Sandra T.E. v. S. Berwyn Sch. Dist. 100, 600 F.3d 612, 622 (7th Cir. 2010); *In re* Prof'ls Direct Ins. Co., 578 F.3d 432, 439 (6th Cir. 2009); *In re* Grand Jury Subpoena, 357 F.3d 900, 907 (9th Cir. 2004); PepsiCo, Inc. v. Baird, Kurtz & Dobson LLP, 305 F.3d 813, 817 (8th Cir. 2002); Montgomery Cnty. v. Microvote Corp., 175 F.3d 296, 305 (3d Cir. 1999); United States v. Adlman, 134 F.3d 1194, 1195 (2d Cir. 1998); *In re* Sealed Case, 146 F.3d 881, 884 (D.C. Cir. 1998); Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co., 967 F.2d 980, 984 (4th Cir. 1992). The First Circuit adopted the test in 2002. Maine v. U.S. Dep't of the Interior, 298 F.3d 60, 68 (1st Cir. 2002). But as will be discussed in Part I.D.3, *infra*, the First Circuit in *Textron* used a modified version of the "because of test."

1. The Road Less Traveled: The "Primary Motivating Purpose" Test

The Fifth Circuit adopted the "primary motivating purpose" test in 1982 in *United States v. El Paso Co.*[41] Under this test, a document is protected against discovery in litigation only when the primary motivating purpose for its creation is to aid in litigation.[42] El Paso, a large public conglomerate, received a summons from the IRS for "any document, memorandum, letter, or work papers which identify potential tax liabilities or tax problems."[43] The head of El Paso's tax department declined to provide the documents, so the IRS petitioned to compel production.[44] The U.S. District Court for the Southern District of Texas ruled for the government, and El Paso appealed.[45] The United States Court of Appeals for the Fifth Circuit affirmed, holding that El Paso's primary motivating purpose in creating the documents was "to bring its financial books into conformity with generally accepted auditing principles" as required by federal securities laws and not "to ready El Paso for litigation over its tax returns."[46]

With apologies to Robert Frost,[47] the road less traveled is generally not taken for good reason. The "primary motivating purpose test" has been viewed as unduly inflexible and at odds with the intent of the Federal Rules of Civil Procedure.[48] As the Second Circuit has observed, "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."[49] Further, unlike the "because of" test, the "primary motivating purpose" test ignores so-called "dual purpose" documents

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

42 *See id.* at 542.

43 *Id.* at 533.

44 *See id.*

45 *See id.*

46 *Id.* at 543. Notably, the Fifth Circuit found that the tax analysis was "not prepared to respond to a specific charge by the IRS or to any pending or impending law suit." *Id.* at 535. However, Rule 26(b)(3) does not require that litigation be either pending or threatened, but instead merely requires that a document be prepared "in anticipation of litigation." FED. R. CIV. P. 26(b)(3).

47 *See* ROBERT FROST, THE ROAD NOT TAKEN 270 (2002).

48 United States v. Adlman, 134 F.3d 1194, 1198 (2d Cir. 1998) (describing the *El Paso* test as at "odds with the text and the policies of the Rule").

49 *Id.*

which are prepared for other business reasons but contain an attorney's mental impressions.[50]

2. The Beaten Path: The "Because Of" Test

The "because of" test is the more frequently applied interpretation of "in anticipation of litigation."[51] Under this test, a document is protected only when "'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.'" [52]

Unlike the "primary motivating purpose" test, the "because of" test is more flexible, recognizing that documents can contain work product even if they are created for use in business decisions. For example, in *Adlman*, the IRS sought production of a document prepared by an attorney and accountant at Arthur Andersen & Co. for its client, Sequa Corporation.[53] The document, which evaluated the tax implications of a potential restructuring,[54] was essentially a "litigation analysis prepared . . . to inform a business decision which turns on the . . . assessment of the likely outcome of litigation."[55] The Second Circuit found that "[w]here a document is created because of the prospect of litigation, analyzing the likely outcome of that litigation, it does not lose protection under this formulation merely because it is created in order to assist with a business decision."[56]

The Second Circuit asserted that the "because of" test accorded better with the plain meaning of Rule 26(b)(3) than the "primary motivating purpose" test.[57] Further, the Second Circuit found the "because of" test desirable because of the rule's inclusiveness—in that documents containing an attorney's "mental impressions" would be

50 The Second Circuit also reasoned that "[w]here the Rule has explicitly established a special level of protection against disclosure for documents revealing an attorney's . . . opinions . . . it would oddly undermine its purposes if such documents were excluded from protection merely because they were prepared to assist in the making of a business decision expected to result in the litigation." *Id.* at 1199.

51 *See supra* note 40 (discussing the use of the "because of" test among several circuits).

52 United States v. Deloitte LLP, 610 F.3d 129, 137 (D.C. Cir. 2010) (quoting *In re* Sealed Case, 146 F.3d 881, 884 (D.C. Cir. 1998)).

53 *Adlman*, 134 F.3d at 1194.

54 *Id.* at 1195.

55 *Id.* at 1197.

56 *Id.* at 1202.

57 *Id.*; *see also supra* notes 48–50 and accompanying text (explaining why the "primary motivating purpose" test is inflexible and at odds with the plain meaning of the rules).

protected—and exclusiveness—in that ordinary, nonlitigation business documents would not receive protection.[58]

3. The Road to Ruin: *Textron*'s "Prepared for Use in Litigation" Test

In 2009, the First Circuit, sitting en banc, decided *Textron* purportedly using the "because of" test.[59] Despite similarities to *Adlman*, however, the two cases came out remarkably different, and the *Textron* dissent—as well as scholarly commentators—have asserted that *Textron* used a new "prepared for use in litigation" test rather than the "because of" test.[60]

In *Textron*, the IRS issued a summons for the tax accrual workpapers maintained by Textron's auditor, Ernst & Young, for nine questionable tax positions.[61] Reversing the District of Rhode Island and vacating a prior First Circuit panel, the *Textron* majority found that the documents did not qualify for protection because the "work papers were prepared to support financial filings and gain auditor approval," not because of litigation.[62] The majority held that "[i]t is not enough to trigger work-product protection that the *subject matter* of a document relates to a subject that might conceivably be litigated."[63] Rather, the documents must be prepared for use in possible litigation.[64]

The dissent in *Textron* was scathing. Judge Torruella, joined by Judge Lipez, said that the majority had ignored previous First Circuit precedent and devised a new "prepared for use in litigation" test that was even narrower than the Fifth Circuit's "primary motivating purpose" test.[65] Repeating many of *Adlman*'s criticisms of *El Paso*, the dissent described the majority's new rule as being inflexible and at odds with the plain meaning of Rule 26(b)(3). But the dissent also

58 *Id.* at 1203 (explaining that the "because of" test is desirable because it "appropriately focuses on both what should be eligible for the Rule's protection and what should not").

59 *See* United States v. Textron Inc., 577 F.3d 21, 21 (1st Cir. 2009).

60 *See id.* at 32 (Torruella, J., dissenting); *see also* Adam M. Braun, Note, *Open Reserve-ations?:* United States v. Textron Inc. *and Its Application to International Tax Accounting*, 86 NOTRE DAME L. REV. 823, 834–35 (2011) (agreeing with the dissent that *Textron* may have created a third split among the Federal Circuits).

61 *Textron*, 577 F.3d at 23–24.

62 *Id.* at 31.

63 *Id.* at 29.

64 *Id.*

65 *Id.* at 32 (Torruella, J., dissenting). Notably, Judge Torruella and Judge Lipez were the majority on the three-judge panel that had previously heard the case.

characterized the *Textron* majority as being at odds with *Hickman*, asserting that the majority ignored the "fundamental concern of [that opinion] with protecting an attorney's 'privacy, free from unnecessary intrusion by opposing parties and their counsel.'"[66]

II. THE ROAD TO RECOVERY: THE D.C. CIRCUIT REINVIGORATES THE WORK-PRODUCT DOCTRINE IN *UNITED STATES V. DELOITTE & TOUCHE*

The *Deloitte* case, a discovery dispute, arose from tax litigation involving the "treatment of two partnerships owned by Dow Chemical Company" and its wholly-owned subsidiaries.[67] In 2005, Dow challenged IRS adjustments made to partnership returns filed by the two partnerships, Chemtech Royalty Associates, L.P. ("Chemtech I") and Chemtech II, L.P. ("Chemtech II").[68] During discovery, the IRS subpoenaed several documents from Dow's independent auditor, Deloitte & Touche USA, LLP.[69] Deloitte produced many of the requested documents, but it declined to do so for three documents that Dow had identified as attorney work product.[70] Deloitte also declined to provide documents held by its Swiss counterpart, Deloitte Switzerland.[71]

The first document, called the "Deloitte Memorandum," was a "1993 draft memorandum prepared by Deloitte that summarize[d] a meeting between Dow employees, Dow's outside counsel, and Deloitte employees about the possibility of litigation over the Chemtech I partnership, and the necessity of accounting for such a possibility in an ongoing audit."[72] Prior to the meeting, Deloitte had warned Dow of

66 *Id.* at 35 (quoting Hickman v. Taylor, 329 U.S. 495, 510 (1947)).

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

68 *See id.*

69 *See id.*

70 *See id.*

71 United States v. Deloitte & Touche USA, 623 F.Supp.2d 39, 40 (D.D.C. 2009). The government argued that Deloitte USA had possession over the documents at the Swiss firm under the Federal Rules of Civil Procedure Rule 45(a)(1)(A)(iii) because Deloitte USA maintained sufficient control over Deloitte Switzerland. *See id.* The District Court found this "unpersuasive," holding that while "Deloitte USA and Deloitte Switzerland are both members of the Swiss *verein*—or membership organization—Deloitte Touche Tohmatsu, the United States has failed to establish that Deloitte USA has the 'the [sic] legal right, authority or ability to obtain documents upon demand' from Deloitte Switzerland." *Id.* at 41 (quoting U.S. Int'l Trade Comm'n v. ASAT, Inc., 411 F.3d 245, 254 (D.C. Cir. 2005)). The District Court's ruling on the Swiss documents was not appealed, and the subject is beyond the scope of this Note.

72 *Deloitte*, 610 F.3d at 133.

the possibility of litigation relating to the Chemtech I partnership's tax treatment.[73]

The second document was a "1998 memorandum and flow chart prepared by two Dow employees—an accountant and an in-house attorney," and the third was "a 2005 tax opinion prepared by Dow's outside counsel."[74] William Curry, Dow's Director of Taxes, recorded in Dow's privilege log that the second and third documents—referred to by the court as the "Dow Documents"—were given to Deloitte so that the accounting firm could "'review the adequacy of Dow's contingency reserves for the Chemtech transactions.'"[75] Deloitte, according to Curry, compelled the disclosure of the documents by threatening to issue a qualified audit opinion.[76] All three documents, according to the privilege log, were prepared "in anticipation of litigation."[77]

Although the tax litigation was filed in the Middle District of Louisiana, because production was sought in Washington, D.C., the government filed the motion to compel in the District Court for the District of Columbia.[78] The District Court denied the motion to compel without reviewing the documents in camera, holding that they were "protected from discovery as attorney work-product because they were created in anticipation of future litigation over the tax treatment" of the Chemtech partnerships.[79] The District Court also held that Dow did not waive privilege claims over the documents when it disclosed them to Deloitte USA.[80]

Because the motion to compel was the only matter before the District Court, the ruling was a final appealable judgment, and the government sought review by the United States Court of Appeals for the District of Columbia Circuit.[81] The government conceded on appeal that the Dow Documents were work product, but maintained that the Deloitte Memorandum was not.[82] The government also argued that work-product protection was waived for all three documents by disclosure to Deloitte.[83]

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73 *Id.*

74 *Id.*

75 *Id.* at 133–34

76 *Id.* at 133.

77 *Id.*

78 *Id.*

79 *United States v. Deloitte & Touche USA*, 623 F. Supp. 2d 39, 40 (D.D.C. 2009).

80 *Id.* at 41. For discussion, see *infra* Part III.

81 *Deloitte*, 610 F.3d at 134.

82 *Id.*

83 *Id.* For discussion, see *infra* Part III.

A. *Applying the "Because Of" Test:* Deloitte *Rebuffs* Textron *and Redeems Work product*

The government advanced two arguments that the Deloitte Memorandum was not work product. First, it argued that because Deloitte—and not Dow—prepared the memorandum, the document could not qualify for work-product protection.[84] Secondly, it argued that the memorandum could not be work product because the memo was prepared as part of the audit process, not in anticipation of litigation. [85] The D.C. Circuit rejected both arguments. [86]

Rule 26(b)(3) applies to documents prepared by a party or its representative.[87] The government first argued that Deloitte is not Dow's representative, relying on *Arthur Young*'s refrain that auditors owe their primary responsibilities to the investing public.[88] In the government's view, under *Arthur Young*, Deloitte cannot be Dow's representative, and resultantly, the Deloitte Memorandum cannot be work product under the plain language of Rule 26(b)(3).[89] Dow countered that the "representative" for purposes of the work-product doctrine is its counsel, whose thoughts and opinions are recorded in the document.[90]

The D.C. Circuit, in rejecting the government's argument, agreed with Dow and found that Rule 26(b)(3) does not contain an exhaustive list of what is work product; *Hickman* was only partially codified by the Federal Rules of Civil Procedure.[91] According to the court, any document containing the "mental impressions" of an attorney can qualify for work-product protection, as can intangible items.[92] Consequently, the government was incorrect in focusing on *who* created the document, because "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."[93] Accord-

84 *See id.* at 135.

85 *See id.*

86 *See id.*

87 FED. R. CIV. P. 26(b)(3)(A).

88 *See Deloitte*, 610 F.3d at 135.

89 *See id* at 136.

90 *See id.* Dow also argued that the Deloitte Memorandum contained the same information as the Dow Documents, which the government had admitted were work product. *See id.*

91 *See id.*

92 *Id.*

93 *Id.*

ingly, the D.C. Circuit ruled that "Deloitte's preparation of the document does not exclude the possibility that it contains Dow's work."[94]

The government also argued that the Deloitte Memorandum was not work product because it was prepared during an annual audit, not in preparation for litigation.[95] Essentially, the government, relying on *El Paso* and *Textron*, was arguing that the *function* of a document—not its content—determines whether it is work product.[96] The D.C. Circuit dismissed this argument.[97] Relying on *Adlman*, the court said "material developed in anticipation of litigation can be incorporated into a document produced during an audit without ceasing to be work-product."[98] The court, as a parting shot, distinguished and criticized *Textron*, implying that the First Circuit did not use the "because of" test.[99]

After rejecting the government's two categorical arguments, the D.C. Circuit concluded "that the district court did not have a sufficient evidentiary foundation for its holding that the memorandum was purely work-product."[100] Accordingly, the case was remanded on this issue.[101]

B. The Impact on Tax Court Decisions

Because the D.C. Circuit Court's evidence rulings govern the United States Tax Court, the *Deloitte* ruling is perhaps the most significant of the federal circuit court decisions. Tax Court Rule 143(a) provides that the rules of evidence applicable to bench trials in the District of Columbia district court apply in Tax Court proceedings.[102] The Federal Rules of Evidence, which bind the D.C. District Court, provide that the rules of privilege and protection at a jurisdiction's common law govern.[103] Thus, after *Deloitte*, the "because of" test will control evidentiary rulings in the United States Tax Court.

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94 *Id.* at 136.

95 *See id.*

96 *Id.* at 137.

97 *See id.* at 138.

98 *Id.*

99 *See id.* ("Judge Torruella's dissenting opinion in *Textron* makes a strong argument that while the court 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.").

100 *Id.*

101 *See id.* at 139.

102 T.C.R. 143(a).

103 FED. R. EVID. 501.

III. A ROADMAP DISCOVERED: *DELOITTE*'S ANALYSIS OF WORK-PRODUCT WAIVER

While the government conceded that the Dow Documents were work product, it argued that Dow waived any protection when it provided the documents to Deloitte.[104] As the D.C. Circuit acknowledged, few, if any, federal appellate courts had previously decided whether disclosing work product to an independent auditor constituted waiver.[105] Dozens of district courts had previously addressed the issue, but they did so with a shocking lack of uniformity, leading to a convoluted maze of case law.[106] Accordingly, *Deloitte*'s waiver analysis is perhaps the most significant aspect of the opinion: as the first federal circuit court to comment on waiver in the context of financial statement audits, the D.C. Circuit's analysis will doubtlessly prove influential, and will shape the work-product doctrine well into the future.

A. *Wandering Aimlessly: The Diverging Paths of the District Courts*

Among the district courts that have evaluated waiver, the overwhelming majority have found no waiver,[107] although the reasoning as to why has varied greatly. For example, in *Regions Financial Corp. v. United States*,[108] the Northern District of Alabama found no waiver because there is "no conceivable scenario in which [the auditor] would file a lawsuit against Regions because of something [the auditor] learned from [the] disclosures" and because the disclosed workpapers were protected by a confidentiality agreement.[109] Contrastingly, in *Lawrence E. Jaffe Pension Plan v. Household International,*

104 *See Deloitte,* 610 F.3d at 139.

105 *See id.* While it may appear shocking that no circuit court has previously addressed the waiver issue, Professor Matthew J. Barrett has offered an explanation: "The fact that parties generally cannot appeal discovery orders until the court has entered a judgment perhaps explains the paucity of appellate opinions. By that time, the litigants may have concluded that the legal issues that arose in discovery do not merit pursuing on appeal." MATTHEW J. BARRETT, ACCOUNTING FOR LAWYERS: 2011 SUPPLEMENT 179 (2011).

106 *See infra,* notes 108–17 and accompanying text.

107 *See Deloitte,* 610 F.3d at 139.

108 Regions Fin. Corp. v. United States, No. 2:06-CV-00895-RDP, 2008 WL 2139008 (N.D. Ala. May 8, 2008), *appeal dismissed,* No. 08-13866 (11th Cir. Dec. 30, 2008). The IRS appealed to the Eleventh Circuit, but subsequently moved to dismiss after the IRS reportedly obtained the requested documents in a settlement. *See* Amy S. Elliott, *Hochman Downplays Significance of Regions Settlement Despite Textron Appeal,* TAX NOTES TODAY, Jan. 13, 2009, at 7-5.

109 *Id.* at 90.

Inc.,[110] the Northern District of Illinois focused on the fact that "[d]isclosing documents to an auditor does not substantially increase the opportunity for potential adversaries to obtain the information."[111] But in *Merrill Lynch & Co., v. Allegheny Energy, Inc.*,[112] the Southern District of New York focused on the nature of the auditor-client relationship and found that "any tension between an auditor and a corporation that arises from an auditor's need to scrutinize and investigate a corporation's records and bookkeeping practices simply is not the equivalent of an adversarial relationship contemplated by the work-product doctrine."[113]

At least two courts, however, have found waiver. In *Medinol Ltd. v. Boston Scientific Corp.*,[114] the Southern District of New York—the same court as in *Merrill Lynch*—found waiver when minutes and materials of a special litigation committee were disclosed to Boston Scientific's auditors.[115] Finding that there was no "common interest" or common adversary, the court ruled that the "privacy interests that the work-product doctrine was intended to protect" were not served and therefore waived.[116] In *In re Diasonics Securities Litigation*, the Northern District of California, citing *Arthur Young*, found waiver because the "relationship between public accountant and client is at odds with [protection] . . . because the public accountant has responsibilities to creditors, stockholders, and the investing public which transcend the relationship with the client."[117]

Thus, there had been a severe lack of uniformity among the district courts, with each court focusing on dramatically different elements. Whereas *Diasonics* found the auditor-client relationship to be adversarial, *Merrill Lynch* found the exact opposite. Whereas *Regions*

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

111 *Id.* at 183 (quoting Vandon Golf Co. v. Karsten Mfg. Corp., 213 F.R.D. 528, 534 (N.D. Ill. 2003). Interestingly, in *Jaffe*, the auditor inadvertently disclosed the documents to the adversary. The court declined to find waiver even under these circumstances, finding that courts must weigh "five factors to determine whether waiver has occurred under such circumstances: (1) the reasonableness of the precautions taken to protect the document; (2) the time taken to rectify the error; (3) the scope of discovery; (4) the extent of the disclosure; and (5) the overriding issue of fairness." *Id.* (citing Urban Outfitters, Inc. v. DPIC Cos., 203 F.R.D. 376, 380 (N.D. Ill. 2001)).

112 Merill Lynch & Co. v. Allegheny Energy, Inc., 229 F.R.D. 441 (S.D.N.Y. 2004).

113 *Id.* at 448.

114 Medinol Ltd. v. Boston Scientific Corp., 214 F.R.D. 113 (S.D.N.Y. 2002).

115 *See id.* at 115–17.

116 *Id.* at 117.

117 *In re* Diasonics Sec. Litig., No. C–83–4584–RFP, 1986 WL 53402, at *1 (N.D. Cal. June 15, 1986) (unpublished decision).

focused on whether the auditor and client would oppose each other in future litigation, *Medinol* focused on whether there was a common adversary. And others, such as *Jaffe*, emphasized the degree to which the communication would remain confidential. With such diversity of opinions—and no appellate precedent—the law had become a confusing maze, and *Deloitte* provided much needed guidance on work-product waiver.

B. Much-Needed Directions: Deloitte*'s Analysis of Work-Product Waiver*

As the *Deloitte* majority observed, while voluntary disclosure waives attorney-client privilege, it does not necessarily waive work-product protection.[118] The court explained:

> [T]he attorney-client privilege and the work-product doctrine serve different purposes: the former protects the attorney-client relationship by safeguarding confidential communications, whereas the latter promotes the adversary process by insulating an attorney's litigation preparation from discovery. Voluntary disclosure waives the attorney-client privilege because it is inconsistent with the confidential attorney-client relationship. Voluntary disclosure does not necessarily waive work-product protection, however, because it does not necessarily undercut the adversary process.[119]

Nonetheless, the court continued, disclosure can constitute waiver if that disclosure undercuts the adversarial process and is "'inconsistent with the maintenance of secrecy from the disclosing party's adversary.'" [120] Essentially, if disclosing to "an adversary or a conduit to an adversary," work-product protection is waived. [121]

The government argued that Dow and Deloitte were potential adversaries because companies and their independent auditors routinely become involved in various disputes.[122] The D.C. Circuit dismissed this argument, declaring that *Deloitte* could not serve as the auditor if there were any pending or threatened litigation between the two firms because Deloitte's independence would be impaired.[123] Further, the D.C. Circuit explained, the test "is not whether Deloitte could be Dow's adversary in any conceivable future litigation, but

118 United States v. Deloitte LLP, 610 F.3d 129, 139 (D.C. Cir. 2010) (citing United States v. Am. Tel. & Tel. Co., 642 F.2d 1285, 1299 (D.C. Cir. 1980)).

119 *Id.* at 139–40 (citations omitted).

120 *Id.* at 140 (quoting Rockwell Int'l Corp. v. U.S. Dep't of Justice, 235 F.3d 598, 605 (D.C. Cir. 2001)).

121 *Id.*

122 *Id.*

123 *Id.* (citing CODE OF PROFESSIONAL CONDUCT, Professional Standards § 101.08 (Am. Inst. Of Certified Pub. Accountants 2005)).

whether Deloitte could be Dow's adversary in the sort of litigation the Dow Documents address."[124] If the former were the test, the court reasoned, any disclosure would constitute waiver.[125]

The court then found that Dow and Deloitte could not be adversaries in the sort of litigation the Dow Documents addressed.[126] The court deduced that Dow anticipated a dispute with the IRS, not with Deloitte: "The documents, which concern the tax implications of the Chemtech partnerships, would not likely be relevant in any dispute Dow might have with Deloitte. Thus Deloitte cannot be considered a potential adversary with respect to the Dow Documents."[127]

The government also argued that Dow and Deloitte were adversaries because "independent auditors have the power to issue opinions that adversely affect their clients."[128] The D.C. Circuit also dismissed this argument, citing *Merrill Lynch* and concluding that "any tension between an auditor and a corporation that arises from an auditor's need to scrutinize and investigate a corporation's records and bookkeeping practices simply is not the equivalent of an adversarial relationship contemplated by the work-product doctrine."[129]

The government relied heavily on *United States v. Massachusetts Institute of Technology*[130] (MIT) for its argument. MIT, a contractor under investigation by the Department of Defense, claimed work-product protection for several expense reports it had given to the Defense Contract Audit Agency, a component of the Department of Defense.[131] The United States Court of Appeals for the First Circuit found waiver because MIT had given the documents to its most likely adversary, the Department of Defense.[132] In *Deloitte*, the D.C. Circuit rejected any similarity between the two cases, calling them "wholly different" because MIT "disclosed its work product not to an independent auditor, but to an auditor affiliated with a potential adversary."[133]

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124 *Id.*

125 *See id.*

126 *See id.*

127 *Id.* Interestingly, large accounting firms routinely provide both audit and tax services to clients. The waiver outcome could conceivably be difficult in a situation where Deloitte was not only the auditor, but also the tax preparer: in this situation, there might be an adversarial relationship in an audit, refund, or even malpractice action. In the research for this Note, no cases were found which addressed this issue.

128 *Id.*

129 *Id.* (quoting Merrill Lynch & Co. v. Allegheny Energy, Inc., 229 F.R.D. 441, 448 (S.D.N.Y. 2004)).

130 United States v. Mass. Institute of Tech., 129 F.3d 681 (1st Cir. 1997).

131 *See id.* at 682–83.

132 *See id.* at 687.

133 *Deloitte*, 610 F.3d at 141.

Finally, the government argued that Deloitte was a conduit to a potential adversary.[134] The D.C. Circuit explained that two discrete inquiries are used to determine whether the "maintenance of secrecy" standard has been met.[135] First, a court must determine "whether the disclosing party has engaged in self-interested selective disclosure by revealing its work product to some adversaries but not to others," with selective disclosure indicating waiver.[136] Second, a court must assess "whether the disclosing party had a reasonable basis for believing that the recipient would keep the disclosed material confidential."[137] The court explained that "[a] reasonable expectation of confidentiality may derive from common litigation interests between the disclosing party and the recipient" or from "a confidentiality agreement or similar arrangement."[138]

On the "selective disclosure" inquiry, the D.C. Circuit found that because Dow had not given the documents to any potential adversaries, Dow did not waive work-product protection.[139] On the "reasonable expectation of confidentiality" inquiry, the court found that while the two parties did not have common litigation interests, "Deloitte, as an independent auditor, ha[d] an obligation to refrain from disclosing confidential client information."[140]

Interestingly, the *Deloitte* opinion incorporated many of the waiver elements used by the various district courts. While the D.C. Circuit explicitly cited *Merrill Lynch* for the proposition that the auditor-client relationship is not tantamount to an adversarial one,[141] criteria from other cases appear prominently in the D.C. Circuit's analysis. *Jaffe*'s examination of whether disclosure to a party substantially increases the opportunity for potential adversaries to obtain the information is the central theme in the two-part "maintenance of secrecy" standard.[142] *Medinol*'s "common interest" or "common adver-

134 *See id.*

135 *See id.*

136 *Id.* (citations omitted).

137 *Id.* (citations omitted).

138 *Id.* (citations omitted).

139 *Id.* at 142.

140 *Id.* (citing CODE OF PROFESSIONAL CONDUCT, Professional Standards § 301.01 (Am. Inst. Of Certified Pub. Accountants 2005)). The government countered that Rule 301 "shall not be construed . . . to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons." *Id.* However, as the D.C. Circuit explained, "[A]n assertion of work-product protection challenges the enforceability of a subpoena with respect to those materials." *Id.*

141 *See supra* note 129 and accompanying text.

142 *See supra* notes 110–111 and accompanying text

sary" test is part of the "reasonable expectation of confidentiality" inquiry,[143] as is *Regions*'s focus on the confidentiality agreement.[144]

Indeed, the only district court opinion that is clearly—even if not explicitly—rebuffed is *Diasonics*, which relied heavily on *Arthur Young* in holding that the "relationship between public accountant and client is at odds with [protection] . . . because the public accountant has responsibilities to creditors, stockholders, and the investing public which transcend the relationship with the client."[145] Calling any reliance on *Arthur Young* misplaced, the D.C. Circuit pointed out that *Arthur Young* "considered whether *accountant* work-product should be granted the same protection *attorney* work-product receives," not whether the auditor's use of attorney work product should lack protection.[146]

Finally, the D.C. Circuit explained several policy considerations with regard to waiver. Recognizing that they are "mindful that independent auditors have significant leverage over the companies whose finances they audit," the D.C. Circuit claimed "[a]n auditor can essentially compel disclosure by refusing to provide an unqualified opinion otherwise."[147] Requiring waiver on such disclosures, the court reasoned, would undermine the adversarial model envisioned in *Hickman* by discouraging companies from seeking robust legal advice and completely and accurately disclosing that information to independent auditors.[148] Further, allowing waiver would make reality of Justice Jackson's great fear and allow the government to litigate "'on wits borrowed from the adversary.'"[149]

In conclusion, *Deloitte*, using many of the standards espoused by the district courts, provided a legal map of a previously convoluted case law.[150] After *Deloitte*, independent auditors are adversaries for work-product purposes only to the extent that litigation is actually contemplated between the auditing firm and the client.[151] Furthermore, auditors are not per se conduits to potential adversaries, as

143 *See supra* notes114–116 and accompanying text

144 *See supra* note 109 and accompanying text

145 *In re* Diasonics Sec. Litig., No. C–83–4584–RFP, 1986 WL 53402, at *1 (N.D. Cal. June 15, 1986) (unpublished decision). *See supra* note 117 and accompanying text.

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

147 *Id.*

148 *See id.*

149 *Id.* (quoting Hickman v. Taylor, 329 U.S. 495, 516 (1947)).

150 *See supra* Part III.

151 *See supra* Part III.

auditors' professional standards help clients meet the "maintenance of secrecy" standard.[152]

IV. A ROAD PAVED WITH GOLD: WHY *DELOITTE* GOT IT RIGHT ON LAW AND PUBLIC POLICY

A. On the Road Again: Why Deloitte *Is Right on the Work-Product Doctrine*

Deloitte, as the first federal circuit decision to come after *Textron* on this issue, was reason for relief among corporate counsel. The *Deloitte* decision effectively rebuffed the *Textron* decision, thereby reinvigorating the work-product doctrine. Nonetheless, *Textron* still has the force of law in the First Circuit, and *El Paso* has the force of law in the Fifth Circuit. Meanwhile, companies with nationwide operations face considerable uncertainty regarding which work-product standard will apply if the IRS summonses any documents containing work product.[153] Because the IRS may serve a summons in the United States district court for the district in which such person resides,[154] companies with operations in the First or Fifth Circuits will not know which work-product protection standard will apply until the summons has been delivered.

Deloitte, unlike *Textron* and *El Paso*, provides a sound legal framework rooted in statute and longstanding case law. Further, weighing the public policy considerations reveals that *Deloitte* is faithful to the spirit of *Hickman* and Rule 26(b)(3). Accordingly, should the circuit court split be resolved in the future, the Supreme Court or Congress should take the beaten path and use the "because of" test.

1. Respecting the Plain Meaning of *Hickman* and Rule 26(b)(3)

The plain meaning of *Hickman* and Rule 26(b)(3) gravitates towards the "because of" test used by *Deloitte* and most other circuits. As the Second Circuit observed in *Adlman*, "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."[155] In this regard, *El Paso* and *Textron* misconstrue the law by requiring that a document be pre-

152 *See supra* Part III.

153 *See* Joy A. Williamson, Note, *The Scope and Application of the Work Product Doctrine As Applied to Dual-Purpose Documents*, 30 VA. TAX REV. 715, 728–30 (2011).

154 I.R.C. § 7604(a) (2006).

155 United States v. Adlman, 134 F.3d 1194, 1198 (2d Cir. 1998).

pared for use in litigation or with litigation as the primary motivating purpose.

Further, as *Hickman* made clear, whether a document contains work product is not a result of its function, but rather a result of whether the document contains an attorney's mental impressions.[156] The work-product doctrine as envisioned in *Hickman* was intended to prevent opposing counsel from having access to an attorney's thoughts, trial strategies, and legal theories. As the Second Circuit stated in *Adlman*:

> Where the Rule has explicitly established a special level of protection against disclosure for documents revealing an attorney's (or other representative's) opinions . . . it would oddly undermine its purposes if such documents were excluded from protection merely because they were prepared to assist in the making of a business decision expected to result in the litigation.[157]

In this regard, the *Textron* and *El Paso* tests are unduly narrow and are an affront to *Hickman* and the plain meaning of Rule 26(b)(3): they deny protection based solely on function, ignoring the underlying content.

2. Preserving the Adversarial System

As Justice Jackson observed in *Hickman*, the work-product doctrine preserved the adversarial system by disallowing parties from litigating on the intelligence, research, and cunning of their adversaries.[158] The Advisory Committee's notes also reflected this policy goal: "[E]ach side's informal evaluation of its case should be protected . . . each side should be encouraged to prepare independently, and . . . one side should not automatically have the benefit of the detailed preparatory work of the other side."[159]

As explained in *Arthur Young*, the IRS would benefit greatly from being able to obtain tax accrual workpapers. These documents immediately reveal the tax positions the IRS is interested in "by highlighting those areas in which the corporate taxpayer has taken a position that may, at some later date, require the payment of additional taxes" and by providing "an item-by-item analysis of the corporation's potential exposure to additional liability."[160] Indeed, the IRS, in *Textron*, has

156 *See* Hickman v. Taylor, 329 U.S. 495, 511 (1947).

157 *Adlman*, 134 F.3d at 1199.

158 *See Hickman*, 329 U.S. at 516 (Jackson, J., concurring).

159 FED. R. CIV. P. 26(b)(3) advisory committee's note (1970 amendment).

160 United States v. Arthur Young & Co., 465 U.S. 805, 813 (1984).

admitted that this is exactly why they wanted the documents that were at issue in that case.[161]

Allowing access to these workpapers, however, shifts the cost of tax enforcement onto companies with a need for audit services. This would allow the IRS to "free ride" on the detailed preparatory work of the companies it seeks enforcement against, and the adverse incentives could lead to unintended consequences. For example, the IRS, armed with limited resources, would have an incentive to go after only the proverbial low-hanging fruit, disproportionately seeking enforcement actions against independently audited companies. The IRS would have little reason to do its own robust legal analysis, as it could rely on the efforts of its opponents. Moreover, revealing a corporate attorney's private assessment of success to the IRS would greatly inhibit the ability of lawyers to represent their clients and advantage the IRS: the corporation would essentially be playing poker with an open hand. Moreover, the IRS would be able to force settlements, even in cases where the company had a defensible tax position. As Judge Torruella observed in the *Textron* dissent:

> Textron's [workpapers] contain exactly the sort of mental impressions about the case that *Hickman* sought to protect. In fact, these percentages contain counsel's ultimate impression of the value of the case. . . . With this information, the IRS will be able to immediately identify weak spots and know exactly how much Textron should be willing to spend to settle each item.[162]

3. Ensuring Robust and Well-Documented Legal Representation

One of the chief concerns of *Hickman* was ensuring the quality of legal representation. As the Supreme Court observed, the "effect on the legal profession [of permitting discovery] would be demoralizing" and the "interests of the clients and the cause of justice would be poorly served."[163] The Court also asserted that "[w]ere such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten."[164]

If the work-product tests focus on a document's content, as was the case in *Deloitte*, "attorneys preparing preventative or pre-transaction legal advice can conduct a comprehensive analysis of the situa-

161 United States v. Textron Inc., 577 F.3d 21, 36 (1st Cir. 2009) (Torruella, J., dissenting) ("Indeed, the IRS explicitly admits that this is its purpose in seeking the documents.").

162 *Id.*

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

164 *Id.*

tion and reduce their assessments to writing because they will have assurance that their work-product will be undiscoverable regardless of the functional document into which their thoughts and opinions are incorporated."[165] However, if the focus is on a document's purpose, attorneys may be forced to question whether to memorialize their thoughts in writing: doing so could cause harm to their client if the document was discovered merely because it was the wrong kind of dual-purpose document.[166] Judge Torruella articulated this in the *Textron* dissent: "[I]f attorneys who identify good faith questions and uncertainties in their clients' tax returns know that putting such information in writing will result in discovery by the IRS, they will be more likely to avoid putting it in writing, thus diminishing the quality of representation."[167]

4. Promoting Completeness and Accuracy in Financial Reporting

Arguably, the most compelling reason to protect dual-purpose documents under the "because of" test is to ensure completeness and accuracy in financial reporting. As explained above, after *El Paso* and *Textron*, lawyers may be hesitant to put their thoughts in writing. But even more dire consequences can come from their being less than candid in their analysis of the tax liability, and after *El Paso* and *Textron*, companies have every incentive to engage in a financial numbers game. Attorneys can easily underestimate the total reserve by conservatively estimating the potential liability or risk of loss. And in a system where the IRS has free access to information and can force settlements,[168] companies would have every incentive to "game" the numbers and lower their liability, particularly where it would help them meet earnings estimates.

While it is true that auditors must conduct their own analysis of a client's tax accrual reserves, the audit process necessitates a review of the client's analysis for reasonableness. Accordingly, it is essential that tax documents be provided to the auditor; otherwise, they simply will not be able to evaluate the reserves for adequacy. Furthermore, even if the auditor did somehow independently determine that the client's numbers were misstated, they would only request an adjustment based on materiality. As such, in this realm, the auditor does not provide an effective check against corporate attorneys who are incentivized to be less than candid.

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165 Williamson, *supra* note 153, at 741.

166 *Id.* at 741–42.

167 *Textron*, 577 F.3d at 36–37 (Torruella, J., dissenting).

168 *See supra* note 161 and accompanying text.

Textron and *El Paso*'s proponents argue that there should not be truthfulness in external financial reporting alone, but also in tax reporting. As the *Textron* majority stated, "tax collection is not a game. Underpaying taxes threatens the essential public interest in revenue collection. If a blueprint to Textron's possible improper deductions can be found in Textron's files, it is properly available to the government . . . ."[169] But this argument is a red herring and puts tax collection above all else, including the aforementioned policy considerations.[170] And it runs roughshod over established notions of work product. As the dissent in *Textron* asserted, "[t]he scope of the work-product doctrine should not depend on what party is asserting it," yet that is exactly what the *Textron* majority did with that statement: they give special consideration to the IRS.[171]

B. Merging Forked Paths: Why Deloitte *Is Right on Waiver*

As the *Deloitte* majority observed, while voluntary disclosure waives attorney-client privilege, it does not necessarily waive work-product protection because it does not undercut the adversarial process. [172] Thus, to the extent that *Deloitte*'s holding protects the adversarial process, it upholds the intent of *Hickman* and Rule 26(b)(3).

The *Deloitte* majority correctly found that nothing per se places auditors and clients in an adversarial relationship. As the D.C. Circuit observed, if any auditor-client dispute results in pending or threatened litigation, the auditor's independence would be impaired.[173] The government argued that auditors and clients routinely become involved in litigation, but as the court found, the test is not whether the auditor could be the client's adversary in any conceivable future litigation, but whether the auditor could be the client's adversary in the sort of litigation the work-product documents contemplate. [174] Otherwise, given the vast universe of possible litigation, voluntary disclosure to a third party would almost always result in waiver.

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169 *Textron*, 577 F.3d at 31.

170 This is essentially the case with all forms of privilege. As Jeremy Bentham claimed, legal privilege obscures the truth in pursuit of other objectives. 8 JOHN HENRY WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2291 (McNaughton rev., Little, Brown & Co. 1961).

171 *Textron*, 577 F.3d at 37 (Tortuella, J., dissenting).

172 United States v. Deloitte LLP, 610 F.3d 129, 139 (D.C. Cir. 2010) (citing United States v. Am. Tel. & Tel. Co., 642 F.2d 1285, 1299 (D.C. Cir. 1980)).

173 *Id.* at 140 (citing CODE OF PROFESSIONAL CONDUCT, Professional Standards, § 101.08 (Am. Inst. of Certified Pub. Accountants 2005)).

174 *Id.*

The more difficult question resolved in *Deloitte* is whether auditors and clients are adversaries because, as the government argued, "independent auditors have the power to issue opinions that adversely affect their clients."[175] The Northern District of California, citing *Arthur Young*, had previously found waiver because the "relationship between public accountant and client is at odds with [waiver] . . . because the public accountant has responsibilities to creditors, stockholders, and the investing public which transcend the relationship with the client."[176] The D.C. Circuit, citing *Merrill Lynch*, disagreed and held that "'any tension between an auditor and a corporation that arises from an auditor's need to scrutinize and investigate a corporation's records and book-keeping practices simply is not the equivalent of an adversarial relationship contemplated by the work-product doctrine.'"[177]

Within the plain meaning of the work-product doctrine, the *Deloitte* and *Merrill Lynch* opinions better align with the spirit and intent of *Hickman* and Rule 26(b)(3). *Hickman* was not seeking to preserve any type of adversarial relationship; rather, it was attempting to preserve an adversarial relationship in litigation.[178] The Supreme Court affirmed this in *United States v. Nobles*, [179] in which the court explained that the work-product doctrine "is an intensely practical one, grounded in the realities of litigation in our adversary system."[180] An independent audit simply is not litigation, is not tantamount to litigation, and often is not even adversarial: the client chooses the auditor and agrees upon a fee. Indeed, the relationship is, at its core, aligned in interest: the auditor joins the client in the effort to release fairly presented financial statements, and both parties seek to root out fraud and eliminate corruption.[181]

A novel argument can be made that by turning documents over to an independent auditor, one is essentially giving the documents to a party the auditor ultimately represents, the general public, who is also represented by—and an adversary via—the IRS. The government did not make such an argument. Nonetheless, this line of reasoning ignores the fact that accountants owe duties to more than the general

175 *Id.*

176 *In re* Diasonics Sec. Litig., No. C-83-4584-RFP, 1986 WL 53402, at *4 (N.D. Cal. June 15, 1986) (unpublished decision).

177 *Deloitte*, 610 F.3d at 140 (quoting Merrill Lynch & Co. v. Allegheny Energy, Inc., 229 F.R.D. 441, 448 (S.D.N.Y. 2004)).

178 *See* Hickman v. Taylor, 329 U.S. 495, 511 (1947).

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

180 *Id.* at 238.

181 Merill Lynch & Co. v. Allegheny Energy, Inc., 229 F.R.D. at 448.

public: they also owe duties to their clients. Indeed, the AICPA's Professional Standards contain numerous references not only to responsibilities to the public but to clients.[182] Furthermore, while an audit may serve the general public, the data used in an audit is not necessarily public information; in fact, it is frequently confidential. And as *Deloitte* observed, auditors have a responsibility to keep confidential client information secret.[183]

This auditor responsibility provides the lynchpin in *Deloitte*'s "reasonable expectation of confidentiality" inquiry, where the court found that while the two parties do not have common litigation interests, "Deloitte, as an independent auditor, has an obligation to refrain from disclosing confidential client information."[184] This fact was mistakenly ignored in *Medinol Ltd. v. Boston Scientific Corp.*, [185] which found waiver because there was no "common interest" or "common adversary," and therefore "privacy interests that the work-product doctrine was intended to protect" were not served and were therefore waived.[186] Prior to *Deloitte*, the D.C. Circuit said that waiver did not occur as long as there was a reasonable maintenance of secrecy, or expectation thereof.[187] *Deloitte* did not change the standard, but merely held that an auditor's professional obligations require him to protect confidential information.

Many of the policy considerations enumerated for the work-product analysis work equally as well for the waiver analysis, and a complete critique need not be repeated here. A blanket rule may reduce the

182 *See, e.g.*, CODE OF PROFESSIONAL CONDUCT, Professional Standards § 53.01 (Am. Inst. of Certified Pub. Accountants 2005) ("The accounting profession's public consists of clients . . . and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.").

183 United States v. Deloitte LLP, 610 F.3d 129, 142 (D.C. Cir. 2010) (citing CODE OF PROFESSIONAL CONDUCT, Professional Standards § 301.01 (Am. Inst. of Certified Pub. Accountants 2005)).

184 *Id.* (citing CODE OF PROFESSIONAL CONDUCT, Professional Standards § 301.01 (Am. Inst. of Certified Pub. Accountants 2005)). The government countered that Rule 301 "shall not be construed . . . to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons." *Id.* However, as the D.C. Circuit explained, "[A]n assertion of work-product protection challenges the enforceability of a subpoena with respect to those materials." *Id.*

185 Medinol Ltd. v. Boston Scientific Corp., 214 F.R.D. 113 (S.D.N.Y. 2002).

186 *Id.* at 115–17.

187 *See* Rockwell Int'l Corp. v. U.S. Dep't of Justice, 235 F.3d 598, 605 (D.C. Cir. 2001) (quoting United States v. Am. Tel. & Tel. Co., 642 F.2d 1285, 1299 (D.C. Cir. 1980)).

quality of legal representation, disincentivize the writing of legal advice, and harm the adversarial system.[188] But more importantly, a blanket waiver rule "could very well discourage corporations from conducting a critical self-analysis and sharing the fruits of such an inquiry with the [auditors]."[189] In this regard, *Deloitte* got it right not only on the law, but on the policy as well.

CONCLUSION

Because *Deloitte* affects the rules of evidence in the Tax Court, provides much needed guidance on work-product waiver, and redeems the work-product doctrine, its effects will reverberate long into the future. It has been a winding road from *Hickman* to *Deloitte*, with many bumps along the way, but *Deloitte* has brought the work-product doctrine back to the path of well established case law, congressional intent, and sound public policy.

To be sure, the work-product doctrine is still evolving: we are not yet at the end of the road. Will other circuits follow *Deloitte*'s roadmap on waiver? We may not know for some time. Meanwhile, the "because of" test may dominate the circuit split, but *Textron* still has the force of law in the First Circuit, as does *El Paso* in the Fifth Circuit. Companies with nationwide operations face considerable uncertainty regarding the status of the work-product doctrine. But at least after *Deloitte* they can breathe a sigh of relief: we are on the road again.

188 *See supra* Part IV.A.

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