United States v. Textron: Can You Secure Work Product Protection Despite Third Party Disclosure?

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In March, the First Circuit took the unusual step of withdrawing a two-month-old panel opinion and dissent, vacating the judgment and entering an order to rehear the case en banc.[1] The court's swift resolve to reexamine the issues in *United States v. Textron*[2] is hopeful, for the original panel decision had troubling ramifications far broader than the narrow circumstances that gave rise to it. On one hand, it endorsed a broad definition of attorney work product by including so-called dual purpose documents within its scope. On the other hand, its analysis of whether those protections were waived by disclosure of the material to a third party creates potential mischief in an already uncertain area. The rehearing was scheduled for early June 2009, and the parties have filed supplemental briefs at the court's invitation, along with an amicus brief filed in support of Textron.[3] Although the full court has not indicated which direction it is leaning in, its vacatur of the decision, together with court rulings issued since the original decision, give reason to hope that the work product privilege protection is not only holding its own, but also may perhaps even be gaining ground.

The cause of all of this controversy was the question of whether the Internal Revenue Service (IRS) could gain access to Textron's tax accrual work papers—documents identifying potential weaknesses in the taxpayer's returns, which included in-house counsel's assessments of the company's ability to prevail in litigation against the IRS as well as dollar amounts reserved to reflect the possibility that the company might lose. Because these types of documents constitute a road map through the returns, the agency's ability to gain access to tax accrual work papers has been a contentious issue for 25 years since the Supreme Court held in *United States v. Arthur Young & Co.*[4] that there exists no accountant-client privilege or accountant work product privilege in connection with an independent auditor's work papers for a public corporation. The issue gained increased urgency in 2002, when the IRS announced its intention to adopt a more aggressive approach to investigating potentially abusive tax shelters by expanding the circumstances under which it would seek to examine tax accrual work papers.[5]

In *Textron*, the company argued that it had created the documents in anticipation of litigation with the IRS over the tax positions, and asserted both attorney-client and work product privilege protection. Holding that the attorney-client privilege did not apply, two panel members found that the tax accrual work papers were protected by the work product privilege. The decision rejected the IRS's contention that, because the papers were also prepared for business and regulatory purposes, work product protection did not apply. The court held that "[d]ual purpose documents created because of the prospect of litigation are protected even though they were also prepared for a business purpose."[6] The court also held that, despite the fact that Textron had shown its work product to its independent auditors Ernst & Young, the company had not waived the protection of the privilege, because Textron had a cooperative rather than an adversarial relationship with the auditors.

However, from the court's perspective, that was only the beginning of the waiver analysis. The court reasoned that "[d]isclosure to a conduit to a potential adversary can also waive work-product protection."[7] Although the company had not permitted Ernst & Young to retain copies of the tax accrual work papers, and had an explicit agreement with the auditor that it would keep the information confidential, the court questioned whether Ernst & Young could be required to disclose its own documents pursuant to a valid subpoena. The issue then became whether Ernst & Young had incorporated Textron's analyses in its own work papers. Because there was no evidentiary record of the extent to which disclosure of Ernst & Young's papers would reveal Textron's own assessments, the First Circuit remanded the case back to the district court for that determination. The court also remanded for findings on the issue of whether Textron had the right to demand Ernst & Young's work papers, because the summons sought any auditor work papers within Textron's control.

Concurring in part and dissenting in part, the remaining justice disputed the "dual purpose" test endorsed by the majority and held that work product protection should not apply because the tax accrual work papers were prepared in the ordinary course of business or otherwise mandated by financial reporting regulations, regardless of whether the company anticipated the need to litigate the issues that the work papers addressed.

As it stood in January, therefore, the case potentially broadened the scope of the work product privilege, since it rested upon a dual-purpose analysis that included business documents as long as litigation was anticipated. Simultaneously, however, it raised the specter of a third party—the independent auditor—having the power to waive the company's protection depending on whether the auditor's own work papers were disclosable to an adversary. Moreover, because the court remanded for a finding as to whether Textron had the right to demand the auditor's work papers, the court apparently contemplated the paradoxical circumstance that Textron might assert work product privilege as to its own work papers but be forced to turn over Ernst & Young's work papers even though they incorporated Textron's analyses. It remains to be seen how much of the court's original analysis remains after rehearing before the full bench in June. Since the decision, however, other courts have upheld and even advanced the parameters of work product protection in circumstances useful to the criminal defense bar.

Related Decisions

In the two months between the First Circuit's panel decision and its March 2009 order, four reported decisions cited to the *Textron* case.[8] Of these, *Westernbank Puerto Rico v. Kachkar, et al.* is noteworthy, for it concerned disclosure of an accounting report prepared at the direction of outside counsel conducting an internal investigation. In *Westernbank*, an outside law firm was retained by the audit committee of the parent company of a bank to conduct an internal investigation of the bank's lending practices, together with a broader review of its loan portfolio. The law firm retained KPMG to provide forensic accounting services in aid of the investigation. KPMG prepared a report on its investigation, the existence of which the bank disclosed in its regulatory filings and which it provided in its entirety to its regular outside auditor Deloitte & Touche. In an action brought by the bank against corporate defendants and their officers regarding certain loans, one of the individuals sought disclosure of the KPMG report. The court rejected the individual's argument that, because the report was prepared to satisfy the bank's financial reporting obligations, it fell outside the work product protection. Noting that the report was prepared "because of" pending litigation with the borrower and anticipated litigation with shareholders concerning the bank's losses, the court cited *Textron* in support of its holding that the report was protected under the dual-purpose test, "so long as it was prepared 'because of expected litigation' even if it was also 'intended to inform a business decision influenced by the prospects of litigation.'"[9] In contrast, departing from the waiver analysis in *Textron*, the court relied upon preexisting cases, holding that disclosure of the report to the company's independent auditor did not waive the work product protection.[10]

More recently, in an unpublished decision in a civil enforcement action filed by the Securities Exchange Commission (SEC), a magistrate judge in the Northern District of California held in the case of *SEC v. Schroeder*[11] that the former CEO of a company, who was charged with improper backdating of stock options, was not entitled to documents prepared by an outside law firm retained by a special committee to investigate the company's option granting practices, despite the law firm's PowerPoint presentation and disclosure of documents to the company's regular outside auditor. Among other attorney-generated material, the defendant CEO subpoenaed from the law firm all documents and communications that the law firm had shared with the company's outside auditors relating to the company's option granting practices and the law firm's internal investigation.[12] The law firm resisted, maintaining that there was no waiver because the auditor did not stand in a position adverse to the company. Noting that the courts are split over the issue of whether disclosure to an independent auditor waives work product protection, the court nonetheless rejected the CEO's contention the protection was waived. The court did not cite to the *Textron* decision, which had been vacated the previous month, nor did it engage in the "conduit" analysis that so troubled the *Textron* court. Rather, it endorsed the view that disclosures to outside auditors do not have the "'tangible adversarial relationship' requisite for waiver."[13] The court found compelling the public policy interests in encouraging corporate self-policing, noting that "'sanctioning a broad waiver here would have a chilling effect on the corporation's efforts to root out and prevent corporate fraud and disclose the results as necessary to its auditors.'"[14]

United States v. Thompson

To the extent these decisions provide reason for optimism, *United States v. Thompson*[15] proves a cautionary tale, although the outcome is ultimately encouraging. In *Thompson*, the Circuit Court for the District of Columbia remanded a case to the district court for it to parse through documents sought by a criminal defendant, rather than endorsing the district court's broad finding of a waiver of work product protection. The discovery order in *Thompson* arose out of investigations by the Department of Justice (DOJ) and the Commodity Futures Trading Commission (CFTC) into the practices of certain energy companies including The Williams Companies and a subsidiary Williams Power Company (collectively "WPC"). During the course of the investigations, WPC retained an outside law firm to conduct an internal investigation of its trading practices. WPC then received a federal grand jury subpoena demanding information regarding its trading practices, and a CFTC subpoena accompanied by a letter from the CFTC advising that it considered "full cooperation" to entail disclosure of the results of the company's internal investigation.

In furtherance of WPC's efforts to cooperate, the company turned over documents to government investigators including attorney notes from interviews of company employees, data developed under company counsel's supervision, and presentations to DOJ attorneys that had, as their goal, influencing the DOJ's charging decisions. Each disclosure was accompanied by a statement that, insofar as other parties and other matters were concerned, the company was not waiving its privileges. Ultimately, the CFTC settled with WPC, and the DOJ executed a deferred prosecution agreement under which the company agreed to cooperate with federal prosecutors, and to refrain from asserting attorney-client privilege or work product protection as to certain factual documents from the internal investigation.

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The DOJ indicted Thompson, a former WPC employee, for conspiracy in connection with his trading activities while employed at the company, and Thompson moved to compel the government to produce information "material to his defense" that was provided to the government

by the company. The district court granted the motion over the arguments of both WPC and the government that WPC had preserved the protected status of the work product and that the government had agreed to those terms in receiving the material. The circuit court granted the company's emergency motion for a stay and expedited the appeal to consider the company's contention that it did not waive its work product protection when it made a limited one-time disclosure of documents to federal prosecutors in response to a grand jury subpoena while the target of a criminal investigation.

Emphasizing that it has rejected the selective waiver doctrine,[16] the circuit court declined to address the company's contention that it was coerced into producing documents to the government by virtue of the grand jury subpoena. However, the court noted that not all disclosures of work-product-protected material waive the privilege; rather, only those disclosures that are inconsistent with maintaining secrecy from the disclosing party's adversary suffice to waive the protections. The court then considered three factors.

First, the court held that WPC did not have a common interest with the government, and therefore its disclosure was inconsistent with maintaining secrecy from an adversary. However, that did not end the analysis. The court next considered WPC's letters to the government expressing its desire to preserve the privileges and limit any waivers. Finding that the company had a reasonable basis for believing the government would keep the material confidential, the court nonetheless held that the company did not go far enough, for the language of the letters expressed the desire to keep the material confidential "to the extent possible" to preserve any privilege claims.

Thus constrained by what the court apparently considered to be the company's awareness of the government's legal obligations to a defendant—and noting that the company produced the material pursuant to a grand jury subpoena, and therefore knew it could potentially be used at a trial—the court held that the company's expectations of confidentiality could not obviate the government's constitutional obligations to turn over potentially exculpatory material or the statutory discovery material to which a federal criminal defendant is entitled.

As to the third factor, the court considered the public policy interests inherent in the work product doctrine and found that, while the company sought confidentiality, the assurances it secured were neither sufficiently strong nor sufficiently unqualified to prevent the government's disclosure of documents material to the preparation of a criminal defense. As crafted by the circuit court, therefore, the issue of discoverability turned on whether the information was material to the defense. The court therefore remanded the case to the district court for an assessment of which documents were material to the defense, thereby attempting to achieve a balance between the company's efforts to protect against public disclosure of privileged material and an outcome consistent with the defendant's right to a fair trial. ■

Conclusion

While these cases by no means provide a clear formula for securing work product protection in the event of disclosure to a third party, they do add to the aggregate available intelligence. The clearest lesson to be learned is that corporate and outside counsel must insist on all available protections without qualification, and that disclosure to third parties—including independent auditors—remains a perilous, fact-specific decision that has been thrown into further confusion by the now-vacated *Textron* decision. One can hope, however, that the First Circuit will remedy its waiver analysis, while continuing to adhere to the expanded scope of work product protection that it endorsed by granting that protection to "dual-purpose" documents.

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Endnotes

1. United States v. Textron, Inc., No. 07-2631 (1st Cir. Mar. 25, 2009) (order of court).
2. United States v. Textron, Inc., 553 F.3d 87 (1st Cir. 2009).
3. *See* Respondent-Appellee Textron Inc.'s Supplemental Brief (en banc review), United States v. Textron, Inc., No. 07-2631 (1st Cir. Apr. 22, 2009); Supplemental Brief for the Appellant, The United States, United States v. Textron, Inc., No. 07-2631 (1st Cir. Apr. 24, 2009); Supplemental Brief for Amici Curiae the Chamber of Commerce of the United States of America et al. Supporting Textron Inc. and in Favor of Affirmance, United States v. Textron, Inc., No. 07-2631 (1st Cir. Apr. 24, 2009).
4. United States v. Arthur Young & Co., 465 U.S. 805 (1984).
5. I.R.S. Announcement 2002-63, 2002-27 I.R.B. 72.
6. *Textron*, 553 F.3d at 96 (quoting 8 Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 2024 (2008)) (internal quotation marks omitted).
7. *Id.* at 103.
8. *See* Comm'r of Revenue v. Comcast Corp., 453 Mass. 293 (2009); Westernbank P. R. v. Kachkar, No. 07-1606 (ADC/BJM), 2009 U.S. Dist. LEXIS 16356 (D.P.R. Feb. 9, 2009); Planalto v. Ohio Cas. Ins. Co., No. 07-142-P-H, 2009 U.S. Dist. LEXIS 15729 (D. Me. Feb. 26, 2009); Tyler v. Suffolk County, 256 F.R.D. 34 (D. Mass. 2009).
9. *Westernbank,* 2009 U.S. Dist. LEXIS 16356, at *20 (quoting Maine v. U.S. Dep't of the Interior, 298 F.3d 60, 68 (1st Cir. 2002)).
10. *Id.* at *25–*26 (citing *In re* Raytheon Secs. Litig., 218 F.R.D. 354, 360 (D. Mass. 2003); Merrill Lynch & Co. v. Allegheny Energy, Inc., 229 F.R.D. 441, 446 (S.D.N.Y. 2004); *In re* Pfizer Inc., Sec. Litig., No. 90 Civ. 1260 (SS), 1993 U.S. Dist. LEXIS 18215, at *21 (S.D.N.Y. Dec. 23, 1993); Gutter v. E.I. Dupont de Nemours & Co., No. 95-CV-2152, 1998 U.S. Dist. LEXIS 23207 (S.D. Fla. May 18, 1995)).
11. SEC v. Schroeder, No. C07-03798 (N.D. Cal. filed Apr. 27, 2009) (order granting in part and denying in part defendant's motion to compel further responses to discovery requests) ("Order").
12. While we focus here on the court's analysis of the disclosure of information to the company's outside auditor, the defendant CEO sought material disclosed to various entities, including the law firm's PowerPoint presentation to the SEC. The firm ultimately agreed to turn over the PowerPoint presentation, rendering moot that portion of the defendant's motion to compel. Notably, the court rejected the defendant's contention that the presentation to the SEC constituted a broad subject matter waiver sufficient to require disclosure of all communications between the law firm and the special committee concerning the internal investigation.
13. *Schroeder*, No. C07-03798 (N.D. Cal. filed Apr. 27, 2009) Order at 14 (citation omitted).
14. *Id.* (citation omitted).
15. United States v. Thompson, 562 F.3d 387 (D.C. Cir. 2009).
16. The concept of "selective waiver" contemplates a limited waiver of attorney-client and work product privilege protections, in which the corporation and the government agency agree that disclosure of otherwise protected material is limited to the government agency, and that those protections are preserved with respect to any other parties. The concept has had limited success in the courts.