

E-ALERT | Tax

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DC CIRCUIT UPHOLDS APPLICATION OF ATTORNEY WORK PRODUCT DOCTRINE TO INFORMATION DISCLOSED TO AUDITORS

Yesterday the DC Circuit issued an important decision affirming the applicability of the attorney work product doctrine to information disclosed by a company to its independent auditor. See *United States v. Deloitte LLP*, No. 09-5171 (D.C. Cir. June 29, 2010). The DC Circuit distinguished *United States v. Textron Inc.*, 577 F.3d 21 (1st Cir. 2009) (en banc), and questioned the standard applied in that case. Further, the court rejected the government's claim that disclosure to an auditor of attorney work product constitutes a waiver.

BACKGROUND

The case arose from ongoing tax litigation involving Dow Chemical Company. In connection with that litigation, the United States sought discovery from Deloitte & Touche USA, LLP ("Deloitte"), Dow's independent auditor. Deloitte withheld three documents on the ground that they were protected by the attorney work product doctrine.

THE DELOITTE MEMORANDUM

The first document was a 1993 draft memorandum prepared by Deloitte (the "Deloitte Memorandum") that summarized a meeting among Dow employees, Dow's outside counsel, and Deloitte employees about the possibility of litigation of the relevant tax issue and how to account for that issue in the financial statements.

The government maintained that the Deloitte Memorandum was not attorney work product and, if it was, that work product protection had been waived. The government argued that the Deloitte Memorandum was not protected because it was not prepared by Dow or its representative. The court rejected this argument, holding that the attorney work product doctrine protects not only documents and tangible things prepared by a party, but also intangible items, such as the information conveyed by Dow and its counsel to Deloitte. According to the court, the fact that that information was memorialized by the auditor does not change the analysis, which focuses not on the identity of the party creating the document, but on "whether the document contains work product—the thoughts and opinions of counsel developed in anticipation of litigation."

The government's second argument was that the Deloitte Memorandum was not protected because it was created during an annual audit, not prepared in anticipation of litigation. This was the same line of argument that the government pursued successfully in *Textron*. The DC Circuit rejected this position as well. The court first noted that the circuits are divided on the proper test for determining whether a document was prepared "in anticipation of litigation"—with a majority asking whether the document was created "because of" anticipated litigation and the Fifth Circuit requiring that anticipation of litigation be the "primary motivating purpose." The court observed that the DC Circuit follows the majority view and asks "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." Applying this test, the court explained that a document can be

protected even if it was prepared with multiple purposes in mind: "a document can contain protected work-product material even though it serves multiple purposes, so long as the protected material was prepared because of the prospect of litigation." Citing with approval the Second Circuit's decision in *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998), the court noted that "material developed in anticipation of litigation can be incorporated into a document produced during an audit without ceasing to be work product." In response to the government's citation of *Textron*, the court observed that in *Textron* the First Circuit found as a fact that the sole purpose of the documents in question was to support the audit, and that the First Circuit "did not exclude the possibility that other documents prepared during the audit process" might qualify. The DC Circuit went further, however, stating that the *Textron* dissent "makes 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."

Based on the foregoing analysis, the DC Circuit concluded that at least portions of the Deloitte Memorandum could be protected by the work product doctrine. The court was unable to determine, however, whether the entire document was protected because the document was not in the record. Accordingly, with respect to the Deloitte Memorandum, the court remanded the case to the district court for *in camera* review.

THE DOW DOCUMENTS

The other two documents sought by the government (the "Dow Documents") were (1) a 1998 memorandum and flow chart prepared by two Dow employees, an accountant, and an in-house attorney; and (2) a 2005 tax opinion prepared by Dow's outside counsel. The government conceded that the Dow Documents were protected under the work product doctrine, but asserted that the protection had been waived by the disclosure to Deloitte. Waiver of work product protection occurs when a document is voluntarily disclosed to an adversary or a conduit to an adversary, and the government asserted that Deloitte was both a potential adversary and a conduit. The DC Circuit concluded that Deloitte was neither because it was not likely to be an adversary of Dow in tax litigation, and because Dow had not engaged in any selective disclosure of documents to any adversaries. Moreover, Dow had a reasonable expectation of confidentiality because of Deloitte's professional obligation to refrain from disclosing confidential information of the client. Based on this analysis, the court held that no waiver had occurred.

APPLICATION

Although the decision in *United States v. Deloitte* confirms that the work product privilege may apply to information disclosed to independent auditors, the case nevertheless highlights the importance of establishing and following sound document management and risk assessment practices. Under the DC Circuit's analysis, controlling the volume and dissemination of sensitive tax risk analysis is critical to optimizing protection.

If you have any questions concerning the material discussed in this client alert, or if you believe that you might benefit from continuing legal education ("CLE") on these or any related topics, please contact the following members of our tax practice group:

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