

TAX ACCRUAL WORKPAPERS AND *TEXTRON*: IS LITIGATION STRATEGY NO LONGER PROTECTED?

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INTRODUCTION

The work-product doctrine was first recognized by the Supreme Court in 1947¹ and was adopted in the Federal Rules of Civil Procedure in 1970.² In the recent case *United States v. Textron Inc.*,³ however, an en banc First Circuit panel ruled that tax accrual workpapers are not protected work product and, in so doing, effectively created a new rule for determining which documents the doctrine protects. The dissent warned that the “bad

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¹ See *Hickman v. Taylor*, 329 U.S. 495, 509–10 (1947).

² FED. R. CIV. P. 26(b)(3) & advisory committee’s note.

³ *United States v. Textron Inc.*, 577 F.3d 21, 26 (1st Cir. 2009) (en banc), *cert. denied*, 130 S. Ct. 3320 (2010).

rule” issued in *Textron* would throw the “law of work-product protection into disarray.”⁴

Echoing the dissent’s alarm, commentators immediately sounded the death knell for the work-product doctrine, and many question what remains. One commentator remarked that “the entire legal profession and all corporations should be in a state of disbelief.”⁵ Yet despite eleven amicus briefs filed in support,⁶ the Supreme Court recently denied a petition for certiorari in *Textron*,⁷ leaving the matter to the circuit courts.

The case arose because Textron, an aerospace and defense conglomerate, refused to comply with the IRS’s demand that it turn over documents related to its 1998–2001 tax returns.⁸ These workpapers included a spreadsheet that consisted of the following:

- (a) lists of items on Textron’s tax returns, which, in the opinion of Textron’s counsel, involve[d] issues on which the tax laws are unclear, and, therefore, may be challenged by the IRS;
- (b) *estimates by Textron’s counsel expressing, in percentage terms, their judgments regarding Textron’s chances of prevailing in any litigation over those issues (the “hazards of litigation percentages”)*; and
- (c) the dollar amounts reserved to reflect the possibility that Textron might not prevail in such litigation (the “tax reserve amounts”).⁹

The IRS also requested the notes and memoranda drafted by in-house attorneys that supported the above information, including the analysis of which items to include on the spreadsheets and the “hazard percentage” to be applied to each item.¹⁰ These documents are referred to collectively as “tax accrual workpapers.”¹¹

The IRS, pursuant to its power to determine “the accuracy of any return, [by] ‘examin[ing] any books, papers, records, or other data which may be relevant or material to such inquiry,’”¹² issued Textron a summons seeking these documents. Textron refused to provide the workpapers, and the IRS brought a suit in federal district court.¹³ Agreeing with Textron’s

⁴ *Id.* at 34, 43 (Torruella, J., dissenting).

⁵ Michelle M. Henkel, *Textron Eviscerates the 60-Year-Old Work Product Privilege*, 125 TAX NOTES 237, 237 (2009). Henkel also noted that the “whole adversarial system would be undermined” if the ruling was “left to stand.” *Id.* at 242.

⁶ Paul L. Caron, *Textron Amicus Briefs*, TAXPROF BLOG (Jan. 28, 2010), http://taxprof.typepad.com/taxprof_blog/2010/01/textron.html.

⁷ *Textron*, 130 S. Ct. 3320.

⁸ *Textron*, 577 F.3d at 23–24.

⁹ *Id.* at 38 (Torruella, J., dissenting).

¹⁰ *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 143 (D.R.I. 2007), *rev’d en banc*, 577 F.3d 21 (1st Cir. 2009), *cert. denied*, 130 S. Ct. 3320.

¹¹ *See id.* at 142 (noting the lack of an immutable definition of the term “tax accrual workpapers”).

¹² *Textron*, 577 F.3d at 24 (quoting I.R.C. § 7602 (2006)).

¹³ *Id.* at 23–24.

claims that the documents were protected by the work-product doctrine,¹⁴ the district court ruled in Textron's favor.¹⁵

The IRS appealed the ruling to the First Circuit, and a three-judge panel initially upheld the lower court ruling.¹⁶ However, an en banc panel vacated that opinion and issued a 3–2 opinion in favor of the IRS. The en banc panel held that Textron's tax accrual workpapers were not prepared in anticipation of litigation, giving little weight to the fact that the prospect of litigation motivated the creation of the documents.¹⁷ In fact, Textron prepared the documents for two reasons: first, to prepare for possible tax litigation and, second, to ensure auditor approval of its financial statements.¹⁸

Textron highlights the inadequacies of current judicial tests for determining whether documents are prepared “in anticipation of litigation.” It also adds a new wrinkle to the current circuit split over the definition of the phrase.¹⁹ Because of this lack of clarity and uniformity in the rules governing work product, the *Textron* opinion may cause courts to narrowly construe the scope of the doctrine's protection. Importantly, many worry that the narrow reading of the work-product doctrine in this context will also weaken protection for corporate documents outside of the tax setting.²⁰ Thus, the *Textron* decision has sparked vigorous legal debate.²¹

¹⁴ See generally *United States v. El Paso Co.*, 682 F.2d 530, 542 (5th Cir. 1982) (“It is settled, of course, that a work product defense may be asserted against enforcement of an IRS summons.” (citing *Upjohn Co. v. United States*, 449 U.S. 383, 397 (1981))).

¹⁵ *Textron*, 507 F. Supp. 2d at 141. Textron also asserted that the summons lacked a legitimate purpose and claimed that the workpapers were protected under the attorney–client and tax practitioner privileges. These claims were not at issue on appeal. *Textron*, 577 F.3d at 24–25.

¹⁶ *Textron*, 577 F.3d at 26.

¹⁷ *Id.* at 31–32.

¹⁸ See *infra* Part III.A.

¹⁹ See *infra* text accompanying notes 67–69.

²⁰ David E. Frank, *Attorneys Predicting ‘Upheaval’ in Wake of Work-Product Ruling*, MASS. LAW. WKLY., Aug. 24, 2009, at 1, available at 2009 WLNR 16691200 (“[T]he court’s ruling will undoubtedly apply to most work-product disputes in federal court.”). Further, any change in federal law will affect work-product rulings in both state and federal courts. See *Pyramid Controls, Inc. v. Siemens Indus. Automations, Inc.*, 176 F.R.D. 269, 276 (N.D. Ill. 1997) (noting that federal law governs issues concerning work-product doctrine in diversity cases).

²¹ For example, Reed Smith LLP uncharacteristically filed an amicus brief on its own behalf to make clear to the Supreme Court that “this is not just an academic dispute.” Tony Mauro, *Reed Smith Gets Personal in the Work-Product Debate Before Supreme Court*, NAT’L L.J. (Jan. 28, 2010), <http://www.law.com/jsp/article.jsp?id=1202439567356&slreturn=1&hblogin=1>; see also Brief for Reed Smith LLP et al. as Amici Curiae in Support of Petitioner, *Textron Inc. v. United States*, 130 S. Ct. 3320 (2010) (No. 09-750), 2010 WL 342153. The partner representing Textron welcomed Reed Smith’s brief as well as briefs submitted by the American Bar Association, the Association of Corporate Counsel, and the Defense Resources Institute, stating, “This is a case that has attracted enormous attention and is of obvious importance to lawyers.” *Id.*; see also Charles L. Steel, IV & Matthew C. Marshall, U.S. v. Deloitte: *Tax Accrual Workpapers Can Contain Attorney Work Product*, WILLIAMS MULLEN TAX LAW ALERT (Sept. 9, 2010), <http://www.williamsmullen.com/files/Publication/e6fa18fd-2181-4e4c-aa5d->

This Note argues that *Textron* allowed policy considerations to affect the outcome of the case without directly analyzing the competing objectives of the privilege. The work-product doctrine, like all privileges, attempts to strike a balance between enforcement and privacy, and the *Textron* decision was guided by the court's desire to balance effective tax law enforcement by the IRS against the need for privacy to conduct detailed legal analysis of tax filings by corporate entities. Regardless of which objective one finds more important, the majority properly brought the policy discussion into the opinion. The majority failed, however, to explicitly balance these two objectives and to set out a framework for lower courts to follow.

Part I takes a detailed look at tax accrual workpapers and explains the difficulty in applying the work-product doctrine to these documents. Part II discusses the history, background, and theoretical underpinning of the work-product doctrine, highlighting the circuit split related to the phrase "in anticipation of litigation." Part III discusses the *Textron* holding in depth and, using the language and theories from the preceding sections, explains how the *Textron* court erred. Finally, Part IV argues that while the doctrine was applied incorrectly, the eventual outcome in *Textron* may have been correct in light of the policy considerations and practical concerns underlying the doctrine.

The Note concludes by arguing that, despite the alarm it has raised, *Textron* did not drastically change the work-product doctrine. Courts and litigants will be able to limit *Textron*'s impact by recognizing that the work-product doctrine requires an explicit balancing between enforcement and privacy. Thus, happily, corporate counsel everywhere can relax their state of disbelief.

I. TAX ACCRUAL WORKPAPERS

Public corporations prepare audited financial statements each year to meet statutory and regulatory requirements and to be eligible to sell securities to the public.²² The Securities Act of 1933 requires that independent public or certified accountants certify these audits.²³ Further, to issue a favorable opinion letter for the audit—indicating that the financial statements fairly represent the company's financials—outside auditors require the company to review its tax return to determine whether the IRS may challenge any positions the company has taken on its tax return. If challenge is possible, the company must estimate its potential liability and

6e632f8921b4/Presentation/PublicationAttachment/fb218834-718f-4b9b-9963-6feb1e84f776/Tax_09-10-2010_USvDeloitte.pdf ("The question of whether tax accrual workpapers are protected from discovery under the work-product doctrine is being hotly debated among the U.S. Courts of Appeals and anxiously watched by corporate taxpayers.").

²² See Henkel, *supra* note 5, at 239.

²³ 15 U.S.C. § 77aa sched. A(25)–(26) (2006); *accord* Henkel, *supra* note 5, at 239.

accrue reserves accordingly.²⁴ Tax accrual workpapers are prepared by the company to calculate such reserves and to provide the support auditors need to certify the statements.

Tax accrual workpapers generally highlight each tax position the company has taken that may require paying additional taxes at a later date.²⁵ Companies take pains to ensure that tax accrual workpapers remain confidential because they list positions that are not obviously justified under the tax laws and disclose the company's and its lawyers' judgments about how any dispute over the tax position would be resolved in litigation.²⁶ As the *Textron* court noted, "tax accrual work papers [would] provide a resource for the IRS . . . by pinpointing the 'soft spots' on a corporation's tax return . . . and providing an item-by-item analysis of the corporation's potential exposure to additional liability."²⁷

Historically, the IRS has hesitated to demand the disclosure of tax accrual workpapers.²⁸ However, in 2002, after the collapse of Enron and other corporate scandals, the IRS changed its policy, announcing that it would seek tax accrual workpapers related to "listed transactions" disclosed on tax returns.²⁹ Listed transactions are transactions that the IRS has identified as tax avoidance transactions.³⁰ Under this new policy, IRS examiners *must* request workpapers for listed transactions claimed on the return and *must* request all tax accrual papers if two or more listed transactions are disclosed.³¹

²⁴ See generally Stuart J. Bassin, *Managing Tax Accrual Workpapers After Textron*, 123 TAX NOTES 571, 572 (2009) (discussing the reasons for tax accrual workpapers).

²⁵ Published financial statements do not identify specific tax items for which a reserve has been calculated but instead reflect only a total reserve number. *United States v. Textron Inc.*, 577 F.3d 21, 23 (1st Cir. 2009) (en banc).

²⁶ Robin L. Greenhouse & Michael F. Kelleher, *Textron Protects Tax Accrual Workpapers from IRS Summons*, 117 TAX NOTES 255, 255 (2007).

²⁷ *Textron*, 577 F.3d at 23 (internal quotation marks omitted).

²⁸ Susan Simmonds & Sam Young, *Government Loses "Test Case" on Tax Accrual Workpapers*, 116 TAX NOTES 815, 815 (2007) (citing IRM 4.10.20.2(2) (July 12, 2004)). This policy of not demanding tax accrual workpapers was formed after a district court ruled in favor of the IRS in *United States v. Arthur Young & Co.*, 496 F. Supp. 1152 (S.D.N.Y. 1980), enforcing the IRS's right to summon tax workpapers prepared by the taxpayer's independent auditors. The ruling was followed by an outcry of concern that broad IRS power in this area would diminish the accuracy of financial statements, to which the IRS responded by issuing a policy of restraint. Greenhouse & Kelleher, *supra* note 26, at 255. By the time the case was affirmed by the Supreme Court in 1984, it was IRS policy not to seek tax accrual workpapers during audits except in unusual circumstances. *Id.* Even under such unusual circumstances, e.g., not being able to obtain the necessary information from the taxpayer, the IRS examiner was required to obtain written approval from the chief of examination. *Id.* Further, any request made was to be limited to only the relevant portion of the workpapers. *Id.*

²⁹ See IRM 4.10.20.3.2 (July 12, 2004), available at http://www.irs.gov/irm/part4/irm_04-010-020.html; Simmonds & Young, *supra* note 28, at 815; see also *Textron*, 577 F.3d at 23.

³⁰ Treas. Reg. § 1.6011-4(b)(2) (2010).

³¹ Greenhouse & Kelleher, *supra* note 26, at 255.

Business and financial groups harshly criticized this policy change. The Clearing House, an independent association that represents large American banks, and the American Bankers Association, a banking trade association, issued a joint statement declaring that they “strongly disagree with the new policy and believe that the new policy is counterproductive.”³² The groups argued that the policy would lead the IRS to request tax accrual workpapers from taxpayers who should not be subject to such requests, would allow the IRS to “abuse and inappropriately alter the balance between the IRS and the taxpayer,” and would force the taxpayer to endure additional litigation.³³ The groups also noted that taxpayers viewed the new policy as penalizing taxpayers for participation in listed transactions.³⁴

An additional change that will undoubtedly affect *Textron*’s implications going forward is the Financial Accounting Standards Board’s 2006 Interpretation of Accounting for Uncertainty in Income Taxes No. 48, commonly referred to as “FIN 48.”³⁵ FIN 48 requires companies, before taking a tax position on a filed return, to determine whether the position is “more likely than not” to be sustained upon examination by the taxing authority.³⁶ By issuing FIN 48, the Financial Accounting Standards Board sought to foster consistency in the tax positions taken by companies in annual returns, but it effectively *required* companies to complete an analysis similar to that found in the tax accrual workpapers when preparing financial statements.³⁷

³² Letter from Norman R. Nelson, Gen. Counsel, Clearing House, and Donna J. Fisher, Dir. of Tax & Accounting, Am. Bankers Ass’n, to Mark W. Everson, Comm’r, IRS, and Eric Solomon, Acting Deputy Assistant Sec’y, Dep’t of the Treasury 1–2 (July 29, 2005) [hereinafter Letter from Nelson & Fisher], available at http://www.theclearinghouse.org/reference/comment_letters/commentLetterDocs/001114.pdf (regarding the IRS’s policy for requesting tax accrual workpapers).

³³ *Id.* at 2–3.

³⁴ *Id.*

³⁵ FIN 48 is an interpretation of how to implement certain aspects of Financial Accounting Standards Board Statement No. 109 and has recently been incorporated in the new codification of standards at Topic 740. FIN. ACCOUNTING STANDARDS BD., FASB INTERPRETATION NO. 48, ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES (2006), available at <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820931560&blobheader=application/pdf> [hereinafter FIN 48]; FIN. ACCOUNTING STANDARDS BD., NO. 2009-06, INCOME TAXES (TOPIC 740): IMPLEMENTATION GUIDANCE ON ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES AND DISCLOSURE AMENDMENTS FOR NONPUBLIC ENTITIES (2009), available at <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819501289&blobheader=application/pdf> [hereinafter 740 UPDATE].

³⁶ FIN 48, *supra* note 35, at 2.

³⁷ FIN 48 governs all material positions taken on income tax returns, including those filed with the local, state, and federal authorities. See 740 UPDATE, *supra* note 35, at 12.

II. THE WORK-PRODUCT DOCTRINE

In federal litigation, discovery rules play an essential role in ensuring that both parties are aware of all relevant facts before trial.³⁸ Privileges and protections, on the other hand, necessarily limit access to the truth.³⁹ When the liberal discovery rules and strict privileges come into conflict, as they often do, judges must balance the underlying interests and decide to protect the documents only when there is an offsetting gain to the system.⁴⁰

The work-product doctrine limits access to information by exempting from discovery documents prepared by attorneys (or at their direction) in anticipation of litigation.⁴¹ Much of the current jurisprudence concerning work-product privilege stems from the first case in which the privilege was recognized, *Hickman v. Taylor*.⁴² In *Hickman*, the plaintiff's lawyer sought to discover "any oral or written statements, records, reports or other memoranda . . . concerning any matter relative to the [incident]."⁴³ Predictably, the defendant's lawyer objected, arguing that the request was "an attempt to obtain indirectly counsel's private files."⁴⁴ The Supreme Court, worried that exposing the work product to full discovery would reduce the effectiveness of investigation and litigation, held that the attorney's work product should be protected. Specifically, the Court reasoned that "it is essential that a lawyer work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel."⁴⁵

The *Hickman* Court recognized that allowing liberal discovery of work product would discourage zealous investigation. When preparing for litigation, a lawyer does not know what type of information an investigation will uncover.⁴⁶ Certain uncovered information, if turned over to the

³⁸ See FED. R. CIV. P. 26 advisory committee's note. "Mutual knowledge of all the relevant facts gathered by both parties is essential to proper litigation." *Hickman v. Taylor*, 329 U.S. 495, 507 (1947).

³⁹ 8 JOHN HENRY WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2291 (McNaughton rev. 1961).

⁴⁰ See RONALD ALLEN ET AL., EVIDENCE: TEXT, PROBLEMS, AND CASES 787–88 (4th ed. 2006) ("The traditional justification for rules of privilege . . . is based on an underlying untested empirical assumption: The benefit derived from recognizing a privilege . . . outweighs the cost of barring relevant evidence.").

⁴¹ See FED. R. CIV. P. 26(b)(3).

⁴² 329 U.S. 495. *Hickman* arose soon after the new Federal Rules of Civil Procedure were introduced, which were intended to produce "the fullest possible knowledge of the issues and fact before trial." *Id.* at 501.

⁴³ *Id.* at 499.

⁴⁴ *Id.* (internal quotation marks omitted).

⁴⁵ *Id.* at 510–11.

⁴⁶ See Petition for Writ of Certiorari at 10, *XYZ Corp. v. United States*, 509 U.S. 905 (1993) (No. 92-1659), 1993 WL 13076778 ("The rationale for the rule is simply that without it, a litigant will be constrained in mounting its defense by the fear that its own efforts will prove even more beneficial to its adversary than to itself . . .").

adversary, could be detrimental to the very case for which the lawyer was hired.⁴⁷ Thus, if lawyers were required to turn over all work product during discovery, they would have an incentive to refrain from investigating the case.⁴⁸

The *Hickman* opinion also expressed concern about the free-riding effect of mandating full disclosure during discovery. Without protection for each attorney's efforts, an opposing party could gain advantages otherwise unavailable. As the concurring opinion explained, disclosure is not proper when it would allow one party to "perform its functions . . . on wits borrowed from the adversary."⁴⁹ Thus, one purpose of the work-product doctrine is often stated as "prevent[ing] exploitation of a party's efforts in preparing for litigation."⁵⁰

The Supreme Court has consistently reaffirmed the strong public policy supporting the work-product doctrine.⁵¹ However, because the work-product doctrine requires courts to balance competing interests in privacy and transparency, it necessarily remains a flexible standard. Thus, courts have employed two methods for narrowing or expanding the doctrine's protection as policy dictates: first, the substantial need exception, and, second, the interpretation of the phrase "in anticipation of litigation."

A. Substantial Need Exception

The work-product doctrine is not absolute. Case law and Federal Rule of Civil Procedure 26(b)(3) allow a court to order the production of work product if the party seeking discovery has demonstrated a substantial need and if obtaining the material through an alternative means would create substantial hardship.⁵² This qualification promotes efficiency in the litigation system. Thus, if one party's need for the information (transparency) outweighs the other party's interest in preventing the information from being released (privacy), then the court will order disclosure.⁵³

"Substantial need" is not clearly defined. Need is generally found when one side has obtained statements from witnesses who are now

⁴⁷ See Ronald J. Allen et al., *A Positive Theory of the Attorney-Client Privilege and the Work Product Doctrine*, 19 J. LEGAL STUD. 359, 385-87 (1990); cf. Ronald J. Allen & Cynthia M. Hazelwood, *Preserving the Confidentiality of Internal Corporate Investigations*, 12 J. CORP. L. 355, 357 (1987) (noting that corporations face similar challenges without a self-evaluative privilege).

⁴⁸ See Allen et al., *supra* note 47, at 385-87.

⁴⁹ *Hickman*, 329 U.S. at 516 (Jackson, J., concurring).

⁵⁰ *Admiral Ins. Co. v. U.S. Dist. Court for the Dist. of Ariz.*, 881 F.2d 1486, 1494 (9th Cir. 1989).

⁵¹ See *Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981); *United States v. Nobles*, 422 U.S. 225, 236-40 (1975).

⁵² 2 EDNA SELAN EPSTEIN, *THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE* 922 (5th ed. 2007).

⁵³ See *id.* at 944.

unavailable because of death, faulty memory, or inability to be found or subpoenaed.⁵⁴ The requirement of undue hardship, which comes directly from *Hickman*, is similarly loosely defined. Referring to the liberal ideas of discovery in the Federal Rules of Civil Procedure, the Court recognized that “production might be justified where the witnesses are no longer available or can be reached only with difficulty.”⁵⁵ Courts have typically interpreted this to mean that neither a “general fishing expedition”⁵⁶ nor a showing of significant cost alone⁵⁷ is sufficient to lift the protection.

Finally, when disclosure is proper, courts distinguish between opinion work product and ordinary work product. While ordinary work product can consist of any documents prepared by or at the request of an attorney, opinion work product generally consists of an attorney’s mental impressions, analyses, legal conclusions, and opinions.⁵⁸ Both the Rules Advisory Committee and the Supreme Court have noted the distinction.⁵⁹ The Federal Rules of Civil Procedure, in fact, require that courts ordering discovery of documents make efforts to “protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party’s attorney,”⁶⁰ sometimes making it “necessary to order disclosure of a document but with portions deleted.”⁶¹ And while the Court has not said that opinion work product is *always* protected, it has required “a far stronger showing of necessity and unavailability.”⁶² Furthermore, courts have given nearly absolute protection to opinion work product that contains assessments of arguments, defenses, and expected settlement amounts.⁶³

B. In Anticipation of Litigation

The work-product doctrine protects only documents prepared in anticipation of litigation, not those prepared in the ordinary course of business.⁶⁴ However, distinguishing between the two types of documents is

⁵⁴ *Id.* at 925–31.

⁵⁵ *Hickman v. Taylor*, 329 U.S. 495, 511 (1947).

⁵⁶ *In re Grand Jury Subpoena Dated November 8, 1979*, 622 F.2d 933, 936 (6th Cir. 1980).

⁵⁷ EPSTEIN, *supra* note 52, at 942–43 (indicating that this view may be softening as courts become more aware of the cost of litigation).

⁵⁸ FED. R. CIV. P. 26(b)(3) advisory committee’s note.

⁵⁹ *Id.*; see *Upjohn Co. v. United States*, 449 U.S. 383, 400 (1981); *Hickman*, 329 U.S. at 508.

⁶⁰ FED. R. CIV. P. 26(b)(3)(B).

⁶¹ FED. R. CIV. P. 26(b)(3) advisory committee’s note.

⁶² *Upjohn Co.*, 449 U.S. at 401–02; see also *Banks v. Office of the Senate Sergeant-at-Arms*, 228 F.R.D. 24, 26 (D.D.C. 2005) (stating that opinion work product is “entitled to special protection and require[s] a stronger showing of necessity to justify release . . . although the precise contours of this showing have not been resolved.” (quoting *Byers v. Burleson*, 100 F.R.D. 436, 439 (D.D.C. 1983)) (internal quotation marks omitted)).

⁶³ EPSTEIN, *supra* note 52, at 950.

⁶⁴ FED. R. CIV. P. 26(b)(3) advisory committee’s note (“Materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation [are not protected work

often extremely difficult. Thus far, the courts' varying interpretations of "in anticipation of litigation" have generated considerable confusion, and *Textron* clearly demonstrates this confusion.

The phrase "in anticipation of litigation" has both temporal and motivational aspects,⁶⁵ though only the second causes problems in *Textron*. The Supreme Court has interpreted the temporal condition quite broadly, and there seems to be little question that a corporation is allowed to anticipate litigation at the time that a questionable tax position is originally taken.⁶⁶ The motivational aspect, on the other hand, has proven much murkier. Seven of the nine circuits that have ruled on the issue—the Second, Third, Fourth, Sixth, Eighth, Ninth, and D.C. Circuits—follow the "because of" test, which protects all material that is prepared because of anticipated litigation.⁶⁷ The Fifth Circuit adheres to the "primary purpose" test, which only protects documents prepared with the primary purpose of litigation.⁶⁸ In *Textron*, the First Circuit effectively created a third rule, which could be called the "prepared for litigation" rule because it protects only documents prepared for use in litigation.⁶⁹

Generally speaking, on the one hand, courts employ the "because of" test to provide broader protection for work product.⁷⁰ On the other hand, courts that read *Hickman* narrowly as protecting only very specific litigation documents follow the primary purpose standard.⁷¹ As a result, single-purpose documents—those prepared solely for litigation or solely for a business purposes—are easily classified under either test. Dual-purpose documents, however, which may be prepared because of litigation but also

product]."). *But see* Thomas Wilson, Note, *The Work Product Doctrine: Why Have an Ordinary Course of Business Exception?*, 1988 COLUM. BUS. L. REV. 587, 604 (noting that although the "[risk assessment] documents themselves were not drafted specifically for use in litigation by the attorney, allowing discovery of such documents gives plaintiffs an unjustifiable advantage").

⁶⁵ EPSTEIN, *supra* note 52, at 836.

⁶⁶ *See Upjohn Co.*, 449 U.S. at 397 (holding that the privilege applied when the investigation started).

⁶⁷ *See, e.g.*, *United States v. Roxworthy*, 457 F.3d 590, 593 (6th Cir. 2006); *United States v. Torf (In re Grand Jury Subpoena)*, 357 F.3d 900, 907 (9th Cir. 2004); *United States v. Adlman*, 134 F.3d 1194, 1202–03 (2d Cir. 1998); *In re Sealed Case*, 146 F.3d 881, 884 (D.C. Cir. 1998); *Martin v. Bally's Park Place Hotel & Casino*, 983 F.2d 1252, 1260 (3d Cir. 1993); *Nat'l Union Fire Ins. Co. of Pittsburgh v. Murray Sheet Metal Co.*, 967 F.2d 980, 984 (4th Cir. 1992); *Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401 (8th Cir. 1987); *Binks Mfg. Co. v. Nat'l Presto Indus.*, 709 F.2d 1109, 1118–19 (7th Cir. 1983).

⁶⁸ *United States v. El Paso Co.*, 682 F.2d 530, 543 (5th Cir. 1982).

⁶⁹ *United States v. Textron Inc.*, 577 F.3d 21, 29 (1st Cir. 2009) (en banc); *see also United States v. Deloitte LLP*, 610 F.3d 129, 138 (D.C. Cir. 2010) ("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." (citing *Textron*, 577 F.3d at 32)).

⁷⁰ *See Adlman*, 134 F.3d at 1197–98.

⁷¹ *See, e.g., El Paso*, 682 F.2d at 542 ("The accent in *Hickman* was on a lawyer's need for a sphere of privacy in preparing a lawsuit.").

serve a business purpose, may be treated differently depending on which test the court applies.

I. The “Because Of” Test.—The Second Circuit opinion in *United States v. Adlman*, which adopted the “because of” test, is frequently cited as leading authority on the test.⁷² The court considered whether the work-product doctrine applies to litigation analysis prepared “to inform a business decision which turns on the party’s assessment of the likely outcome of litigation.”⁷³ The IRS had requested documents concerning a restructuring transaction, including a fifty-eight-page memorandum that “detailed [the] legal analysis of likely IRS challenges to the reorganization and the resulting tax refund claim.”⁷⁴

The court recognized that the work-product doctrine incentivizes attorneys to evaluate their cases and record their impressions in writing. Such writings include documents assessing the strengths and weaknesses of one’s case, and these documents are frequently created for business-related reasons.⁷⁵ If such documents were unprotected simply because they were prepared for a business purpose, one party would be able to take advantage of the other’s assessment of victory, an “unwarranted” result.⁷⁶ Thus, the court found that a standard that protected all documents prepared “because of” anticipation of litigation, whether or not for a business purpose, “appropriately focuses on both what should be eligible for the Rule’s protection and what should not” and adopted that language as the proper standard by which to assess whether a document had been prepared in anticipation of litigation.⁷⁷

The Sixth Circuit’s recent adoption of the “because of” test in *United States v. Roxworthy*⁷⁸ demonstrates a current variation of the standard. The court acknowledged that the contents of the documents—an analysis of the likely outcome of litigation that might result from a corporate restructuring, containing “dense legal analysis of current tax law” and an indication of whether “it is more likely than not” that particular federal tax consequences would result—could be used by the IRS to obtain an unfair advantage and

⁷² EPSTEIN, *supra* note 52, at 857; *see also Textron*, 577 F.3d at 34 (Torruella, J., dissenting) (referring to *Adlman* as “a leading case interpreting the work-product doctrine”).

⁷³ *Adlman*, 134 F.3d at 1197.

⁷⁴ *Id.* at 1195 (“[The memorandum] contained discussion of statutory provisions, IRS regulations, legislative history, and prior judicial and IRS rulings relevant to the claim. It proposed possible legal theories or strategies for [the company] to adopt in response, recommended preferred methods of structuring the transaction, and made predictions about the likely outcome of litigation.”).

⁷⁵ *Id.* at 1201–02.

⁷⁶ *Id.* at 1202.

⁷⁷ *Id.* at 1203.

⁷⁸ 457 F.3d 590 (6th Cir. 2006).

thus “weigh[ed] in favor of recognizing the documents as privileged.”⁷⁹ Nonetheless, the *Roxworthy* court used a subjective–objective lens, considering both whether the defendants anticipated litigation and, if so, whether that anticipation was objectively reasonable.⁸⁰ First, looking at the “circumstances surrounding the documents’ creation” rather than the documents themselves, the court reasoned that the documents resulted from subjective anticipation of litigation.⁸¹ Second, after considering the company’s expectation of a yearly audit, the size of the transaction involved, and the auditor’s assessment that the transaction concerned an unsettled area of law that had been recently targeted by the IRS, the court found it objectively reasonable for the defendant to anticipate litigation.⁸² Thus, the Sixth Circuit applied the “because of” test to protect a dual-purpose document.

2. *The Primary Purpose Test.*—The most frequently cited case for the primary purpose test is the Fifth Circuit’s opinion in *United States v. El Paso Co.*⁸³ The *El Paso* court held that tax accrual workpapers are not prepared for the “primary purpose” of litigation.⁸⁴ Applying the primary purpose test to tax accrual workpapers, the court emphasized the inherent complexity of tax laws and the “business reality” that filing of taxes is not the last word.⁸⁵ First, the court observed that the papers were prepared to please accountants, who are responsible for adhering to securities laws.⁸⁶ Second, the court recognized that the legal analysis was simply a means to reach business-imperative ends.⁸⁷ These two motivations led the court to the conclusion that “the primary motivating force” was financial reporting.⁸⁸

Unfortunately, the *El Paso* court did not explain why it was adopting the primary purpose test.⁸⁹ It simply applied the standard laid out in *United States v. Davis*.⁹⁰ The problem, however, is that *Davis* did not analyze the primary purpose test either but merely concluded that “litigation need not necessarily be imminent, as some courts have suggested, as long as the

⁷⁹ *Id.* at 594–95 (“[T]he IRS would appear to obtain an unfair advantage by gaining access to [the auditor’s] detailed legal analysis of the strengths and weaknesses of [the defendant’s] position. This factor weighs in favor of recognizing the documents as privileged.”).

⁸⁰ *Id.*

⁸¹ *Id.* at 595–97.

⁸² *Id.* at 600.

⁸³ 682 F.2d 530 (5th Cir. 1982).

⁸⁴ *Id.* at 543–44.

⁸⁵ *Id.* at 534.

⁸⁶ *Id.* at 543.

⁸⁷ *Id.*

⁸⁸ *Id.* Importantly, the court did not decide whether the documents were also motivated by anticipated litigation; thus, the court’s reasoning does not foreclose the possibility that tax accrual workpapers can be eligible for protection in a circuit that follows the “because of” test.

⁸⁹ *Id.* at 542–43.

⁹⁰ 636 F.2d 1028, 1040 (5th Cir. 1981).

primary motivating purpose behind the creation of the document was *to aid in possible future litigation*.⁹¹ Thus, neither *El Paso* nor *Davis* provides any substantive rationale for choosing the primary purpose test over the “because of” test.

III. WHAT HAPPENED IN *TEXTRON*

A. Background

Textron Inc. is an aerospace and defense conglomerate with approximately 190 subsidiaries.⁹² As it does with other large corporations, the IRS periodically audits Textron’s federal tax returns.⁹³ Textron can dispute any tax increase through an informal conference with the IRS attorneys, a formal appeal through the IRS, or a lawsuit in federal court if the other processes fail to resolve the dispute.⁹⁴ Textron had disputed proposed adjustments in seven of the eight audit cycles since 1980,⁹⁵ and these disputes resulted in litigation three times.⁹⁶

Textron involved the 2003 IRS audit of Textron’s 1998–2001 tax returns. Textron Financial Corporation, a Textron subsidiary, disclosed nine sale-in, lease-out (SILO) transactions entered into during 2001.⁹⁷ These SILO transactions involved Textron’s purchasing equipment from a foreign entity and leasing it back to the seller on the same day.⁹⁸ Although SILO transactions can be legal and serve legitimate ends, the IRS has flagged these transactions as potential tax shelters subject to abuse and considers them “listed transactions.”⁹⁹ Consistent with the IRS’s then-four-month-old policy to request all tax accrual workpapers when presented with two or more listed transactions, the agency summoned Textron’s workpapers.¹⁰⁰ *Textron* was the first case brought after the change in IRS policy.¹⁰¹

Textron acknowledged that the immediate purpose of the workpapers was to aid in the creation of the reserve figures that would be represented on

⁹¹ *Id.* (emphasis added) (citations omitted).

⁹² *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 141 (D.R.I. 2007).

⁹³ *Id.* During these audits, the IRS may issue a Notice of Proposed Adjustments to the taxpayer indicating that the IRS disagrees with a position the corporation took on its tax returns and intends to levy additional taxes. *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.* at 141–42.

⁹⁷ *Id.* at 142.

⁹⁸ *See United States v. Textron Inc.*, 577 F.3d 21, 23–24 (1st Cir. 2009) (en banc).

⁹⁹ *Id.*

¹⁰⁰ *See id.* at 24 (citing I.R.S. Announcement 2002-63, 2002-27 I.R.B. 72).

¹⁰¹ *Greenhouse & Kelleher*, *supra* note 26, at 255.

the audited financial statement,¹⁰² bringing the statement into compliance with the now-applicable FIN 48 rule. Nonetheless, Textron also asserted that the workpapers were prepared because of anticipated litigation and pointed to the hazards of litigation percentages as evidence of this purpose.¹⁰³ The IRS maintained that the papers were created in the ordinary course of business to meet regulatory requirements.¹⁰⁴ The Rhode Island District Court, following *Maine v. United States Department of the Interior*,¹⁰⁵ applied the “because of” test and concluded that the tax accrual workpapers are protected documents.¹⁰⁶ A First Circuit panel agreed, holding that the two purposes of the documents are “inextricably related” and that the presence of a business purpose does not contradict the fact that the workpapers were prepared because of litigation.¹⁰⁷

After granting the Government’s petition for a rehearing, the en banc First Circuit vacated the panel decision and entered judgment for the Government. The court held that “the Textron work papers were independently required by statutory and audit requirements,” not in anticipation of litigation, “and that the work product privilege does not apply.”¹⁰⁸ In reaching this conclusion, the court explicitly stated that it was reaffirming the *Maine* standard, but it read its holding in *Maine* more narrowly than had previous courts.¹⁰⁹ Importantly, the court also explained that the scope of the work-product protection “turns on a balancing of policy concerns.”¹¹⁰ Part IV below discusses why the court, although correct to address the balance of public policy concerns, failed by not articulating the correct role these concerns should play in the analysis of the scope of “in anticipation of litigation.” First, however, the remainder of this Part examines the court’s analysis.

¹⁰² *Textron*, 577 F.3d at 25.

¹⁰³ *See id.* at 24–25.

¹⁰⁴ *Textron*, 507 F. Supp. 2d at 150.

¹⁰⁵ 298 F.3d 60 (1st Cir. 2002). In *Maine*, the State of Maine sought information filed in a previous lawsuit pursuant to the Freedom of Information Act (FOIA). *Id.* The Department of the Interior withheld over three hundred documents, claiming that they were protected by the work-product doctrine. After quoting the Second Circuit opinion in *Adlman* at length and agreeing that the primary purpose standard is at odds with the policies of Rule 26, the court adopted “the formulation of the work-product rule adopted in *Adlman* and by five other courts of appeals.” *Id.* at 68.

¹⁰⁶ The court relied on the fact that the documents would not have been prepared “but for” litigation and dismissed the fact that they also served a business purpose as irrelevant under the “because of” standard. *Textron*, 507 F. Supp. 2d at 150. It also agreed that the anticipation was well-founded because of the unclear tax laws and the fact that Textron was regularly audited and had disputed positions in the past. *Id.*; *see also supra* text accompanying notes 95–96.

¹⁰⁷ *Textron*, 577 F.3d at 26.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

B. *The En Banc Opinion*

The *Textron* court identified four sources that should inform its decision: Rule 26, Supreme Court doctrine, direct precedent, and the court's own policy judgment.¹¹¹ It also noted that each source favored the IRS. First, the court explained that the “focus of work product protection has been on materials prepared for use in litigation.”¹¹² Relying on English precedent as “doubtless the source of the language in Rule 26” and seemingly ignoring the more recent history, the court determined that only documents that were to be used in actual or anticipated litigation should be protected.¹¹³ “Every lawyer who tries cases,” claimed the court in the now infamous line, “knows the touch and feel of materials prepared for a current or possible (*i.e.*, ‘in anticipation of’) law suit.”¹¹⁴

Turning to direct precedent, the majority said that it was reaffirming *Maine*¹¹⁵ but, as the dissent properly pointed out, applied *Maine* in a novel way.¹¹⁶ Although *Maine* is generally cited for showing that the First Circuit adopted the “because of” test, the *Textron* court simply commented that “[i]n *Maine*, we said that work product protection does not extend to ‘documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.’”¹¹⁷ Effectively, the court used *Maine* only to introduce the rule that documents prepared in the ordinary course of business are not protected by the work-product doctrine—a virtual truism—regardless of the test employed in the circuit.

Looking at other circuit precedent on point, the court also found persuasive the Fifth Circuit's determination in *El Paso* that the tax accrual workpapers' “sole function” was to back up financial statements.¹¹⁸ The *Textron* court simply adopted this reasoning to hold that tax accrual workpapers must not have been prepared in anticipation of litigation. However, the *Textron* court erred in its adoption of the Fifth Circuit's reasoning because the Fifth Circuit applied the primary purpose test, not the “because of” test. Under its primary purpose test, documents prepared *only* for financial statements are treated in the same way as documents prepared *primarily* for financial statements that also serve a litigation purpose: they

¹¹¹ *Id.* at 29.

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.* at 30.

¹¹⁵ *Id.* at 26.

¹¹⁶ The *Textron* dissent opened with a telling statement by Judge Torruella: “To assist the IRS in its quest to compel taxpayers to reveal their own assessments of their tax returns, the majority abandons our ‘because of’ test . . .” *Id.* at 32 (Torruella, J., dissenting).

¹¹⁷ *Id.* at 30 (majority opinion) (quoting *Maine v. U.S. Dep't of the Interior*, 298 F.3d 60, 70 (1st Cir. 2002)).

¹¹⁸ *Id.* (citing *United States v. El Paso Co.*, 682 F.2d 530, 543–44 (5th Cir. 1982)).

are not protected. Although the existence of a litigation purpose is irrelevant under the primary purpose test, if the primary purpose is for financial statements, the presence of a litigation purpose can be critical under the “because of” test applied in the First Circuit.¹¹⁹

Finally, the court discussed policy reasons for requiring the disclosure of the tax accrual workpapers. The discussion, however, focused on implications to the IRS and failed to analyze the implications protection would have on taxpayers. Simply noting that work-product protection of tax accrual workpapers would decrease the ease with which the IRS could collect taxes, the court reasoned that policy considerations weighed in favor of disclosure. While the dissent found this reliance on policy generally objectionable, this Note argues below that the court should have considered a broader set of policy concerns and more carefully weighed the impact of disclosure.

IV. HOW TO INTERPRET AND APPLY THE *TEXTRON* RULING

This Part begins by showing that the *Textron* en banc court incorrectly applied existing First Circuit case law. It then suggests that the court should have explicitly acknowledged that it was establishing a new test. Next, recognizing the en banc court’s authority to change the law of the circuit, this Part also suggests that the panel should have explicitly modified the judicially imposed tests to incorporate the policy concerns it found to be important. Finally, this Part proposes that courts adopt a new standard to clarify work-product doctrine jurisprudence. Specifically, the concerns raised in *Textron* demonstrate why the courts should adopt a modified “because of” standard for interpreting whether or not a document was prepared in anticipation of litigation.

A. *The Court Incorrectly Applied First Circuit Law*

The *Textron* court incorrectly interpreted *Maine* and incorrectly applied the “because of” test. To demonstrate how the court misread *Maine*, which if applied correctly would have protected the papers at issue in *Textron*, this section considers the steps the court should have followed when applying *Maine*. First, the majority should have recognized that the tax accrual workpapers consisted of counsel’s opinions and legal assessments. Second, the majority should have acknowledged that the tax

¹¹⁹ The D.C. Circuit recognized this conflict when it refused to rely on *El Paso* to infer that audit papers were not created for litigation. *United States v. Deloitte LLP*, 610 F.3d 129, 138 (D.C. Cir. 2010) (“*El Paso* was decided under the ‘primary motivating purpose’ test, which is more demanding than the ‘because of’ test we employ. Under the more lenient ‘because of’ test, material generated in anticipation of litigation may also be used for ordinary business purposes without losing its protected status.”).

accrual workpapers were prepared not only for business purposes but also for anticipated litigation.

Textron's tax accrual workpapers consisted almost completely of Textron's counsel's assessments of the likelihood of prevailing in a dispute if particular tax positions were challenged.¹²⁰ That is, the papers focused on opinion, not fact. Litigation assessments are considered the archetype of attorney-opinion work product and, as such, receive nearly absolute protection.¹²¹ Notably, the *Textron* court did not acknowledge the significance of other circuit cases related to individual case reserves—i.e., accounting reserves related to a single issue rather than to a group of issues. The Southern District of New York, for example, determined that individual case reserves should be distinguished from aggregate reserves and recognized as protected under both the “because of” and primary purpose tests.¹²² Similarly, the Eighth Circuit reasoned that disclosing individual case reserves “reveal[s] the mental impression, thoughts, and conclusions of an attorney in evaluating a legal claim.”¹²³ The Eighth Circuit further noted that individual reserves are by their very nature prepared in anticipation of litigation and “consequently . . . are protected from discovery as opinion work product.”¹²⁴ Rather than recognizing this line of cases, the *Textron* court contrasted tax accrual workpapers with “documents unquestionably prepared for potential use in litigation” and concluded that “[t]here is no evidence in this case that the work papers were prepared for such a use or would in fact serve any useful purpose for Textron in conducting litigation if it arose.”¹²⁵

The court additionally failed to recognize the irony in the IRS's claim that the workpapers were relevant because they might identify transactions that the IRS had not identified or fully discovered.¹²⁶ This justification is in stark contrast to the rationale for the work-product doctrine—preventing one party from obtaining the other side's legal analysis of potential litigation.¹²⁷ Thus, the majority should have concluded that the papers were protectable work product based on the content of the workpapers themselves.

¹²⁰ *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 147 (D.R.I. 2007).

¹²¹ See EPSTEIN, *supra* note 52, at 969.

¹²² *In re Pfizer Inc. Sec. Litig.*, No. 90 Civ. 1260 (SS), 1993 WL 561125, at *4 (S.D.N.Y. Dec. 23, 1993).

¹²³ *Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401 (8th Cir. 1987).

¹²⁴ *Id.*; see also *In re Pfizer Inc.*, 1993 WL 561125, at *4 (applying the primary purpose test, stating that individual case reserves are “typical examples of opinion work product,” and contrasting individual case reserves that do not provide meaningful information for the business purpose of preparing a financial return with aggregate information that serves a meaningful business purpose).

¹²⁵ *United States v. Textron Inc.*, 577 F.3d 21, 30 (1st Cir. 2009) (en banc).

¹²⁶ *Greenhouse & Kelleher*, *supra* note 26, at 256.

¹²⁷ See Letter from Nelson & Fisher, *supra* note 32.

Second, the *Textron* court incorrectly determined that the documents' only purpose was to prepare financial statements and that they thus were not prepared in anticipation of litigation.¹²⁸ In addition to the faulty reliance on *El Paso*,¹²⁹ the court's decision that the documents were created only for financial statements was largely based on testimony from a Textron executive and IRS officials, and the court emphasized that even if litigation were remote, Textron would have to prepare the papers to support its financial statements.¹³⁰ This argument, however, ignores much of the regulatory and practical circumstances surrounding tax accrual workpapers. To start, but for the prospect of a redetermination by the IRS and possible ensuing litigation, there would be no reason for the corporation to establish the reserves found in the documents.¹³¹ Additionally, while the Sarbanes–Oxley Act imposes requirements on the officers of the firm to oversee the preparation of financial statements in accordance with Generally Accepted Accounting Principles (GAAP), including the provision for income tax and related reserves,¹³² it is incorrect to argue that a requirement to provide certified financial statements is the same as a requirement to prepare tax accrual workpapers in the elaborate form prepared by Textron.¹³³ As explained by one commentator, “The dual purpose nature of the workpapers—to evaluate litigation risks and to also satisfy the auditors that the reserves comply with GAAP—does not preclude a finding of work product privilege in a circuit that follows the ‘because of’ standard.”¹³⁴

Skeptics may counter that the workpapers were not prepared in anticipation of litigation because they were prepared prior to an adversarial stage and because they only assess the likelihood of success on the merits as a basis for the position taken on the filed return.¹³⁵ This argument, however, confuses the temporal and motivational aspects of the phrase “in anticipation of litigation.” Courts have interpreted the temporal requirement broadly and generally accept that regular audits combined with unclear tax positions and listed transactions suffice to establish

¹²⁸ *Textron*, 577 F.3d at 30. Based on this incorrect conclusion, the court correctly determined that the documents were not prepared in anticipation of litigation because documents prepared in the ordinary course of business (e.g., to prepare financial statements) are not protected.

¹²⁹ See *supra* text accompanying notes 119–21.

¹³⁰ *Textron*, 577 F.3d at 28. This assumption, whether accurate or not in *Textron*'s case, will likely be accurate in future cases because of the requirements imposed by FIN 48. See *supra* text accompanying notes 35–37.

¹³¹ Henkel, *supra* note 5, at 239.

¹³² 15 U.S.C. § 7241 (2006). Note that this requirement was not in effect at the time *Textron* created the workpapers, but the argument would apply to workpapers created after 2002.

¹³³ Henkel, *supra* note 5, at 239.

¹³⁴ See *id.* at 240.

¹³⁵ Linda M. Beale, *Textron, Inc.: Tax Accrual Workpapers, Attorney-Client Privilege, and Work Product Protection*, A TAXING MATTER (Aug. 30, 2007), <http://ataxingmatter.blogs.com/tax/2007/08/textron-inc-tax.html>.

“anticipation of litigation.”¹³⁶ On the motivational aspect, this counterargument merely establishes that the papers are dual-purpose documents. The tax accrual workpapers were litigation analyses “prepared to inform a business decision,” specifically the appropriate tax position to be taken on an IRS filing. The decision turned “on the party’s assessment of the likely outcome of litigation.”¹³⁷ As established above, the mere fact that workpapers also aid in a business decision does not preclude their protection under the “because of” test.

In summary, under the traditional “because of” standard previously adopted by the First Circuit, Textron’s workpapers constitute protectable work product, were prepared in anticipation of litigation, and thus should be protected.¹³⁸ Although the court determined that the tax accrual workpapers were not “for use” in the litigation anticipated,¹³⁹ this unprecedented construction is inconsistent with the First Circuit’s “because of” test and with the *Hickman* doctrine more broadly. As the dissent noted, the “for use” language used by the majority unnecessarily narrows the scope of the doctrine¹⁴⁰ because many documents prepared because of litigation and unquestionably protected by the doctrine are not used in conducting the actual trial—the primary example being litigation assessments.¹⁴¹ Although the en banc court may have wished to mandate the disclosure of the documents for legitimate policy reasons,¹⁴² it masked its analysis in a faulty application of precedent.

¹³⁶ See *supra* text accompanying notes 65–66.

¹³⁷ See *United States v. Adlman*, 134 F.3d 1194, 1197 (2d Cir. 1998); see also Robert T. Duffy, *How the Attorney Work Product Doctrine Can Protect Tax Accrual Workpapers from IRS Summons*, TAX NEWS FOR BUS. LAW. (Am. Bar Ass’n Bus. Law Comm’n on Taxation), Apr. 3, 2009, at 1, <http://apps.americanbar.org/buslaw/committees/CL690000pub/newsletter/200904/duffy.pdf> (“The First Circuit held that because ‘the function of the documents’—of the tax accrual workpapers that Textron prepared—‘was to analyze litigation for the purpose of creating and auditing a reserve fund,’ it follows that Textron prepared those workpapers ‘because of’ the prospect of litigation.”).

¹³⁸ After applying this test, the court must still determine whether any of the defined exceptions, such as “substantial need” or “undue hardship,” mandate disclosure. This answer appears to be substantially clearer than the anticipation question. As opinion work product, if documents are prepared in anticipation of litigation, there is very little room for an exception. Although some courts have found that there is never an exception, the Supreme Court has indicated that it would take an extreme showing of necessity. See *supra* text accompanying notes 58–63. In *Textron*, confirming this analysis, the district court found that the IRS had failed to show a need that overcame the need for work-product protection. *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 141 (D.R.I. 2007). Thus, under the First Circuit’s “because of” test, the tax accrual workpapers should have been protected from disclosure to the IRS. *Id.*

¹³⁹ *United States v. Textron Inc.*, 577 F.3d 21, 27 (1st Cir. 2009) (en banc).

¹⁴⁰ See *id.* at 32 (Torruella, J., dissenting).

¹⁴¹ See *supra* text accompanying notes 121–24.

¹⁴² See *infra* Part IV.B.

B. *The Court Should Not Have Felt Constrained by the Language of the “Because of” Test*

The en banc court should have explicitly acknowledged that it was abandoning the “because of” test in order to directly address the competing policy concerns and the potential effects of any test on various stakeholders. Courts, especially an en banc court admitting the lack of Supreme Court precedent on point, should consider the reasons behind a rule before blindly applying court-made tests or, in this case, artificially applying court-made tests. Instead, by attempting to work within the language set by *Adlman* and *Maine*, the *Textron* court created an incoherent opinion.

As noted above, the court claimed to make its decision because “the only purpose of *Textron*’s papers was to prepare financial statements.”¹⁴³ Yet this simple analysis raises three complex issues. First, as a practical matter, it is questionable whether tax accrual workpapers are prepared only for the purpose of preparing financial statements. As explained above, the court oversimplified this question and brushed over the fact that the tax accrual workpapers were prepared for multiple reasons.¹⁴⁴ Second, the opinion nominally reaffirmed a “because of” standard, but it actually created a new “for use” standard without explicitly stating its reasons for the change and without addressing the fact that neither standard would protect documents prepared for the sole purpose of preparing financial statements.¹⁴⁵ And third, the court did not need to address policy considerations to determine the purpose of the documents but nevertheless spent significant time discussing the IRS’s concerns. The court’s confusion on these issues is clear in the majority’s penultimate paragraph, in which the judges tried to balance multiple considerations:

To sum up, the work product privilege is aimed at protecting work done for litigation, not in preparing financial statements. *Textron*’s work papers were prepared to support financial filings and gain auditor approval; the compulsion of the securities laws and auditing requirements assure that they will be carefully prepared, in their present form, even though not protected; and IRS access serves the legitimate, and important, function of detecting and disallowing abusive tax shelters.¹⁴⁶

Though each sentence may be true individually, linking them together does not produce a coherent argument. The court tried to force an analysis of policy interests while “following” the current standard. And the court failed to explicitly acknowledge that policy arguments are appropriate when determining the breadth of the work-product doctrine.

¹⁴³ *Textron*, 577 F.3d at 30.

¹⁴⁴ See *supra* text accompanying notes 128–30.

¹⁴⁵ *Textron*, 577 F.3d at 30.

¹⁴⁶ *Id.* at 31–32.

A clear acknowledgement of the competing interests would have been in line with the Supreme Court's analysis in *United States v. Arthur Young & Co.*,¹⁴⁷ where the Supreme Court articulated its decision not to create accountant work-product immunity by assessing the effects that such protection would have on the public interest.¹⁴⁸ Specifically, the Court analyzed the need for "full disclosures by corporate clients to their independent accountants" and "the need of the Government for full disclosure of all information relevant to tax liability."¹⁴⁹ Similarly, changes in the scope of the attorney work-product doctrine should be analyzed based on the effects they would have on litigation behavior. The *Textron* court should have taken a two-step approach to analyzing the effects of protecting the tax accrual workpapers. The first step should have been to identify the various stakeholders and to determine how disclosure would alter their incentives. The second step should have been to determine if the resulting change would be a net positive or negative to the litigation process.

As a number of amicus briefs attested, protecting tax accrual workpapers has benefits: the vast majority of in-house counsel find that work-product protection facilitates their work and believe that disclosure would cause employees to hesitate to assist counsel in preparing for litigation.¹⁵⁰ The Association of Corporate Counsel argues that the evolution of the work-product doctrine has allowed corporations to rely on attorneys for "preventive legal advice" and urges that "attorneys must not be chilled from thoroughly analyzing the legal problems faced by their clients."¹⁵¹ The group warns that an "inevitable result [of a narrow 'for use' standard] will be a reduction in effective self-policing and a rise in mismanaged transactions, with litigation inevitably following."¹⁵²

In tax situations specifically, protection likely encourages a detailed analysis of tax positions and review of information in order to accurately predict the outcome of possible litigation arising from questionable tax positions. Forced disclosure of all documents prepared in assessing tax liability could lead to decreased diligence in the preparation and particularly the investigation stages. In fact, the *Textron* court acknowledged the danger of discouraging sound preparation for a lawsuit.¹⁵³ In addition, disclosure may decrease the ability of the IRS to collect taxes without lengthy

¹⁴⁷ 465 U.S. 805 (1984).

¹⁴⁸ *Id.* at 815–21.

¹⁴⁹ *Id.* at 821. In the end, the Court decided that it should not "reduce irrevocably the § 7602 summons power" and left the possibility of creating a new accountant privilege to the legislature. *Id.*

¹⁵⁰ H.R. REP. NO. 110-445, at 2 (2007) ("96% of in-house counsel respondents reported that the privilege and work product doctrines serve an important purpose in facilitating their work as company counsel.").

¹⁵¹ Brief for Amicus Curiae Association of Corporate Counsel in Support of Petitioner at 2, *Textron Inc. v. United States*, 130 S. Ct. 3320 (2010) (No. 09-750), 2010 WL 342152.

¹⁵² *Id.* at 9.

¹⁵³ *United States v. Textron Inc.*, 577 F.3d 21, 31 (1st Cir. 2009) (en banc).

administrative hearings because, some argue, allowing the workpapers to be discovered would increase the amount of litigation between the IRS and taxpayers and extend the examination period.¹⁵⁴

But others argue that the predicted disadvantages of disclosure are exaggerated and that disclosure has additional benefits that critics do not acknowledge. For example, outside legal obligations to prepare tax documents could mitigate the incentive to avoid creating the documents because similar information would be available to the IRS in largely the same manner. The *Textron* court accepted this argument,¹⁵⁵ and the adoption of FIN 48 lends it further credibility. Although FIN 48 likely does not require documents as detailed as the tax accrual workpapers now in question, the regulation may be enough to ensure the quality of the work and diligence in the investigation. In light of these alternative incentives, the effects of disclosing the workpapers may be beneficial.

Another key argument favoring disclosure of tax-related documents is the widely accepted belief that tax cases are different.¹⁵⁶ Supreme Court precedent has clarified that the IRS subpoena power is broader than that enjoyed by the typical litigant.¹⁵⁷ As the en banc panel in *Textron* noted, it is also clear that a “broad public interest” has been established in favor of maintaining a sound tax system¹⁵⁸: “[T]ax collection is not a game. Underpaying taxes threatens the essential public interest in revenue collection.”¹⁵⁹ For transactions that the IRS views as suspicious, mandating more aggressive disclosure may serve the public interest by facilitating detection of abusive and illegal practices. Additionally, as the Ninth Circuit

¹⁵⁴ Letter from Nelson & Fisher, *supra* note 32; *see also* Bassin, *supra* note 24, at 573 (“[C]orporations note that the potential for disclosure of tax accrual workpapers produces perverse incentives; unethical taxpayers who do not take their obligations under FIN 48 seriously and who do not prepare thorough workpapers will be able to maintain more secrets from the IRS (and possibly pay less tax) than honest taxpayers who prepare more thorough workpapers.”).

¹⁵⁵ *Textron*, 577 F.3d at 31 (1st Cir. 2009).

¹⁵⁶ *But see* Brief of Amicus Curiae Chamber of Commerce of the United States of America in Support of Petitioner at 9–10, *Textron*, 130 S. Ct. 3320 (No. 09-750), 2010 WL 320378 (explaining that the IRS already has additional unique tools and should not receive an extra exception).

¹⁵⁷ The IRS has broad authority to issue a summons under I.R.C. § 7602 (2006). Sections 7402(b) and 7604(a) of the Internal Revenue Code grant jurisdiction to district courts to enforce a summons, and section 7604(b) governs the general enforcement of summonses by the IRS. “These grants of power are to be liberally construed in recognition of the vital public purposes which they serve” *De Masters v. Arend*, 313 F.2d 79, 87 (9th Cir. 1963).

¹⁵⁸ *United States v. Lee*, 455 U.S. 252, 260 (1982); *see also* *United States v. Powell*, 379 U.S. 48 (1964) (maintaining a relatively low bar for the IRS to meet when seeking judicial enforcement of its orders); *United States v. Morton Salt Co.*, 338 U.S. 632, 642–43 (1950) (analogizing the broad IRS power of inquisition and investigation to that of a grand jury’s power to “investigate merely on suspicion that the law is being violated”); *United States v. Ins. Consultants of Knox, Inc.*, 187 F.3d 755, 759 (7th Cir. 1999) (reaffirming the “minimal burden” of the IRS when issuing summonses); *United States v. Miller*, 150 F.3d 770, 772 (7th Cir. 1998) (describing the broad power of the IRS to issue summonses when investigating violations of the tax code).

¹⁵⁹ *Textron*, 577 F.3d at 31.

proclaimed, judicial intervention in the investigation stage of tax matters should be limited to prevent undue delay in tax collection.¹⁶⁰ These factors, then, indicate that both the litigation system and general public policy interest are furthered through withholding work-product protection from tax accrual workpapers.

Once a court has assessed how disclosure would alter stakeholders' incentives, it should analyze the resulting changes to identify the position that best serves the public interest and that leads to positive changes and increased efficiency in litigation.¹⁶¹ Unfortunately, the precise balance may not be as obvious, and the cursory analysis provided by the court in *Textron* does not strike a convincing balance. The court, though emphasizing the importance of tax collection, merely noted that encouraging corporations to continue current practices is less important than the efficiency gains created by the IRS reviewing the tax accrual workpapers.¹⁶² If that is true, then efficiency gains would be created by disclosing the workpapers, and the work-product doctrine should not apply. This is in line with the conclusion drawn in the preceding paragraphs. Yet the court acted as if constrained by the old work-product standard and did not make clear how it weighed the costs and benefits of protection in this case, nor did the court provide explicit factors to guide future courts attempting to apply the new test to different documents. Because the correct balance and the practical effects of protecting the papers is hard to predict *ex ante*, the court erred by not engaging in an in-depth review to ensure that it reached the best answer.¹⁶³

C. Proposed Rule: The Modified "Because of" Test

As Edna Epstein noted, "Looking at the cases, it is not evident that either the *primary purpose* language or the *because of* . . . language are material aids to the analytic process."¹⁶⁴ Courts seeking a bright-line rule cannot escape the fact that some documents are created for two reasons, and

¹⁶⁰ *De Masters*, 313 F.2d at 87 (citing *Enochs v. Williams Packing Co.*, 370 U.S. 1, 7 (1962)).

¹⁶¹ This goes beyond looking at what a court believes to be fair. In *United States v. Arthur Young & Co.*, the Supreme Court rejected the "position that fundamental fairness precludes IRS access to accountants' tax accrual workpapers." 465 U.S. 805, 820 (1984). Nonetheless, many have weighed in on the fairness of disclosure. See, e.g., *United States v. Roxworthy*, 457 F.3d 590, 595 (6th Cir. 2006) (noting it would be "unfair" for the IRS to gain access to the firm's detailed legal analysis of the taxpayer's position); Letter from Nelson & Fisher, *supra* note 32 (admonishing the new policy, calling it "unfair," claiming it presented a significant potential for abuse because of the IRS's authority to declare any arrangement to be a listed transaction, and suggesting it "inappropriately alter[s] the balance between the IRS and the taxpayer").

¹⁶² *Textron*, 577 F.3d at 31–32.

¹⁶³ See *In re Murphy*, 560 F.2d 326, 336 (8th Cir. 1977) ("[C]ourts should proceed cautiously when requested to adopt a rule that would have an inhibitive effect on an attorney's freedom to express and record his mental impressions and opinions without fear of having these impressions and opinions used against the client.").

¹⁶⁴ EPSTEIN, *supra* note 52, at 855.

“the two purposes cannot be discretely separated from the factual nexus as a whole.”¹⁶⁵ Though many approaches may get the courts to the same conclusions, a modified “because of” test would be the most coherent and the most easily applied. The proposed test would require courts to follow the “because of” test when ruling on a single-purpose document. When courts are faced with a dual-purpose document, the test would instruct them to look not only at why the document was created—i.e., whether it was created because of possible litigation—but also at what the parties would do differently next time if the documents were discoverable.

The shortfalls of the primary purpose test are widely recognized.¹⁶⁶ The *Adlman* court argued that the primary purpose test “is at odds with the text and the policies of the Rule.”¹⁶⁷ Focusing on the doctrine’s underlying principle of promoting efficient, effective litigation, the *Adlman* court was clearly correct: there is no logical reason why this principle is less relevant simply because a document is prepared for multiple uses. For similar reasons, the new “for use” test seemingly advocated by the *Textron* court makes little sense.¹⁶⁸ In fact, the dissent labeled the majority’s opinion a “bad rule” because the dissenting judges believed it offered no guidance for future courts dealing with the scope of the work-product privilege, confused the court’s ruling in *Maine*, and would lead to inefficiencies and “sharp practices” if dual-purpose documents were no longer protected.¹⁶⁹

But the “because of” test should not be stretched too far. The “ordinary course of business” language appears, at first, to offer a sound principle that limits the doctrine. The problem is that courts are then left to define “ordinary.” This interpretation especially poses a problem when courts are faced with dual-purpose documents. Any test adopted by the courts, then, must address when dual-purpose documents should be privileged and when they should be discoverable by the opposing party.

Unfortunately, a bright line cannot be drawn to deal with all documents. For each type of document, a different policy argument can be made for disclosure or protection of the document.¹⁷⁰ Courts should start by applying the “because of” test but then should consciously analyze, on a case-by-case basis, how the disclosure or protection of the documents at issue would alter the balance of litigation incentives. It is in this context that it becomes relevant to decide if the documents would have been

¹⁶⁵ *In re Grand Jury Subpoena*, 357 F.3d 900, 910 (9th Cir. 2004).

¹⁶⁶ See *supra* text accompanying notes 72–77.

¹⁶⁷ *United States v. Adlman*, 134 F.3d 1194, 1198 (2d Cir. 1998).

¹⁶⁸ See Brief of Amicus Curiae Chamber of Commerce of the United States of America in Support of Petitioner, *supra* note 156, at 11.

¹⁶⁹ *United States v. Textron Inc.*, 577 F.3d 21, 36 (1st Cir. 2009) (en banc) (Torruella, J., dissenting).

¹⁷⁰ For example, policy arguments for protecting or disclosing tax accrual workpapers may differ from arguments regarding internal investigations. See, e.g., *Allen & Hazelwood*, *supra* note 47, at 357.

prepared in the same form regardless of any possible litigation. If so, the adverse incentives are reduced, and there is less reason to protect the documents.¹⁷¹ If there are strong reasons to force disclosure of documents (or alternatively, no reason to protect documents) that were prepared “because of” anticipated litigation, the court should find that the documents are not prepared in anticipation of litigation for purposes of the work-product doctrine.

The modified “because of” test also responds to critics who argue that the “because of” test is too easy to satisfy.¹⁷² Work-product protection, they argue, should only exist to create a “zone of privacy” when preparing a case for trial.¹⁷³ This construction is generally too narrow a reading of both precedent and underlying policy, but these criticisms make more sense in the tax context because accounting regulations require a legal assessment of the merits of a tax dispute when preparing financial statements.¹⁷⁴ FIN 48’s “more likely than not” standard clarifies this requirement further. However, this concern and its application in this specific instance should not be allowed to dismantle the “because of” test, as criticizing the broad scope of the “because of” test ignores the wider implications of employing the alternative primary purpose standard (or changing it to a more restrictive “for use” standard).¹⁷⁵

The flexibility provided by the modified “because of” test would have greatly aided the *Textron* court, allowing it to openly weigh the IRS’s need for the documents against the potential incentives that corporate lawyers would face if the documents were not protected. If the court found that any adverse incentives were outweighed by the efficiency gains in litigating tax disputes, it could have mandated the disclosure of the documents. A rule should not cause a court to do the type of linguistic gymnastics found in the *Textron* opinion. This Note therefore offers a modified “because of” test as a more coherent interpretation of the “anticipation of litigation” requirement, one that is primarily based on the “because of” test but that can be tailored to ensure consistency with the doctrine’s underlying purpose.

¹⁷¹ See EPSTEIN, *supra* note 52, at 855.

¹⁷² Beale, *supra* note 135; see also Elizabeth Thornburg, *Rethinking Work Product*, 77 VA. L. REV. 1515, 1578 (1991) (arguing that the current exemptions from discovery are too broad).

¹⁷³ Beale, *supra* note 135.

¹⁷⁴ *Id.* (“Such consideration is required for two reasons—the ‘realistic possibility of success on the merits’ and ‘more likely than not’ standards set forth in the Code for evaluating positions to determine whether they are strong enough to be advised or reported on a return and the fact that there are judicial doctrines (substance-over-form, step transaction, economic substance, business purpose) that must be evaluated to determine whether a position may be reported on a return.”).

¹⁷⁵ See *United States v. Adlman*, 134 F.3d 1194, 1198 (2d Cir. 1998).

D. Textron Takeaway: Corporate Documents Will Continue to Be Protected

Critics fear that the First Circuit's new "for use" test will "open[] the door for all litigants to discover documentation relating to a corporation's general litigation reserves and many other historically protected documents."¹⁷⁶ A close analysis of *Textron*'s facts, rather than a blind application of the new language, suggests that *Textron* will not greatly alter work-product jurisprudence. Litigants and corporate counsel who are concerned about work-product protection can take certain steps to respond to *Textron*.

Lawyers outside the First Circuit will be able to distinguish the *Textron* panel's interpretation of the "because of" test from the one traditionally applied in other circuits.¹⁷⁷ They should pay special attention to the fact that the panel emphasized an alternative holding in *Maine* and thus did not rely on the traditional "because of" test to reach its conclusion. Litigants seeking protection of documents but bringing suit in the First Circuit will have to argue for a narrow application of the ruling. This, however, should not be a difficult task. The litigant must first remind the court that the work-product doctrine necessarily balances different policy concerns. Although the *Textron* court was not explicit in its ruling, it is clear that the court's decision was affected by these policy concerns. The litigant must distinguish *Textron* on the facts and argue that the new documents raise different policy concerns that do not require a narrow reading of the work-product doctrine's scope. The lawyer can point to the in-depth policy discussion in *Textron* that weighs in favor of the IRS and establish that tax cases are different. If litigants are trying to protect tax accrual workpapers, they will have to seek reversal by demonstrating that the incentives created by disclosure are actually different than those imagined by the panel and will lead to suboptimal outcomes.

CONCLUSION

Very few cases go to trial. In the cases that do progress that far, however, judges make decisions that affect the incentives of lawyers, executives, and everyone else. When a court changes what can be discovered during litigation, this decision also changes the incentives for those who create the documents in the first place. The tension between transparency and privacy is an unavoidable aspect of the work-product doctrine, and balancing the two considerations is difficult. *Textron*

¹⁷⁶ Henkel, *supra* note 5, at 237.

¹⁷⁷ *But see* Brief of Amicus Curiae Council on State Taxation in Support of Petitioner at 11, *Textron Inc v. United States*, 130 S. Ct. 3320 (2010) (No. 09-750), 2010 WL 342151 ("Textron's Narrower Test Will Result in the Involuntary Waiver of Otherwise Valid Claims of Work Product Privilege in Many Jurisdictions.").

attempted to strike a new balance but did so without explicitly acknowledging that it was breaking from precedent. The exact change in incentives under *Textron*'s ruling is hard to determine. The overall effect on the system is even harder to predict. Nonetheless, these concerns are real and need to be considered by a court prior to deciding privilege cases.

In *Textron*, the court attempted to look at the effects of its decision but felt constrained by the language of precedent. Thus, while a correctly applied "because of" test would have protected the tax accrual workpapers in the case, the court artificially narrowed the test in order to adjust for policy concerns not currently incorporated in the jurisprudence. These considerations resulted in an incoherent opinion and an insufficient discussion of the full set of policy implications, leaving significant, unexplored questions about whether the outcome is good or bad for the litigation system. Without the proper analysis, corporate council and taxpayers everywhere simply have to hope that less protection of tax accrual workpapers is good for the system. Though the Supreme Court recently denied certiorari in this case, if given another chance to reshape the doctrine, the Court should explicitly adopt a new test—the modified "because of" test—that would give courts the flexibility to balance, on a case-by-case basis, the policy considerations associated with different types of documents. Significantly, this test requires courts faced with dual-purpose documents to explicitly weigh the incentives created by protecting the document when determining whether the work-product privilege should apply.

