[ORAL ARGUMENT NOT YET SCHEDULED]
No. 09-5171

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

UNITED STATES OF AMERICA,
Appellant

v.

DELOITTE & TOUCHE USA, LLP,
Appellee

DOW CHEMICAL COMPANY,
Intervenor

ON APPEAL FROM THE ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE APPELLANT

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

(1) Parties, intervenors, and amici:

The parties in the District Court and in this Court are Deloitte & Touche USA LLP and the United States of America. The intervenors in the District Court were Chemtech II, L.P., by IFCO, Inc., as tax matters partner, and Chemtech Royalty Associates, L.P., by Dow Europe, S.A., as tax matters partner. Dow Chemical Company has intervened in this appeal. There were no amicus curiae appearing in the District Court, and there are currently none on appeal.

(2) Ruling under review:

The United States seeks review of the March 4, 2009 minute order (JA 3), and the June 9, 2009 memorandum order (JA 155-158) of the United States District Court for the District of Columbia (Honorable Richard J. Leon) denying the United States's motion to compel. The memorandum order is reported at 623 F. Supp. 2d 39.

(3) Related Cases:

This case has not previously been before this Court. A related consolidated case is pending in the United States District Court for the

Middle District of Louisiana, Nos. 05-944-RET-DLD, 06-258-RET-DLD, and 07-405-RET-DLD, in which the two Chemtech partnerships are the plaintiffs and the United States is the defendant. The instant case involves third-party discovery related to that litigation that the United States seeks from Deloitte & Touche.

Page

TABLE OF CONTENTS

Page

Argument:

Page

Page(s)

TABLE OF AUTHORITIES

Cases:

* Authorities chiefly relied upon are marked by asterisks.

Page(s)

Cases (continued):

Page(s)

Cases (continued):

Statutes:

Page(s)

Statutes (continued):

Miscellaneous:

Page(s)

Miscellaneous (continued):

GLOSSARY

Abbreviation	Definition
AICPA	American Institute of Certified Public Accountants
AT&T	American Telephone & Telegraph
Chemtech	Chemtech Royalty Associates, L.P. and Chemtech II, L.P.
Deloitte	Deloitte & Touche USA LLP
Doc.	documents in the District Court record as numbered by the Clerk
Dow	Dow Chemical Company
FASB	Financial Accounting Standards Board
FIN 48	FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes
GAAP	generally accepted accounting principles
IRS	Internal Revenue Service
MIT	Massachusetts Institute of Technology
SEC	Securities & Exchange Commission

JURISDICTIONAL STATEMENT

This appeal arises out of a consolidated action pending in the United States District Court for the Middle District of Louisiana in which two partnerships, Chemtech Royalty Associates, L.P. and Chemtech II, L.P. (collectively Chemtech), have challenged certain adjustments made by the Internal Revenue Service (IRS) to their partnership tax returns for the years 1993-2003. The district court in that case had jurisdiction pursuant to 26 U.S.C. § 6226 and 28 U.S.C. § 1346(e).

The partnerships were formed by subsidiaries of Dow Chemical Company (Dow). (JA 35, 74-75.) In support of its litigation with Chemtech, the United States subpoenaed documents from Dow's independent auditor, appellee Deloitte & Touche USA LLP (Deloitte), pursuant to Rule 45 of the Federal Rules of Civil Procedure (JA 9-14), and then moved to compel Deloitte to comply with the subpoena (JA 4-5). The subpoena sought production of documents in Washington, D.C., and therefore issued from the United States District Court for the District of Columbia. The United States's motion to compel was docketed as a separate action in the District Court for the District of

Columbia. (JA 1.) The District Court (which issued the subpoena) had jurisdiction over the Rule 45 motion to compel. 28 U.S.C. §§ 1331, 1340, 1345. *See Watts v. Securities & Exchange Commission (SEC)*, 482 F.3d 501, 509-510 (D.C. Cir. 2007) (transferring case challenging SEC's refusal to allow its employees to testify in response to subpoenas issued under Rule 45 over which this Court lacked direct-review jurisdiction to district court which would have had jurisdiction if the proponent of the subpoenas had filed a Rule 45 motion to compel); *cf. SEC v. Lines Overseas Mgmt., Ltd.*, No. Civ. A. 04-302, 2005 WL 3627141, at *2 (D.D.C. 2005) ("In the absence of an express jurisdictional grant found in the Securities Act itself, the Judicial Code itself provides this Court with subject matter jurisdiction to enforce the administrative subpoena in this case." (citing 28 U.S.C. §§ 1331, 1337(a), and 1345)).

On March 4, 2009, the District Court entered a minute order denying the United States's motion to compel. (JA 3.) That order is final, disposing of all claims of all parties with regard to the subpoena issued to Deloitte. *See In re Multi-Piece Rim Prods. Liab. Litig.*, 653 F.2d 671, 676 (D.C. Cir. 1981) ("Since the litigation was in the district

court solely for purposes of the discovery motion, the court's disposition of that motion was an appealable final judgment."). On March 18, 2009, within 10 business days of that order, the United States filed a motion requesting that the District Court state the basis for its ruling. (District Court Docket Entry (Doc.) 11.) On May 1, 2009, within 60 days of the District Court's minute order, the United States filed a timely notice of appeal. (JA 152; *see* 28 U.S.C. § 2107 and Fed. R. App. P. 4(a)(1)(B).) On June 9, 2009, the District Court entered a memorandum order explaining the basis for its minute order. (JA 155-158.) The following day, the United States filed an amended notice of appeal, stating that it was appealing the June 9 memorandum order, as well as the earlier March 4 minute order denying its motion to compel. (JA 159.) This Court has jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES

1. The work-product doctrine protects documents generated by a party or its representative in anticipation of litigation or for trial. The question presented on appeal is whether a document generated by

an independent auditor during its audit of a public company's financial statements constitutes work product for the public company.

2. A document loses work-product protection when it is provided to a party's potential adversary or a conduit to a potential adversary. The independent auditor is a public watchdog who has certain disclosure obligations to the SEC and whose loyalties ultimately run to the investing public. The question presented on appeal is whether Dow waived any claim to work-product protection by providing its pre-existing tax advice to the independent auditor as evidential support of its financial statements.

STATUTES AND REGULATIONS

This appeal concerns the work-product doctrine, which is codified in Rule 26(b)(3) of the Federal Rules of Civil Procedure. Rule 26(b)(3) provides as follows:

> (3) *Trial Preparation: Materials*.
>
> (A) *Documents and Tangible Things*. Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor,

insurer, or agent). But, subject to Rule 26(b)(4), those materials may be discovered if:

(i) they are otherwise discoverable under Rule 26(b)(1); and

(ii) the party shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.

(B) *Protection Against Disclosure*. If the court orders discovery of those materials, it must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation.

(C) *Previous Statement*. Any party or other person may, on request and without the required showing, obtain the person's own previous statement about the action or its subject matter. If the request is refused, the person may move for a court order, and Rule 37(a)(5) applies to the award of expenses. A previous statement is either:

(i) a written statement that the person has signed or otherwise adopted or approved; or

(ii) a contemporaneous stenographic, mechanical, electrical, or other recording — or a transcription of it — that recites substantially verbatim the person's oral statement.

STATEMENT OF THE CASE

The United States filed a motion in the District Court to compel Deloitte to comply with a third-party subpoena issued pursuant to Rule 45 of the Federal Rules of Civil Procedure. (JA 4-5.) The motion sought to compel Deloitte to produce two categories of documents: (i) three documents that Deloitte withheld on the basis of privileges asserted by Dow; and (ii) all responsive documents at Deloitte's affiliate in Zurich, Switzerland (Deloitte Switzerland). (JA 4.) After hearing oral argument, the District Court denied the United States's motion to compel by minute order. (JA 3.) The United States then filed a motion requesting that the District Court state its basis for denying the motion to compel. (Doc. 11.) The District Court failed to rule on the United States's motion to state basis within 60 days of issuing its minute order, and, accordingly, the United States filed a protective notice of appeal. (JA 152-153.) The United States then filed a motion in this Court, requesting that the case be remanded to the District Court so that the court could explain the basis for its ruling. While that motion was pending, the District Court issued a memorandum order, granting

the United States's motion to state basis for ruling and explaining why the court had denied the United States's motion to compel. (JA 155-158.) The court stated that the three withheld documents were protected by the work-product doctrine, and that the Deloitte Switzerland documents were beyond Deloitte's control. The United States then filed an amended notice of appeal (JA 159), and asked this Court to dismiss its motion to remand as moot, which this Court granted. The United States now appeals the District Court's ruling with regard to the three documents withheld by Deloitte.[1]

STATEMENT OF FACTS

A. Background

This case concerns a third-party subpoena issued to Deloitte, the independent auditor of Dow. (JA 9-14, 51.) Dow is the majority owner of the two Chemtech partnerships that have brought suit in the United States District Court for the Middle District of Louisiana, challenging certain adjustments that the IRS made to their partnership tax

[1] The United States does not appeal the District Court's ruling regarding the Deloitte Switzerland documents.

returns. (Doc. 7-2; JA 28.) The Deloitte subpoena relates to that pending tax litigation. (JA 24.)

The tax litigation concerns a transaction (the Chemtech transaction) that Dow entered into in 1993 that was designed to generate enormous tax benefits utilizing a partnership with foreign banks that were not subject to U.S. taxation. (JA 33-43.) The IRS disallowed the tax benefits, determining that the transaction involved (among other things) an abusive lease-strip tax shelter and that the Chemtech partnership was a sham because its substance did not correspond to its form.[2] (JA 33-43, 75.) Dow, in turn, argued that it had a business purpose for the partnership and that the form of the transaction should be respected. (JA 80-82.) The United States and

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[2] It is a fundamental principle of tax law that the minimization of a tax liability may not be accomplished through form alone. Where the form and substance of a transaction are in conflict, the substance is controlling. *Gregory v. Helvering*, 293 U.S. 465, 469 (1935); *Dow Chem. Co. v. United States*, 435 F.3d 594, 599 (6th Cir. 2006); *Coltec Indus., Inc. v. United States*, 454 F.3d 1340, 1352 (Fed. Cir. 2006). For general background information on the lease-stripping tax shelter, *see Andantech LLC v. Commissioner*, 331 F.3d 972 (D.C. Cir. 2003); *Nicole Rose Corp. v. Commissioner*, 320 F.3d 282 (2d Cir. 2002); Notice 2003-55, 2003-2 C.B. 395; Notice 95-53, 1995-2 C.B. 334.

Dow are currently litigating the merits of the shelter and whether the partnership is a sham.

B. The subpoena issued to Dow's independent auditor

To determine whether a transaction is a sham for tax purposes, the parties must look beyond the formal transaction documents and analyze the substance of the transaction. Seeking evidence of the substance of the Chemtech transaction, the United States issued a third-party subpoena to Deloitte (JA 9-14), Dow's independent auditor (JA 51). The subpoena sought all documents related to the Chemtech transaction, including any document connected with Deloitte's audit of Dow's financial statements that addressed the Chemtech transaction. (JA 12.)

Federal securities laws require all publicly traded corporations like Dow to have an independent auditor certify that its financial statements comply with generally accepted accounting principles (GAAP). *See* 15 U.S.C. §§ 78*l*, 78m; 17 C.F.R. § 210 *et seq*. As part of that certification process, public companies and their auditors must analyze the company's financial-statement tax reserve for deferred or

contingent tax liabilities and related representations in the company's audited financial statements. *See United States v. Arthur Young & Co.*, 465 U.S. 805, 808, 812-813 (1984); IRS Announcement 2002-63, 2002-2 C.B. 72. When evaluating the adequacy and reasonableness of the corporation's reserve account for contingent tax liabilities, the auditor generates documents (sometimes referred to as tax-accrual workpapers) that analyze the substance of transactions that generate tax benefits and compute a company's potential exposure to the requirement to pay additional taxes, if those tax benefits are challenged by the IRS. *Id.* at 812-813. The auditor also obtains evidential support from the company to support its contingent tax reserve and related financial-statement disclosures. (JA 58-64.) The three documents at issue in this case were created or obtained by Deloitte during its audit of Dow's financial statements. (JA 30, 51-52.)

C. The withheld documents

Before Deloitte produced the documents that were responsive to the subpoena, it permitted Dow to review the proposed production. (JA 131.) After reviewing the documents, Dow instructed Deloitte to

withhold three documents that Dow claimed were privileged. (JA 131.) Deloitte then produced the remaining responsive documents in its possession, and provided the United States a privilege log prepared by Dow's counsel. (JA 15-18.)

According to the privilege log, all three of the withheld documents addressed tax issues related to the Chemtech partnership. (JA 17-18.) As described below, one of the three documents was generated by Deloitte during its audit of Dow's financial statements, and the other two were generated by Dow's tax advisors and were provided to Deloitte so that it could audit Dow's financial statements.[3] (JA 30, 51-52, 119, 123-124, 133-136.)

[3] The documents were briefly described in two declarations that Dow submitted to the District Court in support of its opposition to the United States's motion to compel. The declarations were from (i) Dow's Director of Taxes, William Curry, and (ii) a Deloitte partner who participated in the audit of Dow's financial statements, Troy Biddix. (Doc. 7-2; JA 28-31, 51-52.)

a. 1993 Deloitte financial-audit document

The first withheld document was an internal memorandum generated by Deloitte during its audit of Dow's financial statements in 1993. (JA 18, 30, 119, 123-124, 133-136.) The memorandum summarizes a meeting among Deloitte, Dow, and Dow's outside counsel during which the Chemtech transaction was discussed for purposes of establishing an adequate reserve for contingent tax liabilities on Dow's financial statements. (JA 30, 134-136.) According to Dow, the exchange of information that took place during the meeting was "required under applicable financial accounting rules." (JA 30.) Dow asserted that this memorandum was protected by the attorney work-product doctrine.[4] (JA 18.)

b. 1998 and 2005 Dow tax-advice documents

The other two withheld documents contain legal advice that Dow received from its tax advisors about the Chemtech transactions. (JA

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[4] Dow initially asserted that the Deloitte financial-audit document was also protected by the attorney-client privilege. (JA 18.) Dow, however, later withdrew that assertion during the District Court proceedings. (Doc. 7-2 at 2 n.1.)

30.) One document was a memorandum and flow chart drafted by an in-house attorney and an in-house accountant at Dow in 1998. (JA 17, 136.) Dow asserted that this memorandum was protected by the work-product doctrine, the attorney-client privilege, and the tax practitioner-client privilege set out in Section 7525 of the Internal Revenue Code (26 U.S.C.).[5] (JA 17.)

The other tax-advice document was a tax opinion generated by Dow's outside tax counsel, McKee Nelsen LLP (now known as Bingham McCutchen LLP), in 2005. (JA 17.) Dow asserted that this tax opinion was protected by the work-product doctrine and the attorney-client privilege. (JA 17.)

Dow gave both of these tax-advice documents to its independent auditor so that Deloitte could review the adequacy of Dow's contingent-tax reserve on Dow's financial statements. (JA 30, 51-52, 119, 123-124,

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[5] Section 7525(a)(1) generally extends (for documents generated after July 21, 1998) "[w]ith respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney . . . to a communication between a taxpayer and any federally authorized tax practitioner [including accountants] to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney."

133-136.) When it furnished these two documents to Deloitte as evidence that its financial statements were accurate, Dow expected Deloitte to keep the tax advice confidential. (JA 30.) Deloitte has maintained the documents in confidence. (JA 52.)

D. District Court proceedings

After Deloitte refused to produce the three documents for which Dow asserted a privilege, the United States filed a motion to compel production of those documents. (JA 4-5.) In support thereof, the United States argued that the documents were not protected by the attorney-client privilege, tax practitioner-client privilege, or the work-product doctrine. (Doc. 1, 8.) The United States argued that the Deloitte financial-audit document was not work product because it was created by Deloitte during its independent audit of Dow's financial statements, not by a party representative in anticipation of litigation. (Doc. 8 at 3.) The United States did not challenge Dow's assertion that the two Dow tax-advice documents were privileged documents. (Doc. 1, 8.) Instead, the United States argued that Dow waived the privileges by disclosing those documents to the independent auditor. (*Id.*) With

regard to its argument that disclosure waived work-product protection, the United States asserted that the auditor and the company did not share a common litigation interest, and that the auditor is both a potential adversary and a conduit to potential adversaries of the company. (Doc. 1 at 9-10; Doc. 8 at 3-8.) In support of its waiver argument, the United States submitted as supplemental authority a then-recent decision by the First Circuit in *United States v. Textron Inc. & Subsidiaries*, holding that disclosure of work product to an independent auditor could waive work-product protection because the auditor could be a conduit to potential adversaries.[6] (JA 100-101.)

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[6] *Textron* involves a public company's disclosure of its confidential tax-accrual analysis to its independent auditor. In *Textron*, the district court held that the company's workpapers were work product and that disclosure to the auditor did not waive work-product protection. 507 F. Supp. 2d 138, 152-154 (D.R.I. 2007). While the United States's motion to compel in the instant case was pending in the District Court, a panel of the First Circuit affirmed the *Textron* district court's holding that the workpapers were work product, but vacated the district court's waiver ruling, and remanded the case to determine whether the independent auditor was a conduit to potential adversaries. 553 F.3d 87 (Jan. 21, 2009) (a copy of this now-vacated decision is located at JA 85-106). Shortly after the District Court denied the United States's motion to compel, the First Circuit granted the United States's petition for rehearing *en banc* in *Textron*, vacated the original panel decision, and

(continued...)

In its opposition to the United States's motion to compel, Dow asserted that the work-product doctrine applied to all three documents, and that the attorney-client or tax practitioner-client privilege applied to the two Dow documents. (Doc. 7-2.) Dow argued that the Deloitte document was work product because it "relates to the setting of a reserve amount for the Chemtech transactions" and "records the thoughts and impressions of Dow's attorneys relating to Dow's tax position." (Doc. 7-2 at 29.) Dow further argued that it had not waived any of the privileges. (Doc. 7-2.) In particular, Dow asserted that disclosure of work product to an independent auditor does not waive work-product protection because Deloitte (in Dow's view) was neither a potential adversary nor a conduit to a potential adversary. (Doc. 7-2 at 10-15; JA 137.)[7]

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[6](...continued)
has since held that Textron's workpapers are not work product. __ F.3d __, No. 07-2631, 2009 WL 2476475, at *10 (1st Cir. Aug. 13, 2009). In light of that work-product ruling, it was unnecessary for the First Circuit to address the waiver issue.

[7] Deloitte's opposition to the motion to compel addressed only the Deloitte Switzerland documents, not the three withheld documents for (continued...)

E. District Court order

The District Court denied the United States's motion to compel, determining that the three withheld documents were protected by the work-product doctrine. (JA 155-157.) The court did so without holding an evidentiary hearing and without reviewing the contested documents *in camera*.

The court first determined that the three withheld documents were work product, reasoning that they were created in anticipation of future litigation over the tax treatment of Chemtech. (JA 156.) In holding that the memorandum created by Deloitte qualified for work-product protection under Rule 26(b)(3), the court did not distinguish an independent auditor from a party representative or analyze the context in which the document was created. Instead, the court focused on the document's content, holding that the fact that it was created by an independent auditor during a financial audit "is of no moment, because

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[7](...continued)
which Dow had asserted a privilege. (Doc. 6 at 1 n.1.)

its contents record the thoughts of Dow's counsel regarding the prospect of litigation." (JA 156 n.1.)

The District Court then determined that Dow had not waived its work-product protection by disclosing the work product to its independent auditor. In the court's view, an independent auditor reviewing a public company's financial statements is not "a potential adversary." (JA 156-157.) In so ruling, the court distinguished *United States v. Massachusetts Institute of Technology (MIT)*, 129 F.3d 681 (1st Cir. 1997), a case cited by both parties and holding that disclosure of work product to a Government auditor by a Government contractor waived the contractor's work-product privilege. According to the District Court, *MIT* was distinguishable because there, the Government auditor was obligated to review the accuracy of the contractor's expense submissions and could sue the contractor to recoup overcharges, whereas the independent auditor had no such "obligation or authority." (JA 157 n.2.)

The District Court did not determine whether an independent auditor could be a conduit to potential adversaries, or address the

parties' arguments on that issue. Nor did the District Court address the First Circuit's analysis of the conduit issue in the *Textron* panel decision, even though the District Court cited the *Textron* district court decision as support for its waiver ruling.[8] (JA 157.)

SUMMARY OF ARGUMENT

This case concerns whether the United States may obtain (i) an independent auditor's tax-accrual workpapers (which analyze questionable positions taken by a public company on its federal tax return) generated during a regular financial audit required by the securities laws, and (ii) the company's tax advice relied on by the auditor in that audit. Almost 25 years ago, the Supreme Court unanimously held that tax-accrual workpapers — generated by an independent auditor and incorporating a public company's confidential information regarding its questionable tax-return positions — were not

[8] Because the District Court held that all three documents were protected by the work-product doctrine, it did not address Dow's claim that the two Dow documents were protected by the attorney-client or tax practitioner-client privilege, or the United States's claim that those privileges were waived by disclosure to a third party.

privileged and were subject to an IRS summons. *United States v. Arthur Young*, 465 U.S. 805 (1984).

1. The District Court's sweeping conclusion that an independent auditor's analysis of a public company's contingent tax liability is protected work product is wrong as a matter of law and is in substantial tension with *Arthur Young* (which the District Court failed to even cite). By definition, the independent auditor is a public watchdog, not a party's representative, and its audit workpapers are generated to satisfy federal securities laws, not in anticipation of litigation. That an auditor may incorporate into its analysis information from the company or its representatives regarding the prospect of litigation does not convert an auditor's workpapers into a company's litigation preparation or immunize the auditor's analysis from discovery.

2. The District Court also erred in concluding that any of Dow's tax advice provided to Deloitte during the audit of Dow's financial statements was protected by the work-product doctrine, because Dow waived that protection by disclosing the tax advice to the independent

auditor. Disclosure of work product to a potential adversary, or a conduit to a potential adversary, waives the protection. The District Court's waiver analysis is flawed as a matter of law because it failed to analyze whether the auditor is a conduit to potential adversaries (such as the SEC or the IRS) or account for the auditor's "public watchdog" function as outlined in *Arthur Young*. Because Deloitte is both a potential adversary and a conduit to other potential adversaries, Dow's disclosure to Deloitte waived any work-product protection for its tax advice.

ARGUMENT

The District Court erred in concluding that documents relied on, and generated by, an independent auditor during a regular financial audit mandated by the federal securities laws are protected from disclosure by the work-product doctrine

Standard of Review

This Court generally reviews the denial of a motion to compel under the abuse-of-discretion standard, but if a district court "applied the wrong legal standard" in so ruling, review is "*de novo*." *In re Sealed Case*, 146 F.3d 881, 883 (D.C. Cir. 1998); *see also In re Subpoena Served Upon the Comptroller of the Currency*, 967 F.2d 630, 633 (D.C. Cir. 1992). The District Court committed legal error by failing to analyze whether the Deloitte financial-audit document satisfied Rule 26(b)(3)'s requirements. And the court's categorical ruling that disclosure to an independent auditor does not waive work-product protection poses "an abstract issue of law and review is plenary." *MIT*, 129 F.3d at 683; *accord In re Subpoena (Comptroller of the Currency)*, 967 F.2d at 635.

A. Introduction

In this case, the United States seeks three documents that Deloitte created or relied on when auditing Dow's financial statements. (JA 30, 51-52, 119, 123-124, 133-136.) Deloitte refused to produce those documents, because Dow claimed (among other things) that they were protected by the work-product doctrine.

1. The work-product doctrine

The work-product doctrine is designed "to protect the adversary trial process," and does not protect all confidential communications containing legal analysis. *Coastal States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 864 (D.C. Cir. 1980); *see In re Sealed Case*, 146 F.3d 881, 887 (D.C. Cir. 1998) ("Of course, not all work undertaken by lawyers finds protection in the work-product privilege."). On the contrary, the party claiming work-product protection bears the burden to demonstrate that a document containing confidential legal analysis was prepared (i) "by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or

agent)," and (ii) "in anticipation of litigation or for trial." Fed. R. Civ. P. 26(b)(3)(A).

To determine whether documents have been prepared "in anticipation of litigation," courts have applied either the "because of" test or the "primary purpose" test. This Court has adopted the "because of" test, pursuant to which documents should be deemed prepared in anticipation of litigation and within the scope of the work-product rule if, "'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.'" *In re Sealed Case*, 146 F.3d at 884 (citation omitted). Courts applying the "primary purpose" test provide work-product immunity only where "'the primary motivating purpose behind the creation of the document was to aid in possible future litigation.'" *United States v. El Paso Co.*, 682 F.2d 530, 542 (5th Cir. 1982) (citation omitted). Under either test, work-product protection does not extend to "documents prepared by lawyers 'in the ordinary course of business or for other nonlitigation purposes,'" *In re Sealed Case*, 146 F.3d at 887

(citation omitted), including documents prepared "pursuant to regulatory requirements," *Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co.*, 967 F.2d 980, 984 (4th Cir. 1992); *accord El Paso*, 682 F.2d at 542.

2. Inapplicability of the work-product doctrine to tax-accrual workpapers

The United States's ability to obtain an independent auditor's analysis of a public company's tax-return positions has been recognized since 1984, when the Supreme Court unanimously held that an independent auditor's tax-accrual workpapers were not protected by an accountant's work-product doctrine, which the Court declined to recognize. *Arthur Young*, 465 U.S. at 815-821. The Court determined that work-product protection for tax-accrual workpapers was not appropriate because, unlike an attorney acting as an "advocate" and presenting "the client's case in the most favorable possible light," the independent auditor is a "public watchdog," and the purpose of the audit is to inform the public as to the accuracy of a public company's financial statements, not to assist the company's litigation preparation.

465 U.S. at 817-818. In rejecting a work-product privilege for an auditor's documents, the Court recognized the need for tension in the company-auditor relationship. Far from being a "confidential adviser" of the company, the independent auditor is a "disinterested analyst charged with public obligations" that on occasion will run counter to the company's interest. *Id.* The auditor must always be prepared and willing to (where warranted) issue an "adverse opinion" as to the accuracy of the company's financial statements, and to "notif[y] the investing public of possible potential problems inherent in the corporation's financial reports." *Id.* Thus, the Court concluded, "insulation of tax accrual workpapers from disclosure might well undermine the public's confidence in the independent auditing process." *Id.* at 819 n.15.[9]

Although the Court in *Arthur Young* recognized that the independent auditor's workpapers incorporated and analyzed the

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[9] The Court also rejected the Second Circuit's reasoning that permitting IRS access to tax-accrual workpapers would chill communications between public companies and independent auditors. 465 U.S. at 818-819.

taxpayer's confidential analysis of its questionable tax-return positions, 465 U.S. at 812-813, the Court did not directly address whether a taxpayer's tax-accrual analysis was protected by the attorney work-product doctrine. That question has been addressed by several appellate courts, which uniformly have held that the taxpayer's analysis is not protected work product because it is not created in anticipation of litigation. *See United States v. Textron Inc. & Subsidiaries*, __ F.3d __, No. 07-2631, 2009 WL 2476475, at *4-10 (1st Cir. Aug. 13, 2009) (*en banc*) (holding that the "attorney work product doctrine" does not apply to a public company's "tax accrual work papers" prepared "to support [the company's] calculation of tax reserves for its audited corporate financial statements"); *United States v. Rockwell Int'l*, 897 F.2d 1255, 1266 (3d Cir. 1990) (instructing district court that taxpayer's tax-accrual file was not protected work product if it were "maintained so that [the taxpayer] may comply with [GAAP] and SEC reporting requirements"); *El Paso,* 682 F.2d at 542-544 (documents "'assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation,'" are not protected work

product, and tax-accrual workpapers are not work product because they are ordinary business documents "compelled by the securities laws" in order "to back up a figure on a financial balance sheet") (citation omitted); *see also* American Institute of Certified Public Accountants (AICPA), *Practice Guide on Accounting for Uncertain Tax Positions Under FIN 48*, at 12 (2006) (noting that "IRS could legally" obtain auditor's "tax accrual workpapers") (available at www.aicpa.org). *But cf. Regions Fin. Corp. v. United States*, 2008 WL 2139008, No. 2:06-CV-00895 (N.D. Ala. May 8, 2008) (holding that an independent auditor's tax-accrual workpapers were protected by the work-product doctrine), *appeal dismissed*, No. 08-13866-C (Dec. 30, 2008) (appeal dismissed after parties stipulated that Regions's production of the withheld documents mooted the appeal).

As demonstrated below, the District Court's determination that the three withheld documents are protected by the work-product doctrine cannot withstand scrutiny. First, the court erred in extending work-product protection to the document generated by Deloitte in the course of auditing Dow's financial statements. Regardless of the

purpose for which Dow's tax advisors generated the two tax-advice documents, it is undisputed that Deloitte's memorandum recording the auditors' and Dow's tax-accrual analysis was generated to comply with accounting rules and the federal securities laws, not for litigation purposes. Second, any work-product protection that Dow's tax advice may have had was waived upon disclosure of that information to its independent auditor.

B. The District Court's determination that a document generated by an independent auditor during a financial audit is litigation work product lacks legal and factual support

The District Court's ruling that an independent auditor's tax-accrual workpapers are protected by the work-product doctrine is in substantial tension with *Arthur Young*, a case on which the United States relied below (*e.g.*, Doc. 8 at 4) and which the District Court completely ignored in its decision. There, as noted above, the Supreme Court held that the Government was entitled to an independent auditor's workpapers and rejected the argument that such workpapers should be protected by an accountant's work-product privilege.

Although the Court did not expressly hold that the auditor's workpapers were not protected by Rule 26(b)(3), it clearly expressed the view that an independent auditor's workpapers were not at all "analog[ous]" to those protected by "the attorney work-product doctrine established in *Hickman v. Taylor*." *Arthur Young*, 465 U.S. at 817. As Rule 26(b)(3) (which codifies *Hickman v. Taylor*, 329 U.S. 495 (1947)) provides, a party claiming work-product protection must demonstrate both that the documents were generated (i) by a party or its representative, and (ii) in anticipation of litigation.[10] Here, the District Court's conclusion that Dow satisfied this burden is wrong as a matter of law because Dow has not — and cannot — demonstrate either essential element with regard to the Deloitte financial-audit document.

Before turning to those arguments, we want to make clear that we are not challenging the District Court's work-product determination as it relates to the two tax-advice documents. Those documents were generated by Dow's outside and in-house counsel for the purpose of

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[10] As Dow recognizes (Doc. 7-2 at 26), it bears the burden of proving each element of the asserted privilege.

providing Dow tax advice (not to evaluate Dow's financial statements). Dow claimed, and the District Court found, that Dow prepared those two documents because of the prospect of litigation with the IRS over the tax treatment of Chemtech. (JA 156 n.1.) We have not challenged Dow's claim (or the court's conclusion) that the tax-advice documents satisfied Rule 26(b)(3) when they were originally generated.[11] We do, however, argue in Section C below that the United States is entitled to those documents because any work-product protection that attached was waived when the documents were provided to the Deloitte independent auditors as evidential material for evaluating Dow's financial statements.

[11] Because we have not seen the two tax-advice documents and have no independent knowledge of the circumstances of their preparation, we have no basis for challenging Dow's representations as to their function. Although we have not seen Deloitte's financial-audit document, as we demonstrate the record and the relevant authorities make plain that this document was not prepared for a litigation function.

1. An independent auditor is not a party representative

To be work product, a document must be created "by or for another party or its representative." Fed. R. Civ. P. 26(b)(3)(A). An independent auditor conducting a financial audit pursuant to the federal securities law must, as its title suggests, be independent of the public company that it audits. *See Arthur Young*, 465 U.S. at 817-818 (auditor's "'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust"). The auditor cannot, therefore, be the company's "representative." As the Supreme Court has explained, the independent auditor's function is quite different than the "private attorney's role" upon which the "*Hickman* work-product doctrine was founded." *Id.* Unlike an attorney or other party representative, the independent auditor is "a disinterested analyst charged with public obligations"; it cannot be a "confidential adviser and advocate" of the company that it audits. *Id.* These differences led the Court to conclude that privileging the independent auditor's workpapers (as the District

Court erroneously did) simply is not "a fitting analogue to the attorney work-product doctrine established in *Hickman v. Taylor*." *Id.* (citation omitted).

The District Court's assumption that the independent auditor could in any way serve a role comparable to that of a private attorney and assist a public company in its litigation preparation ignores the auditor's public-watchdog role in contravention of *Arthur Young*. Indeed, Congress has fortified that role in recent legislation mandating and regulating auditor independence. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, Tit. II ("Auditor Independence"), 116 Stat. 771-775; *see* 17 C.F.R. § 210.2-01. Given its required independence and public-disclosure obligations, the Deloitte auditors were not — and cannot be — Dow's "representative" within the meaning of Rule 26(b)(3).

2. Independent auditors generate workpapers in order to satisfy their public obligations under the federal securities laws, not in anticipation of litigation

Not only does the auditor's public-watchdog role disqualify its documents from the scope of Rule 26(b)(3), but the auditor's purpose for creating its documents does not satisfy Rule 26(b)(3)'s "anticipation of litigation" requirement. As explained above, whether they apply the "primary purpose" or the "because of" work-product test, courts uniformly recognize that the work-product doctrine does not apply to documents created "'in the ordinary course of business or for other nonlitigation purposes.'" *In re Sealed Case*, 146 F.3d at 887 (citation omitted); *accord Textron*, 2009 WL 2476475, at *8 (applying "because of" test); *El Paso*, 682 F.2d at 542 (applying "primary purpose" test). Both the relevant case law and the undisputed facts demonstrate that public companies and their auditors prepare tax-accrual workpapers in the ordinary course of business in compliance with federal securities laws, not because of litigation.

Independent auditors generate tax-accrual workpapers "in the course of a routine review of corporate financial statements" that is mandated by the federal securities laws. *Arthur Young*, 465 U.S. at 810-811, 815; *accord In re Newton*, 718 F.2d 1015, 1019 (11th Cir. 1983). Auditors generate workpapers for the purpose of determining whether there are "potential problems inherent in the corporation's financial reports" that the public needs to know about. *Arthur Young*, 465 U.S. at 818-819 & n.15. And these workpapers are generated "solely" for that financial-accounting purpose. *El Paso*, 682 F.2d at 535; *see Textron*, 2009 WL 2476475, at *8 ("only purpose" of company's tax-accrual workpapers is "to prepare financial statements"). Such documents, therefore, are not work product because the protections of Rule 26(b)(3) do not extend to documents generated in the ordinary course of business or pursuant to public filing requirements.

Consistent with this well-established law, the undisputed evidence in this case is that Deloitte's financial-audit document was generated in the ordinary course of Deloitte's annual audit of Dow's financial statements as mandated by the accounting rules and the

federal securities laws, and only for that purpose. (JA 30, 51-52.) As Dow's Director of Taxes (Curry) admitted, the Deloitte document "memorialized" a meeting between the company, its advisors, and the auditors that was "required under applicable financial accounting rules." (JA 30.) Similarly, the Deloitte partner who has been auditing Dow's financial statements for 15 years (Biddex) stated that Deloitte received information from Dow about the Chemtech transaction "[i]n connection" with Deloitte's ongoing audit and review of "Dow's consolidated financial statements." (JA 51-52.) *See also* JA 119, 123, 133-136. Dow did not — and could not — claim that Deloitte's financial-audit document was generated for litigation purposes. Rather, Dow argued only that the document "relates to the setting of a reserve amount for the Chemtech transactions." (Doc. 7-2 at 29.) Thus, the Deloitte financial-audit document was generated in order to evaluate whether Dow's financial statements complied with GAAP. That limited purpose fails to satisfy Rule 26(b)(3)'s "anticipation of litigation" requirement.

3. The District Court erred as a matter of law because it failed to analyze the function of the document created by the independent auditor, and instead extended work-product protection based solely on the document's content

In any work-product determination, the "critical" issue is the purpose or "function" for which a document is created. *Delaney, Migdail & Young, Chtd. v. IRS*, 826 F.2d 124, 127 (D.C. Cir. 1987). The District Court failed to conduct this critical inquiry regarding Deloitte's creation of its financial-audit document. Instead, the District Court focused solely on the "contents" of the Deloitte financial-audit document — which "record the thoughts of Dow's counsel regarding the prospect of litigation" — and dismissed as "of no moment" the undisputed facts that Deloitte was Dow's independent auditor and had generated the document in its auditing role. (JA 156 n.1.) By doing so, the District Court's opinion confuses content with function and thereby sidesteps this Court's work-product analysis altogether.

The District Court's disregard for the Deloitte document's function is legal error. As the First Circuit has recently held, "[i]t is not enough to trigger work product protection that the *subject matter* of a

document relates to a subject that might conceivably be litigated." *Textron*, 2009 WL 2476475, at *8. Instead, the "key issue in determining whether a document should be withheld is the function that the document serves," not its "content." *United States v. Roxworthy*, 457 F.3d 590, 595 (6th Cir. 2006). Rather than focus narrowly on the document's content (as the District Court erroneously did), courts must more broadly determine "the driving force behind the preparation of each requested document" in order to resolve work-product questions. *Nat'l Union*, 967 F.2d at 984. The driving force behind the financial-audit document is the independent auditor's public obligations under the federal securities laws, not Dow's litigation preparation. That some tax-accrual workpapers may — as a matter of content — predict the results of possible IRS litigation does not mean that those workpapers — as a matter of function — were prepared because of that litigation. *See* Dennis J. Ventry Jr., *Protecting Abusive Tax Avoidance*, 120 Tax Notes 857, 870-875 (2008).

Both the First Circuit and the Fifth Circuit have explained this distinction as it applies to tax-accrual workpapers. In *Textron*, the

First Circuit held that the work-product doctrine does not apply to documents prepared by Textron's lawyers "to support Textron's calculation of tax reserves for its audited corporate financial statements," even though the documents contained the lawyers' opinions regarding items that might be challenged by the IRS. 2009 WL 2476475, at *1, 3. As the court explained, the applicability of the work-product doctrine turns on *why* a document was prepared, not its "subject matter." *Id*. at *8 (emphasis omitted). Thus, "[e]ven if prepared by lawyers and reflecting legal thinking, '[m]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes are not under the qualified immunity provided by [Rule 26(b)(3)].'" *Id*. (quoting Fed. R. Civ. P. 26 advisory committee's note (1970)). Similarly, in *El Paso*, the Fifth Circuit stated: "While the analysis must forecast the cumulative results of IRS audit, settlement, and litigation, the tax pool analysis itself is not prepared to respond to a specific charge by the IRS or to any pending or impending lawsuit. The tax pool analysis is undertaken solely to insure that the corporation

sets aside on its balance sheet a sufficient amount to cover contingent tax liability." 682 F.2d at 535. That part of Deloitte's analysis of Dow's financial statements may — as a matter of content — refer to Dow's thoughts regarding the prospect of litigation in no way changes the undisputed fact that Deloitte recorded and analyzed those statements solely for business, not litigation, reasons. To affirm the District Court's contrary determination would create a conflict with the Fifth Circuit's *El Paso* decision and the First Circuit's *Textron* decision.[12]

C. Any work-product protection that Dow's tax advice may have enjoyed was waived when Dow shared that advice with its independent auditor

A party's disclosure of work product to a third party may waive any protection that originally attached to the document. Although

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[12] The District Court cited (JA 156 n.1) an unpublished decision that extended work-product protection to an independent auditor's workpapers solely on the basis of their content, *Regions Fin. Corp. v. United States*, 2008 WL 2139008, No. 2:06-CV-00895 (N.D. Ala. May 8, 2008), *appeal dismissed*, No. 08-13866-C (Dec. 30, 2008) (appeal dismissed after parties stipulated that Regions's production of the withheld documents mooted the appeal). In our view, *Regions* was incorrectly decided, and suffers from the same flaws as the District Court's work-product analysis. Moreover, the court in *Regions* relied heavily on the *Textron* district court's work-product determination, which has since been reversed.

work-product protection is not as easily waived as the attorney-client privilege (which is generally waived by disclosure to any third party), *United States v. Am. Tel. & Tel. (AT&T)*, 642 F.2d 1285, 1299 (D.C. Cir. 1980), "disclosure of work-product materials can waive the privilege for those materials if 'such disclosure, under the circumstances, is inconsistent with the maintenance of secrecy from the disclosing party's adversary,'" *Rockwell Int'l Corp. v. Dep't of Justice*, 235 F.3d 598, 605 (D.C. Cir. 2001) (citation omitted). Disclosure to a potential adversary, or to a conduit to a potential adversary, is inconsistent with maintaining such secrecy and thus waives work-product protection. *See MIT*, 129 F.3d at 687 ("disclosure to an adversary, real or potential, forfeits work product protection"); *In re Raytheon*, 218 F.R.D. 354, 360 (D. Mass. 2003) (disclosure to a "conduit to a potential adversary" waives work-product protection).[13]

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[13] The District Court did not address Dow's claim that its tax-advice documents were protected by the attorney-client or tax practitioner-client privileges. Even if those privileges applied to the documents, the privileges were waived by Dow's disclosure of the documents to a third party. *See In re Grand Jury*, 475 F.3d 1299, 1305 (D.C. Cir. 2007); *El Paso*, 682 F.2d at 541; *First Fed. Sav. Bank of*

(continued...)

This Court examines "[t]hree main factors" to determine whether work-product protection has been waived: (i) whether the party claiming the privilege "'seeks to use it in a way that is not consistent with the purpose of the privilege'"; (ii) whether the "'party had no reasonable basis for believing that the disclosed materials would be kept confidential'"; and (iii) whether "'waiver of the privilege in these circumstances would not trench on any policy elements now inherent in this privilege.'" *United States v. The Williams Companies, Inc.*, 562 F.3d 387, 394 (D.C. Cir. 2009) (quoting *In re Subpoenas Duces Tecum*, 738 F.2d 1367, 1372 (D.C. Cir. 1984)). Applying those factors to the facts of this case, Dow has waived any work-product protection in the three withheld documents. The District Court's contrary analysis cannot withstand scrutiny.[14]

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[13](...continued)
Hegewisch v. United States, 55 Fed Cl. 263, 268-269 (2003).

[14] Other than the original First Circuit opinion in *Textron* (which has now been vacated, *see* above n.6), no appellate court has directly addressed the specific question whether disclosing information to independent auditors waives work-product protection, and the district courts are split on the issue, as described below.

1. Under this Court's work-product-waiver test, the District Court should have concluded that Dow had waived any work-product protection in the three withheld documents

With regard to this Court's first factor, Dow's transfer of its work product to Deloitte is not "consistent with the promotion of trial preparation within the adversary system." *AT&T*, 642 F.2d at 1300; *see Castle v. Sangamo Weston, Inc.*, 744 F.2d 1464, 1466 (11th Cir. 1984) (no waiver where work product is disclosed to a third-party with which the party claiming work-product protection was "engaged in the preparation of a joint trial"). Dow disclosed its work product to Deloitte for the sole purpose of promoting the accuracy of its financial statements and obtaining an auditor's certification, not promoting litigation preparation. (JA 30, 51-52, 119, 123-124, 133-136.)

With regard to this Court's second factor, Dow did not have a reasonable basis for believing that the disclosed materials would be kept confidential. Independent auditors disclose company information to potential adversaries in several ways. The auditor could determine that portions of a company's confidential analysis of its tax transactions

must be publicly disclosed in the footnotes to the financial statements in order to present an accurate picture of the company's financial health. *See* Financial Accounting Standards Board (FASB), Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (available at www.fasb.org); FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) (available at www.fasb.org); AICPA, *Practice Guide on Accounting for Uncertain Tax Positions under FIN 48* (2006). The auditor could testify in proceedings brought against public companies by the SEC or private parties.[15] And the SEC is

[15] Independent auditors sometimes disclose their clients' confidential communications and their own work product to demonstrate to regulatory agencies, creditors, and investors that the auditor has properly performed its public function. *E.g., Pegasus Fund, Inc. v. Laraneta*, 617 F.2d 1335 (9th Cir. 1980) (auditor produces its workpapers to show it had no reason to know of client's misconduct); *Oleck v. Fischer*, 623 F.2d 791 (2d Cir. 1980) (auditor testified regarding reserves appearing in client's financial statement); *SEC v. Price Waterhouse*, 797 F. Supp. 1217, 1222, 1225 (S.D.N.Y. 1992) (auditor testified about "problem areas" in audit and how "reserve figure" was calculated).

"entitled" to obtain a company's confidential tax-accrual information from the auditor, as is the IRS.[16] *Arthur Young*, 465 U.S. at 820.

Indeed, the opportunities for disclosure to the SEC and the public have expanded since *Arthur Young* was decided. In 1995, Congress enacted Section 10A of the Securities and Exchange Act, which imposes an affirmative and absolute duty on independent auditors to make certain disclosures to the SEC regarding company violations of law, rule, or regulation. 15 U.S.C. § 78j-1. Even if auditors do not routinely make such disclosures to the SEC, the potential is present in every audit. *See* Riesenberg, *Trying to Hear the Whistle Blowing: The Widely Misunderstood 'Illegal Act' Reporting Requirements of Exchange Act*

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[16] In *Arthur Young*, the Supreme Court held that the IRS could obtain an auditor's tax-accrual workpapers, even though the workpapers analyzed potential litigation and contained other "confidential" information from the taxpayer, as the Second Circuit's opinion emphasized. *See Arthur Young*, 677 F.2d 211, 215, 217, 219-220 (2d Cir. 1982) (workpapers "predict[ed] the chances that the taxpayer's position will be upheld by the courts" and included "confidential" information from the taxpayer regarding its "thoughts and theories" about its tax-return positions). In reversing the Second Circuit, the Supreme Court did not reverse any of the findings about the workpapers' content, only the ruling that the content warranted protection.

Section 10A, 56 Bus. Law. 1417, 1438 (Aug. 2001) (under Section 10A, "significant violations of the tax" laws must be disclosed to the SEC). And the trend in accounting standards (as evidenced by FIN 48) is for more, not less, candid disclosure regarding tax positions in the financial statements.[17]

In the District Court, Dow relied on Section 301 of the AICPA's Code of Professional Conduct to support its argument that Deloitte was not a conduit to potential adversaries and that it had a reasonable basis for expecting Deloitte to preserve the confidentiality of its documents. (Doc. 7-2 at 14-15.) (A copy of Section 301 is located at JA 55.) Dow's reliance is misplaced. Although Section 301 generally obligates the independent auditor to keep a company's information

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[17] Under the current auditing standards for uncertain tax positions (FIN 48), the information required to be disclosed in the footnotes is even more extensive than the standard that applied under Statement of Financial Accounting Standards No. 5. For example, under FIN 48, if there is a reasonable probability that an income-tax reserve will change in the following 12 months, a company must disclose the "nature of the uncertainty," an "estimate" of the uncertain tax benefits, and the reason for the change. FIN 48 ¶ 21. Moreover, companies must now include a table in the financial-statement footnotes that discloses their balance of contingent tax liabilities. *Id.*; AICPA, *Practice Guide – FIN 48*, at 7.

confidential, it does not preclude the auditor from being a conduit to potential adversaries. Section 301 is expressly subject to the accountant's "obligation to comply with a validly issued and enforceable subpoena or summons" as well as with "applicable laws and government regulations." (JA 55.) Such qualified assurances of confidentiality cannot support a no-waiver determination. *See Williams*, 562 F.3d at 395 (determining that party claiming work-product protection had no reasonable basis for believing that the Government would keep the disclosed materials confidential where, among other things, the Government stated that it would preserve the party's confidentiality "to the extent possible").

Finally, as to this Court's third factor, public policy does not favor an exception to waiver for disclosure to independent auditors. As the Supreme Court noted in *Arthur Young*, permitting the Government access to an auditor's tax-accrual workpapers would not chill communications between public companies and independent auditors, and denying the Government access "might well undermine the public's

confidence in the independent auditing process." 465 U.S. at 818-819 & n.15. As the Supreme Court explained:

> By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust. *To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations*.

Arthur Young, 465 U.S. at 817-818 (emphasis added and omitted).

2. The District Court's contrary decision cannot withstand scrutiny

In the proceeding below, the United States and Dow summarized the waiver inquiry as turning on whether Deloitte was a potential adversary or a conduit to a potential adversary. (JA 113, 137.) In this regard, the United States contended that Deloitte was a "conduit to other potential adversaries, such as the SEC." (Doc. 8 at 5; JA 113.) The District Court ignored this contention in its opinion, stating only

that (in its view) Deloitte was not a "potential adversary." (JA 157.) The District Court's waiver determination cannot withstand scrutiny because the court (a) failed to explain why independent auditors are not potential adversaries of the public companies that they audit, (b) disregarded the auditor's public-watchdog function (recognized in *Arthur Young* and reinforced in Sarbanes-Oxley), which mandates that an auditor be (when warranted) a conduit to potential adversaries, and (c) relied on faulty district court decisions.

a. The independent auditor is a potential adversary of the public company that it audits. The District Court's contrary ruling was not explained and ignores the fact that independent auditors are obligated to review and evaluate a public company's financial statements and that disputes could arise between the company and the auditor over the company's financial statements. If an auditor is unable to certify that the company's financial statements comply with GAAP, then the auditor must issue a "qualified" or "adverse" opinion regarding the financial statements, which could cause the company to suffer "serious consequences." *Arthur Young*, 465 U.S. at 818-819 & n.14. If such a

conflict arises between the company and the auditor, then the company may be precluded from publicly trading its stock. *See* Ventry, *Protecting Abusive Tax Avoidance*, 120 Tax Notes at 872.

In an analogous situation, the First Circuit has ruled that a Government auditor could be a potential adversary of a Government contractor because disputes could arise between the parties during the audit. In *MIT*, the court ruled that work-product protection was waived when MIT (a Defense Department contractor) provided work-product documents to the auditing agency of the Defense Department, even though the agency's regulations and practices had led MIT to expect the agency to preserve the documents' confidentiality and the agency in fact refused to produce the documents to the IRS. 129 F.3d at 683. There, the court determined that the auditor was a "potential adversary" because it did not "share[ ] a common legal interest" with MIT, and its review of "MIT's expense submissions" created "the potential for dispute and even litigation." *Id*. at 687.

Similarly, here, Dow and Deloitte do not share a common litigation interest and have a potentially adversarial relationship

(depending on how accurate Dow's financial statements are). *E.g., Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113, 116-117 (S.D.N.Y. 2002) (disclosure to independent auditor waives work-product protection); 23 Wright & Graham, Fed. Prac. & Proc.: Evidence § 5427, at 809 (1980) ("ethical duties to persons relying on the accountant's reports puts him in a much more adversarial role with respect to the client"). In this regard, the District Court's attempt to distinguish *MIT* is unavailing. The court's statement that Deloitte had no "obligation" to review the accuracy of Dow's submissions (JA 157 n.2) is incorrect. Like the auditor in *MIT* that reviewed MIT's expense submissions for accuracy, Deloitte is obligated by the federal securities laws and accounting rules to review Dow's financial statements for accuracy (JA 30). And although Deloitte generally would not sue Dow as a result of its auditing obligations, Deloitte could issue an adverse opinion. *See Arthur Young*, 465 U.S. at 818-819 & n.14. Such an adverse result could preclude Dow from having its stock publicly traded, a far more devastating outcome than a lawsuit to recover overcharges.

b. The independent auditor is also a conduit to other potential adversaries. The District Court's implicit denial of this fact disregards the Supreme Court's contrary analysis in *Arthur Young*. There, the Court — emphasizing the auditor's "public watchdog" role — determined that the auditor's "ultimate allegiance [is] to the corporation's creditors and stockholders, as well as to the investing public," *i.e.*, to potential adversaries. 465 U.S. at 818. In discharging its public obligations, the auditor is required to "notif[y] the investing public of possible potential problems inherent in the corporation's financial reports." *Id.*; *see* Sarbanes-Oxley Act of 2002, Tit. II ("Auditor Independence"); 15 U.S.C. § 78j-1. Indeed, to deny that Deloitte acts on behalf of the public or that conflict could arise between the auditor and the company (as the District Court erroneously did (JA 156-157)) is to deny the very purpose of having public companies file audited financial statements. That Deloitte could disclose information to other parties, such as the SEC, who could, in turn, file a lawsuit against Dow, renders irrelevant the District Court's supposition (JA 157 n.2) that Deloitte could not sue Dow.

In this regard, the District Court's conclusion that "no evidence suggests that it was unreasonable for Dow to expect Deloitte USA to maintain confidentiality" (JA 157) is misconceived. Law and accounting rules mandating disclosure make it unreasonable for Dow to expect complete confidentiality from Deloitte. And Section 301 of the AICPA's Code of Professional Conduct — which Dow submitted as evidence (JA 55) — *does* suggest that it would be unreasonable for Dow to expect Deloitte to maintain confidentiality at the expense of its legal and professional disclosure obligations.

c. Finally, the District Court's reliance (JA 157) on district court decisions holding that disclosure of information to independent auditors does not waive work-product protection is misplaced. First, one of the two decisions cited by the District Court, *Textron*, has since been vacated. 2009 WL 2476475, at *10. Second, the District Court ignored contrary decisions, such as *Medinol*, holding that disclosure to an independent auditor does waive work-product protection. The decisions finding waiver are more persuasive (although fewer in number) than those reaching a contrary conclusion because they recognize the

independent auditor's public-watchdog function outlined in *Arthur Young* and its potentially "adversarial role" (to use the words of a leading treatise) regarding the company's financial statements, 23 Wright & Graham, § 5427, at 809. *See Medinol*, 214 F.R.D. at 114 ("in order to be effective, [independent auditors] must have interests that are independent of and not always aligned with those of the company"); *In re Diasonics Sec. Litig.*, No. C-83-4584-RFP, 1986 WL 53402, at *1 (N.D. Cal. June 15, 1986) (disclosure to independent auditor waives work-product protection because the auditor "has responsibilities to creditors, stockholders, and the investing public which transcend the relationship").

In contrast, courts finding no waiver are of the view that the company and the auditor shared common interests and therefore the auditor could not be "a conduit to a potential adversary." *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 446 (S.D.N.Y. 2004); *Gutter v. E.I. Dupont & Co.*, No. 95-CV-2152, 1998 WL 2017926, at *5 (S.D. Fla. May 18, 1998); *In re Pfizer Inc. Sec. Litig.*, No. 90 Civ. 1260, 1993 WL 561125, at *6 (S.D.N.Y. Dec. 23, 1993). These courts did not

consider the extent to which law and accounting standards required disclosure of information provided to auditors. Instead, these courts relied on policy considerations that were expressly rejected by the Supreme Court in *Arthur Young*, 465 U.S. at 818-819. *See Merrill Lynch*, 229 F.R.D. at 449 (reasoning that finding a waiver would "discourage corporations from conducting a critical self-analysis and sharing the fruits of such an inquiry" with their auditors) (citing *Arthur Young*, 677 F.2d at 220, *rev'd on this point by* 465 U.S. 805). Indeed, not only did the Supreme Court reject the argument (espoused by the Second Circuit in *Arthur Young* and by district court decisions like *Merrill Lynch*) that disclosure would have a chilling effect on candid analysis, see above n.9, the Court further opined that "insulation of tax accrual workpapers from disclosure might well undermine the public's confidence in the independent auditing process." 465 U.S. at 819 n.15. The District Court's no-waiver ruling has that same impermissible effect.

CONCLUSION

The District Court's order denying the United States's motion to compel should be reversed.

Respectfully submitted,

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SEPTEMBER 2009

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(s)_____
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Dated: September 14, 2009

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It is hereby certified that on this 14th day of September, 2009, the foregoing appellant's brief was filed electronically with the Clerk of the Court using the ECF system. On that same date, eight paper copies were mailed to the Clerk by First Class Mail, and service of this brief was made on counsel for the appellee and the intervenor by sending an electronic copy to, respectively, mwarden@Sidley.com and hartman.blanchard@bingham.com, and by mailing two copies thereof by First Class Mail to counsel at each address set forth below, properly addressed as follows:

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