[ORAL ARGUMENT SCHEDULED FOR FEBRUARY 26, 2010]

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

REPLY BRIEF FOR THE APPELLANT

JOHN A. DiCICCO
Acting Assistant Attorney General

GILBERT S. ROTHENBERG
Acting Deputy Assistant Attorney General

ROBERT W. METZLER (202) 514-3938
JUDITH A. HAGLEY (202) 514-8126
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

Of Counsel:

CHANNING D. PHILLIPS
United States Attorney

Page

TABLE OF CONTENTS

Page(s)

TABLE OF AUTHORITIES

Cases:

* Authorities chiefly relied upon are marked by asterisks.

Page(s)

Cases (continued):

Page(s)

Statutes:

Miscellaneous:

GLOSSARY

Abbreviation	Definition
AT&T	American Telephone & Telegraph
Chemtech	Chemtech Royalty Associates, L.P. and Chemtech II, L.P.
Deloitte	Deloitte & Touche USA LLP
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

SUMMARY OF ARGUMENT

In our opening brief, we explained why the District Court erred in refusing to grant the United States's motion to compel production of an independent auditor's (Deloitte's) workpapers, both as to (i) the document generated by Deloitte during its audit of Dow Chemical's financial statements (the Deloitte Memo), and (ii) the tax advice generated by Dow's tax advisors and used by Deloitte in auditing Dow's financial statements. With regard to the Deloitte Memo, we relied on the fact that it has been settled law since 1984 that the IRS is entitled to obtain an independent auditor's analysis of a taxpayer's contingent tax liabilities, including the auditor's incorporation of a public company's confidential information regarding its questionable tax-return positions. *See United States v. Arthur Young & Co.*, 465 U.S. 805 (1984). With regard to the documents generated by Dow's tax advisors, we demonstrated that, although such documents were eligible for work-product protection when they were originally generated, Dow waived that protection by disclosing them to the independent auditor.

1. Dow has failed to demonstrate that the Deloitte Memo qualifies as work product. Dow admits (Br. 23) that "the Deloitte Memo was

prepared as part of Deloitte's review of Dow's tax contingency" in order to certify Dow's financial statements. Dow contends that the Deloitte Memo is nevertheless eligible for work-product protection because (in its view) (i) the fact that the auditor prepared the document is irrelevant, (ii) the Memo contains "preexisting work product" (Br. 23), and (iii) a document's content — not its function — governs the work-product question. Those contentions are factually and legally flawed. A document's preparer is relevant under the plain terms of Rule 26. Moreover, the Deloitte Memo does not contain "preexisting work product"; rather, it records a meeting held to evaluate Dow's financial-statement tax reserve, not to prepare for litigation. And even if the Deloitte Memo did contain what — in another context — might be considered work product, the Memo would not qualify for protection because work-product determinations are based on a document's function, not its content. The function of the Deloitte Memo, and the analysis contained therein, was to evaluate Dow's financial statements. As such, the Deloitte Memo is not work product under this Court's work-product test, which does not protect documents generated in the

ordinary course of business or for nonlitigation purposes. To hold otherwise would create a conflict with the First and Fifth Circuits, which have both held that a lawyer's contingent-tax-liability analysis generated for financial-accounting purposes is not work product because it is created in the ordinary course of business pursuant to regulatory requirements.

2. Dow has also failed to demonstrate that providing its tax advice to the independent auditor did not waive work-product protection. Disclosure of work product to a potential adversary, or a conduit to a potential adversary, waives the protection. Dow contends that Deloitte is not an actual adversary, but disregards the fact that, as a public watchdog, the independent auditor is — and must be — a *potential* adversary that stands ready to issue an adverse opinion about the public company's financial statements. Moreover, Dow has failed to effectively respond to our argument that the independent auditor is also a conduit to potential adversaries. In particular, Dow has no response to our argument that the auditor is a conduit to the IRS. Under *Arthur Young*, the IRS has the right to obtain an auditor's

workpapers, which, in turn, must record and evaluate the taxpayer's own analysis of its uncertain tax positions. 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

A. Dow has failed to demonstrate that documents prepared by an independent auditor to comply with the federal securities laws qualify for Rule 26's work-product protection

In our opening brief (at 32-36), we demonstrated that the Deloitte Memo could not, as a matter of law, satisfy Rule 26(b)(3)'s requirements: (i) an independent auditor — as a public watchdog — must be independent of the company that it audits and cannot therefore be a party's representative within the meaning of Rule 26(b)(3), and (ii) the auditor's workpapers are generated to comply with its obligations under federal securities laws, not in anticipation of litigation within the meaning of Rule 26(b)(3). We further demonstrated that an auditor's workpapers could not qualify for work-

product protection even if (as here) they contained a taxpayer's confidential analysis of its questionable tax positions that was generated in order to comply with accounting rules and the federal securities laws. *See* Gov't Br. 26-28, 37-40. Although this Court has not yet addressed whether a taxpayer's tax-reserve analysis is protected work product, it has held (consistent with other circuits) that 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 881, 887 (D.C. Cir. 1998) (citation omitted). Every appellate court that has addressed the issue has concluded that a lawyer's analysis of potential tax liabilities generated for financial-accounting purposes is not work product because it is created in the ordinary course of business pursuant to regulatory requirements. *See United States v. Textron Inc. & Subsidiaries*, 577 F.3d 21, 22, 30 (1st Cir. 2009) (en banc) (holding that the "work product doctrine" does not apply to litigation analysis prepared by public company's attorneys "to support [the company's] calculation of tax reserves for its audited corporate financial

statements" because that analysis was "prepared in the ordinary course of business"); *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"); *United States v. El Paso Co.*, 682 F.2d 530, 542-544 (5th Cir. 1982) (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 created by a company's lawyers 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).

In response, Dow does not claim that Deloitte was acting as a "party representative" when it created the financial-audit document. Nor does Dow deny that tax-accrual workpapers are generated — as a matter of law — in the ordinary course of business so that public companies may comply with federal securities laws. Indeed, Dow admits (Br. 12) that Deloitte created the Deloitte Memo "for use in its

audit review" of Dow's financial statements, and not for any litigation purpose. *See also* JA 123 (Deloitte's counsel notes that the Deloitte Memo was "created by Deloitte personnel as part of its audit of the tax provision"). Dow nevertheless contends that the Deloitte Memo qualifies for work-product protection because (in its view) (i) Dow's counsel, not Deloitte, is the relevant party representative for purposes of Rule 26 (Br. 21), (ii) the Deloitte Memo "contains the opinion work product of Dow's attorneys" (Br. 11, 26), and (iii) the document's content — not its function — determines work-product protection (Br. 22-27). As demonstrated below, Dow's contentions lack merit.

Before addressing those arguments, we briefly address Dow's speculation that the United States seeks this information for the sole purpose of "gaining insight into Dow's litigation strategy" (Br. 11; *see also* Br. 38-39). That speculation is unfounded. The central issue in the Chemtech litigation is whether the partnership is a sham, and to determine whether a transaction is a sham for tax purposes, the parties must look beyond the formal transaction documents and discover the substance of the transaction. By requesting all documents from

Deloitte that described the partnership transactions, the United States sought evidence of the transactions' substance, as we pointed out in our opening brief (at 9) and Dow simply disregards. In order to properly analyze the transactions for financial-reporting purposes, Dow and its advisors should have examined the substance of the partnership transactions. It is that candid assessment of how the partnership transactions were really intended to work that the United States seeks in this litigation. *See, e.g.*, *BB&T Corp. v. United States*, 523 F.3d 461, 469 n.10 (4th Cir. 2008) (relying on how a party's "tax advisors characterized the transaction" in determining that the transaction's substance did not match its form); *Tribune Co. v. Commissioner*, 125 T.C. 110, 135 (2005) (relying on taxpayer's representations to shareholders that transaction was in substance a sale in case where taxpayer represented to the IRS that transaction was a tax-free reorganization).[1]

---

[1] Dow's related suggestion (Br. 5) that the documents contain only legal analysis finds no support in the record or in the District Court's decision. Dow's declarants did not testify (JA 28-31, 51-52) — and the District Court did not find (JA 156) — that the three

(continued...)

1. The United States properly focused on the fact that the Deloitte Memo was prepared by an independent auditor

Unable to deny that Deloitte is not a party representative for purposes of Rule 26, Dow instead contends that the preparer of a document claimed to be work product is irrelevant for determining work-product protection, and that the "relevant 'representative' for purposes of the work product at issue in the Deloitte Memo is outside counsel for Dow" (Br. 14-15, 21). Dow provides no support for that contention. The plain language of Rule 26 provides protection for documents "prepared . . . by or for another party or its representative" and thus focuses on the document's preparer. Here, the Deloitte Memo was prepared by Deloitte, not Dow's counsel. And the analysis in the Memo was generated by Deloitte, even if part of Deloitte's analysis quotes, summarizes, or critiques that of Dow's counsel. *See* JA 61.

---

[1](...continued)
documents contained only legal, as opposed to factual, analysis. Indeed, according to the privilege log, the 1998 tax-advice document contains a "Flow Chart" (JA 17), and flow charts are typically factual in nature. Dow's suggestion is also irrelevant. *See In re Sealed Case*, 676 F.2d 793, 811, 817 (D.C. Cir. 1982) (holding that corporation waived work-product protection of "opinion work product").

Arthur Young is instructive on this point. There, the Supreme Court refused to create an accountant's privilege to protect an auditor's tax-accrual workpapers, even though (as here) the auditor's workpapers recorded the taxpayer's confidential evaluation of its uncertain tax positions. The Second Circuit in that case had created such a privilege, and focused on the fact that the auditor's documents recorded the taxpayer's confidential views regarding possible litigation. *Arthur Young*, 677 F.2d 211, 215, 217, 219-220 (2d Cir. 1982) (protecting auditor's workpapers that "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's ruling, the Supreme Court noted that the 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, even though those workpapers "document[ed] the auditor's interviews with corporate personnel," *id.* at 812-813.

2. The Deloitte Memo does not contain preexisting work product

Attempting to distinguish *Arthur Young* and other cases that refused to protect tax-accrual workpapers, Dow contends that the Deloitte Memo records "preexisting" work product (Br. 27, 28 n.9). That contention finds no support in the District Court's opinion or the record.

The District Court did not find that the Deloitte Memo recorded preexisting work product. Rather, the court found that the Memo itself "was prepared because of the prospect of litigation with the IRS," and "record[ed] the thoughts and impressions of Dow's attorneys concerning tax issues related to Chemtech" (JA 156 n.1). In this regard, the United States *does* dispute Dow's contention that the attorney communications recorded in the Deloitte Memo were generated "because of" litigation, and Dow's claim to the contrary (Br. 21) is incorrect. As we spelled out in our opening brief (at 12), Dow's outside counsel discussed the Chemtech transaction at the meeting with the auditors "for purposes of establishing an adequate reserve for

contingent tax liabilities on Dow's financial statements," and that discussion was "'required under applicable financial accounting rules'" (quoting JA 30). *See also* Gov't Br. 35-36. As Dow concedes (JA 30), those accounting rules required Dow to analyze the Chemtech transaction and communicate that analysis to its auditors whether or not Dow anticipated litigating the issue. (JA 60-61.) *See also* JA 134 (describing how Dow's inside and outside counsel assessed Dow's financial-statement tax contingency reserves and relayed that assessment to Deloitte). Moreover, Dow further concedes (Br. 8-9) that the required tax-reserve analysis must address "any uncertain tax positions," not just those for which litigation is anticipated. *See Textron*, 577 F.3d at 27-28. Therefore, Dow's contention (Br. 26) that its attorneys "would never" have opined on the tax issues related to the Chemtech transaction but for the fact that it anticipated litigating those issues is simply incorrect.

To the extent that Dow is arguing that it would not have used attorneys to opine on the Chemtech transaction if it did not anticipate litigating the tax issues, that argument misses the mark. Taxpayers

"must not be allowed, by hiring a lawyer," instead of "an accountant," to "obtain greater protection from government investigators than a taxpayer who did not use a lawyer." *United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999); *accord United States v. Bisanti*, 414 F.3d 168, 171-172 (1st Cir. 2005). Moreover, the work-product doctrine "is not an umbrella that shades all materials prepared by a lawyer." *El Paso*, 682 F.2d at 542.[2]

Although the United States has conceded that the 1998 and 2005 Dow tax-advice documents were preexisting work product that was given to the auditors, the Deloitte Memo — written five years before the first of those tax-advice documents was penned — does not record

---

[2] The mere fact that a tax lawyer has provided a litigation-hazards assessment to a taxpayer does not mean that the lawyer has created work product. Before tax benefits like those generated by the Chemtech transaction may be claimed on a tax return, the Internal Revenue Code and implementing regulations require taxpayers and their advisers to assess various levels of certainty that a tax position would be sustained in litigation. *See* I.R.C. §§ 6662, 6694; Ventry, *Protecting Abusive Tax Avoidance*, 120 Tax Notes 857, 873-874 (2008). For example, to avoid a substantial-understatement penalty, a taxpayer must demonstrate that it reasonably believed that it had a "40 percent to 50 percent level of confidence that the position would be sustained on its merits." *Id.* at 874.

those documents. In this regard, the Deloitte Memo is not of the "same character" or "function" as the two Dow tax-advice documents, as Dow erroneously contends (Br. 20, 23). The communications in the Deloitte Memo relate to Dow's financial-statement tax reserve, whereas the communications in the 1998 and 2005 tax-advice documents do not. And the function of the attorney's analysis during the meeting with the auditors was — unlike the function of the analysis in the two tax-advice documents — to satisfy Dow's financial-audit obligations, not to prepare Dow for litigation.[3]

---

[3] Moreover, any tax advice that Dow received in 1993 when it entered into the Chemtech partnership is too far removed in time to qualify as work product. *See Coastal States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 865 (D.C. Cir. 1980). That Dow may have anticipated a "challenge" by the IRS when it entered into the partnership in 1993 (Br. 7) does not mean that Dow reasonably anticipated litigation at that time. *See Consolidated Edison Co. v. United States*, __ Fed. Cl. __, 2009 WL 3418533, No. 06-305T, at *22-24 (Oct. 21, 2009) (tax opinions were not work product). An administrative dispute with the IRS is not litigation. *E.g., Frederick*, 182 F.3d at 502 ("audit is both a stage in the determination of tax liability, often leading to the submission of revised tax returns, and a possible antechamber to litigation"); *Abel Inv. Co. v. United States*, 53 F.R.D. 485, 488-489 (D. Neb. 1971) (IRS documents created during an audit were not work product, even though they "contain mental impressions, legal theories, and assessments of the strengths and

(continued...)

In addition, there is no evidence — and Dow has never claimed — that the Deloitte Memo contains *only* statements provided by Dow's counsel. On the contrary, both Deloitte auditors and Dow personnel attended the meeting, and therefore it is reasonable to assume that the Deloitte Memo records more than just the opinions of Dow's counsel. Indeed, the District Court did not (and, given its failure to review the documents, could not) find that the Deloitte Memo recorded only the opinions of Dow's counsel.

But even if the Deloitte Memo recorded only the analysis of Dow's counsel, that would not transform the auditor's notes into preexisting work product. In *Arthur Young*, the Supreme Court held that the United States is entitled to the auditor's analysis of a taxpayer's financial-statement tax reserve. As part of its analysis, the auditor must document "significant elements of the [company's] tax liability contingency analysis." (JA 61.) Therefore, to understand the auditor's conclusions, one must have a complete record of the auditor's analysis,

---

[3](...continued)
weaknesses of the government's case," because an IRS audit is not litigation).

including the auditor's discussion and assessment of the company's analysis. As the Supreme Court has explained:

> The auditor's tax accrual workpapers record this process of examination and analysis. *Such workpapers may document the auditor's interviews with corporate personnel*, judgments on questions of potential tax liability, and suggestions for alternative treatments of certain transactions for tax purposes. Tax accrual workpapers also contain an overall evaluation of the sufficiency of the corporation's reserve for contingent tax liabilities, including an item-by-item analysis of the corporation's potential exposure to additional liability.

465 U.S. at 812-813 (emphasis added). The Deloitte Memo recorded Dow's counsel as evidential support for Deloitte's audit of Dow's financial statements. That document — and any analysis recorded therein — became part of the auditor's independent analysis and documentation that the United States is, as a matter of well-established law, entitled to obtain.

3. Even if the Deloitte Memo contained preexisting work product, a document's function — not its content — determines whether it was generated "because of" litigation and therefore qualifies for work-product protection

In our opening brief (at 37-40), we demonstrated that the District Court erred as a matter of law because it failed to analyze the function

of the auditor's document, and instead extended work-product protection based solely on the document's content. In response, Dow contends (Br. 22-27) that the District Court "Properly Focused on the Content in the Deloite Memo." That contention conflicts with the "because of" work-product test applied by this Court as well as other courts. *See* Gov't Br. 37-38 (collecting cases). The "because of" work-product test does not protect any document that — as a matter of content — discloses an attorney's "thoughts, mental impressions, and legal opinions" regarding "likely litigation" (as Dow claims (Br. 26)). Instead, the test's aim is to determine a document's causation, not its contents, and therefore the test protects documents *generated because of* anticipated litigation, not documents *describing* anticipated litigation. As this Court has explained, 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), regardless of the document's content. Instead, the doctrine applies only 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.'" *Id.* at 884 (citation omitted). That tax-accrual workpapers could (in some instances) describe anticipated litigation does not mean that they are generated because of litigation. The context for their creation remains the federal securities laws which mandate that these documents be created in the first place, as both the First Circuit in *Textron* and the Fifth Circuit in *El Paso* (discussed in the following section) have both squarely held.

Indeed, *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998) — a case heavily relied upon by Dow — illustrates this point. In *Adlman*, the court addressed a memorandum that evaluated the "likely outcome of litigation expected to result from [a proposed] transaction" and remanded the case to the district court to determine whether the memorandum was generated "as part of the ordinary course of business of undertaking the restructuring." *Id.* at 1197, 1204. If (as Dow suggests) any document that contains a party's evaluation of

anticipated litigation is protected work product, then there would have been no need for the remand in *Adlman*.[4]

Other decisions applying the "because of" work-product test further undermine Dow's proposition that the test protects any documentation of an attorney's thoughts about an anticipated dispute. For example, in *In re OM Group Securities Litigation*, 226 F.R.D. 579, 586-587 (N.D. Ohio 2005), the court held that certain documents created by a public company's Audit Committee's outside counsel "for [the] dual purposes" of "the possibility of litigation and business impact on past earnings and financial statements" were "not protected by the work-product doctrine." As the court explained, such documents would have been generated in the absence of the pending litigation because "[a]ccuracy of earnings and financial statements is clearly a business

---

[4] That logical analysis of the Second Circuit's holding is not altered by the court's statement — using a hypothetical example — that an audit memorandum should not be denied work-product protection "*merely* because the document was created for a business purpose." *Adlman*, 134 F.3d at 1199-1200 (emphasis added). To state that such a document does not "automatically fall outside the scope of the work-product doctrine," *id.* at 1201, does not mean (as Dow contends (Br. 45)) that it automatically falls in.

matter for all publicly-held corporations, regardless of whether litigation is pending or anticipated." *Id.* at 587; *see also In re Royal Ahold Sec. & ERISA Lit.*, 230 F.R.D. 433, 435 (D. Md. 2005) (no work-product protection for documents created to satisfy independent auditors, even though "company was also preparing for litigation"); *In re Grand Jury Subpoena*, 220 F.R.D. 130, 156, 159, 162 (D. Mass. 2004) (documents that otherwise would be "opinion work product" that were generated as part of a company's "ordinary efforts to remain in compliance with regulations" were not protected under "because of" work-product test, which "simply does not extend to such 'ordinary course of business' transactions"); Barrett, *Opportunities for Obtaining & Using Litigation Reserves & Disclosures*, 63 Ohio St. L. J. 1017, 1093 (2002) ("Because enterprises often undergo annual audits, the response to an audit inquiry letter probably falls in 'the ordinary course of business' category.").

Delaney, Migdail & Young, Chtd. v. IRS, 826 F.2d 124 (D.C. Cir. 1987), is not to the contrary and does not — as Dow contends (Br. 23) — support the District Court's work-product ruling. There, the party

seeking the documents essentially conceded that they were "prepared in anticipation of litigation," and, accordingly, the Court did not perform a causation analysis. *Id.* at 126. Thus, there was no question (as there is here) as to whether the documents would have been generated irrespective of litigation, and there was no evidence that the documents were generated to comply with federal law. Moreover, the Court emphasized that the work-product doctrine does not cover all legal analysis performed by an attorney (as Dow suggests), but was instead "limited" to that analysis done "in anticipation of litigation." *Id.*; *see also Abel Inv.*, 53 F.R.D. at 488 (IRS denied work-product protection for documents created during an audit, even though they "contain mental impressions, legal theories, and assessments of the strengths and weaknesses of the government's case"); *Rupert v. United States*, 225 F.R.D. 154, 157 (M.D. Pa. 2004) (United States denied work-product protection for memorandum prepared by Appeals Officer that evaluated settlement).

Dow admits that the function of the Deloitte Memo was to assist Deloitte "in its audit review" of Dow's financial statements (Br. 12), and

that the Memo describes communications that were "required" by accounting rules (JA 30). Therefore, under this Court's work-product test, and consistent with other appellate courts that have addressed similar tax-reserve documents, the Deloitte Memo does not qualify for work-product protection. That the Dow tax-advice documents — which were generated years after the Deloitte Memo — may contain content similar to that found in the Deloitte Memo does not mean (as Dow contends (Br. 20-21)) that the Deloitte Memo was created "because of" litigation. Unlike the two tax-advice documents, the Deloitte Memo was created in the context of a routine, mandatory financial audit and, as such, does not qualify as protected work product.

4. To extend work-product protection to the Deloitte Memo — a document created for financial-auditing purposes — would create a conflict with the First and Fifth Circuits

As explained in our opening brief (at 38-40), both the First Circuit and the Fifth Circuit have held that a lawyer's analysis of a taxpayer's potential tax liabilities generated for financial-auditing purposes is not protected by the work-product doctrine. Dow has failed to rebut our

claim that affirming the District Court would create a conflict with those circuits.

Dow contends (Br. 27) that *Textron* is "inapposite" because it "did not involve [a] situation[ ] where the content of the document was clear work product." That contention, however, ignores the fact that both the Deloitte Memo and the workpapers at issue in *Textron* addressed the exact same topic (*i.e.*, questionable tax-return positions for which the taxpayer may owe future taxes) and were created for the exact same purpose (*i.e.*, financial-statement certification). Dow's contention also ignores the First Circuit's en banc holding, which emphasized that "[i]t is not enough to trigger work product protection that the *subject matter* of a document relates to a subject that might conceivably be litigated," and ruled that the lawyer's analysis of Textron's potential tax liabilities was not work product because it was created in the "ordinary course of business" so that Textron could "prepare financial statements." *Textron*, 577 F.3d at 29-30 (emphasis in original).[5]

---

[5] Dow also contends (Br. 31) that the Deloitte Memo's analysis is more "extensive" than that contained in Textron's "back up e-mail and

(continued...)

The First Circuit's analysis is not (as Dow contends (Br. 29)) "inconsistent" with this Court's work-product test. Like the First Circuit, this Court examines a document's function — not merely its content — and denies work-product protection to documents generated "'in the ordinary course of business or for other nonlitigation purposes.'" *In re Sealed Case*, 146 F.3d at 887 (citation omitted). Moreover, the First Circuit's common-sense statement that "the focus of work product protection has been on materials prepared for use in litigation, whether the litigation was underway or merely anticipated," *Textron*, 577 F.3d at 29, *is* consistent with this Court's case law, despite Dow's contrary claim (Br. 29). *See In re Sealed Case*, 146 F.3d at 884 ("By ensuring that lawyers can prepare for litigation without fear that opponents may obtain their private notes, memoranda, correspondence, and other

---

[5](...continued)
notes." Whether that contention is accurate or not (we have not seen any of the documents), it would not be a basis for distinguishing *Textron* because the holding in *Textron* turned on the documents' function, not their content. It bears noting, however, that Dow's privilege log does not indicate the length of the Deloitte Memo. (JA 17-18.) If a document's length were relevant to determining whether a privilege applies (which it is not), then that information would need to have been included in the privilege log.

written materials, the privilege protects the adversary process."); *United States v. AT&T*, 642 F.2d 1285, 1299 (D.C. Cir. 1980) (the "purpose of the work product doctrine" is "to encourage effective trial preparation" and to "promote the adversary system by safeguarding the fruits of an attorney's trial preparations").

Similarly lacking in merit is Dow's claim (Br. 32) that the "policy considerations at issue in *Textron*" are not present here. Again, both the First Circuit and this Court have recognized that the purpose of the work-product doctrine is "to protect the adversary trial process," "not to protect any interest of the attorney," as such, including his thought processes or conclusions. *Coastal States*, 617 F.2d at 864; *accord Textron*, 577 F.3d at 30-31 (citing *Coastal States*). The work-product doctrine was developed out of concern that production of work product would discourage attorneys from documenting their litigation preparation. *See Hickman v. Taylor*, 329 U.S. 495, 511 (1947) (explaining that, without the work-product doctrine, "much of what is now put down in writing would remain unwritten"). As in *Textron*, production here does not implicate that concern. Both Textron and

Dow *had* to analyze their potential tax liabilities in order to have their financial statements certified and to thereby remain public corporations. As such, producing that analysis to the United States — either pursuant to an IRS summons (as in *Textron*) or pursuant to civil discovery (as here) — would not create a chilling effect. Producing documents that a company must generate (either as a necessary business matter or to comply with regulatory requirements) does not chill litigation preparation. Indeed, the Supreme Court made a similar point in refusing to protect tax-accrual workpapers generated by independent auditors and incorporating the taxpayer's tax-accrual analysis. *Arthur Young*, 465 U.S. at 818-819.

To affirm the District Court would also generate a split with the Fifth Circuit, which held that a taxpayer's tax-accrual workpapers were not protected by Rule 26's work-product doctrine because they were generated in the ordinary course of business and were mandated by the federal securities laws. *El Paso*, 682 F.2d 530. Dow has failed to justify a split with the result reached in *El Paso*. That case is not "distinguishable" (Br. 31 n.12) on the basis that this Court applies the

"because of" work-product test and the Fifth Circuit applies the "primary purpose" work-product test. As explained in our opening brief (at 24-25) — and Dow simply ignores — under both tests documents generated in the ordinary course of business or irrespective of litigation (such as annual compliance with SEC regulations) are not entitled to work-product protection. Nor is the fact that El Paso used in-house attorneys to analyze its tax reserve and Dow used outside counsel to analyze its tax reserve a basis for distinguishing *El Paso*, as Dow further contends (Br. 31 n.12). In both cases, the attorneys are serving the same function — *i.e.,* analyzing potential tax liabilities so that the public company could certify that its financial statements comply with GAAP.

B. Dow's disclosure of its tax advice to the independent auditor waived any work-product protection

As explained in our opening brief (at 40-55), any work-product protection that Dow's tax advice enjoyed when it was originally generated was waived when Dow shared that advice with the Deloitte independent auditors. In this regard, Dow does not deny that it

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.) In that context, Deloitte is both a potential adversary and a conduit to potential adversaries such as the SEC and the IRS. Dow's arguments to the contrary lack merit.

1. Dow has failed to demonstrate that Deloitte is not a potential adversary. The fact that the auditor must be independent does not preclude it from being a potential adversary. Adversity is not (as Dow claims (Br. 47)) "antithetical to independence." To the contrary, the auditor must be independent so that it has the ability to render adverse results for the company that it audits, whenever warranted. As we explained in our opening brief (at 49-50) — and Dow does not deny — disputes could arise between the company and the auditor over the company's financial statements, and if the company is unwilling to change the financial statement to comply with GAAP, the auditor must issue an "adverse" opinion, which could cause the company to suffer "serious consequences." *Arthur Young*, 465 U.S. at 818-819 & n.14; *see*

Medinol, Ltd. v. Boston Scientific Corp., 214 F.R.D. 113, 116-117 (S.D.N.Y. 2002) (holding that disclosure to an independent auditor waives work-product protection, and noting that "'[G]ood auditing requires adversarial tension between the auditor and the client'") (citation omitted). That an auditor is precluded from auditing a company that has become an actual litigation adversary (Br. 47-48) does not in any way preclude the auditor from being a *potential* adversary during the auditing relationship. And to waive work product, there need only be the "potential for dispute." *United States v. MIT*, 129 F.3d 681, 687 (1st Cir. 1997)[6]; *see Bank of Am. v. Terra Nova Ins. Co.*, 212 F.R.D. 166, 170 (S.D.N.Y. 2002) ("It is not necessary [for

[6] Like the District Court, Dow's attempt to distinguish *MIT* is flawed. A fair reading of the decision demonstrates that the fact that the auditor had the "authority to sue MIT" (Br. 43) was not dispositive. As the Court explained, "MIT doubtless hoped that there would be no actual controversy between it and the Department of Defense, but the potential for dispute and *even litigation* was certainly there." 129 F.3d at 687 (emphasis added). As the emphasized language demonstrates, it was enough that the parties could have a potential dispute over the accuracy of MIT's expense submissions; actual litigation was not necessary. Similarly, here, every audit cycle brings the potential that Deloitte and Dow would dispute the accuracy of Dow's financial statements.

work-product waiver] that the disclosure be made to an actual adversary.").

The United States has not argued (as Dow suggests (Br. 42 n.15)) that "potential adversary" for waiver purposes includes any two parties that "have the potential for future conflict." On the contrary, our argument was specifically tailored to the unique role that the independent auditor plays with regard to the regulation of public companies. In this regard, Dow's attempt to analogize independent auditors (Br. 42 n.15) to attorneys is unavailing. Auditors, unlike attorneys, can preclude public companies like Dow from publicly trading their stock by refusing to issue them a clean opinion regarding their financial statements. And auditors, unlike attorneys, are statutorily required to blow the whistle on public companies that have engaged in certain legal violations, including tax law violations. *See* 15 U.S.C. § 78j-1(b)(3) & (4). Thus, disclosure of work product to an independent auditor waives protection because the auditor is a public watchdog who is legally obligated — where warranted — to disagree with the company it audits and disclose information to adversaries.

2. Dow has also failed to effectively rebut our claim that Deloitte is a conduit to potential adversaries, including the SEC and the IRS. In our opening brief (at 43-46, 52-53), we explained that the auditor is required to disclose company information to potential adversaries in several different ways, including footnote disclosures in the financial statements, in court proceedings, and disclosures pursuant to Section 10A of the Securities and Exchange Act. In response, Dow denies (Br. 49-50) that SEC regulations or accounting rules would ever require disclosure of work product. Dow is wrong, as a simple example demonstrates. If Deloitte learned that Dow's counsel had reviewed a recent court decision, and had informed Dow that (in counsel's opinion) the decision had an impact on Dow's potential tax liability, the auditor would require that information to be released to the public. *E.g.*, *Wachovia Responds to BB&T LILO Ruling By Announcing Charge of Up to $1 Billion*, 84 BNA Daily Tax Rep. G-7 (May 1, 2008) ("'applicable accounting standards require Wachovia to update the assessment of its SILO transactions in light of the *BB&T* decision'") (quoting Wachovia Press Release). Similarly, if Deloitte learned that Dow's counsel had

advised that Dow may have violated a tax law, the auditor might be required under Section 10A to inform the SEC. *See* Riesenberg, *Trying to Hear the Whistle Blowing: The Widely Misunderstood 'Illegal Act' Reporting Requirements of Exchange Act Section 10A*, 56 Bus. Law. 1417, 1438 (Aug. 2001) (Ernst & Young Associate General Counsel explains that "significant violations of the tax" laws must be disclosed to the SEC under Section 10A). And, despite Dow's suggestion to the contrary (Br. 49 n.19), accounting rules now require a company to disclose certain changes to its income-tax reserve and the reason for the change, which (again) could disclose information that the auditor received from the company's attorney. *See* Gov't Br. 46 n.17; Jones, *FASB — The IRS's New Best Friend: How FIN 48 Affects the Taxpayer-IRS Relationship and Potential Taxpayer Challenges*, 25 Ga. St. Univ. L. Rev. 767, 792 (2009) (complaining about the fact that, in limited circumstances, the "FIN 48 financial statement disclosure itself requires revelation of privileged information," and that "FIN 48 disregards the work product doctrine in favor of transparency; that is, FIN 48 places reporting companies in the unenviable position of

practically having to sacrifice protected information created in anticipation of litigation in order to comply with financial reporting rules").

In responding to our argument that the independent auditor is a conduit to potential adversaries, Dow appears to limit its arguments to whether the auditor is a conduit to the SEC (Br. 49-51), even though our opening brief expressly asserted (at 21, 45) that the auditor is also a conduit to the IRS, another potential adversary of Dow.[7] In *Arthur Young*, the Supreme Court held that the IRS could obtain the independent auditor's workpapers, including any tax-accrual analysis provided to the auditor by the taxpayer, and thus permitted the auditor to be a conduit to the IRS. 465 U.S. at 812-815; *see Arthur Young*, 677 F.2d at 218 (workpapers sought by the IRS "reflect[ed] what the *taxpayer* — and his accountant — think about transactions that have already taken place") (emphasis added); *id.* at 220 (auditor's

[7] This issue was also before the District Court. As noted in our opening brief (at 15 & n.6), the United States had submitted to the District Court as supplemental authority in support of its waiver argument the now-vacated panel decision in *Textron*, which had held that the auditor could be a conduit to the IRS (JA 100-101).

workpapers contained "not only the auditor's thoughts but also the t*axpayer's* basic thinking" and provides "a roadmap of the thoughts and theories of a *taxpayer* and its independent auditor") (emphasis added). The Court did not rule that the taxpayer (which had intervened in the proceedings) could redact its analysis from the auditor's workpapers before they were produced to the IRS. On the contrary, the Court ruled that the IRS could obtain all of the auditor's workpapers (including all of the taxpayer's "confidential" analysis provided to the auditor, 677 F.2d at 215, 219). Accordingly, because auditing standards require the auditor to review, document, and analyze the taxpayer's tax-accrual analysis (JA 60-61), and the Supreme Court has held that the IRS can obtain the auditor's workpapers, the auditor serves as a conduit to the IRS.

Finally, Dow's reliance on district court cases holding that disclosure to an independent auditor does not waive work-product protection is misplaced for several reasons. First, those decisions failed to analyze the fact that auditors can be conduits to potential adversaries such as the SEC or the IRS. Although the no-waiver

district courts recognized that the auditor's confidentiality obligations were subject to the auditor's obligation to disclose information as "required by law or accounting standards," *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 448 (S.D.N.Y. 2004), they did not consider the extent to which law and accounting standards required disclosure of information provided to auditors. Second, courts finding no waiver have reasoned that the auditor cannot be "'a conduit to a potential adversary'" because the company and the auditor "'shared common interests.'" *Id.* at 446 (citation omitted). That rationale conflicts with *MIT* (relied on by the District Court), which held that parties with a "common interest" can be potential adversaries. 129 F.3d at 686-687. Finally, the no-waiver courts rely on policy considerations that were expressly rejected by the Supreme Court in *Arthur Young*. As explained in our opening brief (at 26 n.9), the Supreme Court rejected the speculation that disclosure would "discourage corporations from conducting a critical self-analysis and sharing the fruits of such an inquiry" with their auditors, *Merrill Lynch*, 229 F.R.D. at 449 (citing *Arthur Young*, 677 F.2d 211, 220 (2d

Cir. 1982), *rev'd on this point by* 465 U.S. 805 (1984)), finding instead that responsible management would always engage in critical self-analysis and that disclosure to the IRS would foster public confidence in the auditing process. *See Arthur Young*, 465 U.S. at 819 n.15 ("insulation of tax accrual workpapers from disclosure might well undermine the public's confidence in the independent auditing process").

Although the courts are "split" on the issue, and there are (as the no-waiver courts recognize) "good arguments on both sides," *Merrill Lynch*, 229 F.R.D. at 446, we believe that the courts finding waiver have taken the better position because they follow the policy choice endorsed by the Supreme Court. *See Arthur Young*, 465 U.S. at 819 n.15 ("Endowing the workpapers of an independent auditor with a work-product immunity would destroy the appearance of [the] auditor's independence by creating the impression that the auditor is an advocate for the client.").

CONCLUSION

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

Respectfully submitted,

JOHN A. DiCICCO
Acting Assistant Attorney General

GILBERT S. ROTHENBERG
Acting Deputy Assistant Attorney General

/s/ Judith A. Hagley

ROBERT W. METZLER (202) 514-3938
JUDITH A. HAGLEY (202) 514-8126
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

Of Counsel:
CHANNING D. PHILLIPS
United States Attorney

DECEMBER 2009

CERTIFICATE OF COMPLIANCE

1. This reply brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

[X] this brief contains 6,983 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii), or

[ ] this brief uses a monospaced typeface and contains [state the number of] lines of text, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This reply brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because:

[X] this brief has been prepared in a proportionally spaced typeface using Corel Word Perfect X3 in Century Schoolbook 14 pt. type, or

[ ] this brief has been prepared in a monospaced typeface using [state name and version of word processing program] with [state number of characters per inch and name of type style].

3. The undersigned hereby further certifies that the foregoing brief filed electronically with the Court is in PDF searchable format, that the text of the PDF copy is identical to the text of the paper copy, that the PDF version has been electronically scanned for viruses with the Trend Micro OfficeScan 8.0 antivirus program (copyright 2007) and that, according to the program, no viruses were detected.

/s/ Judith A. Hagley

(s)_____
Attorney for appellant

Dated: December 2, 2009

CERTIFICATE OF SERVICE

It is hereby certified that on this 2nd day of December, 2009, the foregoing appellant's reply 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:

Michael D. Warden, Esquire
Sidley Austin LLP
1501 K Street, NW
Washington, D.C. 20005

Hartman E. Blanchard, Jr., Esquire
Bingham McCutchen LLP
2020 K Street, NW
Washington, D.C. 20006

/s/ Judith A. Hagley

JUDITH A. HAGLEY
Attorney for appellant