14-1965

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

GEORG F.W. SCHAEFFLER, INA-HOLDING SCHAEFFLER GMBH & CO. KG, SCHAEFFLER HOLDING GMBH & CO. KG, AND SCHAEFFLER HOLDING, LP,
Petitioners - Appellants,

v.

UNITED STATES OF AMERICA,
Respondent-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES AS *AMICUS CURIAE* IN SUPPORT OF APPELLANTS

Kate Comerford Todd
Warren Postman
U.S. CHAMBER LITIGATION CENTER, INC.
1615 H Street, NW
Washington, DC 20062
(202) 463-5337

Robert A. Long
Counsel of Record
Reeves C. Westbrook
Marianna Jackson
Jason Yen
COVINGTON & BURLING LLP
1201 Pennsylvania Avenue, NW
Washington, DC 20004-2401
(202) 662-6000

Counsel for Amicus Curiae Chamber of Commerce of the United States of America

September 12, 2014

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rules of Appellate Procedure 26.1, the Chamber of Commerce of the United States of America (the Chamber) is a non-profit, tax-exempt organization incorporated in the District of Columbia. The Chamber has no parent company and no publicly held company has ten percent or greater ownership in the Chamber.

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STATEMENT OF INTEREST

The Chamber of Commerce of the United States of America (the "Chamber") is the nation's largest federation of business companies and associations, with underlying membership of more than 3,000,000 businesses and professional organizations of every size and in every sector and geographic region of the country. A principal function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases raising issues of concern to the nation's business community.[1]

This case presents such an issue. The district court has interpreted the attorney work product doctrine in a way that effectively denies protection to documents created in the context of complex business transactions, even when the documents are created because of anticipated litigation and reveal mental impressions and opinions of counsel. The district court's decision is at odds with this Court's decision in *United States v. Adlman*, 134 F.3d 1194, 1195 (2d Cir. 1998), which holds that "a document created because of anticipated litigation, which tends to reveal mental impressions, conclusions, opinions, or theories

[1] Pursuant to Federal Rule of Appellate Procedure 29, the Chamber certifies that no party's counsel authored this brief in whole or in part, no party's counsel contributed money that was intended to fund preparing or submitting this brief, and no person, other than the Chamber, its members, or its counsel, contributed money that was intended to fund preparing or submitting this brief. All parties have consented to the filing of this brief.

concerning the litigation, does not lose work product protection merely because it is intended to assist in the making of a business decision influenced by the likely outcome of the anticipated litigation." As in *Adlman*¸ the district court's decision in this case presents companies with an "untenable choice." 134 F.3d *at* 1200. If a company obtains a thorough and candid analysis "reflecting the company's litigation strategy and its assessment of its strengths and weaknesses," it will be prejudiced when that analysis is turned over to its litigation adversaries. *Id.* If, on the other hand, the company "scrimps on candor and completeness to avoid prejudicing its litigation prospects, it subjects itself . . . to ill-informed decisionmaking." *Id.* In this case, as in *Adlman*, "nothing in the policies underlying the work-product doctrine or the text of the Rule itself" justifies "subjecting a litigant to this array of undesirable choices." *Id.*

SUMMARY OF THE ARGUMENT

1. The district court misapplied this Court's decision in *Adlman*. The district court acknowledged that litigation was highly probable and that the document at issue contained legal strategy and analysis. The district court nevertheless denied work protection by leaping much too quickly from a determination that the company would have *sought* legal advice even if it had not anticipated litigation to an unjustified conclusion that the advice would have taken the same *form* regardless of whether litigation was anticipated.

2. The district court's holding is contrary to the policy goals underlying the work product doctrine, as set forth in *Adlman* and *Hickman v. Taylor*, 329 U.S. 495 (1947). The court reasoned that the complexity of the transaction at issue, as well as the novel legal issues it raised, necessarily meant that the company would have sought detailed and lengthy tax advice from outside counsel even if it did not anticipate litigation. If these factors were sufficient to eliminate work product protection, legal advice concerning complex commercial transactions would virtually always go unprotected, effectively eliminating the protection of the work product doctrine in the arena in which it is most needed.

The district court's decision is also likely to have an adverse effect on the quality of legal advice. As both *Hickman* and *Adlman* recognize, a basic purpose of the protection is to provide lawyers with a zone of privacy in which they may freely develop their case. Under the district court's holding, however, lawyers will hesitate to give candid guidance for fear that their work product will later be revealed to opposing counsel. As a result, businesses will make commercial decisions without the full benefit of uninhibited legal advice, hurting their interests as well as those of their customers.

ARGUMENT

I. THE DISTRICT COURT'S APPROACH TO THE WORK PRODUCT DOCTRINE IS CONTRARY TO THIS COURT'S DECISION IN *ADLMAN*.

A. The District Court's Analysis Departs From *Adlman*.

1. The Second Circuit Has Adopted A "Because Of" Litigation Test.

The work product doctrine, recognized in *Hickman v. Taylor*, 329 U.S. 495 (1947), and codified in Federal Rule of Civil Procedure 26(b)(3), provides a qualified protection against disclosure for documents prepared by an attorney in anticipation of litigation. The doctrine is designed "to preserve a zone of privacy in which a lawyer can prepare and develop legal theories and strategy 'with an eye toward litigation,' free from unnecessary intrusion by his adversaries." *Adlman*, 134 F.3d at 1196 (quoting *Hickman*, 329 U.S. at 510-11). The principal focus is on encouraging careful and thorough preparation by the attorney and preventing the attorney's efforts from redounding to the benefit of the opposing party. *Hickman*, 329 U.S. at 511.

This Court has held that the work product doctrine applies to all documents prepared "because of" litigation. In *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998), the Circuit rejected a narrower formulation of the doctrine under which documents would be protected only if they are prepared "primarily to assist in" litigation, and not if the "primary, ultimate, or exclusive purpose is to assist in

making a business decision." *See Adlman*, 134 F.3d at 1198. In rejecting that narrower formulation, this Court joined other courts in holding that "[w]here a document is created because of the prospect of litigation . . . , it does not lose protection under this formulation merely because it is [also] created in order to assist with a business decision." *Id.* at 1203. Thus, for example, the work product doctrine protects a report concerning the company's litigation prospects that is written to inform a bank's lending policy to a company, as well as a memorandum prepared for an independent auditor to determine the amount of reserves for projected litigation. *See id.* at 1200.

As the Court noted in *Adlman*, the work product protection is not absolute. Although a document that satisfies the "because of" litigation test is eligible for protection, this shield may be overcome if a district court determines that the opposing party has shown a substantial need for the document and is unable to obtain its contents elsewhere without undue hardship. *Id.* at 1195. In addition, the court may find that only certain sections of a document require protection. *Id.* The Court explained, however, that "opinion work product" (documents that tend to reveal the attorney's mental processes) "receive special protection not accorded factual material," because a "core" purpose of the work product doctrine is to "shelter[] the mental processes of the attorney, providing a privileged area within

which he can analyze his client's case." *Adlman*, 134 F.3d at 1197 (quoting *United States v. Nobles*, 422 U.S. 225, 238 (1975)).

2. The District Court's Approach Conflicts With the "Because Of" Test.

Under *Adlman*, the key issue is whether a document was prepared "because of" anticipated litigation. In the instant case, the district court recognized "that Schaeffler believed that litigation was highly probable in light of the significant and difficult tax issues that were raised by the planned refinancing and restructuring." Op. at 28. In addition, the court acknowledged that a tax memorandum prepared by Ernst & Young (the "EY Tax Memo") set forth the legal issues and analyzed the potential arguments that could be made by the parties should the IRS audit the company's return. Op. at 27. Based on these determinations, the court should have concluded that the work product doctrine applied to the EY Tax Memo.

Instead, the court applied a two-part test, based upon the statement in *Adlman* that work protect protections do not extend to "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation." 134 F.3d at 1202. First, the district court considered whether the company would have sought out the type of tax advice provided by Ernst and Young if it had not anticipated an audit or litigation. Op. at 29. Second, the court asked whether the advice given would

have been different in content or form had the company known that no audit or litigation would ensue. Op. at 30.

As Appellant explains in its brief, this analysis departs from *Adlman*, which specifically provided that, "[w]here a document is created because of the prospect of litigation . . . , it does not lose protection under this formulation merely because it is [also] created in order to assist with a business decision." 134 F.3d at 1203. Thus, the Court's reference to documents that "would have been created in essentially similar form irrespective of the litigation" simply refers to documents that, while potentially prepared with litigation on the horizon, are not *core* work product; *i.e.*, documents that do not "reveal mental impressions, conclusions, opinions, or theories *concerning . . . litigation*." *Id.* at 1195 (emphasis added).

B. The District Court Failed To Properly Analyze Whether the Legal Advice Would Have Taken the Same Form Absent Litigation.

In addition to applying the wrong standard in determining the application of work product protection, the district court also erred by denying work product protection based on factors that will be present in virtually any complex business transaction. After determining that the company would have sought tax advice even if had not anticipated an audit or litigation, the court jumped far too readily to the conclusion that the tax advice would have been essentially identical in form and content even if litigation not been anticipated. In determining whether a document "would have been created in essentially similar form irrespective of the

litigation," courts must require more than the district court required in this case, or this single phrase in *Adlman* will effectively negate the work product rule in complex transactions.

The court noted that "the complexity of the tax issues surrounding the relevant transactions engendered the need to hire outside attorneys and advisors as well as the need to generate the lengthy and detailed analysis contained in the EY Tax Memo." Op. at 29. The district court then asserted that all legal advice considers the relevant legal authorities and analyzes how those authorities would be applied to a particular set of facts. On this basis, the court reasoned that it is of "no significance" that the EY Tax Memo evaluates the chances that specific tax positions will succeed in litigation, and specifically identifies and evaluates arguments that the IRS might advance. Op. at 31.

The district court's reasoning ignores the reality that the breadth and depth of an attorney's legal and factual analysis can vary considerably depending upon whether litigation is anticipated. To be sure, it may be difficult to determine what an attorney's opinion would have looked like in a counterfactual scenario that did not include a risk of litigation. That is particularly true in a case such as this one, where the factors the district court relied on – the size, complexity, and novelty of the transaction – created a prospect of litigation. But such difficulties cut *against* any conclusive determination that work product would have taken "essentially

similar form" absent a prospect of litigation. The purpose of the work product doctrine is to protect the attorney's *specific* "mental impressions, conclusions, opinions, or theories concerning . . . litigation." 134 F.3d at 1195. Given this purpose, a court should not eliminate the work protection absent convincing evidence that substantially the same impressions, conclusions, opinions, or litigation theories would have been conveyed even if litigation had not been anticipated.

Rather than engaging in an analysis of the EY Tax Memo's detailed identification of significant issues and examination of potential arguments and counter-arguments, the district court effectively assumed that the complex nature of the transaction vitiated the work product protection. Under the district court's approach, only specific signifiers, such as a discussion of "actions particular to the litigation process" or a section on settlement strategies, would be sufficient to demonstrate that a document was prepared "because of" litigation. By this logic, documents addressing the practical steps of a court case will receive protection, while those considering the core of any litigation—the legal theories and arguments—will be disclosed to adversaries on demand. That would eliminate the heart of the work product doctrine—surely not a result this Court intended to endorse in *Adlman*.

C. The District Court's Conclusion Is Based On A Misunderstanding Of Tax Practice.

In concluding that all tax advice regarding a complex transaction would be created in essentially the same form regardless of litigation, the district court relied on a quotation from Circular 230 that prohibits tax practitioners from taking the possibility of audit into account when providing tax advice. Op. at 30 (*citing* 31 C.F.R. § 10.37(c)(3)(iii) (2014)). The court's reliance on this language reflects a basic misconception about the practice of tax law. The federal income tax system depends on self-assessment. For this reason, tax practitioners are not permitted to provide advice that would circumvent the self-assessment system by suggesting to taxpayers that the determination of whether to assess should turn not on whether the tax is properly assessable, but instead on whether the client is likely to get caught if it wrongly carries out its self-assessment duties.

This requirement—that advice be provided without regard to the likelihood that the facts underlying the assessment question at issue would be discovered—is irrelevant when considering the prospect of litigation. For example, an advisor may expect that certain items, if not assessed by the taxpayer, will never be discovered on audit and never give rise to litigation, but nonetheless quite clearly are assessable. On the other hand, other items may be certain to be discovered on audit but never give rise to litigation or controversy because the IRS would agree that assessment would be improper. Finally, in some situations an advisor may

expect that if an item is discovered on audit (which may be likely or unlikely), controversy may ensue. In short, Circular 230 standards do not imply that all tax advice by definition is prepared for controversy, but only that the self-assessment system duty requires that tax issues be considered on their merits and not on the basis of whether the taxpayer will get caught.

Even if the Court were to assume, contrary to fact, that all tax advice is prepared in anticipation of controversy or litigation, that premise would not imply that no tax advice is protected by the work product doctrine. Indeed, subject to a compelling need analysis, exactly the opposite conclusion would be appropriate—namely, that *all* tax advice would qualify for the protection. Neither bright-line test makes sense, however, because advice on tax law, like other legal advice, may be prepared to provide the recipient a basis by which a legal duty may be determined, but may also may be prepared as part of the process of preparing for an anticipated controversy. A categorical rule that all tax advice is necessarily given as if litigation were contemplated cannot be squared with reality. And a rule that excludes all tax advice from the work product protection is equally untenable.

II. THE DISTRICT COURT'S APPROACH IS CONTRARY TO THE POLICIES UNDERLYING THE WORK PRODUCT DOCTRINE.

A. The District Court's Holding Removes Work Product Protection For Complex Transactions.

The district court's approach to the work product doctrine effectively eliminates work product protection for tax opinions provided for complex transactions. As a result, businesses selected for audit by the IRS would be placed at a significant disadvantage in the process if their legal counsel's mental impressions and strategies were disclosed to the government.

The court relied on the fact that the EY Tax Memo concerned "enormously complex transactions" raising "'complex' and 'novel' federal tax issues" as support for its conclusion that the company would have sought tax advice even absent the threat of litigation. Op. at 29. Most businesses, especially sophisticated businesses, however, seek advance guidance before entering into significant transactions that raise complex and novel issues. Thus, the district court's reasoning effectively strips work product protection from tax advice given in the context of complicated transactions.

This outcome is contrary to the basic purposes of the work product doctrine. *See Adlman*, 134 F.3d at 1500 ("Discovery was hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary." (quoting *Hickman*, 329 U.S. at 516 (Jackson, J., concurring))).

Moreover, the mental impressions of taxpayer's counsel need not be shared in order for the IRS to prepare its case and the taxpayer's assessment to be adjudicated fairly. The IRS has nearly 90,000 employees, including a host of talented highly specialized tax law experts.[2] It is capable of doing its job without relying on the mental impressions of opposing counsel. Indeed, the district court's approach could hinder an efficient and productive audit process. A tax opinion may identify legal theories and litigation strategies that the IRS would not have otherwise asserted. In some cases, counsel may believe that the theories lack merit. Nevertheless, an IRS agent, after reading these theories, may choose to investigate or even argue these positions, slowing the process and delaying a final assessment. This unnecessary conflict is a classic example of the government seeking to build its case on the wits of opposing counsel. As a matter of public policy, barriers should not be erected to taxpayers having full access to all the potential issues associated with a tax return position before exercising their duties as the primary assessors of the income tax.

As the Court recognized in *Adlman*, the policies underlying the work-product doctrine and the text of Rule 26(b)(3) strongly support application of the doctrine in this context. The government imposes on taxpayers a duty to apply and

[2] Table 30, Internal Revenue Service Data Book 2013, *available at* http://www.irs.gov/pub/irs-soi/13databk.pdf.

interpret an extraordinarily complicated set of rules and laws to myriad complex transactions, but would limit access to candid advice of counsel by seeking to obtain that advice and turn it against the taxpayer. Where advice is provided to evaluate a taxpayer's defenses and strategies in litigation, revealing it to litigation adversaries undermines the basic purpose of the work product doctrine. In appropriate cases, the needs of the government may outweigh these policy concerns, but here the government has not asserted such needs. As the government would have it, a taxpayer must ascertain the law, which is often uncertain, and commit to a position on a tax return, choosing either to guess as to how it would defend the position in litigation or to reveal in advance its defense strategy to the government. As in *Adlman*, neither the purpose nor the text of the work product doctrine counsels in favor of such a result.

The adverse consequences of the district court's formulation of the work product doctrine extend beyond the tax realm. In denying protection to the EY Tax Memo, the court asserted that businesses had reasons other than the prospect of litigation to obtain legal advice, including a desire to lower their tax bills. Op. at 29-30. As a result, the court concluded that the company would have sought out the same type of advice even in the absence of anticipated litigation. Op. at 30. This rationale could operate to deny protection to many forms of prospective legal advice received by businesses. For example, a business that collects consumer

data and is the victim of a data breach may revise its data security procedures to prevent further breach while also complying with Section 5 of the Federal Trade Commission Act. *See* 15 U.S.C. § 45. In addressing such a breach, the business will likely seek the advice of counsel to assess its data security procedures. Although this legal guidance may be provided in anticipation of litigation with the FTC, the business would also have other incentives to obtain advice, such as maintaining good customer service. Under the district court's approach, however, the fact that advice prepared in anticipation of litigation may benefit a company in other arenas will weigh against such advice being protected from disclosure.

B. The District Court's Holding Creates Perverse Incentives for Legal Advisors.

The district court's opinion significantly narrows the scope of work product protection for tax opinions. This narrowing of the protection will create pressure to shift the standard practice of those providing tax advice. If work product has little or no chance of qualifying for protection, tax practitioners will face pressure to be less candid in counseling their clients. Because their memos and opinions may be disclosed to adversaries, they may refrain from "showing their work" in reaching their conclusions and may choose not to discuss litigation strategies should they conclude that a transaction is likely to be challenged.

Such perverse incentives are not limited to the tax arena. In other contexts, such as the data security context described above, attorneys may also withhold their candid assessment.

Adlman recognized the potential for such negative effects and specifically noted this possibility as a reason for the test it adopted:

> If the company declines to [candidly discuss litigation strategies, appraisal of the likelihood of success, and the feasibility of reasonable settlement] or scrimps on candor and completeness to avoid prejudicing its litigation prospects, it subjects itself and its co-venturers to ill-informed decisionmaking. On the other hand, a study reflecting the company's litigation strategy and its assessment of its strengths and weaknesses cannot be turned over to litigation adversaries without serious prejudice to the company's prospects in litigation. . . . We perceive nothing in the policies underlying the work-product doctrine or the text of [Rule 26(b)(3)] itself that would justify subjecting a litigant to this array of undesirable choices.

Adlman, 134 F.3d 1194, 1200 (2d Cir. 1998) (citing *Hickman*, 329 U.S. at 516). *Adlman* adopted a test that ensures attorneys a zone in which they can consider the facts, analyze the authorities, and formulate a legal strategy. To uphold the district court's interpretation of the doctrine would significantly constrict that space in a manner that would be "demoralizing" to attorneys, *Hickman*, 329 U.S. at 512, and injurious to clients.

CONCLUSION

The decision of district court should be reversed.

Respectfully submitted,

COVINGTON & BURLING LLP

By: /s/ Robert A. Long

Robert A. Long
Counsel of Record
Reeves C. Westbrook
Marianna Jackson
Jason Yen
COVINGTON & BURLING LLP
1201 Pennsylvania Avenue N.W.
Washington, DC 20004-2401
(202) 662-6000

September 12, 2014

Counsel for Amicus Curiae

CERTIFICATE OF COMPLIANCE

I CERTIFY, pursuant to Federal Rules of Appellate Procedure 29(d) and 32(a)(7) that the foregoing Brief contains 3,751 words, excluding the parts of the Brief exempted under Federal Rule of Appellate Procedure 32. In accordance with Federal Rule of Appellate Procedure 32(a)(5)-(6), this Brief has been prepared in 14-point Times New Roman font.

Dated: September 12, 2014

/s/ Robert A. Long
Robert A. Long
Counsel for Amicus Curiae

CERTIFICATE OF SERVICE

I CERTIFY that on this 12th day of September, 2014, a true and correct copy of the foregoing Brief was served on all counsel of record via CM/ECF pursuant to Local Rule 25.1(h).

Dated: September 12, 2014

/s/ Robert A. Long
Robert A. Long
Counsel for Amicus Curiae