Keep Your Friends Close but Your Auditors Closer: Corporations Risk Waiver When Independent Auditors Request Work Product

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ABSTRACT

In the current transparency-driven regulatory environment, corporations’ efforts at compliance are rife with uncertainty. The work product doctrine is a core safeguard of a lawyer’s work, which may contain sensitive information that corporations would not want disclosed to opposing parties. Meanwhile, independent auditors serve in a perilous capacity as they provide necessary services to their corporate clients while risking potentially adverse exposure of the information these clients and their counsel disclose to them.

The work product doctrine is a time-honored and rule-driven protection that guards the mental impressions and work efforts of lawyers from discovery by opposing parties. Public accounting regulations and securities laws increasingly pressure corporations to disclose as much information as possible, sometimes risking waiver of this invaluable protection. Determining whether disclosure of attorney work product to an independent auditor waives work product protection has led to divergent outcomes, most recently with the D.C. Circuit’s interpretation of this issue—the first court at the circuit level to directly weigh in on this debate.

If future courts that wrestle with this issue do not recognize the appropriate balance between this well-established protection and the goals of financial transparency, the common law waiver rule will be at odds with government goals to discover and prosecute corporate fraud. This Article describes the uncertainty that continues to plague this area of the law and highlights the risks that corporations face. It also critiques recent decisions in this area, offers a
A comprehensive case-by-case approach that reconciles competing concerns of fairness and transparency, and alternatively proposes a bright-line test to provide much-needed certainty.

**INTRODUCTION**

Independent auditors are indispensable guarantors of public trust that provide stability in financial markets, but lawsuits alleging corporate fraud are increasingly prevalent, and complicit independent auditors have not been left impervious to liability.¹ Former New York State Attorney General Andrew Cuomo recently named an independent auditor in a lawsuit, alleging that the auditor committed fraud by signing off on deceptive accounting methods adopted by Lehman Brothers management.² A federal judge in a pending case has left an independent auditor as a defendant along with Bear Stearns in a class action securities lawsuit, in which investors claim that the auditor stood by while executives made misleading statements about the firm’s financial stability.³ During 2010, investors filed 176 class action lawsuits in federal court based on allegations of fraud,⁴ and as private parties continue to file suits based on fraud and government authorities respond and file similar suits, auditors can expect to receive subpoenas for documents protected by the work product doctrine.

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Corporations face unprecedented pressure to make disclosures to their independent auditors in the current regulatory environment, and they risk waiving well-established protections as they respond to requests for otherwise privileged information. However, corporations that manage to convince their independent auditors to approve the filing of misleading information may benefit from these same regulations if courts freely grant work product immunity from discovery. Striking the appropriate balance should reflect awareness of the possibility that an overly broad privilege could counteract other efforts to prevent fraud.

Corporations depend on independent auditors for sound opinions on their publicly issued financial statements. To fulfill this role, auditors are bound to request highly sensitive information from the companies they audit. On the other hand, a corporation risks waiver of significant privileges if it discloses this sensitive information to its independent auditor, especially if that auditor may be a potential adversary in future litigation. When a company discloses documents to its independent auditor, it waives the attorney–client privilege—this


7 See Codification of Accounting Standards and Procedures, Statement on Auditing Standards No. 12, § 337.04 (Am Inst. of Certified Pub. Accountants 1976) (“With respect to litigation, claims, and assessments, the independent auditor should obtain audit evidence relevant to the following factors: a. [t]he existence of a condition, situation, or a set of circumstances indicating an uncertainty as to the possible loss to an entity arising from litigation, claims, and assessments[;] b. [t]he period in which the underlying cause for legal action occurred[;] c. [t]he degree of probability of an unfavorable outcome[;] d. [t]he amount or range of potential loss.”).

8 For a discussion of attorney–client and work product waiver, see infra notes 64–72 and accompanying text.
much is settled. However, courts have reached divergent results when deciding whether these disclosures may also result in waiver of work product protection. As corporations continue to face the requests of their independent auditors, these corporations are plagued by uncertainty beleaguering this area of the law.

The work product doctrine represents a core safeguard of a lawyer’s confidential judgment in the adversarial process, stemming from deeply entrenched policy justifications that support continued reliance on its broad protections. The Supreme Court established the work product doctrine in 1942, and the doctrine was later partially codified in the Federal Rules of Civil Procedure in 1970. The doctrine represents a departure from the characteristically liberal nature of post-nineteenth century discovery, yet it protects from discovery an essential component of a lawyer’s work—the private and personal work efforts made “in anticipation of litigation.”

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9 For a discussion of waiver of the attorney–client privilege, see infra note 70 and accompanying text.
10 For a discussion of work product waiver and the various district court interpretations of the doctrine, see infra notes 70–120 and accompanying text.
11 See Hickman v. Taylor, 329 U.S. 495, 510 (1947) (“In performing his various duties . . . it is essential that a lawyer work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel.”).
13 FED. R. CIV. P. 26(b)(3).
14 See James A. Pike & John W. Willis, Federal Discovery In Operation, 7 U. CHI. L. REV. 297, 297–303 (1939) (noting that the discovery rules as codified in the Federal Rules of Civil Procedure reflect a departure from rigid pleading doctrines in favor of open discovery and mutual disclosure); see also Hickman v. Taylor, 329 U.S. 495, 507 (1947) (“Mutual knowledge of all the relevant facts gathered by both parties is essential to proper litigation . . . [t]he deposition-discovery procedure simply advances the stage at which the disclosure can be compelled from the time of trial to the period preceding it, thus reducing the possibility of surprise.”).
15 See FED. R. CIV. P. 26(b)(3).
The Sarbanes–Oxley Act of 2002 (Sarbanes–Oxley)\textsuperscript{16} was enacted in the wake of the corrupt accounting and reporting practices that led to the demise of several multinational corporations, including Enron, WorldCom, and Tyco.\textsuperscript{17} President George W. Bush confirmed, in signing Sarbanes–Oxley into law, that it “adopts tough new provisions to deter and punish corporate and accounting fraud and corruption, ensure justice for wrongdoers, and protect the interests of workers and shareholders.”\textsuperscript{18}

Sarbanes–Oxley represents a recent movement in favor of greater corporate transparency, notably because it reinforces the independent auditor’s role in restoring investor confidence with thorough financial statement evaluations,\textsuperscript{19} and also because it requires management to disclose instances of fraud to its independent auditors.\textsuperscript{20}


\textsuperscript{17} See S. Rep. No. 107-75, at 2–3 (2002) (“That the Enron collapse, moreover, has been followed by a seeming flood of allegations about large-scale financial fraud at other prominent companies, including WorldCom, Global Crossing, Tyco, Adelphia, and Rite Aid . . . suggests that there have been some basic flaws in our system of market regulation, ones that well warrant the re-examination that the system is currently undergoing.”); \textit{see also} Allison Fass, \textit{One Year Later, The Impact of Sarbanes–Oxley}, FORBES, Jul. 22, 2003, http://www.forbes.com/2003/07/22/cz_af_0722saranes.html (noting that the Act is widely referred to as “the broadest-sweeping legislation to affect corporations and public accounting since the 1933 and 1934 securities acts”).

\textsuperscript{18} Statement on Signing the Sarbanes–Oxley Act of 2002, 38 Weekly Compilation of Presidential Documents 1286 (July 30, 2002).

\textsuperscript{19} Congress created the Public Company Accounting Oversight Board (PCAOB) as part of Sarbanes–Oxley and delegated to this board the authority to oversee the audits of public companies. \textit{15 U.S.C. § 7211(a)} (2006). The PCAOB has since released regulations that require auditors to remain independent throughout the course of an audit. Professional Standards R. 3520 (Pub. Co. Accounting Oversight Bd. 2007). The American Institute of Certified Public Accountants (AICPA) has followed suit by amending its interpretation of auditing standard AU 326; the revised interpretation states that “[t]he auditor should obtain access to the opinion, notwithstanding potential concerns regarding attorney–client or other forms of privilege.” AU § 9324, \textit{Evidential Matter: Auditing Interpretations of Section 326}, at 2.22 (Am Inst. of Certified Pub. Accountants 2003); \textit{see also} Robert A. Prentice & David B. Spence, \textit{Sarbanes–Oxley as Quack Corporate Governance: How Wise is the Received Wisdom?}, 95 GEO. L.J. 1843 (2007) (‘Congress’s main purpose in enacting SOX was not to directly improve corporate performance
Tension between the well-established work product doctrine and the pragmatic response to recent corporate malfeasance through Sarbanes–Oxley has left to courts the complex task of deciding whether increased demands from new regulations wholly unravel the core safeguards of the work product doctrine. The Internal Revenue Service (IRS) recently released an announcement stating that it will not assert waiver of work product or attorney–client privilege during the course of an examination. However, this guidance only expresses the IRS’s probable course of action during an examination, leaving open the possibility that the IRS would still assert waiver in litigation.

Corporate attorneys that would otherwise feel comfortable advising clients with litigation theories under the aegis of the work product doctrine may find this protection unexpectedly slipping away when auditors get involved. Much of the academic discussion has focused on whether dual-purpose documents should be afforded work product protection in the first place. This Article instead focuses on an area previously afforded only limited exploration—whether disclosure of protected work product to an independent auditor amounts to waiver of the privilege. This Article further provides the first in-depth analysis of work product waiver in response to the D.C. Circuit’s decision in United States v. Deloitte LLP, the first decision at the

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22 For purposes of the work product doctrine, dual purpose documents are documents prepared for litigation that may also serve other business purposes. These purposes may include providing support for a public company audit, or providing support for a business assessment.
circuit level that directly analyzes the waiver issue in the realm of disclosures to independent auditors.\textsuperscript{25}

At least one commentator has argued that waiver should never occur when documents are disclosed in the course of an audit,\textsuperscript{26} yet auditors do pose realistic threats as adversaries in possible litigation. One on hand, a complete disallowance of waiver when disclosures are made to independent auditors would unduly hinder the IRS’s goals of discovering aggressive tax positions and restoring investor confidence through financial transparency. On the other hand, finding waiver in every case of disclosure to an independent auditor would create disincentives for corporate disclosure despite the prevailing public view that corporate disclosure is generally beneficial.\textsuperscript{27} These competing concerns thus justify a fact-based analysis of auditor involvement in otherwise protected work product in light of the modern government emphasis on corporate transparency through stricter auditing standards and broader government enforcement policies.

This Article addresses the application of attorney work product protection to materials disclosed to independent auditors and reveals that transparency concerns mandate a case-by-case approach, rather than a firm acceptance or rejection of waiver in this context. Part I provides an overview of the work product doctrine and the two tests that courts apply to determine whether dual-purpose documents qualify for the doctrine’s protection from discovery. Part II examines how disclosure of otherwise privileged information constitutes waiver, discusses the split of authority when courts consider whether disclosure causes waiver in the scope of an audit (including a discussion of \textit{Deloitte}, which is the first decision at the circuit level to directly

\textsuperscript{25} 610 F.3d 129, 133 (D.C. Cir. 2010), \textit{cert. denied}, 130 S. Ct. 3320 (2010).
\textsuperscript{26} See Colón, \textit{supra} note 24.
\textsuperscript{27} See Merrill Lynch v. Allegheny, 229 F.R.D. 441, 449 (S.D.N.Y. 2004) (“[T]o construe a company's auditor as an adversary and find a blanket rule of waiver of the applicable work product privilege . . . could very well discourage corporations from conducting a critical self-analysis and sharing the fruits of such an inquiry with the appropriate actors.”).
address this issue), and presents a model case to illustrate the shortcomings of the approach taken by the majority of courts. Part III addresses the policy arguments for and against finding waiver in cases of disclosure to independent auditors and concludes that, commensurate with the movement toward financial transparency and the realistic role that auditors maintain in relation to the companies they audit, waiver of work product protection should depend on the circumstances of the disclosure. Finally, Part III offers a case-by-case method of analysis for courts that may face this issue in the future, whereby careful consideration of the nature of the relationship between an independent auditor and a disclosing corporation will fairly and comprehensively address the competing interests of the time-honored work product protection and the modern emphasis on corporate transparency. This approach creates consistency and maintains the appropriate level of flexibility that will take into account the real tensions that merit abandonment of strict work product protection in cases of corporate disclosure to independent auditors.

I. THE WORK PRODUCT DOCTRINE: A LAWYER’S BEST FRIEND

While often treated as a privilege, the work product doctrine does not render attorney work product completely outside the scope of discovery, but instead provides a form of qualified immunity from discovery. Work product protection is essential to lawyers, primarily because it protects the integrity of an attorney’s own work efforts and prevents this information from ending up in the hands of opposing parties. This codified doctrine enjoys broad application to

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28 Smith v. Diamond Offshore Drilling, Inc., 168 F.R.D. 582, 584 (S.D. Tex. 1996); Epstein, supra note 24, at 792 (5th ed. 2007) ("The words ‘doctrine,’ ‘immunity,’ and ‘privilege’ (among others) have been used in naming the protection given work product. Any of the terms is probably appropriate. Some resist use of the term ‘privilege’ because the protection is qualified, unlike the traditional communications privileges. In respect to both waiver and the exception issues, how the work–product protection will be treated is quite similar to how the privilege is treated.").
documents and materials prepared to assist lawyers in litigation, but the protection is far from absolute. Unfortunately, this time-honored protection still faces uncertain application, mainly as courts apply work product tests to determine whether documents that serve multiple purposes—beyond strictly assisting lawyers in litigation—qualify for work product immunity. This Part discusses the development of the work product doctrine, as well as the work product tests commonly used to decide whether disputed documents are afforded immunity from discovery.

A. History and Policy of the Work Product Doctrine: From Common Law to Codification

The attorney work product doctrine protects an attorney’s thoughts, analyses, and trial preparation from discovery, limiting access to information in modern litigation.29 The doctrine was established in the seminal Supreme Court case of *Hickman v. Taylor*.30 In *Hickman*, counsel for the defendant sought discovery of “any oral or written statements, records, reports, or other memoranda” from the plaintiff’s lawyer concerning the underlying dispute.31 The Court acknowledged that the Federal Rules of Civil Procedure (newly enacted at the time of its decision) engendered liberal discovery rules intended to disseminate mutual knowledge of all the relevant facts collected by both parties.32 The Court held, however, that unlimited discovery should not extend to attorney work product because “[n]ot even the most liberal of discovery theories can justify unwarranted inquiries into the files and the mental impressions of an attorney.”33 The Court reasoned that a lawyer should remain free to work with a certain degree

29 *See* FED. R. CIV. P. 26(b)(3).
31 *Id.* at 499.
32 *Id.* at 507; *see also* Pike, *supra* note 14, at 303.
33 *Hickman*, 329 U.S. at 510.
of privacy and without unnecessary intrusion by opposing parties and their counsel.\textsuperscript{34} Despite the movement toward more liberal discovery rules, the Court’s decision to protect an attorney’s ideas from opposing counsel serves the vital interest of ensuring that efficient advice is disseminated as attorneys prepare cases for trial.\textsuperscript{35}

Federal Rule of Civil Procedure 26(b)(3) partially codifies the work product doctrine established in \textit{Hickman} and states that documents are afforded protection when: (1) they are prepared “in anticipation of litigation or for trial,” and (2) they are prepared “by or for another party or its representative.”\textsuperscript{36} This rule spans across two categories of attorney work product: (1) opinion work product, which is granted absolute immunity from discovery, and (2) factual work product, which is only entitled to qualified immunity.\textsuperscript{37}

Immunity from discovery of factual work product, such as witness interviews and third party reports gathered during an attorney’s investigation, may be overcome under the rule’s “substantial need exception” if the opposing party cannot obtain its equivalent by other means without undue hardship.\textsuperscript{38} In federal court, this substantial need exception is rarely granted.\textsuperscript{39} More importantly, the substantial need exception does not apply to opinion work product, which usually consists of documents that contain the “mental impressions, conclusions, opinions, or

\textsuperscript{34} \textit{Id.} at 495.
\textsuperscript{35} \textit{Id.} at 511.
\textsuperscript{36} \textit{FED. R. CIV. P.} 26(b)(3).
\textsuperscript{37} United States \textit{ex rel.} Hunt v. Merck–Medco Managed Care, No. 00-CV-737, 2004 WL 868271, at *1 (E.D. Pa. Apr. 21, 2004) (quoting Sporck v. Peil, 759 F.2d 312, 316 (3d Cir. 1985)).
\textsuperscript{38} \textit{FED. R. CIV. P.} 26(b)(3).
\textsuperscript{39} See Leviton Mfg. Co. v. Universal Sec. Instruments, Inc. 606 F.3d 1353, 1365 (5th Cir. 2010) (“[E]xceptions to the work product privilege are ‘very rare’ and exist only in ‘extraordinary circumstances.’”); \textit{see also} \textit{FED. R. CIV. P.} 26 (b)(3) advisory committee’s note (“It will be rare for a party to be able to make such a showing given the broad disclosure and discovery otherwise allowed regarding the expert’s testimony.”).
legal theories of a party’s attorney or other representative of a party concerning the litigation.”

Opinion work product “is virtually undiscoverable,” and the substantial need exception to protection over factual work product is rarely granted, reflecting an important policy concern emphasized by the Supreme Court in *Hickman*: attorneys should never be forced by the opposing party to testify as to their mental opinions or conclusions related to a case.

**B. Work Product Tests: When does the Protection Apply?**

When a party seeks to invoke work product immunity for audit workpapers and other dual-purpose documents, the analysis centers on whether the documents were prepared “in anticipation of litigation.” The circuits are split on this issue, and two main tests have emerged to determine when documents are prepared in anticipation of litigation, and thus immune from discovery under the work product doctrine. The less common test adopted by the Fifth Circuit, deemed the “primary purpose” test, grants work product protection to documents prepared in

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44 See supra note 22.
45 See, e.g., United States v. Textron Inc., 577 F.3d 21, 27 (1st Cir. 2009) (en banc), cert. denied, 130 S. Ct. 3320 (2010) (determining whether audit workpapers were prepared “in anticipation of litigation” in order to be eligible for work product protection); In re Grand Jury Subpoena, 357 F.3d 900, 907 (9th Cir. 2004) (determining whether dual purpose business documents were prepared “in anticipation of litigation” in order to be eligible for work product protection).
anticipation of litigation only if they were prepared primarily to assist in litigation. Courts that apply this standard find that tax accrual workpapers (prepared by lawyers to satisfy the requirements of an audit) are created primarily to comply with securities regulations, rather than to assist in litigation; accordingly, these documents fail the primary purpose test and work product protection is denied.

The more widely adopted approach grants work product protection to documents created “because of” the prospect of litigation. Under this approach, a document does not lose immunity from discovery “merely because it is created in order to assist with a business decision.” Work product immunity is granted more broadly under this approach because a document may be deemed to have been prepared in anticipation of litigation even if the primary purpose for its creation was for a different business reason. Courts that apply this standard take

47 See In re Kaiser Aluminum & Chem. Co., 314 F.3d 586, 593 (5th Cir. 2000); United States v. El Paso, Co., 682 F.2d 530 (5th Cir. 1982); United States v. Davis, 636 F.2d 1028, 1040 (5th Cir. 1981) (“[L]itigation need not be imminent . . . as long as the primary motivating purpose behind the creation of the document was to aid in possible future litigation.”). 48 See, e.g., United States v. El Paso, Co., 682 F.2d 530, 544 (5th Cir. 1982) (holding that a tax pool analysis” (a document similar to a tax accrual workpaper) created by a corporation’s outside counsel does not qualify for work product protection under the “primary purpose” test because, while it does summarize theories about possible litigation, “such analyses are not designed to prepare a specific case for trial or negotiation”). 49 United States v. Deloitte LLP, 610 F.3d 129, 136 (D.C. Cir. 2010) (referring to the “because of” test as the standard adopted by most circuits when deciding whether documents were created in anticipation of litigation). 50 United States v. Adlman, 134 F.3d 1194, 1202 (2d Cir. 1998). Eight other circuits also use the “because of” test for work product. See, e.g., Deloitte, 610 F.3d at 137; Sandra T.E. v. S. Berwyn Sch. Dist.100, 600 F.3d 612, 633 (7th Cir. 2010); In re Professionals Direct Ins. Co., 579 F.3d 432, 449 (6th Cir. 2009); In re Grand Jury Subpoena, 357 F.3d 900, 907 (9th Cir. 2004); PepsiCo, Inc. v. Baird, Kurtz & Dobson LLP, 305 F.3d 813, 817 (8th Cir. 2002); Maine v. U.S. Dep’t of the Interior, 298 F.3d 60, 68 (1st Cir. 2002); Martin v. Bally’s Park Place Hotel, 983 F.2d 1252, 1258 (3d Cir. 1993); Nat’l Union Fire Ins. Co. v. Murray Sheet Metal Co., 967 F.2d 980, 984 (4th Cir. 1992). 51 Parties anticipate litigation when “in light of the nature of the document and the factual situation of the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation.” Deloitte, 610 F.3d at 137 (quoting In re Sealed Case, 146
into account the nature of the document and the facts of each case. Under this approach, for example, most courts would hold that tax accrual work papers developed by a lawyer to satisfy the requirements of an audit should be afforded work product protection. But this outcome is not guaranteed.

In a recent case, *United States v. Textron Inc.*, the First Circuit applied the “because of” test to tax accrual workpapers prepared with the involvement of tax lawyers, but ultimately determined that the workpapers were created solely to meet financial disclosure requirements. Therefore, the court held that the ancillary purpose of providing litigation predictions did not merit work product protection over the workpapers. This interpretation was criticized by two dissenting judges and several commentators as an improper application of the traditional “because of” test. The commentators criticized the majority’s interpretation of the “because of” test and expressed concern that the decision leaves little guidance to lower courts, compounding the uncertainty already inherent to this area of the law.

Although most circuits now apply the “because of” test, *Textron* demonstrates that, in the realm of dual-purpose business documents, the law remains in flux. Once the majority in *Textron* held that the workpapers were not protected work product, it did not need to determine

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52 See, e.g., Deloitte, 610 F.3d at 139 (remanding the issue for in camera review to determine whether tax accrual work papers were created “because of” the prospect of litigation).
53 577 F.3d 21 (1st Cir. 2009) (en banc), cert. denied, 130 S. Ct. 3320 (2010).
54 Id. at 30–31.
55 Id.
57 See Kling, *supra* note 56; Mallett, *supra* note 56.
whether the disclosure to the independent auditor waived work product immunity.58
Increasingly, though, courts have been forced to focus on whether disclosure of work product to
third parties waives work product immunity.59 Plaintiffs often claim that a corporation waived
work product immunity over otherwise protected work product by disclosing documents to its
independent auditor.60 When waiver is at issue, a court must first decide whether disputed
material is protected work product before it can decide whether disclosure waived the privilege
that attached to the underlying material.61 The uncertainty lingering over this preliminary
determination (application of the work product tests) may complicate the subsequent analysis of
work product waiver,62 although these two determinations should remain analytically distinct
because work product waiver, as will be discussed in the following Part, addresses different
policy concerns.63

II. WORK PRODUCT WAIVER: A LAWYER’S NEMESIS

The previous Part introduced the core safeguards and policy underlying the work product
doctrine, and demonstrated the two main tests utilized by federal courts to determine whether
documents prepared by an attorney fall under its protections. This Part discusses whether courts
continue to protect attorney work product from discovery once underlying material that is
deemed protected work product is disclosed to third parties. This Part introduces the application
of work product waiver to disclosures between corporations and third party independent auditors,

58 See id. at 30–31.
59 See infra Part II.
60 Id.
62 See, e.g., id. at 447 n.9 (finding that its “common interests” view of work product waiver
stems from the more expansive “because of” test used to determine whether the disputed material
is protected work product in the first place).
63 For a comprehensive discussion of the problem inherent in mixing the preliminary anticipation
of litigation test with subsequent work product waiver analysis, see infra text accompanying
notes 233–234.
highlights the split of authority at the district court level, and describes the problems created by the first federal circuit level decision to squarely address this issue.

A. Work Product Waiver and Independent Auditors

Waiver of work product protection has developed entirely through case law, as it is not addressed in the Federal Rules of Civil Procedure, where the work product doctrine is codified.\(^{64}\) The work product doctrine has close ties to the attorney–client privilege as both keep certain information from adversaries to ensure that lawyers provide adequate representation.\(^{65}\) But the principles address different concerns.\(^{66}\)

The attorney–client privilege encourages complete and candid communication between clients and their attorneys.\(^{67}\) The work product doctrine encourages thorough preparation for trial because it protects an attorney’s work efforts from discovery by opposing parties.\(^{68}\) Almost all disclosures to third parties vitiate the attorney–client privilege’s core protection of confidentiality, yet some disclosures are entirely consistent with the work product doctrine.\(^{69}\) Accordingly, federal courts have consistently found that the attorney–client privilege is waived when a corporation discloses documents to independent auditors.\(^{70}\) Nevertheless, corporations may successfully assert work product immunity even after the attorney–client privilege is

\(^{64}\) See United States v. Mass. Inst. Of Tech., 129 F.3d 681, 683–84 (1st Cir. 1997) (noting that the issue of waiver by disclosure must be decided according to common law principles because it is not governed by any federal constitutional provision, federal statute, or rule established by the Supreme Court); see also United States v. Nobles, 422 U.S. 255, 239 (1975) (“The privilege derived from the work product doctrine is not absolute. Like other qualified privileges, it may be waived.”).

\(^{65}\) See Epstein, supra note 24, at 791.

\(^{66}\) Id.

\(^{67}\) Id.

\(^{68}\) Id. at 1027.

\(^{69}\) Id.

deemed to have been waived, although some courts have found that disclosure to auditors waives work product immunity.\textsuperscript{71}

Work product waiver occurs when otherwise protected work product is disclosed to a potential adversary or a conduit to a potential adversary.\textsuperscript{72} Variations of this rule exist, but each essentially holds that work product immunity is waived when otherwise protected work product is disclosed in a manner that is inconsistent with keeping it from adversaries.\textsuperscript{73} This emanated from the policy first espoused in \textit{Hickman}: “[t]he purpose of the work product doctrine is to protect information against opposing parties, rather than against all others outside a particular confidential relationship, in order to encourage effective trial preparation.”\textsuperscript{74}

During litigation, the work product waiver issue arises frequently when corporations disclose confidential business documents to independent auditors as part of routine and required

\textsuperscript{71} See, e.g., \textit{In re Grand Jury Proceedings}, 219 F.3d 175, 190 (2d Cir. 2000) (finding that work product immunity is different from and sometimes broader than the attorney–client privilege); United States v. Mass. Inst of Tech., 129 F.3d 681, 687 (1st Cir. 1997) (finding that most decisions are uniform in “implying that work product protection is not as easily waived as the attorney–client privilege.”).

\textsuperscript{72} See Mass. Inst. of Tech., 129 F.3d at 687 (“[D]isclosure to an adversary, real or potential, forfeits work product protection.”). Eight other circuits also use this standard. See, e.g., \textit{In re Grand Jury Proceedings}, 350 F.3d 299, 302 (2d Cir. 2003); Montgomery Cnty. v. MicroVote Corp., 175 F.3d 296, 304 (3d Cir. 1999); \textit{In re Martin Marietta Corp.}, 856 F.2d 619, 623–25 (4th Cir. 1988); Ecuadorian v. Chevron Corp., 619 F.3d 373, 378 (5th Cir. 2010); \textit{In re Columbia/HCA Healthcare Corp. Billing Practices Litig.}, 293 F.3d 289, 306 n.29 (6th Cir. 2002); Pittman v. Frazer, 129 F.3d 983, 988 (8th Cir. 1997); Transamerica Computer Co., IBM Corp., 573 F.3d 646, 648 n.1 (9th Cir. 1978); \textit{In re Qwest Commc’n’s Int’l, Inc.}, 450 F.3d 1179, 1190 (10th Cir. 2006); Genentech, Inc. v. U.S. Int’l Trade Comm’n, 122 F.3d 1409, 1415 (Fed. Cir. 1997); United States v. Deloitte LLP, 610 F.3d 129, 140 (D.C. Cir. 2010).

\textsuperscript{73} United States v. Mass. Inst. of Tech., 129 F.3d 681, 687 (1st Cir. 1997); see also Merrill Lynch v. Allegheny, 229 F.R.D. 441, 445 (S.D.N.Y. 2004) (holding that work product immunity is waived when material is disclosed in a manner that “substantially increases the opportunities for potential adversaries to obtain the information”); United States v. Deloitte LLP, 610 F.3d 129, 140 (D.C. Cir. 2010) (holding that work product immunity is waived when material is disclosed in a manner that “is inconsistent with the maintenance of secrecy from the disclosing party’s adversary”).

\textsuperscript{74} United States v. Am. Tel. & Tel. Co., 642 F.2d 1285, 1299 (D.C. Cir. 1980).
Companies frequently share attorney work product with their independent auditors. In the course of an audit, independent auditors often request summaries of pending or ongoing litigation, minutes of meetings of special litigation committees, internal investigation reports, and tax opinions.

The few state courts that have addressed this issue have reached opposing results when deciding whether work product protection is waived when work product is disclosed to independent auditors, although most find that disclosure does not waive the protection.

One commentator has argued that voluntariness is a critical factor that courts fail to consider. He concludes that disclosures to independent auditors may not be “voluntary” due to the demands of auditing standards and the post-Sarbanes–Oxley regulatory environment. However, in United States v. Massachusetts Institute of Technology, the Court of Appeals for the First Circuit dismissed the argument that disclosure by the Massachusetts Institute of Technology (MIT) to a government audit agency was involuntary. The court stated that “MIT’s disclosure to the audit agency resulted from its own voluntary choice, even if that choice was made at the time it became a defense contractor and subjected itself to the alleged obligation of disclosure.”

75 See Paul A. Straus & Paul B. Maslo, Protection of Work Product Shared With Outside Auditors, N.Y. L.J. 244, No. 116 (Dec. 16, 2010).
76 See id.
77 Id.
78 Compare Laguna Beach Cnty. Water Dist. v. Superior Court of Orange Cnty., 22 Cal. Rptr. 3d 387 (Cal. App. Dep’t Super. Ct. 2004) (holding that work product protection was not waived when letters containing work product were sent to auditors), and Denver Post Corp. v. Univ. of Colo., 739 P.2d 874 (Colo. App. 1987) (holding that a University did not waive work product privilege when it disclosed documents to a state auditor) with In re Rules of Prof’l Conduct, 2 P.3d 806 (Mont. 2000) (holding that disclosures to third-party auditors can be adversaries, but waiver of the work product privilege depends on the facts and circumstances).
79 See Colón, supra note 24, at 136.
80 Id.
81 129 F.3d 681, 686 (1st Cir. 1997).
82 Id.
Even after the enactment of Sarbanes–Oxley, which created increased disclosure requirements for corporations, courts have declined to examine whether disclosures to independent auditors are voluntary. Moreover, the recently enacted Federal Rule of Evidence 502 states that when work product is disclosed “in a federal proceeding” or “to a federal office or agency,” the disclosure does not amount to waiver. Due to this new rule, disclosures to independent auditors likely do not amount to involuntary disclosures because this is generally confined to disclosures imposed directly by government agencies.

A defending party may still argue that disclosure was not voluntary, but a corporation is subject to independent auditor requests only when it voluntarily decides to offer its shares in a public exchange. This is similar to MIT’s choice to become a government contractor, which the court in United States v. Massachusetts Institute of Technology found to be a voluntary decision, although it would inevitably cause MIT to be subject to disclosure requests by government auditors. Accordingly, in cases of disclosures made to independent auditors, courts assume that the disclosures were made voluntarily. Although these requests are often compelled by securities laws and accounting regulations, these constraints instead factor into whether relationships between corporate clients and their independent auditors can be considered “adversarial.”

When courts must decide whether a particular disclosure increases the likelihood that an adversary may obtain the information, many consider whether the disclosing party and the third

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84 See id.
85 In contrast, disclosure is not voluntary, for example, when the material is seized pursuant to a search warrant. See, e.g., United States v. Ary, 518 F.3d 775 (10th Cir. 2008).
86 129 F.3d 681 (1st Cir. 1997).
87 See Sarbanes–Oxley, supra note 6.
88 See infra Part II.A.–B.
party share common interests. 89 Parties that do not share common interests are generally considered actual or potential adversaries, in which case a disclosure between such parties waives work product protection. 90 Outcomes therefore depend on a balancing of competing policy concerns as courts attempt to define the roles of independent auditors.

The Supreme Court in United States v. Arthur Young & Co. long ago characterized independent auditors as “public watchdogs,” so finding that disclosure waived work product protection in these cases supports the idea that independent auditors are “adversarial” in relation to their clients because independent auditors owe their ultimate allegiance to the public. 91 But finding that disclosure caused waiver of the protection may discourage full communication between independent auditors and their clients, which ultimately benefits the public because independent auditors take disclosed information into account as they issue opinions on publicly issued financial statements. Finding that disclosure does not waive work product protection fosters this communication, but at the expense of a limited ability to discover corporate fraud. Moreover, extending work product protection when work product is disclosed to independent auditors also usurps the intended limits of the work product privilege when auditors can become “adversaries.” When courts must decide whether independent auditors should be considered adversaries or conduits to potential adversaries in relation to their clients, the crux of the discussion depends on determining the proper role of an auditor, and federal courts have reached mixed results. 92

90 Id. See United States v. Am. Tel. & Tel. Co., 642 F.2d 1285, 1299 (D.C. Cir. 1980) (“The existence of common interests between transferor and transferee is relevant to deciding whether the disclosure is consistent with the nature of the work product privilege.”).
92 Compare Merrill Lynch, 229 F.R.D. at 441 (conceding that an auditor does not share a common litigation interest with its corporate client, but holding that an auditor’s independent
B. The District Court Split of Authority

One line of cases holds that disclosure to independent auditors does not waive work product protection, and *In re Pfizer Inc. Securities Litigation* is often cited for this proposition.\(^93\) In *Pfizer*, the defendant disclosed to its auditor several legal documents that discussed potential liability related to its sale of defective mechanical heart valves.\(^94\) The plaintiffs sought production of the documents, claiming that disclosure to the auditors waived work product protection.\(^95\) Writing for the United States District Court for the Southern District of New York in *Pfizer*, Judge Buchwald recognized that one of the principles of *Hickman* was to prevent potential adversaries from having the opportunity to obtain opposing counsel’s work product.\(^96\) Accordingly, she applied the prevailing view that a disclosure of work product to a third party waives work product protection if it substantially increases the likelihood that the information will be revealed to adversaries.\(^97\) But in support of Judge Buchwald’s conclusion that work product protection was not waived, she offered only conclusory reasoning.\(^98\) She broadly stated that the independent auditor and the corporation “obviously shared common interests,” without specifically mentioning what interests were involved, and without closely scrutinizing the precise role of the independent auditor.\(^99\)

Writing for the same court, Judge Hellerstein in *Medinol, Ltd. v. Boston Scientific Corp.* articulated another view and held that work product protection was waived as a result of

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\(^94\) *Id.*
\(^95\) *Id.*
\(^96\) *Id.* at *6.
\(^97\) *Id.*
\(^98\) See *id.*
\(^99\) See *id.*
disclosure to an independent auditor, emphasizing the role of the independent auditor as a "public watchdog." In Medinol, the defendant was accused of abusing its position as licensee following its distribution of heart and arterial implants. As part of an internal investigation, the defendant compiled the minutes of a meeting conducted by the Special Litigation Committee of its Board of Directors and showed these minutes to its independent auditors as part of an audit of the company’s litigation exposure. The plaintiff sought production of these minutes and claimed that the defendant waived work product protection when it disclosed the minutes to its independent auditor. The court agreed and held that the disclosure by the defendant waived work product immunity over the disclosed minutes.

The court found that regulatory requirements pressure independent auditors to actively seek the evaluations of litigation exposures conducted by a company’s counsel, and an auditor must then “come to his own understanding of reasonableness, based on the evidence.” Accordingly, an auditor’s review must reflect that auditor’s independent opinion over the fairness of the financial statements, and may not necessarily be aligned with the interests of the audited company. Judge Hellerstein also recognized that, in light of recent accounting scandals and increased government pressure on independent auditors to properly make a fair evaluation of a company’s financial disclosures, auditors “must not share common interests with the compan[ies] they audit” because “[g]ood auditing requires adversarial tension between the

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101 Id. at 114.
102 Id.
103 Id.
104 Id.
105 Id. at 116.
106 Id.
More specifically, the court found that the particular disclosure did not further any litigation purpose. When there is no “common interest” in litigation served by the disclosure, extending work product protection does not serve the privacy interests that the doctrine was intended to protect.

This issue was heard by the United States District Court for the Southern District of New York yet again, but this time the court sided with its previous holding in Pfizer, departing from Medinol. In Merrill Lynch v. Allegheny, the court held that a blanket rule of waiver should not be found in every case of disclosure to independent auditors and that the result depends on the facts of each case. The court weighed in on the types of common interests contemplated by the work product doctrine and whether a corporation and its independent auditors share any such interests. The court noted that an auditor and a client do not share common litigation interests, but then held that this was not essential. The court then moved on to what it called the “critical inquiry”: whether the auditor could be a potential adversary or a conduit to a potential adversary.

The court in Merrill Lynch acknowledged that Sarbanes–Oxley strengthens the independent role that auditors assume in relation to their corporate clients, yet it found in this particular case that there was no adversarial relationship. The court affirmed that the aim of auditor independence and regulatory reform should be to encourage full and frank disclosures by

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108 Id.
109 Id. at 117.
111 Id. at 449.
112 Id. at 447.
113 Id.
114 Id.
115 Id. at 449.
corporations to their independent auditors, which would ultimately make more accurate information available to the investing public.\textsuperscript{116} The court also implied that finding waiver for disclosures to independent auditors might deter the auditors from inquiring too closely into corporate wrongdoing.\textsuperscript{117} Ultimately, the court’s holding came down to a balance of competing policy concerns. On one hand, the work product doctrine should be appropriately limited as a narrow exception to litigants’ perceived right to “every man’s evidence.”\textsuperscript{118} On the other hand, courts should promote complete disclosure by clients to their auditors.\textsuperscript{119} The interest of promoting disclosures won, at the expense of encroachment on the limits of the work product doctrine, and the privilege was protected despite disclosure to a third party independent auditor.\textsuperscript{120}

Dicta from the Second Circuit’s ruling in \textit{United States v. Adlman}, decided between the \textit{Medinol} and \textit{Pfizer} decisions, provides further support for the non-waiver line of cases.\textsuperscript{121} In \textit{Adlman}, the Second Circuit addressed whether a study prepared for an attorney that assessed the results of litigation should be eligible for work product protection.\textsuperscript{122} The court applied the “because of” test and held that the study did merit work product protection in the first place.\textsuperscript{123} As part of the court’s reasoning, it included three hypothetical fact situations, finding in each that work product protection would be granted.\textsuperscript{124} One of those fact patterns involved a request by an

\begin{itemize}
\item \textsuperscript{116} \textit{Id.}
\item \textsuperscript{117} \textit{Id.}
\item \textsuperscript{118} \textit{Id.} (quoting \textit{United States v. Bryan}, 339 U.S. 323, 331 (1950)).
\item \textsuperscript{119} \textit{Id.}
\item \textsuperscript{120} \textit{Id.}
\item \textsuperscript{121} 134 F.3d 1194 (2d Cir. 1998).
\item \textsuperscript{122} \textit{Id.} at 1196.
\item \textsuperscript{123} \textit{Id.} at 1198.
\item \textsuperscript{124} \textit{Id.}
\end{itemize}
independent auditor for legal strategies prepared by a company’s attorney. This analysis was later cited by Magistrate Judge James Francis in American Steamship, Inc. v. Alcoa Steamship, Inc. to support his departure from Medinol, as he concluded that work product immunity was not waived when the material was disclosed to an independent auditor.

Most recently, though, another district court within the jurisdiction of the Second Circuit sided with Medinol, departing from the stronger trend established by Pfizer, Merrill Lynch, and dicta in Adlman. In United States v. Hatfield, the court found that the disputed consulting documents were not protected work product in the first place. But the court went further and stated that, even if the documents had been protected work product, the protection would have been waived because the documents were disclosed to an independent auditor. The court noted that a party asserting work product protection over disputed material must show that it took “reasonable precautions” to ensure the disclosed material would remain confidential. The court again focused on the role of the auditor as a “public watchdog” and found that the possibility always existed that the independent auditor’s investigation could reveal that the disclosing party acted fraudulently or negligently. Accordingly, finding waiver is appropriate because “[s]haring potentially inculpatory information with an entity dedicated to uncovering

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125 Id.
128 Id. at *4.
129 Id.
130 Id.
131 Id. at *3.
financial irregularities is entirely inconsistent with the ‘zone of privacy’ that ‘underlies the work product doctrine.’”

These competing concerns were finally directly addressed by a federal circuit court in *United States v. Deloitte LLP*, in which the D.C. Circuit held that the disclosure of otherwise protected documents to an independent auditor did not amount to work product waiver.\(^{133}\)

C. *The Deloitte Decision*

Besides appearing in dicta in the *Adlman* decision handed down by the Second Circuit, the issue of work product waiver as a result of disclosure to an independent auditor only recently reached the federal circuit level in *Deloitte*. In *Deloitte*, the D.C. Circuit sided with the stronger trend of cases that find non-waiver outlined in Part II.B.\(^{134}\) The decision is important to the analysis of work product waiver because it is the latest decision supporting a clear trend in the interpretation of the work product doctrine and because it establishes a new and overly narrow standard used to determine whether an auditor can be a potential adversary.

In *Deloitte*, Dow challenged IRS tax adjustments to the tax returns of two partnerships owned by Dow.\(^{135}\) The Government subpoenaed Deloitte—Dow’s independent auditor—and sought production of files associated with Deloitte’s audit of reserves that Dow maintained in case the IRS imposed higher taxes.\(^{136}\) Deloitte refused to produce three documents based upon

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\(^{132}\) *Id.* (quoting *Medinol*, 214 F.R.D. at 114–15).

\(^{133}\) 610 F.3d 129, 133 (D.C. Cir. 2010), *cert. denied*, 130 S. Ct. 3320 (2010). The issue of work product waiver was raised in the district court holding of *Textron*, which was later reviewed *en banc* by the First Circuit. *See* United States v. Textron Inc., 507 F.Supp.2d 138, 152 (D.R.I. 2007); United States v. Textron Inc., 577 F.3d 21 (1st Cir. 2009) (*en banc*), *cert. denied*, 130 S. Ct. 3320 (2010). However, the issue of waiver was not appealed, and the First Circuit did not rule on the matter in its *en banc* opinion. *Id.* at 25.

\(^{134}\) *Deloitte*, 610 F.3d. 133.

\(^{135}\) *Id.*

\(^{136}\) *Id.*
Dow’s assertion that the documents were protected under the work product doctrine. The Government then filed a motion to compel Deloitte to produce the documents in the United States District Court for the District of Columbia.

The first disputed document (the “Deloitte Memorandum”) was a draft memorandum prepared by Deloitte that discussed a meeting between Deloitte employees, Dow employees, and Dow’s outside counsel concerning the possibility of litigation over the tax treatment of a partnership, and the need to account for this possibility in the course of an audit. The second document was a flow chart and memorandum created by a Dow accountant and an in-house attorney. The third document was a tax opinion prepared by Dow’s outside counsel. The Government acknowledged that the latter two documents, referred to as the “Dow Documents,” contained protected work product.

The court held that, although the Deloitte Memorandum was prepared by an auditor, it was protected work product because the doctrine focuses on the content of the material, not on the preparer. Because the document contained material that reflected the ideas of Dow’s counsel, the entire memorandum was sent back to the district court for in camera review to determine which parts, if any, contained protected work product material. More importantly, the court applied the broader “because of” test, and by focusing on the document’s contents rather than its function, the court held that the material in the documents could have been

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137 Id.
138 Id. at 132–33.
139 Id. at 133.
140 Id.
141 Id.
142 Id. at 133–34.
143 Deloitte, 610 F.3d at 136.
144 In camera inspection involves “a trial judge’s private consideration of evidence.” BLACK’S LAW DICTIONARY 828 (9th ed. 2009).
145 Deloitte, 610 F.3d at 139.
generated “in anticipation of litigation” even if it could have also been used for ordinary business purposes.\footnote{\textit{Id.} at 138.} According to the court, as long as the material “was prepared because of the prospect of litigation,” it should be afforded work product protection—even though it served the additional function of satisfying the requirements of an audit.\footnote{\textit{Id.}}

Although the Government conceded that the Dow Documents contained protected work product, the Government argued that work product immunity was waived when these documents were disclosed to Deloitte.\footnote{\textit{Id.} at 139.} The court adopted the prevailing standard that results in waiver if disclosure is “inconsistent with the maintenance of secrecy from the disclosing party’s adversary.”\footnote{\textit{Deloitte}, 610 F.3d at 140 (quoting Rockwell Int’l Corp. v. U.S. Dep’t of Justice, 235 F.3d 598, 605 (D.C. Cir. 2001)).} Accordingly, work product privilege is waived if work product is voluntarily disclosed to a potential adversary or a conduit to an adversary.\footnote{\textit{Id.}}

1. \textit{Deloitte as a Potential Adversary}

The court held that Deloitte was not a potential adversary of Dow, stating that the mere possibility that a dispute \textit{could} arise between a company and its auditor was not sufficient to hold that an independent auditor is a potential adversary for the purposes of work product waiver.\footnote{\textit{Id.} (emphasis added).} The court first described professional standards of conduct that require auditor independence and concluded that these standards show that any actual or threatened litigation would compromise independence and require withdrawal from the audit.\footnote{\textit{Id.} at 138. See AICPA PROFESSIONAL STANDARDS, Code of Professional Conduct § 101.08 (Am Inst. of Certified Pub. Accountants 2005) (describing the effect of actual and threatened litigation on auditor independence).} The court then asserted that “an auditor’s need to scrutinize and investigate a corporation’s records and book-keeping practices
simply is not the equivalent of an adversarial relationship contemplated by the work product
doctrine.”  

In accordance with Merrill Lynch, this language suggests that independent auditors are not inherently potential adversaries of their clients despite their roles as corporate financial statement examiners that serve the interests of public transparency. Therefore, an automatic rule of waiver in every case of disclosure to an independent auditor would not make sense because the work product doctrine would cease to protect any documents prepared by attorneys and disclosed to independent auditors.

The court’s focus—to determine whether Deloitte was a potential adversary—depended upon a factual analysis of “whether Deloitte could be Dow’s adversary in the sort of litigation the Dow Documents address.” The court found that Dow could not be an adversary in litigation over what was contained in the Dow Documents because Dow anticipated a dispute with the IRS, not with Deloitte. Furthermore, the tax implications contained in the Dow Documents would probably not be relevant to any possible litigation between Dow and Deloitte.

This standard articulated by the court narrows the definition of “adversary” for work product purposes to cover only a situation where an auditor could be an adversary in the sort of

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153 Deloitte, 610 F.3d at 138 (quoting Merrill Lynch v. Allegheny, 229 F.R.D. 441, 448 (S.D.N.Y. 2004)).  
154 See Merrill Lynch, 229 F.R.D. at 449 (ruling against a blanket rule of waiver of the work product privilege in the case of disclosures to independent auditors).  
155 See Medinol, Ltd. v. Boston Scientific Corp., 214 F.R.D. 113 (S.D.N.Y. 2002); see also Michelle M. Henkel, Textron: The Debate Continues as to Whether Auditor Transparency Waives the Work Product Privilege, 50 TAX MGM’T MEMO. 251, 263 (June 22, 2009) (“[I]f the mere chance of a subsequent disclosure were enough for waiver, the work product privilege would be eviscerated.”).  
156 Deloitte, 610 F.3d at 140.  
157 Id.  
158 Id.
litigation that the disputed documents address.\footnote{159} Under this limitation, a court may find that an auditor can only be an adversary if that auditor has a personal stake in the underlying material addressed in the document. But unless an auditor has violated its professional qualifications or is practicing fraudulently as a CPA, no auditor should have a stake in the audited company’s underlying transactions due to the rules of auditor independence.\footnote{160}

This standard might be met—amounting to a waiver of the work product protection—if corporate documents disclosed to an auditor fairly anticipate a dispute with the auditing firm over its services unrelated to the audit. A large accounting firm may provide both tax and audit services to the same client; conflict-of-interest rules prevent an independent auditor from issuing an opinion on the financial statements of a current litigation adversary, but the auditing firm could become an adversary due to the involvement of its tax arm.\footnote{161} Tax advice can be provided by the same firm that conducts the audit, subject to limitations instituted by Sarbanes–Oxley that mandate audit committee approval.\footnote{162} One can imagine that documents incorporating the work of the independent auditing firm’s tax arm might be disclosed as part of a routine audit to determine the accuracy of contingency reserves.\footnote{163} Subsequently, a tax position addressed in a

\footnote{159} Deloitte, 610 F.3d at 140.

\footnote{160} See Professional Standards R. 3520 (Pub. Co. Accounting Oversight Bd. 2007) (requiring auditors to remain independent throughout the course of an audit); AU § 101, 101-1 Interpretation of Rule 101, at .02 (Am Inst. of Certified Pub. Accountants 2002) (describing various situations that would impair auditor independence).

\footnote{161} See AU § 101, 101-6 Interpretation of Rule 101, at .08 (Am Inst. of Certified Pub. Accountants 2002) (describing the effect of actual or threatened litigation on independence).

\footnote{162} 15 U.S.C. §78k-1(h) (2006) (“A registered public accounting firm may engage in any non-audit service, including tax services . . . only if the activity is approved in advance by the audit committee of the issuer.”).

\footnote{163} See ACCOUNTING FOR CONTINGENCIES, Statement of Fin. Accounting Standards No. 5, para. 1 (Fin. Accounting Standards Bd. 1975) (“[A] contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (hereinafter a ‘gain contingency’) or loss (hereinafter a ‘loss contingency’) to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.”).
document that contains work product may become the central issue in litigation between a client and its auditing firm if, for example, the tax advisors were involved in a scheme of criminal tax avoidance. If the auditors failed to scrutinize these estimates in violation of accounting regulations, this would make an even stronger case for waiver of the privilege under this standard because the client and the auditor could conceivably become litigation adversaries over this auditing failure.

The result is that an auditor becomes an anticipated adversary of the client over an issue that directly relates to material produced with the involvement of the auditor’s tax arm. If this material specifically relating to a possible dispute with the auditor’s firm were then disclosed to the auditor in the course of an audit, this situation would meet the narrow standard established in *Deloitte*. But even if the auditors were not involved in any wrongdoing, because the auditing firm’s tax arm was involved in criminal tax avoidance and documents discussing this were disclosed to the auditors, under the *Deloitte* standard the auditing firm became an anticipated adversary of the client over an issue that directly relates to possible litigation with the firm, and work product protection would be waived.

Alternatively, this standard would not likely be met—work product protection would not be waived—in the model case posed in Part II.D of this Article. In the model case, the auditor was complicit in fraud, but the underlying documents did not address this possibility. Under *Deloitte*’s narrow standard, disclosure would not amount to waiver where the auditor was complicit in fraud because the disclosed documents do not address potential litigation between the auditor and its client. Under the same standard, however, disclosure to an auditor that did not

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164 See supra text accompanying notes 175–178.
act fraudulently, but that handled documents discussing litigation between the client and its tax arm, would have amounted to a waiver of the work product protection.

The standard for determining a “potential adversary” articulated in Deloitte is thus unclear and risks narrow interpretation by lower courts. Corporations, attorneys, and auditors are left wondering whether an auditor may ever become an “adversary” under Deloitte’s standard in the event that the auditor may be criminally liable for fraudulent practices related to the analysis of a document (for example, a knowing failure to apply GAAS or follow GAAP), even if the fraud is not related to a stake in the underlying substance of that document. In effect, the court in Deloitte followed the reasoning of Merrill Lynch, but went a step further and established a standard that will almost always be satisfied when auditors receive otherwise privileged information from their clients, without accounting for suspect circumstances where auditors act fraudulently through coordinated use of disclosed work product.

2. Deloitte as a Conduit to Dow’s Adversaries

After the court held that Deloitte was not an adversary, the Government then argued that Deloitte was a conduit to Dow’s adversaries, and that Dow’s disclosure waived the work product privilege.\(^{165}\) The court identified two factors that tend to indicate that a party is a conduit to an “adversary”: (1) the extent to which a disclosing party engaged in “selective disclosure,” and (2) the extent to which a disclosing party had a reasonable expectation of confidentiality.\(^{166}\) If a close analysis of either of these factors shows that a disclosure was inconsistent with “maintenance of secrecy” from adversaries, then the court should find that the work product privilege was waived.\(^{167}\)

\(^{165}\) Deloitte, 610 F.3d at 141.
\(^{166}\) Id.
\(^{167}\) Id.
“Selective disclosure” occurs when a disclosing party reveals its work product to some adversaries, but not to others. The court succinctly found that “selective disclosure” did not occur because Deloitte was not an “adversary” in the first place. The court then noted that Dow and Deloitte did not share common litigation or other interests in the disclosed documents, but that a reasonable expectation of confidentiality can prevent work product privilege from being waived. Accordingly, the court closely focused on the second factor and sought to determine whether Dow had a reasonable expectation of confidentiality when it disclosed the documents to Deloitte.

Despite the Government’s argument that there are many possible ways in which an independent auditor could reveal the information contained in the document, the court found that “Dow had a reasonable expectation of confidentiality because Deloitte, as an independent auditor, has an obligation to refrain from disclosing confidential client information” according to the American Institute of Certified Public Accountants’ (AICPA) Code of Professional Conduct. Therefore, in the court’s view, Dow had a reasonable expectation that Deloitte would not disclose its confidential information, leading the court to hold that the disclosure of the Dow Documents did not amount to waiver of work product protection.

To this point, this Part has outlined the common law doctrine of work product waiver and presented the split of authority that has predominated primarily within district courts within the

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168  *Id.* at 142.
169  *Id.*  See *supra* notes 153–166 and accompanying text for a discussion of the standard articulated in *Deloitte* for determining whether a party is an “adversary” for work product purposes.
170  *Deloitte*, 610 F.3d at 142.
171  *Id.*
172  See *id.*; see also AICPA PROFESIONAL STANDARDS, Code of Professional Conduct § 301.01 (Am Inst. of Certified Pub. Accountants 2005).
173  *Deloitte*, 610 F.3d at 142.
jurisdiction of the Second Circuit. The Deloitte decision reached by the D.C. Circuit is the first circuit court to directly address the issue, and it appropriately followed the majority of cases that found that disclosures to independent auditors did not waive work product protection. Deloitte and the other non-waiver decisions produced proper outcomes under the particular facts of each respective case, but failed to adequately consider all of the policy concerns that would permit future courts to properly address true adversarial relationships—notably those that would arise from coordination in fraudulent practices—between auditors and their corporate clients. The following model case presents a set of facts that tests the limit of Deloitte’s narrow standard.

D. The Model Case

Imagine a large pharmaceutical company, Safe Medicine, Inc. (SMI), which employs Linda Brown, a products liability attorney, to regularly review the prospects of ongoing litigation related to various over-the-counter drugs sold by SMI in the United States. Several users of SMI’s new migraine pain relief drug sue the company and claim that the drug caused them to experience sudden and debilitating chest pains. SMI’s managers ask Brown to conduct an investigation and ultimately draft a report analyzing the possible success of these claims and estimating the amount that SMI might expect to pay in damages. Brown drafts a report that estimates only a slim chance that the lawsuits may result in large payouts by SMI to successful plaintiffs. SMI managers then use this report to maintain adequate reserves to cover financial

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174 This model case draws from several cases and situations in which otherwise protected work product is disclosed to an independent auditor. See, e.g., Deloitte, 610 F.3d at 129; Merrill Lynch v. Allegheny, 229 F.R.D. 441, 448 (S.D.N.Y. 2004); Medinol, Ltd. v. Boston Scientific Corp., 214 F.R.D. 113 (S.D.N.Y. 2002); In re Pfizer Inc. Securities Litigation, No. 90 Civ. 1260 (SS), 1993 WL 561125, at *1–2 (S.D.N.Y. Dec. 23, 1993); Colón, supra note 24; Bloomberg News, Ernst & Young is Added to a Lehman Lawsuit, N.Y. TIMES, Apr. 26, 2010, at B7. The model is tailored to facilitate analytical clarity throughout this Article by addressing, in particular, the possibility of complicit auditor involvement in corporate fraud.
losses from tort claims. These reserves, along with notice of the pendency of the ongoing lawsuits, are reflected on SMI’s publicly issued financial statements as contingent liabilities.\textsuperscript{175}

During the annual audit of the company’s financial statements, and upon the request of its independent auditors, SMI’s managers provide the auditors with copies of Brown’s reports. The independent auditors compare these reports with SMI’s contingent liabilities reported on its publicly issued financial statements and ultimately issue an unqualified audit opinion for SMI, which states that the company’s financial statements are fairly presented in accordance with applicable securities laws and accounting regulations.

Subsequently, SMI loses a series of tort claims brought by plaintiffs that suffered debilitating side-effects after using SMI’s new migraine pain relief drug, and the company becomes liable for damages well in excess of its estimated reserves. When news spreads the company’s stock price plummets\textsuperscript{176} and investors file a class action lawsuit for lost profits, claiming that SMI’s managers improperly underreported their reserves for contingent liabilities in violation of securities laws. The investors also claim that the underreported liabilities allowed SMI to report inflated earnings that misled investors. The investors include the independent auditors as defendants, claiming that they failed to properly follow auditing standards during their audit of SMI’s financial statements. The investors then issue a subpoena to the auditors requesting copies of the reports drafted by Brown.

\textsuperscript{175} Contingent liabilities are obligations that depend on the outcome of a future uncertain event, such as a court case. See Accounting for Contingencies, Statement of Fin. Accounting Standards No. 5, para. 33 (Fin. Accounting Standards Bd. 1975) (listing three factors to be considered when determining whether disclosure is required with respect to possible claims and assessments: (1) “[t]he period in which the underlying cause” of the assessment occurred, (2) “[t]he degree of probability of an unfavorable outcome,” and (3) “[t]he ability to make a reasonable estimate of the amount of loss”).

When the independent auditors decline to disclose Brown’s reports and assert work product protection\textsuperscript{177} to prevent this material from becoming available to the investors in discovery, the investors claim that SMI waived such protection because the reports were disclosed to the independent auditors.\textsuperscript{178}

This model case presents the very likely possibility that an auditor may be sued for acting in concert with corporate fraud committed by upper management\textsuperscript{179} and demonstrates that the majority approach to work product waiver analysis outlined in this Part is inadequate to address concerns that implicate independent auditors in this sort of fraudulent behavior. The next Part will examine the shortcomings of current approaches to work product waiver analysis in accordance with the model case posed here, offer a more thorough case-by-case method of analysis, and in the alternative offer a bright-line comprehensive fix to the uncertainty compounded by the narrow standard established in \textit{Deloitte}.

\section*{III. Flexibility Persists and Sound Policy Prevails: A Suggested Approach to Account for Realistic Tensions and Cope With an Uncertain Protection}

Because most courts that faced the issue of work product waiver from disclosure to auditors decided not to closely analyze whether the disclosures were voluntary, the analysis instead has focused on whether the disclosure substantially increases the chance that a possible adversary will obtain the information.\textsuperscript{180} Accordingly, a disclosure to an independent auditor

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\textsuperscript{177} The work product doctrine, while often treated as a privilege, more precisely provides a form of qualified immunity from discovery. \textit{See infra} note 28 and accompanying text. In this Article, I will use the terms “doctrine,” “privilege,” “immunity,” and “protection” interchangeably, although these variations all refer to the work product doctrine.


\textsuperscript{179} \textit{See supra} notes 1–5 and accompanying text.

\textsuperscript{180} \textit{See Merrill Lynch & Co. v. Allegheny Energy}, 229 F.R.D. 441, 445 (S.D.N.Y. 2004). Work product protection is waived when disclosure is “inconsistent with the maintenance of secrecy

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waives the privilege if the auditor is considered a potential adversary or a conduit to an adversary. ¹⁸¹ When an opposing party claims that work product protection was waived—to make disclosed information available to both parties in discovery—it will often proceed on both of these alternatives. ¹⁸²

Most courts have concluded that disclosure of attorney work product to independent auditors does not waive the protection, though the results have been mixed. ¹⁸³ At least one court has acknowledged that there are good arguments on both sides of this issue. ¹⁸⁴ Disclosures to independent auditors should generally not cause corporations to waive work product immunity, and most courts that reached this outcome properly addressed at least some of the competing policy concerns. However, the reasoning that guided those outcomes, where courts found that disclosure did not waive work product immunity, may not yield proper future outcomes when there is a true cause for finding that disclosure waives the protection. In other words, the guidance used by the non-waiver line of cases is preferable, but incomplete, as the decisions do not leave room for courts to adequately react when a genuine adversarial relationship may arise between a client and its independent auditor. ¹⁸⁵

¹⁸¹ Deloitte, 610 F.3d at 142.
¹⁸² See, e.g., id. (the Government proceeded on both theories: potential adversary and conduit to a potential adversary).
¹⁸³ See discussion supra Part II.
¹⁸⁴ Merrill Lynch, 229 F.R.D. at 446.
¹⁸⁵ In Merrill Lynch, the court held that disclosure to the auditor did not waive work product protection, and held that there must be a “tangible adversarial relationship,” yet failed to describe when such a relationship may arise. Id. In Deloitte, the court held that an adversarial relationship may only be found when a corporation discloses documents to its auditor that specifically address expected litigation between the client and the auditor. 610 F.3d at 142.
The split of authority within district courts under the jurisdiction of the Second Circuit, where most of the litigation surrounding this issue has taken place, shows that corporations still face uncertainty. The recent D.C. Circuit decision in Deloitte, which sided with the stronger trend from the panoply of district court decisions on this issue within the Second Circuit, provides an appealing precedent for corporations and allays some of this uncertainty. But Deloitte went further and applied an overly narrow standard when it decided whether an auditor becomes a potential adversary. After Deloitte, the IRS issued an announcement that reenacted its previous policy of restraint in making requests for documents otherwise protected under the work product privilege. But the IRS did not acquiesce to the Deloitte decision. Deloitte leaves room for the IRS, other government agencies such as the Department of Justice or the SEC, and certainly private parties, to assert work product waiver in cases that seem more like an auditor could truly become an adversary of its client, despite the decision’s narrow standard. Meanwhile, corporations face continued uncertainty, and government agencies still have an arrow left in their quiver.

186 See discussion supra Part II.A.
189 Jeremiah Coder, Work Product Protection Stronger After Deloitte, Practitioners Say, 2010 TAX NOTES 188-4 (Sept. 28, 2010) (“Expanding the IRS’s policy of restraint in Announcement 2010-76 is not an informal acquiescence to the government’s loss in Deloitte . . . .”).
190 Prior to the Deloitte decision and the IRS Announcement, which reinstated its previous policy of restraint, one commentator suggested that one way to deal with the conflicting policy concerns implicated by work product waiver claims and the uncertain state of the law is to encourage the IRS to use more restraint in its document requests. Andrew Golodny, Lawyers Versus Auditors: Disclosure to Auditors and Potential Waiver of Work Product Privilege in United States v. Textron, 61 TAX LAW. 621, 637 (2008). This compromise, however, still leaves room for uncertainty and inconsistent decisions as private plaintiffs can still assert that the protection was waived in an attempt to discover otherwise protected attorney work product that was disclosed to independent auditors.
As courts continue to wrestle with this issue, they should fully consider the competing policy concerns and adequately address the circumstances at their immediate disposal to determine whether a corporation did in fact disclose its work product to a potential adversary, even if that third party is its independent auditor. This Part offers a case-by-case approach that courts should use to address work product waiver issues in cases of disclosures to independent auditors, suggesting that courts should consider the “nature of the relationship”\textsuperscript{191} between the auditor and the corporate client at the time of the disclosure. This approach offers a thorough balance of the competing policy concerns (which courts should always address in their analysis) and proposes the “nature of the relationship” standard by which courts can adequately account for true adversarial relationships. Finally, this Part offers an alternative method of correcting the problem at the source by proposing a bright-line rule usable by Congress or appellate courts that would prevent waiver in most cases of disclosure to independent auditors. The proposed rule would not create a complete safe harbor from waiver, but would instead allow adequate room for situations where there could be a genuine adversarial relationship between corporations and their independent auditors.

A. A Case-By-Case Approach: When Independent Auditors Become Adversaries

Until Congress offers an alternative to the Hobson’s choice corporations face from pressures for disclosure imposed by Sarbanes–Oxley, courts should adopt a case-by-case

\textsuperscript{191} This proposed fact and circumstances test is consistent with the Supreme Court’s framing of the relationship between independent auditors and their clients in \textit{Arthur Young & Co.}, 465 U.S. 805 (1984). There, the Court viewed independent auditors as “public watchdogs,” so viewing the nature of the relationship between an independent auditor and a disclosing client serves as an appropriate guideline to determine whether the relationship was adversarial in the context of the Supreme Court’s assertion that auditors owe ultimate allegiance to the investing public. \textit{Id.} at 818. A “nature of the relationship” test has also been used to analyze third party standing where a court determines the extent of the stake a third party has in a constitutional challenge. See Secretary of State of Md. v. Joseph H. Munson Company, Inc., 467 U.S. 947, 973 (1984) (Stevens, J., concurring).
approach that neither erodes the work product doctrine nor guarantees its protection for every
disclosure made in the course of an audit. Although a case-by-case approach inherently obviates
complete certainty, courts will reach well-reasoned conclusions by thoroughly addressing both
sides of the policy debate outlined in this Part. Moreover, this proposed approach permits
corporations to take the necessary precautions to avoid triggering a disclosure that would waive
the privilege—creating sufficient certainty for disclosing corporations.

The court in *Deloitte*, when it decided that the independent auditor was not a conduit to
potential adversaries of the corporation, considered whether the corporation reasonably expected
that the auditor would maintain confidentiality.\(^\text{192}\) In the court’s view, a sufficiently strong
confidentiality agreement between a disclosing corporation and its independent auditor provides
reasonable assurance of confidentiality.\(^\text{193}\) In addition, Rule 301 of the AICPA Code of
Professional Conduct also imposes a reasonable expectation of confidentiality.\(^\text{194}\) Finally, the
court considered the number of ways the independent auditor could disclose confidential
information: under an obligation to report acts of fraud, under pressure to testify in proceedings
brought by the SEC or private parties, or by forcing the corporation to disclose its confidential
tax analysis in footnotes to the company’s publicly issued financial statements.\(^\text{195}\) Nevertheless,
these regulations and possible situations never specifically require disclosure, so the court found
that auditor obligations as “public watchdogs” do not make auditors conduits to the adversaries
of their corporate clients.\(^\text{196}\) Under this guidance, corporations can simply enter into

\(^\text{192}\) United States v. Deloitte LLP, 610 F.3d 129, 133 (D.C. Cir. 2010).
\(^\text{193}\) Id.
\(^\text{194}\) Id. See AICPA PROFESSIONAL STANDARDS, Code of Professional Conduct § 101.08 (Am Inst. of Certified Pub. Accountants 2005) (describing the effect of actual and threatened litigation on auditor independence).
\(^\text{195}\) Deloitte, 610 F.3d at 143–44.
\(^\text{196}\) Id. at 144.
“sufficiently strong” agreements with their auditors and expect with reasonably strong certainty that they do not disclose to a conduit to an adversary when they respond to auditor inquiries.\footnote{Corporations should always enter confidentiality agreements with their auditors, and should also ensure that when auditors make requests directly to their counsel, the counsel provides specific restrictions on subsequent disclosure to independent auditors. See United States v. Hatfield, No. 06-CR-0550 (JS), 2010 WL 183522, at *3 (E.D.N.Y. Jan. 8, 2010) (holding that work product protection was waived because the auditors were not given specific restrictions on what work product they could share and did not engage in any discussions about confidentiality).}

The leeway in the “adversary” analysis instead is found when courts must decide whether, in a particular case of disclosure, an auditor could be a potential adversary. Accordingly, when deciding whether an independent auditor could be a potential adversary, courts should apply the following standard: analyze the nature of the precise relationship between the corporation and its auditor at the time of the disclosure (if the parties used disclosures to mutually conduct and conceal fraud, then this militates in favor of finding waiver).

Before this standard is considered in detail, however, it is necessary to explain why courts should not employ a blanket rule of waiver or non-waiver in cases where work product is disclosed to independent auditors. The following section outlines the various policy concerns that courts deciding this issue should always address, and offers support for the flexible fix in Part III.B. This balance of policy concerns supports a rejection of proposed statutory fixes that would create a bright-line rule of waiver or non-waiver and instead justifies a more flexible fix usable by Congress or an appellate court that wishes to design new precedent.

1. **Policy Arguments: Blanket Waiver and Non-Waiver Rules are Unfavorable**

Courts must always recognize that independent auditors, as accountants, serve as “public watchdogs” that owe ultimate allegiance to the investing public. This differs from the role that accountants may assume as consultants. Sarbanes–Oxley limited the additional roles that
independent auditors may assume in an effort to be sure that independent auditors fulfill their primary roles as neutral disseminators of accurate financial information.\textsuperscript{198} Courts that found that waiver occurred from disclosure to an independent auditor usually compared the role of an accountant as a consultant with the role of an accountant as an auditor.\textsuperscript{199} Unpacking these roles in this manner demonstrates that independent auditors do not share the same interests with their clients as accountants that act as consultants.

Courts deciding for and against waiver have acknowledged that independent auditors and their clients should not have common litigation interests,\textsuperscript{200} but some have found that other interests, such as a common interest in creating financial statements that are fairly presented, can be inferred to show that independent auditors are not inherently potential adversaries.\textsuperscript{201} Parties with common business interests, for example, may nonetheless share work product and still enjoy the protection.\textsuperscript{202} In\textit{Merrill Lynch & Co. v. Allegheny Energy, Inc.}, the court found that: “A business and its auditor can and should be aligned insofar as they both seek to prevent, detect, and root out corporate fraud.”\textsuperscript{203} This provides strong support for the conclusion that clients and their auditors should not inherently be considered potential adversaries, despite the strong language in\textit{United States v. Arthur Young & Co.} that mandates “total independence from the client at all times and requires complete fidelity to the public trust.”\textsuperscript{204}

Indeed, finding a blanket rule of waiver in these cases would eviscerate the work product doctrine and would likely prevent corporations from making disclosures to the auditor that would

\begin{footnotesize}
\begin{enumerate}
\item See supra note 6.
\item See, e.g.,\textit{Hatfield}, 2010 WL 183522 (2010).
\item See, e.g.,\textit{United States v. Deloitte LLP}, 610 F.3d 129, 142 (D.C. Cir. 2010).
\item Id.
\item 229 F.R.D. 441, 448 (S.D.N.Y. 2004).
\end{enumerate}
\end{footnotesize}
otherwise benefit the investing public. On the other hand, this presumption should not be steadfastly assumed. Independent auditors have the power to issue qualified (unfavorable) opinions, or disclaimers (in which the auditors decline to issue an opinion) over a client’s financial statements if the client declines to disclose requested information.\textsuperscript{205} Issuing a qualified opinion or a disclaimer of an opinion will likely have adverse effects on the market price of a company’s stock.\textsuperscript{206} In \textit{Arthur Young}, the Supreme Court suggested that this pressure would cause corporate management to think twice about risking unfavorable evaluations of the company’s financial statements just to cover up questionable positions in possible litigation.\textsuperscript{207}

Consequently, a blanket rule of non-waiver should not be imposed either. Sometimes independent auditors overstep the bounds intended by Sarbanes–Oxley.\textsuperscript{208} If a blanket rule of non-waiver is instead imposed, corporations might be protected from liability for fraudulent activity that is ratified by an independent auditor. The \textit{Deloitte} decision meets in the middle, yet

\textsuperscript{205} \textit{See} \textbf{REPORTS ON AUDITED FINANCIAL STATEMENTS}, Statements on Auditing Standards No. 508 (Am. Inst. of Certified Pub. Accountants 1989). An auditor may issue an unqualified opinion, the most favorable report an auditor may give, if the financial statements fairly and accurately present the financial position of the company, the results of its operations, and the changes in its financial position for the period under audit, in conformity with generally accepted accounting principles. \textit{Id.} § 10. Alternatively, the auditor may issue a qualified opinion if the financial statements are fairly presented except for, or subject to, a departure from generally accepted accounting principles, a change in accounting principles, or a material uncertainty. \textit{Id.} An auditor may issue an adverse opinion if the corporation’s financial statements do not fairly present the financial position, results of operations, or changes in financial position of the company in conformity with generally accepted accounting principles. \textit{Id.} Adverse opinions may be issued if an auditor determines that a corporation has materially misstated certain items on its financial statements. \textit{Id.} § 45–49. Finally, an auditor may issue a disclaimer of opinion if the auditor is unable to draw a conclusion as to the accuracy of the corporate financial records. \textit{Id.} § 10. A disclaimer of opinion usually occurs when restrictions are imposed on auditors, also known as “scope limitations,” which significantly limit their ability to audit important elements of the financial statements. \textit{Id.} § 24.

\textsuperscript{206} \textit{See} \textit{Arthur Young}, 465 U.S. at 450.

\textsuperscript{207} \textit{Id.}

\textsuperscript{208} For example, by failing to root out corporation fraud under 15 U.S.C. § 7241(a)(5)(B) (2006), which requires management to disclose instances of fraud to its independent auditors.
it narrowly construed the term “adversary” for the purposes of work product waiver. The D.C. Circuit stated that the question is not whether the corporation could be the auditor’s adversary in any possible future litigation, but whether the corporation could be the auditor’s adversary in the sort of litigation the disclosed documents address.\(^{209}\) Accordingly, the court found that the documents disclosed to the auditors contemplated a dispute with the IRS, and not with the auditor, therefore the documents would not likely be relevant in any dispute between the company and its independent auditor.\(^ {210}\)

This standard is one step closer to finding a proper middle ground between blanket waiver and blanket non-waiver, which is the most appropriate approach unless Congress steps in to clarify that the law should lean one way or the other. But Deloitte’s standard focuses on the content of the document to ascertain its purpose for the waiver issue, which is an improper method of analysis that narrows the scope of possible situations in which a later court would find that a disclosure waived work product protection.\(^ {211}\) In practice, this standard conforms adequately to the competing policy concerns addressed in this Part, but it will miss the mark when auditors can become potential adversaries in cases of auditor fraud and when the disclosed documents do not directly address litigation between the corporation and the independent auditor. As the court in Deloitte stated, an auditor must withdraw in the event that the corporation and the auditor become directly involved with litigation, so the auditor should rarely request and receive a document in which the corporation discusses a suit with that same auditor.\(^ {212}\) One possible exception might be complicit fraud in which attorney work product

\(^{209}\) 610 F.3d at 140.  
\(^{210}\) Id.  
\(^{211}\) See id.  
\(^{212}\) Deloitte 610 F.3d at 140. See AICPA PROFESSIONAL STANDARDS, CODE OF PROFESSIONAL CONDUCT § 101.08 (Am. Inst. of Certified Pub. Accountants 2005).
discusses possible auditor liability, when the auditors then violate accounting regulations by failing to discover and disclose the corporate fraud.

As government regulators enforce recent charges on corporations and culpable individuals for the deception that caused the mortgage crisis, work product waiver will be inadequately served by the Deloitte analysis. For example, in the event that an independent auditor is complicit in fraudulent accounting practices, as was alleged against Ernst & Young (E & Y) for its ratification of Lehman Brothers’ deceptive accounting methods, a court employing Deloitte’s standard would likely fail to recognize this situation as an adversarial relationship that the oversteps the intended protection of the work product doctrine. Courts can employ the waiver principle to help government regulators uncover instances of fraud by following the guidance of recent courts, which have nevertheless formed a strong trend finding that waiver does not occur. Courts should remain flexible and able to recognize a situation where an auditor did maintain a relationship with the client that could result in adversarial tension.

Accordingly, courts should instead adopt a more flexible guideline to determine if a corporation enjoyed a reasonable expectation of confidentiality, so that disclosure to an auditor does not always result in waiver.

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213 During 2009, investors filed 55 class action lawsuits in federal court based on allegations of fraud related to the credit crisis. John Hellerman et al., 2010 Year in Review: Press Release, STANFORD LAW SCHOOL SECURITIES CLASS ACTION CLEARINGHOUSE (Jan. 20, 2011), http://securities.stanford.edu/scac_press/Cornerstone_Research_Filings_2010_YIR_Release.pdf. This may likely put pressure on Government regulators to also file lawsuits based on allegations of fraud in federal court, and in some cases independent auditors may have been culpably involved. Cf. Ernst & Young Sued over Lehman: Going for the Auditors the Ultimate Target of the Lawsuit may be Lehman’s Former Bosses, ECONOMIST, Dec. 29, 2010.

214 See Ernst & Young Sued over Lehman: Going for the Auditors the Ultimate Target of the Lawsuit may be Lehman’s Former Bosses, ECONOMIST, Dec. 29, 2010.

215 See discussion supra Part II.A.
2. Potential Adversaries: Nature of the Relationship Between the Client and the Independent Auditor at the Time of Disclosure

Instead of employing the overly narrow standard adopted by Deloitte, in which a court would consider whether the disclosed document contemplated litigation between the client and the auditor, courts should consider the nature of the relationship between the corporation and its auditor at the time of disclosure. This subsection will offer guidance and justifications for applying this standard.

The assumption that opposing parties are entitled to “every man’s evidence” underlies the liberal rules of discovery, and every exception or privilege “presupposes a very real interest to be protected.”\(^{216}\) The work product doctrine is justified as one such exception, resting on the belief that a lawyer’s ability to prepare for trial without intrusion by an opposing party furthers the truth-finding process.\(^{217}\) The guideline offered in this section prevents corporate clients from exploiting the protections offered by the work product doctrine by encouraging companies to disclose only attorney work product that is essential to the audit function. This guideline also prevents corporate clients from exploiting the work product doctrine by finding that corporations and their auditors become potential adversaries when the relationship becomes “substantially impaired” according to the AICPA Code of Professional Conduct.

Independent auditors typically request disclosures that may contain protected attorney work product in two categories: (1) evaluations of loss contingencies, and (2) detection of fraud and illegal acts.\(^{218}\) As long as courts determine that disclosures were made in furtherance of these two areas of auditor inquiry, work product immunity should not be waived based only upon


\(^{218}\) See Colón, supra note 24, at 136–37.
whether the documents themselves contemplate litigation between the auditor and the client.\textsuperscript{219} Instead, courts should look to the nature of the relationship between the auditor and the client at the time the disclosure was made.

Under this approach, courts would not inquire into every possible dispute that may arise between a corporation and its auditor. Rather, courts analyzing the nature of the relationship between an auditor and a corporate client would be able to identify any number of possible disputes that were extremely likely given the interaction between the corporate client and the auditor presented by the facts of each case. Using the AICPA Code of Professional Conduct’s guidelines, courts can identify whether any of the situations suggesting auditor impairment arose, then determine whether the disclosure was at odds with these guidelines. This would prevent courts from applying overly narrow standards that might miss disclosures that contravene the protections of the work product doctrine. It would also provide clear, identifiable areas where courts can analyze the facts of each case to determine whether a particular disclosure substantially increases the opportunity that the information may end up in the hands of adversaries.

In \textit{Deloitte}, the D.C. Circuit was on the right track when it recognized that certain situations could merit finding that an independent auditor was a potential adversary, but it narrowly confined this to situations where the actual disclosed documents refer to specific litigation between the client and the auditor.\textsuperscript{220} This standard is too narrow, especially in light of the AICPA Code of Professional Conduct, which offers guidelines that suggest situations in which an independent auditor and a client might be placed in a “threatened or actual position of

\textsuperscript{219} This was the standard employed in \textit{Deloitte}.

\textsuperscript{220} See United States v. Deloitte LLP, 610 F.3d 129, 142 (D.C. Cir. 2010).
material adverse interests by reason of threatened or actual litigation.”221 The Code of Professional Conduct also lists two other situations in which auditor involvement can be “impaired,” in which case the AICPA guidelines recommend withdrawal of the auditor from the engagement. Accordingly, courts should reject Deloitte’s narrow standard, which calls for review of the disclosed documents to determine whether they refer to potential litigation, and instead focus on the reasons why the disclosures were made to the auditor.

The model case in Part II.D of this Article may be used to illustrate how a court would use this approach when a court must determine whether the auditor should be considered a potential adversary. In the model case, the underlying work product is a report disclosed by Linda Brown, a products liability attorney, discussing the expected outcome of tort suits. The court would begin by identifying this request as essential to the auditor’s evaluation of loss contingencies. Next, the court might consider whether the fact that the auditor apparently failed to follow accounting regulations justifies finding that the relationship would likely become impaired under the AICPA Standards of Professional Conduct.222 Under the AICPA guidelines, the possibility outlined in this fact pattern is directly addressed.223 The guidelines state that litigation involving a class action suit naming a corporation and its auditor (precisely what occurred to SMI in the model case) does not automatically impair auditor independence and necessitate auditor withdrawal from the audit. However, these situations require careful consideration, as adverse interests can exist if cross-claims are filed alleging fraud by deceit.224

222 Id.
223 Id.
224 Id.
This might occur, for example, if SMI’s auditor later decided to cross-claim against SMI for indemnification, claiming that the managers deceived the auditors. Given this likelihood, and the strong interest in prosecuting collusive manipulation of public financial statements, a court using the “nature of the relationship” standard should find that disclosure was waived. Accordingly, even if a government regulator brought the case against the corporation and the independent auditors as defendants (instead of investors), there is strong justification for also holding that this is a situation where the “nature of the relationship,” based on the collusion, mandates finding that the disclosure waived work product protection.

One concern may be that corporations should be encouraged to disclose as much as possible to their independent auditors, and thus a limit on only essential attorney work product may prevent disclosure of information or prevent companies from seeking the advice of counsel. However, auditor regulations provide sufficient incentives for auditors to request materials that will allow them to issue opinions. As long as the auditors are in the position to request what they feel is necessary, corporations will comply or risk an adverse opinion.

Another concern might be that the Deloitte standard offers greater certainty for disclosing corporations at the time of the disclosure. Under its standard, the corporation would clearly know whether disclosed material addresses possible litigation involving the auditor, based on the content of the material. In contrast, under the “nature of the relationship” proposed standard, courts make the determination based on the attendant facts of the case. However, if courts use the explicit guidelines mentioned in the AICPA Code of Professional Conduct, corporations can control what type of relationships they create to maintain reasonable expectations that they are

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225 The plaintiffs might proceed on a “substantial need” exception, but as discussed in Part I of this Article, this exception is rarely granted.  
227 United States v. Deloitte LLP, 610 F.3d 129 (D.C. Cir. 2010).
not disclosing to “potential adversaries” when they disclose work product to independent auditors.

This proposed standard is especially useful because it does not involve a comparison with the underlying document to determine whether the auditor and the client could be potential adversaries. In Deloitte, two of the disclosed documents were clearly work product; the Department of Justice conceded this fact.\textsuperscript{228} In future cases, however, an underlying document may not appear to clearly contain privileged work product. For example, in United States v. Textron Inc., the First Circuit employed the more widely adopted “because of” test, but reached a result at odds with the majority of courts that used this test.\textsuperscript{229} The court in Textron held that the tax accrual workpapers were not entitled to work product protection, though most courts that adopt the “because of” test have found that dual-purpose documents were entitled to work product protection.\textsuperscript{230} Before this dispute reached a rehearing en banc, the district court held that the documents were protected work product, therefore its analysis centered on the waiver issue.\textsuperscript{231} The district court, relying on Pfizer and Merrill Lynch, found that no waiver occurred.\textsuperscript{232} If the First Circuit had a different set of facts that did pass its broader “because of” test, then the waiver issue would have been addressed, and waiver would have likely been found.

Courts, however, should not use the “because of” test, which itself is already uncertain following Textron, to lend support for the standard the D.C. Circuit adopted in Deloitte, in which the court looked at the underlying disclosed document to determine if it addresses a possible adversarial relationship between the corporation and the auditor. The Textron decision is

\textsuperscript{228} Id. at 142.
\textsuperscript{229} 577 F.3d 21, 30–32 (1st Cir. 2009), cert. denied, 130 S. Ct. 3320 (2010).
\textsuperscript{230} Id.
\textsuperscript{232} Id.
instructive because it shows that the “because of” test is still in flux, and because waiver is tied so closely to this issue, the results are bound to be mixed in the event that the issue is presented again at the circuit level.

Functionally, the standard proposed in this Article proves to be especially salient because it does not involve looking at the contents of the disputed materials directly. Looking at the contents would inherently involve mixing the initial “anticipation of litigation” determination for the underlying material with the analysis of waiver, which should remain distinct because both determinations address vastly different policy concerns: the work product tests serve to identify materials containing the private and personal work efforts of attorneys made in anticipation of litigation, whereas work product waiver serves to identify disclosures at odds with the maintenance of secrecy from adversaries in litigation.\textsuperscript{233} A court that decides to employ the broader “because of” test to grant more material work product protection should not necessarily broaden its approach to determine whether certain disclosures then waive this privilege. Maintaining this analytical distinction prevents courts from utilizing the circumspect analysis in \textit{Merrill Lynch}, in which the court bolstered its finding that no waiver occurred by stating that it in fact takes a \textit{broader} approach to identifying whether the underlying material is protected work product in the first place by using the “because of” test.\textsuperscript{234}

Accordingly, courts should consider the nature of the relationship between the auditor and the client and be sure to clearly separate the initial analysis of whether the underlying material was protected work product in the first place from the subsequent analysis over whether the protection was waived by disclosure to third party independent auditors. This would involve looking at the circumstances of the disclosure, such as whether it was done pursuant to an auditor

\textsuperscript{233} See discussion \textit{supra} Part II.

\textsuperscript{234} Merrill Lynch v. Allegheny, 229 F.R.D. 441, 447 n.9 (S.D.N.Y. 2004).
request related to an evaluation of litigation reserves, or whether the request was related to possible detection of fraud. This would then leave room for possible situations in which the reasons for the disclosure may have been fueled by improper purposes.

Auditors may be pressured to comply in plea bargaining to disclose documents, despite the professional protections granted through the AICPA Code of Professional Conduct, if the auditor is being criminally charged. This is exactly what might happen in the event that the charges against Ernst & Young (E&Y) relating to Lehman Brothers are not settled.\(^\text{235}\) Charging the auditors with the crimes is a means to get them to identify corporate insiders. In this scenario, an auditor seems more like an adversary. The corporation might argue that it is unfair for the government to assert waiver in an attempt to usurp the work product privilege. However, this situation, as well as similar situations involving complicit fraud between auditors and corporations, creates a strong justification for a departure from the narrow standard in Deloitte and is more aligned with the broader standard in Merrill Lynch, which contemplates a “tangible adversarial relationship.”

Congress’s aim through its enactment of Sarbanes–Oxley was to prevent the type of problematic coordination that existed between Enron’s corrupt accounting practices and Arthur Andersen’s ratification of such practices and further concealment of critical issues in its audit.\(^\text{236}\) In light of this highly criticized conduct, Sarbanes–Oxley was enacted to position the auditor more in the form of an adversary in relation to its audited clients, ready to disclose any possible

\(^{235}\) See Ernst & Young Sued over Lehman: Going for the Auditors, ECONOMIST, Jan. 1, 2011, at 97.

instances of corporate fraud in the interest of public disclosure.\textsuperscript{237} Accordingly, this “nature of the relationship” standard applies a reasonable approach to appropriately broaden the trend of cases that find non-waiver in most instances of disclosures of attorney work product to independent auditors. It balances an appropriate amount of certainty while allowing room for government agencies to ferret out fraud in fitting circumstances.

Unless Congress or an appellate court steps in with a bright-line test to clarify the issue, courts will continue to determine whether disclosure substantially increases the chance that attorney work product will end up in the hands of adversaries, and this proposed standard that considers the “nature of the relationship” provides a useful solution.

B. Bright-Line Test: Suggested Legislation or Common Law Fix

Recent cases addressing this issue ruled against \textit{Medinol} and found that waiver of the work product privilege did not occur upon a disclosure to independent auditors.\textsuperscript{238} Yet these courts have not properly taken into account the possible situations where an auditor can be a potential or conduit to an adversary. Until one of these factual situations occurs, corporations still make disclosures with a small, but potentially costly, degree of risk. A court that addresses this issue in the future should reject the guidance in \textit{Deloitte}, where the court looked to whether the auditor had a personal stake in the underlying document to determine if the auditor was a potential adversary. Instead, a court facing this issue should employ a more appropriate case-by-

\textsuperscript{237} \textit{See also} United States v. Arthur Young & Co., 465 U.S. 805, 817–18 (1984) (“The independent public accountant performing this special function owes ultimate allegiance to the corporation’s creditors and stockholders, as well as to the 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.”).

\textsuperscript{238} \textit{See} discussion \textit{supra} Part II.A.
case approach that fully considers whether a disclosing corporation engaged the auditor in activities that could result in an adversarial relationship between the auditor and the client.

The Deloitte standard is too rigid because disclosures between auditors and their clients can almost never amount to waiver under its guidance. Some might argue that this is necessary to facilitate public disclosure, in the sense that corporations will more freely disclose critical information to their auditors if the protection is certain to be unaffected by waiver, thereby enhancing disclosure to the public. But this is the goal that Sarbanes–Oxley addressed by creating the PCAOB and requiring disclosures to auditors in the first place. If the best perceived manner of encouraging full disclosure to the public is through the Sarbanes–Oxley rigid requirement of disclosure to an independent auditor, then in the alternative, Sarbanes–Oxley should be amended to include a waiver provision.

Much would be gained in this uncertain area by creating a bright-line statutory rule that addresses waiver. Alternatively, this clear rule could be employed by the next appellate court that rules on this issue. A clear rule would obviate the need for costly and elaborate inquiry into the motivations for particular disclosures and the potential for further disclosures. As one commentator stated, “Whatever minor unfairness may in some individual case inure to the privilege or protection holder is more than offset by the attendant greater efficiency in litigation and the greater ease in assessing the legal consequences of any such disclosure.”

Following this appeal to certainty, two commentators have suggested statutory fixes: one would find that waiver never occurs, and the other would find that waiver would always occur when

240 See Sarbanes–Oxley, supra note 16.
241 See EPSTEIN, supra note 24, at 1061.
corporations disclose attorney work product to independent auditors as part of an audit of a company’s publicly issued financial statements.\footnote{Compare Colón, supra note 24, at 143–44 (“Whenever an organization produces or discloses documents or information to its independent auditors for the purpose of completing an audit of the organization’s financial statements, and such documents or information are subject to the protection provided by the work product doctrine, such production or disclosure shall not constitute a waiver of the work product protection as to any persons other than the independent auditors, in any civil or criminal proceeding in any federal court.”); with EPSTEIN, supra note 24, at 1063 (“Anything disclosed to a public accountant in conjunction with the preparation of financial statements to be made available to shareholders and the investing public necessarily implies a sufficiently broad dissemination to require a waiver of any work–product protection.”).}

As discussed in Part III.A, competing concerns would inevitably conflict from a blanket rule of waiver or non-waiver in cases of disclosures to independent auditors. A blanket rule of non-waiver, for instance, might not account for the decision in United States v. Massachusetts Institute of Technology, in which a University disclosed documents to a government auditing agency that had the obligation to disclose it to a potential adversary.\footnote{129 F.3d 681, 687 (1st Cir. 1997).} Accordingly, a statutory or common law bright-line rule with flexibility is most appropriate.

Sarbanes–Oxley already contains a safe harbor for documents and information disclosed to the PCAOB as part of an investigation.\footnote{See 15 U.S.C. § 7215(b)(5)(A) (2006).} The information disclosed to the PCAOB under an investigation required under Sarbanes–Oxley “shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process).”\footnote{Id.} Sarbanes–Oxley does not contain similar language, however, when it requires management to make disclosures of instances of fraud to its independent auditors.\footnote{See supra note 20 and accompanying text.} In response, Congress should amend Sarbanes–Oxley by adding a provision that provides waiver for certain disclosures to independent auditors. The provision might state: “A corporation does not waive attorney

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\item 129 F.3d 681, 687 (1st Cir. 1997).
\item \textit{Id.}
\item \textit{See} \textit{supra} note 20 and accompanying text.
\end{enumerate}
work product protection when it makes disclosures to independent auditors as part of an ongoing audit of the corporation’s public financial statements, as long as the disclosures are reasonably necessary to comply with the demands of the independent auditor according to accounting regulations and securities laws.”

By limiting the scope of protected disclosures to those that are “reasonably necessary,” all disclosures are protected as long as they are made pursuant to auditor requests to aid in its evaluation of loss contingencies or to aid in its attempt to detect fraud or illegal acts. These are the required inquiries that auditors must make, so they would certainly be “reasonably necessary.”247 Adoption of this rule by Congress to create uniformity or by an appellate court to solidify the current trend of federal cases that find non-waiver would establish much-needed certainty in this area of the law.248 Moreover, this rule would eliminate the need for elaborate briefing and discovery when courts must inquire into whether a potential likelihood of further disclosure to adversaries exists. Most importantly, this rule would eliminate legal obstacles as corporations cooperate with their independent auditors and provide greater certainty as corporations assess the consequences of these disclosures.

CONCLUSION

Courts have repeatedly recognized that auditors and their clients are at odds, as auditors owe ultimate allegiance to the investing public.249 Against this backdrop, courts have more often

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247 See supra note 205.
248 See Upjohn v. United States, 449 U.S. 383, 393 (1981) (“An uncertain privilege, or one that purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all.”).
249 In re Diasonics Sec. Litig., No. C-83-4584-RFP (FW), 1986 WL 53402, at *1 (N.D. Cal. June 15, 1986) (“While disclosure to one with a common interest under a guarantee of confidentiality does not necessarily waive the protection . . . the relationship between public accountant and client is at odds with such a guarantee because the public accountant has responsibilities to
found that disclosure to independent auditors does not waive work product protection, with *Deloitte* as the most recent decision on this issue at the circuit level. In these cases, courts have continuously failed provide a workable standard that properly accounts for circumstances that may justify a finding of waiver. Courts should instead apply the “nature of the relationship” approach established in this Article to appropriately balance the concerns of transparency and certainty plaguing this uncertain area of the law. This involves balancing the policy concerns and applying a standard that considers the nature of the relationship between the independent auditor and the disclosing corporation.

Alternatively, this Article offers a bright-line fix that Congress or an appellate court may adopt to reconcile the competing policy concerns and provide clarity in this area of the law. Striking this balance creates much-needed certainty in this area of the law because corporations are able to adequately protect themselves using confidentiality agreements and by pressuring their audit committees to limit the scope of tax involvement provided by their audit firms. Conversely, government agencies and plaintiffs seeking material that falls outside of work product protections will not be shut out by overreaching use of *Hickman*’s principles of privilege.

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creditors, stockholders, and the investing public which transcend the relationship with the client.”).

250 *Id.*