ORIGINAL

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PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 82-687

TITLE UNITED STATES, Petitioner v. ARTHUR YOUNG & COMPANY ET AL.

PLACE Washington, D. C.

DATE January 16, 1984

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IN THE SUPREME COURT OF THE UNITED STATES

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UNITED STATES, :

Petitioner :

v. : No. 82-687

ARTHUR YOUNG & COMPANY, ET AL. :

- -x

Washington, D.C.

Monday, January 16, 1984

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:50 a.m.

APPEARANCES:

MARK I. LEVY, ESQ., Washington, D.C.;
on behalf of Petitioner.

CARI D. LIGGIO, ESQ., New York, N.Y.;
on behalf of Respondent Arthur Young & Company.

WILLIAM E. JACKSON, ESQ., New York, N.Y.;
on behalf of Respondent Amerada Hess Corporation.

C O N T E N T S

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P R O C E E D I N G S

CHIEF JUSTICE BURGER: I think you may proceed whenever you're ready, Mr. Levy.

ORAL ARGUMENT OF MARK I. LEVY, ESQ.,

ON BEHALF OF PETITIONER

MR. LEVY: Thank you, Mr. Chief Justice and may it please the Court:

This case is here on writ of certiorari to the United States Court of Appeals for the Second Circuit. The question presented is whether an accountant privilege should be created to shield from the IRS the tax accrual work papers that were prepared by an independent public accountant in connection with his audit of a publicly held corporation pursuant to the federal securities laws.

The Court of Appeals established such a privilege and on that basis denied enforcement of the IRS summons for the tax accrual work papers. This marks the first and only occasion that any federal accountant privilege has ever been adopted.

The background of this case may be briefly stated. The federal securities laws require that publicly held corporations, such as Amerada Hess, file financial statements that have been audited and certified by an independent certified public

accountant. Under generally accepted accounting principles, the corporation must accrue as a charge to earnings a reserve for contingent tax liabilities. This reflects the possibility that the corporation will owe more in taxes than it paid.

In accordance with generally accepted auditing standards, the independent public auditors must determine the adequacy of this reserve in order to certify that the financial statement fairly presents the financial condition of the corporation and was prepared in conformity with generally accepted accounting principles.

QUESTION: Now, federal law doesn't require that; that's a matter of accounting standards, is that right?

MR. LEVY: Federal law requires that the financial statement be audited in accordance with generally accepted auditing standards.

QUESTION: Right. But that just is determined by the practice of the accountants generally, not by federal law.

MR. LEVY: That's correct, and then it is incorporated, as it were, into the SEC regulations.

QUESTION: Mr. Levy, would your position be any different if this were a small closely held

corporation, not listed?

MR. LEVY: Well, I think that would be a different case. Our position would be the same, that the IRS is entitled to those work papers. That case would not raise the dimension that this one does about the conflict that the Court of Appeals perceived between the tax laws and the securities laws. In that situation there would only be the unfairness rationale of the Court of Appeals to sustain any claim to privilege.

QUESTION: Well, certainly some of your arguments here would be inapplicable in that situation, I would think.

MR. LEVY: Well, I think it's really more that the accounting firm's arguments would be in applicable in that situation. They are the ones who have to come forward and justify the privilege, and one of the grounds that the Court of Appeals relied on in sustaining the privilege here was that to allow the IRS to have access to these papers would in some way undermine the securities laws. That simply would not be a problem in the hypothetical.

QUESTION: Wouldn't some of your arguments be inapplicable, to wit, the duty owed to the public?

MR. LEVY: Well, it would be inapplicable in the sense that we wouldn't need to respond to that

argument. In that situation, Justice Blackmun, essentially the argument would be that there is some sort of an accountant privilege that shields in-house work by a corporation. That's an issue that could be litigated, but we think it's very unlikely that any court would recognize a privilege in those circumstances.

There are some cases, I should add, that approach the hypothetical that you put. The El Paso case that's pending here on certiorari here involved in-house auditors, but their work was done in connection with a public securities review. The case the Eleventh Circuit recently decided, In Re Newton, did involve a closely held non-public corporation, but the auditors in that case were outside auditors rather than in-house auditors, so that they approach but are not exactly the same as your hypothetical, Justice Blackmun.

In this case, the IRS was conducting a tax investigation of Respondent Amerada Hess. Respondent Arthur Young is the independent public auditor that audited and certified Amerada Hess' financial statement for the years in question.

The IRS issued a summons to Arthur Young for, among other things, the tax accrual work papers. Arthur Young, acting both at its own instance and at the

directions of Amerada Hess, declined to comply with the summons. The Government then brought this enforcement action in district court.

The district court held that the tax accrual work papers are relevant and not privileged and it ordered that they be produced. A divided Court of Appeals reversed. Although it agreed with the district court that the tax accrual work papers are relevant, it held that they are protected by an acccuntant privilege and that the Government had not made an adequate showing to overcome that privilege.

QUESTION: Mr. Levy, a special agent had shown up before the summons was issued, hadn't he?

MR. LEVY: That's correct. It was a joint civil-criminal investigation at that point.

QUESTION: Would your case be stronger if he hadn't appeared?

MR. LEVY: I don't believe our case would be materially different. We think the IRS has summons authority to get these work papers in a civil case, in a criminal case, or in a joint investigation.

Now, our case would be stronger, and the Court of Appeals recognized that if the IRS were investigating fraud or some other state of mind issue, there would be no privilege for the work papers, and in a criminal

investigation that is much more likely, of course, to arise. But it could also come up in a civil investigation as well.

We think the Court of Appeals made a fundamental mistake in saying that because the IRS had not alleged fraud at the time it issued the summons, then the privilege applied. That put the cart before the horse, since the whole purpose of the investigation was to determine whether there was any basis for liability, including penalties for fraud or any other violation. So that would be the difference if there were a criminal case here, and the Court of Appeals simply ignored the fact that this was a joint civil-criminal investigation.

QUESTION: Well, certainly the appearance of a special agent has criminal case overtones.

MR. LEVY: Yes, a special agent does investigate for criminal purposes. But the Court of Appeals put great weight on the fact that in that investigation the IRS had not made any allegations of fraud in issuing the summons.

We think that was a mistake. The IRS should have the authority to get these work papers for, among other reasons, to determine whether there's any basis for an allegation of fraud, and the Government can't

make that allegation before it conducts its investigation.

The Court of Appeals' creation of an acccuntant privilege in this case rested on twc theories: first, that IRS access to tax accrual work papers would be unfair and prejudicial to the taxpayer; and second, that IRS access would chill candor in communicaticns between the ccrpcration and the independent public auditor, and that this would work to the disadvantage of the investing public and be contrary to the policies of the securities laws.

And me consider each of these theories in turn. But even taken together, we think the Court cf Appeals took too expansive a view of its role to weigh competing policy considerations againt the Government's entitlement to obtain information pursuant to statute, and that neither of its theories justifies the creation of a novel accountant privilege or cvercomes the strcng presumption in the law against the establishment of a new privilege.

First, the claim of unfairness. This claim seems to derive from one of three sources, that IRS access here is unfair: one, because of something atcut the process or the balance of advantage between the taxpayer and the IRS in a tax investigation; or twc,

because something in the relationship between the corporation and its independent public auditor makes it unfair; or three, that there's something in the contents of the work papers that makes it unfair for the IRS to summon these. I'll address each of these in turn.

The claim that the process of tax investigation makes it unfair for the IRS to have access must be assessed in the context of our self-reporting tax system. IRS enforcement of the tax laws serves two basic purposes: First, it furthers the fundamental government interest in collecting revenues; and second, it achieves equity among taxpayers by ensuring that a taxpayer who fully complies voluntarily is not put at a disadvantage in relation to a less scrupulous taxpayer.

Now, under our tax system the taxpayer has an affirmative obligation to pay his fair share of taxes and to compile and to provide to the Government a great deal of information to demonstrate his compliance with the law. That's the nature of the tax system.

While it is of course often true that the IRS and the taxpayer may have opposing views, the nature of the tax system is not arm's length or adversarial in the same sense that a system of litigation is.

QUESTION: Mr. Levy, hasn't this Court gone into this about a thousand times by now, the great

theory of the IRS?

MR. LEVY: I believe so, and I believe everything that's in my presentation --

QUESTION: Well, do we need it for this case?

MR. LEVY: I think it helps to support the Government's position here to realize what is at stake in withholding access to these papers from the IRS.

QUESTION: It's up to you. It's your time.

MR. LEVY: Well, let me move on from that, then.

Whatever may be true in the litigation area, there is no room in a tax investigation system for a sporting theory of justice that requires that the relative advantages between the taxpayer and the IRS be equalized. A tax investigation is not a competitive event like a horse race or a golf match, in which each of the participants has to bear an equalizing handicap.

The fundamental point here, to get to it, is that -- is whether the tax accrual work papers will be available to help to ensure that all facts and all issues are brought out into the open so that the IRS can form a judgment about the taxpayer's tax liabilities and any issues can be resolved through the processes provided by law.

There's no room for the taxpayer to complain,

as Respondents do here, that the IRS' enforcement is too effective or that the relevant information will be too helpful to the IRS in determining the taxpayer's liability.

QUESTION: Well, it's a question basically of Congressional intent, I suppose, isn't it? You know, how effective did Congress intend these procedures to be, and did Congress perhaps imply that there might be some room for this kind of privilege?

MR. LEVY: No one, neither the Court of Appeals nor the Respondents, have identified anything in the Congressional intent that would support a privilege on this branch of the case. It is rather a point of fundamental fairness they claim.

QUESTION: Well, what reason, then, do you think that Judge Feinberg thought supported his opinion if it weren't some implicit Congressional intent?

MR. LEVY: We think that it was a misconception about the role of the judiciary, that he thought that it was the proper role of the federal judiciary to weigh competing social policies against the statutory access authorized by Congress and conferred on the Service. We think that was a fundamental misapproach to the case.

But at least as to this side of it, on the

unfairness argument, he identified nothing in the statute or any legislative history that would support a privilege, and we think this Court's opinions point in exactly the opposite direction, that Congress wanted the IRS to have the broadest possible access and to be able to have every helpful and effective means of enforcing the tax laws.

Now, the claim of unfairness may also rest in part not on this balance of advantage, but on the idea that IRS access will intrude into a sensitive relation between the accountant and the corporation that the law should protect. We think this is simply not so.

In Couch this Court recognized that there is no federal accountant-client privilege, and thus --

QUESTION: Mr. Levy, may I ask you a question here. Supposing -- well, I guess the federal securities laws require an opinion of a lawyer on contingent liabilities in litigation, or it very well could. Supposing in this particular situation the statute, instead of asking for an accountant's opinion, asked for a legal opinion on the adequacy of the reserve for contingent tax liabilities, and all the other -- everything else about the case was exactly the same. What would your view be about it?

MR. LEVY: Well, I think that would certainly

be a harder case and raise issues that haven't been addressed here about the role of the attorney-client privilege and waiver of the attorney-client privilege. To give you my --

QUESTION: Doesn't -- of course, it's an accountant, not a lawyer, and it's kind of a semi-legal judgment that he has to make in interpreting tax laws. And as we all know, accountants probably practice more tax law than lawyers do. So I just wonder if it really isn't very close to the case of asking the legal opinion.

MR. LEVY: Well, we think it is not close to the attorney's role, really, for two fundamental reasons. The attorney has an undivided duty of loyalty to his client. That's the basic nature of the relationship. The accountant, on the other hand, does not.

QUESTION: Well, but in the hypothetical statute I've posited he would have a duty of giving an opinion on which the public would rely.

MR. LEVY: And that's why it would raise hard questions about whether the privilege applied in the first instance, whether he was giving confidential legal advice on behalf of the client or, even if he were, whether it would be waived in the circumstances of that

case.

I think our position might be that we were entitled to the opinion there, but as I say that raises issues that haven't been addressed in this case. This case only involves an accountant whose duty, whose paramount duty, is to the public, including the Government and investors and creditors as well.

The nature of the advice is also quite different. The lawyer in general gives confidential advice and formulates strategy for the client. Here the acccuntant, his functicn is not to give advice. His role is to be independent and he serves as an instrument of public oversight and investigation.

QUESTION: Mr. Levy, regarding that part cf your answer to Justice Stevens, you're stating now what the accountant's role is, that he doesn't give advice like lawyers do. I mean, is this a matter of public reccrd cr dc we take judicial knowledge of some of this differentiation that ycu see between the role of acccuntants and lawyers? Or is it disputed?

MR. LEVY: I don't believe it is disputed. It's supported by the affidavits below, as well as by public --

QUESTION: Well, are you suggesting that a lot of accountants, CPA's, do not give legal advice, abcut

tax particularly?

MR. LEVY: I'm saying that when they're acting as an independent public auditor in connection with the securities laws, their obligation is to the public and it is not one of giving confidential advice.

QUESTION: And you think that function is wound up in both of these kinds of papers that are involved in this case?

MR. LEVY: In this case as it comes to the Court there is only one kind of paper that's involved, the tax accrual work papers, and we think it is fundamentally involved in resolving the issue whether the IRS should have access.

QUESTION: Even if for other purposes they give advice about what tax liability is?

MR. LEVY: That would be a different case, although we think Couch recognizes that there is no general accountant-client privilege.

QUESTION: Mr. Levy, what would happen if the accountant was in a legal office?

MR. LEVY: I'm sorry, Mr. Justice Marshall?

QUESTION: What would happen if the accountant was in a legal law office?

MR. LEVY: If he's performing a role as an independent public auditor, I don't think that would

make any --

QUESTION: It wouldn't?

MR. LEVY: -- difference. I don't believe so. His obligation is to the public.

QUESTION: So that the lawyer and the accountant advising the client, the lawyer is privileged but the accountant is not?

MR. LEVY: Well, if it's in connection with a certification of a public financial statement I think there would be questions about whether the lawyer's advice would be privileged. Those questions aren't involved here, but they touch on the points that Mr. Justice Stevens raised.

QUESTION: Yes, that's what got me on this tangent.

MR. LEVY: But there would be difficult questions about whether the privilege applies and, even if it applies, whether it would be waived by disclosing it to a quasi-public person.

QUESTION: Well, what would -- I know this is way out in left field. What would happen if the lawyer gave the opinion that the accountant should have given? Would that be privileged?

MR. LEVY: As I say, that would raise different questions, and some of those questions are

presented in the El Paso case, in which the Fifth Circuit held that there, at a minimum, was a waiver of any attorney privilege by disclosing it to the outside auditor.

But the Court of Appeals nor the Respondents have raised any of those kinds of issues in this case. The acccuntant privilege here stands on a different footing.

QUESTION: They're not in this case?

MR. LEVY: No, they haven't been raised.

This case is really no different than if the securities laws provided that the SEC would select the outside auditor, rather than letting a corporation do it, or indeed even if the SEC would do the outside audit itself. In those cases, clearly there could be no claim that the IRS was seeking to intrude into some sensitive confidential relationship that the law should protect.

QUESTION: But if the statute did provide it, I dare say that the corporations involved might not be quite as forthcoming with the SEC as they were with their own, or who they thought were their own acccuntants.

MR. LEVY: Well, their obligation is to be every bit as forthcoming here, and the whole point of this illustration is that the independent public auditor

stands in exactly the same position as the SEC would. The obligation for the corporation to make full, accurate, and complete disclosure so that the accountant can certify the financial statement would be exactly the same in the two instances.

QUESTION: Mr. Levy, of course lawyers, just as accountants, file opinions with registration statements with the SEC. How do you draw the distinction between a lawyer's certification, for example, that an issue of securities has been validly authorized and is lawful and outstanding, and an accountant's certificate that a balance sheet and a profit and loss statement are correct?

MR. LEVY: I regret, Mr. Justice Powell, but I'm not fully familiar with the lawyer's obligations in those circumstances. But I would say that if they are comparable to the role of the independent public auditor in this case, those would raise very serious questions about whether a privilege would apply or whether it would be waived. But I am simply not in a position to say anything more definitive because I do not know their full obligations.

QUESTION: Well, there may be more of an opinion expressed by counsel than perhaps by an accountant, although where you're dealing with a tax

accrual estimate that finally comes down to an opinion, I suppose.

MR. LEVY: There is room for judgment, no question, in these papers, although judgment is not the only or even the predominant content of the papers. But there is no, at the same time, privilege for professional opinions. Work product protection is not a badge of professional status that attaches simply because a professional is involved and renders advice.

There need to be substantially more important, compelling reasons of public policy and law to justify it, as in the attorney work papers area of Hickman against Taylor. In that circumstance the attorney did give confidential advice and his very role was to provide the client with strategy in litigation. The Court recognized that the whole basis for the adversarial system of law was that the lawyer needed a certain private domain, a certain thinking and working space, in order to perform his functions.

In addition, the attorney work papers requires that the materials be prepared in anticipation of litigation, that is, that they were prepared for the very purpose of a party defending its position and opposing the claim of the other side. It is not enough that the attorney is involved for some other reason or

that the material might have some effect on the lawsuit. They have to have been prepared for the very purpose of resolving the adversarial dispute.

In this case once again, the role of the independent public auditor is much different. Again, we have the self-reporting tax system that imposes a duty of disclosure on the taxpayer. The independent public auditor does not give confidential advice and strategy. He does not need the same private domain that the lawyer does. Indeed, the tax accrual work papers are prepared with the very idea in mind that they will be subject to disclosure if a challenge later arises under the securities laws.

QUESTION: Mr. Levy, supposing that we reverse the Second Circuit in this case and then a new breed of service comes into effect, the lawyer-accountant, which does all the same work that CPA's used to do except that the person to whom the corporation talks is now a lawyer, and they go about -- a particular corporation consults one of these entities and does work only with the lawyer, but the firm is functioning in the capacity just as the CPA's are here, preparing reports that are required by the SEC.

Now then, would that challenge be resolved any differently than this one?

MR. LEVY: It would raise different questions, but I think in the end fundamentally not.

QUESTION: It would have to be the same.

MR. LEVY: I think that's right, because the obligations under the securities laws are not private confidential advice-giving ones, as lawyers --

QUESTION: Well, after all, the accountants do have lawyers in their organizations, don't they?

MR. LEVY: I expect they do, and I also imagine that many of these CPA's are attorneys as well. I don't think that that would make --

QUESTION: Some law firms have certified public accountants in their establishment, do they not?

MR. LEVY: I expect that that is true, Mr. Chief Justice.

QUESTION: In response to Justice Rehnquist's question, would it not turn on what the particular actions were? If they were the actions of a lawyer traditionally it might have one answer; if it was a function of an accountant it might have a different answer?

MR. LEVY: That may be true as to some particular type of information, and that is the discussion I had with Justice Stevens and Justice Marshall, I think. But I understood Justice Rehnquist's

hypothetical to be that the work was done exactly the same, but it happened that the person who did it was both an accountant and a lawyer.

In those circumstances, the fact that a lawyer, someone with legal as well as accounting training, is involved does not change the existence of the privilege in any way.

QUESTION: Mr. Levy, how big was the reserve in this case?

MR. LEVY: I don't know the answer to that.

QUESTION: I notice a reference in the papers to $7,000 of these foreign payments. Is that all we're talking about?

MR. LEVY: No, that is not all we're talking about. The summons in this case was directed for both the civil and the criminal investigation, and the affidavits in the court below that are reprinted in the joint appendix make it clear that both sides of the investigation are still open and that the summons here is relevant to both parts.

QUESTION: Do you know if in a case of this kind the Government is more interested in finding out what the elements of the contingent liability that are included in the reserve are or the ones that are left out? Which are they primarily looking for?

MR. LEVY: I am not in a position to be able to answer that. I think that the Government's overriding interest is in having full disclosure so that all facts and issues can come out and that a reasoned decision can be made about any tax liability and any issues that arise can be worked out through the normal processes of the law.

QUESTION: I've seen some balance sheets where the contingency actually identifies the area of potential controversy, that there's some fight over inventory or something that's going to recur year after year. But you're mainly thinking of things that would be undisclosed in the balance sheet itself?

MR. LEVY: Well, if the balance sheet itself disclosed certain things, then that would be of substantial assistance to the IRS. But as I understand it, both the requirements of the profession and the implementation of those requirements are somewhat vague. There's room for discretion and the practices among the accountant firms vary quite widely about the degree of detail that's disclosed.

I did, for example, look at the Amerada Hess 10k's in this case and did not see any separate item even for tax accrual liabilities, let alone broken down by the kind of item.

Let me just touch briefly on the second half of the Court of Appeals' reasoning, that there is some perceived conflict between the securities laws and the tax laws and that IRS access here would chill the candor of communications between the corporation and the auditor. This is clearly in the nature of an accountant-client communication privilege and we think therefore inconsistent with Couch.

We also think it's inconsistent with this Court's decision in St. Regis Paper, that holds that a statute is not to be read to create a privilege unless it clearly so provides. There's nothing in the securities laws here that establishes a privilege or cuts back on the IRS summons the Service would otherwise have.

The Court of Appeals' reasoning on this point was quite speculative. They may be right that in some circumstances there will be some effect on some corporations in their communications with their auditors. But beyond that no generalization is possible, and there was no adequate basis for the Court of Appeals' broader generality.

Indeed, there's substantial room for doubting whether the absence of a privilege would have any effect on compliance with the securities laws, because both the

corporation and the auditor are under independent legal duties to perform their functions in accordance with the securities laws.

In particular, the auditor will not give an unqualified opinion if he is not satisfied that the financial statement fairly presents the financial condition and has not had access to adequate information on which to form a judgment. That provides him with a strong means to obtain the cooperation of the corporation in getting access to the necessary materials.

QUESTION: Mr. Levy, since '81 you have guidelines.

MR. LEVY: That's correct.

QUESTION: Do you have any idea how frequently requests are made now under those guidelines?

MR. LEVY: It is not frequently. I cannot give you a quantitative estimate, but the IRS by no means seeks in the routine or the ordinary course to get these work papers. But we think the fact that the IRS exercises discretion with restraint and forebearance does not in any way undermine its legal right to obtain these cases where it sees fit.

I'd like to reserve the balance of my time.

CHIEF JUSTICE BURGER: Mr. Liggio.

ORAL ARGUMENT OF CARI D. LIGGIO, ESQ.,

ON BEHALF OF RESPONDENT ARTHUR YOUNG & COMPANY

MR. LIGGIO: Mr. Chief Justice and may it please the Court:

What the Government seeks here is this Court's sanctioning an invasion into the thought processes of the independent auditors by obtaining the tax accrual work papers. To understand the issue that is presented to this Court, it is essential to understand what is in the tax accrual work papers and, more importantly, what is not in the tax accrual work papers.

The tax accrual papers are prepared by the auditors and are primarily the auditors' opinions, judgments, assessments and thought processes in determining whether the provision for taxes shown on the financial statements of a corporate taxpayer are reasonable. It is not to determine whether the amount provided for on the financial statements are exact or the exact amount of taxes that will eventually be paid by the corporate taxpayer.

They do contain some facts, but these are purely incidental to the judgmental processes of the auditors in evaluating the contingency reserve for taxes on the financial statements. And, contrary to the Government's position which is sprinkled throughout its

papers and in the argument today, the facts comprise a very minimal or minor element.

As in the attorney work product doctrine, an analogue to which the Second Circuit looked in drafting a carefully crafted exception for tax accrual work papers, the fact that there are some facts incidental to the independent -- the lawyer's thought processes, does not make the materials otherwise discoverable unless there is a particularized need shown.

Now, the components of the tax accrual are essentially two. One is an evaluation of possible disallowances by the IRS and possible overpayments by the taxpayer. It is not infrequent that in a review of the tax accounts we will find that a client has provided too much of a tax reserve and will not pay the taxes that it proposes to pay.

The second component is the evaluation of pending disputes with the IRS, either in the form of existing revenue agent reviews or sometimes in actual litigation.

Now, to make these evaluations the auditor must review the corporate records. I note, it is the same universe of corporate records that are available to the IRS when it conducts its audit, and in this case the IRS agents made over 400 document requests to Amerada,

398 of which were complied with, and Amerada produced close to 45,000 pieces of paper to the IRS and expended some 11,500 person-hours of work prior to the time that the IRS sought enforcement of the summons against Arthur Young & Company.

The auditor must make a series of judgments on worst case scenarios, what could happen, what might happen, what's the likelihood of something happening. But it is a judgmental process reviewing those facts. It needs to discuss matters with the client's personnel. For example, if there's been a revenue agent review and a disallowance, it needs to know the client's position with respect to that disallowance to determine whether or not the client has provided for a potential tax liability or whether the client intends to fight it.

It is not infrequent that we will find statements in the tax accrual work papers such as, the client will pay and let someone else litigate and preserve a claim for refund. Similarly, there may already be a litigation and we will have counsel's opinion in the tax accrual work papers on the potential outcome of that litigation.

It is not unusual to find statements in there from counsel to the effect that, although there is a

split in the circuits and we believe the client should prevail, we nevertheless recommend that the client settle this matter in the following amount.

The tax accrual papers, therefore, are an amalgam of opinions and only incidentally, as I noted, do they contain facts. The Government's speculation on this is unsupported by the record below.

In addition, contrary to the Government's reply brief, the fact that an item is included in the contingency reserve does not mean that there is a substantial question about the correctness of the return. Rather, it means that we are trying to evaluate the totality of the reserve in relationship to all the other accounts on the financial statements for the reasonableness of it.

As I noted at the start, it is not the taxes that we think the client will necessarily pay, but whether the amount provided for in the financial statements bears a reasonable relationship.

QUESTION: You use the term "we", Mr. Liggio.

MR. LIGGIO: Excuse me?

QUESTION: You use the term "we".

MR. LIGGIO: I'm talking about Arthur Young & Company.

QUESTION: You meant the client, you meant

Amerada?

MR. LIGGIO: The independent auditor, Your Honor.

QUESTION: The auditor, not the client?

MR. LIGGIO: Well, the client has the first responsibility for providing that provision in the tax return.

QUESTION: In any event, the "we" does not include counsel, is that right?

MR. LIGGIO: That is correct. It does not include counsel. It is the independent audit process, the evaluation of the financial statements. Counsel may be included, as it was in the El Paso case, in that evaluative process and in providing information to the auditor. But basically I am looking at this as a function of the independent auditor in evaluating the financial statement.

QUESTION: You're not suggesting that it's legal advice?

MR. LIGGIO: No, Your Honor, I am not suggesting that it's legal advice, although in the El Paso case it clearly was. But I don't think we need to reach that issue here.

QUESTION: And in giving this information, this advice to Amerada, Arthur Young & Company doesn't

use lawyers for that purpose?

MR. LIGGIO: There may be lawyers in our tax department, but they are not lawyers acting as lawyers. They are acting as certified public accounts.

QUESTION: Mr. Liggio, at one place in your brief, on page 25, you say that under these circumstances, and you describe it. It's the last paragraph of footnote 15: "Under these circumstances, the creation of a qualified privilege is a proper exercise of judicial discretion."

Do you think that's what the Court of Appeals did here, kind of exercised its judicial discretion to create a qualified privilege?

MR. LIGGIO: Well, Your Honor, yes. I think what in reality the court did, and we may be getting into semantics, is as the Third Circuit did in Hickman and this Court did in 1947, it created a doctrine and it weighed the competing interests that were necessary. Now, whether we call it a privilege or whether we call it a doctrine, I think the label is unimportant. It is what the court in fact did, and it weighed those competing interests, and I believe that is an exercise of judicial discretion.

QUESTION: Well, but don't you -- aren't you stuck by some difference that Mr. Levy refers to, that

the Hickman case arose in a context of litigation, where one of the concurring opinions says, even if a lawyer lives by his wits he shouldn't have to live -- be able to live by his adversary's wits? Where there is kind of an idea people should be made equal, it's competitive, adversarial, as opposed to this situation?

MR. LIGGIO: Well, in part that is here also, Your Honor, although the analogy to the work product doctrine, I think it's an analogue. But there is that element of unfairness that's here and I think that is inherently the problem with the access to the tax accrual work papers, because we are making evaluations and judgments.

We're not saying -- and "we", Your Honor, is Arthur Young & Company. Arthur Young is not saying that in this set of circumstances this is the tax liability that the client has to pay. Arthur Young and any independent auditor is looking at the totality of the amount of taxes that have been booked and provided for in the financial statements and they're saying, is it reasonable that the taxpayer is going to pay this over a course of time. There are deferred taxes in there, there are current taxes, there are disallowances that are being litigated.

And it has in that process many judgments. It

has the independent lawyer's opinion who is handling the litigation. It has the client's judgment on how it's going to fight or what it intends to do with the Service. And you have very much an adversarial process there that will be invaded when you allow the IRS to get access to the tax accrual work papers.

QUESTION: Were these papers prepared in your view in anticipation of litigation?

MR. LIGGIO: No, Justice O'Connor, there's no claim that they were prepared in anticipation of litigation.

QUESTION: What if the work papers were sought not by IRS but by the SEC or by some private individual in a securities proceeding? Do you think there should be a privilege there?

MR. LIGGIO: Well, first, Justice O'Connor, depending on the circumstances they may or may not be obtainable by the SEC or by the private litigant. In any event, because of a question raised by Section 7216 of the Internal Revenue Code, it has been Arthur Young's position that we cannot make those papers available without a court order. Otherwise we would be liable for criminal sanctions. This provision relates to parties other than the Internal Revenue Service.

And in that set of circumstances we would,

1 although we've never had the situation today, we would
2 seek an appropriate protective order limiting the
3 disclosure of the materials to the IRS or any other
4 party. Now, I note 72 --
5 QUESTION: What would it turn on if it were
6 sought by the SEC? What would the answer turn on in
7 your view, the terms of a particular statutory provision
8 or some policy?
9 MR. LIGGIO: Well, whether the SEC would be
10 entitled to it would be whether this was a proper
11 subject matter of SEC investigation.
12 QUESTION: Let's assume it is.
13 MR. LIGGIO: Then in that case they would be
14 entitled to obtain it, having made the relevancy
15 showing, and we would seek an appropriate protective
16 order limiting the disclosure that the SEC could
17 otherwise make to that.
18 QUESTION: Well, why should the outcome be
19 different if it's for the IRS?
20 MR. LIGGIO: Because, Your Honor, the IRS --
21 the purpose for which these are prepared and the effect
22 that will result from that is materially different. In
23 the SEC context, we are dealing with whether or not the
24 financial statements are fairly presented in accordance
25 with generally accepted accounting principles, and the

access to that information by the IRS does not put the corporate client in a substantial disadvantage. It is not unfair, inherently unfair, to allow the SEC access. The IRS, it is.

QUESTION: What if the papers had been given by the accountant to the client and they were in the client's possession and the IRS sought them? Should there be a privilege?

MR. LIGGIO: I don't think that should change the result, Justice O'Connor. But as a practical matter the tax accrual work papers are not given to the client. They are our work product, our audit work papers.

Basically what the Service seeks here is the opinions and judgments. As Judge Garwood said in his dissent in El Paso, what the Service wants is the private thoughts and theories of the accountants and the taxpayers. The bottom line is the convenience of the Service.

And not only is the tension imposed upon the auditor-client relationship by allowing the IRS to conscript the auditors into becoming the Service's stalking horse when you allow access to the tax accrual work papers self-evident, but the public record is equally clear that it has had and will have a negative

impact on the audit process and the quality of financial reporting.

The IRS challenges the Second Circuit's finding with respect to this as speculative and denigrates the affidavits submitted below in part of this record, as well as the substantial commentary that has been written on the subject by members of the private bar and the accounting profession as purely an evidence of self-interest.

Yet the Government is conspicuously silent on Commissioner Egger's own recognition that this problem, the access to the tax accrual work papers, the opinions and judgments of the auditors, had reached such emotional proportions that it had real potential for negative effects on the quality of financial reporting.

It ignores the presence of the amici, the other major accounting firms and the AICPA, which have pointed out the existence of this problem. It ignores the reports in the public press on the problem that has happened. And it ignores the AICPA study which is cited in the briefs and published in the Journal of Accountancy in 1981, showing that in fact there was a deterioration of the relationship between --

QUESTION: Mr. Liggio, I don't quite understand this argument. Are you suggesting that the

corporation that is being audited or ultimately may be audited would conceal information from their accounting firm?

MR. LIGGIO: No, Justice Powell.

QUESTION: Are you suggesting that the auditors wouldn't probe for all relevant information?

MR. LIGGIO: No, Justice Powell. What I am suggesting is that the level of candor, the amount of information --

QUESTION: The level of candor by whom?

MR. LIGGIO: By the corporate client.

QUESTION: By the client.

MR. LIGGIO: The willingness to open up and come to us with the problems, to discuss issues, to say: We've got this IRS dispute, we're going to litigate it or we're going to settle it, we're going to settle it for 60 cents on the dollar. I suggest we wouldn't have that information. It would be like pulling teeth, and it would make the audit process substantially more difficult. And it has in fact happened.

QUESTION: If you audit a company's books regularly, do you have a relationship with your client that would not permit that sort of pressing type question?

MR. LIGGIO: Justice Powell --

QUESTION: I would have thought so.

MR. LIGGIO: -- the fact is that the onus of the IRS potential access to this is a very debilitating factor in the relationship, no matter how good it's been with our clients over the years. As a practical matter, we saw it when the Service started subpoenaing the tax accrual work papers, and if they were to have that access again to get into these judgmental processes I sincerely believe that we're going to have that problem again.

QUESTION: But if you didn't have information that you were satisfied was fully adequate, you'd qualify your certificate, wouldn't you?

MR. LIGGIO: That's correct, Your Honor, if we did not have adequate information. But that's only if we thought the financial statements might be materially wrong. There is a range within they could be correct and we would not necessarily have to qualify the accounts on that basis.

QUESTION: But you can always get the information by telling the client you won't certify the audit if they don't give you the information. And I don't think the problem is your access to it; it's rather what you don't want to appear in the file, isn't

it?

MR. LIGGIO: Well, with all deference, Justice Stevens, I am not sure we will in fact get all the information. And part of it is of necessity that the client volunteers things to us, and that level of communication we are convinced is going to be shut off.

QUESTION: Mr. Liggio --

MR. LIGGIO: Yes.

QUESTION: Suppose the client asked its tax lawyer to prepare certain information, not in anticipation of litigation, but concerning potential tax problems. Would any work papers of the lawyer be privileged under existing law?

MR. LIGGIO: They would in the first instance be subject to the attorney-client privilege, Justice O'Connor. And in the second instance, we believe that they would not lose their privileged characteristic by showing them to the independent auditor. There are a number of cases all --

QUESTION: Even though they're -- even if you assume, as I suggested, that they were not prepared in anticipation of litigation?

MR. LIGGIO: The privilege that I'm talking about is the attorney-client privilege in the first instance, and the fact that they may be shown to the

independent auditor we do not believe would lose the quality of that privilege. As I say, there are some district court cases unreported that have in fact said the privilege is not lost under those circumstances.

CHIEF JUSTICE BURGER: Mr. Jackson.

ORAL ARGUMENT OF WILLIAM E. JACKSON, ESQ.,
ON BEHALF OF RESPONDENT AMERADA HESS CORPORATION

MR. JACKSON: Mr. Chief Justice and may it please the Court:

I would like to deal further with the issue which has already been raised, that is one of the grounds for the opinion and decision of the Second Circuit below, and that is the issue of fundamental fairness. And the issue is, quite simply as I see it, whether it is fair in the administration of the adversarial process between the taxpayer and the Service to permit the Service access to the private thoughts of the taxpayer as to how he intends to deal with the IRS in audit and in litigation.

QUESTION: Mr. Jackson, if we should decide in our subjective judgment that it was not "fair" to do that, ought we to affirm the judgment of the Court of Appeals?

MR. JACKSON: I think yes, Your Honor. I think that is one of the grounds on which that court

reached its decision.

QUESTION: What authority in our past cases is there for that sort of a thing, to just evaluate something in terms of "fairness"?

MR. JACKSON: I think, Your Honor, this Court has held in a series of cases, the Powell case being one, that an IRS summons will be enforced only under certain conditions. And one condition is that the Service is not already in possession of the information. That was part of the ruling in Powell.

Here there is no question that the Service is in possession of practically every piece of paper in Amerada's books and records relating to the factual transactional aspects of its tax liabilities. That is, therefore there is no need for the Service to seek the tax accrual papers when it has had access to all the great volume of materials which Mr. Liggio mentioned earlier from the taxpayer.

And in Euge, which is a later case, the Court reinforced that aspect of enforcement of an IRS summons by saying that enforcement must in the case be necessary to the enforcement of the tax laws. Now, we say that access by the Service to the judgmental and private thought papers contained in these tax accrual work papers is not necessary, first because there is no claim

of fraud in this case.

And by the way, Your Honors, when the summons to Arthur Young was issued which is here involved this investigation had been under way for a long time. The Service had had the records of Amerada Hess and it should have known by that time whether there was any basis to claim fraud or not.

But fraud is not in issue. Therefore, it is not essential for the Service to seek for evidence of intent. And indeed, the reply brief, I believe at page 19, disclaims any interest in the judgmental portions of these papers, which I think is certainly a concession that they are not needed for those purposes.

And so, if there is no need then I say it is unfair to enforce the summons against the taxpayer, against his independent auditor, to compel the revelation of his private thoughts as to his strategies in audit and in litigation. And that's -- this Court in a recent case involving an IRS summons, the Badgett case, adverted to considerations of fundamental fairness in the context of the enforcement of an IRS summons.

QUESTION: What if the taxpayer had done his own work and prepared work papers that IRS sought? Would they be somehow protected?

MR. JACKSON: Under this aspect of the Second

Circuit's decision, yes, Your Honor, they would be. Under the alternate ground, the additional ground, which is the intrusion upon the independent auditor's function, they would not be under that rationale because they're not independent.

But certainly from the point of view of compelling the taxpayer to reveal all in this adversarial process to the IRS while the taxpayer can't get the same information from the IRS, it would be most unfair. And that was the situation, Your Honor, that was involved, of course, in El Paso, where the papers had been prepared internally.

QUESTION: Well, I suppose not many taxpayers have ever thought that the proceedings with IRS were necessarily fair, have they?

MR. JACKSON: I will not disagree with that, Your Honor. But I think that the Service overreaches in this instance by seeking the aid of the court to compel the taxpayer to, and his independent auditor to, reveal his strategies for dealing with an adversary.

QUESTION: Mr. Jackson, may I ask you this question. Supposing you have a set reserve. I don't know what the amount might be, a couple hundred thousand dollars. Could you be compelled to disclose the components of that, how much of that is for the

particular pending claim and how much is for something else? Do you think that you're just entitled to have it all concealed in a ballpark figure?

MR. JACKSON: Well, I think that to the extent that there are figures in the taxpayer's books and records with respect to the composition of the reserve, if it is flagged so much for this, so much for that, certainly the IRS could obtain them.

QUESTION: No, I'm assuming they're not, they'e not flagged. You've got three separate claims in litigation. You know what the demand is in each claim. Could you be compelled to say with respect -- and then there's $200,000 set aside. Could you be compelled to say that 100 is for claim A, 50 for claim B, and 50 for claim C?

MR. JACKSON: I would say not, Your Honor, because that gets into judgmental private thoughts and not the facts as booked.

QUESTION: Of course, it wouldn't do you any good if there's only one claim pending.

MR. JACKSON: That would make it more difficult, Your Honor, yes.

QUESTION: Mr. Jackson, you referred to the fundamental fairness argument. But isn't the entire tax system established on the theory that every person who

evades or avoids a tax, particularly evades a tax, puts a burden on every other taxpayer, and doesn't that fundamental fairness have to take into account all of the taxpayers' interests?

MR. JACKSON: Yes, Mr. Chief Justice, I could not differ from that. But I don't think that answers the question here. Here what is involved is not the normal aspects of a tax audit in which the auditor seeks -- the IRS seeks to determine whether there's liability and if so the amount.

This is a far more intrusive process, and I would not want the members of the Court to feel that in some way this privilege which we are arguing for is meant to serve as a cover for nefariousness or for deliberate tax evasion. That is not at all -- this was not at all in the mind of the Second Circuit.

But, Mr. Chief Justice and Justices, as you all know probably from personal experience how difficult the Internal Revenue Code is to read, let alone understand, with its qualifications and its exceptions and its cross-references and what-not. And there exist many times good faith grounds for differences of opinion as to whether a given transaction is, say, subject to normal regular income or capital gains treatment.

And these are the areas in which we think that

the private thoughts of the taxpayer, often informed and assisted by his counsel as well as his independent auditor, should not be subject to the intrusion of the IRS, and that it would be unfair to do so, because as the Second Circuit found, and I think common experience bears this out, the relationship between the taxpayer and the Service is at heart adversarial.

Certainly that is true in the case of a large corporation which is audited automatically, constantly, and the Service -- they are constantly having differences over the treatment of certain items, and the Service's intent is obviously to maximize tax liability, the intent of the taxpayer is to take advantage of all lawful provisions in the tax laws to reduce liability.

Now, I would like to say one word on the subject of Congress' intent, which was raised earlier during the argument. I think Congress' intent in this area must be found not only in the tax laws and not only in the securities laws, but also in Rule 501 of the Federal Rules of Evidence, which was enacted pursuant to Congressional authority and approved by Congress, and that is the rule which authorizes -- indeed, the legislative history shows invites -- the federal courts to develop the law of privilege under the principles of the common law, on the basis of experience in cases

where development of new privileges are warranted.

This is a provision which the Government admits gives the courts the power to develop new privileges, as the Second Circuit did. Their argument is that Congress should be the forum to decide this issue before the Court, rather than -- that is, the issue of privilege -- rather than the courts.

Well, I submit that is no answer. However this Court decides the case, it will be decided one way or the other and it will decide in favor of one party or the other, in favor of fairness or that fairness is not offended. This Court will be making the decision, and indeed this is what Congress envisioned in Rule 501.

And indeed, even before that rule was adopted this Court in the Hickman case, which the court below relied on as an analogue, the Court did not leave the question to Congress. This Court decided it and held proper the creation by the lower court of the attorney's work product privilege.

In short, Your Honors, we think that the position which is taken by the Government here is contrary to the position of the Service itself in its revised guidelines which permit access to the tax accrual work papers only as a last resort, only after all other avenues of factual inquiry have been

exhausted, and only on a shcwing of particularized need for specific issues, nct some generalized desire tc see whatever may turn up in the tax accrual papers.

We think, in short, that the position of the Government on this case is belied by the position cf the Service. We think the Government seeks to overreach and tht this Court should not countenance that result.

CHIEF JUSTICE BURGER: Do you have anything further, Mr. Levy?

MR. LEVY: No, I have nothing further, Mr. Chief Justice.

CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 11:48 a.m., the oral argument in the above-entitled case was submitted.)

* * *

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of:
#82-687 - UNITED STATES, Petitioner v.
ARTHUR YOUNG & COMPANY, ET AL

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BY _____
(REPORTER)