UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, On Behalf of Itself and All Others Similarly Situated, Plaintiff, *- against -* Household International, Inc., et al., Defendants.	Lead Case No. 02-C-5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan

REPLY MEMORANDUM OF THE HOUSEHOLD DEFENDANTS WITH RESPECT TO THE PRELIMINARY ERNST & YOUNG COMPLIANCE ENGAGEMENT WORK PAPERS

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Defendants Household International, Inc. ("Household"), Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilman and J.A. Vozar (collectively, the "The Household Defendants" or "Defendants") submit this Reply Memorandum to respond to the arguments advanced by Plaintiffs in their June 8, 2007 "Memorandum Regarding (1) the Ernst & Young LLP Data Validation and Sampling Work Papers and (2) The Manual Sign Off Date" ("Pls. Mem.").

PRELIMINARY STATEMENT

Plaintiffs' Memorandum mischaracterizes the nature of the 280 boxes of preliminary data sampling and data validation work papers in order to demonstrate a supposed "compelling need" for these documents. The weakness of Plaintiffs' arguments becomes apparent once the true nature of the documents at issue is considered. In addition, their relevance and "need" arguments are beside the point because the preliminary work papers are fully protected from disclosure by the attorney-client privilege. Even if this Court were to reject Household's assertion of privilege as to the entire set of preliminary work papers, Plaintiffs' untimely demand for this material should be denied based on the cumulative nature of the documents, their non-responsiveness to any prior request for documents, as well as the fact that the burden to Defendants of producing and/or logging these documents, and the delay to be expected from any follow up inquiries or motions by Plaintiffs, greatly exceeds any marginal benefit that Plaintiffs might arguably derive.

Plaintiffs fail to respond — because there is no response — to the fact that most of the preliminary work papers were completed at the end of or after the Class Period. Thus, as pointed out in Household's June 5, 2007 Memorandum (Defs. Mem.), these preliminary work papers could not have played any part whatsoever in Household's disclosure decisions during the Class Period. Likewise, the preliminary work papers could not demonstrate the materiality of any alleged misstatement or omission because they do not convey any of the conclusions that E&Y reached as a result of the Compliance Engagement and do not embody

a statistically valid sample of anything. These simple, indisputable facts undercut Plaintiffs' need argument, as well as underscore the lack of relevance of such post-Class Period information to Plaintiffs' securities fraud claims.

The Court should also reject Plaintiffs' argument regarding the privilege log entries for which Defendants made date corrections. These and other minor revisions to the privilege log were the result of further review of the documents by Defendants and further consultations with E&Y personnel involved in the Compliance Engagement in an effort to be as accurate as possible. These changes were thus entirely proper.

ARGUMENT

I. *The E&Y Preliminary Work Papers Should Not Be Produced to Plaintiffs*

A. Plaintiffs Mischaracterize the Nature of the Preliminary Work Papers in Order to Support their Purported Showing of "Compelling Need."

Plaintiffs' supposed "compelling need" for the preliminary work papers is based on blatant mischaracterizations of the nature of the preliminary work papers. Putting aside for the moment the fact that the Court need not consider Plaintiffs' "compelling need" argument at all because the E&Y preliminary work papers are fully protected by the attorney-client privilege (*see* Section B below), Plaintiffs should not be permitted to mislead this Court by concocting their own facts regarding these documents while ignoring the contradictory sworn statements submitted to the Court by John Keller, one of the principal architects of the E&Y Compliance Engagement.

For example, Plaintiffs' fabricated description of the data integrity documents as documents that "reveal the types and causes of errors in Household's loan accounting systems as well as the prevalence of such errors" (Pls. Mem. at 2) tellingly is set forth without any citation. The Keller Affidavits, which contain the only description of data integrity testing appearing in the record, do not mention anything about "types and causes of errors" or the "prevalence of such errors" in Household's loan accounting systems. Nevertheless, Plaintiffs

rely on this description to draw conclusions regarding the "independent evidentiary value" of these documents. *Id*.

Plaintiffs also place great weight on the faulty assumption — which has no basis in fact and is squarely contradicted by the Keller Affidavits — that E&Y created samples in order to build statistical models from which the total of all refunds or consumer lending "problems" could be extrapolated.[1] Pls. Mem. at 2, 8. In reality, as Plaintiffs have been told repeatedly, these documents were "samples" only in the sense that they represented fewer than all. Affidavit of John Keller (Keller Afft.) at ¶15. As Mr. Keller explained, to make sure that Household data was being transferred accurately and completely, and to make sure that E&Y's analytical models were working, before applying them to the full databases assembled for the Compliance Engagement, E&Y validated data transfers and ran other checks as to very small portions of the entire database before beginning the analyses for all accounts that had the particular loan features under investigation. Keller Afft. at ¶13. Neither in theory nor in practice did E&Y ever utilize or even try to assemble statistically significant samples from which the experience of all loans could be derived. Thus, not even the entire batch of data sampling and integrity documents would provide Plaintiffs with sufficient data from which they, or an expert hired by them, could arrive at the conclusions which E&Y eventually reached.

In fact, Plaintiffs confirmed during the April 12, 2007 status conference that they do not want or need E&Y's preliminary work papers, but only its final report (which is clearly privileged, as set forth in Defendants' May 4 Memorandum at pages 3-4). Plaintiffs' counsel represented during that conference that it sought E&Y's analysis only of the "scope of the dollars" spent on refunds issued to Household's customers as reported to Household's General Counsel years after the end of the Class Period. As the Keller Affidavits confirm, this

[1] The document cited by Plaintiffs as support for this statement, and attached as Exhibit A to the June 8, 2007 Declaration of D. Cameron Baker, Esq., does not even discuss or refer to the July, 2002 Compliance Engagement.

information cannot be found in the preliminary data sampling and data validation work papers. Defs. Mem. at 6. In any event, Plaintiffs have already received other, non-privileged documents which concern the amounts of refunds associated with certain loan attributes, as evidenced by their responses to certain of Defendants' interrogatories. *See* Defs. Mem. at n.7.

Even if Plaintiffs could derive some substantive information regarding the conclusions E&Y eventually reached about the number (and dollar amount) of refunds ultimately issued from work papers prepared before E&Y's full analysis began, such information would not be relevant to Plaintiffs' securities fraud claim since none of these conclusions became known to Household's management until they were reported to the General Counsel's Office in January, 2004 — well after the supposed fraudulent disclosures. Thus, the incomplete nuggets of information, if any, that might be derived from the preliminary work papers could not possibly have informed management's state of mind during the Class Period. Plaintiffs have failed to respond to the timing argument made throughout the Household Defendants' various memoranda on the E&Y issues for one simple reason — they have no good answer.

This Court's December 6 finding that "Plaintiffs have demonstrated a substantial need for the E&Y information in that it may assist Plaintiffs in establishing falsity, scienter, and materiality" (Pls. Mem. at 1-2) pertained only to the documents under consideration by the Court at that time. This is self-evident given that the Court was not aware of the approximately 400 boxes of E&Y work papers at the time that ruling was issued, a fact recognized by the Court's February 27, 2007 Order. *See* Order of February 27, at 1-2. Further, in arguing that Defendants were already ordered to produce Class Period documents from the preliminary work papers (Pls. Mem. at 5), Plaintiffs seek to reargue the Court's explicit ruling during the May 31, 2007 conference that it is treating the 280 boxes of preliminary work papers separately from the 110 boxes as to which, and only as to which, it ordered production of Class Period documents.

B. Plaintiffs' "Compelling Need" Argument Is Irrelevant As the E&Y Preliminary Work Papers Are Protected in their Entirety by the Attorney-Client Privilege

As Defendants demonstrated in their May 4 and May 23, 2007 Memoranda, all of the E&Y work papers (including the preliminary data validation and sampling work papers) that were created as part of the Compliance Engagement are privileged in their entirety because they embody the analytical work that accountants performed as agents for Household's General Counsel for the express purpose of assisting Household's attorneys in the provision of legal advice to Household. Defs. Mem. at 2 (referencing May 4 Memorandum at 5-11; May 23 Memorandum at 4-7, and cases cited therein).

Plaintiffs continue to ignore the extensive body of case law supporting Defendants' privilege assertion, but instead argue in conclusory fashion, and in disregard of the sworn record on this point, that the data validation and sampling work papers were "prepared by E&Y for its own use." Pls. Mem. at 1. This argument is ludicrous in light of the relevant facts already enumerated in Defendants' prior memoranda and clearly set forth in the two Keller Affidavits. Nevertheless, Plaintiffs persist with this falsehood in the hopes of convincing this Court to apply a set of inapposite cases dealing with an attorney's "memo to file" and cited in their prior memoranda. *See, e.g.*, The Class' May 11, 2007 Memorandum of Law, at 7. The comparison they invoke simply does not withstand scrutiny. First, E&Y was engaged for the purpose of assisting counsel to provide legal advice to Household, as demonstrated by the July 2002 Engagement letter and as already recognized by this Court. Second, from the outset, E&Y was required and intended to provide to Household the underlying analysis that would be — and was — summarized in E&Y's eventual January 2004 draft report (which was provided to Household). Third, throughout the Compliance Engagement, E&Y's on-going analyses were the subject of regular reporting to and discussions with Household's attorneys, at meetings that averaged one per month throughout the Engagement. *See* Defendants' May

23 Reply Memorandum (May 23 Mem.) at 5 (*citing* Supp. Keller Afft. ¶ 18).[2] Notably, Plaintiffs do not address any of these dispositive distinctions in their Memorandum.

Plaintiffs also rehash their claim that Defendants' have waived privilege by "lump[ing] documents together by folder" in their privilege log. Pls. Mem. at 4. This argument, however, is at odds with relevant authorities highlighted by Defendants (Defs. Mem. at n. 4) and ignored in Plaintiffs' response, and has already been implicitly rejected by the Court. During the April 27 status conference, the Court commented that its *in camera* review of the documents summarized in a number of entries on Defendants' initial E&Y work papers privilege log (pertaining to the first 110 boxes of work papers) demonstrated that the entries accurately reflected the documents at issue. Defendants have followed the same protocol in their preparation of the privilege log entries reflecting the 21 boxes of data sampling and data validation work.

Given the privileged nature of the preliminary work papers (and the lack of any waiver thereof), Plaintiffs' emphasis on their supposed "compelling need" for the preliminary work papers is entirely misplaced and need not even be reached by this Court. While a "compelling need" might under extraordinary circumstances overcome mere fact work product — these work papers are protected from disclosure by the attorney-client privilege, as to which the notion of "need" has absolutely no application.[3]

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[2] Plaintiffs also continue to make the argument that there was no confidential communication vis a vis the class because the Class shares in the privilege up to October 11, 2002 based upon this Court's *Garner* ruling. (Pls. Mem. at 5) Again, Plaintiffs are mistaken. Due to this Court's *Garner* ruling, Plaintiffs' interests are supposed to be aligned with Household's interests until October 11. The myriad communications from Household to E&Y that comprise the preliminary work papers are not any less confidential simply because Plaintiffs have been ruled to share Household's privilege during this brief time.

[3] In any event, the preliminary work papers constitute opinion attorney work product, not mere fact work product. *See Portis* v. *Chicago*, 2004 WL 1535854, at *2 (N.D. Ill. July 7, 2004).

C. Even Apart from Privilege Considerations, the Preliminary Work Papers are Not Subject to Production

Even if this Court were to overrule Household's privilege objection in whole or in part, Plaintiffs' demand for the preliminary work papers still should be denied based on (1) the cumulative nature of the documents; (2) their non-responsiveness to any prior request for documents, and (3) the fact that the burden to Defendants of producing and/or logging these documents (and the burden and delay of dealing with Plaintiffs' inevitable follow up inquiries and/or motions) greatly exceeds any possible marginal benefit to Plaintiffs under a proportionality analysis.

Plaintiffs' incorrectly assert that Defendants' showing regarding the cumulative nature of the preliminary work papers is based only on the mere volume of their document production. Pls. Mem. at 3. Ignoring the broad sampling of cumulative documents identified by description and Bates number in Defendants' June 5, 2007 Memorandum (at 4), Plaintiffs rely on the bald conclusion that Defendants have never produced documents containing equivalent information. Pls. Mem. at 7. Furthermore, Plaintiffs provide no explanation for their utter failure to comply with this Court's directive at the April 12, 2007 status conference to supply a list of the information it had received in discovery that was similar to the E&Y materials. S*ee* 4/12/07 Transcript at 20-21, 24, attached at Tab A to Defendants' Memorandum of June 5, 2007). This silence speaks volumes about Plaintiffs' lack of a legitimate answer.

Plaintiffs' response to the non-responsive nature of individual customer loan information contained in the E&Y work papers is likewise flawed. From the outset of fact discovery in this action, Defendants have consistently objected to producing individual customer files, and Plaintiffs never took exception to this objection. *See* Defs. Mem. at 5. In fact, Plaintiffs acknowledged in their December 29, 2006 response to one of Defendants' motions to compel proper answers to interrogatories that this lawsuit will not turn on individual customer data. *See* The Class' Response to Defendants' Motion for Sanctions and to Compel

Responses to 'Additional' Interrogatories Allowed By The Court's August 10, 2006 Order, December 29, 2006, at 8; attached as Tab C to Defendants' June 5, 2007 Memorandum. The fact that some documents of this nature ultimately made it into Defendants' voluminous document production is entirely irrelevant. Pls. Mem. at 7. In any event, as the individual consumer data embedded in the preliminary work papers is but a fraction of the whole and cannot be extrapolated to the whole, its production would serve no valid purpose at this very late stage of the case.

In addition, Plaintiffs again grossly misrepresent the nature of the 280 boxes, arguing that these documents should not be considered "discrete groups of loans" because they were "used to develop statistical models for the entire loan portfolio." Pls. Mem. at 8. As discussed in more detail above and in Mr. Keller's Affidavits, this is simply not true. The data sampling and data validation documents were assembled for systems testing only and were never used to derive any conclusions with regard to entire loan portfolio.

Under a proportionality analysis, the Court should deny Plaintiffs' request for the preliminary work papers. Given the voluminous body of Class Period documents on the same subjects as the Compliance Engagement already produced in this case, the pre-October 12, 2002 documents already produced from the first 110 boxes of E&Y work papers (pursuant to this Court's application of the *Garner* exception), the late stage of this action, the time and needless expense that Defendants would be forced to incur in reviewing these boxes, and the limited relevance (if any at all) of the preliminary work papers—all reinforced by Plaintiffs' acknowledged lack of need for this information— it is clear that the burden on Defendants and inevitable further delay would significantly outweigh any marginal benefit these documents (or any Class Period subset) might provide to Plaintiffs. Defs. Mem. at 7-8.

II. Using E&Y's "Manual Sign Off" to Date the Entries on the Privilege Log is Proper and Appropriate

Plaintiffs argue that the use of E&Y's "manual sign off" to date entries on Defendants' privilege log is improper because they say it does not reflect the date the document was

"created, received, reviewed or revised." Pls. Mem. at 9 (citing April 27, 2007 Order at 2). In fact, Defendants' use of the "manual sign off date" falls well within this standard. As explained in Defendants' opening Memorandum on this subject, "the manual sign off date was the date on which documents that are included in a logged folder, some of which may have been gathered or printed out on some earlier date, were *reviewed* by E&Y for accuracy and, if necessary, *modified or revised*. Defs. Mem. at 9; Keller Supp. Aff't at ¶4.

In addition, contrary to Plaintiffs' assertion (*see* Pls. Mem. at 9), Defendants *do* contend that the dates of the prior privilege log entries were incorrect. All revisions that were made to Defendants' privilege log were to correct mistakes in the previous log entries. Every correction was based on (i) further consultation with E&Y personnel and/or (ii) further review of a subject document itself.

With regard to the 40 undated entries on Defendants' privilege log that Plaintiffs mention in their Memorandum, Defendants have already produced to Plaintiffs on May 14 and June 8, 2007 revised privilege logs which provide dates for the majority of these entries. There are only seven remaining undated entries as to which Defendants maintain their claim of privilege. Based upon the time line of the E&Y Compliance Engagement set forth in the Keller Affidavits, it is more likely than not that these documents — which are from the substantive analytical work that E&Y began in November or December of 2002 (Keller Aff't at ¶19) — were created after October 11, 2002.

CONCLUSION

For the reasons set forth above and in the previous submissions on point, Plaintiffs' demands for production of all or portions of the 280 boxes of preliminary work papers created during the course of E&Y's privileged Compliance Engagement should be denied, and Defendants' use of E&Y's "manual sign-off" date to establish the correct date for a number of the entries on Defendants' E&Y work papers privilege log should be sustained.

Dated: June 11, 2007
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Respectfully submitted,

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