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, vs. HOUSEHOLD INTERNATIONAL, INC., et al., Defendants.	Lead Case No. 02-C-5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION *IN LIMINE* TO EXCLUDE ANY ARGUMENT THAT DEFENDANTS FULLY DISCLOSED ALL LITIGATION RISKS TO HOUSEHOLD'S OUTSIDE AUDITORS AND TO EXCLUDE ANY EVIDENCE OF OR REFERENCE TO THE ADEQUACY OF HOUSEHOLD'S CLASS PERIOD LITIGATION RESERVES

PLAINTIFFS' MOTION *IN LIMINE* NO. 5

Plaintiffs respectfully submit this memorandum of law in support of their motion *in limine* to exclude any argument that defendants fully disclosed to Household International, Inc.'s ("Household" or the "Company") outside auditors all potential risks stemming from the Company's deceptive lending practices and to exclude any evidence of or reference to the adequacy of Household's Class Period litigation reserves.

I. INTRODUCTION

A central claim in this securities fraud litigation is that defendants did not disclose to the public the level of risk due to Household's predatory lending practices, or the impact of the predatory lending practices on Household's bottom line. Defendants' failure to disclose meant that investors did not know the risk to their investment that Household's practices created, particularly as litigation stemming from Household's deceptive lending practices increased. Plaintiffs also allege that defendants violated Generally Accepted Accounting Principles ("GAAP") and Securities and Exchange Commission ("SEC") rules by failing to disclose the potential loss contingencies resulting from the Company's illegal lending practices – practices that ultimately resulted in a $525 million pre-tax charge during third quarter 2002. Defendants, on the other hand, intend to argue at trial that they fully disclosed to Household's outside auditors, Arthur Andersen LLP ("Andersen") and KPMG LLP ("KPMG") all risks stemming from Household's lending practices and that this "full disclosure" directly negates any evidence of scienter. *See* Defendants' Proposed Jury Instruction No. 1.06 – Plaintiffs' Claims; The Parties' Positions (Ex. I-3 to [Proposed] Final Pretrial Order).

During discovery, however, defendants withheld from production as privileged work product documents and materials that would directly refute defendants' claims of "full disclosure." Additionally, plaintiffs were forced to return many "inadvertently" produced audit-related documents after the Court ruled the documents were protected by the work product doctrine. Because plaintiffs were foreclosed from fully exploring these issues during discovery, defendants

should be precluded from arguing at trial that they fully disclosed to Andersen and KPMG all information about Household's business model, its products, its financial results and the regulatory, legislative, political and litigation risks to which the Company was subjected. For the same reason, defendants should be precluded from introducing evidence of or making arguments concerning the adequacy of Household's Class Period litigation reserves.

II. RELEVANT PROCEDURAL BACKGROUND

Discovery in this case commenced at the end of June 2004. Shortly thereafter, former co-defendant Andersen produced to plaintiffs several documents relating to litigation reserves created in the normal course of Andersen's audit of Household's financial statements. On January 31, 2006, Andersen requested that plaintiffs return these documents, claiming they were privileged and inadvertently produced. Plaintiffs disputed the privilege claim and on April 27, 2006, Andersen moved for the return of documents. *See* Docket No. 495 at 2. In its motion, Andersen claimed that the documents were created "because of" litigation and were therefore protected by the work product doctrine. On May 12, 2006, Household filed a motion in support of Andersen's motion to compel the return of the inadvertently produced documents, arguing that Household had the privilege and urging the Court to find that the documents were protected as opinion work product. *See* Docket No. 508.

The challenged documents included audit letters (both inquiry and response letters), as well as internal Andersen memoranda prepared for the ordinary business purpose of completing Andersen's annual audit and quarterly review of Household's financial statements. Additionally, the challenged documents included opinion letters authored by Kenneth Robin ("Robin"), Household's Senior Vice President, General Counsel and Corporate Secretary, to Andersen (the "Opinion Letters"). The Opinion Letters summarized pending and threatened litigation, along with claims then-outstanding against Household and its subsidiaries. The letters also indicated the estimated

financial exposure to Household posed by such cases and provided Robin's legal opinion as to Household's liability in the cases.

On May 26, 2006, plaintiffs filed their opposition to Household's memorandum of law. Plaintiffs also cross-moved to compel Household to produce documents responsive to plaintiffs' [Corrected] Third Request for Production of Documents. Specifically, plaintiffs sought documents concerning any database used by Household to track or monitor litigation as well as documents relating to the establishment of litigation reserves and/or the amount of any litigation reserves during the Class Period.

On July 6, 2006, Magistrate Judge Nolan granted Andersen's motion for the return of the inadvertently produced documents and denied plaintiffs' cross-motion to compel. *See Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, 237 F.R.D. 176 (N.D. Ill. 2006). The Court concluded the Opinion Letters were prepared "because of" pending or threatened litigation and were therefore protected by the work product doctrine. *Id*. at 181. The Court then held that the work product privilege protected from disclosure Household's litigation database, as the purpose of the database "was to assist Household's counsel in understanding, managing and providing legal advice to management about each lawsuit." *Id.* at 184. The Court declined to find that Household had waived any privilege by sharing the database with Andersen. *Id*. Finally, the Court found that Household's litigation reserve information was also entitled to work product immunity. *Id*. at 185.

On July 25, 2006, plaintiffs filed an objection to Magistrate Nolan's July 6, 2006 Order. *See* Docket No. 612. On January 17, 2007, this Court rejected in whole plaintiffs' objections to Magistrate Nolan's July 6, 2006 Order and adopted the ruling in its entirety. *See* Docket No. 923.

In 2002, KPMG replaced Andersen as Household's outside auditor. In early 2005, plaintiffs sought and KPMG produced work papers and other audit-related documents. Included in the production were opinion letters summarizing pending and threatened litigation against Household

and its subsidiaries, written by Household's General Counsel to KPMG. Subsequently, defendants sought to recall the KPMG opinion letters, claiming they had been inadvertently produced and were protected by the work product doctrine. On January 24, 2007, Judge Nolan held that the KPMG opinion letters fell within the scope of the Court's July 6, 2006 Order and were therefore subject to protection by the work product doctrine. *See* Docket No. 931. Now, despite withholding and retracting these critical workpapers, defendants have stated they intend to invoke an advice of auditor defense. Defendants should not permitted to use the privilege as a shield and sword.

III. ARGUMENT

"[W]hen a party asserts a privilege to preclude its opponent from obtaining information in discovery, it relinquishes the ability to use that information in its favor at trial." *Manning v. Buchan*, 357 F. Supp. 2d 1036, 1048 (N.D. Ill. 2004) (precluding defendants from relying on unnamed confidential informants during trial where defendants refused to disclose the identities of the informants during discovery based on claims of informer privilege). Indeed, principles of fairness dictate that a party should not be permitted to "make selective use of information helpful to him while blocking inquiries into other aspects of the information that might be unhelpful." *Id*. Here, it would be grossly unfair to permit defendants to argue that they fully disclosed all risks to Household's outside auditors, because plaintiffs were precluded from obtaining documents and information during discovery that would refute this claim. Additionally, any evidence of or reference to the adequacy of Household's Class Period litigation reserves should likewise be excluded at trial due to defendants' assertion of the work product doctrine.

A. Defendants Should Be Precluded from Arguing that They "Fully Disclosed" All Risks Stemming from Household's Predatory Lending Practices to the Company's Outside Auditors

A central claim in this securities fraud litigation is that defendants concealed from the public the level of risk due to Household's predatory lending practices, and the impact of the predatory

lending practices on Household's bottom line. Defendants' failure to disclose this information meant that investors did not know the risk to their investment that Household's practices created, particularly as the litigation relating to the Company's predatory lending practices increased. Defendants, on the other hand, intend to assert at trial that they fully disclosed to the public and Household's outside auditors all risks stemming from Household's business model, including its use of deceptive lending practices. *See* Defendants' Proposed Jury Instruction No. 1.06. Defendants further contend that this "full disclosure" negates any inference of scienter. *Id.* Yet plaintiffs were foreclosed from exploring whether defendants did in fact fully disclose to Company auditors all risks stemming from its predatory lending practices due to defendants' assertion of the work product doctrine.

During discovery, both Anderson and KPMG inadvertently produced audit letters and internal memoranda prepared in the course of completing the audit of Household's financial statements. Defendants, however, relying on the work product doctrines, refused to produce any audit letters, claiming the documents were protected work product. On July 6, 2006, the Court ordered plaintiffs to return the inadvertently produced Andersen documents, finding that the documents fell under the work product doctrine. *See Jaffe*, 237 F.R.D. 176. In a subsequent ruling, the Court also ordered plaintiffs to return any inadvertently produced KPMG audit-related documents and opinion letters, as they were substantially similar in form to the Andersen documents. *See* January 24, 2007 Order, Docket No. 931. As a result of defendants' claims of work product, plaintiffs were barred from obtaining evidence relating to the Andersen and KPMG audits of Household's financial statements – documents that would directly refute defendants' claims of "full disclosure."

Indeed, the documents plaintiffs were compelled to return demonstrate that defendants did ***not*** provide complete information to Household's auditors during the Class Period. For example,

beginning in 2000, ACORN held demonstrations at various Household branches to protest the Company's deceptive lending practices. Subsequently, Household and ACORN engaged in negotiations over the Company's predatory lending practices. After negotiations between the two failed, ACORN sued Household for its predatory lending practices in February 2002. Additionally, in November 2001, a nationwide class action alleging numerous predatory lending practices was brought against Household. The plaintiffs in that case sought damages totaling the amount of all finance charges and fees paid. Finally, there were ongoing investigations by federal and state regulators regarding Household's predatory lending practices.[1] Defendants chose to assert the work product privilege over audit-related documents related to litigation risks, thereby preventing plaintiffs from obtaining discovery on this issue. Defendants should not be permitted to argue at trial that they fully disclosed to Household's auditors all risks stemming from the Company's deceptive lending practices, when defendants withheld documents that would have allowed plaintiffs to refute this defense. Allowing defendants to present testimony in support of this claim would be tantamount to defendants using the work product privilege as both a shield and sword. Fairness therefore mandates that defendants be excluded from arguing that they fully disclosed to Household's auditors all risks stemming from potential litigation against the Company. *See, e.g.*, *Turner v. Univ. of Wash.*, No. C05-1575RSL, 2007 U.S. Dist. LEXIS 78281, at *4 (W.D. Wash. Oct. 10, 2007) (excluding from trial materials withheld in discovery based on claims of attorney-client privilege or work product doctrine).

[1] The contents of Household's 2001 and 2002 audit letters were previously discussed in detail in plaintiffs' briefing on this issue. *See, e.g.*, Docket Nos. 519, 537.

B. Defendants Should Be Precluded from Introducing Evidence of or Referring to the Adequacy of Household's Class Period Litigation Reserves

Plaintiffs also allege defendants violated GAAP by failing to fully disclose and properly record potential loss contingencies resulting from the Company's illegal predatory lending practices . Throughout the Class Period, Household was a party to various legal proceedings, including class actions arising from Household's deceptive lending practices that sought damages in very large amounts. Under the applicable accounting rules, Household was required to record and disclose contingencies relating to pending or threatened litigation. In order to track such litigation, Household maintained a litigation database that contained every actual or threatened claim or action, the date of the claim, the amount of damages sought and the current status of the case, among other information. *See* Docket No. 521 (Declaration of Kristen L. Flanagen in Support of the Class' Response to the Household Defendants' Memorandum of Law in Support of the Return of Certain Arthur Andersen Documents and Cross-Motion to Compel Production of Certain Documents Provided to Outside Auditors by Household Defendants). Before conducting an audit, Household's auditors obtained from management a description and evaluation of litigation, claims and assessments that existed at the date of the reporting period. The information provided by management to the auditors was drawn from Household's litigation database. *Id.* Household also maintained litigation reserves, an accounting tool used to ensure there was adequate money put aside so that financial statements will be materially accurate, regardless of the outcome of any litigation.

Accordingly, during discovery plaintiffs sought information and documents concerning Household's litigation database and reserves. Defendants refused to produce any information relating to Household's database and reserves, claiming that the information was protected by the work product doctrine. Although plaintiffs moved to compel defendants to produce this information, the Court ultimately sided with defendants, holding that the database and reserve information was

protected work product. *See Jaffe*, 237 F.R.D. 176. Thus, despite plaintiffs' exhaustive efforts, they were unable to obtain discovery on this issue.

Defendants, having asserted work product privilege over the database and reserve information, should now be barred from introducing evidence of or referring to the adequacy of Household's Class Period litigation reserves. It would be patently unfair to permit defendants to argue that Household's litigation reserves were adequate, as plaintiffs would be unable to rebut any argument on this issue at trial. Asserting work product during discovery, then presenting testimony or evidence on the litigation database and reserves at trial, would be an improper use of the work product privilege. Defendants should not be permitted to use the privilege as both a shield and sword. *See, e.g.*, *Harris v. City of Chicago*, 266 F.3d 750, 751-52 (7th Cir. 2001) (remanding for new trial where defendant invoked Fifth Amendment privilege against self-incrimination during a deposition, then answered all questions posed on direct and cross-examination at trial). As with the audit letters, defendants chose to stonewall plaintiffs on the topic of the Company's litigation reserves; they must now live with the consequences. *See, e.g.*, *Third Wave Techs. Inc. v. Stratagene Corp.*, 405 F. Supp. 2d 991, 999 (W.D. Wis. 2005) (admonishing defendant that it "chose to stonewall plaintiff on the topic of [its general counsel's] knowledge of plaintiff's patents" and therefore had to "live with the consequences"); *Fultz v. Fed. Sign*, No. 94 C 1931, 1995 U.S. Dist. LEXIS 1982, at *4-*5 (N.D. Ill. Feb. 16, 1995) (one cannot assert privilege to keep an opponent from discovering facts that it intends to use at trial as a defense to defeat the opponent's allegations).

IV. CONCLUSION

Plaintiffs respectfully request an Order excluding defendants from arguing that they fully disclosed to Household's outside auditors all risks stemming from the Company's deceptive lending

practices. Plaintiffs also respectfully request defendants be excluded from introducing evidence of or referring to the adequacy of Household's Class Period litigation reserves.

DATED: January 30, 2009

Respectfully submitted,

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DECLARATION OF SERVICE BY ELECTRONIC MAIL AND BY U.S. MAIL

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Diego, State of California, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 655 West Broadway Suite 1900, San Diego, California 92101.

2. That on January 30, 2009, declarant served by electronic mail and by U.S. Mail to the parties the **MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION *IN LIMINE* TO EXCLUDE ANY ARGUMENT THAT DEFENDANTS FULLY DISCLOSED ALL LITIGATION RISKS TO HOUSEHOLD'S OUTSIDE AUDITORS AND TO EXCLUDE ANY EVIDENCE OF OR REFERENCE TO THE ADEQUACY OF HOUSEHOLD'S CLASS PERIOD LITIGATION RESERVES**.

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 30th day of January, 2009, at San Diego, California.

/s/ Teresa Holindrake
TERESA HOLINDRAKE