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**IN THE UNITED STATES DISTRICT COURT**
**FOR THE NORTHERN DISTRICT OF ILLINOIS**
**EASTERN DIVISION**

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| LAWRENCE E. JAFFE PENSION PLAN, On Behalf of Itself and All Others Similarly Situated,<br><br>Plaintiff,<br><br>vs.<br><br>HOUSEHOLD INTERNATIONAL, INC., et al.,<br><br>Defendants. | Lead Case No. 02-C-5893<br>(Consolidated)<br><br>CLASS ACTION<br><br>Judge Ronald A. Guzman<br>Magistrate Judge Nan R. Nolan |



**PLAINTIFFS' MOTION FOR ORDER COMPELLING DEFENDANT ARTHUR ANDERSEN LLP TO PRODUCE WITNESSES FOR DEPOSITION AND DOCUMENTS**

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**STATUTES, RULES AND REGULATIONS**

Pursuant to Federal Rule of Civil Procedure 37(a), plaintiffs respectfully move this Court for an order compelling defendant Arthur Andersen LLP ("Andersen") to (1) produce witnesses for deposition pursuant to plaintiffs' Notice of Deposition of Arthur Andersen LLP Pursuant to Federal Rule of Civil Procedure 30(b)(6) ("Rule 30(b)(6) Notice") and (2) produce documents responsive to Plaintiffs' First Request for Production of Documents to Defendant Arthur Andersen LLP served on May 17, 2004 (the "Request"). Exs. 1-2.[1]

## I. INTRODUCTION

In this securities class action on behalf of all persons who purchased or acquired Household International, Inc. ("Household" or the "Company")[2] securities between October 23, 1997 to October 11, 2002 (the "Class Period"), Andersen, Household's outside auditor, is alleged to have directly participated in, known of and/or turned a blind eye to a massive fraudulent scheme that artificially inflated the price of Household securities. To date, despite the lapse of over eight months of discovery and numerous meet and confers, Andersen, without justification, has refused to produce documents responsive to the bulk of plaintiffs' Request or even a single witness in response to plaintiffs' Rule 30(b)(6) Notice.

Plaintiffs therefore seek an order compelling Andersen to produce one or more corporate designees for deposition regarding the matters identified in the Rule 30(b)(6) Notice, including the professional services Andersen performed for Household, the identity of witnesses who may possess relevant information, the circumstances that led to Andersen's termination, the location and description of documents requested by plaintiffs and Andersen's email system.[3]

Plaintiffs also seek an order compelling the production of the following documents that Andersen refuses to produce:[4]

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[1] All Exhibits referenced herein are attached to the Appendix of Exhibits in Support of Plaintiffs' Motion for Order Compelling Defendant Arthur Andersen LLP to Produce Witnesses for Deposition and Documents, filed herewith.

[2] Unless specified otherwise, Household or the Company includes Household's subsidiaries, Household Finance Corporation, Inc. ("HFC"), Household Realty Corporation and Beneficial Corporation, subsequent to the latter's merger with Household on June 30, 1998.

[3] The examples of deposition categories ("Categories") and their description used in this motion are not intended to limit the Rule 30(b)(6) Notice as written.

[4] The description of document categories used in this motion is not intended to limit the Request as written.

1. documents relating to investigations by or communications with any federal or state agency or regulatory body concerning Household or Andersen's services to Household (Request 1);

2. documents concerning any professional services performed by Andersen for Household, including consulting engagement workpapers and related documents (Requests 4 and 5);

3. documents concerning Household, kept or maintained by Andersen personnel who provided services for Household, particularly audit employee desk files, correspondence and emails (Requests 6 and 9);

4. audit manuals and guides relevant to the Household audit (Request 10);

5. documents concerning the compensation for each partner or principal at Andersen who provided professional services to Household (Request 13);

6. the reviews, evaluations and personnel files for all Andersen employees who provided professional services for Household (Request 17); and

7. any documents concerning peer reviews of Andersen (Request 18).

The deposition and documents sought by this motion are directly relevant to plaintiffs' claims. Andersen was Household's auditor from 1985 until 2002. *See* Exs. 3-4. During the Class Period, Andersen issued unqualified audit opinions, certifying that the Company's financial statements for fiscal years 1997 through 2001 were prepared in accordance with Generally Accepted Accounting Principles ("GAAP") and that Andersen's audits of such financial statements had been performed in accordance with Generally Accepted Auditing Standards ("GAAS"). These statements were false as evidenced by a $600 million (pre-tax) restatement resulting from improper accounting that went as far back as 1994. Andersen also reviewed Household's interim results and press releases and quarterly reports filed with the Securities and Exchange Commission ("SEC"). The Complaint alleges that Andersen knew and/or deliberately turned a blind eye to red flags indicating that Household's revenues and net income for 1997 through 2001, as publicly reported during the Class Period, were materially overstated due to accounting manipulations and improper lending and delinquent loan re-aging practices.

As Household's long-time auditor, accountant and consultant, Andersen was a primary witness to Household's undisclosed fraudulent scheme and had an unparalleled vantage point from which to review and comment on Household's financial condition. Because the fraud was partly effectuated through accounting machinations, the integrity and accuracy of Andersen's auditing

practices and internal and quality controls, as well as the independence of Andersen and its audit partners are squarely at issue.

It is further imperative that plaintiffs have full access to what the Household Defendants[5] and third parties shared and discussed contemporaneously with Andersen about Household. The depositions and documents sought will likely demonstrate that statements about Household's business and financial condition were false and that Andersen knew it or recklessly disregarded that fact. Plaintiffs must be allowed to determine what Andersen knew and when, what the Household Defendants disclosed or failed to disclose to Andersen, what adjustments, if any, were made to the financial results, what reports were made concerning financial controls and what comments Andersen made to the Household Defendants concerning Household's financial statements.

Finally, because the alleged fraudulent scheme began well before the Class Period and evidence of the fraud was revealed after it, plaintiffs seek production of documents for the period January 1, 1994 through the present (the "Relevant Time Period").

## II. STATEMENT OF COMPLIANCE WITH LOCAL RULE 37.2

On July 9, 2004, plaintiffs received Andersen's Objections and Responses to Plaintiffs' First Request for Production of Documents (the "Response and Objections") and a letter indicating Andersen would not produce any witness pursuant to the Rule 30(b)(6) Notice.[6] Exs. 5-6. Thereafter, the parties met and conferred for approximately two hours on July 26, 2004. Andersen refused to produce additional documents, but agreed to follow-up on a number of issues by August 6, 2004. Plaintiffs sent a letter memorializing the meet and confer. Ex. 7. Plaintiffs subsequently sent a letter reminding Andersen of the outstanding issues. Ex. 8. Instead of providing responses, Andersen informed plaintiffs by email, that it wanted to meet and confer again the following week. Ex. 9. Given the length of the initial meet and confer (2+ hours), in an attempt to streamline further discussions, plaintiffs requested that Andersen provide written responses regarding the outstanding issues before a second meet and confer. *Id.* Andersen ignored this request.

A second meet and confer was held on August 16, 2004. During the meet and confer, Andersen provided additional information, but did not respond to all outstanding issues. Andersen

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[5] "Household Defendants" are Household, HFC, William F. Aldinger, David A. Schoenholz, Gary Gilmer and J.A. Vozar.

[6] Plaintiffs never received written objections to the Rule 30(b)(6) Notice.

agreed to follow-up on certain issues the next day, but failed to do so. Plaintiffs then sent a follow-up letter to Andersen memorializing the second meet and confer and requesting additional information promised during the meet and confer. Ex. 10. Andersen did not respond.

Plaintiffs did not hear from Andersen again regarding the Request or Rule 30(b)(6) Notice until two days after the Court imposed a merits discovery stay lasting until October 1, 2004. By letter of September 1, 2004, Andersen informed plaintiffs of alleged but unspecified inaccuracies in plaintiffs' previous letters and stated that it was continuing to investigate and gather information and would respond in a single letter after the discovery stay. Ex. 11.

After the discovery stay ended, Andersen did not respond as promised. On October 12, 2004, plaintiffs, by letter, summarized the status and requested follow-up by October 20, 2004. Ex. 12. Despite the fact that five months had passed since the Request was served and two months had passed since the last meet and confer, on October 14, 2004, counsel for Andersen informed plaintiffs that the October 20 deadline was not feasible.

On October 22, 2004, Andersen sent a letter which purported to identify certain inaccuracies in plaintiffs' letters and set forth Andersen's positions with respect to certain Requests. Ex. 13. The parties met and conferred for a third time on October 28, 2004 and subsequently exchanged correspondence regarding the meet and confer. Exs. 14, 15. The third meet and confer and subsequent correspondence make it clear that the parties have reached an impasse with respect to a number of Requests. As Andersen confirmed by its December 22, 2004 letter and February 15, 2005 production, it refuses to produce any documents other than workpapers and document destruction/retention policies, and will not produce a corporate designee for deposition. Exs. 16, 19. Plaintiffs now seek the Court's assistance.

## III. ARGUMENT

### A. Discovery Standard

In ruling on motions to compel discovery, courts have consistently adopted a liberal interpretation of the discovery rules. *Semien v. Life Ins. Co. of N. Am.*, 03 C 4795, 2004 U.S. Dist. LEXIS 6759, at *3 (N.D. Ill. Apr. 20, 2004); *Wilstein v. San Tropai Condominium Master Ass'n*, 189 F.R.D. 371, 375 (N.D. Ill. 1999). Courts commonly look unfavorably upon significant restrictions placed on the discovery process. *Id.*

Fed. R. Civ. P. 26(b)(1), amended in 2000, permits discovery of information that is "relevant to the claim or defense of any party." The discovery standard is not based upon whether the information sought would be admissible at trial; rather, information is discoverable if it "appears

reasonably calculated to lead to the discovery of admissible evidence." Fed. R. Civ. P. 26(b)(1). A discovery request is considered relevant if there is any possibility that the information sought may be relevant to the subject matter of the action. *Semien*, 2004 U.S. Dist. LEXIS 6759, at *3. The burden rests on the objecting party to show why a particular discovery request is improper. *Id.; Nestle Foods Corp. v. Aetna Cas. & Sur. Co.*, 135 F.R.D. 101, 104 (D.N.J. 1990). Andersen has not met this burden.

**B. Andersen Must Provide Corporate Testimony**

On June 9, 2004, plaintiffs served on Andersen the Rule 30(b)(6) Notice, instructing Andersen to designate and make available its person(s) most knowledgeable regarding several categories of information relevant to plaintiffs' claims. Andersen has flatly refused to make available ***any*** corporate representative to testify, claiming that with the exception of Andersen's email system, there is no one available to testify regarding the requested information. Exs. 6-7.[7]

Plaintiffs, however, "ha[ve] the right to take a 30(b)(6) deposition of [defendant], regardless of whether the company currently has any employees with actual knowledge of the events in the complaint." *Jakob v. Champion Int'l Corp.*, 01 C 0497, 2001 U.S. Dist. LEXIS 19010, at *3 (N. D. Ill. Nov. 14, 2001). "If the persons designated by the corporation do not possess personal knowledge of the matters set out in the deposition notice, the corporation is obligated to prepare the designees so they may give knowledgeable and binding answers for the corporation." *United States v. Taylor*, 166 F.R.D. 356, 361 (M.D.N.C. 1996). Andersen thus has an obligation to educate a corporate designee for deposition. *See Buycks-Roberson v. Citibank Fed. Sav. Bank*, 162 F.R.D. 338, 343 (N.D. III. 1995) (noting that the duty to prepare and present a corporate designee goes beyond matters personally known to that designee).

Andersen's actions in this litigation make it clear that ***somebody*** has the information plaintiffs are entitled to. For example, plaintiffs seek a deponent with knowledge of the identity and location of persons with information regarding Andersen's work for Household. Ex. 1, Categories 1-4, 6. Andersen listed several witnesses as having information relevant to its defenses in its Rule 26 disclosures. Ex. 17. Somebody put this list together. Thus, even if there is no person at Andersen

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[7] Although they do not dispute that someone is available to testify about their email system, to date Andersen simply has refused to produce the individual.

who can testify regarding this information, one can – and pursuant to Rule 30(b)(6) must – be educated.

Plaintiffs also seek to depose a corporate designee regarding the facts and circumstances surrounding Household's restatement. Ex. 1, Categories 4-6. Andersen prepared a 255-page answer to plaintiffs' Complaint specifically addressing each of plaintiffs' allegations and denying (among other things) that Andersen "committed any wrongdoing, or had any knowledge of wrongdoing" and affirmatively contending (among other things) that Andersen's actions "were in good faith, without knowledge of any wrongdoing, without intention to commit fraud, participate in fraud, or facilitate fraud and without any recklessness whatsoever."[8] This information did not simply appear out of thin air. Plaintiffs are entitled to discover the bases for these contentions, if any.

Finally, plaintiffs seek a witness with knowledge of the identity and location of documents relevant to this action. Ex. 1, Category 7. In this case, Andersen has (1) produced some documents; (2) acknowledged the existence of other documents, but refused to produce them; and (3) denied the existence of yet other documents. Again, unless counsel for Andersen is simply shooting from the hip, it is clear that somebody has this information. Plaintiffs are entitled to discover it.

Courts in this district have found unpersuasive Andersen's argument that preparation of Rule 30(b)(6) witnesses who do not have personal knowledge will constitute an undue burden. Such excuses "fail to confront the fact that [defendant has] a duty to provide a witness or witnesses with the requisite knowledge and to prepare these witnesses, despite the difficulty of investigating the subject matter requested by the deposing party." *Buycks-Roberson*, 162 F.R.D. at 343 (rejecting argument that "'it is difficult and time-consuming to investigate unwritten practices that were in effect three years ago'") (citation omitted). Andersen must produce a witness (or witnesses) fully prepared to give testimony binding on Andersen regarding each of the subjects identified in the Rule 30(b)(6) Notice.

### C. Plaintiffs Are Entitled to Responsive Documents from January 1, 1994 to the Date of Production

It is well settled that the relevant period for discovery purposes is not limited to the class period. *See Huddleston v. Herman & MacLean*, 640 F.2d 534, 552-53 (5th Cir. 1981), *aff'd in part and rev'd in part or other grounds sub. nom Herman & MacLean v. Huddleston*, 459 U.S. 375

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[8] *See* Answer and Affirmative Defenses of Defendant Arthur Andersen LLP to Plaintiffs' [Corrected] Amended Consolidated Class Action Complaint.

(1983); *In re Control Data Corp. Sec. Litig.*, Master Docket 3-85-1341, 1987 U.S. Dist. LEXIS 16829, at *8 (D. Minn. Dec. 10, 1987) ("there is no rule fixing discovery in class-action litigation to the class period"), *aff'd*, 1988 U.S. Dist. LEXIS 18603 (D. Minn. Feb. 22, 1988); *Stephens Theatre Corp. v. Loew's, Inc.*, 17 F.R.D. 494, 495 (D.N.Y. 1955) (compelling production of information dating back 23 years and rejecting defendants' bid to limit discovery based on statute of limitations). The proper scope of discovery is not determined according to the convenience of defendants; rather, it is governed by the nature of the litigation. *King v. E.F. Hutton & Co.*, 117 F.R.D. 2, 7 (D.D.C. 1987).

The nature of this litigation is such that information created before and after the Class Period is highly relevant to plaintiffs' case. There is evidence that at least parts of the fraudulent scheme began well before the Class Period. The Complaint alleges that defendants' accounting manipulations went back to 1994. ¶135.[9] Also, the improper and illegal lending practices likely began before the Class Period. ¶18; *see also* Complaint, Ex. B at 3 ("Washington Department of Financial Institutions Expanded Report of Examination for Household Finance Corporation III" (listing customer complaints from 1995 to 2002)). Plaintiffs are entitled to discover the point in time Andersen discovered the fraud.

Plaintiffs are also entitled to receive responsive documents that were created after the Class Period. *See In re Seagate Tech. II Sec. Litig.*, No. C-89-2493(A)-VRW, 1993 U.S. Dist. LEXIS 18065, at *2 (N.D. Cal. June 10, 1993) (defendant's attempt to confine discovery to a narrow period beginning three months before and ending three weeks after the class period is "artificial, arbitrary and designed to avoid the production of relevant documents"). Household's improper reaging practices were the subject of an SEC investigation which continued after the Class Period ended. On March 18, 2003, Household agreed to a consent order with the SEC to cease and desist from further violations of federal securities laws relating to its re-aging practices. Ex. 18. Thus, plaintiffs' Relevant Time Period – January 1, 1994 through the date of production – is reasonable and necessary.

[9] All paragraph references ("¶") are to the Complaint, unless otherwise indicated.

### D. Andersen Must Produce Documents Relating to Investigations by Federal or State Agencies Concerning Household (Request 1)

Andersen admits that it has responsive documents relating to investigations of Household by regulatory bodies but refuses to produce documents in the form they were produced to the regulatory bodies. Andersen also refuses to produce ***any*** communications from regulatory bodies investigating Household. Investigatory documents, including communications relating to Household go to the heart of plaintiffs' claims that there was a fraudulent scheme and that Andersen knew of it. Communications between, and requests for documents from the investigative agencies or regulatory bodies are relevant to determine the scope of the investigations including which agencies were investigating Household, for what purpose, when and their connection to plaintiffs' claims in this case. Thus, all documents produced to any investigative agency should be produced. *See In re Steinhardt Partners, L.P.*, 9 F.3d 230, 232 (2d Cir. 1993). Such documents should be produced in the same manner as produced to the agencies or regulatory bodies, which eliminates any burden connected with this production.

### E. Andersen Must Produce Documents Concerning Professional Services Performed by Andersen for Household (Requests 4 and 5)

Plaintiffs have requested all documents relating to other professional services performed for Household, such as consulting, assurance, accounting and attestation and agreed upon procedures. *See* Requests 4 and 5. Information related to Andersen's consulting and non-audit services for Household is relevant to Andersen's motive and opportunity to commit fraud. *In re Complete Mgmt. Sec. Litig.*, 153 F. Supp. 2d 314, 335 (S.D.N.Y. 2001); *In re MicroStrategy Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 655-56 (E.D. Va. 2000); *In re Leslie Fay Cos. Sec. Litig.*, 835 F. Supp. 167, 174 (S.D.N.Y. 1993) (auditor motivated not to "open his eyes" to underlying facts since this would place him in a position of terminating a profitable financial situation).

In 2000 and 2001, Andersen was paid a remarkable $4.7 million for consulting and non-audit services, in comparison to $3.9 million for audit work. ¶177. The large fees received reflect the vast quantity of non-auditing work performed by Andersen for Household. Indeed, Andersen was not just Household's auditor, but prepared Household's tax returns and provided year-round consulting services on a wide range of topics – its opportunities to discover the fraud were plentiful. ¶¶46, 171.

Andersen personnel were present at Household's headquarters and financial offices throughout the year and had continual access to confidential corporate, financial and business information. *Id.* Andersen was routinely involved in the structuring and/or approval of Household's practices and debt offerings and discussed and approved Household's press releases related to the

dissemination of Household's financial results. ¶¶171, 176. Andersen's non-audit documents will provide important information regarding defendants' fraudulent financial reports and false statements to the public, Andersen's intimate knowledge of Household's business and its involvement in the fraudulent scheme.

### F. Andersen Must Produce Employee Desk Files, Correspondence and Email (Requests 6 and 9)

Despite plaintiffs' repeated requests, Andersen refuses to search personnel desk files for responsive documents, produce all correspondence and search for emails on the Company's servers, back-up tapes, and other likely locations. *See* Requests 6 and 9. All responsive information must be produced, however, regardless of the form in which it is preserved. Defendants may not avoid producing relevant documents simply because they stored the information in a computer database or in other magnetic or electronic form, including email. *In re Brand Name Prescription Drugs Antitrust Litig.*, 94 C 897, MDL 997, 1995 U.S. Dist. LEXIS 8281, at *1-*2 (N.D. Ill. June 13, 1995) ("[C]omputer-stored information is discoverable under the same rules that pertain to tangible, written materials.").

Plaintiffs seek these documents from the members of the engagement team, *i.e.*, the persons at Andersen who communicated with Household, its subsidiaries and its customers, and purportedly reviewed the exact matters plaintiffs now allege were falsely represented to the public. Plaintiffs are entitled to discover the entirety of Andersen's files on Household in order to determine what information Household and third parties provided to – and/or concealed from – Andersen. Email is one of the most commonplace methods of communication and it is beyond question that Andersen's personnel working on Household engagements exchanged email both internally and externally concerning their work. Andersen should be ordered to search employee desk files for and produce responsive documents and emails.

### G. Andersen Must Produce Audit Manuals and Guides (Request 10)

Andersen's audit manuals and guides relate directly to plaintiffs' claims and the specific auditing and accounting violations at issue. Any evaluation of whether Andersen was deceived by the Household Defendants or failed to properly audit Household's financial statements requires that the accounting workpapers be reviewed in conjunction with the audit manuals. The manuals and guides are the auditor's primary reference source of audit standards and accounting principles. They provide auditors with detailed instructions and guidance for each stage of the audit and define Andersen's compliance with GAAS and the interpretation of GAAP. There can be no dispute that

the question of whether or not Andersen complied with its required policies and procedures to adhere to GAAS in performing the Household audit is highly probative. At a minimum, plaintiffs need Andersen's audit manuals and related documents in order to conduct depositions of Andersen's employees regarding the adequacy of their audits of Household. *In re Mercury Fin. Co.*, No. 97 C 3035, 1999 U.S. Dist. LEXIS 11236, at *14 (N.D. Ill. July 12, 1999); *Gohler v. Wood*, 162 F.R.D. 691, 695 (D. Utah 1995); *Fields v. Oliver's Stores, Inc.*, No. 87 Civ. 0894 (WK), 1990 U.S. Dist. LEXIS 2271, at *2-*3 (S.D.N.Y. Mar. 2, 1990).

Andersen's audit manuals are not "trade secrets," disclosure of which would result in competitive harm because (1) Andersen no longer performs auditing services; (2) the requested manuals and guides are several years old; and (3) Andersen's competitors actually reviewed Andersen's audit methodology and audit manuals and guides in periodic peer review programs subject to disclosure restrictions. In any event, the protective order in this case provides adequate safeguards to protect Andersen against any alleged harm from disclosure of its audit manuals. *See* Protective Order, ¶3(12); *see also Mercury Fin.*, 1999 U.S. Dist. LEXIS 11236, at *16; *Gohler*, 162 F.R.D. at 696-97; *Master Palletizer Sys., Inc. v. T.S. Ragsdale Co.*, 123 F.R.D. 351, 353 (D. Colo. 1988).

Moreover, numerous courts have held that audit manuals that do contain trade secrets are relevant and necessary to show that an auditor acted with scienter. *See, e.g., Gohler*, 162 F.R.D. at 697; *Master Palletizer Sys.*, 123 F.R.D. at 352 (balancing the potential harm to Andersen against plaintiff's need for the relevant information, the court ordered audit manuals to be produced). Indeed, one court held the audit manuals were the "single best source of information" in determining whether auditors acted with scienter. *Fields*, 1990 U.S. Dist. LEXIS 2271, at *3. Need is enhanced when information is uniquely available from the party from whom it is sought. *American Standard, Inc. v. Pfizer, Inc.*, 828 F.2d 734, 743 (Fed. Cir. 1987). Here, Andersen represented to plaintiffs (and the workpapers confirm) that it used a new audit methodology for its later audits of Household. Given this change in audit methodology, plaintiffs' need for Andersen's audit manuals is increased.

### H. Andersen Must Produce Documents Related to Partner Compensation (Request 13)

Andersen's executive compensation is relevant to the motive of Andersen to commit fraud. Plaintiffs allege that Andersen participated in the fraud to, *inter alia*, increase the income received by the partners responsible for the Household engagements and that partner income was directly tied to retaining engagements. ¶177.

Courts have uniformly held that executive compensation incentives are a relevant component of averring scienter. *See Schlagal v. Learning Tree Int'l*, Case No. CV98-6384 ABC (Ex), 1998 U.S. Dist. LEXIS 20306, at **50-51 (C.D. Cal. Dec. 23, 1998) ("[compensation] programs are relevant when combined with other alleged incentives"); *In re Wellcare Mgmt. Group Sec. Litig.*, 964 F. Supp. 632, 639 (N.D.N.Y. 1997); *In re Orbital Sciences Corp. Sec. Litig.*, 58 F. Supp. 2d 682, 687 (E.D. Va. 1999). Because executive compensation is relevant to show motive, Andersen should be compelled to produce the requested documents.

## I. Andersen Must Produce Reviews, Evaluations and Personnel Files for the Auditors Who Worked on Household Engagements (Request 17)

The personnel reviews for the members of Household engagement teams are directly relevant to plaintiffs' allegations – they are highly probative of the quality of Andersen's audit of Household. Plaintiffs allege that Andersen committed several audit failures during its audit of Household, and therefore committed fraud by failing to realize or act on the realization that Household was cooking its books or otherwise engaged in fraudulent schemes. The personnel reviews will provide evidence regarding the quality and skill of the particular accountants working on the Household audit, and will therefore go directly to the quality of Andersen's audit of Household. *See In re Hawaii Corp.*, 88 F.R.D. 518, 522 (D. Haw. 1980); *see also In re Oxford Health Plans, Inc. Sec. Litig.*, MDL Civ. 1222 (CLB), 2001 U.S. Dist. LEXIS 5817, at *7-*8 (S.D.N.Y. Apr. 30, 2001) (evaluations, reviews and resumes of audit personnel enable plaintiffs to obtain information including whether the auditors were properly trained for the audit and followed appropriate accounting and auditing procedures).

Andersen seeks to withhold the documents on state-law privilege grounds. Ex. 5. As a general matter, however, personnel files are discoverable in federal question cases, despite claims of privilege. *Garrett v. San Francisco*, 818 F.2d 1515, 1519 (9th Cir. 1987). Federal law does not recognize the existence of state law privileges, such as the Illinois Accountant Privilege or the privilege of self-critical evaluation. *See* Fed. R. Evid. 501; *In re Int'l Horizons, Inc.*, 689 F.2d 996, 1004 (11th Cir. 1982) (no state-created privilege has been recognized in federal cases); *Mercury Fin.*, 1999 U.S. Dist. LEXIS 11236 (there is a strong presumption against the application of privileges); *Baylor v. Mading-Dugan Drug Co.*, 57 F.R.D. 509, 512 (N.D. Ill. 1972) ("a federal district court may no longer apply a state-created accountant privilege in federal question cases").

*Mercury Fin.*, 1999 U.S. Dist. LEXIS 11236 is directly on point. As here, the defendant auditor in *Mercury Fin.* was alleged to have violated GAAS in its audit opinion of the company's financial statements and ignored substantial warnings that the company's accounting policies

violated GAAP. The court rejected the auditor's asserted state law privileges and objections to the relevance of the information, the over breadth of the request and the confidentiality of the personnel files, and ordered that the auditor's job evaluation be produced.

Plaintiffs' request for personnel reviews is narrowly-tailored to the limited number of individuals who worked on the Household audits. The personnel files with employee reviews and evaluations for each member of the team are essential, since the quality of the audit as a whole is at issue.

**J. Andersen Must Produce Peer Reviews (Request 18)**

Deloitte & Touche conducted peer reviews of Andersen in 1995, 1998 and in 2001. To the extent that peer reviews relate to the office that conducted the Household audits (Chicago), such reviews are directly relevant to scienter and must be produced.

Plaintiffs must prove scienter in this case, and, in the case of Andersen, that Andersen knew or recklessly disregarded errors in Household's financial statements. The peer reviews, reports, and communications at issue are relevant because they reflect an investigation of the facts underlying plaintiffs' claims. *See, e.g., In re Sahlen & Assoc., Inc.*, Case No. 89-6308-CIV, 1990 U.S. Dist. LEXIS 18793, at *2 (S.D. Fla. Nov. 5, 1990) (accounting firm peer review files are relevant in securities fraud action); *Control Data*, 1987 U.S. Dist. LEXIS 16829, at *12-*13. As the court in *Control Data* held, peer review reports and internal employee evaluations "have a bearing on the competency with which [the company's] engagements were handled, and will help to elucidate whether individual judgments versus patterns of corporate conduct were at the root of the claimed accounting errors." *Id.* at *13. "Such documents can also shed light on whether the corporation saw fault with its own performance." *Id.*

As with personnel files, any assertion of a state law privilege, such as the "self-critical analysis privilege" or "Illinois Peer Review privilege," is meritless because federal law does not recognize these privileges. *See* Fed. R. Evid. 501; *Federal Deposit Ins. Corp. v. Mercantile Nat'l Bank*, 84 F.R.D. 345, 349 (N.D. Ill. 1979). Additionally, a number of courts have denied putative "self-critical analysis privilege" claims when a plaintiff must meet the difficult burden of proving intent. *See, e.g., Dowling v. American Haw. Cruises*, 971 F.2d 423, 427 (9th Cir. 1992) (so-called "self-critical analysis privilege" to car manufacturers' internal reviews "would place a nearly insurmountable barrier in front of plaintiffs who must prove malice"); *Sahlen*, 1990 U.S. Dist. LEXIS 18793, at *2.

Because peer reviews are relevant to the auditor's competency in conducting the audit, as well as the adequacy of the Andersen audits as a whole, documents relating to or concerning peer reviews of Andersen must be produced.

## IV. CONCLUSION

For the foregoing reasons plaintiffs' motion to compel production of witnesses and documents should be granted.

DATED: March 1, 2005

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