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

LEAD PLAINTIFFS' REPLY IN SUPPORT OF MOTION TO COMPEL THE HOUSEHOLD DEFENDANTS TO PRODUCE ELECTRONIC EVIDENCE IN NATIVE ELECTRONIC FORMAT

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I. INTRODUCTION

The operative Complaint in this litigation alleges that defendants utilized Household International, Inc. and its subsidiaries ("Household" or the "Company") to perpetuate an elaborate, pervasive fraudulent scheme consisting of (1) predatory lending, (2) improper and arbitrary reaging and restructuring of delinquent accounts to manipulate the credit quality of their loans; and (3) accounting manipulations. *See* ¶¶50-141.[1] During the Class Period (October 23, 1997 to October 11, 2002), Household offered real estate secured loans, auto finance loans, credit cards and other types of unsecured loans, as well as credit and specialty insurance products to low income, sub-prime customers. This fraudulent scheme thus involved the majority of Household's business units and departments and lasted almost a decade. The financial impact of the fraud was tremendous, ***resulting in the elimination of well over $25 billion in market capitalization***. ¶6. Household insiders feared that without a "white knight" like HSBC Holdings plc ("HSBC") saving Household after part of the fraud began to be revealed, Household would have gone bankrupt. *See* Exhibit 1.[2] Despite the enormous scope of the fraud and the resulting harm to investors, defendants seek to prejudice the certified Class by severely limiting access to documents to which they are entitled. Defendants mischaracterize this case as a "particularized securities fraud committed by four individuals." Defs' Mem. at 9.[3] Defendants' attempts to make a mole hill out of a mountain ignores the scope of the wide-ranging fraud alleged in the Complaint. Defendants' blatant attempts to

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[1] All paragraph references herein ("¶__") are to the [Corrected] Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws ("Complaint") filed on March 13, 2003.

[2] All Exhibits referenced herein are attached to the Declaration of Sylvia Sum in Support of Lead Plaintiffs' Reply in Support of Motion to Compel the Household Defendants to Produce Electronic Evidence in Native Format filed concurrently herewith unless otherwise indicated.

[3] Memorandum of Law in Opposition to Lead Plaintiffs' Motion to Compel the Household Defendants to Produce Electronic Evidence in Native Electronic Format ("Opposition" or "Defs.' Mem.").

forestall discovery of relevant material should not be countenanced. It is crucial that the issues raised in this Motion be decided promptly in light of defendants' refusal to produce any emails until the Court's decision.

At issue here is whether defendants must search the mailboxes of the "Custodians Still in Dispute" and include 18 "Search Terms Still in Dispute" listed in Appendices 1 and 2 to this reply attached hereto. Despite repeated requests over the last four months that plaintiffs would consider defendants' objections to custodians if defendants actually articulated such objections, defendants refused to do so. On June 30, 2005 – after plaintiffs' Motion to Compel was filed and parties met and conferred – defendants finally made some vague, ***unsupported assertions*** that the custodians and search terms had "no discernable connection" to the issues in this litigation.[4] Owen Aff., Ex. 18.[5] Because plaintiffs have given specific support that the "Custodians Still in Dispute" likely have relevant information, the "Search Terms Still in Dispute" are narrowly tailored to lead to discoverable evidence (*see* Appendices 1 and 2) and, most importantly, defendants have not met their heavy burden of showing why the discovery request is improper, the Court should order defendants to search the mailboxes of the "Custodians Still in Dispute," and to use the "Search Terms Still in Dispute" in addition to the terms and custodians agreed upon by the parties. *See* Fed. R. Civ. P. 26(b)(1).

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[4] Since the filing of Lead Plaintiffs' Motion to Compel the Household Defendants to Produce Electronic Evidence in Native Electronic Format (the "Motion to Compel"), plaintiffs independently re-evaluated the remaining custodians and search terms and eliminated 80 custodians and 45 search terms in order to lessen the burden on this Court. Plaintiffs did so despite defendants' failure to articulate reasons for eliminating certain custodians and search terms and even though plaintiffs have already made numerous compromises throughout the six-month negotiations regarding the production of documents in native format.

[5] Affidavit of David Owen in Support of Defendants' Memorandum of Law in Opposition to Lead Plaintiffs' Motion to Compel the Household Defendants to Produce Electronic Evidence in Native Electronic Format ("Owen Aff.").

In Appendices 1 and 2, plaintiffs have provided documentary evidence to support their requested custodians and search terms. Defendants had this information because these documents were produced to plaintiffs by defendants. The documentary support is only illustrative because plaintiffs do not wish to burden the Court with voluminous examples for each custodian or search term.

II. THE PARTIES' RESOLUTION OF NON-EMAIL ELECTRONIC DOCUMENTS

After plaintiffs filed the Motion to Compel, the parties resolved some of the issues regarding native production of spreadsheets and spreadsheet-type documents. Defendants' contention that the Motion to Compel was not necessary is belied by defendants' failure to abide by the terms of the mutually-accepted proposal, memorialized on March 10, 2005. Defendants refused to produce any electronic documents until the resolution of the custodian and search term issues. *See* Motion to Compel at 1. Instead, they used the ongoing negotiations regarding custodians and search terms as another avenue to delay and stall production of relevant spreadsheets. Defendants' recent motion to stay discovery pending their motion to dismiss, which was denied by Judge Guzman at a hearing on July 7, 2005, is further evidence of defendants' pattern of delaying and stalling the discovery process. The fact that defendants refused to produce spreadsheets for four months after the March 10, 2005 proposal evidences their transparent intention to paralyze discovery until they broke plaintiffs down to agree to defendants' limitations on the custodian and search terms. Defendants refused to produce such spreadsheets despite the fact that 1) spreadsheets could be produced independently of the resolution of the custodian and search term issues, 2) since the start of discovery, plaintiffs had been adamant that discovery needed to proceed expeditiously, 3) both

parties were aware that no discovery stay was in place pending the mediation, [6] and 4) spreadsheets could be produced fairly quickly as no privilege review was required. Plaintiffs' Motion to Compel was necessary. To require an opposing party to file a motion to compel in order to trigger any obligation to even respond to discovery requests in the first instance violates every tenet of the discovery rules. *Carlson v. Freightliner LLC*, 226 F.R.D. 343 (D. Neb. 2004).

At the meet and confer following the filing of the Motion to Compel, it was clear that defendants had not even begun the process of collecting spreadsheets. *See* Owen Aff., Ex. 11. It was just on July 5, 2005, that plaintiffs received the ***only production of electronic documents***. Plaintiffs received a CD-Rom with ***a mere 28 Excel documents***. Defendants' actions speak louder than their empty rants. Defendants have yet to provide any additional spreadsheets.

III. THE CUSTODIANS AND SEARCH TERMS STILL IN DISPUTE ARE RELEVANT TO THIS LITIGATION

Plaintiffs are entitled to obtain discovery regarding any matter, not privileged, that is relevant to their claims. Fed. R. Civ. P. 26(b)(1). Relevance is construed broadly and includes any information "reasonably calculated to lead to the discovery of admissible evidence." *Lakewood Eng'g & Mfg. Co. v. Lasko Prods., Inc.*, No. 01 C 7867, 2003 U.S. Dist. LEXIS 3867, at *4 (N.D. Ill. Mar. 13, 2003); *Aero Prods. Int'l, Inc. v. Intex Recreation Corp.*, No. 02 C 2590, 2005 U.S. Dist LEXIS 12897, at *8 (N.D. Ill. June 9, 2005). Discovery encompasses matters that actually or

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[6] Contrary to defendants' representation that resolution of the custodian and search term lists was "interrupted by preparations for the mediation of this case," it was defendants' unreasonable limitations set on the custodian and search term lists after five months of negotiations that led plaintiffs to conclude that the parties had reached an impasse. Defs' Mem. at 2. Plaintiffs informed defendants of that determination by letter dated April 19, 2005. Ex. 28 to the Declaration of Sylvia Sum in Support of Lead Plaintiffs' Motion to Compel the Household Defendants to Produce Electronic Evidence in Native Electronic Format ("Sum Motion to Compel Decl."). Defendants did not disagree.

potentially affect any issue in the litigation. *Trading Techs. Int'l, Inc. v. eSpeed, Inc.*, No. 04 C 5312, 2005 U.S. Dist LEXIS 10686, at **2-3 (N.D. Ill. Apr. 28, 2005).

Here, all the "Custodians Still in Dispute" appear to have information that is likely to lead to admissible evidence and all "Search Terms Still in Dispute" are relevant. *See* Appendices 1 and 2. Defendants' fraud was pervasive, lasted almost a decade and touched upon many, if not most, parts of Household's business operations. It involved thousands of employees from branch managers and account executives to collection representatives, from technical personnel setting up and programming reage automators and reage counters to administrators creating and generating reports. As is evident by the following brief summary of the pervasive fraud,[7] each of the custodians/search terms sought relates to one or several of the many issues that constituted or related to the pervasive fraud. Thus, plaintiffs' careful selection of the custodians and search terms based in part upon some of the documents produced to plaintiffs, is hardly overbroad.

Plaintiffs have alleged – and evidence obtained thus far supports their allegations – that defendants engaged in a nationwide predatory lending scheme aimed at low-income borrowers that included abusive lending tactics like the concealment of prepayment penalties, the misleading use of a bi-weekly pay program (the "EZ Pay scam"), the upselling of second mortgages at outrageously high interest rates and other improper lending practices. *See* ¶¶51-82. These tactics were designed to ensure that Household would sell as many unnecessary and unwanted products to its borrowers as possible, thereby stripping the borrowers' equity, effectively eliminating the borrowers' ability to refinance their loans with another lender. *See* ¶51. Defendants' scheme involved account executives and branch, district and regional managers across the nation. *See* ¶¶51-101. These account

[7] Plaintiffs refer the Court to the Complaint and Lead Plaintiffs' Response to Household Defendants' Motion to Dismiss [Corrected] Amended Consolidated Class Action Complaint for a more detailed summary of the allegations.

executives and managers were trained by corporate trainers to rope in low-income borrowers using various predatory lending tactics, including specifically selling insurance products without the borrowers' knowledge or consent or misleading customers into believing they were mandatory when they were not. *See* ¶¶51, 54, 68, 72, 90, 96. The predatory lending tactics ultimately led to an investigation of Household by the attorneys general of the 50 states, the implementation of so-called "Best Practices Lending Initiatives" by defendants, and a $484 million (pre-tax) nationwide settlement. *See* ¶¶97-101, 293.

Defendants' fraudulent scheme also included the arbitrary and improper reaging and restructuring of delinquent accounts within and across various Household business units, including Mortgage Services, Consumer Lending, Retail Services and Automotive Finance. *See* ¶¶107-124. Because Household was not a depository bank, defendants depended in large part on securitizations of loans for funding and therefore were highly motivated to make the credit quality of the loan pools, consisting of loans to mostly subprime customers, appear better than it in fact was. *See* ¶¶4, 11, 14, 28, 108. In order to achieve their goal, defendants, among other things, generated, maintained and carefully tracked reports regarding Household borrowers' delinquent accounts, delinquency roll rates, charge-off rates and reage recidivism; incentivized collection representatives to restructure loans rather than collect cash; established reage or restructure targets; used automators to automatically and improperly reage delinquent accounts; reset reage counters to show fewer reages on accounts than were actually made; implemented programs such as rewrite, forebearance, skip-a-pay and special restructure programs; delayed charge-offs of bad accounts and manipulated charge-off and reage policies in order to make delinquent accounts look current or less delinquent. *See* ¶¶12, 112-121. The United States Securities and Exchange Commission ("SEC") found and defendants admitted that Household's reaging manipulations and improper restructuring of loans violated federal securities laws. On the eve of Household's merger with HSBC, defendants entered

into a consent decree with the SEC in which Household agreed to cease and desist further violations of the federal securities laws. *See* Ex. 2.

Additionally, defendants manipulated Household's accounting by improperly accounting for expenses related to certain credit card agreements. *See* ¶¶134-141. The accounting manipulations led to a $600 million (pre-tax) restatement of Household's financial statements. *See* ¶¶135, 142-153. Before Household restated its financial reports, it fired its long-time independent auditor, defendant Arthur Andersen LLP, and replaced it with KPMG LLP. *See* ¶134.

Internally some Household employees questioned defendants' fraudulent scheme. For example, Elaine Markell raised questions and made allegations of improper reaging against Household and was deposed by the SEC regarding these allegations prior to the release of the SEC's findings. The law firms of Wilmer, Cutler, Pickering, Hale and Dorr LLP and Cahill, Gordon & Reindel LLP were hired to investigate Ms. Markell's allegations. *See* Exs. 3, 4. Similarly, Melissa Rutland-Drury, a Washington account executive, who had been trained by Household to engage in predatory lending tactics and was highly praised for successfully implementing these tactics, was later made a scapegoat once news of some of Household's predatory lending practices began to leak to the media. *See* ¶90. Ms. Rutland-Drury maintains that Household trained her in the way she conducted her job – "I've always done what I've been taught." ¶90. She currently has a lawsuit against Household for wrongful termination.

Defendants' fraudulent scheme was designed to falsify and manipulate the financial results of the Company, which were then reported to governmental agencies, such as the SEC, the Office of the Comptroller of the Currency and the Office of Thrift Supervision; rating agencies, such as Fitch Ratings and Standard & Poor's; and, most importantly, investors and the Class. *See, e.g.*, ¶¶115, 200, 225, 246-48, 277-78, 313-15. As a result of the fraud, Household's loss reserves throughout the

Class Period was knowingly inadequate. *See* ¶¶24, 125. When the fraud began to unravel, Household's stock plummeted damaging Class members.

As the detailed explanations and documentary evidence for each "Custodian Still in Dispute" and "Search Terms Still in Dispute" show (*see* Appendices 1 and 2), each of the custodians and search terms actually or potentially affect an issue in this litigation and should therefore be ordered to be included in defendants' searches.

IV. DEFENDANTS HAVE NOT ADEQUATELY SHOWN WHY THE CUSTODIANS STILL IN DISPUTE SHOULD BE ELIMINATED

If discovery appears relevant, the party objecting to the discovery request bears the burden of showing why that request is improper. *Trading Techs.*, 2005 U.S. Dist LEXIS 10686, at **2-3. Throughout the meet and confer process (before and after the filing of the Motion to Compel), instead of setting forth specific reasons why certain custodians or search terms should be removed, defendants merely made vague assertions that the search terms were overbroad and that the custodians and the search terms bore "no conceivable connection" to this lawsuit. *See* Owen Aff., Exs. 6, 15.

Defendants' June 30, 2005 charts, which constitute defendants ***first and only attempt*** to set forth some reasoning why custodians and search terms should be eliminated, demonstrate why the meet and confer process to date has been unproductive.[8] In those charts and in defendants' Opposition, defendants made unsupported, conclusory assertions with respect to all "Custodians Still in Dispute" that they do "not appear to have had a sufficiently high-level position at the Company such that [s]he might be reasonably expected to have any documents relevant to plaintiffs' claims," have "no discernable connection to the issues in dispute in this case," do "not appear to have had a

[8] In a spirit of compromise and in exchange for defendants agreeing to keep certain custodians, plaintiffs eliminated 80 custodians from their original list on July 5, 2005.

significant involvement with the issues presented in this case," or would not be "expected to have any documents relevant to plaintiffs' claims." *See* Owen Aff., Ex. 17; Appendices A and B of the Opposition. As outlined in plaintiffs' Appendices 1 and 2 to this reply, each "Custodian Still in Dispute" appears to have relevant information. Plaintiffs carefully chose them based on a careful review of all documents produced by defendants through March 1, 2005. In fact, defendants themselves believed that at least 40 of the custodians they seek to eliminate have relevant information as these custodians received instructions not to destroy emails relating to this litigation. *See* Ex. 5. Incredibly, defendants even wish to eliminate custodians for whom they have produced hard-copy documents or electronic spreadsheets, *i.e.*, Phil L. Krupowicz and Lidney B. Clarke. *See* Appendix 1 to this reply.

Defendants argue that because a "Custodian Still in Dispute" had "no interactions or communication whatsoever with any individual defendant," a search of that person's mailbox would be futile. Defs.' Mem. at 9-10 (emphasis omitted). However, it is well recognized that mid-level and low-level employees can have relevant discoverable information. *Upjohn Co. v. United States*, 449 U.S. 383, 391-92 (1980) ("[i]n a corporation, it may be necessary to glean information relevant to a legal problem from middle management or non-management personnel as well as from top executives"). Surely, plaintiffs' allegations of a company-wide training program for Household sales personnel to engage in predatory lending tactics to achieve loan growth make it irrelevant if the individual had direct personal interaction with the Individual Defendants or not. Certain Household employees are likely to have relevant information regarding such issues as predatory lending, corporate training from headquarters and lending policies. Under defendants' theory, plaintiffs would be barred from discovering relevant information from an individual merely because he or she does not appear to have had a sufficiently high-level position at the Company. Incredibly,

defendants have failed to produce to plaintiffs organizational charts that would allow plaintiffs to confirm defendants' representations.

Household employed about 32,000 employees in 2001 and 31,000 employees in 2002. Plaintiffs have not selected random employees, but have carefully selected custodians who, from the documents produced by defendants, appeared to have knowledge regarding issues in this case. In the spirit of compromise, plaintiffs have already eliminated 80 custodians from their original list. *See* Owen Aff., Ex. 18. In relation to the actual number of employees employed by Household, the number of custodians requested by plaintiffs amounts to less than 1% of the Company which can hardly be seen as overbroad.

V. DEFENDANTS HAVE NOT ADEQUATELY DEMONSTRATED THAT THE SEARCH TERMS STILL IN DISPUTE SHOULD BE ELIMINATED

Defendants seek to exclude highly relevant search terms on the grounds that they bear no discernable connection to the dispute, might capture some irrelevant emails or that relevant documents might be captured by use of other search terms. *See* Appendix B of Opposition. Again, in the spirit of compromise, plaintiffs have on various occasions eliminated dozens of search terms and are left with only those terms that are highly probative and cannot be further reduced or eliminated or replaced by less broad terms. For instance, plaintiffs allege that defendants sent corporate trainers from their headquarters to train branch managers and account executives across the nation to engage in various predatory lending schemes. To plaintiffs' knowledge, there is no other, less broad term than "trainer" to capture documents that relate to this issue.

Also, plaintiffs allege and there is evidence that one of the largest and most pervasive predatory lending tactics used by defendants was selling insurance products (including life insurance) without the customers' knowledge or by deceiving the customer into believing that such insurance coverage was necessary, when it was not. Plaintiffs' review of documents revealed that there is no less broad term other than "life insurance" to capture documents that go to this issue.

Plaintiffs have performed a similar careful analysis for all "Search Terms Still in Dispute." *See* Appendix 2.

Defendants further complain that plaintiffs request "all iterate forms" of a term. However, as is common sense, people say or write the same things in different ways. Thus, it is not unreasonable to request that defendants search all iterate terms of the word "reage," which could be used by various employees at Household in such forms as "re age," "re-age," "reaging," "re-aging," "re aging," "reaged," "re-aged" or "re aged."

Lastly, defendants are only required to use the search terms in the mailboxes of the custodians ordered by this Court, not from all 31,000 employees of the Company. Thus, the universe of potential hits is limited to those persons who appear to have knowledge regarding issues in this case. Furthermore, plaintiffs have agreed to allow defendants to de-dupe emails, thereby eliminating exact duplicates and further facilitating any review of emails.

As defendants' own documents show, further elimination of custodians and search terms will exclude highly relevant and potentially essential documents that will aid plaintiffs in establishing their case. Plaintiffs are not only entitled to those documents but have a great need for them, as those documents are solely in the possession of defendants and cannot be obtained from other sources.

VI. DEFENDANTS' STALL TACTICS SHOULD NO LONGER BE COUNTENANCED AND PLAINTIFFS ARE WILLING TO CARRY THE BURDEN OF REVIEWING THE DOCUMENTS

Defendants have consistently used the meet and confer process as a stall tactic to delay discovery. Their failure, both during meet and confers and in letters, to articulate reasons underlying their deletion of custodians and search terms from the list rendered the meet and confer process unnecessarily protracted and largely unproductive. Despite plaintiffs' repeated request that the defendants be prepared at meet and confers to discuss why certain terms or custodians be removed,

defendants would not do so but instead repeated their empty mantra that plaintiffs should "spend as much time on the phone as necessary." *See, e.g.*, Owen Aff., Ex. 15.

Given defendants' unreasonable delay in producing electronic documents, plaintiffs seek the Court's assistance in ordering defendants to begin the production of electronic emails within 14 days of the Court's order and complete such production no later than 60 days from the date of such order. In order to assuage any claim of undue burden on defendants, plaintiffs are willing to go forward using the same process as was ordered in *In re VeriSign*. *In re VeriSign, Inc. Sec. Litig.*, Case No. C 02-2270 JW (PVT) (N.D. Cal. Mar. 4, 2004); *In re VeriSign, Inc. Sec. Litig.*, Case No. C 02-2270 JW (PVT) (N.D. Cal. May 27, 2004). There, the Court, noting that defendants' "unreasonable delay in producing documents responsive to Plaintiffs' [ ] Document Request," resulted in the "need for an accelerated production," ordered that defendants provide a copy of all responsive electronic data in the original format, as it was kept in the usual course of business, and ***'[t]o the extent there is insufficient time to remove all irrelevant and privileged material, it will remain in the copy produced,"*** subject to privileged documents retaining their privileged status. Exs. 49 and 50 to the Sum Motion to Compel Decl. (emphasis added). Plaintiffs are willing to accept the burden of receiving documents not reviewed by defendants with an understanding that defendants may challenge in good faith those electronic documents produced without review for privilege at a later time. Plaintiffs' generous offer to agree to non-waiver of privilege severely undermines defendants' claim of undue burden for any additional custodians and search terms.

VII. CONCLUSION

Based on the foregoing reasons, the Court should order defendants to search, in addition to the mailboxes of the custodians and the search terms listed in Appendices A and B of defendants' Opposition, the mailboxes of the "Custodians Still in Dispute" and the "Search Terms Still in Dispute," listed in Appendices 1 and 2 of this reply and to begin production of electronic emails

within 14 days of the Order and complete such production no later than 60 days from the date of the Order.

DATED: July 21, 2005

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DECLARATION OF SERVICE BY UPS DELIVERY

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 Francisco, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 100 Pine Street, Suite 2600, San Francisco, California 94111.

2. That on July 21, 2005, declarant served by UPS, next day delivery, the **LEAD PLAINTIFFS' REPLY IN SUPPORT OF MOTION TO COMPEL THE HOUSEHOLD DEFENDANTS TO PRODUCE ELECTRONIC EVIDENCE IN NATIVE ELECTRONIC FORMAT** to the parties listed on the attached Service List.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 21st day of July, 2005, at San Francisco, California.

/s/
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