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-C5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan

DEFENDANTS' MEMORANDUM IN OPPOSITION TO PLAINTIFFS' OBJECTIONS TO THE MAGISTRATE JUDGE'S JUNE 15, 2006 ORDER

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

This Memorandum is respectfully submitted on behalf of Defendants Household International, Inc. ("Household"), Household Finance Corp., William F. Aldinger, David A. Schoenholz, Gary Gilmer and J.A. Vozar (collectively, "Defendants") in opposition to Plaintiffs' Objections to Magistrate Judge Nolan's June 15, 2006 Order denying Plaintiffs' requests for certain additional post-Class Period discovery (the "June 15 Order").

PRELIMINARY STATEMENT

On June 15, 2006, Magistrate Judge Nolan issued an Order denying Plaintiffs' requests for additional post-Class Period discovery as to seven interrogatories and 25 document requests. (The Class Period runs from July 31, 1999 to October 11, 2002, but Plaintiffs had requested certain additional discovery through the end of 2003, over and above the considerable amount of post-Class Period discovery Defendants had already provided.) For the Court's convenience a copy of the June 15 Order is attached to this Memorandum as Exhibit A.[1] Plaintiffs' objections to Judge Nolan's Order, as gleaned from their "Motion" and supporting Memorandum, are twofold: (i) that Judge Nolan failed to give sufficient deference to the general principle that post-class period information is discoverable, and (ii) that Judge Nolan should not have referred to the fact that Defendants produced four million pages of documents because some of those pages were illegible or duplicates. As discussed below,[2] Judge Nolan's June 15 Order was not erroneous in any respect, and Plaintiffs have not substantiated their request for reversal.

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1 On July 5, 2006, the Clerk of the Court, in a docket entry, struck Plaintiffs' Notice of Motion and Motion regarding the June 15 Order, but stated that "[t]he court shall consider the motion as the class' objections to the magistrate judge's order of June 15, 2006."

2 According to the Advisory Committee Notes to Rule 72(a), "[i]t also is contemplated that a party who is successful before the magistrate will be afforded an opportunity to respond to objections

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MAGISTRATE JUDGE NOLAN'S JUNE 15 ORDER

In her June 15 Order, Magistrate Judge Nolan denied Plaintiffs' current requests for additional post-Class Period discovery on both relevance and burden grounds. She noted that "Plaintiffs' requests . . . appear to be based in large measure on the theory that lower post-Class Period revenues resulting from a change in Household's lending practices would demonstrate that the higher revenues achieved during the Class Period had to be the result of fraudulent practices." (June 15 Order, Ex. A at 10). As Judge Nolan appreciated in rejecting it, this is a "fraud-by-hindsight" argument.

Judge Nolan correctly noted that Plaintiffs' argument was repudiated by the Supreme Court's decision in *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336 (2005) ("*Dura*"), which requires proof of a causal connection between the alleged fraud and the decline in price during the class period. Judge Nolan's order quoted *Dura*, and noted that a change in revenues or price (the basis for Plaintiffs' request for the post-Class Period discovery at issue):

> "may reflect, not the earlier misrepresentations, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price [or decreased revenues]."

(June 15 Order, Ex. A at 10) Judge Nolan concluded that "Plaintiffs have not satisfied the court that post-Class Period information responsive to their seven interrogatories and 25 document requests will serve to advance this case or otherwise assist Plaintiffs in any meaningful way.

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raised to the magistrate's ruling."

Whatever marginal probative value the information may have simply does not justify the immense burden of production." (*Id.*)

Plaintiffs now argue that Judge Nolan failed to give "appropriate deference" to the applicable case law holding that post-Class Period information is relevant (Pls. Mem. at 1), a step they deem "particularly necessary" when "significant events relevant to the elements of scienter and materiality occurred outside the Class Period." (*Id.* at 6). Putting aside Plaintiffs' dubious effort to establish "the elements of scienter and materiality" on an *ex post facto* basis, Plaintiffs are really saying nothing more than that Judge Nolan failed to rule in their favor. Judge Nolan indicated that "[t]he court *agrees* with the general proposition that post-class period information may be relevant in certain circumstances." (June 15 Order, Ex. A at 5; emphasis added)[3]. Having acknowledged this correct legal standard, Judge Nolan applied it carefully to the context at hand and concluded that "[n]one of Plaintiffs' cited cases . . . supports production of post-Class Period information *in this case.*" (*Id.*; emphasis added).

Judge Nolan considered virtually every case cited by Plaintiffs, including an extensive analysis of the case on which Plaintiffs placed their strongest reliance, *In re Control Data Corp. SEC Litig.*, No. 3-85-1341, 1987 U.S. Dist. LEXIS 16829 (D. Minn. Dec. 10, 1987). Judge Nolan concluded that "the facts of these cases [are] distinguishable from those presented here." (June 15 Order, Ex. A at 8). Judge Nolan's conclusion can in no sense be considered "contrary to law" as required by Rule 72(a) to overturn a magistrate judge's ruling on a non-dispositive issue

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[3] All emphasis is supplied except where otherwise indicated.

Judge Nolan's Order also acknowledged the huge volume of material — including extensive post-Class Period material — that had already been produced by the Defendants. "[Defendants] have produced more than four million pages of documents, *including post-Class Period documents that relate to any state or federal investigation into Household's lending products and policies, reage practices and policies, and the earnings restatement that occurred during the Class Period.*" (June 15 Order, Ex. A at 1-2). The Order continued: "Defendants have produced thousands of pages of documents relating to the investigations by, and settlement with, state attorneys general [in October 2002, at the tail end of the Class period]. . ., including documents relating to implementation and monitoring of, and communications covering, changes to Household's policies and/or practices *following the settlement.*" (*Id.* at 2). Judge Nolan further noted that:

> "Defendants have provided Plaintiffs with all of the documents produced to the Securities and Exchange Commission ("SEC") as part of its investigation into Household's reaging policies, which resulted in Household entering into a Consent Order with the SEC [on March 18, 2003, subsequent to the Class Period]."

(*Id.*)

Judge Nolan correctly denied Plaintiffs' request for "still more documentation regarding post-Class Period information." Plaintiffs object to Judge Nolan's references to the four million pages of documents produced to date by Defendants, because they argue that about one million pages of documents are illegible and that Defendants produced multiple copies of some

documents. These quibbles do not in any sense reach the level of showing a "clearly erroneous" ruling as required by Rule 72(a).[4]

ARGUMENT

A. A Magistrate Judge's Ruling on Discovery Matters is Entitled to Considerable Deference.

Fed. R. Civ. P. Rule 72(a) establishes the standard for a district court's review of a magistrate judge's decision on a nondispositive motion. "Routine discovery motions are considered to be 'nondispositive' within the meaning of Rule 72(a)." *Ocean Atlantic Woodland Corp.* v. *DRH Cambridge Homes, Inc.*, No. 02 C 2523, 2004 WL 609326, at *3 (N.D. Ill. Mar. 23, 2004) (Guzman, J.); *see also For Your Ease Only, Inc.* v. *Calgon Carbon Corp.*, No. 02 C 7345, 2003 WL 21475905, at *4 (N.D. Ill. June 20, 2003). Plaintiffs' request for additional post-Class Period discovery is a "routine discovery motion" and, therefore, nondispositive within the meaning of Rule 72(a).

Rule 72(a) provides that the district judge "shall consider such objections and shall modify or set aside any portion of the magistrate judge's order found to be *clearly erroneous or contrary to law*". *See also For Your Ease Only, Inc.*, 2003 WL 21475905, at *3; 12 Charles Alan Wright, Arthur A. Miller and Richard L. Marcos, Federal Practice and Procedure 2d § 3069 (2006). Factual determinations are reviewed under the "clearly erroneous" standard, which "means that the district court can overturn the magistrate judge's ruling only if the district court is left with *the definite and firm conviction that a mistake has been made.*" *Weeks v. Sam-*

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[4] Plaintiffs acknowledged in a recent submission to Judge Nolan that "the core group of documents [produced by Defendants] is substantial in terms of number." The Class' Memorandum in Support of Motion for Additional Deposition Time, at p. 3.

sung Heavy Industries Co., 126 F.3d 926, 943 (7th Cir. 1997). The application of a legal standard to a particular set of facts, as undertaken by Judge Nolan in her June 15 Order, also is reviewable under the "clearly erroneous" standard. *McFarlane* v. *Life Insurance Co.*, 999 F.2d 266, 267 (7th Cir. 1993).

In discovery matters courts frequently defer to determinations made by magistrate judges because "[t]he Federal Rules of Civil Procedure grant magistrate judges broad discretion in resolving discovery disputes." *Ocean Atlantic Woodland Corp.*, 2004 WL 609326, at *3; *Whittaker* v. *NIU Board of* Trustees, No. 00 C 50447, 2004 WL 524949, at *1 (N.D. Ill. Mar. 12, 2004) (deferring to the determination of the magistrate judge because "[t]he magistrate judge has a much higher familiarity with the parties and the conduct of discovery than does this Court.") Magistrate Judge Nolan has been handling discovery matters in this action for the past two years. Her June 15 Order was neither "clearly erroneous" nor "contrary to law." Rather, it was a reasoned application of the applicable law to the relevant facts.

B. Magistrate Judge Nolan Correctly Denied Plaintiffs' Requests for Additional Post-Class Period Discovery.

Judge Nolan concluded that the lack of relevance and the associated burden did not warrant production of the additional post-Class Period discovery sought by Plaintiffs. Plaintiffs' objection to this ruling repeats its rejected arguments to the effect that the discovery they seek is "necessary" because "significant events relevant to the elements of scienter and materiality occurred outside the class period." (*See* Pls. Mem. at 6). For obvious reasons Plaintiffs do

not explain how any post-Class Period events could have affected Household's stock price during the class period.[5]

1. The Supreme Court's Recent Ruling in Dura Demonstrates the Lack of Relevance of the Post-Class Period Information Sought by Plaintiffs

Plaintiffs' submissions to Judge Nolan made much of the decline in Household's stock price as a purported result of the voluntary cessation of certain practices in connection with the October 2002 settlement with state attorneys general and the March 2003 Consent Order it entered into with the SEC. However, the Supreme Court's holding in *Dura* makes clear that Plaintiffs' approach to proving loss causation is fatally flawed. Under the Supreme Court's holding, Plaintiffs must explain *how the loss resulted from disclosure of the alleged fraud*, and distinguish losses that may have been caused by "changed economic circumstances, changed investor expectations, new industry-specific events or firm-specific facts, conditions, or other events," which are not actionable. 544 U.S. at 343.[6]

The focus of a plaintiff's securities fraud case must therefore be on the specific class period at issue. In particular, a plaintiff must now allege *and prove* that:

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5 Plaintiffs also fail to explain how any alleged "fraud" can be established in the alleged Class Period when these allegedly "significant" events had yet to occur by the time the fraud was allegedly revealed to the public. If Plaintiffs' claims in fact depend for "scienter and materiality" upon post-Class Period events, the inescapable conclusion must be that the claims themselves do not meet all of the required elements for fraud.

6 Although this Court recently denied Defendants' motion to dismiss the Complaint on the basis of *Dura* because of Plaintiffs' failure to properly plead loss causation, that ruling only addressed the sufficiency of the pleading. At trial, Plaintiffs will have to prove loss causation as required by *Dura*. (And there currently is pending before this Court Defendants' motion for certification of this decision for immediate appeal, pursuant to 28 U.S.C. § 1292(b).)

(i) defendants made a prior misrepresentation (or omission);

(ii) the misrepresentation (or omission) was corrected, or otherwise made known to the market on a particular date; and

(iii) the price of the security declined significantly following the correction.

See id. at 344-47. A plaintiff cannot prevail unless it can *prove* the existence of a corrective disclosure followed immediately by a decline in the price of the firm's stock. The Supreme Court in *Dura* rejected a plaintiff's efforts to recover for generalized investor losses arising from "inflated prices" absent a detailed showing that the alleged fraud actually caused any losses. *Id.* The Supreme Court's reasoning on this subject confirms that any change in Household's revenues or profits or operating methods within the 15 months after the conclusion of the Class Period — which is the chief basis for Plaintiffs' claimed need for the post-Class Period discovery — is irrelevant to the satisfaction of Plaintiffs' burden in this securities fraud case. Events and financial developments that occurred at the tail end or even during the 15-month period after the termination of the Class Period are far too remote to be probative in explaining how an alleged loss resulted from the correction of an alleged fraud, as required by *Dura*. Investigating Household's reaging practices and policies after the close of the Class Period would tell Plaintiffs nothing about the validity of Defendants' disclosures during the Class Period and would shed no light on the issue of scienter vis-à-vis decisions made on this or any other subject during the Class Period. *See Donohue* v. *Consolidated Operating & Production Corp.*, 736 F.Supp. 845, 872 (N.D. Ill. 1990) ("Both the federal and state claims require a showing that defendants *knew the true nature of the facts at the time they made the challenged misstatements and omissions* — the 'scienter' requirement.") In consequence, as Judge Nolan correctly recognized, there is no justification for the enormous additional burden Plaintiffs seek to impose in aid of their discredited "harm by paying inflated prices" theory.

2. Plaintiffs Have Not Demonstrated the Required Relevance of or Need for Additional Post-Class Period Discovery

In attempting to demonstrate the relevance of the post-Class Period documents they are seeking, Plaintiffs relied mainly on two events in their submissions to Judge Nolan, the March 19, 2003 Consent Order that Household entered into with the SEC and the October 2002 multi-state AG settlement. Plaintiffs repeatedly invoked one or the other of these events (or rather their factually inaccurate characterization of them) to support their requests for additional post-Class Period documents.

With respect to the Consent Order, the SEC did not find that Household engaged in impermissible reaging, as Plaintiffs imply. (*See* Pl. Mem. at 4) Rather, the Consent Order addresses certain *disclosures* about Household's reaging policies, not the practices as such. The cited SEC Order was about prospective disclosure of certain reaging policies and, contrary to Plaintiffs' characterization, it neither required nor triggered changes in Household's reaging, charge-off and delinquency polices and procedures after its entry. In any event, as Judge Nolan explicitly stated, Defendants have produced the *entire* approximately 2.1 million-page production made by Household to the SEC (which included documents dated before and after the Class Period) and have agreed, from the very beginning of the discovery process in this case, to produce documents *dated to the present* to the extent that they relate to any state or federal investigation into Household's lending practices and policies, reaging practices and policies and/or the earnings restatement (the three prongs of the fraud scheme alleged by Plaintiffs, *see* Pls. Mem. at 2) that took place during the Class Period — and have done so.

The other event Plaintiffs cite to justify their additional post-Class Period discovery demands is the October 2002 multi-state AG settlement in which Household agreed to elimi-

nate or modify certain sales practices in connection with consumer loans. (*See* Pls. Mem. at 2-3). With respect to this settlement, Plaintiffs asserted in their submissions to Judge Nolan that "The Class is entitled to discover whether Household in fact implemented those changes as well as when and how the changes were made." That explanation is bizarre. Plaintiffs do not represent the various state attorneys general, who are not members of the Class. Nor do Plaintiffs represent a class of consumers with an interest in monitoring compliance with consensual orders. Plaintiffs most assuredly cannot base their need to discover additional post-Class Period documents from Defendants on some self-appointed status as enforcers of the October 2002 state attorneys general settlement. In any event, as Judge Nolan observed in her June 15 Order, Defendants have already produced thousands of pages of documents relating to the investigation by and the settlement with the state attorneys general, including documents concerning, *inter alia*, implementation and monitoring of, and communications concerning, changes to Household's policies and/or practices following the settlement (which by definition includes documents dated after the Class Period).

Despite the voluminous production of documents pertaining to the investigation of Household by state attorneys general and the SEC, Plaintiffs' objections do not even acknowledge *any of those documents*, or *any of the testimony* of the many witnesses they have deposed to date (not to mention the voluminous transcripts in their possession of all the depositions that were taken during 2003 and 2004 in connection with several alleged predatory lending claims and the SEC investigation). Nor do they cite any of this vast production to even suggest that any additional or similar post-Class Period documents would be relevant to their claims and would assist them in establishing that their claims have merit.

In general, Plaintiffs' requests for post-Class Period documents display Plaintiffs' myopic focus on minute operational details rather than on facts relating to their allegation that Defendants committed securities fraud in connection with public disclosures about their consumer lending practices during the Class Period. For example, Plaintiffs say that they want to compare revenues received by Household after the Class Period from various items, like EZ Pay accounts, discount points, simple premium credit life insurance, etc., as a result of certain post-Class Period changes in these products, with revenues earned from those products during the Class Period. The fact that revenues for specific products might be lower during or at the end of the 15 months after the end of the Class Period could be due to a host of other factors having absolutely nothing to do with fraudulent practices. As Judge Nolan said in her June 15 Order, quoting from the Supreme Court in *Dura* with respect to a later lower stock price, that lower price "may reflect, not the earlier misrepresentations, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions or other events, which taken separately or together account for some of that lower price." (June 15 Order, Ex. A at 10) This is similarly true for any lower revenues that Plaintiffs might conceivably establish through additional (or previous) post-Class Period discovery. Even if they should find proof of such lower revenues after the Class Period, that circumstance would be devoid of probative value and therefore could not justify the immense burden that compliance with these demands would impose.

3. Compliance with the Additional Discovery Demands Would Impose an Unreasonable Burden on Defendants and Unduly Delay the Resolution of This Case

Judge Nolan also correctly considered Plaintiffs' requested additional post-Class Period discovery in the context of the immense and seemingly unfocused discovery program

Plaintiffs have conducted to date. During almost two years of fact discovery, Plaintiffs explicitly understood and agreed that documents created both before and after the Class Period would be produced in response to a significant number of their requests, and Defendants have expended thousands of hours at a huge monetary cost collecting, reviewing and producing more than 4 million pages of documents (including documents dated *as far back as 1994* for certain requests and *to the present* for others). Now Plaintiffs want Household to repeat that exercise for 7 additional interrogatories and 25 additional requests.

Plaintiffs' discovery requests are far from narrowly focused forays into the discovery pond. They are (and always have been) so overbroad and wide-ranging that there is no one individual at Household, or even one department, from which to collect all responsive documents, and thus no way for Defendants to ensure a complete production responsive to Plaintiffs' demands without a voluminous and burdensome collection and review process that to date has already taken more than 18 months. For example, one of the requests for which Plaintiffs now seek post-Class Period compliance, calls for "all documents and communications concerning Household's policies and practices relating to loan delinquencies, charge-off and reaging of loans." (June 15 Order, Ex. A at 3) The breadth of that single request is staggering. And that request is not unique. Another document request seeks "all" post-Class Period documents relating to or reflecting Household's use of discount points in its real estate loans. *Id.* This would require an immense search for documents by Defendants — all documents relating to the servicing of many Class Period loans after October 2002 and would be totally out of proportion to any conceivable marginal relevance such detail may have. Similarly, the notion that Plaintiffs could detect alleged nondisclosures or fraudulent disclosures in connection with the sale of securities during the Class Period by examining, as sought by still another request: "[a]n entire set of

documents that track, analyze or describe prepayment penalties" (*id.* at 4) after October 2002, is nonintuitive to say the least. In short, it is impossible to discern any legitimate reason for putting Defendants to the enormous burden of replicating their Class Period production on picayune operational detail for a subsequent time period.[7]

Allowance of the post-Class Period discovery would also result in a massive increase in the scope of the case and a substantial burden on all parties and, especially, on the Court. Defendants would have no alternative but to seek to demonstrate that decreases or changes in revenues following the termination of the Class Period were not the result of the modification or elimination of certain policies or practices challenged by Plaintiffs, but, as suggested by the Supreme Court in *Dura*, the result of numerous other factors pertaining to the economy in general, the loan industry, the sub-prime loan industry, etc. Expanding the case in this way would be highly unfair to Defendants, who are impatient — and are entitled — to bring this case to a head on the merits within a reasonable time and expose the weakness in Plaintiffs' theories. Plaintiffs, in contrast, persist in deferring that showdown indefinitely by demanding excessive information on minute operational details that have no discernible bearing on their securities fraud claims.

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[7] If the Court were to allow Plaintiffs the additional post-Class Period discovery they now seek, Defendants would essentially have to redo the entire interview, document collection and review process that was necessary to respond to Plaintiffs' document demands to date. This process included interviews of more than 200 individuals, and the collection, review and production of hard-copy and/or electronic documents from approximately 150 individuals and more than 10 departments, and e-mails and attachments from nearly 300 custodians. This additional discovery would impose massive costs on Defendants — both financial and in the disruption of the normal business activities of the Household personnel who would be required to participate in the document collection and production process.

Judge Nolan correctly ruled that, at this stage of the case, Plaintiffs should not be allowed another broad round of collateral discovery on topics for which they cannot articulate a plausible need. For these purposes it does not matter whether Plaintiffs are reluctant to broach dispositive issues, or are trying to assemble prejudicial-sounding consumer lore to shore up a weak securities fraud case, or are hoping to wear down Defendants' ability and will to litigate, or all or none of the above.

4. The Court Can and Should Reject Plaintiffs' Unreasonable Demands for Additional Discovery

Judge Nolan was correct in ruling that, even if the Court were to believe that the post-Class Period discovery Plaintiffs seek may *somehow* be relevant and necessary for their claims, as noted above, the burden imposed on Defendants in producing such documents would far outweigh any such minimal or speculative benefits[8] — especially at this late stage in the discovery phase of the litigation.

In *Mr. Frank, Inc.* v. *Waste Management, Inc., et al.*, No. 80 C 3498, 1983 WL 1859, at *2 (N.D. Ill. July 7, 1983), the court said: "It is appropriate for the court to step in and limit discovery when it feels that the discovery involved is cumulative, unnecessary, or only

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[8] As the Seventh Circuit has indicated, the mere fact that documents *might* be relevant to issues alleged does not itself allow discovery of documents beyond the Class Period. *See Pommer* v. *Medtest Corp.*, 961 F.2d 620, 625 (7th Cir. 1992) ("[t]he truth (or falsity) of defendants' statements and their materiality, must be assessed *at the time the statements are made*, and not in the light of hindsight"); *see also Searls* v. *Glasser*, No. 91 C 6796, 1994 WL 523712 (N.D. Ill. Sept. 23, 1994) (denying plaintiffs' argument that discovery outside the class period could have helped prove the class' securities fraud claim); *In re International Business Machines Corporate Securities Litigation*, 163 F.3d 102, 111 (2d Cir. 1998) (district court properly declined to expand time period for discovery given that information sought was only minimally relevant and where compliance would have placed definite burden on defendant).

marginally relevant or important." Judge Nolan did precisely that in her June 15 Order because she found that the additional post-Class Period discovery sought by Plaintiffs was in fact "cumulative, unnecessary, or only marginally relevant or important."

"A district court has a duty, of special significance in lengthy and complex cases where the possibility of abuse is always present, to supervise and limit discovery to protect the parties and witnesses from annoyance and excessive expense." *Mr. Frank, Inc.*, 1983 WL 1859, at *1. *See International Business Machines*, 163 F.3d at 111 (discovery time period would not be expanded where information sought was only minimally relevant and compliance would have placed definite burden on defendant). Judge Nolan's June 15 Order is fully in accord with these authorities and with the proper approach to be taken by a court supervising discovery. The Court should affirm Judge Nolan's June 15 Order.

CONCLUSION

For the reasons discussed above, the Court should deny Plaintiffs' Objections to Magistrate Judge Nolan's June 15, 2006 Order denying Plaintiffs' request for additional post-Class Period information and should affirm Judge Nolan's Order. Judge Nolan correctly concluded, consistent with the requirements established by the Supreme Court in *Dura*, that Plaintiffs had failed to show the relevance of the requested information to their securities fraud complaint, especially when the burden that would be imposed on Defendants in providing this information is considered, along with the vast amount of documents already provided by Defendants..

Dated: July 14, 2006
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CERTIFICATE OF SERVICE

Adam B. Deutsch, an attorney, certifies that on July 14, 2006, he caused to be served copies of Defendants' Memorandum in Opposition to Plaintiffs' Objections to the Magistrate Judge's June 15, 2006 Order, to the parties listed below via the manner stated.

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