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

THE CLASS' OBJECTION TO THE MAGISTRATE'S ORDER REGARDING THE APPLICATION OF THE WORK-PRODUCT DOCTRINE TO AUDIT LETTERS AND RELATED DOCUMENTS

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STATUTES, RULES AND REGULATIONS

I. PRELIMINARY STATEMENT

On July 11, 2006, Magistrate Judge Nan R. Nolan (the "Magistrate") entered and served upon the parties an Order granting Arthur Andersen's Motion for the Return of Inadvertently Produced Privileged Documents and denying the Class' Cross-Motion to Compel Production of Certain Documents Provided to Outside Auditors by Household Defendants. *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, No. 02 C 5893, 2006 U.S. Dist. LEXIS 49319 (N.D. Ill. July 6, 2006) ("Order"). The Class objects to this Order under Fed. R. Civ. P. 72(a) on the following grounds:

- The Magistrate erred by misapplying Seventh Circuit precedent. That precedent holds that the work-product doctrine applies only to those documents created primarily to aid in future litigation – dual purpose documents are not protected. It also only protects those documents created for litigation with the opposing party seeking discovery.

- In finding that the litigation database was protected, the Magistrate erred by ignoring admissions in sworn affidavits filed by Household International, Inc.'s ("Household" or the "Company") counsel Mark Leopold, which demonstrate that the database was reviewed by Household's outside auditors.

- The Magistrate erred in finding that information related to litigation reserves is *de facto* not discoverable, rather than considering this information in the factual context of this case.

As discussed below, the Magistrate's ruling is clearly erroneous and contrary to the law and must be overturned. Should the Court determine that the Magistrate's evaluation of work product in the factual context of this litigation is proper, the Class requests that the Household defendants be barred from relying on or using audit opinions at summary judgment or trial. *Fultz v. Federal 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).

II. THE DISPUTED DOCUMENTS

A. Andersen Documents: Audit letters (both inquiry and response letters) as well as internal Arthur Andersen LLP ("Andersen") memoranda prepared pursuant to Statement on Auditing Standard ("AU") §337 for the ordinary business purpose of completing the annual audit and quarterly review of financial statements of Household by Andersen. ¶15 to the Declaration of

Kirsten L. Flanagan, CPA, Dkt. No. 521 ("Flanagan Decl."), attached hereto as Exhibit 1. (All exhibits are attached hereto unless otherwise noted.)[1] Under Generally Accepted Accounting Principles ("GAAP"), Household was required to disclose pending or threatened litigation, and record and disclose loss contingencies relating to such litigation in a manner that investors could understand the Company's potential liabilities, so that its financial statements were not misleading. Flanagan Decl., ¶16 (citing Financial Accounting Standards Board Statement ("FAS") No. 5, ¶¶1, 4).

B. Household Documents

(a) Audit letters (both inquiry and response): Defendants have withheld from their production certain documents (similar to the Andersen Documents described above) whose purpose they list in their privilege logs was to "inform auditor of pending or threatened litigation in connection with audit of Household's financial statements." Ex. 2 (attaching privilege entries being challenged).

(b) Request No. 17 – The Litigation Database: Household maintains a database describing all litigation in which it is involved. The Class seeks production of the data fields relating to class actions or suits by a government agency for violations of consumer protection laws or regulations during the Class Period (July 30, 1999-October 11, 2002).

(c) Request No. 18 – Documents relating to Litigation Reserves: The Class seeks the production of documents relating to the establishment or amount of litigation reserves from July 1, 1999 through October 11, 2002 for lawsuits during that period, and not information for the present lawsuit.

III. RELEVANCE OF THE AUDIT INFORMATION SOUGHT BY THE CLASS

A central claim in this securities fraud litigation is that defendants did not disclose to the public the level of risk due to litigation from Household's predatory lending practices, or the impact

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[1] By completely disregarding the Flanagan declaration, which outlined the crucial role played by audit letters in the process of auditing financial statements of a public company, the Magistrate also erred. *See* Flanagan Decl. Without even considering the Flanagan declaration, the Magistrate accepted the defendants' description of these documents as "Opinion Letters." Order at *4. In fact, "lawyers' responses to auditors' inquiries have come to be known as 'audit response letters' or 'FASB 5 letters.'" Douglas R. Richmond, *The Attorney-Client Privilege and Associated Confidentiality Concerns in the Post-Enron Era*, 110 Penn St. L. Rev. 381, 401 (2005). Moreover, the Magistrate's analysis of work product arising out of this faulty premise completely disregarded the audit purpose of these letters as well as plaintiffs' allegations regarding Household's failure to set aside adequate loss contingencies. ¶¶102-106 (paragraph references, unless otherwise indicated are to the [Corrected] Amended Consolidated Class Action Complaint).

of the predatory lending practices on Household's bottom line. ¶¶104-106. This failure to disclose meant that investors did not know the risk to their investment that Household's practices created, particularly as the litigation relating to the predatory lending practices increased. Defendants violated GAAP (specifically FAS No. 5) and Securities and Exchange Commission ("SEC") rules by failing to disclose the potential loss contingencies resulting from its illegal predatory lending practices that ultimately resulted in a $525 million pre-tax charge during 3Q02. ¶¶102-106.

Immediately after the public disclosure of a $484 million multi-state Attorneys General settlement relating to Household's improper lending practices, Household's credit rating in the debt market was downgraded, inhibiting the Company's ability to fund its operations. ¶30. "[A]s part of the settlement Household agreed to change various of its consumer lending practices . . . ." First Amended Answer (Dkt. No. 346), ¶99. Commentators expected these changes to dramatically impact Household's bottom line: "The real concern is that Household's business model has radically changed after recent settlements with regulators." Ex. 3. On rumors of the settlement, the price of Household stock dropped 11% in a single day. ¶101. Analysts downgraded their expectations accordingly, noting: "[T]he settlement reflects past control weaknesses, managerial missteps, and carries a high degree of execution risk for the future." Ex. 4. Thus, following the settlement, investors had one question on their minds: "***Can Household make as much money without predatory lending practices?***" Ex. 5.[2]

The Disputed Documents are highly relevant documents for the following reasons:

- They identify the prior cases brought against Household as a result of the Company's predatory lending practices.
- The documents are evidence that defendants' Class Period denials of engaging in predatory lending practices were false, and that defendants knew they were false.
- By showing that defendants withheld information from the auditors, the documents demonstrate that the audit opinions were not reliable and that Household knew this having withheld the information.
- The documents are relevant to show that Household's litigation reserves disclosed in the financial statements were inadequate and that Household knew they were inadequate.

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[2] All emphasis is added and all citations are omitted unless otherwise noted.

- The documents also establish when defendants first came under a duty to preserve documents based on pending or threatened litigation, including that Household was under such a duty in June 2001 when the Company engaged in a self-described and documented "blitz purge" of documents probative of its predatory lending practices.

As detailed below, these documents were prepared for the ordinary business purposes of an audit, and not prepared to aid in litigation, let alone to aid in this litigation.

IV. APPLICABLE LEGAL STANDARD

Under Fed. R. Civ. P. Rule 72(a), "[w]ithin 10 days after being served with a copy of the magistrate judge's order, a party may serve and file objections to the order." Fed. R. Civ. P. 72(a); *see also Sunstar, Inc. v. Alberto-Culver Co*., Case No. 01 C 0736, 2004 U.S. Dist. LEXIS 16855 (N.D. Ill. Aug. 20, 2004). Rule 72(a) provides that, "[t]he district court to whom the case is assigned 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." Fed. R. Civ. P. 72(a); *see also Raymond v. Ameritech Corp*., 03 C 4509, 2004 U.S. Dist. LEXIS 8083 (N.D. Ill. May 6, 2004) (applying "clearly erroneous or contrary to law" standard).

V. RELEVANT PROCEDURAL HISTORY

Although this lawsuit was filed in August 2002, discovery did not begin and no documents were produced until end of June 2004 as a result of the mandatory discovery stay imposed by the Private Securities Litigation Reform Act. Shortly thereafter, Andersen (a former co-defendant) produced the first of the Disputed Documents. The bulk of the Andersen Documents was produced by December 2004, with the last one produced in December 2005. Although Household received copies, they did not object to the production of any of these documents.

On January 31, 2006, Andersen requested that the Andersen Documents be returned. The Class refused on the grounds that the documents were not privileged. Household did not weigh in on this issue. On April 27, 2006, Andersen moved to compel the return of the documents. Pursuant to the briefing schedule set by the Magistrate, briefing on Andersen's motion and the Class' cross-motion to compel the production of certain other similar documents withheld by Household was complete on June 23, 2006.

On June 30, 2006, Household filed a sur-reply, not contemplated by the briefing schedule set forth by the Magistrate, claiming that the Class had raised new arguments on reply. On July 7, 2006, the Class opposed the request to file a sur-reply and filed, in the alternative, a sur-rebuttal addressing the points raised in sur-reply. Unbeknownst to the Class, on July 6, 2006, the Magistrate signed, but

did not enter or serve until July 11, 2006, an Order accepting the sur-reply, granting Andersen's motion, and denying the Class' cross-motion. Ex. 6 (Dkt. Nos. 579-80).

VI. ARGUMENT

A. The Magistrate Erred by Failing to Follow Seventh Circuit Precedent that the Work-Product Doctrine Applies Only to Those Documents Created Primarily to Aid in Litigation

The Magistrate ruled that the standard for work-product protection is that a document must be '"prepared or obtained ***because of*** the prospect of litigation,'" and specifically rejected as overly narrow the standard that "the primary purpose for creating the document must be to aid in litigation." Order at **12-13. In rejecting the "to aid in litigation" standard, the Magistrate claimed to be rejecting the positions set forth in two Fifth Circuit opinions and a Southern District of New York opinion. *Id.* at *13 (citing *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982), *United States v. Gulf Oil Corp.*, 760 F.2d 292 (Temp. Emer. Ct. App. 1985) and *Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113 (S.D.N.Y. 2002)). However, only a few months ago, this Magistrate adopted the very standard she rejects here – that the application of the work-product doctrine depends on whether "the primary motivation behind the creation of [a document] was to assist in determining whether to pursue litigation and to aid in possible future litigation." *National Jockey Club v. Ganassi*, Case No. 04 C 3743, 2006, U.S. Dist. LEXIS 11826, at *5 (N.D. Ill. Mar. 22, 2006) (citing *Binks Mfg. Co. v. National Presto Indus., Inc.*, 709 F.2d 1109, 1119 (7th Cir. 1983)); *see also SmithKline Beecham Corp. v. Pentech Pharms., Inc.*, Case No. 00 C 2855, 2001 U.S. Dist. LEXIS 18281, at *12 (N.D. Ill. Nov. 6, 2001) (whether a document was "created ***for the purpose of litigation***" determines whether it is work product) (emphasis in original).

Significantly, the Seventh Circuit found persuasive the '"distinction between whether defendant's "in house" report was prepared in the ordinary course of business or was "work product" in anticipation of litigation'" to be an "important one." *Binks*, 709 F.2d at 1119. The court found that "'while litigation need not be imminent, the ***primary motivating purpose*** behind the creation of a document or investigative report must be to ***aid in possible future litigation***.'" *Id.* The Disputed Documents at issue here were not created to "aid in possible future litigation," but rather summarized past litigation for the purpose of an audit. The error of the Magistrate and the defendants in their argument, is the assumption that "because of" litigation means because of past litigation, rather than future litigation.

The Seventh Circuit continues to follow the formulation of work product set forth in *Binks* that ***only*** documents that were created for use in litigation are to be protected work product. *See*

Mattenson v. Baxter Healthcare Corp., 438 F.3d 763, 767-68 (7th Cir. 2006) (finding notes from meeting in which attorney was anticipating and preparing for litigation against Mattenson were work product), *reh'g denied*, No. 04-4270, 2006 U.S. App. LEXIS 8147 (7th Cir. Mar. 31, 2006); *Logan v. Commercial Union Ins. Co*., 96 F.3d 971, 977 (7th Cir. 1996) (finding that documents analyzing how Commercial Union intended to defend against Logan's cases were work product). It similarly finds that documents created for other purposes are not protected. *United States v. Frederick*, 182 F.3d 496, 501-02 (7th Cir. 1999).

Additionally, the Seventh Circuit's discussion in *Mattenson* reaffirmed that it is the purpose for which a document is created that determines whether it is work product. 438 F.3d at 767-68. The court held an attorney's notes analyzing a potential discrimination claim by an employee were entitled to work-product protection because they were created based on a possibility of litigation with that employee. *Id.* The *Mattenson* court explained that the reason for the work-product doctrine is to protect an attorney's research, strategizing, and candid internal assessments. *Id*. at 768 (citing *United States v. Nobles*, 422 U.S. 225, 236-38 (1975)). The justification for the doctrine thus shows that what is to be protected is, indeed, the preparations for litigation. As one district court held, "[o]nly by strictly construing the elements of work-product, can the doctrine's original intent be best served." *Allendale Mut. Ins. Co. v. Bull Data Sys., Inc*., 145 F.R.D. 84, 87 (N.D. Ill. 1992) (applying *Binks* and finding that the "causation element" of work product is not satisfied by the mere existence of litigation, but only where a document is created to "prepare for litigation"). In *SmithKline Beecham*, Magistrate Nolan explained that the application of the work-product doctrine depends on the purpose for which the document was created: the party seeking to withhold documents "must demonstrate the documents in question were created ***for the purpose of litigation***, not in the ordinary course of business." 2001 U.S. Dist. LEXIS 18281, at *12 (emphasis in original).

The Seventh Circuit has never held, as the Magistrate did here, that a document that was not created for use in litigation was nonetheless somehow created "because of" litigation and entitled to protection from discovery. Under the Magistrate's formulation of work product, every document that is created after litigation, regardless of the purpose for its creation, would be protected. Extending the doctrine – as requested by defendants and as done by the Magistrate in this case – to cover documents created for reasons other than preparing for litigation does not serve the goals of the doctrine explained by the Seventh Circuit in *Mattenson* and the Supreme Court in *Nobles*.

1. Audit Letters Are an Essential Part of the Audit Process of the Financial Statements of a Public Company, Like Household, in Order for It to Obtain an Unqualified Audit Opinion

The audit letters and related documents at issue here were not created for use in litigation. Indeed, neither Andersen, nor defendants have argued that they were. Instead, even the Household defendants admit that "Household had a ***business reason*** to cooperate with its outside auditors" by creating the audit letters. Dkt. No. 525 at 7. Notably, in the five briefs that defendants and Andersen have submitted on this issue, nowhere have they argued that these documents were intended to be used in litigation, or were in any sense created for on the "prospect of litigation."

Indeed, defendants would have been hard-pressed to argue otherwise because even the documents themselves on their face state that they were prepared in "the normal course of business" or provided to the outside auditors "[i]n connection with an examination of the financial statements of Household International, Inc. and subsidiaries." *See* Declaration of Azra Z. Mehdi (Dkt. No. 524) ("Mehdi Decl."), Ex. 1 at AA 059988; Ex. 4 at AA16216; Ex. 8 at AA 060068; Ex. 10 at AA 058177; Ex. 13 at AA 058175; Ex. 16 at AA 049474; Ex. 17 at AA 069477.[3] Notably, in *Binks*, the Seventh Circuit considered the purpose stated on the face of a document in determining that the document was not created for use in litigation. 709 F.2d at 1120 ("the letter stated that the purpose of the trip to Alamogordo was to attempt to correct the mechanical problems with the System"). Also, in *SmithKline Beecham*, the Magistrate correctly applied Seventh Circuit law and ordered the production of certain research where a company created a document for "business reasons," not "solely for the purpose of litigation." 2001 U.S. Dist. LEXIS 18281, at *12.

Yet, here, despite the overwhelming evidence that the documents were created for the "normal course of business," the Magistrate found the documents to be protected. By ignoring such admissions, as well as the fact that defendants did not actually meet their burden of showing that the work-product doctrine applied, the Magistrate erred. The burden is on the discovery opponent to establish that the work-product doctrine immunizes the documents at issue from discovery. *Allen v. Chicago Transit Authority*, 198 F.R.D. 495, 499 (N.D. Ill. 2001) (citing *United States v. Hamilton*, 19 F.3d 350, 354 (7th Cir. 1994)).

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[3] All of the briefing underlying the Order as well as the Andersen Documents has been submitted in a separate binder for the Court's convenience.

The Magistrate also erred in ignoring the Flanagan declaration submitted by the Class in support of its position that the documents at issue here were created for a business purpose. *See* Flanagan Decl., ¶¶12-17, 21-39. Under AU §337, Household management was responsible for identifying, evaluating and accounting for litigation, claims and other contingencies under Financial Accounting Standards Board No. 5 as a basis for the preparation of financial statements in conformity with GAAP. Flanagan Decl., ¶¶22-26. The Flanagan declaration further states that defendants were responsible for disclosing this information to Household's outside auditors so that the auditors could perform their own independent analysis of the accuracy, reliability and completeness of Household's financial statements. Flanagan Decl., ¶¶21-23. It also emphasizes that audit letters and related documents are part of the audit work papers and evidential support for an independent audit of a public company's financials. Flanagan Decl., ¶¶18-20, 25, 27, 36-38. The Flanagan declaration clearly shows that the audit letters and related documents were created for the business purpose of enabling the auditors to perform an audit and thus enabling Household to file its legally required financial statements. Flanagan Decl., ¶¶12-17, 21-39.

Numerous courts have found audit letters not to be protected since they are not prepared "because of" litigation. *See, e.g., Independent Petrochemical Corp. v. Aetna Cas. & Sur. Co.*, 117 F.R.D. 292, 298 (D.D.C. 1987) (declining to extend work-product protection to audit letters prepared by an attorney because they were prepared to assist accounting firm "in the performance of regular accounting work done by such accounting firms"); *McEwen v. Digitran Sys., Inc.*, 155 F.R.D. 678, 684 (D. Utah 1994) (concluding that documents were not protected by the work-product privilege because the "primary motivating purpose" behind their creation was the re-issuance of defendant's financial statements); *Medinol*, 214 F.R.D. at 115 (finding that audit letters are prepared in the ordinary course of an audit).

Even under the "because of litigation" definition, to the extent that information in audit letters must be disclosed in the public financial statements of the company being audited, they are not entitled to work-product protection. *See In re Raytheon Sec. Litig.*, 218 F.R.D. 354, 359 (D. Mass. 2003) (requiring both company and auditor to file affidavits setting forth the accounting and legal standards governing the treatment of pending or anticipated litigation in financial statements, and supporting any claim of privilege document by document). Here, neither defendants, nor Andersen satisfied their burden or filed any affidavits outlining the accounting or legal standards governing the treatment of pending or anticipated litigation in financial statements, or supporting any claim of privilege document by document. The Class filed such an affidavit (Flanagan Declaration),

which was completely disregarded by the Magistrate – a clear error. The Magistrate erred in misapplying the Seventh Circuit standard for work product by finding the documents were protected without analyzing whether they were created for use in litigation and despite defendants' admissions that the documents were created for a business purpose.

2. The Magistrate Erred by Failing to Follow Seventh Circuit Precedent that the Work-Product Doctrine Protects Only Those Documents Created for Litigation with the Opposing Party Seeking Discovery

The Magistrate erred by following what it described as "the majority view" that documents need not be created for use against the party seeking their production for the work-product doctrine to apply, instead of following the Seventh Circuit's pronouncement on this issue. Order at **18-19.

Earlier this year, the Seventh Circuit held that: "the work-product doctrine shields materials that are ***prepared in anticipation of litigation from the opposing party***." *Mattenson*, 438 F.3d at 767-68. This statement of the work-product doctrine is consistent with a long line of district court cases in this circuit. For example, *McCook Metals L.L.C. v. Alcoa, Inc.*, 192 F.R.D. 242 (N.D. Ill. 2000), limits the work-product doctrine to situations in which:

> [S]ome articulable claim has arisen that is likely to lead to litigation. ***The articulable claim likely to lead to litigation must pertain to this particular opposing party, not the world in general.*** . . .

Id. at 259 (citing *Binks*, 709 F.2d at 1119-20 and *International Ins. Co. v. Certain Underwriters at Lloyd's London*, No. 88 C 9838, 1990 WL 205461, at *4 (N.D. Ill. Nov. 27, 1990)). In *McCook Metals*, the court analyzed several documents over which Alcoa, Inc. asserted work product. 192 F.R.D. at 260-63. The court's determinations relied in large part on whether Alcoa anticipated "the present litigation" or "this litigation." *Id*. Where a document was found to relate to the litigation with *McCook*, it was work product; if not, it was not work product. *Id*.

Similarly, in *Ferguson v. Lurie*, 139 F.R.D. 362, 368 (N.D. Ill. 1991), the court found that the "work product doctrine does not apply here because, as the defendants admit, the two documents in question were not prepared in contemplation of the present litigation." *See Horizon Fed. Sav. Bank v. Seldon Fox & Assoc.*, No. 85 C 9506, 1988 U.S. Dist. LEXIS 7498, at **3-4 (N.D. Ill. July 19, 1988) (same)

Indeed, the Magistrate has previously held that the work-product doctrine applies only to documents created when there is an "articulable claim likely to lead to litigation [that] must pertain to this particular opposing party, not the world in general." *SmithKline Beecham*, 2001 U.S. Dist.

LEXIS 18281, at *9. In *SmithKline Beecham*, the Magistrate examined documents over which Pentech Pharmaceuticals, Inc. asserted work-product protection. *Id*. at **10-11. The Magistrate examined two sets of documents that appeared from the descriptions in the opinion to be essentially identical except that one group was created when "litigation with this particular opposing party was anticipated" and the other was created prior to that time. *Id*. The Magistrate found that only the documents prepared in anticipation of litigation with SmithKline Beecham Corporation were entitled to protection. *Id.* at **12-13.

There is no indication that the Disputed Documents were created in anticipation of this securities fraud litigation with this Class or any other litigation with its shareholders. At the time the audit letters were created, the shareholders had not brought suit. None of the Andersen documents, for example, which describe pending and possible litigation, even mention this securities litigation. Hence, the Magistrate erred in disregarding established Seventh Circuit law as well as her own prior rulings to find the Disputed Documents covered by work product.[4]

3. The Magistrate Erred by Failing to Follow Seventh Circuit Precedent that Dual-Purpose Documents Are Not Protected Work Product

To be shielded from discovery in this Circuit, not only must documents have been created for use in the litigation at issue, they must also not have been created for any other purpose. *Frederick*, 182 F.3d at 501-02. In *Frederick*, the Seventh Circuit court examined certain documents that otherwise might have qualified as work product, and held that the documents were discoverable because they were created for a non-litigation purpose (tax preparation) as well as "for use in litigation." *Id*. at 501 ("a dual-purpose document – a document prepared for use in preparing tax returns and for use in litigation – is not privileged"). Thus, under Seventh Circuit law on the work-product doctrine, "a dual-purpose document . . . is not privileged." *Id*.; *see also Harper v. Auto-Owners Ins. Co*., 138 F.R.D. 655, 661 (S.D. Ind. 1991) ("Documents prepared for concurrent purposes, therefore, should not be classified as work product.").

The Magistrate sought to distinguish *Frederick* from the present case on the ground that the second purpose for the creation of the documents in *Frederick* was for preparing tax returns, whereas

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[4] In *Tronitech, Inc. v. NCR Corp.*, 108 F.R.D. 655 (S.D. Ind. 1985), where audit letters were deemed not discoverable, it was because the litigation at issue was the subject of the audit letters, and the party seeking production was the adversary in that litigation.

here, the second purpose is not for preparing tax returns. Order at **16-17. This distinction cannot be justified.

First, the Seventh Circuit described the documents as "dual-purpose documents," not as litigation and tax preparation documents. In the conclusion of the opinion, the court affirmed the district court's ruling that the documents were not privileged as work product, stating simply "[m]ost are ***dual-purpose documents, about which no more may be said***." *Frederick*, 182 F.3d at 502. Additionally, the concurring opinion explained the significance of the ruling:

> [T]he majority has also made an important legal ruling that affected its review: ***dual-purpose documents are not privileged. This principle can be expressed without regard to the specific facts of a given case, including this one. . . .***

Id. at 504 (Wood, J., concurring). The unqualified rejection of the privilege for "dual-purpose documents" does not in any way suggest that the nature of the second purpose matters. To the contrary, the use of the phrase "dual-purpose documents" suggests that if there is a second purpose, whatever it may be, there is no work-product protection. Moreover, under *Binks*, the question in the work-product analysis is whether "the primary motivating purpose behind the creation of a document" is "to aid in possible future litigation." 709 F.2d at 1119. Here, there is nothing about the audit letters that suggests that defendants intended to or even could use them in their preparation for any of the litigation discussed in them.

B. The Magistrate's Findings with Respect to the Litigation Database Are Clearly Erroneous

The Class sought parts of Household's litigation database that detail class actions or actions brought by governmental agencies for violations of consumer protection laws and regulations. The Magistrate erred in finding that the database is not discoverable, relying upon the first Affidavit of Mark F. Leopold (Dkt. No. 529) ("Leopold Aff.") that "Household [] implemented strict controls to protect the confidentiality of these records, and that the database has ***never been disclosed*** to Household's outside auditors or any other third party." Order at **24-25 (citing Leopold Aff., ¶¶4-5). Under the facts of this case, the Magistrate's finding is clearly erroneous.

First, the Disputed Documents affirmatively demonstrate that part of the database was reviewed by an Andersen employee, not just that Andersen was aware of it. *See* Mehdi Decl., Ex. 1 at AA 059988-89 where Andersen audit employee Danielle Valkner outlines the audit procedures undertaken by Andersen, which included reviewing the audit response letters in addition to reviewing a sample of cases from Household's legal database. The Valkner memo goes on to state that, based on Andersen's review of all this information, including the litigation database, Andersen

believed that the litigation reserves were reasonable. *Id.* at AA 059989; *see also* Mehdi Decl., Ex. 4 at AA16216; Ex. 10 at AA 058177.[5]

After the Class' filing outlining these facts, defendants filed the Supplemental Affidavit of Mark F. Leopold (Dkt. No. 564) ("Leopold Supp. Aff."), along with Household's sur-reply, which states that "the litigation data ***is not routinely shared*** with Household's outside auditors or any other third party." Leopold Supp. Aff., ¶2. It is significant that Household counsel had to amend his prior affidavit to correct the misrepresentation that the database "has never been disclosed" to the auditors in the face of documents that clearly evidence that the database was indeed shared with the outside auditors. "Never been disclosed" is simply not the same thing as "not routinely shared." Thus, the Magistrate's finding that "the mere fact that Andersen was made aware of the database and some of the litigation it discussed, however, does not establish that Andersen actually viewed the database itself," is clearly erroneous in light of the change in Leopold's affidavit. *Compare* Leopold Aff., ¶5 *to* Leopold Supp. Aff., ¶2.

Further, in the Flanagan declaration, the Class provided evidence establishing that Household's outside auditors had to review the database in performing an audit in accordance with Generally Accepted Auditing Standards: "an auditor cannot rely solely on management representations," but must perform their own independent evaluation of the representations made by management. Flanagan Decl., ¶¶27-34, 39. Indeed, if there are restrictions placed on the auditor's ability to obtain sufficient competent evidential matter to support management's assertions about litigation, claims and assessments, the auditor may be required to qualify his opinion or to disclaim an opinion. *Id.*at ¶27. The Magistrate failed to consider the Flanagan declaration that demonstrates that management representations to auditors that are an essential part of the audit of financial statements and are included in disclosures made to investors, are discoverable in a securities fraud lawsuit.

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[5] The Magistrate also erred in accepting the Household defendants' misrepresentations in the Sur-Reply that "[a]t most the Litigation Review and other documents cited by Plaintiffs show that Household (a) made its outside auditor aware of the existence and operation of the database as part of the latter's routine examinations of the adequacy of Household's systems and controls, and (b) informed Arthur Andersen of the existence and nature of particular litigations." Sur-Reply (Dkt. No. 564) at 3. As described above, the documents themselves show otherwise. The description of the review carried out by Andersen is explicit that Andersen employees reviewed parts of the database. Mehdi Decl., Ex. 1. Concealing material for the purpose of misrepresenting what it says is a misuse of the Court's procedures for protecting legitimately confidential information. *United States v. Cosolito*, 488 F. Supp. 531, 537 (D. Mass. 1980).

Thus, a database setting forth, for every actual or threatened claim or action, the "date of the claim, summary of the claim, the amount of damages sought by the defendant, external counsel assigned to the case and the current status" is not something "for use" in any particular litigation. *See* Mehdi Decl., Ex. 1 at AA 059988. Rather, it is a management tool for a company that "[i]n the normal course of business [ ] is involved in certain pending or threatened litigation." *Id.*

Finally, even if the database had been created to aid in litigation, only one entry on the database – the entry relating to this case – would properly be protected under the work-product doctrine here. *See Mattenson*, 438 F.3d at 767-68. The database was used by Household for the business purpose of drafting the audit letters to the auditors and providing evidential support to the auditors. Because the database was created and maintained for a business purpose, and because it was used in the audit process, it is not work product. *Frederick*, 182 F.3d at 501-02; *SmithKline Beecham*, 2001 U.S. Dist. LEXIS 18281, at *12.

C. The Magistrate Erred in Finding that Information Related to the Amount and Establishment of Litigation Reserves Doctrine Is Covered by the Work-Product Doctrine

The Magistrate held that information relating to litigation reserves is entitled to work-product immunity because "these determinations 'necessarily entail [] consideration of the responsible attorneys' evaluation of the merits of related claims, defenses and strategies.'" Order at *26. In doing so, the Magistrate erred.

Even the jurisprudence relied upon by the Magistrate held "the question of whether reserve figures are protected by the work product doctrine must be made on an ad-hoc basis," and recognized that reserve information is discoverable. *Certain Underwriters at Lloyd's v. Fidelity & Cas. Ins. Co.*, No. 89 C 876, 1998 U.S. Dist. LEXIS 3654 (N.D. Ill. Mar. 20, 1998). For example, in *Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co.*, Case No. 03-1224, 2005 U.S. Dist. LEXIS 39691, at *27 (N. D. Ill. Jan. 31, 2005), the magistrate found that loss reserve information is discoverable if the bad faith claim survived a motion to dismiss because such information would be discoverable as "an indication of good or bad faith."[6] The *Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987), case relied upon by the Magistrate also does not hold that reserve information is

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[6] Subsequently, the district court denied defendants' motion for judgment on the pleadings on the bad faith claim, presumably allowing discovery of reserve information as previously ruled by the magistrate. *Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co.*, Case No. 03-1224, 2005 U.S. Dist. LEXIS 39656 (C.D. Ill. Apr. 14, 2005).

never discoverable. Rather, the Eighth Circuit found that "aggregate reserve information in the risk management documents serves numerous business planning functions, but we cannot see how it enhances the defense of any particular lawsuit." *Id*. at 401-02. There, the court permitted discovery of aggregate reserve information and directed redaction of individual reserve information from the documents.

Here, plaintiffs specifically allege that defendants violated GAAP and SEC rules by failing to disclose and properly record the potential loss contingencies resulting from the Company's illegal predatory lending practices, enabling Household to be under-reserved during the Class Period. ¶¶102-106. Defendants' misrepresentations and omissions ultimately resulted in a $525 million pre-tax charge to Household's earnings in 3Q02. ¶105. As outlined in briefs filed by the Class, litigation reserves are an accounting tool to attempt to ensure that there is adequate money put aside so that the financial statements will be materially accurate, regardless of the outcome of the litigation. Dkt. Nos. 523, 537, 573-74. Although the money reserved for litigation is certainly for use in litigation, the facts of the establishment and amount of the reserves are not. *National Union Fire Ins. Co. v. Continental Illinois Group*, No. 85 C 7080, 1988 U.S. Dist. LEXIS 7826, at **5-6 (N.D. Ill. July 21, 1988) (granting plaintiff's motion to compel information related to litigation reserves because "the setting of the reserve was not identical with the thought processes of counsel").

Without analyzing the specific context here, where disclosures relating to the adequacy of loss contingencies are central to this litigation, the Magistrate found that Household had met its burden of demonstrating work-product protection applies. Order at *28. As discussed, information relating to litigation reserves is particularly relevant here, where it was provided to the auditors in management letters as part of the audit inquiry process – *i.e.*, for the business purpose of having the outside independent auditors sign off on the Company's financial statements, not "for use in litigation." Accordingly, defendants' procedures for setting litigation reserves are not privileged as work product. *National Union*, 1988 U.S. Dist. LEXIS 7826, at **5-6; *Frederick*, 182 F.3d at 501-02.

Further, under *Mattenson*, only information about the litigation reserves for this particular case is protected. 438 F.3d at 767-68. The reserve information being sought here is not for this securities fraud case, but rather for the class actions as well as governmental and regulatory actions that plaintiffs allege defendants knew would have a significant financial impact, but failed to disclose in order to continue obtaining an unqualified audit opinion. As with the audit letters and the

database, very few of the documents will discuss litigation reserves for this litigation against the party now seeking discovery. Notably, the cases relied on by the Magistrate show only that litigation reserves for the case in which they are sought are sometimes protected from discovery. *See Certain Underwriters at Lloyd's*, 1998 U.S. Dist. LEXIS 3654, at **5-6 (noting that analysis must be done on case-by-case basis and redacting reserves calculated for that case); *Harper*, 138 F.R.D. at 675 (redacting reserves taken for that case).

Finally, and perhaps, most significantly, defendants themselves concede that attorneys were not involved in the determination of the litigation reserves. In responding to the Class' interrogatory regarding identification of the individuals responsible for determining accounting treatment to address litigation risk, defendants only listed David Schoenholz, Steve McDonald and the Corporate Accounting Department. Ex. 7 at 59. Given their own verified interrogatory responses that lawyers were not involved in establishing loss contingencies under FAS No. 5, defendants have not met the burden establishing that litigation reserves information is protected by the work-product doctrine. The Magistrate's ruling on this issue should be also overruled.

VII. CONCLUSION

For all the foregoing reasons, the Magistrate's Order misapplying Seventh Circuit precedent on the work-product doctrine to audit letters and related documents, the litigation database and information relating to litigation reserves should be overruled. Alternatively, if the Court affirms the Magistrate's ruling that these documents are covered by the work-product doctrine, then the Household defendants must be barred from seeking to rely on or use the audit opinions at summary judgment or trial.

DATED: July 25, 2006

Respectfully submitted,

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DECLARATION OF SERVICE BY EMAIL 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 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 25, 2006, declarant served by electronic mail and by U.S. Mail the **THE CLASS' OBJECTION TO THE MAGISTRATE'S ORDER REGARDING THE APPLICATION OF THE WORK-PRODUCT DOCTRINE TO AUDIT LETTERS AND RELATED DOCUMENTS** to the parties listed on the attached Service List. The parties' email addresses are as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 25th day of July, 2006, at San Francisco, California.

s/ Jerry Cohen
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