

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

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

THE CLASS' STATUS REPORT

I. INTRODUCTION

At the August 22, 2006 status conference, the Class raised with the Court an issue respecting Household International, Inc.'s ("Household") production of documents relating to some 27 state agencies. At that time, the Class requested the Court address the issue via order, including setting a briefing schedule to address the issue and requesting Household to identify all the documents at issue as required by the terms of the Protective Order. *See* The Class' Amended Memorandum in Support of Motion Regarding State Agency Documents (Docket No. 637). At the August 22 hearing, the Court deferred consideration of the Class' request to allow the relevant state agencies until September 2 to respond to the parties' communications. The Court directed the Class to provide this status report on the state agency issues on September 12.

As directed by the Court, this status report addresses the relevance of the documents at issue. It also provides a factual update of relevant events since the August 22 status conference, summarizes the legal issues presented by this discovery issue and places this issue in the context of the January 31 discovery cut-off established by the Court on August 10.

II. FACTUAL UPDATE

After the August 22 hearing, the Class in writing requested that the relevant agencies provide a decision with respect to release of their documents by September 2. As of today's date, the parties have received responses from all of the relevant state agencies save three.¹ Twelve or approximately half of the responding state agencies have no issue with production of the documents.² Five of these

¹ A list of the relevant state officials and their addresses is attached hereto as Exhibit A (all exhibits are attached hereto). There has been no response as of yet from three states: New Mexico, Ohio and Oregon. To date, Household has withheld from production documents from these agencies and allegedly related internal documents.

² The 12 states falling within this category are Florida, Kentucky, Maryland, Michigan, Missouri, Montana, Nebraska, New Jersey, Pennsylvania, Tennessee, Texas and Virginia. The letters received from the

have requested that the Protective Order be modified so as to cover their documents. The parties have agreed upon the text of the modification but not the scope. The Class is submitting the modification as Ex. C. A second group has indicated that it does not want to be involved in what they see as a dispute between the parties.³ A third group has objected to the production of their documents based on state statutes, even pursuant to a Protective Order.⁴ Some of these have based this response on the fact that state law gives them no discretion to authorize release.

Based on the responses received, Household has identified on a rolling basis the documents it believes are at issue. There are four Household lists at issue. Two refers to previously produced documents to be recalled or redacted; two others identify Robin Allcock's documents to be redacted or withheld. *See* Exs. F-H. The total number of documents at issue is 512. Many of the documents identified by Household on these lists are internal Household documents, which were not shown to the state agencies.

The unresolved state of this issue has impeded the Class' ability to proceed with depositions. Lisa Sodeika's deposition had been scheduled to proceed on October 12, but was rescheduled until November 2, a loss of one month. A proposed deposition schedule for the remainder of the case is attached as Ex. I. This deposition schedule relies upon this issue being resolved by October 12 with Household releasing the remainder of the documents immediately.

agencies as to agencies' positions and the notifications by Household of the agencies' positions are attached collectively as Ex. B.

³ This group consists of three states: Minnesota, New York and West Virginia. There is another state, Iowa, that has taken a similar stance and has deferred the decision to this Court. Ex. D.

⁴ This group consists of eight states: Arizona, Delaware, Hawaii, Kansas, North Carolina, Vermont, Wisconsin and Wyoming. Ex. E. Not all of these agencies have requested recall to their documents.

To ensure timely resolution of this issue, the Class again requests the Court to set a briefing schedule on this issue. As a means to expedite the briefing schedule, the Class will forego filing an opening brief. The Class proposes the following briefing schedule:

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|----|----------------------------------|------------------|
| 1. | State responsive filings, if any | October 3, 2006 |
| 2. | The Class' reply | October 9, 2006 |
| 3. | Court Hearing | October 12, 2006 |

Given the importance of resolving this issue quickly, this briefing schedule is appropriate.

III. THE ISSUES BEFORE THE COURT

As requested by the Court on August 22, the Class summarizes the pending issues as follows:

1. How relevant are the documents at issue?
2. Does state law furnish a basis for withholding these documents from production?
3. Does the bank examination privilege apply to state agency documents or to Household internal documents, particularly where the documents at issue do not relate to any banks?
4. If so, is there good cause to override that privilege in light of the relevance of the documents, the modified protective order, the agreement of other state agencies to release their documents and the Class' ability to obtain similar evidence elsewhere?

We address these points seriatim below.

A. The Documents at Issue Are Highly Relevant and Cannot Be Obtained from Any Other Source

At the August 22 hearing, the Court requested the Class to identify, among other things, the relevance of the documents at issue and whether there were alternative sources. As discussed below, the documents at issue are highly relevant in a trial sense. Further, there are no alternative sources for the information contained in these documents.

As the Court is aware, a central issue in this case is whether Household engaged in predatory lending. The various state agencies regulated Household's consumer lending activities for

compliance with federal and state laws. In their reports and correspondence with Household, these agencies made factual findings to the effect that Household was engaged in predatory lending in violation of federal and state laws. Thus, the state agency reports and correspondence are probative at trial on the issue of scienter and falsity. *See In re Midlantic Corp. S'holder Litig.*, Miscellaneous Docket No. 92-99, 1994 U.S. Dist. LEXIS 21514, at **9-10 (D.D.C. Oct. 24, 1994) (Office of the Comptroller of the Currency documents relevant to scienter and falsity).

During the August 22 status conference, the Court correctly surmised that these documents have to do with predatory lending. *See Ex. J* at 46:24-25, 47:9 (comments of the Court). The state agency reports and correspondence detail findings of predatory lending practices that corroborate the Class' allegations of predatory lending practices in the Complaint, including findings with respect to insurance sales, use of "discount" points, EZ Pay, and prepayment penalties. The internal Household documents discuss these findings and include evaluations of the revenues associated with certain of them. Thus, these documents attack defendants' central claims that a) they did not engage in predatory lending, b) they were not aware of engaging in predatory lending when they told the investing public that it did not engage in predatory lending, and c) the predatory lending activities were not material.

Significantly, the Class has already relied on state agency documents to elicit deposition testimony. The Class has examined witnesses, including Lisa Sodeika and Tom Schneider, on the subject of communications with Household's state regulatory agencies, including but not limited to Minnesota, using as exhibits correspondence between Household and the state regulatory agency. Similarly, the Class has examined deposition witnesses, including Ms. Sodeika and Ned Hennigan, on the results of state examinations and the consequences of those examinations in terms of refunds, including but not limited to Minnesota, Arizona, Kansas, New York, Ohio and Tennessee, using as exhibits internal documents on these subjects. Further, in response to defendants' predatory lending

interrogatories, the Class has identified the category of state regulatory agency reports and communications as documents supporting the Class' allegations. Finally, the Court authorized the Class to proceed for a second day of deposition for Ms. Sodeika on various topics, including the topic of communications with state regulators regarding predatory lending complaints. August 10, 2006 Order at 5 (Docket No. 631).

The documents at issue cannot be obtained from any other source. As to Household's internal documents, it is naturally the only source for these documents. As to the state agency reports and correspondence, each agency has a distinct jurisdiction and thus, they are non-duplicative of each other. Further, they are non-duplicative of the federal agency documents as the federal agencies regulated Household's banks and the states did not. Finally, the state agency documents and the internal Household documents are not found in the KPMG LLP or Arthur Andersen LLP documents.

At the August 22 hearing, the Court indicated that the Class should show how these documents were "trial relevant" and not just "deposition relevant." Ex. J at 44:22-23. The Class has articulated above how these documents meet this heightened standard. However, it would be manifestly unfair if this Court were to impose this heightened standard, which could only punish the Class for circumstances resulting from Household's errors.

This issue results solely from Household's production of the state agency reports without first contacting the agencies. Many of the state agency responses expressly note this point, including the fact that it was illegal for Household to have produced the documents. Ironically, Household produced state agency documents that contained advisory language on their face after the federal agency issue arose in February of this year. Indeed, one of the documents at issue was produced on July 31, 2006. In these circumstances, Household cannot assert its production was "inadvertent."

Even the late discovery of this issue results from a Household mistake, namely the failure to locate 30 boxes of Robin Allcock's files for over two and a half years.⁵ As the Court is aware, Ms. Allcock is not a minor witness, but as head of compliance for consumer lending is a critical witness with critical responsibilities. It is simply incredible that to believe that with reasonable efforts Household could not have located 30 boxes of her files until June of this year. The plain truth is that Household did not look until that date.

In sum, Household alone is responsible for the problem that is before this Court. It would be manifestly unfair to the Class for the Court to impose any heightened burden on the Class, particularly where suppression of these documents prejudices the Class while release of the documents would not harm Household.

B. Privilege in this Action Is Determined by Federal Law and Not State Law

This is a case based on federal subject matter jurisdiction. Therefore, unlike a case based on diversity subject matter jurisdiction, the Court looks to federal common law for the determination of privilege and not state law. As this Court noted in its December 9, 2005 Order, “[i]n federal question cases like the case at bar, ‘the contours and exceptions of . . . privileges are clearly a matter of federal common law; state-created principles of privilege do not control.’” December 9, 2005 Order at 5 (Docket No. 375) (omission in Order) (citing *In re Pebsworth*, 705 F.2d 261, 262 (7th Cir. 1983)). Accordingly, a state law providing for the confidentiality of a state agency report does not support the assertion of privilege in this case.

⁵ This initial mistake was compounded by the failure to identify inadvertently produced documents within ten days as required by the Protective Order.

C. The Bank Examination Privilege Does Not Apply to These Documents

At issue are two types of documents: 1) state agency reports and correspondence relating to violations of predatory lending laws by Household and 2) internal Household documents. As discussed below, neither is subject to the bank examination privilege.

The vast majority of the documents identified to date by Household are its own internal documents.⁶ These documents are not subject to the bank examination privilege. As established in the case law previously cited by the Class, the bank examination privilege is a variant of the deliberative process of privilege and exists to safeguard from unwarranted disclosure the mental processes and deliberations of governmental officials. *In re Bank One Sec. Litig.*, 209 F.R.D. 418, 426 (N.D. Ill. 2002)(bank examination privilege “falls within the realm of a deliberative process protection”). As such, it does not encompass purely internal documents that were never shared with a governmental official.

The objecting states’ correspondence affirm this point. The response from North Carolina requests that Household “withhold from disclosure reports of the examination, investigation and any correspondence regarding such matters.” Ex. E at 7. The response from Wisconsin discusses “certain examinations and examination related documents, prepared by this office.” *Id.* at 13; *see National Sav. & Loan Ass’n v. St. Paul Fire & Marine Ins. Co.*, 515 F. Supp. 12, 14 (E.D. Wis. 1981)(in diversity case, court noted that “the records and information of the Commissioner of Savings and Loans gathered in the course of an examination are privileged under Wisconsin law”). The response from Hawaii discusses “the confidentiality of information possessed by the Commissioner of Financial Institutions.” Ex. E at 4 (discussing Hawaii Revised Statute §412:2-

⁶ Household has, as usual, overdesignated the documents at issue. Some of the documents identified by Household on their face show no relationship to any state agency.

104). The response from Wyoming states that “[d]ocuments provided by our office regarding regulated entities are held to be confidential.” *Id.* at 14. The response from Kansas indicates that the state agency documents and “all correspondence to and from the licensee in response to an examination report” should not be released. *Id.* at 5; *see also id.* at 7-8 (response from North Carolina).

There is no bank examination privilege for purely internal Household documents. This point is confirmed because any such privilege would be derivative of that covering the underlying state agency documents. As discussed below, these state agency documents are not privileged and thus, there is no derivative privilege to apply to internal documents.

The state agencies regulated the operations of Household Finance Corporation and related affiliates, none of which are banks. Patricia Farren, counsel for Household, confirmed this at the August 22 hearing, stating: “Household non-banks have activities in various states that have to be licensed or regulated. . . . So it’s non-bank lending activities by the states.” Ex. J at 31:8-11. Indeed, Ms. Farren went on to note, “They’re not bank examination because the state agencies don’t have jurisdiction to regulate Household banks.” *Id.* at 35:10-11.

This is determinative as the bank examination privilege is limited to the regulation of banks. “The bank examination privilege provides [] protection for the banking industry by promoting and protecting the integrity of candid relations between ***banks and governmental regulatory agencies***.” *Bank One*, 209 F.R.D. at 426 (“Practicality necessitates the bank examination privilege in order to preserve a safe banking environment.”)(citing and discussing *In re Subpoena upon the Comptroller of Currency*, 967 F.2d 630 (D.C. Cir. 1992)); *Schreiber v. Society for Sav. Bancorp, Inc.*, 11 F.3d 217, 220 (D.C. Cir. 1993)(“first task of the district court . . . is to determine whether the banking agency has shown that the requested documents are not primarily factual in nature).

In sum, none of the documents at issue is subject to the bank examination privilege.

D. Good Cause Exists to Override the Qualified Bank Examination Privilege

As the Class has previously demonstrated, the bank examination privilege is a qualified privilege that can be overcome upon a showing of good cause. The Class' Submission Regarding Discovery of Disputed Regulatory Documents (Docket No. 428). Good cause exists here for several reasons.

First, as noted above, the documents at issue are probative as to several issues in the case, scienter, falsity and materiality. Indeed, as this Court is aware, each of the federal regulatory agencies reached this conclusion when faced with this issue and agreed to waive their privilege as to their reports of examination dealing with predatory lending issues. This relevance favors overriding the privilege, if applicable. *See Midlantic*, 1994 U.S. Dist. LEXIS, at **9-10; *Schreiber*, 11 F.3d at 222 (“in their communications with the bank examiners, the officers [of the corporation] might have evidenced (or gained) an awareness of Bancorp’s true financial state at the same time that they were presenting the public with a rosier picture”).

Second, as noted above, the Class has no alternative sources of this information. Again, the federal agencies reached this very conclusion when agreeing to waive their own privilege.

Third, a modification to the Protective Order similar to that made for the federal agencies will adequately protect any confidentiality concerns. Indeed, many of the state agencies have agreed to release their documents on this condition. Others have indicated that their refusal to release their documents stems from the limitations imposed upon them by state law, a limitation that does not and cannot reach this Court. With the modification in place, there will be no prejudice to the state agencies’ interest in confidentiality.

Fourth, the bell cannot be unrung without substantial prejudice to the Class. The Class has already used state agency documents and internal Household documents at exhibits in depositions. This deposition testimony and the exhibits cannot now be withdrawn. Further, defendants have

denied the allegations that they engaged in predatory lending and that they made false statements regarding their engagement in predatory lending with scienter. Presumably, they will offer testimony at trial to support these positions. It would be unfair to deprive the Class of documents with which to refute these positions and the related testimony. *See MG Capital LLC v. Sullivan*, No. 01 C 5815, 2002 U.S. Dist. LEXIS 11803, at **11-12 (N.D. Ill. July 1, 2002)(holding third party's inadvertent production of privileged documents waived party's privilege based on the fairness and prejudice to other party). Further, as the Court is aware, it will cost the Class time and resources to remove any "recalled" documents and to substitute "redacted" versions of previously produced documents.

IV. CONCLUSION

As discussed above, the Class believes that the Court has already sufficient basis to compel the production of all documents at issue. However, the Class recognizes that the Court will want the input of the state agencies prior to deciding. Accordingly, the Court should give the agencies the opportunity to address these points and the Class the ability to reply, if necessary, in accordance with the briefing schedule proposed above.

DATED: September 12, 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 September 12, 2006, declarant served by electronic mail and by U.S. Mail the **THE CLASS' STATUS REPORT** 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 12th day of September, 2006, at San Francisco, California.

s/ Juvily P. Catig

JUVILY P. CATIG