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-C-5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan

THE HOUSEHOLD DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF THEIR DEPOSITION NOTICES AND SUBPOENAS TO NAMED PLAINTIFFS AND CERTAIN INVESTMENT ADVISORS

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PRELIMINARY STATEMENT

As the Court requested at the October 19, 2006 status conference, Defendants Household International, Inc., Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilmer, and J.A. Vozar (collectively the "Household Defendants" or "Household") respectfully submit this Memorandum to explain why the Court's April 18, 2005 ruling, and cases analyzed therein, do not preclude Defendants from taking merits depositions of the named Plaintiffs and certain of their investment advisors. That decision quashed subpoenas issued to various third party investment advisors of named Plaintiff PACE Industry Union Management Pension Fund ("PACE") on the limited ground that questions of individual reliance were not ripe for discovery. Thus, the Court does not need to reconsider the April 2005 ruling in order to allow Defendants to depose the named Plaintiffs or to pursue merits discovery of third parties on subjects going beyond individualized reliance. Should the Court disagree, Defendants respectfully ask it to reconsider that ruling in favor of the liberal reciprocal discovery that the Federal Rules require.

Defendants' Deposition Notices and Proposed Third Party Discovery

Pursuant to Rule 30(b)(6) of the Federal Rules of Civil Procedure, Defendants have issued deposition notices to PACE, Glickenhaus and Co. ("Glickenhaus"), and the International Union of Operating Engineers Local No. 132 Pension Plan ("Local 132") (collectively "named Plaintiffs"). Each of the notices requests a witness prepared to testify on such common merits issues as the basis of certain allegations in the [Corrected] Amended Consolidated Complaint, and the information consulted by the named Plaintiffs or their advisors in connection with their investment in Household International Inc. Exhibit 1 (Rule 30(b)(6) notice).[1] Plaintiffs repeatedly mischaracterize the latter subject as limited to individualized reliance, but irrespective of Plaintiffs' state of mind, they or their advisors have pertinent fact information about the information that was on the market at the time of their respective investments, which will be a key common issue at the summary judgment stage. Defendants wish to explore the same issue with non-party investment advisors to PACE because such testimony will be relevant to the defense of

[1] All exhibits ("Ex") referenced herein are attached for the Court's convenience.

Plaintiffs' fraud-on-the-market allegations by disclosing what truth was on the market at relevant points of time during the Class Period.

The Context of this Motion

During the briefing in early 2005 with respect to the subpoenas directed to PACE's investment advisors, Plaintiffs argued that allowing the requested discovery at that time would impair their ability to pursue their own discovery and unduly distract and oppress Plaintiffs. In the nearly two years since Plaintiffs prevailed on that argument, they have received over three million pages of hard copy document production, hundreds of thousands of pages of electronic discovery, responses to multiple sets of interrogatories and several hundred requests for admission, issued three additional Rule 34 Requests in the last month alone, and taken more than 30 depositions on the way to a total of 55. At the Court's instruction, Household is also diverting employees from their normal tasks to create and operate special computer programs to compile and report data in formats and categories that were not maintained in the normal course at Household.

In stark contrast, and consistent with the asymmetrical warfare that defendants must endure in modern securities class actions, the Household Defendants have taken only *one* deposition (prior to class certification) and have received fewer than 40,000 total pages of hard-copy document production from Plaintiffs (consisting mainly of documents that Plaintiffs received from various state Attorneys General pursuant to FOIA requests). Moreover, it has become increasingly clear since this Court's April 2005 decision that Plaintiffs do not take their discovery obligations seriously. Even where the Court has ordered Plaintiffs to comply, they continue to serve baseless objections and deliberate non-answers that continue to leave Defendants in the dark about basic aspects of Plaintiffs' position. *See infra* at 7.

That, unfortunately, is the background of this briefing. Plaintiffs' counsel has demonstrated a lack of cooperation with both the Federal Rules and this Court's discovery orders, or any notions of basic fairness. Thus Defendants have an even greater need now to examine the named Plaintiffs and their investment advisors to obtain information that would be pointless to seek from Plaintiffs' counsel. The stonewalling of Plaintiffs' counsel will deprive Defendants of a fair opportunity to seek summary judgment if Defendants are prevented from developing alternate sources of information. In the interests of justice, and in accord with the liberal

Federal rules governing discovery and Congress's intention, in enacting the Private Securities Litigation Reform Act, to have class representatives play an active, knowledgeable role in securities fraud litigation, the Household Defendants should be permitted to proceed with the proposed depositions of the named Plaintiffs and investment advisors.

Procedural History

On September 24, 2004, the Household Defendants deposed Maria Wieck, an individual that PACE had designated pursuant to Fed. R. Civ. P. 30(b)(6) as knowledgeable about the decisions that led PACE to purchase Household securities. During the deposition, however, Ms. Wieck was unable to provide any information about the Household securities owned by PACE or the reasons for selecting Household securities for purchase or sale. Rather, Ms. Wieck identified various investment managers who made investment decisions on behalf of PACE. Accordingly, on December 6, 2004, the Household Defendants served fourteen third-party subpoenas seeking relevant documents from investment advisors to PACE, including information relating to PACE's investment history and investments by PACE in the securities of Household Defendants. Three of these subpoenas also sought deposition testimony.[2]

Plaintiffs moved to quash these subpoenas. In their motion for a protective order, Plaintiffs maintained that having to respond to the subpoenas would unduly burden them and hinder their ability to continue seeking discovery from the Household Defendants. Pl. Br. at 7-8. On April 18, 2005, this Court ruled in favor of the Plaintiffs, putting a protective order in place and granting Plaintiffs' motion to quash the subpoenas.

Discovery is winding to a close and the Household Defendants now seek to depose the named Plaintiffs in order to gain information directly relevant to potential defenses to Plaintiffs' claims.[3] At the Status Conference before this Court on October 19, 2006, Plaintiffs

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[2] The parties were operating at that time under the 10 deposition limit set forth in the Federal Rules. The Court has now permitted both sides to take 55 depositions. If given the right to take the depositions of PACE's investment advisors, Household would consider taking more than the three originally set forth in its prior subpoenas. Household would also consider seeking deposition testimony of any investment advisors to the other two named Plaintiffs, if relevant.

[3] The deposition of the PACE representative took place prior to the class stipulation. The Household Defendants have never examined lead Plaintiffs Glickenhaus and Local 132.

argued that the rationale of the Court's April 2005 decision precludes Defendants from ever deposing Plaintiffs or their investment advisors prior to any trial of this action. The Court invited Defendants to distinguish and (if necessary) reargue its prior ruling.

ARGUMENT

I. THE HOUSEHOLD DEFENDANTS ARE ENTITLED TO TAKE DEPOSITIONS OF THE NAMED PLAINTIFFS AND THEIR INVESTMENT ADVISORS

A. The Depositions Will Yield Information Relevant to Common Issues on the Merits of this Dispute

Discovery is generally permitted "regarding any matter, not privileged, that is relevant to the claim or defense of any party." Fed. R. Civ. P. 26(b)(1). As Plaintiffs have frequently touted, discovery requests are examined under a broad and liberal standard. *Thomas & Betts Corp.* v. *Panduit Corp.*, No. 93C 4017, 1996 WL 169389, at *1 (N.D. Ill. Apr. 9, 1996) ([t]he term 'relevant' is much more liberally construed during the discovery stage") citing 8 Wright, Miller & Kane, Federal Practice and Procedure, Civil 2d § 2008 at 99-100.[4] District courts have broad discretion in matters relating to discovery. *Patterson* v. *Avery Dennison Corp.*, 281 F.3d 676, 681 (7th Cir. 2002).

Plaintiffs bear the burden of showing reliance in this securities fraud action, and have indicated that they will be relying on a "fraud on the market" theory of reliance. *See Basic Inc.* v. *Levinson*, 485 U.S. 224, 248 (1988); *see also* (Amended Complaint ¶ 349). In a fraud-on-the market case, "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." *Basic*, 485 U.S. at 248.

In *Asher* v. *Baxter International Inc.*, 377 F.3d 727, 732 (7th Cir. 2004), the Seventh Circuit noted that "[a]n investor who invokes the fraud-on-the-market theory must acknowledge that *all* public information is reflected in the price, just as the Supreme Court said in *Basic*. Thus if the truth or the nature of a business risk is widely known, an incorrect statement can have

[4] All unreported cases cited herein can be found at Exhibit 3.

no deleterious effect, and if a cautionary statement has been widely disseminated, that news too affects the price just as if that statement had been handed to each investor." (Easterbrook, J.)(emphasis in original, internal citations omitted). To that end, it is well-settled that truth on the market serves as a defense to the fraud on the market theory. *See, e.g., Associated Randall Bank* v. *Griffin, Kubik, Stephens & Thompson, Inc.*, 3 F.3d 208, 213-14 (7th Cir. 1993) (noting that the fraud-on-the-market theory has a truth-on-the-market corollary); *Ganino* v. *Citizens Utilities Co.*, 228 F.3d 154, 167 (2d Cir. 2000) ("a misrepresentation is immaterial if the information is already known to the market because the misrepresentation cannot then defraud the market").

Consistent with this line of cases, the depositions that the Household Defendants seek to take will explore information regarding what named Plaintiffs (or their investment advisors if relevant) knew about the nature of and risks inherent in Household's business — not to test their individual reliance, or lack of it, but because such information will help identify what public information was *known to the market*, an indisputably relevant subject. While it may be true, as Plaintiffs have argued, that Defendants can obtain some of this information through the depositions of stock analysts, Household is not required to limit its search for relevant information to sources proposed by Plaintiffs' counsel. Surely it is just as relevant, and arguably more so, if the named Plaintiffs or their investment advisors (who were themselves professional money managers and as sophisticated as many stock analysts) were aware of certain risks in investing in Household.

Plaintiffs have also argued that such discovery goes only to individual issues of reliance, but this is not so. Even accepting, *arguendo*, that individual reliance issues may be premature at this stage of a securities class action, Defendants are entitled to take depositions to develop well-recognized defenses such as that the truth was on the market as to the facts as to which the complaint alleges the market was deceived. *See, e.g., Cooke* v. *Manufactured Homes, Inc.*, 998 F.2d 1256, 1262 (4th Cir. 1993) (affirming summary judgment for defendants based on evidence that "the market was so overwhelmed with information questioning the financial integrity of MH by December 17, 1988, that no reasonable trier of fact could conclude otherwise"); *In re Andrx Corp. Securities Litigation*, 296 F. Supp. 2d 1356 (S.D. Fla. 2003) (granting defendant's motion for summary judgment based on the "truth on the market" doctrine because the information available to the market established, as a matter of law, that the market could not

have been unaware of the problems with Andrx's new product). Reliance aside, Plaintiffs and/or their investment advisors who studied a possible investment in Household necessarily had information about the market's evaluation of Household and about what information was on the market at the time. Whether or not Plaintiffs relied on any of that information is not the point. The point is that the state of information on the market at relevant times are facts within the possession of the named Plaintiffs and/or their investment advisors. Since it is clear that Plaintiffs' lawyers will unreasonably object to and/or obstruct written discovery into the basic facts of their claim (*see infra* at 7), Defendants must be afforded, prior to summary judgment and prior to any trial, the opportunity to depose the named Plaintiffs and their investment advisors about this or any other issue relevant to Plaintiffs' claims or Household's defenses.

B. Permitting Defendants to Depose the Named Plaintiffs Will Further the Fairness Goals of the PSLRA

The Private Securities Litigation Reform Act ("PSLRA") was enacted "to curb perceived abuses in the litigation process — widespread initiation and manipulation — of securities class-actions by 'professional' plaintiffs and lawyers." *Mayo* v. *Apropos Technology, Inc*., No. 01 C 8406, 2002 U.S. Dist. LEXIS 1924, at *6 (N.D. Ill. Feb. 7, 2002). To that end, the PSLRA requires potential class representatives in a private securities class action to provide a sworn certification indicating their willingness to serve as a representative party on behalf of a class and their readiness to provide testimony and deposition at trial if necessary. 15 U.S.C. § 78u-4(a)(2)(A)(iii). In so doing, it ensures that representative plaintiffs "authentically seek to oversee the litigation and represent the class." *Burke* v. *Ruttenberg*, 102 F. Supp. 2d 1280, 1320 (N.D. Ala. 2000). This principle — that the representative plaintiffs should be active participants in a case, and not just fronts for class action lawyers— has become an important element of securities class action defense. *See* Tower C. Snow, Jr. et al., *The Trial of a Securities Class Action: Perspective of the Defense*, 1190 PLI/Corp 13, 35 n.6 (2000) (defendants have a right to depose named plaintiffs and those who will represent the class as lead plaintiffs and/or class representatives).

The PSLRA also seeks to promote fairness by discouraging disparities in the parties' ability to conduct discovery. In *In re AOL Time Warner, Inc. Securities Litigation*, No. MDL 1500, 2006 WL 1997704 (S.D.N.Y. July 13, 2006), the court granted a defendant's motion to lift the mandatory stay of discovery that is required by the PSLRA when a motion to dismiss is

pending. The court reasoned that because plaintiffs had access to approximately fourteen million documents produced by defendants in an underlying action, the asymmetry between the parties' access to discovery "turns the rationale of the PSLRA on its head, providing plaintiffs with a substantial unintended advantage as they pursue their litigation strategy." The court continued, "[u]nder the unique circumstances of this case, prohibiting Time Warner's discovery of Plaintiffs while Plaintiffs are able to formulate their litigation and settlement strategy on the basis of the massive discovery Time Warner has already produced constitutes undue prejudice." *Id*. at *3.

The asymmetrical discovery in this action has been exacerbated by the repeated failure of Plaintiffs' counsel to respond to discovery requests in good faith. For example, consider the five interrogatories the Court authorized Defendants to issue in its August 10 Order to try to get to the bottom of Plaintiffs' predatory lending-cum-securities fraud allegations. Plaintiffs were supposed to tell Defendants — four years into this case — whether certain terms used in Plaintiffs' interrogatories (*e.g.*, discount points, single premium credit insurance, prepayment penalties, etc.) fall within the definition of "illegal predatory lending" as used in the complaint. The August 10 Order was necessary because Plaintiffs had asserted meritless objections to Defendants' earlier efforts to obtain this key information. After a week's extension, Plaintiffs finally served their responses, which consist of over 20 pages of objections (most of which have already been rejected by this Court) and "answers" that are only, at best, partially responsive. Indeed, notwithstanding the Order of this Court, Plaintiffs explicitly refused to provide complete answers to any of the interrogatories. We urge the Court to review this outrageous "response", annexed as Exhibit 2, because it exemplifies the continued resistance of Plaintiffs' counsel to comply with their discovery obligations in good faith. Such behavior heightens Defendants' need to pursue discovery from alternate sources, such as the named Plaintiffs themselves.

Plaintiffs' insistence that Defendants are pursuing these depositions solely to impede Plaintiffs' completion of discovery is baseless. Putting aside that the Household Defendants have sought this discovery since December of 2004, and that the current discovery calendar is a direct result of Plaintiffs' failure to proceed efficiently over the past two years, discovery cannot be the one way street Plaintiffs envision. Defendants are seeking a mere *three* Rule 30(b)(6) depositions from the very organizations that sued Household and agreed to serve as named Plaintiffs in this litigation, as well as any relevant investment advisors to the named Plaintiffs. These proposed depositions will come nowhere close to the 55 depositions that have been

alotted to both sides in this case. The truth of the matter is that Plaintiffs have plenty of resources, as evidenced by their steady stream of discovery demands and increasingly burdensome and frivolous motion practice. Moreover, as the Court once suggested, scheduling conflicts could be avoided by carving out a consensual supplemental period after the regular close of fact discovery for the limited purpose of conducting the Household Defendants' depositions.

C. Basic Notions of Fundamental Fairness and Due Process Support Defendants' Discovery Efforts

It is axiomatic that a party is entitled to discovery in order to inform that party's claims or defenses. Under Plaintiffs' reading of the Court's April 2005 decision, the Household defendants are barred from questioning the named Plaintiffs about the merits of their claims or possible defenses until *after* there has been a determination of liability on the issues raised in their Complaint. Presumably, the Household Defendants would have to file their summary judgment motion and prepare for a possible trial on liability without ever having laid eyes upon, much less having questioned, the entities that have sued them for claims of hundreds of millions of dollars. Such a notion is inconsistent with basic notions of due process and fundamental fairness. Defendants did not understand this to be the intent or effect of the Court's April 2005 decision; rather, Defendants understood that they would have an opportunity to conduct their fact discovery at the end of the Plaintiffs' discovery phase. A decision that prevented Defendants from pursuing the discovery of the named Plaintiffs and their investment advisors until *after* any liability determination would be grossly unfair and prevent Defendants from marshalling evidence necessary to mount their summary judgment motion.

II. IF NECESSARY TO AFFORD RELIEF, THE COURT SHOULD RECONSIDER ITS APRIL 2005 DECISION

A court may reconsider a previous decision where it has misunderstood a party, or when there is a change in the law or facts since the submission of the issue to the court. *Tizes* v. *Curcio*, No. 94 C 7657, 1997 U.S. Dist. LEXIS 12926, at *4-5 (N.D. Ill. Aug. 26, 1997), citing *Bank of Waunakee* v. *Rochester Cheese Sales, Inc.*, 906 F.2d 1185, 1191 (7th Cir. 1990). Here, there is ample reason for this Court to reconsider its prior decision and to allow Household to pursue the depositions it seeks from the named Plaintiffs and investment advisors.

The reasons set forth in the preceding argument support reconsideration. Point I, *supra*. To emphasize, this is not about individual reliance discovery (which was the basis of the

Court's prior decision). The Household Defendants are entitled to discover information that was on the market and that informed the market price of Household securities in order to demonstrate that the truth of the risks of investing in Household was on the market. Such evidence is relevant to rebutting Plaintiffs' fraud on the market theory of reliance on a class wide basis. Plaintiffs have conceded that Defendants may seek such information from securities analysts. There is no good reason why Defendants cannot seek this information from the professional investment advisors involved in the named Plaintiffs' investment decisions. Further arguments for revisiting and reversing this Court's prior decision are set forth below.

A. *Harcourt* is a Post-Class Certification Case

In its April 2005 opinion, this Court distinguished cases cited by Defendants as "pre-class certification cases focusing in part on the use of a plaintiff's investment history to challenge the adequacy or typicality to represent the class." 2005 WL 3801463 at, *15. The Court additionally distinguished the case of *In re Harcourt Brace Jovanovich, Inc. Securities Litigation*, 838 F. Supp. 109 (S.D.N.Y. 1993), on the grounds that it "involved a claim of direct reliance on the defendants' misrepresentations and omissions as well as fraud on the market theory." 2005 WL 3801463, at *4 n.6. However, *Harcourt* provides authority for allowing defendants to take discovery from plaintiffs, post-class certification, in a fraud on the market context.

In *Harcourt*, the plaintiff class was certified and six individuals certified as class representatives in May of 1990. *Harcourt*, 838 F. Supp. at 111. Almost two years *after* class certification, in January of 1992, defendants served a document request on plaintiffs that triggered a discovery dispute between the parties. *Id*. Defendants requested documents concerning any other securities litigation to which the named plaintiffs were or had been a party, as well as information concerning publicly traded securities owned or controlled by the named plaintiffs during the relevant period. *Id*. Defendants argued that "since the fraud on the market theory creates a rebuttable presumption of reliance the defendants ought to be allowed discovery which would assist in rebutting such presumption." *Id*. at 112. It is true that in *Harcourt*, plaintiffs were asserting both fraud on the market and direct reliance theories. However, the court cited *Basic, Inc*. v. *Levinson* for the proposition that in a fraud on the market case, "[t]he causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations." *Id*. at 112-113 quoting

Basic, 485 U.S. at 241-2.

B. Pre-Certification Cases are Relevant and Support Discovery

In addition to the post-certification case of *Harcourt*, the weight of authority in pre-certification cases lies in favor of allowing defendants discovery of plaintiffs' investment histories for reasons other than exploring adequacy, typicality and other class certification issues.[5] The Household Defendants are mindful that the Court was especially interested in post-certification decisions. However, because as a practical matter proposed class representatives are questioned on merits issues at the pre-certification stage, many decisions reported in the class certification context address both class *and* merits issues. Here, Defendants stipulated to class certification while preserving all defenses to the merits of Plaintiffs claims. Class Stipulation ¶ 6. The Court's prior ruling in effect penalizes the Household defendants for stipulating to class certification. It is unfair and prejudicial to refuse the Household Defendants the opportunity to depose the named Plaintiffs and their investment advisors prior to summary judgment and/or prior to a trial on class wide liability because they stipulated to Class Certification.

CONCLUSION

For the foregoing reasons (i) the Household Defendants should be permitted to proceed with depositions of the named Plaintiffs and their investment advisors; and (ii) to the extent necessary to afford relief, this Court should reconsider its April 18, 2005 decision to permit such discovery to go forward.

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[5] *See* The Household Defendants' Memorandum of Law In Opposition to Lead Plaintiffs' Motion for Protective Order and the authority cited therein, which is incorporated by reference.

Dated: October 27, 2006

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