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, v. HOUSEHOLD INTERNATIONAL, INC., et al., Defendants.	Lead Case No. 02-C-5893 (Consolidated) CLASS ACTION Judge Ronald A. Magistrate Judge Nan R. Nolan

THE HOUSEHOLD DEFENDANTS' OBJECTIONS TO MAGISTRATE JUDGE NOLAN'S NOVEMBER 13, 2006 RULING DENYING MOTION FOR LEAVE TO DEPOSE NAMED PLAINTIFFS AND CERTAIN INVESTMENT ADVISORS

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Defendants Household International, Inc., Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilmer, and J.A. Vozar (collectively the "Household Defendants" or "Defendants") respectfully submit these Objections to Magistrate Judge Nolan's November 13, 2006 ruling (entered on the Court's docket and electronically served on the parties on November 16) denying the Household Defendants' Motion for leave to depose the named Plaintiffs and certain investment advisors (the "November 13 Ruling").

PRELIMINARY STATEMENT

Magistrate Judge Nolan has ruled that the Household Defendants cannot take merits depositions of (i) the three named Plaintiffs in this securities fraud class action; and (ii) three investment advisors to one of the named Plaintiffs — until *after* there has been a class-wide determination (if any) on the issue of liability. This ruling is clearly erroneous, contrary to law, and fundamentally unfair.

In contrast to Plaintiffs, who have already taken 34 of the 55 depositions they were allowed by the Magistrate Judge (with the balance to be completed before January 31), Defendants have taken only one — a pre-class certification deposition of named Plaintiff PACE Industry Union-Management Pension Fund ("PACE"), whose representative claimed to have no information whatever about its investment in the stock of Household International, Inc. Thereafter, in the vain hope of preserving resources and achieving an early resolution on the merits, Defendants elected to stipulate to class certification on Plaintiffs' Rule 10b-5 claims, while expressly reserving all of their defenses on the merits against the class and the named plaintiffs. Despite their acceptance of that express reservation, Plaintiffs successfully argued before Magistrate Judge Nolan that the named Plaintiffs (and the investment advisors who reportedly made investment decisions for PACE) are in effect immune from pre-trial merits discovery because individual reliance is not germane to a fraud on the marketplace showing, and because the named Plaintiffs' individual experiences cannot be extrapolated on a class-wide basis.

The basic flaw in this aspect of the Ruling is the incorrect assumption that individual reliance is the only possible issue on which Defendants might question Plaintiffs or their investment advisors. It ignores Defendants' right to test the merits of the named Plaintiffs' individual claims (even in a fraud in the marketplace context) and to depose the named Plaintiffs or their surrogates on merits issues that are indisputably common to the class. Key examples of the

latter — such as Defendants' need to establish what factors other than the supposed fraud influenced the price of Household International securities at particular times during the Class Period — were conflated with the different issue of individual reliance, and therefore rejected as proper subjects of depositions of the named Plaintiffs during the merits phase of the case.

Yet even Plaintiffs agree that an exploration of the state of the market is relevant during the liability phase of this case, as evidenced by their suggestion that Defendants pursue this subject through depositions of financial analysts covering Household. The Magistrate Judge has in fact authorized Defendants to depose third parties for this purpose, but ruled on November 13 that the availability of relevant information from other sources eliminated Defendants' "need" to depose Plaintiffs and their surrogates, and that Defendants had not demonstrated that they would suffer "undue prejudice" by the disallowance of these depositions. Ex. 1 at 3, 5.[1]

Needless to say, Rule 26 does not require a defendant to show need and undue prejudice as a condition of deposing a plaintiff on concededly relevant subjects. The anomalous result of imposing such standards here is that Defendants may pursue discovery on common issues by imposing the cost and burden of compliance on entities that are complete strangers to this litigation, but may not put the same questions to the named Plaintiffs, who are required under the Private Securities Litigation Reform Act of 1995 ("PSLRA") to make themselves available for depositions in this matter.

Another unfair consequence of the November 13 Ruling is that if any issues should survive summary judgment, Plaintiffs are likely to appear at trial to try to put a sympathetic spin on their claims, without allowing Defendants to ask even basic deposition questions about their constituents, operations, investments and alleged grievance. In the usual situation, where extensive discovery on class certification precedes a Rule 23 motion, a defendant has the opportunity to explore such background in detail, often obviating the need for pure merits depositions later. Among other benefits (in addition to reducing the element of surprise at trial and uncovering potential defenses against particular named plaintiffs), such discovery usually en-

[1] All exhibits ("Ex") referenced herein are attached to the Declaration of Landis C. Best in Support of Household Defendants' Objections to Magistrate Judge Nolan's November 13, 2006 Ruling Denying Motion for Leave to Depose Named Plaintiffs and Certain Investment Advisors.

hances a defendant's ability to evaluate possible exposure in any trial of an action and thus make more informed decisions about the relative benefits of trying the case or exploring the possibility of a settlement. Here, in contrast, Defendants are in effect being penalized for stipulating to class certification by being denied any access to Plaintiffs or their surrogates until after any trial of this action. Even without considering the grossly disproportionate burden of discovery Defendants have borne in this action (as summarized in this Court's November 22, 2006 Memorandum and Order), the notion that a named plaintiff in a securities fraud class action is immune from pre-trial merits discovery cannot be reconciled with the letter or spirit of the Federal Rules of Civil Procedure or the PSLRA, or with basic notions of fairness.

We respectfully submit that the November 13 Ruling is clearly erroneous and contrary to law because it imposed a heightened standard of need and undue prejudice on Defendants as a condition of exercising their fundamental right to depose their adversaries before trial, while relieving Plaintiffs of their burden of demonstrating undue hardship or expense to justify the entry of this extraordinary protective order in their favor. The ruling is also clearly erroneous because by focusing too narrowly on whether individual reliance is a suitable subject for pre-trial discovery in this context, it incorrectly held that the broader merits discovery sought by Defendants was not relevant during the liability phase of this case. In the interest of justice, and in keeping with the liberal Federal rules governing discovery and the obligations Plaintiffs assumed under the PSLRA, the November 13 Ruling should be overruled insofar as it precludes Defendants from deposing Plaintiffs (or PACE's investment advisors) until after the conclusion of any trial in this action.

PROCEDURAL HISTORY

On September 24, 2004, prior to the eventual stipulated class certification, the Household Defendants deposed Maria Wieck, an individual that named Plaintiff 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, Ms. Wieck disclaimed personal knowledge about this subject, but identified various investment managers who made investment decisions on behalf of PACE as the individuals knowledgeable about the reasons for selecting Household securities for purchase or sale.

On October 8, 2004 the parties stipulated to class certification in this case, which

stipulation was approved and entered by this Court on December 3, 2004. Ex. 3. The stipulation provides that "[t]he parties agree that nothing herein precludes the parties from making any and all substantive arguments concerning the claims of the named plaintiffs and/or the Class". *Id.* at ¶4.

On December 6, 2004, the Household Defendants served fourteen non-party subpoenas on PACE's investment advisors seeking relevant documents, including information relating to PACE's investment history and facts in their possession concerning Household and/or the consumer finance industry. Ex. 4, "Categories of Documents" at 3.[2] Three of these subpoenas also sought deposition testimony.[3] Ex. 5. At least one of the third parties was prepared to produce responsive documents.[4]

On January 11, 2005, Plaintiffs moved to quash these non-party subpoenas. On April 18, 2005, Magistrate Judge Nolan ruled in favor of "bifurcating discovery regarding class liability issues and discovery regarding individualized reliance issues" by granting Plaintiffs' motion to quash the subpoenas and putting a protective order in place to preclude these depositions. Magistrate Judge Nolan stated that the "need for this discovery at this time is outweighed by the burden imposed on the third-parties and the Class." Ex. 2 at 10.

On April 24, 2006, the Household Defendants served Rule 30(b)(6) deposition notices on the three named Plaintiffs, PACE, Glickenhaus & Co. ("Glickenhaus"), and the International Union of Operating Engineers Local No. 132 Pension Plan ("Local 132") (collectively

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2 The Household Defendants withdrew the subpoenas for three entities who informed defense counsel that PACE was never a client. Thus, eleven (11) third-party subpoenas are currently outstanding.

3 The parties were operating at that time under the 10 deposition limit set forth in the Federal Rules. Magistrate Judge Nolan initially increased this limit to 35 and has now permitted both sides to take 55 depositions. If given the right to take the depositions of PACE's investment advisors, Defendants would consider taking more than the three originally set forth in their prior subpoenas. Defendants also would consider seeking deposition testimony of any investment advisors to the other two named Plaintiffs, if relevant.

4 On December 7, 2004, counsel for one of the non parties subpoenaed by Defendants (Thompson Siegel & Walmsley) called defense counsel and said that his client was gathering responsive documents and should be able to meet the December 20, 2004 deadline for production specified in the subpoena. Best Decl. ¶ 7.

"named Plaintiffs" or "Plaintiffs"). Each of the notices requests a witness prepared to testify as to, *inter alia,* certain allegations in the [Corrected] Amended Consolidated Complaint (the "Complaint"), and the information consulted by the named Plaintiffs or their advisors in connection with their investment in Household International, Inc. Ex. 6.

The notices stated that the depositions would take place "[a]t such time as the Household Defendants are allowed by the Court to take discovery of the individual named plaintiffs and their agents." At several status conferences throughout 2006, counsel for the Household Defendants raised the issue of taking depositions of Plaintiffs. Ex. 1 at 2; Ex. 7 at 36-43 ; Ex. 8 at 74-86. The Court deferred any decision. At the October 19, 2006 status conference, Plaintiffs argued that the rationale of Magistrate Judge Nolan's April 2005 decision precluded Defendants from ever deposing Plaintiffs or their investment advisors prior to any trial of this action. Magistrate Judge Nolan asked Defendants to submit relevant authority supporting their oral motion to depose the named Plaintiffs and their financial advisors. Magistrate Judge Nolan also stated during this conference that Defendants' time to object to her ruling "would start from [a ruling on] this oral motion". Ex. 8, *supra* at 82. Defendants submitted relevant authority on the issue on October 27, 2006, and Plaintiffs responded on November 3, 2006.

On November 13, 2006, Magistrate Judge Nolan ruled in favor of the Plaintiffs, anticipating a bifurcated trial and holding that the Household Defendants were not entitled to depose the named Plaintiffs or their investment advisors in this dispute, until after the conclusion of the liability phase. Ex. 1, *supra*. The decision conflates all possible merits issues with the isolated issue of individual reliance (*see id.* at 3-4), and relies almost exclusively on a case in which the plaintiffs alleged direct reliance, not fraud on the market. *See id.* at 3. The decision also concludes that Defendants had not demonstrated sufficient "need" to depose their opponents on the merits (*see id.* at 3), and that Defendants had not demonstrated "undue prejudice" justifying merits depositions of Plaintiffs until after a trial on liability. *See id.* at 5.

Magistrate Judge Nolan's opinion was entered on the docket and served electronically on all parties on November 16, 2006. Accordingly, the Household Defendants submit these Objections to Magistrate Judge Nolan's November 13, 2006 Ruling.

STANDARD OF REVIEW

Rule 72(a) provides that in reviewing a discovery-related order issued by a magistrate judge, the district judge "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 Weeks v. Samsung Heavy Indus. Co.*, 126 F.3d 926, 943 (7th Cir. 1997); *For Your Ease Only, Inc. v. Calgon Carbon Corp.*, No. 02 C 7345, 2003 WL 21475905, at *3 (N.D. Ill. June 20, 2003);[5] 12 Charles Alan Wright, Arthur R. Miller and Richard L. Marcus, Federal Practice and Procedure 2d § 3069 (2006). Under the clear error review standard, a judge may overturn a magistrate judge's ruling if "the district court is left with the definite and firm conviction that a mistake has been made." *Weeks*, 126 F.3d at 943; *see also Anderson v. City of Bessemer City*, 470 U.S. 564, 573 (1985); *Ocean Atl. Woodland Corp. v. DRH Cambridge Homes, Inc.*, No. 02 C 2523, 2004 WL 609326, at *3 (N.D. Ill. Mar. 23, 2004). A magistrate judge's legal conclusions are subject to de novo review. *McFarlane* v. *Life Ins. Co.*, 999 F.2d 266, 267 (7th Cir. 1993); *Todd* v. *Corporate Life Ins. Co.*, 945 F.2d 204, 207 (7th Cir. 1991).

ARGUMENT

A. The November 13 Ruling Erroneously Imposed Standards of Admissibility, Undue Prejudice and Need.

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). 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. Of particular significance here, the scope of discovery under Rule 26 is not limited to admissible matters. Rather, "relevance for discovery purposes is more generous than it is for determining admissibility of evidence at trial." *Merix Pharm. Corp. v. Glaxosmithkline Consumer Healthcare, L.P.*, No. 05 C 1403, 2006 U.S. Dist. LEXIS 77388 (N.D. Ill. Oct. 11, 2006). Rule 26 does not require a party to demonstrate need or undue preju-

[5] All unreported cases cited herein are contained in the appendix to this memorandum.

dice as a condition of deposing its adversary. Rather the party *seeking* protection from a deposition notice must demonstrate that the requested discovery would be abusive, oppressive, or unduly burdensome, *see* Fed. R. Civ. P. 26(c), and bears the burden of demonstrating that the requested discovery should be disallowed. *See Petersen v. Union Pacific Railroad Co.*, 2006 WL 2054365, at *1 (C.D. Ill. July 21, 2006).

In contravention of these governing standards, the November 13 Ruling evaluated whether evidence elicited from individual named Plaintiffs would be admissible at an envisioned liability-only trial (concluding incorrectly that it would not be, as discussed below), and without imposing any burden on the party opposing discovery, it evaluated Defendants' deposition notices under standards of undue prejudice and need.. *See* Ex. 1 at 3. ("[T]here is no need to depose the individual named Plaintiffs in order to determine what information was on the market." *See also id.* at 5 ("Defendants have not demonstrated any unique circumstances, undue prejudice, or due process concerns that would justify allowing them to depose the named Plaintiffs and their financial advisors prior to a determination of class-wide liability"). In fact, Defendants easily satisfy even these heightened burdens, but as these were not the appropriate standards to apply to a routine request to depose an opponent before trial, this Court does not have to consider such aspects in order to overrule the November 13 Ruling.

A party is entitled to "obtain discovery regarding any matter, not privileged, that is relevant to the claim or defense of any party" Fed. R. Civ. P. 26(b)(1). Requiring the party *seeking* discovery to demonstrate "need", "unique circumstances, undue prejudice or due process concerns" before allowing discovery to which Defendants are *presumptively* entitled turns the standard upon its head. The November 13 Ruling should be overruled because it improperly shifted the burden of proof to Defendants, which is incorrect as a matter of law.

B. The Discovery Sought is Relevant to Defendants' Liability Defense

In ruling that depositions of the named Plaintiffs and their agents may not proceed before an assumed liability-only trial, the November 13 Ruling accepted Plaintiffs' argument that virtually all of the discovery Defendants sought on the motion below boiled down to individual reliance issues. On that basis, the November 13 Ruling concluded (incorrectly) that information in the possession of the named Plaintiffs or their investment advisors was "irrelevant". Magis-

trate Judge Nolan placed considerable reliance on *In re Vivendi Universal, S.A.*, No. 02 Civ. 5571(RJH), 03 Civ. 2175(RJH), 2004 WL 876050, at *5 (S.D.N.Y. Apr. 22, 2004) for the proposition that Defendants' truth on the market defense does not depend on representations made to any individual plaintiff. Ex. 1 at 3. However, the reason *In re Vivendi* stated that "the truth on the market defense has nothing to do with plaintiffs' individual claims" was because the plaintiffs in that case were asserting *direct reliance*, not fraud on the market.

Passing for the moment whether it was erroneous to deny Defendants pre-trial discovery about the named Plaintiffs' state of reliance, the basic flaw in this aspect of the Ruling is the incorrect assumption that reliance is the only possible issue on which Defendants might question Plaintiffs or their investment advisors. Plainly there are other key issues as to which discovery of Plaintiffs and their agents is entirely appropriate now — before issue is joined at the summary judgment stage or at trial. One obvious example is the congruence of factors that accounted for the level and movement of the price of Household International's securities at various points during the relevant period. This Court emphasized the cardinal relevance of this issue in its November 22, 2006 Memorandum and Order about the temporal scope of certain documentary discovery in this matter. *See id.* at 8, *citing Dura Pharms. Inc. v. Broudo*, 544 U.S. 336, 343 (2005). As the Supreme Court explained in *Dura*, a lower stock price may be caused by a host of market factors unrelated to fraudulent misrepresentations, including "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." *Id.*

A related issue that Defendants highlighted below is an exploration of the truth that was on the market at relevant points in time during the Class Period. 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*. *See* 485 U.S. at 246, 108 S. Ct. 978 . . .. Thus if the truth or the nature of a business risk is widely known, an incorrect statement can have 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). To that end, it is well-settled that truth on the market serves as a de-

fense to claims brought under a 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). Magistrate Judge Nolan agreed in her November 13 Ruling that "a misrepresentation is immaterial if the information is already known to the market because the misrepresentation cannot then defraud the market" Ex. 1 at 3, citing *Ganino* v. *Citizens Utilities Co.*, 228 F.3d 154, 167 (2d Cir. 2000)). Magistrate Judge Nolan also agreed that "[i]f the market has become aware of the allegedly concealed information, the fact allegedly omitted by the defendant would already be reflected in the stock's price and the market will not be misled." *See* Ex. 1, *supra*, at 3, citing *Provenz v. Miller*, 95 F. 3d 1376, 1391 (9th Cir. 1996) (citations omitted)).

Under the "truth on the market" corollary to the fraud on the market presumption, *any* truthful material information, from *any* market source, can be relevant to the defense. It does not matter whether the source is an analyst, investment advisor, press release or newspaper reporter, as long as the information is publicly known. *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); *Rand* v. *Cullinet*, 847 F. Supp. 200, 203 (D. Mass. 1994) (granting defendant's motion for summary judgment because any misstatements or omissions "were corrected and rendered immaterial by subsequent information brought into the market by Cullinet and others"); *In re Apple Computers Security Litigation*, 886 F.2d 1109, 1115 (9th Cir. 1989) (affirming summary judgment for defendants based on "truth on the market" doctrine for statements where the "information [had] been made credibly available to the market by other sources").

Defendants are entitled to explore information regarding what named Plaintiffs (or their investment advisors, if relevant) knew about the nature of and risks inherent in Household's business — because such information will help identify what public information was

known to the market, an indisputably relevant subject. Plaintiffs do not disagree, but at their urging, Defendants have been given leave to seek such material only from third parties unrelated to the named Plaintiffs.

However, Plaintiffs allege that Defendants made material misstatements or omissions about Household International's alleged "illegal predatory lending practices", restructuring of loans and/or accounting treatment for certain contracts. Whatever the truth or falsity of those allegations, in order to develop evidence in connection with a "truth on the market" defense, Defendants are entitled to discover what facts were already known to the market about Household International's business model and operations. For example, did the market know the extent to which Household utilized any of the discrete products or practices that Plaintiffs condemn as "illegal predatory practices"? Was the market aware that Household was (a) a subprime lender that was highly regulated, (b) subject to various legislation, lawsuits and fines as a result of its lending practices, or (c) engaged in discussions with various State Attorneys General and regulators with respect to its lending practices? In light of Plaintiffs prolix, 154-page Complaint, the other areas of inquiry relevant to Defendants' truth on the market defense are extensive.

Significantly, Plaintiffs concede the relevance of such discovery for purposes of Rule 26 by arguing that Defendants should obtain some of this information through the depositions of stock analysts, rather than from the named Plaintiffs or their agents. But there is no principled reason for that distinction, and Defendants are not required to limit their search for relevant information to sources proposed by Plaintiffs' counsel. Defendants note that pension plans and their investment advisors have a fiduciary duty to research and evaluate investment decisions (s*ee Jenkins* v. *Yager*, 444 F.3d 916, 927 (7th Cir. 2006)("A trustee is required to use due care and diligence when investing plan funds, meaning that he or she must 'employ[] the appropriate methods to investigate the merits of the investment and to structure the investment.'")(citing *Eyler* v. *C.I.R.*, 88 F.3d 445, 454 (7th Cir. 1996)), and that named Plaintiff Glickenhaus & Co. is itself an SEC-registered investment advisor presumably employing a staff of analysts. The irony (and logical inconsistency) of the November 13 Ruling is that Defendants now have been directed by Magistrate Judge Nolan (as urged by Plaintiffs) that they may depose

any third-party analyst *except* those third parties who are connected to the named Plaintiffs as their investment advisors.[6]

Obviously information in the possession of the Plaintiffs is just as relevant as information in possession of analysts, and arguably more so, because if information was known to the named Plaintiffs (who traded in Household securities) or their investment advisors (who were themselves professional money managers and as sophisticated as many stock analysts), then it can be shown that the information was *in fact* known to "the market" for Household securities.

C. Defendants Are Entitled to Merits Discovery Relevant to Defenses to the Named Plaintiffs' Claims Prior to any Class-Wide Trial

The November 13 Ruling reaffirmed Magistrate Judge Nolan's April 18, 2005 Ruling (Ex. 2, *supra*) and denied the documentary discovery and depositions that Defendants sought from named Plaintiff PACE's investment advisors until *after* a determination of class-wide liability. These rulings ignore the weight of authority, set forth below, that allows discovery into plaintiffs' investment histories in securities fraud actions.

Plaintiffs bear the burden of showing reliance in this securities fraud class action. Plaintiffs have indicated that to meet that burden they intend to rely on a "fraud on the market" presumption of reliance — a presumption that can be rebutted. *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. Magistrate Judge Nolan recognized that a defendant can rebut the fraud on the market presumption of reliance by "(1) disproving materiality; (2) despite materiality, showing an insufficient number of traders relied to inflate

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[6] At the October 4 Status Conference, Judge Nolan stated with respect to depositions: "you can [depose] the [analysts] you know already, so I want you to get them their names, and we'll let you know on the three named plaintiffs after Allison and I read the April order." Ex. 7, *supra*, at 47. Counsel for the Plaintiffs agreed: "If they want to depose analysts who were covering [H]ousehold, if they want to depose other third parties who they think might have relevant information, we're not objecting to that at all." *Id.* at 38.

the price; (3) showing that an individual plaintiff purchased despite knowledge of the falsity of a representation; or (4) showing that an individual plaintiff would have purchased anyway had he known of the falsity of the representation." Ex. 2, *supra*, at 5, citing *Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975).

There is no question that the named Plaintiffs' investment histories are relevant in this matter. Plaintiffs conceded and Magistrate Judge Nolan recognized that the information is relevant. Ex. 2 at 6; 7, n.5, citing Pl. Jan. 11, 2005 Br. at 6-7. Magistrate Judge Nolan, however, accepted Plaintiffs' argument to postpone "discovery related to individual claims and defenses until after class-wide liability has been determined." Ex. 2 at 11.

This decision to postpone discovery into individual reliance issues of the named Plaintiffs is erroneous for a number of reasons. First, postponing discovery until *after* a class-wide trial on the merits is simply too late, given the pressure that mounts *before* trial in a massive securities fraud class action such as this one. Establishing that a named Plaintiff did not rely on the market (but invested for other reasons) would defeat *that* named Plaintiff's claim. Certainly such information is significant to the overall strategy of the case. Yet, the Household Defendants will not be able to factor such discovery into their summary judgment, trial, and mediation or settlement strategy, even though the underlying information will remain fully accessible to Plaintiffs' counsel.

Second, such information could lead to a defense on a class-wide basis if found to be true for a significant number of class members. *See Easton & Co. v. Mut. Ben. Life Ins. Co.*, 1994 WL 248172, at *4 (D.N.J. May 18, 1994)("[I]f the discovery shows that a significant number of class members who were purchasers in the market had information . . . it would tend to prove that the market was not defrauded, and thus the benefit of the 'fraud on the market' presumption would be unavailable on a common basis to any of the class members.").

Finally, Magistrate Judge Nolan's Ruling in effect punishes the Household Defendants for stipulating to class certification. As a practical matter, proposed class representatives are questioned on merits issues at the pre-certification stage. Here, Defendants stipulated to and did not contest class certification, thereby significantly conserving the parties' (and this Court's) time and resources. However, Defendants expressly reserved "all substantive arguments concerning the claims of the named plaintiffs and/or the Class." Ex. 3, *supra*, at ¶ 4. It is

unfair and prejudicial to refuse to allow the Household Defendants the standard opportunity to depose the Lead Plaintiffs and their investment advisors on reliance issues simply because they stipulated to class certification. A plaintiff's investment history is normally relevant to adequacy and typicality of a prospective lead plaintiff precisely *because* that information "bears on the merits of the case." *See Roseman Profit Sharing Plan* v. *Sports and Recreation*, 165 F.R.D. 108, 111 (M.D. Fla. 1996); *In re Grand Casinos, Inc.*, 181 F.R.D. 615, 620 (D. Minn. 1998) ("[w]ith regard to the merits of the Plaintiffs' claims, we are persuaded . . . that the proposed discovery of the Lead Plaintiffs' investment histories and strategies could lead to the discovery of admissible evidence; namely, evidence which could serve to rebut any presumption that they relied on the integrity of the market"). Future securities fraud class action defendants may be unwilling to stipulate to class certification if they know that by doing so they will forfeit their right to depose the named plaintiffs in a timely fashion.

In addition, *post*-class certification cases recognize that defendants are entitled to discovery from the named plaintiffs relevant to rebut the presumption of reliance on the merits. *See Cooper v. Pacific Life Ins. Co.*, __ F. Supp. 2d __, No. CV 203-131, 2006 WL 2699135, at *4 (S.D. Ga. Sept. 18, 2006); *Grossman* v. *Waste Mgmt., Inc.*, 589 F. Supp. 395, 405-06 (N.D. Ill. 1984) (defendant can show that decision to purchase was based on factors "wholly extraneous to the market" in order to rebut fraud on the market theory); *In re Harcourt Brace Jovanovich, Inc. Sec. Lit.*, 838 F. Supp. 109, 112 (S.D.N.Y. 1993) ("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 a presumption").

The April 18 Ruling that was ratified by the November 13 Ruling relied heavily on *In re Lucent Technologies Inc. Securities Litigation*, No. Civ.A. 00-621JAP, 2002 WL 32818345 (D. N.J. May 7, 2002) for the proposition that the investment behavior of certain named parties was not relevant to reliance issues. However, in *Lucent*, the issue was not whether discovery should be had from the lead plaintiffs (because that discovery *was obtained*), but whether there should be discovery from non-representative plaintiffs who were treated as "absent class members" for the purposes of discovery. *Id.* at *1; see also *In re Lucent Technologies Inc. Securities Litigation*, No. 2:00-CV-621, 2002 WL 32815233, at *1 (D. N.J. July 16, 2002) (ruling on objections to district court). In *Lucent*, there was no challenge to the defendants' right to

obtain discovery of the *lead plaintiffs*' investment history – which is precisely what Defendants are seeking in the instant case.

The effect of quashing this discovery is to turn the rebuttable presumption of fraud on the market into a conclusive presumption improperly. Defendants should be permitted discovery into reliance issues *now, when it matters* — rather than waiting until any future (and likely very lengthy and costly) class-wide trial on the merits.

D. Defendants Should be Allowed to Depose the Named Plaintiffs as a Matter of Due Process and to Further the Fairness Goals of the PSLRA

It is axiomatic that a party is entitled to discovery in order to inform that party's claims or defenses. Under the November 13 Ruling, 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. As noted above, 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 taken the lead in suing them for hundreds of millions of dollars. Merely stating such a proposition serves to refute it. The November 13 Ruling, which imposes a radically one-sided approach to discovery, is inconsistent with basic notions of due process and the fundamental fairness goals of the PSLRA.

The PSLRA was designed "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).

Discovery cannot be the one way street Plaintiffs envision. Defendants are seeking Rule 30(b)(6) depositions from the three organizations that sued Household and agreed to serve as Lead Plaintiffs in this litigation, as well as any relevant investment advisors to the Lead Plaintiffs. These proposed depositions will come nowhere close to the 55 depositions that have been allotted to both sides in this case, just as the few categories of documents Defendants seek are a miniscule fraction of the millions of pages of documents they have been required to produce. In view of the extraordinary discovery imbalances noted by the Court in its November 22, 2006 Memorandum and Order, Plaintiffs' argument that Defendants are pressing these long-standing deposition notices only to hobble their discovery efforts deserves no answer. Suffice it to say allowing these depositions will not compromise the January 31, 2007 fact discovery cut-off. As Magistrate Judge Nolan once suggested, scheduling conflicts could be avoided by having a supplemental period after the regular close of fact discovery for the limited purpose of conducting the Household Defendants' depositions.

CONCLUSION

For the foregoing reasons this Court should sustain the Household Defendants' Objections to the Magistrate Judge's November 13, 2006 Memorandum Opinion and Order.

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