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' REPLY BRIEF IN FURTHER SUPPORT OF MOTION TO COMPEL ANDREW KAHR DOCUMENTS IMPROPERLY WITHHELD AS PRIVILEGED OR DESTROYED BY THE HOUSEHOLD DEFENDANTS

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I. INTRODUCTION

Defendants' response to the Class' Motion to Compel the Andrew Kahr Documents speaks volumes for what it fails to do: It fails to satisfy defendants' burden of demonstrating that the attorney-client privilege applies, *i.e.*, that communications with Mr. Kahr were made for the purpose of obtaining legal advice between an attorney and a client; it fails to demonstrate that Household's[1] lawyers were anything but a conduit to cover up improper matters contained in Mr. Kahr's communications; it fails to demonstrate that Mr. Kahr was necessary to Household for obtaining legal advice; it fails to demonstrate that Document No. 2740 on Exhibit A was prepared in anticipation of litigation; it fails to take an unequivocal position that no Kahr memos were ordered destroyed at the most senior level with the knowing participation of defendants David Schoenholz and William Aldinger; it fails to explain why there was a specific memo at the most senior level discussing the disposition of a specific category of documents relating to a specific individual and why that was in the "normal course of business" for Household.

The Household Defendants believe that this Court will just accept their version of Mr. Kahr's role at Household, despite the disputed factual evidence showing otherwise. This fact-finding role is reserved for the trier of fact, and the Class has presented an inordinate amount of evidence demonstrating that not only were Mr. Kahr's ideas for growth initiatives adopted, Mr. Kahr was instrumental in ensuring their implementation and the sales training that ensured the success of his initiatives. Ironically, defendants appear to have paid Mr. Kahr multi-millions over the course of three years to generate ideas that they now claim were not adopted.[2]

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[1] "Household" or the "Company" refers to Household International, Inc. as that term is defined in the operative Complaint.

[2] Defendants produced heavily redacted documents indicating that Household paid about $2.36 million in compensation to Mr. Kahr between September 1999 and July 2002. *See* Reply Declaration of Azra Z.

If, as defendants now claim, Mr. Kahr's initiatives were not implemented, where does the question of privilege arise at all? If defendants' alternative contention is to be given any credence, that Mr. Kahr's ideas were not implemented in the form he suggested – again, this begs the question, what privilege attaches to his communications? How do defendants explain the fact that Mr. Kahr only dealt with the most senior level executives at Household? How do defendants explain the fact that Household continued to retain Mr. Kahr up until June 2002, when they affirmatively blocked his access to Household shortly after damning memos written by Mr. Kahr promoting deceptive sales practices for Providian were exposed to the public by the San Francisco Chronicle.

Based on defendants' complete failure to carry the heavy burden of establishing that the Kahr Documents on Exhibit A and A-1 (attached hereto) are protected by privilege, they should be ordered to produce these documents.[3] Additionally, given defendants' failure to adequately explain what happened to the Kahr memos that were ordered destroyed, the Class seeks appropriate sanctions pursuant to Fed. R. Civ. P. 37, including a recommendation for an adverse inference instruction for defendants' failure to preserve and/or knowing destruction of relevant documents despite notice.

Mehdi in Further Support of the Class' Motion ("Mehdi Reply Decl."), Ex. 3, filed herewith. The Class questions the validity of these documents because nothing on these documents indicates a payment to Andrew Kahr. Rather, the payments are to a "Cable GL." *Id.* Defendants have not provided any reliable evidence demonstrating the link between Mr. Kahr and "Cable GL."

[3] After the Class filed its motion, defendants added two more documents on their privilege log pertaining to Andrew Kahr. *See* Exhibit A-1. Accordingly, the Class believes that these two documents should also be produced for the same reasons outlined in the Class' opening brief and reply.

II. ARGUMENT

A. Defendants Have Failed to Carry Their Burden of Demonstrating that the Attorney-Client Privilege Applies to the Kahr Documents

Generally, the Seventh Circuit finds the attorney-client privilege is in derogation of the search for truth and must be strictly construed. *United States v. White*, 970 F.2d 328, 334 (7th Cir. 1992). Thus, the mere assertion of a privilege is not enough; instead, a party that seeks to invoke the attorney-client privilege has the burden of establishing all of its essential elements. *See United States v. BDO Seidman*, 337 F.3d 802, 811 (7th Cir. 2003) (internal citations omitted). Here, defendants have not met the burden of establishing all the elements of the attorney-client privilege with respect to the Kahr Documents. Significantly, defendants have failed to establish that the Kahr Documents reflect communications necessary for "legal advice," that Household's lawyers were anything more than shields for Mr. Kahr's improper and deceptive ideas generated for the benefit of Household, or that Mr. Kahr was indispensable for Household's obtaining legal advice.

As an initial matter, defendants concede that "Mr. Kahr was an outside consultant who generated ***marketing*** ideas." Defs' Mem. (Dkt. No. 917) at 1. Indeed, Mr. Detelich, the CEO of Household's Consumer Lending business unit testified that Mr. Kahr's "***whole purpose in our organization was to help us think about different ways to do business***." Mehdi Reply Decl., Ex. 1 at 189 (emphasis added). While the Class has laid out detailed evidence of Mr. Kahr's initiatives with documentation, defendants' response fails to demonstrate that "legal advice" – the cornerstone of the assertion of attorney-client privilege – was sought from Mr. Kahr as opposed to business advice relating to sales or marketing ideas. *See* Class' Mot. (Dkt. No. 895) at 3-10. The attorney-client privilege is restricted to those instances where employees secure legal, not business, advice or services, or where in-house counsel provides legal advice or legal services to corporate personnel. *See Kramer v. Raymond Corp.*, Civ. No. 90-5026, 1992 U.S. Dist. LEXIS 7418, at *4 (E.D. Pa. May 26, 1992) (privilege applies where a "corporation . . . clearly demonstrate[s] that the communication

in question was made for the express purpose of securing legal not business advice"). Defendants have not, contrary to their assertions, demonstrated that the communications with Mr. Kahr related to legal, as opposed to business advice. Defendants' descriptions in the privilege logs (Exs. A and A-1) do not become legal, merely because they throw in the talismanic phrase "legal advice." Additionally, Mr. Kahr in his own words did not describe himself as someone who was in the position to give legal advice. Mehdi Decl. (Dkt. No. 896), Exs. 21-22; Class Mot. at 8-9.

The mere fact that Mr. Kahr's ideas were subsequently subject to legal review does not render these ideas into "legal advice." Indeed, in *McCaugherty v. Siffermann*, 132 F.R.D. 234, 238 (N.D. Cal. 1990) – a case relied upon both by the Class and defendants – although the external consultant hired for the express purpose of selling the Federal Savings Bank, the Court required parties to make a showing with competent evidence (by way of declaration or otherwise) that would support an inference that the communication was made primarily in order to generate legal advice and that neither business purposes nor regulatory requirements would have provided sufficient incentive to make the communication. *Id.* at 239 (citing *Fisher et al. v. United States et al.*, 425 U.S. 391, 403 (1975)) ("No privilege can attach to any communication as to which a business purpose would have served as a sufficient cause.") The Court insisted that the declarations must be by the author of the communication or by the person at whose direction the communication was made. *Id.* Here, defendants have failed to provide any such declaration, but rather offer conclusory statements that the documents are subject to the attorney-client privilege.

Not surprisingly, given the plain language contained in a number of Mr. Kahr's memos (*see* Mehdi Decl., Exs. 13, 21-23) demonstrating that Household's legal department was merely used to funnel through communications with Mr. Kahr (*see* Class' Mot. at 8-10), defendants do not even attempt to address this point in their response. Their silence is telling, particularly given Mr. Kahr's certainty that Household's legal department would approve anything so long as he described it as a

"legal" practice. *Id.* Other memos illustrate how Mr. Kahr used Household's legal department as a pawn to do his bidding and replace any adverse written opinion with a new opinion that effectively allowed Household to adopt the initiatives he proposed. *See* Mehdi Decl., Ex. 23; Class' Mot. at 9. Again, for these reasons as well, the Court should examine critically defendants' assertions of attorney-client privilege as to the Kahr Documents. *See B.F.G. of Illinois, Inc. v. Amentech Corp*., No. 99 C 4604, 2001 U.S. Dist. LEXIS 18930, at *15 (N.D. Ill. Nov. 8, 2001) (courts in this district do not "tolerate the use of in-house counsel to give a veneer of privilege to otherwise non-privileged business communications").

Defendants' attempt to extend the attorney-client privilege to the Kahr Documents on the basis of an agency argument, also fails. Defs' Mem. at 3-4. The cases relied upon by defendants are all distinguishable. In those cases, although the attorney-client privilege protection was extended to external consultants under certain circumstances in each of those cases, the external consultants were hired specifically to deal with a subject matter that involved legal matters. For example, the subject matter of the documents at issue in the *FTC v. GlaxoSmithKline*, 352 U.S. App. D.C. 343, 294 F.3d 141, 145 (D.C. Cir. 2002), was for patent infringement and all the teams that received the documents were "'involved in seeking or giving legal advice and/or gathering and recording information in anticipation of or preparation for litigation.'" *Id. See also In re Bieter Co.*, 16 F.3d 929, 931-34 (8th Cir. 1994) (independent consultant submitted a declaration that his primary responsibility was to secure tenants for the development and work with architects, consultants, and counsel, and appeared at public hearings before the City Council and the Planning Commission and subsequently in the litigation that resulted from the failure to develop said property); *McCaugherty*, 132 F.R.D. at 247 (requiring a declaration supporting an inference that communications were made for purpose of legal advice). Defendants make no such argument here. Rather, they concede that

"***Mr. Kahr was an outside consultant who generated marketing ideas***." Defs' Mem. at 1 (emphasis added).

Moreover, as detailed in the Class' opening brief, in considering the applicability of the attorney-client privilege to outside consultants, "courts have been cautious in extending its application." *Freeport-McMoran Sulphur, LLC v. Mike Mullen Energy Equip. Res., Inc*., No. 03-1496, 2004 U.S. Dist. LEXIS 10048, at *15-*16 (E.D. La. June 2, 2004) (citing *United States Postal Service v. Phelps Dodge Refining Corp.*, 852 F. Supp. 156, 161 (E.D.N.Y. 1994)) (finding that outside scientific consultants hired to conduct an environmental audit and to oversee remedial work were not agents for the purposes of the privilege). Further, courts generally take into consideration many factors to make the determination whether the attorney-client privilege applies to external consultants, including, whether the consultants: (1) were incorporated in the staff to perform a corporate function, which is necessary in the context of actual or anticipated litigation; (2) possessed information needed by attorneys in rendering legal advice; (3) possessed authority to make decisions on behalf of the company; and (4) were hired because the company lacked sufficient internal resources and/or adequate prior experience within the consultant's field. *See In re Bristol-Myers Squibb Secs. Litig.*, Civ. No. 00-1990 (SRC), 2003 U.S. Dist. LEXIS 26985, at *12-*13 (D.N.J. June 25, 2003) (citing *Upjohn Co. v. United States*, 449 U.S. 383, 390 (1981)); *In re Copper Mkt. Antitrust Litig.*, 200 F.R.D. 213, 215-220 (S.D.N.Y. 2001). Here, defendants have failed to meet the factors above.

Finally, defendants have failed to demonstrate that Mr. Kahr was indispensable to the Company obtaining legal advice. Class' Mot. at 10. Again, just like their failure to address a number of other arguments raised by the Class, defendants have nothing to say in response. The reason is simple – Mr. Kahr was neither providing legal advice, not was he critical to the provision of legal advice by anyone else.

Accordingly, given defendants' failure to carry their burden, the attorney-client privilege does not attach to any of the Kahr Documents. Thus, they should be produced in their entirety.

B. The Fact-finder, Rather than This Court, Makes Findings Regarding Household's Self-Serving Statements that Andrew Kahr's Ideas Were Not Adopted in the Face of the Overwhelming Evidence Presented by The Class Demonstrating that Mr. Kahr's Ideas Were Indeed Implemented at Household During the Class Period

In addition to contesting the relevance of Mr. Kahr's consumer lending ideas, defendants dispute whether these ideas were ever adopted. Defs' Mem. at 1-3. Leaving aside the question of whether this Court is in the position to occupy the role of the trier of fact and make determinations as to factual disputes, the Class' opening brief provided detailed examples on how at least two of Mr. Kahr's ideas were part of Household sales practices – hiding prepayment penalties in detailed loan terms, the "effective rate" interest rate scam. Class' Mot. at 5-8. These practices were central to the deceptive practices at issue in the multi-state Attorneys General ("AG") $484 million settlement. Additionally, if defendants' recent production is accurate and complete, defendants paid Mr. Kahr at least $2.36 million. Mehdi Reply Decl., Ex. 3. This fact also begs the questions – why pay someone multi-millions for his ideas if they are not acceptable to the Company?

Defendants have not, and cannot present any contemporaneous contradictory evidence from the Class Period to dispute the Class' assertion. All they offer instead are self-serving, out-of-context snippets of testimony. Defendants conveniently neglect to quote portions of the deposition transcripts that indicate that Mr. Kahr's ideas were indeed adopted. For example, Mr. Detelich testified that Household's Pay Right Rewards program was an alternative mortgage qualifying under AMPTA and was an idea that may have come from Mr. Kahr. Mehdi Reply Decl., Ex. 1 at 186-289. Indeed, Mr. Detelich clarified an earlier statement he had made regarding Mr. Kahr's ideas: "When I said he has a lot of ideas, not a lot of good ones, he has a few good ones." *Id*. at 189.

Even the portions of testimony defendants rely upon underscore the witnesses' uncertainty one way or the other whether Mr. Kahr's initiatives were adopted, or indicate that Mr. Kahr's initiatives evolved over time. The mere fact that at present the Class does not possess all the documents that were generated by Mr. Kahr and does not have any verification given the memo that was circulated amongst Chief Information Officer ("CIO") Ken Harvey, defendants Aldinger and Schoenholz and General Counsel Ken Robin regarding the compilation and disposition of the Kahr documents (*see infra* §II.D), the Court should defer making any factual findings regarding what initiatives were adopted and in what form.

C. Defendants Failure to Defend Their Assertion of Work Product on Document No. 2740 Mandates Production in Its Entirety

With respect to Document No. 2740, defendants asserted both attorney-client privilege as well as work-product. As detailed in the Class' opening brief, it is apparent from defendants' description in the log that this document was neither created by an attorney, not was it created in "anticipation of litigation." *See* Class' Mot. at 11-12. Defendants do not even attempt to defend their assertion of the work-product doctrine on this document. That's because they cannot. Accordingly, the Court should order the production of Document No. 2740 based also upon defendants' failure to satisfy their burden of demonstrating that work-product protects this document.

D. Defendants Do Not and Cannot Deny that Relevant Evidence Was Knowingly Destroyed Notwithstanding Ongoing and Threatened Litigation

Defendants' response to the Class' detailed and well-supported arguments regarding defendants' destruction of the Kahr memos makes it clear that defendants believe that the Court will simply ignore the overwhelming evidence of defendants' spoliation. Defendants assert that they have "no reason to believe that any Kahr-related documents were destroyed ***after the start of this litigation***. . ." Defs' Mem. at 4 (emphasis added). The e-mail from the CIO Ken Harvey to

defendants Schoenholz and Aldinger and General Counsel Ken Robin discussing the gathering and disposition of the documents is dated ***June 24, 2002 - before the start of this litigation***. *See* Ex. C attached hereto.[4] Significantly, June 24, 2002 is the very same day that Household received a data request from the Washington Attorney General's office for information relating to Household's sales practices in advance of the multi-state AG negotiations relating to the AG complaints regarding Household's predatory lending practices. *See* Mehdi Reply Decl., Ex. 2 at 3. This fact alone is dispositive not only of the relevance of the Kahr Documents, but also that the disposition was intentional. *See Zubulake v. U.S. Warburg LLC*, 220 F.R.D. 212, 220 (S.D.N.Y. 2003) (When evidence is destroyed or rendered unavailable in bad faith or through gross negligence, this fact alone is sufficient to satisfy the relevance requirement).

Even more significantly, Household already knew that the group of AG were contemplating litigation against the Company because on June 22, 2002 (two days before the e-mail instructing the destruction of all Kahr memos was exchanged), Household attorney Denis O'Toole sent Rich Blewitt of the public relations firm Rowan & Blewitt an e-mail "requesting expert assistance in providing legal advice regarding threatened AG litigation" with an attached chart. *See* Ex. B attached hereto. In *Anderson v. Sotheby's Inc. Severance Plan*, 04 Civ. 8180 (SAS), 2005 U.S. Dist. LEXIS 23517, at *15-*16 (S.D.N.Y. Oct. 11, 2005), the court found that where a party claims that it reasonably anticipates litigation as of a certain date, that party's duty to preserve documents arises as of that date. *See also Alliance to End Repression v. Rochford*, 75 F.R.D. 438, 440 (N.D. Ill. 1976) (imposing discovery sanctions on defendants where document destruction occurred before filing of the lawsuit where defendants were aware that a lawsuit would be filed). Here, defendants were aware even in 2001 that certain states had issued subpoenas relating to Household's predatory

[4] This exhibit was also attached to the Mehdi Decl., as Ex. 27.

lending practices. *See* Mehdi Reply Decl., Ex. 2. Notwithstanding this awareness, defendants recklessly ordered the destruction of relevant evidence.

Defendants' assertion that "if any Kahr-related documents were discarded or destroyed in the normal course [of business] . . . Defendants cannot produce material that they do not possess," begs the question of what was "normal course of business" at Household. Defs' Mem. at 4. The e-mail by CIO Ken Harvey discussing the compilation and destruction of the Kahr memos as well as defendant Schoenholz' response that a note should be sent out to on "disposing" all Kahr memos is anything but "normal course of business." *Anderson*, 2005 U.S. Dist. LEXIS 23517, at *11 ("the obligation to preserve evidence even arises prior to the filing of a complaint where a party is on notice that litigation is likely to be commenced"). Importantly, here as in *Alliance*, defendants have not stated that document destruction here in issue was in the ordinary course of business. *Alliance*, 75 F.R.D. at 440.[5]

Defendants have also failed to offer any explanation as to why a specific category of documents relating to one specific individual, *i.e.*, the Kahr memos were the only subject selected for disposition during the "normal course of business," or why only a handful of the memos were produced when in fact Mr. Kahr submitted at least 266 memos. Class' Mot. at 11. Indeed, the plain language of Ex. C, unequivocally discusses the destruction of evidence. Given that defendants do not and cannot deny destruction of relevant evidence, a recommendation for an adverse inference arising out of those documents is the only appropriate remedy here.

[5] Given the facts that have developed this far, it would not be surprising, however, if defendants mean that it was normal course of business for Household to dispose of anything that was detrimental.

III. CONCLUSION

For the foregoing reasons as well as the reasons outlined in the Class' opening motion (Dkt. No. 895) and supporting Declaration, the Court should order defendants to produce the Kahr Documents that defendants have improperly withheld on the basis of privilege. With respect to the Kahr Documents compiled and knowingly destroyed pursuant to the June 24, 2002 e-mail, the Class respectfully requests a recommendation for an adverse inference. The Class would be happy to submit a proposed order relating to this request.

DATED: January 24, 2007

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 January 24, 2007, declarant served by electronic mail and by U.S. Mail to the parties the: **THE CLASS' REPLY BRIEF IN FURTHER SUPPORT OF MOTION TO COMPEL ANDREW KAHR DOCUMENTS IMPROPERLY WITHHELD AS PRIVILEGED OR DESTROYED BY THE HOUSEHOLD DEFENDANTS**. 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 24th day of January, 2007, at San Francisco, California.

s/ Monina O. Gamboa
MONINA O. GAMBOA