United States District Court, Northern District of Illinois

Name of Assigned Judge or Magistrate Judge	Ronald A. Guzman	Sitting Judge if Other than Assigned Judge	
CASE NUMBER	02 C 5893	DATE	2/1/2007
CASE TITLE	Jaffe vs. Household Int'l, Inc. et al.		

DOCKET ENTRY TEXT

For the reasons provided in this Minute Order, the Court overrules the Household defendants ("Household") and the class' objections to Magistrate Judge Nolan's December 6, 2006 Order and adopts the ruling in full. The Court grants the class' Motion to Compel Documents Pertaining to Household's Consultations with Ernst & Young LLP ("E&Y") [doc. no. 708] and denies the class' Motion to Compel Further Responses to the Class' Questions for Per Eckholdt Concerning Exhibit 13 and the Production of Documents Underlying Wilmer, Cutler & Pickering Reports [doc. no. 712].

■[For further details see text below.] Docketing to mail notices.

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Under Federal Rule of Civil Procedure 72(a) a magistrate judge "to whom a pretrial matter not dispositive of a claim or defense of a party is referred to hear and determine shall promptly conduct such proceedings as are required and when appropriate enter into the record a written Order setting forth the disposition of the matter." Fed. R. Civ. P. 72(a). Routine discovery motions are not dispositive. *Adkins v. Mid-Am. Growers, Inc.*, 143 F.R.D. 171, 175 n.3 (N.D. Ill. 1992). The Federal Rules of Civil Procedure grant magistrate judges broad discretion in resolving discovery disputes. *Heyman v. Beatrice Co.*, No. 89 C 7381, 1992 WL 245682, at *2 (N.D. Ill. Sept. 23, 1992). A magistrate judge's ruling on a nondispositive matter may only be reversed on a finding that the ruling is "clearly erroneous or contrary to law." Fed. R. Civ. P. 72(a); *see* 28 U.S.C. § 636(b)(1). Although Household argues that issues of law referred to and decided by a magistrate judge are reviewed *de novo*, the two cases cited do not support the proposition because one case cited does not address the issue and in the other case cited, the parties had consented to proceed before the magistrate judge and thus the appellate court was reviewing the magistrate judge's rulings as if the magistrate judge were the district court judge in that instance.

The Court notes that neither party has fully complied with LR5.2(b) with regard to line spacing or font size requirements of text and footnotes. The Court orders both parties to comply with the Local Rule in all future filings in this case.

I. Household's Objections

Household objects to Magistrate Judge Nolan's December 6, 2006 Order to the extent that it grants the class' Motion to Compel Documents Pertaining to Household's Consultations with E&Y. Household argues that Magistrate Judge Nolan's rulings that the E&Y documents fit within the attorney-client privilege

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exception enunciated in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), and that the class has established "substantial need" to rebut the work product protection afforded the E&Y documents were clearly erroneous. The Court disagrees.

Household argues that the magistrate judge should not have applied the *Garner* exception in this nonderivative suit because two post-*Garner* Supreme Court decisions, *Upjohn Co. v. United States*, 449 U.S. 383, 392-93 (1981), and *Swidler & Berlin v. United States*, 524 U.S. 399, 409 (1998), denote a preference for bright line rules when it comes to the attorney-client privilege so that corporations may order their affairs without unpredictability. However, neither case mentions *Garner* or addresses the facts presented in *Garner*. Household also points to several district court cases that have rejected the *Garner* exception. However, as Magistrate Judge Nolan noted, the Seventh Circuit recognizes a fiduciary exception to the attorney-client privilege, *Bland v. Fiatallis N. Am., Inc.*, 401 F.3d 779, 787 (7th Cir. 2005), and other circuits have held *Garner* applies even in nonderivative suits, *Fausek v. White*, 965 F.2d 126, 130-31 (6th Cir. 1992), *Ward v. Succession of Freeman*, 854 F.2d 780, 786 (5th Cir. 1988). Further, the Seventh Circuit has mentioned *Garner* with approval in *In Re Witness Before Special Grand Jury 2000-2*, 288 F.3d 289, 294 (7th Cir. 2002), stating that "a corporate attorney has no right or obligation to keep otherwise confidential information from shareholders." Given that there is no binding authority that *Garner* is not good law or is inapplicable in a nonderivative suit and there is no indication that this circuit is hostile to the particular privilege exception, the Court holds that Magistrate Judge Nolan's application of *Garner* was not clearly erroneous.

Household also argues that it was clear error for Magistrate Nolan to hold that there was mutuality of interest when the E&Y documents were created. Household argues that it was inappropriate for Magistrate Judge Nolan to consider the evidence that the class represents a substantial majority of shareholders who owned stock at the time of the communications at issue because the class presented such evidence in its reply brief. However, the issue was broached in plaintiffs' opening brief when the class argued that the *Garner* exception should apply because the action is being brought on behalf of a large percentage of shareholders and Household did not contest or address this assertion in its response brief. Further, given Magistrate Judge Nolan's experience with the defendants and their willingness to file sur-replies and supplements to briefing during discovery in this case, the Court holds that it was not clear error for her to exercise her discretion and consider the evidence raised in the class' reply brief. Thus, the Court agrees with Magistrate Judge Nolan that Household did not contest the issue.

Household also argues that the evidence that the class represents a substantial majority of shareholders who owned stock at the time of the communications at issue was unreliable and thus Magistrate Judge Nolan's reliance on that evidence was clearly erroneous. As stated above, however, the issue whether a large percentage or a substantial majority of shareholders is/are represented by the class was uncontested, and it was not clear error for Magistrate Judge Nolan to concentrate her efforts on the contested issues before the court. In addition, Magistrate Judge Nolan considered a host of other factors that contributed to her determination that plaintiffs had established good cause, *see Garner v. Wolfinbarger*, 430 F.2d 1093, 1104 (5th Cir. 1970) (listing indicia of good cause): (1) the class' claim of illegal conduct (securities fraud) was colorable and had survived motions to dismiss; (2) there are no trade secrets involved; (3) a protective order exists; (4) the requested information concerns past actions that are the subject of the instant litigation; (5) E&Y is not a law firm and was not acting as an agent of in-house counsel; (6) E&Y's investigation did not require a separate legal analysis or expertise; and (7) it does not appear that the class could obtain from another source the underlying data E&Y used in conducting the investigation. Based on the facts and arguments before her, the magistrate judge properly found that plaintiffs had established good cause to invoke the *Garner* exception to the attorney-client privilege.

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Further, Magistrate Judge Nolan did not err in holding that the class had overcome the work product protection in relation to the E&Y documents. Magistrate Judge Nolan properly rejected Household's broad argument that the E&Y documents were opinion work product merely because they would reveal to the class the nature and focus of the work being conducted by E&Y at the request of Household's attorneys. Simply put, all E&Y documents did not automatically become attorney opinions or mental impressions merely because they were created at the behest of an attorney. Household has not met its burden in showing that the E&Y documents are opinion work product. In addition, this Court agrees with Magistrate Judge Nolan that the plaintiffs have shown substantial need and undue hardship with regard to the E&Y documents. The documents shed great light on a number of issues in this case, *e.g.*, the falsity of Household's statements regarding predatory lending practices, as well as scienter and materiality. It would be nearly impossible for plaintiffs to obtain all of the specific data provided to E&Y or to re-create the investigation from depositions and other documents.

II. The Class' Objections

The class objects to Magistrate Judge Nolan's December 6, 2006 Order to the extent that it denies the class' Motion to Compel Further Responses to the Class' Questions for Per Eckholdt Concerning Exhibit 13 and the Production of Documents Underlying Wilmer, Cutler & Pickering Reports (collectively "WilmerHale documents"). The class argues that Magistrate Judge Nolan committed clear error when she ruled that the WilmerHale documents were protected by the attorney-client and work product privileges and that Household's production of the WilmerHale documents to the SEC did not waive the privileges because the selective waiver doctrine applied.

The class argues that the WilmerHale documents are not protected by the attorney-client or work product privilege. Having read the restructuring report, the engagement letter and related documents (including but not limited to Eckholdt's responses to questions regarding Exhibit 13), this Court agrees with Magistrate Judge Nolan that all communications and documents relating to the WilmerHale investigation are privileged because they clearly involve what the law firm considered to be legally relevant facts to form the attorneys' opinions regarding materiality under the SEC laws and were created because of the *Markell* case against Household and the SEC's investigation of Household. The Court agrees that the documents were created for the benefit of Household and not just Household's Audit Committee as shown by the engagement letter. Magistrate Judge Nolan also properly found that the class had not overcome the work product privilege to the extent that it sought to compel fact work product because there is no substantial need for the underlying documents for cross-examination purposes if Household does not introduce the restructuring report at trial and no undue hardship because the class has the underlying data KPMG used to test the accuracy of the restructuring report as well as the report itself.

Next, the class argues that Magistrate Judge Nolan's application of the selective waiver theory to the WilmerHale documents that Household produced to the SEC under a confidentiality agreement constituted clear error. The Seventh Circuit has not yet determined whether to adopt the selective waiver theory and the Supreme Court has chosen not to resolve the issue, *see Qwest Communications International Inc. v. New England Health Care Employees Pension Fund*, 127 S. Ct. 584 (2006) (denying writ of certiorari). Thus, Magistrate Judge Nolan was not bound by any authority to reject the theory.

Further, Magistrate Judge Nolan's ruling is well-reasoned. In support of her ruling, she relied on the sound rationale provided in *In re Steinhardt Partners, L.P.*, 9 F.3d 230, 236 (2d Cir. 1993), a case decided in

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the Second Circuit, which adjudicates a large volume of securities cases. That courts in other circuits disagree with the Second Circuit does not necessarily mean that Magistrate Judge Nolan's reliance on *In re Steinhardt Partners* was clear error.

In *In re Steinhardt Partners*, the court declined to adopt a *per se* rule that all voluntary disclosures to the government waive work product protection. *Id.* The Second Circuit stated that "[c]rafting rules relating to privilege in matters of governmental investigations must be done on a case-by-case basis." *Id.* (citing *Upjohn Co. v. United States*, 449 U.S. 383, 396 (1981)). In doing so, the Second Circuit recognized that "[e]stablishing a rigid rule would fail to anticipate situations in which the disclosing party and the government may share a common interest in developing legal theories and analyzing information, or *situations in which the SEC and the disclosing party have entered into an explicit agreement that the SEC will maintain the confidentiality of the disclosed materials*." *Id.* (emphasis added). This Court finds, as did Magistrate Judge Nolan, this reasoning persuasive as it strikes a proper balance between all of the countervailing policy considerations.

Magistrate Judge Nolan found, and this Court agrees, that the confidentiality agreement between Household and the SEC precludes waiver of privilege in this case. The agreement stated that: (1) Household did not "waive the protections of the attorney work product doctrine, attorney-client privilege or any other privilege applicable as to third parties" and (2) the SEC agreed that it would maintain the confidentiality of the disclosed materials "to the extent that the Staff determines that disclosure is otherwise required by law or would be in furtherance of the Commission's discharge of its duties and responsibilities." (Order of 12/6/06 34; Beer Decl., Ex. H at 1-2.)

The class is not put at a disadvantage by the court's permitting privileged information to be disclosed to the SEC because Household presumably would not have revealed confidential information to it without the confidentiality agreement or the privilege. *See Upjohn*, 449 U.S. at 395. Thus, the class is not in a worse position now than if the privileged communication had never occurred in the first place. Without the protection of such confidentiality, corporate clients will be less apt to root out problems, openly discuss potential liability with their attorneys or cooperate with government investigations.

The Court agrees with the reasoning of the court in *Saito v. McKesson HBOC, Inc.*, which states that "[t]he SEC and private litigants alike benefit from confidential disclosures because the integrity of the capital markets is preserved at a lower cost to society." No. Civ. A. 18553, 2002 WL 31657622, at *8 (Del. Ch. Nov. 13, 2002), *aff'd*, 870 A.2d 1192 (Del. 2005). The *Saito* court explained that "[w]hen the SEC more efficiently protects the integrity of capital markets, shareholders benefit." *Id.*

In sum, the Court agrees with Magistrate Judge Nolan that the selective waiver exception is applicable based on the particular facts of this case. Accordingly, the Court rejects the class' objections. For the reasons stated above, the Court also rejects Household's objections. The Court adopts Magistrate Judge Nolan's December 6, 2006 Memorandum Opinion and Order in full and grants the class' Motion to Compel Documents Pertaining to Household's Consultations with E&Y and denies the class' Motion to Compel Further Responses to the Class' Questions for Per Eckholdt Concerning Exhibit 13 and the Production of Documents Underlying Wilmer, Cutler & Pickering Reports.