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' MOTION FOR RECONSIDERATION OF THE COURT'S JANUARY 24, 2007 ORDER FINDING WAIVER OF KPMG DOCUMENTS, BUT PRECLUDING DISCLOSURE FOR FAILURE TO DEMONSTRATE PREJUDICE

REDACTED VERSION

I. INTRODUCTION

The Class respectfully moves the Court for reconsideration of its January 24, 2007 Order (Dkt. No. 931), finding that although the Household Defendants had waived privilege on certain KPMG audit letters, the Class could not use these documents because it had "not demonstrated that they have suffered, or will suffer, any prejudice due to Defendants' untimely recall." Order at 1. A motion for reconsideration is appropriate here because the Court did not allow the Class the opportunity to make any showing respecting prejudice, but rather made its decision on this issue without the Class having an opportunity to be heard. It is also appropriate because the Court imposed a requirement upon the Class, *i.e.*, "a demonstration that the Class will suffer undue prejudice," that does not have a basis in law. Even if the Class were required to demonstrate undue prejudice, it can make this showing given that these documents are key evidence respecting senior management's knowledge of material litigation and what management provided to its auditors.

Accordingly, for these reasons, the Court should grant the Class' motion for reconsideration of the January 24, 2007 Order and allow the Class to use the audit letters. At a minimum, fairness mandates that the Court permit the Class discovery of the selected highlighted excerpts of these letters, which the Class has already relied upon in its preparation of the case.[1]

II. LEGAL ARGUMENT

A. Standard on a Motion for Reconsideration

A motion for reconsideration is appropriate where "(1) the court has patently misunderstood a party; (2) the court has made a decision outside the adversarial issues presented to the court by the parties; (3) the court has made an error not of reasoning but of apprehension; (4) there has been a

[1] These documents are attached as Exhibits A – I to the Declaration of Azra Z. Mehdi in Support of the Class' Motion for Reconsideration ("Mehdi Decl."), filed herewith. Notably, the Class has not highlighted any entries in the audit letters addressing this case.

controlling or significant change in the law since the submission of the issue to the court; or (5) there has been a controlling or significant change in the facts since the submission of the issue to the court." *United States v. Ligas*, No. 04 C 930, 2005 U.S. Dist. LEXIS 12365, at *1 (N.D. Ill. May 17, 2005) (citing *Bank of Waunakee v. Rochester Cheese Sales, Inc.*, 906 F.2d 1185, 1191 (7th Cir. 1990)).

Here, the Court made a determination that notwithstanding defendants' waiver of the KPMG documents, the Class had not demonstrated that it has suffered, or will suffer, any prejudice due to defendants' untimely recall. Order at 1. Because the Court made this determination "outside the adversarial issues presented to the Court by the parties," inasmuch as the Class did not have an opportunity to present any arguments, this situation presents the type of situation where "[a] grievous wrong may be committed by some misapprehension or inadvertence by the judge for which there would be no redress." *Bank of Waunakee*, 906 F.2d at 1192. For the reasons detailed below, the Court should grant the Class' motion and reconsider its January 24, 2007 Order.

B. The Court Erred in Failing to Allow the Class to Make a Record of the Adversarial Issues to Preserve Its Rights

The issue of defendants' waiver with respect to certain KPMG documents was first raised in the Class' Status Report filed on January 8, 2007 and thereafter discussed at the January 10, 2007 status conference. Dkt. No. 889 at 9-10; January 10, 2007 Hearing Tr. at 101-115. At that status conference, the Class explained how defendants belatedly objected to the Class using certain audit letters at the December 7, 2006 deposition of Kenneth Robin. During the January 10, 2007 status conference, the Court requested certain information from Household regarding which of the KPMG documents were duplicates and which were never before the Court as part of the prior Arthur Andersen briefing. January 10, 2007 Hearing Tr. at 111-112. The Class offered to brief this issue, but the Court declined this offer. *Id.* at 118 ("We're going to let you know whether we need it. We may not need a brief.") On January 12, 2007, the Household Defendants provided the Court with a

list of 36 documents, only seven of which were identical to those that were covered by the Court's July 6, 2006 ruling, but 29 documents were never before this Court.

The Court subsequently concluded that "defendants have offered no reasonable explanation for their failure to bring the KPMG documents to the Court's attention in a timely manner," but nonetheless ruled that the documents are protected without giving the Class an opportunity to present any argument. Order at 1. Earlier during this hearing, the Court recognized the difficulty that parties have in appealing issues where they are not permitted to make a record under the bifurcated Magistrate Judge/Judge system. In response to a suggestion by defense counsel to "table" an issue raised by the Class, the Court stated:

> I can't table it because of this bifurcated system with Judge Guzman. Because if they want to take an appeal or you want to take an appeal of anything I do, I think the magistrate judges, our sort of integrity, falls on the right of people to take these appeals. So, I mean, that's part of why I feel like why we have got to crank out these opinions so that you have got — you have got ten days by statute. You have got to do it.

January 10, 2007 Hearing Tr. at 73. Thus, the Class should be permitted to address the issue of prejudice not only to give this Court the opportunity to consider these points but also to make a record of the Class' arguments to preserve the right to appeal.

C. The Court's Requirement that the Class Must Demonstrate Undue Prejudice Is Erroneous

As an initial matter, there is no basis in law for the requirement that the Class make a demonstration of undue prejudice before finding that defendants' waiver mandates discovery. Under the balancing test applied by courts in this District in making a determination whether there is waiver, courts consider "the reasonableness of the precautions taken to prevent the disclosure, the time taken to rectify the error, the scope of discovery, the extent of the disclosure, and the overriding issue of fairness." *R. J. Reynolds Tobacco Co. v. Premium Tobacco Stores, Inc.*, No. 99 C 1174, 2001 U.S. Dist. LEXIS 17602, at *19-*20 (N.D. Ill. Oct. 16, 2001). Undue prejudice to the

discovering party, however, is not a factor in this balancing test. Indeed, courts that have considered the fairness factor, have required that the party seeking to maintain the documents as privileged demonstrate actual prejudice to the producing party as a result of disclosure, not the other way around. *See e.g.*, *Wunderlich-Malec Sys., Inc. v. Eisenmann Corp.*, No. 05C 04343, 2006 U.S. Dist. LEXIS 84889, at *22-*23 (N.D. Ill. Nov. 17, 2006) (finding that the party seeking to maintain the document as privileged despite waiver must show "actual prejudice beyond what is naturally felt by a party who loses a privilege."). Thus, the Court erroneously imposed a requirement upon the Class that has no basis in existing law.

D. The Class Can Demonstrate that It Will Suffer Undue Prejudice from the Court's Decision to Bar Discovery of the KPMG Documents

Assuming *arguendo* that the Class must show prejudice, it can do so here. As an initial matter, the Court recognized that "[i]t is inconceivable that Defendants were unaware that both Arthur Andersen and KPMG served as [Household's] outside auditors," and that audit letters were produced to the Class by both of these auditors. Order at 1. Yet, the Class has been and will be deprived of the opportunity of using these KPMG audit letters at depositions, such as the deposition of Kenneth Robin as well as the upcoming depositions of Individual Defendants Joe Vozar and David Schoenholz, as well as Arthur Andersen, Household former outside auditor. Such deprivation alone constitutes prejudice. Significantly, these documents have probative value on the issue of falsity, scienter and materiality.

A central claim in this securities fraud litigation is that defendants did not disclose to the public the level of risk due to litigation from Household's predatory lending practices, or the impact of the predatory lending practices on Household's bottom line. ¶¶104-106.[2] Here, the Class has no

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[2] All ¶¶__ refer to the [Corrected] Amended Consolidated Class Action Complaint for Violation of the Federal Securities Law.

alternative evidence to demonstrate what senior management knew about pending litigation or what litigation Household's senior management deemed to be material. For example, the January 14, 2002 audit letter (HI KPMG 007007-7046) lists factual information regarding the claims made by the Minnesota Department of Commerce. The letter provides as follows:

Mehdi Decl., Ex. A at HI KPMG 007022.[3] This document, thus, establishes senior management's awareness of the Minnesota regulatory investigation and that senior management considered this investigation to be material.

Other audit letters contain similar factual evidence. In the July 17, 2002 audit letter (HI KPMG 017298-304) the following are all factual recitations relevant to the Class' case:

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[3] These are all pure facts. There are no opinions included in this excerpt.

Mehdi Decl., Ex. B at HI KPMG 017299-301.

Additionally, the letter demonstrates that Household senior management failed to disclose other significant material information to its auditors. Although it lists the ongoing investigations by the group of Attorneys General, it fails to include the fact that internally defendants had already estimated the cost of the "predatory lending litigation" to Household. Other audit letters provide evidence that Household failed to inform its auditors of other key facts and litigation. Compare Mehdi Decl., Ex. A at 7-8 (January 14, 2002 letter, discussing *Monroe* case) and Mehdi Decl., Ex. H at 7 (January 13, 2003 letter, discussing *Monroe* case).

The evidence represented by these audit letters is probative of falsity, scienter and materiality – all of which are elements of a securities fraud action. For instance, in *Bairnco*, the court found that the opinions rendered by Keene Corporation's counsel concerning the condition of asbestos-related litigation, as well as the underlying facts and information passed to Keene from counsel, were clearly

relevant to the central issue of scienter. *Bairnco Corp. Sec. Litig. v. Keene Corp.*, 148 F.R.D. 91, 100 (S.D.N.Y. 1993).

Further, defendants will no doubt offer the KPMG and Arthur Andersen audit opinions at trial. However, it would be patently unfair result to allow defendants here to hide behind its auditors' opinions, yet prohibit the Class from access to the very documents that the auditors relied on. *See United States v. Bilzerian*, 926 F.2d 1285, 1292-93 (2d Cir. 1991) (a defendant may not use the privilege to prejudice his opponent's case or to disclose some selected communications for self-serving purposes).

The Class has submitted as exhibits hereto relevant audit letters and, for the Court's convenience, has highlighted those portions of the letters with particular relevance. To the extent the Court were to limit the production of the audit letters to these highlighted portions, the Class requests that the Court also issue a finding to the effect that defendants did not disclose any other relevant material litigation to either of their auditors.

The Class cannot obtain the substantial equivalent of the KPMG materials without undue hardship, if at all. Depriving the Class these letters to prove its case work an undue prejudice on the Class. Hence, the Court should reconsider its January 24, 2007 Order and permit discovery of the KPMG documents. At a minimum, the Court should permit the Class discovery the highlighted portions.

III. CONCLUSION

For all the foregoing reasons, the Court should grant the Class' motion to reconsider its January 24, 2007 Order.

DATED: February 7, 2007

Respectfully submitted,

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