

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

LAWRENCE E. JAFFE PENSION PLAN, On)	Lead Case No. 02-C-5893
Behalf of Itself and All Others Similarly)	(Consolidated)
Situated,)	
) <u>CLASS ACTION</u>
Plaintiff,)	
) Judge Ronald A. Guzman
vs.)	Magistrate Judge Nan R. Nolan
)
HOUSEHOLD INTERNATIONAL, INC., et)	
al.,)	
)
Defendants.)	
_____)	

**THE CLASS' OBJECTION REGARDING MAGISTRATE JUDGE'S FAILURE TO
ENFORCE THIS COURT'S FEBRUARY 1, 2007 ORDER REQUIRING PRODUCTION
OF ERNST & YOUNG LLP COMPLIANCE AUDIT DOCUMENTS AND REQUEST
FOR EXPEDITED CONSIDERATION**

I. INTRODUCTION

On February 1, 2007, this Court issued an Order compelling Household International, Inc. (“Household”) to produce all documents respecting a compliance audit done by Ernst & Young LLP (“E&Y”) (“February 1 Order”). In that February 1 Order, which considered and adopted the Magistrate Judge’s December 6, 2006 Order, this Court rejected Household’s arguments to limit the production of the E&Y documents to a specific date range, such as the Class Period (July 30, 1999 through October 11, 2002), holding “the Court agrees with Magistrate Judge Nolan that Household did not contest the issue.” February 1 Order at 2. Subsequent to this Order, Household withheld numerous documents on the grounds that they were generated after October 11, 2002, the end of the Class Period. Then, Household disclosed existence of 400 boxes of E&Y work papers, which E&Y had provided in 2004 to Household pursuant to its request. The Class moved to compel production of these documents; however on February 27, 2007¹ the Magistrate Judge effectively reconsidered this Court’s February 1 Order and accepted Household’s post-Class Period argument. The Class sought reconsideration of this February 27 ruling, which motion was denied from the bench orally on March 12, 2007. As the Magistrate Judge was without authority to reconsider arguments already rejected by this Court and that were waived by not being raised during the initial briefing, the Magistrate Judge’s rulings are contrary to law. Accordingly, this Court should sustain this objection and direct Household to produce all E&Y compliance audit documents immediately. The Class requests expedited consideration of the objection since its resolution will save the parties and the Magistrate Judge considerable effort that would be rendered necessary if this objective is sustained.

¹ The Magistrate Judge’s Order is dated February 27, but was served on the parties on March 5, 2007. The Class shall refer to this Order and the other orders by the date indicated on the Order and not the service date. This Objection is timely filed within ten days of the February 27 Order.

II. FACTUAL BACKGROUND

On October 16, 2006, the Class filed its motion with the Magistrate Judge seeking all documents relating to the E&Y compliance audit, which Household had asserted were privileged under the attorney-client privilege and the attorney work product doctrine. Class' Motion to Compel Production of Documents Pertaining to Household's Consultations with Ernst & Young LLP (Dkt. No. 708) ("MTC"). As to the attorney-client privilege, the Class argued, *inter alia*, that under the *Garner* exception, the Class was entitled to all such documents. In opposition, the Household defendants advanced various arguments, but did not contest the Class' showing of the mutuality of interest between the Class and Household's management. Nor did the Household defendants argue that there was any date on which this mutuality of interest ended. On December 6, 2006, the Magistrate Judge granted the Class' motion ("December 6 Order"), finding that "Plaintiffs have presented evidence – and Defendants do not dispute – that the Class represents a substantial majority of shareholders who owned stock at the time of the communications in question" and that "the fiduciary exception applies to the communications between E&Y and Household." December 6 Order at 14. The court did not impose any time limitation on the application of the *Garner* exception or restrict documents to be produced by Household to those generated within the Class Period.

The Household defendants objected to the December 6 Order. In their briefs to this Court, defendants argued strenuously that the Magistrate's December 6 Order was incorrect as a matter of law because the Magistrate Judge did not limit defendants' production of the E&Y documents to documents prepared prior to August 14, 2002. We quote but a portion of that argument:

Here, in making the pivotal and supposedly undisputed finding that Household and the Jaffe class had a mutuality of interest throughout the period the privileged communications were created (*see* December 6 Ruling at 14), the Magistrate Judge made two clear errors. *First*, contrary to the record on the motion, the Ruling implicitly assumed that all of the privileged communications at issue were created during the Class Period, which ran from July 31, 1999 to October 11, 2002. . . . ***Plaintiffs made no showing that they and their putative class represented a majority of the shareholders at any time after October 11, 2002, and the fact that***

they filed this lawsuit in August, 2002 put them in an openly adversarial position to Household thereafter.

Second, even as to the Class Period, Plaintiffs made no showing that would justify a conclusive finding of mutuality of interest between the class and Household through October 2002. . . .

Household Opening Brf. at 10-11 (emphasis added).²

By Order dated February 1, 2007, this Court rejected these arguments and “[f]or the reasons provided in this Minute Order, the Court overrules the Household defendants’ . . . 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.” February 1 Order at 1. This Court specifically rejected defendants’ arguments respecting mutuality of interest at the time the documents were created, concluding that “the Court agrees with Magistrate Judge Nolan that Household did not contest the issue.” *Id.* at 2.

However, despite being under a duty to produce all the E&Y compliance audit documents, Household withheld approximately 187 documents³ because they were generated after the end of the Class Period. At this time, the Class learned from counsel for E&Y that Household was in possession of E&Y’s original work papers, which had been neither produced nor put on a privilege log. Household asserted that it had just discovered these work papers by E&Y, which apparently amount to approximately 400 boxes, and had been provided for E&Y to Household pursuant to a request made by Household in October 2004.

² “Household Opening Brf.” refers to the Household Defendants’ Objections to Magistrate Judge Nolan’s December 6, 2006 Order Compelling Production of Certain Attorney-Client Communications and Work Product (Dkt. No. 841).

³ February 27 Order at 2. The actual number is less than that because this number includes documents relating to other engagements by E&Y. *Id.* The Class is not disputing the withholding of these other engagement documents.

The Class filed a motion to compel production of documents pursuant to this Court's February 1 Order and for sanctions with the Magistrate Judge. Following briefing, on February 27, 2007, the Magistrate Judge ruled that Household did not need to produce documents after the Class Period. February 27 Order at 2. In support of her ruling, the Magistrate Judge indicated that she was not aware previously that the compliance audit documents extended past the Class Period, noting that neither the Class nor Household had raised the post-Class Period argument before her. *Id.* at 1. The Magistrate Judge also found that this Court had not considered this post-Class Period issue based on her conclusion that this Court's February 1 Order was "silent" on the issue. *Id.* at 2. The Magistrate Judge affirmed her ruling that there was good cause to overcome the work product doctrine as to all of the compliance audit documents regardless of the date of the document. *Id.* The Magistrate Judge also concluded that there was "no reason to doubt" that Household's failure to previously locate the 400 boxes of E&Y work papers was inadvertent. *Id.*

The Class sought reconsideration of this ruling as clearly contrary to this Court's February 1 ruling given this Court's rejection of all Household's arguments to limit the production of the compliance audit documents to Class Period documents and applicable Seventh Circuit law.

In its motion, the Class also demonstrated that there was evidence before the Magistrate Judge respecting the post-Class Period status of certain of the documents in the form of exhibits submitted by Household during the initial briefing. Indeed, one of these exhibits is a letter from Household's counsel written as part of the meet and confer correspondence, wherein she wrote:

We now understand that Ernst & Young was engaged by Household for three separate projects before the termination of the class period. ***I should stress that most of their work was completed after the conclusion of the class period and that their findings were relayed to Household's General Counsel after the class period as well. In light of those facts and Magistrate Judge Nolan's opinion of June 15, 2006 denying post class period discovery, we seriously question whether the documents concerning those engagements have any relevance to your case***

Exhibit 3 at 1 to the Buckley Decl. (emphasis added).⁴ The relevant entries in privilege logs submitted to the Magistrate Judge similarly showed that many of the documents at issue were post-Class Period. *See* Buckley Decl., Ex. 13. Thus, the Magistrate Judge had evidence before her as to this engagement extending past the Class Period.

The Class also challenged the Magistrate Judge's finding with respect to the recent discovery of the 400 boxes of E&Y work papers. The Class reminded the Magistrate Judge that these documents were always under the control of the General Counsel according to the Declaration of Kenneth H. Robin ("Robin Decl."), Household's General Counsel, submitted with respect to the initial motion. Robin Decl., ¶5 (E&Y acted as my agent "[a]t all times . . . subject to my control and direction"); *id.*, ¶8 ("Office of the General Counsel has taken care to hold the results of the compliance Engagement and related privileged material in strictest confidence.") (Dkt. No. 749). Further, Household's counsel represented that they had conducted an investigation into all the E&Y engagements during the summer of 2006, which investigation should have revealed the location of this quantity of work papers. Buckley Decl., ¶4. Finally, there was the December 6 Order requiring the production of the work papers that should have triggered a further investigation. Instead, Household and its counsel supposedly only became aware of the existence of the 400 documents after counsel for E&Y in February of the year informed the Class of the transfer of these work papers.

On March 12, 2007, the Magistrate Judge denied the Class' Motion for Reconsideration in its entirety from the bench at the conclusion of the status conference "for reasons stated on the record."

⁴ "Buckley Decl." refers to the Declaration of Susan Buckley in Opposition to Plaintiffs' Motion to Compel the Production of Documents Pertaining to Household's Consultations with Ernst & Young LLP (Dkt. No. 749).

March 15, 2007 Minute Order. As discussed below, the Magistrate Judge's ruling is contrary to law and this objection should be sustained.

III. LEGAL ARGUMENT

A. The Magistrate Judge Improperly Reconsidered the Post-Class Period Argument Despite This Court's Prior Rejection of that Argument and Despite Household's Waiver through Failure to Raise that Argument During the Prior Briefing

A Magistrate Judge cannot overrule or reverse a ruling by a District Court Judge. Nor does a Magistrate Judge have the discretion to amend or alter a District Court's ruling. Instead, the Magistrate Judge must enforce the District Court's ruling as it stands. However, while these limitations on a Magistrate Judge's authority would seem unremarkable, here the Magistrate Judge has done precisely the opposite of what a Magistrate Judge is supposed to do – the Magistrate Judge has reconsidered and accepted arguments that this Court rejected. Moreover, the Magistrate Judge did so in an Order that both acknowledges that Household did not present this argument to the Magistrate Judge in the initial briefing to her and that arguments not raised with the Magistrate Judge in the first instance are waived. February 27 Order at 2. The Magistrate Judge committed clear error.

On February 1, 2007, this Court adopted in full the Magistrate Judge's prior December 6 Order. Once this Court adopted the December 6 Order and granted the Class' motion to compel, it became the Magistrate Judge's obligation to ensure defendants' compliance with the February 1 Order. "Principles of authority [] do inhere in the 'mandate rule' that binds a lower court on remand to the law of the case established on appeal. The very structure of a hierarchical court system demands as much." 18B Charles Alan Wright, Arthur R. Miller and Edward H. Cooper, Federal Practice and Procedure §4478 at 637 (2002); *id.* §4478.3 at 733 ("an inferior tribunal is bound to honor the mandate of a superior court within a single judicial system").

More particularly, the Magistrate Judge has no authority to reconsider arguments that defendants made to this Court but were rejected by it. The Magistrate Judge in her March 5 Order seeks to evade this restriction by considering this Court's February 1 Order to be "silent" on this issue. However, that interpretation does not hold water. This Court clearly rejected the Household defendants' arguments to limit the production of documents to those created prior to the end of the Class Period as opposed to the open-ended production required by the Magistrate Judge's initial December 6 Order when this Court adopted that Order in full, including the open-ended production. February 1 Order at 1; *compare* Household Opening Brf. at 10-11. Once this Court adopted the December 6 Order, the Magistrate Judge was without authority to alter it, much less to reconsider arguments this Court rejected.

In the Seventh Circuit, moreover, implied rejection of an argument by a superior court, such as this Court, triggers the law of the case doctrine and binds the lower court. *Burlington N. R.R. v. City of Superior, Wis.*, 962 F.2d 619, 620 (7th Cir. 1992). Using language easily paraphrased to apply to this situation, the Seventh Circuit held that "In rejecting the narrow interpretation, we necessarily rejected all the reasons that the city gave for its interpretation, where or not we mentioned each and every one of them." *Id.* Thus, when this Court declined to restrict the date range of the E&Y documents to be produced, it rejected all arguments presented by Household in favor of such narrowing, whether the Court specifically mentioned those arguments or not in its February 1 Order. Significantly, the Class cited *Burlington* to the Magistrate as part of its briefing on this issue. Under Seventh Circuit case law, the Magistrate Judge cannot construe this Court's "silence" on the post-Class Period argument to be anything under than a complete rejection of the post-Class Period argument that defendants made to the Court in support of their objection to the December 6 Order, which this Court adopted in full.

In addition to committing error by reconsidering and accepting the very argument rejected by this Court, the Magistrate Judge committed error in allowing Household to raise arguments that it did not raise in the initial briefings to her in 2006. The Magistrate Judge did so despite citing in the February 27 Order two cases for the proposition that arguments not presented to the Magistrate Judge are waived, including a prior opinion by this Court. February 27 Order at 2 (citing *United States v. Melgar*, 227 F.3d 1038, 1040 (7th Cir. 2000) and *American Family Mut. Ins. Co. v. Roth*, No. 05 C 3839, 2006 WL 2192004, at *9 (N.D. Ill. July 27, 2006) (Guzman, J.). And in the March 5, 2007 Order on another privilege issue,⁵ the Magistrate Judge stated “[A] court’s orders ‘are not mere first drafts, subject to revision and reconsideration at a litigant’s pleasure.’” March 5 Order at 1 (quoting *Ohio Farmers Ins. Co. v. Hotler*, No. 03-2138, 2006 WL 272779, at *1 (C.D. Ill. Jan. 31, 2006)) (Dkt. No. 1002).

As indicated above, the record before the Magistrate Judge contains numerous exhibits, including correspondence from Household’s counsel and the privilege log, establishing that Household knew the E&Y compliance audit documents extended past the Class Period and yet did not make any argument to the Magistrate Judge on that basis. Indeed, in the meet and confer letter discussed above, Household’s counsel invoked the Magistrate Judge’s prior post-Class Period Order as a basis for disputing the relevance of the E&Y documents being sought by the Class. Buckley Decl., Ex. 3 at 1. Household’s decision⁶ not to assert a post-Class Period argument before the Magistrate Judge constitutes knowing waiver of the post-Class Period argument and thus,

⁵ This issue concerns additional audit letters that were not identified by Household during the prior briefing before the Magistrate Judge and this Court.

⁶ In its motion for reconsideration, the Class explained why Household would decide not to make this argument as it would have undercut their privilege arguments, which were based on then pending litigation risks posed by the then-pending Attorney General discussions, risks that were resolved on October 11 in the Attorney General settlement. The Class’ Motion for Reconsideration of the Court’s February 27, 2007 Order (Dkt. No. 1010) (“Class’ Recon. Mot.”) at 2-3.

irrespective of this Court's February 1 Order, that argument cannot now be resuscitated, particularly since both the Magistrate Judge and this Court have ordered them to produce all compliance audit documents. "Efficiency in judicial administration requires that all arguments be presented to the magistrate judge in the first instance." *Am. Family*, 2006 WL 2192004, at *1.

For these reasons, the Magistrate Judge's orders declining to compel production of all E&Y compliance audit documents pursuant to this Court's February 1 Order was clear error and this Objection should be sustained. We turn next to the Magistrate Judge's finding with respect to Household's failure to disclose the additional 400 boxes of E&Y work papers until February of this year.

B. The Magistrate Judge Improperly Failed to Find Household's Recent Disclosure of 400 Boxes of E&Y Work Papers to Be Inexcusable

As this Court is aware, this case has been pending since August 2002. On March 13, 2003, the Class filed its amended complaint asserting that Household's predatory lending practices, which resulted in the \$525 million settlement with the Attorneys General, constituted one prong of the fraud perpetuated on the Class. Dkt. No. 54. At the time of the filing, the E&Y compliance engagement was ongoing under the auspices of the General Counsel's office. Indeed, Mr. Robin submitted a declaration to this Court asserting that "[a]t all times . . . E&Y acted as my agent . . . subject to my control and direction." Robin Decl., ¶5. In October 2004, the engagement apparently ended and Household requested that E&Y provide it with all work papers relating to the engagement. Prior to that date, in May 2004, the Class propounded its first set of document requests, which included requests addressed to all documents pertaining to Household's predatory lending practices and investigations into Household's lending practices and policies.⁷ *See* Class' Mot. for

⁷ For example, the Class' very first document urgent served on May 17, 2004 requests: "All documents and communications concerning or relating to Household's lending practices and policies related to loans

Recon. at 8 and supplement thereto (identifying some 30 different requests). Thus, at the time Household obtained the E&Y work papers, it was already under a discovery obligation to produce them and should have been searching diligently for precisely these types of documents. In a case of this size and significance, the General Counsel's office would be involved in this search.

In July 2006, after the Class subpoenaed E&Y for its documents, counsel for Household in this case conducted an investigation into the various E&Y documents. Counsel represented that the scope of this investigation was thorough, including interviews of relevant personnel. Buckley Decl., ¶4. Ms. Buckley further declared that according to her investigation, "extraordinary care was taken to maintain the privileged nature of the work." Buckley Decl., Ex. 3.

Subsequently, the Class filed its Motion to Compel the E&Y compliance audit documents. In its opening brief, the Class noted that not all of the relevant documents appeared on the privilege log. MTC at 9-10. Household subsequently amended its privilege log to include new entries relating to the compliance audit. However, even after this, it was apparent to the Class that not all of the documents had been logged. *See* the Class' Reply in Support of Motion to Compel Production of All Documents Pertaining to Household's Consultations with Ernst & Young LLP (Dkt. No. 766). Brief at 13.

On December 6, 2006, the Magistrate Judge issued her Order requiring the production of all E&Y compliance audit documents. Although Household objected, it should have commenced the process of collecting the responsive documents in the event that this Court affirmed the Magistrate Judge's ruling *in toto*, which was exactly what happened.

secured by real property (as described in the Complaint), including, but not limited to, correspondence, analyses, statistics, presentations, training materials, public statements, memoranda and notes." The second request is equally applicable and seeks investigations into the lending practices by any "body." *See* Class' Recon. Mot. at 8 (quoting relevant document requests).

Despite all this, including the oversight and involvement in the compliance audit by the General Counsel's office, Household's litigation counsel asserted benignly at the February 27, 2007 hearing that they had no prior knowledge of these documents, which E&Y has represented, and Household does not dispute, were requested by Household in 2004. Regardless of whether litigation counsel had actual knowledge of these work papers, Household's General Counsel's office knew about these work papers and certainly litigation counsel should have known about them, particularly given all the attention paid to this issue by both the parties and the Court. The subject matter of the E&Y engagement, and compliance with predatory lending laws, should have made it abundantly clear to both the General Counsel's office (and litigation counsel) that these documents would be central to the case since, as this Court found, they "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." February 1 Order at 3. Even if that were not enough, E&Y was still working during October 2004, months after the Class propounded document requests seeking the very documents that E&Y was then creating.

Given this factual record, a simple exculpatory (and conclusory) statement from litigation counsel unadorned by factual detail cannot be accepted at face value, particularly when the disclosure comes after three years of fact discovery. The Magistrate Judge should have been as outraged by the situation as Class counsel and demanded at the least some comprehensive declarations demonstrating why after all the years of alleged diligent searching and the repeated certifications of completeness as to document production, these work papers were not previously discovered and produced. Absent such declarations, the record before the Magistrate Judge compelled the finding that Household's failure to locate these work papers sooner was inexcusable.

C. The Magistrate Judge Should Have Sanctioned Household for Its Failure to Produce the E&Y Compliance Documents in Response to This Court's February 1 Order

The Magistrate Judge has refused to issue sanctions against defendants despite the willful violation of this Court's February 1 Order. Defendants knew that this Court rejected their mutuality of interest arguments, including their attempt to limit the production to Class Period documents, but nonetheless withheld documents on that basis in direct contravention of the February 1 Order. Household cannot contend that it somehow "misconstrued" the scope of production required under the February 1 Order because in its Objection to this Court, Household acknowledged that the December 6 Order, which this Court adopted in full, required the production of post-Class Period documents. Household Opening Brf. at 10-11. When a party deliberately disobeys a Court Order, there must be some consequences for such misconduct. However, the Magistrate Judge not only did not impose sanctions, but rewarded defendants for their misconduct by postponing related depositions and accepting other delays in the schedule, delays which effectively rewarded defendants for their conduct. While the Class recognizes that the Magistrate Judge has discretion to determine the appropriate punishment, the Magistrate Judge should exercise this discretion in accordance with the severity of defendants' deliberate disobedience of the February 1 Order. This Court should remand this issue back to the Magistrate Judge for her determination as to the appropriate sanction.

D. Request for Expedited Consideration

The Class respectfully requests that this Court expedite its review of this Objection. The central issue that the Magistrate Judge cannot reconsider Household's post-Class Period argument in light of this Court's February 1 Order and Household's waiver of that argument below is a simple one. A speedy resolution of this issue in the Class' favor will save the parties and the Magistrate Judge considerable time and effort because right now the Magistrate Judge is trying to devise a procedure pursuant to which she will conduct an *in camera* review of a selective portion of these

work papers for privilege while Household must review the 400 boxes to segregate the attorney-client privileged documents, a process it has complained about as being expensive and burdensome. If the Class is correct, the Magistrate Judge need not embark upon any *in camera* review and Household can save the money and effort associated with review of the documents. Further, the Class will obtain these documents sooner. Accordingly, the Class respectfully requests that this Court resolve these issues under an expedited review if at all possible.

IV. CONCLUSION

This Court should vacate the Magistrate Judge's February 27 Order and the March 12 bench ruling and require Household defendants to produce all compliance study documents by a date certain, including the newly "discovered" boxes of E&Y work papers. The Class recognizes that production of the 400 boxes at this late date raises scheduling issues, but it should not be punished for Household's inexcusable failure to locate and produce these documents previously. Further, the Court should find Household's failure to locate these documents previously despite nearly three years of document discovery, its own investigations and Court Orders to be inexcusable. The Court should remand the sanctions issue to the Magistrate Judge for reconsideration of sanctions in light of defendants' willful disobedience of the February 1 Order.

DATED: March 16, 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 March 16, 2007 declarant served by electronic mail and by U.S. Mail to the parties the: **THE CLASS' OBJECTION REGARDING MAGISTRATE JUDGE'S FAILURE TO ENFORCE THIS COURT'S FEBRUARY 1, 2007 ORDER REQUIRING PRODUCTION OF ERNST & YOUNG LLP COMPLIANCE AUDIT DOCUMENTS AND REQUEST FOR EXPEDITED CONSIDERATION.** 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 16th day of March, 2007, at San Francisco, California.

s/ Monina O. Gamboa

MONINA O. GAMBOA