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, *- against -* 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 HOUSEHOLD DEFENDANTS' RESPONSE TO PLAINTIFFS' OBJECTION TO MAGISTRATE JUDGE NOLAN'S FEBRUARY 27, 2007 ORDER

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Defendants Household International, Inc. ("Household"), Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilmer, and J.A. Vozar (collectively the "Household Defendants" or "Defendants") respectfully submit this Response Memorandum of Law in Opposition to Plaintiffs' Objections to Magistrate Judge Nolan's February 27, 2007 application of previous rulings in this matter regarding the fiduciary exception to the attorney client privilege. A copy of the challenged ruling is annexed for the Court's convenience.

PRELIMINARY STATEMENT

In this latest Objection, Plaintiffs ask this Court to reinterpret Magistrate Judge Nolan's December 6, 2006 Memorandum Opinion and Order in a way that would extend its narrow application of the fiduciary exception into a later time period, well after the parties' alleged alignment in interest had given way to an adversarial relationship. Plaintiffs seek this insupportable relief even though (i) they made absolutely no showing in advance of the December 6 Order (or at any time thereafter) of a fiduciary relationship between the parties following the end of the Class Period in October 2002; (ii) that omission constituted a waiver, as well as a reflection of Plaintiffs' inability to satisfy this key threshold requirement; (iii) the December 6 Order was necessarily limited to the period for which Plaintiffs had made an evidentiary showing, as Judge Nolan confirmed in her February 27 Ruling; (iv) the interpretation Plaintiffs seek is not rational, because any expansion of the fiduciary exception to privileged communications created after the parties became adversaries would be squarely at odds with relevant precedent in this jurisdiction; and (v) in response to Defendants' Objection to part of the December 6 Order, Plaintiffs affirmatively represented to this Court that the time frame for which they sought production of Ernst and

Young ("E&Y") documents under the fiduciary exception was limited to the Class Period, and they affirmatively argued that Judge Nolan's Order had recognized that limitation.

Based on Plaintiffs' own failure of proof, their express representations to this Court directly contrary to their current position, and the legal insufficiency of their position, Plaintiffs' Objection should be summarily overruled. Judge Nolan correctly interpreted her prior order and correctly denied Plaintiffs' request for sanctions based upon their own overreaching.

The Magistrate Judge is likewise correctly handling the disposition of recently discovered E&Y workpapers, which were never requested from Household in Plaintiffs' discovery demands, and which largely post-date the Class Period. Plaintiffs' argument that such workpapers should have been turned over depends entirely on their misreading of the Court's prior orders, and the Magistrate Judge correctly rejected Plaintiffs' request for sanctions. Because Judge Nolan's February 27 Ruling is correct and the Magistrate Judge is considering the disposition of the E&Y workpapers in a timely and proper manner, there is no need for expedited consideration of Plaintiffs' Objection.

BACKGROUND

As the following chronology shows, Plaintiffs' unworthy accusations that Judge Nolan has irrationally modified her December 6 Order and defied the instructions of this Court find no support in the record.

In a motion to compel filed on October 16, 2006, Plaintiffs invoked the fiduciary exception with respect to certain E&Y documents on Defendants' privilege log. Plaintiffs' opening papers on that motion contained no showing of the existence of a fiduciary relationship that might warrant further analysis under *Garner* v. *Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970).

However, in footnote 7 of their reply memorandum, Plaintiffs alluded to a newly-submitted exhibit that purported to show (if one accepted their unsubstantiated assumption about rate of turnover) that members of the Class collectively owned a majority of Household International stock by the end of the Class Period. Plaintiffs' footnote, exhibit and other submissions made no effort to show the existence of a fiduciary relationship between the parties with respect to any time period other than July 1999 through October 2002, the Class Period.

On December 6, 2006, Judge Nolan issued an opinion that *inter alia* (i) found that the attorney client privilege did apply to the subject E&Y documents because they were created as part of a privileged engagement performed by E&Y as the agent of Household's General Counsel for the purpose of rendering legal advice to Household; (ii) found that such privilege had not been waived; and (iii) allowed a "narrow" application of the fiduciary exception to require disclosure of some E&Y documents, based in part on the "undisputed" showing of a fiduciary relationship in footnote 7 of Plaintiffs' reply memorandum. The December 6 Order did not explicitly discuss the temporal scope of documents to which the exception applied, apparently because Plaintiffs had led Judge Nolan to believe that the E&Y engagement had been started and completed within the Class Period to which they limited their showing.

Defendants filed an Objection to the December 6 Order insofar as it applied both the fiduciary exception and an exception to the work product doctrine to allow disclosure of certain E&Y documents from Household's privilege log. The Objection mentioned Defendants' concern that the Order could be read to impermissibly invade Defendants' attorney client privilege for time periods as to which Plaintiffs had made no evidentiary showing and during which the parties' interests were already adverse.

Plaintiffs mooted this concern in their Response Memorandum by affirmatively representing to this Court that they sought production of E&Y documents only for the Class Period — and they indicated that Judge Nolan had observed that limitation. At page 8 of that brief they said:

> The Magistrate Judge's finding of good cause was based on the Garner factors, including each of the following: 1) the Class represents a substantial majority of Household's shareholders toward the end of the three year Class Period (July 31, 1999 through October 11, 2002"), ***the time frame for which they seek E&Y documents*** . . . . (Pls. Jan. 11, 2007 Brief at 8; emphasis added)

On February 1, 2007, this Court affirmed the December 6 Order in every respect. The February 1 opinion gave no indication that it extended beyond the four corners of the December 6 Order or its underlying evidentiary record, and no indication that the Court intended to make new law in this jurisdiction by allowing a plaintiff in a securities fraud action to invade its opponent's attorney client privilege as to communications created after the start of the lawsuit.

On February 12, 14 and 21, 2007, in compliance with the affirmed December 6 Order, the Household Defendants produced all E&Y documents from their privilege log that fell within the Class Period and pertained to the July 2002 engagement that was the subject of the December 6 Order.

On February 27, 2007, Judge Nolan issued the ruling that is the subject of the instant Objection. In response to Plaintiffs' argument that Defendants should also have produced privileged E&Y documents for time periods after the end of the Class Period, when the parties were already in an adversarial relationship, Judge Nolan explained that her December 6 Order did not explicitly address that subject, although "[i]nherent in [the December 6 Order] is a requirement that Plaintiffs have a fiduciary relationship with Household at the time of each particular com-

munication between E&Y and Household in order for *Garner* to apply." The February 27 Ruling also recognized that "Judge Guzman 'adopt[ed] in full' these premises" in his February 1 opinion. February 27 Ruling at 1.

Plaintiffs filed a motion for reconsideration of Judge Nolan's February 27 ruling on March 8, 2007, which was denied by Judge Nolan during a status hearing on March 12, 2007 and in a March 12, 2007 Minute Order. Plaintiffs filed their Objection to the February 27 Ruling on March 16, 2007, asking for an expedited disposition.

At a telephonic status conference on March 20, 2007, Judge Nolan reiterated on the record that the disposition of privileged E&Y documents created after the start of this lawsuit had not been put before her in connection with her December 6 Order. She also fine-tuned an expedient process for taking inventory of such documents, creating privilege logs and arranging for *in camera* inspections as needed, so that she will be in a position to resolve the parties' dispute about their proper disposition. Plaintiffs' effort to short-circuit that process through their current Objection goes well beyond the evidentiary record and briefing underlying the December 6 Order should not be entertained.

ARGUMENT

A. A Magistrate Judge's Disposition of a Discovery Dispute is Entitled to Substantial Deference

As this Court has already noted, the Federal Rules of Civil Procedure grant magistrate judges broad discretion in resolving discovery disputes. See February 1 Order, at 1. A magistrate judge's discovery rulings are entitled to substantial deference because that "[t]he magistrate judge has a much higher familiarity with the parties and the conduct of discovery . . . ."

Whittaker v. *NIU Board of Trustees*, No. 00 C 50447, 2004 WL 524949, at *1 (N.D. Ill. Mar. 12, 2004). Fed. R. Civ. P. 72(a) sets forth the exacting standard that governs a district judge's review of a magistrate judge's decision on a nondispositive motion such as this discovery dispute. *See also Ocean Atlantic Woodland Corp*. v. *DRH Cambridge Homes, Inc*., No. 02 C 2523, 2004 WL 609326, at *3 (N.D. Ill. Mar. 23, 2004) (Guzman, J.) ("Routine discovery motions are considered to be 'nondispositive' within the meaning of Rule 72(a)."). The Rule provides that the district judge "'shall consider such objections and shall modify or set aside any portion of the magistrate judge's order found to be *clearly erroneous or contrary to law.'" See also* 12 Charles Alan Wright *et al*., *Federal Practice and Procedure 2d* § 3069 (1997) (emphasis added) .

With respect to factual determinations, the "clearly erroneous" standard "means that the district court can overturn the magistrate judge's ruling only if the district court is left with the definite and firm conviction that a mistake has been made." *Weeks* v. *Samsung Heavy Industries Co*., 126 F.3d 926, 943 (7th Cir. 1997). The application of a legal standard to a particular set of facts is also reviewed under the "clearly erroneous" standard. *McFarlane* v. *Life Insurance Co. of North America*, 999 F.2d 266, 267 (7th Cir. 1993). This Court has already concluded that Judge Nolan's application of *Garner* in her December 6 Order was not clearly erroneous. The same analysis requires rejection of the instant Objection because Judge Nolan's February 27 ruling merely clarified the scope of her prior order.

B. Judge Nolan's Clarification of the Scope of her December 6 Order was Not Clearly Erroneous

Plaintiffs never argued in advance of the December 6 Order that Judge Nolan should apply the fiduciary exception to privileged material created after the end of the Class Period, and

they never advanced any facts on which Judge Nolan could even consider the application of *Garner* to such material. To the contrary, their belated evidentiary showing on the fiduciary relationship requirement under *Garner* was expressly limited to the Class Period, and in defending the fiduciary exception aspect of the December 6 Order, Plaintiffs assured this Court that Judge Nolan had correctly concluded that the class owned a majority of Household stock "toward the end of the three year Class Period (July 31, 1999 through October 11, 2002), the time frame for which they seek E&Y documents." (Pls. Jan 11 Br. at 8) Nowhere in their current Objection do Plaintiffs refer the Court to any section of their motion to compel in which they affirmatively sought production of privileged material created after the start of this lawsuit. Because there was no development of this issue on the record underlying the December 6 Order, Plaintiffs have literally no basis to argue that a phantom ruling on this subject has become the law of the case. *See Gertz* v. *Robert Welch, Inc*., 680 F.2d 527, 533 (7th Cir. 1982) ("It is critical to determine what issues were actually decided in order to define what is the "law" of the case.")[1]

Although Plaintiffs try mightily to concoct a waiver on Defendants' part on this issue (*see* Pls. Obj. at 8), it was *Plaintiffs'* burden to demonstrate that they were eligible to invoke the fiduciary exception for materials created after the time-frame of their showing, and there is no fair or rational basis to equate Defendants' supposed failure to rebut arguments Plaintiffs never made with a *carte blanche* to invade their privileged files. Indeed, the concept of waiver is rele-

[1] In any event, the law of the case doctrine would not prevent Judge Nolan from reconsidering her own decision if she chose to do so. This doctrine is "a self-imposed prudential limitation rather than recognition of a limitation of the courts' power...the law of the case doctrine must be distinguished from res judicata: 'one directs discretion; the other supercedes it and compels judgment.'" *Gertz*, 680 F.2d at 532 (*citing Southern Railway Co*. v. *Clift*, 260 U.S. 316, 319 (1922)).

vant here only as an independent ground to hold Plaintiffs to their limited argument before the Magistrate Judge that the Class represented a majority of shareholders during the Class Period. Because that is all that Plaintiffs asked Judge Nolan to find regarding the fiduciary relationship prerequisite, they have waived their right to argue for a ruling substantially broader (and considerably less defensible) than the one they solicited and attempted to support. *See* February 27 Ruling at 2 (*citing United States* v. *Melgar*, 227 F.3d 1038, 1040 (7th Cir. 2000) ("[A]rguments not made before a magistrate judge are normally waived . . . . [T]here are good reasons for the rule that district courts should not consider arguments not raised initially before the magistrate judge.... Failure to raise arguments will often mean that facts relevant to their resolution will not have been developed . . .")).

Because in her December 6 Order Judge Nolan had no occasion or evidentiary support to address the application of the fiduciary exception to material created after October 2002, it is also specious for Plaintiffs to suggest that this Court implicitly ruled on that open issue when it affirmed the December 6 Order. Even passing the utter lack of factual support for that supposed extrapolation, Plaintiffs' argument necessarily assumes that this Court has radically departed from relevant precedent in this jurisdiction — including cases that require a threshold showing of a fiduciary relationship as a pre-requisite for invoking a fiduciary exception in any context, *see e.g., Ferguson* v. *Lurie,* 139 F.R.D. 362, 365 (N.D. Ill. 1991) ("The fiduciary duty exception is based upon the notion that a communication between an attorney and a client is not privileged from those to whom the client owes a fiduciary duty."), and cases that reject the application of *Garner* to privileged material created after the parties became adversaries. *See, e.g., Ohio-Sealy Mattress Manufacturing Co. v. Kaplan,* 90 F.R.D. 21, 31-32 (N.D. Ill. 1980) (in a

shareholder derivative action, declining to allow disclosure of privileged documents created after the start of the lawsuit because "[t]he information that plaintiffs would obtain by virtue of their representation of Sealy in the derivative action could be used to the corporation's detriment in the individual litigation between plaintiffs and Sealy"); *Panter v. Marshall Field & Co.*, 80 F.R.D. 718, 724 (N.D. Ill. 1978) (in a derivative action, holding that there was no good cause for abrogating defendants' attorney client privilege for documents created after the start of the subject litigation or after the filing of another lawsuit challenging the same alleged misconduct). *Accord*, *LTV Securities Litigation*, 89 F.R.D. 595, 608 (N.D. Tex. 1981) ("The Plaintiff class is frozen when corporate wrongdoing ends. From that time on, the class interests are adverse to the corporation which allegedly had defrauded it, and possibly adverse to nonparty shareholders as well.").[2]

Plaintiffs are also mistaken in trying to blame Judge Nolan for failing to piece together clues (such as "exhibits, including correspondence from Household's counsel and the privilege log") that supposedly should have alerted her that the scope of their motion was actually broader than Plaintiffs represented (and broader than they tried to substantiate in their motion papers). This argument should be rejected out of hand. Even if Plaintiffs could demonstrate through such vague, indirect references that they had implicitly solicited a ruling as to the disposition of privileged material created after the end of the Class Period, the fact that they made absolutely no showing that the parties stood in a fiduciary relationship when such privileged material was created would have been fatal to that unstated aspect of their motion. *See. e.g.,* February

[2] Defendants take exception to any application of Garner in a non-derivative action for damages, but that issue is not presently before the Court.

27 Ruling at 1 ("Inherent in [the December 6 Order] is a requirement that Plaintiffs have a fiduciary relationship with Household at the time of each particular communication between E&Y and Household in order for *Garner* to apply.").

As Judge Nolan has correctly ruled, once "Plaintiffs had filed this lawsuit against Household [they] were no longer in a fiduciary relationship with the Company [and] any communications between E&Y and Household dated after [August 16, 2002] are not subject to the *Garner* exception and remain privileged." February 27 Ruling at 2. This Court should likewise reject Plaintiffs' invitation to apply *Garner* so as to allow access to privileged information for a time period in which Plaintiffs' interests were no longer even arguably aligned with Household's. Such a ruling would prejudice the interests of shareholders on whose behalf the post-Class Period privileged communications were created. The suggestion that Judge Nolan's recognition of this premise is clearly erroneous or has somehow offended this Court's jurisdiction is flatly wrong.

C. Plaintiffs' Request for Sanctions Was Properly Denied by Magistrate Judge Nolan and Should Not Be Remanded for Reconsideration

This Court should also reject Plaintiffs' request that Judge Nolan be instructed to reconsider her denial of sanctions against Defendants. Judge Nolan expressly agreed with Defendants' interpretation of both her December 6 Order and this Court's February 1, 2007 opinion, and found no violation, willful or otherwise, on the part of Defendants. *See* February 27 Ruling at 2. Judge Nolan is entitled to substantial deference in interpreting and applying her December 6 Order, which this Court did not modify in any respect in its February 1, 2007 opinion affirming it in full. Further, it is absurd for Plaintiffs to argue that Defendants were in a position to "know"

or even guess that this Court had supposedly rejected their "mutuality of interest" argument regarding post-Class Period documents (*see* Pl. Obj. at 12) — especially since Plaintiffs' clarification that they were only seeking Class Period documents made it unnecessary for the Court to consider the implications of Plaintiffs' total lack of an evidentiary showing for later time periods. S*ee* January 11 Brief at 8. Like the Court, Defendants had every right to rely on that representation. Sanctions are completely unwarranted under these circumstances.

Nor did Judge Nolan err in refusing to sanction Household for the non-production of recently-located E&Y workpapers. Although these documents were not the subject of the February 27 ruling or its predecessors, the Household Defendants are compelled to address this subject briefly because Plaintiffs devote so much of their brief to this extraneous issue, in an obvious effort to prejudice the Court. First, as Judge Nolan acknowledged, Plaintiffs never requested *any* category of E&Y documents from Household, much less the work papers from the E&Y Compliance Engagement, in any of their document demands. *See* February 27 Ruling at 3. Rather, Plaintiffs' first demand to Household for the warehoused E&Y documents was tacked on to their motion to compel post-Class Period E&Y documents from Household's privilege log. *See* Class Motion to Compel dated February 22, 2007. Second, Plaintiffs never challenged Ernst & Young's objections to Plaintiffs' May 2006 subpoena to that entity, which did expressly request workpapers. *Id*. Household highlighted that failure in response to Plaintiffs' original motion to compel, which was aimed at documents on Household's privilege log. (November 3, 2006 Opposition at 3 n. 2) Nonetheless, it was not until February 2007, almost a year after serving the subpoena, that Plaintiffs finally followed up with E&Y. It was thus only within the past month that E&Y discovered and advised defense counsel that boxes of E&Y's workpapers were stored

at Household's warehouse storage facility at Iron Mountain. *See* Declaration of Landis C. Best, dated February 26, 2007, at Ex. 7. As Household had never before been asked for E&Y workpapers, it had no previous occasion to investigate its archives for such documents. *See* Best Decl., at Ex. 7. Significantly, Judge Nolan accepted Household's representations on this subject. *See* February 27 Ruling at 3 ("The court has no reason to doubt Defendants' representation that they just learned about the 425 boxes....").[3] In light of these facts, Judge Nolan's conclusion not to award sanctions against Household was reasonable and sound.

CONCLUSION

Defendants' Objection Regarding Magistrate Judge Nolan's Failure to Enforce the February 1, 2007 Order should be denied in full.

Dated: March 23, 2007

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[3] Defense counsel's July 2006 investigation to which Plaintiffs refer in their brief was "an investigation into Household's engagements of E&Y in order to determine whether communications and documents relating to those engagements were protected from disclosure pursuant to the attorney-client privilege, the attorney work product doctrine or other privileges." *See* Declaration of Susan Buckley, dated November 3, 2006, at ¶4. It was not an investigation into the clerical arrangements for storage of all documents related to the Compliance Engagement as Plaintiffs would have this Court believe.

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