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UNITED STATE DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

FILED
OCT - 3 2006
OCT 3 2006
MICHAEL W. DOBBINS
CLERK, U.S. DISTRICT COURT

LAWRENCE E. JAFFEE PENSION PLAN, on)	
Behalf of itself and others Similarly Situated)	
)	Lead Case No. 02-C-5893
Plaintiff,)	(Consolidated)
)	
v.)	Class Action
)	
HOUSEHOLD INTERNATIONAL, INC., et al.)	Judge Ronald A. Guzman
)	Magistrate Judge Nan R. Nolan
Defendants,)	
-----)	

**MEMORANDUM REGARDING REQUEST FOR
PRIVILEGED AND CONFIDENTIAL
VERMONT INVESTIGATIONS AND EXAMINATION REPORTS**

NOW COMES the State of Vermont, by and through William H. Sorrell, Attorney General, and submits this memorandum to the Court regarding Plaintiff's request for privileged and confidential Vermont Department of Banking, Insurance, Securities and Health Care Administration (the "Department") investigations and examination reports.

INTRODUCTION AND BACKGROUND

The Department received correspondence from Household Defendant's counsel and from Plaintiff's counsel informing the Department that Plaintiff has requested that Household Defendants produce copies of investigations and examination that the Banking Division of the Department conducted related to Household's licensed lender or mortgage broker activities. Furthermore, to the extent that the investigations and examinations are privileged or confidential, Plaintiff has requested that the Department waive the privilege.

The Department has informed counsel for both parties that the Banking Division's examinations and investigations are both privileged and confidential under Vermont law and that the Department does not have the authority to waive the privilege and release the documents in any private civil action.

Plaintiff's counsel has informed the Department that they have requested that the Court order Household to produce the confidential and privileged Banking Division examinations and investigations. Plaintiff's counsel has also informed the Department that they understand the Department may wish to be heard on this issue and that briefs and memorandum to the Court on this issue should be filed by October 3, 2006.

The State of Vermont is filing this memorandum: (a) to inform the Court that Vermont state law specifically and unequivocally renders the Banking Division's investigations and examinations privileged and confidential; and (b) to request that the Court deny Plaintiff's request to order the Household Defendants to produce copies of these privileged and confidential materials.

LEGAL ANALYSIS AND ARGUMENT

1. Vermont Law Specifically And Unequivocally Provides That Banking Division Examinations and Investigations, Including Information Pertaining To A Consumer Complaint, Are Privileged And Confidential.

The relevant Vermont statute, 8 V.S.A. §23, reads as follows:

(a) This section shall apply to all persons licensed, authorized or registered, or required to be licensed, authorized or registered, under Parts 2¹ and 5 of Title 8.

(b) Regardless of source, all records of investigations, including information pertaining to a complaint by or for a consumer, and all records and reports of examinations by the commissioner, whether in the possession of a supervisory agency or another person, shall be confidential and privileged, shall not be made public, and shall not be subject to discovery or introduction into evidence in any

¹ The licensed lender and mortgage broker statute is contained within part 2 of Title 8. Thus, Household's licensed lender and mortgage broker examinations are covered by 8 V.S.A. §23.

private civil action. No person who participated on behalf of the commissioner in an investigation or examination shall be permitted or required to testify in any such civil action as to any findings, recommendations, opinions, results or other actions relating to the investigation or examination.

(c) The commissioner may, in his or her discretion, disclose or publish or authorize the disclosure or publication of any such record or report or any part thereof in the furtherance of legal or regulatory proceedings brought as a part of the commissioner's official duties. The commissioner may, in his or her discretion, disclose or publish or authorize the disclosure or publication of any such record or report or any part thereof, to civil or criminal law enforcement authorities for use in the exercise of such authority's duties, in such manner as the commissioner may deem proper.

(d) For the purposes of this section, records of investigations and records and reports of examinations shall include joint examinations by the commissioner and any other supervisory agency....

The Vermont courts have recognized that a confidentiality statute also creates an evidentiary privilege when the legislature intent to do so is clearly expressed. "Where we have recognized evidentiary privileges, the intent of the legislature to do so was far more clearly expressed. In [citations omitted], the statutes in question stated that the information involved could not be admitted in evidence in a court proceeding." *In re F.E.F.*, 156 Vt. 503, 514, 594 A.2d 897, 904 (1991). Here, the relevant statute clearly and unambiguously provides that "regardless of source, all records of investigations, including information pertaining to a complaint by or for a consumer, and all records and reports of examination by the commissioner, whether in the possession of a supervisory agency or another person, shall be confidential and privileged, shall not be made public, and shall not be subject to discovery or introduction into evidence in any private civil action." 8 V.S.A. §23(b).

Although the plain language of the statute is sufficient to show that the documents are protected by Vermont law, the legislative history of 8 V.S.A. § 23 further confirms the point. The predecessor of the current § 23 was the subject of federal bankruptcy court litigation in

Glinka v. Howard Bank, N.A., 227 B.R. 61 (Bankr. D. Vt. 1998). The *Glinka* court found that the prior statute did not create an evidentiary privilege because it did not protect the privileged material from both discovery and admissibility into evidence. *Id.* at 65 - 66. The Vermont Legislature subsequently amended Section 23 to meet the standards established by the courts. Section 23 provides that the investigations and examinations "shall be confidential and privileged, shall not be made public, and shall not be subject to discovery or introduction into evidence in any private civil action." 8 V.S.A. §23(b). Section 23 also provides that the documents are confidential and privileged whether they are in the possession of a supervisory agency or another person. The legislative intent to create both a confidentiality statute and an evidentiary privilege could not be any clearer.

2. Vermont Law Does Not Grant The Department The Statutory Authority To Waive The Privilege And Release Confidential Materials To Plaintiff.

Plaintiff has requested that, to the extent the materials are privileged or confidential, the Department waive the privilege. Section 23(b)-(c) provides in pertinent part as follows:

(b) ... all records of investigation, including information pertaining to a complaint by or for a consumer, and all records and reports of examinations by the commissioner, ... shall be confidential and privileged, shall not be made public, and shall not be subject to discovery or introduction into evidence in any *private* civil action. ...

(c) ... *The commissioner may*, in his or her discretion, *disclose or* publish or authorize the disclosure or publication of any such record or report or any part thereof, *to civil or criminal law enforcement authorities for use in the exercise of such authority's duties*, in such manner as the commissioner may deem proper.

(emphasis added).

A plain reading of Section 23(b)-(c) reveals that the Commissioner does not have the authority to release the investigations and examination reports in any private civil action such as Plaintiff's current action against the Household Defendants. The Commissioner's sole discretion

is limited to releasing the information to civil or criminal enforcement authorities, such as another regulatory agency or the Attorney General's Office, to enable such enforcement authorities to carry out their duties under state and federal laws.

3. In light of Vermont's strong interest in protecting its bank examinations, this Court should apply the bank examination privilege and bar release of the requested documents.

Although the federal courts are not obligated to apply state-law privileges unless state law provides the rule of decision, *see* F.R.E. 501, federal courts may apply a state-law privilege in recognition of principles of federalism and comity. *See, e.g., United States v. King*, 73 F.R.D. 103, 105 (D.C.N.Y. 1976) ("A strong policy of comity between state and federal sovereignties impels federal courts to recognize state privileges where this can be accomplished at no substantial cost to federal substantive and procedural policy."); *see also In re Grand Jury Investigation*, 918 F.2d 374, 384 n.12 (3d Cir. 1990) (acknowledging *King* analysis as "helpful"). As Judge Weinstein acknowledged in *King*, a "state's promise of protection from divulgence is greatly attenuated" when "federal authorities may force public revelation at will." 73 F.R.D. at 105. The same concern is relevant here: the candor with which state regulators and banks communicate will suffer if state law's promise of confidentiality is disregarded in the federal courts.

Vermont therefore urges the Court to recognize its strong interest in protecting the bank examination process by applying the bank examination privilege, which has been recognized by a number of federal courts. *See, e.g., In re Bankers Trust Co.*, 61 F.3d 465 (6th Cir. 1995) (recognizing qualified bank examination privilege); *In re Subpoena Served Upon Comptroller of Currency*, 967 F.2d 630 (D.C. Cir. 1992) ("courts have long recognized that the report of a bank examiner is protected by a qualified privilege") (collecting cases). Although the federal bank

examination privilege is qualified, the public interest and the legislatively endorsed interests of the state of Vermont weigh heavily in favor of recognizing the privilege in this case.

In *In re Bank One Securities Litigation*, 209 F.R.D. 418, 427 (N.D. Ill. 2002) the Court identified five factors to consider when a party seeks discovery of privileged bank investigations and examinations:

Traditionally, courts have considered the following five factors to assess the competing interests of the privilege versus that of disclosure: (1) the relevance of the evidence sought to be protected; (2) the availability of other evidence; (3) the seriousness of the litigation and the issues involved; (4) the role of the government in the litigation; and (5) the possibility of future timidity by government employees who will be forced to recognize that their secrets are avoidable.

The Department cannot fully address the first factor, as it is not a party to this litigation and is not familiar with the substance of the claims presented by the plaintiffs. The Department notes, however, that its examination is based on factual material that is fully available to the plaintiffs by other discovery directed to the bank and its officers. Plaintiffs should be required to make a substantial showing to demonstrate that the Department's analyses and conclusions, as opposed to the data on which they are based, are relevant to this litigation.

With respect to factor number two, availability of other evidence, the Department's examinations consist of looking at a number of files and documents, asking questions of the licensee's employees and managers, and drawing conclusions regarding compliance with applicable laws and regulations. Plaintiff can obtain access to the same raw data considered by the Department and can interview and depose Household employees and managers. Plaintiff does not meet the second prong of the test.

The third prong of the test deals with the seriousness of the litigation and the issues involved. Once again, the Department is not a party to this action and is not familiar with this action or the history of this case. For this reason, the Department cannot comment directly on the seriousness of the issues at stake. The Department reiterates, however, that recognizing the bank examination privilege in this context does not shield any factual material from the parties or the Court; the plaintiffs can obtain the same data that was available to the Department through ordinary discovery channels.

The fourth prong of the test is the Department's role in this litigation. The Department is not a party to this litigation. Were it not for Plaintiff's efforts to seek confidential and privileged Department material, the Department would not be filing any documents with the Court. The Department does not have an interest in the outcome of this case. In its August 25, 2006 correspondence to counsel for both Plaintiff and the Household Defendants, the Department informed both parties:

This letter is not intended as statement or opinion on the Class Plaintiff's underlying cause of action or on the Household Defendants' defense in such action. This letter is limited solely to the interpretation of 8 V.S.A. §23 and the privileged and confidential nature of the Banking Division's examinations and investigations of licensed lenders and mortgage brokers doing business in Vermont.

The fourth prong of the test is not met.

The fifth prong of the test addresses "the possibility of future timidity by government employees who will be forced to recognize that their secrets are voidable." *In re Bank One Securities Litigation*, 209 F.R.D. at 427. As the Court noted in *In re Bank One Securities Litigation*, 209 F.R.D. at 428:

The memos and examinations created by the [Department] contain the thoughts and recommendations of the government. Should the government be forced to produce these documents, it is probable that future government employees may be

reluctant to capture the full breadth of their opinions and thoughts in written format for fear of future disclosure. A break in confidentiality could have a "chilling effect" on the ability of bank regulators to perform their duties in the future.

The Department is very concerned about the "chilling effect" that an order to require the Household Defendants to produce the investigations and examinations would have on the Department's ability to perform its regulatory function. Neither the Department, the Department's examiners, nor those the Department regulates could engage in any open or meaningful discussions if the parties involved constantly have to be concerned that the Department's regulatory and examination function is nothing more than a free and easy discovery process for future plaintiff's counsel. Given the significant chilling effect that would result in the Department's ability to carry out its function, the fifth prong of the test is not met.

In balancing the five factors, the Department's interest in maintaining the integrity of its investigations and examinations outweighs the Plaintiff's interest in disclosure.

CONCLUSION

Section 23 of Title 8 is the duly adopted expression of legislative policy. Based upon 8 V.S.A. §23 and relevant case law, the Department's examinations and investigations of Household's mortgage broker and licensed lender activities are privileged and confidential, are not subject to discovery or introduction into evidence, and may not be produced in response to the Plaintiff's discovery requests.

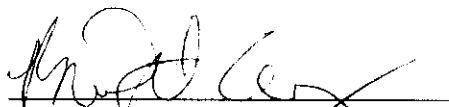
For the foregoing reasons, the State of Vermont respectfully requests that the Court reject Plaintiff's request to order the Household Defendants to produce any records of investigations by the Vermont Banking Division, including information pertaining to a complaint by or for a consumer, or any records and reports of examinations by the Vermont Banking Division, regardless of source, as contemplated by 8 V.S.A. §23.

Dated at Montpelier, Vermont, this 2nd day of October 2006.

STATE OF VERMONT

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By:



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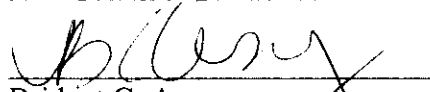
CERTIFICATE OF SERVICE

I, Bridget C. Asay, Assistant Attorney General for the State of Vermont, hereby certify that on October 2, 2006, I caused a copy of a Memorandum Regarding Request for Privileged and Confidential Vermont Investigations and Examination Reports to be placed in the United States mail, first-class, postage paid, addressed to counsel for all parties as indicated on the attached service list.

STATE OF VERMONT

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