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

DEFENDANTS' RESPONSE TO PLAINTIFFS' OCTOBER 27, 2006 PROPOSALS FOR RESOLVING STATE AGENCY DOCUMENT ISSUES

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In keeping with the Court's instructions on October 31, 2006, this Response will discuss the appropriate resolution of Plaintiffs' demand for production of Confidential information that certain state regulators have prohibited Defendants from disclosing (in some cases under pain of criminal prosecution). As the Court requested, we are also submitting a log of documents that we have been instructed to withhold or redact by the nine state regulators whose objections have not been withdrawn or overruled. Plaintiffs have previously received copies of this log, as amended from time to time to reflect developments.[1]

For the reasons discussed below, Defendants respectfully submit that there is no need for further proceedings at this time with respect to Plaintiffs' proposals and demands, and no excuse for further delay based on Plaintiffs' quest for cumulative anecdotal information from the handful of remaining states. If the Court were inclined to rule on this matter notwithstanding Plaintiffs' failure to pursue appropriate administrative process, it should (a) sustain the states' objections for the strong policy reasons many of them have articulated in briefs and letters to the Court, and (b) instruct Plaintiffs to comply with the demands of certain states for the prompt return of inadvertently produced state records.

1. Plaintiffs Cannot Demonstrate Significant Relevance or Need

(a) The number of restricted documents is small.

During the Class Period, Household operated approximately 1,300 consumer lending branch offices in 45 states. As of the date of this submission, Defendants are precluded from

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[1] In addition to withholding or redacting the logged documents at the direction of particular states, Defendants have also been instructed by most of the nine states at issue to seek the recall of duplicate or comparable documents that were inadvertently produced to Plaintiffs. Defendants have notified Plaintiffs of all such requests and affected documents.

disclosing the substance of the Confidential examination reports of only nine states, which are listed below. (The states shown in bold are those Plaintiffs say they are willing to forego.)

State	Number of Branches	Number of Withheld Reports	Timeframe of Documents	State's Position (*See letters and briefs annexed at Tab A)*
Delaware	13	2	October to December 2001	"[P]lease withhold from production any documents that constitute confidential supervisory information . . . . With regard to the confidential examination materials that inadvertently were included among the documents already produced in this case, please notify all receiving parties of the requirements of [Delaware law] and request the prompt return of all copies of privileged documents."
Hawaii	7	1	March to June 2002	"An examination report and its contents are specifically stated in the statute to be the property of the Commissioner and shall not be disclosed to anyone other than the financial institution or its agents. Third parties may request that certain documents protected by this section be disclosed, but only through a subpoena and subsequent protective order. *Any subpoena must be directed to the Commissioner, not the financial institution.*"
Kansas	23	1	July 2002	"The Administrator, pursuant to this statute, has decided to conduct private examinations of all licensees. The results of those examinations are confidential and are the property of the state of Kansas. . . . Further it is our position that all correspondence to and from the licensee in response to an examination report constitutes part of the Administrator's private examination and are also subject to the confidentiality provisions of [Kansas law]."
New Mexico	12	0	n/a	"The Financial Institutions Division maintains its objection to disclosure by Household International Inc. of documents that appear to be confidential under [New Mexico law]."

North Carolina	64	11	June 2001 to July 2002	"[North Carolina law] prohibits the disclosure of examination reports and other related documents." "[Examination Reports] are a tool for financial regulation; they are not a tool to further private litigation." Disclosure would be contrary to North Carolina law and establish a very bad precedent.
Ohio	115	0	June to July 2002	"[The Ohio Department of Commerce, Division of Financial Institutions] does not see any justification for releasing privileged and confidential documents in this shareholder action."
Vermont	0[2]	1		"Vermont law specifically and unequivocally provides that Banking Division Examinations and Investigations, including information pertaining to a consumer complaint, are privileged and confidential." "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." "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."

2 Although Household did not operate a branch in the state of Vermont, consumers living in Vermont were serviced at various Household branches in other states including New York, Massachusetts and New Hampshire. Thus, the regulatory agency in Vermont opted to conduct examinations of Household branches that serviced Vermont consumers.

Wisconsin	16	1	May 2001	"Under Wisconsin law, the documents are absolutely privileged and cannot be produced." "Here, the Wisconsin Legislature created an absolute state privilege against disclosure of the documents, a privilege on which Department officials rely. Disclosure, even under the confidentiality order of the case, would involve disclosure to dozens of individuals, including numerous defendants, plaintiffs, attorneys, accountants and other experts. It is probably that disclosure here could have exactly the type of chilling effect described by the courts. Wisconsin is willing to allow Plaintiffs to inspect its documents in camera, solely for the purpose of proposing a bilateral stipulation.
Wyoming	3	0	n/a	"[T]hese documents are not public records and are not open for public inspection."
TOTALS	236, or approx. 20% of branches	17[3]		

In addition to the few reports of examination counted above, Defendants have withheld or redacted supervisory correspondence between the Company and the various regulators as well as internal documents regarding those reports. Defendants have withheld or redacted these documents based upon a fair interpretation of the various state laws at issue and *only* if (a) the relevant regulator reviewed the documents and instructed Defendants to withhold or redact them because they contain material restricted from disclosure under governing statutes or regulations, or (b) (as to the states that did not respond to our inquiry regarding specific documents), they contain exact quotes from or close paraphrases of restricted reports, such that their unredacted disclosure would be tantamount to disclosing information Defendants have been prohibited from

3 The number of reports of examination included here does not include duplicate copies of the same report. Even counting all duplicate copies, Defendants have withheld only 37 Reports of Examination from production.

disclosing. The total number of documents in these two categories that have been withheld or redacted is approximately 193.

With respect to every state as to which regulators have allowed (or the Court has ordered) production of Class Period reports of examination, Defendants have produced or are in the process of producing the reports themselves and all related non-privileged documents, whether internal or generated by or communicated to an agency. In consequence, Plaintiffs have access to examination reports (if any) and all related non-privileged material from 36 states, which collectively supervised approximately 80% of Household's consumer lending branches during the class period.

(b) As this is a securities fraud action, not a consumer protection action, anecdotal observations about a small fraction of Household's consumer loans has marginal relevance at best.

According to Household's 2002 10-K report, in the final year of the Class Period (to which virtually all of the state-restricted documents apply), Household had approximately 32 million active consumer lending accounts, with managed consumer lending receivables of approximately $43.4 billion. As demonstrated by the already-produced state reports Defendants provided to the Court on October 19, 2006, the predominant approach to such exams was for one or more field inspectors to review a small sample of active accounts to check for compliance with a variety of laws, regulations and standards on a broad range of subjects (including many that have no ostensible bearing on the amorphous category of predatory lending). The examiner's questions or observations were not the products of adjudicated proceedings, but rather starting points for further analysis by the Company, and/or an iterative process in which answers, defenses, explanations, differing statutory interpretations, etc. were explored as part of the Company's on-going dialogue with each agency.

As Defendants (and the States of Vermont and North Carolina) have briefed elsewhere, an important rationale for protecting the confidentiality of examination reports is to encourage an open and candid exchange of facts and viewpoints of the regulator and licensed entity. *See, e.g., Bobkoski* v. *Board of Education*, 141 F.R.D. 88, 91 (N.D. Ill. 1992) ("The primary rationale for the deliberative process privilege, which is analogous to the attorney-client privilege's underlying purpose, is that effective and efficient governmental decision making requires a free flow of ideas among government officials and that inhibitions will result if officials know that their communications may be revealed to outsiders") (internal quotation marks omitted). *See also* Memorandum Regarding Request for Privileged and Confidential Vermont Investigations and Examination Reports at 8 ("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.").

Although Plaintiffs say they envision a trial based on examiners' observations about particular accounts, questions of materiality and scienter cannot turn on such untested anecdotal evidence. (This principle is akin to Plaintiffs' vigorous argument that the level of reliance (if any) of all class members cannot be extrapolated from the experience of a statistically insignificant subset.) In these final few weeks of a prolonged discovery period, one would expect Plaintiffs to start turning their focus away from branch level operations and toward trying to understand what allegedly material facts were conveyed to and/or acted upon by members of senior management. But even if Plaintiffs would prefer to keep their sights on irrelevant, prejudicial-sounding anecdotes, there is no justification for wasting more time and resources on their seemingly insatiable quest for cumulative branch-level material. In no event should this issue be accepted as an excuse for further adjournments of depositions or other impairment of the January 31, 2007 cut-off date for fact discovery.

(c) Even if the few remaining agency documents were marginally relevant, they are cumulative of a considerable body of more direct evidence from the same general time period.

It is a matter of record in this case (in fact, it is a core premise of Plaintiffs' Complaint) that in October 2002 Household entered into an agreement with a Multi-State Task Force of state Attorneys General to resolve asserted concerns and threatened claims about allegedly abusive lending practices. (*See* Cpt. ¶¶ 97, 99, 100, 242, 271, 282, 302, 319, 332, 343 and 344.)

The Task Force was established in or around May 2002, following (and apparently triggered by) the State of Washington's provision to other states of a report of its investigation into alleged abuses with respect to 21 of the more than 31,000 consumer loans written in that state.[4] Over the next few months, relatively senior representatives of Household met with representatives of the Task Force (who generally were not from the ranks of the agencies that generated the routine reports of examination). At these meetings and through the exchange of written submissions, Household tried to understand and respond to the Task Force's allegations and asserted concerns. These discussions culminated in a negotiated resolution that was announced on October 11, 2002. The related announcement, and a sample of Household's agreements with individual states that comprised the Task Force, are annexed at Tab B.

These events covered the same general time period as the few remaining reports of examination that have not been disclosed. The Task Force allegations and proceedings were known to representatives of management, and are well documented in Defendants' production.

4 Plaintiffs' complaint contains numerous allegations about the Washington State investigation. *See* Cpt. ¶¶ 18, 21, 53, 58, 62, 65, 74, 80, 84, and 330.

Plaintiffs have received documents showing the Task Force Members' allegations and their asserted bases, Household's responses and other aspects of the negotiations, and Plaintiffs continue to depose Household employees in detail on these subjects. Plaintiffs have also received in Household's production, and questioned deponents about, correspondence from state personnel transmitting complaints raised by individual consumers or self-appointed consumer watchdog groups such as the now-discredited ACORN. Under these circumstances, Plaintiffs cannot show a need for a handful of routine regulatory reports from the same general time period sufficient to outweigh the states' interests in preserving the confidentiality of their supervisory processes.

Moreover, participating in the regulators' branch examinations was by no means Household's only — or primary — source of information about branch operations and possible violations of its standards. Defendants have produced extensive documentation of Household's own systematic review of branch operations for compliance with its consumer protection standards. These include the Internal Audit Department's reports and summaries and tens of thousands of pages of Branch Visit Tracking System Reports, which include follow-up reports, reports of District Sales Manager Audit Visits, Insurance Sales Manager Branch Visits, Special Investigation Visits, and Comprehensive Sales Visits. Given this voluminous record of what various levels of management were told about branch-level compliance at particular points in time during the Class Period, the lack of a small number of field reports from a smattering of state regulators is not a matter of serious concern in a securities fraud action that will not turn on the accuracy of allegations about individual accounts.

2. ***The foregoing factors would preclude Plaintiffs from prevailing in any balancing of states' interests against Plaintiffs' wish for cumulative branch-level material.***

When the discovery demands of private litigants clash with well-settled governmental interests, courts typically apply a multi-part balancing test that includes such factors as a showing of substantial relevance and need, inability to obtain suitable information by other means, and the interest in maintaining the confidentiality of an agency's supervisory processes in order to encourage openness and candor in the on-going dialogue between an agency and its licensee. *See In re Bank One Securities Litigation*, 209 F.R.D. 418, 427 (N.D. Ill. 2002) (listing the factors used to balance the harm to the government by release of its documents with a party's need for those documents). Such criteria would unquestionably apply here if Plaintiffs' demands were ripe for judicial resolution[5] because federal common law recognizes the "deliberative process privilege", *e.g. United States* v. *Farley*, 11 F.3d 1385, 1389 (7th Cir. 1993) (internal citation omitted) ("The deliberative process privilege protects communications that are part of the decision-making process of a governmental agency . . . communications made prior to and as a part of an agency determination are protected from disclosure."), and federal courts have recognized that there is no principled reason to distinguish between federal and state regulations in this regard. *See In re One Bancorp Securities Litigation*, 134 F.R.D. 4, 9 (D. Me. 1991)

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5 *But see Raffa v. Wachovia Corp.*, 242 F. Supp. 2d 1223, 1225 (M.D. Fla. 2002) (declining to evaluate the discoverability of non-public OCC information pending determination by the OCC); *National Union Fire Insurance Co. v. Midland Bancor, Inc.*, 159 F.R.D. 562, 572 (D. Kan. 1994) ("When the party seeking documents has not completed the proper procedures, it is unnecessary for the Court to pursue a balancing test to determine if the information sought is confidential or privileged and whether or not such information should be disclosed."). By addressing the Court's questions in this submission, Defendants do not intend to waive, and should not be deemed to have waived, their objection as to Plaintiffs' failure to exhaust proper administrative process before asking for rulings, on an insufficient record, as to the sufficiency of the states' objections. For example, the state of Arizona instructed Plaintiffs to apply in the first instance to the Superintendent of the Department of Financial Institutions for permission to view Arizona documents. If Plaintiffs did approach the Arizona Superintendent and were rebuffed, that information would be material to any balancing test. If they did not do so, their failure to exhaust the required administrative process rendered their application to this Court premature. That is why Defendants' inquiry about Plaintiffs' still undisclosed unilateral communications with state regulators was and is relevant.

(holding that plaintiffs were not entitled to production of confidential *state* bank examination reports); *N.O.* v. *Callahan*, 110 F.R.D. 637, 642-43 (D. Mass. 1986) (applying protections of federal deliberative process privilege to internal state communications). *See also Allen* v. *Chicago Transit Authority*, 198 F.R.D. 495, 502 (N.D. Ill. 2001) (looking to developments in the Illinois state courts, which had declined to recognize the deliberative process privilege in that state, in determining whether the federal deliberative process privilege applied to Illinois state agency processes). Indeed, several of the subject states affirmatively told Plaintiffs that to seek a waiver they must first subpoena or petition the relevant state agency, as the owner of the information and any attendant privilege, but to the best of Defendants' knowledge, Plaintiffs did not exhaust appropriate administrative process before pressing this court to assert jurisdiction and override the states' objections. (As Plaintiffs will not divulge the substance of any *ex parte* overtures to state regulators, we do not know whether or not they attempted a direct approach to any state and failed.)

3. *Plaintiffs' proposed "compromises" are unacceptable for other reasons.*

Without belaboring the issue, it bears noting that Plaintiffs' supposed compromises for resolving this dispute are illusory, legally insupportable in some cases, and at base, unfair. For example, the essence of their North Carolina solution is to cherry pick certain aspects of restricted documents (such as the conclusion that a certain executive saw the state's reports) while barring the use of the substance of the reports — an outcome that could create a false impression of material negative knowledge on the executive's part, while depriving Defendants of the ability to show otherwise. Moreover, as Mr. Baker correctly explained during the October 30 conference call, Household is powerless to negotiate the waiver of privileges that belong to the relevant state agencies.

4. *Defendants' Proposals*

In the interest of putting this issue to rest promptly, and in a manner that avoids unnecessary conflicts between the Company and its regulators while observing basic principles of comity and fairness, Defendants respectfully ask the Court to reject Plaintiffs' demand for any further relief on the subject of the few remaining state agency documents. Plaintiffs will of course remain free to seek these cumulative, marginally relevant documents through appropriate channels (provided they do not impede completion of fact discovery on January 31, 2007), but they should be ordered to inform Defense counsel of any such approaches so that a state regulator will hear a balanced presentation.

If the Court should be inclined to rule on the objections of the nine remaining states notwithstanding Plaintiffs' failure to exhaust administrative process or address the jurisdictional concerns raised by certain states, Defendants respectfully submit that the Court should refuse to order the Company to disobey the instructions of its state regulators. As shown in this submission, Plaintiffs have failed to demonstrate a level of relevance and need sufficient either to outweigh the confidentiality interests of the states or to justify the burden and delay of any necessary appeals. Finally, if the Court does order Defendants to produce restricted documents, Defendants ask that it impose a brief stay in order to allow Defendants to notify the affected states and give them and/or Defendants sufficient time to implement any appropriate response. This request does not denote any wish to compound proceedings or obstruct the prompt completion of discovery, and it certainly reflects no disrespect for the Court's careful attention to this matter. Rather, it seems a prudent and necessary measure in the face of threats of criminal prosecution by certain states (such as Hawaii) that do not acknowledge that the disposition of their privileged information is properly before this Court.

Dated: November 3, 2006

Chicago, Illinois

Respectfully submitted,

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