UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

PLAINTIFFS' OPPOSITION TO DEFENDANT ARTHUR ANDERSEN LLP'S MOTION TO STRIKE PARAGRAPHS 180 AND 181 OF PLAINTIFFS' [CORRECTED] AMENDED CONSOLIDATED COMPLAINT

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Plaintiffs oppose defendant Arthur Andersen LLP's ("Andersen") motion to strike ¶¶180-81 of plaintiffs' [Corrected] Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws, filed on 3/13/03 ("Complaint").[1] Andersen has failed to meet its heavy burden under Fed. R. Civ. P. 12(f) of demonstrating that ¶¶180-81 should be stricken.

Motions to Strike Are Generally Disfavored as a Drastic Remedy

1. It is well established that motions to strike[2] are generally disfavored as a "drastic remedy" and are normally denied unless the language in the pleading "'has ***no possible relation*** to the controversy and is clearly prejudicial.'" *Heller Financial, Inc. v. Midwhey Powder Co.*, 883 F.2d 1286, 1294 (7th Cir. 1989); *Lert v. C. Nielsen Co.*, No. 92 C 2216, 1993 U.S. Dist. LEXIS 4242, at *4 (N.D. Ill. Mar. 31, 1993) (Guzman, J.) (emphasis added; citation omitted); *Resolution Trust Corp. v. Vanderweele*, 833 F. Supp. 1383, 1387 (N.D. Ind. 1993).

2. "[T]he standard employed to decipher pertinence and materiality questions is whether or not the 'allegations have no possible relation to the controversy.'" *Khalid Bin Talal Bin Abdul Azaiz Seoud v. E.F. Hutton & Co.*, 720 F. Supp. 671, 686 (N.D. Ill. 1989) (citation omitted); *Talbot v. Robert Matthews Distrib. Co.*, 961 F.2d 654, 664 (7th Cir. 1992) (matter is "scandalous" if it "bears no possible relation to the controversy or may cause the objecting party prejudice").

Andersen's Motion to Strike Attacks Allegations Relevant to Scienter

3. Andersen asks this Court to strike ¶¶180-81, which summarize Andersen's role in ten securities fraud class actions where the gravamen of each case was accounting fraud or accounting improprieties. *Id.* Significantly, Andersen was a named defendant in each of those actions and was the purportedly independent auditor for the respective defendant companies during the time in which the accounting improprieties occurred. ¶180.

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[1] All paragraph ("¶___") references are to the Complaint unless otherwise indicated.

[2] The Federal Rules of Civil Procedure allow courts, in their discretion, to strike "from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. P. 12(f).

4. Plaintiffs allege that Andersen abandoned its function as a "public watchdog" by failing to maintain complete independence and helping Household International, Inc. ("Household" or the the "Company") perpetrate the massive accounting fraud. ¶172. Further, plaintiffs allege that Andersen's role and egregious conduct in Household's fraud was not an isolated incident, but rather shared the same underlying themes as its conduct in some of the most significant financial disasters in history – disasters that wiped out the market capitalization in many public companies and deprived investors of their life savings. *See* ¶180 ("Andersen is a recidivist violator of the federal securities laws with a history of accounting improprieties, conflicts of interest and document destruction in some of the most egregious cases of accounting fraud in the history of the U.S. securities markets, its now-former client list making up a veritable 'who's who' of financial disasters.").

5. Andersen's conduct as described in ¶¶180-81 is also relevant to "'overcome [the] irrational inference that the accountant would risk its professional reputation to participate in the fraud of a single client,'" a burden Andersen argues plaintiffs must sustain in order to properly plead scienter. *See* Memorandum of Law in Support of Defendant Arthur Andersen LLP's Motion to Dismiss Counts I, III and IV of Plaintiffs' [Amended] Consolidated Class Action Complaint, at 7 n.4 (citation omitted). Where an auditor has demonstrated a consistent lack of regard for its reputation, as alleged in ¶¶180-81, such an inference can no longer be labeled "irrational."

Andersen Has Failed to Meet Its Heavy Burden of Demonstrating that Plaintiffs' Allegations Have "No Possible Relation" to the Controversy

6. Andersen's only argument for striking these paragraphs is that they have "no relevance." Defendant Arthur Andersen LLP's Motion to Strike Paragraphs 180 and 181 of Plaintiffs' [Corrected] Amended Consolidated Complaint ("Def's MTS"), ¶3. Andersen argues that audits of financial statements of other companies have no relevance to Andersen's audits of Household's financials and that allegations of Andersen's involvement in other litigations is not relevant to this Complaint. *Id.*

7. Andersen is simply wrong. Before the court will strike portions of a complaint, the

moving party has the burden of showing that the "challenged allegations are ***so unrelated to plaintiff's claim*** as to be devoid of merit, unworthy of consideration, and unduly prejudicial." *Carroll v. Chicago Transit Authority*, No. 01 C 8300, 2002 U.S. Dist. LEXIS 2125, at *3 (N.D. Ill. Feb. 7, 2002) (emphasis added to terms Andersen chose to omit in its submission to the Court).[3] Andersen has not met its heavy burden of demonstrating that these facts have no relevance, much less the more stringent showing that these facts are so unrelated to plaintiffs' claims as to be devoid of merit, unworthy of consideration and unduly prejudicial.

8. Plaintiffs are not using these allegations to demonstrate Andersen's propensity to commit fraudulent acts. Rather, these facts are highly relevant to pleading scienter, an essential element of plaintiffs' case.[4] Recently, the district court in the Southern District of Texas found some of these very same facts, among others, to be persuasive in determining that plaintiffs had "alleged specific facts giving rise to ... scienter." *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 706 (S.D. Tex. 2002). The district court in Texas found that:

> Lead Plaintiff has described ***several similar prior fraudulent audits*** of other companies, ***establishing a pattern of such conduct***, and the SEC's and courts' repeated imposition of penalties on Arthur Andersen and its employees, including the consent decree and injunction from the Waste Management fraud which was in effect at the time Lead Plaintiff alleges that Arthur Andersen violated §10(b) in auditing Enron.

Id. (emphasis added). *See also Cox v. Joe Rizza Ford*, No. 94 C 5688, 1996 U.S. Dist. LEXIS 1581 (N.D. Ill. Feb. 8, 1996) (court refused to strike paragraphs that referred to an investigation by the Attorney General of New York, despite defendants' claim that they were irrelevant to the lawsuit in

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[3] Andersen misleads the Court with incomplete self-serving citations giving the impression that courts routinely strike allegations in complaints, when, in fact, motions to strike are a "drastic," last-resort remedy. *See* Def's MTS, ¶2.

[4] When pleading securities fraud under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), plaintiffs must allege facts either (1) showing that Andersen had both motive and opportunity to commit fraud; or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness. *In re First Merchants Acceptance Corp. Sec. Litig.*, Master File No. 97 C 2715, 1998 U.S. Dist. LEXIS 17760, at *28 (N.D. Ill. Nov. 2, 1998). Whether or not plaintiffs have met this standard is not the relevant inquiry here and is discussed in detail in Plaintiffs' Response to Arthur Andersen LLP's Motion to Dismiss Counts I, III and IV of Plaintiffs' [Corrected] Amended Consolidated Complaint.

Illinois); *In re Catanella & E.F. Hutton & Co., Sec. Litig.*, 583 F. Supp. 1388, 1400 (E.D. Pa. 1984) (court refused to strike the complaint's reference to a prior lawsuit in which one of the defendants had been found guilty of violating §10(b) of the Securities Exchange Act of 1934). The injunction from the Waste Management fraud was also in effect the during Class Period here – 10/23/97 to 10/11/02.

9. The two cases on which Andersen rests its argument are distinguishable and in fact fail to support their position. Def's MTS at 3, ¶3 (citing *Beck v. Cantor, Fitzgerald* & Co., 621 F. Supp. 1547 (N.D. Ill. 1985), and *Illinois v. Sperry Rand Corp.*, 237 F. Supp. 520 (N.D. Ill. 1965)).

10. In *Beck*, plaintiffs sought to rescind a contract for the purchase of securities relying on allegations of an SEC investigation and findings against the auditors. *Beck*, 621 F. Supp. at 1565. In striking these allegations, the court found that plaintiffs had not relied on false financial statements reviewed by the auditors in purchasing the securities. *Id.* Thus, the court found these allegations to be irrelevant to the matter at hand. *Id.* In *Sperry Rand*, the court struck the references to a pending government civil action against defendants under §5(a) of the Clayton Act. *Sperry Rand*, 237 F. Supp. at 523. Because the pending government civil case against the defendant had not reached the trial stage and no testimony had been taken, Judge Will found that such bare allegations served no useful purpose. *Id.*[5] ("It is well established that for a judgment to be 'final,' as contemplated by section 5(a) of the Clayton Act, the time for appeal must have run or the judgment affirmed by a court of last resort.").

11. Accordingly, Andersen's contention that allegations of similar conduct in other litigations are irrelevant, is wrong and unsupported. Def's MTS at 2-3.

Allegations of "Other Bad Acts" Are Permissible to Show Motive, Opportunity, Intent, Preparation, Plan or Knowledge

12. In a securities fraud case, pre- and post-class period acts are relevant at the dismissal

[5]Section 5(a) permits other parties to use, as *prima facie* evidence, any judgment or decree obtained by the United States against a defendant under the antitrust laws against that defendant. *See* 15 U.S.C. §16(a). Indeed, §5(a)'s express limitation is that it does not apply to consent judgments or decrees entered before any testimony has been taken. *Sperry Rand*, 237 F.Supp. at 523.

stage. Plaintiffs may introduce evidence of "other crimes, wrongs, or acts" for the limited purpose of showing a person's "motive, opportunity, intent, preparation, plan, [or] knowledge" relating to the charged offense. Fed. R. Evid. 404(b). *See In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 72 (2d Cir. 2001) ("Any information that sheds light on whether class period statements were false or materially misleading is relevant.").

13. Andersen contends that its audits of other clients are irrelevant. Def's MTS at 2-3, ¶3. Further, in a footnote, Andersen contends that, "should the Court reach this issue, Rule 404 of the Federal Rules of Evidence precludes plaintiffs from doing what they are seeking to do here." Def's MTS at 4 n.2. Notwithstanding Andersen's failure to intelligibly articulate its argument, it should be noted that although plaintiffs are not seeking to enter anything into evidence at the pleading stage, similar facts have been found admissible in the Seventh Circuit.

14. The Seventh Circuit has found that specific facts alleging other acts are not only permissible at the pleading stage, but also admissible under Federal Rule of Evidence 404(b) for the purpose of showing intent, knowledge, plan or motive. *See Jannotta v. Subway Sandwich Shops, Inc.*, 125 F.3d 503, 517 (7th Cir. 1997) (at trial, the district court found admissible plaintiffs' evidence of 12 present and former landlords holding unpaid judgments against Subway for the purpose of showing defendants' intent under Fed. R. Evid. 404(b)); *United States v. Scop*, 940 F.2d 1004, 1008-09 (7th Cir. 1991) (evidence of other uncharged stock manipulation was "highly probative" of a "common and indeed inseparable scheme" to violate federal securities laws).[6]

15. District courts in this district agree with and follow this rationale. *See, e.g., Chicago*

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[6]Notably, Andersen's out-of-circuit cases have no persuasive authority for district courts here when the Seventh Circuit has specifically addressed the admissibility of other bad act evidence under Fed. R. Evid. 404(b). In any event, the cases relied upon by defendants are distinguishable because they are at a different procedural stage than the case at hand -- all arise post-discovery and some even post-judgment. *See Berkovich v. Hicks*, 922 F.2d 1018 (2d Cir. 1991) (appeal from a judgment entered after a jury trial excluding evidence used to demonstrate defendant's propensity to commit act in question, rather than to show motive, opportunity, intent, common plan or scheme); *Johnson v. Ford Motor Co.*, 988 F.2d 573 (5th Cir. 1993) (appeal from a judgment entered after a jury trial excluding evidence of other accidents, where such evidence used to establish liability rather than to show that defendants had notice); *Roberts v. Harnischfeger Corp.*, 901 F.2d 42 (5th Cir. 1989) (appeal from a judgment entered after a jury trial excluding hearsay evidence).

Printing Co. v. Heidelberg USA, Inc., No. 01 C 3251, 2001 U.S. Dist. LEXIS 21358, at *3 (N.D. Ill. Dec. 14, 2001) (where intent is a "critical issue" evidence of prior misconduct, *i.e.*, specific facts that defendant defrauded another customer, is admissible under Fed. R. Evid. 404(b)); *Fujisawa Pharm. Co. v. Kapoor*, No. 92 C 5508, 1999 U.S. Dist. LEXIS 11381, at *39 (N.D. Ill. July 20, 1999) ("other crimes" evidence relating to abbreviated new drug applications is permissible under Fed. R. Evid. 404(b) to show intent, knowledge or a common scheme or plan; evidence could go to establish defendants' scienter).

16. Additionally, courts in other circuits also allow admission of "other acts" evidence in cases charging securities law violations. *Rothberg v. Rosenbloom*, 771 F.2d 818 (3d Cir. 1985), for example, involved a district court's finding that defendants had traded on insider information. In affirming that finding, the Third Circuit rejected arguments that a new trial was warranted because the district court had admitted evidence showing defendants' other instances of using insider information. Evidence of the similar acts was "clearly admissible" as evidence of the "nature and purpose" of joint ventures defendants had set up in order to facilitate "trading on insider information." *Id.* at 823. In *United States v. Smith*, 727 F.2d 214 (2d Cir. 1984), the Second Circuit affirmed defendant's securities fraud and wire fraud convictions, holding that other evidence of securities violations "shed light upon important elements" of the defendant's scheme. *Id.* at 219-20.

17. Cases relied upon by defendants simply do not apply here because this case is still at the pleading stage, not at the advanced discovery stage. *See, e.g., In re One Bancorp Sec. Litig.*, 134 F.R.D. 4, 11 (D. Me. 1991) (addressing a discovery dispute over audit plans, programs and procedures for "'clients that are in the same or similar business as One Bancorp"') (citation omitted); *WAIT Radio v. Century Broadcasting Corp.*, No. 85 C 07579, 1989 U.S. Dist. LEXIS 12364 (N.D. Ill. Oct. 12, 1989) (addressing discovery dispute in a case regarding misappropriation of partnership assets; documents and workpapers concerning trade and barter transactions of other Peat Marwick clients were disallowed because expert did not rely on such documents in reaching his conclusions); *California Public Employees Retirement System et al. v. Arthur Andersen LLP*, No. Civ. 97-1899,

Memorandum and Order on Plaintiffs' Motion to Compel Production of Certain Documents Requested in Request No. 53 of Plaintiffs' First Request for Production (D. Ariz. June 7, 1999) (where the complaint did not allege that Andersen should have issued a going concern qualification, discovery of documents regarding audits of other Andersen clients for comparison purposes not permitted).

18. Thus, Andersen's self-serving, out-of-context quotations are misleading. As detailed above, district courts are wary of striking allegations. "[A]ny doubt as to the striking of matter in a pleading should be resolved in favor of the pleading." *Pain Prevention Lab, Inc. v. Electronic Waveform Labs, Inc.*, 657 F. Supp. 1486, 1491 (N.D. Ill. 1987).

Andersen's Attempts to Argue a Motion to Dismiss Should Be Disregarded

19. Andersen then attempts to argue the merits of its motion to dismiss. Def's MTS at 5, ¶¶4-5. A motion to strike under Fed. R. Civ. P. 12(f) is "neither an authorized nor a proper way to procure the dismissal of all or part of a complaint." *Williams v. Adams*, 625 F. Supp. 256, 258 n.3 (N.D. Ill. 1985).

20. Andersen would have this Court strike "other act" allegations that a plaintiff, as master of his complaint, includes, but proffers unsupported and non-citable adjudications in other litigations in support of Andersen's lack of scienter. *See* Def's MTS at 5, ¶4 (stating without any supporting authority that nothing was inappropriate about Andersen's conduct in the Global Crossing matter); *Bartlett v. Arthur Andersen LLP*, No. 01-17327, 2003 U.S. App. LEXIS 1591 (9th Cir. Jan. 24, 2003) (dismissal for failure to meet pleading requirements).[7]

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[7]Andersen's citation to *Bartlett* violates Seventh Circuit Rule 53(e), which prohibits citing an unpublished opinion of any court if citation is prohibited in the rendering court. U.S.C.S. Ct. App. 7th Cir., Circuit R. 53 (2003). The Ninth Circuit, which rendered the *Bartlett* opinion, expressly stated that the opinion was not appropriate for publication and "may not be cited to" (except under circumstances not applicable here). U.S.C.S. Ct. App 9th Cir., Circuit R. 36-3 (2003). In addition, where a party failed to indicate that a case cited was an unpublished opinion, courts in this District have found the party's citation of an unpublished case, to say the least, somewhat misleading. *Anzaldua v. Chicago Transit Authority*, No. 02 C 2902, 2003 U.S. Dist. LEXIS 526, at *9 (N.D. Ill. Jan. 14, 2003); *Watts v. Advance Transformer Co.*, No. 02 C 4603, 2002 U.S. Dist. LEXIS 19897, at *6 (N.D. Ill. Oct. 17, 2002).

Andersen's Consent Decree with the SEC Is Admissible

21. In a footnote, Andersen claims that the consent agreement with the SEC in the Waste Management matter is inadmissible and should be stricken from the Complaint. Def's MTS at 4 n.3. First, it is well established law in this Circuit that substantive arguments raised in footnotes are waived. *Kaplan v. Shure Bros.*, 153 F.3d 413, 418 n.2 (7th Cir. 1998). In any event, Andersen is wrong. Allegations in a complaint regarding a consent decree are proper because consent decrees may be admissible into evidence. *See, e.g., Enron*, 235 F. Supp. 2d at 675 (finding that Arthur Andersen had violated an SEC consent decree arising out of its involvement in the Waste Management accounting scandal by again participating in the cover-up of accounting fraud at another of its biggest clients); *United States v. Gilbert*, 668 F.2d 94 (2d Cir. 1981) (holding a decree clearly admissible under Fed. R. Evid. 404(b) to show that defendant knew of the SEC reporting requirements involved in the decree).

22. Andersen's reliance on *Sperry Rand* and *Petruzzi's IGA Supermarkets v. Darling-Delaware Co.*, 998 F.2d 1224 (3d Cir. 1993), is also misplaced. Def's MTS at 4 n.3. *Sperry Rand* and *Petruzzi's* both hold that prior government antitrust consent judgments or decrees are admissible as *prima facie* evidence against the defendant in subsequent actions where testimony has been taken. *See* ¶10, *supra*; *see Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co. Inc.*, No. 3:CV-86-0386 (Judge McClure), 1992 U.S. Dist. LEXIS 13054, at **57-58 (M.D. Pa. July 31, 1992), *aff'd*, 998 F.2d 1224 (3d Cir. 1993) (The lower court's finding that "[n]one of the five prior actions cited by Petruzzi's qualifies for admission under section 5(a). Only three ... potentially qualify, the other two not being actions filed by the government. Of those three, none terminated in a final judgment of liability against any defendant named in this action" was affirmed by the circuit court.).

23. Accordingly, allegations regarding Waste Management the SEC Consent Decree are proper.

Andersen Has Not Shown that It Has Suffered Any Prejudice

24. Andersen has failed to demonstrate prejudice. First, Andersen concedes that reports

about litigation alleged in the Complaint "may be known to the Court." Def's MTS at 1-2, ¶1. Second, simply because facts alleged in the Complaint may now offend Andersen's sensibilities, it is not sufficient grounds to strike them. *See Scop*, 940 F.2d at 1009 (evidence concerning truly similar stock manipulation activities is not unduly prejudicial and hence admissible).

25. Moreover, "[t]he facts [in the Complaint] may be unpleasant ... to have on the record and they certainly contain charges of reprehensible conduct but the same is true of many facts of life which are entitled to be pleaded as relevant to a cause of action or a defense. Such, for example, are the facts concerning a divorce for adultery. These may be scandalous and annoying and prejudicial to the accused party but plaintiff or defendant is certainly entitled to plead them. They would, however, have no place ordinarily in an automobile accident case and in such case would be stricken as scandalous." *Gateway Bottling, Inc. v. Dad's Rootbeer Co.*, 53 F.R.D. 585, 588 (D. Pa. 1971). Because allegations of Andersen's involvement in other litigations are not unduly prejudicial, they should not be stricken.

26. Finally, recognizing that its motion to strike is frivolous and without merit, Andersen resorts to taking pot shots at plaintiffs' counsel. Def's MTS at 5 n.4. When counsel resorts to hitting below the belt in a losing fight, the merits of their motion are cast in an especially doubtful light.

CONCLUSION

27. For the foregoing reasons, Andersen's motion to strike ¶¶180 and 181 should be denied.

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Respectfully submitted,

MARVIN A. MILLER
MILLER FAUCHER AND CAFFERTY LLP
30 North LaSalle Street, Suite 3200
Chicago, IL 60602
Telephone: 312/782-4880
312/782-4485 (fax)

Liaison Counsel and Designated Local Counsel

MILBERG WEISS BERSHAD
HYNES & LERACH LLP
WILLIAM S. LERACH
401 B Street, Suite 1700
San Diego, CA 92101
Telephone: 619/231-1058
619/231-7423 (fax)

MILBERG WEISS BERSHAD
HYNES & LERACH LLP
PATRICK J. COUGHLIN
SUSAN K. ALEXANDER
AZRA Z. MEHDI (90785467)
LUKE O. BROOKS (90785469)
100 Pine Street, Suite 2600
San Francisco, CA 94111
Telephone: 415/288-4545
415/288-4534 (fax)

Lead Counsel for Plaintiffs

See Case File For Exhibits