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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' RESPONSE TO HOUSEHOLD DEFENDANTS' MOTION TO DISMISS [CORRECTED] AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

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I. INTRODUCTION

A $484 million settlement between Household International, Inc. ("Household" or the "Company") and the 50 state attorney generals to settle charges of "violations of consumer protection, consumer lending and insurance laws and regulations," SEC findings that Household's reaging practices violated federal securities laws, a $600 million restatement for improper accounting practices, and a quickie sale to a foreign corporation when Household's house of cards was about to collapse and all sources of public funding were drying – these practices are each detailed in the Complaint[1] with particularity. ¶¶2-31, 50-170; Defs' Ex. B.[2] The contents of defendants' false statements, when they were made, by whom and to whom are painstakingly detailed in the Complaint. ¶¶192-95, 197-216, 218-41, 243-66, 269-70, 272-80, 283-301, 303-306, 310-17, 320-30, 333-41. The Complaint further alleges why each of these statements was false when made. ¶¶196, 217, 242, 267-68, 271, 281-82, 302, 307-308, 318-19, 331-32, 342. Together, these allegations plead falsity.

Defendants' persistent efforts to conceal their improper practices and defendants' affirmative misrepresentations to mask their fraud are also detailed in the Complaint. ¶¶19-22, 83-91, 266, 280, 293-94, 300-301, 317, 320-21, 329-30, 334-35, 339-41. Defendants' motivation to engage in these improper and illegal activities in order to meet Wall Street analysts' earnings expectations, thus artificially inflating the Company's stock price and maximizing their own financial gains, is also particularly alleged in the Complaint. ¶¶156-64. The Complaint explains how defendants used the fraud to attain "record" financial results for many years. ¶¶50-344. Cumulatively, those allegations plead scienter.

Thus, plaintiffs have more than satisfied the pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). Defendants' repeated arguments for "substantiation" or

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[1] "Complaint" refers herein to the [Corrected] Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws, filed 3/13/03. All paragraph references ("¶") are to the Complaint, unless otherwise indicated.

[2] All references to "Defs' Ex. _" are to Defendants' Appendix of Exhibits, filed concurrently with the Memorandum of Law in Support of Defendants' Motion to Dismiss the Corrected Amended Consolidated Class Action Complaint ("Defs' Mem.").

that even more detail could be pled, amount here to requiring plaintiffs to plead evidence. *In re Cabletron Systems, Inc.*, 311 F.3d 11, 33 (1st Cir. 2002). The law does not go that far. In *Cabletron Systems*, the First Circuit reversed a dismissal – in the face of precisely these assertions by defendants – holding that "the rigorous standards for pleading securities fraud do not require a plaintiff to plead evidence." *Id.*

Courts in this District are cognizant that "'[a]lthough pleading securities fraud after the PSLRA can no longer be described as merely "notice pleading," courts must be careful not to set the hurdles so high that even meritorious actions cannot survive a motion to dismiss. Such a regime would defeat the remedial goals of the federal securities laws.'" *Sutton v. Bernard*, No. 00C 6676, 2001 U.S. Dist. LEXIS 11610, at **16-17 (N.D. Ill. Aug. 6, 2001).[3]

"Unless reasonable inferences from circumstances suffice to get a case to a jury, the welfare of victimized investors and the integrity of the stock market may be insufficiently protected from deceptive manipulators." *Ronconi v. Larkin*, 253 F.3d 423, 428 (9th Cir. 2001). Because the Complaint meets the stringent requirements of the PSLRA, defendants' motion to dismiss the Complaint should be denied in its entirety.

II. STATEMENT OF FACTS[4]

Plaintiffs are a group of investors – comprised of pension funds, retirement benefit plans, nonprofit charitable institutions and an investment advisor – that purchased or acquired Household securities from 10/23/97 to 10/11/02 (the "Class Period"). ¶36. Plaintiffs and members of the class bought Household securities at prices artificially inflated due to defendants' false and misleading statements and lost hundreds of millions of dollars. ¶¶36, 349-50, 375, 380, 382, 392.

[3]Here, as elsewhere, footnotes and citations have been omitted and any emphasis has been added, unless otherwise indicated.

[4]In the interest of preventing repetition, plaintiffs have outlined only the essential fraudulent scheme in the Statement of Facts. Particulars with respect to the scheme and defendants' false statements in furtherance of the scheme are specified in detail in the respective sections of the Argument, where they apply.

Defendants are the Company, three senior officers and various members of the Board of Directors.[5] Household is a large consumer lender holding company that provides consumer loans, mortgage services, auto finance and credit insurance products, and credit card services. ¶¶7, 37. Household's customer base is primarily composed of nonconforming, nonprime or subprime customers. ¶¶8, 107. Such customers generally have limited credit histories, modest incomes or high debt-to-income ratios or have experienced credit problems caused by occasional delinquencies, prior charge-offs or other credit-related actions. *Id.*

Defendants informed Household shareholders that they were able to achieve "record" financial results quarter after quarter by implementing an aggressive loan growth strategy and maintaining low defaults. ¶¶192, 197, 204, 214, 218, 229, 233, 237, 243, 252, 263, 272, 285, 289, 311, 324, 333. In fact, defendants were only able to accomplish those "record" results by, among other things:

(i) Engaging in improper and illegal predatory lending practices designed to maximize amounts loaned to borrowers in the subprime market at unconscionable interest rates. ¶¶51-82. When caught, the Company took a ***$525 million charge to pre-tax income*** during third quarter 2002 to settle various lawsuits and regulatory actions relating to such improper practices. ¶¶5, 97-102, 105.

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[5]Defendants in this securities fraud class action are (a) Household; (b) Chief Executive Officer ("CEO") William F. Aldinger; (c) Chief Operating Officer ("COO") and Vice-Chairman of the Board David A. Schoenholz, who was the Chief Financial Officer ("CFO") and Chief Accounting Officer ("CAO") during the Class Period; and (d) Vice-Chairman of Consumer Lending/Group Executive of U.S. Consumer Finance Gary Gilmer (collectively, the "Officer Defendants"); all members of the Company's Board of Directors who were members at the time of and/or signatories of Household's 6/01/98 Form S-4 Registration Statement (the "Beneficial Registration Statement") (collectively the "Director Defendants"); and Household Finance Corporation, Inc.'s ("HFC") Board of Directors ("HFC Directors"). ¶¶1, 37-40, 44-45, 47. Unless otherwise specified, Household or the Company includes its subsidiaries, Household Finance Corporation, Inc. ("HFC") and Beneficial Corporation ("Beneficial") subsequent to its merger with Household on 6/30/98. ¶1 n.1. Defendant HFC is a wholly owned subsidiary and the finance arm of Household and was responsible for issuing approximately $90 billion of debt, which proceeds were used to finance Household's lending activities, conducted primarily through HFC. ¶37. The Complaint also names Household auditor Arthur Andersen LLP ("Andersen"), and Goldman Sachs & Co. ("Goldman Sachs") and Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"). ¶¶1, 46, 48-49. These defendants have filed individual motions to dismiss, and plaintiffs' respective oppositions to those motions incorporate the necessary facts and legal argument.

(ii) Arbitrarily "reaging" delinquent accounts to conceal Household's true levels of loan defaults and delinquencies. ¶¶107-24. This resulted in Household's agreeing to a ***consent order with the United States Securities and Exchange Commission*** ("SEC"), dated 3/18/03, in which Household agreed to cease and desist from further violations of federal securities laws. *See* Exs. 1 & 2 to the Compendium of Exhibits in Support of Plaintiffs' Request for Judicial Notice ("RJN Ex. __"), filed concurrently herewith.

(iii) Improperly accounting for expenses associated with its credit card co-branding, affinity and marketing agreements, which after Household's dismissal of Andersen, was discovered by the Company's newly-appointed auditor, KPMG, LLP ("KPMG"), and led to a ***$600 million (pre-tax) restatement*** (going as far back as 1994), and resulted in lowering earnings by $386 million. ¶¶5, 25, 50, 134-41.

A. Defendants Caused Household to Engage in Illegal and Abusive Lending Practices Designed to Maximize Loan Amounts Without Providing Any Benefit to the Borrowers

During the Class Period, defendants implemented a variety of illegal sales practices and improper lending techniques designed to deliberately confuse or mislead their subprime customers with respect to crucial aspects of the loan process. ¶¶2, 51-82. These illegal predatory lending practices prevented borrowers from paying off their Household loans early or refinancing loans through competitors. ¶¶17, 51-52, 55-82. Household's goal was to maximize the borrowers' loan amounts so that the borrowers' equity in their property was used up at the time the loan was made. ¶¶15-17, 50-51, 74. Additionally, by preventing refinancing, defendants were able to conceal their abusive sales tactics for a prolonged period. The Officer Defendants accomplished this goal by implementing the following corporation-wide abusive lending practices:

The EZ Pay Plan Scam: Household misrepresented the actual interest rates on loans by falsely telling customers that, by making bi-weekly payments with Household's EZ Pay Plus Bi-Weekly Payment Plan ("EZ Pay Plan"), they would effectively pay the lower interest rate of 7%, when in fact they actually paid significantly higher rates – over 12%. ¶¶52, 55-60.

Using "Discount Points" to Extract Additional Fees: Household routinely charged borrowers additional "discount points" equal to 7%-8% of the loan value. ¶¶62-63. These points did not reduce

the borrowers' interest rate (although they are designed to do so by allowing borrowers to "buy-down" the applicable interest rate, ¶61), were often ***not*** disclosed to borrowers, and, when disclosed, borrowers were not given an option of the amount of points to be prepaid. ¶¶52, 62-66. The up-front finance charges (including points and fees) not only added to the effective interest rate, but these charges were also added to the loan amount, thereby increasing the total debt secured against the borrower's home and significantly inhibited the borrower's ability to refinance the loan through a competitor. ¶64.

Concealing Prepayment Penalties: Household included undisclosed prepayment penalties in its loans to limit the customers' abilities to refinance their Household loans. ¶¶52, 68-70. Rather than affirmatively disclose the existence of prepayment penalties and their impact, as required by the federal Truth in Lending Act ("TILA"), Household implemented an internal policy whereby loan officers were trained to either simply skip over the section without disclosing it to customers or outright lie about the penalties. *Id.*

Insurance Packing: Household routinely added on insurance products to the loan without the customers' knowledge or by falsely leading them to believe the insurance was compulsory. ¶¶52, 71-72. Defendants concealed (i) the total cost of insurance products sold in connection with the loans; (ii) that the policies did not provide for protection for the life of the loan; (iii) that the customers were paying additional up-front points based on the cost of the insurance; and (iv) that these points would not be refunded if the insurance was cancelled. *Id.*

Illegally "Up-Selling" Loans with Exorbitant Interest Rates of 20% or Higher: Household illegally up-sold second loans carrying exorbitant interest rates of 20% or higher even though customers had neither requested nor needed them. ¶¶52, 75, 79. Household mischaracterized these second mortgages as open-ended lines of credit in order to avoid federal disclosure requirements and restrictions applicable to closed-end loans. ¶80. This allowed Household to spring these second mortgages on borrowers on the day their loans closed. ¶75. Household loan officers inflated the customers' income to increase the size of the first mortgage or intentionally directed appraisers to undervalue property in order to use up the loan-to-value ratio on the first mortgage so that borrowers

would have to purchase an expensive second mortgage. ¶¶78-79. Indeed, Household's underwriters often required second loans before they would even approve first mortgage loans. ¶77.

B. Defendants Manipulated Household's Credit Quality Numbers by Improperly "Reaging" or "Restructuring" Delinquent Accounts to Reset Them as Current

Throughout the Class Period, defendants also materially understated the Company's true credit quality by improperly reaging and restructuring delinquent loans to make them current without any evidence that the delinquency had been cured. ¶¶2, 12-14, 24-25, 50, 107-133. Household established procedures, approved by the Officer Defendants and implemented through the Company's sophisticated centralized automated system – Vision, whereby delinquent accounts ***at any level of delinquency***, including accounts that were over 270 days past due, were reaged with merely a single partial payment that was added to the end of the loan without any evidence that the delinquency had been cured. ¶¶12-13, 110, 117-21. Accounts were often reaged multiple times in a single year so that even a customer who made only three or four minimum payments a year would appear current. ¶118.

By falsely presenting an increased number of "current" accounts, defendants made Household's credit quality appear more favorable to investors and the market than it actually was. ¶¶2, 111. Because Household was perceived as having a better quality of subprime customer than its peers, management and analysts recommended the purchase of Household stock. ¶¶25, 28, 128, 193, 222, 323. This further allowed the Company to continue achieving record-breaking results quarter after quarter throughout the Class Period.

C. Defendants Engaged in Improper Accounting of Costs Associated with Various Credit Card Co-Branding, Affinity and Marketing Agreements, Resulting in a $600 Million (Pre-Tax) Restatement of Earnings

In addition to predatory lending and improper account reaging, defendants also manipulated the accounting of Household's significant credit card-related agreements in order to post continuing record growth. ¶¶142-55. Household was required under Generally Accepted Accounting Principles ("GAAP") to write off expenses related to these agreements by prorating them over a certain period of time, *i.e.*, amortizing the expenses. By spreading these expenses over longer periods than those

allowed under GAAP, defendants overstated Household's income. ¶¶134-41. The Company falsely reported its financial results by improperly accounting for:

Co-Branding Agreements: During 1992, Household entered into a co-branded credit card agreement with General Motors (the "GM Card"), which called for Household to pay an up-front fee (origination cost) to its partner for each new credit card account. ¶138(a). Household, in violation of GAAP, inappropriately amortized the origination costs over the term of the agreement, thus spreading the costs paid to its partner over a longer period of time than the one year allowed under GAAP. ¶¶138(a), 147-49. This inappropriate accounting resulted in the overstatement of net income throughout the Class Period. *Id.*

Affinity Agreements: During 1996, Household acquired the AFL-CIO's $3.4 billion "Union Privilege" affinity card portfolio. ¶138(b). In accordance with GAAP, Household began amortizing the premium paid to the AFL-CIO over the contract life. *Id.* In 1999, Household arbitrarily, in violation of GAAP, increased the amortization period for the premium, thus spreading the cost over a longer period of time, resulting in the overstatement of net income throughout 1999, 2000, 2001 and the first half of 2002. ¶¶138(b), 150.

Independent Third Party Marketing Agreement: In 6/99, Household entered into a credit card marketing agreement with an independent marketing company whereby Household was to be reimbursed for marketing expenses in return for a share of revenue from those marketing efforts over a three-year period. ¶138(c). Household, in violation of GAAP, accounted for the revenue sharing payments over a three-year period when, in fact, such payments should have been expensed as incurred, thus overstating net income throughout 1999, 2000, 2001 and the first half of 2002. ¶¶138(c), 152-53.

D. Defendants Were Driven to Meet Analysts' Earnings Expectations to Raise Funding and Enhance Their Own Financial Gains

It was critical to Household's profitability that it produce loan pools that were sizable, stable and consistent. ¶¶11-12, 109. Household was not a depository bank and used the debt markets to raise funding for its operations. ¶¶4, 11, 28, 108. Household not only generated loans from high-risk borrowers but also sold a significant portion of these loans as asset-backed securities

to raise the necessary funding for its operations. ¶¶4, 11-12, 28, 108-109. Household received cash for these asset-backed securities – such securitization income constituted over 28% of Household's total revenue. ¶¶11, 108.

Defendants instituted abusive sales practices and techniques to ensure large loan pools by maximizing borrower loan amounts. ¶¶51-82. Recognizing that their subprime customer base would frequently default due to the excessive monthly payments, defendants programmed their centralized automated Vision system, and trained their collection officers, to arbitrarily reage delinquent loans and reset them as "current," even if the borrower had not satisfied the prerequisites for the account to be reaged. ¶¶107-124. Also, defendants threw in a good measure of improper accounting practices to solidify their fraudulent goals. ¶¶134-53. These fraudulent acts resulted in direct concrete financial benefits to the Officer Defendants because their bonuses and other executive compensation were directly tied to targeted earnings per share ("EPS"), targeted revenue growth, targeted reserve-to-charge-off ratio, targeted return on equity and targeted increases in the number of Household's products used per customer. ¶¶156-64.

E. Defendants Arranged the Sale of Household in an Attempt to Cut Their Losses When Their Scheme Began to Unfold

Together, the predatory lending practices, arbitrary reaging of accounts, improper accounting of expenses and defendants' fraudulent concealment of each of them not only violated GAAP, SEC rules and the confidence of investors, analysts and the market, but also resulted in well over $1 billion of charges and writeoffs and the elimination of over $20 billion of market capitalization. ¶344. Once defendants' house of cards had collapsed, they orchestrated a prompt sale to HSBC Holdings plc ("HSBC"), a foreign bank that is not subject to the SEC's stringent disclosure requirements, ensuring that they received tens of millions of dollars leaving Household shareholders holding the bag. ¶¶6, 30-31, 344.

III. STANDARD OF REVIEW

In considering a motion to dismiss, the Seventh Circuit has made clear that district courts must "take all facts alleged in the complaint, and any inferences that might be reasonably drawn from those factual allegations, in the light most favorable to the plaintiff[s]." *Szumny v. American Gen.*

Fin., Inc., 246 F.3d 1065, 1067 (7th Cir. 2001). The claims averred in the complaint may be dismissed under Rule 12(b)(6) "only if it appears ***beyond doubt*** that the plaintiff can prove ***no set of facts*** in support of his [or her] claim which would entitle him [or her] to relief.'" *Lindelow v. Hill*, No. 00 C 3727, 2001 U.S. Dist. LEXIS 10301, at *8 (N.D. Ill. July 19, 2001) (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). "'When a federal court reviews the sufficiency of a complaint ... its task is necessarily a limited one. The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims.'" *Caremark, Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 648 (7th Cir. 1997) (quoting *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974)).

The PSLRA did not change the standard by which a complaint is reviewed in the context of a motion to dismiss and, thus defendants' burden remains the same. *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 78 (1st Cir. 2002) ("Even under the PSLRA, the district court ... must draw all reasonable inferences from the particular allegations in the plaintiff's favor ...."). The PSLRA requires a complaint alleging securities fraud to "specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading." 15 U.S.C. §78u-4(b)(1); Fed. R. Civ. P. 9(b) (the circumstances constituting fraud must be stated with particularity). Plaintiffs must plead "'the identity of the person making the misrepresentation, the time, place, and content of the misrepresentation, and the method by which the misrepresentation was communicated to the plaintiff.'" *Fishman v. Meinen*, 02 C 3433, 2003 U.S. Dist. LEXIS 2527, at *12 (N.D. Ill. Feb. 21, 2003) (Guzman, J.) (complaint must specify the "who, what, when, where and hows of the allegedly fraudulent acts") (quoting *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990)).

Importantly, Rule 10b-5(a) also imposes liability where specific fraudulent "schemes" are alleged, even though no specific misrepresentation or omission is alleged: "It shall be unlawful for any person ... (a) to employ ***any device, scheme, or artifice to defraud,*** in connection with the purchase or sale of any security." 17 C.F.R. §240.10b-5(a); *see SEC v. Zandford*, 535 U.S. 813, 819 (2002) (stating that even after the PSLRA "this Court has [n]ever held that there must be a misrepresentation" where a fraudulent scheme is alleged); *see also In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 693-704 (S.D. Tex. 2002) (sustaining Rule 10b-5

claims against Enron Corp.'s bankers under the PSLRA where their direct participation in ***fraudulent scheme*** was alleged even though bankers were ***not*** alleged to have made any material misrepresentations or omissions).

Further, the PSLRA requires plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. §78u-4(b)(2). Although the Seventh Circuit has not yet addressed what facts satisfy the PSLRA's scienter requirement, this Court and other courts in the Northern District of Illinois have followed the Second Circuit's pleading standard, which requires plaintiffs to allege facts either (1) showing that the defendant had both motive and opportunity to commit fraud; or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness. *Fishman*, 2003 U.S. Dist. LEXIS 2527, at **13-14.

Although the PSLRA requires some precision in alleging facts, it does ***not*** require pleading of all of the evidence and proof thereunder supporting a plaintiff's claim. *Cabletron Systems*, 311 F.3d at 33.

IV. ARGUMENT

A. Plaintiffs Have Identified Each False Statement with Particularity and Provided Detailed Reasons for Its Falsity

The Complaint specifies "each statement alleged to have been misleading," ¶¶192-95, 197-216, 218-41, 243-66, 269-70, 272-80, 283-301, 303-306, 310-17, 320-30, 333-41, and the "reason or reasons why the statement is misleading" for each year within the Class Period in distinctly identified sections. ¶¶196, 217, 242, 267-68, 271, 281-82, 302, 307-08, 318-19, 331-32, 342. *See* 15 U.S.C. §78u-4(b)(1)(B). Plaintiffs allege that between 10/23/97 and 10/11/02 Household's press releases announcing financial results, and SEC filings incorporating these financial results were false and misleading because defendants achieved these financial results by engaging in improper and illegal lending practices, arbitrarily reaging delinquent loans to make them current and improperly manipulating the accounting treatment of expenses of their credit card-related agreements. *Id.* Where necessary, plaintiffs have also provided additional reasons for the falsity. *See* ¶¶217(e), 242(e), 271(e), 302(e), 342(e) (identifying the specific falsity of various financial statements as a

result of the restatement). In *Danis v. USN Communs., Inc.*, 73 F. Supp. 2d 923, 932 (N.D. Ill. 1999), the court found that the particularity requirement was met where "[t]he complaint, in excess of one hundred pages, quotes each alleged misstatement and identifies the document or release in which the statement was made, the speaker or author, and explains why the statement was false and misleading." *See also Fugman v. Aprogenex, Inc.*, 961 F. Supp. 1190, 1194-95 (N.D. Ill. 1997) (complaint identified 60 specific false statements, identifying the speaker, the time of the statement and the substance with a brief explanation why plaintiffs believed the statement was false).

Even the two paragraphs identified by defendants, where they claim falsity is not particularly alleged, underscore the weakness of their position. *See* Defs' Mem. at 10 (identifying ¶¶197 and 311). Both ¶¶197 and 311 refer to Household's press releases announcing purportedly "record" financial results for fiscal years 1997 and 2001, respectively. The Complaint particularly alleges that the financial results reported by the Company during those years were false and materially misleading (¶¶197, 311), and the reasons for their falsity. *See* ¶¶217, 342. Defendants have already conceded, by virtue of the $600 million restatement, that the financial results for 1997 and 2001 were false because of improper accounting practices. ¶¶142-53. The Complaint details the financial impact of the restatement for each respective reporting period. ¶¶217(c), 342(c). The Complaint alleges that the financial results were also false because defendants engaged in a pervasive, nationwide scheme of illegal and abusive lending practices to achieve their loan growth strategy. ¶¶217(a)-(b), 342(a)-(b). The Complaint further details that the Company's reported financial results were false and misleading because defendants engaged in arbitrary reaging of delinquent accounts thereby manipulating the delinquency ratios and the amount of credit loss reserves needed to cover potential defaulting loans. ¶¶217(c), 342(c). Similar details are also alleged with respect to each false statement identified in the Complaint. Defendants' contention that the false statements arbitrarily address a "variety of topics," like the discussion of the Transamerica Corp. and ACC Consumer Finance Corp. acquisition, is inaccurate. Defs' Mem at 10. The acquisition of consumer finance company Transamerica Corp. in 5/97 and subprime auto lender, ACC Consumer Finance Corp. in 8/97 facilitated defendants' engagement in abusive lending on a nationwide scale. ¶9 (incorporated by reference in ¶217).

Defendants choose to ignore these detailed statements, inaccurately summarizing the falsity allegations as "operational difficulties" or "operational problems." Defs' Mem. at 9-10. Defendants' attempt to minimize plaintiffs' factual allegations is wholly inappropriate on a motion to dismiss, where plaintiffs' allegations must be taken as true and considered in the light most favorable to plaintiffs. *American Nat'l Bank & Trust Co. v. Axa Client Solutions LLC*, 00 C 6786, 01 C 9974, 2002 U.S. Dist. LEXIS 8708, at *3 (N.D. Ill. May 16, 2002); *Suez Equity Investors v. Toronto-Dominion Bank*, 250 F.3d 87, 100 (2d Cir. 2001) (district court's dismissal reversed where district court "failed to draw all reasonable inferences in favor of the non-movant").

The only case defendants cite from this District to dispute that plaintiffs have not met their burden is distinguishable. In *Clark v. TRO Learning*, No. 97 C 8683, 1998 U.S. Dist. LEXIS 7989, at *10 (N.D. Ill. May 19, 1998), the court found that plaintiff had failed to describe in his complaint ***any*** specific false statements that defendants had made. Plaintiffs there lumped together over 100 paragraphs under the heading "Substantive Allegations" but failed to identify which of these allegations constituted defendants' false statements. *Id.* at *13. Unlike the plaintiff in *Clark*, plaintiffs here have particularly identified defendants' false statements and provided reasons for their falsity. ¶¶192-342.

Defendants' argument that even more detail should be required before there is any discovery amounts to requiring plaintiffs to plead evidence. *Cabletron Systems*, 311 F.3d at 33. Moreover, where more specific information is exclusively in the hands of defendants, more is not needed. *In re First Merchants Acceptance Corp. Sec. Litig.*, Master File No. 97 C 2715, 1998 U.S. Dist. LEXIS 17760, at *25 (N.D. Ill. Nov. 2, 1998) ("given that most of this information is in the hands of defendants, the court finds that plaintiffs have satisfied their burden at this stage of the litigation"). Thus, plaintiffs have sufficiently identified defendants' false statements and provided reasons for their falsity.

B. Plaintiffs Adequately Provide the Basis for the Allegations in the Complaint

Plaintiffs' Complaint identifies the basis for its allegations, including SEC filings, analyst reports, news media, interviews with former Household employees, and findings of regulatory

agencies such as the Washington Department of Financial Institutions ("WA Department"), federal and state complaints against defendants. ¶345. For example, the basis of the Complaint's allegation that Household's predatory lending practices were nationwide "and likely fostered by the corporation itself" is the $484 million settlement with the 50 states' attorney generals. ¶¶5, 23, 97. This allegation is corroborated by the lengthy investigation and specific findings by the WA Department on the uniformity of the abusive practices and headquarters' knowledge of the disclosures and sales practices when responding to complaints, as well as by the Minnesota Commissioner's comments based on his year-long investigation into Household's practices ("Household's corporate culture encouraged rather than prohibited these deceptive and abusive lending practices."). ¶¶21, 23, 54, 58-59, 92, 98.

Further, contrary to defendants' contention, plaintiffs are not required to identify their sources or tie each omitted fact to a particular source where the basis of allegations is so particularly alleged. Defs' Mem. at 11, 14, 16, 19, 23, 28. The First, Second, Fifth, Eighth and Ninth Circuits have all agreed that plaintiffs need not identify their sources as long as the complaint allegations "'provide an adequate basis for believing that the defendants' statements were false.'" *See Cabletron Systems*, 311 F.3d at 30 (finding that holding to the contrary would have a chilling effect on employees who provide information about "corporate malfeasance");[6] *accord ABC Arbitrage v. Tchuruk*, 291 F.3d 336, 353 (5th Cir. 2002); *Florida Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 668 (8th Cir. 2001); *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000).

District courts in the Northern District of Illinois follow this rationale. *See, e.g., Johnson v. Tellabs, Inc.*, No. 02 C 4356, 2003 U.S. Dist. LEXIS 8513, at *20 (N.D. Ill. May 19, 2003) (citing *Novak*, 216 F.3d at 314) ("we find no requirement in existing law that, in the ordinary course, complaints in securities fraud cases must name confidential sources"); *Danis*, 73 F. Supp. 2d at 938 n.8 (reliance upon "SEC filings and press releases is sufficient to meet the requirements of the

[6]In *Cabletron Systems*, Judge Lynch noted that, "In fact, it is not the Ninth Circuit decision but the *Silicon Graphics* district court opinion, 970 F. Supp. at 763-64, that sets out a strong *per se* rule" against naming confidential sources at the pleading stage. 311 F.3d at 29 n.9.

PSLRA"). Because plaintiffs have provided an ample basis for their allegations, they are not required to name their confidential sources.

C. Plaintiffs Have Adequately Alleged Facts that Raise a Strong Inference of Scienter

The PSLRA requires that the Complaint "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. §78u-4(b)(2). Plaintiffs plead scienter with combined allegations of defendants' motive, opportunity, and direction of the fraudulent scheme.

1. Defendants Had Strong Motives to Engage in Fraud – to Meet Analysts' Consensus of Earnings (a Significant Component of Defendants' Bonuses) and to Artificially Inflate the Stock Price to Obtain Funding from Investors

Defendants were strongly motivated to ensure that the Company was able to meet or exceed analysts' expectations with respect to income and EPS during the Class Period (i) because their compensation and bonuses were tied to EPS and other financial performance of the Company, ¶¶156-61; and (ii) to raise crucial funding, without which Household could not have survived as a business. ¶156. In a recent complaint against a company and its CEO, the SEC took the position that artificially inflating earnings to match Wall Street analysts' expectations is a valid motive for fraud. *See SEC v. HealthSouth Corp., et al.*, Civil Action No. CV-03-J-0615-S, Complaint for Injunctive and Other Relief (N.D. Ala. Mar. 19, 2003). Indeed, despite defendants' dismissive arguments, the Complaint alleges that, absent these improprieties, Household would have failed to meet analysts' consensus estimates for ***each and every quarter*** of the Class Period. *See* ¶¶156, 162 (chart detailing reported EPS, consensus estimates and change in EPS upon restatement).

Courts have consistently held that motive is sufficiently alleged in cases like this that demonstrate defendants could have secured a concrete benefit by the fraudulent misrepresentations alleged if their scheme was successful. *See Novak*, 216 F.3d at 307 ("Motive would entail concrete benefits that ***could*** be realized by one or more of the false statements and wrongful nondisclosures alleged."). Defendants here obtained concrete benefits from their fraudulent conduct during the Class Period: Aldinger got $15.8 million, Schoenholz got $7.27 million and Gilmer got $7.1 million in bonuses alone. ¶¶160-61. Additionally, Aldinger, Schoenholz and Gilmer received over 2.8

million, 728,000 and 683,000 Household shares, respectively, as part of their compensation, in addition to a salary and other executive compensation. *Id.* Defendants' scheme was tailored to meet the very criteria their bonuses were based on – attaining targeted EPS (achieved by accounting improprieties and predatory lending), targeted reserve to charge-off ratio (achieved by improper reaging), targeted core receivable growth (achieved by predatory lending), targeted increases in the number of Household products used per customer (achieved by insurance packing, illegally upselling secondary loans and cross-selling other Household products in connection with reaging). ¶¶159-64. Where defendants' compensation depends upon a company's earnings, financial incentives to exaggerate earnings may be considered among other facts to show scienter. *Aldridge*, 284 F.3d at 83.

In addition, motive to commit fraud in order to obtain funding has also been recognized as valid to support scienter. *See Queen Uno Ltd. Pshp. v. Coeur d'Alene Mines Corp.*, 2 F. Supp. 2d 1345, 1359 (D. Colo. 1998) (corporation had motive to inflate stock price where doing so would permit it to complete a $150 million convertible securities offering); *In re Kidder Peabody Sec. Litig.*, Master File, 94 CIV. 3954 (JFK), 1995 U.S. Dist. LEXIS 14481, at *16 (S.D.N.Y. Oct. 4, 1995) (scienter adequately alleged where defendant "badly needed bank financing and the only way to get that financing was to show profitability"). In this case, public funding was crucial to the Company – Household was not a depository bank and needed to obtain funding from the public market. ¶¶11-12, 30. The only way it could raise funding was by securitizing a significant portion of its receivables and selling them for cash, which it used to run its lending operations. ¶¶11-12, 108-109. In order to access public markets continuously (defendants raised over $75 billion in funding during the Class Period through securitizations), defendants had to demonstrate loan growth as well as stable credit quality. *Id.* When the settlement with the state attorney generals was announced on 10/11/02, Household was placed on a Rating Watch Negative because "***the bigger challenge for Household will be replenishing lost revenue resulting from the implementation of 'Best Practices.' An ability to offset these revenue streams could pressure future profitability, which in turn could put pressure on the current rating.***" ¶¶100, 169. Significantly, even defendant Aldinger acknowledged "funding issues" were the primary reason for slow growth in third quarter

2002 the same time that the predatory lending settlement and accounting issues were announced. ¶¶30-31.

Defendants cite *Mortensen v. AmeriCredit Corp.*, 123 F. Supp. 2d 1018 (N.D. Tex. 2000) for the position that allegations of manipulating the delinquency ratio to obtain financing is not a sufficient motive. Defs' Mem. at 21 n.15. However, this is where the similarity ends. Plaintiffs in *Mortensen* argued that "their alleged motive – obtaining debt on more favorable terms – ***is sufficient of itself***." 123 F. Supp. 2d at 1024. They failed to plead specific facts or "strong circumstantial evidence that AmeriCredit granted a deferral that did not comply with AmeriCredit's stated guidelines." *Id.* at 1027. In contrast, the Complaint alleges that Household not only violated its own reaging policies but also engaged in other practices that the SEC found violated §10(b).[7] ¶¶107-133, *see* RJN Exs. 1 & 2, filed herewith. Moreover, plaintiffs' Complaint alleges defendants' opportunity to commit fraud and their personal direction of the specific fraud scheme.

The Complaint here does more than simply rely on motive. Motive is only part of the total scienter analysis.

2. Defendants Had the Opportunity to Commit Fraud by Virtue of Their Positions, Access to and Control over Company Financials and Information

In addition to pleading defendants' motive, the Complaint also pleads that defendants had the opportunity to commit fraud. ¶¶41-43, 165-70. Defendants, core members of the senior management team during the Class Period, (i) ran Household and its subsidiaries as "hands-on" managers with direct involvement in day-to-day operations; (ii) were privy to proprietary information

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[7]Other cases relied upon by defendants also state that financial benefit or the desire to raise funding ***alone*** are insufficient ***by themselves without more*** to raise a strong inference of scienter. Defs' Mem. at 20-21. *See Abrams v. Baker Hughes, Inc.*, 292 F.3d 424, 430 (5th Cir. 2002) ("Allegations of motive and opportunity, ***standing alone***, are no longer sufficient."); *Kushner v. Beverly Enters.*, 317 F.3d 820 (8th Cir. 2003) ("'that a defendant's compensation depends on corporate value or earnings does not, ***by itself***, establish motive'"); *In re Allscripts Sec. Litig.*, 00 C 6796, 2001 U.S. Dist. LEXIS 8897, at *33 (N.D. Ill. June 29, 2001) ("***without more*** particularized allegations, plaintiffs cannot satisfy the scienter requirement by alleging motive"); *In re E.Spire Communs., Inc. Sec. Litig.*, 127 F. Supp. 2d 734, 742 (D. Md. 2001) ("Allegations of [motive to enhance compensation and stock holdings] ***by themselves*** are insufficient to create 'a strong inference of scienter'"; *City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245, 1249 (10th Cir. 2001) ("we reject the argument that pleading motive and opportunity, ***without more***, provides an alternative method to establish scienter").

concerning Household's business, operations, growth, financial statements and financial condition; (iii) were the primary spokespersons on behalf of the Company and hosted quarterly and annual conference calls to announce financial results; (iv) had access to and control over the centralized and highly automated "Vision" information system that connected all of Household's over 1,400 branches across the nation, allowing various offices to view the same information on customer accounts in real time; and (v) controlled the contents and dissemination of information by the Company, including its SEC filings, reports to shareholders, press releases and other public statements regarding Household's operations and financial condition. *Id.* It is beyond "doubt[] that the defendants had the opportunity, if they wished, to manipulate the price of [the company's] stock." *In re Time Warner, Inc., Sec. Litig.*, 9 F.3d 259, 269 (2d Cir. 1993); *Rehm v. Eagle Fin. Corp.*, 954 F. Supp. 1246, 1253 (N.D. Ill. 1997).

3. Plaintiffs' Allegations of Defendants' Fraudulent Scheme Are Sufficiently Particular and Give Rise to a Strong Inference of Scienter

The Complaint's allegations regarding defendants' direction of the specific fraudulent scheme also show strong circumstantial evidence of conscious misbehavior or recklessness. As the Ninth Circuit held in *Ronconi*, "falsity and scienter in private securities fraud cases are generally strongly inferred from the same set of facts...." 253 F.3d at 429.

a. The Predatory Lending Allegations Are Sufficiently Particular and Constitute Strong Circumstantial Evidence of Defendants' Conscious Misbehavior or Recklessness

The predatory lending allegations in the Complaint are detailed and exceed the PSLRA requirements for particularity. The Complaint alleges that Officer Defendants, through Household and its subsidiaries (the who), engaged in a nationwide and consistent pattern of abusive lending practices (the where and what), at least from 10/97 to 10/02 (the when). Further, the Complaint particularly details the type of abusive lending practices (the how) as follows:

- Household ***misrepresented the interest rates and savings associated with loans*** by providing deceptive and nonconforming loan documents to borrowers that were designed to obscure actual loan amounts and interest rates. ¶¶55-60.

  A notorious example of this practice was the EZ Pay Plan scam, where Household loan officers and branch managers were instructed by corporate headquarters to tell

borrowers that they were cutting their interest rate to 7% when, in reality, the interest rate was much higher – over 12%. ¶¶55-60. By early 2000, the EZ Pay Plan accounted for over one-third of Household's new loan originations and was a significant source of revenue for Household. ¶94.

- Household failed to disclose "discount points" that were nothing more than stacked fees and had no bearing on the ultimate interest rate charged on loans. ¶¶61-67.

- Household concealed the existence of prepayment penalties, despite federal law requiring disclosure. ¶¶68-70.

- Household used fraud, coercion and forgery to sell ancillary products, such as life, disability and other types of credit insurance. ¶¶71-74.

- Household illegally "up-sold" second loans with exorbitant interest rates of over 20%. ¶¶75-82.

Contrary to defendants' contentions, the predatory lending allegations are not vague as to time and place, Defs' Mem. at 11, but rather aver that, during the Class Period, all of the Company's branches, via training received from corporate headquarters in Illinois, engaged in a pervasive pattern and practice of abusive lending. ¶¶54, 72, 90, 96, 167. The Complaint details the time period when the predatory lending practices were occurring (as early as 1996 until 2002). *See* ¶¶18, 72. The Complaint also sufficiently alleges that the abusive lending techniques were consistent and widespread across the nation, demonstrating a pattern and corporate practice at Household of promoting such practices to sell more and larger loans. *See* ¶¶21, 23, 53-54, 58-59, 72, 86, 90, 92-93, 98-99.

Allegations about Household's nationwide practices are bolstered by numerous corroborating sources and satisfy both the falsity and scienter prongs of the PSLRA:

- ***Trainers from corporate headquarters in Illinois visited branch offices to provide training in Company-approved sales practices between 1996 and 2002.*** ¶¶54, 72, 90, 96, 167. As early as 1996, trainers were sent from Illinois to meet with branch managers and account executives to highlight the significance of getting 60%-70% penetration in the sale of insurance. ¶72. Consumers were not informed insurance was being tacked on or were led to believe it was compulsory, when it was not. ¶71. Trainers instructed branch managers and account executives to outright lie that the quote did not include insurance or, as a Texas District Manager counseled, to just disclose one quote on 90% of the loans. ¶72. Melissa Drury's Declaration, unsealed in 4/03, corroborates that: at least from 1989 through 7/01, Household's corporate-wide programs, sales goals, sales tools, materials and methods were rolled out to the branches through corporate trainers, divisional managers and regional

managers.[8] RJN, Ex. 3, ¶¶5, 26. Drury also corroborates training and routine review and approval of sales materials by corporate trainers and the Corporate Compliance department. RJN, Ex. 3, ¶¶20, 23, 27, 31, 34, 67-70, 83, 89, 173-175 (requiring all branch managers to push insurance).

- ***Defendant Gilmer***, who was responsible for U.S. consumer lending operations, ***designed an updated training manual used by offices throughout the country.*** ¶96. Gilmer personally orchestrated revisions to the training manual, which contained various sales pitches, including the EZ Pay Plan scam. ¶¶55-60, 91-95. Drury confirms the use of corporate-developed sales materials, including handouts and videos at training sessions. RJN, Ex. 3 at ¶¶23, 26, 28, 34, 94 (forms from upper management summarized the standard approach to be used by all employees).

- ***Defendant Aldinger approved a misleading EZ Pay Plan presentation created by Southwest Division Manager Dennis Hueman in 1999.*** ¶¶94-95. Hueman distributed worksheets related to the EZ Pay Plan to all Household offices from California to Pennsylvania. ¶¶59, 91-95. Drury corroborates this. RJN, Ex. 3, ¶¶111-19 (confirming the sales techniques outlined by Hueman and corroborating that Company documents memorialized these techniques, including the trap-sale approach). *See also id.*, RJN, Ex. 4 at 151-52 (even corporate management used the same misleading terminology in their responses to regulatory investigators).

- ***Corporate Management Refused to Cooperate with Regulators' Investigations, Further Concealing the Fraud.*** Household corporate headquarters withheld information and refused to cooperate with the WA Department's investigation. RJN, Ex. 4 at 50-54, 56-57. Beginning in late 1999-early 2000, Household's withholding of information became such an issue that there were regular meetings with corporate executives, including Tom Detelich ("Detelich"), currently Group Executive-U.S. Consumer Lending Business. *Id.*

- ***Predatory sales practices were uniform throughout the country from California to Pennsylvania.*** ¶53 (consumer complaints alleging substantially the same improper sales practices in Illinois, Minnesota, Colorado, California and Washington), ¶56 (same misleading EZ Pay Plan scam in Ohio, Washington and Arizona), ¶58 (EZ Pay Plan practice identified by regulators in other states to the WA Department), ¶59 (Southwest Division Sales Manager Hueman drew up presentations and worksheets for the EZ Pay Plan scam in 1999 that were used throughout the country from California to Pennsylvania), ¶¶75-82 ("closing or blocking the back door" technique was ingrained into sales agents to prevent refinancing of Household loans, further concealing defendants' improper practices). *See also* RJN, Ex. 3, ¶¶26, 28, 34-35, 38, 68, 70, 74, 94-95, 111-12, 115-16, 118, 125, 153-92, 198-99, 201, 218 (describing similar sales practices).

- ***The Officer Defendants had access to Household's 1,400 branches and its award-winning centralized, automated information management system, Vision*** – that supported its underwriting, loan administration and collection functions in real time across all consumer business segments. ¶111. The Vision system was purported to generate sales leads, reduce paperwork and, most importantly, ***centralize decision making throughout the loan origination process***. ¶¶10, 111. This included generating scripts for sales staff, monitoring collections and delinquencies and determining charge-offs. ¶¶10, 112; RJN, Ex. 3, ¶161.

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[8]The Complaint alleges that Melissa Drury was the former branch manager in Bellingham and used sales pitches that were both approved and provided by Household. ¶90. On 4/09/03, the Drury Declaration, filed in the *Luna* litigation, was unsealed.

- The WA Department specifically found that it was ***inconceivable that borrowers from remotely different locations could all be confused about exactly the same thing in the same way*** and that the sham proffered by HFC representatives was known and likely fostered by the corporation itself. ¶¶21, 92. *See* 9/02 *Forbes* article ("Household's questionable tactics seem to be in far wider use than [Bellingham]," listing examples of defrauded customers from Ohio, Arizona, Minnesota and California).[9] ¶¶56, 76, 93.

- Minnesota Commerce Commissioner Jim Bernstein ("Bernstein"), whose office investigated Household's predatory lending practices for over a year and led the attorney general case, said, ***"Household's corporate culture encouraged rather than prohibited these deceptive and abusive lending practices .... When we talked with regulators in other states, the story was the same ...."*** 10/12/02 *Star Tribune*. ¶¶23, 93, 98. Bernstein also said the settlement was "the best deal we could get," and ***"Household should have to pay much more, but the deal avoids years of costly litigation."*** *Id.*

- ***Aldinger admitted that Household had engaged in predatory lending*** when the settlement with attorney generals from all 50 states for the resolution of charges of violations of consumer protection, consumer lending and insurance laws and regulations was announced. ¶97; Defs' Ex. B.

As detailed above, the Complaint alleges specific material facts known by the Officer Defendants, rather than simply relying on their positions or on conclusory allegations. *Cf. Fleming*, 264 F.3d at 1255 (conclusory allegations that "defendants were senior officers; therefore had actual knowledge," without more, insufficient under the PSLRA).

Plaintiffs allege that the Company's nationwide illegal and abusive lending practices violated federal and state laws and regulations, including, among others, TILA. ¶¶51-82. The Complaint also alleges that defendants' predatory lending practices resulted in falsifying the Company's financials reported to the SEC and the public during the Class Period. ¶¶102-106. Defendants violated GAAP Statement of Financial Accounting Standards ("SFAS") No. 5, ¶8 and SEC Regulation S-K by knowingly or recklessly disregarding that the Company was engaging in abusive lending practices on a nationwide basis and failing to disclose the effect and the potential effect of these acts of the Company's financial statements. *Id.* SFAS No. 5 requires a company to establish a loss contingency, *i.e.*, a reserve when the estimated loss is probable and reasonably estimated, or to disclose the nature of the contingency when there is ***at least a reasonable possibility*** that a loss or additional loss may

[9]Defendants protest that the Complaint's primary source of predatory lending allegations is the Washington Department's Expanded Report of Examination for Household Finance Corporation III, dated 4/30/02 ("WA Report") and a 9/02 *Forbes* article. Defs' Mem. at 11. They are wrong. The Complaint incorporates corroborating facts from a number of different sources and plaintiffs' investigation. ¶345. Defendants do not (and cannot) cite authority requiring a specific number of sources.

have been incurred. ¶¶104-105 (citing SFAS No. 5, ¶8). Because Household was engaged in abusive lending practices throughout the Class Period that were endorsed and promoted by the Officer Defendants, Household should have established a large enough reserve to address this contingency or, in the alternative, disclosed the predatory lending practices. ¶¶102-106. *Aldridge*, 284 F.3d at 80 (booking sales subject to contingencies requires adequate accounting reserves or where size of contingencies impossible to estimate, disclosure should be made).

Additionally, relying on *Greebel v. FTP Software, Inc.*, 194 F.3d 185 (1st Cir. 1999), defendants state that plaintiffs must identify more specific facts than already alleged regarding losses from this contingency. Defs' Mem. at 12. Defendants are wrong. The same court that decided *Greebel* held in a later case that, where there were sufficient facts for a reasonable inference of an improper pattern of a sales practice (as here), the lack of specific identifying information, such as amounts, is not fatal to a pleading. *See Aldridge*, 284 F.3d at 81 ("*Greebel* did not hold that a plaintiff, before discovery, must in every case allege the amount of overstatement of revenues and earnings in order to state a claim that undisclosed [sales practices] were fraudulent."). Moreover, the fact that plaintiffs in *Greebel* had discovery was a crucial distinction noted by the court. *Id.* It is not "fraud by hindsight" where a plaintiff alleges that a company failed to disclose certain known material information as to contingencies and defendants' subsequent admission as to the existence of those practices. *Id.* at 81-82.

The Complaint also alleges that Household violated Regulation S-K, which provides that management's discussion and analysis section shall "describe any other ***significant components of revenues or expenses*** that ... should be described in order to understand ... results of operations" and "describe any ***known trends or uncertainties*** that have had or that the registrant reasonably expects will ***have a material favorable or unfavorable impact on net sales or revenues*** or income from continuing operations." ¶106 (citing 17 C.F.R. §229.303(a)(3)). By failing to disclose the illegal predatory lending practices, defendants violated Regulation S-K. *See In re Providian Fin. Corp. Secs. Litig.*, 152 F. Supp. 2d 814 (E.D. Pa. 2001) (where credit card lending company engaged in illegal or fraudulent business practices failed to disclose these practices, but attributed company's phenomenal financial results to its "customer focused approach," omission material and could form

basis of violation of securities laws). Defendants do not dispute, and thus concede, that the violation of Regulation S-K has been sufficiently pled under the PSLRA.

Defendants attack the Complaint for failing to ***establish*** that the predatory lending practices were illegal. Defs' Mem. at 12. For example, defendants attack Commissioner Bernstein's assertions about Household's corporate culture on the grounds that they (a) are conclusory; (b) must be viewed in the context of Bernstein's limited jurisdictional authority – Minnesota; and (c) are unsupported by factual particulars. *Id.* at 14. Bernstein's office investigated Household's deceptive practices together with state authorities throughout the country for over a year. ¶¶23, 98. Thus, he has a basis for making such a statement – his knowledge of Household's practices extends beyond Minnesota. Moreover, his statement about Household's "corporate culture" of deception is corroborated by numerous other sources in the Complaint. *Cabletron Systems*, 311 F.3d at 34 (consistent accounts from a number of different sources are self-verifying and reinforce one another). At most, defendants' factual dispute is with the substance of plaintiffs' allegations, which is improper on a motion to dismiss. *Evergreen Fund, Ltd. v. McCoy*, No. 00 C 0767, 2000 U.S. Dist. LEXIS 16876, at *18 (N.D. Ill. Nov. 1, 2000).

(1) A Strong Inference of Scienter Also Arises from the Officer Defendants' Aggressive Denials of Any Illegal or Fraudulent Predatory Lending Practices that Further Concealed the Fraud

Significantly, defendants' conscious misconduct is evident from their persistent denials of the existence of these illegal practices. Defendants' denials began in late 2000, when Household issued a press release on 11/07/00, distancing itself from its peers, like Associates First Capital, which were found to be engaging in discriminatory lending, announcing:

> Household's ***longstanding view*** has been that unethical lending practices of any type are ***abhorrent to our company***, employees, and most importantly our customers. So-called ***"predatory lending" practices undermine the integrity of the industry in which we compete.***

¶¶257, 266. Aldinger's statements to analysts at Household's Annual Financial Relations Conference on 4/03/01 regarding this issue led them to issue reports stating that "Household has one of the cleanest consumer lending operations in the U.S. and thus is least likely to have predatory lending issues." ¶284.

On 7/23/01, a number of public interest organizations wrote to defendant Aldinger, informing him of the various improper and abusive practices occurring at Household that resulted in "unjust harm to borrowers and to communities across the country ...." ¶83; Ex. A, attached hereto.[10] Yet, defendants continued to deny that these practices were occurring at Household. Instead, Aldinger announced a "Best Practices in Subprime Lending" Initiative, which purported to reinforce Household's so-called "already comprehensive" responsible lending program that Household claimed went "beyond any existing city, state or federal regulatory/legal requirements." ¶¶293-94.

On 11/16/01, defendants dismissively explained away a suit brought by the California Department of Corporations relating to imposition of improper fees and charges on California customers as a "computer glitch." ¶¶19, 300. Just ten days later, on 11/26/01, Household issued a formal statement in the *National Mortgage News* "vehemently den[ying] any assertion that it has willfully violated laws that regulate its business." ¶301. In 1/02, however, Household settled this suit for $12 million – $9 million of which was for penalties. ¶19.

As the fabric of defendants' furtive campaign of deception began to slowly unravel, defendants' denials became fast and furious:

2/07/02	On news of a nationwide consumer class action lawsuit accusing Household of fraud and misrepresentation and use of improper techniques to prevent refinancing in consumer lending, Aldinger and Schoenholz met with analyst Robert Napoli, who reported that the Association of Community Organizations for Reform Now [ACORN] lawsuit looks frivolous to us and management agreed...." ¶¶20, 317, 320.
2/07/02	Craig Streem, head of Household Investor Relations, said to the *Contra Costa Times*: "They have ***charged us in the past with being a predatory lender, but those allegations have almost uniformly proven false and misleading***." ¶317.
2/07/02	Company spokesperson Megan Hayden told *Copley News Service*: "We make good loans that not only are legal loans, but are beneficial for our customers." ¶20.
2/18/02	Schoenholz insisted in *National Mortgage News* that ***predatory lending allegations were "not a significant issue***, not indicative of any ***widespread problem*** and certainly ***not a concern that it will spread elsewhere***." ¶317.

[10]District courts may consider documents incorporated by reference to the pleadings. *United States v. Wood*, 925 F.2d 1580, 1581 (7th Cir. 1991); *see also* Fed. R. Civ. P. 10(c).

4/22/02	Hayden told the *Bellingham Herald*: "It is absolutely against our policy to in any way quote a rate that is different than what the true rate is .... I can't underscore that enough." ¶20.
02/02-05/02	Household went on a media offensive, publishing several very expensive, full-page ads in *The Wall Street Journal*, with headlines that read, "For 124 years, we've set the standard for responsible lending. And now, we're doing it again." The bottom of the ad carried the legend, "Advocates for Responsible Lending." ¶88; Ex. B, attached hereto.
5/10/02	Hayden told *The Record*: "Our position is that the accusations [regarding predatory lending] are baseless .... The loans are legal, they are compliant with state and federal laws and our own policies, and in each instance they have benefits for each customer.... The loan[s] conform[] to the company's 'tangible benefits test.'" ¶329.
5/14/02	Streem, in *AP Online*, stated: "All of [Household's] lending policies are in accord with federal and state regulations and requirements ...." *Id.*
5/31/02	Hayden characterized the WA Report in *American Banker* as a "draft" with "factual errors" and downplayed the report, stating:"[W]e take proper steps to ***work with the department to uncover the facts*** and if necessary formulate an appropriate resolution for the borrower."[11] ¶330.
7/16/02	Defendants again dismissed a $400,000 refund to Washington borrowers as a "computer" error. ¶89.
7/17/02	During a conference call with analysts, Aldinger stated: "[O]ur best practices exceed what these states have been asking ... because ***we do not do predatory lending***.... [W]e run a very strict model and a very good model for our customers, and ***we don't think when we are sitting here talking to you next year there will be anything substantially different in the returns or practices***." ¶334.
8/29/02	The WA Report became public. Defendants had fought hard between 4/02 to 8/02 to keep it from becoming public, filing an injunction in federal court seeking to block its publication. ¶¶21, 84.
9/16/02	Tom Detelich, the newly-appointed Group Executive for Consumer Lending, wrote a letter to *Forbes*, saying: "***99.99% of our consumer-lending customers do not have a complaint regarding their loan***.... [M]ore than 56,000 customer audit calls are made to ensure we meet the highest standards of responsible lending." ¶341.

Defendants' fervent denials, designed to mask the illegal and fraudulent predatory lending practices, are, thus, highly probative of conscious misconduct. Once these practices were exposed, Household suffered a significant reduction in revenues and was forced to take a $525 million charge to settle nationwide claims. ¶¶5, 102, 105. *See, e.g., In re System Software Assocs. Sec. Litig.*,

[11] Ironically, according to Charles Cross, Household corporate headquarters refused to cooperate with the department's investigation. *See* RJN, Ex. 4 at 50-54, 56-57 & §IV.C.3.a at 19, *supra*.

Master File No. 97 C 177, 2000 U.S. Dist. LEXIS 3071, at *44 (N.D. Ill. Mar. 8, 2000) ("'The more serious the error, the less believable are defendants' protests that they were completely unaware of [the company's] true financial status and the stronger is the inference that defendants must have known about the discrepancy.'") (quoting *Rehm*, 943 F. Supp. at 1256). Additionally, new facts have come to light indicating that during the Class Period, Household shredded customer files, forms, sales materials, presentations made to customers and correspondence with customers at the direction of upper management to conceal evidence of their fraudulent practices. RJN, Ex. 3, ¶¶132-34, 141-51. Although these facts were not available to plaintiffs until 4/11/03 because defendants fought to keep this document sealed, they bolster the already strong inference of scienter from plaintiffs' allegations. These facts, taken together, raise a strong inference that defendants not only knew of these improper and illegal sales techniques but encouraged them to accomplish their loan growth strategy.

(2) It Is Reasonable to Infer that the Officer Defendants Had Knowledge of the Pervasive Predatory Lending Scheme that Impacted Core Operations of Household's Business – Consumer Lending

In addition to facts alleging knowledge by Aldinger, Schoenholz and Gilmer, it is also reasonable to infer that the Officer Defendants knew or were reckless in not knowing of nationwide illegal and fraudulent sales practices and techniques that permeated their core business operations, consumer lending. Defendants cannot avoid liability by disclaiming knowledge of matters fundamental to the Company's business and operations, particularly where the Complaint describes each of the fraudulent practices in detail and alleges that these practices were nationwide. "[I]t is strongly inferential that every officer or director ... either had the knowledge of the [core project] or, if not, that his failure to have such knowledge equated to reckless disregard." *Lindelow*, 2001 U.S. Dist. LEXIS 10301, at *24. *See also Dardick v. Zimmerman*, 149 F. Supp. 2d 986, 988-89 (N.D. Ill. 2001) ("[I]t is highly significant that what [plaintiff] relies on is the failure of all defendants to have disclosed a deep and pervasive corporate illness .... To the outsider looking in, it is surely strongly inferential that every officer or director of [the company] either had the knowledge of such deep financial difficulties, or, if not, that his failure to have such knowledge equated to reckless

disregard."); *In re Aetna Inc. Sec. Litig.*, 34 F. Supp. 2d 935, 953 (E.D. Pa. 1999) ("the alleged fraud in this case relates to the core business of Aetna during the time period in which [individual] [d]efendants ... were at Aetna's helm").

b. Allegations of Defendants' Manipulation of Delinquency Rates and Credit Loss Reserves by Improperly Reaging Delinquent Accounts Are Corroborated by the SEC's Findings that Household's Reaging Practices Violated the Securities Act of 1934

Defendants' scheme of manipulating delinquency ratios by arbitrarily "reaging" delinquent accounts to report a higher ratio of "current " loans further corroborates defendants' scienter. Defendant Aldinger admitted to Household shareholders in writing on 3/19/03 that the SEC had found "certain aspects of the description of our ***reaging and forbearance policies contained in*** certain of [Household's] ***prior SEC filings*** were ***incomplete or inaccurate*** constituting ***a violation of Section 10(b) and 13(a) of the Securities Exchange Act of 1934***, as amended, and certain related SEC rules." *See* RJN, Ex. 1 at 2. Aldinger also admitted that "Household has agreed to cease and desist from further such violations of the federal securities laws." *Id.* The SEC found that:

> Household's disclosures regarding its restructure policies fail to present an accurate description of the minimum payment requirements applicable under the various policies and are therefore false and misleading. In numerous instances Household will accept one or zero payments prior to restructure.... There are also instances where Household will restructure a delinquent loan without receiving any payments ....
>
> Household's restructure policy disclosures are also false and misleading since they fail to disclose Household's policy of automatically restructuring numerous loans. With automatic restructures, no communication with the customer is required to determine whether the cause of delinquency is cured. ***In Consumer Lending, for example, the majority of the more than $1 billion of restructures per month are performed automatically ....***

RJN, Ex. 2, ¶¶8-9.

Significantly, the Complaint alleges these very same practices almost verbatim and even provides additional detail. The fact that plaintiffs unearthed these facts, which are corroborated by the SEC, only enhances their credibility:

- Officer Defendants caused Household to violate its own policies and reage accounts at any level of delinquency, including accounts that were over 270 days past due, with merely a single payment. ¶117.
- Accounts were often reaged multiple times in a year. ¶118.

- Customers were unaware of restructuring because Vision automatically reaged. ¶121.
- The Vision System was designed to automatically reage delinquent accounts – without any evidence that the delinquency had been cured. ¶112.
- The Vision System was programmed not to generate paperwork when delinquent accounts were reaged. ¶121.
- Customers were completely unaware that, when their account was restructured, the missed payments were added to the end of the loan. ¶¶117, 121.

Thus, defendants' contention that the Complaint fails to allege how the reaging was arbitrary is disingenuous. Defs' Mem. at 15. The particulars of how defendants carried out this scheme and ensured that employees strictly followed it is also detailed in the Complaint. ¶¶110-24. At the 30-day delinquency, loan officers followed up with customers, using the opportunity to up-sell or cross-sell, converting unsecured loans into loans secured by their homes and cars. ¶116. When the delinquent loan was finally turned over to collections, Household ensured that its representatives reaged accounts via incentives and threats. *See* ¶119 (employees were given monthly awards (cash/electronics) to attain accounts reaging goals, whether justified or not), ¶120 (by 8/01, collections managers were pressuring collections officers to restructure all accounts, randomly monitoring calls and reprimanding employees who failed to persuade a borrower to restructure).

Again, defendants' requests for even more detail are unsupported. "[C]ourts will allow private securities fraud complaints to advance past the pleadings stage when some questions remained unanswered, provided the complaint as a whole is sufficiently particular to pass muster under the PSLRA." *Cabletron Systems*, 311 F.3d at 33. *See, e.g., Aldridge*, 284 F.3d at 79-82 (failure of complaint to document precise amounts of overstatements of revenue not fatal); *Rothman v. Gregor*, 220 F.3d 81, 91 (2d Cir. 2000) (complaint need not "fix the exact date and time that [defendants] became aware" of information that rendered their accounting practices misleading because it adequately alleged awareness within necessary time frame).

Defendants designed these policies, which were implemented throughout the nation via the centralized, automated Vision System. ¶¶10, 111-14, 121. Vision was intentionally paperless. ¶121. Defendants knew or were reckless in not knowing that the Company's reaging policies were arbitrary and had the effect of manipulating Household's financial results. Significant financial metrics, such

as delinquency ratios and credit loss reserves, were manipulated due to defendants' improper and arbitrary reaging of delinquent accounts. ¶¶2, 14, 24, 126-33. Defendants established reserves for bad accounts based on figures that relied upon the reaged or restructured accounts, thus manipulating Household's credit quality, understating the reserve amounts and overstating net income. ¶¶14, 116, 126-33. Defendants' practices allowed the Company to show better credit quality than its peers. ¶¶25, 28, 128, 222, 323. Defendants failed to disclose the impact of Household's reaging practices to investors and failed to properly reserve for loss contingencies, thereby violating GAAP, as set forth in SFAS No. 5, ¶¶8, 10, and FASB Statement of Concepts ("FASCON") No. 1, ¶¶34, 42. ¶¶129-33.

Indeed, the SEC confirms that defendants' arbitrary reaging practices had a direct and significant impact on Household's financials as follows:

> One of the ***critical measures of Household's financial performance is the delinquency rate for its loan portfolio and related disclosures and statistics concerning the restructuring (or so-called re-aging) of delinquent accounts.*** Household, like its peer lending institutions, reports to the investing public its "2+ delinquency" rate. The 2+ delinquency rate refers to the percentage of loans in Household's total loan portfolio that are at least sixty days past due. The ***2+ delinquency rate and restructuring statistics are key measures of Household's financial performance because they positively correlate to charge-off rates and loan loss reserves. Investors and analysts use Household's 2+ delinquency rate and restructuring statistics to evaluate the relative credit quality of Household's consumer finance receivables***. The 2+ delinquency rate and restructuring statistics are especially important for subprime lenders like Household because of the increased likelihood of credit quality problems in subprime loan portfolios.

RJN, Ex. 2, ¶4.

Courts in the Northern District of Illinois have found that where "credit losses are the 'defining characteristic' of [defendants'] loan servicing business," and defendants make statements putting an "optimistic and reassuring 'spin' on otherwise damaging credit loss reports ... defendants acted with knowledge of [the Company's] deteriorating earnings." *See Rehm*, 954 F. Supp. at 1256. Here, lending was Household's core business, and the Officer Defendants were intimately involved with running the day-to-day operations of the Company. ¶¶38-43. Throughout the Class Period, defendants made specific statements about Household's improving credit quality knowing that it impacted both stock price and defendants' ability to obtain financing. ¶¶193, 198, 201, 205, 214, 226, 233-34, 236, 238, 243-44, 247, 258, 270, 272, 278, 284-85, 287, 291, 298, 304, 306, 311, 315,

323. Indeed, defendants designed Vision to be paperless to avoid detection and failed to disclose reaging statistics until second quarter 2002, and when they did, it demonstrated that 20% of its real estate secured loans, 17% of the domestic portfolio and over 27% of the "non credit-card" debt had been previously reaged. ¶¶121, 123, 127. The court in *Rehm* found that "the crucial significance of accurate credit loss accounting in determining the financial viability of [the company], combined with defendants' careful statements mitigating the seriousness of the credit loss problem, raises a strong inference that defendants acted with knowledge of their public misstatements or were willfully blind to the truth." *Rehm*, 954 F. Supp. at 1256.

Again, plaintiffs' scienter allegations are confirmed and corroborated by the SEC – the very agency charged with enforcing federal securities laws. The SEC found that "Household ***knew or was reckless in not knowing that its disclosures regarding restructuring policies were false and misleading***.... Household knew that it was outside its peer group range with respect to the volume of delinquent loans that it restructures and with respect to its practice of automatically restructuring delinquent loans." RJN, Ex. 2, ¶11. The Complaint specifically alleges that while Household's competitors were struggling to survive, Household's arbitrary reaging policies allowed the Company to report "record" financial results. ¶¶25, 128. Further, the SEC found that "***Household chose to disclose its restructure policies in a way that connoted strict controls, rather than in a way that accurately described the policies***" and that "***Household knowingly or recklessly omitted to disclose that loans in forbearance [were] excluded from its 2+ delinquency rates.***" RJN, Ex. 2, ¶¶11-13.

When all of these allegations are viewed in totality, plaintiffs have adequately pled that defendants either knew about or recklessly disregarded the arbitrary reaging of delinquent loans that resulted in manipulating Household's key financial metrics (delinquency rates of loan portfolio, reaging statistics, and credit loss reserves). These practices rendered Household's reported financial results during the Class Period false and misleading and artificially inflated the price paid for Household stock.

c. Plaintiffs' Detailed Allegations of Improper Accounting and Household's Restatement Raise a Strong Inference that Defendants Acted with Scienter in Manipulating Household's Financial Results to Meet Wall Street Expectations

Defendants provided investors with false financial information during the Class Period and three years prior. The falsity of these financials is not at issue here because defendants admit they were false and restated these results on 8/14/02. ¶¶134-53. In addition to pleading falsity, the restatement allegations also support a strong inference of scienter.

The Complaint does more than rely on the restatement – it alleges in detail the improper accounting treatment accorded to each type of agreement. Defendants manipulated the amortization rate (the period of time over which they had to spread expenses) so that they could fraudulently dilute expenses and report higher net income. ¶¶137-38. With the co-branded GM Card, GAAP required Household to amortize the up-front fee (origination costs) over a one-year period, but Household spread the expense over the entire privilege period (the period of time the cardholder is entitled to use the card). ¶¶138-39. With the AFL-CIO affinity agreement, from 1996 until 1999, Household amortized premiums paid over the life of the contract. ¶138(b). In 1999, Household ***arbitrarily increased the amortization period*** for the premium ***for its financial reporting*** from 10 to about 15 years but ***maintained the original amortization period for its regulatory reporting***. ¶150. Finally, with respect to its credit card marketing agreement, rather than recording expenses as incurred, Household amortized them over a three-year period. ¶¶138(c), 152. At the pleading stage, defendants cannot legitimately contend that a restatement is not sufficient to establish that original statements were false when made. *In re SmarTalk Teleservices Inc. Sec. Litig.*, 124 F. Supp. 2d 527, 543 (S.D. Ohio 2000).

When Household's new auditor, KPMG, discovered these fraudulent accounting practices, defendants restated Household's financial results going back to 1994 and took a ***$600 million (pre-tax) charge*** that reduced previously reported earnings by $386 million. ¶¶5, 134-35, 146. The restatement was mandated by GAAP to correct misstatements in financial statements based on information ***known at the time the financial statements were originally filed*** and therefore was an admission that Household's financial results were incorrect based on information known by

defendants at the time the results were originally reported. ¶¶142-153 (citing Accounting Principles Board ("APB") No. 20, ¶¶7-13).

Indeed, defendant Schoenholz, who was the principal accounting officer during the Class Period, admitted that the restatement was necessitated by the misapplication of GAAP. ¶146; Ex. C attached hereto. The amounts by which defendants misstated and ultimately restated EPS during the Class Period are alleged in the Complaint (¶139):

Diluted EPS

	As Originally Reported	Restated	Difference
FY97	$1.93	$1.86	<$0.07>
FY98	$1.03	$0.94	<$0.09>
FY99	$3.07	$2.95	<$0.12>
1Q00	$0.78	$0.74	<$0.04>
2Q00	$0.80	$0.77	<$0.03>
3Q00	$0.94	$0.91	<$0.03>
4Q00	$1.03	$0.99	<$0.04>
1Q01	$0.91	$0.85	<$0.06>
2Q01	$0.93	$0.90	<$0.03>
3Q01	$1.07	$1.03	<$0.04>
4Q01	$1.17	$1.13	<$0.04>
1Q02	$1.09	$1.04	<$0.05>
2Q02	$1.08	$1.07	<$0.01>

The question for this Court is whether the Complaint's allegations give rise to a "strong inference" of scienter. 15 U.S.C. §78u-4(b)(2). The answer is a resounding "yes." Household's false financial statements themselves provide additional strong support for plaintiffs' scienter pleading. "Under SEC regulations ... filings that do not comply with GAAP 'will be presumed to be misleading.'" 17 C.F.R. §210.4-01(a)(1). Courts in this District have held that "[g]eneral accounting violations and/or financial restatements, ***standing alone***, are insufficient ... however, a company's overstatement of earnings or revenues combined with other circumstantial evidence can suggest fraudulent intent sufficient to support a strong inference of scienter." *In re Anicom Sec. Litig.*, No. 00 C 4391, 2001 U.S. Dist. LEXIS 6607, at *15 (N.D. Ill. May 18, 2001) (allegations of GAAP violations, including the need for financial restatements, "raise a strong inference that the defendants knew or recklessly disregarded that [the company] was disseminating incorrect information and ... having financial difficulties"). *See also Cabletron Systems*, 311 F.3d at 39 ("'Accounting shenanigans' are among the characteristic types of circumstances which may demonstrate scienter

for securities fraud."). *Provenz v. Miller*, 102 F.3d 1478, 1490 (9th Cir. 1996) (violations of GAAP and company's revenue policy are circumstantial evidence of scienter).

Defendants knew there were issues with respect to their accounting treatment of their GM Card agreement as early as 1993, when Emerging Issues Task Force ("EITF") released Issue No. 93-1 ("EITF 93-1"). ¶148. At the 8/14/02 conference call, Schoenholz, Household's CAO, admitted having consultations with senior persons at Andersen about this very issue and together making the decision to account for it in violation of GAAP. ¶¶148-49; Ex. C attached hereto. A strong inference of scienter also arises from defendants' arbitrary change in the accounting of its affinity agreement with the AFL-CIO card in 1999. ¶150. Defendants knew that an arbitrary increase in the regulatory reporting from 10 years to as much as 15 years would be scrutinized and disallowed; ***Household did not change the amortization period for regulatory reporting purposes, but did for financial reporting.*** *Id.* Defendants had no basis for increasing the amortization period other than to report more favorable net income associated with the affinity portfolio by "spreading" the impact of the premium paid over a longer period of time than allowed for under GAAP. *Id.*

Contrary to defendants' protests, decisional law confirms that a restatement supports an inference of scienter. *See, e.g., In re Adaptive Broadband Sec. Litig.*, No. C 01-1092 SC, 2002 U.S. Dist. LEXIS 5887, at *43 (N.D. Cal. Apr. 2, 2002) (a restatement of earnings, coupled with allegations of accounting improprieties and corporate reshuffling, together support an inference of scienter); *In re Cylink Secs. Litig.*, 178 F. Supp. 2d 1077, 1084 (N.D. Cal. 2001) ("the mere fact that the statements were restated at all supports such an inference [of scienter]"); *Miller v. Material Sciences Corp.*, 9 F. Supp. 2d 925, 928 (N.D. Ill. 1998) (accounting improprieties requiring a revision of financial statements where senior management ignored obvious financial errors "can constitute the sort of recklessness necessary to support §10(b) liability"). Indeed, the SEC's position is that "the Commission often seeks to enter into evidence restated financial statements, and the documentation behind those restatements, in its securities fraud enforcement actions in order, *inter alia*, to prove the falsity and materiality of the original financial statements [and] to demonstrate that persons responsible for the original misstatements acted with scienter." *See In re Sunbeam Sec. Litig.*, No. 98-8258-Civ.-Middlebrooks, Brief of the United States Securities and Exchange

Commission as *Amicus Curiae* Regarding Defendants' Motions *in Limine* to Exclude Evidence of the Restatement and Restatement Report at 2 (S.D. Fla. filed Jan. 31, 2002), attached hereto as Ex. D at 2.

Defendants seek at the pleading stage to convince this Court that Household's restatement of $600 million, and the resulting $386 million reduction in earnings, "pales into insignificance" next to Household's total assets and is therefore not material. Defs' Mem. at 16 n.9, 31. "Whether a statement [or omission] is material depends on how it affects an investor's perception of the security." *In re Next Level Sys. Inc. Sec. Litig.*, Case No. 97 C 7362, 1999 U.S. Dist. LEXIS 5653, at *22 (N.D. Ill. Mar. 31, 1999). This question is not properly decided on a motion to dismiss. *See Marks v. CDW Computer Ctrs.*, 122 F.3d 363, 370 (7th Cir. 1997) ("The problem with ... materiality arguments is that the 'determination [of materiality] requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact ....'") (quoting *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 450 (1976)). As the determination of materiality is a "highly fact-dependent analysis," unless the statements or omissions at issue are so obviously unimportant that reasonable minds could not differ about their significance, the Court should leave the materiality determination to the trier of fact. *Searls v. Glasser*, 64 F.3d 1061, 1065-66 (7th Cir. 1995); *see also McCoy v. WGN Cont'l Broad. Co.*, 957 F.2d 368, 371 (7th Cir. 1992) (holding that even summary judgment is "rarely appropriate" on materiality grounds).

For precisely these reasons, the Second Circuit has also held that "'a complaint may not properly be dismissed ... on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could differ on the question of their importance.'" *Ganino v. Citizens Util. Co.*, 228 F.3d 154, 162 (2d Cir. 2000). It cannot be said that a $600 million restatement is "obviously unimportant" to investors. The significance of the restatement is further confirmed by the fact that Household would have missed analysts' EPS estimates for every one of the eight quarters of 2000 and 2001 and the first half of 2002 absent the accounting improprieties detailed herein. ¶¶140, 156, 162-63.

Defendants seek to engage in a fact-based argument regarding the stock price response to their fraud. Defs' Mem. at 17 n.9. First, defendants overlook plaintiffs' allegations that the market's response to the fraud was delayed by defendants' secondary fraud in attempting to disguise the first fraud – specifically, (i) defendants' continued assurances to analysts and institutional investors on 8/14/02 that no fraud had occurred at Household, ¶140; (ii) full-page ads in the media with headlines stating, "For 124 years, we've set the standards for responsible lending. And now, we're doing it again," ¶88 and Ex. B, attached hereto; and (iii) continued vehement denials that the Company was engaged in fraudulent conduct with respect to its core lending operations. *See* §IV.C.3.a.1, *supra*. Second, because "the market is subject to distortions," both the Second and Ninth Circuits, relying on Supreme Court law, have held that stock price movement is not necessary to plead materiality. *See, e.g., No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920, 934 (9th Cir. 2003) (refusing to adopt a bright-line rule requiring immediate market reaction); *United States v. Bilzerian*, 926 F.2d 1285, 1298 (2d Cir. 1991) (public company's stock price movement does not establish materiality of the statements made).

Accordingly, the Complaint alleges that defendants intentionally and recklessly manipulated the accounting treatment of their various credit card co-branded, affinity and marketing agreements, causing false financial statements to be filed with the SEC, and therefore, pleads both falsity and scienter. Defendants' inappropriate attempts to inject factual issues at the pleading stage should be rejected.

4. Viewed in Totality, the Complaint's Allegations Cumulatively Raise a Strong Inference of Scienter

In their motion to dismiss, defendants incorrectly attack each of plaintiffs' allegations ***individually*** in their analysis of scienter. In determining whether a strong inference of scienter has been established, however, "[e]ach individual fact about scienter may provide only a brushstroke, but the resulting portrait satisfies the requirement for a strong inference of scienter under the PSLRA." *Cabletron Systems*, 311 F.3d at 40. *See also Riggs Ptnrs v. Hub Group, Inc.*, No. 02 C 1188, 2002 U.S. Dist. LEXIS 20649, at *14 (N.D. Ill. Oct. 23, 2002) ("'A court should not consider each relevant factual allegation solely in isolation ... but rather, as a part of the overall

factual picture painted by the complaint.'"). Taken as a whole, the Complaint's particularized allegations of motive, opportunity and defendants' direction of the fraud schemes adequately support a strong inference of scienter.

D. Household and the Officer Defendants Are Liable for All the False and Misleading Statements Outlined in the Complaint

1. Defendant Gilmer Is Liable for False and Misleading Statements Directly Attributable to Him

Despite overseeing all of Household's United States consumer finance operations and being part of senior management throughout the Class Period, defendant Gilmer, having resigned from the Company, now conveniently disavows liability for all statements, including the false statements directly attributable to him. ¶¶111, 203, 236, 280; Defs' Mem. at 45.[12] Defendants only raise issues with ¶¶203 and 280. *Id.*

Defendants could not have been as successful as they were in their fraudulent scheme without the active participation of the man who headed the Consumer Finance group – Gilmer. In addition to having responsibility for lending operations of all Household subsidiaries, Gilmer was instrumental in spearheading the Household training manual revision project and approved its use to train Household employees to mislead borrowers. ¶96. The project lasted six months and was comprised of district managers, branch managers and account executives from across the nation. *Id.*

That defendant Gilmer was in a position with the Company to enable him to participate in representing the Company at investor/analyst meetings and speak at these meetings, ¶¶203, 236, makes abundantly clear that he was one of the "high-level individuals with direct involvement in the

[12]Defendant Gilmer misleads the Court in asserting that he is only mentioned a "mere five times" in the Complaint. *See* Defs' Mem. at 45. Gilmer is mentioned at least ***15*** times by name (¶¶40 (three times), 47, 96, 111, 160-61, 203 (twice), 236, 280 (twice), 297, 387) and ***63*** times as part of the Officer Defendants group (¶¶21, 41 (five times), 42 (three times), 43 (six times), 83, 94, 110-11, 117, 120, 128, 156 (three times), 157-58, 160, 162, 164-65 (three times), 166-67 (twice), 168, 196(d), 196(g), 198, 205, 217(d), 242(d), 242(g), 271(d), 271(e), 302(d), 302(e) (twice), 308, 342(d), 342(e), 343 (twice), 347, 348, 352 (three times), 356, 359, 360-61). Moreover, contrary to defendants' contention, Gilmer is named in all of the Claims for Relief, not merely in the First and Second Claims for Relief.

everyday business of the company." *Sutton*, 2001 U.S. Dist. LEXIS 11610, at *15 n.5.[13] In addition, the misstatements and omissions at issue, which concerned financial reports to the SEC, press releases and other public statements discussing Household's financial condition and operations, are the kinds of statements normally attributed to insiders and company officials under the group pleading doctrine. *See, e.g., Danis*, 73 F. Supp. 2d at 939 (citing *Epstein v. Itron, Inc.*, 993 F. Supp. 1314, 1325-26 (E.D. Wash. 1998)). Moreover, Gilmer received concrete benefits from his fraudulent conduct – he was paid annual bonuses based on performance goals that had the effect of encouraging his participation in the reaging, predatory lending and accounting schemes. ¶¶160-161.

In addition, Gilmer took an aggressive stance in the secondary fraud, falsely defending Household against charges of predatory lending, stating that "unethical lending practices of any type are abhorrent to our company, our employees, and most importantly our customers." ¶280. Gilmer also signed the ads Household ran in *The Wall Street Journal* falsely touting Household's philosophy of responsible lending practices. ¶88; *see* Ex. B attached hereto. The Complaint alleges facts demonstrating that this was not Household's position. As described in §IV.C.3.a, *supra*, unethical and predatory lending practices were the key drivers of Household's loan growth. Gilmer, who headed up all of consumer lending and has since resigned, cannot now feign ignorance of a pervasive scheme within the Company – at least not at the pleading stage. *See Sutton*, 2001 U.S. Dist. LEXIS 11610, at *11 (CEO's statement actionable where the complaint alleges facts supporting the inference that CEO's statements lacked reasonable basis).

Accordingly, Gilmer is liable not only for the false and misleading statements directly attributable to him but also for statements found in other public documents under the "group publication" doctrine.

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[13]Even members of senior management who do not make any statements are liable for false statements made by other members of their senior management team. *See SmarTalk*, 124 F. Supp. 2d at 543 ("In any case, a high ranking company official cannot sit quietly at a conference with analysts, knowing that another official is making false statements and hope to escape liability for those statements. If nothing else, the former official is at fault for a material omission in failing to correct such statements in that context.").

2. The Group Pleading Doctrine Remains Viable Under the PSLRA

The "group pleading" doctrine allows plaintiffs to rely on the presumption that certain statements of a company, such as financial reports, prospectuses, registration statements and press releases, are the collective work of those high level individuals with direct involvement in the everyday business of the company. *Sutton*, 2001 U.S. Dist. LEXIS 11610, at *15 n.5; *Danis*, 73 F. Supp. 2d at 939 n.9. Because a corporation can speak or act only through its agents, *see Pearson v. Youngstown Sheet & Tube Co.*, 332 F.2d 439, 447 (7th Cir. 1964); *Steelco Stainless Steel, Inc., v. Federal Trad Com.*, 187 F.2d 693, 697 (7th Cir. 1951), the group pleading doctrine's presumption is a logical construct of corporate governance.

Although it has been observed that there is a "schism," *Dardick*, 149 F. Supp. 2d at 987, among the district courts that have considered whether the group pleading doctrine survived the PSLRA, including in this District, *compare Sutton*, 2001 U.S. Dist. LEXIS 11610, at *17 (collecting cases), *with Geinko v. Padda*, No. 00 C 5070, 2001 U.S. Dist. LEXIS 15706, at *11 n.3 (N.D. Ill. Sept. 28, 2001), the majority view of courts in this District is that the doctrine remains viable. *See, e.g., In re NeoPharm Inc. Sec. Litig.*, 02 C 2976, 2003 U.S. Dist. LEXIS 1862, at *45 (N.D. Ill. Feb. 7, 2003) (finding individual defendant's liability sufficiently pled relying on the "group pleading" doctrine); *Dardick*, 149 F. Supp. 2d at 987 ("it is not fatal ... to collectivize 'defendants' in certain respects – for example, in describing the duties of disclosure"); *Tricontinental Indus. Ltd. v. Anixter*, 215 F. Supp. 2d 942 (N.D. Ill. 2002) (relying on the "group pleading" doctrine); *In re Westell Techs., Inc. Sec. Litig.*, 00 C 6735, 2001 U.S. Dist. LEXIS 17867, at *37 n.7 (N.D. Ill. Oct. 26, 2001) (finding allegations sufficient based partly on the "group pleading" doctrine); *Sutton*, 2001 U.S. Dist. LEXIS 11610, at *16 (citing cases).[14] In fact, in this case, only defendant Gilmer challenges the

[14]Defendants concede that courts in this District are split on the continued viability of the group pleading doctrine, but rely significantly on cases from other circuits and districts in support of their argument that the group pleading doctrine has been extinguished. Defs' Mem. at 46. The cases on which defendants rely evidence the minority view and have not been followed by other courts in this District and are distinguishable. *See Chu v. Sabratek Corp.*, 100 F. Supp. 2d 827 (N.D. Ill. 2000); *Allscripts*, 2001 U.S. Dist. LEXIS 8897 (cited by *Tricontinental*, 215 F. Supp. 2d 942, but not followed). Indeed, defendants' practice of disregarding the wisdom of district courts in Illinois and the Seventh Circuit is endemic throughout their motion.

doctrine's applicability, but he also acknowledges the divergence of opinions on the issue. Defs' Mem. at 45-46. Because the doctrine's continued viability makes better sense, a majority of courts continue to apply the doctrine, and because plaintiffs have met its pleading requirements, the Complaint should not be dismissed on the ground that plaintiffs did not specifically (and repeatedly) name each defendant with respect to each statement issued by defendants on the Company's behalf. *See Dardick*, 149 F. Supp. 2d at 989 (holding that "it makes no difference whatever that the allegations [in the complaint] speak of 'defendants' collectively, rather than naming them one by one").

Gilmer was in a position to know the truth, which plaintiffs allege was contrary to Gilmer's public statements. In *Lindelow*, Judge Holderman held that "[w]hether or not the statements truly were false or misleading, defendants were responsible for the statements, or defendants were reckless in making the statements, are facts which can be elicited during discovery." 2001 U.S. Dist. LEXIS 10301, at *27.

Accordingly, Gilmer, as well as the other Officer Defendants, cannot escape liability at the pleading stage for making or authorizing the alleged false and misleading statements and omissions that appeared in group-published documents. *Id.* at *23.

3. Each Officer Defendant's Liability for Statements Made by Him to Analysts and Repeated to the Market Is Beyond Question

The Officer Defendants' liability for statements made to analysts is hardly a disputable issue. Courts in this District have held defendants liable for statements in analyst reports where the report specifically mentions discussions with "the Company's management." *See Westell*, 2001 U.S. Dist. LEXIS 17867, at *32 ("Where, as here, the plaintiff has narrowed the possible sources of information to Westell's CEO, [CFO] and the head of Investment Relations, the court finds that plaintiff has sufficiently pled who made the alleged misrepresentations."). *See also Sutton*, 2001 U.S. Dist. LEXIS 11610, at *10 (finding that plaintiffs had clearly attributed statements in analyst reports to defendants, thus meeting their pleading burden); *NeoPharm*, 2003 U.S. Dist. LEXIS 1862, at **33-41 (finding statements in analyst reports that specifically mentioned discussions with senior management to be well pled and actionable, while dismissing those that were not attributable to any

defendant or company person). Defendants' disagreement with well established precedent in this District and reliance on out-of-Circuit authority is simply not persuasive. Defs' Mem. at 32-35 and 34 n.24.

Following the mandate of courts in this District, the Complaint clearly avers that the false and misleading statements detailed in the analyst reports outlined in the Complaint came from defendants, and specifically attributes statements in the analyst reports to specific Officer Defendants. *See, e.g.*, ¶¶195, 203, 213, 216, 220, 228, 236, 251, 255-57, 261, 270, 275, 283-84, 291, 296-97, 300, 304, 306, 312, 320, 323, 325, 334, 337, 340. Even the out-of-District and Circuit authority on which defendants rely supports plaintiffs' position. *See Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1998) ("corporate defendants may be directly liable under 10b-5 for providing false or misleading information to third-party securities analysts"); *Warshaw v. Xoma*, 74 F.3d 955, 956 (9th Cir. 1996) (defendants cannot escape liability by filtering their false statements through the eyes and ears of analysts).[15]

4. Defendants' Reliance on the PSLRA "Safe Harbor" Defense Is Inappropriate at the Motion-to-Dismiss Stage

Defendants cannot hide behind the "safe harbor" defense because the alleged false statements were (a) not forward looking; (b) not "accompanied by "cautionary language"; and (c) knowingly false when made.

a. The Safe Harbor Does Not Apply to Misrepresentations or Omissions of Existing or Historical Fact

Defendants' attempt to characterize a number of their Class Period misrepresentations as "forward-looking" statements is unavailing. Defs' Mem. at 36-39. The Complaint sets forth affirmative misstatements of fact that are plainly not protected by the PSLRA's safe harbor. For example, defendants' statement "we are on track," ¶229, is a statement of current business condition. *See In re Secure Computing Corp.*, 184 F. Supp. 2d 980, 990 (N.D. Cal. 2001) ("'By stating that

[15]Where plaintiffs have met their pleading burden with respect to a significant number of material misstatements and omissions to securities analysts, it is of no impact that certain of the reports do not refer to specific information provided by defendants or management generally. *See, e.g., Sutton*, 2001 U.S. Dist. LEXIS 11610, at **10–14 ("we need not parse through each and every alleged misstatement contained in the complaint to determine if it is actionable"). Only ¶¶193, 198, 205 and 291 are not attributed to a specific defendant.

Secure was on track to meet expectations, Defendants represented that a reasonable person who know (sic) what Defendants knew at the time the statements were made could reasonably conclude that Secure was likely to meet analysts' expectations. Considered as statements of current business conditions, these statements were not forward-looking.'"). Similarly, many of the other statements delegated by defendants to footnotes are also statements of past or current business conditions:

¶233 "Business fundamentals ***are*** strong and reflect the positive trends we have seen since late last year. Our net interest margin percentage ***expanded*** substantially, credit quality improved and costs ***remained*** well under control. Receivable growth was strong in the consumer finance business. We ***have*** excellent momentum."

¶252 "The year is off to a great start," Aldinger concluded. "We ***are seeing*** a continuation of the very positive business trends that emerged in the second half of 1999. We ***remain comfortable*** with our receivable, revenue and earnings per share growth targets for 2000."

¶272 "Commenting on the full year results, Aldinger continued, 'Our record earnings per share ***reflect*** strong top-line growth and improved credit quality. At the same time, we ***made*** significant investments in our technology and human capital that enhance our ability to achieve sustainable and consistent revenue and receivables growth. We ***have built*** a powerful franchise that ***is capable*** of delivering 13 to 15 percent annual earnings per share growth.'"

¶285 "We ***are*** very comfortable with our ability to achieve our receivable and earnings per share growth targets for 2001."

¶289 "Our strong performance ***to date has positioned*** us well to achieve another record year in 2001," Aldinger concluded.

¶324 Aldinger concluded, "We ***are*** off to a great start, and I ***am comfortable*** with our ability to meet our 13 to 15 percent earnings per share growth target for 2002."

¶333 Aldinger concluded, "The company's operating performance ***has been*** very strong in the first half of 2002, and, although the economic environment is likely to remain uncertain, we believe our businesses ***are well-positioned*** for the remainder of the year."

¶336 "The company's operating performance in the first half of the year ***has been*** very strong, and our businesses ***are well-positioned*** for the remainder of the year."

The statements set forth above are clearly not forward-looking, since they concern the then-existing or recent historical state of Household's business. The PSLRA's safe harbor (and related "bespeaks caution" doctrine) only protect defendants' purely forward-looking statements; it cannot be used to neutralize the effect of misrepresentations of current facts. *See Danis*, 73 F. Supp. 2d at 935 ("'warnings of future risks cannot adequately caution against a misstatement of historical, present facts'"); *In re Oxford Health Plans, Inc. Sec. Litig.*, 187 F.R.D. 133, 141 (S.D.N.Y. 1999) (neither

the safe harbor nor bespeaks caution doctrine applies where plaintiffs were not relying on the corporation's financial projections but, rather, defendants' failure to disclose historical and existing material facts).

Even statements that may conceivably be forward-looking but reference then-existing facts fail to come under the "safe harbor" for forward-looking statements. *See, e.g., Lindelow*, 2001 U.S. Dist. LEXIS 10301, at *15 (statements that appear to be forward looking were not actually forward looking in the context in which they were made because they could reasonably be read to be premised on the existence of past events). *See also Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1213 (1st Cir. 1996) (superseded by statute on other grounds) (forward-looking statements that encompass a "representation of present fact" are not immune from liability); *In re APAC Teleservices, Inc. Sec. Litig.*, No. 97 C 9145(BSJ), 1999 U.S. Dist. LEXIS 17908, at *23 (S.D.N.Y. Nov. 12, 1999) ("[l]inking future success to present and past performance does not render statements immune from liability").

b. Defendants' Statements Were Not Accompanied by "Meaningful Cautionary Language" and Hence Fail to Trigger the Safe Harbor Protection

Further, even if defendants could show that some of the misstatements were purely "forward looking," defendants have failed to meet their heavy burden of showing that the purportedly "cautionary statements" were sufficient to render their misstatements immaterial as a matter of law. It is well established in the Seventh Circuit that "[v]ague or boilerplate disclaimers advising that a particular investment has risks generally will not suffice." *United States v. Morris*, 80 F.3d 1151, 1167 (7th Cir. 1996). To be effective, any cautionary language "'must be substantive and tailored to the specific future projections, estimates or opinions' that are alleged to be misleading." *Id.*

The purportedly cautionary language cited by defendants with respect to their forward-looking statements is inadequate to trigger safe harbor protection. Indeed, the purportedly cautionary language in defendants' press releases was precisely what Judge Holderman found insufficient in

Lindelow. *See* 2001 U.S. Dist. LEXIS 10301, at **16-17.[16] The cited cautionary language merely makes cursory references to miscellaneous general risks and is not "substantive" or "tailored" to any specific risks to which Household was subject. Indeed, the cautionary language on which defendants rely is so generic that it could just as easily have been applied to the Company's operations at any other point in time, or to virtually any modern company.[17]

c. The Safe Harbor Does Not Apply to Knowingly False Misrepresentations or Omissions that Are Forward Looking

Moreover, as demonstrated in §IV.C above, the Complaint adequately alleges that defendants had actual knowledge that their forward-looking statements were materially false and misleading. All of the generic risk disclosures in the world cannot excuse knowingly false statements, including forward-looking statements, that are belied by facts known to defendants at the time the statements are made. The Complaint alleges in painstaking detail information that defendants knew, but failed to disclose.

As a result, defendants' generic risk disclosures do not insulate them from liability. "Bespeaks caution" principles have never permitted a defendant to conceal a ***known*** or ***existing*** problem by describing it merely as a ***potential*** problem. "'To warn that the untoward may occur

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[16]Household's "purported" cautionary language provides:

> This press release contains certain estimates and projections that may be forward-looking in nature, as defined by the Private Securities Litigation Reform Act of 1995. A variety of factors may cause actual results to differ materially from the results discussed in these forward-looking statements. Factors that might cause such a difference are discussed in Household International's Annual Report on Form 10-K for the year ended December 31, 1997, filed with the SEC.

Defs' Ex. D-1 (*see also* D-2, E-1 to E-5, F-1 to F-5, G-1 to G-5, H-1 to H-3, I-1 to I-2 (referencing similar cautionary language)).

[17]The cases cited by defendants are readily distinguishable because they involved cautionary language that was far more substantive than the boilerplate language at issue here. Defs' Mem. at 38, n.29. In *Rasheedi v. Cree Research, Inc.*, 1:96CV00890, 1:96CV01069 Consolidated Cases, 1997 U.S. Dist. LEXIS 16968, at **5-6 (M.D.N.C. Oct. 17, 1997), the court found that where defendants had specifically cautioned against the very factor that caused financial results to materially differ, failure to include every conceivable factor was not necessary. In *Harris v. Ivax Corp.*, 182 F.3d 799, 809 (11th Cir. 1999), the challenged press release that announced a $16 million loss in the second quarter of 1996 but stated that the company believed "the challenges unique to this period in our history are now behind us," specifically warned that the stated bases for the expected turnaround – improved reorders and a renegotiated credit facility – were uncertain.

when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit.'" *Danis*, 73 F. Supp. 2d at 935. As the Seventh Circuit has held, "[w]arnings ... that ... put investors on notice that there is a chance things may not go as hoped in the future ... do not put investors on notice that statements made in the prospectus are untrue at the time, or that important facts have been left out of the prospectus." *Eckstein v. Balcor Film Investors*, 8 F.3d 1121, 1127 (7th Cir. 1993); *In re Prudential Sec. Ltd. P'ships Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996) ("General risk disclosures in the face of specific known risks which border on certainties do not bespeak caution .... The doctrine of bespeaks caution provides no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead ***when he knows with near certainty*** that the Grand Canyon lies one foot away."). As such, defendants are not protected even if their statements were otherwise deserving of protection as forward-looking statements, which, as discussed above, they are not.[18]

5. Defendants' False and Misleading Statements Are Not Puffery and Therefore Actionable

Defendants' statements are actionable, not puffery or statements of opinion, because defendants were aware of contemporaneous facts that belied their statements. *See* Defs' Mem. at 35-36. Contrary to defendants' position, courts have consistently found statements of opinion and other subjective statements to be actionable under §10(b) if the speaker is aware of undisclosed facts that tend seriously to undermine the statement's accuracy and if the statement, in context, would likely have been important to investors. *See, e.g., Lindelow*, 2001 U.S. Dist. LEXIS 10301, at *12 ("statements of opinion will be actionable if it is possible defendants 'said things that were so discordant with reality that they would induce a reasonable investor to buy the stock at a higher price than it was worth *ex ante*'") (quoting *Eisenstadt v. Central Corp.*, 113 F.3d 738, 746 (7th Cir. 1997));

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[18]In any event, whether the supposed cautionary language was sufficiently curative raises issues of fact that cannot be resolved on a motion to dismiss. *See, e.g., In re Lucent Techs., Inc. Sec. Litig.*, 217 F. Supp. 2d 529, 557 (D.N.J. 2002) ("The question whether any cautionary language is sufficiently 'meaningful' raises fact issues that are improperly resolved on this motion to dismiss."); *Fidel v. Farley*, Civil Action No. 1:00-CV-48-M, 2001 U.S. Dist. LEXIS 9461, at *20 (W.D. Ky. June 27, 2001) (issue of whether alleged forward-looking statements were accompanied by meaningful cautionary language is more appropriate for summary judgment than on a motion to dismiss). Accordingly, defendants' "safe harbor" arguments should be rejected.

Next Level, 1999 U.S. Dist. LEXIS 5653, at *17 (court held that statements "boasting" of the company's "bright future" were actionable, where defendants were aware of significant problems that the company faced).

As discussed in §IV.D.4.a, *supra*, the false and misleading statements that defendants now claim were puffery concerned statements of existing fact rather than mere "optimistic rhetoric." *See, e.g.*, ¶¶193, 203 ("[m]anagement conveyed a more positive tone .... Management reiterated its profitability and growth targets."); ¶205 ("The company is optimistic about credit card growth in 1998, with plans to increase its marketing budget significantly."); ¶236 ("Management appears optimistic about internally generated loan growth at HFC ....").[19] Cases relied on by defendants do not help their cause. They provide the Court with an incomplete citation of *Eisenstadt* (*see supra*), and, in *San Leandro Emergency Medical Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 811 (2d Cir. 1996), the court held that defendants' vague statements concerning pricing policy "simply reflected company policy at the time; they were not promises to maintain that policy in the future, and thus were not rendered misleading by the company's subsequent consideration of an alternative plan." Here, by contrast, plaintiffs allege that the statements were materially false and misleading at the time they were disseminated, not rendered false by a later event. Thus, they are not "mere puffery."

E. Plaintiffs' Section 11 and 12(a)(2) Claims Are Both Actionable and Timely

1. The Complaint States a Claim Under Sections 11 and 12(a)(2) with Respect to Both the Beneficial Registration Statement and the Debt Securities Offerings

Section 11 "prohibits the issuance of false or misleading securities registration statements, including the portion of the registration statement that circulates as the prospectus," and §12(a)(2) "imposes civil liability on any person who makes a false or misleading statement in the offer or sale of a security, whether in an oral communication or prospectus." *Danis*, 73 F. Supp. 2d at 930 (citing 15 U.S.C. §§77k, 771(a)(2)). "'To establish a *prima facie* §11 claim, a plaintiff need show only that

[19]Similarly, other statements referenced by defendants are actionable. ¶¶270, 296. Even defendants are incapable of finding the "puffery" in some of the statements. *See, e.g.*, ¶¶223, 229, 233, 237, 251, 261, 275, 284-85, 289, 297, 303.

he bought the security and that there was a material misstatement or omission. Scienter is not required for establishing liability under this section.'" *First Merchants*, 1998 U.S. Dist. LEXIS 17760, at *34. Indeed, "the liability of the issuer of a materially misleading registration statement is 'virtually absolute, even for innocent misstatements.'" *Id.* at **34-35 (quoting *Herman & MacLean*, 459 U.S. 375, 382 (1983)). The PSLRA pleading requirements do not apply to §11 claims. *In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 338 (S.D.N.Y. 2003).

Here, plaintiffs have alleged the specific false and misleading statements in the Beneficial Registration Statement, ¶¶362-69, and the various debt securities registration statements, ¶¶390-91. Additionally, plaintiffs allege the false financials and the false statements underlying the §§11 and 12(a)(2) violations for the Beneficial Merger, as well as the debt securities offerings. ¶¶362-69. Finally, plaintiffs have shown that they purchased the securities at issue from Household. ¶¶357, 375, 385, 392-93. Plaintiffs have therefore sufficiently pled a claim under §§11 and 12(a)(2) against Household, the Officer Defendants, Director Defendants and HFC Directors. Plaintiffs address defendants' remaining concerns in turn *infra*.

2. Each of Plaintiffs' Section 11 Claims Was Brought Within the Appropriate Five Year Statute of Limitations

Defendants argue that plaintiffs' §§11 and 12(a)(2) claims based on the 1998 Beneficial Registration Statement and 02/99 and 07/99 debt registrations should be dismissed because they were not filed within the applicable statute of limitations. Defs' Mem. at 40. This argument is premised on the old three-year statute of limitations set forth in §13 of the Securities Act of 1933 ("1933 Act").[20] *Id.* Section 13, however, is no longer the governing statute.

On 7/30/02, President Bush signed the Sarbanes-Oxley Act into law.[21] Under the Sarbanes-Oxley Act, the statute of limitations for ***all*** private causes of action under the securities

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[20]Under §13 of the 1933 Act, §11 claims must be "brought within one year after the discovery of the untrue statement of the omission, or after such discovery should have been made by the exercise of reasonable diligence.... In no event shall any such action be brought to enforce a liability created under [§11] ... more than three years after the security was bona fide offered to the public." 15 U.S.C. §77m.

[21]The Sarbanes-Oxley Act's stated purpose is "To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." Pub. L. No. 107-204, 116 Stat. 745 (2002).

laws was expanded to the earlier of (1) two years after the discovery of the facts constituting the violation; or (2) five years from such violation. 28 U.S.C. §1658(b). Defendants do not (and indeed cannot), argue that the facts underlying plaintiffs' §§11 and 12(a)(2) claims were discovered more than two years before the complaint was filed, nor do they (or can they) argue defendants' violations occurred more than five years ago. Indeed, the initial complaint in this action was filed on 8/20/02, and the operative Complaint was filed on 3/13/03. Defendants' earliest §§11 and 12(a)(2) violations occurred on 6/01/98 -- well within five years of the date of either complaint.[22] Accordingly, plaintiffs' §§11 and 12(a)(2) claims were timely filed.

Defendants argue that the Sarbanes-Oxley Act does not expand the statute of limitations for claims under §§11 and 12(a)(2) because it is limited to claims asserted in fraud. In making this argument, however, defendants ignore both the plain language of §804 of the Sarbanes-Oxley Act and its extensive legislative history.

a. The Text of the Sarbanes-Oxley Act Clearly and Unambiguously Lengthens the Statute of Limitations Applicable to the Section 11 and 12(a)(2) Claims Asserted in Plaintiffs' Complaint

Any question of statutory interpretation begins with an examination of the text of the statute to determine whether its meaning is clear. *See Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 739 (1989); *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989)(holding that when a statute's language is plain, "the inquiry should end"); *Kelly v. Boeing Petroleum Servs., Inc.*, 61 F.3d 350, 362 (5th Cir. 1995) (stating that if the statutory language is plain and unambiguous, it must be given effect). Here, the text of the statute at issue is plain and unambiguous and its meaning is clear. Section 804 of the Sarbanes-Oxley Act amends 28 U.S.C. §1658 by extending the statute of limitations for ***all*** private securities claims to two years from the discovery of facts constituting the violation, rather than one year, and to five years from the violation, rather than three years. Indeed, the pertinent portion of 28 U.S.C. §1658 now provides:

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[22]With regard to an effective date for §804, the statute reads, "The limitations period provided by section 1658(b) of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act." Pub. L. No. 107-204, 116 Stat. 745, 804 (2002). Since the Act was signed into law on 7/30/02, prior to the filing of any complaint in this action, §804 clearly applies.

> [A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(47)), may be brought not later than the earlier of –
>
> (1) 2 years after the discovery of the facts constituting the violation; or
>
> (2) 5 years after such violation.

Section 3(a)(47) of the Securities Exchange Act of 1934 ("1934 Act") provides: "***The term 'securities laws' means the Securities Act of 1933*** (15 U.S.C. 77a *et seq.*), the Securities Exchange Act of 1934 (15 U.S.C. §78a *et seq.*) ..." *See* §3(a)(47) of the 1934 Act (15 U.S.C. §78c(a)(47)). The amended 28 U.S.C. §1658 ***specifically references*** non-fraud 1933 Act claims under §3(a)(47). Indeed, the 1933 Act does not contain any fraud-based private right of action. 15 U.S.C. §77 (only §§11, 12 and 15 of the 1933 Act provide for a private right of action). By its own terms, the Sarbanes-Oxley Act's statute of limitations explicitly applies to all private securities claims, including those for violations of the 1933 Act.

Had Congress sought to exclude 1933 Act claims from the reach of the Sarbanes-Oxley Act, it could have easily done so by not referring to 1933 Act claims in the express language of §804. However, in §804 of the Sarbanes-Oxley Act, Congress explicitly refers to "the securities laws, as defined in section 3(a)(47)." As previously mentioned, §3(a)(47) specifically states that "***[t]he term 'securities laws' means the Securities Act of 1933***." 15 U.S.C. §78c(a)(47). Thus, Congress clearly intended for the new Sarbanes-Oxley Act statute of limitations to apply to 1933 Act claims.[23] Accordingly, defendants' contention that the amended 28 U.S.C. §1658 applies only to claims sounding in fraud is wrong.

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[23]There is no controlling authority on this issue. The Western District of Wisconsin found that the extended statute of limitations did not apply to the 1933 Act based on the Court's inaccurate reading of the statute, as follows: "Section 804 of the Sarbanes-Oxley Act ... amends 29 U.S.C. §1658 to state that a plaintiff has two years from the date of discovering the violation in which to bring a claim under the ***1934 Act***." *Friedman v. Rayovax*, Nos. 02-C-308-C, 02-C-325-C, 02-C-370-C (W.D. Wis. June 2, 2003), at 20-21. As discussed here, §804 of the Sarbanes-Oxley Act does not state that on its face. In any event, this aspect of the opinion is presently the subject of a motion for reconsideration.

b. The Complaint's Disavowal of Fraud Does Not Preclude Application of the Extended Statute of Limitations to the Section 11 and 12(a) Claims

Defendants contend that the extended statute of limitations does not apply to plaintiffs' §§11 and 12(a) claims because plaintiffs have expressly disavowed fraud as a basis for these claims. Defs' Mem. at 42. This contention simply has no merit. First, fraud is never an element of a §11 or 12(a)(2) claim. *See* 15 U.S.C. §§77k and 77l(a)(2).[24] Second, the application of §804 is not limited to fraud claims only; it applies to "claim[s] of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws." 28 U.S.C. §1658. Defendants' reliance on the Supreme Court decision in *Ernst v. Hochfelder*, 425 U.S. 185 (1976) for the premise that the terms "fraud, deceit, manipulation or contrivance" are synonymous with scienter is misplaced. Defs' Mem. at 41. The Supreme Court in *Hochfelder* explicitly stated that "[t]he words manipulative or deceptive ***used in conjunction with*** device or contrivance strongly suggest that §10(b) was intended to proscribe knowing or intentional misconduct." *Hochfelder*, 425 U.S. 197. The Supreme Court emphasized that the "[u]se of the word 'manipulative' is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Id.* at 198. Notably, the Supreme Court does not include the word "contrivance" in its definition of scienter. *See Herman v. MacLean*, 459 U.S. 375, 382 (1983) ("A §10(b) plaintiff ... must prove that the defendant acted with scienter, *i.e.*, with intent to deceive, manipulate, or defraud.") (citing *Hochfelder*, 425 U.S. at 193). By itself, the word "contrivance" is not suggestive of fraud or intent, but rather the vehicle through which the fraud is achieved. *See Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979) ("Canons of construction ordinarily suggest that terms connected by a disjunctive be given separate meanings, unless the

[24]Although some courts have erroneously applied a Rule 9(b) pleading standard to §§11 and 12 claims that "sound in fraud," these decisions do not import fraud as an element in proving such claims. *See, e.g., First Merchants*, 1998 U.S. Dist. LEXIS, at *36 n.6 (Rejecting application of 9(b) to §11 claims, the court stated: "It is illogical to require plaintiffs to plead more than they would have to prove to succeed on a § 11 claim standing alone."). By asserting that their §§11 and 12 claims do not sound in fraud, plaintiffs merely invoke a common pleading convention.

context dictates otherwise ...."). Accordingly, while they do not allege fraud, plaintiffs' §§11 and 12(a)(2) claims are governed by the longer statute of limitations under the Sarbanes-Oxley Act.

c. The Legislative History of the Sarbanes-Oxley Act Contradicts Defendants' Interpretation of the Act

Even if the Sarbanes-Oxley Act were not clear and unambiguous on its face, a careful review of the legislative history of the Act, particularly the Conference Report, further shows that Congress intended the Sarbanes-Oxley Act to be applied to ***all*** private securities causes of action filed after the date of enactment of the Sarbanes-Oxley Act. The section of the Sarbanes-Oxley Act at issue, Title VIII, was authored by Senator Leahy who intended the application of the Sarbanes-Oxley Act to all private securities actions be apparent from its face. Indeed, Senator Leahy's section by section analysis of Title VIII is included in the Congressional Record of 7/26/02, as part of the official legislative history:

> Section 804. – Statute of Limitations
>
> This provision states that it is not meant to create any new private cause of action, but only ***to govern all the already existing private causes of action under the various federal securities laws that have been held to support private causes of action. This provision is intended to lengthen any statute of limitations under federal securities law, and to shorten none.*** The section, by its plain terms, applies to any and all cases filed after the effective date of the Act, regardless of when the underlying conduct occurred.

See Legislative History of Title VIII of HR 2673: The Sarbanes-Oxley Act of 2002, 148 Cong. Rec. S. 7418 (2002) (Statement of Senator Leahy). Thus, Senator Leahy's analysis conclusively demonstrates that Congress intended for the extended statute of limitations to apply to all federal securities laws, including §§11 and 12(a)(2) of the 1933 Act.

In *In re Foster J. Gibbons*, Chapter 7, Case No. 01-13915 (ALG) 289 B.R. 588, 2003 Bankr. LEXIS 161 (Bankr. S.D.N.Y. Mar. 7, 2003), the court discussed Senator Leahy's section-by-section analysis of the Sarbanes-Oxley Act. "Courts frequently give substantial weight to a 'section-by-section analysis' in determining legislative intent." *Id* at *17 (citing *Garrett v. United States*, 471 U.S. 773 (1985)); *Philko Aviation, Inc. v. Shacket,* 462 U.S. 406 (1983)). "Moreover, the purpose of the section-by-section analysis was 'to provide guidance in the legal interpretation' of the Sarbanes-Oxley Act, and it was offered by Senator Leahy, the author of the Accountability Act

and Senate Judiciary Committee Chairman at the time of the enactment of the legislation." *Id.* at **17-18 (citing 148 Cong. Rec. S7418 (daily ed. July 26, 2002) (statement of Senator Leahy)). Furthermore, the *Gibbons* court observed, "A section-by-section analysis may not be as persuasive if it was introduced after the enactment of the legislation. In this case, however, the section-by-section analysis was offered into the *Congressional Record* as legislative history contemporaneously with the passage of the Sarbanes-Oxley Act of 2002, and without any objection." *Id.* at *18 n.12.

Accordingly, Senator Leahy's instruction that §804 is intended to "govern ***all*** the already existing private causes of action under ***the various federal securities laws*** that have been held to support private causes of action" and "is intended to lengthen ***any*** statute of limitations ***under federal securities law***" must be given substantial weight. 148 Cong. Rec. S. 7418.

Thus, it is clear from both the statutory language and legislative history that §804 of the Sarbanes-Oxley Act was intended to expand the statute of limitations for all private securities actions, including those under §§11 and 12(a)(2) of the 1933 Act.

3. Plaintiffs Have Alleged Damages Resulting from False Statements in the Beneficial Registration Statement Raising Valid Claims Under Sections 11 and 12(a)(2)

Sections 11 and 12(a)(2) impose strict liability on issuers and other signatories of a registration statement containing material misstatements or omissions. 15 U.S.C. §§77k(a) & 77l(a). Plaintiff West Virginia Laborers' Trust Fund ("West Virginia Fund") acquired its Household shares in exchange for their Beneficial shares pursuant to the 6/01/98 Beneficial Registration Statement. ¶¶357, 375, 377.

Defendants here do not claim that plaintiff West Virginia Fund did not suffer any loss, *i.e.*, that they sold their Household stock acquired in the 6/30/98 merger for a higher price than they paid to obtain these shares. Defs' Mem. at 43. *Cf. In re McKesson HBOC, Inc. Secs. Litig.*, 126 F. Supp. 2d 1248, 1262 (N.D. Cal. 2000) (shareholders who sell their stock at a price higher than their purchase price are entitled to no relief under §11 because all measure of damages under §11 are limited to differences in trading price). Instead, defendants contend that because West Virginia Fund sold its shares prior to 2002 – when the market became aware of the false statements in the

Beneficial Registration Statement – any loss they suffered could not have been caused by the false statements in the Registration Statement. *Id.*

Defendants' logic is faulty. First, the Complaint on its face clearly alleges a loss to West Virginia Fund. ¶¶357, 375, 377. Damages for a §11 violation are measured by the difference between the amount paid for the security and its price at ***either the time it was sold or the date the §11 claim was filed***. *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1421 (9th Cir. 1994) (citing 15 U.S.C. §77k(e)).[25] Second, unlike the pleading requirements for other securities fraud claims, loss causation is not a necessary element of a *prima facie* §11 or §12(a)(2) cause of action. *Miller v. Apropos Tech., Inc.*, No. 01 C 8406, 2003 U.S. Dist. LEXIS 5074, at *25 (N.D. Ill. Mar. 31, 2003) (refusing to dismiss §11 claims for failure to allege loss causation); *Endo v. Albertine*, 863 F. Supp. 708, 734 (N.D. Ill. 1994).

Finally, the failure to show loss causation is an affirmative defense and will only support a motion to dismiss under Rule 12(b)(6) when a plaintiff's allegations ***clearly*** point to the existence of the defense. *Evergreen*, 2000 U.S. Dist. LEXIS 16876, at **20-21. Defendants have not conclusively established the lack of loss causation. The Complaint clearly alleges numerous false and misleading statements contained in the Beneficial Registration Statement. *See, e.g.*, ¶¶362-67 (false and misleading statements regarding Household's financial performance); ¶369 (false representation that Household was operating in compliance with applicable laws); and ¶372 (false and misleading fairness opinion). Thus, the Complaint alleges that absent the false statements or omissions, plaintiffs would either have refused to vote for the merger or obtained a better exchange ratio than they did, *i.e.*, received a higher price for their Beneficial shares or more Household shares. If anything, these are disputed factual issues, improper for disposition at this stage of the pleading. *Brown v. C.I.L., Inc.*, No. 94C 1479, 1996 U.S. Dist. LEXIS 4917, at *52 (N.D. Ill. Jan. 28, 1996).

[25]Although West Virginia Fund sold its Household shares acquired during the 1998 Beneficial Merger later that year, defendants do not challenge West Virginia Fund's ability to represent the subclass of class members who also obtained their Household shares during the Beneficial Merger and held onto those shares until they were converted into HSBC shares as a result of the 3/28/03 merger of Household with HSBC.

The cases defendants rely upon are inapposite and easily distinguishable because, in each of those cases, the fraudulent conduct or accounting improprieties occurred in the target companies (here Beneficial), causing the courts to appropriately find that the target shareholders who received shares issued pursuant to a false registration statement actually received a better deal that they would have, had information about the illegality been included in the registration statement. *See McKesson HBOC*, 126 F. Supp. 2d at 1261 ("disclosure of true facts would have substantially depreciated the value of HBOC's shares and have been an inducement to the shareholders to elect to accept the terms of the merger," raising the issue of absolute negative causation); *In re DNAP Sec. Litig.*, No. C 99-00048 WHA, 2000 U.S. Dist. LEXIS 13482, at **7-8 (N.D. Cal. Sept. 13, 2000) ("The information omitted from the proxy/prospectus was actually ***negative*** information about DNAP. Negative information about DNAP would hardly have induced DNAP shareholders to hold out for more consideration for the sale of DNAP or to seek to enjoin the transaction."). Here, the accounting improprieties were committed by the acquiror/issuer (Household), not Beneficial.

Because defendants cannot prove the lack of causation merely from the face of the Complaint, dismissal of plaintiffs' §§11 and 12(a)(2) claims is improper. *Miller*, 2003 U.S. Dist. LEXIS 5074, at *25 n.6 (affirmative defense not sufficiently proved from face of plaintiffs' complaint to merit dismissal).

F. Each Officer Defendant Is Liable as a Control Person Under the 1933 Act as Well as the 1934 Act

1. The Officer Defendants Are Liable Under Section 20(a) of the 1934 Act

Because plaintiffs have properly alleged primary violations of §10(b) and Rule 10b-5, plaintiffs' claims for relief asserting control person liability under §20(a) of the 1934 Act should not be dismissed. Plaintiffs allege (and with the exception of Gilmer, *see* §IV.D.1 & 2, *supra*, defendants do not deny) that, as top officers of Household, the Officer Defendants controlled the content of Household's press releases, SEC filings and other public statements that give rise to this action. *See In re Nanophase Techs. Corp. Sec. Litig.*, No. 98 C 3450, 2000 U.S. Dist. LEXIS 11744, at *20 (N.D. Ill. Aug. 11, 2000) ("To plead control person liability, the plaintiffs must adequately allege that each 'control person' participated in or exercised control over the company in general and

that he or she possessed the 'power or ability to control [the specific] transactions upon which the primary violation was predicated,' ***whether or not*** that power was exercised.") (quoting *Harrison v. Dean Witter Reynolds Inc.*, 974 F.2d 873, 881 (7th Cir. 1992)).

In any event, this Court has recognized that, "[o]rdinarily, whether a defendant is a 'controlling person' under §20(a) is a question of fact that cannot be determined at the pleading stage." *In re Discovery Zone Sec. Litig.*, 943 F. Supp. 924, 943 (N.D. Ill. 1996). Moreover, plaintiffs, like those in *Discovery Zone*, do not merely plead control by position, but rather "describe the defendants' power to direct the specific violations at issue in this case," including defendants' control over the contents of quarterly and annual reports and press releases, the documents containing the alleged misrepresentations; and defendants' access to adverse non-public information by way of internal Company documents, communications with other officers and directors, and attending management and board meetings. *Id.* at 943-44; ¶¶38-43. Plaintiffs also allege that each of the Officer Defendants was provided with copies of the Company's reports and press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. ¶41. Accordingly, each of the Officer Defendants was responsible for the accuracy of the public reports and releases detailed herein and was hence liable for the representations contained therein. *See also Anicom*, 2001 U.S. Dist. LEXIS 6607, at **19-20 (allegations that defendant held position of Chairman of the Board and then Chairman of the Executive Management Committee that gave him power to direct control of the company were sufficient to plead §20(a) claim).

2. The Officer Defendants and the Director Defendants Are Liable as Control Persons Under Section 15(a) of the 1933 Act

Section 15 of the 1933 Act makes "every person who ... controls any person liable under Sections 11 or 12 of the Securities Act of 1933] ... jointly and severally [liable] with and to the same extent as such controlled person ...." *See Miller*, 2003 U.S. Dist. LEXIS 5074, at *7 (citing 15 U.S.C. §77o). The requirements for claims under §15 are largely co-extensive with the requirements for §11 and §12 claims. The only additional element that §15 would require is that the defendant was in a position of control over the alleged violators of §11. *Id. See also Goldsmith v. Tech.*

Solutions Co., No. 92C 4374, 1993 U.S. Dist. LEXIS 6136 (N.D. Ill. May 6, 1993) (noting that liability of the defendants under §15 is wholly dependent on their alleged liability under §11).

The Complaint alleges that Household, the Officer Defendants, Director Defendants, and HFC Directors were "control persons." *See* ¶¶41-45, 47. Because plaintiffs have adequately alleged a claim against these defendants for a predicate violation under §§11 and 12, they are jointly and severally liable for violations by persons under their control. *See, e.g., Evergreen*, 2000 U.S. Dist. LEXIS 16876, at **23-24 (upholding plaintiff's §15(a) claims against officer defendants).

V. REQUEST FOR LEAVE TO AMEND

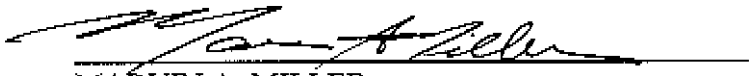
Plaintiffs believe the Complaint is particularized and alleges sufficient facts indicating that defendants' statements during the Class Period were false and misleading and raise a strong inference of scienter. Plaintiffs are continuing their investigation in anticipation of the denial of defendants' motions to dismiss. If, for any reason, the Court finds the Complaint, or any part thereof, inadequate, plaintiffs respectfully request leave to amend the Complaint pursuant to Fed. R. Civ. P. 15 to cure any possible pleading deficiencies. *See Ferguson v. Roberts*, 11 F.3d 696, 706 (7th Cir. 1993) ("[L]eave to amend should be granted under Federal Rule of Civil Procedure 15(a) unless there is 'undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, [or] futility of amendment.'") (quoting *Foman v. Davis*, 371 U.S. 178, 182 (1962)).

VI. CONCLUSION

For the foregoing reasons, plaintiffs respectfully request that defendants' motion to dismiss the Complaint be denied in its entirety.

DATED: June 19, 2003

Respectfully submitted,



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See Case File for Exhibits