UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, ON BEHALF OF ITSELF AND ALL OTHERS SIMILARLY SITUATED, Plaintiff, *- against -* HOUSEHOLD INTERNATIONAL, INC., ET AL., Defendants.	Lead Case No. 02-C-5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan

MEMORANDUM OF LAW IN SUPPORT OF THE HOUSEHOLD DEFENDANTS' MOTION TO COMPEL PLAINTIFFS TO SUPPLEMENT THEIR INITIAL DISCLOSURES PURSUANT TO FED. R. CIV. P. 26(a)(1)(A)(iii)

CAHILL GORDON & REINDEL LLP
80 Pine Street
New York, New York 10005
(212) 701-3000

EIMER STAHL KLEVORN & SOLBERG LLP
224 South Michigan Ave.
Suite 1100
Chicago, Illinois 60604
(312) 660-7600

Attorneys for Defendants Household International, Inc., Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilmer and J.A. Vozar

INTRODUCTION

The Federal Rules of Civil Procedure require Plaintiffs to disclose all information "bearing on the nature and extent of injuries suffered." Fed. R. Civ. P. 26(a)(1)(A)(iii). Since 2004, Defendants have sought to learn the facts underlying Plaintiffs' claim of injury and damages arising from an alleged securities fraud beginning in 1997. In 2004, Plaintiffs put off making the required Rule 26 disclosure, claiming that an expert would explain their theory later. It is now four years later and Plaintiffs now take the position that their expert cannot provide basic information about the claimed injury such as when the fraud and injury are claimed to have actually started. Defendants seek to compel Plaintiffs to cure that material deficiency.

It is axiomatic that in a securities fraud case any damages to which a plaintiff is entitled must flow from an actionable misstatement or omission. From information Plaintiffs have provided in revised Rule 26 disclosures, interrogatory responses, and expert reports, it appears that they intend to seek damages on the basis of alleged misstatements and omissions that "artificially inflated" Household's stock price some time before July 30, 1999. However, Plaintiffs still refuse to disclose at what point prior to July 30, 1999 the stock price became inflated. Instead, they have indicated that they simply assume that it existed on the first day of the class period, and instructed their expert to make this same assumption.

Defendants need the withheld information to rebut Plaintiffs' theory of loss causation and damages and to establish that all of Plaintiffs' claims are barred by the applicable statute of repose. Specifically, Defendants seek an order requiring Plaintiffs to specify the date or dates on which the "artificial inflation" upon which their claim for damages is based was first introduced into Household's stock price as a result of the alleged fraud that Plaintiffs claim existed prior to July 30, 1999. Since Plaintiffs seek an award of class period damages based upon alleged inflation that arose before the class period; refusing to disclose when it arose is unreasonable and deprives Defendants of their ability to pursue related defenses, including a showing that all of Plaintiffs' claims are barred by the statute of repose. As set forth below, Judge Guzman instructed Defendants to complete discovery on exactly this issue before renewing their motion seeking judgment on all time-barred claims.

ARGUMENT

A. Plaintiffs Have Not Provided Information Underlying Their Claim for Damages

Judge Guzman has already ruled that Plaintiffs are precluded as a matter of law by the applicable statute of repose from pursuing claims based on alleged misstatements or omissions in the period before July 30, 1999. *Lawrence E. Jaffe Pension Plan* v. *Household International, Inc.*, 2006 WL 560589 (N.D. Ill. Feb. 28, 2006). Plaintiffs' theory of damages appears to be that the "artificial inflation" that was present in Household's stock price during the class period was first introduced as a result of one or more unspecified misrepresentations that occurred on unspecified dates before the start of the class period. Thus far, Plaintiffs have refused to provide any discovery on the potentially dispositive questions of when and how they allege that "artificial inflation" arose.

Plaintiffs' Complaint alleges that Defendants began defrauding investors in late 1997 when they began issuing false financial statements that reported inflated revenue and concealed the company's credit quality. Plaintiffs claim that these misrepresentations and omissions artificially inflated Household's stock price. (AC at ¶ 349) Defendants are entitled to learn what events gave rise to the "artificial inflation" that is the basis of Plaintiffs' claim for damages and when those events occurred. The relevance of such discovery is beyond dispute. The Court of Appeals recently noted that securities fraud plaintiffs must show, *inter alia*: (1) that Defendants artificially inflated the stock price through material misrepresentations, and (2) that the inflation later came out of the stock once the market learned the "truth." *Ray* v. *Citigroup Global Markets, Inc.*, 482 F.3d 991, 995 (7th Cir. 2007) ("plaintiffs must show ***both*** that defendants' alleged misrepresentations artificially inflated the price of the stock and that the value of the stock declined once the market learned of the deception") (emphasis added); *see also Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336, 345-46 (2005) (explaining that the PSLRA "expressly imposes on plaintiffs 'the burden of proving' that the defendant's misrepresentations 'caused the loss for which the plaintiff seeks to recover.'") (citation omitted).

Defendants have sought this explanation since June 2004, including through a successful (if not fruitful) motion to compel Plaintiffs' compliance with their affirmative obligations under Rule

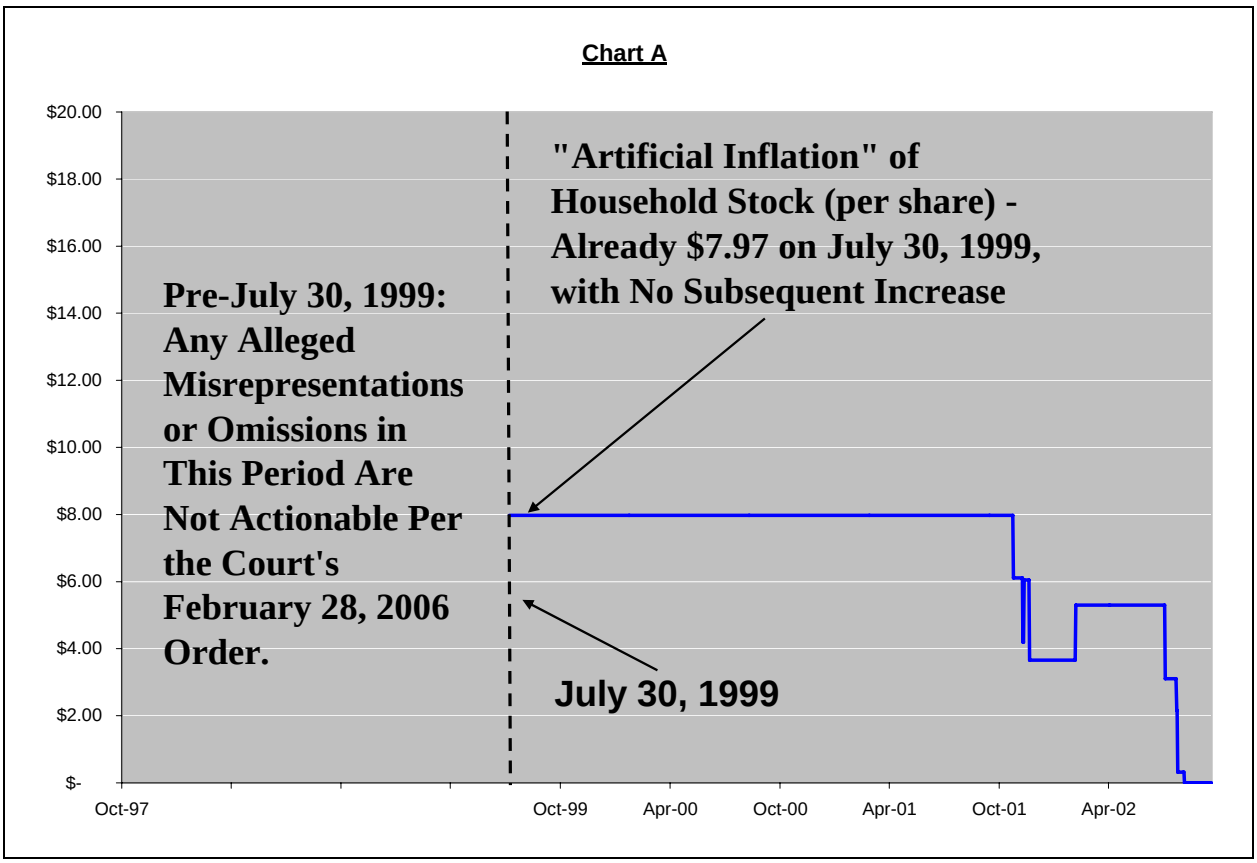
26(a)(1)(A)(iii) and served numerous contention interrogatories asking Plaintiffs to explain how the alleged fraud artificially inflated the price of Household's stock and whether the value of the stock declined once the market learned of the alleged deception. Initially, Plaintiffs demurred on the ground that this subject required expert evaluation, but their damages expert provided no explanation about the alleged origin of the "artificial inflation" Plaintiffs allege.

The expert Plaintiffs retained to explain their theory of damages is Daniel R. Fischel, a Professor at Northwestern University School of Law. Professor Fischel attempted to show with his analysis that "truth" about the alleged fraud was revealed during the class period, causing the stock price to decline. This is not all that is required by the securities laws. As the Seventh Circuit made clear in *Ray*, Plaintiffs must also show that the alleged misrepresentations artificially inflated the stock price. Professor Fischel, however, disclaims any knowledge or opinion as to which, if any, alleged misrepresentations introduced inflation into the stock price before the class period. (Rebuttal Report of Daniel R. Fischel, Declaration of Janet A. Beer, dated February 14, 2008 ("Beer Decl."), Ex. A at ¶36) In their second revised damages statement, Plaintiffs also refused to provide the missing information, claiming that it is irrelevant to their claims. (Lead Plaintiffs' Further Supplement to Their Prior Statement Regarding Damages, Beer Decl., Ex. B at 2) Plaintiffs' stonewalling on a required element of their claim is in flat violation of the Federal Rules of Civil Procedure and the federal securities laws upon which Plaintiffs base their claims. *See Trading Technologies Int'l, Inc.* v. *eSpeed, Inc.*, No. 04 C 5312, 2005 U.S. Dist. LEXIS 10686, at *2 (N.D. Ill. Apr. 28, 2005) (citing *Oppenheimer Fund, Inc.* v. *Sanders*, 437 U.S. 340, 351 (1978)) ("Discovery encompasses matters that actually or potentially affect any issue in the litigation.").

B. Defendants Need the Information They Seek to Establish That Plaintiffs' Claims Are Time-Barred by the Statute of Repose

Plaintiffs asked Professor Fischel to "analyze the economic evidence as it relates to their claims, determine whether it is consistent with these claims, and, if so, analyze the amount of alleged artificial inflation in Household's stock price during the Class Period attributable to such claims." (*See* Fischel Report, Beer Decl., Ex. C at 6) Professor Fischel prepared a report summarizing his findings,

which Plaintiffs served on Defendants on August 15, 2007. The Fischel Report (which accepts Plaintiffs' allegations as true) reflects Professor Fischel's conclusion that *by July 30, 1999*, Household's stock price was "artificially inflated" as a result of unspecified misrepresentations and/or omissions in the amount of $7.97 per share over and above the "true value" of the stock on that day. (*See* Beer Decl. Ex. C at Ex. 53) Professor Fischel's Report concludes that ***not a penny of additional inflation*** was introduced into Household's stock price between July 30, 1999 and November 15, 2001, when, according to Plaintiffs, the "truth" of Household's alleged fraud began to be revealed to the market. *Id.* "Chart A" below provides a graphic representation of data reported by Professor Fischel, describing the "artificial inflation" of Household's stock claimed by Plaintiffs. (*See* Beer Decl. Ex. C at Ex. 53)



As Judge Guzman held in his February 2006 Order, once the three-year statute of repose period expired, any action based on alleged misrepresentations or omissions made prior to that time was forever time-barred. *Lawrence E. Jaffe Pension Plan* v. *Household International, Inc.*, 2006 WL 560589 (N.D. Ill. Feb. 28, 2006). Taking Plaintiffs' contentions and their expert's conclusions regarding

the alleged "artificial inflation" of Household's stock price as true, at some unspecified point in time *prior to July 30, 1999* certain misrepresentations caused Household's stock price to become "artificially inflated" by $7.97 per share. Although Professor Fischel does not specify the nature or timing of the pre-July 30, 1999 inflation reflected in his Report, by definition the alleged misrepresentation that caused the "artificial inflation" of $7.97 per share did not occur on or after July 30, 1999 — the bright line cut-off date for application of the statute of repose, as previously held by this Court as a matter of law. *Id.* at *3.

Based upon Plaintiffs' disclosures, Defendants made a motion to the District Court asserting that Plaintiffs' claims are time-barred under the applicable statute of repose. On September 4, 2007, the parties appeared before Judge Guzman for presentment of the motion. Plaintiffs argued that the Court should put off deciding the motion at that time because expert discover was not complete. Judge Guzman agreed that were the Court to dismiss Plaintiffs' claims as time-barred, he would prefer to do so with a complete set of facts explaining the circumstances raised by Plaintiffs' damages theory and Defendants' motion. (Transcript of Proceedings, September 4, 2007, Beer Decl., Ex. D at 10) Judge Guzman stated:

> "I think [Professor Fischel] says things that caused you to draw that conclusion [that all of Plaintiffs' claims are time-barred]. And it may be a correct conclusion. ***But before I'm ready to draw that conclusion and permanently terminate their cause of action, I think I would rather have the entire set of discovery facts before me.***"

(Beer Decl., Ex. D at 7) (emphasis added).

Now that the time has come to provide the complete disclosure expected by Judge Guzman, however, Plaintiffs seek to evade the hard question about when the inflation actually arose. In response to this Court's Order that Professor Fischel disclose this information for Plaintiffs, Fischel stated that he does not actually know when Plaintiffs claim the inflation came into the stock price. He now asserts in "rebuttal" that his analysis cannot pinpoint any time in the company's history when there was zero inflation, and that Plaintiffs have told him to "assume" that it was already present as of July 30, 1999. (Beer Decl., Ex. A at ¶36) Plaintiffs themselves call the question "irrelevant." (Beer Decl. Ex. B at 2)

The time for hiding the ball has passed. Since Professor Fischel is apparently unable to comply with this Court's Order to disclose the dates when the stock price became inflated, the Plaintiffs must discharge their own disclosure obligations arising from the claims they have brought. Judge Guzman has specifically stated that he wants a complete record on which to decide the merits of the statute of repose issue at summary judgment. This Court has previously indicated that the Defendants have a right to know when the inflation was zero (*i.e.*, when the fraud allegedly started). Plaintiffs must not be permitted to duck this issue again.

C. Defendants Need the Information They Seek to Rebut Plaintiffs' Claim That Alleged "Artificial Inflation" Can Be Attributed to Particular Frauds

Putting aside the statute of repose issue, Defendants need the information on when Plaintiffs claim the "artificial inflation" arose in Household's stock to understand and rebut Plaintiffs' theory of loss causation and damages.

The following hypothetical may provide a useful illustration of the problem. Assume that a company misrepresented Fact A in 1985, Fact B in 1990, and Fact C in 1995. Suppose that a plaintiff then brought suit under the securities laws, alleging that the company's stock price was "artificially inflated" by $10 per share as a result of the company's misrepresentations of Fact A, Fact B, and Fact C, and that the company had committed a "continuing violation" of the securities laws by omitting to disclose the truth of Fact A, Fact B, and Fact C in its SEC filings during the period beginning July 30, 1999. The plaintiff's claim might be, as the Plaintiffs' claim here, that the full amount of artificial inflation was fully present in the company's stock price on July 30, 1999, the first day of the class period. Suppose that this hypothetical plaintiff claimed that the truth that Fact A, Fact B, and Fact C were previously misrepresented was revealed over the course of 2002, thus removing the $10 per share of alleged artificial inflation from the company's stock price. If, however, the truth of Fact A were actually revealed to the market on January 1, 1998, then the defendant could establish that plaintiff had no claim to per-share damages for the portion of the $10 of artificial inflation attributable to Fact A. But without knowing when the inflation resulting from the misrepresentation of Fact A entered the stock price, and the extent of the "artificial inflation" attributable to Fact A, it would be impossible to determine what part of the total $10 inflation the plaintiff would be entitled to recover. In such a case, as here, the de-

fendant would be unfairly prejudiced by plaintiffs' failure to provide basic information relevant to a valid defense.

Plaintiffs claim that by July 30, 1999 Defendants had made material misrepresentations that were relied upon by the market, and that this "fraud on the market" resulted in Household's stock price becoming "artificially inflated" by $7.97 per share. Plaintiffs' expert apparently calculated this inflation by summing the declines in stock price that occurred on certain days in 2002 when, according to him, the "truth" of Defendants' alleged fraud was revealed. However, it is Defendants' position that certain portions of the alleged fraud were known to the market prior to July 30, 1999. If Defendants are correct, then no one in the class can hope to recover for that portion of the claimed $7.97 per share of artificial inflation that is related to information that was revealed before the class period. Defendants need to know when (*i.e.*, the specific time or times) the "artificial inflation" upon which Plaintiffs' theory for damages is based first arose in Household's stock price.

D. Plaintiffs Are Required to Participate in Discovery

Plaintiffs are required by the Federal Rules of Civil Procedure to provide to Defendants all information known to them "bearing on the nature and extent of injuries suffered." Fed. R. Civ. P. 26(a)(1)(A)(iii). Plaintiffs' Complaint alleges that Household was issuing misrepresentations to the market as far back as 1997. They claim that these misrepresentations inflated Household's stock price and were the cause of Plaintiffs' losses (AC at ¶ 349). Moreover, Plaintiffs made clear to this Court that it was these very pre-class period misrepresentations and omissions that introduced this "artificial inflation" and that now provide the basis of their claim for damages. For example, at the most recent status conference, Mr. Burkholz stated:

> "The way that — the way it is going to work in this case is we have a July 30th — a July 30th start to our case. We have no statement on that date. We are — our position is the stock was inflated on that date by a failure of Household to disclose the true facts. And if they did disclose the true facts on that day, the stock would have went [sic] down by the amount of the fraud decline that Dr. Fischel found later, the $7.97. And the fact is that there was a July 22nd statement, eight days before, that was alive in the market on that day."

Transcript of Feb. 7, 2008 Status Conference at 25.[1]

Having affirmatively contended that the "artificial inflation" created by alleged pre-class period misrepresentations and omissions underlies their claim, Plaintiffs cannot simply argue, now that the requested facts could undermine their position, that these facts are suddenly irrelevant. To the contrary, without knowing when Plaintiffs contend the "artificial inflation" came into Household's stock price, Defendants and the Court cannot evaluate Plaintiffs claims. Defendants do not know whether Plaintiffs allege that the $7.97 of inflation was introduced by misrepresentations in 1999, 1997, 1990, or even 1878. Clearly, if the inflation was introduced as far back as 1878, when Household was founded, Plaintiffs' claims would be time-barred. Likewise, if the $7.97 of inflation was introduced by statements unrelated to the issues of this litigation, or if Defendants could establish that the truth of some alleged component fraud included in the $7.97 was revealed to the market before the class period, then Plaintiffs' claims would fail.

Defendants are not presently asking the Court to consider whether Plaintiffs' claims are time-barred by the statute of repose or what portion of the $7.97 Plaintiffs may properly allege as damages. In discovery, however, at a minimum, Plaintiffs must provide the information required by Rule 26(a)(1)(A)(iii), and formally requested by Defendants, that would allow Defendants to evaluate the validity of Plaintiffs' damages claim and prepare for trial. *See Payne* v. *Philadelphia*, 2004. U.S. Dist. LEXIS 8425 (E.D. Pa. May 5, 2004) (ordering a party to produce, in accordance with Rule 26(a)(1)(A)(iii), underlying factual information bearing on the party's damages claim); *see also Kemper/Prime Industrial Partners* v. *Montgomery Watson Americas, Inc.*, 97 C 4278, 2004 U.S. Dist. LEXIS 5543 (N.D. Ill. Mar. 31, 2004) (Guzman, J.) (imposing sanctions under Fed. R. Civ. P. 37 where Plaintiff had "failed to produce any evidence in discovery that would allow a trier of fact to determine

[1] If it is in fact Plaintiffs' position (as vaguely suggested by Mr. Burkholz' recent statement to the Court) that all of the inflation asserted to exist on the first day of the class period came into the stock price on July 22, 1999 (e.g. "the fact is that there was a July 22nd statement") then it should not be difficult for Plaintiffs to assert that is the day that the stock price became inflated. As it stands now, however, Plaintiffs continue to take no position at all on the subject. apart from the vague allusions that perpetuate the unfair ambiguity of what is being claimed by Plaintiffs in this case.

the existence or extent of its damages" as required by Fed. R. Civ. P. 26(a)(1)(A)(iii)). "The Federal Rules of Civil Procedure contemplate liberal discovery, and 'relevancy' under Rule 26 is extremely broad." *For Your Ease Only, Inc.* v. *Calgon Carbon Corp.*, No. 02 C 7345, 2003 U.S. Dist. LEXIS 20267, at *4 (N.D. Ill. Nov. 10, 2003) (Nolan, M.J.). "Under Fed. R. Civ. P. 26(b)(1) 'parties may obtain discovery regarding any matter, not privileged, that is relevant to the claim or defense of any party.'" *Trading Technologies International, Inc.* v. *eSpeed, Inc.*, No. 04 C 5312, 2005 U.S. Dist. LEXIS 10686, at *2 (N.D. Ill. Apr. 28, 2005) (citation omitted).

Plaintiffs argue that they do not have to provide this information because they do not believe that their claims are time-barred or otherwise invalid. Plaintiffs cannot unilaterally decree what is relevant based on their preferred interpretation of the law. Their supposed disagreement with Defendants' understanding of the law does not excuse their refusal to participate in discovery. *See Union Carbide Corp.* v. *State Board of Tax Commissioners*, 161 F.R.D. 359, 366 (S.D. Ind. 1993). Specifically, when the merits of a claim or defense are contested on a discovery motion "discovery should not be denied because it relates to a claim or defense that is being challenged as insufficient." *Union Carbide Corp*, 161 F.R.D. at 366 (granting motion to compel discovery despite opposing party's objection that the information sought was irrelevant because the moving party was misinterpreting the applicable statute) quoting, 8 Charles A. Wright and Arthur R. Miller, *Federal Practice and Procedure* § 2008, p. 44 (1970).

Plaintiffs' relevancy objections are baseless in any event. The Seventh Circuit has made clear that the type of information that Defendants request is not only relevant to a securities fraud case, but is integral to its outcome. To demonstrate loss causation if this case ever came to trial, "plaintiffs must show [] that defendants' alleged misrepresentations artificially inflated the price of the stock" *Ray* v. *Citigroup Global Markets, Inc.*, 482 F.3d at 995. Even if Plaintiffs intended (and were allowed) to try their case without including information about this key factual issue, Defendants would be and are entitled to disclosure of relevant facts in Plaintiffs' possession. Defendants need this information in order to test the merits of Plaintiffs' claims and make appropriate arguments about the time-barred nature of

Plaintiffs' claims and Plaintiffs' failure or inability to address loss causation in the manner prescribed by the Seventh Circuit.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that Defendants' motion to compel be granted. To evaluate and defend against Plaintiffs' claim for damages, Defendants need to know when (*i.e.*, the specific date or dates) the "artificial inflation" upon which Plaintiffs' claim for damages is based was first introduced into Household's stock price.

Dated: February 14, 2008

New York, New York

EIMER STAHL KLEVORN & SOLBERG LLP

By: s/ Adam B Deutsch

Nathan P. Eimer (#00735353)
Adam B. Deutsch (#6236959)
224 S. Michigan Avenue, Suite 1100
Chicago, Illinois 60604
(312) 660-7600

-and-

CAHILL GORDON & REINDEL LLP
Thomas J. Kavaler
Howard G. Sloane
Landis C. Best
Patricia Farren
David R. Owen
80 Pine Street
New York, New York 10005
(212) 701-3000

Attorneys for Defendants Household International, Inc., Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilmer and J.A. Vozar

CERTIFICATE OF SERVICE

The undersigned attorney certifies that on February 14, 2008, he caused to be served copies of **Household Defendants' Motion To Compel Plaintiffs To Supplement Their Initial Disclosures Pursuant To Fed. R. Civ. P. 26(a)(1)(A)(iii)** to the parties listed below via the manner stated.

/s/ Adam B. Deutsch
Adam B. Deutsch

Via Email
Azra Z. Mehdi
D. Cameron Baker
Spence Burkholz
COUGHLIN STOIA GELLER RUDMAN
& ROBBINS LLP
100 Pine Street, Suite 2600
San Francisco, CA 94111
(415) 288-4545

Via Email
Marvin A. Miller
Lori A. Fanning
MILLER LAW LLC
115 South LaSalle Street
Suite 2910
Chicago, IL 60606
(312) 332-3400
(312) 676-2676 (fax)