IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

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

REPLY MEMORANDUM OF LAW IN SUPPORT OF HOUSEHOLD DEFENDANTS' MOTION TO DISMISS THE CORRECTED AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

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The Household defendants respectfully submit this reply memorandum in support of their motion to dismiss plaintiffs' Complaint[1] pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6) and the Private Securities Litigation Reform Act, 15 U.S.C. §§ 78u-4, et seq. (the "PSLRA").

PRELIMINARY STATEMENT

Plaintiffs attempt to conjure "fraud" by mixing innocuous statements with publicized past operational problems. Plaintiffs' apparent hope—having filed a 154-page rambling Complaint and now a 55-page memorandum in which they repeatedly seek impermissibly to enlarge their allegations beyond those contained in the Complaint—is that this Court will mistake volume for substance. Once stripped of its chaff, however, the Complaint is revealed as an opportunistic endeavor by plaintiffs to capitalize on nothing more than Household's announcement of bad news. Neither the Federal Rules of Civil Procedure nor the PSLRA sanctions such "strike" suits.

Defendants' opening memorandum detailed how plaintiffs' near-400 paragraph Complaint utterly fails to satisfy the basic pleading requirements mandated by Federal Rule of Civil Procedure 9(b) and the PSLRA. The Complaint fails to plead any false or misleading statements with the particularity as required by Rule 9(b) for claims under Section 10(b) and Rule 10b-5. It also fails to plead scienter with the particularity required under the PSLRA. The Complaint further seeks to premise liability on numerous statements which are simply not actionable because they are not attributable to defendants, are mere opinion or "puffery," or are protected under the PSLRA's safe harbor for forward-looking statements.

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[1] As used herein, "Complaint" refers to the [Corrected] Amended Consolidated Class Action Complaint for Violations of the Federal Securities Laws.

Furthermore, as defendants' opening memorandum demonstrated, the Complaint's Sections 11 and 12(a)(2) claims are time barred and/or lack loss causation. The Complaint's "control person" claims also lack a predicate violation. And, none of the alleged misleading statements are attributable to defendant Gary Gilmer, and no action can proceed against him.

Plaintiffs have done little to respond to these arguments. Instead, plaintiffs have: (a) ignored the substance of defendants' arguments, instead addressing other issues with resort to inapposite authority; (b) simply reiterated the Complaint's prolix, yet insufficient, allegations; or (c) attempted to buttress the Complaint by resort to unpleaded, but still insufficient, allegations. In all instances, plaintiffs have failed to provide any basis upon which this Court could deem the Complaint to be sufficient.

ARGUMENT

POINT I

THE COMPLAINT FAILS TO ALLEGE ANY FALSE OR MISLEADING STATEMENTS WITH PARTICULARITY.

Plaintiffs' Complaint relies on a technique—discredited in this District and elsewhere—of simply lining up block quotes from a company's SEC filings and press releases next to a list of alleged operational problems, and pronouncing that the referenced statements therefore must have been false. As demonstrated in defendants' opening memorandum, see Def. Mem. at 8-11, plaintiffs' technique fails to satisfy the pleading requirement under Rule 9(b) and the PSLRA that plaintiffs allege with particularity the reasons why statements were false or misleading when made, with appropriate attribution to the facts and sources on which that allegation is based. See 15 U.S.C. § 78u-4(b)(1). Plaintiffs' memorandum does not rebut this argument.

Indeed, plaintiffs' response employs the same insufficient strategy as the Complaint, citing *en masse* to allegedly "false" statements and then parroting the supposed "schemes" described in the Complaint related to predatory lending, reaging of loans, and cost accounting, without making any ostensible effort to integrate the two. See, e.g., Pl. Mem. at 10-11. Plaintiffs attempt to compare this pleading technique to the complaint upheld in Danis v. USN Communications, Inc., 73 F. Supp.2d 923 (N.D. Ill. 1999), but the Danis plaintiffs specifically identified why particular statements identified in the complaint were allegedly false. See id. at 932. Here, by contrast, defendants and the Court are left the task of divining which of the statements within plaintiffs' 154-page Complaint are misleading and why.

Moreover, unable to muster a response to most of the cases cited in the defendants' opening memorandum, plaintiffs simply ignore them.[2] The cases plaintiffs do attempt to address, they are unable to plausibly distinguish. For example, plaintiffs attempt to distinguish the complaint dismissed in Clark v. TRO Learning, Inc., 1998 WL 292382 (N.D. Ill. May 20, 1998)[3], as having provided no "reasons" to explain falsity, Pl. Mem. at 12, even though what plaintiffs have done here is actually far more egregious. In Clark, the plaintiff had excerpted a long list of statements "combined with one general explanation regarding falsity." Clark, 1998 WL 292382 at *4 (emphasis added). Here, plaintiffs' Complaint lumps together a long list of statements with multiple general allegations regarding falsity, yet fails to link particular statements to particular explanations as to why they were false. Deducing plaintiffs' "reasons" for falsity here is thus substantially more difficult than it was with the dismissed complaint in Clark.

Nor do any of the cases relied upon by plaintiffs sanction their premising the vast majority of their allegations on a three-sentence boilerplate paragraph listing various unspecified sources uncovered by "investigation of counsel" that are somehow supposed to function as a basis for each and every allegation. Compl. ¶ 345; Pl. Mem. at 12-13 (describing basis of allegations as "SEC filings, analyst reports, news media, interviews with former Household employees and findings of regulatory agencies [...], federal and state complaints against defendants"). This is exactly the kind of pleading that courts have regularly considered to be

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[2] For example, plaintiffs fail to address: Havenick v. Network Express, Inc., 981 F. Supp. 480 (E.D. Mich. 1997); In re Capstead Mortgage Corp. Sec. Litig., 2003 WL 1813837 (N.D. Tex. Mar. 31, 2003); Wenger v. Lumisys, Inc., 2 F. Supp.2d 1231 (N.D. Cal. 1998); and In re Oak Tech. Sec. Litig., 1997 WL 448168 (N.D. Cal. Aug. 1, 1997)). See Def. Mem. at 9-10 (discussing cases).

[3] Copies of unreported cases are included in the attached Appendix of Unreported Cases.

insufficient. For example, in In re Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970, 984 (9th Cir. 1999), the Ninth Circuit affirmed the dismissal of a complaint relying on a nearly identical boilerplate list of sources, explaining:

> The boilerplate section of [plaintiff's] complaint, titled "Basis of Allegations," ... is an insufficient basis for fraud allegations because it fails to state "with particularity all facts on which [plaintiff's] belief is formed." See 15 U.S.C. § 78u-4(b)(1). This means that a plaintiff must provide, in great detail, all the relevant facts forming the basis of her belief.... [Plaintiff] would have us speculate as to the basis for the allegations about the reports, the severity of the problems, and the knowledge of the officers. We decline to do so.

Id. at 985 (emphasis added). Other circuits have similarly rejected the notion that plaintiffs are permitted to support their allegations with general boilerplate statements citing to unspecified sources, instead insisting that plaintiffs tie each individual allegation to a particular documentary or personal source, or face dismissal. In re Cabletron Systems, Inc., 311 F.3d 11, 29 n.8 (1st Cir. 2002); ABC Arbitrage Plaintiffs Group v. Tchuruk, 291 F.3d 336, 357-359 (5th Cir. 2002).[4] There is no factor in this case that would call for a different standard.

Plaintiffs' memorandum further fails to identify particular facts alleged in the Complaint that support the underlying "schemes" plaintiffs contend defendants engaged in during the putative class period. See Def. Mem. at 11-16. The defendants' opening memorandum showed how the Complaint insufficiently alleged these "schemes," omitting even

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[4] Plaintiffs' lengthy argument that they need not identify their purported "confidential sources" by name misses the point. See Pl. Mem. at 13-14. As plaintiffs' own cases describe, the issue is not whether sources are identified by name, but instead whether sources, named or not, are described "with sufficient particularity to support the probability that a person in the position occupied by the source as described would possess the information pleaded to support the allegations of false or misleading statements." ABC Arbitrage, 291 F.3d at 358 (affirming district court's dismissal of plaintiffs' Section 10(b) and Rule 10b-5 claims where complaint relied on a general allegation of interviews with business journalists, analysts and employees) (citing Novak v. Kasaks, 216 F.3d 300, 314 (2d Cir. 2000)); see also Cabletron Systems, 311 F.3d at 29-30.

the most basic factual descriptions regarding time and place, participants, execution, and sources. For example, as to the Complaint's "predatory lending" allegations, Compl. ¶¶ 51-106, defendants demonstrated, *inter alia*:

- Plaintiffs' failure to explain how the allegations of "predatory lending" caused all of Household's financial statements to violate GAAP throughout the class period; and

- Plaintiffs' failure to allege facts suggesting that the so-called "predatory lending" practices were so widespread or pervasive that the likelihood of substantial civil liability or regulatory sanctions was significant enough to trigger a duty to disclose the practices or account for them as a contingent liability. See Def. Mem. at 11-15.

As to the Complaint's reaging allegations, Compl. ¶¶ 107-133, defendants demonstrated, *inter alia*:

- Plaintiffs' failure to allege how the "scheme" was carried out, what specific accounts were reaged, why the reaging was "arbitrary," or violated internal policies; and

- Plaintiffs' failure to allege what, if any, particular effect the alleged improper reaging had on Household's bottom line. See Def. Mem. at 15-16.

And, as to the Complaint's cost accounting allegations, defendants demonstrated, *inter alia*:

- Plaintiffs' failure to specify any conduct in furtherance of the alleged "scheme" or provide any specific dates on which the "scheme" was carried out. See Def. Mem. at 16.

Plaintiffs make no response to any of these arguments, thus apparently conceding their validity.

In sum, plaintiffs would have this Court: (a) accept as sufficient plaintiffs' conclusory allegations about the underlying "schemes"; (b) attempt to link—with no guidance from plaintiffs—each of more than 100 allegedly false statements to one of several alleged operational problems; and (c) speculate about plaintiffs' sources for all these allegations. Rule 9(b) and the PSLRA neither compel nor permit this Court to engage in such a futile exercise.

POINT II

PLAINTIFFS HAVE FAILED TO ALLEGE PARTICULAR FACTS THAT RAISE A "STRONG INFERENCE" OF SCIENTER.

The PSLRA also compels dismissal of the Complaint because plaintiffs have failed to plead particular facts establishing a "strong inference" that the defendants made any statements with scienter. Plaintiffs concede that they must show that the defendants made particular statements with actual knowledge that they were false or misleading or with reckless indifference to their falsity. Plaintiffs contend that they have met that standard "with combined allegations of defendants' motive, opportunity and direction of the fraudulent scheme." Pl. Mem. at 14. Yet, plaintiffs have failed to point to a single allegation that would show that any defendant was aware of any undisclosed fact that materially contradicted or rendered misleading any public statement made by that defendant.

A. Plaintiffs Have Not Alleged Particular Facts Showing "Motive and Opportunity."

Plaintiffs concede that their "motive and opportunity" allegations amount to no more than assertions that defendants made the allegedly false statements because they wanted to achieve earnings targets on which their compensation was based and wanted to maintain Household's ability to fund its business. Pl. Mem. at 14-15. They cite several cases that they say support the proposition that such pleading is sufficient for PSLRA purposes and then attempt to distinguish the authorities relied on by defendants as involving more paltry allegations of motive and opportunity than plaintiffs have alleged here. See Id. at 16 n.7. Neither of these responses has merit.

Even the cases relied on by plaintiffs squarely hold that a complaint must allege that defendants had some unusual or extraordinary personal incentive to exaggerate earnings.

Such incentives include, for example: "keep[ing] the stock price artificially high while they sold their own shares at a profit," Novak, 216 F.3d at 308; falsely meeting targets where the defendants' "jobs were in jeopardy if the goals were not met," Aldridge v. A.T. Cross Corp., 284 F.3d 72, 84 (1st Cir. 2002); overstating earnings where "the only way to get [] financing was to show profitability," In re Kidder Peabody Sec. Litig., 1995 U.S. Dist. LEXIS 14481 at *16 (S.D.N.Y. Oct. 4, 1995); or making misleading statements where the completion of a securities offering "would [not] have been possible had [the] stock price not been [artificially] inflated," Queen Uno Ltd. P'shp. v. Coeur D'Alene Mines Corp., 2 F. Supp.2d 1345, 1359 (D. Colo. 1998).

The Complaint here, however, contains no such allegation of unusual or extraordinary personal incentives. There is no allegation that the defendants sold any shares during the putative class period, a factor that "actually negates an inference of scienter." In re SCB Computer Technology, Inc. Sec. Litig., 149 F. Supp.2d 334, 351 (W.D. Tenn. 2001) (citing In re World of Wonder Sec. Litig., 35 F.3d 1407, 1425 (9th Cir. 1994)) (emphasis added). There is no allegation that the announcement of the financial restatement in August 2002 or the A.G. Settlement in October 2002 caused Household to lose its ability to finance its business. And, there is no allegation that the announcement of the SEC Consent Order in March 2003 jeopardized financing or the completion of the HSBC merger on the terms originally agreed. In short, the Complaint alleges nothing but

> motives possessed by virtually all corporate insiders, including: (1) the desire to maintain a high corporate credit rating, or otherwise sustain "the appearance of corporate profitability, or of the success of the investment," and (2) the desire to maintain a high stock price in order to increase executive compensation.

Novak, 216 F.3d at 307 (citations and quotations omitted).

Moreover, in their effort to distinguish their Complaint from those found wanting in the authorities cited by defendants, plaintiffs overstate their own allegations and understate the allegations described in defendants' authorities. In none of the cases cited by defendants did a plaintiff purport to rely solely on compensation or funding allegations, as plaintiffs do here. Instead, in each case, the complaint was dismissed despite the plaintiff's attempts to base scienter on multiple other allegations as well, including: the existence of confidential corporate reports and insider trading, see Abrams v. Baker Hughes Inc., 292 F.3d 424 (5th Cir. 2002); the sheer size of the scheme and its effect on the company's core business as well as a guilty plea entered into by the company, see Kushner v. Beverly Enterprises, Inc., 317 F.3d 820 (8th Cir. 2003); GAAP violations, the defendants' position within the company and the existence of internal memoranda, see City of Philadelphia v. Fleming Cos., Inc., 264 F.3d 1245 (10th Cir. 2001); access to adverse, non-public information, GAAP violations and the receipt of specified contradictory information, see In re Allscripts, Inc. Sec. Litig., 2001 WL 743411 (N.D. Ill. June 29, 2001); and a pattern of insider trading, GAAP violations and a zero tolerance policy against employee lying adopted by a new CEO, see In re E.Spire Communications, Inc. Sec. Litig., 127 F. Supp.2d 734 (D. Md. 2001).

Likewise, contrary to plaintiffs' description of Mortensen v. AmeriCredit Corp., 123 F. Supp.2d 1018 (N.D. Tex.), aff'd, 240 F.3d 1073 (5th Cir. 2000), the dismissed complaint in that case actually based scienter on at least three different categories of allegations. In addition to pleading motive (obtaining funds on more favorable terms), the Mortensen plaintiffs sought to infer scienter by alleging an intentional violation of GAAP and by asserting, in striking similarity to plaintiffs' allegations regarding Household's Vision technology, that "the minute knowledge about the overall status of AmeriCredit's account receivables" enabled the company

to "assess how many accounts were about to become delinquent and take the necessary step to avoid booking too many delinquencies." Id. at 1024. The court rejected all of plaintiffs' contentions and dismissed their securities fraud claims for failure to sufficiently plead scienter. Id. at 1028.[5]

B. Plaintiffs Have Not Alleged Facts Raising a "Strong Inference" of Scienter with Regard to Any Supposed Undisclosed "Scheme."

Plaintiffs also claim that defendants must have known or disregarded that the many statements quoted in the Complaint were false and misleading because the defendants had "direct[ed]" the "specific fraudulent scheme[s]" described in the Complaint—predatory lending, erroneous cost accounting and improper reaging of loans. Pl. Mem. at 17. In no respect, however, have plaintiffs alleged any fact that would show that any defendant made any statement regarding these issues while knowing of, or being recklessly indifferent to, information that would render the statement false or misleading when it was made.

1. Predatory Lending Allegations

Plaintiffs' elaborately repetitious "predatory lending" allegations boil down to three facts: (a) Household, with 50 million customer accounts, was the subject of one highly critical state agency report in 2001 that was based on about 20 consumer complaints directed

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[5] Plaintiffs' additional claim that defendants had the "opportunity to commit fraud" by virtue of their positions, access to and control over the Company financials and information, Pl. Mem. at 16-17, is obviously so generic that it cannot give rise to a "strong inference" of scienter. See, e.g., Tricontinental Indus. Ltd. v. Anixter, 215 F. Supp.2d 942, 949 (N.D. Ill. 2002) ("allegations that a defendant had 'access' to information and 'paid close attention to sales trends,' by themselves, 'paint with too broad a brush and cannot satisfy the PSLRA's pleading standards,' which require particularity") (citations omitted); Def. Mem. at 24-25. In any event, "[b]ecause plaintiffs have failed adequately to plead motive, the court need not address whether they have sufficiently pleaded opportunity." Mortensen, 123 F. Supp.2d at 1025 n.9.

mostly against a single one of Household's 1400 branches, and was the defendant in three related lawsuits; (b) Household disclosed the existence of these disputes but denied liability; and (c) Household ultimately entered into a nationwide settlement with the states' attorneys general that included no official findings nor admissions of fraudulent conduct. Combining these facts with contentions that defendants "directed" Household's lending operations, plaintiffs attempt to draw a "strong inference" that the defendants lied when denying the predatory lending allegations and improperly failed to establish appropriate loss contingency reserves or disclose the nature of any predatory lending contingency. Plaintiffs' purported "strong inference" is only wishful thinking.

Most strikingly, plaintiffs' claim that the defendants somehow failed to "disclose the nature of the contingency" related to the allegations of predatory lending, Pl. Mem. at 20, is shown to be utterly false by the extensive disclosures in the very securities filings that the Complaint brands as misleading.[6] For example, Household's 2001 Annual Report on Form 10K disclosed that the company was a party to "various legal proceedings" including "class actions seeking damages in very large amounts" and "class actions by consumer groups (such as AARP and ACORN) claiming that our loan products or our lending policies and practices are unfair or misleading to consumers." Def. Ex. H-3 at 12. Household, moreover, cautioned that "attempts by local, state and national regulatory agencies ... to control alleged 'predatory' lending practices" as well as "the costs, effects and outcomes of regulatory reviews or litigation relating to our nonprime loan receivables or the business practices of any of our business units" were an important risk factor which "could cause our results to vary materially from those expressed in

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[6] Where factual allegations are inconsistent with the actual language of documents relied upon by plaintiffs, "the inconsistent allegations are not accepted as true, and the terms of the written document, fairly construed, prevail." Lunn v. Montgomery Ward & Co., Inc. Ret. Sec. Plan, 1998 WL 102751, at *3 (N.D. Ill. Feb. 26, 1998), aff'd, 166 F.3d 880 (7th Cir. 1999) (citing Perkins v. Silverstein, 939 F.2d 463, 469 n.4 (7th Cir. 1991)).

public statements." Id. at 11 (emphasis added).[7] The notion that defendants failed to alert investors to potential contingencies or to disclose "known trends or uncertainties" pursuant to GAAP and Regulation S-K provisions is thus obviously false.

Moreover, plaintiffs' talismanic reliance on defendants having "directed" Household's lending operations—including training and automated systems—entirely misses the point. The only relevant issue is whether defendants, notwithstanding their denials of liability, knew that any of Household's practices were indeed unlawful and/or would result in a loss that was probable and reasonably estimated so as to have required a loss reserve under SFAS No. 5. Plaintiffs' allegations on this issue are nonexistent. Plaintiffs cannot, for example, point to any admission by a defendant or its accountants or a finding by any regulator or court that Household, in fact, engaged in any predatory lending practices so pervasive as to undermine the veracity of defendants' public denials or propriety of Household's loss reserve decisions.[8] They can cite to no such finding in the WA Report; they can cite to no such finding by the Minnesota Commissioner[9]; they can (honestly) cite to no such admission in the A.G. Settlement[10]; and they

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[7] Similarly, Household's Form 10Q/A for the first quarter of 2002 warned investors that "[s]tate regulatory agencies, including the attorneys general of certain states, have been focusing on origination policies, procedures and practices of our consumer lending business" and that Household "expect[s] that [consumer] complaints, which are part of an organized effort by certain consumer activists, will continue to be a focus for regulatory authorities." Def. Ex. K at 20. See also 10K for FY97, Def. Ex. D-2 at 7; 10K for FY98, Def. Ex. L at 8; 10K for FY99, Def. Ex. M at 8; 10K for FY00, Def. Ex. G-5 at 8; 10K for FY01, Def. Ex. H-3 at 11-12; 10Q per June 30, 2002, Def. Ex. H-2 at 16.

[8] Plaintiffs' continued insistence that defendants' "persistent" and "aggressive denials" somehow demonstrate guilty knowledge, Pl. Mem. at 22-25, is nonsensical. "[M]aintenance of innocence is not fraud." Anderson v. Abbott Laboratories, 140 F. Supp.2d 894, 906-907 (N.D. Ill. 2001).

[9] Instead, what plaintiffs present as "the Minnesota Commissioner's comments," Pl. Mem. at 13, 22, are patently unreliable and unconfirmed generic quotes from two newspaper articles. Compl. ¶ 23, 93, 98. See In re McKesson HBOC, Inc. Sec. Litig., 126 F. Supp.2d 1248, 1272 (N.D. Cal. 2000) ("newspaper articles should be credited only to the extent that other factual

(footnote continued)

acknowledge by silence that the allegations of the three consumer class action suits do not, in and of themselves, create such an inference.[11] Plaintiffs are similarly unable to identify any allegations that would corroborate their conjecture that Household violated SFAS No. 5, the GAAP provisions that plaintiffs—but no one else, including Household's auditors—say was violated.

The Eighth Circuit's recent decision in Kushner, addressing nearly identical issues, is instructive. There, the plaintiffs alleged a "scheme" to "materially and artificially inflate[] the company's reported revenue in its financial statements" by establishing insufficent reserves to cover a subsequent large civil settlement. Kushner, 317 F.3d at 826-827. Affirming the dismissal of plaintiffs' claims, the Eighth Circuit held:

> Without allegations of particular facts demonstrating how the defendants knew of the scheme at the time they made their statement of compliance, that they knew the financial statements overrepresented the company's true earnings, or that they were aware of a GAAP violation and disregarded it, a showing in hindsight that the statements were false does not demonstrate fraudulent intent.

(footnote continued)

allegations would be – if they are sufficiently particular and detailed to indicate their reliability").

[10] The A.G. Settlement, as a matter of settled law, is not admissible for purposes of showing that the settled claims were factually well founded. Lipsky v. Commonwealth United Corp., 551 F.2d 887, 893 (2d Cir. 1976); see Def. Mem. at 13, n.6. Plaintiffs reiterate their alternate allegation that defendant Aldinger, in connection with the A.G. settlement, "admitted that Household had engaged in predatory lending," Pl. Mem. at 20, but ignore its context and admissibility, let alone the fact that the plain language of the Report on Form 8K filed in connection with the A.G. settlement is exactly to the contrary. Def. Mem. at 13-14, n.6-7, Def. Ex. A.

[11] Nor can the July 23, 2001 letter to defendant Aldinger, which was written by ACORN, create such an inference. Pl. Mem. at 23. Leaving aside the fact that a letter written by a class action plaintiff can hardly qualify as a corroborative source, the letter contained only broad allegations and provided no particulars indicating its reliability.

Id. at 827. The Eighth Circuit declined to infer "that the scheme was widespread throughout the company and known by the defendants because of the sheer size of the civil settlement," without specific allegations showing that "defendants had knowledge of contradictory crucial information at the time they made their statements of compliance." Id. at 829.

Instead of pointing to any such "contradictory crucial information" alleged in the Complaint, plaintiffs improperly reach outside the pleadings to cite deposition and affidavit testimony from another case given by Melissa Rutland-Drury, a former employee of Household's Bellingham office in Washington state, and Charles Cross, the author of the Washington Report. This testimony is outside the pleadings, and should be disregarded. See, e.g., Car Carriers, Inc. v. Ford Motor Co., 745 F.2d 1101, 1107 (7th Cir. 1984) ("consideration of a motion to dismiss is limited to the pleadings"); Harrell v. United States, 13 F.3d 232, 236 (7th Cir. 1993) (holding that plaintiff cannot cure deficiencies "by inserting the missing allegations in a document that is not either a complaint or an amendment to a complaint"). Even if the testimony were considered, however, it would not support plaintiffs' claims.

Plaintiffs rely on Ms. Drury's testimony to make the ultimately irrelevant point that Household's sales materials and methods were centrally developed. See Pl. Mem. at 18-19. Conspicuously, plaintiffs ignore the fact that Ms. Drury's testimony fails to support plaintiffs' primary contention that Household's practices or training were fraudulent. For example, Ms. Drury confirmed that Household's contract interest rates were always clearly stated and that the EZ Pay Plan that plaintiffs label a "scam" actually "made sense to me and the numbers worked out true." Plaintiffs' Request for Judicial Notice ("Pl. RJN") Ex. 3 at ¶¶ 188, 309. Ms. Drury similarly testified that most customers seemed to have no trouble understanding loan terms and that the fees were disclosed to customers at least twice and were always contained in the first

good faith estimates sent to customers. Id. at ¶¶ 158, 179, 211. Ms. Drury further stated that "[i]nsurance was always optional for the customers and we presented it as such" and explained that Household provided "ethical requirements" to all employees via its intranet, which included rules such as "no coercive sales tactics." Id. at ¶¶ 171, 178.[12]

Similarly, plaintiffs selectively include excerpts from the deposition of Mr. Cross in their request for judicial notice, carefully omitting Mr. Cross's testimony that the Washington Report was highly speculative, did "not [contain] a finding by the director [of the department] that a violation has occurred," and that there was "[n]ever a violation found against Household or any of its subsidiaries by anyone who is delegated that authority." Def. Ex. N at 31, 32, 237. Plaintiffs further fail to mention Mr. Cross's admissions that: (a) he "excluded any of the information that was favorable to Household" because the "purpose of this report [was] not to come to the fairest overall appraisal of all of Household's practices as to all of its borrowers in the State of Washington," id. at 393-95; (b) he was unable to identify Mr. Aldinger, Mr. Schoenholz or Mr. Gilmer as being aware of any alleged "equivalent interest sham" in the EZ Pay Plan, see id. at 151-52; (c) the report's conclusion that the sham was "likely fostered by the corporation itself" was speculation, see id. at 151-52, 255; and (d) he could not find any

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[12] Purportedly based on Ms. Drury's affidavit, plaintiffs also present a new allegation that Household shredded documents in order to conceal evidence of its fraudulent practices. Pl. Mem. at 25. This allegation is clearly outside the pleadings and must be disregarded. Even if it had been pleaded, however, it would not be supported by Ms. Drury's declaration which only explains that some old sales materials and other documents at the Bellingham, Washington branch were discarded in connection with the conversion of hard copy files to the paperless Vision computer system, and she clearly does not suggest that the discarded materials constituted evidence of a fraud or were discarded to "conceal" some "scheme." RJN Ex. 3 at ¶¶ 142-151. Nor does Ms. Drury suggest that any of the defendants had either knowledge of or involvement in the decision to discard the outdated materials.

fraudulent content in Household's training manuals or the other internal documents he reviewed, see id. at 250-51.

Plaintiffs are no more successful when they delineate their lengthy bullet-point list of supposed "corroborating sources." Pl. Mem. at 18-20. This list breaks down into:

— various blanket assertions about "corporate-developed" sales materials and methods, "uniform" practices, access to an "automated information management system," and "Household's corporate culture." Pl. Mem. at 18-20 (points 1, 2, 5, 6, 8). Far from showing with particularity that defendants orchestrated some pervasive "scheme," these assertions do not demonstrate scienter.

— generic allegations based on the unofficial "findings" of Mr. Cross that "corporate management refused to cooperate with regulators' investigations" and the "sham" was "likely fostered by the corporation itself." Id. (points 4, 7). Leaving aside that the non-cooperation allegations are outside the pleadings, these allegations are highly speculative, have limited geographic relevance, mischaracterize Mr. Cross's testimony, and do not even attempt to tie any conscious misconduct to any particular defendant.

— seemingly more specific, yet ultimately extraneous allegations with respect to defendants Aldinger and Gilmer. Id. (points 2, 3, 9). These allegations are uniformly either outside the pleadings or they are flatly contradicted by the very sources on which plaintiffs rely—e.g., Mr. Aldinger's purported "admission" of predatory lending practices in connection with the A.G. settlement.[13]

In sum, no matter how many times plaintiffs repeat the allegations asserted by Mr. Cross in the Washington Report or by a few other class action plaintiffs, the fact remains that they have identified no information that would establish that defendants "directed" lending practices that they knew were unlawful, knowingly or recklessly made any false statements regarding the existence of predatory lending practices, or violated GAAP in failing to establish a loss contingency reserve.

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[13] See supra note 10.

2. Reaging Allegations

Aware that the Complaint fails to make a single specific allegation that defendants purposefully directed some illegal "reaging scheme" or improperly reaged loans to avoid establishing loss reserves or taking write-offs, plaintiffs seek to introduce new allegations on the basis of a March 19, 2003 Household Proxy Statement ("Proxy Statement") and a closely related SEC Consent Order dated March 18, 2003 ("Consent Order"). Pl. Mem. at 26-29; Pl. RJN Ex. 1 and 2. This belated attempt to rehabilitate the pleadings should be rejected.

As a preliminary matter, plaintiffs' claims regarding the Proxy Statement and Consent Order are nowhere found in the Complaint and thus cannot be relied upon by plaintiffs to somehow mend the Complaint's insufficient reaging allegations. Plaintiffs' arguments regarding these documents should thus be ignored.

Even if plaintiffs had plead these claims, however, they would nonetheless be precluded from relying on them to allege any conscious wrongdoing by the defendants. It is well established that a consent order is a product of private bargaining, and is "not the result of an actual adjudication of any of the issues" it addresses. Lipsky, 551 F.2d at 893 (emphasis added). "Consequently, [a consent order] can not be used as evidence in subsequent litigation between [the] corporation and another party." Id. (emphasis added); see also Beck v. Cantor, Fitzgerald & Co., 621 F. Supp. 1547, 1566 (N.D. Ill. 1985) (striking allegations referring to SEC opinions and defendants' acquiescence in those opinions), disapproved on other grounds, Pinter v. Dahl, 486 U.S. 622 (1988).

In any event, plaintiffs' efforts to rely on the Consent Order and Proxy Statement in establishing scienter are misplaced as they both explicitly state that defendants were not admitting to any wrongdoing. See Pl. RJN Ex. 1 at 3-4 (stating that Household agreed to the Consent Order "without admitting or denying any wrongdoing" and "without admitting or

denying the SEC's findings"); Pl. RJN Ex. 2 at 1; see also Beck, 621 F. Supp. at 1566 (finding that SEC allegations relied upon by plaintiffs were "irrelevant and immaterial" because "none of the defendants have admitted that the SEC was correct in its opinion").

Moreover, plaintiffs conspicuously fail to note that their allegations and those of the SEC pertain to almost completely separate time periods. The SEC alleges misleading statements in the time period from March 13, 2002 until October 24, 2002, Pl. RJN Ex. 2 at ¶ 7, whereas plaintiffs base their Complaint on "Household's failure to disclose its 'reaging' practices and statistics prior to 2QO2." Compl. ¶ 130 (emphasis added).

Plaintiffs' attempts to use the Consent Order and Proxy statement to somehow buttress their unsubstantiated allegations that Household's reaging practices were "arbitrary" and "violate[d] its own policies," Pl. Mem. at 26-27, are also futile. Nowhere in the Consent Order or Proxy Statement is there any suggestion or contention that Household ever arbitrarily or improperly reaged accounts in violation of its own policies. Instead, the SEC merely contended that certain of Household's public statements regarding its reaging policies did not accurately describe those policies in detail (and, again, nowhere has Household admitted to even those limited allegations).

Indeed, if the Consent Order and Proxy Statement are relevant to any of plaintiffs' claims, it is because they squarely contradict plaintiffs' allegation that the reaging, by virtue of avoiding write-offs or loss reserves, resulted in an overstatement of income throughout the five-year class period. Pl. Mem. at 28, Compl. ¶¶ 128-129. The SEC did not claim that Household's loss reserves were calculated in violation of GAAP or that they should have been one penny higher than they were. Accordingly, no restatement was required by, or as a result of, the

Consent Order. Pl. RJN Ex. 1 at 4. In fact, the Consent Order did not even cause Household to write off more loans or take larger loan loss reserves in its financial statements.[14]

The Consent Order and Proxy Statement thus provide no support whatsoever for plaintiffs' blanket assertions that the defendants consciously caused Household to overstate its net income in connection with the reaging of loans, or that the defendants knew of, or recklessly disregarded, any contingency in that respect.

3. Cost Accounting Allegations

Plaintiffs' so-called "cost accounting scheme" allegations are a classic example of "fraud by hindsight." Plaintiffs offer only allegations that accounting policies adopted on the advice of KPMG should have been applied in periods prior to KPMG's having been retained. But since "[r]estatements of earnings are common," Goldberg v. Household Bank, F.S.B., 890 F.2d 965, 967 (7th Cir. 1989), and "only a fraction of financial deteriorations reflect fraud, plaintiffs may not proffer the different financial statements and rest." DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir. 1990). "Investors must point to some facts suggesting that the difference is attributable to fraud." Id. (emphasis added). Plaintiffs, however, cannot point to a single allegation in the Complaint describing with particularity how defendants knew or recklessly disregarded at the time they made their statements that the accounting methods proposed by their auditors were wrong and that years later other auditors would recommend different methods, which, in turn, would result in a restatement.

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[14] Plaintiffs' extensive reliance on Rehm v. Eagle Finance Corp., 954 F. Supp. 1246 (N.D. Ill. 1997) is therefore misplaced. Pl. Mem. at 28-29. In Rehm, there was an actual increase of reported credit losses of 300% which eviscerated the yearly earnings from roughly $3.5 million to $325,000. Rehm, 954 F. Supp. at 1250. Here, not even plaintiffs allege there was any such change in Household's financials occasioned by the Consent Order.

Again, baldly attempting to revive their faulty allegations by reaching outside the pleadings, plaintiffs now contend that defendant Schoenholz, at an August 14, 2002 conference call, "admitted having consultations with senior persons at Andersen about this very [cost accounting] issue and together making the decision to account for it in violation of GAAP." Pl. Mem. at 32. (citing Compl. ¶ 148-149, even though the Complaint includes no such allegation). Even if this allegation were to be considered, it would be flatly contradicted by the very conference call transcript submitted by plaintiffs. That transcript shows that Mr. Schoenholz said:

> In connection with the engagement of KPMG, our new auditors, we have ... adopted certain revisions, [including] the accounting treatment of our MasterCard Visa Affinity and cobranded credit card relationship agreements as well as related marketing agreement with a third party credit marketing company.... These revisions have led us to restate our earnings and balance sheet from January 1st 1999 forward to modify the accounting for these agreements which date from 1993 to 1999. These agreements [in]volve complicated (inaudible) accounting decisions which were discussed and approved by our prior auditors Arthur Anderson and with the concurrence of the company's audit committee. The changes arise from good faith differences of opinion with KPMG.

Pl. Mem. Ex. C at 1-2 (emphasis added). Obviously, this is no admission of consciously violating GAAP. To the contrary, the explanations given in the August 14, 2002 conference call for the accounting changes demonstrate that perfectly valid reasons existed for applying different methods in the past and the persons responsible for preparing financial statements acted with "good faith," on advice of a fully informed auditor, and with approval of the audit committee. Id. at 1-3.

Despite plaintiffs' protestation that their Complaint "does more than rely on the restatement," the most support plaintiffs can actually marshall for that claim is that the Complaint also "alleges in detail the improper accounting treatment accorded to each type of agreement." Pl. Mem. at 30. Plaintiffs then go on to simply regurgitate the reasons why KPMG ultimately disagreed with the original accounting treatment. See Pl. Mem. at 30. This, however,

has nothing to do with whether the defendants believed that the accounting treatment violated GAAP prior to KPMG raising the issue and certainly does not distinguish plaintiffs' allegations from a bare reliance on the restatement itself.

In the absence of any particularized allegation that defendants knew as early as 1997 that the applied accounting methods would change some five years later, plaintiffs are therefore left with the argument that the restatement itself is sufficient to demonstrate scienter. This theory, however, is inconsistent with well settled law.[15] See, Allscripts, 2001 WL 743411 at *11 ("[I]t is difficult to build inferences of scienter upon accounting errors because such errors often involve complex calculations about which reasonable people can differ in opinion."); Def. Mem. at 30. It is also notably contradicted by the Accounting Principles Board Opinion that plaintiffs purport to rely on, which states: "Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared." Accounting Principles Board Opinions, Opinion No. 20 at ¶ 13. Recognizing that errors in financial statements can result from, among other things, "mistakes in the application of accounting

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[15] Plaintiffs fail to cite any case where mere claims of a restatement precipitated by a good faith difference of opinion between auditors were permitted to stand. Cabletron Systems, 311 F.3d at 39-40, involved allegations of personal and direct involvement of defendants in fraudulent activities, coupled with insider trading. Miller v. Material, 9 F. Supp.2d 925, 927-928 (N.D. Ill. 1998), involved allegations of an outright, elaborate, and extremely obvious accounting fraud. In re Anicom Inc. Sec. Litig., 2001 U.S. LEXIS Dist. 6607 at *15 (N.D. Ill. May 15, 2001), involved allegations of fictitious invoices procured at defendants' direction. In re Adapative Broadband Sec. Litig., 2002 U.S. Dist. LEXIS 5887 at *42 (N.D. Cal. April 2, 2002), involved allegations of consecutive restatements coupled with other "strong evidence of deliberately reckless accounting" and "highly suspicious" corporate reshuffling. In re Cylink Sec. Litig., 178 F. Supp.2d 1077, 1082-83 (N.D. Cal. 2001), involved allegations of five specific transactions described in great detail in which a CFO allowed premature recognition of revenue in obvious violation of GAAP. Provenz v. Miller, 102 F.3d 1478, 1490 (9th Cir. 1996), involved allegations that defendants withheld crucial information from auditors.

principles," the opinion entirely refutes plaintiffs' conclusion that a restatement would automatically constitute an admission of conscious or reckless misconduct.[16]

In sum, plaintiffs have pointed to no information in the Complaint that any particular defendant was aware of any accounting impropriety prior to the 2002 restatement and deliberately or recklessly chose to ignore it.[17]

C. Even When Considered in its Totality, the Complaint Does Not Adequately Plead Scienter.

Plaintiffs also argue that even if their individual scienter allegations are insufficient—which they are—that they nonetheless provide "brushstrokes" that when viewed in their totality create a "portrait" of scienter. Pl. Mem. at 34-35. Plaintiffs' point is poetic, yet mistaken. As shown above, courts have regularly rejected combinations of scienter allegations similar to, indeed even stronger than, those here. See supra Point II.A. Instead of assembling "brushstrokes," plaintiffs have merely "combine[d] inadequate allegations of motive with inadequate allegations of recklessness ... to demonstrate scienter. [There is] no support for this approach, and [this Court should] decline to accept it." Kalnit v. Eichler, 264 F.3d 131, 141 (2d Cir. 2001).

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[16] Nor does the SEC's brief in the Sunbeam litigation support Plaintiffs proposition that scienter can be inferred from a restatement alone. On the contrary, the SEC acknowledged the "risk of the jury's improper inference of scienter based solely on the fact that a restatement occurred." Pl. Mem. Ex. D at p.11-12 (emphasis added).

[17] Nor do plaintiffs address defendants' argument that the size of the restatement strongly militates against an inference of scienter. See Def. Mem. at 30-31. Instead, plaintiffs try to confuse things by making the argument that the question whether a fact contained in an allegedly false statement was material is not properly decided on a motion to dismiss. Pl. Mem. at 33. This, of course, is a different issue. See Def. Mem. at 16n.9.

POINT III

STATEMENTS ALLEGED TO BE FALSE OR MISLEADING ARE NOT ACTIONABLE ON OTHER GROUNDS.

Plaintiffs either concede or fail to adequately respond to defendants' arguments that the Complaint impermissibly seeks to premise liability on numerous statements that are not actionable because they are not attributable to the defendants, are mere opinion or puffery, or are protected under the PSLRA's safe harbor for forward-looking statements.

A. Defendants Are Not Liable for Statements Made by Analysts and Other Third Parties.

As demonstrated in defendants' opening memorandum, substantial portions of the analyst statements quoted in the Complaint can only be read as the analyst's own opinion and thus are not attributable to the defendants. Def. Mem. at 33 n.23. Plaintiffs make no attempt to identify allegations in the Complaint that would show that these statements were reviewed and approved by individual defendants and therefore implicitly concede that these statements cannot form the basis of any claim against the defendants.

Plaintiffs also have not challenged defendants' argument that statements in analyst reports—like most of the ones quoted in the Complaint—that are not specifically attributed to a particular defendant are insufficient under Rule 9(b) and the PSLRA. See Def. Mem. at 34 & n.24. As the Second Circuit explained in In re Time Warner Inc. Sec. Litig., 9 F.3d 259 (2d Cir. 1993), saddling defendants with discovery where allegations are based on anonymous statements serves no purpose since the likelihood that anonymous statements funneled through an analyst report would "manipulate stock prices" is "limited." Id. at 265. The First Circuit has similarly held that a complaint's allegations must "identify the speaker." Suna v. Bailey Corp., 107 F.3d 64, 73 (1st Cir. 1997).

B. The PSLRA's Safe Harbor is Applicable and Protects Numerous Forward-Looking Statements.

Plaintiffs' attempt to defend those portions of the Complaint which rely upon forward-looking statements that are protected by the PSLRA's safe harbor, 15 U.S.C. § 78u-5, is also unavailing. Indeed, plaintiffs' arguments would gut the safe-harbor provision.

Plaintiffs impermissibly seek to pull phrases from statements that are clearly forward-looking as a whole and allege that they refer instead to current facts. See Pl. Mem. at 39-41. Plaintiffs' own cases, however, make clear that statements must be considered "in the context in which they were made." Lindelow v. Hill, 2001 U.S. Dist. LEXIS 10301, *15 (N.D. Ill. July 19, 2001).[18] The Eleventh Circuit has similarly explained that statements which are forward-looking as a whole cannot be rendered actionable simply because some historical facts are included in the explanation of the prediction:

> Forward-looking conclusions often rest both on historical observations and assumptions about future events. Thus, were we to banish from the safe harbor lists that contain both factual and forward-looking factors, we would inhibit corporate officers from fully explaining their outlooks. Indeed, liability-conscious officers would be relegated to citing only the factors that individually could be called forward-looking. That would hamper the communication that Congress sought to foster.

Harris v. Ivax Corp., 182 F.3d 799, 806-07 (11th Cir. 1999). The Seventh Circuit has embraced the same reasoning in the context of considering Securities Act Rule 175 (whose safe-harbor

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[18] Plaintiffs cite no case that supports a different position. Danis v. USN Communications, Inc., 73 F. Supp.2d 923 (N.D. Ill. 1999), involved specific allegations that "reported revenues, accounts receivable, new sales, and lines sold and provisioned were false, fictitious, and/or materially overstated" and the court simply made the unremarkable statement that "warnings of future risks cannot adequately caution against a misstatement of historical, present facts." Id. at 935. And, in In re Oxford Health Plans, Inc., 187 F.R.D. 133 (S.D.N.Y. 1999), the "plaintiffs point[ed] out that they are not relying on the falsity of Oxford's financial projections and estimates, but rather the defendants' failure to disclose historical and existing material facts." Id. at 141 (emphasis added).

provisions provided the model for the PSLRA's). See Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 514-15 (7th Cir. 1989).

Moreover, properly considered, even the excerpts that plaintiffs seek to recharacterize as statements of past or current business conditions, are actually forward-looking standing on their own. Plaintiffs seem to rely on a "purely grammatical argument ... that a present-tense statement cannot predict the future," which the Harris court specifically rejected as "unpersuasive." Harris, 182 F.3d at 805. Rather, "a statement about the state of the company whose truth or falsity can only be determined after it is made necessarily refers only to future performance." Id. at 805. Similarly, in In re Advanta Corp. Sec. Litig., 180 F.3d 525 (3d Cir. 1999), the court found that statements that the company had "achieved excellent growth and returns," that its loans were made to "better quality customers," that its loans' "credit quality remained excellent," and that "Advanta continued to produce better-than-industry credit measures" were all within the safe harbor. Id. at 538; see also Harris, 182 F.3d at 805 (statement that company was "very well-positioned" was within safe harbor).

Furthermore, plaintiffs' criticism of the cautionary language employed by Household as "boilerplate," Pl. Mem., at 41-42, misses the thrust of defendants' arguments. Plaintiffs focus only on the statements contained in the various press releases themselves, and ignore the press releases' specific references to Household's various 10Ks and other documents. As defendants explained in their opening memorandum, it is those other documents that contain specific cautions. See Def. Mem. at 38; see also Grossman v. Novell, 120 F.3d 1112, 1122-24 (10th Cir. 1997) ("[C]ourts have not required cautionary language to be in the same document as the alleged misstatement or omission.").

Finally, plaintiffs' contention that the Complaint overcomes the safe harbor because the defendants knew the forward-looking statements were false when made, Pl. Mem. at 42-43, simply recycles plaintiffs' inadequate arguments on scienter. Plaintiffs must allege sufficient facts to give rise to a strong inference of scienter, which, as discussed above, they have not done.

C. Various Statements Quoted in the Amended Complaint Are Non-Actionable Opinion or Puffery.

The remainder of the Complaint which is not forward-looking is simply not actionable because it is mere opinion or puffery. Plaintiffs' assertion that liability can be premised on subjective statements of opinion whenever "defendants were aware of contemporaneous facts that belied their statements," Pl. Mem. at 43, entirely ignores the law of this Circuit which clearly permits a company to disclose projections "so long as it has a 'reasonable basis,'" even if it is aware of other estimates that are inconsistent with those projections. Wielgos, 892 F.2d at 516 (a company may "reveal the projection it thinks best while withholding others"). Even if plaintiffs were correct on the law, however, they have nonetheless failed to allege facts that would show that defendants possessed knowledge of any such "contemporaneous facts" that belied any of the defendants' subjective statements.

Furthermore, the numerous statements that plaintiffs rely upon in which defendants state that the company is "strong" or has "momentum" or similar favorable statements are not actionable because they are not verifiable and are "simply too vague to constitute a material statement of fact." Searls v. Glasser, 64 F.3d 1061, 1066 (7th Cir. 1995).

POINT IV

PLAINTIFFS' SECTIONS 11 AND 12(A)(2) CLAIMS SHOULD BE DISMISSED.

Plaintiffs have failed to rebut defendants' showing that their claims under Sections 11 and 12(a)(2) of the Securities Act of 1933 should be dismissed either because they are time-barred and/or because they lack loss causation.

A. Plaintiffs' Claims Regarding the Beneficial Registration Statement and the 1999 Debt Registration Statements are Time Barred.

As set forth in defendants opening memorandum, plaintiffs' §§ 11 and 12(a)(2) claims based upon the 1998 Beneficial Registration Statement and the February and July 1999 debt registrations are time-barred under the applicable three-year statute of repose provided by § 13 of the Securities Act, 15 U.S.C. § 77m. The extended statute of limitations periods included within Sarbanes-Oxley, 28 U.S.C. § 1658, upon which plaintiffs rely, apply only to securities claims involving "fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws," and not to claims under Sections 11 and 12, which are not fraud-based claims and require no scienter.[19] See also Def. Mem. at 40-42.

The only decisions to pass on the application of Sarbanes-Oxley to claims under §§ 11 and 12(a)(2) (both rendered after defendants' opening memorandum was filed) have held that Sarbanes-Oxley does not extend the statute of limitations for those claims. See In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 2003 WL 21518833, at *19 (S.D.N.Y. July 2, 2003) (ruling that Sarbanes-Oxley's extended statute of limitations applied to the plaintiff's

[19] In making their §§ 11 and 12(a)(2) claims, plaintiffs disclaimed "any allegation complained of herein that could be construed to allege intentional or reckless conduct." Compl. ¶¶ 354, 383.

§ 10(b) claim, but not to her claims under §§ 11 and 12(a)(2), which were governed by § 13 of the Securities Act); Friedman v. Rayovac, No. 02-C-308-C, 02-C-325-C, 02-C-370-C, slip op. at 20-21 (W.D. Wis. June 2, 2003), affirmed on reconsideration, slip op. at 1-4 (June 23, 2003) (rejecting argument that Sarbanes-Oxley's extension of statute of limitations applied to "all" securities claims, and holding that resort to legislative history was inappropriate because statute was unambiguous).

Plaintiffs nevertheless ask this Court to find that while Congress left § 13 of the Securities Act and its three-year statute of repose intact, Sarbanes-Oxley implicitly repealed that section. They rely on three deeply flawed arguments.

First, plaintiffs argue that "[b]y its own terms," this section of Sarbanes-Oxley applies to all private securities claims. Pl. Mem. at 46-47. This argument, of course, disregards the explicit language of the statute which limits the extension of the statute of limitations only to causes of action involving "a claim of fraud, deceit, manipulation, or contrivance." 28 U.S.C. § 1658; see also Friedman v. Rayovac, supra, slip op. at 2 (June 23, 2003).

Second, plaintiffs argue that the terms "fraud, deceit [and] manipulation" used in Sarbanes-Oxley are synonymous with scienter, and that the use of the word "contrivance" reflects an intention by Congress to extend the statute of limitations to securities claims for which scienter is not required. See Pl. Mem. at 48-49. In advancing this argument, plaintiffs mischaracterize the Supreme Court's decision in Ernst & Ernst v. Hochfelder, 425 U.S. 185, 198 (1976), which explicitly equated "contrivance" with a claim requiring scienter. Id. at 199 (holding that "the words 'manipulative,' 'device,' and 'contrivance' . . . make unmistakable a congressional intent to proscribe a type of conduct quite different from negligence.") (emphasis added). Yet, even if one were to put the Court's holding in Hochfelder aside, plaintiffs'

interpretation of the word "contrivance" would be at odds with common usage of the term, which must be applied in construing a statute. See Perrin v. United States, 444 U.S. 37, 42 (1979). Webster's, for example, defines "deceit" synonymously with "contrivance." See Webster's Third New International Dictionary (1961) (defining "deceit" as, inter alia, "[a]ny trick, collusion, contrivance, false representation, or underhand practice, used to defraud another.") (emphasis added).

Lastly, plaintiffs attempt to seek refuge in what they present as the legislative history of the Sarbanes-Oxley Act, by pointing to parts of statements read into the record by Senator Leahy. See Pl. Mem. at 49-50. It is well established, however, that resort to legislative history to construe a statute is inappropriate where the statute is clear on its face. See Barnhill v. Johnson, 503 U.S. 393, 401-02 (1992); see also Friedman v. Rayovac, supra, slip op. at 2 (June 23, 2003).[20] This Court should dismiss Count III in its entirety and Count IV (as to the February and July 1999 debt registrations) with prejudice as time-barred.

B. Plaintiffs' Sections 11 and 12(a)(2) Claims Regarding the Beneficial Registration Statement Fail for Lack of Loss Causation.

Under the plain language of the securities laws, if a plaintiff does not suffer any loss due to a defendant's alleged misrepresentations or omissions, the plaintiff's claim fails for lack of loss causation. See 15 U.S.C. §§ 77k(e), 77l(b). Here, plaintiff West Virginia Trust has admitted through the allegations in the Complaint that it suffered no loss because it sold all of the

[20] In any event, contrary to plaintiffs' distortions, the legislative history confirms that Congress intended the enlarged statute of limitations to apply only to "private securities fraud cases." See Legislative History of Title VIII of HR 2673: The Sarbanes-Oxley Act of 2002, 148 Cong. Rec. S. 7418, 7418-7420 (2002). Indeed, even Senator Leahy explicitly said: "This section would set the statute of limitations in private securities fraud cases to the earlier of two

(footnote continued)

Household stock it acquired from the Beneficial Registration Statement years before defendants' supposed corrective disclosure. See Def. Mem. at 43-44.

Plaintiffs have no answer for the apparent lack of loss causation, other than to argue: (a) that the measure of damages on a § 11 claim includes the difference between the price paid and the price at which it was sold; (b) that the Complaint alleges loss causation notwithstanding the plaintiffs' quick sale of the stock years before any corrective disclosure; and (c) that loss causation is not properly the subject of a Rule 12(b)(6) motion. See Pl. Mem. at 50-53. Plaintiffs are wrong on all counts.[21]

Plaintiffs' argument about the measure of damages for a § 11 claim is a red herring. The measure of damages is irrelevant if the alleged loss could not have been caused by the alleged misrepresentation or omission. Section 11 explicitly states that if a defendant can prove that a plaintiff's loss is attributable to some element other than the alleged false and misleading statements, the plaintiff is not entitled to any recovery. See 15 U.S.C. § 77k(e)(3); see also Akerman v. Oryx Comm., Inc., 810 F.2d 336, 341 (2d Cir. 1987).

Likewise, plaintiffs' argument that the West Virginia Trust has suffered a cognizable loss because of the Complaint's allegation that "absent the false statements or omissions, plaintiffs would either have refused to vote for the merger or obtained a better

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(footnote continued)

years after [] discovery of the [] violation or five years after such violation." Id. at 7418 (emphasis added).

[21] Plaintiffs also err in suggesting that West Virginia Funds is a suitable class representative despite the fact that it has suffered no loss resulting from the alleged misrepresentations. See Pl. Mem. at 51 n.25. It is settled law in this Circuit that a plaintiff without standing to pursue his own claim cannot be an adequate class representative. See Walters v. Edgar, 163 F.3d 430, 432-33 (7th Cir. 1998).

exchange ratio than they did," is meritless. See Pl. Mem. at 51. The Complaint makes no such allegation; it merely alleges that the West Virginia Trust sold its shares at a loss and that the Beneficial Registration statement was misleading. See Compl. ¶ 377, and Ex. 1, Certification of Named Plaintiff. Even if considered, such an allegation would fail to save this claim from dismissal because it is too generic and conclusory, and, in any event, under plaintiffs' theory, the continuing misrepresentations bolstered the sale prices of the Household stock that the West Virginia Trust sold.

Lastly, case law is settled that defendants should not have to suffer through needless costly discovery when there is a clear showing on the face of the complaint that loss causation does not exist. See, e.g., Miller v. Apropos Tech., Inc., 2003 WL 1733558, at *8 n.6 (N.D. Ill. Mar. 31, 2003) (loss causation may be an appropriate basis for dismissal under Rule 12(b)(6)). There is no conceivable way that plaintiff West Virginia Trust suffered a loss due to any supposed misrepresentation or omission made by defendants. Count III should therefore be dismissed with prejudice.

POINT V

PLAINTIFFS' "CONTROL PERSON" CLAIMS IN COUNTS II, III AND IV SHOULD BE DISMISSED.

For the reasons set forth in defendants' opening memorandum and not rebutted by plaintiffs, Counts II, III, and IV in the Complaint asserting claims under Section 15 of the Securities Act, 15 U.S.C. § 77o, and Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), should be dismissed because of plaintiffs' failure to state an underlying securities claim. See Harrison v. Dean Witter Reynolds, Inc., 79 F.3d 609, 617 (7th Cir. 1996).

POINT VI

THE COMPLAINT SHOULD BE DISMISSED AS TO DEFENDANT GILMER.

As demonstrated in defendants' opening memorandum, this Court should dismiss Mr. Gilmer from this lawsuit. Plaintiffs have not alleged any statements made by Mr. Gilmer that were false and that he knew to be false when made. At best, plaintiffs allege that Mr. Gilmer made the following statements:

- "'Vision' has had an overwhelmingly positive effect on virtually every aspect of out consumer finance business. We have enjoyed faster and more profitable growth because our account executives are provided with greater numbers of qualified leads, prioritized by the Vision system. Our credit losses are minimized because of the real-time links to our underwriting system ...." Compl. ¶ 111.

- "Gary Gilmer who is now the senior executive in charge of HFC presented a review of the business." Compl. ¶ 203.

- "In a series of meetings with investors this week, Household's Bill Aldinger, Gary Gilmer, and Bobby Mehta provided updates on the company's businesses." Compl. ¶ 236.

- "Household's 'position on predatory lending is perfectly clear. Unethical lending practices of any type are abhorrent to our company, our employees and most importantly our customers.'" Compl. ¶ 280.

Two of these "statements"—those in paragraphs 203 and 236—do not attribute any specific representation to Mr. Gilmer at all. As to the other two, plaintiffs fail to set forth facts with sufficient particularity demonstrating either that the statements were false when made or that Mr. Gilmer knew them to be false when he made them.[22] Plaintiffs instead fall back on the argument that Mr. Gilmer "cannot now feign ignorance of a pervasive scheme" of predatory lending. Pl.

[22] Plaintiffs seem to suggest that Mr. Gilmer could be liable if he failed to correct a false statement made by another company official at an investor or analyst meeting. Pl. Mem. at 36 n.13. Plaintiffs, however, have not alleged any false statement to have been made in Mr. Gilmer's presence which he had some purported responsibility to correct.

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Mem. at 36. Plaintiffs nonetheless fail to allege facts that would suggest Mr. Gilmer actually knew or should have known that Household was engaging in supposed predatory lending.

Plaintiffs' resort to the group pleading doctrine to revive its claims against Mr. Gilmer is equally fruitless. Even if group pleading survived the advent of the PSLRA—which it has not[23]—plaintiffs have not pleaded facts demonstrating the doctrine's applicability to Mr. Gilmer. For example, general allegations that Mr. Gilmer was "responsible for all aspects of the consumer lending arm of Household's business," Compl. ¶ 40, are insufficient to invoke the doctrine. See Johnson v. Tellabs, Inc., 2003 WL 21183390, at *7 (N.D. Ill. May 19, 2003) (plaintiffs, at a minimum, must "include allegations in the complaint relating to an individual defendant's duties or legal obligations that create a presumption that the company's statement was somehow caused by or attributable to an individual defendant.").

Moreover, plaintiffs' contention that their general references to "Officer Defendant" in over 60 allegations somehow supports their claims against Mr. Gilmer is contrary to the law. Pl. Mem. at 35 n.11. Simply put, "repeated references to 'Defendants' or 'Individual Defendants' [or 'Officer Defendants'] do not satisfy the PSLRA's requirements of pleading with

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[23] Plaintiffs concede that numerous courts, including courts in this District, have held that the group pleading doctrine does not survive the PSLRA, finding it "nonsensical to require that a plaintiff specifically allege facts regarding scienter as to each defendant, but to allow him to rely on group pleading in asserting that the defendant made the statement or omission." Coates v. Heartland Wireless Communications, Inc., 26 F. Supp.2d 910, 916 (N.D. Tex. 1998); see also Chu v. Sabratek Corp., 100 F. Supp.2d 827, 836 (N.D. Ill. 2000); Geinko v. Padda, 2001 WL 1163728, at *4 n. 3 (N.D. Ill. Sep. 28, 2001); In re Enron Corp. Sec., Derivative & ERISA Litig., 2003 WL 230688, at *6 (S.D. Tex. Jan. 28, 2003); In re Digital Island Securities Litigation, 223 F. Supp.2d 546, 553 (D. Del. 2002); In re Lockheed Martin Corp. Sec. Litig., 2002 WL 32081398, at *4-5 (C.D. Cal. July 22, 2002); P. Schoenfeld Asset Mgmt. LLC v. Cendant Group, 142 F. Supp.2d 589, 620 (D.N.J. 2001). And while the Seventh Circuit has not ruled on the viability of the group pleading doctrine following the enactment of the PSLRA, even before the PSLRA, the Seventh Circuit recognized that in securities fraud cases "a complaint that attributed misrepresentations to all defendants, lumped together for pleading purposes, generally is insufficient." Sears v. Likens, 912 F.2d 889, 893 (7th Cir. 1990).

specificity as to each Defendant." Tellabs, 2003 WL 21183390, at *7. The Court should disregard these allegations.

POINT VII

PLAINTIFFS SHOULD NOT BE PERMITTED LEAVE TO AMEND ANY DISMISSAL UNDER RULE 12(B)(6).

Relying on Foman v. Davis, 371 U.S. 178, 182 (1962), plaintiffs request leave to amend under Rule 15 should this Court dismiss the Complaint in whole or in part. See Pl. Mem. at 54. Foman plainly holds, however, that leave to replead should be denied if it would be a futile act. Id.; see also Williams v. U.S. Postal Serv., 873 F.2d 1069, 1072 (7th Cir. 1989); IBJ Whitehall Bank & Trust Co. v. Cory & Assoc., Inc., 2000 WL 1364410, at *1 (N.D. Ill. Sept. 15, 2000) (Guzman, J.). In this case, the Court should not allow leave to replead any of the following Counts because of defects which, by their very nature, may not be cured:

- dismissal of all or parts of Count I based upon statements which are not actionable (Point III supra);
- dismissal of Count III and parts of Count IV which are time-barred (Point IV supra);
- dismissal of Count III for lack of standing (Point IV supra);
- dismissal of all Counts against defendant Gary Gilmer because there are no false or misleading statements attributable to him (Point VI supra); and
- dismissal of any of the corresponding "control person" claims in Counts II, III and IV (Point VII supra).

CONCLUSION

The Household defendants' motion to dismiss the Amended Complaint should be granted.

Dated: July 21, 2003

Respectfully submitted,

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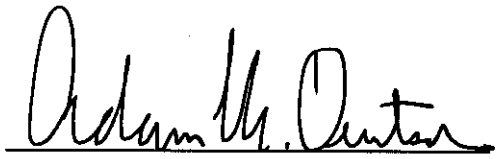
CERTIFICATE OF SERVICE

The undersigned, an attorney, certifies that he served true and correct copies of the foregoing Notice of Agreed Motion, Agreed Motion for Leave to File Instanter an Oversized Reply Memorandum of Law in Support of Household Defendants' Motion to Dismiss the Corrected Amended Consolidated Class Action Complaint, and Reply Memorandum of Law in Support of Household Defendants' Motion to Dismiss the Corrected Amended Consolidated Class Action Complaint upon the individuals listed on the attached Service List this 21st day of July 2003 via Federal Express:



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