UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

GMR

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

MEMORANDUM OF LAW IN SUPPORT OF THE HOUSEHOLD DEFENDANTS' MOTION FOR SUMMARY JUDGMENT DISMISSING ALL REMAINING CLAIMS OF THE CLASS

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Defendants Household International, Inc. ("HII"), Household Finance Corporation ("HFC"), William F. Aldinger, David A. Schoenholz and Gary Gilmer (collectively "Household" or "Defendants") respectfully submit this Memorandum in support of their motion for summary judgment on all of the securities fraud claims asserted by Lead Plaintiffs on behalf of persons (the "Class") who purchased or otherwise acquired HII securities during the period July 30, 1999 through October 11, 2002 (the "Class Period"). The admissions of Lead Plaintiffs and other indisputable facts that warrant judgment in Household's favor are set forth in Defendants' Statement Pursuant to Local Rule 56.1(a)(3) in Support of Their Motion for Summary Judgment ("Def. St.") and accompanying Appendix, both of which are filed herewith.

PRELIMINARY STATEMENT

The filing of this action was a predictable response to Household's 2002 announcement of an accounting-related restatement that proved to be of no consequence to the market.[1] Although conclusory accusations of accounting fraud remain in the case, along with an inexplicable claim that Household concealed "loan reaging" policies that it openly reported to the SEC, the main focus of the Corrected Amended Consolidated Class Action Complaint ("Amended Complaint" or "AC") is the theory that throughout the Class Period Household orchestrated a "massive predatory lending scheme" that it fraudulently concealed and denied until October 11, 2002, when it announced a consumer lending settlement with a task force of state attorneys general. The Class is proceeding on the basis of a "fraud-on-the-market" theory of securities fraud under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, with a related claim under § 20(a) of the Securities Exchange Act.[2]

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1 As the Court of Appeals observed in *Higginbotham* v. *Baxter International Inc*., 495 F.3d 753, 756 (7th Cir. 2007), "Any restatement of a public company's financial results is likely to be followed by litigation." In this instance, the lag time was only three business days.

2 One of the Lead Plaintiffs and two non-lead plaintiffs have asserted a separate count alleging violations of §§ 11 and 15 of the Securities Act of 1933 by movants and former HFC director J.A. Vozar. *See* Amended Complaint, Count IV. These individual claims, which would support only *de minimis* (if any) damages if they were sustained, were not certified for class action treatment and are not addressed by this motion.

This motion addresses the failure of the Class to prove loss causation, an essential element of its § 10(b) claims.[3] These claims fail as a matter of law because the Class cannot prove "*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." *Ray* v. *Citigroup Global Markets, Inc.*, 482 F.3d 991, 995 (7th Cir. 2007) (citing *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336 (2005) (emphasis added). The Class cannot meet the first prong of this burden because the expert report that Lead Plaintiffs adopted as their loss causation showing admitted that *none* of the dozens of Class Period misrepresentations they allege inflated the price of HII stock. (*See* Point I (A).) The Class cannot satisfy the second prong of its loss causation burden for two dispositive reasons. First, the price of HII stock did not decline, but rather *increased* on the days the Amended Complaint alleges that the claimed fraud was revealed. (*See* Point I (B).) Second, the significant downturn in the price of HII stock (along with the rest of the market) *preceded* the alleged revelation of the claimed fraud — a circumstance that rendered summary judgment "inevitable" in *Ray* because it signified that the plaintiff's losses were caused by factors other than alleged fraud. *See id.* at 996. (*See* Point I (C).) A ruling in Defendants' favor on loss causation will dispose of all remaining claims of the Class, and make it unnecessary for the Court to consider the insufficiency of the Class's showing on other required elements of these claims.

Defendants first alerted the Court to the fatal defects in the Class's loss causation showing in their August 30, 2007 "Motion for Implementation of This Court's February 28, 2006 Order." (Doc. 1121) That motion highlighted Lead Plaintiffs' admission that no artificial inflation was introduced into the price of Household stock by the Class Period "affirmative misstatements" alleged in their pleading and interrogatory answers. It also demonstrated that Lead Plaintiffs' fall-back effort to recover for the consequences of alleged pre-Class Period fraud was barred by the Court's Memorandum and Order of February 28, 2006 (the "Repose Bar Order"), which "dismiss[ed] with prejudice all § 10(b) claims based on any misrepresentation or omission that occurred before July 30, 1999 in connection with the sale or purchase of a security." (Doc. 434)

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[3] The Class's §20(a) claim is not separately addressed in this Memorandum, because judgment for the corporate Defendants on Plaintiffs' §10(b) and Rule 10b-5 claims will necessarily dispose of the Class's § 20(a)claims, which have "as a necessary predicate a securities violation by the alleged controlled person." *Harrison* v. *Dean Witter Reynolds, Inc.*, No. 86 C 8003, 1995 WL 127792, at *7 (N.D. Ill. Mar. 22, 1995) (Marovich, J.).

At the presentment of the motion to implement the Repose Bar Order, defense counsel explained that Lead Plaintiffs had adopted the August 15, 2007 Expert Report of Professor Daniel R. Fischel as their loss causation showing, thus impermissibly basing the claims of the Class on time-barred sources of "artificial inflation" that Professor Fischel assumed to be already in place on July 30, 1999. (Transcript of September 4, 2007 Presentment, Def. St. ¶ 20) The Court responded as follows:

> "I think [Professor Fischel] says things that caused you to draw that conclusion. 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. . . .
>
> * * *
>
> I'm just not ready to make that jump between what the expert has said and your conclusion that that precludes all of their claims. I'm just not ready to make that jump at this time. And we are actually at the tail end of this horribly long and expensive process so that the savings in this case in terms of resources for all the parties, including the Court, would not be, I think, sufficiently significant for me to say let's go ahead and do it this way, let's go up on appeal and see what happens.
>
> I think I would prefer to rule on the summary judgment motion. It just makes more sense at this stage. So for that reason and that reason only, I'm going to deny your motion." (*Id.* at 7, 10)

Thereafter, the parties completed fact and expert discovery and established Lead Plaintiffs' final position on the timing and source of the alleged artificial inflation on which they base the Class's loss causation showing. This stage included follow-up on Lead Plaintiffs' answers to contention interrogatories on this subject, Lead Plaintiffs' adoption of Professor Fischel's Rebuttal Report on February 1, 2007, and Defendants' deposition of Professor Fischel on March 21, 2008. As shown in this Memorandum and the accompanying Statement Pursuant to Local Rule 56.1(a)(3), that additional discovery has only strengthened and reinforced Defendants' entitlement to judgment. During expert discovery, Professor Fischel repeated his admission that no artificial inflation entered HII's stock price on any of the days on which Lead Plaintiffs allege that Defendants made affirmative representations. (Def. St. ¶¶ 38 - 39) Professor Fischel also admitted that he had *assumed* the existence of "artificial inflation" in the price of HII stock as of the opening day of the Class Period (Def. St. ¶¶ 41, 45), and Lead Plaintiffs admitted that Professor Fischel had not established the source or starting date of the alleged inflation. (Def. St. ¶ 46) Although Lead Plaintiffs themselves have refused to identify the origin of the assumed artificial inflation (which itself disqualifies the Class's claims under *Dura*), they admit

that it was introduced by events that occurred no later than July 22, 1999, and perhaps as early as October 23, 1997. (Def. St. ¶¶ 40, 42, 43, 44, 47)

Based on these and other admissions, Point II exposes the fatal errors in Lead Plaintiffs' futile effort to circumvent *Dura* by arguing that the Class was harmed by Household's alleged failure to cure fraud that they *assume* inflated the price of HII stock during the period of repose.[4] Without curing in any way the deficiencies in their proof of loss causation, Lead Plaintiffs' new and unsubstantiated theory raises incurable problems under the statute of repose. (*See* Point II (A)-(C).) Furthermore, by refusing to identify the origin of the alleged artificial inflation (no doubt to avoid highlighting their reliance on time-barred events), Lead Plaintiffs inevitably fail to prove, as they must, that "defendants' alleged misrepresentations artificially inflated the price of the stock," *Ray*, 482 F.3d at 995, and that "it was the very facts about which the defendant[s] lied which caused [their] injuries" *Tricontinental Industries, Ltd.* v. *Pricewaterhouse-Coopers, LLP*, 475 F.3d 824, 842 (7th Cir. 2007) (citation omitted). (*See* Point II (D).) Finally, in strategically abandoning the allegations in their pleading as to when the alleged fraud was revealed, Lead Plaintiffs adopt the discredited fiction that truth can be simultaneously concealed and revealed in an efficient market. As Class Counsel should know from their previous attempts to circumvent *Dura* in this fashion, this theory fails as a matter of law. (*See* Point II (E).)

The survival of the Amended Complaint to this point as a matter of notice pleading does not speak to or impair Defendants' right to summary judgment because on core issues (such as how alleged artificial inflation incepted and allegedly came to be undone) Lead Plaintiffs' current positions are exact opposites of the theories they pleaded. Furthermore, as the Supreme Court made clear in *Tellabs*, a case about pleading standards under the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4(b)(4), "'the test that is used at the summary-judgment and judgment-as-a-matter-of-law stages'. . . is measured against a different backdrop" than a mo-

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[4] In their February 6, 2008 Status Report to Magistrate Judge Nolan (Doc. 1174), Lead Plaintiffs described their fall-back approach in the following terms, bereft of any citation to legal authority: "The existence of pre-Class Period artificial inflation would not preclude plaintiffs' cause of action for defendants' subsequent false statements that continued to artificially prop up Household's share price. This is because each statement made by defendants to the market that failed to disclose the adverse information regarding Household's improper business practices (predatory lending, improper re-aging, improper accounting) was an inflationary event. Had the adverse information been disclosed, Household's share price would have fallen to its true value . . . ." (citations to Professor Fischel's Report omitted)

tion at the pleading stage. *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2510 n.5 (2007) (citation omitted). "It is improbable that Congress, without so stating, intended courts to test pleadings, unaided by discovery, to determine whether there is 'no genuine issue as to any material fact.'" *Id.*, quoting Fed. R. Civ. P. 56(c). *See also Goldberg* v. *Household Bank, F.S.B.*, 890 F.2d 965, 967 (7th Cir. 1989) ("Securities litigation is expensive to the parties in money, and to the court in time; it should be brought to a conclusion at the first opportunity.").

PROCEDURAL HISTORY

A. The Pleadings and Related Motion Practice

Lead Plaintiffs filed their Amended Consolidated Class Action Complaint on March 7, 2003, and substituted a corrected version one week later. (Doc. 50) The Amended Complaint alleges that HII, its subsidiary HFC, and certain of HII's Class Period senior officers (Chairman/CEO William F. Aldinger, Vice Chairman/Chief Financial Officer David A. Schoenholz, and Vice Chairman of Consumer Lending Gary Gilmer) violated 15 U.S.C. §§ 78j(b) and 78t(a) (§§ 10(b) and 20(a) of the Securities Exchange Act of 1934) and 17 C.F.R. § 240.10b-5 (Rule 10b-5). As noted below, claims against numerous other Defendants were eventually settled or dismissed. Granting the instant motion will terminate all claims of the Class in this action.

In a Memorandum and Order dated March 22, 2004 (Doc. 135), the Court sustained the pleading of the claims summarized above and dismissed claims of fraud in connection with the preparation and filing of certain registration statements.[5] On December 3, 2004, the Court certified a Class solely as to the § 10(b) claims. Members of the "Glickenhaus Institutional Group" (an amalgam of three named plaintiffs with miniscule holdings in HII securities) were named as Lead Plaintiffs. (Doc. 194; *see* Def. St. ¶¶ 4 - 6)[6]

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5 The dismissal of Count III had the effect of terminating all claims against Merrill Lynch, Pierce, Fenner & Smith, Inc., Goldman Sachs & Co., Inc., and Household Directors Robert J. Darnell, Gary G. Dillon, John A. Edwardson, Mary Johnson Evans, J. Dudley Fishburn, Cyrus F. Friedheim, Louis E. Levy, George A. Lorch, John O. Nichols, James B. Pitblado, S. Jay Stewart, and Louis W. Sullivan.

6 Defendants consented to certification of the Class based on the claims then pleaded and the facts then known.

In an Amended Answer filed on December 8, 2005 (Doc. 346), Household denied all allegations of wrongdoing and averred that the claims of the Class are time barred.

In the Repose Bar Order filed on February 28, 2006 (Doc. 434), the Court "*dismissed with prejudice the § 10(b) claims based on any misrepresentation or omission that occurred before July 30, 1999 in connection with the sale or purchase of a security.*" (*Id.* at 6; emphasis added) The Court held that such claims had expired "regardless of the fact that plaintiffs allege they did not have inquiry notice as to those claims until much later." (*Id.* at 5) One effect of this ruling was to reset the temporal scope of the Class Period (which Lead Plaintiffs had originally alleged to begin on October 23, 1997) to July 30, 1999 through October 11, 2002.

On April 6, 2006, the Court dismissed all claims against original Defendant Arthur Andersen & Co. (Doc. 485), based on a $1.5 million settlement that Lead Plaintiffs characterized as "fair, reasonable and adequate." (Doc. 456)[7]

On April 24, 2006, the Court denied Defendants' motion to dismiss the Amended Complaint based on the insufficiency under *Dura* of the allegation that investors had "paid too much" for Household securities. (Doc. 494) Significantly, this ruling was made before Lead Plaintiffs admitted, as a matter of fact, that the Class Period misstatements they alleged did not inflate the price of HII stock, and also before they attempted to abandon their corrective disclosure allegations.

On August 30, 2007, Defendants filed their Motion for Implementation of Repose Bar Order (Doc. 1121), based on Lead Plaintiffs' admission that the Class's remaining claims arise from alleged artificial inflation that was introduced into the price of Household stock during the period of repose. (Doc. 1120) As noted, at the presentment of the motion on September 4, 2007, the Court observed that although Defendants may be correct, it would prefer to have all

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[7] Lead Plaintiffs had devoted 13 pages of their Amended Complaint to scathing accusations that Arthur Andersen, as HII's one-time outside auditor, had "abandoned its professional standards by helping Household perpetrate the massive accounting fraud alleged" (AC ¶ 172), thus demonstrating a "callous, reckless disregard for its duty to investors and the public trust." (AC ¶ 181) In representing to the Court that the $1.5 million settlement they had negotiated was "fair, reasonable and adequate," Lead Plaintiffs admitted that "under current case law" proving their claims against Arthur Andersen would have been "challenging and thus posed significant risk that lead Plaintiffs would obtain no recovery from Andersen." Memorandum of Law in Support of Lead Plaintiffs' Motion for Final Approval of Settlement with Arthur Andersen LLP at 3, 4. (Doc. 456)

discovery at hand before considering a motion that could have the effect of terminating the Class's case. (*See* Def. St ¶ 20) All discovery is now at hand, and this is that motion.

B. Discovery

Lead Plaintiffs conducted exhaustive fact discovery in this matter, focused largely on the minutiae of HFC's consumer lending operations during the Class Period. In all, Defendants produced approximately five million pages of documents in response to six waves of document requests, answered 85 multi-part interrogatories and 252 requests for admission, and created new computer programs to retrieve quarterly loan origination data in formats Lead Plaintiffs preferred. (Def. St. ¶ 15) Lead Plaintiffs deposed some 61 fact witnesses over 72 deposition days, including 52 present or former employees of HII and HFC. (Def. St. ¶ 16)

During fact discovery Household relied primarily on interrogatories to try to explore the basis of the Class's claims.[8] With the Court's permission, Lead Plaintiffs deferred answering Household's contention interrogatories until two months before the scheduled close of fact discovery, and deferred providing final answers to certain contention interrogatories pending input from their retained expert witnesses. (*See* Def. St. ¶¶ 17 - 18) Lead Plaintiffs supplemented their contention interrogatory answers on August 15, 2007 to adopt the Reports of their retained experts, and supplemented these answers on February 1, 2008 to adopt their experts' rebuttal Reports. (Def. St. ¶¶ 29, 31, 33, 35, 37)

Given that the Class's loss causation expert assumed the existence of "artificial inflation" on the opening day of the Class Period without offering any proof that could pinpoint when or how the alleged inflation came to exist (*see* Def. St. ¶¶ 41, 45), Defendants tried without success to elicit Lead Plaintiffs' position on when and how the alleged inflation was introduced into the price of HII stock. (*See* Def. St. ¶¶ 48 - 50) In related motion practice, Lead Plaintiffs (for better or worse) took the position that such information was needless and "irrelevant" to the claims of the Class, and on that basis resisted Defendants' demands. (Def. St. ¶ 47)

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8 Lead Plaintiffs' responses invariably sought to keep all possible options open, while conveying no useful clarification of their claims. For example, in response to Interrogatory No. 45, which asked Lead Plaintiffs to explain their allegation that particular HFC products violated federal and/or state law. Lead Plaintiffs provided five pages of text and a 32-page single-spaced list containing almost 3,000 undifferentiated entries comprising some 50,000 pages of documents produced by Household.

Expert discovery was concluded on April 29, 2008, (Def. St. ¶ 19), and this case is now ripe for summary disposition.

SUMMARY OF LEAD PLAINTIFFS' ADMISSIONS AND OTHER INDISPUTABLE FACTS

A. The Parties

(1) Lead Plaintiffs and Their Trading in HII Securities

During the Class Period (July 30, 1999 through October 11, 2002) the three Lead Plaintiffs were among the smallest institutional investors in HII securities, collectively holding less than half of one percent of the outstanding shares of the Company's stock. (Def. St. ¶¶ 4.1, 4.3, 5.1, 6.1) None of the institutional investors that collectively held the majority of HII stock during the relevant period has joined in this action.[9]

Between January 1, 2001 and August 2, 2002 (the last day for which it provided information), co-Lead Plaintiff Glickenhaus & Co., an investment advisor, purchased approximately 179,700 shares of HII stock (out of approximately 466 million shares outstanding at the time). (Def. St. ¶ 4.1) Approximately three-fourths of these purchases were made *after* November 15, 2001, the date on which Lead Plaintiffs now allege the market saw the first of several "partial corrective disclosures" of Household's alleged fraud. (*See* Def. St. ¶ 4.2)

Between March 22, 2001 and March 14, 2002, co-Lead Plaintiff PACE Industry Union Management Pension Fund ("PACE") purchased approximately 45,000 shares of HII stock. (Def. St. ¶ 5.1) Between January 29, 2001 and July 30, 2002, PACE sold approximately 45,500 shares of HII stock. (*Id.*)

Between August 13, 2001 and July 17, 2002, co-Lead Plaintiff The International Union of Operating Engineers Local 132 Pension Plan (IUOE) purchased approximately 27,800 shares of HII stock. (Def. St. ¶ 6.1) Between December 5, 2001 and July 30, 2002, IUOE sold approximately 3000 shares of HII stock. (*Id.*)

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9 As the Court of Appeals recently noted, "One can't help thinking that the unwillingness of any substantial shareholder to step forward as a representative suggests that the suit may not be in investors' interest." *Asher* v. *Baxter International, Inc.*, 505 F.3d 736, 738 (7th Cir. 2007).

(2) Defendants

During the Class Period, Defendant HII was a publicly traded, non-operating holding company with operating subsidiaries engaged in consumer lending, mortgage servicing and credit card servicing businesses. (Def. St. ¶ 9) Defendant HFC was a wholly-owned subsidiary of HII that was engaged in the consumer lending business. (Def. St. ¶ 10) Defendant William F. Aldinger served as Chairman and Chief Executive Officer of HII. (Def. St. ¶ 11) Defendant David A. Schoenholz served as Vice Chairman and Chief Financial Officer of HII. (Def. St. ¶ 12) Defendant Gary Gilmer served as HII's Vice President of Consumer Lending and Group Executive of U.S. Consumer Finance. (Def. St. ¶ 13)

B. Stock Price Changes for HII and Other Consumer Finance Companies During the Class Period

During the Class Period, the Dow Jones Industrial Average declined (after interim ups and downs) from a high of 11,723 on January 14, 2000 to 7,850 on October 11, 2002, or 33%. (Def. St. ¶ 51) The price of HII stock declined approximately 59.41% between its Class Period high on July 18, 2001 and the end of the Class Period on October 11, 2002. (Def. St. ¶¶ 52 - 53) During the same period, the stock price for companies classified as "consumer finance companies" in Standard & Poor's Supercomposite 1500 Index fell by 53.17% on average. (Def. St. ¶ 54) Competitors of HII that experienced significant stock price declines during that period included Americredit (down 88.23%), Providian (down 92.55%), and Capital One (down 53.18%). (Def. St. ¶¶ 54.1 - 54.4)

On April 9, 2002, when the Amended Complaint alleges "that defendants finally revealed the impact of 'reaging'" (AC ¶ 127) — thus allegedly exposing one aspect of Household's claimed fraud — the price of HII stock *increased* by 19 cents; it increased an additional 10 cents on the following day. (Def. St. ¶¶ 55 - 55.2) On August 13, 2002, the day before HII announced its accounting-related restatement — thus allegedly exposing another aspect of Household's claimed fraud — the price of HII stock closed at $37.80. (Def. St. ¶¶ 56 - 56.1) On August 14, 2002, the day the restatement was announced, the price of HII stock *increased to* $38.09. (Def. St. ¶ 56.1) The next day, the closing price increased again to $39.60. (Def. St. ¶ 56.2)

The price of HII stock also increased upon the supposed revelation of Household's alleged "massive predatory lending scheme" that, according to the Amended Complaint, was exposed on October 11, 2002. (AC ¶ 23) On October 10, 2002, the *American Banker* reported that HII's stock price had "surged more than 25% on market talk that it could reach an agreement as soon as Friday [October 11] that would settle investigations by state attorneys gen-

eral into its subprime consumer lending business." (Def. St. ¶ 57.1) The price increase on October 10, 2002 was $5.30, the largest single-day movement in the price of HII stock during the Class Period. (Def. St. ¶ 57.2) On October 11, 2002, when the agreement with state attorneys general was formally announced, the price of HII stock increased by an additional $1.90. (Def. St. ¶ 57.3)

C. Lead Plaintiffs' Admissions Regarding the Lack of Artificial Inflation Arising from Alleged Class Period Fraud

Lead Plaintiffs allege that Household made numerous affirmative misrepresentations that had the effect of artificially inflating the price of HII stock during the Class Period. (AC ¶ 349) In response to Defendants' Interrogatories Nos. 41-43 seeking details of the alleged affirmative misrepresentations, Lead Plaintiffs provided a list of 83 statements, all but four of which were made during the Class Period. (Def. St. ¶¶ 21 - 27) In response to several interrogatories that sought an explanation of Plaintiffs' loss causation theory, Lead Plaintiffs served answers that "incorporate by reference and identify the Report of Daniel R. Fischel . . . and all documents referenced therein." ("Fischel Report") (Def. St. ¶¶ 29, 31, 33, 35, 37) In the referenced Report, Professor Fischel (and therefore Lead Plaintiffs, through their sworn adoption of his Report) admitted that no artificial inflation entered HII's stock price on any of the Class Period days on which Lead Plaintiffs allege that the affirmative representations were made. (Def. St. ¶ 38)

Moreover, the Fischel Report *assumed* that any artificial inflation in the price of HII stock was already in place by July 30, 1999, and opined that the level of that inflation did not increase at all before the start of alleged "partial corrective disclosures" more than two years later. (Def. St. ¶¶ 38, 41, 43, 45) Professor Fischel repeated that conclusion in the course of his March 21, 2008 deposition. (Def. St. ¶ 39) ("I didn't find any statistically significant price increases that resulted in inflation from the beginning of the period and through November 15, 2001.").

Lead Plaintiffs also adopted Professor Fischel's February 1, 2008 Rebuttal Report, which confirmed that Professor Fischel was merely *assuming* the existence of "artificial inflation" in the price of HII stock as of July 30, 1999. (Def. St. ¶¶ 29, 31, 33, 35, 37) In the course of his March 21, 2008 deposition, Professor Fischel reiterated that he was *assuming* that an "actionable disclosure defect" had caused artificial inflation, and that the assumption "may or may not be correct." (Def. St. ¶ 45) He repeated that he is "not expressing an opinion on whether there were in fact misrepresentations or omissions." (*Id.*)

In a status report submitted to Magistrate Judge Nolan on February 6, 2008, Lead Plaintiffs admitted that Professor Fischel's event study "was not designed to determine the date on which inflation came into the stock . . . ." (Def. St. ¶ 46) In the same Status Report, Lead Plaintiffs represented that it was their position that "Household's stock price was artificially inflated on July 30, 1999 by Household's failure to disclose material adverse facts in connection with its July 22, 1999 statement announcing its second quarter results. . . . Indeed, Household's stock may have been inflated since the beginning of the old Class period [on October 23, 1997], or even before that time." (Def. St. ¶ 42) Class Counsel repeated that statement in open court during a status conference before Magistrate Judge Nolan on February 7, 2008, when they argued that the origin of the alleged inflation was not relevant. (Def. St. ¶ 47)

Thereafter, Lead Plaintiffs successfully opposed Defendants' demand for information about the existence, origin and inception date of the "artificial inflation" they assume, again arguing that this information is not relevant. (Def. St. ¶ 49)

THE STANDARDS GOVERNING THIS MOTION

Rule 56(c)

Summary judgment is required when the pleadings, depositions, answers to interrogatories, and admissions on file, together with any affidavits, show that there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); *Celotex Corp.* v. *Catrett*, 477 U.S. 317, 322 (1986). "Summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed to secure the just, speedy and inexpensive determination of every action." *Id.* at 327 (citation and internal quotation marks omitted).

As the Court of Appeals has instructed, summary judgment is "the 'put up or shut up' moment in a lawsuit, when a party must show what evidence it has that would convince a trier of fact to accept its version of events." *Schacht* v. *Wisconsin Department of Corrections*, 175 F.3d 497, 504 (7th Cir. 1999). Rule 56(c) mandates the granting of summary judgment against the non-moving party who fails to make a "sufficient showing on an essential element of [its] case with respect to which [it] has the burden of proof." *Celotex*, 477 U.S. at 323. "Thus, there is a 'substantial burden' on the non-moving party to make known those material facts that are in dispute. Furthermore, a district court need not scour the record in search of material facts in dispute when the non-movant fails to make such a showing." *Nanophase Technologies Corp.*, v. *Celox, Ltd.*, No. 02CV4340, 2003 WL 22220186, at *3 (N.D. Ill. Sept. 24, 2003) (Guzman, J.) (citations omitted).

The Class's Burden of Proof

To establish a claim for relief under § 10(b) of the Exchange Act and Rule 10b-5, the Class must prove all of the following elements by a preponderance of admissible evidence:

> "(1) a material misrepresentation (or omission);
>
> (2) scienter, i.e., a wrongful state of mind;
>
> (3) a connection with the purchase or sale of a security;
>
> (4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as 'transaction causation,' see *Basic* [v. *Levinson,* 485 U.S. 224 (1988)] (non-conclusively presuming that the price of a publicly traded share reflects a material misrepresentation and that plaintiffs have relied upon that misrepresentation as long as they would not have bought the share in its absence);
>
> (5) economic loss; and
>
> (6) 'loss causation,' i.e., a causal connection between the material misrepresentation and the loss."

Dura, 544 U.S. at 341-42 (citations and emphasis omitted). Any tie goes to Defendants. *Tellabs*, 127 S. Ct. at 2514 (Scalia, J., concurring). This motion addresses the Class's failure and inability to satisfy the essential element of loss causation, without which its claims fail as a matter of law.

ARGUMENT

During the pendency of this action, the Supreme Court and Court of Appeals have given considerable attention to the standards for establishing a securities fraud claim under the Private Securities Litigation Reform Act ("PSLRA"). *See*, *e.g*., *Dura*, 544 U.S. at 342-45 (articulating the requirements for establishing loss causation); *Ray*, 482 F.3d at 996 (holding that summary judgment for defendant is "inevitable" where the alleged corrective disclosure occurred after the value of the subject stock had already declined); *Tricontinental*, 475 F.3d at 842 (emphasizing that a § 10(b) plaintiff must prove a direct connection between an alleged fraudulent statement and its alleged losses).

Collectively these cases demonstrate the courts' resolve to apply the PSLRA as Congress intended — "[a]s a check against abusive litigation by private parties." *See*, *e.g*., *Tellabs*, 127 S. Ct. at 2504 ("Private securities fraud actions, however, if not adequately con-

tained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law."). *See also Dura*, 544 U.S. at 345:

> "The securities statutes seek to maintain public confidence in the marketplace. They do so by deterring fraud, in part, through the availability of private securities fraud actions. But the statutes make these latter actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause."

(internal citations omitted).

With guidance from these controlling authorities, this motion addresses the fatal deficiencies in the Class's showing on the essential element of loss causation. Point I demonstrates the insufficiency of the Class's original loss causation theory, based on (i) Lead Plaintiffs' admission that the Class Period misrepresentations they allege introduced no artificial inflation into the price of HII stock; (ii) indisputable evidence that the price of HII stock had already declined (consistent with the overall trend in lending industry performance), before the alleged revelation of the claimed fraud, and (iii) indisputable evidence that the price of HII stock increased following each revelation alleged in the Amended Complaint. Point II examines the legal insufficiency of the Class's fall-back theory that the decline in HII's stock price in the last year of the Class Period was due to the dissipation of pre-Class Period "artificial inflation." Besides being time-barred, this approach is precluded by Lead Plaintiffs' refusal to identify the source of the assumed pre-Class Period inflation or otherwise prove that it even existed.

Defendants' right to judgment as a matter of law on each of these independently sufficient grounds makes it unnecessary for the Court to examine other deficiencies in the Class's claims, and renders immaterial any alleged factual disputes on other aspects of those claims.

I. THE CLASS HAS FAILED TO PROVE LOSS CAUSATION

A. A Showing of Loss Causation Requires Proof of Both Artificial Inflation Caused by the Alleged Fraud *And* a Significant Price Decline upon Disclosure of the Fraud

The cornerstone of any securities fraud claim is proof that a misleading statement artificially inflated the subject company's stock price and caused shareholders to lose their investment when the fraud was revealed. *See* 15 U.S.C. § 78u-4(b)(4); *Dura*, 544 U.S. 336.

In *Dura*, the Supreme Court ruled that a plaintiff could not satisfy the loss causation requirement of § 10(b) "simply by alleging in the complaint and subsequently establishing

that 'the price' of the security '*on the date of the purchase* was inflated because of the misrepresentation.' " *Id.* at 338 (emphasis in original; citation omitted). The Court explained that "[n]ormally, in cases such as this one (*i.e.*, fraud-on-the-market cases), an inflated purchase price will not itself constitute or proximately cause the relevant economic loss" because investment losses are typically caused by factors other than fraud, including "changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions or other events, which taken separately or together account for some or all of that lower price." 544 U.S. at 342-43. Moreover, said the Court,

> " . . . allowing a plaintiff to forego giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the statutes seek to avoid. Cf. *H.R. Conf. Rep. No. 104-369, p. 31* (1995), U.S. Code Cong. & Admin. News 1995, pp. 679, 730 (criticizing 'abusive' practices including 'the routine filing of lawsuits . . . with only [a] faint hope that the discovery process might lead eventually to some plausible cause of action'). It would permit a plaintiff 'with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the [discovery] process will reveal relevant evidence.' *Blue Chip Stamps, 421 U.S. at 741, 44. L. Ed. 2d 539, 95 S. Ct. 1917.* Such a rule would tend to transform a private securities action into a partial downside insurance policy. See *H.R. Conf. Rep. No. 104-369*, at 31, U.S. Code Cong. & Admin. News 1995, pp. 679, 730; see also *Basic, supra, 485 U.S. at 252, 99 L. Ed. 2d 194, 108 S. Ct. 978* (White, J., joined by O'Connor, J., concurring in part and dissenting in part)."

544 U.S. at 347-48.

In keeping with the Supreme Court's guidance in *Dura,* courts in this Circuit require proponents of "fraud-on-the-market" claims to allege and prove "*both* that the 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." *Ray*, 482 F.3d at 995 (emphasis added) (affirming summary judgment for the defendant where the company's competitors suffered similar losses and the alleged corrective disclosure was made after the stock price had already collapsed); *Tricontinental Industries*, 475 F.3d at 843 (affirming dismissal of securities fraud claims due to the plaintiff's failure to show causative link between allegedly fraudulent statement and the claimed loss); *In re Northfield Laboratories, Inc. Securities*, 527 F. Supp. 2d 769, 789 (N.D. Ill. 2007) (Marovich, J.) ("[T]he 'fraud on the market' approach, requires plaintiffs to allege 'both that the 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.' ") (citation omitted).

B. Lead Plaintiffs Admit That None of the Dozens of Alleged Misstatements They Attribute to Household During the Class Period Inflated the Price of HII stock

The Amended Complaint lists virtually every one of the public SEC filings made by HII during the Class Period and alleges that every one was false and caused them to pay too much for HII securities. (*See* AC ¶¶ 192-341) Presumably Lead Plaintiffs acted with the "hope that the discovery process might lead eventually to some plausible cause of action." *Dura*, 544 U.S. at 347. Plainly it did not.

In the final weeks of a massive, multi-year discovery program, when Lead Plaintiffs were finally called upon to identify "each statement that Plaintiffs contend was an affirmative misrepresentation" with respect to each of their three theories of fraud, they adopted by reference the allegations in their pleading and listed 83 specific "affirmative representations," all but four of which were made during the Class Period. (Def. St. ¶¶ 21 - 27) When asked to explain their loss causation theory, Plaintiffs adopted by reference "the Expert Report of Daniel R. Fischel . . . and all documents referred to therein." (Def. St. ¶¶ 28 - 37) In that Report, Professor Fischel admitted on the basis of an "event study" he had conducted that none of the dozens of Class Period "misrepresentations" alleged by Lead Plaintiffs introduced any inflation in the price of HII stock. (Def. St. ¶ 38) As Professor Fischel repeated at his deposition, "I didn't find any statistically significant price increase that resulted in inflation from the beginning of the [Class] period and through November 15, 2001" (Def. St. ¶ 39), the date on which he says the assumed "artificial inflation" started to dissipate. (Def. St. ¶ 38)

Under *Dura* and *Ray*, the Class cannot prevail on its securities fraud claims because Lead Plaintiffs admittedly cannot prove that any artificial inflation was introduced in the price of HII stock by reason of the Class Period misrepresentations they allege. As a matter of law, the fact that no new inflation arose during the Class Period precludes the required finding of a causal connection between the alleged misrepresentations and the Class's alleged loss.

C. The Corrective Disclosures Alleged in the Amended Complaint Were Followed by Increases in HII's Stock Price

With respect to its theory of reaging-related fraud, the Amended Complaint alleges that "it was not until an analyst presentation on 4/9/02 that [D]efendants finally revealed the impact of 'reaging'" (AC ¶ 127) The Amended Complaint also alleges that HII's August 14, 2002 restatement revealed purported accounting fraud going back to 1994. (AC ¶ 25) As for the Class's primary theory that Defendants had concealed a "massive predatory lending scheme," the Amended Complaint asserts that "[i]t was only at the end of the Class Period, on 10/11/02, when

defendants announced that the Company would pay $484 million to settle predatory lending charges, that investors learned Household had been conducting its nationwide operations in direct violation of federal and state lending laws." (AC ¶ 23) Factual distortions aside,[10] these allegations expose another fatal defect in Lead Plaintiffs' loss causation theory. Under *Dura* and *Ray*, the Class is required to prove, *inter alia*, that "the value of [HII] stock declined once the market learned of the deception." *Ray*, 482 F.3d at 995. But it is incontrovertible that the price of HII stock *increased* following each of these alleged corrective disclosures. (*See* Def. St. ¶¶ 55 - 57.3 for table of prices of HII stock during the Class Period.)

Indeed, on October 10, 2002, when news of the impending settlement with attorneys general first broke, HII's closing price "surged" by 25% — the largest single-day change during the Class Period — and on the following day, when the agreement was confirmed, the stock price increased again. (Def. St. ¶¶ 57.1 - 57.3) The Class's own expert admitted that the positive market reaction to this alleged "corrective disclosure" is in conflict with Lead Plaintiffs' theory of fraud. Fischel Report, footnote 21 ("One would expect that [such news] would have caused the Company's price to decline significantly.") (Def. St. ¶ 58)

As a matter of law, the fact of market increases on the very days Lead Plaintiffs allege that a "massive" fraud was revealed *precludes* the necessary finding "that the value of the stock declined once the market learned of the deception." *Ray*, 482 F.3d at 995. *See also, e.g.*, *Nathenson* v. *Zonagen Inc.*, 267 F.3d 400, 418 (5th Cir. 2001) (affirming summary judgment for the defendants because the price of the subject stock increased following the alleged corrective disclosure); *Oran* v. *Stafford*, 226 F.3d 275, 283 (3d Cir. 2000) (alleged fraud was immaterial because its disclosure had no appreciable negative effect, but was in fact followed by an increase in the company's stock price); *In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.) (lack of "appreciable effect on the market price of [defendant's] common stock" when alleged deception was revealed rendered deceptive statements immaterial) (internal quotation marks omitted); *In re Buca Inc. Securities Litigation*, No. 05-1762, 2006 U.S. Dist. LEXIS 75224, at *27 (D. Minn. Oct. 16, 2006) (dismissing complaint because

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10 For example, the only valid aspect of the allegations in paragraph 23 is that HII made an announcement of a certain agreement with state attorneys general on October 11, 2002. Contrary to Plaintiffs' rhetoric, no "predatory lending" charges had been filed by any of the attorneys general, and there was no admission or finding that HII or its subsidiaries had violated any state or federal law.

increase in stock price following alleged partial disclosure of fraud precluded finding of loss causation).

D. The Corrective Disclosures Alleged in the Amended Complaint Did Not Cause the Earlier Downturn in HII's Stock Price

By October 11, 2002, the date on which the Amended Complaint states that investors first learned that "Household had been conducting its nationwide operations in direct violation of federal and state lending laws" (AC § 23), the downturn in the price of HII stock had already taken place, consistent with the Class Period decline of the Dow Jones Industrial Average (Def. St. ¶ 51) and the Standard & Poors Supercomposite 1500 Consumer Finance Index. (Def. St. ¶ 54) Indeed, HII's stock price decline was milder than market losses experienced by other consumer finance companies during the same period. (Def. St. ¶¶ 54.1 - 54.4) This is precisely the fact pattern that rendered summary judgment for the defendants "inevitable" in *Ray*, 482 F.3d at 996. As the Court of Appeals recognized in a passage of particular relevance here,

> "The rub was this: throughout the time period at issue — 2000 to 2002 — the stock market as a whole was declining. Publicly available information tells us that the Dow Jones Industrial Average stood at 11,723 on January 14, 2000, which at the time was an all-time high; by December 31, 2002, after interim ups and downs, it was 8,341. See chart of the Dow Jones Industrial Average since 1974, at http://www.the-privateer.com/chart/dow-long.html."

Id. at 993. The *Ray* Court noted that the price of the subject stock had declined substantially during the relevant period (from a high of $80 to $2.00 per share) and, as here, the stock of the company's competitors "suffered the same fate." *Id.* And as here, the substantial downturn in the company's stock price had already occurred by the time the *Ray* plaintiffs alleged they learned of the asserted fraud. *Id.* at 995.

As a matter of law the fact pattern presented here defeats a finding of loss causation under *Dura*, which "attempts to distinguish cases where the misrepresentation was responsible for the drop in the share's value from those in which market forces are to blame." *Id.* at 995; *see also Bastian* v. *Petren Resources Corp.*, 892 F.2d 680, 684-85 (7th Cir. 1990) ("If the plaintiffs would have lost their investment regardless of the fraud, any award of damages to them would be a windfall."). The same analysis requires summary judgment in Defendants' favor here.

II. LEAD PLAINTIFFS' ATTEMPTED CIRCUMVENTION OF *DURA* IS UNAVAILING

Dura, *Ray*, and *Tricontinental* were decided by the Supreme Court or Court of Appeals after this lawsuit began, and destroyed Lead Plaintiffs' hope of connecting their stock market losses to an alleged fraudulent scheme. The fact that the Class's own expert was unable to attribute any artificial inflation to alleged Class Period misrepresentations is a sufficient basis, without more, to dismiss all of the Class's securities fraud claims. *Dura* and the express terms of the PSLRA require no less.

In an effort to salvage their claims in the wake of these developments, Lead Plaintiffs now speculate that by means of Class Period "omissions" Household "delayed the dissipation" of artificial inflation they *assume* was present in the price of HII stock when the Class Period began. And because in *Ray* the Court of Appeals held that summary judgment was "inevitable" where the price of the relevant stock had already declined substantially before the alleged "truth" became known, Lead Plaintiffs now assert that the alleged fraud came to light gradually (and despite what they allege were Household's continued efforts at concealment) over the course of the full year leading up to October 2002. This hindsight-constructed approach purports now to capture most of the general market decline otherwise precluded by governing caselaw. Passing for now the impermissible cherry-picking of the generic "partial disclosures" selected for this new approach, this Memorandum focuses on four other fatal flaws in the Class's fall-back position: (i) its dependence on time-barred sources of alleged artificial inflation, in direct conflict with the law of the case as reflected in the Repose Bar Order; (ii) the legal insufficiency of treating "misrepresentations" that caused no harm as omissions that supposedly did; (iii) the Class's failure to prove, rather than merely assume, that pre-Class Period artificial inflation existed at all; and (iv) the erroneous proposition that truth can be simultaneously disclosed and concealed, a fiction that has been rejected in other post-*Dura* cases pursued by counsel for this Class.

A. The Class's Revamped Loss Causation Theory is Barred by the Statute of Repose

1. It is the law of the case that losses arising from alleged misrepresentations or omissions prior to July 30, 1999 are time barred

This Court recognized in its February 28, 2006 Repose Bar Order that the applicable statute of repose is an absolute bar to claims based on misrepresentations or omissions that occurred before July 30, 1999. Once the three-year statute of repose period has expired, any action based on alleged misrepresentations or omissions made prior to that time is forever time

barred. *Id. See also Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 364 (1991) ("As there is no dispute that [plaintiffs' complaint] was filed more than three years after [the] alleged misrepresentations, [plaintiffs'] claims were untimely."); *Beard* v. *J.I. Case Co.*, 823 F.2d 1095, 1097 n.1 (7th Cir. 1987) ("[A] period of repose bars a suit a fixed number of years after an action by the defendant . . . even if this period ends before the plaintiff suffers any injury."); *Wafra Leasing Corp.* v. *Prime Capital Corp.*, 192 F. Supp. 2d 852, 864 (N.D. Ill. 2002) (Bucklo, J.) ("The 'violation' for the purposes of the Rule 10b-5 statute of repose occurs when the defendant makes a misrepresentation in connection with the sale or purchase of securities."); *Antell* v. *Arthur Andersen LLP*, No. 97 C 3456, 1998 WL 245878, at *5 (N.D. Ill. May 4, 1998) (Andersen, J.) ("[T]he repose period is triggered by the alleged misrepresentation. . . .").

2. The Class has unambiguously staked its claims on alleged inflation caused by time-barred events

In response to Defendants' interrogatories seeking an explanation of the Class's loss causation theory under *Dura*, Lead Plaintiffs expressly adopted Professor Fischel's expert Report as their sworn answer. (Def. St. ¶¶ 28 - 37) The Fischel Report (which *assumes* allegations of fraud to be true) embodies Lead Plaintiffs' *assumption* that by July 30, 1999, HII's stock price was already "artificially inflated" in the amount $7.97 per share over and above the true value of the stock on that day. (*See* Def. St. ¶¶ 40 - 46)[11] Professor Fischel's Report reflects his corollary conclusion that none of the dozens of alleged "affirmative misrepresentations" caused any additional inflation between July 30, 1999 and November 15, 2001, when Lead Plaintiffs now say the "truth" of Household's alleged fraud began to appear on the market. (Def. St. ¶¶ 38 - 39) Although Lead Plaintiffs have deliberately elected not to prove when or how (and therefore whether) the pre-Class Period "artificial inflation" arose (Def. St. ¶ 46), they represented to the Court that it was in place at least as early as July 22, 1999, and may have started as early as October 1997, if not earlier. (Def. St. ¶ 42)[12] The time to seek relief for any harm arising from

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[11] Professor Fischel's so-called "leakage" analysis similarly assumes that pre-Class Period inflation existed as of July 30, 1999, albeit at an even higher level. (Def. St. ¶ 41, Def. App., Tab 11, Exh. 56)

[12] In a Minute Entry issued on February 29, 2008, Magistrate Judge Nolan acknowledged the Class's admission in the following passage:

". . . Plaintiffs initially identified numerous alleged misstatements made between October 23, 1997 and July 29, 1999, that are no longer actionable. (See, e.g., Doc. 50, at 70-87.) Defendants are free to utilize those statements as evidence that some or all of the inflation

Footnote continued on next page.

such inflation-causing event(s) has long since expired. *See* Bar Repose Order (Doc. 434) and cases cited therein.

B. Lead Plaintiffs Cannot Avoid the Statute of Repose by Strategically Relabeling Alleged Class Period Misstatements as "Omissions"

As noted, Lead Plaintiffs and their expert attribute no new artificial inflation to the affirmative misrepresentations Household allegedly made during the Class Period — thus excluding any and all such statements as predicates for relief, even if the Class could satisfy every other element of its claims. *See Dura*, 544 U.S. at 346 (a plaintiff must "prove that the defendant's misrepresentation (or other fraudulent conduct) proximately caused the plaintiff's economic loss"); *Ray*, 482 F.3d at 995 (to show a recoverable loss in a fraud-on-the-marketplace claim, plaintiffs must demonstrate, *inter alia*, "that the defendants' alleged misrepresentations artificially inflated the price of the stock"). Lead Plaintiffs' "solution" to the fatal impact of these rulings is to argue that Household's Class Period "fraud" consisted of failing to admit, every time it made any affirmative statement, that the statement was false. Each supposed "omission" during the Class Period was allegedly an "inflationary event" (notwithstanding the admitted lack of new inflation) because the assumed pre-Class Period inflation supposedly would have dissipated sooner had Household admitted that *all* of its statements were false (albeit for exactly the same alleged reasons that prevailed during the period of repose). This erroneous theory, which is utterly incapable of proof, fails for each of the independent reasons discussed below.

1. Lead Plaintiffs' attempt to recharacterize their allegations is legally untenable

Household's Interrogatories No. 41-43 called upon Lead Plaintiffs to specify the bases of their claim that Household had affirmatively deceived investors. Each of them followed the same pattern:

> "If Plaintiffs contend that Defendants made affirmative misrepresentations regarding Household's 'alleged Fraudulent Scheme' involving ['predatory lending,' re-aging or accounting, as the case may be], identify each statement that Plaintiffs

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Footnote continued from previous page.

> Plaintiffs attribute to the July 22 and/or August 16, 1999 statements actually entered the stock price as far back as October 23, 1997."

(Minute Entry dated February 27, 2008, Doc. 1189 at 2)

> contend was an affirmative misrepresentation and the reasons Plaintiffs contend each statement was false."

(Def. St. ¶¶ 21, 23, 25) In response to these interrogatories, Lead Plaintiffs adopted by reference their listing of alleged "false and misleading statements" in the Amended Complaint and in addition listed 83 statements they alleged to be "affirmative misrepresentations made by the Company or the Individual Defendants." (Def. St. ¶¶ 22, 24, 26) Now that their expert has admitted that none of these "affirmative misrepresentations" introduced artificial inflation, Lead Plaintiffs seek to redefine all of the identified statements as "omissions." This strategic wordplay cannot dispel the dispositive consequences of their expert's admission, which Lead Plaintiffs have adopted in full. (*See* Def. St. ¶¶ 28 - 37)

Besides contradicting their sworn interrogatory answers, Lead Plaintiffs' revised argument has no legal support. In numerous cases that explore the "omissions-misrepresentations dichotomy," courts routinely reject "strained attempt[s] to recharacterize the alleged wrongdoing" for strategic reasons.[13] *E.g., Joseph* v. *Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000) (allegations that the defendant had "omitted to disclose that its financial statements had been falsified" and "concealed the existence of the unlawful scheme" pleaded misrepresentations, despite the plaintiff's "valiant struggle" to couch them as omissions). In the words of the court:

> "Any fraudulent scheme requires some degree of concealment, both of the truth and of the scheme itself. We cannot allow this mere fact of concealment to transform the alleged malfeasance into an omission rather than an affirmative act."

Id. at 1163. *Accord Johnston* v. *HBO Film Management, Inc.*, 265 F.3d 178, 193 (3d Cir. 2001) ("This claim should not be transformed into an omission simply because the defendants failed to disclose that the allegedly misleading fact was untrue. Under an approach of that nature nearly any misrepresentation could become an omission. . . ."); *Lewis* v. *Straka*, No. 05-C-1008, 2006 WL 2927658, at *8 (E.D. Wis. Oct. 12, 2006) (a complaint reciting (i) alleged distortions of truth as to a company's financial health and (ii) false assurances about the adequacy of lending procedures pleaded misrepresentations, not omissions); *In re Northern Telecom Ltd. Securities Litigation*, 116 F. Supp. 2d 446, 458 (S.D.N.Y. 2000) ("[U]nder plaintiff's theory, any misrepre-

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[13] This issue commonly arises in cases where plaintiffs seek to attribute alleged fraud to omissions in order to take advantage of the Supreme Court's ruling in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), allowing a trier of fact to presume reliance in the context of a § 10(b) claim that is based on a failure to disclose material information.

sentation could be recharacterized as an omission in order to prove causation, a strategy which would eliminate the requirement that a misrepresentation inflate stock price.").

2. A misrepresentation that is not actionable because it causes no market impact cannot be revived by merely renaming it an omission

The Class's new theory depends on the erroneous assumption that renaming the alleged affirmative misrepresentations somehow absolves it from having to prove the required inflationary effect on HII's stock price. In *Northern Telecom*, the court granted summary judgment for the defendant because "[r]egardless of whether the statements are characterized as 'maintaining' or 'inflating' [the defendant's] stock price, there is no evidence that the statements had any effect whatsoever on the stock price. Defendant's own expert testified that there was no such effect." 116 F. Supp. 2d at 460. The same is true here, except that in this case, it was *Plaintiffs'* expert who admitted that "none of the challenged statements had any effect on [defendants'] stock price." *Id.* (*See* Def. St. ¶¶ 38 - 39) Merely *saying* that the stock price would have been lower but for the alleged "omission" does not suffice. 116 F. Supp. 2d at 461 ("It would be an odd rule to allow greater leeway to an expert's speculative and hypothetical analysis about what would have happened to a company's stock price if certain information had been disclosed than to an expert's analysis about what in fact happened to a company's stock price when certain representations were actually made."). *Cf. In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Securities Litigation*, No. 03 Civ. 2467, 2008 WL 512779, at *7 (S.D.N.Y. Feb. 26, 2008) (rejecting "maintenance theory" as a legally insufficient predicate for finding a common question under Rule 23 because there is no way to test plaintiff's speculation that challenged statements "stave[d] off a decline in price").

Indeed, because the admitted lack of new inflation during the Class Period is at least equally consistent with an absence of fraud, a jury could not possibly find for the Class on this record by a preponderance of the evidence. *See Tellabs*, 127 S. Ct. at 2514 (Scalia, J. concurring) (noting the "ordinary rule" in civil litigation that "a tie goes to the defendant").

Lead Plaintiffs' speculation also ignores the efficient market theory on which the Class's "fraud-on-the-market" case depends. In an efficient market, a company's stock price reflects investors' expectations of future cash flows from owning the stock. The stock price remains unaffected if investors receive old or "stale" information as that information would already have been reflected in the stock price when it was news. *See generally Basic Inc.* v. *Levinson*, 485 U.S. 224, 246 & n.24 (1988) ("[T]he market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations.")

(citing Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 Bus. Law. 1, 4 n.9 (1982)). Had any new fraud transpired during the period after July 30, 1999 that was material to and relied upon by the market, the underlying misrepresentations or omissions would necessarily have caused artificial inflation over and above the allegedly pre-existing level. *See Basic*, 485 U.S. at 246; *Ravens* v. *Iftikar*, 174 F.R.D. 651, 668 (N.D. Cal. 1997) ("Because of *Basic*'s assumption of an efficient market, the artificial inflation in a security's price must be assumed to be zero at the start of the class period as well as at its end."). Here, Professor Fischel has identified no new inflation attributable to Class Period events. (Def. St. ¶¶ 38 - 39)

C. Lead Plaintiffs' Argument, If Accepted, Would Nullify the Statute of Repose

This Court has already ruled in the Repose Bar Order that harm arising from any misstatements or omissions before July 30, 1999 cannot be a predicate for relief. It follows that a showing of alleged dissipation of "artificial inflation" introduced during the period of repose cannot satisfy the Class's burden to prove that actionable Class Period fraud was the proximate cause of its alleged loss. Any other conclusion would gut the statute of repose and the law of the case by reviving stale misrepresentation claims merely by recasting them as new omissions claims. By Lead Plaintiffs' logic, a company that allegedly failed to cure misstatements that inflated the price of its stock at any time in the past would remain liable indefinitely, with no proof of new inflation, so long as it failed to correct a time-barred misstatement. This is not the law.

The 1934 Act statute of repose imposes an absolute bar to suit three years after a defendant violates the Act.[14] *See Lampf*, 501 U.S. at 363 ("the purpose of the 3-year [statute of repose] is clearly to serve as a cutoff . . . ."); *Law* v. *Medco Research, Inc.*, 113 F.3d 781, 786 (7th Cir. 1997) ("the three-year statute of repose gives defendants a definite limit beyond which they needn't fear being sued"); *Short* v. *Belleville Shoe Manufacturing Co.*, 908 F.2d 1385, 1391 (7th Cir. 1990) ("Unless the 'in no event more than three years' language cuts off claims of tolling and estoppel at three years . . . it serves no purpose. . . ."). Accordingly, courts reject the concept of a "continuing wrong" that Lead Plaintiffs espouse here. *See, e.g.*, *In re Ditech Net-*

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14 Unlike a statute of limitations, the 1934 Act statute of repose is substantive rather than procedural — it extinguishes a plaintiff's right to bring suit under the 1934 Act after the three year period ends. *See P. Stolz Family Partnership L.P.* v. *Daum*, 355 F.3d 92, 103 (2d Cir. 2004) (explaining that a statute of repose "does not bar a cause of action, its effect, rather, is to prevent what might otherwise be a cause of action, from ever arising . . . .").

works, Inc. Derivative Litigation, No. C 06-5157, 2007 WL 2070300, at *8 (N.D. Cal. July 16, 2007) ("[T]he Court is highly skeptical of a continuing wrong theory that would allow the revival of a time-barred claim under Section 10(b) upon the issuance of a further financial statement that failed to correct the prior false statement.") (footnote omitted); *Pro Bono Investments, Inc.* v. *Gerry*, No. 03 Civ. 4347, 2005 U.S. Dist. LEXIS 22348, at *29 (S.D.N.Y. Sept. 30, 2005) (continuing wrong doctrine is "inapplicable" to securities fraud litigation); *In re Enron Corp. Securities, Derivative and ERISA Litigation*, 310 F. Supp. 2d 819, 845-49 (S.D. Tex. 2004) (the statute of repose is not subject to the "continuing violation" doctrine); *see also Green* v. *Asset Fund Management, L.P.*, 19 F. Supp. 2d 227, 233 (D.N.J. 1998) ("[T]he allegation that defendants committed a continuing violation . . . by failing to correct prior misleading statements in subsequent reports is unavailing" in Investment Company Act suit.).

D. The Class Has Not Proved That Pre-Class Period Artificial Inflation Ever Existed

Even if a theory of "delayed dissipation" of repose period inflation did not founder on statute of repose grounds, it would not be available to the Class in this action because Lead Plaintiffs and their expert admit that they merely *assumed* the existence of such inflation (Def. St. ¶¶ 41, 45), and Lead Plaintiffs successfully resisted disclosing any facts about the origin and source of the assumed inflation. (Def. St. ¶¶ 48 - 50) Apparently to avoid an overt admission that their lawsuit is based on time-barred statements or omissions, Lead Plaintiffs made the strategic decision not to seek to prove when and how (and therefore whether) the alleged artificial inflation began. (Def. St. ¶¶ 42, 44, 47) Consequently, the Class can present no facts from which a jury could conclude that HII's stock price was artificially inflated as a result of fraud either before or during the Class Period. Professor Fischel offers the Class no support on this subject because he was merely asked to *assume* that HII's stock price was already inflated on the first day of the Class Period and he has emphasized that he takes no position on the validity of that assumption. (Def. St. ¶ 45) Moreover, Lead Plaintiffs have represented that Professor Fischel was not asked to demonstrate when and how any "artificial inflation" began. (Def. St. ¶ 46)

The result Lead Plaintiffs contemplate is absurd. Without satisfying a single one of the required elements of loss causation that the Supreme Court spelled out in *Dura* — indeed, without even providing the basic "who, what, where, when and how" details needed to plead even a simple claim of common law fraud, *see Tricontinental*, 475 F.3d at 840 — Lead Plaintiffs propose asking a jury to *assume* that some unidentified fraud occurred at an unspecified point in time before July 30, 1999, that in some unexplained fashion that fraud introduced an *assumed*

level of "artificial inflation" into the price of HII stock, and that the *assumed* inflation persisted at an identical level for most of the Class Period. On top of these unproven assumptions, Lead Plaintiffs' theory further requires that a series of Class Period statements to which the Class's expert attributes no market impact nevertheless be constructively treated as "inflationary events" based on Lead Plaintiffs' unprovable speculation that the stock price would otherwise have declined sooner. This outlandish proposal cannot possibly be reconciled with the Supreme Court's insistence in *Dura* that securities fraud plaintiffs affirmatively establish the connection between an alleged fraud and an adverse market impact that it proximately caused. *See* 544 U.S. at 342. Because merely alleging that a defendant's conduct caused harm is insufficient to plead proximate cause under the PSLRA (*id.*), *a fortiori*, a plaintiff that affirmatively refuses to substantiate the source and existence of the "artificial inflation" on which its claim depends cannot be allowed to proceed.[15]

The Court of Appeals' recent decision in *Tricontinental* demonstrates the impossibility of prevailing on a securities fraud claim that lacks a clear nexus between alleged fraud and resulting harm. The plaintiff in *Tricontinental* alleged that the defendant had made material misrepresentations in a 1997 audit statement, and that the plaintiff had been injured when the price of the audited company's stock declined upon the issuance of 1998 and 1999 audit statements. In an effort to connect the alleged fraud with an apparently unrelated market reaction, the plaintiff argued that the 1997 misrepresentations were part of an "ongoing scheme" that was reinforced by later audit statements. *Tricontinental*, 475 F.3d at 842. In affirming the dismissal of this § 10(b) claim, the Court of Appeals held that the plaintiff's position could not be reconciled with the Supreme Court's emphasis in *Dura* on the requirement of establishing "a causal connection between the alleged material misrepresentation and the loss, not simply that the misrepresentation touches upon a later economic loss." *Id.* at 843 (quoting *Dura*, 544 U.S. at 342, 342) (citations and internal quotation marks omitted).

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14 Having "strategically chosen not to" disclose essential elements of their claim in discovery, Lead Plaintiffs may not attempt to cure their failure of proof by attempting to explain the source of alleged inflation for the first time in response to this motion. *See Kemper/Prime Industrial Partners* v. *Montgomery Watson Americas, Inc.*, 97 C 4278, 2004 U.S. Dist. LEXIS 5543, at *14 (N.D. Ill. Mar. 31, 2004) (Guzman, J.) ("Rule 37(c) provides that '[a] party that without substantial justification fails to disclose information required by Rule 26(a) . . . is not, unless such failure is harmless, permitted to use evidence at a trial, at a hearing, or on motion any witness or information not so disclosed.' ").

The Court specified that the plaintiff's burden was to show that the contested 1997 audit contained a material misrepresentation that caused the plaintiff a loss when *that* material misrepresentation became generally known. Alleging market losses triggered by disclosure of the 1998 and 1999 audits was not sufficient to state a claim for losses arising from the alleged 1997 fraud, notwithstanding the plaintiff's invocation of a supposed interrelated scheme. *Tricontinental*, 475 F.3d at 843. As in *Tricontinental*, the glaring defect in the Class's fall-back theory of loss causation is the lack of any nexus between actionable fraud and the market losses for which the Class seeks damages. Lead Plaintiffs admit that the "affirmative misrepresentations" they attribute to Household during the Class Period did not inflate the price of HII stock. They also admit that the claimed "artificial inflation" (whose alleged dissipation their expert purports to estimate) arose during the period of repose (*i.e.,* no later than July 22, 1999). Notwithstanding their broad rhetoric about a connected "scheme" or "delayed dissipation," Lead Plaintiffs are not able to connect the "artificial inflation" to any alleged Class Period fraud. Indeed, their refusal to specify when and how that pre-Class Period "inflation" began makes it impossible for them even to begin. As the Supreme Court explained in *Dura* and the Court of Appeals reemphasized in *Tricontinental*, alleged misrepresentations that merely "touch upon" a claimed loss are not actionable as securities fraud.

E. Class Counsel's Discredited Argument That Truth Was Simultaneously Disclosed and Concealed Should Not Be Countenanced Here

Lead Plaintiffs are not the first parties to improvise a new loss causation theory in a transparent effort to circumvent *Dura. See, e.g.*, *Redback Networks, Inc. Securities Litigation*, No. C 03-5642, 2007 U.S. Dist. LEXIS 27389, at **14-15 (N.D. Cal. Mar. 30, 2007); *Powell* v. *Idacorp, Inc.*, Nos. CV04-249-S-EJL, 04-322-S-EJL, 2007 WL 1498881, at **3-4 (D. Idaho May 21, 2007). In each of these cases, as here, the plaintiffs (represented by the same law firm in *Redback*, *Powell*, and here) tried to revamp their original position in a futile effort to capture market losses that preceded the corrective disclosure dates they had alleged in their complaints.

In *Powell*, the plaintiffs claimed that the defendant had engaged in risky financial transactions and "improper" contracts, thereby falsely inflating the value of its assets and manipulating earnings. The court dismissed the claims in reliance on *Dura* because the plaintiffs had failed to allege a corrective disclosure that caused the company's stock price to decline. The plaintiffs then amended their complaint to assert that although the alleged fraud was not fully disclosed until the defendants entered into a certain settlement agreement, the element of loss causation was satisfied by " 'partial disclosures' of the 'impact' the Defendants' misconduct had on the company" — an approach virtually identical to the Class's fall-back position here. The

court rejected this argument because, as here, it premised the plaintiffs' alleged losses not on the disclosure of any fraud as such, but rather on the market impact of the supposed misconduct the defendant had failed to disclose. *Id.* at *3. The court said:

> "Even if the scheme was beginning to 'unravel,' the fact that the statements, forecasts, and earnings guidance issued by the Defendants during the Class Period continued to conceal the misconduct, as Plaintiff alleges, makes it impossible for the misconduct to have caused the market's reaction lowering the price because the truth of the misrepresentations was still unknown to the market."

Id. at *4.

In *Redback*, where the price of the defendant's stock had dropped over $100 during the class period, a fraud complaint was dismissed because the corrective disclosure it alleged took place after the stock had already lost most of its value. 2007 U.S. Dist. LEXIS 27389, at **18-19. Based on this sequence, the court concluded that the market loss was necessarily caused by factors other than disclosure of the alleged fraud. In an effort to capture the market decline thus precluded under *Dura*, the plaintiffs amended their complaint to allege "that the 'truth' began to come out in June 2001," when the stock price was still relatively high. In rejecting this ploy, the court pointed out that the plaintiffs' assertion of an earlier corrective disclosure date was contradicted by their original allegations, and depended on the fiction that truth could simultaneously be disclosed and concealed:

> "What is confusing about Plaintiff's allegations is that they simultaneously allege that Defendants *concealed* the true cause of [Defendant's] revenue drop. . . . Plaintiffs cannot have it both ways. . . . [W]hile they allege that the 'truth' began coming out in June 2001, Plaintiffs clearly do not mean the 'truth' about the allegedly improper sales to Qwest and others, because Plaintiffs simultaneously allege that Defendants *concealed* that the true cause of [Defendant's] revenue drop was the loss of Qwest revenues."

Id. at **14-19 (emphasis in original).

Lead Plaintiffs are pursuing that same discredited strategy here. Explicitly relying on the fraud-on-the-market theory (AC ¶ 349), the Amended Complaint states that "[t]hroughout the Class Period, defendants concealed that Household was engaged in a massive predatory lending scheme" (AC ¶ 3), that the fraud continued to be concealed throughout 2002 (AC ¶¶ 19, 20, 83, 84, 86, 87, 88, 89, 90), and that the market did not learn of alleged "nationwide" violations of state and federal laws by Household until the final day of the Class Period, when the Company announced its settlement with several state attorneys general. (AC ¶¶ 6, 23, 87, 97, 101) According to the Amended Complaint:

> "It was only at the end of the Class Period, on 10/11/02, when defendants announced that the Company would pay $484 million to settle predatory lending charges, that investors learned Household had been conducting its nationwide operations in direct violation of federal and state lending laws."

(AC ¶ 23). Plaintiffs' contention interrogatory answers echoed this position and identified disclosures on February 7, April 22, July 16, July 17, July 26, and September 2, 2002 as examples of such ongoing concealment. (Def. St. ¶¶ 59 - 62)

As in *Powell* and *Redback*, allegations of continuing, successful efforts to conceal the alleged fraud cannot be reconciled with Lead Plaintiffs' newly-minted reliance on simultaneous corrective disclosures throughout the final year of the Class Period. This theory fails as a matter of law. *Redback*, 2007 U.S. Dist. LEXIS 27389, at *15; *see In re IKON Office Solutions, Inc. Securities Litigation*, 131 F. Supp. 2d 680, 691 (E.D. Pa. 2001) ("If the . . . misstatements were successfully covered up, they were never disclosed to the market and therefore could not have caused a loss.").

CONCLUSION

As there is no genuine dispute of material fact, and the Class's admissions and other indisputable facts entitle Defendants to summary judgment on all remaining Class claims, Defendants respectfully submit that this motion should be granted in full as to Household, HFC, Aldinger, Schoenholz and Gilmer, and the Class's claims should be dismissed.

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Respectfully submitted,

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