UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

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

DEFENDANTS' MEMORANDUM OF LAW IN OPPOSITION TO PLAINTIFFS' MOTION *IN LIMINE* TO PRECLUDE EVIDENCE RE: DEFENDANTS' TRUTH ON THE MARKET DEFENSE AND DEFENDANTS' STOCK TRADING [*sic*] PURSUANT TO FED. R. CIV. P. 37

(PLAINTIFFS' MOTION *IN LIMINE* NO. 1)

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Defendants Household International, Inc., William F. Aldinger, David A. Schoenholz and Gary Gilmer (collectively "Household" or "Defendants") respectfully submit this Brief in Opposition to Plaintiffs' Memorandum of Law in Support of Plaintiffs' Motion *In Limine* to Preclude Evidence re: Defendants' Truth on the Market Defense [and Defendants' Stock Trading [*sic*]][1] Pursuant to Fed. R. Civ. P. 37.

PRELIMINARY STATEMENT

Plaintiffs' "Motion *In Limine* No. 1" reveals their fraud claims to be ultimately empty and contradicted by reality. Although Plaintiffs assert that their motion is directed at what (only) they call a "truth on the market defense," the real target of the motion is the truth itself. Their instant request to exclude evidence is part and parcel of Plaintiffs' improper effort to prove their case through bogus motions for discovery sanctions rather than actual evidence.

As the Court has recognized, Plaintiffs' basic theory is that it could be securities fraud for a company to say publicly that it was making its money one way, when in fact it was actually making its money another way ("robbing banks" in the colorful example Plaintiffs posited). Of course, Plaintiffs have never alleged (and could not truthfully allege) that the income Household reported was not actually coming in from the loans actually made by the Company.

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[1] From the title of Plaintiffs' motion, it appears that at some point they contemplated an argument seeking to preclude evidence of what they were planning to refer to as Defendants' stock trading [*sic*] — actually, their acquisition and net retention of Household common stock throughout the Class Period. Yet Plaintiffs set out no argument on that topic in their memorandum of law. Plaintiffs therefore cannot address these disclosures in reply. *See Hess* v. *Reg-Ellen Machine Tool Corp.*, 423 F.3d 653, 665 (7th Cir. 2005) (holding that issues raised for first time in reply briefs are waived); *and Holmes* v. *Pierce*, No. 04 C 8311, 2009 WL 57460, at *5 n.3 (N.D. Ill. Jan. 7, 2009) (Guzman, J.) ("It is well settled that issues raised for the first time in a reply brief are deemed waived.") (quoting *Nelson* v. *La Crosse County Dist. Atty.*, 301 F.3d 820, 836 (7th Cir. 2002)). Plaintiffs' vestigial reference to "defendants' failure to produce the stock trading [*sic*] documents" (Pls. Mot. at 4) cannot constitute "notice" of any such argument. No doubt, as part of their standard playbook, Plaintiffs' counsel examined Household officers' Forms 4 and 5 – which, like securitization prospectuses, are filed with the SEC and publicly accessible – prior to filing their complaint in search of evidence that the officer defendants sold their stock before the date the alleged "truth" was revealed. Plaintiffs have apparently chosen not to make such an argument, mindful of the fact that Household's officers actually increased their holdings of Household stock during the latter half of the Class Period.

Instead, Plaintiffs contend that the public was never informed that the money was coming in from what they assert to be improper "predatory lending" and "restructuring" practices at Household. The problem for Plaintiffs in this case (and the real reason behind Plaintiffs' "No. 1" *in limine* motion) is the fact that consumer finance companies are different from most other businesses. Consumer finance companies have to disclose virtually every detail about how the money comes in.

To raise money to help finance its operations, a consumer finance company sells securitized assets to investors. To satisfy the information demands of those investors, every material aspect of the loans being securitized is disclosed in a prospectus. The details disclosed include, *inter alia*: (1) the kinds of customers the company has and indications of their creditworthiness, (2) the loan terms of the underlying loans themselves and the nature of the collateral, and (3) the collections and servicing policies followed by the company in dealing with payments made on the loans. To satisfy SEC requirements, every one of those prospectuses is publicly filed. Throughout the Class Period, Household repeatedly filed these documents pursuant to the 1933 Act as Form 424 SEC filings. (***E.g.***, Declaration of Thomas J. Kavaler in Opposition to Plaintiffs' Motions In Limine Nos. 1, 3-10 ("Kavaler Decl.") Exs. 30, 31).

The precise information Plaintiffs now say Household fraudulently concealed was publicly laid out in exhaustive detail in these public documents. The longer-term prepayment penalties, the side loans, and the high loan-to-value ratio loans that Plaintiffs and their "expert" Ms. Ghiglieri claim to be undisclosed "predatory lending" were disclosed. The interest rates and points they deem to be too high and therefore "predatory" were disclosed. The restructuring policies that the Company used to facilitate collections were disclosed. In short, the very existence of these prospectuses is fatal to Plaintiffs' claims, and it is not in the least surprising that Plaintiffs wish to "preclude" this proof.

Plaintiffs' motion to exclude these facts is nothing less than an attempt to distort the facts to be presented to the jury into an alternate reality in which they can falsely claim that investors were defrauded by the concealment of facts that were actually disclosed. Plaintiffs'

lame (but revealing) justification for the requested exclusion asserts that "plaintiffs devoted their discovery efforts, including document requests, interrogatories, and depositions, to other issues." Pl. Br. at 4. In a fraud case, what more important issue could there be than the public disclosure of the allegedly concealed facts? As the old adage goes, "there are none so blind as those that will not see."[2]

The exclusion Plaintiffs seek is improper for at least three reasons: (i) because the securitization prospectuses were publicly filed and equally available to both parties at all times from a variety of sources, including the SEC's free public database at www.sec.gov, and Plaintiffs themselves indicated their awareness of the prospectuses during fact discovery; (ii) because Defendants objected to each pertinent document request to the extent it purported to require production of copies of publicly available documents, and Plaintiffs never moved to compel production of documents within the scope of that objection; and (iii) most fundamentally, because plaintiffs relying on a "fraud on the market" presumption of reliance cannot be heard to argue, as Plaintiffs do here, that they were "surprised" by information that Household publicly filed with the SEC, which was well-known to the market, and thus a factor in the setting of Household's stock price during the relevant time. Plaintiffs' Motion *In Limine* No. 1 should therefore be denied in its entirety.

STATEMENT OF FACTS

Throughout the Class Period Household securitized receivables from certain loan portfolios. In conjunction with these debt securitizations, the company filed detailed securitization prospectuses with the SEC describing how the company managed these portfolios. Securitization prospectuses differ from the numerous other yearly and quarterly statements Household filed (*e.g.*, filings on Forms 10-K and 10-Q) because they offer significantly more detailed information and are tailored to the operational policies that relate to their respective loan portfo-

[2] JONATHAN SWIFT, POLITE CONVERSATION 191 (1738).

lios. Relying on the advice of multiple external auditors, Household incorporated detailed information regarding these policies into its securitization prospectuses. These prospectuses were and are always freely available through the publicly-accessible online database maintained by the SEC and through a variety of other sources.

Among the disclosures Household made in securitization prospectuses, many relate to the specifics of the loans in the portfolio, including matters such as the interest rates on those loans, the loan-to-value ratios of the loans, and the applicability of pre-payment penalties to the loans. Household's securitization prospectuses also disclosed extensive information regarding Household's loan restructuring program, which was designed to allow customers to avoid foreclosure by applying policies that in certain circumstances moved delinquent payments to the end of a customer's loan period rather than simply foreclosing and charging off the account. Household's securitization prospectuses also disclosed extensive information regarding the criteria for loan restructuring, which varied occasionally over time and by portfolio. Nonetheless, and notwithstanding Rule 11(b)(3)'s admonition that the "factual contentions [of the Complaint must] have evidentiary support," Plaintiffs filed a complaint alleging that Household failed to disclose these very matters. Plaintiffs' claims cannot be reconciled with reality. Rather than refraining from "later advocating" (Rule 11(b)) their meritless claims, however, Plaintiffs seek instead to alter the jury's view of reality. Hence, the instant motion.

ARGUMENT

I. HOUSEHOLD'S SECURITIZATION PROSPECTUSES WERE PUBLICLY FILED AND EQUALLY AVAILABLE TO BOTH PARTIES AT ALL TIMES

It is black letter law that public information need not be redisclosed in discovery. *See King* v. *Burlington Northern & Santa Fe Railway Co.*, 538 F.3d 814, 819 (7th Cir. 2008) (recognizing that "publicly available" information can be obtained by a party "without depositions or other discovery"); *Gross* v. *Town of Cicero*, No. 04 C 0489, 2005 WL 2420372, at *3 (N.D. Ill. Sept. 28, 2005) (Darrah, J.) (rejecting motion to strike certain documents that had not been produced during discovery because "some of the documents were public record docu-

ments"); *SEC* v. *Samuel H. Sloan & Co.*, 369 F. Supp. 994, 995 (S.D.N.Y. 1973) ("discovery need not be required of documents of public record which are equally accessible to all parties").

Plaintiffs are well aware of this rule, having cited it themselves when they thought it convenient. In the context of another pending motion, Plaintiffs argue: "Rule 26(e) does not require disclosure of the obvious; formal disclosure is required only 'if the additional or corrective information has not otherwise been made known to the other parties during the discovery process or in writing.'" Plaintiffs' Opposition to Defendants' Cross-Motion, Dkt. 1310, at 4 (Jan. 28, 2009). Plaintiffs do not dispute, nor could they, that the securitization prospectuses at issue were at all times publicly available and easily accessible to them on the SEC's database.

That Plaintiffs were well aware of the documents at issue here as long ago as 2003 is clear from the face of the Complaint where Plaintiffs repeatedly reference, and describe in detail, Household's debt securitization program. *E.g.*, Am. Compl. ¶¶ 108-109, n.3. Additionally, the Complaint in this action alleges 1933 Act violations. During fact discovery, Plaintiffs' counsel extensively questioned Household's Chief Financial Officer David Schoenholz on the subject of the content and preparation of these same securitization prospectuses:

> Q: When did you decide to publicly disclose in SEC filings information about reaging?
>
> MR. OWEN: I object to the form of the question, foundation.
>
> A: Well, I think going back to the time period that you referred to at the beginning, ***in 99 to 2002, that in SEC filings for asset backed prospectuses — I think that's the plural of prospectus — that there were detailed disclosures in those SEC documents related to account administration practices.*** And those investors focused on -- on the inherent collateral securing those bonds. They would have had the most detailed interest in that. Our decision to expand or extend those disclosures to the 10-K's or 10-Q's came probably in January of 2002.
>
> BY MR. BROOKS:
>
> ***Q: What was the process for preparing the SEC filings related to asset backed securities?***

> A: Well, you had the Controller's Department, Legal Department, Treasury Department working together to draft disclosures. You had external auditors involved which had to perform certain procedures just like they would on any other SEC filing. You had Credit Risk people review those prospectuses. So you had a joint effort in preparing those documents. Then they would have also been reviewed by underwriters' counsel, external counsel.
>
> . . .
>
> ***Q: Were the disclosures that were in these filings specific as to the pool of loans that was being securitized?***
>
> A: My general recollection is that they would have referred to policies from which pools would have been selected, which is a slightly different statement than just saying that it's the pool itself.
>
> ***Q: Can you elaborate for me what that means?***
>
> A: Well, you would have pools of eligible criteria — or eligible collateral. And generally the selection criteria was intended to be fairly random. So you didn't cherry pick your portfolio. It was a fairly random selection of your collateral that went into these different pools of collateral. My general recollection is that the disclosures that would have been included would have pertained to the pools from which the specific collateral pool for that specific securitization applied.

(*See* Declaration of Thomas J. Kavaler in Support of the Household Defendants' Opposition to Plaintiffs' Motions In Limine Nos. 1-10 ("Kavaler Decl.") Ex. 20, Schoenholz Tr. 174:20-179:4 (Feb. 28, 2007)) (emphasis added). Plaintiffs raised similar questions at the deposition of the Chief Financial Officer of Household's Consumer Lending business unit, Joseph Vozar. (*E.g.*, Kavaler Decl. Ex. 21, Vozar Tr. 36:21-23 (Feb. 7, 2007) ("***Q: Were the Consumer Lending restructure policies disclosed in securitization prospectuses? A: I believe they were, yes.***")) (emphasis added).[3]

[3] Notwithstanding their extensive deposition questioning related to the securitization prospectuses at issue on this motion, Plaintiffs have the temerity to argue, *pro forma*, that they are prejudiced because "the longer the parties get from the events from which the claims arose, the more likely it is that witnesses will have died or their memories will have faded." Pl. Br. at 4. The witnesses in question were and are alive. Plaintiffs know that because Plaintiffs deposed them and have listed them on their witness list for trial.

The fact that the securitization prospectuses were and are publicly available requires the denial of Plaintiffs' motion. Public documents need not be produced in discovery. Nor were Plaintiffs ignorant of the securitization prospectuses, as is clear from the contents of their Complaint and their extensive deposition questioning on the subject. Thus, Plaintiffs' ritualistic claims of "surprise" and "prejudice" are unsupported in law and hollow in the extreme.

II. DEFENDANTS OBJECTED TO DOCUMENT REQUESTS THAT PURPORTED TO REQUIRE PRODUCTION OF PUBLICLY AVAILABLE DOCUMENTS, AND PLAINTIFFS NEVER MOVED TO COMPEL PRODUCTION OF SUCH DOCUMENTS

Defendants made clear on multiple occasions during discovery that counsel would not undertake to reproduce copies of publicly filed documents in responding to discovery requests. Beginning with their Responses and Objections to Plaintiffs' First Request for Production of Documents, served on July 9, 2004, Defendants objected to Plaintiffs' demands to the extent they purported to require Household to produce publicly available documents. *See, e.g.*, Kavaler Decl. Ex. 32, Responses and Objections to Plaintiffs' First Request for Production of Documents, Specific Response and Objection No. 22 (objecting to requests for documents relating to sale of debt securities on ground that, *inter alia*, "this request seeks documents that are publicly available or in plaintiffs' possession"); *see also id.*, General Response and Objection No. 6 (objecting to the requests "to the extent they seek documents that are publicly available."). Plaintiffs failed to contest these objections during fact discovery, and they cannot be heard to do so now.[4]

[4] Plaintiffs incorrectly argue that Defendants should have identified the securitization prospectuses in response to "interrogatories concerning defendants' affirmative defenses." Putting aside the numerous defects discussed herein, this confused notion is an incorrect description of the broad relevance of these documents. Reliance, falsity, and scienter are elements of Plaintiffs' fraud claim. That the absence of those elements is conclusively demonstrated by these documents is not an affirmative defense. Moreover, Defendants objected to the Interrogatories "to the extent they seek information that is publicly available or is in Plaintiffs' possession." Plaintiffs never contested that objection during fact discovery.

In response to voluminous requests from Plaintiffs' counsel, Defendants provided over five million pages of responsive documents. Throughout the discovery process Plaintiffs made numerous motions to compel production in response to almost any objection asserted by Defendants.[5] Apparently recognizing the silliness of making such a motion to Magistrate Judge Nolan, Plaintiffs never sought to compel production of publicly available documents that Plaintiffs could quite easily get for themselves. To claim now that discovery sanctions are warranted because public documents were secretly and improperly withheld by Defendants during fact discovery in order to surprise Plaintiffs during expert discovery is simply ludicrous.

III. HAVING ADOPTED A "FRAUD ON THE MARKET" PRESUMPTION OF RELIANCE, PLAINTIFFS CANNOT BE HEARD TO ARGUE THAT THEY WERE "SURPRISED" BY INFORMATION THAT HOUSEHOLD FILED PUBLICLY WITH THE SEC

Plaintiffs' fraud claims are premised on the so-called "fraud on the market" presumption of reliance. *See Basic Inc.* v. *Levinson*, 485 U.S. 224, 241 (1988). As the Supreme Court recognized when it adopted the "fraud on the market" presumption in *Basic*, plaintiffs who benefit from the presumption that a company's stock price in an efficient market incorporates all available information must also accept the necessary corollary that the stock price also reflects all available truthful information about the subject matter of an alleged fraud. *See In re Discovery Zone Securities Litigation*, 943 F. Supp. 924, 934 n.6 (N.D. Ill. 1996) (Castillo, J.) ("plaintiffs are charged with knowing all available information") (citing *Roots Partnership* v. *Lands' End, Inc.*, 965 F.2d 1411, 1419 (7th Cir. 1992)).

This rule unquestionably applies to SEC disclosures. *See Ong* v. *Sears, Roebuck & Co.*, 388 F. Supp. 2d 871, 900 (N.D. Ill. 2004) (Pallmeyer, J.) (assuming that "the market was

[5] Were it not for those boundaries, carving out from production such reasonable categories as the one at issue here (*i.e.*, declining to produce publicly available documents), fact discovery (which was virtually entirely one way) might still be ongoing.

aware" of certain charge-off policies where information needed to understand such policies was disclosed *in a securitization prospectus*). *Picard Chemical Inc. Profit Sharing Plan* v. *Perrigo Co.*, 940 F. Supp. 1101, 1123 (W.D. Mich. 1996) ("[A]s a matter of law . . . where information is contained in a document filed with the SEC, the market has knowledge of such matters."). Moreover, any possible question about whether the securitization prospectuses were known to the market is answered in the affirmative by the fact that equity securities analysts referred to the prospectuses for information about Household's policies and practices. For instance, an October 18, 2001 Ventana Capital analyst report explained that the analyst's review of Household's public filings included 10-K forms, 10-Q forms, annual reports, *and securitization documents*. (Kavaler Decl. Ex. 22, HHS 03114784).

Having invoked the fraud on the market theory to satisfy the element of reliance, Plaintiffs cannot pick and choose the information that is presumptively reflected in Household's stock price. *Asher* v. *Baxter International Inc.*, 377 F.3d 727, 732 (7th Cir. 2004) ("An investor who invokes the fraud-on-the-market theory must acknowledge that ***all*** public information is reflected in the price, just as the Supreme Court said in *Basic*. Thus if the truth or the nature of a business risk is widely known, an incorrect statement can have no deleterious effect, and if a cautionary statement has been widely disseminated, that news too affects the price just as if that statement had been handed to each investor.") (emphasis original, internal citations omitted). Plaintiffs' transparent attempt to hide from the jury the very disclosures that refute Plaintiffs' allegations of falsity, reliance, and scienter must therefore be rejected.

An example illustrates the insurmountable problem these disclosures pose for Plaintiffs' fraud claims. Plaintiffs contend Household failed to disclose that it restructured certain delinquent loans using an automated system which applied the applicable policies to select accounts eligible for restructure. Am. Compl. ¶ 112 (alleging that Household's automated loan administration system "was designed to automatically 'reage' delinquent accounts if it received even a partial payment without any evidence that the delinquency was cured"). However, in an August 9, 2001 securitization prospectuses, Household openly disclosed that "[d]elinquent accounts may be restructured (deemed current) every six months. Accounts are automatically re-

structured if the customer has made the equivalent of one payment equal to at least 95% of a full standard payment. Once restructured, the account is deemed current; however, the credit limit is zero." (Kavaler Decl. Ex. 30, HRSI Funding Inc. II, Prospectus Supplement (Form 424B5), at 77 (Aug. 9, 2001)). This is just one example of a full and accurate public disclosure that directly contradicts and refutes Plaintiffs' allegations. There are many others. For instance, Plaintiffs' "expert" Ms. Ghiglieri identifies five year prepayment penalties as one of the "predatory" practices Household failed to disclose. That claim is directly refuted by the fact that Household disclosed in securitization prospectuses that "[a] majority of the home equity loans provide for payment of a prepayment charge for full prepayments made within three to five years of the origination of the home equity loans." (Kavaler Decl. Ex. 31, Household Home Equity Loan Trust 2002-1, Prospectus Supplement (Form 424B2), at S-20 (March 8, 2002)). Other similar disclosures contradict and refute numerous other of Plaintiffs' allegations. (Kavaler Decl. Ex. 14, Rule 26 of Robert E. Litan, Exhibit 1)).

When the statements contained in the securitization prospectuses are considered along with the rest of Household's other public filings, Plaintiffs' fraud claim crumbles. Likewise, Plaintiffs' efforts to establish scienter are undermined by the simple fact that no jury could properly find that a defendant held the requisite intent to conceal a fact when irrefutable evidence demonstrates that he disclosed the same fact. *See Medcom Holding Co.* v. *Baxter Travenol Laboratories, Inc.*, No. 87 C 9853, 1993 WL 62367, at *8 (N.D. Ill. Mar. 5, 1993) (Conlon, J.) ("[g]iving a sophisticated investor free access to the facts is a poor means of perpetrating willful and wanton fraud"). The contents of Household's securitization prospectuses reveal the precise information about Household's policies and practices that Plaintiffs allege Household concealed. The fact that these public filings are inconvenient for Plaintiffs, and indicate a reality very different from the one Plaintiffs would like to concoct and flog to the jury, is no basis for their exclusion. Indeed, this is the very reason the securitization prospectuses must be admitted in evidence.

CONCLUSION

Although Plaintiffs have cast this motion as one seeking discovery sanctions, the real concern driving Plaintiffs' filing of this motion lies in the fact that the extensive disclosures contained in Household's securitization prospectuses reveal Plaintiffs' claim of fraud for the absurdity it is and always has been. Defendants were not required to produce additional copies of these publicly available documents, and Defendants told Plaintiffs repeatedly during fact discovery that they would not do so. In any event, Plaintiffs evidently obtained for their use in discovery the actual documents themselves as they have always been free to do. Having invoked the "fraud on the market" presumption of reliance, Plaintiffs cannot be heard to argue that this Court should allow them to conceal from the jury the reality of Household's extensive public disclosures. Plaintiffs' Motion *In Limine* No. 1 should therefore be denied in its entirety.

Dated: February 10, 2009
New York, New York

Respectfully submitted,

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