

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

LAWRENCE E. JAFFE PENSION PLAN, On)	Lead Case No. 02-C-5893
Behalf of Itself and All Others Similarly)	(Consolidated)
Situated,)	
Plaintiff,)	<u>CLASS ACTION</u>
vs.)	Judge Ronald A. Guzman
)	Magistrate Judge Nan R. Nolan
HOUSEHOLD INTERNATIONAL, INC., et)	
al.,)	
Defendants.)	
_____)	

**PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS'
MOTION *IN LIMINE* TO EXCLUDE THE ALLEGEDLY FALSE AND MISLEADING
STATEMENTS THAT WERE NOT IDENTIFIED BY PLAINTIFFS IN DISCOVERY**

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Lead plaintiffs respectfully submit this memorandum of law in opposition to defendants' motion *in limine* to exclude the allegedly false and misleading statements that were not identified by plaintiffs in discovery.

I. INTRODUCTION

Defendants' motion should be denied in its entirety. Defendants are seeking the extraordinary sanction of excluding plaintiffs from presenting the following types of false statements made by defendants: (1) Household International, Inc.'s ("Household" or the "Company") Form 10-Q's for each quarter of the Class Period (Statement Nos. 2, 4, 8, 10, 14, 20, 24, 27, 38 and 45 of plaintiffs' False Statement Chart (Exhibit A of Ex. A (Statement of Uncontested Facts) to the [Proposed] Final Pretrial Order); (2) Household's credit quality information, including its delinquency ("2+") and charge off numbers, set forth in each of its quarterly press releases, Form 10-Q's and 10-K's during the Class Period (Statement Nos. 1-11, 13-15, 17-18, 20-21, 24-25, 27, 30, 33, 35, 38, 43 and 45); (3) defendants' statements at a Goldman Sachs Conference on December 4, 2001 (Statement No. 29); (4) a portion of the statements in a December 3, 2001 *BusinessWeek* article (Statement No. 28); and (5) statements made at an April 9, 2002 Financial Relations Conference (Statement No. 34). *See* Ex. A of Ex. A (Statement of Uncontested Facts) to [Proposed] Final Pretrial Order.

Defendants claim that they have somehow suffered prejudice because they will now have to alter their defense for trial. Memorandum of Law in Support of the Household Defendants' Motion *in Limine* to Exclude the Allegedly False and Misleading Statements that Were Not Identified by Plaintiffs in Discovery ("Defs' Mem.") at 7. Yet, defendants have been on notice since the [Corrected] Amended Consolidated Class Action Complaint ("CAC") was filed in March, 2003, that plaintiffs alleged each of Household's quarterly press releases, Form 10-Q's, and yearly financial results (Form 10-K's) were false or misleading and that the improper reaging of delinquent loans

made Household's 2+ and chargeoff numbers misleading. *See* CAC, ¶¶107-133, 235-342. Plaintiffs' interrogatory answers at issue incorporate the CAC by reference as well as plaintiffs' expert reports which addressed these same issues. Lead Plaintiffs' Third Supplemental Amended Responses and Objections to Household Defendants' [Seventh] Set of Interrogatories to Lead Plaintiffs Pursuant to the Court's March 30, 2007, Order, Interrogatory Nos. 41-43, Ex. L hereto. Plaintiffs' discovery (whether document requests, interrogatories, or depositions) also addressed the same issues. Defendants claim they somehow would have conducted expert discovery differently. Even defendants' own experts opined on the same issues. The topic of Household's 2+ delinquency and chargeoff manipulation was discussed in detail in the reports of defendants' experts, Roman Weil and Robert E. Litan. *See, e.g.*, Expert Report of Roman L. Weil at 29 (addressing plaintiffs' expert Devor's opinion that Household's credit quality concealment techniques made Household's 2+ delinquency and chargeoff statistics inaccurate), Ex. A hereto; Report of Robert E. Litan, ¶¶177-191 (responding to plaintiffs' expert Catherine Ghiglieri's opinion that Household's restructure and reaging policies masked the Company's true delinquency and charged-off loan statistics), Ex. B hereto.

Defendants rest their entire argument on a narrow reading of plaintiffs' interrogatory responses and of plaintiff counsel's comments at the December 16, 2008 hearing. If Azra Mehdi's comments caused confusion, they were clarified only 30 days later when defendants received plaintiffs' false statement chart. Defendants' motion at the presentment hearing sought a clarification of the false statements to be proffered at trial. Plaintiffs' list provided 30 days later reduced and clarified the false statements. None of the false statements are from documents not previously identified. Defendants certainly were not shocked to see that the final list included the same documents and statements previously identified.

Defendants also gloss over the fact that they propounded a total of *six* interrogatories addressing the omissions and affirmative misrepresentations made by defendants during the Class Period. *See* Household Defendants' Fourth Set of Interrogatories to Lead Plaintiffs, Interrogatory Nos. 36-38, 41-43, Ex. C hereto. By limiting their focus to plaintiffs' response to Interrogatory Nos. 41-43, defendants ignore that plaintiffs' response to Interrogatory No. 37 alerted them to plaintiffs' contention that "Household's *reported delinquency and charge-off statistics* were manipulated by the Company's aggressive and improper reaging practices and other accounting manipulation." *See* Lead Plaintiffs' Amended Responses and Objections to Household Defendants' [Seventh] Set of Interrogatories to Lead Plaintiffs Pursuant to the Court's January 10 and 19, 2007 Orders, response to Interrogatory No. 37, Ex. D hereto. Plaintiffs' response to Interrogatory No. 37 also identified to defendants the Household public filings alleged to be false and misleading, stating "[d]uring the Class Period, *Household reported 2+ delinquency figures in Household's financial statements and elsewhere.*" *Id.* (Emphasis added.) Defendants also disregard the report of plaintiffs' expert, Harris Devor, incorporated by reference into plaintiffs' third amended response to Interrogatory No. 37, which specifically opined that "Household's *reported 2+ delinquency rate and charge-off statistics were inaccurate and not adequately disclosed.*" *See* Corrected Rule 26 Statement of Harris L. Devor, ¶35, Ex. E hereto.

Defendants' effort to restrict plaintiffs from presenting the statements made by defendants at the December 4, 2001 Goldman Sachs Conference and April 9, 2002 Financial Relations Conference is completely without merit but typical of the essence of defendants' motion. Plaintiffs clearly identified the Goldman Sach's December 4, 2001 Presentation in their interrogatory responses, contending defendants made false statements about Household's accounting practices, including reaging and restructuring. Lead Plaintiffs' Amended Responses and Objections to Household Defendants' [Seventh] Set of Interrogatories to Lead Plaintiffs Pursuant to the Court's January 10

and 19, 2007 Orders, response to Interrogatory No. 42, Ex. D hereto. Defendants produced the *one* document containing the statements in discovery. On plaintiffs' false statements chart, plaintiffs simply clarify the specific parts of the *one* document used by defendant William F. Aldinger at the conference that were clearly false and misleading. Where is the prejudice to defendants?

In a similar vein, is defendants' request to strike parts of their April 9, 2002 Financial Relations Conference statements. Once again, in their interrogatory responses (plaintiffs' response to Interrogatory No. 42), plaintiffs stated that:

[D]efendants made numerous false statements regarding Household's reaging and restructuring policies. For example, defendants informed investors that Household's policies were "appropriate for each customer segment; that the Company's reage policies were [n]ot intended to defer credit loss recognition or to overstate net income; that the reage policies were in place to [sic] for the customer's benefit; that customers who were reaged had indicated willingness and ability to pay; that Household's reage policies had been "consistently applied and [were] appropriate for each product. ***Defendants also falsely assured investors at the April 9, 2002 conference that Household had in place strict restructuring controls.*** Household also presented inaccurate statistical data regarding restructures and assured investors that the Company was adequately reserved.

Id.

Plaintiffs false statement chart used the same *one* document and listed the specific statements and financial charts in the *one* document that defendants presented to analysts and investors at the conference. Once again, where is the prejudice? Defendants have known for years that plaintiffs alleged the individual defendants made false statements at both the December 4, 2001 Goldman Sachs Conference and the April 9, 2002 Financial Relations Conference.¹

Thus, while defendants contend that plaintiffs failed to identify the "new" statements contained on plaintiffs' false statement chart, the truth of the matter is that defendants have been on

¹ Defendants also seek to exclude one part of the December 3, 2001 *BusinessWeek* article, because that particular part of the article was not referenced in the interrogatory responses. This request should be denied for the same reasons.

notice of the falsity of all of those statements for more than five years. The falsity of Household's U.S. Securities and Exchange Commission ("SEC") filings and quarterly press releases has been the core of plaintiffs' case for years. The statements made at the December 4, 2001 Goldman Sachs Conference, the April 9, 2002 Financial Relations Conference, and in the *BusinessWeek* article have also been at issue for years. Defendants cannot credibly claim that they are "surprised" by plaintiffs' intent to present these statements to a jury at trial. Nor can defendants establish that they have or will suffer any real prejudice in the event these statements are not excluded. Plaintiffs are not changing the theory of their case at the eleventh hour and in fact have *narrowed* the list of false statements they intend to present at trial. Defendants are therefore correct that these false statements "are at the very heart of Plaintiffs' securities fraud claims" – they have been since the inception of this case. Because defendants have been well aware of the statements for more than five years, their motion should be denied in its entirety.

II. ARGUMENT

Defendants' claim that plaintiffs "blatantly" violated Fed. R. Civ. P. 26(e) by failing to supplement their interrogatory responses is simply not true. Pursuant to Court order, plaintiffs supplemented their response to Interrogatory Nos. 36-38, 41-43 on *three* separate occasions. Plaintiffs most recently amended their responses to Interrogatory Nos. 36-38 on February 2, 2008, less than one year ago. Thus, defendants' claim that plaintiffs "deliberately" failed to comply with the Federal Rules of Civil Procedure should be rejected, as plaintiffs have fully complied with their obligation to supplement their interrogatory responses under Rule 26(e).

Defendants also claim that plaintiffs' interrogatory responses and subsequent amendments failed to identify the dozens of "new" statements listed on plaintiffs' false statement chart – statements relating primarily to the chargeoff and delinquency statistics reported in Household's quarterly press releases, Form 10-Q's and Form 10-K's during the Class Period (although defendants

also inexplicably seek to exclude the entirety of the Form 10-Q's).² Defendants' argument completely ignores that defendants propounded a total of *six* interrogatories seeking information about defendants' Class Period affirmative misrepresentations *and* omissions. See Household Defendants' Fourth Set of Interrogatories to Lead Plaintiffs, Interrogatory Nos. 36-38, 41-43, Ex. C hereto. Conveniently absent from defendants' memorandum of law, defendants' "omission" interrogatories addressed the very same false statements defendants contend should now be excluded at trial. Defendants' "omissions" interrogatories, as rewritten by the Court in its January 10, 2007 Order,³ read as follows:

Interrogatory No. 36: Identify the particular facts Household failed to disclose to the market regarding its purported "Illegal Predatory Lending Practices" as alleged in Part VI.A of the Complaint.

Interrogatory No. 37: Identify the particular facts Household failed to disclose to the market regarding its purportedly "Improper[] Reaging or Restructuring [of] Delinquent Accounts" as alleged in part VI.B of the Complaint.

Interrogatory No. 38: Identify the particular facts Household failed to disclose to the market regarding its purported "Improper Accounting of Costs Associated with Various Credit Card Co-Branding, Affinity and Marketing Agreements" as alleged in Part VI.C of the Complaint.

² Defendants also seek to exclude a November 1, 2000 *St. Louis Dispatch* article wherein Household spokesperson Craig Stroom ("Stroom") stated that a \$76,900 loan with 12.5 percent interest was "not a predatory loan by any definition." See Declaration of Thomas J. Kavalier in Support of Defendants' Motion *in Limine* to Exclude the Allegedly False and Misleading Statements ("Kavalier Decl."), Appendix A, Ex. 6. This article was discussed in detail at the deposition of Stroom. Because the statements made in the *St. Louis Dispatch* article were "otherwise made known" to defendants during discovery, plaintiffs had no obligation to supplement under Rule 26(e)(1)(A). *Gutierrez v. AT&T Broadband, LLC*, 382 F.3d 725, 733 (7th Cir. 2004) (upholding refusal to exclude evidence not disclosed in discovery because defendants had knowledge that this was potentially relevant information through deposition testimony).

³ Plaintiffs objected to Interrogatory Nos. 36-38 as originally written on grounds that the interrogatories were incomprehensible, unintelligible and inconsistent as drafted. See Lead Plaintiffs' Amended Responses and Objections to Household Defendants' [Seventh] Set of Interrogatories to Lead Plaintiffs Pursuant to the Court's January 10 and 19, 2007 Orders, response to Interrogatory Nos. 37-38, Ex. D hereto. Apparently recognizing the validity of plaintiffs' objections, the Court rewrote defendants' inartfully drafted interrogatories before compelling plaintiffs to respond. See Dkt. No. 910 (Jan. 10, 2007 Minute Entry).

See Dkt. No. 910 (Jan. 10, 2007 Minute Entry). On January 29, 2007, plaintiffs served defendants their amended response and objections to defendants' fourth set of interrogatories. Plaintiffs' response to Interrogatory No. 37 stated in part:

In fact, Household's ***reported delinquency and charge-off statistics*** were manipulated by the Company's aggressive and improper reaging practices and other accounting manipulation. Each time Household reaged a delinquent loan, the loan no longer appeared in a delinquency bucket, but instead appeared as current on Household's books. Such loans were ***reported to investors as current*** and were not counted among Household's disclosed delinquency statistics. Thus, defendants manipulated Household's financial statistics by reporting as current loans that should have been classified as 2+ delinquent. ***By falsely presenting an increased number of "current" accounts and decreased 2+ delinquency numbers, thereby reducing charg[e]-offs, defendants made Household's balance sheet and credit quality appear more favorable to investors than it actually was.***

During the Class Period, ***Household reported 2+ delinquency figures in Household's financial statements and elsewhere.*** The SEC found that the 2+ delinquency rate was "one of the critical measures of Household's financial performance." ***Household's disclosures of its 2+ delinquency rate throughout the Class Period were not accompanied by statements indicating the impact of Household's reage policies and practices on the delinquent numbers.*** Household failed to disclose to investors the true nature of its account management policies and practices, including its widespread practice of reaging or restructuring loans in order to manage delinquencies.

See Lead Plaintiffs' Amended Responses and Objections to Household Defendants' [Seventh] Set of Interrogatories to Lead Plaintiffs Pursuant to the Court's January 10 and 19, 2007 Orders at 25-26, Ex. D hereto (emphasis added).

Plaintiffs subsequently amended their response to Interrogatory No. 37 a second time, incorporating by reference the expert report of Harris L. Devor. Mr. Devor offered an expert opinion on the subject of Household's credit quality concealment techniques, including the following:

[T]he Company's financial statements during the Relevant Timeframe were not in compliance with GAAP as a result of its failure to accurately and adequately disclose certain account management techniques. Additionally, as a result of these account management practices, ***Household's reported 2+ delinquency rate and charge-off statistics were inaccurate and not adequately disclosed.***

See Corrected Rule 26 Statement of Harris L. Devor, ¶35, Ex. E hereto (emphasis added); Lead Plaintiffs' Third Supplemental Amended Responses and Objections to Household Defendants' [Seventh] Set of Interrogatories to Lead Plaintiffs Pursuant to the Court's March 30, 2007 Order, Ex. L hereto. Mr. Devor's report and opinions cover all Form 10-Q's and Form 10-K's issued by Household during the Class Period:

Lead Counsel for the Plaintiffs and the Class in this matter have asked that I opine on whether the consolidated financial statements of Household International, Inc. ("Household," or "HI" or "the Company") and for Household Financial Corporation ("HFC") for the quarter ended June 30, 1999 through the quarter ended June 30, 2002, as well as for the fiscal years ended December 31, 1999, 2000, and 2001 (the "Relevant Timeframe"), as originally presented by Household and HFC, were fairly stated in accordance with generally accepted accounting principles ("GAAP")

Id., ¶5. In a 38-page section of her report, plaintiffs' expert Catherine Ghiglieri explained how Household manipulated its 2+ and chargeoff numbers and opined that it allowed Household to file false and misleading statements in its securities filings to the SEC. See Expert Witness Report of Catherine A. Ghiglieri at 131-168, Ex. F hereto. Plaintiffs' response to Interrogatory Nos. 41-43 specifically incorporates by reference their response to defendants' "omission" interrogatories, Nos. 36-38. Plaintiffs' response to defendants' interrogatories therefore clearly alerted defendants of plaintiffs' intention to pursue the falsity of Household's chargeoff and delinquency statistics at trial.⁴

⁴ Moreover, Household's chargeoff and delinquency statistics were also discussed at length during numerous depositions, many of which occurred years ago. See, e.g., Bianucci Depo Tr. at 73:10-77:9, Ex. G hereto (testifying that former auditor Arthur Andersen examined Household's 2+ delinquency numbers in assessing the adequacy of Household's loan loss reserve); *id.* at 101:9-111:9 (discussing SEC Cease and Desist Order concerning Household's reaging and credit quality manipulation); Gilmer Depo Tr. at 379:1-380:1, Ex. H hereto (discussing significance of Household's 2+ statistics to Wall Street analysts); Little Depo Tr. at 40:11-15, Ex. I hereto (discussing importance of 2+ delinquency statistics in measuring credit quality of a portfolio); see also *Gutierrez*, 382 F.3d at 733 (upholding refusal to exclude evidence not disclosed in discovery because defendants had knowledge that this was potentially relevant information through deposition testimony).

Given the contents of plaintiffs' CAC, plaintiffs' interrogatory responses, Mr. Devor's and Ms. Ghiglieri's expert reports, and defendants' own expert reports, defendants cannot realistically claim that they were unaware that the falsity of Household's chargeoff and delinquency statistics were a core component of plaintiffs' case. Defendants' claim that plaintiffs "deliberately withheld" this information is equally disingenuous. Defendants have been on notice for many years of plaintiffs' contention that Household's chargeoff and 2+ delinquency statistics were materially understated due to defendants' failure to disclose the existence, nature and extent of Household's reaging practices.

Nor can defendants credibly claim they were sandbagged by statements made in previously undisclosed documents. Indeed, Household's chargeoff and delinquency statistics appear in the *same* Household press releases plaintiffs identified as false and misleading over two years ago. *See* Lead Plaintiffs' Amended Responses and Objections to Household Defendants' [Seventh] Set of Interrogatories to Lead Plaintiffs Pursuant to the Court's January 10 and 19, 2007 Orders, Interrogatory Nos. 41-43. Likewise, each of the press releases, Form 10-Q and Form 10-K filings reporting false delinquency statistics, net income and earnings per share were referenced in plaintiffs' CAC filed almost *six* years ago and specifically incorporated by reference into plaintiffs' interrogatory responses. *See* CAC, ¶¶235, 239, 254, 260, 269, 288, 292, 299, 328; Lead Plaintiffs' Amended Responses and Objections to Household Defendants' [Seventh] Set of Interrogatories to Lead Plaintiffs Pursuant to the Court's January 10 and 19, 2007 Orders, response to Interrogatory No. 41 ("Lead Plaintiffs respond to this interrogatory (or more aptly "interrogatories") by stating as an initial matter that in its detailed and particularized Complaint, Lead Plaintiffs have identified all the false and misleading statements made during the Class Period, including the source of the statement (press release, SEC filing, presentation made to analysts, etc.), the date of the statement, and the circumstances in which the statement was made."). As the foregoing demonstrates,

655 West Broadway, Suite 1900
San Diego, CA 92101
Telephone: 619/231-1058
619/231-7423 (fax)

COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
AZRA Z. MEHDI (90785467)
D. CAMERON BAKER (154432)
LUKE O. BROOKS (90785469)
JASON C. DAVIS (253370)
100 Pine Street, Suite 2600
San Francisco, CA 94111
Telephone: 415/288-4545
415/288-4534 (fax)

Lead Counsel for Plaintiffs

MILLER LAW LLC
MARVIN A. MILLER
LORI A. FANNING
115 S. LaSalle Street, Suite 2910
Chicago, IL 60603
Telephone: 312/332-3400
312/676-2676 (fax)

Liaison Counsel

LAW OFFICES OF LAWRENCE G.
SOICHER
LAWRENCE G. SOICHER
110 East 59th Street, 25th Floor
New York, NY 10022
Telephone: 212/883-8000
212/355-6900 (fax)

Attorneys for Plaintiff

DECLARATION OF SERVICE BY ELECTRONIC MAIL AND BY U.S. MAIL

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Diego, State of California, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 655 West Broadway Suite 1900, San Diego, California 92101.

2. That on February 10, 2009, declarant served by electronic mail and by U.S. Mail to the parties the **PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION *IN LIMINE* TO EXCLUDE THE ALLEGEDLY FALSE AND MISLEADING STATEMENTS THAT WERE NOT IDENTIFIED BY PLAINTIFFS IN DISCOVERY.**

The parties' email addresses are as follows:

TKavaler@cahill.com PSloane@cahill.com PFarren@cahill.com LBest@cahill.com DOwen@cahill.com	NEimer@EimerStahl.com ADeutsch@EimerStahl.com MMiller@MillerLawLLC.com LFanning@MillerLawLLC.com
--	--

and by U.S. Mail to:

Lawrence G. Soicher, Esq.
Law Offices of Lawrence G. Soicher
110 East 59th Street, 25th Floor
New York, NY 10022

David R. Scott, Esq.
Scott & Scott LLC
108 Norwich Avenue
Colchester, CT 06415

I declare under penalty of perjury that the foregoing is true and correct. Executed this 10th day of February, 2009, at San Diego, California.

/s/ Teresa Holindrake

TERESA HOLINDRAKE