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. Guzmán

DEFENDANTS' RESPONSE TO PLAINTIFFS' SUBMISSION PURSUANT TO THE COURT'S APRIL 17, 2009 STATEMENTS

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Defendants respectfully submit this response to Plaintiffs' Submission Pursuant to the Court's April 17, 2009 Statements, dated April 20, 2009, Docket No. 1564 ("Plaintiffs' Submission" or "Pls. Br."), concerning their assertion that Defendants had a duty to accuse themselves of predatory lending in Household's Form 10-K and 10-Q Securities and Exchange Commission ("SEC") filings during the relevant period.

I. BACKGROUND

On January 30, 2009 Plaintiffs submitted to the Court, as part of the [Proposed] Final Pretrial Order, Plaintiffs' Statement of Contested Issues of Fact and Law ("Plaintiffs' Statement"). Exhibit A to Plaintiffs' Statement was a 24-page table specifying the allegedly false and misleading statements that were identified by Plaintiffs as the basis of their claims in this case.[1] Plaintiffs' Statement and the attached Exhibit A, entitled "Household International False Statements," are included in the Final Pretrial Order filed on March 12, 2009. (*See* Final Pretrial Order, Exhibit B-1(A)). The majority of the statements on Plaintiffs' Exhibit A are statements that Plaintiffs selected from Household's Form 10-K and Form 10-Q filings.

During the April 17, 2009 Jury Instructions Conference, the Court addressed Plaintiffs' contention, and the related opinion testimony by their expert witness Harris Devor, that the statements selected from Household's 10-Ks and 10-Qs were false or misleading because Defendants had failed to disclose in each of those SEC filings the widespread use of predatory lending practices that Plaintiffs have alleged. The Court expressed concern that Mr. Devor's

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[1] On Exhibit A the alleged false and misleading statements were grouped into 47 numbered items. Certain statements were excluded by the Court's rulings in response to Defendants' motions in limine, and Plaintiffs chose not to introduce evidence on certain other statements, so Plaintiffs' current list of alleged false statements includes 40 numbered items. (*See* Plaintiffs' Exhibit 1473 for identification (PX 1473 ID). Defendants' reference to the proposed exhibit in this Response is not intended as and should not be deemed a waiver of any objection Defendants may assert with respect to its format and substance.)

testimony that Generally Accepted Accounting Principles ("GAAP") required Household to include information about predatory lending in its financial statements was "an end run" around the Court's ruling, in response to Defendants' *Daubert* motion, barring Mr. Devor from opining that Household's financial statements falsely reported its revenues because they included as revenue money obtained from alleged predatory lending. (Tr. 2705:20–2706:17). The Court observed that, with only two exceptions, the statements from Household's 10-Ks and 10-Qs did not give rise to a duty to disclose such information. (Tr. 2716:5–2727:22). The Court also rejected the argument that statements in Household's press releases created a duty to disclose information in subsequent 10-K or 10-Q filings. (Tr. 2712:21–2713:9)

Although the Court suggested that the issue be considered in connection with the end-of-trial jury instructions, Plaintiffs requested, and were granted, an opportunity to address the Court's position in a written submission. (Tr. 2720:11–13; Tr. 2721:10–11). The Court identified four cases for Plaintiffs to look at and address in their submission. (Tr. 2721:12–20, Tr. 2762:21–2763:4).[2] Plaintiffs' Submission was filed on April 20, 2009.

II. ARGUMENT

A. Plaintiffs' Argument That Materiality Gives Rise to a Duty to Disclose Is Erroneous

Plaintiffs argue that Defendants had a duty to disclose that Household engaged in predatory lending practices simply because those practices "contributed a material amount to Household's net income." Pls. Br. at 3; see also *id*. at 4 ("Because the practices were clearly

[2] The cases are: *Roeder* v. *Alpha Industries, Inc*., 814 F.2d 22 (1st Cir. 1987); *Galati* v. *Commerce Bancorp, Inc*., 220 Fed. Appx. 97, 2007 WL 934893 (3d Cir. 2007); *Oran* v. *Stafford*, 226 F.3d 275 (3d Cir. 2000); and *Freedman* v. *Louisiana-Pacific Corp*., 922 F. Supp. 377 (D. Or. 1996).

material to Household's net income, defendants had a duty to disclose those practices.").[3] Even passing the absence of any factual support for Plaintiffs' "clearly material" premise, Plaintiffs' assertion that materiality gives rise to a duty to disclose under 10b-5 flatly misstates the law.

An omitted fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc.* v. *Levinson*, 485 U.S. 224, 231-32 (1988); *see also Stransky* v. *Cummins Engine Co., Inc.*, 51 F.3d 1329, 1331 n.1 (7th Cir. 1995). However, the non-disclosure of even material information does not give rise to liability under Rule 10b-5 unless the defendant had an affirmative duty to disclose that information. *Oran* v. *Stafford*, 226 F.3d 275, 285 (3d Cir. 2000); *Galati* v. *Commerce Bancorp, Inc*., 220 Fed. Appx. 97, 101 (3d Cir. 2007).

Plaintiffs acknowledge that "an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts." Pls. Br. at 2, citing *In re Time Warner Inc. Securities Litigation*, 9 F.3d 259, 267 (2d Cir. 1993). Each of the cases referenced by the Court at the April 17 conference makes precisely the same point:

- "The materiality of the information claimed not to have been disclosed, however, is not enough to make out a sustainable claim of securities fraud. Even if information is material, there is no liability under Rule 10b-5 unless there was a duty to disclose it." *Roeder* v. *Alpha Industries, Inc*., 814 F.2d 22, 26 (1st Cir. 1987) (absent inaccurate, incomplete or misleading disclosures, defendant corporation had no affirmative duty to disclose that it had paid a bribe to obtain subcontracts). *Id*. at 27.

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[3] Plaintiffs' materiality argument is as devoid of factual foundation as it is legally unsound. The argument rests solely on the opinion testimony of Plaintiffs' expert, Harris Devor, who used a set of numbers that appear in a single unexplained document as the springboard to a sweeping speculation that "approximately $3.2 billion of Household's Class Period net income" was attributable to predatory lending practices. Pls. Br. at 3-4, 5. There is literally no evidence of such a conclusion in the trial record (or in the discovery record, for that matter). Plaintiffs' bald assertion that "Household's deceptive lending practices were widespread, systemic and emanated from the CEO and President of Consumer Lending" likewise lacks any factual foundation. Pls. Br. at 5.

- "[T]he District Court found that even though information concerning the conduct of [three corporate officers] would be material to investors, defendants did not have a duty under Rule 10b-5 to disclose the information. We agree." *Galati* v. *Commerce Bancorp, Inc*., 220 Fed. Appx. 97, 101 (3d Cir. 2007) (accurate factual recitations of past earnings do not create liability under 10b-5; statements concerning defendant's "strong performance," "dramatic deposit growth," and "unique business model" were mere "puffery" that did not "put into play" the integrity of defendant's lending practices and trigger a duty to disclose alleged bid-rigging and other unlawful practices). *Id*. at 102.

- "[That investors viewed information as material] does not end our inquiry, however. Even non-disclosure of material information will not give rise to liability under Rule 10b-5 unless the defendant had an affirmative duty to disclose that information." *Oran* v. *Stafford*, 226 F.3d 275, 285 (3d Cir. 2000) (simple, accurate factual assertion about FDA finding and review process, without "affirmative characterization" of the process, did not constitute any material misrepresentation or omission; rejecting the claim that SEC Regulation S-K, Item 303(a) imposed an affirmative duty of disclosure that could give rise to a claim under 10b-5). *Id*. at 285, 286 n.6.

- "Mere possession of material nonpublic information, absent some other act, does not create a duty to disclose." *Freedman* v. *Louisiana-Pacific Corp*., 922 F. Supp. 377, 387 (D. Or. 1996) (citation omitted) (defendant's duty to disclose must arise from 10b-5; plaintiff may not use NYSE rules or SEC regulations to establish the existence of a duty to disclose under § 10(b) and Rule 10b-5). *Id*. at 390.

Understandably, Plaintiffs have made no serious effort to dispute or distinguish these cases. Instead, they rely principally on *Greenfield* v. *Professional Care, Inc*., 677 F. Supp. 110 (E.D.N.Y. 1987), an outlier case, [4] for the proposition that information that relates to earnings is *per se* material and therefore ought to be disclosed. In *Greenfield*, the court sustained a complaint alleging that defendants' public documents were materially misleading as to the company's true financial condition because they failed to disclose, *inter alia*, that an identifiable portion of the company's earnings had been illegally obtained and were subject to forfeiture.[5]

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[4] Immediately after discussing this E.D.N.Y case at length, Plaintiffs observe that *In re Sofamor Danek Group, Inc*., 123 F.3d 394 (6th Cir. 1997), is not controlling Seventh Circuit law.

[5] Three of Greenfield's executives had been indicted for Medicaid fraud (one had pled guilty), and a subsequent audit by the New York State Attorney General's Office had quantified the amount that the company owed in wrongfully paid Medicaid funds.

Apparently assuming the existence of a duty to disclose, and without discussion, the *Greenfield* court focused its analysis solely on the materiality of the undisclosed information. Finding that "the information concerning the true nature of PC's earnings was material," the court declined to dismiss the complaint.[6] Plaintiffs assert that, as in *Greenfield*, "Household's predatory lending practices related directly to the Company's net income," Pls. Br. at 4, and then argue that defendants had a duty to disclose the alleged predatory lending practices merely "[b]ecause the practices were clearly material to Household's net income." *Id*.

Plaintiffs' position cannot be reconciled with the great weight of relevant authority, including the cases referenced by the Court. "Even material omissions are not, in and of themselves, sufficient to state a claim for securities fraud. Plaintiffs must show that defendants had a duty to disclose that information." *Anderson* v. *Abbott Laboratories*, 140 F. Supp. 2d 894, 903 (N.D. Ill. 2001) (Moran, J.); see also *Stransky,* 51 F.3d at 1331 ("Mere silence about even material information is not fraudulent absent a duty to speak."); *Menkes* v. *Stolt-Nielsen S.A*., No. 03 Civ. 409, 2005 WL 3050970 (D. Conn. Nov. 10, 2005) ("[T]he fact that a corporation's employees engaged in illegal conduct may well be material to the reasonable investor for several obvious reasons, but the obligation to disclose uncharged illegal conduct does not arise from the materiality of this information alone.").

Plaintiffs' strained efforts to distinguish *Roeder*, *In re Sofamor Danek Group, Inc*., 123 F.3d 394 (6th Cir. 1997), and *Galati* factually, Pls. Br. at 4-5, contribute nothing to their effort to demonstrate that Defendants had a duty to disclose any alleged predatory lending practices. Plaintiffs' conclusory argument that they have alleged from the inception of this case

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[6] Besides predating by nearly 10 years the stringent pleading requirements of the PSLRA, *Greenfield* has been called into question in its own circuit. *See In re FBR Inc. Securities Litigation*, 544 F. Supp. 2d 346, 356 n.6 (S.D.N.Y. 2008): "It should be noted that a case cited by plaintiffs appears to *suggest* that if a company's earnings are substantially derived from illegal sources, its earnings statements may constitute violations of Rule 10b-5 even absent a statement that puts the cause of the company's success at issue. . . . However, as at least one other court has noted, *Greenfield* represents the minority view in this Circuit. *See Menkes* v. *Stolt-Nielsen S.A*., 2005 U.S. Dist. LEXIS 28208, at *22-*23, 2005 WL 3050970, *7 (D.Conn. Nov. 10, 2005)." (emphasis added, citation omitted).

that "Household's financial statements were inaccurate" as a result of Defendants' failure to disclose that Household engaged in predatory lending does not identify any statement that was rendered misleading by the alleged omission, thus giving rise to a duty to disclose.

Plaintiffs end this section as they began — with an incorrect and insupportable assertion that materiality gives rise to a duty to disclose.

B. Plaintiffs' Attempt to Introduce New Alleged False Statements is Untimely, and the Newly Designated Statements Do Not Trigger a Duty to Disclose

Plaintiffs' second argument is that Defendants had a duty to disclose that Household engaged in predatory lending practices because each of Household's 10-Ks and 10-Qs during the relevant period "put Household's ethics and the source of the Company's record growth squarely 'into play'." Pls. Br. at 5. Having combed the documents to find additional examples that might bear any similarity to the two examples the Court pointed out to them during the April 17, 2009 conference, Plaintiffs now contend that scores of references in Household's 10-Ks and 10-Qs to management's responsibility for ethical standards and to the *existence* of "strong growth" – none of which has ever been identified as the basis of Plaintiffs' 10b-5 claims – are sufficient to put at issue the *sources* of Household's financial results and its growth. *Id*. at 7–8.

On January 30, 2009, after literally years of resistance and only two months before trial, Plaintiffs finally identified the particular statements upon which their claims in this case are based. Those particular alleged false statements were enumerated in Plaintiffs' Statement of Contested Issues of Fact and Law, which was included in Plaintiffs' [Proposed] Final Pretrial Order submissions, as well as in the Final Pretrial Order filed on March 12, 2009. *See* Final Pretrial Order, Exhibit B-1(A). Plaintiffs' belated effort to expand that list substantially by attaching 64 additional marked pages to Plaintiffs' Submission is a blatant, unauthorized attempt to unilaterally modify the Court's Final Pretrial Order in mid-trial. The tactic is unfair and prejudicial to Defendants, and it should not be countenanced. Plaintiffs'

counsel have had nearly seven years to read Household's SEC filings and identify the particular statements upon which to base their claims.[7] Yet Plaintiffs now contend that the newly identified statements, "whether listed in the false statement chart or not," created a duty to disclose, and defendants' failure to disclose gave rise to the actionable omissions alleged by plaintiffs." Pls. Br. at 7 n.3. In other words, because Plaintiffs previously designated a handful of specific statements from each of Household's 10-K and 10-Q filings, Defendants should have been on notice that anything else that was contained in those voluminous reports might also be put in play, at any time. The time has long since passed for Plaintiffs to hold their options and change the nature and scope of their claims. Having designated particular statements, hardly in haste or without ample time to review and consider the discovery record, Plaintiffs should now bear the consequences of their choices.

Moreover, none of the newly identified statements is sufficiently objective or connected to the alleged misconduct to mislead a reasonable investor about the nature of Household's lending practices. *See In re FBR Inc. Securities Litigation*, 544 F. Supp. 2d 346, 357 (S.D.N.Y. 2008). Many of Plaintiffs' belatedly identified "false and misleading statements" are immaterial, inactionable puffery. *See, e.g.*, Pls. Br. Ex. 2 at 5 (PX 1462, 1999 10-K at 86) ("These initiatives have resulted in improved profitability and, we believe, have laid the foundation for future growth."); Pls. Br. Ex. 2 at 7 (PX 1462, 1999 10-K at 88) ("Receivables growth has been a key contributor to our improved results."); Pls. Br. Ex. 2 at 19 (DX 854, 1999 10-Q at HHT 0015899) ("The increases were primarily due to managed receivable growth.").[8]

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[7] Plaintiffs offer no explanation for having selected certain statements for inclusion in Exhibit B-1(A) while omitting the same or similar statements contained in other 10-Ks or 10-Qs.

[8] These types of vague, generic statements of optimism and other similar statements are inactionable puffery, as this Court and the Court of Appeals have held in other circumstances. *Central Laborers' Pension Fund* v. *Sirva, Inc.*, No. 04 C 7644, 2006 U.S. Dist. LEXIS 73375, at *18-19 (N.D. Ill. Sept. 22, 2006) (Guzmán, J.) ("vague, optimistic statements" such as "market opportunities are considerable, as the markets are large and the corporate outsourcing trend is at an earlier stage of development" and "[w]e are approaching this international opportunity from a position of strength, with a leading market share position . . ." are not actionable); *Eisenstadt* v. *Centel Corp.*, 113 F.3d 738, 746 (7th Cir. 1997) ("[m]ere sales puffery is not actionable under

Other newly designated statements specify which products or business areas have contributed to improved financial results — in effect, stating which numbers have changed — but make no reference to sources of revenues. *See, e.g.*, Pls. Br. Ex. 2 at 3 (PX 1462, 1999 10-K at 80) ("Our improved results were due to strong growth in our consumer finance business and significant declines in operating expenses."). Still others relate to business groups outside of Consumer Lending. *See, e.g.,* Pls. Br. Ex. 2 at 19 (PX 1462, 1999 10-K at 86) ("These [credit card marketing] initiatives resulted in increases in both receivables and number of accounts in the second half of the year.")

In support of their effort to fabricate a duty to disclose by expanding the universe of alleged false statements, Plaintiffs rely on distinguishable cases that do not represent the weight of authority: *In re Par Pharmaceuticals Securities Litigation*, 733 F. Supp. 668 (S.D.N.Y. 1990) (duty to disclose drug manufacturer's FDA bribery scheme arose from public disseminations touting the company's competitive advantage in obtaining speedy FDA approvals); *In re Van Der Moolen*, 405 F. Supp. 2d 388 (S.D.N.Y. 2005) (sustaining complaint based on failure to disclose the true source of revenues in discussing the sources and significance of revenues); *In re Providian Financial Corp. Securities Litigation*, 152 F. Supp. 2d 814 (E.D. Pa. 2001) (sustaining a complaint based on defendants' failure to disclose illegal or fraudulent practices when attributing revenues to a "customer-focused approach.")

Rule 10b-5."); *Searls*, 64 F.3d 1061 at 1066–67 (statements that a company was "recession-resistant" and would maintain a "high" level of disposition gains are "devoid of any substantive information" and too vague to constitute material statements of fact). *See also Lasker* v. *New York State Electric & Gas Corp*., 85 F.3d 55, 59 (2d Cir. 1996) (statements that a company refused to "compromise its financial integrity," that it had a "commitment to create earnings opportunities" and that these "business strategies [would] lead to continued prosperity" constitute "precisely the type of 'puffery' that this and other circuits have consistently held to be inactionable"); *In re JP Morgan Chase Securities Litigation*, 363 F. Supp.2d 595, 633 (S.D.N.Y. 2005) ("[t]he particular misstatements that plaintiffs allege — generalizations regarding integrity, fiscal discipline and risk management — amount to no more than puffery"); *In re Kidder Peabody Securities Litigation*, 10 F. Supp.2d 398, 413 n.15 (S.D.N.Y. 1998) ("[t]he Court agrees with defendants that they cannot be liable for these statements [extolling Kidder's 'culture,' 'cost controls,' 'integrity,' 'strategic planning,' and 'personal accountability'] insofar as these statements amount to mere puffery").

Each of these cases throws into high relief just what is lacking in the instant case: Statements that are rendered misleading by the omission of material information, creating a duty to disclose that information about the true sources of defendants' business results.

C. Statements in Household's Press Releases Do Not Create a Duty to Disclose Information in Separate, Subsequent SEC Filings, and No Duty to Correct Is Applicable

Finally, Plaintiffs contend that Defendants had a duty to disclose in each of Household's 10-Ks and 10-Qs that Household engaged in predatory lending practices because the statements made in Household's earnings press releases gave rise to a "duty to correct." Plaintiffs have provided no authority — and Defendants are aware of none — for the novel theory that a purported half-truth in one document gives rise to a duty to disclose in a separate document of a different nature, published through a different channel for a different purpose, and often lagging behind by a month or more. Instead, Plaintiffs attempt to squeeze the facts of this case into a "duty to correct" theory, citing inapposite authority.

In explaining their "duty to correct" theory, Plaintiffs allege that "defendants knew that previously reported statements made in Household's press releases were false and misleading, but subsequently repeated the same false statements." Pls. Br. at 9. Under Rule 10b-5, a duty to correct arises only "when a company makes a historical statement that, at the time made, the company believed to be true, but as revealed by subsequently discovered information actually was not." *Stransky* v. *Cummins Engine Co., Inc.*, 51 F.3d 1329, 1331 (7th Cir. 1995). *Accord Oran* v. *Stafford*, 226 F.3d 275, 286 (3d Cir. 2000). Plaintiffs' assertion that the duty to correct "must likewise apply" in a case where the defendants allegedly knew the prior statements were false, Pls. Br. at 9, is legally unfounded. The sole case Plaintiffs reference in support of their turnabout duty — *Gallagher* v. *Abbott Laboratories*, 269 F.3d 806, 810 (7th Cir. 2001) — is silent on the issue of Defendants' knowledge of falsity, as that was not at issue in the case, noting only that an *error* in a dollar amount quoted as net income should be corrected. *Id*.

Furthermore, Plaintiffs challenge the earnings results in Household's press releases and public filings on the basis of the purported origin of the revenues but they do not claim that the earnings themselves were false. However, "a statement may be 'corrected' only if it was *in*correct when made." *Gallagher*, 269 F.3d at 810 (finding no duty to correct where nothing said in the earlier statement was incorrect) (emphasis in original). *See also Oran*, 226 F.3d at 286 (finding no legal duty to update in the absence of a misleading prior representation). Not only are accurate earnings results inactionable under Rule 10b-5 even where they allegedly resulted in part from illicit practices (as mentioned in Sections A and B above), an announcement of such earnings does not trigger any sort of duty to correct or update them because it is uncontested that they were accurately reported.

III. CONCLUSION

Plaintiffs have previously identified certain statements from Household's 10-K and 10-Q filings as statements upon which they will base their 10b-5 claims. Plaintiffs should be precluded from supplementing or adding to the list of alleged false statements reflected in the document identified as PX ID 1473. Further, Plaintiffs should be precluded from arguing to the jury or adducing testimony (1) that any statement on PX ID 1473 is false or misleading as a result of any Defendant's failure to disclose, in the same filing, information about the predatory lending practices that Plaintiffs allege were used at Household; (2) that any Generally Accepted Accounting Principle or any rule or regulation promulgated by the SEC or any self-regulatory authority creates a duty to disclose that may give rise to liability under 10b-5; or (3) that there is any general duty to disclose information in a 10 K or 10-Q.

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Respectfully submitted,

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