UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION FOR JUDGMENT AS A MATTER OF LAW PURSUANT TO RULE 50(a)

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I. INTRODUCTION

Plaintiffs submit this memorandum in opposition to Defendants' Motion for Judgment As a Matter of Law Pursuant to Rule 50(a) ("Defs' Mem."). As shown in greater detail below, defendants' motion should be denied as plaintiffs have presented substantial evidence as to each of the elements necessary to establish liability as to each defendant. Significantly, defendants' distorted recitation of the facts bears little, if any, resemblance to the testimony and exhibits in the record. In fact, defendant William F. Aldinger – Household International, Inc.'s ("Household" or the "Company") CEO – admitted on the stand that the reaging policies set forth in the 2001 Form 10-K that both he and defendant David A. Schoenholz signed were materially false and misleading. Transcript of Proceedings ("Tr.") at 3437:22-3441:16. This admission, the testimony of plaintiffs' witnesses and the contemporaneous documents admitted as evidence at trial are more than sufficient to let a jury resolve this matter. Simply put, defendants cannot meet the heavy burden under Rule 50(a) for judgment as a matter of law.

II. LEGAL STANDARD

The movant on a Federal Rules of Civil Procedure ("Rule") 50(a) motion bears a heavy burden. A motion under Rule 50(a) "should be granted cautiously and sparingly" because it "deprives the party opposing the motion of a determination of the facts by a jury." 9A C. Wright & A. Miller, *Federal Practice and Procedure* § 2524, at 252 (1995). Under Rule 50(a), judgment as a matter of law is proper only where "a reasonable jury would not have a legally sufficient evidentiary basis to find" for the nonmoving party. Fed. R. Civ. P. 50(a); *see Zimmerman v. Chicago Bd. of Trade*, 360 F.3d 612, 623 (7th Cir. 2004); *see also Reeves v. Sanderson Plumbing Prods., Inc.*, 530 U.S. 133, 149 (2000). "[T]he court is required to view the evidence in the light most favorable to the nonmoving party, and must draw all reasonable inferences in that party's favor." *Zimmerman*, 360 F.3d at 623 (citing *Reeves*, 530 U.S. at 150-51); *see Lytle v. Household Mfg., Inc.*, 494 U.S. 545

(1990)). As the Seventh Circuit explained, "We may not weigh the evidence or pass on the credibility of witnesses, nor may we substitute our view of the contested evidence for the jury's." *Zimmerman*, 360 F.3d at 623. "[T]he standard for granting summary judgment 'mirrors' the standard for judgment as a matter of law, such that 'the inquiry under each is the same.'" *Reeves*, 530 U.S. at 150.[1]

Accordingly, "in entertaining a motion for judgment as a matter of law, the court should review all of the evidence in the record." *Id.* "In doing so, however, the court must draw all reasonable inferences in favor of the nonmoving party, and it may not make credibility determinations or weigh the evidence." *Id.* Under this standard, defendants' Rule 50(a) motion should be denied in its entirety.

III. THE EVIDENCE ADMITTED IN THIS CASE ESTABLISHES LOSS CAUSATION

Defendants contend that Professor Daniel R. Fischel's testimony and related exhibits fail to establish loss causation under *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005) and its progeny. Defendants are wrong. *Dura* held that the acquisition of stock at an inflated purchase price alone does not satisfy the loss causation element of Rule 10b-5; rather, the plaintiff also had to show that a subsequent drop in the stock price was the result of the truth becoming known. *Id*. at 347. Applying *Dura*, the Seventh Circuit explained in *Ray v. Citigroup Global Mkts.*, 482 F.3d 991, 994-95 (7th Cir. 2007) that "loss causation" requires proof of "the fact that the defendant's actions had something to do with the drop in value." As the *Ray* court indicated, *Dura* did not change the standard for pleading or proving loss causation in the Seventh Circuit. *Id.* at 995 (citing *Bastian v. Petren Resources Corp.*, 892 F.2d 680, 683 (7th Cir. 1990) (loss causation is a standard common law

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[1] Here, as elsewhere, citations are omitted and emphasis added unless otherwise noted.

concept applied in securities fraud cases) and *Caremark, Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 647 (7th Cir. 1997) (but for circumstances loss concealed, value of investment would not have declined)). Significantly, Professor Fischel's testimony and related exhibits establish the loss causation required by *Dura* by linking declines in Household's stock price to the truth becoming known.

A. Professor Fischel's Testimony and Event Study Established that Defendants' False Statements and Omissions Caused Inflation and Resulted in Losses When the Truth Became Known

The evidence of loss causation provided by Professor Fischel is fully consistent with Seventh Circuit precedent and this Court's rulings. In *Ray*, the Seventh Circuit explained there are "several ways in which a plaintiff might go about proving loss causation." 482 F.3d at 995. The *Ray* court held that plaintiffs prove loss causation if they "show 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." *Id.* (citing *Dura*, 544 U.S. 336). This is exactly what Professor Fischel did at trial.

Professor Fischel testified as to the analysis he performed and the conclusions that he drew from this analysis:

> Q. Now, given that assumption, what did you do in this case?
>
> A. What I did was, obviously, first familiarize myself with the background of the case, looking at the allegations, the pleadings, the responses, a set of legal issues that formed the background of the case.
>
> And then I looked at a massive amount of information, documents about Household disclosures, analyst commentary about those disclosures.
>
> I also looked very carefully at Household's stock price movements during the relevant period, the stock -- comparable stock price performance of competitors of Household, various indexes that Household identified as the way its performance should be judged against.
>
> I performed a statistical analysis of stock price movements relating the information that became known to investors during the class period to Household's

> stock price. And I measured the amount of inflation on every day during the relevant period using two different methods, which is a way to calculate the amount of loss that any individual investor suffered during the relevant period, depending on what day they purchased and what day they sold.
>
> Q. Based on the analysis that you described, did you form any opinions in this case?
>
> A. Yes. I formed the opinion that Household's disclosure defects, its inaccurate disclosures, caused there to be significant inflation in Household stock price for much of the relevant period. And as a result, again depending on when investors purchased and when they sold, investors in Household stock suffered very significant losses as a result of Household's defective disclosures.

Tr. at 2603:10-2604:14 (testimony of Professor Fischel).

The statistical analysis that Professor Fischel performed is what is commonly referred to as an event study. Tr. at 2621:1-3; Plaintiffs' Trial Exhibit ("Pltfs' Ex.") 1391 (the event study). Based on this event study, Professor Fischel developed two models to quantify inflation as to each day of the Class Period, which he explained at length with the assistance of demonstrative exhibits and other documentary evidence. Pltfs' Exs. 1395 & 1397. He explained both methods he used to quantify inflation (Tr. at 2601:11-2671:18, 2671:19-2685:23, 2837:22-2855:23, 2963:20-2969:9); explained why the "specific disclosure" model was more conservative than the "leakage model" (*see, e.g.*, Tr. at 2851:20-24; 2852:17-20); and prepared three charts that have been admitted into evidence demonstrating the existence and amount of artificial inflation in Household's common stock related to the alleged fraud, during the relevant period. *See* Pltfs' Ex. 1391 (Event Study); Pltfs' Ex. 1397 (Estimate of Alleged Artificial Inflation Using Specific Disclosures); Pltfs' Ex. 1395 (Estimate of Alleged Artificial Inflation For Quantification Including Leakage).

In his "specific disclosures" model, Professor Fischel identified 14 separate fraud-related disclosures during the November 14, 2001 to October 11, 2002 time frame in which there was statistically significant stock movement. He quantified the impact of each disclosure on the price of Household stock. Pltfs' Ex. 1397; Tr. at 2669:11-2670:1. In his "leakage" model, Professor Fischel calculated a second quantification of the impact of fraud-related disclosures on Household's stock

price. Pltfs' Ex. 1395; Tr. at 2855:17-23 (leakage model "takes into account the economic reality in this case where negative information came out slowly over time precisely because Household did not admit the predatory lending practices that it was involved in or the improper accounting as a result of re-aging, and the restatement of the truth only became known gradually as a result of real world events and commentary by third parties"); Tr. at 2969:3-7 (leakage model takes into account "all the evidence of the leakage of the Washington Department of Financial Insurance report, as well as all the leakage of the settlements, the possible settlements, and all the criticism of Household's predatory lending practices, as well as its re-aging policies").

Professor Fischel explained that the "first date" on which a stock's price is artificially inflated is the date on which defendants start making materially false statements or omissions:

> Q. And if there is no false or misleading statement before August 16, 1999, does that mean that there's zero inflation in the stock?
>
> A. No. So long as there is a false and misleading statement on this particular date, inflation would begin on this date going forward but again I want to be careful because if there's no false and misleading statement before this date then any purchasers before this date wouldn't suffer any harm and wouldn't be entitled to any recovery. There would be no difference between the stock price and the true value the way there is on my exhibit because I assumed the false and misleading statements began on July 30, 1999. But if it's more accurate as I said in my report actually to start on August 16, then anybody who purchased between July 30 and August 16, those columns in the exhibit would basically disappear and inflation would begin on August 16.

Tr. at 2850:20-2851:11.

He further explained that the determination of ***whether*** a false and misleading statement occurred on any particular date is a question for the jury. He "assumed that the defendants did make false statements during the relevant period in order to perform [his] quantifications." Tr. at 2602:21-23. That is a "necessary assumption to make that's ***always made*** because the job of determining whether or not statements are false or misleading, that's an issue for the Court and the jury . . . [t]hat's not an economic question." Tr. at 2603:1-4.

Because both of Professor Fischel's models are based on an event study, both models provide evidence of loss causation. This Court has already held that Professor Fischel's methodology is a proper way to satisfy loss causation. Dkt. No. 1527. The Court specifically noted in rejecting defendants' *Daubert* motion that "'[t]ypically, event studies work backward from what is ultimately determined to be a fair price, after dissipation of inflation, to determine ***how much inflation*** was contained in the price due to fraud during the relevant time frame ***all the way back to the beginning.***" Dkt. No. 1527 at 2. This Court also noted, "To the extent that defendants take issue with Fischel's analysis, they are, in essence, questioning the validity of the use of an event study to establish materiality and causation. However, an event study is '[t]he gold standard, which is accepted by both courts and economists . . . .'" *Id.* (quoting Marge S. Thorsen *et al.*, *Rediscovering the Economics of Loss Causation*, 6 J. Bus. & Sec. L. 93, 99 (2006).

Significantly, defendants do not take issue with Professor Fischel's methodology here. Rather, defendants suggest that Professor Fischel, "with one minor, quickly reversed exception," found the statements at issue "had no impact on the price of Household stock." Defs' Mem. at 4; *see also id.* at 5 (asserting Professor Fischel found only one statement that "introduced artificial inflation" into the stock price). This assertion is a complete mischaracterization of the results of Professor Fischel's event study and his testimony. As Professor Fischel explained, there does not need to be a "statistically significant" price increase after a statement is made in order for that statement to cause inflation in the stock if that statement is in fact false or misleading or omits a material fact:

> Q. Let me ask you a simple question. Counsel showed you all these public statements that Household made. Do you need to find a statistically significant price increase on the dates of these public statements in order for there to be inflation in Household's stock under your specific disclosure model?
>
> A. No. That's really the whole point, that the reason why there's no statistically significant price increase in response to all those disclosures where there's big red Xs

> is because in each one of those disclosures, Household was reaffirming its growth strategy. It was denying any wrongdoing. It was defending its accounting.

Tr. at 2963:21-2964:6.

Professor Fischel's testimony is in accord with the case law.[2] *See*, *e.g.*, *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 419 (5th Cir. 2001) ("in certain special circumstances public statements falsely stating information which is important to the value of a company's stock traded on an efficient market may affect the price of the stock even though the stock's market price does not soon thereafter change. For example, if the market believes the company will earn $1.00 per share and this belief is reflected in the share price, then the share price may well not change when the company reports that it has indeed earned $1.00 a share even though the report is false in that the company has actually lost money (presumably when that loss is disclosed the share price will fall."); *McEwen v. Digitran Sys.*, 160 F.R.D. 631, 640 (D. Utah 1994) (attached to the accompanying Appendix of Unreported Authorities ("App."), Tab 1). *See also In re Cendant Corp. Litig.*, 264 F.3d 201, 239 n.21 (3rd Cir. 2001).

The *McEwen* court's ruling is directly applicable here:

> Evidence before the Court at this point is to the effect that the market expected the additional fiscal 1992 revenues of $1.4 million, which could explain why there was no change in the price of Digitran's stock when the contracts in question were announced to the public. Manifestly, the market does not react to information that is already anticipated. Had Digitran announced that its revenues for the fiscal year 1992 would be much lower than forecasted, a downward adjustment in the price of Digitran's securities reasonably could have been expected. A similar result likely would have occurred if Digitran had reported that for the past three years that it had improperly included capitalized simulator development costs as an asset on its balance sheet. The point is that if plaintiffs' allegations are true, it clearly can be said that the market price was artificially affected or inflated by the

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[2] Professor Fischel's testimony also finds support in the relevant economic literature. 22 B. Cornell and R.G. Morgan, "*Using Finance Theory to Measure Damages in Fraud on the Market Cases*," 37 UCLA L. Rev. 883, 905 (1990) (Figure 1 shows that the observed market price can become inflated even if it remains basically constant because, had adverse information been disclosed, the market price would have declined.).

> misrepresentations and omissions notwithstanding the fact that the market price did not change after the two contracts were announced towards the end of the 1992 fiscal year.

McEwen, 160 F.R.D. at 640. The *McEwen* court also explained the fallacy in defendants' arguments on this point: "the fraud-on-the-market theory . . . applies not just when a material misrepresentation or omission causes a change in price, but rather when a misrepresentation or omission has an artificial effect upon the price of the security." *Id.* at 640 n.11.

Significantly, defendants do not directly argue that plaintiffs must show the ***price*** of the stock "increased" on the date of a denial or omission. This would be a radical innovation contrary even to the case law defendants cited in their brief. For example, *In re Northern Telecom Ltd. Sec. Litig.*, 116 F. Supp. 2d 446 (S.D.N.Y. 2000), actually states that plaintiffs' burden on loss causation is the "burden of coming forward with evidence creating a triable issue of fact on whether the statements or omissions at issue inflated or maintained Nortel's stock price." *Id.* at 461; *accord In re Blech Sec. Litig.*, 928 F. Supp. 1279, 1286 (S.D.N.Y. 1996) (upholding complaint alleging violations of securities laws where defendants had artificially "inflate[ed] and maintain[ed] the trading volumes and trading prices" of certain securities). Simply put, neither *Northern Telecom* nor *In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Securities Litig*, 250 F.R.D. 137 (S.D.N.Y. 2008) (App., Tab 2), the other case cited by defendants, holds that plaintiffs must prove a statistically significant price increase as a result of the false statements or omissions.

Defendants also claim that under his specific disclosures model, Professor Fischel concluded that $7.97 per share of inflation was "fully in place on the first day" of the Class Period. Defs' Mem. at 8. They suggest that this means plaintiffs are pursuing "time barred" claims. *Id.* Defendants simply ignore Professor Fischel's testimony that ***by definition*** a stock is not inflated until the first false statement or omission was made. Responding to defense counsel's question of whether the

"same statement" made on July 22, 1999 (pre-Class Period) could have "caused" the inflation in Household's stock on August 16, 2002 (during the Class Period), Professor Fischel explained:

> Well it doesn't stay the same because there can't be any inflation before July 30 according to the relevant period as defined by the Court in this case. ***So there is no inflation on July 22 by definition because it's not part of the case. There's nothing to quantify. Inflation only begins when the relevant period begins as of the first date that the jury finds that a statement was false and misleading.*** I guess the only way the July 22 statement could be relevant would be if there was a duty on the part of Household to correct a prior false statement as of July 30 but still the first relevant date would be July 30, nothing before then could constitute inflation because it's not part of the case.

Tr. at 2976:25-2977:11; *see also* Tr. at 2924:10-13 ("There cannot be any inflation ***before*** the jury concludes that a statement that Household made was false or a time when Household had an obligation to correct misstatements that were made in the past, correct."); Tr. at 2922:25-2923:2 ("***If there's no claim of any right to recover*** on July 29th, then I would say, by definition, there's no inflation on July 29th.").

Professor Fischel explained that his analysis calculates damages as of the first date that the jury determines a false and misleading statement or omission was made, going forward. Tr. at 2851:20-24 ("Under what my analysis does is it provides a method of quantifying the amount of inflation on any given day ***and subsequent days***, provided that the jury finds that as of that date a false and misleading statement has been made."); *see also* Tr. at 2852:17-20 ("But basically, as of the ***first false and misleading*** statement, there would be inflation on ***every single day after that until the false and misleading information was corrected***."). Later statements that include the same false information or fail to disclose accurate information are actionable in and of themselves.

Plaintiffs have provided more than sufficient evidence that defendants' false and misleading statements during the Relevant Period caused inflation in the price of Household stock as required under *Dura*. Nothing more is required.

B. Plaintiffs Have Adduced Evidence Sufficient to Support Any Reasonable Jury's Conclusion that the Revelation of Household's Fraud Caused Its Stock to Decline and Caused Substantial Economic Harm to the Class

Plaintiffs have provided ample evidence that Household's misrepresentations and omissions are responsible for plaintiffs' economic losses. However, defendants continue to claim, citing no evidentiary support whatsoever, that some unrelated market force caused Household's stock to decline. Defs' Mem. at 6. Significantly, with respect to loss causation, it is defendants' burden under Rule 50(a) to "establish that, ***as a matter of undisputed fact***, the depreciation in the value of the [security] ***could not have resulted from the alleged false statement or omission of the defendant***." *Caremark*, 113 F.3d at 649-50. Defendants have not met their burden.

Professor Fischel testified that he used a regression analysis replicated in his event study (which has been admitted into evidence as Pltfs' Ex. 1391) to ***isolate*** information and damage due ***only*** to defendants' misrepresentation and omissions. Tr. at 2622:8-12 ("And what the regression analysis does that's reproduced in the event study is, it analyzes on any given day how much of a company's stock price movement is explained by the market in the industry as opposed to how much is specific to the particular company.").

Both of the methods Professor Fischel used to quantify inflation – based on his event study – ***further isolate*** information and related stock movements specific to the fraud alleged by plaintiffs in this case. Using the 14 disclosure dates in his specific disclosures model, Professor Fischel "isolate[ed] the fraud-related disclosures that were important to investors." Tr. at 2628:3-4. Similarly, Professor Fischel isolated the stock movement due to fraud in his "leakage" model:

> Q. Like your specific disclosure model, does this quantification use statistical methods to account for the market and industry influences on Household's stock prices?
>
> A. ***Yes, it does***.

Tr. at 2683:13-16.

Defendants' reliance on *In re Williams Sec. Litig.*, 496 F. Supp. 2d 1195, 1272 (N.D. Okla. 2007), *aff'd*, *In re Williams Sec. Litig.* – WCG Subclass, 558 F.3d 1130 (10th Cir. 2009) is misplaced. *In re Williams* does not support defendants' position that plaintiffs have not "proved" loss causation. Defs' Mem. at 9-10. As this Court noted in rejecting Household's *Daubert* motion, "the [*Williams*] court barred the loss causation expert's testimony because he 'performed no regression analysis, or even an analysis of statistical significance, to differentiate fraud-related effects from forces unrelated to the fraud'" (Dkt. No. 1527 at 3 n.1), where as "[i]n the instant case, however, Fischel performed a regression analysis and employed a statistical significance measure in his event study." *Id.*

Defendants argue Professor Fischel "admitted" that he included inflation "not at all fraud related." Defs' Mem. at 9-10. To the contrary. Professor Fischel testified that he controlled for non-fraud factors, and that any non-fraud factors included in the leakage model had ***no effect*** on the inflation in Household's stock because the non-fraud disclosures cancelled each other out:

> Q. And did you also analyze whether company-specific factors unrelated to the alleged fraud can explain Household's stock price decline during this latter part of the relevant period?
>
> A. Yes, I did. I looked at that carefully.
>
> I noticed that there were a lot of disclosures that had some fraud-related information in it and some other disclose -- and part of the disclosure did not have – dealt with something other that was fraud related.
>
> There were some -- some of those disclosures that had a positive effect, some had a negative effect; but overall it was impossible to conclude that the difference between the true value line and the actual price would have been any different had there been no disclosures about non-fraud-related information during this particular period. ***Some positive, some negative. They cancel each other out.***

Tr. at 2683:17-2684:6.

In sum, defendants' Rule 50(a) motion concerning loss causation fails for the same reasons their *Daubert* motion failed on the exact same substantive issues.

IV. PLAINTIFFS' CLAIMS ARE NOT TIME-BARRED

Defendants' arguments respecting the statute of repose are a rehash of the arguments made in their summary judgment motion. Plaintiffs therefore incorporate by reference the arguments made in their opposition to that motion. Dkt. No. 1239. Defendants' argument is no more persuasive the second time around. Professor Fischel's testimony establishes that the artificial inflation present in the stock price during the Class Period was in fact caused by defendants' statements during the Class Period.

As discussed above, each statement is an independent cause of action. Plaintiffs' first alleged false statement is the Household Form 10-Q issued on August 16, 1999. Defs' Ex. 854. In conducting his analysis, Professor Fischel assumed that plaintiffs could prove this was a false or misleading statement. Tr. at 2849:11-16 (testimony of Professor Fischel). August 16, 1999 is outside the statute of repose. Accordingly, plaintiffs' claims are not time-barred.

Defendants erroneously suggest that any inflation existing in the stock price as of August 16, 1999 and thereafter results from pre-Class Period statements. As Professor Fischel explained, the existence of inflation in the stock price on a particular day is contingent upon whether defendants disclose the truth on that day. Put differently, if defendants had revealed the truth on the first day of the Class Period or at any time thereafter, there would have been no inflation as of that day.

> Q. And do each subsequent statement – public statement by Household cause inflation to remain in a stock?
>
> A. Yes, absolutely. And any increases or decreases depending on misrepresentations, which occurred at the time of December 5 when there was the response to the Barron's article, another misrepresentation with the best practices initiative in February, those would be misrepresentations which affect the amount of inflation.
>
> There would be more inflation coming in to the stock on those days. But basically, as of the first false and misleading statement, there would be inflation on every single day after that until the false and misleading information was corrected.

Tr. at 2852:8-20 (testimony of Professor Fischel); *see also id.* at 2619:19-24 (same).

Defendants' statute of repose argument therefore fails.

V. PLAINTIFFS HAVE DEMONSTRATED THAT DEFENDANTS' FALSE STATEMENTS AND OMISSIONS WERE MATERIAL

Defendants argue that plaintiffs have failed to establish the materiality of defendants' misrepresentations and omissions on the grounds that they did not have any affect on the price of Household stock. Defendants' argument is both legally and factually flawed. As the Supreme Court noted in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the test for materiality is fact specific and depends on the significance the reasonable investor would place on the withheld or misrepresented information. *Id*. at 240; *Eisenstadt v. Centel Corp.*, 113 F.3d 738, 742 (7th Cir. 1997) (whether a fact is material depends on whether a reasonable investor would have considered it a reason to buy or not sell). The reaction of the stock price is one of many factors that bears on materiality. *Greenhouse v. MCG Capital Corp.*, 392 F.3d 650, 660-61 (4th Cir. 2004) ("The majority rule seems to be that [stock price history] can be ***some*** evidence, but not, standing alone, ***dispositive*** evidence.") (emphasis in original). More to the point, defendants' argument is flatly refuted by the testimony of Professor Fischel and the related exhibits that establish that defendants' misrepresentations and omissions did have an impact on the price of Household stock. Additionally, defendants themselves admitted the materiality of their misrepresentations and omissions. Plaintiffs have, thus, presented adequate evidence of materiality.

As Professor Fischel explained during trial, a false statement does in fact "impact" the artificial inflation in the stock if it maintains that inflation:

> There is also an equally equivalent way that inflation can occur if a company discloses information but fails to disclose something negative about itself that it knows about but investors in the marketplace do not know about. In that situation the stock is inflated because the stock is prevented from falling to a lower level, which is the level that the stock would have fallen to had the company disclosed the additional negative information that it failed to disclose. That's a traditional omission type of situation causing inflation.

Tr. at 2605:10-19 (testimony of Professor Fischel). By contrast, a disclosure regarding the true financial status would cause the inflation to decline. *See Nathenson*, 267 F.3d at 419; *McEwen*, 160 F.R.D. at 640 n.11. Thus, as noted above, if defendants had revealed the truth on the first day of the Class Period or at any time thereafter, the inflation would have dissipated. Tr. at 2852:8-20 (testimony of Professor Fischel); *see also id.* at 2619:19-24 (same).

More to the point, plaintiffs have established substantial record evidence regarding the materiality of defendants' false statements. As an initial matter, Professor Fischel's analysis establishes the materiality of defendants' false statements. As he testified, there were statistically significant stock price declines as the truth came out about the fraud. In addition, defendants themselves have admitted the materiality. As to the reaging statements and omissions, defendant Aldinger admitted on the stand that Household made a materially false and misleading statement regarding reaging in the 2001 Form 10-K. Tr. at 3437:22-3441:16; *see also* Tr. at 1898:13-18; 1899:5-10 (Schoenholz admitting materiality of 2+ statistics); Tr. at 3009:25-3010:18; 3022:3-10 (Aldinger admitting materiality of 2+ statistics). As to the restatement, defendants admitted materiality when they restated their prior financial statements as a restatement only occurs when there is a material error. Tr. at 2493:22-2494:12 (Testimony of Harris L. Devor); Tr. at 3053:19-21 (testimony of Aldinger). Defendants likewise admitted on the stand that their statements and omissions as to the predatory lending practices were material. Tr. at 3329:10-12 (testimony of Aldinger: "the effect the negative press has on the shares could be very material"); *id.* at 3331:12-22 (testimony of Aldinger: "the concerns about regulatory issues were dragging our stock price down").

There is substantial evidence in the record regarding the materiality of the false statements and omissions at issue.

VI. PLAINTIFFS HAVE ESTABLISHED FRAUD IN CONNECTION WITH HOUSEHOLD'S RESTATEMENT

Plaintiffs have introduced sufficient evidence demonstrating fraud with respect to the August 14, 2002 restatement. Contrary to defendants' conclusory assertions, this record evidence is more than simply the fact that Household restated. Plaintiffs presented evidence regarding the magnitude and seriousness of the restated accounting, its impact on defendants' compensation (motive), and the red flags received by management. This evidence, together with the evidence of scienter discussed elsewhere in this brief,[3] provides a solid evidentiary basis for any reasonable jury to decide that defendants acted with scienter under the totality of the circumstances test adopted by the Seventh Circuit. *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 603 (7th Cir. 2006), *reversed on other grounds*, 551 U.S. 308 (2007); *Chu v. Sabratek Corp.*, 100 F. Supp. 2d 815, 825 (N.D. Ill. 2000). Moreover, the announcement of the restatement resulted in a relative price decline. Tr. at 2626:18-23 (testimony of Professor Fischel). Given plaintiffs' evidence as to securities fraud with respect to the restatement, the jury should be allowed to resolve this issue.

Restatements are evidence of fraud, including scienter. "The more serious the error, the less believable are defendants' protests that they were completely unaware of [the company's] true financial status and the stronger is the inference that defendants must have known about the discrepancy." *Rehm v. Eagle Fin. Corp.*, 954 F. Supp. 1246, 1255-56 (N.D. Ill. 1997). Here defendants made four errors, each having the effect of improperly bolstering income by deferring the recognition of expenses: "All four of them – all four contracts, the accounting for it, overstated net income for all those periods." Tr. at 2489:23-25 (testimony of Mr. Devor). By virtue of this

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[3] Plaintiffs discuss additional evidence bearing on defendants' scienter in Sections VIII and X, which they incorporate herein by reference.

accounting, reported revenues during the Class Period increased between 6.5 and 1.2% depending on the quarter and/or year. *Id.* at 2491:4-2493:20.

Defendants' scienter is also established by their motive to increase their personal compensation. The admittedly improper accounting positively impacted reported earnings per share during the Class Period and thus, defendants' personal compensation, which was heavily dependent upon reaching earnings per share targets. If defendants had properly accounted for these contracts, defendants would not have made these earnings per share targets. *See* Pltfs' Ex. 774 at HHS03174113 (showing target of EPS of $4.05 under incentive plan); Tr. at 2051:12-20 (testimony of Schoenholz – reported EPS dropped from $4.08 to $3.91 in 2001 as a result of the restatement). Bonus compensation for the defendants during this period was up to five times their base salary. Pltfs' Ex. 772 at HHS03173760 (salary of $1 million and bonus of $5 million). "[T]he Seventh Circuit has established motive as a 'useful indicator,' and should not be taken lightly." *In re JPMorgan Chase & Co. Sec. Litig.*, MDL No. 1783 - C.A. No. 06 C 4674, 2007 U.S. Dist. LEXIS 93877, at *24 (N.D. Ill. Dec. 18, 2007) (App., Tab 3). The fact that defendants were motivated to increase their personal incentive compensation, therefore, is an important consideration in proving scienter. *Id.*

Additionally, Household's accounting of these credit card contracts was important enough to be raised every year with the Audit Committee. Pltfs' Exs. 176 and 694. For example, the November 13, 2000 Quality of Accounting presentation to the Audit Committee expressly discussed the GM, AFL-CIO and UP accounting. Pltfs' Ex. 176 at HHS02018104. It also referenced the Kessler contracts. *Id.* at HHS02018103. The Audit Committee presentation in 2001 also referenced the accounting for these three contracts. Pltfs' Ex. 694. Schoenholz testified that he would have reviewed these presentations. Tr. at 1882:7-9.

Plaintiffs have presented additional evidence of red flags that called the accounting into question. Mr. Devor testified, "There's testimony and things that indicate the way this [the GM contract] was accounted for, that Arthur Andersen was not comfortable with the accounting." Tr. at 2522:13-15. Mr. Devor further testified that Andersen received indications from the relevant accounting body that the proposed accounting that Household later adopted was improper and that Andersen shared this information with Household. *Id.* at 2522:21-2523:3.

Further, in 1998, the Office of the Comptroller of the Currency raised questions about Household's accounting for three of the four contracts, the GM, AFL-CIO and UP contracts. Pltfs' Ex. 712. The OCC specifically stated "Management should determine if these cash vs. accrual timing and recognition differences are in keeping with FASB Statement of Concepts #3 concerning accrual accounting and expenses. The unique and complex terms of the UP and GM programs result in numerous deferred expenses and income. In several cases, the timing and recognition of certain fees (expenses) differ materially from actual cash payments." *Id.* at HHS03117481. The OCC also pointed out "assumptions that need close review" including the "recapture of the $40 million advance payment to the AFL-CIO." *Id.* at HHS03117482.

Under the totality of the circumstances test employed by the Seventh Circuit, this evidence of scienter is sufficient to allow this case to go to a jury.

A. Defendants Did Not Rely Upon Their Auditors

It is the management's responsibility to file accurate financial statements. Tr. at 2495:2-3 (testimony of Mr. Devor) [add Aldinger testimony]. This responsibility is not – and cannot be – delegated to a company's auditors. For this reason, there is no "good faith" reliance upon auditor defense. *United States v. Erickson*, 601 F.2d 296, 305 (7th Cir. 1979).

Defendants' attempt to rely upon advice from Arthur Andersen is problematic for another reason. Although defendants state that Andersen gave them a clean audit opinion, Mr. Devor

testified that Andersen had concerns about some of the Company's accounting and raised it with the Company. Tr. at 2522:13-15 & 2525:9-12. Similarly, Mr. Devor testified that Andersen provided no advice as to whether to recognize income with respect to the Kessler contracts: "It doesn't look like they looked at the revenue recognition issue that ultimately resulted in the company restating." Tr. at 2544:14-16. The evidence, thus, is that defendants did not rely upon their auditor's advice as to two of the four contracts at issue. In any event, this argument, even if true, would at most create a factual dispute for the jury to resolve.

B. Household's Accounting Assertion Was Not Reasonable

Defendants pretend that they were caught between the conflicting opinions of their successive auditors, Andersen and KPMG. Defs' Mem. at 19. As discussed above, this is untrue – defendants made their own choices about how to account for these credit card contracts. The fact that defendants restated is itself an admission that defendants' initial accounting was in error *ab initio.* Equally probative is Mr. Devor's testimony that Household's accounting was not reasonable. In discussing the AFL-CIO contract accounting, Mr. Devor pointed out that "FASB Statement of Financial Accounting Concept No. 5 requires that expenses be allocated in a systematic, rational manner to the period in which the related assets are expected to provide benefits. This asset wasn't being amortized at all." Tr. at 2538:17-22. In this situation, he found no room for a legitimate difference of opinion:

> I think, you know, if they were amortizing this asset over four years instead of two years or seven years instead of five years, I would say there might be a difference of opinion. But they weren't amortizing this asset at all. They were leaving this asset on the balance sheet and they weren't amortizing it at all. You know, that, to me, is not necessarily a difference of opinion. I don't agree with that.

Tr. at 2539:9-15.

Finally, putting aside all of the foregoing, defendants' evidence merely triggers a factual dispute with plaintiffs' substantial evidence of scienter such that the jury should be allowed to resolve this issue.

C. The Stock Price Declined On a Relative Basis

Defendants' claim that Household's stock price increased as a result of the restatement is simply absurd. As Professor Fischel testified, in measuring the market's reaction to a company-specific disclosure, one must account for how the market as a whole and the relevant industry performed. Tr. at 2621:24-2623:17. Viewed relative to the movement of the market, Household's stock price saw a statistically significant ***decline*** as a result of Restatement. *Id.* at 2624:3-2627:4 (testimony of Professor Fischel regarding August 14, 2002 movement of Household stock price). Indeed, on that date, Household stockholders suffered a loss of 94 cents per share. *Id.* at 2626:18-23. This evidence establishes loss causation as to this issue.

For the foregoing reasons, there is more than sufficient evidence to allow the jury to decide whether defendants committed fraud with respect to the Restatement.

VII. DEFENDANTS' FAILURE TO DISCLOSE HOUSEHOLD'S PREDATORY LENDING PRACTICES IN ITS FORM 10-K AND FORM 10-Q CLASS PERIOD FILINGS IS A MATERIAL OMISSION THAT RENDERS EACH FORM 10-K AND FORM 10-Q ACTIONABLE

Under the federal securities laws, omitted facts or information are material "only if a reasonable investor would have viewed the misrepresentation or omission as 'having significantly altered the total mix of information made available.'" *In re Sofamor Danek Group, Inc.*, 123 F.3d 394, 400 (6th Cir. 1997) (quoting *Basic*, 485 U.S. at 232); *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1332 (7th Cir. 1995) (same). Indeed, "a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. Rather, an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts." *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993). However, once a

defendant speaks, there is a duty to "speak truthfully and to make such additional disclosures as [were] necessary to avoid rendering the statements made misleading." *In re Par Pharm., Inc. Sec. Litig.*, 733 F. Supp. 668, 675 (S.D.N.Y. 1990) (concluding that a jury could find defendants' statements extolling Par's ability to obtain FDA approvals and comparing Par's success to other companies to be materially misleading to a reasonable investor).

Plaintiffs have clearly set forth enough evidence from which a jury could conclude that Household's predatory lending practices were material. First, as noted above, defendants themselves have admitted materiality. *See*, *e.g.*, Tr. at 3329:10-12, 3331:12-22 (testimony of Aldinger). Second, plaintiffs' accounting expert, Mr. Devor, testified, based on Company documents, that approximately $3.2 billion of Household's Class Period net income was attributable to the Company's predatory lending practices during the relevant time period out of nearly $100 billion. Tr. at 2409:9-2410:9 (testimony of Devor). In 1999, for example, 28% of Household's net income was attributable to its predatory lending practices. Tr. at 2415:2-5 (testimony of Devor). In 2000, 32% of Household's net income was derived from the Company's predatory lending practices. Tr. at 2415:7-9 (testimony of Devor). In 2001, 36% of the Company's net income was attributable to Household's predatory lending practices. Tr. at 2415:11-12 (testimony of Devor). In the first two quarters of 2002, it was 32.8%. Tr. at 2415:13-15 (testimony of Devor). Mr. Devor further testified that the amounts attributable to predatory lending were material. Tr. at 2416:7-14. Based on Mr. Devor's testimony, a jury could easily find that Household's failure to disclose its predatory lending practices "'significantly altered the "total mix" of information made available.'" *Basic*, 485 U.S. at 232.

Moreover, Household's Class Period Form 10-Q and Form 10-K are actionable because they failed to disclose Household's predatory lending practices. During the Class Period, Household filed three Form 10-Ks and ten Form 10-Qs. Each filing reported increased net income and EPS

attributed in part to Household's strong growth. These reported numbers are actionable. *Chu*, 100 F. Supp. 2d at 820-21 (upholding complaint where statements at issue were the inflated earnings numbers).[4]

Additionally, in the very same paragraph in which Household reported its net income and EPS for the quarter, Household would attribute its "improved results" to the Company's ***strong growth***.[5] For example, in Household's Form 10-Q for the period ending June 30, 1999, Household reported:

> Our net income for the second quarter of 1999 was $326.9 million, compared to operating net income of $249.4 million a year ago. Net income for the first six months of 1999 was $647.7 million, compared to operating net income of $488.7 million in the year ago period. Diluted earnings per share was $.67 in the second quarter and $1.32 for the first six months of 1999, compared to diluted operating earnings per share of $.49 and $.96 in the same periods in 1998. ***These improved results were due to strong growth in our consumer finance business*** and significant declines in operating expenses.

Defendants' Trial Exhibit ("Defs' Ex.") 854 at HHT0015894. By putting the source of Household's growth directly "into play," defendants had a duty to "'disclose information concerning the source of its success'" – the Company's predatory lending practices – "'since reasonable investors would find that such information would significantly alter the mix of available information.'" Defendants' failure to disclose crucial information about the true source of Household's "strong growth" renders each of Household's Class Period Form 10-K and Form 10-Q filings actionable. *In re Van Der*

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[4] Plaintiffs have previously addressed this issue and incorporate by reference their earlier filing. Plaintiffs' Submission Pursuant to the Court's April 17, 2009 Statements. Dkt. No. 1564. Defendants rely on *Sofamor*, 123 F.3d 394 and its progeny for the proposition that defendants had no duty to disclose that Household engaged in predatory lending practices. As discussed in plaintiffs' earlier submission, each of the cases relied upon by defendants are distinguishable from this case.

[5] Pursuant to the Court's direction at the April 27, 2009 hearing, plaintiffs will submit a chart identifying the specific statements and circumstances giving rise to defendants' duty to disclose the existence and nature of Household's predatory lending practices with respect to each Class Period Form 10-Q and Form 10-K. Plaintiffs incorporate that chart herein by reference.

Moolen Holding N.V. Sec. Litig., 405 F. Supp. 2d 388, 401 (S.D.N.Y. 2005) (concluding that because defendants put the source of VDM Specialists revenue at issue, the failure to disclose the true sources of such revenue could give rise to liability under §10(b)); *see also In re Providian Fin. Corp. Secs. Litig.*, 152 F. Supp. 2d 814 (E.D. Pa. 2001) (same); *Steiner v. MedQuist Inc.*, No. 04-5487 (JBS), 2006 U.S. Dist. LEXIS 71952, at *53 (D.N.J. Sept. 29, 2006) (App., Tab 4) (holding that statements putting the source of the Company's revenue at issue were misleading, specifically where defendant failed to disclose its fraudulent billing scheme, instead of attributing its revenue to legitimate business factors).

VIII. PLAINTIFFS HAVE ESTABLISHED A LEGALLY SUFFICIENT BASIS FOR THEIR SECTION 10b-5 VIOLATIONS REGARDING DEFENDANTS' KNOWING MANIPULATION OF THE REPORTED DELINQUENCY RATIOS

Plaintiffs have more than sufficiently established that defendants failed to disclose the true credit quality of Household's loan portfolio by concealing the various account management techniques they employed to keep the reported 2+ delinquency ratio artificially low.

Defendants provided statements about the 2+ delinquency ratio during the relevant period in Household's earnings releases, Forms 10-K and Forms 10-Q and at the December 4, 2001 Goldman Sachs investor conference and the April 9, 2002 Financial Relations Conference ("FRC"). Household only achieved the reported 2+ ratio by reaging and other credit quality manipulations. These manipulations of the 2+ numbers were not disclosed as part of the public statements prior to March, 2002. This renders the reported 2+ numbers false and misleading. Moreover, defendants knew this at the time they disclosed these numbers publicly and thus, acted with scienter.

Plaintiffs' industry expert, Catherine Ghiglieri, testified as to how Household used reaging to manipulate the reported 2+ delinquency number. Tr. at 680:24-681:4; *id.* at 689:10-13 ("they're even planning when they're going to use it so that these loans won't then become delinquent and show up again in the two-plus bucket at year-end"). Ms. Ghiglieri discussed specific exhibits that

supported her conclusions. *See, e.g.*, Pltfs' Ex. 1387 (Mortgage Services internal e-mail: "there was no other reason for the implementation of these restructure policies other than to 'make' the predetermined delinquency number, you must take the bullet point out that restructures are not done to defer loss recognition, since it clearly does."); Pltfs' Ex. 654 (internal e-mail with Schoenholz as "cc" regarding Retail Services re-age policy): "For maximum benefit to year-end, Retail Services should perform the re-age between the customer cycle date and month end with a sweep at month end. This will ensure that all September re-ages will be unable to reach two+ at year end."); *see also* Tr. at 2365:13-2367:2 (testimony of Walter Rybak, Director of Credit Risk for Consumer Lending, one goal of reaging and restructuring was to bring down Household's 2+ delinquency number).

Ms. Ghiglieri testified as to the volume of loans reaged two or more times, and what multiple reaging meant:

> Q. And then this 47.9 percent number, what does that mean?
>
> A. Of the 15 billion, 47.9 percent had been re-aged, almost half of the 15 billion had been re-aged multiple times.
>
> Q. And what does that mean, re-aged multiple times?
>
> A. Well, it's really -- when you re-age something, you know, you're taking it out of the delinquency and you're putting it into the current bucket. And then they're not paying again, and then you re-age it again and you re-age it again. And so you are, in effect, masking your past due because there's no way for the customer -- the customer is not paying. You're just re-aging it to take it out of the delinquency bucket.
>
> And that's what Household was doing.

Tr. at 686:10-21. When defendants, including Schoenholz, finally disclosed multiple reage statistics at the April 9, 2002 Household Financial Relations Conference, they fudged the numbers with respect to the number of multiple reages by $3 billion and by not reporting re-aged loans that been

re-aged again within a year to bring them current.[6] Tr. at 2001:10-25; 2005:4-12; Pltfs' Ex. 135 (Schoenholz's presentation at FRC); Pltfs' Ex. 188 (internal document re the use of incorrect number of "re-reaged" accounts at FRC); Pltfs' Ex. 1100 (Consumer Lending would restructure loans more than once every 12 months if it secured an EZ Pay arrangement with customer). In fact, the recidivism figures for each product at Household were significantly higher if subsequent re-ages were included – for real estate loans (Household's largest loan portfolio), it was 53.9% instead of the 13% disclosed. Pltfs' Ex. 75 (e-mail regarding "re-stating" recidivism statistics to include subsequently re-aged accounts as recidivists); Pltfs' Ex. 79 (e-mail regarding Schoenholz's request – OTS recidivists); Tr. at 2006:1-2010:9 (testimony of Schoenholz).

Ms. Ghiglieri testified as to other practices used at Household to manipulate the reported 2+ numbers, including the "skip-a-pay" programs, grace period and rewrites. Tr. at 678:23-679:3 (skip-a-pay), 693:6-694:8 & 695:12-697:1 (grace period), 698:20-25 (rewrites). Ms. Ghiglieri tied defendants' reage and rewrite practices to their predatory lending practices. *Id.* at 698:10-700:7. "There's a correlation between predatory lending practices and the need for Household to re-age and mask their delinquencies." *Id.* at 700:5-7.

Other exhibits and testimony corroborate Ms. Ghiglieri's testimony and demonstrate the individual defendants' intent to manipulate the reported 2+ number and their awareness of the manipulation.

- Pltfs' Ex. 313 – an August, 2001 e-mail to Aldinger with a copy to Schoenholz discussing "a one-time across-the-board skip-a-pay program for September that would reduce year-end delinquency." Pltfs' Ex. 313 at HHS02846025;

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[6] Both Aldinger and Gilmer attended this conference. Tr. at 3267:3-19 (testimony of Aldinger re both Gilmer and himself present).

- Pltfs' Ex. 180 – May 2002 presentation regarding corporate initiative to eliminate reages being made to customers who can't or won't pay. Pltfs' Ex. 180 at HHS02025723; Tr. at 2242:9-22 (testimony of Helen Elaine Markell);

- Pltfs' Ex. 618 – July 12, 2002 e-mail communicating Schoenholz's decision[7] to not implement new corporate reage policies because the "financial impact is too variable to risk the plan for 2002," which was a reference to the projected 2+ delinquency statistics. Pltfs' Ex. 618; Tr. at 2244:25-2245:13 (testimony of Ms. Markell);

- Pltfs' Ex. 858 – December 27, 1999 e-mail to Gilmer showing that change in reage policy had an impact of $40 million in the reported 2+ number and discussing one payment real estate reages. Pltfs' Ex. 858 at HHS03256322; *see also* Tr. at 1171:4-1173:7 (testimony of Gilmer). Schoenholz knew of and approved changes to Consumer Lending's re-age policies. Tr. at 1168:15-22;

- Pltfs' Ex. 102 shows that in 2000, a strategic decision was made by the Credit Committee to use restructures "much more aggressively" than before in order to positively impact the resulting 2+ delinquency number, not to help the customer as Household publicly stated. Pltfs' Ex. 102 at HHS01352228; *see also* Tr. at 2367:7-2369:6;

- Pltfs' Ex. 360 – April 15, 2002 memorandum from Schoenholz to Aldinger with a copy to Gilmer reporting the impact of a Mortgage Services reage policy change and the need to rescind that change "to have delinquency well back in line by June," *i.e.*, by the time the delinquency statistics were reported in the second quarter Form 10-Q. Pltfs' Ex. 360 at HHS02865009; *see also* Pltfs' Ex. 118 (Schoenholz changed Mortgage Service reage policy due to "delinquency blow");

- Pltfs' Ex. 1048 – March 2002 internal e-mail stated "The way some of our collectors have used restructes [sic] is like being addicted to heroin. It is hard to get off." Pltfs' Ex. 1048 at HHS-E0022523.0001;

- Pltfs' Ex. 454 - February 2000 e-mail chain involving Gilmer discussing the impact of the grace period ("the majik" [sic]) on the 2+ delinquency statistics. Pltfs' Ex. 454 at HHS02902417;

- Pltfs' Ex. 262 – series of internal e-mails showing impact of grace period on Mortgage Services delinquency statistics;

- Gilmer admitted that Household restructured loans automatically, *i.e.*, without contacting the customer. Tr. at 1479:8-1481:3;

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[7] Both Gilmer and Rybak testified that Schoenholz was responsible for approving all changes that were made to the reage and charge-off policies – Gilmer could not order these changes on his own for the Consumer Lending business unit. Tr. at 1166:11-1169:4; Pltfs' Ex. 157; *see also* Tr. at 2328:25-2329:2.

- Aldinger testified that he understood that skip-a-pays and collector incentives were used across all business units to drive down Household's delinquency rate. Tr. at 3002:8-3008:3;

- Ms. Markell, the VP of HMS Default Servicing, testified that she personally told Schoenholz that reaging was being inappropriately used at HMS to mask the true 2+ numbers. Tr. at 2186:9-2187:9. In response, Schoenholz told her to "proceed gradually to minimize the delinquency increases," which Ms. Markell understood to mean that she had to find a way to implement the reage policy changes more gradually so that the 2+ delinquency numbers would not have big spikes. Tr. at 2208:18-2209:4; and

- Ms. Markell also testified that Household's compensation structure incentivized collectors to restructure loans because they were compensated on the movement of loans using 2+ as a key driver rather than for collecting cash. Tr. at 2223:7-2229:17; *see also* Pltfs' Ex. 313 at HHS02846025 (discussing collector incentives in Mortgage Services).

This evidence shows defendants' knowledge and awareness of the impact of reaging and similar practices on the reported 2+ numbers throughout the Class Period. That the reage policies had significant import is reflected in the fact that management included them in the yearly Quality of Accounting presentations to the Audit Committee, which were required presentations under the accounting rules. Pltfs' Exs. 176 (2000 presentation); Pltfs' Ex. 694 (2001 presentation); Tr. at 1881:20-1882:9 (testimony of Schoenholz). Nonetheless, defendants did not publicly disclose these practices until March 13, 2002, and even then the disclosures were materially false.

On March 13, 2002, the Company filed its Form 10-K for the year 2001 that included language about its reaging practices. *See* Defs' Ex. 852. Significantly, this disclosure in the March 13, 2002 Form 10-K was materially false and misleading as CEO defendant Aldinger conceded during his testimony:

> Q: And it reads, "Our policies for consumer receivables permit reset of the contractual delinquency status of an account to current, subject to certain limits, if a predetermined number of consecutive payments has been received and there is evidence that the reason for the delinquency has been cured." Do you see that?
> A. I do.
>
> * * *

Q. That was the policy that Household told investors that you used to re-age loans, right?
A. That's what it says.
Q. Okay. You needed two things, correct?
A. That's what it says.
Q. You needed consecutive payments, right?
A. That's what it says.
Q. And consecutive, you understand that means more than one, don't you, sir?
A. I think I do.
Q. Okay. So at least two, right?
A. Right.

* * *

Q. Okay. So you also said that you had to have evidence that the reason for the delinquency had been cured, right?
A. That's what it says.
Q. And you didn't tell investors that you actually re-aged with one payment, did you?
A. Not there.
Q. You didn't tell investors that you actually re-aged automatically, did you?
A. It doesn't say that.
Q. Okay. You know that this was materially false and misleading, don't you?
A. I understand it was incorrect at the time.
Q. My question is, sir, you understand that this is materially false and misleading, correct?
A. You could say that.
Q. No, sir. I'm asking you a question. Do you understand that this is materially false and misleading?
A. I'll accept that characterization.
Q. Is that a yes, sir?
A. Yes.

Tr. at 3437:22-3441:16.

Given this admission, defendants cannot seriously challenge the materiality of the reported 2+ statistics[8] nor that they were false or misleading. Scienter likewise can not be contested. The

[8] The materiality of the reage disclosures is not in dispute since both CEO defendant Aldinger, as well as, CFO defendant Schoenholz admitted that Household reported its 2+ delinquency statistics in its Form 10-Ks and Form 10-Qs because that was an important metric followed both by Wall Street and investors. Tr. at 1898:13-18, 1899:5-10 (testimony of Schoenholz); Tr. at 3009:35-3010:18, 3022:3-10 (testimony of Aldinger); *see also* Pltfs' Exs. 176 & 694 (Audit Committee presentations, including description of reage policies).

March 13, 2002 disclosure came just three months after defendant Aldinger personally hired KPMG to do a benchmarking study. Tr. at 3408:8-3409:12 (testimony of Aldinger). This study was completed on March 12, 2002 and reviewed by Aldinger and Schoenholz. Pltfs' Ex. 1224; Tr. at 2029:12-17 (testimony of Schoenholz that he reviewed drafts of benchmarking study); Tr. at 3426:5-14 (testimony of Aldinger that he read parts of the report). Based on the KPMG study and other evidence, including Pltfs' Exs. 649 & 1100, the Audit Committee presentations, which contained materially different language regarding the reage policies (Pltfs' Exs. 176 & 694), and the testimony of Gilmer (Tr. at 1479:8-1481:3), each of the defendants knew that the reaging language in the 2001 Form 10-K was false and misleading.

Notwithstanding these false representations, defendants contend that their disclosures regarding the probability of loan losses and the purported adequacy of credit loss reserves gave sufficient context to the 2+ delinquency numbers. Defendants' vague references to the probability of loan losses and the purported adequacy of credit loss reserves are insufficient to counter-balance the false 2+ delinquency statistics because: (1) they are both estimates and not hard statistics unlike the 2+ numbers which were reporting an actual number based upon current data - *see* Tr. at 2183:7-2184:11 (CFO Schoenholz agreeing that reserves are a future prediction based on judgmental analysis of historical data of what defendants thought would get charged off in the future, while the 2+ numbers reported in the Form 10-Qs and Form 10-Ks were an actual "reported statistic"); and (2) defendants reported not only the hard statistic of the 2+ delinquency numbers in their SEC filings and earnings releases, but along with the contractual delinquency numbers further elaborated that Household was able to maintain such favorable credit quality because of their prudent business and collection practices. For example, the Form 10-Ks for FY 1999 and FY 2000 stated:

> Delinquency and Chargeoffs. Our delinquency and net chargeoff ratios reflect, among other factors, the quality of receivables, the average age of our loans, the success of our collection efforts and general economic conditions. . . . Our focus is to use risk-based pricing and effective collection efforts for each loan. We have a

> process which we believe gives us a reasonable basis for predicting the asset quality of new accounts. This process is based on our experience with numerous marketing, credit and risk management tests. We also believe that our frequent and early contact with delinquent customers is helpful in managing net credit losses.

Pltfs' Ex. 35 at GS001610 (Form 10-K for FY 1999 issued March 28, 2000); Pltfs' Ex. 708 (Form 10-K for FY 2000 issued March 28, 2001).

Subsequently, in March 2002, this disclosure changed to the following:

> Our credit and portfolio management procedures focus on risk-based pricing and effective collection efforts for each loan. We have a process which we believe gives us a reasonable basis for predicting the credit quality of new accounts. This process is based on our experience with numerous marketing, credit and risk management tests. We also believe that our frequent and early contact with delinquent customers, as well as policies designed to manage customer relationships, such as reaging delinquent accounts to current in specific situations, are helpful in maximizing customer collections. . . . As a result, charge-off and delinquency performance has been well within our expectations.
>
> * * *
>
> We believe our policies are responsive to the specific needs of the customer segment we serve. . . . Our policies have been consistently applied and there have been no significant changes to any of our policies during any of the periods reported. Our loss reserve estimates consider our charge-off policies to ensure appropriate reserves exist for products with longer charge-off lives. We believe our charge-off policies are appropriate and result in proper loss recognition.
>
> Our policies for consumer receivables permit reset of the contractual delinquency status of an account to current, subject to certain limits, if a predetermined number of consecutive payments has been received and there is evidence that the reason for the delinquency has been cured. Such reaging policies vary by product and are designed to manage customer relationships and maximize collections.[9]

Pltfs' Ex. 709 at HHS03111647-48 (Form 10-K for FY 2001 issued March 13, 2002).

Defendants point out the alleged improved cash flows and customer benefits associated with reaging. Significantly, these issues were not part of defendants' internal discussions regarding the reage policies – to the contrary, those discussions focused on how the reage policies impacted the

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[9] *See also* Pltfs' Ex. 878 (Form 10-Q for 2Q02 issued August 14, 2002).

delinquency statistics. *See generally* Pltfs' Exs. 102, 313, 360, 454, 618 & 858. Moreover, these "benefits" were not the issue for investors. Instead, the issue was how reliable were defendants' reported 2+ numbers.

In light of the above, a reasonable jury could find that plaintiffs have sufficiently established that defendants made materially false and misleading statements with scienter about Household's credit quality.

IX. THE JURY MUST DECIDE IF THE TRUTH WAS ON THE MARKET

Defendants assert that notwithstanding their alleged misrepresentations, the market and investors were aware of the truth. However, plaintiffs have established through the testimony of Professor Fischel that there were statistically significant stock price declines during the November 14, 2001 through October 11, 2002 time frame on dates when there were fraud-related disclosures. Additionally, the disclosures cited by defendants do not and cannot establish that the concealed information was in fact publicly available at all, much less with the required level of intensity and credibility to overcome defendants' contemporaneous denials. In sum, there are factual issues for the jury to resolve.

It is significant that Household's stock price declined materially upon revelation of the truth. *See Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 167-68 (2d Cir. 2000) (defendants' truth on the market defense failed where their evidence, the lack of stock price movement, was in dispute); *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920, 935 (9th Cir. 2003) (market reaction to disclosures "even if slightly delayed, further supports a finding of materiality" particularly where the defendant "continued to reassure analysts that the settlement agreement and compliance therewith would not have noticeable economic effects on the company").

The parties have stipulated that Household stock price traded in an efficient market. Therefore, if defendants were correct that the truth was on the market as to the fraud alleged prior to November 14, 2001, there would have been no negative market reactions to the later, post-November 14, 2001 disclosures alleged by plaintiffs. However, as set forth in the testimony of plaintiffs' expert, Professor Fischel, after November 14, 2001 and continuing through the end of the Class Period, the market did react negatively to both specific disclosures of the truth regarding defendants' predatory lending, reaging and restatement as well as leakage of that truth into the market. *See, e.g.*, Tr. at 2642:4-2643:16 (significant stock price decline in response to July 26 article re predatory lending); *id.* at 2637:5-2638:19 (statistically significant stock price decline in response to December 1, 2001 reaging disclosure); *id.* at 2641:14-2642:3 (statistically significant stock price decline in response to December 11, 2001 disclosure relating to reaging); *id.* at 2644:3-13 (statistically significant stock price decline upon announcement of restatement); *id.* at 2852:21-2854:22 (discussing declines in artificial inflation in stock price as truth comes out in late 2001 through 2002); *see also* Pltfs' Exs. 1391, 1395 & 1397. Professor Fischel's testimony constitutes strong economic evidence that the market did not know about the allegedly concealed facts. This evidence alone creates a factual dispute that the jury must resolve.

Further to the point, the disclosures cited by defendants do not show that the market was aware of the truth prior to November 14, 2001, when the truth began to leak into the market. Defendants' alleged disclosures of the truth fall into two categories: 1) securitization documents and 2) analyst reports and newspaper articles. Plaintiffs address them in that order.

As it became clear during the testimony of Aldinger, which occurred after defendants' motion was written, the securitization documents do not establish truth on the market. They are not disclosures by Household International. Indeed, when asked about one securitization document (Defs' Ex. 471), Aldinger responded "I don't know what it is." Tr. at 3447:12. Additionally, each

securitization document applies only a relatively small pool of loans representing less than one percent of Household's total loan portfolio. *Id.* at 3450:25-3451:3 (testimony of Aldinger); *id.* at 3452:24-3453:5 (same).

Further to the point, the securitization documents do not disclose the truth as to the underlying fraud at issue. With respect to reaging, the securitization documents refer to how loans within the pool will be treated in the future, not how they were treated in the past. *See, e.g.*, Defs' Ex. 695 at HHT0002335 ("Delinquent accounts may be restructured (deemed current) every six months."); Defs' Ex. 880 at HHT017968 ("The master servicer may in its discretion . . . ."). As Professor Fischel noted in his testimony, even after Household's reaging became an issue in December of 2001, analysts reviewing the securitization documents remained confused about Household's reaging practices and Household's true financial situation.

> And what this particular analyst concludes, as I think is obvious from the language, is that looking at everything, looking at the disclosures in the financial statements, the disclosures in the securitization prospectuses, Household's defense of its re-aging practices, the analyst is simply not convinced that investors are getting an accurate picture of Household's true financial situation and is raising all these doubts and all these questions that remain unanswered.

Tr. at 2845:7-15 (testimony of Professor Fischel regarding the impact of a December 11, 2001 Legg Mason report, Pltfs' Ex. 1410); *see also* Pltfs' Ex. 1410 (December 11, 2001 Legg Mason analyst report raising questions regarding Household's reaging practices after reviewing securitization documents). Some analysts even had the wrong impression of the reage policies after reviewing the securitization documents. *Compare* Pltfs' Ex. 1410 ("While we believe that a delinquent home equity loan can only be reaged once a year, we could find no specific mention of this in the trust document") with Pltfs' Ex. 1100 (would reage real estate loan more than once every 12 months).

With respect to predatory lending, the securitization documents do not disclose the specific predatory lending practices at issue in this case, *i.e.*, misrepresentation of rates and fees, packing of insurance, prepayment penalties violative of state law and the misrepresentations on the Good Faith

Estimate. *See* Defs' Ex. 880 at HHT0017940 (second loans) and at HHT0017936 (high interest rates). Indeed, where the securitizations disclose Household's prepayment penalties, the disclosures are false as they describe the prepayment penalties as "permitted under applicable state law" when that plainly was not the case. Defs' Ex. 880 at HHT0017944 ("prepayment charge generally is the maximum amount permitted under applicable state law"); Defs' Ex. 881 at HHT0018076 ("prepayment charge is an amount equal to six months interest on the loans or the maximum amount permitted under applicable state law, if state law applies"). Moreover, one must compare the securitization documents' vague language with defendants' specific denials of predatory lending. *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1159-60 (C.D. Cal. 2008) (rejecting the truth-on-the market defense where defendants claimed that Countrywide's improper practices were revealed in statistics contained in securitization prospectuses that were on file with the SEC and available to the public because prospectuses are very large documents and coupled with Countrywide's alleged public misrepresentations, blunted any disclosures in the prospectuses).

The analyst reports and newspapers cited by defendants, likewise, do not show that the market was aware of the truth. These disclosures focus on third party allegations, principally made by ACORN, that Household was engaging in "industry-wide" predatory lending practices. Defs' Mem. at 29. However, these disclosures, even when considered collectively, do not show any pre-November 14, 2001 awareness of defendants' particular nationwide, pervasive predatory sales practices, such as the effective rate presentation, the improper disclosure on the GFE, prepayment penalties that exceeded those allowed under state law, and insurance packing. Moreover, as Professor Fischel explained, third party disclosures are "not the same thing as Household itself telling investors about its own practices." Tr. at 2838:8-9. This is particularly important because, during this period, Household specifically denied engaging in predatory lending. *See Countrywide*, 588 F. Supp. 2d at 1159-60. These denials are included in the same newspaper articles cited by

defendants as revealing the truth. *See, e.g.*, Pltfs' Ex. 824 (*St. Louis Post-Dispatch* article quoting Household spokesperson Craig A. Streem); Pltfs' Ex. 1451 (July 27, 2001 *Minneapolis Star Tribune* article quoting Household spokesperson Megan E. Hayden-Hakes). Significantly, the economic evidence shows that it was not until November 14, 2001, when one of Household's regulators, the California Department of Corporations, took public action against it via lawsuit, that the market commenced to react to these third party disclosures.

In sum, plaintiffs have presented substantial evidence that the truth was not on the market via the securitization documents and pre-November 14, 2001 analyst reports and newspaper articles.

X. PLAINTIFFS HAVE PROVIDED AMPLE EVIDENCE OF SCIENTER

Defendants' argument seems to be if they didn't admit to lying on the stand, then plaintiffs' claims should be dismissed for a failure of proof on the element of scienter. This argument, like the prior one, founders on Aldinger's testimony, specifically Aldinger's admission that Household did make a false and misleading statement regarding reaging in the 2001 Form 10-K, which he and Schoenholz both signed. Tr. at 3437:22-3441:16. Moreover, contrary to defendants' assertion, plaintiffs can establish scienter via indirect evidence and have provided ample evidence of scienter such that this is a factual issue for the jury to resolve.

The Seventh Circuit's test for scienter involves consideration of numerous factors in their totality.[10] *Tellabs*, 437 F.3d at 603; *Schleicher v. Wendt*, 529 F. Supp. 2d 959, 971 (S.D. Ind. 2007) ("Many factors can be relevant in evaluating allegations of scienter depending on the circumstances."); *Chu*, 100 F. Supp. 2d at 822-23.

[10] Additionally, the jury may consider evasive, conflicting or implausible testimony of the defendants or those in direct line of communication with defendants in determining scienter. *SEC v. Michel*, 521 F. Supp. 2d 795, 828 (N.D. Ill. 2007).

A. Defendants' Incentive Compensation Is Evidence of Scienter

Prior to discussing scienter as to specific statements, plaintiffs note the evidence regarding defendants' motives. This evidence includes their incentive compensation, which was heavily weighted in favor of incentives tied to the Company's performance, and their plan to sell the Company (and their stock) while the price was still inflated. As noted elsewhere, this evidence of personal motive is an important consideration in determining scienter. *JPMorgan*, 2007 U.S. Dist. LEXIS 93877, at *24.

For calendar year 2001, Aldinger received a base salary of $1 million with an actual bonus of $5 million and stock grants of an additional $19 million. Pltfs' Ex. 772 at HHS03173760. Put differently, Aldinger's bonus was 26 times his annual salary of $1 million. That same year, Gilmer and Schoenholz received a base salary of $500 thousand with a bonus of $2.5 million and stock grants of an additional $5.8 million. *Id.* At this time, the annual incentives were "[p]rimarily measured by EPS growth." *Id.* at HHS03173764. In 2001, each of the individual defendants' bonuses was linked to achievement of a $4.05 earnings per share in 2001, which was exceeded by $.03. Pltfs' Ex. 774 at HHS03174113. Based on achievement of this target, "awards should be calculated as max points." *Id.* Gilmer had an additional objective of achieving net income of $810 million, which he exceeded by $1 million. *Id.* at HHS03174117.

Similarly for calendar year 2000, defendants' bonuses were tied to achievement of an EPS of $3.50, which they exceeded by $.05. Pltfs' Ex. 759 at HHS03159033. That year, Aldinger received a $4 million bonus and stock grants of $13.2 million. Pltfs' Ex. 774 at HHS03174135. Gilmer and Schoenholz received bonuses of $2 million each and stock grants of $4.3 million each.

In 1999, Aldinger received a bonus of $3 million while Schoenholz and Gilmer received $1.5 million each. Pltfs' Ex. 759 at HHS03159052. That year, Aldinger received an additional $8.8

million in stock grants while Gilmer and Schoenholz received stock grants of $4.4 million each. *Id.* at HHS03159056.

As additional evidence of scienter, the individual defendants planned to sell their stock while the price was still highly inflated as part of a sale of Household to Wells Fargo. The parties reached an agreement subject to due diligence whereby Wells Fargo would purchase Household for $66.82 per share. Pltfs' Ex. 1359 at WF 006002-3. The sale of their stock would have provided individual defendants with a substantial windfall. However, in addition, the individual defendants had "very rich" employment contracts that provided for over $100 million in termination payments upon a change of control in a merger, as well as millions more due to early acceleration of options at an inflated share price. Pltfs' Exs. 1371 and 1038.

After the Wells Fargo deal fell apart,[11] defendants then successfully negotiated with HSBC to sell the entire company (and their stock) and to receive their "golden parachutes" upon the change in control. *See* Tr. at 3992:17-20 ("And your golden parachute entitled you to about $20 million in cash when HSBC purchased Household, didn't it? A. It was three times salary and bonus. About that number, that's right."). In sum, the evidence shows that the individual defendants planned a

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[11] The individual defendants' plan to sell to Wells Fargo failed because Wells Fargo learned of their reaging and predatory lending practices. *See* Pltfs' Ex. 1351 (reaging "mask[s] true run rate of [Household's] losses . . . hard to imagine that they are not also being employed to boost earnings"); Pltfs' Ex. 1340 ("To the exten[t] that they are being aggressive in fees, frequency of rewriting loans, and other things that might be viewed as non-consumer friendly or even predatory in approach, we need to assess the future impact . . . . This could be big). After Wells Fargo terminated merger discussions, Household's chief credit officer Paul Makowski sent an e-mail to individual defendants Aldinger and Schoenholz on June 24, 2002, and told them Wells Fargo "focused on the loans that have been reaged three or more times," which they "calculated correctly" had grown to $3.4 billion as of March 2002. Pltfs' Ex. 514. This "multiple reage" category of loans is the same category of loans Schoenholz affirmatively misrepresented at Household's April 4, 2002 Financial Relations Conference by $3 billion. Tr. at 2185:4-10. Schoenholz could not possibly have believed the multiple reaged loans were "immaterial" after learning Wells Fargo terminated $31 billion corporate transaction in large part because of that number.

"pump and dump" scheme made all the more lucrative by the "golden parachutes" they would get upon sale of the company.

Plaintiffs have provided powerful evidence that shows the individual defendants had tremendous financial motivation to engage in the alleged fraud.

B. Direct Evidence of Scienter

Defendants wrote their brief prior to defendant Aldinger's admission that Household made a false and misleading statement regarding reaging in the 2001 Form 10-K. Tr. at 3437:22-3441:16. Both Aldinger and Schoenholz signed the 2001 Form 10-K. Defs' Ex. 851; Tr. at 1922:6-8 (testimony of Schoenholz). Moreover, both Aldinger and Schoenholz at the time had received and reviewed the KPMG benchmarking study, which alone establishes scienter as to the reaging language in the 2001 Form 10-K.[12] Tr. at 3257:10-18 (testimony of Aldinger regarding KPMG benchmarking study (Defs' Ex. 61)); *id.* at 2029:12-2030:7 (testimony of Schoenholz regarding KPMG benchmarking study (Pltfs' Ex. 1224)). Additionally, Schoenholz had received an e-mail earlier specifically apprising him that "[o]ne of our policies that creates 'headline risk' is the one payment reage." Pltfs' Ex. 649 (January 2002 e-mail from Paul Makowski copying Schoenholz). Aldinger also testified that the business unit CEO's, *i.e.*, Gilmer, were responsible for submission of the information in the Form 10-K. Tr. at 3287:18-24 (business unit CEO's with their own team together with central accounting group would put together the numbers); *id.* at 3427:16-25 (business unit CEO's with their teams were responsible for putting together information regarding reaging). There is direct evidence of scienter as to all defendants.

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[12] Although Aldinger testified that he did not read the "nits and gnats" of the report (Tr. at 3427:13), the jury could disbelieve that testimony based on the contrary testimony by Aldinger that he personally called the Vice-Chairman of KPMG to commission the study and his testimony regarding how important it was to get this information out to the public. *Id.* at 3427:10-15, 3428:1-17.

C. Scienter Regarding Predatory Lending Practices

Defendants' arguments regarding the lack of evidence of scienter as to predatory lending practices seriously misrepresent the evidence before the jury. There is abundant evidence that all defendants knew of the rampant predatory lending practices commencing in 1999 and made, approved or furnished information for statements they knew to be false or misleading.[13]

As plaintiffs have demonstrated through trial testimony and exhibits, defendants embarked on a scheme to inflate the stock price for their own personal gains. This scheme involved growing the Consumer Lending business unit through practices they knew or understood to be predatory, including practices generated internally and practices generated by Andrew Kahr. On December 18, 1998 senior management, including Gilmer, Aldinger and Schoenholz, met to discuss growth. Pltfs' Ex. 458; Tr. at 985:21-986:11. Following that meeting, Gilmer sent out an e-mail to his direct reports on growth at Household. He started his e-mail with the frank assessment that "We stink at growth." Pltfs' Ex. 458 at HHS02904017. He noted that if Household could convince the market that it could grow, its stock price would rise. Gilmer set the bar high: "Let's start the discussion at 20%." Gilmer concluded his e-mail, "One final point that might help drive home how important this is to you and me. Once we fix our growth problem, we will, no doubt, fix the market concern with respect to our growth issue. That done, I have listed below what the price of our stock would be next year if we are given fair credit vs. the noted comparisons." Pltfs' Ex. 458 at HHS02904018 (identifying "expected HI stock price" in range of $53 to $66); *see also* Pltfs' Ex. 267 at HHS02216936 (growth had Gilmer's attention to the same level as a "sharp pencil in my eye").

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[13] Aldinger testified that Gilmer as CEO of the Consumer Lending unit was responsible for furnishing information to be used in the SEC filings and press releases. Tr. at 3287:18-24 (business unit CEO's with their own team together with central accounting group would put together the numbers); *id.* at 3427:16-25 (business unit CEO's with their teams were responsible for putting together information regarding reaging).

By this time, defendants had already hired Kahr to help generate this growth. Pltfs' Ex. 347 (December 14, 1998 memorandum from Paul Creatura to Gilmer regarding Kahr's initiatives, including biweekly effective rate). During 1999, defendants implemented two of Kahr's initiatives and others to grow despite knowing that the initiatives would result in predatory lending, such as misrepresentations of the interest rate of the loan and points being charged. Defendants' growth initiatives worked and they touted "record" quarters while concealing the truth about the reasons for this growth. They denied engaging in predatory lending despite knowing it was the source of the record profits.

Plaintiffs discuss the specific predatory practices at issue and defendants' knowledge and awareness of each.

1. Andrew Kahr Growth Initiatives

Each of the defendants was aware of and approved implementation of two Kahr growth initiatives, the effective rate presentation and prepayment penalties under the Alternative Mortgage Treatment Parity Act. There is evidence[14] from which the jury could conclude that defendants implemented these Kahr initiatives knowing that they constituted predatory lending. Defendants' scienter on the Kahr initiatives is further supported by defendants' document destruction.

a. The Effective Rate Presentation

On January 27, 1999, Gilmer circulated a memorandum regarding Kahr's growth initiatives for the Consumer Lending business unit to Household's senior management, including defendants

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[14] Plaintiffs presented evidence on the Kahr growth initiatives in addition to that referenced in the text. Additional evidence respecting the effective rate presentation includes: Pltfs' Ex. 265 (First Mortgage training materials); Pltfs' Ex. 276 (customer complaint); Pltfs' Ex. 445 (memo regarding increasing complaints regarding interest rate); Pltfs' Ex. 516 (Attorney Generals' letter regarding widespread predatory practices, including effective rate misrepresentations); Pltfs' Ex. 773 (First Mortgage training materials); Pltfs' Ex. 826 (effective rate worksheet); Pltfs' Ex. 1096 (customer complaint); and Pltfs' Ex. 1205 (OTS Report discussing numerous predatory practices). Additional evidence respecting prepayment penalties includes many of the documents referenced in the proceeding sentence.

Aldinger and Schoenholz. Pltfs' Ex. 348. One of Kahr's initiatives was "[o]ffer bi-weekly payment loans to reduce effective APR and make our mortgage terms more competitive." Pltfs' Ex. 348 at HHS0281369. *See also* Pltfs' Ex. 347 (December 14, 1998 memorandum from Paul Creatura to Gilmer regarding Kahr initiatives, including biweekly effective rate); Pltfs' Ex. 461 at HHS2904322 (January 18, 1999 memorandum from Gilmer to Aldinger discussing implementation of a "number of 'out of the box' initiatives developed by our people in conjunction with Andrew Kahr"). Defendants implemented Kahr's effective rate initiative because Household's interest rates were not competitive. As Ms. Ghiglieri testified, there would be "no reason to tell a consumer that their rate was lower than it really was if their rates weren't – if their rates were competitive because they could just be straight up with them." Tr. at 715:14-17 (testimony of Ms. Ghiglieri); *see also id*. at 717:18-21 (discussing Dennis Hueman video and need to have lower rates than "Billy Bob's Loan Company"); Pltfs' Ex. 1383 (Hueman training video). There is no dispute that the effective rate presentation was deceptive. Tr. at 1444:2-5 (testimony of Gilmer).

Household trainer Llewelyn Walter traveled throughout the nation in mid-1999 teaching how to present the "effective rate." Tr. at 496:8-15 (testimony of C. Ghiglieri); *id.* at 2812:16-2818:2 (testimony of Robert O'Han regarding Walter training); Pltfs' Ex. 899 (copy of Walter training); Pltfs' Ex. 903 (same effective rate worksheets as in Pltfs' Ex. 899); Pltfs' Ex. 379 at HHS02868075 (Thomas Schneider e-mail regarding Walter training around the country). In the Southwest Division, Division General Manager Dennis Hueman conducted similar training. Pltfs' Ex. 1383 (Hueman training video).

The effective rate sales pitch was used across the nation from 1999 to May 24, 2001. For example, Pltfs' Ex. 901 is a May 24, 2001 e-mail from one of defendants' senior sales managers in the Northeast Division discussing the use of the effective rate in his group. Similarly, a senior sales manager in the Central Division acknowledged use of the effective rate in that division as well.

Pltfs' Ex. 926; *see also* Tr. at 2828:10-13 (testimony of O'Han). Plaintiffs introduced evidence of use of the effective rate in the other divisions as well. Pltfs' Ex. 1383 (Hueman training video); Tr. at 2826:12-15 (O'Han testimony regarding Walter training in Northwest and complaints regarding effective rate); Pltfs' Ex. 379 at HHS02868090 (no corrective action for March 26, 2001 "effective rate" letter because "this was enforced by HFC training materials that existed at the time"); Pltfs' Ex. 799 (equivalent rate form was common form); Pltfs' Ex. 290 at HHS02498670 (Washington DFI Report noting use in Washington and elsewhere); Charles Cross Depo. Tr. at 139:1-20 (attached as Ex. A to the accompanying Declaration of Michael J. Dowd) ("Dowd Decl.")[15] (15 to 20 other states reported use of the effective rate presentation).

Defendants continued to use the effective rate pitch, albeit in modified form, after May 24, 2001.[16] In an e-mail dated May 25, 2001 from Kenneth Walker to O'Han, Walker stated that Schneider, then head of Policy and Compliance at Consumer Lending, "indicated we cannot quote the customer a comparable or equivalent interest rate. He did say that you can verbally tell the customer due to the reduced term and interest, it would be like getting a lower interest rate, but that we must stay away from quoting an actual lower rate other than the contract rate or APR the customer is to receive." Pltfs' Ex. 900. As Ms. Ghiglieri testified, this was "still deceiving the customer." Tr. at 508:9-10.

As noted above, the effective rate presentation grew out of a Kahr initiative vetted and approved by Household senior management, including Aldinger, Schoenholz and Gilmer.

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[15] To provide this Court with a complete evidentiary record, plaintiffs have substituted transcripts for all of their deposition designations as exhibits to the Dowd Declaration.

[16] Defendants' change in the effective rate presentation resulted from growing numbers of customer complaints and regulatory pressure. Pltfs' Ex. 794 (May 25, 2001 memorandum from Carla Madura re Complaints); Pltfs' Ex. 828 (May 17, 2001 memorandum prepared by Washington Department of Financial Institution's examiner regarding complaints made to DFI).

Defendants knew that it was deceptive and approved it anyway to achieve the growth that would provide them with personal monetary rewards. The effective rate presentation had a powerful impact on Consumer Lending's loan growth, not only increasing the number of loans originated despite Household's uncompetitive rates but also increasing the revenues associated with points and ancillary insurance products. Tr. at 445:13-23 (testimony of C. Ghiglieri). According to an internal estimate, the refunds owed to borrowers relating to allegations of interest rate misrepresentations the effective rate presentation were $1.253 billion in interest alone. Pltfs' Ex. 681 at HHS03070935.

b. Prepayment Penalties

A second Kahr growth initiative concerned the use of the Parity Act to preempt state laws. In January of 1999, Gilmer informed Aldinger that Consumer Lending would be using the Parity Act to implement prepayment penalties that exceeded those permitted under state law. Pltfs' Ex. 461 at HHS02904321; *see also* Pltfs' Ex. 447 (Gilmer January 13, 1999 e-mail regarding use of Parity Act). Gilmer and Schoenholz worked directly with Kahr regarding use of the Parity Act. Pltfs' Ex. 533 (Kahr March 20, 1999 memorandum addressed to Joseph A. Vozar with copies to Gilmer and Schoenholz); Pltfs' Ex. 835 (Kahr May, 1999 memoranda to Schoenholz and others); *see also* Pltfs' Ex. 349 (Gilmer and Schoenholz together headed implementation of the Kahr initiatives).

Significantly, Kahr himself expressed uncertainty as to whether a loan whose rate adjusted based on subsequent payment performance, the loan product adopted by Household as the Pay Right Rewards product, would qualify as an alternative loan. "A provision for reduction of rate in the event of exemplary payment performance probably also would qualify." Pltfs' Ex. 533 at HHS0292388. Moreover, in that same memorandum, Kahr noted that Kenneth Robin, Household General Counsel, warned that "anything which appears 'unconscionable' (even if 'legal' as to its specific terms) could wind up as a litigation as well as a PR problem." *Id.* at HHS0292387.

Notwithstanding these red flags, defendants proceeded with this Kahr initiative and introduced the Pay Right Rewards product. Tr. at 532:7-533:2 (testimony of Ms. Ghiglieri).

Numerous states challenged the prepayment penalty feature of this loan product and rejected defendants' contention that the Pay Right Rewards product was an alternative mortgage subject to the Parity Act. Pltfs' Ex. 508 (internal e-mail identifying states); *see also* Pltfs' Ex. 965 (e-mail identifying states that have objected to Household's attempt to use the Parity Act to preempt state laws regarding prepayment penalties); Pltfs' Ex. 329 (New Jersey report of examination); Pltfs' Ex. 585 (Colorado report of examination).

The extended five-year prepayment penalty used by Household prevented borrowers from refinancing loans with other companies, thus keeping the borrower paying Household's high interest rates and requiring the borrower to refinance with Household, if at all. Tr. at 443:13-14 (testimony of C. Ghiglieri). In an internal estimate that focused only on prepayment fees themselves, Household estimated $161 million owed to borrowers. Pltfs' Ex. 681 at HHS03070938.

In addition to the foregoing, defendants' document destruction pertaining to both these Kahr initiatives is probative of scienter. *United States v. Battista*, 646 F.2d 237, 244 (6th Cir. 1981); *In re Enron Corp. Secs., Derivative & ERISA Litig.*, No. H-01-3624, 2003 U.S. Dist. LEXIS 1668, at *61 (S. D. Tex. Jan. 28, 2003) (App., Tab 5). In the summer of 2001, Household reacted to regulatory pressure regarding the effective rate presentation by ordering a "purge" of the branches. Tr. at 669:7-11 (testimony of C. Ghiglieri regarding May 2001 document destruction binge); Pltfs' Ex. 596 (July 5, 2001 e-mail regarding reblitz purge); Pltfs' Ex. 796. There is also record evidence of Schoenholz, with Aldinger's knowledge, ordering destruction of the Kahr memoranda. Tr. at 2089:12-2092:12, 2096:5-2098:24; *see also* Pltfs' Ex. 1026 (June 24, 2002 e-mail from Kenneth Harvey to Schoenholz and Mr. Robin with copy to Aldinger regarding destruction of Kahr memos).

2. Insurance Packing

Another predatory lending practice at issue concerns insurance packing, particularly of single premium credit insurance. As explained during the testimony of plaintiffs' expert, Ms. Ghiglieri, adding insurance to the loan documents without the customer's knowledge was one form of insurance packing used by Household. Tr. at 437:2-6. Household's training, sales goals and compensation all promoted insurance packing.

Household trained its employees to assume the customer wanted the insurance and to automatically put the insurance on the loan documents. Tr. at 493:6-10 (testimony of C. Ghiglieri); *see also* Pltfs' Ex. 898 (insurance training dated May 12, 2000). Household also trained its employees how to respond to customer objections if the customer noticed the insurance, including the alleged "free look" cancellation policy. Tr. at 437:11-24 (testimony of C. Ghiglieri). Significantly, Gilmer testified that "I knew what was going on in my branches." Tr. at 1043:11-12.

In 1999, Household set a penetration rate target of 70%. Pltfs' Ex. 916 at HHS03421387. In 2000, Household set a penetration rate target of 75%. That is, 3 out of every 4 loans originated at the branches were to have insurance. Pltfs' Ex. 898; *see* Tr. at 527:9-528:14 (testimony of C. Ghiglieri explaining significance of Pltfs' Ex. 898); *see also* Pltfs' Ex. 1095; Tr. at 1778:13-1779:12 (testimony of Thomas Detelich regarding insurance penetration goals). As Ms. Ghiglieri explained, a penetration rate of 50% indicates insurance packing. Tr. at 528:11-14; *see also* Cross Depo. Tr. at 131:1-3 (Dowd Decl., Ex. A), played at trial on April 9, 2009 ("alarms with red flags would start going off" with penetration rates above 60%); Pltfs' Exs. 967, 1204, 1205 (OTS letters and reports raising questions about high penetration rates); Pltfs' Ex. 19 (FDIC Report); Pltfs' Ex. 290 (Washington DFI Report); Pltfs' Ex. 516 (Attorneys General letter); Pltfs' Ex. 1103. Significantly, defendants tracked the insurance penetration rates during 1999-2002. Tr. at 1016:22-24. Gilmer's

monthly memoranda to Aldinger regarding the sales results, included references to the penetration rates. Pltfs' Ex. 481 at HHS02911737 (November 16, 2000 memorandum).

Household adopted a compensation program that rewarded insurance packing. Tr. at 526:13-25 (testimony of C. Ghiglieri). As Ms. Ghiglieri explained, Household's insurance compensation bonuses were:

> [P]articularly interesting because not only did it reward the individual salesperson for packing on insurance of a variety of kinds – credit life, single premium credit, accident and health; you know, whatever – but there was a portion of the incentive went into a pool for all branch employees. So, it helped produce peer pressure for the branch for everyone to do this particular practice.

Tr. at 557:3-10 (testimony of C. Ghiglieri discussing Pltfs' Ex. 269).

Household internally estimated refunds relating to this predatory lending practice at $460 million. Pltfs' Ex. 681 at HHS03070937.

3. Disclosures of "Discount" Points on the Good Faith Estimate

Another of Household's predatory lending practices concerns the use of "discount" points and disclosing a range of points on the Good Faith Estimate from $0 to several thousand dollars. The majority of the time Household charged at the high end of the range or in excess of the range. Tr. at 439:3-5 (testimony of C. Ghiglieri). This was a violation of the Real Estate Settlement Procedures Act and a predatory practice.

Defendants' disclosure of an overly broad range of "discount" points on the GFE's is plainly prohibited under the statute. As noted in Pltfs' Ex. 285,

> Based on a common sense reading of the regulations, overly broad ranges of settlement charges fail to satisfy the criteria that the estimates be made "in good faith" and "bear a reasonable relationship" to likely settlement charges. To give a broad estimate when the lender knows that the cost tends toward the high end of a range is plainly not good faith. Specifically, with respect to discount points, a range of 6-13 or 0-8 (*i.e.*, a range of 7 or more points) provided by a lender with information on the borrower is plainly not sufficient to demonstrate good faith.

Pltfs' Ex. 285 (July 5, 2002 letter from U.S. Department of Housing and Urban Development).

Mr. Cross of the Washington Department of Financial Institutions raised an objection to this practice in 1999. Cross Depo. Tr. at 150:22-151:8 (Dowd Decl., Ex. A) (discussing prior deposition testimony), played on April 9, 2009; *see also* Pltfs' Ex. 290. Numerous other state regulators also raised this issue, including Kansas (Pltfs' Ex. 956), Michigan (Pltfs' Ex. 445), Minnesota (Pltfs' Ex. 324), New Jersey (Pltfs' Ex. 964), Virginia (Pltfs' Ex. 333). This was also raised by the multi-state group of Attorneys General and the OTS. Pltfs' Ex. 516; Cross Depo. Tr. at 150:4-12 (Dowd Decl., Ex. A); Pltfs' Ex. 1205.

Defendants' internal calculation of refunds to be issued with respect to this issue was $1.087 billion. Pltfs' Ex. 681 at HHS03070934.

4. Loan Flipping

Defendants also engaged in loan flipping. As Ms. Ghiglieri testified, Household would refinance their own loans adding points and insurance. The practice of charging "points on points" was instituted when Gilmer became head of Consumer Lending. Pltfs' Ex. 562. Defendants themselves recognized that they engaged in loan flipping. Pltfs' Ex. 1103 (e-mail string in which Rybak questions propriety of adding insurance to rewritten loans for customers who are already 120 days overdue on the current loan); Pltfs' Ex. 1589 (Vozar's notes). The issue was raised by the multi-state group. Pltfs' Ex. 516. Defendants internally estimated the refunds on such loans of $66 million. Pltfs' Ex. 681 at HHS03070936.

5. Loan Splitting

Another practice at issue is Household's origination of two loans to the customer at the same time, a closed end loan and a "revolving" loan. *See* Pltfs' Ex. 901 (discussing typical offer, including "split" loans). The second "revolving" loan was used to pay points and insurance on the first loan and was generally completely drawn down at origination. Tr. at 523:23-524:10 (Ms. Ghiglieri testimony). This issue was raised by the multi-state group of Attorneys General. Pltfs' Ex.

516 at HHS02915308; *see also* Pltfs' Ex. 290 (Washington DFI Report). Defendants internally estimated the refunds associated with this practice at $217 million. Pltfs' Ex. 681 at HHS03070933.

6. Summary of Scienter Relating to Predatory Lending Statements

The foregoing establishes that there is substantial evidence in the record from which the jury could reasonably conclude that: 1) all defendants decided in 1999 to use Kahr's initiatives and other predatory practices to grow Household's revenues even though defendants at the time knew the initiatives to be deceptive and predatory; and 2) all defendants knew that these initiatives would have and did have a material impact on Household's reported revenues and earnings and yet failed to disclose these initiatives, including the use of the effective rate, when announcing or discussing the "record" financial results of Household. *See* Pltfs' Ex. 550 at HHS02933758 (August 14, 2002 letter from David Huey, Washington State Attorney General's office: "we note that several of the most insidiously deceptive sales practices which attracted regulatory attention to Household's practices at the outset relate to products and practices initiated by Household in 1999. Industry figures indicate that since 1999, Household's originations have nearly doubled. Almost assuredly, the misleading sales practices the states have identified have contributed to that growth.").

In addition to this evidence, plaintiffs have also provided evidence regarding the complaints from customers about these practices. Pltfs' Ex. 242 (November 15, 1999 memorandum regarding October 1999 AG, BBB and Regulatory Complaints); Pltfs' Ex. 245 (January 1, 2001 memorandum regarding November & December 2000 AG, BBB and Regulatory Complaints); Pltfs' Ex. 794 (May 25, 2001 memorandum regarding March and April 2001 AG, BBB and Regulatory Complaints). As defendants recognize, their complaint tracking system was defective such that the tracked number of complaints is unreliable. Defs' Mem. at 41. More to the point, complaints, even when properly tracked, are not indicative of the number of customers affected due to the difficulties involved in

actually submitting a written complaint. Tr. at 639:21-640:10 (testimony of Ms. Ghiglieri); Pltfs' Ex. 798 ("these are only the complaints that made it to this level!!!").

Defendants attempt to counter this evidence by referencing their self-serving directives to employees. Plaintiffs undercut this evidence by showing that objective third parties reached the conclusion that Gilmer was "creating a system of plausible deniability . . . creating policies that seem to crack down, but keeping sales standards so high they still hurt the customer." Pltfs' Ex. 993 (questions of B. Condon, author of "Homewrecker" article). In any event, defendants' "evidence" creates a disputed issue of fact.

D. Defendants Sold Stock During the Class Period

Defendants make the blatantly false assertion that "[u]nlike many securities fraud actions, this case lacks allegations or evidence of any insider trading by the Individual Defendants." Defs' Mem. at 42-43. Defendants then cite *Higginbotham v. Baxter Int'l, Inc.*, 495 F.3d 753, 759 (7th Cir. 2007) and *Pugh v. Tribune Co.*, 521 F.3d 686, 695 (7th Cir. 2008) for the proposition that the absence of insider sales "negates" scienter. Defs' Mem. at 42-43. However, unlike those cases, here plaintiffs have presented evidence regarding defendants' attempt to sell the Company (and their stock) to Wells Fargo at an inflated price (*see supra*, at 36), and have established that Aldinger and Gilmer together sold **$22** million worth of Household common stock during the Class Period. Indeed, Aldinger admitted that he made over **$19** million in stock sales during the Class Period:

> Q. In fact, you made over 19 million during 1999 through 2002 by selling Household stock, right?
>
> A. I thought that's what we covered yesterday, yes.

Tr. at 3486:9-11; *see also* Defs' Exs. 774 & 775 ($28.1 million in gross sales). Aldinger's $19 million windfall supports scienter.

Gilmer unloaded $4.1 million and bought $1.4 million, for net sales of $3 million (Tr. at 1429:24-1430:2) ("Q. Okay. It looks to me like you made $3 million – $3,065,000 just on your

sales during the class period; is that right, sir? A. I surely did."). *See also* Defs' Exs. 758, 759 & 763. Gilmer's stock sales support scienter.

E. There Is Record Evidence of Scienter With Respect to the Restatement and Reaging False Statements

In this subsection, defendants challenge plaintiffs' evidence of scienter as to the restatement and reaging, issues that they raised in other sections in their brief and that plaintiffs have previously addressed. *See* sections VI and VIII *supra.* Accordingly, in this section, plaintiffs will summarize the evidence from those earlier sections that establishes scienter as to both issues.[17]

The evidence regarding scienter as to the restatement includes the following:

1. the magnitude and impact of the restatement (Tr. at 2491:4-2493:20 & 2859:23-25 (testimony of H. Devor));

2. the importance of the accounting (Pltfs' Exs. 176, 694 (presentations to Audit Committee)); Tr. at 1882:7-10 (testimony of Schoenholz that he would have reviewed these presentations); and

3. the red flags regarding the accounting (Tr. at 2522:13-15, 2522:2523:3 (testimony of H. Devor regarding concerns raised by Arthur Andersen and an accounting board with the Company)), Pltfs' Ex. 712 (1998 OCC Report of Examination raising questions regarding the accounting for 3 of the 4 contracts).

With respect to evidence of scienter as to the reaging, that evidence includes the following:

1. the magnitude and impact of reaging on the reported 2+ numbers (Tr. at 680:24-681:4, 686:10-21, 689:10-13 (testimony of C. Ghiglieri); Tr. at 1479:8-1481:3 (testimony of Gilmer); Tr. at 2208:18-2209:4 (testimony of Ms. Markell); Pltfs' Ex. 1387 (e-mail stating reages

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[17] Plaintiffs incorporate by reference the more complete discussion of the record evidence on these issues set out in sections VI and VIII respectively of this brief.

done to mask delinquency); Pltfs' Ex. 654 (e-mail regarding timing the reage to prevent reaged account from reaching 2+ by year-end); Pltfs' Ex. 180 (May 2002 e-mail regarding eliminating reages for customers who can't or won't pay); Pltfs' Ex. 618 (July 2002 e-mail regarding Schoenholz's decision not to implement new reage plans because of possible impact on delinquency numbers); Pltfs' Ex. 858 (December 1999 e-mail to Gilmer regarding $40 million impact to 2+ delinquency as a result of reage policy change); Pltfs' Ex. 120 (discussing strategic decision in 2000 to use reages more aggressively); Pltfs' Ex. 360 (April 2002 memo from Schoenholz to Aldinger regarding changing reage policy to get delinquency back in line));

2. the other forms of credit manipulations used (Tr. at 678:23-679:3, 693:6-694:8, 695:12-697:1, 698:20-25 (testimony of Ms. Ghiglieri regarding skip-a-pay, grace period and rewrites); Tr. at 3002:8-3008:3 (testimony of Aldinger); Pltfs' Ex. 313 (August 2001 e-mail from Makowski to Aldinger regarding "across-the-board Skip-A-Pay program for September that would reduce year-end delinquency"); Pltfs' Ex. 454 (e-mail to Gilmer discussing "majik [sic]" of the grace period in reducing 2+ delinquency); Pltfs' Ex. 262 (series of e-mails showing reduction of 2+ delinquency due to grace period));

3. Household's compensation for collectors (Tr. at 2223:7-2229:17 (testimony of Ms. Markell); Pltfs' Ex. 1048 (stating the way collectors use restructures "is like being addicted to heroin")); and

4. FDIC criticism of Household's reaging policies (Pltfs' Ex. 19 at FDIC-0694).

Significantly, all of the individual defendants were involved in the making of, or aware of, decisions regarding these credit manipulations. Tr. at 1166:11-1169:4 (testimony of Gilmer that Ms. Schoenholz had to approve proposed reage policy changes); Pltfs' Ex. 157 (December, 16, 1999 e-mail from Gilmer regarding proposed reage policy change); Pltfs' Ex. 313 (August, 2001 e-mail to

Aldinger regarding proposed skip-a-pay program); Pltfs' Ex. 858 (December 1999 e-mail to Gilmer regarding $40 million impact to 2+ delinquency as a result of reage policy change).

With respect to the specific statements regarding reaging in the 2001 Form 10-K and the FRC conference, there is additional evidence of scienter including:

1. the KPMG benchmarking report discussing one-payment and automatic restructures (Pltfs' Ex. 1224);

2. a January 2002 e-mail apprising Schoenholz of "headline risk" associated with one-payment restructure policy (Pltfs' Ex. 649); and

3. an April 4, 2002 e-mail from Rybak to Gilmer regarding restructuring loans more than once every 12 months (Pltfs' Ex. 1100).

The foregoing evidence together with evidence as to scienter with respect to predatory lending and evidence probative of motive, such as defendants' compensation, warrants submission of this factual issue to the jury.

XI. PLAINTIFFS HAVE ESTABLISHED THAT DEFENDANT GARY GILMER MADE AN ACTIONABLE STATEMENT OR OMISSION

Defendants' claim that the CEO of Household's largest business unit accounting for almost 40% of the Company's revenues, Gilmer, did not make an actionable statement or omission, is erroneous.[18] They concede that he made the March 23, 2001 statement in *The Origination News* where he told the market that "[T]he company's 'position on predatory lending is perfectly clear. Unethical lending practices of any type are abhorrent to our company, our employees and most importantly our customers.'" This, however, is not the only statement that Gilmer made publicly. In

[18] Gilmer was an executive officer of Household until his "retirement" in the Summer of 2002. Defs' Ex. 850 at HHT0015419 (1999 Form 10-K); Defs' Ex. 851 at HHT0015515 (2000 Form 10-K); Defs' Ex. 852 at HHT0015666 (2001 Form 10-K). He was appointed Vice-Chairman, Consumer Lending in 2002. Defs' Ex. 852 at HHT015666.

addition to another statement directly attributable to Gilmer in Household's press release dated March 12, 2001, Gilmer is also responsible for the Company's statements where Gilmer approved or furnished information to be included in SEC filings or press releases containing a false statement of fact or the omission of a fact that was necessary, in light of the circumstances, to prevent a statement that was made from being false or misleading.[19] *See Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 708 (7th Cir. 2008).

Contrary to defendants' assertions, Aldinger testified, with disclosures made in the Forms 10-K and other SEC filings, "each of the[] businesses has its own CEO, a CFO, Chief Financial Officer, a chief credit officer, a head of collections, and all of those people, including the controllers and accounting support, work on putting our packages together." Tr. at 3427:16-22. Thus, as CEO of Consumer Lending, Gilmer was responsible for putting together the disclosures for that business unit.

Moreover, Gilmer provided information to Household's spokesperson, Hayden-Hakes, in connection with media inquiries relating to the Company's lending practices. *See* Tr. at 1494:20-23; 1495:14-1496:6 (Household Director of Corporate Communications, Hayden-Hakes, testified that she communicated with Household senior management, including Gilmer, in connection with how she should respond to the media). Hayden-Hakes made numerous statements at issue in this case. Tr. at 1494:24-25, 1496:22-1503:20, 1505:15-1508:20, 1515:23-1524:21, 1529:20-1535:25 (testimony of Hayden-Hakes); *see also* Pltfs' Exs. 1439, 1440, 1442-43, 1445-48, and 1451.

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[19] Press Release dated March 12, 2001 entitled "Household International Applauds Federal Reserve Board's Proposed Amendments to Regulation Z"; "'Household's position on predatory lending is perfectly clear,' said Gary Gilmer, president and CEO of HFC and Beneficial. 'Unethical lending practices of any type are abhorrent to our company, our employees, and most importantly, our customers.' . . . The company reaffirmed that it fully complies with all applicable federal and state laws and regulations."

Additionally, Gilmer knew before the April 9, 2002 Financial Relations Conference that the real estate restructure policy communicated to the market and buy and sell-side analysts was inaccurate. Rybak, Director of Credit Risk for Consumer Lending, informed senior management, including Gilmer and HI Director of Credit Risk, Makowski, in early April 2002 that the real estate restructure policy he had previously communicated to them was inaccurate – Household restructured real estate accounts more than once in 12 months and restructured Beneficial legacy accounts every 9 months. Rybak was aware that this information was further communicated to the market. Tr. at 2325:6-2329:2; Pltfs' Ex. 1100.

Gilmer was present at the April 9, 2002 FRC and was aware that reages were a material part of the presentation being made, but neither disclosed this information, nor corrected Schoenholz while he was making false statements about HI's real estate reage policy. Pltfs' Ex. 135. "[A] high ranking company official cannot sit quietly at a conference with analysts, knowing that another official is making false statements and hope to escape liability for those statements. If nothing else, the former official is at fault for a material omission in failing to correct such statements in that context." *See In re SmarTalk Teleservices, Inc. Sec. Litig.*, 124 F. Supp. 2d 527, 543 (S.D. Ohio 2000).

The Court has already ruled that the two statements Gilmer made on March 12, 2001 and March 23, 2001 are not inactionable puffery. Dkt. No. 1502. Distinguishing *Searls v. Glasser*, 64 F.3d 1061 (7th Cir. 1995), the Court held that "[t]hough there is no bright line that separates actionable statements from puffery, "'[t]he key [to distinguishing them] is whether the proposition at issue can be proven or disproven using standard tools of evidence.'" *City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 674 (6th Cir. 2005)." *Id*. at 2. Thus, defendants' challenge on this basis falls flat as well. Finally, as detailed in Sections III & VII above, plaintiffs have sufficiently established the materiality and causal relationship between these statements and

plaintiffs' losses. Accordingly, plaintiffs have established that Gilmer made actionable statements and omissions.

XII. PLAINTIFFS HAVE ESTABLISHED SECTION 20(a) LIABILITY FOR THE INDIVIDUAL DEFENDANTS

For the reasons set forth above, plaintiffs have submitted substantial evidence that each of the defendants is liable under §10(b) and Rule 10b-5. This establishes the predicate violation necessary for §20(a) "control person" liability. As this was the sole basis for defendants' arguments with respect to this claim (Defs' Mem. at 46), the Court should allow this claim to go to the jury.

XIII. CONCLUSION

For the reasons discussed above, Defendants' Motion for Judgment As a Matter of Law Pursuant to Rule 50(a) should be denied in its entirety.

DATED: April 27, 2009

Respectfully submitted,

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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 W. Broadway, Suite 1900, San Diego, California 92101.

2. That on April 27, 2009, declarant served by electronic mail and by U.S. Mail to the parties the PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION FOR JUDGMENT AS A MATTER OF LAW PURSUANT TO RULE 50(A).

The parties' e-mail addresses are as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 27th day of April, 2009, at Chicago, Illinois.

/s/ Rika J. Ellis
RIKA J. ELLIS