IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, on Behalf of Itself and All Others Similarly Situated,	)	Lead Case No. 02-C-5893 (Consolidated)
Plaintiff,	)	CLASS ACTION
v.	)	Judge Ronald A. Guzmán
HOUSEHOLD INTERNATIONAL, INC., *et al.*,	)	
Defendants.	)	

DEFENDANTS' RESPONSE TO "PLAINTIFFS' PROPOSED PLAN FOR OBTAINING RESPONSES TO THE DISCOVERY INQUIRY ON THE PROOF OF CLAIM"

Defendants submit this response to Plaintiffs' "Proposed Plan for Obtaining Responses" to the Court-ordered question contained in the Proof of Claim form from beneficial owners on whose behalf custodian banks and other nominees have filed purported claims. Plaintiffs have not provided a meaningful or appropriate plan for obtaining answers; instead, they propose that no answer should be required from *94 percent* of the beneficial owners on whose behalf nominees have filed purported Proof of Claim forms that contain no answer to the Court-ordered question. Plaintiffs' proposal ignores the Supreme Court's holding in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), because it would eliminate completely Defendants' right to rebut *Basic*'s presumption of reliance as to at least 11,760 claimants.[1]

[1] By submitting this response, Defendants do not concede—and, indeed, continue to dispute—that the Proof of Claim form's interrogatory question provides Defendants with any meaningful opportunity to rebut *Basic*'s presumption of reliance as to the majority of class members as to whom Defendants have been denied any other discovery. Indeed, testimony elicited at the May 9, 2011 deposition of Putnam Investment Management ("Putnam") highlights the infirmities of the interrogatory question as a reasonable means to elicit information on the issue of a class member's actual reliance. Putnam's representative testified that he would feel comfortable answering the interrogatory question "no" as to *all* of Putnam's funds—even though the representative was not the decision maker. (Putnam Rough *(cont'd)*

The only justification Plaintiffs offer for their proposal is the unsupported assertion that it would be a "Herculean" task for custodian banks and other nominees to attempt to obtain responses to the Proof of Claim form's reliance question from beneficial owners with potentially allowable losses of $250,000 or less.[2] Plaintiffs' protestations about the burden custodian banks and other nominees would face if required to make efforts to obtain answers to the Proof of Claim form's reliance question are specious. No institution has submitted an affidavit or objection to this Court asserting that it would be an unduly burdensome task to comply with the *de minimus* and straightforward requirements for obtaining verified and proper Proof of Claim forms, with the reliance question answered by the actual decision makers. All that is required is that the custodian banks and other nominees *either*: (1) provide the names and addresses of these

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Tr. at 62:6–65:4, attached as Exhibit A). In particular, the Putnam representative was asked the following question and gave the following answer:

> Q. But within Putnam, you don't have to actually know what the person who bought the position on a given -- bought stock of Household on a given day was thinking to know the answer to that question?
>
> A: Correct. When I read the question that you reference, I think it is clear that the answer is, no, across the board.

(*Id*. at 64:19–65:4.)

[2] At this stage of the proceedings, there has been no final determination of *any* class member's allowable loss. Plaintiffs' representations about the *potentially* allowable losses of certain beneficial owners and the class as a whole are based on the claims administrator's preliminary analyses of Proof of Claim forms submitted to date. Many of the claim forms are incomplete and require follow-up by the claims administrator to obtain supporting documentation, including proofs of purchases and sales and verified answers to the reliance question. At least some Proofs of Claim were filed by custodian banks without authorization from the beneficial owners. (*See infra* at 12 (quoting testimony that claims filed by Northern Trust Company, purportedly on behalf of Putman funds, had been filed without Putnam's authorization). Furthermore, the amount of allowable losses as to any class member, and as to the class as a whole, cannot be determined until the conclusion of Phase II of the proceedings, which likely will require a jury trial on reliance. Until Phase II is concluded, and this court has ruled on Defendants' post-verdict motions, there will not be a final, completed verdict on all elements of Plaintiffs' securities fraud claim as to *any* class member. Defendants would be entitled to appeal any adverse ruling to the Court of Appeals.

class members to the claims administrator; or (2) mail Court-approved follow-up notice to the beneficial owners on whose behalf they have submitted Proofs of Claims.

Notably, Plaintiffs do not contend that it will be a "Herculean" task for the nominees ultimately to mail checks to their clients who have claims of $250,000 or less. Indeed, as a business matter, the custodian banks and other authorized nominees are in regular communication with their current customers, such as by sending them account statements and other routine communications. There is no sound reason why an appropriate verified and completed Proof of Claim form for such claimants should not be required and obtained at this stage.

For these reasons, the Court should reject Plaintiffs' inadequate proposal and direct that the Proof of Claim form, or a Court-approved follow-up notice, be sent to *all* beneficial owners on whose behalf custodian banks or other nominees submitted Proof of Claim forms that do not contain an answer to the reliance question. The Court also should hold that if, after receiving the Proof of Claim form or follow-up notice, and following a reasonable time period to respond, a class member still does not provide a verified answer to the Proof of Claim form's reliance question, that class member's claim should be deemed invalid.

BACKGROUND

On November 22, 2010, the Court, over Defendants' objection, held that (except with respect to Wells Fargo) the *only* means by which Defendants would be permitted to attempt to rebut *Basic*'s presumption of reliance as to individual class members was through a single question, to be included in the Proof of Claim form, asking whether the responding class member would have purchased Household stock had the class member known that the price was artificially inflated. (Docket No. 1703 at 8–10.)

On December 20, 2010, Defendants moved for reconsideration. (Docket No. 1710.) Defendants argued that limiting Phase II discovery to Plaintiffs' interrogatory question would deprive Defendants of any meaningful opportunity to obtain evidence to rebut the presumption of reliance and, thus, effectively would deprive Defendants of their Seventh Amendment right to a jury trial on the reliance element of Plaintiffs' securities fraud claim. (Docket No. 1711-1.)

At a status hearing on January 5, 2011, the Court reconsidered and permitted some limited discovery during the period otherwise designated for submission of Proof of Claim forms. The Court allowed Defendants 120 days, until May 24, 2011, "to delve into *whatever issues of reliance they wish to address.*" (Jan. 5 Tr. at 20:11–13, attached as Exhibit B (emphasis added).) The Court specifically authorized discovery of major institutional holders by means of interrogatories and Rule 30(b)(6) depositions, and reiterated that Defendants could ask "any question you want in your interrogatories and in your discovery, your 30(b)(6) deposition." (*Id.* at 22:10–15.) The Court memorialized its January 5 rulings in a Minute Order dated January 14, 2011. (Docket No. 1724.)

Defendants promptly attempted to commence the authorized discovery by serving written discovery and deposition notices on top institutional holders of record and the three Lead Plaintiffs. In response, Plaintiffs moved for a protective order. (Docket No. 1731.) On January 31, 2011, the Court granted in part and denied in part Plaintiffs' motion for a protective order, and limited interrogatories and documentary discovery to non-public information and deposition discovery to 15 institutional holders. (Docket No. 1737.)

Following the Court's January 31 ruling, Defendants served revised deposition notices and written discovery requests. Defendants' written discovery requests sought to obtain, among other things, information and documents relating to the institutional holders' internal, non-public

analyses of Household and Household stock. At the urging of Plaintiff's Counsel, most of the discovery recipients refused to provide this information, claiming that their internal analyses did not constitute "non-public" information. Defendants, therefore, filed a motion to compel on April 4, 2011. (Docket No. 1745.) At a status hearing on April 7, 2011, the Court denied Defendants' motion to compel. (Docket No. 1751.)[3]

At the April 7 status conference, Plaintiffs' Counsel also advised the Court that many claims had been submitted by custodian banks on behalf of beneficial owners of Household stock, but the custodian banks were unable to answer the Proof of Claim form's question regarding reliance, because the beneficial owners, not the banks, made the actual investment decisions to purchase Household stock. The Court directed Plaintiffs' counsel to propose a plan, by May 6, 2011, regarding the most efficient way to obtain responses from the beneficial owners or actual decision makers to the Proof of Claim form's reliance question. (Docket No. 1753.)[4]

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[3] The Court denied Defendants' motion to compel despite the fact that the Court, in its November 22, 2010 Memorandum Opinion and Order, had acknowledged that, although "there is no evidence that any class member purchased Household stock with actual knowledge that its price had been artificially inflated by defendants' fraud . . . *that does not foreclose the remote possibility that some class member may have purchased Household stock for a reason totally unrelated to its value as reflected by the market price*." (Docket No. 1703 at 7–8 (emphasis added).) It also is entirely possible that an investor may have disbelieved Household's denials that it was engaged in predatory lending and purchased Household stock anyway. *See Basic*, 485 U.S. at 248 (explaining that one way to rebut the presumption of reliance would be to show "that an individual plaintiff traded or would have traded despite knowing the statement was false").

Sworn deposition testimony in this case supports Defendants' position that investors' subjective internal analyses of Household constitute non-public information not already incorporated into the market price that is relevant to evaluating their reliance. *See, e.g.*, Putnam Tr. (Ex. A) at 35:19–36:6 ("Q. And so these reports contained nothing other than public information and [a Putnam analyst's] analysis of that public information? A. Correct. Q. All right. Nevertheless, you consider that proprietary? A. Correct. Q. And you consider that valuable? A. Correct. Q. You consider that essential to Putnam's decision-making process? A. Correct.").

[4] The Court recognized at the April 7 conference that "it's actually the person who made the decision to buy or sell is the one" who has relevant knowledge as to the answer to the Proof of Claim form's reliance question. (Apr. 7 Tr. at 12:13–15, attached as Exhibit C.) In deposition testimony this week, Putnam's designee testified that the relevant persons with such knowledge at Putnam were the *(cont'd)*

ARGUMENT

I. Plaintiff's Proposal Must Be Rejected Because It Would Deny Defendants Any Opportunity to Rebut *Basic*'s Presumption of Reliance as to 94% of the Beneficial Owners on Whose Behalf Custodian Banks and Other Nominees Have Filed Claims.

In their May 6, 2011 submission, Plaintiffs propose that the most efficient way to proceed would be to require custodian banks and other nominees to obtain answers from beneficial owners only with respect to claims that, according to the claims administrator's preliminary analysis, may represent potential allowed losses of more than $250,000 per claim. As Plaintiffs acknowledge, under their proposal, no answer to the Proof of Claim form's reliance question would be required as to *94% (11,760 out of 12,506)* of the claims that have been submitted to date by custodian banks and other nominees, notwithstanding that Plaintiffs estimate that these 11,760 claims represent potential allowed losses of $233,245,777. (Pls.' Proposal at 2–3.) Plaintiffs' proposal thus would result in Defendants being denied *any* discovery whatsoever as to these class members' reliance, since these claimants were not the recipients of Defendants' discovery requests, which were directed only to the largest institutional holders of record.

Plaintiffs' proposal must be rejected because a defendant's right to rebut *Basic*'s presumption of reliance is *absolute*—not optional. In *Basic*, a plurality of the Supreme Court held that: (1) "[i]t is not inappropriate to apply a presumption of reliance supported by the fraud-on-the-market theory"; and (2) "[t]hat presumption, however, *is rebuttable*." 485 U.S. at 250 (emphasis added); *see also id.* at 251 (agreeing with the plurality that "if Rule 10b-5's reliance requirement is to be left with any content at all, the fraud-on-the-market presumption must be

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portfolio managers, but that his deposition preparation did not include learning the portfolio managers' reasons for investing in Household stock during the relevant time period because this was outside the scope of discovery allowed by the Court. (Putnam Tr. (Ex. A) at 53:16–58:4.) This limitation is inconsistent with *Basic*, which specifically contemplates rebuttal of the presumption of reliance based on the subjective beliefs of a particular investor. 485 U.S. at 250–51.

capable of being rebutted by showing that a plaintiff did not 'rely' on the market price." (White and O'Connor, JJ., dissenting from the plurality's adoption of the fraud-on-the-market theory).

Plaintiffs' proposal would abrogate completely Defendants' Seventh Amendment right to a jury trial on all elements of Plaintiffs' claim as to at least 11,760 class members having potential claims of up to $250,000 each. Plaintiffs effectively are asking the Court to enter judgment on these claims without Defendants' ever having any opportunity to rebut the presumption of reliance, thus denying Defendants due process and depriving them of their right to a jury trial on the element of reliance.

Any contention that such a result would be justified in order to foster the efficiencies of the class action procedure is refuted by *Basic* itself. As the Supreme Court explained in *Basic*, requiring a plaintiff to bear the burden of proof on reliance in the first instance effectively would preclude class action treatment as to *other* elements of a securities fraud claim for which common questions of law and fact existed, such as falsity, materiality, and scienter:

> This case required resolution of several common questions of law and fact concerning the falsity or misleading nature of the three public statements made by Basic, the presence or absence of scienter, and the materiality of the misrepresentations, if any. . . . Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones. The District Court found that the presumption of reliance created by the fraud-on-the-market theory provided "a practical resolution to the problem of balancing the substantive requirement of proof of reliance in securities cases against the procedural requisites of [Fed. Rule Civ. Proc.] 23."

Basic, 485 U.S. at 242; *see also id*. at 245 (explaining that "presumptions are . . . useful devices for allocating the burdens of proof between parties").

The rebuttable presumption of reliance adopted by the Supreme Court in *Basic* thus was simply a device to facilitate class action treatment of common issues, with individual issues

reserved for a separate proceeding or proceedings. *See, e.g.*, *Jaroslawicz v. Engelhard Corp.*, 724 F. Supp. 294, 300 (D. N.J. 1989) ("[The court] must allow defendants to rebut the claimed reliance of each and every class member. Otherwise proof of Jaroslawicz's own 'non-rebuttable' reliance will become conclusive as to all other class members. This result would let a 'scheme of investors' insurance' into securities law through the back door."). As the Seventh Circuit recently admonished, when discussing *Basic*, lower courts "can't revise principles established by the Supreme Court." *Schleicher v. Wendt*, 618 F.3d 679, 683 (7th Cir. 2010); *see also* 28 U.S.C. § 2072(b) (providing that the Federal Rules of Civil Procedure "shall not abridge, enlarge or modify any substantive right").

The Court has acknowledged that Defendants cannot be deprived of *all* opportunities to address the issue of reliance and to rebut *Basic*'s presumption as to claimants. In its January 31, 2011 Order granting in part Plaintiffs' motion for a protective order, the Court acknowledged that Defendants have "a claim of *a constitutional right to challenge the presumption of reliance to a jury*." (Docket No. 1737 at 1 (emphasis added).) And when Plaintiff's counsel advised the Court at the April 7 status of the problem of custodian banks and other nominees being unable to answer the Proof of Claim form's interrogatory, the Court again acknowledged that the interrogatory "goes to the one remaining issue . . . on the question of liability, which is *the defendants' right to rebut the presumption of reliance*." (Apr. 7 Tr. (Ex. C) at 22:13–15 (emphasis added).)

The Court's remarks during the April 7 hearing, moreover, show that the Court recognizes that excusing beneficial owners from submitting a verified Proof of Claim form answering the interrogatory question presented would, at a minimum, be inconsistent with *Basic* and violate Defendants' constitutional right to have a jury decide disputed factual issues on the

essential element of reliance. At the April 7 hearing, the Court repeatedly stated that it would be necessary to extend the schedule in order to obtain answers to the Proof of Claim form's question from beneficial owners. *See* April 7 Tr. at 9:16–19) ("[W]e'll just have to make time for the questionnaire to be sent out to those claimants."); *id.* at 14:25–15:2 ("I don't have any problem adjusting the time to allow it to be done."); *id.* at 26:23–27:1 ("I am going to extend the process for answering the question, which we included in the notice of the need to file a claim, for the reasons that have been given here.").

The plain language of the April 11 Order, moreover, makes absolutely clear that the Court did *not* contemplate a proposal that would excuse Plaintiffs from making any effort to obtain answers to the Proof of Claim form's interrogatory question as to 11,760 (or more) class members. In the April 11 Order, the Court specifically directed Plaintiffs' counsel to "propose a plan by May 6, 2011 as to the most efficient way to proceed *in order to obtain responses to the discovery inquiry*, including but not limited to an estimate of the number of claims that would require an extension of time in which to respond to the discovery inquiry, the requisite time frame, and the manner and scope of any notification of the extension." (*Id.* at 17:16–17 (emphasis added).) The Court therefore should reject Plaintiffs' proposal and require that a verified Proof of Claim form answering the question be completed by *all* claimants with potentially allowable losses as to whom custodian banks and other nominees have filed claim forms that do not contain an answer to the Proof of Claim form's interrogatory question.

In addition, the Court should order that the follow-up notice advise recipients that, if they fail to submit a completed and verified Proof of Claim form within a specified reasonable time period, answering the form's question, their claims will be disallowed. To do otherwise, and allow such claimants to recover based on incomplete Proof of Claims forms that do not include

an answer to the question, would be to ignore wholly the Supreme Court's holding in *Basic* and to require Household to act as an insurer against investment losses. *See, e.g.*, *Jaroslawicz*, 724 F. Supp. at 300.

II. Plaintiffs' Assertion that Requiring a One-Page Notice Be Sent to All Beneficial Holders Would Be a "Herculean" Task Is Unsupported, Meritless, and, In Any Event, Provides No Basis to Ignore the Holding of *Basic*.

Plaintiffs argue that requiring custodian banks and other nominees to obtain answers to the Proof of Claim form's question from the 11,760 beneficial owners (to date) with purported claims of $250,000 or less would "constitute a 'Herculean task'" and "a costly one." (Pls.' Proposal at 3, 5.) As an initial matter, this assertion is wholly unsupported. Plaintiffs purport to base this contention on conversations their counsel allegedly had with *unidentified* representatives of the Bank Depository User Group ("BDUG"). (*Id.* at 3–5.) Plaintiff asserts that, according to the unidentified BDUG representatives, unidentified custodian banks would have to engage in a series of onerous steps, such as "figure[ing] out who at the bank had direct contact with the clients," "determin[ing] the appropriate account manager responsible for dealing with [each] client," and "educat[ing" the account managers "on what needed to be done and why it needed to be done." (*Id.* at 4.)

Tellingly, Plaintiffs have not submitted an affidavit or declaration from the alleged BDUG representatives or from any authorized custodian. And not a single institution has filed any objection with this Court indicating that the straightforward requirements of this Court's prior Court Order are burdensome or onerous. Nor could any such assertion plausibly be

advanced. The custodian banks need not to do *anything* other than forward the names and addresses of the beneficial owners to class counsel or the claims administrator.[5]

Indeed, any alleged inconvenience to one or more custodian banks is purely a result of their own failure to follow the Court's earlier instructions. On January 11, 2011, the Court approved the proposed Notice of Verdict and Proof of Claim forms drafted by Plaintiffs. (Docket No. 1721.) Section V of the Notice of Verdict, captioned **"NOTICE TO BANKS, BROKERS, AND NOMINEES,"** directed banks, brokerage firms, institutions, and other persons who were nominees for beneficial owners of Household stock, within ten days of receipt of the notice: (1) to provide Plaintiffs' counsel with the names and addresses of the beneficial owners (if the nominees had not already done so in connection with the earlier settlement with Arthur Andersen); or (2) to forward copies of the Notice of Verdict and Proof of Claim form to each beneficial owner and to confirm to Plaintiff's counsel that they had done so. (*Id.*, Ex. 1 at 6.) The notice also advised nominees that "Plaintiffs' Counsel offer to prepay your reasonable costs and expenses of complying with this provision upon submission of appropriate documentation." (*Id.*)

Neither Plaintiffs nor any BDUG member has explained why certain BDUG members chose to ignore the Court's explicit instructions in the Notice of Verdict form. Moreover, it appears that nominees at times file claims on behalf of clients when *they have no authorization to do so.* For example, Northern Trust Company purportedly submitted 67 separate Proofs of Claim on behalf of Putnam and mutual funds it manages, but at Putnam's May 9, 2011 deposition, Putnam's designated witness testified that he was unaware of these filings and that

[5] If a beneficial owner was not the actual decision maker, the beneficial owner may have to consult with its account representative or financial advisor to answer the Proof of Claim form's reliance question. But truthfully answering the question is the responsibility of the claimant and cannot be excused.

they were not authorized. (Putnam Tr. (Ex. A) at 90:20–1:6.) At point, the attorney representing Putnam, a partner at Mintz. Levin, Cohn, Ferris, Glovsky & Popeo, P.C. ("Mintz Levin"), explained:

> I can say for the record that Northern Trust has no authority to file claims for Putnam, and we frequently encounter in class actions that they file duplicate claims, not only for Putnam, but for other institutional clients.

(Putnam Tr. (Ex. A) at 92:1–5.) The Putnam deponent then confirmed that he agreed with the attorney's statements, and also confirmed that Putnam would file its Proofs of Claim, if any, directly. (*Id.* at 92:9–24.) This testimony makes clear why it is essential to obtain completed and verified Proof of Claim forms from the *actual class members*, rather than from their purported nominees, who may or may not have authority to file on behalf of beneficial owners.

Finally, Plaintiffs' protestations that the custodian banks should not be saddled with the costs of contacting beneficial owners is a red herring. As the Notice of Verdict form drafted by Plaintiffs' counsel shows, it *is Plaintiffs' counsel's* burden to pay the costs of any necessary notice to class members. All the custodian banks need to do is provide the names and addresses of beneficial owners to the claims administrator, who can handle any necessary mailing to these class members.

To allow 11,760 (or more) beneficial owners potentially to recover tens of thousands, and, indeed, hundreds of thousands, of dollars without even being required to submit verified Proofs of Claim with answers to the form's reliance question, would be plain error.

CONCLUSION

For the reasons set forth herein, the Court should reject Plaintiffs' proposed plan and require custodian banks and other nominees to obtain verified Proof of Claim forms with an answer to the reliance question from *all* beneficial owners on whose behalf the nominees submitted claims.

Dated: May 13, 2011

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CERTIFICATE OF SERVICE

R. Ryan Stoll, an attorney, hereby certifies that on May 13, 2011, he caused true and correct copies of the foregoing Defendants' Response to Plaintiffs' Proposed Plan for Obtaining Answers to the Claim Form's Question Regarding Reliance to be served via the Court's ECF filing system on the following counsel of record in this action:

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