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, Plaintiff, v. HOUSEHOLD INTERNATIONAL, INC., *et al.*, Defendants.	)	Lead Case No. 02-C-5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzmán

DEFENDANTS' SUBMISSION REGARDING
REBUTTAL OF THE PRESUMPTION OF RELIANCE

By Order dated August 24, 2011, the Court directed Defendants to "file and serve on plaintiffs a list of claims as to which they contend the evidence in the record rebuts the presumption of reliance along with a citation to those portions of the record which support their contention on or before October 14, 2011." (Docket No. 1776.) Defendants respectfully submit this filing in accordance with the Court's August 24 Order.

The presumption of reliance is subject to rebuttal by two principal means. First, the presumption of market reliance as to a particular misrepresentation is rebutted if that misrepresentation did not independently lead to a distortion in the price of the stock, *i.e.*, the particular misrepresentation did not have an independent inflationary price impact. Alternatively, the presumption of reliance is rebutted if an investor would have purchased the stock even if the investor had been aware of the misrepresentation or could be shown not to have relied on the integrity of the market.

Prior to the completion of Phase I, what misrepresentations were actionable, the inflationary price impact assigned to those misrepresentations, and the particular claimants subject to Phase II proceedings were not established. The verdict in Phase I, first determining what misrepresentations were actionable and then applying Professor Fischel's "Leakage Model," has resulted in a verdict that rebuts the presumption of reliance.

In brief, in applying Professor Fischel's "Leakage Model," the jury attributed the entire inflation affecting Household's stock to a single statement that only dealt with "Predatory Lending." In so doing, the jury necessarily and expressly found that no inflation can be attributed to the "Restatement" or "Re-aging" issues (*see* pp. 3-13, *infra*).[1] With respect to the first misrepresentation found by the jury as to the sole issue of "Predatory Lending," the presumption of reliance is also rebutted due to a fundamental failure of proof. The entire premise of the "leakage" theory presented by Professor Fischel was that the actionable inflation was the result of all three alleged wrongs ("Predatory Lending," "Restatement" and "Re-aging" issues) and therefore the full inflationary price impact of the "Leakage Model" could not be assigned to a misrepresentation concerning the single issue of "Predatory Lending" (*see* pp. 13–18, *infra*).

The constrained discovery in Phase II also identified: (1) claimants who would have purchased Household stock even if they were aware of the misrepresentations at issue; (2) claimants who did not rely upon the integrity of the market in their purchasing decisions; and (3) claimants who failed to comply with required Phase II discovery. The presumption of reliance is also rebutted as to all such claimants (*see* pp. 18–31, *infra*).

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[1] Other than for a one-week period relating to a single statement on December 4, 2001 regarding "Re-aging" (*see* pp. 11-13, *infra*).

Finally, the procedure now being used by the Court does not comport with the Federal Rules of Civil Procedure. Moreover, were the Court to resolve a disputed fact issue and hold that Defendants have not rebutted the presumption of reliance, Defendants would have been denied fundamental rights under the Seventh Amendment (*see* pp. 31–32, *infra*).

I. The Verdict in Phase I Establishes a Rebuttal of the Presumption of Market Reliance.

A. The Legal Context

"[R]eliance is an element of a Rule 10b-5 cause of action . . . [and] provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988) (citations omitted). In *Basic*, the Supreme Court authorized a "presumption of reliance supported in part by the fraud-on-the-market theory," *id.* at 242, but held that the presumption is subject to rebuttal. *Id.* at 248; *accord Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2185 (2011) ("The Court [in *Basic*] also made clear that the presumption was just that, and could be rebutted by appropriate evidence.").

As noted in *Basic*, the presumption of market reliance with respect to a misrepresentation is rebutted if "the misrepresentation in fact did not lead to a distortion of price." 485 U.S. at 248. Thus, courts consistently have held that the presumption of market reliance is rebutted as to a particular misrepresentation if the misrepresentation did not have an independent inflationary "price impact." *See, e.g., In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 638 (3d Cir. 2011) ("[A] defendant's successful rebuttal demonstrating that misleading material statements or corrective disclosures did not affect the market price of the security defeats the presumption of reliance."); *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 483 (2d Cir. 2008) ("*Basic* made clear that *defendants* could 'rebut proof of the elements giving rise to the presumption, or show that the misrepresentation in fact did not lead to a distortion of price.'" (emphasis in original, quoting

Basic, 485 U.S. at 248)); *Nathenson v. Zonagen*, 267 F.3d 400, 415 (5th Cir. 2001) (holding that where it is established that a misrepresentation "did not affect the price of the stock" then the *Basic* presumption has been rebutted); *Semerenko v. Cendant Corp.*, 223 F.3d 165, 179 (3d Cir. 2000) ("[T]he presumption of reliance may be rebutted by showing that the market did not respond to the alleged misrepresentations. . . ."); *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 256 F.R.D. 586, 595 (N.D. Ill. 2009) ("[D]efendants can rebut this presumption by rebutting 'proof of the elements giving rise to the presumption, or show[ing] that the misrepresentation in fact did not lead to a distortion of the price.'" (*quoting In re Salomon Analyst Metromedia Litig.*, 544 F.3d at 483)); *In re System Software Assocs. Sec. Litig.*, No. 97 C 177, 2000 U.S. Dist. LEXIS 3071, at *39 (N.D. Ill. Mar. 8, 2000) ("Defendants may rebut the presumption of reliance by establishing that any alleged misstatement did not lead to a distortion in price or that an individual plaintiff would have purchased stock even if the misstatement were known to be false." (citing *Basic*, 485 U.S. at 248)).

The analysis provided in *Nathenson* is illustrative. In *Nathenson*, plaintiffs alleged securities fraud based on a series of alleged public misrepresentations concerning two of defendants' drug products. 267 F.3d at 404. Addressing the issue of the *Basic* presumption and inflationary "price impact," the court emphasized that, although *Basic* authorized a presumption of reliance "with respect to publicly disseminated materially misleading statements concerning companies whose shares are traded on a well-developed, efficient market," the Supreme Court in *Basic* also made clear that the presumption was rebutted where the market price was not, in fact, affected by a particular misrepresentation because "in such a case 'the basis for finding that the fraud had been transmitted through the market price would be gone.'" *Id.* at 414 (*quoting Basic*, 485 U.S. at 248). Thus, "[i]t is clear that a fraud-on-the-market theory may not be the basis for recovery in respect to an alleged misrepresentation which does *not* affect the market price of the security in question." *Id.* (emphasis in original).

Because the record in *Nathenson* established that there was no independent "price impact" arising from certain of the alleged misrepresentations, the court affirmed dismissal of those claims, concluding:

> [A]lthough there is generally a presumption that potentially significant publicly disseminated information is reflected in the price of stock traded on an efficient market, the presumption is rebuttable, and where the facts properly considered by the district court reflect that the information in question did not affect the price of the stock then the district court may properly deny fraud-on-the-market based recovery.

Id. at 415.

This core principle, and the "efficient market hypothesis" upon which the *Basic* presumption is premised,[2] are embedded in the "Leakage Model" which Professor Fischel presented and the jury adopted. As Professor Fischel acknowledged, the "Leakage Model" is based on scholarly work co-authored by Professor Bradford Cornell.[3] Professor Cornell confirms this fundamental principle of rebutting the *Basic* presumption of market reliance:

> In the paper on which Professor Fischel based his "Leakage Model" I discuss the economic and finance principles that are directly applicable to rebutting the "fraud on the market" presumption of reliance established in *Basic*. Section III (B) of my paper is entitled "Rebutting the Presumption of Reliance," and specifically addresses the application of the efficient market hypothesis as a tool to determine whether the *Basic* presumption

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2 As explained in *Basic*, the fraud-on-the-market theory "'is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business.'" 485 U.S. at 241 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160–61 (3d Cir. 1986)).

3 Fischel Expert Report (Docket No. 1361-2) at ¶¶ 38–42 (stating that his "Leakage Model" is based on an article by B. Cornell and R. Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 UCLA L. REV. 905 (1990).)

> has been rebutted as to alleged misrepresentations. As set forth in my paper, a necessary corollary of the "fraud on the market" presumption is that where it is shown that an alleged misrepresentation did not independently result in an additional amount of artificial inflation in the stock price, the market did not rely upon the alleged misrepresentation and the *Basic* presumption is rebutted.

See Affidavit of Bradford Cornell, attached as Exhibit A and cited as "Cornell Aff.," at ¶ 13.[4]

B. The Verdict

In its verdict in Phase I, the jury was required to answer eight questions, three of which bear directly upon the issue of the inflationary "price impact" associated with the specific misrepresentations alleged. (Verdict Form (Docket No. 1611).)

Question No. 1 on the Verdict Form required the jurors to answer the following question with respect to each of the 40 statements that Plaintiffs alleged constituted a false or misleading statement of fact:

> Have Plaintiffs prevailed on their 10(b)/Rule 10b-5 claims with regard to any of the statements set forth in Table A?

Id. at 1.

Question No. 2 on the Verdict Form instructed:

> If you answered 'yes' to any of the statements in Question No. 1, identify the issue or issues that the statement misrepresented by placing an 'X' on the appropriate line(s). **(more than one line can be checked)**.

4 The fact that the jury verdict rebuts the presumption of reliance is established by the verdict itself, including the jury's application of Professor Fischel's "Leakage Model." Professor Cornell's affidavit is submitted to more fully address and explain the consequences of the application of the "Leakage Model" and the jury's findings with respect to rebuttal of the presumption of reliance. As Professor Cornell states in his affidavit, for these purposes he has assumed that the findings in the "Leakage Model" presented by Professor Fischel are correct. *See* Cornell Aff. at ¶ 11.

Id. (bold type in original)[5]

Question No. 4 on the Verdict Form directed the jury to select "which, if any, of plaintiffs' proposed damages models reasonably estimates plaintiffs' damages," and to:

> [W]rite the amount of loss per share, if any, that according to the model you have chosen, any defendant's conduct caused plaintiffs to suffer on each of the dates set forth in Table B. (If no loss was caused on any date, write 'none' or '0').

Id. at 41.

Only two theories of inflationary price impact were presented to the jury in the Phase I trial by Professor Fischel: (1) a "Leakage Model"; and (2) a "Specific Disclosures Model." *Id.*

As to Question No. 1, the jury found that 17 of the 40 specified statements constituted an actionable false or misleading statement or omission of material fact. (*Id.* at 1–40.) With respect to those 17 statements, the jury identified, as required by Question No. 2, "the issue or issues that the statement misrepresented." (Trial Tr. at 4723:15–16.) As to Question No. 4, the jury completed Table B of the Verdict Form pursuant to the "Leakage Model" introduced into evidence by Professor Fischel and the Court's instruction that "damages . . . is the difference between the price plaintiffs paid for each share of Household stock and the price each share would have cost if no false or misleading statement or omission of material fact had occurred, in other words, the measure of inflation in the stock price." (Trial Tr. at 4720:10–14.)

The first statement the jury found to be actionable in Question No. 1 was contained in a March 23, 2001 *Origination News* article (Statement No. 14 on the Verdict Form (Docket No. 1611) and Table A thereto): "Gary Gilmer, president and chief executive of Household's subsidiaries HFC and Beneficial said the company's 'position on predatory lending is perfectly

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5 Question No. 2 on the Verdict Form identified the three separate components of the alleged fraud as "Predatory Lending," "2+ Delinquency/Re-Aging," and "Restatement." (*Id.* at 1–40.)

clear. Unethical lending practices of any type are abhorrent to our company, our employees and most importantly our customers.'" (Verdict Form (Docket No. 1611), Table A at 11.) The jury found this statement constituted a false and misleading statement or omission of material fact *only* with respect to the issue of "Predatory Lending." (Verdict Form (Docket No. 1611) at 14.)

With respect to this statement, concerning *solely* the "Predatory Lending" issue, the jury assigned an inflationary price impact of $23.94 pursuant to the "Leakage Model." (*Id.*, Table B.)

C. The Verdict Rebuts The Presumption of Reliance With Respect to All Actionable Statements Regarding the "Restatement" Issue and All But One Actionable Statement Regarding the "Re-Aging" Issue.

The Phase I verdict result necessarily rebuts the presumption of reliance as to all actionable misrepresentations found by the jury concerning the "Restatement" issue and all but one statement relating to the "Re-aging" issue of the alleged fraud.

At trial, Plaintiffs' expert, Professor Fischel, purported to calculate the "measure of inflation" present in Household's stock price under each of his proposed models for each day of the Class Period from July 30, 1999 through October 11, 2002. Professor Fischel testified that, although his models showed "artificial inflation" for every day of the Class Period, in fact there could be no "artificial inflation" until the first day on which the jury found a misstatement:

> Well, when the inflation comes into the stock, as I've explained numerous times, is a function of what the jury concludes as to when the first leading—first misleading statement is.

(Trial Tr. at 2870:24–2871:2.)

Professor Fischel stated that he began his inflationary price impact analysis on July 30, 1999, the first day of the Class Period, because this was "the first possible date" on which the jury could find that Household's stock price was "artificially inflated." (*Id.* at 2922:1–2.) Professor Fischel explained how his model should be applied if the jury were to conclude (as it did) that the first actionable misstatement occurred on a date subsequent to July 30, 1999:

> But if the jury concludes it's not July 30th, it's August 16th or October 19th—whatever date the jury picks—the exhibit can be used. It's just that ***every date prior to the first date that the jury picks as the first false and misleading disclosure, there is no artificial inflation.*** And artificial inflation begins on whatever the jury decides the first date is of a false and misleading disclosure.

(*Id.* at 2922:3–9 (emphasis added)); *see also id.* at 2888:14–17 ("And the proper number of inflation is zero on every day until the day that the jury concludes, if they so conclude, that Household made a misleading disclosure.").[6]

Professor Fischel's "Leakage Model" determined the aggregate "measure of inflation in the stock price" attributable to the combined impact of all three "issues" of the alleged fraud was a maximum amount of $23.94. (Fischel Report (Docket No. 1361-2) at ¶ 42.) Assuming for purposes of his "Leakage Model" a combined impact attributable to all three issues in the alleged fraud on or prior to March 23, 2001, Professor Fischel designated the "measure of inflation in the stock price" on March 23, 2001 to be the maximum aggregate inflationary price impact of $23.94. (*Id.* (Docket No. 1361-5), Ex. 56.) The jury filled in that amount on Table B to the Verdict Form for March 23, 2001, and also filled in the corresponding "artificial inflation" amounts per Professor Fischel's "Leakage Model" for each day thereafter through the end of the Class Period on October 11, 2002. (Verdict Form (Docket No. 1611), Table B.)

Consistent with its finding that the first actionable misstatement occurred on March 23, 2001, for each day prior to March 23, 2001, the jury found and recorded on Table B to the Verdict Form that the amount of "artificial inflation" was zero. (*Id.*) The jury thus determined

[6] Defendants objected to this approach and Professor Fischel's instructions regarding the application of his models. Defendants preserve those objections, but for purposes of this submission assume Professor Fischel's models as presented.

that a statement that related solely to the "Predatory Lending" issue of the alleged fraud caused Household's stock price to be "artificially inflated" by $23.94 on March 23, 2001, the first date on which the jury found the stock price was inflated.[7]

As Table B to the Verdict Form shows, the jury determined that, for every subsequent statement that it found to be actionable from March 23, 2001 through November 15, 2001, the date Professor Fischel identified as the date of the first "corrective disclosure," the amount of "artificial inflation" remained constant at $23.94. (Verdict Form (Docket No. 1611), Table B.) The verdict, therefore, establishes that any statements during the period from March 23 through November 15, 2001 that related to Plaintiffs' "Re-aging" or "Restatement" allegations did not result in any *additional* "artificial inflation" in Household's stock price—*i.e.*, those statements had no independent inflationary "price impact" because they did not in any manner increase the amount of "artificial inflation" in the stock price. *See* Cornell Aff. at ¶ 19.

From November 15, 2001, through the end of the Class Period on October 11, 2002, the jury found that the amount of "artificial inflation" decreased each day, with the exception of minor increases on a few days. (Verdict Form (Docket No. 1611), Table B.) Only two of those minor increases (the increase from $22.59 on December 3, 2001 to $23.94 on December 4, 2001, and the increase from $23.65 on April 16, 2002 to $23.94 on April 17, 2002) occurred on dates on which the jury found an actionable misstatement. (*Id.*) Professor Fischel testified that the increase in inflation on April 17, 2002 was not statistically significant:

> Q. Did you find any statistically-significant price increase that resulted in inflation on April 17, 2002?
>
> A. No, sir, I did not.

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[7] According to Professor Fischel's "Specific Disclosures Model," which the jury rejected, the amount of "artificial inflation" on March 23, 2001 was $7.97. (Fischel Report (Docket No, 1361-4), Ex. 53.)

(Trial Tr. at 2909:16–19.)[8]

The minor increase in "artificial inflation" on December 4, 2001 followed comments by Mr. Aldinger at a Goldman Sachs conference (Statement No. 23 on the Verdict Form (Docket No. 1611) and Table A thereto), which the jury determined related solely to Plaintiff's "Re-aging" allegations. (Verdict Form (Docket No. 1611) at 23.) Although Professor Fischel testified that the December 4, 2001 increase in "artificial inflation" was statistically significant (Trial Tr. at 2878:5–7, 14–18), Professor Fischel's report and event study show that this increase in "artificial inflation" rapidly dissipated and was gone completely by December 11, 2001, at which time the amount of "artificial inflation" had declined to $22.20. (Fischel Report (Docket No. 1361-5), Ex. 56.) Professor Fischel testified that, if the December 4, 2001 statement were the sole actionable misstatement in the case, then only investors who purchased between December 4 and December 11, 2001 would have suffered any harm. (Trial Tr. at 2883:18–2885:3, 2924:3–7.)

To summarize: (1) the jury found that the first misstatement occurred on March 23, 2001, constituted an actionable misrepresentation or omission relating solely to the "Predatory Lending" issue, and caused Household's stock price to be "artificially inflated" by $23.94 on that date; (2) the jury found that the $23.94 of "artificial inflation" remained constant through November 15, 2001, and did not increase in response to any of the subsequent actionable statements during that period that the jury found were related to Plaintiff's "Re-aging" or "Restatement" allegations (*i.e.*, those misrepresentations had no "price impact"); and (3) from

[8] A stock price movement "is 'statistically significant' if it cannot be attributed to market and sector factors, or random volatility, but rather [was] likely caused by company-specific information." *In re Motorola Sec. Litig.*, 505 F. Supp. 2d 501, 511 (N.D. Ill. 2007), *aff'd* 644 F.3d 511 (7th Cir. 2011) (internal quotations and citation omitted).

November 15, 2001 through the end of the Class Period on October 11, 2002, the only statistically significant increase in "artificial inflation" associated with any of the statements the jury found to be actionable occurred on December 4, 2001, related solely to the "Re-aging" issue, and dissipated entirely by December 11, 2001. *See* Cornell Aff. at ¶¶ 18–20.

The jury's verdict thus establishes that: (1) *none* of the actionable statements that related to the "Restatement" issue of Plaintiffs' securities fraud claim resulted in any "artificial inflation" at any time during the Class Period; and (2) only one of the actionable statements relating to the "Re-aging" issue, *i.e.*, the statement on December 4, 2001, resulted in $1.35 of "artificial inflation" that was present only during the one-week period from December 4, 2001 to December 11, 2001. *Id.* at ¶ 22. In the absence of "artificial inflation" the presumption of reliance stands rebutted.

As confirmed by Professor Cornell in his affidavit:

> As set forth in my paper, and as a settled principle of economic and finance theory, if the difference between the "true value line" and the actual stock price does not increase (*i.e.*, the amount of "artificial inflation" does not increase) as a consequence of an alleged misrepresentation, then the market did not rely upon the alleged misrepresentation and the "fraud on the market" presumption has been rebutted.
>
> The jury verdict thus establishes the following: (1) No misrepresentation identified by the jury to be attributable to the issue of the "Restatement" resulted in any increase in "artificial inflation," and (2) With respect to the issue of "Re-aging," only the December 4, 2001 misrepresentation resulted in a statistically significant increase in "artificial inflation," and that increase of $1.35 fully dissipated by December 11, 2001.
>
> The verdict thus establishes that the "fraud on the market" presumption of reliance has been rebutted, based upon an absence of inflationary price impact, for all alleged misrepresentations on the issue of the "Restatement" and for all alleged misrepresentations with respect to the issue of "Re-aging," except for the $1.35 amount of inflationary price impact attributable to the

> December 4, 2001 statement and only for the period between December 4, 2001 and December 11, 2001.

Id. at ¶¶ 21–23.

D. The Verdict Assignment of the Entire Amount of "Artificial Inflation" to the March 23, 2001 Statement Is Unsupportable, and Plaintiffs' Failure to Establish an Independent Price Impact Associated with that Statement or the Single Issue of "Predatory Lending" Rebuts the Presumption of Reliance as to the March 23, 2001 Statement.

Professor Fischel's calculation of "artificial inflation" for each day of the Class Period under both his "Specific Disclosures Model" and his "Leakage Model" was based on the premise that Household's stock price was inflated on each day of the Class Period by misstatements that related to *all three issues* alleged by Plaintiffs. *See* Cornell Aff. at ¶ 24; *see also* Trial Tr. at 2602:7–23; 2671:1–13. Putting aside other problems with Professor Fischel's "Specific Disclosures Model," if the jury had adopted that model it may have been possible to determine how much of the "artificial inflation" present in Household's stock on a particular date related to each of the three distinct issues of the alleged fraud. *See* Cornell Aff. at ¶¶ 25, 29. The jury, however, did not do so.[9]

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[9] Professor Fischel calculated "artificial inflation" under the "Specific Disclosures Model" by: (1) identifying 14 specific "corrective disclosures" that occurred during the period from November 15, 2001 through the end of the Class Period on October 11, 2002; (2) determining through statistical analysis the residual stock price change associated with each of the 14 disclosures; (3) adding the residual stock price changes together to arrive at a total figure for "artificial inflation" as of July 30, 1999, the first day of the Class Period, of $7.97 per share; and (4) determining the "artificial inflation" for each day thereafter through the end of the Class Period on October 11, 2002. (Fischel Report (Docket No. 1361-2) at 20–23.) Professor Fischel also testified as to the particular issue or issues to which each of the "corrective disclosures" pertained. (Trial Tr. at 2631:1–2663:12; 2949; 2968.) Thus, had the jury adopted the "Specific Disclosures Model," it might have been possible to determine how much of the total $7.97 of "artificial inflation" under that model related to the three distinct issues of the alleged fraud. Professor Fischel gave the following example:

> I attempted to quantify the amount of artificial inflation attributable to the reaging issue in this particular part of my report. So hypothetically if the evidence with respect to the reaging issue changed, or if there were no reaging issue, or if the reaging issue were somehow different than

(cont'd)

As explained by Professor Cornell in his affidavit, and as set forth in Professor Cornell's paper that Professor Fischel used to develop his "Leakage Model," "leakage models" do not identify, and cannot be used to identify, the specific amount of inflation attributable to any one issue of a multiple-issue fraud:

> In discussing the underlying principles of economics and finance in my paper upon which Professor Fischel based his model, I and my co-author noted a critical feature and limitation of the "Leakage Model" approach: "Finance theory does make clear, however, that when there are interrelated frauds, separate value lines cannot be constructed. . . . Instead, the total damage must be estimated using one value calculated backwards from the time at which all elements of the fraud have been effectively disclosed."

Cornell Aff. at ¶ 24 (quoting 37 U.C.L.A. L. REV. at 908).

Professor Cornell further explains:

> That is, when, as here, it has been alleged that a securities fraud involved multiple "issues," the "Leakage Model" cannot be used to determine the amount of "artificial inflation" attributable to just one of those "issues" ("separate value lines cannot be constructed"). Instead, the "Leakage Model" develops a "true value line" that necessarily reflects misrepresentations as to all components of the alleged fraud. This is a well-established principle of finance and economics. In fact, Professor Fischel's "leakage model" assumes a single "true value line" based upon all three alleged fraudulent "issues" without distinction. Moreover, Professor Fischel has never stated, and could never state in a manner consistent with economic and finance theory, that his "Leakage Model" provides a means to determine the inflationary price impact associated with any one individual issue among the three fraudulent issues alleged by Plaintiffs.

(*Id.*)

(cont'd from previous page)

> what I analyzed in my report, that could be taken into account at a subsequent point in time.

(*Id.* at 66:18–67:2.) The "Leakage Model" that the jury adopted and applied had no mechanism to disaggregate the impact of the separate issues.

Because Professor Fischel's calculation of "artificial inflation" under his "Leakage Model" *is not*, and *cannot be*, separated into specific amounts attributed to each of the three fraudulent "issues" collectively asserted by Plaintiffs (and assumed by Professor Fischel), it is not possible to determine what portion, if any, of the $23.94 of "artificial inflation" relates solely to the issue of "Predatory Lending" or can be attributed to the March 23, 2001 statement (Statement 14 in the Verdict Form). Thus, "although it can definitively be stated that the entire amount of $23.94 cannot be assigned to the March 23, 2001 statement or the single issue of 'Predatory Lending,' there is no valid basis under the jury verdict, and the jury's selection and application of Professor Fischel's 'Leakage Model,' to determine the actual inflationary price impact attributable to Statement 14." Cornell Aff. at ¶ 28.

Not surprisingly, given that it is impossible to disaggregate the effects of separate fraud issues under a "leakage" theory, the jury was not instructed on how to do so if it determined that an actionable statement did not relate to all three "issues" of the alleged fraud. The jury, therefore, attributed the entire $23.94 of "artificial inflation," which according to Professor Fischel's model was caused by misstatements relating to all three issues of the alleged fraud, to a statement relating only to the "Predatory Lending" issue. But as Professor Cornell notes, "there is no valid basis under Professor Fischel's model by which the full $23.94 inflationary price impact can be assigned to the March 23, 2001 statement or the single issue of 'Predatory Lending,'" and this verdict result is "squarely inconsistent" with Professor Fischel's expert report. *Id.* at ¶ 27.

In summary, as the attached affidavit of Professor Cornell explains: (1) The "Leakage Model" introduced by Professor Fischel cannot, and did not, disaggregate between the impacts of the three different "issues" of fraud alleged by Plaintiffs; (2) As a matter of settled economic and finance theory, the "Leakage Model" employed by Professor Fischel is unable to identify the specific price impact associated with a single issue of a multi-issue fraud such as that alleged in this case; (3) It is contrary to the core economic principles underlying the "fraud on the market" theory and Professor Fischel's "Leakage Model" to ascribe the full $23.94 of "inflation" solely to the issue of "Predatory Lending" and to do so is flatly inconsistent with Professor Fischel's model and testimony; and (4) Plaintiffs failed to present, and the verdict does not provide, a means to determine the specific amount of inflation attributable to the March 23, 2001 statement or the issue of "Predatory Lending." *See* Cornell Aff. at ¶¶ 24–30. As stated by Professor Cornell:

> Accordingly, the jury's assignment of an inflationary price impact of $23.94 to the March 23, 2001 statement, is squarely inconsistent with Professor Fischel's own "Leakage Model" and contrary to the established principles of finance and economics that underlay the use of such a model. There is no valid basis under settled principles of economics and finance to determine, based on the jury verdict and its application of Professor Fischel's "Leakage Model", the proper inflationary price impact attributable to the March 23, 2001 Statement.

Id. at ¶ 30.[10]

Plaintiffs cannot assert that the March 23, 2001 statement concerned misrepresentations or omissions regarding *all three* issues of the fraud and that the statements thereafter merely "maintained" the "inflation" attributable to *all three* issues. Any such argument would be in

[10] Independently, and as Defendants asserted in prior filings, there are several other legal deficiencies arising from the jury verdict assigning $23.94 of artificial inflation to the March 23, 2001 statement. First, the March 23 statement was merely a recitation by a third-party of a prior statement issued by Household on March 12, 2001, and "a market will not double-count the same information." *Greenberg v Crossroads Sys. Inc.*, 364 F.3d 657, 663 (5th Cir. 2004); *accord In re Omnicom Group, Inc. Sec. Litig.*, 597 F.3d 501, 512 (2d Cir. 2010). In addition, the March 23 statement reflects the type of non-specific commentary that courts routinely find to be non-actionable under the federal securities laws. *See, e.g.*, *Searls v. Glasser*, 64 F.3d 1061, 1066 (7th Cir. 1995); *In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 354 (S.D.N.Y. 2011). Finally, according to Exhibit 56 to Professor Fischel's Report (Docket No, 1361-5, Ex. 56), the amount of "artificial inflation" increased by only $.67 per share on March 23, 2001.

direct conflict with the specific instructions upon which the verdict was based. The jury was not instructed to make any determination as to whether, as of March 23, 2001, Defendants were under a duty to disclose information relating to the "Restatement" or "Re-Aging" issues of the alleged fraud, nor did the jury make any such finding. To the contrary, the jury was directed to identify the particular issue or issues with respect to which the specific statement constituted an actionable misstatement or omission of material fact, and was instructed that in determining whether a listed statement was false or misleading as to a particular issue, a defendant "has a duty to disclose a fact if a prior or contemporaneous statement he or it made *about the same subject* would be misleading if the fact is not disclosed." (Trial Tr. at 4715:12–14 (emphasis added).) Consistent with these instructions, the jury determined that the March 23, 2001 statement was actionable *only* as to the issue of "Predatory Lending."

Plaintiffs chose to present the Fischel "Leakage Model" over Defendants' objection and the Court permitted introduction of the "Leakage Model" notwithstanding Defendants' *Daubert* challenge. (Docket Nos. 1361, 1364, 1527.) Plaintiffs invited Professor Fischel to present a model that assumed certain predicates (*i.e.*, the combined impact of all three alleged fraudulent "issues") in a manner that failed to address the specific determinations that might be rendered by the jury in its verdict. In fact, the verdict ultimately manifested this basic disconnect between the necessary assumptions of the "Leakage Model" employed by Professor Fischel and the jury's determination with respect to the specific misrepresentations at issue. The verdict, which adopted the "Leakage Model" but found that the *first* actionable misrepresentation dealt *solely* with the issue of "Predatory Lending," thus establishes a fundamental failure of proof. *See* Cornell Aff. at ¶ 28. Given that it is impossible to determine the specific inflationary price impact of the March 23, 2001 statement based upon the jury verdict and Professor Fischel's "Leakage Model," there is no valid basis to support the proposition that the market relied, in a statistically significant manner, on the March 23, 2001 statement. Thus, the presumption of reliance on the March 23, 2001 statement is rebutted.[11]

Accordingly, as a consequence of the verdict, Defendants have rebutted the presumption of reliance as to all claimants other than those purchasing between the dates of December 4, 2001, and December 11, 2001. A list of claimants who purchased between December 4, 2001 and December 11, 2001 is included in the Appendix as Exhibit 1. These are the only claimants as to which the presumption of reliance has *not* been rebutted. For these claimants, the jury verdict provides an inflationary "price impact" of $1.35 per share.[12]

II. Despite the Constraints on Phase II Discovery, Evidence Obtained from Certain of the Limited Number of Claimants From Whom Restricted Discovery Was Permitted Rebuts the Presumption of Reliance or Raises Genuine Issues of Material Fact for Trial.

Where information is solely within the possession of an opposing party, courts recognize that discovery regarding an element of the disputed claim should be given "almost as a matter of course." *See, e.g.*, *Brown v. Mississippi Valley State Univ.*, 311 F.3d 328, 333 n.5 (5th Cir. 2002) (internal quotations and citation omitted); *accord Sames v. Gable*, 732 F.2d 49, 51–52 (3d Cir.

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11 This failure of proof is fatal to Plaintiffs' case. *See, e.g.*, *Hartford Accident & Indem. Co. v. Gulf Ins. Co.*, 837 F.2d 767, 774 (7th Cir. 1988) ("'Failure to put into evidence all the proof necessary for sustaining a judgment is generally fatal. Further, on review, a case is ordinarily not remanded to give a party the opportunity to supply the missing evidence.'" (*quoting Rochez Bros., Inc. v. Rhoades*, 527 F.2d 891, 894 (3d Cir. 1975)). Given a failure of proof to establish a valid market price impact attributable to the March 23, 2001 statement, the presumption of reliance on the March 23, 2001 statement cannot be sustained and is rebutted as to that statement. *See Basic*, 485 U.S. at 248. At a minimum, trial is necessary on this essential element of Plaintiffs' claim. *Hartford Accident & Indemnity Co.*, 837 F.2d at 774; *see also, e.g.*, *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 891, 895 (3d Cir. 1975).

12 Because the list of claimants who purchased other than during the one-week period of December 4, 2001 through December 11, 2001 is 785 pages long, Defendants have not submitted a copy of this list with this filing. Defendants have provided a copy of the list to Plaintiffs' counsel and are prepared to submit the list to the Court if the Court wishes to review it.

1984). Indeed, in *Anderson v. Liberty Lobby, Inc.*, the Supreme Court held that judges should deny summary judgment "where the nonmoving party has not had the opportunity to discover information that is essential to his opposition." 477 U.S. 242, 250 n.5 (1986); *see also, e.g.*, *Bennett. v. Schmidt*, 153 F.3d 516, 519 (7th Cir. 1998) ("Litigants are entitled to discovery before being put to their proof.").

Defendants in a securities fraud case are entitled to discovery in order to rebut the presumption of reliance. *In re Adelphia Comm'cns Corp. Sec. and Deriv. Litig.*, No. 03 MD 1529 (LMM), 2005 U.S. Dist. LEXIS 43300, at *27 (S.D.N.Y. Aug. 22, 2005) (holding it would be "fundamentally unfair" to find that defendants had not rebutted the presumption of reliance before they were afforded the opportunity to conduct discovery where "all documents and information attesting to Plaintiffs' reliance are within the exclusive control of Plaintiffs"); *accord In Re Grand Casinos, Inc. Sec. Litig.*, 181 F.R.D. 615, 620 (D. Minn. 1998).

The Court precluded Defendants from obtaining basic discovery essential to address properly the element of reliance.[13] Defendants have presented their objections to the constraints the Court placed on Phase II discovery in their prior filings (*see* Docket Nos. 1710, 1711, 1734, 1746, 1757, 1764) and renew and incorporate those objections herein.[14]

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[13] These limitations included, *inter alia*: (1) precluding any information bearing on the issue of reliance for those beneficial holder claimants with estimated allowed losses of $250,000 or less; (2) as to the remainder of the class (other than the 98 institutions to whom written discovery was propounded), limiting discovery to the legally insufficient question in the Proof of Claim form; and (3) as to the discovery propounded on a limited number of institutional investors, constraining the discovery inquiry solely to the issue of whether claimants were in possession of "non-public information" from Household and precluding Defendants from otherwise obtaining any information regarding the underlying basis of the claimant's decision to purchase Household stock.

[14] The presumption of reliance cannot be held unrebutted where defendants have been precluded from obtaining necessary discovery of information solely within the possession of claimants. The fact that this action is a class proceeding pursuant to Rule 23 cannot eviscerate Defendants' rights to litigate their defenses to individual claims. "Rule 23's requirements must be interpreted in keeping with Article III constraints, and with the Rules Enabling Act, which instructs that rules of procedure 'shall

(cont'd)

Despite the restrictions on Phase II discovery, evidence obtained from certain of the limited number of claimants as to whom limited discovery was permitted rebuts the presumption of reliance, or at the very least raises genuine issues of material fact for trial.[15]

A. Claimants that Answered "Yes" to the Proof of Claim Form's Interrogatory

A number of claimants answered "Yes" to the Proof of Claim form's interrogatory, admitting that they would have purchased Household stock even if they had known the stock price was inflated by Defendants' "false and misleading statements." As the Supreme Court unambiguously held in *Basic*, such an admission rebuts the presumption of reliance. 485 U.S. at 248 (stating that a defendant can rebut the presumption by showing that "an individual plaintiff traded or would have traded despite his knowing the statement was false").

The list of claimants that answered "Yes" to the Proof of Claim form's interrogatory is included in the Appendix as Exhibit 2.

B. Categories of Traders that Would Have Invested In Household Stock Even If Aware of the Misrepresentations

The concurring opinion in *Basic* identified buying or selling a stock "for reasons unrelated to its price" as a factor that rebuts the presumption of reliance. *Id.* 485 U.S. at 251 (White & O'Connor, JJ., concurring in part and dissenting in part). The claimants identified

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not abridge, enlarge or modify any substantive right,' 28 U.S.C. § 2072(b)." *Amchem Prods. Inc. v. Windsor*, 521 U.S. 591, 613 (1997); *accord Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 845 (1999) ("[N]o reading of the Rule can ignore the Act's mandate that 'rules of procedure "shall not abridge, enlarge or modify any substantive right."'" (quoting *Amchem*)). Accordingly, just this last term, the Supreme Court held in *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2561 (2011), that "a class cannot be certified on the premise that Wal-Mart will not be entitled to litigate its statutory defenses to individual claims." (citing 18 U.S.C. § 2072(b) and *Ortiz.*)

[15] Given the restrictions on Phase II discovery, the examples cited herein are, for the most part, representative only. The limitations placed on discovery preclude Defendants from being able to provide complete lists of claimants in each of the categories discussed below.

below confirmed that their investment decisions were not influenced by price. Based on their descriptions of their trading practices and rationale, there is reason to believe that Defendants could have identified additional instances of non-price influences had they been permitted to examine additional claimants or inspect their decision-makers' internal analyses and stated rationales.

A number of the large institutional claimants employed passive indexing strategies, the objective of which was simply to mirror the composition of and thereby track the performance of an index, such as the S&P 500 Index. For example, as explained in a November 12, 2001 prospectus for the Vanguard U.S. Stock Index Funds:

> An index fund holds all, or a representative sample, of the securities that make up its target index. Unlike actively managed funds, index (or "passively managed") funds do not buy and sell securities based on research and analysis. Rather, index funds simply attempt to mirror what the target index does, for better or worse.

(App. Ex. 6 at VG 00003.) Similarly, an April 30, 2001 prospectus for the Munder Funds explains:

> The advisor employs a "quantitative" or "indexing" investment approach, which attempts to duplicate the investment composition and performance of the particular index through statistical procedures. ***The advisor invests in stocks that are included in the particular index, in approximately the same proportions as they are represented in the index.*** As a result, the advisor does not use traditional methods of fund investment management, *i.e.*, it does not select stocks on the basis of economic, financial and market analysis.

(App. Ex. 7 at MCM 0000410 (emphasis added).)

James Glickenhaus, the Rule 30(b)(6) deponent for Lead Plaintiff Glickenhaus & Company ("Glickenhaus"), described the same process in the following terms:

> Q. [I]f I'm running an index fund and my reference index is the Dow Jones and it turns out that IBM is 6.2 percent of the Dow Jones [Index], then I'm supposed to make IBM 6.2 percent of my fund?
>
> A. Yes, you would endeavor to do that as close as you can.
>
> Q. That's what an index fund is?
>
> A. Yes.
>
> Q. Okay. And let's assume I wake up one morning and for whatever reason I'm out of balance, IBM is still 6.2 percent of the Dow Jones and it's only 5.9 percent of my fund. I need to go out that day and buy .3 [percent] of my fund in IBM.
>
> A. If you want to keep the index fund as accurate as possible, yes.

(Glickenhaus Tr. (App. Ex. 8) at 90:24–91:14.)

A list of index funds, identified by the claims administrator, Gilardi & Co., LLC ("Gilardi"), is included as Exhibit 3 in the accompanying Appendix.

As noted above, indexer Vanguard answered "Yes" to the Proof of Claim form's reliance question and acknowledged that it would have purchased Household stock even if it had known the stock price was inflated. The other index funds that answered "Yes" to the reliance question are included in Exhibit 2 in the accompanying Appendix (the list of claimants who answered "Yes" to the reliance question). Other index investors answered the reliance question "No." But as the testimony of the Rule 30(b)(6) deponent for claimant State Street Corporation ("State Street") reveals, these "No" answers cannot be accepted at face value and raise disputed issues of fact and credibility that must be determined by a jury.

Lynn Blake, State Street's Rule 30(b)(6) deponent, explained how the State Street index funds selected stocks to purchase and hold as follows: "They all use what's called the replication approach. So that means, essentially, we own all or substantially all of the stocks that are included in the index." (Blake Tr. (App. Ex. 9) at 12:16–20.) Ms. Blake also admitted that State Street could not decide to actively manage an index fund "[b]ecause it would violate the objective of the strategy and fund." (*Id.* at 26:17–27:15.) Notwithstanding these admissions, State Street answered "No" to the reliance question. Ms. Blake, who had answered the reliance question on behalf of State Street after consulting with two of her colleagues, explained:

> We tried to understand under what context the question could be plausible and actually have happened or if we had any kind of, you know, similar situation that had ever happened in the last, you know, 20 years that all three of us have been in the business, and we couldn't come up with anything and because of that we decided that the answer was no, it was a hypothetical that couldn't really exist in a free market structure.

(*Id.* at 41:10–42:6.) Later, Ms. Blake inconsistently testified that if State Street knew "the price was inflated as a result of the fraud, then yes. We would not have traded at the inflated price." (*Id.* at 53:7–18.) Such inconsistencies, and issues arising out of the "replication approach" adhered to by State Street and other index traders, raise genuine issues of material fact for a jury to resolve.

In addition to these index fund claimants, the deponents for claimants Teachers Retirement System of Georgia ("TRS Georgia") and State Teachers Retirement System of Ohio ("TRS Ohio") testified at their depositions that certain of their internally managed funds employed indexing or mathematical trading models.

Michael Majure, the Rule 30(b)(6) deponent for TRS Georgia, testified that TRS Georgia's "quant fund," which invested in Household stock during March 2001 through October 2002, was a fund that used mathematical formulas to determine the optimal portfolio and did not take into account a company's public statements. (Majure Tr. (App. Ex. 10) at 16:4–17:1, 38:13–22, 44:13–16.) Although Mr. Majure testified that TRS Georgia's analysts had the discretion to override purchases for the internal funds that employed indexing or mathematical trading models, he acknowledged that the model could recommend purchase of a stock whose price was artificially inflated and that the analyst would not override the purchase. (*Id.* at 36:24–37:5; 41:1–8.)[16]

This evidence establishes genuine issues of material fact regarding whether passive investors relied on the integrity of the market price. *See, e.g.*, *In re Schering-Plough Corp. Sec. Litig.*, No. 01-0829, 2003 U.S. Dist. LEXIS 26297, at *15 (D.N.J. Oct. 9, 2003) (explaining that the fact that the plaintiff's stock purchases were made in order to replicate the performance of indices such as the S&P 500 "does not perforce preclude [the plaintiff] from *invoking* the fraud-on-the-market theory," because "'a jury may conclude that pursing an index trading strategy entails reliance' on the integrity of the market." (emphasis in original, quoting *In re Nortel Networks Corp. Sec. Litig.*, No. 01 Civ. 1855 (RMB), 2003 U.S. Dist. LEXIS 15702, at *10 (S.D.N.Y. Sept. 5, 2003)). A jury also reasonably could conclude that entities pursuing an indexing strategy did *not* rely on the integrity of the market.

As *Basic* makes clear, the presumption of reliance is rebutted if the trier of fact concludes that "an individual plaintiff traded or would have traded despite his knowing that the statement [the particular representation at issue] was false." 485 U.S. at 248. "For example, a plaintiff who decides, months in advance of an alleged misrepresentation, to purchase stock or who buys or sells a stock for reasons unrelated to its price . . . . surely none of these people can state a valid

[16] Alan Warner, the Rule 30(b)(6) deponent for TRS Ohio, likewise testified that the pension plan maintained internal funds, such as an S&P 500 passive fund, that were index funds and invested in an externally managed fund that made investment decisions based on a mathematical computer model. (Warner Tr. at 78:12-79:4; 79:23-80:15; 90:14-17; 92:1-4; 93:10-15.) Because the transcript of Mr. Warner's deposition testimony was designated confidential, Defendants have not included the relevant pages from Mr. Warner's deposition transcript in the Appendix.

claim under Rule 10b-5." *Id.* at 251 (White J., O'Connor JJ., concurring in part and dissenting in part).

Thus, whether each of the identified index trader and program trader claimants did, or did not, rely on the integrity of the market presents a genuine issue of material fact that must be resolved by a jury and cannot be decided by the Court as a matter of law. *See, e.g.*, *Serednyj v. Beverly Healthcare, LLC*, No. 10-2201, 2011 U.S. App. LEXIS 17810, at *9 (7th Cir. Aug. 26, 2011) ("A genuine issue of material fact exists 'if the evidence is such that a reasonable jury could return a verdict for the nonmoving party.'" (quoting *Anderson*, 477 U.S. at 248)).

C. Claimants that Disavowed Reliance on the Integrity of the Market

Some institutional investors disavowed any belief in, or reliance on, the efficient market hypothesis. For example, Andrew F. Barth, the Rule 30(b)(6) deponent for Capital Guardian Trust Company ("Capital Guardian"), stated Capital Guardian's view as follows: "I think we'd say that history would show that the efficient capital markets pricing theory is not always accurate." (Barth Tr. (App. Ex. 11) at 69:12–15.) Likewise, Martin Romo, the Rule 30(b)(6) deponent for Capital Research & Management Company ("Capital Research"), stated that Capital Research's "investment philosophy" would suggest that the efficient market hypothesis is "not true." (Romo Tr. (App. Ex. 12) at 37:11–38:2.)

Kenneth Feinberg, the Rule 30(b)(6) representative for Davis Selected Advisors ("Davis Selected"), was even more emphatic in repudiating the efficient market hypothesis. When asked whether Davis Selected believed in the efficient capital market hypothesis, Mr. Feinberg replied: "In this case our firm relies with the smartest investors we know, which are Warren Buffett and Charlie Munger. . . . And they say it is hogwash." (Feinberg Tr. (App. Ex. 13) at 45:20–25.) Mr. Feinberg, the individual responsible for investing in Household stock on behalf of Davis Selected, further stated: "I'm not a believer in the efficient market theory and I think the world has sort of proven that, not in the academic world, but in the real world. And Warren Buffett and Charlie Munger would absolutely swear to you, and they are our heroes, that they don't believe in it." (*Id.* at 211:20–212:3.)

A claimant that expressly disavows belief in the efficient market hypothesis on which *Basic*'s presumption of reliance is predicated should not be permitted to invoke such a presumption as proof of an element essential to sustain its claims. Accordingly, this testimony rebuts the presumption of reliance as to Capital Guardian, Capital Research, and Davis Selected.

D. Lead Plaintiff Glickenhaus & Company

James Glickenhaus, the Rule 30(b)(6) deponent for Lead Plaintiff Glickenhaus, admitted that Glickenhaus did not rely on the March 23, 2001 statement in *Origination News* (the first actionable misstatement found by the jury), and that Glickenhaus already was aware of a March 12, 2001 press release containing the same statement subsequently recited in the *Origination News* article. (Glickenhaus Tr. (App. Ex. 8) at 60:10–20; 62:3–18.) Mr. Glickenhaus explained that he relied on Household's March 12, 2001 press release but not the March 23, 2001 *Origination News* article because "the fact that Origination News quotes something I don't necessarily believe that it's accurate or true. If the Household Finance issues a press release, I believe that they are, in fact, stating that and their press release went further than the other one [the *Origination News* article] did." (*Id.* at 58:25–59:7.) Mr. Glickenhaus added: "I would take the statement they [Household] made at face value because of the seriousness of a press release, a public statement, and I would rely on it in making investment decisions." (*Id.* at 64:25–65:5.)

The March 12, 2001 statement created no inflation in Household's stock, per the jury and Professor Fischel. Mr. Glickenhaus's testimony that he relied only on the March 12 statement and not the March 23 statement, therefore, rebuts the presumption of reliance as to Glickenhaus and any claimants for which Glickenhaus made investment decisions, or at a minimum raises a triable issue of fact.

E. Davis Selected Advisors

In addition to disavowing belief in the efficient markets hypothesis, *see* Subsection C, *supra*, Kenneth Feinberg, the Rule 30(b)(6) deponent for Davis Selected, testified that the fact that Household restated its financial statements was of little importance to Davis Selected because the accounting changes that Household's auditors required it to make were "bad for near-term earnings but over three years has no impact at all after three years." (Feinberg Tr. (App. Ex. 14) at 185:16–23.) Mr. Feinberg explained that Davis Selected had a longer-term investment horizon than many other investors and judged its results over 3, 5, and 10 years. (*Id.* at 95:4–11.) When asked directly whether Davis Selected viewed the restatement as significant, Mr. Feinberg reiterated that the restatement was "not significant." (*Id.* at 231:20–25.) This testimony rebuts any presumption that Davis Selected relied on misstatements involving the "Restatement" prong of the alleged fraud, or at a minimum raises a triable issue of fact.

III. The Presumption Should Be Held Rebutted As To Claimants Who Failed to Comply With Court-Approved Discovery.

Various claimants failed to comply with the limited discovery authorized by the Court. Such claimants cannot continue to invoke a presumption of reliance having failed to meet basic discovery obligations regarding this disputed element. The proper inference from such failure is that the material withheld would have undermined the presumption. *See, e.g., Chicago Architecture Found. v. Domain Magic, LLC*, No. 07 C 764, 2007 U.S. Dist. LEXIS 76226, at *18–19 (N.D. Ill. Oct. 12, 2007) (drawing negative inference where defendant failed to respond to interrogatories regarding whether it had received "click-through" revenue on its web site: "As a result of this negative inference, the court finds that Domain Magic did receive payment generated by 'click-through' advertising.").

A. Claimants that Failed to Provide an Answer to the Proof of Claim Form's Interrogatory

At the June 15, 2011 status conference, counsel for Plaintiffs informed the Court that many of the Proof of Claim forms that had been received by the May 24, 2011 deadline did not contain answers to the reliance question. The Court directed Plaintiffs' counsel to send a follow-up notice to all such claimants, except for those who had claims of $250,000 or less. Notwithstanding receipt of the follow-up notice, many claimants declined to answer the reliance question. A list of the claimants with claims of more than $250,000 who did not answer the reliance question is included as Exhibit 4 in the Appendix.[17]

B. Claimants that Failed to Comply with Defendants' Discovery Requests

A number of claimants failed to comply with properly served discovery demands and disregarded Defendants' efforts to follow up. In some cases, the respondent indicated a willingness to comply if given a brief extension of time, but defaulted on the extended return date. In most cases, the respondents simply defaulted and refused to acknowledge subsequent communications from defense counsel. Entities that provided no discovery responses to properly served demands and rebuffed all follow-up efforts, and entities that defaulted notwithstanding

[17] Over Defendants' objection, the Court held that nominees who filed claims on behalf of beneficial holders with claims of $250,000 or less did not need to obtain answers to the reliance question, thus allowing recovery by such claimants without affording Defendants any opportunity whatsoever to rebut the presumption of reliance as to such claimants. (Docket No. 1763.) Defendants renew and incorporate their objections to this procedure herein. Because the list of claimants with claims of $250,000 or less that did not answer the reliance question is 507 pages long, Defendants have not submitted a copy of this list with this filing. Defendants have provided a copy of the list to Plaintiffs' counsel and are prepared to submit the list to the Court if the Court wishes to review it.

grants of extensions of time based on promises to respond, are listed in Exhibit 5 in the accompanying Appendix.

Defendants made diligent efforts to meet and confer with each of these defaulting entities, and in each case they did not learn that the entity had filed claims (or had claims filed on their behalf) until shortly before, and in some cases after, the close of the discovery period. In keeping with the Court of Appeals' direction in *Brennan v. Midwestern United Life Insurance Co.*, 450 F.2d 999, 1004–06 (7th Cir. 1971), claims filed by or on behalf of these non-compliant claimants should be dismissed. At the very least, Defendants are entitled to a negative inference that the discovery would have been adverse to the non-responding claimants. *Chicago Architecture Foundation,* 2007 U.S. Dist. LEXIS 76226, at *18–19.

C. Claimants that Evaded Discovery by Representing Inaccurately that They Would Not File Claims

Seven Fidelity Funds should be excluded from recovery because each of them filed one or more substantial claims after declining to respond to discovery based on their representation that they were not participating in this action.

On March 21, 2011, Defendants served discovery demands on the Fidelity Funds believed to be the beneficial owners of Household shares based on publicly available information. On April 21, 2011, the Funds objected to the demands because they "ha[d] taken no affirmative steps to participate in the proceedings." *See* Fidelity Funds' Objections to Discovery Requests (App. Ex. 14) at 1. They added that "Defendants . . . have offered no evidence that the Funds are even class members eligible to participate in any settlement." *Id.* After the close of the discovery period, on June 7, 2011, Defendants received copies of 67 claims filed by and on behalf of the Fidelity Funds from claims administrator Gilardi, with an aggregate value in excess of $139 million. The funds in question are: Fidelity Contrafund, Fidelity Dividend Growth Fund, Fidelity

Equity-Income Fund, Fidelity Puritan Fund, Fidelity Magellan Fund, Fidelity VIP Equity-Income Fund, and Fidelity VIP II Contrafund Portfolio.[18]

Sustaining the claims of the Fidelity Funds and BNY Mellon/Mellon Bank, N.A. would reward this evasion of discovery and render the presumption of reliance conclusive notwithstanding Defendants' inability to test the claimants' invocation of the presumption of reliance. Dismissal of these claims is thus warranted. *See Brennan*, 450 F.2d at 1006.

IV. The Court's Procedure Is Inconsistent With The Federal Rules of Civil Procedure and Defendants' Seventh Amendment Rights.

The Court's Order of August 24, 2011, requiring Defendants to affirmatively present evidence that they contend rebuts the presumption of reliance, is without basis in the Federal Rules of Civil Procedure. Federal Rule of Civil Procedure 56 governs the procedures with respect to summary judgment. The Court's Order turns the specific procedures contemplated by Rule 56 backwards, placing the onus on the non-movant. Plaintiffs should be required to adhere to Rule 56, and in the face of any such motion as to particular claimants, Defendants should be entitled to invoke the procedural protections set forth in Rule 56 and the attendant discovery rights and inferences. *See, e.g.*, *Anderson*, 477 U.S. at 255 ("The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor."); *see also Bolton El v. Serv. Corp. Int'l*, No. 04 C 1125, 2005 U.S. Dist. LEXIS 20950, at *10 (N.D. Ill. Sept. 20, 2005) ("All facts must be viewed and all reasonable inferences drawn in the light most favorable to the

[18] BNY Mellon/Mellon Bank, N.A. likewise refused to respond to Defendants' discovery demands, on the ground that discovery was "premature" because it had not filed any claim. After the close of the discovery period, Gilardi provided Defendants with copies of certain claims filed by or on behalf of these entities. At this point, Defendants are unable to determine the value of the claims submitted by BNY Mellon/Mellon Bank, N.A., because these entities did not file claims directly, and Defendants are uncertain about exactly which claims filed by custodians were filed on behalf of these entities.

nonmoving party." (quoting *NLFC, Inc. v. Devcom Mid-America, Inc.*, 45 F.3d 231, 234 (7th Cir. 1995)) (Guzmán, J.).

Throughout these proceedings, Defendants have consistently and repeatedly raised the issue of their right to a jury trial regarding the essential element of reliance. *See, e.g.*, Docket Nos. 1710, 1711. In a case involving a cause of action for civil damages, "the Seventh Amendment provides a right to a jury on all issues pertinent to an award of statutory damages. . . ." *Feltner v. Columbia Pictures Television, Inc.*, 523 U.S. 340, 355 (1998). Accordingly, Rule 38(a) of the Federal Rules of Civil Procedure provides: "The right of trial by jury as declared by the Seventh Amendment to the Constitution . . . is preserved to the parties *inviolate*." Fed. R. Civ. P. 38(a) (emphasis added). Rule 42(b) of the Federal Rules of Civil Procedure, allowing for bifurcated proceedings, specifies that when ordering "a separate trial of one or more separate issues," the court "must preserve any federal right to a jury trial." Fed. R. Civ. P. 42(b). Furthermore, "[t]he applicability of the *Seventh Amendment* is not altered simply because the case is [a] *Rule 23(b)(3)* class action," and "use of *Rule 23(b)(3)* . . . does not alter the required elements which must be found to impose liability and fix damages." *Cimino v. Raymark Indus., Inc.*, 151 F.3d 297, 312–314 (5th Cir. 1998) (emphasis in original). A class action cannot deprive a defendant of the right to "litigate its statutory defenses to individual claims." *Wal-Mart Stores*, 131 S. Ct. at 2561.

The procedure contemplated by the Court, if applied to hold that Defendants have not rebutted the presumption of reliance, is in derogation of Defendants' rights under the Seventh Amendment and Federal Rules of Civil Procedure.

Dated: October, 14, 2011

/s/R. Ryan Stoll

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CERTIFICATE OF SERVICE

R. Ryan Stoll, an attorney, hereby certifies that on October 14, 2011 he caused ed true and correct copies of the foregoing Defendants' Submission Regarding Rebuttal of the Presumption of Reliance and the accompanying Appendix of Exhibits to be served via the Court's ECF filing system on the following counsel of record in this action:

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