UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, ON BEHALF OF ITSELF AND ALL OTHERS SIMILARLY SITUATED, Plaintiffs, v. HOUSEHOLD INTERNATIONAL, INC., ET AL., Defendants.	Lead Case No. 02-C-5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' RENEWED MOTION FOR JUDGMENT AS A MATTER OF LAW OR, IN THE ALTERNATIVE, A NEW TRIAL

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Pursuant to this Court's June 20, 2013 Order, Doc. 1856, Defendants Household International, Inc., William F. Aldinger, David A. Schoenholz, and Gary Gilmer (collectively "Defendants") respectfully submit this memorandum in support of their renewed motion for judgment as a matter of law or, in the alternative, a new trial.

PRELIMINARY STATEMENT

On August 3, 2009, following "Phase I" proceedings, Defendants filed motions for judgment as a matter of law pursuant to Federal Rule of Civil Procedure 50(b) or, in the alternative, a new trial pursuant to Federal Rule of Civil Procedure 59. *See* Doc. 1650. On July 28, 2010, this Court struck the motions as premature. Doc. 1696. More than four years have passed since the jury rendered its verdict in Phase I, and more than three years have passed since this Court deemed post-trial motions relating to the Phase I verdict premature. In the interim, the law has not stood still.

As set forth below, Defendants are entitled to judgment as a matter of law or, at a minimum, a new trial based on a number of deficiencies that render Plaintiffs' claims and the jury verdict legally infirm. Notably, given the passage of time between the Phase I verdict and the present post-trial motions, substantial intervening authority has confirmed the legal errors that require either judgment for Defendants or a new Phase I trial. Indeed, as to certain of the errors, the United States Supreme Court itself has issued intervening decisions that lay bare the legal defects requiring that the verdict not stand.

For instance, in *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011), the Supreme Court reiterated that "to prevail on the merits in a private securities fraud action," Plaintiffs must prove "loss causation," and to do so must "prove that the decline in [] stock 'was because of the correction to a prior misleading statement' and 'that the subsequent loss could not otherwise be explained by some additional factors revealed then to the market.'" *Id.* at 2185.

Here, Plaintiffs failed on all fronts. The "leakage model" upon which Plaintiffs rested their theory of loss causation failed to identify specific misrepresentations that introduced inflation into Household's stock (instead, the model simply assumed pre-existing inflation); failed to identify the specific "corrective disclosures" to which the decline in Household stock price could be attributed (instead, the model simply assumed unidentified "partial disclosures" led to a complete dissipation of the inflation by the close of the Class Period); and failed to account for non-fraud firm-specific factors that might explain some (or all) of Household's stock price decline during the Class Period (instead, the model simply assumed that all such factors would "cancel each other out" (Tr. 2684:6)). These are not mere quibbles. Without identification of the specific fraudulent statements that introduced inflation, the specific corrective disclosures that removed that inflation, and an accounting for non-fraud firm-specific news, a leakage model does no more to prove loss causation than a price chart. As *Halliburton* confirms, Plaintiffs' leakage model was legally defective and thus Plaintiffs failed to present competent evidence to meet their burden of proof on the essential element of loss causation.

Underscoring the error, here the jury not only adopted the legally defective leakage model presented by Plaintiffs, but also misapplied the model in a manner wholly inconsistent with the premises of the model itself, rendering an irrational and unsupported verdict. In this respect, the Supreme Court's recent decision in *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013), makes the fatal problem with the jury's application of the model clear. In *Comcast*, the Supreme Court found a damages model deficient as a matter of law when some of the "market distortions" upon which the model was based were no longer at issue. A damages model based on four different theories of injury was deemed useless once only one of the theories survived; even if the model was valid in the abstract it ceased to be useful as a means of assessing damages from a single theory of injury. *Id.* at 1433-35. So too here. The jury misapplied the leakage model to attribute all of the inflation that the model ascribed to the *combined* effect of Plaintiffs' three alleged fraud theories to a single statement concerning only one of those fraud theories. The result was an irrational, unsupported, and legally defective verdict. *See infra* at p. 29.

With respect to jury instructions, the impact of intervening Supreme Court precedent is even more devastating. The Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), leaves *no* question that the jury was wrongly instructed on who could be held liable for the alleged misstatements in this case. The jury was instructed that it could find a Defendant responsible for a representation if "[t]he defendant made, *approved, or furnished information to be included*, in a false statement . . . ." Tr. 4714:5-6. Whatever the validity of that instruction before *Janus* (and Defendants objected and preserved the issue), *Janus* removed all doubt. *Janus* squarely addressed, and unequivocally rejected, the theory that one who furnishes information to be included in a statement may be held liable in a private securities fraud case for a statement that he or she did not make. *See* 131 S. Ct. at 2302; *infra* at pp. 40-44. This fundamental instructional error requires a new trial.

As set forth below, separate and apart from such intervening Supreme Court guidance, numerous additional errors and deficiencies of proof further require that judgment be entered as a matter of law on behalf of Defendants or, at a minimum, that a new trial be ordered.

STANDARD OF REVIEW

"Under Rule 50, a court should render judgment as a matter of law when 'a party has been fully heard on an issue and there is no *legally sufficient* evidentiary basis for a reasonable jury to find for that party on that issue.'" *Reeves v. Sanderson Plumbing Prods., Inc.*, 530 U.S. 133, 149 (2000) (emphasis added). A Rule 50 movant is entitled to judgment as a matter of law when "the non-moving party has failed to make a sufficient showing on an essential element of

[his] case with respect to which [he] has the burden of proof." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986); *see, e.g.*, *Robbins v. Koger Properties, Inc.*, 116 F.3d 1441, 1449 (11th Cir. 1997) ("Because plaintiffs failed to support an essential element of their 10b-5 claim, loss causation, the district court erred in denying Deloitte's Fed.R.Civ.P. 50(a) motion for judgment as a matter of law."). Judgment as a matter of law is also appropriate when a jury based its verdict on unreliable expert testimony. *See Weisgram v. Marley Co.*, 528 U.S. 440, 457 (2000) ("the authority of courts of appeals to direct the entry of judgment as a matter of law extends to cases in which, on excision of testimony erroneously admitted, there remains insufficient evidence to support the jury's verdict").

Under Rule 59, a new trial is warranted when "the clear weight of the evidence is against the jury verdict," *Scaggs v. Consolidated Rail Corp.*, 6 F.3d 1290, 1293 (7th Cir. 1993), or when a jury verdict is internally inconsistent, *ABM Marketing, Inc. v. Zanasi Fratelli, S.R.L.*, 353 F.3d 541, 543 (7th Cir. 2003) (a new trial is warranted when "'a jury returns a factually inconsistent … verdict'"); *Turyna v. Martam Constr. Co.*, 83 F.3d 178, 179, 182 (7th Cir. 1996) (remanding for a new trial where verdict was internally inconsistent and verdict form was "hopelessly confused"). A new trial is also mandated when a jury is given an erroneous legal instruction on a fundamental element of a cause of action. *See Dawson v. New York Life Ins. Co.*, 135 F.3d 1158, 1165 (7th Cir. 1998); *cf. United States v. River Rouge Improvement Co.*, 269 U.S. 411, 421 (1926) ("[T]he error in the charge could not but mislead the jury in reference to a material element necessary for its consideration. . . . ."). Courts often order new trials based on the combined effect of errors in the jury instructions and verdict form. *See, e.g.*, *Malone v. ReliaStar Life Ins. Co.*, 558 F.3d 683, 694 (7th Cir. 2009) ("Considered together, . . . these errors were anything but harmless."); *Umpleby v. Potter & Brumfield, Inc.*, 69 F.3d 209, 214 (7th Cir. 1995) (ordering new trial where "jury instructions not only did not correct this error in the verdict form, but more likely further clouded the picture").

In addition, erroneous evidentiary rulings require a new trial if they have a substantial and injurious influence on the jury's determinations. *See Doe v. Smith*, 470 F.3d 331, 348 (7th Cir. 2006). Even where an individual trial error, standing alone, may be harmless error, a new trial is required where the cumulative effect of multiple errors resulted in an unfair trial. *See Frymire-Brinati v. KPMG Peat Marwick*, 2 F.3d 183, 188 (7th Cir. 1993) (remanding for new trial because while "[o]ne or two" trial errors "might have been excused as harmless," together "they presented the jury such a skewed picture that the verdict is unreliable").

ARGUMENT

I. PLAINTIFFS' "LEAKAGE MODEL" FAILED TO ESTABLISH LOSS CAUSATION AS A MATTER OF LAW AND, IN ANY EVENT, THE JURY'S MISAPPLICATION OF THE MODEL RESULTED IN AN IRRATIONAL AND UNSUPPORTED VERDICT.

"To prevail on the merits in a private securities fraud action, investors must demonstrate that the defendant's deceptive conduct caused their claimed economic loss. This requirement is commonly referred to as 'loss causation.'" *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2183 (2011); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 342 (2005). To prove loss causation, Plaintiffs "needed to prove that the decline in [Household's] stock was 'because of the correction to a prior misleading statement' and 'that the subsequent loss could not otherwise be explained by some additional factors revealed then to the market.'" *Halliburton*, 131 S. Ct. at 2185; *see also Ray v. Citigroup Global Markets, Inc.*, 482 F.3d 991, 995 (7th Cir. 2007). That is, Plaintiffs were required to (1) identify the specific material misrepresentations (2) that caused Household's stock price to increase, and then (3) demonstrate that when the market learned of the falsity of the specified misrepresentations, its stock price declined as a result of that knowledge. *See Tricontinental Indus., Ltd. v. Pricewaterhouse-Coopers, LLP*, 475 F.3d 824, 842 (7th Cir. 2007) (noting that "*Dura* stresses that the complaint must specify each misleading misstatement, and that there must be a causal connection between the material misstatement and the loss" (internal quotations omitted)).

With respect to this essential element of loss causation, Plaintiffs rested their proof on the testimony of Professor Daniel R. Fischel.[1] Professor Fishel offered two alternative models of loss causation: (1) a "specific disclosures model" and (2) a "leakage model." The specific disclosures model sought to identify specific statements that caused the stock price to decline by revealing the "truth" to the market. The leakage model, by contrast, was not premised on specific disclosures, but instead *assumed* that Household's stock price was artificially inflated on the first day of the Class Period, *assumed* that this pre-Class inflation dissipated gradually during the Class Period due to a series of partial disclosures disconnected from any actual decreases in Household stock price, and *assumed* that all of the inflation existing in Household's stock price at the outset of the Class Period had been removed from the stock price by the last day of the Class Period. *See* Doc. 1361-6, Ex. 3 (Fischel Rebuttal Rep.) at 25-26; *see also* Doc. 1361-5, Ex. 2 (Fischel Dep. Tr.) at 84:3-7, 127:18-24. Jurors adopted, in a partial and *ad hoc* manner, Plaintiffs' leakage model. As set forth below in Section I(A), the flawed leakage model resulted in a fundamental failure of proof, as a matter of law, under Rule 50(b). In any event, as set forth below in Section I(B), the jury's misapplication of the leakage model resulted in an irrational and

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[1] Professor Fischel's positions with respect to loss causation were adopted in full by Plaintiffs. *See* Lead Plaintiffs' Response to Defendants' Interrogatory No. 64 ("Lead Plaintiffs incorporate by reference and identify the Expert Report of Daniel R. Fischel, served concurrently herewith, and all documents referenced therein."); *see also* Lead Plaintiffs' Responses to Defendants' Interrogatories Nos. 6, 15, 17, 27, 30, 31, 32, 33, and 35.

unsupportable verdict under Rule 59, and, as explained in Section I(C), precluded findings of materiality and reliance, and, independently, required judgment for Defendant Schoenholz.

A. Plaintiffs' Leakage Model Failed To Establish Loss Causation As A Matter Of Law.

The leakage model impermissibly assumed the predicates necessary to establish loss causation: (1) it assumed that inflation arising from all three strands of Plaintiffs' alleged fraud was present on the first day of the Class Period without identifying *any* specific misrepresentations that introduced the inflation;[2] (2) it assumed that unidentified "partial disclosures" ultimately caused all inflation to leave the stock price by the end of the Class Period; and (3) it disregarded any attempt to determine non-fraud, firm-specific factors that impacted Household's stock price during the Class Period, and instead simply assumed (without any evidentiary showing) that the effect of such factors would somehow "cancel each other out." Tr. 2684:6. These assumptions rendered the leakage model deficient, as a matter of law, to sustain the proof required to establish the element of loss causation. Indeed, Professor Fischel conceded that, at most, the leakage model was "*consistent* with" Plaintiffs' claims for predatory lending, re-aging, and restatement; not that it established requisite *proof* of loss causation for the claims. Doc. 1361-2, Ex. 1 (Fischel Rep.) at 17-18 (emphasis added). Yet, the leakage model and Fischel's testimony were not merely a complement to Plaintiffs' proof of loss causation; they were the sum total of the evidence of loss causation Plaintiffs put before the jury. Because the leakage model relied on in this case did not, and could not, establish loss causation, judgment

[2] In a Status Report to Magistrate Judge Nolan before trial, Plaintiffs acknowledged that Professor Fischel's Expert Report "was not designed to determine the date on which inflation came into the stock . . . ." Doc. 1174 at 4-5; *see id.* ("Household's stock price was artificially inflated on July 30, 1999 by Household's failure to disclose material adverse facts in connection with its July 22, 1999 statement announcing its second quarter results. . . . Indeed, Household's stock may have been inflated since the beginning of the old Relevant Period [October 23, 1997], or even before that time.").

should be entered for Defendants.[3] *See, e.g., Kempner Mobile Elec. v. Sw. Bell Mobile Sys.*, 428 F.3d 706, 716-17 (7th Cir. 2005) (granting defendant's judgment as a matter of law where plaintiff failed to present sufficient evidence to support an element of the claim).

1. *The Leakage Model Failed To Identify The Misrepresentations Alleged To Have Introduced Inflation Into Household's Stock Price.*

Plaintiffs were required to show that Household's "alleged misrepresentations artificially inflated the price of" Household's stock. *Ray*, 482 F.3d at 995. Rather than attempt to establish that fact, Plaintiffs' leakage theory of loss causation simply assumed that inflation was in Household's stock price on the first day of the Class Period, July 30, 1999, and Professor Fischel acknowledged that his "analysis [wa]s premised on [this] assumption." Tr. 2936:11-2937:24; Doc. 1361-6, Ex. 3 (Fischel Rebuttal Rep.) at 25-26; *see also* Doc. 1361-5, Ex. 2 (Fischel Dep. Tr.) at 84:3-7, 127:18-24.

That "assumption," however, rendered Plaintiffs' leakage model insufficient to prove loss causation as a matter of law. Demonstrating how and when a stock price became inflated due to a material misrepresentation is one of the bedrock requirements of proving loss causation. *See Ray*, 482 F.3d at 995 (plaintiff must show that a defendant's "alleged misrepresentations artificially inflated the price of the stock"); *see* H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.) (stating that the PSLRA's loss causation requirement mandates that a plaintiff "prove that the price at which the plaintiff bought the stock was artificially inflated as the result of the misstatement or omission"). Plaintiffs cannot simply assume that they have met that burden; they must, in fact, meet it. Because Plaintiffs assumed that the inflation in Household's stock price was already built in at the beginning of the Class Period, they did not even attempt to prove

[3] Defendants' loss causation argument is more fully explicated in their earlier submissions on this subject. *See* Doc. 1235, 1249, 1364, 1488, 1569, 1597.

one critical element of loss causation: how and when artificial inflation initially entered Household's stock price in the first place. *See Schleicher v. Wendt*, 618 F.3d 679, 687 (7th Cir. 2010) (After "other elements of the claim have been established, the court will need to pin down *when* the stock's price was affected by any fraud . . . . If the data are so ambiguous that the decision can't be made at all, then the class loses outright (plaintiffs bear the burden of persuasion, after all).").

That failure alone requires judgment to be entered for the Defendants. If the original source of the alleged inflation is unknown, literally any public statement could be said to have sustained that preexisting inflation, transforming any statement into a misstatement for purposes of securities liability. Courts have rejected reliance on such freeform loss causation theories. *See, e.g.*, *Dura*, 544 U.S. at 342-348; *Ray*, 482 F.3d at 995; *Tricontinental*, 475 F.3d at 842-44; *In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Sec. Litig.*, 250 F.R.D. 137, 144 (S.D.N.Y. Feb. 26, 2008) ("there is no way to test for this maintenance effect" because "it is based not on facts but speculation"); *Ravens v. Iftikar*, 174 F.R.D. 651, 667 (N.D. Cal. 1997) ("more than 40 percent of the 76 percent price increase . . . occurred before the class period began and, thus, can form no part of Plaintiffs' claim for class damages").

A so-called "inflation maintenance" theory, such as the one discussed in *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282, 1317 (11th Cir. 2011), cannot excuse Plaintiffs' failure to establish the source of the inflation in this case. Even the Eleventh Circuit's holding in *FindWhat* would require a plaintiff to prove that specific pre-class misrepresentations inflated a stock's price and to then identify the specific related misrepresentations during the class period that maintained the inflation created by the earlier specified misrepresentations. But here Plaintiffs did neither. Instead, Plaintiffs' theory is that new and different misrepresentations made during the Class Period maintained the inflation associated with unidentified pre-Class Period misrepresentations. No court has endorsed that as a tenable theory of loss causation.

Moreover, Plaintiffs' roundabout attempt to rely on unidentified pre-Class Period statements as the source of inflation lays bare a fatal statute of repose problem. The Class Period in this case was dictated by the securities fraud statute of repose in force when Plaintiffs' complaint was filed. Pursuant to that statute, any securities fraud claim had to be brought within one year after the discovery of the facts constituting the violation and within three years after the violation actually occurred. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 360, 364 (1991). This Court thus correctly trimmed Plaintiffs' asserted Class Period from October 23, 1997 through October 11, 2002 to July 30, 1999 through October 11, 2002. *See Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, No. 02-5893, 2006 WL 560589, at *3 (N.D. Ill. Feb. 28, 2006). But having done so, it was clearly inappropriate to allow Plaintiffs to proceed from the assumption that there was artificial inflation attributable to unidentified pre-Class Period misstatements. To do so would make the statute of repose meaningless.[4]

[4] It also would be incorrect as a matter of law to allow Plaintiffs to proceed on a theory that any inflation in Household's stock price at the start of the Class Period on July 30, 1999 resulted from Defendants' failure, as of that date, to correct earlier, unidentified misstatements of material fact. The plain language of Rule 10b-5 only makes it unlawful to "omit to state a material fact *necessary in order to make the statements made*, in the light of the circumstances under which they were made, *not misleading*." 17 C.F.R. § 240.10b-5 (emphasis added); *see also Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1321 (2011) ("Disclosure is required under these provisions only when necessary 'to make . . . statements made, in the light of the circumstances under which they were made, not misleading.'" (quoting 17 C.F.R. § 240.10b-5(b)); *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988) ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5."). Having failed to identify any specific pre-Class Period misstatements of material fact, Plaintiffs necessarily fail to establish any duty to correct such unidentified statements. *See, e.g.*, *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1331 (7th Cir. 1995) (explaining that a duty to correct applies "when a company makes a historical statement that, at the time made, the company believed to be true, but as revealed by subsequently discovered information actually was not"); *see also In re Northern Telecom*, 116 F. Supp. 2d at 460 (rejecting plaintiffs' theory that a failure to make a corrective disclosure on January 26, 1993, the

2. *Plaintiffs' Leakage Model Failed To Establish A Causal Connection Between An Alleged Misrepresentation And A Loss.*

Proving that Household's stock price was artificially inflated as a result of specific, identified misrepresentations was only the first required step in proving loss causation. "Loss causation . . . requires a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." *Halliburton*, 131 S. Ct. at 2186 (emphasis in original); *Dura*, 544 U.S. at 342 ("an inflated purchase price will not itself constitute or proximately cause the relevant economic loss"); 15 U.S.C. § 78u-4(b)(4) ("the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages"). The leakage model also failed, as a matter of law, to provide the requisite proof of a causal nexus.

After starting from the premise that Household's stock price was artificially inflated at the beginning of the Class Period, the leakage model also assumed that all of that hypothetical inflation exited the stock price by the end of the Class Period. *See* Doc. 1361-5, Ex. 2 (Fischel Dep. Tr.) at 138:14-18; 202:17-20. The remainder of Plaintiffs' loss causation analysis is no more than an exercise in assigning stock declines to dates between July 30, 1999 and October 11, 2002, so that all of the inflation assumed to be in the stock at the beginning of the Class Period exits the stock price by the end of the Class Period. Plaintiffs' leakage model makes no attempt to isolate corrective disclosures, it fails to marry those disclosures with subsequent price declines, and—as discussed *infra*—it fails to rule out non-fraud explanations for the stock price movement observed. No other evidence made up for these deficiencies in the leakage model.

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first day of the class period, maintained preexisting inflation: "Plaintiffs identify no prior statement that a January 26, 1993 disclosure was necessary to correct or update.").

Courts have uniformly recognized that a plaintiff must prove a causal connection between an alleged misrepresentation and the loss the plaintiff suffers. *See, e.g.*, *Halliburton*, 131 S. Ct. at 2186; *Dura*, 544 U.S. at 342. The mere fact that a stock is declining coupled with the fact that the market learns of a prior misrepresentation is not enough, especially where, as here, stock prices in an entire sector—and, indeed, the entire market—were declining. Between July 30, 1999 and October 11, 2002, the S&P 500 index fell 37.7% while Household's stock price declined by about 34.5%. Over the same period, Household was the median of the consumer finance index (measuring the sector in which Household was included); three member companies' stock performed worse than Household's over the period and three member companies' stock performed better.[5] Tr. 4114:10-4116:7.

To demonstrate that an inflated purchase price "touches upon" a later economic loss is not to show that it "cause[d] a loss, and it is the latter that the law requires." *Dura*, 544 U.S. at 343 (citing 15 U.S.C. § 78u-4(b)(4)); *see Tricontinental*, 475 F.3d at 842 (plaintiff must establish "a causal connection between the material misrepresentation and the loss, not simply that the misrepresentation touches upon a later economic loss"); *In re Williams Sec. Litig. – WCG Subclass*, 558 F.3d 1130, 1137 (10th Cir. 2009) ("Without showing a causal connection that specifically links losses to misrepresentations, [Plaintiff] cannot succeed."); *see also In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 574 F.3d 29, 41 (2d Cir. 2009) (plaintiff must "link[]" "the decline in the price of [the] stock" with "corrective disclosures"). Plaintiffs were thus required to demonstrate specifically how the inflation in Household's stock price was removed, for example, by specific corrective disclosures that prompted a corresponding decrease in share price,

[5] Some companies in the consumer finance sector fared particularly poorly over this same period—Americredit's stock price declined by over 50% from July 1999 to October 2002, and Providian's stock price declined by over 90%. Tr. 4114:10-4116:7.

resulting in Plaintiffs' loss. Because Plaintiffs relied on a model that simply assumed that all inflation would dissipate by the end of the Class Period, Plaintiffs failed to make this critical link. That failure requires judgment for Defendants.[6]

The fundamental disconnect between any supposed revelation of the truth about the alleged fraud and Plaintiffs' alleged losses is most easily understood by reviewing the leakage model as submitted to the jury. Plaintiffs' leakage model covered the time period from July 30, 1999 to October 11, 2002. During that time period, there are numerous instances where the leakage model concluded that inflation exited Household's stock price without any explanation (and therefore without any proof) whatsoever. For example, between December 28, 2001 and January 2, 2002 the leakage model concluded that $1.36 of inflation left Household's stock price despite the fact that the trial record is devoid of any purported corrective disclosures of any kind during this period. PX1395 at 13. Likewise, between January 7 and January 10, 2002 no disclosures were identified, yet the leakage model concluded that another $1.49 of inflation left the stock. *Id.* at 14. Between May 2 and May 6, 2002, there is nearly a dollar of loss, again, without any purported corrective disclosure made during that time period. *Id.* at 15. And in the 10-day period from July 5, 2002 to July 15, 2002, Plaintiffs cite to no Household statements of any kind, yet Plaintiffs' loss causation model concluded that there was a $2.52 decrease in the inflation of Household's stock price. Thus, a class member that purchased stock on July 5 and sold it on July 15 would be able to recover for securities fraud under Plaintiffs' view of loss causation despite the fact that there was no disclosure-driven movement in Household's stock

[6] In the context of discussing his specific disclosures model, Professor Fischel acknowledged the necessity of linking specific corrective disclosures and price movements. *See* Tr. 2628:2-11 ("I had to isolate disclosures. I had to determine whether those disclosures occurred at a time when there was a statistically significant stock price movement. And I had to be reasonably confident that the fraud-related disclosure was responsible for the price movement."). The leakage model satisfied none of these requirements.

price.[7] That counterintuitive outcome is simply illustrative of the broader problem with the model, and underscores that Plaintiffs' leakage model was incapable of establishing loss causation throughout the Class Period. The model fails to establish a "logical link between the inflated share purchase price and any later economic loss." *Dura*, 544 U.S. at 342. Especially in a situation where share prices in the entire sector were generally declining, this deficiency is critical. Permitting Plaintiffs to recover without establishing the required link would turn the securities law into just the sort of "broad insurance against market losses" that the *Dura* Court unanimously rejected. *Id*. at 345.

This is not to say that a leakage-based theory of loss causation is incapable *per se* of establishing the required nexus between material misrepresentations and stock market losses in a securities fraud case. Albeit on a challenge at the class certification stage, the Seventh Circuit has recognized that such a theory of loss causation may be relied on by a securities plaintiff. *See Schleicher*, 618 F.3d at 681-82. There may be circumstances where a plaintiff can demonstrate with particularity that inflation in a defendant's stock price was removed over time through a series of partial disclosures correcting a prior material misstatement. *See id.* at 686-87; *Dura*, 544 U.S. at 342. But such circumstances do not obviate the need to prove loss causation or to identify the specific mechanism by which the truth was revealed to the market.

"To satisfy the requirements of *Dura*, . . . any theory—even a leakage theory that posits a gradual exposure of the fraud rather than a full and immediate disclosure—will have to show some mechanism for how the truth was revealed." *In re Williams*, 558 F.3d at 1138; *see Tricontinental*, 475 F.3d at 843 (plaintiffs must "specify each misleading statement" and then

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[7] The same would be true for stock purchased on December 28, 2001 and sold on January 2, 2002, stock purchased on January 7, 2002 and sold on January 10, 2002, and stock purchased on May 2, 2002 and sold on May 6, 2002.

demonstrate that there was "a causal connection between the material misrepresentation and the loss" (internal quotations and citation omitted)); *Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse First Boston*, 853 F. Supp. 2d 181, 192 (D. Mass. 2012) (holding that under a "leakage" model of loss causation a plaintiff "must establish the mechanism by which the truth was revealed" (citation omitted)). Leakage models, such as the one presented here, that chart price increases and declines without attributing inflation to specific statements and losses to specific corrective disclosures are insufficient as a matter of law. *See In re Flag Telecom*, 574 F.3d at 41 ("Plaintiffs have failed to demonstrate that any of the information that 'leaked' into the market prior to [the end of the class period] revealed the truth with respect to the specific misrepresentations alleged."); *Katyle v. Penn Nat'l Gaming, Inc.*, 637 F.3d 462, 472-73 (4th Cir. 2011) (Even under a leakage theory, a plaintiff must prove that "(1) [the] disclosures gradually revealed to the market the undisclosed truth about [defendant's] fraudulent press releases, and (2) such disclosures resulted in the decline of [defendant's] share price."). "A plaintiff cannot simply state that the market had learned the truth by a certain date and, because the learning was through a gradual process, attribute all prior losses to the revelation of the fraud. The inability to point to a single corrective disclosure does not relieve the plaintiff of showing how the truth was revealed; he cannot say, 'Well, the market *must* have known.'" *In re Williams*, 558 F.3d at 1138.

But that is exactly what Plaintiffs did. Plaintiffs merely assumed that there was some sort of growing awareness that Household had committed fraud, without offering any proof of such a revelation or connecting the disclosure of the facts informing this awareness with specific declines in the inflation in Household's stock price. Plaintiffs' assumptions do not meet their burden of proof, mandating judgment in Defendants' favor.[8]

3. The Leakage Model Failed To Account Properly For Stock Price Declines Resulting From Non-Fraud Firm-Specific Factors, In Contravention Of Dura.

Plaintiffs' leakage theory also failed to account for non-fraud firm-specific explanations for the decline in Household's stock price during the Class Period. As a result, it was impossible for the jury to determine just how much of Household's stock price decline was attributable to the dissipation of misrepresentation-induced artificial inflation, as opposed to unrelated firm-specific negative information. This too mandates judgment for Defendants.

In *Dura*, a unanimous Supreme Court recognized that even when securities fraud takes place, investment losses may not result from the fraud—"changed economic circumstances, changed investor expectations, new industry-specific or firm-specific factors, conditions, or other events, . . . taken separately or together [may] account for some or all of th[e] lower price." 544 U.S. at 342-43. In recognition of this fact, courts have consistently rejected attempts by securities fraud plaintiffs to rely on economic theories that fail to separate out losses caused by the alleged fraud from losses caused by everything else, including factors leading to an overall sector decline. *See In re Omnicom Group, Inc. Sec. Litig.*, 541 F. Supp. 2d 546, 554 (S.D.N.Y. 2008) ("Because the law requires the disaggregation of confounding factors, disaggregating only

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[8] Moreover, the overlap between the period of time during which the jury found that statements caused inflation to come into the stock price and Fischel's leakage period critically undermines any alleged link between Household's purported fraud and subsequent declines in Household's stock price. Fischel testified that the "truth" about Household's practices "leaked" out over an 11-month period beginning on November 15, 2001. Tr. 2849:21-2850:19, 2671:18-2672:15. Yet almost half of the 17 statements at issue were made during that period. Therefore, according to Plaintiffs and their expert, investors were somehow simultaneously deceived and told the truth. But "Plaintiffs cannot have it both ways. They cannot allege that Defendants made certain misstatements . . . and simultaneously argue that the misstatement itself constituted a corrective disclosure." *In re Flag Telecom*, 574 F.3d at 41.

some of them cannot suffice to establish that the alleged misrepresentations actually caused Plaintiffs' loss."), *aff'd*, 597 F.3d 501 (2d Cir. 2010); *In re REMEC Inc. Sec. Litig.*, 702 F. Supp. 2d 1202, 1273-74 (S.D. Cal. 2010) (rejecting a leakage model for failing to control for firm-specific variables); *United States v. Ferguson*, 584 F. Supp. 2d 447 (D. Conn. 2008) (same).

Even when—perhaps, especially when—a plaintiff's loss causation argument turns on a leakage theory such as the one at issue here, non-fraud firm-specific factors must be eliminated from the plaintiff's calculation of loss. As the court in *In re Williams Securities Litigation* explained, "*Dura* leaves no room for doubt that even where a securities fraud plaintiff proceeds on a 'leakage' theory of corrective disclosure, he must still establish that the lower price reflects the fraud-related inflation and not" non-fraud related factors like those listed in *Dura*. 496 F. Supp. 2d 1195, 1266-67 (N.D. Okla. 2007) (internal citation omitted), *aff'd*, 558 F.3d 1130 (10th Cir. 2009); *In re Flag Telecom*, 574 F.3d at 36 (plaintiffs must "disaggregate those losses caused by [the *Dura* non-fraud factors] from disclosures of the truth behind the alleged misstatements"); *Fener v. Operating Eng's Constr. Indus. & Misc. Pension Fund*, 579 F.3d 401, 410 (5th Cir. 2009) (A damages model "that shows only how a 'stock reacted to the *entire bundle* of negative information,' rather than examining the 'evidence linking the *culpable* disclosure to the stock price movement'" is insufficient. (emphasis in original, internal citation omitted)).

The leakage model presented in this case did not properly account for Household specific stock price impacts unrelated to the alleged fraud. The analysis underlying Plaintiffs' leakage model is uncomplicated. It compares Household's stock performance to that of the market, using the S&P 500 and S&P Financial indexes as baselines. Doc. 1361-2, Ex. 1 (Fischel Rep.) at 17-18. That comparison was used to attempt to eliminate the effect of general market factors on Household's stock price movement during the Class Period. Starting from the assumption that inflation was already in Household's stock price at the beginning of the Class Period and had left the stock by the end of the Class Period, Professor Fischel attributed all movements in Household's stock price not in keeping with general market and industry movements to an assumed leakage of the truth regarding Household's alleged fraud. Doc. 1361-6, Ex. 3 (Fischel Rebuttal Rep.) at 25-26.

Professor Fischel conceded that non-fraud related movements in Household stock were significant, agreeing that "there [we]re a bunch of stock price movements that were significant under [his] regression analysis that were not attributable to fraud related disclosures." Doc. 1361-5, Ex. 2 (Fischel Dep. Tr.) at 57:12-16. Professor Fischel further acknowledged that whether a stock price movement was "purely fraud related, combined fraud related or not at all fraud related, they were all included in the leakage model." Tr. 2959:24-2960:17. Yet, rather than systematically account for and address such non-fraud related movements—as the element of loss causation requires—Professor Fischel simply assumed that the non-fraud related impacts would "cancel each other out." Tr. 2684:6. Indeed, given the lack of rigor in accounting for non-fraud related impacts, Professor Fischel conceded that the leakage model made it "impossible to conclude" whether exclusion of non-fraud firm-specific information would have altered his inflation calculation. Tr. 2683:17-2684:6. Perhaps that is why he took such pains to emphasize that his modeling showed *only* that the behavior of Household's stock price during the Class Period was "consistent with" Plaintiffs' allegations. Doc. 1361-2, Ex. 1 (Fischel Rep.) at 6; Doc. 1361-5, Ex. 2 (Fischel Dep. Tr.) at 49:21-51:1.[9]

[9] Even if Plaintiffs had proved, as Fischel speculated, that all non-fraud, firm-specific disclosures over the entire 330-day period "cancel each other out," Tr. 2684:6, it was still improper to fail to systematically address such movements in the analysis, because the specific dates of non-fraud related movement would be critical to assessing damages for any particular plaintiff depending on the dates of stock trades. For example, Fischel's evaluation included a 10-day period between

The author of the sole authority cited by Professor Fischel in reference to the leakage model presented in this case, pointed out precisely this fundamental defect. The only source cited by Professor Fischel in support of the application of his leakage model was an article by Bradford Cornell and R. Gregory Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 UCLA L. Rev. 883 (1990). *See* Doc. 1361-2, Ex. 1 (Fischel Rep.) at 25-26. Professor Fischel cited Professor Cornell's article nearly a dozen times in his report. Setting aside the questions raised by the fact that Professor Fischel was able to locate only one source in support of his leakage model, *see Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 594 (1993), Professor Cornell flatly rejected the manner in which Plaintiffs and Professor Fischel applied the leakage theory in this case:

> The trouble with the [model], is that it attributes any decline in the security price that is not due to movements in the market or the industry to disclosure of the fraud. If the disclosure of fraud is associated with the release of other company-specific news, the . . . [model] will over-estimate the true damages . . . . For companies like Household over a period as long as the alleged leakage period [11 months], there are hundreds, if not thousands, of news items. Assuming the model employed by Prof. Fischel properly nets out market and industry related effects, there are still hundreds of news items that deal with Household itself. Prof. Fischel's leakage model assumes, without demonstrating, that all the news items that affect Household's stock price are related to the fraud. In my opinion as an economist, that assertion does not provide adequate evidence, indeed it really provides no evidence, that the stock price decline was caused by leakage of fraud related information rather than disclosure of other firm specific news. . . .

Doc. 1361-7, Ex. 9 (Cornell Pre-Trial Aff.) at 4-5.

July 5 and July 15, 2002, during which there was no identified news, fraud-related or otherwise, yet the leakage model indicates a $2.52 decrease in inflation during that period. PX1395 at 16. A class member who purchased stock at the beginning of that 10-day period and sold it at the end would in theory be able to recover under the leakage model, despite the fact the model identified no fraud-related movement during this period. Asserting some fraud-related movement elsewhere "cancelled out" this decline does not cure the legal insufficiency of this outcome, and would violate the rule that under the securities laws a plaintiff is entitled only to "actual damages" caused by fraud. 15 U.S.C. § 78bb(a).

The leakage model's failure to account properly for "'[n]onfraud company-specific information'" "collides directly with loss causation doctrine," and is flatly inconsistent with *Dura* and its progeny. *In re Williams*, 496 F. Supp. 2d at 1266 (internal citation omitted). This legal deficiency independently requires judgment for Defendants as a matter of law.

4. The Leakage Model Applied In This Case Suffers From Numerous Additional Technical Infirmities That Reinforce The Model's Structural Errors.

Plaintiffs' leakage model suffers additional defects beyond the foundational problems already discussed that made it incapable of proving loss causation. First, the limited regression analysis that Plaintiffs employed in conducting their loss causation inquiry utilized a one-tail test to determine whether stock price movements were statistically significant. Doc. 1361-5, Ex. 2 (Fischel Dep. Tr.) at 53:15-17; *see* Doc. 1364 at 24-26, 1488 at 21-23 (noting issues with one-tailed test). As numerous courts have recognized, "[u]nlike the more common 'two-tailed' standards, which assess the likelihood that any differences between two groups would occur by chance, a one-tailed standard assumes that any deviation from what might be predicted by chance will be in only one direction." *Dicker v. Allstate Life Ins. Co.*, No. 89 C 4982, 1997 U.S. Dist. LEXIS 4512, at *117 (N.D. Ill. Apr. 7, 1997). Thus one-tailed statistical significance tests are not appropriate unless a variable can move in only one direction. Because stock prices move both up and down, a one-tailed test is inappropriate when analyzing securities claims.

Second, though styled as an "event study," Plaintiffs' leakage-based model of loss causation is no such thing. As the name suggests, an event study "measures the impact of a specific event on the value of a firm." Craig MacKinlay, *Event Studies in Economics and Finance*, 35 J. of Econ. Lit. 13, 13 (1997). Plaintiffs' leakage model does not measure the impact of any specific event. Rather, it measures only how much Household's stock allegedly underperformed the market during the last 11 months of the Class Period, without reference to any particular event or events that may have caused the decline.

Third, Plaintiffs' "event study" is applied to information pertaining to a 330-day period. That is far too long a period for event study methodology to be reliably applied. Because the efficient market hypothesis is premised on the notion that the market incorporates all information immediately, the generally accepted size of an event study "event window" is one or two days. *Cf. Goldberg v. Household Bank, F.S.B.*, 890 F.2d 965, 966-67 (7th Cir. 1989); *Short v. Belleville Shoe Manufacturing Co.*, 908 F.2d 1385, 1392 (7th Cir. 1990). The Supreme Court identified the crux of the problem in *Dura*: "the longer the time" involved "the more likely that other factors caused the loss," such as "changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price." 544 U.S. at 343. Courts have thus appropriately been skeptical of attempts to apply event studies over long periods of time. *See Ferguson*, 584 F. Supp. 2d at 453 (concluding that a 30-day event study window was "not justified sufficiently").[10]

Finally, the leakage model attributes to Household's alleged fraud all residual stock price declines on every day of the Class Period even if particular movements were not statistically significant. As Professor Fischel has acknowledged elsewhere, it is a well-accepted tenet of economic analysis that stock price movements can be attributed to a specific event only when the

[10] Applying regression models over unduly long periods of time also exacerbates the problems from which those models suffer more generally. As Professor Cornell noted when evaluating Plaintiffs' defective leakage model, "[n]o regression model perfectly accounts for market and industry factors. Nonetheless, if the models are used to calculate residual returns over intervals of no more than a few days, the errors are generally minor." Doc. 1361-7, Ex. 9, (Cornell Pre-Trial Aff.) at 5-6. But "when a model is used to predict returns over periods hundreds of days long the errors compound. Such compounding, in turn, can produce significant errors in measured inflation." *Id*.

movement is statistically significant. *See* Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 Bus. Law. 1, 19 (1982) ("If the difference between the actual return and the predicted return is not statistically significant, investors were not injured . . . ."). These technical infirmities further underscore that Plaintiffs' leakage model could not prove loss causation and that judgment for Defendants is required.[11]

B. The Jury's *Ad Hoc*, Partial Adoption Of The Leakage Model Resulted In An Irrational And Unsupported Verdict.

As set forth above, the deficiencies in the leakage model as presented in this case rendered it insufficient to prove loss causation as a matter of law. Further, *ad hoc* adjustments to the leakage model at trial, and the jury's partial adoption of the model in rendering its verdict, resulted in an irrational and unsupported verdict. *See Turyna*, 83 F.3d at 179, 182 (remanding for a new trial where verdict was internally inconsistent).

During his trial testimony Professor Fischel altered the leakage model presented in his expert report. Professor Fischel advised the jury that it could disregard his calculations of the amount of inflation in Household's stock price for each day of the Class Period and determine the inflation itself by replacing Fischel's calculated inflation numbers with a zero for every day before the date of the first statement the jury found to be false. Tr. 2966:6-10. Fundamentally altering the model in that way should have required Plaintiffs to prove a completely different case—one that attributed inflation to specific misrepresentations during the Class Period. But Plaintiffs did not change course to account for this radically different theory, and this Court permitted the trial to continue as if nothing had happened despite the fact that there was no

[11] These infirmities and the numerous other analytical flaws already discussed make clear that Fischel's testimony should have been excluded. *See* Doc. 1364 (Memorandum of Law In Support Of Household Defendants' *Daubert* Motion To Exclude The "Expert" Testimony Of Daniel Fischel); *see Zenith Elec. Corp. v. WH-TV Broadcasting Corp.*, 395 F.3d 416, 419 (7th Cir. 2005).

evidentiary basis for Professor Fischel's on-the-fly alteration of his leakage model. *See* Fed. R. Civ. P. 26(e) (theories not advanced in expert reports should not be presented to or considered by the jury); *United States v. Moore*, 521 F.3d 681, 683-85 (7th Cir. 2008) (expert testimony must be based on reliable principles and methods soundly applied to reliable facts and data).

The verdict form, and the instruction imbedded within Question No. 4 of the verdict form, compounded the error. If the jury found liability, the verdict form instructed it to proceed to Question No. 4. Doc. 1611 at 41. Question No. 4 gave the jury only three, mutually exclusive options: (1) to find that Fischel's Leakage Model provided a reasonable estimate of damages; (2) to find that Fischel's Specific Disclosures Model provided a reasonable estimate of damages; or (3) to find that neither of Fischel's models provided a reasonable estimate of damages. In the latter case, the verdict form instructed that the jury had completed its task. *Id.* In the event the jury selected one of Fischel's models, the verdict form further instructed:

> Otherwise, write 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.") **You may use only one model—the one you have chosen—to fill out Table B.**

Id.

Defendants objected to this instruction, noting that Plaintiffs' expert's damage theories did not provide a proper evidentiary basis to determine the inflation associated with a specific misstatement if jurors found that other alleged misstatements were not actionable:

> [I]f the jury rejects any aspect of Professor Fischel's analysis, if they find that on any day reflected in his table there was not a corrective disclosure that he found or there was not a false statement that he relied upon in developing his table . . . the jury has no guidance whatsoever on how to reflect that decision. And the form in its totality then becomes meaningless. . . . I'm trying to be very, very specific in this objection to this particular question asking the jury that if no loss was caused on any date, write none. Once they have reached that conclusion, that on any given date the inflation was none, there's really—they have no guidance for how

> to determine the figure to use on any day following that doesn't just rely on speculation.

Tr. 4680:17-4681:18. The Court overruled the objection.

The end result was the irrational and unsupported verdict forewarned in Defendants' objection. The jury found Defendants not liable for 23 of the 40 challenged statements, and then attempted to apply Professor Fischel's leakage model to the remaining 17 statements. The first statement found actionable by the jury (chronologically, the 14th statement of 40) was published in a March 23, 2001 *Origination News* article quoting a release issued 10 days earlier: "Gary Gilmer, president and chief executive of Household's subsidiaries HFC and Beneficial said the company's 'position on predatory lending is perfectly clear. Unethical lending practices of any type are abhorrent to our company, our employees and most importantly our customers.'" Doc. 1611, Table A at 11. The jury found this statement misleading with respect to only one of Plaintiffs' three theories of fraud: "Predatory Lending." *Id*.; Verdict Form at 14. On March 12, 2001, when the statement was originally published, and every day after that until March 23, 2001, the jury found zero inflation in Household's stock price.

According to the jury verdict, the single March 23, 2001 statement—a third-party reprint of a 10-day-old statement—somehow caused Household's stock to go from having zero of its \$54.72 per share price attributable to inflation on March 22, 2001, to having \$23.94 of its \$58.12 per share price attributable to inflation on March 23, 2001. *Id*., Table B; PX1395. That facially absurd finding was wholly precluded by the leakage model itself, which determined \$23.94 to be the maximum amount of inflation attributable to the *combined* impact of Plaintiffs' three fraud theories over the entire Class Period. The jury's attribution of the entire \$23.94 to a single theory of fraud, let alone a single statement relating to only a single theory of fraud, requires a new trial. *Cf. Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013); *infra* at p. 29.

Relatedly, there was no evidence to support a finding that $23.94 of inflation was introduced into Household's stock price on March 23, 2001. And that lack of evidentiary support permeates the verdict—for every day in the Class Period after March 23, the jury simply adopted Professor Fischel's leakage model inflation calculations despite the fact that those calculations did not even remotely track the jury's liability findings.[12] For 14 of the 17 days on which the jury found an actionable statement, the amount of inflation in the stock price remained static or actually decreased, and for the other three statements, Professor Fischel's testimony confirmed that the inflationary increases reflected in his model were *not* caused by the false statements. Equally contradictory, the jury found inflationary increases on hundreds of days when no misrepresentation even allegedly occurred. The fundamental problem is that the leakage model was designed (albeit improperly) to assess the "deflation" of assumed inflation already in the stock price, yet the jury attempted to employ it to measure the inflationary effects of various allegedly fraudulent—as opposed to corrective—statements during the Class Period.

1. *The Jury's Finding That The March 23, 2001 Statement Introduced The Leakage Model's Total Sum Of Inflation Into The Stock Price Is Legally Impossible And Foreclosed By The Model Itself.*

The jury's putative application of the leakage model produced the legally impossible and internally inconsistent finding that the total sum of inflation from Plaintiffs' three separate theories of fraud entered the stock price simultaneously, in a single day, as a result of a statement related to only one of those theories.

[12] In effect, the jury created its own theory of liability, something this Court expressly forbade. *See* Tr. 4367:20-4368:2 (The jurors "only have two ways to figure out what's a reasonable damage amount: Either of the two theories Fischel gave them. Anything else is outside the evidence presented in the case. It would be creating their own theory of liability."). There was simply no evidentiary basis for the jury's pick-and-choose approach to the leakage model.

Professor Fischel based both of his artificial inflation models on the assumption that Household's stock price was inflated by three discrete types of fraud: predatory lending, re-aging, and the credit card accounting that resulted in the restatement. Tr. 2854:20-2855:23. The specific disclosures model purported to (1) identify 14 specific "corrective disclosures" that occurred during the Class Period; (2) determine the residual stock price change associated with each of the 14 disclosures; and (3) add the residual stock price changes together to arrive at a total figure of artificial inflation for each day of the Class Period, with a peak of $7.97 per share. In this respect, the specific disclosures model purported to identify specific corrective disclosures relating to each of the three distinct issues in the case, thereby theoretically providing a means to disaggregate the $7.97 of inflation to each disclosure and issue. *See* Doc. 1361-5, Ex. 2 (Fischel Dep. Tr.) at 66:18-67:2.

The leakage model partially adopted by the jury, however, had no mechanism to disaggregate the impact of the three distinct theories of fraud. As explained by Professor Cornell in the article relied upon by Professor Fischel, 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: "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." Doc. 1780-1, Ex. A (Cornell Post-Trial Aff.) at 9 (quoting 37 UCLA L. Rev. at 908). Professor Cornell elaborated in an affidavit: "[W]hen, 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' . . . This is a well-established principle of finance and economics. . . . 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*. at 9-10.

The jury's assignment of the full $23.94 of inflation to a statement relating only to predatory lending is thus problematic for at least two reasons. First, because Professor Fischel's inflation calculations under his leakage model are not, and cannot be, separated into specific amounts attributed to each of the three theories of fraud on which the model is premised, 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 could possibly be attributed to the March 23 statement. If the jury had adopted Plaintiffs' theory of liability in its entirety, the jury would simply have assigned to March 23 the 67 cent inflationary increase calculated by Professor Fischel. But once the jury found Defendants not liable for the first 13 statements challenged by Plaintiffs and found no inflationary impact associated with those statements, the leakage model no longer provided the jury with any basis to determine the inflationary impact of the March 23 statement standing alone. *See* Doc. 1780-1, Ex. A (Cornell Post-Trial Aff.) at 12. ("[T]here 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" the March 23 statement.).

Second, even if the jury could have relied on Professor Fischel's leakage model to assign an artificial inflation amount to a misrepresentation involving only one of Plaintiffs' three fraud theories, it is legally impossible to assign the *entire* $23.94 to a statement relating solely to predatory lending. Professor Fischel calculated $23.94 to be the maximum aggregate inflationary stock price impact based on the *combined* effect of the three alleged frauds. PX1395. The notion that the full $23.94 is attributable to a single theory of fraud, let alone a single repeated statement addressing only predatory lending, is irreconcilable with the leakage model's assumption that all three of the alleged frauds inflated Household's stock price. *See* Doc. 1780-1, Ex. A (Cornell Post-Trial Aff.) at 12 ("[I]t 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.'").

Although it arose in a different procedural posture, the jury's attribution of all the inflation to one of the three alleged frauds is reminiscent of the error the Supreme Court corrected in its recent decision in *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013). In *Comcast*, the Court held that a class action antitrust suit was wrongly certified because it was rooted in a fatally flawed theory of damages. The plaintiffs in that case "proposed four theories of antitrust impact," but the district court rejected all but one. *Id.* at 1430. The district court then allowed the case to proceed despite the fact that the model used to calculate class damages "did not isolate damages resulting from any one theory of antitrust impact." *Id.* at 1431. The Supreme Court reversed the district court because there was "no question that the model failed to measure damages resulting from the particular antitrust injury on which [Comcast's] liability in this action is premised." *Id.* at 1433. "The methodology might have been sound . . . if all four of th[e] alleged [market] distortions remained in the case," but once that was no longer true plaintiffs' theory of damages became untenable. *Id.* at 1434. The same is true here. Plaintiffs' leakage theory was an all-or-nothing proposition. The leakage model did not offer any mechanism for isolating the economic impact of a single theory of fraud, let alone a single statement. Nor did it allow the jury to distinguish between purported inflation from the 17 statements found fraudulent and purported inflation from the 23 statements the jury found nonfraudulent. Once the jury decided not to adopt Plaintiff's theory wholesale, adopting it piecemeal was not an option.

2. Application Of The Leakage Model Resulted In A Nonsensical Verdict Having No Basis In The Evidence Or Correlation Between The Artificial Inflation The Jury Assigned To The Stock Price And The Misrepresentations That Supposedly Caused The Inflation.

The jury's attribution of $23.94 to a single statement regarding predatory lending is flatly inconsistent with the leakage model it purported to adopt. But even in the absence of that legal impossibility, there is no rational relationship between the evidence and the jury's verdict.

Simply, *no* record evidence supports the jury's finding that $23.94 of inflation was introduced into the stock price by a single statement reported on March 23, 2001, but actually made 10 days earlier. As noted, Professor Fischel found only a 67 cent inflationary increase that day, and testified that Gilmer's statement about predatory lending did *not* have an inflationary impact on the stock price—the 67 cent increase was not caused by any false statement, but was the product of a modeling artifact resulting from the method Professor Fischel used to calculate inflation for all dates prior to November 15, 2001. Given this complete absence of evidence, the jury could not properly determine that Household's stock price went from having zero of its $54.72 per share price attributable to inflation on March 22, 2001, to having $23.94 of its $58.12 per share price attributable to inflation on March 23, 2001.[13]

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[13] Indeed, the March 23 statement, even if it had conveyed new information, would not be actionable under the securities law. A statement that "unethical lending practices of any type are abhorrent to our company" is mere "puffery"—a statement that investors do not take seriously in assessing a potential investment. *See ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 205-07 (2d Cir. 2009) (holding that a defendant's statements that it "set the standard for integrity" and employed a "highly disciplined risk management process" were "no more than 'puffery' which does not give rise to securities violations").

The leakage calculations adopted by the jury for the rest of the Class Period fare no better. Not a single one of the 17 statements found actionable by the jury bears any rational relationship to the supposed inflationary movement in Household's stock price. Indeed, 14 of the 17 statements at issue occurred on dates on which the jury, applying the leakage model, found no increase in inflation. *See* Doc. 1634-2 at 18-19. For example, although the jury found that a March 28, 2001 statement was fraudulent, the leakage model reflects no corresponding increase in inflation on that date. The same is true for the April 18, May 9, July 18, August 10, October 17, and November 14, 2001 statements; the January 16, March 13, April 9, May 10, and July 17, 2002 statements; and the two August 14, 2002 statements. PX1395. As for the three remaining statements, Professor Fischel's testimony confirmed that the inflationary increases reflected in his model were *not* attributable to the false statements. Professor Fischel's report stated that the purported inflation "increase" of 67 cents on March 23, 2001 was due to a modeling artifact, not fraud. Similarly, the purported inflation increase on December 4, 2001 could not have been caused by the fraudulent statement on that date because Professor Fischel testified that the statement was incorporated by the market after trading hours, meaning any increase in inflation would have occurred on December 5, 2001. Tr. 2875:5-11; 2884:25-2885:7. The leakage model found, however, no increase in inflation on that date. PX1395. As for the final date, April 17, 2002, Professor Fischel testified that there was no statistically significant price increase that day. Tr. 2909:16-18.

Further and equally contradictory, even though the jury did not find any fraudulent statement on February 27, 2002, *see* Doc. 1611, Table A, the leakage model indicates that an inflationary increase occurred on that date, *see* PX1395; Tr. 2928:11-16. The same contradiction occurs with respect to March 1, 2002, March 4, 2002, March 6, 2002, and hundreds of other dates on which the jury adopted Professor Fischel's leakage model calculations despite the absence of any finding of a false statement. PX1395.

C. The Jury's Finding That The March 23, 2001 Statement Introduced The Leakage Model's Total Sum Of Inflation Into The Stock Price Precludes A Finding Of Materiality Or Application Of The "Fraud-On-The-Market" Presumption Of Reliance To Other Statements And, Independently, Requires Judgment For Defendant Schoenholz.

The jury verdict, assigning the total sum of inflation from the leakage model to the March 23, 2001 statement, was not only legally impossible and foreclosed by the leakage model itself, but also precluded a finding of materiality, and foreclosed application of the "fraud-on-the-market" presumption of reliance, as to other statements. Independently, because jurors found Defendant Schoenholz not to be liable for that March 23 statement, he is entitled to judgment as a matter of law.

As discussed, the jury found no artificial inflation for each day from the start of the Class Period (July 30, 1999) until March 23, 2001. The jury found that statement—one relating solely to Plaintiffs' predatory lending theory—to artificially inflate Household's stock price by $23.94. For the next eight months, from March 23 to November 15, 2001, the jury found that the $23.94 of artificial inflation remained constant; none of the purportedly actionable statements during that eight-month period had any price impact. The jury then found that from November 15, 2001 until the end of the Class Period (October 11, 2002), artificial inflation decreased.[14] *See* Doc. 1780-1, Ex. A (Cornell Post-Trial Aff.) at 6-8.

Accordingly, the jury's verdict wholly untethers the vast majority of actionable

[14] During that time, the jury found only *one* actionable statement—a December 4, 2001 statement relating to Plaintiffs' re-aging theory of fraud—which inflated the price by $1.35 before dissipating within one week. PX1395. Professor Fischel testified that, if the December 4, 2001 statement were the sole actionable misstatement in the case, then only investors who purchased Household stock between December 4 and December 11, 2001 would have suffered any harm. Tr. 2883:18–2885:3.

statements from any distortions of price. Of the *17* purported misrepresentations made during the Class Period, only a single statement on March 23, 2001 (about predatory lending) and a single statement on December 4, 2001 (about re-aging) were associated with any statistically significant inflation of Household's stock price. Indeed, *none* of the restatement or re-aging statements after March 23, 2001 (with the sole exception of the December 4, 2001 statement) had any impact on the prices that investors paid for Household stock. *See id*.

"If a market is generally efficient in incorporating publicly available information into a security's market price, it is reasonable to presume that a particular public, material misrepresentation will be reflected in the security's price." *Amgen, Inc. v. Conn. Ret. Plans and Trust Fund*, 133 S. Ct. 1184, 1192 (2013). Thus, "[b]ecause immaterial information, by definition, does not affect market price, it cannot be relied upon indirectly by investors who, as the fraud-on-the-market theory presumes, rely on the market price's integrity." *Id.* at 1195.

Here, based on the flawed leakage model and its application by the jury, the jury found that *all* inflation in the market price of Household stock was attributable to the March 23, 2001 statement (*i.e.*, no other misrepresentation, with the sole exception of the December 4, 2001 statement, "affect[ed] market price"). The other statements are therefore immaterial as a matter of law. *Id.* at 1195; *see also Oran v. Stafford*, 226 F.3d 275, 282 (3d Cir. 2000) ("[I]f a company's disclosure of information has no effect on stock prices, 'it follows that the information disclosed . . . was immaterial as a matter of law.'" *Id.* (citing *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.)).

So too, because other statements did not "affect market price" by further inflating the value of Household stock, "there is no basis for presuming classwide reliance on those misrepresentations and omissions through the information-processing mechanism of the market price." *Amgen*, 133 S. Ct. at 1194; *see also, 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."); *Nathenson v. Zonagen*, 267 F.3d 400, 415 (5th Cir. 2001) (where it is established that a misrepresentation "did not affect the price of the stock" then the *Basic* presumption has been rebutted).

The Court reasoned that a statement need not correspond with any increase in inflation because "expert testimony credited by the jury" showed that a statement may cause inflation by merely "maintaining the market expectations"—that is, that a price distortion need not be reflected in an actual increase. Doc. 1822 at 3. But that "inflation maintenance" theory is legally untenable for all the reasons discussed above. *See supra*. More fundamentally, the Court's invocation of testimony supposedly "credited by the jury" to find no "triable issue" on rebuttal of the presumption of reliance is a non-sequitur where the Court instructed the Phase I jury to *presume* reliance as a matter of law.[15]

[15] The presumption of reliance on the March 23, 2001 statement had no valid basis. The jury attributed the entire $23.94 to the March 23 statement and predatory lending fraud, then suggested that subsequent restatement and re-aging statements maintained the exact level of inflation created by the March 23 statement about the separate, distinct theory of fraud. But, as discussed *supra*, there was a failure of proof: The leakage model did not disaggregate between the impacts of predatory lending, restatement, and re-aging, and indeed, under established principles of finance and economics, it could not. There was thus no rational basis for the jury's finding of a specific inflationary price impact of the March 23 statement. *See* Doc. 1780-1, Ex. A (Cornell Post-Trial Aff.) at 9-10.

The Court, in an effort to justify the jury's verdict, has previously stated that the "inextricably intertwined" nature and "interdependence of the fraudulent statements" made it "virtually impossible to parse out the damages by topic." Doc. 1822 at 4. But that justification flatly contradicted the Court's own guidance to the jury. At an April 2009 hearing about the verdict form, the Court flatly disagreed with Plaintiffs' contention that the jury need not determine which theory of fraud is implicated by which misleading statement. Tr. 4067:4–4068:2; 4068:4–15; 4069:7-11. Calling this "a formula for reversal," *id.* at 4069:13, the Court specifically directed the jury to identify the fraud theory for each statement deemed actionable.

Independently, because the jury found that *all* inflation in the market price of Household stock was attributable to the March 23, 2001 statement, but that Defendant Schoenholz was not liable for that statement, Doc. 1611, Schoenholz is entitled to judgment as a matter of law.[16]

II. PLAINTIFFS' THEORIES OF FRAUD FAILED AS A MATTER OF LAW.

Judgment in Defendants' favor is further required as a matter of law because there was no legally tenable basis for the jury to find the three theories of fraud presented by Plaintiffs to be actionable. In particular, as a matter of law, the record evidence fails to meet the requisite standards of scienter to support the imposition of § 10(b) and Rule 10b-5 liability.

To establish scienter in the securities fraud context, the plaintiff must show that the defendant "either knew the statement was false or was reckless in disregarding a substantial risk of its being false." *City of Livonia Emps.' Ret. Sys. & Local 295/Local 851, IBT v. Boeing Co.*, 711 F.3d 754, 756 (7th Cir. 2013). Plaintiffs' blurring of the three theories of fraud cannot hide their obligation to satisfy each element of a violation as to each alleged fraud and each alleged statement. "Establishing scienter is often a plaintiff's greatest hurdle," *Wade v. WellPoint, Inc.*, 892 F. Supp. 2d 1102, 1124 (S.D. Ind. 2012), and here that hurdle was not cleared.

Id. at 4070:2-5; *see also id.* at 4715:11-14 (in determining whether a statement was false or misleading as to an 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"). The Court even issued rulings to ensure that only the specific issue that a statement might concern was included on the verdict form. *E.g.*, Doc. 1602 at 2 ("the Court strikes from the verdict form the 'predatory lending' option with respect to [proposed verdict form] statements" 1, 3, 5, 7, 9, 12, 17, 20, 22, 32, and 38). The Court should not endorse a fatally inconsistent approach now.

[16] Indeed, this simply underscores the irrationality of the verdict. Although the jury found Schoenholz was not liable for the statement to which they ascribed *all* inflation, jurors nonetheless found Schoenholz 15% responsible "for any loss plaintiffs suffered." Doc. 1611.

A. The Restatement Theory.

Plaintiffs' theory is that Household's 2002 announcement—that it was restating income reported in its year-end 1999, 2000, 2001, and first-quarter 2002 financial statements due to a change in accounting treatment for certain credit card servicing contracts—resulted from fraudulent accounting. But this theory fails as a matter of law because Plaintiffs cannot show scienter from a restatement or GAAP violation standing alone. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976); *Roth v. OfficeMax, Inc.*, 527 F. Supp. 2d 791, 797 (N.D. Ill. 2007).

To be sure, Plaintiffs paid lip service to a handful of circumstantial "red flags" beyond the restatement as further evidence of scienter. First, Plaintiffs invoked strained innuendo about the size of the restated accounting and potential for increased compensation. But such innuendo is manifestly insufficient to establish an intent to deceive or defraud investors. *See Plumbers & Pipefitters Local Union 719 Pension Fund v. Zimmer Holdings, Inc.*, 679 F.3d 952, 956 (7th Cir. 2012) (declining to "infer scienter" because the generic fact that "managers had an incentive to … improve their bonuses … does not imply that any particular manager committed fraud"); *In re Bally Total Fitness Sec. Litig.*, 2006 WL 3714708, at *7 (N.D. Ill. July 12, 2006) (the "Seventh Circuit has observed that even a very large restatement is not itself evidence of scienter").

Second, Plaintiffs pointed to an Office of the Comptroller of the Currency (OCC) report from 1998 that raised a single question about Household's accounting of three contracts. But far from feigning ignorance, Household's management relied in good faith on the contrary advice of its then-external auditors. As is undisputed, Arthur Andersen signed off on the accounting every year until KPMG recommended a different course in 2002. Tr. 2173:19-2175:19, 2587:3-22; Tr. 2174:12-2178:6 (Schoenholz), Tr. 3216:11-3218:5, 3219:23-3220:8 (Aldinger). *See Stavroff v. Meyo*, No. 95-4118, 1997 WL 720475, at *6 (N.D. Ohio Nov. 12, 1997); *Mathews v. Centex Telemanagement, Inc.*, No. C-92-1837-CAL, 1994 WL 269734, at *7 (N.D. Cal. June 8, 1994).

And the divergence of opinions between Arthur Andersen, KPMG, the OCC, the OCC Ombudsman, and Plaintiffs' experts over the correct accounting treatment only reinforces the reasonableness of Household's choice of one tack before the other. That legitimate difference of expert opinion further negates scienter. *See, e.g.*, *In re Allscripts, Inc. Sec. Litig*, No. 00–c–6796, 2001 WL 743411, at *11 (N.D. Ill. June 29, 2001) (noting the difficulty of creating inferences of scienter even with clear accounting errors).

B. The Predatory Lending Theory.

Plaintiffs' second theory is that Household fraudulently concealed its predatory lending practices on 10 occasions. But that theory too fails as a matter of law because none of the statements supports Plaintiffs' claims that Household acted with deceptive intent.

All but one of the 10 statements were accurate recitations of Household's actual revenues and growth in press releases and earnings reports. Plaintiffs contend that those materials were misleading because Household should have further disclosed that such revenues and growth could not be sustained going forward. But those statements of the company's financials did not put Household's lending practices squarely at issue. Nor did they give rise to a duty to disclose the specific subject of Household's alleged predatory loan origination practices; indeed, the Court previously recognized that Plaintiffs could not proceed on their predatory lending theory as to Household's 10-Qs and 1999 10-K because "they are, with respect to revenues derived from lending, just accurate recitations of historical information, which do not give rise to section 10(b) or Rule 10b-5 liability." Doc. 1602; *see also In re Almost Family, Inc. Sec. Litig.*, 3:10-CV-00520-H, 2012 WL 443461, at *4 (W.D. Ky. Feb. 10, 2012) ("Plaintiffs do not specifically allege that the financials themselves were substantively inaccurate . . . . [S]uch 'hard' information, when accurate, cannot serve as the premise for a violation of federal securities law."). And those statements did not give rise to a duty to disclose the unsustainability of that level of growth going forward. *See Searls v. Glasser*, 64 F.3d 1061, 1066 (7th Cir. 1995).

The tenth statement, meanwhile, was an industry publication's reprint of a single-sentence remark by an executive that "[u]nethical lending practices of any type are abhorrent to our company, our employees and most importantly our customers." Doc. 1611, Table A, No. 14. That generic and immaterial puffery "contains no useful information upon which a reasonable investor would base a decision to invest" and is nonmaterial by definition. *Searls*, 64 F.3d at 1066; *see supra* note 13; *see also City of Sterling Heights Gen. Emps.' Retirement Sys. v. Hospira, Inc.*, No. 11 C 8332, 2013 WL 566805, at *24 (N.D. Ill. Feb. 13, 2013) (describing vague statements about company's "commitment to quality" and "culture of continuous improvement" as nonmaterial puffery).

More generally, any inference of scienter was belied by proof that Household was exceptionally forthcoming about its lending practices and the investment risks. Defendants adduced undisputed evidence that Household's management actively promoted responsible lending practices and reasonably believed that over 99% of Household's loans were compliant with the law. In fact, contrary to the unreliable opinion of Plaintiffs' witness Catherine Ghighlieri that Household engaged in systematic predatory lending practices, Tr. 615:15-16, it was undisputed that the total number of unresolved complaints fell well under 0.5% of Household's outstanding loans. Tr. 1255:6-1257:11 (Gilmer); PX242, 245, 794, DX143 (only 0.00141% of Household customers filed complaints).

In addition, Household's business operations, criticisms of those operations, and the risks associated with the subprime lending model were all public knowledge. *See Higginbotham v. Baxter Int'l, Inc.*, 495 F.3d 753, 759 (7th Cir. 2007) ("no duty to disclose "information … already in the public domain"). Not only were ACORN and other consumer advocacy groups vocal critics of Household's lending practices, but in March 2001 and April 2002, proposals detailing the increasing scrutiny of such practices were distributed to all Household shareholders for consideration at their annual meeting. DX360 at 21; Tr. 3162:5-3168:1; DX99 at 23; Tr. 3173:20-3174:20. Thus, the jury's conclusion that Household intentionally and fraudulently concealed such lending practices from the public is contradicted by the clear weight of the evidence.

C. The Re-Aging Theory.

Plaintiffs' third theory is that Household fraudulently concealed its credit quality by re-aging loans in order to defer charge-offs and restore delinquent loans to current status. But the accuracy of Household's data and the extensiveness of its accompanying disclosures regarding loss reserves and probable loan losses thoroughly dispel the suggestion that any minor inaccuracies were made with knowledge of falsity or recklessness.

Plaintiffs failed to prove that Household's loan-delinquency data reported in its earnings reports and press releases were inaccurate. In fact, the actual reported 2+ figures and reserves were never restated. And as accurate descriptions of financial results, as a matter of law they cannot sustain 10b-5 liability. *See, e.g.*, *In re Sofamor Danek*, 123 F.3d 394, 400 n.3 (6th Cir. 1997). Thus, the nub of Plaintiffs' claim is that Household failed to disclose the true purpose of its re-aging policy changes. In essence, Plaintiffs assert that management should have taken charge-offs earlier—that is, written off the bad investment sooner. But this is at its core a disagreement with a management decision, not fraud. *See DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990) ("If all that is involved is a dispute about the timing of a writeoff … we do not have fraud; we may not even have negligence.").

Moreover, in the very reports disclosing delinquency data, Household made candid disclosures about its loss reserves and probable loan losses that further negate any inference of scienter. *See Allscripts*, 2001 WL 743411, at *9 (defendant "confronted squarely in its Form 10-K the risks of its endeavor" and had "no companion duty to report every glitch that arises"). The bare handful of supposed discrepancies Plaintiffs point to in the April 2002 FRC are patently immaterial—for instance, one listed the subset of loans re-aged multiple times as 4.3% rather than 7.5%, while correctly stating the total percentage of reaged accounts. Tr. 2156:24-2158:18. And, in any event, the corrective disclosure exposing this supposed discrepancy did not occur until months *after* the Relevant Period. *See* Tr. 2451:22-2453:7 (Devor); Tr. 4285:7-11 (Fischel); Tr. 4499:2-4500:15. As in *Ray*, 482 F.3d at 995-96 (7th Cir. 2007), where the court affirmed summary judgment was "inevitable" where the alleged corrective disclosure was not made until after the stock price already collapsed, here the disclosure came too late. Thus, judgment for Defendants is required with respect to the alleged re-aging fraud.

III. ERRORS IN THE JURY INSTRUCTIONS AND VERDICT FORM YIELDED AN IMPROPER AND IRRATIONAL VERDICT REQUIRING A NEW TRIAL.

A. The Jury Was Incorrectly Instructed.

When a jury is given an erroneous legal instruction on a fundamental element of a cause of action, and thereby permitted to apply an erroneous theory of law, a new trial is mandated. *See Dawson*, 135 F.3d at 1165; *cf. River Rouge Improvement Co.*, 269 U.S. at 421 ("[T]he error in the charge could not but mislead the jury in reference to a material element necessary for its consideration. . . .").

As explained in *Dawson*, "[w]hen a jury could have based its verdict on either correct or incorrect statements of the law, its verdict must be set aside even if the verdict may have been based on a theory on which the jury was properly instructed." 135 F.3d at 1165 (internal quotations and citations omitted). Courts do "not assume that the jury decided one way or another. Prejudice to the complaining party includes the possibility that the jury based its decision on incorrect law." *Id.* (internal quotations and citations omitted).

Here, over Defendants' objection, the jury was erroneously instructed on the central elements of (1) responsibility for the "making" of a misrepresentation and (2) scienter. The prejudice arising from these fundamental errors of law, and the associated jury confusion, permeates the verdict—infecting the consideration of primary liability, secondary liability and allocation of liability. A new trial is required as a matter of law.

1. *The Jury Instruction On Responsibility For A Representation Is Flatly Inconsistent With The Supreme Court's Decision In* Janus*.*

The jury instruction on the first element of the Rule 10b-5 claim directed jurors to address whether

> the defendant made, ***approved, or furnished information to be included in*** a false statement of fact or omitted a fact that was necessary, in light of the circumstances, to prevent a statement that was made from being false or misleading during the relevant time period between July 30, 1999, and October 11, 2002 . . . .

Tr. 4714:5-10 (emphasis added). Defendants repeatedly objected to the Court's inclusion of the "approved, or furnished information" language as a misstatement of governing law. *E.g.*, *id.* at 3853:9-16, 3862:13-15, 4004:10-23. Defendants emphasized that this error of law would adversely impact not only the first element of the cause of action, but also the issues of scienter, secondary liability, and the allocation of liability among the Defendants. *E.g.*, *id.* at 3840:10-3843:6, 3858:12-3859:8, 3860:6-20. The Court itself noted that this aspect of the instruction could give rise to reversible error. *Id*. at 3848.

That error is now confirmed unequivocally by Supreme Court precedent. *See Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). In *Janus*, the Supreme Court squarely addressed and rejected the position that furnishing information to be included in a statement renders one responsible for the statement under § 10(b) and Rule 10b-5. *Id*. at 2302. The Court held the position advanced by the Government—that one who "'provides the false or misleading information that another person then puts into the statement'" may be found directly responsible under the Act—to misstate the law. *Id*. at 2303. The Court made clear that "'[s]ubstantial assistance'" in formulating the content of a representation is not itself a basis for direct liability in a private right of action under § 10(b) and Rule 10b-5. *Id.* at 2302. Rather, the statutory language permitting a private cause of action against one who "make[s] any untrue statement of a material fact" is to be construed as meaning that "[o]ne 'makes' a statement by stating it." *Id*. at 2301. The Seventh Circuit has further noted that a plaintiff may not attempt to "get around" *Janus* by asserting that a defendant who did not "make" a statement nonetheless has a duty to correct a misstatement made by another—"no statute or rule creates such a duty." *Fulton Cnty. Emps. Ret. Sys. v. MGIC Inv. Corp.*, 675 F.3d 1047, 1051-52 (7th Cir. 2012).

In addition to *ipso jure* prejudice, this misstatement of law and the resulting juror confusion manifested itself in an irrational and unsupportable verdict. For instance, Gary Gilmer (an officer of a corporate subsidiary) was found responsible as a "maker" of representations in Household's Form 10-K and 10-Q filings despite not "making," in any plausible respect, the identified statements in those filings (at best, the subsidiary company of which he was an officer "furnished" limited information used by others to prepare the filings). This finding cannot be reconciled with *Janus*. *See, e.g.*, *City of Roseville Emps.' Ret. Sys. v. EnergySolutions, Inc.*, 814 F. Supp. 2d 395, 417 (S.D.N.Y. 2011) (holding, under *Janus*, that two individuals could not be held liable for misstatements in a registration statement they did not sign). Indeed, under a proper application of the law, Gilmer could not have been found to be a "maker" of 16 of the 17 statements found by the jury to be actionable.

As to the one statement actually made by Gilmer—the statement in the March 23, 2001 *Origination News* article to which the jury assigned the entire $23.94 of "artificial inflation" in Household's stock price—the error is equally manifest. The quote in the article is attributed solely to Gilmer, who was interviewed as "president and chief executive of Household's subsidiaries HFC and Beneficial." Doc. 1611, Table A, No. 14. As *Janus* directs, "in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed." 131 S. Ct. at 2302. There is no evidence of any kind that Aldinger, the CEO of parent Household, was directly responsible for, *i.e.* "made," this quoted statement attributed solely to Gilmer. Yet, based on the erroneous jury instruction, the jurors found that Aldinger and Household were "knowing" makers of this statement that was made "recklessly" by Gilmer alone. Doc. 1611 at 14.

Similar manifest errors permeate the verdict. For instance, the jury found that Gilmer and Schoenholz "made" a statement that was, in fact, made solely by Aldinger during a Goldman Sachs presentation on December 4, 2001. *Id.* at 23. Likewise, the jury found that Gilmer and Aldinger "made" statements that, in fact, were made solely by Schoenholz at a conference on April 9, 2002. *Id.* at 28. These findings are flatly inconsistent with *Janus*. *See, e.g., In re UBS Sec. Litig.*, No. 07 Civ. 11225 (RJS), 2012 U.S. Dist. LEXIS 141449, at *32 (S.D.N.Y. Sept. 28, 2012) (noting that "a theory of liability premised on treating corporate insiders as a group cannot survive a plain reading of the *Janus* decision" and citing decisions).

As the jury's finding with respect to the March 23, 2001 statement illustrates, this patent error of law impacted not only the first element of the Rule 10b-5 claim, but also the jury's consideration of other central elements of the claim, such as scienter. Scienter, of course, depends on the state of mind of the person who actually made the statement at issue. 15 U.S.C § 78u-4(b)(2) (requiring that allegations give rise to a strong inference that "the defendant" acted with the required state of mind); *see also Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 364-65 (5th Cir. 2004) ("These PSLRA references to 'the defendant' may only reasonably be understood to mean 'each defendant' in multiple defendant cases, as it is inconceivable that Congress intended liability of any defendants to depend on whether they were all sued in a single action or were each sued alone in several separate actions."); *accord Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 603 (7th Cir. 2006) ("While we will aggregate the allegations in the complaint to determine whether it creates a strong inference of scienter, plaintiffs must create this inference with respect to each individual defendant in multiple defendant cases."), *vacated on other grounds*, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 329 (2007); *see also Pugh v. Tribune Co.*, 521 F.3d 686, 693 (7th Cir. 2008) (rejecting group pleading doctrine and holding that a plaintiff "must create a strong inference of scienter with respect to each individual defendant"). Yet, for the March 23, 2001 quote, the jury found the statement to have been "knowingly" made by Aldinger and Household only by assigning scienter to these Defendants who, by law, could not be held primarily liable for "making" the statement at all. Accordingly, Aldinger and Household are entitled to judgment as a matter of law as to this statement or, at the very least, a new trial.

This error of law as to legal responsibility also necessarily infected the jury's consideration of the proper apportionment of liability among the four Defendants. Given the jury's erroneous determination of which Defendants were responsible for each of the 17 statements found actionable, the jury apportioned liability as follows: Household (55%); Aldinger (20%); Schoenholz (15%); and Gilmer (10%). Doc. 1611 at 42. Had the jury been instructed properly on when a defendant is legally responsible for a misstatement, the consideration of apportionment would have been informed in a materially different manner. The Court cannot speculate that the jury would have arrived at this same allocation of responsibility had it been properly instructed. *Dawson*, 135 F.3d at 1165.

2. The Jury Was Improperly Instructed On Scienter.

The jury also was improperly instructed on the third element of Plaintiffs' § 10(b) claim. With respect to the scienter element, the jury was instructed:

> Defendants William Aldinger, David Schoenholz, Gary Gilmer acted with the required state of mind in making a statement of material fact if he made the statement knowing that it was false or misleading or with reckless disregard for a substantial risk that it was false or misleading. . . .
>
> A defendant's conduct is reckless if it is an extreme departure from the standards of ordinary care and he knows that it presents a risk of misleading investors or the risk is so obvious that he had to have been aware of it.
>
> ***A finding that any defendant acted with the required state of mind depends on what he knew or should have known when he made a particular statement or omission.***

Tr. 4717:7-12; 4717:20-4718:1 (emphasis added). The Court added the "knew or should have known" clause *sua sponte* and over Defendants' objection. *Id.* at 4688:23-4690:24. Defendants made clear that this clause is "inconsistent with the definition of recklessness that has been given by Seventh Circuit, which has specifically rejected any finding of scienter on the basis of negligence." *Id.* at 4688:7-10. The Court overruled Defendants' objection, stating: "I feel the language that we've included in here comes straight out of the case law, and it's appropriate. And so I'll give it over the objections." *Id.* at 4691:7-9.[17]

[17] Defendants repeatedly requested that the Court instruct the jury that "'scienter' refers to a mental state embracing intent to deceive, manipulate, or defraud." *See, e.g.*, PTC Tr. 486:15-23; Tr. 4028:13-22; 4418:2-4419:1; 4687:9-20; Doc. 1585 at 6. The requested instruction was based on the Supreme Court's definition of scienter in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193

Contrary to the Court's ruling, *no* governing precedent imports a "knew or should have known" standard into the scienter requirement of a Rule 10b-5 claim. In *Hochfelder,* the Supreme Court held that negligence does *not* meet the scienter requirement. 425 U.S. at 193 & n.12. The Supreme Court has reiterated that holding on several occasions. *See Herman & Maclean v. Huddleston*, 459 U.S. 375, 383 (1983) ("[A]ctions under § 10(b) require proof of scienter and do not encompass negligent conduct."); *Merck & Co. v. Reynolds*, 559 U.S. 633, 130 S. Ct. 1784, 1796 (2010) ("A plaintiff cannot recover without proving that a defendant made a material misstatement *with an intent to deceive*—not merely innocently or negligently."). Further, the Seventh Circuit repeatedly has emphasized that the "recklessness" standard employed in the Rule 10b-5 context is a heightened, "extreme" standard. *See, e.g., City of Livonia Emps.' Ret. Sys.*, 711 F.3d at 756 (internal citations omitted).[18]

The Court's instruction to the jury to evaluate a Defendant's scienter based on "what he knew *or should have known* when he made a particular statement or omission" impermissibly compromised the required distinction between the heightened recklessness standard applicable to Rule 10b-5 claims and the "should have known" standard of negligence. *See, e.g.*, *Dolphin and Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (holding that extreme recklessness "does not involve a 'should have known standard" (internal citation omitted)); *Glazer Capital Mgmt., LP v. Magistri*, 549 F.3d 736, 748 (9th Cir. 2008) (allegation that defendant "should have known" was insufficient because scienter requires "some degree of intentional or conscious

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n.12 (1976). Defendants also requested that the jury be given the Seventh Circuit's complete definition of recklessness and instructed that mere negligence does not constitute recklessness. Doc. 1585 at 6-8.

[18] The Supreme Court has yet to address whether recklessness is a sufficient basis for scienter under the federal securities laws. *See Hochfelder*, 425 U.S. at 108 n.12 (reserving issue); *Tellabs*, 551 U.S. at 319 n.3. (same); *Matrixx*, 131 S. Ct. at 1323-24 (assuming, without deciding that "deliberate recklessness" standard applied by Ninth Circuit was sufficient to establish scienter).

misconduct" (internal quotations and citation omitted)); *Howard v. SEC*, 376 F.3d 1136, 1138 (D.C. Cir. 2004) (concluding that the SEC "wound up applying a 'should have known' negligence standard," and finding that, under a correct recklessness scienter standard, the evidence was insufficient to sustain most of the charges against the defendant).

Notably, even *Plaintiffs'* proposed scienter instruction required proof of a Defendant's awareness of the possibility of deception. Doc. 1545-7 at 34. This Court's *sua sponte* insertion of the "should have known" clause into the scienter instruction is at odds with the controlling decisions of the Supreme Court and the Seventh Circuit, as well as with every published Circuit Court pattern jury instruction.[19]

The prejudice to Defendants is plain. As set forth in Section II, Plaintiffs' fraud theories fell well-short of the scienter required to sustain a Rule 10b-5 claim. Nonetheless, jurors were permitted to evaluate a Defendant's scienter for a given statement based upon information unknown to that Defendant but which jurors believed "should have been known" to the Defendant. No governing precedent supports such a dilution of the strict scienter requirement and the instruction misstates the law. *See Dawson*, 135 F.3d at 1167 (reversing and remanding where jury instruction on legal standard of "recklessness" in defamation case was insufficient). Of course, this dilution of the scienter standard also misinformed and compromised other aspects of the verdict, such as the jury's consideration of the allocation of responsibility among Defendants.

B. The Verdict Form Was Defective.

The prejudicial errors of law set forth in the improper jury instructions were further compounded by a defective verdict form that directed jurors in a legally erroneous manner. *See,*

[19] Pattern Jury Instructions (Civil Cases) – Fifth Circuit § 7.1 at 78; Manual of Model Civil Jury Instructions – Ninth Circuit § 18.3, at 489 (2007); Pattern Jury Instructions (Civil Cases) – Eleventh Circuit § 4.2, at 262; *see also* American Bar Association, Model Jury Instructions – Securities Litigation § 4.02[4].

e.g., *Malone v. ReliaStar Life Ins. Co.*, 558 F.3d 683, 694 (7th Cir. 2009) (ordering new trial because of combined effect of errors in jury instructions and errors in verdict form: "Considered together, . . . these errors were anything but harmless."); *Umpleby v. Potter & Brumfield, Inc.*, 69 F.3d 209, 214 (7th Cir. 1995) (ordering new trial where "[t]he jury instructions not only did not correct this error in the verdict form, but more likely further clouded the picture.").

Defendants consistently requested a verdict form that would ensure proper consideration by the jurors of each required element with respect to the specific misrepresentations alleged. Doc. 1546-6 at 19-27; Doc. 1546-7 at 2-58; Doc. 1607; Tr. 4365:1-16. Defendants' proffered verdict form was rejected and the verdict form tendered by the Court, over objection, directed the jurors to consider and complete the verdict in a legally erroneous manner.

1. *Arthur Andersen Was Wrongly Excluded From The Set Of Those Potentially At "Fault" For Plaintiffs' Losses, Rendering The Apportionment Verdict Legally Defective.*

Plaintiffs' [Corrected] Amended Complaint (Doc. 54) devoted more than ten pages to a description of how Household's former auditor, Arthur Andersen LLP ("Andersen"), participated in Defendants' purported fraud, including allegations that Andersen made false statements with scienter in violation of § 10(b) and Rule 10b-5. *See Amgen*, 133 S. Ct. at 1197 n.6 (noting that a party "remains bound" by pleadings, which constitute "'judicial admissions conclusively binding on the party who made them'" (internal citations omitted)). On April 6, 2006, Andersen settled with Plaintiffs. Doc. 485. At trial, however, the Court allowed Plaintiffs to strike any reference to Andersen from the allocation of responsibility section of the verdict form. Doc. 1601. The two reasons given by the Court for this decision are incorrect as a matter of law.

First, the Court, after noting that Plaintiffs alleged Andersen knowingly made false statements of material fact, incorrectly held that the PSLRA does not permit liability to be apportioned among knowing violators of the securities laws. *Id.* at 2. To the contrary, the

PSLRA *requires* liability to be apportioned among *all* persons claimed to have caused or contributed to the plaintiff's losses. The PSLRA provides, in pertinent part:

> [T]he court shall instruct the jury to answer special interrogatories . . . with respect to each covered person *and each of the other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff, including persons who have entered into settlements with the plaintiff or plaintiffs,* concerning: (i) whether such person violated the securities laws; (ii) the percentage of responsibility of such person, measured as a percentage of the *total fault* of all persons who caused or contributed to the loss incurred by the plaintiff; and (iii) whether such person knowingly committed a violation of the securities laws.

15 U.S.C. §78u-4(f)(3)(A) (emphasis added). Consideration of whether a defendant to whom liability has been apportioned acted knowingly or recklessly comes only *after* the allocation of liability among all responsible parties is determined. *Laperriere v. Vesta Ins. Group, Inc.*, 526 F.3d 715, 720-21 (11th Cir. 2008) (describing the three-step process for apportioning liability under the PSLRA). Pursuant to the plain language of the statute, the jury should have been required to answer, in order, the three interrogatories listed in § 78u-4(f)(3)(A) as to each of the four remaining Defendants and Andersen.

Second, the Court ruled that no evidence had been introduced from which a reasonable jury could conclude that Andersen recklessly violated the securities laws. Doc. 1601 at 2. This holding ignores that the relevant statutory inquiry under the PSLRA is the "total fault" of those who "caused or contributed to the loss," is inconsistent with the evidence, and disregards the legal effect of Plaintiffs' own pleadings. Trial testimony established, without contradiction, that Andersen and Household were inextricably intertwined in the preparation of the challenged financial statements Household was later required to restate. Tr. 2173:17-25, 2174:1-4, 2174:25-2176:12, 2521:21-2522:5. As Schoenholz testified, Andersen "had done the original audit work of those financial statements and had valid audit opinions . . . that were in effect for 1999, 2000 and 2001." *Id.* at 2174:1-4. Aldinger agreed that "Household's previous accounting treatment was . . . blessed repeatedly over the years by . . . Andersen," and that "[i]n one case, the company even received such a 'blessing' from the senior technical person at Andersen. . . ." *Id.* at 3235:12-3236:12; DX558. If such evidence is sufficient to support a jury finding that Defendants acted with scienter in connection with the alleged accounting fraud (and Defendants contend that it is not), the same evidence is equally applicable to support a finding that Andersen was also at fault.

Furthermore, given the express allegations in Plaintiffs' Amended Complaint regarding Andersen's role in the alleged fraud, Plaintiffs were estopped from arguing that Andersen bore no responsibility for Plaintiffs' losses. *Amgen*, 133 S. Ct. at 1197 n.6; *see also, e.g.*, *Guise v. BWM Mortg., LLC*, 377 F.3d 795, 801 (7th Cir. 2004) ("Judicial admissions are concessions in the pleadings that bind the party making them and that withdraw a fact from contention"); *Soo Line R.R. v. St. Louis Sw. Ry. Co.*, 125 F.3d 481, 483 (7th Cir. 1997) (noting "the well-settled rule that a party is bound by what it states in its pleadings"); *Higgins v. Mississippi*, 217 F.3d 951, 955 (7th Cir. 2000) ("[A] judicial admission is in the nature of a waiver.").

Excluding Andersen from the jury verdict form prejudiced Defendants by depriving them of their statutory right to have any final judgment reduced by the greater of Andersen's settlement or Andersen's percentage of responsibility for Plaintiffs' losses, as determined by the jury. 15 U.S.C. § 78u-4(f)(7)(B). Only a new trial can correct this fundamental error.

2. The Verdict Form Rendered The Section 20(a) Verdict Legally Deficient, Unsupported, And Irrational.

Plaintiffs' failure to prove a primary violation of § 10(b) and Rule 10b-5 by any Defendant necessarily constitutes a failure of proof with respect to Plaintiffs' § 20(a) claims for controlling person liability against Aldinger and Schoenholz. *See Pugh v. Tribune Co.*, 521 F.3d

686, 693 (7th Cir. 2008). Regardless, defects in the verdict form lead to irrational findings as to secondary liability under § 20(a).

The Seventh Circuit directs "a two-prong test for determining control person liability" pursuant to § 20(a) of the Securities Exchange Act, 15 U.S.C. § 20(a), 15 U.S.C. § 78t(a). *Donohoe v. Consolidated Operating & Prod. Corp.*, 30 F.3d 907, 911 (7th Cir. 1994). "First, the 'control person' needs to have actually exercised general control over the operations of the wrongdoer, and second, the control person must have had the power or ability—even if not exercised—to control *the specific transaction or activity* that is alleged to give rise to liability." *Id*. at 911-12 (emphasis added).

The verdict form failed to require the jury to find, as it needed to, control with regard to a "specific transaction or activity" for which a primary violation was found—namely, the making of a particular false statement or omission of material fact as to one of the three theories of fraud advanced by Plaintiffs. Rather, the verdict form contained only the free-floating, generic question: "With respect to the Section 20(a) claim, have plaintiffs proved that Defendant [Aldinger, Schoenholz or Gilmer] is a controlling person as to [the other Defendants]." Doc. 1611 at 43. Defendants' objection to this legal deficiency and failure to require specificity was denied. Tr. 4372:9-4376:17.

Without application to any particular statement or issue, the jury found generically that Aldinger was a controlling person as to Household, Schoenholz, and Gilmer; and Schoenholz was a controlling person as to Household, Aldinger, and Gilmer. Doc. 1611 at 43. By failing to require that §20(a) secondary liability be determined with respect to the particular misrepresentations at issue, the verdict form yielded an ungrounded verdict that is irrational and unsupported as to the specific transactions found actionable.

For instance, as already discussed, the statement parroted in the March 23, 2001 *Origination News* article to which the jury attributed the entire $23.94 of "artificial inflation" in Household's stock price was made solely by Gilmer. There is no evidence that Aldinger or Schoenholz had any involvement with, or control over, Gilmer with respect to Gilmer's making of this "reckless" comment. Gilmer spoke as "president and chief executive of Household's subsidiaries HFC and Beneficial," Doc. 1611 at 11 & Table A, No. 14. Plaintiffs presented no evidence from which the jury could have concluded that Aldinger and Schoenholz controlled the making of this quoted statement by an officer of a Household subsidiary.

Moreover, there was no evidence to support the jury's irrational conclusion that Schoenholz, a lower ranking officer of the Company who reported to Aldinger, "controlled" Aldinger, the CEO of the Company, as to any statements made by Aldinger.[20]

In sum, this confluence of errors in both the instructions and verdict form misstated the law, confused the jurors, and yielded a defective, unsupported, and irrational verdict.[21] Such

[20] Even if Schoenholz were a controlling person under § 20(a), his proportionate share of the total liability could not exceed 15 percent. Schoenholz did not act "knowingly" with respect to any misstatement for which the jury found he was responsible, Doc. 1611 at 15-18, 20-24, 27-29, 32, 36-38, and his share of liability was limited to 15 percent, *id.* at 42. *See, e.g.*, *Laperriere*, 526 F.3d at 727-28 (PSLRA's proportionate liability provisions, 15 U.S.C. § 78u-4(f)(2), override § 20(a)'s joint and several liability provisions).

[21] There are multiple other inconsistencies and irrationalities with the verdict, including, *inter alia*: (1) jurors finding only certain 10-K and 10-Q reports actionable despite the undisputed evidence that the accounting methodology at issue was adopted in 1994, well before the start of the Relevant Period, and used until the restatement was announced, *e.g.*, Tr. 2050:12-2051:1, 2489:2-2490:4, 2516:19-2520:25, 3215:16-19; (2) the jury finding that the 10-Q Household filed on August 14, 2002, DX874, which Plaintiffs' alleged contained the "corrective disclosure" of Household's previous, allegedly fraudulent method of accounting for credit card marketing contracts, Tr. 2931:12-18, contained the very accounting fraud that Plaintiffs attributed to the prior accounting methodology and that the report allegedly exposed, Doc. 1611, No. 38.; and (3) the jury finding that Defendants were liable for statements in Household's 2000 10-K, issued on March 28, 2001, Doc. 1611, No. 15, even though it found no liability for the disclosure of the identical information in a press release on January 17, 2001, both of which reported on Household's annual and fourth-quarter results for the year 2000 and presented identical

errors permeated the jury's consideration of primary responsibility, scienter, price inflation caused by specific representations, secondary liability with respect to specific misrepresentations, and allocation of liability. To allow such a verdict to stand would be a "miscarriage of justice." *Frain v. Andy Frain, Inc.*, 660 F. Supp. 97, 103 (N.D. Ill. 1987).[22]

IV. THE AGGREGATE IMPACT OF ERRONEOUS EVIDENTIARY RULINGS RESULTED IN AN UNFAIR TRIAL.

Over and above the instructional and verdict errors that mandate a new trial as a matter of law, the trial was also unduly impacted by evidentiary errors that independently, and in the aggregate, resulted in an unfair and prejudicial proceeding that requires a new trial.

A. The Court Erred By Admitting Prejudicial And Unsupported Expert Testimony.

Because the testimony of an expert witness exerts a powerful influence on a lay jury, *see United Stated v. Brown*, 7 F.3d 648, 655 (7th Cir. 1993), the district court bears a heavy responsibility to act as a vigilant "gatekeeper" at each and every step to ensure that such testimony is both relevant and reliable. *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 147-49 (1999) (interpreting *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579 (1993)). "The opportunity for vigorous cross examination and the presentation of contrary evidence—the traditional and appropriate means of attacking shaky but admissible evidence—is not a basis for allowing otherwise inadmissible testimony to be admitted." *Loeffel Steel Prods., Inc. v. Delta Brands, Inc.*, 387 F. Supp. 2d 795, 800 (N.D. Ill. 2005) (internal citation omitted).

A cornerstone of the analysis required under *Daubert* and *Kumho Tire* is the determination that the proposed expert has arrived at his or her conclusions through an analytical

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information relating to net income and delinquencies. Doc. 1611, No. 13.

[22] Defendants objected to inconsistencies in the verdict before the jury was excused. Tr. 4806:25-4807:10 ("We believe the verdict is fatally inconsistent in a number of ways, which we're prepared to detail to the Court.").

process that is verifiable, *i.e.*, a process that could be replicated, and the results verified, by another expert working with the same underlying information. *See, e.g.*, *Zenith Elec. Corp. v. WH-TV Broad. Corp.*, 395 F.3d 416, 419 (7th Cir. 2005) ("Someone else using the same data and methods must be able to replicate the result."). Mere "subjective belief or unsupported speculation" is unacceptable, even when offered by an otherwise qualified expert. *Daubert*, 509 U.S. at 590; *Lewis v. CITGO Petroleum Corp.*, 561 F.3d 698, 705 (7th Cir. 2009). Based on this controlling law, the testimony of Plaintiffs' experts Catherine Ghiglieri, Charles Cross, and Harris Devor should have been excluded.[23]

1. Ghiglieri's Subjective And Unreliable Testimony Should Have Been Excluded.

Plaintiffs proffered Ghiglieri as their "expert" on consumer lending practices. In her seven years as Texas Banking Commissioner and 18 years at the Office of the Comptroller of Currency, Ghiglieri never regulated a consumer lending company. *See* Tr. 378:20-388:13, 653:4-654:11. Yet, she freely offered conclusions as to consumer lending industry norms. Ghiglieri also repeatedly announced to the jury that "Household engaged in company-wide, systemic predatory lending" throughout the Relevant Period. *See* Tr. 393:13-15, 453:14-19, 600:15-20, 612:18-25, 615:7-16, 619:8-11, 628:6-11, 630:1-11, 665:3-14. In reaching this conclusion, however, Ghiglieri did not interview any of Household's peers, customers, regulators, or anyone else who might have had actual knowledge about the validity or scope of complaints regarding alleged customer abuses by Household; instead, she chose not to look beyond the limited selection of materials provided to her by Plaintiffs' counsel. Tr. 403:5-16, 704:19-707:7.

[23] For the reasons explained in Part I, *supra*, the testimony of Plaintiffs' damages expert, Professor Fischel, should have been excluded as well.

Ghiglieri admitted that she had undertaken no effort to quantify instances of alleged customer abuse at Household to determine whether they were representative of Household's overall business, Tr. 704:1-8, 928:15-929:12—the logical and legally required *sine qua non* of any attempt to portray a practice as systemic or pervasive. *See United States v. Mikos*, No. 02-137, 2003 WL 22922197, at *4 (N.D. Ill. Dec. 9, 2003) (Guzmán, J.) (an extremely small sample cannot be used reliably to extrapolate general principles); *BASF Corp. v. Old World Trading Co., Inc.*, No. 86-5602, 1992 WL 232078, at *4 (N.D. Ill. Sept. 8, 1992) (anecdotal evidence lacking statistical significance held irrelevant).

Despite the fact that the very crux of her expert testimony was the assessment of purportedly "systemic predatory lending," Ghiglieri admitted she had no idea how many Household customers were affected by the practices she claimed to be predatory or what percentage of Household's total number of loans or total loan volume may have been affected. *See* Tr. 745:16-21 ("I didn't count them, so I don't know what the number would be, plus I only looked at a subset of, you know, the total loans obviously."); Tr. 710:21-711:3; 711:13-15; 713:21-714:18; 719:5-11; 746:7-13; 930:3-931:5; 934:17-19.

Given her lack of any form of reliable analysis, Ghiglieri should not have been allowed to offer an opinion that abuses at Household were "systemic" and "pervasive." *See, e.g.*, *Minasian v. Standard Chartered Bank, PLC*, 109 F.3d 1212, 1216 (7th Cir. 1997) (affirming decision to exclude affidavit of purported banking expert because the expert "does not identify and test any hypothesis; he does not identify hypotheses considered and rejected; indeed, he does not suggest any way in which his views may be falsified"); *Porter v. Whitehall Labs., Inc.*, 9 F.3d 607, 616 (7th Cir. 1993) (affirming decision to exclude testimony of plaintiff's experts where experts "gave opinions unsupported by any method—generally accepted or otherwise"); *Lang v. Kohl's*

Food Stores, Inc., 217 F.3d 919, 924 (7th Cir. 2000) ("Talking off the cuff—deploying neither data nor analysis—is not an acceptable methodology.").

Ghiglieri's result-oriented testimony regarding Household's re-aging practices, an area in which she had no meaningful background or training, also fails *Daubert*'s reliability prong. Ghiglieri opined that "Household used various re-aging tactics and practices to mask their [sic] delinquencies." Tr. 680:24-681:4. In reaching this conclusion, Ghiglieri did not perform any analysis of Household's recidivism statistics, Tr. 928:15-19; had no concrete knowledge of the percentage of re-aged accounts that were current one year after the re-age, Tr. 928:20-929:5; did not perform a cash flow analysis to evaluate the income from re-aged accounts, Tr. 929:10-12; and did not evaluate re-aging as a factor in influencing customer behavior, Tr. 929:24-931:5. Instead of providing analytical support for her conclusions, Ghiglieri merely read aloud the text of a string of internal e-mails and then announced, *ipse dixit*, that Household had fraudulently manipulated its delinquency numbers. Tr. 681:5-700:7.[24]

In sum, Ghiglieri performed no expert analysis and employed no recognizable methodology to reach or verify her conclusory opinions. The only role Ghiglieri played was to tell the jury, from the limited stock of information she reviewed, what to think about the merits of Plaintiffs' claims. This was not proper expert testimony, and it should not have been allowed.

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[24] Ghiglieri also relied on a small, unverified and biased set of anecdotes in testifying that Household routinely trained its salespeople across the country to engage in predatory practices. Tr. 496:8-15, 513:21-514:7. Her sole support for this central conclusion was the existence of an "effective rate comparison" example in a short-lived training program, which was discontinued a mere two months after it was issued, and replaced with a version that made no reference to "effective rate comparisons," Tr. 493:11-496:19 & PX379; Tr. 926:3-927:17 & PX379, and an unauthorized and immediately confiscated amateur training video, Tr. 508:24-510:1 & PX1383; Tr. 920:18-921:6. By extrapolating from these two patently inadequate examples without reviewing or testifying about a single *authorized* training manual or program, Ghiglieri irresponsibly mischaracterized the supposed training and discipline protocol for Household's entire staff of 30,000 employees.

See, e.g., *Durkin v. Equifax Check Servs., Inc.*, 406 F.3d 410, 420-21 (7th Cir. 2005) (affirming exclusion of expert's "untestable say-so" where expert "recited" and "endorsed" plaintiff's claims without articulating any methodology by which he reached his conclusions).

2. *Cross's Biased And Statistically Inadequate Conclusions Should Have Been Excluded.*

Cross, an employee of the Washington Department of Financial Institutions (the "DFI"), was the author of a report titled "Expanded Report of Examination for Household Finance Corporation as of April 30, 2002" (the "DFI Report"). PX290. The DFI Report contained an evaluation of unadjudicated complaints from only about 20 customers in the State of Washington (out of a base of 31,292 loans) that, in Cross's opinion, reflected violations of particular state or federal regulations. DX298 at 4; Cross Tr. 49:23-50:02. Cross concluded in the DFI Report that these alleged violations and remarks made by unnamed regulators from other states demonstrated that Household was engaged in a nationwide scheme of deceptive sales practices. Cross Tr. 133:9-11, 135:23-137:10, 145:21-148:4, 150:4-9, 150:11-12, 167:16-169:14, 178:24-179:7 & PX290 at 43-49.[25]

Cross admitted outright that the handful of unadjudicated customer complaints from which he extrapolated his conclusions in the DFI Report represented a "woefully inadequate population to draw from." Cross Tr. 69:13-70:10. Cross also testified that the DFI Report was "just dealing with problems and negative issues, not the positive side of the business." Cross Tr. 85:24-86:10. Cross acknowledged that the purpose of the report was not to reach a fair evaluation of Household's practices, but rather to assemble support for his argument that "these

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[25] In a portion of his deposition that was not presented to the jury, Cross explicitly stated that, if he had been asked to testify as an expert in this case, he would have refused. Doc. 1651-2, Ex. 6 at 102:13-21. Nonetheless, Plaintiffs designated him as an expert witness and portions of his videotaped deposition were played to the jury.

consumers were harmed." Cross Tr. 88:18-89:08, 89:23-90:06. Cross's intentionally biased conclusions were unreliable and should have been excluded under *Daubert*.

3. Devor's Opinion As To Revenues Allegedly Derived From "Improper" Practices Should Have Been Excluded.

Plaintiffs' accounting expert Devor reinforced and built upon the prejudice engendered by the unreliable testimony of Ghiglieri and Cross by telling the jury that a full third of Household's annual income was "attributable" to "improper lending practices." Tr. 2414:12-2415:22; Doc. 1651, Ex. 12. Devor's conclusion rested on a critical assumption that had no support in the record and that was predicated on otherwise inadmissible and prejudicial evidence.

Devor did not take any steps to actually measure revenues or income that Household derived in a given year from alleged "improper lending practices." Tr. 2409:14-19, 2410:6-13. Instead, Devor based his opinion on two different numbers that were not—and under the principles informing Rule 408 could not properly be deemed to be—a measure of earnings from "improper practices." The first number was the amount Household agreed to pay in October 2002 to resolve an investigation by several state attorneys general. Thus Devor improperly converted an offer of compromise into an admission of wrongdoing and a supposedly expert measure of related harm. The second number, $3.2 billion, was the sum of the dollar amounts contained in an untitled and unidentified document produced by Defendants that Plaintiffs *speculated* was a quantification of Household's potential exposure from the collective opening demands of negotiators for the attorneys general.[26] The trial record contains no evidence that Plaintiffs' speculation was correct. Devor's factually unsupported testimony about the revenues Household supposedly derived from "improper lending practices" was unreliable and, under

[26] The document (PX681) was introduced during Plaintiffs' direct examination of Aldinger, who testified that he did not recognize the document. Despite the absence of any foundation, the document was admitted over Defendants' objection. Tr. 3480:1-3485:17.

Daubert, should have been excluded.

B. Plaintiffs Misused Hearsay Evidence For Improper Substantive Purposes And Improperly Circumvented Exclusion Orders.

Plaintiffs built their predatory lending case almost exclusively on prejudicial and inadmissible hearsay. Although an expert may base his or her opinions on hearsay, an expert may not be used as a vehicle to introduce otherwise inadmissible hearsay:

> The fact that inadmissible evidence is the (permissible) premise of the expert's opinion does not make that evidence admissible for other purposes, purposes independent of the opinion. . . . If for example the expert witness (call him A) bases his opinion in part on a fact (call it X) that the party's lawyer told him, the lawyer cannot in closing argument tell the jury: "See, we proved X through our expert witness, A."

James Wilson Assocs. v. Metro. Life Ins. Co., 965 F.2d 160, 173 (7th Cir. 1992); *see also, e.g.*, *Loeffel Steel*, 387 F. Supp. 2d at 808 ("[W]hile Rule 703 was intended to liberalize the rules relating to expert testimony, it was not intended to abolish the hearsay rule and to allow a witness, under the guise of giving expert testimony, to in effect become the mouthpiece of the witnesses on whose statements or opinions the expert purports to base his opinion.").

Before trial, the Court properly ruled that customer complaints and pleadings in other litigations were not to be introduced for the truth of the underlying allegations, but only for the limited purpose of explaining an expert's rationale or demonstrating Defendants' knowledge. Doc. 1516. Plaintiffs repeatedly disregarded and circumvented this ruling, using their experts to introduce hearsay documents for their truth, including unadjudicated customer complaints (individually and in regulatory reports), untested allegations in other civil cases, and the conclusory preliminary opinions of unidentified regulators or field examiners. Plaintiffs' experts presented the substance of these hearsay documents as fact, accepted them as true, and thereby opined that Household was a systemic predatory lender.

In closing, Plaintiffs' counsel improperly summarized this "evidence" as substantive proof of Defendants' liability. For example, even though Plaintiffs had introduced no factual evidence of systemic predatory lending at Household, Plaintiffs' counsel said in his summation: "And she [Ghiglieri] walked you through all those predatory practices that the company engaged in, didn't she?" Tr. 4471:18-19. Plaintiffs' counsel further argued: "[A]nd he [Devor] said that he's seen internal company documents where they estimate the refunds at 3.2 billion. . . . So we know, ladies and gentlemen, we know that this was a material issue, that this was far widespread . . . ." Tr. 4481:6-14.

So too, Plaintiffs impermissibly made Household's settlement with the state attorneys general (the "Settlement") a substantive centerpiece of the trial. It is, of course, well-settled that the fact of a settlement, its dollar value, the substance of settlement negotiations, and even back-of-the-envelope calculations of an adversary's demands cannot properly be introduced as evidence of liability or of the validity of such demands. *See, e.g.*, *Winchester Packaging, Inc. v. Mobil Chem. Co.*, 14 F.3d 316, 320 (7th Cir. 1994); *Kritikos v. Palmer Johnson, Inc.*, 821 F.2d 418, 423 (7th Cir. 1987). The Court appropriately ruled pretrial that the risk of unfair prejudice was too great to permit Plaintiffs to present evidence of the settlement negotiations and the resulting Settlement. Doc. 1516 ("March 17 Order"). The Court limited Plaintiffs' use of the Settlement to testimony relevant to the alleged inadequacy of Household's disclosures or the effect on Household's stock price, specifically, the "date, time, means and nature of the disclosure . . . without requiring the introduction of any actual settlement documents or any documents or testimony concerning allegations that were settled or the settlement terms or negotiations." *Id*. at 6.

Plaintiffs breached this limitation through improper expert testimony. For instance, not only did Devor improperly testify about the amount of the Settlement, he also told the jury, in direct contravention of the March 17 order, that "the amounts that Household agreed to make restitution . . . to consumers through their states" were material. Tr. 2415:24-2416:5. Ghiglieri likewise flouted the March 17 Order by gratuitously injecting information about the Settlement and its dollar value in responses to questions unrelated to that subject, repeatedly asserting that the fact and amount of the Settlement meant that predatory practices had to have been pervasive because the Settlement involved a large dollar amount. Tr. 864:6-865:13.[27]

The improper use of the Settlement-related information, in contravention of Rules 403 and 408, was unduly prejudicial. Combined with the improper admission of the expert testimony set forth above, these evidentiary errors rendered the trial fundamentally unfair and entitle Defendants to a new trial.[28]

[27] Asked whether the Company's response to an individual customer's complaint was adequate, Tr. 859:24-862:1; whether she had reviewed any regulators' opinions that differed from hers, Tr. 806:1-13; and whether the Company had practices in place to educate customers and disclose procedures, Tr. 864:6-865:13, Ghiglieri each time responded with the non sequitur that Household settled with the states for $484 million. The Court, based on Plaintiffs' argument, rationalized that Defendants had fair warning that Ghiglieri would testify about the Settlement because she had relied upon it in her report. Tr. 896:2¬900:24. But as the report was written in August 2007 and the Court's ruling precluding such evidence at trial came in March 2009, Defendants had no reason to expect Ghiglieri to violate the Court's order.

[28] The proceedings in the wake of Plaintiffs' misuse of the settlement information further exacerbated the prejudice. Given Ghiglieri's improper use of the settlement information, Defendants elected to ask a single question that fell squarely within the one exception the March 17 Order allowed—the performance of Household's stock upon disclosure of the Settlement. Tr. 865:8-13. By the time of the testimony of CEO Aldinger, Plaintiffs had repeatedly interjected improper and prejudicial use of the Settlement, including the terms of the Settlement; the final amount of the Settlement payment; and a good deal of expert testimony using the fact and dollar value of the Settlement as "proof" of pervasive wrongdoing. Tr. 859:19-862:1 (Ghiglieri); Tr. 2415:24-2416:14 (Devor); Tr. 2660:11-2661:4 (Fischel). Given this backdrop, Aldinger attempted to explain the economic reasons for the Settlement. The Court then found that Defendants' measured response to Plaintiffs' repeated deliberate disclosures of the Settlement "opened the door" and allowed Plaintiffs to introduce prejudicial documents excluded by the

V. THE PHASE II PROCEEDINGS DEPRIVED DEFENDANTS OF THE RIGHT TO A PROPER ADJUDICATION OF THE ELEMENT OF RELIANCE.

Reliance "is an essential element of the §10(b) private cause of action," ensuring "'a proper connection between a defendant's misrepresentation and a plaintiff's injury.'" *Amgen*, 133 S. Ct. at 1192 (quoting *Halliburton*, 131 S. C.t at 2184). Although the Supreme Court applies a rebuttable presumption of reliance based on the fraud-on-the-market theory, "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption." *Basic, Inc. v. Levinson*, 485 U.S. 224, 248 (1988); *Amgen*, 133 S. Ct. at 1193 ("'the presumption,' . . . is 'just that, and [can] be rebutted by appropriate evidence.'" (quoting *Halliburton*, 131 S. Ct. at 2185)). The presumption of reliance is rebutted when it is shown either that "misrepresentation[s] in fact did not lead to a distortion of price" or "plaintiff[s] traded or would have traded despite … knowing the statement was false." *Basic*, 485 U.S. at 248.

The Court previously addressed and rejected Defendants' challenges to the Phase II

March 17 Order, including a document (PX516) that laid out the task force's most extreme accusations, Tr. 3456:2-3457:11, 3459:21-3476:10, 4479:15-4481:15, and a document (PX681) that purportedly estimated Household's worst-case exposure, Tr. 3476:11-3477:13; 4481:19-4483:3. Plaintiffs acknowledged their purpose was to "establish what [the attorneys general] were alleging" and "what [payment] they sought to obtain from Household." Combined with the unfair prejudice already occasioned by Plaintiffs' persistent leaking of inadmissible Settlement details, the Court's reaction to Defendants' limited defensive showing deprived Defendants of a fair trial. Moreover, although the Court told the jury once—at the start of the five-week trial—that inadmissible or limited-purpose evidence presented by the experts would be introduced only to explain the basis of the experts' opinions, Tr. 433:16-434:6, this generic limitation did not go nearly far enough in the particular circumstances of this case. As Defendants urged during trial, the jury should have been instructed and reminded at appropriate junctures and in the final charge that neither an expert's opinion, nor any summary of evidence that was a basis of that opinion, establishes the truth of those facts for purposes of satisfying Plaintiffs' burden of proof. Given Plaintiffs' almost exclusive reliance on expert testimony, coupled with the risk that lay juries will vest experts with undue credibility, the failure to give adequate limiting instructions was unduly prejudicial to Defendants and therefore requires a new trial.

proceedings and the rebuttal of the presumption of reliance. Those rulings are in error. First, as set forth above in Section I(C), the misapplication by the jury of Plaintiffs' flawed leakage model establishes, as a matter of law, that the presumption of reliance has been rebutted. *Amgen*, 133 S. Ct. at 1192. Second, the Court rejected discovery evidence demonstrating that certain class members "traded or would have traded despite . . . knowing the statement was false," and impermissibly restricted Defendants' right to rebut the presumption of reliance through appropriate discovery and trial proceedings in Phase II.

A. The Limited Phase II Discovery Underscored The Absence Of Reliance.

The Phase II discovery evidence, severely restricted as it was, independently rebuts the presumption of reliance as to particular claimants by showing that they would have made the same investment decisions even if they knew of the alleged misrepresentations. *See Basic*, 485 U.S. at 248 (presumption can be rebutted by evidence that a plaintiff "traded or would have traded despite his knowing the statement was false").

First, numerous index and program traders indicated that their investment decisions were based on passive strategies unrelated to stock price. *See id.* at 251 (White and O'Connor, JJ., concurring in part and dissenting in part) ("surely" no plaintiff "who buys or sells a stock for reasons unrelated to its price … can state a valid claim under Rule 10b-5"). Large institutional claimants, ranging from Glickenhaus & Company, Vanguard U.S. Stock Index Funds, Munder Funds, and State Street Corporation to Teachers Retirement System of Georgia and State Teachers Retirement System of Ohio, use "indexing" or "mathematical trading" models which aim to mirror the composition of a target index. To avoid diluting or undermining that strategy, such models avoid active management decisions. Not surprisingly, then, Vanguard admitted on the Proof of Claim form that it would have purchased Household stock even if it had known the price was inflated by false and misleading statements by Defendants.[29]

Second, Capital Guardian Trust Company, Capital Research & Management Company, and Davis Selected Advisors disavowed reliance on the efficiency of the market. *See* Barth Tr. 69:7-15 ("not always accurate"); Romo Tr. 37:11-38:2 ("not true"); Feinberg Tr. 45:14-25 ("hogwash"). The Court dismissed those statements as "irrelevant." Doc. 1822, at 7. But the efficient market hypothesis is the predicate of the presumption of reliance and thus of central relevance: "If a market is generally efficient in incorporating publicly available information into a security's market price, it is reasonable to presume that a particular public, material misrepresentation will be reflected in the security's price" and "to presume that most investors … *will rely on the security's market price* as an unbiased assessment of the security's value." *Amgen*, 133 S. Ct. at 1192 (emphasis added). Claimants who do not believe in the integrity of the market cannot be shown, as hypothesized, to have relied on prices set by the efficient market in making their purchases of Household stock.[30]

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[29] With further discovery, other claimants with similar indexing models would have likewise clarified that their decisions were unrelated to price. For instance, TRS Georgia's deponent testified that their mathematical formulas do not account for a company's public statements and could recommend purchase of an inflated stock—and that it was possible that no TRS Georgia analyst would override that purchase. Majure Tr. 41:1-8; 44:13-16. Even institutional claimants who claimed they would *not* have traded at inflated prices raised triable issues of material fact. State Street, for instance, noted on the Proof of Claim form that it would not have bought Household stock had it known the price was inflated. But State Street's deponent offered a crucial clarification: The answer merely reflected how State Street had never had a "similar situation that had ever happened in the last, you know, 20 years" and "because of that we decided that … it was a hypothetical that couldn't really exist in a free market structure." Blake Tr. 41:10-42:8. The Court's rigid insistence on treating all "no" answers on the Proof of Claim form as uniformly foreclosing any "triable issue of fact" thus ignores the totality of evidence. And to the extent the Court faulted Defendants for not offering additional evidence, *cf.* Doc. 1822, at 6 ("the evidence about the investment goals of index funds … is all the defendants offer"), those limitations only reflected the extent to which Defendants' discovery efforts were restricted.

[30] Presuming the reliance of Davis Selected is particularly misplaced because its deponent testified that Household's restatement was "not significant" to it; whatever the "near-term"

Finally, lead Plaintiff Glickenhaus & Company disavowed reliance on the March 23, 2001 statement. *See* Glickenhaus Tr. 58:25–59:7 ("the fact that Origination News quotes something I don't necessarily believe that it's accurate or true"). To be sure, Glickenhaus claimed to have relied on Household's March 12, 2001 press release weeks earlier, *id.* at 64:25–65:5, but that statement was not associated with any inflation. Thus, Glickenhaus and any claimants for which Glickenhaus made investment decisions did not rely on any actionable statement.

In sum, even the limited Phase II discovery evidence rebuts the presumption of reliance as to various groups of claimants and individual claimants. At a minimum, the evidence raises genuine issues of fact as to significant numbers of claimants that must be tried by a jury—issues that the Court brushed aside only by fundamentally failing to view the facts in the light most favorable to Defendants and to draw the obvious inferences. The Court's erroneous endorsement of the presumption of reliance requires judgment for Defendants.

B. The Phase II Proceedings Constrained Defendants From Definitively Rebutting Reliance.

More fundamentally, the presumption of reliance cannot be deemed unrebutted where Defendants were irreparably handicapped in their efforts to obtain basic discovery evidence rebutting reliance. "Litigants are entitled to discovery before being put to their proof." *Bennett v. Schmidt*, 153 F.3d 516, 519 (7th Cir. 1998). Where "all documents and information attesting to Plaintiffs' reliance are within the exclusive control of Plaintiffs," as here, it is "fundamentally

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impact, Davis Selected judged results over the long term and believed it would have "no impact at all after three years." Feinberg Tr. 95:4-11, 185:16–23, 231:20–25. The Court insisted that this testimony created no "triable issue" because the deponent did not *additionally* testify that Davis Selected "would have purchased Household stock even if it had known of the fraud." Doc. 1822, at 8. But that approach reflected a fundamental failure to view the facts in the light most favorable to Defendants and draw inferences accordingly.

unfair" to hold defendants who have not had the opportunity to conduct discovery to a failure to amass sufficient rebuttal evidence. *In re Adelphia Commc'ns Corp. Sec. and Deriv. Litig.*, No. 03 MD 1529, 2005 U.S. Dist. LEXIS 43300, at *27 (S.D.N.Y. Aug. 22, 2005). Nor does this fundamental unfairness dissipate simply because this is a class action proceeding. *See Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2561 (2011) ("a class cannot be certified on the premise that Wal-Mart will not be entitled to litigate its statutory defenses to individual claims").

The Court specifically held that rebuttal of reliance would be reserved for Phase II. Doc. 225, 786, 935. But Defendants' efforts to conduct Phase II discovery were hamstrung by a panoply of unreasonable constraints. *See* Doc. 1710, 1711, 1734, 1746, 1757, 1764. As to virtually all claimants, the Court limited discovery to the legally insufficient question in the Proof of Claim form. As to the limited number of institutional investors with respect to whom some discovery was permitted, the Court limited the inquiry to the narrow issue of whether claimants had non-public information from Household and precluded Defendants from inquiring into the underlying basis of the claimant's decision to purchase Household stock. By these unduly constrained limitations, Defendants were denied any viable ability to obtain the information necessary to address and rebut the presumption of reliance.

CONCLUSION

For the foregoing reasons, the Court should resolve all claims in Defendants' favor and grant Defendants' Renewed Motion for Judgment as a Matter of Law. Plaintiffs failed to introduce sufficient evidence for a reasonable jury to find that Defendants committed violations of § 10(b), Rule 10b-5, or § 20(a). In the alternative, because the jury's verdict was irreconcilably inconsistent, numerous judicial errors individually and cumulatively deprived Defendants of a fair trial, and a verdict for Plaintiffs was against the weight of the evidence, the Court should grant Defendants' Motion for a New Trial.

Dated: July 30, 2013

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CERTIFICATE OF SERVICE

Paul D. Clement, an attorney, hereby certifies that on July 30, 2012, he caused true and correct copies of the foregoing Memorandum of Law in Support of Defendants' Renewed Motion for Judgment as a Matter of Law or, in the Alternative, a New Trial to be served via the Court's ECF filing system on the following counsel of record in this action:

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