UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

LEAD PLAINTIFFS' RESPONSE TO HOUSEHOLD DEFENDANTS' MOTION PURSUANT TO THE SEVENTH CIRCUIT'S DECISION IN *FOSS V. BEAR, STEARNS CO.*

I. INTRODUCTION

Defendants Household International, Inc. ("Household"), Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilmer and J.A. Vozar seek to dismiss "all of the Class's Section 10(b) claims that arose prior to July 30, 1999." Defs' Mem. at 7.[1] This is odd, given that none of plaintiffs' claims arose until at least August 14, 2002, when plaintiffs were first placed on inquiry notice. Because plaintiffs' claims arose ***after*** July 30, 2002 – when the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act") became law – defendants' reliance on *Foss v. Bear, Stearns & Co.*, 394 F.3d 540 (7th Cir. 2005) and *In re Enterprise Mortgage Acceptance Co., LLC, Sec. Litig.*, 391 F.3d 401 (2d Cir. 2004), is misplaced. Both *Foss* and *Enterprise* involved claims that had ***arisen and expired*** before Sarbanes-Oxley became effective. For the longer limitations periods to apply in such a case, Sarbanes-Oxley would have to apply retroactively to revive stale claims. The Second Circuit in *Enterprise* held that it does not, and the Seventh Circuit agreed in *Foss* without further reasoning. This case, however, is different.

Plaintiffs' claims here did not even arise, much less expire, until after July 30, 2002. Thus, plaintiffs do not need Sarbanes-Oxley to retroactively revive their claims. Instead, plaintiffs need only apply the statute in effect when their claims arose, *i.e.*, Sarbanes-Oxley's two-year statute of limitations and five-year statute of repose. As defendants concede, the extended statute of limitations under Sarbanes-Oxley "applies to securities fraud claims asserted in the Complaint ***to the extent*** that such claims were not already extinguished" prior to July 30, 2002.[2] Defs' Mem. at 5

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[1] "Defs' Mem." refers to the Memorandum of Law in Support of Household Defendants' Motion Pursuant to the Seventh Circuit's Recent Decision in *Foss v. Bear, Stearns Co.* to Dismiss the Complaint in Part.

[2] All references to the "Complaint" and paragraph references ("¶") herein are to the operative [Corrected] Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws, filed on March 13, 2003.

(emphasis in original); *Tello v. Dean Witter Reynolds, Inc*., 410 F.3d 1275 (11th Cir. 2005). Since plaintiffs' claims had not yet ***accrued*** when Sarbanes-Oxley was enacted and thus could not have been extinguished, the statute of repose governing all of plaintiffs' claims – including those based on misrepresentations and purchases prior to July 30, 1999 – is the five-year period under Sarbanes-Oxley. *Tello*, 410 F.3d at 1275 (holding that Sarbanes-Oxley applies to claims for §10(b) violations occurring more than three years prior to July 30, 2002, provided plaintiffs were not on inquiry notice until after Sarbanes-Oxley was enacted). Because plaintiffs were not on inquiry notice until after the Act was enacted, plaintiffs' claims were timely filed and defendants' motion should be denied.

II. ARGUMENT

A. Legal Standard

A court may not grant a motion for judgment on the pleadings under Fed. R. Civ. P. 12(c) unless plaintiffs can prove no set of facts that would entitle them to relief. *Northern Indiana Gun & Outdoor Shows, Inc. v. City of S. Bend*, 163 F.3d 449, 453 (7th Cir. 1998). Because defendants answered the Complaint before filing the instant motion, their motion is properly construed as a motion pursuant to Rule 12(c). *See Lanigan v. Village of E. Hazel Crest*, 110 F.3d 467, 470 (7th Cir. 1997); *see also* Lead Plaintiffs' Response to Household Defendants' Motion to Dismiss Based on the Supreme Court's Decision in *Dura Pharmaceuticals, Inc. v. Broudo* ("Pls' *Dura* Brf.") at 5. In considering a Rule 12(c) motion, the court must assume that all facts alleged in the complaint are true, and construe those facts and all reasonable inferences flowing from them in the light most favorable to the plaintiff. *Bethlehem Steel Corp. v. Bush*, 918 F.2d 1323, 1326 (7th Cir. 1990). Thus, "[u]nless the complaint alleges facts that create an ironclad defense, a limitations argument must await factual development." *Foss*, 394 F.3d at 542.

As detailed below, defendants here have failed to demonstrate that the Complaint's facts create an "ironclad defense." Defendants' motion should be denied.

B. Sarbanes-Oxley's Five-Year Statute of Repose Applies to All of Plaintiffs' Securities Fraud Claims

1. Claims Arising After July 30, 2002 Are Governed by Sarbanes-Oxley

On July 30, 2002, Sarbanes-Oxley was signed into law. Sarbanes-Oxley lengthened the statute of limitations for claims brought under the federal securities laws because "[c]ases where victims have lost their entire life savings should be decided on the merits, not based on procedural hurdles that may now be used to throw legitimate victims out of court." 148 Cong. Rec. S 6436 (daily ed. July 9, 2002) (statement of Sen. Daschle). Section 804 of Sarbanes-Oxley increased the limitations period for private securities actions from a one-year/three-year model to a two-year/five-year approach. Specifically, Sarbanes-Oxley increased the statute of limitations for private causes of action under the securities laws to the earlier of (1) two years after the discovery of the facts constituting the violation; or (2) five years from such violation. 28 U.S.C. §1658(b). Sarbanes-Oxley explicitly states that the new limitations period "shall apply to all proceedings addressed by this section that are commenced ***on or after*** the date of enactment of this Act [July 30, 2002]." Sarbanes-Oxley §804(b).[3] As defendants acknowledge, "Sarbanes-Oxley's new statute of limitations therefore applies to securities fraud claims asserted in the Complaint ***to the extent*** that such claims were not already extinguished" prior to the filing of this action. Defs' Mem. at 5 (emphasis in original).

Plaintiffs agree that the five-year statute of repose under Sarbanes-Oxley applies to claims which accrued after July 30, 2002. This view is consistent with the Eleventh Circuit's recent decision in *Tello*, holding that the longer limitations scheme of Sarbanes-Oxley applies to claims based on securities fraud violations occurring more than three years before July 30, 2002, provided

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[3] All emphasis is added and internal citations omitted unless otherwise indicated.

those claims had not yet accrued as of Sarbanes-Oxley's effective date. 410 F.3d at 1289. *Tello* is the only circuit court decision on point.

In *Tello*, the plaintiff filed his suit on November 15, 2002, alleging the conduct giving rise to defendants' §10(b) violations began on January 1, 1998 and ended on August 19, 1998 – more than three years before Sarbanes-Oxley took effect. *Id.* at 1277. Based on a plain reading of the statute, and considering the remedial purpose of Sarbanes-Oxley – "to help financially injured plaintiffs by deciding their cases on the merits and not to shut them out of court procedurally" (*id.* at 1287-88) – the Eleventh Circuit held that Sarbanes-Oxley "is applicable to the alleged fraudulent securities conduct in this case, provided inquiry notice was not sufficiently established to enable the plaintiff class to file this class action prior to issuance of the SEC Order." *Id.* at 1282-83. Because the question of inquiry notice is a factual question not properly decided at the pleading stage, the court found that the factual record before it was not sufficiently developed to make a determination of whether plaintiffs were on inquiry notice prior to Sarbanes-Oxley's enactment, vacated the district court's order dismissing the case and remanded it for further proceedings to determine "the date that the plaintiff class had sufficient factual information of their financial losses being the result of fraudulent conduct by [defendant] to constitute inquiry notice to enable the class-action complaint to be filed in this case." *Id*. at 1295.

Although defendants "have the burden of proving an affirmative defense, such as that the statute of limitations has run," they have not even attempted to argue that plaintiffs were on inquiry notice of defendants' fraud prior to July 30, 2002. *Law v. Medco Research, Inc.*, 113 F.3d 781, 786 (7th Cir. 1997). As discussed, in §II.B.2, *infra*, plaintiffs were not. Accordingly, this case, like *Tello*, "is not a case about retroactive application of a new law and revival of time-barred claims." 410 F.3d at 1293. Rather, because plaintiffs were not on inquiry notice at least until August 14, 2002, when Sarbanes-Oxley was already in effect, "this case [ ] require[s] only a straightforward

application of the new, remedial statute of limitations designed to encompass the securities fraud conduct at issue." *Id.* Like plaintiffs in *Tello*, plaintiffs here "were not 'delinquent plaintiffs who slept on their rights' and possibly could be unjustly rewarded for pursuing time-barred claims; ***instead, they fit within the new statute of limitations under [Sarbanes-Oxley], which was effective when the subject complaint was filed."*** *Id.* at 1289.

The cases defendants rely on, *Foss* and *Enterprise*, are inapplicable to the facts of this case. Both *Foss* and *Enterprise* involved causes of action which, unlike plaintiffs' claims here, ***arose and were extinguished*** under the limitations law in effect prior to the July 30, 2002 enactment of Sarbanes-Oxley. *Enterprise*, 391 F.3d at 404; *Foss*, 394 F.3d at 542. Thus, the "central issue" raised in *Enterprise* and *Foss* "is whether [Sarbanes-Oxley] revives previously expired securities claims." *Enterprise*, 391 F.3d at 403. In *Foss*, the Seventh Circuit adopted – without analysis – the Second Circuit's holding in *Enterprise* that it does not. *Foss*, 394 F.3d at 542 ("We find [*Enterprise*] persuasive and have nothing to add to the second circuit's explanation."); Defs' Mem. at 5.

In a case decided after *Tello*, the Eighth Circuit also found that Sarbanes-Oxley does not revive securities fraud claims that have both ***arisen and expired*** prior to the enactment of Sarbanes-Oxley, because a literal reading of the statute would "lead to a puzzling result" whereby "stale claims filed prior to July 30, 2002, would not be revived, whereas claims filed on or after July 30, 2002, would be revived." *In re ADC Telecomms., Inc. Sec. Litig.*, 409 F.3d 974, 977 (8th Cir. 2005). Plainly, application of Sarbanes-Oxley to claims accruing ***after*** July 30, 2002, does not lead to this "puzzling" result. Indeed, the *ADC* court found that "at the time [plaintiff's] cause of action accrued on March 28, 2001, the relevant statute of limitations was one year" and was "time barred on March 28, 2002." *Id.* at 976. The Eighth Circuit noted that the date on which the plaintiff's claims were time barred, March 28, 2002, was a "crucial fact," giving rise to the "critical issue" in that case: "[W]hether the Sarbanes-Oxley Act applies retroactively, and enables [plaintiff's] February 26,

2003, complaint to ***revive stale claims***." *Id.* That "crucial issue" and "critical issue" are noticeably absent here – plaintiffs' claims accrued after July 30, 2002, and were never extinguished.

In *Tello*, the Eleventh Circuit acknowledged the holdings of both *Foss* and *Enterprise* that Sarbanes-Oxley "cannot be applied retroactively to revive securities fraud cases, when the claims were time-barred under the former statute of limitations," but held that such a determination need not be reached where the plaintiff was not on inquiry notice until after July 30, 2002. *Tello*, 410 F.3d at 1295 n.18.

The court in *Tello* rejected defendants' contention that plaintiffs improperly sought to revive already stale claims:

> Rather than "reviving" their cause of action, about which they purportedly were unknowing until the SEC Order issued, the plaintiffs' class action was filed or commenced after the knowledge of Dean Witter's fraudulent conduct through the SEC Order, which was after the new statute of limitations under the SOA had become effective on July 30, 2002.

410 F.3d at 1289. Indeed, the Eleventh Circuit explicitly found that:

> [T]he filing date of this class action [ ] fits the second part of the SOA statute of limitations: five years after the securities violation, because the violative conduct allegedly existed from January 1 through August 19, 1998. ***Plaintiffs, however, had no reason to file their class action until they knew that they had been injured financially by [defendants'] securities fraud.***

Id. at 1289 n.14.

Thus, the key issue here is not, as defendants claim, "whether Sarbanes-Oxley's new statute of limitations retroactively revives claims that were already time-barred on July 30, 2002." Defs' Mem. at 5. Rather, the key issue is whether plaintiffs' claims arose prior to July 30, 2002. *Tello*, 410 F.3d at 1275. They did not. As discussed below, unlike the claims in *Foss*, *Enterprise* and *ADC*, that arose and expired before the new statute of limitations took effect, plaintiffs' Complaint demonstrates that their claims did not arise until after July 30, 2002, when the new statute of limitations was already in effect. Because plaintiffs filed their Complaint, applying the appropriate

five-year statute of repose in place at the time, it is undisputed that none of plaintiffs' claims is time-barred. *Id*.

2. Plaintiffs' Claims Arose After Sarbanes-Oxley Took Effect

Defendants contend that "all claims based on the purchase of a Household security prior to July 30, 1999 arose . . . prior to July 30, 2002." Defs' Mem. at 7. Defendants incorrectly conflate their securities fraud violations with the accrual of plaintiffs' claims. Although the date of defendants' violation is relevant to determine when the effective statute of repose begins to run, it is irrelevant to determining when plaintiffs' claims accrued: "A cause of action accrues under the securities acts when a plaintiff is placed on inquiry notice; that is, 'when the victim of the alleged fraud became aware of facts that would have led a reasonable person to investigate whether he might have a claim.'" *Lennon v. Christoph*, No. 94 C 6152, 1996 U.S. Dist. LEXIS 9943, at *27 (N.D. Ill. July 12, 1996); *see also ADC*, 409 F.3d at 976 (for purposes of Sarbanes-Oxley retroactivity analysis, plaintiffs' claims accrued on the date defendants disclosed guidance would not be met and the stock fell, *i.e.*, when they were on inquiry notice – not at the time the violation occurred).

The inquiry notice law in this Circuit is well established. In *Fujisawa Pharm. Co. v. Kapoor*, 115 F.3d 1332 (7th Cir. 1991), the Seventh Circuit held that:

> [I]nquiry notice . . . must not be construed so broadly that the statute of limitations starts running too soon for the victim of the fraud to be able to bring suit . . . . The facts constituting such notice must be sufficiently probative of fraud – sufficiently advanced beyond the stage of a mere suspicion, sufficiently confirmed or substantiated – not only to incite the victim to investigate but also to enable him to tie up any loose ends and complete the investigation in time to file a timely suit.

Id. at 1335. Inquiry notice thus requires "that the suspicious circumstance place the potential plaintiff in possession of, or with ready access to, the essential facts that he needs in order to be able to sue." *Id*. at 1337. In sum, "inquiry notice does not begin to run unless and until the investor is able, with the exercise of reasonable diligence (whether or not actually exercised), to ascertain the

information needed to file suit." *Marks v. CDW Computer Ctrs., Inc.*, 122 F.3d 363, 368 (7th Cir. 1997).

Under *Fujisawa's* controlling standard, plaintiffs' claims did not arise until at least August 14, 2002, the earliest date that plaintiffs could have discovered the essential facts underlying defendants' fraud. It was not until that date, when Household announced its $386 million restatement, resulting in a $600 million charge to earnings, that investors first began to learn the true facts about Household's financial and operating condition. ¶¶5, 25-27, 140-141. Indeed, plaintiffs were likely not on inquiry notice regarding defendants' fraudulent predatory lending and reaging practices until even later, when on October 11, 2002, the market was informed of Household's $484 million multi-state settlement with the 50 state attorneys general (resulting in another $525 million charge to earnings). ¶¶5-6, 97. In *Tello*, the court found that even though the plaintiff "knew that he had sustained a loss" several years before Sarbanes-Oxley was passed, he was not on inquiry notice until such time as he became aware "of the causative securities violations" by defendant. 410 F.3d at 1289. Plaintiffs here had not even sustained their losses, let alone discovered them, until years after the securities violations at issue in this motion. *See* Pls' *Dura* Brf.[4]

Plaintiffs were not aware of the securities law violations which caused this loss until August 14, 2002, at the earliest. Like plaintiffs in *Tello*, plaintiffs here ***"had no reason to file their class action until they knew that they had been injured financially by [defendants'] securities fraud."***

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[4] Ironically, at the same time defendants filed this motion erroneously contending that plaintiffs' claims arose prior to July 1999, they filed another motion contending (again erroneously) that plaintiffs failed to properly plead loss causation. *See* Household Defendants' Motion to Dismiss Pursuant to the Supreme Court's Recent Decision in *Dura Pharmaceuticals, Inc. v. Broudo* and Memorandum of Law in Support thereof. Loss causation, by its very nature, does not occur at the same time as defendants' violations of §10(b) and Rule 10b-5, *i.e.*, when defendants made misrepresentations and omissions in connection with the purchase or sale of Household securities. *Dura Pharms., Inc. v. Broudo*, 544 U.S. __, 125 S. Ct. 1627 (2005). Thus, defendants' position that plaintiffs' claims arose when defendants violated §10(b) and Rule 10b-5 is completely untenable.

410 F.3d at 1289 n.14. Since plaintiffs' claims did not arise until August 14, 2002, when they were on notice that defendants' fraud may have caused their loss, Sarbanes-Oxley's five-year statute of repose applies and plaintiffs' claims here were timely filed.

III. CONCLUSION

Because plaintiffs' claims did not accrue until after Sarbanes-Oxley was in effect, the new statute of limitations repose governs this action, regardless of when defendants' securities violations occurred. Under Sarbanes-Oxley's two-year statute of limitations and five-year statute of repose, all of plaintiffs' claims are timely filed. Defendants' motion seeking to dismiss the first two years of the Class Period should be denied.

DATED: August 18, 2005

Respectfully submitted,

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