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

LAWRENCE E. JAFFE PENSION PLAN, on Behalf of Itself and All Others Similarly Situated,

Plaintiff,

v.

HOUSEHOLD INTERNATIONAL, INC., et al.

Defendants.

Lead Case No. 02-C-5893
(Consolidated)

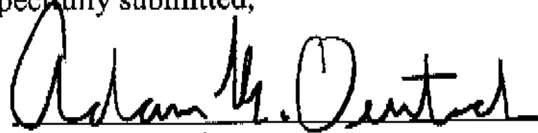
CLASS ACTION

Judge Ronald A. Guzman
Magistrate Judge Nan R. Nolan

NOTICE OF FILING

PLEASE TAKE NOTICE that, on September 16, 2005, we filed with the Clerk of the United States District Court for the Northern District of Illinois, Eastern Division, Household Defendants' Reply Memorandum of Law in Further Support of Their Motion to Dismiss Pursuant to the Supreme Court's Recent Decision in *Dura Pharmaceuticals, Inc. v Broudo*, a copy of which is attached hereto.

Respectfully submitted,

By: 

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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,	Lead Case No. 02-C-5893 (Consolidated)
- against -	CLASS ACTION
HOUSEHOLD INTERNATIONAL, INC., ET AL., Defendants.	Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan

HOUSEHOLD DEFENDANTS' REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THEIR MOTION TO DISMISS PURSUANT TO THE SUPREME COURT'S RECENT DECISION IN *DURA PHARMACEUTICALS, INC.* v. *BROUDO*

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This reply memorandum is submitted on behalf of Household International, Inc., Household Finance Corp., William F. Aldinger, David A. Schoenholz, Gary Gilmer, and J.A. Vozar (referred to collectively herein as "Household" or "Defendants"), in further support of their motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) for failure to plead loss causation in accordance with *Dura Pharmaceuticals, Inc.* v. *Broudo* ("*Dura*") and its progeny.

INTRODUCTION

In order to accept Plaintiffs' arguments in opposition to Defendants' motion to dismiss, this Court would have to adopt a rule which the Supreme Court specifically rejected in *Dura* — permitting Plaintiffs to "transform a private securities action into a partial downside insurance policy" for any and all market price declines. *Dura*, 125 S. Ct. 1627, 1634 (2005).

Defendants' opening brief demonstrated that Household's stock price did not decline (and in fact increased) in response to the revelation of *each* of the three so-called "frauds." (DM at 10-20.)[1] Plaintiffs' opposition does not offer any explanation for the absence of a concurrent (*i.e.*, caused-by-the-"fraud") loss, let alone an explanation pled somewhere in Plaintiffs' Amended Complaint (hereinafter, "AC" or "Complaint").

Instead, Plaintiffs argue that three separate and unrelated theories pled in the Complaint should survive this motion as a "single multi-component fraud scheme." (PM at 9.) That is not what Plaintiffs' Amended Complaint alleges. Plaintiffs' Amended Complaint separately asserts three distinct theories of fraud relating to: (i) reported delinquency statistics (AC ¶¶ 134-155), (ii) a restatement of credit card expenses (AC ¶¶ 107-133), and (iii) alleged consumer lending misconduct (AC ¶¶ 50-106). The three theories do not depend on each other for any of their "facts" and, as pled, are independent of each other.

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[1] "DM" refers to Defendants' June 30, 2005 opening memorandum on this motion. Likewise, "PM" refers to Plaintiffs' August 18, 2005 memorandum in opposition to this motion.

Cases addressing loss causation issues involving distinct allegations of fraud routinely analyze loss causation relating to each distinct theory separately, accepting or rejecting each distinct theory on its own merits, *vel non*. *See infra* pp. 4-5 and note 4. This case is no different. Plaintiffs cannot evade *Dura's* pleading requirements by simply "intertwining" three distinct theories in a memorandum of law and thereby seek to capture *all* declines in Household's stock price over a five-year class period. Such reasoning would defeat *Dura's* requirement that Plaintiffs (i) explain how the loss resulted from disclosure of the alleged fraud, and (ii) distinguish losses caused by "changed economic circumstances, changed investor expectations, new industry-specific events or firm-specific facts, conditions, or other events," *Dura*, 125 S. Ct. at 1632, which are not actionable. Indeed, by asserting that *all* losses were presumptively caused by the alleged "manifold scheme," Plaintiffs have put forth a new theory which is indistinguishable from the "price inflation" theory explicitly rejected by the Supreme Court.

Nothing better demonstrates Plaintiffs' refusal to accept the fact that their counsel's loss in *Dura* changed the landscape than their statement that: "Notwithstanding that complete information about the scope and impact of the re-aging practices was not fully disclosed until after the end of the Class Period, the market had *already absorbed most of the bad news and taken the inflation out of the stock* price by the time of the multi-state attorneys general settlement on October 11, 2002." (PM at 16.)[2] Are Plaintiffs seriously arguing that this is supposed to provide "the defendants with notice of what the relevant economic loss might be"? *Dura*, 125 S. Ct. at 1634. It does not come close to satisfying *Dura*. Couple that argument with Plaintiffs' further assertion that "whether the market knows the truth is a fact issue for summary judgment or trial" (PM at 20) and what you have is a restatement of pre-*Dura* law.

Rather than explaining how the losses claimed in the Complaint can be distinguished from this general market decline (as *Dura* requires), Plaintiffs argue that this Court need not, indeed

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[2] All emphasis is supplied except where otherwise indicated.

may not, consider this clearly relevant and undisputed fact on this motion at all. (PM at 5 n.6.)[3] There is simply no basis for any such argument under *Dura* or under pre-*Dura* established law in this district. *See* DM at 13 n.14; *Grimes* v. *Navigant Consulting, Inc.*, 185 F. Supp. 2d 906, 914 (N.D. Ill. 2002) (taking judicial notice of the company's stock prices and granting defendant's motion to dismiss because, where the stock "did not fall but rose" following the corrective disclosure, the alleged misrepresentations or omissions were immaterial as a matter of law).

Plaintiffs also object that this Court may not consider the first post-*Dura* decision by a federal court of appeals interpreting and applying *Dura*. *See D.E. & J. Limited Partnership* v. *Conaway*, 133 Fed. Appx. 994 (6th Cir. 2005) ("*Conaway*"). *Conaway* is directly on point and application of its holding — like that of *Dura* — is fatal to Plaintiffs' Complaint. (DM at 9, 13-14.) Plaintiffs' professed basis for objecting to *Conaway* is that it is unofficially published and, according to Plaintiffs, insufficiently novel to warrant consideration by this Court. (PM at 16-17.) Plaintiffs' objection is unfounded because Seventh Circuit Rule 53(e) readily permits citation to the *Conaway* decision. Moreover, as *Plaintiffs* themselves repeatedly cite to unpublished district court decisions interpreting the Supreme Court's new pronouncement in *Dura* (*see, e.g.*, PM at 3, 7, 8, 13, 14 n.11, 18), their desperate attempt to avoid *Conaway* on any basis rather than confront it on the merits is unmistakable.

Plaintiffs also rely on questionable authorities to "spin" *Dura* into something it is not. Plaintiffs urge this Court to interpret *Dura* through a lens of: (i) questions posed by certain Justices at oral argument (PM at 3-4 n.4), (ii) *amicus* briefing by non-parties submitted in connection with the Supreme Court proceeding (PM at 3-4, 7, 13), and (iii) pre-*Dura* Ninth Circuit decisions setting forth the now-discredited standard of "price inflation" pleading that *Dura* explicitly

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[3] Plaintiffs also assert without explanation that they will provide "expert testimony" regarding the *greater* decline of the S&P 500 as compared to Household stock which will somehow show that Household's theory of loss causation is "flawed." (PM at 5 n.6.) Plaintiffs' prognostications regarding unidentified "experts" purporting to controvert indisputable facts should not be considered on this motion.

overruled. (PM at 4, 13, 15.) These "authorities" do not change the central holdings of *Dura* and its progeny, *Conaway.*

There is no dispute in this case that the value of Plaintiffs' investment in Household securities declined during the class period. As noted in Defendants' opening brief, however, after *Dura,* allegations relating to such generalized declines are not a sufficient basis to allege securities fraud. (DM at 2, 7-9.) As in *Dura*, Plaintiffs' failure to plead "what the *causal connection* might be between [the alleged] loss and the [Defendant's alleged] misrepresentation" requires dismissal. *Dura*, 125 S. Ct. at 1634.

ARGUMENT

I. PLAINTIFFS' ARGUMENT THAT THEY ARE ASSERTING A "SINGLE MULTI-COMPONENT FRAUD SCHEME" CANNOT AVOID THE INSURMOUNTABLE DEFECTS IDENTIFIED IN DEFENDANTS' OPENING BRIEF OR EVADE THE APPLICATION OF *DURA* TO THIS CASE

Plaintiffs' opposition argues that a separate analysis of each of Plaintiffs' three theories of "fraud" under *Dura* would be improper (PM at 3), and that any loss causation defects of Plaintiffs' three theories standing alone disappear when the theories are treated together as a "manifold scheme." (PM at 2-3.) But there is no "manifold scheme" pled in this Complaint. Instead, the Complaint separately pleads three distinct theories of fraud: Plaintiffs' Predatory Lending Claim: AC ¶¶ 50-106; Plaintiffs' Re-age Theory: ¶¶ 107-133; and Plaintiffs' Restatement Theory: ¶¶ 134-155.

Dura makes clear that a separate loss causation analysis is required for *each* theory of fraud alleged in a securities complaint. As *Dura* notes: "The District Court dismissed the complaint. In respect to the plaintiffs' drug-profitability claim, it held that the complaint failed adequately to allege an appropriate state of mind . . . . In respect to the plaintiffs' spray device claim, it held that the complaint failed adequately to allege 'loss causation.'" *Dura*, 125 S. Ct. at 1630. The loss causation discussion that followed addressed only the "spray device claim" and not any other claims submitted therewith. *Id.* *Dura* and countless other cases make clear that where, as here, dis-

tinct theories of fraud are alleged, the Court analyzes each theory to determine whether that particular fraud has actually caused any loss.[4]

The purpose of Plaintiffs' effort to recast the Complaint's allegations is obvious — unless this Court adopts their newly conceived "amalgamation" of theories, Plaintiffs' Complaint fails under *Dura*. As Defendants previously explained (DM at 10-20), on the date when each of the three alleged "frauds" was supposedly revealed to the market, the stock price closed *higher* than it had the previous day. Indeed, for each of the three theories, it closed at a higher price *even weeks after the alleged "fraud" was supposedly revealed to the market.*[5] *See* subsequent price *increases* connected to the "revelation" of the "true facts" of each of: (i) Plaintiffs' restatement theory (AC ¶¶ 134-155);[6] (ii) Plaintiffs' re-aging theory (AC ¶¶ 107-133);[7] and (iii) Plaintiffs' predatory lending

4 *See, e.g., Davidoff* v. *Farina*, No. 04 Civ. 7617 (NRB), 2005 U.S. Dist. LEXIS 17638 (S.D.N.Y. Aug. 22, 2005) (separately addressing and ultimately dismissing each alleged theory of fraud, dividing the theories of fraud into IPO statements and post-IPO statements and dismissing claims under the post-IPO statements for failure to plead loss causation); *Dresner* v. *Utility.com, Inc.*, 371 F. Supp. 2d 476 (S.D.N.Y. 2005) (separately addressing and ultimately dismissing each alleged theory of fraud, dividing the theories of fraud into pre-merger misrepresentations, merger misrepresentations and post merger misrepresentations and dismissing claims under the post-merger misrepresentations for failure to plead loss causation); *In re Acterna Corp. Securities Litigation*, 378 F. Supp. 2d 561, 566 (D. Md. 2005) (indicating the court's determination that "[e]ssentially, the violations Plaintiffs' [sic] allege can be boiled down to two main categories: (1) pertaining to the testing and valuation of Acterna's goodwill, and (2) pertaining to violations of Generally Accepted Accounting Principles ('GAAP')," and ultimately dismissing plaintiff's complaint on, *inter alia*, loss causation grounds).

5 For a security "efficiently" traded on the New York Stock exchange, such as Household common stock, the release of new information into the market is incorporated into the stock price by the end of the trading day. (*See* DM at 11-12.) Nevertheless, the sustained increases over the days and weeks following the "revelation" of the supposed "fraud" underscore Plaintiffs' insurmountable loss causation problem.

6 *See* DM at 15-16. The Complaint's "restatement" claims note that Household announced the re-amortization of certain credit card program expenses on August 14, 2002—the day of the "restatement." (AC ¶ 140.) However, Household's stock price *increased* on that day. On August 13, 2002, the day prior to the restatement, the stock price closed at 37.80. Following the restatement, Household stock closed at 38.09, *up* .29 from the day before. *See* Affidavit of Thomas J. Kavaler dated June 14, 2005 ("Kavaler Aff."), Ex. A at 26 (stock price history submitted with Defendants' opening brief). The day after the restatement, the stock closed *up* even more, at 39.60, up 1.80 from the pre-announcement closing price. The stock price *increased* more over the following weeks, closing at 39.08 on August 26, 2002.

7 *See* DM at 14-15. The Complaint's "re-aging" claims note that Household disclosed its re-age policies to the public on April 9, 2002, the day of Household's annual Financial Relations Conference ("FRC") in

Footnote continued on next page.

theory. (AC ¶¶ 50-106.)[8] This amounts to a complete and total failure to allege "what the *causal connection* might be between [the alleged] loss and the [Defendants' alleged] misrepresentation." *Dura*, 125 S. Ct. at 1634. In this case there can be no "causal connection" because there was no loss.

Plaintiffs' opposition tries to circumvent this issue by reliance on: (i) vague allegations of loss that cannot be connected to any disclosures about the Company (PM at 9-12, 15-16), and (ii) the now-rejected pre-*Dura* "artificial inflation" pleading standard (PM at 8-9, 15). (*See also* AC ¶ 349.) Plaintiffs' pre-*Dura* Complaint studiously avoids mentioning specific declines in price in connection with specific announcements or other corrective events on specific dates. Indeed, the 398 paragraphs of the Complaint make only *three* references to particular declines on particular dates — two of which are simply inaccurate, and the third of which is obviously immaterial. The first reference occurs in paragraph 101 where the Complaint *incorrectly* references an alleged *decline* of 3.50 per share on October 10, 2002 — *a date when Household stock actually closed up 5.30*

Footnote continued from previous page.

which the Company detailed the percentage of accounts that had been re-aged and how re-aging broke down by product. (AC ¶ 123, 127.) Household simultaneously released to the public an 8-K that contained all the FRC information relevant to re-aging. (AC ¶ 123.) The actual trading in Household stock on April 9, 2002, however, reveals that there was no decline in price following the FRC or the simultaneous release of the 8-K. In fact, the share price went up. Prior to the FRC, on April 8, 2002, Household stock closed at 59.06. On April 9, 2002, after the FRC and 8-K, it closed up nearly twenty cents at 59.25. The next day, April 10, the stock was up another ten cents, closing at 59.35. In fact, the stock remained higher for weeks afterward, closing at 59.60 on April 26, 2002. *See* Kavaler Aff., Ex. A at 26.

[8] *See* DM at 16-20. On October 11, 2002, the date that the Complaint asserts that investors "learned" that Household had engaged in so-called illegal predatory lending (AC ¶ 23), there was similarly no drop in price. In fact, as is the case with the other two "theories," the stock price increased. On October 10, 2002, prior to the announcement of the settlement, Household stock closed at 26.30. After the announcement on October 11, it closed up significantly at 28.20. On Monday, October 14 (the next trading day), it was still up significantly over the pre-announcement price, closing at 28.06. In fact the stock similarly remained above its pre-settlement price for weeks, closing at 26.45 on October 23. *See* Kavaler Aff., Ex. A at 26-27.

over the previous day. Kavaler Aff., Ex. A at 26-27. Plaintiffs do not acknowledge this error despite referring to that paragraph among others in its brief. (PM at 9.)[9]

The second reference occurs at paragraph 140 of the Complaint which refers to "a decline of over $4.71 per share relative to the prior day's close" on "August 14, 2002," the date Household announced a restatement of the amortization of certain credit card program expenses. (PM at 11, 15.) Again, Plaintiffs' suggestion that the stock closed lower *as a result of* this announcement is incorrect. In fact, on August 14, notwithstanding intra-day trading at lower prices, the stock closed at 38.09—*up .29 over the previous day's close.* Kavaler Aff., Ex. A. at 26. Indeed, it remained up for some time and, as noted herein, on August 26, nearly two weeks after the announcement, the stock still closed 1.28 above the pre-announcement price at 39.08. Kavaler Aff., Ex. A. at 26. Apart from these two incorrect and inaccurate references, the single remaining reference asserts nothing more than that there was a 2.75 decline in the closing price following a negative article about the Company in *Forbes*—a common event in the investment world and hardly the stuff of "securities fraud." (AC ¶ 57; PM at 11.)

The remainder of Plaintiffs' loss allegations consist entirely of vague references to price declines over months and/or years, unconnected to any disclosure either by or about the Company. Indeed, as Plaintiffs' brief illustrates, far from making the required "short and plain statement" explaining Plaintiffs' theory of loss causation required by both Rule 8(a) and *Dura*, the Complaint relies upon vague and/or incomprehensible language, including, *inter alia*:

(a) An unspecified "entrance of the partial truth into the market" that allegedly caused an unspecified loss (PM at 11);

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[9] The Court need not accept this pled fact as "true" because it is flatly inconsistent with publicly available information. *See Sony Electronics, Inc.* v. *Soundview Technologies, Inc.*, 157 F. Supp. 2d 180, 183 (D. Conn. 2001) ("[a] motion to dismiss pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, admits all well pleaded facts, but does not admit facts which the court will judicially notice as not being true") (quoting *Interstate Natural Gas Co.* v. *Southern California Gas Co.*, 209 F.2d 380, 384 (9th Cir.1953)). *See also* 5C Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1368 (explaining, in a Rule 12(c) context, that "[t]he motion for judgment on the pleadings admits all facts well pleaded, but does not admit . . . facts which the court will take judicial notice are not true").

(b) An unspecified "cumulative effect of the revelation of defendants' wrongful course of conduct" that allegedly caused an unspecified loss (AC ¶ 29);

(c) An unspecified "magnitude and pervasiveness of defendants' fraud [that] leaked to investors" that allegedly caused an unspecified loss (AC ¶ 22); and

(d) A vague claim that "[i]t was not until mid-2002 that investors *began to learn* about the actual . . . condition of the Company," which allegedly caused an unspecified loss. (AC ¶ 5.)[10]

None of these pre-*Dura* allegations or Plaintiffs' current post-*Dura* effort to re-cast them is accompanied by any particularized date or decline in stock price. And, as shown above, they could not be because the actual facts do not aid Plaintiffs. As explained in *Conaway*: "[I]f these allegations would suffice here, the mere inclusion of boilerplate language would suffice everywhere and would defeat the requirement that a Plaintiff explain how the loss occurred." 133 Fed. Appx. at 1000.

II. PLAINTIFFS' FAILURE TO ALLEGE ANY CORRECTIVE DISCLOSURES FOLLOWED BY A STOCK PRICE DROP SIMILARLY REQUIRES DISMISSAL OF THE COMPLAINT

Prior to *Dura*, cases in this district had held, consistent with the now-rejected Ninth Circuit view, that a plaintiff could recover under Rule 10b-5 merely by asserting, as Plaintiffs do here, that the purchase price was "artificially inflated" due to a defendant's alleged misrepresentations. *See, e.g., Miller* v. *Apropos Technology, Inc.*, No. 01 C 8406, 2003 U.S. Dist. LEXIS 5074, at *26-27 (N.D. Ill. Mar. 31, 2003);[11] *Danis* v. *USN Communications, Inc.*, 73 F. Supp. 2d 923, 943

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[10] Plaintiffs' opposition purports to revise this pleading in their brief to now state: "On August 14, 2002 investors began to learn of the true facts . . . concealed by the multi-component fraud scheme." (PM at 10 (citing AC ¶ 5).) Putting aside this post-hoc effort to amend the pleadings to reflect new positions adopted in response to this motion, this apparent concession would dictate, pursuant to *Dura*, that any declines in price *prior* to August 14, 2002 *could not be the result of any fraud by Defendants*. Moreover, if the August 14, 2002 date and an alleged "manifold scheme" actually reflect Plaintiffs' position all along, and they are not attempting to offer only an undefined target by improperly requiring defendants to guess as to plaintiffs' allegations, *Dura*, 125 S. Ct. at 1634, then it raises the question of what the purpose was of all vague references to pre-August 14 price declines in Plaintiffs' brief (PM at 2, 11) and the Complaint (AC ¶¶ 6, 22, 29, 53, 84, 85) if they cannot be the result of any fraud alleged therein.

[11] An appendix of unpublished decisions, other than those previously provided to the Court as appendices to the prior briefing by the parties, is submitted herewith.

(N.D. Ill. 1999) (holding that "[p]laintiffs' allegations of an inflated purchase price suffice to meet their burden of pleading loss causation"); *Fujisawa Pharmaceutical Co.* v. *Kapoor*, 814 F. Supp. 720, 727 (N.D. Ill. 1993). After *Dura*, such cases are no longer good law. *See, e.g., Conaway*, 133 Fed. Appx. at 1000 ("[r]ather, the heart of [plaintiff's] causation theory looks remarkably like Broudo's allegations in his complaint: 'Plaintiffs and the Class have suffered damages in that, in reliance on the integrity of the market, they *paid artificially inflated prices* for Kmart publicly traded securities'" (emphasis in original)).

In attempting to portray the watershed *Dura* opinion as a non-event, Plaintiffs argue that *Dura* effected no change at all in Seventh Circuit law. This is supposedly because two of the three pre-*Dura* cases in this District cited above can be "distinguished" as "IPO" cases, for which a different loss causation rule supposedly is followed in this Circuit. (PM at 7 & n.9.) No such distinction appears in *any* of the three cases, let alone the two that Plaintiffs purport to "distinguish." In any event, Plaintiffs are simply wrong. *Dura* makes clear that its rules apply to *all* securities fraud cases irrespective of their facts or theories. *Dura*, 125 S. Ct. at 1631-33 (citing, *inter alia*, the Restatement (Second) of Torts and the Private Securities Litigation Reform Act of 1995, 109 Stat. 737). It is therefore simply inaccurate to argue that *Dura* did not effect a change to the law in this Circuit, or that courts within this Circuit did not previously permit the "artificial inflation" type pleading contained both in this Complaint and in the complaint drafted by the same counsel in *Dura*.

After *Dura*, all securities fraud plaintiffs must state a theory of loss causation that does not simply claim *all* price declines were "caused" by the alleged fraud. *Dura* precludes recovery for market price declines that take place *before* any prior misrepresentations are corrected, because the market has (by definition) not yet incorporated the value of the deception into the stock price. 125 S. Ct. at 1631.[12] *Dura* also precludes recovery for market price declines that take place

[12] In this sense, given Plaintiffs' latest designation of August 14, 2002 as the date that "investors began to learn the true facts about Household's . . . multi-component fraud scheme" (PM at 10), *Dura* precludes any recovery by class members who sold their holdings prior to August 14, 2002. *Id.* at 1631.

after prior misrepresentations are corrected, unless the plaintiff can explain *how* the corrected misstatements caused the loss. *Id.* at 1632 ("[w]hen the purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific events or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price").

To distinguish between (i) losses caused by fraud and (ii) unrecoverable losses arising from "changed economic circumstances, changed investor expectations, new industry-specific events or firm-specific facts," a plaintiff must be able to connect a particular decline in price to the "truth" entering the market place, and the market's reaction to that new "truth"—"apples to apples" *Dura*, 125 S. Ct. at 1634 (dismissing complaint for failure to specify "what the *causal connection* might be between [the alleged] loss and the [Defendant's alleged] misrepresentation"). Although *Dura* itself does not use the term "corrective disclosure," it is the "corrective" effect of the "truth" entering the marketplace and the market's reaction to that new information that, under *Dura*, determines whether a plaintiff has stated a claim or not.

Plaintiffs' contention that *Dura* does not substantively require any "corrective disclosure" to satisfy loss causation (PM at 3-4, 12-17) is a mischaracterization of that decision. Indeed, the corrective disclosure and the market's reaction thereto is what *Dura* is all about.[13]

The Sixth Circuit's *Conaway* decision specifically negates Plaintiffs' argument and provides persuasive reasoning for this Court. Applying *Dura's* principles to a similar complaint asserting damages from allegedly "artificially inflated prices," the Sixth Circuit dismissed a securi-

[13] Plaintiffs improperly cite to the *questions* posed by certain Justices during oral argument as reflecting the *law* announced by the Supreme Court in the *Dura* opinion. (PM at 3 & n. 4.) This is just silly. Judges' and Justices' questions during oral argument are at least as likely to be testing counsel's position as they are to be stating the questioner's point of view. Likewise, on a nine Justice Court, a single Justice's questions might, at best, be suggested to reflect only that Justice's views—assuming they do so at all. Plaintiffs' reliance on non-party *amicus* briefing fares no better. (PM at 3-4, 7, 13.) Any suggestion that a non-party's brief speaks for the Court to which it was submitted is ridiculous.

ties plaintiff's complaint for failure properly to identify any corrective disclosure and failure to distinguish between ordinary market losses and losses caused by the alleged "fraud." *Conaway*, 133 Fed. Appx. at 999-1000.[14] To this end the Sixth Circuit observed:

> [The complaint] did not plead that the alleged fraud became known to the market on any particular day, did not estimate the damages that the alleged fraud caused, and did not connect the alleged fraud with the ultimate disclosure and loss. Rather, the heart of [plaintiff's] causation theory looks remarkably like Broudo's allegations in his complaint: "Plaintiffs and the Class have suffered damages in that, in reliance on the integrity of the market, they *paid artificially inflated prices* for Kmart publicly traded securities."

Id. (emphasis in original).

Applying *Dura's* principles in practice, the *Conaway* court explained that the Supreme Court found the *Dura* plaintiffs' complaint "legally insufficient" for three distinct reasons, because it:

> (1) failed "to claim that Dura's share price fell significantly after the truth became known,"
>
> (2) failed to specify "the relevant economic loss," and
>
> (3) failed to describe the "causal connection . . . between [the] loss and the misrepresentation."

133 Fed. Appx. at 999 (quoting *Dura*, 125 S. Ct. at 1634) (alteration in original).

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[14] Recognizing that *Conaway* cannot be avoided on the merits, Plaintiffs object to this Court's consideration of it on rule grounds. Plaintiffs' argument — which cites to the wrong rule — fails. *See* PM at 16 (citing Seventh Circuit Rule 53(b)(2)(iv)). But Seventh Circuit Rule 53(e) readily permits citation to *Conaway* on this motion. *See Rauen* v. *United States Tobacco Manufacturing L.P.*, 161 F. Supp. 2d 899, 905 n.8 (N.D. Ill. 2001) (relying upon Seventh Circuit Rule 53(e) to support citation to unpublished Sixth Circuit decisions that have "precedential value in relation to a material issue in a case" (quoting 6th Cir. R. 28(g))), *aff'd*, 319 F.3d 891 (7th Cir. 2003). As the first circuit court decision applying *Dura, Conaway* clearly adds "precedential value" to this case. Indeed, it is worth noting that Rule 53(b)(2)(iv) — the rule wrongly cited by Plaintiffs with respect to *Conaway* — actually *prohibits Plaintiffs'* citation to *Greater Pennsylvania Carpenters Pension Fund* v. *Whitehall Jewelers, Inc.*, 04 C 1107, 2005 U.S. Dist. LEXIS 12971 (N.D. Ill. June 30, 2005), which is cited repeatedly and improperly in Plaintiffs' brief. (PM at 3, 7, 8, 13.)

Numerous other decisions have similarly required plaintiffs explicitly to allege a "corrective disclosure" or other "corrective event" either by or about the company to properly plead loss causation. *See, e.g.*, *Lentell* v. *Merrill Lynch & Co.*, 396 F.3d 161, 175 n.4 (2d Cir. 2005) (affirming dismissal of fraud claims and noting that plaintiffs' allegations did "not amount to a corrective disclosure . . . because they [did] not reveal to the market the falsity of the prior recommendations"); *In re Acterna Corp. Securities Litigation*, 378 F. Supp. 2d 561, 582 (D. Md. 2005); *In re Initial Public Offering Securities Litigation*, MDL 1554 (SAS), No. 21 MC 92 (SAS), 04 Civ. 3757 (SAS), 2005 WL 1162445, at *3 (S.D.N.Y. May 16, 2005) ("*IPO 1*").[15]

Although some decisions do not specifically use the phrase "corrective disclosure," *all* post-*Dura* decisions maintain the same substantive requirement for pleading loss causation—*i.e.*, that the defendants' stock price fell "significantly" as a result of the truth becoming known. *See, e.g.*, *Porter* v. *Conseco Inc.*, No 1:02-cv-01332-DFH-TAB, 2005 U.S. Dist. LEXIS 15466, at *7 (S.D. Ind. July 14, 2005) (finding that "[t]he key allegation missing from the complaint, in the Supreme Court's view, was an allegation 'that Dura's share price fell significantly after the truth became known'") (citing *Dura*, at 1634). This includes, *inter alia, In re Daou Systems, Inc.*, relied upon heavily by Plaintiffs (PM at 3, 13, 14, 17) for the incorrect proposition that "corrective disclosures" or their equivalent are not required by *Dura*. *See In re Daou Systems, Inc.*, 411 F.3d 1006, 1026-27 (9th Cir. 2005) (accepting for loss causation purposes "a steep drop in Daou's stock price following the revelation of Daou's true financial situation," but rejecting *pre-disclosure* price drops because "the true nature of Daou's financial condition had not yet been disclosed"). The only opinion referenced by Plaintiffs that even implicitly rejects such a substantive requirement is *In re Worlds of Wonder*. And that is because *Worlds of Wonder* is a *repudiated* pre-*Dura* Ninth Circuit decision.[16]

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[15] *See also, e.g.*, *In re Initial Public Offering Securities Litigation*, MDL 1554 (SAS), No. 21 MC 92 (SAS), 04 Civ. 3757 (SAS), 2005 U.S. Dist. LEXIS 12845, at *28 (S.D.N.Y. June 28, 2005) ("*IPO 2*"). In *IPO 2*, the court explicitly held that "plaintiffs' failure to allege a corrective disclosure of the falsity of defendants' opinion precludes any claim that such falsity caused their loss." *Id.* at *29.

[16] Indeed, Plaintiffs' opposition relies heavily on *In re Worlds of Wonder Securities Litig.*, 35 F.3d 1407

Footnote continued on next page.

Plaintiffs' argument that "*Dura* does not require a stock price drop tied to a corrective disclosure" (PM at 12-17) is just wrong. Of course, a "corrective" disclosure need not be, as Plaintiffs suggest (PM at 3 n.4), an explicit statement that "I'm a liar." Instead, what must be alleged are: (i) identifiable facts revealed on a particular date that (ii) exposed a prior false statement, and (iii) the market's "significant" negative reaction to that new revelation. *See, e.g., IPO 1*, 2005 WL 1162445 at *3 ("in material misstatement and omission cases [after *Dura*] . . . a plaintiff must explicitly allege a disclosure *or some other corrective event*").

Plaintiffs' invocation of cases like *WorldCom* is likewise of no moment. (PM at 14-15.) Such cases have no relevance to this case. As part of HSBC, Household is today a successful, thriving business, not a bankrupt shell of a company with an incarcerated former CEO. Putting this distinction aside, however, there is nothing about the corrective disclosure requirement of *Dura* and *Conaway* that would insulate malefactors like WorldCom from liability. Indeed, Plaintiffs' brief explicitly notes that three successive corrective disclosures took place over the course of WorldCom's meltdown. (PM at 14-15 (noting three successive billion dollar restatements ending on March 12, 2004 with a "$74 billion restatement").) *Each* of these events led to well-known market reactions and a "significant" decline in WorldCom's stock price—eventually to zero.[17] *See, e.g., In re Acterna Corp. Securities Litigation*, 378 F. Supp. 2d 561, 582-85 (D. Md. 2005) (referring to the

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Footnote continued from previous page.

(9th Cir 1994). (PM at 4, 13, 15.) Put simply, *Worlds of Wonder*, as a pre-*Dura* loss causation case from the Ninth Circuit, has been **overruled** by *Dura*. The opinion in *Worlds of Wonder* explicitly relies for its holding on the now-rejected proposition that "[l]oss causation exists where the misrepresentation *touches upon* the *reasons* for the investment's decline in value." *Id.* at 1422 (emphasis in original) (citations and internal quotation marks omitted). This construction of loss causation, however, was *explicitly rejected* by the Supreme Court in *Dura*. 125 S. Ct. at 1632 ("[t]o 'touch upon' a loss is not to *cause* a loss, and it is the latter that the law requires") (emphasis original). Notwithstanding Plaintiffs' stubborn (and desperate) reliance on it, *Worlds of Wonder* is no longer good law.

[17] Plaintiffs citation (PM at 15) to *Goldberg* v. *Household Bank*, 890 F.2d 965 (7th Cir. 1989), is also specious, because Defendants do not contend that "other parts of [the company's] business did better than expected, counterbalancing the loss." This irrelevant citation only demonstrates Plaintiffs' desperate desire to deflect any consideration of the real problems inherent in their Complaint.

information that revealed the fraud in *WorldCom* and other such cases as "corrective disclosure[s]" and holding that a "plaintiff must allege . . . that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security" (citations and quotation marks omitted)).

Which is, of course, the key distinction in this case. Although Household's stock did decline over the class period along with the rest of the market, there was no "revelation" of a "fraud" that led to ("caused") a "significant" decline in Household's stock price. *Dura*, 125 S. Ct. at 1634; *Conaway*, 133 Fed. Appx. at 999. To the contrary, the "disclosure" of the "frauds" alleged by Plaintiffs' Complaint did not lead to ("cause") any declines at all. Such claims cannot survive this new Supreme Court authority.

III. PLAINTIFFS' CONSUMER-BASED "PREDATORY LENDING" CLAIM FAILS UNDER *DURA* AND ESTABLISHED FEDERAL SECURITIES LAW

While the Complaint is replete with partial and misleading quotations from numerous "sources," the reasoning that supposedly transforms "predatory lending" into "securities fraud" is reflected in one, and only one, paragraph, which asserts:

> As set forth in ¶¶ 51-106, defendants' fraudulent predatory lending scheme persisted throughout the entire Class Period and eventually resulted in a $525 million charge against Household's earnings, $484 million of which was for a nationwide settlement with state attorney generals [sic]. (AC ¶ 319.)

Although the alleged "$525 million charge" is presented in the Complaint as if it were a correction to prior financial statements, on its face it plainly is not. It reflects a settlement of disputed legal claims, plain and simple. The Complaint does not allege that the results of operations were inaccurately or falsely reported as a result of any alleged "predatory lending." Nor does it allege that investors were unaware of the existence of various consumer lawsuits against the Company before they were settled. To the contrary, Plaintiffs' own Complaint repeatedly admits that the

state lawsuits were highly publicized. (*See, e.g.*, AC ¶¶ 53, 56, 58, 62, 65, 66, 69, 74, 76, 79, 80, 82, 84, 85, 89, 90, 92, 93.)[18]

Plaintiffs' recently conjured argument of convenience that the "predatory lending" claims are not actually based upon Household's $484 million settlement of "consumer claims" does not survive scrutiny of the Complaint. Indeed, notwithstanding the fact that Plaintiffs' brief *omits* any mention of the settlement, it is undeniably the *settlement* of those consumer claims that is the centerpiece of Plaintiffs' improper effort to repackage "consumer" claims before this Court as "securities fraud." (AC ¶¶ 51-106; 319.)

Likewise, Plaintiffs' suggestion that the alleged "fraudulent statements" reflect something other than a denial made in good faith of disputed "consumer claims" does not survive scrutiny of the Complaint. (*See* PM at 20 (contending that "defendants attributed Household's dramatic success to management's savvy business acumen and . . . minimized the impact of consumer lawsuits").) To the contrary, the Complaint's alleged "misrepresentations" relating to "predatory lending" focus directly upon the disputed consumer lawsuits. For example, the supposedly "fraudulent" statements identified in the Complaint include the following:

(i) [T]he Company had issued a formal statement regarding charges of predatory lending, stating that Household "vehemently denies any assertion that it has willfully violated laws that regulate its business." (AC ¶ 301);

(ii) "Our position is that the accusations [regarding predatory lending] are baseless . . . The loans are legal, they are compliant with state and federal laws and our own policies . . . ." (AC ¶ 329);

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[18] Plaintiffs now contend that the public did not know about "the existence of such lawsuits before they were settled," notwithstanding the dozens of admissions in their own Complaint that contradict this new contention. *Compare* PM at 20 (asserting that "truth is a fact issue"), *with* AC ¶¶ 53, 56, 58, 62, 65, 66, 69, 74, 76, 79, 80, 82, 84, 85, 89, 90, 92, 93 (contradicting any contention by Plaintiffs that investors were unaware of the existence of the state attorneys general lawsuits before they were settled). Plaintiffs cannot survive this motion by contradicting their own allegations or attempting to retract their own admissions.

(iii) "It is our regulators' and the attorney general's [sic] job to investigate any complaints brought forth by consumers in their state, and we don't find anything unique or surprising that they are doing their job . . . ." (AC ¶ 330); and

(iv) "Now let's talk about the lawsuits. . . . We think they are wrong . . . . I cannot go into details, except to say that I am confident that our best practices and our current model will ultimately prevail." (AC ¶ 334.)

Plaintiffs now seek to mischaracterize and recast these allegations precisely because such statements cannot support a piggyback claim for "securities fraud" upon a subsequent settlement of disputed allegations.

It is well established that a company is not required to admit a disputed liability in order to avoid violating the securities laws. *See, e.g.*, *Anderson* v. *Abbott Laboratories*, 140 F. Supp. 2d 894, 906-07 (N.D. Ill.) ("SEC rules do not create a duty to confess contested charges. . . . Where there exists a good faith dispute as to facts or an alleged legal violation, the [law] only requires disclosure of the dispute" (citations and quotations omitted) (alteration in original)), *aff'd sub nom. Gallagher* v. *Abbott Laboratories*, 269 F.3d 806 (7th Cir. 2001). Nor is a company required to accuse itself of wrongdoing:

> [T]he SEC's proxy disclosure rules do not require a company's management to confess guilt to uncharged crimes, or "to accuse itself of antisocial or illegal policies. . . ." [S]uch a requirement "would make a silly, unworkable rule. It would not promote increased disclosure, but would serve only to support vexatious litigation and abusive discovery." There is no reason why a different rule should apply under § 10(b). . . . It would be "silly" and "unworkable" to require [a company] to state, for example, "The Company promotes a corporate culture in which violations of government regulations are bound to occur," or "The Company is in flagrant violation of numerous governmental regulations."

See Ballan v. *Wilfred American Educational Corp.*, 720 F. Supp. 241, 249 (E.D.N.Y. 1989) (citations omitted). Indeed, *In re Providian Financial Corp. Securities Litigation*, cited by Plaintiffs (PM at 17-19), explicitly recognizes this principle which is fatal to Plaintiffs' predatory lending allegations. *See* 152 F. Supp. 2d 814, 824 (E.D. Pa. 2001) ("*Providian*") ("the defendant does not have a Rule 10b-5 duty to disclose mere speculations of investigation or litigation or generally to disparage Providian's business practices").

Plaintiffs' argument that "this is not a consumer case" falls apart when Plaintiffs explain how investors allegedly "learned" of the alleged "fraud." It is not from any disclosure of falsely reported revenue. It is not from any admission by the Company that its financial statements were incorrect. Nor, as in *Providian*, is it from any admission, *inter alia*, that the company had "report[ed] at least $20 million in late fees that were not actually earned." *Id.* at 823. Instead, it is from nothing more or less than the *settlement of the disputed consumer claims*. The Complaint states:

> It was only at the end of the class period, on 10/11/02, *when defendants announced that the Company would pay $484 million to settle predatory lending charges*, that investors learned Household had been conducting its nationwide operations in direct violation of federal and state lending laws. (AC ¶ 23.)

This allegation is the "punch line" of Plaintiffs' theory of "predatory lending" as "securities fraud." Thus, this supposed "fraud" is revealed to be nothing more or less than a voluntary settlement of disputed consumer complaints — a decision made by the Company because it was in the Company's interest to do so. And investors did respond to this decision -- *positively*. As this motion observes, upon the Company's settlement of these disputed claims, Household's stock price went *up*, not down. *See supra* pp. 5-6 and note 8.

The Complaint's failure to specify or explain what *other than* the consumer lawsuit settlement actually supports these claims for "securities fraud" is another part of Plaintiffs' insurmountable *Dura* problem. Were Plaintiffs to identify an actual "corrective disclosure," there would be no need to "guess" about "what the *causal connection* might be between that loss and the [alleged] misrepresentation." *Dura*, 125 S. Ct. at 1634. Likewise, if the October 11, 2002 settlement that ends the class period truly was the date when "investors learned" of the alleged scheme to defraud (AC ¶ 23), the stock price would have gone down, not up.

Dura requires that Plaintiffs distinguish losses "caused" by the alleged fraud from other losses caused by other factors. *Dura*, 125 S.Ct. at 1632. To permit Plaintiffs to allege anything less would "transform . . . private securities action[s] into a partial downside insurance policy" for any and all market price declines. *Id.* at 1634. The Complaint fails to meet its burden under

Dura, and Plaintiffs have insisted that they have no obligation to do any more than they have done. As a result, dismissal is compelled.

CONCLUSION

For the foregoing reasons, as well as the reasons set forth in Defendants' opening brief on this motion, the allegations of Plaintiffs' Complaint as to loss causation are legally insufficient given the Supreme Court's decision in *Dura* and the Complaint should be dismissed without leave to replead.

Dated: September 16, 2005
Chicago, Illinois

Respectfully submitted,

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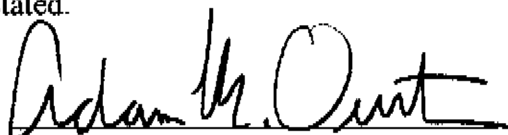
CERTIFICATE OF SERVICE

Adam B. Deutsch, an attorney, certifies that on September 16, 2005, he served copies of Household Defendants' Reply Memorandum of Law in Further Support of Their Motion to Dismiss Pursuant to the Supreme Court's Recent Decision in *Dura Pharmaceuticals, Inc. v Broudo*, to the parties listed below via the manner stated.



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