

No. 13-3532

**UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

GLICKENHAUS INSTITUTIONAL GROUP,

Plaintiff-Appellee,

v.

HOUSEHOLD INTERNATIONAL, INC., ET AL.,

Defendants-Appellants.

On Appeal from the United States District Court
for the Northern District of Illinois
No. 02-CV-5893
The Honorable Ronald A. Guzmán, District Judge

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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)
Situating,)

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

DEMAND FOR JURY TRIAL

**[CORRECTED] AMENDED CONSOLIDATED CLASS ACTION COMPLAINT
FOR VIOLATION OF THE FEDERAL SECURITIES LAWS**

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I. INTRODUCTION

1. This is a securities class action on behalf of all persons who purchased or otherwise acquired securities of Household International, Inc. ("Household" or the "Company"),¹ during the period from 10/23/97 to 10/11/02 (the "Class Period"), including common and preferred stock, bonds, notes, InterNotes(SM) and Trust indentures. This action is brought against the Company, certain of its senior officers and directors, its outside auditor, Arthur Andersen LLP ("Andersen"), as well as Goldman Sachs & Co., Inc. ("Goldman Sachs") and Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"), which acted as financial advisors in connection with Household's 6/98 acquisition of Beneficial in an \$8 billion share-for-share exchange.

2. Between 10/97 and 10/02, Household engaged in the widespread abuse of its customers through a variety of illegal sales practices and improper lending techniques, such as deliberately confusing or misleading them with respect to rates, points, fees and penalties and other federally mandated disclosures. During the Class Period, defendants also improperly "reaged" or "restructured" delinquent accounts, thereby manipulating Household's publicly reported financial statistics regarding delinquencies and credit loss reserve ratios so as to make Household's operations appear stronger and more profitable than they were. The false statistics reported by defendants were also designed to give the appearance that the credit quality of Household's borrowers was more favorable than it actually was.

3. Throughout the Class Period, defendants concealed that Household was engaged in a massive predatory lending scheme, in violation of federal disclosure guidelines, whereby Household systematically abused customers for the purpose of reporting purported "record" financial results throughout the Class Period. Defendants' wrongful scheme allowed them to artificially inflate the Company's financial and operational results, key financial metrics and risks associated with investing in the Company, including revenues, net income and earnings per share ("EPS"). Together with Andersen, Household's senior executives also manipulated the manner in which Household

¹ Unless specified otherwise, Household or the Company includes its subsidiaries, Household Finance Corporation, Inc. ("HFC"), and Beneficial Corporation ("Beneficial"), subsequent to its merger with Household on 6/30/98.

accounted for costs associated with the Company's co-branding agreements, affinity agreements and marketing agreements.

4. Defendants' scheme was crucial to Household's operations, as the perceived strength of its borrowers and the credit quality of its loan portfolio were extremely important to Household because the Company's business required it to constantly return to the debt securitization markets to fund Household's operations. In fact, Household registered and/or sold more than \$75 billion worth of debt securities during the Class Period by consistently registering and selling securities via its HFC subsidiary. The credit quality of its customers and the strength of its reported statistics concerning delinquencies and credit loss reserve ratios were the metrics by which the quality, and thus the desirability, of the securities were evaluated by the market. Therefore, it was of paramount importance to Household that it continue to conceal the truth about its operating performance throughout the Class Period.

5. It was not until mid-2002 that investors began to learn about the actual financial and operating condition of the Company. For example, during 3Q02, defendants were forced to admit that Household's earnings had been falsely reported for approximately eight and one-half years and that *Household would take a \$600 million charge and restate its previously reported earnings for each and every quarter of the Class Period*. This \$600 million (pre-tax) charge had the effect of wiping out \$386 million of earnings previously reported by the Company. Then, during the first weeks of 4Q02, Household announced it had entered into a \$484 million settlement agreement to resolve claims relating to its illegal, widespread predatory lending practices. Defendants have now admitted that this settlement and related costs resulted in a massive \$525 million charge against the Company's earnings.

6. As investors would later come to discover, the strong growth claimed by Household during the Class Period was illusory. Rather, it was the combination of predatory lending practices, improper reaging of delinquent loans and false accounting that allowed Household to report "record" financial results quarter after quarter throughout the Class Period. In fact, predatory lending, reaging and accounting manipulations were so central to Household's business model that, as defendants were forced to abandon these illegal practices, the price of Household securities plummeted. As

news of the massive predatory lending settlement leaked out during the first week of 10/02, the price of Household stock dropped to as low as \$20.00 per share, 70% below its Class-Period high. The decline in the price of Household stock reflected the market's realization that, without the ability to continue the unlawful activities detailed herein, the Company had lost its "competitive advantage." In fact, on 11/14/02 – one month after taking the second of two charges totaling over \$1 billion – Household's Board of Directors ("Board") decided to sell the Company to HSBC Holdings plc ("HSBC") at a time when Household stock was trading at a seven-year low. Defendants' decision to sell Household quickly and at a bargain-basement price was a direct result of the fact that Household could no longer produce "record" results, having lost the advantage of using (a) predatory lending practices; (b) improper "reaging" techniques; and (c) accounting chicanery to manipulate Household's financials. With HSBC as a white knight, Household would be able to have HSBC supplement the Company's reserves and avoid additional massive writeoffs. Notwithstanding the fact that defendants' fraud has resulted in the elimination of well over \$25 billion in market capitalization, the sale to HSBC was structured to ensure an immediate windfall to defendants William F. Aldinger ("Aldinger") and David A. Schoenholz ("Schoenholz"). Aldinger will receive over \$60 million in consideration and options accelerations as a result of the proposed merger with HSBC, including a \$10 million "special retention grant" for selling Household to HSBC. Schoenholz will receive over \$20 million.

II. SUMMARY OF THE ACTION

7. Household was created as a holding company in 1981 as a result of the restructuring of HFC, which was established in 1878. Prior to the restructuring, Household operated in the financial services, individual life insurance, manufacturing, transportation and merchandising industries. Following the restructuring, the Company shifted the focus of its operations into the financial services business. From late 1994 through 1997, Household exited from several businesses that the Company claimed were providing insufficient returns on investment, such as its first mortgage origination and servicing business in the United States and Canada, the individual life and annuity product lines of its individual life insurance business, its consumer branch banking business, and its student loan business.

8. By the beginning of the Class Period, Household was principally a nonoperating holding company whose subsidiaries provided middle-market consumers with several types of loan products in the United States, United Kingdom and Canada. Household's customer base is primarily composed of nonconforming, nonprime or subprime consumers. Such customers generally have limited credit histories, modest incomes or high debt-to-income ratios or have experienced credit problems caused by occasional delinquencies, prior charge-offs or other credit-related actions.

9. Household became one of the nation's largest mortgage lenders, through a combination of organic growth and acquisitions. In fact, immediately prior to and through the beginning of the Class Period, Household acquired several large consumer finance companies, which fueled its rapid growth, including:

- 5/97 Household acquires Transamerica Corporation's consumer finance business for \$1.1 billion in cash.
- 8/97 Household acquires ACC Consumer Finance Corporation, a subprime auto lending business, for \$200 million in cash and stock.
- 6/98 Household acquires Beneficial, a consumer finance holding company, in an \$8 billion acquisition, with Household issuing over 168 million shares of common stock.
- 8/99 Household acquires Decision One Holding Company LLC, a privately held originator of nonconforming first and second mortgage loans.
- 2/00 Household acquires Renaissance Holdings, Inc. (a privately held issuer of secured and unsecured credit card programs), for \$300 million.
- 3/00 Household acquires Banc One's \$2.15 billion home equity portfolio for cash.

10. As Household grew through acquisitions, the Company consistently told the market that Household had a competitive advantage through a sophisticated centralized technology system known as "Vision." The Vision system was purported to generate sales leads, reduce paperwork and, most importantly, centralize decision making throughout the loan origination process. This included generating scripts for sales staff, monitoring collections and delinquencies and determining charge-offs. The Vision system purportedly allowed the Company to maximize profits by cross-selling and up-selling products to its customers, monitoring delinquencies and collections, and managing lending risk. The Vision system was so critical to the Company's purported success that, in 2/00, Household

was awarded a national information technology award from *CIO* magazine for the Vision system's superior technology and information management.

11. Monitoring loan originations and performance was critical to Household's success – not only were Household's revenues dependent on loan originations, but the Company also met its funding requirements by reselling its loans as asset-backed securities through securitizations of its loan pools, *i.e.*, selling receivables for cash but continuing to service them for a fee. Since these securitized loan pools were sold immediately for cash, Household was able to record income from the spread between its loan cost and the price for which it sold the loan pool – commonly referred to as net interest margin ("NIM") income. Additionally, since Household was not a depository bank, income from securitizations was essential to its continuing operations. During the Class Period, Household raised over \$75 billion in funding through the securitization markets.

12. Since Household both generated loans from high risk borrowers and then sold these loans as asset-backed securities, it was critical to Household's profitability that it produce loan pools that were both stable and consistent. Investors were consistently assured that Household could achieve this goal through its sophisticated Vision system, as well as from having a unique "hands-on" customer relations programs and "flexible" loan collection policies. In fact, the Vision system enabled the Company to monitor and detect delinquent loans and was central to defendants' scheme of arbitrary "reaging" or "restructuring" of delinquent loans to make them current. Indeed, the Vision system itself was programmed to automatically reage delinquent accounts.

13. The Company's stated policy for reaging consumer receivables permitted Household to reset the contractual delinquency status of an account to current if a predetermined number of consecutive payments had been received, and there was evidence that the reason for the delinquency had been cured. Defendants, however, failed to follow their own internal reaging policies. Throughout the Class Period, delinquent accounts were clandestinely reaged, in violation of Household's policy, upon the receipt of partial payment without any evidence that the account would no longer be delinquent.

14. Thus, throughout the Class Period, defendants concealed that they had used reaging as a means to simply avoid reporting otherwise delinquent accounts and had failed to adequately

reserve for them. Defendants used "reaging" in order to materially understate the Company's true asset quality ratio and overstate EPS during the Class Period. This had the effect of lowering the number of defaults or delinquencies – a significant risk factor of Household's securitization program.

15. In addition, to address the other significant risk factor of their securitization program – prepayment of loans – defendants engaged in a consistent and widespread pattern of predatory lending practices prior to and throughout the Class Period, as detailed in ¶¶51-106 herein.

16. By mid-1998, Household began its exit from the consumer, mass-market credit card business, selling almost \$2 billion in credit card receivables because this business had become too competitive. The credit card market was plagued by severe cannibalization, as credit card debtors were regularly solicited with better offers for increasingly lower financing deals.

17. Intent on evading the pitfalls of the mass-market credit card business, defendants knew they had to prevent premature payoff of Household's secured loans via loan refinancings. To prevent prepayment of its secured loans via refinancings, defendants concocted the scheme complained of herein, whereby loans made to Household customers used all of a borrower's equity in a property at the time a loan was made. In this way, Household substantially reduced prepayment risk because it knew that it would be virtually impossible for competitors to come in and refinance Household customers under such circumstances. Also, in order to further deter prepayment of its secured loans, Household hid prepayment penalties in its loan documents and had Household employees conceal this from borrowers.

18. Throughout the Class Period, Household engaged in the following forms of predatory lending practices: (a) false and deceptive loan practices, including fraud and forgery; (b) improper disclosures; (c) insurance sales abuses; (d) charging "discount points," which bore no relation to interest rates charges; and (e) concealing prepayment charges. These practices were detailed in the "Washington Department of Financial Institutions Expanded Report of Examination for Household Finance Corporation III," dated 4/30/02 ("WA Report"), published by the Washington Department of Financial Institutions ("WA Department"), attached hereto as Ex. 2, the contents of which were publicly disclosed on 8/29/02. The WA Report listed Household customer complaints from 1995 to 2002 and described in detail complaints between 2000 and 2002.

19. In 1/02, Household entered into a \$12 million settlement with the California Department of Corporations relating to the imposition of improper fees, penalties and charges on California customers. Although the price of Household's stock declined almost 20% in the days following Household's settlement with the California Department of Corporations, defendants continued their scheme and wrongful course of business by attempting to conceal the truth about the California Department of Corporations' actions – maintaining that the overcharges were due to computer errors. Almost 75% of the settlement (\$9 million) was for penalties, while only \$3 million was for customer refunds.

20. Concerned that they would no longer be able to conceal their reaging and predatory lending scheme, defendants redoubled their efforts in early 2002 to convince the market that the Company was not engaged in any improper lending practices or accounting improprieties. For example, on 2/07/02, Company spokesperson Megan Hayden ("Hayden") was quoted by *Copley News Service* as stating, "We make good loans that not only are legal loans, but are beneficial for our customers." In addition, defendant Schoenholz insisted that predatory lending allegations were "not a significant issue, not indicative of any widespread problem and certainly not a concern that it will spread elsewhere." *National Mortgage News*, 2/18/02. Defendants' repeated assurances had the effect of reinflating the price of Household stock almost 20%, to over \$52 per share, by the end of 2/02. As pressure on Household's stock mounted, defendants' denials became more and more adamant: "It is absolutely against our policy to in any way quote a rate that is different than what the true rate is I can't underscore that enough." *Bellingham Herald* (quoting Household spokeswoman Hayden), 4/22/02. Defendants' constant stream of assurances about the integrity and strength of Household's operations buoyed the price of Household stock back over \$60 per share in late 4/02.

21. By mid-2002, defendants' scheme was beginning to unravel, as the Officer Defendants worked tirelessly to conceal their wrongful course of business. For example, defendant Aldinger fought tirelessly between 4/02 and 8/02 to ensure that the WA Report detailing defendants' illegal practices would remain concealed from the market. However, the pervasiveness and materiality of Household's wrongful business practices could no longer be concealed. In 7/02, Household was

forced to announce another settlement of \$400,000 in Washington – again blamed on a computer "glitch." On 8/29/02, defendants lost their battle to bury the WA Report, and its damning evidence of defendants' wrongdoing was made public. Regarding the Company's position that Household's predatory lending practices were isolated or nonrecurring, the WA Department noted:

It is inconceivable that borrowers from remotely different locations could all be confused about exactly the same thing in the same way, or that HFC could somehow believe that the occurrence was isolated to a single branch location. The Department believes that the "equivalent rate" sham proffered by HFC representatives is known and likely fostered by the corporation itself or at the least, by corporate officers overseeing large segments of the country. This belief appears to be supported by HFC headquarters' knowledge of the disclosures and sales practices when responding to complaints.

Id. at 53 (emphasis added).²

22. Despite this evidence, defendants continued to deny that predatory lending practices pervaded the Company's operations. However, concerns about the veracity of defendants' denials seeped into the market, causing the price of Household securities to slip. Indeed, the reaction of the securities markets to these revelations was dramatic and eliminated billions of dollars of market value. The price of Household stock declined from over \$53.00 per share in 6/02 to approximately \$30.00 per share in late 8/02, as the magnitude and pervasiveness of defendants' fraudulent practices began to be digested by investors.

23. 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. Indeed, in 10/02, Minnesota Commerce Commissioner James Bernstein, whose department had investigated Household's predatory lending tactics for more than a year, was quoted in the Minneapolis *Star-Tribune* as stating, "Household claims that it's only a few bad apples, but we've ... found that the whole orchard is rotten.... Household's corporate culture encouraged rather than prohibited these deceptive and abusive lending practices"

24. In addition to lowering defaults through abuse of the Company's reaging policies and to lowering prepayment rates through over-financing and up-selling loans, the widespread abuse of

² All emphasis has been added, unless otherwise indicated.

Household's lending practices also had the effect of rendering the Company's financial statements materially false and misleading. Household's regularly reported key operational metrics, such as credit loss reserves, delinquencies, net charge-offs, credit quality and asset performance, were materially misrepresented by defendants' predatory lending and improper reaging practices.

25. Once Household's reaging and lending practices were revealed, it became obvious how Household had been able to report quarter after quarter of record-breaking financial success – especially during the period when the Company's competitors (such as Associates First Capital, whose shares fell by almost 50% in 1999, and ContiFinancial, which, by the end of 1999, teetered on the verge of bankruptcy) were struggling to survive. However, predatory lending and improper account reaging only partly explain how Household was able to post continuing strong growth. In addition to these manipulative and illegal activities, defendants also resorted to some simple, down-home book cooking. As investors learned in 8/02, when the Company's Chief Executive Officer ("CEO") and Chief Operating Officer ("COO") were required under the Sarbanes-Oxley Act to certify the veracity of their financial statements, Household had improperly booked an astounding \$600 million in revenue during the period 1994 through 1H02.

26. At the time this restatement was announced, Household stated that its impact on earnings by period was as follows:

\$ millions	FY94-98	FY99	FY00	FY01	1H02	1Q02	2Q02	Total
Restatement Amount	\$155.8M	\$58.1M	\$70.1M	\$75.9M	\$26.1M	\$6.1M	\$20.0M	\$386.0M

27. The restatement was dramatic and offered valuable insight into the Company's unprecedented ability to meet or exceed analysts' consensus estimates quarter after quarter. A review of the restated numbers confirms that, *without the boost provided by Household's improper accounting manipulations, the Company would not have had been able to post its purported string of back-to-back record-breaking quarters or have met or exceeded analysts' expectations throughout the Class Period.*

28. Thus, in the end, Household's secret formula for success, and its apparent ability to outperform its peers in a very trying market, was one part predatory lending, two parts accounting

chicanery and three parts public funding. Throughout the Class Period, defendants were able to fund Household's operations and grow its businesses using a combination of public offerings, billions of dollars of debt offerings and the securitization of loans. As discussed herein, defendants were able to use 168 million shares of the Company's stock as currency to acquire Beneficial, in part due to investors' perceived value that Household shares were fairly priced – not, as they came to learn after the Class Period, artificially inflated. In addition, by manipulating its lending policies and collection practices, Household was also able to reduce its loan securitization costs and artificially inflate its reported net interest margin.

29. The cumulative effect of the revelation of defendants' scheme or wrongful course of business decimated the price of Household shares. While Household shares traded as high as \$63.25 at the beginning of 1Q02, they traded in the \$20s – marking a record seven-year low for Household shares – as the truth about Household's illegal operations and accounting fraud was publicly revealed. The following chart illustrates how defendants successfully destroyed shareholder value during the Class Period:

Post-Class Period Events

30. On 11/14/02, Household announced that it had agreed to be acquired by HSBC, Europe's biggest bank. Under the proposed terms of the transaction, Household shareholders would receive 2.675 HSBC ordinary shares, or 0.5035 American Depositary Shares ("ADS"), for each Household share. Household's stock was trading at its seven-year low, and the deal valued Household shares at approximately \$28.75. Joel Gornberg, an analyst with William Blair & Company, L.L.C. ("William Blair & Co."), also noted that Household's funding problems likely were a key driver of the merger. In fact, immediately after the public disclosure of the Company's improper activities, Household's credit rating in the debt market was downgraded, inhibiting the Company's ability to fund its operations. Even defendant Aldinger acknowledged, as was reported by the *Washington Post* on 11/15/02, that growth had slowed in 3Q02 because of "funding issues." Since HSBC maintained a large base of deposit customers, it could provide funding to Household without being forced to engage in securitizations.

31. In addition, *Barron's*, on 11/18/02, made the following observations on HSBC's proposed acquisition of Household:

The deal was quickly proclaimed an odd-couple pairing of a worldly British bank and a Midwestern lender to moderate-income, often financially strapped, Americans. In this view, Household was the desperate party, eager for quick cash. And HSBC treated the company the way Household deals with its customers, using its leverage to set the terms to its greatest and most profitable advantage.

HSBC agreed to pay ... a 33% premium to Household's price before the deal, but it's half what the stock commanded as recently as April.

Household has been knocked back on its heels since then by concerns about its aggressive lending practices and accounting questions that have made the fixed-income markets unwilling to finance the company at favorable terms. Last December, with the stock around 60, Barron's suggested that Household had systematically understated its problem loans.

So, HSBC was able to grab Household at what appears to be a slender price, with the promise that the larger institution's enormous financing clout can fund the Household business at advantageous rates.

III. JURISDICTION AND VENUE

32. The claims asserted herein arise under §§10(b) and 20(a) of the Securities Exchange Act of 1934 ("Exchange Act" or "1934 Act"), 15 U.S.C. §§78j(b) and 78t(a), and Securities and Exchange Commission ("SEC") Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5. In addition, asserted herein are claims of strict liability and/or negligence arising under §§11, 12(a)(2) and 15 of the Securities Act of 1933 ("Securities Act" or "1933 Act"), 15 U.S.C. §§77k, 77l(a)(2) and 77o, and 28 U.S.C. §1331.

33. Jurisdiction is conferred by §27 of the 1934 Act, 15 U.S.C. §78aa, and §22 of the 1933 Act, 15 U.S.C. §77v.

34. Venue is proper pursuant to §22 of the 1933 Act, §27 of the 1934 Act and 28 U.S.C. §1391(3). Many of the acts and transactions giving rise to the violations of law complained of herein, including the preparation and dissemination of false and misleading information to the investing public, occurred in this District.

35. In connection with the acts, conduct and other wrongs complained of, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, the United States mails and the facilities of the national securities markets.

IV. PARTIES

A. PLAINTIFFS

36. (a) Lead plaintiff Glickenhau & Company ("Glickenhau") is an SEC-registered investment advisor with hundreds of millions of dollars of assets under management. Glickenhau is a member of the New York Stock Exchange, the National Association of Securities Dealers, the Municipal Securities Rulemaking Board and the Securities Investor Protection Corporation. Glickenhau specializes in the management of equity, balanced and fixed-income portfolios. Glickenhau purchased Household securities during the Class Period as detailed in the attached Certification and suffered substantial damage as a result thereof.

(b) Lead plaintiff PACE Industry Union Management Pension Fund ("PACE") is a self-insured, qualified Taft-Hartley Defined Benefit plan that is jointly administered and overseen by management and union trustees. Currently, the fund administers over \$3.5 billion of

pension and retirement benefits for 75,000 plan participants, including paper, pulp and board mills workers and refinery workers from the Oil, Chemical & Atomic Workers Union that merged with the PACE International Union in 2000. The PACE International Union has over 250,000 members in the United States and Canada. PACE purchased Household securities during the Class Period as detailed in the attached Certification and suffered substantial damage as a result thereof.

(c) Lead plaintiff The International Union of Operating Engineers Local No. 132 Pension Plan ("IUOE") is a self-insured, qualified Taft-Hartley Defined Benefit plan that is jointly administered and overseen by management and union trustees. Currently, the fund administers over \$160 million of pension and retirement benefits for over 3,000 plan participants. The IUOE purchased Household securities during the Class Period as detailed in the attached Certification and suffered substantial damage as a result thereof.

(d) Named plaintiff The Archdiocese of Milwaukee Supporting Fund, Inc. ("AMS Fund") is a nonprofit institution that was formed to support charitable organizations. By supporting charities in the Milwaukee area, as well as throughout the United States, the AMS Fund seeks to promote educational and social service initiatives that primarily are designed to provide assistance to the indigent and others similarly in need of assistance. The AMS Fund purchased Household securities during the Class Period as detailed in the attached Certification and suffered substantial damage as a result thereof.

(e) Named plaintiff The West Virginia Laborers' Trust Fund (the "West Virginia Fund") is a self-insured, qualified Taft-Hartley Defined Benefit plan that receives direct employer fringe contributions required under local collective bargaining agreements. Currently, the West Virginia Fund administers pension and health care benefits to more than 2,000 active and retired laborers and their families. The West Virginia Fund has approximately \$20 million in assets under management. The West Virginia Fund purchased Household securities during the Class Period as detailed in the attached Certification and suffered substantial damage as a result thereof.

B. HOUSEHOLD

37. Defendant Household is a holding company with three primary segments: consumer, credit card services and international. Defendant HFC is a wholly owned subsidiary of Household. During the Class Period, HFC acted as the finance arm of the Company and was responsible for issuing approximately \$90 billion of debt, which proceeds were used to finance Household's lending activities, conducted primarily through HFC. Household's consumer segment includes consumer lending, mortgage services, retail services and auto finance businesses. The credit card services include the domestic MasterCard and Visa credit card businesses. The Company's international segment includes foreign operations in the United Kingdom and Canada.

C. OFFICER DEFENDANTS

38. Defendant Aldinger was, during the Class Period, CEO and Chairman of the Board. Aldinger joined Household in 9/94 as President and CEO and became Chairman in 5/96. During the Class Period, Aldinger was a member of Senior Management and of the Executive Committee, which acts for the Board during intervals between Board meetings. As Household's CEO, Aldinger had general authority over all matters relating to the business and affairs of the Company, including, among other things, approving lending practices, reaging and collection techniques, as well as other business practices relating to the core operations of the Company – consumer lending.

39. Defendant Schoenholz was, during the Class Period, President and COO and Vice-Chairman of the Board. During the Class Period, Schoenholz also served as Chief Financial Officer ("CFO"), Executive Vice President-CFO and Vice-President-Chief Accounting Officer. As Household's principal financial officer and chief accounting officer throughout the Class Period, Schoenholz's responsibilities included, among other things, approving lending practices, reaging and collection techniques, as well as other business practices relating to the core operations and financial accounting of the Company.

40. Defendant Gary Gilmer ("Gilmer") was, during the Class Period, Vice-Chairman of Consumer Lending and Group Executive of U.S. Consumer Finance, as well as a member of Senior Management. Beginning in 1972, Gilmer ran HFC private label and credit insurance. He also headed United Kingdom operations before being promoted to head of U.S. Consumer Finance on

January 1, 1997. As the head of Consumer Finance throughout the Class Period, Gilmer was responsible for all aspects of the consumer lending arm of Household's business, including, among other things, approving lending practices, reaging and collection techniques, as well as other business practices relating to the core operations of the Company – consumer lending.

41. The defendants named above in ¶¶38-40 are sometimes collectively referred to herein as the "Officer Defendants." Because of their senior executive, managerial positions, the Officer Defendants knew the adverse nonpublic information about Household's business, as well as its finances, markets and present and future business prospects via access to internal corporate and financial documents (including Household's operating plans, actual and projected quarterly reports, actual and projected revenue reports and actual and projected expense reports), conversations and connections with other corporate officers and employees, attendance at management and/or Board meetings and committees thereof and via reports and other information provided to them in connection therewith. Each Officer Defendant had access to Household's core business through the Company's internal, automated technology system known as "Vision." The Officer Defendants signed various false financial statements filed with the SEC. Defendants Aldinger and Schoenholz also signed the Management's Report to Shareholders. As detailed in ¶¶192-344, during the Class Period, the Officer Defendants participated in the issuance of false and/or misleading statements, including the preparation of the false and/or misleading press releases, financial statements and other statements to the public made to analysts during conference calls and one-on-one meetings with analysts during Household's annual Financial Relations Conferences.

42. Because of their senior executive and managerial positions with the Company, the Officer Defendants possessed the power and authority to control the contents of Household's quarterly and annual reports, press releases and presentations to securities analysts, money and portfolio managers and institutional investors, *i.e.*, the market. Each of the Officer Defendants was provided with copies of the Company's reports and press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. In fact, running the business and maintaining its financial and commercial success were the principal responsibilities of the Officer Defendants.

43. The Officer Defendants are liable for the false statements pled herein, as those statements were each "group published" information, the result of the collective action of the Officer Defendants. The Officer Defendants knew or recklessly disregarded that said adverse undisclosed information had not been disclosed to and was being concealed from the investing public. The Officer Defendants also knew that the positive representations being made were then materially false and misleading. Each of the Officer Defendants either knew or recklessly disregarded the fact that the illegal acts and practices and misleading statements and omissions described herein would adversely affect the integrity of the market for Household securities and would artificially inflate or maintain the price of those securities. Each of the Officer Defendants, by acting as herein described, did so knowingly or in such a reckless manner as to constitute a fraud and deceit upon plaintiffs and members of the class plaintiffs seek to represent.

D. DIRECTOR DEFENDANTS

44. Each of the defendants listed herein was a signatory of the Registration Statement and/or a director of Household at the time of the 6/98 Beneficial merger, including:

(a) Aldinger is and was CEO and Chairman of the Board of Directors ("Board") of the Company.

(b) Schoenholz is and was CFO of the Company.

(c) Defendant Robert J. Darnall ("Darnall") is and was a member of the Board.

(d) Defendant Gary G. Dillon ("Dillon") is and was a member of the Board and the Board's Audit Committee.

(e) Defendant John A. Edwardson ("Edwardson") is and was a member of the Company's Board and the Board's Audit Committee.

(f) Defendant Mary Johnston Evans ("Evans") was a director of the Company until 5/02 and a member of the Board and the Board's Audit Committee.

(g) Defendant J. Dudley Fishburn ("Fishburn") is and was a member of the Board.

(h) Defendant Cyrus F. Freidheim, Jr. ("Freidheim") is and was a member of the Company's Board of Directors.

(i) Defendant Louis E. Levy ("Levy") is and was a director of the Company, a member of its Board and Chairman of its Audit Committee. Defendant Levy retired as Vice Chairman of KPMG, LLP ("KPMG") (a provider of accounting and consulting services) in 1990, having been with KPMG since 1958.

(j) Defendant George A. Lorch ("Lorch") is and was a member of the Board.

(k) Defendant John D. Nichols ("Nichols") is and was a member of the Board.

(l) Defendant James B. Pitblado ("Pitblado") is and was a member of the Board and the Board's Audit Committee.

(m) Defendant S. Jay Stewart ("Stewart") is and was a member of the Board.

(n) Defendant Louis W. Sullivan ("Sullivan") was a director of the Company until 5/02 and a member of the Board.

45. The defendants named in ¶44(a)-(n) are collectively referred to herein as "Director Defendants." Each of the Director Defendants signed the Registration Statement used by Household to issue 168 million Household shares in connection with the 6/98 Beneficial merger. Each of the Director Defendants participated in the issuance of the shares.

E. AUDITOR DEFENDANT

46. Defendant Andersen, a firm of certified public accountants, was engaged by Household to provide independent auditing, accounting, management consulting and tax services. Throughout the Class Period, Andersen reviewed Household's filings with the SEC, performed audits or reviews of the financial statements included in the Company's Registration Statements and other SEC reports, including audited and unaudited financial information and provided other consulting services, for which it received large fees. Andersen was engaged to and did perform these services so that Household's financial statements would be presented to stock purchasers, government agencies, the investing public and members of the financial community. As a result of the myriad services it rendered to Household, Andersen's personnel were present at Household's corporate headquarters and financial offices frequently during the Class Period and had continual access to Household's confidential corporate financial and business information, including Household's financial condition, false financial statements and business problems. Andersen actively participated

in the issuance of Household's false financial statements, issuing a false opinion on Household's financial statements during the Class Period, which was included in the Registration Statement.

F. HFC DIRECTOR DEFENDANTS

47. Defendants Aldinger, Schoenholz, Gilmer and J.A. Vozar ("Vozar") were, at all relevant times during the Class Period, directors at HFC.

G. INVESTMENT BANK DEFENDANTS

48. Merrill Lynch is a worldwide financial management and advisory company. As an investment bank, Merrill Lynch is a leading global underwriter of debt and equity securities and strategic advisor to corporations, governments, institutions and individuals worldwide.

49. Goldman Sachs is a global investment banking, securities and investment management firm that provides a wide range of services, including evaluations of mergers and acquisitions.

**VI. DEFENDANTS' FRAUDULENT SCHEME
AND WRONGFUL COURSE OF BUSINESS**

50. Defendants' fraudulent scheme and wrongful course of business was designed to, and did, allow Household to regularly report "*record*" revenues and earnings and caused Household's securities to trade at artificially inflated levels throughout the Class Period. Defendants' misconduct included:

- (a) Predatory lending practices designed to maximize amounts lent to borrowers in the subprime market at unconscionable interest rates;
- (b) Misrepresentation and manipulation of defaults and delinquencies by arbitrarily reaging delinquent accounts, thereby effectively lowering the amount of credit loss reserves necessary and proper to cover the risk to which the Company was exposed; and
- (c) Improper accounting of expenses associated with its credit card co-branding, affinity and marketing initiatives agreements, which, when discovered by the Company's newly-appointed auditor, KPMG, led to a \$600 million (pre-tax) restatement (going as far back as 1994), and resulted in lowering earnings throughout the Class Period.

A. HOUSEHOLD'S ILLEGAL PREDATORY LENDING PRACTICES WERE FORMULATED BY DEFENDANTS AT THE COMPANY'S CORPORATE HEADQUARTERS

51. Household's lending strategy was to provide loans to borrowers tailored to maximize the loan-to-value ("LTV") ratio of a loan (and thus the loan amount), rather than to meet the borrowers' financial needs. Loan officers were trained to ensure that the loan would be for as much money as possible, equal to or higher than the equity a borrower had in a property. The Company targeted homeowners who carried both a mortgage and significant consumer debt and persuaded these individuals, by deliberately misleading them using confusing and unfair sales tactics, that consolidating their debts into one or more secured loans with Household would save them money, when in fact it would not. Household would then make secured loans to borrowers in amounts high enough in relation to the value of their homes that the resulting debt-to-value ratio, coupled with prepayment penalties and other restrictions, prevented them from refinancing their loans with Household's competitors – thereby ensuring continued profits from the Company's own high cost loans. On top of those loans, Household would "up-sell" secondary loans to borrowers, whether they needed or wanted a secondary loan, frequently without the borrowers' knowledge. These loans were used primarily to pay for the excessive charges the Company had piled onto the borrowers' primary loans. In fact, Household designed its secondary loans so it could avoid federal disclosure rules and spring them on borrowers at the time of closing. These secondary loans, which regularly carried interest rates of 20% and above, also served the purpose of further eliminating borrowers' equity.

52. Household's sophisticated and specially designed predatory lending practices include:

- (a) Misrepresenting the actual interest rates on loans by falsely telling customers that making bi-weekly payments with Household's EZ Pay Plus Bi-weekly Payment Plan ("EZ Pay Plan") would produce lower interest rates, when it would not;
- (b) Charging finance charges or "discount points" that bore no relation to interest rates charged, failing to disclose the existence or amount of up-front finance charges and failing to disclose to customers that finance charges would be added to the amount of total debt owed;
- (c) Failing to disclose that loans contained prepayment penalties that effectively prevented refinancing with another lender;

- (d) Illegally requiring borrowers to purchase credit, life and other types of insurance in order to secure loans and frequently forging signatures indicating customer approval of insurance purchases; and
- (e) Illegally "up-selling" loans carrying exorbitant interest rates of 20% or higher, mischaracterizing closed-ended loans as open-ended to avoid heightened disclosure requirements and restrictions connected with closed-ended loans and failing to comply even with the more relaxed disclosure requirements for open-ended loans.

53. Household's illegal predatory lending practices are well documented in government agency reports condemning the Company's lending practices, including the WA Report, as well as in lawsuits filed in the States of California, Illinois and Washington. *ACORN, et al. v. Household Int'l, Inc., et al.*, Case No. 02-1240 CW (N.D. Cal.) (the "California Complaint"); *Bell, et al. v. Household Int'l, Inc., et al.*, Case No. 02-CH-08640 (Circuit Court of Cook County, Ill.) (the "Illinois Complaint"), and *Luna, et al. v. Household Finance Corp., et al.*, Case No. 02-2-00178-0 (Chelan County Superior Court Wash.) (the "Washington Complaint") (collectively, "Consumer Fraud Complaints"), attached hereto as Exs. 3-5.

54. The Company's use of illegal and unconscionable lending practices throughout the Class Period was both widespread and ingrained in Household's corporate culture. Significantly, between 1997 and 2002, *trainers from Household's corporate headquarters in Illinois visited branch offices to provide training in the various illegal lending techniques described above.*

The EZ Pay Plan Scam – Defendants Misrepresented the Interest Rates and Savings Associated with Household Loans

55. Throughout the Class Period, Household engaged in a pattern of intentionally misrepresenting interest rate amounts and lying to customers about the savings they would reap by refinancing with Household. This was done most often by using the EZ Pay Plan to confuse borrowers.

56. The EZ Pay Plan scam was described, along with other lending abuses, in an article entitled "Home Wrecker; William Aldinger says his Household International succeeds in lending to bad credit risks by managing smarter. People suckered into his mortgages cite other reasons: lies and deceit." The article, which was published in the 9/02/02 issue of *Forbes* magazine ("9/02 *Forbes* Article"), detailed the EZ Pay Plan scam used by Household, stating:

[In 1999,] Household ... began EZ Pay Plus, a program under which many borrowers, like [William] Myers [of Dayton, Ohio], were lured with lower interest rates but were really charged higher ones. EZ Pay Plus also hooked Corina Galindo, a teacher's assistant in Phoenix. In April 2000 *Household offered to replace her \$67,300 mortgage, a Chase Manhattan Bank loan at 8.5% interest, with a bigger but seemingly cheaper one: \$86,300 at an "effective rate" of 7.6%*, enough to pay off the old mortgage and a \$12,200 personal loan she was paying off at 15.7%. At least, that is how she read a worksheet from a Household loan officer. Galindo signed up. Four days later, she says, she got nervous and reviewed the 80-page agreement – signed or initialed in two dozen places – and *spotted the real interest rate: 12.2%*.

How did it happen? Galindo says her agent, Jose Avila, handed her the worksheet, titled Bi-Weekly Payment Quote, with this sentence at the bottom: "If I can put together a loan that pays out like a 7.579%-a-year loan, but has a total term of 18.63 years ... would you be interested?" She was, though the claim wasn't exactly true. Her loan term would be reduced from 30 to 19 years, and payments would be automatically deducted from her checking account every two weeks. By paying off her mortgage faster, Galindo would pay lower total interest. Her new loan's payments would total \$219,000 over 19 years. The Household pitch: Spread that over 30 years, and it's like a 30-year loan at 7.6%, lower than her Chase loan.

Never mind that her new mortgage wasn't a 30-year loan to begin with – and 12.2% is 12.2%. The \$86,300 loan included processing fees of \$6,000, or 7%, plus other charges. Many lenders levy 1% to 2%.

57. Responding to the information in the 9/02 *Forbes* Article, Household stock opened \$2.75 lower on 9/03/02.

58. The EZ Pay Plan scam was also at the core of the WA Report, which documented a consistent pattern of widespread lending abuses, including wide use of the EZ Pay Plan scam:

[B]orrowers have been told that by accepting the bi-weekly payment program they can effectively reduce the interest rate on their loan from approximately 14% down to 7%. The Department has encountered reference to this 14% to 7% statement a number of times and addressed the problem directly with HFC management in mid-2001. HFC informed the Department that the "practice" was isolated to a single branch in Washington and that the matter was not a corporate practice. However, the Department has identified the practice to other branches in Washington and has even received reports from regulators in other states concerning the practice. Contrary to HFC's claims, the Department does not believe the practice is isolated.

While an interest rate savings will be achieved through the bi-weekly payment program, for HFC to claim that the interest rate can be reduced through use of the program is a false and misleading statement designed to convince borrowers to accept a loan rate in the neighborhood of 14%, disguised as a loan rate of 7%.

Ex. 2 at 41.

59. Household's practice of misleading customers about their loans' true interest rates (and the savings such loans would offer over customers' already existing loans) was widespread. *Household loan officers and branch managers were instructed by Household corporate*

headquarters to tell the customers that, in effect, they were cutting their interest rate to 7% by participating in the EZ Pay Plan when, in reality, the interest rate was substantially higher. Characterized internally as "one of Household's biggest scams," the EZ Pay Plan resulted in customers being misled into thinking they were receiving low-interest loans when, in reality, they were not. In 1999, HFC Southwest Division Manager Dennis Hueman ("Hueman") drew up EZ Pay Plan presentations and worksheets that were subsequently used by HFC loan officers throughout the country to bilk customers via the EZ Pay Plan scam. In fact, the EZ Pay Plan scam was used across the country from California to Pennsylvania.

60. Customer complaint calls received by collections representatives for Household Recovery Services during the Class Period confirmed to defendants that the account executives and branch managers who had originated loans had represented as a matter of course that the actual interest rate on Household loans was as low as 7%, even though they were actually sold with substantially higher interest rates.

Household Improperly Used "Discount Points" to Extract Additional Fees from Borrowers Rather Than Reduce Their Interest Rate, as Represented to Borrowers

61. In general, when taking out a loan, a borrower can make an up-front cash payment to "buy down" the applicable interest rate. In this manner, a borrower can pay up front for a discount on the applicable interest rate. The rationale is that the higher the up-front cash payment, the lower the interest rate applied to a loan. At Household, discount points were routinely abused as a means to charge borrowers additional fees.

62. The WA Report revealed that: (a) discount points regularly bore no relation to any interest-rate reduction; (b) borrowers were regularly provided with a "range" of buy-down points, yet at closing, the discount points charged were almost always at the top of the range and equaled 7.00%-7.25% of the loan value; (c) borrowers did not know that the points being paid were purportedly to buy down the rate of their loans; (d) borrowers were not offered any option of the amount of points to be prepaid; and (e) the applicable points on the loan would often be concealed from borrowers.

63. The abuse of points and fees by Household pervaded its lending operations. Household real estate loans regularly had 7.5 to 8 points added to them as a method to extract additional fees from Household customers. These "discount points" did not have any buy-down effect on the interest rate of the loan. Account executives were instructed to sell customers on the loan's contract rate, *i.e.*, the rate of the loan *before* points, fees, insurance and other add-ons, over the annual percentage rate, which had the effect of misleading Household customers into thinking that the applicable interest rate was the same as the contract rate, when it was actually materially higher.

64. The up-front finance charges (including points and fees) not only added to the effective interest rate paid by Household customers, but these charges were added to the amount that Household customers borrowed, thereby increasing the total debt secured against their homes. This practice was designed to, and did, significantly decrease borrowers' equity in their homes, inhibiting their ability to refinance their loans with Household's competitors.

65. The WA Report confirmed that Household borrowers were consistently unaware, at the time their loans closed, that they had been assessed these up-front finance charges (often in excess of 7% of the loan amount) or that the fees and points had been added to their principal balance. *Household had intentionally withheld this information from its customers in order to sell the largest loan possible, which in fact was confirmed with respect to every single customer interviewed by the WA Department. Id. at 45.*

66. The WA Department also detailed that Household had violated Regulation X of the Real Estate Settlement Procedures Act ("RESPA") by failing to provide, or providing customers inaccurate, good faith estimates ("GFE") of known charges. The WA Department concluded that the consistency with which the Company charged discount points equal to 7.25% of any loan belied Household's position that disclosing a wide "range" of points in the GFE provided to borrowers fulfilled their disclosure obligations. The WA Department stated that, "In the case of HFC ... the lender has knowledge of what it intends to charge. To disclose anything else is nothing more than a pretense.... To argue that a 'range' should be disclosed in the rare event that a lower amount of points may occur, is a mendacious use of its control over the disclosure process." *Id. at 48.*

67. Household's abusive use of up-front fees was fundamental and systemic, occurring across the nation.

**Household Concealed the Existence of
Prepayment Penalties in Its Loan Documents**

68. Household included prepayment penalties in its loans to thwart customers' abilities to refinance their Household loans. Rather than disclosing the existence of prepayment penalties and their impact, *i.e.*, crippling borrowers' ability to refinance their loans, loan officers were trained to conceal or even lie about them.

69. Household structured loans to include prepayment penalties, hiding the written disclosures in the loan documents by burying them like a "needle in a haystack" and affirmatively misrepresenting their very existence. *Id.* at 42. Rather, the WA Department found that HFC structured its sales process so as "*to sneak the prepayment penalty past the point of rescission.*" *Id.* at 43. It was the conclusion of the WA Department that borrowers "were either not told of a prepayment penalty or that they were intentionally misled about the prepayment penalty." *See id.* at 42.

70. Household implemented a policy that did not require customers to initial the prepayment penalty section indicating that they had read and understood the penalties. Rather, Household instructed its loan officers simply skip over this section without disclosing it to customers.

**Household Improperly Tacked Insurance Products onto
Its Loans by Misleading Borrowers into Believing They
Were Compulsory and/or Concealing Their Inclusion**

71. Throughout the Class Period, Household routinely engaged in "Insurance Packing" – *i.e.*, selling insurance products to consumers in conjunction with loans when they were either unaware that they were purchasing such insurance or led to believe that such insurance was compulsory when it was not. In addition, the Household defendants routinely concealed (a) the total cost of insurance products sold in connection with the loans; (b) that the policies did not provide protection for the life of the loan; (c) that the customers were paying additional up-front points based

on the cost of the insurance; and (d) that these points would not be refunded if the insurance was cancelled.

72. Defendants' practice of insurance packing pervaded Household's operations and was both a fundamental profit driver and core aspect of Household's business. By at least 1996, Household had its branch managers and account executives throughout the country meet with "insurance trainers" sent from Household's corporate headquarters in Illinois, who stressed the importance of maintaining 60%-75% penetration when selling insurance (each type of loan had one to three opportunities to sell insurance, and loan officers were expected to close 60%-75% of these opportunities). To achieve this result, branch managers and account executives were instructed to give the customer two quotes on a loan's monthly payment – one that included insurance and one that did not. In fact, they were instructed by the insurance trainers to *outright lie to customers* about insurance costs by telling them that the higher quote did not include insurance and the lower quote did include insurance when, in fact, it was the opposite. Indeed, it was not uncommon for loan officers to add on insurance without informing the customer, especially with closed-end loans. For example, Texas District Manager Bruce Kwidzinski instructed his account executives to disclose only one quote, which included insurance, to their customers on 90% of their loans. On the other 10% of their loans, they were allowed to tell the customers that insurance was optional. At Household, account executives were constantly measured against each other through district and regional rankings, and insurance sales played a significant role in the rankings.

73. In some parts of the country, insurance penetration rates reached as high as 92% to 100% at certain branches, in part due to Household's consistent refusal to provide the material disclosures required to be provided to borrowers under the Truth in Lending Act.

74. The WA Report concluded:

The inclusion of unwanted or unneeded insurance products (as discussed throughout this report) by steering methods, misrepresentations or out-and-out fraud through forgery appears to be part of HFC's practice of obtaining maximum revenue from consumers regardless of any actual benefit to the consumer. HFC encourages its employees to maximize the number of products sold, the dollar amount of loans sold and insurance products sold. A review of HFC's Branch Sales Compensation policy for 2001 shows that account executives, branch managers and sales assistants are paid significant monthly incentives for maximizing borrower transactions in these areas.

See id. at 59.

Household Illegally "Up-Sold" Loans Carrying Exorbitant Interest Rates (20% or Higher)

75. Household engaged in a consistent pattern of illegally up-selling second loans to customers who had not requested them and who did not need them, but for the unconscionable and often undisclosed fees regularly charged on the first loans. When springing these high interest (20% and higher) loans on customers at the time of closing, Household often failed to disclose to customers that the projected monthly payments under their consolidated loans included payments toward separate, so-called open-ended second loans. Household made these second loans at interest rates significantly higher than those quoted and failed to disclose that the second loan would amortize at a slower rate than the customers' existing loans (if they amortized at all) and could result in balloon payments at end of the loan term.

76. The 9/02 *Forbes* Article describes Household's conduct, stating:

At the closing on a Saturday, Galindo says, [Household loan officer] Avila also sprung on her a second mortgage – set up as a line of credit of \$10,000 at 23.9%. At her closing, she was drawing down \$4,800 on this line to pay off yet another outstanding debt – a debt she had expected to be taken care of in the \$86,300 first mortgage. *Household structures many second mortgages as lines of credit, which lets it avoid federal rules that mortgage terms must be disclosed at least three days before closing.*

She protested but signed anyway. *"I felt a lot of pressure," she says. "Avila told us he never opens on Saturday and his family was waiting for him. But I can't do anything. I signed the papers."* Galindo now works nights cleaning classrooms to help pay off the new loans....

* * *

William Myers paid off his credit card debt by refinancing his mortgage last year. But he says *his new lender, Household International, charged him 11% interest, not 7.2% as promised. Then it added \$14,400 in fees and insurance to his \$80,100 loan and stuck him with a \$15,000 second mortgage – at 20% interest. He didn't notice it until his first bill.*

* * *

Myers, 66, was left owing a third more than his home was worth, scaring away rival lenders that might come to the rescue.... Household agents call [this tactic] "closing the back door."

77. "Blocking the back door" was so essential to Household's operations that many of Household's underwriters would require second side-loans before they would approve first mortgage

loans. For example, if branch managers or account executives sent a mortgage loan with an 80% LTV ratio to the underwriting department, in many instances the loan would be rejected unless the customer took out an additional loan that would bring the total LTV ratio above 100%.

78. Household employees were also required to pressure customers into taking larger loans than they wanted or could pay off, including loans with 125% LTV ratios. After its acquisition of Beneficial, Household caused Beneficial to implement a practice to make loans for over 100% of the value of a borrower's home. In order to increase the size of the loan sold to borrowers, Household loan officers were encouraged to inflate the customer's income if the borrower's true debt-to-income ratio was above 60% so that the recalculated ratio would fall below 50%. Extending loans based on the value of a borrower's home rather than the borrower's ability to repay the loan violates federal lending statutes.

79. HFC also engaged in "blocking the back door" by intentionally directing appraisers to undervalue property in order to use up the LTV ratio on the first mortgage, thereby ensuring that the borrower would have to purchase an expensive second mortgage. The WA Department confirmed this consistent pattern of "up-selling" loans at Household, stating:

Accompanying the sale of two loans to borrowers was the consistent pattern of convincing the borrowers that the first would be carried at a very low rate (7%) while actually being made at a fairly high rate (11-14%). Most of these first mortgages also carried a significant amount of discount points (generally more than 7 points). Often, the financed discount points alone ate up so much loan principal that the borrowers were forced into the high rate second in order to achieve the financing they sought.

Some borrowers complained that the value of their homes came in far too low. The Department believes that HFC may intentionally direct the appraiser to undervalue the property in order to use up the LTV on the first mortgage, thereby forcing a high rate second of up to 25%.

* * *

It is apparent to the Department that in at least some, if not many, transactions, the borrowers did not "apply" for a second mortgage and did not desire a second mortgage, but at closing were faced with only one financing option: to take out a first and undesired second mortgage. In certain cases it appears that the second mortgage was primarily used to pay for high points being charged by HFC. Further, all of the second mortgages reviewed by the Department carried very high rates of interest (generally in excess of 20%), as well as origination fees at nearly 4%. In situations where the borrowers were required to take out a second mortgage primarily to pay points on the first mortgage, the borrower paid additional points

for points, as well as an exorbitant interest charge on the financing of both layers of the points.

Ex. 2 at 43, 59.

80. Moreover, in order to avoid the enhanced disclosure requirements and restrictions applicable to closed-end loans, Household often styled second mortgages as open-ended lines of credit. These second loans were not, however, open-ended. Household's mischaracterization allowed the Company to spring these second mortgages on borrowers on the day their loans were closed without any prior disclosure. This practice violated Regulation Z, §226.34(b), of the Truth in Lending Act ("TILA"), which prohibits lenders from structuring home-secured loans as open-ended plans to evade the more stringent disclosure requirements contained in Regulation Z, §226.32 (governing closed-ended loans). Moreover, Household failed to comply even with the more relaxed disclosure requirements applicable to open-ended loans, concluding that Household "has a practice of failing to make the material disclosures as required pursuant to [Regulation Z] §226.5b," which governs disclosure requirements for open-ended loans. WA Report at 54. The WA Department also concluded that Household was in serious violation of material disclosure requirements relating to closed-ended credit.

81. Under Regulation Z, §226.15(a)(ii)(3), "[i]f the required notice and material disclosures are not delivered, *the right to rescind shall expire 3 years after the occurrence giving rise to the right of rescission*, or upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first." 12 C.F.R. §226.15(a)(ii)(3). Thus, due to Household's consistent mischaracterization of closed-ended loans as open-ended loans, and its failure to provide proper disclosure of the terms of those loans under Regulation Z (governing both closed- and open-ended loans), Household customers' right to rescind the purportedly open-ended second loans was expanded from three days to three years.

82. As detailed in several complaints brought on behalf of consumers nationwide, Household engaged in a multitude of "up-selling" techniques to sell their purported open-ended loans:

- (a) Household falsely designated loans as open-ended despite the fact that they did not reasonably contemplate repeat transactions in order to avoid federal

disclosure requirements under the Home Owners Equity Protection Act ("HOEPA"), 15 U.S.C. §1639, that would alert borrowers to the high costs and unfavorable terms of the loans;

- (b) Household did not provide the disclosures in advance of closing as required by HOEPA;
- (c) Household included prepayment penalties in violation of HOEPA;
- (d) Household routinely extended loans based primarily on the value of the borrowers' homes rather than their ability to repay the loans;
- (e) Household failed to provide the disclosures required by 15 U.S.C. §1637(a), (b) and (e) to be given upon application for true open-ended loans; and
- (f) With respect to closed-ended loans, Household consistently failed to make the disclosures required by HOEPA.

Moreover, Household did not disclose that the projected monthly payments under their consolidated loans included payments toward the open-ended loans made at interest rates significantly higher than those quoted, nor did they disclose that the separate, so-called open-ended loans would amortize at a slower rate than the customers' existing loans (if they amortized at all) and could result in balloon payments at the end of the loan term.

**Household Vehemently Denied Engaging in
Predatory Lending Throughout Much of the Class Period**

83. In an effort to conceal the wrongful business practices that were allowing defendants to meet or beat analysts' EPS expectations throughout the Class Period, defendants consistently took the position that the predatory lending practices discussed above were not occurring at Household, and any assertion to the contrary was false. In fact, defendants maintained that Household's strong performance was based on its use of underwriting criteria that prevented the potential for customer abuse, that it had adopted technology that would alert management to early signs of abuse and that Household applied a "tangible benefits" test for its loans to ensure fair treatment of its customers. Although defendant Aldinger was advised by letter dated 7/23/01 that HFC and Beneficial were engaged in a pervasive predatory lending pattern, the Officer Defendants continued to disclaim the Company's involvement in such practices.

84. At the same time Household was issuing such public denials regarding its predatory lending practices, it had also filed an injunction in Washington state court seeking to block the

publication of the WA Report that detailed Household's predatory tactics. Hayden characterized the WA Report as a "draft" with "factual errors" that Household wanted to correct and tried to downplay the situation, stating, "It is our regulators' and the attorney general's 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 [W]e take proper steps to work with the department to uncover the facts and if necessary formulate an appropriate resolution for the borrower." Hayden also admitted that some "customers in Bellingham may have indeed been justified in their confusion about the rate of their loans" and claimed Household "took full and prompt responsibility" and is "satisfied that this situation was localized to the Bellingham branch." *American Banker* article, dated 5/31/02.

85. But suspicions of Household's role in predatory lending were highlighted. On or about 6/26/02, Judge Claudia Wilken of the Northern District of California upheld the California Complaint on a motion to dismiss, ruling that the purpose and effect of arbitration agreements being used by Household were "tainted with illegality."

86. For example, on 7/26/02, Household admitted it was "possible" that one or a small group of rogue employees isolated at one of its remote branches in Washington "may" have misrepresented mortgage terms to "some" Whatcom County homeowners who refinanced their home loans at the Company's Bellingham office. This mischaracterization of the scope of defendants' fraud was typical of the Company's attempts to conceal the fact that such manipulations and illegal acts pervaded Household's operations and emanated from Household corporate headquarters.

87. Yet, defendants continued to attempt to downplay the pervasiveness of the Company's predatory lending practices even after the WA Report was made available and Household was forced to announce that it would pay almost \$500 million to settle claims against it for illegal lending practices, when investors began to appreciate the true magnitude of defendants' fraudulent scheme and wrongful course of conduct.

88. The Company also went on a media offensive, publishing several very expensive, full-page ads in *The Wall Street Journal*, with headlines that read, "For 124 years, we've set the standard for responsible lending. And now we're doing it again." The text of the ad outlined the set

of initiatives the Company had already taken to improve its lending procedures, and the bottom of the ad carried the legend, "Advocates for Responsible Lending."

89. On 7/16/02, the WA Department announced that it had caused Household to return over \$400,000 to over 1,000 Washington borrowers who were overcharged by the Company in connection with their real estate loans. The WA Department stated that the refunds resulted from overcharges in real estate loans. Yet, on 7/17/02, Household attempted to deflect attention from the massive scheme used to drive its "record" results, stating that the overcharges were the result of simple computer system errors.

90. Again attempting to make the rampant lending abuses taking place at Household appear to be isolated incidences of bad acts by rogue brokers, Company spokesperson Hayden, on 7/26/02, told the *Bellingham Herald* that Household employees "may" have misrepresented mortgage terms to "some" Whatcom County homeowners who refinanced their home loans at the Bellingham office of HFC. Hayden further stated that the manager of that office was replaced. The manager, Melissa Drury ("Drury"), however, claimed that she was being made a scapegoat for the Company and stated that she was a highly rated employee who had strong audits and conducted her job in accordance with her training and in accordance with Company guidelines and manager mandates. Drury was quoted as stating, "I've always had excellent audits. I've been probably one of the best employees that they've had over the last 13 years. I've always done what I've been taught." Drury further stated that *the sales pitches she used on potential borrowers were both approved and provided by Household.*

91. Even the Company's new position, that acts of predatory lending were isolated and sporadic, was belied by the fact that borrowers in states across the country were duped by the same predatory lending tactics.

92. The WA Department rejected the Company's position that Household's predatory lending practices were isolated or nonrecurring, stating:

Consumers repeatedly complained that they had relied on certain representations or promises by HFC representatives that proved to be misrepresentations, deceptions or false promises. These misrepresentation claims ranged widely, including dishonest statements about rates and fees, prepayment penalties, monthly payment amount, insurance or other loan terms.

* * *

It is inconceivable that borrowers from remotely different locations could all be confused about exactly the same thing in the same way, or that HFC could somehow believe that the occurrence was isolated to a single branch location. The Department believes that the "equivalent rate" sham proffered by HFC representatives is known and likely fostered by the corporation itself or at the least, by corporate officers overseeing large segments of the country. This belief appears to be supported by HFC headquarters' knowledge of the disclosures and sales practices when responding to complaints.

* * *

The sameness of complaint allegations coupled with the wide diversity of complaint locales has made it *evident to the Department that misrepresentations, as well as the other five areas discussed [herein] are not relegated to specific transactions or loan officers, but rather to the HFC organization as a whole, including its affiliate Beneficial, which has had a similar number and type of complaints filed against it.*

Ex. 2 at 39, 53.

93. In addition, as reported in the 9/02 *Forbes* Article, customers and some ex-employees tell of the same interest rate trick in a dozen states. *"Household encourages, or at least tolerates, these abuses,"* says Minnesota Commerce Commissioner James Bernstein. *'It's not just an occasional rogue loan officer or a rogue office. It has to do with the corporate culture.'* In fact, following Household's acquisition, Beneficial implemented the Household model to have Household District Managers almost immediately begin to pressure branch managers to engage in dishonest lending practices. Refusals by branch managers to engage in these practices and predatory techniques resulted in daily phone calls from District Managers, who would vigorously reprimand them for failing to do so in order to meet the Company's unrealistic sales goals and bring in as much money as other branch offices.

94. Throughout the Class Period, Household's senior management, including the Officer Defendants, was aware of and, in fact, encouraged Household's predatory lending practices. In 1999, HFC Southwest Division Manager Hueman created an EZ Pay Plan presentation that he required all branches in his division to follow. This sales pitch included telling customers that, if they signed up for the EZ Pay Plan, they would receive an interest rate reduction on their loans. In addition, Hueman distributed worksheets and other paperwork related to the EZ Pay Plan to all Household

offices. By early 2000, the EZ Pay Plan accounted for one-third of Household's new loan originations.

95. Upon rolling out his EZ Pay Plan presentation, Hueman visited branch offices in his division. When asked whether his sales presentation had been approved by Household's corporate management, *Hueman confirmed misleadingly that he had made the presentation to defendant Aldinger and Household's legal department and that it had, in fact, been approved for use in Household's branch offices.*

96. In 1/99, following Household's acquisition of Beneficial, a group of district managers, branch managers and account executives were instructed to put together an updated "sales training module" from different offices throughout the country. The training manual update project was overseen by defendant Gilmer, then President of Household's consumer lending unit. The updated manual contained various sales techniques and included an EZ Pay Plan sales pitch stressing to borrowers that signing up for the program would effectively reduce a borrower's interest rate on the loan. Upon its completion in 7/99, the manual was distributed to all account executives and branch managers in all offices nationwide. Thereafter, Account Executives were trained in their branch offices using the manual.

The Predatory Lending Settlement

97. On 10/11/02, Household issued a release announcing that, in addition to its most recent charge of \$600 million (pre-tax) to cover the cost of its restatement, the Company would now be forced to pay \$484 million (pre-tax) in restitution to customers nationwide (plus the cost of reimbursing the states for their investigation) to settle claims by a multistate group of attorney generals and banking regulators related to its predatory lending practices from 1/01/99 to 9/30/02. *This was the largest settlement ever in a state or federal consumer case.* In the release announcing the settlement, Aldinger admitted that Household had engaged in predatory lending, apologizing to customers for not always living up to their expectations.

98. On 10/12/02, the *Star Tribune* (Minneapolis-St. Paul) published an article about Household's payment of \$484 million to settle claims against the Company for its illegal practices. Minnesota Commerce Commissioner James Bernstein ("Bernstein") (whose department had

investigated Household's predatory lending tactics for more than a year) was quoted as stating, "*Household claims that it's only a few bad apples, but we've ... found that the whole orchard is rotten Household's corporate culture encouraged rather than prohibited these deceptive and abusive lending practices Household took advantage of Minnesota consumers who were facing difficult situations and, as a result, many were trapped in costly loans. When we talked with regulators in other states, the story was the same.*" Bernstein confirmed that, contrary to Household's representations in early 2002, the changes in Household's lending practices announced in 2/02 were made "because of regulatory pressure from Minnesota and other states."

99. Household's settlement with state attorney generals and banking regulators was finalized on 12/19/02 and addressed its predatory lending activity in all 50 states and the District of Columbia. Household confirmed that it would no longer engage in the improprieties alleged herein, but rather would (a) ensure that its loans actually provide a benefit to customers before making them; (b) limit prepayment penalties on current and future loans only to the first two years of a loan; (c) limit points and origination fees to 5%; (d) reform and improve disclosure to customers; and (e) eliminate "piggyback" second mortgages.

100. In response to the announcements of Household's massive charges and its apparent agreement to refrain from the illegal activities, which had driven Household's strong EPS growth during the Class Period, Fitch placed the Company on Rating Watch Negative and issued a release stating:

The action takes into account today's announcement that Household is planning on taking two separate charges during the second half of 2002. The first charge, which could amount up to a sizeable \$484 million pre-tax, is related to a proposed settlement between Household and state attorneys general and state banking regulatory agencies. This represents a nationwide resolution of issues related to Household's real estate lending practices and the Household Financial Corp. and Beneficial Finance Corp.'s branch businesses....

Following the expected settlement with the multi-state group, management is hopeful that any uncertainty with respect to legal proceedings related to consumer protection laws will be removed from Household, which could stabilize capital market concerns going forward.... In Fitch's view, *the bigger challenge for Household will be replenishing lost revenue resulting from the implementation of "Best Practices."* *An ability to offset these revenues streams could pressure future profitability, which in turn could put pressure on the current rating.*

101. On 10/10/02, on rumors of a potential settlement relating to its predatory lending, shares of Household immediately declined another \$3.50 per share, or 11%, to close trading at \$27.75 per share on 10/10/02. Standard & Poor's credit rating service also lowered ratings on Household's long- and short-term debt to single-A-minus/A-2 from A/A1 after the announcement of the proposed settlement.

Defendants' Illegal Predatory Lending Violated Generally Accepted Accounting Principles

102. Throughout the Class Period, defendants engaged in improper and illegal "predatory lending" practices, as detailed in ¶¶51-101, that ultimately resulted in a \$525 million charge to pre-tax income during 3Q02. By engaging in such practices, defendants violated Generally Accepted Accounting Principles ("GAAP") in that they failed to disclose the effect and potential effect of the illegal acts on Household's financial statements throughout the Class Period.

103. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. SEC Regulation S-X states that financial statements filed with the SEC that are not prepared in compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. 17 C.F.R. §210.4-01(a)(1). Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosures that would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. §210.10-1(a).

104. GAAP, as set forth in Statement of Financial Accounting Standards ("SFAS") No. 5, Accounting for Contingencies, requires that a company establish a loss contingency, *i.e.*, reserve, when the estimated loss is probable and reasonably estimated. SFAS No. 5, ¶8. SFAS No. 5 further states:

If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made.

SFAS No. 5, ¶10.

105. Defendants violated GAAP and SEC rules by failing to disclose the potential loss contingencies resulting from its illegal predatory lending practices that ultimately resulted in a \$525 million pre-tax charge during 3Q02.

106. Further, Household had an obligation to disclose to investors the impact its predatory lending practices had on its overall financial results. Regulation S-K states that management's discussion and analysis section shall:

- (a) Describe any unusual or infrequent events or transaction or any significant economic changes that materially affected the amount of reported income from continuing operations and, in each case, indicate the extent to which income was affected. In addition, *describe any other significant components of revenues or expenses that, in the registrant's judgment, should be described in order to understand the registrant's results of operations.*
- (b) *Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed.*

17 C.F.R. §229.303(a)(3).

B. DEFENDANTS MANIPULATED HOUSEHOLD'S CREDIT QUALITY NUMBERS BY IMPROPERLY "REAGING" OR "RESTRUCTURING" DELINQUENT ACCOUNTS

107. Household admits in its SEC filings that its customer base is primarily composed of nonconforming, nonprime or subprime consumers with limited credit histories, modest incomes or high debt-to-income ratios or who have experienced credit problems due to occasional delinquencies, prior charge-offs or other credit-related actions. To compensate for this additional risk, Household customers are charged a higher interest rate on loans.

108. Household securitizes a significant portion of its receivables, *i.e.*, sells them for cash, but continues to service them, as part of their asset securitization program, for a fee with limited

recourse for future credit losses.³ Household's securitization of consumer receivables was, throughout the Class Period, a core source of funding for the Company. Household reported NIM, fee and other income, and provision for credit losses for securitized receivables as a net amount in securitization income. The Company also recorded a provision for estimated probable losses that it expected to incur over the life of the securitization. Throughout the Class Period, securitization income as a percent of total revenue (other revenue and NIM after provision for credit losses) averaged about 28%.

109. Since Household both generates loans from high-risk borrowers and then sells these loans as asset-backed securities, it is critical to Household's profitability that it generate loan pools that are both stable and consistent. In order to achieve this goal and prevent defaults, defendants engaged in a consistent pattern of improperly reaging delinquent loans, throughout the Class Period, to make them current.

110. "Reaging" resets as current loans that otherwise are in default. Household would reset the contractual delinquency status of an account to current if a predetermined number of consecutive payments were received and there was evidence that the delinquency was cured. In effect, the Company "reaged" the loan by adding the delinquencies to the end of the loan. At Household, however, the Officer Defendants established procedures whereby accounts were reaged arbitrarily and without any evidence that the delinquency had been cured.

111. Household had a centralized and highly automated system to support its underwriting, loan administration and collection functions across all consumer business segments. This system was known as "Vision." The Vision system centralized decision making throughout the loan

³ Household describes its securitization program as follows:

In the securitizations and secured financing transactions, Household sells a dedicated pool of receivables to a wholly-owned bankruptcy remote special purpose entity for cash, which, in turn, assigns the receivables to an unaffiliated trust that is a qualifying special purpose entity under Statement of Financial Accounting Standards No. 125 and/or 140, as applicable. Household continues to service the receivables and receives a servicing fee.

In connection with each transaction, we obtain opinions from nationally known law firms that the transfer of the receivables to the special purpose entity qualifies as a "true sale" for legal purposes and that the entity would not be "substantially consolidated" into any bankruptcy estate of the transferor.

origination process, including generating scripts for the sales staff, monitoring delinquencies and collections and determining charge-offs. Defendants claimed that, by virtue of this system, they were able to detect delinquent accounts at an early stage and immediately initiate collection efforts. The Vision system was so critical to the Company's purported success that, in 2/00, Household was awarded *CIO* magazine's prestigious "Enterprise Value Award." According to *CIO*, Household was given the award for its use of the "Vision" system in 1999. In accepting the award, defendant Gilmer stated:

"Vision" has had an overwhelmingly positive effect on virtually every aspect of our consumer finance business. We have enjoyed faster and more profitable growth because our account executives are provided with greater numbers of qualified leads, prioritized by the Vision system. *Our credit losses are minimized because of the real-time links to our underwriting system*

Receiving real-time information about loan delinquencies, credit quality and cross-selling opportunities enabled the Officer Defendants to see the problems in its loan departments and collections. This allowed defendants to effectively and efficiently perpetrate the scheme alleged herein that was allowing the Company to achieve its record-breaking results.

112. Indeed, the Vision system was designed to automatically "reage" delinquent accounts if it received even a partial payment without any evidence that the delinquency was cured.

113. Defendants relied on the Vision system to track the success of Household's fraudulent scheme, stating:

We service each customer with a focus to understand that customer's personal financial needs.... [O]ur policies are designed to be *flexible to maximize the collectibility of our loans* while not incurring excessive collection expenses on loans that have a high probability of being ultimately uncollectible. Cross-selling of products, proactive credit management, "hands-on" customer care and targeted product marketing are means we use to retain customers and grow our business.

114. Even prior to the nationwide implementation of the Vision system, Household's loan collection policies were very flexible. This "flexibility" was critical to the Company for two reasons. First, since many of Household's customers were high risk borrowers, they required a closer relationship with their lenders and often required more specialized methods to keep their loans current and out of default. Second, as a result of requiring more flexibility in collections, investors placed much greater reliance on Household's internal systems to identify which loans were truly

delinquent, and which could be salvaged with Household's specialized intervention, also known as "reaging." Again, while this flexibility increased investor reliance on the Company's internal monitoring and collections procedures, investors were consistently reassured that, because Household had over 130 years of experience in the subprime market, it had developed a unique strategy to avoid charge-offs and increase loan collectibility.

115. Household's policies for loan delinquencies and charge-offs were reported in the Company's FY01 Report on Form 10-K, as follows:

Our credit and portfolio management procedures focus on risk-based pricing and effective collection efforts for each loan. We have a process which we believe gives us a reasonable basis for predicting the credit quality of new accounts. This process is based on our experience with numerous marketing, credit and risk management tests. We also believe that our frequent and early contact with delinquent customers, as well as policies designed to manage customer relationships, such as reaging delinquent accounts to current in specific situations, are helpful in maximizing customer collections.

* * *

We believe our policies are responsive to the specific needs of the customer segment we serve.... Our policies have been consistently applied and there have been no significant changes to any of our policies during any of the periods reported. Our loss reserve estimates consider our charge-off policies to ensure appropriate reserves exist for products with longer charge-off lives. We believe our charge-off policies are appropriate and result in proper loss recognition.

116. At Household, loan officers followed up on delinquent loans when a payment was 30 days past due. The loan officer was supposed to call the customer to get a "promise" of payment from the customer and use the call as an opportunity to up-sell or cross-sell products by convincing customers to take out additional loans or lines of credit, or consolidate their bills and convert their unsecured loans into loans secured with their homes or cars. Often customers did not even realize that their new consolidated loans were being secured by their homes or cars. Defendants established reserves designed to ensure that delinquent accounts were restructured rather than foreclosed.

117. In furtherance of its scheme, the Officer Defendants caused Household to violate its own policies and reage accounts *at any level of delinquency*, including accounts that were over 270 days past due, with merely a single payment. The missed payments would then be added to the end of the loan. The single payment was the lesser of either one minimum monthly payment or 2.5% of the account balance. If it was the latter, that amount would become the new minimum payment.

118. Accounts were often reaged multiple times in a single year. Indeed, a customer who made only three or four minimum payments a year could still appear current.

119. Household used an incentive program to induce collections representatives to push reaging or restructuring of delinquent accounts. By virtue of this incentive program, collections representatives could receive monthly cash rewards or electronic items for reaging a sufficient number of accounts, regardless of whether such reaging was actually justified or enhanced the prospect for repayment.

120. Although defendants characterized loan reaging or restructuring as a service to help out customers, it was clear that the main purpose behind the reaging was to make it appear that the statistics on Household's borrowers and its outstanding loans was stronger than it actually was. In fact, by 8/01, the Officer Defendants were so desperate that they had collections managers require representatives to pressure all customers to restructure their accounts. Even though collections representatives expressed discomfort with pushing restructuring to customers, they were forced to do so under the constant threat of being fired for not following instructions. Collection calls were randomly monitored by collections managers, and if a collections representative did not try to persuade all of his customers to restructure their accounts, a collections manager would reprimand him and tell him that corrective action would be taken unless the representative restructured more accounts. Monthly meetings were held with department managers to monitor collections goals.

121. To cover their tracks, Household programmed its Vision system so that it did not generate any paperwork when delinquent accounts were reaged. In addition, because Vision automatically reaged accounts upon receiving even a partial payment, the customer was often unaware that missed payments were capitalized at the back of the loan.

122. Household's charge-off policy and its policies on accruing interest varied by product, as follows:

Product	Charge-off Policy	Nonaccrual Policy
Real estate	Carrying values in excess of net realizable value are charged off at the time of foreclosure or when settlement is reached with the borrower.	Interest income accruals are suspended when secured principal or interest payments are more than three months contractually past due and resumed when the receivable becomes less than three months contractually past due.

Product	Charge-off Policy	Nonaccrual Policy
Auto finance	Carrying values in excess of net realizable value are charged off at the earlier of the following: •The collateral has been repossessed and sold; •The collateral has been in our possession for more than 90 days; or •The loan becomes 150 days contractually delinquent.	Interest income accruals are suspended when principal or interest payments are more than two months contractually past due and resumed when the receivable becomes less than two months contractually past due.
MasterCard and Visa	Charged off at six months contractually delinquent.	Interest accrues until charge-off.
Private label	Charged off at six months contractually delinquent.	Interest accrues until charge-off.
Personal non-credit card	Charged off at nine months contractually delinquent and no payment received in six months, but in no event to exceed twelve months.	Interest income accruals are suspended when principal or interest payments are more than three months contractually delinquent. For Personal Home Owners' Loans ("PHLs"), interest income accruals resume if the receivable becomes less than three months contractually past due. For all other personal non-credit card receivables, interest income is recorded as collected.

123. Beginning in 2002, Household consistently defended its collection and reaging policies as being necessary to its unique business. What investors did not know until the end of the Class Period, however, was that defendants had used reaging as a means to simply avoid reporting otherwise delinquent accounts. While Household sporadically disclosed its reaging policies, it was not until the Company filed a Form 8-K during 2Q02, on 4/9/02, that Household first broke out its reaging statistics, which revealed a huge number of accounts that had been reaged multiple times. In fact, at the time Household ultimately released its reaging statistics, 20% of its real estate secured loans and almost 17% of its domestic portfolio had been previously reaged. In addition, at this time, investors also learned for the first time that over 27% of the Company's "non-credit card" debt had been reaged during the Class Period.

124. In addition to lowering defaults, the widespread abuse of the Company's reaging policies also had the effect of rendering the Company's financial statements materially false and misleading.

Household's "Reaging" Policies Violated GAAP

125. Throughout the Class Period, defendants engaged in the practice of "reaging" Household's delinquent accounts. See ¶¶107-124, *supra*. By reaging such accounts, defendants were able to report lower credit loss reserves, thus overstating net income reported in Household's SEC filings.

126. Household's "reaging" practice is a "modification" of the contractual method of aging loans and more resembles the "recency-of-payments" method of aging.⁴ According to the American Institute of Certified Public Accountant's ("AICPA") Audit and Accounting Guide – Audits of Finance Companies – the recency-of-payments method is considered a less conservative method of aging accounts. The AICPA also describes how some finance companies weaken the basis of the contractual method by modifying their calculations to consider accounts contractually current when two timely payments have been made on an account previously considered delinquent. The AICPA warns that, *while recent payments may alter the classification of a particular account, it doesn't necessarily indicate that the account is ultimately collectible*. The AICPA also cautions that *renewals without evidence of increased ability or willingness to repay may diminish the reliability of aging schedules*. See ¶¶2.114-2.118 of AICPA Audit and Accounting Guide Audits of Finance Companies With Conforming Changes as of 5/01/00.

127. While Household engaged in "reaging" practices from the commencement of the Class Period, it was not until an analyst presentation on 4/9/02 that defendants finally revealed the impact of such practices. Incredibly, 17% of Household's total domestic portfolio had been reaged as of 12/31/01 and 6/30/02. Further, over 27% of Household's domestic "personal non-credit card" loans had been reaged as of 12/31/01 and 6/30/02.

128. Further, by engaging in "reaging" practices that violated its own internal policies, as well as those policies disclosed to the public, the Officer Defendants caused Household to report lower credit loss reserves than required under GAAP and SEC reporting, thus overstating net income

⁴ The contractual method of aging is based on the status of payments under the original terms of the contracts, while the "recency-of-payments" method ages a loan based on the month in which the most recent collections were received, regardless of contractual payment terms for amounts of payments or loan periods.

throughout the Class Period. Household's delinquency rate was significantly lower than those of its peers – about half the rate of other subprime mortgage lenders, like Provident Financial Corp. and AmeriCredit Corp.

129. GAAP, as set forth in SFAS No. 5, Accounting for Contingencies, requires that a company establish a loss contingency, *i.e.*, reserve, when the estimated loss is probable and reasonably estimated. SFAS No. 5, ¶8.

130. Additionally, Household's failure to disclose its "reaging" practices and statistics prior to 2Q02, when the Company was engaging in those practices during the entire Class Period, violates the most basic of GAAP principles and SEC rules. *Household had an obligation to disclose to investors the impact its "reaging" practices had on its overall financial results.*

131. SFAS No. 5 further sets forth the following:

If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made.

SFAS No. 5, ¶10.

132. GAAP, as described in FASB Statement of Concepts ("FASCON") No. 1, ¶¶34, 42, states that:

34. Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.

* * *

42. Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' and creditors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance.

FASCON 1, ¶¶34, 42.

133. For this reason, financial reporting includes not only financial statements, but also other means of communicating information that relates directly or indirectly to the information in the financial statements. FASCON 1, ¶7.

C. DEFENDANTS ENGAGED IN IMPROPER ACCOUNTING OF COSTS ASSOCIATED WITH VARIOUS CREDIT CARD CO-BRANDING, AFFINITY AND MARKETING AGREEMENTS, RESULTING IN AN ALMOST \$600 MILLION (PRE-TAX) RESTATEMENT OF EARNINGS

134. On 8/14/02, CEO Aldinger and COO Schoenholz (as the Company's principal financial officer) were required to file sworn statements, pursuant to §21(a)(1) of the Exchange Act, attesting to the accuracy of the Company's most recent annual and quarterly financial reports pursuant to the SEC Order dated 6/27/02. At this time, Household announced that, pursuant to a thorough review of its financial statements by its new independent auditors, KPMG, the Company had determined to adopt certain revisions to the accounting treatment of its MasterCard/Visa co-branding and affinity credit card relationships and a credit card marketing agreement with a third party.

135. In its audit, KPMG concluded that the amortization rates approved by Andersen, which Household had used for co-branding and affinity credit card agreements and marketing agreements, were improper. Therefore, Household corrected its amortization schedules for prepaid expenses related to these agreements. Additionally, for marketing agreements, Household was to recognize expenses immediately, as opposed to over the life of the contract. As a result, Household would be restating its previously reported financial results as far back as 1994 and continuing until 2Q02 in the amount of about \$600 million (pre-tax), or a decrease of \$386 million in earnings.

136. At the time this restatement was announced, Household stated that its impact on earnings by period was as follows:

\$ Millions	FY94-98	FY99	FY00	FY01	1Q02	2Q02	1H02	Total
Restatement								
Amount (After Tax)	\$155.8M	\$58.1M	\$70.1M	\$75.9M	\$6.1M	\$20.0M	\$26.1M	\$386.0M

137. Defendants caused the Company to falsely report its financial results by improperly accounting for its: (a) co-branding agreements;⁵ (b) exclusive affinity agreements;⁶ and (c) third-party credit card marketing agreements. As a result of the improper accounting for the above, defendants caused Household to overstate its finance income, securitization income and fee income and misstate certain of its expenses, resulting in an overstatement of net income throughout the Class Period.

138. Some of the improprieties are summarized as follows:

(a) Co-Branding Agreements. During 1992, Household entered into a co-branded credit card agreement with General Motors, referred to as the GM Card, which called for Household to pay an up-front fee (origination cost) to its partner for each new credit card account. The contract was modified during 1994. The existing GAAP at the time the contract was entered into and subsequently modified, required the origination costs to be netted with the credit card fee charged to the cardholder, if any, and amortized over the privilege period of the card. The privilege period is the period of time that the cardholder is entitled to use the card. GAAP further requires that if no significant fee is charged to the cardholder, the origination costs should be amortized over one year. Household, in violation of GAAP, inappropriately amortized the origination costs over the term of the agreement, thus spreading the cost of the origination fees paid to its partner over a longer period of time than the one year allowed under GAAP. This inappropriate accounting resulted in the overstatement of net income throughout the Class Period.

(b) Affinity Agreement. During 1996, Household acquired the AFL-CIO's \$3.4 billion "Union Privilege" affinity card portfolio. The Union Privilege was created by the AFL-CIO to market benefits to union members, and Household paid a premium for the Union Privilege portfolio. In accordance with GAAP, Household began amortizing the premium over the contract life. This same amortization period was used for Household's regulatory reporting. In 1999,

⁵ Household defines a co-branded credit card in its FY01 Report on Form 10-K as "[a] MasterCard or Visa account that is jointly sponsored by the issuer of the card and another corporation (e.g., the GM Card®). The account holder typically receives some form of added benefit for using the card."

⁶ Household defines an affinity credit card in its FY01 Report on Form 10-K as "[a] MasterCard or Visa account jointly sponsored by the issuer of the card and an organization whose members share a common interest (e.g., the AFL-CIO Union Plus (up) Credit Card Program)."

however, Household, in violation of GAAP, arbitrarily increased the amortization period for the premium, thus spreading the cost of the premium over a longer period of time, resulting in the overstatement of net income throughout 1999, 2000, 2001 and the first half of 2002.⁷

(c) Independent Third-Party Marketing Agreement. In 6/99, Household entered into a credit card marketing agreement with an independent marketing company. As part of the agreement, Household was reimbursed for marketing expenses, such as mass collective mailings, in return for a share of revenue from those mailings. Since the revenue-sharing payments were, in effect, Household's advertising and marketing expenses, GAAP requires such expenses to be recorded as incurred, and therefore the revenue-sharing payments should have been expensed as each mailing was dropped. Household, however, accounted for the revenue-sharing payments over a three-year period, thus overstating net income throughout 1999, 2000, 2001 and the first half of 2002.

139. As a result of the above improprieties, Household's restatement covered the period from 1994 through 2Q02. The amounts by which Household misstated and ultimately restated its EPS during the Class Period are shown below:

	<u>Diluted EPS</u>		
	As Originally Reported	Restated	Difference
FY97	\$1.93	\$1.86	(\$0.07)
FY98 ^a	\$1.03	\$0.94	(\$0.09)
FY99	\$3.07	\$2.95	(\$0.12)
1Q00	\$0.78	\$0.74	(\$0.04)
2Q00	\$0.80	\$0.77	(\$0.03)
3Q00	\$0.94	\$0.91	(\$0.03)
4Q00	\$1.03	\$0.99	(\$0.04)
1Q01	\$0.91	\$0.85	(\$0.06)
2Q01	\$0.93	\$0.90	(\$0.03)
3Q01	\$1.07	\$1.03	(\$0.04)
4Q01	\$1.17	\$1.13	(\$0.04)
1Q02	\$1.09	\$1.04	(\$0.05)
2Q02	\$1.08	\$1.07	(\$0.01)

⁷ The amortization period for the premium remained the same for Household's regulatory reporting.

^a 1998 reported and restated diluted EPS includes a \$751 million after-tax charge related to the merger and integration of Beneficial and a \$118.5 million after-tax gain related to the sale of Beneficial's Canadian operations. The net impact of these items was to reduce diluted EPS by \$1.27.

140. The effect of these belated disclosures was significant. The Company's release regarding the restatement was issued before the markets opened for trading, and when shares of Household opened, they immediately plunged to as low as \$32.09 per share -- a decline of over \$4.71 per share relative to the prior day's close of \$37.80 per share. During the trading day on 8/14/02, institutional investors reacted to efforts by defendants to bolster the price of Household stock, which caused the stock to stabilize before closing slightly higher on that day. Once such institutional buying tapered off and the Company made further disclosures regarding the effect of the restatement on Household's business and operations, shares of the Company declined once again. *The significance of the restatement is further confirmed by the fact that Household would have missed analysts' EPS estimates for every one of the eight quarters of 2000 and 2001 and the first half of 2002 absent the accounting improprieties detailed herein.*

141. Following the filing on 8/27/02 of the Company's amended FY01 Report on Form 10-K incorporating the restatement, shares of Household continued to trade lower, reaching below \$33.00 on 9/4/02. By 10/10/02, Household shares reached a seven-year low of \$20.65. By 10/24/02, when the Company filed its 3Q02 Report on Form 10-Q, which broke out its massive reaged statistics for the first time, shares of Household traded as low as \$21.40 per share.

Household's Restatement Is an Admission that the Company's Financial Statements Violated GAAP

142. *The fact that Household restated its financial statements is an admission that the financial statements originally issued were false and that the misstatements were material.* Pursuant to GAAP, as set forth in Accounting Principles Board ("APB") No. 20, the type of restatement announced by Household was to correct for material errors in its previously issued financial statements. APB No. 20, ¶¶7-13. The restatement of past financial statements is a disfavored method of recognizing an accounting change, as it dilutes confidence by investors in the financial statements, makes it difficult to compare financial statements and is often difficult, if not impossible, to generate the numbers when restatement occurs. *Id.*, ¶14. Thus, GAAP provides that financial statements should only be restated in limited circumstances, *i.e.*, when there is a change in the reporting entity, when there is a change in accounting principles used or to correct an error in

previously issued financial statements. Household's restatement was not due to a change in reporting entity or a change in accounting principle but rather was due to errors in previously issued financial statements.

143. The fact that Household corrected its financial statements through a restatement indicates that the errors were not merely a change in estimate based on events occurring after the financial statements were issued. Otherwise, the restatement would violate APB No. 20, ¶31, which states, "[a] change in an estimate should not be accounted for by restating amounts reported in financial statements of prior periods" *Id.*, ¶31. Thus, the restatement is an admission by Household that the financial results reported during the Class Period were incorrect based on information available to defendants at the time the results were originally reported. It is also an admission that the Company's previously issued financial results and its public statements regarding those results were materially false and misleading.

144. The SEC recently reiterated its position regarding restatements:

[R]estatements should not be used to make any adjustments to take into account subsequent information that did not and could not have existed at the time the original financial statements were prepared. That is, GAAP does not allow a change in an accounting estimate resulting from new information or subsequent developments to be accounted for as a restatement of previous financial statements. See APB Opinion 20, ¶31. The APB has defined the kind of "errors" that may be corrected through a restatement: "Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time that the financial statements were prepared." See *id.* at ¶¶13, 36-37. In accordance with APB 20, the Commission does not condone the use of restatements by public companies or auditors to make any adjustments (particularly to judgmental reserves) to take into account subsequent information that did not and could not have existed at the time the original financial statements were prepared.

145. In addition, the SEC noted:

[T]he Commission often seeks to enter into evidence restated financial statements, and the documentation behind those restatements, in securities fraud enforcement actions in order, *inter alia*, to prove the falsity and materiality of the original financial statements [and] to demonstrate that persons responsible for the original misstatements acted with scienter

146. On 8/14/02, Household hosted a conference call to discuss the restatement. Based on defendant Schoenholz's comments, it is clear that the restatement was necessitated by the

misapplication of GAAP and the misuse and oversight of facts that existed at the time. Specifically, on this call, Schoenholz stated:

In connection with the engagement of KPMG as our new auditors we've undergone a thorough review of our banking statements and related accounting policies. Part of this review we've adapted certain revisions to the accounting treatment of our MasterCard/Visa affinity and co-branded credit card relationship agreements as well as a related marketing agreement with a third party credit card marketing company.

147. The "revisions to the accounting treatment" to which defendant Schoenholz referred were due to misapplications of GAAP and misuse of facts available at the time.⁹ The primary Financial Accounting Standards Board ("FASB") SFAS for Household's accounting of its co-branded agreements, affinity agreement and marketing agreement is SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases. SFAS No. 91 was issued with an effective date of fiscal years beginning after 12/15/87 – well before Household entered into the agreements described above.

148. Further, in reference to the co-branded agreement, on 5/20/93 the Emerging Issues Task Force released Issue No. 93-1, Accounting for Individual Credit Card Acquisitions ("EITF 93-1"). EITF 93-1 was issued to provide guidance on how to account for credit cards that are acquired individually ("one at a time") by paying an amount to a third party for each approved credit card agreement. EITF 93-1 specifically identifies co-branders as such third parties. EITF 93-1 makes it clear that Household should have been amortizing the amounts paid to its co-brander over the privilege period or, if no fee is charged to the cardholder, no more than one year. EITF 93-1 states, in relevant part:

The Task Force reached a consensus that credit card accounts acquired individually should be accounted for as originations under Statement 91 and Issue 92-5. Amounts paid to a third party to acquire individual credit card accounts should be deferred and netted against the related credit card fee, if any, and the net amount should be amortized on a straight-line basis over the privilege period. If a significant fee is charged to the cardholder, the privilege period is the period that the fee entitles the cardholder to use the credit card. If there is no significant fee, the privilege period should be one year.

⁹ The "revisions to the accounting treatment" were not due to a change in accounting principles because APB No. 20 only allows restatement for a change in accounting principle for a few specific circumstances, none of which apply to Household. The special circumstances relate to inventory, initial public distribution and reporting a change in entity. APB No. 20, ¶¶19, 27-30, 34-35.

EITF 93-1.

149. During the 8/14/02 conference call, defendant Schoenholz admitted that Household was amortizing payments made to its co-brander over the term of the contract, rather than over one year, and therefore would be restating its previously reported financial statements to reflect the one-year amortization period.

150. Household also violated GAAP and SEC rules in accounting for the premium paid for its affinity portfolio when, in 1999, it arbitrarily increased the amortization period for premium paid by 50%, from 10 years to as much as 15 years. Defendants had no basis for increasing the amortization period other than to report more favorable net income associated with the affinity portfolio by "spreading" the impact of the premium paid over a longer period of time than allowed for under GAAP. In fact, defendants knew a change to Household's regulatory reporting would be scrutinized and such an arbitrary change would not be allowed, therefore, Household did not change the amortization period for regulatory reporting purposes.

151. Ultimately, KPMG required Household to change the extended amortization period back to the original ten-year period and restate its previously issued financial statements. As discussed in ¶¶142-150, had this change simply been a change in estimate, restatement would not have been allowed.

152. During 6/99, Household entered into a credit card marketing agreement with a third party provider of credit card marketing services. This agreement allowed Household to be reimbursed for marketing (advertising) expenses and mass collective mailings in return for a share of revenue from those mailings over a three-year period. These "revenue-sharing" payments were for the marketing, advertising and solicitation of the cards – they were not incremental *direct* costs of origination.¹⁰ Household improperly accounted for these indirect marketing expenses (revenue-sharing payments) by amortizing them over a three-year period, when, in fact, such payments should have been expensed as incurred.

¹⁰ SFAS No. 91 defines incremental direct costs as "costs to originate a loan that (a) result directly from and are essential to the lending transaction and (b) would not have been incurred by the lender had that lending transaction not occurred." SFAS No. 91, Appendix C, ¶80.

153. SFAS No. 91 requires that such marketing costs be expensed for as incurred. SFAS 91 specifically states:

All other lending-related costs, including costs related to activities performed by the lender for advertising, soliciting potential borrowers, servicing existing loans ... shall be charged to expense as incurred.

SFAS No. 91, ¶7.

VI. OTHER GAAP VIOLATIONS

154. Due to these accounting improprieties, the Company presented its financial statements in a manner that violated GAAP, including the following fundamental accounting principles:

(a) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);

(b) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASCON 1, ¶40);

(c) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASCON 1, ¶50);

(d) The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASCON 2, ¶¶58-59);

(e) The principle of completeness, which means that nothing is left out of the information that may be necessary to ensure that it validly represents underlying events and conditions, was violated (FASCON 2, ¶79); and

(f) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered

was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASCON 2, ¶¶95, 97).

155. Further, the undisclosed adverse information concealed by defendants during the relevant period is the type of information that, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information that is expected to be, and must be, disclosed.

**HOUSEHOLD'S EXECUTIVE COMPENSATION PROGRAM
REWARDED THE OFFICER DEFENDANTS
FOR THEIR FRAUDULENT ACTIVITY**

156. The Officer Defendants were both highly motivated and had ample opportunity to perpetrate the fraud complained of herein.

(a) The Officer Defendants had a strong personal financial gain motive in making false and misleading statements relating to Household's financial results. The Officer Defendants also had a strong motive in concealing that Household was improperly reaging delinquent accounts and preventing timely charge-offs, thereby causing the reported credit asset quality of Household's customers to appear more favorable than it was in reality. The Officer Defendants concealed that the Company's strong performance was resulting from its participation in predatory lending practices in violation of federal and state laws. In fact, it was only through defendants' fraudulent conduct and scheme detailed in ¶¶150-155 that Household was able to meet or exceed analysts' expectations with respect to the Company's income and EPS during the Class Period and earn the millions of dollars of compensation and bonus payments. Absent the improprieties alleged herein, Household would have failed to meet analysts' consensus estimates for each quarter of FY00 and FY01 and 1H02.

157. The Officer Defendants' annual compensation and incentives were tied to the financial, as well as non-financial, performance of the Company throughout the Class Period. Household purported to be a "pay-for-performance" company. Household's corporate goal was to link compensation to financial performance; hence, compensation programs were designed so that base salaries were generally competitive with a comparable group (12 companies, all in the S&P Financials Index), with substantially higher earnings potential on bonus and long-term compensation

if employees delivered superior stockholder earnings results. Performance during the Class Period was measured primarily by EPS growth.

158. The four components of executive compensation for the Officer Defendants were: (i) Base Salary (determined by individual financial and non-financial performance, position in salary range and general economic conditions); (ii) Annual Cash Bonus (tied directly to overall and/or business unit financial performance, as well as individual performance ... when certain objective or subjective performance goals are not met, annual bonuses may be reduced or not paid); (iii) Long-Term Incentives (compensation based on the increase in stock price); and (iv) Executive Benefits (other perks).

159. For example, defendant Aldinger's executive compensation outlined in the FY97 Proxy Statement provided:

Mr. Aldinger's annual cash bonus was determined based on the satisfaction of various individual objective non-financial and financial performance goals. Under the 1994 Key Executive Bonus Plan, the financial performance goals of Household are (a) *targeted earnings per share*, (b) *targeted return on equity*, (c) *targeted operating efficiency ratio*, (d) *targeted reserve to charge-off ratio*, and (e) *targeted equity to managed assets ratio*. Mr. Aldinger had additional goals in 1997 to build depth in management, complete an auto lending strategy, and actively represent us with stock analysts, portfolio managers and institutional shareholders. All were met. For 1997, Mr. Aldinger's total annual bonus opportunity was between zero and 225% of his annual salary (with a target bonus of 150%). He was awarded a bonus of \$1,500,000 (188% of his base salary) based on his individual objectives and corporate performance as certified by the Committee.

160. Between FY98 and FY01, defendant Aldinger received bonus payments alone of \$14.3 million. These payments were based upon Aldinger's ability each year to cause Household to meet targeted EPS, targeted core receivable growth, targeted operation efficiency ratios, targeted tangible equity to managed assets, targeted increases in the number of Household's products used per customer and targeted revenue growth – the very same metrics that the Officer Defendants manipulated through their fraudulent conduct throughout the Class Period. Thus, each of the metrics used to determine defendant Aldinger's bonuses and other compensation during the Class Period had the effect of encouraging him to engage in the improprieties detailed herein in ¶¶50-155.

WILLIAM F. ALDINGER

<u>Year</u>	<u>Salary</u>	<u>Bonus</u>	<u>Other Annual Compensation</u>	<u>Number of Shares Underlying Options</u>	<u>LT Payouts</u>	<u>All Other Compensation</u>
1997	\$ 794,233	\$1,500,000	\$186,185	450,000	-0-	\$155,156
1998	888,463	2,300,000	82,188	500,000	-0-	151,383
1999	1,000,000	3,000,000	107,639	460,000	-0-	213,104
2000	1,000,000	4,000,000	154,242	600,000	-0-	245,382
2001	1,000,000	5,000,000	160,763	800,000	-0-	305,382

DAVID A. SCHOENHOLZ

<u>Year</u>	<u>Salary</u>	<u>Bonus</u>	<u>Other Annual Compensation</u>	<u>Number of Shares Underlying Options</u>	<u>LT Payouts</u>	<u>All Other Compensation</u>
1997	\$370,674	\$ 435,000	-0-	120,000	\$172,813	\$ 51,844
1998	425,482	750,000	-0-	134,000	222,305	56,918
1999	500,000	1,500,000	-0-	124,000	456,094	79,101
2000	500,000	2,000,000	-0-	150,000	-0-	123,433
2001	500,000	2,500,000	-0-	200,000	-0-	155,382

GARY D. GILMER

<u>Year</u>	<u>Salary</u>	<u>Bonus</u>	<u>Other Annual Compensation</u>	<u>Number of Shares Underlying Options</u>	<u>LT Payouts</u>	<u>All Other Compensation</u>
1997	\$296,155	\$ 270,000	\$579,368	75,000	-0-	\$ 36,070
1998	404,809	850,000	288,951	134,000	-0-	34,954
1999	500,000	1,500,000	44,303	124,000	-0-	83,459
2000	500,000	2,000,000	63,743	150,000	-0-	122,873
2001	500,000	2,500,000	25,125	200,000	-0-	155,382

161. Defendants Schoenholz and Gilmer, as well as other senior executives, were also paid annual bonuses based on performance goals that had the effect of encouraging their participation in the reaging, predatory lending and accounting schemes, as defined herein, including:

162. Thus, as demonstrated above, a significant portion of each of the Officer Defendants' compensation was directly tied to his ability to cause Household to meet targeted EPS, regardless of the long-term impact on Household or the risk that such practices would result in earnings restatements or regulatory sanctions. Although the Company did not provide details for the entire restated period, the following table compares the impact of the restatement on diluted EPS to the consensus estimate for 1Q00 through 2Q02, illustrating the significance of defendants' accounting manipulations on Household's performance vis-a-vis earnings estimates:

<u>Quarter</u>	<u>As Reported</u>	<u>Restated</u>	<u>Consensus Estimate</u>	<u>Reported v. Restated</u>
1Q00	0.78	0.74	0.77	+0.01 v. - (\$0.03)
2Q00	0.80	0.77	0.79	+0.01 v. - (\$0.03)
3Q00	0.94	0.91	0.94	+0.00 v. - (\$0.04)
4Q00	1.03	0.99	1.03	+0.00 v. - (\$0.04)
1Q01	0.91	0.85	0.91	+0.00 v. - (\$0.04)
2Q01	0.93	0.90	0.93	+0.00 v. - (\$0.04)
3Q01	1.07	1.03	1.07	+0.00 v. - (\$0.04)
4Q01	1.17	1.13	1.17	+0.00 v. - (\$0.04)
1Q02	1.09	1.04	1.05	+0.04 v. - (\$0.01)
2Q02	1.08	1.07	1.08	+0.00 v. - (\$0.01)

163. Without the boost provided by defendants' improper accounting, Household would likely not have had a single quarter of meeting or exceeding analysts' expectations, not to mention posting its purported string of back-to-back "record" results. Moreover, the financial impact of the Company's predatory lending practices and improper reaging on the Company's operations was devastating.

164. Household's predatory lending and reaging practices were directly related to, and greatly impacted, Household's core business operations. Indeed, consumer lending accounted for the overwhelming majority of the Company's revenue during the Class Period. Throughout the Class Period, each of the Officer Defendants was a high-level corporate executive engaged in the management and oversight of the core aspects of Household's businesses.

165. Additionally, the Officer Defendants ran Household and its subsidiaries as "hands-on" managers and closely monitored the Company's business on a regular basis. See ¶¶41-43. Each of the Officer Defendants was a core member of the senior management team during the Class Period and was directly involved in the day-to-day operations of the Company. They were privy to proprietary information concerning Household's business, operations, growth, financial statements and financial condition. The Officer Defendants had access to, and control over, the Vision system that was launched in July 1999 and provided them with information relating to all aspects of the Company's performance. *Id.*

166. The Officer Defendants also controlled the contents of public statements issued by or on behalf of Household and made statements and predictions regarding Household's operations

and financial condition. They were the primary spokespeople on behalf of the Company and hosted quarterly and annual conference calls to announce financial results. In addition, defendants hosted periodic one-on-one meetings with analysts, where they provided very positive information about the Company's operations and key financial metrics, while knowing or recklessly disregarding that these analysts would then repeat their statements to the market, directly impacting stock price. See ¶¶41-43.

167. Defendants were able to perpetrate the fraudulent scheme complained of herein in part by using the Company's centralized and highly automated "Vision" information system. Developed over three years at a cost of \$83 million, Vision was launched in July 1999. Vision connected all of Household's over 1,400 branches across the nation, allowing various offices to view the same information on customer accounts in real time and enabling the Officer Defendants and Household's senior management to monitor the Company's day-to-day lending operations. Using Vision, the Officer Defendants were able to centralize decision-making throughout the loan process, including generating scripts for the sales staff, monitoring delinquencies and collectibles, determining charge-offs and training the sales force.

168. In addition, Vision priced each loan automatically based on criteria specified by Household. Vision also enhanced defendants' ability to analyze and assess Household's cross-selling ability by providing "suggestive selling" techniques. After the customer's information was input into Vision, the system prompted the account executive to up-sell or offer an alternative that Vision had selected as a product that the customer would have a high propensity to buy. Upon closing, Vision created all the loan documents and printed them on the branch office printer. In this way, the Officer Defendants were able to directly monitor and control Household's lending practices.

169. On 10/11/02, Fitch Ratings placed the Company on Rating Watch Negative and issued a release stating:

In Fitch's view, the bigger challenge for Household will be replenishing lost revenue resulting from the implementation of "Best Practices." An ability to offset these revenues streams could pressure future profitability, which in turn could put pressure on the current rating.

170. Indeed, on 1/15/03, Household issued a Press Release announcing 4Q02 results. Household reported net income of \$388 million and EPS of \$0.66, compared to 4Q01 net income of \$549 million and EPS of \$1.17, a 44% decrease in EPS.

**VIII. ANDERSEN'S ROLE IN DEFENDANTS'
FRAUDULENT SCHEME AND UNLAWFUL COURSE OF CONDUCT**

A. GENERAL

171. Andersen, a worldwide firm of certified public accountants, was involved in various facets of Household's business. Andersen audited Household's financial statements, prepared Household's tax returns and provided consulting services on a wide range of topics throughout the Class Period. Andersen examined and opined on Household's financial statements for FY97, FY98, FY99, FY00 and FY01 and reviewed Household's interim results and releases. As a result of the far-reaching scope of services provided by Andersen, it was intimately familiar with Household's business affairs, and its personnel were present at Household's Chicago headquarters on a year-round basis. Andersen's Chicago office was routinely involved in the structuring and/or approval of the practices and/or Offerings detailed herein.

172. Andersen, however, turned its back on its responsibilities to Household investors and the investing public and abandoned its professional standards by helping Household perpetrate the massive accounting fraud alleged herein.

173. Andersen falsely represented that Household's financial statements for FY97, FY98, FY99, FY00 and FY01 were presented in accordance with GAAP and that Andersen's audits of Household's financial statements had been performed in accordance with Generally Accepted Auditing Standards ("GAAS"). Andersen also consented to the incorporation of its reports on Household's financial statements in Household's Reports on Form 10-K for those years and in Household's Registration Statements for the Company's: (a) registration of over \$75 billion of debt securities, filed on 2/16/99, 7/01/99, 3/24/00, 9/13/00, 2/23/01, 5/03/01, 11/20/01, 12/18/01 and 4/09/02; and (b) registration of approximately 168 million shares of Household stock valued at approximately \$8 billion, declared effective or filed on or about 6/01/98. Andersen also consented to the use of its name as an expert in each Registration Statement filed and issued pursuant to these

offerings, including the Form S-4 registration statement used to consummate the Beneficial merger (the "Beneficial Registration Statement"). Andersen's issuance of, and multiple consents to reissue materially false reports on, Household's 1997-2001 financial statements were themselves violations of GAAS.

174. With respect to Household's financial statements for 2001, Andersen represented in a report dated 1/14/02, the following:

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of Household International, Inc.

We have audited the accompanying consolidated balance sheets of Household International, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of income, changes in preferred stock and common shareholders' equity and cash flow for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of Household International, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Household International, Inc. and subsidiaries as of December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

175. Andersen issued nearly identical audit reports for 1997 (issued 1/21/98), 1998 (issued 1/20/99), 1999 (issued 1/14/00) and 2000 (issued 1/15/01).

176. Andersen's reports were false and misleading due to its failure to conduct its audits in compliance with GAAS and because Household's financial statements were not prepared in conformity with GAAP, as alleged in detail in ¶¶102-106 and 125-155, so that issuing the reports was in violation of GAAS and SEC rules. Andersen knew its reports would be relied upon by potential investors in Household securities. Throughout the same period, Andersen performed

reviews of Household's quarterly financial statements, reviewed and approved Household's quarterly Reports on Form 10-Q and reviewed, discussed and approved Household's press releases.

B. ANDERSEN WAS NOT INDEPENDENT

177. Household was an extremely important client to Andersen. In 2001 alone, Andersen received \$4.6 million in fees for services it provided to Household, of which \$1.9 million related to the audit fees and another \$2.7 million related to its highly-profitable non-audit services, including consulting work. In 2000, Andersen received \$4 million in fees, of which \$2 million related to audit fees and \$2 million related to non-audit services. In 2000 and 2001, these fees were particularly important to Andersen's partners, as their incomes were dependent on the continued business from Household. Andersen's Chicago partners had a particular incentive and were under enormous pressure to not only retain Household but increase the billings to the client, which generated significant revenues for the Chicago office. Andersen partners assigned to the Household account held regular meetings during the Class Period to discuss ways to sell more services and bill more fees to Household.

178. Because Andersen partners could not increase the fees from Household fast enough by performing traditional audit and accounting work, Andersen incentivized its partners to sell its much more lucrative consulting services. Andersen tied part of its audit partners' compensation to the solicitation and marketing of non-audit consulting services and creating other revenue-sharing arrangements between audit and consulting partners groups. Andersen put tremendous pressure on partners to generate more fees. A "depth chart" was developed for each audit client based upon the level of services provided to that client. Partners received extra units (worth about \$200,000 per year) based on the additional services sold. Hundreds of Andersen partners were each earning in excess of \$1 million per year during the Class Period, based primarily upon the level of fees that each individual partner "controlled" or sold to his or her assigned clients.

179. Professional Audit Standards promulgated by both the AICPA and the SEC require that auditors be independent, objective and free of conflicts of interest. ET, §§54, 55, 102.

C. ANDERSEN'S PARTICIPATION IN THE FRAUD IS CONSISTENT WITH ITS PRIOR PARTICIPATION IN A SERIES OF MAJOR ACCOUNTING FRAUDS

180. Andersen's egregious conduct surrounding the Household affair is hardly an isolated incident. Andersen is a recidivist violator of the federal securities laws with a history of accounting improprieties, conflicts of interest and document destruction in some of the most egregious cases of accounting fraud in the history of the U.S. securities markets, its now-former client list making up a veritable "who's who" of financial disasters. Moreover, Andersen's conduct in these cases often shares the same underlying themes as its conduct in the Household debacle. A nonexhaustive list of Andersen's involvement in major accounting scandals follows:

(a) Enron. Andersen's intimate involvement in the world's most notorious accounting scandal is now common knowledge. Indeed, the entire Andersen partnership was convicted of obstruction of justice charges because of its felonious conduct, directed from Andersen world headquarters in Chicago, the office which perpetrated the accounting improprieties detailed herein. As summarized by Judge Melinda Harmon of the Southern District of Texas:

Lead Plaintiff has identified numerous violations by Arthur Andersen of GAAS, GAAP, risk factors for fraud, accounting rules, and rules of professional conduct for accounts that Arthur Andersen violated. Yet Arthur Andersen certified that Enron's financial statements for 1997-2000 were in compliance with GAAP and its audits of the financial statements complied with GAAS.... Lead Plaintiff has also alleged that Arthur Andersen destroyed documents to conceal its fraudulent accounting. All of these constitute primary violations under §10(b).

Furthermore Lead Plaintiff has alleged specific facts giving rise to a strong inference of scienter. Arthur Andersen's comprehensive accounting, auditing, and consulting services to Enron necessarily made it intimately privy to the smallest details of Enron's alleged fraudulent activity.

In re Enron Corp. Secs., Derivative & ERISA Litig., MDL-1446, Civil Action No. H-01-3624 Consolidated Cases, 2002 U.S. Dist. LEXIS 25211, at *706 (S.D. Tex. Dec. 20, 2002).¹¹

(b) Worldcom. Worldcom was a telecommunications giant that reported stellar revenue, net income and EPS growth in the latter half of the 1990s and into 2002. The growth caused Worldcom's stock price to soar and enabled it to compile over 70 acquisitions and raise

¹¹ Judge Harmon also noted "several similar prior fraudulent audits of other companies, establishing a pattern of such conduct, and the SEC's and courts' repeated imposition of penalties on Arthur Andersen and its employees" *Id.*

billions of dollars from public investors. All along, Andersen audited – or, rather, “cooked” – Worldcom's books. Worldcom is now bankrupt. Worldcom's precipitous fall into the largest bankruptcy ever has caused well over \$100 billion in damages to investors. Andersen's complicity in the fraud speaks for itself. Shortly before its bankruptcy filing in 6/02, Worldcom admitted that Andersen had overseen Worldcom's *overstatement of income by \$3.85 billion*. By 9/02, Worldcom had disclosed that more than \$9 billion in previously-recognized revenue just did not exist when it was recorded. On 11/04/02, the court-appointed bankruptcy examiner issued an interim report detailing a “smorgasbord” of questionable accounting practices going back several years, stating: “These issues relate to the culture, internal controls, management, integrity, disclosures and financial statements.” Andersen, Worldcom's auditor throughout this period, worked closely with Worldcom senior executives for almost half a decade while this massive fraud took place.

(c) Dynegy. Like Enron and Worldcom, Andersen audited Dynegy's financial statements, which also were patently false and misleading to investors. These false and misleading financial statements enabled Dynegy to issue over \$1 billion in debt that is now nearly worthless and caused billions of dollars of damages to persons who were fraudulently induced into buying Dynegy securities. That these financial statements were the product of fraud is not open to debate. On 9/24/02, the SEC announced:

The Commission [has] found that Dynegy engaged in securities fraud in connection with its disclosures and accounting for Project Alpha, and negligently included materially misleading information about the round-trip energy trades in two press releases it issued in early 2002.... Dynegy, without admitting or denying the Commission's findings, has agreed to the entry of the cease-and-desist order and to pay a \$3 million penalty in a related civil suit filed in U.S. district court in Houston.

In 11/02, Dynegy restated results for 1999 through 2001. On 1/31/03, Dynegy announced its second major restatement in three months, stating that it would revise results for 1999 through 2001 and the first three quarters of 2002 as a result of a reaudit that would reduce net income by *\$431 million* over the four-year period.

(d) Qwest. Qwest has been forced to restate *all* of its financial statements for 1999 through 2001 – the entire length of its engagement with Andersen! Once again, this fraud took place while Qwest was being audited by Andersen. Further, Qwest is now the subject of

Congressional, SEC and Department of Justice investigations into its accounting manipulations. Qwest's defense is that it relied on the advice of its accountants – Andersen. The falsity of Qwest's financial reporting is clear. Notably, in 9/02, Qwest announced that its restatement would erase \$950 million in revenue (later revised to \$1.86 billion). The vast majority of this restated revenue was booked in so-called "swap" transactions that Qwest never registered as revenue until it hired Andersen. Many of these swaps were made with another Andersen client, the now-defunct Global Crossing (*see below*). Furthermore, in 8/01, Qwest was required by the SEC to amend its FY00 Report on Form 10-K to include a disclosure that its 2000 results had benefited from a pension credit of \$299 million, or \$182 million after tax, in FY00, compared to a charge of \$8 million in 1999 – again, a transaction permitted by Andersen. On 7/20/01, Qwest admitted that its classification of costs had been incorrect such that cost of sales had been overstated and Sales, General & Administrative ("SG&A") expenses had been understated.

(e) Global Crossing. Global Crossing, the bankrupt fiber-optic network operator, once had a \$38.9 billion market value – but again, its stock value was based on false financials certified by Andersen. Global Crossing sought protection from creditors on 1/28/02 after amassing \$12.4 billion in debt. The SEC and the Federal Bureau of Investigation have begun examining Global Crossing's accounting – accounting approved by Andersen – after a former vice-president of finance alleged that the company inflated revenue from leasing space on its lines while under-reporting costs for buying space on rivals' networks – the very same "swap" transactions as Qwest. When these bogus revenue figures were erased, Global Crossing was revealed to be a financial disaster and never would have been able to secure public funding of its operations had it told the truth.

(f) Waste Management. In 1998, Waste Management restated its 1992 through 1996 financial statements, which had been audited by Andersen's Houston office, revealing a massive fraud that included the overstatement of profits by as much as \$1.7 billion. At the time, this was the largest restatement of earnings in history. In 6/01, as a result of its egregious behavior associated with its audits of its Waste Management client, the SEC hit Andersen with the first anti-fraud injunction in 20 years and the largest civil penalty (\$7 million) in SEC history for an

accounting firm. The SEC also required Andersen to sign a consent decree promising to refrain from wrongdoing in the future. Andersen partner Goolsby signed that agreement. Andersen knew its ongoing conduct with another client, Enron, violated the agreement when it was signed. As with Enron, Andersen's willingness to keep quiet about fraudulent accounting to protect the huge fees it earned played a significant role in Waste Management's ability to perpetrate one of the largest accounting frauds in history. Andersen recognized Waste Management's "aggressive" accounting as early as 1988, according to SEC documents, and by 1993, Andersen had documented that Waste Management was a "high-risk client" and that the client inflated profits by more than \$100 million. However, during the same time frame, Andersen was relentlessly marketing its consulting services to the client, resulting in consulting fees more than double the size of the audit fees. Even when Waste Management refused to fix the improper accounting practices recommended by Andersen in prior years, Andersen caved in and continued to sign off on the company's annual audits. This went on for the next three years. According to the SEC, those decisions were backed at the highest levels at the same Andersen office that audited Household's financial statements. These decisions were backed by Andersen's Practice Director, the firm's Managing Partner and the Audit Division Head for the firm's national office in Chicago. Several parallels exist between the conduct of the Chicago office of Andersen in Waste Management, Enron and here. For example: Enron and Waste Management were major Andersen clients that generated millions of dollars in fees each year. Andersen's Chicago office participated in the audits of Waste Management, Enron and Household.

(g) Sunbeam. In 5/01, the SEC filed an injunctive action against Andersen partner Phillip E. Harlow, the former engagement partner on the Sunbeam account, for authorizing the issuance of unqualified audit opinions on Sunbeam's 1996 and 1997 financial statements, even though he was aware of many of the company's accounting improprieties and disclosure failures. In 2001, Andersen paid \$110 million to settle shareholder lawsuits in connection with Sunbeam's restatement of six quarters of financial results. Indeed, the SEC stated that Sunbeam's purported turnaround was little more than accounting gimmicks, accomplished through the creation of inappropriate "cookie-jar" reserves. In Sunbeam, as in Enron, Andersen's document destruction was a common theme. In fact, an Andersen partner testified that, months after the restatements were

announced and after shareholder lawsuits had been filed, the firm ordered its Fort Lauderdale employees to dispose of any workpapers or correspondence that did not agree with the final documentation of the Sunbeam restatement.

(h) Baptist Foundation of Arizona. In a suit filed by the Arizona Attorney General, Andersen agreed to pay investors \$217 million to settle a suit in connection with the 1999 failure of the Baptist Foundation of Arizona ("Foundation"), where an ongoing Ponzi scheme wiped out \$590 million of the savings of investors, many of them retirees. The Arizona authorities brought the action to revoke the licenses of three Andersen auditors. Jay Steven Ozer ("Ozer"), one of the senior partners on Andersen's audits of the Foundation, audited Charles Keating's ("Keating") Lincoln Savings & Loan, described below. Ozer agreed to give up his Arizona accounting license. Particularly egregious in the Foundation situation was the fact that outside CPAs and professionals continued to warn Andersen for two years that they highly suspected fraudulent accounting at the Foundation, yet Andersen completely ignored them. An accountant for the Foundation testified that, more than two years before the bankruptcy, she met with Andersen and openly explained the nature of the fraud. Subsequently, a Texas Baptist group became suspicious, called Andersen and told Andersen about the suspected fraudulent accounting at the Foundation. Additionally, a sole practitioner CPA figured the fraud out in an afternoon by conducting a simple search of public records, revealing that the company used to engage in transactions with the Foundation had a negative net worth of approximately \$106 million and couldn't possibly make good on the debt to the Foundation. Calls were made to the Andersen office involved here and stated, "You must withdraw your unqualified opinion immediately. The company's effectively broke. Call me."

(i) Colonial Realty Company. In the mid 1990s, the State of Connecticut revoked Andersen's license to practice after investigating Andersen's conduct in its audits surrounding the collapse of Colonial Realty Company, a national real estate syndication firm. Central to the Colonial Realty Company fraud was a Ponzi scheme that involved deliberate and grossly exaggerated valuation of Colonial Realty Company properties. Andersen furnished unqualified opinions supporting Colonial Realty Company's extravagant valuations and claims and assisted in preparing private placement memoranda in connection with the public offerings that resulted in investors'

sustaining substantial losses. As with Enron, after conducting an extensive investigation, Connecticut's Attorney General concluded that Andersen employees destroyed incriminating documents under the auspices of complying with Andersen's document retention policy.

(j) Lincoln Savings/ACC. Andersen was also associated with this infamous fraud perpetrated by Keating. In 1984 and 1985, Andersen improperly issued "clean" or unqualified audit opinions on the ACC/Lincoln Savings financial statements. Those opinions were included in ACC/Lincoln Savings SEC filings and helped Keating promote an illusion of prosperity that was used to market notes to investors. Thus, Andersen participated in the Keating fraud that bilked investors out of over \$500 million. In 1992, Andersen paid \$30 million to settle the securities fraud action. Andersen, of course, did not learn a lesson from this experience. In fact, Ozer, an Andersen partner and a member of the Andersen audit team on ACC/Lincoln Savings, went on to be a key Andersen auditor on the aforementioned Foundation scandal.

181. These cases demonstrate that for years Andersen has demonstrated a callous, reckless disregard for its duty to investors and the public trust. Andersen's conduct throughout this period displays an uncaring, calculated cost/benefit approach to ignoring fraud and improper accounting in its audit engagements. As the facts above indicate, Andersen remained, until the end, unrepentant, choosing to fight these cases rather than actually rectify its improper behavior. In essence, Andersen considered compromising its integrity and getting caught allying itself with management's interests to be an ordinary and necessary cost of doing business.

D. ANDERSEN DISREGARDED MAJOR INDICATORS OF FINANCIAL STATEMENT FRAUD AT HOUSEHOLD ("RED FLAGS")

Andersen Knew the Risk of Fraud Was Extremely High

182. Andersen had direct knowledge of Household's improper accounting as alleged herein. Andersen also knew that the risk of fraudulent financial reporting at Household was very high. In designing and carrying out audit procedures, professional standards specifically require that auditors assess the risk of material misstatement due to fraud. To that end, Andersen, pursuant to Statement of Auditing Standards ("SAS") No. 82 (AU §§316, 110), was required to assess the risk of fraudulent financial statements at Household. Andersen had a "responsibility to plan and perform

the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." AU §316 provides categories of fraud risk factors that should be considered in making that assessment. Andersen knew that Household possessed many of the risk factors delineated in AU §316.16-18, including:

Risk factors relating to management's characteristics and influence over the control environment....

- A significant portion of management's compensation represented by bonuses, stock options, or other incentives, the value of which is contingent upon the entity achieving unduly aggressive targets for operating results, financial position, or cash flow.
- An excessive interest by management in maintaining or increasing the entity's stock price or earnings trend through the use of unusually aggressive accounting practices.
- A practice by management of committing to analysts, creditors, and other third parties to achieve what appear to be unduly aggressive or clearly unrealistic forecasts.

* * *

- Management setting unduly aggressive financial targets and expectations for operating personnel.

AU §316.17(a).

183. Andersen knew that Household management had not only an "excessive interest" but a highly unusual interest in maintaining the Company's stock price. Household executives received multi-millions of dollars in bonuses from hitting a series of stock-price targets based on Household's compensation practices.

184. As depicted in the following chart, Household experienced dramatic growth between 1997 and 2001. Note the following:

	1997	1998	1999	2000	2001
Reported EPS	\$1.93	\$2.30 ¹²	\$3.07	\$3.55	\$4.08

¹² 1998 EPS has been adjusted for a \$118.5 million after-tax gain related to the sale of Beneficial Corporation's Canadian operations and a \$751 million after-tax charge related to the merger and integration of Beneficial.

Upon restatement, the EPS was reduced as follows:

	1997	1998	1999	2000	2001
Restated EPS	\$1.86	\$2.21	\$2.95	\$3.40	\$3.91

E. ANDERSEN KNEW HOUSEHOLD'S DISCLOSURES WERE FALSE

185. In accordance with GAAS, Andersen was required to consider whether Household's disclosures accompanying its financial statements were adequate. SAS No. 32, as set forth in AU §431.02-.03, states:

.02 The presentation of financial statements in conformity with generally accepted accounting principles includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth. An independent auditor considers whether a particular matter should be disclosed in light of the circumstances and facts of which he is aware at the time.

.03 If management omits from the financial statements, including the accompanying notes, information that is required by generally accepted accounting principles, the auditor should express a qualified or an adverse opinion and should provide the information in his report, if practicable, unless its omission from the auditor's report is recognized as appropriate by a specific Statement on Auditing Standards....

AU §431.02-.03.

186. The required disclosures include those concerning Household's illegal predatory lending practices and the impact its reaging practices had on Household's reported results. As detailed herein, Household's disclosures with respect to its accounting practices were woefully inadequate.

187. Further, auditors are required to consider the effect of an illegal act on the financial statements. If an auditor concludes that an illegal act has or is likely to have occurred, then the auditor is required to evaluate the adequacy of disclosure in the financial statements of the potential effects of the illegal act and should also consider if a loss contingency is required. AU §317.14-.15 states:

.14 The auditor should consider the effect of an illegal act on the amounts presented in financial statements including contingent monetary effects, such as fines, penalties and damages. Loss contingencies resulting from illegal acts that may be required to be disclosed should be evaluated in the same manner as other loss contingencies. Examples of loss contingencies that may arise from an illegal act are: threat of expropriation of assets, enforced discontinuance of operations in another country, and litigation.

.15 The auditor should evaluate the adequacy of disclosure in the financial statements of the potential effects of an illegal act on the entity's operations. If material revenue or earnings are derived from transactions involving illegal acts, or if illegal acts create significant unusual risks associated with material revenue or earnings, such as loss of significant business relationship, that information should be considered for disclosure.

F. ANDERSEN VIOLATED PROFESSIONAL STANDARDS

188. In addition to Andersen's improper departures from professional standards as particularized above, Andersen also violated the following professional standards, among others.

189. The bylaws of AICPA require that members adhere to the Principles and Rules of the Code of Professional Conduct ("ET"). Andersen violated those rules, including the following:

ET §53 – Article II – The Public Interest

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

ET §102 – Integrity and Objectivity

.02 *Knowing misrepresentations in the preparation of financial statements or records.* A member shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET §102.01] when he or she knowingly

a. Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET §102.01]

ET §501 – Acts Discreditable

.05 501.4 – *Negligence in the preparation of financial statements or records.* A member shall be considered to have committed an act discreditable to the profession in violation of rule 501 [ET §501.01] when, by virtue of his or her negligence, such member –

a. Makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity; or

b. Fails to correct an entity's financial statements that are materially false and misleading when the member has the authority to record an entry; or

c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

Additionally, AU §220 – Independence further states that:

.01 The second general standard is:

In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.

.02 This standard requires that the auditor be independent; aside from being in public practice (as distinct from being in private practice), he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be. However, independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors.

190. One of Andersen's responsibilities as Household's independent auditor was to obtain "[s]ufficient competent evidential matter ... to afford a reasonable basis for an opinion regarding the financial statements under audit" as to "the fairness with which they present, in all material respects, financial position, results of operations, and its cash flows in conformity with generally accepted accounting principles." AU §§150.02, 110.01. In violation of GAAS, and contrary to the representations in its report on Household's financial statements, Andersen did not obtain sufficient, competent evidential matter to support Household's assertions regarding its income, assets, debt and shareholders' equity for FY97, FY98, FY99, FY01 and FY01. Moreover, Andersen deliberately ignored information indicating that Household's financial statements did not "present fairly" the Company's financial position.

191. Due to Andersen's false statements, knowledge of the improper accounting, failure to identify and modify its reports to identify Household's false financial reporting, and lack of independence, Andersen violated the following GAAS standards:

(a) The first general standard is that the audit should be performed by persons having adequate technical training and proficiency as auditors.

(b) The second general standard is that the auditors should maintain an independence in mental attitude in all matters relating to the engagement.

(c) The third general standard is that due professional care is to be exercised in the performance of the audit and preparation of the report.

(d) The first standard of field work is that the audit is to be adequately planned and that assistants should be properly supervised.

(e) The second standard of field work is that the auditor should obtain a sufficient understanding of internal controls so as to plan the audit and determine the nature, timing and extent of tests to be performed.

(f) The third standard of field work is that sufficient, competent, evidential matter is to be obtained to afford a reasonable basis for an opinion on the financial statements under audit.

(g) The first standard of reporting is that the report state whether the financial statements are presented in accordance with GAAP.

(h) The second standard of reporting is that the report shall identify circumstances in which GAAP has not been consistently observed.

(i) The third standard of reporting is that informative disclosures are regarded as reasonably adequate unless otherwise stated in the report.

(j) The fourth standard of reporting is that the report shall contain an expression of opinion or the reasons why an opinion cannot be expressed.

IX. FALSE AND MISLEADING STATEMENTS DURING THE CLASS PERIOD

A. DEFENDANTS' FALSE AND MISLEADING STATEMENTS DURING 1997

192. On 10/23/97, Household announced 3Q97 financial results in a press release entitled "Household Reports All-Time Record Results," which stated:¹³

Household International today reported record net income of \$187.2 million for the third quarter, up 34 percent from \$139.9 million for the year-ago quarter. Earnings per share rose 23 percent to a quarterly record of \$1.70, compared with \$1.38 a year earlier.

* * *

William F. Aldinger, Household's chairman and chief executive officer, said "We are pleased to announce another record quarter. Contributing to our good results were wider margins, higher average managed receivables, and a continued focus on efficiency, which more than offset the impact of higher credit losses."

¹³ The financial results and per-share amounts until 6/07/98 included herein are not adjusted for the 3:1 split that occurred on 6/01/98.

193. On 10/24/97, these financial results and management's discussion of the results were repeated to the market in analysts' reports. In addition to artificially inflating the price of Household shares, defendants' false statements also had the effect of misleading analysts who relied on these misleading representations in issuing very positive reports and advising investors to purchase shares of Household, as follows:

Joel Gomberg (William Blair & Co.) Report of 10/24/97

Household reported third-quarter EPS of \$1.70 ... and \$0.02 better than our \$1.68 estimate and that of consensus. Household continues to deliver on its commitment for 20%-plus EPS growth. Earnings per share were better than expected due to expense controls; however, internally generated loan growth was disappointing during the quarter....

HI is growing at a rate in excess of 20%, yet trades at a 1998 P/E multiple that represents a relative discount to its peer group and a 25%-plus discount to our long-term growth rate. Foremost, we are attracted to this experienced senior management team and its disciplined strategy to focus on a few high-margin businesses, to be a leader in cost-management, skill at executing acquisitions, and conservative income recognition and balance sheet management....

* * *

Management conveyed a more positive tone with respect to credit quality.... We anticipate that the company's credit losses will remain lower than industry averages, due to its co-branding strategy in the credit card area and high percentage of consumer finance receivables backed by residential real estate. Lastly, Household's significant loan-loss provision levels during the past couple years have provided loan-loss reserve coverage well above peer levels and management earnings flexibility in 1998.

* * *

Profitability is strong because the typical HFC customer will pay a higher price for personal service and is more sensitive to the payment amount than interest rate. Management also has instilled a very sales-oriented culture, supported by an aggressive incentive compensation structure.

194. On 11/13/97, Household filed with the SEC its 3Q97 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the false financial results and other false representations as were made in the 10/23/97 corporate release, the 3Q97 Report on Form 10-Q also stated that the unaudited financial results were prepared in accordance with GAAP and included, "[i]n the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation." The 3Q97 Report on Form 10-Q was signed by defendant Schoenholz.

195. On 12/08/97, defendant Aldinger visited the offices of William Blair & Co., after which analyst Joel Gomberg issued a very positive report on Household the next day, reiterating his long-term Buy rating on the stock. The report stated, in part, that:

The meeting [with Aldinger] reinforced our positive view of Household.

* * *

Bill Aldinger is confident that the company will deliver on its commitment of 20% or better EPS growth in 1998. We are maintaining our 1998 EPS estimate of \$7.95, up 22% from our 1997 EPS estimate of \$6.50. We expect 1998 to represent the seventh consecutive year of 20%-plus EPS growth.... Investors are likely to focus on internally generated loan growth during the next few quarters. *Loan growth is the key that drives revenue and earnings growth over the long term and represents a catalyst to drive the stock higher.*

196. The statements made by defendants in ¶¶192-195 above were each materially false and misleading when made. As set forth in ¶¶1-155, the true facts, which were then known to or recklessly disregarded by defendants, based on their review of Household's internal operating data, were:

(a) Defendants were engaged in a widespread and consistent pattern of improper and illegal predatory lending practices, which included, among other things:

(i) Misrepresenting the interest rates and savings associated with loans by providing deceptive and nonconforming loan documents to borrowers that were designed to obscure actual loan amounts and interest rates (¶¶55-60);

(ii) Failing to disclose "discount points" that were nothing more than stacked fees and had no bearing on the ultimate interest rate charged on loans (¶¶61-67);

(iii) Concealing the existence of prepayment penalties (¶¶68-70);

(iv) Using such practices as fraud and forgery to sell ancillary products, such as life, disability and other types of credit insurance (¶¶71-74); and

(v) Illegally "up-selling" second loans with exorbitant interest rates (¶¶75-82).

(b) As set forth in ¶¶51-106, defendants were engaged in a sophisticated and fraudulent predatory lending scheme.

(c) As set forth in ¶¶107-133, defendants improperly engaged in the practice of "reaging" or "restructuring" delinquent loans to make them current if the customer made one minimum monthly payment, such that the missed payments were added to the back end of the loan. Although defendants characterized "reaging" as a customer service, in fact, the Company used it to:

(i) Manipulate its reported delinquency ratios and delay or prevent charge-offs (¶¶107-133);

(ii) Cross-sell or up-sell additional loans or lines of credit (¶¶107-116);
and

(iii) Convert customers' unsecured loans into loans secured by their homes or cars without disclosing this information to them (¶116). In addition, as detailed in ¶¶111-114 and 121, defendants designed the Vision system to automatically reage delinquent accounts when the computer received only a partial payment without any evidence that the delinquency had been cured.

(d) The Officer Defendants designed the predatory lending practices and reaging of delinquent accounts, allowing the Company to:

(i) Understate its true levels of delinquencies, such that any financial metrics that were dependent upon delinquencies or defaults and important to investors as a measure of Household's health, including credit loss reserves, were also materially false and misleading (¶¶125-133);

(ii) Under-report non-performing assets and misreport credit quality (¶¶125-133);

(iii) Consistently report lower loan loss reserves by improperly lowering defaults and prepayments (¶¶102-106 and 125-133);

(iv) Recognize interest income that should not have been accrued in accordance with the Company's own lending practices and policies (¶¶102-106, 125-133 and 154-155); and

(v) Artificially inflate reported revenues and EPS throughout the Class Period (¶¶102-106 and 125-155).

(e) As set forth in ¶¶134-155, throughout the Class Period, defendants engaged in improper accounting for Household's credit card co-branding, affinity and third-party marketing agreements, causing Household to overstate its finance income, securitization income and fee income and misstate certain of its expenses, resulting in an overstatement of net income.

(f) In addition to the false and materially misleading financial data, the Company's SEC filings also concealed the true risks of investing in Household, including the risk of investing in a company that was not reporting its financial results in conformity with GAAP, which disclosures were wholly ineffective and inappropriate and did not alert investors to the true risks of investing in Household securities.

(g) Household and the Officer Defendants had no basis to, and did not in fact, believe Aldinger's forecasts of 20+% growth in EPS in FY98 and FY99 because they were impossible to achieve in light of ¶¶(a)-(f) above.

B. DEFENDANTS' FALSE AND MISLEADING STATEMENTS DURING 1998

197. On 1/21/98, Household announced its FY97 results in a press release entitled "Household EPS Grows More than 20% for 6th Consecutive Quarter" that stated, in part:

Household International today reported all-time record net income and earnings per share for the fourth quarter and year ended December 31, 1997. Full-year earnings per share of \$6.50 rose 22 percent and net income increased 27 percent to \$686.6 million.

Quarterly earnings per share totaled \$1.98, a 22 percent increase from \$1.62 for the fourth quarter of 1996, on a greater number of average shares outstanding. Net income rose 33 percent to an all-time quarterly record of \$217.6 million, compared with \$163.6 million a year earlier.

William F. Aldinger, Household's chairman and chief executive officer, said, "Household achieved another year of earnings per share growth in excess of 20 percent – the sixth consecutive year that we've done so. We grew revenues 18 percent and kept expenses essentially flat. We absorbed increased chargeoffs consistent with industry-wide trends and further strengthened our credit loss reserves. We also improved our return on managed assets. Our return on equity exceeded 18 percent, even though we significantly increased our capital levels. Overall, it was a terrific year."

Mr. Aldinger added, "1997 was not only a record year, it was a year of investing in the long-term growth of our company. We acquired the consumer finance business of Transamerica Corporation and ACC Consumer Finance, an industry leader in non-prime auto finance. We expect both acquisitions to contribute to another record year in 1998."

198. The Officer Defendants' false statements also had the effect of misleading analysts who relied on these representations in issuing very positive reports and advising investors to purchase shares of Household, as follows:

Jennifer Scutti (Prudential Securities) Report of 2/18/98

Based on improving efficiency ratio levels, manageable credit quality, expanding margins, and stable portfolio growth, we believe that Household International is positioned to consistently generate earnings growth in the 18%-20% range over the next two years.

* * *

[C]ross-selling of other Household products has helped to keep the "churn" rate on loans low. The company, however, intends to include prepayment penalties increasingly on current and future loan originations. In addition to helping keep prepayments low, cross-selling has also supported portfolio growth for the company as 40% of Household Finance Corp.'s home equity borrowers are private-label cardholders, while 30% are bankcard customers.

The company has maintained a conservative posture as it has grown the business slowly and deliberately while managing costs carefully....

* * *

Broad funding strategy offers flexibility and supports growth. The company has maintained a broad funding strategy, utilizing securitizations, commercial paper, and medium- and long-term debt. Currently, 40% of funding is due to securitization activity, which we believe could fall to 35% over the next few quarters.

199. On 3/13/98, the Company, through its subsidiary, HFC, caused to be declared effective a registration statement on Form S-3, registering for sale \$3 billion of debt securities.

200. On 3/30/98, Household filed with the SEC its FY97 Report on Form 10-K, signed by defendants Aldinger and Schoenholz, as well as the Director Defendants. In addition to reiterating the same false representations as were made in the 1/21/98 corporate release, the FY97 Report on Form 10-K also stated that the Company's financial statements met the requirements of Regulation S-X and incorporated by reference information specified by Item 302 of Regulation S-K.

201. With respect to its loan delinquencies and charge-off policies, defendants represented that:

Our focus is to continue using risk-based pricing and effective collection efforts for each loan. We have a process that gives us a reasonable basis for predicting the asset quality of new accounts. This process is based on our experience with numerous marketing, credit and risk management tests. We also believe that our

frequent and early contact with delinquent customers is helpful in managing net credit losses.

202. Additionally, Andersen issued a "clean" audit opinion on 1/21/98, which was incorporated by reference into the Report on Form 10-K. Andersen stated that it had audited Household's financial statements and Schedule 14(d) for FY97 in accordance with GAAS and opined that they "fairly state[] in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole."

203. On 4/3/98, defendants Aldinger and Gilmer hosted the Company's annual Financial Relations Conference for analysts and investors. Immediately after this conference, several analysts issued very positive reports and encouraged investors to purchase shares of Household as follows:

Joel Gombert (William Blair & Co.) Report of 4/6/98

Management conveyed a positive tone

Management reiterated its profitability and growth targets. Bill Aldinger, chairman and CEO, is confident that the company will deliver on its commitment of 20% or better EPS growth in 1998 (its seventh consecutive year of 20%-plus earnings growth). Management also reaffirmed several long-term financial targets....

Household appears on track to meet or exceed first-quarter estimates. Our first-quarter EPS estimate is \$1.50, compared with \$1.30 a year ago.

We reaffirm our Long-term Buy recommendation. Management has a very disciplined strategy to focus on a few high-margin businesses, be the low-cost provider, and out execute the competition....

D. Hochstim (Bear Stearns) Report of 4/06/98

Gary Gilmer who is now the senior executive in charge of HFC presented a review of the business. HFC continues to seek to generate loan growth by 1) increasing its new originations and 2) reducing payoffs. In addition to growth, there is also a focus on maintaining credit quality. To increase growth, the company plans to target its marketing efforts and refine its compensation system to encourage the origination of more real estate secured loans. There has also been an increased emphasis on selling real estate secured loans to existing unsecured customers (private label and personal unsecured) in an effort to increase the proportion of real estate secured lending.... The company plans to increase its originations of PHLs (personal home loans) which are underwritten as unsecured loans but have some real estate as collateral.

* * *

A range of initiatives – increased customer contact, increased manual underwriting, and further refinements of loss prediction and account management tools

204. On 4/23/98, Household announced its 1Q98 financial results in a press release entitled, "Household International Reports First Quarter Net Income Up 30%, to a Record \$170 Million," which stated, in part, that:

Household International today reported first quarter net income rose 30 percent to a record \$170.3 million, compared with \$131.5 million for the first quarter of 1997. Earnings per share increased 18.5 percent to a record \$1.54 from \$1.30 a year ago.

William F. Aldinger, Household's chairman and chief financial officer, said, "Our first quarter results reflect improving fundamentals in our two largest businesses. The strong growth in earnings was driven by an expanded net interest margin, higher receivables and improved efficiency...."

205. The Officer Defendants' false statements regarding the Company's better-than-expected, "record" financial results also had the effect of misleading analysts, who relied on these representations in issuing very positive reports and advising investors to purchase shares of Household, as follows:

Joel Gomberg (William Blair & Co.) Report of 4/23/98

Household reported first-quarter earnings per diluted share of \$1.54 ... \$0.04 better than our \$1.50 estimate, and \$0.02 above the Street consensus of \$1.52.

* * *

The company is optimistic about credit card growth in 1998, with plans to increase its marketing budget significantly.

* * *

Management conveyed a positive tone with respect to credit quality.

206. On 5/12/98, Household filed with the SEC its 1Q98 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations as were made in the 4/23/98 corporate release, the 1Q98 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

207. On 6/30/98, Household acquired Beneficial in a stock-swap deal valued at over \$8 billion. Household issued over 168 million shares of common stock.

208. On or about 7/20/98, the Company, through its subsidiary, HFC, caused to be declared effective, a registration statement on Form S-3, registering for sale \$5 billion of debt securities.

209. On 7/22/98, Household announced 2Q98 results in a press release entitled, "Household International Reports Second Quarter Income of \$249.4 Million and Earnings Per Share of \$.49, Before Merger Charge," which stated:¹⁴

Household International today reported second quarter income of \$249.4 million and earnings per share of \$.49, for the combined operations of Household and Beneficial Corporation before costs related to the merger, completed on June 30, 1998, and related integration.... Including the \$1 billion pretax merger charge. Household incurred a loss for the quarter of \$501.6 million, or \$1.03 per share. Net income for the second quarter of 1997 was \$238.6 million, and earnings per share were \$.50.

Before giving effect to the merger, Household's earnings per share would have been a second quarter of \$.61, a 24 percent increase over the year-ago quarter. Beneficial's earnings per share would have been \$.81 for the second quarter of 1998, compared to \$1.61 a year ago, which included \$.59 of securitization and other nonrecurring gains.

William F. Aldinger, Household's chairman and chief executive officer, said ... "I am really excited about the company's prospects. The Beneficial acquisition strengthens many of our key businesses, provides significant opportunities to improve efficiency and gives us a platform for additional revenue growth."

210. Based on these purported positive results, shares of Household traded to over \$51.62 per share, before closing at \$51.25 per share that day. In addition, many analysts covering the stock issued or reiterated "Buy" recommendations on shares of Household.

211. On or about 8/03/98, the Company, through its subsidiary, HFC, caused to be declared effective, a registration statement on Form S-3, registering for sale \$3 billion of debt securities.

212. On 8/14/98, Household filed with the SEC, its 2Q98 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations as were made in the 7/22/98 corporate release, the 2Q98 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of

¹⁴ Since the Beneficial merger was accounted for as a pooling of interests, all prior and current period information reflect the combined companies' results. In addition, EPS data have been restated to reflect Household's three-for-one common stock split effective 6/01/98.

management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

213. On 9/2/98, BT Alex. Brown Incorporated ("BT Alex. Brown") hosted a conference call with defendant Schoenholz and industry analysts, after which they also issued very positive reports and encouraged investors to purchase shares of the Company, stating:

Mark Alpert (BT Alex. Brown) Report of 9/2/98

Maintain "strong buy" investment rating, with target price of \$65, or 20x our 1999 EPS estimate [at \$3.25].

* * *

As a result of expected synergies from the merger, the Company recently endorsed 20% EPS growth for 1999 and 2000 and set a 17% growth target in 2001....

We are maintaining our EPS estimates of \$2.27 in 1998 and \$3.25 in 1999 (fully pooled). Our target price remains \$65 (on a 12-month horizon) or 20x our 1999 EPS estimate....

* * *

Loan Growth ... is running about 10-12%, and while retention is an issue (prepayments), it's less of a problem than earlier (helped by the problems of the monoline competitors)....

214. On 10/22/98, Household announced 3Q98 results in a press release entitled, "Household International Reports Record Third Quarter Results," which stated, in part, that:

Household International today *reported net income rose 20 percent to a third-quarter record of \$318.0 million*, compared with \$264.7 million for the third quarter of 1997. *Earnings per share increased 19 percent to a third-quarter record of \$.63* from \$.53 a year ago.

William F. Aldinger, Household's chairman and chief executive officer, said, "Our tight focus on our core markets, our conservative capital base and our *disciplined approach to funding and liquidity management enabled Household to achieve record earnings for the quarter.*

Commenting on Household's results for the quarter, Mr. Aldinger added, "The company's operating results were solid with 6 percent annualized receivable growth, margin expansion and improving efficiency. Credit quality was within expectations and reserve coverage remains conservative."

215. On or about 11/13/98, Household filed with the SEC, its 3Q98 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations as were made in the 10/22/98 corporate release, the 3Q98 Report on Form 10-Q also stated, in part, that the

unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

216. On 12/15/98, after meeting with management of the Company, BT Alex. Brown analyst Mark Alpert issued a "Strong Buy" recommendation on shares of Household and stated that recent weakness in the Company's shares appeared "unwarranted." Notwithstanding that stocks in the banking and subprime lending industry were trading lower, the BT Alex. Brown report entitled "Visit With Management In Chicago Convinces Us That The Story Is Sound" stated, in part, that:

Stock price weakness appears unwarranted, in our view. All businesses with the exception of U.S. Visa and MasterCard are performing well and generally producing ROEs of at least 20%.

* * *

Balance sheet is very strong (capital and reserves), in our opinion.

* * *

We believe stock is very undervalued. We reiterate our \$53 target price (12 month horizon) and "strong buy" investment rating on the shares.

* * *

Household is reducing its usage of securitizations to alleviate accounting concerns (gain on sale). Securitizations are about 30% of receivables, down from a past target of 35%-40%. The Company hasn't securitized a home equity loan in 2 years.

217. The statements made by defendants in ¶¶197-216 above were each materially false and misleading when made. As set forth in ¶¶1-155, the true facts, which were then known to or recklessly disregarded by defendants, based on their review of Household's internal operating data, including information provided to them by Household's Vision system, were:

(a) Defendants were engaged in a widespread and consistent pattern of improper and illegal predatory lending practices, which included, among other things:

(i) Misrepresenting the interest rates and savings associated with loans by providing deceptive and nonconforming loan documents to borrowers that were designed to obscure actual loan amounts and interest rates (¶¶55-60);

- (ii) Failing to disclose "discount points" that were nothing more than stacked fees and had no bearing on the ultimate interest rate charged on loans (§§61-67);
- (iii) Concealing the existence of prepayment penalties (§§68-70);
- (iv) Using such practices as fraud and forgery to sell ancillary products, such as life, disability and other types of credit insurance (§§71-74); and
- (v) Illegally "up-selling" second loans with exorbitant interest rates (§§75-82).

(b) As set forth in §§51-106, defendants were engaged in a sophisticated and fraudulent predatory lending scheme.

(c) As set forth in §§107-133, defendants improperly engaged in the practice of "reaging" or "restructuring" delinquent loans to make them current if the customer made one minimum monthly payment, such that the missed payments were added to the back end of the loan. Although defendants characterized "reaging" as a customer service, in fact, the Company used it to:

- (i) Manipulate its reported delinquency ratios and delay or prevent charge-offs (§§107-133);
 - (ii) Cross-sell or up-sell additional loans or lines of credit (§§107-116);
- and
- (iii) Convert customers' unsecured loans into loans secured by their homes or cars without disclosing this information to them (§116). In addition, as detailed in §§111-114 and 121, defendants designed the Vision system to automatically reage delinquent accounts when the computer received only a partial payment without any evidence that the delinquency had been cured.

(d) The Officer Defendants designed the predatory lending practices and reaging of delinquent accounts, allowing the Company to:

- (i) Understate its true levels of delinquencies, such that any financial metrics that were dependent upon delinquencies or defaults and important to investors as a measure of Household's health, including credit loss reserves, were also materially false and misleading (§§125-133);

- (ii) Under-report non-performing assets and misreport credit quality (¶¶125-133);
- (iii) Consistently report lower loan loss reserves by improperly lowering defaults and prepayments (¶¶102-106 and 125-133);
- (iv) Recognize interest income that should not have been accrued in accordance with the Company's own lending practices and policies (¶¶102-106, 125-133 and 154-155); and
- (v) Artificially inflate reported revenues and EPS throughout the Class Period (¶¶102-106 and 125-155).

(e) As set forth in ¶¶134-155, throughout the Class Period, defendants engaged in improper accounting for Household's credit card co-branding, affinity and third-party marketing agreements, causing Household to overstate its finance income, securitization income and fee income and misstate certain of its expenses, resulting in an overstatement of net income. Due to defendants' improper accounting, the Company was forced to restate earnings for an eight-year period from 1994 through 2Q02. As set forth in ¶¶134-155, defendants have admitted that Household's results for FY97 were materially false and misleading and have restated these results as follows:

DILUTED EPS

	<u>As Reported</u>	<u>Restated</u>	<u>Difference</u>
FY97	\$1.93	\$1.86	<\$0.07>

(f) In addition to the false and materially misleading financial data, the Company's SEC filings also contained inadequate risk disclosures that did not disclose the true risks of investing in Household – specifically, the risk of investing in a company that was not reporting its financial results in conformity with GAAP. In addition, and as a result thereof, the purported risk disclosures were wholly ineffective and inappropriate and did not alert investors to the true risks of investing in Household securities.

C. DEFENDANTS' FALSE AND MISLEADING STATEMENTS DURING 1999

218. On 1/20/99, Household issued a press release entitled, "Household International Reports Q4 and Full Year Results," which stated, in part, that:

Household International today announced that it achieved record net income and earnings per share for the fourth quarter ended December 31, 1998. Net income of \$349.9 million was up 71 percent from \$204.8 million recorded in Q497, and reported EPS of \$.71 was up 73 percent from \$.41 reported in Q497....

* * *

Receivables of the company's core consumer finance businesses, other than bankcard, grew 12 percent from a year ago and three percent sequentially.

* * *

The company's managed net interest margin widened to 8.03 percent, up from 7.92 percent in the prior quarter and 7.80 percent a year ago. The sequential quarter and year-over-year improvement resulted from higher yields on unsecured products and lower funding costs, partially offset by the effect of a shift in mix toward secured products.

219. Based on these purported positive results, shares of Household rallied, climbing almost \$3.00 per share, to close trading at \$44.50 per share, on heavy trading volume of 3.4 million shares.

220. On 1/26/99, Household senior management held a meeting with analyst Warburg Dillon Read, who met with each of the Company's business line managers. Based on representations at this meeting, analyst Thomas Hanley issued a positive report that stated, in part:

Thomas Hanley (Warburg Dillon Read) Report of 1/27/99

[T]he outlook for growth looks strong. The consumer finance operation is doing better than anticipated

* * *

At the meeting, senior management outlined their financial objectives for 1999, including earnings per share of \$3.00-\$3.10, a return on managed assets of 1.70%-1.90%, a return on common equity of 20%-22%, an efficiency ratio of 35%, and core receivable growth of 8%-10%. We believe these goals are quite achievable.

221. On 2/16/99, the Company, through its subsidiary, HFC, caused to be declared effective, a registration statement on Form S-3, registering for sale \$6.05 billion of debt securities.

222. The materially false and misleading statements issued by defendants had their intended effect, and, on 3/09/99, Duff & Phelps Credit Rating Co. reaffirmed all credit ratings for Household and its subsidiaries, publishing a press release that stated, in part:

The reaffirmation is based upon the expectation that Household's capital measures will be maintained in the targeted range, particularly tangible equity-to-tangible managed assets (TEMA) of 7 to 7.25 percent and managed debt-to-tangible equity (leverage) of 12.5 to 14 times. Household's TEMA and leverage ratios are currently at the lower end and higher end, respectively, of its peers. Positively, recent shifts in the receivables portfolio to less risky assets such as real estate-secured loans and a reduction in higher-risk credit card receivables, are supportive of the current capital targets....

The renewed focus on higher-risk customers should bring higher yields, but greater risk, to the managed portfolio. Partially offsetting this higher risk is the aforementioned shift in asset mix towards lower-risk real estate-secured product. *Given the continuing competitive environment and the focus on higher-risk customers, it is important that Household accurately identify and price for risk in the origination process.*

223. The following day, 3/10/99, *The Wall Street Journal* reported that Household had announced its institution of a repurchase of \$2 billion worth of shares, whereby defendants would cause the Company to repurchase up to 10% of Household's outstanding shares. According to *The Wall Street Journal*, defendant Aldinger stated that the reason for the share repurchase was that shares of the Company were "undervalued."

224. Following the publication of these releases on 3/9/99 and 3/10/99, shares of Household rallied over \$4.00 per share, to close trading above \$45.81 per share, on heavy trading volume of 3.5 million shares traded on 3/10/99.

225. On 3/30/99, Household filed with the SEC its FY99 Report on Form 10-K, signed by Aldinger, Schoenholz and the Director Defendants. In addition to reiterating the same false representations as were made in the 1/20/99 corporate release, the FY99 Report on Form 10-K also stated that the Company's financial statements met the requirements of Regulation S-X and incorporated by reference information specified by Item 302 of Regulation S-K.

226. With respect to its loan delinquencies and charge-off policies, defendants represented that:

Our focus is to continue using risk-based pricing and effective collection efforts for each loan. We have a process that gives us a reasonable basis for predicting the asset quality of new accounts. This process is based on our experience with

numerous marketing, credit and risk management tests. We also believe that our frequent and early contact with delinquent customers is helpful in managing net credit losses.

227. Andersen issued a "clean" audit opinion on 1/20/99, incorporated by reference in the Report on Form 10-K. Andersen stated that it had audited Household's financial statements and Schedule 14(d) for FY98 in accordance with GAAS and opined that they "fairly state[] in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole."

228. In late 3/99 and early 4/99, Aldinger and other senior management participated in a series of conferences and one-on-one analyst meetings, during which defendants again reassured analysts about the strength of Household's business. After these meetings, analysts issued reports stating:

Mark Alpert (BT Alex. Brown) Report of 3/30/99

Focus is on top line revenue growth (est. 10%-12% in 1999) and consistent long-term earnings growth of at least 15%, in our opinion.

* * *

Our target price is \$55 or approximately 15x our 2000 estimate (on a 12-18 month horizon). We reiterate our "strong buy" rating.

* * *

Management remains comfortable with consensus EPS estimates for 1Q99 (\$0.62), full year 1999 (in a range of \$3.00-\$3.10), and full year 2000 (growth of about 16%).

* * *

There is a new emphasis on cross-selling. For example, Household has begun to offer "preapproved" credit cards to new home equity borrowers, and has experienced a 70% acceptance rate in tests, at an acquisition cost of only \$25 per account (about 1/4 the industry average). In addition, it booked \$40 million in home equity loans in February by cross-marketing to existing credit card holders. The goal is to increase the estimated 12% "wallet share" the Company holds on average of its 40 million customers (home equity, auto, credit cards, and unsecured loans). Every 1% point increase would translate into about \$5 billion of receivables growth.

229. On 4/22/99, Household announced 1Q99 results in a press release entitled, "Household International Reports Record First Quarter Results," which stated:

Household International today reported record first quarter operating income and operating earnings per share. Net operating income rose 34 percent to \$320.8

million, compared with net operating income of \$239.3 million a year ago. Earnings per share increased 38 percent to \$.65 from operating EPS of \$.47 a year ago....

* * *

William F. Aldinger, Household's chairman and chief executive officer, said, "Strong loan growth in our consumer finance business, improved efficiency and higher income from our tax refund loan business led to the strongest first quarter in our 120 year history.... We have great momentum in this business."

* * *

Aldinger continued, "1999 is off to a very good start and we are on track to meet our earnings and growth targets."

230. Following the publication of the release of purported record-breaking 1Q99 results, Household traded above \$51.00 per share. In addition, also helping to sustain the artificial inflation in Household shares was a report by ABN AMRO, also published on 4/22/99, which proclaimed Household the brokerage house's "top pick" and gave the Company's shares a near-term price target of \$65.00 per share. Prudential Securities also issued a "strong buy" rating on shares of Household with a \$62.00 near-term price target, raised from the prior target of \$56.00 per share.

231. On 5/13/99, Household filed with the SEC its 1Q99 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations as were made in the 4/22/99 corporate release, the 1Q99 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

232. On 7/1/99, the Company, through its subsidiary, HFC, caused to be declared effective a registration statement on Form S-3, registering for sale \$7.5 billion of debt securities.

233. On 7/22/99, Household announced 2Q99 results in a press release entitled, "Household International Reports Record Second Quarter Results," which stated, in part, that:

Household International today reported that second quarter net income rose 31 percent to a record \$326.9 million, compared with operating net income of \$249.4 million a year ago. Earnings per share increased 37 percent to a record \$.67, compared with operating EPS of \$.49 a year ago. Cash basis EPS for the quarter rose 28 percent.

William F. Aldinger, Household's chairman and chief executive officer, said, "Our results, a second quarter record, highlight the growth and improved profitability of our consumer finance businesses...."

Aldinger continued, "Business fundamentals are strong and reflect the positive trends we have seen since late last year. Our net interest margin percentage expanded substantially, credit quality improved and costs remained well under control. Receivable growth was strong in the consumer finance business. We have excellent momentum."

Aldinger added, "Growth in the HFC and Beneficial consumer finance branch business continues to improve and also gives us an excellent platform from which to cross-sell many of our other products. Our 1,400 branches and 7,000 branch employees give us a real advantage as we focus on satisfying more of our customers' credit needs."

234. Following the publication of the release of purported record-breaking 1Q99 results, shares of Household traded above \$51.00 per share. In addition, also helping to sustain the artificial inflation in Household shares was a report by Prudential Securities, on 7/23/99, which reiterated its "strong buy" rating on shares of the Company and its \$62.00 near-term share price target; and a report by Warburg Dillon Read reiterating a "Buy," stating, in part:

Thomas H. Hanley (Warburg Dillon Read) Report of 7/22/99

HI appears to be firing on all cylinders. The ROE improved to 20.9% and the ROMA increased to 1.78%. We find no fundamental reason the stock should trade at a discount to its peers and we reiterate our Buy.

* * *

* Credit quality improved for the second consecutive quarter.

* * *

Overall, given the strong showing in the branches, we are very comfortable with management's target of 10% core receivable growth in 1999.... Consequently, we remain comfortable with our EPS estimates of \$3.05 in 1999 and \$3.60 in 2000.

235. On 8/16/99, Household filed with the SEC its 2Q99 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations as were made in the 7/22/99 corporate release, the 2Q99 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

236. In late 9/99 and early 10/99, Household participated in a series of conferences and one-on-one analyst meetings at Company headquarters, during which defendants again reassured them about the strength of the Company's business. After these meetings analysts reported, in part, as follows:

Mark Alpert (Deutsche Banc Alex. Brown) Report of 9/30/99

[T]he fundamental businesses appear positioned the best they've been in several years while the company's relative P/E ratio is at its lowest level since fall 1994.

* * *

Household's stock price has been adversely affected (as have most financial stocks) by the negative sentiment stemming from rising interest rates. Nonetheless, business remains as strong, if not stronger, than it has been in some time. Branch loan growth appears to be running in the 12%-15% range, aided by the Beneficial integration, the demise of securitizers, and the success of a new technology platform, VISION.

* * *

We are maintaining our 1999 and 2000 EPS estimates of \$3.07 and \$3.55, respectively.... Our target price is 15x our 2000 EPS estimate, or \$53 (on a 12-month horizon).

* * *

Household's credit quality picture is actually improving. Home equity loans, which are secured by property, represent about 70% of the branch loan portfolio, the highest percentage in recent history.

* * *

Household has spent about \$90 million in the last two years on systems designed to increase productivity and cross-selling in its branches. Household measures branch productivity as "loans closed per account executive per month." This ratio has increased 69% under the new platform known as VISION.

D. Hochstim (Bear Stearns) Report of 10/08/99

In a series of meetings with investors this week, Household's Bill Aldinger, Gary Gilmer, and Bobby Mehta provided updates on the company's businesses.

Management appears optimistic about internally generated loan growth at HFC and improved profitability as well as account and loan growth in the bankcard business. Loans are expected to grow by about 2.5% in 3Q.

* * *

We continue to recommend purchase with a price target of \$55 to \$60.

* * *

Branch business growth has accelerated.... Beneficial branches account for about 1000 of the company's 1400 branches and are now operated with Household's compensation program. Compensation is up (roughly 2/3 is performance based) and attrition is at the lowest level in years. The company's new VISION system enables prescreened leads to be provided as desired to the branches based on a range of criteria.

Loan production per branch has increased by about 25% from a year ago and payoffs/liquidations have fallen by about 20%. Internally generated loans in the branch system are growing at a 15% annualized rate The company also believes that Fannie Mae's and Freddie Mac's efforts to expand into non-prime lending will have little impact on Household's home equity lending as a result of the loans' lower average balances and borrowers' payment problems. Household's focus is on helping borrowers consolidate their debt. Nearly all borrowers are approached with offers, almost none approach the company seeking credit. Customers of both the Household and Beneficial branch systems are primarily payment sensitive.

* * *

[T]he company has begun to focus on using its proprietary information to refine its marketing efforts and to attract customers and build business. For example, home equity customers in the branches have been underwritten for credit cards. Branch personnel are paid a fee for each card issued which reduces account acquisition costs to \$25 to \$40. Underwriting is performed by the company's centralized systems.

237. On 10/19/99, Household announced 3Q99 results in a press release entitled, "Household International Reports Highest Quarterly Earnings in Company's History," which stated, in part:

Household International today reported that third quarter net income rose 26 percent to a record \$399.9 million, compared with \$318.0 million a year ago. Earnings per share increased 32 percent to a record \$.83, from \$.63 a year ago.

William F. Aldinger, Household's chairman and chief executive officer said, "Our quarter reflects excellent performance in all of our businesses, with the key drivers being accelerating internal receivable and revenue growth. Retail consumer finance growth was particularly strong. Looking ahead to the fourth quarter and into next year, we see great momentum across all businesses, but most notably in our HFC/Beneficial finance business. I am confident we will achieve our earnings goal for this year and we are well positioned for next year."

238. Defendants' false statements had their intended effect, and following the announcement of 3Q99 results, analysts from Bear Stearns ("The company delivered what it promised: margin improvement, an increase in profitability, stable credit performance, and faster internally generated receivable growth."), J.P. Morgan and ABN AMRO ("this is a 'blow out' for HI," reiterating Buy and top pick rating) on 10/19/99 again issued very positive reports and advised investors to purchase shares of Household.

239. On 11/12/99, Household filed with the SEC its 3Q99 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations as were made in the 10/19/99 corporate release, the 3Q99 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

240. Immediately following defendants' publication of these purported positive results, shares of Household rallied almost \$4.00 per share, to close trading at \$44.13 per share, on heavy trading volume of 1.2 million shares.

241. Taking advantage of the artificial inflation in the price of Household's stock, on 12/2/99, defendants announced in a press release that they had arranged to acquire Renaissance Holdings, Inc. ("Renaissance"), a privately held credit card issuer formerly based in Beaverton, Oregon, for \$300 million in stock and cash. Following disappointing receivables growth in the 3Q99, down 21% year-over-year, analysts were quick to note that, while Household was paying six times book value, the Renaissance acquisition was important to the Company because it supplied much-needed growth.

242. The statements made by defendants in ¶¶218-241 above were each materially false and misleading when made. As set forth in ¶¶1-155, the true facts, which were then known to or recklessly disregarded by defendants, based on their review of Household's internal operating data, including information provided to them by the Vision system, were:

(a) Defendants were engaged in a widespread and consistent pattern of improper and illegal predatory lending practices, which included, among other things:

(i) Misrepresenting the interest rates and savings associated with loans by providing deceptive and nonconforming loan documents to borrowers that were designed to obscure actual loan amounts and interest rates (¶¶55-60);

(ii) Failing to disclose "discount points" that were nothing more than stacked fees and had no bearing on the ultimate interest rate charged on loans (¶¶61-67);

(iii) Concealing the existence of prepayment penalties (¶¶68-70);

(iv) Using such practices as fraud and forgery to sell ancillary products, such as life, disability and other types of credit insurance (§§71-74); and

(v) Illegally "up-selling" second loans with exorbitant interest rates (§§75-82).

(b) 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.

(c) As set forth in §§107-133, defendants improperly engaged in the practice of "reaging" or "restructuring" delinquent loans to make them current if the customer made one minimum monthly payment, such that the missed payments were added to the back end of the loan. Although defendants characterized "reaging" as a customer service, in fact, the Company used it to:

(i) Manipulate its reported delinquency ratios and delay or prevent charge-offs (§§107-133);

(ii) Cross-sell or up-sell additional loans or lines of credit (§§107-116);
and

(iii) Convert customers' unsecured loans into loans secured by their homes or cars without disclosing this information to them (§116). In addition, as detailed in §§111-114 and 121, defendants designed the Vision system to automatically reage delinquent accounts when the computer received only a partial payment without any evidence that the delinquency had been cured.

(d) The Officer Defendants designed the predatory lending practices and reaging of delinquent accounts, allowing the Company to:

(i) Understate its true levels of delinquencies, such that any financial metrics that were dependent upon delinquencies or defaults and important to investors as a measure of Household's health, including credit loss reserves, were also materially false and misleading (§§125-133);

(ii) Under-report non-performing assets and misreport credit quality (§§125-133);

(iii) Consistently report lower loan loss reserves by improperly lowering defaults and prepayments (§§102-106 and 125-133);

(iv) Recognize interest income that should not have been accrued in accordance with the Company's own lending practices and policies (§§102-105, 125-133 and 154-155); and

(v) Artificially inflate reported revenues and EPS throughout the Class Period (§§102-106 and 125-155).

(e) As set forth in §§134-155, throughout the Class Period, defendants engaged in improper accounting for Household's credit card co-branding, affinity and third-party marketing agreements, causing Household to overstate its finance income, securitization income and fee income and misstate certain of its expenses, resulting in an overstatement of net income. Due to defendants' improper accounting, the Company was forced to restate earnings for an eight-year period from 1994 through 2Q02. As set forth in §§134-153, defendants have admitted that Household's results for FY98 were materially false and misleading and have restated these results as follows:

	DILUTED EPS		
	<u>As Reported</u>	<u>Restated</u>	<u>Difference</u>
FY98	\$1.03	\$0.94	<\$0.09>

(f) In addition to the false and materially misleading financial data, the Company's SEC filings also contained inadequate risk disclosures that did not disclose the true risks of investing in Household – specifically, the risk of investing in a company that was not reporting its financial results in conformity with GAAP. In addition, and as a result thereof, the purported risk disclosures were wholly ineffective and inappropriate and did not alert investors to the true risks of investing in Household securities.

(g) Household and the Officer Defendants had no basis to, and did not in fact, believe Aldinger's forecasts of 20+% growth in EPS in FY99 and FY00 because they were impossible to achieve in light of §§(a)-(f) above.

D. DEFENDANTS' FALSE AND MISLEADING STATEMENTS DURING 2000

243. On 1/19/00, Household announced 4Q99 and FY99 results in a press release entitled,

"Household International Reports Best Quarter and Year in Its History," that stated, in part:

Household International today reported that fourth quarter earnings per share increased 30 percent to a record \$.92 from \$.71 a year ago. Fourth quarter net income rose 25 percent to a record \$438.8 million, compared with \$349.9 million a year ago.

For the full year, Household reported record earnings per share of \$3.07, which was 33 percent over 1998 operating earnings per share. Net income totaled \$1.5 billion, or 29 percent above the prior year's operating net income.

* * *

William F. Aldinger, Household's chairman and chief executive officer, said "We are very pleased to report another record quarter, the culmination of an absolutely outstanding year for Household. Growth and profitability in the quarter were excellent and exceeded our expectations. Revenues were particularly strong."

Commenting on the full year results, Aldinger continued, "Our record earnings reflect an outstanding year in our consumer finance business, a dramatic turnaround in our MasterCard/Visa business, and strong results in all of our other businesses. We are particularly pleased with excellent receivable growth in 1999, particularly in our branches, while fully realizing all of the acquisition synergies of the Beneficial merger. We move into the new year with a real sense of excitement, great momentum throughout the company and strong competitive positions in each of our businesses."

* * *

Credit quality improved from both the third quarter and a year ago.

* * *

Reserves to nonperforming loans were 100.1 percent at year end.

244. In addition to artificially inflating the price of Household's shares, defendants' false statements also resulted in analysts from Bear Stearns (reiterating "buy") and ABN AMRO (reiterating "top pick" rating -- "Credit Quality improved and charge off's have declined to levels not seen since 1997; the outlook is for further improvement") issuing very positive reports on 1/19/00 and 1/20/00 and advising investors to purchase shares of Household.

245. On 3/24/00, the Company, through its subsidiary, HFC, caused to be filed (or declared effective), a Registration Statement on Form S-3, registering for sale \$11.261 billion of debt securities.

246. On 3/28/00, Household filed with the SEC its FY99 Report on Form 10-K, signed by Aldinger, Schoenholz and the Director Defendants. The FY99 Report on Form 10-K also contained key financial indicators and representations regarding the operational condition of the Company, in part, as follows:

Our return on average common shareholders' equity ("ROE") rose to 23.5 percent in 1999 compared to 18.2 percent in 1998, excluding merger and integration related costs and the gain on sale of Beneficial Canada, and 17.3 percent in 1997. Our return on average owned assets ("ROA") improved to 2.64 percent in 1999 compared to 2.29 percent in 1998, excluding the nonrecurring items, and 2.03 percent in 1997. Our return on average managed assets ("ROMA") improved to 1.99 percent in 1999 compared to 1.60 percent in 1998, excluding the nonrecurring items, and 1.38 percent in 1997. Including the merger and integration related costs and the gain on sale of Beneficial Canada, ROE was 8.1 percent, ROA was 1.04 percent and ROMA was .72 percent in 1998. *Our operating net income, ROA, ROMA and ROE have increased steadily over the past three years as a result of our focus on higher-return core businesses and improved efficiency.* We expect this trend to continue as we focus on growth of these higher return core businesses.

247. With respect to its loan delinquencies and charge-off policies, defendants represented that:

Our focus is to continue using risk-based pricing and effective collection efforts for each loan. We have a process that gives us a reasonable basis for predicting the asset quality of new accounts. This process is based on our experience with numerous marketing, credit and risk management tests. We also believe that our frequent and early contact with delinquent customers is helpful in managing net credit losses.

248. In addition to reiterating the same false representations as were made in the 1Q00 corporate release, the FY99 Report on Form 10-K also stated that the Company's financial statements met the requirements of Regulation S-X and incorporated by reference information specified by Item 302 of Regulation S-K. The FY99 Report on Form 10-K also contained the "Management's Report" (signed by Aldinger and Schoenholz), which represented to Household shareholders that the consolidated financial statements for FY99 had been prepared in accordance with GAAP, had been audited by Andersen and were an accurate representation of the Company's financials for FY99.

249. Additionally, defendant Andersen issued a clean audit opinion on 1/14/00, which was incorporated by reference into the Report on Form 10-K. Andersen stated that it had audited Household's financial statements and Schedule 14(d) for FY99 in accordance with GAAS and opined

that it "fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole."

250. In a further effort to ensure that the Company could continue to manipulate delinquencies and loan loss reserves, in a footnote to the FY99 Report on Form 10-K, Household revealed that it had shifted over \$6.7 billion in credit card receivables to its subsidiary, HFC, from its banking unit, after federal banking regulations slated to go into effect would have resulted in the Company stiffening credit charge-offs and delinquency reporting requirements for unsecured consumer debt held. New regulations had an adverse effect on bank credit card issuers that were competitors of Household. According to Household's FY99 Report on Form 10-K, however, "The application of the new rules will not have an impact on our financial statements."

251. On 4/05/00, defendants hosted their annual Financial Relations Conference with analysts and investors, during which they provided additional guidance about the Company. After this meeting, analysts again issued very positive reports and "Buy" and "Strong Buy" recommendations on Household, in part, as follows:

Mark Alpert (Deutsche Banc Alex. Brown) Report of 4/05/00

The bullish tone at Household's recent 2 day investor conference confirmed our confidence in our EPS outlook

Management reviewed trends across all business lines revealing continued strong operating momentum throughout the company in 1Q00.

Technology continues to drive improved efficiency at the company and remains one of management's primary focuses. We expect a continued high level of technology investments by the company in 2000 to further drive efficiency improvements over the next several years.

Chairman and CEO Bill Aldinger affirmed expected EPS and receivables growth of 15% and 12%, respectively in 2000.

* * *

We remain comfortable with our "street high" 1Q and full year 2000 EPS estimates of \$0.78 and \$3.55, respectively. We expect the company to report 1Q EPS on 4/19. Maintain our STRONG BUY rating.

* * *

Technology has been a core focus at HI since the mid 80's and is a main factor in the improved efficiency at Household over the last few years. The VISION system is a proprietary centralized platform that generates and prioritizes millions of new

leads and routs them to the corresponding branch. This not only has driven cross-sell opportunities, but also allowed the sales force to make more efficient targeted sales calls. Additionally the system also identifies customers most likely to switch to competitors. *This accompanied by the company's customer care focus (which it momentarily rewards employees based on)* allows branch managers to better manage customer retention levels.

R. Napoli (ABN AMRO) Report of 4/05/00

The company committed to 10% to 12% loan growth and 15% EPS growth in 2000.

Detailed segment presentations confirmed that this company is operationally "hitting on all cylinders"

Much of the time was spent on HI's rapidly developing Internet and other technology efforts (Vision loan management system), in our opinion, the technology strength of this business positively surprised attendees and should help the street view this company as having a foot in the "New Economy."

We reiterate our Top Pick rating on HI and \$65 target price.

* * *

The strongest growth in the branches will come from traditional home equity and the PHL product. Home equity loans represented 36% of the portfolio up from 30% two years ago. We believe this will continue to increase.

D. Hendrix (Friedman, Billings Ramsey & Co.) Report of 4/5/00

Yesterday's investor conference enhanced our confidence in Household's ability to meet or exceed the company's 15% EPS growth and 10-12% asset growth goals for 2000. The message was resoundingly clear yesterday – strategic focus, coupled with cost discipline and technological advancement will perpetuate asset and EPS growth. Household is not only the most efficient diversified lender, but also the only lender that offers a full complement of secured and unsecured products catering to the middle-market, specifically sub-prime customer.

252. On 4/19/00, Household announced 1Q00 results in a press release entitled,

"Household International Reports Record First Quarter Results," which stated, in part:

Household International today reported that earnings per share rose 20 percent to a first quarter record of \$.78, from \$.65 a year ago. Net income increased to \$372.9 million, up 16 percent from \$320.8 million in the first quarter of 1999. Cash earnings for the quarter totaled \$415 million.

William F. Aldinger, Household's chairman and chief executive officer, said, "This was the *strongest first quarter in our company's history, with all of our businesses performing well.* Revenue and receivable growth were strong, and credit quality continued to improve. To build upon the momentum that is evident in these results, we increased our investment in marketing programs and e-commerce initiatives."

* * *

"The year is off to a great start," Aldinger concluded. "We are seeing a continuation of the very positive business trends that emerged in the second half of 1999. We remain comfortable with our receivable, revenue and earnings per share growth targets for 2000."

* * *

Revenues grew 21 percent compared to the year-ago quarter, driven by significant receivables growth, an expanded net interest margin and higher fee income.

253. These consensus-beating results also spurred analysts to issue additional positive reports encouraging investors to purchase Household shares. On 4/20/00, William Blair & Co. reiterated its long-term "Buy" rating and raised its 2000 EPS estimate to \$3.53 per share from \$3.50, and Bear Stearns also reiterated its "Buy" rating on Household shares and reiterated its near-term price target of \$60.00 per share.

254. On 5/10/00, Household filed with the SEC its 1Q00 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations as were made in the 4/19/00 corporate release, the 1Q00 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

255. On 5/18/00, after meeting with Household management, including CEO Aldinger, in Philadelphia on 5/17/00, Deutsche Banc issued a report with a "Strong Buy" rating and highlighted the Company's ability to leverage the existing customer base and the fact that Household's credit quality remained stable and was contributing to growth and profitability, as follows:

LEVERAGING THE CUSTOMER BASE. A key to the Household growth story is its potential to leverage the existing base of 45 million customers. Currently, the cross-sell ratio is 1.2x, and management expects to bring that to at least 2x. It estimates that it holds a 12% share of its customer wallet today, and that every 1% increase would add \$5 billion to receivables growth. Examples of leveraging the customer would include 1) the branches are now selling 15,000 credit cards per month (home equity borrowers are pre screened and offered a card), 2) the private label business is generating 30% of the branch customers (as they are used for leads to debt consolidation business), and 3) the 6 million of annual turndowns in the private label card business are used to generate card business at the subprime business of recently acquired Renaissance Holdings. Many of the new business leads are generated by the company's technology-based VISION system, which holds data on 200 million consumers, as much as some credit bureaus. Each day, branch representatives have leads ranked by priority and product.

Deutsche Banc also called Household an "under appreciated 'growth'" story.

256. On 5/26/00, Bear Stearns also issued a report with a "Buy" rating on shares of Household after participating in a conference call with the Company's Chief Information Officer, Ken Harvey, who discussed the improvements in information technologies that gave defendants greater loan monitoring and loss prevention controls and abilities, in part, as follows:

The company has seen significant increases in productivity from the implementation of its Vision system in HFC and Beneficial branches. New accounts grew by 39% over the past year and there was a 69% increase in balances associated with new accounts.

257. On 6/22/00, Deutsche Banc Alex. Brown issued a follow-up report on Household focusing on the Company's denials of claims that it had engaged in predatory lending practices in the face of the Department of Justice's announcement that it would institute an action against Associates First, a competitor in the subprime lending market. The Deutsche Banc Alex. Brown report stated, in part:

We also believe that Household, while in many of the same markets as Associates, has a different business model that is less likely to lead to similar legal problems. We reiterate our STRONG BUY rating.

258. On 7/19/00, Household announced 2Q00 results in a press release entitled, "*Household International Reports Strongest Second Quarter in Its History,*" which stated, in part:

Household International today reported that earnings per share rose to a second quarter record \$.80, up 19 percent from \$.67 a year ago. Net income increased 17 percent to \$383.9 million, from \$326.9 million in the second quarter of 1999. Cash earnings per share for the quarter totaled \$.88.

"Our superb second quarter results were highlighted by *outstanding receivables and revenue growth and a significant improvement in credit quality,*" said William F. Aldinger, Household's chairman and chief executive officer.

The company's managed receivables portfolio grew 22 percent from a year ago, reaching almost \$80 billion. The company added \$4.5 billion of receivables in the quarter, an increase of 6 percent. Revenues rose 20 percent compared to the year-ago quarter.

Aldinger continued, "Our record performance reflects strong sales and marketing results in all of our businesses coupled with our continued focus on risk management and operational efficiency."

Aldinger concluded, "Our results to date include significant investments in people, technology and marketing to support future growth and profitability. While our plan calls for additional investment in the second half of the year, we are comfortable in our ability to achieve our 15 percent EPS growth target for 2000."

259. Defendants' false statements had their intended effect, and following the announcement of 2Q00 results, analysts at UBS Warburg ("company reaffirmed its 15% EPS growth target for 2000"; "[w]e believe HI shares represent a good value"; "reiterate our Buy rating"), Bear Stearns (maintained "Buy" rating), William Blair & Co. ("Our Long-term Buy ... recommendation is supported by management's disciplined strategy to focus on high-margin businesses, be the low-cost provider, and its commitment to strong reserve and capital levels.") and ABN AMRO ("The real story was the cleanliness and quality of the reported earnings We reiterate our Top Pick rating on this clean, easy to understand story.") again issued very positive reports and advised investors to purchase shares of Household.

260. On 8/11/00, Household filed with the SEC its 2Q00 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations made in the 6/19/00 corporate release, the 2Q00 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

261. On 9/07/00, after meeting with CEO Aldinger and heads of major Household operating divisions at the Company's Chicago offices, Deutsche Banc Alex. Brown reiterated its "Strong Buy" recommendation on the Company in its report, as follows:

Aldinger reiterated the sentiment that Household's businesses are stronger than ever. He expressed comfort with an EPS growth rate of 15% for FY 2000, and a 13-15% EPS growth target over the next 3-4 years.

* * *

Fundamentally, all of the metrics seem to be in place for a strong FY 2000 and 2001. Management has set a three- to four-year EPS growth target range of 13-15%. Internal receivables growth is running above the high-end of management's target of 12-15%.

In the aftermath of Citigroup's agreement to acquire Associates First, Household gains scarcity value, in our opinion, and management will be under greater scrutiny to enhance shareholder value. We reiterate our target price of 15x our 2001 EPS estimate of \$4.00, or \$60 (on a one year horizon). We continue to rate the shares a STRONG BUY.

* * *

Household's home equity portfolio is the strongest that it has ever been (\$34.0 billion in receivables), with 80% of the growth coming from the secured portfolio. Key drivers of internal growth are Household's branch network (1400 branches with expectations of opening 25 per year), its centralized processing model, customer relationships, and personnel.

* * *

We were given a demonstration of Household's proprietary lead generation tool, Vision. The system runs on all of the company's branches, allowing various offices to view the same information on customer accounts in real-time. Vision tracks customer account history, queuing customer service reps. on the next best product to sell. Once a sale is closed, the system generates the appropriate paperwork and correspondence. Thus, Vision raises the level of productivity, allowing the sales force to focus on selling ancillary products, as well as bringing in new business. The system also allows branch managers to be more effective in delegating accounts to the sales force. Going forward, management expects Vision to increase the cross-sell ratio from 1.2x to at least 2x. *By all accounts, the Vision technology platform is ahead of what we've seen at other companies, and is central to Household's cross-sell and e-commerce initiatives.* In our opinion, Vision gives Household a competitive advantage, allowing the company to leverage its 45 million customer base.

262. On 9/13/00, the Company, through its subsidiary, HFC, caused to be filed (or declared effective), a Registration Statement on Form S-3, registering for sale \$10 billion of debt securities.

263. On 10/18/00, Household announced 3Q00 results in a press release entitled, *"Household International Reports Highest Quarterly EPS in Its History; Nlth Consecutive Record Quarter,"* which stated, in part:

Third quarter earnings per share rose 13 percent to \$.94, compared to \$.83 a year ago. Net income also rose to a third quarter record of \$451.2 million, a 13 percent increase from \$399.9 million a year ago. Cash earnings per share for the quarter totaled \$1.02.

* * *

"Our strong third quarter results reflect a continuation of outstanding receivables and revenue growth. At the same time, we achieved year-over-year improvements in credit quality," said William F. Aldinger, Household's chairman and chief executive officer.... These positive trends give us a high degree of confidence in our ability to deliver 15 percent EPS growth for 2000."

264. Following the publication of the release of these record-breaking, stellar results, shares of Household traded above \$50.00 per share on 10/19/00.

265. In addition to inflating the price of Household shares, defendants' false statements also resulted in analysts from Friedman, Billings, Ramsey & Co. ("With obvious strength in its business model, HI's management has guided analysts to the top end of its 12-15% annual EPS

growth range ... price target raised to \$55 from \$48.") and ABN AMRO (reiterating "Top Pick" rating) issuing favorable reports on the Company.

266. On 11/07/00, Household issued a press release entitled, "Household International Responds to Citigroup's Announcement to Change Lending Practices at Associates First Capital," which stated:

Household International supports Citigroup's announcement today of its efforts to boost consumer protections at Associates First Capital. Their proposed changes are generally consistent with the stringent policies and procedures that have long been in place at Household International.

Household's long-standing view has been that unethical lending practices of any type are abhorrent to our company, employees, and most importantly our customers. So-called "predatory lending" practices undermine the integrity of the industry in which we compete.

267. The statement in ¶266 above was materially false and misleading when made. As set forth in ¶¶1-155, the true facts, which were then known to or recklessly disregarded by defendants, based on their review of Household's internal operating data, including information provided to them by Household's Vision system, were that defendants were engaged in a widespread and consistent pattern of improper and illegal predatory lending practices. These practices included, among other things:

(a) Misrepresenting the interest rates and savings associated with loans by providing deceptive and nonconforming loan documents to borrowers that were designed to obscure actual loan amounts and interest rates (¶¶55-60);

(b) Failing to disclose "discount points" that were nothing more than stacked fees and had no bearing on the ultimate interest rate charged on loans (¶¶61-67);

(c) Concealing the existence of prepayment penalties (¶¶68-70);

(d) Using such practices as fraud and forgery to sell ancillary products, such as life, disability and other types of credit insurance (¶¶71-74); and

(e) Illegally "up-selling" second loans with exorbitant interest rates (¶¶75-82).

268. As set forth in ¶¶51-106, defendants' fraudulent predatory lending scheme persisted.

269. On 11/14/00, Household filed with the SEC its 3Q00 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations made in the

10/18/00 corporate release, the 3Q00 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

270. During the first week of 12/00, defendants Aldinger and Schoenholz participated in a series of one-on-one meetings with analysts, during which defendants again reassured them about the strength of the Company's business. After the meetings, these analysts issued reports as follows:

D. Hochstim (Bear Stearns) Report of 12/01/00

The company has seen no signs of credit deterioration The company has stress tested its portfolio and has assumed worse than expected delinquencies and chargeoffs in its 2001 planning. We believe reserves are adequate given the company's conservative coverage of losses and the continuing shift to secured lending.

* * *

We continue to recommend purchase of HI shares with a Buy rating and a near term target price of \$61, or 15x our 2001 estimate. We continue to believe that the company's solid EPS growth justifies a higher valuation.

Joel Gomberg (William Blair & Co.) Report of 12/06/00

Management conveyed a positive outlook, and the all-day meetings renewed our conviction in the company's increasing ability to add considerable value through its broad product array, multiple distribution channels, partnership skill-set, and potent technology platform.

271. The statements made by defendants in ¶¶243-265 and 269-270 above were each materially false and misleading when made. As set forth in ¶¶1-155, the true facts, which were then known to or recklessly disregarded by defendants, based on their review of Household's internal operating data, including information provided to them by Household's Vision system, were:

(a) Defendants were engaged in a widespread and consistent pattern of improper and illegal predatory lending practices, which included, among other things:

(i) Misrepresenting the interest rates and savings associated with loans by providing deceptive and nonconforming loan documents to borrowers that were designed to obscure actual loan amounts and interest rates (¶¶55-60);

- (ii) Failing to disclose "discount points" that were nothing more than stacked fees and had no bearing on the ultimate interest rate charged on loans (§§61-67);
- (iii) Concealing the existence of prepayment penalties (§§68-70);
- (iv) Using such practices as fraud and forgery to sell ancillary products, such as life, disability and other types of credit insurance (§§71-74); and
- (v) Illegally "up-selling" second loans with exorbitant interest rates (§§75-82).

(b) 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.

(c) As set forth in §§107-133, defendants improperly engaged in the practice of "reaging" or "restructuring" delinquent loans to make them current if the customer made one minimum monthly payment, such that the missed payments were added to the back end of the loan. Although defendants characterized "reaging" as a customer service, in fact, the Company used it to:

- (i) Manipulate its reported delinquency ratios and delay or prevent charge-offs (§§107-133);
 - (ii) Cross-sell or up-sell additional loans or lines of credit (§§107-116);
- and
- (iii) Convert customers' unsecured loans into loans secured by their homes or cars without disclosing this information to them (§116). In addition, as detailed in §§111-114 and 121, defendants designed the Vision system to automatically reage delinquent accounts when the computer received only a partial payment without any evidence that the delinquency had been cured.

(d) The Officer Defendants designed the predatory lending practices and reaging of delinquent accounts, allowing the Company to:

- (i) Understate its true levels of delinquencies, such that any financial metrics that were dependent upon delinquencies or defaults and important to investors as a measure

of Household's health, including credit loss reserves, were also materially false and misleading (§§125-133);

(ii) Under-report non-performing assets and misreport credit quality (§§125-133);

(iii) Consistently report lower loan loss reserves by improperly lowering defaults and prepayments (§§102-106 and 125-133);

(iv) Recognize interest income that should not have been accrued in accordance with the Company's own lending practices and policies (§§102-106, 125-133 and 154-155); and

(v) Artificially inflate reported revenues and EPS throughout the Class Period (§§102-106 and 125-153).

(e) As set forth in §§134-155, throughout the Class Period, defendants engaged in improper accounting for Household's credit card co-branding, affinity and third-party marketing agreements, causing Household to overstate its finance income, securitization income and fee income and misstate certain of its expenses, resulting in an overstatement of net income. Due to defendants' improper accounting, the Company was forced to restate earnings for an eight-year period from 1994 through 2Q02. As set forth in §§134-153, the Officer Defendants have admitted that Household's results for FY99, 1Q00, 2Q00 and 3Q00 were materially false and misleading and have restated these results as follows:

	DILUTED EPS		
	<u>As Reported</u>	<u>Restated</u>	<u>Difference</u>
FY99	\$3.07	\$2.95	<\$0.12>
1Q00	\$0.78	\$0.74	<\$0.04>
2Q00	\$0.80	\$0.77	<\$0.03>
3Q00	\$0.94	\$0.91	<\$0.03>

(f) In addition to the false and materially misleading financial data, the Company's SEC filings also contained inadequate risk disclosures that did not disclose the true risks of investing in Household -- specifically, the risk of investing in a company that was not reporting its financial results in conformity with GAAP. In addition, and a result thereof, the purported risk

disclosures were wholly ineffective and inappropriate and did not alert investors to the true risks of investing in Household securities.

E. DEFENDANTS' FALSE AND MISLEADING STATEMENTS DURING 2001

272. On 1/17/01, Household announced 4Q00 and FY00 results in a press release entitled, *"Household International Reports Highest Full Year and Quarterly EPS in Its History; Tenth Consecutive Record Quarter,"* which stated, in part, that:

Household International today reported full year earnings per share of \$3.55, a 16 percent increase over \$3.07 a year ago and the highest earnings per share in the company's 122-year history. Net income totaled \$1.7 billion, or 14 percent above the prior year.

Net managed revenues for the full year increased 18 percent to \$8.9 billion, compared to \$7.5 billion in 1999.

Household's fourth quarter earnings per share rose 12 percent to a record \$1.03, from \$.92 a year ago. Fourth quarter net income rose 12 percent to an all-time high of \$492.7 million, compared with \$438.8 million a year ago.

"These strong fourth quarter results cap off a terrific year in which we delivered on all of our earnings and growth goals," said William F. Aldinger, Household's chairman and chief executive officer. *"Growth and profitability in the quarter were excellent, while credit quality and our balance sheet remained strong...."*

Commenting on the full year results, Aldinger continued, *"Our record earnings per share reflect strong top-line growth and improved credit quality. At the same time, we made significant investments in our technology and human capital that enhance our ability to achieve sustainable and consistent revenue and receivables growth. We have built a powerful franchise that is capable of delivering 13 to 15 percent annual earnings per share growth."*

273. Following the publication of the release of these record-breaking, stellar results, shares of Household traded as high as \$57.13 per share.

274. Defendants' false statements had their intended effect, and, following the announcement of 4Q00 and FY00 results, analysts again issued very positive reports, strongly reiterating "Buy" ratings and advising investors to purchase shares of Household.

275. On 2/01/01, Deutsche Banc Alex. Brown hosted an investor meeting for Household's CEO, Aldinger, in New York. As a result of this meeting, and based on Aldinger's discussions with analysts, Deutsche Banc Alex. Brown issued a report that stated, in part:

Mr. Aldinger expressed his bullishness on the future prospects for the company

Household is very comfortable with its guidance of 13%-15% EPS over the next three years. Mr. Aldinger provided several reasons why Household will meet its objective. First, the company is entering 2001 with higher receivables than expected. Second, Fed rates cuts which were not factored into Household business model will further improve the company's margin. Household estimates that for a 50 bps reduction in rates, EPS improves by \$0.10. Third, the slowing economy will likely provide Household with portfolio acquisition opportunities. Lastly, in a slowing economy, Household believes it is better positioned against competitors based on its brand name, market presence, diverse revenue stream, and borrower profile.

* * *

Household believes that its pre-payment fees on its real estate portfolio lessens the impact from refinance (refi) activity. About 75% of the portfolio carries pre-payment penalties, making it expensive for a borrower to exit the Household network. In 1998, only 25% of home equity loans had prepayment penalties. Household has also extended the life of its loans to reduce refi activity. Lastly, the company has enhanced its service, thereby raising the level of customer satisfaction. This three-pronged strategy has led to lower attrition.

* * *

We reiterate our STRONG BUY rating on the stock.

276. On 2/23/01, the Company, through its subsidiary, HFC, caused to be filed (or declared effective), a Registration Statement on Form S-3, registering for sale \$1 billion of unsecured medium-term notes called "HFC InterNotes (SM)."

277. On 3/28/01, Household filed with the SEC its FY00 Report on Form 10-K, signed by Aldinger, Schoenholz and the Director Defendants. In addition to reiterating the same false representations made in the 1/17/01 corporate release and in the meetings with analysts, the FY00 Report on Form 10-K also stated, in part, that the Company's financial statements met the requirements of Regulation S-X and incorporated by reference information specified by Item 302 of Regulation S-K. The FY00 Report on Form 10-K also contained the "Management's Report" (signed by Aldinger and Schoenholz), which represented to Household shareholders that the consolidated financial statements for FY00 had been prepared in accordance with GAAP, had been audited by Andersen and were an accurate representation of the Company's financials for FY00.

278. With respect to its loan delinquencies and charge-off policies, defendants represented that:

Our focus is to continue using risk-based pricing and effective collection efforts for each loan. We have a process that gives us a reasonable basis for predicting the asset quality of new accounts. This process is based on our experience with

numerous marketing, credit and risk management tests. We also believe that our frequent and early contact with delinquent customers is helpful in managing net credit losses.

279. Additionally, defendant Andersen issued a clean audit opinion on 1/15/01, which was incorporated by reference into the FY00 Report on Form 10-K. Andersen stated that it had audited Household's and its subsidiaries' financial statements for each of the three years in the period ended 12/31/00 in accordance with GAAS and opined that these consolidated financial statements "present fairly, in all material respects, the consolidated financial position" of Household and its subsidiaries in conformity with GAAP.

280. On 3/23/01, *Origination News*, a division of *American Banker*, also quoted Gilmer, who again defended the Company from charges of predatory lending. Gilmer was quoted as stating that Household'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." *The Christian Science Monitor* also reported Household spokesman Craig Stroom's statement that the Company had conducted research to determine whether customers understood the terms of their loans, and the result was that, overwhelmingly, borrowers fully understood the terms of their loans.

281. The statement in ¶280 above was materially false and misleading when made. As set forth in ¶¶51-101, the true facts, which were then known to or recklessly disregarded by defendants, based on their review of Household's internal operating data, including information provided to them by Household's Vision system, were that defendants were engaged in a widespread and consistent pattern of improper and illegal predatory lending practices. These practices included, among other things:

(a) Misrepresenting the interest rates and savings associated with loans by providing deceptive and nonconforming loan documents to borrowers that were designed to obscure actual loan amounts and interest rates (¶¶55-60);

(b) Failing to disclose "discount points" that were nothing more than stacked fees and had no bearing on the ultimate interest rate charged on loans (¶¶61-67);

(c) Concealing the existence of prepayment penalties (¶¶68-70);

(d) Using such practices as fraud and forgery to sell ancillary products, such as life, disability and other types of credit insurance (¶¶71-74); and

(e) Illegally "up-selling" second loans with exorbitant interest rates (¶¶75-82).

282. As set forth in ¶¶51-101, 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.

283. At a 4/02/01 dinner for investors, CFO Aldinger strongly reaffirmed the Company's outlook for 13%-15% EPS growth in 2001, regardless of declining economic conditions that were already adversely affecting Household's competitors.

284. On 4/03/01, following defendants' Annual Financial Relations meeting, analysts were so impressed with senior management's discussion of business that they reiterated or raised Household's rating to a "Buy." Bear Stearns raised its price target to \$70.00 (from \$65.00) in a report that stated:

D. Hochstim/S. Coren (Bear Stearns) Report of 4/04/01

Household remains particularly well positioned for a slowdown *The company continues to carefully manage credit risk, improve customer service, productivity, and operating efficiency.* In addition, the company has been preparing for a downturn for more than a year, having tightened underwriting standards, raising cutoffs, reducing credit lines, and building its collection staff. The company's experience lending to consumers over the past one hundred-plus years, its tightening of underwriting, and its continued reserve building should enable the company to effectively weather a downturn. (Interestingly there are no signs yet of credit stress among its customers.)

* * *

The company continue [sic] to emphasize secured lending and is only soliciting home owners.

Prepayment penalties on 75% of the portfolio (and about 95% of recent production) provide prepayment protection.

Robert P. Napoli (ABN AMRO) Report of 4/04/01

There were no real surprises at the meeting other than the fact that the business continues to perform so well in an environment that includes a continuous stream of negative company announcements.

Credit trends stand out in particular, as HI seems to have the sector's most positive trends. We are projecting increasing credit losses for essentially all consumer and commercial finance companies under our coverage ... a 20% increase in consumer credit losses for the US. Supporting our outlook is the fact that consumer bankruptcies have spiked up this year by about 16% (year to date) after falling for two years. HI is bucking this trend as it repeatedly said credit losses are stable.

Chairman/CEO Bill Aldinger strongly affirmed HI's outlook for 13% to 15% EPS growth in 2001, regardless of the economic environment.

* * *

Predatory lending issues do not seem to be a significant risk for HI We continue to believe that HI has one of the cleanest consumer lending operations in the U.S. and thus is least likely to have predatory lending issues.

Legg Mason reiterated a strong "Buy" rating and noted in a 4/04/01 report:

David Sochol (Legg Mason) Report of 4/05/01

We concur with management's assessment that HI is well positioned to deliver attractive relative growth even amid a sharper economic slowdown, as NIM improvement, portfolio acquisitions, and share buybacks should more than offset higher credit costs (although at present HI continues to see fairly stable portfolio performance).

* * *

[David Schoenholz] commented that he is *absolutely confident that HI is well ahead of the curve on asset quality* and expects a solid 1Q01 as well as strong 2001. HI is seeing stable delinquency trends in 1Q01, and expects further increase in the risk-adjusted margin during the year.

285. On 4/18/01, Household issued a release announcing another "Record" Quarter, reporting its *"11th Consecutive Record Quarter."* The release stated:

Household International today reported that earnings per share rose 17 percent to a first quarter record of \$.91 from \$.78 a year ago. Net income increased to \$431.8 million, up 16 percent from \$372.9 million in the first quarter of 2000. This quarter marked the 11th consecutive quarter of record results.

William F. Aldinger, Household's chairman and chief executive officer, said "Our outstanding results reflect the sustainability and earnings power of our franchise. Receivables and revenues grew nicely in the quarter. At the same time, credit quality remained stable and we strengthened our balance sheet. We also repurchased 8.8 million shares in the quarter.

"All of our businesses are performing well and have great momentum," Aldinger added....

"We are very comfortable with our ability to achieve our receivable and earnings per share growth targets for 2001." Aldinger concluded, "I look forward to another record year."

286. On 5/03/01, the Company, through its subsidiary, HFC, caused to be filed (or declared effective), a Registration Statement on Form S-3, registering for sale \$16.57 billion of debt securities.

287. Following the announcement of yet another "record" quarter, shares of Household traded to a near-Class-Period high of \$64.00 per share. By 5/08/01, Household shares traded as high as \$66.75, and by 5/17/01, they reached the Class-Period high of \$69.90 per share.

288. On 5/09/01, Household filed its 1Q01 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations made in the 4/18/01 release, the 1Q01 Report on Form 10-Q also stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

289. On 7/18/01, Household issued a release announcing its "*12th Consecutive Record Quarter.*" The release stated:

Household International today reported record earnings per share of \$.93, up to 16 percent from a year ago. Net income rose 14 percent, to \$439.0 million, from \$383.9 million for the second quarter of 2000.

William F. Aldinger, Household's chairman and chief executive officer, said, "We had a terrific quarter – our 12th consecutive quarter of record results. *Given the softening economic environment, I am particularly pleased with our ability to consistently deliver strong, quality earnings.*

"Results for the quarter were excellent," Aldinger added. "We enjoyed strong receivable and revenue growth compared to a year ago, with all of our businesses performing well. In addition, delinquency was stable in the quarter ...

"Our strong performance to date has positioned us well to achieve another record year in 2001," Aldinger concluded.

290. Based on these purported positive results, shares of Household again rallied to a Class-Period-closing high of \$69.48 on 7/18/01.

291. Defendants' false statements had their intended effect, and, on 7/18/01, following the release of the report of 2Q01 results, several analysts issued very positive reports and advised

investors to purchase shares of Household: UBS Warburg report ("Credit quality continues to hold up better than expected with charge-offs up 15 basis points to 3.71% and delinquencies holding steady at 4.27% ... reiterate our Buy rating"); William Blair & Co. report ("Another impressive quarter.... Management reiterates confidence in 15% EPS growth in 2001.... *Household has among the best credit-quality patterns in the industry.... Management anticipates generally stable credit for balance of 2001*"); Legg Mason report ("reiterate our Strong Buy rating based on the company's continuing solid execution, better-than-expected fundamentals, impressive absolute and relative performance, our increased confidence in its ability to consistently deliver 15% EPS growth this year and next, and our expectation that this will drive further P/E multiple expansion"); and Bear Stearns report ("No surprises, very clean quarter, receivable growth strong, credit stable, profitability (23% ROE) still very high.").

292. On 8/10/01, Household filed with the SEC its 2Q01 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations made in the 7/18/01 release, the 2Q01 Report on Form 10-Q falsely stated that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

293. On 7/23/01, defendants caused Household to issue a release entitled, "Household International Redefines Best Practices in Subprime Lending," stating:

Household International, the \$101 billion (managed assets) consumer lender, announced today the broadest set of voluntary responsible lending initiatives ever seen in the consumer finance industry ... and will protect millions of consumers from unethical and unfair lending practices.

Household's new Best Practice Initiatives are an addition to the company's already comprehensive responsible lending practices and go far beyond any existing city, state or federal regulatory/legal requirements.

Designed to become a benchmark in the consumer finance industry, Household's initiatives include:

- reducing the prepayment fee duration from five years to three years on all real estate loans;
- identifying borrowers nationwide who have been victims of predatory lending and are at risk of losing their homes through foreclosure; and providing them with tailored solutions, such as subsidized interest rates and no-fee loans;

- providing new and existing customers who have a better credit rating/payment history with dramatically-improved interest rates;
- implementing new and enhanced standards to ensure every loan made by Household has numerous tangible customer benefits; and
- doubling customers' time to cancel any insurance product (from 30 to 60 days) and improving disclosure.

* * *

"On behalf of Household and our 32,000 employees, I am very proud to announce the adoption of these Best Practice Initiatives that perfectly complement our 123 year history of responsible lending," said William F. Aldinger, chairman and chief executive officer of Household International.

* * *

In addition to these new Initiatives, Household already has a variety of responsible lending programs and practices in place to ensure its customers are treated fairly. For example, at the time of loan closing, Household shows all borrowers (unless they specifically decline to view it) an educational video on the loan closing process that reiterates the terms, features and conditions of their loan. Then, they are asked to complete a survey confirming they understand the key elements of their loan and their satisfaction with the service they received.

294. On 7/24/01, *The New York Times* published a statement by Household spokesperson Craig Stroom, which said that the timing of these policies was not tied to actions by any fair-lending advocates and that the Company had been working on the announced changes for "quite some time. So, it really is a coincidence."

295. The clear purpose and intent was to condition investors to believe that Household was *not* engaged in predatory lending and that the Company had adopted and initiated a comprehensive program to assure that such illicit practices were not being adopted by Household employees.

296. On 8/30/01, after meeting with executive management at the Company's headquarters, William Blair & Co. analyst Joel Gombert issued a report stating, in part:

Management conveyed a positive outlook, and the onsite meeting renewed our conviction in the company's increasing ability to add considerable value through its broad product array, multiple distribution channels, risk-management skills, and potent technology platform.

* * *

Management continues to be confident in its ability to achieve its target of 15% EPS growth in 2001 and 13%-15% in 2002. While the extent of the economic deceleration remains unknown, Household took a more defensive posture early by migrating its portfolio from unsecured credit to lower-loss real estate secured.

297. On 9/26/01, after meeting with management (Aldinger, Schoenholz, Gilmer, Bangs, Fabiano and Harvey) at the Company's headquarters, Deutsche Banc Alex. Brown analyst Mark Alpert issued a report reiterating defendants' false representations. The report raised EPS estimates, stating:

We have more confidence in our earnings forecast for Household than virtually any other company in our universe (except the GSEs, Fannie and Freddie).

* * *

Household's course has not changed over the last 12-18 months....

Management is sticking to its long-term EPS growth target of 13%-15%, driven by revenue growth.... Momentum is strong going into next year, and the company is confident that even in a recession it will meet the low end of the range.

There are few other companies with such solid outlook in our universe.

298. On 10/17/01, Household announced 3Q01 results in a release entitled, "*Household Reports Highest Quarterly Net Income in Its 123-Year History.*" The release stated:

Earnings per share of \$1.07 rose 14 percent from \$.94 the prior year. Net income increased 12 percent, to \$504 million, from \$451 million in the third quarter of 2000.

"Household's performance this year has been outstanding, even as the economy has continued to weaken," said William F. Aldinger, chairman and chief executive officer. "The third quarter was no exception. *Receivable and revenue growth were strong, and credit performance was within our expectations. We further strengthened our balance sheet* and continued to repurchase shares.

* * *

"The strength of our franchise gives me confidence that we will achieve the high end of our earnings target of 13 to 15 percent EPS growth for the year," Aldinger concluded.

299. On 11/14/01, Household filed with the SEC its 3Q01 Report on Form 10-Q, signed by defendant Schoenholz. In addition to reiterating the same false representations made in Household's 3Q01 release, the 3Q01 Report on Form 10-Q stated, in part, that the unaudited quarterly financial results were prepared in accordance with GAAP and included, "in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation."

300. On 11/16/01, UBS Warburg issued a report reiterating management's explanation that a suit against Household brought by the California Department of Corporations regarding over-

billing was the result of a computer "glitch." Based on the Company's assurances, UBS Warburg did not adjust its rating on shares of Household and continued to maintain a \$70.00 price target for Household shares. Reflecting defendants' assurances, Bear Stearns issued a report calling the share price decline that resulted from the announcement of the California settlement an "overreaction." Bear Stearns did not adjust its \$75.00 price target on Household shares.

301. On 11/26/01, the *National Mortgage News* reported that the 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."

302. The statements made by defendants in ¶¶272-279 and 283-301 above were each materially false and misleading when made. As set forth in ¶¶1-155, the true facts, which were then known to or recklessly disregarded by defendants, based on their review of Household's internal operating data, including information provided to them by Household's Vision system, were:

(a) Defendants were engaged in a widespread and consistent pattern of improper and illegal predatory lending practices, which included, among other things:

(i) Misrepresenting the interest rates and savings associated with loans by providing deceptive and nonconforming loan documents to borrowers that were designed to obscure actual loan amounts and interest rates (¶¶55-60);

(ii) Failing to disclose "discount points" that were nothing more than stacked fees and had no bearing on the ultimate interest rate charged on loans (¶¶61-67);

(iii) Concealing the existence of prepayment penalties (¶¶68-70);

(iv) Using such practices as fraud and forgery to sell ancillary products, such as life, disability and other types of credit insurance (¶¶71-74); and

(v) Illegally "up-selling" second loans with exorbitant interest rates (¶¶75-82).

(b) 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.

No. 13-3532

**UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

GLICKENHAUS INSTITUTIONAL GROUP,

Plaintiff-Appellee,

v.

HOUSEHOLD INTERNATIONAL, INC., ET AL.,

Defendants-Appellants.

On Appeal from the United States District Court
for the Northern District of Illinois
No. 02-CV-5893
The Honorable Ronald A. Guzmán, District Judge

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February 12, 2014

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02C5893 Judge Guzman
Case: 13-3532 Document: 49-2
Filed: 02/12/2014 Pages: 233
Jaffe v. Household International, Inc.
Filed Jury Instructions (Given).

SR
FILED
MAY 7 2009
MAY 07 2009
RONALD A. GUZMAN, JUDGE
UNITED STATES DISTRICT COURT

Members of the jury, you have seen and heard all the evidence and arguments of the attorneys. Now I will instruct you on the law.

You have two duties as a jury. Your first duty is to decide the facts from the evidence in the case. This is your job, and yours alone.

Your second duty is to apply the law that I give you to the facts. You must follow these instructions, even if you disagree with them. Each of the instructions is important, and you must follow all of them.

Perform these duties fairly and impartially. Do not allow sympathy, prejudice, fear or public opinion to influence you. You should not be influenced by any person's race, color, religion, national ancestry or sex.

Nothing I say now, and nothing I said or did during the trial, is meant to indicate any opinion on my part about what the facts are or about what your verdict should be.

FILED
MAY 07 2009
MAY 7 2009
MICHAEL W. DOBBINS
CLERK, U.S. DISTRICT COURT

In this case, Defendants William Aldinger, David Schoenholz and Gary Gilmer are individuals, Defendant Household is a corporation and Plaintiffs are entities that purchased Household stock that represent a class of others similarly situated. All parties are equal before the law. Defendants and Plaintiffs are entitled to the same fair consideration.

The evidence consists of the testimony of the witnesses, the exhibits admitted in evidence, and stipulations.

During the trial, certain testimony was presented to you by the reading of a deposition and video. You should give this testimony the same consideration you would give it had the witness appeared and testified here in court.

A stipulation is an agreement between both sides that certain facts are true. If the parties have stipulated to a fact, you must accept that fact as proved.

In determining whether any fact has been proved, you should consider all of the evidence bearing on the question regardless of who introduced it.

Certain things are not to be considered as evidence. I will list them for you:

First, if I told you to disregard any testimony or exhibits or struck any testimony or exhibits from the record, such testimony or exhibits are not evidence and must not be considered.

Second, anything that you may have seen or heard outside the courtroom is not evidence and must be entirely disregarded. This includes any press, radio, Internet or television reports you may have seen or heard. Such reports are not evidence and your verdict must not be influenced in any way by such publicity.

Third, questions and objections or comments by the lawyers are not evidence. Lawyers have a duty to object when they believe a question is improper. You should not be influenced by any objection, and you should not infer from my rulings that I have any view as to how you should decide the case.

Fourth, the lawyers' opening statements, periodic summations and closing arguments to you are not evidence. Their purpose is to discuss the issues and the evidence. If the evidence as you remember it differs from what the lawyers said, your memory is what counts.

You will recall that during the course of this trial I instructed you that I admitted certain evidence only for a limited purpose. You must consider this evidence only for the limited purpose for which it was admitted.

During the trial I provided you with a written copy of the limiting instructions that apply to certain categories of evidence, including analyst reports, investor relations reports, presentations to investors, ratings agency reports, newspaper and magazine articles, complaints and settlements in other legal proceedings, and individual customer complaints. I will not read those instructions again, but they are included in the instructions that you will take to the jury room and that you must follow in your deliberations.

Some evidence was admitted for the limited purpose of assisting you to evaluate an expert witness' opinion. Such evidence must not be used by you for any other purpose.

Certain evidence in this case is admitted for a limited purpose only to show that the contents were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents. You must consider this evidence only for the limited purpose for which it was admitted.

First, a number of documents known as analyst reports were admitted in evidence. Analyst reports are written by market analysts employed by investment banks or brokerage firms, who comment on Household's business, its securities, and the economy in general. These exhibits are not admitted to show that what the analysts said was true. This evidence is admitted only to show that the contents of the analyst reports were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents, and for no other purpose.

Second, certain documents called investor relations reports were admitted in evidence. Household's investor relations report were prepared by Household employees for internal use within the company. The investor relations reports typically include quotations or excerpts from selected analyst reports. To the extent the investor relations reports quote from, attach or paraphrase statements made by analysts, you may consider those portions of the investor relations reports only for the limited purpose of showing that the contents of the analyst reports were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents, and for no other

purpose.

Third, certain evidence was admitted about presentations that Household executives made to analysts and investors, either in person or on conference calls. This evidence is admitted for the limited purpose of showing that the contents of the presentations were publicly available or whether they affected the price of Household stock, and for no other purpose.

Fourth, some reports prepared by ratings agencies that relate to Household's financial condition were admitted. These reports were not admitted to show that what the ratings agencies said was true. This evidence was admitted only to show that the contents of the ratings agencies' reports were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents, and for no other purpose.

Fifth, a number of newspaper and magazine articles were admitted. These articles are not admitted to show that the contents of the articles were true. Unless I instruct you to the contrary, you are to consider newspaper or magazine articles only for the limited purpose of showing that the contents of the articles were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents, and for no other purpose.

Certain evidence in this case is admitted only for the limited purpose of showing what one or more of the Defendants knew when they made the public statements that Plaintiffs allege were false or misleading. You must consider this evidence only for the limited purpose for which it was admitted.

First, evidence was admitted about complaints that were filed publicly against Household in certain other lawsuits during the relevant time period. This evidence is not admitted to show that the allegations asserted against Household in those prior lawsuits were true. These litigation documents, and any testimony about them, are admitted only for the limited purpose of (a) showing that the existence and nature of the prior lawsuits were known to one or more of the Defendants, (b) showing that this information was publicly available, or (c) showing whether the complaints affected the price of Household stock. You are not to consider this evidence for any other purpose.

Second, evidence was admitted about complaints made by certain individual customers of Household. The evidence about individual customer complaints is not admitted to show that the customers' complaints were true. This evidence is admitted only for the limited purpose of showing that the existence and nature of the complaints were known to one or more of the Defendants, and for no other purpose.

Third, evidence was admitted about settlements that Household entered into to resolve certain legal proceedings during the relevant time period.

Evidence about a settlement is not admitted to show that Household was at fault or admitted any wrongdoing in the matter that was settled. The evidence is admitted only for the limited purpose of showing whether a settlement affected the price of Household stock, and you must not consider this evidence for any other purpose.

Each party is entitled to have the case decided solely on the evidence that applies to that party.

Any notes you have taken during the trial are only aids to your memory. The notes are not evidence. If you have not taken notes, you should rely on your independent recollection of the evidence and not be unduly influenced by the notes of other jurors. Notes are not entitled to any greater weight than the recollections or impressions of each juror about the testimony.

You should use common sense in weighing the evidence and consider the evidence in light of your own observations in life.

In our lives, we often look at one fact and conclude from it that another fact exists. In law we call this "inference." A jury is allowed to make reasonable inferences. Any inference you make must be reasonable and must be based on the evidence in the case.

You may have heard the phrases "direct evidence" and "circumstantial evidence." Direct evidence is proof that does not require an inference, such as the testimony of someone who claims to have personal knowledge of a fact. Circumstantial evidence is proof of a fact, or a series of facts, that tends to show that some other fact is true.

As an example, direct evidence that it is raining is testimony from a witness who says, "I was outside a minute ago and I saw it raining." Circumstantial evidence that it is raining is the observation of someone entering a room carrying a wet umbrella.

The law makes no distinction between the weight to be given to either direct or circumstantial evidence. You should decide how much weight to give to any evidence. In reaching your verdict, you should consider all the evidence in the case, including the circumstantial evidence.

You must decide whether the testimony of each of the witnesses is truthful and accurate, in part, in whole, or not at all. You also must decide what weight, if any, you give to the testimony of each witness.

In evaluating the testimony of any witness, including any party to the case, you may consider, among other things:

the ability and opportunity the witness had to see, hear, or know the things that the witness testified about;

the witness's memory;

any interest, bias, or prejudice the witness may have;

the witness's intelligence;

the manner of the witness while testifying;

and the reasonableness of the witness's testimony in light of all the evidence in the case.

You may consider the statements given by any party or witness who testified under oath before trial as evidence of the truth of what he or she said in the earlier statements, as well as in deciding what weight to give his or her testimony.

With respect to other witnesses, the law is different. If you decide that, before the trial, one of these witnesses made a statement not under oath or acted in a manner that is inconsistent with his testimony here in court, you may consider the earlier statement or conduct only in deciding whether his testimony here in court was true and what weight to give to his testimony here in court.

In considering a prior inconsistent statement or conduct, you should consider whether it was simply an innocent error or an intentional falsehood and whether it concerns an important fact or an unimportant detail.

It is proper for a lawyer to meet with any witness in preparation for trial.

You may find the testimony of one witness or a few witnesses more persuasive than the testimony of a larger number. You need not accept the testimony of the larger number of witnesses.

The law does not require any party to call as a witness every person who might have knowledge of the facts related to this trial. Similarly, the law does not require any party to present as exhibits all papers and materials mentioned during this trial.

Plaintiffs contend that defendants at one time destroyed documents regarding Andrew Kahr's recommendations for Household and documents regarding use of the effective rate presentation. However, defendants contend that they did not destroy any documents regarding Andrew Kahr's recommendations, and whatever they did with regard to documents relating to the effective rate presentation was for legitimate business purposes.

Defendants' destruction of a document, standing alone, does not warrant an inference that the document contained information that is unfavorable to the defendants. You may assume that such evidence would have been unfavorable to defendants only if you find by a preponderance of the evidence that:

1. Defendants intentionally destroyed evidence or caused evidence relevant to plaintiffs' claims to be destroyed; and
2. Defendants destroyed the evidence or caused the evidence to be destroyed in bad faith, in other words, for the purpose of hiding adverse information.

You have heard witnesses give opinions about matters requiring special knowledge or skill. You should judge this testimony in the same way that you judge the testimony of any other witness. The fact that such a person has given an opinion does not mean that you are required to accept it. Give the testimony whatever weight you think it deserves, considering the reasons given for the opinion, the witness's qualifications, and all of the other evidence in the case.

Certain demonstrative exhibits have been shown to you. Those exhibits are used for convenience and to help explain the facts of the case. They are not themselves evidence or proof of any facts.

You must give separate consideration to each claim and each party in this case.

When I say a particular party must prove something by "a preponderance of the evidence," or when I use the expression "if you find," or "if you decide," this is what I mean: when you have considered all the evidence in the case, you must be persuaded that it is more probably true than not true.

Plaintiffs contend that Defendants Household, William Aldinger, David Schoenholz and Gary Gilmer violated Section 10b of the Securities Exchange Act and the Securities Exchange Commission or SEC's Rule **10b-5**. From now on, I will use "10b-5" to refer to both the Section and the Rule.

To prevail on their 10b-5 claim against any defendant, plaintiffs must prove each of the following elements by a preponderance of the evidence as to that defendant:

(1) 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;

(2) the false statement or omission was material;

(3) the defendant acted with a particular state of mind; and

(4) the defendant's statement or omission was a substantial factor in causing plaintiffs' economic loss.

If you find that the plaintiffs have proved each of the above elements as to any defendant, your verdict should be for the plaintiffs and against that defendant. If you find that the plaintiffs have not proved each of the above elements as to any defendant, your verdict should be for that defendant and against the plaintiffs.

To meet the first element of their 10b-5 claim against any defendant, plaintiffs must prove that during the relevant time period the defendant made a false or misleading statement of fact or omitted a fact that was necessary to prevent a statement that was made from being misleading.

Table A to the verdict form that you will be given, sets forth the statements that plaintiffs claim are false and misleading.

In determining whether a statement of fact is false or misleading, you must consider the statement in light of the circumstances that existed at the time it was made.

An omission violates 10b-5 only if the defendant has a duty to disclose the omitted fact. The defendants do not have a duty to disclose every fact they possess about Household or any fact that is in the public domain. But each 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. If a defendant does not have a duty to disclose a fact but chooses to make a statement about it, the statement must be truthful and not misleading.

Defendant Household is required to file with the SEC an annual report, called a 10-K, and quarterly reports, called 10-Qs, for the first three quarters of each year. These reports include financial statements and other disclosures. Financial statements present a company's financial position at one moment in

time, or its operating results and cash flows for a specified period. Household has no duty to update its 10-Q reports on any cycle other than quarterly.

Household is required to prepare its financial statements regarding the delinquency status of loans and the accounting for its credit card agreements in accordance with generally accepted accounting principles or GAAP. GAAP are the accepted rules and procedures used by accountants in preparing financial statements. If you find that any of Household's financial statements regarding the delinquency status of loans and the accounting for its credit card agreements was not prepared in accordance with GAAP, you may presume that that portion of the financial statement is false or misleading.

To meet the second element of their 10b-5 claim against any defendant, plaintiffs must prove that the false or misleading statement of fact that the defendant made, or failed to make, was material.

A statement of fact or omission is material if there is a substantial likelihood that a reasonable investor would have considered it important in deciding whether to buy or sell Household stock. An important statement or omission is one that a reasonable investor would view as significantly altering the total mix of information to be considered in deciding whether to buy or sell Household stock.

A reasonable investor is presumed to have ordinary intelligence and is presumed to have information available in the public domain.

In determining whether a statement or omission is material, you must consider it in light of the circumstances that existed at the time the statement was made or the fact was omitted.

To meet the third element of their 10b-5 claim against any defendant, plaintiffs must prove that the defendant acted with a specific state of mind. 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.

Defendants William Aldinger, David Schoenholz or Gary Gilmer acted with the required state of mind in failing to disclose a material fact if he knew that the omission would make another statement he made on the same subject misleading or he recklessly disregarded a substantial risk that the omission would make another statement he made on the same subject 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.

Defendant Household, which can only act through its employees, had the required state of mind with respect to a false statement or omission if defendants William Aldinger, David Schoenholz, Gary Gilmer or any other Household

employee made the statement or omission with the required state of mind while acting within the scope of his or her employment.

The fact that Household restated certain financial statements does not, by itself, prove that any defendant acted knowingly or recklessly with respect to the information in the original financial statements. However, you may consider it along with any other evidence to determine whether any defendant acted knowingly or recklessly.

The intent of a person or the knowledge that a person possesses at any given time may not ordinarily be proved directly because there is no way of directly scrutinizing the workings of the human mind. In determining the issue of what a person knew or what a person intended at a particular time, you may consider any statements made or acts done by that person and all other facts and circumstances received in evidence which may aid in your determination of that person's knowledge or intent.

You may infer, but you are certainly not required to infer, that a person intends the natural and probable consequences of acts knowingly done or knowingly omitted. It is entirely up to you, however, to decide what facts to find from the evidence received during this trial.

To meet the last element of their 10b-5 claim against any defendant as to any false or misleading statement or omission of material fact, plaintiffs must prove that the defendant's particular statement or omission was a substantial cause of the economic loss plaintiffs suffered. Plaintiffs do not have to prove that any statement or omission was the sole cause of plaintiffs' loss.

A statement or omission of material fact is a substantial cause of plaintiffs' loss if (1) it causes Household's stock price to be higher than it would be if the statement had not been made or the concealed fact had been disclosed; and (2) the market's discovery of the truth about that statement or omission causes Household's stock price to decrease. The truth may be revealed to the market through a single disclosure or a series of disclosures made by any person or entity.

Household is liable for any violation of 10b-5 that you find defendants William Aldinger, David Schoenholz, Gary Gilmer, or any other Household employee committed while acting within the scope of his or her employment and trying to further Household's goals. A Household officer or employee acts within the scope of his or her employment when transacting business Household assigned to him or her or doing anything that can reasonably be considered to be part of his or her employment.

If you find that plaintiffs have not proved all of the elements of their 10b-5 claim against any defendant, then you should not consider the question of damages.

If you find that plaintiffs have proved all of the elements of their 10b-5 claim against any defendant, then you must determine the amount of per share damages, if any, to which plaintiffs are entitled. Plaintiffs can recover only actual damages, which is the difference between the price plaintiffs paid for each share of Household stock and the price each share would have cost if no false or misleading statement or omission of material fact had occurred, in other words, the measure of inflation in the stock price. This is the only damages calculation you will be asked to make in this case. Any damages you award must have a reasonable basis in the evidence. Damages need not be proved with mathematical certainty but there must be enough evidence for you to make a reasonable estimate of damages.

Under Section 20(a) of the Securities Exchange Act, a defendant may be liable for what is called a "secondary violation," even if he did not violate 10b-5, if he had the authority to control another defendant who violated 10b-5. Plaintiffs claim that each of the Individual Defendants, William Aldinger, David Schoenholz, and Gary Gilmer is liable for a secondary violation under Section 20(a).

To prove that any defendant is liable for a secondary violation, plaintiffs have the burden of proving both of the following elements:

1. that another defendant (called a "primary violator") violated 10b-5 in the manner I have previously explained; and
2. that the defendant was a "controlling person" with respect to the primary violator.

If you determine that no defendant has violated 10b-5, you do not have to consider whether any defendant was a controlling person.

If you find that any defendant was a primary violator, however, you must then determine whether any of the other defendants was a "controlling person" as to that primary violator.

To establish that William Aldinger, David Schoenholz or Gary Gilmer was a "controlling person," plaintiffs must prove that:

- (1) the defendant actually exercised general control over the operations of the primary violator; and
- (2) the defendant had the power or ability, even if that power was not exercised, to control the specific transaction or activity upon which the primary violation was based — in this case, making the specific false statement or omission of material fact.

Both of these elements must be established as to each individual defendant. The parties have stipulated that both William Aldinger and David Schoenholz actually exercised general control over the operations of Household, so no proof is required on that element as to those two defendants, in their relation to Household.

Upon retiring to the jury room, you must select a presiding juror. The presiding juror will preside over your deliberations and will be your representative here in court.

A verdict form has been prepared for you.

[Verdict form read.]

Take the verdict form to the jury room, and when you have reached unanimous agreement on the verdict, your presiding juror will fill in and date the appropriate form, and all of you will sign it.

I do not anticipate that you will need to communicate with me. If you do need to communicate with me, the only proper way is in writing. The writing must be signed by the presiding juror, or, if he or she is unwilling to do so, by some other juror. The writing should be given to the marshal, who will give it to me. I will respond either in writing or by having you return to the courtroom so that I can respond orally.

If you do communicate with me, you should not indicate in your note what your numerical division is, if any.

The verdict must represent the considered judgment of each juror. Your verdict for or against any party must be unanimous.

You should make every reasonable effort to reach a verdict. In doing so, you should consult with one another, express your own views, and listen to the opinions of your fellow jurors. Discuss your differences with an open mind. Do not hesitate to reexamine your own views and change your opinion if you come to believe it is wrong. But you should not surrender your honest beliefs about the weight or effect of evidence solely because of the opinions of other jurors or for the purpose of returning a unanimous verdict.

All of you should give fair and equal consideration to all the evidence and deliberate with the goal of reaching an agreement that is consistent with the individual judgment of each juror. You are impartial judges of the facts.

UNITED STATES DISTRICT COURT
FOR THE Northern District of Illinois – CM/ECF LIVE, Ver 4.0.3
Eastern Division

Lawrence E Jaffe, et al.

Plaintiff,

v.

Case No.: 1:02-cv-05893

Hon. Ronald A. Guzman

Household International Inc., et al.

Defendant.

NOTIFICATION OF DOCKET ENTRY

This docket entry was made by the Clerk on Wednesday, July 28, 2010:

MINUTE entry before Honorable Ronald A. Guzman: The Court denies defendants' Motion for Summary Judgment Dismissing All Remaining Claims of the Class [doc. no. 1227] as moot. Mailed notice (cjb,)

ATTENTION: This notice is being sent pursuant to Rule 77(d) of the Federal Rules of Civil Procedure or Rule 49(c) of the Federal Rules of Criminal Procedure. It was generated by CM/ECF, the automated docketing system used to maintain the civil and criminal dockets of this District. If a minute order or other document is enclosed, please refer to it for additional information.

For scheduled events, motion practices, recent opinions and other information, visit our web site at www.ilnd.uscourts.gov.

**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.)

02 C 5893 (Consolidated)

)

HOUSEHOLD INTERNATIONAL, INC.,)

Judge Ronald A. Guzmán

MERRILL LYNCH, PIERCE, FENNER,)

& SMITH, INC., GOLDMAN SACHS &)

CO., INC., ARTHUR ANDERSEN, L.L.P.,)

WILLIAM F. ALDINGER, DAVID A.)

SCHOENHOLZ, GARY GILMER,)

J.A. VOZAR, ROBERT J. DARNALL,)

GARY G. DILLON, JOHN A.)

EDWARDSON, MARY JOHNSTON)

EVANS, J. DUDLEY FISHBURN,)

CYRUS F. FREIDHEIM, LOUIS E. LEVY,)

GEORGE A. LORCH, JOHN D.)

NICHOLS, JAMES B. PITBLADO,)

S. JAY STEWART, and LOUIS W.)

SULLIVAN,)
)
)
 Defendants.)

MEMORANDUM OPINION AND ORDER

Before the Court are the parties' submissions regarding post-verdict Phase II of this case. This Order addresses the parties' concerns and creates the protocol for Phase II, as well as the appropriate method of calculating damages with respect to each class member's claims.

Background

On May 7, 2009, the jury found that defendants Household International, Inc., William Aldinger, David Schoenholz and Gary Gilmer violated 15 U.S.C. §78(j)(b) (10(b)) of the Exchange Act of 1934 (1934 Act), and 17 C.F.R. §240.10b-5 (Rule 10b-5) and 15 U.S.C. §78(t)(a) (20(a)) with respect to statements made from March 23, 2001 to October 11, 2002. In addition, the jury determined the inflation per share from March 23, 2001 to October 11, 2002.

We now move to Phase II of the class action. Previously, Magistrate Judge Nan R. Nolan bifurcated class discovery and held that discovery as to any individual plaintiff's reliance would occur after a determination of class-wide liability and the applicability of the fraud-on-the-market theory. Neither party filed objections to that ruling. Accordingly, Phase II shall address the issue of defendant's rebuttal of the presumption of reliance as to particular individuals as well as the calculation of damages as to each plaintiff. In creating a Phase II

protocol, this Court receives very little guidance from other courts because securities fraud class actions have rarely proceeded to trial, let alone reached subsequent proceedings. *See, e.g., Edward J. Bartolo Corp. v. Coopers & Lybrand*, 928 F. Supp. 557, 560 (W.D. Pa. 1996).

On one hand, plaintiffs contend that the only remaining tasks are implementing the procedure by which defendants will exercise the right to rebut the presumption of reliance and determining the formula for calculating class members' claims and calculating damages. Plaintiffs ask the Court to approve a notice to be sent to class members advising them of the verdict and their right to file a claim for recovery along with an interrogatory addressing the issue of reliance.

On the other hand, defendants argue that due process guarantees their right to a jury trial as well as pretrial discovery regarding the contested individual issues of reliance. Defendants contend that there is no reasonable substitute for the consideration of class members' actual trading history to quantify damages.

Discussion

I. Rebutting the Presumption of Reliance

Having prevailed on their fraud-on-the-market theory, plaintiffs are entitled to a presumption of reliance. *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988). In *Basic*, the Court explained the fraud-on-the-market doctrine as follows:

An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market

price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action. *Id.* The fraud-on-the-market doctrine provides a practical resolution to the problem of balancing the substantive requirement of proof of reliance in securities cases against the procedural requisites of [Federal Rule of Civil Procedure] 23. *Id.* at 242 (alteration in original). Following *Basic*, the Seventh Circuit has explained that the reliance required for a Rule 10b-5 action is not reliance as used in the lay sense of the term:

[R]eliance is a synthetic term. It refers not to the investor's state of mind but to the effect produced by a material misstatement or omission. Reliance is the confluence of materiality and causation. The fraud on the market doctrine is the best example—a material misstatement affects the security's price, which injures investors who did not know of the misstatement.

Eckstein v. Balcors Film Investors, 58 F.3d 1102, 1170 (7th Cir. 1995).

When someone makes a false (or true) statement that adds to the supply of available information, that news passes to each investor through the price of the stock. And since all stock trades at the same price at any one time, every investor effectively possesses the same supply of information. The price both transmits the information and causes the loss.

Schleicher v. Wendt, ___ F.3d ___, No. 09-2154, 2010 WL 3271904, at ___ (7th Cir. Aug. 20, 2010). Thus, when the fraud-on-the-market theory applies, the plaintiff has indirect knowledge of the misrepresentation or omission underlying the fraud. He is reacting to a change in price, and the change was induced by a misrepresentation, so he receives as it were the distant signal of the misrepresentation and acts in response to it. *Hartmann v. Prudential Ins. Co. of Am.*, 9 F.3d 1207, 1213 (7th Cir. 1993). Accordingly, [w]hen a company's stock trades in a large and

efficient market, the contestable elements of the Rule 10b-5 claim reduce to falsehood, scienter, materiality, and loss. *Schleicher*, 2010 WL 327194, at 1.

In order to rebut the presumption of reliance, defendants must show that in purchasing Household shares, class members did not rely on the integrity of Household's stock price. The *Basic* Court said a defendant could rebut the presumption by making a showing that: (1) "the market makers were privy to the truth . . . , and thus that the market price would not be affected by [defendants'] misrepresentations" (2) the truth had "credibly entered the market and dissipated the effects of the misstatements" or (3) something severed "the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff." *Id.* at 248-49.

At trial, defendants addressed the first two methods when they raised a "truth on the market" defense and attempted to prove that the truth about Household's predatory lending practices and credit quality manipulation was well known. (*See* Trial Tr. at 124:21-23 (testimony by Gary Gilmer, then-Vice Chairman of Consumer Lending and Group Executive of U.S. Consumer Finance, that there was a discussion in the marketplace about Household's use of prepayment penalties) *id.* at 121:20-129:2 (discussing press coverage of Household's use of origination points) *id.* at 128:25-129:3 (A: It is true that the things that we have been discussing were well publicized. Q: No secret. A: None whatsoever.) *id.* at 1287:11-1288:3 (stating that Household never hid the fact that it often placed a second mortgage on top of first mortgages) *id.* at 1292:7-15 (discussing that the market was aware of Household's use of the high loan-to-value (LTV) loan (loan amount that exceeds or nearly exceeds the value of the house that is used as collateral) *id.* at 1308:10 (testifying that the "world knew" that Household loans had prepayment penalties) *id.* at 1385:8-1387:20 (stating that the market was aware that Household utilized incentive compensation methods with its employees) *id.* at

1283:9-17 (discussing analyst report recommending "sell" due to ACORN lawsuit and questioning Household's lending practices)*id.* at 1284-128-21 (stating information about the ACORN lawsuit was "out in the marketplace" and "available to the shareholders")*id.* at 1341:17-1345:7 (testifying that Household's lending practices were criticized routinely in the press)*id.* at 1391:10-1394:15 (stating that there was discussion "in the press and in the marketplace about Household's customer complaints")*id.* at 1403:22-140-3 (testifying that investors knew that Household faced headline risk)*id.* at 1410:5-1412:7 (stating that there was an awareness in the marketplace that Household was facing a "more onerous regulatory environment")*id.* at 1711:4-20, 1713:-10 (discussing that investors knew about the debate in the market on the subject of predatory lending, knew what Household's products were, knew that Household's employees violated Company policy and knew that state and federal regulators "were on to that")*id.* at 2133:1-23 (stating that Household's one-payment reage and automatic reage policies were disclosed to the public in securitization documents)*id.* at 2137:5-18-2152:1-2153:4 (testimony by David Schoenholz, then-President and CEO and Chairman of the Board, stating that Household utilized a "two-pronged disclosure approach" regarding its reaging policies in 2002)*id.* at 2147:13-22, 32-5:22-32-2 (arguing that Household's reage policies were explained to the investment community at the April 9, 2002 Financial Relations Conference)*id.* at 3085:8-15 (testimony by William Aldinger, then-CEO and Chairman of the Board, explaining that "professional investors" and individual investors, in fact "rely on [analyst] reports, such as the Legg Mason report, in making their investment decisions.")*id.* at 3100:12-14 (stating that it was his "understanding that a document filed with the SEC is available to everybody")*id.* at 315-17-3158:9 (testifying that while there was no disclosure in the 2001 Form 10-K of Household's one-payment practice, this practice was disclosed in a

November 12, 1999 securitization prospectus) *id.* at 3158:13-3159:24 (explaining that while Household did not disclose its automatic reage practice in the 2001 Form 10-K, the practice was disclosed in a securitization document filed with the SEC on August 3, 2001) *id.* at 3159:23-24 (stating, "It's hard to conceal anything that you've filed with the SEC. It's a public record after that.") *id.* at 3185:2-3193:21 (discussing the Legg Mason analyst report that analyzed Household's use of high LTV loans and other Household lending practices) *id.* at 3251:24-3254:23 (arguing that Household had been disclosing its re-aging policies for "quite some time") Defs. Trial E (Defs. E) 91 (analyst report discussing Household's growth strategy of writing the largest home equity loan it prudently could write) Defs. E 222 (Salomon Smith Barney analyst report discussing Household's predatory lending-related headline risk) Defs. E 338 (*American Banker* article discussing Household's predatory lending-related headline risk) Defs. E 230 (discussing Goldman Sachs analyst report that defendants claim made the market aware of Household's incentive compensation programs) Defs. E 534 (analyst report discussing lawsuit filed by ACORN) Defs. E 13 (newspaper article discussing ACORN complaints) Defs. E 24 (news article questioning predatory lending) Defs. E 95 at HHT0002335 (stating that "[d]elinquent accounts may be restructured (deemed current) every six months. Accounts are automatically restructured if the customer has made the equivalent of one payment equal to at least 95% of a full standard payment. Once restructured, the account is deemed current—however, the credit limit is zero.") Defs. E 852 at F11IT-15798 (our policies . . . permit reset of the contractual delinquency status of an account to current, subject to certain limits, if a predetermined number of consecutive payments has been received and there is evidence that the reason for the delinquency has been cured.) Defs. E 880 at HHT-1798 (providing that "[t]he master servicer may in its discretion . . . treat a home equity loan as current

if the borrower has made one scheduled payment to cure the delinquency status of the home equity loan).

Throughout the trial, defendants presented evidence that the investors in Household stock were among the most sophisticated in the world and could not have been fooled by the alleged misrepresentations regarding Household's predatory lending and re-aging practices and their impact on its credit quality. Unfortunately for defendants, however, the jury concluded otherwise. The jury found that defendants made material false statements or omissions and caused plaintiffs' economic loss on a class-wide basis, in other words, that the truth did not enter the market and dissipate the effects of defendants' false statements or omissions. Thus, the issues with regard to the first two of the three methods of rebutting the presumption of reliance have been litigated and defendants will not be afforded a second bite at the apple, regardless of how they frame the issue.

As to the third method of rebutting the presumption of reliance, however, Phase II will afford defendants an opportunity to rebut the presumption using the third method set forth in *Basic*, i.e., that the link between the alleged misrepresentations and either the price received or paid by the plaintiff was severed. Plaintiffs argue that it is difficult to imagine a circumstance in which a class member would have purchased Household stock with actual knowledge of defendants' fraud and that there is no basis to believe that any class member did so. The Court agrees. The evidence establishes that defendants did not provide any material nonpublic information to any investors (except Wells Fargo). Thus, there is no evidence that any class member purchased Household stock with actual knowledge that its price had been artificially inflated by defendants' fraud. However, that does not foreclose the remote possibility that some

class member may have purchased Household stock for a reason totally unrelated to its value as reflected by the market price.

Accordingly, the Notice and Preliminary Claim Questionnaire to plaintiffs will require each class member to answer, under the penalty of perjury, the following question:

If you had known at the time of your purchase of Household stock that defendants' false and misleading statements had the effect of inflating the price of Household stock and thereby caused you to pay more for Household stock than you should have paid, would you have still purchased the stock at the inflated price that you paid? YES NO

(Court's Modified Proof of Claim and Release.) This question goes to the heart of the issue of individual reliance.¹ If the answer is "no," it does not matter whether the individual plaintiff purchased or sold any Household share (1) via an options contract, (2) as a day trader, (3) to hedge another tracking strategy, (4) through an automatic dividend reinvestment program or (5) pursuant to a proprietary trading model. However, if the answer is "yes," defendants will have evidence that helps them rebut the presumption of reliance. Defendants may issue additional interrogatories to plaintiffs answering "yes" to obtain convincing proof that price paid no part whatsoever in their decision-making. This protocol sensibly resolves the tension between the rebuttable presumption of reliance and the practicalities and purposes behind Federal Rule of Civil Procedure 23.

There is one exception to this protocol: Wells Fargo. Defendants already have reason to suspect that Wells Fargo, as part of its due diligence investigation of a potential (but

¹ Defendants concede that they have no incentive to waste time and money on examining small shareholders who do not indicate that they would have purchased stock regardless of whether they knew of defendants' false and misleading statements.

unconsummated) merger with Household in 2002, was privy to non-public information regarding Household's pervasive and aggressive write-off, expense deferral and re-aging policies, which ultimately scotched the merger. As to Wells Fargo, the Court will allow discovery as to whether its knowledge of these policies in 2002 severs the link between Household's misrepresentations and either the price received (or paid) by Wells Fargo for Household stock. Defendants will be permitted to proceed with discovery as to Wells Fargo without waiting for Wells Fargo to return its completed questionnaire.

II. Calculating Damages

A. The Netting Approach

Next, the Court addresses threshold damages issues with regard to the calculation of the class members' claims. Although damages cannot be based on pure speculation, they need not be calculated with mathematical precision. *Hoefflerle Truck Sales, Inc. v. Divco-Wayne Corp.*, 523 F.2d 543, 553 (7th Cir. 1975) (see, e.g., *Olympia Equip. Leasing Co. v. W. Union Tel. Co.*, 797 F.2d 370, 383 (7th Cir. 1986) ("Speculation has its place in estimating damages, and doubts should be resolved against the wrongdoer."). The parties agree that the correct measure of damages in a Rule 10b-5 case is out-of-pocket loss. See *Associated Randall Bank v. Griffen, Kubik, Stephens & Thompson, Inc.*, 3 F.3d 208, 214 (7th Cir. 1993) (EARNOLD S. JACOBS, *Out of Pocket Measure of Damages, in DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS* § 20:7 (2010)). Under this measure, damages are defined as the difference between the purchase price and the price that would have been received but for the alleged fraud. *Harris Trust & Sav. Bank v. Ellis*, 810 F.2d 700, 707 (7th Cir. 1987). Defendants argue that recovery should be

limited to actual damages, which would require plaintiffs' out-of-pocket losses to be netted against any of plaintiffs' inflationary gains attributable to defendants' fraud. (Defs. Resp. 8. (arguing that actual damages are calculated by netting inflation-related gains against losses).) Plaintiffs argue that gains made with respect to the sale of shares are irrelevant because their claims are based on losses that resulted solely from purchases (as opposed to sales) of Household shares. (Pls. Post-Merdict Submission 18. *see In re Schering-Plough Corp. Sec. Litig.*, No. 1 ¶ 029, 2003 U.S. Dist. LEXIS 2297, at ¶ 2 (D.N.J. Ct. 9, 2003).

While the Seventh Circuit has yet to address whether out-of-pocket damages are limited to actual damages in Rule 10b-5 cases, the Second, Fifth, Ninth and Tenth Circuits have held that they are and require that plaintiffs' losses be netted against their profits attributable to the same fraud.² *See Byrnes v. Faulkner, Dawkins & Sullivan*, 550 F.2d 1303, 1313-14 (2d Cir. 1977); *Abrahamson v. Gleschner*, 58 F.2d 82, 878-79 (2d Cir. 1977); *Blackie v. Barrack*, 524 F.2d 891, 908-09 (9th Cir. 1975) (holding that if the stock is resold at an inflated price the purchaser's damages should be offset by any profits recovered due to inflation in the stock price attributable to the fraud); *Wolf v. Frank*, 477 F.2d 47, 478-79 (5th Cir. 1973); *Richardson v. MacArthur*, 451 F.2d 35, 43-44 (10th Cir. 1971). Courts in this district have also generally held that damages should be offset by any inflationary gains attributable to the defendant's fraud. *See Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 25 F.R.D. 58, 599 (N.D. Ill. 2009) (netting plaintiffs' losses with gains from inflated stock prices attributable to fraud); *In re Comodisco Sec. Litig.*, 150 F. Supp. 2d 943, 945-4 (N.D. Ill. 2001) (holding the same). This Court agrees that in a Rule 10b-5 action out-of-pocket damages should be limited to actual damages because it is a better measurement of the true economic loss sustained by plaintiffs due to defendants'

² These courts said that conclusion was dictated by the Securities Exchange Act of 1934, which states that "no person . . . shall recover, . . . a total amount in excess of his actual damages on account of the act complained of." 178bb(a) (emphasis added). Rule 10b-5 does not endorse any specific theory or methodology of quantifying economic loss.

fraud. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 339, 345 (2005) (stating that securities laws are not designed to provide investors with insurance against market losses, but to protect them against economic losses that misrepresentations actually cause) *Arekson v. Broadcom Corp.*, No. SA C 02 301GLT, 2004 WL 3253 4, at 2 (C.D. Cal. Dec. 1, 2004) (holding that where a plaintiff engages in multiple purchases and sales during the period in which the stock is inflated, the proper damages methodology is to take all the inflation losses resulting from all purchases at the inflated price and reduce this amount by all the inflation gain resulting from all sales at the inflated price) *see also* Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 1, 51-52 (1985) (basing damages on the net harm that an offender's acts cause should achieve optimal deterrence). Therefore, this Court holds that out-of-pocket damages are limited to actual damages such that plaintiffs' losses must be netted against any of their profits attributable to the same fraud.

The jury has already determined the per share inflation for each day Household's stock was affected by defendants' fraud March 23, 2001 through October 11, 2002 (Damages Period). Accordingly, the measure of each plaintiff's out-of-pocket damages depends on when, and if, he bought and sold shares during the Damages Period. Consistent with the standard set forth above, damages in this case will be as follows: (1) for shares purchased during the Damages Period but not sold, damages will be the amount of artificial inflation at the time of purchase (2) for shares purchased before the class period and sold during the Damages Period at a gain or a loss damages will be plaintiff's out-of-pocket loss less any gain obtained or loss avoided because of artificial inflation at the time of the sale and (3) for shares purchased during the Damages Period, damages will be the artificial inflation at the time of purchase less the artificial inflation at the time of sale.

Further, plaintiffs' damages will be limited by the mathematical formula provided in the 90-Day Rule. The Private Securities Litigation Reform Act of 1995 (PSLRA) 90-Day Rule provides that damages:

[S]hall not exceed the difference between the purchase . . . price paid . . . by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

78u4(e)(1). For purposes of the 90-Day Rule, the "mean trading price" of a security shall be an average of the daily trading price of that security, determined as of the close of the market each day during the 90-day period. 78u4(e)(3).

Here, the 90-day period begins on October 11, 2002, the date the jury found defendants' fraud no longer affected Household's stock. Consistent with the formula set forth above, recoverable damages in this case will be limited by the 90-Day Rule as follows: (1) no limitation for Household shares sold prior to October 11, 2002 (2) for Household shares sold during the 90-Day period from October 11, 2002 through January 8, 2003, damages will be limited to the purchase price per share less the average closing price from October 11, 2002 through the day of the sale and (3) for Household shares retained at the end of January 8, 2003, damages will be limited to the purchase price per share less the 90-day average closing price from October 11, 2002 through January 8, 2003. 78u4(e)(1)(3).

B. FIFO v. LIFO

The parties also disagree as to the appropriate method for matching purchases and sales when a shareholder has engaged in multiple transactions. Here, the parties propose two

opposing theories for matching transactions: the first-in first-out (FIFO) method and the last-in first-out (LIFO) method. Each method, however, clearly favors one party over the other. The LIFO method favors the defendants by taking into consideration gains that might have accrued to plaintiffs during the class period. *See In re eSpeed, Inc. Sec. Litig.*, 232 F.R.D. 95, 101-02 (S.D.N.Y. 2005) (explaining that LIFO leads to lower damages by offsetting gains). Under LIFO, sales of the defendant's stock during the class period are matched against the last shares purchased. *Id.* at 102. Because both the purchase and sale occurred during the class period, it is likely that both transactions were affected by the fraud. *See id.* Thus, any gains that might have accrued to plaintiffs through the sale of stock during the class period because of fraud related inflation in the stock price are offset from plaintiff's total losses during the class period, thereby lowering plaintiff's total damages. *Id.*

The FIFO method, however, often gives plaintiffs a windfall by not taking into consideration gains they obtained from sales of stock during the class period at a price that was inflated by fraud. *In re Schering-Plough.*, 2003 U.S. Dist. LEXIS 20297, at 20 Under FIFO, plaintiff's sales are matched first against the earliest purchases of stock, often matching sales during a class period with stock purchased prior to the class period. *Hodges v. Akeena Solar, Inc.*, 203 F.R.D. 528, 532 (N.D. Cal. 2009). Because some of the sales are matched with pre-class period stock, courts applying FIFO exclude such transactions from the damage calculations (including any gains from such transactions), thus usually resulting in a higher damages for the plaintiffs.³ *Johnson v. Dana Corp. et al.*, No. 3:05 CV 7388, 2006 WL 78274, at 13 (N.D.

³ Courts that find deterrence to be the primary objective of Rule 10b-5 tend to use FIFO because it creates higher damage awards, while courts emphasizing compensation as the primary objective tend to use LIFO. *Compare Kane v. Shearson Loeb Rohades, Inc.*, No. 80551-CI, 1989 U.S. Dist. LEXIS 19022, at 15, 23 (S.D. Fla. May 3, 1989), with *S.E.C. v. Bear, Stearns & Co., Inc.*, No. 03 Civ. 2937, 2005 WL 217018, at 7 (S.D.N.Y. Jan. 31, 2005). This Court attempts to apply a solution that reasonably and fairly accomplishes both objectives.

Ohio May 24, 2008) (explaining that FIFO does not provide for netting of inflation-related gains). Consequently, the major reason (if not the only reason) why numerous courts have held that LIFO is the appropriate method for matching transactions in securities fraud cases is because it takes into account inflation related gains due to the fraud, and therefore, is a more accurate reflection of plaintiff's damages. See *In re eSpeed*, 232 F.R.D. at 102. If, however, as this Court provides, plaintiff's gains attributable to defendant's fraud are netted from the plaintiff's total loss, then such gains are taken into consideration and utilizing FIFO as a method of matching does not produce a windfall to the plaintiffs. See RAMUND WONG, NERA ECON. CONSULTING, PURCHASE-~~S~~SALE MATCHING IN SECURITIES LITIGATION: FIFO, LIFO, AND OFFSETS 9, 17, 22-23 (2008) (noting that many court decisions reveal that losses claimed by plaintiffs in securities class action cases should be offset by gains related to the alleged fraud regardless of whether FIFO or LIFO is used to avoid a windfall to plaintiff, even if these gains were from sales of securities purchased prior to the class period), available at <http://www.nera.com/image/PURCHASE-Sale-Matching-Wong1008.pdf>.

Further, FIFO has historically been the accounting method of choice for governmental institutions. For instance, FIFO has been used by courts and the Internal Revenue Service (IRS) to determine losses and gains for tax purposes. Treas. Reg. 1.1012-1(c) see *Holmes v. Comm'r of Internal Revenue*, 134 F.2d 219, 221 (3d Cir. 1943) ("FIFO is so old and well known . . . it is incorporated in [the tax code]. It is sufficient to say that it establishes a presumption to be followed.") *Thompson v. Shaw Group, Inc.*, No. 04-185, 2004 IS. Dist. Leis 2541, at 14 n.5 (E.D. La. Dec. 15, 2004) ("Many federal appeal courts and commentators regard FIFO, which the IRS consistently uses, as a firmly established

methodology for calculating loss for tax purposes in the context of securities investments. FIFO also has been the preferred method of calculating losses by the IRS where shares of stock cannot be identified with any particular lots purchased. *Helvering v. Campbell*, 313 U.S. 15, 20-21 (1941). Further, because of the convergence between Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards ("IFRS"), which do not permit the use of LIFO as an inventory method, LIFO will likely become obsolete for both financial reporting and tax purposes in the near future.⁴ FIFO has been established as a reasonable measure for computing losses or gains from stock purchases or sales in the past, and as such this Court holds that FIFO is the appropriate method for matching purchases and sales given the tax laws and recent developments in the accounting world.

In sum, by utilizing netting this Court has avoided applying FIFO in a way that will result in a windfall to the plaintiffs. Therefore, this Court holds that the fair and reasonable method for calculating damages in this class action is to apply FIFO for the method of matching purchases and sales while netting plaintiffs' losses against any profits attributable to defendants' fraud.

Conclusion

⁴ Although GAAP is currently authoritative in the United States, IFRS has been developing a set of accounting standards that are becoming the global standard. *IFRS Resources*, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, www.ifrs.com/updates/FAS%20IAS%20Projects.html (last visited Oct. 21, 2010). These standards do not permit the use of LIFO as an inventory method. IAS International Accounting Standard 2.25. The SEC, backed by the American Institute of Certified Public Accountants ("AICPA") and others, have agreed to a series of steps that could require the use of IFRS by publicly traded companies in the United States by 2014. Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers, 73 Fed. Reg. 70,811-70,825 (proposed Nov. 21, 2008) (to be codified at 17 C.F.R. pts. 210, 229, 230, 240, 244 & 249).

As outlined herein, the Court has addressed the parties' arguments regarding the protocol for Phase II and determined the appropriate method of calculating damages with respect to each class member's claims. The Court approves lead plaintiff's proof of claim form and release as modified by the Court's rulings herein. Plaintiffs shall prepare and file a final version that includes the proposed schedule for mailing the form and release to the class as well as the deadline for responses thereto prior to the status hearing of January 5, 2011.

SO ORDERED.

ENTERED: November 22, 2010

A handwritten signature in black ink, reading "Ronald A. Guzman". The signature is written in a cursive style. Below the signature is a horizontal line of small, empty rectangular boxes, likely a placeholder for a stamp or a signature verification code.

HON. RONALD A. GUZMAN

United States District Judge

**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,**)

Plaintiffs,)

v.)

Household International, Inc., et al.,)

Defendants.)

No. 02 C 5893

Hon. Ronald A. Guzmán

Order

Plaintiffs move the Court for a protective order pursuant to Federal Rule of Civil Procedure 2(c)(1)(D). Plaintiffs seek an order limiting defendants' discovery demands to: (1) interrogatories and document requests that address whether institutional class members had any material non-public information or otherwise knew of the fraud and still purchased Household stock; (2) only allowing depositions of, and discovery of trading strategies or models from, the institutional class members who indicate in their responses to interrogatories and document requests that they had material non-public information or otherwise knew of the fraud and still purchased Household stock knowing the price was inflated; (3) prohibiting defendants from seeking discovery regarding reliance issues such as the truth on the market defense already rejected by the jury; (4) prohibiting any discovery regarding any firewall policy separating analysts and investment decisions; and (5) limiting the relevant period for discovery to March 22, 2001 through October 11, 2002. Plaintiffs also seek similar restrictions regarding deposition questions.

The motion is prompted by defendants' rather expansive discovery requests. It appears that defendants have served 98 class members and all 3 named plaintiffs with identical Rule 30(b)(1) deposition notices, requests for production of documents and interrogatories.

The issue presented is not new to this case. It was a topic of discussion at the March 2009 pretrial conference. As the Court put it then:

The problem, of course, is that if a class action is going to mean anything, it's going to mean that we don't have to bring before the court every single investor in this case on any issue including the issue of reliance. On the other hand, a claim of a constitutional right to challenge the presumption of reliance to a jury if taken to its logical extreme, would require giving the defendant the right to bring in every single investor, which would, of course, destroy the entire concept of a class action. So how we balance those concerns is a question.

(3/12/09 Hr'g Tr. 34.) Defendants' discovery requests and plaintiffs' motion for a protective order now require the court to resolve this issue.

Discovery, of course, is not without limits. Federal rule of Civil Procedure 26(c) allows the court to limit discovery to protect the parties or persons from, among other things, undue burden or expense. Moreover, discovery from non-named class members is not warranted as a matter of course. In allowing some such discovery, the Seventh Circuit stated:

If discovery from the absent member is necessary or helpful to the proper presentation and correct adjudication of the principal suit, we see no reason why it should not be allowed so long as adequate precautionary measures are taken to insure that the absent member is not misled or confused. While absent class members should not be required to submit to discovery as a matter of course, if the trial judge determines that justice to all parties requires that absent parties furnish certain information, we believe that he has the power to authorize the use of the Rules 33 and 34 discovery procedures.

Brennan v. Midwestern United Life Ins. Co., 450 F.2d 999, 1005 (7th Cir. 1971) (see *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 810 n.2 (1985) (stating that generally, "an absent class action plaintiff is not required to do anything") (Clark v. Universal Builders, 501 F.2d 324, 340-41 (7th Cir. 1974). Indeed, one of the principal advantages of class actions over massive joinder or consolidation would be lost if all class members were routinely subject to discovery. Manual for Complex Litigation, Fourth, ¶21.41.

Plaintiffs object to the interrogatories, requests to produce and deposition notices because, in their view, the proposed discovery items seek information meant to relitigate the truth on the market defense and/or information that is neither relevant nor likely to lead to admissible evidence. For example, Interrogatory 3 states: "Identify all Documents that you reviewed or relied upon in making any decision to engage in any Transaction with respect to Household Securities." Plaintiffs responded:

Objectionable to the extent it calls for publicly available information. Defendants litigated truth on the market at trial and should not be given a second bite at the apple. Further, class members should not have to respond further, if they answer "no" to the claim form type question. A response to this Interrogatory should be deferred until a class member answers "yes" to the claim form type question.

Because the jury has already determined that the publicly available information was insufficient to dissipate the effect of defendants' fraudulent statements, *i.e.*, rejected the truth on the market defense, it is highly unlikely that this inquiry will lead to evidence of class members who chose to purchase knowing that the price of the stock was fraudulently inflated. Moreover, responding to defendants' many detailed interrogatories and production requests about hundreds or thousands of individual transactions that took place nearly a decade ago would impose an unacceptably onerous burden on unnamed class members. As a result, it is very likely that having to respond to the requests will discourage eligible unnamed class members from making claims. This issue is more directly and simply addressed by the question each party claiming damages will have to answer under oath in

responding to the class notice/claims form.¹ The answers to that question will allow defendants to determine whether there are any purchasers to whom the presumption of reliance does not apply without imposing a high burden on unnamed class members or discouraging eligible members from making claims.

Because the truth on the market defense has already been fully litigated and rejected, the likelihood that any individual purchaser concluded from his or her knowledge of publicly available information that the price of the stock was fraudulently inflated is small. The same is not true, however, for decisions based upon nonpublicly available information. Requests for disclosure of any nonpublicly available information relied upon by individual purchasers would be more likely to uncover admissible evidence and would not pose as great a burden on the respondents. If the interrogatories and requests to produce are limited to this issue, are phrased in such a manner as to go directly to the issue and do not impose an unnecessary burden on the unnamed class members, the Court will allow them.

Requests that are improperly tailored, however, will be prohibited. For example, a request to produce all documents relating to any information regarding pricing or market analyses considered in each of hundreds of transactions, would be unnecessarily burdensome. The same is true for discovery requests relating to trading strategies utilized during the damages period. If still available, such information would not likely require inquiry into thousands of individual transactions while still allowing defendants to identify the existence of a consideration that might be reasonably likely to lead to admissible evidence of nonreliance.

Plaintiffs contend that defendants' burdensome discovery requests are intended to harass class members and deter them from filing claims. (Mem. Law Supp. Pls. Mot. Protective Order 2.) Plaintiffs' argument is a common one in discovery disputes, although it is more often the defendants complaining of plaintiffs' unnecessary requests. And indeed, one of the considerations articulated by the *Brennan* Court in allowing discovery was that it found nothing in the record to suggest that the discovery procedures were being used as a tactic to take undue advantage of the class members or as a stratagem to reduce the number of claimants. But the Court need not reach the conclusion as to defendants' intention that plaintiffs urge. It is sufficient that in this case the request for a protective order is supported, in addition to the reasons given above, by defendants' own prior representations to this Court. As far back as the pretrial conference of March 12, 2009, Ms. Patricia Farren, counsel for the defendants, while discussing the desirable parameters of the second phase of the proceedings, informed the Court that it was not defendants' intention to "drag in every pension fund in the country" to be deposed. In fact, she pointed out:

[I]f we deposed 10 entities . . . we would capture information on 50% of the stock ownership of this Company. . . . [T]he institutional investors who owned the lions

¹Part III of the claim form requires each claimant to answer the following question: "If you had known at the time of your purchase of Household stock that defendants' false and misleading statements had the effect of inflating the price of Household stock and thereby caused you to pay more for Household stock than you should have paid, would you still have purchased the stock at the inflated price that you paid?"

share of Household stock were big major sophisticated banks and other funds We could capture information about 50% of stock ownership by deposing only 10 of them. We could capture 10% by deposing only 15 of them. It may be that one or two sample depositions will tell us what we need to know and whether this is a worthwhile defense or not.

(3/12/09 Hr'g Tr. 27.) Ms. Farren repeated this assertion a few minutes later: "[A]s I said, Your Honor, we could encompass 10% of the ownership by looking at only 15 large institutional investors." (*Id.* 32.) Finally, Ms. Farren drove the point home one more time, virtually telling the Court just what defendants needed to do in discovery in order to prepare to rebut the presumption of reliance:

"But we don't have any intention, your honor, of dragging every small investor in here. We need to know what the 15 big institutional investors did, whether or not they can prove reliance on an individual basis, whether we can or I should put it correctly. Whether we can rebut the rebuttable presumption of reliance as to them by simply finding out the facts that were denied during fact discovery.

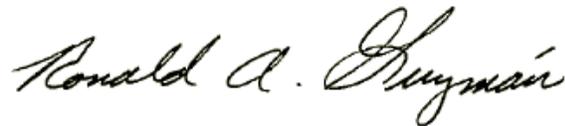
(*Id.* 33) (emphasis added).

It could not be clearer from these statements that defendants, after careful consideration and investigation, determined that the depositions of 10 to 15 large institutional investors would be sufficient to prepare to rebut the presumption of reliance. And, it was with this premise in mind, that the Court, in response to defendants' requests to reconsider, allowed them to move ahead with discovery even before any responses to the reliance interrogatory were returned. With good reason, the Court fully expected that defendants would proceed to prepare to depose 10, or at most 15, of the large institutional investors. Yet now, these same defendants tell us that they never committed to any such limited number of depositions, but actually require the deposition of nearly 100 investors.² The difference is, to say the least, substantial. Yet, defendants do not explain how or why 15 became 98.

The Court finds the defendants' first representations to be reasonable. Therefore, defendants will be allowed a maximum of 15 depositions prior to the return of the claim forms.

SO ORDERED

ENTER: January 31, 2011



RONALD A. GUZMAN
U.S. District Judge

²Whether defendants committed to a certain number of depositions is irrelevant. The point is they told the Court that 10 to 15 depositions are what they needed and even stated the reasons for this determination.

EXHIBIT A

**Affidavit of
Bradford Cornell
October 13, 2011**

Affidavit of Bradford Cornell

I. Qualifications

- (1) I am currently a visiting Professor of Finance at the California Institute of Technology. Previously, I was a Professor of Finance and Director of the Bank of America Research Center at the Anderson Graduate School of Management at the University of California, Los Angeles (“UCLA”) for 26 years.
- (2) I earned a master’s degree in Statistics from Stanford University in 1974 and earned my doctorate in Financial Economics from Stanford in 1975. I have served as an editor of numerous journals relating to business and finance and have written approximately 100 articles and two books on finance and securities, including *Corporate Valuation: Tools For Effective Appraisal and Decision Making* (1993), published by McGraw-Hill, and *The Equity Risk Premium and the Long-Run Future of the Stock Market* (1999), published by John Wiley and Sons. To complement my academic writing, I have also authored articles for *The Wall Street Journal* and the *Los Angeles Times*.
- (3) My research has been widely recognized. In 1988, I was cited by the Financial Management Association as one of the ten most prolific authors in the field of finance. I have received prizes and grants for my research from the Chicago Board of Trade, the Chicago Mercantile Exchange and the Institute for Quantitative Research in Finance. My article, “Corporate Stakeholders and Corporate Finance,”¹ received the 1987 Distinguished Applied Research Award from the Financial Management Association. In 1999, I was awarded the I/B/E/S prize for empirical work in finance and accounting (with Wayne Landsman and Jennifer Conrad). Richard Roll and I received a Graham and Dodd Scroll Award from the Financial Analyst Society for our work on delegated agent

¹ Journal of Portfolio Management, 35, (2009).

Affidavit of Bradford Cornell

asset pricing theory. I won another Graham and Dodd Scroll Award in 2011 for my work on economic growth and equity investing. Recently, my paper entitled, "Luck, Skill, and Investment Performance" won an Outstanding Article prize from the 11th Annual Bernstein, Fabozzi/Jacobs, Levy Awards in *The Journal of Portfolio Management*.

- (4) I have also been active in my profession. I have served as a Vice President of the Western Finance Association. I am also a past director of both the American Finance Association and the Western Finance Association. I have served as an associate editor of numerous professional journals including: *The Journal of Finance*, *The Journal of Futures Markets*, *The Journal of Financial Research* and *The Journal of International Business Studies*. I have served as a reviewer for nearly a dozen other professional journals.
- (5) My teaching and writing have focused on a number of different financial and economic issues, many of which are relevant to the subject matter of this declaration. I currently teach Applied Corporate Finance and Investment Banking at Caltech. Examples of other classes I have taught over the course of my academic career include Corporate Valuation, the Law and Finance of Corporate Acquisitions and Restructurings, Corporate Financial Theory, and Security Valuation and Investments. I have drawn upon this experience in formulating my opinions in this case.
- (6) In addition to my teaching, writing, and research studies, I also serve as senior consultant to CRA International ("CRA"), an international consulting firm. In my position as a senior consultant, I advise business and legal clients on financial economic issues. Prior to my affiliation with CRA, which began in March of 1999, I operated FinEcon, a financial economic consulting company, through which I also advised business and legal clients on financial economic issues.

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- (7) I have served as a consultant and given testimony for both plaintiffs and defendants in a variety of securities, regulatory and commercial lawsuits. During my many years of experience as an expert witness and consultant, I have provided economic analyses and expert testimony (again, for both plaintiffs and defendants) related to valuation, corporate finance and damages issues. I have been engaged as a damages expert in numerous high-profile cases that revolved around complex financial and securities transactions.
- (8) My background is described more fully in my curriculum vitae, which is attached as Exhibit I to this affidavit. A list of my publications may also be found as part of Exhibit 1.
- (9) My hourly rate in this matter is \$800.

II. Materials Reviewed

- (10) In preparing my opinions in this matter I have reviewed the following documents related to the *Jaffe v. Household* litigation:
 - a. Professor Fischel's expert report dated August 15, 2007.
 - b. Professor Fischel's rebuttal report dated February 1, 2008.
 - c. Professor Fischel's deposition testimony dated March 21, 2008.
 - d. Professor Fischel's trial testimony (direct and rebuttal).
 - e. The jury verdict and Plaintiffs' Exhibits 1395 and 1397 referenced in the verdict form.

III. Opinions

- (11) For purposes of this affidavit, I have been requested by Counsel to accept as correct the "Leakage Model" as presented by Professor Fischel in this case and to address that

Affidavit of Bradford Cornell

model, the jury verdict rendered in the Phase I proceedings, and the economic and finance principles applicable to the issue of the rebuttal of the presumption of reliance where, as here, the “fraud on the market” presumption of reliance set forth in *Basic Inc. v. Levinson*,² has been applied.

- (12) As explained in his expert report,³ Professor Fischel expressly based his “Leakage Model” on a paper which I co-authored entitled: “Using Finance Theory to Measure Damages in Fraud on the Market Cases.”⁴ My paper is the only article cited by Professor Fischel as the basis for his “Leakage Model” in his expert report dated August 15, 2007.
- (13) In the paper on which Professor Fischel based his “Leakage Model” I discuss the economic and finance principles that are directly applicable to rebutting the “fraud on the market” presumption of reliance established in *Basic*. Section III (B) of my paper is entitled “Rebutting the Presumption of Reliance,” and specifically addresses the application of the efficient market hypothesis as a tool to determine whether the *Basic* presumption has been rebutted as to alleged misrepresentations. As set forth in my paper, a necessary corollary of the “fraud on the market” presumption is that where it is shown that an alleged misrepresentation did not independently result in an additional amount of artificial inflation in the stock price, the market did not rely upon the alleged misrepresentation and the *Basic* presumption is rebutted.
- (14) The economic and finance principles set forth in my paper, upon which Professor Fischel relied in developing his “Leakage Model,” involve the determination of a “true value line” representing an “equivalent disclosure price.” The paper outlines a methodology for determining this “true value line” based upon stock price movements during an

² 485 U.S. 224 (1988).

³ Fischel Expert Report dated 08/15/07, pp. 23-24, paragraph 38.

⁴ UCLA Law Review, Vol. 37, No. 2, 1990, pp. 883–924.

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“observation window” in which price reaction is measured. A “Constructed Return” model is then built, and a “true value line” is calculated using the formula: $\text{Value}(t-1) = \text{Value}(t)/(1 + \text{Constructed Return}(t-1))$.⁵ The inflationary price impact associated with an alleged misrepresentation is then determined by the difference between the “true value line” and the actual stock price and the changes in that differential across alleged misrepresentations.

- (15) As set forth in his Expert Report, Professor Fischel specifically relied upon the model set forth in my paper to prepare his “Leakage Model.”⁶ First, Professor Fischel selected an “observation window” consisting of the period from November 15, 2001 to October 11, 2002 (“Because I found that fraud-related information leaked out beginning no later than November 15, 2001, the observation window begins on this date; it ends on October 11, 2002, the last day of the Class Period.”). Second, Professor Fischel used “the actual returns and predicted returns to construct a time series of daily stock price returns (‘Constructed Returns’) during the Class Period.” Third, Professor Fischel calculated the “true value line” using the formula: “ $\text{Value}(t-1) = (\text{Value}(t) + \text{Dividend}(t))/(1 + \text{Constructed Return}(t))$.” Applying this model, Professor Fischel “computed daily artificial inflation as the difference between the Company’s stock price and the true value line” and “[i]f the resulting inflation on any day was greater than the cumulative residual price decline during the observation window of \$23.94” the inflation was limited to a maximum “artificial inflation” of \$23.94. Professor Fischel stated that in following these steps he was “using the ‘event study approach’ described by Cornell and Morgan.”
- (16) I previously prepared an affidavit identifying certain problems associated with Professor Fischel’s application of the model set forth in my paper: namely, that (a) Professor

⁵ UCLA Law Review, Vol. 37, No. 2, 1990, pp. 897-900.

⁶ Fischel Expert Report dated 08/15/07, pp. 23-26, paragraphs 38-41.

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Fischel's methodology did not adequately address the impact of non-fraudulent company specific information during the observation window in an appropriate manner, and (b) the long observation window used by Professor Fischel created a compounding effect that produces significant errors in measured inflation (Affidavit of Bradford Cornell dated 10/30/08, attached as Exhibit 2). As noted above, however, for present purposes I am not offering specific criticisms of Professor Fischel's "Leakage Model" as it was developed and presented by him. Rather, I am taking Professor Fischel's "Leakage Model" as a given and simply addressing the consequences of the jury verdict by applying Professor Fischel's "Leakage Model" as presented.

- (17) It is my understanding that the jury was asked, in part, to determine (a) which of the 40 alleged statements was a false and misleading statement or omission of material fact under the court's instructions; (b) as to which of the three "issues" that plaintiffs alleged to be a basis of the fraud the statement was a false and misleading statement or omission of fact (the following three "issues" were alleged to be the basis of the fraud by plaintiffs and were addressed by Professor Fischel in his model: (i) "Predatory Lending," (ii) "Re-aging," and (iii) "Restatement"); and (c) selecting one of Professor Fischel's models, the "measure of inflation," defined as "the difference between the price plaintiffs paid for each share of Household stock and the price each share would have cost if no false or misleading statement or omission of material fact occurred."
- (18) The jury determined that the first false and misleading statement or omission of material fact occurred on March 23, 2001 as a result of what was identified in the jury verdict form as "Statement 14." The jury specified that "Statement 14" was a false and misleading statement or omission of material fact only with respect to the issue of "Predatory Lending." After selecting the "Leakage Model" presented by Professor

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Fischel, the jury assigned an amount of “artificial inflation” of \$23.94 to Statement 14. I have been advised by counsel that based upon the jury instructions and the jury verdict form, the jury determined that Statement 14 was a false and misleading statement or omission of material fact solely with respect to “Predatory Lending” and that the jury assigned “artificial inflation” of \$23.94 to this alleged false and misleading statement or omission of material fact on the issue of “Predatory Lending” only.

- (19) I have examined the jury verdict with respect to the amounts of “artificial inflation” assigned by the jury in the verdict form pursuant to Professor Fischel’s “Leakage Model.” For the period prior to Professor Fischel’s “observation window,” the jury found 7 additional statements to be misrepresentations. The jury assigned the same maximum “artificial inflation” amount of \$23.94 to each of these statements during this period. As a matter of straightforward economic and finance theory, this finding means that the jury found that there was no incremental independent inflationary price impact with respect to any of those statements. Rather, the \$23.94 of artificial inflation attributed to the Statement 14 “Predatory Lending” misrepresentation had been maintained on dates of each of the 7 statements.
- (20) With respect to the “observation window” period under Professor Fischel’s “Leakage Model,” the jury found an additional 9 statements to be misrepresentations. During this “observation window” the amount of “artificial inflation” generally decreased throughout the period. On only two of the dates for which the jury found a misrepresentation were there increases in the amount of “artificial inflation”: An increase from \$22.59 on December 3, 2001 to \$23.94 on December 4, 2001, and an increase from \$23.65 on April 16, 2002 to \$23.94 on April 17, 2002. The increase in inflation on April 17, 2002 was

Affidavit of Bradford Cornell

not statistically significant, as Professor Fischel acknowledged.⁷ The increase in “artificial inflation” on December 4, 2001, which corresponds to Statement No. 23 on the Verdict Form, is a statement determined by the jury to be a false and misleading statement or omission of material fact with respect to only the “Re-aging” issue.⁸ The jury verdict and Professor Fischel’s “Leakage Model” establish that the \$1.35 incremental increase in “artificial inflation” attributable to this statement fully dissipated by December 11, 2001 (at which time the amount of “artificial inflation” had declined to \$22.20). Professor Fischel acknowledged in his testimony that the increased “artificial inflation” associated with the December 4, 2001 Statement was statistically significant⁹, but also that it was eliminated by December 11, 2001, and thus only investors who purchased between December 4 and December 11, 2001 would have suffered any harm attributable to the December 4, 2001 misrepresentation.¹⁰

- (21) As set forth in my paper, and as a settled principle of economic and finance theory, if the difference between the “true value line” and the actual stock price does not increase (*i.e.*, the amount of “artificial inflation” does not increase) by a statistically significant amount as a consequence of an alleged misrepresentation, then the market did not rely upon the alleged misrepresentation and the “fraud on the market” presumption has been rebutted.¹¹
- (22) The jury verdict thus establishes the following: (1) No misrepresentation identified by the jury to be attributable to the issue of the “Restatement” resulted in any increase in “artificial inflation,” and (2) With respect to the issue of “Re-aging,” only the December

⁷ Fischel Trial Transcript at 2909: 16–19.

⁸ Jury Verdict Form, page 23.

⁹ Fischel Trial Transcript at 2878:5–7; 14–18.

¹⁰ Fischel Trial Transcript at 2883:18–2885:3.

¹¹ UCLA Law Review, Vol. 37, No. 2, 1990, pp. 917-923.

Affidavit of Bradford Cornell

4, 2001 misrepresentation resulted in a statistically significant increase in “artificial inflation,” and that increase of \$1.35 fully dissipated by December 11, 2001.

- (23) The verdict thus establishes that the “fraud on the market” presumption of reliance has been rebutted, based upon an absence of inflationary price impact, for all alleged misrepresentations on the issue of the “Restatement” and for all alleged misrepresentations with respect to the issue of “Re-aging,” except for the \$1.35 amount of inflationary price impact attributable to December 4, 2001 statement and only for the period between December 4, 2001 and December 11, 2001.
- (24) This verdict result also has significant consequences with respect to the question of market reliance regarding Statement 14, the March 23, 2001 statement for which the jury assigned the full, maximum amount of “artificial inflation” of \$23.94 under Professor Fischel’s “Leakage Model.” In discussing the underlying principles of economics and finance in my paper upon which Professor Fischel based his model, I and my co-author noted a critical feature and limitation of the “Leakage Model” approach: “Finance theory does make clear, however, that when there are interrelated frauds, separate value lines cannot be constructed. . . . Instead, the total damage must be estimated using one value calculated backwards from the time at which all elements of the fraud have been effectively disclosed.”¹² That is, when, as here, it has been alleged that a securities fraud involved multiple “issues,” the “Leakage Model” cannot be used to determine the amount of “artificial inflation” attributable to just one of those “issues” (“separate value lines cannot be constructed”). Instead, the “Leakage Model” develops a “true value line” that necessarily reflects misrepresentations as to all components of the alleged fraud. This is a well-established principle of finance and economics. In fact, Professor Fischel’s

¹² UCLA Law Review, Vol. 37, No. 2, 1990, pp. 908.

Affidavit of Bradford Cornell

“Leakage Model” assumes a single “true value line” based upon all three alleged fraudulent “issues” without distinction. Moreover, Professor Fischel has never stated, and could never state in a manner consistent with economic and finance theory, that his “Leakage Model” provides a means to determine the inflationary price impact associated with any one individual issue among the three fraudulent issues alleged by Plaintiffs.

- (25) Professor Fischel did present an alternative model in his expert report under which inflation could be estimated for each of the three fraud allegations. This is the “Quantification using Specific Disclosures Model” discussed on pages 20-23 of Professor Fischel’s report. The inflation estimates calculated using the “Specific Disclosures Model” assign non-zero inflation to each of the three fraud allegations. For example, on 12/11/01 Legg Mason published an analyst report critical of Household’s re-aging policies and the artificial inflation as estimated by the “Specific Disclosures Model” declined from \$6.05 to \$3.66 thereby assigning at least \$2.39 of artificial inflation to the “Re-aging” fraud issue.¹³ On 11/14/01 Household was sued for alleged predatory lending practices and the artificial inflation declined from \$7.97 to \$6.11 thereby assigning at least \$1.86 of inflation to the “Predatory Lending” fraud issue.¹⁴ On 8/14/02 Household announced that it was restating its prior reported financial results downwards and the artificial inflation declined from \$2.16 to \$0.32 thereby assigning inflation of at least \$1.84 to the “Restatement” fraud issue.¹⁵
- (26) Professor Fischel also states that his two inflation models, the “Leakage Model” and the “Specific Disclosures Model” are internally consistent. He explains this point in detail in his rebuttal report in footnote 6, concluding that, “... my quantifications of artificial

¹³ Fischel Trial Transcript at 2640-41.

¹⁴ Fischel Trial Transcript at 2629-31.

¹⁵ Fischel Trial Transcript at 2643-44.

Affidavit of Bradford Cornell

inflation are consistent...”¹⁶ It follows from Professor Fischel’s analysis and explanation that, while the “Leakage Model” does not disaggregate inflation into components related to each of the three fraud allegations, the numerical values of each of these three individual inflation components in the “Leakage Model” calculation must be non-zero. That is, although the “Leakage Model” does not provide a means to disaggregate the specific amount of inflationary price impact attributable to each of the three fraud “issues,” the total inflationary price impact of \$23.94 determined by Professor Fischel in his “Leakage Model” must be the result of some positive amount of inflationary price impact contributed by each of the three “issues.”

- (27) This raises a fundamental problem based on the jury verdict with respect to Statement 14. The jury determined that Statement 14 was a misrepresentation only with respect to the issue of “Predatory Lending,” but it assigned the full “artificial inflation” of \$23.94 to that statement and therefore implicitly assigned an artificial inflation of \$0 to “Re-aging” and “Restatement” fraud allegations. This is squarely inconsistent with the fact that each of the three individual inflation components must be non-zero according to Professor Fischel’s expert report as discussed above. At no time did Professor Fischel attempt to disaggregate within his “Leakage Model” the amount of “artificial inflation” attributable to the each of the three fraudulent issues, nor is the “Leakage Model” designed to do so. However, there is no valid basis under Professor Fischel’s model by which the full \$23.94 inflationary price impact can be assigned to the March 23, 2001 statement or the single issue of “Predatory Lending.”
- (28) As set forth above, the “Leakage Model” presented by Professor Fischel did not, and cannot be used to, determine the specific inflationary price impact associated with either

¹⁶ Fischel Rebuttal Report dated 02/01/08, pp. 4-5, footnote 6.

Affidavit of Bradford Cornell

Statement 14 or the single issue of “Predatory Lending.” Accordingly, although it can definitively be stated that the entire amount of \$23.94 cannot be assigned to the March 23, 2001 statement or the single issue of “Predatory Lending,” there is no valid basis under the jury verdict, and the jury’s selection and application of Professor Fischel’s “Leakage Model,” to determine the actual inflationary price impact attributable to Statement 14 or the single issue of “Predatory Lending”.

- (29) It should be noted that, in certain cases, it may be possible to disaggregate total inflation into different components of a “multi-issue” fraud, but one would have to abandon the “Leakage Model” to do so. As discussed earlier, the “Specific Disclosures Model” developed by Professor Fischel, but rejected by the jury, could potentially have been used as a means to allocate the amount of inflation attributable to separate “issues” in a multi-issue fraud. It is noteworthy that, although Professor Fischel did not undertake such an analysis, a review of the specific, statistically significant disclosures identified by Professor Fischel which he testified relate solely to the issue of “Predatory Lending” account for less than 40% of the aggregate amount of \$7.97 of inflationary price impact he identified under his “Specific Disclosures Model.” This serves to further demonstrate that there is no valid basis under Professor Fischel’s “Leakage Model,” or under economic and finance theory, to assign the entire amount of \$23.94 of inflationary price impact to Statement 14 or the single issue of “Predatory Lending”.
- (30) Accordingly, the jury’s assignment of an inflationary price impact of \$23.94 to the March 23, 2001 statement, is squarely inconsistent with Professor Fischel’s own “Leakage Model” and contrary to the established principles of finance and economics that underlay the use of such a model. There is no valid basis under settled principles of economics and finance to determine, based on the jury verdict and its application of Professor

Affidavit of Bradford Cornell

Fischel's "Leakage Model", the proper inflationary price impact attributable to the March 23, 2001 Statement.



Bradford Cornell

October 13, 2011

STATE OF CALIFORNIA)

)

COUNTY OF LOS ANGELES)

Subscribed and sworn to me on this 13th day of October, 2011, by

BRADFORD CORNELL, proved to me on the basis of

satisfactory evidence to be the person who appeared before me.

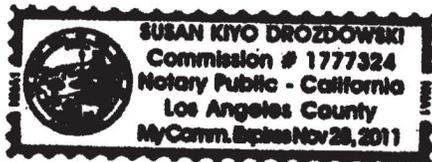




Exhibit 1

Bradford Cornell
Senior Consultant

PhD Financial Economics
Stanford University

MS Statistics
Stanford University

AB (Interdepartmental)
Physics, Philosophy,
and Psychology
Stanford University

Academic and professional positions

1999–Present	<i>Senior Consultant, CRA</i>
2005–Present	<i>Visiting Professor of Financial Economics, California Institute of Technology</i>
1987–2005	<i>Professor of Finance and Director of the Bank of America Research Center, Anderson Graduate School of Management, UCLA</i>
1990–1999	<i>President, FinEcon: Financial Economic Consulting</i>
1988–1990	<i>Vice-President and Director of the Securities Litigation Group, Economic Analysis Corporation</i>
1979–1986	<i>Assistant and Associate Professor of Finance, UCLA</i>
1983–1984	<i>Visiting Professor of Finance, California Institute of Technology</i>
1977–1979	<i>Assistant Professor of Finance, University of Southern California</i>
1975–1977	<i>Assistant Professor of Finance, University of Arizona</i>

Courses taught

- Applied Corporate Finance and Investment Banking
- Corporate Valuation
- The Law and Finance of Corporate Acquisitions and Restructurings
- Corporate Financial Theory
- The Theory of Finance (in the UCLA Law School)
- Security Valuation and Investments
- A wide variety of executive and community education programs

Special education programs include

- The US Business School in Prague—Special Finance Program, Summer 1991
- The Lead Program for Business Education of Minority High School Students, 1987–1997

Consulting and professional activities

Selected service at UCLA

- Twice Chairman of Finance Department
- Twice Vice Chairman of the Anderson School
- Three-time member of the staffing and promotion committee

Service to scholarly journals and organizations

Served as an associate editor for a variety of scholarly and business journals, including *Journal of Finance*, *Journal of International Business Studies*, *Journal of Business and Economics*, *Journal of Financial Research*, *Journal of Futures Markets*, and the *Investment Management Review*.

Served as a reviewer for numerous finance and economics journals, including *American Economic Review*, *Journal of Political Economy*, *Journal of Financial Economics*, *Journal of Business*, *Journal of Financial and Quantitative Analysis*, and the *Review of Economics and Statistics*.

Memberships in professional societies

- American Finance Association, 1973–Present
 - Member of Board of Directors, 1987–1989
- Western Finance Association, 1973–Present
 - Member of Board of Directors, 1982–1985
 - Vice President, 1987
- American Economic Association, 1973–Present
- American Bar Association, 1995–1999
- American Statistical Association, 1992–1999
- International Association of Financial Engineers, 1993–2003
- American Law and Economics Association, 1995–2000
- Human Behavior and Evolution Society, 1995–2000

Research evaluation

- Project reviewer for the National Science Foundation, 1979–Present
- Program committee for the Western Finance Association, Various years

Selected board and committee memberships

- Pension Policy Board, The Aerospace Corporation, 1985–2008
- Chairman, Mayor's Blue Ribbon Commission on Los Angeles' Municipal Investments, 1995
- Director, Forms Engineering Corporation, 1976–1997

- Trustee, Kellow Trust, 1982–1991

Expert witness

Numerous cases involving the application of financial economics

Media experience

- Occasional contributor to *The Wall Street Journal* and *The Los Angeles Times*
- Occasional commentator for local television and radio stations
- Lecturer on valuation theory, appraisal practice, and securities pricing

Publications

Books and book chapters

“Stock Repurchases: Tradeoffs and Trends.” *Dividends and Dividend Policy*, H. Kent Baker, ed., Blackwell Publishing, New York, 2009.

“Securities Fraud Damages.” With J. Hirshleifer and J. Haut. *Developments in Litigation Economics*, Vol. 87, P. Gaughan and R. Thornton, eds., Elsevier, Ltd., Oxford, UK, 2005.

The Equity Risk Premium and the Long-run Future of the Stock Market. John Wiley and Sons, New York, NY, 1999.

“Corporate Valuation.” *Handbook of Modern Finance*, 3rd edition, Dennis Logue, ed., Warren Gorham Lamont, Boston, MA, 1994.

Corporate Valuation: Tools for Effective Appraisal and Decision Making. McGraw-Hill, New York, NY, 1993.

Academic articles

“Market Efficiency and Securities Litigation: Implications of the Appellate Decision in Thane,” *Virginia Law and Business Review*, forthcoming 2011.

“Investment Strategies and Investment Track Records,” invited editorial, *Journal of Portfolio Management*, forthcoming 2011.

“The Equity Premium Revisited.” With M. Moroz, *Journal of Portfolio Management*, forthcoming 2011.

“The Intriguing Case of KMP and KMR,” *Journal of Portfolio Management*, 2011, Vol. 37, 3, 121–127.

“Warren Buffett, Black-Scholes, and the Valuation of Long-Dated Options,” *Journal of Portfolio Management*, Summer 2010, 36, 4, 107–111.

“Economic Growth and Equity Investing.” *Financial Analysts Journal*, January/February, 2010, Vol. 66, 1, 54–64. Winner Graham and Dodd G&D Scroll Award for 2010.

"Beliefs Regarding Fundamental Value and Optimal Investing." With J. Cvitanic and L. Goukasian, *Annals of Finance*, January 2010, Vol. 6, 1, 83–105.

"Collateral Damages and Securities Litigation." With J. Rutten. *Utah Law Review*, Vol. 2009, 3, pp. 717–748.

"The Fundamental Nature of Recessions: A Contracting and Restructuring Approach, *The Economists Voice*, October 2009, pp. 1–4.

"The Pricing of Volatility and Skewness." *Journal of Investing*, Vol. 18, Fall 2009, pp. 27–31.

"Implications of the Financial Crisis for Financial Education." *Journal of Financial Education*, Vol. 35, Spring, pp. 1–6.

"Investment Research: How Much Is Enough." Management Online Review, Oxford Management Publishing, 2009, <http://www.moreexpertise.com/download.php?id=135>.

"Luck, Skill, and Investment Performance." *Journal of Portfolio Management*, Vol. 35, Winter 2009, pp. 85–89. Winner Bernstein/Fabozzi Award for 2009.

"The Basic Speed Law for Capital Market Returns." *CFA Magazine*, November/December 2008, pp. 10–11. Also published electronically by *Real Capital Markets*, October 24, 2008, http://www.realclearmarkets.com/articles/2008/10/the_basic_speed_law_for_capita_1.html.

"The Impact of Analysts' Forecast Errors and Forecast Revisions on Stock Prices." With W. Beaver, W. Landsman, and S. Stubben. *Journal of Business Finance and Accounting*, Vol. 35, No. 5/6, 2008, pp. 709–740.

"Market Efficiency, Crashes, and Securities Litigation." With J. Rutten. *Tulane Law Review*, Vol. 81, No. 2, 2006.

"Dividends, Stock Repurchases, and Valuation." *Journal of Applied Finance*, Vol. 15, No. 2, 2005, pp. 13–24.

"How Do Analysts' Recommendations Respond to Major News?" With J. Conrad, W. Landsman, and B. Roundtree. *Journal of Financial and Quantitative Analysis*, Vol. 41, No. 1, 2006, pp. 39–68.

"A Delegated Agent Asset Pricing Model." With R. Roll. *Financial Analysts Journal*, Vol. 61, No. 1, 2005, pp. 57–69. Winner Graham and Dodd G&D Scroll Award for 2006.

"Co-movement as an Investment Tool." *Journal of Portfolio Management*, Vol. 30, Spring 2004, pp. 1–5.

"Compensation and Recruiting: Private Universities vs. Private Corporations." *Journal of Corporate Finance*, Vol. 10, No. 1, 2004, pp. 37–52.

"Accounting and Valuation: Is the Quality of Earnings an Issue?" With W. Landsman. *Financial Analysts Journal*, Vol. 59, No. 6, 2003, pp. 20–28.

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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.)

02 C 5893 (Consolidated)

HOUSEHOLD INTERNATIONAL, INC.,)
MERRILL LYNCH, PIERCE, FENNER,)
& SMITH, INC., GOLDMAN SACHS &)
CO., INC., ARTHUR ANDERSEN, L.L.P.,)
WILLIAM F. ALDINGER, DAVID A.)
SCHOENHOLZ, GARY GILMER,)
J.A. VOZAR, ROBERT J. DARNALL,)
GARY G. DILLON, JOHN A.)
EDWARDSON, MARY JOHNSTON)
EVANS, J. DUDLEY FISHBURN,)
CYRUS F. FREIDHEIM, LOUIS E. LEVY,)
GEORGE A. LORCH, JOHN D.)
NICHOLS, JAMES B. PITBLADO,)
S. JAY STEWART, and LOUIS W.)
SULLIVAN,)

Judge Ronald A. Guzmán

Defendants.)

MEMORANDUM OPINION AND ORDER

In phase one of this bifurcated case, a jury returned a verdict in favor of plaintiffs and against some or all of the defendants on the Section 10(b)/Rule 10b-5 claims as to Statement Nos. 14-18, 20-24, 27-29, 32, 36-38 (“the seventeen statements”). (Verdict Form at 14-18, 20-24, 27-29, 32, 36-38; *id.*, Table A, Alleged False or Misleading Statements at 11-26.) This means the jury found that the statements made and/or facts withheld regarding predatory lending, 2+ delinquency/re-aging, and the Restatement were false or misleading, material, made with the requisite state of mind, and substantially caused the economic loss plaintiffs suffered. (*See id.*; *see also* Jury Instructions at 25-

32.) In addition, the jury credited the Leakage Model of damages presented by plaintiffs' expert Daniel Fischel. (*See* Verdict Form at 41.) At trial, defendants offered, and the jury rejected, two of the three types of evidence that can be used to rebut the presumption of reliance, *i.e.*, that market makers were privy to the truth, and the truth had credibly entered the market and dissipated the effects of the omissions and misstatements. Thus, in phase two, the focus has been on the third kind of rebuttal evidence, that which severs the link between the alleged omissions and misstatements and either the price paid or received by any claimant. Accordingly, each claimant was required to respond "yes" or "no" to the following inquiry: "If you had known at the time of your purchase of Household stock that defendants' false and misleading statements had the effect of inflating the price of Household stock and thereby caused you to pay more for Household stock than you should have paid, would you have still purchased the stock at the inflated price that you paid?" (hereinafter "claim form question"). (1/11/11 Order, Ex. 2 at 8.) The Court also permitted the custodian banks and third-party claim filers to send claimants with an allowed loss greater than \$250,000.00 a supplemental form that asked the same question. (5/31/11 Order.) In addition, the parties were afforded discovery to meet their respective burdens with regard to the presumption of reliance. The parties now present the individual claims as to which they contend there is no triable issue with regard to reliance.

There are three categories of claimants: (1) those that responded "no" to the claim form question;¹ (2) those that responded "yes" to the claim form question; and (3) those that returned the

¹When the Court uses the term "claim form question" it refers to the question that appeared in Section III of the initial proof-of-claim notice to all plaintiffs and/or the supplemental form sent to those plaintiffs with an allowed loss of greater than \$250,000.00.

claim form but did not answer the claim form question.²

If a claimant responded “no” to the claim form question, and defendants do not point to any evidence that reasonably suggests “no” does not mean “no,” that claimant is entitled to judgment as to liability because defendants have not created a triable issue of fact as to his reliance on price. Defendants argue that anything short of a jury trial on all issues relating to an award of statutory damages is a deprivation of their Seventh Amendment rights. *See* U.S. Const. amend. VII (stating that “[i]n Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved”). It is well settled, however, that summary disposition procedures do not violate the Seventh Amendment. *Burks v. Wis. Dep’t of Transp.*, 464 F.3d 744, 759 (7th Cir. 2006). Thus, if there are no factual issues to be resolved, the claims can be adjudicated short of trial without running afoul of the Seventh Amendment.

Defendants also argue that the jury verdict itself rebuts the presumption of market reliance as to the entire class because the dates on which the actionable misstatements/opinions occurred do not correspond to an increase in inflationary impact on Household stock. However, the expert testimony credited by the jury was that a misstatement or omission may cause inflation in the stock price merely by maintaining the market expectations or preventing them from falling further, even if the inflation does not increase on the date the misstatement or omission is made. (*See, e.g.*, Trial Tr. at 2605 (plaintiffs’ expert Fischel stating that stock is inflated where stock is prevented from falling to a lower level)); *see Schleicher v. Wendt*, 618 F.3d 679, 683 (7th Cir. 2010) (price can be inflated by false statement or omission when it stops price from declining); *Nathenson v. Zonagen*

²Claimants who answered “yes” or “no” to the claim form question, but explained that they did not make the contested investment decision are included in this category.

Inc., 267 F.3d 400, 419 (5th Cir. 2001) (statement actionable with no price increase); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 562 (S.D.N.Y. 2011) (“[A] statement can cause inflation by causing the stock price to be artificially maintained at a level that does not reflect its true value.”). Thus, the fact that the artificial inflation did not increase each day on which the jury found an actionable misstatement or omission occurred does not mean that there is a triable issue as to whether the presumption of reliance has been rebutted.

Defendants also argue that the jury verdict itself rebuts the presumption of market reliance as to the entire class because the Leakage Model did not isolate as to any given day the inflation caused by a misstatement or omission regarding each of the three subjects presented to the jury, *i.e.*, predatory lending vs. 2+ delinquency/re-aging vs. Restatement, and thus plaintiffs have failed to show that the actionable misstatement or omission about a particular subject caused an independent inflationary price impact. (Defs.’ Submission Regarding Rebuttal Presumption Reliance at 3-17.) As the evidence at trial demonstrated, the actionable misstatements or omissions on these three subjects were inextricably intertwined. The jury found that defendants made actionable misstatements about re-aging to cover up their predatory lending practices and, in turn, made actionable Restatement misstatements to cover up their re-aging methods. Moreover, as Fischel explained, the inflated price of Household’s stock at any given time reflected the ever-changing mix of information that was publicly available. Given the interdependence of the fraudulent statements and the volatility of the information mix, it would be virtually impossible to parse out the damages by topic.

Fortunately, the law does not require the impossible. Rather, it gives a jury discretion to determine a damages award, as long as the award has a reasonable basis in the evidence. *See Am.*

Nat'l Bank & Trust Co. v. Reg'l Transp. Auth., 125 F.3d 420, 435-40 (7th Cir. 1997); *Dresser Indus., Inc. v. Gradall Co.*, 965 F.2d 1442, 1447 (7th Cir. 1992) (per curiam); *First Nat'l Bank of Kenosha v. United States*, 763 F.2d 891, 896 (7th Cir. 1985); (see also Jury Instructions 34 (“Any damages you award must have a reasonable basis in the evidence. Damages must not be proved with mathematical certainty but there must be enough evidence for you to make a reasonable estimate of damages.”)). In this case, there were multiple statements and partial disclosures over an extended time period, and the parties’ experts provided testimony in support of their positions regarding whether the stock price was affected by misrepresentations or omissions and the estimate of damages stemming therefrom, and the jury chose to credit Fischel’s Leakage Model of damages (discounting industry, market or company-specific non-fraud declines unrelated to the actionable misstatements or omissions) over defendants’ counter-arguments. Here, all of the evidence, including Fischel’s testimony about the amount of artificial inflation, provided a reasonable basis for the jury’s damages award.

Defendants also argue that they have rebutted the presumption of reliance as to index funds that answered “no” to the claim form question because the evidence shows that the price of stock has no impact on their purchasing decisions. (See, e.g., Defs.’ Ex. 7, The Munder Institutional Funds Prospectus at MCM 0000410 (stating that it “attempts to duplicate the investment composition and performance of the particular index through statistical procedures”).) The Court disagrees. The weight of each stock in a capitalization-weighted index is proportional to each company’s market capitalization, *i.e.*, its market price multiplied by the number of outstanding shares. See Reuters.com, Financial Glossary, http://glossary.reuters.com/index.php/Capitalization-Weighted_Index &

http://glossary.reuters.com/index.php/Market_Capitalization (last visited Sept. 20, 2012).³ In other words, indexes rely on investor opinion as reflected in market price to assign weight to stocks. Likewise, the index funds, which adjust their portfolios to match a target index, rely on investor opinion as reflected in stock price each time they make an adjustment. (*See* Defs.’ Ex. 9, Rule 30(b)(6) Dep. State Street at 43-44 (“[W]e wouldn’t have purchased the stock in any of the portfolios which were found to be fraudulent.”).) In short, the evidence about the investment goals of index funds, which is all that defendants offer, does not support the inference that such funds are indifferent to market price. *See In re Countrywide Fin. Corp. Sec. Litig.*, 273 F.R.D. 586, 602 (C.D. Cal. 2009) (“Defendants argue that because index purchases seek to match a predetermined index of securities, such purchases are not made in reliance on any misrepresentation. To the contrary: because index purchases seek only to match the index and exclude other considerations (such as, for example, reliance on nonpublic information or other idiosyncratic motivations), index purchases rely exclusively upon the market to impound any representations (including misrepresentations) into securities’ prices.”); *see also In re Connetics Corp. Sec. Litig.*, 257 F.R.D. 572, 578 (N.D. Cal. 2009) (rejecting argument that plaintiff, which made some of its trades “based on a computer program that was designed to mirror a stock index,” was not typical of the class of investors because there was no evidence suggesting “that the index did not . . . rely on the integrity of the market”). Defendants have not, therefore, created a triable issue of fact as to the reliance of index investors that responded “no” to the claim form question.

The same is true for Capital Guardian Trust Co., Capital Research & Management Co. and

³Defendants have not offered any evidence that suggests any of these investors are something other than capitalization-weighted index funds.

Davis Select Advisors (“DSA”), claimants who gave a “no” answer to the claim form question but testified that they rejected or doubted the validity of the efficient capital market theory. (*See* Pls.’ Ex. 13, Capital Guardian Trust Co. Rule 30(b)(6) Dep. at 68-69 (“[H]istory . . . show[s] that the efficient capital markets pricing theory” that “all current available information has already been factored into the stock price[,]” is “not always accurate.”); Pls.’ Ex. 14, Capital Research & Management Co. Rule 30(b)(6) Dep. at 37-38 (testifying that its “investment philosophy” suggests it is “not true” that “the price of a stock reflects all the information available at that time”); Pls.’ Ex. 12, DSA Rule 30(b)(6) Dep. at 45-46 (stating that it “cannot be correct,” given the stock market’s history, that “stocks are fairly priced at all times because [the market price] immediately reflects all information in the public domain”). Given the parties’ stipulation that “Household common stock traded in an efficient market” (Final Pretrial Order, Ex. A, Uncontested Fact No. 10), whether these claimants fully subscribe to the efficient market theory is irrelevant. What is relevant is whether they would have traded in Household stock if they had known about the fraud. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 248 (1988). Each of them unequivocally answered “no.” (*See* Pls.’ Ex. 12, DSA Rule 30(b)(6) Dep. at 143 (“It is definitely not appropriate to invest in companies run by crooked executives.”); Pls.’ Ex. 13, Capital Guardian Trust Co. Rule 30(b)(6) Dep. at 35 (“If we’d ever known that a management had knowingly misled or misstated or produced false statements, I think that would almost, . . . automatically exclude us from wanting to invest in – with such a company.”); Pls.’ Ex. 14, Capital Research & Management Co. Rule 30(b)(6) Dep. at 71-73 (deponent testifying that he could not “imagine a scenario where [he] would have bought . . . Household stock knowing that it was inflated above its true value” because “part of our investment philosophy is to find undervalued assets . . . [and] that involves the values of the enterprise, the

strength of the fundamentals and a sense of trust in the management”); *id.* at 74 (“[I]f we would have known [the price of Household stock] was inflated, we wouldn’t have purchased the stock.”.) Thus, these claimants’ testimony about efficient market theory does not create a triable issue as to whether they relied on price when they engaged in the stock transactions at issue in this case.

Alternatively, defendants argue that DSA could not have relied on any Restatement misstatement in purchasing Household stock because the Restatement affected earnings near term and DSA judges its performance over a three- to ten-year term. (*See* Defs.’ Ex. 13, DSA Rule 30(b)(6) Dep. at 95, 185.) But DSA does not say that it would have purchased Household stock even if it had known of the fraud. On the contrary, DSA testified that “one of the biggest parts of an investment decision is the price of the stock and management’s integrity and what they are telling you.” (*Id.* at 185.) Thus, no reasonable jury could infer solely from DSA’s emphasis on long-term performance that it did not rely on the integrity of the Household stock price. Defendants have not, therefore, raised a triable issue as to DSA’s reliance on the Restatement misstatements.

Defendants also argue that they have created a triable issue as to whether lead plaintiff Glickenhau & Co. and claimants for which it made investment decisions relied on the March 23, 2001 *Origination News* article misstatement. (*See* Verdict Form, Table A at 11 (“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.”) In support, defendants cite to Glickenhau’s deposition testimony that it would not “necessarily believe that [an *Origination News* quote is] accurate or true,” but believes that Household’s press releases are true and “relies on [them] in making investment decisions.” (Defs.’ Ex. 8, Glickenhau Rule 30(b)(6) Dep. at 58-65.)

It is undisputed, however, that the quote from the *Origination News* article appeared in a Household press release. (*Id.*) Thus, viewing the facts in defendants' favor, no reasonable jury could find that Glickenhauß did not rely on Gilmer's quote. The Court, therefore, holds that defendants have not created a triable issue of fact as to Glickenhauß' reliance.

Defendants have, however, created a triable issue of fact as to the reliance of claimants who: (1) responded "yes" to the claim form question; (2) submitted duplicate claims with conflicting answers to the claim form question; and (3) submitted multiple claims with different answers to the claim form question. These claims must be resolved at trial.

That leaves the claims of those who did not answer the claim form question and/or supplemental interrogatory. Defendants contend that, by failing to respond to discovery, these claimants have forfeited their claims. Plaintiffs argue that summary dismissal is too harsh a sanction and contend that these claims should be tried. The parties' arguments underscore the challenge of balancing defendants' right to gather information for their defense with the class members' right not to be subjected to abusive discovery. (*See, e.g.*, 3/12/09 Hr'g Tr. at 34.)

Initially, the task did not seem daunting, as defendants said their discovery needs were slight:

[T]he institutional investors who owned the lion's share of Household stock were big major sophisticated banks and other funds We could capture information about 50 percent of stock ownership by deposing only 10 of them. We could capture 60 percent by deposing only 15 of them. It may be that one or two sample depositions will tell us what we need to know and whether this is a worthwhile defense or not.

. . . .

We need to know what the 15 big institutional investors – what they did, whether or not they can prove reliance on an individual basis, whether we can – I should put it correctly. Whether we can rebut the rebuttable presumption of reliance as to them by simply finding out the facts that were denied during fact discovery.

(*Id.* at 27, 33.) Accordingly, the Court ordered that Notice of the Verdict and Claim Form be sent to the class and gave defendants 120 days to take discovery of any class member. (*See* 11/22/10 Mem. Op. & Order at 9; 1/5/11 Hr’g Tr. at 20, 25-26.)

Among other things, the Notice sent to the class members states you “must submit a valid Proof of Claim form enclosed with this notice no later than May 24, 2011” to be able to recover under the verdict. (1/11/11 Order, Ex. 1 at 6.) Moreover, the Proof of Claim form itself states: (1) if you fail to submit a properly addressed . . . Proof of Claim and Release, your claim may be rejected and you may be precluded from any recovery pursuant to the verdict”; (2) **“YOU MUST ANSWER THE QUESTIONS IN PART III OF THE CLAIM FORM IN ORDER TO BE ELIGIBLE TO RECOVER PURSUANT TO THE VERDICT”**; and (3) **“YOU MUST ALSO ANSWER THE [Claim Form] QUESTION IN ORDER TO BE ELIGIBLE FOR RECOVERY ON YOUR CLAIM PURSUANT TO THE VERDICT.”** (*Id.*, Ex. 2 at 1, 3, 8) (emphasis original).

Subsequently, defendants served document production requests, interrogatories and Rule 30(b)(6) deposition notices on ninety-eight institutional class members. Plaintiffs argued that the discovery was overly burdensome and harassing and asked the Court for a protective order. The Court granted plaintiffs’ motion in part and ordered that defendants take no more than fifteen depositions, the number defendants initially said they would need, before the claim forms were returned. (*See* 1/31/11 Order at 4.)

In early April 2011, plaintiffs told the Court that:

[S]everal custodian banks have expressed concern regarding the difficulty of obtaining the investor clients’ answers to a discovery inquiry on the claim form prior to the claim deadline of May 24, 2011. This difficulty arises from the fact that although these custodian banks are authorized to file claims on behalf of their clients, they were not the decision-makers regarding the relevant investments as to those

clients. Thus, to obtain an answer to the discovery inquiry, such custodian banks must identify, and transmit the discovery inquiry to, each relevant decision-maker.

(4/11/11 Order at 1-2) (footnote omitted). Consequently, the Court ordered plaintiffs “to propose a plan . . . as to the most efficient way to . . . obtain responses” to the claim form question from this group of claimants. (*Id.* at 2.)

Plaintiffs reported that thirty-eight custodian banks and third-party filing services had filed multiple claims, “12,506 [of which] generate an allowed loss . . . of \$1,248,357,070.” (Lead Pls.’ Proposed Plan Obtaining Resp. Disc. Inquiry Proof Claim Form at 2.) 11,760 of these claims had an allowed loss of \$250,000.00 or less, 326 had an allowed loss of \$250,001.00-\$500,000.00, 204 had an allowed loss of \$500,001.00-\$1,000,000.00 and 216 had an allowed loss of more than \$1,000,000.00. (*Id.*) Given this information, plaintiffs proposed that the custodian banks only be required to obtain an answer to the claim form question from the claimants whose losses accounted for the bulk of the claimed damages, those with an allowed loss in excess of \$250,000.00 (*Id.* at 5-6.)

Defendants objected to the plan because it did not require the custodian banks to obtain answers from the 11,760 claimants whose allowed loss was less than \$250,000.00. (*See* Defs.’ Resp. Pls.’ Proposed Plan Obtaining Resp. Disc. Inquiry Proof Claim at 1.) They urged the Court to reject the plan and order that “the Proof of Claim form, or a Court-approved follow-up notice, be sent to *all* beneficial owners on whose behalf custodian banks or other nominees submitted Proof of Claim forms that do not contain an answer to the reliance question.” (*Id.* at 3) (emphasis original).

The Court considered the parties’ arguments in light of defendants’ need for the information, the class members’ need to be protected from unduly burdensome discovery and the unique

circumstances of the case and, with certain modifications, adopted plaintiffs' plan:

We now know that discovery of 80% of the claimed losses can be achieved by addressing only 6% of the claims. This, coupled with the other avenues of discovery the court has already approved, constitutes a reasonable approach to balancing the needs of the defendants for discovery with the need to protect class members from discouragement and the need to move this already 9 year-old case towards a conclusion.

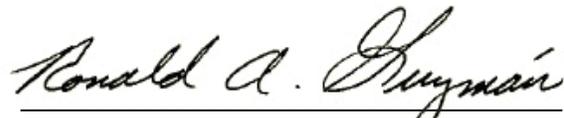
(5/31/11 Order at 7.) Thus, class members with claims of more than \$250,000.00 that were filed by custodian banks were sent a second notice that contained the claim form question and said: **“TO RECOVER FROM THE VERDICT FUND YOU MUST ANSWER THE QUESTION.”** (*See id.* at 7-8; Lead Pls.' Proposed Plan Obtaining Resp. Discovery Inquiry Proof Claim Form, Ex. B.) (emphasis original).

Though they were told repeatedly that they could recover in this suit only if they answered the claim form question, a substantial number of claimants did not. Plaintiffs argue that the Court should ignore this noncompliance and set the claims for trial. That the Court will not do. The Court carefully structured the discovery process to enable defendants to get the information they needed without overburdening the members of the class. Toward that end, each claimant was given the opportunity, larger claimants got two, to perfect his claim by answering “yes” or “no” to one simple discovery question. Given these unique circumstances, the only appropriate sanction for a claimant's failure to answer the question is dismissal of his claim. *See Newman v. Metro. Pier & Exposition Auth.*, 962 F.2d 589, 591 (7th Cir. 1992) (“A plaintiff's failure to comply with discovery orders is properly sanctioned by dismissal of the suit, a defendant's by entry of a default judgment.”). Thus, defendants are entitled to judgment on any claims for which the claimant did not answer the claim form question.

To facilitate resolution of the claims that need not be tried, the Court appoints Phillip S. Stenger of Stenger & Stenger as special master to identify in accordance with this Order: (1) the claims on which plaintiffs are entitled to judgment as a matter of law and the amount of each such allowed claim; (2) the claims on which defendants are entitled to judgment as a matter of law; and (3) the claims that must be resolved at trial.

SO ORDERED

ENTERED: September 21, 2012



HON. RONALD A. GUZMAN
United States District Court Judge

Page 1

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,)
Plaintiffs,)
vs.) No. 02 C 5893
HOUSEHOLD INTERNATIONAL, INC.,)
et al.,)
Defendants.)

The videotape deposition of
DANIEL R. FISCHEL, taken before Richard H. Dagdigian,
Illinois CSR No. 084-000035, Notary Public, Cook
County, Illinois, pursuant to the Federal Rules of
Civil Procedure for the United States District Courts
pertaining to the taking of depositions, at 115 South
LaSalle Street, Suite 2910, Chicago, Illinois,
commencing at 8:56 a.m. on the 21st day March 2008.

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21
22
23
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I N D E X

1
2 March 21, 2008
3 THE WITNESS EXAMINATION BY COUNSEL FOR
4 PLAINTIFFS DEFENDANTS
5 DANIEL FISCHEL
6 (By Mr. Owen) 6
7 FISCHEL DEPOSITION EXHIBITS
8 NUMBER DESCRIPTION PAGE
9 Exhibit 1 Report of Daniel R. Fischel 10
10 Exhibit 2 Rebuttal report of Daniel R. Fischel 10
11 Exhibit 3 Document titled "Efficient Capital 21
12 Markets, the Crash, and the Fraud on
13 the Market Theory", by Daniel R. Fischel
14 Exhibit 4 Document titled "Appendix 1, 89
15 Household's Prospectus Disclosures"
16 Exhibit 5 Document dated Oct. 18, 2001 from 94
17 Ventana Capital, titled "Household
18 International (HI-\$58-Sell)"
19 Exhibit 6 Document titled "Lead Plaintiffs' 105
20 Opposition to Household Defendants'
21 Motion to Compel", etc.
22 Exhibit 7 Document titled "VMS, Monitoring 170
23 Report", Bates Nos. HHS 02948918
24 through 02948926

1 A The footnote says that those two things are
2 different pieces of information. That's correct.

3 Q When you are conducting the analysis that
4 you do in your report, do you have to identify all
5 the different pieces of information in order to reach
6 conclusions about material changes in the stock
7 prices?

8 A Now, you are shifting to my report?

9 Q It's a more abstract question, but it's
10 about the methodology that you are following.

11 You have to identify the key pieces of
12 information in order to analyze the changes in stock
13 price?

14 A I'm not sure what you mean by "identify the
15 keys pieces of information".

16 I did an events study analyzing the
17 relationship between the stock price movements to all
18 disclosures on every day during the class period; and
19 for that matter, a stock price reaction today where I
20 couldn't identify any disclosures.

21 Q Well, my question is, in footnote six of
22 your article, you talk about and identify two
23 distinct pieces of information that could relate to
24 the claim of fraud in that hypothetical case.

1 Generally speaking, do you have to know
2 what the relevant pieces of information are when you
3 are analyzing a plaintiff's claim of fraud?

4 A I think what the footnote suggests is you
5 have to interpret stock price movements in a
6 particular context, and that's the purpose of the
7 footnote.

8 I think that's always true, if that's the
9 question.

10 Q How can you tell if a particular piece of
11 information relates to an alleged fraud or not?

12 A Again, generally, hypothetically, under any
13 conceivable circumstances?

14 Q Uh hum. What would be the way you would
15 analyze it?

16 A Again, it's very difficult to answer
17 questions at this level of generality because every
18 situation has to be analyzed based on the relevant
19 facts and circumstances.

20 But, generally speaking, I would say you
21 would look at the allegations in the case, the
22 relevant public disclosures.

23 The stock price reaction to those
24 disclosures likely perform an events study or

1 regression analysis to make sure that the stock price
2 reactions that you were interpreting are not
3 attributable to market or industry or some other
4 factors.

5 You look at all the other relevant economic
6 evidence that might or might not be relevant
7 depending on the facts and circumstances, and make a
8 judgment, as well as look looking at all the other
9 relevant publicly available information.

10 Q Your opinion says that the economic
11 evidence that you reviewed is "consistent with the
12 plaintiffs claims in this case".

13 A Are you referring to a particular statement
14 in the report?

15 Q It's on page six, the last paragraph before
16 Roman numeral III, the last sentence before Roman
17 numeral III.

18 A I see that.

19 Q "I have concluded that the economic
20 evidence is consistent with plaintiffs' claim that
21 the alleged wrongdoing caused investors in
22 Household's common stock to incur losses".

23 What do you mean by the words "consistent
24 with"?

1 A What I mean is, in the context of this
2 case, that there are allegations about particular
3 nondisclosures and misrepresentations.

4 I don't have an opinion on whether there
5 were in fact misrepresentations or nondisclosures.

6 But in looking at the economic evidence, if
7 there were in fact material omissions or
8 nondisclosures as alleged, I would expect to see
9 certain behavior of stock price movements as well as
10 a certain pattern of reaction by market participants.

11 And when I looked at the economic evidence,
12 it was consistent, as I said in the report, with the
13 claims that are being made by the plaintiffs in this
14 case for the reasons described in my reports.

15 Q Let me give you a hypothetical just to see
16 if I understand what you just said.

17 Take two hypothetical companies; each of
18 them is accused of the same undisclosed misconduct,
19 and one of them is accused falsely, and the other is
20 accused accurately.

21 The stock prices of both the companies
22 decline significantly on the accusation.

23 Both of the companies deny the allegations,
24 and both of the companies settle the claims for

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1 undisclosed reasons while continuing to profess
2 innocence. Both are then sued for securities fraud.

3 Your methods, as they have been applied
4 here, would identify the presence of inflation for
5 both companies, is that correct?

6 A I just don't know if that's correct. I
7 think I would have to look at all the relevant facts
8 and circumstances and -- and if this were a real
9 world situation.

10 But I do want to emphasize what might be
11 the premise of your question, which is that I'm not
12 expressing an opinion on whether there were in fact
13 misrepresentations or omissions.

14 The economic evidence that I've looked at
15 does not allow me to express an opinion on that
16 subject.

17 I can express an opinion as to whether
18 the economic evidence is consistent with those
19 allegations, but does not establish that the
20 allegations themselves are true.

21 Q Let me just see if I understood that.

22 The economic evidence could be consistent
23 with the claims, but the claims themselves could be
24 false?

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1 A The claim that there is legal liability for
2 misrepresentations or omissions -- that may or may
3 not be correct.

4 I don't have an opinion one way or the
5 other on whether the claims that there were
6 disclosure defects that were actionable under the
7 securities laws -- I don't have an opinion on that.

8 I have an opinion as to whether the
9 economic evidence is consistent with those
10 allegations in the way that I described; that if
11 those allegations were accurate, I would expect to
12 see a certain pattern of stock price behavior as well
13 as a certain pattern to my analysis of publicly
14 available information.

15 I was able to test those things by looking
16 at relevant disclosures, publicly available
17 information, stock price movements, controlling for
18 market and industry movements.

19 I looked at all of Doctor Bajaj's
20 criticisms, responded to those, and I reached the
21 opinions that I reached.

22 But that's why the last sentence of
23 paragraph 11 says that, "the economic evidence is
24 consistent with plaintiffs' claim" as opposed to

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1 establishes plaintiffs' claim.

2 Q You are aware that Household settled a
3 bunch of different matters of litigation against it,
4 disputes of regulators in this case?

5 A I am.

6 Q Are you offering any opinion as to the
7 reasons Household settled any of those matters or
8 litigations?

9 A No, I am not.

10 Q Now, you conduct a regression analysis in
11 connection with your first report?

12 A Correct.

13 Q And that regression analysis tries to
14 identify statistically significant changes in stock
15 price after controlling for market and industry
16 factors?

17 A That's correct.

18 Q What standard is being applied for
19 statistical significance in your report?

20 A You mean what is -- I'm not sure what you
21 mean by "what standard".

22 Q Well, supposedly the regression will say
23 this movement is significant, and this other movement
24 is not significant.

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1 And I want to know what the standard is to
2 decide which is which.

3 A I used, as I typically do, as is
4 conventional, a standard of any stock price movement
5 that had a t-statistic of greater than 1.65, I
6 consider to be statistically significant.

7 And any stock price movement that had a
8 t-statistic less than 1.65, I did not consider to be
9 statistically significant under the specification
10 that's described in my report.

11 Q You talk about another standard involving a
12 t-statistic of 1.96, I think?

13 A Correct.

14 Q What -- why do you talk about that
15 standard?

16 A Just for purposes of providing background
17 about the difference between a 1-tail test and a
18 2-tail test.

19 Q So the other standard doesn't have anything
20 to do with the actual analysis that you do?

21 A I'm not sure what you mean by "doesn't have
22 anything to do with" it. I think anybody could look
23 at the results that are reported and conclude that
24 the results are significant in either a 1-tail test

Pages 49 to 52

1 or a 2-tail test, or neither.

2 But in terms of the standard that I used, I

3 used a t-statistic of 1.65 which is the conventional

4 level of statistical significance in a 1-tail test.

5 Q Speaking generally -- let me start again.

6 Did you apply a 2-tail test to any of the

7 dates that you analyzed in your regression analysis?

8 A Well, the results lend themselves to

9 applying any level of statistical significance.

10 You could apply statistical significance at

11 the ten percent level, which would be the lowest

12 t-statistic; you could apply statistical significance

13 at the one percent level which would be a higher

14 t-statistic.

15 But in terms of what I consider to be

16 statistically significant, I used a 1-tail test and,

17 therefore, a t-statistic of 1.65.

18 But the results allow you to use any level

19 of statistical significance that anyone wants to do

20 for any purpose.

21 But if you are asking me what I did, for

22 the most part, I used a 1-tail test and a -- a

23 t-statistic of 1.65.

24 Q So you talked about the 2-tail test in your

1 Q So fewer events are going to meet the

2 2-tail criteria than the 1-tail criteria?

3 A Holding everything else constant, correct.

4 Q Speaking generally, what does a significant

5 -- statistically significant price change indicate to

6 you?

7 A Generally it means that there is -- a

8 residual of this size will be attributable to chance

9 alone less than five percent of the time.

10 Q Do you use that inference to support a

11 conclusion that some new piece of information has

12 entered the marketplace that is affecting the stock

13 in a way that can't be explained by market or

14 industry factors?

15 A Sometimes. It depends on the relevant

16 facts and circumstances.

17 Q Are there any statistically significant

18 stock price movements of Household for which you have

19 drawn that conclusion?

20 A Well, yes, I think there are -- in the

21 context of my report, I think I identified 14 events

22 where I drew that conclusion.

23 But if I looked at the full events study,

24 there would be a lot more than 14. I just didn't

1 report but you didn't actually use it?

2 A Again, I'm not sure what you mean by

3 "use it". By reporting it, again, this is

4 conventional, anybody can decide whether a particular

5 event is statistical -- excuse me, statistically

6 significant at the five percent level under either a

7 1-tail test or a 2-tail test.

8 But if you are asking me what I consider to

9 be statistically significant, I used a 1-tail test at

10 the five percent level, as opposed to a 1-tail test

11 at the ten percent level, a 1-tail test at the one

12 percent level, a 2-tail test at the ten percent

13 level, a 2-tail test at the one percent level, or any

14 other possible combination.

15 Q Does the 2-tail test provide a stronger

16 indication of statistical significance than the

17 1-tail test?

18 A I'm not sure what you mean by a stronger

19 indication. It requires a higher level of -- a

20 higher t-statistic.

21 So, therefore, fewer events would be

22 statistically significant at any given level of

23 statistical significance in a 2-tail test than a

24 1-tail test.

1 consider other statistically significant stock price

2 movements attributable to fraud related disclosures.

3 Q I'm looking at days where there was no

4 statistically significant movement controlling the

5 industry and market factors.

6 Whatever new information might have been

7 available on those days wasn't sufficient to cause

8 the stock price to change?

9 A In a statistically significant way,

10 correct.

11 MR. OWEN: Do you want to take a break?

12 A Sure.

13 THE VIDEOGRAPHER: Going off the record at

14 10:17 a.m.

15 (Whereupon, a short recess

16 was taken.)

17 THE VIDEOGRAPHER: This marks the beginning

18 of tape two in the deposition of Daniel Fischel.

19 Going on the record, the time is now

20 10:26 a.m. Please proceed.

21 MR. BURKHOLZ: Excuse me, Mr. Owen, I think

22 there was a discrepancy in his second to last answer

23 regarding whether he said fraud or non-fraud related

24 disclosures that I think he wants to clarify.

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1 He thinks he said one thing and the record
 2 came out differently.
 3 A I don't have it in front of me, but I think
 4 -- he pointed out to me that the transcript didn't
 5 reflect what I said.
 6 It's on line 19, the sentence, "I just
 7 didn't consider other statistically significant price
 8 movements", and I guess it should say, "not
 9 attributable to fraud related disclosures", so it's
 10 clear in context.
 11 BY MR. OWEN:
 12 Q So there are a bunch of stock price
 13 movements that were significant under your regression
 14 analysis that were not attributable to fraud related
 15 disclosures?
 16 A Correct.
 17 Q And that actually leads into my next
 18 question, which is, I want to talk about the alleged
 19 fraud that you are analyzing in this case.
 20 I guess, first, I want to ask you is, is it
 21 three theories of fraud or one theory of fraud in
 22 your mind?
 23 A I'm not sure how to answer that. I guess I
 24 don't have independent theories of fraud.

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1 characterization.
 2 Q Well, let's look at it. It says --
 3 starting on page six, Roman numeral III, "The
 4 relationship between plaintiffs' allegations and
 5 investors' losses" -- and the next heading is A,
 6 "Predatory Lending", and thereafter you talk about
 7 predatory lending issues for seven pages before you
 8 get to page 13 where it says, "B. Reaging", and you
 9 talk about reaging for five or six pages, and then
 10 you get to page 16, it says, "C. The Restatement".
 11 That's what I mean when I say you analyzed
 12 them separately.
 13 A Again, I'm not sure whether anything from
 14 for my purposes turns on whatever distinction you are
 15 trying to draw.
 16 But in terms of the organization of the
 17 report, these are subsections under one general
 18 heading.
 19 So even as a semantic matter, I'm not sure
 20 it's completely accurate to describe them as -- as
 21 distinct as opposed to different aspects of the
 22 plaintiffs' allegations.
 23 But, again, the distinction that you are
 24 drawing doesn't have any particular economic

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1 My understanding is that the plaintiffs are
 2 alleging a fraud with several different components,
 3 three different components.
 4 Q So the overall lawsuit alleges fraud, and
 5 that fraud has three parts to it?
 6 A That's my understanding, but I don't have
 7 -- in response to your earlier question, I don't have
 8 my own independent theory of fraud.
 9 Q In the complaint, they plead them
 10 separately, do you know that?
 11 A I don't know if that's true or not true.
 12 It wouldn't have any significance to me in any event.
 13 Q Okay. I don't need to show you the thing.
 14 I will represent to you that there are three
 15 different sections, and each deal with restatement,
 16 reage and predatory lending.
 17 That doesn't have any effect on your answer
 18 to the prior question?
 19 A How the complaint is drafted, whether there
 20 are three sections, three different sections? No,
 21 that has no relevance to me.
 22 Q And your report analyzes the three
 23 components you talked about separately?
 24 A I'm not sure I agree with that

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1 significance to me anyway.
 2 Q Well, I guess the question I have is, in
 3 your mind, are the facts and circumstances of the
 4 three different components, as you call them,
 5 interrelated or are they distinct?
 6 A I guess my understanding is that the
 7 plaintiffs claim that they are distinct -- I'm sorry,
 8 the plaintiffs claim they are interrelated rather
 9 than distinct, but I don't have any independent
 10 opinion on that one way or the other.
 11 Q And you would agree that of the components,
 12 there are distinct factual issues and even different
 13 business units involved?
 14 A I guess I understand that the three
 15 different components involve different areas of
 16 Household's business, so that by definition there
 17 would be some different factual issues involved.
 18 Q Now, one set of issues relating to one
 19 component could be correct and, then, another set of
 20 issues relating to the other component could be
 21 false, and the falsity of the second component
 22 wouldn't necessarily have anything to do with the
 23 first component, right?
 24 MR. BURKHOLZ: Objection, form.

1 and the associated exhibits.

2 Q Are there any practices that you are

3 analyzing with respect to the predatory lending issue

4 that are not described in those paragraphs that you

5 just identified?

6 A Again, it really doesn't quite accurately

7 capture what I did. I wasn't performing an

8 independent analysis of Household's lending

9 practices, as I think I've been clear about.

10 I analyzed the relationship between

11 Household's lending practices and, particularly, the

12 criticism of those lending practices in publicly

13 available information to relevant stock price

14 movements during the class period, focusing

15 particularly on a series of events described in

16 paragraphs 12 through 21 and the referred to

17 exhibits.

18 Q My question really relates to how am I

19 supposed to know what practices you are analyzing.

20 And if I understand you correctly, I'm supposed to

21 look at paragraphs 12 through 25 to find out the

22 answer to that question -- I'm sorry, 12 through 21

23 to answer that question?

24 MR. BURKHOLZ: Objection, form.

1 any determination of whether every market participant

2 understood the same thing by the term "predatory

3 lending".

4 The focus in my report is on market

5 participants' belief that certain practices were

6 improper, ranging from excessive fees to improper

7 disclosures, and that those practices once revealed

8 might have certain legal consequences, and had a

9 particular effect on -- a particular negative effect

10 on Household's stock price.

11 That's what I focused on, and I focused on

12 it in slightly different ways in different parts of

13 the report.

14 But since you are only asking me about the

15 quantification of specific disclosures, I will limit

16 myself to the disclosures relating to predatory

17 lending that I considered to be fraud related,

18 because they had a statistically significant price

19 reaction associated with them.

20 Q Let me see if I understand what you are

21 saying when you refer to disclosures relating to

22 predatory lending that I considered to be fraud

23 related because they had a statistically significant

24 price reaction associated with them.

1 A I think the question misstates my previous

2 answers. I didn't perform an analysis of Household's

3 lending practices in the abstract.

4 I did what I described in my previous

5 answers and what I think is described more

6 comprehensively in my reports.

7 BY MR. OWEN:

8 Q Does it matter what the definition of

9 predatory lending means in terms of the paragraphs 12

10 through 21?

11 A In terms of the analysis that I performed,

12 I don't think it matters, no, in terms of what I

13 focused on is what market participants consider to be

14 predatory lending.

15 I didn't form any independent judgment as

16 to what the definition is of predatory lending.

17 Q But suppose different market participants

18 had different ideas about what was predatory lending.

19 Wouldn't that raise a question for you as to what

20 they meant when they used the term?

21 A Again, if you are referring to something

22 specific, you should refer me to it. I will give you

23 my best sense.

24 But my particular analysis did not require

1 How did you know if a disclosure related to

2 predatory lending that you considered to be fraud

3 related?

4 A I described that in my report with respect

5 to the specific disclosures.

6 But, you know, again, generally speaking,

7 to the extent there were disclosures about

8 Household's predatory lending practices that had a

9 statistically significant stock price reaction

10 associated with them, I took those disclosures into

11 account in my quantification of inflation focusing on

12 specific disclosures.

13 Q Well, Household disputed whether it had any

14 practices that were, quote-unquote, predatory lending

15 practices, right?

16 A That's not completely clear to me either

17 based on the material that I've reviewed.

18 Q But if somebody else said predatory lending

19 in the context of one of Household's practices, then

20 you deemed that report to be related to predatory

21 lending at Household?

22 A I think what I did is described in my

23 report. To the extent that there were specific

24 disclosures that I identified, both when the

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1 disclosures were, why the disclosures were considered
 2 by me to be fraud related, what their effect was on
 3 my calculations of inflation, it's all described in
 4 my report.
 5 I'm happy to answer any questions about any
 6 particular disclosure, but that's the general
 7 methodology that I followed.
 8 Q So you didn't have to know what people
 9 meant when they said "predatory lending" to do your
 10 analysis?
 11 A Well, you know, that goes a little bit too
 12 far. I think I said I didn't need to know whether
 13 everybody subjectively thought exactly the same
 14 thing.
 15 But the disclosures themselves refer to
 16 what people meant when they refer to predatory
 17 lending in terms of, as I said, charging excessive
 18 fees, providing inaccurate disclosures, inducing
 19 homeowners to enter into inappropriate transactions
 20 -- all these different disclosures that I refer to
 21 just don't use the term "predatory lending" in the
 22 abstract.
 23 They describe what the factual context is
 24 for their particular conclusions with respect to

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1 Q Does your opinion assume that Household was
 2 doing predatory lending things during the class
 3 period?
 4 MR. BURKHOLZ: Objection, form.
 5 A Well, if what you mean by "predatory
 6 lending things" -- again, not the most clearly
 7 defined term in the world --
 8 BY MR. OWEN:
 9 Q I agree with that.
 10 A That my opinion assumes that Household's
 11 disclosures with respect to its lending practices
 12 were deficient in the sense that Household did not
 13 provide full disclosure of the extent to which it was
 14 involved in predatory lending, and the various
 15 practices that market participants concluded
 16 constituted predatory lending which could have
 17 possible adverse legal consequences and adverse
 18 consequences for the value of Household stock.
 19 Q Would that condition also exist in the time
 20 before the class period started?
 21 A I guess I don't have an opinion on that one
 22 way or the other.
 23 Q Well, your inflation analysis shows 7.97 of
 24 inflation on the first day of the class period, does

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1 Household's predatory lending practices.
 2 Q We have talked about practices in the
 3 context of Household's business.
 4 Did you understand the term "predatory
 5 lending" to include any products separate and apart
 6 from the methods by which those products were sold?
 7 A I don't think I have an understanding on
 8 that one way or the other.
 9 Q So you don't know?
 10 A Well, you asked do I have an understanding
 11 of it. I don't. I didn't form an understanding one
 12 way or another on that question.
 13 Q And as you said before, you don't have any
 14 particularized expertise with respect to any of these
 15 concepts? Just reading analysts' reports?
 16 MR. BURKHOLZ: Objection, form.
 17 A I don't claim to have any particular
 18 expertise as to whether or not Household's lending
 19 practices conformed with applicable legal and
 20 regulatory requirements.
 21 I didn't make any independent determination
 22 of that issue. I don't have any particular expertise
 23 on that issue.
 24 BY MR. OWEN:

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1 it not?
 2 A Correct.
 3 Q And that inflation presumably relates to a
 4 state of affairs that exists on that first day of the
 5 class period, correct?
 6 A That I'm assuming exists on the first day
 7 of the class period, correct.
 8 Q And have you no opinion about whether or
 9 not it exists the day before the class period or not?
 10 A As I said, I don't have an opinion whether
 11 it exists on any day during the class period other
 12 than --
 13 Q Fair enough --
 14 A -- than what I've already stated. I don't
 15 have an opinion as to the accuracy of Household's
 16 disclosures in the abstract other than in the way
 17 that I've already stated.
 18 Q Okay. Well, you said you assumed that it
 19 exists on the first day of the class period?
 20 A I assumed that there were disclosure
 21 defects on the first day of the class period, without
 22 having an opinion about whether there were or there
 23 were not.
 24 Q And those disclosures on the first day of

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1 the class period would presumably relate to
 2 circumstances that existed prior to the class period,
 3 and practices and products that were being sold at
 4 that time?
 5 A Again, that's possible, but I don't have an
 6 opinion on that one way or the other.
 7 Q Assume some of the practices that we are
 8 talking about as within the meaning of predatory
 9 lending were disclosed to the public, but were
 10 nevertheless criticized as predatory lending by
 11 activists or others.
 12 Would that affect your inflation analysis?
 13 A My analysis assumes that there were
 14 disclosure defects. So I guess my answer to your
 15 question would be maybe. It just would depend on the
 16 relevant facts and circumstances.
 17 Q What would be the facts and circumstances
 18 you would want to know?
 19 A Whether or not whatever disclosures you are
 20 assuming in your question constituted full disclosure
 21 or eliminating the possibility of any disclosure
 22 defects.
 23 Q One of the things that's at issue in this
 24 case is the settlement that Household entered into

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1 legal and regulatory repercussions which adversely
 2 affected the value of Household securities during the
 3 class period.
 4 BY MR. OWEN:
 5 Q Would Household in making this hypothetical
 6 disclosure on the first day of the class period have
 7 had to accuse itself of illegal misconduct to correct
 8 the disclosure defects that you discuss in your
 9 report?
 10 A I don't really have an opinion on what
 11 Household would have had to have disclosed to be in
 12 compliance with all applicable disclosure
 13 requirements on the first day of the class period.
 14 Q You identify inflation on that day though?
 15 A I do, that's correct.
 16 Q And you don't have an opinion about how it
 17 could have eliminated that inflation on the first day
 18 of the class period?
 19 A I have the opinion that I stated earlier;
 20 by having disclosures on that day and subsequent days
 21 which eliminated the alleged disclosure defects with
 22 respect to its lending practices.
 23 Q Let me just say this as clearly as I can.
 24 In response to the question, what should Household

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1 with this group of Multi-state Attorneys General.
 2 Looking again at the first day of the class
 3 period, is that a disclosure defect that existed in
 4 your mind as of that date?
 5 A I'm not sure I understand the question.
 6 Obviously, the settlement itself is not a disclosure
 7 defect because it hadn't occurred on the first day of
 8 the class period.
 9 Q I'm not really talking about the settlement
 10 itself. I guess it's the possibility of that future
 11 settlement.
 12 MR. BURKHOLZ: Objection, form.
 13 BY MR. OWEN:
 14 Q Well, let me try again. Is it a part of
 15 plaintiffs' claim here at all, as you understand it,
 16 that Household should have disclosed that they would
 17 settle with the Multi-state group of Attorneys
 18 General?
 19 MR. BURKHOLZ: Same objection, form.
 20 A You know, I guess I don't have an opinion
 21 on that question one way or the other, except to the
 22 extent that I understand plaintiffs' claim to be that
 23 Household failed to disclose details of its lending
 24 practices which ultimately resulted in a series of

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1 have said to correct the disclosure defects on the
 2 first day of the class period with respect to the
 3 predatory lending issue, you don't have any answer?
 4 A Other than what I've said, correct. I
 5 don't consider myself a disclosure expert, and I have
 6 not attempted to create model disclosures.
 7 But in order to eliminate the inflation
 8 that my analysis shows on the first day of the class
 9 period, it would be necessary for there to be an
 10 absence of any disclosure defects with respect to
 11 this particular issue and the other issues addressed
 12 in my report.
 13 Q And I guess at trial, it will be
 14 plaintiffs' burden to establish that these defects
 15 existed?
 16 MR. BURKHOLZ: Objection, form.
 17 A Again, I'm not sure who would have what
 18 burden, but certainly there would have to be an
 19 adjudication that there were disclosure defects for
 20 my analysis to be meaningful.
 21 BY MR. OWEN:
 22 Q Are you offering any opinion regarding
 23 scienter?
 24 A No, I'm not.

1 just giving you my understanding of what the
 2 allegations are.

3 Q Okay. That's important, because you are
 4 the one who is quantifying the effects of those
 5 allegations.

6 A Is that a question?

7 Q Well, is it not important for you to
 8 understand what the allegations are accurately if you
 9 are going to put forth an opinion about what the
 10 effects of those allegations may have been?

11 A I would say it is important for my analysis
 12 to understand that the plaintiffs allege that there
 13 were disclosure defects in the three areas that I
 14 discuss in my report dating back to the beginning of
 15 the class period.

16 Q And the disclosure defects, as you
 17 understand them, relate to quarterly financial
 18 results, 10-K's, 10-Q's, 8-K's, and anything else?

19 A I only use those as illustrative. I
 20 haven't attempted to -- to identify every single
 21 disclosure that the plaintiffs allege to be false and
 22 misleading either because of a misrepresentation, or
 23 omission, or both.

24 Q But they had to relate to financial results

1 concluded that the artificial inflation on July 30th
 2 and August 16th was identical, and the basis -- my
 3 understanding of the basis for that conclusion with
 4 respect to July 30th is the company's disclosure on
 5 July 22nd, that I guess I would agree that the amount
 6 of inflation that I've calculated on those two days
 7 is the same with the very important caveat of what I
 8 described at length before lunch, that in order to
 9 have inflation, you have to have a basis to recover.

10 BY MR. OWEN:

11 Q But putting aside the basis to recover, the
 12 falsity would be the same as to the announcement of
 13 results on the 22nd of July and a reporting of the
 14 results on August 16th?

15 MR. BURKHOLZ: Objection, form.

16 A I would say based on my analysis, the
 17 impact of a hypothetical disclosure or series of
 18 disclosures on those two dates would be the same.

19 But there is the important caveat that I'm
 20 not going to repeat again.

21 BY MR. OWEN:

22 Q That was the caveat in my question. I
 23 accept it, that that's your position.

24 Assume that Household had disclosed its

1 at the very least?

2 A I'm not ensure that's true. Again, I'm not
 3 the one making the allegations, but I could imagine
 4 there could be allegations about particular
 5 disclosures that don't report actual financial
 6 results.

7 Q And you don't know whether plaintiffs are
 8 claiming those or not?

9 MR. BURKHOLZ: Objection, form.

10 A You know, as I sit here, I don't recall
 11 exactly what plaintiffs' allegations are with respect
 12 to every single disclosure that Household made during
 13 the class period.

14 BY MR. OWEN:

15 Q Let's look at the August 16th date, 1999,
 16 when they release quarterly financial results.

17 A Okay.

18 Q Would the allegedly false statements for
 19 that -- applicable to that particular quarterly
 20 statement be the same for the announcement of the
 21 results that took place on July 22nd?

22 MR. BURKHOLZ: Objection, form.

23 A I think for purposes of my analysis, I
 24 think it is fair to say that to the extent that I've

1 second quarter 99 results on some day other than
 2 the 16th, say the 18th. Would that have any impact
 3 on your inflation chart in your report?

4 A Which inflation chart?

5 Q The specific disclosures chart.

6 A No, it would not. It would on the other
 7 one, but not -- it would on the leakage model, but
 8 not the quantification based on specific disclosures.

9 Q The last two words of that sentence says
 10 "in order to become inflated".

11 And I think we understand that on all of
 12 the days we are talking about here at the beginning
 13 of the class period, the inflation stays exactly the
 14 same.

15 In what sense --

16 A I'm sorry, on all --

17 Q Well, from July 30 to August 17, the day
 18 after the first announcement, the inflation is the
 19 same on each day?

20 A Correct.

21 Q I want to understand in the sense that you
 22 use the words "to become inflated", how the stock
 23 price is becoming inflated on any of those days?

24 A I think I've explained that at length, as a

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1 result of my quantification of what I am assuming to
2 be a series of nondisclosures on the first day of the
3 class period where the inflation remained constant,
4 until there was a disclosure either increasing the
5 amount of inflation or decreasing the amount of
6 inflation which, based on my analysis, occurred on
7 November 15th of 2001.

8 Q And I think you've already answered this,
9 but I'm just going to ask it to be clear.

10 The impact of the nondisclosures you are
11 talking about can't be measured with an event study
12 using specific disclosures of the kind you use in
13 your report?

14 A I don't agree with that.

15 Q Well, illuminate me.

16 MR. BURKHOLZ: Objection, form.

17 A The impact of those assume nondisclosures
18 as exactly what's calculated using an events study.

19 BY MR. OWEN:

20 Q It's not your opinion in connection with
21 this case that there was artificial inflation in the
22 stock?

23 A I think I've answered that numerous times.
24 In order for there to be artificial inflation, there

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1 has to be an actionable disclosure defect.

2 I'm assuming the existence of actionable
3 disclosure defects.

4 Based on that assumption, I have attempted,
5 using two different methods, to calculate the amount
6 of inflation resulting from those disclosure defects.

7 Q Plaintiffs' theory that we are talking
8 about here, again in paragraph 38, doesn't rely upon
9 the presence of statistically significant changes in
10 price, is that correct?

11 A Are you asking me about what exactly? The
12 plaintiffs' -- the sentence -- the first sentence of
13 paragraph 38, plaintiff's theory in this case or
14 generally -- I'm not sure what you are asking me.

15 Q Well, it says, "Under this theory the
16 company's stock price did not have to increase".
17 So I'm saying the theory then doesn't demonstrate
18 itself by way of increases in stock price.

19 A I'm not sure what you mean by "the theory
20 doesn't demonstrate itself".

21 What I would say is exactly what this
22 sentence says, that again, in the context of the
23 proper use and limits of regression analysis, that it
24 would be an incorrect interpretation of regression

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1 analysis to conclude that because there is no
2 statistically significant price reaction to a
3 statement, that necessarily means that the statement
4 did not produce artificial inflation. That's the
5 purpose of the sentence.

6 Q Looking at the period between July 30 and
7 November 15 -- July 30, 1999 and November 15, 2001,
8 are the alleged omissions that prevented the price
9 from falling to its true uninflated value the same at
10 all times between those two dates?

11 A Well, I would say, based on my analysis,
12 the economic effect of the alleged omissions is the
13 same between those two dates.

14 Q Do you know the answer to the question I
15 asked you, though, whether the alleged omissions are
16 the same?

17 A I can't answer that question because of
18 what I've said numerous times, that I haven't made
19 any independent analysis of the adequacy of
20 disclosures at any point in time, including between
21 those two points in time.

22 Q Well, I'm not really asking about whether
23 they were adequate or not.

24 I'm asking whether or not the alleged

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1 omissions are the same during the time period
2 between those two dates?

3 A I guess the only opinion that I have about
4 that is what I said, that based on my analysis, the
5 economic effect of the alleged omissions is the same
6 between those two dates based on my analysis of
7 quantification using specific disclosures.

8 It's not the same based on my other theory
9 which -- not really a theory, my other calculation,
10 which in some ways, as I discuss in the report, I
11 think more accurately reflects a proper
12 interpretation of Household's stock price movements
13 during the class period.

14 Q Do you not know whether the alleged
15 omissions are the same during that period?

16 MR. BURKHOLZ: Objection to form, asked and
17 answered.

18 A I haven't analyzed that question because I
19 haven't attempted to analyze the alleged disclosure
20 defects apart from the economic effect of those
21 alleged disclosure defects under two different
22 methods.

23 BY MR. OWEN:

24 Q So you didn't investigate it. I'm

1 sorry. Let me start again.
 2 You know, I'm not talking about the
 3 economic effects now. I'm just talking about what
 4 the alleged omissions are during that period, and
 5 whether they are the same throughout the period.
 6 And I understand you to be saying you
 7 didn't investigate that so you can't answer the
 8 question.
 9 And my question comes, because you didn't
 10 investigate the question, you don't know whether they
 11 are the same or not throughout that period?
 12 MR. BURKHOLZ: Objection, form.
 13 A This actually is related to what I said
 14 earlier. In connection with this one analysis that
 15 I performed, the quantification using specific
 16 disclosures, I analyzed the economic effect of
 17 particular statements that occurred during the class
 18 period.
 19 And I made an assessment based on the
 20 economic effect of those statements, what the amount
 21 of inflation was at the beginning of the class period
 22 and, at least under that first method, how long that
 23 amount of inflation that existed at the beginning of
 24 the class period lasted until it varied, went up or

1 information until then".
 2 I want to focus on the words "new adverse
 3 information", and ask you what you were referring to
 4 there.
 5 Q Again, there is two different methods that
 6 I used, and I don't want to suggest by focusing on
 7 one, that that was what I --
 8 Q We are not talking about leakage at all.
 9 A I understand.
 10 But when you ask me what I meant by a
 11 sentence, I can't really answer that using your
 12 restrictions, because what I meant was everything
 13 I discussed in the report, not the limits that you
 14 want to place upon me in terms of what you are asking
 15 about.
 16 So I can answer in terms of what I meant --
 17 Q Okay, please.
 18 A Okay. That during the class period, over
 19 the course of the class period, there were a series
 20 of specific disclosures which I identified, which
 21 provided new adverse information to investors about
 22 Household's practices, and one of the different areas
 23 in those are included in my first methodology
 24 quantifying inflation based on specific disclosures.

1 down based on the existence of other events or
 2 statements that occurred during the class period.
 3 If, however, as I said before, the evidence
 4 at trial or other developments between now and trial
 5 indicate that my analysis should be modified in one
 6 direction or another, my analysis is capable of
 7 incorporating any of those developments.
 8 So if, for example, it was the case that
 9 one of the issues falls out of the case altogether,
 10 or the evidence shows that there is a difference in
 11 the nature of the omitted or misrepresented
 12 information at any point in time, the analysis can be
 13 modified to incorporate any of those developments.
 14 But for present purposes, I am assuming
 15 that the information that came out during the period
 16 about these three different areas was something that
 17 the company did not disclose during the class period
 18 beginning from the first day of the class period.
 19 Q Looking at paragraph 39, the second
 20 sentence, reads, "Because plaintiffs allege that
 21 defendants failed to disclose new adverse information
 22 concerning Household's business practices until later
 23 in the class period, investors in the company did not
 24 learn and therefore could not react to this

1 But as I said in the report, I think that's
 2 a very incomplete analysis of the artificial
 3 inflation that existed, because numerous commentators
 4 all refer to a decline in Household's stock price
 5 over the course of the class period.
 6 That was attributable to market
 7 participants learning new negative information about
 8 Household's practices that are the subject of the
 9 alleged disclosure defects.
 10 And I confirmed that commentary by market
 11 participants, by comparing Household's performance
 12 over a longer period in comparison with various
 13 indexes.
 14 I looked for alternative explanations for
 15 Household's long term stock price decline, and what I
 16 concluded was that investors learned what I refer to
 17 as new adverse information concerning Household's
 18 business practices both as a result of stock price
 19 reactions to specific disclosures which resulted in
 20 statistically significant stock price declines, as
 21 well as by a gradual release of information during
 22 the class period both by Household and by other
 23 market participants revealing that Household was much
 24 less profitable than market participants originally

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1 Things that are fully disclosed themselves
 2 don't produce changes in stock prices, at least as a
 3 first approximation, without knowing anything more
 4 about the relevant facts and circumstances.
 5 That's the difficulty that I'm having with
 6 your question.
 7 Anything that's fully disclosed is not
 8 going to be something that creates inflation in my
 9 quantification of inflation based on specific
 10 disclosures.
 11 And my leakage model is based specifically
 12 on market participants learning new information about
 13 the alleged disclosure defects that were not
 14 previously disclosed.
 15 So for those reasons, a determination that
 16 something was or was not disclosed in a
 17 securitization prospectus wouldn't have any obvious
 18 effect on any of my opinions.
 19 BY MR. OWEN:
 20 Q I understand what you are saying. And here
 21 is what I'm trying to get at. I think it could have
 22 an impact even if it was disclosed, but it would be
 23 for a different reason.
 24 If the marketplace knows that Household is

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1 reasons, the predicate of your question I don't think
 2 would have any effect on my opinions.
 3 Q Bear with me. I'm trying to find an
 4 exhibit.
 5 We can't seem to find the exhibit. But I
 6 will just read to you from an analyst report, and one
 7 of the things it says is, "We suspect" -- it's not
 8 important for the point -- it's not important for the
 9 point. I just want to read the sentence.
 10 "We suspect that Household may have become
 11 more of a lightning rod for consumer groups as it is
 12 the only large public company in the space".
 13 And --
 14 MR. BURKHOLZ: I'm sorry, Exhibit I, you said?
 15 BY MR. OWEN:
 16 Q My question is, if that's in fact the case,
 17 wouldn't a change in the regulatory approach on a
 18 subject, say, like single premium credit insurance
 19 have an effect on Household that wouldn't be
 20 registering with respect to other companies in the
 21 industry index that you used?
 22 MR. BURKHOLZ: Objection, form.
 23 A Well, first of all, I know I used an
 24 industry index, but I also used the industry index

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1 selling single premium credit insurance, and a lot of
 2 people are unhappy about that, they think it's a bad
 3 product, it's predatory, it's unfair, it's improper
 4 -- whatever pejorative terms you want to put on it --
 5 and information comes out that suggests that these
 6 criticisms are going to bear fruit in the form of
 7 Household stopping selling single premium credit
 8 insurance, the stock price could go down even though
 9 the product itself was well known?
 10 MR. BURKHOLZ: Objection, form.
 11 A Well, I guess I have a couple of reactions
 12 to that.
 13 First, I don't think that -- or that the
 14 factual predicate of your question fairly describes
 15 what I described in my report as market participant's
 16 analysis of why Household stock price was declining.
 17 Secondly, because there is an industry
 18 variable in my regression, a second industry variable
 19 based on the industry variable that Doctor Bajaj
 20 claims that we should have included, any change in
 21 the regulatory framework that affects the
 22 profitability of the entire industry is going to be
 23 taken into account in my analysis.
 24 So I guess for those reasons, both of those

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1 that Doctor Bajaj identified as the proper industry
 2 index to use.
 3 So --
 4 BY MR. OWEN:
 5 Q I'm not quarreling with the industry index
 6 that you selected or the one Bajaj selected. It's
 7 really a question of what's going to show up in that
 8 index.
 9 If Household is the biggest player in that
 10 field, and a change is made that affects Household
 11 more than anybody else, isn't that going to be
 12 something that could produce a significant impact on
 13 Household's stock price after controlling for
 14 industry and market forces?
 15 MR. BURKHOLZ: Objection, form.
 16 A I would say yes, potentially, but not
 17 simply because it's the biggest.
 18 If it disproportionately affected by --
 19 hypothetically -- a regulatory change, meaning that
 20 the regulatory change has a bigger effect on its
 21 expected future profitability than for other firms,
 22 then the industry index would maybe partially pick up
 23 the effect of the change.
 24 But there still could be hypothetically a

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1 firm specific effect for Household.

2 BY MR. OWEN:

3 Q And that would be because, notwithstanding

4 the fact that it was a known product, a disclosed

5 product, or almost because of the fact that it was a

6 disclosed product?

7 A Well, that's a separate issue. I wasn't

8 speaking about the actual facts and circumstances of

9 the case.

10 I was just speaking, as a matter of

11 statistics, is it possible that a regulatory change

12 that affects the entire industry could affect one

13 firm, whether Household or any other firm,

14 disproportionately.

15 So even though you have a control for an

16 industry variable, you still have a firm specific

17 component to the return, and the answer to that is

18 yes.

19 Q So my point, I guess, is that the fact that

20 a product that Household sells is being called

21 predatory, notwithstanding the fact that it's been

22 disclosed, could have a negative effect on Household

23 that would show up in the form of negative price

24 changes after controlling for industry and market

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1 inflation continues beyond that date.

2 But because that date is the end of the

3 class period, that's the date, for purposes of my

4 inflation calculations, I'm assuming that there is no

5 further inflation.

6 Q What is the information that the settlement

7 provides to produce the full disclosure statement?

8 A As I said, it's really assumed full

9 disclosure, because --

10 Q Okay. Assumed full disclosure. I will

11 accept that.

12 A Well, I discussed that extensively in my

13 rebuttal report, on pages 11 through 13, in

14 paragraphs 15, 16 and 17.

15 Q What is the explanation that's contained in

16 these paragraphs?

17 A Well, I think the paragraphs speak for

18 themselves, and I incorporate them by reference.

19 But I would say the points that come to

20 mind, as I sit here, is that some market participants

21 thought that the settlement amount might be

22 significantly higher; some market participants were

23 concerned that there might be no settlement at all.

24 Those are the things that come to mind.

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1 forces?

2 A Again, are you asking me hypothetically or

3 under the facts and circumstances of this case?

4 Q It's hypothetical.

5 A Hypothetically, it's what I said in my

6 previous couple of answers.

7 Hypothetically, a regulatory change could

8 have a disproportionate effect on Household in either

9 direction.

10 It either could affect Household more than

11 the industry or less than the industry.

12 Q On the last day of the class period, the

13 inflation level reaches zero, is that correct?

14 A Correct, by definition.

15 Q What does that mean when it reaches zero?

16 A Well, for purposes of my analysis, it means

17 that because it's the last day of the class period,

18 I'm assuming that full disclosure occurred as of that

19 date, meaning that there is no further inflation to

20 measure after that date.

21 Q Now, the number -- the inflation number

22 reaches zero as a result of the settlement with the

23 Multi-state Attorney General group?

24 A Correct. I should say, it's possible that

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1 Q I'm sorry, maybe I'm looking at the wrong

2 place. Pages 11 through 13 -- yes, okay. I'm sorry.

3 Here we go.

4 So the new information is the actual

5 settlement amount?

6 A And the fact of the settlement.

7 Q And the fact of the settlement. Is the

8 fact of the settlement good news?

9 A Based on the reaction of market

10 participants, I would say yes.

11 Q But in another sense, it ultimately

12 revealed the fraud that the plaintiffs have alleged

13 in this case, isn't that true?

14 A I'm not sure I understand that question.

15 Q Well, until you get to the last day, my

16 understanding of the plaintiffs' allegations is that

17 the fraud is still on.

18 MR. BURKHOLZ: Objection, form.

19 A I'm not sure what you mean by "fraud is

20 still on".

21 Under the plaintiffs' claim, which I

22 analyzed the economic evidence in connection with,

23 there is still artificial inflation in the stock

24 until the last day of the class period.

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1 BY MR. OWEN:
 2 Q I want to read to you from paragraph 23 of
 3 the complaint.
 4 It says, "It was only at the end of the
 5 class period on October 11th, 02, when defendants
 6 announced that the company would pay \$484 million to
 7 settle the predatory lending charges, that investors
 8 learned that Household had been conducting its
 9 nationwide operations in direct violation of federal
 10 and state lending laws".
 11 So the plaintiffs are saying that investors
 12 in the marketplace learned about the fraud on the
 13 same day that Household makes an announcement that
 14 you just characterized as good news, and I see some
 15 tension between those two propositions.
 16 MR. BURKHOLZ: Objection, form.
 17 A Well, obviously, my report focuses on my
 18 analysis as opposed to the allegations in the
 19 complaint.
 20 And I think I've described the reason why
 21 market participants interpreted the announcement of
 22 the settlement as good news, and why it not only is
 23 not inconsistent with the existence of inflation, but
 24 why it supports the conclusion of earlier inflation,

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1 A I actually don't know exactly. I don't
 2 send them out. I would say they have been
 3 significant. We have done a considerable amount of
 4 work over a long period. But I don't know exactly
 5 what the amount is.
 6 Q Can you give me a ballpark number?
 7 A I can, but I wouldn't want to be held to it
 8 because it's something that could be checked. I
 9 don't know the answer.
 10 If I had to estimate, I would say somewhere
 11 between 500,000 and a million.
 12 MR. OWEN: You guys know what the answer to
 13 this is, right --
 14 A I could be wrong. As I said, I wouldn't
 15 want to be held to it. It's a good faith estimate.
 16 BY MR. OWEN:
 17 Q Is there any portion of that bill that
 18 hasn't been paid, to your knowledge?
 19 A Maybe the last bill -- I think we have been
 20 paid currently, with some lag for a month or possibly
 21 two months.
 22 MR. OWEN: Could you guys provide us that
 23 information.
 24 MR. BURKHOLZ: We will. It's allowed under

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1 all of which is described at length in my report.
 2 MR. OWEN: I think we are getting pretty
 3 close. Can we take a short break.
 4 THE VIDEOGRAPHER: Going off the record at
 5 4:16 p.m.
 6 (Whereupon, a short recess
 7 was taken.)
 8 THE VIDEOGRAPHER: Going back on the record at
 9 4:24 p.m. Please proceed.
 10 BY MR. OWEN:
 11 Q Mr. Fischel, how much have you been paid in
 12 connection with your engagement with the plaintiffs
 13 in this case?
 14 A Well, are you asking what the amount of the
 15 bill submitted by the firm has been, or how much have
 16 I personally been paid? Those are two different
 17 questions.
 18 Q The bill submitted by the firm to whom?
 19 A I'm not sure who we send them to. I assume
 20 we send them to counsel for the plaintiffs --
 21 Q Oh, the firm being Lexecon?
 22 A Yes.
 23 Q Okay, yes. How much of the bill is from
 24 Lexecon then?

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1 our agreement, I believe.
 2 MR. BAKER: Actually, it's not. The agreement
 3 is pretty specific, that you can ask deposition
 4 questions, but we can look at the issue again.
 5 I think the stipulation is pretty specific.
 6 Don't roll your eyes, David. I mean,
 7 because we thought we were allowed subpoenas, and you
 8 said no, and the Judge has issued a pretty clear
 9 ruling that it's not covered by the stipulation.
 10 We can look at the issue, and maybe we will
 11 provide it, and maybe we won't.
 12 MR. OWEN: All of our witnesses have provided
 13 that information. We haven't objected to it. We
 14 think it's certainly relevant.
 15 MR. BURKHOLZ: Have they provided it in
 16 deposition?
 17 MR. OWEN: Indeed.
 18 MR. BURKHOLZ: The amounts that they have been
 19 billed and paid?
 20 MR. OWEN: Yes.
 21 MR. BURKHOLZ: Why don't you maybe leave a
 22 blank in his deposition, and he can fill it in when
 23 he reviews it.
 24 A Okay. I will be happy to do that.

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1 MR. OWEN: All right. I don't have any more
 2 questions really. Thank you very much.
 3 A Thank you. Again, I apologize for the
 4 weather.
 5 THE VIDEOGRAPHER: This marks the conclusion
 6 of today's deposition of Daniel Fischel.
 7 Going off the record, the time is now
 8 4:28 p.m.
 9 (Whereupon, at 4:28 p.m., the
 10 signature of the witness having
 11 been reserved, the witness being
 12 present and consenting thereto,
 13 the taking of the instant
 14 deposition ceased.)
 15
 16 IN THE UNITED STATES DISTRICT COURT
 17 FOR THE NORTHERN DISTRICT OF ILLINOIS
 18 EASTERN DIVISION
 19
 20 LAWRENCE E. JAFFE PENSION PLAN,)
 21 on behalf of Itself and All)
 22 Others Similarly Situated,)
 23 Plaintiffs,)
 24 vs.) No. 02 C 5893

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1 at said deposition except as I have so indicated
 2 on the errata sheets provided herein.
 3
 4 _____
 5 DANIEL R. FISCHEL
 6
 7 No corrections (Please initial) _____
 8 Number of errata sheets submitted _____ (pgs)
 9
 10 SUBSCRIBED AND SWORN TO
 11 before me this ____ day
 12 of _____, 2008.
 13
 14 _____
 15 NOTARY PUBLIC
 16
 17
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 19
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Page 210

1 HOUSEHOLD INTERNATIONAL, INC.,)
 2 et al.,)
 3 Defendants.)
 4
 5 I, DANIEL R. FISCHEL, state that
 6 I have read the foregoing transcript of the
 7 testimony given by me at my deposition on
 8 the 21st day of March 2008, and that said
 9 transcript constitutes a true and correct
 10 record of the testimony given by me
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1 STATE OF ILLINOIS)
) SS:
 2 COUNTY OF C O O k)
 3
 4 I, RICHARD H. DAGDIGIAN, Illinois CSR No.
 5 084-000035, Registered Professional Reporter and
 6 Notary Public in and for the County of Cook, State of
 7 Illinois, do hereby certify that previous to the
 8 commencement of the examination, said witness was
 9 duly sworn by me to testify the truth; that the said
 10 deposition was taken at the time and place aforesaid;
 11 that the testimony given by said witness was reduced
 12 to writing by means of shorthand and thereafter
 13 transcribed into typewritten form; and that the
 14 foregoing is a true, correct, and complete transcript
 15 of my shorthand notes so taken as aforesaid.
 16 I further certify that there were present at
 17 the taking of the said deposition the persons and
 18 parties as indicated on the appearance page made a
 19 part of this deposition.
 20 I further certify that I am not counsel for
 21 nor in any way related to any of the parties to this
 22 suite, nor am I in any way interested in the outcome
 23 thereof.
 24

1 I further certify that this certificate
2 applies to the original signed IN BLUE and certified
3 transcripts only. I assume no responsibility for the
4 accuracy of any reproduced copies not made under my
5 control or direction.

6

7 IN TESTIMONY WHEREOF, I have hereunto set
8 my hand and affixed my notarial seal this ___ day of
9 _____, 2008.

10

11

12

13

Richard H. Dagdigian, CSR, RMR, CRR

14

15

My Commission expires

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May 1, 2011.

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THE CLERK: 02 C 5893, Jaffe v. Household
International.

THE COURT: Good morning, everyone. Is there any
issues that the parties want to take up?

09:18:29

MR. DOWD: I believe, your Honor, we brought our
response to the Court's jury instructions this morning. I
believe Mr. Drosman has them.

04-16-09 Volume 12

8 A. Thank you.

9 Q. And is that your quantification of the inflation under
04: 12: 15 10 your leakage model?

11 A. Yes. If you can put it on the screen maybe.

12 Q. Did you prepare this document?

13 A. I did.

14 MR. BURKHOLZ: Your Honor, I don't believe there's an
04: 12: 24 15 objection to 1395 if we can move it into evidence.

16 THE COURT: It will be admitted.

17 (Plaintiffs' Exhibit 1395 received in evidence.)

18 BY MR. BURKHOLZ:

19 Q. Can you explain what this exhibit is?

04: 12: 35 20 A. This exhibit, again, is analogous to the previous exhibit
21 which focused on the 14 specific disclosures; but this exhibit
22 takes leakage into account and, once again, has a calculation
23 of the stock price on every day, what the true value is, which
24 is what my calculation is of the uninflated price, what the
04: 13: 00 25 price should have been had there been no fraudulent

Fischel - direct

2683

1 disclosures or omissions in the various Household statements
2 and disclosures during the relevant period. That's the second
3 column, true value.

4 And the artificial inflation is the number in the
04: 13: 20 5 last column. And, again, you'll see that it's different from
6 7.97 at the beginning because this calculation doesn't just
7 focus on 14 disclosures. It focuses on all the negative
8 disclosures that came out, particularly after November 15th
9 when the market started to, in a much more systematic way,
04: 13: 44 10 disbelieve Household's denials that it was engaging in
11 predatory lending and that it was engaging in improperly

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12 aggressive accounting.

13 Q. Like your specific disclosure model, does this

14 quantification use statistical methods to account for the

04:14:00 15 market and industry influences on Household's stock prices?

16 A. Yes, it does.

17 Q. And did you also analyze whether company-specific factors

18 unrelated to the alleged fraud can explain Household's stock

19 price decline during this latter part of the relevant period?

04:14:16 20 A. Yes, I did. I looked at that carefully.

21 I noticed that there were a lot of disclosures that

22 had some fraud-related information in it and some other

23 disclose -- and part of the disclosure did not have -- dealt

24 with something other that was fraud related.

04:14:37 25 There were some -- some of those disclosures that had

Fischel - direct

2684

1 a positive effect, some had a negative effect; but overall it

2 was impossible to conclude that the difference between the

3 true value line and the actual price would have been any

4 different had there been no disclosures about

04:15:02 5 non-fraud-related information during this particular period.

6 Some positive, some negative. They cancel each other out.

7 Q. Okay. Now, reaching your opinion about inflation, did you

8 consider whether investors during the relevant period were

9 fully informed about Household's accounting and lending

04:15:17 10 practices?

11 A. I did.

12 Q. And what did you find?

13 A. I found that they were not fully informed for a number of

14 different reasons.

04:15:25 15 Q. And what were the reasons?

16 A. Well, first, the disclosures coming out criticizing

04-16-09 Volume 12

17 Household's practices didn't come from Household; and if a
18 company is disclosing information about itself, it's one thing
19 for third parties to comment, but it's another thing for the
04: 15: 46 20 information to come directly from the company itself.

21 Since the company was not disclosing what the
22 analysts and the critics were saying, market participants did
23 not have full information.

24 Q. Okay. So you had your analysts' reaction or commentary,
04: 16: 03 25 some of -- the Barron's article and the analysts' reports, the

Fischel - direct

2685

1 Legg Mason article we looked at -- report we looked at in
2 December, right?

3 A. Yeah, and many others. In other words, disclosures by
4 third parties is not the same as disclosures by the company
04: 16: 17 5 itself.

6 In a situation like this, disclosures by third
7 parties are given less weight; and, therefore, investors were
8 not fully informed for that reason.

9 But that effect is compounded by the fact that
04: 16: 30 10 Household, throughout the period, is denying that there's any
11 problem, so that even with respect to the third-party
12 disclosures, which are less important than disclosures by the
13 company, those disclosures are being discounted through much
14 of the period until the very end because of management
04: 16: 50 15 denials.

16 By the very end, the denials of management are
17 systematically disregarded by many analysts and market
18 participants.

19 In addition to that, I came across a lot of
04: 17: 06 20 information that regulators concluded, a lot of exam reports,

3 04-16-09 Volume 12
MR. DOWD: No, your Honor, just 12:30 tomorrow?

4 THE COURT: 12:30 tomorrow.

04:30:45 5 MR. DOWD: Thank you, your Honor.

6 THE COURT: We'll see you all then.

7 MR. KAVALER: Thank you, your Honor.

8 THE COURT: Thank you.

9 (Court adjourned, to reconvene at 12:30 p.m. on 4-17-09.)

10 * * * * *

11 C E R T I F I C A T E

12 We certify that the foregoing is a correct
13 transcript from the record of proceedings in the
14 above-entitled matter.

15 /s/ Nancy C. LaBella
16 _____

17 /s/ Frances Ward
18 _____

19 /s/ Kathleen Fennell
20 _____ April 17, 2009
Date

21 Official Court Reporters
22 United States District Court
Northern District of Illinois
Eastern Division

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04-20-09 Volume 14

2802

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

3 LAWRENCE E. JAFFE PENSION PLAN,)
4 on behalf of itself and all)
5 others similarly situated,)
Plaintiff,)

6 vs.)

7 HOUSEHOLD INTERNATIONAL, INC.,)
8 et al.,)
9 Defendants.)

No. 02 C 5893

Chicago, Illinois
April 20, 2009
9:00 a.m.

10 VOLUME 14
11 TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a jury

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04-20-09 Volume 14

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THE CLERK: 02 C 5893, Jaffe v. Household
International.

THE COURT: Good morning, everyone.
Can we bring the jury out?

09:10:59

MR. DOWD: Your Honor, there are a couple of issues I
mentioned on Friday that needed to be addressed. One was a
stipulation regarding the exhibit that was the record of

04-20-09 Volume 14

3 MR. KAVALER: Pass them out.

4 (Brief pause.)

5 BY MR. KAVALER:

6 Q. And what this exhibit shows us, Professor, it presents the
7 quantification of total inflation on each day during the
8 relevant time period using your first method?

9 A. That's correct.

01:10:04 10 Q. And in this quantification using specific disclosures, you
11 only included those dates on which news --

12 MR. KAVALER: Withdrawn. That's not right.

13 BY MR. KAVALER:

14 Q. This is every day from July 30 -- every -- that's not
01:10:20 15 right, either.

16 This is every trading day from July 30, 1999, through
17 October 11, 2002?

18 A. Correct.

19 Q. Okay. Got it right on the third try.

01:10:30 20 Now, as you and I were discussing before lunch,
21 you've already shown us at least one example of inflation
22 going into the stock price; and, that was the December 5,
23 2001, event, correct?

24 A. Correct.

01:10:42 25 Q. Okay.

♀

Fischel - cross

2874

1 And that was after Mr. Aldinger spoke at the Goldman
2 Sachs conference?

3 A. Correct.

4 Q. Okay.

01:10:53 5 And, so, we know at least on that day we can find
6 inflation coming into the stock. And let's see if we can look

04-20-09 Volume 14

7 together at how that works.

8 Turn in this exhibit, if you would, to Page 13.

9 MR. KAVALER: And can we highlight the entry for

01: 11: 12 10 December 5, 2001.

11 BY MR. KAVALER:

12 Q. And this shows us actual inflation in that column is

13 \$6.05, correct?

14 A. That's right.

01: 11: 29 15 Q. Okay.

16 And on December 6th, the inflation is also \$6.05?

17 A. Correct.

18 Q. And on December 7, same thing: \$6.05?

19 A. Correct.

01: 11: 38 20 Q. But on December 4, the day before, it was \$4.20, correct?

21 A. Correct.

22 Q. So, that's where you got the number that was on the
23 demonstrative you showed us during your direct testimony of a

24 dollar eighty-five. A dollar eighty-five is the difference

01: 11: 53 25 between 4.20 and 6.05?

♀

Fischel - cross

2875

1 A. That's right.

2 Q. So, the way we did that is we saw the inflation increase
3 from 4.20 to 6.05?

4 A. Correct.

01: 12: 03 5 Q. So, Mr. Aldinger's statement to Goldman Sachs at the

6 Goldman Sachs conference, in the language you and I agreed to
7 use this morning about measure effect, had an effect, correct?

8 A. Correct.

9 Q. And the effect was to create artificial inflation in the

01: 12: 17 10 amount of a dollar eighty-five?

11 A. Correct.

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12 Q. Okay.

13 Now, let me show you Plaintiffs' Demonstrative 139.

14 And that was your analysis of this day.

01:12:42 15 The residual price change of 1.85 is the very thing
16 you and I just talked about?

17 A. Correct.

18 Q. And the text on there discusses the event that caused that
19 effect. That's Mr. Aldinger's speech at Goldman Sachs?

01:12:56 20 A. That's right.

21 Q. Okay.

22 And now let's look at Exhibit 1391 in evidence.

23 MR. KAVALER: And, again, your Honor, may I publish
24 this to the jury, as well, so they can follow on their own
01:13:21 25 copy?

♀

Fischel - cross

2876

1 MR. BURKHOLZ: Your Honor, Mr. Kavalier did not follow
2 the protocol of providing me with everything he's --

3 MR. KAVALER: I'm terribly sorry. Very sorry.
4 They're your exhibits.

01:13:29 5 MR. BURKHOLZ: I don't have any objection.

6 MR. KAVALER: Okay.

7 MR. BURKHOLZ: That's fine.

8 MR. KAVALER: Give him the other one, too.

9 THE COURT: I'm sorry, is there an objection?

01:13:37 10 MR. KAVALER: May I hand them out, your Honor?

11 THE COURT: Is there an objection?

12 MR. KAVALER: No, there's no objection.

13 MR. BURKHOLZ: I would like all of the other ones
14 they're going to show the jury.

01:13:43 15 THE COURT: Why don't we do that now --

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A439

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16 MR. KAVALER: Okay.

17 THE COURT: -- and get it done.

18 MR. KAVALER: There are only two others I might show
19 the jury.

01:13:52 20 Why don't you give him copies of --

21 I think I won't show them to them, your Honor.

22 THE COURT: I'm sorry?

23 MR. KAVALER: I think I won't show them. They're
24 single pages. Easy enough. I'm showing them these because

01:14:04 25 they're large and cumbersome.

♀

Fischel - cross

2877

1 THE COURT: All right.

2 Does he have all the ones you're going to use now?

3 MR. BURKHOLZ: I believe so.

4 MR. KAVALER: The one ones I intend to publish to the
01:14:11 5 jury, yes, your Honor.

6 THE COURT: Okay.

7 Which exhibit are you seeking to publish now?

8 MR. KAVALER: Plaintiffs' 1391 in evidence, your
9 Honor.

01:14:16 10 THE COURT: It's in evidence. It may be published.

11 MR. KAVALER: Thank you, your Honor.

12 (Document tendered to the jury.)

13 (Brief pause.)

14 BY MR. KAVALER:

01:14:30 15 Q. All right. Now, this, Professor Fischel -- 1391 -- is the
16 results of your event study?

17 A. Correct.

18 THE COURT: Why don't you wait a second until the
19 jurors are through passing those around.

01:14:45 20 MR. KAVALER: Yes, sir.

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21 (Brief pause.)

22 MR. KAVALER: Okay. Looks like everyone has one.

23 BY MR. KAVALER:

24 Q. Professor, if you turn to Page 30 and look at an entry for

01:14:59 25 December 5 --

Fischel - cross

2878

1 MR. KAVALER: Can we highlight that, please, Brian?

2 BY MR. KAVALER:

3 Q. And that tells us, according to what you testified to
4 Thursday because of the three -- well, let me ask this way:

01:15:15 5 Does this tell us that this is a statistically-significant

6 price increase that resulted in inflation on December 5, 2001?

7 A. Yes, it does.

8 Q. Okay.

9 So, we've just gone through together an example of
01:15:36 10 inflation coming into the price of Household stock as an
11 effect or as a result of a statement that Mr. Aldinger made,
12 correct?

13 A. That's right.

14 Q. And I think you testified on direct that the reason the
01:15:53 15 price went up is because of what Mr. Aldinger said?

16 A. Correct.

17 Q. So, Mr. Aldinger's remarks caused the price to go up?

18 A. Correct.

19 Q. Gotcha.

01:16:01 20 All right. So, let's put December 5, 2001, on the
21 white board.

22 MR. KAVALER: Can everybody see that, more or less?

23 (Jurors nodding.)

24 BY MR. KAVALER:

04-20-09 Volume 14

01:16:32 25 Q. So, this will be a list, Professor Fischel, of days where
Fischel - cross

2879

1 we can see a remark by a defendant causing the price of the
2 stock to go up.

3 A. Okay. That's fine.

4 Q. Okay.

01:16:42 5 Now let's look at Plaintiffs' Demonstrative 140.

6 This is a week later. It's a Legg Mason report. And this
7 time this causes the price to go down, correct?

8 A. That's right.

9 Q. It goes down \$2.39?

01:17:08 10 A. Adjusted for market and industry movements based on the
11 statistical model that I used, correct.

12 Q. That's your number up there, 2.39?

13 A. That's right.

14 Q. That's all I'm pointing to.

15 A. That's fine.

16 Q. I'm not quarrelling with you at all.

17 A. I'm not quarrelling with you, either.

18 Q. Okay.

19 (Laughter.)

20 BY THE WITNESS:

21 A. We're agreeing on everything.

22 BY MR. KAVALER:

23 Q. Excellent. Very agreeable fellows here.

24 Okay. And this is the Legg Mason report that causes
01:17:26 25 this decline?

Fischel - cross

2880

1 A. That's correct.

2 Q. And it relates to the same subject matter as
Page 67

04-20-09 Volume 14

3 Mr. Aldinger's remarks at Goldman Sachs a week earlier?

4 A. That's right.

01:17:35 5 Q. Okay. I'm getting the hang of this.

6 And, again, if you look at your Exhibit 1397 at Page

7 13 -- I'm in the wrong place -- I'm in the right place,

8 sorry -- for December 12, 2001, what we see there is we see

9 the price is at three dollars and six- -- I'm sorry.

01:18:11 10 MR. KAVALER: Withdrawn.

11 BY MR. KAVALER:

12 Q. The artificial inflation is at \$3.66 on December 12,

13 correct?

14 A. I don't want to interrupt you, sir, but could I also have

01:18:21 15 a copy?

16 Q. Oh, absolutely.

17 A. I prefer that to --

18 Q. I apologize.

19 A. -- Looking back and forth.

01:18:24 20 Q. I thought you had the exhibits up there.

21 A. Yeah, but I have to find them every time. It's just

22 simpler if I have a copy.

23 Q. I apologize.

24 MR. KAVALER: Get me a copy of the other one, too.

01:18:36 25 I thought you had Thursday's exhibits. Sorry.

♀

Fischel - cross

2881

1 (Document tendered.)

2 THE WITNESS: Thank you. Appreciate it.

3 MR. KAVALER: Here's a copy of 1391, as well.

4 THE WITNESS: Got it.

01:18:44 5 (Document tendered.)

6 MR. KAVALER: Figured since I wasn't moving them into

04-20-09 Volume 14

7 evidence, I'd save the trip.

8 BY MR. KAVALER:

9 Q. Okay. So, we're on Page 13 of 1397. We're looking at the
01:18:51 10 entry for December 12, 2001. We see that the artificial
11 inflation is \$3.66, correct?

12 A. Correct.

13 Q. And the day before, the artificial inflation on December
14 11 was \$6.05, correct?

01:19:04 15 A. That's right.

16 Q. And the difference between those two, if my math serves,
17 is the \$2.85 we're talking about?

18 A. That's right.

19 Q. \$2.39, which appears on Plaintiffs' Demonstrative 140?

01:19:15 20 A. Correct.

21 Q. Okay. Good.

22 And now if you'll look at your event study, which is
23 Plaintiffs' 1391 in evidence, and turn to Page 31 and you'll
24 see the entry there for December 12, 2001. And that shows a
01:19:38 25 statistically-significant price decrease that resulted in

Fischel - cross

2882

1 inflation on December 12, correct?

2 A. Correct.

3 Q. And that's as a result of the Legg Mason report, correct?

4 A. Correct.

01:19:49 5 Q. And if we go to Plaintiffs' Demonstrative 140, we see,
6 again, the same format. Up in the box, you've got the dollar
7 amount of the residual price change; and, in the text, you
8 explain what it is Legg Mason is saying?

9 A. Correct.

01:20:06 10 Q. All right.

11 So, in this one example, we see the inflation coming
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12 in on December 5, and we see it coming out on December 12,
13 correct?

14 A. We see inflation increasing on December 5th and decreasing
01:20:28 15 on December 12th, that's correct.

16 Q. And the amount of the decrease is larger than the amount
17 of the increase?

18 A. Correct.

19 Q. So, all of the inflation that increased on December 5 came
01:20:39 20 out in the decrease a week later?

21 A. I guess you could call it that, but --

22 Q. I'll tell you why I think that.

23 A. Please, go ahead.

24 Q. Sure.

01:20:50 25 MR. BURKHOLZ: Your Honor, he's interrupting the
Fischel - cross

2883

1 witness.

2 MR. KAVALER: I'm sorry.

3 BY MR. KAVALER:

4 Q. It came in because of whatever Mr. Aldinger said at
01:21:00 5 Goldman Sachs?

6 A. Well, when you say "came in," there's pre-existing
7 inflation. So, it increased as a result of the statements
8 made on December 5th. And, then, because there was a partial
9 corrective disclosure on December 12th, that decreased the
01:21:19 10 amount of inflation.

11 I think that's the proper relationship.

12 Q. I appreciate your correcting my terminology. I'll try to
13 stick to "increased" and "decreased."

14 And the amount of the decrease was greater than the
01:21:31 15 amount of the increase?

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16 A. Based on those two dates, that's correct.

17 Q. Right.

18 So, for example, Professor, if we were to assume --
19 just like the plaintiff asked you to make an assumption, I'm
01:21:46 20 asking you to make an assumption -- that's all this case were
21 about; the only statement by Mr. Aldinger or by Household in
22 this case were that one; he made it on the 4th; the market
23 reacted on the 5th; there was what you described as a partial
24 corrective disclosure on the 12th; the decrease was larger
01:22:08 25 than the increase, you would say the inflation that -- the

Fischel - cross

2884

1 increased inflation that -- occurred had been dissipated --
2 at least dissipated -- because the decrease was smaller -- and
3 we're finished, right?

4 A. Decrease is larger, not smaller.

01:22:24 5 Q. I apologize.

6 You understood my point?

7 A. Well, in your hypothetical, if that were the whole case, I
8 would say that assuming the -- again, the -- hypothetical jury
9 found the statement on December 5th to be false and
01:22:38 10 misleading, then all purchasers of Household stock between
11 December 5th and December 12th suffered harm because they
12 purchased at a price that was greater than the true value;
13 and, then, the price and the true value equaled each other,
14 again, on December 12th.

01:22:58 15 So, in your hypothetical, any investors before
16 December 12th wouldn't suffer any harm and any investors after
17 December 12th wouldn't suffer any harm, but investors between
18 December 5th and December 12th would suffer harm.

19 Q. I'd be happy to take the gift you just gave me, but I
01:23:14 20 think you misspoke when you said any investors before December

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21 12 wouldn't suffer harm and any investors after December 12th
22 wouldn't suffer any harm. You meant before the 5th and after
23 the 12th?

24 A. I did. If I misspoke, I appreciate the correction.

01: 23: 25 25 Q. And when you said Mr. Aldinger's statement on the 5th, you
Fischel - cross

2885

1 meant his statement on the 4th, which is when he spoke to
2 Goldman Sachs after the market closed, right?

3 A. Yeah. I was thinking in terms of trading days.

4 Q. Right. That was exactly my point.

01: 23: 36 5 He spoke, you know, after the market closed, so it's
6 reflected in the following day's trading?

7 A. That's my recollection.

8 Q. Perfect. Okay.

9 Let's see if we can do that same exercise, Professor,
01: 23: 56 10 with some other dates.

11 A. Okay.

12 Q. Hopefully, now that we know how to do it, at least I can
13 do it more efficiently.

14 Let's look at some of the other dates that the
01: 24: 03 15 plaintiffs have either shown this jury or I understand are
16 going to show this jury or they may show this jury.

17 They've shown this jury the 10-K -- I'm sorry, the
18 10-Q -- that Household filed on August 16, 1999.

19 A. Okay.

01: 24: 20 20 Q. Okay. Let's see what happened on August 16, '99. Let's
21 do the same methodology we just used. Let's start by looking
22 at Plaintiffs' 1397. And we'll look on Page 1 for August 16,
23 1999.

24 And that shows us that the artificial inflation that

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01: 24: 40 25 day was 7.97, correct?

♀

Fischel - cross

2886

1 A. Correct.

2 Q. And the artificial inflation the day before was 7.97,
3 correct?

4 A. That's right.

01: 24: 45 5 Q. And the artificial inflation the day after was 7.97?

6 A. Correct.

7 Q. In fact, to save time, the "Artificial Inflation" column
8 on this entire page is 7.97?

9 A. That's right.

01: 24: 54 10 Q. Okay.

11 So, that means, in the language we were just using --
12 we've just used -- the filing of the Household 10-K on August
13 16, 1999, had no effect on the amount of inflation in the
14 stock?

01: 25: 15 15 A. You know, you can't say that definitively. It depends.

16 Is this the -- what assumption am I making as to whether this
17 is the first false and misleading disclosure?18 Q. I'll tell you what assumptions to make. Assume your chart
19 is accurate.

01: 25: 29 20 A. Okay.

21 Q. Assume I've read the numbers correctly.

22 A. Okay.

23 Q. And assume I'm trying to understand the process. So, I'm
24 looking at August 13, where I see the inflation is 7.97, okay?

01: 25: 39 25 A. Okay.

♀

Fischel - cross

2887

1 Q. And, then, I'm looking at August 16 or August 17 because
2 we don't know what time of the day it was filed.

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3 A. Right.

4 Q. And on both days I see "7.97."

01:25:48 5 A. Okay.

6 Q. So, the number hasn't changed?

7 A. All right. And let me explain why that is, sir.

8 Q. First, you agree with me?

9 A. No, obviously, the number hasn't changed.

01:25:57 10 Q. Okay.

11 And you prepared these numbers?

12 A. I did.

13 Q. I had nothing to do with it?

14 A. No, that's right, you had nothing to do with it.

01:26:03 15 But --

16 Q. All right.

17 A. -- the reason is that this document, as I hopefully
18 explained earlier, is based on the assumption that the first
19 time where there is a false and misleading disclosure or the
01:26:19 20 failure to make an accurate disclosure is on July 30th, 1999,
21 which is why the exhibit begins on July 30th, 1999.

22 Based on my first method, the specific disclosure
23 method -- not the second method, the specific disclosure
24 method -- nothing changes between the time of the first

01:26:45 25 misleading disclosure or failure to disclose on July 30th and

Fischel - cross

2888

1 August 16th. And that is why there was no change in inflation
2 between August 15th, August 16th, August 17th.

3 If, on the other hand -- and this is what I tried to
4 explain in terms of how the exhibit should be interpreted, if

01:27:08 5 -- the jury were to conclude that there was no misleading

6 disclosure on July 30th or failure to disclose accurately on

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7 July 30th, but the first misleading disclosure was the second
8 quarter result announcement on August 16th, then the right way
9 to read the exhibit would be that the amount of artificial
01:27:32 10 inflation from July 30th to August 15th is zero; and, then, it
11 goes from zero to 7.97 on August 16th.

12 So, when inflation increases or decreases is a
13 function of what the jury concludes as to when the first
14 misleading disclosure that Household makes is. And the proper
01:27:54 15 number of inflation is zero on every day until the day that
16 the jury concludes, if they so conclude, that Household made a
17 misleading disclosure.

18 Q. But I'm looking at 1397 in the column headed "Artificial
19 Inflation." I don't see any zeros, right?

01:28:12 20 A. There's no zeros because of the assumption that -- I hope
21 I explained clearly, but if not, I'll try and explain it,
22 again.

23 Q. That's okay.

24 A. -- that the first time inflation entered Household's stock
01:28:25 25 price was July 30th. But that's a jury determination. It's

Fischel - cross

2889

1 not a determination for me to make.

2 So, any date later than that, if the jury concludes
3 that's the first date of a misleading disclosure, the right
4 way to read the exhibit is to substitute zero for 7.97 until
01:28:45 5 the date -- the first date -- that the jury concludes there
6 was a misleading disclosure.

7 Q. For purposes of this question, I'll agree with you. Let's
8 assume it starts on July 30, 1999, okay?

9 A. Okay.

01:28:57 10 Q. So, then, we agree that if it starts on July 30, 1999,
11 whatever Household said on August 16 had no effect?

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12 A. That's correct --

13 Q. Okay.

14 A. -- based on that assumption.

01:29:11 15 Q. A witness named Mr. Devor was here last week and he showed
16 us this chart (indicating). I don't know if you can see that.

17 It's just the cover sheets of a series of 10-Ks and -Qs. And
18 this is the one I just asked you about, the June 30, 1999 --

19 A. Okay.

01:29:30 20 Q. -- Q, which was filed on August 16, 1999.

21 So, based on what we just talked about, I'm going to
22 cross that off my list. I will not come back to it, again,
23 and I will not put it on that list over there (indicating).

24 Okay?

01:29:49 25 A. Okay.

♀

Fischel - cross

2890

1 Q. Okay.

2 If you look at your event study for this day --
3 that's Exhibit 1391, and it's on Page 1 -- did you find a
4 statistically-significant price increase that resulted in

01:30:22 5 inflation on August 16, 1999?

6 A. No, sir, I did not.

7 Q. Okay.

8 I should have asked you that before I put my X up
9 there. I apologize. I'll get the hang of this.

01:30:35 10 All right. Let's look at the next one.

11 Plaintiffs may show you a press release that -- I'm
12 sorry, plaintiffs may show the jury a press release -- that
13 Household issued on October 19, 1999. I'm going in
14 chronological order. How much did you find that inflation

01:30:53 15 increased or decreased on that date when that press release

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16 was issued?

17 And to do that, we're going to look, again, at

18 Plaintiffs' 1397. We're going to turn to Page 2, look at the

19 entry for October 19. And to save time, I will observe --

01:31:10 20 tell me if I'm right -- this whole page also has actual

21 inflation steady at 7.97 throughout, correct?

22 A. Correct.

23 And, again, I just want to make sure we're talking

24 about my -- the first method.

01:31:20 25 Q. The first method.

Fischel - cross

2891

1 A. Okay.

2 Q. Absolutely.

3 A. Because the second method is different.

4 Q. Understood.

01:31:24 5 Your first method, 7.97 throughout the page, right?

6 A. Correct.

7 Q. So, therefore -- can I cut to the chase and eliminate all

8 the interim steps, therefore -- you agree that the filing by

9 Household -- the issuance by Household -- of the press release

01:31:38 10 on October 19, 1999, had no effect on the amount of inflation?

11 A. I would not agree with that for the reasons that I stated

12 before.

13 It would have no effect on the amount of inflation if

14 the jury were to conclude that Household made a false and

01:31:57 15 misleading disclosure prior to this date. If that were the

16 case, then there would be no change. But if the jury were

17 conclude that this was the first date where Household made a

18 false and misleading disclosure, again, then the proper way to

19 read the exhibit would be every day prior to this date would

01:32:15 20 have zero inflation and \$7.97 of inflation would have entered

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21 Household's stock price on this date.

22 Q. What I'm trying to avoid is me asking you the exact same
23 questions for every document and you giving me the exact same
24 answers. I'm accepting, for purposes of this series of
01:32:31 25 questions, what you said earlier, that your starting

Fischel - cross

2892

1 assumption was the first false statement was July 30.

2 A. Fine. It's just that I have to answer your question
3 accurately as you ask it.

4 Q. I appreciate that.

01:32:46 5 But on those assumptions, just as we established with
6 regard to the June 30 10-Q, so you would agree, would you not,
7 that the -- let me ask you before I do that -- let's look at
8 1391.

9 And we're looking for October 19, which is on Page 3.
01:33:06 10 October 19, 1999.

11 Do you see that?

12 A. I do.

13 Q. Did you find any statistically-significant price increase
14 that resulted in inflation on October 19, 1999?

01:33:19 15 A. No, I did not.

16 Q. Okay.

17 So, based on those two answers, I'm going to cross
18 off this one (indicating), and I'm not going to list it on
19 that board following the methodology we're using?

01:33:32 20 A. Sir, what you decide to cross off or what you do with your
21 boards, I'm not going to give you any advice on that.

22 Q. Fair enough.

23 But we agreed that we would list over there on the
24 white board any disclosure that caused an increase in

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01: 33: 45 25 inflation. Remember that?

♀

Fischel - cross

2893

1 A. Again, I'm not sure what decision rule you're using with
2 respect to what you're writing down, what you're crossing off,
3 what you're leaving alone. You know, that's however you
4 decide to do it.

01: 34: 02 5 Q. I'm sure the jury remembers what we said to each other.
6 I'm going to cross off this one and not come back to it,
7 again.

8 Let's go to the next one.

9 Plaintiffs have shown this jury the December 31st,
01: 34: 27 10 1999, 10-K that Household filed on March 28, 2000. Let's look
11 at first Exhibit No. 1397 for March 28, 2000. And that's on
12 Page 4.

13 And, again, we'll highlight it on the board there.

14 And to save time, you agree that the number in the
01: 34: 53 15 "Artificial Inflation" column on this page is \$7.97 throughout
16 the page?

17 A. I do, sir.

18 Q. Okay.

19 Then let's go to your event study, which is
01: 35: 03 20 Plaintiffs' Exhibit 1391, and we'll find the same date, which
21 is 3-28-2000.

22 And that will be on Page 8.

23 A. Okay, I have it.

24 Q. Did you find any statistically-significant price increase
01: 35: 28 25 that resulted in inflation on March 28th, 2000?

♀

Fischel - cross

2894

1 A. No, sir, I did not.

2 Q. All right. I won't bother you about this one.

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3 MR. KAVALER: Don't have it? Plaintiffs'

4 Demonstrative 99.

01: 35: 44 5 Sorry. 99, 10-K.

6 BY MR. KAVALER:

7 Q. Plaintiffs have shown this jury the March 31, 2000, 10-K

8 that Household filed on May 10, 2000. Let's do the same

9 exercise. Let's look at your chart, which is 1397 in

01: 36: 22 10 evidence. Let's look at 5-10-2000, which is on Page 5.

11 Again, try to save time. Same result: No increase
12 in artificial inflation?

13 A. Correct.

14 Q. And now let's look at your event study, which is

01: 36: 39 15 Plaintiffs' 1391 for the same date. It's on Page 10. Did you

16 find a statistically-significant price increase that resulted

17 in inflation on May 10, 2000?

18 A. No, sir, I did not.

19 Q. Okay.

01: 36: 58 20 So, once again --

21 MR. KAVALER: I think I'm crossing the wrong thing

22 off. I'll fix it later. I'm confusing myself here.

23 BY MR. KAVALER:

24 Q. Plaintiffs have shown this jury the June 30 10-K -- 10-Q,

01: 37: 25 25 rather -- that Household filed on August 11, 2000. Let's look

Fischel - cross

2895

1 at August 11, 2000, in the first document, which is 1397.

2 It's on Page 6.

3 Once again, no increase in artificial inflation,
4 correct?

01: 37: 41 5 A. Correct.

6 Q. And let's look at it in your event study on Page 14.

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A455

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7 Did you find any statistically-significant price
8 increase that resulted in inflation on August 11, 2000?

9 A. No, sir, I did not.

01:38:03 10 Q. All right.

11 Plaintiffs have shown this jury a newspaper article
12 in the St. Louis Post-Dispatch on November 1, 2000, and that
13 one says something about, "Craig Strem says HFC never
14 pressures people to buy credit life insurance."

01:38:33 15 Let's do the same exercise. Look at Plaintiffs'
16 Exhibit 1397 for November 1, 2000, at Page 7.

17 A. I see it.

18 Q. Okay.

19 No increase in artificial inflation in connection
01:38:49 20 with that event, either, right?

21 A. That's correct.

22 Q. All right.

23 Now, let's look at your event study, which is
24 Plaintiffs' Exhibit 1391. I'm going to go to Page 17. And
01:39:04 25 you see the entry there for 11-1-2000?

♀

Fischel - cross

2896

1 A. I do, sir.

2 Q. Did you find any statistically-significant price increase
3 that resulted in inflation on 11-1-2000?

4 A. No, sir, I did not.

01:39:17 5 Q. Okay.

6 MR. KAVALER: Plaintiffs' Demonstrative No. 12,
7 please.

8 BY MR. KAVALER:

9 Q. Plaintiffs have shown this jury the Origination News
01:39:28 10 article that appeared on March 23, 2001, which says something
11 about Gary Gilmer saying the company's position on predatory

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12 Lending is perfectly clear.

13 I think we have the language up here. It's the
14 second one. This one here (indicating), down at the bottom.

01:39:50 15 A. I see it, sir.

16 Q. Okay. Thank you.

17 Let's look at your Plaintiffs' Exhibit 1397. We'll
18 go to Page 9. We'll look at 3-23-01. And let's look at
19 3-28-01. It's possible there might be a mistake in the
01:40:19 20 dating, possibly not; but, either way, there's no change in
21 the artificial inflation in that column?

22 A. That's correct, sir.

23 Q. Okay.

24 And, then, let's go to your event study. And I guess
01:40:33 25 we'll have to -- this is Exhibit No. 1391. It is the right

Fischel - cross

2897

1 date.

2 And we'll look at Page 21. Did you find a
3 statistically-significant price increase that resulted in
4 inflation in connection with either March 23 or March 28,
01:41:01 5 2001?

6 A. Let me just check something because -- it looks like March
7 23rd is a statistically-significant price increase.

8 Q. And the 28th is not?

9 A. Correct.

01:41:22 10 Q. Okay.

11 This is plaintiffs' board. So, we'll see how we
12 resolve that.

13 Let me ask you this -- well, let me come back to
14 that. So, we'll leave this one open for the moment.

01:41:39 15 The plaintiffs have shown this jury the December 31,

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16 2000, 10-K that Household filed on March 28th, '01. That's
17 one of the dates we just looked at and, in Exhibit 1397, we
18 found no change in artificial inflation, correct?

19 A. That's correct.

01:41:53 20 Q. And on your event study, which is Exhibit 1391, we found
21 no statistically-significant price increase that resulted in
22 inflation on March 28, correct?

23 A. That changed the amount of inflation, correct.

24 Q. Okay.

01:42:12 25 So, that's the December 31 10-K. Plaintiffs have

Fischel - cross

2898

1 shown this jury the Star Tribune article that appeared on July
2 27, 2001 --

3 MR. KAVALER: This is Plaintiff's Demonstrative 13.

4 BY MR. KAVALER:

01:42:42 5 Q. -- in which they say Household spokeswoman Megan Hayden
6 said the terms of loans are disclosed to all customers?

7 MR. KAVALER: You can put it right in front. Put it
8 up -- sorry. Should have known you'd know what to do.

9 BY MR. KAVALER:

01:43:01 10 Q. So, we're looking at July 27, '01. It's this one over
11 here (indicating).

12 It's Megan Hayden saying, "The terms of loans are
13 disclosed to all customers as required by state and federal
14 laws -- " and something has been left out on this board -- "so

01:43:25 15 I take exception to any characterization that we engaged in
16 predatory lending practices."

17 By the way, Professor, you understand these are
18 plaintiffs' boards, we just blew them up?

19 A. I don't have -- I don't have -- any understanding, one way
01:43:36 20 or the other.

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21 Q. Do you see in the lower right-hand corner it says
22 "PDEM013"?

23 A. Actually, I can't really read it from here, but I'm sure
24 that's what it -- there's no need to show it to me. I'm sure
01: 43: 47 25 that's what it says.

♀

Fischel - cross

2899

1 Q. I was going to bring it over to you.

2 A. No, I'm happy to --

3 Q. And you know that means "plaintiffs' demonstrative"?

4 A. That's fine.

01: 43: 53 5 Q. So, I'm not the one who left whatever's left out of there,
6 but I'm not suggesting anything follows from it.

7 Okay. Let's look at that date in Exhibit 1397. It's
8 on Page 11. And, again, we have an entire page where
9 artificial inflation is 7.97, correct?

01: 44: 13 10 A. That's right.

11 Q. So, no change here, either?

12 A. Correct.

13 Q. All right.

14 Let's now look in your event study. This is at
01: 44: 20 15 Page -- this is Exhibit 1391. And we go to Page 26, it's the
16 second entry down.

17 Did you find any statistically-significant price
18 increase that resulted in inflation on July 27, 2001?

19 A. No, sir, I did not.

01: 44: 54 20 Q. Let me see if I can shorten this. In fact, you didn't
21 find any statistically-significant price increases that
22 resulted in inflation from July 30, 1999, through November 15,
23 2001; is that right?

24 A. Under the first method, that's correct.

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01: 45: 25 25 Q. The first method. Absolutely.

Fischel - cross

2900

1 A. Correct.

2 Q. Right?

3 Okay.

4 MR. KAVALER: Let's put up everything we have that
01: 45: 33 5 the plaintiffs were kind enough to furnish us that occurred
6 before November 15, 2001.

7 (Brief pause.)

8 MR. KAVALER: January 19, 2000; April 19, 2000;
9 August 11, 2000; October 18, 2000; January 17, 2001.

01: 47: 23 10 MR. BURKHOLZ: Your Honor, is there a question
11 pending or is this demonstrative --

12 MR. KAVALER: These are all following from the last
13 question, your Honor. He told me everything remains the same
14 through a certain date. I'm simply trying to expedite matters
01: 47: 35 15 so we don't waste all afternoon. This is the same process I
16 went through each of the other exhibits. I'd be happy to do
17 it piecemeal. It will just take forever.

18 THE COURT: Do you have an objection?

19 MR. BURKHOLZ: Is there a question pending?

01: 47: 47 20 THE COURT: Do you have an objection?

21 MR. BURKHOLZ: No. It's fine, your Honor.

22 THE COURT: Okay.

23 MR. KAVALER: Thank you.

24 THE COURT: Proceed.

01: 47: 55 25 MR. KAVALER: July 18, 2001.

Fischel - cross

2901

1 BY MR. KAVALER:

2 Q. Now, Professor, I may not have a board for every
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3 statement, but if the statement falls within the same time
4 frame as my last question, you'd give me the same answer?

01:48:17 5 A. If you're just asking me the mechanical question as to
6 whether there's a change in the amount of inflation or whether
7 there's a statistically-significant price increase --

8 Q. Those are my only questions.

9 A. If those are your only questions, as opposed to explaining
01:48:32 10 why the numbers are what they are, then I agree with you.

11 Q. All right.

12 Now let's look at some days after November 15.

13 A. Okay.

14 Q. We're not going to be able to expedite. We're going to
01:48:43 15 have to go day by day.

16 A. Okay.

17 Q. Okay. Plaintiffs may show this jury a December 4 -- I
18 think we did that already. We did Goldman Sachs. It's that
19 one (indicating).

01:48:55 20 MR. KAVALER: Plaintiffs' Demonstrative 23, please.

21 BY MR. KAVALER:

22 Q. Plaintiffs may show this jury a press release that
23 Household issued on January 16, 2002. It looks like this
24 (indicating). It's Mr. Aldinger in the photograph here and
01:49:18 25 talks about receivable and revenue growth exceeded our

Fischel - cross

2902

1 expectations, et cetera.

2 Let's look at January 16, 2002, in your exhibit,
3 Plaintiffs' Exhibit 1397. And that will be on Page 14.

4 And you see that the inflation on January 15 is 3.66.
01:49:45 5 On January 16, it's 3.66. On January 17, it's 3.66.

6 So, although we no longer have a full page of 7.97,

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A461

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7 we still have the same phenomenon. The artificial inflation
8 did not increase upon the issuance of this press release,
9 correct?

01: 50: 00 10 A. That's correct.

11 Q. Okay.

12 And now let's go to your event study, which is

13 Plaintiffs' Exhibit 1391. And let's find the same date, which
14 is January 16, 2002, which will be on Page 32. And tell me

01: 50: 19 15 whether you found a statistically-significant price increase
16 that resulted in inflation on January 16, 2002.

17 A. No, sir, I did not.

18 Q. Plaintiffs have shown this jury the Copley News Service
19 article --

01: 50: 42 20 MR. KAVALER: This is Plaintiffs' Demonstrative 13,
21 please.

22 BY MR. KAVALER:

23 Q. Plaintiffs have shown this jury the Copley News Service
24 article which appeared on February 6th, 2002. I have it over

01: 50: 56 25 here (indicating): "We do the right thing for our borrowers.

Fischel - cross

2903

1 We make good loans. They're not only legal loans, but are
2 beneficial for our customers."

3 Do you see that?

4 A. I do, sir.

01: 51: 05 5 Q. Okay.

6 Let's look at our old friend Plaintiffs' 1397 for
7 that date, February 6. I think we're on the same page, Page
8 14.

9 And you see the inflation there is -- it's a 3.66
01: 51: 19 10 number in a whole column of 3.66 numbers. Not the entire
11 page, but a bunch of them, right?

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12 A. Correct.

13 Q. Again, inflation did not increase upon the release of this
14 press release, right?

01:51:29 15 A. That's right.

16 Again, we're talking only about the first method.

17 Q. Only the first model.

18 A. That's right.

19 Q. Absolutely. I promise you when I switch to the second
01:51:35 20 model, I'll tell you. I have it in my notes.

21 A. Okay.

22 Q. First model. I agree with you.

23 Now, let's look at your event study, Plaintiffs'

24 1391, for the same date, which is February 6, '02, which will
01:51:50 25 be Page 33.

♀

Fischel - cross

2904

1 Did you find any statistically-significant price
2 increase that resulted in inflation from any disclosure on
3 February 6th, 2002?

4 A. Statistically it's giving price decrease, but not
01:52:09 5 increase.

6 Q. But not increase?

7 A. Correct.

8 Q. That's exactly my point. I'm asking about an increase.
9 Not an increase?

01:52:14 10 A. Okay. Not an increase.

11 Q. In other words, whatever Ms. Hayden-Hakes said, it did not
12 artificially -- it did not increase the amount of artificial
13 inflation?

14 A. That's correct. Decreased it.

01:52:33 15 MR. KAVALER: Plaintiffs' Demonstrative 14.

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16 BY MR. KAVALER:

17 Q. Plaintiffs have shown this jury the National Mortgage News
18 article which appeared on February 18, 2002. And that's --
19 what it says there is -- "Our first take on the allegations of
01:52:48 20 predatory lending raised in the ACORN action is that it is not
21 a significant issue, not indicative of any widespread problem
22 and certainly not a concern that it will spread elsewhere?"

23 It's attributed to David Schoenholz. Do you see
24 that?

01:53:01 25 A. Can I just -- in my previous answer, when I said it

Fischel - cross

2905

1 decreased it in this first method, and no effect, I want to
2 correct my previous answer.

3 Q. Okay.

4 I'll be clear with you. You be clear with me.

01:53:13 5 Again, I'm not trying to trick you.

6 A. You have been clear --

7 Q. The first method.

8 A. You have been clear --

9 Q. The first method.

01:53:18 10 A. -- I misspoke. I wanted to correct it.

11 Q. Okay. And I appreciate that.

12 And, just, the point is previously you said it
13 decreased it. Now, you're saying it was flat. My question
14 was: It didn't increase it, correct?

01:53:27 15 A. Correct.

16 Q. All right.

17 So, from my point of view, both your answers are the
18 same. You've now made it more accurate, but it's still not an
19 increase --

01:53:35 20 A. Okay.

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21 Q. -- correct?

22 A. Correct, yes.

23 Q. Thank you.

24 Okay. Let's look at this date (indicating). We'll

01:53:43 25 go to Plaintiffs' 1397. The date is February 18, 2002. We

Fischel - cross

2906

1 are on Page 14. And we see there is no "February 18, 2002,"

2 probably because it's a weekend. There's a "February 15" and

3 "February 19."

4 Do you see that?

01:53:58 5 A. Yes, sir, I do.

6 Q. Where should I go, the 19th?

7 A. If it came out on the weekend, you should go to the 19th.

8 Q. It doesn't matter because it's 3.66 for days and days

9 before, and days and days after, correct?

01:54:08 10 A. Correct.

11 Q. So, again, this didn't cause any increase in artificial

12 inflation, correct?

13 A. That's right.

14 Q. Now, let's go to 1391, your Event Study, and let's see if

01:54:19 15 we can find the same date.

16 This is February 18 (indicating) and it looks like

17 it's February 19, and it's on Page 34.

18 Do you see that?

19 A. I do, sir.

01:54:30 20 Q. Okay.

21 Am I on the right date?

22 A. You are.

23 Q. All right.

24 And did you find any statistically-significant price

Page 90

A465

04-20-09 Volume 14

01: 54: 36 25 increase under your first method that resulted in inflation on

♀

Fischel - cross

2907

1 February 18, 2002?

2 A. No, sir, I did not.

3 Q. Plaintiffs have shown this jury the December 31, 2001,

4 10-K filed by Household on March 13, 2002.

5 MR. KAVALER: Did we do this already?

6 (Brief pause.)

7 MR. KAVALER: We did not. Okay.

8 BY MR. KAVALER:

9 Q. Let's look at Plaintiffs' 1397. We'll look at it for

01: 55: 11 10 March 13, 2002.

11 And you see that artificial inflation is 5.30 there

12 (indicating), and 5.30 for several days before and 5.30 for

13 several days thereafter, right?

14 A. I see that, sir.

01: 55: 23 15 Q. Once again, no increase in artificial inflation upon the

16 filing of the December 31 10-K, correct?

17 A. Correct.

18 Q. And let's look at your Event Study, which is Exhibit 1391.

19 Let's go to March 13, 2002, which looks like it's on

01: 55: 41 20 Page 35.

21 Did you find any statistically-significant price

22 increase that resulted in inflation on March 13, 2002?

23 A. No, sir, I did not.

24 Q. Plaintiffs have shown this jury statements made at the

01: 56: 09 25 Household Financial Relations Conference that took place on

♀

Fischel - cross

2908

1 April 9, 2002.

2 Let's look at your Exhibit 1397.

Page 91

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3 I think we're on Page 15.

4 No increase in artificial inflation on April 9 or
01:56:32 5 April 10 or April 11 of 2002, correct?

6 A. Correct.

7 Q. Let's look at your Event Study, Plaintiffs' 1391, for the
8 same date, which will be on Page 36.

9 Did you find any statistically-significant price
01:56:49 10 increase that resulted in inflation on April 9, 2002?

11 A. No, sir, I did not.

12 Q. Okay.

13 So, we don't have a board for that; but, if we did,
14 we'd cross it off.

01:56:59 15 Plaintiffs may show this jury a press release issued
16 by Household on April 17, 2002.

17 Let's look at Plaintiffs' Exhibit 1397 for April 17.

18 Again, no increase in artificial inflation that day
19 or any of the days within five or ten thereafter, right?

01:57:19 20 A. Let me look at it on there.

21 Q. Absolutely. Please, please.

22 A. No change in inflation on those dates.

23 Q. Okay.

24 I'm just giving you a window so as to make it easier
01:57:29 25 for you to hone in.

♀

Fischel - cross

2909

1 Let's look at your Event Study, which is Exhibit --
2 Plaintiffs' -- 1391, for the same day, which will be on Page
3 37, I think.

4 Give me a second here.

5 (Brief pause.)

6 BY MR. KAVALER:

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7 Q. Correct. 37?

8 Now, I'm not sure I understand the entry here. It
9 says, "4-21," and, then, there's nothing.

10 Am I on the wrong date?

11 Hang on.

12 (Brief pause.)

13 BY MR. KAVALER:

14 Q. I'm on the wrong date. I apologize.

01:58:04 15 4-17. Okay. 4-17.

16 Did you find any statistically-significant price
17 increase that resulted in inflation on April 17, 2002?

18 A. No, sir, I did not.

19 Q. All right.

01:58:14 20 And that's this press release here (indicating), with
21 a picture of Mr. Aldinger, talking about, "A credit quality
22 performance was well within our expectations," et cetera.

23 Plaintiffs have shown this jury the Bellingham Herald
24 article that appeared on April 21, 2002. This is Plaintiffs'

01:58:36 25 Demonstrative No. 14, the second item, and that's this one

Fischel - cross

2910

1 here in the middle (indicating).

2 "Megan Hayden-Hakes: It is absolutely against our
3 policy in any way to quote a rate that is different than a
4 true rate."

01:58:55 5 I can't underscore that enough -- that quote.

6 Let's look at Plaintiffs' Exhibit 1397 for April 21,
7 2002, Page 15.

8 Again, no change in the artificial inflation
9 associated with that event, right?

01:59:08 10 A. I believe that's correct, but it's not highlighted yet.

11 Q. Oh, sorry.

Page 93

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02: 33: 41 25 right up against July 30, 1999, which you understand to be the
Fischel - cross

2935

1 first day of the relevant period, correct?

2 A. Correct.

3 MR. KAVALER: Your Honor, I offer Plaintiffs'

4 Demonstrative 1511 in evidence pursuant to Rule 801(d)(2).

02: 34: 03 5 THE COURT: A response?

6 MR. BURKHOLZ: I don't think it's a party admission
7 under that rule, your Honor.

8 THE COURT: Excuse me.

9 MR. BURKHOLZ: I don't think it's a party admission
02: 34: 17 10 under 801(d)(2).

11 MR. KAVALER: I refer specifically, your Honor, to
12 subpart (B) or (C) or (D).

13 THE COURT: I will allow it subject to a later ruling
14 after we have a sidebar.

02: 34: 43 15 But you may proceed as if it has been admitted.

16 MR. KAVALER: Thank you, your Honor.

17 BY MR. KAVALER:

18 Q. Now, turn your attention, Professor Fischel, to

19 Plaintiffs' Exhibit -- Plaintiffs' Demonstrative -- 154?

02: 34: 55 20 A. Can I just have a copy, sir?

21 Q. Absolutely. Sorry.

22 You can even have a color copy.

23 Here's 151.

24 (Document tendered.)

02: 35: 04 25 MR. KAVALER: Mr. Burkholz, one for you.

Fischel - cross

2936

1 (Document tendered.)

2 MR. KAVALER: Now, let's do 154.

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3 Copies, please.

4 (Brief pause.)

02: 35: 15 5 MR. KAVALER: Let the record reflect I'm handing the
6 witness 154.

7 THE WITNESS: Thank you.

8 MR. KAVALER: And a copy for counsel.

9 (Document tendered.)

10 BY MR. KAVALER:

11 Q. The same series of questions, Professor Fischel.

12 Once again, the horizontal axis shows at the extreme
13 left-hand end July 30, 1999, correct?

14 A. Correct, sir.

02: 35: 36 15 Q. And you go up that axis, you see a blue line (indicating),
16 which is the true value; a red line (indicating), which is
17 price; and, a pink -- it looks blue up there (indicating) --
18 whatever color it is, the area between the lines is shaded in?

19 A. Yeah.

02: 35: 54 20 That corresponds precisely to the table that we were
21 just looking at on the amount of inflation. So -- well, since
22 we haven't talked about this yet, if you just put the other
23 one up on the screen for a second?

24 Q. Okay. Sure.

02: 36: 23 25 Go back to 151.

♀

Fischel - cross

2937

1 (Brief pause.)

2 BY THE WITNESS:

3 A. So, what the -- the red line is the actual price, and you
4 can see what it was relative to -- the level of the price
02: 36: 24 5 relative to -- the vertical axis on price.

6 And the blue line is the true value.

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7 So, what this predicts is that the price fluctuates
8 every day; but, the true value, based on my calculations, is
9 \$7.97 lower than the actual price until November 15th of 2001;
02:36:53 10 and, then, it gets more or less than -- the inflations
11 increases or decreases based on the specific disclosure.

12 BY MR. KAVALER:

13 Q. I hear you. None of that is my question.

14 I want to go back to -- I put up 151 because you
02:37:03 15 wanted me to. I want to go to 154 for a minute.

16 A. I apologize.

17 Okay. Thank you.

18 Q. 154, my only question is: You prepared this chart?

19 A. I did.

02:37:11 20 Q. Okay.

21 On this chart, as on the other one, the blue line,
22 the red line and the shaded-in space all butt right up against
23 July 30, 1999, correct?

24 A. Correct, for the reasons I've stated.

02:37:24 25 MR. KAVALER: Your Honor, I offer Plaintiffs'

Fischel -

2938

1 Demonstrative 154 in evidence, pursuant to Rule 801(d)(2).

2 THE COURT: Let's take our afternoon break now.

3 We'll take 15 minutes; we'll discuss this; and, then, we'll
4 bring the jury back out and continue.

02:38:38 5 (Jury out.)

6 THE COURT: So, you're offering these two
7 demonstrative exhibits as?

8 MR. KAVALER: As an admission by a party opponent,
9 your Honor.

02:38:43 10 THE COURT: Okay.

11 A response?

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7 you've got a residual price change of minus \$1.86.

8 Do you see that?

9 MR. BURKHOLZ: Could you show him where it is?

03:27:51 10 MR. KAVALER: Sure.

11 BY MR. KAVALER:

12 Q. It's tab three, which just happens to be the first one
13 in --

14 A. I'm looking at it on the screen.

03:27:54 15 Q. If I were looking at the price of the stock, closing price
16 on the New York Stock Exchange, on November 15, 2001, I
17 wouldn't see minus \$1.86, would I?

18 A. You would not, for the reasons that I explained at length.

19 Q. And if I were watching Bloomberg News, I wouldn't see
03:28:12 20 minus \$1.86, would I?

21 A. Probably not.

22 Q. And if I were reading the Wall Street Journal in the
23 morning or the New York Times or the Chicago Tribune, I
24 wouldn't see minus \$1.86?

03:28:22 25 A. I suspect you would not.

♀

Fischel - cross

2959

1 Q. And if I were looking at my brokerage statement if I owned
2 Household stock, I wouldn't see minus \$1.86?

3 A. No. But in all those documents, you might see discussion
4 of how the stock price movement compared with the overall
03:28:39 5 market and movements of other firms in the industry. That's a
6 very common measure that Household itself used in its proxy
7 statements that's, in effect, required by SEC regulations.

8 Q. I'm making --

9 A. So this is just a quantification of what investors look at
03:28:57 10 all the time.

11 Q. I'm making a very small point, sir. Stocks are quoted in
Page 135

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12 a price which is the price usually that they close on the New
13 York Stock Exchange, right?

14 A. Correct. But there's also frequently comparisons of stock
03: 29: 12 15 prices and prices of the overall -- movement to the overall
16 market, movements in the industry. That's what Household
17 itself disclosed in its proxy statement. This is just a
18 quantification of that relationship.

19 Q. You've been very patient all afternoon while we talked
03: 29: 28 20 about your first model. I want to turn to your second model.

21 A. Okay.

22 Q. This is the model with the leakage, right?

23 A. Okay.

24 Q. Okay. And you agree there are a bunch of stock price
03: 29: 39 25 movements that were significant under your aggression analysis

Fischel - cross

2960

1 that were not attributable to fraud-related disclosures, don't
2 you?

3 A. There were probably some, both positive and negative, but
4 a lot of the significant movements were combined disclosures
03: 29: 57 5 of -- they had some fraud-related aspect and then they had
6 some other aspect in addition to the fraud-related aspect.

7 Q. And were there some, any, that had no fraud-related
8 aspect?

9 A. It's a matter of judgment as to whether something has a
03: 30: 13 10 fraud-related aspect or not. I would say there were a few,
11 but there were also, I would say, a significant number of the
12 statistically significant movements that had this combined
13 aspect.

14 But just to be clear, under the leakage model,
03: 30: 31 15 whether they did -- whether they were purely fraud related,

04-20-09 Volume 14

16 combined fraud related or not at all fraud related, they were
17 all included in the leakage model.

18 Q. I understand. But my point is there was some of all
19 three?

03: 30: 46 20 A. You probably could -- that would probably be a fair
21 statement.

22 Q. Okay. Now, this is not on either model. This is a
23 general question.

24 A. Okay.

03: 30: 56 25 Q. You assumed that the defendants did make false statements

Fischel - cross

2961

1 during the relevant period, didn't you?

2 A. That's correct.

3 Q. Okay. Can you do this: Assume the opposite. Assume the
4 defendants did not make any false statements during the
03: 31: 10 5 relevant period.

6 A. Okay.

7 Q. Okay. The stock price still declined in the real world,
8 didn't it?

9 A. The stock price declined in the real world, that's
03: 31: 23 10 correct.

11 Q. Why?

12 A. I think the stock price declined for a variety of
13 different factors. I touched on this in my testimony. There
14 was a -- a big part of the stock price decline that's --
03: 31: 40 15 according to both of my calculations that's attributable to
16 some combination of market industry and non-fraud-related
17 effects. And also some percentage of the stock price decline
18 that's attributed -- attributable -- excuse me -- to the
19 market learning correct information about Household's

03: 32: 05 20 predatory lending practices, its re-aging policies and the

Page 137

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7 Q. Is it a common method to focus on the disclosures later in
8 the relevant period to quantify the inflation due to the
9 statements Household made earlier in the relevant period?

03: 37: 01 10 A. It's completely standard because if what you're trying to
11 do is measure the value of the truth and the truth is not
12 provided early in the period, the only way to analyze the
13 effect of the truth is to see what the effect on investors and
14 market prices is when the truth comes out. And by doing that,
03: 37: 23 15 you're able to make a judgment, as I did, about what the,
16 quote, true value of the stock would have been at the
17 beginning had the truth been told the entire time.

18 Q. Now, counsel showed you the beginning of the relevant
19 period, July 30, 1999, and then the first statement on August
03: 37: 43 20 16, 1999, the 10-Q.

21 Do you remember that?

22 A. I do.

23 Q. And do you have an understanding that the beginning of the
24 relevant period, July 30, 1999, is due to a Court decision in
03: 37: 54 25 this case?

♀

Fischel - redirect

2966

1 A. That's my understanding.

2 Q. Okay. And if the first false statement that plaintiffs
3 allege in this case is on August 16, 1999, how would you
4 calculate inflation on that date?

03: 38: 06 5 A. I would calculate inflation the same way as of August 16,
6 but there would be no inflation from July 30 to August 15. So
7 as I indicated, where I have an entry for artificial inflation
8 from July 30 to August 15, the correct way to interpret the
9 exhibit is just to replace the inflation number with a zero
03: 38: 28 10 for every day until August 16. And beginning on August 16, it
11 would then be \$7.97 under the first method.

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12 Q. And your assumption that plaintiffs will be able to prove
13 the various statements are false and misleading during the
14 relevant period is a common assumption that you make in your
03: 38: 58 15 field?

16 A. Again, it's a necessary assumption because the
17 responsibility of determining whether a statement is false or
18 not, that's not for an expert witness, for any expert witness.
19 It's not for an economist. It's really a function for the
03: 39: 12 20 jury to decide.

21 MR. BURKHOLZ: Can we bring up Plaintiffs' Exhibit
22 1391. Can we have the switch, your Honor.

23 If we can turn to the third page.

24 If we can highlight the last date on the bottom,
03: 39: 36 25 November 12, 1999.

Fischel - redirect

2967

1 BY MR. BURKHOLZ:

2 Q. That's the date of a public statement by Household.

3 Do you see the three bars on the right?

4 A. I do.

03: 39: 49 5 Q. What does that signify?

6 A. That it's a statistically significant day.

7 Q. And that was a statistically significant price increase on
8 that date, correct?

9 A. Correct.

03: 39: 57 10 Q. Why didn't you take, under your specific disclosure model,
11 the \$7.97 and just add the dollar and two cent inflation on
12 that date?

13 A. Because, as I indicated, to be one of my 14 specific
14 disclosures, three criteria had to be met. There had to be an
03: 40: 16 15 event, there had to be a statistically significant stock price

04-20-09 Volume 14

16 reaction and I had to believe to a reasonable degree of
17 certainty that the event caused the stock price reaction.

18 So what I did with respect to dates like November 12
19 was that there was a statistically significant price increase.

03: 40: 38 20 I could have included that date to increase the amount of
21 inflation, but I didn't do it because I wasn't confident that
22 there was a fraud-related disclosure on that date that was
23 responsible for that price increase, which is why in my first
24 method of quantification I only had 14 dates, as opposed to
03: 41: 00 25 every date where there was a statistically significant price

Fischel - redirect

2968

1 movement.

2 Q. And under your leakage model, the inflation varies
3 throughout the relevant period?

4 A. Correct, from the first day to the last day. It varies
03: 41: 12 5 every day.

6 Q. And then counsel was quizzing you on some of the specific
7 disclosure dates. I want you to go back to the September 23,
8 2002, date, which is tab 16 in your binder.

9 A. Okay. I have it.

03: 41: 29 10 Q. And he asked you whether or not that date related to
11 predatory lending. And I think you said it did. But you
12 didn't look at the actual report. Can you look at the second
13 page of the report?

14 A. I have it.

03: 41: 51 15 Q. Okay. Do you see the first paragraph -- at the end of the
16 first paragraph on the second page, Moreover, skepticism
17 regarding the company's rapid portfolio growth, particularly
18 within the auto business, and mounting credit quality concerns
19 related to Household's loan workout and re-aging practices
03: 42: 08 20 have also been a drag on the stock.

Page 143

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21 A. Correct, I see that. The correct answer would have been
22 this disclosure related both to predatory lending practices as
23 well as a re-aging, not just to predatory lending.

24 Q. And, finally, it's your opinion that the leakage model is
03:42:26 25 a better estimate of inflation from Household's false

Fischel - recross

2969

1 statements as alleged by the plaintiffs than your specific
2 disclosure model?

3 A. Yes, because of all the evidence of the leakage of the
4 Washington department of financial insurance report, as well
03:42:41 5 as all the leakage of the settlements, the possible
6 settlements, and all the criticism of Household's predatory
7 lending practices, as well as its re-aging policies.

8 MR. BURKHOLZ: Nothing further at this time, your
9 Honor.

03:43:00 10 THE COURT: Recross.

11 MR. KAVALER: Briefly, your Honor.

12 (Brief pause.)

13 THE WITNESS: Be careful.

14 RECROSS EXAMINATION

03:43:05 15 BY MR. KAVALER:

16 Q. Anything happens a lot of lawyers that will throw their
17 cards at my body.

18 Let me just pursue what you just told Mr. Burkholz.
19 He directed your attention to November 12, 1999. Let's look
03:43:32 20 at Plaintiffs' Exhibit 1397, page two. That's your list
21 there.

22 A. 13 -- which --

23 Q. 1397 is this one, the one with the columns.

24 A. Okay. Let me find it. I've got 1395.

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C E R T I F I C A T E

We certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

/s/ Nancy C. LaBell a

/s/ Joseph Ri ckhoff

April 21, 2009

Official Court Reporters
United States District Court
Northern District of Illinois
Eastern Division

Date

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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,)

vs.

HOUSEHOLD INTERNATIONAL, INC.,)
et al.,)
Defendants.)

No. 02 C 5893
Chicago, Illinois
April 24, 2009
11:00 o'clock a.m.

VOLUME 18
TRANSCRIPT OF TRIAL PROCEEDINGS
BEFORE THE HONORABLE RONALD A. GUZMAN

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3825

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♀

3826

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THE CLERK: 02 C 5893, Jaffe vs. Household
International, incorporated.
THE COURT: Good morning, everyone.
MR. BURKHOLZ: Good morning.
MR. KAVALER: Good morning, your Honor.
THE COURT: Does anybody remember where we left off

04-24-09 Volume 18

11: 19: 02 25 what the factual record is, that's for the jury to decide

3838

1 unless you can convince me in your motion for ruling as a
2 matter of law that there's an absolute lack of any such
3 information; and, therefore, the issue shouldn't go to the
4 jury.

11: 19: 15 5 You know, when we argue these instructions, we posit
6 that there's sufficient evidence out there for it to go to the
7 jury. If that's the case, how do we instruct the jury on what
8 the rules are in determining whether, depending on what they
9 find the evidence shows, liability has been established?

11: 19: 41 10 MS. BEER: I think we were focusing on the factual
11 record, in part, to suggest that giving the jury an abstract
12 statement like this is simply going to be confusing; and, it
13 opens the door to a great many individuals about whom there is
14 no evidence whatsoever in the record.

11: 19: 58 15 There's also --

16 THE COURT: Well, why don't we tell them we're
17 talking about Vozar and Rybak?

18 MR. BURKHOLZ: Vozar, Rybak, McDonald and Makowski.

19 And McDonald and Makowski came out with the
11: 20: 09 20 Schoenholz testimony about the 10b-5-K. So, it's in the
21 record with respect to those -- certainly those -- four
22 individual corporate officials that are so high up at
23 Household, that they meet the Tellabs standard.

24 MS. BEER: I think we also need to look at the timing
11: 20: 23 25 of their statements, as they -- the timing of the statements

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1 that they made providing information to the individual
2 defendants, as opposed to as that relates to the timing of the

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3 statements that were issued to the public. Because the
4 scienter of the corporation will have to be determined by the
11:20:43 5 scienter -- by the state of mind at the time the statements
6 were made public.

7 MR. BURKHOLZ: Well, certainly that's for argument,
8 your Honor. They can argue that.

9 THE COURT: Let's see.

11:21:40 10 MS. BEER: The instruction we would propose, your
11 Honor, would simply identify the individuals -- the three
12 individual defendants -- and the two corporate spokespeople by
13 name and not try to confuse the jury with a statement of law
14 that could open the door to any number of other people who
11:21:57 15 have yet to be identified to us.

16 And if the inclination is to include the language
17 from the Tellabs case, it needs to be modified, because it has
18 been changed in a way that makes the -- what are parenthetical
19 subsidiary points in the Tellabs opinion appear to be
11:22:27 20 equivalent bases for liability.

21 THE COURT: I'm not sure I know what that means.

22 MR. BURKHOLZ: I don't, either.

23 THE COURT: What does that mean?

24 MS. BEER: Making the different parts of the sentence
11:22:38 25 No. 1, 2 and 3 elevates them all to the same level. And

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1 that's not the way the language appears in Tellabs.

2 MR. BURKHOLZ: I could modify that, your Honor, to
3 have the exact language from Tellabs. I thought we were
4 pretty close.

11:22:55 5 I'm looking at it. It says, "Corporate liability for
6 a violation of 10b-5 requires -- "

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7 THE COURT: Slow down and louder.

8 MR. BURKHOLZ: Sorry about that.

9 I'll read it in, again.

11:23:11 10 "To establish corporate liability for a violation of
11 10b-5 requires 'looking to the state of mind of the individual
12 corporate official or officials who make or issue the
13 statement, or order or approve it or its making or issuance,
14 or who furnish information or language for inclusion therein
11:23:32 15 or the like.'"

16 That's it.

17 THE COURT: I think that's pretty much what I said,
18 isn't it?

19 MR. BURKHOLZ: It is.

11:23:48 20 THE COURT: Is there a structure in there that I
21 don't -- that I'm missing?

22 Is there a structuring of that sentence that I'm
23 missing?

24 MS. BEER: I'm sorry?

11:23:57 25 THE COURT: What am I missing here? You were arguing

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1 that --

2 MS. BEER: Well, we're arguing, first of all, that
3 the sentence should not be included in the instruction at all.

4 THE COURT: Okay.

11:24:06 5 And why is that?

6 MS. BEER: Because there's been no -- there's no
7 court in this circuit that has imposed liability on the basis
8 of the scienter of individuals within the organization, who
9 were not also the persons who issued the statement.

11:24:20 10 THE COURT: You mean no district courts?

11 MS. BEER: There's no court.
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12 THE COURT: Okay.

13 MS. BEER: The Tellabs case recites this language,
14 but it does not deal with this issue.

11: 24: 30 15 THE COURT: Right. But it appears to be the most
16 recent instruction that we can glean from Seventh Circuit
17 opinions on the precise issue that we're talking about now,
18 right?

19 You're telling me it's not a holding, but it appears
11: 24: 50 20 to be the best language we have right now to interpret the
21 Seventh Circuit's thinking on this precise issue. Why
22 shouldn't we adopt it?

23 MS. BEER: The language appears in the Tellabs case,
24 in a section in which the court is attempting to limit the
11: 25: 08 25 scope of the corporate scienter doctrine, not in a context in

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1 which they're attempting to expand it beyond those who are
2 individual defendants.

3 The case that the Court draws the language from --
4 the Southland Securities case in the Fifth Circuit -- quotes a
11: 25: 29 5 case from California -- the Apple Computer case -- in which
6 the court says, "It is not enough to establish fraud on the
7 part of a corporation that one corporate officer makes a false
8 statement."

9 THE COURT: No, no, I missed that whole first part.
11: 25: 42 10 You have got to slow it down a bit for me.

11 MS. BEER: The Southland case from the Fifth Circuit,
12 the Apple Computer Securities Litigation case from the
13 Northern District of California are the authorities that the
14 Tellabs case is relying on. Those cases both refused to find
11: 26: 08 15 or permit cases to proceed on allegations that the scienter of

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16 a corporation could be established on the basis of the
17 scienter of an employee or officer of the corporation, who was
18 not also the individual who had made the allegedly false
19 statement.

11:26:30 20 So, the same language that is appearing in Tellabs --
21 that is now being argued to open the doors more widely -- was
22 quoted in Tellabs in exactly the opposite direction and --

23 THE COURT: Well --

24 MS. BEER: -- was applied in the cases that are being
11:26:46 25 cited to limit liability to -- to limit the imputation of

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1 scienter to those persons who had also made the statements.

2 And if I could just clarify the timing point.

3 If we're going to be looking to the state of mind of
4 individuals, other than the individual defendants and the
11:27:04 5 corporate spokespersons, that state of mind needs to be
6 assessed at the time they provided the information.

7 THE COURT: Of course. When else?

8 But we --

9 MR. KAVALER: Your Honor --

11:27:17 10 THE COURT: -- haven't gotten to that issue yet.

11 I just don't understand how it is that, because the
12 language that establishes the scope of the corporation's
13 liability in regards to the acts of its employees, was applied
14 to a certain set of facts -- and, the result reached was that
11:27:38 15 there was no liability -- that that language is somehow not
16 valid to be applied to the set of facts that we have in this
17 case.

18 The language is the language. Whether it resulted in
19 a no-liability finding, in Tellabs or any other case,
11:27:59 20 shouldn't determine whether we apply the language in this

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21 case, should it?

22 Whether there's going to be a resulting liability or
23 lack of liability will depend on the facts in this case; and,
24 fortunately, that's a determination that the jury will make in
11:28:11 25 this case, not the Court, because we're at the stage where

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1 we're actually having a trial.

2 MR. KAVALER: Your Honor, may I --

3 THE COURT: And I don't think -- I'm trying to --

4 MS. BEER: There are a number of cases that deal with
11:28:29 5 this issue, your Honor, that end with a statement something
6 like, "It's theoretically possible" or "It's conceivable," but
7 not here.

8 And I think our position on the factual record in
9 this case is that that's where we are here, as well.

11:28:47 10 It may be theoretically possible, but is it
11 appropriate to be giving the jury an instruction on something
12 that is theoretically possible, when the factual record will
13 not support it?

14 THE COURT: Well, I think that's another way of
11:29:15 15 telling me that there's insufficient basis to instruct the
16 jury on this issue --

17 MS. BEER: I believe that's the case.

18 THE COURT: -- and the factual -- okay, which I'm
19 sure you argue in your motion for a ruling as a matter of law.

11:29:30 20 Let's try to get past that and assume that it goes to
21 the jury; and, therefore, assume there's a sufficient factual
22 basis for the different theories of liability, that are not
23 knocked out on your motion for judgment as a matter of law.

24 How, then, do we instruct the jury?

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11: 29: 50 25

Not do we instruct them or not destruct them, but

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1 how, then, do we instruct them?

2 And I think that the Pugh case -- the Tribune case --
3 is clearly the Seventh Circuit's latest statement on the law
4 that should be applied. And I think that they ruled, you

11: 30: 05 5 know, as you're arguing, that the facts pled in that case were
6 not sufficient to establish the inference of scienter.

7 But we're not at that stage. And the question is:
8 If we get past that stage, how do we instruct the jury on how
9 they should undertake this deliberation?

11: 30: 27 10 And I fail to see why that language, which is a
11 language the court cites as the appropriate language,
12 shouldn't be used. It doesn't --

13 Well, go ahead. You've been standing for a while,
14 Mr. Kavalier. I don't want you to get tired. Go ahead.

11: 30: 48 15 MR. KAVALER: I'm way beyond tired, your Honor.

16 I just want to make a pragmatic observation, which
17 occurred to me as I listened to your question about three back
18 as directly responsive to precisely where you are now.

19 The answer to why we shouldn't -- I take your point
11: 31: 04 20 entirely. This entire dialogue assumes you deny the motion
21 and the motion is addressed to the sufficiency of the
22 evidence. Agreed. Understood.

23 The reason you shouldn't, as a pragmatic matter, your
24 Honor, is because if it engenders this much debate at this
11: 31: 20 25 session here today, and it is possible that Ms. Beer's

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1 interpretation of what the Seventh Circuit said and meant is
2 correct, if you include the instruction and you get a

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3 plaintiffs' verdict, you will you have a big problem in the
4 Seventh Circuit if there's a reversal.

11: 31: 36 5 On the other hand, if you don't include the
6 instruction and you get a plaintiffs' verdict, there's no
7 problem.

8 So, the question for the plaintiffs is --

9 THE COURT: Well, sure there is. Then they go up and
11: 31: 45 10 appeal and they say, "That instruction should have been
11 included," and we've got a big problem for a reversal.

12 MR. KAVALER: No, your Honor. I'm positing you get a
13 plaintiffs' verdict. I'm saying if you get a plaintiffs'
14 verdict, then there's no issue.

11: 31: 55 15 THE COURT: Sure, but let's look at -- I have to look
16 at -- both sides, unfortunately.

17 MR. KAVALER: I agree. I'm trying to get there.

18 THE COURT: Okay.

19 MR. KAVALER: So, the question is for the plaintiffs,
11: 32: 01 20 your Honor. If they think it is worth the risk of including
21 this language, and they press for it, they create a situation
22 of their own making.

23 If they, rather, think they're better off without
24 this language, they create a different situation. I'm merely
11: 32: 16 25 pointing out that what you're really dealing with here is a

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1 practical question about a sentence in a Seventh Circuit
2 opinion, which the parties have differing views as to what it
3 means and how it is to be applied, whether it's a holding or
4 not a holding.

11: 32: 30 5 It's clearly not a holding. And the question is
6 predicting what the Seventh Circuit will do when they see that

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7 issue, again.

8 My point is simply Mr. Bley drew a matrix on the
9 board yesterday. This is a matrix situation. And I'm just
11:32:43 10 suggesting that people should think about it as a practical
11 matter of what the consequences are, appreciating your Honor's
12 point it could be error either way. I understand that.

13 The question is: Who wants to be arguing which side
14 of that error, based upon if error it is, because one way or
11:33:00 15 the other it's error, based upon what everybody thinks about
16 everything else in the case.

17 What I'm saying is, it does tie into the motion. If
18 the factual record survives the motion, my suspicion is it
19 will be barely. And in a case where the factual record barely
11:33:17 20 survives the motion, the Court, I respectfully submit, should
21 err on the side of caution. That's my only observation.

22 THE COURT: I understand your argument and it's one
23 of my pet peeves. I don't know that I acted any differently
24 when I was a trial attorney; but, as I sit up here now, I
11:33:36 25 often think to myself: "Why? Why?"

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1 The chances that they're going to win this case on
2 this instruction and nothing else are about like that
3 (indicating); and, the door for an argument on appeal, that
4 they're opening up, is like this (indicating).

11:33:57 5 What's the risk benefit here?

6 But that's not my decision to make. It's not my
7 decision to force on a case. That's the decision for the
8 litigants to make.

9 And I could say the same thing about defendants, as
11:34:09 10 well, frankly, on many occasions. But more so the plaintiffs
11 usually.

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12 So, given that they're asserting this theory of
13 liability, it seems to me that -- I think that the Makor or
14 Makor case language tells us what the law is, or is likely to
11: 34: 29 15 be, as close as we can come in this circuit when it arrives up
16 there. And I think that's the language that we should use in
17 instructing the jury.

18 I think we should tell them -- and how we put it in
19 here is a different matter. I mean, I'm looking at a false or
11: 34: 47 20 misleading statement instruction, where we talk about, "The
21 plaintiff must prove that the defendant made a false or
22 misleading statement." Not necessarily so.

23 I mean, "made," "issued," "ordered," "provided false
24 information to be included in," I think there's evidence as to
11: 35: 12 25 most of those. And it seems to me that that's a place where

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1 we start incorporating this language.

2 Go ahead.

3 MR. BURKHOLZ: Well, I don't know if we need to do
4 that. I think the defendant is Household. They make the
11: 35: 31 5 statements. Their scientist is what we're struggling with --
6 the definition.

7 THE COURT: That's one defendant. But unless I'm
8 mistaken, there was a substantial amount -- or you asked a
9 substantial number -- of questions of -- oh, who was the lady
11: 35: 44 10 that --

11 MR. BURKHOLZ: Ms. Hayden-Hakes.

12 THE COURT: Yes, Ms. Hayden-Hakes.

13 -- about who told her to say this and did she have
14 knowledge or did she get the knowledge from somebody else, as
11: 35: 54 15 to the various public statements that she made.

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16 Are those statements attributable to the defendant
17 that gave her the information to include in the statements?

18 MR. BURKHOLZ: Well, the statements are attributable
19 to the company that she's making.

11: 36: 10 20 THE COURT: Yes.

21 Are they attributable to the defendant who told her,
22 "Go out there and say that there's no predatory lending"?

23 Are you going to argue that? Is Mr. Dowd going to
24 argue that in closing? Is he going to say, "He told her to

11: 36: 24 25 say those things"?

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1 MR. BURKHOLZ: That goes to the scienter issue of the
2 company.

3 THE COURT: It goes to the making of the statement
4 issue, as well.

11: 36: 30 5 MR. BURKHOLZ: Well, that's the company's statement;
6 and, the scienter of the company, you look at the --

7 THE COURT: So, you are not going to argue that when
8 Mr. Gilmer said to Ms. Hayden-Hakes, "Go out there and make
9 this statement," but when they got together and discussed it
11: 36: 49 10 and when they put together the statements that she was going
11 to issue to the press, that the statements she subsequently
12 made were statements also made by Mr. Gilmer, that he can be
13 held accountable for those?

14 You're not going to argue that? You're just going to
11: 37: 06 15 argue that the corporation can be held liable?

16 MR. BURKHOLZ: Right. The individual defendants are
17 liable for the company's statements.

18 THE COURT: Gee, there you go. Okay.

19 So, you're going to argue just the company's liable;
11: 37: 23 20 and, then, you're going to, because the company is liable for

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21 that statement, say that you're going to impute the company's
22 intent to Mr. Gilmer and to Mr. -- well, the other defendants?

23 MR. BURKHOLZ: Aldinger and Schoenholz.

24 THE COURT: Yes.

11: 37: 40 25 Is that your theory?

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1 MR. DOWD: Your Honor, I think it depends which
2 statements we're talking about.

3 I mean, the issue I think --

4 THE COURT: I'm asking but all them because I want to
11: 37: 51 5 know if I should instruct the jury as to all them.

6 MR. DOWD: I understand, your Honor.

7 I think it's -- I mean, I think it's true that the
8 defendants, to the extent that they're involved in furnishing
9 the statements, they're liable for them.

11: 38: 05 10 THE COURT: Well, the instruction we have right now,
11 you know, just says, "prove that the defendant made a false or
12 misleading statement of fact or omitted a fact that was
13 necessary"; and, if that's the case, then -- and if that's all
14 there is -- and I don't know that the statements made by any
11: 38: 24 15 of their subordinates, that were -- that they ordered or
16 issued or provided the information for, are statements that
17 they would be liable for.

18 MR. BURKHOLZ: Well, but we have the -- I think it's
19 the -- respondeat superior statement that talks about the
11: 38: 44 20 company is --

21 THE COURT: You're focusing on the corporation's
22 liability. I'm focusing right now on the individual
23 defendants. Okay?

24 What I don't want is for Mr. Dowd to get up and

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11: 38: 56 25 argue, "You know, Mr. Gilmer told Ms. Hayden-Hakes to supply

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1 this information to the press." She did it and that's a false
2 and material misleading statement by him. And for the
3 defendants to get up and say, "Objection. It's not what the
4 instructions say. Objection, your Honor." He shouldn't even
11: 39: 17 5 be allowed to argue that.

6 And for the jury, then, to go back with no guidance
7 on that -- because I have -- I mean, unless those questions
8 you were asking her about -- where she got the information and
9 who told her to make the statement and whether she had
11: 39: 30 10 independent knowledge of the truth or falsity of the statement
11 she was making -- were going nowhere, I assumed that you were
12 going to make that argument.

13 If you're not, that's fine. I'd rather not instruct
14 the jury.

11: 39: 54 15 But if you are going to make that argument, then I
16 think we need to instruct the jury as to, essentially, the
17 language in the Makor case, that that's what we're talking
18 about. We're talking about -- I think other cases have called
19 it -- "substantial participation."

11: 40: 22 20 And the corporation, it seems to me, is the same
21 language with respect to scienter. If it fits within that
22 Makor language, how do we instruct on that? There's a
23 different --

24 MR. DOWD: I think --

11: 41: 01 25 THE COURT: We find the defendants' instruction,

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1 where?

2 MR. BURKHOLZ: It's on Page 60- -- I think it starts
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3 on Page 63 of their red-lined version -- 63 of their red-line
4 version. The language that they have proposed is on the
11: 41: 18 5 bottom of 64, running into 65 of their red-line version they
6 propose.

7 THE COURT: So, what about their language do you
8 oppose?

9 MR. BURKHOLZ: The -- I guess the -- what's missing
11: 43: 48 10 is the "or furnishing information or language for inclusion"
11 in the statement, which would go on the top of Page 65 after
12 "In making a false statement or omission of material fact."

13 MS. BEER: We object, your Honor, to the addition of
14 that language as being unsupported by controlling law in the
11: 44: 22 15 Seventh Circuit and not supported by the factual record of
16 this case.

17 THE COURT: Then what do we tell the jury about scope
18 of employment? Do you think they know what that is?

19 Does the defense have a definition for "scope of
11: 45: 15 20 employment" language?

21 MS. BEER: We did not include a definition of the
22 language on the assumption that it is relatively common
23 terminology that --

24 THE COURT: Well, among lawyers, I'm sure it is; but,
11: 45: 45 25 I don't know too many lay people who walk around talking about

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1 scope of employment, do you?

2 Well, I mean, in my circles they don't, maybe in your
3 circles --

4 (Laughter.)

11: 46: 02 5 THE COURT: -- I don't know.

6 Actually, I think I lost a page here: "Was acting

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7 within the scope of his or her employment. "

8 Well, I guess I could suggest language from the
9 Illinois pattern jury instructions, which reads something

11:46:34 10 like, "An agent is acting within the scope of his authority if
11 he is engaged in the transaction of business, which has been
12 assigned to him by his principal; or, if he is doing anything
13 which may reasonably be said to have been contemplated as a
14 part of his employment.

11:46:57 15 "It is not necessary that an act or failure to act
16 must have been expressly authorized by his principal. "

17 MR. BURKHOLZ: That's fine with plaintiffs.

18 MS. BEER: We have no problem with the language, your
19 Honor.

11:47:18 20 Where would this fit into the instruction?

21 THE COURT: I don't know. You folks are proposing
22 the instructions. I guess it would fit in about where -- or
23 it may be a separate instruction to add after the instruction
24 on scienter.

11:48:08 25 MS. BEER: It might make sense, then, your Honor, to

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1 pull all of the material, rather than doing a separate
2 instruction only on the scope of employment, to put -- pull --
3 all of the material on the imputation of an employee's state
4 of mind to the corporation, into that separate instruction.

11:48:38 5 THE COURT: Yes, there's a lot of ways of doing it
6 for sure. I have no preference, one way or the other. I
7 think that first we need to go back and revisit the language
8 on the first element of the 10b-5 claim, to include language
9 in the Makor case, which makes perfect sense to me.

11:49:18 10 I mean, it just makes -- it's just logical that an
11 individual defendant's liability for violating the rules

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12 against fraud in the sale of securities, should not depend on
13 whether he, himself, actually uttered the words that caused
14 the violation, but should also be assigned to him if he
11: 49: 54 15 provided the information for that purpose or ordered someone
16 else to do it or directed someone else to do it.

17 I can't -- it would be a really crab reading, I
18 think, of the statute, not to conclude that.

19 And, then, with respect to scienter --

11: 50: 24 20 MS. BEER: Can we back up to that just for a moment,
21 your Honor? I'm sorry to interrupt.

22 If that language is introduced, what's the point of a
23 20-A claim? Maybe I'm missing something in this, but I don't
24 see the distinction between "imposing liability on an
11: 50: 44 25 individual defendant for statements he did not make" and

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1 "imposing liability on that individual defendant, as the
2 controlling person who caused someone else's statements."

3 THE COURT: Well, I don't think it's quite the same
4 thing. For example, "controlling person" depends on
11: 51: 10 5 establishing a primary liability. So, if the theory is that,
6 for example, Mr. Gilmer is liable for what Ms. Hayden-Hakes
7 said, you would first have to establish that Ms. Hayden-Hakes
8 committed a liability -- was liable; committed a violation of
9 10b-5. And if she did not have the requisite intent or
11: 51: 31 10 scienter, that fails. It's a non-starter. It doesn't even
11 get there.

12 So, whether he's her controlling person or not
13 doesn't bring liability on him.

14 I think "controlling person" is for a slightly
11: 51: 46 15 different situation. I mean, it's for the situation where

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16 Ms. Hakes actually had the Full Monty, if you will. She made
17 the statement, she knew it was false, she had the intent, she
18 had everything. And Mr. Gilmer was her controlling person.
19 This is exactly the opposite situation, really -- what we're
11: 52: 11 20 talking about.

21 We're talking about -- we're talking about -- sending
22 liability in a different direction in the situation that we're
23 involved in.

24 MS. BEER: If we started off talking about the
11: 52: 28 25 individuals who provided information to the individual

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1 defendants --

2 THE COURT: That's not what we're talking about.
3 We're talking about the individual defendants as the
4 individuals who provided information to those who are not
11: 52: 40 5 defendants.

6 Mr. Gilmer, who is a defendant, providing information
7 or instruction or instructing or ordering Ms. Hakes to tell a
8 lie; to commit a fraud under 10b-5 -- which, I think, is the
9 whole crux of the cross-examination that they were doing of
11: 53: 03 10 Ms. Hakes -- as to whether she knew the truth of what she was
11 saying as to where she got the information, who it came from.

12 I don't see how, given that situation, we're somehow
13 eradicating "controlling authority" liability.

14 MS. BEER: We started off with attempting to analyze
11: 53: 36 15 the instructions in which the corporation can be found to have
16 a wrongful state of mind on the basis of the actions of
17 employees who did nothing but provide information to someone
18 else who made a statement.

19 THE COURT: Okay.

11: 54: 03 20 MS. BEER: Now, we're talking about providing --
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21 finding liability on the part of an individual defendant
22 who -- for a statement that individual defendant did not make,
23 on the basis that that individual provided information to
24 someone else who did speak.

11: 54: 29 25 Am I following that correctly? It seems we've

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1 shifted to something quite different.

2 THE COURT: Well, we're talking about two things.

3 Along the way, it struck me -- as I was looking at the
4 scienter materials, based upon the conversation we had last
11: 54: 44 5 time -- that the language that the Seventh Circuit used in its
6 scienter discussion also applied to the making of a statement.

7 I mean, they talked about not only uttering the
8 statement, but providing information for it, and so on.

9 And, so, it appeared to me that it would be necessary
11: 55: 06 10 or appropriate to go back to our instruction on making a false
11 or misleading statement and include that language in it.

12 Ultimately, we're back at where we started out, which
13 is imputing the scienter to the corporation and how we should
14 instruct there. And it shouldn't surprise anyone that some of
11: 55: 34 15 the same language applies to both questions.

16 So, it's not as if I started out saying one thing or
17 doing another. It's that the language led me to consider
18 something else and I brought it up here.

19 MS. BEER: I think it may be that a part of the
11: 55: 52 20 difficulty comes from attempting to break the cause of action
21 down into the elements. Because the act that provides a basis
22 for liability includes both the making of a statement and the
23 wrongful state of mind; and, by atomizing those into separate
24 elements to be analyzed, we're separating -- we're maybe

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11:56:16 25 separating -- them too far.

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1 And if we end up with a situation where one person
2 does the statement -- makes the statement -- and another
3 person has the state of mind, it's one thing to talk about
4 that going up to the corporation, and quite another thing to
11:56:31 5 say that someone who didn't make the statement can now have --
6 that liability can be imposed on someone who didn't make a
7 statement, without finding the elements of the cause of action
8 as to that individual.

9 THE COURT: Well, I mean, the argument seems to me
11:56:49 10 you're making -- and now we are talking about the individual
11 liability -- is that if -- I hate to pick on him, but, again,
12 let's use Mr. Gilmer.

13 If Mr. Gilmer said to Ms. Hakes -- if Mr. Gilmer
14 believed in his heart of hearts and his mind that the company
11:57:08 15 was involved in predatory lending practices and he said to
16 Ms. Hakes, "Go out there and tell them we're not involved in
17 any such thing," that he would not be liable under 10b-5.

18 Is that your argument?

19 MS. BEER: No, that's not my argument.

11:57:22 20 THE COURT: Okay.

21 Well, that's all I'm saying is that by including the
22 language in our "false or misleading" instruction -- "ordered
23 approved or furnished information to be included in the
24 statement" -- the person can be liable, assuming that all the
11:57:45 25 other elements are met, as well, of course.

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1 That's all I'm saying. I don't find that to be a
2 radical proposition.

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3 But I guess I'm misunderstanding your argument. What
4 --

11: 58: 12 5 MS. BEER: Yes, I can understand the note.

6 MR. HALL: Your Honor, I think maybe the confusion is
7 that we're talking about statements made by the corporation.
8 And I think the only reading of 10b-5 is that the only
9 primary -- primarily -- liable party for a statement by a
11: 58: 25 10 corporation is the corporation. Anybody else you want to
11 impute liability to has to come in through 20-A. So, that's
12 the secondary liability issue. I think there's two layers.

13 MR. BURKHOLZ: I don't think that's correct. There's
14 "substantial participation" language in a number of cases. I
11: 58: 46 15 think we might have even proposed some language with our
16 initial instructions.

17 But if the individual defendants substantially
18 participate in the making of a statement by the company, or
19 somebody else on behalf of the company, they can be held
11: 58: 59 20 liable. And that's the --

21 MR. HALL: I think that's a separate issue, your
22 Honor. I just want to make sure we're separating out the
23 issues.

24 THE COURT: Well, I think that's the issue I was
11: 59: 08 25 talking about. I mean, I think -- I hope -- that's the issue

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1 I was talking about.

2 MR. BURKHOLZ: That is.

3 MR. DOWD: Your Honor, I took what you were saying
4 was that the scienter issue as to the corporation that led you
11: 59: 28 5 to wonder about the false statement one because you have to
6 have the substantial participation issue covered.

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7 THE COURT: Yes.

8 MR. DOWD: And we agree with that.

9 THE COURT: Yes.

11:59:36 10 I mean, the language in the Seventh Circuit opinion
11 just immediately popped into my mind, that we're not just
12 talking about with scienter here, we're talking about the
13 actual acts, as well: Who makes the statement? Who makes the
14 statement?

11:59:55 15 And only individuals make statements, you know. We
16 can -- then the corporation can derive liability from that,
17 but you also have the liability of the individuals. And, so,
18 we have to clearly define when they're deemed to have made a
19 statement.

12:00:09 20 And it's not just that they opened their mouths and
21 told the press. It can also be that they told someone else to
22 tell the press. And that's all. That's all I'm saying here.
23 That's why I went back to that false and misleading and said,
24 "We should add this language, I think, and make it clear."

12:00:26 25 But now getting back to the corporate liability and

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1 the scienter issue, it appears that the language that you have
2 in 64 and 65 is -- starting on the last paragraph on Page 64
3 and going on to Page 65 -- there's not a great deal of
4 disagreement with that; is that correct?

12:01:07 5 MR. BURKHOLZ: That's correct. It's just the
6 "furnishing information or language for inclusion in the
7 statement" that's missing, that's, you know, from the Tellabs
8 case.

9 But, otherwise, the rest of it's fine, except for, of
12:01:19 10 course, the last paragraph of the instruction. And we
11 probably could add in the definition of "scope of employment"

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12 after the -- that -- sentence that discusses it.

13 MS. BEER: Yeah, we've come full circle, but I just

14 want to reiterate our objection to adding the "furnishing

12: 01: 51 15 information" language into the instruction.

16 THE COURT: Yes, it's on the record.

17 And I think we have to give an instruction on the

18 scope of employment. I don't think you can leave that to the

19 jury, unless the parties want to stipulate that there's no

12: 02: 20 20 issue as to scope of employment in this case.

21 I, frankly, think this is a case where there's no

22 issue as to scope of employment. I don't think anybody that

23 has been named here can reasonably be argued not to fit within

24 the definition of "doing something that he was assigned to do"

12: 02: 40 25 or that "might reasonably be said to have been contemplated as

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1 part of his employment" -- any of the people that the

2 plaintiffs have named.

3 But if there's no agreement on that, then I think

4 this instruction tells the jury how to determine whether

12: 03: 00 5 that --

6 MS. BEER: We'd be happy to consider a stipulation,

7 if we have a specific list of the individuals and the

8 communications that the plaintiffs intend to bring within the

9 scope of it.

12: 03: 12 10 An open-ended stipulation might be a little bit more

11 problematic.

12 MR. BURKHOLZ: I would just propose that we include

13 the language from the pattern instruction regarding "scope of

14 employment," so the jury has a better understanding of what

12: 03: 23 15 that might be within the context of this instruction.

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16 THE COURT: Okay.

17 And do you want to take a turn at preparing a
18 scienter instruction that complies with what we discussed
19 here?

12: 03: 48 20 MR. BURKHOLZ: We will.

21 Should we also take a shot at the first element --
22 revising that?

23 THE COURT: I'm sorry?

24 MR. BURKHOLZ: Should --

12: 04: 04 25 THE COURT: If you want to try to -- yes.

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1 I think we can move, then, to "Loss causation."

2 MR. BURKHOLZ: We're fine with the Court's
3 instruction.

4 THE COURT: Let me try to find the defendants'.

12: 05: 03 5 MR. BURKHOLZ: Page 73 of their mark-up.

6 THE COURT: Thank you.

7 By the way, the language about "scope of employment"
8 came out of Illinois Pattern Jury Instruction 50.06, the 2006
9 Edition, with very, very, very little modification.

12: 06: 49 10 MS. BEER: The changes that defendants have proposed
11 in that instruction, your Honor, are intended to make clear to
12 the jury that, "Loss causation must be proved as to a
13 particular false statement or omission."

14 THE COURT: Okay.

12: 07: 23 15 MS. BEER: And, in fact, if I might, we have some
16 additional language that we'd like to propose in the final
17 paragraph of our proposed instruction.

18 THE COURT: Give me a second to finish looking
19 through it.

12: 10: 11 20 (Brief pause.)

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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,

vs.

HOUSEHOLD INTERNATIONAL, INC.,)
et al.,)

Defendants.)

No. 02 C 5893

Chicago, Illinois
April 27, 2009
1:25 p.m.

VOLUME 19
TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a jury

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THE CLERK: 02 C 5893, Jaffe v. Household.

THE COURT: Good afternoon, everyone.

Give me a second.

(Brief pause.)

01:28:00

THE COURT: Okay. I think I have the plaintiffs'

latest submission here. We can just go over those.

MR. KAVALER: Your Honor, if I may? Just so we can
Page 2

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3 MR. BURKHOLZ: Yes.

4 MS. BEER: Yes, your Honor.

02: 29: 50 5 THE COURT: I think it was in here, in my proposed
6 instructions, because somebody, if not both of you, submitted
7 a summary instruction. But that will be withdrawn.

8 Court's next is No. 19, previously 18, demonstrative
9 exhibits. I don't believe there's an issue as to that one.

02: 30: 26 10 MR. BURKHOLZ: There is not.

11 MS. BEER: No, your Honor.

12 THE COURT: Next is Court's No. 20, previously
13 No. 19, multiple claims, multiple defendants.

14 MR. BURKHOLZ: I think we addressed this already, and
02: 30: 42 15 I think this was what the Court decided.

16 MS. BEER: Defendants' requested instruction No. 21
17 included language that I believe has been now adopted into
18 other instructions. So we have no objection to the Court's
19 No. 20.

02: 31: 05 20 THE COURT: Okay.

21 Next is Court's instruction No. 21, previously
22 Court's No. 20, dismissed/withdrawn defendant.

23 MR. BURKHOLZ: I think we covered that in the later
24 instruction on the elements regarding Andersen. So the
02: 31: 35 25 Court's current instruction, I think, is appropriate.

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1 THE COURT: I believe so.

2 MS. BEER: Provided the language appears in the
3 instruction on the 10b-5 elements, which, I believe, is where
4 we discussed it on Friday.

02: 31: 52 5 MR. BURKHOLZ: It's in there.

6 MS. BEER: After we finished discussing it.

7 We have no objection to the Court's instruction
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8 No. 21, previously 20, so long as the language is in the later
9 instruction.

02: 32: 06 10 THE COURT: Next is Court's 22, previously No. 21,
11 burden of proof.

12 MR. BURKHOLZ: No objection.

13 MS. BEER: No objection.

14 THE COURT: Next is Court's 23, previously 22.

02: 32: 46 15 MS. BEER: Defendants have no objection to the
16 additional language in the second paragraph of this
17 instruction.

18 We do object to the revisions to the third paragraph,
19 which is the first -- the description of the first 10b-5
02: 33: 01 20 element. And we request that that paragraph be given as
21 provided in defendants' requested instruction No. 25.

22 The language is, "First, that during the relevant
23 time period between July 30, 1999, and October 11, 2002, the
24 defendant made a false or misleading statement of fact or
02: 33: 25 25 omitted a fact that was necessary in light of the

4004

1 circumstances to prevent a statement that was made from being
2 misleading."

3 MR. BURKHOLZ: I think we covered this in detail last
4 week, your Honor. This is the language I thought we came up
02: 33: 38 5 with, and that's why I added it in.

6 MS. BEER: We did have an extended discussion of it,
7 your Honor, but I don't believe we reached agreement on it.

8 THE COURT: Okay. Well, this is the language I
9 recall that the Court settled on. So we'll give it like that.

02: 33: 58 10 MS. BEER: We object to that language, your Honor, as
11 being legally incorrect.

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12 THE COURT: Very well.

13 MS. BEER: We know of no authority, your Honor, and I

14 don't believe the plaintiffs have provided any, for the

02: 34: 10 15 imposition of 10b-5 liability on any actor who has not made a

16 material misrepresentation or false or misleading statement.

17 THE COURT: Okay.

18 MS. BEER: In particular, your Honor, if I could

19 refer the Court to the decision of the Supreme Court in

02: 34: 28 20 January 2008 in the StoneRidge Investment case, in which the

21 Court specifically addressed the question of liability for an

22 actor who did not make a direct statement to the plaintiffs

23 and rejected that theory.

24 THE COURT: Well, as I recall, the Seventh Circuit

02: 34: 49 25 cases subsequent to that -- and I think before that as well --

4005

1 indicate that if someone authorizes or provides information to
2 be used in a false statement for that purpose, that that
3 person is liable.

4 It would be, indeed, I think ironic if all corporate
02: 35: 23 5 officers could shield themselves completely from 10b-5
6 liability by simply hiring innocent spokespersons, press
7 relations people, intentionally giving them false information
8 and then telling them to provide that information to the
9 public. It just doesn't make any sense to me.

02: 35: 57 10 MS. BEER: In that scenario, your Honor, those
11 individuals would not be shielded from liability because a
12 20(a) claim would lie.

13 THE COURT: Not necessarily.

14 MR. DROSMAN: Moreover, your Honor, StoneRidge has no
02: 36: 10 15 applicability to this case. StoneRidge dealt with a
16 third-party, I believe, supplier. It had nothing to do with

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3 thing they're going to be asked to determine as they go
4 through as to each statement is whether it's true or false,
04: 52: 17 5 whether they've established the falsity of the statement; and
6 if they haven't, they don't have to do the other columns.
7 They just go straight down to the next one.

8 If it turns out to be as you hope and suspect, that
9 the vast majority of findings will be that there's no falsity
04: 52: 32 10 in these statements, it will be just as quick. It will be
11 just as quick putting it all in one form for them to check off
12 the columns than have them go through it three times.

13 And hopefully it will be less daunting for them as
14 they look at the form that they have to go through. So we
04: 52: 52 15 only have to do this once. Let's get to it.

16 So that would be my suggestion.

17 The other suggestion I guess we can -- we can table
18 until we get your -- you're going to make a submission, I
19 guess, on need to establish the disclosure dates for purposes
04: 53: 14 20 of preserving the issue of determining the cap, which will
21 come at another point in time.

22 If we end up submitting that to the jury, which is my
23 predilection now, question number 17, where you have that
24 issue, I think we need to, although much can be identified
04: 53: 44 25 from looking at the record, I think you need to add as to each

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1 event what issues are involved, predatory lending,
2 restatement. Otherwise, we may not -- I mean it's possible
3 that you have a disclosure as to predatory lending, but not as
4 to restatement or re-aging or credit card statements, and so
04: 54: 17 5 we won't be establishing a date for each of those three.

6 Many of these statements only relate to one topic;
7 but it would be good, I think, to put in the description of

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8 the event the issue as to which the jury is finding that there
9 was disclosure on that date.

04: 54: 40 10 Are you following me?

11 MR. DROSMAN: Yeah, I think I understand what you're
12 saying.

13 Can we just back up for one moment? I know it's
14 getting late. I just wanted to make one point.

04: 54: 48 15 THE COURT: I hadn't noticed.

16 MR. DROSMAN: And this bears on what you were
17 discussing. It's sort of captured in questions number 3 and 6
18 and 9 and 12 and 15, I think.

19 And that's the issue -- I understood how you asked us
04: 55: 03 20 to put it in a landscape format, sort of incorporate these
21 into one question rather than making them three, but my
22 question is --

23 THE COURT: You don't have to put it in landscape
24 format. If you can get it in the way it is, that's fine. I'm
04: 55: 17 25 just saying if we need to spread it out, I would rather -- I

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1 don't particularly like that format, but I would rather do
2 that so they only have to go through the list once.

3 MR. DROSMAN: Right, right.

4 I guess my concern was that by asking them to
04: 55: 29 5 delineate why the statement is false or the basis, the reason
6 for the falsity, what we're doing is we're imposing on the
7 jury a step that isn't required by the law. And I spent some
8 time this weekend researching this issue to try to find out
9 whether -- to try to see whether I could see other instances
04: 55: 50 10 where plaintiffs were required to explain or prove why the
11 jury found a particular statement false and misleading.

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12 And I surveyed the civil cases on the issue. I
13 couldn't find a single case where plaintiffs were required to
14 prove why.

04:56:06 15 And I'm not sure that -- I mean I read the 10(b) and
16 then Rule 10b-5, and neither of those two statutory
17 requirements contemplate a basis for the falsity. What they
18 ask is was it materially false and misleading, which I think
19 your first question asks; and if it's materially false and
04:56:26 20 misleading, I understand why we need to understand why --
21 whether it was reckless or knowing because you may or may not
22 apportion liability based on that finding.

23 But the issue of the reason or the basis for the
24 falsity is not found anywhere, and here's the concern. You
04:56:45 25 have this question number three and the jury gets to it, and

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1 you have a lively discussion, let's just hypothetically say on
2 statement number one.

3 THE COURT: Question number three is?

4 MR. DROSMAN: Question number three is check all that
04:56:58 5 apply. For each of the statements to which you answered yes,
6 why was the statement false or misleading? Check each that
7 applies.

8 So then you've got statement number one, predatory
9 lending, two-plus delinquency or restatement. And you could
04:57:09 10 imagine a scenario where the jurors go back there and five
11 feel very strongly that it was false and misleading for all
12 three of those reasons, and five feel very strongly that it's
13 false and misleading for only one of the reasons, and then you
14 have a hung jury over an issue that isn't even a requirement
04:57:27 15 under the statute, and that's the concern.

16 THE COURT: Well, let me tell you why we need to do
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17 that because you just brought it up.

18 Statement number one includes how many different

19 issues as to which the jury you could find that the statement

04: 57: 38 20 was false?

21 MR. DROSMAN: Three.

22 THE COURT: How do we know which one? How could we

23 know that all of them agreed to one?

24 MR. DROSMAN: We don't.

04: 57: 46 25 THE COURT: Maybe two agreed to delinquency

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1 restatements and eight agreed -- disagreed with that.

2 MR. DROSMAN: Right.

3 THE COURT: And agreed to predatory lending, and we

4 have no unanimity of a finding.

04: 57: 59 5 MR. DROSMAN: But we do. We have unanimity.

6 THE COURT: No, we don't.

7 MR. DROSMAN: What you have is you have unanimity

8 that they made a materially false and misleading statement.

9 You don't need unanimity as to the reason that that statement

04: 58: 13 10 was false and misleading.

11 THE COURT: I disagree, period. I disagree.

12 MS. BEER: The other danger, your Honor --

13 THE COURT: I think that's a formula for reversal.

14 MR. DROSMAN: I'm sorry?

04: 58: 19 15 THE COURT: I think that's a formula for reversal.

16 MR. DROSMAN: I searched the cases. There's nothing

17 I could find that talked about that issue.

18 THE COURT: How many cases did you find that talk

19 about it at all?

04: 58: 30 20 MR. DROSMAN: 36 discuss -- you know, had something

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21 to do with the issue.

22 THE COURT: And how many made findings and how many
23 went up and were either confirmed or reversed?

24 MR. DROSMAN: Yeah, I mean there's no case on point.

04:58:43 25 I freely admit that.

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1 THE COURT: That's right. That's right.

2 You want to break out each one of these statements

3 and make it 80 statements or 120, otherwise, we're going to

4 check as to what -- which statement and why. I think it's the

04:59:01 5 only way to do it. I just think it's the only way to do it.

6 Will we be through tomorrow with the evidence?

7 MR. KAVALER: Your Honor, we, as I mentioned earlier,

8 we're calling one more witness. We've told them who it is,

9 Professor Bajaj. There's no secret about it. Then we're

04:59:21 10 going to rest.

11 I understand they may or may not call Professor

12 Fischel. It's my expectation we'll be through with all the

13 evidence tomorrow, as far as we imagine either one of our

14 times, Professor Bajaj won't take any more than that.

04:59:33 15 THE COURT: Okay. Well, then, if that's the case, I

16 suspect that we're going to have to give the jury a day off

17 while we finalize the instructions and then bring them back on

18 one day for closing arguments and instructions.

19 MR. KAVALER: I'm sorry. Today is Monday, so if we

04:59:46 20 finish the evidence tomorrow, give them a day off, it will be

21 Thursday.

22 MR. BURKHOLZ: That makes sense, your Honor.

23 MR. KAVALER: Okay.

24 THE COURT: Yeah, it will be. I mean if you think

04:59:56 25 that we can finish the instructions --

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1 MR. KAVALER: You said Wednesday. I thought I heard
2 you say give them a day off and come back Wednesday.

3 THE COURT: No. I think I said another day, which
4 may have sounded like Wednesday.

05:00:08 5 MR. KAVALER: Sorry, Judge.

6 So the plan is to sum up on Thursday.

7 THE COURT: So far.

8 MR. KAVALER: Or later.

9 THE COURT: I -- no, not later.

05:00:17 10 MR. KAVALER: Not Wednesday is my question.

11 THE COURT: It's not likely to be Wednesday, I don't
12 think.

13 MR. KAVALER: Can we rely on that, or should we be
14 prepared?

05:00:25 15 THE COURT: I mean I suppose if you folks send me
16 back a set of revised forms and instructions that you've given
17 to opposing counsel and they agree with all of them and there
18 are no objections or changes and I read the submissions that
19 you make and I agree with everything you say and so nothing

05:00:45 20 has to be changed and we all agree as to which of these
21 statements are going to go to the jury and which aren't, and
22 if all those things are resolved in time, between the time
23 that you finish the evidence tomorrow and Wednesday morning, I
24 guess we could go to the jury on Wednesday.

05:01:11 25 MR. KAVALER: Your Honor, do you want the flying pigs

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1 to stop in the courtroom or outside?

2 THE COURT: Yeah, but that's -- so --

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3 MR. KAVALER: Fair enough.

4 THE COURT: -- I don't envision it happening.

05:01:23 5 MR. KAVALER: We'll plan on Thursday.

6 THE COURT: I think that would be a wise move.

7 MR. KAVALER: And I assume, your Honor, just as with
8 the openings, there are no specific time limits. We're each
9 limited by our remaining portion of our 44 hours.

05:01:33 10 THE COURT: Let's talk about that. I don't want --
11 no, I don't want 44 hours of argument. I don't want ten hours
12 of argument. I don't want 12 hours of argument.

13 You folks tell me how much time you think you need.

14 You might want to go back to some of the 7th Circuit writings.

05:01:53 15 I think they have opined on how many notes the human mind can
16 adequately cope with. There may just be too many notes in
17 what you're planning. And come up with a reasonable period of
18 time for your closing arguments. We're not going to do an
19 unlimited number of hours left over. Not going to do that.

05:02:17 20 But certainly it's a long case, and I'll be
21 reasonable.

22 Okay, anything else?

23 MR. BURKHOLZ: No.

24 MR. DROSMAN: No, your Honor.

05:02:25 25 THE COURT: Thank you.

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1 MR. KAVALER: 9:00 o'clock tomorrow, your Honor?

2 THE COURT: Excuse me?

3 MR. KAVALER: 9:00 o'clock tomorrow?

4 THE COURT: Yes, sir.

5 MR. KAVALER: Okay. Thank you.

6 (Court adjourned, to reconvene at 9:00 a.m. on 4-28-09.)

7 * * * * *

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C E R T I F I C A T E

We certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

/s/ Nancy C. LaBella

/s/ Kathleen Fennell

Official Court Reporters
United States District Court
Northern District of Illinois
Eastern Division

April 28, 2009

Date

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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,

vs.

HOUSEHOLD INTERNATIONAL, INC.,)
et al.,)

Defendants.)

No. 02 C 5893

Chicago, Illinois
April 28, 2009
9:10 a.m.

VOLUME 20
TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a jury

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BY: MR. MARVIN ALAN MILLER

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THE CLERK: 02 C 5893, Jaffe v. Household.

THE COURT: Good morning, everyone.

Are we ready to proceed with the jury?

MR. KAVALER: Your Honor, you asked us to hand up --

09:10:16 I thought I'd hand you before we start -- the spoliation

language --

THE COURT: Sure.
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12 Q. So this shows us the price of Household stock declining?

13 A. It shows price of Household stock going up for part of the
14 period and going down for part of the period.

10: 13: 22 15 Q. Does -- I'm sorry.

16 A. And the period it went down, in light of what we talked
17 about the economic environment, is not at all surprising.

18 Q. Does it tell us anything whatsoever about inflation?

19 A. It has nothing to do with inflation.

10: 13: 35 20 Q. Nothing to do with it.

21 In preparing your analysis, Professor, that you're
22 testifying about here today, did you identify other consumer
23 finance companies as a first step to conducting your analysis?

24 A. Yes, I did.

10: 13: 50 25 Q. How did you do that? How did you identify these consumer

Bajaj - direct

4113

1 finance companies?

2 A. So there is an industry code assigned by the government to
3 various publicly traded companies based on what is their major
4 line of business. It's called GCIS code. And according to
10: 14: 11 5 Standard & Poor's, Household belonged to a certain GCIS code
6 along with six other companies that traded over the relevant
7 period.

8 So I looked at those six companies with the same GCIS
9 code as a first step in my statistical analysis to put
10: 14: 37 10 Household's stock price movements in context.

11 Q. And that's a code provided by the United States
12 government?

13 A. Yes.

14 Q. And Standard & Poor's tells you what companies fall within
10: 14: 49 15 that code?

16 A. Yes. And this is a very, very, very well-accepted and

04-28-09 Volume 20

17 commonly used methodology to start to look for comparable
18 companies.

19 Q. And how did Household's stock price perform relative to
10:14:59 20 other consumer finance companies during the same time period?

21 MR. BURKHOLZ: Objecti on, vague as to time.

22 MR. KAVALER: I'll speci fy.

23 BY MR. KAVALER:

24 Q. During the period between July 30, 1999 -- I'll do even
10:15:14 25 better than that.

Bajaj - direct

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†
1 Did you look at how Household's stock price performed
2 during the period from July 30, 1999, to October 11, 2002, in
3 relationship to the other companies which fall within this
4 government code called GCIS and are identified as being
10:15:33 5 consumer finance companies?

6 A. Yes, I did. And what I found is Household's stock price
7 was right in the middle of the pack.

8 Q. Do you have a demonstrative that shows that?

9 A. Yes.

10:15:42 10 Q. Can we see DDX 405, please.

11 Okay. Tell us what this chart is designed to show.

12 A. Well, this chart shows what would happen if you invested a
13 hundred dollars in Household stock on July 29, 1999, the day
14 before the relevant period, and you held it until the end of
10:16:08 15 the relevant period. Unfortunately, over this relevant
16 period, you would have lost about 34 and a half percent of
17 your money.

18 Q. That's --

19 A. Your -- I'm sorry.

10:16:18 20 Q. I apologize. Go ahead.

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21 A. I was just going to say, your hundred dollars becomes \$65
22 at the end of the period.

23 Q. A bad result?

24 A. A bad result.

10:16:26 25 Q. But you said Household was in the middle of the pack?

Bajaj - direct

4115

1 A. Yes.

2 Q. Do we have the capacity to see the rest of the pack on
3 this chart?

4 A. Yes.

10:16:34 5 Q. Show us the rest of the pack, please.

6 What does the chart show now, Professor?

7 A. Well, the first thing I would point out is the red line,
8 and you'll see the label on the right-hand side, S&P 500.

9 You'll see if you had invested \$100 in the most well-

10:16:55 10 diversified U.S. large company stocks that investment

11 professionals recommend you do -- that's S&P 500 portfolio,
12 it's the proxy for the market, it's about 80 percent of the
13 market value of all publicly traded companies -- you would
14 have \$62.29 left of your hundred dollars.

10:17:19 15 Q. So Household performed better than the S&P 500 during the
16 time period we're looking at?

17 A. Household did better than the market over the relevant
18 period; not by much, but it did better.

19 Q. What about the rest of these companies?

10:17:34 20 A. Of the six consumer finance companies that share the GCIS
21 code with Household, Provident, AmeriCredit and Capital One
22 did worse than Household. Had you invested \$100 in Provident
23 instead of in Household, you would have lost over 90 percent
24 of your money. You would have less than \$1 left at the end of
10:17:56 25 this period.

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Bajaj - direct

4116

1 With AmeriCredit, you would have \$47 left. With
2 Capital One Financial, you would have \$63 left or almost 64,
3 as compared to with Household, 65.50.

4 But three consumer finance companies did better than
10:18:16 5 Household. MBNA did better. Cash America did better. Cash
6 America broke even, made a positive 1 percent return. And
7 Countrywide did the best. They had a 25 percent return.

8 But the other thing I want to point out, just going
9 back to our previous point, you know, the reason these trends
10:18:38 10 are not as clear, the \$65 going from \$100 looks almost like a
11 flat line, is there's no way to scale this chart to show that.
12 35 percent decline to most people would look like a pretty
13 significant decline.

14 Look at the volatility in these individual companies.
10:19:00 15 Look at the green line AmeriCredit. This is what it means to
16 invest in individual stocks. They go up and down a lot. And
17 Household was right in the middle of the pack during this time
18 period.

19 Q. And so does that mean that other finance companies also
10:19:20 20 lost money during the same time period?

21 A. Well, three did, three didn't. And also it depends on
22 when you invested. Like we talked about AmeriCredit doing
23 worse than Household. But what if you were lucky enough to
24 buy just before a big run-up and you happened to sell at the
10:19:37 25 top of the run-up? You would have made a lot of money.

♀

Bajaj - direct

4117

1 Q. Did you prepare a demonstrative listing the factors that,
2 in your opinion, affected Household's stock price during the

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16 hi m. He i s my hero.

17 THE COURT: Yes, yes. Well, we all need one, don't
18 we?

19 All right. We will see you folks tomorrow, usual
04: 44: 46 20 ti me.

21 THE CLERK: Court stands adjourned.

22 MR. KAVALER: Your Honor, are we going to sit on
23 Fri day?

24 Is the jury going to deliberate on Friday?

04: 44: 58 25 THE COURT: We will talk about that.

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1 (An adjournment was taken at 4:44 p.m.)

2 * * * * *

3 C E R T I F I C A T E

4 We certify that the foregoing is a correct
5 transcript from the record of proceedings in the
6 above-entitled matter.

7 /s/ Nancy C. LaBella
8 _____

9 /s/ Joseph Rickhoff
10 _____

11 /s/ Frances Ward
12 _____ April 29, 2009
13 _____ Date

14 Official Court Reporters
15 United States District Court
16 Northern District of Illinois
17 Eastern Division

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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,

vs.

HOUSEHOLD INTERNATIONAL, INC.,)
et al.,)

Defendants.)

No. 02 C 5893

Chicago, Illinois
May 1, 2009
1:20 p.m.

VOLUME 23

TRANSCRIPT OF PROCEEDINGS - JURY INSTRUCTIONS CONFERENCE
BEFORE THE HONORABLE RONALD A. GUZMAN

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4673

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THE CLERK: 02 C 5893, Jaffe v. Household.

THE COURT: Okay. Good afternoon, everyone. I hope
you've all noticed the weather is as promised. It's beautiful
today.

01:29:12

Let's see. Can you hand those out to each side?

(Tendered.)

THE COURT: I thought we'd start with these proposed
Page 2

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1 calculate an element of damages.

2 MR. KAVALER: Your Honor, they're going to calculate
3 inflation.

4 THE COURT: You can call it an inflation element of
01: 33: 23 5 damages or you can just call it damages for the sake of this
6 jury. They don't know the difference, and it won't make any
7 difference to them. The calculation they're being asked to
8 make will serve our purposes in the next round.

9 MR. KAVALER: It may serve some purpose, your Honor.
01: 33: 34 10 It will not serve the purpose of either accuracy of the law or
11 fairness. Those are my concerns.

12 THE COURT: Well, I don't think --

13 MR. KAVALER: I believe it's unfair, and I believe
14 it's inaccurate. I believe it's error. And I respectfully
01: 33: 45 15 ask you to reconsider. And if the only argument against it is
16 retying a portion of the charge, you know, we'll do what we
17 can to alleviate the burden. We're not trying to make work
18 for you.

19 THE COURT: I understand. It's not merely a question
01: 33: 58 20 of retying a few words, as you know. Everything has a
21 trickle effect in these instructions. Everything. We would
22 have to review the entire set of instructions. And we'd have
23 to consider whether the language you're asking us to use
24 comports with the language that was used during the course of
01: 34: 13 25 the trial. And I'm not sure that it does. I think the term

4680

1 inflation and the term damages were used interchangeably.

2 And we make it clear to the jury in these

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3 instructions, the instructions on damages, we tell them that
4 the only damages they're going to be asked to ascertain in
01:34:28 5 this case is the price change per share, which is the
6 inflation. And we even use the word inflation in the damages
7 instruction. So I just disagree.

8 All right. Then if there are no other objections --

9 MS. BEER: Your Honor, this is not a request for any
01:34:47 10 additional changes on the page that has been handed out. But
11 we do want for the record to reflect that while we've been
12 trying to cooperate with the Court in developing a version of
13 this form that will be useful to the jury, we have not
14 withdrawn our request that defendants' proposed verdict form
01:35:06 15 be used and not any form that the plaintiffs submitted or the
16 verdict form that we've been looking at today.

17 One of the reasons -- and we put many of our
18 objections on the record previously. But one of the reasons
19 is that in answering question four, if the jury rejects any
01:35:26 20 aspect of Professor Fischel's analysis, if they find that on
21 any day reflected in his table there was not a corrective
22 disclosure that he found or there was not a false statement
23 made that he relied upon in developing his table, that from
24 that day forward none -- the jury has no guidance whatsoever
01:35:49 25 on how to reflect that decision. And the form in its totality

4681

1 then becomes meaningless.

2 THE COURT: Well, I think what you're attacking --

3 MS. BEER: It's a fundamental flaw with the form.
4 It's a fundamental failure of proof on the plaintiffs' part.

01:36:08 5 THE COURT: That's what you're arguing. You're
6 arguing Dr. Fischel's theory is insufficient to support the
7 plaintiffs' claim. I understand that. You've argued that.

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8 To the extent that we disagree with that and we've ruled
9 against that, any form we prepare is going to reflect that
01:36:20 10 ruling. And that's what you're pointing out here. I
11 understand that.

12 MS. BEER: I'm trying to be very, very specific in
13 this objection to this particular question asking the jury
14 that if no loss was caused on any date, write none. Once they
01:36:40 15 have reached that conclusion, that on any given date the
16 inflation was none, there's really -- they have no guidance
17 for how to determine the figure to use on any day following
18 that that doesn't just rely on speculation.

19 THE COURT: Okay. Well, that statement has been
01:36:57 20 there since this form was first proposed. And to the extent
21 that you've made your objection, it stands on the record.

22 MR. KAVALER: Your Honor, just because I'm aware of
23 your devotion to accuracy, I just want to point out you've
24 fallen to Mr. Dowd's erroneous method of speech. It's
01:37:17 25 Professor Fischel and Dr. Bajaj.

4682

1 MS. BEER: And if I may, there's also one other
2 objection that we have previously made that I want to be sure
3 that we are aware of today and reflected in the record.

4 To the extent the verdict form requires a
01:37:35 5 determination of the elements of a 10b-5 claim on the numbered
6 items 1 through 40 that are included on Table A, defendants do
7 object to the combination of separate statements drawn from
8 the same document as though they are one -- one statement. We
9 feel that will be confusing to the jury and does not require
01:38:00 10 that the elements be assessed separately as to each separate
11 alleged false statement.

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1 THE COURT: Yes, that applies to the verdict form,
2 all of it, Tables A and B. Okay.

3 MR. MILLER: Should the demonstrative exhibits be
4 taken away from the jury box before they return on Monday?

02:08:36 5 THE COURT: We'll take care of destroying those.

6 MR. DOWD: Thank you, your Honor.

7 THE COURT: Okay. Thank you.

8 (Trial adjourned until May 4, 2009, at 9:00 o'clock a.m.)

9 * * * * *

10 C E R T I F I C A T E

11 We certify that the foregoing is a correct
12 transcript from the record of proceedings in the
13 above-entitled matter.

14 /s/ Nancy C. LaBella

May 2, 2009

15 _____
16 Official Court Reporters
17 United States District Court
Northern District of Illinois
Eastern Division

_____ Date

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4701

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

3 LAWRENCE E. JAFFE PENSION PLAN,)
4 on behalf of itself and all)
others similarly situated,)
5 Plaintiff,)

6 vs.)

7 HOUSEHOLD INTERNATIONAL, INC.,)
8 et al.,)
9 Defendants.)

No. 02 C 5893

Chicago, Illinois
May 4, 2009
9:00 a.m.

10 VOLUME 24
11 TRANSCRIPT OF PROCEEDINGS - TRIAL
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05-04-09 Volume 24

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THE CLERK: 02 C 5893, Jaffe v. Household.
THE COURT: Good morning, Ladies and gentlemen.
Are we ready for the jury?
MR. KAVALER: Your Honor, in an abundance of caution,
I would like to renew our 50(a) motion before you charge the
jury.
If I might just say, at the close of all the

09:16:10

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12 whether his testimony here in court was true and what weight
13 to give to his testimony here in court.

14 In considering a prior inconsistent statement or
09: 30: 57 15 conduct, you should consider whether it was simply an innocent
16 error or an intentional falsehood and whether it concerns an
17 important fact or an unimportant detail.

18 It is proper for a lawyer to meet with any witness in
19 preparation for trial.

09: 31: 18 20 You may find the testimony of one witness or a few
21 witnesses more persuasive than the testimony of a larger
22 number. You need not accept the testimony of the larger
23 number of witnesses.

24 The law does not require any party to call as a
09: 31: 41 25 witness every person who might have knowledge of the facts

4712

1 related to this trial. Similarly, the law does not require
2 any party to present all exhibits -- all papers and materials
3 mentioned during this trial.

4 I'm sorry. Let me reread that.

09: 31: 59 5 Similarly, the law does not require any party to
6 present as exhibits all papers and materials mentioned during
7 this trial.

8 Plaintiffs contend that defendants at one time
9 destroyed documents regarding Andrew Kahr's recommendations
09: 32: 15 10 for Household and documents regarding use of the effective
11 rate presentation. However, defendants contend that they did
12 not destroy any documents regarding Andrew Kahr's
13 recommendations, and whatever they did with regard to
14 documents relating to the effective rate presentation was for
09: 32: 35 15 legitimate business purposes.

16 Defendants' destruction of a document, standing
Page 10

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17 alone, does not warrant an inference that the document
18 contained information that is unfavorable to the defendants.

19 You may assume that such evidence would have been unfavorable
09: 32: 55 20 to defendants only if you find by a preponderance of the
21 evidence that:

22 One, defendants intentionally destroyed evidence or
23 caused evidence relevant to plaintiffs' claims to be
24 destroyed; and, two, defendants destroyed the evidence or
09: 33: 14 25 caused the evidence to be destroyed in bad faith, in other

4713

1 words, for the purpose of hiding adverse information.

2 You have heard witnesses give opinions about matters
3 requiring special knowledge or skill. You should judge this
4 testimony in the same way that you judge the testimony of any
09: 33: 37 5 other witness. The fact that such a person has given an
6 opinion does not mean that you are required to accept it.
7 Give the testimony whatever weight you think it deserves,
8 considering the reasons given for the opinion, the witness'
9 qualifications, and all of the other evidence in the case.

09: 34: 01 10 Certain demonstrative exhibits have been shown to
11 you. Those exhibits are used for convenience and to help
12 explain the facts of the case. They are not themselves
13 evidence or proof of any facts.

14 You must give separate consideration to each claim
09: 34: 26 15 and each party in this case.

16 When I say a particular party must prove something by
17 "a preponderance of the evidence" or when I use the expression
18 "if you find" or "if you decide," this is what I mean: When
19 you have considered all the evidence in the case, you must be
09: 34: 49 20 persuaded that it is more probably true than not true.

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21 Plaintiffs contend that defendants Household, William
22 Aldinger, David Schoenholz and Gary Gilmer violated Section
23 10(b) of the Securities Exchange Act and the Securities
24 Exchange Commission or SEC's Rule 10b-5. From now on, I will
09:35:19 25 use 10b-5 to refer to both the section and the rule.

4714

1 To prevail on their 10b-5 claim against any
2 defendant, plaintiffs must prove each of the following
3 elements by a preponderance of the evidence as to that
4 defendant:

09:35:38 5 One, the defendant made, approved or furnished
6 information to be included in a false statement of fact or
7 omitted a fact that was necessary, in light of the
8 circumstances, to prevent a statement that was made from being
9 false or misleading during the relevant time period between
09:36:01 10 July 30, 1999, and October 11, 2002;

11 Two, the false statement or omission was material;

12 Three, the defendant acted with a particular state of
13 mind; and

14 Four, the defendant's statement or omission was a
09:36:24 15 substantial factor in causing plaintiffs' economic loss.

16 If you find that the plaintiffs have proved each of
17 the above elements as to any defendant, your verdict should be
18 for the plaintiffs and against that defendant. If you find
19 that the plaintiffs have not proved each of the above elements
09:36:47 20 as to any defendant, your verdict should be for that defendant
21 and against the plaintiffs.

22 To meet the first element of their 10b-5 claim
23 against any defendant, plaintiffs must prove that during the
24 relevant time period, the defendant made a false or misleading
09:37:07 25 statement of fact or omitted a fact that was necessary to

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1 prevent a statement that was being made from being misleading.

2 Table A to the verdict form that you will be given
3 sets forth the statements that plaintiffs claim are false and
4 misleading.

09: 37: 24 5 In determining whether a statement of fact is false
6 or misleading, you must consider the statement in light of the
7 circumstances that existed at the time it was made.

8 An omission violates 10b-5 only if the defendant has
9 a duty to disclose the omitted fact. The defendants do not
09: 37: 45 10 have a duty to disclose every fact they possess about
11 Household or any fact that is in the public domain. But each
12 defendant has a duty to disclose a fact if a prior or
13 contemporaneous statement he or it made about the same subject
14 would be misleading if the fact is not disclosed. If a
09: 38: 09 15 defendant does not have a duty to disclose a fact but chooses
16 to make a statement about it, the statement must be truthful
17 and not misleading.

18 Defendant Household is required to file with the SEC
19 an annual report, called a 10-K, and quarterly reports, called
09: 38: 33 20 10-Qs, for the first three quarters of each year. These
21 reports include financial statements and other disclosures.
22 Financial statements present a company's financial position at
23 one point in time, or its operating results and cash flows for
24 a specified period. Household has no duty to update its 10-Q
09: 38: 56 25 reports on any cycle other than quarterly.

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1 Household is required to prepare its financial
2 statements regarding the delinquency status of loans and the

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C E R T I F I C A T E

I certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

/s/ Nancy C. LaBella

May 5, 2009

Official Court Reporter
United States District Court
Northern District of Illinois
Eastern Division

Date

CERTIFICATE OF SERVICE

I hereby certify that on February 12, 2014, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Seventh Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

s/D. Zachary Hudson
D. Zachary Hudson

No. 13-3532

**UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

GLICKENHAUS INSTITUTIONAL GROUP,

Plaintiff-Appellee,

v.

HOUSEHOLD INTERNATIONAL, INC., ET AL.,

Defendants-Appellants.

On Appeal from the United States District Court
for the Northern District of Illinois
No. 02-CV-5893
The Honorable Ronald A. Guzmán, District Judge

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VOLUME II**

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February 12, 2014

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02C5893 Judge Guzman
Case: 13-3532 Document: 49-2
Filed: 02/12/2014 Pages: 233
Jaffe v. Household International, Inc.
Filed Jury Instructions (Given).

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FILED
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MAY 07 2009
RONALD A. GUZMAN, JUDGE
UNITED STATES DISTRICT COURT

Members of the jury, you have seen and heard all the evidence and arguments of the attorneys. Now I will instruct you on the law.

You have two duties as a jury. Your first duty is to decide the facts from the evidence in the case. This is your job, and yours alone.

Your second duty is to apply the law that I give you to the facts. You must follow these instructions, even if you disagree with them. Each of the instructions is important, and you must follow all of them.

Perform these duties fairly and impartially. Do not allow sympathy, prejudice, fear or public opinion to influence you. You should not be influenced by any person's race, color, religion, national ancestry or sex.

Nothing I say now, and nothing I said or did during the trial, is meant to indicate any opinion on my part about what the facts are or about what your verdict should be.

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MAY 7 2009
MICHAEL W. DOBBINS
CLERK, U.S. DISTRICT COURT

In this case, Defendants William Aldinger, David Schoenholz and Gary Gilmer are individuals, Defendant Household is a corporation and Plaintiffs are entities that purchased Household stock that represent a class of others similarly situated. All parties are equal before the law. Defendants and Plaintiffs are entitled to the same fair consideration.

The evidence consists of the testimony of the witnesses, the exhibits admitted in evidence, and stipulations.

During the trial, certain testimony was presented to you by the reading of a deposition and video. You should give this testimony the same consideration you would give it had the witness appeared and testified here in court.

A stipulation is an agreement between both sides that certain facts are true. If the parties have stipulated to a fact, you must accept that fact as proved.

In determining whether any fact has been proved, you should consider all of the evidence bearing on the question regardless of who introduced it.

Certain things are not to be considered as evidence. I will list them for you:

First, if I told you to disregard any testimony or exhibits or struck any testimony or exhibits from the record, such testimony or exhibits are not evidence and must not be considered.

Second, anything that you may have seen or heard outside the courtroom is not evidence and must be entirely disregarded. This includes any press, radio, Internet or television reports you may have seen or heard. Such reports are not evidence and your verdict must not be influenced in any way by such publicity.

Third, questions and objections or comments by the lawyers are not evidence. Lawyers have a duty to object when they believe a question is improper. You should not be influenced by any objection, and you should not infer from my rulings that I have any view as to how you should decide the case.

Fourth, the lawyers' opening statements, periodic summations and closing arguments to you are not evidence. Their purpose is to discuss the issues and the evidence. If the evidence as you remember it differs from what the lawyers said, your memory is what counts.

You will recall that during the course of this trial I instructed you that I admitted certain evidence only for a limited purpose. You must consider this evidence only for the limited purpose for which it was admitted.

During the trial I provided you with a written copy of the limiting instructions that apply to certain categories of evidence, including analyst reports, investor relations reports, presentations to investors, ratings agency reports, newspaper and magazine articles, complaints and settlements in other legal proceedings, and individual customer complaints. I will not read those instructions again, but they are included in the instructions that you will take to the jury room and that you must follow in your deliberations.

Some evidence was admitted for the limited purpose of assisting you to evaluate an expert witness' opinion. Such evidence must not be used by you for any other purpose.

Certain evidence in this case is admitted for a limited purpose only to show that the contents were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents. You must consider this evidence only for the limited purpose for which it was admitted.

First, a number of documents known as analyst reports were admitted in evidence. Analyst reports are written by market analysts employed by investment banks or brokerage firms, who comment on Household's business, its securities, and the economy in general. These exhibits are not admitted to show that what the analysts said was true. This evidence is admitted only to show that the contents of the analyst reports were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents, and for no other purpose.

Second, certain documents called investor relations reports were admitted in evidence. Household's investor relations report were prepared by Household employees for internal use within the company. The investor relations reports typically include quotations or excerpts from selected analyst reports. To the extent the investor relations reports quote from, attach or paraphrase statements made by analysts, you may consider those portions of the investor relations reports only for the limited purpose of showing that the contents of the analyst reports were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents, and for no other

purpose.

Third, certain evidence was admitted about presentations that Household executives made to analysts and investors, either in person or on conference calls. This evidence is admitted for the limited purpose of showing that the contents of the presentations were publicly available or whether they affected the price of Household stock, and for no other purpose.

Fourth, some reports prepared by ratings agencies that relate to Household's financial condition were admitted. These reports were not admitted to show that what the ratings agencies said was true. This evidence was admitted only to show that the contents of the ratings agencies' reports were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents, and for no other purpose.

Fifth, a number of newspaper and magazine articles were admitted. These articles are not admitted to show that the contents of the articles were true. Unless I instruct you to the contrary, you are to consider newspaper or magazine articles only for the limited purpose of showing that the contents of the articles were publicly available, whether they affected the price of Household stock, or that Defendants were on notice of the contents, and for no other purpose.

Certain evidence in this case is admitted only for the limited purpose of showing what one or more of the Defendants knew when they made the public statements that Plaintiffs allege were false or misleading. You must consider this evidence only for the limited purpose for which it was admitted.

First, evidence was admitted about complaints that were filed publicly against Household in certain other lawsuits during the relevant time period. This evidence is not admitted to show that the allegations asserted against Household in those prior lawsuits were true. These litigation documents, and any testimony about them, are admitted only for the limited purpose of (a) showing that the existence and nature of the prior lawsuits were known to one or more of the Defendants, (b) showing that this information was publicly available, or (c) showing whether the complaints affected the price of Household stock. You are not to consider this evidence for any other purpose.

Second, evidence was admitted about complaints made by certain individual customers of Household. The evidence about individual customer complaints is not admitted to show that the customers' complaints were true. This evidence is admitted only for the limited purpose of showing that the existence and nature of the complaints were known to one or more of the Defendants, and for no other purpose.

Third, evidence was admitted about settlements that Household entered into to resolve certain legal proceedings during the relevant time period.

Evidence about a settlement is not admitted to show that Household was at fault or admitted any wrongdoing in the matter that was settled. The evidence is admitted only for the limited purpose of showing whether a settlement affected the price of Household stock, and you must not consider this evidence for any other purpose.

Each party is entitled to have the case decided solely on the evidence that applies to that party.

Any notes you have taken during the trial are only aids to your memory. The notes are not evidence. If you have not taken notes, you should rely on your independent recollection of the evidence and not be unduly influenced by the notes of other jurors. Notes are not entitled to any greater weight than the recollections or impressions of each juror about the testimony.

You should use common sense in weighing the evidence and consider the evidence in light of your own observations in life.

In our lives, we often look at one fact and conclude from it that another fact exists. In law we call this "inference." A jury is allowed to make reasonable inferences. Any inference you make must be reasonable and must be based on the evidence in the case.

You may have heard the phrases "direct evidence" and "circumstantial evidence." Direct evidence is proof that does not require an inference, such as the testimony of someone who claims to have personal knowledge of a fact. Circumstantial evidence is proof of a fact, or a series of facts, that tends to show that some other fact is true.

As an example, direct evidence that it is raining is testimony from a witness who says, "I was outside a minute ago and I saw it raining." Circumstantial evidence that it is raining is the observation of someone entering a room carrying a wet umbrella.

The law makes no distinction between the weight to be given to either direct or circumstantial evidence. You should decide how much weight to give to any evidence. In reaching your verdict, you should consider all the evidence in the case, including the circumstantial evidence.

You must decide whether the testimony of each of the witnesses is truthful and accurate, in part, in whole, or not at all. You also must decide what weight, if any, you give to the testimony of each witness.

In evaluating the testimony of any witness, including any party to the case, you may consider, among other things:

the ability and opportunity the witness had to see, hear, or know the things that the witness testified about;

the witness's memory;

any interest, bias, or prejudice the witness may have;

the witness's intelligence;

the manner of the witness while testifying;

and the reasonableness of the witness's testimony in light of all the evidence in the case.

You may consider the statements given by any party or witness who testified under oath before trial as evidence of the truth of what he or she said in the earlier statements, as well as in deciding what weight to give his or her testimony.

With respect to other witnesses, the law is different. If you decide that, before the trial, one of these witnesses made a statement not under oath or acted in a manner that is inconsistent with his testimony here in court, you may consider the earlier statement or conduct only in deciding whether his testimony here in court was true and what weight to give to his testimony here in court.

In considering a prior inconsistent statement or conduct, you should consider whether it was simply an innocent error or an intentional falsehood and whether it concerns an important fact or an unimportant detail.

It is proper for a lawyer to meet with any witness in preparation for trial.

You may find the testimony of one witness or a few witnesses more persuasive than the testimony of a larger number. You need not accept the testimony of the larger number of witnesses.

The law does not require any party to call as a witness every person who might have knowledge of the facts related to this trial. Similarly, the law does not require any party to present as exhibits all papers and materials mentioned during this trial.

Plaintiffs contend that defendants at one time destroyed documents regarding Andrew Kahr's recommendations for Household and documents regarding use of the effective rate presentation. However, defendants contend that they did not destroy any documents regarding Andrew Kahr's recommendations, and whatever they did with regard to documents relating to the effective rate presentation was for legitimate business purposes.

Defendants' destruction of a document, standing alone, does not warrant an inference that the document contained information that is unfavorable to the defendants. You may assume that such evidence would have been unfavorable to defendants only if you find by a preponderance of the evidence that:

1. Defendants intentionally destroyed evidence or caused evidence relevant to plaintiffs' claims to be destroyed; and
2. Defendants destroyed the evidence or caused the evidence to be destroyed in bad faith, in other words, for the purpose of hiding adverse information.

You have heard witnesses give opinions about matters requiring special knowledge or skill. You should judge this testimony in the same way that you judge the testimony of any other witness. The fact that such a person has given an opinion does not mean that you are required to accept it. Give the testimony whatever weight you think it deserves, considering the reasons given for the opinion, the witness's qualifications, and all of the other evidence in the case.

Certain demonstrative exhibits have been shown to you. Those exhibits are used for convenience and to help explain the facts of the case. They are not themselves evidence or proof of any facts.

You must give separate consideration to each claim and each party in this

case.

When I say a particular party must prove something by "a preponderance of the evidence," or when I use the expression "if you find," or "if you decide," this is what I mean: when you have considered all the evidence in the case, you must be persuaded that it is more probably true than not true.

Plaintiffs contend that Defendants Household, William Aldinger, David Schoenholz and Gary Gilmer violated Section 10b of the Securities Exchange Act and the Securities Exchange Commission or SEC's Rule **10b-5**. From now on, I will use "10b-5" to refer to both the Section and the Rule.

To prevail on their 10b-5 claim against any defendant, plaintiffs must prove each of the following elements by a preponderance of the evidence as to that defendant:

(1) 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;

(2) the false statement or omission was material;

(3) the defendant acted with a particular state of mind; and

(4) the defendant's statement or omission was a substantial factor in causing plaintiffs' economic loss.

If you find that the plaintiffs have proved each of the above elements as to any defendant, your verdict should be for the plaintiffs and against that defendant. If you find that the plaintiffs have not proved each of the above elements as to any defendant, your verdict should be for that defendant and against the plaintiffs.

To meet the first element of their 10b-5 claim against any defendant, plaintiffs must prove that during the relevant time period the defendant made a false or misleading statement of fact or omitted a fact that was necessary to prevent a statement that was made from being misleading.

Table A to the verdict form that you will be given, sets forth the statements that plaintiffs claim are false and misleading.

In determining whether a statement of fact is false or misleading, you must consider the statement in light of the circumstances that existed at the time it was made.

An omission violates 10b-5 only if the defendant has a duty to disclose the omitted fact. The defendants do not have a duty to disclose every fact they possess about Household or any fact that is in the public domain. But each 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. If a defendant does not have a duty to disclose a fact but chooses to make a statement about it, the statement must be truthful and not misleading.

Defendant Household is required to file with the SEC an annual report, called a 10-K, and quarterly reports, called 10-Qs, for the first three quarters of each year. These reports include financial statements and other disclosures. Financial statements present a company's financial position at one moment in

time, or its operating results and cash flows for a specified period. Household has no duty to update its 10-Q reports on any cycle other than quarterly.

Household is required to prepare its financial statements regarding the delinquency status of loans and the accounting for its credit card agreements in accordance with generally accepted accounting principles or GAAP. GAAP are the accepted rules and procedures used by accountants in preparing financial statements. If you find that any of Household's financial statements regarding the delinquency status of loans and the accounting for its credit card agreements was not prepared in accordance with GAAP, you may presume that that portion of the financial statement is false or misleading.

To meet the second element of their 10b-5 claim against any defendant, plaintiffs must prove that the false or misleading statement of fact that the defendant made, or failed to make, was material.

A statement of fact or omission is material if there is a substantial likelihood that a reasonable investor would have considered it important in deciding whether to buy or sell Household stock. An important statement or omission is one that a reasonable investor would view as significantly altering the total mix of information to be considered in deciding whether to buy or sell Household stock.

A reasonable investor is presumed to have ordinary intelligence and is presumed to have information available in the public domain.

In determining whether a statement or omission is material, you must consider it in light of the circumstances that existed at the time the statement was made or the fact was omitted.

To meet the third element of their 10b-5 claim against any defendant, plaintiffs must prove that the defendant acted with a specific state of mind. 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.

Defendants William Aldinger, David Schoenholz or Gary Gilmer acted with the required state of mind in failing to disclose a material fact if he knew that the omission would make another statement he made on the same subject misleading or he recklessly disregarded a substantial risk that the omission would make another statement he made on the same subject 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.

Defendant Household, which can only act through its employees, had the required state of mind with respect to a false statement or omission if defendants William Aldinger, David Schoenholz, Gary Gilmer or any other Household

employee made the statement or omission with the required state of mind while acting within the scope of his or her employment.

The fact that Household restated certain financial statements does not, by itself, prove that any defendant acted knowingly or recklessly with respect to the information in the original financial statements. However, you may consider it along with any other evidence to determine whether any defendant acted knowingly or recklessly.

The intent of a person or the knowledge that a person possesses at any given time may not ordinarily be proved directly because there is no way of directly scrutinizing the workings of the human mind. In determining the issue of what a person knew or what a person intended at a particular time, you may consider any statements made or acts done by that person and all other facts and circumstances received in evidence which may aid in your determination of that person's knowledge or intent.

You may infer, but you are certainly not required to infer, that a person intends the natural and probable consequences of acts knowingly done or knowingly omitted. It is entirely up to you, however, to decide what facts to find from the evidence received during this trial.

To meet the last element of their 10b-5 claim against any defendant as to any false or misleading statement or omission of material fact, plaintiffs must prove that the defendant's particular statement or omission was a substantial cause of the economic loss plaintiffs suffered. Plaintiffs do not have to prove that any statement or omission was the sole cause of plaintiffs' loss.

A statement or omission of material fact is a substantial cause of plaintiffs' loss if (1) it causes Household's stock price to be higher than it would be if the statement had not been made or the concealed fact had been disclosed; and (2) the market's discovery of the truth about that statement or omission causes Household's stock price to decrease. The truth may be revealed to the market through a single disclosure or a series of disclosures made by any person or entity.

Household is liable for any violation of 10b-5 that you find defendants William Aldinger, David Schoenholz, Gary Gilmer, or any other Household employee committed while acting within the scope of his or her employment and trying to further Household's goals. A Household officer or employee acts within the scope of his or her employment when transacting business Household assigned to him or her or doing anything that can reasonably be considered to be part of his or her employment.

If you find that plaintiffs have not proved all of the elements of their 10b-5 claim against any defendant, then you should not consider the question of damages.

If you find that plaintiffs have proved all of the elements of their 10b-5 claim against any defendant, then you must determine the amount of per share damages, if any, to which plaintiffs are entitled. Plaintiffs can recover only actual damages, which is the difference between the price plaintiffs paid for each share of Household stock and the price each share would have cost if no false or misleading statement or omission of material fact had occurred, in other words, the measure of inflation in the stock price. This is the only damages calculation you will be asked to make in this case. Any damages you award must have a reasonable basis in the evidence. Damages need not be proved with mathematical certainty but there must be enough evidence for you to make a reasonable estimate of damages.

Under Section 20(a) of the Securities Exchange Act, a defendant may be liable for what is called a "secondary violation," even if he did not violate 10b-5, if he had the authority to control another defendant who violated 10b-5. Plaintiffs claim that each of the Individual Defendants, William Aldinger, David Schoenholz, and Gary Gilmer is liable for a secondary violation under Section 20(a).

To prove that any defendant is liable for a secondary violation, plaintiffs have the burden of proving both of the following elements:

1. that another defendant (called a "primary violator") violated 10b-5 in the manner I have previously explained; and
2. that the defendant was a "controlling person" with respect to the primary violator.

If you determine that no defendant has violated 10b-5, you do not have to consider whether any defendant was a controlling person.

If you find that any defendant was a primary violator, however, you must then determine whether any of the other defendants was a "controlling person" as to that primary violator.

To establish that William Aldinger, David Schoenholz or Gary Gilmer was a "controlling person," plaintiffs must prove that:

- (1) the defendant actually exercised general control over the operations of the primary violator; and
- (2) the defendant had the power or ability, even if that power was not exercised, to control the specific transaction or activity upon which the primary violation was based — in this case, making the specific false statement or omission of material fact.

Both of these elements must be established as to each individual defendant. The parties have stipulated that both William Aldinger and David Schoenholz actually exercised general control over the operations of Household, so no proof is required on that element as to those two defendants, in their relation to Household.

Upon retiring to the jury room, you must select a presiding juror. The presiding juror will preside over your deliberations and will be your representative here in court.

A verdict form has been prepared for you.

[Verdict form read.]

Take the verdict form to the jury room, and when you have reached unanimous agreement on the verdict, your presiding juror will fill in and date the appropriate form, and all of you will sign it.

I do not anticipate that you will need to communicate with me. If you do need to communicate with me, the only proper way is in writing. The writing must be signed by the presiding juror, or, if he or she is unwilling to do so, by some other juror. The writing should be given to the marshal, who will give it to me. I will respond either in writing or by having you return to the courtroom so that I can respond orally.

If you do communicate with me, you should not indicate in your note what your numerical division is, if any.

The verdict must represent the considered judgment of each juror. Your verdict for or against any party must be unanimous.

You should make every reasonable effort to reach a verdict. In doing so, you should consult with one another, express your own views, and listen to the opinions of your fellow jurors. Discuss your differences with an open mind. Do not hesitate to reexamine your own views and change your opinion if you come to believe it is wrong. But you should not surrender your honest beliefs about the weight or effect of evidence solely because of the opinions of other jurors or for the purpose of returning a unanimous verdict.

All of you should give fair and equal consideration to all the evidence and deliberate with the goal of reaching an agreement that is consistent with the individual judgment of each juror. You are impartial judges of the facts.

UNITED STATES DISTRICT COURT
FOR THE Northern District of Illinois – CM/ECF LIVE, Ver 4.0.3
Eastern Division

Lawrence E Jaffe, et al.

Plaintiff,

v.

Case No.: 1:02-cv-05893

Hon. Ronald A. Guzman

Household International Inc., et al.

Defendant.

NOTIFICATION OF DOCKET ENTRY

This docket entry was made by the Clerk on Wednesday, July 28, 2010:

MINUTE entry before Honorable Ronald A. Guzman: The Court denies defendants' Motion for Summary Judgment Dismissing All Remaining Claims of the Class [doc. no. 1227] as moot. Mailed notice (cjb,)

ATTENTION: This notice is being sent pursuant to Rule 77(d) of the Federal Rules of Civil Procedure or Rule 49(c) of the Federal Rules of Criminal Procedure. It was generated by CM/ECF, the automated docketing system used to maintain the civil and criminal dockets of this District. If a minute order or other document is enclosed, please refer to it for additional information.

For scheduled events, motion practices, recent opinions and other information, visit our web site at www.ilnd.uscourts.gov.

**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.)

02 C 5893 (Consolidated)

HOUSEHOLD INTERNATIONAL, INC.,)

Judge Ronald A. Guzmán

MERRILL LYNCH, PIERCE, FENNER,)

& SMITH, INC., GOLDMAN SACHS &)

CO., INC., ARTHUR ANDERSEN, L.L.P.,)

WILLIAM F. ALDINGER, DAVID A.)

SCHOENHOLZ, GARY GILMER,)

J.A. VOZAR, ROBERT J. DARNALL,)

GARY G. DILLON, JOHN A.)

EDWARDSON, MARY JOHNSTON)

EVANS, J. DUDLEY FISHBURN,)

CYRUS F. FREIDHEIM, LOUIS E. LEVY,)

GEORGE A. LORCH, JOHN D.)

NICHOLS, JAMES B. PITBLADO,)

S. JAY STEWART, and LOUIS W.)

SULLIVAN,)
)
)
 Defendants.)

MEMORANDUM OPINION AND ORDER

Before the Court are the parties' submissions regarding post-verdict Phase II of this case. This Order addresses the parties' concerns and creates the protocol for Phase II, as well as the appropriate method of calculating damages with respect to each class member's claims.

Background

On May 7, 2009, the jury found that defendants Household International, Inc., William Aldinger, David Schoenholz and Gary Gilmer violated 15 U.S.C. §78(j)(b) (10(b)) of the Exchange Act of 1934 (1934 Act), and 17 C.F.R. §240.10b-5 (Rule 10b-5) and 15 U.S.C. §78(t)(a) (20(a)) with respect to statements made from March 23, 2001 to October 11, 2002. In addition, the jury determined the inflation per share from March 23, 2001 to October 11, 2002.

We now move to Phase II of the class action. Previously, Magistrate Judge Nan R. Nolan bifurcated class discovery and held that discovery as to any individual plaintiff's reliance would occur after a determination of class-wide liability and the applicability of the fraud-on-the-market theory. Neither party filed objections to that ruling. Accordingly, Phase II shall address the issue of defendant's rebuttal of the presumption of reliance as to particular individuals as well as the calculation of damages as to each plaintiff. In creating a Phase II

protocol, this Court receives very little guidance from other courts because securities fraud class actions have rarely proceeded to trial, let alone reached subsequent proceedings. *See, e.g., Edward J. Bartolo Corp. v. Coopers & Lybrand*, 928 F. Supp. 557, 560 (W.D. Pa. 1996).

On one hand, plaintiffs contend that the only remaining tasks are implementing the procedure by which defendants will exercise the right to rebut the presumption of reliance and determining the formula for calculating class members' claims and calculating damages. Plaintiffs ask the Court to approve a notice to be sent to class members advising them of the verdict and their right to file a claim for recovery along with an interrogatory addressing the issue of reliance.

On the other hand, defendants argue that due process guarantees their right to a jury trial as well as pretrial discovery regarding the contested individual issues of reliance. Defendants contend that there is no reasonable substitute for the consideration of class members' actual trading history to quantify damages.

Discussion

I. Rebutting the Presumption of Reliance

Having prevailed on their fraud-on-the-market theory, plaintiffs are entitled to a presumption of reliance. *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988). In *Basic*, the Court explained the fraud-on-the-market doctrine as follows:

An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market

price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action. *Id.* The fraud-on-the-market doctrine provides a practical resolution to the problem of balancing the substantive requirement of proof of reliance in securities cases against the procedural requisites of [Federal Rule of Civil Procedure] 23. *Id.* at 242 (alteration in original). Following *Basic*, the Seventh Circuit has explained that the reliance required for a Rule 10b-5 action is not reliance as used in the lay sense of the term:

[R]eliance is a synthetic term. It refers not to the investor's state of mind but to the effect produced by a material misstatement or omission. Reliance is the confluence of materiality and causation. The fraud on the market doctrine is the best example—a material misstatement affects the security's price, which injures investors who did not know of the misstatement.

Eckstein v. Balcors Film Investors, 58 F.3d 1102, 1170 (7th Cir. 1995).

When someone makes a false (or true) statement that adds to the supply of available information, that news passes to each investor through the price of the stock. And since all stock trades at the same price at any one time, every investor effectively possesses the same supply of information. The price both transmits the information and causes the loss.

Schleicher v. Wendt, ___ F.3d ___, No. 09-2154, 2010 WL 3271904, at 1 (7th Cir. Aug. 20, 2010). Thus, when the fraud-on-the-market theory applies, the plaintiff has indirect knowledge of the misrepresentation or omission underlying the fraud. He is reacting to a change in price, and the change was induced by a misrepresentation, so he receives as it were the distant signal of the misrepresentation and acts in response to it. *Hartmann v. Prudential Ins. Co. of Am.*, 9 F.3d 1207, 1213 (7th Cir. 1993). Accordingly, [w]hen a company's stock trades in a large and

efficient market, the contestable elements of the Rule 10b-5 claim reduce to falsehood, scienter, materiality, and loss. *Schleicher*, 2010 WL 327194, at 1.

In order to rebut the presumption of reliance, defendants must show that in purchasing Household shares, class members did not rely on the integrity of Household's stock price. The *Basic* Court said a defendant could rebut the presumption by making a showing that: (1) "the market makers were privy to the truth . . . , and thus that the market price would not be affected by [defendants'] misrepresentations" (2) the truth had "credibly entered the market and dissipated the effects of the misstatements" or (3) something severed "the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff." *Id.* at 248-49.

At trial, defendants addressed the first two methods when they raised a "truth on the market" defense and attempted to prove that the truth about Household's predatory lending practices and credit quality manipulation was well known. (*See* Trial Tr. at 124:21-23 (testimony by Gary Gilmer, then-Vice Chairman of Consumer Lending and Group Executive of U.S. Consumer Finance, that there was a discussion in the marketplace about Household's use of prepayment penalties) *id.* at 121:20-129:2 (discussing press coverage of Household's use of origination points) *id.* at 128:25-129:3 (A: It is true that the things that we have been discussing were well publicized. Q: No secret. A: None whatsoever.) *id.* at 1287:11-1288:3 (stating that Household never hid the fact that it often placed a second mortgage on top of first mortgages) *id.* at 1292:7-15 (discussing that the market was aware of Household's use of the high loan-to-value (LTV) loan (loan amount that exceeds or nearly exceeds the value of the house that is used as collateral) *id.* at 1308:10 (testifying that the "world knew" that Household loans had prepayment penalties) *id.* at 1385:8-1387:20 (stating that the market was aware that Household utilized incentive compensation methods with its employees) *id.* at

1283:9-17 (discussing analyst report recommending "sell" due to ACORN lawsuit and questioning Household's lending practices)*id.* at 1284-128-21 (stating information about the ACORN lawsuit was "out in the marketplace" and "available to the shareholders")*id.* at 1341:17-1345:7 (testifying that Household's lending practices were criticized routinely in the press)*id.* at 1391:10-1394:15 (stating that there was discussion "in the press and in the marketplace about Household's customer complaints")*id.* at 1403:22-140-3 (testifying that investors knew that Household faced headline risk)*id.* at 1410:5-1412:7 (stating that there was an awareness in the marketplace that Household was facing a "more onerous regulatory environment")*id.* at 1711:4-20, 1713:10-11 (discussing that investors knew about the debate in the market on the subject of predatory lending, knew what Household's products were, knew that Household's employees violated Company policy and knew that state and federal regulators "were on to that")*id.* at 2133:1-23 (stating that Household's one-payment reage and automatic reage policies were disclosed to the public in securitization documents)*id.* at 2137:5-18-2152:1-2153:4 (testimony by David Schoenholz, then-President and CEO and Chairman of the Board, stating that Household utilized a "two-pronged disclosure approach" regarding its reaging policies in 2002)*id.* at 2147:13-22, 32-5:22-32-2 (arguing that Household's reage policies were explained to the investment community at the April 9, 2002 Financial Relations Conference)*id.* at 3085:8-15 (testimony by William Aldinger, then-CEO and Chairman of the Board, explaining that "professional investors" and individual investors, in fact "rely on [analyst] reports, such as the Legg Mason report, in making their investment decisions.")*id.* at 3100:12-14 (stating that it was his "understanding that a document filed with the SEC is available to everybody")*id.* at 315-17-3158:9 (testifying that while there was no disclosure in the 2001 Form 10-K of Household's one-payment practice, this practice was disclosed in a

November 12, 1999 securitization prospectus) *id.* at 3158:13-3159:24 (explaining that while Household did not disclose its automatic reage practice in the 2001 Form 10-K, the practice was disclosed in a securitization document filed with the SEC on August 3, 2001) *id.* at 3159:23-24 (stating, "It's hard to conceal anything that you've filed with the SEC. It's a public record after that.") *id.* at 3185:2-3193:21 (discussing the Legg Mason analyst report that analyzed Household's use of high LTV loans and other Household lending practices) *id.* at 3251:24-3254:23 (arguing that Household had been disclosing its re-aging policies for "quite some time") Defs. Trial E (Defs. E) 91 (analyst report discussing Household's growth strategy of writing the largest home equity loan it prudently could write) Defs. E 222 (Salomon Smith Barney analyst report discussing Household's predatory lending-related headline risk) Defs. E 338 (*American Banker* article discussing Household's predatory lending-related headline risk) Defs. E 230 (discussing Goldman Sachs analyst report that defendants claim made the market aware of Household's incentive compensation programs) Defs. E 534 (analyst report discussing lawsuit filed by ACORN) Defs. E 13 (newspaper article discussing ACORN complaints) Defs. E 24 (news article questioning predatory lending) Defs. E 95 at HHT0002335 (stating that "[d]elinquent accounts may be restructured (deemed current) every six months. Accounts are automatically restructured if the customer has made the equivalent of one payment equal to at least 95% of a full standard payment. Once restructured, the account is deemed current—however, the credit limit is zero.") Defs. E 852 at F11IT-15798 (our policies . . . permit reset of the contractual delinquency status of an account to current, subject to certain limits, if a predetermined number of consecutive payments has been received and there is evidence that the reason for the delinquency has been cured.) Defs. E 880 at HHT-1798 (providing that "[t]he master servicer may in its discretion . . . treat a home equity loan as current

if the borrower has made one scheduled payment to cure the delinquency status of the home equity loan).

Throughout the trial, defendants presented evidence that the investors in Household stock were among the most sophisticated in the world and could not have been fooled by the alleged misrepresentations regarding Household's predatory lending and re-aging practices and their impact on its credit quality. Unfortunately for defendants, however, the jury concluded otherwise. The jury found that defendants made material false statements or omissions and caused plaintiffs' economic loss on a class-wide basis, in other words, that the truth did not enter the market and dissipate the effects of defendants' false statements or omissions. Thus, the issues with regard to the first two of the three methods of rebutting the presumption of reliance have been litigated and defendants will not be afforded a second bite at the apple, regardless of how they frame the issue.

As to the third method of rebutting the presumption of reliance, however, Phase II will afford defendants an opportunity to rebut the presumption using the third method set forth in *Basic*, i.e., that the link between the alleged misrepresentations and either the price received or paid by the plaintiff was severed. Plaintiffs argue that it is difficult to imagine a circumstance in which a class member would have purchased Household stock with actual knowledge of defendants' fraud and that there is no basis to believe that any class member did so. The Court agrees. The evidence establishes that defendants did not provide any material nonpublic information to any investors (except Wells Fargo). Thus, there is no evidence that any class member purchased Household stock with actual knowledge that its price had been artificially inflated by defendants' fraud. However, that does not foreclose the remote possibility that some

class member may have purchased Household stock for a reason totally unrelated to its value as reflected by the market price.

Accordingly, the Notice and Preliminary Claim Questionnaire to plaintiffs will require each class member to answer, under the penalty of perjury, the following question:

If you had known at the time of your purchase of Household stock that defendants' false and misleading statements had the effect of inflating the price of Household stock and thereby caused you to pay more for Household stock than you should have paid, would you have still purchased the stock at the inflated price that you paid? YES NO

(Court's Modified Proof of Claim and Release.) This question goes to the heart of the issue of individual reliance.¹ If the answer is "no," it does not matter whether the individual plaintiff purchased or sold any Household share (1) via an options contract, (2) as a day trader, (3) to hedge another tracking strategy, (4) through an automatic dividend reinvestment program or (5) pursuant to a proprietary trading model. However, if the answer is "yes," defendants will have evidence that helps them rebut the presumption of reliance. Defendants may issue additional interrogatories to plaintiffs answering "yes" to obtain convincing proof that price paid no part whatsoever in their decision-making. This protocol sensibly resolves the tension between the rebuttable presumption of reliance and the practicalities and purposes behind Federal Rule of Civil Procedure 23.

There is one exception to this protocol: Wells Fargo. Defendants already have reason to suspect that Wells Fargo, as part of its due diligence investigation of a potential (but

¹ Defendants concede that they have no incentive to waste time and money on examining small shareholders who do not indicate that they would have purchased stock regardless of whether they knew of defendants' false and misleading statements.

unconsummated) merger with Household in 2002, was privy to non-public information regarding Household's pervasive and aggressive write-off, expense deferral and re-aging policies, which ultimately scotched the merger. As to Wells Fargo, the Court will allow discovery as to whether its knowledge of these policies in 2002 severs the link between Household's misrepresentations and either the price received (or paid) by Wells Fargo for Household stock. Defendants will be permitted to proceed with discovery as to Wells Fargo without waiting for Wells Fargo to return its completed questionnaire.

II. Calculating Damages

A. The Netting Approach

Next, the Court addresses threshold damages issues with regard to the calculation of the class members' claims. Although damages cannot be based on pure speculation, they need not be calculated with mathematical precision. *Hoefflerle Truck Sales, Inc. v. Divco-Wayne Corp.*, 523 F.2d 543, 553 (7th Cir. 1975) (see, e.g., *Olympia Equip. Leasing Co. v. W. Union Tel. Co.*, 797 F.2d 370, 383 (7th Cir. 1986) ("Speculation has its place in estimating damages, and doubts should be resolved against the wrongdoer."). The parties agree that the correct measure of damages in a Rule 10b-5 case is out-of-pocket loss. See *Associated Randall Bank v. Griffen, Kubik, Stephens & Thompson, Inc.*, 3 F.3d 208, 214 (7th Cir. 1993) (EARNOLD S. JACOBS, *Out of Pocket Measure of Damages, in DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS* § 20:7 (2010)). Under this measure, damages are defined as the difference between the purchase price and the price that would have been received but for the alleged fraud. *Harris Trust & Sav. Bank v. Ellis*, 810 F.2d 700, 707 (7th Cir. 1987). Defendants argue that recovery should be

limited to actual damages, which would require plaintiffs' out-of-pocket losses to be netted against any of plaintiffs' inflationary gains attributable to defendants' fraud. (Defs. Resp. 8. (arguing that actual damages are calculated by netting inflation-related gains against losses).) Plaintiffs argue that gains made with respect to the sale of shares are irrelevant because their claims are based on losses that resulted solely from purchases (as opposed to sales) of Household shares. (Pls. Post-trial Submission 18. *see In re Schering-Plough Corp. Sec. Litig.*, No. 1:02-cv-0029, 2003 U.S. Dist. LEXIS 2297, at 22 (D.N.J. Oct. 9, 2003).

While the Seventh Circuit has yet to address whether out-of-pocket damages are limited to actual damages in Rule 10b-5 cases, the Second, Fifth, Ninth and Tenth Circuits have held that they are and require that plaintiffs' losses be netted against their profits attributable to the same fraud.² *See Byrnes v. Faulkner, Dawkins & Sullivan*, 550 F.2d 1303, 1313-14 (2d Cir. 1977); *Abrahamson v. Gleschner*, 588 F.2d 802, 878-79 (2d Cir. 1977); *Blackie v. Barrack*, 524 F.2d 891, 908-09 (9th Cir. 1975) (holding that if the stock is resold at an inflated price the purchaser's damages should be offset by any profits recovered due to inflation in the stock price attributable to the fraud); *Wolf v. Frank*, 477 F.2d 407, 478-79 (5th Cir. 1973); *Richardson v. MacArthur*, 451 F.2d 35, 43-44 (10th Cir. 1971). Courts in this district have also generally held that damages should be offset by any inflationary gains attributable to the defendant's fraud. *See Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 25 F.R.D. 58, 599 (N.D. Ill. 2009) (netting plaintiffs' losses with gains from inflated stock prices attributable to fraud); *In re Comodisco Sec. Litig.*, 150 F. Supp. 2d 943, 945-46 (N.D. Ill. 2001) (holding the same). This Court agrees that in a Rule 10b-5 action out-of-pocket damages should be limited to actual damages because it is a better measurement of the true economic loss sustained by plaintiffs due to defendants'

² These courts said that conclusion was dictated by the Securities Exchange Act of 1934, which states that "no person . . . shall recover, . . . a total amount in excess of his actual damages on account of the act complained of." 1788bb(a) (emphasis added). Rule 10b-5 does not endorse any specific theory or methodology of quantifying economic loss.

fraud. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 333, 345 (2005) (stating that securities laws are not designed to provide investors with insurance against market losses, but to protect them against economic losses that misrepresentations actually cause) *Arekson v. Broadcom Corp.*, No. SA C 02 301GLT, 2004 WL 32534, at 2 (C.D. Cal. Dec. 3, 2004) (holding that where a plaintiff engages in multiple purchases and sales during the period in which the stock is inflated, the proper damages methodology is to take all the inflation losses resulting from all purchases at the inflated price and reduce this amount by all the inflation gain resulting from all sales at the inflated price) *see also* Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 1, 51-52 (1985) (basing damages on the net harm that an offender's acts cause should achieve optimal deterrence). Therefore, this Court holds that out-of-pocket damages are limited to actual damages such that plaintiffs' losses must be netted against any of their profits attributable to the same fraud.

The jury has already determined the per share inflation for each day Household's stock was affected by defendants' fraud March 23, 2001 through October 11, 2002 (Damages Period). Accordingly, the measure of each plaintiff's out-of-pocket damages depends on when, and if, he bought and sold shares during the Damages Period. Consistent with the standard set forth above, damages in this case will be as follows: (1) for shares purchased during the Damages Period but not sold, damages will be the amount of artificial inflation at the time of purchase (2) for shares purchased before the class period and sold during the Damages Period at a gain or a loss damages will be plaintiff's out-of-pocket loss less any gain obtained or loss avoided because of artificial inflation at the time of the sale and (3) for shares purchased during the Damages Period, damages will be the artificial inflation at the time of purchase less the artificial inflation at the time of sale.

Further, plaintiffs' damages will be limited by the mathematical formula provided in the 90-Day Rule. The Private Securities Litigation Reform Act of 1995 (PSLRA) 90-Day Rule provides that damages:

[S]hall not exceed the difference between the purchase . . . price paid . . . by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

78u4(e)(1). For purposes of the 90-Day Rule, the "mean trading price" of a security shall be an average of the daily trading price of that security, determined as of the close of the market each day during the 90-day period. 78u4(e)(3).

Here, the 90-day period begins on October 11, 2002, the date the jury found defendants' fraud no longer affected Household's stock. Consistent with the formula set forth above, recoverable damages in this case will be limited by the 90-Day Rule as follows: (1) no limitation for Household shares sold prior to October 11, 2002 (2) for Household shares sold during the 90-Day period from October 11, 2002 through January 8, 2003, damages will be limited to the purchase price per share less the average closing price from October 11, 2002 through the day of the sale and (3) for Household shares retained at the end of January 8, 2003, damages will be limited to the purchase price per share less the 90-day average closing price from October 11, 2002 through January 8, 2003. 78u4(e)(1)(3).

B. FIFO v. LIFO

The parties also disagree as to the appropriate method for matching purchases and sales when a shareholder has engaged in multiple transactions. Here, the parties propose two

opposing theories for matching transactions: the first-in first-out (FIFO) method and the last-in first-out (LIFO) method. Each method, however, clearly favors one party over the other. The LIFO method favors the defendants by taking into consideration gains that might have accrued to plaintiffs during the class period. *See In re eSpeed, Inc. Sec. Litig.*, 232 F.R.D. 95, 101-02 (S.D.N.Y. 2005) (explaining that LIFO leads to lower damages by offsetting gains). Under LIFO, sales of the defendant's stock during the class period are matched against the last shares purchased. *Id.* at 102. Because both the purchase and sale occurred during the class period, it is likely that both transactions were affected by the fraud. *See id.* Thus, any gains that might have accrued to plaintiffs through the sale of stock during the class period because of fraud related inflation in the stock price are offset from plaintiff's total losses during the class period, thereby lowering plaintiff's total damages. *Id.*

The FIFO method, however, often gives plaintiffs a windfall by not taking into consideration gains they obtained from sales of stock during the class period at a price that was inflated by fraud. *In re Schering-Plough.*, 2003 U.S. Dist. LEXIS 20297, at 20 Under FIFO, plaintiff's sales are matched first against the earliest purchases of stock, often matching sales during a class period with stock purchased prior to the class period. *Hodges v. Akeena Solar, Inc.*, 203 F.R.D. 528, 532 (N.D. Cal. 2009). Because some of the sales are matched with pre-class period stock, courts applying FIFO exclude such transactions from the damage calculations (including any gains from such transactions), thus usually resulting in a higher damages for the plaintiffs.³ *Johnson v. Dana Corp. et al.*, No. 3:05 CV 7388, 2006 WL 78274, at 13 (N.D.

³ Courts that find deterrence to be the primary objective of Rule 10b-5 tend to use FIFO because it creates higher damage awards, while courts emphasizing compensation as the primary objective tend to use LIFO. *Compare Kane v. Shearson Loeb Rohades, Inc.*, No. 80551-CI, 1989 U.S. Dist. LEXIS 19022, at 15, 23 (S.D. Fla. May 3, 1989), with *S.E.C. v. Bear, Stearns & Co., Inc.*, No. 03 Civ. 2937, 2005 WL 217018, at 7 (S.D.N.Y. Jan. 31, 2005). This Court attempts to apply a solution that reasonably and fairly accomplishes both objectives.

Ohio May 24, 2008) (explaining that FIFO does not provide for netting of inflation-related gains). Consequently, the major reason (if not the only reason) why numerous courts have held that LIFO is the appropriate method for matching transactions in securities fraud cases is because it takes into account inflation related gains due to the fraud, and therefore, is a more accurate reflection of plaintiff's damages. *See In re eSpeed*, 232 F.R.D. at 102. If, however, as this Court provides, plaintiff's gains attributable to defendant's fraud are netted from the plaintiff's total loss, then such gains are taken into consideration and utilizing FIFO as a method of matching does not produce a windfall to the plaintiffs. *See RAMUND WONG, NERA ECON. CONSULTING, PURCHASE- SALE MATCHING IN SECURITIES LITIGATION: FIFO, LIFO, AND OFFSETS* 9, 17, 22-23 (2008) (noting that many court decisions reveal that losses claimed by plaintiffs in securities class action cases should be offset by gains related to the alleged fraud regardless of whether FIFO or LIFO is used to avoid a windfall to plaintiff, even if these gains were from sales of securities purchased prior to the class period), *available at* <http://www.nera.com/image/PURCHASE-SALE-Matching-Wong-1008.pdf>.

Further, FIFO has historically been the accounting method of choice for governmental institutions. For instance, FIFO has been used by courts and the Internal Revenue Service (IRS) to determine losses and gains for tax purposes. *Treas. Reg. 1.1012-1(c)* *see Holmes v. Comm'r of Internal Revenue*, 134 F.2d 219, 221 (3d Cir. 1943) ("FIFO is so old and well known . . . it is incorporated in [the tax code]. It is sufficient to say that it establishes a presumption to be followed.") *Thompson v. Shaw Group, Inc.*, No. 04-185, 2004 IS. Dist. Leis 2541, at 14 n.5 (E.D. La. Dec. 15, 2004) ("Many federal appeal courts and commentators regard FIFO, which the IRS consistently uses, as a firmly established

methodology for calculating loss for tax purposes in the context of securities investments. FIFO also has been the preferred method of calculating losses by the IRS where shares of stock cannot be identified with any particular lots purchased. *Helvering v. Campbell*, 313 U.S. 15, 20-21 (1941). Further, because of the convergence between Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards ("IFRS"), which do not permit the use of LIFO as an inventory method, LIFO will likely become obsolete for both financial reporting and tax purposes in the near future.⁴ FIFO has been established as a reasonable measure for computing losses or gains from stock purchases or sales in the past, and as such this Court holds that FIFO is the appropriate method for matching purchases and sales given the tax laws and recent developments in the accounting world.

In sum, by utilizing netting this Court has avoided applying FIFO in a way that will result in a windfall to the plaintiffs. Therefore, this Court holds that the fair and reasonable method for calculating damages in this class action is to apply FIFO for the method of matching purchases and sales while netting plaintiffs' losses against any profits attributable to defendants' fraud.

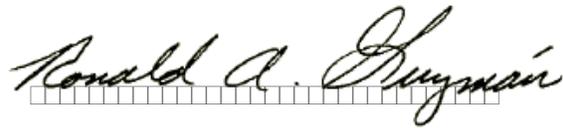
Conclusion

⁴ Although GAAP is currently authoritative in the United States, IFRS has been developing a set of accounting standards that are becoming the global standard. *IFRS Resources*, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, www.ifrs.com/updates/FAS%20IAS%20Projects.html (last visited Oct. 21, 2010). These standards do not permit the use of LIFO as an inventory method. IAS International Accounting Standard 2.25. The SEC, backed by the American Institute of Certified Public Accountants ("AICPA") and others, have agreed to a series of steps that could require the use of IFRS by publicly traded companies in the United States by 2014. Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers, 73 Fed. Reg. 70,811-70,825 (proposed Nov. 21, 2008) (to be codified at 17 C.F.R. pts. 210, 229, 230, 240, 244 & 249).

As outlined herein, the Court has addressed the parties' arguments regarding the protocol for Phase II and determined the appropriate method of calculating damages with respect to each class member's claims. The Court approves lead plaintiff's proof of claim form and release as modified by the Court's rulings herein. Plaintiffs shall prepare and file a final version that includes the proposed schedule for mailing the form and release to the class as well as the deadline for responses thereto prior to the status hearing of January 5, 2011.

SO ORDERED.

ENTERED: November 22, 2010

A handwritten signature in black ink, reading "Ronald A. Guzman". The signature is written in a cursive style. Below the signature is a horizontal line of small, empty rectangular boxes, likely a placeholder for a stamp or a signature verification code.

HON. RONALD A. GUZMAN

United States District Judge

**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,**)

Plaintiffs,)

v.)

Household International, Inc., et al.,)

Defendants.)

No. 02 C 5893

Hon. Ronald A. Guzmán

Order

Plaintiffs move the Court for a protective order pursuant to Federal Rule of Civil Procedure 2(c)(1)(D). Plaintiffs seek an order limiting defendants' discovery demands to: (1) interrogatories and document requests that address whether institutional class members had any material non-public information or otherwise knew of the fraud and still purchased Household stock; (2) only allowing depositions of, and discovery of trading strategies or models from, the institutional class members who indicate in their responses to interrogatories and document requests that they had material non-public information or otherwise knew of the fraud and still purchased Household stock knowing the price was inflated; (3) prohibiting defendants from seeking discovery regarding reliance issues such as the truth on the market defense already rejected by the jury; (4) prohibiting any discovery regarding any firewall policy separating analysts and investment decisions; and (5) limiting the relevant period for discovery to March 22, 2001 through October 11, 2002. Plaintiffs also seek similar restrictions regarding deposition questions.

The motion is prompted by defendants' rather expansive discovery requests. It appears that defendants have served 98 class members and all 3 named plaintiffs with identical Rule 30(b)(1) deposition notices, requests for production of documents and interrogatories.

The issue presented is not new to this case. It was a topic of discussion at the March 2009 pretrial conference. As the Court put it then:

The problem, of course, is that if a class action is going to mean anything, it's going to mean that we don't have to bring before the court every single investor in this case on any issue including the issue of reliance. On the other hand, a claim of a constitutional right to challenge the presumption of reliance to a jury if taken to its logical extreme, would require giving the defendant the right to bring in every single investor, which would, of course, destroy the entire concept of a class action. So how we balance those concerns is a question.

(3/12/09 Hr'g Tr. 34.) Defendants' discovery requests and plaintiffs' motion for a protective order now require the court to resolve this issue.

Discovery, of course, is not without limits. Federal rule of Civil Procedure 26(c) allows the court to limit discovery to protect the parties or persons from, among other things, undue burden or expense. Moreover, discovery from non-named class members is not warranted as a matter of course. In allowing some such discovery, the Seventh Circuit stated:

If discovery from the absent member is necessary or helpful to the proper presentation and correct adjudication of the principal suit, we see no reason why it should not be allowed so long as adequate precautionary measures are taken to insure that the absent member is not misled or confused. While absent class members should not be required to submit to discovery as a matter of course, if the trial judge determines that justice to all parties requires that absent parties furnish certain information, we believe that he has the power to authorize the use of the Rules 33 and 34 discovery procedures.

Brennan v. Midwestern United Life Ins. Co., 450 F.2d 999, 1005 (7th Cir. 1971) (see *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 810 n.2 (1985) (stating that generally, "an absent class action plaintiff is not required to do anything") (Clark v. Universal Builders, 501 F.2d 324, 340-41 (7th Cir. 1974). Indeed, one of the principal advantages of class actions over massive joinder or consolidation would be lost if all class members were routinely subject to discovery. Manual for Complex Litigation, Fourth, ¶21.41.

Plaintiffs object to the interrogatories, requests to produce and deposition notices because, in their view, the proposed discovery items seek information meant to relitigate the truth on the market defense and/or information that is neither relevant nor likely to lead to admissible evidence. For example, Interrogatory 3 states: "Identify all Documents that you reviewed or relied upon in making any decision to engage in any Transaction with respect to Household Securities." Plaintiffs responded:

Objectionable to the extent it calls for publicly available information. Defendants litigated truth on the market at trial and should not be given a second bite at the apple. Further, class members should not have to respond further, if they answer "no" to the claim form type question. A response to this Interrogatory should be deferred until a class member answers "yes" to the claim form type question.

Because the jury has already determined that the publicly available information was insufficient to dissipate the effect of defendants' fraudulent statements, i.e., rejected the truth on the market defense, it is highly unlikely that this inquiry will lead to evidence of class members who chose to purchase knowing that the price of the stock was fraudulently inflated. Moreover, responding to defendants' many detailed interrogatories and production requests about hundreds or thousands of individual transactions that took place nearly a decade ago would impose an unacceptably onerous burden on unnamed class members. As a result, it is very likely that having to respond to the requests will discourage eligible unnamed class members from making claims. This issue is more directly and simply addressed by the question each party claiming damages will have to answer under oath in

responding to the class notice/claims form.¹ The answers to that question will allow defendants to determine whether there are any purchasers to whom the presumption of reliance does not apply without imposing a high burden on unnamed class members or discouraging eligible members from making claims.

Because the truth on the market defense has already been fully litigated and rejected, the likelihood that any individual purchaser concluded from his or her knowledge of publicly available information that the price of the stock was fraudulently inflated is small. The same is not true, however, for decisions based upon nonpublicly available information. Requests for disclosure of any nonpublicly available information relied upon by individual purchasers would be more likely to uncover admissible evidence and would not pose as great a burden on the respondents. If the interrogatories and requests to produce are limited to this issue, are phrased in such a manner as to go directly to the issue and do not impose an unnecessary burden on the unnamed class members, the Court will allow them.

Requests that are improperly tailored, however, will be prohibited. For example, a request to produce all documents relating to any information regarding pricing or market analyses considered in each of hundreds of transactions, would be unnecessarily burdensome. The same is true for discovery requests relating to trading strategies utilized during the damages period. If still available, such information would not likely require inquiry into thousands of individual transactions while still allowing defendants to identify the existence of a consideration that might be reasonably likely to lead to admissible evidence of nonreliance.

Plaintiffs contend that defendants' burdensome discovery requests are intended to harass class members and deter them from filing claims. (Mem. Law Supp. Pls. Mot. Protective Order 2.) Plaintiffs' argument is a common one in discovery disputes, although it is more often the defendants complaining of plaintiffs' unnecessary requests. And indeed, one of the considerations articulated by the *Brennan* Court in allowing discovery was that it found nothing in the record to suggest that the discovery procedures were being used as a tactic to take undue advantage of the class members or as a stratagem to reduce the number of claimants. But the Court need not reach the conclusion as to defendants' intention that plaintiffs urge. It is sufficient that in this case the request for a protective order is supported, in addition to the reasons given above, by defendants' own prior representations to this Court. As far back as the pretrial conference of March 12, 2009, Ms. Patricia Farren, counsel for the defendants, while discussing the desirable parameters of the second phase of the proceedings, informed the Court that it was not defendants' intention to "drag in every pension fund in the country" to be deposed. In fact, she pointed out:

[I]f we deposed 10 entities . . . we would capture information on 50% of the stock ownership of this Company. . . . [T]he institutional investors who owned the lions

¹Part III of the claim form requires each claimant to answer the following question: "If you had known at the time of your purchase of Household stock that defendants' false and misleading statements had the effect of inflating the price of Household stock and thereby caused you to pay more for Household stock than you should have paid, would you still have purchased the stock at the inflated price that you paid?"

share of Household stock were big major sophisticated banks and other funds We could capture information about 50% of stock ownership by deposing only 10 of them. We could capture 10% by deposing only 15 of them. It may be that one or two sample depositions will tell us what we need to know and whether this is a worthwhile defense or not.

(3/12/09 Hr'g Tr. 27.) Ms. Farren repeated this assertion a few minutes later: "[A]s I said, Your Honor, we could encompass 10% of the ownership by looking at only 15 large institutional investors." (*Id.* 32.) Finally, Ms. Farren drove the point home one more time, virtually telling the Court just what defendants needed to do in discovery in order to prepare to rebut the presumption of reliance:

"But we don't have any intention, your honor, of dragging every small investor in here. We need to know what the 15 big institutional investors did, whether or not they can prove reliance on an individual basis, whether we can or I should put it correctly. Whether we can rebut the rebuttable presumption of reliance as to them by simply finding out the facts that were denied during fact discovery.

(*Id.* 33) (emphasis added).

It could not be clearer from these statements that defendants, after careful consideration and investigation, determined that the depositions of 10 to 15 large institutional investors would be sufficient to prepare to rebut the presumption of reliance. And, it was with this premise in mind, that the Court, in response to defendants' requests to reconsider, allowed them to move ahead with discovery even before any responses to the reliance interrogatory were returned. With good reason, the Court fully expected that defendants would proceed to prepare to depose 10, or at most 15, of the large institutional investors. Yet now, these same defendants tell us that they never committed to any such limited number of depositions, but actually require the deposition of nearly 100 investors.² The difference is, to say the least, substantial. Yet, defendants do not explain how or why 15 became 98.

The Court finds the defendants' first representations to be reasonable. Therefore, defendants will be allowed a maximum of 15 depositions prior to the return of the claim forms.

SO ORDERED

ENTER: January 31, 2011



RONALD A. GUZMAN
U.S. District Judge

²Whether defendants committed to a certain number of depositions is irrelevant. The point is they told the Court that 10 to 15 depositions are what they needed and even stated the reasons for this determination.

EXHIBIT A

**Affidavit of
Bradford Cornell
October 13, 2011**

Affidavit of Bradford Cornell

I. Qualifications

- (1) I am currently a visiting Professor of Finance at the California Institute of Technology. Previously, I was a Professor of Finance and Director of the Bank of America Research Center at the Anderson Graduate School of Management at the University of California, Los Angeles (“UCLA”) for 26 years.
- (2) I earned a master’s degree in Statistics from Stanford University in 1974 and earned my doctorate in Financial Economics from Stanford in 1975. I have served as an editor of numerous journals relating to business and finance and have written approximately 100 articles and two books on finance and securities, including *Corporate Valuation: Tools For Effective Appraisal and Decision Making* (1993), published by McGraw-Hill, and *The Equity Risk Premium and the Long-Run Future of the Stock Market* (1999), published by John Wiley and Sons. To complement my academic writing, I have also authored articles for *The Wall Street Journal* and the *Los Angeles Times*.
- (3) My research has been widely recognized. In 1988, I was cited by the Financial Management Association as one of the ten most prolific authors in the field of finance. I have received prizes and grants for my research from the Chicago Board of Trade, the Chicago Mercantile Exchange and the Institute for Quantitative Research in Finance. My article, “Corporate Stakeholders and Corporate Finance,”¹ received the 1987 Distinguished Applied Research Award from the Financial Management Association. In 1999, I was awarded the I/B/E/S prize for empirical work in finance and accounting (with Wayne Landsman and Jennifer Conrad). Richard Roll and I received a Graham and Dodd Scroll Award from the Financial Analyst Society for our work on delegated agent

¹ Journal of Portfolio Management, 35, (2009).

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asset pricing theory. I won another Graham and Dodd Scroll Award in 2011 for my work on economic growth and equity investing. Recently, my paper entitled, "Luck, Skill, and Investment Performance" won an Outstanding Article prize from the 11th Annual Bernstein, Fabozzi/Jacobs, Levy Awards in *The Journal of Portfolio Management*.

- (4) I have also been active in my profession. I have served as a Vice President of the Western Finance Association. I am also a past director of both the American Finance Association and the Western Finance Association. I have served as an associate editor of numerous professional journals including: *The Journal of Finance*, *The Journal of Futures Markets*, *The Journal of Financial Research* and *The Journal of International Business Studies*. I have served as a reviewer for nearly a dozen other professional journals.
- (5) My teaching and writing have focused on a number of different financial and economic issues, many of which are relevant to the subject matter of this declaration. I currently teach Applied Corporate Finance and Investment Banking at Caltech. Examples of other classes I have taught over the course of my academic career include Corporate Valuation, the Law and Finance of Corporate Acquisitions and Restructurings, Corporate Financial Theory, and Security Valuation and Investments. I have drawn upon this experience in formulating my opinions in this case.
- (6) In addition to my teaching, writing, and research studies, I also serve as senior consultant to CRA International ("CRA"), an international consulting firm. In my position as a senior consultant, I advise business and legal clients on financial economic issues. Prior to my affiliation with CRA, which began in March of 1999, I operated FinEcon, a financial economic consulting company, through which I also advised business and legal clients on financial economic issues.

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- (7) I have served as a consultant and given testimony for both plaintiffs and defendants in a variety of securities, regulatory and commercial lawsuits. During my many years of experience as an expert witness and consultant, I have provided economic analyses and expert testimony (again, for both plaintiffs and defendants) related to valuation, corporate finance and damages issues. I have been engaged as a damages expert in numerous high-profile cases that revolved around complex financial and securities transactions.
- (8) My background is described more fully in my curriculum vitae, which is attached as Exhibit I to this affidavit. A list of my publications may also be found as part of Exhibit 1.
- (9) My hourly rate in this matter is \$800.

II. Materials Reviewed

- (10) In preparing my opinions in this matter I have reviewed the following documents related to the *Jaffe v. Household* litigation:
 - a. Professor Fischel's expert report dated August 15, 2007.
 - b. Professor Fischel's rebuttal report dated February 1, 2008.
 - c. Professor Fischel's deposition testimony dated March 21, 2008.
 - d. Professor Fischel's trial testimony (direct and rebuttal).
 - e. The jury verdict and Plaintiffs' Exhibits 1395 and 1397 referenced in the verdict form.

III. Opinions

- (11) For purposes of this affidavit, I have been requested by Counsel to accept as correct the "Leakage Model" as presented by Professor Fischel in this case and to address that

Affidavit of Bradford Cornell

model, the jury verdict rendered in the Phase I proceedings, and the economic and finance principles applicable to the issue of the rebuttal of the presumption of reliance where, as here, the “fraud on the market” presumption of reliance set forth in *Basic Inc. v. Levinson*,² has been applied.

- (12) As explained in his expert report,³ Professor Fischel expressly based his “Leakage Model” on a paper which I co-authored entitled: “Using Finance Theory to Measure Damages in Fraud on the Market Cases.”⁴ My paper is the only article cited by Professor Fischel as the basis for his “Leakage Model” in his expert report dated August 15, 2007.
- (13) In the paper on which Professor Fischel based his “Leakage Model” I discuss the economic and finance principles that are directly applicable to rebutting the “fraud on the market” presumption of reliance established in *Basic*. Section III (B) of my paper is entitled “Rebutting the Presumption of Reliance,” and specifically addresses the application of the efficient market hypothesis as a tool to determine whether the *Basic* presumption has been rebutted as to alleged misrepresentations. As set forth in my paper, a necessary corollary of the “fraud on the market” presumption is that where it is shown that an alleged misrepresentation did not independently result in an additional amount of artificial inflation in the stock price, the market did not rely upon the alleged misrepresentation and the *Basic* presumption is rebutted.
- (14) The economic and finance principles set forth in my paper, upon which Professor Fischel relied in developing his “Leakage Model,” involve the determination of a “true value line” representing an “equivalent disclosure price.” The paper outlines a methodology for determining this “true value line” based upon stock price movements during an

² 485 U.S. 224 (1988).

³ Fischel Expert Report dated 08/15/07, pp. 23-24, paragraph 38.

⁴ UCLA Law Review, Vol. 37, No. 2, 1990, pp. 883–924.

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“observation window” in which price reaction is measured. A “Constructed Return” model is then built, and a “true value line” is calculated using the formula: $\text{Value}(t-1) = \text{Value}(t)/(1 + \text{Constructed Return}(t-1))$.⁵ The inflationary price impact associated with an alleged misrepresentation is then determined by the difference between the “true value line” and the actual stock price and the changes in that differential across alleged misrepresentations.

- (15) As set forth in his Expert Report, Professor Fischel specifically relied upon the model set forth in my paper to prepare his “Leakage Model.”⁶ First, Professor Fischel selected an “observation window” consisting of the period from November 15, 2001 to October 11, 2002 (“Because I found that fraud-related information leaked out beginning no later than November 15, 2001, the observation window begins on this date; it ends on October 11, 2002, the last day of the Class Period.”). Second, Professor Fischel used “the actual returns and predicted returns to construct a time series of daily stock price returns (‘Constructed Returns’) during the Class Period.” Third, Professor Fischel calculated the “true value line” using the formula: “ $\text{Value}(t-1) = (\text{Value}(t) + \text{Dividend}(t))/(1 + \text{Constructed Return}(t))$.” Applying this model, Professor Fischel “computed daily artificial inflation as the difference between the Company’s stock price and the true value line” and “[i]f the resulting inflation on any day was greater than the cumulative residual price decline during the observation window of \$23.94” the inflation was limited to a maximum “artificial inflation” of \$23.94. Professor Fischel stated that in following these steps he was “using the ‘event study approach’ described by Cornell and Morgan.”
- (16) I previously prepared an affidavit identifying certain problems associated with Professor Fischel’s application of the model set forth in my paper: namely, that (a) Professor

⁵ UCLA Law Review, Vol. 37, No. 2, 1990, pp. 897-900.

⁶ Fischel Expert Report dated 08/15/07, pp. 23-26, paragraphs 38-41.

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Fischel's methodology did not adequately address the impact of non-fraudulent company specific information during the observation window in an appropriate manner, and (b) the long observation window used by Professor Fischel created a compounding effect that produces significant errors in measured inflation (Affidavit of Bradford Cornell dated 10/30/08, attached as Exhibit 2). As noted above, however, for present purposes I am not offering specific criticisms of Professor Fischel's "Leakage Model" as it was developed and presented by him. Rather, I am taking Professor Fischel's "Leakage Model" as a given and simply addressing the consequences of the jury verdict by applying Professor Fischel's "Leakage Model" as presented.

- (17) It is my understanding that the jury was asked, in part, to determine (a) which of the 40 alleged statements was a false and misleading statement or omission of material fact under the court's instructions; (b) as to which of the three "issues" that plaintiffs alleged to be a basis of the fraud the statement was a false and misleading statement or omission of fact (the following three "issues" were alleged to be the basis of the fraud by plaintiffs and were addressed by Professor Fischel in his model: (i) "Predatory Lending," (ii) "Re-aging," and (iii) "Restatement"); and (c) selecting one of Professor Fischel's models, the "measure of inflation," defined as "the difference between the price plaintiffs paid for each share of Household stock and the price each share would have cost if no false or misleading statement or omission of material fact occurred."
- (18) The jury determined that the first false and misleading statement or omission of material fact occurred on March 23, 2001 as a result of what was identified in the jury verdict form as "Statement 14." The jury specified that "Statement 14" was a false and misleading statement or omission of material fact only with respect to the issue of "Predatory Lending." After selecting the "Leakage Model" presented by Professor

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Fischel, the jury assigned an amount of “artificial inflation” of \$23.94 to Statement 14. I have been advised by counsel that based upon the jury instructions and the jury verdict form, the jury determined that Statement 14 was a false and misleading statement or omission of material fact solely with respect to “Predatory Lending” and that the jury assigned “artificial inflation” of \$23.94 to this alleged false and misleading statement or omission of material fact on the issue of “Predatory Lending” only.

- (19) I have examined the jury verdict with respect to the amounts of “artificial inflation” assigned by the jury in the verdict form pursuant to Professor Fischel’s “Leakage Model.” For the period prior to Professor Fischel’s “observation window,” the jury found 7 additional statements to be misrepresentations. The jury assigned the same maximum “artificial inflation” amount of \$23.94 to each of these statements during this period. As a matter of straightforward economic and finance theory, this finding means that the jury found that there was no incremental independent inflationary price impact with respect to any of those statements. Rather, the \$23.94 of artificial inflation attributed to the Statement 14 “Predatory Lending” misrepresentation had been maintained on dates of each of the 7 statements.
- (20) With respect to the “observation window” period under Professor Fischel’s “Leakage Model,” the jury found an additional 9 statements to be misrepresentations. During this “observation window” the amount of “artificial inflation” generally decreased throughout the period. On only two of the dates for which the jury found a misrepresentation were there increases in the amount of “artificial inflation”: An increase from \$22.59 on December 3, 2001 to \$23.94 on December 4, 2001, and an increase from \$23.65 on April 16, 2002 to \$23.94 on April 17, 2002. The increase in inflation on April 17, 2002 was

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not statistically significant, as Professor Fischel acknowledged.⁷ The increase in “artificial inflation” on December 4, 2001, which corresponds to Statement No. 23 on the Verdict Form, is a statement determined by the jury to be a false and misleading statement or omission of material fact with respect to only the “Re-aging” issue.⁸ The jury verdict and Professor Fischel’s “Leakage Model” establish that the \$1.35 incremental increase in “artificial inflation” attributable to this statement fully dissipated by December 11, 2001 (at which time the amount of “artificial inflation” had declined to \$22.20). Professor Fischel acknowledged in his testimony that the increased “artificial inflation” associated with the December 4, 2001 Statement was statistically significant⁹, but also that it was eliminated by December 11, 2001, and thus only investors who purchased between December 4 and December 11, 2001 would have suffered any harm attributable to the December 4, 2001 misrepresentation.¹⁰

- (21) As set forth in my paper, and as a settled principle of economic and finance theory, if the difference between the “true value line” and the actual stock price does not increase (*i.e.*, the amount of “artificial inflation” does not increase) by a statistically significant amount as a consequence of an alleged misrepresentation, then the market did not rely upon the alleged misrepresentation and the “fraud on the market” presumption has been rebutted.¹¹
- (22) The jury verdict thus establishes the following: (1) No misrepresentation identified by the jury to be attributable to the issue of the “Restatement” resulted in any increase in “artificial inflation,” and (2) With respect to the issue of “Re-aging,” only the December

⁷ Fischel Trial Transcript at 2909: 16–19.

⁸ Jury Verdict Form, page 23.

⁹ Fischel Trial Transcript at 2878:5–7; 14–18.

¹⁰ Fischel Trial Transcript at 2883:18–2885:3.

¹¹ UCLA Law Review, Vol. 37, No. 2, 1990, pp. 917-923.

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4, 2001 misrepresentation resulted in a statistically significant increase in “artificial inflation,” and that increase of \$1.35 fully dissipated by December 11, 2001.

- (23) The verdict thus establishes that the “fraud on the market” presumption of reliance has been rebutted, based upon an absence of inflationary price impact, for all alleged misrepresentations on the issue of the “Restatement” and for all alleged misrepresentations with respect to the issue of “Re-aging,” except for the \$1.35 amount of inflationary price impact attributable to December 4, 2001 statement and only for the period between December 4, 2001 and December 11, 2001.
- (24) This verdict result also has significant consequences with respect to the question of market reliance regarding Statement 14, the March 23, 2001 statement for which the jury assigned the full, maximum amount of “artificial inflation” of \$23.94 under Professor Fischel’s “Leakage Model.” In discussing the underlying principles of economics and finance in my paper upon which Professor Fischel based his model, I and my co-author noted a critical feature and limitation of the “Leakage Model” approach: “Finance theory does make clear, however, that when there are interrelated frauds, separate value lines cannot be constructed. . . . Instead, the total damage must be estimated using one value calculated backwards from the time at which all elements of the fraud have been effectively disclosed.”¹² That is, when, as here, it has been alleged that a securities fraud involved multiple “issues,” the “Leakage Model” cannot be used to determine the amount of “artificial inflation” attributable to just one of those “issues” (“separate value lines cannot be constructed”). Instead, the “Leakage Model” develops a “true value line” that necessarily reflects misrepresentations as to all components of the alleged fraud. This is a well-established principle of finance and economics. In fact, Professor Fischel’s

¹² UCLA Law Review, Vol. 37, No. 2, 1990, pp. 908.

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“Leakage Model” assumes a single “true value line” based upon all three alleged fraudulent “issues” without distinction. Moreover, Professor Fischel has never stated, and could never state in a manner consistent with economic and finance theory, that his “Leakage Model” provides a means to determine the inflationary price impact associated with any one individual issue among the three fraudulent issues alleged by Plaintiffs.

- (25) Professor Fischel did present an alternative model in his expert report under which inflation could be estimated for each of the three fraud allegations. This is the “Quantification using Specific Disclosures Model” discussed on pages 20-23 of Professor Fischel’s report. The inflation estimates calculated using the “Specific Disclosures Model” assign non-zero inflation to each of the three fraud allegations. For example, on 12/11/01 Legg Mason published an analyst report critical of Household’s re-aging policies and the artificial inflation as estimated by the “Specific Disclosures Model” declined from \$6.05 to \$3.66 thereby assigning at least \$2.39 of artificial inflation to the “Re-aging” fraud issue.¹³ On 11/14/01 Household was sued for alleged predatory lending practices and the artificial inflation declined from \$7.97 to \$6.11 thereby assigning at least \$1.86 of inflation to the “Predatory Lending” fraud issue.¹⁴ On 8/14/02 Household announced that it was restating its prior reported financial results downwards and the artificial inflation declined from \$2.16 to \$0.32 thereby assigning inflation of at least \$1.84 to the “Restatement” fraud issue.¹⁵
- (26) Professor Fischel also states that his two inflation models, the “Leakage Model” and the “Specific Disclosures Model” are internally consistent. He explains this point in detail in his rebuttal report in footnote 6, concluding that, “... my quantifications of artificial

¹³ Fischel Trial Transcript at 2640-41.

¹⁴ Fischel Trial Transcript at 2629-31.

¹⁵ Fischel Trial Transcript at 2643-44.

Affidavit of Bradford Cornell

inflation are consistent...”¹⁶ It follows from Professor Fischel’s analysis and explanation that, while the “Leakage Model” does not disaggregate inflation into components related to each of the three fraud allegations, the numerical values of each of these three individual inflation components in the “Leakage Model” calculation must be non-zero. That is, although the “Leakage Model” does not provide a means to disaggregate the specific amount of inflationary price impact attributable to each of the three fraud “issues,” the total inflationary price impact of \$23.94 determined by Professor Fischel in his “Leakage Model” must be the result of some positive amount of inflationary price impact contributed by each of the three “issues.”

- (27) This raises a fundamental problem based on the jury verdict with respect to Statement 14. The jury determined that Statement 14 was a misrepresentation only with respect to the issue of “Predatory Lending,” but it assigned the full “artificial inflation” of \$23.94 to that statement and therefore implicitly assigned an artificial inflation of \$0 to “Re-aging” and “Restatement” fraud allegations. This is squarely inconsistent with the fact that each of the three individual inflation components must be non-zero according to Professor Fischel’s expert report as discussed above. At no time did Professor Fischel attempt to disaggregate within his “Leakage Model” the amount of “artificial inflation” attributable to the each of the three fraudulent issues, nor is the “Leakage Model” designed to do so. However, there is no valid basis under Professor Fischel’s model by which the full \$23.94 inflationary price impact can be assigned to the March 23, 2001 statement or the single issue of “Predatory Lending.”
- (28) As set forth above, the “Leakage Model” presented by Professor Fischel did not, and cannot be used to, determine the specific inflationary price impact associated with either

¹⁶ Fischel Rebuttal Report dated 02/01/08, pp. 4-5, footnote 6.

Affidavit of Bradford Cornell

Statement 14 or the single issue of “Predatory Lending.” Accordingly, although it can definitively be stated that the entire amount of \$23.94 cannot be assigned to the March 23, 2001 statement or the single issue of “Predatory Lending,” there is no valid basis under the jury verdict, and the jury’s selection and application of Professor Fischel’s “Leakage Model,” to determine the actual inflationary price impact attributable to Statement 14 or the single issue of “Predatory Lending”.

- (29) It should be noted that, in certain cases, it may be possible to disaggregate total inflation into different components of a “multi-issue” fraud, but one would have to abandon the “Leakage Model” to do so. As discussed earlier, the “Specific Disclosures Model” developed by Professor Fischel, but rejected by the jury, could potentially have been used as a means to allocate the amount of inflation attributable to separate “issues” in a multi-issue fraud. It is noteworthy that, although Professor Fischel did not undertake such an analysis, a review of the specific, statistically significant disclosures identified by Professor Fischel which he testified relate solely to the issue of “Predatory Lending” account for less than 40% of the aggregate amount of \$7.97 of inflationary price impact he identified under his “Specific Disclosures Model.” This serves to further demonstrate that there is no valid basis under Professor Fischel’s “Leakage Model,” or under economic and finance theory, to assign the entire amount of \$23.94 of inflationary price impact to Statement 14 or the single issue of “Predatory Lending”.
- (30) Accordingly, the jury’s assignment of an inflationary price impact of \$23.94 to the March 23, 2001 statement, is squarely inconsistent with Professor Fischel’s own “Leakage Model” and contrary to the established principles of finance and economics that underlay the use of such a model. There is no valid basis under settled principles of economics and finance to determine, based on the jury verdict and its application of Professor

Affidavit of Bradford Cornell

Fischel's "Leakage Model", the proper inflationary price impact attributable to the March 23, 2001 Statement.



Bradford Cornell

October 13, 2011

STATE OF CALIFORNIA)

)

COUNTY OF LOS ANGELES)

Subscribed and sworn to me on this 13th day of October, 2011, by

BRADFORD CORNELL, proved to me on the basis of

satisfactory evidence to be the person who appeared before me.

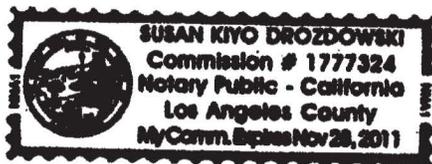




Exhibit 1

Bradford Cornell

Senior Consultant

PhD Financial Economics
Stanford University

MS Statistics
Stanford University

AB (Interdepartmental)
Physics, Philosophy,
and Psychology
Stanford University

Academic and professional positions

1999–Present	<i>Senior Consultant, CRA</i>
2005–Present	<i>Visiting Professor of Financial Economics, California Institute of Technology</i>
1987–2005	<i>Professor of Finance and Director of the Bank of America Research Center, Anderson Graduate School of Management, UCLA</i>
1990–1999	<i>President, FinEcon: Financial Economic Consulting</i>
1988–1990	<i>Vice-President and Director of the Securities Litigation Group, Economic Analysis Corporation</i>
1979–1986	<i>Assistant and Associate Professor of Finance, UCLA</i>
1983–1984	<i>Visiting Professor of Finance, California Institute of Technology</i>
1977–1979	<i>Assistant Professor of Finance, University of Southern California</i>
1975–1977	<i>Assistant Professor of Finance, University of Arizona</i>

Courses taught

- Applied Corporate Finance and Investment Banking
- Corporate Valuation
- The Law and Finance of Corporate Acquisitions and Restructurings
- Corporate Financial Theory
- The Theory of Finance (in the UCLA Law School)
- Security Valuation and Investments
- A wide variety of executive and community education programs

Special education programs include

- The US Business School in Prague—Special Finance Program, Summer 1991
- The Lead Program for Business Education of Minority High School Students, 1987–1997

Consulting and professional activities

Selected service at UCLA

- Twice Chairman of Finance Department
- Twice Vice Chairman of the Anderson School
- Three-time member of the staffing and promotion committee

Service to scholarly journals and organizations

Served as an associate editor for a variety of scholarly and business journals, including *Journal of Finance*, *Journal of International Business Studies*, *Journal of Business and Economics*, *Journal of Financial Research*, *Journal of Futures Markets*, and the *Investment Management Review*.

Served as a reviewer for numerous finance and economics journals, including *American Economic Review*, *Journal of Political Economy*, *Journal of Financial Economics*, *Journal of Business*, *Journal of Financial and Quantitative Analysis*, and the *Review of Economics and Statistics*.

Memberships in professional societies

- American Finance Association, 1973–Present
 - Member of Board of Directors, 1987–1989
- Western Finance Association, 1973–Present
 - Member of Board of Directors, 1982–1985
 - Vice President, 1987
- American Economic Association, 1973–Present
- American Bar Association, 1995–1999
- American Statistical Association, 1992–1999
- International Association of Financial Engineers, 1993–2003
- American Law and Economics Association, 1995–2000
- Human Behavior and Evolution Society, 1995–2000

Research evaluation

- Project reviewer for the National Science Foundation, 1979–Present
- Program committee for the Western Finance Association, Various years

Selected board and committee memberships

- Pension Policy Board, The Aerospace Corporation, 1985–2008
- Chairman, Mayor's Blue Ribbon Commission on Los Angeles' Municipal Investments, 1995
- Director, Forms Engineering Corporation, 1976–1997

- Trustee, Kellow Trust, 1982–1991

Expert witness

Numerous cases involving the application of financial economics

Media experience

- Occasional contributor to *The Wall Street Journal* and *The Los Angeles Times*
- Occasional commentator for local television and radio stations
- Lecturer on valuation theory, appraisal practice, and securities pricing

Publications

Books and book chapters

“Stock Repurchases: Tradeoffs and Trends.” *Dividends and Dividend Policy*, H. Kent Baker, ed., Blackwell Publishing, New York, 2009.

“Securities Fraud Damages.” With J. Hirshleifer and J. Haut. *Developments in Litigation Economics*, Vol. 87, P. Gaughan and R. Thornton, eds., Elsevier, Ltd., Oxford, UK, 2005.

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Academic articles

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"Testing the Tax Timing Option Theory: A New Approach." 1984.

"Determinants of Corporate Capital Structure: An Empirical Analysis." With J. Dietrich. 1979.

Awards and honors

Bernstein, Fabozzi/Jacobs, Levy Award for outstanding research from *The Journal of Portfolio Management*, 2010

Graham and Dodd G&D Scroll Award for research on securities analysis and valuation (with Richard Roll), 2006

I/B/E/S award for research in empirical finance (with W. Landsman and J. Conrad), 1999

Cited as one of the 10 most prolific research authors in the field of finance in "Most Frequent Contributors to the Finance Literature" by Jean Louis Heck and Phillip L. Cooley, *Financial Management*, Autumn 1988

Financial Management Association Prize for Applied Research, 1987

Institute for Quantitative Research in Finance, Research Grant, 1984

Center for the Study of Futures Markets, Research Grant, 1983

Center for the Study of Futures Markets, Research Grant, 1981

Chicago Mercantile Exchange, Research Grant, 1979

Phi Beta Kappa, Stanford University, 1970

**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.)

02 C 5893 (Consolidated)

HOUSEHOLD INTERNATIONAL, INC.,)
MERRILL LYNCH, PIERCE, FENNER,)
& SMITH, INC., GOLDMAN SACHS &)
CO., INC., ARTHUR ANDERSEN, L.L.P.,)
WILLIAM F. ALDINGER, DAVID A.)
SCHOENHOLZ, GARY GILMER,)
J.A. VOZAR, ROBERT J. DARNALL,)
GARY G. DILLON, JOHN A.)
EDWARDSON, MARY JOHNSTON)
EVANS, J. DUDLEY FISHBURN,)
CYRUS F. FREIDHEIM, LOUIS E. LEVY,)
GEORGE A. LORCH, JOHN D.)
NICHOLS, JAMES B. PITBLADO,)
S. JAY STEWART, and LOUIS W.)
SULLIVAN,)

Judge Ronald A. Guzmán

Defendants.)

MEMORANDUM OPINION AND ORDER

In phase one of this bifurcated case, a jury returned a verdict in favor of plaintiffs and against some or all of the defendants on the Section 10(b)/Rule 10b-5 claims as to Statement Nos. 14-18, 20-24, 27-29, 32, 36-38 (“the seventeen statements”). (Verdict Form at 14-18, 20-24, 27-29, 32, 36-38; *id.*, Table A, Alleged False or Misleading Statements at 11-26.) This means the jury found that the statements made and/or facts withheld regarding predatory lending, 2+ delinquency/re-aging, and the Restatement were false or misleading, material, made with the requisite state of mind, and substantially caused the economic loss plaintiffs suffered. (*See id.*; *see also* Jury Instructions at 25-

32.) In addition, the jury credited the Leakage Model of damages presented by plaintiffs' expert Daniel Fischel. (*See* Verdict Form at 41.) At trial, defendants offered, and the jury rejected, two of the three types of evidence that can be used to rebut the presumption of reliance, *i.e.*, that market makers were privy to the truth, and the truth had credibly entered the market and dissipated the effects of the omissions and misstatements. Thus, in phase two, the focus has been on the third kind of rebuttal evidence, that which severs the link between the alleged omissions and misstatements and either the price paid or received by any claimant. Accordingly, each claimant was required to respond "yes" or "no" to the following inquiry: "If you had known at the time of your purchase of Household stock that defendants' false and misleading statements had the effect of inflating the price of Household stock and thereby caused you to pay more for Household stock than you should have paid, would you have still purchased the stock at the inflated price that you paid?" (hereinafter "claim form question"). (1/11/11 Order, Ex. 2 at 8.) The Court also permitted the custodian banks and third-party claim filers to send claimants with an allowed loss greater than \$250,000.00 a supplemental form that asked the same question. (5/31/11 Order.) In addition, the parties were afforded discovery to meet their respective burdens with regard to the presumption of reliance. The parties now present the individual claims as to which they contend there is no triable issue with regard to reliance.

There are three categories of claimants: (1) those that responded "no" to the claim form question;¹ (2) those that responded "yes" to the claim form question; and (3) those that returned the

¹When the Court uses the term "claim form question" it refers to the question that appeared in Section III of the initial proof-of-claim notice to all plaintiffs and/or the supplemental form sent to those plaintiffs with an allowed loss of greater than \$250,000.00.

claim form but did not answer the claim form question.²

If a claimant responded “no” to the claim form question, and defendants do not point to any evidence that reasonably suggests “no” does not mean “no,” that claimant is entitled to judgment as to liability because defendants have not created a triable issue of fact as to his reliance on price. Defendants argue that anything short of a jury trial on all issues relating to an award of statutory damages is a deprivation of their Seventh Amendment rights. *See* U.S. Const. amend. VII (stating that “[i]n Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved”). It is well settled, however, that summary disposition procedures do not violate the Seventh Amendment. *Burks v. Wis. Dep’t of Transp.*, 464 F.3d 744, 759 (7th Cir. 2006). Thus, if there are no factual issues to be resolved, the claims can be adjudicated short of trial without running afoul of the Seventh Amendment.

Defendants also argue that the jury verdict itself rebuts the presumption of market reliance as to the entire class because the dates on which the actionable misstatements/opinions occurred do not correspond to an increase in inflationary impact on Household stock. However, the expert testimony credited by the jury was that a misstatement or omission may cause inflation in the stock price merely by maintaining the market expectations or preventing them from falling further, even if the inflation does not increase on the date the misstatement or omission is made. (*See, e.g.*, Trial Tr. at 2605 (plaintiffs’ expert Fischel stating that stock is inflated where stock is prevented from falling to a lower level)); *see Schleicher v. Wendt*, 618 F.3d 679, 683 (7th Cir. 2010) (price can be inflated by false statement or omission when it stops price from declining); *Nathenson v. Zonagen*

²Claimants who answered “yes” or “no” to the claim form question, but explained that they did not make the contested investment decision are included in this category.

Inc., 267 F.3d 400, 419 (5th Cir. 2001) (statement actionable with no price increase); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 562 (S.D.N.Y. 2011) (“[A] statement can cause inflation by causing the stock price to be artificially maintained at a level that does not reflect its true value.”). Thus, the fact that the artificial inflation did not increase each day on which the jury found an actionable misstatement or omission occurred does not mean that there is a triable issue as to whether the presumption of reliance has been rebutted.

Defendants also argue that the jury verdict itself rebuts the presumption of market reliance as to the entire class because the Leakage Model did not isolate as to any given day the inflation caused by a misstatement or omission regarding each of the three subjects presented to the jury, *i.e.*, predatory lending vs. 2+ delinquency/re-aging vs. Restatement, and thus plaintiffs have failed to show that the actionable misstatement or omission about a particular subject caused an independent inflationary price impact. (Defs.’ Submission Regarding Rebuttal Presumption Reliance at 3-17.) As the evidence at trial demonstrated, the actionable misstatements or omissions on these three subjects were inextricably intertwined. The jury found that defendants made actionable misstatements about re-aging to cover up their predatory lending practices and, in turn, made actionable Restatement misstatements to cover up their re-aging methods. Moreover, as Fischel explained, the inflated price of Household’s stock at any given time reflected the ever-changing mix of information that was publicly available. Given the interdependence of the fraudulent statements and the volatility of the information mix, it would be virtually impossible to parse out the damages by topic.

Fortunately, the law does not require the impossible. Rather, it gives a jury discretion to determine a damages award, as long as the award has a reasonable basis in the evidence. *See Am.*

Nat'l Bank & Trust Co. v. Reg'l Transp. Auth., 125 F.3d 420, 435-40 (7th Cir. 1997); *Dresser Indus., Inc. v. Gradall Co.*, 965 F.2d 1442, 1447 (7th Cir. 1992) (per curiam); *First Nat'l Bank of Kenosha v. United States*, 763 F.2d 891, 896 (7th Cir. 1985); (see also Jury Instructions 34 (“Any damages you award must have a reasonable basis in the evidence. Damages must not be proved with mathematical certainty but there must be enough evidence for you to make a reasonable estimate of damages.”)). In this case, there were multiple statements and partial disclosures over an extended time period, and the parties’ experts provided testimony in support of their positions regarding whether the stock price was affected by misrepresentations or omissions and the estimate of damages stemming therefrom, and the jury chose to credit Fischel’s Leakage Model of damages (discounting industry, market or company-specific non-fraud declines unrelated to the actionable misstatements or omissions) over defendants’ counter-arguments. Here, all of the evidence, including Fischel’s testimony about the amount of artificial inflation, provided a reasonable basis for the jury’s damages award.

Defendants also argue that they have rebutted the presumption of reliance as to index funds that answered “no” to the claim form question because the evidence shows that the price of stock has no impact on their purchasing decisions. (See, e.g., Defs.’ Ex. 7, The Munder Institutional Funds Prospectus at MCM 0000410 (stating that it “attempts to duplicate the investment composition and performance of the particular index through statistical procedures”).) The Court disagrees. The weight of each stock in a capitalization-weighted index is proportional to each company’s market capitalization, *i.e.*, its market price multiplied by the number of outstanding shares. See Reuters.com, Financial Glossary, http://glossary.reuters.com/index.php/Capitalization-Weighted_Index &

http://glossary.reuters.com/index.php/Market_Capitalization (last visited Sept. 20, 2012).³ In other words, indexes rely on investor opinion as reflected in market price to assign weight to stocks. Likewise, the index funds, which adjust their portfolios to match a target index, rely on investor opinion as reflected in stock price each time they make an adjustment. (*See* Defs.’ Ex. 9, Rule 30(b)(6) Dep. State Street at 43-44 (“[W]e wouldn’t have purchased the stock in any of the portfolios which were found to be fraudulent.”).) In short, the evidence about the investment goals of index funds, which is all that defendants offer, does not support the inference that such funds are indifferent to market price. *See In re Countrywide Fin. Corp. Sec. Litig.*, 273 F.R.D. 586, 602 (C.D. Cal. 2009) (“Defendants argue that because index purchases seek to match a predetermined index of securities, such purchases are not made in reliance on any misrepresentation. To the contrary: because index purchases seek only to match the index and exclude other considerations (such as, for example, reliance on nonpublic information or other idiosyncratic motivations), index purchases rely exclusively upon the market to impound any representations (including misrepresentations) into securities’ prices.”); *see also In re Connetics Corp. Sec. Litig.*, 257 F.R.D. 572, 578 (N.D. Cal. 2009) (rejecting argument that plaintiff, which made some of its trades “based on a computer program that was designed to mirror a stock index,” was not typical of the class of investors because there was no evidence suggesting “that the index did not . . . rely on the integrity of the market”). Defendants have not, therefore, created a triable issue of fact as to the reliance of index investors that responded “no” to the claim form question.

The same is true for Capital Guardian Trust Co., Capital Research & Management Co. and

³Defendants have not offered any evidence that suggests any of these investors are something other than capitalization-weighted index funds.

Davis Select Advisors (“DSA”), claimants who gave a “no” answer to the claim form question but testified that they rejected or doubted the validity of the efficient capital market theory. (*See* Pls.’ Ex. 13, Capital Guardian Trust Co. Rule 30(b)(6) Dep. at 68-69 (“[H]istory . . . show[s] that the efficient capital markets pricing theory” that “all current available information has already been factored into the stock price[,]” is “not always accurate.”); Pls.’ Ex. 14, Capital Research & Management Co. Rule 30(b)(6) Dep. at 37-38 (testifying that its “investment philosophy” suggests it is “not true” that “the price of a stock reflects all the information available at that time”); Pls.’ Ex. 12, DSA Rule 30(b)(6) Dep. at 45-46 (stating that it “cannot be correct,” given the stock market’s history, that “stocks are fairly priced at all times because [the market price] immediately reflects all information in the public domain”). Given the parties’ stipulation that “Household common stock traded in an efficient market” (Final Pretrial Order, Ex. A, Uncontested Fact No. 10), whether these claimants fully subscribe to the efficient market theory is irrelevant. What is relevant is whether they would have traded in Household stock if they had known about the fraud. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 248 (1988). Each of them unequivocally answered “no.” (*See* Pls.’ Ex. 12, DSA Rule 30(b)(6) Dep. at 143 (“It is definitely not appropriate to invest in companies run by crooked executives.”); Pls.’ Ex. 13, Capital Guardian Trust Co. Rule 30(b)(6) Dep. at 35 (“If we’d ever known that a management had knowingly misled or misstated or produced false statements, I think that would almost, . . . automatically exclude us from wanting to invest in – with such a company.”); Pls.’ Ex. 14, Capital Research & Management Co. Rule 30(b)(6) Dep. at 71-73 (deponent testifying that he could not “imagine a scenario where [he] would have bought . . . Household stock knowing that it was inflated above its true value” because “part of our investment philosophy is to find undervalued assets . . . [and] that involves the values of the enterprise, the

strength of the fundamentals and a sense of trust in the management”); *id.* at 74 (“[I]f we would have known [the price of Household stock] was inflated, we wouldn’t have purchased the stock.”.) Thus, these claimants’ testimony about efficient market theory does not create a triable issue as to whether they relied on price when they engaged in the stock transactions at issue in this case.

Alternatively, defendants argue that DSA could not have relied on any Restatement misstatement in purchasing Household stock because the Restatement affected earnings near term and DSA judges its performance over a three- to ten-year term. (*See* Defs.’ Ex. 13, DSA Rule 30(b)(6) Dep. at 95, 185.) But DSA does not say that it would have purchased Household stock even if it had known of the fraud. On the contrary, DSA testified that “one of the biggest parts of an investment decision is the price of the stock and management’s integrity and what they are telling you.” (*Id.* at 185.) Thus, no reasonable jury could infer solely from DSA’s emphasis on long-term performance that it did not rely on the integrity of the Household stock price. Defendants have not, therefore, raised a triable issue as to DSA’s reliance on the Restatement misstatements.

Defendants also argue that they have created a triable issue as to whether lead plaintiff Glickenhau & Co. and claimants for which it made investment decisions relied on the March 23, 2001 *Origination News* article misstatement. (*See* Verdict Form, Table A at 11 (“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.”) In support, defendants cite to Glickenhau’s deposition testimony that it would not “necessarily believe that [an *Origination News* quote is] accurate or true,” but believes that Household’s press releases are true and “relies on [them] in making investment decisions.” (Defs.’ Ex. 8, Glickenhau Rule 30(b)(6) Dep. at 58-65.)

It is undisputed, however, that the quote from the *Origination News* article appeared in a Household press release. (*Id.*) Thus, viewing the facts in defendants' favor, no reasonable jury could find that Glickenhauß did not rely on Gilmer's quote. The Court, therefore, holds that defendants have not created a triable issue of fact as to Glickenhauß' reliance.

Defendants have, however, created a triable issue of fact as to the reliance of claimants who: (1) responded "yes" to the claim form question; (2) submitted duplicate claims with conflicting answers to the claim form question; and (3) submitted multiple claims with different answers to the claim form question. These claims must be resolved at trial.

That leaves the claims of those who did not answer the claim form question and/or supplemental interrogatory. Defendants contend that, by failing to respond to discovery, these claimants have forfeited their claims. Plaintiffs argue that summary dismissal is too harsh a sanction and contend that these claims should be tried. The parties' arguments underscore the challenge of balancing defendants' right to gather information for their defense with the class members' right not to be subjected to abusive discovery. (*See, e.g.*, 3/12/09 Hr'g Tr. at 34.)

Initially, the task did not seem daunting, as defendants said their discovery needs were slight:

[T]he institutional investors who owned the lion's share of Household stock were big major sophisticated banks and other funds We could capture information about 50 percent of stock ownership by deposing only 10 of them. We could capture 60 percent by deposing only 15 of them. It may be that one or two sample depositions will tell us what we need to know and whether this is a worthwhile defense or not.

. . . .

We need to know what the 15 big institutional investors – what they did, whether or not they can prove reliance on an individual basis, whether we can – I should put it correctly. Whether we can rebut the rebuttable presumption of reliance as to them by simply finding out the facts that were denied during fact discovery.

(*Id.* at 27, 33.) Accordingly, the Court ordered that Notice of the Verdict and Claim Form be sent to the class and gave defendants 120 days to take discovery of any class member. (*See* 11/22/10 Mem. Op. & Order at 9; 1/5/11 Hr’g Tr. at 20, 25-26.)

Among other things, the Notice sent to the class members states you “must submit a valid Proof of Claim form enclosed with this notice no later than May 24, 2011” to be able to recover under the verdict. (1/11/11 Order, Ex. 1 at 6.) Moreover, the Proof of Claim form itself states: (1) if you fail to submit a properly addressed . . . Proof of Claim and Release, your claim may be rejected and you may be precluded from any recovery pursuant to the verdict”; (2) **“YOU MUST ANSWER THE QUESTIONS IN PART III OF THE CLAIM FORM IN ORDER TO BE ELIGIBLE TO RECOVER PURSUANT TO THE VERDICT”**; and (3) **“YOU MUST ALSO ANSWER THE [Claim Form] QUESTION IN ORDER TO BE ELIGIBLE FOR RECOVERY ON YOUR CLAIM PURSUANT TO THE VERDICT.”** (*Id.*, Ex. 2 at 1, 3, 8) (emphasis original).

Subsequently, defendants served document production requests, interrogatories and Rule 30(b)(6) deposition notices on ninety-eight institutional class members. Plaintiffs argued that the discovery was overly burdensome and harassing and asked the Court for a protective order. The Court granted plaintiffs’ motion in part and ordered that defendants take no more than fifteen depositions, the number defendants initially said they would need, before the claim forms were returned. (*See* 1/31/11 Order at 4.)

In early April 2011, plaintiffs told the Court that:

[S]everal custodian banks have expressed concern regarding the difficulty of obtaining the investor clients’ answers to a discovery inquiry on the claim form prior to the claim deadline of May 24, 2011. This difficulty arises from the fact that although these custodian banks are authorized to file claims on behalf of their clients, they were not the decision-makers regarding the relevant investments as to those

clients. Thus, to obtain an answer to the discovery inquiry, such custodian banks must identify, and transmit the discovery inquiry to, each relevant decision-maker.

(4/11/11 Order at 1-2) (footnote omitted). Consequently, the Court ordered plaintiffs “to propose a plan . . . as to the most efficient way to . . . obtain responses” to the claim form question from this group of claimants. (*Id.* at 2.)

Plaintiffs reported that thirty-eight custodian banks and third-party filing services had filed multiple claims, “12,506 [of which] generate an allowed loss . . . of \$1,248,357,070.” (Lead Pls.’ Proposed Plan Obtaining Resp. Disc. Inquiry Proof Claim Form at 2.) 11,760 of these claims had an allowed loss of \$250,000.00 or less, 326 had an allowed loss of \$250,001.00-\$500,000.00, 204 had an allowed loss of \$500,001.00-\$1,000,000.00 and 216 had an allowed loss of more than \$1,000,000.00. (*Id.*) Given this information, plaintiffs proposed that the custodian banks only be required to obtain an answer to the claim form question from the claimants whose losses accounted for the bulk of the claimed damages, those with an allowed loss in excess of \$250,000.00 (*Id.* at 5-6.)

Defendants objected to the plan because it did not require the custodian banks to obtain answers from the 11,760 claimants whose allowed loss was less than \$250,000.00. (*See* Defs.’ Resp. Pls.’ Proposed Plan Obtaining Resp. Disc. Inquiry Proof Claim at 1.) They urged the Court to reject the plan and order that “the Proof of Claim form, or a Court-approved follow-up notice, be sent to *all* beneficial owners on whose behalf custodian banks or other nominees submitted Proof of Claim forms that do not contain an answer to the reliance question.” (*Id.* at 3) (emphasis original).

The Court considered the parties’ arguments in light of defendants’ need for the information, the class members’ need to be protected from unduly burdensome discovery and the unique

circumstances of the case and, with certain modifications, adopted plaintiffs' plan:

We now know that discovery of 80% of the claimed losses can be achieved by addressing only 6% of the claims. This, coupled with the other avenues of discovery the court has already approved, constitutes a reasonable approach to balancing the needs of the defendants for discovery with the need to protect class members from discouragement and the need to move this already 9 year-old case towards a conclusion.

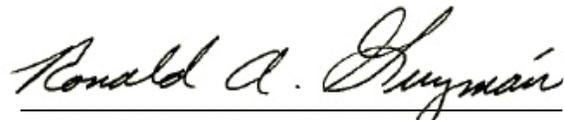
(5/31/11 Order at 7.) Thus, class members with claims of more than \$250,000.00 that were filed by custodian banks were sent a second notice that contained the claim form question and said: **“TO RECOVER FROM THE VERDICT FUND YOU MUST ANSWER THE QUESTION.”** (*See id.* at 7-8; Lead Pls.' Proposed Plan Obtaining Resp. Discovery Inquiry Proof Claim Form, Ex. B.) (emphasis original).

Though they were told repeatedly that they could recover in this suit only if they answered the claim form question, a substantial number of claimants did not. Plaintiffs argue that the Court should ignore this noncompliance and set the claims for trial. That the Court will not do. The Court carefully structured the discovery process to enable defendants to get the information they needed without overburdening the members of the class. Toward that end, each claimant was given the opportunity, larger claimants got two, to perfect his claim by answering “yes” or “no” to one simple discovery question. Given these unique circumstances, the only appropriate sanction for a claimant's failure to answer the question is dismissal of his claim. *See Newman v. Metro. Pier & Exposition Auth.*, 962 F.2d 589, 591 (7th Cir. 1992) (“A plaintiff's failure to comply with discovery orders is properly sanctioned by dismissal of the suit, a defendant's by entry of a default judgment.”). Thus, defendants are entitled to judgment on any claims for which the claimant did not answer the claim form question.

To facilitate resolution of the claims that need not be tried, the Court appoints Phillip S. Stenger of Stenger & Stenger as special master to identify in accordance with this Order: (1) the claims on which plaintiffs are entitled to judgment as a matter of law and the amount of each such allowed claim; (2) the claims on which defendants are entitled to judgment as a matter of law; and (3) the claims that must be resolved at trial.

SO ORDERED

ENTERED: September 21, 2012



HON. RONALD A. GUZMAN
United States District Court Judge

Page 1

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,)
Plaintiffs,)
vs.) No. 02 C 5893
HOUSEHOLD INTERNATIONAL, INC.,)
et al.,)
Defendants.)

The videotape deposition of
DANIEL R. FISCHEL, taken before Richard H. Dagdigian,
Illinois CSR No. 084-000035, Notary Public, Cook
County, Illinois, pursuant to the Federal Rules of
Civil Procedure for the United States District Courts
pertaining to the taking of depositions, at 115 South
LaSalle Street, Suite 2910, Chicago, Illinois,
commencing at 8:56 a.m. on the 21st day March 2008.

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21
22
23
24

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I N D E X

1
2 March 21, 2008
3 THE WITNESS EXAMINATION BY COUNSEL FOR
4 PLAINTIFFS DEFENDANTS
5 DANIEL FISCHEL
6 (By Mr. Owen) 6
7 FISCHEL DEPOSITION EXHIBITS
8 NUMBER DESCRIPTION PAGE
9 Exhibit 1 Report of Daniel R. Fischel 10
10 Exhibit 2 Rebuttal report of Daniel R. Fischel 10
11 Exhibit 3 Document titled "Efficient Capital 21
12 Markets, the Crash, and the Fraud on
13 the Market Theory", by Daniel R. Fischel
14 Exhibit 4 Document titled "Appendix 1, 89
15 Household's Prospectus Disclosures"
16 Exhibit 5 Document dated Oct. 18, 2001 from 94
17 Ventana Capital, titled "Household
18 International (HI-\$58-Sell)"
19 Exhibit 6 Document titled "Lead Plaintiffs' 105
20 Opposition to Household Defendants'
21 Motion to Compel", etc.
22 Exhibit 7 Document titled "VMS, Monitoring 170
23 Report", Bates Nos. HHS 02948918
24 through 02948926

1 A The footnote says that those two things are
2 different pieces of information. That's correct.

3 Q When you are conducting the analysis that
4 you do in your report, do you have to identify all
5 the different pieces of information in order to reach
6 conclusions about material changes in the stock
7 prices?

8 A Now, you are shifting to my report?

9 Q It's a more abstract question, but it's
10 about the methodology that you are following.

11 You have to identify the key pieces of
12 information in order to analyze the changes in stock
13 price?

14 A I'm not sure what you mean by "identify the
15 keys pieces of information".

16 I did an events study analyzing the
17 relationship between the stock price movements to all
18 disclosures on every day during the class period; and
19 for that matter, a stock price reaction today where I
20 couldn't identify any disclosures.

21 Q Well, my question is, in footnote six of
22 your article, you talk about and identify two
23 distinct pieces of information that could relate to
24 the claim of fraud in that hypothetical case.

1 Generally speaking, do you have to know
2 what the relevant pieces of information are when you
3 are analyzing a plaintiff's claim of fraud?

4 A I think what the footnote suggests is you
5 have to interpret stock price movements in a
6 particular context, and that's the purpose of the
7 footnote.

8 I think that's always true, if that's the
9 question.

10 Q How can you tell if a particular piece of
11 information relates to an alleged fraud or not?

12 A Again, generally, hypothetically, under any
13 conceivable circumstances?

14 Q Uh hum. What would be the way you would
15 analyze it?

16 A Again, it's very difficult to answer
17 questions at this level of generality because every
18 situation has to be analyzed based on the relevant
19 facts and circumstances.

20 But, generally speaking, I would say you
21 would look at the allegations in the case, the
22 relevant public disclosures.

23 The stock price reaction to those
24 disclosures likely perform an events study or

1 regression analysis to make sure that the stock price
2 reactions that you were interpreting are not
3 attributable to market or industry or some other
4 factors.

5 You look at all the other relevant economic
6 evidence that might or might not be relevant
7 depending on the facts and circumstances, and make a
8 judgment, as well as look looking at all the other
9 relevant publicly available information.

10 Q Your opinion says that the economic
11 evidence that you reviewed is "consistent with the
12 plaintiffs claims in this case".

13 A Are you referring to a particular statement
14 in the report?

15 Q It's on page six, the last paragraph before
16 Roman numeral III, the last sentence before Roman
17 numeral III.

18 A I see that.

19 Q "I have concluded that the economic
20 evidence is consistent with plaintiffs' claim that
21 the alleged wrongdoing caused investors in
22 Household's common stock to incur losses".

23 What do you mean by the words "consistent
24 with"?

1 A What I mean is, in the context of this
2 case, that there are allegations about particular
3 nondisclosures and misrepresentations.

4 I don't have an opinion on whether there
5 were in fact misrepresentations or nondisclosures.

6 But in looking at the economic evidence, if
7 there were in fact material omissions or
8 nondisclosures as alleged, I would expect to see
9 certain behavior of stock price movements as well as
10 a certain pattern of reaction by market participants.

11 And when I looked at the economic evidence,
12 it was consistent, as I said in the report, with the
13 claims that are being made by the plaintiffs in this
14 case for the reasons described in my reports.

15 Q Let me give you a hypothetical just to see
16 if I understand what you just said.

17 Take two hypothetical companies; each of
18 them is accused of the same undisclosed misconduct,
19 and one of them is accused falsely, and the other is
20 accused accurately.

21 The stock prices of both the companies
22 decline significantly on the accusation.

23 Both of the companies deny the allegations,
24 and both of the companies settle the claims for

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1 undisclosed reasons while continuing to profess
 2 innocence. Both are then sued for securities fraud.
 3 Your methods, as they have been applied
 4 here, would identify the presence of inflation for
 5 both companies, is that correct?
 6 A I just don't know if that's correct. I
 7 think I would have to look at all the relevant facts
 8 and circumstances and -- and if this were a real
 9 world situation.
 10 But I do want to emphasize what might be
 11 the premise of your question, which is that I'm not
 12 expressing an opinion on whether there were in fact
 13 misrepresentations or omissions.
 14 The economic evidence that I've looked at
 15 does not allow me to express an opinion on that
 16 subject.
 17 I can express an opinion as to whether
 18 the economic evidence is consistent with those
 19 allegations, but does not establish that the
 20 allegations themselves are true.
 21 Q Let me just see if I understood that.
 22 The economic evidence could be consistent
 23 with the claims, but the claims themselves could be
 24 false?

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1 establishes plaintiffs' claim.
 2 Q You are aware that Household settled a
 3 bunch of different matters of litigation against it,
 4 disputes of regulators in this case?
 5 A I am.
 6 Q Are you offering any opinion as to the
 7 reasons Household settled any of those matters or
 8 litigations?
 9 A No, I am not.
 10 Q Now, you conduct a regression analysis in
 11 connection with your first report?
 12 A Correct.
 13 Q And that regression analysis tries to
 14 identify statistically significant changes in stock
 15 price after controlling for market and industry
 16 factors?
 17 A That's correct.
 18 Q What standard is being applied for
 19 statistical significance in your report?
 20 A You mean what is -- I'm not sure what you
 21 mean by "what standard".
 22 Q Well, supposedly the regression will say
 23 this movement is significant, and this other movement
 24 is not significant.

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1 A The claim that there is legal liability for
 2 misrepresentations or omissions -- that may or may
 3 not be correct.
 4 I don't have an opinion one way or the
 5 other on whether the claims that there were
 6 disclosure defects that were actionable under the
 7 securities laws -- I don't have an opinion on that.
 8 I have an opinion as to whether the
 9 economic evidence is consistent with those
 10 allegations in the way that I described; that if
 11 those allegations were accurate, I would expect to
 12 see a certain pattern of stock price behavior as well
 13 as a certain pattern to my analysis of publicly
 14 available information.
 15 I was able to test those things by looking
 16 at relevant disclosures, publicly available
 17 information, stock price movements, controlling for
 18 market and industry movements.
 19 I looked at all of Doctor Bajaj's
 20 criticisms, responded to those, and I reached the
 21 opinions that I reached.
 22 But that's why the last sentence of
 23 paragraph 11 says that, "the economic evidence is
 24 consistent with plaintiffs' claim" as opposed to

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1 And I want to know what the standard is to
 2 decide which is which.
 3 A I used, as I typically do, as is
 4 conventional, a standard of any stock price movement
 5 that had a t-statistic of greater than 1.65, I
 6 consider to be statistically significant.
 7 And any stock price movement that had a
 8 t-statistic less than 1.65, I did not consider to be
 9 statistically significant under the specification
 10 that's described in my report.
 11 Q You talk about another standard involving a
 12 t-statistic of 1.96, I think?
 13 A Correct.
 14 Q What -- why do you talk about that
 15 standard?
 16 A Just for purposes of providing background
 17 about the difference between a 1-tail test and a
 18 2-tail test.
 19 Q So the other standard doesn't have anything
 20 to do with the actual analysis that you do?
 21 A I'm not sure what you mean by "doesn't have
 22 anything to do with" it. I think anybody could look
 23 at the results that are reported and conclude that
 24 the results are significant in either a 1-tail test

1 or a 2-tail test, or neither.

2 But in terms of the standard that I used, I

3 used a t-statistic of 1.65 which is the conventional

4 level of statistical significance in a 1-tail test.

5 Q Speaking generally -- let me start again.

6 Did you apply a 2-tail test to any of the

7 dates that you analyzed in your regression analysis?

8 A Well, the results lend themselves to

9 applying any level of statistical significance.

10 You could apply statistical significance at

11 the ten percent level, which would be the lowest

12 t-statistic; you could apply statistical significance

13 at the one percent level which would be a higher

14 t-statistic.

15 But in terms of what I consider to be

16 statistically significant, I used a 1-tail test and,

17 therefore, a t-statistic of 1.65.

18 But the results allow you to use any level

19 of statistical significance that anyone wants to do

20 for any purpose.

21 But if you are asking me what I did, for

22 the most part, I used a 1-tail test and a -- a

23 t-statistic of 1.65.

24 Q So you talked about the 2-tail test in your

1 Q So fewer events are going to meet the

2 2-tail criteria than the 1-tail criteria?

3 A Holding everything else constant, correct.

4 Q Speaking generally, what does a significant

5 -- statistically significant price change indicate to

6 you?

7 A Generally it means that there is -- a

8 residual of this size will be attributable to chance

9 alone less than five percent of the time.

10 Q Do you use that inference to support a

11 conclusion that some new piece of information has

12 entered the marketplace that is affecting the stock

13 in a way that can't be explained by market or

14 industry factors?

15 A Sometimes. It depends on the relevant

16 facts and circumstances.

17 Q Are there any statistically significant

18 stock price movements of Household for which you have

19 drawn that conclusion?

20 A Well, yes, I think there are -- in the

21 context of my report, I think I identified 14 events

22 where I drew that conclusion.

23 But if I looked at the full events study,

24 there would be a lot more than 14. I just didn't

1 report but you didn't actually use it?

2 A Again, I'm not sure what you mean by

3 "use it". By reporting it, again, this is

4 conventional, anybody can decide whether a particular

5 event is statistical -- excuse me, statistically

6 significant at the five percent level under either a

7 1-tail test or a 2-tail test.

8 But if you are asking me what I consider to

9 be statistically significant, I used a 1-tail test at

10 the five percent level, as opposed to a 1-tail test

11 at the ten percent level, a 1-tail test at the one

12 percent level, a 2-tail test at the ten percent

13 level, a 2-tail test at the one percent level, or any

14 other possible combination.

15 Q Does the 2-tail test provide a stronger

16 indication of statistical significance than the

17 1-tail test?

18 A I'm not sure what you mean by a stronger

19 indication. It requires a higher level of -- a

20 higher t-statistic.

21 So, therefore, fewer events would be

22 statistically significant at any given level of

23 statistical significance in a 2-tail test than a

24 1-tail test.

1 consider other statistically significant stock price

2 movements attributable to fraud related disclosures.

3 Q I'm looking at days where there was no

4 statistically significant movement controlling the

5 industry and market factors.

6 Whatever new information might have been

7 available on those days wasn't sufficient to cause

8 the stock price to change?

9 A In a statistically significant way,

10 correct.

11 MR. OWEN: Do you want to take a break?

12 A Sure.

13 THE VIDEOGRAPHER: Going off the record at

14 10:17 a.m.

15 (Whereupon, a short recess

16 was taken.)

17 THE VIDEOGRAPHER: This marks the beginning

18 of tape two in the deposition of Daniel Fischel.

19 Going on the record, the time is now

20 10:26 a.m. Please proceed.

21 MR. BURKHOLZ: Excuse me, Mr. Owen, I think

22 there was a discrepancy in his second to last answer

23 regarding whether he said fraud or non-fraud related

24 disclosures that I think he wants to clarify.

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1 He thinks he said one thing and the record
2 came out differently.

3 A I don't have it in front of me, but I think
4 -- he pointed out to me that the transcript didn't
5 reflect what I said.

6 It's on line 19, the sentence, "I just
7 didn't consider other statistically significant price
8 movements", and I guess it should say, "not
9 attributable to fraud related disclosures", so it's
10 clear in context.

11 BY MR. OWEN:

12 Q So there are a bunch of stock price
13 movements that were significant under your regression
14 analysis that were not attributable to fraud related
15 disclosures?

16 A Correct.

17 Q And that actually leads into my next
18 question, which is, I want to talk about the alleged
19 fraud that you are analyzing in this case.

20 I guess, first, I want to ask you is, is it
21 three theories of fraud or one theory of fraud in
22 your mind?

23 A I'm not sure how to answer that. I guess I
24 don't have independent theories of fraud.

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1 characterization.

2 Q Well, let's look at it. It says --
3 starting on page six, Roman numeral III, "The
4 relationship between plaintiffs' allegations and
5 investors' losses" -- and the next heading is A,
6 "Predatory Lending", and thereafter you talk about
7 predatory lending issues for seven pages before you
8 get to page 13 where it says, "B. Reaging", and you
9 talk about reaging for five or six pages, and then
10 you get to page 16, it says, "C. The Restatement".

11 That's what I mean when I say you analyzed
12 them separately.

13 A Again, I'm not sure whether anything from
14 for my purposes turns on whatever distinction you are
15 trying to draw.

16 But in terms of the organization of the
17 report, these are subsections under one general
18 heading.

19 So even as a semantic matter, I'm not sure
20 it's completely accurate to describe them as -- as
21 distinct as opposed to different aspects of the
22 plaintiffs' allegations.

23 But, again, the distinction that you are
24 drawing doesn't have any particular economic

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1 My understanding is that the plaintiffs are
2 alleging a fraud with several different components,
3 three different components.

4 Q So the overall lawsuit alleges fraud, and
5 that fraud has three parts to it?

6 A That's my understanding, but I don't have
7 -- in response to your earlier question, I don't have
8 my own independent theory of fraud.

9 Q In the complaint, they plead them
10 separately, do you know that?

11 A I don't know if that's true or not true.
12 It wouldn't have any significance to me in any event.

13 Q Okay. I don't need to show you the thing.
14 I will represent to you that there are three
15 different sections, and each deal with restatement,
16 reage and predatory lending.

17 That doesn't have any effect on your answer
18 to the prior question?

19 A How the complaint is drafted, whether there
20 are three sections, three different sections? No,
21 that has no relevance to me.

22 Q And your report analyzes the three
23 components you talked about separately?

24 A I'm not sure I agree with that

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1 significance to me anyway.

2 Q Well, I guess the question I have is, in
3 your mind, are the facts and circumstances of the
4 three different components, as you call them,
5 interrelated or are they distinct?

6 A I guess my understanding is that the
7 plaintiffs claim that they are distinct -- I'm sorry,
8 the plaintiffs claim they are interrelated rather
9 than distinct, but I don't have any independent
10 opinion on that one way or the other.

11 Q And you would agree that of the components,
12 there are distinct factual issues and even different
13 business units involved?

14 A I guess I understand that the three
15 different components involve different areas of
16 Household's business, so that by definition there
17 would be some different factual issues involved.

18 Q Now, one set of issues relating to one
19 component could be correct and, then, another set of
20 issues relating to the other component could be
21 false, and the falsity of the second component
22 wouldn't necessarily have anything to do with the
23 first component, right?

24 MR. BURKHOLZ: Objection, form.

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1 and the associated exhibits.

2 Q Are there any practices that you are

3 analyzing with respect to the predatory lending issue

4 that are not described in those paragraphs that you

5 just identified?

6 A Again, it really doesn't quite accurately

7 capture what I did. I wasn't performing an

8 independent analysis of Household's lending

9 practices, as I think I've been clear about.

10 I analyzed the relationship between

11 Household's lending practices and, particularly, the

12 criticism of those lending practices in publicly

13 available information to relevant stock price

14 movements during the class period, focusing

15 particularly on a series of events described in

16 paragraphs 12 through 21 and the referred to

17 exhibits.

18 Q My question really relates to how am I

19 supposed to know what practices you are analyzing.

20 And if I understand you correctly, I'm supposed to

21 look at paragraphs 12 through 25 to find out the

22 answer to that question -- I'm sorry, 12 through 21

23 to answer that question?

24 MR. BURKHOLZ: Objection, form.

1 any determination of whether every market participant

2 understood the same thing by the term "predatory

3 lending".

4 The focus in my report is on market

5 participants' belief that certain practices were

6 improper, ranging from excessive fees to improper

7 disclosures, and that those practices once revealed

8 might have certain legal consequences, and had a

9 particular effect on -- a particular negative effect

10 on Household's stock price.

11 That's what I focused on, and I focused on

12 it in slightly different ways in different parts of

13 the report.

14 But since you are only asking me about the

15 quantification of specific disclosures, I will limit

16 myself to the disclosures relating to predatory

17 lending that I considered to be fraud related,

18 because they had a statistically significant price

19 reaction associated with them.

20 Q Let me see if I understand what you are

21 saying when you refer to disclosures relating to

22 predatory lending that I considered to be fraud

23 related because they had a statistically significant

24 price reaction associated with them.

1 A I think the question misstates my previous

2 answers. I didn't perform an analysis of Household's

3 lending practices in the abstract.

4 I did what I described in my previous

5 answers and what I think is described more

6 comprehensively in my reports.

7 BY MR. OWEN:

8 Q Does it matter what the definition of

9 predatory lending means in terms of the paragraphs 12

10 through 21?

11 A In terms of the analysis that I performed,

12 I don't think it matters, no, in terms of what I

13 focused on is what market participants consider to be

14 predatory lending.

15 I didn't form any independent judgment as

16 to what the definition is of predatory lending.

17 Q But suppose different market participants

18 had different ideas about what was predatory lending.

19 Wouldn't that raise a question for you as to what

20 they meant when they used the term?

21 A Again, if you are referring to something

22 specific, you should refer me to it. I will give you

23 my best sense.

24 But my particular analysis did not require

1 How did you know if a disclosure related to

2 predatory lending that you considered to be fraud

3 related?

4 A I described that in my report with respect

5 to the specific disclosures.

6 But, you know, again, generally speaking,

7 to the extent there were disclosures about

8 Household's predatory lending practices that had a

9 statistically significant stock price reaction

10 associated with them, I took those disclosures into

11 account in my quantification of inflation focusing on

12 specific disclosures.

13 Q Well, Household disputed whether it had any

14 practices that were, quote-unquote, predatory lending

15 practices, right?

16 A That's not completely clear to me either

17 based on the material that I've reviewed.

18 Q But if somebody else said predatory lending

19 in the context of one of Household's practices, then

20 you deemed that report to be related to predatory

21 lending at Household?

22 A I think what I did is described in my

23 report. To the extent that there were specific

24 disclosures that I identified, both when the

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1 disclosures were, why the disclosures were considered
 2 by me to be fraud related, what their effect was on
 3 my calculations of inflation, it's all described in
 4 my report.
 5 I'm happy to answer any questions about any
 6 particular disclosure, but that's the general
 7 methodology that I followed.
 8 Q So you didn't have to know what people
 9 meant when they said "predatory lending" to do your
 10 analysis?
 11 A Well, you know, that goes a little bit too
 12 far. I think I said I didn't need to know whether
 13 everybody subjectively thought exactly the same
 14 thing.
 15 But the disclosures themselves refer to
 16 what people meant when they refer to predatory
 17 lending in terms of, as I said, charging excessive
 18 fees, providing inaccurate disclosures, inducing
 19 homeowners to enter into inappropriate transactions
 20 -- all these different disclosures that I refer to
 21 just don't use the term "predatory lending" in the
 22 abstract.
 23 They describe what the factual context is
 24 for their particular conclusions with respect to

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1 Q Does your opinion assume that Household was
 2 doing predatory lending things during the class
 3 period?
 4 MR. BURKHOLZ: Objection, form.
 5 A Well, if what you mean by "predatory
 6 lending things" -- again, not the most clearly
 7 defined term in the world --
 8 BY MR. OWEN:
 9 Q I agree with that.
 10 A That my opinion assumes that Household's
 11 disclosures with respect to its lending practices
 12 were deficient in the sense that Household did not
 13 provide full disclosure of the extent to which it was
 14 involved in predatory lending, and the various
 15 practices that market participants concluded
 16 constituted predatory lending which could have
 17 possible adverse legal consequences and adverse
 18 consequences for the value of Household stock.
 19 Q Would that condition also exist in the time
 20 before the class period started?
 21 A I guess I don't have an opinion on that one
 22 way or the other.
 23 Q Well, your inflation analysis shows 7.97 of
 24 inflation on the first day of the class period, does

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1 Household's predatory lending practices.
 2 Q We have talked about practices in the
 3 context of Household's business.
 4 Did you understand the term "predatory
 5 lending" to include any products separate and apart
 6 from the methods by which those products were sold?
 7 A I don't think I have an understanding on
 8 that one way or the other.
 9 Q So you don't know?
 10 A Well, you asked do I have an understanding
 11 of it. I don't. I didn't form an understanding one
 12 way or another on that question.
 13 Q And as you said before, you don't have any
 14 particularized expertise with respect to any of these
 15 concepts? Just reading analysts' reports?
 16 MR. BURKHOLZ: Objection, form.
 17 A I don't claim to have any particular
 18 expertise as to whether or not Household's lending
 19 practices conformed with applicable legal and
 20 regulatory requirements.
 21 I didn't make any independent determination
 22 of that issue. I don't have any particular expertise
 23 on that issue.
 24 BY MR. OWEN:

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1 it not?
 2 A Correct.
 3 Q And that inflation presumably relates to a
 4 state of affairs that exists on that first day of the
 5 class period, correct?
 6 A That I'm assuming exists on the first day
 7 of the class period, correct.
 8 Q And have you no opinion about whether or
 9 not it exists the day before the class period or not?
 10 A As I said, I don't have an opinion whether
 11 it exists on any day during the class period other
 12 than --
 13 Q Fair enough --
 14 A -- than what I've already stated. I don't
 15 have an opinion as to the accuracy of Household's
 16 disclosures in the abstract other than in the way
 17 that I've already stated.
 18 Q Okay. Well, you said you assumed that it
 19 exists on the first day of the class period?
 20 A I assumed that there were disclosure
 21 defects on the first day of the class period, without
 22 having an opinion about whether there were or there
 23 were not.
 24 Q And those disclosures on the first day of

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1 the class period would presumably relate to
 2 circumstances that existed prior to the class period,
 3 and practices and products that were being sold at
 4 that time?
 5 A Again, that's possible, but I don't have an
 6 opinion on that one way or the other.
 7 Q Assume some of the practices that we are
 8 talking about as within the meaning of predatory
 9 lending were disclosed to the public, but were
 10 nevertheless criticized as predatory lending by
 11 activists or others.
 12 Would that affect your inflation analysis?
 13 A My analysis assumes that there were
 14 disclosure defects. So I guess my answer to your
 15 question would be maybe. It just would depend on the
 16 relevant facts and circumstances.
 17 Q What would be the facts and circumstances
 18 you would want to know?
 19 A Whether or not whatever disclosures you are
 20 assuming in your question constituted full disclosure
 21 or eliminating the possibility of any disclosure
 22 defects.
 23 Q One of the things that's at issue in this
 24 case is the settlement that Household entered into

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1 legal and regulatory repercussions which adversely
 2 affected the value of Household securities during the
 3 class period.
 4 BY MR. OWEN:
 5 Q Would Household in making this hypothetical
 6 disclosure on the first day of the class period have
 7 had to accuse itself of illegal misconduct to correct
 8 the disclosure defects that you discuss in your
 9 report?
 10 A I don't really have an opinion on what
 11 Household would have had to have disclosed to be in
 12 compliance with all applicable disclosure
 13 requirements on the first day of the class period.
 14 Q You identify inflation on that day though?
 15 A I do, that's correct.
 16 Q And you don't have an opinion about how it
 17 could have eliminated that inflation on the first day
 18 of the class period?
 19 A I have the opinion that I stated earlier;
 20 by having disclosures on that day and subsequent days
 21 which eliminated the alleged disclosure defects with
 22 respect to its lending practices.
 23 Q Let me just say this as clearly as I can.
 24 In response to the question, what should Household

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1 with this group of Multi-state Attorneys General.
 2 Looking again at the first day of the class
 3 period, is that a disclosure defect that existed in
 4 your mind as of that date?
 5 A I'm not sure I understand the question.
 6 Obviously, the settlement itself is not a disclosure
 7 defect because it hadn't occurred on the first day of
 8 the class period.
 9 Q I'm not really talking about the settlement
 10 itself. I guess it's the possibility of that future
 11 settlement.
 12 MR. BURKHOLZ: Objection, form.
 13 BY MR. OWEN:
 14 Q Well, let me try again. Is it a part of
 15 plaintiffs' claim here at all, as you understand it,
 16 that Household should have disclosed that they would
 17 settle with the Multi-state group of Attorneys
 18 General?
 19 MR. BURKHOLZ: Same objection, form.
 20 A You know, I guess I don't have an opinion
 21 on that question one way or the other, except to the
 22 extent that I understand plaintiffs' claim to be that
 23 Household failed to disclose details of its lending
 24 practices which ultimately resulted in a series of

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1 have said to correct the disclosure defects on the
 2 first day of the class period with respect to the
 3 predatory lending issue, you don't have any answer?
 4 A Other than what I've said, correct. I
 5 don't consider myself a disclosure expert, and I have
 6 not attempted to create model disclosures.
 7 But in order to eliminate the inflation
 8 that my analysis shows on the first day of the class
 9 period, it would be necessary for there to be an
 10 absence of any disclosure defects with respect to
 11 this particular issue and the other issues addressed
 12 in my report.
 13 Q And I guess at trial, it will be
 14 plaintiffs' burden to establish that these defects
 15 existed?
 16 MR. BURKHOLZ: Objection, form.
 17 A Again, I'm not sure who would have what
 18 burden, but certainly there would have to be an
 19 adjudication that there were disclosure defects for
 20 my analysis to be meaningful.
 21 BY MR. OWEN:
 22 Q Are you offering any opinion regarding
 23 scienter?
 24 A No, I'm not.

1 just giving you my understanding of what the
 2 allegations are.

3 Q Okay. That's important, because you are
 4 the one who is quantifying the effects of those
 5 allegations.

6 A Is that a question?

7 Q Well, is it not important for you to
 8 understand what the allegations are accurately if you
 9 are going to put forth an opinion about what the
 10 effects of those allegations may have been?

11 A I would say it is important for my analysis
 12 to understand that the plaintiffs allege that there
 13 were disclosure defects in the three areas that I
 14 discuss in my report dating back to the beginning of
 15 the class period.

16 Q And the disclosure defects, as you
 17 understand them, relate to quarterly financial
 18 results, 10-K's, 10-Q's, 8-K's, and anything else?

19 A I only use those as illustrative. I
 20 haven't attempted to -- to identify every single
 21 disclosure that the plaintiffs allege to be false and
 22 misleading either because of a misrepresentation, or
 23 omission, or both.

24 Q But they had to relate to financial results

1 concluded that the artificial inflation on July 30th
 2 and August 16th was identical, and the basis -- my
 3 understanding of the basis for that conclusion with
 4 respect to July 30th is the company's disclosure on
 5 July 22nd, that I guess I would agree that the amount
 6 of inflation that I've calculated on those two days
 7 is the same with the very important caveat of what I
 8 described at length before lunch, that in order to
 9 have inflation, you have to have a basis to recover.

10 BY MR. OWEN:

11 Q But putting aside the basis to recover, the
 12 falsity would be the same as to the announcement of
 13 results on the 22nd of July and a reporting of the
 14 results on August 16th?

15 MR. BURKHOLZ: Objection, form.

16 A I would say based on my analysis, the
 17 impact of a hypothetical disclosure or series of
 18 disclosures on those two dates would be the same.

19 But there is the important caveat that I'm
 20 not going to repeat again.

21 BY MR. OWEN:

22 Q That was the caveat in my question. I
 23 accept it, that that's your position.

24 Assume that Household had disclosed its

1 at the very least?

2 A I'm not ensure that's true. Again, I'm not
 3 the one making the allegations, but I could imagine
 4 there could be allegations about particular
 5 disclosures that don't report actual financial
 6 results.

7 Q And you don't know whether plaintiffs are
 8 claiming those or not?

9 MR. BURKHOLZ: Objection, form.

10 A You know, as I sit here, I don't recall
 11 exactly what plaintiffs' allegations are with respect
 12 to every single disclosure that Household made during
 13 the class period.

14 BY MR. OWEN:

15 Q Let's look at the August 16th date, 1999,
 16 when they release quarterly financial results.

17 A Okay.

18 Q Would the allegedly false statements for
 19 that -- applicable to that particular quarterly
 20 statement be the same for the announcement of the
 21 results that took place on July 22nd?

22 MR. BURKHOLZ: Objection, form.

23 A I think for purposes of my analysis, I
 24 think it is fair to say that to the extent that I've

1 second quarter 99 results on some day other than
 2 the 16th, say the 18th. Would that have any impact
 3 on your inflation chart in your report?

4 A Which inflation chart?

5 Q The specific disclosures chart.

6 A No, it would not. It would on the other
 7 one, but not -- it would on the leakage model, but
 8 not the quantification based on specific disclosures.

9 Q The last two words of that sentence says
 10 "in order to become inflated".

11 And I think we understand that on all of
 12 the days we are talking about here at the beginning
 13 of the class period, the inflation stays exactly the
 14 same.

15 In what sense --

16 A I'm sorry, on all --

17 Q Well, from July 30 to August 17, the day
 18 after the first announcement, the inflation is the
 19 same on each day?

20 A Correct.

21 Q I want to understand in the sense that you
 22 use the words "to become inflated", how the stock
 23 price is becoming inflated on any of those days?

24 A I think I've explained that at length, as a

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1 result of my quantification of what I am assuming to
2 be a series of nondisclosures on the first day of the
3 class period where the inflation remained constant,
4 until there was a disclosure either increasing the
5 amount of inflation or decreasing the amount of
6 inflation which, based on my analysis, occurred on
7 November 15th of 2001.

8 Q And I think you've already answered this,
9 but I'm just going to ask it to be clear.

10 The impact of the nondisclosures you are
11 talking about can't be measured with an event study
12 using specific disclosures of the kind you use in
13 your report?

14 A I don't agree with that.

15 Q Well, illuminate me.

16 MR. BURKHOLZ: Objection, form.

17 A The impact of those assume nondisclosures
18 as exactly what's calculated using an events study.

19 BY MR. OWEN:

20 Q It's not your opinion in connection with
21 this case that there was artificial inflation in the
22 stock?

23 A I think I've answered that numerous times.
24 In order for there to be artificial inflation, there

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1 has to be an actionable disclosure defect.

2 I'm assuming the existence of actionable
3 disclosure defects.

4 Based on that assumption, I have attempted,
5 using two different methods, to calculate the amount
6 of inflation resulting from those disclosure defects.

7 Q Plaintiffs' theory that we are talking
8 about here, again in paragraph 38, doesn't rely upon
9 the presence of statistically significant changes in
10 price, is that correct?

11 A Are you asking me about what exactly? The
12 plaintiffs' -- the sentence -- the first sentence of
13 paragraph 38, plaintiff's theory in this case or
14 generally -- I'm not sure what you are asking me.

15 Q Well, it says, "Under this theory the
16 company's stock price did not have to increase".

17 So I'm saying the theory then doesn't demonstrate
18 itself by way of increases in stock price.

19 A I'm not sure what you mean by "the theory
20 doesn't demonstrate itself".

21 What I would say is exactly what this
22 sentence says, that again, in the context of the
23 proper use and limits of regression analysis, that it
24 would be an incorrect interpretation of regression

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1 analysis to conclude that because there is no
2 statistically significant price reaction to a
3 statement, that necessarily means that the statement
4 did not produce artificial inflation. That's the
5 purpose of the sentence.

6 Q Looking at the period between July 30 and
7 November 15 -- July 30, 1999 and November 15, 2001,
8 are the alleged omissions that prevented the price
9 from falling to its true uninflated value the same at
10 all times between those two dates?

11 A Well, I would say, based on my analysis,
12 the economic effect of the alleged omissions is the
13 same between those two dates.

14 Q Do you know the answer to the question I
15 asked you, though, whether the alleged omissions are
16 the same?

17 A I can't answer that question because of
18 what I've said numerous times, that I haven't made
19 any independent analysis of the adequacy of
20 disclosures at any point in time, including between
21 those two points in time.

22 Q Well, I'm not really asking about whether
23 they were adequate or not.

24 I'm asking whether or not the alleged

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1 omissions are the same during the time period
2 between those two dates?

3 A I guess the only opinion that I have about
4 that is what I said, that based on my analysis, the
5 economic effect of the alleged omissions is the same
6 between those two dates based on my analysis of
7 quantification using specific disclosures.

8 It's not the same based on my other theory
9 which -- not really a theory, my other calculation,
10 which in some ways, as I discuss in the report, I
11 think more accurately reflects a proper
12 interpretation of Household's stock price movements
13 during the class period.

14 Q Do you not know whether the alleged
15 omissions are the same during that period?

16 MR. BURKHOLZ: Objection to form, asked and
17 answered.

18 A I haven't analyzed that question because I
19 haven't attempted to analyze the alleged disclosure
20 defects apart from the economic effect of those
21 alleged disclosure defects under two different
22 methods.

23 BY MR. OWEN:

24 Q So you didn't investigate it. I'm

1 sorry. Let me start again.
 2 You know, I'm not talking about the
 3 economic effects now. I'm just talking about what
 4 the alleged omissions are during that period, and
 5 whether they are the same throughout the period.
 6 And I understand you to be saying you
 7 didn't investigate that so you can't answer the
 8 question.
 9 And my question comes, because you didn't
 10 investigate the question, you don't know whether they
 11 are the same or not throughout that period?
 12 MR. BURKHOLZ: Objection, form.
 13 A This actually is related to what I said
 14 earlier. In connection with this one analysis that
 15 I performed, the quantification using specific
 16 disclosures, I analyzed the economic effect of
 17 particular statements that occurred during the class
 18 period.
 19 And I made an assessment based on the
 20 economic effect of those statements, what the amount
 21 of inflation was at the beginning of the class period
 22 and, at least under that first method, how long that
 23 amount of inflation that existed at the beginning of
 24 the class period lasted until it varied, went up or

1 information until then".
 2 I want to focus on the words "new adverse
 3 information", and ask you what you were referring to
 4 there.
 5 Q Again, there is two different methods that
 6 I used, and I don't want to suggest by focusing on
 7 one, that that was what I --
 8 Q We are not talking about leakage at all.
 9 A I understand.
 10 But when you ask me what I meant by a
 11 sentence, I can't really answer that using your
 12 restrictions, because what I meant was everything
 13 I discussed in the report, not the limits that you
 14 want to place upon me in terms of what you are asking
 15 about.
 16 So I can answer in terms of what I meant --
 17 Q Okay, please.
 18 A Okay. That during the class period, over
 19 the course of the class period, there were a series
 20 of specific disclosures which I identified, which
 21 provided new adverse information to investors about
 22 Household's practices, and one of the different areas
 23 in those are included in my first methodology
 24 quantifying inflation based on specific disclosures.

1 down based on the existence of other events or
 2 statements that occurred during the class period.
 3 If, however, as I said before, the evidence
 4 at trial or other developments between now and trial
 5 indicate that my analysis should be modified in one
 6 direction or another, my analysis is capable of
 7 incorporating any of those developments.
 8 So if, for example, it was the case that
 9 one of the issues falls out of the case altogether,
 10 or the evidence shows that there is a difference in
 11 the nature of the omitted or misrepresented
 12 information at any point in time, the analysis can be
 13 modified to incorporate any of those developments.
 14 But for present purposes, I am assuming
 15 that the information that came out during the period
 16 about these three different areas was something that
 17 the company did not disclose during the class period
 18 beginning from the first day of the class period.
 19 Q Looking at paragraph 39, the second
 20 sentence, reads, "Because plaintiffs allege that
 21 defendants failed to disclose new adverse information
 22 concerning Household's business practices until later
 23 in the class period, investors in the company did not
 24 learn and therefore could not react to this

1 But as I said in the report, I think that's
 2 a very incomplete analysis of the artificial
 3 inflation that existed, because numerous commentators
 4 all refer to a decline in Household's stock price
 5 over the course of the class period.
 6 That was attributable to market
 7 participants learning new negative information about
 8 Household's practices that are the subject of the
 9 alleged disclosure defects.
 10 And I confirmed that commentary by market
 11 participants, by comparing Household's performance
 12 over a longer period in comparison with various
 13 indexes.
 14 I looked for alternative explanations for
 15 Household's long term stock price decline, and what I
 16 concluded was that investors learned what I refer to
 17 as new adverse information concerning Household's
 18 business practices both as a result of stock price
 19 reactions to specific disclosures which resulted in
 20 statistically significant stock price declines, as
 21 well as by a gradual release of information during
 22 the class period both by Household and by other
 23 market participants revealing that Household was much
 24 less profitable than market participants originally

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1 Things that are fully disclosed themselves
 2 don't produce changes in stock prices, at least as a
 3 first approximation, without knowing anything more
 4 about the relevant facts and circumstances.
 5 That's the difficulty that I'm having with
 6 your question.
 7 Anything that's fully disclosed is not
 8 going to be something that creates inflation in my
 9 quantification of inflation based on specific
 10 disclosures.
 11 And my leakage model is based specifically
 12 on market participants learning new information about
 13 the alleged disclosure defects that were not
 14 previously disclosed.
 15 So for those reasons, a determination that
 16 something was or was not disclosed in a
 17 securitization prospectus wouldn't have any obvious
 18 effect on any of my opinions.
 19 BY MR. OWEN:
 20 Q I understand what you are saying. And here
 21 is what I'm trying to get at. I think it could have
 22 an impact even if it was disclosed, but it would be
 23 for a different reason.
 24 If the marketplace knows that Household is

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1 reasons, the predicate of your question I don't think
 2 would have any effect on my opinions.
 3 Q Bear with me. I'm trying to find an
 4 exhibit.
 5 We can't seem to find the exhibit. But I
 6 will just read to you from an analyst report, and one
 7 of the things it says is, "We suspect" -- it's not
 8 important for the point -- it's not important for the
 9 point. I just want to read the sentence.
 10 "We suspect that Household may have become
 11 more of a lightning rod for consumer groups as it is
 12 the only large public company in the space".
 13 And --
 14 MR. BURKHOLZ: I'm sorry, Exhibit I, you said?
 15 BY MR. OWEN:
 16 Q My question is, if that's in fact the case,
 17 wouldn't a change in the regulatory approach on a
 18 subject, say, like single premium credit insurance
 19 have an effect on Household that wouldn't be
 20 registering with respect to other companies in the
 21 industry index that you used?
 22 MR. BURKHOLZ: Objection, form.
 23 A Well, first of all, I know I used an
 24 industry index, but I also used the industry index

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1 selling single premium credit insurance, and a lot of
 2 people are unhappy about that, they think it's a bad
 3 product, it's predatory, it's unfair, it's improper
 4 -- whatever pejorative terms you want to put on it --
 5 and information comes out that suggests that these
 6 criticisms are going to bear fruit in the form of
 7 Household stopping selling single premium credit
 8 insurance, the stock price could go down even though
 9 the product itself was well known?
 10 MR. BURKHOLZ: Objection, form.
 11 A Well, I guess I have a couple of reactions
 12 to that.
 13 First, I don't think that -- or that the
 14 factual predicate of your question fairly describes
 15 what I described in my report as market participant's
 16 analysis of why Household stock price was declining.
 17 Secondly, because there is an industry
 18 variable in my regression, a second industry variable
 19 based on the industry variable that Doctor Bajaj
 20 claims that we should have included, any change in
 21 the regulatory framework that affects the
 22 profitability of the entire industry is going to be
 23 taken into account in my analysis.
 24 So I guess for those reasons, both of those

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1 that Doctor Bajaj identified as the proper industry
 2 index to use.
 3 So --
 4 BY MR. OWEN:
 5 Q I'm not quarreling with the industry index
 6 that you selected or the one Bajaj selected. It's
 7 really a question of what's going to show up in that
 8 index.
 9 If Household is the biggest player in that
 10 field, and a change is made that affects Household
 11 more than anybody else, isn't that going to be
 12 something that could produce a significant impact on
 13 Household's stock price after controlling for
 14 industry and market forces?
 15 MR. BURKHOLZ: Objection, form.
 16 A I would say yes, potentially, but not
 17 simply because it's the biggest.
 18 If it disproportionately affected by --
 19 hypothetically -- a regulatory change, meaning that
 20 the regulatory change has a bigger effect on its
 21 expected future profitability than for other firms,
 22 then the industry index would maybe partially pick up
 23 the effect of the change.
 24 But there still could be hypothetically a

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1 firm specific effect for Household.

2 BY MR. OWEN:

3 Q And that would be because, notwithstanding

4 the fact that it was a known product, a disclosed

5 product, or almost because of the fact that it was a

6 disclosed product?

7 A Well, that's a separate issue. I wasn't

8 speaking about the actual facts and circumstances of

9 the case.

10 I was just speaking, as a matter of

11 statistics, is it possible that a regulatory change

12 that affects the entire industry could affect one

13 firm, whether Household or any other firm,

14 disproportionately.

15 So even though you have a control for an

16 industry variable, you still have a firm specific

17 component to the return, and the answer to that is

18 yes.

19 Q So my point, I guess, is that the fact that

20 a product that Household sells is being called

21 predatory, notwithstanding the fact that it's been

22 disclosed, could have a negative effect on Household

23 that would show up in the form of negative price

24 changes after controlling for industry and market

Page 203

1 inflation continues beyond that date.

2 But because that date is the end of the

3 class period, that's the date, for purposes of my

4 inflation calculations, I'm assuming that there is no

5 further inflation.

6 Q What is the information that the settlement

7 provides to produce the full disclosure statement?

8 A As I said, it's really assumed full

9 disclosure, because --

10 Q Okay. Assumed full disclosure. I will

11 accept that.

12 A Well, I discussed that extensively in my

13 rebuttal report, on pages 11 through 13, in

14 paragraphs 15, 16 and 17.

15 Q What is the explanation that's contained in

16 these paragraphs?

17 A Well, I think the paragraphs speak for

18 themselves, and I incorporate them by reference.

19 But I would say the points that come to

20 mind, as I sit here, is that some market participants

21 thought that the settlement amount might be

22 significantly higher; some market participants were

23 concerned that there might be no settlement at all.

24 Those are the things that come to mind.

Page 202

1 forces?

2 A Again, are you asking me hypothetically or

3 under the facts and circumstances of this case?

4 Q It's hypothetical.

5 A Hypothetically, it's what I said in my

6 previous couple of answers.

7 Hypothetically, a regulatory change could

8 have a disproportionate effect on Household in either

9 direction.

10 It either could affect Household more than

11 the industry or less than the industry.

12 Q On the last day of the class period, the

13 inflation level reaches zero, is that correct?

14 A Correct, by definition.

15 Q What does that mean when it reaches zero?

16 A Well, for purposes of my analysis, it means

17 that because it's the last day of the class period,

18 I'm assuming that full disclosure occurred as of that

19 date, meaning that there is no further inflation to

20 measure after that date.

21 Q Now, the number -- the inflation number

22 reaches zero as a result of the settlement with the

23 Multi-state Attorney General group?

24 A Correct. I should say, it's possible that

Page 204

1 Q I'm sorry, maybe I'm looking at the wrong

2 place. Pages 11 through 13 -- yes, okay. I'm sorry.

3 Here we go.

4 So the new information is the actual

5 settlement amount?

6 A And the fact of the settlement.

7 Q And the fact of the settlement. Is the

8 fact of the settlement good news?

9 A Based on the reaction of market

10 participants, I would say yes.

11 Q But in another sense, it ultimately

12 revealed the fraud that the plaintiffs have alleged

13 in this case, isn't that true?

14 A I'm not sure I understand that question.

15 Q Well, until you get to the last day, my

16 understanding of the plaintiffs' allegations is that

17 the fraud is still on.

18 MR. BURKHOLZ: Objection, form.

19 A I'm not sure what you mean by "fraud is

20 still on".

21 Under the plaintiffs' claim, which I

22 analyzed the economic evidence in connection with,

23 there is still artificial inflation in the stock

24 until the last day of the class period.

Pages 201 to 204

Page 205

1 BY MR. OWEN:
 2 Q I want to read to you from paragraph 23 of
 3 the complaint.
 4 It says, "It was only at the end of the
 5 class period on October 11th, 02, when defendants
 6 announced that the company would pay \$484 million to
 7 settle the predatory lending charges, that investors
 8 learned that Household had been conducting its
 9 nationwide operations in direct violation of federal
 10 and state lending laws".
 11 So the plaintiffs are saying that investors
 12 in the marketplace learned about the fraud on the
 13 same day that Household makes an announcement that
 14 you just characterized as good news, and I see some
 15 tension between those two propositions.
 16 MR. BURKHOLZ: Objection, form.
 17 A Well, obviously, my report focuses on my
 18 analysis as opposed to the allegations in the
 19 complaint.
 20 And I think I've described the reason why
 21 market participants interpreted the announcement of
 22 the settlement as good news, and why it not only is
 23 not inconsistent with the existence of inflation, but
 24 why it supports the conclusion of earlier inflation,

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1 A I actually don't know exactly. I don't
 2 send them out. I would say they have been
 3 significant. We have done a considerable amount of
 4 work over a long period. But I don't know exactly
 5 what the amount is.
 6 Q Can you give me a ballpark number?
 7 A I can, but I wouldn't want to be held to it
 8 because it's something that could be checked. I
 9 don't know the answer.
 10 If I had to estimate, I would say somewhere
 11 between 500,000 and a million.
 12 MR. OWEN: You guys know what the answer to
 13 this is, right --
 14 A I could be wrong. As I said, I wouldn't
 15 want to be held to it. It's a good faith estimate.
 16 BY MR. OWEN:
 17 Q Is there any portion of that bill that
 18 hasn't been paid, to your knowledge?
 19 A Maybe the last bill -- I think we have been
 20 paid currently, with some lag for a month or possibly
 21 two months.
 22 MR. OWEN: Could you guys provide us that
 23 information.
 24 MR. BURKHOLZ: We will. It's allowed under

Page 206

1 all of which is described at length in my report.
 2 MR. OWEN: I think we are getting pretty
 3 close. Can we take a short break.
 4 THE VIDEOGRAPHER: Going off the record at
 5 4:16 p.m.
 6 (Whereupon, a short recess
 7 was taken.)
 8 THE VIDEOGRAPHER: Going back on the record at
 9 4:24 p.m. Please proceed.
 10 BY MR. OWEN:
 11 Q Mr. Fischel, how much have you been paid in
 12 connection with your engagement with the plaintiffs
 13 in this case?
 14 A Well, are you asking what the amount of the
 15 bill submitted by the firm has been, or how much have
 16 I personally been paid? Those are two different
 17 questions.
 18 Q The bill submitted by the firm to whom?
 19 A I'm not sure who we send them to. I assume
 20 we send them to counsel for the plaintiffs --
 21 Q Oh, the firm being Lexecon?
 22 A Yes.
 23 Q Okay, yes. How much of the bill is from
 24 Lexecon then?

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1 our agreement, I believe.
 2 MR. BAKER: Actually, it's not. The agreement
 3 is pretty specific, that you can ask deposition
 4 questions, but we can look at the issue again.
 5 I think the stipulation is pretty specific.
 6 Don't roll your eyes, David. I mean,
 7 because we thought we were allowed subpoenas, and you
 8 said no, and the Judge has issued a pretty clear
 9 ruling that it's not covered by the stipulation.
 10 We can look at the issue, and maybe we will
 11 provide it, and maybe we won't.
 12 MR. OWEN: All of our witnesses have provided
 13 that information. We haven't objected to it. We
 14 think it's certainly relevant.
 15 MR. BURKHOLZ: Have they provided it in
 16 deposition?
 17 MR. OWEN: Indeed.
 18 MR. BURKHOLZ: The amounts that they have been
 19 billed and paid?
 20 MR. OWEN: Yes.
 21 MR. BURKHOLZ: Why don't you maybe leave a
 22 blank in his deposition, and he can fill it in when
 23 he reviews it.
 24 A Okay. I will be happy to do that.

Page 209

1 MR. OWEN: All right. I don't have any more
 2 questions really. Thank you very much.
 3 A Thank you. Again, I apologize for the
 4 weather.
 5 THE VIDEOGRAPHER: This marks the conclusion
 6 of today's deposition of Daniel Fischel.
 7 Going off the record, the time is now
 8 4:28 p.m.
 9 (Whereupon, at 4:28 p.m., the
 10 signature of the witness having
 11 been reserved, the witness being
 12 present and consenting thereto,
 13 the taking of the instant
 14 deposition ceased.)
 15
 16 IN THE UNITED STATES DISTRICT COURT
 17 FOR THE NORTHERN DISTRICT OF ILLINOIS
 18 EASTERN DIVISION
 19
 20 LAWRENCE E. JAFFE PENSION PLAN,)
 21 on behalf of Itself and All)
 22 Others Similarly Situated,)
 23 Plaintiffs,)
 24 vs.) No. 02 C 5893

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1 at said deposition except as I have so indicated
 2 on the errata sheets provided herein.
 3
 4 _____
 5 DANIEL R. FISCHEL
 6
 7 No corrections (Please initial) _____
 8 Number of errata sheets submitted _____ (pgs)
 9
 10 SUBSCRIBED AND SWORN TO
 11 before me this ____ day
 12 of _____, 2008.
 13
 14 _____
 15 NOTARY PUBLIC
 16
 17
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Page 210

1 HOUSEHOLD INTERNATIONAL, INC.,)
 2 et al.,)
 3 Defendants.)
 4
 5 I, DANIEL R. FISCHEL, state that
 6 I have read the foregoing transcript of the
 7 testimony given by me at my deposition on
 8 the 21st day of March 2008, and that said
 9 transcript constitutes a true and correct
 10 record of the testimony given by me
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1 STATE OF ILLINOIS)
) SS:
 2 COUNTY OF C O O k)
 3
 4 I, RICHARD H. DAGDIGIAN, Illinois CSR No.
 5 084-000035, Registered Professional Reporter and
 6 Notary Public in and for the County of Cook, State of
 7 Illinois, do hereby certify that previous to the
 8 commencement of the examination, said witness was
 9 duly sworn by me to testify the truth; that the said
 10 deposition was taken at the time and place aforesaid;
 11 that the testimony given by said witness was reduced
 12 to writing by means of shorthand and thereafter
 13 transcribed into typewritten form; and that the
 14 foregoing is a true, correct, and complete transcript
 15 of my shorthand notes so taken as aforesaid.
 16 I further certify that there were present at
 17 the taking of the said deposition the persons and
 18 parties as indicated on the appearance page made a
 19 part of this deposition.
 20 I further certify that I am not counsel for
 21 nor in any way related to any of the parties to this
 22 suite, nor am I in any way interested in the outcome
 23 thereof.
 24

1 I further certify that this certificate
2 applies to the original signed IN BLUE and certified
3 transcripts only. I assume no responsibility for the
4 accuracy of any reproduced copies not made under my
5 control or direction.

6

7 IN TESTIMONY WHEREOF, I have hereunto set
8 my hand and affixed my notarial seal this ___ day of
9 _____, 2008.

10

11

12

Richard H. Dagdigian, CSR, RMR, CRR

14

15 My Commission expires

16 May 1, 2011.

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04-16-09 Volume 12

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THE CLERK: 02 C 5893, Jaffe v. Household

International.

THE COURT: Good morning, everyone. Is there any
issues that the parties want to take up?

09:18:29

MR. DOWD: I believe, your Honor, we brought our
response to the Court's jury instructions this morning. I
believe Mr. Drosman has them.

04-16-09 Volume 12

8 A. Thank you.

9 Q. And is that your quantification of the inflation under
04: 12: 15 10 your leakage model?

11 A. Yes. If you can put it on the screen maybe.

12 Q. Did you prepare this document?

13 A. I did.

14 MR. BURKHOLZ: Your Honor, I don't believe there's an
04: 12: 24 15 objection to 1395 if we can move it into evidence.

16 THE COURT: It will be admitted.

17 (Plaintiffs' Exhibit 1395 received in evidence.)

18 BY MR. BURKHOLZ:

19 Q. Can you explain what this exhibit is?

04: 12: 35 20 A. This exhibit, again, is analogous to the previous exhibit
21 which focused on the 14 specific disclosures; but this exhibit
22 takes leakage into account and, once again, has a calculation
23 of the stock price on every day, what the true value is, which
24 is what my calculation is of the uninflated price, what the
04: 13: 00 25 price should have been had there been no fraudulent

Fischel - direct

2683

1 disclosures or omissions in the various Household statements
2 and disclosures during the relevant period. That's the second
3 column, true value.

4 And the artificial inflation is the number in the
04: 13: 20 5 last column. And, again, you'll see that it's different from
6 7.97 at the beginning because this calculation doesn't just
7 focus on 14 disclosures. It focuses on all the negative
8 disclosures that came out, particularly after November 15th
9 when the market started to, in a much more systematic way,
04: 13: 44 10 disbelieve Household's denials that it was engaging in
11 predatory lending and that it was engaging in improperly

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04-16-09 Volume 12

12 aggressive accounting.

13 Q. Like your specific disclosure model, does this
14 quantification use statistical methods to account for the
04:14:00 15 market and industry influences on Household's stock prices?

16 A. Yes, it does.

17 Q. And did you also analyze whether company-specific factors
18 unrelated to the alleged fraud can explain Household's stock
19 price decline during this latter part of the relevant period?

04:14:16 20 A. Yes, I did. I looked at that carefully.

21 I noticed that there were a lot of disclosures that
22 had some fraud-related information in it and some other
23 disclose -- and part of the disclosure did not have -- dealt
24 with something other that was fraud related.

04:14:37 25 There were some -- some of those disclosures that had

Fischel - direct

2684

1 a positive effect, some had a negative effect; but overall it
2 was impossible to conclude that the difference between the
3 true value line and the actual price would have been any
4 different had there been no disclosures about

04:15:02 5 non-fraud-related information during this particular period.

6 Some positive, some negative. They cancel each other out.

7 Q. Okay. Now, reaching your opinion about inflation, did you
8 consider whether investors during the relevant period were
9 fully informed about Household's accounting and lending

04:15:17 10 practices?

11 A. I did.

12 Q. And what did you find?

13 A. I found that they were not fully informed for a number of
14 different reasons.

04:15:25 15 Q. And what were the reasons?

16 A. Well, first, the disclosures coming out criticizing

04-16-09 Volume 12

17 Household's practices didn't come from Household; and if a
18 company is disclosing information about itself, it's one thing
19 for third parties to comment, but it's another thing for the
04: 15: 46 20 information to come directly from the company itself.

21 Since the company was not disclosing what the
22 analysts and the critics were saying, market participants did
23 not have full information.

24 Q. Okay. So you had your analysts' reaction or commentary,
04: 16: 03 25 some of -- the Barron's article and the analysts' reports, the

Fischel - direct

2685

1 Legg Mason article we looked at -- report we looked at in
2 December, right?

3 A. Yeah, and many others. In other words, disclosures by
4 third parties is not the same as disclosures by the company
04: 16: 17 5 itself.

6 In a situation like this, disclosures by third
7 parties are given less weight; and, therefore, investors were
8 not fully informed for that reason.

9 But that effect is compounded by the fact that
04: 16: 30 10 Household, throughout the period, is denying that there's any
11 problem, so that even with respect to the third-party
12 disclosures, which are less important than disclosures by the
13 company, those disclosures are being discounted through much
14 of the period until the very end because of management
04: 16: 50 15 denials.

16 By the very end, the denials of management are
17 systematically disregarded by many analysts and market
18 participants.

19 In addition to that, I came across a lot of
04: 17: 06 20 information that regulators concluded, a lot of exam reports,

3 04-16-09 Volume 12
MR. DOWD: No, your Honor, just 12:30 tomorrow?

4 THE COURT: 12:30 tomorrow.

04:30:45 5 MR. DOWD: Thank you, your Honor.

6 THE COURT: We'll see you all then.

7 MR. KAVALER: Thank you, your Honor.

8 THE COURT: Thank you.

9 (Court adjourned, to reconvene at 12:30 p.m. on 4-17-09.)

10 * * * * *

11 C E R T I F I C A T E

12 We certify that the foregoing is a correct
13 transcript from the record of proceedings in the
14 above-entitled matter.

15 /s/ Nancy C. LaBella
16 _____

17 /s/ Frances Ward
18 _____

19 /s/ Kathleen Fennell
20 _____ April 17, 2009
Date

21 Official Court Reporters
22 United States District Court
Northern District of Illinois
Eastern Division

23
24
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04-20-09 Volume 14

2802

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

3 LAWRENCE E. JAFFE PENSION PLAN,)
4 on behalf of itself and all)
5 others similarly situated,)
Plaintiff,)

6 vs.)

7 HOUSEHOLD INTERNATIONAL, INC.,)
8 et al.,)
9 Defendants.)

No. 02 C 5893

Chicago, Illinois
April 20, 2009
9:00 a.m.

10 VOLUME 14
11 TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a jury

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04-20-09 Volume 14

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THE CLERK: 02 C 5893, Jaffe v. Household
International.

THE COURT: Good morning, everyone.
Can we bring the jury out?

09:10:59

MR. DOWD: Your Honor, there are a couple of issues I
mentioned on Friday that needed to be addressed. One was a
stipulation regarding the exhibit that was the record of

04-20-09 Volume 14

3 MR. KAVALER: Pass them out.

4 (Brief pause.)

5 BY MR. KAVALER:

6 Q. And what this exhibit shows us, Professor, it presents the
7 quantification of total inflation on each day during the
8 relevant time period using your first method?

9 A. That's correct.

01:10:04 10 Q. And in this quantification using specific disclosures, you
11 only included those dates on which news --

12 MR. KAVALER: Withdrawn. That's not right.

13 BY MR. KAVALER:

14 Q. This is every day from July 30 -- every -- that's not
01:10:20 15 right, either.

16 This is every trading day from July 30, 1999, through
17 October 11, 2002?

18 A. Correct.

19 Q. Okay. Got it right on the third try.

01:10:30 20 Now, as you and I were discussing before lunch,
21 you've already shown us at least one example of inflation
22 going into the stock price; and, that was the December 5,
23 2001, event, correct?

24 A. Correct.

01:10:42 25 Q. Okay.

♀

Fischel - cross

2874

1 And that was after Mr. Aldinger spoke at the Goldman
2 Sachs conference?

3 A. Correct.

4 Q. Okay.

01:10:53 5 And, so, we know at least on that day we can find
6 inflation coming into the stock. And let's see if we can look

04-20-09 Volume 14

7 together at how that works.

8 Turn in this exhibit, if you would, to Page 13.

9 MR. KAVALER: And can we highlight the entry for

01: 11: 12 10 December 5, 2001.

11 BY MR. KAVALER:

12 Q. And this shows us actual inflation in that column is

13 \$6.05, correct?

14 A. That's right.

01: 11: 29 15 Q. Okay.

16 And on December 6th, the inflation is also \$6.05?

17 A. Correct.

18 Q. And on December 7, same thing: \$6.05?

19 A. Correct.

01: 11: 38 20 Q. But on December 4, the day before, it was \$4.20, correct?

21 A. Correct.

22 Q. So, that's where you got the number that was on the
23 demonstrative you showed us during your direct testimony of a

24 dollar eighty-five. A dollar eighty-five is the difference

01: 11: 53 25 between 4.20 and 6.05?

♀

Fischel - cross

2875

1 A. That's right.

2 Q. So, the way we did that is we saw the inflation increase
3 from 4.20 to 6.05?

4 A. Correct.

01: 12: 03 5 Q. So, Mr. Aldinger's statement to Goldman Sachs at the

6 Goldman Sachs conference, in the language you and I agreed to
7 use this morning about measure effect, had an effect, correct?

8 A. Correct.

9 Q. And the effect was to create artificial inflation in the

01: 12: 17 10 amount of a dollar eighty-five?

11 A. Correct.

Page 63

04-20-09 Volume 14

12 Q. Okay.

13 Now, let me show you Plaintiffs' Demonstrative 139.

14 And that was your analysis of this day.

01:12:42 15 The residual price change of 1.85 is the very thing
16 you and I just talked about?

17 A. Correct.

18 Q. And the text on there discusses the event that caused that
19 effect. That's Mr. Aldinger's speech at Goldman Sachs?

01:12:56 20 A. That's right.

21 Q. Okay.

22 And now let's look at Exhibit 1391 in evidence.

23 MR. KAVALER: And, again, your Honor, may I publish
24 this to the jury, as well, so they can follow on their own
01:13:21 25 copy?

Fischel - cross

2876

1 MR. BURKHOLZ: Your Honor, Mr. Kavalier did not follow
2 the protocol of providing me with everything he's --

3 MR. KAVALER: I'm terribly sorry. Very sorry.
4 They're your exhibits.

01:13:29 5 MR. BURKHOLZ: I don't have any objection.

6 MR. KAVALER: Okay.

7 MR. BURKHOLZ: That's fine.

8 MR. KAVALER: Give him the other one, too.

9 THE COURT: I'm sorry, is there an objection?

01:13:37 10 MR. KAVALER: May I hand them out, your Honor?

11 THE COURT: Is there an objection?

12 MR. KAVALER: No, there's no objection.

13 MR. BURKHOLZ: I would like all of the other ones
14 they're going to show the jury.

01:13:43 15 THE COURT: Why don't we do that now --

Page 64

A439

04-20-09 Volume 14

16 MR. KAVALER: Okay.

17 THE COURT: -- and get it done.

18 MR. KAVALER: There are only two others I might show
19 the jury.

01:13:52 20 Why don't you give him copies of --

21 I think I won't show them to them, your Honor.

22 THE COURT: I'm sorry?

23 MR. KAVALER: I think I won't show them. They're
24 single pages. Easy enough. I'm showing them these because

01:14:04 25 they're large and cumbersome.

♀

Fischel - cross

2877

1 THE COURT: All right.

2 Does he have all the ones you're going to use now?

3 MR. BURKHOLZ: I believe so.

4 MR. KAVALER: The one ones I intend to publish to the
01:14:11 5 jury, yes, your Honor.

6 THE COURT: Okay.

7 Which exhibit are you seeking to publish now?

8 MR. KAVALER: Plaintiffs' 1391 in evidence, your
9 Honor.

01:14:16 10 THE COURT: It's in evidence. It may be published.

11 MR. KAVALER: Thank you, your Honor.

12 (Document tendered to the jury.)

13 (Brief pause.)

14 BY MR. KAVALER:

01:14:30 15 Q. All right. Now, this, Professor Fischel -- 1391 -- is the
16 results of your event study?

17 A. Correct.

18 THE COURT: Why don't you wait a second until the
19 jurors are through passing those around.

01:14:45 20 MR. KAVALER: Yes, sir.

Page 65

04-20-09 Volume 14

21 (Brief pause.)

22 MR. KAVALER: Okay. Looks like everyone has one.

23 BY MR. KAVALER:

24 Q. Professor, if you turn to Page 30 and look at an entry for

01:14:59 25 December 5 --

Fischel - cross

2878

1 MR. KAVALER: Can we highlight that, please, Brian?

2 BY MR. KAVALER:

3 Q. And that tells us, according to what you testified to
4 Thursday because of the three -- well, let me ask this way:

01:15:15 5 Does this tell us that this is a statistically-significant

6 price increase that resulted in inflation on December 5, 2001?

7 A. Yes, it does.

8 Q. Okay.

9 So, we've just gone through together an example of

01:15:36 10 inflation coming into the price of Household stock as an

11 effect or as a result of a statement that Mr. Aldinger made,
12 correct?

13 A. That's right.

14 Q. And I think you testified on direct that the reason the

01:15:53 15 price went up is because of what Mr. Aldinger said?

16 A. Correct.

17 Q. So, Mr. Aldinger's remarks caused the price to go up?

18 A. Correct.

19 Q. Gotcha.

01:16:01 20 All right. So, let's put December 5, 2001, on the

21 white board.

22 MR. KAVALER: Can everybody see that, more or less?

23 (Jurors nodding.)

24 BY MR. KAVALER:

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01:16:32 25 Q. So, this will be a list, Professor Fischel, of days where
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1 we can see a remark by a defendant causing the price of the
2 stock to go up.

3 A. Okay. That's fine.

4 Q. Okay.

01:16:42 5 Now let's look at Plaintiffs' Demonstrative 140.

6 This is a week later. It's a Legg Mason report. And this
7 time this causes the price to go down, correct?

8 A. That's right.

9 Q. It goes down \$2.39?

01:17:08 10 A. Adjusted for market and industry movements based on the
11 statistical model that I used, correct.

12 Q. That's your number up there, 2.39?

13 A. That's right.

14 Q. That's all I'm pointing to.

15 A. That's fine.

16 Q. I'm not quarrelling with you at all.

17 A. I'm not quarrelling with you, either.

18 Q. Okay.

19 (Laughter.)

20 BY THE WITNESS:

21 A. We're agreeing on everything.

22 BY MR. KAVALER:

23 Q. Excellent. Very agreeable fellows here.

24 Okay. And this is the Legg Mason report that causes
01:17:26 25 this decline?

Fischel - cross

2880

1 A. That's correct.

2 Q. And it relates to the same subject matter as
Page 67

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3 Mr. Aldinger's remarks at Goldman Sachs a week earlier?

4 A. That's right.

01:17:35 5 Q. Okay. I'm getting the hang of this.

6 And, again, if you look at your Exhibit 1397 at Page

7 13 -- I'm in the wrong place -- I'm in the right place,

8 sorry -- for December 12, 2001, what we see there is we see

9 the price is at three dollars and six- -- I'm sorry.

01:18:11 10 MR. KAVALER: Withdrawn.

11 BY MR. KAVALER:

12 Q. The artificial inflation is at \$3.66 on December 12,

13 correct?

14 A. I don't want to interrupt you, sir, but could I also have

01:18:21 15 a copy?

16 Q. Oh, absolutely.

17 A. I prefer that to --

18 Q. I apologize.

19 A. -- Looking back and forth.

01:18:24 20 Q. I thought you had the exhibits up there.

21 A. Yeah, but I have to find them every time. It's just

22 simpler if I have a copy.

23 Q. I apologize.

24 MR. KAVALER: Get me a copy of the other one, too.

01:18:36 25 I thought you had Thursday's exhibits. Sorry.

♀

Fischel - cross

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1 (Document tendered.)

2 THE WITNESS: Thank you. Appreciate it.

3 MR. KAVALER: Here's a copy of 1391, as well.

4 THE WITNESS: Got it.

01:18:44 5 (Document tendered.)

6 MR. KAVALER: Figured since I wasn't moving them into

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7 evidence, I'd save the trip.

8 BY MR. KAVALER:

9 Q. Okay. So, we're on Page 13 of 1397. We're looking at the
01:18:51 10 entry for December 12, 2001. We see that the artificial
11 inflation is \$3.66, correct?

12 A. Correct.

13 Q. And the day before, the artificial inflation on December
14 11 was \$6.05, correct?

01:19:04 15 A. That's right.

16 Q. And the difference between those two, if my math serves,
17 is the \$2.85 we're talking about?

18 A. That's right.

19 Q. \$2.39, which appears on Plaintiffs' Demonstrative 140?

01:19:15 20 A. Correct.

21 Q. Okay. Good.

22 And now if you'll look at your event study, which is
23 Plaintiffs' 1391 in evidence, and turn to Page 31 and you'll
24 see the entry there for December 12, 2001. And that shows a
01:19:38 25 statistically-significant price decrease that resulted in

Fischel - cross

2882

1 inflation on December 12, correct?

2 A. Correct.

3 Q. And that's as a result of the Legg Mason report, correct?

4 A. Correct.

01:19:49 5 Q. And if we go to Plaintiffs' Demonstrative 140, we see,
6 again, the same format. Up in the box, you've got the dollar
7 amount of the residual price change; and, in the text, you
8 explain what it is Legg Mason is saying?

9 A. Correct.

01:20:06 10 Q. All right.

11 So, in this one example, we see the inflation coming
Page 69

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12 in on December 5, and we see it coming out on December 12,
13 correct?

14 A. We see inflation increasing on December 5th and decreasing
01: 20: 28 15 on December 12th, that's correct.

16 Q. And the amount of the decrease is larger than the amount
17 of the increase?

18 A. Correct.

19 Q. So, all of the inflation that increased on December 5 came
01: 20: 39 20 out in the decrease a week later?

21 A. I guess you could call it that, but --

22 Q. I'll tell you why I think that.

23 A. Please, go ahead.

24 Q. Sure.

01: 20: 50 25 MR. BURKHOLZ: Your Honor, he's interrupting the
Fischel - cross

2883

1 witness.

2 MR. KAVALER: I'm sorry.

3 BY MR. KAVALER:

4 Q. It came in because of whatever Mr. Aldinger said at
01: 21: 00 5 Goldman Sachs?

6 A. Well, when you say "came in," there's pre-existing
7 inflation. So, it increased as a result of the statements
8 made on December 5th. And, then, because there was a partial
9 corrective disclosure on December 12th, that decreased the
01: 21: 19 10 amount of inflation.

11 I think that's the proper relationship.

12 Q. I appreciate your correcting my terminology. I'll try to
13 stick to "increased" and "decreased."

14 And the amount of the decrease was greater than the
01: 21: 31 15 amount of the increase?

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16 A. Based on those two dates, that's correct.

17 Q. Right.

18 So, for example, Professor, if we were to assume --
19 just like the plaintiff asked you to make an assumption, I'm
01:21:46 20 asking you to make an assumption -- that's all this case were
21 about; the only statement by Mr. Aldinger or by Household in
22 this case were that one; he made it on the 4th; the market
23 reacted on the 5th; there was what you described as a partial
24 corrective disclosure on the 12th; the decrease was larger
01:22:08 25 than the increase, you would say the inflation that -- the

Fischel - cross

2884

1 increased inflation that -- occurred had been dissipated --
2 at least dissipated -- because the decrease was smaller -- and
3 we're finished, right?

4 A. Decrease is larger, not smaller.

01:22:24 5 Q. I apologize.

6 You understood my point?

7 A. Well, in your hypothetical, if that were the whole case, I
8 would say that assuming the -- again, the -- hypothetical jury
9 found the statement on December 5th to be false and
01:22:38 10 misleading, then all purchasers of Household stock between
11 December 5th and December 12th suffered harm because they
12 purchased at a price that was greater than the true value;
13 and, then, the price and the true value equaled each other,
14 again, on December 12th.

01:22:58 15 So, in your hypothetical, any investors before
16 December 12th wouldn't suffer any harm and any investors after
17 December 12th wouldn't suffer any harm, but investors between
18 December 5th and December 12th would suffer harm.

19 Q. I'd be happy to take the gift you just gave me, but I
01:23:14 20 think you misspoke when you said any investors before December

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21 12 wouldn't suffer harm and any investors after December 12th
22 wouldn't suffer any harm. You meant before the 5th and after
23 the 12th?

24 A. I did. If I misspoke, I appreciate the correction.

01: 23: 25 25 Q. And when you said Mr. Aldinger's statement on the 5th, you
Fischel - cross

2885

1 meant his statement on the 4th, which is when he spoke to
2 Goldman Sachs after the market closed, right?

3 A. Yeah. I was thinking in terms of trading days.

4 Q. Right. That was exactly my point.

01: 23: 36 5 He spoke, you know, after the market closed, so it's
6 reflected in the following day's trading?

7 A. That's my recollection.

8 Q. Perfect. Okay.

9 Let's see if we can do that same exercise, Professor,
01: 23: 56 10 with some other dates.

11 A. Okay.

12 Q. Hopefully, now that we know how to do it, at least I can
13 do it more efficiently.

14 Let's look at some of the other dates that the
01: 24: 03 15 plaintiffs have either shown this jury or I understand are
16 going to show this jury or they may show this jury.

17 They've shown this jury the 10-K -- I'm sorry, the
18 10-Q -- that Household filed on August 16, 1999.

19 A. Okay.

01: 24: 20 20 Q. Okay. Let's see what happened on August 16, '99. Let's
21 do the same methodology we just used. Let's start by looking
22 at Plaintiffs' 1397. And we'll look on Page 1 for August 16,
23 1999.

24 And that shows us that the artificial inflation that

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01: 24: 40 25 day was 7.97, correct?

♀

Fischel - cross

2886

1 A. Correct.

2 Q. And the artificial inflation the day before was 7.97,
3 correct?

4 A. That's right.

01: 24: 45 5 Q. And the artificial inflation the day after was 7.97?

6 A. Correct.

7 Q. In fact, to save time, the "Artificial Inflation" column
8 on this entire page is 7.97?

9 A. That's right.

01: 24: 54 10 Q. Okay.

11 So, that means, in the language we were just using --
12 we've just used -- the filing of the Household 10-K on August
13 16, 1999, had no effect on the amount of inflation in the
14 stock?

01: 25: 15 15 A. You know, you can't say that definitively. It depends.

16 Is this the -- what assumption am I making as to whether this
17 is the first false and misleading disclosure?18 Q. I'll tell you what assumptions to make. Assume your chart
19 is accurate.

01: 25: 29 20 A. Okay.

21 Q. Assume I've read the numbers correctly.

22 A. Okay.

23 Q. And assume I'm trying to understand the process. So, I'm
24 looking at August 13, where I see the inflation is 7.97, okay?

01: 25: 39 25 A. Okay.

♀

Fischel - cross

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1 Q. And, then, I'm looking at August 16 or August 17 because
2 we don't know what time of the day it was filed.

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3 A. Right.

4 Q. And on both days I see "7.97."

01:25:48 5 A. Okay.

6 Q. So, the number hasn't changed?

7 A. All right. And let me explain why that is, sir.

8 Q. First, you agree with me?

9 A. No, obviously, the number hasn't changed.

01:25:57 10 Q. Okay.

11 And you prepared these numbers?

12 A. I did.

13 Q. I had nothing to do with it?

14 A. No, that's right, you had nothing to do with it.

01:26:03 15 But --

16 Q. All right.

17 A. -- the reason is that this document, as I hopefully
18 explained earlier, is based on the assumption that the first
19 time where there is a false and misleading disclosure or the
01:26:19 20 failure to make an accurate disclosure is on July 30th, 1999,
21 which is why the exhibit begins on July 30th, 1999.

22 Based on my first method, the specific disclosure
23 method -- not the second method, the specific disclosure
24 method -- nothing changes between the time of the first

01:26:45 25 misleading disclosure or failure to disclose on July 30th and

Fischel - cross

2888

1 August 16th. And that is why there was no change in inflation
2 between August 15th, August 16th, August 17th.

3 If, on the other hand -- and this is what I tried to
4 explain in terms of how the exhibit should be interpreted, if

01:27:08 5 -- the jury were to conclude that there was no misleading

6 disclosure on July 30th or failure to disclose accurately on

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7 July 30th, but the first misleading disclosure was the second
8 quarter result announcement on August 16th, then the right way
9 to read the exhibit would be that the amount of artificial
01:27:32 10 inflation from July 30th to August 15th is zero; and, then, it
11 goes from zero to 7.97 on August 16th.

12 So, when inflation increases or decreases is a
13 function of what the jury concludes as to when the first
14 misleading disclosure that Household makes is. And the proper
01:27:54 15 number of inflation is zero on every day until the day that
16 the jury concludes, if they so conclude, that Household made a
17 misleading disclosure.

18 Q. But I'm looking at 1397 in the column headed "Artificial
19 Inflation." I don't see any zeros, right?

01:28:12 20 A. There's no zeros because of the assumption that -- I hope
21 I explained clearly, but if not, I'll try and explain it,
22 again.

23 Q. That's okay.

24 A. -- that the first time inflation entered Household's stock
01:28:25 25 price was July 30th. But that's a jury determination. It's

Fischel - cross

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1 not a determination for me to make.

2 So, any date later than that, if the jury concludes
3 that's the first date of a misleading disclosure, the right
4 way to read the exhibit is to substitute zero for 7.97 until
01:28:45 5 the date -- the first date -- that the jury concludes there
6 was a misleading disclosure.

7 Q. For purposes of this question, I'll agree with you. Let's
8 assume it starts on July 30, 1999, okay?

9 A. Okay.

01:28:57 10 Q. So, then, we agree that if it starts on July 30, 1999,
11 whatever Household said on August 16 had no effect?

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12 A. That's correct --

13 Q. Okay.

14 A. -- based on that assumption.

01:29:11 15 Q. A witness named Mr. Devor was here last week and he showed
16 us this chart (indicating). I don't know if you can see that.

17 It's just the cover sheets of a series of 10-Ks and -Qs. And
18 this is the one I just asked you about, the June 30, 1999 --

19 A. Okay.

01:29:30 20 Q. -- Q, which was filed on August 16, 1999.

21 So, based on what we just talked about, I'm going to
22 cross that off my list. I will not come back to it, again,
23 and I will not put it on that list over there (indicating).

24 Okay?

01:29:49 25 A. Okay.

♀

Fischel - cross

2890

1 Q. Okay.

2 If you look at your event study for this day --
3 that's Exhibit 1391, and it's on Page 1 -- did you find a
4 statistically-significant price increase that resulted in

01:30:22 5 inflation on August 16, 1999?

6 A. No, sir, I did not.

7 Q. Okay.

8 I should have asked you that before I put my X up
9 there. I apologize. I'll get the hang of this.

01:30:35 10 All right. Let's look at the next one.

11 Plaintiffs may show you a press release that -- I'm
12 sorry, plaintiffs may show the jury a press release -- that
13 Household issued on October 19, 1999. I'm going in
14 chronological order. How much did you find that inflation

01:30:53 15 increased or decreased on that date when that press release

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16 was issued?

17 And to do that, we're going to look, again, at

18 Plaintiffs' 1397. We're going to turn to Page 2, look at the

19 entry for October 19. And to save time, I will observe --

01:31:10 20 tell me if I'm right -- this whole page also has actual

21 inflation steady at 7.97 throughout, correct?

22 A. Correct.

23 And, again, I just want to make sure we're talking

24 about my -- the first method.

01:31:20 25 Q. The first method.

Fischel - cross

2891

1 A. Okay.

2 Q. Absolutely.

3 A. Because the second method is different.

4 Q. Understood.

01:31:24 5 Your first method, 7.97 throughout the page, right?

6 A. Correct.

7 Q. So, therefore -- can I cut to the chase and eliminate all

8 the interim steps, therefore -- you agree that the filing by

9 Household -- the issuance by Household -- of the press release

01:31:38 10 on October 19, 1999, had no effect on the amount of inflation?

11 A. I would not agree with that for the reasons that I stated

12 before.

13 It would have no effect on the amount of inflation if

14 the jury were to conclude that Household made a false and

01:31:57 15 misleading disclosure prior to this date. If that were the

16 case, then there would be no change. But if the jury were

17 conclude that this was the first date where Household made a

18 false and misleading disclosure, again, then the proper way to

19 read the exhibit would be every day prior to this date would

01:32:15 20 have zero inflation and \$7.97 of inflation would have entered

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21 Household's stock price on this date.

22 Q. What I'm trying to avoid is me asking you the exact same
23 questions for every document and you giving me the exact same
24 answers. I'm accepting, for purposes of this series of
01:32:31 25 questions, what you said earlier, that your starting

Fischel - cross

2892

1 assumption was the first false statement was July 30.

2 A. Fine. It's just that I have to answer your question
3 accurately as you ask it.

4 Q. I appreciate that.

01:32:46 5 But on those assumptions, just as we established with
6 regard to the June 30 10-Q, so you would agree, would you not,
7 that the -- let me ask you before I do that -- let's look at
8 1391.

9 And we're looking for October 19, which is on Page 3.
01:33:06 10 October 19, 1999.

11 Do you see that?

12 A. I do.

13 Q. Did you find any statistically-significant price increase
14 that resulted in inflation on October 19, 1999?

01:33:19 15 A. No, I did not.

16 Q. Okay.

17 So, based on those two answers, I'm going to cross
18 off this one (indicating), and I'm not going to list it on
19 that board following the methodology we're using?

01:33:32 20 A. Sir, what you decide to cross off or what you do with your
21 boards, I'm not going to give you any advice on that.

22 Q. Fair enough.

23 But we agreed that we would list over there on the
24 white board any disclosure that caused an increase in

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01: 33: 45 25 inflation. Remember that?

♀

Fischel - cross

2893

1 A. Again, I'm not sure what decision rule you're using with
2 respect to what you're writing down, what you're crossing off,
3 what you're leaving alone. You know, that's however you
4 decide to do it.

01: 34: 02 5 Q. I'm sure the jury remembers what we said to each other.
6 I'm going to cross off this one and not come back to it,
7 again.

8 Let's go to the next one.

9 Plaintiffs have shown this jury the December 31st,
01: 34: 27 10 1999, 10-K that Household filed on March 28, 2000. Let's look
11 at first Exhibit No. 1397 for March 28, 2000. And that's on
12 Page 4.

13 And, again, we'll highlight it on the board there.

14 And to save time, you agree that the number in the
01: 34: 53 15 "Artificial Inflation" column on this page is \$7.97 throughout
16 the page?

17 A. I do, sir.

18 Q. Okay.

19 Then let's go to your event study, which is
01: 35: 03 20 Plaintiffs' Exhibit 1391, and we'll find the same date, which
21 is 3-28-2000.

22 And that will be on Page 8.

23 A. Okay, I have it.

24 Q. Did you find any statistically-significant price increase
01: 35: 28 25 that resulted in inflation on March 28th, 2000?

♀

Fischel - cross

2894

1 A. No, sir, I did not.

2 Q. All right. I won't bother you about this one.

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3 MR. KAVALER: Don't have it? Plaintiffs'

4 Demonstrative 99.

01: 35: 44 5 Sorry. 99, 10-K.

6 BY MR. KAVALER:

7 Q. Plaintiffs have shown this jury the March 31, 2000, 10-K

8 that Household filed on May 10, 2000. Let's do the same

9 exercise. Let's look at your chart, which is 1397 in

01: 36: 22 10 evidence. Let's look at 5-10-2000, which is on Page 5.

11 Again, try to save time. Same result: No increase
12 in artificial inflation?

13 A. Correct.

14 Q. And now let's look at your event study, which is

01: 36: 39 15 Plaintiffs' 1391 for the same date. It's on Page 10. Did you

16 find a statistically-significant price increase that resulted

17 in inflation on May 10, 2000?

18 A. No, sir, I did not.

19 Q. Okay.

01: 36: 58 20 So, once again --

21 MR. KAVALER: I think I'm crossing the wrong thing

22 off. I'll fix it later. I'm confusing myself here.

23 BY MR. KAVALER:

24 Q. Plaintiffs have shown this jury the June 30 10-K -- 10-Q,

01: 37: 25 25 rather -- that Household filed on August 11, 2000. Let's look

Fischel - cross

2895

1 at August 11, 2000, in the first document, which is 1397.

2 It's on Page 6.

3 Once again, no increase in artificial inflation,
4 correct?

01: 37: 41 5 A. Correct.

6 Q. And let's look at it in your event study on Page 14.

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7 Did you find any statistically-significant price
8 increase that resulted in inflation on August 11, 2000?

9 A. No, sir, I did not.

01:38:03 10 Q. All right.

11 Plaintiffs have shown this jury a newspaper article
12 in the St. Louis Post-Dispatch on November 1, 2000, and that
13 one says something about, "Craig Strem says HFC never
14 pressures people to buy credit life insurance."

01:38:33 15 Let's do the same exercise. Look at Plaintiffs'
16 Exhibit 1397 for November 1, 2000, at Page 7.

17 A. I see it.

18 Q. Okay.

19 No increase in artificial inflation in connection
01:38:49 20 with that event, either, right?

21 A. That's correct.

22 Q. All right.

23 Now, let's look at your event study, which is
24 Plaintiffs' Exhibit 1391. I'm going to go to Page 17. And
01:39:04 25 you see the entry there for 11-1-2000?

♀

Fischel - cross

2896

1 A. I do, sir.

2 Q. Did you find any statistically-significant price increase
3 that resulted in inflation on 11-1-2000?

4 A. No, sir, I did not.

01:39:17 5 Q. Okay.

6 MR. KAVALER: Plaintiffs' Demonstrative No. 12,
7 please.

8 BY MR. KAVALER:

9 Q. Plaintiffs have shown this jury the Origination News
01:39:28 10 article that appeared on March 23, 2001, which says something
11 about Gary Gilmer saying the company's position on predatory

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12 Lending is perfectly clear.

13 I think we have the language up here. It's the
14 second one. This one here (indicating), down at the bottom.

01:39:50 15 A. I see it, sir.

16 Q. Okay. Thank you.

17 Let's look at your Plaintiffs' Exhibit 1397. We'll
18 go to Page 9. We'll look at 3-23-01. And let's look at
19 3-28-01. It's possible there might be a mistake in the
01:40:19 20 dating, possibly not; but, either way, there's no change in
21 the artificial inflation in that column?

22 A. That's correct, sir.

23 Q. Okay.

24 And, then, let's go to your event study. And I guess
01:40:33 25 we'll have to -- this is Exhibit No. 1391. It is the right

Fischel - cross

2897

1 date.

2 And we'll look at Page 21. Did you find a
3 statistically-significant price increase that resulted in
4 inflation in connection with either March 23 or March 28,
01:41:01 5 2001?

6 A. Let me just check something because -- it looks like March
7 23rd is a statistically-significant price increase.

8 Q. And the 28th is not?

9 A. Correct.

01:41:22 10 Q. Okay.

11 This is plaintiffs' board. So, we'll see how we
12 resolve that.

13 Let me ask you this -- well, let me come back to
14 that. So, we'll leave this one open for the moment.

01:41:39 15 The plaintiffs have shown this jury the December 31,

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16 2000, 10-K that Household filed on March 28th, '01. That's
17 one of the dates we just looked at and, in Exhibit 1397, we
18 found no change in artificial inflation, correct?

19 A. That's correct.

01:41:53 20 Q. And on your event study, which is Exhibit 1391, we found
21 no statistically-significant price increase that resulted in
22 inflation on March 28, correct?

23 A. That changed the amount of inflation, correct.

24 Q. Okay.

01:42:12 25 So, that's the December 31 10-K. Plaintiffs have

Fischel - cross

2898

1 shown this jury the Star Tribune article that appeared on July
2 27, 2001 --

3 MR. KAVALER: This is Plaintiff's Demonstrative 13.

4 BY MR. KAVALER:

01:42:42 5 Q. -- in which they say Household spokeswoman Megan Hayden
6 said the terms of loans are disclosed to all customers?

7 MR. KAVALER: You can put it right in front. Put it
8 up -- sorry. Should have known you'd know what to do.

9 BY MR. KAVALER:

01:43:01 10 Q. So, we're looking at July 27, '01. It's this one over
11 here (indicating).

12 It's Megan Hayden saying, "The terms of loans are
13 disclosed to all customers as required by state and federal
14 laws -- " and something has been left out on this board -- "so
01:43:25 15 I take exception to any characterization that we engaged in
16 predatory lending practices."

17 By the way, Professor, you understand these are
18 plaintiffs' boards, we just blew them up?

19 A. I don't have -- I don't have -- any understanding, one way
01:43:36 20 or the other.

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21 Q. Do you see in the lower right-hand corner it says
22 "PDEM013"?

23 A. Actually, I can't really read it from here, but I'm sure
24 that's what it -- there's no need to show it to me. I'm sure
01: 43: 47 25 that's what it says.

♀

Fischel - cross

2899

1 Q. I was going to bring it over to you.

2 A. No, I'm happy to --

3 Q. And you know that means "plaintiffs' demonstrative"?

4 A. That's fine.

01: 43: 53 5 Q. So, I'm not the one who left whatever's left out of there,
6 but I'm not suggesting anything follows from it.

7 Okay. Let's look at that date in Exhibit 1397. It's
8 on Page 11. And, again, we have an entire page where
9 artificial inflation is 7.97, correct?

01: 44: 13 10 A. That's right.

11 Q. So, no change here, either?

12 A. Correct.

13 Q. All right.

14 Let's now look in your event study. This is at
01: 44: 20 15 Page -- this is Exhibit 1391. And we go to Page 26, it's the
16 second entry down.

17 Did you find any statistically-significant price
18 increase that resulted in inflation on July 27, 2001?

19 A. No, sir, I did not.

01: 44: 54 20 Q. Let me see if I can shorten this. In fact, you didn't
21 find any statistically-significant price increases that
22 resulted in inflation from July 30, 1999, through November 15,
23 2001; is that right?

24 A. Under the first method, that's correct.

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01: 45: 25 25 Q. The first method. Absolutely.

Fischel - cross

2900

1 A. Correct.

2 Q. Right?

3 Okay.

4 MR. KAVALER: Let's put up everything we have that
01: 45: 33 5 the plaintiffs were kind enough to furnish us that occurred
6 before November 15, 2001.

7 (Brief pause.)

8 MR. KAVALER: January 19, 2000; April 19, 2000;
9 August 11, 2000; October 18, 2000; January 17, 2001.

01: 47: 23 10 MR. BURKHOLZ: Your Honor, is there a question
11 pending or is this demonstrative --

12 MR. KAVALER: These are all following from the last
13 question, your Honor. He told me everything remains the same
14 through a certain date. I'm simply trying to expedite matters
01: 47: 35 15 so we don't waste all afternoon. This is the same process I
16 went through each of the other exhibits. I'd be happy to do
17 it piecemeal. It will just take forever.

18 THE COURT: Do you have an objection?

19 MR. BURKHOLZ: Is there a question pending?

01: 47: 47 20 THE COURT: Do you have an objection?

21 MR. BURKHOLZ: No. It's fine, your Honor.

22 THE COURT: Okay.

23 MR. KAVALER: Thank you.

24 THE COURT: Proceed.

01: 47: 55 25 MR. KAVALER: July 18, 2001.

Fischel - cross

2901

1 BY MR. KAVALER:

2 Q. Now, Professor, I may not have a board for every
Page 85

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3 statement, but if the statement falls within the same time
4 frame as my last question, you'd give me the same answer?

01:48:17 5 A. If you're just asking me the mechanical question as to
6 whether there's a change in the amount of inflation or whether
7 there's a statistically-significant price increase --

8 Q. Those are my only questions.

9 A. If those are your only questions, as opposed to explaining
01:48:32 10 why the numbers are what they are, then I agree with you.

11 Q. All right.

12 Now let's look at some days after November 15.

13 A. Okay.

14 Q. We're not going to be able to expedite. We're going to
01:48:43 15 have to go day by day.

16 A. Okay.

17 Q. Okay. Plaintiffs may show this jury a December 4 -- I
18 think we did that already. We did Goldman Sachs. It's that
19 one (indicating).

01:48:55 20 MR. KAVALER: Plaintiffs' Demonstrative 23, please.

21 BY MR. KAVALER:

22 Q. Plaintiffs may show this jury a press release that
23 Household issued on January 16, 2002. It looks like this
24 (indicating). It's Mr. Aldinger in the photograph here and
01:49:18 25 talks about receivable and revenue growth exceeded our

Fischel - cross

2902

1 expectations, et cetera.

2 Let's look at January 16, 2002, in your exhibit,
3 Plaintiffs' Exhibit 1397. And that will be on Page 14.

4 And you see that the inflation on January 15 is 3.66.
01:49:45 5 On January 16, it's 3.66. On January 17, it's 3.66.

6 So, although we no longer have a full page of 7.97,

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7 we still have the same phenomenon. The artificial inflation
8 did not increase upon the issuance of this press release,
9 correct?

01: 50: 00 10 A. That's correct.

11 Q. Okay.

12 And now let's go to your event study, which is

13 Plaintiffs' Exhibit 1391. And let's find the same date, which
14 is January 16, 2002, which will be on Page 32. And tell me

01: 50: 19 15 whether you found a statistically-significant price increase
16 that resulted in inflation on January 16, 2002.

17 A. No, sir, I did not.

18 Q. Plaintiffs have shown this jury the Copley News Service
19 article --

01: 50: 42 20 MR. KAVALER: This is Plaintiffs' Demonstrative 13,
21 please.

22 BY MR. KAVALER:

23 Q. Plaintiffs have shown this jury the Copley News Service
24 article which appeared on February 6th, 2002. I have it over

01: 50: 56 25 here (indicating): "We do the right thing for our borrowers.

Fischel - cross

2903

1 We make good loans. They're not only legal loans, but are
2 beneficial for our customers."

3 Do you see that?

4 A. I do, sir.

01: 51: 05 5 Q. Okay.

6 Let's look at our old friend Plaintiffs' 1397 for
7 that date, February 6. I think we're on the same page, Page
8 14.

9 And you see the inflation there is -- it's a 3.66
01: 51: 19 10 number in a whole column of 3.66 numbers. Not the entire
11 page, but a bunch of them, right?

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12 A. Correct.

13 Q. Again, inflation did not increase upon the release of this
14 press release, right?

01:51:29 15 A. That's right.

16 Again, we're talking only about the first method.

17 Q. Only the first model.

18 A. That's right.

19 Q. Absolutely. I promise you when I switch to the second
01:51:35 20 model, I'll tell you. I have it in my notes.

21 A. Okay.

22 Q. First model. I agree with you.

23 Now, let's look at your event study, Plaintiffs'

24 1391, for the same date, which is February 6, '02, which will
01:51:50 25 be Page 33.

♀

Fischel - cross

2904

1 Did you find any statistically-significant price
2 increase that resulted in inflation from any disclosure on
3 February 6th, 2002?

4 A. Statistically it's giving price decrease, but not
01:52:09 5 increase.

6 Q. But not increase?

7 A. Correct.

8 Q. That's exactly my point. I'm asking about an increase.
9 Not an increase?

01:52:14 10 A. Okay. Not an increase.

11 Q. In other words, whatever Ms. Hayden-Hakes said, it did not
12 artificially -- it did not increase the amount of artificial
13 inflation?

14 A. That's correct. Decreased it.

01:52:33 15 MR. KAVALER: Plaintiffs' Demonstrative 14.

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16 BY MR. KAVALER:

17 Q. Plaintiffs have shown this jury the National Mortgage News
18 article which appeared on February 18, 2002. And that's --
19 what it says there is -- "Our first take on the allegations of
01:52:48 20 predatory lending raised in the ACORN action is that it is not
21 a significant issue, not indicative of any widespread problem
22 and certainly not a concern that it will spread elsewhere?"

23 It's attributed to David Schoenholz. Do you see
24 that?

01:53:01 25 A. Can I just -- in my previous answer, when I said it

Fischel - cross

2905

1 decreased it in this first method, and no effect, I want to
2 correct my previous answer.

3 Q. Okay.

4 I'll be clear with you. You be clear with me.

01:53:13 5 Again, I'm not trying to trick you.

6 A. You have been clear --

7 Q. The first method.

8 A. You have been clear --

9 Q. The first method.

01:53:18 10 A. -- I misspoke. I wanted to correct it.

11 Q. Okay. And I appreciate that.

12 And, just, the point is previously you said it
13 decreased it. Now, you're saying it was flat. My question
14 was: It didn't increase it, correct?

01:53:27 15 A. Correct.

16 Q. All right.

17 So, from my point of view, both your answers are the
18 same. You've now made it more accurate, but it's still not an
19 increase --

01:53:35 20 A. Okay.

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A464

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21 Q. -- correct?

22 A. Correct, yes.

23 Q. Thank you.

24 Okay. Let's look at this date (indicating). We'll

01:53:43 25 go to Plaintiffs' 1397. The date is February 18, 2002. We

Fischel - cross

2906

1 are on Page 14. And we see there is no "February 18, 2002,"

2 probably because it's a weekend. There's a "February 15" and

3 "February 19."

4 Do you see that?

01:53:58 5 A. Yes, sir, I do.

6 Q. Where should I go, the 19th?

7 A. If it came out on the weekend, you should go to the 19th.

8 Q. It doesn't matter because it's 3.66 for days and days

9 before, and days and days after, correct?

01:54:08 10 A. Correct.

11 Q. So, again, this didn't cause any increase in artificial

12 inflation, correct?

13 A. That's right.

14 Q. Now, let's go to 1391, your Event Study, and let's see if

01:54:19 15 we can find the same date.

16 This is February 18 (indicating) and it looks like

17 it's February 19, and it's on Page 34.

18 Do you see that?

19 A. I do, sir.

01:54:30 20 Q. Okay.

21 Am I on the right date?

22 A. You are.

23 Q. All right.

24 And did you find any statistically-significant price

Page 90

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01: 54: 36 25 increase under your first method that resulted in inflation on
Fischel - cross 2907

1 February 18, 2002?

2 A. No, sir, I did not.

3 Q. Plaintiffs have shown this jury the December 31, 2001,
4 10-K filed by Household on March 13, 2002.

5 MR. KAVALER: Did we do this already?

6 (Brief pause.)

7 MR. KAVALER: We did not. Okay.

8 BY MR. KAVALER:

9 Q. Let's look at Plaintiffs' 1397. We'll look at it for
01: 55: 11 10 March 13, 2002.

11 And you see that artificial inflation is 5.30 there
12 (indicating), and 5.30 for several days before and 5.30 for
13 several days thereafter, right?

14 A. I see that, sir.

01: 55: 23 15 Q. Once again, no increase in artificial inflation upon the
16 filing of the December 31 10-K, correct?

17 A. Correct.

18 Q. And let's look at your Event Study, which is Exhibit 1391.

19 Let's go to March 13, 2002, which looks like it's on
01: 55: 41 20 Page 35.

21 Did you find any statistically-significant price
22 increase that resulted in inflation on March 13, 2002?

23 A. No, sir, I did not.

24 Q. Plaintiffs have shown this jury statements made at the
01: 56: 09 25 Household Financial Relations Conference that took place on

Fischel - cross

2908

1 April 9, 2002.

2 Let's look at your Exhibit 1397.
Page 91

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3 I think we're on Page 15.

4 No increase in artificial inflation on April 9 or
01:56:32 5 April 10 or April 11 of 2002, correct?

6 A. Correct.

7 Q. Let's look at your Event Study, Plaintiffs' 1391, for the
8 same date, which will be on Page 36.

9 Did you find any statistically-significant price
01:56:49 10 increase that resulted in inflation on April 9, 2002?

11 A. No, sir, I did not.

12 Q. Okay.

13 So, we don't have a board for that; but, if we did,
14 we'd cross it off.

01:56:59 15 Plaintiffs may show this jury a press release issued
16 by Household on April 17, 2002.

17 Let's look at Plaintiffs' Exhibit 1397 for April 17.

18 Again, no increase in artificial inflation that day
19 or any of the days within five or ten thereafter, right?

01:57:19 20 A. Let me look at it on there.

21 Q. Absolutely. Please, please.

22 A. No change in inflation on those dates.

23 Q. Okay.

24 I'm just giving you a window so as to make it easier
01:57:29 25 for you to hone in.

♀

Fischel - cross

2909

1 Let's look at your Event Study, which is Exhibit --
2 Plaintiffs' -- 1391, for the same day, which will be on Page
3 37, I think.

4 Give me a second here.

5 (Brief pause.)

6 BY MR. KAVALER:

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7 Q. Correct. 37?

8 Now, I'm not sure I understand the entry here. It
9 says, "4-21," and, then, there's nothing.

10 Am I on the wrong date?

11 Hang on.

12 (Brief pause.)

13 BY MR. KAVALER:

14 Q. I'm on the wrong date. I apologize.

01:58:04 15 4-17. Okay. 4-17.

16 Did you find any statistically-significant price
17 increase that resulted in inflation on April 17, 2002?

18 A. No, sir, I did not.

19 Q. All right.

01:58:14 20 And that's this press release here (indicating), with
21 a picture of Mr. Aldinger, talking about, "A credit quality
22 performance was well within our expectations," et cetera.

23 Plaintiffs have shown this jury the Bellingham Herald
24 article that appeared on April 21, 2002. This is Plaintiffs'

01:58:36 25 Demonstrative No. 14, the second item, and that's this one

Fischel - cross

2910

1 here in the middle (indicating).

2 "Megan Hayden-Hakes: It is absolutely against our
3 policy in any way to quote a rate that is different than a
4 true rate."

01:58:55 5 I can't underscore that enough -- that quote.

6 Let's look at Plaintiffs' Exhibit 1397 for April 21,
7 2002, Page 15.

8 Again, no change in the artificial inflation
9 associated with that event, right?

01:59:08 10 A. I believe that's correct, but it's not highlighted yet.

11 Q. Oh, sorry.

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02: 33: 41 25 right up against July 30, 1999, which you understand to be the
Fischel - cross

2935

1 first day of the relevant period, correct?

2 A. Correct.

3 MR. KAVALER: Your Honor, I offer Plaintiffs'

4 Demonstrative 1511 in evidence pursuant to Rule 801(d)(2).

02: 34: 03 5 THE COURT: A response?

6 MR. BURKHOLZ: I don't think it's a party admission
7 under that rule, your Honor.

8 THE COURT: Excuse me.

9 MR. BURKHOLZ: I don't think it's a party admission
02: 34: 17 10 under 801(d)(2).

11 MR. KAVALER: I refer specifically, your Honor, to
12 subpart (B) or (C) or (D).

13 THE COURT: I will allow it subject to a later ruling
14 after we have a sidebar.

02: 34: 43 15 But you may proceed as if it has been admitted.

16 MR. KAVALER: Thank you, your Honor.

17 BY MR. KAVALER:

18 Q. Now, turn your attention, Professor Fischel, to

19 Plaintiffs' Exhibit -- Plaintiffs' Demonstrative -- 154?

02: 34: 55 20 A. Can I just have a copy, sir?

21 Q. Absolutely. Sorry.

22 You can even have a color copy.

23 Here's 151.

24 (Document tendered.)

02: 35: 04 25 MR. KAVALER: Mr. Burkholz, one for you.

Fischel - cross

2936

1 (Document tendered.)

2 MR. KAVALER: Now, let's do 154.

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3 Copies, please.

4 (Brief pause.)

02: 35: 15 5 MR. KAVALER: Let the record reflect I'm handing the
6 witness 154.

7 THE WITNESS: Thank you.

8 MR. KAVALER: And a copy for counsel.

9 (Document tendered.)

10 BY MR. KAVALER:

11 Q. The same series of questions, Professor Fischel.

12 Once again, the horizontal axis shows at the extreme
13 left-hand end July 30, 1999, correct?

14 A. Correct, sir.

02: 35: 36 15 Q. And you go up that axis, you see a blue line (indicating),
16 which is the true value; a red line (indicating), which is
17 price; and, a pink -- it looks blue up there (indicating) --
18 whatever color it is, the area between the lines is shaded in?

19 A. Yeah.

02: 35: 54 20 That corresponds precisely to the table that we were
21 just looking at on the amount of inflation. So -- well, since
22 we haven't talked about this yet, if you just put the other
23 one up on the screen for a second?

24 Q. Okay. Sure.

02: 36: 23 25 Go back to 151.

♀

Fischel - cross

2937

1 (Brief pause.)

2 BY THE WITNESS:

3 A. So, what the -- the red line is the actual price, and you
4 can see what it was relative to -- the level of the price
02: 36: 24 5 relative to -- the vertical axis on price.

6 And the blue line is the true value.

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7 So, what this predicts is that the price fluctuates
8 every day; but, the true value, based on my calculations, is
9 \$7.97 lower than the actual price until November 15th of 2001;
02:36:53 10 and, then, it gets more or less than -- the inflations
11 increases or decreases based on the specific disclosure.

12 BY MR. KAVALER:

13 Q. I hear you. None of that is my question.

14 I want to go back to -- I put up 151 because you
02:37:03 15 wanted me to. I want to go to 154 for a minute.

16 A. I apologize.

17 Okay. Thank you.

18 Q. 154, my only question is: You prepared this chart?

19 A. I did.

02:37:11 20 Q. Okay.

21 On this chart, as on the other one, the blue line,
22 the red line and the shaded-in space all butt right up against
23 July 30, 1999, correct?

24 A. Correct, for the reasons I've stated.

02:37:24 25 MR. KAVALER: Your Honor, I offer Plaintiffs'

Fischel -

2938

1 Demonstrative 154 in evidence, pursuant to Rule 801(d)(2).

2 THE COURT: Let's take our afternoon break now.

3 We'll take 15 minutes; we'll discuss this; and, then, we'll
4 bring the jury back out and continue.

02:38:38 5 (Jury out.)

6 THE COURT: So, you're offering these two
7 demonstrative exhibits as?

8 MR. KAVALER: As an admission by a party opponent,
9 your Honor.

02:38:43 10 THE COURT: Okay.

11 A response?

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7 you've got a residual price change of minus \$1.86.

8 Do you see that?

9 MR. BURKHOLZ: Could you show him where it is?

03:27:51 10 MR. KAVALER: Sure.

11 BY MR. KAVALER:

12 Q. It's tab three, which just happens to be the first one
13 in --

14 A. I'm looking at it on the screen.

03:27:54 15 Q. If I were looking at the price of the stock, closing price
16 on the New York Stock Exchange, on November 15, 2001, I
17 wouldn't see minus \$1.86, would I?

18 A. You would not, for the reasons that I explained at length.

19 Q. And if I were watching Bloomberg News, I wouldn't see
03:28:12 20 minus \$1.86, would I?

21 A. Probably not.

22 Q. And if I were reading the Wall Street Journal in the
23 morning or the New York Times or the Chicago Tribune, I
24 wouldn't see minus \$1.86?

03:28:22 25 A. I suspect you would not.

♀

Fischel - cross

2959

1 Q. And if I were looking at my brokerage statement if I owned
2 Household stock, I wouldn't see minus \$1.86?

3 A. No. But in all those documents, you might see discussion
4 of how the stock price movement compared with the overall
03:28:39 5 market and movements of other firms in the industry. That's a
6 very common measure that Household itself used in its proxy
7 statements that's, in effect, required by SEC regulations.

8 Q. I'm making --

9 A. So this is just a quantification of what investors look at
03:28:57 10 all the time.

11 Q. I'm making a very small point, sir. Stocks are quoted in
Page 135

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12 a price which is the price usually that they close on the New
13 York Stock Exchange, right?

14 A. Correct. But there's also frequently comparisons of stock
03: 29: 12 15 prices and prices of the overall -- movement to the overall
16 market, movements in the industry. That's what Household
17 itself disclosed in its proxy statement. This is just a
18 quantification of that relationship.

19 Q. You've been very patient all afternoon while we talked
03: 29: 28 20 about your first model. I want to turn to your second model.

21 A. Okay.

22 Q. This is the model with the leakage, right?

23 A. Okay.

24 Q. Okay. And you agree there are a bunch of stock price
03: 29: 39 25 movements that were significant under your aggression analysis

Fischel - cross

2960

1 that were not attributable to fraud-related disclosures, don't
2 you?

3 A. There were probably some, both positive and negative, but
4 a lot of the significant movements were combined disclosures
03: 29: 57 5 of -- they had some fraud-related aspect and then they had
6 some other aspect in addition to the fraud-related aspect.

7 Q. And were there some, any, that had no fraud-related
8 aspect?

9 A. It's a matter of judgment as to whether something has a
03: 30: 13 10 fraud-related aspect or not. I would say there were a few,
11 but there were also, I would say, a significant number of the
12 statistically significant movements that had this combined
13 aspect.

14 But just to be clear, under the leakage model,
03: 30: 31 15 whether they did -- whether they were purely fraud related,

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16 combined fraud related or not at all fraud related, they were
17 all included in the leakage model.

18 Q. I understand. But my point is there was some of all
19 three?

03: 30: 46 20 A. You probably could -- that would probably be a fair
21 statement.

22 Q. Okay. Now, this is not on either model. This is a
23 general question.

24 A. Okay.

03: 30: 56 25 Q. You assumed that the defendants did make false statements

Fischel - cross

2961

1 during the relevant period, didn't you?

2 A. That's correct.

3 Q. Okay. Can you do this: Assume the opposite. Assume the
4 defendants did not make any false statements during the
03: 31: 10 5 relevant period.

6 A. Okay.

7 Q. Okay. The stock price still declined in the real world,
8 didn't it?

9 A. The stock price declined in the real world, that's
03: 31: 23 10 correct.

11 Q. Why?

12 A. I think the stock price declined for a variety of
13 different factors. I touched on this in my testimony. There
14 was a -- a big part of the stock price decline that's --
03: 31: 40 15 according to both of my calculations that's attributable to
16 some combination of market industry and non-fraud-related
17 effects. And also some percentage of the stock price decline
18 that's attributed -- attributable -- excuse me -- to the
19 market learning correct information about Household's

03: 32: 05 20 predatory lending practices, its re-aging policies and the

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7 Q. Is it a common method to focus on the disclosures later in
8 the relevant period to quantify the inflation due to the
9 statements Household made earlier in the relevant period?

03:37:01 10 A. It's completely standard because if what you're trying to
11 do is measure the value of the truth and the truth is not
12 provided early in the period, the only way to analyze the
13 effect of the truth is to see what the effect on investors and
14 market prices is when the truth comes out. And by doing that,
03:37:23 15 you're able to make a judgment, as I did, about what the,
16 quote, true value of the stock would have been at the
17 beginning had the truth been told the entire time.

18 Q. Now, counsel showed you the beginning of the relevant
19 period, July 30, 1999, and then the first statement on August
03:37:43 20 16, 1999, the 10-Q.

21 Do you remember that?

22 A. I do.

23 Q. And do you have an understanding that the beginning of the
24 relevant period, July 30, 1999, is due to a Court decision in
03:37:54 25 this case?

♀

Fischel - redirect

2966

1 A. That's my understanding.

2 Q. Okay. And if the first false statement that plaintiffs
3 allege in this case is on August 16, 1999, how would you
4 calculate inflation on that date?

03:38:06 5 A. I would calculate inflation the same way as of August 16,
6 but there would be no inflation from July 30 to August 15. So
7 as I indicated, where I have an entry for artificial inflation
8 from July 30 to August 15, the correct way to interpret the
9 exhibit is just to replace the inflation number with a zero
03:38:28 10 for every day until August 16. And beginning on August 16, it
11 would then be \$7.97 under the first method.

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12 Q. And your assumption that plaintiffs will be able to prove
13 the various statements are false and misleading during the
14 relevant period is a common assumption that you make in your
03: 38: 58 15 field?

16 A. Again, it's a necessary assumption because the
17 responsibility of determining whether a statement is false or
18 not, that's not for an expert witness, for any expert witness.
19 It's not for an economist. It's really a function for the
03: 39: 12 20 jury to decide.

21 MR. BURKHOLZ: Can we bring up Plaintiffs' Exhibit
22 1391. Can we have the switch, your Honor.

23 If we can turn to the third page.

24 If we can highlight the last date on the bottom,
03: 39: 36 25 November 12, 1999.

Fischel - redirect

2967

1 BY MR. BURKHOLZ:

2 Q. That's the date of a public statement by Household.

3 Do you see the three bars on the right?

4 A. I do.

03: 39: 49 5 Q. What does that signify?

6 A. That it's a statistically significant day.

7 Q. And that was a statistically significant price increase on
8 that date, correct?

9 A. Correct.

03: 39: 57 10 Q. Why didn't you take, under your specific disclosure model,
11 the \$7.97 and just add the dollar and two cent inflation on
12 that date?

13 A. Because, as I indicated, to be one of my 14 specific
14 disclosures, three criteria had to be met. There had to be an
03: 40: 16 15 event, there had to be a statistically significant stock price

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16 reaction and I had to believe to a reasonable degree of
17 certainty that the event caused the stock price reaction.

18 So what I did with respect to dates like November 12
19 was that there was a statistically significant price increase.

03:40:38 20 I could have included that date to increase the amount of
21 inflation, but I didn't do it because I wasn't confident that
22 there was a fraud-related disclosure on that date that was
23 responsible for that price increase, which is why in my first
24 method of quantification I only had 14 dates, as opposed to
03:41:00 25 every date where there was a statistically significant price

Fischel - redirect

2968

1 movement.

2 Q. And under your leakage model, the inflation varies
3 throughout the relevant period?

4 A. Correct, from the first day to the last day. It varies
03:41:12 5 every day.

6 Q. And then counsel was quizzing you on some of the specific
7 disclosure dates. I want you to go back to the September 23,
8 2002, date, which is tab 16 in your binder.

9 A. Okay. I have it.

03:41:29 10 Q. And he asked you whether or not that date related to
11 predatory lending. And I think you said it did. But you
12 didn't look at the actual report. Can you look at the second
13 page of the report?

14 A. I have it.

03:41:51 15 Q. Okay. Do you see the first paragraph -- at the end of the
16 first paragraph on the second page, Moreover, skepticism
17 regarding the company's rapid portfolio growth, particularly
18 within the auto business, and mounting credit quality concerns
19 related to Household's loan workout and re-aging practices
03:42:08 20 have also been a drag on the stock.

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21 A. Correct, I see that. The correct answer would have been
22 this disclosure related both to predatory lending practices as
23 well as a re-aging, not just to predatory lending.

24 Q. And, finally, it's your opinion that the leakage model is
03:42:26 25 a better estimate of inflation from Household's false

Fischel - recross

2969

1 statements as alleged by the plaintiffs than your specific
2 disclosure model?

3 A. Yes, because of all the evidence of the leakage of the
4 Washington department of financial insurance report, as well
03:42:41 5 as all the leakage of the settlements, the possible
6 settlements, and all the criticism of Household's predatory
7 lending practices, as well as its re-aging policies.

8 MR. BURKHOLZ: Nothing further at this time, your
9 Honor.

03:43:00 10 THE COURT: Recross.

11 MR. KAVALER: Briefly, your Honor.

12 (Brief pause.)

13 THE WITNESS: Be careful.

14 RECROSS EXAMINATION

03:43:05 15 BY MR. KAVALER:

16 Q. Anything happens a lot of lawyers that will throw their
17 cards at my body.

18 Let me just pursue what you just told Mr. Burkholz.

19 He directed your attention to November 12, 1999. Let's look
03:43:32 20 at Plaintiffs' Exhibit 1397, page two. That's your list
21 there.

22 A. 13 -- which --

23 Q. 1397 is this one, the one with the columns.

24 A. Okay. Let me find it. I've got 1395.

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/s/ Nancy C. LaBell a

/s/ Joseph Ri ckhoff

April 21, 2009

Official Court Reporters
United States District Court
Northern District of Illinois
Eastern Division

Date

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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,)

vs.

HOUSEHOLD INTERNATIONAL, INC.,)
et al.,)
Defendants.)

No. 02 C 5893
Chicago, Illinois
April 24, 2009
11:00 o'clock a.m.

VOLUME 18
TRANSCRIPT OF TRIAL PROCEEDINGS
BEFORE THE HONORABLE RONALD A. GUZMAN

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THE CLERK: 02 C 5893, Jaffe vs. Household
International, incorporated.
THE COURT: Good morning, everyone.
MR. BURKHOLZ: Good morning.
MR. KAVALER: Good morning, your Honor.
THE COURT: Does anybody remember where we left off

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11: 19: 02 25 what the factual record is, that's for the jury to decide

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1 unless you can convince me in your motion for ruling as a
2 matter of law that there's an absolute lack of any such
3 information; and, therefore, the issue shouldn't go to the
4 jury.

11: 19: 15 5 You know, when we argue these instructions, we posit
6 that there's sufficient evidence out there for it to go to the
7 jury. If that's the case, how do we instruct the jury on what
8 the rules are in determining whether, depending on what they
9 find the evidence shows, liability has been established?

11: 19: 41 10 MS. BEER: I think we were focusing on the factual
11 record, in part, to suggest that giving the jury an abstract
12 statement like this is simply going to be confusing; and, it
13 opens the door to a great many individuals about whom there is
14 no evidence whatsoever in the record.

11: 19: 58 15 There's also --

16 THE COURT: Well, why don't we tell them we're
17 talking about Vozar and Rybak?

18 MR. BURKHOLZ: Vozar, Rybak, McDonald and Makowski.

19 And McDonald and Makowski came out with the
11: 20: 09 20 Schoenholz testimony about the 10b-5-K. So, it's in the
21 record with respect to those -- certainly those -- four
22 individual corporate officials that are so high up at
23 Household, that they meet the Tellabs standard.

24 MS. BEER: I think we also need to look at the timing
11: 20: 23 25 of their statements, as they -- the timing of the statements

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1 that they made providing information to the individual
2 defendants, as opposed to as that relates to the timing of the

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3 statements that were issued to the public. Because the
4 scienter of the corporation will have to be determined by the
11:20:43 5 scienter -- by the state of mind at the time the statements
6 were made public.

7 MR. BURKHOLZ: Well, certainly that's for argument,
8 your Honor. They can argue that.

9 THE COURT: Let's see.

11:21:40 10 MS. BEER: The instruction we would propose, your
11 Honor, would simply identify the individuals -- the three
12 individual defendants -- and the two corporate spokespeople by
13 name and not try to confuse the jury with a statement of law
14 that could open the door to any number of other people who
11:21:57 15 have yet to be identified to us.

16 And if the inclination is to include the language
17 from the Tellabs case, it needs to be modified, because it has
18 been changed in a way that makes the -- what are parenthetical
19 subsidiary points in the Tellabs opinion appear to be
11:22:27 20 equivalent bases for liability.

21 THE COURT: I'm not sure I know what that means.

22 MR. BURKHOLZ: I don't, either.

23 THE COURT: What does that mean?

24 MS. BEER: Making the different parts of the sentence
11:22:38 25 No. 1, 2 and 3 elevates them all to the same level. And

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1 that's not the way the language appears in Tellabs.

2 MR. BURKHOLZ: I could modify that, your Honor, to
3 have the exact language from Tellabs. I thought we were
4 pretty close.

11:22:55 5 I'm looking at it. It says, "Corporate liability for
6 a violation of 10b-5 requires -- "

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7 THE COURT: Slow down and louder.

8 MR. BURKHOLZ: Sorry about that.

9 I'll read it in, again.

11: 23: 11 10 "To establish corporate liability for a violation of
11 10b-5 requires 'looking to the state of mind of the individual
12 corporate official or officials who make or issue the
13 statement, or order or approve it or its making or issuance,
14 or who furnish information or language for inclusion therein
11: 23: 32 15 or the like.'"

16 That's it.

17 THE COURT: I think that's pretty much what I said,
18 isn't it?

19 MR. BURKHOLZ: It is.

11: 23: 48 20 THE COURT: Is there a structure in there that I
21 don't -- that I'm missing?

22 Is there a structuring of that sentence that I'm
23 missing?

24 MS. BEER: I'm sorry?

11: 23: 57 25 THE COURT: What am I missing here? You were arguing

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1 that --

2 MS. BEER: Well, we're arguing, first of all, that
3 the sentence should not be included in the instruction at all.

4 THE COURT: Okay.

11: 24: 06 5 And why is that?

6 MS. BEER: Because there's been no -- there's no
7 court in this circuit that has imposed liability on the basis
8 of the scienter of individuals within the organization, who
9 were not also the persons who issued the statement.

11: 24: 20 10 THE COURT: You mean no district courts?

11 MS. BEER: There's no court.
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12 THE COURT: Okay.

13 MS. BEER: The Tellabs case recites this language,
14 but it does not deal with this issue.

11: 24: 30 15 THE COURT: Right. But it appears to be the most
16 recent instruction that we can glean from Seventh Circuit
17 opinions on the precise issue that we're talking about now,
18 right?

19 You're telling me it's not a holding, but it appears
11: 24: 50 20 to be the best language we have right now to interpret the
21 Seventh Circuit's thinking on this precise issue. Why
22 shouldn't we adopt it?

23 MS. BEER: The language appears in the Tellabs case,
24 in a section in which the court is attempting to limit the
11: 25: 08 25 scope of the corporate scienter doctrine, not in a context in

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1 which they're attempting to expand it beyond those who are
2 individual defendants.

3 The case that the Court draws the language from --
4 the Southland Securities case in the Fifth Circuit -- quotes a
11: 25: 29 5 case from California -- the Apple Computer case -- in which
6 the court says, "It is not enough to establish fraud on the
7 part of a corporation that one corporate officer makes a false
8 statement."

9 THE COURT: No, no, I missed that whole first part.
11: 25: 42 10 You have got to slow it down a bit for me.

11 MS. BEER: The Southland case from the Fifth Circuit,
12 the Apple Computer Securities Litigation case from the
13 Northern District of California are the authorities that the
14 Tellabs case is relying on. Those cases both refused to find
11: 26: 08 15 or permit cases to proceed on allegations that the scienter of

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16 a corporation could be established on the basis of the
17 scienter of an employee or officer of the corporation, who was
18 not also the individual who had made the allegedly false
19 statement.

11:26:30 20 So, the same language that is appearing in Tellabs --
21 that is now being argued to open the doors more widely -- was
22 quoted in Tellabs in exactly the opposite direction and --

23 THE COURT: Well --

24 MS. BEER: -- was applied in the cases that are being
11:26:46 25 cited to limit liability to -- to limit the imputation of

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1 scienter to those persons who had also made the statements.

2 And if I could just clarify the timing point.

3 If we're going to be looking to the state of mind of
4 individuals, other than the individual defendants and the
11:27:04 5 corporate spokespersons, that state of mind needs to be
6 assessed at the time they provided the information.

7 THE COURT: Of course. When else?

8 But we --

9 MR. KAVALER: Your Honor --

11:27:17 10 THE COURT: -- haven't gotten to that issue yet.

11 I just don't understand how it is that, because the
12 language that establishes the scope of the corporation's
13 liability in regards to the acts of its employees, was applied
14 to a certain set of facts -- and, the result reached was that
11:27:38 15 there was no liability -- that that language is somehow not
16 valid to be applied to the set of facts that we have in this
17 case.

18 The language is the language. Whether it resulted in
19 a no-liability finding, in Tellabs or any other case,
11:27:59 20 shouldn't determine whether we apply the language in this

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21 case, should it?

22 Whether there's going to be a resulting liability or
23 lack of liability will depend on the facts in this case; and,
24 fortunately, that's a determination that the jury will make in
11:28:11 25 this case, not the Court, because we're at the stage where

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1 we're actually having a trial.

2 MR. KAVALER: Your Honor, may I --

3 THE COURT: And I don't think -- I'm trying to --

4 MS. BEER: There are a number of cases that deal with
11:28:29 5 this issue, your Honor, that end with a statement something
6 like, "It's theoretically possible" or "It's conceivable," but
7 not here.

8 And I think our position on the factual record in
9 this case is that that's where we are here, as well.

11:28:47 10 It may be theoretically possible, but is it
11 appropriate to be giving the jury an instruction on something
12 that is theoretically possible, when the factual record will
13 not support it?

14 THE COURT: Well, I think that's another way of
11:29:15 15 telling me that there's insufficient basis to instruct the
16 jury on this issue --

17 MS. BEER: I believe that's the case.

18 THE COURT: -- and the factual -- okay, which I'm
19 sure you argue in your motion for a ruling as a matter of law.

11:29:30 20 Let's try to get past that and assume that it goes to
21 the jury; and, therefore, assume there's a sufficient factual
22 basis for the different theories of liability, that are not
23 knocked out on your motion for judgment as a matter of law.

24 How, then, do we instruct the jury?

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11: 29: 50 25

Not do we instruct them or not destruct them, but

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1 how, then, do we instruct them?

2 And I think that the Pugh case -- the Tribune case --
3 is clearly the Seventh Circuit's latest statement on the law
4 that should be applied. And I think that they ruled, you

11: 30: 05 5 know, as you're arguing, that the facts pled in that case were
6 not sufficient to establish the inference of scienter.

7 But we're not at that stage. And the question is:
8 If we get past that stage, how do we instruct the jury on how
9 they should undertake this deliberation?

11: 30: 27 10 And I fail to see why that language, which is a
11 language the court cites as the appropriate language,
12 shouldn't be used. It doesn't --

13 Well, go ahead. You've been standing for a while,
14 Mr. Kavalier. I don't want you to get tired. Go ahead.

11: 30: 48 15 MR. KAVALER: I'm way beyond tired, your Honor.

16 I just want to make a pragmatic observation, which
17 occurred to me as I listened to your question about three back
18 as directly responsive to precisely where you are now.

19 The answer to why we shouldn't -- I take your point
11: 31: 04 20 entirely. This entire dialogue assumes you deny the motion
21 and the motion is addressed to the sufficiency of the
22 evidence. Agreed. Understood.

23 The reason you shouldn't, as a pragmatic matter, your
24 Honor, is because if it engenders this much debate at this
11: 31: 20 25 session here today, and it is possible that Ms. Beer's

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1 interpretation of what the Seventh Circuit said and meant is
2 correct, if you include the instruction and you get a

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3 plaintiffs' verdict, you will you have a big problem in the
4 Seventh Circuit if there's a reversal.

11: 31: 36 5 On the other hand, if you don't include the
6 instruction and you get a plaintiffs' verdict, there's no
7 problem.

8 So, the question for the plaintiffs is --

9 THE COURT: Well, sure there is. Then they go up and
11: 31: 45 10 appeal and they say, "That instruction should have been
11 included," and we've got a big problem for a reversal.

12 MR. KAVALER: No, your Honor. I'm positing you get a
13 plaintiffs' verdict. I'm saying if you get a plaintiffs'
14 verdict, then there's no issue.

11: 31: 55 15 THE COURT: Sure, but let's look at -- I have to look
16 at -- both sides, unfortunately.

17 MR. KAVALER: I agree. I'm trying to get there.

18 THE COURT: Okay.

19 MR. KAVALER: So, the question is for the plaintiffs,
11: 32: 01 20 your Honor. If they think it is worth the risk of including
21 this language, and they press for it, they create a situation
22 of their own making.

23 If they, rather, think they're better off without
24 this language, they create a different situation. I'm merely
11: 32: 16 25 pointing out that what you're really dealing with here is a

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1 practical question about a sentence in a Seventh Circuit
2 opinion, which the parties have differing views as to what it
3 means and how it is to be applied, whether it's a holding or
4 not a holding.

11: 32: 30 5 It's clearly not a holding. And the question is
6 predicting what the Seventh Circuit will do when they see that

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7 issue, again.

8 My point is simply Mr. Bley drew a matrix on the
9 board yesterday. This is a matrix situation. And I'm just
11:32:43 10 suggesting that people should think about it as a practical
11 matter of what the consequences are, appreciating your Honor's
12 point it could be error either way. I understand that.

13 The question is: Who wants to be arguing which side
14 of that error, based upon if error it is, because one way or
11:33:00 15 the other it's error, based upon what everybody thinks about
16 everything else in the case.

17 What I'm saying is, it does tie into the motion. If
18 the factual record survives the motion, my suspicion is it
19 will be barely. And in a case where the factual record barely
11:33:17 20 survives the motion, the Court, I respectfully submit, should
21 err on the side of caution. That's my only observation.

22 THE COURT: I understand your argument and it's one
23 of my pet peeves. I don't know that I acted any differently
24 when I was a trial attorney; but, as I sit up here now, I
11:33:36 25 often think to myself: "Why? Why?"

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1 The chances that they're going to win this case on
2 this instruction and nothing else are about like that
3 (indicating); and, the door for an argument on appeal, that
4 they're opening up, is like this (indicating).

11:33:57 5 What's the risk benefit here?

6 But that's not my decision to make. It's not my
7 decision to force on a case. That's the decision for the
8 litigants to make.

9 And I could say the same thing about defendants, as
11:34:09 10 well, frankly, on many occasions. But more so the plaintiffs
11 usually.

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12 So, given that they're asserting this theory of
13 liability, it seems to me that -- I think that the Makor or
14 Makor case language tells us what the law is, or is likely to
11: 34: 29 15 be, as close as we can come in this circuit when it arrives up
16 there. And I think that's the language that we should use in
17 instructing the jury.

18 I think we should tell them -- and how we put it in
19 here is a different matter. I mean, I'm looking at a false or
11: 34: 47 20 misleading statement instruction, where we talk about, "The
21 plaintiff must prove that the defendant made a false or
22 misleading statement." Not necessarily so.

23 I mean, "made," "issued," "ordered," "provided false
24 information to be included in," I think there's evidence as to
11: 35: 12 25 most of those. And it seems to me that that's a place where

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1 we start incorporating this language.

2 Go ahead.

3 MR. BURKHOLZ: Well, I don't know if we need to do
4 that. I think the defendant is Household. They make the
11: 35: 31 5 statements. Their scientist is what we're struggling with --
6 the definition.

7 THE COURT: That's one defendant. But unless I'm
8 mistaken, there was a substantial amount -- or you asked a
9 substantial number -- of questions of -- oh, who was the lady
11: 35: 44 10 that --

11 MR. BURKHOLZ: Ms. Hayden-Hakes.

12 THE COURT: Yes, Ms. Hayden-Hakes.

13 -- about who told her to say this and did she have
14 knowledge or did she get the knowledge from somebody else, as
11: 35: 54 15 to the various public statements that she made.

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16 Are those statements attributable to the defendant
17 that gave her the information to include in the statements?

18 MR. BURKHOLZ: Well, the statements are attributable
19 to the company that she's making.

11: 36: 10 20 THE COURT: Yes.

21 Are they attributable to the defendant who told her,
22 "Go out there and say that there's no predatory lending"?

23 Are you going to argue that? Is Mr. Dowd going to
24 argue that in closing? Is he going to say, "He told her to

11: 36: 24 25 say those things"?

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1 MR. BURKHOLZ: That goes to the scienter issue of the
2 company.

3 THE COURT: It goes to the making of the statement
4 issue, as well.

11: 36: 30 5 MR. BURKHOLZ: Well, that's the company's statement;
6 and, the scienter of the company, you look at the --

7 THE COURT: So, you are not going to argue that when
8 Mr. Gilmer said to Ms. Hayden-Hakes, "Go out there and make
9 this statement," but when they got together and discussed it
11: 36: 49 10 and when they put together the statements that she was going
11 to issue to the press, that the statements she subsequently
12 made were statements also made by Mr. Gilmer, that he can be
13 held accountable for those?

14 You're not going to argue that? You're just going to
11: 37: 06 15 argue that the corporation can be held liable?

16 MR. BURKHOLZ: Right. The individual defendants are
17 liable for the company's statements.

18 THE COURT: Gee, there you go. Okay.

19 So, you're going to argue just the company's liable;
11: 37: 23 20 and, then, you're going to, because the company is liable for

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21 that statement, say that you're going to impute the company's
22 intent to Mr. Gilmer and to Mr. -- well, the other defendants?

23 MR. BURKHOLZ: Aldinger and Schoenholz.

24 THE COURT: Yes.

11: 37: 40 25 Is that your theory?

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1 MR. DOWD: Your Honor, I think it depends which
2 statements we're talking about.

3 I mean, the issue I think --

4 THE COURT: I'm asking but all them because I want to
11: 37: 51 5 know if I should instruct the jury as to all them.

6 MR. DOWD: I understand, your Honor.

7 I think it's -- I mean, I think it's true that the
8 defendants, to the extent that they're involved in furnishing
9 the statements, they're liable for them.

11: 38: 05 10 THE COURT: Well, the instruction we have right now,
11 you know, just says, "prove that the defendant made a false or
12 misleading statement of fact or omitted a fact that was
13 necessary"; and, if that's the case, then -- and if that's all
14 there is -- and I don't know that the statements made by any
11: 38: 24 15 of their subordinates, that were -- that they ordered or
16 issued or provided the information for, are statements that
17 they would be liable for.

18 MR. BURKHOLZ: Well, but we have the -- I think it's
19 the -- respondeat superior statement that talks about the
11: 38: 44 20 company is --

21 THE COURT: You're focusing on the corporation's
22 liability. I'm focusing right now on the individual
23 defendants. Okay?

24 What I don't want is for Mr. Dowd to get up and

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11: 38: 56 25 argue, "You know, Mr. Gilmer told Ms. Hayden-Hakes to supply

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1 this information to the press." She did it and that's a false
2 and material misleading statement by him. And for the
3 defendants to get up and say, "Objection. It's not what the
4 instructions say. Objection, your Honor." He shouldn't even
11: 39: 17 5 be allowed to argue that.

6 And for the jury, then, to go back with no guidance
7 on that -- because I have -- I mean, unless those questions
8 you were asking her about -- where she got the information and
9 who told her to make the statement and whether she had
11: 39: 30 10 independent knowledge of the truth or falsity of the statement
11 she was making -- were going nowhere, I assumed that you were
12 going to make that argument.

13 If you're not, that's fine. I'd rather not instruct
14 the jury.

11: 39: 54 15 But if you are going to make that argument, then I
16 think we need to instruct the jury as to, essentially, the
17 language in the Makor case, that that's what we're talking
18 about. We're talking about -- I think other cases have called
19 it -- "substantial participation."

11: 40: 22 20 And the corporation, it seems to me, is the same
21 language with respect to scienter. If it fits within that
22 Makor language, how do we instruct on that? There's a
23 different --

24 MR. DOWD: I think --

11: 41: 01 25 THE COURT: We find the defendants' instruction,

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1 where?

2 MR. BURKHOLZ: It's on Page 60- -- I think it starts
Page 25

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3 on Page 63 of their red-lined version -- 63 of their red-line
4 version. The language that they have proposed is on the
11:41:18 5 bottom of 64, running into 65 of their red-line version they
6 propose.

7 THE COURT: So, what about their language do you
8 oppose?

9 MR. BURKHOLZ: The -- I guess the -- what's missing
11:43:48 10 is the "or furnishing information or language for inclusion"
11 in the statement, which would go on the top of Page 65 after
12 "In making a false statement or omission of material fact."

13 MS. BEER: We object, your Honor, to the addition of
14 that language as being unsupported by controlling law in the
11:44:22 15 Seventh Circuit and not supported by the factual record of
16 this case.

17 THE COURT: Then what do we tell the jury about scope
18 of employment? Do you think they know what that is?

19 Does the defense have a definition for "scope of
11:45:15 20 employment" language?

21 MS. BEER: We did not include a definition of the
22 language on the assumption that it is relatively common
23 terminology that --

24 THE COURT: Well, among lawyers, I'm sure it is; but,
11:45:45 25 I don't know too many lay people who walk around talking about

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1 scope of employment, do you?

2 Well, I mean, in my circles they don't, maybe in your
3 circles --

4 (Laughter.)

11:46:02 5 THE COURT: -- I don't know.

6 Actually, I think I lost a page here: "Was acting

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7 within the scope of his or her employment. "

8 Well, I guess I could suggest language from the

9 Illinois pattern jury instructions, which reads something

11:46:34 10 like, "An agent is acting within the scope of his authority if

11 he is engaged in the transaction of business, which has been

12 assigned to him by his principal; or, if he is doing anything

13 which may reasonably be said to have been contemplated as a

14 part of his employment.

11:46:57 15 "It is not necessary that an act or failure to act

16 must have been expressly authorized by his principal. "

17 MR. BURKHOLZ: That's fine with plaintiffs.

18 MS. BEER: We have no problem with the language, your

19 Honor.

11:47:18 20 Where would this fit into the instruction?

21 THE COURT: I don't know. You folks are proposing

22 the instructions. I guess it would fit in about where -- or

23 it may be a separate instruction to add after the instruction

24 on scienter.

11:48:08 25 MS. BEER: It might make sense, then, your Honor, to

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1 pull all of the material, rather than doing a separate

2 instruction only on the scope of employment, to put -- pull --

3 all of the material on the imputation of an employee's state

4 of mind to the corporation, into that separate instruction.

11:48:38 5 THE COURT: Yes, there's a lot of ways of doing it

6 for sure. I have no preference, one way or the other. I

7 think that first we need to go back and revisit the language

8 on the first element of the 10b-5 claim, to include language

9 in the Makor case, which makes perfect sense to me.

11:49:18 10 I mean, it just makes -- it's just logical that an

11 individual defendant's liability for violating the rules

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12 against fraud in the sale of securities, should not depend on
13 whether he, himself, actually uttered the words that caused
14 the violation, but should also be assigned to him if he
11: 49: 54 15 provided the information for that purpose or ordered someone
16 else to do it or directed someone else to do it.

17 I can't -- it would be a really crab reading, I
18 think, of the statute, not to conclude that.

19 And, then, with respect to scienter --

11: 50: 24 20 MS. BEER: Can we back up to that just for a moment,
21 your Honor? I'm sorry to interrupt.

22 If that language is introduced, what's the point of a
23 20-A claim? Maybe I'm missing something in this, but I don't
24 see the distinction between "imposing liability on an
11: 50: 44 25 individual defendant for statements he did not make" and

3856

1 "imposing liability on that individual defendant, as the
2 controlling person who caused someone else's statements."

3 THE COURT: Well, I don't think it's quite the same
4 thing. For example, "controlling person" depends on
11: 51: 10 5 establishing a primary liability. So, if the theory is that,
6 for example, Mr. Gilmer is liable for what Ms. Hayden-Hakes
7 said, you would first have to establish that Ms. Hayden-Hakes
8 committed a liability -- was liable; committed a violation of
9 10b-5. And if she did not have the requisite intent or
11: 51: 31 10 scienter, that fails. It's a non-starter. It doesn't even
11 get there.

12 So, whether he's her controlling person or not
13 doesn't bring liability on him.

14 I think "controlling person" is for a slightly
11: 51: 46 15 different situation. I mean, it's for the situation where

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16 Ms. Hakes actually had the Full Monty, if you will. She made
17 the statement, she knew it was false, she had the intent, she
18 had everything. And Mr. Gilmer was her controlling person.
19 This is exactly the opposite situation, really -- what we're
11: 52: 11 20 talking about.

21 We're talking about -- we're talking about -- sending
22 liability in a different direction in the situation that we're
23 involved in.

24 MS. BEER: If we started off talking about the
11: 52: 28 25 individuals who provided information to the individual

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1 defendants --

2 THE COURT: That's not what we're talking about.
3 We're talking about the individual defendants as the
4 individuals who provided information to those who are not
11: 52: 40 5 defendants.

6 Mr. Gilmer, who is a defendant, providing information
7 or instruction or instructing or ordering Ms. Hakes to tell a
8 lie; to commit a fraud under 10b-5 -- which, I think, is the
9 whole crux of the cross-examination that they were doing of
11: 53: 03 10 Ms. Hakes -- as to whether she knew the truth of what she was
11 saying as to where she got the information, who it came from.

12 I don't see how, given that situation, we're somehow
13 eradicating "controlling authority" liability.

14 MS. BEER: We started off with attempting to analyze
11: 53: 36 15 the instructions in which the corporation can be found to have
16 a wrongful state of mind on the basis of the actions of
17 employees who did nothing but provide information to someone
18 else who made a statement.

19 THE COURT: Okay.

11: 54: 03 20 MS. BEER: Now, we're talking about providing --
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21 finding liability on the part of an individual defendant
22 who -- for a statement that individual defendant did not make,
23 on the basis that that individual provided information to
24 someone else who did speak.

11: 54: 29 25 Am I following that correctly? It seems we've

3858

1 shifted to something quite different.

2 THE COURT: Well, we're talking about two things.

3 Along the way, it struck me -- as I was looking at the
4 scienter materials, based upon the conversation we had last
11: 54: 44 5 time -- that the language that the Seventh Circuit used in its
6 scienter discussion also applied to the making of a statement.

7 I mean, they talked about not only uttering the
8 statement, but providing information for it, and so on.

9 And, so, it appeared to me that it would be necessary
11: 55: 06 10 or appropriate to go back to our instruction on making a false
11 or misleading statement and include that language in it.

12 Ultimately, we're back at where we started out, which
13 is imputing the scienter to the corporation and how we should
14 instruct there. And it shouldn't surprise anyone that some of
11: 55: 34 15 the same language applies to both questions.

16 So, it's not as if I started out saying one thing or
17 doing another. It's that the language led me to consider
18 something else and I brought it up here.

19 MS. BEER: I think it may be that a part of the
11: 55: 52 20 difficulty comes from attempting to break the cause of action
21 down into the elements. Because the act that provides a basis
22 for liability includes both the making of a statement and the
23 wrongful state of mind; and, by atomizing those into separate
24 elements to be analyzed, we're separating -- we're maybe

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11:56:16 25 separating -- them too far.

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1 And if we end up with a situation where one person
2 does the statement -- makes the statement -- and another
3 person has the state of mind, it's one thing to talk about
4 that going up to the corporation, and quite another thing to
11:56:31 5 say that someone who didn't make the statement can now have --
6 that liability can be imposed on someone who didn't make a
7 statement, without finding the elements of the cause of action
8 as to that individual.

9 THE COURT: Well, I mean, the argument seems to me
11:56:49 10 you're making -- and now we are talking about the individual
11 liability -- is that if -- I hate to pick on him, but, again,
12 let's use Mr. Gilmer.

13 If Mr. Gilmer said to Ms. Hakes -- if Mr. Gilmer
14 believed in his heart of hearts and his mind that the company
11:57:08 15 was involved in predatory lending practices and he said to
16 Ms. Hakes, "Go out there and tell them we're not involved in
17 any such thing," that he would not be liable under 10b-5.

18 Is that your argument?

19 MS. BEER: No, that's not my argument.

11:57:22 20 THE COURT: Okay.

21 Well, that's all I'm saying is that by including the
22 language in our "false or misleading" instruction -- "ordered
23 approved or furnished information to be included in the
24 statement" -- the person can be liable, assuming that all the
11:57:45 25 other elements are met, as well, of course.

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1 That's all I'm saying. I don't find that to be a
2 radical proposition.

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3 But I guess I'm misunderstanding your argument. What
4 --

11: 58: 12 5 MS. BEER: Yes, I can understand the note.

6 MR. HALL: Your Honor, I think maybe the confusion is
7 that we're talking about statements made by the corporation.
8 And I think the only reading of 10b-5 is that the only
9 primary -- primarily -- liable party for a statement by a
11: 58: 25 10 corporation is the corporation. Anybody else you want to
11 impute liability to has to come in through 20-A. So, that's
12 the secondary liability issue. I think there's two layers.

13 MR. BURKHOLZ: I don't think that's correct. There's
14 "substantial participation" language in a number of cases. I
11: 58: 46 15 think we might have even proposed some language with our
16 initial instructions.

17 But if the individual defendants substantially
18 participate in the making of a statement by the company, or
19 somebody else on behalf of the company, they can be held
11: 58: 59 20 liable. And that's the --

21 MR. HALL: I think that's a separate issue, your
22 Honor. I just want to make sure we're separating out the
23 issues.

24 THE COURT: Well, I think that's the issue I was
11: 59: 08 25 talking about. I mean, I think -- I hope -- that's the issue

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1 I was talking about.

2 MR. BURKHOLZ: That is.

3 MR. DOWD: Your Honor, I took what you were saying
4 was that the scienter issue as to the corporation that led you
11: 59: 28 5 to wonder about the false statement one because you have to
6 have the substantial participation issue covered.

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7 THE COURT: Yes.

8 MR. DOWD: And we agree with that.

9 THE COURT: Yes.

11:59:36 10 I mean, the language in the Seventh Circuit opinion
11 just immediately popped into my mind, that we're not just
12 talking about with scienter here, we're talking about the
13 actual acts, as well: Who makes the statement? Who makes the
14 statement?

11:59:55 15 And only individuals make statements, you know. We
16 can -- then the corporation can derive liability from that,
17 but you also have the liability of the individuals. And, so,
18 we have to clearly define when they're deemed to have made a
19 statement.

12:00:09 20 And it's not just that they opened their mouths and
21 told the press. It can also be that they told someone else to
22 tell the press. And that's all. That's all I'm saying here.
23 That's why I went back to that false and misleading and said,
24 "We should add this language, I think, and make it clear."

12:00:26 25 But now getting back to the corporate liability and

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1 the scienter issue, it appears that the language that you have
2 in 64 and 65 is -- starting on the last paragraph on Page 64
3 and going on to Page 65 -- there's not a great deal of
4 disagreement with that; is that correct?

12:01:07 5 MR. BURKHOLZ: That's correct. It's just the
6 "furnishing information or language for inclusion in the
7 statement" that's missing, that's, you know, from the Tellabs
8 case.

9 But, otherwise, the rest of it's fine, except for, of
12:01:19 10 course, the last paragraph of the instruction. And we
11 probably could add in the definition of "scope of employment"

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12 after the -- that -- sentence that discusses it.

13 MS. BEER: Yeah, we've come full circle, but I just
14 want to reiterate our objection to adding the "furnishing
12: 01: 51 15 information" language into the instruction.

16 THE COURT: Yes, it's on the record.

17 And I think we have to give an instruction on the
18 scope of employment. I don't think you can leave that to the
19 jury, unless the parties want to stipulate that there's no
12: 02: 20 20 issue as to scope of employment in this case.

21 I, frankly, think this is a case where there's no
22 issue as to scope of employment. I don't think anybody that
23 has been named here can reasonably be argued not to fit within
24 the definition of "doing something that he was assigned to do"
12: 02: 40 25 or that "might reasonably be said to have been contemplated as

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1 part of his employment" -- any of the people that the
2 plaintiffs have named.

3 But if there's no agreement on that, then I think
4 this instruction tells the jury how to determine whether
12: 03: 00 5 that --

6 MS. BEER: We'd be happy to consider a stipulation,
7 if we have a specific list of the individuals and the
8 communications that the plaintiffs intend to bring within the
9 scope of it.

12: 03: 12 10 An open-ended stipulation might be a little bit more
11 problematic.

12 MR. BURKHOLZ: I would just propose that we include
13 the language from the pattern instruction regarding "scope of
14 employment," so the jury has a better understanding of what
12: 03: 23 15 that might be within the context of this instruction.

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16 THE COURT: Okay.

17 And do you want to take a turn at preparing a
18 scienter instruction that complies with what we discussed
19 here?

12: 03: 48 20 MR. BURKHOLZ: We will.

21 Should we also take a shot at the first element --
22 revising that?

23 THE COURT: I'm sorry?

24 MR. BURKHOLZ: Should --

12: 04: 04 25 THE COURT: If you want to try to -- yes.

3864

1 I think we can move, then, to "Loss causation."

2 MR. BURKHOLZ: We're fine with the Court's
3 instruction.

4 THE COURT: Let me try to find the defendants'.

12: 05: 03 5 MR. BURKHOLZ: Page 73 of their mark-up.

6 THE COURT: Thank you.

7 By the way, the language about "scope of employment"
8 came out of Illinois Pattern Jury Instruction 50.06, the 2006
9 Edition, with very, very, very little modification.

12: 06: 49 10 MS. BEER: The changes that defendants have proposed
11 in that instruction, your Honor, are intended to make clear to
12 the jury that, "Loss causation must be proved as to a
13 particular false statement or omission."

14 THE COURT: Okay.

12: 07: 23 15 MS. BEER: And, in fact, if I might, we have some
16 additional language that we'd like to propose in the final
17 paragraph of our proposed instruction.

18 THE COURT: Give me a second to finish looking
19 through it.

12: 10: 11 20 (Brief pause.)

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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,

vs.

HOUSEHOLD INTERNATIONAL, INC.,
et al.,

Defendants.

No. 02 C 5893

Chicago, Illinois
April 27, 2009
1:25 p.m.

VOLUME 19
TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a jury

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THE CLERK: 02 C 5893, Jaffe v. Household.

THE COURT: Good afternoon, everyone.

Give me a second.

(Brief pause.)

01:28:00

THE COURT: Okay. I think I have the plaintiffs'

latest submission here. We can just go over those.

MR. KAVALER: Your Honor, if I may? Just so we can
Page 2

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3 MR. BURKHOLZ: Yes.

4 MS. BEER: Yes, your Honor.

02: 29: 50 5 THE COURT: I think it was in here, in my proposed
6 instructions, because somebody, if not both of you, submitted
7 a summary instruction. But that will be withdrawn.

8 Court's next is No. 19, previously 18, demonstrative
9 exhibits. I don't believe there's an issue as to that one.

02: 30: 26 10 MR. BURKHOLZ: There is not.

11 MS. BEER: No, your Honor.

12 THE COURT: Next is Court's No. 20, previously
13 No. 19, multiple claims, multiple defendants.

14 MR. BURKHOLZ: I think we addressed this already, and
02: 30: 42 15 I think this was what the Court decided.

16 MS. BEER: Defendants' requested instruction No. 21
17 included language that I believe has been now adopted into
18 other instructions. So we have no objection to the Court's
19 No. 20.

02: 31: 05 20 THE COURT: Okay.

21 Next is Court's instruction No. 21, previously
22 Court's No. 20, dismissed/withdrawn defendant.

23 MR. BURKHOLZ: I think we covered that in the later
24 instruction on the elements regarding Andersen. So the
02: 31: 35 25 Court's current instruction, I think, is appropriate.

4003

1 THE COURT: I believe so.

2 MS. BEER: Provided the language appears in the
3 instruction on the 10b-5 elements, which, I believe, is where
4 we discussed it on Friday.

02: 31: 52 5 MR. BURKHOLZ: It's in there.

6 MS. BEER: After we finished discussing it.

7 We have no objection to the Court's instruction
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8 No. 21, previously 20, so long as the language is in the later
9 instruction.

02: 32: 06 10 THE COURT: Next is Court's 22, previously No. 21,
11 burden of proof.

12 MR. BURKHOLZ: No objection.

13 MS. BEER: No objection.

14 THE COURT: Next is Court's 23, previously 22.

02: 32: 46 15 MS. BEER: Defendants have no objection to the
16 additional language in the second paragraph of this
17 instruction.

18 We do object to the revisions to the third paragraph,
19 which is the first -- the description of the first 10b-5
02: 33: 01 20 element. And we request that that paragraph be given as
21 provided in defendants' requested instruction No. 25.

22 The language is, "First, that during the relevant
23 time period between July 30, 1999, and October 11, 2002, the
24 defendant made a false or misleading statement of fact or
02: 33: 25 25 omitted a fact that was necessary in light of the

4004

1 circumstances to prevent a statement that was made from being
2 misleading."

3 MR. BURKHOLZ: I think we covered this in detail last
4 week, your Honor. This is the language I thought we came up
02: 33: 38 5 with, and that's why I added it in.

6 MS. BEER: We did have an extended discussion of it,
7 your Honor, but I don't believe we reached agreement on it.

8 THE COURT: Okay. Well, this is the language I
9 recall that the Court settled on. So we'll give it like that.

02: 33: 58 10 MS. BEER: We object to that language, your Honor, as
11 being legally incorrect.

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12 THE COURT: Very well.

13 MS. BEER: We know of no authority, your Honor, and I

14 don't believe the plaintiffs have provided any, for the

02: 34: 10 15 imposition of 10b-5 liability on any actor who has not made a

16 material misrepresentation or false or misleading statement.

17 THE COURT: Okay.

18 MS. BEER: In particular, your Honor, if I could

19 refer the Court to the decision of the Supreme Court in

02: 34: 28 20 January 2008 in the StoneRidge Investment case, in which the

21 Court specifically addressed the question of liability for an

22 actor who did not make a direct statement to the plaintiffs

23 and rejected that theory.

24 THE COURT: Well, as I recall, the Seventh Circuit

02: 34: 49 25 cases subsequent to that -- and I think before that as well --

4005

1 indicate that if someone authorizes or provides information to

2 be used in a false statement for that purpose, that that

3 person is liable.

4 It would be, indeed, I think ironic if all corporate

02: 35: 23 5 officers could shield themselves completely from 10b-5

6 liability by simply hiring innocent spokespersons, press

7 relations people, intentionally giving them false information

8 and then telling them to provide that information to the

9 public. It just doesn't make any sense to me.

02: 35: 57 10 MS. BEER: In that scenario, your Honor, those

11 individuals would not be shielded from liability because a

12 20(a) claim would lie.

13 THE COURT: Not necessarily.

14 MR. DROSMAN: Moreover, your Honor, StoneRidge has no

02: 36: 10 15 applicability to this case. StoneRidge dealt with a

16 third-party, I believe, supplier. It had nothing to do with

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3 thing they're going to be asked to determine as they go
4 through as to each statement is whether it's true or false,
04: 52: 17 5 whether they've established the falsity of the statement; and
6 if they haven't, they don't have to do the other columns.
7 They just go straight down to the next one.

8 If it turns out to be as you hope and suspect, that
9 the vast majority of findings will be that there's no falsity
04: 52: 32 10 in these statements, it will be just as quick. It will be
11 just as quick putting it all in one form for them to check off
12 the columns than have them go through it three times.

13 And hopefully it will be less daunting for them as
14 they look at the form that they have to go through. So we
04: 52: 52 15 only have to do this once. Let's get to it.

16 So that would be my suggestion.

17 The other suggestion I guess we can -- we can table
18 until we get your -- you're going to make a submission, I
19 guess, on need to establish the disclosure dates for purposes
04: 53: 14 20 of preserving the issue of determining the cap, which will
21 come at another point in time.

22 If we end up submitting that to the jury, which is my
23 predilection now, question number 17, where you have that
24 issue, I think we need to, although much can be identified
04: 53: 44 25 from looking at the record, I think you need to add as to each

4066

1 event what issues are involved, predatory lending,
2 restatement. Otherwise, we may not -- I mean it's possible
3 that you have a disclosure as to predatory lending, but not as
4 to restatement or re-aging or credit card statements, and so
04: 54: 17 5 we won't be establishing a date for each of those three.

6 Many of these statements only relate to one topic;
7 but it would be good, I think, to put in the description of

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8 the event the issue as to which the jury is finding that there
9 was disclosure on that date.

04: 54: 40 10 Are you following me?

11 MR. DROSMAN: Yeah, I think I understand what you're
12 saying.

13 Can we just back up for one moment? I know it's
14 getting late. I just wanted to make one point.

04: 54: 48 15 THE COURT: I hadn't noticed.

16 MR. DROSMAN: And this bears on what you were
17 discussing. It's sort of captured in questions number 3 and 6
18 and 9 and 12 and 15, I think.

19 And that's the issue -- I understood how you asked us
04: 55: 03 20 to put it in a landscape format, sort of incorporate these
21 into one question rather than making them three, but my
22 question is --

23 THE COURT: You don't have to put it in landscape
24 format. If you can get it in the way it is, that's fine. I'm
04: 55: 17 25 just saying if we need to spread it out, I would rather -- I

4067

1 don't particularly like that format, but I would rather do
2 that so they only have to go through the list once.

3 MR. DROSMAN: Right, right.

4 I guess my concern was that by asking them to
04: 55: 29 5 delineate why the statement is false or the basis, the reason
6 for the falsity, what we're doing is we're imposing on the
7 jury a step that isn't required by the law. And I spent some
8 time this weekend researching this issue to try to find out
9 whether -- to try to see whether I could see other instances
04: 55: 50 10 where plaintiffs were required to explain or prove why the
11 jury found a particular statement false and misleading.

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12 And I surveyed the civil cases on the issue. I
13 couldn't find a single case where plaintiffs were required to
14 prove why.

04:56:06 15 And I'm not sure that -- I mean I read the 10(b) and
16 then Rule 10b-5, and neither of those two statutory
17 requirements contemplate a basis for the falsity. What they
18 ask is was it materially false and misleading, which I think
19 your first question asks; and if it's materially false and
04:56:26 20 misleading, I understand why we need to understand why --
21 whether it was reckless or knowing because you may or may not
22 apportion liability based on that finding.

23 But the issue of the reason or the basis for the
24 falsity is not found anywhere, and here's the concern. You
04:56:45 25 have this question number three and the jury gets to it, and

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1 you have a lively discussion, let's just hypothetically say on
2 statement number one.

3 THE COURT: Question number three is?

4 MR. DROSMAN: Question number three is check all that
04:56:58 5 apply. For each of the statements to which you answered yes,
6 why was the statement false or misleading? Check each that
7 applies.

8 So then you've got statement number one, predatory
9 lending, two-plus delinquency or restatement. And you could
04:57:09 10 imagine a scenario where the jurors go back there and five
11 feel very strongly that it was false and misleading for all
12 three of those reasons, and five feel very strongly that it's
13 false and misleading for only one of the reasons, and then you
14 have a hung jury over an issue that isn't even a requirement
04:57:27 15 under the statute, and that's the concern.

16 THE COURT: Well, let me tell you why we need to do
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17 that because you just brought it up.

18 Statement number one includes how many different

19 issues as to which the jury you could find that the statement

04: 57: 38 20 was false?

21 MR. DROSMAN: Three.

22 THE COURT: How do we know which one? How could we

23 know that all of them agreed to one?

24 MR. DROSMAN: We don't.

04: 57: 46 25 THE COURT: Maybe two agreed to delinquency

4069

1 restatements and eight agreed -- disagreed with that.

2 MR. DROSMAN: Right.

3 THE COURT: And agreed to predatory lending, and we

4 have no unanimity of a finding.

04: 57: 59 5 MR. DROSMAN: But we do. We have unanimity.

6 THE COURT: No, we don't.

7 MR. DROSMAN: What you have is you have unanimity

8 that they made a materially false and misleading statement.

9 You don't need unanimity as to the reason that that statement

04: 58: 13 10 was false and misleading.

11 THE COURT: I disagree, period. I disagree.

12 MS. BEER: The other danger, your Honor --

13 THE COURT: I think that's a formula for reversal.

14 MR. DROSMAN: I'm sorry?

04: 58: 19 15 THE COURT: I think that's a formula for reversal.

16 MR. DROSMAN: I searched the cases. There's nothing

17 I could find that talked about that issue.

18 THE COURT: How many cases did you find that talk

19 about it at all?

04: 58: 30 20 MR. DROSMAN: 36 discuss -- you know, had something

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21 to do with the issue.

22 THE COURT: And how many made findings and how many
23 went up and were either confirmed or reversed?

24 MR. DROSMAN: Yeah, I mean there's no case on point.

04: 58: 43 25 I freely admit that.

4070

1 THE COURT: That's right. That's right.

2 You want to break out each one of these statements

3 and make it 80 statements or 120, otherwise, we're going to

4 check as to what -- which statement and why. I think it's the

04: 59: 01 5 only way to do it. I just think it's the only way to do it.

6 Will we be through tomorrow with the evidence?

7 MR. KAVALER: Your Honor, we, as I mentioned earlier,

8 we're calling one more witness. We've told them who it is,

9 Professor Bajaj. There's no secret about it. Then we're

04: 59: 21 10 going to rest.

11 I understand they may or may not call Professor

12 Fischel. It's my expectation we'll be through with all the

13 evidence tomorrow, as far as we imagine either one of our

14 times, Professor Bajaj won't take any more than that.

04: 59: 33 15 THE COURT: Okay. Well, then, if that's the case, I

16 suspect that we're going to have to give the jury a day off

17 while we finalize the instructions and then bring them back on

18 one day for closing arguments and instructions.

19 MR. KAVALER: I'm sorry. Today is Monday, so if we

04: 59: 46 20 finish the evidence tomorrow, give them a day off, it will be

21 Thursday.

22 MR. BURKHOLZ: That makes sense, your Honor.

23 MR. KAVALER: Okay.

24 THE COURT: Yeah, it will be. I mean if you think

04: 59: 56 25 that we can finish the instructions --

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1 MR. KAVALER: You said Wednesday. I thought I heard
2 you say give them a day off and come back Wednesday.

3 THE COURT: No. I think I said another day, which
4 may have sounded like Wednesday.

05:00:08 5 MR. KAVALER: Sorry, Judge.

6 So the plan is to sum up on Thursday.

7 THE COURT: So far.

8 MR. KAVALER: Or later.

9 THE COURT: I -- no, not later.

05:00:17 10 MR. KAVALER: Not Wednesday is my question.

11 THE COURT: It's not likely to be Wednesday, I don't
12 think.

13 MR. KAVALER: Can we rely on that, or should we be
14 prepared?

05:00:25 15 THE COURT: I mean I suppose if you folks send me
16 back a set of revised forms and instructions that you've given
17 to opposing counsel and they agree with all of them and there
18 are no objections or changes and I read the submissions that
19 you make and I agree with everything you say and so nothing

05:00:45 20 has to be changed and we all agree as to which of these
21 statements are going to go to the jury and which aren't, and
22 if all those things are resolved in time, between the time
23 that you finish the evidence tomorrow and Wednesday morning, I
24 guess we could go to the jury on Wednesday.

05:01:11 25 MR. KAVALER: Your Honor, do you want the flying pigs

4072

1 to stop in the courtroom or outside?

2 THE COURT: Yeah, but that's -- so --

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A516

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3 MR. KAVALER: Fair enough.

4 THE COURT: -- I don't envision it happening.

05:01:23 5 MR. KAVALER: We'll plan on Thursday.

6 THE COURT: I think that would be a wise move.

7 MR. KAVALER: And I assume, your Honor, just as with
8 the openings, there are no specific time limits. We're each
9 limited by our remaining portion of our 44 hours.

05:01:33 10 THE COURT: Let's talk about that. I don't want --
11 no, I don't want 44 hours of argument. I don't want ten hours
12 of argument. I don't want 12 hours of argument.

13 You folks tell me how much time you think you need.

14 You might want to go back to some of the 7th Circuit writings.

05:01:53 15 I think they have opined on how many notes the human mind can
16 adequately cope with. There may just be too many notes in
17 what you're planning. And come up with a reasonable period of
18 time for your closing arguments. We're not going to do an
19 unlimited number of hours left over. Not going to do that.

05:02:17 20 But certainly it's a long case, and I'll be
21 reasonable.

22 Okay, anything else?

23 MR. BURKHOLZ: No.

24 MR. DROSMAN: No, your Honor.

05:02:25 25 THE COURT: Thank you.

♀

4073

1 MR. KAVALER: 9:00 o'clock tomorrow, your Honor?

2 THE COURT: Excuse me?

3 MR. KAVALER: 9:00 o'clock tomorrow?

4 THE COURT: Yes, sir.

5 MR. KAVALER: Okay. Thank you.

6 (Court adjourned, to reconvene at 9:00 a.m. on 4-28-09.)

7 * * * * *

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C E R T I F I C A T E

We certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

/s/ Nancy C. LaBella

/s/ Kathleen Fennell

Official Court Reporters
United States District Court
Northern District of Illinois
Eastern Division

April 28, 2009

Date

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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,

vs.

HOUSEHOLD INTERNATIONAL, INC.,)
et al.,)

Defendants.)

No. 02 C 5893

Chicago, Illinois
April 28, 2009
9:10 a.m.

VOLUME 20
TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a jury

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THE CLERK: 02 C 5893, Jaffe v. Household.

THE COURT: Good morning, everyone.

Are we ready to proceed with the jury?

MR. KAVALER: Your Honor, you asked us to hand up --

09:10:16 I thought I'd hand you before we start -- the spoliation

language --

THE COURT: Sure.
Page 2

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12 Q. So this shows us the price of Household stock declining?

13 A. It shows price of Household stock going up for part of the
14 period and going down for part of the period.

10: 13: 22 15 Q. Does -- I'm sorry.

16 A. And the period it went down, in light of what we talked
17 about the economic environment, is not at all surprising.

18 Q. Does it tell us anything whatsoever about inflation?

19 A. It has nothing to do with inflation.

10: 13: 35 20 Q. Nothing to do with it.

21 In preparing your analysis, Professor, that you're
22 testifying about here today, did you identify other consumer
23 finance companies as a first step to conducting your analysis?

24 A. Yes, I did.

10: 13: 50 25 Q. How did you do that? How did you identify these consumer

Bajaj - direct

4113

1 finance companies?

2 A. So there is an industry code assigned by the government to
3 various publicly traded companies based on what is their major
4 line of business. It's called GCIS code. And according to
10: 14: 11 5 Standard & Poor's, Household belonged to a certain GCIS code
6 along with six other companies that traded over the relevant
7 period.

8 So I looked at those six companies with the same GCIS
9 code as a first step in my statistical analysis to put
10: 14: 37 10 Household's stock price movements in context.

11 Q. And that's a code provided by the United States
12 government?

13 A. Yes.

14 Q. And Standard & Poor's tells you what companies fall within
10: 14: 49 15 that code?

16 A. Yes. And this is a very, very, very well-accepted and

04-28-09 Volume 20

17 commonly used methodology to start to look for comparable
18 companies.

19 Q. And how did Household's stock price perform relative to
10:14:59 20 other consumer finance companies during the same time period?

21 MR. BURKHOLZ: Objection, vague as to time.

22 MR. KAVALER: I'll specify.

23 BY MR. KAVALER:

24 Q. During the period between July 30, 1999 -- I'll do even
10:15:14 25 better than that.

Bajaj - direct

4114

†
1 Did you look at how Household's stock price performed
2 during the period from July 30, 1999, to October 11, 2002, in
3 relationship to the other companies which fall within this
4 government code called GCIS and are identified as being
10:15:33 5 consumer finance companies?

6 A. Yes, I did. And what I found is Household's stock price
7 was right in the middle of the pack.

8 Q. Do you have a demonstrative that shows that?

9 A. Yes.

10:15:42 10 Q. Can we see DDX 405, please.

11 Okay. Tell us what this chart is designed to show.

12 A. Well, this chart shows what would happen if you invested a
13 hundred dollars in Household stock on July 29, 1999, the day
14 before the relevant period, and you held it until the end of
10:16:08 15 the relevant period. Unfortunately, over this relevant
16 period, you would have lost about 34 and a half percent of
17 your money.

18 Q. That's --

19 A. Your -- I'm sorry.

10:16:18 20 Q. I apologize. Go ahead.

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21 A. I was just going to say, your hundred dollars becomes \$65
22 at the end of the period.

23 Q. A bad result?

24 A. A bad result.

10:16:26 25 Q. But you said Household was in the middle of the pack?

Bajaj - direct

4115

1 A. Yes.

2 Q. Do we have the capacity to see the rest of the pack on
3 this chart?

4 A. Yes.

10:16:34 5 Q. Show us the rest of the pack, please.

6 What does the chart show now, Professor?

7 A. Well, the first thing I would point out is the red line,
8 and you'll see the label on the right-hand side, S&P 500.

9 You'll see if you had invested \$100 in the most well-

10:16:55 10 diversified U.S. large company stocks that investment

11 professionals recommend you do -- that's S&P 500 portfolio,

12 it's the proxy for the market, it's about 80 percent of the

13 market value of all publicly traded companies -- you would

14 have \$62.29 left of your hundred dollars.

10:17:19 15 Q. So Household performed better than the S&P 500 during the
16 time period we're looking at?

17 A. Household did better than the market over the relevant
18 period; not by much, but it did better.

19 Q. What about the rest of these companies?

10:17:34 20 A. Of the six consumer finance companies that share the GCIS

21 code with Household, Provident, AmeriCredit and Capital One

22 did worse than Household. Had you invested \$100 in Provident

23 instead of in Household, you would have lost over 90 percent

24 of your money. You would have less than \$1 left at the end of

10:17:56 25 this period.

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♀

Bajaj - direct

4116

1 With AmeriCredit, you would have \$47 left. With
2 Capital One Financial, you would have \$63 left or almost 64,
3 as compared to with Household, 65.50.

4 But three consumer finance companies did better than
10:18:16 5 Household. MBNA did better. Cash America did better. Cash
6 America broke even, made a positive 1 percent return. And
7 Countrywide did the best. They had a 25 percent return.

8 But the other thing I want to point out, just going
9 back to our previous point, you know, the reason these trends
10:18:38 10 are not as clear, the \$65 going from \$100 looks almost like a
11 flat line, is there's no way to scale this chart to show that.
12 35 percent decline to most people would look like a pretty
13 significant decline.

14 Look at the volatility in these individual companies.
10:19:00 15 Look at the green line AmeriCredit. This is what it means to
16 invest in individual stocks. They go up and down a lot. And
17 Household was right in the middle of the pack during this time
18 period.

19 Q. And so does that mean that other finance companies also
10:19:20 20 lost money during the same time period?

21 A. Well, three did, three didn't. And also it depends on
22 when you invested. Like we talked about AmeriCredit doing
23 worse than Household. But what if you were lucky enough to
24 buy just before a big run-up and you happened to sell at the
10:19:37 25 top of the run-up? You would have made a lot of money.

♀

Bajaj - direct

4117

1 Q. Did you prepare a demonstrative listing the factors that,
2 in your opinion, affected Household's stock price during the

04-28-09 Volume 20

16 hi m. He i s my hero.

17 THE COURT: Yes, yes. Well, we all need one, don't
18 we?

19 All right. We will see you folks tomorrow, usual
04: 44: 46 20 ti me.

21 THE CLERK: Court stands adjourned.

22 MR. KAVALER: Your Honor, are we going to sit on
23 Fri day?

24 Is the jury going to deliberate on Friday?

04: 44: 58 25 THE COURT: We will talk about that.

♀

4303

1 (An adjournment was taken at 4:44 p.m.)

2 * * * * *

3 C E R T I F I C A T E

4 We certify that the foregoing is a correct
5 transcript from the record of proceedings in the
6 above-entitled matter.

7 /s/ Nancy C. LaBell a
8 _____

9 /s/ Joseph Ri ckhoff
10 _____

11 /s/ Frances Ward
12 _____ April 29, 2009

13 Official Court Reporters
14 United States District Court
Northern District of Illinois
Eastern Di vi si on
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Date

05-01-09 Volume 23

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THE CLERK: 02 C 5893, Jaffe v. Household.

THE COURT: Okay. Good afternoon, everyone. I hope
you've all noticed the weather is as promised. It's beautiful
today.

01:29:12

Let's see. Can you hand those out to each side?

(Tendered.)

THE COURT: I thought we'd start with these proposed
Page 2

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4679

1 calculate an element of damages.

2 MR. KAVALER: Your Honor, they're going to calculate
3 inflation.

4 THE COURT: You can call it an inflation element of
01:33:23 5 damages or you can just call it damages for the sake of this
6 jury. They don't know the difference, and it won't make any
7 difference to them. The calculation they're being asked to
8 make will serve our purposes in the next round.

9 MR. KAVALER: It may serve some purpose, your Honor.
01:33:34 10 It will not serve the purpose of either accuracy of the law or
11 fairness. Those are my concerns.

12 THE COURT: Well, I don't think --

13 MR. KAVALER: I believe it's unfair, and I believe
14 it's inaccurate. I believe it's error. And I respectfully
01:33:45 15 ask you to reconsider. And if the only argument against it is
16 retyping a portion of the charge, you know, we'll do what we
17 can to alleviate the burden. We're not trying to make work
18 for you.

19 THE COURT: I understand. It's not merely a question
01:33:58 20 of retyping a few words, as you know. Everything has a
21 trickle effect in these instructions. Everything. We would
22 have to review the entire set of instructions. And we'd have
23 to consider whether the language you're asking us to use
24 comports with the language that was used during the course of
01:34:13 25 the trial. And I'm not sure that it does. I think the term

4680

1 inflation and the term damages were used interchangeably.

2 And we make it clear to the jury in these

05-01-09 Volume 23

3 instructions, the instructions on damages, we tell them that
4 the only damages they're going to be asked to ascertain in
01:34:28 5 this case is the price change per share, which is the
6 inflation. And we even use the word inflation in the damages
7 instruction. So I just disagree.

8 All right. Then if there are no other objections --

9 MS. BEER: Your Honor, this is not a request for any
01:34:47 10 additional changes on the page that has been handed out. But
11 we do want for the record to reflect that while we've been
12 trying to cooperate with the Court in developing a version of
13 this form that will be useful to the jury, we have not
14 withdrawn our request that defendants' proposed verdict form
01:35:06 15 be used and not any form that the plaintiffs submitted or the
16 verdict form that we've been looking at today.

17 One of the reasons -- and we put many of our
18 objections on the record previously. But one of the reasons
19 is that in answering question four, if the jury rejects any
01:35:26 20 aspect of Professor Fischel's analysis, if they find that on
21 any day reflected in his table there was not a corrective
22 disclosure that he found or there was not a false statement
23 made that he relied upon in developing his table, that from
24 that day forward none -- the jury has no guidance whatsoever
01:35:49 25 on how to reflect that decision. And the form in its totality

4681

1 then becomes meaningless.

2 THE COURT: Well, I think what you're attacking --

3 MS. BEER: It's a fundamental flaw with the form.
4 It's a fundamental failure of proof on the plaintiffs' part.

01:36:08 5 THE COURT: That's what you're arguing. You're
6 arguing Dr. Fischel's theory is insufficient to support the
7 plaintiffs' claim. I understand that. You've argued that.

Page 8

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8 To the extent that we disagree with that and we've ruled
9 against that, any form we prepare is going to reflect that
01:36:20 10 ruling. And that's what you're pointing out here. I
11 understand that.

12 MS. BEER: I'm trying to be very, very specific in
13 this objection to this particular question asking the jury
14 that if no loss was caused on any date, write none. Once they
01:36:40 15 have reached that conclusion, that on any given date the
16 inflation was none, there's really -- they have no guidance
17 for how to determine the figure to use on any day following
18 that that doesn't just rely on speculation.

19 THE COURT: Okay. Well, that statement has been
01:36:57 20 there since this form was first proposed. And to the extent
21 that you've made your objection, it stands on the record.

22 MR. KAVALER: Your Honor, just because I'm aware of
23 your devotion to accuracy, I just want to point out you've
24 fallen to Mr. Dowd's erroneous method of speech. It's
01:37:17 25 Professor Fischel and Dr. Bajaj.

4682

1 MS. BEER: And if I may, there's also one other
2 objection that we have previously made that I want to be sure
3 that we are aware of today and reflected in the record.

4 To the extent the verdict form requires a
01:37:35 5 determination of the elements of a 10b-5 claim on the numbered
6 items 1 through 40 that are included on Table A, defendants do
7 object to the combination of separate statements drawn from
8 the same document as though they are one -- one statement. We
9 feel that will be confusing to the jury and does not require
01:38:00 10 that the elements be assessed separately as to each separate
11 alleged false statement.

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4700

1 THE COURT: Yes, that applies to the verdict form,
2 all of it, Tables A and B. Okay.

3 MR. MILLER: Should the demonstrative exhibits be
4 taken away from the jury box before they return on Monday?

02:08:36 5 THE COURT: We'll take care of destroying those.

6 MR. DOWD: Thank you, your Honor.

7 THE COURT: Okay. Thank you.

8 (Trial adjourned until May 4, 2009, at 9:00 o'clock a.m.)

9 * * * * *

10 C E R T I F I C A T E

11 We certify that the foregoing is a correct
12 transcript from the record of proceedings in the
13 above-entitled matter.

14 /s/ Nancy C. LaBella

May 2, 2009

15 _____
16 Official Court Reporters
17 United States District Court
Northern District of Illinois
Eastern Division

Date

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05-04-09 Volume 24

4701

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

3 LAWRENCE E. JAFFE PENSION PLAN,)
4 on behalf of itself and all)
5 others similarly situated,)
Plaintiff,)

6 vs.)

7 HOUSEHOLD INTERNATIONAL, INC.,)
8 et al.,)
9 Defendants.)

No. 02 C 5893

Chicago, Illinois
May 4, 2009
9:00 a.m.

10 VOLUME 24
11 TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a jury

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05-04-09 Volume 24

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THE CLERK: 02 C 5893, Jaffe v. Household.
THE COURT: Good morning, Ladies and gentlemen.
Are we ready for the jury?
MR. KAVALER: Your Honor, in an abundance of caution,
I would like to renew our 50(a) motion before you charge the
jury.
If I might just say, at the close of all the

09:16:10

05-04-09 Volume 24

12 whether his testimony here in court was true and what weight
13 to give to his testimony here in court.

14 In considering a prior inconsistent statement or
09: 30: 57 15 conduct, you should consider whether it was simply an innocent
16 error or an intentional falsehood and whether it concerns an
17 important fact or an unimportant detail.

18 It is proper for a lawyer to meet with any witness in
19 preparation for trial.

09: 31: 18 20 You may find the testimony of one witness or a few
21 witnesses more persuasive than the testimony of a larger
22 number. You need not accept the testimony of the larger
23 number of witnesses.

24 The law does not require any party to call as a
09: 31: 41 25 witness every person who might have knowledge of the facts

4712

1 related to this trial. Similarly, the law does not require
2 any party to present all exhibits -- all papers and materials
3 mentioned during this trial.

4 I'm sorry. Let me reread that.

09: 31: 59 5 Similarly, the law does not require any party to
6 present as exhibits all papers and materials mentioned during
7 this trial.

8 Plaintiffs contend that defendants at one time
9 destroyed documents regarding Andrew Kahr's recommendations
09: 32: 15 10 for Household and documents regarding use of the effective
11 rate presentation. However, defendants contend that they did
12 not destroy any documents regarding Andrew Kahr's
13 recommendations, and whatever they did with regard to
14 documents relating to the effective rate presentation was for
09: 32: 35 15 legitimate business purposes.

16 Defendants' destruction of a document, standing
Page 10

05-04-09 Volume 24

17 alone, does not warrant an inference that the document
18 contained information that is unfavorable to the defendants.

19 You may assume that such evidence would have been unfavorable
09: 32: 55 20 to defendants only if you find by a preponderance of the
21 evidence that:

22 One, defendants intentionally destroyed evidence or
23 caused evidence relevant to plaintiffs' claims to be
24 destroyed; and, two, defendants destroyed the evidence or
09: 33: 14 25 caused the evidence to be destroyed in bad faith, in other

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1 words, for the purpose of hiding adverse information.

2 You have heard witnesses give opinions about matters
3 requiring special knowledge or skill. You should judge this
4 testimony in the same way that you judge the testimony of any
09: 33: 37 5 other witness. The fact that such a person has given an
6 opinion does not mean that you are required to accept it.
7 Give the testimony whatever weight you think it deserves,
8 considering the reasons given for the opinion, the witness'
9 qualifications, and all of the other evidence in the case.

09: 34: 01 10 Certain demonstrative exhibits have been shown to
11 you. Those exhibits are used for convenience and to help
12 explain the facts of the case. They are not themselves
13 evidence or proof of any facts.

14 You must give separate consideration to each claim
09: 34: 26 15 and each party in this case.

16 When I say a particular party must prove something by
17 "a preponderance of the evidence" or when I use the expression
18 "if you find" or "if you decide," this is what I mean: When
19 you have considered all the evidence in the case, you must be
09: 34: 49 20 persuaded that it is more probably true than not true.

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21 Plaintiffs contend that defendants Household, William
22 Aldinger, David Schoenholz and Gary Gilmer violated Section
23 10(b) of the Securities Exchange Act and the Securities
24 Exchange Commission or SEC's Rule 10b-5. From now on, I will
09:35:19 25 use 10b-5 to refer to both the section and the rule.

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1 To prevail on their 10b-5 claim against any
2 defendant, plaintiffs must prove each of the following
3 elements by a preponderance of the evidence as to that
4 defendant:

09:35:38 5 One, the defendant made, approved or furnished
6 information to be included in a false statement of fact or
7 omitted a fact that was necessary, in light of the
8 circumstances, to prevent a statement that was made from being
9 false or misleading during the relevant time period between
09:36:01 10 July 30, 1999, and October 11, 2002;

11 Two, the false statement or omission was material;

12 Three, the defendant acted with a particular state of
13 mind; and

14 Four, the defendant's statement or omission was a
09:36:24 15 substantial factor in causing plaintiffs' economic loss.

16 If you find that the plaintiffs have proved each of
17 the above elements as to any defendant, your verdict should be
18 for the plaintiffs and against that defendant. If you find
19 that the plaintiffs have not proved each of the above elements
09:36:47 20 as to any defendant, your verdict should be for that defendant
21 and against the plaintiffs.

22 To meet the first element of their 10b-5 claim
23 against any defendant, plaintiffs must prove that during the
24 relevant time period, the defendant made a false or misleading
09:37:07 25 statement of fact or omitted a fact that was necessary to

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1 prevent a statement that was being made from being misleading.

2 Table A to the verdict form that you will be given
3 sets forth the statements that plaintiffs claim are false and
4 misleading.

09: 37: 24 5 In determining whether a statement of fact is false
6 or misleading, you must consider the statement in light of the
7 circumstances that existed at the time it was made.

8 An omission violates 10b-5 only if the defendant has
9 a duty to disclose the omitted fact. The defendants do not
09: 37: 45 10 have a duty to disclose every fact they possess about
11 Household or any fact that is in the public domain. But each
12 defendant has a duty to disclose a fact if a prior or
13 contemporaneous statement he or it made about the same subject
14 would be misleading if the fact is not disclosed. If a
09: 38: 09 15 defendant does not have a duty to disclose a fact but chooses
16 to make a statement about it, the statement must be truthful
17 and not misleading.

18 Defendant Household is required to file with the SEC
19 an annual report, called a 10-K, and quarterly reports, called
09: 38: 33 20 10-Qs, for the first three quarters of each year. These
21 reports include financial statements and other disclosures.
22 Financial statements present a company's financial position at
23 one point in time, or its operating results and cash flows for
24 a specified period. Household has no duty to update its 10-Q
09: 38: 56 25 reports on any cycle other than quarterly.

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1 Household is required to prepare its financial
2 statements regarding the delinquency status of loans and the

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C E R T I F I C A T E

I certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

/s/ Nancy C. LaBella

May 5, 2009

Official Court Reporter
United States District Court
Northern District of Illinois
Eastern Division

Date

CERTIFICATE OF SERVICE

I hereby certify that on February 12, 2014, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Seventh Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

s/D. Zachary Hudson
D. Zachary Hudson