

JUN 24 2003

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

PLAINTIFFS' RESPONSE TO THE MOTION TO DISMISS THE
[CORRECTED] AMENDED CONSOLIDATED CLASS ACTION
COMPLAINT BY DEFENDANTS GOLDMAN SACHS & CO. AND
MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

FILED
6/19/03

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Plaintiffs respectfully submit this Response to the Motion to Dismiss the [Corrected] Amended Consolidated Class Action Complaint by Defendants Goldman Sachs & Co. and Merrill Lynch, Pierce, Fenner & Smith, Inc.

I. INTRODUCTION

In 1998, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") and Goldman Sachs & Co. ("Goldman Sachs") (collectively, the "Banks") were paid more than \$56 million (over \$34 million and \$22 million, respectively) for their role in a stock-for-stock merger between Household International, Inc. ("Household") and Beneficial, Inc. ("Beneficial") valued at over \$8.676 billion. *See* Exs. A and G attached hereto.¹ Had the merger not gone through, the Banks would have received "only" \$4 million each for their services. *See* Ex. A attached hereto.

In exchange for this sum, the Banks participated in the preparation and issuance of the Registration Statement and Joint Proxy Statement-Prospectus filed with the SEC by Household on 6/1/98 (the "Registration Statement") by which Household shares were issued and exchanged for Beneficial shares to complete the merger. ¶372.² The Banks also offered their expert opinions that the exchange ratio of 1.0222 Household shares for each Beneficial shares was fair from a financial point of view. *Id.*

Both the Registration Statement and fairness opinions contained materially false and misleading statements. Under §11 of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §77k, the Banks are strictly liable for the substantial financial harm suffered by Beneficial shareholders who exchanged their shares for artificially inflated Household shares pursuant to the Registration Statement.³

¹This Court may properly take into consideration documents incorporated by reference to the pleadings. *See United States v. Wood*, 925 F.2d 1580, 1581 (7th Cir. 1991); *see also* Fed. R. Civ. P. 10(c).

²Unless otherwise indicated, all paragraph ("¶__") references are to plaintiffs' [Corrected] Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws ("Complaint"), filed 3/13/03.

³Plaintiffs do not assert claims against the Banks under §§12(a)(2) (as statutory sellers) or 15 (as control persons) of the Securities Act.

Rather than accept any responsibility for their role in the \$8.676 billion merger, the Banks contend they are merely innocent bystanders who have been wrongfully drawn into this litigation. Memorandum of Law of Defendants Goldman Sachs and Merrill Lynch in Support of Their Motion to Dismiss the Corrected Amended Consolidated Class Action Complaint ("Bank Defs' Mem.") at 2. Defendants assert that for their \$56 million, they merely "performed a variety of [financial] analyses," for which they are not liable. Bank Defs' Mem. at 12. The Complaint tells a different story – one that must be accepted as true for purposes of a motion to dismiss.

II. STANDARD OF REVIEW

A complaint should not be dismissed unless it appears "beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). In considering a motion to dismiss, the United States Court of Appeals for the Seventh Circuit has made clear that district courts within this Circuit must "take all facts alleged in the complaint, and any inferences that might be reasonably drawn from those factual allegations, in the light most favorable to the plaintiff[s]." *Szumny v. American Gen. Fin., Inc.*, 246 F.3d 1065, 1067 (7th Cir. 2001) (citing *Autry v. Northwest Premium Servs.*, 144 F.3d 1037, 1039 (7th Cir. 1998)). "When a federal court reviews the sufficiency of a complaint ... its task is necessarily a limited one. The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Caremark, Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 648 (7th Cir. 1997) (quoting *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974)).

The Securities Act embraces "a fundamental purpose ... to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*." *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 171 (1994) (quoting *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972)). In furtherance of this goal, §11 of the Securities Act imposes strict liability upon issuers, underwriters and others when a registration statement contains an untrue statement of material fact or fails to disclose material information required to be stated therein or necessary to make the statements contained therein not misleading. See 15 U.S.C. §77k; see also *Herman & Maclean v. Huddleston*, 459 U.S. 375, 382 (1983). Section 11 "imposes a stringent standard of liability on the parties who play a direct role in a registered offering." *Huddleston*, 459 U.S. at 381-82. A plaintiff

who "purchased a security issued pursuant to a registration statement ... need only show a material misstatement or omission to establish his *prima facie* case. Liability against the issuer of a security is virtually absolute Other defendants bear the burden of demonstrating due diligence." *Id.* at 382. Section 11 does not require a plaintiff to plead or prove scienter. *See id.* at 381-82; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200 (1976) (congressional policy underlying §11 was to create liability regardless of fault).

In this case, plaintiffs specifically disavowed any allegations of fraud or intentional conduct as to their Securities Act claims. ¶354. Accordingly, Rule 9(b) does not apply, scienter is not required, and plaintiffs need only meet a Rule 8 standard for pleading strict liability. As set forth below, plaintiffs have met this burden.

III. FACTS ALLEGED IN THE COMPLAINT

Plaintiffs' opposition to the Household defendants' motion to dismiss contains a detailed summary of the facts contained in the Complaint. Those facts will not be restated here. In brief, the Banks' liability is predicated in their involvement as statutory underwriters of the Registration Statement and authors of fairness opinions regarding the value of the respective stocks involved in the merger. ¶¶371-76. Defendants performed tasks – acting as financial advisors to Beneficial, negotiating the rate of exchange for the merger and drafting fairness opinions approving the exchange ratio – that were necessary to the consummation of the merger. *Id.* In addition, defendants held themselves out in the fairness opinions as authorities in the valuation of businesses in connection with mergers and acquisitions. ¶372. They also consented to have those opinions included in the Registration Statement. *Id.* Both the Registration Statement and fairness opinions contained materially false and misleading statements. ¶¶362-69, 372-74.

IV. ARGUMENT

Plaintiffs' claims against the Banks were timely filed well within the applicable five-year statute of limitations set by the Sarbanes-Oxley Act. *See* 28 U.S.C. §1658(b)(2). The Banks are liable for the contents of the entire Registration Statement under §11(a)(5) because, having performed acts necessary to the distribution of the securities, they are statutory underwriters. *See Harden v. Raffensperger, Hughes & Co.*, 65 F.3d 1392, 1400 (7th Cir. 1995). Moreover, the Banks

are also liable under §11(a)(4) because they are entities whose profession gave authority to fairness opinions rendered by them, they consented to the inclusion of the fairness opinions in the Registration Statement, and the fairness opinions contained materially false and misleading statements. *See* 15 U.S.C. §77k(a)(4). Under either §11 theory, the Banks are strictly liable. *See Huddleston*, 459 U.S. at 382.

A. Plaintiffs' Claims Were Timely Filed

Pursuant to the Sarbanes-Oxley Act, the statute of limitations governing all private causes of action arising under the securities laws as defined by §3(a)(47) of the Securities Exchange Act of 1934, is the earlier of two years after discovery of the violation or five years after the violation occurred. *See* 28 U.S.C. §1658(b)(2). Section 3(a)(47) specifically states that "[t]he term 'securities laws' means the Securities Act of 1933." 15 U.S.C. §78c(a)(47). Thus, the Sarbanes-Oxley Act explicitly incorporates all claims under the Securities Act, including non-fraud claims for violations of §11. The Sarbanes-Oxley Act's legislative history supports this interpretation: The statute of limitations is intended "to govern *all* the already existing private causes of action under *the various federal securities laws* that have been held to support private causes of action." *See Legislative History of Title VIII of HR 2673: The Sarbanes-Oxley Act of 2002*, 148 Cong. Rec. S. 7418 (2002) (Statement of Senator Patrick J. Leahy) (emphasis added). A more detailed analysis of this issue is contained in §IV.E.2 of plaintiffs' opposition to the Household defendants' motion to dismiss.

Under the applicable statute, plaintiffs' Complaint is timely. Plaintiffs' §11 claims against the Banks are premised on the false and misleading statements contained in the Registration Statement which became effective on 6/30/98. The first complaint in this action was filed on 8/20/02, and the operative complaint was filed on 3/13/03. Plaintiffs' claims therefore fall well within the applicable five-year statute of limitations set by the Sarbanes-Oxley Act. 28 U.S.C. §1658(b)(2); ¶381.

B. As Underwriters, the Banks Are Liable Under Section 11(a)(5) for All False and Misleading Statements Contained in the Registration Statement⁴

Section 11(a)(5) allows any person who acquired securities pursuant to a registration statement containing false and misleading statements to sue "every underwriter with respect to such security." 15 U.S.C. §77k(a)(5). In analyzing the meaning of "underwriter," the Seventh Circuit explained that "one who 'participates,' or 'takes part in,' an underwriting is subject to section 11 liability." *Harden*, 65 F.3d at 1400 (citation omitted); *see also* 15 U.S.C. §77b(11).⁵

Both the Supreme Court and the Seventh Circuit have broadly interpreted the phrases "participate in" and "participation" found in §2(11). *Harden*, 65 F.3d at 1400 (citing *Pinter v. Dahl*, 486 U.S. 622 (1988)). The "statutory definition [of underwriter, contained in section 2(11)] specifically covers *every person who participates in a distribution of securities.*" *Id.* (quoting *SEC v. Van Horn*, 371 F.2d 181, 188 (7th Cir. 1966)) (emphasis added and brackets in original). Section 2(11) does not require that a defendant "buy, sell, distribute, or solicit orders for the [securities issued]" to qualify as an underwriter. *Harden*, 65 F.3d at 1394-95, 1401. Indeed, "*the term 'underwriter' is broad enough to encompass all persons who engage in steps necessary to the distribution of securities.*" *Id.* at 1400 (emphasis added) (holding defendant could be liable under §11(a)(5) even though it did not "agree to buy, sell, distribute, or solicit orders for the [securities issued]," because its role - providing a valuation with regard to the yield at which the debt was to be distributed -- was "necessary to the distribution of [the] securities") (quoting *SEC v. Holschuh*, 694 F.2d 130, 139 n.13 (7th Cir. 1982)). As underwriters, the Banks are liable for *all* false and misleading statements contained in the Registration Statement. *See* 15 U.S.C. §77k(a)(5); *Harden*, 65 F.3d at 1400.

⁴Ignoring substantial portions of plaintiffs' Complaint regarding their participation in effectuating the merger, the Banks erroneously argue plaintiffs' only §11 claim against them arises under §11(a)(4). Bank Defs' Mem. at 11 n.5. Plaintiffs' Complaint, however, pleads facts supporting liability under both §§11(a)(4) and 11(a)(5).

⁵ Section 2(11) of the Securities Act defines the term "underwriter" in pertinent part as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or *participates or has a direct or indirect participation in any such undertaking.*" 15 U.S.C. §77b(11)(emphasis added).

By virtue of "participat[ing] in drafting, revising or approving" and "issu[ing], caus[ing] to be issued and participat[ing] in the issuance of the Registration Statement" (§§376, 379; Bank Defs' Mem. at 10), the Banks performed several tasks necessary to the distribution of Household securities to Beneficial shareholders and therefore qualify as underwriters as defined by §2(11) of the Securities Act. Specifically, they acted as financial advisors to Beneficial throughout the merger process, they participated in the negotiations with Household that resulted in the determination of the exchange ratio and they drafted fairness opinions, approving of the exchange ratio they helped negotiate. *See* §372; Exs. A-C attached hereto. Beneficial paid the Banks more than \$56 million to act as financial advisors in connection with the merger. *See* Ex. A attached hereto. To make such a payment for non-essential services would be unconscionable. Negotiating and establishing an exchange ratio (or acquisition price) is, of course, necessary for any stock-for-stock merger to occur. The fairness opinions were also necessary to the consummation of the merger. *See, e.g., PPM Am. v. Marriott Corp.*, 853 F. Supp. 860, 878 (D. Md. 1994) ("The obtention by Marriott of a fairness opinion and a solvency opinion were necessary in order to comply with certain aspects of corporate law, as well as to give the Transaction credibility in the eyes of the securities markets.").

Indeed, Beneficial management both relied on the fairness opinions in approving the merger, and used them in the Joint-Proxy Prospectus to solicit shareholder approval. *See* Exs. D-E attached hereto. That the Banks placed their imprimatur on the exchange ratio was undeniably a material factor in obtaining shareholder approval – another necessary occurrence in consummating the merger. *See* Ex. F attached hereto ("The affirmative vote of the holders of a majority of the voting power represented by the outstanding shares of Beneficial ... stock is required for approval of the Merger.").

Accordingly, the Banks qualify as statutory underwriters pursuant to §2(11) and are liable under §11(a)(5) for every material false and misleading statement contained in the Registration Statement. *See Harden*, 65 F.3d at 1400.

Plaintiffs' Complaint clearly alleges numerous false and misleading statements contained in the Registration Statement. *See, e.g.,* §§362-67 (false and misleading statements regarding Household's financial performance); §369 (false representation that Household was operating in

compliance with applicable laws); and ¶372 (false and misleading fairness opinions authored by the Banks). Other than arguing, speciously (*see* §IV.C.3, *infra*), that the fairness opinions themselves did not contain any false and misleading statement, the Banks do not contest any of plaintiffs' allegations that contents of the Registration Statement were materially false and misleading. Plaintiffs' §11 claims against the Banks therefore must not be dismissed.

C. The Banks Are Also Liable Pursuant to Section 11(a)(4) for the False and Misleading Statements Contained in Their Fairness Opinions

1. The Banks' Profession Gives Authority to Statements Made by Them Within the Meaning of Section 11(a)(4)

Under §11(a)(4), "any person ... may ... sue ... every ... person whose profession gives authority to a statement made by him, who has with his consent been named as ... having prepared or certified any report or valuation which is used in connection with the registration statement," if that report or valuation contains a false or misleading statement. 15 U.S.C. §77k(a)(4). The Banks are entities whose profession gives authority to statements made by them within the meaning of §11, with respect to the fairness opinions they rendered. *See Kitchens v. U.S. Shelter*, Civil Action No. 82-1951-1, 1988 U.S. Dist. LEXIS 18546, at *68 (D. S.C. June 30, 1988) (investment advisor who prepared fairness opinion is "a 'person' whose profession lends authority to a statement in the Registration Statement or a 'person' who prepared a report contained in the Registration Statement") (citation omitted); *see also* Michael W. Martin, *Notes: Fairness Opinions and Negligent Misrepresentation: Defining Investment Bankers' Duty to Third-Party Shareholders*, 60 *Fordham L. Rev.* 133 (1991) ("[A]scertaining the fair price of a deal is an economic and financial determination as to which the investment banker's expertise is particularly fitted.") (citation and quotation omitted).

Defendants do not dispute that plaintiffs' Complaint alleges the Banks "acted as financial advisors and experts within the meaning of §11, concerning the fairness 'from a financial point of view'" of the exchange ratio. ¶371 (citation omitted). The Complaint identifies Goldman Sachs as "a global investment banking, securities and investment management firm that provides a wide range of services, including evaluations of mergers and acquisitions." ¶49. Similarly, the Complaint identifies, Merrill Lynch as "a worldwide financial management and advisory company," and alleges

that "[a]s 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." ¶48.

Indeed, the text of the Registration Statement emphasizes the Banks' professional authority. In its fairness opinion, for example, Goldman Sachs boasts that it "provides a full range of financial advisory and security services" and "is continually engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for estate, corporate and other purposes." ¶372. Merrill Lynch also touted to Beneficial shareholders its "continuous[] engage[ment] in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for ... corporate and other purposes." *See* Ex. C attached hereto. Thus, contrary to defendants' assertion, the Complaint offers more than a simple "talismanic incantation" (Bank Defs' Mem. at 11) that the Banks fall within the purview of §11(a)(4). *See* 15 U.S.C. §77k(a)(4); *Kitchens*, 1988 U.S. Dist. LEXIS 18546, at *68.

Defendants, however, seek to dismiss plaintiffs' §11(a)(4) claims, arguing that the Banks "were not, as a matter of law, acting as 'experts,'" because they were not named in the "Experts" section of the Registration Statement. *See* Bank Defs' Mem. at 11 (citation omitted). This argument is a red herring. As discussed, liability under §11(a)(4) is not contingent on defendants' identification as "experts" in the Registration Statement, but rather whether the speaker's "profession gives authority to a statement made by him." *See* 15 U.S.C. §77k(a)(4).

In fact, defendants appear to have concocted this requirement out of thin air – neither case cited by them even remotely supports their proposition. In *In re Flight Transp. Sec. Litig.*, 593 F. Supp. 612 (D. Minn. 1984), the court held only that lawyers acting as counsel to underwriters do not fall within the ambit of §11. *Flight Transp.*, 593 F. Supp. at 616. In *McFarland v. Memorex Corp.*, 493 F. Supp. 631 (N.D. Cal. 1980), the court held that "an independent accountant's liability under [S]ection 11 is limited to those figures which he certifies.... ***The only question is whether the accountants are named as having prepared or certified any part of the registration statement.***"

Id. at 643 (citation and quotation omitted; emphasis added). Neither case even so much as mentions a requirement that defendants be labeled "experts" in the Registration Statement in order to prevail on a claim under §11(a)(4), and no such requirement exists. *See* 15 U.S.C. §77k(a)(4).

2. The Banks Consented to Be Named in the Registration Statement

Section 11(a)(4) requires that a defendant consent to be named "as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement." 15 U.S.C. §77k(a)(4). Plaintiffs' Complaint alleges just that. ¶372. The Banks consented to be named in the Registration Statement. *See* Bank Defs' Mem., Ex. B, Goldman Sachs' Consent ("We hereby consent to the inclusion in the Registration Statement ... our opinion letter ... and to the references to our firm name therein."); and Merrill Lynch's Consent ("We hereby consent to the use of our opinion letter ... and to the references to such opinion in" the Registration Statement.).

Defendants again attempt to alter the requirements of §11(a)(4), by seeking dismissal on the grounds that they did not consent to the inclusion of the fairness opinions in the Registration Statement as the opinions of "experts." Bank Defs' Mem. at 13. Defendants cite no case supporting their novel theory, and rely instead on the Banks' disclaimer in their letters of consent that they do not admit to being experts under the Securities Act. *Id.* Of course, §11(a)(4) does not contain the word "expert" anywhere in its text and requires only that the Banks consented to have their fairness opinions "used in connection with the Registration Statement." 15 U.S.C. §77k(a)(4). Plaintiffs' Complaint therefore adequately pleads that the Banks, by issuing fairness opinions and consenting to have them incorporated into the Registration Statement, fall within the purview of §11(a)(4). *See* 15 U.S.C. §77k(a)(4); *Kitchens*, 1988 U.S. Dist. LEXIS 18546, at *68.

3. The Banks' Fairness Opinions Contained False and Misleading Statements

In order to render a fairness opinion actionable, a plaintiff need only allege facts contravening the investment advisor's conclusion that the merger was fair. *See Minzer v. Keegan*, 218 F.3d 144, 151 (2d Cir. 2000) ("To attack [an investment advisor's fairness] opinion as materially misleading ... appellants must allege ... 'provable facts,' undercutting the statement that the merger was 'fair from

a financial point of view.") (citing *Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1094 (1991)). The analysis relates to *objective* facts pled, not allegations regarding defendants' *subjective* state of mind. *Id.*

There is no dispute that the Complaint includes such objective allegations. Plaintiffs allege the exchange ratio was not fair to holders of Beneficial shares because "the strength of Household's historical performance, its prospects and its financial statements were overstated." ¶¶373-74. Indeed, the Complaint alleges in painstaking detail Household's widespread and pervasive scheme – a combination of false accounting, *see* ¶¶134-55, improper reaging of delinquent loans, *see* ¶¶107-133, and predatory lending, *see* ¶¶51-106, that rendered Household's reported financial and operating results false and artificially inflated the value of Household shares. These allegations, if true, can be proven by reference to objective facts. Plaintiffs' Complaint therefore pleads an adequate basis for the Banks' liability under §11(a)(4), based on the false and misleading fairness opinions contained in the Registration Statement.

The Supreme Court's decision in *Virginia Bankshares* is consistent with the Second Circuit's holding in *Minzer*. *See Virginia Bankshares*, 501 U.S. at 1094. In *Virginia Bankshares*, the Court "considered statements ... which misstate the speaker's reasons [for approving the merger] *and also* mislead about the stated subject matter (e.g., the value of the shares)." *Id.* at 1095 (emphasis added). As to statements regarding share value, the Court found that "*such conclusory terms in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading.*" *Id.* at 1093 (emphasis added). The Court then explained that determination of the veracity of the defendants' representations that the proposed acquisition price was "high" and the merger proposal "fair," "depended on whether provable facts about the [target's] assets, and about actual and potential levels of operation, substantiated a value that was above, below, or more or less at the [merger price]," not the subjective state of mind of the defendants at the time the statement was made. *Id.* at 1094.

Similarly, the Seventh Circuit's interpretation of *Virginia Bankshares*, makes clear that "beliefs are 'facts' ... when they are open to objective verification." *Eckstein v. Balcor Film Investors*, 8 F.3d 1121, 1132 (7th Cir. 1993)(citing *Virginia Bankshares*, 501 U.S. at 1095-96). Thus,

"statements of opinion and belief ... are actionable if they are made without a reasonable basis." *Ziemack v. Centel Corp.*, 856 F. Supp. 430, 435 (N.D. Ill. 1994)(citing *Virginia Bankshares*, 501 U.S. 1083; *Eckstein*, 8 F.3d at 1132). Pursuant to this rule, "qualifying these statements by stating that they were matters of the speaker's belief" does not render them inactionable; nor does it invoke a requirement that plaintiffs offer proof of the speaker's state of mind. *Beedie v. Battelle Mem'l Inst.*, 01 C 6740, 2002 U.S. Dist. LEXIS 171, at **13-14 (N.D. Ill. Jan. 4, 2002)("Defendant's statement ... is a statement that is open to objective verification, however defendant's representative styled it. Defendant's alleged oral misrepresentations thus are actionable.").

Indeed, a number of courts have held that a plaintiff can adequately plead the falsity of an opinion by alleging objective facts showing the subject matter of that opinion is false. *See, e.g., Zemel Family Trust v. Philips Int'l Realty Corp.*, 00 Civ. 7438 (MGC), 2000 U.S. Dist. LEXIS 17320, at *23 (S.D.N.Y. Nov. 30, 2000)("A proxy may be false and misleading if it includes a fairness opinion that lacks a reasonable basis *or* is made without a genuine belief in its accuracy.") (emphasis added); *see also In re Westinghouse Sec. Litig.*, Civil Action No. 91-354, 1998 U.S. Dist. LEXIS 3033, at **26-28 (W.D. Pa. Mar. 12, 1998) (rejecting defendant auditor's argument that plaintiff's §11 claim alleging opinion false and misleading should be dismissed for failure to plead knowledge or belief); *Herskowitz v. Nutri/System, Inc.*, 857 F.2d 179, 185 (3d Cir. 1988) (expert opinion is false if expert "adopts an assumption which the factfinder concludes was objectively unreasonable in the circumstances"); *Kaplan v. Rose*, 49 F.3d 1363, 1371-72 (9th Cir. 1994) (finding statement that "[t]he Company believes the Medstone System compares favorably with other [such systems]" materially misleading when that system actually "compared poorly" with another such system).

The Banks contend that the misrepresentations contained in their fairness opinions are not actionable because plaintiffs have failed to allege defendants knew the misrepresentations were false when made. Bank Defs' Mem. at 6-8. Section 11, however, contains no scienter requirement; it does not require that plaintiffs plead or prove that the Banks did not believe in the truth of the fairness opinions. All plaintiffs must allege is that the fairness opinions contained material misstatements; they have no obligation to establish lack of good faith as part of their *prima facie*

case. *See, e.g., Griffin v. PaineWebber Inc.*, 84 F. Supp. 2d 508, 513 (S.D.N.Y. 2000) (refusing to dismiss Securities Act claim for failure to plead that sellers were aware of the misstatement because plaintiffs are not required "to plead statements in anticipation of affirmative defenses"). Notwithstanding this hornbook principle, defendants attempt to import a scienter requirement into §11 by faulting the Complaint for its failure to allege that the Banks "did not genuinely believe the Exchange Ratio was fair." Bank Defs' Mem. at 6. Section 11, however, places the burden on defendants (other than the issuer of the Registration Statement) to prove as an affirmative defense that they exercised diligence and reasonably believed the statement was true. 15 U.S.C. §77k(b)(3); *Huddleston*, 459 U.S. at 383. Their affirmative defense is not properly before the Court at the pleading stage.

This Court should not be swayed by the aberrant, out of circuit, district court cases cited by defendants. *See* Bank Defs' Mem. at 6-7. Each of these cases either relies on the reasoning of *Freedman v. Value Health, Inc. (Freedman I)*, 958 F. Supp. 745 (D. Conn. 1997),⁶ or provides no pertinent analysis at all.⁷ *Freedman I* is no longer good law in light of the Second Circuit's decision in *Minzer*. *Freedman I* also misinterprets *Virginia Bankshares*. The court in *Freedman I* concluded that a fairness opinion could be actionable only if it was not sincerely believed in addition to being objectively false, reasoning that, "if the objective prong were both necessary and sufficient to establish liability, it seems odd that the Court [in *Virginia Bankshares*] would discuss at some length the contours of a plaintiff's required showing under the subjective prong." *Freedman I*, 958 F. Supp. at 753. This reading of *Virginia Bankshares* ignores that the Supreme Court analyzed a statement that plaintiffs alleged was misleading for two reasons: (1) that the directors approved the merger for reasons other than those stated by them *and* (2) that the merger price was not fair. *Virginia*

⁶*See* Bank Defs' Mem. at 6-7 (citing *In re McKesson HBOC, Inc., Secs. Litig.*, 126 F. Supp. 2d 1248, 1264-65 (N.D. Cal. 2000); *Flake v. Hoskins*, 55 F. Supp. 2d 1196, 1227 (D. Kan. 1999)). In addition, two of the three cases cited by the Banks for the proposition that the speaker must act at least with reckless disregard for an opinion to be actionable under the securities laws also rely on *Freedman I*. *See* Bank Defs' Mem. at 7 n.4 (citing *Freedman v. Value Health, Inc. (Freedman II)*, 135 F. Supp. 2d 317, 337 (D. Conn. 2001); *In re Reliance Secs. Litig.*, 135 F. Supp. 2d 480, 515 (D. Del. 2001)). The third, *Pertman v. Zell*, 938 F. Supp. 1327, 1340 (N.D. Ill. 1996), again, offers no pertinent analysis.

⁷*Kahn v. Wien*, 842 F. Supp. 667, 677 (E.D.N.Y. 1994).

Bankshares, 501 U.S. at 1092. Here, only the second part of the *Virginia Bankshares* analysis applies. Plaintiffs allege the Banks' statements were false because the exchange ratio was not fair from a financial view -- an allegation that can be proven by reference to objective facts without considering defendants' state of mind.

Thus, plaintiffs have properly alleged the Banks' fairness opinions contained false and misleading statements within the ambit of §11(a)(4). *See Minzer*, 218 F.3d at 151.

4. Defendants Are Liable for the Content of Their False Statements

The Banks are liable under §11(a)(4) for their false statements that the exchange ratio was fair from a financial point of view. This liability is not relieved by their claimed reliance on information provided to them by Household and Beneficial. *See Picard Chem. Inc. Profit Sharing Plan v. Perrigo Co.*, 940 F. Supp. 1101, 1120 (W.D. Mich. 1996) (defendants argued that there were no material misstatements attributable to them because the information they conveyed to the public was received from the company; court denied the motion to dismiss, finding that because the information from the company was incorporated in a broader analysis, defendants were the "original source" of the fraudulent predictions).

The Banks attempt to escape liability by arguing that they did not "expertise" Household's allegedly false financial information. Bank Defs' Mem. at 12. Defendants' theory appears to be that since the Banks assumed some of the information given to them was correct, they are not liable for their false conclusion that the exchange ratio was fair. Once again, defendants' contention is unsupported by the cases they cite, each of which stands for the simple proposition that under §11(a)(4), a defendant is liable only for the portion of the registration statement prepared by him. *See Huddleston*, 459 U.S. at 381 n.11 ("Accountants are liable under §11 only for those matters which purport to have been prepared or certified by them."); *In re Jiffy Lube Sec. Litig.*, Civil No. Y-89-1939, 1990 U.S. Dist. LEXIS 20141, at *6 (D. Md. Oct. 31, 1990) (dismissing §11(a)(4) claim against accountant for failure to identify those misstatements or omissions made by accountant). The Complaint clearly identifies the statements alleged to be false in the reports prepared by the Banks. ¶¶372-73.

Moreover, the Banks' attempt to hide behind Household's false financials (Bank Defs' Mem. at 11), is belied by their own fairness opinions, detailing the extent of their prior experience with Household and the breadth of the other sources of information they consulted in evaluating the exchange ratio. ¶372. The Banks were not paid \$56 million simply to do a few math problems. In rendering their opinions, defendants reviewed internal financial analyses for both companies, conducted discussions with Household and Beneficial senior management, compared both companies' market prices, operations and performance with similar companies in the subprime lending industry, and made assessments of general economic, market and monetary conditions. *Id.* Moreover, at the time of the merger, Goldman Sachs was intimately familiar with Household by virtue of having performed extensive investment banking services for Household, including underwriting asset securitizations and a secondary offering of Household common stock. *Id.* And, the Banks told investors that they had done these things. *Id.*

Thus, the message delivered by the fairness opinions to Beneficial shareholders was that the Banks had engaged in extensive research and made an in-depth investigation into both companies and the subprime lending industry – research that should have uncovered numerous "red flags" and alerted defendants to Household's true financial and operational status. These "red flags" include Household's inexplicable outperformance of the industry, including its string of record setting quarters, ¶¶192, 197, 204; multi-million dollar bonuses received by Household executives for hitting a series of stock-price targets, ¶¶156-63; Household's high percentage of reaged loans compared to its competitors, ¶¶123, 127, 174; Household's practice of automatically restructuring delinquent accounts which was far outside the industry norm, Consent Decree, ¶6, attached as Ex. 2 to Plaintiffs' Request for Judicial Notice, filed concurrently herewith; the vast number of accounts that had been reaged multiple times, ¶123; Household's reported delinquency rates which were about one-half of those of other subprime mortgage lenders, including Provident Financial Corp., one of the companies specifically studied by the Banks, ¶¶14, 124, 127-128; Household's unusually high percentage of revenue from points on its loans compared to other similarly situated lenders, ¶¶61-64; and Household's unusually high rate of insurance product penetration in connection with its loans, ¶¶72-73. The Banks, however, turned a blind eye and walked away with their \$56 million.

V. CONCLUSION

For the foregoing reasons, the Banks' motion to dismiss should be denied. If, for any reason, the Court finds the Complaint, or any part thereof, inadequate, plaintiffs respectfully request leave to amend pursuant to Fed. R. Civ. P. 15 to cure any possible pleading deficiencies. *See Ferguson v. Roberts*, 11 F.3d 696, 706 (7th Cir. 1993).

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Respectfully submitted,



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*See Case
File for
Exhibits*