UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

HOUSEHOLD DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF HOUSEHOLD DEFENDANTS' MOTION PURSUANT TO THE COURT'S OCTOBER 17, 2007 ORDER AND FOR PRECLUSION

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This Memorandum is submitted on behalf of Defendants (referred to collectively herein as "Household" or "Defendants"), in support of their motion pursuant to this Court's October 17, 2007 Order, and for an order of preclusion under Rule 37 of the Federal Rule of Civil Procedure.

INTRODUCTION

In its October 17, 2007 Order ("Order"), this Court found Plaintiffs' disclosures on the subject of damages to be deficient in several respects, and ordered Plaintiffs to identify their proposed method of calculating damages to Defendants to enable Defendants' expert to evaluate and respond to the report of Plaintiffs' expert. As the Court held: "Defendants are entitled to know Plaintiffs' theory now so their expert can provide a response." *See* Order at 5.

This motion is necessitated by Plaintiffs' refusal to comply with the instructions of the Court's Order, which, *inter alia*, required Plaintiffs to explain:

1. "whether Plaintiffs intend to claim damages for inflation already present in the stock price on the first day of the Class Period";
2. "whether Plaintiffs intend to use a netting or transactional approach for class members who profited from some trades but suffered losses from others"; and
3. "which of Professor Fischel's [two inflation] tables will be used for each type of investor" Order at 4-5.

Instead of providing a complete explanation on the covered subjects in keeping with Rule 26(a)(1)(C), Plaintiffs responded with an unsworn, procedurally ambiguous two page document entitled "Supplemental Statement Regarding Damages" ("Supplemental Statement").[1] This perfunctory and evasive response treats the issues raised by the Court as mere "yes" or "no" ques-

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[1] Defendants moved to compel proper disclosures under Federal Rule of Civil Procedure 26(a)(1)(C) and with respect to identified sworn interrogatory responses on these subjects. This Court's October 17, 2007 Order granted that motion. Nonetheless, Plaintiffs refused to provide Defendants with sworn disclosures under Rule 26 or to update their deficient interrogatory responses. Rather, they have provided only an unsworn legal brief styled a "Supplemental Statement on Damages." Defendants therefore request that Plaintiffs be required to update any relevant responses including those specifically raised in Defendants' motion, and to provide sworn disclosure of their damages which supersedes their prior deficient Rule 26 disclosure.

tions, providing no explanation at all.[2] This is not what is required by Rule 26(a)(1)(C), and it is not what this Court ordered.

Plaintiffs continue to provide ***no information whatsoever*** about the alleged misrepresentations that gave rise to the alleged pre-class artificial inflation claimed by Professor Fischel, or when they were allegedly made, and now have disregarded an Order on the subject. Defendants' expert is also left to guess which of the two inflation charts submitted by Plaintiffs' expert they intend to advance and how they actually work to produce their $4.1 billion damages number. The refusal to identify the source of the alleged inflation that informs their damages model also makes it impossible to perform the netting of investor gains against losses that Plaintiffs have stated is appropriately done to calculate damages. As explained more fully in the accompanying affidavit of Dr. Mukesh Bajaj, these and other omissions and ambiguities in Plaintiffs' Statement present significant impediments to the preparation of his responsive expert report.

In its Order, the Court emphasized that a party's failure to comply with its Rule 26 obligations "result[s] in a party being precluded from presenting the withheld information at trial" pursuant to Fed. R. Civ. P. 37(c)(1). Plaintiffs' patently evasive response invites precisely this sanction. As Defendants previously noted, Judge Guzman has not hesitated to dismiss a case for failure to comply with Rule 26. While Defendants (and Dr. Bajaj) are continuing to seek the explanation that was ordered, preclusion is amply warranted by Plaintiffs' conduct.[3]

ARGUMENT

The "artificial inflation" in a company's stock price that supports a claim for damages must result from a misrepresentation or material omission by the defendants. *See*, *e.g.*, *Ray* v.

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[2] The precedents that spell out the needs for *explanations* of a party's damages theory are summarized at page 3 of *Defendant's Memorandum of Law in Support of the Household Defendants' Motion to Compel Discovery Pursuant to Rule 26(a)(1)(C) and This Court's Orders, or in the Alternative for a Recommendation of Preclusion*, filed on October 5, 2007. Rather than use the time afforded by the Court to comply with this requirement, Plaintiffs hastily submitted their so-called Supplement a week prior to the Court's deadline in an unsuccessful effort to oppose an extension of the deadline for submission of Defendants' expert reports.

[3] On November 5, 2007, Defendants met and conferred with Plaintiffs, complying with their obligations under Fed. R. Civ. P. 37(a)(2)(B) and Local Rule 37.2.

Citigroup Global Markets, Inc., 482 F.3d 991, 995 (7th Cir. 2007) (noting that a recoverable loss in securities a fraud case requires, *inter alia*, "that the defendants' alleged misrepresentations artificially inflated the price of the stock"). Indeed, the misrepresentation by a defendant that inflates the stock price is the touchstone upon which a fraud claim for damages is founded.

Plaintiffs' expert report and interrogatory responses assert that the stock price was "inflated" as of the first day of the class period, and claim this inflation as the basis for Plaintiffs' claimed damages. They do not, however, identify which alleged misrepresentations by Defendants artificially inflated the price of the stock or when such misrepresentations occurred, or explain how the alleged inflation fits in with their theory of damages. Instead, the Plaintiffs simply assert that on the first day of the class period, the stock price was already "inflated" by unspecified misrepresentations. These deficiencies and the resulting prejudice to Defendants were spelled out in Defendants' motion to compel disclosure of the missing information.

In response to the Court's Order granting Defendants' motion, Plaintiffs acknowledged for the first time (without explanation) that they intend to claim damages based on the inflation present on the first day of the class period, but failed to explain what misrepresentations gave rise to that claim for damages. (*See* Declaration of David R. Owen, dated November 14, 2007 ("Owen Decl."), Ex. 1 at 2 (Plaintiffs' Supplemental Statement).) Plaintiffs' response also acknowledged (also without explanation) that they intend to "net" investor gains from the fraud in calculating damages, but withheld the pre-class inflation information that that would make such netting possible. Plaintiffs also vaguely assert that "both" of Professor Fischel's inflation charts applied to all class members, but provided no indication of how. (*Id.*) These unexplained "yes we are" contentions do not comply with the Court's decision.

Among other problems discussed by Dr. Bajaj, the netting of gains against losses cannot properly be performed without an explanation of when the inflation went into the stock price. (*See* Owen Decl. Ex. 2 (Affidavit of Dr. Mukesh Bajaj) at 9.)

A similar problem identified by Dr. Bajaj arises from Plaintiffs' failure to explain how the stock price became inflated with respect to the use of Fischel's Exhibits 53 and 56. (*See* Owen Decl., Ex. 2 at 5.) Without identifying which misrepresentations or events inflated the stock price, there is no way to know precisely what "fraud" Plaintiffs are claiming or whether

later price drops are a result of the claimed "fraud" or a result of changed investor expectations or circumstances unrelated to the "fraud." *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336, at 343 (2005) (noting that without some connection to the "earlier misrepresentation" a "lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price."). At the very least, Plaintiffs are required to say what the "earlier misrepresentation" was.

Unless Plaintiffs provide information on when and how they contend artificial inflation was introduced into Household's stock price, their damages theory remains incomplete, and Defendant's expert will be deprived of the opportunity to respond to important and required elements of Plaintiffs' claims.

I. Defendants' Expert Needs Information On Plaintiffs' Unidentified Pre-Class Period Inflation

As Plaintiffs have acknowledged (if only in principle), in order to determine whether a shareholder was damaged by an alleged misrepresentation or omission, that shareholder's losses must be netted against that shareholder's gains resulting from the artificial inflation caused by the actionable misrepresentation or omission. In the case of shares purchased at an inflated price, but sold at a less inflated or uninflated price, the shareholder suffers a loss as a result of the alleged fraud. Conversely, in the case of shares purchased at an uninflated or less inflated price, but sold at a more inflated price, the shareholder receives a benefit from the putative fraud. Plaintiffs agree with the concept of netting gains resulting from the alleged fraud against losses resulting from the alleged fraud. (Owen Decl., Ex. 1 at 2) They say that they "intend to use a netting approach for Class members who profited from some trades of Household's common stock acquired during the class period and sold after November 14, 2001, but suffered losses from other trades of Household's common stock during this same period." *Id.* While recognizing the necessity of netting gains against losses, Plaintiffs apparently intend to draw an arbitrary line as to which gains should be netted against alleged losses by netting only purchases and sales made after July 30, 1999. Further, Plaintiffs refuse to say when and how the price of Household shares became inflated, which is necessary for a full netting of gains against losses, as Dr. Bajaj more fully explains.

Plaintiffs say that they intend to base damages on artificial inflation caused by alleged misrepresentations and omissions already present in Household's stock price on July 30, 1999. This means that the misrepresentation or omission that caused this artificial inflation must have occurred prior to that day. Therefore, by ignoring all transactions made prior to the start of the class period (but after the alleged misleading statements had introduced this artificial inflation), Plaintiffs' disclosure seeks to avoid even the possibility that a full netting of gains against losses can be calculated.

Plaintiffs' unsworn Supplemental Statement purports to interpret the Court's Order to require nothing more than a "yes" or "no" answer, with no analysis or explanation. Plaintiffs' Supplemental Statement is therefore in direct violation of Rule 26, not to mention this Court's Order.[4]

II. Defendants' Expert Needs Information On Which Inflation Model Plaintiffs Intend to Use to Calculate Damages

In addition to Plaintiffs' failure to clarify their position on shareholders who benefited from the alleged fraud by selling shares purchased prior to the class period, Plaintiffs also fail to clarify the meaning of Professor Fischel's Exhibits 53 and 56. In its Order, the Court speculated that Plaintiffs might intend to use Fischel's Exhibit 56 "leakage" chart as the basis for claiming damages for "in and out" investors. Order at 4. Such speculation was necessary because of Plaintiffs' refusal to explain how they can claim one theory of damages on the basis of these two

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4 In a letter from Plaintiffs' counsel Azra Mehdi, dated November 7, 2007, Plaintiffs stated that the information Defendants seek about pre-class period artificial inflation is not necessary to evaluate Plaintiffs' damages theory because shareholders who purchased Household stock prior to the class period "are not members of the Class." (Owen Decl., Ex. 3) Excluding all shareholders who made any purchases prior to the class period (even if such shareholders also purchased during the class period), would moot the issue of netting by excluding every purchaser from the period of undefined inflation. However, Plaintiffs failed to include this position in their unsworn Supplemental Statement, and Defendants are skeptical that Plaintiffs truly intend to bind themselves to this position. If (as seems more probable) Plaintiffs would *not* exclude shareholders who purchased before the class period if they later purchased shares during the class period, this representation by Plaintiffs *does not* moot the ambiguity raised herein, because some gains will remain undefined. To comply with the Court's earlier Order, Plaintiffs must either bind themselves to this new position in a procedurally proper sworn document or provide the information on alleged pre-class period inflation so that Defendants' expert can evaluate and respond to their theory of damages.

fundamentally inconsistent exhibits. The Court ordered Plaintiffs to "clarify which of Professor Fischel's tables will be used for each type of investor." *Id.* In their Supplemental Statement, Plaintiffs' only answer is that, somehow, "[b]oth methods are applicable to all Class members . . . ." (Owen Decl., Ex. 1 at 1) This unresponsive and unintelligible "response" flouts the Court's Order.

Plaintiffs say they intend to prove the amount of daily per share damages instead of proving aggregate damages. (Owen Dec., Ex. 1 at 2 ("[P]laintiffs will ask the jury to determine the artificial inflation in Household's common stock on a per share basis for each day of the Class Period")). The daily inflation amounts in Exhibit 53 are different from the daily inflation amounts in Exhibit 56, so it is no answer at all for Plaintiffs to point to "both methods". Plaintiffs would like to take two positions now (the one in Exhibit 53 and the one in Exhibit 56) so they can keep their options open, but the time for such equivocation and obfuscation has long passed.[5]

III. Plaintiffs' Continued Refusal to Articulate Their Damages Theory and to Comply With the Court's Order Warrants Preclusion

Fed. R. Civ. P. 37(c)(1) provides that "[a] party that without substantial justification fails to disclose information required by Rule 26(a). . .or to amend a prior response to discovery as required by Rule 26(e)(2), is not . . . permitted to use as evidence at a trial, at a hearing, or on a motion any witness or information not so disclosed." Fed. R. Civ. P. 37(c)(1). The sanction for failure to comply with Rule 26(a) is "automatic and mandatory" unless Plaintiffs can prove that their Rule 26(a) violations were either justified or harmless. *Salgado* v. *General Motors Corp.*

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[5] The Court also ordered Plaintiffs to provide the "estimated aggregate damages claimed by the class as a whole", (Order at 5), and to "identify their proposed method of calculating those damages". *Id.* Rather than provide any calculation of aggregate damages that could be evaluated by Defendants' expert, Plaintiffs' unsworn Supplemental Statement only stated that these calculations (whatever they may have been) resulted in an estimation of $4.1 billion. (Owen Decl., Ex. 1 at 3) No support for this number was given. Any quantification of damages must be some function of the estimated daily alleged inflation. However, given the wide variation in the two daily alleged inflation estimates (exhibits 53 and 56), the resultant damages estimates could vary by billions of dollars, depending on the inflation measure chosen and the formula applied to it. Plaintiffs should be ordered to provide whatever calculations they made in order to arrive at this $4.1 billion figure. As Dr. Bajaj notes in his affidavit, he has been unable to reproduce this number using either of Plaintiffs' inflation estimates. (Owen Decl. Ex. 2 at 4)

150 F.3d 735, 741, 742 (7th Cir. 1998). Plaintiffs have refused to provide important information about their damages theory, even in the face of this Court's explicit Orders. The prejudice to Defendants of having to rebut an unstated and still ambiguous damages theory is manifest. Plaintiffs have sought to avoid any potentially damaging disclosures until ***after*** our experts have spoken. This continued evasion defies the Court's ruling that "Defendants are entitled to know Plaintiffs' theory ***now*** so their expert can provide a response." *See* Order at 5 (emphasis added).

Plaintiffs' blatant refusal to provide the information Defendants' expert needs in the face of the Court's Order mandates Plaintiffs' preclusion from offering evidence on these points during summary judgment proceedings or at trial. *See Finwall* v. *City of Chicago*, 239 F.R.D. 494, 496, 500 (N.D. Ill. 2006) (granting defendant's motion to exclude the opinions of plaintiff's experts under Fed. R. Civ. P. 37(c)(1) where "the plaintiff has ignored the expert discovery deadlines. . . .is unapologetic for its flagrant noncompliance. . . . [is] [u]nwilling to accept the slightest responsibility for its violations of [Magistrate] Judge Manning's deadlines and of the local rules of this court, [and] incredibly seeks to shift the focus to the defendants").

Indeed, as Defendants noted in their original motion to compel these disclosures, the preclusion flows by a straight-forward operation of the Federal Rules. Specifically, Plaintiffs must be precluded from proving any damages allegedly suffered by shareholders who purchased Household stock on or after July 30, 1999 who also purchased Household stock prior to July 30, 1999, and Plaintiffs must be precluded from presenting at trial the information contained in either of Professor Fischel's inflation charts (Exhibits 53 and 56) as a proper estimation of per share damages.

CONCLUSION

This Court held that "Defendants are entitled to know Plaintiffs' theory now so their expert can provide a response." Plaintiffs have failed to provide vital information regarding their theory, leaving critical questions unanswered, and have thus hindered Defendants' expert in his evaluation of Plaintiffs' damages theory and in his formulation of a response.

For these reasons, Defendants request that the Court grant Defendants' motion and:

(a) order that Plaintiffs must either (1) bind themselves in a procedurally proper sworn document expressing their new position as articulated in their November 7, 2007 letter, that

Plaintiffs agree to exclude from the Class shareholders that made any purchases prior to the class period, even if such shareholders also purchased Household stock during the class period, (2) provide an explanation of the source and timing of the pre-class period inflation so that Defendants' expert can evaluate and respond to it; or (3) be precluded from proving any damages allegedly suffered by shareholders who purchased Household stock on or after July 30, 1999 who also purchased Household stock prior to July 30, 1999;

(b) order that Plaintiffs must either (1) identify how each of Professor Fischel's two inflation tables (Exhibits 53 and 56) are to be used to support a single damages calculation; or (2) be precluded from presenting at trial the information contained in either of Professor Fischel's inflation charts as a proper estimation of per share damages;

(c) order Plaintiffs to update relevant interrogatory responses, including those interrogatory responses specifically identified in Defendants' original motion to compel; and

(d) order Plaintiffs to explain the calculations they performed that led to the contention that the Class' aggregate damages are approximately $4.1 billion.

November 14, 2007
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Respectfully submitted,

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