UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

LEAD PLAINTIFFS' STATUS REPORT FOR THE FEBRUARY 7, 2008 TELEPHONE STATUS CONFERENCE

Lead plaintiffs respectfully submit this statement in advance of the February 7, 2008 status conference call.

A. Professor Fischel's Report Complies with the Court's November 20, 2007 Order

Lead Plaintiffs served their expert rebuttal reports on February 1, 2008, including the rebuttal report of economic expert Professor Daniel R. Fischel. Professor Fischel's report identifies the source of inflation in Household International, Inc.'s ("Household") stock on the first day of the Class Period and explained why regression analysis is not appropriate in this case to identify the day Household shares first became inflated.[1] Lead plaintiffs also served on defendants a further statement regarding damages that addresses the additional points of clarification sought by defendants' expert Dr. Mukesh Bajaj.[2] Professor Fischel's rebuttal and plaintiffs' supplemental statement address all of the purported deficiencies identified by Dr. Bajaj in his report.[3]

Defendants now contend that plaintiffs failed to comply with the November 20, 2007 Order because Professor Fischel did not provide a regression analysis taking the artificial inflation "back to zero." As discussed below, however, lead plaintiffs have complied fully with the Court's Order by responding to all of the issues raised by Dr. Bajaj.[4]

In the November 20, 2007 Order, Dr. Bajaj was directed to "specify all exceptions and deficiencies in Professor Fischel's report, including those that prevent Dr. Bajaj from offering his

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[1] Professor Fischel's rebuttal report is attached as Exhibit A.

[2] The supplemental statement is attached as Ex. B.

[3] A copy of the relevant portion of Dr. Bajaj's report is attached as Ex. C.

[4] Defendants do not take issue with plaintiffs' supplemental statement which explains that because plaintiffs intend to propose the FIFO (first in, first out) method of "matching" and have never proposed the netting of shares purchased before the Class Period it is not necessary to determine pre-Class Period inflation (whether going back to July 22, 1999, October 23, 1997, or some earlier date) in order to calculate damages for class members based on the current Class Period.

own analysis," and plaintiffs were ordered to respond. *See* November 20, 2007 Order. Professor Fischel's rebuttal report complies with this Order. Ex. A at ¶¶25-29. In his report, Professor Fischel explained the source of inflation in the stock on the first day of the Class Period which is the information Dr. Bajaj claimed he needed. Ex. A at ¶36; Ex. C at 87; *see also* November 20 Order ("Defendants [] claim that their expert required more information as to the source of the pre-Class Period inflation Professor Fischel claims is present in the price of Household stock on the first day of the Class Period.").

Lead plaintiffs understood the Court's November 20 Order to require them to respond to the "exceptions and deficiencies" identified by Dr. Bajaj, which they did. Although the Court indicated in the Order that it "***expect[ed]*** Professor Fischel [would] provide a regression analysis showing the date on which there was zero inflation in the stock price," plaintiffs did not understand that the Court had, without even seeing Dr. Bajaj's report (which was served after the Order), ordered plaintiffs' expert to provide that analysis. As explained by Professor Fischel such an analysis was not required in order to respond to Dr. Bajaj's criticisms, which he points out were "incorrect and misleading because [Dr. Bajaj] mischaracterizes Plaintiffs' allegations and the use of regression analysis to quantify artificial inflation." Ex. A at ¶37.

Notably, Dr. Bajaj did not indicate in his report that a regression analysis from Professor Fischel indicating the first date on which inflation came into the stock, was necessary for him to provide his own analysis. Ex. C at 87-89. The parties met and conferred to discuss these issues Wednesday afternoon and during the call defendants acknowledged that Dr. Bajaj could provide his own analysis without this information.[5] Until now, defendants have argued that the information they

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[5] The meet and confer alluded to by defendants in their report occurred ***before*** Dr. Bajaj even served his report, thus defendants' "offer" to "meet and confer with Plaintiffs regarding any issues they may have encountered in complying" was, to say the least, illusory. Defs' Status Report at 2. Following receipt of Dr.

seek is necessary for Dr. Bajaj's analysis. This was their entire basis for insisting that Dr. Bajaj be permitted a sur-rebuttal. In their status report, however, defendants now claim that "this issue bears, *inter alia*, on whether Plaintiffs are seeking damages for the consequences of time-barred events." Defs' Status Report at 2. As Professor Fischel explained, defendants' assertions misconstrue plaintiffs' claims. Ex. A at ¶37.

Professor Fischel identified the source of inflation in Household stock on the first day of the Class Period. Ex. A at ¶36. He stated that Household's stock price was artificially inflated on July 30, 1999 by Household's failure to disclose material adverse facts in connection with its July 22, 1999 statement announcing its second quarter results. *Id.* It is a legal issue for Judge Guzman to decide whether the Class Period can start on July 30, 1999 or if it has to start on August 16, 1999, the date of the first public statement during the Class Period.

In any event, Professor Fischel's opinion that Household's stock was inflated during the Class Period does not change if the Court shortens the start of the Class Period from July 30, 1999 to August 16, 1999, or to a later date; nor does it matter if, or how much, Household's stock was inflated prior to the first actionable statement. ¶36. Indeed, Household's stock may have been inflated since the beginning of the old Class Period (October 23, 1997), (or even before that time) but that is no longer part of plaintiffs' case because it was dismissed by Judge Guzman on statute of limitations grounds. The existence of pre-Class Period artificial inflation would not preclude plaintiffs' cause of action for defendants' subsequent false statements that continued to artificially prop up Household's share price. This is because each statement made by defendants to the market that failed to disclose the adverse information regarding Household's improper business practices

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Bajaj's report, plaintiffs and their expert understood the purported "deficiencies and exceptions" and did not require further clarification from defendants in order to respond. *See* Exs. A and B.

(predatory lending, improper re-aging and improper accounting) was an inflationary event. *Id.*, ¶¶36-38. Had the adverse information been disclosed, Household's share price would have fallen to its true value as identified by Professor Fischel in Exhibits 53 and 56. *Id.* at ¶¶36-39.

Furthermore, as Professor Fischel clearly explains in his report, a regression analysis cannot be used in this case to show the date on which there was zero inflation in Household's stock price:

> Plaintiffs claim that the alleged omissions were inflationary events because they prevented the price from falling to its true, uninflated value. Under this theory, the Company's stock price did not have to increase upon defendants allegedly false statements (*e.g.*, quarterly financial results) in order to become inflated. Consequently, the fact that I did not identify statistically significant price increases that resulted in the inflation increasing between the beginning of the Class Period and November 15, 2001 does not contradict plaintiffs' allegations. Moreover, event studies (which are based on regression analysis) are intended to measure stock price movements upon disclosure of new information, not the non-disclosure of information. Therefore, no regression analysis can be used to identify the day on which the stock price became inflated in this case.

Ex. A at ¶38 (citation omitted).[6] Accordingly, Professor Fischel's event study was not designed to determine the date on which the inflation came into the stock, but instead to estimate the artificial inflation in Household stock based on the effect of corrective disclosures and leakage from November 14, 2001 through the end of the Class Period. Ex. A at ¶¶38-39.

Defendants did not indicate in their Status Report what "remedy" they seek and did not specify a remedy when asked during the meet and confer; however, given Professor Fischel's comprehensive response to the issues raised by Dr. Bajaj, lead plaintiffs urge the Court to allow expert discovery to move forward without additional delay. Defendants will have the opportunity to further explore these issues at Professor Fischel's deposition.

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[6] In arguing to the contrary, defendants misquote Fischel's statement in paragraph 39. Defs' Status Report at 2. The full sentence should read, "Regression analysis . . . can be used in this case to calculate the amount of artificial inflation resulting from an alleged omission on any day ***during the Class Period***." Ex. A at 39 (omitted portion in bold).

B. Any Limited Sur-Rebuttal Should be Served by March 1, 2008

Defendants have not informed plaintiffs if and when they intend to file a sur-rebuttal from Dr. Bajaj in light of the response to Dr. Bajaj's criticisms provided by Professor Fischel and plaintiffs. If Dr. Bajaj wishes to submit a limited sur-rebuttal, plaintiffs will not object, provided defendants agree to serve that report by March 1, 2008 (giving defendants' expert an entire month) and to complete his deposition by March 14, 2008.

C. Expert Depositions

Judge Guzman has scheduled a status hearing on March 17, 2008 to set a summary judgment and trial schedule. All depositions must be complete by March 14, 2008 so the parties can appear before Judge Guzman on March 17, 2008. Lead plaintiffs have offered Professor Fischel for deposition on March 13, 2008 but still have not received a date for Dr. Bajaj. Defendants have been on notice for months that plaintiffs want to depose Dr. Bajaj prior to March 14, 2008 to avoid any further delay in setting this case for trial. The rest of the retained expert depositions have been scheduled, and will be completed in time for the March 17, 2008 trial setting conference.

D. Defendants' Refusal to Provide Information Relating to the 23 Non-Retained Expert Witnesses

Rather than complying with the Court's January 31, 2008 Order, without any advance notice or a properly noticed motion for reconsideration, defendants request in their status report that the Court reconsider its ruling. Aside from the procedural deficiencies of the motion, defendants fail to identify any meritorious grounds, as to why this Court should reconsider its well-reasoned opinion. Indeed, defendants' status report simply reiterates the exact same points they made in their original opposition. However, disagreeing with the Court's Order is not a proper basis for reconsideration.

As outlined in plaintiffs' submissions, the specific opinions the 23 witnesses will offer and the bases for those opinions is information necessary not only for plaintiffs to determine what additional steps, if any, they need to take with respect to defendants' "experts," but also for the Court

to perform its gatekeeper function under *Daubert*. The Federal Rules do not envision "trial by ambush." Accordingly, defendants should be required to provide the information outlined in the Court's January 31 Order.

DATED: February 6, 2008

Respectfully submitted,

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Exhibit A

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

REBUTTAL REPORT OF DANIEL R. FISCHEL

Lawrence E. Jaffe Pension Plan vs. Household International, Inc., et al.

REBUTTAL REPORT OF DANIEL R. FISCHEL

I. INTRODUCTION

1. I submitted a report dated August 15, 2007 (the "Fischel Report") in the above-captioned litigation.[1] In that report, I set forth and provided the bases for my principal conclusion that the economic evidence is consistent with Plaintiffs' claim that the alleged wrongdoing caused investors in Household's common stock to incur losses. Fischel Report ¶ 11. I also provided two alternative quantifications of the amount of alleged artificial inflation in Household's stock price during the Class Period, one based on the price reactions to specific fraud-related disclosures ("Quantification Using Specific Disclosures") and one that accounts for the stock price effect of fraud-related information that leaked into the market during the latter part of the Class Period ("Quantification Including Leakage"). *Id.* ¶ 30.

2. Defendants have submitted the Expert Report of Mukesh Bajaj dated December 10, 2007 (the "Bajaj Report"). In his report, Dr. Bajaj claims that "Professor Fischel's Analysis Suffers From Several Fundamental Flaws And Results In Incorrect And Unsupportable Conclusions." Bajaj Report at 8. He also provides multiple criticisms of my analysis and conclusions.

3. I have been asked by counsel for Plaintiffs to review and respond to Dr. Bajaj's criticisms as described in the Bajaj Report. I have been assisted by Lexecon's staff. Exhibit A describes the materials I have relied upon in forming my

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1. The Fischel Report provides information on my qualifications and defines capitalized terms.

opinions contained in this report. Based on my review of these materials and our analysis, I have concluded that Dr. Bajaj's criticisms are incorrect and therefore do not affect my conclusion.

II. DR. BAJAJ'S CRITICISMS OF MY CONCLUSION ARE INCORRECT

A. Dr. Bajaj's Claim that I "Provided No Economic Evidence" to Support My Conclusion Is Incorrect

4. As I explained in the Fischel Report, Plaintiffs allege that the Defendants engaged in a fraudulent scheme and wrongful course of business, the components of which I refer to as Predatory Lending, Re-aging, and the Restatement. Fischel Report ¶ 10. Plaintiffs further claim that the cumulative effect of the revelation of Defendants' alleged wrongful course of business caused Household's stock price to decline. *Id*. Dr. Bajaj opines that "Professor Fischel Has Provided No Economic Evidence That Would Warrant His Conclusions That Economic Evidence Is Consistent With Plaintiffs' Claim." Bajaj Report at 11. Dr. Bajaj is incorrect because he ignores the extensive economic evidence in the Fischel Report that is consistent with Plaintiffs' allegations.

5. In my report, I used a well-known and established technique in financial economics known as an "event study" to establish that Household's stock price reacted significantly to disclosures related to the alleged fraud. Fischel Report ¶¶ 30 & 34-5. Using my event study, I accounted for the effect of market factors on the Company's stock price following each of these disclosures and demonstrated that net of market factors, the cumulative impact of the disclosures caused the stock price to decline. *Id*. ¶ 36. In addition, I provided numerous examples of news articles and commentary by

market participants which demonstrate that a steady stream and extensive amount of incomplete information related to Defendants' alleged fraud was disclosed beginning at least as early as November 15, 2001. *Id.* § III & ¶ 39. I also established that, although only some of these disclosures were associated with significant changes in Household's stock price, the stock lost more than half of its value beginning November 15, 2001 through the end of the Class Period and that market participants attributed this decline to concerns regarding Defendants' allegedly fraudulent practices. *Id.* ¶¶ 28 & 39. Moreover, I showed how the stock substantially underperformed the market and comparable indexes over this period, indicating that under the facts and circumstances of this case, Household's stock price decline cannot be fully explained by adverse market events and is on the contrary consistent with Plaintiffs' claim that the decline occurred as investors learned of the Company's allegedly fraudulent practices and Defendants' denials became less credible. *Id.* ¶¶ 29 & 39. I concluded that the combination of the significant stock price decline, the concurrent leakage of fraud-related information, and market participants' attribution of the decline to this fraud-related information is strong economic evidence that in this case, the long-run relative underperformance of Household's stock price beginning November 15, 2001 through the end of the Class Period was caused by leakage of artificial inflation from the price. *Id.*

6. Dr. Bajaj ignores this economic evidence and offers no compelling argument to otherwise explain Household's stock price underperformance in the latter part of the Class Period.[2] Instead, he mischaracterizes the Fischel Report[3, 4] and my

2. In fact, using his estimation period, Dr. Bajaj calculated substantial artificial inflation in Household's stock price during the Class Period. Bajaj Report at 83 & Exhibit 6.
3. Dr. Bajaj claims that "Professor Fischel anecdotally discusses events that occurred on 41 dates during the Class Period when the markets purportedly received information

report in another case,[5] falsely claims that my quantifications are internally inconsistent,[6] and presents a fundamentally flawed "illustration" that, contrary to his claim, does not

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related to the Plaintiffs' theories of alleged fraud" and that "such information did not collectively have a significant impact on HI's stock price on a market-adjusted basis." Bajaj Report at 17. But, he ignores that I acknowledged in my report that not all of the 41 "events" – some of which were newspaper articles describing past events (*see*, *e.g.*, Fischel Report ¶ 15) – were associated with statistically significant market-adjusted price changes and that I provided strong economic evidence to support my conclusion. *Id.* ¶ 39. This evidence included that analysts reacted negatively to the incomplete disclosures related to the alleged fraud on different dates. *Id*. ¶ 20. Based on all of the economic evidence, the fact that the market did not react significantly on every day that incomplete information related to Plaintiffs' allegations was disclosed is consistent with my conclusion that artificial inflation leaked out of Household's stock price in the latter part of the Class Period.

4. Dr. Bajaj claims that "Professor Fischel describes his Leakage model as an 'event study approach' when it is not." Bajaj Report at 16. However, as I explained in the Fischel Report, my Quantification Using Leakage uses "the 'event study approach' described by Cornell and Morgan." Fischel Report ¶ 41. According to these authors: "The event study approach assumes that the price and value of the security move in tandem except on days when fraud-related information is disclosed. … [I]f no fraud-related information is disclosed, set the [Constructed Return (*i.e.*, the stock price return underlying the estimate of the stock's value absent the fraud)] for that day equal to the actual return on the security; if fraud-related information is disclosed, or there is evidence that such information is leaking into the market, set the [Constructed Return] for that day equal to the return on the security predicted by the market model." B. Cornell and R.G. Morgan, "Using Finance Theory to Measure Damages in Fraud on the Market Cases," 37 *UCLA L Rev.* (1990) at 899. This is exactly what I did. Fischel Report ¶ 41. Dr. Bajaj also criticizes the event study approach by misquoting Cornell and Morgan's discussion of a limitation in an alternative approach – which I did not use – that they call the "comparable index approach." Compare, Bajaj Report at 72 *with* Cornell and Morgan (1990) at 903.
5. Based on his mischaracterization of my report in another case (*In re Blech Securities Litigation*, which he incorrectly refers to as *In re Bizch Securities*), Dr. Bajaj claims that "Professor Fischel now makes the same mistake for which he has criticized others in the past." Bajaj Report at 74. On the contrary, my reports in the two cases are entirely consistent. In *Blech*, I stated that it is a mistake to assume without more economic evidence that underperformance relative to an index constitutes inflation. Here, I explain why underperformance, in combination with the statistically significant stock price declines in response to specific disclosures and analyst and other commentary, all are consistent with Plaintiffs' claims.
6. Dr. Bajaj claims that "The Two Alternative Quantifications of Alleged Artificial Inflation That Professor Fischel Proposes Are Internally Inconsistent" and that this purported "internal inconsistency … demonstrates that his quantification of alleged inflation is fundamentally flawed and unreliable." Bajaj Report at 75-6. His claim is

show the purported "fallacy" in my analysis.[7] Consequently, Dr. Bajaj's arguments do not affect my conclusion.

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based on two declines in artificial inflation in my Quantification Using Specific Disclosures (on November 15, 2001 and December 5, 2001) that are not reflected in my Quantification Including Leakage. *Id.* However, in making this criticism, he ignores that I state in the Fischel Report that in the latter quantification "[i]f the resulting inflation on any day was greater than the cumulative residual price decline during the observation window of $23.94, I limited the inflation to $23.94 and adjusted the true value line accordingly." Fischel Report ¶ 42. To demonstrate that my quantifications of artificial inflation are consistent, Exhibit B presents my daily quantifications but without applying the limitation on the Quantification Including Leakage. As shown on page 14 of this exhibit, prior to employing the constraint, the artificial inflation in both quantifications declines on November 15, 2001 and December 5, 2001. Thus, the differences he notes are artifacts of the constraint, not an internal inconsistency in my calculations. Dr. Bajaj's claim is particularly disingenuous because he employs the limitation when he replicates my Quantification Including Leakage using his estimation period. Bajaj Report Exhibit 6.

7. Dr. Bajaj's misunderstanding of the Fischel Report and the event study approach leads him to create a fundamentally flawed "illustration" using stock price information for "all 30 members … of the Dow Jones Industrial Average ('DJIA')" during the Class Period to create "Pseudo-Damages" that purportedly show the "fallacy" in my analysis. Bajaj Report at 76. This illustration is flawed for at least three reasons. First, the illustration is based on the "comparable index approach" which assumes that "the observation window [where the leakage could have occurred] is expanded to cover the entire class period" (Cornell and Morgan (1990) at 906), not on the event study approach that I used in the Fischel Report. Second, unlike his analysis which he admits was performed "without any further factual analysis" other than the use of stock price data (Bajaj Report at 76), my Quantification Including Leakage was based on the analysis of the economic evidence presented in the Fischel Report. Third, because he did not conduct any factual analysis and thus has no reason to believe that the DJIA members' stock prices were inflated, had he used the event study approach that I used, Dr. Bajaj would have found zero "Pseudo-Damages." To see why, note that in his illustration, Dr. Bajaj "assumes that the difference between a DJIA Member's actual stock price and its True Value represents daily 'inflation.'" *Id.* As explained *supra* n. 4, the event study approach requires that if no fraud-related information is disclosed, the stock price return underlying the estimate of True Value for that day is set equal to the actual return on the security. Therefore, because he has no reason to believe that any fraud-related information was disclosed on any day during the Class Period for the DJIA members, he should have set their True Value returns equal to the actual returns on every day during this period. Had he done so, the True Value would have equaled the actual stock price for each DJIA member and thus he would have found zero daily inflation in these companies' stock prices and zero "Pseudo-Damages."

B. Dr. Bajaj's Analysis of Dates "Most Relevant to Plaintiffs' Three Distinct Theories of Alleged Fraud" Is Incorrect

7. Dr. Bajaj also claims that my "conclusion is factually incorrect" because "on the three days when new information most relevant to Plaintiffs' three distinct theories of alleged fraud was revealed, HI's stock price actually increased." Bajaj Report at 8. These "three days" are August 14, 2002, April 9, 2002, October 10, 2002, and October 11, 2002. *Id*. at 8-10. Once again, Dr. Bajaj is incorrect because, as explained above, he ignores the extensive economic evidence in my report concerning disclosures on days other than these "three" that is consistent with Plaintiffs' allegations. As I explain below, Dr. Bajaj is also incorrect because he ignores the economic evidence related to these "three days."

i. August 14, 2002

8. Dr. Bajaj states that "[o]n August 14, 2002, HI announced that it would restate its earnings back to 1994" and that "HI's price increased by 29 cents (or 0.77%) following this Restatement." *Id*. at 8-9. However, as I explained in the Fischel Report, after accounting for the effect of market factors on Household's stock price on August 14, 2002, I found that it declined by $0.94 (or 2.5%); I also found that this decline was statistically significant. Fischel Report n. 16. In addition, I explained that market participants were surprised by the announcement. *Id*. ¶ 27. Dr. Bajaj recognizes that "unless the market received new information about the alleged fraud, and the stock's market-adjusted price change following such news was statistically significant, there is no economic basis to claim that the observed price change should be attributed to a 'disclosure' related to the alleged fraud, nor to measure the Plaintiffs' harm based on such a price change." Bajaj Report at 7. But, he admits that the market received new

information about the alleged fraud on August 14, 2002 and recognizes that I found the market-adjusted price change to be statistically significant (*id*. at 14 & n. 15), yet he ignores this economic evidence. Dr. Bajaj's criticism is particularly disingenuous because his own analysis of Household's stock price movements demonstrates that on a market-adjusted basis, the stock price declined significantly on August 14, 2002. *Id*. at 82 & Exhibit 8 at 1055.

9. Moreover, market commentators attributed the Company's stock price decline early on August 14, 2002 to the Restatement, which was announced before trading began on August 14, 2002. *Reuters News* reported that "Household International tumbled after the consumer finance company said it would downwardly revise its net income due to accounting changes." *See* Exhibit C. Similarly, in an article dated August 14, 2002 at 11:22 AM, *Dow Jones Business News* reported that "Household International Inc.'s (HI) shares fell after the consumer-finance company announced that it restated profits downward by $386 million – for the period spanning from 1994 to the second-quarter of this year – to reflect a change in accounting tied to certain contracts within credit-card business." *See* Exhibit D.

10. In addition, Dr. Bajaj asserts that "[a]ccording to a large body of academic research, accounting changes that do not significantly affect investors' expectations about future cash flows or the risk associated with such cash flows, do not impact the stock price." *Id*. at 9. While generally true, this assertion is irrelevant in this case because there is evidence that the Restatement significantly affected investors' expectations about future cash flows. As I explained in the Fischel Report, analysts at Morgan Stanley commented that the restatement "suggests to us that returns in the credit card business are lower than we previously thought" and reduced their earnings forecasts

and price target while CIBC World Markets analysts also reduced their 2002 and 2003 earnings estimates and lowered their price target. Fischel Report ¶ 27.

11. Dr. Bajaj further asserts that I "fail[] to note that despite modest reductions in forecast earnings in the short term, these analysts continued to be very bullish on HI's stock, forecasting significant increases in HI's stock price." Bajaj Report at 25. This assertion is also irrelevant because, as I explained above, the analysts lowered their earnings forecasts and price targets. The fact that they did not change their recommendations or lower their price targets below the current price does not mean that investors did not lower their expectations about future cash flows or that the stock price did not decline on August 14, 2002 after accounting for market-related factors.

12. Dr. Bajaj also asserts that another Morgan Stanley report stated that "'Household's restatement does not materially affect future earnings, and the company has not changed guidance'" and that "'[a]ll three rating agencies affirmed Household's ratings on the news, reiterating that the restatement does not affect Household's future business, and included their expectations for capital levels to increase.'" Bajaj Report at 26. However, this report was issued by a fixed income analyst, not a stock analyst. *Id*. n. 92. Holders of fixed income (*i.e.*, debt) securities (which are the securities rated by the rating agencies) have claims on a company's assets that are senior to those of equity security holders and are thus less sensitive to changes in expectations about future cash flows. Therefore, the fact that fixed income analysts and ratings agencies did not consider the Restatement to materially affect Household's future earnings from the perspective of fixed income security holders does not mean that equity security holders did not lower their expectations about future cash flows or that the stock price did not decline on August 14, 2002 after accounting for market-related factors.

ii. April 9, 2002

13. Dr. Bajaj states that "Plaintiffs allege that the Company first 'broke out its reaging statistics' on April 9, 2002" and that "HI's stock price, however, increased insignificantly by 19 cents (or 0.32%) on that day, once again indicating that an event which Plaintiffs (and Professor Fischel) claim represented a 'disclosure,' was value-irrelevant."[8] *Id.* at 9. But, he ignores the economic evidence I presented in the Fischel Report that information related to Plaintiffs' Re-aging claim was disclosed on other dates (including earlier dates) and that several of these disclosures were associated with statistically significant price declines. Fischel Report ¶¶ 22-6, 34-5, n. 16, 19 & 20. In addition, Dr. Bajaj ignores that the stock price may not have reacted significantly on April 9, 2002 because investors had already adjusted the price to reflect information disclosed earlier that was related to Plaintiffs' Re-aging claim, thereby making the news on April 9, 2002 "value-irrelevant."

14. Dr. Bajaj also states that I "mention[] the SEC Cease-and-Desist Order ('SEC Order') dated March 18, 2003" and claims that I "fail[] to examine HI's stock price reaction to the SEC Order" as "[o]n March 19, 2003 (the date of the SEC Order Press Release) … increased insignificantly by 25 cents (or 0.89% from $28.20 to close at $28.45)." Bajaj Report at 39-40. However, contrary to Dr. Bajaj's claim, I did examine this reaction and found it to be inconclusive. On November 14, 2002, several months prior to the SEC Order announcement, Household and HSBC Holdings plc

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8. I understand that Plaintiffs contend that Household's April 9, 2002 disclosure of its re-aging statistics is a false and misleading statement, not a corrective disclosure. Indeed, I noted in the Fischel Report that analysts at Prudential Securities commented that the "new info on account re-aging lacked historical and comparative context and could be a misleading indicator of HI's approach to managing credit losses." Fischel Report ¶ 25.

("HSBC") jointly announced that they entered into an agreement pursuant to which HSBC would acquire the Company; the merger was expected to be completed during the first quarter of 2003. *See* Household Finance Corporation SEC Form 8-K dated November 14, 2002. Under the terms of the agreement, a fixed ratio was established in which each Household share would be converted into the right to receive 2.675 HSBC ordinary shares or 0.535 HSBC American depositary shares.[9] *See id.* The merger was consummated on March 28, 2003. Fischel Report n. 1. Following announcements of acquisitions where the consideration is based on the acquirer's stock price, the stock prices of the target company typically are determined by the prices of the acquirer.[10] In these types of mergers, the target's price generally would deviate significantly from the acquirer's price only if there is a reason to believe that the acquisition would not be completed at the agreed-upon terms. In Household's instance, there was no reason to believe that following the announcement of the SEC Order the acquisition would not be completed at the agreed-upon terms. In fact, HSBC's March 19, 2003 press release

9. In terms of market capitalization, HSBC was almost eight times larger than Household on March 18, 2003. According to their respective SEC filings, Household had 474.6 million common shares outstanding and HSBC had 9.5 billion ordinary shares outstanding as of December 31, 2002. According to *Bloomberg*, Household's stock price and HSBC's American depositary share ("ADS") price closed at $28.20 and $54.51 on March 18, 2003, respectively. Therefore, Household's market capitalization on March 18, 2003 was $13.4 billion. Because each HSBC ADS represents the right to receive five HSBC ordinary shares (*see* Household Finance Corporation SEC Form 8-K dated November 14, 2002), HSBC had 1.9 billion ADS-equivalent shares outstanding as of December 31, 2002 and its market capitalization on March 18, 2003 was thus $103.4 billion.
10. *See*, *e.g.*, E. Hutson and C. Kearney, "Merger arbitrage and the interaction between target and bidder stocks during takeover bids," 19 *Research in International Business and Finance* (2005) at 1 & 21 ("Interaction between bidder and target stocks is strong for stock-swap and mixed cases, where the bid price is transferred from bidder to target. … The interaction term in the target mean equations … shows considerable price transfer from bidder to target.").

regarding the SEC Order stated that "HSBC remains fully committed to completing the merger with Household subject to the terms and conditions contained in the merger agreement." *See* Exhibit E. Consequently, the fact that Household's stock price did not change significantly following the SEC Order announcement establishes nothing and does not affect my conclusions.

iii. October 10, 2002 and October 11, 2002

15. Dr. Bajaj states that "Professor Fischel attributes HI's price reaction on October 10, 2002 and October 11, 2002 to 'market talk' and the announcement of the terms of HI's nationwide settlement of investigations by various 'state attorneys general into its subprime consumer lending business' (the 'AG Settlement') on these two dates, respectively," and that "HI's stock price, however, increased significantly by $5.30 (or 25.24%) on October 10, 2002 and further by $1.90 (or by 7.22%) on October 11, 2002." Bajaj Report at 10-1. He notes that the Company "announced it would pay 'up to $484 million' to settle the investigations, and that it 'expected the changes in business practices to cut earnings by 10 cents a share in 2003, by 20 cents in 2004, and by 30 cents in 2005'" and that "[r]atings agencies lowered HI's debt ratings upon this news." *Id*. at 10. He also notes that I explained in the Fischel Report that the fact that the stock increased in value upon disclosure of this negative information is evidence that it had declined earlier by at least as much in anticipation of a larger payment and/or changes in Household's business practices that would have had a worse impact on the Company's future prospects. *Id*. at 66. Dr. Bajaj claims that my explanation contradicts "the facts surrounding the AG Settlement" and "Professor Fischel's theory that HI's stock price declined on the Alleged P[redatory] L[ending]

Disclosures because of curative disclosures that revealed a fraud related to the Plaintiffs' theory of 'Predatory Lending.'"[11] *Id*. Dr. Bajaj's claims are incorrect.

16. Dr. Bajaj claims that my explanation "is inconsistent with the facts" because "the announced settlement amount ($484 million) was within the range that investors and analysts had been expecting for several months." *Id*. at 68. But, he ignores the fact that if the announced settlement amount was within the expected range of the market consensus, there would have been no reason for Household's stock price to react positively or negatively to the settlement announcement. Instead, as I explained in the Fischel Report, analysts were concerned the fine could be higher; for example, analysts at UBS stated that "we estimate this fine could exceed $500 million." Fischel Report ¶ 21. In addition, Professor Bajaj ignores the fact that market participants were highly concerned that no settlement would be reached at all. For example, Howard Mason of Sanford Bernstein commented on October 3, 2002: "A more serious risk is that Household cannot reach agreement with the AGs and the rating agencies, unnerved by chronic regulatory problems, downgrade the outlook or rating on Household's senior debt. The impact could go beyond raising the cost of debt funding toward restricting access and creating liquidity challenges." *See* Exhibit F. Therefore, it is not surprising that when a settlement was reached, Household's stock price reacted positively.

17. Dr. Bajaj claims that if "price declines on the Alleged P[redatory] L[ending] Disclosures dates were in part caused by investors' expectations about larger

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11. Dr. Bajaj further claims that I "fail[] to consider whether HI's price reaction is explained by non-fraud related factors" and that in particular I "fail[] to exclude the possibility that HI's stock price had been depressed by headline risk regarding alleged 'predatory lending' …." Bajaj Report at 67. As I explain *infra* ¶¶ 26-9, his claim that Household stock price declines related to "headline risk" cannot be attributable to the alleged fraud is incorrect.

negative impacts of the impending AG Settlement than were subsequently announced, then such price declines cannot be entirely attributed to the 'alleged artificial inflation related to the above disclosures' as Professor Fischel claims in his event study methodology." Bajaj Report at 69. But, he ignores that by including the price increases on October 10, 2002 and October 11, 2002 in my Quantification Using Specific Disclosures, I net them against prior price declines caused by prior disclosures.[12] Fischel Report ¶ 36. Dr. Bajaj incorrectly assumes either that I do not net the price increases against the price decreases I measure or that the net effect on Household's stock price from the announcement that the Company would pay hundreds of millions of dollars and change its business practices such that future earnings would be reduced, which caused rating agencies to lower their ratings on Household's fixed income securities, was zero.

C. Dr. Bajaj's Analysis of Other Relevant Dates Is Incorrect

18. Dr. Bajaj also criticizes other dates relevant to the alleged fraud on which I base my Quantification Using Specific Disclosures. Bajaj Report at 30-7 & 40-65. His criticisms can be summarized as falling into five basic categories: 1) I "cherry-picked" these dates; 2) I did not adequately consider other non-fraud related reasons that could explain Household's stock price changes on some of these dates; 3) the information disclosed on some of these dates was "stale," *i.e.*, already publicly known; 4) stock price declines related to "headline risk" purportedly "cannot be attributable to the alleged fraud;" and 5) the stock price changes on some of these dates were not statistically

12. This also holds true for my Quantification Including Leakage in which I net the price increases on October 10, 2002 and October 11, 2002 against prior price declines caused by prior disclosures and leakage.

significant because my regression model is "flawed" and "mis-specified." I address each of these categories below.[13]

i. Dr. Bajaj's claim that I "cherry-picked" the Specific Disclosure dates is incorrect

19. Dr. Bajaj claims that "Professor Fischel has [] 'cherry-picked' his Specific Disclosures because he has ignored many dates (including dates that he himself has cited in his report, as well as numerous other dates that he has entirely ignored) when the markets did receive news related to Plaintiffs' theories of alleged fraud, but HI's stock price change was not significant, which indicates that such news was not value-relevant." Bajaj Report at 15-6. Once again, he mischaracterizes my report. The analysis used to identify the Specific Disclosures was comprehensive and consistent, not "cherry-picking."[14] In addition, the other dates in § III of my report, combined with the other economic evidence contained in my report, provided the basis for my conclusions that there was a significant relationship between Plaintiffs' allegations and investors' losses during the latter part of the Class Period, and that leakage of artificial inflation from the price caused Household's long-run relative stock price underperformance during this period. Fischel Report ¶¶ 28-9 & 39. As such, Fischel Report § III documented numerous instances where market participants explained how news related to Plaintiffs' allegations led them to revise downward their valuation of the Company's stock. For

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13. In the attached Appendix, I provide additional examples of Professor Bajaj's flawed criticisms.
14. Specifically, we first identified dates on which news related to Plaintiffs' allegations became available to the market. We then examined each of these dates to determine whether the news related to Plaintiffs' allegations led the market to significantly alter its valuation of Household's stock. We only included in the Quantification Using Specific Disclosures those dates on which news related to Plaintiffs' allegations had a statistically significant effect on the Company's stock price.

example, it documented that on May 7, 2002, *Newsday* reported that as news of Household's lending practices came out, the New York State Comptroller became so concerned that he considered selling his 2.5 million shares of the Company's stock. *Id.* ¶ 19. The Comptroller's concerns did not provide the market with new information related to Plaintiffs' allegations that caused it to significantly change the stock's value and so this date was not included in the Quantification Using Specific Disclosures. However, the concerns demonstrate how the revelations of improper lending practices led market participants to revise their valuations of the stock.

ii. Dr. Bajaj's claim that the price changes on some Specific Disclosure dates may be due to other non-fraud related reasons is flawed

20. Dr. Bajaj argues that the price changes on some Specific Disclosure dates may be explained by non-fraud related events which affected Household's industry. For example, he claims that news of a decline in the 10-year Treasury note yield "may have adversely impacted HI's stock price" on September 23, 2002. Bajaj Report at 62. But, he ignores that, as I explained in my report, I controlled for such industry effects in my event study. Fischel Report ¶ 32. Dr. Bajaj criticizes my event study because the underlying regression model did not include the index of consumer finance company stocks he created. *See infra* ¶ 32. But, even if I include this index in my regression model, I still find that all of the market-adjusted stock price changes on the Specific Disclosure dates I identified are statistically significant. *See id.* & Exhibit G.

21. The specific non-fraud related events Dr. Bajaj offers to explain the changes in Household's stock price on Specific Disclosure Dates are implausible.[15] For example, he claims that the Company's stock price decline on November 15, 2001 (the date Household responded to the CDC lawsuit (Fischel Report ¶ 12)) may have been due to "Providian's statement that its default rates had increased," which he notes occurred after the market closed on November 14, 2001, the prior day. Bajaj Report at 50-1. But, Providian's stock opened down substantially on November 15, 2001 while Household's stock price was largely unchanged until the Company responded to the lawsuit at 1:40 PM.[16, 17] *See* Fischel Report Exhibit 5.

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15. In a number of instances, Dr. Bajaj's assertions regarding non-fraud related explanations of Household's performance involve mischaracterizations of the facts. For example, Dr. Bajaj criticizes the Fischel Report for attributing Household's price decline on September 23, 2002 to news regarding Household's alleged predatory lending in a report by analysts at CIBC. Bajaj Report at 62 & Fischel Report ¶ 34. Dr. Bajaj argues that the CIBC analysts "Downgraded HI's Stock Based On The Possible Adverse Impacts Of Macro-Economic Factors That Were Unrelated To The Alleged Fraud" and that "the CIBC report did not reveal any news related to the Plaintiff's claim of 'Predatory Lending.'" Bajaj Report at 61-2. But the analysts did not downgrade Household's rating (the title of the report is "Household International Lowering Price Target On Persistent Headline Risk, But Maintaining SP Rating") and their only reaction to macro-economic factors was to trim their 2003 earnings estimates by about one percent (from $5.18 to $5.12 per share). Fischel Report Exhibit 46. Dr. Bajaj ignores that the CIBC analysts reduced their price target by over thirty-five percent (from $57 to $36) due to concerns related to predatory lending. *Id.* ¶ 28. The analysts commented that "[i]n particular, building concerns regarding the company's lending practices, which have been accused of being predatory in nature and is currently the subject of an investigation by the Washington Department of Financial Institutions, have dampened price performance" and then stated that "we have reduced our price target on the stock given the lack of visibility as to a resolution of the highlighted investigations and pending lawsuits." *Id.* & Exhibit 46.
16. Providian closed at $3.68 on November 14, 2001, opened at $3.02 on November 15, 2001, and closed at $2.87 on this day. In contrast, Household closed at $60.90 on November 14, 2001, opened at $60.60 on November 15, 2001, traded at $60.39 at 1:40 PM, and closed at $58.90 on this day.
17. Dr. Bajaj also claims that the CDC lawsuit was "stale" information because it was filed on November 9, 2001 and reported in the press on the same day. Bajaj Report at

22. Moreover, the Salomon Smith Barney analysts Dr. Bajaj cites attributed Household's price decline on November 15, 2001 to concerns regarding the CDC's allegations, stating that "HI shares sold off almost 4% intra-day on news that the California Department of Corporations has filed an $8.5 million lawsuit against HI for lending law violations (i.e., predatory lending)."[18] *See* Exhibit H. These analysts' concerns included that "[t]he greater potential risk, in our view, is that this lawsuit turns into a larger development. … to the extent that there were further findings from another audit, or another regulatory body was interested in pursuing the matter, there could be further chapters in the story." *See id.* Further, as discussed in the Fischel Report, the Deutsche Bank Alex Brown Inc. report Dr. Bajaj cites stated that the CDC lawsuit raised the questions of "1) how much more in refunds might Household owe? 2) will the accusations escalate (within or beyond the state)? and 3) will there be any operational constraints?" Fischel Report ¶ 12.

23. In another example, Dr. Bajaj criticizes the Fischel Report for attributing the decline in Household's stock price on December 3, 2001 to questions about the Company's accounting raised by a *Barron's* article published on Saturday, December 1, 2001. Bajaj Report at 31 & Fischel Report ¶ 22. He suggests that the stock price may have fallen because the *Barron's* article "adversely affected investors' expectations in a post-Enron world for non-fraud related reasons."[19] Bajaj Report at 34.

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48. But, he ignores that, as I explained in my report, Household did not publicly respond to the lawsuit until November 15, 2001. Fischel Report ¶ 12. The decline in the Company's stock price following its press release (*see supra* n. 16) indicates that the market was reacting not only to the CDC's complaint but also to Household's response.

18. In fact, neither of the analyst reports Dr. Bajaj cites that were released on November 15, 2002 even mention Providian. *See* Exhibit H & Fischel Report Exhibit 6.

19. Dr. Bajaj also claims that "the *Barron's* article did not provide any new information

But the closest Dr. Bajaj comes to identifying these "non-fraud related reasons" is his assertion that "[i]n the post-Enron world the 'market … [became] extremely emotional and sensitive' to any allegations of questionable accounting."[20, 21] *Id.* The only support he provides for his assertion is a Deutsche Banc Alex. Brown Inc. report which was issued over two months later and does not even mention the *Barron's* article or December 3, 2001. *See* Exhibit I & *id.* n. 136.

24. In contrast to the tenuous support for Dr. Bajaj's non-fraud related explanation for Household's stock price decline on December 3, 2001, market commentators provided clear, unequivocal support that the stock price fell because the *Barron's* article raised concerns about the Company's accounting. For example, on the morning of December 3, 2001, *Reuters News* reported that "[s]hares of loan and credit card firm Household International Inc. fell 5 percent on Monday, amid heavy trade, following an article in business weekly *Barron's* which cited analysts' views that the firm

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to the market" because it was based on an analyst report by William Ryan which was published more than six weeks earlier. Bajaj Report at 32. But, he ignores that, as I explained in my report, the article also discusses the concerns of a securities analyst whose firm worked for Household. Fischel Report ¶ 22. According to the article, the analyst was "puzzled by Household's statement that it had net chargeoffs of just 0.52%" in the last quarter on its home equity loans when "other subprime mortgage lenders have experienced losses at twice that level." *Id.* Exhibit 36. The analyst went on to say that "Household's loss rate on subprime mortgages is close to that of the savings-and-loan industry, even though S&Ls generally have more affluent borrowers and issue fewer second mortgages which, by their nature, are shakier than first mortgages." *Id.* ¶ 22.

20. Dr. Bajaj also notes that Enron filed for Chapter 11 bankruptcy protection (Bajaj Report at 33) but does not explain why this coincidence matters to Household's stock price.

21. Dr. Bajaj's assertion is consistent with Plaintiffs' allegations that investors' expectations of Household's prospects were adversely affected by concerns of accounting fraud.

was underestimating bad loans." *See* Exhibit J. The following day, analysts at Sanford Bernstein wrote:

> [Household's] stock is reacting to concerns about management credibility. Specifically, is management using the latitude provided by its loss recognition policies to enhance economic returns by adopting a more flexible stance towards customers, or abusing this latitude to distort reported payment behavior by postponing the recognition of losses?

See Exhibit K.

iii. Dr. Bajaj's criticisms regarding the purportedly "stale" information are unfounded

25. Dr. Bajaj's criticisms regarding the purportedly "stale" information are unfounded because he ignores information related to the alleged fraud that was first disclosed on each Specific Disclosure date. For example, he claims that the July 26, 2002 *Bellingham Herald* article "Only Provided Stale Information" because "complaints regarding Household's lending practices in Whatcom County, Washington had emerged almost four months earlier!" Bajaj Report at 52. But, he ignores the first sentence of the article, quoted in the Fischel Report, which states: "For the first time, Household International has acknowledged that its employees may have misrepresented mortgage loan terms to some Whatcom County homeowners who refinanced their homes at the Bellingham office of Household Finance Co., a subsidiary." Fischel Report ¶ 18. This was particularly significant since, as noted in the Fischel Report, the article went on to report that: "'[U]ntil now, company spokesmen have portrayed Household as an industry leader in consumer protection, with elaborate safeguards to make sure borrowers understand the deals they are signing' but 'this week, [a company spokesperson] said an internal company probe of the complaints had uncovered some serious problems.'" *Id.* Dr. Bajaj also ignores that the article provided new information suggesting that the

problems were not limited to the Company's Bellingham office. It reported that the former Bellingham office manager "said the sales pitches she used on potential borrowers came from the company." *Id*. Exhibit 23.

iv. Dr. Bajaj's claim that Household stock price declines related to "headline risk" cannot be attributable to the alleged fraud is incorrect

26. Dr. Bajaj claims that I "fail[] to recognize that the purported 'disclosures' [I] identified could have adversely affected investors' beliefs about HI's 'headline risk' exposure, *i.e.*, increased the market's assessment of the unknown future costs of settling allegations of 'predatory lending' or complying with future regulations" and further claims that "[a]ny price decline caused by news that changed HI's headline risk exposure cannot be attributable to the alleged fraud." Bajaj Report at 47. His claim is incorrect for several reasons.

27. First, Dr. Bajaj fails to explain why "headline risk" is inconsistent with Plaintiffs' predatory lending allegations. Rather, Household's "headline risk" during the Class Period was directly related to the alleged wrongdoing. For example, as I noted in my report, Stephens Inc. analysts stated that the Company's stock "has been plagued by 'headline' risk over predatory lending practices." Fischel Report ¶ 28.

28. Second, Plaintiffs allege that Household was not complying with existing regulations, not the undefined future ones that Dr. Bajaj alludes to in his description of the Company's "headline risk" exposure. As I noted in my report, on July 26, 2002, *The Bellingham Herald* reported that "Household International has acknowledged that its employees may have misrepresented mortgage loan terms to some Whatcom County homeowners" after "an internal company probe of [] complaints had uncovered some serious problems." *Id*. ¶ 18.

29. Third, Dr. Bajaj ignores the fact that market participants revised their valuations to take into account Household's likely lower profits as it brought its lending practices into compliance. For example, on September 3, 2002, Sanford Bernstein wrote:

> The report of the Washington State Department of Financial Institutions (DFI) – made public by the media on Wednesday last week – indicates that confusing sales practices in the Household branch system are more widespread than a few renegade loan officers, and quite possibly systemic. The effect on earnings growth as Household responds to regulatory pressure for sales practice reform will be commensurate. Specifically, we believe that as sales practice reform takes hold Household will need to reset its long run EPS growth target of 13-15% to 10-12%. … Driving factors are lower up-front points, reform of practices involving misrepresentation of loan rates, and the elimination of single-premium credit life insurance. Sales practice reform will also tend to slow growth in the branch real estate portfolio […] for two reasons: First, the practice of up-selling – restructuring the entire mortgage debt of a customer looking only for a "top-up" home loan to refinance credit card and other unsecured debt – will become more difficult under tougher regulatory scrutiny and higher company hurdles for customer net tangible benefit. Second, it is impractical for Household to offer loans at the 7% rates that representatives promise to induce refinancing by borrowers with prime bank mortgages, and this business will be forgone."

See Exhibit L.

v. Dr. Bajaj's criticisms of my regression analysis are fundamentally flawed

30. Dr. Bajaj claims that my estimation period (*i.e.*, the period over which I estimated the relationship between Household's return and the returns on the S&P 500 and S&P Financials Indexes underlying my event study analysis) is "[a]rbitrary" and "[i]ncorrect," because there "is no basis to arbitrarily select a segment of the Class Period to determine the 'historical relationship between changes in a company's stock price and changes in the performance of a market index (and possibly an industry index).'" Bajaj Report at 82 & n. 319. Dr. Bajaj is incorrect. As I explained in my

report, I used the period from November 15, 2000 to November 14, 2001 as my estimation period, which is "the calendar year prior to the earliest date I found that Household's stock price was negatively affected by the fraud." Fischel Report ¶ 32. My choice of estimation period is supported by the academic literature. For example, Tabak and Dunbar note: "[O]ne would typically like to use an estimation window close to the event because the relation between the company's stock and an index changes over time. Therefore, the closer the estimation window is to the event, the more relevant the estimated relation will be … The most common choice places the estimation window before the event."[22] In addition, MacKinlay states: "Given the selection of a normal performance model, the estimation window needs to be defined. The most common choice, when feasible, is using the period prior to the event window for the estimation window."[23]

31. Dr. Bajaj claims that I "provide[] no explanation for using the S&P 500 and the S&P Financials indices as the market and industry benchmarks in [my] regression model."[24] Bajaj Report at 79. But, he ignores that, as I explained in my report, Household compared its stock price performance to the S&P 500 Index and S&P Financials Index in its annual Proxy Statements filed with the SEC during the Class Period. Fischel Report n. 10.

32. Dr. Bajaj also claims that my model suffers from the "Omitted Variable" problem, where "a mis-specified regression model which excludes an

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22. D.I. Tabak and F.C. Dunbar, "Materiality and Magnitude: Event Studies in the Courtroom," in R.L. Weil, M.J. Wagner, and P.B. Frank (eds), *Litigation Services Handbook* (Wiley, 2001) at 19.5.
23. The event window in this case is November 15, 2001 through October 11, 2002.
24. A.C. MacKinlay, "Event Studies in Economics and Finance," 35 *Journal of Economic Literature* (March 1997) at 15.

important explanatory variable can result in the results of a regression being spurious."[25] Bajaj Report at 80. He purportedly solves this problem by constructing a "daily value-weighted index of consumer finance companies" (the "Consumer Finance Index") and including this index in his regression analysis. *Id.* n. 316. I added this variable to my regression analysis and found that all of the price changes in my Quantification Using Specific Disclosures remained statistically significant at the 5 percent level of significance in a "one-tailed" test and that the true value lines in both of my quantifications were still below Household's stock price.[26] *See* Exhibits G & M. Therefore, Dr. Bajaj's claim that my model is "mis-specified" because it suffers from the "Omitted Variable" problem does not affect my conclusions. Moreover, he ignores the fact that Household's stock underperformed his Consumer Finance Index during the

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25. Because Household is part of both the S&P 500 Index and S&P Financials Index, Dr. Bajaj claims that "it is incorrect as a matter of statistical principles, to attempt to explain HI's stock returns by variables that are in part influenced by the same returns." Bajaj Report n. 317. However, as Dr. Bajaj notes, Household's stock only comprised "0.83% of the S&P Financials Index" as of October 11, 2002. *Id.* n. 315. Moreover, according to *Bloomberg,* the stock only comprised 0.17% of the S&P 500 Index on the same date. Because these weights are so small, there is no reason to believe that Household's stock substantially "influenced" the indices or that there would be significant changes to my results. Indeed, Dr. Bajaj does not claim that there would be significant changes if I had excluded the stock from the indices.
26. In testing for statistical significance, I note that the ten percent level of significance (*i.e.*, a t-statistic of 1.65 or greater in a "two-tailed" test of significance) is also commonly considered statistically significant. *See*, *e.g.*, M.L. Mitchell and J.M. Netter, "The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission," 49 *Business Lawyer* (1994) at 564 ("A third commonly used decision rule is ten percent – here, the probability is ten percent that a randomly selected value will lie 1.65 standard deviations or more from the mean value.") *and* N.I. Crew, K.L. Gold and M.A. Moore, "Federal Securities Acts and Areas of Expert Analysis," in R.L. Weil, P.B. Frank, C.W. Hughes and M.J. Wagner (eds), *Litigation Services Handbook* (Wiley, 2007) at 18.11 ("Courts have not specified the level of statistical significance that corresponds to a legal definition of materiality. As with much academic research, they commonly use the 95 percent confidence level but also recognize the 90 percent and 99 percent levels as thresholds for statistical significance.").

period from November 15, 2001 to October 11, 2002 – the stock fell 53.2% while his index declined 29.6%, adjusted for dividends.

33. Dr. Bajaj also criticizes my estimation period because it includes September 11, 2001. He claims that the inclusion of September 11, 2001 in my estimation period "could result in an unreliable predictor for HI's future returns in the longer run." Bajaj Report at 83. But, he fails to provide any evidence to support this speculation or demonstrate that it affected my conclusions. Moreover, his estimation period also includes September 11, 2001. *Id.* at 81. Dr. Bajaj also claims that my use of a "narrow one-year horizon" is an additional reason why September 11, 2001 should not be included in the estimation period. *Id.* at 83. However, use of a one-year estimation period is common in the academic literature on event studies.`[27]

34. Dr. Bajaj further criticizes my regression model because it yields a negative coefficient for the S&P 500 Index. *Id.* at 79. But this is simply an artifact of my two-factor model. My regression model as a whole has substantial explanatory power. *Id.* To show that the returns on Household's stock and the S&P 500 Index were positively correlated during my estimation period, we ran a one-factor regression model

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27. *See, e.g.,* MacKinlay (March 1997) at 17 ("For each announcement the 250 trading day period prior to the event window is used as the estimation window."). A calendar year has approximately 250 trading days. Dr. Bajaj "consider[s] the entire Class Period as the relevant estimation period because … it is inappropriate to measure the relationship between HI's stock return and that of various indices based on an arbitrarily-selected and truncated Estimation Period (November 15, 2000 – November 14, 2001) as Professor Fischel has done." *Id.* n. 318. However, Dr. Bajaj's estimation period is objectionable because it unnecessarily includes the period of price movements he is analyzing. As MacKinlay points out: "Generally the event period itself is not included in the estimation period to prevent the event from influencing the normal performance model parameter estimates." MacKinlay (March 1997) at 15.

with this index as the sole explanatory variable and found that the coefficient for the S&P 500 Index was positive at 0.81.[28]

III. DR. BAJAJ MISCHARACTERIZES PLAINTIFFS' ALLEGATIONS AND MY USE OF REGRESSION ANALYSIS TO QUANTIFY ALLEGED ARTIFICIAL INFLATION IN THIS CASE

35. I understand that in an order dated November 20, 2007, the Court stated: "Defendants [] claim that their expert requires more information as to the source of the pre-Class Period inflation Professor Fischel claims is present in the price of Household stock on the first day of the Class Period. The court expects that Professor Fischel will provide a regression analysis showing the date on which there was zero inflation in the stock price …." My response is below.

36. At the outset before discussing my analysis of the economic evidence, some background is necessary. I understand that the original class period as pled in the Complaint began on October 23, 1997 when Household issued a press release announcing its financial results for the third quarter of 1997 and Plaintiffs allege Household's stock price became artificially inflated because Defendants concealed adverse information related to the Company's business practices. I further understand that the Class Period was shortened to begin on July 30, 1999, making this date the first day that Plaintiffs allege the stock price was artificially inflated because they allege that Defendants failed to reveal the adverse information on July 22, 1999 when the Company announced its second quarter financial results. I also understand that Plaintiffs further allege that Defendants failed to reveal the adverse information in the Company's Form

28. We also re-ran our results using Dr. Bajaj's method (Bajaj Report Exhibit 8 at 1222) and found that it made no difference.

10-Q for the quarterly period ended June 30, 1999 filed on or about August 16, 1999. This is because, according to Plaintiffs, each time Household issued public statements regarding its business (such as its quarterly financial results) during the Class Period, it failed to disclose material facts. Thus, any shortening of the Class Period at the beginning would not change Plaintiffs' allegation that Household's stock price was inflated on later dates. My analysis is premised on my assumption that artificial inflation in Household's stock price began on July 30, 1999 or no later than August 16, 1999.

37. With this background, I now turn to my analysis of the economic evidence and specifically Dr. Bajaj's mischaracterizations. He claims that "in both his Specific Disclosures model as well as his Leakage model, Professor Fischel explicitly assumes that no inflationary events occurred prior to November 15, 2001 (and after July 30, 1999, the first day of the Class Period)" and further claims that "[t]his assumption contradicts the Plaintiffs' claim that HI's stock became inflated through various alleged misrepresentations and/or omissions ('inflationary events') during the Class Period prior to November 15, 2001." Bajaj Report at 12-3. He also claims that "it is crucial under [my Quantification Including Leakage] to at least demonstrate that inflation was introduced into HI's stock price as a result of specific misstatements and omissions at some point in time before information about such alleged inflation purportedly began to 'leak' into the market."[29] *Id.* at 85-6. Dr. Bajaj's claims are incorrect and misleading

29. Dr. Bajaj further claims that "[Plaintiffs] also include as damages any difference between the stock price and the True Value when the stock price drops below the True Value; a difference which cannot be attributed to the fraud, according to the Plaintiffs' theories of alleged fraud." Bajaj Report at 89. But the evidence that Household's stock price had dropped below its true value as a result of the alleged fraud was the stock's reaction to the Specific Disclosures on October 10, 2002 and October 11, 2002. Fischel Report Note 21. As explained in the Fischel Report, this interpretation of the stock's return on these dates is fully consistent with Plaintiff's

because he mischaracterizes Plaintiffs' allegations and the use of regression analysis to quantify alleged artificial inflation.

38. Plaintiffs claim that the alleged omissions were inflationary events because they prevented the price from falling to its true, uninflated value. Under this theory, the Company's stock price did not have to increase upon Defendants allegedly false statements (*e.g.*, quarterly financial results) in order to become inflated.[30] Consequently, the fact that I did not identify statistically significant price increases that resulted in the inflation increasing between the beginning of the Class Period and November 15, 2001 does not contradict Plaintiffs' allegations. Moreover, event studies (which are based on regression analysis) are intended to measure stock price movements upon disclosure of new information, not the non-disclosure of information. Therefore, no regression analysis can be used to identify the day on which the stock price became inflated in this case.

39. Regression analysis, however, can be used in this case to calculate the amount of artificial inflation resulting from an alleged omission on any day during the Class Period. Because Plaintiffs allege that Defendants failed to disclose new adverse information concerning Household's business practices until later in the Class Period,

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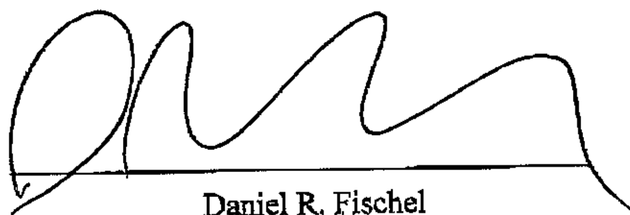
claims. *Id.* n. 21.

30. As Cornell and Morgan show in their Figure 1, the observed market price can become inflated even if it remains basically constant because, had adverse information been disclosed, the market price would have declined. Figure 1 of Cornell and Morgan (1990) at 887. Cornell and Morgan explain: "The price line and the value line coincide before a fraud or misrepresentation begins. Failure to disseminate information, or the dissemination of false or misleading information, then leads to an artificial inflation in the price of the security. Because the efficient market hypothesis states that the price of a security reflects publicly available information quickly and without bias, the price and value lines converge on the date that the fraud or misrepresentation is disclosed or corrected." *Id.* at 886.

investors in the Company's stock did not learn and therefore could not react to this information until then. Consequently, I used regression and event study analysis in this case to estimate the effect of corrective disclosures and leakage that dissipated the artificial inflation existing from the time of the first actionable non-disclosure.



Daniel R. Fischel

February 6, 2008

Appendix

Additional Examples of Dr. Bajaj's Flawed Criticisms

Dr. Bajaj's Claim	Response
December 12, 2001	
Dr. Bajaj criticizes the Fischel Report for attributing Household's price decline on December 12, 2001 to a report issued by analysts at Legg Mason at 6:04 PM on December 11, 2001. Bajaj Report at 36 & Fischel Report ¶¶ 23 & 34. He argues this report "largely repeated comments from the same analysts made in reports published" before the close on the same day. Bajaj Report at 37.	Dr. Bajaj ignores new information in the 6:04 PM report which is directly relevant to Plaintiff's claims. The Legg Mason analysts requested Household to "report asset quality problems more conventionally (a late is a late until repaid in full)" and expressed their concern that "[w]ithout this conventional disclosure, we are left with many unanswered questions." *Compare* Exhibits N & O *with* Fischel Report ¶ 23. The analysts stated in the 6:04 PM report that Household's disclosures raised specific concerns about three of its largest lines of business; these specific concerns were not discussed in the earlier reports. First, with regard to the Company's consumer loans, the analyst wrote: > We find this lenient reaging policy disturbing as it undermines the analytical value of the reported asset quality statistics. … We are not asking for HI to discontinue its flexible collections practices, just report asset quality problems more conventionally (a late is a late until repaid in full). Without this conventional disclosure, we are left with many unanswered questions. What percent of the portfolio has been restructured and what is the trend; how has that portfolio subsequently performed; is there a maximum number of times that an account can be restructured; should we be concerned about asset quality trends in the portfolio beyond the reported (and understated, in our view) delinquency statistics. *Compare* Exhibits N & O *with* Fischel Report Exhibit 38. Second, with regard to Household's private label credit loans, they noted: > What we don't know: how many months delinquent can an account be (1 month, 4 months?) and still be brought current with just one payment. It would appear that if a customer makes four payments, misses one and then makes the next payment, he is automatically reaged and is now current. This is troubling, in our view, as most lenders we spoke with would re-underwrite an account before restructuring (and some also required more than one payment). Also, if he skips the next three payments, and then makes a payment in

Additional Examples of Dr. Bajaj's Flawed Criticisms

Dr. Bajaj's Claim	Response
	month 10, is he (i) once again current, or (ii) three months contractually delinquent, or (iii) four months contractually delinquent? In essence, under what circumstances is this loan considered delinquent and reported in HI's two-month-and-over contractually delinquent report? This should not be such a grey area, in our opinion. These policies lead to more questions. What percentage of the portfolio has been reaged and how has it performed? What does "equivalent" mean? Can partial payments be aggregated over a time period exceeding one month and thus serve to bring the account current? Is there a maximum number of times that an account can be reaged? … Clearly, HI does not follow the FFIEC guidelines for reaging, in our opinion, which notes that (i) the account should exist for at least nine months before any reaging or deferment; (ii) the borrower should make at least three consecutive monthly payments; (iii) no reaging or any such modification should be done more than once in 12 months, and no more than two times in a five year period. *Id.* Finally, with regard to Household's home equity loans, they wrote: What we don't know: how many months delinquent can an account be (1 month, 4 months?) and still be brought current with just two consecutive payments. How often can an account (not seriously delinquent) be reaged? How is delinquency reported? What portion of the portfolio has been reaged and how has it performed? Is there a maximum number of times that an account can be reaged? … While we believe that a delinquent home equity loan can only be reaged once a year, we could find no specific mention of this in the trust document … It is not clear how much less than 100% [of the required payment] is acceptable [to cure the delinquency status of a home equity loan]. *Id.*

Additional Examples of Dr. Bajaj's Flawed Criticisms

Dr. Bajaj's Claim	Response
	Moreover, Dr. Bajaj offers no alternative explanation for the stock price decline on December 12, 2001.
February 27, 2002	
Dr. Bajaj criticizes the Fischel Report for attributing the increase in Household's stock price on February 27, 2002 to the Company's disclosure about its Best Practice Initiatives. Bajaj Report 70 & Fischel Report ¶¶ 17 & 35. He argues that: Household's return on February 27, 2002 could have been due to Federal Reserve Chairman Alan Greenspan indicating "an economic recovery was on its way;" "the markets already knew of the Company's Best Practices Initiatives, which had been first announced on July 23, 2001;" and "Professor Fischel has provided no support to conclude that the Company's disclosures about its Best Practices Initiatives were false or misleading." Bajaj Report at 70 & 71.	I controlled for and removed market and industry effects on the Company's stock price, such as comments regarding the economy from Federal Reserve Chairman Alan Greenspan, in my event study. Fischel Report ¶ 32. If I also control for Dr. Bajaj's Consumer Finance Index by including it in the regression model underlying my event study, I still find that on February 27, 2002 Household's market-adjusted stock price increase was statistically significant. *See* Exhibit G. On this date the Company announced an expansion of its Best Practice Initiatives which "rais[ed] industry standards for responsibly serving middle-market borrowers." Fischel Report ¶ 17. The Company's press release states that "Household will immediately begin the implementation of the following, unprecedented Best Practice Initiatives on new real estate loans originated in its 1,400 HFC and Beneficial branches in order to provide borrowers with clearer information, increased flexibility and better benefits." *See* Exhibit P. Plaintiffs allege that the Company's disclosure about its Best Practice Initiatives was false and misleading. Among the expanded initiatives announced on February 27, 2002 that was to be initiated "immediately" was a five percent cap on points and fees. *Id.* However, *The New York Times* reported on August 17, 2002 that the Company announced earlier in the week that the cap was not yet in place and that new loans were still being made with points and fees of more than seven percent. Fischel Report n. 7 & Exhibit 16. In any event, Household's stock price increased on a market-adjusted basis on February 27, 2002. Removal of this increase from my quantifications as Dr. Bajaj recommends would increase the inflation on every day during the Class Period prior to this date since the inflation that was removed later would have had to have been introduced earlier.
August 16, 2002	
Dr. Bajaj criticizes the Fischel Report because it "attributes HI's stock price	Dr. Bajaj ignores that the *Forbes* article went beyond simply cataloging complaints. It accuses Household of numerous improper practices:

Additional Examples of Dr. Bajaj's Flawed Criticisms

<table>
<tr><th>Dr. Bajaj's Claim</th><th>Response</th></tr>
<tr><td>decline on August 16, 2002 to the publication of an article in Forbes after trading hours on August 15, 2002." Id. at 53. He argues the Forbes article did not provide any new information because "numerous other complaints regarding HI's lending practices had been publicly discussed in the past." Id.</td><td><blockquote>In addition to the bait-and-switch on interest rates, [Household] charges high prepayment penalties and service fees; it lures clients with proposals showing monthly savings that at times fail to materialize; and it structures mortgages to include last-minute second loans that make it difficult for borrowers to defect and get refinancing elsewhere. Household agents call it "closing the back door."</blockquote>
Fischel Report Exhibit 24.

The article also provides new evidence that state regulators believed these practices were not isolated instances. Id. ¶ 18. As late as August 14, 2002, Household was claiming the problems being investigated by state regulators were isolated instances:
<blockquote>State regulatory agencies, including the attorney generals [sic] of certain states, have been focusing on the origination policies, procedures and practices of our consumer lending business. We have responded to all customer complaints brought to us by these authorities and believe those that may be valid have been limited to isolated situations.</blockquote>
See Household Form 10-Q for the quarterly period ended June 30, 2002 (the "6/30/02 10-Q") at 22.

Moreover, Dr. Bajaj offers no alternative explanation for the stock price decline on August 16, 2002.</td></tr>
<tr><td colspan="2"></td></tr>
<tr><td colspan="2">September 3, 2002</td></tr>
<tr><td>Dr. Bajaj criticizes the Fischel Report for attributing the decline in Household's stock price on September 3, 2002 to a report by analysts at Sanford Bernstein (the "Bernstein Report"). Bajaj Report at 60 & Fischel Report ¶¶ 20 & 34. He states "the Bernstein Research report</td><td>The Bernstein Report provided a 20-page analysis of the effect sales practice reforms (which Bernstein believed Household would have to institute in response to the WA report) would have on Household's earnings growth. Fischel Report Exhibit 30. An American Banker article on September 10, 2002 recognized the importance and novelty of Bernstein's analysis:
<blockquote>"For the first time, an equity analyst has put some hard numbers behind concerns that Household International Inc.'s lending troubles would reduce its earnings. Howard K. Mason, an analyst at Sanford</blockquote></td></tr>
</table>

Additional Examples of Dr. Bajaj's Flawed Criticisms

Dr. Bajaj's Claim	Response
represented stale, value-irrelevant information to investors in an efficient market." Bajaj Report at 60. Dr. Bajaj also claims that any price change was more likely due to a downgrade of Citigroup which drove down the prices of financial services firms generally. *Id.* at 61.	C. Bernstein & Co., cut his earnings per share growth projection for the company to 10% to 12%, from 13% to 15%, and said Household's sales reforms would trim earnings by 3 cents per share this year and 18 cents in 2003." Fischel Report Exhibit 32. Dr. Bajaj quotes *The Wall Street Journal* as reporting that "diversified financial services were the poorest performing sector after Mike Mayo of Prudential Securities downgraded Citigroup to sell." However, Dr. Bajaj ignores that I controlled for and removed such market and industry effects on the Company's stock price in my event study. Fischel Report ¶ 32. If I also control for Dr. Bajaj's Consumer Finance Index by including it in the regression model underlying my event study, I still find that on September 3, 2002 Household's market-adjusted stock price decline was statistically significant. *See* Exhibit G.
October 4, 2002	
Dr. Bajaj criticizes the Fischel Report for attributing the decline in Household's stock on October 4, 2002 to an article in *The Wall Street Journal* which discusses a possible settlement between Household and state attorneys general. Bajaj Report at 63 & Fischel Report ¶¶ 21 & 34. Dr. Bajaj argues that: the Fischel Report ignores other dates when information about the settlement was disclosed, specifically July 31, 2002 (when a report by analysts at Morgan Stanley was released) and August 14, 2002 (when the Company's Form 10-Q for the fiscal quarter ended June 30, 2002 was filed); the change in Household's stock price is	The Morgan Stanley analysts did mention they were "factoring in $500 million in legal damages/regulatory fines" but they provided no analysis to support this figure and conceded it was only "an educated guess." Fischel Report Exhibit 28. In contrast, the settlement estimate discussed in *The Wall Street Journal* on October 4, 2002 was arrived at by "calculating the fees, loan rates and credit insurance provided to Household clients." Fischel Report Exhibit 33. Moreover, this article discusses that Household "may be near a settlement with state attorneys general." *Id.* Dr. Bajaj ignores that the 10-Q said nothing about the likelihood of a settlement or the settlement amount. News of Conseco's problems was stale information. At least as early as August 8, 2002, approximately two months prior to October 4, analysts commented that Conseco "will probably file for Chapter 11 bankruptcy protection or reach a bankruptcy deal pre-approved by creditors." *See* Exhibit Q. On August 9, 2002, Standard & Poor's revised Conseco's counterparty credit ratings to "'SD' (selective default) … because of Conseco's announcement that it is exercising a 30-day grace period on upcoming bond interest payments. … At the same time, Standard & Poor's revised its ratings on the five issues that will miss payment to 'D' (default)." *See* Exhibit R. By September 9,

Additional Examples of Dr. Bajaj's Flawed Criticisms

Dr. Bajaj's Claim	Response
more likely explained by Standard & Poor's ratings cut of Conseco to "default" as they saw CEO Gary Wendt's resignation as a "'prelude' to a Conseco bankruptcy;" and the article provides no new information because it only "summarized the conclusions of an analyst report from Bernstein Research the previous day." Bajaj Report at 63-5 and n. 267.	2002, almost a month before October 4, ratings agency Fitch lowered Conseco's rating to "Default" status, following "the expiration of the 30-day grace period on unpaid bond interest payments." *See* Exhibit S. In addition, if I control for Dr. Bajaj's Consumer Finance Index, I still find that Household's return on October 4, 2002 was negative and statistically significant. *See* Exhibit G. Dr. Bajaj's notes that an e-mail from Howard Mason of Bernstein Research to Household on October 3, 2002 at 7:39 A.M. attached the report (Bajaj Report n. 242), but this does not establish that the report was available to the market during the day on October 3, 2002.

Exhibit B

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

LEAD PLAINTIFFS' FURTHER SUPPLEMENT TO THEIR PRIOR STATEMENTS REGARDING DAMAGES

Lead plaintiffs further supplement their September 7, 2004 and October 24, 2007 statements regarding their damages theory in response to some of the criticisms of defendants' expert Dr. Mukesh Bajaj that lead plaintiffs have not provided sufficient information. Bajaj Report at 86-92.[1] Some of the issues raised by Dr. Bajaj have already been addressed by lead plaintiffs and their expert Professor Fischel. Other issues raised by Dr. Bajaj represent a misunderstanding by Dr. Bajaj of lead plaintiffs' damages theory or are inconsistent with such theory and thus, are not relevant to lead plaintiffs' obligations under the initial disclosures provisions of Fed R. Civ. P. 26(a)(1) (hereafter "Rule 26(a)(1)"). Lead plaintiffs have, therefore, satisfied their obligations to set forth a complete theory of their damages calculation under the initial disclosures provisions of Rule 26(a)(1).

A. Lead Plaintiffs' Proposed Method for "Matching"

Dr. Bajaj criticizes lead plaintiffs' proposed damages methodology for "fail[ing] to explain how shares bought on a particular date are to be 'matched' to shares sold."[2] Bajaj Report at 90. This is a damages calculation issue that the Court will adjudicate after a trial on class-wide liability, assuming that plaintiffs obtain a verdict, and is a question of law. *Arenson v. Broadcom Corp.*, No. SA CV 02-301-GLT (MLGx), 2004 U.S. Dist. LEXIS 27522 (C.D. Cal. Dec. 6, 2004) (citing *Crow Tribe of Indians v. Racicot*, 87 F.3d 1039, 1045 (9th Cir. 1996)). Notwithstanding that the issue is not ripe, in the interest of avoiding further disputes over lead plaintiffs' initial disclosure obligations, lead plaintiffs state that they intend to propose the use of a FIFO (first-in, first-out) method of matching purchases and sales rather than a LIFO (last-in, first-out) method.

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[1] It should be noted that Professor Daniel R. Fischel has directly responded to the issues raised by the Court's November 20, 2007 Order in his Rebuttal Report, which is being concurrently served on defendants on February 1, 2008. "Bajaj Report" refers to the December 10, 2007 Expert Report of Mukesh Bajaj.

[2] Notably, Dr. Bajaj did not set forth in his report his opinion on the appropriate method for "matching" and sales.

B. Lead Plaintiffs Do Not Propose Netting Shares that Were Purchased Prior to the Class Period

Dr. Bajaj also complains that without a measure of pre-Class Period inflation, "[i]t is not possible to net the gains on shares sold at inflated prices during the Class Period, that were bought at uninflated or less-inflated values ***before the Class Period began.***" Bajaj Report at 87 (emphasis added). However, lead plaintiffs have not proposed the netting of shares purchased before the Class Period, and do not believe it is appropriate to do so.[3] Indeed, lead plaintiffs' October 24, 2007 statement clearly limits any "netting" to shares purchased during the Class Period and sold after the first disclosure on November 14, 2001: "Lead plaintiffs 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." Lead Plaintiffs' October 24, 2007 Statement at 2 (emphasis added). The pre-Class Period purchases – shares held by plaintiffs before the beginning of the Class Period – are only relevant to the extent that they are used under the FIFO method to "match" up with the Class Period sales, which matching up is not used in any calculation of gains or losses under lead plaintiffs' damages theory as previously stated in prior disclosures.[4] As the determination of pre-Class Period inflation is not within lead plaintiffs' damages theory, such inflation is not encompassed within lead plaintiffs' initial disclosure obligations under Rule 26(a)(1). It appears,

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[3] In securities fraud cases, plaintiffs recover damages for shares they purchased ***during the Class Period*** based on the extent to which artificial inflation in the stock at the time of purchase has been diminished by the time of sale or the end of the Class Period. Lead plaintiffs previously identified the specific formulas for measuring the damages based on the date of purchase and the date of sale. Lead Plaintiffs' Supplemental Statement Regarding Damages Pursuant to the Court's October 17, 2007 Order ("Lead Plaintiffs' October 24, 2007 Statement") at 1. These formulas do not require the determination of the artificial inflation present in Household International, Inc.'s stock on any date prior to the Class Period to calculate damages. *See* Rebuttal Report of Daniel R. Fischel at 25-28.

[4] LIFO, the other method accepted by courts for "matching" shares, similarly does not consider shares held before the Class Period.

therefore, that Dr. Bajaj's criticism is based on a misunderstanding or manipulation of lead plaintiffs' stated position on netting.[5]

DATED: February 1, 2008

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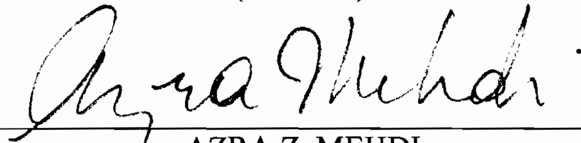

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[5] Again, although Dr. Bajaj claims to be confused regarding this position, he fails to offer any explanation what he believes to be the appropriate procedure for netting.

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Exhibit C

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

In re: Lawrence E. Jaffe Pension Plan	)	
Plaintiff,	)	
	)	
v.	)	Lead Case No. 02-C-5893
	)	
Household International, Inc., et al	)	
	)	
	)	
Defendant,	)	
	)	

EXPERT REPORT OF MUKESH BAJAJ

December 10, 2007

B. The Damage Methodology Proposed By Plaintiffs Is Incomplete

I understand that, on November 20, 2007 the Court in this case ordered from Professor Fischel additional "analysis showing the date on which there was zero inflation in the stock price."[325] The Court further requested that I provide an explanation as to specific issues that underlie the November 20 Order.

As an economic matter, only that portion of a Plaintiff's loss that arises from a stock price decline upon a curative disclosure can constitute economic harm caused by the fraud. Professor Fischel's Specific Disclosures model purports to quantify inflation by measuring the impact of curative disclosures, which, as I have discussed at length above, is deeply flawed and does not establish that any inflation was ever removed from HI's stock price.

Professor Fischel's Leakage model does not even attempt to measure inflation in HI's stock price by quantifying the market-adjusted price drop upon curative disclosures. Instead, Professor Fischel proposes such a model because he claims that "a steady stream and extensive amount of incomplete information related to Defendants' alleged fraud was disclosed beginning at least as early as November 15, 2001"[326] which purportedly results in his Specific Disclosures model "significantly understat[ing] the amount of artificial inflation in the stock price during the Class Period"[327] [Bracketed text added.]

The Leakage model, however, does not even purport to demonstrate any link between a curative disclosure and the inflation that was allegedly removed as a result. Therefore, it is crucial under such a theory to at least demonstrate that inflation was introduced into HI's stock price as a result of specific misstatements

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[325] Memorandum Order by Judge Nan R. Nolan, *Lawrence E. Jaffe Pension Plan, On Behalf of Itself and All Others Similarly Situated, v. Household International, Inc., et al*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, November 20, 2007, page 2.
[326] Fischel Report, paragraph 39.
[327] Fischel Report, paragraph 40.

and omissions at some point in time **before** information about such alleged inflation purportedly began to "leak" into the market. Professor Fischel has made no attempt to do so. As a result, his Leakage model does not establish any causal link between Plaintiffs' alleged losses and the alleged fraud. Therefore, Plaintiffs have not provided a complete inflation analysis through Professor Fischel's report.

Plaintiffs claim that they will offer both of Professor Fischel's inconsistent inflation measures as alternatives for the jury to choose.[328] As I have explained earlier, Professor Fischel's inflation measures are irreconcilable with one another. That is, the events that purportedly introduced (or removed) inflation from HI's stock price according to one model did not according to the other. Therefore, the damages calculated based on Professor Fischel's inflation measures would not be "alternatives," as Plaintiffs suggest because they would not represent the alleged harm caused by the same economic reasons.

1. Professor Fischel's Inflation Analyses Alone Do Not Provide A Complete Basis To Calculate Plaintiffs' "Damages"

Although Professor Fischel is silent about the manner in which damages should be calculated, given an appropriate inflation measure, Plaintiffs' counsel has proposed such a methodology. In my opinion, Plaintiffs' methodology is not only fundamentally flawed from an economics perspective, it is incomplete for several reasons.

Plaintiffs admit that economic harm should properly be calculated on a net basis.[329] Specifically, they propose that each Plaintiff's net damages should be calculated on a **per share** basis, **for shares bought during the Class Period,** as the difference in inflation present in HI's stock price on the purchase and sale

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[328] Plaintiffs' Supplemental Statement, page 1.
[329] Plaintiffs' Supplemental Statement, page 2.

dates, respectively.[330] There are, however, at least three reasons why Professor Fischel's report is incomplete for the purposes of properly computing net damages.

i. Plaintiffs' Damages Cannot Be Properly Determined Without Information About The Pre-Class Period Inflation That Professor Fischel Has Not Provided

It is not possible to net the gains on shares sold at inflated prices during the Class Period, that were bought at uninflated or less-inflated values before the Class Period began, since Professor Fischel does not provide any measure of pre-Class Period inflation.

Professor Fischel's inflation models conclude that there were no inflationary events between July 30, 1999 and November 14, 2001.[331] Yet, Professor Fischel claims that thereafter, "Household's stock price was negatively affected by the alleged fraud."[332] It follows, as a matter of economic logic, that HI's stock price must have first become inflated either on July 30, 1999, or earlier. Professor Fischel has provided no explanation of how HI's stock price became inflated on or before July 30, 1999, nor quantified such pre-Class Period inflation (if any).

Professor Fischel's conclusions about inflation are all the more curious because I understand that, according to the Guzman Order, Plaintiffs are barred from claiming any damages from misrepresentations and/or omissions that occurred before July 30, 1999.[333] Professor Fischel has been required by the Court to explain the source of the pre-Class Period inflation that his analyses conclude existed as of the first day of the Class Period.[334] At this time, absent such

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[330] The "sale date" inflation is assumed to be zero in cases when the shares were held until after the Class Period ended.
[331] Plaintiffs' Supplemental Statement, page 2.
[332] Fischel Report, paragraph 28.
[333] Guzman Order, page 6.
[334] Memorandum Order by Judge Nan R. Nolan, *Lawrence E. Jaffe Pension Plan, On Behalf of Itself and All Others Similarly Situated, v. Household International, Inc., et al*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, November 20, 2007.

information, one can envision an infinite number of possibilities as to how HI's stock became inflated as of July 30, 1999, and equally many different damage conclusions.

If the entire inflation in Household's stock price on the first day of the Class Period was introduced on that day (July 30, 1999) alone, then Plaintiffs (or Professor Fischel) would need to explain what misstatement or omission on that day caused such inflation. Any explanation provided with respect to the alleged fraud on July 30, 1999 will obviously have implications for Plaintiffs' explanation of allegedly curative disclosures during the Class Period.

Alternatively, if the inflation in Household's stock price on July 30, 1999 was introduced earlier, then Plaintiffs (or Professor Fischel) must explain the manner and extent to which such inflation was introduced and whether or not such claims are consistent with either of the 2 inflation functions "illustrate[d]" in Professor Fischel's report.[335] [Bracketed text added.]

Consider the Oil Company Example that I introduced earlier. Assume that the alleged cause of inflation in the oil company's stock price was a failure to disclosure that the Nigerian government was going to shut down the company's oil field in that country, which shareholders allege that the company's management knew but failed to disclose. Suppose the company's stock price declined on January 6, following a newspaper article that repeated news regarding the company's oil field fire in Venezuela. This news could not have been value-relevant in an efficient market because news of the fire had been previously released. Moreover, plaintiffs cannot allege that the price decline observed on January 6 had anything to do with the alleged fraud, which relates to the company's Nigerian operations. Therefore, in this example, plaintiffs have no economic basis to claim that the price decline observed on January 6 measures their economic harm caused by the alleged fraud. Absent additional information

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[335] Plaintiffs' Supplemental Statement, page 1.

about what events caused the alleged inflation in the pre-Class Period, it is not possible to fully examine Plaintiffs' and Professor Fischel's claims about the subsequent price declines after November 14, 2001.

Moreover, absent information about the extent of alleged inflation present in HI's stock price during the pre-Class Period, when Plaintiffs may have acquired shares that were subsequently sold during the Class Period, it is impossible to calculate each Plaintiff's **net** damages from the alleged fraud.

ii. Plaintiffs' Proposed Treatment Of Negative Inflation On Sale Dates Contradicts Economic Principles

Plaintiffs intend to treat sale dates with negative and positive inflation identically in calculating damages.[336] Such a treatment of negative inflation on sale dates contradicts economic principles, as the following example illustrates. As a matter of economic reasoning, if a Plaintiff bought shares that were inflated by $10 per share on the purchase date, then this Plaintiff's economic harm cannot exceed $10 per share. Yet, according to the Plaintiffs' proposed approach, if the same Plaintiff sold the shares on a date when the inflation was -$2 per share, then her damages would be $12 per share.[337] That is, on one hand, Plaintiffs claim that they were harmed by alleged misrepresentations and/or omissions that caused the stock price to increase **above** its "True Value" (the "inflation") but they intend to also include as damages any difference between the stock price and the True Value when the stock price drops **below** the True Value; a difference which **cannot** be attributed to the fraud, according to the Plaintiffs' theories of alleged fraud.

iii. Plaintiffs' Proposed Damages Methodology Is Incomplete Because It Does Not Specify Any Algorithm To Match Sales And Purchases

Plaintiffs' methodology is specified on a **per share basis,** *i.e.,* damages are calculated based on the difference between inflation on the purchase and sale

[336] Plaintiffs' Supplemental Statement, page 2.
[337] Plaintiffs' Supplemental Statement, page 2.

dates, associated with the **same** share. Plaintiffs (or Professor Fischel), however, have failed to explain how shares bought on a particular date are to be "matched" to shares sold.

As a matter of economic logic, such a matching mechanism is critical in calculating the Plaintiffs' damages, if certain transactions are excluded in calculating damages as the Plaintiffs intend to do in this case. In this case, Plaintiffs intend to exclude from damages calculations (1) shares sold during the Class Period before November 15, 2001;[338] and (2) shares purchased prior to the beginning of the Class Period.[339] Setting aside the economic flaws associated with such assumptions for the moment,[340] implementing such a "truncated" damage calculation is impossible without a properly-specified matching algorithm.

For instance, consider the following hypothetical example (Example 1) in which by excluding shares sold before November 15, 2001, the damages critically depend on how purchases and sales are matched. Suppose a Plaintiff bought shares on two different dates (buying 100 shares each time), namely (a) on February 1, 2000, when the stock was inflated by $10 per share; and (b) on March 1, 2000 when the stock was inflated by $8 per share. Suppose the Plaintiff then sold (c) 100 shares on June 1, 2000 at $5 inflation per share; and (d) 100 shares on March 1, 2002 at $1 inflation per share.

The manner in which the purchases [(a) and (b)] are matched to the sales [(c) and (d)] is critical, given the assumption that sales prior to November 15, 2001 are to

[338] Plaintiffs' Supplemental Statement, page 2.
[339] Letter from Plaintiffs' Counsel to Defendants' Counsel, David Owen, dated November 7, 2007.
[340] As discussed above, excluding shares purchased prior to the Class Period would incorrectly ignore benefits that a Plaintiff may have received from the sale of such shares at purported inflated prices during the Class Period. Similarly, by excluding shares sold prior to November 15, 2001 at purported inflated prices, Plaintiffs damages may be exaggerated depending on the manner in which purchases and sales are matched, as I explain through an example later.

be excluded (*i.e.*, any damages related to the sale on June 1, 2000 in this example are to be excluded).

If (a) is matched to (c), and (b) is matched to (d), then the total damages before any exclusions is $1,200. However, the damages of $500 associated with the **first** of these matched transactions would be removed from the total damage calculations,[341] and the resultant net damages would be **$700**.

If instead, (a) is matched to (d), and (b) is matched to (c), then the total damages before any exclusions remains at $1,200. However, the damages of $300 associated with the **second** of these matched transactions would be removed from the total damage calculations,[342] and the resultant net damages would be **$900**. That is, the resultant net damages can vary between $700 and $900, depending on the matching algorithm assumed.

Let us consider another hypothetical example (Example 2) which indicates that the damages critically depend on how purchases and sales are matched if shares acquired before the Class Period begins (July 30, 1999) are excluded. Suppose a Plaintiff bought shares on two different dates (buying 100 shares each time), namely (a) on July 1, 1999 (before the Class Period began), when the stock is assumed to be uninflated;[343] and (b) on March 1, 2000 when the stock was inflated by $8 per share. Suppose the Plaintiff then sold (c) 100 shares on June 1, 2000 at $5 inflation per share; and (d) 100 shares on March 1, 2002 at $1 inflation per share.

Again, the manner in which the purchases [(a) and (b)] are matched to the sales [(c) and (d)] is critical, given the assumption that pre-Class Period purchases are

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[341] $500 is calculated as 100 x ($10 - $5).
[342] $300 is calculated as 100 x ($8 - $5).
[343] Professor Fischel's inflation measures do not provide any estimate of the alleged artificial inflation per share before the Class Period began.

to be excluded (*i.e.*, any damages related to the purchase on July 1, 1999 in this example are to be excluded).

If (a) is matched to (c), and (b) is matched to (d), then the total net damages (netting out the benefit of $500 associated with the first transaction which is related to the pre-Class Period purchase (a)) is $200. However, if the benefit associated with the first of these matched transactions is not netted out, then the Plaintiff's damages would be **$700.**

If (a) is matched to (d), and (b) is matched to (c), then the total net damages (netting out the benefit of $100 associated with the first transaction which is related to the pre-Class Period purchase (a)) is $200. If, however, the benefit associated with the first of these matched transactions is not netted out, then the Plaintiff's damages would be **$300.** That is, the resultant net damages can vary between $300 and $700, depending on the matching algorithm assumed.

In summary, the Plaintiffs' damage methodology, in conjunction with the Fischel Report, provides a flawed and incomplete explanation about how they propose to calculate class-wide damages.

Respectfully submitted,

Mukesh Bajaj

December 10, 2007

DECLARATION OF SERVICE BY E-MAIL AND BY U.S. MAIL

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Francisco, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 100 Pine Street, Suite 2600, San Francisco, California 94111.

2. That on February 6, 2008, declarant served by electronic mail and by U.S. Mail to the parties **LEAD PLAINTIFFS' STATUS REPORT FOR THE FEBRUARY 7, 2008 TELEPHONE STATUS CONFERENCE**. The parties' email addresses are as follows:

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Colchester, CT 06415

I declare under penalty of perjury that the foregoing is true and correct. Executed this 6th day of February, 2008, at San Francisco, California.

s/ Marcy Medeiros
MARCY MEDEIROS