



## I. INTRODUCTION

The issue before this Court is relatively straightforward: Have plaintiffs provided sufficient information regarding their damage theory to satisfy the initial disclosure requirements of Fed. R. Civ. P. 26(a)(1)(A)(iii)? The answer is yes. Plaintiffs have submitted two extensive expert reports of Professor Daniel R. Fischel and their Supplemental Statements on Damages submitted on October 24, 2007 and February 1, 2008.<sup>1</sup> These documents comprehensively explain plaintiffs' damage theory and its application, even as to issues that will not become relevant until the claims administration process.

As to the question posed by defendants "When did the fraud start?," plaintiffs have already answered it. The fraud is each actionable false statement or omission made by defendants in connection with the sale of a security. Plaintiffs have already identified these actionable false statements and omissions (*i.e.*, the fraud), and how they damaged purchasers of Household International, Inc. ("Household" or the "Company") shares during the Class Period. Plaintiffs will show that purchasers of Household stock on Day One of the Class Period overpaid for the stock because it was artificially inflated by defendants' failure to disclose the truth about Household on that day. Plaintiffs have already provided this information in ¶36 of the Rebuttal Report of Daniel R. Fischel ("Fischel Rebuttal Report").

Plaintiffs' submissions include the specific formulas for determining each Class member's damages. Professor Fischel's reports also provide two models that quantify the amount of artificial inflation in Household's stock for each day of the Class Period. In accordance with loss causation

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<sup>1</sup> Attached to the Declaration of Jason C. Davis filed herewith as Exhibit A is Lead Plaintiffs' Supplemental Statement Regarding Damages Pursuant to the Court's October 17, 2007 Order, and as Exhibit B is Exhibit 56 to the Report of Daniel R. Fischel. The other referenced materials are attached as exhibits to the Declaration of Janet A. Beer in Support of the Household Defendants' Motion to Compel Plaintiffs to Supplement Their Initial Disclosures Pursuant to Fed. R. Civ. P. 26(a)(1)(A)(iii) (Dkt. No. 1180).

principles, Professor Fischel has calculated the amount of daily inflation in Household's stock price by removing all market factors from any later price declines in Household's stock when the truth regarding Household's fraud began to be revealed to the market from November 14, 2001 through October 11, 2002. This daily inflation is the sum total of inflation in Household's stock price on that day as reflected in the fraud-related declines from November 14, 2001 to October 11, 2002. Plaintiffs' damage theory (Fischel Rebuttal Report, ¶¶36-38) is that if the Household defendants had disclosed the truth about the Company's actual business practices on Day One of the Class Period (July 30, 1999), Household's stock would have declined to its true value (*i.e.*, by \$7.97 under the specific disclosures model or \$17.81 under the leakage model).

The analysis with respect to *any* inflation in Household's stock on any day *prior* to the first day of the Class Period (July 30, 1999) is not required in either proving a §10b claim or any damages related to such a claim. The basic elements of a §10b claim include: (1) a material misrepresentation (or omission); (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) "loss causation," *i.e.*, a causal connection between the material misrepresentation and the loss. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342 (2005). With respect to "economic loss" or damages, plaintiffs will need to show inflation in Household's stock price *during* the Class Period, *not* prior to the Class Period.

On February 28, 2006, Judge Guzman granted defendants' motion to shorten the Class Period to begin on July 30, 1999, the date their motion identified even though Household made no public statement on that date and their first Class Period statement was not until August 16, 1999. *See* February 28, 2006 Memorandum Opinion and Order (Dkt. No. 434); *see also* Defs' *Foss* Brf., at 2

(Dkt. No. 245)<sup>2</sup> (arguing to reduce the October 1997–October 2002 class period because it “necessarily includ[ed] *purchases* for which relief can no longer be sought because they occurred prior to July 30, 1999”) (emphasis added). Defendants did not move to dismiss the claims of purchasers from July 30, 1999 to August 15, 1999. As fiduciaries of the Class, plaintiffs took a precautionary approach and instructed their expert to measure inflation back to July 30, 1999 as opposed to August 16, 1999. The fact that Household’s stock was inflated on July 22, 1999 or July 30, 1999 has no bearing on whether plaintiffs’ claims are actionable even with a Class Period start of August 16, 1999 since Household’s stock was inflated that day (Fischel Rebuttal Report, ¶36) by defendants’ failure to disclose the truth.

Although defendants’ damage theory (which they have not yet put forward) may somehow utilize pre-Class Period inflation, the burden is on them to have their damages expert calculate and present it. Plaintiffs have fully complied with their initial disclosure requirements in providing all the information necessary to support their damages theory. Defendants’ motion is simply a delay tactic and should be denied.

## II. ARGUMENT

### A. The Initial Disclosure Standard Regarding Damages

The text of Rule 26(a)(1)(A)(iii), which was formerly Rule 26(a)(1)(C),<sup>3</sup> provides in full:

a computation of each category of damages claimed by the disclosing party—who must also make available for inspection and copying as under Rule 34 the documents or other evidentiary material, unless privileged or protected from disclosure, on which each computation is based, including materials bearing on the nature and extent of injuries suffered.

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<sup>2</sup> “Defs’ *Foss* Brf.” refers to the defendants’ Memorandum of Law in Support of Household Defendants’ Motion Pursuant to the Seventh Circuit’s Recent Decision in *Foss v. Bear, Stearns Co.* to Dismiss the Complaint in Part.

<sup>3</sup> The organization of Rule 26 was changed in 2007 as a result of stylistic amendments. See Notes regarding 2007 Amendments.

Fed. R. Civ. P. 26(a)(1)(A)(iii). “Rule 26(a)(1) requires disclosure only of information and documents that the disclosing party may use to support its claims or defenses.” Steven Baicker-McKee, William M. Janssen & John B. Corr, *Federal Civil Rules Handbook 2008*, at 641 (2007) (“*Handbook*”). As noted above, plaintiffs have complied by providing all information necessary to set forth *their* damage theory. Defendants concede as much in their brief when they explain their “need” for this information hinges on their own affirmative defenses rather than an understanding of plaintiffs’ damage theory.

Defendants’ initial briefing on this issue in October 2007 supports plaintiffs now. In that briefing, defendants sought a disclosure regarding plaintiffs’ “proposed methodology for calculating class-wide damages in this matter.” Defs’ Oct. 5 Brf. at 1 (Dkt. No. 1136)<sup>4</sup>; *see also id.* at 10 (seeking an order from the Court requiring plaintiffs “to disclose any and all of Plaintiffs’ damages claims in a manner that explains those claims and includes both the aggregate amount claims and the methodology by which that figure can be reached by anyone reviewing the Fischel report.”). In their October 16, 2007 reply brief, defendants made the same point, namely that “[i]n securities fraud cases [the initial damage disclosure] can be accomplished without reference to individual class member data by explaining the proposed methodology and, *inter alia*, estimating aggregate damages or identifying categories of eligible claims through the use of what some expert describe as ‘trading models.’” Defs’ Oct. 16 Reply Brf. at 2 (Dkt. No. 1142)<sup>5</sup> (citing article by Professor Daniel R. Fischel and David J. Ross). As indicated above, plaintiffs have provided this information already.

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<sup>4</sup> “Defs’ Oct. 5 Brf.” refers to Memorandum of Law in Support of the Household Defendants’ Motion to Compel Discovery Pursuant to Rule 26(A)(1)(C) and This Court’s Orders, or in the Alternative for a Recommendation of Preclusion.

<sup>5</sup> “Defs’ Oct. 16 Reply Brf.” refers to Reply Memorandum of Law in Further Support of the Household Defendants’ Motion to Compel Discovery Pursuant to Rule 26(A)(1)(C) and This Court’s Orders, or in the Alternative for Recommendation of Preclusion.

Ignoring their earlier motion's arguments that provision of a damage methodology suffices, defendants now argue that this same rule requires "Plaintiffs to disclose all information 'bearing on the nature and extent of injuries suffered.'" Defs' Brf. at 1 (Dkt. No. 1179)<sup>6</sup> (quoting Fed. R. Civ. P. 26(a)(1)(A)(iii)); *see also id.* at 7. However, defendants' new interpretation misquotes the text of the rule. The language defendants quote does not modify the word "information" as defendants assert, but rather documents supporting the disclosing party's damage theory. Plaintiffs are to disclose all documents supporting their damage theory, not all documents or information supporting defendants' contrary damage theories. *See Handbook* at 641. Plaintiffs have already met this requirement – providing two expert reports totaling 55 pages, 76 exhibits, and two statements on damages.

In any event, a party need only provide available information and documents in response to its initial disclosure obligations. *Id.* at 642 ("The parties must make their initial disclosures based on the information then 'reasonably available.'"). Professor Fischel has stated in his rebuttal report that "no regression analysis can be used to identify the day on which the stock price became inflated in this case." Fischel Rebuttal Report, ¶38. Defendants make no suggestion that the pre-Class inflation information that they demand is available to plaintiffs and can be obtained notwithstanding Professor Fischel's statement.

**B. There Is No Case Law Supporting Defendants' Position**

In its February 7, 2008 Order, this Court directed defendants to provide "supporting authority" for their position in this motion. February 7, 2008 Order at 1 (Dkt. No. 1176). Despite this requirement, defendants do not (and cannot) cite any authority for the proposition that Rule 26(a)(1)(A)(iii) requires plaintiffs to compute pre-Class Period inflation. Nor do defendants cite any

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<sup>6</sup> "Defs' Brf." refers to Memorandum of Law in Support of the Household Defendants' Motion to Compel Plaintiffs to Supplement Their Initial Disclosures Pursuant to Fed. R. Civ. P. 26(a)(1)(A)(iii).

caselaw for the proposition that plaintiffs' initial disclosure obligation extends to the provision of information or documents that does *not* support their theory of damages. To the contrary, the case law that defendants do cite is consistent with plaintiffs' views that the initial disclosure obligation is limited to supportive information and documents. *Kemper/Prime Indus. Partners v. Montgomery Watson Am., Inc.*, No. 97 C 4278, 2004 U.S. Dist. LEXIS 5543, at \*15 (N.D. Ill. Mar. 31, 2004) ("plaintiff failed to produce any evidence in discovery that would allow a trier of fact to determine the existence or extent of its damages").

Defendants also assert that plaintiffs' statements and Professor Fischel's reports are insufficient with respect to the loss causation required by *Ray v. Citigroup Global Mkts., Inc.*, 482 F.3d 991 (7th Cir. 2007) and *Dura*, 544 U.S. 336. Defs' Brf. at 2 & 9. However, Professor Fischel's reports adequately address this issue. Indeed, in response to defendants' first motion, this Court expressly held that Professor Fischel's initial report by itself "sufficiently explains Plaintiffs' theory of the causal connection between the decline in the price of Household's stock and the revelation of the truth that was concealed by Defendants' omissions or misrepresentations." October 17, 2007 Order at 3 (Dkt. No. 1144) (citing *Dura*); *see also id.* at 2 (discussing *Ray*).

Defendants also assert that Judge Guzman expects plaintiffs to provide pre-Class Period inflation information. *See* Defs' Brf. at 5. However, Judge Guzman's statements, including that cited by defendants, suggest only that he expected the record to be completed through routine expert discovery, including a deposition of Professor Fischel, and provide no support whatsoever for the argument that plaintiffs must provide pre-Class Period information as part of their initial disclosure.

**C. Defendants' Need for Pre-Class Period Inflation Information Is Unrelated to Plaintiffs' Damage Theory**

Defendants present two arguments to support their claim for their need for this information from plaintiffs: (1) to support a statute of repose argument; and (2) to rebut plaintiffs' showing of

artificial inflation attributable to defendants' fraud. Neither argument is persuasive with respect to this motion, or at all.

Defendants specifically claim a need to know when the inflation was zero in Household's stock. Plaintiffs' case will not involve showing any pre-Class Period inflation as that information has no bearing on plaintiffs' methodology for calculating damages. Further, as noted by Professor Fischel, this date cannot be determined via a regression analysis. *See* Fischel Rebuttal Report, ¶38. Significantly, defendants cite no legal authority to support their request for this information.

As indicated above, a party's initial disclosure obligation focuses on information and documents that it is likely to use to support its case in chief, not its opponents' case. *See* Fed. R. Civ. P. 26(a)(1)(A)(iii). Defendants do not argue that the information they seek supports plaintiffs' damage theory. Indeed, the state of the record is that this information has no bearing on that damage theory.

Defendants boldly assert that plaintiffs are obligated to provide the pre-Class Period inflation information because plaintiffs must participate in discovery. Plaintiffs acknowledge that they need to provide information in response to formal discovery. However, they have done so and have also provided two extensive expert reports as well as supplemented their damages disclosures. Defendants cite to no formal discovery to support their argument – not even Interrogatories Nos. 2 and 15, which got a footnote in the initial motion. *See* Defs' Oct. 5 Brf. at 3 n.3. Defendants' cases that rest upon formal discovery requests are therefore inapposite. *See Payne v. City of Philadelphia*, No. 03-3919, 2004 U.S. Dist. LEXIS 8425, at \*2 (E.D. Pa. May 5, 2004) (documents requested in deposition notice).

Defendants argue that plaintiffs had some unspecified discovery obligation because their claims as initially pled commenced in 1997 and because “[p]laintiffs made clear to this Court that it was these very pre-class misrepresentations and omissions that introduced this ‘artificial inflation’



and that now provide the basis of their claim for damages.” Defs’ Brf. at 7. This is a mischaracterization of plaintiffs’ position and portrays a fundamental misapprehension of the law on defendants’ part.

Under the securities law, each false statement and each omission form a separate actionable claim. In this case, defendants did not reveal the true details of their fraud to the market. In the context of Judge Guzman’s prior ruling, plaintiffs’ position is that defendants’ omissions on July 30, 1999 caused Household’s stock to be inflated on that day. In “but for” language, but for defendants’ omissions, that artificial inflation would not have existed in the stock price. *See* Fischel Rebuttal Report at 27 n.30.

The slight twist here arises from the fact that plaintiffs do not allege an affirmative statement by defendants on July 30, 1999, which is the first date of the Class Period as a result of Judge Guzman’s prior order. Plaintiffs do allege affirmative statements by defendants on August 16, 1999, when Household filed its Form 10-Q for the 2Q99. [Corrected] Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws, ¶235. The last statement prior to that statement took place on July 22, 1999 and was a press release announcing the financial results for 2Q99. *See id.*, ¶234. If Judge Guzman determines that plaintiffs cannot use defendants’ failure on July 30, 1999 to correct the earlier July 22, 1999 statement, he may push the Class Period commencement date back to August 16, 1999. Judge Guzman’s Order is not entirely clear on this point and defendants requested the July 30, 1999 start date rather than the August 16, 1999 date, implicitly agreeing that the July 22, 1999 statements could be used by purchasers from July 30, 1999 through August 15, 1999. Even if Judge Guzman were to shorten the Class Period, there is no “repose” for artificial inflation existing at that time since defendants’ omissions on August 16, 1999 caused that inflation to exist on that date regardless of what happened prior to that date. *See* Fischel Rebuttal Report nn.29 & 30. Again, in “but for” language, but for defendants’ omissions relating to

the fraud when speaking on August 16, 1999, the artificial inflation would have not been there and Household's stock would have declined by \$7.97 (according to Exhibit 53 of the Report of Daniel R. Fischel) or \$16.48 (according to Exhibit 56 of the Report of Daniel R. Fischel). Defendants' argument that any pre-Class Period artificial inflation was immutably "baked" in once the Class Period began, thus, runs counter to both law and economic theory.

A related fallacy is defendants' mischaracterization of Professor Fischel's damage theories as not supporting the proposition that defendants' misrepresentations during the Class Period did not cause artificial inflation to increase. As noted above, this is a misinterpretation of plaintiffs' damage theory and Professor Fischel's reports. There is no requirement that defendants' false statements during the Class Period *increase* inflation each time. As laid out in Fischel's Rebuttal Report (¶37), the failure to disclose the truth will keep a company's stock price inflated and not fall to its true value.

### III. CONCLUSION

In sum, plaintiffs have set forth their damage theory in detail. Nothing has been hidden or withheld from defendants. In fact, plaintiffs have produced information far beyond what is required in a securities case. Defendants should take Professor Fischel's deposition and fully explore these issues. Defendants' motion is simply an attempt to delay these proceedings and should be denied.

DATED: February 21, 2008

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DECLARATION OF SERVICE BY ELECTRONIC 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 21, 2008, declarant served by electronic mail and by U.S. Mail to the parties the: **LEAD PLAINTIFFS' OPPOSITION TO HOUSEHOLD DEFENDANTS' MOTION TO COMPEL PLAINTIFFS TO SUPPLEMENT THEIR INITIAL DISCLOSURES PURSUANT TO FED. R. CIV. P. 26(a)(1)(A) (iii)**. The parties' email addresses are as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 21st day of February, 2008, at San Francisco, California.

s/ Marcy Medeiros  
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MARCY MEDEIROS