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 Honorable Jorge L. Alonso

DECLARATION OF DANIEL S. DROSMAN IN SUPPORT OF PLAINTIFFS' MOTION TO PRECLUDE DEFENDANTS FROM SUBSTITUTING NEW EXPERTS

I, Daniel S. Drosman, declare as follows:

1. I am an attorney duly licensed to practice before all of the courts of the State of California and I am also admitted *pro hac vice* in this Court for this action. I am a member of the law firm of Robbins Geller Rudman & Dowd LLP, Lead Counsel of record for plaintiffs in the above-entitled action. I have personal knowledge of the matters stated herein and, if called upon, I could and would competently testify thereto.

2. Attached are true and correct copies of the following exhibits:

Exhibit 1: Testimony of Mukesh Bajaj from the Household Int'l trial, dated Feb. 28, 2009;

Exhibit 2: Expert Report of Mukesh Bajaj, dated Dec. 10, 2007;

Exhibit 3: Sur-Rebuttal Report of Mukesh Bajaj, dated March 3, 2008;

Exhibit 4: Transcript of deposition of Mukesh Bajaj, dated March 25, 2008;

Exhibit 5: Chart showing summaries of the fraud-related articles on 125 days during the disclosure period; and

Exhibit 6: Excerpts of testimony from the Household Int'l trial by defendants David Schoenholz (April 14, 2009) and William Aldinger (April 21, 2009).

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed this 24th day of November, 2015 at San Diego, California.

/s/ Daniel S. Drosman
DANIEL S. DROSMAN

CERTIFICATE OF SERVICE

I hereby certify that on November 24, 2015, I authorized the electronic filing of the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses denoted on the attached Electronic Mail Notice List.

I certify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on November 24, 2015.

/s/ Daniel S. Drosman
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EXHIBIT 1

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN,)
on behalf of itself and all)
others similarly situated,)
)
Plaintiff,)
)
vs.) No. 02 C 5893
)
HOUSEHOLD INTERNATIONAL, INC.,)
et al.,) Chicago, Illinois
) April 28, 2009
Defendants.) 9:10 a.m.

VOLUME 20
TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a ju

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THE CLERK: 02 C 5893, Jaffe v. Household.
THE COURT: Good morning, everyone.
Are we ready to proceed with the jury?
MR. KAVALER: Your Honor, you asked us to hand up -- I thought I'd hand you before we start -- the spoliation language --
THE COURT: Sure.
MR. KAVALER: -- that you asked us to prepare. A copy for counsel.
I want to be clear, your Honor, we're handing this up without prejudice to our position that there should be no spoliation instruction whatsoever. Your Honor indicated the other day that this was for our own benefit. We decline that benefit. Thank you very much.
Apparently, subsequent to that, you decided sua sponte to change your mind. I'd like to be heard on that tomorrow. Meanwhile, we're giving you the language that we said we would.
THE COURT: Sure.
Anything else?
MR. BURKHOLZ: No, your Honor.
THE COURT: Okay. Let's bring the jury out.
(Jury in.)
THE COURT: Good morning, ladies and gentlemen.
Welcome back.

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Are we ready to proceed?
MR. KAVALER: Yes, your Honor. The defendants call Dr. Mukesh Bajaj.
(Witness sworn.)
MR. KAVALER: Your Honor, we have a jury binder of exhibits that were previously approved by plaintiffs' counsel. May we pass it out?
THE COURT: Yes.
MR. KAVALER: Thank you, your Honor.
(Brief pause.)
MUKESH BAJAJ, DEFENDANTS' WITNESS, SWORN
DIRECT EXAMINATION
BY MR. KAVALER:
Q. Good morning, Dr. Bajaj. You're the one we've all been waiting for, the last witness.
Would you state your name for the record, please?
A. Good morning, counsel. My name is Mukesh Bajaj.
Q. And what is your educational background, sir?
A. I got an undergraduate degree in chemical engineering from the Indian University of Technology in Delhi, India. And I got interested in social sciences, so I joined the MBA program at the University of Texas at Austin. And then I developed an interest for financial economics, and I enrolled in the Ph.D. program at University of California, Berkeley. I graduated with a Ph.D. in finance in 1988.

Q. So would it be right to call you Dr. Bajaj?
A. You can call me Mukesh or Dr. Bajaj.
Q. Okay.
A. Would you let me know if I'm at the right distance from the mike, please?
MR. KAVALER: Can everyone hear him? Okay.
BY MR. KAVALER:
Q. I'll call you Dr. Bajaj. We'll leave it to your friends to call you Mukesh.
Do you have any experience, Doctor, involving liability on damages in securities fraud cases?
A. Yes, counsel. I've been engaged in dozens of such matters over the years.
Q. And have you ever testified in court previously?
A. Yes, I've testified on about 45 matters.
Q. And have you been retained by both plaintiffs and defendants over the years?
A. Yes.
Q. And have you ever worked for any government agencies?
A. I have been frequently engaged by Internal Revenue Service, by the Department of Justice, by U.S. Attorney's Office, by the Securities and Exchange Commission, by Franchise Tax Board of California and by Dallas City Appraisal District.
Q. And what is your current position, sir?

A. I'm senior managing director and I head the securities practice of LECG, which is an international consulting firm focused on expert services.
Q. Do you teach any courses at the university level?
A. Yes, I teach at University of California, Berkeley in their master's program. I've done that continuously since 1997.
Q. So would it be all right if I called you Professor Bajaj?
A. That would be fine, too.
Q. Okay. Do you also conduct research in the same areas as you teach?
A. Yes. I have maintained an active research program for the last 25 years. And a lot of my research is focused on empirical analysis of capital market data to understand how, when market receives new information, it gets impounded into stock prices. And I have published many articles involving the use of event study technique that we've been listening about in this case quite a bit.
Q. And are those scholarly journals in the field of finance?
A. Yes. I've published in some of the most prestigious academic journals like the Journal of Finance, Journal of Financial Economics, as well as many well-regarded applied journals.
Q. Has your work been cited from time to time?
A. Yes, my work has been extensively cited.

Q. And does your research and writing relate to the impact of information on the price of the stock of companies?
A. Yes.
Q. Okay. And did we engage you to give an opinion in this case?
A. You engaged me to examine some economic evidence in this case to formulate my opinions.
Q. Okay. And were you sitting in the courtroom last week when I interviewed -- spoke with Professor Fischel?
A. Yes, I was.
Q. I believe he's sitting here today. There he is. He's watching you.
It's pretty normal for experts in cases like this to watch each other?
A. Yes. I happen to know Professor Fischel a little bit and happy to see him again always.
Q. Okay. Now, you listened to my questioning of Professor Fischel as I walked him through the analysis he did of the various days, and we crossed out some days in red on those charts.
Do you remember all of that?
A. Yes, I do remember.
Q. Did you form an opinion at that point as to what was going on between me and Professor Fischel, what point I was making?
A. Well, I believe I understood the point you were making,

yes.
Q. What did you take away from that?
A. Well, I understood your point to be that Professor Fischel's analysis leads him to conclude that there was a certain amount of inflation that purportedly came out of Household's stock during a period when he believed the market learned corrective information. And in his specific disclosure model, for example, that inflation he quantified at $7.97 on November 14, 2001.
Now, plaintiffs have alleged, if I recall correctly, 22 false statements between July 30 and November 14, 2001. So while plaintiffs have alleged there were 22 lies told by Household to the market, none of those lies has any effect whatsoever on how much inflation was present in Household's stock price as of November 14.
So how could that $7.14 in inflation that he quantified as a matter of logic be related to any of the lies that plaintiffs have asserted? In fact, the same amount of inflation was present on the very first day of the relevant period. So the only logical inference from an economic perspective is the inflation Professor Fischel concluded must have come about as a result of things that happened before the relevant period and then it was maintained throughout the period.
Think about it in another way. Professor Fischel

said, well, it's for the jury to find which of these 22 lies were, in fact, misstatements. But whether the jury finds one of these 22 lies were, in fact, a lie or all 22 or some combination thereof, there are actually four million different permutations and combinations that the jury could find.
Regardless of what the jury finds, according to Professor Fischel, inflation on November 14, 2001, was exactly 7.97 which existed before any lie was told. I think that's the point you were making.
Q. All right. And does that make any sense to you?
A. From what I understand this case is about, it does not make any sense to me.
Q. Let's forget the questions I asked Professor Fischel the other day, and let me ask you this: Did you review Professor Fischel's analysis independently and come to your own conclusions?
A. Yes, I did.
Q. And what conclusion did you draw about the validity of Professor Fischel's analysis as applied to the facts of this case that these plaintiffs have put before this jury?
A. So I have examined all of the economic evidence available in this matter, hundreds of analyst reports, tens of thousands of press stories, stock price data, what I gather from the economic industry about the industry, Household and its competitors. And based on my review of all the economic

evidence, I concluded that there is absolutely no economic evidence that Household's stock price was ever inflated during the relevant period.
Q. Now, you say you examined thousands of documents. Did yo do this all by yourself or did you have help?
A. No, I was very ably assisted by a lot of my good colleagues at LECG.
Q. How large a team did it take to do this analysis?
A. Well, over two and a half years or so that we've been engaged, there must be 25-odd colleagues who worked significantly on this matter, and collectively they worked for about 10,000 hours.
Q. And did you use computers to assist you in this work?
A. Sophisticated computers, econometric packages and other statistical programs and a variety of other tools, yes.
Q. Is that why we hired you in the first place, because you have to be an expert with sophisticated abilities and skills and assistance to do this kind of analysis?
A. To examine the evidence carefully, I believe that expertise is helpful, yes.
Q. Okay. Now, is it your understanding that plaintiffs put on Professor Fischel to show that the alleged misrepresentations by Household caused the investors to suffer loss?
A. Yes.

Q. And what does someone, given that assignment, need to show in order to make that case? What does an expert have to bring forth to make that showing?
A. Well, from an economic perspective, the first thing you have to establish is the alleged falsehoods led to the stock price being inflated.
Second aspect of your analysis has to establish that when the market learned the truth, learning of that truth resulted in stock price declining, thereby causing economic harm to investors who purchased the stock at an inflated price due to earlier falsehoods.
Q. Can we refer to those two concepts today for shorthand purposes as an up leg, which is the inflation going in, and a down leg, which is the inflation coming out?
A. Yes.
Q. Okay. Did Professor Fischel show this jury an up leg, the inflation coming in?
A. There was nothing in his analysis to that effect.
Q. Is there any relationship in your mind between the exercise I went through of crossing out a lot of statements with my big red marker and an up leg?
A. Well, I thought that was the point of your examination, that Professor Fischel's analysis does not show that any of the alleged falsehoods ever created any inflation in Household's stock price, at least until November 15, 2001. I

believe there are two dates subsequent to November 15, 2001, when Professor Fischel claims Household's misrepresentations resulted in stock price being inflated.
Q. So at least up until November 15, 2001, even if you assume he showed a down leg, if he didn't show an up leg, he didn't fulfill the assignment he had to fulfill?
MR. BURKHOLZ: Your Honor, objection, leading.
THE COURT: I'll allow it. Don't lead, please.
MR. KAVALER: Yes, sir.
BY THE WITNESS:
A. Well, my understanding is that even if you quantified the amount of inflation that preexisted in the stock price by looking at what happens when market learns the truth, the whole point of what is called loss causation analysis from an economic perspective is to link the negative effect of stock price decline when market learned the truth to specific falsehoods that are alleged in the case.
Otherwise, you haven't fulfilled the objective of loss causation analysis, namely, showing that there was a relationship between plaintiffs' losses and what's alleged to be false. You have to link what you call the down leg to specific falsehoods that are asserted in this case, which you call the up leg. Unless you establish that link, you haven't shown economic evidence that plaintiffs' allegations caused anybody any loss.

BY MR. KAVALER:
Q. Now, I spent a lot of time with Professor Fischel talking about the up leg. I didn't spend much time on the down leg. So let me ask you: Did Professor Fischel show the down leg correctly?
A. No. As I pointed out in my detailed reports in this case, there are several methodological flaws in Professor Fischel's analysis. And most of the time when he believes market learned the truth on a certain day, he's actually got the wrong date. He's looking at stale information rather than new. So in my opinion, Professor Fischel has not reliably shown what you describe as the down leg.
Q. And this up leg and down leg are measuring the movement of something called inflation?
A. Correct.
Q. And would you tell us what you mean by the term inflation in the context of this lawsuit.
A. Well, inflation in most simple terms and very commonsensically could be understood as the overpricing of the stock that results from a lie that the plaintiffs assert.
Q. All right. When you say the stock -- did I understand you just to say that for the stock to be inflated is the same as to say the stock is overpriced?
A. Well, stock can be overpriced without there being a lie, in which case you would not call it inflation, because nobody

is perfect. It's -- the market doesn't know what a stock should be exactly priced at on any given day. Stock prices are very noisy. They go up and down for all kinds of reasons.
In fact, any day a company's stock trades on the Exchange, if it goes up, that's because some people have formed an opinion that the stock is a good buy at its current price. They think it's undervalued and they'd like to buy it. And for every buyer there's a seller, somebody thinking this stock is a bad hold at this price; it's going to go down. That's why they're selling.
So people form expectations and opinions about what's going to happen to a stock all the time, which makes stock prices move. And sometimes due to market expectations changing, we may determine with the benefit of hindsight maybe some stocks were overpriced. Like after the Internet bubble burst, everybody realized, hey, these stocks were way overpriced.
But the crucial distinction here is that we are talking about overpricing that results from defendants' lies, and that is the job of economic analysts to determine how much was the stock overpriced as a result of defendants' lie; that's the up leg concept.
Q. Now, did Professor Fischel -- who did -- whose job did Professor Fischel say it was to determine by how much the stock was overpriced on any particular day?

A. Well, what I heard him say again and again is it's for the jury to determine whether plaintiffs' allegations are true that the defendants lied. And I agree with him on that. That's the jury's job. The jury listens to the fact testimony. The jury listens to a lot of witnesses, looks at the record and determines whether any of the alleged misstatements and omissions are, in fact, lies.
But then Professor Fischel curiously told this jury, once you've determined that the first lie happened on a certain date, I have given you a table which says there was zero inflation prior to that date and there was exactly $7.97 inflation for all days subsequent to that date. And that is a very curious statement and not economically logical.
Because, think about it. You have 27 -- I'm sorry -- 22 different misstatements that are alleged. What if the jury determines 21 of the 22 were not falsehoods at all? Only one of the 22 was wrong. Does that mean that one single misstatement caused the same amount of inflation, 7.97, compared to if the jury determines all 22 were false?
What if the jury determines that, yes, there was a falsehood but there is a gradation here? There was just a little bit of a lie, not much of a lie. How does the jury apportion how much of 7.97 belongs to that small lie versus a big lie?
So I just don't understand the economic logic of the

approach that Professor Fischel asked the jury to follow.
Q. Now, you told us that you've testified in the past for plaintiffs. When you testify for plaintiffs, do you come up with a number?
A. Yes. If I'm asked to determine damages, it's my obligation to come up with a number that ties specifically to specific allegations in the case.
Q. From an economic perspective, Professor, in your opinion, did Professor Fischel do his job in this case?
A. Well, I regard him highly. I wouldn't want to say he didn't do his job or anything like that. I believe his analysis is flawed and not reliable for this case.
Q. What causes an -- in economic theory, Professor, what causes a stock price to become inflated or overpriced in the context you're using those terms here?
A. If a company lies and that lie is considered material or important or significant by the market, then that lie can result in the stock price becoming inflated.
Q. Can you give us an example, a hypothetical, of inflation causing -- of a lie causing inflation in the price of a stock?
A. Yes. So, you know, these days people are very concerned about global warming. So let's say a car company comes up with an announcement which says, you know, we have a revolutionary new engine, not very expensive. You can put that engine in your big SUVs for only a couple hundred

dollars; and if you do that, you'll have zero emissions, you'll get 200 miles to a gallon, and this will really be a revolutionary development in the car market.

And let's say before that statement were made, that company's stock was trading at $100 a share. We see that statement being made and the stock price goes up by $20 a share. In my hypothetical, if the company's statement was false, the jury finds in a proceeding like this later that the company made a false statement that day, the jury will then have an objective basis to determine that on the day of the company's announcement of this engine, $20 of inflation came into the stock price. That's your up leg.

Q. All right. Could a company's stock price also become inflated because of something the company failed to disclose at a particular time, in other words, an omission?

A. Yes, indeed.

Q. And tell us how that would work in your same hypothetical.

A. Okay. So in the same hypothetical, let's say the day the company made the announcement, it didn't lie. It really had a research program going and it truly believed that it has this revolutionary engine. So the statement was truthful when made. Nobody was trying to deceive anybody, and the stock went from $100 to $120.

Let's say that happened on January 1, 2008. And let's say six months later, the company learns that the

technological breakthrough it was counting on is not going to happen. So now the company knows that this engine ain't going to work.

And let's say on that day, the company has a legal obligation to disclose that information to the market, but it keeps quiet about it, fails to tell the market the truth. In this example, that omission has created an inflation, and the amount of inflation is how much the stock price would have dropped had the company truthfully made the announcement that it was legally required to do.

So you can have a stock price becoming inflated because of an affirmative misrepresentation or a lie that makes it go up after adjusting for market and industry; or you can have inflation when the company fails to tell the truth, thereby preventing a decline in stock price, assuming it had a duty to tell that truth.

Q. So in both cases, Professor, there's an identifiable event that causes the stock to be overpriced?

A. Yes. There has to be, for proper loss causation analysis, an identifiable event which maps into a quantified quantum of inflation, whether it is an omission or it is a misrepresentation.

Q. From an economist's perspective, Doctor, is there an important difference between telling a lie that causes inflation and omitting to make a statement that causes

inflation?

A. There's no fundamental difference as we just explained.

Q. So would a proper expert analysis identify either the misstatement or the omission that gives rise to inflation in either event?

A. A proper economic analysis, whether it is about omission or misrepresentation, will tie the amount of inflation determined by the economic analysis to what was it that caused the inflation, what specific lie, what specific omission caused how much inflation.

Q. So in that case, why can't the jurors just do what Professor Fischel suggested they do, pick the first statement that they believe to have been false and make that the date on which the stock price became inflated?

A. Well, assuming jurors don't believe my analysis, which would be the easy way out, they'd have to do a lot of work themselves to actually do all the statistical analysis to determine how much a particular misstatement or omission affected the stock price to create inflation.

Q. Professor Fischel has not provided them with those -- that data?

A. Well, the only way Professor Fischel's analysis is relevant is if the jurors believe 100 percent of the plaintiffs' claim is correct and there are no methodological flaws in Professor Fischel's analysis and he hit it right on

the head and came with the right number. And even then I think there is a crucial piece of analysis that is missing from Professor Fischel's quantification.

Q. And what's that?

A. Professor Fischel repeatedly said that I have given you my estimate of inflation that existed on the first day of the relevant period, July 30, 1999. And then between July 30, 1999, and November 15, 2001, for about a year and a half, while there are 22 separate lies being asserted by the plaintiffs, inflation does not change by one single cent.

So what did this inflation -- where did this inflation come from? Economic logic tells us, whether we call something an inflation or not as a result of legal subtlety, the $7.97 overpricing in the stock must have come from what happened before the relevant period. Or why would it be there on the first day of the relevant period and never change? So --

Q. Doctor --

A. -- if his inflation came from before the class period, then it's my understanding that such inflation may not be considered for purposes of damages in this case pursuant to this Court's ruling.

Q. Professor, is there a similar problem with calculating the amount of the inflation as among the three separate subject matters, that is, predatory lending, re-age and restatement,

or does Professor Fischel's analysis cover that adequately?
A. No, it's the same problem with regards to the fact that plaintiffs have alleged three categories of lies, and Professor Fischel has not told us how much of his quantified inflation comes from which of these three categories of lies.
Q. Okay. Is there a similar problem for days after November 15, 2001, in Professor Fischel's analysis?
A. After November 15, 2001, Professor Fischel's analysis looks at specific dates when he believes market learned the truth or plaintiffs' misrepresentations added to inflation that preexisted even the relevant period, but there are several methodological flaws with that part of the analysis.
At least in principle, that analysis is based on what an economist would be consider the reliable ways of thinking. Whether he executed it correctly or not is something that we differ on, obviously.
Q. Let's look at Plaintiffs' Exhibit 1397 if we can. That's Professor Fischel's inflation chart.
Now, the plaintiffs claim that there was a misrepresentation on September 2, 2002, when a Household spokeswoman said that she was not aware of any pending enforcement actions or settlement talks. Let's look at September 2.
How would Professor Fischel's chart work if the jury finds that's the first misrepresentation?

A. September -- I'm not able to see the heading of this chart and I haven't got it memorized.
Q. There it is. There's the heading.
A. Okay.
Q. Professor, you can look at the screen in front of you or at the big screen or we can get you a copy of this document.
A. That's fine. I understand now what the columns are.
Q. Okay. Go down to September 2, please.
A. I see.
Q. Or September 3, I guess.
A. It must be, because September 2 was not a trading date.
Q. Right.
A. So the effect of that alleged misstatement would have been felt in the stock price on the next trading day of September 3.
Q. So what Professor Fischel would say is the jury should put zeroes on every day before September 2?
A. That is correct.
Q. Does that work?
A. Well, then the misstatement did not create any inflation. There's negative inflation on that day according to Professor Fischel, right?
Q. That's my question. What does a minus sign mean there?
A. That means the stock was underpriced as a result of this alleged lie. It was correctly priced before. The lie is

supposed to inflate the stock price, but his analysis shows that it actually ended up deflating the stock price.
Q. So if the jury accepts his invitation to pick a date and they pick this one and then they accept his invitation to put zeroes instead of the 7.97s for every entry before here, and they get to this date and they've done exactly what Professor Fischel told them to do, they just applied their judgment and they found the September 2 false statement -- I'm sorry -- the September 2 statement is false and it's the first false statement, that's exactly what he told them to do, right?
A. Right.
Q. Then you have the false statement creating negative inflation?
A. That is correct.
Q. Does that make any sense to you?
A. No. It's very curious.
Q. But they've done everything exactly the way he told them?
A. I would assume so, yes.
Q. So they didn't make a mistake in my hypothetical?
A. No. Obviously, this means the misstatement had the opposite effect of what plaintiffs thought it did.
Q. Does that make any sense to you?
A. It makes no economic sense.
Q. But I just want to be clear. In the hypothetical I'm asking you, the jury would have done exactly what Professor

Fischel told them, pick a date, replace all the numbers before it with zeroes, look at my chart for the inflation and we're there, correct?
A. That's correct. That's what he said.
Q. But it would give you a ridiculous result; it would show negative inflation?
A. Well, it would be a curious result, of course.
Q. But it wouldn't be the jury's fault?
A. I mean, I don't know what I would do if I were a juror in that situation.
Q. Okay. Let's get to the bottom line. Is it realistically possible for a jury or for me or for anyone who is not an economist like you are with 10,000 hours of staff help and sophisticated computers to calculate how much inflation resulted from a particular statement?
MR. BURKHOLZ: Objection, compound, leading.
MR. KAVALER: Let me rephrase the question.
BY MR. KAVALER:
Q. Is it possible to do what Professor Fischel suggested, take this chart, cross out some days, put in zeroes and figure out the right number?
A. I don't think that would lead to an economically sensible result at all.
Q. To lead to an economically sensibly result, would you have to do a regression analysis?

A. Yes.
Q. Would I be able to do a regression analysis here at the lectern? I have a pencil and I have some papers. Can I do it?
A. Counsel, I have a very high degree of confidence in you, so I'm reluctant to say you cannot do something, but it would be hard.
Q. Very hard. In part because a regression analysis requires a computer?
A. Yes. You need sophisticated statistical programs to do a proper analysis.
Q. Okay. All right. Well, instead of me trying to do it, I'm sure you've done it. You have all these sophisticated tools. So help us out.
After reviewing all the economic evidence in this case, when do you think Household's stock price became inflated as a result of a false statement?
A. As I said, counsel, I looked very carefully and I found no evidence that Household's stock price was ever inflated during the relevant period. It doesn't mean Household's stock price didn't decline for part of the period. Like the rest of the market and other finance companies, consumer finance companie in particular, there was time when Household's stock declined a lot. But I did not find any evidence that any of that decline was a result of previous inflation.

In fact, Professor Fischel's own analysis, when corrected, leads to the conclusion that Household's stock price was weighed down by headline risk. And as that headline risk became worse, stock kept on getting punished more and more. And in the end when Household alleviated this headline risk by buying peace with attorneys general, the stock price went up over two days by 33 percent, which is the largest history -- largest increase in history of the stock ever since it was a public company.
And all the economic evidence is consistent with Household's stock price never being inflated for a single day during the relevant period. And Professor Fischel's own analysis, when reasonably corrected, supports that conclusion.
Q. Now, can anything other than a lie cause inflation?
A. Inflation is a term of art in a proceeding such as this where overpricing that results from a lie is called inflation. So as I said, you can have a stock being overpriced or underpriced with the benefit of the hindsight.
If you look at all the stocks that lost a lot of money yesterday and there was no news, well, with the benefit of hindsight we can say, yeah, the day before yesterday, they were overpriced. But inflation comes into consideration when it is a misrepresentation or omission, namely, a lie that creates overpricing.
Q. So if I understand correctly, inflation is different than

just the price of the stock going up and down?
A. Absolutely. That's a crucial distinction in a case like this to keep in mind.
Q. Okay. Maybe it would help if you would walk us through what might happen when a stock -- a company's stock price becomes inflated. Have you prepared a demonstrative that would help you to illustrate this point?
A. Yes, I have.
Q. Can we see DDX 568-01, please.
Now, Professor Fischel -- I'm sorry. Professor Bajaj, could you explain to us -- could you explain to us what this demonstrative is showing us, please.
A. Yes. So in this demonstrative, if you look at the vertical axis --
Q. What is that? Where am I looking?
A. That's on the left-hand side of the chart.
Q. Where it says dollars of inflation?
A. You'll see zero, five, ten, 15 and $20 labeled on the chart. That axis measures inflation.
So going back to our hypothetical car company example, if the company's stock was trading at $100 a share and it told a lie and the stock went up by $20, this chart shows $20 of inflation came in. So stock price would be 120, but inflation is $20.
Q. Let me stop you there. I don't see the hundred on this

chart. Where's the hundred?
A. Because in my axis I have not measured stock price. I have only measured overvaluation as a result of a lie, namely, inflation.
Q. So we're just going to measure the inflation?
A. Yes.
Q. The stock price can be anything it wants to be?
A. Stock price could be $50, $100, $2, $300, whatever.
Q. Why does the line that goes up -- the red line with the arrow, why does it start at zero?
A. Because before there is a lie, there is no inflation. That goes to your up leg concept. You have to demonstrate that there was a lie and that made stock price inflated.
Q. So for this exercise, the chart always has to begin at zero?
A. Yes.
Q. Okay. Sir, I'm sorry I interrupted you. Let's continue. What's the next step on your chart?
A. Well, suppose a lie is told on January 1, 2008. Going back to our automobile example, a $100 stock became 120; and for the next six months, the stock may go from 120 to 500 or it may drop to 10.
Investors would either make a lot of money or lose a lot of money. But none of their gains and none of their losses have anything to do with economic harm that the jury

has to determine in this particular case. As long as the market did not learn the truth about the original lie, that inflation remains constant even though stock price may go up or down.

So what we have to do in economic analysis is to separate changes in stock price that result from any factor other than a lie or a correction of the lie. We have to focus on change in inflation, not change in stock price.

Q. What happens next after this second stage?

A. So in this hypothetical, when the market learns the truth that the company had lied, there was no such engine, and stock price drops, that's when inflation has come out of the stock.

And the measure of economic harm that is at issue in this case is the loss investors suffered if they held the stock when it was inflated and suffered the consequences of that inflation coming out of the stock. The rest of their gains and losses have nothing to do with this case or a similar case.

Q. Professor, I noticed that your chart both begins and ends at zero. Is that a coincidence?

A. No. Because before there is first actionable misstatement, there must be zero inflation. And I apologize for the jargon. Before there is a lie that the Court has ruled can be considered for purposes of this case, by definition, the stock is not inflated. And after the market

has learned the truth, which is at the end of the relevant period, all the truth is out and inflation is zero.

So in a proper analysis, you begin with zero inflation and you end with zero inflation. So an investor who had purchased before there was any inflation and held the stock until after all the inflation was out has not been harmed. Only investors who have been harmed are those investors who purchased while the stock maintained an inflation and they held until after the inflation came out.

Q. Let's look at one of Professor Fischel's inflation charts. Can we see Plaintiffs' Demonstrative 151, please.

Does Professor Fischel show inflation starting at zero?

A. Not in the range of his chart. So on the first day of the relevant period, Professor Fischel shows $7.97 of inflation.

Q. In other words, Professor Bajaj, over here on the left side, I think you called it the left axis. Let's put your chart and this chart next to each other. Can we do that?

Okay. Do you see here on the left side of your chart, your up leg starts at zero and goes up?

A. Correct.

Q. Where is Professor Fischel's analogous up leg showing the first time a false statement put inflation into the price of Household's stock?

A. There is nothing in Professor Fischel's analysis that

tells us how that inflation came in. It couldn't have magically appeared. There must be some economic falsehood, some lie. And the only reasonable interpretation is there was $7.97 of inflation because of lies that existed before July 30, which we have never been told about what those lies were so that we could examine whether those lies, in fact, resulted in stock price going up after adjusting for market and industry factors.

Q. As a professional economist, Professor, what is your opinion of the significance of the fact that Professor Fischel's chart doesn't start at zero; it has no up leg whatsoever?

A. Well, the only way to interpret this chart is the inflation Professor Fischel quantifies existed through November 15, 2001, pertained to some untold lies and misrepresentations and omissions that happened before July 30. Each and every one of the 22 lies that plaintiffs claim happened between July 30, 1999, and November 15, 2001, did n change his inflation quantification one bit.

Q. And you're just assuming there were lies, right?

A. Well, if there were, in fact, lies, then economic evidence would have shown some sort of an impact. And that's what you were doing when you were examining Professor Fischel. His event study does not show any economic impact of those misstatements that are alleged by the plaintiffs, so they did

not change his inflation.

Q. So what does that tell you? Does that mean his study is wrong, or does it mean there are no lies? What does it mean?

A. Well, what that tells you is the study is unreliable and, further, as we will discuss more, the plaintiffs' entire theory of the case is not consistent with economic evidence. The market always knew about what plaintiffs allege. Household had a duty to tell the public, failed to tell the public, the public did not know, and when it found out, the stock price went down. There is simply no evidence that's consistent with those allegations.

Q. Okay. Let's focus on your model again. Do Household's stock prices -- let's go back to your model -- from 1999 to 2002 fit with this model?

A. No, it did not.

Q. Have you prepared a demonstrative to illustrate that point?

A. Yes, I have.

Q. Can we see DDX 551-01, please.

Professor, explain to us what this shows us.

A. So as we were looking at Professor Fischel's inflation chart, Professor Fischel says inflation existed on the first day of the class period or it would exist whenever the jury thinks there was an actionable disclosure defect. He has not shown us how that inflation got into the stock price. What were the specific misrepresentations and omissions and how did they affect the stock price to create the inflation?

He assumes the existence of the inflation based on what he found during tail end of the relevant period when Household's stock price went down along with the rest of the industry, and he assumes that decline must be because there was inflation earlier.

Q. Let's go on to the next slide, please.

Professor, please walk us through this one.

A. So this segment says during the period July 30, 1999, to November 15, 2001, when there were 22 separate lies according to the plaintiffs, there was not any change in inflation. None of them had any effect on the inflation, didn't increase it by a cent, didn't decrease it by a cent.

Q. Does that make any sense to you?

A. It makes no economic sense to me.

Q. Let's go to the next slide.

What does this show us, please?

A. Well, curiously in this case, plaintiffs are asserting that all of Household's lies were about three categories that we've been hearing about and plaintiffs have asserted in their complaints and other filings when the market learned the truth about those three categories of lies.

So if, in fact, there had been inflationary lies, you would expect when market learns the truth for stock price to

come down. For each and every one of the dates when plaintiffs claim market actually learned the truth, we find no evidence of stock price decline.

In fact, as we were just saying, their major allegation on predatory lending, which they say was revealed right at the end of the relevant period, resulted in the largest stock price increase in the history of this company as a publicly traded company.

Q. And is that what this final chart shows us?

A. That is correct.

Q. And that would not be true if the theory of the case made sense?

A. I think that right there tells you that there is no loss causation in this case. There is something wrong with the plaintiffs' theory of the case when confronted with economic evidence.

Q. Okay. Didn't Mr. Dowd in his opening show the jury a big chart demonstrating how Household's stock went down overall, and you're saying Household's stock price didn't go down? Am I missing something here?

A. No, I'm not saying Household's stock price didn't go down at all. Household's stock price suffered terribly between November 15, 2001, and October 11, 2002, when the relevant period ends. But think of what the time period was in our economic history.

November 15 is right after 9/11 when the economy, which was already weakening, started to suffer more. And we've heard a lot of testimony that Household's customers were medium- to low-income working people, who are among the first to be affected by weakening economy. They tend to lose their jobs. They don't have enough savings so they can't pay their bills. That was not a good time for Household. So Household as well as other consumer finance companies were facing a rough time in the marketplace.

And then we had December 3 when Enron imploded. We had a couple of months of the most difficult time in our economic history between December 3 and October of 2002 whe corporate America be -- came under great deal of suspicion. After Enron's meltdown, we had Global Crossing implode. We had WorldCom implode. We had Adelphia implode. We had Tyc almost not make it.

So people were reacting to a lot of innuendo and rumor, and corporate America was not believed. There was Sarbanes-Oxley Act enacted. And in this environment, Household was in an industry that had been growing explosively.

Lending to middle- to low-income Americans didn't practically exist until 1995. And starting in 1995 and over this relevant period, this was becoming a big market. I cite to a Fed study in my report how subprime sector was exploding.

And as the economy, as the industry was becoming larger, regulators were thinking about what are good practices to lend to these consumers? How are they going to regulate them?

Certain states and cities started enacting their own legislations; whereas, lenders like Household preferred to work with national regulators so they could use their national scale to their advantage. And over this period of time, over and over again, in hundreds of analysts' reports, you will see statements like headline risk is the bane of subprime lenders.

And during this period, Household's stock price suffered. So did other consumer finance companies' stock price. The question is, was that decline related to market learning truth about the earlier fraud? Decline is not the issue. It's whether the decline was related to revelation about truth about the earlier fraud.

Q. Let's see if we can put that in some context. Are some investments riskier than other investments?

A. Yes.

Q. Do you have a demonstrative that you prepared to illustrate this concept?

A. Yes.

Q. Can we have DDX 820-01, please.

What is this, Professor Fischel -- Professor Bajaj? That's two.

A. This demonstrative shows what rate of return on an

annualized basis you could get if you wanted to --
A JUROR: Talk into the mike.
BY THE WITNESS:
A. I'm sorry. Thank you.
So investors have a choice to make. We can invest our money in relatively safe investments or risky investments. And there's a spectrum of investments with different degree of risk and different expected return.
What we teach our students in our finance classes is the safest investment you can imagine is short-term U.S. treasury bills. And what this chart shows you is that if you invested in one-month treasury bills, you would never have had a dime of loss going back to 1996. This is as close to a risk-free asset as you can get. Of course, you wouldn't have made much of a return.
And when you do see a little bit of a respectable return, that was in a very high inflation environment. So adjusting for inflation, you basically tread water. You might as well put your money under a mattress if you want it to be totally safe. That's the U.S. treasury bill.
BY MR. KAVALER:
Q. Professor, where did you get this information from? There's a source note on the bottom. Where did this come from?
A. This is an accepted source for such data, Ibbotson SBBI

Yearbook, and it's a standard reference for compilation of return data.
Q. What about stocks? Do you have a demonstrative that shows us how stocks compared to government bonds over the same tim
A. Yes, I have.
Q. Can we see DDX 820-02, please.
What are we looking at now, Professor?
A. Well, if we were looking at very calm, classic waters, here we are seeing a storm, right? This is what would happen if you had put your money in a well-diversified portfolio of large U.S. company stock. On a year-by-year basis going back to 1926, in good years, you might get over 50 percent return. But in bad years, you can lose up to 40 percent of your investment, historically speaking.
And this is a well-diversified portfolio of large company stocks, and you can see this is a much riskier investment. And individual stock, it's this chart on steroids.
Q. Again, where does this data come from?
A. This data, again, comes from the same source that I talked about, Ibbotson's Yearbook.
Q. A commonly consulted reference?
A. Yes. It's the standard and well-accepted reference for such data.
Q. What about investment in Household stock? Was that any

different?
A. As I said, investment in a single stock is this particular chart you're looking at on steroids. It's much riskier.
Q. Let's look at that. Let's look at Plaintiffs' Demonstrative 132.
And this, I believe, is the chart that Mr. Dowd showed us in the opening. What does this tell you with regard to the charts we just looked at?
A. Without additional context, it tells me nothing other than this is a risky investment. It did well for a while and it -- then it did poorly.
Q. So this shows us the price of Household stock declining?
A. It shows price of Household stock going up for part of the period and going down for part of the period.
Q. Does -- I'm sorry.
A. And the period it went down, in light of what we talked about the economic environment, is not at all surprising.
Q. Does it tell us anything whatsoever about inflation?
A. It has nothing to do with inflation.
Q. Nothing to do with it.
In preparing your analysis, Professor, that you're testifying about here today, did you identify other consumer finance companies as a first step to conducting your analysis?
A. Yes, I did.
Q. How did you do that? How did you identify these consumer

finance companies?
A. So there is an industry code assigned by the government to various publicly traded companies based on what is their major line of business. It's called GCIS code. And according to Standard & Poor's, Household belonged to a certain GCIS code along with six other companies that traded over the relevant period.
So I looked at those six companies with the same GCIS code as a first step in my statistical analysis to put Household's stock price movements in context.
Q. And that's a code provided by the United States government?
A. Yes.
Q. And Standard & Poor's tells you what companies fall within that code?
A. Yes. And this is a very, very, very well-accepted and commonly used methodology to start to look for comparable companies.
Q. And how did Household's stock price perform relative to other consumer finance companies during the same time period?
MR. BURKHOLZ: Objection, vague as to time.
MR. KAVALER: I'll specify.
BY MR. KAVALER:
Q. During the period between July 30, 1999 -- I'll do even better than that.

Did you look at how Household's stock price performed during the period from July 30, 1999, to October 11, 2002, in relationship to the other companies which fall within this government code called GCIS and are identified as being consumer finance companies?
A. Yes, I did. And what I found is Household's stock price was right in the middle of the pack.
Q. Do you have a demonstrative that shows that?
A. Yes.
Q. Can we see DDX 405, please.
Okay. Tell us what this chart is designed to show.
A. Well, this chart shows what would happen if you invested a hundred dollars in Household stock on July 29, 1999, the day before the relevant period, and you held it until the end of the relevant period. Unfortunately, over this relevant period, you would have lost about 34 and a half percent of your money.
Q. That's --
A. Your -- I'm sorry.
Q. I apologize. Go ahead.
A. I was just going to say, your hundred dollars becomes $65 at the end of the period.
Q. A bad result?
A. A bad result.
Q. But you said Household was in the middle of the pack?

A. Yes.
Q. Do we have the capacity to see the rest of the pack on this chart?
A. Yes.
Q. Show us the rest of the pack, please.
What does the chart show now, Professor?
A. Well, the first thing I would point out is the red line, and you'll see the label on the right-hand side, S&P 500. You'll see if you had invested $100 in the most well-diversified U.S. large company stocks that investment professionals recommend you do -- that's S&P 500 portfolio, it's the proxy for the market, it's about 80 percent of the market value of all publicly traded companies -- you would have $62.29 left of your hundred dollars.
Q. So Household performed better than the S&P 500 during the time period we're looking at?
A. Household did better than the market over the relevant period; not by much, but it did better.
Q. What about the rest of these companies?
A. Of the six consumer finance companies that share the GCIS code with Household, Providian, AmeriCredit and Capital One did worse than Household. Had you invested $100 in Providian instead of in Household, you would have lost over 90 percent of your money. You would have less than $1 left at the end of this period.

With AmeriCredit, you would have $47 left. With Capital One Financial, you would have $63 left or almost 64, as compared to with Household, 65.50.
But three consumer finance companies did better than Household. MBNA did better. Cash America did better. Cash America broke even, made a positive 1 percent return. And Countrywide did the best. They had a 25 percent return.
But the other thing I want to point out, just going back to our previous point, you know, the reason these trends are not as clear, the $65 going from $100 looks almost like a flat line, is there's no way to scale this chart to show that. 35 percent decline to most people would look like a pretty significant decline.
Look at the volatility in these individual companies. Look at the green line AmeriCredit. This is what it means to invest in individual stocks. They go up and down a lot. And Household was right in the middle of the pack during this time period.
Q. And so does that mean that other finance companies also lost money during the same time period?
A. Well, three did, three didn't. And also it depends on when you invested. Like we talked about AmeriCredit doing worse than Household. But what if you were lucky enough to buy just before a big run-up and you happened to sell at the top of the run-up? You would have made a lot of money.

Q. Did you prepare a demonstrative listing the factors that, in your opinion, affected Household's stock price during the relevant period, by that I mean the same time period we just looked at?
A. Yes, I did.
Q. Can we look at DDX 553-01, please.
Can you describe to us, Professor Bajaj, what these factors are? These are the factors that in your opinion affected Household's stock price during the relevant period.
A. Yes. The first is market and industry factors, and we talked about it a little bit. After the NASDAQ bubble started to burst in the beginning of 2000, Federal Reserve --
Q. I'm sorry. The what bubble?
A. NASDAQ stock prices.
Q. What is NASDAQ?
A. These are high-tech company stocks that are traded on a marketplace called NASDAQ, national association of dealers or something, but it's high-tech stocks. The Internet stocks are most identified by -- with NASDAQ.
Q. I'm sorry to interrupt. Go ahead.
A. So we remember the beginning of 2000, market prices started to crash in the stock market; and Federal Reserve started to cut interest rates very rapidly. And that -- other things being equal, the interest rate cuts, per se, is a good thing for finance companies. Because when interest rates --

short-term interest rates go down, they can borrow the money that they use to lend out more cheaply.

We also talked a little bit about this being a time period when the industry as a whole was facing explosive growth. It was also a period when the industry was facing a changing regulatory environment.

Larger consumer finance companies wanted to have national level legislation so they could standardize their products. They didn't have to worry about what legal risk they faced in what jurisdiction. They were better positioned because of their nationwide technology.

And Household was mentioned in analyst reports to be better than its competitors during this period. When a lot of mom-and-pop businesses that lent to subprime lenders were making mistakes, facing regulatory sanctions, some going out of business, people thought Household was -- had a competitive advantage because it had a large company culture. It had seasoned management. It had technology infrastructure, so it could navigate the regulatory waters better than its competitors.

There's a lot of talk in analyst reports about that being a favorable factor during part of the relevant period. And then the headline risk started growing. And after a while, Household was the only large stand-alone player left in subprime market because Citigroup bought its biggest

competitor, First Associates.

So consumer activists started to get very focused on Household. One of Professor Fischel's exhibits quotes a consumer activist as saying, We will not rest until Household's subprime customers are treated the same way as conforming loan customers.

Well, you can't lend to subprime customers on same terms that banks give to conforming loan customers so you can stay in business.

Q. Professor, what's a conforming loan and what is a conforming loan customer?
A. These are people with very good credit, very good income, good savings that are usually very rate sensitive and are very creditworthy with major banks and other depository institutions.
Q. Sometimes called prime customers?
A. Those are prime customers.
Q. Okay.
A. So headline risk became a big factor. And as you see us talk about various analyst reports and what the market was learning, you will see evidence of headline risk affecting Household's stock price.

There were other non-fraud related firm specific factors, and then there were days when nothing happened and stock price moved a lot. If I remember correctly, in

Professor Fischel's event study, the largest negative return happens on a day when he finds no news. That's just changing investor expectations. It happens all the time. Nothing wrong with that finding.

Every day of the week investors have new expectations about stock. And sometimes market analysts change their expectations, not because they've discovered something new. But based on what is already public, they may become less bearish on a stock or more bearish or less bullish or more bullish. And sometimes their opinions impact stock price because certain investors follow these analyst recommendations.

Q. Did you find any economic evidence that Household's stock price was affected by fraud?
A. As I said before, and I'm sure we'll examine this evidence carefully, there is absolutely no economic evidence that Household's stock price was affected by fraud during this relevant period.
Q. Okay. Now, did you evaluate what information was available to the market about the risks you've just enumerated?
A. Yes.
Q. And you mentioned stock analysts in this case who wrote up various reports that we've seen. Did analysts also discuss these risks that you're talking about?

A. Yes.
Q. Why don't we take a look at what some of those analysts said about headline risks. Let me show you a Paine Webber analyst report. Well, let me show you Defendants' Exhibit 232.

A copy to counsel. A copy for you, Professor.

(Tendered.)

BY MR. KAVALER:

Q. Is this one of the documents you looked at in formulating your opinions here in this case?
A. Yes, I did, counsel.

MR. KAVALER: I offer Defendants' --

MR. BURKHOLZ: Your Honor, I object to this document. It's not listed in his expert report as a document.

MR. KAVALER: Your Honor, I'm told it's in his event study. It's specifically called out in his event study, which is listed in and attached to his expert report.

MR. BURKHOLZ: He lists all the documents he's relied upon in Exhibit 2 to his report.

MR. KAVALER: Let me ask him, your Honor.

THE COURT: It's 10:25. Let's take our morning break.

MR. KAVALER: Okay.

THE COURT: And we'll discuss it during the break.

(Jury out.)

THE COURT: You may step down, sir.
What do we have here?
MR. KAVALER: If you give us a minute, your Honor, when we come back, I'll ask him if it's in his event study. I'll have him point to where it is. If that satisfies counsel, so be it. If not, we'll move on.
THE COURT: All right. Ten minutes.
MR. KAVALER: Thank you, your Honor.
THE CLERK: The court is in recess for ten minutes.
(Recess taken.)
THE COURT: Okay. Where do we stand with the objection?
MR. KAVALER: We fixed it. Everything is okay.
THE COURT: No objection?
MR. BURKHOLZ: No objection.
THE COURT: Okay. Bring the jury out.
MR. KAVALER: Thank you for that, your Honor. The break was very helpful. We straightened the whole thing out.
(Jury in.)
THE COURT: We're ready to proceed again.
MR. KAVALER: Thank you, your Honor.
I think the last thing I said was I offer Defendants' 232 in evidence, your Honor.
THE COURT: No objection?
MR. BURKHOLZ: No objection, subject to the limiting

instruction, your Honor.
MR. KAVALER: I agree with that, your Honor.
THE COURT: Okay. It's admitted subject to the limiting instruction.
BY MR. KAVALER:
Q. Okay. Let's look at this one. Professor Bajaj, do you see where it says, The political/legal risk facing subprime lenders appears to be steadily growing?
A. Yes, I do.
Q. And then it goes on to say that, In recent weeks and months, we've seen sanctions against Advanta, Delta Financial and other subprime lenders?
A. Yes, I do.
Q. And then it says, Further, we hear continued rhetoric from Washington about predatory and discriminatory lending.
Do you see that?
A. Yes, I do.
Q. And then it says, Our ongoing concerns are we are unable to forecast either the timing of government/legal decisions or the ultimate earnings impact of these decisions.
Do you see that?
A. Yes, I do.
Q. And there are several other quotes to the same effect?
A. Indeed.
Q. Is that what you were referring to earlier when you talked

about the market's awareness of headline risk?
A. Yes.
Q. And the date on this document is December 3, 2001?
I'm sorry. Wrong document.
The date of this document is June 23, 2000?
A. That's correct.
Q. Let's look at another one. This is Defendants' 289.
A copy for counsel. A copy for you, Dr. Bajaj.
(Tendered.)
BY MR. KAVALER:
Q. Is this another document that you looked at in formulating your opinion that you're testifying about here today?
A. Yes, I did.
MR. KAVALER: Offer Defendants' 289, your Honor.
THE COURT: Admitted.
BY MR. KAVALER:
Q. This is a UBS Warburg report from November 16, 2001?
A. Yes, it is.
Q. Another analyst report?
A. Correct.
Q. And if you'll turn to the second page, third bullet, it says, We believe the more immediate danger to Household's stock price stems from the headline risk and association, justified or not, with predatory lending.
Do you see that?

A. Yes, I do.
Q. Is that one of the things you were referring to?
A. Indeed.
Q. And is this one of the things that supports your view that it was headline risk and not fraud that caused Household's stock price to decline in 2002?
A. Yes.
Q. Let me show you another document, Defendants' 357.
A copy for counsel. A copy for you, Professor Bajaj.
(Tendered.)
BY MR. KAVALER:
Q. Is this another analyst report that you relied on in formulating your opinions that you're giving here today?
A. Yes, I did, counsel.
MR. KAVALER: Your Honor, I offer Defendants' 357.
MR. BURKHOLZ: Same limiting instruction, your Honor.
MR. KAVALER: Agreed.
THE COURT: Admitted with the same limiting instruction.
BY MR. KAVALER:
Q. This is a Bear Stearns report dated December 3, 2001?
A. Yes.
Q. And the heading is, Is the biggest risk in subprime lending headline risk.
Do you see that?

A. I do.
Q. And turn to the second page, first full paragraph there. It says, The real risk of subprime lending appears to be headline risk.
Do you see that?
A. Yes.
Q. Is that another piece of information that you relied on in coming to your conclusion that what was affecting Household during the relevant period was headline risk and not fraud?
A. Yes.
Q. Are there others as well?
A. There are many, many, many more.
Q. Let's talk briefly about an event study.
To do this -- an event study is a method of analysis?
A. Yes. It's a widely recognized and accepted method of analysis.
Q. And to do this kind of an analysis -- withdrawn.
For what does one use an event study in connection with what we're talking about here today?
A. Well, as the name implies, event study is a statistical technique to study the impact of an event on stock price of a company after adjusting for market and industry or other unrelated factors.
Q. And what is your goal -- withdrawn.
Did you do an event study to come to your conclusions

in this case?
A. Yes, I did.
Q. And what is the goal of the event study that you performed in this case?
A. Well, the goal in an event study was to see if there is any relationship between plaintiffs' allegations and investors' losses.
Q. And do you use a tool called a regression analysis in conducting an event study?
A. Yes. Regression analysis is a tool that is used to conduct an event study.
Q. And in order to conduct an event study, do you need to perform a careful review of all of the economic evidence available?
A. That is correct.
Q. Now, did Professor Fischel conduct an event study in this case?
A. He did.
Q. And have you had an opportunity to review and study his event study?
A. Yes, I did.
Q. In your opinion, is the event study that Professor Fischel conducted a proper event study?
A. In my opinion, his event study is subject to very serious methodological flaws.

Q. Let me ask you a hypothetical.
Let me not.
Let me ask you in this context, let's see if I can understand the process. If a company announces on January 1, 2010, next January, that it's going to open a new factory and that day its stock price increases by 5 percent, can I conclude that the market increased the value of 5 by -- 5 percent due to the decision to open a new factory?
A. No, you cannot.
Q. Why not?
A. Well, that's why you need an event study. In the hypothetical that you gave me, if the company announces that it's going to open a new factory, and let's say it's a computer company, and the stock price goes up by 5 percent, before you attribute that 5 percent increase in stock price to that announcement, you have to remove effect of other unrelated influences on the stock price.
So if this is a computer company and you find, based on historical study of how this company's stock price co-moves with other computer companies, that on average when an index of computer companies goes up by 1 percent, this company's stock price goes up by 1 percent and vice versa.
Now, armed with this historical pattern, this historical relationship that you determine through regression analysis, in your hypothetical, I would look at the 5 percent

stock price increase that happened on the same day that the factory news came into the market, and I'll see what happened to other computer companies' stock. And if an index of computer company stock went up by 3 percent on the same day, then I say, wait a minute, on average this company goes up one for one with other computer companies; and on this particular day, other computer companies went up by 3 percent, so 3 percent of the 5 percent increase that we are talking about is due to market or industry factors.
So the part of stock price increase that I can associate with this factory announcement is not 5 percent, but 2 percent. This is the abnormal return after correcting for market and industry. And before I conclude that even this 2 percent increase can be linked to announcement of the factory, I have to see whether there was something else announced. Let's assume not. Then I have to see whether this 2 percent is significant enough, is it large enough, or is it within the range of random noise that happens on a day-to-day basis in stock prices.
And the regression analysis that allows me to benchmark this company's stock price with other computer companies also gives me a threshold level of movement which is considered significant. So the regression analysis might show that it's really the case that this company's stock price moves over and above computer index by 2 percent.

And the threshold level that statisticians usually use and financial economists use is typically 5 percent. In other words, when abnormal return is large enough that there is less than 5 percent chance that it is just a random fluctuation, then we will consider it significant.

So there are several steps I would need to take in order to determine what was the impact of the announcement of a new factory in your hypothetical. I'll start with 5 percent. Based on regression analysis in my hypothetical, 3 of the 5 percent is due to industry factors. That leaves me 2 percent. And then I will see whether this 2 percent number is unusual enough or significant enough. And if it is, then I will say the impact of the factory's announcement on this company's stock is 2 percent, not 5 percent. And if it is not significant, I would say there is no evidence that this announcement significantly changed this computer company's stock price at all.

Q. Is it your opinion, sir, that Professor Fischel's event study gave him unreliable results?

A. Yes.

Q. Do you have an opinion as to why that is?

A. Well, there are two or three main reasons why I believe he got unreliable results.

Q. Please list them for me.

A. Okay. So, one, remember when we were talking about the

computer company example? If the announcement was made on January 1, 2008, let's say, and you have to do a regression analysis to see what's the normal relationship between this stock price and the computer industry, you have to pick a period of time over which you measure what is the average relationship between the stock price and the computer industry. In the jargon of economists, it's called the estimation window.

So you do your regression analysis over an estimation window to determine what is the normal relationship between this stock and the market and the industry.

And in my opinion, Professor Fischel made a mistake in the estimation window he picked.

Q. What did he pick?

A. Well, since you do white board so well, I think it would help if you just draw the relevant period on a white board, counsel.

Q. I'll just draw a straight line. And we'll just label -- this is July 30, 1999. And this is October 12, 2002.

You mean like that?

A. Yes. This is the relevant period, right.

Q. Okay.

A. Now, typically when you do event studies, you pick estimation window so it is close enough to the event that you are studying. You don't want to find out that this company

moved relative to industry in a certain way five years back and whatever your regression was may not be relevant now, so you can reach an erroneous conclusion. So you want to pick your estimation window to be near enough. And you want to pick your estimation window so the relationship between the company and the market is a reasonable descriptor of the period you are going to study.

And people do this typically in two ways. One, people look at period just preceding the event. So if your first event that you want to study is August 16, 2000, what you might do is you study one-year period before the beginning of the relevant period ending July 30, and you estimate regression. And it's a reasonable inference that whatever interrelationship you study describes how the stock price is related to market and industry on the event date of October 16.

Q. And what period did Professor Fischel pick here for his estimation window?

A. Well, Professor Fischel picked a period right in the middle of this estimation window, starting November 14, 2000, and ending November 14, 2001.

Q. Have I done this approximately right?

A. Yes.

Q. Okay. And is that the usual approach?

A. It's not the usual approach. And in this case -- what's

more important is that in this case, it leads to two serious methodological problems with this event study.

Q. What are those?

A. Well, if we look at Professor Fischel's own charts, you will find the estimation window that he picked was very unusual.

Over that one-year period, Household's stock price went up by about 25 percent, when Standard & Poor's 500 Index, which is his market measure, went down by about 17 and a half percent. I may not remember it exactly, but it's approximately that. And the industry index that he relied on, Standard & Poor Financial, went down by about 6 and a half percent.

So now what Professor Fischel is doing is he's looking at about 250 data points. There are about 250 trading dates in a year. And he's telling his computer, take 250 data points on Household stock return day by day, market return on S&P 500 and Standard & Poor Financial return. Household's stock price index is trending up, market is declining and industry is declining.

Household outperformed Standard & Poor's 500 by over 40 percentage point in this one-year period. And it outperformed its industry index by over 30 percent in this period.

So the only way a computer can make this data fit is it spits out an equation which says, on average, when Household's stock price goes up, Standard & Poor's market index goes down. That's the only way computer can fit this data. That's what the dumb computer does in a regression analysis. It finds the best possible fit.

And because the market went down a lot and the company stock went up a lot, built into Professor Fischel's regression model is a prediction that more the market goes down, higher S&- -- higher Household stock price should be.

And now when he takes that regression equation and he applies it to various purported corrective disclosures after this period, it creates a bias.

Q. When you say after this period, Professor, you mean after November 14, '01?
A. Yes.
Q. So he derives some kind of a formula over here in this area shown by the circle, the estimation period, and he uses it out here?
A. That is correct, subsequent to this period.
Q. What -- this is the estimation period. What do we call this period?
A. He calls it his corrective disclosures period.
Q. Is this where he finds the down leg?
A. This is where he says the fraud is being learned by the market, the down leg, yes.

Q. So this is the down leg. And this is the estimation period.

Okay. Please continue.
A. So, you know, what happens here is, we talked about how starting November 15, 2001, to October 12, 2002, the end of the relevant period, was a bad time in the market. S&P 500 did poorly. Most stocks did poorly.

But now Professor Fischel is working with a model that makes him predict that, other things being equal, worse the market does, better Household should have done. And, of course, over this period, that 40 percent overperformance, superior performance related to S&P that was true during his estimation window doesn't happen.

So as a result, he is biasing his measure of how poorly Household is doing on any day that he studies Household's stock price reaction. He's putting too high a benchmark and, therefore, concluding Household's stock price declined by a lot and it is significant, even though it was not. This bias makes him find inflation coming out of the stock when, in a proper regression analysis, he would not have so concluded. So that's one of the important biases that results from wrong choice of estimation window.
Q. When you use the word bias in that answer, you don't mean bias the way we use it when we talk about someone is biased against someone? It's an economic term?

A. Oh, not at all. I didn't mean to imply that at all. This is a statistical term of art where your model is biased. I don't mean to suggest Professor Fischel is in any way, shape or form biased. He's a respected scholar. I have high regard for him. It's just that his method is biased.
Q. It's a mistake?
A. It's a mistake, yes.
Q. People make mistakes?
A. Well, I know I do.
Q. Okay. Is there a second mistake that Professor Fischel made?
A. Yes. There is a second implication of his picking the wrong window.
Q. And what's that?
A. The period that he picks for his estimation window was relatively calm period for Household. It's like you go to the ocean. Some days are very calm days; and, you know, if you'll see a five-foot wave, you'll say, wow, this is a big one. And there are other days when ocean is very stormy and almost every other wave will be more than five feet. Or, you know, in Chicago in the middle of the winter, 30 degrees would be considered balmy and nice and hot. And if you use that benchmark to judge what happens in the summer, you'll find every day in the summer very abnormally hot.

So what happens is because of his estimation window,

he ends up setting too low a bar for what he considers to be a significant price movement. And he does that in two ways. Remember, I told you typically statisticians say a reaction is not significant unless there's 5 percent or more chance that it's not just a random occurrence. Professor Fischel picks a 10 percent threshold rather than 5 percent.

That choice, combined with the fact that his estimation window is unusually quiet for Household, except normal returns didn't vary as much -- this was a good time for Household -- means he judges too many of his specific disclosure dates significant; whereas, under a proper threshold, he would not have found them significant. So that's the second of the three errors in his regression analysis.
Q. And what's the third one?
A. Well, the third one is this: You want to adjust for market and industry factors when you study a particular stock price movement by carefully picking the right benchmarks.

And what he did in picking the two indices is normal and fine as a starting point. Most people compare a company's stock price to a broad-based market index. Professor Fischel testified that Household itself in its proxy statement compared itself to Standard & Poor's 500. Nothing wrong there. I have no quarrel with his choice of S&P 500 there.

Of course, he should have noticed why is he predicting a negative coefficient on S&P 500, meaning more the market went -- goes down, higher Household should go up. Well, that's not the reason Household compares itself to S&P 500. He might have been alerted to his estimation window being wrong perhaps, but leave that aside.

He picks the S&P 500. And then he picks a broad-based financial index called Standard & Poor's Financials, which have over 80 companies, if I remember, most of whom were not in consumer finance business. And he says, well, Household uses that comparison too in its proxy statement; so that's fine and good.

But what is missing in his regression equation is a benchmark that's close to Household's business. That's the consumer finance business.

Q. Let me stop you there a minute. Let's go back to DDX 405.

This is the one we looked at earlier. Is this what you're talking about, the Consumer Finance Index?

A. Yes.

Q. And you think this would have been a better index to use as a comparison?

A. Well, I would say in all the tests I did statistically, every time, model tracked the data better. And the performance of the model on technical measures that you typically use to see how good your model is improved when you added an index of consumer finance companies in addition to

Standard & Poor 500 Index and S&P Financial Index that he used.

I don't say that he chose the wrong indices. In fact, in my report, I used the same two indices. But I added a third one, which is consumer finance companies because the economic environment during this time that explained Household's return was being felt by consumer finance companies that had similar clientele to Household.

So I thought S&P 500 for broad market-based influences, Standard & Poor Financial for broad financial sector, and then an index of these six consumer finance companies for consumer finance business would make a better model.

Q. All three of these indices include Household; is that right?

A. Yes. But I took care to exclude Household from these indices because otherwise you end up comparing Household against itself. It doesn't matter a whole lot in this particular case because Household was a very small part of S&P 500 and a very small part of S&P Financials; but it was a significant part of consumer finance companies. So I constructed the Consumer Finance Index without Household in it. And I also adjusted S&P index and S&P Financial Index to make sure that I take out the influence of Household in those indices.

Q. So would you say that your analysis is slightly more sophisticated than his?

A. Well, I believe it is more precise.

Q. Precise.

A. And it gives you a better picture of what is happening. And there is a measure that statisticians use to know how good their model is. It's called R-square. And my R-square was significantly higher than his R-square.

Q. I'm not going to ask you what R-square is.

Let me ask you this: Your Ph.D. is in economics and finance?

A. Yes.

Q. Do you know what Professor Fischel's Ph.D. is in?

A. Well, I understand his formal training is as a lawyer. But I'm not going to sit here and say he's not an accomplished scholar. He's a very smart man. He's contributed a lot to use of economics in law. He's very well-qualified.

Q. Agreed. But you had to study a lot of technical stuff like R-squared that lawyers don't study in law school?

A. Well, I know some law school courses go into pretty sophisticated econometrics. I do not know whether he studied econometrics or not.

Q. In any event, your analysis was more precise, in your opinion, than his?

A. I believe my analysis is more precise, yes.

Q. Because you added the most appropriate comparative schedule, which is the other finance companies?

A. Yes. And I chose a more appropriate estimation window.

Q. Okay. Did you prepare a demonstrative which compares Household's returns to the various stock indices you mentioned for a particular day during the relevant period?

A. Yes.

Q. Let's look at DDX 750-02.

What does this chart show us, Professor?

A. Well, this chart shows you, through an example of a specific disclosure date in Professor Fischel's analysis as to how shortcomings of his regression analysis cause him to conclude that inflation came out of Household's stock price; whereas, in fact, there was nothing abnormal about this day at all in a properly specified regression analysis.

Q. Tell us what day we're looking at here.

A. If you look at the bottom, it is looking at -- it says it's -- we are looking at September 3, 2002, which is one of his specific disclosure dates.

Q. Okay. And tell us -- walk us through this chart, Professor, and tell us what it shows us.

A. So this was a day that was a pretty bad day in the market. As you can see, S&P 500 Index declined by more than 4 percent. That's pretty unusual. It was a bad market day. And S&P Financials Index declined by almost 5 percent, 4.9 percent.

And these are some of the largest financial companies. So it was not a good day for financial companies in general.

Now, remember I told you Professor Fischel's regression model contains these two indices, Standard & Poor's 500 and S&P Financials. So in his model when it's a bad day for S&P Financials, he says, well, I expect Household to do poorly too because it is positively related to S&P Financials.

So the minus 5 percent that you see on S&P Financials causes him to predict that Household's stock price should have gone down on this day by some amount. But he has a negative coefficient on his market index, S&P 500 portfolio.

Because of that odd result, this being a very bad day in the market, it causes him to revise upward his prediction of how Household should have done. So other things being equal, on a bad market day, he would predict Household's stock price should go up, when we know it didn't go up. It actually declined by 7.62 percent.

So Professor Fischel's prediction was it would go down because it was a bad day for S&P Financials. It would go up because it was a bad day for the market. And overall, he predicted that on this day, Household should have declined by around 4 percent; and it declined by 7 and a half. He says that 3 and a half percent of difference is abnormal return. And given his low threshold of judging significance, he says 3 and a half percent is significant.

And this is why I conclude on this day, the news that came into the market about Household significantly affected it negatively after adjusting for market and industry. And I conclude inflation came out of the stock price. But this mistaken conclusion is because of shortcomings in his event study.

Q. Okay. And you've added the Consumer Finance Index here?
A. Yes.
Q. And how does that change what we're looking at?
A. So there are two reasons why I found that there was nothing abnormal on this day.

One, in my model, I don't have this odd prediction that when market goes down, Household should go up. My mode says when market goes down, Household is likely to go down. And that's why Household compared itself to the entire market. So that's one difference between Professor Fischel's event study model and mine.

And, second, I found that Household moved together on average with Consumer Finance Index. And you'll see what Consumer Finance Index did that day. It went down by almost as much as Household did, by 7 and a half percent.

So based on these two differences, I found that Household's 7 and a half percent drop that day was within the range of what you would have expected; and the market did not learn anything significant on September 3.

Q. Now, did you prepare a demonstrative, Professor, illustrating how Household compared to other companies in the Consumer Finance Index on that day?
A. Yes, I did.
Q. Can we see DDX 751-02, please.

Professor, is this that demonstrative?
A. This is the demonstrative.
Q. And what does this show us, please?
A. It shows each and every company in Consumer Finance Index had a down day that day. Cash America by very little. But most companies declined by at least 4 percent. All the rest declined by at least 4 percent. Countrywide, over 4 percent decline; AmeriCredit, over 4 percent decline; Capital One, 6 and a quarter percent decline; MBNA, 8.76 decline, more steep than Household; Providian, 10.39 percent decline, much more steep than Household. Household was behaving like other consumer finance companies on that day. This was not an unusual day for Household.

And what you will find on Professor Fischel's 14 specific disclosure dates, most of the time when he says Household's stock price declined significantly and I say no, which happens on most of the days, if you draw charts like this, if you look at data like this, you will find Household was behaving like other consumer finance companies were behaving. So that's the reason he misses the fact that the

declines were not extraordinary, and he ends up concluding a lot more often than he should have, according to me, that Household's stock price declined significantly when the market learned certain news.

In my regression analysis, most of his days are not statistically significant.
Q. Let's talk a little bit about specific issues confronting Household and the rest of the consumer finance industry during the relevant time period.

Did you consider those issues in conducting your analysis?
A. Yes, I did.
Q. And are you aware that Mr. Dowd in his opening statement suggested that Household was focused on growth?
A. Yes.
Q. Are you also aware that Mr. Aldinger testified that he disagreed with Mr. Dowd?
A. Yes. I read that transcript.
Q. Did you investigate the issue of growth in the industry during the relevant period?
A. Yes. As I had said in my report, it was indeed a period when this subprime lending industry became very big, relative to where it had started.

As I was saying earlier, before 1995, if you were not what is called a prime customer, you couldn't get credit to buy a house or buy a car easily. You had to go to hard-money lenders, who were predatory.

Starting in 1995, companies like Household moved into the sector for residential lending and grew rapidly. The whole industry grew very rapidly. But it is incorrect to say Household grew more rapidly than the industry. In fact, according to the Fed study that I talked about in my report, if you looked at top 25 players in this space, which is called B and C lending as against prime lending or A lending, if you look at top 25 players over the years in question, Household's ranking on growth was always between 20 and 25. It was not growing faster than other players in this industry. It was actually growing much slower than other players in this industry.

Q. Are you able to rank Household vis-a-vis other players in the consumer finance industry during the relevant period in terms of growth?

A. Yes.

Q. And where does it rank?

A. Well, as I said, among B and C lenders referenced in the Fed study, Household always ranked between number 20 and 25 out of 25, at the bottom of the pack.

Q. I guess I should have asked you this earlier. I apologize.

What's a B and C lender?

A. B and C lender is a term of art for nonconforming loan providers; whereas, A paper is considered conforming loans. These are Freddie Mac, Fannie Mae underwritten guideline type of loans that banks and mortgage bankers make to wealthier customers.

Q. Where would a bank like Wells Fargo be?

A. Well, Wells Fargo is a very big bank; and they are in all kinds of things. But they're primarily known to be A paper lenders.

Q. Let's turn to the two models that Professor Fischel produced.

Can you briefly tell us what they are?

A. Yes. He uses two models. First one he calls an event study approach, not an event study, but an event study approach. It's his so-called leakage model. It is not an event study. There is not an event in that model.

The second model he uses is an event study. He calls it a specific disclosure model.

Q. And did you come to any conclusions about either of these models?

A. Yes, I did.

Q. And what were those conclusions?

A. Well, I believe his specific disclosure model is more consistent with how event studies are generally performed in a setting such as this. But as I testified, it is subject to

certain methodological flaws that make Professor Fischel reach erroneous conclusions.

His leakage model, from economic perspective or from statistical perspective, is deeply flawed and unreliable and has nothing to do with what is at issue in this case, in my opinion.

Q. Let's start with that one, his leakage model. Can you expand upon what you just said and tell us why you came to that opinion?

A. Well, in leakage model, Professor Fischel says, well, maybe the market learned certain news over a period of time. So one of his disclosures that he considers, for example, is November 15, 2001, CDC lawsuit. That's his first corrective disclosure. And it is indeed true that that was not the only day that the market heard about CDC lawsuit. That lawsuit was actually filed and the market knew about it on November 9. And even in Professor Fischel's event study, nothing happened on November 9.

So if you want to consider leakage, if you say, well, maybe I did not find a significant price reaction on November 15, is because market had learned part of the story on November 9, even though in this case, market had learned all of the story on November 9. Then I can understand that you take this leakage and consider whether the market price reaction on November 9 and November 15, 2001, put together wa

statistically significant. He actually did that in one place in his report.

On December -- on October 10th and 11th, the last two days in the relevant period when Household stock price went way up upon settling with attorney general, in his report, he says, well, on October 10th, the news had leaked out. I agree with him, the news had leaked out. And he looked at how the market reacted on 10th and how the market reacted on 11th. And he concluded correctly so, that on those two days together, considering the leakage and considering the news, the market price reaction was significantly positive.

But in his leakage model, he does none of that. What he does is he takes his regression equation over his estimation window, which, of course, as we discussed earlier is predicated on an odd result that if the market goes down, Household should go up; and then he uses that model to see how Household performed each and every day after November 15, 2001, until the end of the relevant period, whether there was any event or not, whether there was any news or not, whether the news had anything to do with the fraud or not, he just added it all up. And he says, that's my quantification of inflation coming out of the stock due to leakage. No statistical test of significance. No careful evaluation of whether there was an event or not.

There are lots of days when the market reacts very

negatively and there is no news in his event study. And he adds it all up, and he calls it leakage-based quantification of inflation. That's not accepted methodologically at all.
Q. Let me ask you about that. So you're saying that this method, the leakage method, is not a recognized method in the field of economics for conducting an event study?
A. Absolutely not. It has nothing to do with what we are here for, which is to find how much the stock price declined because of market learning the truth about the purported fraud. It has no linkage with any of the purported fraud.
Q. But Professor Fischel says that he relies on some professor at UCLA, Professor Cornell, to support his approach.
Have you looked at Professor Cornell's work?
A. I know his work well, and I know Professor Cornell well.
Q. And does his work support Professor Fischel's method here?
A. Absolutely not.
Q. Let me ask you this: If he doesn't identify any days when anything special happened in his leakage model, special in the sense that it was related to the alleged fraud, how does he come up with inflation figures that he says are fraud related?
A. Well, all he has measured is underperformance in Household's stock price between November 15, 2001, and end of the relevant period, based on his faulty regression model. That has nothing to do with fraud per se.
Q. Is that the same problem we were looking at over here on

the white board; he's got this estimation period where he's got the wrong high bar, I think you said it was, and now he's comparing the price of the stock in a declining stock market and that's giving him the result?
A. Yes.
Q. Okay. And is this -- is this leakage model that Professor Fischel used capable -- can you use it to distinguish stock price movements that might be attributable to fraud from other movements that have nothing to do with fraud?
A. By construction it cannot separate such sources of movement.
Q. It's just going to measure decline?
A. It's the kitchen sink.
Q. All right. Let's talk about his other model, the specific disclosures model. That, at least, is a model you recognize?
A. The methodology is well-accepted. I have differences with Professor Fischel about how that methodology was implemented.
Q. We'll get to how he implemented it in a minute.
Let's start with the basic methodology. Please tell us how that kind of a specific disclosure model is supposed to work to measure inflation.
A. Okay. So let's go back to what you were talking about, a typical pattern in these cases. There's an up leg. Inflation comes in. And there is a down leg when market learns the truth and inflation goes up.

Now, you can conduct economic analysis in one or both of the following ways: You can look at the plaintiffs' allegations. Lie number one was told on date number one. And you can quantify inflation on that date number one. Whether it is a misrepresentation or it's an omission, you can use well-accepted statistical techniques and methods to say I now know as an economist the company lied, stock price was inflated by 50 cents a share on lie number one.
And you can quantify inflation by adding up all the inflation that came into the stock price on all the dates that lies were told.
In addition to this methodology, or depending on facts and circumstances sometimes instead of this methodology, you might say it's more reliable for me to measure how much inflation came out of the stock when the market learned the truth. That's the approach Professor Fischel has adopted. It's factually incorrect. It's methodologically incorrect. But in principle, there's nothing wrong per se in adopting that approach.
But if you are quantifying inflation, as an economist whose work is going to be the basis of award of damages, you've got to link the amount of inflation you have quantified to specific lies that are at issue in this case.
And as we discussed earlier, Professor Fischel, by looking at certain disclosures after November 15, 2001, has

concluded that as of November 14, 2001, there was $7.97 of inflation. But there is nothing in his work that can tell us how much of that 7.97 is because of lie number one or lie number 40 that plaintiffs allege in that case.
In fact, the oddness of the result is during July 30, 1999, to November 15, 2001, when 22 lies were told, according to the plaintiffs, that inflation does not change one cent. How could the inflation he determined be -- in any reliable way be tied to the fraud plaintiffs allege has been committed in this case?
That is the major shortcoming of Professor Fischel's specific disclosure model at a conceptual level, rather than methodological levels.
Q. You told us a few minutes ago, Professor Bajaj, that the information related to plaintiffs' claims was already known to investors before, I think you were talking about November 15, 2001. Does that apply to Professor Fischel's specific disclosures model, the one we're talking about now?
A. Yes, it does.
Q. Why?
A. Well, Professor Fischel, as I was saying, is a respected scholar in use of economics for legal proceedings. And I am a fan of some of his writings in the area. And in his own writings, Professor Fischel has said that markets are efficient. He's assumed that Household traded in an efficient

market.
Q. What does an efficient market mean, sir?
A. An efficient market is one where market reacts to news. It does not wait a week or two to react to stale information. An efficient market is one where investors are awake and paying attention to what they are learning. And market imbibes news into stock prices immediately.
Q. What does immediately mean? In a minute, in a second, in an hour, in a day, in a week, in a month?
A. There are thousands of academic papers, some of which I have written, in the -- testing market efficiency. One social scientist says it's the most-tested hypothesis in all of social science. And you know what these papers show?
Q. What?
A. When companies announce earnings of prices, for example, the game is over within five minutes or less. If your broker calls you and says, hey, company announced positive earnings, it was more than the market expected, and if it is going to take you more than a minute to place a trade, the game is over. The market has already reacted to it because there are people on the floor of the Exchange, you know, who are tied to the tape, who will immediately put the order before the price reflects the positive news to earn a little bit of profit. Because of these active traders, market imbibes content of news into stock prices very quickly.

Now, for actively-traded companies, like Household, followed by dozens of analysts, it might mean minutes. And for some upscale company that hardly ever trades or certain kinds of announcements which are very difficult to understand and interpret and that as a team we will return to when talking about Household's restatement, it may be a two-day period. But market -- in parts, market imbibes the value of the news when it is news before it is stale information.

In this particular case, Professor Fischel says he did not find any evidence of market learning about Household's fraud prior to November 15, 2001.

We will see a chart today which will show there were hundreds of announcements earlier in the class period. It was not a secret in the market that Household was in the subprime business, that subprime business was subject to attack.

Just sit back and think about the fact, we've heard in this case Household had over three million customers that were residential customers. And when you combine credit card and other businesses, it had 48 million customers. If Household's business practices were illegal, could that remain a secret when one in every seven Americans is Household's customers that deal with Household, they experience those practices firsthand, they are -- they have friends, they have brokers, they themselves are investors. Record is replete with --

MR. BURKHOLZ: Your Honor, I move to strike this. This is a narrative not responsive to the question at hand, which goes to market efficiency.

MR. KAVALER: I'll ask another question, your Honor.

THE COURT: Ask another question.

BY MR. KAVALER:
Q. Professor Bajaj, from an economic perspective, why does it matter whether the same information that Professor Fischel has picked for a particular day was already known to the market, say, a week earlier? What difference does that make?
A. Because if it was known a week earlier, you cannot attribute market price reaction to that information. It must be due to something else.
Q. In other words, if Household makes an announcement on day one, the market reacts on day one?
A. It should.
Q. And if it makes the same announcement on day ten, should it make any difference?
A. None whatsoever.
Q. Let me give you a more specific example.

If Household discloses a certain fact on July 22, 1999, by when would you expect the market to react to that?
A. If that was a trading day, I would expect by the end of the trading day for that fact to be reflected in stock prices, assuming the announcement took place at least a few minutes

before the trading day ended.
Q. And then if Household made the same exact precise announcement or disclosure again on August 16, 1999, would you expect there to be any market reaction?
A. No.
Q. Why not?
A. Because in an efficient market, market doesn't react to stale information.
Q. And you and Professor Fischel agree that Household traded in an efficient market?
A. Yes, we both agree on that.
Q. So was -- in your opinion, was Professor Fischel correct in considering information that was already known to the public, what you call stale information, as part of his analysis?
A. No, he was incorrect.
Q. Why?
A. Because in an efficient market, that piece of news, when it was news, would have been reflected in the stock price.
Q. Previously?
A. Previously.
Q. The first time it was announced?
A. Yes.
Q. Have you prepared a demonstrative to illustrate this point?

A. Yes, I have.
Q. Let's have DDX 703-01, please.
Have I got the right demonstrative here?
A. Yes.
Q. I have? Okay. Sorry. I have the wrong tab in my book then.
All right. Please explain what we're looking at here.
A. So Professor Fischel said in his report and clarified repeatedly that the methodology he followed is looking at what he considered to be fraud-related disclosures; and if they were significant, he considered them in quantification of his inflation.
And that is flawed methodology because, as I said, there is information, and that dog did not bark. The point is, if Household announces something or the market learns something about Household and you see no market reaction, and then that information is repeated when it's stale information and you see a market reaction, you should look hard for why that market reaction happened. It was not to stale information. It is either because of some other news or it's random noise.
So there is a statistical bias -- and, again, I don't mean this in a derogatory sense, to clarify. As a term of art, there is a statistical bias in his methodology. And that

is explained by this exhibit.
So if you told me you are a champion at tossing coins, you can always get heads, I said, okay, Mr. Kavaler, prove it to me. And you took out the coin and you tossed it a hundred times. And I noticed sometimes you record your results and other times you just toss it again before recording your results. And then you come to me and say, see, 50 times I tossed heads. I tell you, Mr. Kavaler, you haven't proven anything because the other 50 times when you didn't record your results, you tossed tails. You've got to consider that evidence in totality of evidence to know whether you're a champion head-tosser or not.
So Professor Fischel ended up ignoring information when the market heard something and didn't react. And that's a significant source of bias in his results.
MR. KAVALER: Your Honor, I'm about to move into a topic -- a discrete topic, which I can either start now or break for lunch and start after lunch. The topic is lengthy, and I won't finish it in the ten minutes left before lunch.
THE COURT: We can break now. Let's take our lunch break now. Let's resume at 1:00 o'clock, ladies and gentlemen.
MR. KAVALER: Thank you, your Honor.
(Jury out.)
THE COURT: You may step down, sir.

We'll recess until 1:00 o'clock, folks.
(Trial recessed until 1:00 p.m. of the same day.)

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN,)
on behalf of itself and all)
others similarly situated,)
)
Plaintiff,)
)
vs.) No. 02 C 5893
)
HOUSEHOLD INTERNATIONAL, INC.,)
et al.,) Chicago, Illinois
) April 28, 2009
Defendants.) 1:00 o'clock p.m.

TRANSCRIPT OF TRIAL PROCEEDINGS
BEFORE THE HONORABLE RONALD A. GUZMAN

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THE CLERK: 02 C 5893, Jaffe vs. Household.
THE COURT: All set for the jury?
MR. KAVALER: Ready, your Honor.
THE COURT: Bring them out, please.
(Jury in.)
MR. KAVALER: Thank you, your Honor.
MUKESH BAJAJ, DEFENDANTS' WITNESS, PREVIOUSLY
DIRECT EXAMINATION - Resumed
BY MR. KAVALER:
Q. Professor Bajaj, you were here when Professor Fischel testified. So, you know that he walked us through his 14 dates and he had an exhibit, Plaintiffs' Demonstrative 150. I think we'll put that up and look at it, again.
Can you see that, okay?
A. Yes, I do.
MR. KAVALER: Can you all see that?
Your Honor, can you see that or should I tilt it a little bit?
THE COURT: That's fine.
MR. KAVALER: Okay.
BY MR. KAVALER:
Q. You understand these to be the dates that Professor Fischel picked?
A. Yes.
Q. Okay.

Let's start with the first one, November 15, 2001. And you were here for Professor Fischel's testimony about that?
A. Yes, I was.
Q. Okay.
Let's look at Plaintiffs' 1405.
MR. KAVALER: And, ladies and gentlemen, this is Tab 1 in the jury notebook.
Copy for you, counsel.
BY MR. KAVALER:
Q. This is a copy for you, Professor Bajaj.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. It's a little bit light, a little hard to read. Let's look at the fourth paragraph.
It says, "'Household and Beneficial are engaging in joint pervasive patterns of abusive lending practices consisting of routine statewide imposition of excessive and improper fees, penalties, interest and charges, in violation of state consumer protection laws,' the lawsuit said."
Do you see that?
A. Yes, I do.
Q. That's referring to a lawsuit by the California Department of Corporations?
A. Yes.

Q. And this is a news release -- a news story -- that appeared on November 14, 2001; is that right?
A. This is something that appeared on Bloomberg --
Q. Okay.
A. -- on November 14, 2001, after the market closed, at 5:16 p.m.
Q. Okay.
That's what 7:16 means up there?
A. 17.
Q. 17:16?
A. Right.
Q. Okay.
And Professor Fischel picked this as his first disclosure date, did he?
A. Yes.
Q. All right.
And he says that it disclosed information which caused inflation to be removed from the Household stock price?
A. Yes.
Q. Did you analyze this date, as well?
A. Yes, I did.
Q. Okay.
And did you identify an earlier article which contained the same information?
A. Yes.

Q. Let's look at Defendants' 615.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. What is Defendants' 615?
A. This is the press release that I found dated November 9, 2001, Friday, which announces the same lawsuit.
Q. Okay.
MR. KAVALER: I offer 615, your Honor.
MR. BURKHOLZ: No objection.
THE COURT: It will be admitted.
(Defendants' Exhibit No. 615 received in evidence.)
MR. KAVALER: And this is also contained in Tab 1 of your notebooks behind the blue divider.
BY MR. KAVALER:
Q. And this article says, "The state sued Household Finance Corp. of California and its Beneficial California, Inc., unit today for more than $8 million, accusing both of a pattern of abusing lending practices -- " "abusive lending practices."
Do you see that?
A. Yes, I do.
Q. Okay.
What is the significance of the fact that you found

an earlier article -- that is, earlier than the one Professor Fischel relied on -- which contains the same information?
A. Well, the market would have reacted to this lawsuit when it was news, not when it was stale information. And even in Professor Fischel's event study, there is no significant reaction to this particular announcement.
Q. On November 9?
A. On November 9.
Q. Right.
And what is the significance, in your opinion, of the fact that the same article -- the same content -- is contained --
MR. KAVALER: Well, withdrawn.
BY MR. KAVALER:
Q. Do you view these articles as conveying the same information to the marketplace?
A. Indeed.
Q. And what is the significance of the fact that Professor Fischel is using the second -- the later of these dates, the November 14 article -- and not the November 9 article?
A. Well, to the extent Professor Fischel found market reaction or that Household's stock price declined significantly on November 15th -- which in my event study is not significant, but leaving that aside; to the extent he found that stock price declined significantly on November

15th -- it couldn't be because of this news. This was old information. It could be something else or it could be random noise. We cannot attribute the price reaction to this news the way he does.
Q. So, if we're going through this list of 14 disclosure dates trying to see which ones allow us to attribute price reaction to the news as Professor Fischel suggests they do, this one is not one that satisfies that requirement?
A. Yes.
Q. So, we cross it off the list.
Let's go to the next one.
You were here when Professor Fischel discussed a news article dated December 3, 2001, reporting on Household's accounting practices; is that right?
A. Correct.
Q. All right.
MR. KAVALER: Let's look at Plaintiffs' 1409, which is in evidence.
And this is Tab 2 in your binder, ladies and gentlemen.
A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor Bajaj.
(Document tendered to counsel and the witness.)
BY THE WITNESS:

A. Thank you.
BY MR. KAVALER:
Q. Does this article disclose any information about Household's re-age practices?
A. I did not see those words in this article.
Q. Okay.
Does it disclose Household's accounting issues -- any Household accounting issues?
A. Yes. It discusses certain accounting practices of Household.
Q. Okay.
And this is the -- what's the date of this article?
A. It is December 1, 2001, which is a Saturday.
Q. And in what publication does it appear?
A. It is in Barron's.
Q. Barron's is a magazine?
A. Yes.
Q. If you look at Page 4, look at the seventh full paragraph, it says, "It's easy to dismiss Ryan's criticisms as quibbles as Household's management is wont to do. After all, Household disclosed all the changes, albeit often in the small print of financial filings."
Do you see that?
A. Yes.
Q. Okay.

At the time that the Barron's article came out, Professor, did you identify any analyst commentary addressing this article?
A. Yes.
Q. All right.
MR. KAVALER: And let's look at Defendants' 259.
A copy for counsel.
BY MR. KAVALER:
Q. A copy for your, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this one of the items of analyst commentary you found addressing the Barron's article?
A. Yes, I did.
MR. KAVALER: I offer 259, your Honor.
MR. BURKHOLZ: No objection subject to the limiting instruction.
MR. KAVALER: I agree with that.
THE COURT: Admitted, subject to the limiting instruction.
(Defendants' Exhibit No. 259 received in evidence.)
BY MR. KAVALER:
Q. And the title of this article is, "Ridiculous Bashing by Barron's."
Do you see that?

A. Yes, I do.
Q. And if you look at page ending 692, it goes on to say, "The cover article on this weekend's Barron's bashed Household on accounting issues, almost all of which have been aired before and most of which are inaccurate."
Do you see that?
A. Yes, I do.
Q. All right.
And it goes on to say, "Both Barron's and Business Week carry articles bashing Household this week, both of which are largely reprints of a report previously published by a short-selling boutique."
Do you see that?
A. Yes, I do.
Q. Let me just stop you and ask you, what is a short-selling boutique?
A. So, while most investors in the stock market buy stock in the hope that stock price will go up and they will make money, there are certain investors who attempt to make money by selling stock short. Namely, they borrow shares that they do not own from their broker and sell those shares in the marketplace hoping that stock price will drop and they will be able to buy those shares back at a cheaper price to return them to their broker and make money in this manner.
And, of course, for most investors, their interests

are aligned to see stock prices go up. Short sellers are treated with a lot of suspicion on Wall Street because they profit if stock prices go down.
So, companies and analysts often view short sellers' statements with suspicion as if they might be designed to drive the stock price down for their personal gain.
Q. Let's go back to the Barron's article. Professor Fischel picked that as his second disclosure date here. It says, "Barron's Article."
Do you see that (indicating)?
A. Yes.
Q. Okay.
And he claimed that this article disclosed information which caused inflation to be removed from Household's stock price; am I right?
A. That was his conclusion.
Q. Did you analyze this disclosure event, as well?
A. Yes, I did.
Q. And did you identify a previous report which contained similar information?
A. Yes, I did.
Q. Let me show you Defendants' 516.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.

(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this one of the reports you identified?
A. Yes.
MR. KAVALER: I offer 516 in evidence, your Honor.
MR. BURKHOLZ: No objection. Limiting instruction.
MR. KAVALER: I agree with that.
THE COURT: Admitted with a limiting instruction.
(Defendant's Exhibit No. 516 received in evidence.)
MR. KAVALER: All right.
This is also, ladies and gentlemen, in Tab 2 of your binder, again, past the blue subdivider behind Tab 2.
BY MR. KAVALER:
Q. And what is this, Professor?
A. Well, this is one of the reports authored by William Ryan when he was with the short-selling boutique Ventana Capital, Inc. And the Barron's article that Professor Fischel cited was largely a reprint of allegations made in Mr. Ryan's Ventana Capital report, which was published several weeks earlier.
Q. Let's get the date of that. Is there a date on the cover, October 12, 2001?
A. Yes.
Q. And Professor Fischel was talking about a Barron's article on December 3, 2001?

A. That is correct.
Q. And you found the substance of both reports to be the same?
A. Yes.
Q. So, whatever the consequences for Household's stock price are of this information coming into the market, the market would have reacted on or about October 12?
MR. BURKHOLZ: Objection. Leading.
BY MR. KAVALER:
Q. Would the market have reacted --
MR. KAVALER: Withdrawn.
BY MR. KAVALER:
Q. Would you expect the market to have reacted to the information in the Ventana Capital account story about Household, or not, within a reasonable time after October 12, 2001?
A. Yes.
Q. Would you expect the market to react, again, when the same information is re-published by Barron's on December 3, 2001?
A. Not for purposes of any news. And I should also point out that, according to my event study, the market did not significantly react on December 3rd. The price reaction was not significant on that day.
Q. Let me show you another exhibit, which is Defendants' 517.
MR. KAVALER: A copy for counsel.

BY MR. KAVALER:
Q. A copy for you.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. It's another Ventana Capital report.
Did you review this article, as well, in preparing to give your opinions, Professor?
A. Yes, I did.
MR. KAVALER: I offer 517 -- Defendants' 517 -- your Honor.
THE COURT: Admitted --
MR. KAVALER: The same limiting instruction, I would imagine.
THE COURT: Admitted with the same limiting instruction.
MR. KAVALER: Thank you, your Honor.
(Defendant's Exhibit No. 517 received in evidence.)
MR. KAVALER: Ladies and gentlemen, this is the next blue tab behind Tab 2 in your binders.
BY MR. KAVALER:
Q. And this one is dated October 18, 2001; is that right, Professor?
A. That is correct.
Q. All right.
And if you turn to page ending 183 in the first

paragraph, it says, "As noted in our original 'sell' recommendation, we believe Household, at a minimum, is set up for a dramatic decline in the quality of the company's earnings and at most a potential reduction in earnings estimates and/or credit-related charge."
Do you see that?
A. Yes, I do.
Q. And do you see in this Ventana Capital report where Mr. Ryan is directing investors to consider Household's public SEC filings of securitization documents for additional information about the company's account management policies?
A. It is saying that Ventana Capital reached its conclusions based on Mr. Ryan's review of Household's public filings.
Q. Does this give you any view as to whether analysts were talking about public disclosures of Household's account management policies that were disclosed in these securitization prospectuses?
MR. BURKHOLZ: Objection. Leading.
THE COURT: Sustained.
BY MR. KAVALER:
Q. What conclusion do you draw from seeing this reference to securitization practices in this Ventana Capital report of October 18, 2001, Professor?
A. Well, Mr. Ryan's criticisms were based entirely on his review of Household's publicly-filed financial statements and

securitization prospectuses, as he very clearly discusses in his reports. So, he, himself, was relying on information that was publicly available years ago.
Q. And in his recommendation based on those --
MR. KAVALER: Withdrawn.
BY MR. KAVALER:
Q. And based on his review of those public documents, does he recommend a buy, a hold or a sell?
A. He is recommending a sell.
Q. And what is the significance of the fact that you found these two analyst reports dated October --
MR. KAVALER: Withdrawn.
BY MR. KAVALER:
Q. Is it your opinion, Professor, that these two analyst reports dated October 12 and October 18 convey the same information to the marketplace as the December 3 Barron's article?
A. Yes.
Q. What is the significance, in your opinion, of the fact that you found these two analyst reports dated October 12 and 18, 2001, which convey the same information as the Barron's article dated December 3, 2001, in connection with the validity of Professor Fischel's choosing December 3 as one of his 14 dates?
MR. BURKHOLZ: Objection. Leading.

THE COURT: Sustained.
BY MR. KAVALER:
Q. Do you have an opinion about the significance of Defendants' 516 and Defendants' 517 with regard to the inclusion by Professor Fischel of December 3rd on his list of 14 dates?
A. Yes. I believe --
Q. What's that opinion?
A. -- because there was no news on December 3rd, December 3 cannot be properly considered a disclosure date. Besides, in a properly-conducted event study, the market reaction on December 3rd was not significant. So, Professor Fischel's report considered December 3rd as a disclosure date in error.
Q. Do you have a demonstrative that makes the -- helps you demonstrate the point you just made?
A. Yes, I do.
MR. KAVALER: Let's see DDX 559-04, please.
BY MR. KAVALER:
Q. Professor, tell us what this demonstrative shows us.
A. So, if you look at the right-hand side, the Barron's article refers to Mr. Ryan's opinion -- "We believe Household, at a minimum, is set up for a dramatic decline in quality of company's earnings and at most a potential reduction in earnings estimates and/or credit-related charges -- " charge, in the singular.

And if you see on the left-hand side, same opinion is expressed by Mr. Ryan on October 12 and October 18. On October 12, Mr. Ryan says, "We believe Household, at a minimum, is set up for a dramatic decline in quality of company's earnings and at most a potential reduction in earnings estimates and/or credit-related charges."
And the opinion he expresses on October 18th is, again, almost verbatim the same.
Q. Professor, did Mr. Ryan's statements on October 12 or October 18 have any impact on the market price of Household stock?
A. The stock did not react significantly on those dates.
Q. Do you have an opinion as to the significance of these two earlier publications -- I already asked you that. I'm sorry.
So, on the basis of what you just said, is it appropriate for Professor Fischel to be counting the December 3rd Barron's article as one of his 14 days or not?
A. It's not appropriate.
Q. So, I should cross it off this chart?
A. Sure.
Q. All right. Let's look at the next one, the third day, December 5, 2001, reporting on comments Bill Aldinger made at a conference on December 4.
MR. KAVALER: Let's look at Plaintiffs' 1433.
A copy for counsel.

BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. What is this, Professor?
A. This is an article I found on conference in -- that was published in American Banker on December 5, 2001.
Q. And did it form part of your opinion in this case?
A. Yes.
MR. KAVALER: Your Honor, I offer -- this is Plaintiffs' 1433. I offer it in any event. Plaintiffs' 1433, your Honor. The same limiting instruction.
THE COURT: It's admitted with the same limiting instruction.
(Plaintiff's Exhibit No. 1433 received in evidence.)
MR. KAVALER: And, ladies and gentlemen, this is Tab 3 in your binder today.
BY MR. KAVALER:
Q. Now, what's the date of this article, Professor?
A. The article is dated December 5, 2001.
Q. And you see on the first page there, it says, "The Chairman and Chief Executive of Household International stepped forward Tuesday with a rebuttal of accusations that his consumer finance company is playing accounting tricks to mask bad loans, saying repeatedly that his company has a good

balance sheet and a conservative approach."
Do you see that?
A. Yes, I do.
Q. Okay.
Now, Professor Fischel picked this article for his third disclosure date claiming that it disclosed information which inflated Household's stock price; is that right?
A. That is correct.
Q. Did you analyze this disclosure, as well?
A. I did.
Q. And had the investors found out about this information previously?
A. Yes. In fact, right after the Barron's article, there were several analyst reports that anticipated Mr. Aldinger's remarks at a Goldman Sachs news con- -- investor conference -- on Tuesday, December the 4th. It was a well-publicized event.
And Mr. Aldinger spoke at that event between 2:30 and 3:20 Eastern. And as this article says, he gave his address on Tuesday, which is December 4th. American Banker is simply reporting on what happened the previous day.
Q. Let's mark Plaintiffs' Exhibit 1248.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)

BY MR. KAVALER:
Q. Is this a document that you considered in coming to your opinions that you're testifying about here today?
A. Yes.
Q. And what do you understand this to be?
A. This appears to be Mr. Aldinger's presentation at Goldman Sachs conference dated December 4, 2001.
MR. KAVALER: Your Honor, I offer Plaintiffs' 1248. I'm sorry, it's in evidence. I apologize. I don't offer it.
Ladies and gentlemen, it's Tab 3 of your binder behind the first blue subdivider.
I knew I had seen that before. Okay.
BY MR. KAVALER:
Q. And on Slide 9 of Bill Aldinger's presentation, which is at page ending in 152, he says, "Why are Household's credit losses better?"
A. I see that.
Q. "Prudent growth rates, lower risk portfolio mix."
Do you see that?
A. Yes.
Q. All right.
And on Slide 26, on page ending in 160, he talks about summary, and the third bullet down is "Fortress Balance Sheet."
Do you see that?

A. Yes, I do.
Q. What is the significance of the fact that you located this presentation made on December 4, which is earlier in time than the American Banker article on December 5?
A. Well, whatever the market price did on December 5 -- and, according to my event study, it did nothing significant -- it should not be attributed to Mr. Aldinger's presentation because that news was in the marketplace the day before.
There is also another inconsistency here in Professor Fischel's theory. He testified that beginning November 15th, the market stopped believing Household. And if the market stopped believing Household and Mr. Aldinger denies Barron's accusations, why would he say that would lead to stock price becoming more inflated?
Q. He -- in your last -- you say "why would he say." You mean Professor Fischel?
A. Yes.
Q. All right.
Have you prepared a demonstrative reflecting on the interrelationship of these two exhibits?
A. Yes, I have.
MR. KAVALER: Let's look at DDX 559-06.
BY MR. KAVALER:
Q. And please tell us, Professor, what this shows.
A. Well, on the right-hand side, we have the American

Barron -- American Banker -- article that Professor Fischel cited as inflationary news. On the left-hand side, you have Mr. Aldinger's presentation giving the same information to the market a day earlier, when even in Professor Fischel's event study the stock did not react significantly.
Q. So, if we go back to Plaintiffs' Demonstrative 150, in your opinion, is this another entry that Professor Fischel cited that doesn't support his conclusion?
A. Yes.
Q. Should I cross this one off, as well?
A. Okay.
Q. Let's go to the fourth day. You were here when Professor Fischel talked about a news article published after trading hours on December 11 reporting on Household's restructuring practices. Let me show you -- were you here that day?
A. Yes. I think you said news article. I think you meant analyst report.
Q. I'm sorry, I might have. Let me see if I can speed this up a little bit.
He testified about all these days the same day?
A. Yes.
Q. And you were here then?
A. Yes.
Q. All right. So, I won't ask you that every time.
Let's look at Plaintiffs' 1410.

MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
MR. KAVALER: This is in evidence, your Honor.
Ladies and gentlemen, this is behind Tab 4 in your binder.
BY MR. KAVALER:
Q. And what is this, Professor?
A. Well, this is an analyst report issued by certain analysts at Legg Mason investment firm on 11 December, 2001, at 6:04 p.m. Eastern. It says "Part 3" in its title.
Q. That's the Legg Mason report referred to by Professor Fischel as Item 4 here on Plaintiffs' Demonstrative 150?
A. Yes.
Q. Okay.
And if you look at the second page, it says, quote -- last paragraph -- "We find this lenient re-aging policy disturbing, as it undermines the analytical value of the reported asset quality statistics."
Do you see that language?
A. Yes, I do.
Q. All right.
And what role did this report play, as you understand it, in Professor Fischel's analysis?

A. Professor Fischel concluded -- incorrectly so, I believe -- that the market reacted negatively to this report the next trading day, on December 12, 2001. And he, therefore, concluded some $2.39 of inflation came out of the stock.
Q. And you said he concluded incorrectly. Why do you say that?
A. Because this report was Part 3 of two earlier reports with the same criticism that were issued by Legg Mason during trading hours on December 11th. And even according to Professor Fischel's own event study, the market did not react on December 11th because this was old news even on December 11th.
Q. Let me show you Plaintiffs' Exhibit 318.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this a document you relied upon in forming your opinions in this case?
A. Yes.
MR. KAVALER: I offer Defendants' 318, your Honor -- sorry, Plaintiffs' 318. Same limiting instruction.
THE COURT: It will be admitted. Same limiting

instruction.
(Plaintiff's Exhibit No. 318 received in evidence.)
MR. KAVALER: And, ladies and gentlemen, this is in your binder behind the next blue tab, behind Tab 4.
BY MR. KAVALER:
Q. And is this, Professor, a Legg Mason report that you're talking about?
A. Yes. This is Part 1 of the three-part report. And this one was issued at 10:50 a.m. Eastern.
Q. During trading hours?
A. During trading hours.
Q. And if you look at page ending in 378, the first page at the second bullet, it says, "The company's surprisingly lenient asset quality policies and the wide variation in how these policies are implemented among HI's five major business lines -- partial payments, delinquencies, re-aging, rewrites, non-accruals, chargeoffs, BK-related losses -- makes us question the company's impressive performance of solid earnings growth and stable asset quality and lowers our confidence going forward."
Do you see that?
A. Yes, I do.
Q. Is there still another analyst report that you're referring to?
A. Yes. There was a Part 2 of this report also issued during

trading hours on December 11th.
Q. Let me show you Plaintiffs' 319.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this the document you're referring to?
A. Yes.
Q. Did you rely on this in forming your opinions?
A. Yes, I did.
MR. KAVALER: Your Honor, I offer Plaintiffs' 319 in evidence, subject to the same limiting instruction.
THE COURT: Admitted.
(Plaintiff's Exhibit No. 319 received in evidence.)
MR. KAVALER: Ladies and gentlemen, this is behind the next blue subdivider behind Tab 4 in your binders.
BY MR. KAVALER:
Q. And if you look at page ending in 380, the first page, Professor, about four lines from the bottom, it says, "We believe the company's lenient and aggressive asset quality policies and the wide variation in how these policies are implemented among HI's five major business lines call this record into question."
Do you see that?

A. Yes, I do.
Q. What is the significance, in your opinion, of the fact that you found these earlier analyst reports?
A. Well, there was no news in the third analyst report that Professor Fischel mistakenly attributed the Household negative stock price reaction to.
Q. Did you prepare a demonstrative that helps illustrate this point?
A. Yes, I did.
MR. KAVALER: Let's have DDX 559-08, please.
BY MR. KAVALER:
Q. Professor, please tell us what this shows us.
A. Well, on the right-hand side is what Professor Fischel considered to be news, for which he attributed what he concluded to be negative price reaction on December 12. It says, "Lenient re-aging policy disturbing as it undermines the analytical value of reported asset quality statistics."
And on the left-hand side, we find the first of two reports issued by the same author from the same company during trading hours on December 11, making the same allegations.
Q. Now, Professor, I see that both of these reports are issued on December 11. The one on the right at 6:04 p.m. and the one on the left at 10:50 a.m., and they're both Eastern Standard Time.
What is the significance of that time difference of

about seven hours?
A. So, if you did not have the earlier reports and the only report the market had received was the one that Professor Fischel considered at 6:04 p.m. Eastern, by then stock market would have closed. So, market wouldn't have had the opportunity to react to this report. And that's why you would look at what the market did on December 12th --
Q. And that's what they used?
A. -- in response to this report.
Q. And that's -- he used the 12th?
A. Yes.
Q. Because he's working off the 6:00 p.m. release?
A. Yes.
Q. In your opinion, what would actually have happened when the first release came out at 10:50 in the morning?
A. The first one came out at 10:50, and the second one came out at 1:15 in the afternoon, both during trading hours.
Q. And what would have -- would the market have reacted during trading hours?
A. Yes. If it was significant, it would have reacted then.
Q. So, the one -- in your opinion, is the one Professor Fischel is relying on stale?
A. It is stale information.
Q. Should I cross it off my list?
A. Sure.

Q. Let's look at the next one. Day number 5, February 27, 2002. Professor Fischel says something about expansion of best practices.
He's discussing a news article there?
A. Or a press release. I don't recall.
Q. All right. Let's see if we can refresh your recollection.
Here's Plaintiffs' 1453.
MR. KAVALER: Copy for counsel.
BY MR. KAVALER:
Q. Copy for you.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Does this refresh your recollection as to what he's talking about, Professor?
A. Yes.
Q. Is this something you reviewed in coming to your opinion?
A. Yes, I did.
MR. KAVALER: Your Honor, I offer Plaintiffs' 1453 in evidence, subject to the same limiting instruction.
THE COURT: Admitted.
(Plaintiffs' Exhibit No. 1453 received in evidence.)
MR. KAVALER: Ladies and gentlemen, this is Tab 5 in your binder.
BY MR. KAVALER:
Q. This one on Page 1 in the first paragraph says, "Household

announced today significant additions to its already extensive set of voluntary responsible consumer lending practices following on the heels of the company's best practices initiatives announced in July, 2001. Household is, once again, raising industry standards for responsibly serving middle market borrowers."
Do you see that?
A. Yes, I do.
Q. And this is the article that underlies Professor Fischel's fifth disclosure date, correct?
A. Correct.
Q. Did you identify any previous article containing the same information?
A. I did.
Q. Let me show you Defendants' 1084.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this one such article, Professor?
A. Yes, it is.
Q. And did you rely on it in forming your opinions?
A. Yes, I did.
MR. KAVALER: I offer Defendants' 1084, your Honor, subject to the same limiting instruction.
THE COURT: Admitted.
(Defendants' Exhibit No. 1084 received in evidence.)

MR. KAVALER: And this, ladies and gentlemen, is also in Tab 5 behind the blue subdivider.
BY MR. KAVALER:
Q. Professor, this is an article from the Chicago Tribune dated, when?
A. 26th of February, 2002.
Q. And Professor Fischel's article -- or reference -- is to something dated February 27th, 2002; is that right?
A. That is correct.
Q. Okay.
And this article says on Page 1, "Household Finance and Beneficial, which traditionally make loans to less creditworthy borrowers, will cut loan rates a quarter percentage point for every year a borrower makes payments within 30 days of the due date."
Do you see that?
A. Yes.
Q. And it continues to say, "Other reforms included caps on points and fees, a one-page plain-English disclosure form and a provision that would let borrowers cancel a deal as late as ten days after getting their money."
Do you see that?
A. Yes, I do.
Q. And do you consider these reforms to be the same as the voluntary responsible consumer lending practices referenced

the following day in the article Professor Fischel chose?
A. They are identical.
Q. And what, in your opinion, is the significance of the fact that they're identical?
A. Well, if the market had reacted to these announcements, it would have reacted on February 26th, not on February 27th. And, once again, this is also inconsistent with Professor Fischel's theory that after November 15th if Household said "We're not doing anything wrong," market stopped believing them. But over here Household is advancing itself in a positive light and, according to Professor Fischel, the market is reacting positively and that is introducing inflation in the stock.
Q. Okay.
Did you prepare a demonstrative that illustrates why this selection by Professor Fischel was also stale information?
A. Yes, I did.
MR. KAVALER: Can we see DDX 559-12, please.
BY MR. KAVALER:
Q. Tell us what this is, Professor Bajaj.
A. Well, on the right-hand side we have the source Professor Fischel cites about company's best practices initiative as a source of inflation introduced into Household's stock price on February 27th. And on the left-hand side, you have Chicago

Tribune's story reporting on this news the previous day. So, it was obviously stale information on the 27th.
Q. Based on your testimony just now, would it be correct for Professor Fischel to include the February 27th item as one of the 14 disclosure dates in his survey?
A. It would not be correct for him to include it.
Q. Should I cross that one off my list, as well?
A. Okay.
Q. Let's turn to the next one. Before I do that, Professor, let me ask you this: Did Professor Fischel testify that in order for inflation to enter a company's stock price, there must be an actionable disclosure defect?
A. Yes.
Q. Did plaintiffs allege any false statement that occurred on February 27th that you know of?
A. I don't believe plaintiffs have asserted the statement to be false.
Q. All right.
Did Professor Fischel find any inflation on this date?
A. He claimed to.
Q. How much inflation did he find, based on their demonstrative?
A. $1.64, if I'm reading it correctly.
Q. Is that right here (indicating)?

A. Yes.
Q. Plus 1.64. It's in black. A lot of these numbers are in red. Some are in black. Okay.
A. Okay.
Q. So, tell me, even if on every other date that Professor Fischel identified -- well, let me ask you this: How can his 7.97 inflation calculation be consistent with plaintiffs' fraud claims in light of the fact that he's got a significant date here where there's no claimed false statement?
A. Well, by definition, 7.97 cannot be the right answer because he included a date that plaintiffs don't allege any falsehood occurred. And, therefore, by definition there can be no inflation on that day.
Q. I'm sure Professor Fischel would say, "But it's a net number." He's taking the 7.97, netted all these numbers. I see what he did here. I think his words were, "I gave you credit for the numbers that appear in black."
Does that change your view?
A. No. His math is wrong.
Q. He added this column up wrong?
A. Absolutely.
Q. Because?
A. Because the dollar sixty-four should not be there at all. It's not in plaintiffs' theory of the case. It's not in plaintiffs' allegations.

Q. But that would make this number higher?
A. That's besides the point. It would make the number higher, but the number is incorrect.
Q. I'm calling to your attention a number that's bad for me.
A. Okay.
Q. But this number would be higher (indicating), but it would still be wrong?
A. It would be wrong, yes.
Q. Okay.
Let's turn to Day 6. July 26th, Bellingham Herald article. Let's look at Plaintiffs' 283, which is already in evidence.
MR. KAVALER: And, ladies and gentlemen, this is in Tab 6 of your notebook.
Copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. This is the article that underlies Professor Fischel's sixth disclosure date, correct?
A. That's correct.
Q. Okay.
And let's see what it says. Look at page ending in 077 at the top: "But this week, Hayden said an internal

company probe of the complaints had uncovered some serious problems."
Do you see that? She's talking about the Bellingham office?
A. Yes.
Q. "Those investigations did, indeed, show there were some customers whom we believe had legitimate confusion on the interest rate of their loans."
Do you see that?
A. Yes, I do.
Q. All right.
And he picked this article for his sixth disclosure date because he said this information caused inflation to be removed from Household's stock price?
A. Yes.
Q. All right.
And did you analyze this disclosure, as well?
A. I did.
Q. Did you identify a previous article which contained the same information?
A. Yes, I did.
Q. Let me show you Plaintiffs' Exhibit 1446, which is in evidence.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:

Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. The date Professor Fischel has here for Item 6 is July 26th, 2002.
What is the date for Plaintiffs' Exhibit 1446?
A. It is May 31, 2002.
Q. Is that earlier?
A. It is earlier than July 26th, 2002.
MR. KAVALER: Ladies and gentlemen, this document appears at Tab 6 in your binder.
Is that right? Yes.
Behind the blue subdivider at Tab 6.
BY MR. KAVALER:
Q. And if you look at the second page of this document, Professor, it says, in the sixth and seventh paragraphs, "'Some customers in Bellingham may, indeed, have been justified in their confusion about the rate of their loan,' she said. Ms. Hayden said Household took full and prompt responsibility."
Do you see that?
A. Yes.
Q. What is the significance of the fact that you found a May 31 article which contains --
MR. KAVALER: Withdrawn.

BY MR. KAVALER:
Q. Do you view the information disclosed in the May 31 article to be identical to the information contained in the July 26th article?
A. Yes, I do.
Q. What is the significance of the fact that you found an article dated May 31, which contains the same article as the -- same information as the -- article dated July 26, which Professor Fischel counts as his sixth disclosure date?
A. Once again, Professor Fischel made the mistake of counting old information as news and a corrective disclosure.
Q. Did you prepare a demonstrative that illustrates this point?
A. Yes.
MR. KAVALER: Can we have 559-14, please.
BY MR. KAVALER:
Q. What does this show us, Professor?
A. On the right is the Bellingham Herald article that Professor Fischel cited as a corrective disclosure. On the left is the American Banker article we just reviewed dated May 31, 2002, some two months earlier which had the same information.
Q. Based on your testimony, Professor, is it possible for Professor Fischel to have correctly included as his sixth disclosure date July 26th, 2002?

A. No. He made a mistake.
Q. I'll cross this one off.
Okay with you?
A. Yes.
Q. Okay.
Let's go to the next date, Day 7. This is -- Professor Fischel's entry reads, "8-14-02 Financial Restatement."
You know what that's about?
A. Yes.
Q. And he picked this one for his seventh disclosure date because he said it revealed information to the market causing inflation to be removed from Household's stock price?
A. That is correct.
Q. Did you analyze this disclosure date, as well?
A. Yes, I did.
Q. Did you determine whether the restatement significantly affected Household's stock price?
A. Yes, I did determine.
Q. What did you conclude?
A. This event is a little complicated.
Q. Unlike the rest of your testimony.
(Laughter.)
BY THE WITNESS:
A. Household announced a restatement of its earnings due to

some credit card-related amortization items on August 14, 2002, and the stock, indeed, opened significantly lower. Throughout the day, there was analyst commentary indicating that this was a technical accounting matter that affected different -- that reflected difference of opinion between Household's old auditor and Household's new auditor; did not indicate any malfeasance on part of Household; that the amounts involved were small relative to Household's balance sheet and income; and, in any case, this did not involve any cash implications.

And a fundamental principle of finance is that in an efficient market, accounting changes that do not involve cash flow differences, the market looks through, does not react to.

And as this commentary hit the market during the day on August 14th and continued after the closing hours on August 14th and into August 15th, Household's stock price continued to recover. On August 14th, it closed up from where it opened or relative to previous day's close by 29 cents. So, it hadn't declined by the end of the day on August 14th. And August 15th, it went up and, if I recall correctly, significantly so, according to Professor Fischel's event study.

In any case, when you add August 14th and August 15th, the period over which market absorbed this news, the market did not react negatively to this news at all, and it

was not significant by anybody's event study.

Q. Do you have a demonstrative that illustrates what you just said, Professor?

A. Yes, I do.

MR. KAVALER: Can we see 559-16, please.

BY MR. KAVALER:

Q. What are we looking at here, Professor?

A. Professor Fischel focuses on Household's stock price reaction on August 14th, which he says is significantly negative, even though in absolute terms, Household's stock price increased that day.

But what I indicate is when you look at the two-day period of August 14th and August 15th -- and I believe I recall Professor Fischel testifying here on the stand that this was a controversial day, where there was a lot of analyst commentary. When you look at the totality of analyst commentary and the market understanding what this complicated accounting issue was, over those two dates, even in Professor Fischel's own event study, nothing happened. There was no significant decline in Household's stock price after adjusting for market and the industry.

Q. Now, Professor, in the last few examples, you've always pointed to things being virtually immediately absorbed by the market, and here you're telling us it took two separate days for the market to fully understand this. How do you reconcile

those two opinions?

A. Well, I think they are perfectly consistent. It's a facts-and-circumstances issue, and that's why you need some expertise to evaluate the results of an event study.

Here, there must have been at least a dozen analyst reports that were received over August 14th and August 15th. And we have to remember the environment and the period over which this restatement was announced. This was in the middle of 2002. And ever since Enron's implosion on August 3rd -- which is Professor Fischel's Barron's date -- a lot of analysts said that a mere suggestion that some company's accounting may be questionable would oftentimes elicit an immediate negative reaction on part of the market that was -- that had heightened sensitivity after Enron to accounting-related issues.

And it took a lot of back-and-forth between analysts to flush out what this restatement was about for the market to realize this was not cash flow relevant. This was not significant. This was simply a technical accounting matter where two auditors disagreed. And, therefore, I believe it's appropriate in an instance like this to look at a two-day price reaction.

Q. Now, Professor, you mentioned numerous analyst reports. We've all seen those before. So, I won't waste everyone's time showing them to you, again. But you've seen them.

They're all in the record. You know they're exhibits in this case?

A. Yes, I'm familiar with that.

Q. Okay.

So, let's go back to Professor Fischel's demonstrative, Plaintiffs' Demonstrative 150 here.

So, in your opinion, is Professor Fischel right in counting as his seventh disclosure date which caused inflation to come out of the price of Household stock August 14th, 2002?

A. No, he is not.

Q. So, should I cross it off the list?

A. Yes.

Q. Let's to the eighth date. This is August 16, the Forbes article. August 16 of 2002.

Are you familiar with that article?

A. Yes, I am.

MR. KAVALER: Give me a second here.

(Brief pause.)

BY MR. KAVALER:

Q. Notwithstanding what I just told you, I do need to show you one analyst report to -- from that period.

MR. KAVALER: Counsel, Defendants' 566.

BY MR. KAVALER:

Q. And one for you, Professor Bajaj.

(Document tendered to counsel and the witness.)

BY MR. KAVALER:
Q. Is this one of the analyst reports you were talking about which discussed the financial restatement?
A. Yes.
Q. Did you rely on this in coming to your opinion in this case?
A. Yes.
MR. KAVALER: Your Honor, I offer Defendants' 566, subject to the same limiting instruction.
THE COURT: Admitted.
(Defendant's Exhibit No. 566 received in evidence.)
MR. KAVALER: Ladies and gentlemen, that's at Tab 7 in your binder.
BY MR. KAVALER:
Q. I'm not going to spend time going through it with you, though, Professor.
Let me also show you Plaintiffs' 69.
MR. KAVALER: Copy for counsel.
This is already in evidence.
BY MR. KAVALER:
Q. A copy for you, Professor Bajaj.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this another document related to the -- I think I'm ahead of myself. Give me a second here.

(Brief pause.)
MR. KAVALER: Okay. I'm slightly ahead of myself.
BY MR. KAVALER:
Q. So, we're up to 8, the Forbes "Home Wrecker" article.
Let's look at Plaintiffs' 69, which is in evidence.
MR. KAVALER: And that's Tab 8 in the jury's binder.
BY MR. KAVALER:
Q. Does this attach the Forbes "Home Wrecker" article, Professor?
A. Yes.
Q. Okay.
And this article is what Professor Fischel chose as Item 8 on his list?
A. Yes.
Q. If you go to Page 363 in the middle of the page, it says, "In July, Forbes has learned authorities from more than a dozen states descended on Household to demand refunds and reforms."
Do you see that?
A. Yes, I do.
Q. And Professor Fischel picked this information for his eighth disclosure date, claiming it revealed information to the market causing inflation to be removed from Household's stock price; is that right?
A. That's correct.

Q. Did you analyze this disclosure, as well?
A. I did.
Q. Did you identify a prior disclosure with similar information?
A. Yes, I did.
Q. And what did you find?
A. I found that same information was received by the market, and the market did not react.
Q. Okay.
What was the date of the Forbes article?
A. The date of the e-mail is August 16. The Forbes article has a date of September 2nd. But it's common practice for magazines like Forbes and Business Week to hit the newsstand prior to the date indicated on that addition. And the e-mail exchange says that this Forbes article -- this Forbes issue -- will hit the newsstand on Monday, August 19th.
Q. So, the 8-16 date is the date of the e-mail, and that's the date Professor Fischel used on his chart?
A. Yes.
Q. Okay.
Let's look at Defendants' 74.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you.
(Document tendered to counsel and the witness.)

MR. KAVALER: And this is in evidence.
BY MR. KAVALER:
Q. Is this the earlier disclosure of the same thing that you're looking at -- that you're referring to?
A. Yes.
Q. And this is a transcript of an earnings call that Household held on July 17?
A. Yes.
Q. Remind us what an earnings call is, Professor.
A. Well, every quarter when company announces -- a publicly-traded company announces -- its earnings, it typically issues a press release stating the earnings. Along with that, they host a call where analysts can call in and ask questions. They discuss their results and, then, subsequently they formally file with the Securities and Exchange Commission a quarterly report presenting results of the quarter formally with the Securities and Exchange Commission.
MR. KAVALER: So, Defendants' Exhibit 74 is in your binder, ladies and gentlemen, behind Tab 8, behind the first blue subdivider.
BY MR. KAVALER:
Q. Now, turn, if you will, Professor, to the page ending with 491 in Defendants' Exhibit 74, please.
And you see there it says, "On the AGs, obviously, again, it's a very political issue"?

A. Yes.
Q. Okay.
Does this mean to you that you found an earlier disclosure of the same subject that Professor Fischel cited the Forbes article for?
A. Yes. And there was a lot of talk in analyst reports and other commentary around this time.
Q. Now, when this was first disclosed or previously disclosed on July 17, 2002, in the analyst call, which is Defendants' 74, did the market react significantly to that?
A. No, it did not.
Q. Based on the opinion you just gave, does August 16, 2002, qualify under Professor Fischel's theory as one of the disclosure dates which caused inflation to come out of the price of Household stock?
A. No.
Q. Should I cross it off the list?
A. Yes.
Q. Let's turn to the next one. Item No. 9 is August 27, the KPW Report and the Bellingham Herald.
Let me show you Plaintiffs' 1429, which is in evidence.
MR. KAVALER: And is Tab 9 of your binder, ladies and gentlemen.
Copy for counsel.

BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY THE WITNESS:
A. Thank you.
BY MR. KAVALER:
Q. Look at the first page. This is a -- the Bellingham Herald from August 27, 2002?
A. Yes.
Q. The first page, it says, "A state investigative report on Household Finance Corp. suppressed by court order for more than three months contains a blistering assessment of the mortgage lending giant's mortgage practices."
Do you see that?
A. Yes.
Q. This is what Professor Fischel picked as his ninth disclosure date, saying that it revealed information to the market which caused inflation to be removed from Household's stock price?
A. Yes.
Q. Did you analyze this date, as well?
A. I did.
Q. Did you identify a previous article which contained similar information?
A. Yes.

Q. Let me show you Plaintiffs' Exhibit 1428.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor Bajaj.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this an article that you looked at in forming your opinions that you're testifying here today?
A. Yes, I did.
Q. Testifying to here today.
MR. KAVALER: Your Honor, I offer Plaintiffs' Exhibit 1428, subject to the same limiting instruction.
THE COURT: Admitted.
(Plaintiffs' Exhibit No. 1428 received in evidence.)
MR. KAVALER: And, ladies and gentlemen, this is also in Tab 9 of your binder. It's behind the blue subdivider.
BY MR. KAVALER:
Q. And what is the date on this one, Professor?
A. August 26, 2002.
Q. The day before Professor Fischel's date, right?
A. Yes.
Q. And in what periodical did this appear?
A. This appeared in American Banker.
Q. Look at Page 1. It says, "A controversial -- I think it's talking about the Washington Department of Financial

Institutions.
"A controversial report on Household International, Inc., alleges that the subprime lender violated federal and state consumer protection laws by failing to make key disclosures and by using sales tactics intended to mislead, misdirect or confuse the borrower."
Do you see that?
A. Yes, I do.
Q. Let me show you Plaintiffs' Exhibit 284.
MR. KAVALER: Copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this another document that you looked at in formulating your opinions that you're testifying to here today?
A. I did.
MR. KAVALER: Your Honor, I offer Plaintiffs' 286 in evidence, subject to the same limiting instruction.
THE COURT: 286?
MR. KAVALER: 286. I apologize, your Honor. 286.
THE COURT: Admitted.
(Plaintiffs' Exhibit No. 286 received in evidence.)
MR. KAVALER: And, ladies and gentlemen, this is also in Tab 9 of your binder behind a blue subdivider.

BY MR. KAVALER:
Q. And this one is dated when, Professor?
A. This is dated May 30th, 2002.
Q. And what major publication is this from?
A. This is from the New York Post.
Q. And it says -- page ending 737, which is the first page -- "I don't know what's in that -- " referring to the Washington report " -- but I bet it isn't complimentary of Household."
Do you see that?
A. Yes, I do.
Q. What is the significance of the --
MR. KAVALER: Withdrawn.
BY MR. KAVALER:
Q. Do these disclosures disclose the same information as the articles that Professor Fischel is citing as his Item No. 9?
A. Yes.
Q. What is the significance of the fact that you found earlier disclosures containing the same information as Professor Fischel is using for his ninth disclosure day?
A. Once again, Professor Fischel mistakenly considers old information as news.
Q. He made another mistake?
A. It appears so.
Q. Okay.
Do you have a demonstrative that shows this point?

A. Yes, I do.
Q. Let's look at 559-20.
Please tell us what we're looking at here, Professor.
A. What we're seeing is, on the right-hand side, the publication that Professor Fischel cites for his August 27th purported disclosure date. That's the Bellingham Herald article. And on the left-hand side, we see that the same information had previously been revealed by American Banker on the previous day and anticipated by New York Post several months earlier.
Q. What is the significance of these facts with regard to the viability of Professor Fischel's inclusion of August 27, 2002, as his ninth disclosure date of a date which supposedly took inflation out of the price of Household stock?
A. Well, I don't believe that conclusion is justified.
Q. Should I strike this from the list?
A. Yes.
Q. Let's look at his 10th day. Let me show you Exhibit 1431, which is in evidence.
MR. KAVALER: A copy for counsel.
BY MR. KAVALER:
Q. A copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. This is the Bernstein report that Professor Fischel talked about?
A. Yes.

MR. KAVALER: Ladies and gentlemen, this is Tab 10 of your binder.
BY MR. KAVALER:
Q. Look at Page 1, the second bullet. It says, "We believe that as a sales practice reform" -- "We believe that as a sales practice reform takes hold, Household will need to reset its long-term EPS growth target of 13 to 15 percent to 10 to 12 percent."
Do you see that?
A. Yes, I do.
Q. Professor Fischel picked this date -- September 3, 2002 -- as his 10th disclosure date, claiming that it revealed information to the market, causing inflation to be removed from the price of Household stock; is that correct?
A. That's correct.
Q. Did you analyze this date -- or this disclosure -- as well?
A. I did.
Q. Did you identify a previous report with similar information?
A. Yes, I did.
Q. Let me show you Plaintiffs' Exhibit 1412.
MR. KAVALER: A copy for counsel.

BY MR. KAVALER:
Q. And a copy for you, Professor Bajaj.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Professor Bajaj, is this one of the documents that you found?
A. Yes, it is.
Q. Did you rely on this in forming your opinion that you're testifying about here today?
A. Yes, I did.
MR. KAVALER: Your Honor, I offer Plaintiffs' 1412, subject to the same limiting instruction.
THE COURT: Admitted.
(Plaintiffs' Exhibit No. 1412 received in evidence.)
MR. KAVALER: Ladies and gentlemen, this is in your binder at Tab 10, behind the first blue subdivider.
BY MR. KAVALER:
Q. All right.
Professor, what is the date of this disclosure in Exhibit -- Plaintiffs' -- 1412?
A. It is August 12, 2002, and this report is time-stamped before the market opened on August 12th.
Q. Okay.
And Professor Fischel's 10th disclosure date is September 3?

A. Yes.
Q. And do you see where it says, "We are lowering our target price to $53 from $63"?
A. Yes.
Q. "We're also lowering our long-term growth rate to 10 to 12 percent from 14 percent"?
A. Yes.
Q. "As we believe Household's loan growth rate -- " I'm sorry -- "loan growth will slow, as lending restrictions gradually take hold."
Do you see that?
A. Yes, I do.
Q. Is it your opinion that that is substantially the same as the information contained by Professor Fischel's 10th disclosure date item in the Bernstein report?
A. Yes, it is.
Q. And this one is dated August 12; Plaintiffs' 1412 is dated August 12; and, the Bernstein report is dated September 3, correct?
A. That is correct.
Q. What is the significance of these facts, in your opinion?
A. Once again, Professor Fischel has mistaken old information as news on September 3rd.
Q. Did you prepare a demonstrative reflecting this example?
A. Yes, I have.

MR. KAVALER: Can we have DDX 559-24, please?
(Brief pause.)
BY MR. KAVALER:
Q. Tell us what this says, Professor.
A. Again, we see on the right-hand side the Bernstein Research Report that Professor Fischel considered a corrective disclosure; but, we see the same information being received by the market on at least two earlier dates: August 12th, 2002, Deutsche Banc Report that we just discussed, as well as a Morgan Stanley report that was issued even earlier on July 31, 2002.
Q. Let me show you that one. I think I missed Plaintiffs' Exhibit 1241.
MR. KAVALER: A copy for counsel and a copy for you.
(Document tendered to the witness and counsel.)
BY MR. KAVALER:
Q. Is this the Morgan Stanley report you're talking about?
A. Yes.
MR. KAVALER: Your Honor, if I didn't previously offer it, I offer Plaintiffs' 1241, subject to the same limiting instruction, sir.
THE COURT: It will be admitted.
(Plaintiffs' Exhibit No. 1241 received in evidence.)
MR. KAVALER: And that appears, ladies and gentlemen, in your binder at Tab 10, behind the next blue subdivider.

BY MR. KAVALER:
Q. I'm sorry, Professor, did you finish with the demonstrative?
A. Yes.
Q. Okay.
On the basis of the testimony you've just given, is there any basis for Professor Fischel having included the Bernstein report on September 3, 2002, in his list of disclosure dates, or dates on which disclosure caused inflation to come out of the price of Household stock?
A. No, that's not justified.
Q. Should I cross this (indicating) off the list?
A. Yes.
Q. The next one is No. 11. It's the CIBC report on September 23, 2002.
Let me show you Exhibit 1435 in evidence.
MR. KAVALER: A copy for counsel and a copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. Is this the CIBC report that Professor Fischel was talking about?
A. Yes, it is.
Q. All right.
Page 2 at the top of Exhibit 1435, it says, "We have

lowered our price target for HI from $36 -- to $36 -- from $57, as persistent headline risk should continue to pressure Household's valuation."
And it skips some words.
"Building concerns regarding the company's lending practices, which have been accused of being predatory in nature."
Do you see that language?
A. I do.
Q. Does this report reveal any new information about re-aging?
A. No, it does not.
Q. Now, Professor Fischel picked this information for his 11th disclosure date, saying that it revealed information to the market, causing inflation to be removed from Household's stock price; is that right?
A. That's correct.
Q. Did you analyze this disclosure, as well?
A. I did.
Q. Did you identify a previous article with similar information?
A. Yes, I did.
Q. All right.
Is one of the articles you're referring to Defendants' 892 -- one of the disclosures you're referring to

Defendants' 892?
MR. KAVALER: A copy for counsel and a copy for you, Professor.
(Document tendered to counsel and the witness.)
BY THE WITNESS:
A. Yes, it is.
BY MR. KAVALER:
Q. And I believe that's in evidence.
MR. KAVALER: And, ladies and gentlemen, that's at Tab 11 -- it should be at Tab 11 -- of your binder.
Okay. It's not at Tab 11 of your binder. Sorry.
I stand corrected. It is at Tab 11, behind the blue divider. Sorry.
BY MR. KAVALER:
Q. Okay.
And let's look at Page 1, the third bullet. It says, "We are reducing our 12-month price target on HI shares from $41 to $54, to reflect the negative sentiments that have surfaced recently surrounding HI shares specifically, as well as the financial sector in general."
Do you see that?
A. I do.
Q. And, then, the same page, the fifth bullet says, "In our view, the preannouncement by Americredit, ACF yesterday, along with continued concern over potential regulatory action

related to predatory lending, contributed heavily to the weakness."
Do you see that?
A. Yes.
MR. KAVALER: Your Honor, I apologize. I neglected to offer this. I offer Defendants' 892 in evidence --
MR. BURKHOLZ: A limiting instruction.
MR. KAVALER: -- with the same limiting instruction, your Honor.
THE COURT: Admitted.
(Defendants' Exhibit No. 892 received in evidence.)
MR. KAVALER: Sorry about that.
BY MR. KAVALER:
Q. Okay.
What does it mean that you found an earlier article, Professor?
A. Well, it means the material Professor Fischel cited as news, that took inflation out of the stock, was not news at all. It was old information. This was already something that the public had learned about earlier.
Q. In your opinion, is the information contained in the UBS Warburg Report, dated September 18, which is Defendants' Exhibit 892, substantially the same as the information contained in the CIBC World Markets Report, dated September 22, which is Plaintiffs' Exhibit 1435, which forms the basis

for Professor Fischel's 11th entry?
A. Yes.
Q. So, in your opinion, is he justified in claiming the 11th entry -- the September 23, 2002, CIBC report -- as a day on which a disclosure took inflation out of the price of Household stock?
A. No, he is not justified in doing that.
Q. Should I cross it off the list?
A. Yes.
Q. Let's go to the 12th one.
This is -- Professor Fischel chose the October 4, 2002, Wall Street Journal article. It's Plaintiffs' Exhibit 1375 in evidence.
MR. KAVALER: A copy for counsel and a copy for you, Professor.
(Document tendered to counsel and the witness.)
BY MR. KAVALER:
Q. What's the date of this article?
A. October 4, 2002.
MR. KAVALER: Ladies and gentlemen, this is Tab 12 in your binder.
BY MR. KAVALER:
Q. And this article states, "Household may be near a settlement with State Attorneys General that could total $350 million to $550 million, according to go a report by Wall

Street analysts."
Do you see that?
A. Yes.
I think you mistakenly said "550." It is 350 to 500 million.
Q. I apologize. I get my 50s wrong.
You are exactly right, 350 million to 500 million.
And he picked this information for his 12th disclosure date, claiming that it revealed information to the market, causing inflation to be removed from Household's stock price, correct?
A. Yes.
Q. Did you independently analyze this disclosure, as well?
A. I did.
Q. Did you identify a previous article with similar information?
A. Well, actually, this article refers to a previous analyst report as the basis for this information.
Q. Go back three documents to Plaintiffs' 1241, which is the Morgan Stanley report.
Is this the prior report it's referring back to?
A. No, that's an even earlier report, but I was also mentioning that the Wall Street Journal article is talking about Howard Mason's report that was issued the previous day.
So, there are two older sources, which provide the

same information.
Q. Okay.
In any event, if there are two or three or more than that, what is the significance, in your opinion, of the fact that the article he cites -- the October 4, 2002, Wall Street Journal article -- is not the first public disclosure of this same information?
A. There was no news content to the story. It was old information.
Q. So, then, in your opinion, is he justified in including this item as No. 12 on his list of dates, on which, in his opinion, new information came into the market which caused inflation to come out of the price of Household stock?
A. No, that's not a justified conclusion.
Q. Should I strike this one from the list?
A. Yes, please.
(Brief pause.)
BY MR. KAVALER:
Q. Let's look at No. 13.
Were you here when the professor discussed Household's announcement of its preliminary agreement with the Attorneys General on October 10 and October 11, 2002?
A. Yes.
Q. And he's got one article on the 10th and one on the 11th.
The first one is called, "AG Settlement Rumors" and

the second one is "Ag Settlement Announced."
Do you see that?
A. I do.
Q. Let's look at Plaintiffs' 1418 in evidence.
MR. KAVALER: A copy for counsel.
(Document tendered.)
BY MR. KAVALER:
Q. A copy for you, Professor Bajaj.
(Document tendered to the witness.)
BY MR. KAVALER:
Q. Is this one of the articles Professor Fischel relied upon?
A. Yes.
Q. And do you see on Page 1 where it says --
MR. KAVALER: I'm sorry, this is Tab 13 in your binder, ladies and gentlemen.
BY MR. KAVALER:
Q. Page 1, where it says, "One standout was Household International, which surged more than 25 percent on market talk that it could reach an agreement as soon as Friday, that would settle investigations by State Attorneys General into its sub-prime lending business."
Do you see that?
A. I do.
Q. And that was on October 11?
A. Yes.

Q. And let me show you Defendants' 684.
MR. KAVALER: A copy to counsel.
(Document tendered to counsel.)
BY MR. KAVALER:
Q. And a copy to you, Professor.
(Document tendered.)
BY MR. KAVALER:
Q. Is this an article you relied upon in coming to your opinions in this case?
A. Yes, I did.
MR. KAVALER: Your Honor, I offer Defendants' 684, subject to the same limiting instruction.
THE COURT: Admitted.
(Defendants' Exhibit No. 684 received in evidence.)
MR. KAVALER: And, ladies and gentlemen, this is also in Tab 13 of your binder, behind the blue subdivider, and it's the last document in your binder.
BY MR. KAVALER:
Q. And this one says on the first page, "Household International, HI, one of the nation's largest lenders to consumers, with spotty credit histories, agreed to pay up to $484 million to settle allegations of deceptive lending practices to consumers."
Do you see that?
A. I do.

Q. And this is the Wall Street Journal and Dow Jones News Service dated October 11, 2002?
A. Yes, it is.
Q. These are the articles Professor Fischel picked for his 13th and 14th entries here (indicating) --
A. Yes.
Q. -- for days that he included on his list, claiming that it returned the inflation and Household stock price back to zero, right?
A. Yes.
Q. And what did you determine about Professor Fischel's findings with respect to October 10 and 11, 2002?
A. Well, I think the market's reaction to these two dates, which is the largest price reaction ever in Household's history as a public company, till that point, is very telling about Plaintiffs' claims.
If, indeed, as plaintiffs have claimed, the market finally learned the truth about Household's predatory lending practices, then you would expect that, upon announcement of this truth, the stock price should go down.
Instead, we have almost seven -- we have almost 33 percent increase in stock price.
No question it was a very significant event. Small differences in event study, et cetera, can't change the fact that the market reacted very, very significantly upon hearing

of the settlement.
What this evidence tells us, along with all the other analyst reports and everything else we are seeing, is that Household's stock price was weighed down by market's concerns about regulatory developments; and, when Household alleviated this regulatory risk by settling with the Attorneys General, it paid almost $500 million to buy that peace.
But that's about one dollar a share. And Household's stock price went up over those two days by $7 a share.
The market is reacting to the relief -- that this regulatory headwind has now been alleviated -- and Household can continue to be in business. And its business would not be threatened.
And if you look at the analyst reports that Professor Fischel has cited in his own reports -- if you look at each and every one of the analyst reports, starting November 15, 2001 -- whenever you see an analyst say, "This is our target price where Household was trading at the time," on average, their target price was 35 percent higher.
What does that tell us? That tells us the market was well aware of the headline risk to Household; the talk that this headline risk was weighing down Household stock price; and, when Household settled with Attorneys General to alleviate this headline risk, its stock price went up by 33 percent.

So, I think plaintiffs have it exactly wrong. There is no evidence that Household's stock price was ever inflated. Analysts thought Household's stock price was weighed down due to headline risk, regulatory developments that were creating headwind for Household, distracting management, making it difficult for it to be in business; and, when Household did settle these allegations, even though it had to pay a lot of money, the market was relieved and the stock price went up.
The stock was never overvalued. There is absolutely no evidence -- no economic evidence -- that the stock was overvalued. And truthful disclosures took inflation out of the stock, which is the basis of Professor Fischel's inflation quantification.
Q. Did you prepare a demonstrative to illustrate this point, Professor?
A. I did.
Q. Let's look at DDX 559-30.
And what does this chart show us, Professor?
A. Well, this shows that market evidence on October 10th and 11th is totally inconsistent with plaintiffs' fraud claims in this case.
Professor Fischel has it wrong. Economic evidence shows us the opposite of what he believes it shows us.
Q. Another mistake?
A. I guess so.

Q. Let's look back at Plaintiffs' Demonstrative 150.
On the basis of the testimony you've just given, are entries 13 and 14 on this chart dates which probably should be included on a listing of days on which the events Professor Fischel describes took inflation out of the price of Household stock?
A. No.
Q. Can I cross them off?
A. You can.
(Brief pause.)
BY MR. KAVALER:
Q. Now, Professor, we've just walk together through all 14 dates that Professor Fischel identified and we saw various issues with each of them.
Did you prepare a demonstrative that visually depicts those issues?
A. Yes.
MR. KAVALER: Let's look at DDX 705-01.
BY MR. KAVALER:
Q. Tell us what we're looking at here, Professor.
A. This is a chart I prepared where each of Professor Fischel's 14 purported disclosure dates are shown by Xs on the chart.
So, on the horizontal axis, you have calendar date; and, you will see all 14 Xs appear in period November 15,

2001, forward.
And on the vertical axis is Professor Fischel's measure of abnormal return.
So, if Professor Fischel claimed that a particular disclosure removed inflation from the stock, that "X" will be below the zero line. That's the abnormal return on that date was negative; namely, stock price declined after adjusting for market and industry.
And you'll see a lot of dots in the negative column because, according to Professor Fischel, inflation was coming out of the stock starting November 15, punctuated by a few dates -- four dates -- when he said inflation went in.
There's the Aldinger Goldman Sachs conference date that is above zero on December 5. Then there is the announcement of Best Practices date on February 27, 2002. That is shown above zero.
And the last two Xs that are shown above zero are the final two dates in the relevant period when market learned about Attorneys General settlement, and the stock price exploded positively.
Q. Do you have any further example of your analysis of Professor Fischel's dates?
A. Yes. We discussed how each and every one of these dates, for the most part, represented -- or I shouldn't say "each and every." Most of these dates represented stale information.

Q. All right.
MR. KAVALER: Can you go to 705-03?
(Brief pause.)
BY MR. KAVALER:
Q. What is this showing us?
A. So, what this shows is the effect of Professor Fischel picking the wrong dates.
If, instead of picking July 22, 2002, as his disclosure date, he had picked the earlier date when market learned of this information. That would have been May 31, 2002.
And you'll see in the red dot there (indicating), May 31, 2002, is closer to the zero line.
In other words, on May 31, 2002, even in Professor Fischel's own event study, the abnormal return would have been smaller in magnitude; and, hence, not significant; and, hence, it would not qualify as a disclosure date. Because, remember, his disclosure dates have to be statistically significant, according to his event study; and, May 31, 2002, is close enough to zero, that it won't even show up if he had found the right date.
It wouldn't be considered a disclosure at all.
Q. Let's look at another day.
MR. KAVALER: How about 705-04.
(Brief pause.)

BY MR. KAVALER:
Q. What does this show us?
A. Once again, if, instead of picking December 3rd as his disclosure date, he had picked the earlier October 12th disclosure date.
You will see the market reaction was less negative and it wouldn't have been significant; and, if would, therefore, not even be a disclosure date, according to Professor Fischel.
Q. Do you have a demonstrative that shows how many of his days were stale?
A. Yes.
MR. KAVALER: Let's look at 705-05.
(Brief pause.)
BY MR. KAVALER:
Q. What does this show us?
A. This shows earlier dates that we talked about, corresponding to each and every one of the 14 disclosure dates, when applicable, accept for the last two, of course.
And what you will see is instead of these 14 corrective disclosure in the aggregate having large negative numbers, that add up to a larger amount than the positive numbers, then maybe we could refer to the chart we've been discussing.
You see, on the 14 dates put together, according to

Professor Fischel, a total of $16.33 of inflation came out.
But $8.37 went in, and that's why he concludes "net 7.97" came out.
Well, when you see the negative dates moving up towards zero, the net result is if you do the math, there was no inflation, according to his own methodology, if he had not chosen stale dates.
Q. Now, Professor, during the period when Professor Fischel claims inflation was being removed from the price of Household stock, did most analysts that you looked at have a view as to whether Household's stock was overpriced or was being weighed down by headline risk?
A. You know, all the analyst reports -- I was keeping track, as we were discussing them today; and, I know many more have been discussed over the course of last couple of weeks -- I would invite anybody to do within exercise of looking at these analyst reports; and, they sometimes have a target price and they indicate what the current price is.
Even reports that are critical -- that Professor Fischel says removed inflation from the stock -- you will see a target price significantly higher than where the stock was trading. And these target prices are for 12 to 15-month period, on average.
So, analysts on average, if you do the math, take all the analyst reports that Professor Fischel himself has cited

in his report, starting November 15th, 2001. On average, they conclude Household stock's target price should be 35 percent higher than where it was trading at the time.
And we know what happened on the last two dates. The stock went up by about 33 percent.
The analysts did not consider, for the most part -- other than Montana Capital and Mr. Ryan, and a few exceptions -- most analysts in the analyst community thought Household was being unfairly punished in this political environment, and its stock was being weighed down by headline risk, which Household removed by settling with the Attorneys General, creating a big pop in the stock price.
Q. Professor, in your research, aside from the 14 dates that we looked at here on Plaintiffs' Demonstrative 150, all of which turn out to be improperly counted, did you find any initial dates that, in your opinion, Professor Fischel should have considered?
A. Yes.
Q. How many?
A. Hundreds.
Q. What was your test for a date that he you should have considered?
A. I looked for same kind of news items that Professor Fischel said, after November 15th, resulted in the market learning the truth about Household's fraud, I looked at my

event study; I search for key words, such as "predatory lending," and I looked at the analyst reports that either he cited in his report or I cited in mine, and I gave a comprehensive list of all such dates.

And, if I recall correctly, there are 166 of those dates. And those dates start well before November 15, 2001, which is very significant in Professor Fischel's methodology.

If you recall, his estimation window, when he estimated his regression between 11-15-2000 and 11-15-2001 -- and we talked about this morning -- his justification for that estimation window was he didn't find any corrective disclosures before November 15, 2001.

I found over a hundred disclosures before November 15, 2001.

And, you know, as I said in my report, if you pick an estimation window that precedes those disclosure dates, according to his methodology, using his own methodology, even keeping his stale dates, there will be zero inflation. You cannot show a single cent of inflation.

Q. Did you prepare a demonstrative to illustrate all of the dates that Professor Fischel failed to include?

A. Yes, I did.

MR. KAVALER: Can we see 799-01, please?

(Document tendered.)

BY MR. KAVALER:

Q. Explain to us what this shows us, Professor.

A. Red dots are dates and stories that Professor Fischel did not analyze.

BlueCrosses are his 14 purported disclosure dates.

Including in red dots are 27 dates that Professor Fischel discussed in his report, but did not analyze quantitatively.

And when you look at the evidence, it's very clear, so-called predatory lending and other practices were no secret to the market. That was part of being in this business.

It's true that headline risk grew over this period, you'll see greater density of these stories as we go later towards the period, because regulators were becoming more and more concerned. Headline risk was increasing.

But it's not true that the market did not know of headline risk. There were shareholder resolutions offered at Household's annual meetings, saying that maybe we should look senior management's compensation to managing headline risk, managing risk of predatory lending acquisitions. What greater proof there can be that investors knew about this risk of investing in the stock.

Q. All right, Professor Bajaj, we're almost done. Let me just ask you can couple more questions.

You told us a few minutes ago the stock went up, not down, on each of the three dates the plaintiffs say marked the

end of one of their major pieces of the case: Predatory lending, re-aging and restatement.

If the public learned it had been deceived by a fraud, would you expect the price to go up or down?

A. Down.

Q. We're talking about the price now -- the price of the market -- not just inflation.

You'd expect the price to go down?

A. Yes.

Q. This is ordinary common sense, something I can see, right there on the New York Stock Exchange closing price, without all this regression analysis stuff?

A. Other things being equal, yes.

Q. Okay.

And, yet, we saw -- we've seen throughout this -- that on each of these dates the price of the stock went up?

A. That's correct.

Q. Have you prepared a demonstrative that examines this phenomenon?

A. Yes, I have.

Q. Let's look at DDX 230-01.

What is this day?

A. This shows you how Household's stock price -- what Household's stock price was around April 9th, 2002, when Household presented detailed statistics on its re-aging

practices.

And you'll see, from the day before to the day after, stock price went up.

Q. All right.

Let's look at DDX 230.02.

This is the date of the restatement.

What does this one show us?

A. Well, August 14th was the restatement date.

You will see from the day before, the stock price was 37.80.

It closed slightly up by 29 cents on the date of the -- on the date of the restatement -- and it closed up to 39.60, the day after the restatement, as analyst commentary had continued and the market absorbed this information.

Q. And let's look at DDX 2230-03.

This is the Attorney General settlement. What does this show us?

A. This shows you that when Household settled with Attorneys General, its stock price went up from $21 a share to $28.20 a share. That's seven times the increase on a per share basis that the settlement represented in payments by Household.

Q. And did you prepare a demonstrative summarizing these three points?

A. Yes, I did.

Q. Let's look at DDX 577-04.

Tell us what this shows us?
A. Well, it summarizes what we've been discussing, on April 9th, when Household -- according to the plaintiffs -- disclosed its re-aging policies at Financial Relations Conference. The stock price went up.
On August 14th, when Household issued its restatement, the stock price went up -- and August 10th and 11th, when Household settled with Attorneys General -- the stock price went up.
Q. Professor Bajaj, is any of the economic evidence in this case in any way consistent with fraud?
A. No.
MR. KAVALER: No further questions, your Honor.
THE COURT: I think it's a good time to take our break for the afternoon.
Take a 15-minute break, ladies and gentlemen.
(Jury out.)
(Brief recess.)
(Proceedings heard in open court:)
THE COURT: Ready?
MR. BURKHOLZ: All set.
(Jury in at 3:13 p.m.)
CROSS-EXAMINATION
BY MR. BURKHOLZ:
Q. Sir, you criticized Professor Fischel on market efficiency

and the 14 dates that he selected saying that the information was stale, yet you were never cited like Professor Fischel was on market efficiency in the stock market by the U.S. Supreme Court in the seminal case of Basic v. Levinson, were you, sir?
Have you ever been cited by the U.S. Supreme Court?
A. No, sir, I haven't.
Q. Thank you. It's a "yes" or "no."
Have you ever been cited by the U.S. Supreme Court with respect to market efficiency?
A. No, sir.
Q. Now, Professor Fischel, plaintiffs' expert, who the defendants' counsel refers to as "wrote the book," teaches market efficiency and how you calculate inflation here at the University of Chicago and Northwestern University and cited by the U.S. Supreme Court.
He is wrong in all his opinions in this case; isn't that true, sir? Isn't that your position, that he is wrong, right?
A. That is the market evidence and that is my opinion.
Q. That is your opinion, right, sir? He is wrong on all of his opinions, right? Yes or no?
A. Well, Counsel, as I --
Q. Is he right or wrong, sir? You can't answer that question?
A. Well, I testified he is wrong.

Q. Right. Okay.
Now, you will agree with me, won't you, sir, that you don't need a stock price increase on the day a company makes a false statement in order for inflation to come into that company's stock price? Do you agree with that?
A. Yes, I do.
Q. Thank you.
In fact, in the Computer Associates case, another case in which you were an expert, you gave the opinion that you don't have to measure a stock price increase in order to estimate inflation, right?
You did that in that case, right?
A. Well, what I did in that case was estimate inflation on the way in by looking at other companies --
Q. Sir, that wasn't my question, sir.
My question was, in that case you didn't measure the stock price increase in order to estimate inflation, right? You didn't do that, right?
A. Counsel, if I may answer?
Q. It's a "yes" or "no," sir. Did you do it?
I asked you the question at your deposition and you answered it.
A. Well, I think a "yes" or "no" answer would be misleading, so --
Q. I don't want you to mislead anybody here.

MR. BURKHOLZ: I will withdraw the question, your Honor.
BY MR. BURKHOLZ:
Q. Now, you will agree with me, sir, that a company does not need to admit it committed fraud for inflation to come out of the stock price?
A. As a general proposition that could be true, yes.
Q. Okay.
In fact, there are a number of ways in which inflation can come out of a company's stock price. It can come out through a company admission. It can come out from information from third parties, such as analysts or the media. Isn't that correct, sir?
A. Not necessarily.
Q. Okay. Sir, your deposition was taken in this case, right?
A. Yes.
Q. And you gave an oath to tell the truth in the deposition, right?
A. Of course I did.
Q. Okay. Let's look at your deposition at Page 43, Lines 5 through 21.
(Said videotape was played in open court.)
BY MR. BURKHOLZ:
Q. That was your testimony that day, right, sir?
MR. KAVALER: I'm going to move to strike. That's

not proper. He said the same thing on the stand that he said in his deposition.
THE COURT: I will allow it.
MR. BURKHOLZ: Thank you, your Honor.
BY MR. BURKHOLZ:
Q. Now, it's your opinion in this case that even if this jury finds that Household made false statements, there is still zero inflation, right, sir? That is your opinion, right?
A. That mischaracterizes my opinion.
MR. BURKHOLZ: Can we see the deposition at Page 142, Lines 18 to 25, please.
(Said videotape was played in open court.)
BY MR. BURKHOLZ:
Q. That was your testimony on that day, right, sir?
A. That is correct.
Q. Thank you.
Now, did you read Mr. Aldinger's testimony in this case where he admitted that Household's 2001 10-K was materially false and misleading? Did you read that testimony?
A. I read through his testimony, and I do recall that interchange even though I did not carefully study his testimony.
Q. Well, let me give you that page so you can refresh your recollection.
(Document tendered.)

BY MR. BURKHOLZ:
Q. Let me read from the transcript of April 22nd, 2009, Page 3441.
"Q. Okay. You know that this was materially false and misleading, don't you?"
And this is a discussion of the 10-K, 2001 10-K.
"A. I understand that it was incorrect at the time.
"Q. My question is, sir, you understand that this is materially false and misleading, correct?
"A. You could say that.
"Q. No, sir. I am asking you a question.
"Do you understand that this is materially false and misleading?
"A. I will accept that characterization.
"Q. Is that a 'yes,' sir?
"A. Yes."
Did I read that correctly?
A. Yes, you did read the transcript correctly.
Q. And it's still your opinion that there is no inflation in this case, correct?
A. I am not aware of any economic evidence --
Q. It's a simple question.
There is no inflation in this case, right? That's your opinion, right?
Even after Mr. Aldinger admitted that the 2001 10-K

was false, it's still your opinion that there is zero inflation in this case, right, sir?
You can answer that "yes" or "no," can't you?
A. It is my opinion that there is no economic evidence in this case that shows that there was any inflation in Household's stock price at any time during the relevant period.
Q. And isn't it the jury's determination -- isn't it their role to decide whether or not any of Household's statements were false and misleading in this case?
You agree with me on that, don't you?
A. Yes, I do.
Q. Thank you.
Let's talk about the index that you created, the six companies that you put together.
Household was a Fortune 500 company during the time period that we were discussing here, right, 1999 to 2002?
A. Yes.
And I did not put those companies together. I selected those companies, yes.
Q. Right. Okay. You selected them.
So Household is a Fortune 500 company.
Let's look at one of the companies that you selected. It's called CashAmerica. This is how you described it in your expert report.

A. Okay.
Q. I don't want to misrepresent it, so I am going to give you a copy of your report.
(Document tendered.)
BY THE WITNESS:
A. Thank you, Counsel.
BY MR. BURKHOLZ:
Q. You refer to CashAmerica as a specialty financial services enterprise principally engaged in acquiring, establishing, and operating pawn shops in 16 states, in the United Kingdom, and Sweden. The company also provides check-cashing services in 21 states.
I got that right, didn't I, sir, in the description?
A. You paraphrased it a little bit, but it is substantially correct, yes.
Q. Thank you.
Household didn't own any pawn shops or check-cashing services, did they?
A. Not to my knowledge.
Q. Thank you.
Now, Household identified the S&P financials and the S&P 500 in their SEC filings, right, as their peer group to compare themselves to?
A. They did present stock returns on Household and that on S&P 500 portfolio and S&P financial portfolio.

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Q. Let me show you also what we will mark as Exhibit 199.
(Document tendered.)
BY THE WITNESS:
A. Thank you, Counsel.
BY MR. BURKHOLZ:
Q. Do you see that Plaintiffs' Exhibit 199 is an investor relations report for Household for September, October 2002, sir?
A. Yes, I do.
MR. BURKHOLZ: Your Honor, we move 199 into evidence subject to the limiting instruction.
THE COURT: It will be admitted.
(Said exhibit was received in evidence.)
BY MR. BURKHOLZ:
Q. If you can, turn to the fifth page of the document. It has Bates No. 742.
A. What did you say the Bates number was?
Q. It's 742. It's the fifth page of the document.
Do you have the page, sir?
A. Yes, I do have that page.
Q. Do you see where it's entitled "Household International Peer Group Stock Price Report, October 31, 2002"?
A. It says that, yes.
Q. And you understand this is a document that -- it's a Household document, prepared by Household, right?

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A. I understand that to be the case.
Q. Let's look at the peers that Household compared itself to.
MR. BURKHOLZ: If we can, highlight the left-hand side.
BY MR. BURKHOLZ:
Q. Do you see the companies AIG; AXP, which is American Express; COF, that's Capital One, that's one of your six companies, right?
A. If you say so. I do not remember the ticker symbol of Capital One.
Q. C, which was Citigroup, right?
A. Yes.
Q. KRB. You know what that is, right?
A. No, I do not recall what the ticker symbol is.
Q. One, and then USB, and then you see WFC. That's Wells Fargo, right?
A. Yes, WFC is Wells Fargo.
Q. These are the nine companies that Household internally compared itself to. And this document, this isn't a document that you even looked at in forming your opinion; isn't that correct, sir?
A. You might have shown this to me during my deposition, if I recall correctly, or something similar. But it doesn't ring a bell.
Q. Well, you told me in your deposition that you never even

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looked at these investor relations reports. And you haven't, have you, sir?
A. No. As I am telling you, unless you showed it to me in my deposition, I don't recall seeing this document.
Q. So you didn't consider this document in forming your opinion, right?
A. That is correct, yes.
Q. And your group of six is not listed as a Household peer group, right? By Household, right?
A. Well, this document -- I think you told me one of the companies overlap, but this document doesn't list all six here.
Q. Let's look at another document, Exhibit 772. It's already in evidence.
(Document tendered.)
MR. BURKHOLZ: Copy for counsel.
(Document tendered.)
BY MR. BURKHOLZ:
Q. Now, do you see the first page of the document? It's "Household Compensation Committee Meeting, September 10, 2002"?
A. Yes, that's what it says.
Q. Okay. Then, if you turn to the page that I tabbed for you, which is Bates No. 3774, do you see where it says "Peer group as identified by Household"?

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A. Yes, it says that.
Q. Now, two of your companies, MBNA and Capital One, of your six companies are listed here, right?
A. That is correct, yes.
Q. Your other four are not listed, right?
A. They are not on this page.
Q. And you have never seen this document before, have you?
A. I don't believe I have.
Q. So defendants' counsel didn't give you Household's compensation documents which showed the peer groups that Household was comparing itself to in order to justify Mr. Aldinger's $25 million pay package? They didn't give you that document?
A. Counsel, you are wrong on two counts.
Number one, I was given access to the entire database of over 5 million pages of discovery in this case, and I selected to review whatever was relevant for purposes of my analysis.
Q. I understand that. But you have never seen this document before today, have you?
A. Yes. Nor have I seen each and every one of the millions of other pages that weren't relevant to my work.
MR. BURKHOLZ: Let's bring up Plaintiffs' Demonstrative 136, please.
BY MR. BURKHOLZ:

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Q. This shows Household's stock price performance during the disclosure period that Professor Fischel identifies and that you analyzed and criticized him in your respective expert reports. And it shows Household going down 53 percent, the S&P financials index a little over 20 percent, and the S&P 500 index a little over 25 percent. Right, sir?
A. That's what it shows, yes.
Q. Okay. And in your deposition I asked you about your Consumer Finance Index group during the same time period, and I showed you that Professor Fischel had calculated that your six companies as an index had gone down 29.6 percent during this time period, or about 30 percent.
Do you remember that?
A. Something like that comes to mind, yes.
Q. You didn't disagree with the calculations of Professor Fischel at that time, right?
A. I took your representation for it.
Q. Well, you didn't do any -- after the deposition you didn't -- or looking at his expert report, you didn't do a calculation that came up with anything different than about 30 percent decline for your group during this time period, did you?
A. I did not examine that, yes.
Q. Now, Professor Fischel's opinion is that the underperformance of Household compared to its peers in your

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group of six was due to news coming out about Household's predatory lending, reaging, and restatement.
You have opined that headline risk, not fraud, is the reason that Household stock price declined. Yet in this case you didn't quantify Household stock decline that was due to this headline risk, did you? You didn't do that quantification?
A. I don't understand your question at all.
Q. You didn't quantify how much of Household's stock price decline was due to headline risk, did you?
Simple "yes" or "no." Did you do the quantification?
A. I didn't consider it. It didn't seem like a sensible thing to do which would be relevant to whatever it is that I was asked to do.
Q. In fact, you didn't even quantify the stock price impact of Household's peers during the same time period. You didn't do it for Household and you didn't do it for their peers, did you?
A. You are wrong, Counsel.
Q. Okay. I am wrong about this?
MR. BURKHOLZ: Can we bring up Page 131 of his deposition, Lines 4 to 14.
I am sorry. Let's start out with Lines 15 to 25.
(Said videotape was played in open court.)
BY MR. BURKHOLZ:

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Q. That was your testimony on that day, right, sir?
A. Yes.
Q. Thank you.
Now, sir, you are not an expert on reaging, correct?
A. I am not an accountant who specializes in reaging.
Q. I didn't ask you if you were an accountant. I asked you if you were an expert on reaging.
You have never given expert testimony on reaging, have you?
A. You could say that. I will accept that characterization.
Q. So you are not an expert on reaging, right?
A. From an accounting or legal perspective, yes.
Q. You have never been qualified to give an expert opinion on reaging, have you?
A. I have never been engaged to give any such opinion, Counsel.
Q. And you are not an expert on predatory lending, right?
A. Not from a legal or disclosure point of view, yes.
Q. And you are not opining here on whether Household's disclosures in its securitization documents or its 10-Ks comply with the federal securities laws, right?
A. I am not a lawyer, and I am not offering any such opinion.
Q. Let me show you what's been already admitted into evidence as Plaintiffs' 1410.
(Document tendered.)

Bajaj - cross

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BY THE WITNESS:
A. Thank you.
MR. BURKHOLZ: Copy for counsel.
(Document tendered.)
BY MR. BURKHOLZ:
Q. You have seen this document before, right, sir?
A. Yes, Counsel, I have.
Q. This is the third of the Legg Mason reports on December 11, 2001, right?
A. That is correct.
MR. BURKHOLZ: Let's highlight on the first page the bottom.
BY MR. BURKHOLZ:
Q. "Obviously a big surprise to many, including us, was the 570-day charge-off policy."
Do you see that?
A. Yes, I do.
Q. Then, turn to the third page of the document.
And you understand that this analyst is looking at Household's public filings in issuing this report, right, the three reports he issued on that day?
A. Yes, that's correct.
Q. And it's your opinion that he issued a third report after the market closed that day, but it didn't have any new information that wasn't in the first two reports, right?

A. I didn't see any significant new information in it, relative to the first two reports, that would have been material to investors in Household's stock.
Q. Okay. Let's look at the third page of the document.
MR. BURKHOLZ: Can we highlight where it says "Once again"?
BY MR. BURKHOLZ:
Q. It says, "Once again, a few questions. Is it 300 days (ten months) or 270 days (nine months) as stated in the annual report?"
Do you see that?
A. I do.
Q. Now let's talk about some of the disclosure dates that you criticized Professor Fischel as including in his specific disclosure model. Let's talk about the --
A. Counsel, excuse me. Are we done with this?
Q. For now we are.
A. Okay. Thank you.
Q. Let's talk about the December 3rd, 2001 date, the day that the Barron's article came out. Okay?
A. Okay.
Q. Let me show you what we have marked as Plaintiffs' Exhibit 820.
(Document tendered.)
MR. BURKHOLZ: This is an investor relations report

during that time period, November to December 2001.
Your Honor, I move 820 into evidence.
THE COURT: This is an investor report?
MR. BURKHOLZ: Yes, subject to the limiting instruction.
THE COURT: It will be admitted with the limiting instruction.
(Said exhibit was received in evidence.)
BY THE WITNESS:
A. Just give me one moment, Counsel.
(Brief pause.)
BY THE WITNESS:
A. Thank you.
BY MR. BURKHOLZ:
Q. Now, it's your opinion that the Barron's article was stale news, right, because it cited to an analyst report that Mr. Ryan had put out a month before? That's the gist of what you were saying, right?
A. With one correction. There is no such thing as stale news. It's stale information. Either it's news or it's not stale.
Q. Okay. Let's look at the third bullet point of the first page. This is what Household said about the Barron's article.
"On December 3rd the stock dropped $2.69, or 4.6 percent, to 56.30 following articles in Barron's and

BusinessWeek that alleged Household's strong results were in part driven by aggressive charge-off policies."
You see that, right?
A. Yes.
Q. Again, this is an investor relations report.
You've never seen this document before, right, sir?
A. Unless you showed it to me in my deposition, I don't recall seeing this document. I know you showed me some investor relations conferences -- investor relations reports internally prepared by Household during my deposition. I don't recall which ones.
Q. But here Household is attributing the decline to the Barron's article, right, and BusinessWeek articles?
A. It says what it says. The document speaks for itself.
Q. Let me show you another document. I want to show you the Barron's article, Plaintiffs' 1409.
(Document tendered.)
BY MR. BURKHOLZ:
Q. December 1st, 2001, Dow Jones & Company. Headline, Barron's, "Does It Add Up? A look at Household's accounting."
MR. BURKHOLZ: We move this into evidence, your Honor, 1409, with the same limiting instruction.
THE COURT: Admitted.
(Said exhibit was received in evidence.)
BY MR. BURKHOLZ:

Q. Now, when we focus on the bottom of the first page -- actually, it's on the second page of this copy, third paragraph from the bottom where it says, "Company officials are thin-skinned."
A. Okay.
Q. Follow along with me.
"Company officials are thin-skinned when questioned about their accounting or operating philosophy. A recent civil suit by the California Department of Corporations accuses Household of abusive lending practices, including the padding of late fees and prepayment penalties. It provoked a public-relations broadside from the company, strongly denying the allegations and taking the state agency to task."
Then, the next part I want you to focus on is, "Household's managers certainly aren't shy about lashing out at critics. As a consequence, a securities analyst who has a less-than-enthusiastic buy recommendation on Household, expressed some reluctance even to discuss the company."
Now, this is an analyst that isn't Mr. Ryan, right, sir?
A. Actually, I know quite a bit about this issue. If you look at --
Q. I am not asking what you know about the issue.
I am asking you the question, it's not Mr. Ryan that the article is talking about here, right?

A. Counsel, I think I am trying to be responsive to your question.
Q. Is it Mr. Ryan they are talking about or not?
A. Okay.
Q. They are not talking about --
A. This is not Mr. Ryan.
Q. Mr. Ryan is referred to in the article, right?
A. That is correct, yes.
Q. So this is somebody else?
A. This is somebody else.
Q. Okay.
And then it goes on to say -- he has a less-than-enthusiastic buy recommendation on Household, expressed some reluctance even to discuss the company -- "Look, we bank them.'"
And reading this article, you understand that to mean that his company has an investment banking relationship with Household, right, when he says, "We bank them"?
A. That's how I understand that.
Q. Okay. "'Look, we bank them, so please don't use my name in connection with your story,' the analyst asseverates. 'I just have a bad gut feeling about Household's model.' So much for the value of one Wall Street buy rating."
Do you see that?
A. That's what it says. Do you want me to comment on it?

Q. You considered this part of the article in forming your opinion, right, sir? Yes or no?
A. Yes, I did.
Q. Okay. It goes on to say, "The analyst professes to be bothered by factors, including the company's loan-loss reserve coverage, which seems somewhat skimpy."
Do you see that?
A. I see that, and I also -- well.
Q. Sir, I just asked you if you saw it?
A. Okay.
Q. The information that we just read is not information that was in either of Mr. Ryan's two prior analyst reports, right?
A. You don't need me to explain, just say "yes" or "no"?
Q. Your lawyer can ask you questions.
A. That's fine.
It was not Mr. Ryan's comments. That's correct.
Q. So this is new information that wasn't in either of Mr. Ryan's reports, right?
A. I don't consider it new information, but you don't want me to explain, so maybe my counsel will ask me about it.
Q. Let me show you another document marked as Plaintiffs' 1247.
(Document tendered.)
MR. BURKHOLZ: Copy for counsel.
(Document tendered.)

BY MR. BURKHOLZ:
Q. Feel free to read the entire document. I'm going to focus -- it's a two-page document. I am going to focus on the first part of the e-mail string.
THE COURT: What's the exhibit number again?
MR. BURKHOLZ: It's 1247. It's an e-mail from Kenneth Posner to Michael Blumstein.
I move it into evidence, your Honor.
MR. KAVALER: We have an objection to this one, your Honor, under 402 and 403 and 802.
THE COURT: I am sorry?
MR. KAVALER: We objected to this document under Rules 402, 802, and 403.
THE COURT: Does somebody have a copy of the documer I can look at?
MR. BURKHOLZ: I have a copy.
THE COURT: I have no idea what it is.
MR. KAVALER: The resolution in the pretrial proceedings was that they would use it in their case in chief. I recognize it isn't their case in chief. That's why I haven't brought it up before, your Honor.
Would you like me to hand you my copy?
THE COURT: If you don't have an extra copy, it's all right.
MR. KAVALER: No. I know what it says, your Honor.

Can I hand it up?
THE COURT: Okay.
(Document tendered.)
THE COURT: What's it being offered to prove?
MR. BURKHOLZ: It's being offered to prove the relationship between Mr. Aldinger and the analyst that banked with the firm similar to the article I just showed the witness.
THE COURT: For that purpose I will overrule the objection. It may come in for that purpose.
MR. BURKHOLZ: Can we highlight the second and third paragraphs, please.
BY MR. BURKHOLZ:
Q. Now, you understand that Mr. Posner was an analyst at Morgan Stanley here on January 23rd, 2001, right, sir?
In fact, we referenced one of his reports, right?
A. That's what it appears to be, yes.
Q. So let's look what he wrote to Mr. Blumfield {sic}.
"The fact that we downgraded HI's shares three weeks after hosting an investor luncheon apparently pissed off Aldinger (that's a new one to me). Also, Aldinger is apparently upset because of our generally pro-GSE stance. He sent comments on my research to Frank, who mentioned them in our phone call but hasn't passed them (or any feedback) on to me."

You see that right, sir?
A. That's what it says.
Q. Okay. Now, the next paragraph it says, "In my view, this is a very unsavory situation, a petulant CEO" -- and you know what "petulant" means, right, sir? It means easily irritated or annoyed?
A. Yes.
Q. -- "a petulant CEO who holds banking hostage to research ratings."
Do you see that?
A. That's what it says.
Q. And you understood, sir, that Morgan Stanley, the firm that Mr. Posner worked for, was one of many investment banking firms that did business with Household?
A. I don't know that for a fact, but it doesn't surprise me.
Q. Mr. Aldinger was saying no more fees for the bankers if the analysts don't support the stock.
Isn't that what he is saying there?
A. Well, I can't speak to this document. I have never seen this. I have never considered this. I don't know the context. I don't know what business Morgan Stanley did or didn't do with Mr. Aldinger. This is way outside the scope of anything I did.
Q. Well, just like the Barron's article that you looked at and you considered, in the Barron's article they discuss an

analyst who's afraid to talk because his company has an investment banking relationship with Household and they want to get fees from Household for doing the banking.
Here we have the same situation with Mr. Posner.
And you considered that in forming your opinion, didn't you, sir?
A. And you didn't want me to explain.
Q. No. You considered that in forming your opinion, didn't you?
A. Yes, I did.
Q. Okay. Thank you.
Now, you reject Professor Fischel's leakage model in this case, don't you?
A. Yes, I do.
Q. Okay. And Professor Fischel's opinion is that his leakage model is the most appropriate way to estimate damages in this case, right? That's your understanding of his opinion, right?
A. I heard him say that he preferred his leakage model, yes.
Q. Now, you, sir, in fact, in your expert report, Page 58, referred to the fact that the Washington DFI report had leaked out at four various times during the summer of 2002, right, sir?
A. Where are you referring to in my expert report?
Q. Page 58.
A. I see that, yes.

Q. So there was evidence of leakage in this case on this Washington DFI report which basically said Household was committing predatory lending practices in Washington and around the country. And you saw evidence of that leakage, didn't you, sir? You put it in your report?
A. And as I testified this morning, there is a proper way to analyze that leakage.
Q. Okay. So your quarrel with Professor Fischel is over the way that he quantified the leakage, right? That's really your qualm, right?
A. I have no quarrel with Professor Fischel. I like the man. I am simply saying I have a difference of opinion with him on how to analyze this evidence of leakage.
Q. Okay. Now let's talk about the October 10th and 11th dates, okay?
Household gained about 3 billion in value on that day because the stock went from $22 to about $28, right, sir? About $6 a share, right?
A. I think it's about $7 a share, and it's about 3.3 billion, but give or take, you are about right.
Q. Now, Household stock had lost somewhere between 16 and $18 billion from November 15th, 2001, to October 10th, 2002, right, sir? Somewhere in that area?
A. I didn't do the calculation, but I can take your representation for it.

Q. But your opinion is that none of that stock price decline was due to fraud, right?
A. I didn't see any economic evidence showing me that that decline had anything to do with your fraud allegations.
Q. Okay.
Now, you will agree with me, won't you, sir, that if the company lies and the stock is inflated, if it makes additional statements that are lies, it keeps the stock inflated, right?
A. I think your statement is way too general and overbroad for me to agree or disagree with it.
Q. Company lies in the 10-K, the stock is inflated on that day. The company lies three months later in a press release, the stock stays inflated.
You will agree with me on that, right?
A. No. I think your statement is way too generally worded and way too imprecise for me to either agree or to disagree with it.
Q. Now, you talked about testifying for the plaintiffs and the defendants in these cases. But, sir, it's true, isn't it, that in these kind of cases, the securities class action cases on behalf of investors, that you testified for the defense all the time, not for the plaintiffs, right?
Isn't that what you told me in your deposition?
A. What I said in my deposition was consistent with what I

said today, that I have been engaged by plaintiffs' counsel in cases involving securities fraud allegations.
It is true that I have not been engaged to testify, by counsel, in a securities class action case.
MR. BURKHOLZ: Thank you. No further questions at this time, your Honor.
MR. KAVALER: Your Honor, I have no further questions of this witness at all.
MR. BURKHOLZ: Your Honor -- go ahead.
THE COURT: I am sorry?
MR. BURKHOLZ: No further questions.
THE COURT: And you have no further questions?
MR. KAVALER: Right.
THE COURT: So you both have no further questions?
MR. BURKHOLZ: We don't.
(Laughter.)
THE COURT: Sir, you may step down.
THE WITNESS: Thank you, your Honor.
(Witness excused.)
THE COURT: Call your next witness.
MR. KAVALER: Your Honor, we have three exhibits we need to move into evidence. We asked plaintiffs about them this morning, if they have any objection. If they have no objection, we will move those into evidence and then rest.
If they do have an objection, we will move them into

evidence and address the objection and then rest.
THE COURT: Well, go ahead.
What are the exhibits?
Are there objections?
(Brief pause.)
MR. KAVALER: Your Honor, we offer Defendants' 454 and Defendants' 397 without objection.
THE COURT: Admitted without objection.
(Said exhibits were received in evidence.)
MR. KAVALER: And as to 182, I understand that the plaintiffs want me to make some redactions on it. I think it was just the cover page, but we will work that out with them.
Subject to working that out, we offer Defendants' 182.
MR. DOWD: It was the videotape, your Honor. And the Court allowed them to play parts and, I think, not the other parts. As long as the parts that were admitted go back to the jury, we have no problem.
MR. KAVALER: We will conform it to what we played, your Honor.
THE COURT: We will take it under advisement.
You can reserve your right with respect to that exhibit in case you need to reopen your case.
MR. KAVALER: Very good, your Honor.
In that case, defendants rest.

THE COURT: Very well.
Plaintiffs?
MR. BURKHOLZ: We have a motion, your Honor, to submit to the Court, Rule 50(a).
THE COURT: Why don't you -- I will reserve your right to do that. You can do that after we are done with the evidence.
MR. BURKHOLZ: Plaintiffs recall Professor Daniel Fischel to the stand.
THE COURT: Professor, I am going to reswear you, please.
Raise your right hand.
DANIEL R. FISCHEL, PLAINTIFFS' REBUTTAL WITNESS, SV
DIRECT EXAMINATION
BY MR. BURKHOLZ:
Q. Sir, you sat through Professor Bajaj's testimony, right?
A. I did.
Q. Lots of criticisms of your approach in this case?
A. I heard many of them.
Q. Did his testimony change any of your opinions in this case?
A. No.
Q. Let's discuss -- now, you are recognized as an expert on the use of regression analysis and event studies?
A. Yes, sir.

Q. And you used an event study in this case for both your specific disclosures and your leakage model, didn't you?
A. Correct.
I believe Professor Bajaj stated that my leakage model was not based on an event study. That's simply incorrect.
Q. And did you follow, in your leakage model, the approach that's been accepted in your field that's laid out in the Cornell and Morgan article?
A. Yes, exactly.
Q. Now, your specific disclosure model, did you consider and reject any nonfraud reasons that Household stock price dropped on those dates?
A. Yes.
Q. And did you find that new information was disclosed on each of those dates?
A. Yes. What I noticed, listening to Dr. Bajaj's testimony where he continually stated that information that I said was part of a corrective disclosure was disclosed previously, he was very selective in what he pointed to in terms of what was disclosed previously, and he left out critical information in my disclosure dates in connection with his statement that each and every -- all 14 happen to be stale or whatever the reason was that was given for the red lines, like the red Xs that we had last time.

EXHIBIT 2

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

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I. Qualifications

I am Senior Managing Director leading the securities practice of LECG, a global expert services firm founded in 1988 by professors from the University of California at Berkeley. LECG specializes in economics and financial analysis.

I received my Ph.D. in Business Administration with a specialty in finance from the University of California at Berkeley in 1988. I also hold an MBA from the University of Texas at Austin, which I received in 1987. Prior to my graduate studies, I received a Bachelor of Technology from the Indian Institute of Technology, in Delhi, India, in 1981. Since 1996, I have testified as an expert either in court or at a deposition in 41 matters, including 11 matters involving liability and/or damages issues in securities fraud cases. In such securities fraud cases I have testified on behalf of the government in a criminal matter, and I have testified on behalf of both plaintiffs and defendants in civil matters.

In addition to my work with LECG, I am also a practicing academic with an active research program. I am currently affiliated with the Haas School of Business at the University of California at Berkeley, where I am a visiting lecturer, and where I was a Graduate Student Instructor while earning my Ph.D. there between 1983 and 1988. From 1988 to 1995, I was an Assistant Professor of Finance and Business Economics at the University of Southern California, in Los Angeles.

I have authored or co-authored over 20 publications and working papers in the field of financial economics. My research has frequently employed various statistical techniques, including event studies, to analyze the impact of news announcements and other events on companies' stock prices. My research has been published in leading journals that serve academic and practitioner communities and has been extensively cited. In particular, I have published in *The Journal of Finance, Journal of Financial Economics, Journal of Financial*

Research, Journal of Applied Finance, International Economic Review, Research in Finance, the Journal of Corporation Law, and *Journal of Derivatives*. I am a member of the American Finance Association, the Western Finance Association, and the Financial Management Association, and I have lectured widely on a variety of issues in financial economics. A curriculum vitae detailing my credentials is attached to this report as Exhibit 1.

II. Scope of Assignment and Compensation

Professor Daniel Fischel has submitted a report dated August 15, 2007 (the "Fischel Report"), on behalf of the Plaintiffs in this matter.[1] According to Professor Fischel:[2]

> Plaintiffs allege that throughout the Class Period, Defendants engaged in a fraudulent scheme and wrongful course of business that rendered Household's financial statements materially false and misleading and caused the market prices of its securities to trade at artificially inflated levels. *Id.* ¶¶ 24 & 50. Plaintiffs principally allege that Defendants: 1) employed improper lending practices designed to maximize amounts lent to borrowers in the subprime market (**"Predatory Lending"**) and denied that these practices were occurring; 2) misrepresented and manipulated defaults and delinquencies (metrics closely followed by analysts and investors) by artificially re-aging delinquent accounts (**"Re-aging"**); and 3) improperly accounted for expenses associated with certain of its credit card agreements, which led to a restatement going as far back as 1994 that lowered earnings throughout the Class Period (the **"Restatement"**). *Id.* ¶¶ 2, 50 & 83. [Emphasis added.]

Professor Fischel opines that: "Based on our review and analysis, I have concluded that the economic evidence is consistent with Plaintiffs' claim that the alleged wrongdoing caused investors in Household's common stock to incur losses."[3] Professor Fischel provides two alternative methods of quantifying the alleged artificial inflation in Household International Inc.'s ("Household," "HI"

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[1] Report of Daniel R. Fischel, *Lawrence E. Jaffe Pension Plan, On Behalf of Itself and All Others Similarly Situated vs. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District Of Illinois, Eastern Division, August 15, 2007 (henceforth the "Fischel Report").
[2] Fischel Report, paragraph 10.
[3] Fischel Report, paragraph 11.

or the "Company") stock price during the Class Period (July 30, 1999 – October 11, 2002),[4] which he labels "Quantification Using Specific Disclosures" and "Quantification Including Leakage" (which I henceforth refer to alternatively as the "Specific Disclosures" model and the "Leakage" model, respectively).

I have been retained by counsel for the Defendants to review and comment on the Fischel Report. LECG is being compensated for my work on this matter at an hourly rate of $700. That compensation is not in any way dependent on the opinions I express on issues in this case. I am independent of the Defendants, the Plaintiffs, and any other parties named in this matter. I have been assisted in my work on this case by colleagues and staff at LECG.

The information I have relied upon in connection with this report is listed on Exhibit 2. If additional information becomes available, I reserve the right to supplement and/or amend the opinions set forth in this report.

III. Overview of Opinions

A. The Economic Principles Of Determining Economic Harm That Is Attributable To Securities Fraud

This is a securities fraud case brought by "all persons who purchased or otherwise acquired securities" of HI during the Class Period,[5] who allege that they lost money by investing in the Company's stock.

According to Professor Fischel, HI's stock traded in an "efficient market," *i.e.,* a market in which the stock price properly reflects all publicly available

[4] [Corrected] Amended and Consolidated Complaint, *Lawrence E. Jaffe Pension Plan, On Behalf of Itself and All Others Similarly Situated vs. Household International, Inc., et al.,* Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, March 12, 2003 (henceforth the "Complaint"); Memorandum Order by Judge Ronald A. Guzman, *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, February 28, 2006 (henceforth the "Guzman Order").

[5] Complaint, paragraph 1.

information about a company's future prospects.[6] The value of a company's stock in an efficient market is the present value of expected future cash flows investors can obtain by owning the shares.[7] New information that affects the market's expectation about future cash flows or risk of such cash flows is reflected in the value of its stock quickly and correctly.[8] Thus, the stock price change upon an announcement is a measure of "the value of the new information to investors."[9] In an efficient market, old information does not affect the stock price because such information would already have been incorporated into the market price when investors first learned of it. Similarly, it is well accepted by financial economists, based on a large body of empirical research, that information that only affects accounting earnings (but not future cash flows or risk associated with such cash flows) does not affect stock prices because investors are only "concerned with the firm's cash flows and the portion of those cash flows to which they are entitled,"[10] not with accounting earnings.

Plaintiffs allege that HI's management (Defendants) "inflated" the Company's stock price above its "true value"[11] through their misstatements and omissions about the Company's future prospects,[12] and that HI's stock price declined following "the revelation of defendants' scheme."[13] Under his Specific Disclosures model, Professor Fischel attempts to quantify the amount of alleged artificial inflation in HI's stock by measuring HI's stock "price reaction to several

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[6] Fischel Report, paragraph 31 and footnote 11.
[7] Brealey, Richard A., Stewart C. Myers and Franklin Allen, 2006, *Principles of Corporate Finance*, 8th Ed., New York, NY: McGraw – Hill/Irwin, Chapter 4 and 13 (henceforth "Brealey, Myers and Allen").
[8] Brealey, Myers and Allen, Chapter 13, page 339.
[9] Fischel Report, paragraph 31.
[10] Brealey, Myers and Allen, page 352.
[11] Professor Fischel defines true value as "the price at which the stock would have traded but for the alleged fraud, calculated as the difference between the stock price and artificial inflation." [Source: Fischel Report, paragraph 37.]
[12] According to Plaintiffs, "Defendants' fraudulent scheme and wrongful course of business was designed to, and did, allow Household to regularly report 'record' revenues and earnings and caused Household's securities to trade at artificially inflated levels throughout the Class Period." [Source: Complaint, paragraph 50.]
[13] Complaint, paragraph 29.

disclosures related to the alleged fraud."[14,15] According to Plaintiffs, investors who bought HI's stock at inflated prices and sold or continued to hold the stock after such curative disclosures had occurred, lost money and were "damaged," *i.e.,* incurred economic harm ("harm") caused by the alleged fraud.[16]

Unlike federally-insured bank deposits, stocks are risky investments. That is, there is no guarantee that a stock's price cannot decline after an investor buys the stock even if there is no fraud. Such price changes reflect changes in investors' expectations about the future cash flows from holding the stock, or the risk associated with such cash flows, following "value-relevant" news. In most instances, the value-relevant news that results in stock price changes, even large changes, has nothing to do with any fraud. Value-relevant news may be about the market as a whole, the industry to which the company belongs or company-specific news unrelated to any fraud. Therefore, as an economic matter, Plaintiffs' investment losses do not automatically constitute compensable economic harm ("damages"). Instead, damages must be carefully limited to only such investment losses that are demonstrably tied, through proper economic analysis, to a "curative disclosure," *i.e.,* a price correction upon revelation of fraudulent misstatements or omissions. Hence, an essential part of any reasonable economic assessment of the Plaintiffs' damages must examine what **caused** the Plaintiffs' loss, and must exclude any losses that result from non-fraud related reasons from any damage calculation.

[14] Fischel Report, paragraph 30.

[15] Under his Specific Disclosures model, Professor Fischel measures the residual price change on the following 14 dates: November 15, 2001, December 3, 2001, December 5, 2001, December 12, 2001, February 27, 2002, July 26, 2002, August 14, 2002, August 16, 2002, August 27, 2002, September 3, 2002, September 23, 2002, October 4, 2002, October 10, 2002, and October 11, 2002 (henceforth the "Specific Disclosures" or the "Specific Disclosure" dates).

[16] Lead Plaintiffs' Supplemental Statement Regarding Damages Pursuant to the Court's October 17, 2007 Order, *Lawrence E. Jaffe Pension Plan, On Behalf of Itself and All Others Similarly Situated vs. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, October 24, 2007, page 1 (henceforth the "Plaintiffs' Supplemental Statement").

The following hypothetical example (the "Oil Company Example") helps explain this important economic principle. Suppose that an oil company, with oil fields in Nigeria and Venezuela, announces on January 1, that its oil field in Venezuela has caught fire and its future profits will be lower as a result. In an efficient market, the company's stock price would decline rapidly (and correctly) to reflect the value of its anticipated losses.[17] Losses resulting from such price declines do not represent economic harm from securities fraud unless plaintiffs demonstrate that the company had known about the fire earlier and intentionally failed to disclose this material news in a timely manner when it had a duty to do so, thereby causing some investors to purchase its stock at inflated prices. Only in such a situation may investors, who bought shares at "inflated" prices as a result of this material omission, claim damages, *i.e.,* only if the stock price decline can be attributed to the alleged fraud and not to non-fraud related factors.

To support their damages claims, Plaintiffs have offered the report of Professor Fischel. Professor Fischel claims that, in his Specific Disclosures model, he has conducted an "event study" in order to quantify inflation in HI's stock price prior to purported curative disclosures.[18] Event study analysis measures the impact of news on a company's stock price after adjusting for contemporaneous changes in market and industry indices.[19] Using standard statistical tests one can then infer whether such a "market-adjusted" stock price change is "statistically significant," *i.e.,* if there is a high degree of certitude that the market-adjusted price change is larger than the routine, day-to-day variation observed historically.[20] Notably,

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[17] For simplicity and without any loss of generality, in this example I am assuming that this incident had no effect on the value of other securities issued by the company, if any.

[18] As I discuss later, there are several methodological flaws in Professor Fischel's event study that make his conclusions incorrect and unreliable.

[19] The stock's "market-adjusted" price change on a given date is the difference between the stock's observed return (or price change) less its "predicted" return for that date, *i.e.,* the return predicted based on the stock's historical relationship to changes in selected market and/or industry benchmarks or indices, which is generally estimated using a regression model.

[20] The conventional minimal confidence level for significance testing is 95% in a two-tailed test, meaning that a price change is considered statistically significant if there is only a 5% likelihood that the observed market-adjusted price change (either positive or negative) is due to the stock's routine, day-to-day price fluctuation. (Conversely, a price change is considered statistically

however, 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. Even statistically significant stock price changes may simply represent random "noise." In other words, even if using the usual standard of 95% confidence level we identify a statistically significant market-adjusted price change, there remains a 5% chance that, although the stock price change is large enough to be considered "statistically significant," the change is unrelated to any particular event(s) and should properly be attributed to the stock's random daily fluctuation.

As I explained above, in an efficient market, a company's stock price reflects investors' expectation of future cash flows from owning the stock. The stock price remains unaffected if investors receive "old" or "stale" information as that information would already have been reflected in the stock price when it was news. For instance, in my hypothetical Oil Company Example, suppose a newspaper repeated the story of the fire in the company's Venezuelan oil field on January 6, *i.e.,* five days after the market first learned of the news. In an efficient market, this stale information about the fire would not affect the stock price. Thus, if the company's stock price did change significantly on January 6, then such a price change was either caused by some other non-fraud-related news or simply represented random noise.

In order to properly attribute a company's stock price decline to a "curative disclosure" about alleged securities fraud, it is necessary to demonstrate through economic analysis that the price change was both: (a) "statistically significant," and (b) a result of previously unknown, value-relevant news about the alleged fraud. If the price change is not statistically significant, or if the purported

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insignificant if the market-adjusted price change is indistinguishable from zero with 95% confidence).

"curative disclosure" simply contained stale information, then the stock's price change cannot be attributed to the alleged fraud. Proper economic analysis to quantify damages must demonstrate that a company's stock price change cannot be attributed to non-fraud related events. A price decline observed following a purported "curative disclosure" was likely caused by non-fraud related reasons, unless there is an economically plausible reason to believe that a company's stock price was "inflated" earlier.

B. Professor Fischel's Analysis Suffers From Several Fundamental Flaws And Results In Incorrect And Unsupportable Conclusions

Professor Fischel opines that: "Based on our review and analysis, I have concluded that the economic evidence is **consistent** with Plaintiffs' claim that the alleged wrongdoing caused investors in Household's common stock to incur losses."[21] [Emphasis added.] As I discuss below, Professor Fischel's analysis is flawed and the conclusions he draws are incorrect, both factually and from an economics perspective.

1. Professor Fischel's Conclusion Is Factually Incorrect

Professor Fischel's conclusion is factually incorrect. Notably, 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.** Such price increases on days when the market received new information relevant to the Plaintiffs' theories of alleged fraud directly contradicts Plaintiffs' claims that they were defrauded.

i. HI's Stock Price Increased Following News Related To Plaintiffs' Theory Of Restatement

On August 14, 2002, HI announced that it would restate its earnings back to 1994 to reflect a change in its accounting treatment of certain costs related to three contracts it had entered into between 1992 and 1996. The Restatement involved

[21] Fischel Report, paragraph 11.

technical accounting issues, and HI's price **increased** by 29 cents (or 0.77%)[22] following this Restatement. According 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. Given the negligible price reaction to the Restatement, economic reasoning suggests that the market did not consider the news to be value-relevant or that the "economic evidence is consistent with the Plaintiffs' claim" as Professor Fischel concludes.[23]

ii. HI's Stock Price Increased Following News Related To Plaintiffs' Theory Of Re-Aging

Plaintiffs allege that the Company **first** "broke out its reaging statistics" on April 9, 2002.[24] 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. Market participants were well aware that sub-prime lenders often restructured delinquent accounts by resetting them to current status ("re-aging") to enable their customers to work out "bumps in the road."[25] Re-aging was considered a sound business practice because it improved loan collections and allowed the lender to charge higher rates and fees for providing its sub-prime borrowers such payment flexibility.[26,27] HI had provided information about its re-aging practice in its

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[22] All stock prices and returns in this report are based on data from Center for Research on Security Prices, University of Chicago (henceforth "CRSP").
[23] Fischel Report, paragraph 11.
[24] Complaint, paragraph 123.
[25] Ball, Bradley, Edwin G. Groshans, and William C. Keaten, "HI: Fundamentals Are Fine in Our View–Raising Estimates: Yet, We Believe Political/Headline Issues Remain–Lowering Target," *Prudential Securities, Inc.*, April 10, 2002, at 7:56 A.M. (EDT), page 3.
[26] Memorandum of Defendant Arthur Andersen LLP in Support of Proposed Settlement with the Plaintiff Class, *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, March 30, 2006, page 10 (henceforth the "Arthur Andersen Memorandum").
[27] During the conference call on April 9, 2002, Mr. Schoenholz said: "I think our preference would be never to re-age accounts. But the reality is our customers in the finance company world are sometimes sloppy payers. I mean, they are not the most pristine discipline in terms of some of their credit. And so to them our re-age policies are an integral part of the value proposition that we

public filings with the Securities and Exchange Commission ("SEC"),[28] starting many years before the Class Period and has not been required to restate its loan quality metrics[29] or to increase its credit loss reserves because it had previously "misrepresented and manipulated defaults and delinquencies,"[30] as Plaintiffs allege.[31] Thus, there is no basis to conclude that HI's stock price was ever inflated according to the Plaintiffs' theory of Re-aging. HI's price reaction to the events of April 9, 2002 confirms that they were not value-relevant.

iii. HI's Stock Price Increased Following News Related To Plaintiffs' Theory Of "Predatory Lending"

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"[32] (the "AG Settlement") on these two dates, respectively. The Company announced it would "pay up to $484 million"[33] 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."[34] Ratings agencies lowered HI's debt ratings upon this news.[35]

Professor Fischel opines that such news constituted Specific Disclosures that had "substantial negative implications for Household's market value."[36] If that theory is correct, then, as Professor Fischel recognizes, "one would expect that [such

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offer them and they pay for that." [Source: Household International Conference Call Transcript, April 9, 2002, at 8:15 A.M. (CT), (HHS 03106482 – HHS 03106612), at HHS 0310659.]

[28] Various Household public filings including 10-Ks, 10-Q's, annual reports, and securitization documents. (See, *e.g.,* Household International SEC Form 10-Q filing for the fiscal quarter ended March 31, 1996, filed March 13, 1996.)

[29] For simplicity of exposition, I refer to key operational metrics related to the Plaintiffs' theory of Re-aging such as credit loss reserves, delinquencies, net charge-offs, credit quality and asset performance as "loan quality metrics" in this report.

[30] Fischel Report, paragraph 10.

[31] Complaint, paragraph 50.

[32] Fischel Report, footnote 21.

[33] Fischel Report, paragraph 7.

[34] Fischel Report, paragraph 7.

[35] Fischel Report, footnote 21.

[36] Fischel Report, footnote 21.

news] would have caused the Company's stock price to decline significantly."[37] [Bracketed text added.] 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, contradicting the Plaintiffs' theory.

Professor Fischel has failed to reject (or even consider) a plausible, non-fraud related explanation for HI's stock price reaction following the AG Settlement, *i.e.*, the impact of "headline risk" on HI's stock price. As I discuss in detail later, allegations of "predatory lending," and the uncertain future costs of resolving such allegations, were a well-known matter of headline risk that adversely impacted all sub-prime lenders, including HI. Professor Fischel has failed to even consider the possibility that HI's stock price declines on earlier dates with purported disclosures related to the Plaintiffs' theory of "Predatory Lending" were caused by investors' heightened concerns about such headline risk and that HI's stock price increased following news of the AG Settlement on October 10, 2002 and October 11, 2002 because the settlement was viewed as a success by HI in reducing its headline risk related to alleged "predatory lending."[38]

2. Professor Fischel Has Provided No Economic Evidence That Would Warrant His Conclusions That Economic Evidence Is Consistent With Plaintiffs' Claim

Contrary to his claim, Professor Fischel's analysis does not provide any support that "the economic evidence is consistent with Plaintiffs' claim that the alleged wrongdoing caused investors in Household's common stock to incur losses"[39] for at least two reasons.

First, as I have discussed above, HI's stock price increased following news related to the Plaintiffs' theories of alleged fraud. Hence, Professor Fischel has failed to demonstrate that HI's stock price was ever inflated as a result of the alleged fraud,

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[37] Fischel Report, footnote 21.
[38] Posner, Kenneth A., and Athina L. Meehan, "Bending Before Adversity," *Morgan Stanley - Equity Research*, October 17, 2002.
[39] Fischel Report, paragraph 11.

and subsequently declined because the truth about such alleged fraud came into the marketplace, as the Plaintiffs claim. Professor Fischel concludes that artificial inflation existed as of the first day of the Class Period. Professor Fischel has not, however, identified any specific alleged misrepresentations or omissions before November 15, 2001 that could explain this inflation.[40]

Second, Professor Fischel's conclusions contradict rather than support the Plaintiffs' claims about the alleged misrepresentations and/or omissions. In particular, in his Specific Disclosures model, Professor Fischel first identifies a variety of alleged misrepresentations or omissions that purportedly were inflationary (even though he cites no economic evidence to support his assumption), and then purportedly measures alleged inflation by the amount by which Household's stock price dropped upon purported "curative disclosures" about such misrepresentations and/or omissions. Notably, however, **none** of the alleged misrepresentations and/or omissions that Professor Fischel has identified occurred **before** November 15, 2001, which is the first Specific Disclosure that Professor Fischel has identified.[41] As a matter of economic logic, therefore, any decline in HI's stock price before an allegedly inflationary fraud was committed cannot be taken to be a correction of the alleged fraud or provide a basis for any damage calculation.

Moreover, 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).[42] This assumption **contradicts** the Plaintiffs' claim that HI's stock became inflated

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[40] Fischel Report, paragraph 28.

[41] Professor Fischel (incorrectly) claims that the first Specific Disclosure occurred after trading hours on November 14, 2001 and attributes HI's price reaction the following day (November 15, 2001) to this disclosure. [Source: Fischel Report, paragraph 12.]

[42] According to Professor Fischel's Specific Disclosures model, the inflation in HI's stock remained $7.97 per share from July 30, 1999 to November 14, 2001. [Source: Fischel Report, Exhibit 53.] Under Professor Fischel's Leakage model, the "Constructed Return" (*i.e.,* HI's stock return absent the alleged fraud) equals HI's actual stock return from July 30, 1999 to November 14, 2001. [Source: Fischel Report, paragraph 41.]

through various alleged misrepresentations and/or omissions ("inflationary events") during the Class Period prior to November 15, 2001.[43]

In short, there is an inconsistency between Professor Fischel's and the Plaintiffs' assumptions about the fundamental economic issue in this case; namely, how and when HI's stock price became inflated. Accordingly, as a matter of economic reasoning, it is incorrect to apply the conclusions derived from Professor Fischel's theory as "economic evidence" that is consistent with the Plaintiffs' allegations because they are internally inconsistent.[44]

3. Professor Fischel's Analysis Does Not Demonstrate That The Prior Alleged Fraud Caused HI's Stock Price To Decline

Even if we counter-factually accept Professor Fischel's assertion that the economic evidence is **"consistent"** with the Plaintiffs' claim, such an assertion does not imply that Plaintiffs are entitled to claim damages as a matter of economic reasoning. In order to do so, Plaintiffs must establish that their losses were **caused** by the alleged fraud. That is, Plaintiffs must not only demonstrate that the stock price declined following purported disclosures about the alleged fraud, they must also establish that the identified price decline **cannot** also be explained by non-fraud related reasons. Professor Fischel has made no attempt to do so, nor does he claim to have found any economic evidence which demonstrates that Plaintiffs' losses were caused by the alleged fraud.

In his Specific Disclosures model, Professor Fischel claims that HI's price changes on 14 dates can be attributed to investors' reactions in an efficient market to disclosures related to the Plaintiffs' theories of alleged fraud. He fails, however, to even consider various non-fraud related reasons that can explain HI's

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[43] Complaint, paragraphs 192-299.

[44] Moreover, Plaintiffs propose to employ the two alternative inflation measures that Professor Fischel has derived to calculate the harm (or "damages") that each Plaintiff purportedly incurred as a result of the alleged fraud. Such damages would too, by definition, be inconsistent with the Plaintiffs' theories of alleged fraud because Professor Fischel's inflation measures are based on assumptions that contradict the Plaintiffs' theory of the alleged fraud, as I have explained above.

price reactions in an efficient market on these dates, as I will demonstrate later in this report. Hence, he fails to demonstrate that the identified price changes were caused by the alleged fraud. Accordingly, Professor Fischel's estimates of the "alleged artificial inflation"[45] present in HI's stock during the Class Period, based on his Specific Disclosures model, are entirely unsupported.

In his Leakage model, Professor Fischel makes no attempt to identify **any** (fraud- or non-fraud related) news that could explain HI's daily stock price change. Therefore, in his Leakage model, not only does Professor Fischel not demonstrate when, if ever, HI's stock price came to be inflated, he also makes no attempt to explain why the price decline on particular dates should be attributed to news about the alleged fraud. Thus, this model does not demonstrate, as a matter of economic logic, that any inflation ever came into or was ever removed from HI's stock price. Professor Fischel does not even attempt to provide any loss causation analysis in his Leakage model.

4. Professor Fischel's Specific Disclosures Model Is Flawed From Economics And Statistics Perspectives

Professor Fischel identifies 14 Specific Disclosures (from November 15, 2001 through October 11, 2002), which he claims produced statistically significant changes in HI's stock price on a "market-adjusted"[46] basis. Professor Fischel also claims that these abnormal price changes were "in response to"[47] purported disclosures related to the Plaintiffs' theories of alleged fraud and measure the extent of the alleged inflation in the stock price that was removed through these disclosures. Such a claim is incorrect for several reasons.

First, the regression model that Professor Fischel uses to determine HI's market-adjusted price change is deeply flawed for reasons I discuss later. As a result, he

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[45] Fischel Report, paragraph 11.

[46] Both of Professor Fischel's inflation models purport to "take into account the effect of market factors on stock price returns" based on a regression analysis that results in an estimated "abnormal return" or "market-adjusted return" for HI. [Source: Fischel Report, paragraph 32.]

[47] Fischel Report, paragraph 34.

identifies HI's price change to be statistically significant on several dates, when they are not. There is no basis to conclude, as Professor Fischel has done, that HI's stock price changes on such dates were not caused by random noise alone.

Second, even if HI's market-adjusted price change on a particular date was statistically significant based on a well-specified regression model, such a statistical observation is insufficient to rule out non-fraud related explanations for the same price change. In order to do so, a careful and complete review of the facts from an economics perspective is necessary, which Professor Fischel has failed to do.

Professor Fischel concludes that HI's stock price reacted significantly following the 14 Specific Disclosures because he (incorrectly) claims that the market received value-relevant news through such Specific Disclosures. Professor Fischel's conclusion is incorrect from an economics perspective because it is based on a selective and incomplete review of the facts. The information he identifies as Specific Disclosures was stale, *i.e.,* already publicly known. In an efficient market (the assumption upon which Professor Fischel's theory rests) the rehash of old information must be value-irrelevant. Professor Fischel does not adequately consider other non-fraud related reasons that could explain HI's stock price changes on the Specific Disclosure dates.[48]

Professor Fischel has also "cherry-picked" his Specific Disclosures because he has ignored many dates (including dates that he himself has cited in his report,[49] as well as numerous other dates that he has entirely ignored) when the markets **did** receive news related to the Plaintiffs' theories of alleged fraud, but HI's stock

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[48] Moreover, as mentioned earlier, random noise alone is sufficient to explain HI's market-adjusted price change on certain Specific Disclosure dates, after flaws in Professor Fischel's regression analysis are corrected.

[49] As I discuss later in more detail, Professor Fischel mentions 41 dates in his report when the markets received information related to the alleged fraud.

price change was **not** significant, which indicates that such news was not value-relevant.

Given these flaws, Professor Fischel's inflation estimate based on his Specific Disclosures model is incorrect and cannot provide a reliable basis to measure the Plaintiffs' alleged economic harm.

5. Professor Fischel's Leakage Model Is Flawed From Economics And Statistics Perspectives

Professor Fischel proposes the Leakage model because he claims that the Specific Disclosures model "likely understates the amount of inflation because it does not take into account the stock price effect of all of the information related to the alleged fraud … that leaked into the market in the latter part of the Class Period."[50] Such a claim is incorrect for several reasons.

First, Professor Fischel describes his Leakage model as an "event study approach"[51] when it is not. According to an academic article authored by Professor MacKinlay, which Professor Fischel has cited, "an event study measures the impact of a **specific event** on the value of a firm."[52] [Emphasis added.] Professor Fischel has made no attempt to identify any events in his Leakage model that caused HI's stock price to decline because the truth about the alleged fraud purportedly came out. Nor has he ruled out (or even considered) that HI's stock price decline could be explained by non-fraud-related factors. In his Leakage model, Professor Fischel mechanically assumes that the difference between HI's actual price and an estimated "True Value" represents daily inflation regardless of whether this difference was caused by factors related to the alleged fraud or not.[53] The court recently rejected a "leakage" model of inflation

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[50] Fischel Report, paragraph 30.
[51] Fischel Report, paragraph 30.
[52] MacKinlay, A. Craig, 1997, "Event Studies in Economics and Finance," *Journal of Economic Literature*, March, Vol 35, page 13. Professor Fischel cites this study in footnote 12 of his report.
[53] This True Value is a function of a "Constructed Return" which over the November 15, 2001 to October 11, 2002 period is an estimated return (based on HI's historical relationship to selected

in another matter for failing to consider non-fraud related explanations of the stock price changes.[54] Professor Fischel, too, has criticized inflation models for claiming that the difference between the observed stock price and estimated True Value represents inflation "because it assumes that any decline in the prices of Damages Securities that is not explained by the movement of the industry index is attributable to the alleged wrongdoing."[55] Yet, Professor Fischel has ignored his own advice in this instance.

Professor Fischel anecdotally discusses events that occurred on 41 dates during the Class Period when the markets purportedly received information related to the Plaintiffs' theories of alleged fraud (See Exhibit 3).[56] Even if one were to incorrectly[57] assume that HI's price change was attributable to "information related to the alleged fraud … that leaked into the market"[58] on these 41 dates, such information did not collectively have a significant impact on HI's stock price on a market-adjusted basis, as I demonstrate in Exhibit 7 (Panel C).

Second, given Professor Fischel's failure to identify how the truth about the alleged fraud came into the market to remove the purported inflation in HI's stock

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indices) and is equal to HI's observed return for the July 30, 1999 to November 14, 2001 period. [Source: Fischel Report, paragraph 41.]

[54] Memorandum Opinion and Order by Judge Stephen P. Friot, *In re Williams Securities Litigation*, Case No. 02-cv-072-SPF-FHM et al., filed in the United States District Court, Northern District of Oklahoma, July 6, 2007, pages 114-115.

[55] Report of Daniel R. Fischel, *In re Bizch Securities*, Case No. 94 Civ 7696 (RWS), filed in the United States District Court, S.D. New York, September 7, 2001, paragraph 16.

[56] These 41 unique trading dates represent 54 events related to the alleged fraud that Professor Fischel discusses in his report. However, in his Specific Disclosures model, Professor Fischel computes the purported inflation in HI's stock price throughout the Class Period based on HI's market-adjusted stock price change on only 14 of these 41 dates (the "Specific Disclosure" dates).

[57] There is no basis to assume that any of the dates that Professor Fischel has identified can be considered dates on which HI's stock price was affected by information of the alleged fraud because there is no evidence that the stock price was ever inflated as a result of the alleged fraud in the first place, as I have discussed earlier. Moreover, the price movements following many of the identified disclosure dates were statistically insignificant according to Professor Fischel's event study, and Professor Fischel has made no attempt to determine whether other non-fraud related events also occurred simultaneously on such purported disclosure dates or not. Hence, even if the identified events were related to the Plaintiffs' theories of alleged fraud, there is no evidence to conclude that such events were value-relevant in an efficient market.

[58] Fischel Report, paragraph 30.

price, it is critical for him to explain how HI's stock price became inflated during the Class Period to begin with. Professor Fischel has, however, failed to do so. In fact Professor Fischel **assumes** that no inflationary events occurred during the Class Period through November 15, 2001.[59] In the absence of any economic reasoning to demonstrate that either HI's stock price was ever inflated or that such alleged inflation was ever removed, any "damages" that are calculated based on Professor Fischel's Leakage model-based inflation measure will be spurious. That is, such damages will automatically result if the stock happened to out-perform certain purported benchmarks over certain periods and under-perform in other periods. Any stock, however, will show such patterns, even absent any fraud, relative to an index.

Third, the daily inflation that Professor Fischel calculates using his Leakage model requires him to predict, using a regression model, the return ("Constructed Return") that HI's stock price would have realized absent the alleged fraud. The inflation estimate critically depends on the precision with which such predicted returns are estimated.[60] An improperly-specified model results in "potentially biased"[61] conclusions, according to the Cornell and Morgan study that Professor Fischel has cited.[62] The regression model that Professor Fischel has used is deeply flawed and unreliable for reasons I discuss at length later in this report.

6. Professor Fischel's Report Does Not Provide A Reliable Basis To Compute Plaintiffs' Alleged Economic Harm

Professor Fischel does not estimate Plaintiffs' economic harm or damages nor does he provide any methodology to do so. Instead, he merely provides two (critically flawed) daily inflation measures based on his Specific Disclosure and

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[59] Professor Fischel assumes that the "Constructed Return" used to calculate the daily True Value in his Leakage model is equal to HI's observed return for the July 30, 1999 to November 14, 2001 period. [Source: Fischel Report, paragraph 41.]
[60] Cornell, Bradford, and R. Gregory Morgan, 1990, "Using Finance Theory to Measure Damages in Fraud on the Market Cases," *UCLA Law Review*, Vol. 37:883, page 911 (henceforth "Cornell and Morgan").
[61] Cornell and Morgan, page 911.
[62] Fischel Report, footnote 22.

Leakage models. Plaintiffs have stated that they will propose these two inflation models as alternatives.[63] The two inflation models are, however, internally inconsistent as I discuss in more detail later. Thus, the economic harm calculated using the two different inflation measures would be significantly different and **could not be attributed to the same economic causes.**

In addition, although Professor Fischel is silent about how his inflation measures can be used to calculate Plaintiffs' damages, the Plaintiffs have proposed a methodology to do so.[64] This methodology is incomplete and economically unsound as I discuss in detail later in this report.

Among other flaws, Plaintiffs recognize that each Plaintiff's benefits from the sale of shares at inflated prices should be netted against that Plaintiff's economic harm.[65] Plaintiffs, however, ignore the fact that such netting benefits may arise from the sale of shares that were purchased before the start of the Class Period, when the stock price was either not inflated or inflated by an unknown amount because Professor Fischel's inflation models do not measure pre-Class Period inflation.[66] As a result, given the incomplete inflation measures that Professor Fischel has provided thus far, Plaintiffs' net damages cannot be calculated.[67]

IV. HI's History & Operations[68]

Household was created as a holding company in 1981 as a result of a shareholder approved restructuring of Household Finance Corporation (''HFC''), which traces its history back to 1878. As of July 30, 1999, the beginning of the Class Period,

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[63] Plaintiffs' Supplemental Statement, page 1.
[64] Plaintiffs' Supplemental Statement.
[65] Plaintiffs' Supplemental Statement, page 2.
[66] Fischel Report, Exhibit 53 and 56.
[67] Moreover, in order to exclude the benefit that a Plaintiff receives from the sale of shares at inflated shares during the Class Period that were acquired prior to the Class Period ("pre-Class Period shares"), Plaintiffs must specify which particular sales transactions are matched to such pre-Class Period shares, which they have not done.. As I explain later, the Plaintiffs' proposed damage methodology is incomplete and flawed for this, and other reasons.
[68] Household International SEC Form 10-K filing for the fiscal year ended December 31, 2000, filed March 28, 2001.

Household was principally a non-operating holding company. Household's subsidiaries primarily provided middle-market consumers in the United States, the United Kingdom and Canada with several types of loan products including real estate secured loans, auto finance loans, MasterCard and Visa credit cards, private label credit cards, tax refund anticipation loans, retail installment sales finance loans and other types of unsecured loans, as well as credit and specialty insurance. As of December 31, 2000, the Company had approximately 28,000 employees and served over 48 million customers with $87.6 billion in managed receivables and $67.4 billion in owned receivables.

The Company's operations were divided into three reportable segments:

1) **The Consumer segment** included the following three businesses:

   - HI's consumer lending business had over 1,400 branches located in 46 states and 3.4 million open customer accounts,[69] making it one of the largest U.S. sub-prime home equity originators.[70]
   - HI's retail business was the second largest provider of third party private label credit cards in the U.S. with over 60 active merchant relationships, approximately $9.9 billion in managed receivables and 8.5 million active customer accounts.
   - HI's auto finance business was one of the largest non-captive non-prime automobile lenders in the United States.

2) **The Credit Card Services segment** included HI's MasterCard and Visa receivables in the U.S., including the GM Card, the Union Privilege credit card, a Household Bank branded card, and the Orchard Bank card.

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[69] Household International SEC Form 10-K filing for the fiscal year ended December 31, 2000, filed March 28, 2001 and Household International SEC Form 10-K405 filing for the fiscal year ended December 31, 2001, filed March 13, 2002.

[70] Chomsisengphet, Souphala, and Anthony Pennington-Cross, 2006, "The Evolution of the Subprime Mortgage Market," *Federal Reserve Bank of St. Louis Review*, January/February, 88(1), pages 39-40 (henceforth the "Fed Study").

3) **The International segment** included HI's foreign operations in the United Kingdom and Canada where the Company offered secured and unsecured lines of credit, secured and unsecured closed-end loans, insurance products and credit cards.

V. Flaws In Professor Fischel's "Quantification Using Specific Disclosures" Methodology

In his Specific Disclosures model, Professor Fischel assumes that HI's stock price change on 14 Specific Disclosure dates was "in response to disclosures related to the alleged fraud"[71] and that "as the price reacts to each disclosure, inflation increases or decreases by the amount of the residual price change on that date."[72] Putting aside his Leakage model, which is not an event study, the 14 Specific Disclosure dates identified by Professor Fischel reflect **all** days in which he specifically asserts that the fraud alleged by Plaintiffs was revealed to the public.

In order for HI's stock price change on any of these 14 dates to be considered a measure of the alleged artificial inflation, Professor Fischel must demonstrate that (a) the stock price change was statistically significant after adjusting for contemporaneous changes in the market and industry indices and (b) some news related to the alleged fraud was released publicly for the first time on that date. As I discuss below, Professor Fischel's analysis fails with respect to both (a) and (b).

Professor Fischel's conclusions under his Specific Disclosures model are based on a flawed, incomplete and selective review of the facts:

1) **Flawed review of the facts:** Relying on his flawed event study, Professor Fischel concludes that HI's price changes on certain dates are statistically significant. Professor Fischel mistakenly reaches this conclusion by failing to properly account for contemporaneous market and industry

[71] Fischel Report, paragraph 34.
[72] Fischel Report, paragraph 36.

factors. Having mistakenly identified insignificant price movements as "significant," Professor Fischel then chooses, without explanation, a subset of those days, looking for any information released on that day that arguably were related to the Plaintiffs' theories of alleged fraud. He then incorrectly attributes the entire observed price change on that day to whatever information he found.

2) **Incomplete review of the facts:** In attributing all of these price movements to the alleged fraud, Professor Fischel does not even consider, much less rule out, other possible non-fraud related explanations for the change in HI's stock price on the Specific Disclosure dates. For example, Professor Fischel fails to (a) verify that the purported disclosure represented new information that was not already known to the market; and (b) conduct any analysis to examine whether other non-fraud related factors could also have caused HI's price change on the Specific Disclosure dates. Notably, Professor Fischel fails to reject (or even consider) whether HI's price reaction on his selected Specific Disclosure dates is explained by non-fraud related factors, such as changes in economic circumstances, investor expectations, or new industry-specific and/or firm-specific factors, as proper economic "review and analysis"[73] requires.

3) **Selective review of the facts:** Professor Fischel's analysis is selective because he has "cherry-picked" his 14 Specific Disclosure dates while ignoring other dates[74] when the market also received information related to the Plaintiffs' theories of alleged fraud. Professor Fischel ignores dates on which HI's stock price movement contradicts his analysis. Professor Fischel also fails to recognize that the purported disclosures he has

[73] Fischel Report, paragraph 11.

[74] Professor Fischel's Specific Disclosures model ignores certain dates in computing the alleged inflation even though he claims to have found information related to the Plaintiffs' theories of alleged fraud. In addition, Professor Fischel is altogether silent about other dates when the markets received information related to the Plaintiffs' theories of alleged fraud.

identified represented "stale" information. HI's stock price did not change significantly when such information was first released to the market, indicating that such purported disclosures were not value-relevant in an efficient market.

A thorough analysis of the facts reveals that Professor Fischel's conclusion, that HI's stock price changes on the Specific Disclosure dates were caused by "disclosures" related to the Plaintiffs' theories of alleged fraud, is counter-factual and contradicts the underlying principle of market efficiency upon which he has relied.

A. Professor Fischel Fails To Establish That The Restatement Was Value-Relevant And That It Ever Caused HI's Stock Price To Be Inflated

On August 14, 2002, the Company announced that it would restate its earnings back to 1994[75] to reflect "a retroactive change in Household's cost amortization accounting after Household hired new auditors."[76,77] According to Arthur Andersen, the Company's auditors at the time the above-mentioned contracts were entered into, the "restatement clearly arose from a good-faith disagreement among auditors regarding a complex matter of professional judgment, specifically whether new GAAP guidance should be applied retroactively to change the amortization periods under existing contracts, or only on a prospective basis."[78] HI's price did not decline following news related to the Plaintiffs' theory of

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[75] "Household International Certifies Accuracy of SEC Filings in 2002," *PR Newswire*, August 14, 2002, at 7:28 A.M.

[76] Arthur Andersen Memorandum, page 2.

[77] The Restatement pertained to three contracts: (1) a co-branding Agreement with GM Motors entered into on April 14, 1992, (2) a credit card affinity relationship with AFL-CIO and Union Privilege entered into on June 14, 1996, and (3) a marketing agreement with Kessler Financial Services entered into in June 1996. [Source: Kuska, Alan, and William Long, "Accounting Treatment – GM Card Arrangement," *KPMG*, August, 2002, (HI KPMG 025789 - HI KPMG 025801); Long, William, "Accounting Treatment - AFL-CIO and UP Contracts," *KPMG*, August, 2002, (HI KPMG 025529 - HI KPMG 025541); and Kuska, Alan, and William Long, "Accounting Issue – Kessler Agreements," *KPMG*, August, 2002, (HI KPMG 025257 - HI KPMG 025270), respectively and Household International Conference Call Transcript, August 14, 2002, at 7:30 A.M. (CT), (HHE 02286136 – HHE 02286192), at HHE 02286137.]

[78] Arthur Andersen Memorandum, page 2.

Restatement. Instead, HI's stock price **increased** by 29 cents per share (or by 0.77%) following the Restatement to close at $38.09 on August 14, 2002.

The market's negligible price reaction to the Restatement is consistent with a universally-accepted economic principle, namely, "accounting changes do not fool the market."[79] In an efficient market, a stock's price at any point in time reflects investors' expectations, based on available public information at the time about the shareholder's future cash flows from the stock, and the risk associated with such cash flows. Accordingly, in an efficient market, a restatement related to expenses reported for accounting purposes in the **past** will only affect the stock's current price if it changes investors' perceptions regarding the firm's **future** cash flow prospects or the risks associated with such future cash flows. The fact that the stock price does not respond mechanically to earnings reported for accounting purposes has been well-documented in the academic literature in finance. As Professors Ross, Westerfield and Jaffe note, the "market appears efficient enough to see through different accounting choices."[80] Similarly, another standard finance text by Brealey, Myers and Allen (2006) also notes:[81]

> In an efficient market there are no financial illusions. Investors are unromantically concerned with the firm's cash flows and the portion of those cash flows to which they are entitled.

Several analysts also opined that the Restatement was "immaterial"[82] and "not significant"[83] after the facts had been "digested."[84]

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[79] Ross, Stephens A., Randolph W. Westerfield, and Jeffrey Jaffe, 2005, *Corporate Finance*, 7th Ed., New York, NY: McGraw-Hill/Irwin, Chapter 13, page 372.
[80] Ross, Stephens A., Randolph W. Westerfield, and Jeffrey Jaffe, 2005, *Corporate Finance*, 7th Ed., New York, NY: McGraw-Hill/Irwin, Chapter 13, page 372.
[81] Brealey, Myers and Allen, Chapter 13, page 352.
[82] See, *e.g.*, Hesser, Van, and Justin Ziegler, "Household Announces Earnings Restatement. While a Surprise, We Believe the Impact to be Immaterial and the Issue Largely Resolved; Reiterating Our Buy Recommendation," *Credit Suisse First Boston – Fixed Income Research*, August 14, 2002, page 1.
[83] See, *e.g.*, King, William, and Olivia Lee, "Household, Earnings Restatement Not Significant," *UBS Warburg - Fixed Income Research*, August 15, 2002, page 1.
[84] See, *e.g.*, King, William, and Olivia Lee, "Household, Earnings Restatement Not Significant," *UBS Warburg - Fixed Income Research*, August 15, 2002, page 1.

For instance, Credit Suisse First Boston analysts re-iterated their "Strong Buy" rating and $75 price target for HI stock in a report published on August 14, 2002, noting that "the ratings agencies have all affirmed HI's ratings."[85] The same Credit Suisse First Boston analysts provided additional commentary about the Restatement in another report published on August 15, 2002. The main thesis of the second report, which also reiterated the Strong Buy and $75 price target, is succinctly expressed in the report's title: *HI: Earnings Restated--Business Unaffected.*[86]

A Moody's Investor Service Press Release on August 14, 2002 also noted that they expected the direct financial impact to be "small":[87]

> In Moody's opinion, the accounting changes and cumulative restatements do not represent a systemic breakdown in Household's accounting policies or controls, or corporate governance. On a go-forward basis, the direct financial impact on Household will likely be small.

According to Professor Fischel, analysts at Morgan Stanley and CIBC World Markets reduced their earnings forecasts and price targets for HI stock following the Restatement.[88] Professor Fischel, however, fails 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. Thus, while it is logical that such a Restatement may affect reported earnings in the short-run, the economic value of the firm depends on the present value of its future expected free cash flows in the short-term as well as the long-term horizons. A minor shifting of future income recognition need not affect the economic value of the firm.

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[85] Orenbuch, Moshe, Michael Hecht, Douglas Harter, and Kerry Hueston, "HI: Restating Earnings," *Credit Suisse First Boston - Equity Research*, August 14, 2002, at 1:17 P.M. (EDT), page 1.
[86] Orenbuch, Moshe, Michael Hecht, Douglas Harter, and Kerry Hueston, "HI: Earnings Restated--Business Unaffected," *Credit Suisse First Boston - Equity Research*, August 15, 2002.
[87] "Moody's Affirms the Ratings of Household International, Inc. and Its Rated Subsidiaries, Including Household Finance Corporation," *Moody's Investor Service Press Release*, August 14, 2002, page 1.
[88] Fischel Report, paragraph 27.

The Morgan Stanley report that Professor Fischel has cited states:[89, 90]

> With over 40% upside to the new price target, Household remains one of 3 Overweight-rated stocks in our specialty finance coverage group, which we rate as "In-Line." The restatement was required by KPMG, Household's new auditors, and has to do with the speed at which credit card marketing agreements have been amortized since the early 1990s. **There is no change to our 5-year EPS growth forecast of 8%.** [Emphasis added.]
>
> Most important, we don't see any negative implications for our investment thesis, namely the view that the shares adequately discount a number of legal and regulatory risk factors, but do not reflect the strong growth dynamics of the company's core subprime lending business.

Similarly, another Morgan Stanley report, published on the day of the Restatement by analyst Susan Berliner, stated that "Household's restatement does not materially affect future earnings, and the company has not changed guidance."[91] Ms. Berliner further noted that:[92]

> All 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.

Professor Fischel has also cited a CIBC analyst report by Jennifer Scutti and Barrie Stesis which lowered its price target for HI.[93] Professor Fischel fails to mention that the same report noted:[94]

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[89] Fischel Report, paragraph 27 and Exhibit 43.
[90] Posner, Kenneth A., and Athina L. Meehan, "Household International: Price Target to $53 on Earnings Restatement, Part 1," *Morgan Stanley - Equity Research*, August 15, 2002, at 9:07 A.M. (EDT), page 2.
[91] Berliner, Susan, "Household International: Reaction to Restatement," *Morgan Stanley - Fixed Income Research*, August 14, 2002, page 1.
[92] Berliner, Susan, "Household International: Reaction to Restatement," *Morgan Stanley - Fixed Income Research*, August 14, 2002, page 1.
[93] Fischel Report, paragraph 27 and Exhibit 44.
[94] Scutti, Jennifer, and Barrie Stesis, "Household International, Restates EPS On Accounting Revisions Related To Old Credit Card Contracts," *CIBC World Markets - Equity Research*, August 14, 2002, page 3.

> … the company had been in compliance with its previous auditors and has only made the change given the replacement of Arthur Anderson with KPMG. As a result, the implication is that the company did not "cook" the books or intentionally falsify earnings, but rather has made the adjustment related to a difference of opinion between auditing firms. As a result, we have maintained our Buy rating on the stock, because the fundamental outlook continues to be healthy.

In addition, this CIBC report stated that:[95]

> Although we have lowered our earnings estimates, we believe the fundamental outlook for the company remains strong, particularly given the ongoing low interest-rate environment and refinancing activity. As a result, we have maintained our Buy rating on the stock.

Professor Fischel fails to note that the Morgan Stanley and CIBC reports he cites both projected price targets that were significantly higher than HI's closing price of $38.09 on August 14, 2002.[96]

Professor Fischel notes that analysts' commentary about HI's Restatement continued the following day (August 15, 2002).[97] Also that day, shortly before close of trading, the Association of Community Organization for Reform Now ("ACORN") announced another lawsuit against HI in Massachusetts[98] alleging, among other things, that the Company was engaged in "predatory lending" practices.[99] Professor Fischel ignores this news article and erroneously cites a later article on August 16, 2002 (which is one of his 14 Specific Disclosure dates) as the release of news of this ACORN lawsuit.[100] HI's market price reaction to

[95] Scutti, Jennifer, and Barrie Stesis, "Household International, Restates EPS On Accounting Revisions Related To Old Credit Card Contracts," *CIBC World Markets - Equity Research*, August 14, 2002, page 2.
[96] The Morgan Stanley and the CIBC price targets were 39% and 50% higher, respectively, than HI's closing price on August 14, 2002.
[97] Fischel Report, paragraph 27.
[98] As I discuss later, ACORN had earlier filed similar lawsuits against HI in other states.
[99] Pope, Justin, "Community Group Files Lawsuit Alleging Predatory Lending," *Associated Press Newswires*, August 15, 2002, at 3:53 P.M.
[100] Fischel Report, paragraph 15.

both the Restatement as well as the news of the ACORN lawsuit, was not statistically significant (See Exhibit 7, Panel A).[101]

B. Professor Fischel Fails To Establish That Re-aging Was Value-Relevant And That It Ever Caused HI's Stock Price To Be Inflated

Plaintiffs allege that Defendants "improperly 'reaged' or 'restructured' delinquent accounts, thereby manipulating Household's publicly reported financial statistics regarding delinquencies and credit loss reserve ratios so as to make Household's operations appear stronger and more profitable than they were" during the Class Period.[102] Such an assertion is counter-factual and inconsistent with economic principles, as I discuss below.

The Company, like other major lenders,[103] employed a re-aging policy, *i.e.,* restructured certain delinquent loans.[104] This practice is common in the consumer finance industry, "particularly when dealing with subprime borrowers, and allows the lender to work with customers facing financial difficulty in order to preserve

[101] That is, an indicator variable that is assigned a value of 1 on August 14, 2002 and August 15, 2002 and 0 on all other dates is statistically insignificant at the 95% confidence level in a two-tailed test when it is included as an explanatory variable in the regression model described in Exhibit 7 (Panel A).
[102] Complaint, paragraph 2.
[103] Household's comparables (*e.g.,* Capital One Financial Corp and MBNA Corp) were also re-aging certain delinquent loans and alluded to their re-aging policies in their SEC filings. [Source: Capital One Financial Corp SEC Form 10-K filing for the fiscal year ended December 31, 2001, filed March 22, 2002 and MBNA Corp SEC Form 10-K filing for the fiscal year ended December 31, 2001, filed March 22, 2002.]
[104] Re-aging refers to resetting the status of a contractually delinquent account to current, subject to certain limits.

customer relationships and ultimately maximize collections."[105,106] As a Prudential Securities analyst noted:[107]

> The intention of re-aging is not to defer credit losses, but to get customers through a challenging period ("bumps in the road"). This is consistent with HI's customer value proposition — including pricing that runs 300-400 basis points above comparable bank rates.

A Merrill Lynch analyst report also stated that HI's "accounting is a lot more transparent than most of the companies we follow, and there have been no changes in accounting policy."[108]

The Company has always adequately reserved for its credit losses and never been required to restate its loan quality metrics or to increase its credit reserves because of its re-aging policy.[109] Professor Fischel's analysis does not provide any support for the claim that HI ever "misrepresented and manipulated defaults and delinquencies"[110] which would have misled investors to value HI's stock at an artificially high price. KPMG, the Company's auditor noted that it "did not encounter evidence that policies benchmarked [were] designed or applied to manipulate or delay recognition of losses."[111] [Bracketed text added.] Re-aging was simply a business tool available to the firm to maximize its collections.

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105 Arthur Andersen Memorandum, page 10.
106 During the conference call on April 9, 2002, Mr. Schoenholz said: "I think our preference would be never to re-age accounts. But the reality is our customers in the finance company world are sometimes sloppy payers. I mean, they are not the most pristine discipline in terms of some of their credit. And so to them our re-age policies are an integral part of the value proposition that we offer them and they pay for that." [Source: Household International Conference Call Transcript, April 9, 2002, at 8:15 A.M. (CT), (HHS 03106482 – HHS 03106612), at HHS03106501.]
107 Ball, Bradley, Edwin G. Groshans, and William C. Keaten, "HI: Fundamentals Are Fine in Our View–Raising Estimates: Yet, We Believe Political/Headline Issues Remain–Lowering Target," *Prudential Securities, Inc.*, April 10, 2002, at 7:56 A.M. (EDT), page 3.
108 Hughes, Michael R., "Household International Inc (HI/NYSE) - Articles Stretch the Truth, Parts 2," *Merrill Lynch – Global Securities Research*, December 3, 2001, at 12:09 P.M. (EST), page 2.
109 Deposition testimony of William Long of KPMG, August 9, 2006, 123:10 to 124:1.
110 Fischel Report, paragraph 10.
111 "KPMG Report on Accounting and Credit Policies," March 12, 2002 (HI KPMG 031680 – HI KPMG 031694), at HI KPMG 031684.

Professor Fischel adopts the Plaintiffs' claim that HI's stock price was inflated as a result of the Company's re-aging practices, without considering the above facts that contradict his conclusions. His conclusions about the Specific Disclosure dates related to the Plaintiffs' theory of Re-aging are counter-factual and are based on his selective and incomplete analysis of contemporaneous events as I discuss in the following section.

1. Professor Fischel Identifies 7 Dates Related To Plaintiffs' Theory Of Re-Aging Out Of Which Only 3 Are Purportedly "Significant," Even According To His Own Flawed Analysis

Professor Fischel discusses 7 dates[112] that are related to the Plaintiffs' theory of Re-aging and conducts an event study that attempts to "take into account the effect of market factors on [HI's] stock price returns."[113] [Bracketed text added.] He finds that HI's stock price movement was statistically significant on only 3 of the above 7 dates (December 3, 2001, December 5, 2001 and December 12, 2001)[114] and uses HI's market-adjusted price changes on these dates in calculating alleged artificial inflation in his Specific Disclosures model. According to Professor Fischel, HI's stock price "declined significantly in response to disclosures"[115] related to the Plaintiffs' theory of Re-aging on December 3, 2001 and December 12, 2001 and "increased significantly"[116] on December 5, 2001 following "Aldinger's rejoinder to the December 1, 2001 Barron's article."[117]

As I discuss in Section VII, Professor Fischel's event study methodology is severely flawed and results in flawed and unreliable conclusions. In particular, Professor Fischel's methodology does not properly account for contemporaneous

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[112] These 7 dates are December 1, 2001, December 5, 2001, December 11, 2001, April 9, 2002, April 10, 2002, June 7, 2002, and August 19, 2002. Professor Fischel recognizes that events on December 1, 2001 and December 11, 2001 occurred after trading hours and attributes HI's stock price reaction on December 3, 2001 and December 12, 2001 to these 2 events, respectively.
[113] Fischel Report, paragraph 32.
[114] The remaining 4 dates (April 9, 2002, April 10, 2002, June 7, 2002, and August 19, 2002) are not statistically significant according to Professor Fischel's Event Study. [Source: Fischel Report, Exhibit 49.]
[115] Fischel Report, paragraph 34.
[116] Fischel Report, paragraph 35.
[117] Fischel Report, paragraph 35.

"changes in the performance of a market index (and possibly an industry index)"[118] that could explain HI's stock return on specific days. My analysis reveals that none of the 7 dates (including his 3 Specific Disclosure dates) that Professor Fischel identifies as related to the Plaintiffs' theory of Re-aging are statistically significant (See Exhibit 8).

Through his incomplete and selective review of the facts pertaining to the Specific Disclosure dates related to the Plaintiffs' theory of Re-aging, Professor Fischel has also failed to establish loss causation, *i.e.,* he has failed to establish a causal connection between the purported fraud and HI's price decline on the dates of such disclosures.

2. Professor Fischel's Analysis Of The Purportedly "Significant" Re-Aging Related Disclosure Dates Is Incorrect Because It Is Based On A Selective And Incomplete Review Of The Facts

i. December 3, 2001: The Barron's Article That Professor Fischel Cites Was Based On An Analyst Report Published More Than 6 Weeks Earlier

The Fischel Report attributes HI's stock price movement on this day to a *Barron's* article published on Saturday, December 1, 2001.[119] However, several analysts had noted that the *Barron's* article (and another published in *Business Week*[120] the same weekend) had "bashed Household on accounting issues, almost all of which have been aired before and most of which are inaccurate."[121] A Bear Stearns report published before the market opened on December 3, 2001 noted:[122]

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[118] Fischel Report, paragraph 32.

[119] Laing, Jonathan R., "Does It Add Up? A Look At Household's Accounting," *Barron's*, December 1, 2001 (HI KPMG 031437 – HI KPMG 031446).

[120] Timmons, Heather, "Do Household's Numbers Add Up? The Lender's Accounting Methods Raise Some Questions," *BusinessWeek*, December 10, 2001. I understand that the date stamp on the article is December 10, 2001 while analysts referred to this article as being available to the investors and the public over the weekend of December 1, 2001.

[121] Alpert, Mark C., Randolf St. Leger, and Garrett T. Swanberg, "Household International Inc. (HI) 'Strong Buy' – Ridiculous Bashing by Barron's," *Deutsche Banc Alex. Brown Inc.*, December 3, 2001, page 1.

[122] Hochstim, David, and Scott R. Coren, "Household International* (HI $58.99) – Buy, Is the Biggest Risk in Sub-Prime Lending Headline Risk? Another Wave of Criticism, Part 1," *Bear Stearns & Co., Inc. - Equity Research*, December 3, 2001, 8:16 A.M. (EST), page 2.

> In the fine tradition of US business reporting, two magazines [*Barron's* and *Business Week*] published articles over the weekend that criticize accounting changes made at Household three and five years ago. The articles rehash old news, but with a twist - they include several significant factual errors in their efforts to create controversy. [Bracketed text added.]

The analysts noted that the sections of the *Barron's* article that were critical of HI were "based mostly on the views of one bearish analyst,"[123] William Ryan of Ventana Capital, a "short-selling boutique"[124] firm. Notably, Professor Fischel ignores the fact that Mr. Ryan's negative opinion of HI's re-aging practices had been publicly known for more than 6 weeks. Mr. Ryan had initiated coverage on HI with a "sell" recommendation on October 12, 2001 and published a second report on October 18, 2001, which was largely reprinted in the *Barron's* article that Professor Fischel has cited.[125,126] Thus, the *Barron's* article did not provide any new information to the market. Hence, Professor Fischel's assertion that the purported re-aging related disclosure in the *Barron's* article[127] caused HI's stock price decline on Monday, December 3, 2001[128] contradicts his central premise that HI's stock traded in an efficient market. In an efficient market, such a

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[123] Hughes, Michael R., "Household International Inc (HI/NYSE) - Articles Stretch the Truth, Part 1," *Merrill Lynch - Global Securities Research*, December 3, 2001, at 12:09 P.M. (EST), page 2.

[124] Alpert, Mark C., Randolf St. Leger, and Garrett T. Swanberg, "Household International Inc. (HI) 'Strong Buy' – Ridiculous Bashing by Barron's," *Deutsche Banc Alex. Brown Inc.*, December 3, 2001, page 1.

[125] Ryan, William, "This Trend is Not Your Friend - Initiating Coverage of Household International With a Sell Rating," *Ventana Capital*, October 12, 2001; and Ryan, William, "Household International (HI-$58-Sell), When the Going Gets Tough... The Accounting Department Gets Going," *Ventana Capital*, October 18, 2001 (henceforth the "Ryan Reports").

[126] Additionally, Professor Fischel fails to note that Mr. Ryan's comments reported in the *Barron's* article he has cited were not considered entirely impartial. First, *Ventana Capital* was a "short-selling boutique" firm. Short-selling is a trading strategy that results in profits only if the stock price declines after the short-sale is executed. Second, the *Barron's* article itself had noted that "there's been some bad blood between Ryan and the company in recent years, dating from when he toiled as a consumer-finance analyst at Prudential and later Salomon Smith Barney." [Source: Laing, Jonathan R., "Does It Add Up? A Look At Household's Accounting," *Barron's*, December 1, 2001 (HI KPMG 031437 – HI KPMG 031446) at HI KPMG 031441.]

[127] Fischel Report, footnote 9 and paragraph 22.

[128] Monday, December 3, 2001 was the first trading day following the so-called disclosure in the *Barron's* article on December 1, 2001.

"rehash [of] old news"[129] that is also incorrect, is not value-relevant, *i.e.,* does not affect the "financial community's best estimate of the present value of … [the firm's future] prospects."[130] [Bracketed text added.]

Professor Fischel also ignores the fact that HI's price had not changed significantly following publication of the Ryan Reports, indicating that Mr. Ryan's remarks were not considered value-relevant.[131] HI's price reaction to the Ryan Reports is not surprising because, like the *Barron*'s article that Professor Fischel has cited, these reports also did not provide any new information to the market. Instead, Mr. Ryan's critique of HI's re-aging practice was explicitly based solely on a review of the Company's prior **public** filings over the past five years.[132]

Additionally, Professor Fischel fails to note that HI's stock price decline on December 3, 2001 coincided with Enron's filing for Chapter 11 bankruptcy protection.[133,134] The implosion of Enron, once one of the world's largest

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[129] Hochstim, David, and Scott R. Coren, "Household International* (HI $58.99) – Buy, Is the Biggest Risk in Sub-Prime Lending Headline Risk? Another Wave of Criticism, Part 1," *Bear Stearns & Co., Inc. - Equity Research*, December 3, 2001, at 8:16 A.M. (EST), page 2.

[130] Fischel Report, paragraph 31.

[131] The Ryan Reports are not time-stamped. Therefore, to account for the possibility that these reports were released after trading hours on October 12, 2001 and October 18, 2001, I analyzed Household's price reaction on these two dates as well as on the next trading day, *i.e.,* on October 12, 2001 and October 15, 2001, and on October 18, 2001 and October 19, 2001. HI's stock price change was statistically insignificant.

[132] The October 18, 2001 analyst report from Mr. Ryan provides discussion of Household's "accounting changes" starting from 1996 based on public filings including 10-Ks, 10-Q's, annual reports, and securitization documents. [Source: Ryan, William, "Household International (HI-$58-Sell), When the Going Gets Tough… The Accounting Department Gets Going," *Ventana Capital*, October 18, 2001, page 1.]

[133] *PR Newswire* reported on Sunday, December 2, 2001, that Enron announced "that it along with certain of its subsidiaries have filed voluntary petitions for Chapter 11 reorganization with the U.S. Bankruptcy Court for the Southern District of New York." [Source: "Enron Files Voluntary Petitions for Chapter 11 Reorganization; Sues Dynegy for Breach of Contract, Seeking Damages of At Least $10 Billion," *PR Newswire*, December 2, 2001, at 3:41 P.M.]

[134] Additionally, *The Wall Street Journal* reported that "Dow Jones Indexes said Xcel Energy Inc. will replace Enron Corp. in the utilities sector of the Dow Jones Sector Titans Indexes, effective today. At the same time, FirstEnergy Corp. will replace Enron in the 15-stock Dow Jones Utility Average." [Source: "Enron Is Replaced in Indexes," *The Wall Street Journal*, December 3, 2001.]

electricity and natural gas traders, and a Fortune 100 corporation,[135] was attributed to accounting fraud of unprecedented proportions that caused significant turmoil in the financial markets. In the post-Enron world the "market ... [became] extremely emotional and sensitive"[136] to any allegations of questionable accounting. [Bracketed text added.] Professor Fischel fails to reject (or even consider) the possibility that any negative impact that the *Barron's* article may have had on HI's stock price cannot be attributed to the alleged fraud because the article adversely affected investors' expectations in a post-Enron world for non-fraud related reasons. As a Merrill Lynch analyst noted on December 3, 2001, the *Barron's* article was based on "some fairly nasty comments without much backup based mostly on the views of one bearish analyst"[137] even though "there have been no accounting changes at Household for several years."[138]

ii. December 5, 2001: Professor Fischel Incorrectly Attributes HI's Positive Stock Price Movement On This Day To Aldinger's Presentation That Occurred During Trading Hours On The Previous Day

Professor Fischel claims that HI's "price increased significantly [on December 5, 2001] in response to Defendant Aldinger's rejoinder [at a conference on Tuesday, December 4, 2001] to the December 1, 2001 *Barron's* article."[139,140] [Bracketed text added.] Such a claim contradicts the principle of market efficiency.

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[135] See, *e.g.*, "FORTUNE 5 Hundred Index," *Fortune*, April 16, 2001.

[136] See, *e.g.*, Alpert, Mark C., Randolf St. Leger, and Garrett T. Swanberg, "Household International Inc. (HI) 'Strong Buy' - Unsubstantiated Claims Continue to Haunt Stock," *Deutsche Banc Alex. Brown Inc.*, February 7, 2002, page 2.

[137] Hughes, Michael R., "Household International Inc (HI/NYSE) - Articles Stretch The Truth, Part 1," *Merrill Lynch - Global Securities Research*, December 3, 2001, at 12:09 P.M. (EST), page 2.

[138] Hughes, Michael R., "Household International Inc (HI/NYSE) - Articles Stretch The Truth, Part 1," *Merrill Lynch - Global Securities Research*, December 3, 2001, at 12:09 P.M. (EST), page 1.

[139] Fischel Report, paragraph 35.

[140] Professor Fischel cites an *American Banker* article published on December 5, 2001 in this connection. This article reported that "the chairman and chief executive of Household International stepped forward Tuesday [December 4, 2001] with a rebuttal of accusations that his consumer finance company is playing accounting tricks to mask bad loans." [Bracketed text added.] [Source: Fischel Report, Exhibit 37.]

Mr. Aldinger's presentation at the Goldman Sachs conference on Tuesday, December 4, 2001 was scheduled to begin at 2:30 P.M. and end by 3:20 P.M. (EST) on Tuesday, December 4, 2001.[141] HI's stock price **declined** marginally following Mr. Aldinger's presentation, from $58.25 at 3:20 P.M. to $58.23 by the close of trading on December 4, 2001.[142] HI's close-to-close return on December 4, 2001 was not statistically significant. That is, contrary to Professor Fischel's claim, HI's stock price did not increase following Mr. Aldinger's "rejoinder."[143]

Even if we were to incorrectly assume that Mr. Aldinger's "rejoinder" resulted in alleged inflation being introduced into HI's stock price on December 4, 2001, Professor Fischel never explains how Plaintiffs were "harmed" as a consequence because he never identifies when such incremental inflation related to the Plaintiffs' theory of Re-aging (introduced on December 4, 2001) was subsequently removed from HI's stock price.

Professor Fischel ignores the fact that by December 5, 2001, several analysts had recognized that the December 1, 2001 *Barron's* article he has cited only provided the market with stale information as discussed earlier. Moreover, on December 4, 2001, Mr. Aldinger reiterated comments that analysts had already made earlier.[144] Therefore, Professor Fischel's claim that HI's stock price increase on December 5, 2001 can be attributed to Mr. Aldinger's rejoinder to the *Barron's* article the previous day contradicts the principle of market efficiency upon which he relies.

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[141] "Household International to Present at Goldman Sachs Conference," *PR Newswire*, November 29, 2001 at 12:28 P.M.
[142] Trade and Quotes ("TAQ").
[143] Fischel Report, paragraph 35.
[144] For example, Mr. Aldinger noted that "no significant changes [had been] made since 1996" to the Company's charge-off policies, which were "appropriate for our target market and result in proper loss recognition." [Bracketed text added.] [Aldinger, William, Goldman Sachs Presentation, December 4, 2001, (HHS 03115452 - HHS 03115473), at HHS 03115472.] On December 3, 2001, UBS Warburg analyst John McDonald had similarly commented that "Household's practices appear in compliance with relevant accounting standards, and have been fully disclosed and uniformly applied since 1996." [Source: McDonald, John E., and Richard Amland, "Household: A First Look at Accounting Practices," *UBS Warburg*, December 3, 2001, at 3:49 P.M. (EST), page 1.]

Professor Fischel fails to consider another non-fraud explanation for HI's stock price increase on December 5, 2001, *i.e.,* in his presentation the previous day which Professor Fischel has referenced, Mr. Aldinger had also discussed various factors that had "enabled Household to deliver favorable credit performance in a difficult economic environment"[145] and re-affirmed earnings growth forecasts for the Company. HI's price reaction to such positive remarks by HI's CEO cannot be attributed to the alleged fraud because neither Plaintiffs nor Professor Fischel have alleged that such remarks about the Company's future prospects by Mr. Aldinger were materially false.

iii. December 12, 2001: The Information From The Legg Mason Analyst Report Cited By Professor Fischel Was Available To The Market During Trading Hours On December 11, 2001

Professor Fischel notes that on December 11, 2001, "Legg Mason issued a report in which its analysts expressed their confusion regarding certain of the disclosures in the Company's reports concerning its accounting, in particular its re-aging policies."[146] The Legg Mason report that Professor Fischel has cited was published at 6:04 P.M. (EST) on December 11, 2001.[147] Professor Fischel asserts that HI's stock price declined significantly the following day (December 12, 2001) "as analysts reassessed the risks of investing in the Company's stock due to the alleged fraud, including following the publication of the December 11, 2001 Legg Mason report regarding Household's re-aging policies."[148]

Such a claim again reflects the selective nature of Professor Fischel's analysis and contradicts the principle of market efficiency. The same Legg Mason analysts, David Sochol and Chris Brendler, had published at least two other reports during

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[145] McDonald, John E., and Richard Amland, "Household: Management Remains Confident in Outlook, Part 1," *UBS Warburg*, December 5, 2001 at 5:58 A.M. (EST), page 1.
[146] Fischel Report, paragraph 23.
[147] Fischel Report, Exhibit 38.
[148] Fischel Report, paragraph 34.

trading hours on December 11, 2001.[149] In a report published within two hours of the market open at 10:50 A.M. (EST) on December 11, 2001, Mr. Sochol and Mr. Brendler had raised the same questions about HI's purportedly "lenient" re-aging policy and sought further disclosures on the issue from the Company, and had already increased HI's risk rating and lowered its recommendation on the stock from "Strong Buy" to "Market Perform." HI's market-adjusted stock price change on December 11, 2001 was insignificant, even according to Professor Fischel's event study.[150] This price reaction to the Legg Mason reports published during trading hours on December 11, 2001 is not surprising because these reports unearthed no new information about the Company's re-aging policies.

Professor Fischel's analysis again contradicts the principle of market efficiency because he attributes HI's stock price change on December 12, 2001 to the **third** report published by Legg Mason on December 11, 2001, even though this report largely repeated comments from the same analysts made in reports published earlier the same day. By doing so, Professor Fischel ignores the fact that HI's stock price change on December 11, 2001 was statistically insignificant on a market-adjusted basis, which suggests that remarks in the Legg Mason report were not considered value-relevant by the market.

3. In His Selective Review Of Events, Professor Fischel Ignores HI's Stock Price Reaction On Dates When The Company Disclosed New Details About Its Re-Aging Policies, Which Also Suggest That The Re-Aging Was Value-Irrelevant

Professor Fischel ignores HI's stock price change on dates when the Company disclosed new details about its re-aging policies in response to questions raised by certain analysts and in the media. By doing so, he presents a misleading

[149] Sochol, David B., and Chris Brendler, "HI: Downgrading Rating to Market Performance," *Legg Mason Wood Walker, Inc.*, December 11, 2001, at 10:50 A.M. (EST); Sochol, David B., and Chris Brendler, "HI: Downgrading Rating to Market Performance; Part 2," *Legg Mason Wood Walker, Inc.*, December 11, 2001, at 1:15 P.M. (EST).

[150] According to Professor Fischel's event study, the residual return on this day was -2.20% with a t-statistic of -1.59. [Source: Fischel Report, Exhibit 49.]

conclusion about the value-relevance of the allegations related to the Plaintiffs' theory of Re-aging.

i. April 9, 2002: Professor Fischel Fails To Consider Household's Price Reaction On A Day When Household Hosted A Conference In Which It Provided Additional Details Regarding Its Re-Aging Practice

Professor Fischel recognizes that Household hosted an analyst conference on April 9, 2002 where it provided additional details about its re-aging practice. The Company also submitted the same information to the SEC through a public form 8-K filing. Although Plaintiffs allege that this was the first time that the Company "broke out its reaging statistics, which revealed a huge number of accounts that had been reaged multiple times,"[151] Professor Fischel fails to examine the market response to such information. Instead, he states that "market participants did not consider the disclosures [on April 9, 2002] to be complete."[152] [Bracketed text added.] Such an unexplained claim is counter-factual and makes no economic sense. If the disclosures were considered incomplete, the market would have reacted negatively anticipating that the Company would release more bad news later (in fact failure to fully disclose would have rationally led the market to assume the worst). The Company, however, was never subsequently required to re-state any of its reported loan quality metrics or increase its loan loss reserves. HI's stock price increased by 19 cents on April 9, 2002 (a positive, but insignificant price movement of 0.32%) which suggests that the news related to the Plaintiffs' theory of Re-aging provided in this conference was value-irrelevant.

Thus, Professor Fischel fails to demonstrate that HI's stock price had ever been inflated as a result of the Company's allegedly "improper" re-aging practices.

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[151] "While Household sporadically disclosed its reaging policies, it was not until the Company filed a Form 8-K during 2Q02, on 4/9/02, that Household first broke out its reaging statistics, which revealed a huge number of accounts that had been reaged multiple times." [Source: Complaint, paragraph 123].

[152] Fischel Report, paragraph 25.

ii. March 19, 2003: Professor Fischel Fails To Consider Household's Price Reaction On The Day When Market Learned That Household Entered Into A Consent Order With SEC Without Admitting Wrongdoing

Professor Fischel mentions the SEC Cease-And-Desist Order ("SEC Order") dated March 18, 2003[153] as an instance when investors received information related to the Plaintiffs' theory of Re-aging.[154] However, he fails to examine HI's stock price reaction to the SEC Order.[155] In its press release on March 19, 2003, the Company discussed findings of the SEC Order and the commencement of "the distribution of supplemental proxy materials relating to the special meeting of Household shareholders to be held on March 28, 2003 to approve Household's merger with HSBC Holdings plc."[156] Pursuant to the SEC Order, HI was required to modify the language describing its re-aging practice in its 10-K for 2001.[157] The Company did not admit to any wrongdoing and was not required to pay any fines.[158] The SEC Order did not require a restatement of HI's consolidated

[153] It is worth noting that this SEC Order is dated well after the end of the Class Period (October 11, 2002) and also after the filing date of the Complaint (March 12, 2003).

[154] Although the SEC Order is dated March 18, 2003, there appears to be no public release of the news until the following day at 10:57 A.M. (EST). Therefore as I discuss above, I analyzed HI's price reaction to this news on March 19, 2003. I have also examined HI's price reaction on March 18, 2003. HI's stock price increased insignificantly by 4 cents (or 0.14% from $28.16 to close at $28.20). Even according to Professor Fischel's flawed event study, this price reaction was statistically insignificant. [Sources: "Order Instituting Cease-And-Desist Proceedings, Making Findings, and Imposing Cease-And-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934," *In The Matter Of Household International, Inc.*, before the Securities and Exchange Commission, Release No. 47528, File No. 3-11072, March 18, 2003 (henceforth the "SEC Order"); and "REG-HSBC Holdings PLC (HSBA.L) Household International," *Regulatory News Service*, March 19, 2003, at 10:57 A.M. (EST).]

[155] Fischel Report, paragraph 8.

[156] "Household Announces Mailing of Supplemental Proxy Material to Shareholders; Enters into Consent Order with SEC Without Admitting or Denying Wrongdoing," *Household International Press Release*, March 19, 2003.

[157] Household noted in its 2001 Annual Report that it reset delinquent loans "to current, subject to certain limits, if a predetermined number of consecutive payments has been received and there is evidence that the reason for the delinquency has been cured." Household later amended that statement to clarify that "(1) in numerous instances Household accepts one or zero payments prior to resetting the delinquency status, and (2) in many instances, we restructure delinquent accounts automatically." [Source: Household International SEC Form 10-K405 for fiscal year ended December 31, 2001, filed March 13, 2002, page 14 and Household International SEC Form 10-K/A for the fiscal year ended December 31, 2001, filed March 20, 2003, page 29.]

[158] "Household Announces Mailing of Supplemental Proxy Material to Shareholders; Enters into Consent Order with SEC Without Admitting or Denying Wrongdoing," *Household International Press Release*, March 19, 2003.

financial statements or its loan loss reserves and did not require HI to change any of its re-aging policies.[159] On March 19, 2003 (the date of the SEC Order Press Release), HI's stock price increased insignificantly by 25 cents (or 0.89% from $28.20 to close at $28.45).

C. Professor Fischel Fails To Establish That The Alleged "Predatory Lending" Fraud Ever Caused HI's Stock Price To Be Inflated

1. "Predatory Lending" Allegations Were A Source Of "Headline Risk" For All Sub-Prime Lenders

As a January 2004 study on "predatory lending" commissioned by Congress ("GAO Study") noted there was no "uniform" definition for the term "subprime" lending.[160] While the term generally referred to borrowers with "credit scores that are below a certain threshold," such a "threshold can vary according to the policies of the individual lender."[161] Similarly, the GAO Study noted that:[162]

> While **there is no universally accepted definition**, the term "predatory lending" is used to characterize a range of practices, including deception, fraud, or manipulation, that a mortgage broker or lender may use to make a loan with terms that are disadvantageous to the borrower. [Emphasis added.]

The GAO Study also recognized that: [163]

> Predatory lending is difficult to define partly because certain loan attributes may or may not be abusive, depending on the overall context of the loan and the borrower. For example, although prepayment penalties can be abusive in the context of some loans, in the context of other loans they can benefit borrowers by reducing the overall cost of loans by reducing the lender's prepayment risk.

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[159] Deposition testimony of William Long of KPMG, August 9, 2006, 123:10 to 124:1; and SEC Order.

[160] "Report to the Chairman and Ranking Minority Member, Special Committee on Aging, U.S. Senate: Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending," *The United States General Accounting Office*, January 2004, page 21 (henceforth the "GAO Study").

[161] GAO Study, page 21.

[162] GAO Study, cover page.

[163] GAO Study, page 19.

Mortgage loans to borrowers with relatively poor credit histories (or so-called "sub-prime" loans) grew by 228% from $65 billion in 1995 to $213 billion in 2002 and an additional 56% (to $332 billion) in 2003.[164] Several factors contributed to such growth, including changes in lending laws that permitted lenders to charge higher rates and fees on higher-risk mortgages,[165] and loans with variable interest rates and balloon mortgages.[166] Changes in the tax laws also favored the use of home equity loans to finance consumer spending.[167] As interest rates declined in the 1990s and early 2000s, borrowers with large home equity began cashing out such equity using sub-prime real-estate secured loans. Such "cash-out refinancing" accounted for over half of sub-prime loan originations.

According to the GAO Study, "banking regulators, consumer advocates, and industry participants generally agree[d] that predatory loans are most likely to occur in the market for 'subprime' loans."[168] [Bracketed text added.] Thus, as the sub-prime lending segment of the market grew rapidly so did allegations about "predatory lending" practices associated with a small minority of such loans. According to Plaintiffs' expert, Ms. Catherine A. Ghiglieri, " 'Predatory lending' came into focus in the early 1990's."[169] However, as the GAO Study noted, "subprime lending is not inherently abusive, and certainly all subprime loans are not predatory."[170]

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[164] Fed Study, Table 3 which is based on data provided by *Inside B&C Lending*.
[165] For instance, the 1980 Depository Institutions Deregulation and Monetary Control Act ("DIDMCA") eliminated state usury laws (unless such laws were re-introduced by the states) and permitted lenders to charge high rates and fees, which was not possible previously. [Source: Fed Study, page 38.]
[166] Such mortgages were permitted after the enactment of the Alternative Mortgage Transaction Parity Act ("AMTPA") in 1982. [Source: Fed Study, page 38.]
[167] The Tax Reform Act of 1986 prohibited borrowers from deducting their interest expenses on consumer loans from taxable income, but mortgage interest expenses remained tax-deductible. [Source: Fed Study, page 38.]
[168] GAO Study, page 4.
[169] Expert Witness Report of Catherine A. Ghiglieri, *Lawrence E. Jaffe Pension Plan, On Behalf of Itself and All Others Similarly Situated, vs. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, August 15, 2007, page 15 (henceforth the "Ghiglieri Report").
[170] GAO Study, page 21.

The GAO Study further recognized that the "emergence of a subprime mortgage market has enabled a whole class of credit-impaired borrowers to buy homes or access the equity in their homes"[171] and that:[172]

> Originating lenders charge higher interest rates and fees for subprime loans than they do for prime loans to compensate for increased risks and for higher servicing and origination costs. In many cases, increased risks and costs justify the additional cost of the loan to the borrower, but in some cases they may not. Because subprime loans involve a greater variety and complexity of risks, they are not the uniformly priced commodities that prime loans generally are. This lack of uniformity makes comparing the costs of subprime loans difficult, which can increase borrowers' vulnerability to abuse.

The regulatory environment governing "predatory lending" was complex and ill-defined. Regulatory changes accompanied the growing public attention on the issue of "predatory lending." As the Ghiglieri Report notes, the Home Ownership and Equity Protection Act ("HOEPA") was enacted in 1994, five years before the Class Period started. The GAO Study noted that HOEPA was the only federal law[173] at the time that was "specifically designed to combat predatory lending."[174,175]

Regulatory attention continued to be focused on "predatory lending" even after the enactment of HOEPA. The Ghiglieri Report provides a detailed description of the regulatory changes that were being introduced in the late 1990s and into the

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[171] GAO Study, page 22.
[172] GAO Study, page 21.
[173] Home Ownership and Equity Protection Act was an amendment to the Truth in Lending Act (TILA). [Source: GAO Study, page 4.]
[174] GAO Study, cover page.
[175] Federal agencies such as the Federal Trade Commission ("FTC"), the Department of Justice ("DOJ") and the Department of Housing and Urban Development ("HUD") also undertook regulatory actions to combat alleged predatory lending under other consumer protection laws such as the Federal Trade Commission Act ("FTC Act"), Truth in Lending Act ("TILA") generally, and the Real Estate Settlement Procedures Act ("RESPA"). [Source: GAO Study, pages 7-8.] In addition, "25 states, the District of Columbia, and 11 localities [had] passed their own laws addressing predatory lending" as of January 2004. [Bracketed text added.] [Source: GAO Study, page 10.]

Class Period. According to the Ghiglieri Report, such changes include, but are not limited to the following:[176]

> On March 3, 1999, [before the Class Period had started] the four federal banking agencies, the Federal Reserve, FDIC, OCC and OTS, issued "Interagency Guidance on Subprime Lending" [Bracketed text added.]
>
> ....
>
> In July 1999, North Carolina "became the first state to enact comprehensive legislation to address the abuses of predatory home mortgage lending."
>
> ....
>
> On April 5, 2000, the OTS issued an Advanced Notice of Proposed Rulemaking (ANPR) on predatory lending entitled "Responsible Alternative Mortgage Lending."
>
> ....
>
> On May 24, 2000, Ellen Seidman, Director of the OTS, testified before the U.S. House Committee on Banking and Financial Services regarding predatory lending.

In such a complex regulatory environment, alleged "predatory lending" practices became a matter of growing "headline risk", *i.e.*, the potential adverse stock price impact caused by negative publicity or adverse regulatory developments. As Plaintiffs' expert, Ms. Ghiglieri acknowledges, "Household had to resort to dealing with the media from a defensive position, as public opinion moved against it."[177]

Analysts recognized the headline risk that HI and other sub-prime lenders faced during the Class Period. For example, Bear Stearns analysts noted that "the real

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[176] Ghiglieri Report, pages 18-20.
[177] Ghiglieri Report, page 57.

risk of sub-prime lending appears to be headline risk."[178] On October 29, 2001, Salomon Smith Barney noted that, "consumer advocacy groups will continue to get attention criticizing (justly or unjustly) the practices of sub-prime lenders."[179] On November 16, 2001, a UBS Warburg analyst covering HI noted:[180]

> We believe a more immediate danger to the company's stock price stems from headline risk and association, justified or not, with predatory lending.

Through its SEC filings, Household had disclosed the risks stemming from the uncertain regulatory environment concerning lending practices. For instance, Household described this complex regulatory environment and the associated risks in its 10-K filing with the SEC for the fiscal year ended December 31, 2001:[181]

> Our consumer finance businesses operate in a highly regulated environment. These businesses are subject to laws relating to discrimination in extending credit, use of credit reports, privacy matters, disclosure of credit terms and correction of billing errors. They also are subject to certain regulations and legislation that limit their operations in certain jurisdictions.
>
> ...There has been a significant amount of legislative activity, nationally, locally and at the state level, aimed at curbing lending abuses deemed to be "predatory". A predatory loan or lending practice is not a legally defined term and does not have a commonly recognized definition...Household does not condone or endorse any of these practices. We are working with regulators and consumer groups to create appropriate safeguards to eliminate these abusive practices while allowing middle-market borrowers to continue to have unrestricted access to credit for personal purposes, such as the purchase of homes, automobiles, and consumer goods. As part of this effort we have adopted a set of

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[178] Hochstim, David, and Scott R. Coren, "Household International* (HI $58.99) – Buy, Is the Biggest Risk in Sub-Prime Lending Headline Risk? Another Wave of Criticism, Part 1," *Bear Stearns & Co., Inc. - Equity Research*, December 3, 2001, at 8:16 A.M. (EST), page 2.
[179] Vetto, Matthew L., Sonia Parechanian, and Sanjay Sakhrani, "HI: Initiating Coverage With Outperform Rating (Part 2 of 2)," *Salomon Smith Barney*, October 29, 2001, at 4:18 P.M. (EST), page 1.
[180] McDonald, John, "HI: California Files $8.5 Million Lawsuit, Cites Unlawful Charges," *UBS Warburg*, November 16, 2001, at 1:13 P.M. (EST), page 2.
[181] Household International SEC Form 10-K405 for the fiscal year ended December 31, 2001, filed March 13, 2002, pages 8-9.

> lending best practice initiatives. … Notwithstanding these efforts, it is possible that broad legislative initiatives will be passed which will impose additional costs and rules on our businesses. Although we have the ability to react quickly to new laws and regulations, it is too early to estimate the effect, if any, these activities will have on us in a particular locality or nationally.

In addition, HI's 10-K filings during the Class Period also noted that the Company was a party to "various legal proceedings," certain of which "purport to be class actions seeking damages in very large amounts" and "due to the uncertainties in litigation and other factors, [the Company] cannot assure [investors] that [it] will ultimately prevail in each instance."[182] [Bracketed text added.]

The Fischel Report ignores such disclosures by the Company but selectively cites Household's 10-K form filed on March 13, 2002:[183]

> Household has [] been named in purported class actions by consumer groups (such as AARP and ACORN) claiming that our loan products or our lending policies and practices are unfair or misleading to consumers. We do not believe that any of these legal actions has merit or will result in a material financial impact on Household.
>
> … we do not believe, and we are not aware of, any unaddressed systemic issue affecting our compliance with any state or federal lending laws within any of our businesses.

Professor Fischel claims that the above excerpt represented a denial of "predatory lending" allegations by the Company.[184] Professor Fischel does not explain why he presumes that HI was a predatory lender, nor why he assumes that the "company's denials" were incorrect. Moreover, Professor Fischel does not explain how any alleged misstatements or omissions about the Company's

[182] Household International SEC Form 10-K for years ended December 31, 1999, December 31, 2000, December 31, 2001, and December 31, 2002.
[183] Fischel Report, paragraph 17.
[184] Fischel Report, paragraph 17.

lending practices by the Defendants resulted in HI's stock price becoming inflated.

Professor Fischel also fails to consider non-fraud related reasons, such as headline risk associated with "predatory lending" allegations, that could explain HI's stock price changes on dates he identifies as disclosures related to Plaintiffs' theory of "Predatory Lending." Investors were well-aware of "predatory lending" allegations against HI and other sub-prime lenders throughout the Class Period and even earlier. As Household disclosed, the outcome of such allegations was "unpredictable" given the unstable regulatory environment and the "judicial climate."[185] New allegations (even if unproven) or regulatory proposals (albeit unfinalized) heightened uncertainty about the ultimate costs that lenders may have to bear to resolve such issues, and thus exacerbated sub-prime lenders' headline risk.

Professor Fischel claims that HI's stock price declined when the market received information related to the Plaintiffs' theory of "Predatory Lending." As I discuss in the next subsection, Professor Fischel's selection of such "disclosure dates" is based on a selective and incomplete review of the facts. Moreover, his analysis fails to establish loss causation for at least two reasons.

First, as I have discussed earlier, Professor Fischel has failed to provide any support for the claim that HI's stock price was ever artificially inflated because the Company knew, but failed to publicly disclose its anticipated future costs associated with settling allegations of "predatory lending" or complying with future regulations.

Second, Professor Fischel fails to consider if the price declines that he finds to be consistent with the Plaintiffs' theory of "Predatory Lending" could also be

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[185] Household International SEC Form 10-K filing for the fiscal year ended December 31, 2001, filed March 13, 2002, page 12.

explained by non-fraud related factors. In particular, he fails to recognize that the purported "disclosures" he has 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. Any price decline caused by news that changed HI's headline risk exposure cannot be attributable to the alleged fraud.

2. Professor Fischel's Analysis Of Events Regarding The Plaintiffs' Theory Of "Predatory Lending" Is Selective, Incomplete And Misleading

Professor Fischel's analysis is selective because he identifies 34 dates[186] on which he claims that the market received information related to the Plaintiffs' theory of "Predatory Lending," but ultimately relies on HI's price changes on only 10 of these dates in calculating the alleged artificial inflation in HI's stock under his Specific Disclosures model.[187] Professor Fischel provides no explanation for selecting these 10 dates and rejecting others. Therefore, Professor Fischel's conclusion that HI's stock price change on his cherry-picked 10 dates was "in response to disclosures related to the alleged fraud" is based on an incomplete and selective review of the facts.[188] Even after he chooses these 10 Specific Disclosure dates, Professor Fischel fails to reject (or even consider) whether HI's price reaction on these dates is explained by non-fraud related factors, such as changes in economic circumstances, investor expectations, or new industry-

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[186] These 34 unique trading dates represent 42 events related to the Plaintiff's theory of "Predatory Lending" that Professor Fischel discusses in his report. (See Exhibit 3 for the list of these events.)

[187] Of the 34 dates on which Professor Fischel claims that the market received information related to the Plaintiffs' theory of "Predatory Lending," HI's stock price reaction was positive on 12 and negative on 22 dates. According to Professor Fischel's Exhibit 49, HI's market-adjusted stock price change was statistically significant on 16 of these 34 dates (the price change was significantly positive on 6 of these dates and significantly negative on the remaining 10 dates). After taking into account market and industry factors, my analysis shows that only 7 out of these 34 dates are statistically significant. However, as noted above, Professor Fischel only considers 10 (3 positively significant and 7 negatively significant) of these 16 dates as Specific Disclosure dates, *i.e.,* dates on which HI's market-adjusted stock price change is a measure of the change in the purported inflation.

[188] Fischel Report, paragraph 34.

specific and/or firm-specific factors, as proper economic "review and analysis"[189] requires.

3. Professor Fischel's Analysis Of The Specific Disclosure Dates Related To The Plaintiffs' Theory Of "Predatory Lending" Is Flawed And Inconsistent With Economic Principles

i. November 15, 2001: The Purported Disclosure Related To The California Department Of Corporations Lawsuit That Professor Fischel Identifies On This Date Had Already Occurred Earlier

Professor Fischel claims that Household's "stock price declined significantly following the November 14, 2001 disclosure of the [California Department of Corporations] CDC lawsuit."[190] [Bracketed text added.] Such a claim is inconsistent with the facts and economic principles of market efficiency that Professor Fischel relies upon.

The lawsuit, claiming civil penalties of $8.5 million (or approximately 0.03% of HI's market capitalization as of November 15, 2001[191]) for alleged lending law violations, was filed against the Company in the Superior Court of Los Angeles County on November 9, 2001, and reported in the press on the same day.[192] Hence, contrary to Professor Fischel's claim, the market had already known about the CDC lawsuit for almost a week. There is therefore no basis to conclude, as Professor Fischel has done, that in an efficient market, such stale information would have caused HI's stock price to decline significantly.[193] In an efficient

[189] Fischel Report, paragraph 11.
[190] Fischel Report, paragraph 34.
[191] HI's assets were equal to $89 billion and the Company's market capitalization was equal to $27 billion as of November 15, 2001. [Sources: Household International SEC Form 10-K405 filing for the fiscal year ended December 31, 2001, filed March 13, 2002; CRSP.]
[192] "Abusive Lending," *City News Service*, November 9, 2001.
[193] Professor Fischel also notes that the "Company issued a press release denying 'any assertion that it has willfully violated the lending laws that regulate its business.' " [Source: Fischel Report, paragraph 12.] It is unclear what conclusions Professor Fischel has drawn (or would like the reader to draw) from this quote. When the Company ultimately settled the lawsuit with CDC, it did not admit to any willful misconduct. [Source: Sweeney, James P., "Household Agrees to Pay $9 Million Fine for Predatory Lending," *Copley News Service*, January 4, 2002.]

market, investors react quickly to news that is value-relevant: they do not wait for a week.[194]

Professor Fischel has also ignored the fact that when the markets first learned of the CDC lawsuit on November 9, 2001, the price reaction was insignificantly positive, which indicates that the news of the CDC lawsuit was not considered value-relevant.[195] Analysts noted that the CDC lawsuit was for an immaterial sum[196] and that this lawsuit would likely be settled soon.[197]

On January 4, 2002 (less than two months after the CDC lawsuit was announced), the markets learned that HI had entered into a settlement of $12 million with the CDC without admitting any willful misconduct.[198] The price reaction on this day was positive, though not significant.[199] Analysts viewed the CDC settlement as a "positive sign; resolution was quick and inexpensive, amounting to less than 2 cents per share"[200] and supported "Household's claim that the infractions were accidental errors that were not willful or discriminatory."[201] Analysts considered the CDC lawsuit as "potential for add[itiona]l headline risk (particularly in a weaker consumer economy)",[202] not a curative disclosure related to the Plaintiff's

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[194] Brealey, Myers and Allen, pages 337-341.

[195] Household's stock price closed 0.33% higher at $57.98 on November 9, 2001. The *City News Service* article is not time-stamped. Therefore, to account for the possibility that this news was released after trading hours on November 9, 2001, I also analyzed Household's price reaction on the next trading day (November 12, 2001). Household's stock price increased insignificantly again on November 12, 2001 by 0.40% to close at $58.21.

[196] Vetto, Matthew L., Sonia Parechanian, and Sanjay Sakhrani, "HI: California Lawsuit Likely More Bark Than Bite," *Salomon Smith Barney*, November 15, 2001, at 7:42 P.M. (EST), page 1.

[197] See, *e.g.*, Alpert, Mark C., Randolf St. Leger, and Garrett T. Swanberg, "HI: California Dept of Corporations Files Complaint of Lending Abuses - Strong Buy," *Deutsche Banc Alex. Brown Inc.*, November 15, 2001, at 5:29 P.M.

[198] Sweeney, James P., "Household Agrees to Pay $9 Million Fine for Predatory Lending," Copley News Service, January 4, 2002.

[199] HI's stock price increased by 3.75% on January 4, 2002. The *Copley News Service* article is not time-stamped. Household's price reaction on the next trading day (January 7, 2002) was also insignificant (a decrease of 1.84%).

[200] Mason, Howad K., and Rick L. Biggs, "Household International: California Settlement Lifts Cloud," *Bernstein Research*, January 18, 2002, page 1.

[201] Mason, Howad K., and Rick L. Biggs, "Household International: California Settlement Lifts Cloud," *Bernstein Research*, January 18, 2002, page 3.

[202] Vetto, Matthew L., Sonia Parechanian, and Sanjay Sakhrani, "HI: California Lawsuit Likely More Bark Than Bite," *Salomon Smith Barney*, November 15, 2001, at 7:42 P.M. (EST), page 1.

theory of "Predatory Lending," as Professor Fischel incorrectly asserts. [Bracketed text added.]

In order to establish loss causation, it is not sufficient to merely find "economic evidence" that is "consistent with" the Plaintiffs' theories of alleged fraud, as Professor Fischel claims to have done.[203] The "economic evidence" must also be inconsistent with non-fraud explanations. Professor Fischel has made no attempt in his report to assess whether such non-fraud related factors could have caused the price declines that he has identified following purported curative disclosures.

Professor Fischel failed to note that on November 15, 2001, Providian, another large consumer finance company, "suspended its quarterly dividend indefinitely and withdrew previous financial guidance for the fourth quarter of 2001 and the 2002 year"[204] and its stock price declined by 22.01%. Providian attributed its performance to factors that include the "weakening" economy as "more customers are defaulting on their loans,"[205] and "disappointment with the company's turnaround efforts."[206]

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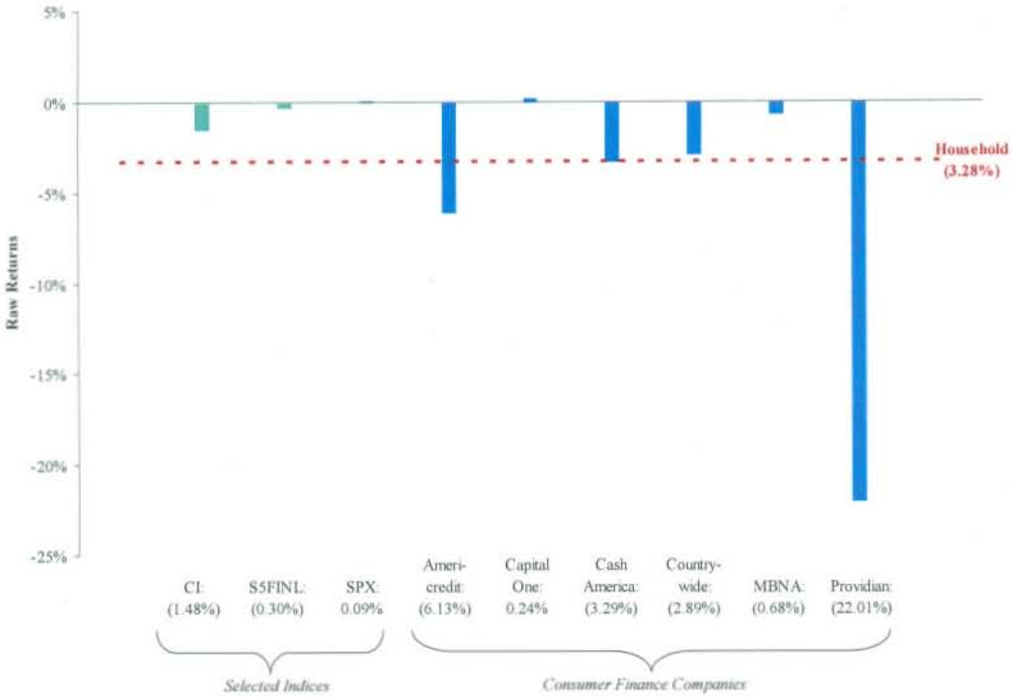
[203] Fischel Report, paragraph 11.
[204] Providian announced this news after hours on November 14, 2001. [Source: "Providian Suspends Div for Indefinite Period," *Dow Jones News Service*, November 14, 2001, at 5:46 P.M.]
[205] Liedtke, Michael, "Providian to Close Nev. Facility," *AP Online*, November 14, 2001.
[206] Liedtke, Michael, "Credit Card Issuer Providian Financial Suffers Another Wall Street Beating," *Associated Press Newswires*, November 15, 2001, at 12:26 P.M.

Figure 1: Change In The Stock Prices Of Household, Other Consumer Finance Companies And In The Values Of The S&P 500, S&P Financials, And Consumer Finance Indices On November 15, 2001



Sources: Bloomberg; CRSP

The stock prices of companies in the same industry tend to move together because investors' expectations about such companies' future prospects are to some degree shaped by common industry-wide issues. Professor Fischel fails to consider the possibility that Providian's statement that its default rates had increased could have adversely affected investors' expectations about other lenders' future default rates, including those of HI. The significant price declines of certain other lenders on November 15, 2001 further suggest that this may have been the case. (See Figure 1 above.)

Finally, as I have noted earlier, if a stock's price movement on a market-adjusted basis is not statistically significant, then one cannot conclude that the news that investors received that day was value-relevant in an efficient market. Although Professor Fischel claims that HI's stock price movement on November 15, 2001 was statistically significant, his claim is based on a flawed regression model as I discuss in detail later. After properly accounting for contemporaneous changes in the prices of other consumer finance companies on November 15, 2001, my analysis reveals that HI's price change on that day was not statistically significant (See Exhibit 8).

ii. July 26, 2002: The Bellingham Herald Article That Professor Fischel Claims Was A Specific Disclosure Only Provided Stale Information That Was Value-Irrelevant In An Efficient Market

Professor Fischel identifies July 26, 2002 as the date when the *Bellingham Herald* reported that "the Company acknowledged its employees may have misrepresented mortgage loan terms to some homeowners" in Whatcom County, Washington.[207] However, complaints regarding Household's lending practices in Whatcom County, Washington had emerged **almost four months earlier!** On April 5, 2002, the *Bellingham Herald* reported a lawsuit filed by four Whatcom County couples "against Household alleging fraud and misrepresentation, and asking the court to modify or invalidate their loan contracts."[208] HI stock's positive, though insignificant, price reaction to the news on April 5, 2002 indicates that this allegation was not value-relevant.[209] Again, by ignoring the first release of news of alleged "predatory lending" in Whatcom County and HI's corresponding price reaction, Professor Fischel provides a selective review of contemporaneous events that contradicts his maintained assumption of efficient markets.

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[207] Fischel Report, paragraph 34.

[208] Stark, John, "County Couples Accuse Mortgage Lender of Fraud," *The Bellingham Herald*, April 5, 2002.

[209] Household's stock price closed 2.02% higher at $57.98 on April 5, 2002. In addition to the lawsuit reported on April 5, 2002, there were other subsequent news related to Washington lawsuits faced by HI. For instance, the Seattle Post-Intelligencer reported on April 18, 2002 that Household "customers turned in complaints to the state Attorney General's Office in Seattle, then protested at an HFC office." HI's stock return on April 18, 2002 was also positive but not statistically significant. On Sunday, April 21, 2002, the Bellingham Herald reported that "the owners of 19 other Whatcom County homes have stepped forward with similar allegations of misleading sales pitches by representatives." HI's price reaction on Monday, April 22, 2002 was negative but not statistically significant. [Sources: Hadley, Jane, "Complaints Are Mounting Over HFC's Lending ; Borrowers Claim Company Boosts Interest Rates, Fees For Home Mortgages," *Seattle Post-Intelligencer*, April 18, 2002; Stark, John, "Complaints Grow Against Household Finance Corp.," *The Bellingham Herald*, April 21, 2002.]

Professor Fischel also fails to consider the possibility that the day's events (such as the publication of the *Bellingham Herald* article that he has cited) could have potentially exacerbated the headline risk associated with "predatory lending" allegations and adversely impacted HI's stock price. Such a price decline caused by heightened headline risk cannot be attributed to the alleged fraud. Professor Fischel fails to establish that the Defendants knew, but failed to disclose information regarding future cash flow implications associated with settling "predatory lending" allegations.

iii. August 16, 2002: Both Events That Professor Fischel Identifies On This Date Provided Stale Information And Therefore Household's Stock Price Change Cannot Be Attributed To Purported Disclosures

The Fischel Report attributes HI's stock price decline on August 16, 2002 to the publication of an article in *Forbes* after trading hours on August 15, 2002.[210] The *Forbes* article questioned HI's lending practices based on complaints expressed by HI customers. However, numerous other complaints regarding HI's lending practices had been publicly discussed in the ***past.*** In fact, the Morgan Stanley report that Professor Fischel has cited listed 13 unique dates prior to August 16, 2002 when "negative press" articles related to HI's lending practices had been published.[211] Professor Fischel is again selective and incomplete in his analysis by attributing HI's stock price change to stale information, not news.

The Fischel Report also references a *Boston Globe* article on August 16, 2002 as reporting that ACORN "had filed a class-action lawsuit against Household in Massachusetts, and had previously filed class-action lawsuits in Illinois,

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[210] The *Forbes* article is dated September 2, 2002. However, an internal Household e-mail stated that the article appeared on www.forbes.com on the night of August 15, 2002 and would "hit the news stands this coming Monday, August 19, 2002." [Source: Email from Megan Hayden of Household International, August 15, 2002, (HHS 00066361 - HHS 00066362), at HHS 00066361.]

[211] A Morgan Stanley analyst report dated July 31, 2002, which Professor Fischel includes in his report as Exhibit 28, lists "selected negative press" related to HI's lending practices. The first of these news articles was published on September 12, 2001. [Source: Posner, Kenneth A., and Athina L. Meehan, "Household International, Discounts the Risk: Upgrade," *Morgan Stanley - Equity Research*, July 31, 2002.]

California, and New York."[212] This was not the first public report of news regarding ACORN's Massachusetts lawsuit. Professor Fischel fails to note that the market had already received this information the prior day (August 15, 2002) during trading hours,[213] and HI's stock price had closed 3.96% **higher** at $39.60 that day.

Even though HI's stock price increase on August 15, 2002 was statistically significant in Professor Fischel's event study, he fails to examine events on this day, except to note in passing that:[214]

> Although Household's stock price increased significantly on August 15, 2002, the day after the restatement was announced, there is evidence that the restatement contributed to the cloud over the Company's stock after the announcement and to the subsequent decline in Household's stock price.

As I have discussed earlier, HI's market-adjusted stock price change over the two-day period (August 14, 2002 and August 15, 2002) was statistically insignificant (See Exhibit 7, Panel A). Based on his incomplete and selective review of the facts, Professor Fischel has repeatedly claimed that HI's stock price declined when the markets received information that was stale. Such a claim contradicts the fundamental principle of market efficiency upon which Professor Fischel's event study methodology rests. HI's positive price change on August 15, 2002 following news of the ACORN class-action lawsuit in Massachusetts indicates that this news was not considered value-relevant.

Professor Fischel acknowledges that news of ACORN's prior lawsuits against HI was publicly-known prior to August 16, 2002.[215] These lawsuits were "similar"[216] to ACORN's Massachusetts lawsuit announced on August 15, 2002.

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[212] Fischel Report, paragraph 15.
[213] Pope, Justin, "Community Group Files Lawsuit Alleging Predatory Lending," *Associated Press Newswires*, August 15, 2002, at 3:53 P.M.
[214] Fischel Report, footnote 17.
[215] Fischel Report, paragraph 15.
[216] Pope, Justin, "Community Group Files Lawsuit Alleging Predatory Lending," *Associated Press Newswires*, August 15, 2002, at 3:53 P.M.

Yet, he fails to consider HI's price reaction to such earlier news releases. ACORN's Illinois lawsuit was reported by *Reuters News* during trading hours at 3:25 P.M. on May 2, 2002.[217] HI's stock price increased slightly immediately following the news. The stock closed 27 cents lower compared to the previous day's closing price, which was an insignificant price change according to Professor Fischel's event study. Such an insignificant price response to news of the ACORN lawsuit, and contemporaneous press and analysts reports, suggest that the news of ACORN's Illinois lawsuit against HI was not value-relevant. As a *Chicago Tribune* article noted:[218]

> Wall Street seems unconcerned about the effect a new lawsuit against Household International Inc. will have on the company's earnings.
>
> ....
>
> "We do not believe that lawsuit represents a material financial risk to Household," finance industry analyst Moshe Orenbuch wrote Friday in a research report for Credit Suisse First Boston.
>
> Pointing to Household's recent initiatives to prevent lending abuses at the company, Orenbuch said the lawsuit does not present "any risks to Household's business practices."

ACORN's California lawsuit against HI was announced shortly after close of regular trading hours on February 6, 2002.[219] Following this news, HI's stock price increased by $3.30 per share (or 7.38%) on February 7, 2002. Even after taking into account market and industry factors, Professor Fischel's event study indicates that such a price increase was statistically significant.

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[217] "Household Faces Suit Alleging Misled Borrowers," *Reuters News*, May 2, 2002, at 3:25 P.M.
[218] Allison, Melissa, "Investors Shrug Off Lawsuit's Effect On Household," *Chicago Tribune*, May 5, 2002.
[219] Helliker, Kevin, "WSJ: Household International Sued For Loan Practices," *Dow Jones News Service*, February 6, 2002, at 4:03 P.M.

Professor Fischel also fails to note that analysts did not consider the news of the ACORN lawsuit in California value-relevant. For example, an ABN AMRO analyst noted on February 7, 2002:[220]

> We read the recent lawsuit and it looks frivolous to us and management agreed. Essentially, the lawsuit appears to be a way for ACORN to gain publicity. ACORN has openly been going after HI for years. HI has close relationships with many community groups and has aggressively worked to be on the right side of the predatory lending issues, in our opinion.

Professor Fischel provides a selective review of contemporaneous events that contradicts his assumption of efficient markets by ignoring the fact that the events he has identified as "disclosures" related to the Plaintiffs' theory of "Predatory Lending" after trading hours on August 15, 2002 and on August 16, 2002 were not disclosures, just a repetition of old information. He fails to consider HI's price reactions, when such news had been released earlier. Such price changes are inconsistent with the conclusion that the ACORN lawsuits against HI were value-relevant disclosures that that resulted in a decline in HI's stock price.

Professor Fischel also fails to note that the purported disclosures he has identified occurred before the markets opened on August 16, 2002 and HI's price reaction to such purported disclosures was negligible. HI's stock price opened only 25 cents below its previous day's closing price. Moreover, the decline in HI's stock price by the end of the day on August 16, 2002 (from its previous day's closing price) is not statistically significant, as Professor Fischel claims based on a methodologically flawed event study. Correcting for such flaws, HI's residual return on August 16, 2002 is, in fact, not significant.

Again, Professor Fischel fails to consider the possibility that events such as the *Forbes* article or the ACORN lawsuit could potentially exacerbate the headline

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[220] Napoli, Robert P., Laura E. Kaster, and Jeffery Harte "Household International, Inc., Conf. Call Dispels Concerns & Increases Transparency, Reit. Buy and $75 target," *ABN-AMRO*, February 7, 2002, page 2.

risk that HI faced and adversely impact its stock price. Such a price decline caused by heightened headline risk cannot be attributed to the alleged fraud. Professor Fischel fails to establish that the Defendants knew but failed to disclose, information regarding future cash flow implications associated with settling "predatory lending" allegations.

iv. August 27, 2002: While The Bellingham Herald's Coverage Of Washington Department Of Financial Institutions Report Provided Details On The Report, Other News Media Had Leaked The Contents Of This Report Prior To August 27, 2002

Professor Fischel attributes HI's stock decline on August 27, 2002 to a Keefe, Bruyette & Woods report that initiated coverage of the Company with a Market Perform rating and described HI as "uninvestable"[221] and to a *Bellingham Herald* article that "reported on the contents of the WA Report."[222] Professor Fischel's analysis of the causes of HI's stock price change on August 27, 2002 is again flawed from an economics perspective and based upon a selective and incomplete review of the facts.

Professor Fischel quotes Vincent Daniel, an analyst at Keefe, Bruyette & Woods in a second-hand manner. Professor Fischel selectively cites an *American Banker* article published the following day (August 28, 2002), which summarizes some of Mr. Daniel's (and his co-analyst's) remarks.[223] Professor Fischel fails to note that the same *American Banker* article recognized that Mr. Daniel's assessment that HI was "uninvestable" was attributed to headline risk associated with the "potential cost of dealing with the lending allegations."[224] Neither the Plaintiffs nor Professor Fischel have alleged that HI's headline risk was not adequately disclosed. Therefore, even if investors' expectations about HI's future prospects

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[221] Fischel Report, paragraph 34.
[222] Fischel Report, footnote 19.
[223] Although the *American Banker* article notes that the Keefe Bruyette & Woods analyst report was published on Tuesday (August 27, 2002), Professor Fischel does not provide any evidence of the publication's exact time.
[224] Bergquist, Erick, "Battered Household Is Hit Again; Securities Analysts Downgrade Household International Inc.," *American Banker,* August 28, 2002. (See also Fischel Report, Exhibit 27.)

changes through a re-assessment of headline risk, and such changed expectations resulted in a significant stock price change on certain days during the Class Period, there is no economic basis to assert that such price declines represent economic harm.

Moreover, Professor Fischel fails to note that Mr. Daniel's comments were not based upon his assessment of HI's headline risk associated with alleged "predatory lending" practices alone. Instead, in his co-authored report, Mr. Daniel noted various other non-fraud related factors that resulted in their overall opinion, including heavy dependence on capital markets for financing and high credit costs.[225]

In identifying August 27, 2002 as a Specific Disclosure, Professor Fischel also cites a *Bellingham Herald* article published that day, which provided details of the WA Report. The article, however, reported information that was several weeks old, which would be value-irrelevant in an efficient market. The article noted:[226]

> In recent weeks, copies of the report have been leaked to every news organization that has been following the HFC story – including The New York Times, Forbes Magazine, American Banker magazine [sic] and The Bellingham Herald.

Specifically, the market received information about the WA Report on at least four prior occasions (April 18, 2002, May 30, 2002, June 10, 2002, and August 26, 2002). As Professor Fischel recognizes, investors came to learn of the WA Report as early as April 18, 2002.[227] On May 30, 2002, Mr. Crudele of the *New York Post* stated that "yesterday Household got a temporary injunction against the release of [the WA Report]." Mr. Crudele further commented that he didn't "know what's in that report, but [he] bet it isn't complimentary to Household" and

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[225] Daniel, Vincent, and Raj Kommineni, "Initiating Coverage of Household International With a Market Perform Rating, Yet Another Un-Investable Situation," *Keefe, Bruyette & Woods*, August 27, 2002.
[226] Fischel Report, paragraph 16.
[227] Fischel Report, paragraph 16.

that Household had told him that the report was "fraught with inaccuracies."[228] [Bracketed text added.] On June 10, 2002, *National Mortgage News* discussed the WA Report with the acting director of the Washington Department of Financial Institutions ("DFI"), which revealed that "in more recent complaints, consumers have said they aren't understanding the terms of their loans."[229] An *American Banker* article on August 26, 2002, which Professor Fischel has cited as a disclosure, also provided a detailed discussion of the various allegations made in the WA Report.[230]

Professor Fischel fails to note that HI's stock price reaction was insignificant on each of the above-mentioned dates, indicating that the market did not consider discussions of the impending WA Report to be value-relevant. HI's stock price reaction to the final publication of the entire WA Report on August 28, 2002 was also insignificant.[231]

In summary, the events that Professor Fischel has identified on August 27, 2002 cannot be considered curative disclosures. My analysis reveals that HI's market-adjusted price change on August 27, 2002 was not statistically significant (See Exhibit 8).

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[228] Crudele, John, "Household Blocks Report in Suit Over Financing Practices," *New York Post*, May 30, 2002.

[229] Venetis, Kyriaki, "Household Facing Investigations, Lawsuits in Washington State," *National Mortgage News*, June 10, 2002.

[230] "Wash. State Report Slams Household's '99-'01 Tactics," *American Banker*, August 26, 2002.

[231] I understand that the complete WA report was available on the *Bellingham Herald* website on August 28, 2002. [Source: "Complete Report by the Washington Department of Financial Institutions," *Bellingham Herald*, August 27, 2002, (HHS 02944208 – HHS 02944215) and Email from Larry West of The Bellingham Herald, September 9, 2002 (BP 000568 – BP 000569), at BP 000568.] Since the time-stamp for this news was unavailable I examined HI's stock price reaction on August 28, 2002 and August 29, 2002 and found both dates' price reactions to be statistically insignificant.

v. September 3, 2002: The Bernstein Research Call Analyst Report Published On This Date Was An Assessment Of The Possible Valuation Impact Of Washington Department Of Financial Institutions Report, Which Was Already Publicly Available Prior To This Date

Professor Fischel notes that a Bernstein Research report published on September 3, 2002 "lowered … [its] expectations of Household's future prospects"[232] based on its assessment of the impact that the WA Report might have on the Company's future sales practice.[233] [Bracketed text added.] Professor Fischel identifies September 3, 2002 as a Specific Disclosure date and attributes HI's negative stock price movement on that date to the Bernstein Research report. Such a claim is unfounded for several reasons.

First, HI's market-adjusted price change on September 3, 2002 was not statistically significant (See Exhibit 8) as Professor Fischel concludes based on his flawed event study. Thus, the price change observed on September 3, 2002 was not abnormally large relative to the stock's daily random variations observed historically.

Second, the Bernstein Research analyst report that Professor Fischel considers to be a Specific Disclosure provided a commentary about the WA Report, which (as the Bernstein report itself states[234]) had been completely revealed to public on August 28, 2002.[235] Thus, the contents of the Bernstein Research report represented stale, value-irrelevant information to investors in an efficient market.

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[232] Fischel Report, paragraph 20.

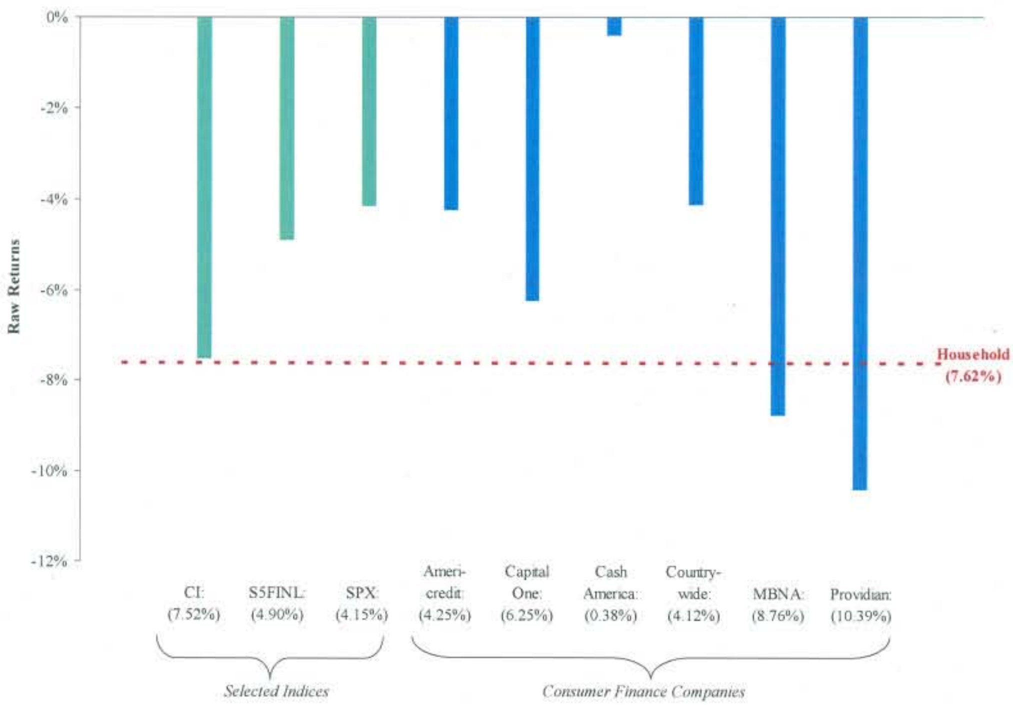
[233] Mason, Howard K., and Rick L. Biggs, "HI, Cutting Long-Run Growth Estimates on Impact of Sales Practice Reform in Branch-Based Real Estate Lending," *Bernstein Research Call*, September 3, 2002.

[234] Mason, Howard K., and Rick L. Biggs, "HI, Cutting Long-Run Growth Estimates on Impact of Sales Practice Reform in Branch-Based Real Estate Lending," *Bernstein Research Call*, September 3, 2002, page 1.

[235] Email from Larry West of The Bellingham Herald, September 9, 2002 (BP 000568 – BP 000569), at BP 000568.

Third, Professor Fischel fails to consider the potential price impact of other events, unrelated to the alleged fraud, which also occurred on September 3, 2002. For example, Citigroup's stock price declined by 10.26% on September 3, 2002 after Prudential Securities downgraded the stock to "sell."[236] *The Wall Street Journal* reported that on September 3, 2002, "diversified financial services were the poorest-performing group after Mike Mayo of Prudential Securities downgraded Citigroup to sell."[237] (See Figure 2 below.)

Figure 2: Change In The Stock Prices Of Household, Other Consumer Finance Companies And In The Values Of The S&P 500, S&P Financials, And Consumer Finance Indices On September 3, 2002



Sources: Bloomberg; CRSP

vi. September 23, 2002: The CIBC Analyst Report Published On This Date Downgraded HI's Stock Based On The Possible Adverse

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[236] Prudential cut Citigroup's rating "citing lower earnings and legal risk as lawmakers take a close look at its corporate governance." [Source: "Research Alert - Prudential Cuts Citigroup to 'Sell'," *Reuters News*, September 3, 2002, at 9:47 A.M.]

[237] Talley, Karen, "Small-Stock Focus: Russell 2000 Slumps in a Down Day for Stocks," *The Wall Street Journal*, September 4, 2002.

Impacts Of Macro-Economic Factors That Were Unrelated To The Alleged Fraud

Professor Fischel attributes HI's price decline on September 23, 2002 to a September 22, 2002 CIBC report in which "the analysts lowered their target price to $36 from $57 and reduced their earnings estimate for 2003."[238] However, the CIBC Report did not reveal any news related to the Plaintiffs' theory of "Predatory Lending." Hence, this report's publication cannot be considered a disclosure of the alleged fraud, as Professor Fischel claims.

Professor Fischel fails to note that the CIBC Report "trimmed [its] 2003 earnings estimates [for HI] to $5.12 from $5.18 per share owing **primarily** to the likelihood of slower refinancing activity as interest rates begin to rise."[239] [Emphasis and bracketed text added.] Although the adverse impacts of macro-economic factors are potentially value-relevant, such influences are not related to the alleged fraud. Hence, there is no basis to conclude that HI's stock price reaction to news on September 23, 2002 was caused by disclosures about the alleged fraud.

Professor Fischel also fails to consider other macro-economic events, unrelated to the alleged fraud, which occurred on September 23, 2002 and which may have adversely impacted HI's stock price. *Reuters News* reported on this date that "the 10-year Treasury note yield fell to a low of 3.66% Monday - a level not seen since 1961 - amid a familiar refrain of weak stocks, lackluster economic data and rumbling credit and geopolitical concerns, with fingers for both pointed at Fannie Mae (FNM) and Iraq, respectively."[240] The stock prices of two other large consumer lenders, MBNA and Providian, also declined on this day.

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238 Fischel Report, paragraph 34.

239 Scutti, Jennifer, and Barrie Stesis, "Household International, Lowering Price Target On Persistent Headline Risk, But Maintaining SP Rating," *CIBC World Markets - Equity Research*, September 22, 2002, page 2.

240 Mackenzie, Michael, "Flight To Quality Driving Interest Rate Markets...Again," *Dow Jones Capital Markets Report*, September 23, 2002, at 1:17 P.M.

vii. October 4, 2002: The AG Settlement Had Been Discussed Earlier And HI's Stock Price Reacted Positively When It Was Announced

Professor Fischel identifies October 4, 2002 as a Specific Disclosure date, noting that *The Wall Street Journal* had published an article that day, which "mentioned that Household was close to completing a $350-$500 million settlement with state attorneys general over its predatory lending practices."[241] This is another example of Professor Fischel's cherry-picking of "Specific Disclosure" dates. *The Wall Street Journal* article that he quotes provided no new information to the market and hence cannot be considered a curative disclosure. Instead, the article summarized the conclusions of an analyst report from Bernstein Research the previous day.[242] Professor Fischel fails to recognize that HI's market-adjusted stock return was positive, but statistically insignificant on October 3, 2002. Such a price **increase** contradicts Professor Fischel's claim that HI's stock price declined following news of the AG Settlement.

In identifying October 4, 2002 as a purported "disclosure" date, Professor Fischel not only ignores the Bernstein Research report published the previous day, but also selectively ignores portions of other **earlier** reports (which he does consider elsewhere in his report for other purposes) that had also provided the market with news regarding the AG Settlement and the estimated settlement amount. For instance, Professor Fischel fails to note that the Morgan Stanley report of July 31, 2002 stated:[243]

> **Impact of predatory lending may be overblown**: New lending practices could reduce the company's consumer finance margins from 2.0% to 1.5-1.75%, and we're factoring in $500 million in legal damages/regulatory fines in our price target. Even so, the stock looks undervalued. [Emphasis in original.]

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[241] Fischel Report, paragraph 21.

[242] Mason, Howard K., Rick L. Biggs, "HI, Impact of AG Settlement on Earnings, Funding and Capital," *Bernstein Research Call*, October 3, 2002. See also Email from Howard Mason of Bernstein Research, October 3, 2002, at 7:39 A.M. (HHS 02980445 - HHS 02980454), at HHS 02980445.

[243] Fischel Report, paragraph 20 and Exhibit 28.

HI's market-adjusted stock price change was significantly positive on July 31, 2002.[244] Such a price **increase** indicates that news of the AG Settlement was not considered a disclosure of prior fraud, as Professor Fischel counter-factually asserts. The Company had already discussed the AG Settlement in a prior public filing with the SEC.[245]

The logical inconsistency in Professor Fischel's analysis is apparent from the fact that HI's stock price rose significantly by $5.30 (or 25.24%) on October 10, 2002 following "market talk"[246] that AG Settlement could be reached as early as the following day (October 11, 2002) and rose an additional $1.90 (or by 7.22%) on October 11, 2002.[247] That is, HI's stock price increased cumulatively by 34.3% over this two day period when news of the AG Settlement became known.[248]

In addition, Professor Fischel has failed to account for other non-fraud related events on October 4, 2002 that may explain HI's stock price decline on this date. Professor Fischel ignores the fact that after the market closed on October 3, 2002, financial services company Conseco announced that its CEO Gary Wendt had stepped down as the company's CEO.[249] During trading hours on Friday October 4, 2002, Standard and Poor's "cut Conseco Inc.'s credit and debt ratings to 'D,' or 'default' and said Chief Executive Gary Wendt's resignation on Thursday is a

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[244] Professor Fischel cites from a copy of the Morgan Stanley analyst report that has no time stamp. [Source: Fischel Report, Exhibit 28.] I was able to locate a copy of the Morgan Stanley analyst report published before trading hours on July 31, 2002 that contains the same citation. [Sources: Posner, Kenneth A., and Athina L. Meehan, "Discounts the Risk: Upgrade, Part 1," *Morgan Stanley - Equity Research*, July 31, 2002, at 7:09 A.M. (*) and Posner, Kenneth A., and Athina L. Meehan, "Discounts the Risk: Upgrade, Parts 2 & 3," *Morgan Stanley - Equity Research*, July 31, 2002, at 7:10 A.M. (*)]
[245] Household International SEC Form 10-Q filing for the fiscal quarter ended June 30, 2002, filed August 14, 2002.
[246] Fischel Report, footnote 21.
[247] Fischel Report, footnote 21.
[248] HI's stock price increased from $21 (closing price on October 9, 2002) to $28.20 (closing price on October 11, 2002).
[249] "Wendt Staying as Conseco Chairman; Stepping Down as CEO," *Business Wire*, October 3, 2002, at 4:10 P.M, (EST).

'prelude' to a Conseco bankruptcy."[250] Following the bad news the market received about Conseco, the stock prices of most companies in the consumer finance sector declined in comparable magnitude to HI's stock price on October 4, 2002.[251] Professor Fischel does not consider this non-fraud related reason that could explain HI's market-adjusted price reaction on October 4, 2002, which was **not** statistically significant after flaws in Professor Fischel's regression analysis are corrected.

In short, Professor Fischel identified the 7 above-mentioned dates[252] on which he claims that HI's stock price decline reflects curative disclosure of prior inflation in HI's stock that can be attributed to the Plaintiffs' theory of "Predatory Lending" ("Alleged PL Disclosures"). On October 10, 2002 and October 11, 2002, however, HI's stock price increased significantly after the markets learned of the AG Settlement. Such a positive stock price movement undermines Professor Fischel's opinions and is consistent with a non-fraud related explanation, *i.e.,* HI's stock price had been depressed by headline risk regarding alleged "predatory lending" and investors reacted positively to the AG Settlement, which was viewed as a successful resolution of such headline risk.

4. Professor Fischel's Analysis Of The AG Settlement Is Counter-Factual And Internally Inconsistent With Other Claims In The Fischel Report

Professor Fischel asserts that news of the AG Settlement, which was announced on October 11, 2002 but was anticipated by October 10, 2002,[253] had "substantial negative implications for Household's market value."[254] He notes that:[255]

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[250] "S&P Says Cuts Conseco to 'D', Expects Bankruptcy," *Reuters News*, October 4, 2002 at 10:10 A.M. (EST).

[251] HI's stock price declined 7.29% on October 4, 2002. Stock prices for AmeriCredit, Capital One, MBNA, and Providian declined 8.00%, 6.32%, 7.11%, and 8.13%, respectively on this date.

[252] These 7 dates are: November 15, 2001, July 26, 2002, August 16, 2002, August 27, 2002, September 3, 2002, September 23, 2002, and October 4, 2002.

[253] Fischel Report, footnote 21.

[254] Fischel Report, footnote 21.

[255] Fischel Report, paragraph 7.

> The Company agreed to pay up to $484 million and adopt a series of business practices to benefit borrowers... Household management said 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.

Professor Fischel also states that in response to the news, Standard and Poor's lowered its debt ratings for Household and Fitch placed its ratings on "negative watch."[256]

Professor Fischel recognizes that "one would expect that [such news] would have caused the Company's stock price to decline significantly."[257] [Bracketed text added.] HI's stock price, however, **increased** on October 10, 2002 and October 11, 2002[258] which contradicts his, and the Plaintiffs' theory. Professor Fischel attempts to resuscitate his "inflation" theory by providing the following explanation for HI's apparently inconsistent price reaction to news related to the Plaintiffs' theory of "Predatory Lending":[259]

> The fact that the stock increased in value upon disclosure of such 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.

Professor Fischel's speculation regarding HI's apparently inconsistent price reaction to news related to the Plaintiffs' theory of "Predatory Lending" contradicts:

1) the facts surrounding the AG Settlement;

2) Professor Fischel's theory that HI's stock price declined on the Alleged PL Disclosures because of curative disclosures that revealed a fraud related to the Plaintiffs' theory of "Predatory Lending";

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[256] Fischel Report, footnote 21.
[257] Fischel Report, footnote 21.
[258] HI's stock price increased significantly by $5.30 per share or 25.24% on October 10, 2002 and further increased by $1.90 per share or 7.22% on October 11, 2002.
[259] Fischel Report, footnote 21.

3) Professor Fischel's claim that HI stock price "increased significantly due to disclosures related to the alleged fraud" on February 27, 2002.[260]

Professor Fischel assumes that investors treated HI's resolution of its regulatory dispute as an admission of a previously denied and concealed fraud. He fails to note that the Company did not "admit [to] any wrongdoing."[261] [Bracketed text added.]

Professor Fischel also fails to consider whether HI's price reaction is explained by non-fraud related factors, as proper economic "review and analysis" requires. In particular, he fails to exclude the possibility that HI's stock price had been depressed by headline risk regarding alleged "predatory lending" and investors reacted positively to the AG Settlement, which was viewed as a successful mitigation of a well-known headline risk as the following remarks by HI's CEO, Mr. Aldinger suggest:

> I recommended approval even though I felt we had done nothing wrong. And as the Attorneys General frequently pointed out to us, **you may have not have broken any laws and your products are all legal, but we can sue you one month at a time and drag your stock price down. We can get you in bad press every month.** [Emphasis added.][262]
>
> And so with the pressure we were getting from multiple Attorneys General, all of whom had different objectives, and when I looked at the cost to our stock price, I look into the amount of time my management was spending on this, the reputational damage we were dealing with, I did recommend a settlement to our board. But it was painful because, frankly, I don't think we did anything wrong. And – and so it was a very hard process.[263]
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> … [G]oing back to the AG settlement, again, we said that we felt that there were numerous benefits to getting an AG settlement and

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[260] Fischel Report, paragraph 35.

[261] Bernard, Tara Siegel, "Household Intl: Business Changes To Cost 10c/Share In '03," *Dow Jones News Service*, October 11, 2002, at 12:23 P.M.

[262] Deposition testimony of William Aldinger of Household International, January 29, 2007, (114:11-16) (henceforth "Aldinger Deposition").

[263] Aldinger Deposition (114:17-25).

> – and that would be that we would remove uncertainty, we would get the cloud from the stock price lifted – which it did – and so there was a certain price we were willing to pay. I think, also, the AG settlement was a more reasonable one.[264] [Bracketed text added.]

i. Factual Details Of The AG Settlement Are Inconsistent With Professor Fischel's Speculation Regarding HI's Stock Price Change On October 11, 2002

Professor Fischel claims that "the fact that the stock increased in value upon disclosure of such negative information [on October 11, 2002] is evidence that it had declined earlier by at least as much in anticipation of a larger payment."[265] [Bracketed text added.]

Such a claim is inconsistent with the facts. A July 31, 2002 Morgan Stanley analyst report, cited by Professor Fischel, had estimated "$500 million in legal damages/regulatory fines."[266] The Company had already discussed the AG Settlement in a prior public filing with the SEC.[267] Moreover, as Professor Fischel recognizes, investors had already learned by October 4, 2002 that "Household was close to completing a $350-$500 million settlement with state attorneys general over its predatory lending practices."[268] Thus, the announced settlement amount ($484 million) was within the range that investors and analysts had been expecting for several months. As the Morgan Stanley analysts, whose July 31, 2002 report Professor Fischel has cited, noted in another report they published on October 17, 2002:[269]

> The uncertainty related to predatory lending issues has been reduced after Household's [litigation] announcement last Friday ... [which] was largely in line with our expectations. [Bracketed text added.]

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[264] Aldinger Deposition (169:8-16).
[265] Fischel Report, footnote 21.
[266] Fischel Report, paragraph 20 and Exhibit 28.
[267] Household International SEC Form 10-Q filing for the fiscal quarter ended June 30, 2002, filed August 14, 2002.
[268] Fischel Report, paragraph 21.
[269] Posner, Kenneth A., and Athina L. Meehan, "Bending Before Adversity," *Morgan Stanley - Equity Research*, October 17, 2002.

ii. Professor Fischel's Explanation Of HI's Stock Price Change On October 11, 2002 Is Internally Inconsistent With His Explanation Of HI's Stock Price Changes Following The Alleged Predatory Lending Disclosures

Contrary to Professor Fischel's theory, HI's stock price **increased** following news of the AG Settlement. Such a price increase contradicts Professor Fischel's theory because, in his opinion, this news was a disclosure related to the Plaintiffs' theory of "Predatory Lending" and had "substantial negative implications for Household's market value."[270]

Professor Fischel tries to fit his "theory" to the facts by arguing that HI's price declines on the prior Alleged PL Disclosures were partly caused by investors anticipating "a larger payment and/or changes in Household's business practices that would have had a worse impact on the Company's future prospects."[271] Such price declines caused by changes in investors' expectations cannot be attributable to the alleged fraud.

If such price declines on the Alleged PL Disclosures dates were in part caused by investors' expectations about larger 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"[272] as Professor Fischel claims in his event study methodology.[273]

Professor Fischel also fails to identify any prior materially inaccurate statements by the Company that were purported "corrected" by the Alleged PL Disclosures. He also fails to reject (or even consider) a non-fraud related explanation of HI's price declines following these Alleged PL Disclosures, namely that these "disclosures" increased the Company's headline risk in the form of negative publicity.

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[270] Fischel Report, footnote 21.
[271] Fischel Report, footnote 21.
[272] Fischel Report, paragraph 36.
[273] Fischel Report, Exhibit 53.

iii. Professor Fischel's Explanation Of HI's Stock Price Change On October 11, 2002 Is Internally Inconsistent With His Claim That HI Management Inflated The Company's Stock Price On February 27, 2002

Professor Fischel claims that "as information was disseminated into the market about Household's lending practices, Defendants continued to deny the allegations of predatory lending"[274] citing the Company's February 27, 2002 announcement that it would extend its Best Practices Initiative as an example. He asserts that HI's stock price increase on February 27, 2002 was "due to disclosures related to the alleged fraud."[275] Such a claim is flawed for several reasons.

First, Professor Fischel has provided no support to conclude that the Company's disclosures about its Best Practice Initiatives were false or misleading. Hence, even if HI's stock price reaction could be attributed to the Company's February 27, 2002 announcement, there is no basis to claim such price reaction is related to any alleged fraud.

Second, Professor Fischel's claim that HI's stock price "increased significantly"[276] on February 27, 2002 is incorrect because it is based on a flawed event study. My analysis reveals that HI's market-adjusted price change on that day was not statistically significant (See Exhibit 8). Such an insignificant price reaction suggests that the Company's announcement on February 27, 2002 was not considered value-relevant, contrary to what Professor Fischel claims. This conclusion is also supported by the fact that the markets already knew of the Company's Best Practices Initiatives,[277] which had been first announced on July 23, 2001.[278] HI's stock price reaction following that announcement had also been

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[274] Fischel Report, paragraph 17.
[275] Fischel Report, paragraph 35.
[276] Fischel Report, paragraph 35.
[277] "Household Expands Best Practice Lending Initiatives, Creates Unprecedented Protections for Borrowers," *Household International Press Release*, February 27, 2002.
[278] "Household International Redefines Best Practices in Subprime Lending," *PR Newswire*, July 23, 2001, at 10:36 A.M.

statistically insignificant, even according to Professor Fischel's event study. Thus, Professor Fischel ignores the results of his event study, which suggests that news of the Best Practices Initiatives was not considered value-relevant in an efficient market and that HI's stock price change on February 27, 2002 was not abnormally large given its historical daily variation.

Third, Professor Fischel again fails to consider other plausible non-fraud related explanations for HI's stock price increase on February 27, 2002. HI's price increase on this day could plausibly reflect investors' positive reaction to management's efforts to alleviate the headline risk that the Company faced through its announced extension of its Best Practices Initiative. In addition, Professor Fischel ignores the potential impact of other market and industry-related events that occurred on February 27, 2002. *Reuters News* reported that "credit card and consumer finance firm shares rallied on Wednesday [February 27, 2002] after Federal Reserve Chairman Alan Greenspan indicated an economic recovery was on its way, but that an interest rate hike was unlikely in the near future."[279] [Bracketed text added.] Stock prices for many consumer lenders increased in comparable or larger magnitude relative to HI on February 27, 2002.[280]

In short, Professor Fischel's analysis of purported disclosures related to the alleged fraud is incomplete and selective. There is no basis to conclude that the price changes he identifies on 14 Specific Disclosure dates can be attributed as a matter of economic reasoning to news related to the alleged fraud. Statistically, the joint impact of all 14 Specific Disclosure dates that Professor Fischel has identified is insignificant (See Exhibit 7, Panel B).[281]

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[279] "Credit Card Companiess *[sic]* Rally On Greenspan," *Reuters News*, February 27, 2002, at 12:25 P.M.

[280] HI's stock price increased 4.20% by the close of trading on February 27, 2002 compared to its closing price on February 26, 2002. Americredit and Capital One, two other consumer finance companies, had stock price increases of 6.48% and 3.21%, respectively.

[281] The indicator variable, that is assigned a value of 1 on these 14 Specific Disclosure dates and a value of 0 on all other dates during the Class Period, is statistically insignificant in the regression model described in Exhibit 7 (Panel B).

VI. Flaws In Professor Fischel's "Quantification Including Leakage" Methodology

Professor Fischel claims that his Specific Disclosures model "likely significantly understates the amount of artificial inflation in HI's stock price during the Class Period"[282] 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."[283] Therefore, Professor Fischel proposes his alternative Leakage model, which results in an even larger inflation estimate. Under this model, alleged artificial inflation on each day during the Class Period is defined as HI's stock price on that day less its "True Value."[284] As I discuss below, this model is fraught with conceptual and methodological errors which make it fundamentally flawed and unreliable.

A. Professor Fischel Fails To Establish Loss Causation In His Leakage Model

Professor Fischel attempts to support the use of his Leakage model by citing a study by Cornell and Morgan. However, Cornell and Morgan themselves recognize that the Leakage model has a serious limitation. They specifically note that:[285]

> it attributes any decline in the security price that is not due to movements in the market or the industry to disclosure of the fraud. If the disclosure of a fraud is associated with the release of other company-specific bad news, [this method] will **overestimate** the true damages." [Emphasis and bracketed text added.]

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[282] Fischel Report, paragraph 40.
[283] Fischel Report, paragraph 39.
[284] Professor Fischel sets the "True Value" for HI to be equal to HI's stock price on October 11, 2002 and the True Value on each preceding day (t - 1) is calculated as: (Value on date t + Dividends on date t) / (1 + Constructed Return on date t) where the daily Constructed Return equals the Predicted Return for each day from November 15, 2001 to October 11, 2002, and the actual HI return "for all other dates." If the resulting inflation on any day is greater than the cumulative residual price decline during the observation window of $23.94, Professor Fischel limits the inflation to $23.94 and adjusts the true value line accordingly. [Source: Fischel Report, paragraph 42.]
[285] Cornell and Morgan, page 903.

Accordingly, as Cornell and Morgan note that:[286]

> … **substantial factual analysis must precede the use of the [value line] model.** Without a detailed understanding of the information misrepresented or omitted, the information eventually revealed, the differences between those sets of information, and the other information available to the market, litigants and lawyers **cannot be confident that what the market model measures is really the economic effect of the fraud.** [Emphasis and bracketed text added.]

That is, absent such a detailed economic analysis of the facts and circumstances on each day of the Class Period, any assertion that the mechanically estimated difference between the Company's stock price and its "True Value" is a measure of inflation is unsubstantiated for it fails to establish loss causation. Professor Fischel conducts no such detailed analysis.

A recent court opinion made the same point in excluding a "leakage" model of inflation offered by the Plaintiffs' expert in that matter. The court noted: [287]

> The [U.S. Supreme] Court's opinion in Dura leaves no room for doubt that even where a securities fraud plaintiff proceeds on a "leakage" theory of corrective disclosure, he must still establish that the lower price reflects the fraud-related inflation and not "changed economic circumstances, changed investor expectations, new-industry-specific facts, conditions or other events, which taken separately or together account for some or all of that lower price."
>
> ….
>
> **Because Dr. Nye fails to address the obvious alternative explanations as required by the law of loss causation**, his Scenario 1 will be excluded. [Emphasis added.]

Professor Fischel, too, has made the same criticism:[288]

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[286] Cornell and Morgan, page 923.

[287] Memorandum Opinion and Order by Judge Stephen P. Friot, *In re Williams Securities Litigation*, Case No. 02-cv-072-SPF-FHM et al., filed in the United States District Court, Northern District of Oklahoma, July 6, 2007, pages 114 – 115.

[288] Report of Daniel R. Fischel, *In re Bizch Securities*, No. 94 Civ 7696 (RWS), filed in the United States District Court, S.D. New York, September 7, 2001, paragraph 16.

> Dr. Nye purports to calculate the "true value" of each of the "Damages Securities" by adjusting the September 22, 1994 price "to reflect the returns on a corresponding industry index." Nye Report, ¶ 16. … Dr. Nye then calculates the "dollar amount of inflation per share" as "the difference between the closing price on each date and the security's true value," so calculated. Nye Report, ¶ 18. **This procedure is invalid because it assumes that any decline in the prices of Damages Securities that is not explained by the movement of the industry index is attributable to the alleged wrongdoing.** For the reasons discussed above, this assumption cannot be made with respect to the price declines on September 22, 1994. (Those declines can be attributed to the decline in liquidity caused by the closure of Blech & Co.) [Emphasis and bracketed text added.]

Then in a footnote to his report, Professor Fischel further elaborates that:[289]

> At any point in time, the performance of individual stocks may differ from the performance of an industry index due to random factors, firm-specific factors, different sensitivities to industry factors or different sensitivities to market factors. For this reason, one cannot assume that differences between the performance of the Blech Securities and the performance of an industry index are attributable to the alleged manipulative scheme.

Yet, by assuming that difference between HI's stock price and the estimated "True Value" is a measure of inflation without adequate analysis of possible non-fraud related reasons, Professor Fischel now makes the same mistake for which he has criticized others in the past.

Moreover, as Cornell and Morgan warn, the Leakage model is "potentially biased"[290] and its results depend on the fit of the market model that is used:[291]

> because the assumption on which the analysis is based, that the actual return equals the predicted return had the fraud not occurred, is only an approximation that depends on the accuracy of the market model.

[289] Report of Daniel R. Fischel, *In re Bizch Securities*, No. 94 Civ 7696 (RWS), filed in the United States District Court, S.D. New York, September 7, 2001, footnote 3.
[290] Cornell and Morgan, page 911.
[291] Cornell and Morgan, page 911 and 923.

> … substantial factual analysis must precede the use of the model. Without a detailed understanding of the information misrepresented or omitted, the information eventually revealed, the differences between those sets of information, and the other information available to the market, litigants and lawyers cannot be confident that what the market model measures is really the economic effect of the fraud.

Yet, Professor Fischel has failed to conduct such a factual analysis preceding the use of his Leakage model and as I discuss in Section VII, the regression model that he has considered is methodologically flawed for several reasons.

B. The Two Alternative Quantifications Of Alleged Artificial Inflation That Professor Fischel Proposes Are Internally Inconsistent

Professor Fischel's two approaches to measuring alleged inflation are also inconsistent with one another. For instance, according to the Specific Disclosures model,[292] November 15, 2001 is identified as the first of 14 Specific Disclosure dates, and Professor Fischel states that the alleged inflation in Household's common stock price declined by $1.86 per share (from $7.97 per share to $6.11 per share), following the announcement of a lawsuit by the CDC against Household after trading hours the previous day. However, according to the Leakage model,[293] there is no change in the alleged inflation level ($23.94 per share) on November 15, 2001. That is, Professor Fischel's assertion that "Household's stock price was negatively affected by the alleged fraud"[294] is consistent with one of his inflation illustrations (the Specific Disclosures model), but is contradicted by the other (the Leakage model). Similarly, according to Professor Fischel's Specific Disclosures model, $1.85 per share of inflation was introduced into Household's stock price on December 5, 2001, following remarks by Household's CEO Aldinger at a Goldman Sachs conference.[295] However, the

[292] Fischel Report, Exhibit 53.
[293] Fischel Report, Exhibit 56.
[294] Fischel Report, paragraph 28.
[295] Fischel Report, Exhibit 53.

events of December 5, 2001 did not introduce any alleged inflation according to the Leakage model.[296]

The internal inconsistency in Professor Fischel's methods of calculating HI's predicted return further demonstrates that his quantification of alleged inflation is fundamentally flawed and unreliable.

C. The Leakage Model Will Result In Pseudo-Damages Because It Fails To Consider Loss Causation: An Illustration Using All Members Of The Dow Jones Industrial Average

Professor Fischel's Leakage model mechanically results in large differences between the stock's actual price and its estimated True Value on certain dates. Assuming this difference is "inflation" that is entirely attributable to the alleged fraud, without any consideration of the facts and circumstances of the case, as the Fischel Report has done, is incorrect, as Professor Fischel himself has noted on prior occasions.[297]

The fallacy in such an analysis is apparent from the following illustration. Consider the set of all 30 members ("Member" or "DJIA Member") of the Dow Jones Industrial Average ("DJIA"). In the spirit of Professor Fischel's Leakage model, let us assume that (a) each DJIA Member's daily Constructed Return over the HI Class Period (July 30, 1999 - October 11, 2002) is equal to the price-weighted average stock return across all the DJIA Members on that day; (b) the DJIA Member's True Value equals its actual stock price on October 11, 2002 and (c) the True Value on each preceding day (t - 1) is equal to its Value on date t divided by one plus the Constructed Return.

Without any further factual analysis, let us assume that the difference between a DJIA Member's actual stock price and its True Value represents daily "inflation."

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[296] Fischel Report, Exhibit 56.

[297] Report of Daniel R. Fischel, *In re Bizch Securities,* Case No. 94 Civ 7696 (RWS), filed in the United States District Court, S.D. New York, September 7, 2001, footnote 3.

A particular DJIA Member's price may lie above or below its True Value on a given day, *i.e.,* on any given date, a particular DJIA Member's stock price may be considered "inflated." Notably, however, the aggregate inflation across all 30 Members must add up to **zero on each date**, by construction. Therefore, the "damages" for the set of all 30 Members too should be zero over the Class Period, by construction.[298]

As a result, any "damages" resulting from this experiment represent pseudo-damages, not true economic harm to investors. Yet, "damages" are calculated to be $367 billion in total for all 30 DJIA Members over the HI Class Period (See Exhibit 4 for details of these calculations). Such "damages," however, are simply the result of a mechanical calculation. These pseudo-damages result because of the random difference that arises daily between a stock's observed price and its estimated "True Value" is considered economic harm without any consideration of loss causation, as in Professor Fischel's Leakage model.

VII. Other Methodological Flaws In Professor Fischel's Analysis

A. Flaws In Professor Fischel's Event Study Methodology

In his event study, Professor Fischel calculates HI's "residual return" on each date during the Class Period, *i.e.,* the stock's return on a given date in excess of the "predicted" return for that date, which is based on the historical relationship between HI's return and that of market and industry benchmarks, estimated using regression analysis (or a "market model").[299]

[298] This follows mathematically from the observation that damages (per share), even according to the Plaintiffs' flawed methodology, are calculated as the difference between the purchase and sale date inflation amounts, respectively. If inflation on all dates is zero by construction, it follows that damages too must be zero by construction.

[299] Professor Fischel used the returns on the Standard & Poor's 500 Composite Stock Price Index (the "S&P 500 Index") and the Standard & Poor's Composite Financial Stock Price Index (the "S&P Financials Index") as the market and industry benchmarks, respectively and ran his regression of HI's stock return against these indices over the period from November 15, 2000 to November 14, 2001 (the "Estimation Period"). [Source: Fischel Report, paragraph 32.]

The residual return measures the "unexplained" portion of the stock's observed return on a given date after taking into consideration the contemporaneous changes in the market and industry indices. The residual return could occur as a result of certain company-specific events that occurred on that date or purely as a matter of chance, *i.e.,* due to the normal daily random fluctuations in the stock's price. The residual return on a given date is considered "statistically significant" when the likelihood that it occurred purely as a matter of chance, and not because of a company-specific event that occurred on that date, is small. Conventionally such a threshold of error[300] is assumed to be no greater than 5%,[301] as Professor Fischel recognizes.[302]

A well-specified market model should result in relatively small daily residual returns, and only few of these should be statistically significant. However, according to Professor Fischel, 165 days (or more than 20%) of the 805 trading days in the Class Period are statistically significant.[303] Using a 5% significance level threshold to determine statistical significance in a two-tailed test (that is, a t-statistic of absolute value greater than 1.96), Professor Fischel's event study methodology yields 102 statistically significant days (or about 13% of all days in the Class Period).[304] The relatively large number of significant dates that

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[300] Such an error is known in statistics as the error of rejecting a true null hypothesis or a Type I error. A 5% level of significance means that the probability of incorrectly rejecting the true null (*i.e.,* that the stock's return is equal to its predicted return) is 5%.
[301] Correspondingly, the inference drawn is correct at a 95% confidence level.
[302] Professor Fischel considers HI's residual return to be significant if the t-statistic (a "standardized measure of the size of the residual return") associated with a particular day's residual return has "an absolute value of 1.65 or greater." He claims that such a threshold denotes statistical significance at the 5% level of significance in a "one-tailed" test of statistical significance (*i.e.,* testing for significance where the residual return has a particular sign). However, Professor Fischel's event study does not specify a one-tailed hypothesis, *i.e.,* it does not *a priori* identify the direction that HI's stock price would be expected to move on each date of the Class Period. That is, Professor Fischel has *de facto* used a "two-tailed" test of inference. A t-statistic with an absolute value of 1.65 or greater in a two-tailed test corresponds to a 10% significance level. In order to state with 95% confidence that HI's residual return on a given date is significantly different from zero, its corresponding t-statistic's absolute value must be 1.96 or greater. [Source: Fischel Report, paragraph 33.]
[303] Fischel Report, Exhibit 49.
[304] Fischel Report, Exhibit 49.

Professor Fischel's model yields is due to an improperly-specified market model, as I discuss below.

1. The "Indexes" That Professor Fischel Uses As Explanatory Variables In His Regression Do Not Adequately Reflect The Historical Relationship Between HI's Stock Return And Industry-Wide Factors

Professor Fischel provides no explanation for using the S&P 500 and the S&P Financials indices as the market and industry benchmarks in his regression model.[305] According to Kennedy, a well-known econometrics text:[306]

> Econometricians should search for the "best" set of independent variables by determining which potential set of independent variables produces the highest $\overline{R}^2$ ("adjusted R^2").[307]

Professor Fischel has failed to produce the adjusted R^2 that his regression analysis yielded.[308] My replication of Professor Fischel's regression results in an adjusted R^2 value of 53.56%. Moreover, as Professor Fischel has noted,[309] his regression model yields a **negative** estimated coefficient for the S&P 500 Index. That is, according to Professor Fischel's regression result, HI's stock return should **decline** on average when the S&P 500 Index increases, holding other factors

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[305] Professor Fischel only notes that the Company compared its stock price performance separately to these indexes in its annual Proxy statements filed with the SEC. [Source: Fischel Report, footnote 10.]

[306] Kennedy, Peter, 2003, *A Guide to Econometrics*, 5th Ed., Cambridge, MA: The MIT Press, page 91 (henceforth "Kennedy").

[307] The R^2 is the "coefficient of determination." It is a commonly-used statistic in econometrics and represents the proportion of the variation in the dependent variable (in this case HI's daily stock return) that is "explained" by the variation in the independent variables. Adding independent variables "cannot cause the R^2 to fall." Hence, the R^2 statistic is "adjusted" to reflect the "degrees of freedom," which is defined in the context of an OLS regression (such as Professor Fischel's regression) as the difference between the number of observations in the sample (n) less the number of independent variables used. [Source: Kennedy, pages 90-91.]

[308] Professor Fischel has also not provided the daily index values for the two indices that he has used. Using the daily index values for the S&P Financials Index that I have obtained from Bloomberg and from Standard & Poor's, I have been unable to verify Professor Fischel's series of daily returns although such returns were purportedly computed from the same series of daily index values.

[309] Fischel Report, Exhibit 49, footnote on last page.

constant. Such a counter-intuitive result[310] suggests that Professor Fischel's regression is mis-specified. As Kennedy notes,[311]

> A remarkably common occurrence when doing applied work is to run an *a priori* favorite specification and discover a "wrong" sign. Rather than considering this a disaster, a researcher should consider it a blessing – this result is a friendly message that some detective work needs to be done – there is undoubtedly some shortcoming in one's theory, data, specification, or estimation procedure. If the "correct" signs had been obtained odds are the analysis would not be double-checked. What should be checked?
>
> The first step is always to check economic theory. It is amazing how after the fact economists can conjure up rationales for incorrect signs. But one should never stop here. If there was good reason *a priori* to expect a different sign, there is a moral obligation to check econometric reasons for why the "wrong" sign was obtained, before changing the theory.

Kennedy identifies a "top ten list of econometric reasons for "wrong" signs,"[312] with the "Omitted Variable" problem at the top of the list.[313] That is, according to Kennedy, a mis-specified regression model which excludes an important explanatory variable can result in the results of a regression being spurious.

HI was one of the country's largest consumer finance companies during the Class Period.[314] Therefore, it is reasonable to assume that the Company's stock returns

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310 Household was classified as a Personal Credit Institution (SIC Code: 6141) during Professor Fischel's Estimation Period (November 15, 2000 – November 14, 2001). [Source: HI's SEC Form 10-K filings from 1999 to 2003.] Companies that were classified in the same industry (*i.e.*, under the same SIC code) as HI had positive equity betas (the estimated regression coefficient for the market index, the S&P 500 Index), according to *Ibbotson's Cost of Capital Quarterly*. [Source: "Cost of Capital Quarterly 1999-2003 Yearbooks," *Ibbotson Associates*, Chicago, IL: McGraw-Hill Companies, Inc.]

311 Kennedy, page 397.

312 Kennedy, page 397.

313 Kennedy provides the following example to illustrate the Omitted Variable problem: "Suppose you are using a sample of females who have been asked whether they smoke, and then are resampled twenty years later. You run a probit [*i.e.*, a regression that estimates the probability] on whether they are still alive after twenty years, using the smoking dummy [indicator variable] as the explanatory variable, and find to your surprise that the smokers are more likely to be alive! This could happen if the nonsmokers in the sample were mostly older, and the smokers mostly younger. Adding age as an explanatory variable solves this problem." [Bracketed text added.] [Source: Kennedy, page 398.]

314 Fed Study, page 39.

would be more closely related to the stock returns of other **consumer finance** companies rather than very broad indices such as the S&P 500 Index which consists of the 500 largest companies from different industries or the S&P Financials Index, which contained 81 firms on October 11, 2002, as Professor Fischel notes.[315] In his regression model, Professor Fischel has failed to include a benchmark that adjusts for the impact of contemporaneous changes in the value of consumer finance companies on HI's returns.

Accordingly, I constructed a daily returns series for an index of six leading consumer finance companies in the Class Period (the "Consumer Finance Index").[316] I included this Consumer Finance Index in Professor Fischel's regression model, *i.e.,* I regressed HI's daily stock return against the two benchmarks that Professor Fischel had employed (the S&P Financials Index and the S&P 500 Index)[317] as well as this Consumer Finance Index over the entire Class Period.[318] This regression model yields a much higher adjusted R^2 value of 60.33% compared to the adjusted R^2 value of 53.56% in Professor Fischel's

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315 As of October 11, 2002, the S&P Financials Index contained 81 members out of which only 4 were consumer finance companies as identified using the Global Industry Classification Standard ("GICS") code: Capital One (0.44% of the index), Countrywide Financial Corp (0.39% of the index), MBNA Corp (1.44%), Providian (0.08% of the index). These 4 consumer finance companies represented approximately 2.35% of the S&P Financials Index. As of October 11, 2002, Household also comprised 0.83% of the S&P Financials Index.

316 Standard and Poor's ("S&P") publishes a daily value-weighted index of consumer finance companies, which includes companies that belong to the S&P Supercomposite 1500 Index and are classified as "consumer finance companies" according to the GICS code (GICS code of 40201010). During the Class Period, HI and six other companies were members of this index. The Consumer Finance Index that I employ in my regression analysis is a value-weighted index of these 6 members of the S&P Consumer Finance Index (excluding HI). (See Exhibit 5 for business descriptions of these six companies.)

317 Household was a member of both indices (the S&P 500 Index and the S&P Financials Index) that Professor Fischel uses in his event study. Therefore, 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. Professor Fischel makes no attempt to correct for this statistical error by removing the influence of HI's daily returns on his 2 explanatory variables (the S&P 500 Index and the S&P Financials Index). Accordingly, for the sake of comparison, I too have not done so in the regression results reported in Exhibit 8. I have, however, confirmed that my conclusions about the flaws in Professor Fischel's statistical analyses remain unchanged even after removing the influence of HI's daily returns on the S&P 500 Index and the S&P Financials Index.

318 I consider the entire Class Period as the relevant estimation period because, as I explain in the next sub-section, 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.

regression.[319] My regression model yields far fewer statistically significant dates, *i.e.,* dates when HI's stock price movement cannot be explained by contemporaneous changes in market and industry benchmarks. According to my analysis, 36 days (or about 4.5%) of the 805 days in the Class Period are statistically significant.[320] Only 5 out of Professor Fischel's 14 Specific Disclosure dates remain significant in my regression model (July 26, 2002, August 14, 2002, September 23, 2002, October 10, 2002, and October 11, 2002). However, such statistical significance does not imply that HI's residual return on these dates was caused by the alleged fraud, as I have discussed earlier.

2. The "Estimation Period" (November 15, 2000 - November 14, 2001) That Professor Fischel Uses For His Regression Analysis Is Arbitrary And Incorrect

Professor Fischel identifies the above Estimation Period purportedly because it is the year prior to November 15, 2001, which he selected as his first Specific Disclosure date. There are at least two fundamental flaws in his choice of such an Estimation Period.

First, Professor Fischel's methodology is fundamentally flawed because it assumes that "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)," estimated using regression analysis over the one-year Estimation Period, would necessarily provide a reliable way of determining HI's daily "predicted return" during the Class Period.[321] Such a claim is valid only if "the historical relationship between changes in a company's stock price and changes in the

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[319] Professor Fischel estimated the regression coefficients he used to estimate HI's predicted return by regressing HI's stock return against the indices he had selected over the November 15, 2000 - November 14, 2001 period, which lies within the alleged Class Period. 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)." [Source: Fischel Report, paragraph 32.]

[320] This result is based on the conventional 95% confidence level threshold in a two-tailed test. Even using the more lax 10% significance level for a two-tailed test that Professor Fischel adopted, my model indicates that only 58 (or about 7%) of the 805 trading days in the Class Period are statistically significant.

[321] Fischel Report, paragraph 32.

performance of a market index (and possibly an industry index)"[322] does not change significantly over time, *i.e.,* if the estimated regression coefficients are stable over time. This is not the case here. As mentioned earlier, Professor Fischel estimated the coefficient of the market index (the S&P 500 Index) to be negative based on his Estimation Period. In contrast, when the entire Class Period is considered as an estimation period, this estimated coefficient is positive. Such a change in the sign of the coefficient suggests the regression model Professor Fischel uses is mis-specified as I discussed earlier. In particular, the Estimation Period that Professor Fischel considered (November 15, 2000 - November 14, 2001) spans September 11, 2001, the date of the terrorist attacks in the U.S. Such events sent the financial markets into a turmoil. Professor Fischel fails to consider that any relationship between HI's returns and various indices estimated over a narrow one-year time horizon when such significant and highly unusual events occurred could result in an unreliable predictor for HI's future returns in the longer run. As Exhibit 6 shows, the daily alleged artificial inflation in HI's stock price under Professor Fischel's Leakage model is higher if the Constructed Returns used to calculate HI's True Value are based on the Estimation Period that Professor Fischel has selected instead of using the entire Class Period as the Estimation Period.

Second, Professor Fischel's claim that November 15, 2001 was the first date when "Household's stock price was negatively impacted by concerns regarding the Company's alleged predatory lending practices"[323] is based on his incorrect assertion that the CDC lawsuit which included "predatory lending" allegations against HI was announced after trading hours on November 14, 2001. As I have discussed earlier, this news was made public almost a week earlier on November 9, 2001. Hence, by Professor Fischel's own logic, the Estimation Period should have been different.

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[322] Fischel Report, paragraph 32.
[323] Fischel Report, paragraph 28.

3. All Events Discussed In The Fischel Report Are Jointly Insignificant

The Fischel Report cites a total of 41 unique dates during the Class Period on which purported disclosures related to the Plaintiffs' theories of alleged fraud occurred (See Exhibit 3). The **joint** impact of such purported disclosures on HI's stock price can also be analyzed statistically by including "indicator variables" in the event study methodology discussed above. The use of such indicator variables is well-established in the literature on event studies and entails adding three separate indicator variables, one for each of the Plaintiffs' theories of alleged fraud (the Restatement, the Re-aging and the "Predatory Lending"). That is, if Professor Fischel has identified an event related to the Plaintiffs' theories of alleged fraud occurred on a particular date, then I have assigned a value of one to the indicator variable that corresponds to that theory and a value of zero to the indicator variable(s) to which the identified event is not related. If no disclosure occurred on a particular date, then all three indicator variables are assigned values of zero.

Exhibit 7 (Panel C) presents the results of this analysis. The coefficients of each of the three indicator variables are found to be statistically insignificant. That is, all purported events related to the Plaintiffs' theories of alleged fraud that Professor Fischel has identified, considered jointly, did not have a statistically significant impact on HI's stock price on a market-adjusted basis. These results again highlight the fact that Professor Fischel has failed to establish loss causation in his Leakage model.[324]

[324] Professor Fischel's Leakage model assumes that news of the alleged fraud purportedly "leaked" out to the market on dates other than the Specific Disclosure dates. However, Professor Fischel makes no attempt to identify such additional disclosure dates in his report. My results in Exhibit 7 (Panel C) show that even if one were to (incorrectly) consider **all** dates that the Fischel Report has discussed as purported disclosures, HI's stock price was not significantly impacted by such disclosures collectively.

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

[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

[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

Mukesh Bajaj

December 10, 2007

EXHIBIT 3

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	)	
	)	CLASS ACTION
	)	Judge Ronald A. Guzman
	)	Magistrate Judge Nan R. Nolan
	)	
	)	
Defendant,	)	
	)	

SUR-REBUTTAL REPORT OF MUKESH BAJAJ

March 3, 2008

I. Introduction

Plaintiffs in the above-captioned litigation have submitted the Report of Daniel R. Fischel, dated August 15, 2007 (the "Fischel Report"), which provides the bases for Professor Fischel's conclusion that "the economic evidence is consistent with Plaintiffs' claim that the alleged wrongdoing caused investors in Household's common stock to incur losses"[1] and two alternative quantifications of the amount of alleged artificial inflation in Household's ("Company" or "HI") stock price during the Class Period.[2] Notably, Professor Fischel does not quantify the Plaintiffs' damages nor clarify how his alternative alleged inflation estimates should be used to calculate such damages. Instead, Plaintiffs' counsel has proposed a damage methodology that purports to rely on Professor Fischel's alternative inflation measures.[3]

I submitted a report dated December 10, 2007 ("Bajaj Report")[4] in which I explained in detail why "Professor Fischel's Analysis Suffers From Several Fundamental Flaws And Results In Incorrect And Unsupportable Conclusions"[5] and why Plaintiffs' proposed damage methodology is "not only fundamentally flawed from an economics perspective, it is incomplete."[6]

In response, Professor Fischel submitted a second report, dated February 1, 2008 (the "Fischel Rebuttal Report") in which he argues that my criticisms of the Fischel Report

[1] Report of Daniel R. Fischel, *Lawrence E. Jaffe Pension Plan,, v. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, August 15, 2007, paragraph 11 (henceforth the "Fischel Report").

[2] According to Professor Fischel, one of the measures is based on HI's purported stock price reactions to specific fraud-related disclosures ("Quantification Using Specific Disclosures" or the "Disclosures model") and the other purportedly 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" or the "Leakage model"). [Source: Fischel Report, Exhibits 53 and 56.]

[3] Lead Plaintiffs' Supplemental Statement Regarding Damages Pursuant to the Court's October 17, 2007 Order, *Lawrence E. Jaffe Pension Plan, v. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, October 24, 2007, page 1 (henceforth the "Plaintiffs' Supplemental Statement").

[4] The Bajaj Report includes information regarding my qualifications and defines all capitalized terms that I shall use in this report.

[5] Bajaj Report, page 8.

[6] Bajaj Report, page 86.

are incorrect and do not affect his conclusion.[7] Plaintiffs have also submitted a further supplement to their prior statements regarding damages ("Plaintiffs' Further Supplement").[8] I have been asked by Defendants' counsel to review and respond to the Fischel Rebuttal Report and Plaintiffs' Further Supplement.

The additional information I have relied upon in connection with this report is listed in Exhibit 1.[9] If further information becomes available, I reserve the right to supplement and/or amend the opinions set forth in this report.

Based on my review and analysis of the Fischel Rebuttal Report, it remains my conclusion that Professor Fischel's inflation analysis is without any economic merit. Professor Fischel does not (and cannot) dispute that an "essential part of any reasonable economic assessment of the Plaintiffs' damages" is to independently "examine what caused the Plaintiffs' loss"[10] ("loss causation analysis"). Yet, Professor Fischel does not attempt to independently establish loss causation, but only attempts to show that the economic evidence is "consistent" with Plaintiffs' allegations.[11] He **assumes** almost everything he needs to conclude that the "economic evidence is consistent with the Plaintiffs' claim."[12] By assuming that the Plaintiffs' theory to be true to begin with, it is not surprising that Professor Fischel "concluded" that economic evidence is "consistent" with Plaintiffs' allegations. In short, Professor Fischel has assumed his conclusions.

In order to establish loss causation, an independent analysis of the facts and circumstances must be conducted to:

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[7] I refer to the Fischel Report and the Fischel Rebuttal Report collectively as the "Fischel Reports."

[8] Lead Plaintiffs' Further Supplement to Their Prior Statements Regarding Damages, *Lawrence E. Jaffe Pension Plan, v. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, February 1, 2008 (henceforth "Plaintiffs' Further Supplement").

[9] Exhibit 2 of the Bajaj Report contains the information that I relied upon in connection with that report. Exhibit 1 of this report, only lists the additional information that I have relied upon in connection with this report, *i.e.*, information that is not already listed in Exhibit 2 of the Bajaj Report.

[10] Bajaj Report, page 5.

[11] Fischel Report, paragraph 11.

[12] Rebuttal Report of Daniel R. Fischel, *Lawrence E. Jaffe Pension Plan, v. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, February 1, 2008, paragraph 1 (henceforth the "Fischel Rebuttal Report").

1. Identify the alleged mis-representations that the defendants made, *i.e.*, determine the specific date and nature of each alleged mis-representation.

2. Identify the quantum of alleged artificial inflation that such alleged mis-representations introduced into the stock price.[13]

3. Identify how the truth about such alleged fraud first came into the market, *i.e.*, identify all curative "disclosures" of new information about the subject matter of each alleged false statement(s).

4. Identify and control for market, industry and firm specific non-fraud factors that could impact the stock price movement following such disclosures.

5. Determine whether the disclosure was value-relevant, *i.e.*, impacted the stock price in a statistically significant[14] manner, after controlling for the non-fraud factors.[15]

Instead of performing such an independent analysis, Professor Fischel's conclusions rest on a series of **assumptions**:

1. Professor Fischel assumes that Defendants must have made one or more mis-representations (material mis-statements or omissions) at unspecified points in time prior to July 30, 1999 (the start of the Class Period) regarding its (a) lending practices ("Predatory Lending"); (b) re-aging of delinquent accounts

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[13] In an efficient market, "price changes reflect changes in investors' expectations about the future cash flows from holding the stock, or the risk associated with such cash flows, following "value-relevant" news. In most instances, the value-relevant news that results in stock price changes, even large changes, has nothing to do with any fraud. Value-relevant news may be about the market as a whole, the industry to which the company belongs or company-specific news unrelated to any fraud." [Source: Bajaj Report, Section III.A and sources cited therein.]

[14] "The residual return [or price change after controlling for market and industry factors] on a given date is considered "statistically significant" when the likelihood that it occurred purely as a matter of chance, and not because of a company-specific event that occurred on that date, is small." [Source: Bajaj Report, page 78 and sources cited therein.]

[15] Bajaj Report, pages 6-7.

("Re-Aging"); and (c) accounting of certain contract costs (the "Restatement")[16] as the Plaintiffs have alleged.

2. Professor Fischel assumes that these unidentified mis-representations caused HI's stock price to become inflated prior to July 30, 1999, as the Plaintiffs have alleged.[17]

3. Professor Fischel (incorrectly[18]) contends that such Pre-Class Period inflation cannot, and need not, be quantified daily because the Plaintiffs' "Persistence Theory" of fraud precludes such quantification.[19] Thus, Professor Fischel's

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[16] Fischel Report, paragraph 10.

[17] Lead Plaintiffs' Status Report for the February 7, 2008 Telephone Status Conference, *Lawrence E. Jaffe Pension Plan, v. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, February 6, 2008, page 3 (henceforth the "Status Report").

[18] Professor Fischel claims that he can quantify the Phantom Inflation in HI's stock price on a day-by-day basis from October 11, 2002 going backward in time, using his Specific Disclosures and Leakage models in a mechanical manner until July 30, 1999 (the start of the Class Period). But he asserts that these methods somehow cannot measure daily inflation prior to July 30, 1999 even though his mechanical inflation quantifications do not depend on when the Class Period begins. This is an illogical claim given the Plaintiffs' admission that the Class Period could begin on August 16, 1999 ("Alternative Class Period Start Date.") [Source: Status Report, page 3.] That is, Professor Fischel can, and already has, purportedly quantified the Phantom Inflation on a daily basis prior to the Alternative Class Period Start Date, but he somehow cannot do so prior to the currently-specified Class Period start date, July 30, 1999. Professor Fischel's inflation methods can be used to quantify the purported Phantom Inflation daily to the first day that HI's stock prices are available from the University of Chicago's Center for Research on Security Prices (CRSP) database, *i.e.*, July 2, 1962. Such an analysis indicates that HI's stock price was always inflated from July 2, 1962 onwards, according to Professor Fischel's methodology, which makes no economic sense.

[19] Plaintiffs have now clarified that their damage claims rests on the assumptions that (a) HI's stock price became inflated prior to July 30, 1999, (b) such inflation persisted intact during the Class Period because Defendants failed to correct such mis-statements before the Class Period began, which the Plaintiffs characterize as "omissions" or "inflationary events," and (c) "Had the adverse information been disclosed, HI's share price would have fallen to its true value as identified by Professor Fischel in Exhibits 53 and 56" [Source: Status Report, pages 3-4.] Professor Fischel assumes that no new inflation was introduced during the Class Period and "news related to the Plaintiffs' allegations" that negatively affected HI's stock price commenced no earlier than November 14, 2001. [Source: Fischel Rebuttal Report, footnote 14.] I refer to this set of assumptions as the Plaintiffs' and Professor Fischel's "Persistence Theory" of damages. Note that Professor Fischel's inflation quantification contradicts this theory for the following two reasons: (1) HI's Restatement included fiscal years 1999-2002. Professor Fischel fails to recognize that if the restated contract costs had introduced inflation into HI's stock price, as Plaintiffs and Professor Fischel claim, then some incremental inflation must have also been introduced over the fiscal years 1999-2002. Yet, Professor Fischel's Phantom Inflation theory concludes otherwise because it assumes that no incremental inflation was introduced between July 30, 1999 and November 14, 2001; and (2) Professor Fischel's Specific Disclosures model concludes that incremental inflation was allegedly introduced into HI's stock price on December 5, 2001 and February 27, 2002. [Source: Fischel Report, Exhibit 53.] However, according to the Persistence Theory, no such incremental inflation was introduced during the Class Period.

analysis rests on a theory of "Phantom Inflation"[20] that is not based on independent, scientific enquiry.

4. Lacking any economic evidence that HI's stock price was ever inflated, Professor Fischel nevertheless assumes that HI's price decline (beginning November 15, 2001[21]) must reflect the dissipation of Phantom Inflation just as the Plaintiffs have alleged.[22] In his Leakage model, Professor Fischel makes no attempt to determine specific dates when and the extent to which such Phantom Inflation purportedly dissipated.

5. In his Specific Disclosures model, Professor Fischel assumes that the Phantom Inflation began dissipating after November 14, 2001 following 14 purported Specific Disclosures when he claims the market received "news related to Plaintiffs' allegations."[23] Professor Fischel chooses these Specific Disclosures based on a selective, incomplete and misleading analysis of the facts. Specifically:

   a. Professor Fischel fails to distinguish between curative disclosures and allegations. He assumes that selected third-party commentary or allegations, which by definition are "related to the Plaintiffs' allegations" constitute disclosures (*i.e.*, reflect the "truth" about the alleged fraud coming into the market).

   b. Professor Fischel ignores economic evidence that contradicts his central premise that HI's stock price was ever inflated because he rejects dates when the market received similar news of allegations and

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[20] The term "Phantom Inflation" refers to the Pre-Class Period inflation that Professor Fischel and the Plaintiffs assume, without any factual or economic analysis, was introduced into HI's stock price before the Class Period began and persisted during the Class Period until purported "disclosures" began on November 15, 2001, *i.e.*, the inflation that Professor Fischel assumes exists even though he cannot determine when and the extent to which the specific alleged mis-representations caused HI's stock price to become inflated.
[21] November 15, 2001 is the first Specific Disclosure in Professor Fischel's analysis. [Source: Fischel Report, paragraph 34.]
[22] Fischel Report, paragraph 10.
[23] Fischel Rebuttal Report, footnote 14.

third party commentary but (a) such news arrived before November 15, 2001; or (b) HI's residual return was not statistically significant on that date.

i. By rejecting numerous dates prior to November 15, 2001 and July 30, 1999 when the market received news that he considers a "disclosure," Professor Fischel ignores the efficient market principle[24] that he purportedly relied upon.[25] This is a fundamental flaw because he fails to therefore consider if some or even all of the Phantom Inflation had dissipated before the Class Period began, in which case Plaintiffs' damages would be zero.

ii. By rejecting dates when the market received news that he considers a "disclosure," but HI's price reaction was statistically insignificant even using his own flawed statistical methodology,[26] Professor Fischel directly rejects evidence that contradicts his central premise that HI's stock price was ever inflated.

iii. Professor Fischel's methodologies violate well-accepted statistical principles, according to which HI's residual return was **not** statistically significant on 12 of the 14 Specific Disclosures and hence could not be considered dissipation of Phantom Inflation, according to Professor Fischel's own (flawed) logic.

[24] "In an efficient market, old information does not affect the stock price because such information would already have been incorporated into the market price when investors first learned of it." [Source: Bajaj Report, page 4.]
[25] Fischel Report, paragraph 31.
[26] See Bajaj Report, section VII for my criticisms of Professor Fischel's statistical analyses.

The Plaintiffs' theory of damages, which relies on Professor Fischel's alternative (and flawed) inflation measures, is incorrect and critically incomplete from an economics perspective. By the nature of its construction, Professor Fischel's alternative inflation measures – and the Plaintiffs' proposed damage computation methodology – will result in vastly over-stated damage claims.

II. Professor Fischel's Conclusions Are Without Economic Merit

In an efficient market, a stock's price may decline following bad news about the market as a whole, or the industry or even company-specific news unrelated to the alleged fraud. Not all price declines represent curative disclosures, *i.e.*, "truth" about some prior fraud coming into the market. There is no economic basis to claim damages based on a price decline unless such a decline can be attributed to the dissipation of inflation previously introduced by some identifiable material mis-representation by the defendants, *i.e.*, unless loss causation is established through independent analysis of the facts, which Professor Fischel has not done.

This critical flaw in Professor Fischel's theory can be highlighted through the Oil Company Example I provided in the Bajaj Report. In that example:[27]

> …an oil company, with oil fields in Nigeria and Venezuela, announces on January 1, that its oil field in Venezuela has caught fire and its future profits will be lower as a result. In an efficient market, the company's stock price would decline rapidly (and correctly) to reflect the value of its anticipated losses.

Suppose the company's stock price declined by $10 on a "market-adjusted" basis following the news on January 1. According to Professor Fischel's flawed theory, the $10 price decline in my example would reflect the dissipation of Phantom Inflation that was previously present, **by assumption**, and constitutes basis for fraud-related damages for the company's shareholders who had bought the stock before January 1 even if there was never any material mis-representation. There is no economic basis for such a claim, however, unless loss causation is established, *i.e.*, (a) "plaintiffs demonstrate that the

[27] Bajaj Report, page 6.

company had known about the fire earlier and intentionally failed to disclose this material news in a timely manner when it had a duty to do so,"[28] (b) such alleged misrepresentation had caused the company's stock price to previously become inflated by at least $10, and (c) the stock's price decline on January 1 cannot be attributed to non-fraud related news.

That is, in order to claim fraud-related damages it is essential to answer three questions:

1. How, when and to what extent did the alleged fraud cause the stock price to become initially inflated?

2. Did some, or all, of this inflation get dissipated before the price decline on the selected date occurred?

3. Can the price decline on the selected date be attributed to non-fraud related news rather than a corrective "disclosure"?

Professor Fischel has failed to address these questions and instead assumed answers that are "consistent with the Plaintiffs' claims." His conclusions are thus devoid of economic merit.

A. Professor Fischel fails to identify how, when and to what extent the alleged fraud caused HI's stock price to initially become inflated.

Plaintiffs have alleged three distinct types of fraud ("Predatory Lending," "Restatement" and "Re-aging") caused HI's stock price to become inflated.[29] Thus, in order to quantify such alleged inflation, which Professor Fischel purports to do, the first step is to identify how, when and the extent to which each of the three above-mentioned types of alleged

[28] Bajaj Report, page 6.

[29] "Plaintiffs principally allege that Defendants: 1) employed improper lending practices designed to maximize amounts lent to borrowers in the subprime market ("Predatory Lending") and denied that these practices were occurring; 2) misrepresented and manipulated defaults and delinquencies (metrics closely followed by analysts and investors) by artificially reaging delinquent accounts ("Re-aging"); and 3) improperly accounted for expenses associated with certain of its credit card agreements, which led to a restatement going as far back as 1994 that lowered earnings throughout the Class Period (the "Restatement")." [Source: Fischel Report, paragraph 10.]

fraud may have caused the stock price to initially become inflated. Professor Fischel, however, incorrectly argues that he cannot do so, given the Plaintiffs' Persistence Theory of damages.[30]

Given the Plaintiffs' Persistence Theory of damages, to establish loss causation it is essential to determine (a) the extent to which each of the three types of alleged fraud inflated HI's stock price to begin with[31] and (b) if subsequent "leakage" or additional mis-representations changed the quantum of such initial inflation by the time the Class Period began.

This is evident from the following hypothetical example. Suppose plaintiffs allege that three facts were mis-represented ("Facts 1, 2 and 3") on January 1, 1997, January 1, 1998 and January 1, 1999, respectively, but fail to quantify the amount of inflation that each such Fact introduced into the company's stock price, as is the case here. The plaintiffs may assume, as they have done here, and Professor Fischel has assumed, that the total amount of inflation introduced by the three facts collectively was $20 per share, which persisted into the Class Period (July 30, 1999) because the company failed to correct the mis-representations in its SEC filings. Suppose, however, that $5 of inflation introduced by Fact 1 was removed by leakage of information related to that particular alleged fraud before the Class Period began. Then plaintiffs' inflation estimate (of $20 per share) during the Class Period would be over-stated by at least $5 per share. That is, plaintiffs' damage claims based on the assumption the entire $20 per share inflation did not dissipate before the Class Period began would be arbitrary and incorrect absent an independent analysis of (a) the extent to which each of the three types of alleged fraud inflated the stock price to begin with and (b) the change in such initial inflation through leakages related to each type of alleged fraud by the time the Class Period began.

[30] Fischel Rebuttal Report, paragraph 38.

[31] I had discussed this issue through the Oil Drilling Company example in the Bajaj Report, namely Plaintiffs who allege that fraud about the Company's failure to disclose "that the **Nigerian** government was going to shut down the company's oil field in that country" caused the stock price to become inflated, cannot assume that the stock's price decline attributable to other news (*e.g.*, news of a fire in a company oil field in **Venezuela**) was caused by a "disclosure" of the prior fraud and that such a price decline measures the inflation assumed to be previously present in the company's stock price. [Source: Bajaj Report, page 6 and 88.]

Yet, Professor Fischel has failed to analyze these issues. Instead, he argues that analysis of such Pre-Class Period inflation is impossible to do and is unnecessary because Plaintiffs only claim damages on shares purchased after "the first actionable statement."[32] Hence, Professor Fischel has only estimated the Phantom Inflation that he assumes prevailed after the "first actionable non-disclosure."[33] Professor Fischel fails to recognize that unless he can demonstrate that a statement inflated HI's stock price, based on independent economic analysis, his inflation estimates are devoid of any economic merit.

Professor Fischel offers two excuses for not performing such a loss causation analysis, and instead only estimates Phantom Inflation from the end of the Class Period to the beginning of the Class Period on July 30, 1999, as he was "instructed"[34] to do by Plaintiffs' counsel. Both excuses are invalid, as I discuss below.

First, Plaintiffs' claim that the Phantom Inflation persisted during the Class Period because Defendants failed to correct previous mis-statements related to "Predatory Lending," "Re-Aging" or "Restatement" fraud. That is, Plaintiffs allege that "each statement made by defendants to the market that failed to disclose the adverse information regarding HI's improper business practices (predatory lending, improper re-aging and improper accounting) was an inflationary event."[35] Professor Fischel claims that because such "inflationary events" were "alleged omission[s]"[36] (rather than mis-statements), he cannot determine how much inflation was introduced upon such "non-disclosure of information."[37] This excuse is invalid because at least some portion of the Phantom Inflation allegedly originated from alleged accounting mis-statements, not

[32] Status Report, page 3.
[33] Fischel Rebuttal Report, paragraph 39.
[34] Lead Plaintiffs' Opposition to Household Defendants' Motion to Compel Plaintiffs to Supplement Their Initial Disclosures Pursuant to Fed. R. Civ. P. 26(a)(1)(iii), *Lawrence E. Jaffe Pension Plan, v. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, February 21, 2007, page 3 (henceforth the "Lead Plaintiffs' Opposition").
[35] Status Report, pages 3-4.
[36] Fischel Rebuttal Report, paragraph 38.
[37] Fischel Rebuttal Report, paragraph 38.

omissions, according to the Complaint.[38] Professor Fischel does not deny that event studies can be used to quantify inflation allegedly introduced through mis-statements.[39]

Second, Professor Fischel has already estimated inflation on a daily basis during the Class Period despite the Plaintiffs' claims that the "inflationary events" during this Period, which caused the Phantom Inflation to persist, comprise "omissions," not mis-statements. As the Plaintiffs concede, the models Professor Fischel has employed to estimate inflation are mechanical in nature that do not depend on when the Class Period starts.[40] Therefore, contrary to Professor Fischel's claim, his models can be used to mechanically generate the estimated alleged artificial inflation on **any** date prior to October 11, 2002, including dates before the start of the Class Period (July 30, 1999).[41] I have done so, using Professor Fischel's Leakage model[42] (See Exhibit 3) and his

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[38] See *e.g.*, [Corrected] Amended and Consolidated Complaint, *Lawrence E. Jaffe Pension Plan, v. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, March 12, 2003, (henceforth the "Complaint"), paragraphs 196 and 217..

[39] Moreover, Professor Fischel's claim is not true as a logical matter. In quantifying inflation he assumed that HI's stock price was uninflated after the Class Period ended (October 11, 2002) and estimated HI's True Value going **backward** in time (a "backward cast approach"). He could instead have reversed the procedure and begun by assuming that HI's stock price was not inflated at some sufficiently early date and then estimated its True Value going **forward** in time, using the results of a regression analysis as before (a "forward cast approach"). I performed such a forward-cast analysis, starting on each feasible Pre-Class Period date when Plaintiffs alleged that the stock may have first become inflated, *i.e.*, each date from October 23, 1997 through July 29, 1999, using Professor Fischel's own regression model estimated over the 250 trading days prior to each start date. Exhibit 2 displays the resultant estimated inflation as of July 30, 1999. As this analysis reveals, regardless of when Plaintiffs may assert that HI's stock price may have first become inflated, the resultant inflation that prevailed as of July 30, 1999 is never equal to $17.81 per share or $7.97 per share (with any estimation period ending in 1999) as Professor Fischel assumes without considering market factors and facts during the Pre-Class Period. If omissions lead to an inflated stock price, it should be possible to use regression analysis to measure inflation in a forward cast model just as easily as Professor Fischel purports to do in his backward casting model from the end of the Class Period to its beginning. I provide this analysis only to show that there is no merit in Professor Fischel's claim that inflation cannot be quantified mechanically using a regression analysis if the alleged fraud relates to omissions. This analysis should not be viewed as my opinion that there was any inflation in HI's stock price as I have found no evidence that such inflation was ever present.

[40] Status Report, page 3.

[41] If the Court were to determine that the Class Period should start from August 16, 1999 instead of July 30, 1999 based on the Plaintiffs new claims described in the Status Report, then Professor Fischel's **existing** quantifications of daily alleged inflation for the July 30, 1999 - August 15, 1999 period using the Disclosures or Leakage models would be estimates of Pre-Class Period inflation, by construction.

[42] In his rebuttal report, Professor Fischel has proposed a new version of his Leakage model, in which he assumes that the daily inflation should be computed without the "artifact" of an inflation cap adjustment, even though Professor Fischel himself had introduced such a cap in the Fischel Report. [Source: Fischel Rebuttal Report, footnote 6.] In Exhibit 3, I have produced the daily inflation estimates for all dates from January 3, 1992 to July 29, 1999 using Professor Fischel's unadjusted Leakage model. Note, however, that

Disclosures model.[43] Neither model can identify when the alleged fraud introduced inflation into HI's stock price. That is, according to both of Professor Fischel's models, there is no day (going as far back as January 3, 1992),[44] when HI's stock price was not inflated.

Notably, as I discussed earlier, Plaintiffs now concede that the Court may determine the first actionable non-disclosure did not occur until August 16, 1999 and Professor Fischel has already provided daily inflation estimates for dates that precede such an Alternative Class Period Start Date.

Thus, Professor Fischel's mechanical calculations **can** be extended backward in time to trace the alleged Phantom Inflation to its alleged inception, regardless of how early such alleged fraud may have occurred. Professor Fischel has refused to do so perhaps because doing so highlights the illogical roots of Professor Fischel's Phantom Inflation theory, according to which HI's stock price was always "inflated" from its very inception as a public company by $7.97 per share, according to one of his inflation models. Absent any investigation of how, when and the extent to which inflation was introduced into HI's stock price, or dissipated prior to November 15, 2001, Professor Fischel has provided "quantifications" of Phantom Inflation that are by assumption (at the Plaintiffs' instruction), "consistent with the Plaintiff's claims."[45]

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the daily inflation estimate is never higher than $23.94. Hence, these daily inflation estimates would remain unchanged even if the "adjusted" version of Professor Fischel's Leakage model was used instead. Neither version yields a single date from January 3, 1992 through July 30, 1999 when the inflation was estimated to be zero.

[43] According to Professor Fischel's Disclosures model, the daily alleged inflation will remain constant at $7.97 per share on all dates prior to July 30, 1999.

[44] The Class Period was originally alleged to begin on October 23, 1997. [Source: Complaint, paragraph 1.] Plaintiffs allege that mis-statement of certain contract costs related to certain contracts, the earliest of which was entered into on April 14, 1992, Predatory Lending and Re-Aging fraud caused HI's stock price to be inflated between "10/97 and 10/02." [Sources: Complaint, paragraph 342(e) and paragraph 2; and Kuska, Alan, and William Long, "Accounting Treatment – GM Card Arrangement," KPMG, August, 2002, (HI KPMG 025789 - HI KPMG 025801).] Hence, January 3, 1992 predates by at least three months the possible advent of any inflation in HI's stock price, according to the Plaintiffs' Complaint.

[45] Lead Plaintiffs' Opposition, page 3.

B. Professor Fischel concludes that none of the Phantom Inflation dissipated before November 15, 2001 ignoring numerous prior events that would be deemed disclosures according to his own flawed logic.

According to Professor Fischel's analysis, no new inflation was introduced into HI's stock price after July 30, 1999. The Phantom Inflation he quantifies was introduced earlier, and simply persisted during the Class Period because of what Professor Fischel calls "inflationary events" that did not actually affect the level of claimed inflation at all until November 14, 2001. Professor Fischel has, however, failed to examine whether prior disclosures had caused the Phantom Inflation to dissipate before the Class Period began. If such prior disclosures had dissipated all the Phantom Inflation before July 30, 1999 then Plaintiffs damage claims would be equal to zero. Professor Fischel refuses to examine the economic evidence about such prior disclosures that would contradict the Plaintiffs' claims upon which his analysis rests.

As I discussed earlier, there is no economic basis to assume that "news related to Plaintiffs' allegations"[46] constitute disclosures of the "truth" as Professor Fischel assumes. By definition, selected third-party commentary or allegations are "related to Plaintiffs' allegations."[47] Such events do not constitute disclosures (*i.e.*, reflect the "truth" about the alleged fraud coming into the market) as Professor Fischel assumes. Setting aside this fundamental flaw, Professor Fischel ignores numerous similar events[48] that would be deemed disclosures by his own logic that occurred before November 15, 2001. In an efficient market, such disclosures would have dissipated the Phantom Inflation (if any ever existed) by Professor Fischel's own logic. By refusing to consider this possibility, Professor Fischel violates the market efficiency principle of that he claims to rely upon.

[46] Fischel Rebuttal Report, footnote 14.
[47] Fischel Rebuttal Report, footnote 14.
[48] For instance, Plaintiffs' own expert, Catherine A. Ghiglieri, identifies numerous such events prior to November 15, 2001 that would be considered "disclosures." [Source: Expert Witness Report of Catherine A. Ghiglieri, *Lawrence E. Jaffe Pension Plan, v. Household International, Inc., et al.*, Case No. 02-C-5893, filed in the United States District Court, Northern District of Illinois, Eastern Division, August 15, 2007, Appendix D (henceforth the "Ghiglieri Report").] Additionally, in Exhibit 4, I have provided 20 instances of similar events that would be also considered "disclosures" under Professor Fischel's own flawed logic.

Professor Fischel's analysis is thus fatally flawed because he has refused to analyze the economic evidence to assess independently whether the Phantom Inflation (assuming it ever existed) had dissipated prior to the beginning of the Class Period (July 30, 1999) because he was instructed not to do so.[49]

C. Professor Fischel incorrectly assumes that HI's price change is attributable to the alleged fraud, and he ignores contradictory economic evidence.

1. Professor Fischel's Leakage Model

In his Leakage model, Professor Fischel makes no attempt to identify disclosures that could have caused HI's stock price decline, whether related to the alleged fraud or not. Professor Fischel's analysis fails to establish loss causation because, by assumption, he attributes "decline in the security price that is not due to movements in the market or the industry to disclosure of the fraud,"[50] which over-estimates any true damages when "the disclosure of a fraud is associated with the release of other company-specific bad news,"[51] according to a paper by Cornell and Morgan that Professor Fischel has relied upon.

There is no basis to conclude from an economic or logical perspective that (a) simply because HI's stock price did not perform as well as the industry or the market over a selected period, the Plaintiffs' can claim fraud-related damages; or (b) such damages, if any, can be determined by comparing its performance to the industry and the market index, because many other non-fraud related factors can affect HI's daily relative performance.[52, 53]

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[49] Lead Plaintiffs' Opposition, page 3.

[50] Cornell, Bradford and R. Gregory Morgan, 1990, "Using Finance Theory To Measure Damages In Fraud On The Market Cases," *UCLA Law Review*, Vol 37:883, page 903 (henceforth "Cornell and Morgan"). In his Leakage model, Professor Fischel assumes that HI's stock price would have earned the "predicted return" he has (incorrectly) estimated using a regression model, on each date between November 15, 2001 and October 11, 2002. The statistical analysis which he used to calculate the predicted return is fundamentally flawed as I have discussed in the Bajaj Report.

[51] Cornell and Morgan, page 903.

[52] Professor Fischel claims that I do not explain HI's stock price underperformance and that I calculated "substantial artificial inflation" in Exhibit 6 of the Bajaj Report. The calculation of artificial inflation in Exhibit 6 was not my attempt of providing an alternative inflation model. It was rather an illustration to

2. *Professor Fischel's Specific Disclosures Model*

In his Specific Disclosures model, Professor Fischel assumes that the Phantom Inflation began dissipating after November 14, 2001 following 14 purported Specific Disclosures when the market received "news related to Plaintiffs' allegations." He cherry-picks these Specific Disclosures through a selective, incomplete and misleading analysis and ignores evidence that directly contradicts his conclusion that "economic evidence is consistent with Plaintiffs' claim that the alleged wrongdoing caused investors in HI's common stock to incur losses."[54] Professor Fischel protests my criticism that his methodology reflects "cherry-picking." However, Professor Fischel's selection criteria[55] confirm that his methodology **is** precisely "cherry picking." He has (a) ignored dates when the market received news related to the Plaintiffs' allegations (*i.e.*, a potential disclosure date, according to his flawed logic) but HI's price change was not significant; but (b) included other dates when the market did not receive news (and instead received stale information that reflected third party commentary about old allegations) because he (incorrectly) concluded that HI's stock price change on those dates was statistically significant. Professor Fischel's analysis is thus flawed for at least four reasons.

First, Professor Fischel assumes that selected "news related to the Plaintiffs allegations"[56] constitutes curative disclosure. Thus, Professor Fischel views news or commentary about allegations as "disclosures" because such events are "related to the Plaintiffs' allegations." He fails to recognize that allegations, criticism or negative commentary do not automatically reflect truth about the alleged fraud coming into the market. Absent any independent analysis of whether the alleged fraud ever caused HI's stock price to

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show the flaw in Professor Fischel's analysis (*i.e.*, his inflation measures are subject to change significantly by changing the estimation period).

[53] If one assumes that inflation existed for any company, then one will conclude that large damages exist by construction, as I demonstrated in my illustration involving all 30 member companies of the Dow Jones Industrial Average ("DJIA"). [Source: Bajaj Report, Section VI-C, pages 76-77] Professor Fischel criticizes this illustration because it is based on the "comparable index approach" and lacks "analysis of the economic evidence." [Source: Fischel Rebuttal Report, footnote 7.] However, the "economic evidence" provided by Professor Fischel relating to HI is merely a collection of assumptions about inflation based on Plaintiffs' allegations. Also, as I explain in this section, Professor Fischel's "Quantification Including Leakage" model is based on the same "comparable index" approach.

[54] Fischel Report, paragraph 11.

[55] Fischel Rebuttal Report, footnote 14.

[56] Fischel Rebuttal Report, footnote 14.

become inflated, or whether such inflation had dissipated earlier, there is no logical basis to assume, as Professor Fischel does, that HI's stock price declines on Specific Disclosures after November 14, 2001 reflects dissipation of inflation.

Second, Professor Fischel ignores dates when "news related to the Plaintiffs' allegations" came into the market but investors yawned in response, *i.e.,* HI's price reaction was insignificant even by Professor Fischel's own (flawed) measure. Such economic evidence directly refutes Professor Fischel's central premise that HI's stock price must have been inflated to begin with.[57] Since Professor Fischel ignores economic evidence that is inconsistent with Plaintiffs' theory, his conclusion that there exists economic evidence that is consistent with Plaintiffs' theory is unsurprising and meaningless.

For instance, Professor Fischel claims that the markets first came to learn of a California Department of Corporations ("CDC") lawsuit against HI for violating lending laws on November 14, 2001 (after close of trading). He is wrong because this news was made public on November 9, 2001[58] and HI's stock price reaction that day was statistically insignificant, even according to Professor Fischel's own flawed statistical analysis. Moreover, nearly five months earlier, on June 19, 2001, the market learnt that the CDC had "compelled two consumer finance lenders [including HI] to refund over $1.5 million to customers as a result of irregularities discovered in routine examinations."[59] HI's stock price reaction that day was also statistically insignificant even according to Professor Fischel's own (flawed) statistical analysis.[60]

[57] Fischel Rebuttal Report, paragraph 36.
[58] Plaintiffs' expert, Catherine A. Ghiglieri recognizes that November 9, 2001 was the date when the CDC lawsuit was announced. [Source: Ghiglieri Report, Appendix E.]
[59] "Corporations Delivers $1.5 Million for Consumers; Routine Examinations Result in Significant Refunds," *Business Wire*, June 19, 2001, at 12:21 P.M.
[60] Professor Fischel dismisses other non-fraud related news released on November 15, 2001 that could explain HI's price reaction on that date such as the news (released after-hours on the prior day) about the increase in the default rates of Providian, another consumer finance company. He remarks "Household's stock price was largely unchanged until the Company responded to the lawsuit at 1:40 PM." [Source: Fischel Rebuttal Report, paragraph 21.] He fails to note that HI denied CDC's allegations. According to Professor Fischel's theory, HI's denials introduced, not removed, inflation. [Source: Fischel Report, paragraph 23.] Therefore, HI's price decline following the Company's denial on November 15, 2001 cannot be viewed as dissipation of inflation, according to his own theory.

Third, as discussed earlier, Professor Fischel ignores potential disclosures prior to July 30, 1999 and thus fails to consider whether HI's stock price was inflated due to Pre-Class Period mis-representations by the beginning of the Class Period on July 30, 1999.[61]

Fourth, Professor Fischel's claim that the 14 Specific Disclosure dates he picked were ones when HI's stock price reaction was statistically significant is incorrect, even if we set aside the bias in using such a criterion in the first place. Correcting for methodological flaws in his statistical analysis, only 2 of these 14 dates remain significant as I discuss below. Moreover, statistical significance by itself is insufficient to establish loss causation because the stock's price movement on a particular date could have been caused by non-fraud related reasons including random noise.

III. Professor Fischel's Quantification Of Phantom Inflation Violates Well-Accepted Statistical Principles

A. Professor Fischel's regression analysis is flawed.

Professor Fischel's inflation quantifications are based on a regression analysis which depends critically on the Sample Period[62] and the market and industry indices (or regressors) selected. Professor Fischel's selection of both these critical elements is fundamentally flawed. Therefore, the results of his analysis are unreliable and speculative and which generate unreliable measures of inflation that are significantly over-stated by design.[63]

Notably, according to Professor Fischel's own logic, HI's stock returns were "affected" by the alleged fraud during Professor Fischel's Sample Period (November 15, 2000 - November 14, 2001) because these dates are within the Class Period. However, according to Cornell and Morgan's study, which Professor Fischel claims to have relied

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[61] I explain in detail why Professor Fischel's rebuttals to other selected dates are invalid in Exhibit 5.

[62] The period over which 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)" is estimated. [Source: Fischel Report, paragraph 32.] Professor Fischel uses 248 trading days preceding November 15, 2001 as the Sample Period in his regression analysis. Moreover, as discussed earlier, Professor Fischel's section of November 15, 2001 as the first Disclosure date is incorrect from an economic perspective. Hence, his Sample Period is tainted (henceforth "Tainted Sample Period").

[63] Bajaj Report, Section VII.A.

upon, the sample period should be selected when the company's stock returns are **not** affected by the alleged fraud.[64,65] Only 3 of the 14 selected Specific Disclosure dates remain statistically significant[66] using Professor Fischel's own regression model, run over the 250 trading days prior to the start of the Class Period instead of over his Tainted Sample Period.

Moreover, Professor Fischel's selection of regressors in the regression model he presented in the Fischel Report ("Original Fischel Model") is critically flawed.[67,68] As I explained in the Bajaj report, Professor Fischel's selection of indices is incompatible with statistical reasoning. By omitting a significant explanatory variable (an index of consumer finance companies such as HI), Professor Fischel had concluded that HI's stock return was negatively related to the market index, *i.e.*, HI's returns on average declined when the market (the Standard & Poor's 500 index, or "SPX") went up. Such a

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[64] Cornell and Morgan, pages 898-899.

[65] Professor Fischel incorrectly claims that my "estimation period is objectionable because it unnecessarily includes the period of price movements he is analyzing." [Source: Fischel Rebuttal Report, footnote 27.] He fails to note that in running my regression over the entire Class Period I had separately identified each of Professor Fischel's Specific Disclosure dates, using an Indicator Variable. This is a well-accepted statistical technique. [Source: Kennedy, Peter, 2003, *A Guide to Econometrics*, 5th Ed., Cambridge, MA: The MIT Press, page 253.] My analysis had demonstrated that: "Statistically, the joint impact of all 14 Specific Disclosure dates that Professor Fischel has identified is insignificant." [Source: Bajaj Report, Exhibit 7B.]

[66] Statistically significant at the 5% level in a 2-tailed test.

[67] In that model, Professor Fischel uses the Standard & Poor's 500 index ("SPX") and the Standard & Poor's Financial index ("S&P Financials") as the two regressors because he notes that HI compared its stock performance to these indices in its proxy statements. He claims in his rebuttal that I had ignored such an explanation which he had provided in the Fischel Report paragraph 31. I had not. Instead, as I had explained in the Bajaj Report, running a regression model requires statistical analysis that is different from a simple comparison of two sets of numbers as HI had done in its proxy statement. The selection of regressors requires consideration of various measures of the strength of the estimated statistical relationship derived using these indices in tandem, *e.g.*, the regression's adjusted R-squared (as a study by Tabak and Dunbar, that Professor Fischel has cited, notes). Professor Fischel has failed to provide the adjusted R-squared of his model, even though this is a well-known measure that is routinely considered to determine the validity of a particular regression model. Nor has he explained what statistical criteria, if any, he did employ to select his particular regressors. [Source: Tabak, Richard, and Frederick Dunbar, 2001, "Materiality and Magnitude: Event Studies in the Courtroom," *Litigation Services Handbook*, Chapter 19, (henceforth "Tabak and Dunbar"), page 6.]

[68] After reviewing my explanation, Professor Fischel concedes that his regression model is flawed in design because he fails to remove HI from the two indices he used in running his market model. [Source: Fischel Rebuttal Report, footnote 25.] In light of the more fundamental technical and conceptual errors in his analysis, I had stated that "my conclusions about the flaws in Professor Fischel's statistical analyses remain unchanged even after removing the influence." [Source: Bajaj Report, footnote 317.] Professor Fischel, however, incorrectly interpreted my remark as sufficient reason for him not to correct his analysis, which remains "incorrect as a matter of statistical principles" as a result.

counter-intuitive result is a strong sign that the model being employed is mis-specified (in this case because of the "omitted variable"). In rebuttal, Professor Fischel has introduced two new regression models, namely one in which he adds the consumer finance index that I had constructed ("New Fischel Model 1"), and another in which he drops the S&P Financials and uses a single repressor, namely SPX ("New Fischel Model 2"). Notably, Professor Fischel retains his Tainted Sample Period in both new models.

Professor Fischel claims that he continues to find that all 14 of his Specific Disclosure dates remain statistically significant under New Fischel Model 1.[69] However, this claim is without merit because it is an artifact of his choice of a tainted Sample Period. Running the New Fischel Model 1 either over the entire Class Period or over the 250 days prior to the start of the Class Period would result in only 5 and 2 of the 14 Specific Disclosure dates as being statistically significant, respectively.[70,71]

Professor Fischel claims that the sign of his regressor (SPX) turns positive as predicted when he drops the S&P Financials. Such a claim, however, does not establish that the regression model that Professor Fischel relied upon to quantify inflation is correct. Instead, it confirms that his original regression model, and the inflation quantifications based on that model are fundamentally flawed, as I explained in Bajaj Report. In addition, as Tabak and Dunbar noted, the choice of a model is "suspect" when it is made

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[69] Fischel Rebuttal Report, paragraph 20.

[70] In running these regressions, I removed HI from the S&P 500 Index and the S&P Financials Index.

[71] Such significance is measured at the 5% level in a two-tailed test. As I had described in Bajaj Report, Section VII.A, and in particular in footnote 302, statistical significance is commonly determined at the 5% level in a **two-tailed** test, i.e. a test in which there is no hypothesis *a priori* about the direction in which the stock price will move in reaction to a day's events. Professor Fischel has employed such a two-tailed test (and not a one-tailed test as he incorrectly claims) because his regression model identifies both positive and negative residual returns. In such a two-tailed test, the farther the t-statistic is from zero, the stronger is the statistical evidence that the day's market adjusted price change was not caused by random noise alone. [Notably, however, the direction of such a change is **not** pre-specified.] If the t-statistic is greater than 1.96 in absolute magnitude then the conclusion that the day's market adjusted price change was not caused by random noise alone can be made with 95% confidence, the commonly accepted threshold. Professor Fischel claims to have relied upon such a 95% confidence threshold but incorrectly considers HI's stock residual returns with t-statistics greater **in absolute sign** than 1.65 as evidence of statistical significance. His choice of such a lax standard reflects his confusion about statistical principles that govern tests of significance. Professor Fischel fails to recognize that t-statistics for a one-tailed test is never defined in absolute terms (as he has done) and t-statistics is always defined in absolute terms in a two-tailed test (which he claims not to have employed).

by the expert "without objective criteria."[72] They note that objective criteria, such as the adjusted R-squared, should be considered in comparing the strength of predicted relationships between the stock's return and alternative sets of regressors. Notably, however, Professor Fischel has never provided the adjusted R-squared for any of the regressions he has run thus far in either his direct or his rebuttal reports. I have replicated his analysis and found that the adjusted R-squared declines from 53.55% in the Original Fischel Model to 32.39% in the New Fischel Model 2, when the tainted Sample Period is retained. In contrast, my regression analysis "yields a much higher adjusted R^2 value of 60.33% compared to the adjusted R^2 value of 53.56% in Professor Fischel's regression."[73]

Although Professor Fischel has proposed two new regression models in attempting to rectify the shortcomings in his original model, he has failed to note that each of these models will result in two new inflation quantifications using his own theory, *i.e.*, 4 new inflation quantifications, which Professor Fischel does not provide.[74] In addition, Professor Fischel has purportedly corrected an "artifact" of a "$23.94 inflation cap" that he had previously included in his Leakage-based inflation quantification.[75] Therefore, in total, Professor Fischel's analyses would result in 7 different inflation measures. Professor Fischel does not clarify which of these models he considers a reasonable representation of the inflation in HI's stock price caused by the alleged fraud. Instead, Plaintiffs propose offering these, and possibly other quantifications that Professor Fischel may be instructed to determine, as a menu from which the jury can select.

Such a proposal contradicts economic logic. Even if the Plaintiffs' Persistence Theory of damages were assumed to be valid, it is incorrect from an economics perspective to claim that the **same fraud** introduced **different amounts of inflation on the same date**, or not introduce any inflation at all on a given date according to one model but do so according

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[72] Tabak and Dunbar, page 5.
[73] Bajaj Report, pages 81-82.
[74] As discussed earlier, based on the results of a regression model Professor Fischel quantifies alleged inflation in two different ways (using the Leakage and Disclosures approaches). Thus, given two new regression models, he would have two new Leakage-based inflation measures and two new Disclosures-based inflation measures.
[75] Fischel Rebuttal Report, Exhibit B.

to another. Yet, this is precisely what the 7 alternative inflation models based on Professor Fischel's theory show. Such differences are considerable. For instance, the inflation that purportedly persisted on the first day of the Class Period (July 30, 1999) is $7.97 per share according to Professor Fischel's Disclosures model and $17.81 per share according to Professor Fischel's Leakage model even though this inflation was purportedly introduced by the **same** alleged Pre-Class Period fraud.[76] This inconsistency again reveals the fundamental fallacy of Professor Fischel's analysis. He has failed to properly assess loss causation and identify how, when and the extent to which such alleged fraud ever caused HI's stock price to become inflated and to examine whether some of such initial inflation dissipated before the Class Period began.

B. Neither of Professor Fischel's inflation models is an "event study" as described in the published research that he purportedly relied upon.

Cornell and Morgan describe the steps necessary to quantify inflation using either an "event study" or a "comparables index" approach. Both begin with selecting a sample period during which the stock's return is not affected by the alleged fraud. Yet, as discussed earlier, Professor Fischel's selected Sample Period is tainted precisely in this manner. Hence, neither Professor Fischel's Specific Disclosure model nor his Leakage model can be considered an "event study," according to criteria established by Cornell and Morgan, the study Professor Fischel claims to have relied upon in developing his methodology.

Moreover, Cornell and Morgan note that, "The comparable index approach is a limiting case [of the event study approach] in which the observation window is expanded to cover the entire class period."[77] Under a "Leakage" theory, the observation window could be widened to include more than one day. According to Tabak and Dunbar, "In securities

[76] Moreover, there is no logical basis to perform a backward-cast analysis to estimate daily inflation. Using a forward-cast inflation estimation process, assuming that the inflation was by definition equal to zero at some Pre-Class Period date, is equally logical and would result in other different inflation measures. For instance, Professor Fischel states 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." [Source: Fischel Rebuttal Report, paragraph 36.]

[77] Cornell and Morgan, page 906. "Observation window" refers to the length of time over which the identified event's impact on the stock's return is measured.

fraud cases, many experts have adopted the convention of looking at one-day, two-day, or five-day periods following an announcement."[78] In contrast, Professor Fischel claims that the observation window in this case should span the 228-day period (November 15, 2001 through October 11, 2002; the "Post November 14, 2001 Period"). Notably, in Professor Fischel's analysis the Class Period includes (a) the Sample Period which should not be tainted according to Cornell and Morgan, and (b) the "Post November 14, 2001 Period, when HI's stock return was also purportedly affected by the alleged fraud.

In Cornell and Morgan's analysis, the "class period" is the entire period over which the stock is assumed to be affected by the alleged fraud. Therefore, if Professor Fischel claims that his Sample Period is not tainted (without which assumption both his inflation models are fundamentally flawed according to Cornell and Morgan), then he is implying that the class period (in Cornell and Morgan's terms) is entirely spanned by the Post-November 14, 2001 Period. By estimating HI's True Value over the Post-November 14, 2001 Period based on comparable indices alone, Professor Fischel's Leakage model is identical to Cornell and Morgan's comparable index approach.

As discussed earlier, assuming that the daily deviation between HI's stock return and the return predicted by changes in market and industry indices represents "inflation," as is done in the Comparable Index approach, and as Professor Fischel does in his Leakage model over the Post November 14, 2001 Period, fails to consider the myriad of firm-specific non-fraud factors that affected HI's stock price over these 11 months and results in over-stated and unreliable damages estimates.[79]

IV. Plaintiffs' Selective Netting Theory Is Flawed From An Economics Perspective

Plaintiffs argue that in assessing the validity of their damages claims from an economics perspective determination of Pre-Class Period Inflation (before July 30, 1999) is

[78] Tabak and Dunbar, pages 7-8.
[79] Cornell and Morgan, page 903.

irrelevant because they are not entitled to losses incurred during that period given the Court's statute of limitations decision.[80]

Plaintiffs' argument is incorrect for two reasons. First, an independent analysis of Pre-Class Period Inflation is critical in this case to determine what caused the Plaintiffs' losses. Second, as Plaintiffs concede, their alleged damages should be netted against the gains they derived from selling inflated shares. Plaintiffs, however, argue that such netting of gains should be done selectively, *i.e.,* gains on shares purchased before the Class Period began ("Pre-Class Period Purchases") that were subsequently sold at allegedly inflated prices during the Class Period should not be considered in computing net damages.[81] There is no economic basis for such a selective netting approach, which Plaintiffs' expert, Professor Fischel, has not endorsed. The Court, too, has not ruled on the merits of the Plaintiffs' selective netting theory from a legal perspective.

If the Court were to rule that gains on Pre-Class Period Purchases that were sold during the Class Period should be netted then one would have to determine the extent to which such shares were inflated at the time of purchase.[82] Hence, Plaintiffs' damage theory remains critically incomplete, given Professor Fischel's failure to quantify when HI's stock price became inflated prior to the Class Period and the extent of daily inflation that was allegedly present thereafter.

Respectfully submitted,

Mukesh Bajaj

Mukesh Bajaj, Ph.D.

[80] Status Report, page 3.
[81] Plaintiffs' Further Supplement.
[82] Affidavit of Mukesh Bajaj, *Lawrence E. Jaffe Pension Plan, 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 13, 2007.

EXHIBIT 4

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

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LAWRENCE E. JAFFE PENSION PLAN, on Behalf of Itself and All Others Similarly Situated,

Plaintiff,

Lead Case

-against- No. 02-C-5893

HOUSEHOLD INTERNATIONAL, INC., et al.,

Defendants.

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VIDEOTAPE DEPOSITION of MUKESH BAJAJ, taken by the Plaintiff at the offices of Cahill, Gordon & Reindell, 80 Pine Street, New York, New York 10005, on March 25, 2008, at 9:35 o'clock a.m., before Catherine M. Donahue, a Certified Court Reporter and Notary Public within and for the State of New York.

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ALSO PRESENT:
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I N D E X

E X H I B I T S

(Exhibits attached with transcript.)

IT IS HEREBY STIPULATED AND AGREED, by and between the attorneys for the respective parties hereto that the sealing and filing of the within deposition be, and the same hereby are waived; and that the transcript may be signed before any Notary Public with the same force and effect as if signed before the Court.

IT IS FURTHER STIPULATED AND AGREED that all objections, except as to the form of the question, shall be reserved to the time of the trial.

THE VIDEOGRAPHER: Here begins the videotape deposition of Mukesh Bajaj, Tape 1, Volume 1, in the matter of Lawrence E. Jaffe Pension Plan versus Household International, et al, filed in the United States District Court, Northern District of Illinois, Eastern Division, Case No. 02-C-5893.

Today's date is March 25, 2008, and the time on the video monitor is 9:37. The video operator today is T. J. Freda, representing West Court Reporting Services. The court reporter is Catherine Donahue of Regency Reporting on behalf of West Court Reporting Services. Today's deposition is being taken on behalf of plaintiff and taking place at 80 Pine Street, New York, New York.

Counsel please introduce yourself and state whom you represent.

MR. BURKHOLZ: Spencer Burkholz, and with me is Luke Brooks, Cameron Baker and Mike Keable from Lexon, for

the plaintiff.

MR. OWEN: David Owen with Cahill, Gordon & Reindell, and with me is Jason Hall, Michael Wernke and Megan Cremins, and I work for the Household defense.

THE VIDEOGRAPHER: Would the court reporter please swear in the witness.

(The witness is sworn by the court reporter.)

THE VIDEOGRAPHER: Please proceed.

M U K E S H B A J A J, called as a witness by Plaintiff, having been first duly sworn by Catherine M. Donahue, a Notary Public within and for the State of New York, was examined and testified as follows:

EXAMINATION BY MR. BURKHOLZ:

Q. Good morning.
A. Good morning, Counselor.
Q. Is there any reason you can't give your best testimony today?
A. No.
Q. Are you under any medication?

A. No, nothing that would be of any concern.
Q. Okay.
So, you're ready to have your deposition taken today?
A. Sure.
Q. Okay.
And you understand the English language, obviously, correct?
A. Yes.
Q. And you have given your deposition a number of times in the past, right?
A. Yes.
Q. And testified in court also, correct?
A. Correct.
Q. And you understand you're testifying under penalty of perjury today?
A. Yes.
Q. Okay. Thank you.
I would like to take breaks on the hour. If you need a break before then, just let me know and I'll try to accommodate that. If I have a pending question, I would appreciate if you answer it; otherwise, if you need to take a

break, you'll let me know.
Okay?
A. I understand.
Q. Okay.
What were you asked to do in this case?
A. I was asked to review a report of Daniel Fischel filed in this action and to evaluate it from an economic perspective.
Q. Were you asked to opine on any liability issues in this case?
A. Well, I was asked to consider whether Professor Fischel's analysis is consistent with loss causation. I don't know if that would count as a liability issue or not.
Q. Separate from loss causation, were you asked to -- strike that.
You're not opining, are you, on any liability issues with respect to Household's reageing practices, are you?
MR. OWEN: Object to the form of the question. The question is ambiguous.
A. I'm not opining on any factual determination that would go into adjudicating

the liability issue. I'm only opining on economic evidence that Professor Fischel analyzed.
Q. Do you have an opinion as to whether or not Household's public disclosures violated the Federal securities laws?
A. I don't have any opinion on that issue from a factual or legal perspective, but based on my review of the economic evidence, it is my opinion that there is no economic evidence that could be consistent with Household defendants having violated securities laws.
Q. So, just so we're clear, you are offering opinion in this case that Household's public disclosures complied with the Federal securities laws?
A. I am not here to testify on whether or not Household's disclosure policies complied with applicable legal standards. I am here to opine on my conclusion that economic evidence is not consistent with plaintiff's assertions that as a result of material misstatements and omissions by Household defendants, the company's stock price was inflated going into the class period.

Q. Have you ever offered an expert opinion in the area of reageing practices?
A. Not that any comes to mind explicitly on reageing practices.
Q. We're going to look at your report in this case and the testimony that you presented to us, your prior testimony. I didn't see anything in that area. I just want to make sure I understand this, and you have not provided any opinion in a prior case in the area of predatory lending, have you?
A. Not explicitly focused on predatory lending and nothing comes to mind, actually.
Q. Okay.
What about in terms of accounting practices, have you opined in the area of whether or not a company's practices comply with accounting regulations?
A. Not from the point of view of accounting regulations and requirements. Only from an economic perspective.
Q. And what case would that be?
A. Again, I'd have to look at my CV, but in securities fraud cases there often is an issue of whether or not company's accounting

statements were misstated and that becomes the basis for plaintiff's argument that there was securities fraud.
Q. So you've never been qualified by a court to testify as an expert in the area of reageing, correct?
A. Not for reageing. Yes, I don't consider myself an expert on accounting or legal issues pertaining to reageing.
Q. Okay.
And in the area of predatory lending, no court has ever qualified you as an expert to opine in that area, correct?
A. Same answer. In other words, I am not an expert on accounting or legal issues as they might pertain to allegations of predatory lending.
Q. Do you have any expertise in the area of predatory lending?
A. Well, I'm a financial economist and I consider myself to be an expert to evaluate economic evidence as it pertains to allegations of predatory lending.
Q. In what case have you done that in before?

A. No particular case comes to mind.
Q. In what case have you done that in the area of reageing?
A. Again, no case comes to mind.
Q. Now, you've provided an expert report and a rebuttal report in this case, correct?
A. I provided an expert report which was a rebuttal report and then a surrebuttal report.
Q. Yes.
And you criticized Dr. -- Professor Fischel's approach to estimating inflation in this case, correct?
A. Among other things, yes.
Q. You have a number of criticisms in your report, correct?
A. Correct.
Q. Okay.
Have you independently attempted to estimate inflation in Household's stock in this case?
A. I found no basis to estimate any inflation in Household's stock today because I did not see any evidence that the stock was ever

inflated.
Q. Did you ever separate from analyzing and criticizing the model that Professor Fischel came up with, did you independently come up with a model on your own to try to estimate inflation?
A. Again, my examination of evidence led me to the conclusion that there would be no basis to estimate any inflation because there is no evidence that the stock was ever inflated.
Q. And so you did not independently try to estimate inflation through a model different than what Professor Fischel put forth in his report?
A. You know, I think I have answered this question. You know, I just want to make sure I'm being responsive to you but, as I said, the only way to answer this question that I can think of that would be responsive is there was no need to estimate any inflation because there's no evidence that there was ever any inflation.
Q. And when you say there's no evidence, did you take any assumptions into mind in terms of the defendant's defenses in this

case; in other words, did you assume that their defenses were correct in this case?
MR. OWEN: Object to form.
A. I don't understand your question.
Q. Okay.
A. If you're asking --
Q. It was a bad question. Let me try to rephrase it.
A. Okay.
Q. Your analysis in this case shows that there's no inflation in Household's stock price during the class period, correct?
A. Yes.
Q. And that the plaintiffs in this case would be entitled to zero damages, correct?
A. Well, if there's no inflation, then it follows that there are no damages.
Q. Do you agree with any part of Professor Fischel's analysis in this case?
A. Well, I certainly believe the kind words he had to say about me in his deposition.
Q. Other than that?
A. I would have to review the report. And if you're asking me are there parts of his report, sentences in the report that I would

agree with, I'm sure there are; but I thought from a substantive point of view his opinions were incorrect.
Q. And Professor Fischel is somebody you respect, correct?
A. Yes.
Q. You have actually worked on cases with his company, correct?
A. Yes.
Q. And you have been on the other side of cases with him also?
A. Yes.
Q. Now, Professor Fischel selected in doing his regression model S&P 500 and the S&P --S&P Finance Group, correct?
A. He used S&P 500 index and S&P financial index, yes.
Q. Okay.
And then you criticized him for that and said that he should consider a peer group of consumer finance companies, I believe six of them that you put together in your rebuttal report, correct?
A. Well, I criticized him for the fact that his regression analysis in the form in

which he used it was obviously misspecified, and that one way to correct that problem would be to include, in addition, the consumer finance index. I did not say that the only reasonable form of regression would be one with consumer finance index in it.
So my criticisms are a little bit more general than what particular type of regression would be better than the one that he presented.
Q. Okay.
And Professor Fischel then went ahead and incorporated your consumer finance group, peer group into his analysis and he presented that in his rebuttal report; you have seen that, correct?
A. I saw where he claimed that when he also includes this additional index while keeping the obviously incorrect estimation period, he got results that were reasonably consistent with his original report. That was not a proper fix and that did not get rid of the misspecification issue that I had pointed out, nor was his inclusion of the S&P or the consumer finance index carried out in an appropriate way.

Q. Okay.
We'll get to that. I have a lot of questions about the model. I just want to understand your differences with Professor Fischel.
I want to show you what we'll mark as Bajaj Exhibit 1, which is Professor Fischel's rebuttal report. And I've gone ahead and tabbed on some of these documents the pages I'm going to have you look at to make it easier for us.
(Rebuttal Report of Professor Fischel was marked as Bajaj Exhibit 1 for identification, as of this date.)
MR. BURKHOLZ: And for counsel also.
MR. OWEN: Thank you.
BY MR. BURKHOLZ:
Q. So I want to have you just take a look at, and feel free to look at it and familiarize yourself with the document, but I know you have seen this report before. I'm turning you to Exhibit G of his rebuttal report.
The first tab I'm going to get to in a little bit.

A. Okay.
Q. The second tab is Exhibit G, and that is separate with the issues from the estimation period. This is his attempt at incorporating your six company consumer finance group into his regression analysis. And those are the results, you've seen that before, right?
A. I've seen that, but this table does not give me the regression equation that leads to the numbers and other entries that are on this page.
Q. Okay.
And you've read Professor Fischel's, you've read this report before, because, in fact, you filed a surrebuttal report, right?
A. Yes, indeed.
Q. You indicated the approach he took -- strike it.
Is it the R squared you're looking for; is that what you're concerned about?
A. No. I was looking for the coefficient estimates on each of the independent variables, as well as whether he used orthogonized versions of these variables and what the R squared was, as well.

Q. And did you run, did you notice -- did you -- strike that.
The issue with the orthogonalization, did you attempt to run his model with the Ortho? Let's just call that the Ortho method. Can we do that today so I don't mispronounce it? Is that fair enough?
A. Okay.
As long as you promise not to use a hard legal term with me, I'll give you that concession.
Q. Fair enough.
Did you yourself attempt to run Professor Fischel's model with, as shown in Exhibit G, with the consumer finance group and apply the Ortho method to it, did you do that?
A. I don't recall. I know we ran his model over a different estimation period and various other things. But as I sit here right now, I don't recall whether that's exactly what we did.
Q. Okay.
Using his estimation, and I understand you have a difference in opinion on the appropriate estimation period, but using his

estimation period and the results in Exhibit G where he incorporates your consumer finance group, did you then run the Ortho method on that approach and see whether or not it made a difference?
A. I can give you a more precise answer if I could review my surrebuttal report to refresh my recollection.
Q. Okay.
Is there a particular part of the report you need to see?
A. Well, I would like to look at the report and maybe an exhibit or certain sections of the report to refresh my recollection.
MR. BURKHOLZ: Okay.
Let's go ahead and mark Bajaj 2 which is your initial report.
(Initial report of Mukesh Bajaj was marked as Bajaj Exhibit 2 for identification, as of this date.)
BY MR. BURKHOLZ:
Q. You have called your rebuttal report. Exhibit 3 we have remarked as your surrebuttal report. Is that the document you

need to look at?
(Rebuttal Report of Mukesh Bajaj was marked as Bajaj Exhibit 3 for identification, as of this date.)
A. Yes, please. Just give me a moment.
Q. Sure.
A. So, here is what I am looking for that I do not find in Professor Fischel's report or my commentary on his rebuttal report in my surrebuttal report. I don't have in front of me what the coefficient estimates are in his regression model when he includes consumer finance index. Is it still the case that coefficient on S&P 500 index is negative and would it remain negative with or without orthogonalization.
Of course, the focus of my commentary in my surrebuttal report was that the estimation period is incorrect, and then I take this regression or correct estimation period, the claim that he makes in paragraph 20 in Exhibit G of his rebuttal report is incorrect.
Q. Okay.
And I understand the difference in

the estimation period. Did you try to replicate Fischel Exhibit G by taking into account the criticisms that you have just laid out, especially the Ortho method and the coefficient problem, did you try to replicate it to see whether or not if you made those changes it would make a difference?
A. I believe the answer is yes, but I do not have a perfect recall.
Q. Okay.
Did you document that anywhere in your surrebuttal report?
A. Well, as I said, my surrebuttal report discusses what happens when I use this estimation over the correct estimation period, but it does not document the results of various quantitative analysis we did in that process.
Q. Okay. My question is simple.
Using Professor Fischel's estimation period, not yours, using his, using his results in Exhibit G, I believe it is in his rebuttal report that's in front of you, did you then take the criticisms that you have laid out, the Ortho criticism and the coefficient criticism and see whether or not if you had done the two things he

should have done you say whether it made a difference on Exhibit G. That's all I'm asking, did you do that?
A. Well, the answer is most probably yes, but I did not document every flaw I found in the regression.
Q. Okay.
A. And, therefore, I don't have a perfect recall or the results of various analysis right here in front of me.
Q. Just so we're clear, you may or may not have done that, correct?
A. As I said, I recall having checked his calculations, done various things.
Q. Okay.
And I want your best estimate. Did you actually do this process that we have been talking about, correcting for the two errors with his report?
A. I don't have a perfect recall on that issue.
Q. So you might have or you might not have?
A. Yes, that's accurate. That's the best answer I can give you right now.

Q. Okay.
And do you have a recollection as to whether or not -- so you don't know whether you did it or not?
A. I tried my best to recall everything and I don't have any further recollection.
Q. And so you don't know whether it would have changed the results in Exhibit G if you don't recall whether you did it, right?
A. I don't recall right now.
Q. Okay. Fair enough.
Now, can you turn to the first tab of Fischel Exhibit 1 -- Bajaj Exhibit 1, which is the Fischel report, Fischel rebuttal report. The first tab that I gave you was page, I think it was page 23 of his report.
A. Okay.
Q. Now, do you see where Professor Fischel at the bottom of that page notes that Household's stock underperformed his consumer finance index during the period from November 15, 2001 to October 11, 2002, the stock fell 53.2 percent while his index declined 29.6 percent adjusted for dividends.
Do you see it runs on to the next

page?
A. I see that.
Q. Okay.
You don't have any reason to doubt that calculation by Professor Fischel, do you?
A. Not right now, no.
Q. Did you look and see whether or not it was or question the accuracy of how Household's stock performed during this period versus your six, we'll call it the consumer finance group index that you put together?
A. Again, I don't recall whether I checked the accuracy of this calculation or not.
Q. You have no reason sitting here to doubt the accuracy of the numbers in his report, do you, at this point?
A. No, I do not.
Q. Now, considering the fact that Household's stock went down about 53 percent during this percent and consumer finance index went down approximately 30 percent during this period, 29.6 percent, what do you account for the difference in Household's basically underperformance compared to the consumer finance index group during this time?

MR. OWEN: Object to the form of the question.
A. Well, I think the overall evidence suggests that rather than the difference being accounted for fraud, that Professor Fischel assumes the difference is very consistent with the notion that Household to a greater degree than some of the consumer finance companies suffered from the increasing criticism that all these companies faced concerning sub prime lending and of listening to political and regulatory climate over the period which seemed to finish the stock price of Household and lead to a situation where when Household resolved these uncertainties by reaching a settlement with various Attorney Generals, the stock increased significantly to a degree larger than many of the consumer finance companies, Household business model depending on the company having access to financing from capital markets through securitization. And they will still -- there was still a cloud over the company's access to capital markets as a result of these regulatory and political issues that to some degree were industrywide.

That's what led for Household to be acquired by HSBC at a pretty significant premium a couple of weeks after October 11, 2002 where Professor Fischel's comparison ends. So the overall evidence is a lot more consistent in my view with a non-fraud related explanation and is totally inconsistent with Professor Fischel's assumption that just because there was underperformance over some period, it must be fraud.
Q. Now, what you just testified about was basically the issue, what you have identified in your report as the issue of headline risk, correct?
A. It was along those lines, yes.
Q. Okay.
And your position, your opinion is that headline risks impacted Household and its stock price more than other sub prime lenders, correct?
A. To a degree and over the period that Professor Fischel is highlighting.
Q. Right.
And just so we're clear, your opinion is that the headline risk issue affected

Household more than the six companies in your consumer finance group, right?
A. Well, that could account for the underperformance that Professor Fischel is highlighting.
Q. Okay.
And so is it your opinion that the headline risk impacted Household more than the six companies in the consumer finance group index, and that is the reason for the underperformance compared to that group?
A. Well, as I said, I did not explicitly analyze the degree of underperformance and various factors that could explain the underperformance.
I told you that my review of the evidence is a lot more consistent with the explanation that to the degree there wasn't a performance over a period it could be well explained by headline risk, but I did not affirmatively compute a degree of underperformance and attribute it to various causes in a quantitative manner.
Q. Okay. Thank you.
What is the evidence that you have

seen, and I understand you didn't independently analyze like you just said the underperformance of Household to its consumer finance group during this period, but you did testify that you believed that Household was impacted more by headline, what you have determined to be headline risk than other companies?
What is the evidence that you've seen that Household was impacted more by changing in regulatory environment, as you have defined it?
A. Well, what I said is that underperformance, now -- let me step back for a moment.
If you look at any stock and compare it to an index of companies in its industry group, there are going to be periods when the stock underperforms that comparable group and other periods when stock outperforms that comparable group.
The point I was making is that just because the stock underperforms a certain industry group does not provide you with strong economic evidence as Professor Fischel claims that indicates the stock must be inflated prior

to the period of underperformance because of securities fraud. And in this particular case, if you look at the facts that Professor Fischel did examine, to the degree Household underperformed over a certain period, those facts are a lot more consistent with the possibility that Household was affected to a larger degree by headline risk and other non-fraud related factors than the comparable companies.
Q. Okay.
I respect you want to give your opinions here today. The deposition will go a lot smoother today if you try to focus on my question and what I'm asking you, which is you testified that Household, that there was evidence that Household was different than other companies in terms of the impact of headline risk.
And I'm asking you, can you point me to the evidence, whether it is an analyst's report or some piece of evidence in the marketplace, that said that Household would be impacted more so by headline risk being changing regulatory environments than other lenders?

MR. OWEN: Object to the form of the question.
A. Okay.
So a few things come to mind. First, we saw, as Professor Fischel acknowledged, that Household stock price went up very significantly, excess return over two days, if I recall correctly, was of the order of 30 percent or more, when Household announced that it was settling with various state Attorney Generals' allegations on predatory lending.
Professor Fischel himself acknowledges in his opening report that Household business model made it very dependent on it being able to obtain financing from capital markets through securitization. It was not owned by a bank. Over this period, there is clear evidence that Household carried out a lot of securitization. In fact, the complaint itself alleges that there was about $75 billion worth of securitizations undertaken by Household over the particular class period.
Various analysts reports talk about the difficulty that Household might have getting access to reasonably priced financing in order

to carry out its business due to political and regulatory circumstances. Towards the end of the class period, several rating agencies downgraded Household debt. And if you read press commentary leading into HSBC's bid for Household and the subsequent merger, once again, you find evidence that the reason HSBC was able to offer a substantial premium to Household shareholders was to take away the impairment in value coming from Household's difficulty in accessing capital markets at a reasonable price.

MR. BURKHOLZ: Okay. Move to strike as nonresponsive.

Q. Can you take a look at your Exhibit 1 to your expert report that we had marked as Bajaj 2. I've gone ahead and tabbed that page for you so that you can find it easily.

A. Where did you say you wanted me to look at?

Q. It is your testimony, your prior testimony, which is Exhibit 1 to your initial report in this case which I have tabbed for you.

MR. OWEN: Hang on. 1 is the rebuttal report. 2 is --

MR. BURKHOLZ: 2 is his initial report in the case and 3 is his surrebuttal report.

MR. OWEN: We're looking at 2, and what page?

MR. BURKHOLZ: His testimony which is Exhibit 1. I have tabbed it for you also.

A. Actually, Exhibit 1 is my curriculum vitae. And you're referring to page 4 of 9.

Q. I am.

A. Of Exhibit 1.

Q. Thank you for the clarification.

This is a listing of your prior testimony over a number of years, correct?

A. Yes.

Q. Okay.

In any of these cases, have you ever testified for the plaintiffs in a securities class action case?

A. I know I have testified for the plaintiffs. I don't recall whether it was in a class action case.

Q. I know you have testified for the government before, but my question is: In a

civil action, a plaintiff's securities fraud class action, have you ever testified for the plaintiffs before?

A. Well, I don't recall whether the Adelphia Communications case in which I testified for the company, that was a plaintiff. That wouldn't be a class action.

Yes, that's correct. I believe the answer is no. I have not testified for plaintiff's counsel in a civil securities class action case.

Q. And how about for the defendants, have you testified for the defendants in a securities fraud class action case?

A. I believe the answer is yes.

Q. In which case would that be?

A. The first case that is indicated on page 4 of 9 of Exhibit 1 to Bajaj 2.

Q. The New York Specialists case?

A. That's one.

Q. Okay.

A. In the IDT case I was engaged.

Q. What number is that?

A. That's No. 14. But I'm not sure that I recall whether that was a class action --

no, I think that was a private party dispute. That was not a class action either.

Then the Sherewin I. Ray case, it involved many plaintiffs, and the Commonwealth Holdings, but, again, I don't know whether that was a class action or just several different plaintiffs. I just don't recall.

Q. No. 15 case, the Sherewin case, you provided testimony for the defendants in that case, correct?

A. Yes. I was engaged by counsel for the defendants.

And then No. 17, that's WorldCom ERISA litigation. I was engaged by counsel for defense in that matter; so, those are the cases that come to mind.

Q. Okay. Thank you.

Now, you've also provided expert reports in other cases that are not listed here, correct?

A. Correct. This is a list of only testimony on record.

Q. Have you ever analyzed the leakage theory in any of the cases you have worked on?

MR. OWEN: Object to the form of

the question.
BY MR. BURKHOLZ:
Q. You understand what the leakage theory is, don't you?
A. I understand generally what you're talking about in the context of this case, yes.
Q. You understand there's a leakage theory of damages that Cornell and Morgan have written about, you understand that, right?
A. Well, again, I don't want to get caught up in terminology, but I think I understand what you're asking.
Q. And I'm not trying to trick you. You won't see me do that at all today. I want to be on the same wavelength. But you understand?
A. I can't guarantee that, though.
Q. You understand, Professor Fischel has a leakage theory of damages, correct?
A. Yes.
Q. And you under -- you also know and you pointed it out in your surrebuttal report that Cornell and Morgan discussed the leakage theory of damages, correct?
A. Again, I don't recall whether I

describe Cornell and Morgan's discussion as leakage theory of damages. I might have.
Again, I am not trying to say I didn't, but we both know what we're talking about regardless of the terminology.
Q. Have you ever worked on a case where you have analyzed the leakage, a leakage model of damages like you did in this case?
A. Yes.
Q. And what case would that be?
A. Well, in connection with various cases, I have seen similar models being put forth by various plaintiffs' experts from time to time. I am not sure that I am at liberty to tell you about names of cases where my work has not resulted in any testimony on record.
Q. Okay.
And of the cases that you have identified as testimony on record, including some of the ones that we have looked at earlier, did any of those cases involve a leakage theory of damage?
A. I think at least in part, yes, is what my recall is.
Q. Which case are you thinking of?

A. I am thinking of two matters in the Adelphia Communications matter, I believe Professor Fischel used an argument that was similar in spirit in that he looked at the price decline in Adelphia stock over an extended period to allege that if the price decline measured over valuation of Adelphia securities prior to that period, then the plaintiff in that case benefited from selling of the value of securities and I believe certain damage constructs Professor Fischel put forth in the IDT v. Telfonica case, No. 14.
Q. Another case you were on the opposite side of Professor Fischel?
A. Yes. I think, if my recall is correct, that some of that analysis was in similar spirit.
Q. Any other cases other than No. 4 and 14 in which there was a leakage model being espoused by the other expert?
A. That's my best recall, as I sit here right now.
Q. Okay.
And have you in any of your reports or testimony adopted the leakage model?

A. No, I have not.
Q. Do you outright reject the leakage model?
A. Well, that's a very strong statement and I'm not sure without thinking of facts and circumstances I'm prepared to reject out of hand any model. But in the context of this case and in situations in which I have encountered this model, I believe there is valid and compelling reason to believe that the model overstating alleged damages is not consistent with proper loss causation analysis.
Q. Okay.
So you have never seen a situation where you think it is an appropriate measure of damages, correct?
A. I don't recall seeing such a situation.
Q. In the cases involving leakage that you have looked at, how do you explain -- do you have an alternative explanation for the company's relative stock price decline?
A. Well, as I said before, relative stock price decline could be due to changed investor expectations and firm specific or

industrywide news that is unrelated to fraud allegations; so, what the explanation is depends on facts and circumstances.

But I reject the premise of the leakage model that just because a particular stock underperforms certain index for a period of time, that provides justification to claim securities fraud damages.

Q. Isn't the whole purpose of having an index and a regression model to take out the industry impacts on the company stock price?

A. Well, that's an attempt to ameliorate industrywide effects, but like everything else in life, no model is perfect, and there could be situations where when the model is estimated over a period, the company stock price may be more sensitive to a particular factor that is industrywide over a certain other period, it could be the case that there is firm specific news that's unrelated to alleged fraud. That could create underperformance. There could simply be change in investor expectations.

Q. But shouldn't that affect all companies in the index?

A. It need not affect all companies in the index. Exactly, if you look at any index and, I provided over the alleged class period example of at least 30 stocks, it is bound to be the case that regardless of there being any fraud allegations, sometimes a stock will outperform an index and sometimes it will underperform an index and that could just be the noise inherent in securities valuation.

Q. Let's turn to loss causation and company's disclosures with respect to loss causation.

You have testified in that area before, correct?

A. Yes.

Q. A number of times, right?

A. Yes.

Q. Now, it's not your opinion that a company's disclosure -- a company has to disclose that it engaged in fraudulent activities in order for there to be a price decline that can be used for inflation purposes, is it?

MR. OWEN: I object to the form of the question.

A. If you could restate the question. I think it was either too general or not sufficiently precisely worded.

Q. Okay.

Would you agree with me that there are a number of ways in which under a loss causation principle, the inflation can come out of a company's stock price?

A. In general, yes.

Q. Now, does a company need to admit that it engaged in fraud in order for the price drop to be proper for inflation, calculating inflation?

MR. OWEN: Object to the form of the question.

A. Again, without regard to particular facts and circumstances as a hypothetical matter, it's not necessary for a company to admit fraud from a loss causation perspective, stock price drop can be attributed to inflation coming out of the stock price.

Q. And the inflation can come out in a number of ways, including market participants, whether they be analysts or newspaper articles criticizing a company's or raising the issue of

a company's possibly fraudulent activities; isn't that a way, also?

MR. OWEN: Object to the form of the question.

A. I think now we are getting into murky waters when we are talking about third party opinion and criticisms.

I can't say that there could be no circumstances where, as a result of those criticisms, stock price might become less inflated. But I think one has to have very strong evidence consistent with the inference that third party criticism leads to inflation coming out of the stock price and not just some sort of a correlation that's open to many different interpretations to have a conclusion that third party criticism can make inflation come out of the stock price.

Q. But you, in fact, have testified in other cases that inflation can come out of a company's stock price due to criticisms of potential fraudulent activity by newspapers, haven't you?

A. I don't recall what you're talking about. If you have anything in mind, let me

know.
Q. Okay.
THE WITNESS: Would this be a good time to take a little break?
MR. BURKHOLZ: Absolutely.
THE WITNESS: Okay.
THE VIDEOGRAPHER: This is the end of Videotape No. 1 in the videotape deposition of Mukesh Bajaj. The time is 10:30.
(Whereupon, at 10:30 o'clock a.m., a recess was taken to 10:45 o'clock a.m.)
THE VIDEOGRAPHER: This is the beginning of Videotape No. 2 in the videotape deposition of Mukesh Bajaj. We're now back on the record. The time is 10:45.
BY MR. BURKHOLZ:
Q. Now, have you ever offered an opinion on headline risk in any other case?
A. Not particularly that I recall, even though I think one could argue that there were some elements of that reasoning that applied in the Adelphia case.

Q. Now, that's one of the reports that you did not turn over to us, correct?
A. It is my understanding that I am not allowed to turn over that report pursuant to confidentiality obligations.
Q. And that case has not gone to trial yet, correct?
A. I believe so, yes. I don't know whether it has been settled. I believe it might have been settled.
Q. You were not qualified as an expert by the court in that case because it didn't come to trial?
A. I think, yes, that's correct.
Q. One of your criticisms of Professor Fischel was that he uses an estimation period one year before the event window in this case, correct?
A. He uses an estimation period during the class period that he characterizes to be one year prior to the period of underperformance.
Q. Okay.
Which is the event window. You understand what I mean when I say the event window? That's the time period you're looking

in the regression analysis is whether the disclosure is taking value out of the stock price, correct?
A. That's not correct. When economists typically talk about an event window, they talk about a few days rather than one day. I don't believe it is customary for financial economists to use, quote/unquote, an event window of over a year as Professor Fischel has done.
Q. Is there any literature that you can point me to that says that you can't do it the way that Professor Fischel did it in this case?
A. Well, I do believe I have provided that reasoning and relevant authorities in my surrebuttal report pointing out that Professor Fischel claims to have relied on the Tabak and Dunbar paper. And, if I recall, the Tabak and Dunbar paper discusses that some people use an event window of three to five days under appropriate circumstances.
I also talked about the fact that what Professor Fischel has done is taken the period that is analogous to, under Cornell and Morgan authority, that he cites of using a comparable index approach. And, you know, I

have over the last 25 years in the context of teaching and research seen thousands of event studies. I have published many event studies, and I don't recall a single incidence of an event study being published in a respected peer-reviewed journal using such a long event window.
Q. Okay.
Separate from, because you pointed out some literature in your surrebuttal report or rebuttal report, separate from what you think that literature supports the fact that you can't have a long event window period, is there anything else that's not in your report that supports that notion, because I want to understand that?
A. Is there anything else in my report?
Q. No.
Is there anything outside of your report in terms of literature that you think doesn't support the notion of having the event window that Professor Fischel has selected in this case?
A. There is a significant body of literature that talks about using long horizon

returns in event studies as to how that can lead to misleading inferences, even though those studies that use these long term by and whole type measures of performance are a lot more carefully done than Professor Fischel's analysis in this case.

Whenever you have a long window of measurement and you attribute all underperformance to certain factors, you run the risk that over that long window a lot else is going on that you are unable to precisely measure and attribute and control for; so, there is well understood principle among financial economists that the longer the event window, the greater the chance of reaching false conclusions from under/over reaction that you might measure.

Q. And you never used an event window where there were a number of disclosures that expand a period of time, have you?

MR. OWEN: Object to the form of the question.

A. Of course I have.

Q. Oh, you have?

A. I have done that in this case. I have done that in the IDT Telfonica case.

Professor Fischel did it in IDT Telfonica case without relying on this kind of thing.

Q. Let's make sure we're talking about the same thing.

You're critical of not only where he places his estimation period during the class period, but you're also critical of the fact that he uses an event window of approximately ten months during this case. And I understand that that's your opinion in this case. I have been trying to explore that in the last couple of minutes with you.

My question is, is have you ever used an event window that expand more than two, three, four, days and involved a number of disclosures like this case?

A. And the answer is yes, and I have provided that analysis. Even in this case the right way to do that analysis is the way I conducted it in my surrebuttal report, namely, if you believe that the relevant corrective disclosures span several identified days, you can use the indicator variable approach in an event study where you indicate all of those days as being yes or no, which is precisely the

approach financial economists use to measure joint significance of several events.

Q. So the criticism of Professor Fischel is not the fact that his event window covers the ten-month period, per se; your criticism is the way that he went about identifying the dates and whether or not they were statistically significant or not.

Is that a fair assessment?

A. It is not. What Professor Fischel did is attribute the entire underperformance over this ten-month period to inflation coming out of the stock in his quoted leakage model instead --

Q. Let's take each model out of it. Let's talk about the specific disclosure.

A. Counsel, may I please complete my answer?

Q. Absolutely.

A. Okay.

Given that he had identified specific days that were purportedly deflationary over that ten-month period, he could have but failed to use a more appropriate approach which would, rather than attribute the entire

underperformance of Household relative to an index the way he quantified it to inflation coming out of the stock, he could test whether all of those specified days taken together provide statistical significant results in whether or not inflation came out of the stock over those days taken together collectively, which is precisely the approach he had used in the IDT Telfonica case. And he failed to do that here.

Q. Okay.

I think I understand what you're saying.

But separate, okay, so separate from the leakage model, you understand he has another approach which he terms the specific disclosure approach; you're aware of that, right?

A. Yes.

Q. And considering that approach, the problem you have with the long event -- you don't have a problem, per se, with the fact that he's looking at a ten-month period, do you?

A. No, not per se.

Q. That's not the issue?

A. That's not the issue. Even though I

have other problems with that issue in that how could he focus on that ten-month period that was not factually warranted and what I think about other issues that I address, but that, per se, is not the problem in the context of the event study.

Q. That's what I have been trying to understand in the last couple of minutes.

The issue is the way he applies or looks at that ten-month period. That's the issue you have and you have a number of criticisms, right?

A. You could say that, yes.

Q. Now, with respect, let's go back to the estimation period.

You're critical of his use of the one-year estimation period before the event window because that estimation period is during the class period, correct?

A. That's not the only reason for the criticism. I also note in my report that using that window leads to Professor Fischel finding very many more days to be statistically significant in a spurious manner and, in fact, if he had used the statistical standard that he

professes to use correctly, he would not expect to find as many days to be significant as turned out to be significant under his approach.

That is clear indication that his event window comes from a time period that is inappropriate to measure properly the evidence that he wants to measure during his purported event window.

Q. Okay.

We're going to be here all day. I can tell you that. Now, let me ask you this question.

Have you ever used an estimation period that was part of the class period of the case?

A. Yes.

Q. In what case was that?

A. In this matter.

Q. Okay.

Any other cases in which you have used the estimation period that was part of the class period?

A. In a properly specified indicator variable approach, I also use that in the ITD Telefonica matter just like I used it in this

matter.

Q. Any of the other cases on here? For example, No. 7, which is the Kumar case.

A. Again, I don't remember the methodological details in that case, but I do recall that there were events split over more than one day in that case. And in that context, my expectation is I would have used an event measured or rather the regression period along with indicator variables during the class period.

Q. Okay.

So your position is there's nothing, per se, wrong with using the estimation period during the class period; it's just that you have to apply it a certain way.

Is that fair?

A. I don't think that would be a fair way to characterize it.

Q. So, yes or no, can you use the estimation period during the class period or not in an appropriate model? It is a simple question.

A. Yes. And I, again, I'm trying to be responsive to you, but I don't want to give you

an incorrect answer either.

The point is not whether it is okay to use estimation period during the class period. The point is if you believe that the estimation period that you use which normally is before the class period is representative of the class period. The underlying relationship that you are measuring are stationary. Then you can use an estimation period and use the approach of determining whether a particular day is significant or not, but if it turns out you have reasons to believe that the economic relationship between the variables that you are studying in your regression may be different during the class period than it is pre-class period, then you run regression that is contemporaneous with the class period and use indicator variables for certain identified days to measure whether they were significant or not.

Q. So there's nothing, per se, wrong with using an estimation period during the class period?

A. I cannot agree with you. That's why I gave you a longer answer.

Q. But you've used the estimation

period during the class period in this case and in other cases, correct?

A. In the way I described, I used contemporaneous period to run the regression with indicator variables to measure significance of identified days.

Q. It is a "yes" or "no" question.

A. But that's not properly characterized as using estimation period during the class window is what I'm trying to tell you. That would be an incorrect way of characterizing that approach.

Q. Okay.

Now, you remember testifying in the item that's listed as No. 7, United States of America versus Sanjay Kumar?

A. Yes.

Q. You were retained by the government in that case, correct?

A. By the SEC and U.S. Attorney's Office.

Q. And your job was to estimate damages in that case?

A. Well, I was asked to evaluate whether the admitted securities fraud led to

harm to shareholders over or below a certain threshold amount.

Q. Okay. Let's put this aside.

Before we get to the case No. 7 on your resume, your testimony, I want to circle back to something we talked about before the break.

In this case, have you ever been involved in a case where the liability was bifurcated from the damages at trial and you testified after the liability phase?

A. Well, I have been involved in cases where there was such a bifurcation and I testified both during liability and the damages phase. I don't recall, it may be true, but I just don't recall when I might have testified on.

Actually, in some of the Winstar stock cases, I believe liability was already decided and I was testifying only to damages issues.

Q. In this case, if the court did, let's assume the court bifurcated the liability and damages and the jury came back with a verdict of liability that Household had violated

the Federal securities laws, would you still find that there was no inflation in Household stock?

A. Well, you're asking me a legal question.

Q. I'm not asking you a legal question. It is not a legal question.

The jury has come back with the determination of liability against Household saying they violated the Federal securities laws. And my question is: Would you still have a finding that you estimate that there's zero inflation in this case?

A. Well, if the jury were to find that there was violation of Federal securities laws due to whatever legal instructions, it would still be my opinion that there is no evidence that there was ever any inflation in the stock or any alleged omissions and misrepresentations led to material effect on stock prices; and, therefore, my conclusion would be that there is no damage.

And the reason I said you asked me a legal question is I don't know the standards under which there could be liabilities for

securities fraud, could it be some sort of qualitative materiality standard, some other standard that's not rooted in economic evidence.

Q. Well, the jury -- the jury will be asked whether or not Household violated the Federal securities laws in issuing a public statement that either misrepresented facts or omitted to disclose material facts. And if they made a finding that Household did fail to comply with the Federal securities laws and omitted or misrepresented facts in its public disclosures, your position is that there would still be zero inflation and zero damages for the plaintiffs, correct?

MR. OWEN: I object to the form of the question.

A. Well, again, I would say you're asking me a legal question. It is my understanding that misrepresentation or omission would have to be material. That it would -- there may be other legal requirements both finding of securities fraud.

I did not find any evidence of any material effect on Household's stock price as a result of any of the alleged misstatements or omissions that I have examined in this case. Therefore, I would conclude that if the question is whether these alleged misstatements or omissions that I evaluated led to any material inflation in Household's stock price and, therefore, there were damages, my answer would be there is no evidence to support that conclusion from an economic perspective.

If there is liability for securities fraud due to certain other legal standards and certain other dimensions that I am unaware of that's not within my realm of expertise, then I can't answer that question.

Q. So your position would be if a jury came back with a finding of liability, that there would still be no damages in this case, correct?

MR. OWEN: Object to the form of the question. Asked and answered.

MR. BURKHOLZ: Objection noted.

A. Again, you're asking me too general a question. My expertise is that of a financial economist. If the question to me is are there any damages based on evidence of inflation in Household's stock price due to alleged

misstatements and omissions, the answer would be no.

Q. And that doesn't change whether or not the alleged omissions and misrepresentations are found to be actual omissions and misrepresentations by a jury?

A. Again, I believe that you're asking me an improper question of an economist because there could be legal standards under which there could be liability without there being any materiality from an economic perspective. I can't answer that question one way or the other.

Q. I want you to take a look at the reports that you issued in No. 7 on your testimony of record. It is the Kumar case.

Can we refer to it as the Computer Associates case?

A. Sure.

MR. BURKHOLZ: Can we go ahead and mark Dr. Bajaj's initial report in that case as Exhibit 4.

(Report of Mukesh Bajaj in Kumar case was marked as Bajaj Exhibit 4 for identification, as of this date.)

MR. BURKHOLZ: Let's go ahead and mark as Exhibit 5, Dr. Bajaj's September 20, 2006 rebuttal report in the same case.

(Rebuttal Report of Mukesh Bajaj in Kumar case was marked as Bajaj Exhibit 5 for identification, as of this date.)

MR. BURKHOLZ: Then as Exhibit 6, Dr. Bajaj's supplemental report which is October 9, 2006 in the same case.

(Supplemental Report of Mukesh Bajaj in Kumar case was marked as Bajaj Exhibit 6 for identification, as of this date.)

BY MR. BURKHOLZ:

Q. Go ahead and take a minute to familiarize yourself with your reports that you issued in those cases.

MR. OWEN: Do you want him to read them?

MR. BURKHOLZ: No, just familiarize yourself. I'm going to point to certain parts of them. He

wrote them. I want to make sure that he knows what they're about, but I want to make sure he has a minute to look through them and they are what I say they are.

THE WITNESS: Okay.

BY MR. BURKHOLZ:

Q. Okay.

Now, these are the reports that you issued in the Computer Associates case, correct?

A. Correct.

Q. Okay.

And in that case you were -- you were trying to estimate damages to shareholders, correct?

A. Well, as I said, it wasn't my role to estimate damages. My role was to opine on whether or not, based on economic evidence and admitted securities fraud, damages were larger than a certain threshold amount.

So to the extent that my conclusion of economic harm to the shareholders was understated, I wasn't concerned about that issue as long as my analysis was sufficient to answer the question is it greater than a certain number

X.
Q. Okay.
And, but you actually came up with an estimate of damages in your initial report and then you came up with a larger number with, I guess your surrebuttal report, right?
A. Well, I came up with a lower bound on economic harm to shareholders.
Q. In order to do that, you ran regression analysis, correct?
A. Yes.
Q. And in the first, and understanding it was a lower bound of damages, in the first instance you came up with approximately $330 million of damages to shareholders, right? That's on page 4 of your initial report in that case under your Summary of Opinions.
Do you see paragraph 15?
A. So this $330 million lower bound is due to quantification of the effect of improper book of revenues over one particular fiscal quarter and it does not include certain other measures of harm.
Q. I understand.
It was your lower bound of damages.

I understand that. I understand what you did in the report. Okay.
A. I have no doubt you understand the report. I'm trying to, for the record, to be accurate in that if you're going to say the damages here were 330 million and then there was a larger number in a subsequent report, that's apples to oranges, because damages in this report were for a particular set of issues and only that, only those issues, and the subsequent report addressed additional causes of harm, and that's why I was trying to properly answer the question.
Q. Okay. We'll get to that.
A. Okay.
Q. Okay.
So, in calculating the $330 million of harm in paragraph 15, you performed a regression analysis in which you also looked at the earnings misses of 92 comparable companies which are in Exhibit 3 of the report as discussed in paragraph 45 of the report. The actual regression analysis that you did is laid out there, if you want to look at that.
A. Thank you for pointing me out to

that part because --
Q. That's page 19, paragraph 45.
A. Okay.
I have now familiarized myself with that analysis.
Q. And what you were doing in this case is you were looking at 92 comparable companies to see what the stock price reaction was when they had an earnings miss, and then you were comparing it to Computer Associates and trying to do -- because Computer Associates had an earnings miss in this particular case, and you were trying to do a comparison to determine whether, what should be -- how -- strike that.
Let's go back to the beginning.
What was the purpose of performing a regression analysis with these 92 companies in this case?
A. The purpose of performing the regression analysis described in Exhibit 3 was to answer the question whether during the time period at issue in that particular matter for companies that were in the enterprise software sector of the economy market reacted on average negatively to a significant miss in earnings

forecast.
Q. And your analysis, using your regression analysis of these 92 companies, was that the median abnormal return was minus 10.68 percent, correct?
A. Correct.
Q. And so then you took that 10.68 percent and you applied it to Computer Associates in that case?
A. Okay.
Give me a moment to refresh my recall of what I did.
Q. And you'll see in Exhibit 9.
A. Okay.
I have refreshed my recall on Exhibit 9.
Q. Okay.
And going back to the regression analysis you did with the 92 companies, and let's look at paragraph 45 where you describe it. That's back on page 19.
A. Okay.
Q. That's your description of how you conducted your event study using a regression analysis, right?

A. Yes.
Q. And you regressed the broad market index, the S&P 500 index and also the industry index, the NASDAQ computer index as your two industry indexes in that case, right?
A. Correct.
Q. And you also used an estimation period of 254 trading days before the earnings miss date in that case, right?
A. And ending four trading days before the miss.
Q. Right.
And so, the 254 trading days was your estimation period in that case, right?
A. Ending four days before the earnings miss I was studying, correct.
Q. Right.
And the earnings miss would have been the event period in that case, correct?
A. Earnings miss measured over, I believe it was one day --
Q. I understand.
A. -- was the event window in that period.
Q. Okay.

Just so we're talking about the same thing here. Now, in this case, you're using approximately, you're going back approximately one year for the estimation period before, before the event window, right?
A. Again, I want to clarify, it's one year that precedes the relevant, one-day event window --
Q. I understand that.
A. -- by four days and spans about a year, yes.
Q. I understand that. Okay.
And that includes a time period in which Computer Associates' stock was affected by fraud, right?
A. For different companies it is different period. These 92 companies had misses on different dates as indicated in Exhibit 3. And what I'm doing there is using a regression analysis in case of each of those companies estimating the regression equation for approximately a one-year period up to four days, ending four days before the miss, and then using that estimation to estimate excess return over a one-day window for each of those companies. And

that estimation period could be April '97 to March '98 as it would be for landmark case, or it could be October 2003 to October 2004 for buying a new development case.
And the estimation window changed and sometimes it remained while the period in question for Computer Associates and sometimes it wouldn't, but I wasn't conducting a regression on Computer Associates to estimate a regression window.
Q. I understand. And you misunderstood my question. Let me try to articulate it better.
For the 92 companies you looked at the estimation period of the 254 trading days encompassed the period in which those stocks trading prices were affected with fraud, right?
A. I have no basis to say that each of these 92 companies before they announced an earnings miss were engaged in fraud. That's an incorrect way of describing what happened here.
Q. You don't know one way or the other, do you?
A. But that's not relevant. I am not doing here what Professor Fischel has done in

the subject matter that we are talking about today. I am looking at whether or not an earnings miss for enterprise software companies in the 1998 to 2004 period was material news as evaluated by market participants based on their one-day price reaction.
Q. Okay.
Let me ask you this question: Let's go back to paragraph 45 which discusses your regression analysis.
A. Okay.
Q. You used the S&P 500 index, right?
A. Yes.
Q. And you also used the NASDAQ computer index, correct?
A. Correct.
Q. And did you take -- when you were analyzing the 92 companies, many of those companies were in the NASDAQ computer index, right?
A. Yes.
Q. All right.
And did you take those companies out of the index when you did the regression analysis?

A. Each of these companies where I'm drawing the inference for that one particular company at that time was a miniscule part of the NASDAQ computer index. And I might have tested my results by excluding the company from the NASDAQ computer index. I just don't recall all the details of all the analyses I did.
Q. It's not in this report, though. I can't see it in this report whether you did that.
A. Well, it won't serve any purpose to include it in that report because I'm drawing a large sample inference on 92 companies doing one company at a time. Collectively the inference that I draw would not be at all effected at all by the issue that you're raising. And I probably did check whether that was an issue that we needed to control for or not.
Q. If the company was a large percentage of the NASDAQ computer index, would you then have tried to take it out of the index and do a new regression analysis?
A. Right.
Q. You would have?
A. Yes.

Q. But if it was a small percentage, you wouldn't have?
A. If it was a miniscule percentage, then you get approximately correct results. And the purpose for which these results are being measured, it doesn't matter because the only question here that I'm trying to answer is whether or not an earnings miss for an enterprise software company during '98 to 2004 would be considered material by the market under those economic circumstances.
That's all for that question. It's not that critical.
Q. Okay.
What, in your mind, would be miniscule in terms of the percentage of the index that these companies have that you wouldn't find a need to run the model taking them out? Certainly not Oracle, which was like 7 or 8 percent of the index. I understand that.
You said if it had a large percentage, I would maybe looking at it taking it out. If it had a miniscule percentage, maybe I wouldn't.
Where do you draw the line?

A. It is a judgment based issue. If it is less than a half of a percent, then it probably wouldn't matter. And, again, whether or not that's a critical issue depends on whether the regression you are performing is going to be used to estimate damages for that particular company, where it matters whether or not the price reaction is going to be affected by correlation that may be set off a little bit. If you are generally examining materiality of a certain kind of event and then you're drawing an inference on another company, then it wouldn't matter.
And, as I said, it is routine practice for me to at least check whether or not my results are robust to exclusion to the subject company in a regression analysis if that company is also a component of the indices being used in the regression analysis.
Q. But I can't tell from this report whether you did that, can I?
A. Apparently not, since you said you read the report carefully and you understood exactly what I did.
Q. Well, is there anything in the

report that shows to me that you actually ran that analysis and whether you took the participant out of the NASDAQ computer index?
A. I don't know because I haven't had a chance to carefully examine the report.
Q. Why don't you look at it after lunch, and if you find it, you'll tell me.
A. Okay.
MR. OWEN: We'll object to that.
Q. Let's turn to paragraph 67, which is page 28 of this report.
MR. OWEN: The Computer Associates report?
MR. BURKHOLZ: Yes.
BY MR. BURKHOLZ:
Q. We're in the initial report. To refresh your recollection, you can look at paragraph 66 that leads up to paragraph 67 so you have the context in mind. All the way through the end of paragraph 69, please.
A. Okay.
Please give me a few minutes.
Q. Take your time.
A. Okay.
Q. You have actually read to the end of

your report?
A. Yes.
Q. Which is fine.
So you read through paragraphs 66 to 72, right?
A. Correct.
Q. And in those paragraphs you're trying to compute the damages, what you call the lower bound of damages for the time period of October 20, 1999 to January 25, 2000?
A. Correct.
Q. And you used the inflation that you've calculated, the $7.56 of inflation, correct?
A. Yes.
Q. And you used some of the claims data from the securities class action civil case that had been submitted with respect to the settlement in that case, right?
A. I was provided claims data by government counsel. I don't recall in what connection that claims data was submitted.
Q. But it was from the securities class action settlement in the civil case, right, Footnote 70 of your report?

A. Well, okay, yes. That refreshes my recollection. Thank you.
Q. Okay.
And you then attempted to -- and you noted that the claims data was -- that not everybody claimed for damages; so, you noted that it didn't include people that didn't claim, right?
A. Correct.
Q. And then you attempted to compute the damages for this time period of October 20, '99 through January 25, 2000, right?
A. I computed damages to people who purchased stock during that period on a net basis.
Q. Okay.
And you offset any, any damages they had by any gains during that period also, right?
A. Correct.
Q. And, in fact, if they didn't have a net loss, you didn't count it in the damages, right?
A. If they had sold more shares during that period than they purchased, then I did not estimate any damages for those individuals.

Q. Okay.
For these people that you analyzed that purchased during this time period -- when I talk about time period, I'm talking about October 20, '99 through January 25, 2000.
A. Okay.
Q. Okay.
You didn't calculate any offsets for them for shares that they purchased before October 20, 1999 and sold during the time period of October 20, 1999 in January 25, 2000, right?
A. Incorrect.
Q. You did?
A. Of course.
Q. Where is that in your report?
A. Well, let's read the relevant paragraph.
Q. And just so we're clear, I'm talking about people that purchased -- I understand you were analyzing people that purchased during the time period of October '99 to January 25, 2000.
For those people, did you do an offset for any of their purchases made before the time period and then they sold during the time period?

A. I did.
Q. And where is that?
A. That's what I'm trying to describe to you. So if you look at the top of page 29, I say, I compute damages only on net purchases affected by each investor between October 20 and January 25, 2000. The term "net purchases" refers to the difference between purchases and sales if this difference is greater than zero.
So what this language is telling me and what I clearly recall is you have an individual, Joe Smith, who bought a hundred shares over this period but sold 150 shares over this period. Clearly, the 50 of the 150 shares had to represent shares that were purchased prior to this period. And in this particular case, Joe Smith in my example would be in a net gain position due to selling more shares at the assumed inflation during this period than he purchased over this period and his damage would be zero.
So in computing all sales over this period, I did not say I will only count those sales over this period that are shown to be tied to purchases over this period. I also included

sales even if they came from inventory carried into this period.

Q. Where do you say that in your report?

A. Well --

Q. Where do you use the words "before the time period," because I don't see it?

A. I have no reason to anticipate that you would be so confused and, therefore, use more explicit language. But I'm telling you what I did.

Q. And somebody -- so the Joe Smith person that you just described as an example, they would be entitled to no damages in this case, right?

A. Correct.

Q. Okay.

So they were not considered for part -- strike that.

They were not considered for the number you came up with, the total damage number, right?

A. And we should clarify another thing here because the record would be otherwise unclear from the way you phrased the question.

This was not a case about assessing certain amount of damages that were going to be provided to with temps. This was, in my understanding, a case where I was asked where the aggregate harm to shareholders as a result of the admitted securities fraud was greater than a certain threshold amount.

So to the extent the Joe Smith person in my example had a claim of damages on additional shares purchased outside this quarter, the question of net benefit due to sales during this quarter being used to offset subsequent damages on subsequent sales was moot, because this was not a proceeding where somebody was going to collect the collective harm amount and then distribute it to certain individuals. This was analysis conducted for criminal sentencing purposes to answer the question whether the aggregate harm was more than a hundred, 200 million, or whatever the threshold is that is relevant for sentencing purposes.

Q. Have you made any changes to these reports since you submitted them in this case, in the Computer Associates case?

A. No.

THE VIDEOGRAPHER: Counselor.

MR. BURKHOLZ: Okay.

BY MR. BURKHOLZ:

Q. How did you determine whether or not the shares that were purchased before the time period here, October 20, '99 through January 25, 2000, were inflated or not?

A. Well, I, in order to give the benefit of the doubt to the defendant and compute a lower bound on damages for purposes of this calculation, I assumed that shares purchased prior to this quarter were purchased at zero inflation. If, in fact, they were purchased at some inflation, then I provided too large an offset to the total dollar amount of harm I concluded for this particular purpose.

Q. And where is that analysis in this report because I don't see that either?

A. Well, I didn't know that this report when written was going to be used in this subsequent proceeding, so I didn't write it for purposes of answering questions that were not relevant for that proceeding.

Q. But is that offset practice that you just described, is that somewhere in the

document, in any of the three documents that I can find?

A. If you read the report clearly and, you know, I have only spent maybe five or less than ten minutes certainly on these reports which were many years ago, I think that would probably be a reasonable inference; but that's what I clearly recall doing.

Q. And I'm going to ask you one more question before we go off and take a break.

The Computer Associates fraud went back to 1999 in this case, didn't it?

A. I know the government alleged fraud going back from before this period, but whether, given the nature of the allegations, the stock price was inflated before this period or not, you couldn't tell because this was a case about the company borrowing sales from the future. So every quarter whether or not overall sales were inflated depended on both filling the hole that you dug in the past, plus the incremental borrowing you did from the future.

So I concluded that based on contract data that I was provided, I was unable to tell whether or not there was net inflation

in revenues prior to the quarter for which I analyzed this harm.
MR. BURKHOLZ: Okay. Let's take our break right now. About ten minutes.
THE VIDEOGRAPHER: This is the end of Video No. 2 in the videotape deposition of Mukesh Bajaj. The time is 11:44.
(Whereupon, at 11:44 o'clock a.m., a recess was taken to 12:01 o'clock p.m.)
THE VIDEOGRAPHER: This is the beginning of Videotape No. 3 in the videotape deposition of Mukesh Bajaj. We are now back on the record. The time is 12:01.
BY MR. BURKHOLZ:
Q. I do want to get back to the Computer Associates case, but let me just ask you a few more questions before we get back to that.
Do you believe in this case that Household's stock traded in an efficient market?
A. I wasn't asked to examine that issue in particular and I have not seen any evidence

that would make me conclude that it was not traded in an efficient market.
Q. Okay.
And we talked before about the issue of taking a company out of the index, the peer group index that you're looking at. I think we discussed that in the context of Computer Associates case.
In the context of this case, did you run Professor Fischel's analysis without Household in the indexes that he uses?
A. I seem to recall something like that. And if I could see my surrebuttal report, I think there is a footnote somewhere in there to that effect, but I don't remember the details right now.
If you look at Footnote 70 in my surrebuttal report, page 20.
Q. 70?
A. Yes. Here I'm describing Professor Fischel claims that he continues to find all 14 of his specific disclosure dates --
Q. I'm sorry, what page are you on, page 20?
A. Page 20, the first full paragraph.

Q. Okay.
And you're referring to Footnote 70?
A. Yes.
Q. And you actually removed Household from the two indexes?
A. Yes. And the sentence that precedes Footnote 70 says, "However, this claim is without merit because it is an artifact of his choice of a tainted sample period. Running the new Fischel Model 1 either over the class period or over 250 days prior to the start of the class period would result in only 5 and 2 of the 14 specific disclosure dates as being statistically significant," and that result is based on Footnote 70 methodology.
Q. I understand that.
Did you run what you did in Footnote 70, taking Household out of the S&P 500 index and the S&P financial index, did you run Professor Fischel's model with his estimation period, not your estimation period of either in the entire class period or a time before the class period, but his estimation period, did you do that?
A. All right.

Again, as I was telling you, I don't recall what other quantitative analyses we did, other than those that are reported here.
Q. Okay.
So you may or may not have?
A. Yes.
Q. And do you recall whether or not it made a difference in the results using his estimation period, taking Household out of these two indexes?
A. No, I don't recall.
Q. Thank you. Okay.
Let's go back to Computer Associates. You ran a regression analysis with the 92 peer companies, right? We looked at that.
A. Over the '98 to 2004 period, yes.
Q. And you also ran a regression analysis using Computer Associates, correct?
A. Just one moment. I think I need to make sure that my previous answer is accurate.
These are 92 earnings miss events over '98 to 2004 period. These are not 92 companies because several companies appear more than once.

Q. Okay. Fair enough.
My question is: Separate from the 92 companies, you also ran a regression analysis involving Computer Associates' stock, correct?
A. I don't recall.
Q. Okay.
Take a look at your -- take also a look at your surrebuttal report.
A. In this case?
Q. Yes.
No, in the Computer Associates case.
A. You mean to say the supplemental report?
Q. The supplemental report.
A. Okay.
Q. Do you see Exhibit 1?
A. Okay.
Q. Okay.
And that is -- does that refresh your recollection that you ran Computer Associates using a regression model?
A. Just one moment. Do you know what paragraph in the report would describe the results of Exhibit 1 --
Q. Sure. Sure.

A. -- or I should scan it?
Q. Look at page 19. Footnote 57 refers to it.
Do you see Exhibit 57?
A. Just one moment. So as I refreshed my recall, if you look at paragraphs 34 through and paragraph 35, I believe the methodology I am describing is the methodology that involves running regression analysis with specific disclosure dates that are tagged with indicator variables, D-1, D-2 and D-3.
So you run the regression analysis over the effective period with indicator variables for the effective dates and you measure whether those are significant or not. And if they are significant the coefficient estimate gives, you measure effects as return and you can test for joint significance of those indicator variables.
Q. So did you use Computer Associates in a regression model in this case?
A. In the indicator variable approach, yes.
Q. And what was your estimation period in this approach?

A. Well, that's why I'm trying to clarify, Counsel. There are two ways of running event studies. You can take a period before the class period and estimate a regression equation and then you assume that the relationship estimated in the regression equation would apply to the class period and test whether certain dates are significant. That is appropriate if the assumption that the relationship remains constant is a correct one.
The other approach of conducting event studies is you include the fraud-related period but you bypass the two-step process of first estimating a relationship and then applying it. You look at the regression during the effected period with various independent variables as control variables turning on days of interest with indicator variables, and that approach is not tantamount to estimation of the type that we describe under the first approach. You're not estimating the model over one period, assuming that model remains true and applying it over another period. You are running a regression where you're saying after controlling for market or industry, market and industry,

during the affected period, are those particular identified days significant.
That's the approach I followed in this particular matter.
Q. So is there an estimation period that you can identify when you were doing this -- identifying these three additional drops?
A. You know, with all due respect, that's not a proper question because I'm not estimating a relationship and then using it to judge a date to be significant. You bypass the necessity of doing that estimation.
Q. Okay.
Are both of the approaches that you identified accepted approaches?
A. Some, under some circumstances using estimation period may be an accepted approach, but what I have criticized Professor Fischel for doing inappropriately under that circumstance, his estimation window is inappropriate. And I have not seen any authority use the kind of approach that he has used in this particular report in this matter.
Q. Because he's used an estimation

period that's during the class period, right?
A. Not only that, he persisted in using that estimation period despite clear evidence that he was getting too many significant days.
If you run a regression where you say I will use 10 percent standard of significance and you end up with 25 percent or over 20 percent of the days as significant or the period over which you are using your estimated equation, that itself should tell you there is something wrong with your estimation period. You may be measuring relationship during a relatively stable period and applying it to more volatile period, you will end up with spurious significant days.
And that's exactly what happened in Professor Fischel's analysis.
Q. You, in fact, yourself, have used an estimation period in cases that have included a time period of fraud, haven't you?
A. But only in the indicator variable sense. And that's what I also did in my surrebuttal report for this case to show that all the days that he considers as disclosure days taken together are, in fact, insignificant,

whether you look at his 14 days or his 41 days.
Q. So it is okay for you to use an estimation period during a time period in which there's fraud, but it is not okay for Professor Fischel, correct?
MR. OWEN: Object to the form of the question. Misstates his testimony.
A. You know, you are misstating what I said in an inappropriate manner. If you mean it as a serious question, I can attempt to answer it.
Q. I actually do, but let's move on.
Why don't you look at page 19 of your surrebuttal report, supplemental report in Computer Associates case.
A. Okay.
Q. And, in this particular case now you're identifying three fraud disclosures that you think, that you believe should be used to approximate losses to investors, correct?
A. I'm identifying three dates over which facts in that case indicate that, market had partial collective disclosures.
Q. And the first one you referred to as D-1 is an April 29, 2001 New York Times article,

correct?
A. Yes.
Q. And it is suggesting as you wrote that Computer Associates had been using accounting manipulations to systematically overstate its revenue profits for years, correct?
A. Correct.
Q. And at that time the company denied the facts set forth in the article, correct?
A. I don't recall exactly.
Q. All right.
Let's go back to your first report, page 12, paragraph 28.
Do you see where it says in a press release the following day, CA denied these allegations?
A. I see that.
Q. All right.
So let's go back to your supplemental report. So despite the fact that the company, Computer Associates, in this case denied the allegations of The New York Times article, the stock dropped on that day, on the 30th, and you used -- taking out the market

industry factors, you used the $3.39 for inflation purposes, correct?
A. Just one moment. What was your question again?
Q. My question is: Despite the fact that the company, Computer Associates, issued a press release that next day saying the allegations are not true, the stock did drop that day, April 30, and you took the market industry factors out and you found the difference of $3.39. And you used that to calculate your losses, correct?
A. Given my knowledge at the time I was doing the analysis that the defendant in this case had subsequently admitted to falsity of that denial and pleaded to having carried out accounting fraud.
Q. And where is that in your report, what you just said, where is that in your report?
A. That's the record of the case. And the defendant is serving prison sentence right now.
Q. Right.
You know, you're very careful in

your reports to have footnotes where you describe everything that supports your opinion on certain things. Is there a reason why you didn't articulate in any of the footnotes the 34 a, anything regarding the defendant's later admission of guilt?
A. The footnotes I put in the report are relevant to explaining economic reasoning and facts that I relied upon as I deemed them to be necessary. You can look up. There is no secret that Mr. Kumar is right now serving prison sentence for having admitted to this accounting fraud.
Q. Okay.
And on October 30, 2001, when the market digested The New York Times article, did it know that he was going to plead guilty three years later? It didn't, did it?
A. Yes. And if Mr. Kumar had never been found guilty of having conducted any securities fraud, if upon the announcement of what the plaintiff in the case would deem to be corrective disclosure, Computer Associates' stock price had jumped up by 30 percent, given those facts it would be wholly inappropriate for

me to take the market price decline based on mistaken fear that there may be accounting fraud as a measure of accounting fraud-related damages.
Q. Okay.
On April 30, 2001, did the market have any idea that the defendant was going to plead guilty three years later to accounting fraud with the company denying the allegations of the New York Times article at that time?
A. Of course the market didn't. The question is whether after the fact this 10 percent decline is an appropriate measure of harm caused the shareholders, and that depends on what after the fact we know, in fact, happened. We are not in a situation where Computer Associates restated its accounting dealing with these issues and the market realized, ah-ha, that fear was irrational, there is no fraud and the stock price goes up like 50 percent.
Had that been the fact pattern, I would not have taken this reaction that we are talking about as a measure of economic harm caused to the shareholders.

Q. So why does it matter in that case that the defendant pled guilty but it doesn't matter in this case that Household has denied the allegations?
MR. OWEN: Objection to the form of the question.
A. That's exactly what I'm trying to explain to you.
Q. Is there anything else that's not in any of these three reports in the Computer Associates case that I should know about that relates to your opinion in those cases, in that case?
MR. OWEN: Object to the form of the question. It is an invasion.
A. That is such a broad question, how can I know?
Q. You have been telling me about things not in the report. I want to know if there's anything else that's not identified in the Computer Associates three reports that you issued that I should know about?
MR. OWEN: I object to the form, this whole line of questioning.
A. Counsel, I can't control how well

informed you are or you are not, how well you have done your homework in reviewing these reports or not. I'm simply telling you, having looked at these reports after the years, the best answer I'm capable of giving to some very detailed questions about work going back years.
Q. So my question going back to the beginning of this is rather simple.
On April 30, 2001, did the market participants know anything other than a denial of the company about the allegations with respect to whether the company did anything wrong?
MR. OWEN: Objection. Asked and answered.
A. The way you phrased that question, the answer is I don't know. Anything other than this market participants probably knew a lot other than this. That's not the question.
Q. Even though the company had denied the allegations at that time, correct?
A. Yes, the company had denied the allegations at that time.
Q. Okay.
Let's look at fraud disclosure

No. 2. This is the February 20, 2002 disclosure, correct?
A. Yes.
Q. And that is approximately 10 to 11 months after the fraud disclosure, number one, correct?
A. Correct.
Q. And you're using this disclosure in your calculation of damages in that case, correct?
A. Correct.
Q. Okay.
And then we have fraud disclosure No. 3. And that takes place on October 8, 2003, correct?
A. Yes.
Q. And that's over approximately a year and a half after fraud disclosure No. 2, correct?
A. I'll take your representation for that, yes.
Q. Okay.
And with respect to fraud disclosure No. 3, you're looking at Computer Associates' stock price decline over two trading days

following the October 8 announcement regarding the audit committee investigation, correct?
A. Yes.
Q. And, okay, you're looking at the returns, the abnormal returns of Computer Associates' stock on October 9 and 10, 2003, correct?
A. Together, yes.
Q. Okay.
And then as you identify in paragraph 35, you have added up the three inflation figures in your three different fraud disclosures and you've come up with $15.29, correct?
A. Well, more precisely, I used the indicator variable to measure the joined effect of fraud disclosures No. 1, 2 and 3 in a regression analysis and said that the resulting value of indicator variables translates into $15.29 inflation being taken out.
Q. And you got the $15.29 inflation by adding up D-1, D-2 and D-3, right?
A. No. Actually, more precisely, the regression calculation estimates, an average coefficient. And you multiply that by 3, if I

recall correctly, and that's how you add up the $15, I believe. But, as I said, it has been a long time.
Q. Now, the $15.29, as you note in Footnote 61, is separate from the losses from your earnings miss analysis, correct?
A. Actually, let me clarify my answer to your previous question. Because these are three separate indicator variables, I'm trying to see whether there would be a separate coefficient estimate or one estimate for all of these. I'm not sure as I sit here right now.
And the other thing that I want to clarify, this is not necessarily inflation coming out of the stock. This is the diminution in value of the stock due to the bad acts which need not be inflation coming out of the stock. This is harm caused shareholders due to diminution in value of the enterprise due to criminal conduct by senior management of the firm, which is a question that is separate and apart from inflation in stock price as a result of revenue recognition issues.
Q. Okay.
Did the market know on April 30,

2001 that the defendant was going to plead guilty three years later? It is a simple question. Did they know that?
A. No. I have already answered it no.
Q. And did Computer Associates' stock trade in an efficient market in this case?
A. I believe it did.
Q. Now, let's look on page 22, paragraph 37. If you could read that. You have two different scenarios I want to ask you about.
A. Okay.
Q. Okay.
And so you have two scenarios here where you have tried to estimate damages from the disclosure of fraud?
A. Yes.
Q. Why in scenario one did you start on January 1, 1998?
A. Again, this is many years ago. My recall is that the record in the case reflected that the fraud at issue had begun in a material way going back to at least January 1, 1998, but that's just my recall as I sit here today.
Q. And so in scenario No. 1, are you trying to capture the purchasers of stock during

that period that suffered losses?
A. Net of all their sales of stock either purchased prior to that period or during that period taken together, yes.
Q. And is there anywhere in paragraph 37A that I can see where you have put in the words "prior to that period," meaning prior to January 1, 1998?
A. Well, I'm telling you that's what I did and that's how I read that paragraph.
Q. Okay.
How did you determine whether or not there was inflation in the purchases before January 1, 1998 in scenario No. 1?
A. I'm sorry?
Q. Strike that.
Did you make a determination as to whether or not there was any inflation in Computer Associates' stock before January 1, 1998?
A. Not for this purpose. I didn't need to.
Q. Even though you were using those shares for offset purposes, you didn't need to do that analysis?

A. Well, the methodology I used was conservative in that to the extent shares purchased prior to January 1, 1998 were purchased at inflated prices, and let's say the inflation was the same as during this period, then, there was no gain to those shareholders if they sold those shares during that period. But I gave them credit for the entire gain to reduce the measure of economic harm that was at issue for sentencing purposes in that particular case.
Q. So, the inflation during this period that you were using was the $15.23, correct?
A. Correct.
Q. And, sir, are you telling me that for shares that were purchased before January 1, 1998, that you assumed that they were also inflated by $15.28?
A. No. What I'm saying is by assuming that all such purchases took place at zero inflation, I maximized the value of the offset in favor of the defendant in this matter by assuming that the entire 15.98 inflation amount was a benefit of the alleged fraud to shareholders who did not hold on to their shares until the fraud was fully revealed.

Q. So you assumed in that case that there was no inflation in the shares that anybody purchased before January 1, 1998?
A. Well, I wouldn't go that far. I determined a lower bound on damages which is done under the procedure that you calculate offset with maintained assumption of zero inflation prior to that date for the purposes of computing the offset.
Q. Okay.
So you used zero inflation for the purposes before January 1, 1998? It is a simple question.
A. For purposes of computing the offset, yes. Simple answer.
Q. Thank you.
How did you know what they purchased the stock price at for the January 1, 1998 period?
A. Again, I was given a database of all the purchases over a certain period. And as I sit here right now, I don't know what the period of that data was. It is probably in one of these data reports. I only considered those purchases that were given to me in the database.

Q. How can we tell from your reports how much the offset was?
A. I don't know whether all the calculations are detailed here or not. Give me a moment, please, to review my report to see what the data period was.
I was hoping to find a date after a period of which I was given sales and purchase data, but I see that Footnote 70 talks about class period of that particular civil action in connection with which this data was produced and does not give specific dates.
So that's in connection with your previous question. And I think you asked me a question after that.
Q. How can we tell from your reports how much the offset was that you graciously provided the defendant in that case?
A. I'm going to ignore the "graciously provided the defendant in this case."
Q. That's all right. It will get better at trial. I promise you.
A. Okay.
I don't know that I broke that out.
Q. All right.

Let's turn to scenario No. 2.
A. Which report and which page?
Q. Right where we left off. Page 22, paragraph 37 of your supplemental report.
A. Okay.
Q. So now you have scenario No. 2 of you're calculating damages for April 1, 1998 to April 28, 2001, correct?
A. Yes.
Q. And --
A. Can you give me a moment, please?
Q. Sure.
A. Okay. I'm sorry. Go ahead, please.
Q. Is there any way I can tell under scenario No. 2 the offsets that were provided for pre-April 1, 1999 for purposes?
A. Just given in that paragraph the net purchases by investors, so I have not broken it down.
Q. Tell me how did you treat the purchases that took place between January 1, 1998 and April, I guess March 31, 1999, for purposes of offsetting, determining offsets?
A. With the caveat that I don't know that the database began on January 1, '98.

Q. It had to. You assumed the claims period for that.
MR. OWEN: Object to the form.
A. Thank you for correcting me.
I was trying to look for a date somewhere and I didn't find the date. You're right, the report says that.
Q. I asked you in scenario No. 1 the purchases that took place before the first date in scenario No. 1, January 1, 1998.
A. Right.
Q. Now I'm asking you for the time period that includes scenario No. 1, January 1, 1998.
A. Right.
Q. Before the first date in scenario No. 2, April 1, 1999.
A. Okay.
Q. During that one year and three month period.
A. Right.
Q. Tell me how you calculated the offset in terms of determining inflation for shares purchased during that period.
A. So, this is my recall of the

calculation that was done. You have a database that gives you all the purchases and sales transactions that were submitted in the claims process. So, for scenario 2, I added up all the purchases by separately identified entities between April 1, 1999 and April 28, 2001. And if the same entity that made the purchase had sold certain number of shares during this period, regardless of whether or not these shares were acquired prior to this period, I took the net purchase amount by entity.
So if Joe Smith bought 500 shares between April 1, 1999 and April 28, 2001, and sold total of 300 shares during this period, regardless of when those purchases were made, I subtracted those 300 shares sales from 500 share purchases and computed damages on the net 200 shares for that individual.
And I did the identical calculation for all the participants for whom I had data that was provided to me.
Q. I understand that. That's not my question.
My question is -- and we have been talking about offsets for trading gains?

A. Right.
Q. How did you determine whether -- strike that.
In scenario No. 2 I assume you reduced the amounts of your net purchases by -- that if an investor, Joe Smith, sold more than he purchased during this period, that you somehow used that as a gain and reduced your total loss number?
MR. OWEN: Object to the form of the question.
A. No.
Q. That's not correct?
A. That's not correct.
So, you know, my impulse is to want to get up and write on the board to explain, but let me try without the benefit of any visual aid here, through a couple of examples.
Q. You know what, we don't need to get into examples. I think I understand your testimony and I'll just withdraw the question.
A. Okay.
Q. I would like to get through some material here.
A. Okay.

Q. Did you use the LIFO or FIFO method in calculating losses in scenario 1?
A. I did not use -- I did not need to use LIFO or FIFO. When you're dealing with a scenario where inflation is assumed to be zero, before April 1, 1999, then if shares that were sold between April 1, 1999 and April 28, 2001 were purchased during this very same period, they go out, they were purchased at the same inflation and sold at the same inflation, they never accumulate damages.
If shares that are sold during this period, you know, again, as I'm explaining this, there is -- you know, I'm not sure I can recall all the details. If shares that are sold during this period are -- again, I don't remember now.
Q. So you don't know whether you used LIFO or FIFO?
A. I do not remember now. I would have to go back and look at the calculations.
Q. Now, for scenario No. 2 --
A. Uh-hum.
Q. -- I just want to understand, make sure I understand this correctly.
You assumed that all of the

purchases before this period, April 1, 1999, that were then sold during the period --
A. Right.
Q. -- had zero inflation. We'll call them the pre-scenario 2 time period purchases.
A. You know, this is what I recall. Again, we are getting into detailed methodological issues that are, you know, more than a year old, about a year and a half old.
My assumptions were to maximize the benefit of the offset, whatever assumption I needed to make to maximize benefit of the offset; so, in other words, if there were sales during this period, I made whatever assumptions would lead to those sales providing the maximize possible assumed gain as an offset to damages that I concluded.
Q. Okay.
So the 13-month period that I'm talking about before April 1, 1999 where you assumed that any of those purchases had zero inflation because you were trying to maximize the offset, in scenario No. 1, that period you found the shares to be inflated by $15 a share, right?

A. I'm sorry. I did not make any factual determination.
Q. Okay.
Just in calculating your damages under scenario 1, you used the fact that the shares were inflated by $15.23 during that period, right?
A. No. I assumed that under scenario 1, if shares were purchased with $15 inflation, then, I assumed zero inflation prior to that period to maximize the offset.
Q. I understand that.
And, but you used -- forget the offsets for scenario No. 1. People that purchased shares during that time period, January 1, 1998 to April 28, 2001, your calculation was that there was $15.29 of inflation for those purchases, right?
A. Well --
Q. That's what you put, 228 million shares multiplied by $15.29, right?
A. Counsel, if you want me to repeat what's written here, then I can't help you understand what's written here. If you would like me to explain --

Q. Let me ask you something.
A. -- what I did and why, then I'm happy to.
Q. I didn't mean to interrupt you.
Let me ask you: You said the shares during the time period of scenario 1 were inflated by $15.29. Now I'm asking you for those same purchases during that period, when you used those purchases to determine an offset for scenario No. 2, why did you give them zero inflation in scenario No. 2 if you gave them $15.29 of inflation in scenario No. 1? That's my question.
A. To maximize the value of the offset, because my task there was to determine a low amount on damages.
Q. Okay.
Now, when you used -- let's go back to your first report, Exhibit 3, your use of the 92 companies.
A. 92 events.
MR. OWEN: We're still talking about the Computer Associates?
Q. 92 events. Thank you.
MR. OWEN: We're still on

Computer Associates?
MR. BURKHOLZ: Yes, Exhibit 3. Exhibit 3 to his first report in that case.
MR. OWEN: I got it.
A. I'm going to Exhibit 3 of Charge 4, is that correct?
Q. That's correct.
I want to look at your results in that Exhibit 3.
Okay?
A. Okay.
Q. Now, for some of these companies, and we can look at the bottom of the first page, the announcement date took place in -- took place in April of 2002, right? You see IBM on No. 45?
A. Yes.
Q. Okay.
And you went back 254 trading days -- well, let's look at Peregrine. Peregrine Systems, No. 42.
Do you see that?
A. No. 42, yes.
Q. That was a San Diego company. Let's

talk about that.
A. I don't know, you probably know the company well.
Q. They have their own problems but we won't talk about that.
So for the Peregrine Systems announcement date, January 3, 2002?
A. Yes.
Q. You went back over 254 trading days before the four days before January 3, 2002, right?
A. No. I went back 254 trading days before the announcement date and stopped four trading days before the announcement.
Q. That's what I was trying to say.
A. Okay.
Q. So that's approximately back to the spring of 2001?
A. Beginning of the year 2001, approximately.
Q. And you ran your regression analysis using the S&P 500 index and the NASDAQ computer index over that time, right?
A. Yes.
Q. Okay.

And considering the fact that, that that time period covered September 11, 2001 and the events of September 11, 2001, did you do anything to take into account the events of September 11, 2001 in this analysis?
A. I don't recall doing so for this purpose.
Q. And that would hold true for the other companies for which the 254 trading days covered 9/11/2001, that you didn't make an adjustment for anything related to 9/11/2001, right?
A. Yes. For some part of the sample, that could be true.
MR. BURKHOLZ: Okay. I think this is a good time to take our lunch break.
THE VIDEOGRAPHER: This is the end of Tape 3 in the videotape deposition of Mukesh Bajaj. We're going off the record. The time is 12:51.
(Whereupon, at 12:51 o'clock p.m., a luncheon recess was taken.)

A F T E R N O O N S E S S I O N
March 25, 2008
1:44 o'clock p.m.

THE VIDEOGRAPHER: This is the beginning of Videotape No. 4 in the videotape of Mukesh Bajaj. We're back on the record. The time is 1:44.
MR. OWEN: I just want to note the presence of Elizabeth Grippando.
MR. BURKHOLZ: It is noted for the record.
M U K E S H B A J A J, resumed and testified further as follows:
EXAMINATION BY MR. BURKHOLZ:
Q. Do you have any opinions in this case that are not reflected in the reports that you have provided in this case?
A. Not as I sit here, no.
Q. And do you anticipate providing any other opinions before trial?
A. I will answer questions I'm asked and, you know, I don't intend to.
Q. Can you tell me how much you've billed the defendants for your work in this

case?
A. I think the total bills for all of LECG work would probably be somewhere between 1.5 and $2 million, but I'm not sure.
Q. Is that an approximation?
A. Yes.
Q. And how much have you been paid out of your billings to date?
A. I think whatever is the normal cycle that we get paid regularly.
Q. So do you know -- do you have any outstanding bills at this time?
A. I'm sure our bill for last month is probably still outstanding.
Q. So have you been paid approximately 1.5 million or more?
A. I didn't check, so I can't tell you. But whatever is the normal outstanding cycle is what is outstanding.
Q. Did you write the report, your reports by yourself, or did you have some people helping you?
A. I worked with my colleagues who assisted me under my direction and supervision, but I either adopted or edited everything in the

report.
Q. Now, let's go back to, just for a little bit longer, to the Computer Associates situation.
Okay.
A. Okay.
I must say, Counsel, if you examine the record in this case, in that case, we've talked about it three times longer than I was cross-examined on that case.
Q. Very good.
How did the inflation get into the Computer Associates' stock in that case?
A. The allegations were that the company had a practice of keeping quarters open for as long as they needed to meet the revenue targets that they had. So that would sometimes lead to borrowing, if you will, additional amounts from future quarters than the whole quarter in question started with, and sometimes the other way around.
Q. Did you analyze the event study and identify dates in which the inflation entered the stock price in that case?
A. As I said, given the facts of the

case, because this alleged practice had spanned many years and the government did not have complete information --
MR. OWEN: Sorry. Hold on.
THE VIDEOGRAPHER: We are going off the record. The time is 1:48.
(Short recess.)
THE VIDEOGRAPHER: We are now back on the record. The time is 1:48.
BY MR. BURKHOLZ:
Q. Let me ask the question again so we can start off again.
A. Okay.
Q. Did you use a regression analysis in the Computer Associates case to determine the date in which there was zero inflation in Computer Associates' stock?
A. No. Given the facts of the case that was neither necessary nor the right thing to do.
Q. And why is that?
A. Well, as I was explaining, the government counsel told me that they had information on admitted improperly booked revenues for a one-year period; and, so, since I

did not know for the first quarter how much revenue that was properly booked in that quarter went to meeting the deficit from the preceding quarter, I couldn't analyze whether or not there was improperly inflated revenue in that particular quarter. And given the patterns in the data, it turned out that there was only one quarter for which I could, given the facts available on what were admittedly improper booked contracts, determine the amount of inflated revenue.
So, given those circumstances, the only thing that I could do was to ask the question as to what would the stock price be if that particular quarter's numbers were truthfully announced. And that became the metric of how much inflation was there at the end of the quarter. Then I carefully examined if there was any statements, announcements or any other evidence that would allow me to determine whether there was any change in the level of inflation during that quarter. And because I found none, I assumed the inflation that I could ascertain at the end of the quarter was maintained throughout the quarter.

Q. So you didn't measure any stock price increases during this time period in Computer Associates?
A. Given the facts of that particular case, yes.
Q. And if you didn't measure any stock price increases in Computer Associates case, was -- strike that.
So let me be clear on this. You didn't measure any of the stock price increases in the Computer Associates case, correct?
MR. OWEN: Object to the form of the question. Mischaracterizes testimony.
A. In the context in which you asked me that question, I answered yes, and that's the answer.
Q. And so in the Computer Associates case, the inflation was caused by an omission with respect to their reporting of their financial statements?
A. No. It was caused by a misstatement of the financial statement for that particular quarter. And I could use the kind of events technique that we discussed to estimate what the

market reaction would have been had the financial statements been truthfully reported and that, therefore, becomes the measure of additional information that was introduced on the income announcement date by misstatement of the income in that case.
Q. And in the one quarter that you were certain about that you were focusing on, you didn't see any price increase when they announced their financial results which were -- which were improperly reported to the public?
A. Well, I don't recall. I think we looked over some exhibits that looked at what the market price reaction to the announcement was and I considered what it would have been had the correct financials been announced; and the difference of the two gave me a measure of inflation introduced on the earnings announcement date as a result of the misstatement of earnings.
Q. So, did you measure the stock price increase or not?
A. Well, I did in the way I just explained. I looked at the avoided stock price drop as a measure of inflation introduced on the

day the earnings were improperly announced.
Q. What about the day that they, they published the reports, did you analyze the stock price reaction on that day?
A. When they published the reports meaning?
Q. When they published their financials that were false.
A. Well, the market reaction to the announcement, not necessarily when the 10Qs are filed or published, if that's what you're getting to, and I don't recall whether I looked at the 10Q filing date or I looked at the announcement date or both.
MR. BURKHOLZ: Let's just go off the record for a moment.
Okay?
THE WITNESS: Okay.
THE VIDEOGRAPHER: We are going off the record. The time is 1:55.
(Whereupon, at 1:55 o'clock p.m., a recess was taken to 1:59 o'clock p.m.)
THE VIDEOGRAPHER: We are now back on the record. The time is 1:59.

BY MR. BURKHOLZ:
Q. I want to go back to the headline risk issue that we talked about this morning.
Your opinion is that headline risk affected Household stock during the class period, correct?
A. Yes, you could say that.
Q. And it also affected other peer, peers of Household, correct?
A. It affected other companies that were in similar businesses, yes.
Q. And it is your testimony that the headline risk came into the marketplace at various times during the class period?
A. Well, there were various developments in the marketplace that affected the degree of headline risk that Household faced.
Q. And when disclosures came in to the marketplace about headline risk, did you need to see a statistically significant decrease in Household stock price in order for it to be considered material?
MR. OWEN: Object to the form of the question.

A. In general, yes, whether you want -- if you want to answer a question as to whether a particular realization of headline risk materially affected the stock, as an economist, the only way you would answer that question is to see if it led to a statistically significant decline in stock price.

Q. And did you perform that analysis for Household stock?

A. Yes.

Q. Okay.

And did you -- you identified dates in which headline risk came into the marketplace and there was statistically significant drops?

A. Yes.

Q. And what dates were those that you found in your report?

A. Well, if you look at the event chronology that I provided, you will find that there were many days when there were developments that created situations where Household and other companies such as Household faced greater uncertainty about regulatory climate, greater uncertainty about political climate in connection with lending to low income

borrowers, greater threats of lawsuits and increased regulatory and other monitoring costs to comply with various regulations and various political demands and pressures and the potential fear on the part of market participants in buying securities that Household needed to sell in order to fund its lending operations, and you find that there were many days when there were such announcements and the stock price of Household declined and many times stock price of other companies in that segment also declined.

Q. Did you do an analysis to quantify the impact of headline risk on peer companies of Household?

A. In the way that I described, I noted that many of the days that, for example, Professor Fischel mistakenly found to be significant when he concluded that stock price change for Household was statistically significant after adjusting for market and industry because he did not include consumer finance companies in his regression analysis. He concluded larger negative stock price reaction than he would have concluded had he

considered other similar companies. And I have a couple of pretty looking charts in my report demonstrating that.

Q. My question is really a little different than what you just answered and that is: Did you make any attempt to quantify the impact of headline risk, not on Household, but on Household's peer group, including the six companies you identified, to see how much of a decline in their stock price was due to headline risk? Did you do that?

A. Not as a goal by itself, but only indirectly for purposes of doing my analysis in the way that I described it.

Q. Now, tell me for Household's relative stock underperformance during November 15, 2001 to the end of the class period, how much of that was due to headline risk?

MR. OWEN: I object to the form of the question.

A. Well, I have not done an analysis that would allocate the relative underperformance quantitatively to headline risk.

Q. Okay.

And let me ask you this, if you could turn to page 43 of your rebuttal report, this would be your -- hold on a second. It is your initial report. It is Bajaj 2.

Let's wait for your counsel to get there. It is page 43.

A. Do you mind if I straighten out the page?

Q. No. Okay.

Do you see that you reference various dates and information that came out on those dates from Ms. Ghiglieri's report on page 33 of your report, do you see you reference the March 3, 1999 --

A. Yes. And, as I said, the Ghiglieri report provides a detailed description of evidentiary changes, regulatory changes that were being introduced in the 1990s into the class period. And here I'm referring to certain regulatory developments that are identified in that report on certain dates.

Q. Okay.

And the April 2000 and the May 2000 references that you have in your report, are

those examples of headline risk that you're talking about impacting Household stock?
A. Those are examples of developments that created headline risk for Household and some of the other companies.
Q. And it's your opinion that these kind of disclosures, including the April 2000 and May 2000 disclosures, negatively impacted Household stock?
A. Well, no, because these are not disclosures. These are certain developments. It's entirely possible that some of the dates mentioned here when developments took place were well anticipated prior to that date. So --
Q. How would they be --
A. I would call them, therefore, disclosures when you would expect to necessarily pick up the evidence in stock price changes on these dates.
Q. I'm a little confused. How would the market know what the OTS was going to do when it issued the advanced notice of proposed rule making on April 5, 2000?
How would the market know beforehand that the OTS was going to do that?

A. I'm not necessarily an expert in OTS processes, but in my experience, it is not uncommon for regulatory bodies to consult with industry participants, consult with politics, consult with consumers, sometimes hold advanced hearings, and there is a process that usually leads to issuance of new regulation on various milestones associated with issuance of new regulation.
Q. Okay.
So you don't have any evidence that Household stock price declined due to these regulatory developments, do you?
A. I did not attempt to associate these developments with changes in Household's stock price for the reasons that I describe.
Q. You're aware of Professor Cornell, are you not?
A. Yes.
Q. And he's a respected expert in this field, isn't he?
A. He is an accomplished academic and I have seen him serve as an expert on many cases.
Q. He, in fact, the article that he wrote in 19 -- 1990, I assume it is Professor

Morgan, is an article that you relied on in this case, right?
A. Well, that's one of the articles I have cited on event studies for purposes of securities fraud analysis. Of course, there is a very, very large body of literature in financial economics on event studies.
Q. Now, if you look at the Fischel rebuttal report, page 27, Footnote 30. Take a look at that for a minute.
A. Okay.
Q. Okay.
You don't disagree with what Cornell and Morgan have described in their article that's referenced in Footnote 30 of Professor Fischel's report, do you?
A. I disagree with Professor Fischel's invocation of Cornell and Morgan in this particular context to justify the analysis that he failed to do.
Q. Okay.
And do you believe that fraudulent omissions can inflate a company's stock price?
A. Fraudulent omissions in general,

depending on facts and circumstances, could inflate a company's stock price.
Q. So you don't need a company's statement to cause a stock price to increase in order to have a fraudulent statement?
A. I'm sorry. If you read your question back, I know there was something there.
Q. I'll rephrase it.
Do you need a stock price increase upon a company's statement in order for there to be inflation in a company's stock price?
A. Not necessarily.
Q. Let me give you a hypothetical. Okay. I may come back to the hypothetical, but let's -- I want to ask you a different question.
Have you ever been involved in a case where a court has shortened the beginning of a class period because of statute of limitation purposes?
A. Yes.
Q. Okay.
Which case was that?
A. Again, I'm not sure that I will be able to have a perfect recall. It is a very common occurrence, and I can recall this

circumstance in connection with some cases that I do not have testimony on the record and, therefore, are not on my resume and I can't talk about my involvement in those cases on the record.

As I sit here right now, I'm not sure I would recall in which of the cases that I have testimony on the record that was a circumstance.

Q. Okay.

So, we looked at your testimony on the record. There is a number of cases. You're saying it may have happened in one of those cases, but you can't recall sitting here now?

A. Right now it doesn't jog my memory, but I understand this to be a very common development and I certainly remember well many of my cases where there's been no testimony on the record where, in fact, class period has been shortened on statute of limitations grounds.

Q. And have you also been involved in cases where class period was shortened in the beginning because the plaintiff's evidence didn't support a finding of false statements at that time and they either dropped the

allegations or the court at summary judgment, you know, threw out those earlier statements as not being false?

MR. OWEN: I object to this on the grounds that these are calling for a legal evaluations.

MR. BURKHOLZ: I'm not asking for his legal evaluations.

MR. OWEN: You're using a lot of legal terms.

If the witness can answer, then go ahead.

BY MR. BURKHOLZ:

Q. Okay.

A. I'm a little confused. Either this is a legal question and I can't answer it. If this is legal standard, Class B would begin on November 15, 2001, pursuant to Professor Fischel's report, because he couldn't find any evidence of inflation prior to that.

Q. Let's not go down that road. I know what your position is on all that.

I asked you, you said that, look, I don't know on the cases that are -- that I testified in and there are certain cases that I

did a report on and didn't testify in in which the class period was shortened because of statute of limitations grounds, right?

A. Or I was never asked to do a report or I am in the process of doing a report. All of those possibilities.

Q. You understand there are other reasons other than statute of limitation grounds that a class period could be shortened at the beginning?

MR. OWEN: Same objection.

A. I assume there could be many legal reasons.

Q. Okay.

In the cases in which -- in which the class period was shortened at the beginning that you were involved in, were you testifying for the plaintiff in any of the cases or providing an opinion for the plaintiff in any of the cases?

A. Do you mind if I refresh my recall on my CV before I answer this question?

Q. No, I don't.

A. Okay.

I'm sorry, can you repeat your

question again?

Q. Were you a plaintiff in any of those cases in which there was a shortened class period?

A. I have never been a plaintiff.

Q. Let me rephrase that.

Were you an expert retained by the plaintiff in any of those cases?

A. I don't believe so.

Q. Okay.

In those cases, so then you were retained by the defendant in those cases, correct?

A. I was retained by counsel for one of the defendants in those cases.

Q. Now, you understand in this case the court shortened the class period to begin on July 30, 1999, correct?

A. Yes.

Q. Did you read the judge's order in this case on that issue?

A. I believe so.

Q. And you understand it was based on statute of limitation grounds?

A. I don't recall the reasoning.

MR. OWEN: I think I'm going to object to the representation that he ordered.
MR. BURKHOLZ: Okay.
MR. OWEN: That it was a statute of repose, among other things.
MR. BURKHOLZ: Okay.
Q. Now, you understand there was no public statement by Household on July 30, 1999, right?
A. I don't exactly recall, so I don't have a belief one way or the other. I would have noted it in my event chronology.
Q. Do you have an opinion as to whether or not the statement by Household on July 22, 1999, when they issued their court-ordered results, could have inflated Household stock price on the first day of the class period?
MR. OWEN: Object to the form of the question.
A. Based on the facts that I know, it is my opinion that there would be no basis to believe that the financial statements by Household on July 22, 1999 led to inflation in Household's stock price.

Q. On July 30, 1999?
A. On any other date.
Q. If the court rules in this case that the class period can't start on July 30, 1999, but has to start on August 16, 1999, when Household issued its 10Q, do you have an opinion on whether or not there can be inflation in this case?
MR. OWEN: I'm going to object to the form of the question. Again, it calls for legal speculation as to court rulings.
The witness is not a lawyer, but if you can answer.
BY MR. BURKHOLZ:
Q. I'm asking you to assume that the Judge does that.
Do you have an opinion as to whether or not there can be an inflation on that is the date that statement comes out August 16, 1999?
A. I'm not aware of anything in the record that would lead me to conclude that the financial statements announced my Household on August 16, 1999 would be materially false in a way that could lead to inflation in stock price.

Q. Did you read any of the other defendant's experts' reports in this case, not the plaintiff expert reports, but the defendant's expert reports?
A. I don't believe I did. If I considered them, they would be in the materials considered list.
Q. They're not listed in the documents relied upon. I just want to make sure you didn't rely on any of the other expert reports for the defendants, correct?
A. No.
Q. Now, your position in this case is that you need to know the pre-class period inflation in order to determine any trading gains of class members, correct?
A. Well, first of all, that's not my position. That's my conclusion based on economic easement. And, second, there are two reasons why I believe Professor Fischel should have provided pre-class period inflation; one, in order to implement netting in computation of damages to do such netting properly, number two, in order to evaluate whether his conclusion of inflation based on the backward casting approach

that he has adopted is, in fact, true, he needed to have examined that evidence to determine if inflation that somehow magically dissipated starting November 15, 2001, according to him, was not already dissipated before that date or the beginning of the class period.
Q. I'm asking a question that goes to the claims process in this case.
Professor Fischel doesn't even deal with the claims process in this case. I want you to focus on the claims process.
A. I'm sorry, that's not what your question was.
Q. Let me try to be a little more specific.
Class members in this case file proof of claims with their claims information. Only those people that purchased shares during the class period are entitled to recover. You want to know what their purchases were before the class period, right?
A. And what the inflation path was before the class period in order to properly determine what, if any, damages they may be entitled to.

Q. Did you do any calculation of what the inflation was before the class period in this case, yes or no, did you do it?
A. I found no evidence that there was any inflation any time during the class period.
Q. Before the class period I'm asking you.
A. Or before the class period.
Q. Okay.
And tell me how far back are class members supposed to go to show the shares that they purchased before the class period that might be subject to netting under your approach?
A. From an common logic perspective, quite apart from any legal considerations, it would have to begin at least until the date when inflation first started affecting the stock price.
Q. And tell me when that was in this case.
MR. OWEN: Object to the form of the question.
A. As I said, I found no evidence that there was ever any inflation in the stock price, nor have I seen any evidence of Professor

Fischel showing me there was any inflation in the stock price.
Q. Before the class period, my question is, how far back do class members have to go in terms of providing purchase dates for shares that might have been sold during the class period, a year, five years, ten years?
MR. OWEN: Object to the form of the question. It was asked and answered.
A. If inflation affected Household's stock price six months before the beginning of the class period, then it would be necessary to get all the purchases prior to that date without necessarily getting detailed schedules on those purchases and all the purchases with relevant dates beginning that date in order to properly compute damages, if any were, indeed, payable.
Q. Okay.
Now, you have not estimated any inflation for any time period before the class period, correct?
A. Well, as I said, there is no evidence that there was ever any inflation; so, you could say I have estimated it and it is

zero.
Q. Have you ever been involved in a case where you have analyzed inflation before the class period and have done that kind of analysis to determine whether there is inflation or not for purposes of offsets?
A. Yes.
Q. In what case would that be?
A. Again, this is a case where I have not offered testimony on record.
Q. Is it privileged protected?
A. I don't know. I was involved in mediation and the case settled. I don't know if it is privileged.
Q. Are you allowed to testify about it today?
A. My presumption is that I'm not.
Q. Now, with respect to the 14 specific disclosure dates that Professor Fischel identifies in his specific disclosure model --
A. Yes.
Q. -- you're with me on that?
A. Yes.
Q. Okay.
You analyzed the stock price

reaction on those days, correct?
A. Correct.
Q. And you referred to what you labeled non-fraud factors that Professor Fischel didn't consider, right?
A. Among other things, yes.
Q. Okay.
And, for example, on certain days there were other companies that information came out about, whether it was Conseco or Citigroup or Providian, that you felt that Professor Fischel didn't look at, right?
A. That sounds familiar.
Q. We'll look at one of them.
A. Okay.
Q. Let's look at -- we'll look at the Citigroup situation that you identified. So it is page 60 of your report.
A. Which report?
Q. I think it is your first one in this case; so, it is your rebuttal report.
A. Okay. Okay.
Q. And why don't you familiarize yourself with pages 60 and 61.
A. I can't seem to read the production

of page 61 for some reason.
Q. Which part are you having a tough time reading?
A. Looking at the labels underneath the figure. It looks like this is not the original copy of the report.
Q. Why don't you switch with your counsel. He might have a better --
MR. OWEN: I have the same problem. I wasn't going to complain about it.
BY MR. BURKHOLZ:
Q. Are you having a tough time reading the symbols for some of the companies, is that the problem?
A. Yes.
MR. OWEN: There are percentages and names. I can't read any of them.
Actually, I can read a couple of them.
MR. BURKHOLZ: Let's focus on the Citigroup issue on the top of the page. It's not important. If you have a cleaner copy, let's show it to him.
Thank you. I appreciate it.

THE WITNESS: Okay.
BY MR. BURKHOLZ:
Q. I wanted to really focus on the fact that you pointed out to Professor Fischel that he didn't consider the Citigroup stock decline of 10.62 percent on that day, right, that's what you're pointing out?
A. Yes.
Q. Okay.
And, okay, you see that, right?
A. Right.
Q. And my question is: Did you actually determine that Household stock price dropped on this day due to this non-fraud factor?
A. Well, actually, the way to interpret my remarks is as follows: There was clearly news in the marketplace that affected Household's sector and Citigroup, which was the largest consumer finance group ahead of Household, even though there are a lot of other businesses, too, suffered a very steep stock price decline for a company of that size. And, in addition, we see reverberations among consumer finance companies, Household being one

of the seven consumer finance companies, and one of them, Providian, declined in stock price that day by 10.4 percent, MBNA by --
Q. I understand. I see all the changes.
A. -- by 8.8 percent. And the valuated index of consumer finance companies declined by 7.5 2 percent. Whereas, Household declined by 7.6 2 percent.
So, had Professor Fischel properly benchmarked Household with other consumer finance companies, they would -- he would not have concluded that there was a significant stock price decline after adjusting for market and industry factors on September 3, 2002.
Q. But you said, taking aside the estimation period which you have a difference of opinion with him, you don't quarrel with his use of the S&P 500 index, the S&P financial index and your consumer finance group index, using those three in his regression model, right?
MR. OWEN: Objection to the form of the question. Misstates the record.
A. Well, I do, because the only reason he finds September 3 to be significant in his

regression analysis is either because he doesn't include consumer finance index or he uses consumer finance index in other companies in an inappropriate manner for the wrong time period with the wrong sign of coefficient for S&P 500.
MR. OWEN: Hang on.
Q. I didn't mean to cut you off at the end.
A. Since you interrupted me, he did not take into account that his regression was obviously incorrect because there was negative sign with the market return.
Q. Did you actually find or determine that in this particular case on September 3, that the Citigroup information caused Household stock price to decline?
A. What I determined is that Citigroup stock price declined visibly for reasons that had overlapped with the consumer finance sector declining by as much as Household did on that day; and, therefore, in a properly specified regression that day did not result in a statistically significant stock price decline.
Q. Now, you're not testifying that Professor Fischel should have only used the

consumer finance index in his regression analysis, are you?
A. No, I'm not saying that at all.
Q. That was a simple question. I just asked you that. That's all.
Can you go to page 14 of your surrebuttal report.
A. Okay. Could I be given that exhibit, please?
Q. You have it right here.
A. Okay. Thank you.
MR. OWEN: What page?
MR. BURKHOLZ: Page 14 of the surrebuttal.
BY MR. BURKHOLZ:
Q. And I'm going to ask you to focus on -- why don't you read the whole page, including Footnote 48.
A. Just this page?
Q. That's it. That's all I want to ask you about.
Now, in Footnote 48 you refer to Exhibit 4 of your report as 20 instances of similar events that would be considered disclosures under Fischel's logic, right?

A. Just one moment.
Yes. I give these as examples in addition to other examples that are already in the record, if you look at the event chronology that I submitted.
Q. Okay.
And these are examples of what?
A. These are examples of the same kind of announcements that he takes as corrective disclosures after November 15, 2001.
In fact, if you were to count in the events schedule I have provided, there are 99 announcements involving Household and predatory lending. And if you were to count --
Q. I'm just asking about these two.
A. 20. 20. Let me finish.
If you were to count the majority of them, according to Professor Fischel's own regression analysis or you take my regression analysis would have had a positive excess return. In fact, the median price reaction in those 99 events is pretty close to zero. That's likely positive. And there are events, some of them exemplified through Footnote 48 prior to July 30, 1999, that criticize Household for

predatory lending when these criticisms come from third parties, the kind of events he considers corrective disclosures.
Q. Okay. I understand that.
And I want to ask you about those 20, the 20 instances that you attached as Exhibit 4. I want us to focus on that.
A. Okay.
Q. All right.
Did you analyze to see whether or not Household's stock price declined in a statistically significant way when the disclosures that you attached as Exhibit 4 --
A. No, I did not.
Q. Would it surprise you to know that there was no statistical significance on the dates, any of the dates of the articles that you listed in Exhibit 4?
A. It wouldn't surprise me at all, because any of the disclosures he's identified are hardly ever statistically significant. And I just told you there are 99 of them during the event study period. And median price reaction is zero and majority have a positive, have normal return, according to Professor Fischel's

study.
Q. But you didn't analyze the 20 that you provided here to see whether there was a statistically significant drop, did you?
A. Well, I found them as examples of the kinds of things that if they happened after November 15, 2001 and if they had a sign of excess return that supported plaintiff's theory, Professor Fischel cited to claim inflation while ignoring evidence that did not support plaintiff's theory.
Q. All right.
Before we break, I just want to make sure the testimony is clear.
You didn't analyze to see whether or not these disclosures on these 20 instances caused a statistically significant drop?
A. No, I did not.
MR. BURKHOLZ: Okay. Let's take a break and then we can move on to another subject.
THE VIDEOGRAPHER: This concludes Videotape No. 4 in the videotape deposition of Mukesh Bajaj. We're going off the record at 2:45.

(Whereupon, at 2:45 o'clock p.m., a recess was taken to 3:04 o'clock p.m.)
THE VIDEOGRAPHER: This is the beginning of Videotape No. 5 in the videotape deposition of Mukesh Bajaj. We're now back on the record. The time is 3:04.
BY MR. BURKHOLZ:
Q. I think you testified that you found 99 dates in which there was information regarding headline risk that came out?
A. Well, 99 days when there was some mention of predatory lending in connection with actual -- in the event chronology -- excuse me -- that I submitted with my report.
Q. Okay.
And did you actually do an analysis of those 99 dates other than in your head, I mean, actually document it?
A. Well, what I was describing, I'm afraid, was not quite in my head. I can't calculate excess returns on 99 events in my head.
So I did look at them, and as I was

telling you, slight majority of those days are associated with positive excess return. Many of those days that are by definition during the class period because that's what the chronology is about, dozens of those dates are prior to November 15, 2001, when Professor Fischel states he first found evidence of corrective disclosures and the median price reaction is something like 0.01 percent or some such. It is miniscule, but positive.
Q. Have you actually documented that in some kind of worksheet or analysis that I can see?
A. Well, I looked at it. It is all implicit in the analysis, but I was curious so I asked my colleagues to tabulate it and they shared the results with me and that's what I'm talking about.
Q. Do you still have that analysis?
A. I don't have it physically with me.
Q. Do you have it at your company?
A. Probably somewhere.
Q. Okay.
And the 99 days that you identified, were they all statistically significant?

A. No.
Q. How many of them were?
A. I don't remember. The point I'm making is --
Q. That's simple. That's fine.
A. Okay.
Q. The 20 days that you identified in Exhibit 4 to your surrebuttal report that we looked at before --
A. Yes.
Q. -- the 20 articles, disclosures, those are part of the 99 dates, correct?
A. No.
Q. Are they in addition to the 99 days?
A. They are in addition to the 99 days, my recall. I just wanted examples; so, I'm not claiming that these 20 are a comprehensive sample. In fact, I would be surprised if they are.
I think these are dates that we found somewhere in the database that is in the record, that's what distinguishes them. Documents that exist on the hard drive we got, and I'm not saying this is the most comprehensive search either.

Q. Okay.
So the 20 days are different than the 99 days that you also identified?
A. Which are part of my event chronology, yes.
Q. Okay. And --
A. And I can't say if any of these 20 happen to be in the event chronology, too. But they were two separate and independent exercises is what I'm trying to tell you.
Q. Wouldn't you expect them to be in the event chronology?
A. I don't know. I haven't -- as I said, I asked for two independent exercises and I didn't sit there matching them.
Q. I know.
But would you expect them, going back to our first example on page 43, the April 5, 2000, OTS issuance, would you expect to see that in the event study or not?
A. No, because the event chronology is, I believe, only for the class period. Maybe if I can see that.
Q. That is the class period. Look at page 43 of your initial report.

A. Okay.
Q. Right there. Okay.
Remember, we were looking at the OTS disclosure on April 5, 2000.
A. April 5, 2000, yes.
Q. We were looking at that before. That's during the class period in this case, right?
A. Right.
Q. Okay.
Now, would you expect to see the April 5, 2000 OTS issuance of the advanced notice of proposed rule making, is that information would you expect to see that in your event study or not?
A. I'm not sure, because my recall is the way we did the event study is we looked for articles that had certain key words, including "Household" either in title or in the first paragraph of the story. And if this particular announcement did not have the name of the company "Household" in either the title or the first paragraph of the story, it wouldn't have been caught unless it was caught because of some other key word.

Q. And so now you're saying that there's 99 dates in which headline risk is being disclosed to the market, there's another 20 disclosures that are in your Exhibit 4, right, that refer to headline risk, right?
A. Well, no. What I said is there are 99 days in my event chronology where there is a story that talks about predatory lending. Second, there are these examples from plaintiff's industry expert's report which are cited on page 43. In addition, there are 20 articles in that I have cited in my surrebuttal report that are examples of headline risk prior to November 15, 2001, as described in my surrebuttal report.
Q. And --
A. And there could be overlaps in these samples.
Q. Okay.
And there was not a statistically significant drop on many of those dates, right?
A. Yes.
Q. Meaning a number of those days, there was no statistical significance?
A. And some there was and some there

wasn't. I don't recall right now.
Q. So on the days in which there was no statistical significance in which these disclosures were made that either the 99 or the 20 you have identified, the additional ones?
MR. OWEN: Object to the form of the question.
Q. Was the headline risk leaking into the market on those days?
A. No. I think the way to understand the importance of those events is the following.
Professor Fischel looks at certain dates when stock price reaction was consistent with his theory, and there was usually some reputational stale information by a third party mentioning Household and something that was critical of Household. For example, predatory lending, and interprets those events as inflation coming out of the stock.
The reality is these kind of stories are there by the dozens. And if you look at these kinds of stories, and sometimes there's no stock price reaction, sometimes it's positive, sometimes it's negative, that tells you that his interpretation of the events that he included to

quantify inflation is flawed.
Q. Okay. Thank you.
It is a simple "yes" or "no" question. Does the fact that there's no statistical significance on many of these dates reflect leakage or not?
MR. OWEN: Object to the form of the question.
A. I can't answer that question with "yes" or "no."
Q. Okay. Okay.
Can you turn to the documents in your two reports that you reviewed, the materials you reviewed? I think it is like Exhibit 2 to each of your reports.
A. Okay.
As long as I don't have to answer about documents in the Kumar report.
Q. I can't promise that, but I think we're done with the Kumar.
So it is Exhibit 2 on the first report and then Exhibit 1 on your second report.
Okay. Let's focus on Exhibit 2 of your first report. And I want you to focus on the documents produced in discovery part of that

which is on the seventh page of that exhibit.
A. Okay.
Q. Do you see where I am?
A. I see page 7 of 9, yes.
Q. And do you see the documents produced in discovery listed turning to the next page, 11 documents?
A. Yes.
Q. Okay.
And you relied on those 11 documents in forming your opinion, correct?
A. Yes.
Q. And then in your surrebuttal report you don't list any other documents produced in discovery?
A. Just one moment.
Q. That would be Exhibit 2 of your surrebuttal report.
A. Yes.
I do not list any additional documents under that same title.
Q. Okay.
So let's go back to the documents that you relied upon that were produced in discovery.

A. Okay.
Q. The 11 documents.
You see a number of them are internal Household documents?
A. Okay.
Q. And my question to you is: Did you review any other internal Household documents in this case other than the ones listed in Exhibit 2 to your first report?
A. As I sit here today, I can't recall reviewing others. I know we had a whole hard drive with the discovery database that was made available to us.
Q. You had that?
A. Yes.
Q. Do you know how many pages that you had on it of documents?
A. I remember people talking about the number of pages in the millions.
Q. Right.
And you have selected 11 to rely upon, is that correct? Or of the 11 there is some Household documents you relied upon, right?
A. Well, yes, those are the ones that are listed.

Q. Okay.
And of -- and so, did you review, out of the millions of pages, did you review any documents other than the ones that are listed here on Exhibit 2 to your report?
MR. OWEN: Object to the form of the question.
A. Yes. Some of those documents overlap with, for example, analyst reports of other materials is my recall, but I'm not a hundred percent sure.
Q. Well, when you looked at analysts reports, you weren't using what the defendants gave you as the database of the documents produced in this case, were you?
A. No. We received some analysts reports from counsel. So we don't have to spend the money buying them again. And then we supplemented wherever there was a hole, we were aware of additional analysts reports that we wanted to look.
Q. Separate from the analysts internal documents, did you look at any internal company documents other than the ones that you listed here?

A. I did not rely upon any other documents other than the ones that are listed here, to the best of my knowledge.
Q. That's not actually the question I'm asking.
I'm asking: Did you actually review any other documents, Household internal documents?
A. There may have been considered by my staff, but I understand the list of documents that I relied upon are listed in Exhibit 2.
Q. How did you and your staff determine which Household internal documents to look at?
A. Well, I would have questions and then ask them to research the available evidence and determine what documents are responsive to my question.
Q. Do you understand because you cited to Ms. Ghiglieri's report that she has a report in this case, right?
A. Yes.
Q. Did you review the exhibits that are referenced, the Household internal documents that are referenced in her report?
A. No, I did not go through all the

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documents that she lists in her report.
Q. Okay. Thank you.
Have you reviewed any Household investor relations reports in this case?
A. As I sit here, no. I can't recall.
MR. BURKHOLZ: Let's mark our next Exhibit 7. We'll mark as Exhibit 7 Household Bates 02075765 through 02075777.
(Document bearing Bates Stamp Nos. 02075765 through 02075777 was marked as Bajaj Exhibit 7 for identification, as of this date.)
BY MR. BURKHOLZ:
Q. Again, feel free to look through the entire document. I'm going to ask you questions on the first two pages of the document.
A. Okay. Okay.
Q. Okay.
Have you ever seen this document before today?
A. It doesn't look familiar to me.
Q. Okay.
And do you know how Household prepared -- do you have any knowledge of how

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Household prepared the investor relations report?
A. No, I don't.
Q. Wasn't it important to you to know what Household management thought was the cause of Household's stock price declines during the class period?
A. Not necessarily.
Q. Okay.
And did you ever read a deposition of Celeste Murphy in this case?
A. That doesn't sound familiar.
Q. So what Household internally thought was the cause of its stock price decline has no relevance to you in your analysis?
A. Well, you asked me about Household management and now you're asking me what they internally thought. Regardless of that distinction, I understand some of the members of the management were defendants in this case and may still be defendants, I don't know. And my view is that I should look at objective market evidence and draw my own conclusions rather than take someone opinions of what might be driving stock price.

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Q. So it has no relevance to you of what Household management thought of Household's reaction to information that was disclosed in the marketplace?
A. I wouldn't go so far as to say it has no relevance, but it's not particularly an important piece of information.
MR. BURKHOLZ: Let's take a break.
THE VIDEOGRAPHER: We are going off record. The time is 3:23.
(Whereupon, at 3:23 o'clock p.m., a recess was taken to 3:31 o'clock p.m.)
THE VIDEOGRAPHER: We are now back on the record. The time is 3:31.
MR. BURKHOLZ: I pass the witness at this time.
MR. OWEN: I have no questions for the witness.
THE VIDEOGRAPHER: This is the end of Videotape No. 5, Volume 1, in the deposition of Mukesh Bajaj.
The original videotapes will be retained by West Court Reporting. The

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time is 3:33.
(Whereupon, at 3:33 o'clock p.m., the deposition was concluded.)

____
MUKESH BAJAJ

Subscribed and Sworn to
before me this ____ day
of ________________, 2008

C E R T I F I C A T E

STATE OF NEW YORK)
)SS:
COUNTY OF NEW YORK)

I, CATHERINE M. DONAHUE, a Certified Court Reporter and Notary Public within and for the State of New York, do hereby certify:

That the witness whose deposition is hereinbefore set forth was duly sworn by me and that such deposition is a true record of the testimony given by such witness.

I further certify that I am not related to any of the parties to this action by blood or marriage, and that I am in no way interested in the outcome of this matter.

IN WITNESS WHEREOF, I have hereunto set my hand this 27th day of March, 2008.

____
CATHERINE M. DONAHUE, CCR

E R R A T A

I wish to make the following changes, for the following reasons:

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EXHIBIT 5

Jaffe v. Household Int'l
Summary of Articles from Ex. 8 to the Expert Report of Mukesh Bajaj Referencing Household's Fraudulent Practices
(November 15, 2001-October 11, 2002)
125 Total Days

No.	Date	Article Summary
1.	11/15/01	**<u>Suit alleges 2 lenders got illegal fees</u>** *San Diego Union Tribune* State attorneys have accused two of California's largest subprime lenders of systematically collecting millions of dollars in illegal fees and charges from largely poor and minority customers. Household Finance Corp. of California and its subsidiary, Beneficial California Inc., have admitted more than 36,000 violations of state law in connection with audits performed last year, according to a lawsuit filed by the state Department of Corporations.
2.	11/18/01	**<u>California sues Household, alleges customer overcharges</u>** *Chicago Tribune* The California Department of Corporations has filed an $8.5 million civil suit charging business units of consumer finance giant Household International Inc. with charging excessive late fees and prepayment penalties, among other things.
3.	11/19/01	**<u>Minority Americans Receive Higher Interest Rates on Loans, Study Says</u>** *KRTBN Knight-Ridder Tribune Business News: The Business Press - Ontario* Minority borrowers receive a disproportionate share of high-interest home loans from financial institutions, according to a national study by an advocacy group for low- and moderate-income families… The report specifically accused Household Finance of "routinely overcharging its customers with high-interest rates and fees" and deceptively selling them credit insurance... The day after the release of the report, Household Finance was accused of overcharging consumers in a lawsuit filed in Los Angeles County Superior Court by California regulators.
4.	11/21/01	**<u>Household's Bum Rap?</u>** *American Banker* Household International Inc. doesn't dispute that several years ago it overcharged some customers loan fees.
5.	11/26/01	**<u>Household Sued By CA Regulators</u>** *National Mortgage News* Household Finance Corp. of California and Beneficial California Inc., both subsidiaries of Household International Inc., are being sued by the California Department of Corporations for, among other related allegations, inflating loan fees charged to borrowers.

No.	Date	Article Summary
6.	11/28/01	**State Sues Consumer Lenders** *The Press Democrat Santa Rosa* Household Finance Corp. and its sister corporation, Beneficial Inc., have been sued for $8.5 million by state regulators who claim the companies have repeatedly overcharged California borrowers and violated state lending laws. The parent company, Household International, issued a statement saying it "vehemently" denies the allegations. Household Finance has an office in Santa Rosa.
7.	12/1/01	**California Tries to Crack Down on Predatory Lending Practices** *KRTBN Knight-Ridder Tribune Business News: San Jose Mercury News - California* Loan interest rates may have dropped to historic lows, but some people are still getting stuck with unfairly expensive home and personal loans, officials say… In the latest move, the state of California has sued Household Finance, one of the largest lenders to people with scarred credit records, alleging that the company persists in gouging California borrowers through excessive fees and other unfair lending practices. Household acknowledges past abuses, which the company attributes to accounting technology problems, but says it has fixed them.
8.	12/2/01	**Suit Alleges Lender Gouged Consumers; Household Finance Says It Has Corrected Past Abuses** *San Jose Mercury News* Loan interest rates may have dropped to historic lows, but some people are still getting stuck with unfairly expensive home and personal loans, officials say. In the latest move, the state of California has sued Household Finance, one of the largest lenders to people with scarred credit records, alleging that the company persists in gouging California borrowers through excessive fees and other unfair lending practices. Household acknowledges past abuses, which the company attributes to accounting technology problems, but says it has fixed them.
9.	12/3/01	**Does It Add Up? A look at Household's accounting** *Barron's* During his seven years at Household International's helm, William Aldinger has done much to transform the more-than-century-old finance company into a cult stock… Company officials are thin-skinned when questioned about their accounting or operating philosophy. A recent civil suit by the California Department of Corporations accuses Household of abusive lending practices, including the padding of late fees and prepayment penalties. It provoked a public-relations broadside from the company, strongly denying the allegations and taking the state agency to task.

No.	Date	Article Summary
10.	12/4/01	**Markets Enron, Mideast Weigh on Stocks Wall St.: Dow declines 0.9%, and Nasdaq is down 1.3%. Oil prices rise; bond yields fall.** *Los Angeles Times* Household International fell $2.60 to $56.39. The consumer-finance company may be using accounting practices to obscure loan losses, Barron's magazine said, citing analysts.
11.	12/5/01	**Aldinger Defends Household's Accounting** *American Banker* The chairman and chief executive of Household International stepped forward Tuesday with a rebuttal of accusations that his consumer finance company is playing accounting tricks to mask bad loans.
12.	12/7/01	**Best Interests: How Big Lenders Sell A Pricier Refinancing To Poor Homeowners --- People Give Up Low Rates To Pay Off Other Debts,...** *The Wall Street Journal* Late last year, Household International sent a bulletin to its loan officers, telling them not to refinance subsidized loans, a spokesman says. He adds that the company has long had a policy against the deals.
13.	12/10/01	**Do Household's Numbers Add Up? The lender's accounting methods raise some questions** *BusinessWeek* But some critics are starting to question Household's success. The company, they say, may be headed for a fall.
14.	12/23/01	**The Home Equity Highway: Busy and Hazardous** *The New York Times* Household International in Prospect Heights, Ill., which operates Beneficial, said that it had not ''baited'' Ms. Stewart and that it had helped her to pay off six other debts and to save $400 a month in payments.
15.	12/31/01	**Falling interest rates don't trickle down; The poor still pay high rates on credit cards, mortgages, and short- term loans.** *Christian Science Monitor* Mastercard interest rates at 40 percent. Short-term loans with triple-digit interest rates. Mortgages that are almost double the going rate. Even as the Federal Reserve has cut short-term interest rates to their lowest level in more than 40 years, this is the reality faced by low-income borrowers, many of them minorities... That's the case with Cecelia Brown-Fisher, who last August found herself saddled with a 10.5 percent mortgage rate from one national finance company after spending hours with a loan officer at Household Finance Corp. redoing her application.

No.	Date	Article Summary
16.	1/4/02	**Household Agrees to Pay $9 Million Fine for Predatory Lending** *Copley News Service* Household Finance Corp. has agreed to pay nearly $12 million in penalties and refunds to settle a state lawsuit that alleged the big subprime lender deliberately overcharged thousands of its poor and minority customers. An independent audit has found some 60,000 violations of state lending laws involving Household and its subsidi-ary, Beneficial California, said a spokesman for the state Department of Corporations. The violations include excessive administrative, late and recording fees, as well as a failure to recalculate interest on loans repaid early.
17.	1/5/02	**Subprime lender to settle suit over fees** *The San Diego Union-Tribune* Household Finance Corp. has agreed to pay nearly $12 million in penalties and refunds to settle a state lawsuit that claimed the big subprime lender deliberately overcharged thousands of its poor and minority customers.
18.	1/6/02	**Shark Attacks; An Encounter With Predatory Lenders Can Leave You Without Your Money - Or Your Home** *The Record* It wasn't long before Gladys Russell's dream of homeownership turned into a nightmare of crushing debt… Fairbanks Mortgage, which approved the loan even though her only income was the $866-a-month government disability check… The primary mortgage holder, Household Finance, which bought the primary loan from Fairbanks, has notified her that she has to be out of the house by the end of February.
19.	1/7/02	**Predatory Lenders Can Leave You Without Your Money or Home.** *KRTBN Knight-Ridder Tribune Business News: Hackensack Record* It wasn't long before Gladys Russell's dream of homeownership turned into a nightmare of crushing debt… Fairbanks Mortgage, which approved the loan even though her only income was the $866-a-month government disability check… The primary mortgage holder, Household Finance, which bought the primary loan from Fairbanks, has notified her that she has to be out of the house by the end of February.
20.	1/8/02	**Fines, Tight Scrutiny in Household Settlement** *American Banker* The subprime lending leader Household International Inc. agreed Friday to pay $12 million of fines and be subject to an unprecedented level of oversight from its California regulator to settle one of two high-profile lawsuits against its business practices there.

No.	Date	Article Summary
21.	1/10/02	**California Lender Settles in State Lawsuit Finances: Household International agrees to pay $12 million over allegations its comp...** *Los Angeles Times* The parent corporation of Household and Beneficial finance companies has agreed to pay about $12 million to settle regulators' allegations that it routinely overcharged Californians on small loans, Department of Corporations officials said Tuesday.
22.	1/11/02	**Household to pay $12 million; Lender settles overcharge suit** *Chicago Tribune* Consumer finance giant Household International Inc. has agreed to pay $12 million to settle a lawsuit from California regulators claiming the company intentionally bilked customers.
23.	1/12/02	**Household International Enters Settlement Agreement with California Department of Corporations** *PR Newswire* Household International (NYSE: HI), announced today that its Household Finance Corporation of California and Beneficial California, Inc. business units, have entered into a settlement agreement with the California Department of Corporations relating to alleged lending violations in California.
24.	1/13/02	**Household Intl Units Settle Calif. Lending Allegations** *Dow Jones News Service* Household International Inc. (HI) units Household Finance Corp. of California and Beneficial California Inc. agreed to settle litigation with the California Department of Corporations concerning alleged lending violations.
25.	1/21/02	**Household Finance Settles Case with California Regulators** *National Mortgage News* Household Finance Corp. of California and Beneficial California Inc., both subsidiaries of Household International Inc., have settled with the California Department of Corporations, resolving the complaint the department brought against them late last year.
26.	1/22/02	**Another Look at Predatory Loans; D.C. Council To Hear Views On 2 New Bills** *The Washington Post* For the second time in a little more than a year, District lawmakers are tackling the issue of how to protect homeowners from mortgage loan rip-offs while not crimping lending... Non regulated lenders, such as independent mortgage giant Countrywide Credit Insurance Inc. and consumer finance giant Household International, would have to meet tougher city rules.

No.	Date	Article Summary
27.	1/24/02	**Predatory Lending** *The Columbus Dispatch* Everyone who has an interest in how the mortgage industry conducts business agrees that so-called predatory lending -- fleecing unsophisticated borrowers by means of sharp dealing -- is bad… In California, for example, Household Finance Corp. agreed to pay nearly $12 million in penalties and refunds to settle a state lawsuit alleging that the company deliberately overcharged thousands of customers. An independent audit found 60,000 violations of lending laws by the company and a subsidiary, Beneficial California, according to the state.
28.	1/25/02	**Household Subsidiaries Resolve California Complaint** *Origination News* Household Finance Corp. of California and Beneficial California Inc., both subsidiaries of Household International Inc., have resolved a complaint filed against them last year by the California Department of Corporations.
29.	2/1/02	**Household Gets Rapped** *USBanker* California has locked a ball-and-chain around Household International's leg in punishment for cheating the finance company's customers in California. Household claims it made a mistake.
30.	2/6/02	**Lawsuit Alleges Predatory Lending** *AP Online* A community group and two alleged victims of predatory lending filed a lawsuit Wednesday accusing one of the nation's largest lenders of defrauding borrowers. The suit covers what the plaintiffs estimate is $2 billion in secured loans to tens of thousands of borrowers over the last four years by Prospect Heights, Ill.-based Household International and its subsidiaries, Household Finance Corporation of California and Beneficial California Inc.
31.	2/7/02	**Consumers group sues finance firm over claims** *National Post* A community organization representing low-income borrowers has filed suit charging that Household International Inc. misleads and defrauds its customers.

No.	Date	Article Summary
32.	2/8/02	**<u>Prospect Heights, Ill.-Based Payday Lending Company Sued by Community Group.</u>** *KRTBN Knight-Ridder Tribune Business News: Sacramento Bee* A community group and two alleged victims of predatory lending filed a lawsuit Wednesday accusing one of the nation's largest lenders of defrauding borrowers. The suit, filed by the Association of Community Organizations for Reform Now (ACORN), covers what the plaintiffs estimate is $2 billion in secured loans to tens of thousands of borrowers over the last four years by Prospect Heights, Ill.-based Household International and its subsidiaries, Household Finance Corp. of California and Beneficial California Inc.
33.	2/10/02	**<u>Household has a volatile week</u>** *Chicago Tribune* Household International, Prospect Heights, had a roller-coaster week. It has been beset by concerns regarding its accounting procedures and fears of overextended credit card use. Household shares traded as low as $43.50 Wednesday, but ended up 90 cents for the week, at $52. The stock gained $3.99, or 8 percent, Friday.
34.	2/15/02	**<u>Group speaks out on predatory lenders</u>** *Star-Tribune Newspaper of the Twin Cities Mpls.-St. Paul* Predatory lending affects more than 10,000 Minnesota homeowners annually and costs more than $83 million in home equity, interest payments and mortgage insurance, an advocacy group said Thursday. ACORN (Association of Community Organizations for Reform Now) made its announcement outside a Beneficial Loan and Thrift office in downtown St. Paul, calling Beneficial and its parent company, Household Finance, "one of the most egregious offenders of predatory lending."... Household Finance officials denied the claims.
35.	2/18/02	**<u>ACORN Says Household 'Tricked' Clients</u>** *National Mortgage News* In the latest blow to Household International Inc.'s California subsidiaries, Household Finance Corp. of California and Beneficial California Inc. are being sued in a class-action lawsuit led by the Association of Community Organizations for Reform Now. Household International's vice chairman and chief financial officer, David A. Schoenholz, commented on the complaint in a investors' conference call saying, "We got the action late yesterday, so we haven't reviewed it in detail.

No.	Date	Article Summary
36.	2/22/02	**ACORN Suing Household** *Origination News* In the latest blow to Household International Inc.'s California subsidiaries, Household Finance Corp. of California and Beneficial California Inc. are being sued in a class-action lawsuit lead by the Association of Community Organizations for Reform Now. Household International's vice chairman and chief financial officer, David A. Schoenholz, commented on the complaint during a investors' conference call saying, "We got the action late yesterday, so we haven't reviewed it in detail.
37.	2/24/02	**Household to fight suit on loan terms** *Chicago Tribune* Consumer finance powerhouse Household International Inc. has been accused in a recent lawsuit of deliberately misleading California borrowers into accepting overpriced loans and erroneously believing they would save money by consolidating their loans and refinancing. Household, based in Prospect Heights, denies the allegations in the complaint, brought by three named and several unidentified borrowers and the national community group Acorn. It was filed in California Superior Court in Alameda County on Feb. 6.
38.	2/26/02	**Household and Beneficial Inform State of Completed Audit and Refunded Consumers; Department of Corporations to Test Audit Results ...** *Business Wire* The Davis Administration was informed today by Household Finance Corporation and Beneficial California, Inc. that Andersen has performed an independent audit of the companies' consumer loans and that all appropriate refunds have been made to overcharged customers, as required by the Department of Corporations in the settlement of a lawsuit filed last November.
39.	2/27/02	**Household Int'l says boosts fair lending practices.** *Reuters News* Household International Inc. on Wednesday said it was beefing up its lending standards, as the No. 2 U.S. consumer finance firm faced ongoing charges from consumer advocates that it engages in unfair lending practices. The Prospect Heights, Illinois-based company, which has a powerful presence among people with spotty or poor credit histories, said it is modifying the way it charges prepayment fees. Prepayment fees penalize customers for paying their loans early, and have been harshly criticized by consumer advocates.

No.	Date	Article Summary
40.	2/28/02	**Household to alter practices on loans; Borrowers to get new protections** *Chicago Tribune* Following a barrage of accusations that it has mistreated customers, Household International Inc. promised Wednesday to change some of its lending practices and provide potential customers with more information about their mortgages. Household officials say the new protections for borrowers have nothing to do with a new lawsuit from the housing advocacy group ACORN or a recently settled lawsuit from California regulators.
41.	3/1/02	**Metro Digest** *Denver Post* Activists fighting predatory lending have filed complaints against Household Finance Corp. for allegedly continuing to sell much criticized single premium life and disability insurance in Colorado. Denver ACORN said it would ask the Colorado Division of Insurance to investigate the company for selling the products when most in the industry have agreed to stop.
42.	3/6/02	**FTC says Citigroup stalling in loan abuse suit.** *Reuters News* The Federal Trade Commission, which last year sued Citigroup Inc. for alleged deceptive and abusive lending practices, has accused the No. 1 U.S. financial services company of failing to turn over documents requested for the case… The No. 2 U.S. consumer finance company, Household International Inc. , said last week it would cut fees and reduce interest rates to address charges by consumer advocates that its lending practices are unfair.
43.	3/9/02	**Lender Alters Its Rules** *The Boston Globe* In response to a campaign by a national consumer group against alleged predatory lending practices, Household International has adopted changes in its rates and application process. Under its new offerings, the parent company of Illinois-based Household Finance offers: An option for home buyers to choose between a lower-rate loan with a prepayment fee or a higher-rate loan without a prepayment fee.
44.	3/11/02	**Household Cleared On Refund Effort** *National Mortgage News* Arthur Andersen has performed an independent audit of Household Finance Corp.'s and Beneficial California Inc.'s consumer loans and all appropriate refunds have been made to overcharged customers, said California's Department of Corporations.

No.	Date	Article Summary
45.	3/21/02	**Household Chief at A Difficult Juncture** *American Banker* Story on William Aldinger: ...These are sensitive times for the 54-year-old Brooklyn native, who has built Household into the largest independent consumer finance corporation… analysts say that if Mr. Aldinger doesn't do something about his company's accounting and lending practices, its stock won't be hitting new highs regularly again anytime soon.
46.	3/26/02	**Worries About Sub-Prime Market Drag Down Lenders, Card Issuers Financial services: Some analysts fear that rising interest rates could ...** *Los Angeles Times* Shares of credit card companies and lenders to consumers with spotty payment histories tumbled Monday after a Metris Cos. financial report raised concerns about the so-called sub-prime market… Household International Inc., the giant lender to borrowers with tarnished credit, fell $1.84 to $56.30.
47.	3/31/02	**Best Strategy With Predatory Lenders: Avoid** *The Tampa Tribune* In the past month, politicians and regulators found ways to punish predatory lenders that manage to gouge consumers by making shady home loans. But it's still better for consumers to avoid these lenders than it is to exact punishment after enduring financial turmoil... there are plenty of resources to help you find out what your credit score is and what kind of loan it will qualify you for, said Lisa Sodeika, vice president of consumer lending practices for... Household International... Bear in mind that Household International has been criticized for its lending practices... Starting in April, Household International will make it standard practice to issue a one-page list of the highlights of the loan terms, Sodeika said.
48.	4/1/02	**Smart Buyers Avoid, FTC Seeks to Punish Predatory Mortgage Lenders.** *KRTBN Knight-Ridder Tribune Business News: Tampa Tribune* In the past month, politicians and regulators found ways to punish predatory lenders that manage to gouge consumers by making shady home loans. But it's still better for consumers to avoid these lenders than it is to exact punishment after enduring financial turmoil... there are plenty of resources to help you find out what your credit score is and what kind of loan it will qualify you for, said Lisa Sodeika, vice president of consumer lending practices for... Household International. Household International has been criticized for its lending practices... Starting in April, Household International will make it standard practice to issue a one-page list of the highlights of the loan terms, Sodeika said.

No.	Date	Article Summary
49.	4/10/02	**Household Defends Practices, Predicts Good 2002** *American Banker* Household International executives defended their accounting and lending practices at the company's annual financial services conference Tuesday and said it will post good 2002 results despite the economy.
50.	4/13/02	**Put halt to predatory lending** *Bellingham Herald* The case of Joe and Jeanie Luna is going through the court system… When the Lunas discovered their new mortgage with Household Finance Corp. was actually digging them deeper into debt, they went to the Industrial Credit Union to try to secure a new mortgage. ICU said it couldn't help because the loan was for more than the house was worth... The Lunas' complaint, and that of three other Whatcom County families who are challenging Household Finance, is not unique.... Complaints to the state Department of Financial Institutions... have been on the increase.
51.	4/14/02	**Borrowers' Backlash Costly Fees, High Interest Rates Spur Campaign Against Subprime Lenders** *The Boston Globe* Deborah Bluestein… $340 of the $378 payment she faithfully sent to the financing company every month went to finance charges and to credit insurance she said she never signed for… Nancy Cook… One of her lenders was Bluestein's, too: Household Finance…. Cook found herself paying stiff prepayment penalties and getting socked in other ways... Bluestein and Cook are among 50 Massachusetts borrowers who have just filed or soon will file complaints about Household's lending practices... being coordinated by... ACORN...
52.	4/16/02	**Program in Three States Rescues Homeowners From Predatory Loans.** *KRTBN Knight-Ridder Tribune Business News: The Vindicator* Holmes believes he may have to find work or lose his home… Holmes is one of several area homeowners seeking help with home mortgages they can't afford under a consumer rescue loan program sponsored by the National Community Reinvestment Coalition… the loan program aims to assist low-income homeowners who have been victimized by predatory lenders... Funds for the loan program will come from a multimillion-dollar fund and underwriting commitment from Household, owner of Household Finance Corporation...

No.	Date	Article Summary
53.	4/18/02	**Complaints Are Mounting Over HFC's Lending; Borrowers Claim Company Boosts Interest Rates, Fees For Home Mortgages** *Seattle Post-Intelligencer* … yesterday… In a public display of frustration, about 20 customers turned in complaints to the state Attorney General's Office in Seattle, then protested at an HFC office… The customers said HFC charged some of them interest rates far higher than they were promised, trapped them in loans with high prepayment penalties and sold them costly credit life insurance policies that were unnecessary.
54.	4/21/02	**Complaints grow against Household Finance Corp.** *Bellingham Herald* A lawsuit against Household International filed by four Whatcom County couples appears to be gaining momentum. Since a report on that lawsuit appeared in the April 5 issue of The Bellingham Herald, the owners of 19 other Whatcom County homes have stepped forward with similar allegations of misleading sales pitches by representatives at the Bellingham office of Household Finance Corp.
55.	4/22/02	**Finance Company Draws Complaints** *Bellingham Herald* Bellingham area homeowners feel rushed, betrayed by HFC... Floy Markham... said he didn't realize what the actual terms of the loan were until just a few weeks ago, when he went in to a local credit union to explore another refinancing. The credit union people told him that his actual annual rate... was 13.89 percent.
56.	4/23/02	**Fed. Court Reverses H&R Settlement** *AP Online* A federal appeals court Tuesday tossed out a $25 million settlement of a suit targeting H&R Block's popular tax refund loans... The class-action suit alleged Block and its banking partner, Household Finance, illegally gouged customers by providing "refund anticipation loans" at interest rates exceeding 100 percent.
57.	4/24/02	**Greedy lenders continue to pitch their predatory loans** *The Harrisburg Patriot* The Coys took out two mortgage loans from Household Finance, one for $132,859, including $10,670 in settlement costs and $6,527 in credit life and credit disability insurance. Why the insurance? Because the Household rep told them they had to have it -- which they didn't. The interest rate was 12.49 percent with an APR of 13.58 percent.

No.	Date	Article Summary
58.	5/1/02	**<u>Making "best practices" household's words. (Compliance Clinic).(overview of Household International) (Brief Article)</u>** *ABA Banking Journal* ...set of initiatives to improve fairness and value for Household credit customers… a bid to get out in front of the predatory lending controversy by taking voluntary steps that may mute or even silence criticism. The company's situation is interesting as a case study in the difficulty that lenders experience in getting off the defensive once they've landed there. It's also instructive because some of Household's new policies may become industry standards...
59.	5/2/02	**<u>Lawsuit accuses Household International of defrauding borrowers</u>** *Associated Press Newswires* Three borrowers are accusing one of the nation's biggest consumer finance firms of defrauding low- and moderate-income consumers. The lawsuit filed Thursday in Cook County Circuit Court alleges Prospect Heights, Ill.-based Household International and its subsidiaries misled borrowers about terms and conditions on loans totaling at least $45 million. The suit seeks class-action status...
60.	5/3/02	**<u>Ill. Class Action Compounds Household's Litigation Woes</u>** *American Banker* In a class action filed Thursday, three borrowers claim Household International Inc. engaged in predatory practices on an estimated $45 billion of loans. The suit, filed in Cook County Circuit Court in Illinois, accuses the subprime lending giant and two of its subsidiaries of deliberately misleading borrowers about high rates and fees. It also alleges that Household made loans for more than the value of the borrower's house and then used prepayment penalties to trap the borrowers into these loans.
61.	5/4/02	**<u>Advocacy Group Files Class-Action Suit against Household International.</u>** *KRTBN Knight-Ridder Tribune Business News: Pueblo Chieftain* An advocacy group for low-income people has filed a class-action lawsuit against Household International and its subsidiaries, Household Finance Corp. and Beneficial Corp., charging a wide range of fraud and misrepresentation. The suit, filed on behalf of three homeowners, accuses Household of deliberately misleading borrowers about the terms and conditions of their loans, including high rates and fees, principal amounts which exceed the actual value of their homes, and prepayment penalties that effectively trap borrowers in overpriced loans.

No.	Date	Article Summary
62.	5/5/02	**Chicago Tribune Business Finance Notebook Column.** *KRTBN Knight-Ridder Tribune Business News: Chicago Tribune* Wall Street seems unconcerned about the effect a new lawsuit against Household International Inc. will have on the company's earnings. Shares fell just 27 cents, to $57.43, in twice its usual volume Thursday, when the national homeowner's group Acorn filed a widely publicized lawsuit in Chicago accusing the Prospect Heights-based consumer finance giant of predatory lending practices, including overcharging customers and making it difficult for them to refinance loans. On Friday, shares finished unchanged.
63.	5/7/02	**N.Y. Comptroller Calls Household a Predator** *American Banker* New York State Comptroller H. Carl McCall has attacked Household International, saying the company needs to "take drastic steps to reform its predatory lending practices."
64.	5/8/02	**Household Intl. sued for predatory lending practices** *Credit Union Times* Three victims of predatory lending filed a national class-action suit on May 2, 2002, in the Circuit Court of Cook County, IL, accusing Household International and its subsidiaries, Household Finance Corp. and Beneficial Corp. of a wide range of fraud and misrepresentation.
65.	5/10/02	**Suit against Household International Could Benefit Home Owners in New Jersey.** *KRTBN Knight-Ridder Tribune Business News: Hackensack Record* More than 5,000 New Jersey home mortgage loan borrowers could receive restitution from a predatory lending lawsuit filed in Illinois, according to the Association of Community Organizations for Reform Now, or ACORN… The plaintiffs allege they were defrauded by Household International, the nation's second largest consumer finance company, on terms and conditions of loans worth at least $45 billion.
66.	5/11/02	**Investment board speaks out against predatory lending** *St. Paul Pioneer Press (MN)* The Minnesota State Board of Investment, which invests state funds, has taken a stand against practices that critics say amount to predatory lending. The board this week voted to support a shareholder resolution involving Household International… The proposal calls for Household to study ways of linking some executive compensation to improving predatory lending issues.

No.	Date	Article Summary
67.	5/12/02	**<u>Group creating credit union in low-income neighborhoods</u>** *Chicago Tribune* … Shareholders of Household International Inc. will decide at the consumer finance giant's annual meeting Tuesday whether to link executive pay to corporate efforts to prevent predatory lending. That is the thrust of a stockholder proposal by institutional investors Domini Social Investments LLC in New York and Northstar Asset Management Inc. in Boston.
68.	5/13/02	**<u>Disgruntled Borrowers Sue Household</u>** *National Mortgage News* Three borrowers have joined together in a class-action complaint against Household International Inc., Household Finance Corp. and Beneficial Corp. The companies are accused, collectively, of misleading sales practices and failure to make disclosures with relation to areas including upfront finance charges, projected monthly payments, prepayment penalties and credit life insurance products.
69.	5/14/02	**<u>Household's Loans Actions Protested</u>** *AP Online* Protesters angry about what they called predatory lending practices stood vigil on Tuesday outside a collections office in rural Kentucky where the annual meeting of one of the nation's largest personal finance companies was held. The protest was the latest action by groups representing low-income borrowers to pressure Household International to change its lending practices.
70.	5/15/02	**<u>Vote buoys Household protesters 30% Of Shareholders Support Resolution On Predatory Lending</u>** *The Lexington Herald Leader* Protesters against predatory lending practices claimed a small victory yesterday when shareholders of one of the nation's largest subprime lending firms gave significant support to a resolution calling on the company to address abusive lending concerns. Members of the Association of Community Organizations for Reform Now, or ACORN, a national community advocacy group, led a protest and testified at Household International's annual shareholders meeting in London.
71.	5/16/02	**<u>Activists, Shareholders Claim Symbolic Victory against Subprime Lender.</u>** *KRTBN Knight-Ridder Tribune Business News: Lexington Herald-Leader* Protesters against predatory lending practices claimed a small victory yesterday when shareholders of one of the nation's largest subprime lending firms gave significant support to a resolution calling on the company to address abusive lending concerns. Members of the Association of Community Organizations for Reform Now, or ACORN, a national community advocacy group, led a protest and testified at Household International's annual shareholders meeting in London. About 30 percent of shareholders voted in favor of the resolution, which did not pass.

No.	Date	Article Summary
72.	5/18/02	**<u>Protesters take a stand against Household Finance Corp.</u>** *Bellingham Herald* About 30 local homeowners who have loans with Household Finance Corp. along with members ACORN - the Association of Community Organizations for Reform Now, a national group that has filed a class-action lawsuit accusing the company of illegalities - protest against Household Finance Corp. lending practices at the Bellingham office in Sunset Square Friday afternoon.
73.	5/20/02	**<u>Shareholder Vote Puts Pressure on Household to Curb ‘Predatory’ Practices</u>** *National Mortgage News* The increasing number of lawsuits filed against Household International has prompted shareholder concern and an unexpected 20%-30% vote in favor of a resolution that demands the company “link executive pay to predatory lending practices.” Filed jointly by NorthStar Asset Management of Boston, and Domini Social Investments of New York, the resolution was introduced to Household’s annual shareholders’ meeting on May 14 receiving a surprisingly higher approval compared to the 5% vote a similar resolution received in 2001, or expectations at 7%-10%.
74.	5/24/02	**<u>Overcharged Borrowers Will Get Refunds</u>** *Seattle Post-Intelligencer* Refund checks totaling more than $586,000 are going out to 3,100 Washington borrowers who were overcharged by Beneficial Finance or Household Finance Corporation, state regulators said yesterday. The overcharges were for non-real estate loans and were the result of “flaws in the companies’ computer systems,” the state Department of Financial Institutions said. The refunds range from less than $1 to $782.
75.	5/26/02	**<u>Consumer Organizations Try to Fight ‘Predatory Lending’ Practices.</u>** *KRTBN Knight-Ridder Tribune Business News: The Buffalo News* The Association of Community Organizations for Reform Now last month sued... Household International Inc. for what it considers predatory lending involving $45 billion in loans nationwide. At Household International’s annual shareholder meeting May 14, up to 30 percent of shareholders voted in favor of a resolution supported by ACORN directing the company to tie executive compensation to addressing the alleged predatory lending practices within the company... Determining whether Household’s loans are predatory often deteriorates into a he-said-she-said exchange.

No.	Date	Article Summary
76.	5/28/02	**<u>Household Required To Pay More Refunds For Overcharging</u>** *American Banker* On Thursday the Washington State Department of Financial Institutions announced that in a routine examination of the Prospect Heights, Ill., company last summer it uncovered violations of the state's Consumer Loan Act. According to Mark Thomson, an agency spokesman, when refinancing existing consumer loan borrowers into new loans, Household had been charging customers points on the balances of both loans, which is prohibited by the act.
77.	5/30/02	**<u>Household Blocks Report In Suit Over Financing Practices</u>** *New York Post* Wall Street is concerned that Household International's profits won't be up to expectations - because the company might not be able to continue doing some nasty things it has been accused of doing…What has created this odd concern is... a class action lawsuit alleging that Household was dishonest to its borrowers. Household just last week paid $586,000 under an agreement with Washington state's Department of Financial Institutions... Yesterday Household got a temporary injunction against the release of a report about the company done by the state's DFI.
78.	5/31/02	**<u>For Household, New Fight and Small Victory</u>** *American Banker* Household International Inc… scored at least a temporary victory this week, getting an injunction against state regulators who had planned to release a report detailing 179 borrower complaints against its consumer finance units. Household argued that regulatoryexam information should not be made public.
79.	6/2/02	**<u>Household fighting image of predator; Suits, politicians put pressure on stock price</u>** *Chicago Tribune* For Household International Inc., it's been one slap after another. The nation's largest lender to people with spotty credit has come under increasing scrutiny in recent months for practices that some consumer advocates and politicians deem predatory--specifically, for making loans with high fees, interest rates, prepayment penalties and other terms that they claim create hardships for borrowers.

No.	Date	Article Summary
80.	6/5/02	**Firm Revokes Foreclosure Of Habitat For Humanity Home** *The Lexington Herald Leader* Household International called off the upcoming auction after a reporter informed company officials yesterday afternoon that Sue Cook's house, originally under a zero-interest Habitat loan, was refinanced at a high-interest rate five years ago by Beneficial Kentucky Inc., now a Household subsidiary. Refinancing a special-interest mortgage, such as those offered by Habitat or other affordable-housing programs, violates Household policy... Household spokeswoman Megan Hayden. "Should we ever have refinanced a zero-interest mortgage? The answer is no."
81.	6/6/02	**State understaffed to combat consumer fraud** *Bellingham Herald* The state of Washington doesn't have enough investigators to crack down on mortgage lenders who cheat their customers, state senators were told Wednesday… Blaine resident Jeanie Luna... told senators how she and her husband wound up refinancing their home at a higher rate than they had been paying under their previous mortgage, based on misleading statements from a representative in Household's Bellingham loan office.
82.	6/8/02	**Reparations mask widespread lender problems Group Says Georgetown Woman's Mortgage Predicament Not Uncommon** *The Lexington Herald Leader* A year after moving out of her house to escape calls from her mortgage company, Sue Cook, who just days ago faced foreclosure, is preparing to return home. Her lender's parent company, Household International Corp., has waived her $54,000 loan and has apologized for striking a disastrous deal with her five years ago: refinancing her Habitat for Humanity zero-interest mortgage at 13.25 percent.
83.	6/10/02	**Household Facing Investigations, Lawsuits in Washington State** *National Mortgage News* Subsidiaries of Household International are once again being sued by borrowers and investigated by state government agencies. This time it's in Washington state, and the subsidiaries are Household Finance Corp., Household Realty Corp. and Beneficial Mortgage Corp... Household could not be reached for comment by press time.
84.	6/12/02	**In Brief: Household Wins Delay on Predator Report** *American Banker* Household International Inc. has managed yet again to suppress a controversial report from its Washington regulator detailing 179 borrower complaints against two of the Prospect Heights, Ill., lender's units operating in the state.

No.	Date	Article Summary
85.	6/19/02	**Household Finance, unit face complaints** *Chicago Sun-Times* Meryl Hurd was unpleasantly surprised to learn it was costing her $7,601 to borrow $8,756… Hurd and seven other Chicagoans filed complaints Tuesday against Household Finance Corp. and its subsidiary, Beneficial, with the Illinois attorney general's office... ACORN filed suit in Illinois against Household International in May, accusing the company of misleading customers about the terms of at least $45 billion in loans.
86.	6/26/02	**Judge Allows Calif. Suit vs. Household to Proceed** *American Banker* Allowing a lawsuit against Household International to proceed on Monday, a federal judge in California called the lender's use of a common but controversial subprime lending practice "unconscionable" under state contract law… denied a motion by Household to compel arbitration in a class action that could affect over $2 billion of loans it made in the state over the past four years. Her decision could vastly expand Household's potential liability in the case.
87.	6/29/02	**Suit Vs. Lender Goes On** *The Boston Globe* Judge Claudia Wilken of the US District Court for Northern California has decided Household Finance can't compel the use of arbitration in the cases of the three plaintiffs in the class- action suit known as Association of Community Organizations for Reform Now (ACORN) vs. Household International. It alleges predatory lending. The decision means that the suit, filed in California last year, will proceed.
88.	7/1/02	**More Than 100 Protest Against Household's Lending Practices** *Chicago Daily Herald* Holding aloft bright orange posters and a balloon of an inflated shark, more than 100 people filed off of buses Sunday at Household International to protest the company's lending practices.
89.	7/2/02	**In Brief: Unfriendly Household Visits** *American Banker* The Association of Community Organizations for Reform Now took its fight against Household International Inc. to a personal level Sunday, when close to 2,000 of its members protested outside the Chicago-area homes of Household chief executive William Aldinger and other board members.

No.	Date	Article Summary
90.	7/08/02	**Court Denies Household Request For Arbitration in Predatory Case** *National Mortgage News* A California Northern District Court judge has denied the motions of Household International and two of its subsidiaries, Household Finance of California and Beneficial California Inc., to have a predatory lending suit against them dismissed and be allowed to handle the matter in arbitration.
91.	7/14/02	**Predatory Lenders Take Aim At Ariz. Home Buyers** *The Arizona Republic* Corina and Martin Galindo… called Household Finance Corp. and were immediately approved for a loan… it wasn't the deal they said they were promised. It was two loans -- a refinanced mortgage and a credit line -- instead of one, and both carried rates much higher than they had been paying... Household International Inc., parent of HFC, the largest U.S. independent consumer finance company, was accused in the lawsuit of misleading borrowers about the terms of at least $45 billion in loans. Household and its subsidiaries engaged in fraud over the past three years, according to... ACORN... figures that Arizona borrowers such as the Galindos have been overcharged an estimated $336 million by Household.
92.	7/16/02	**$400,000 Returned To Overcharged Borrowers** *Seattle Post-Intelligencer* Refunds totaling nearly $400,000 have been sent to 1,039 Washington borrowers who were overcharged in their real estate loans… The refunds... were sent to customers overcharged by Household Finance Corp. and Beneficial Washington, Inc. The payments were in addition to more than $586,000 in refunds sent out by the companies earlier this year.
93.	7/17/02	**Change in Federal Rules May Allow States to Regulate Subprime Lenders.** *KRTBN Knight-Ridder Tribune Business News: Fort Lauderdale Sun-Sentinel* Florida Attorney General Bob Butterworth is among 44 state attorneys general supporting a change in a federal rule that may help deter unfair home loan practices… Jimmye Monroe, 69, of Pompano Beach says she was a victim of predatory lending… agreed to refinance her home four years ago when a lender from Household Financial Corp. persistently called her... charged her hundreds in monthly fees and interest and did away with the escrow account she used to pay her property taxes... The proposed federal rule change comes just months after Florida lawmakers approved a new anti-predatory law that seeks to eliminate these kinds of stalemates and conflicts.

No.	Date	Article Summary
94.	7/26/02	**<u>Lender admits to violations; Finance: Household International says some policies may have been violated by Bellingham office.</u>** *Bellingham Herald* 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. Household International spokeswoman Megan Hayden said the Bellingham office manager has been replaced as a result of the company's own investigation of consumer complaints. But the departed manager told The Bellingham Herald that she's being made a scapegoat.
95.	7/30/02	**<u>In Brief: Acorn Seeks Report's Release</u>** *American Banker* The Association of Community Organizations for Reform Now has filed a petition in Washington to compel Household International Inc. to release a controversial state report about its lending practices.
96.	8/14/02	**<u>Bloomfield, N.J., Protestors Accuse Mortgage Company of Predatory Lending.</u>** *KRTBN Knight-Ridder Tribune Business News: Hackensack Record* The protest at the Beneficial office on Glenwood Avenue in Bloomfield against alleged predatory lending was put together by ACORN… ACORN has launched a nationwide attack on Household International, parent company of Beneficial Mortgage and Household Finance, holding similar protests at other storefronts and filing a class-action suit on behalf of borrowers who the group says are paying too much.
97.	8/15/02	**<u>Lawsuit Is Filed Vs. Household Int.</u>** *AP Online* A national community group brought its campaign against alleged predatory lending by mortgage giant Household International to Massachusetts on Thursday, suing the company in state court… ACORN... accuses Household, which it says has made an estimated $500 million in refinance loans in Massachusetts since 2000, of violating state laws and regulations designed to prevent charges from piling up against poor homeowners.
98.	8/16/02	**<u>Household Accused Of Overcharging On Home Loans Advocates File Suit Over Points, Fees</u>** *The Boston Globe* Members of a grass-roots, antipoverty group filed suit yesterday in Suffolk Superior Court alleging that Household International and its subsidiaries, Household Finance Co. and Beneficial Massachusetts Inc., violated state banking regulations by overcharging customers points and fees on home loans.

No.	Date	Article Summary
99.	8/17/02	**Lawsuits and Regulators Shadow Big Lender's Future** *The New York Times* Household International has dodged the problems that have felled many other lenders to people with poor credit and low incomes. Now, though, a set of challenges will test its battle-hardened management. The threats include lawsuits claiming predatory lending, tougher lending laws in many states and greater regulatory scrutiny -- all at a time when a sagging economy could make it harder for many of its low-income customers to pay their bills.
100.	8/18/02	**FHA lenders to face closer monitoring** *Chicago Tribune* The consumer advocacy group Acorn stood behind a lawsuit filed last week against Household International Inc. in Massachusetts. It seeks class action status and alleges that the Prospect Heights-based consumer finance giant ignored state regulations regarding high-cost mortgage lending.
101.	8/19/02	**ACORN Challenges Household in Mass.** *National Mortgage News* ACORN has filed another class-action lawsuit against Household International, this time in Massachusetts, alleging the subprime mortgage lender is ignoring state laws and regulations in making high-cost mortgages.
102.	8/20/02	**Household probed by Washington prosecutors.** *Reuters News* Washington state prosecutors are working with other U.S. states to investigate possible lending abuses by Household International Inc.
103.	8/21/02	**Scrutiny of Household Widens** *American Banker* The Washington Attorney General's Office said Tuesday that it is working with prosecutors in other states to investigate Household International's lending practices.
104.	8/22/02	**More Woe for Household** *American Banker* As the bad news continues to pile up at Household International Inc., three forces are putting pressure on earnings. The Prospect Heights, Ill., lender pledged to boost capital after its earnings restatement last week. It has also promised to hold down customer fees as part of its campaign to burnish its image. Finally, it faces the prospect of big fines or settlements stemming from a slew of lawsuits.

No.	Date	Article Summary
105.	8/23/02	**ACORN vs. HI, Take Three, Filed in Mass.** *Origination News* ACORN at press time had filed another class-action lawsuit against Household International, this time in Massachusetts, alleging the subprime mortgage lender is ignoring state laws and regulations in making high-cost mortgages.
106.	8/24/02	**Minneapolis Protestors Demonstrate at Illinois-Based Lender's Investor Meeting.** *KRTBN Knight-Ridder Tribune Business News: Saint Paul Pioneer Press* ACORN members picketed a Household International Inc. investor meeting in downtown Minneapolis Friday, focusing attention on the Illinois-based company's alleged abusive lending practices.
107.	8/26/02	**Wash. State Report Slams Household's '99-'01 Tactics** *American Banker* A controversial report on Household alleges that the subprime lender violated federal and state consumer protection laws by failing to make key disclosures and by using "sales tactics intended to mislead, misdirect, or confuse the borrower."
108.	8/27/02	**State report details HFC lending abuse; Finance: Copy of suppressed report is leaked to several news organizations.** *Bellingham Herald* A state investigative report on Household Finance Corp., suppressed by court order for more than three months, contains a blistering assessment of the nationwide lending giant's mortgage loan practices in Whatcom County and elsewhere in the state.
109.	8/28/02	**Battered Household Is Hit Again** *American Banker* American Banker reports that Wall Street is finally beginning to react to allegations of predatory lending against Household International Inc. -- which chairman and chief executive officer William F. Aldinger calls "headline risk."
110.	8/29/02	**HFC report on Herald Web site** *Bellingham Herald* A state investigative report on Household Finance Corp. can be read at The Bellingham Herald's Web site - http://www.bellinghamherald. com. The report, suppressed by court order for more than three months, contains a blistering assessment of the lending giant's mortgage loan practices in Whatcom County and elsewhere in the state. The Herald reported the details of the report Tuesday. Technical problems delayed putting the full report on the Herald's Web site.

No.	Date	Article Summary
111.	8/31/02	**Protesters Blast Former Washington State Governor's Ties to Lender.** *KRTBN Knight-Ridder Tribune Business News: Seattle Times* Former Gov. Booth Gardner has kept a low profile since leaving the governor's mansion, but his business relationship with Household Finance, a company under investigation for reportedly scamming hundreds of people into expensive loans, is putting him back in the spotlight. Yesterday, a dozen protesters stood outside his Seattle office shouting "criminal offender, predatory lender," and waving signs calling for the former governor to cut his ties with the controversial company.
112.	9/2/02	**State Regulator Slams Household Practices** *National Mortgage News* After investigating Household International for more than a year and issuing a scathing report on its lending practices, state regulators in Washington are seriously considering bringing an enforcement action against the subprime lending giant.
113.	9/5/02	**Wood County, W.Va., Couple Gets House Deed to Settle Predatory-Loan Case.** *KRTBN Knight-Ridder Tribune Business News: Charleston Gazette* A Wood County couple will receive the deed to their house and a monetary payment to drop a lawsuit against Household Finance, who they allege ripped them off.
114.	9/11/02	**Credit-card issuers patronize politicians** *The Harrisburg Patriot* While you're struggling to keep up with your credit-card payments, the big guns of the card industry are giving money right and left to your senators and representatives… ACORN, which has fought and won many battles for consumers (most recently taking on Household Finance on the subject of predatory loans), last week picketed MBNA headquarters in Wilmington, Del., demanding that the credit-card bank stop supporting bankruptcy reform legislation.
115.	9/12/02	**Fishy Findings At Household** *New York Post* When New York State Attorney General Eliot Spitzer gets finished beating up Wall Street, he might want to take a jab at Household International, the financing company that makes loans to people who don't know the right questions to ask... This week I got a copy of the report on Household put together by the Washington Department of Financial Institutions. The finding: Complaints against Household rose sharply in the first months of this year, and the company failed to disclose the true interest rate to borrowers and then stonewalled the investigators.

No.	Date	Article Summary
116.	9/13/02	**Ag Leading Wide Probe Into Lender** *New York Post* Household International is under scrutiny in a multistate probe led in part by New York Attorney General Eliot Spitzer into the giant consumer financial services firm's lending practices, said a source close to the investigation.
117.	9/16/02	**Editorial: Worst Practices** *National Mortgage News* It always used to bother us, when The Associates was the largest subprime lender in the country, that allegations of predatory lending were constantly surfacing against it. Now, with the (unofficial) release of a scathing report on its practices by the Washington state Department of Financial Institutions, the same thing is happening with its successor as the biggest B&C lender, Household International.
118.	9/18/02	**Research Alert-UBS cuts Household Int'l target.** *Reuters News* UBS Warburg said it cut its price target on consumer lender Household International Inc. on Wednesday, citing capital levels, problems at competitors in the same business and legal problems over alleged predatory lending.
119.	9/20/02	**Citigroup agrees to pay millions** *The Fort Worth Star-Telegram* Citigroup agreed Thursday to pay $240 million and settle charges that an Irving company it purchased in 2000 had regularly packed loans with excessive fees and insurance policies… Citigroup isn't the only big lender to come under the spotlight of regulators and activists. ACORN has sued Household International in California and Illinois, challenging the terms of billions of dollars worth of loans. Household also was sued by AARP in New York.
120.	10/1/02	**Household's predatory plea. (The Front).(settlement of Household International)** *Multinational Monitor* Household International, the parent company of Household Finance Corporation and Beneficial Finance Corporation -- two of the country's largest sub-prime mortgage lenders -- settled predatory lending charges in October, agreeing to pay a record penalty. Household will pay $484 million in restitution to consumers nationwide -- the largest restitution fund in U.S. history established for consumers who were victims of predatory lending. (Note that this was a monthly publication)

No.	Date	Article Summary
121.	10/4/02	**Household International Inc. May Be Near Large Settlement** *The Wall Street Journal* Household International Inc., the big consumer-finance company under fire for its lending practices, may be near a settlement with state attorneys general that could total $350 million to $500 million, according to a report by a Wall Street analyst.
122.	10/6/02	**Area woman fights lender she believes is predatory** *Wichita Eagle (KS)* Wichita Eagle reports a story about an individual's fight against predatory lending with her lender, Beneficial, which is a division of Household International.
123.	10/7/02	**The Housing Boom's Dark SIDE Scams and over-extended buyers threaten the market's strength** *BusinessWeek* With interest rates at their lowest in four decades, consumers... are rushing to get in on the mortgage-money bonanza… The rich pickings have brought out hordes of unscrupulous and fraudulent operators… Household Finance Corp. salesman came knocking on the door of one couple's modest Natchez (Miss.) house last year... They would have to purchase $15,000 in credit insurance. "He told them: 'It's the only way you can get the loan,''"... But it turns out credit insurance wasn't required... They, along with 16 others, are suing Household Finance.
124.	10/10/02	**Finance company agrees to pay $484 million in lending case** *Associated Press Newswires* Household International will pay $484 million to settle illegal lending allegations by state attorneys general and state financial regulators, California officials said Thursday evening.
125.	10/11/02	**Household Seen Settling Loan Suit With States $500m Agreement Would End Allegations Of Predatory Lending** *The Boston Globe* Under siege from attorneys general in more than two dozen states, Household International Inc. plans today to announce a record settlement of up to $500 million to end allegations of predatory lending practices, according to sources close to the agreement. Today's announcement stems from a task force representing regulators in dozens of states, including Massachusetts, that have been investigating Household's practices of providing home loans to so-called subprime borrowers, or people with poor or short credit histories.

EXHIBIT 6

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN,)
on behalf of itself and all)
others similarly situated,)
)
Plaintiff,)
)
vs.) No. 02 C 5893
)
HOUSEHOLD INTERNATIONAL, INC.,)
et al.,) Chicago, Illinois
) April 14, 2009
Defendants.) 8:45 a.m.

VOLUME 10
TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a ju

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THE CLERK: 02 C 5893, Jaffe v. Household International.
THE COURT: Good morning, everyone.
MR. DOWD: Good morning, your Honor.
THE COURT: Do we need to take anything up before we bring the jury out?
MR. SLOANE: Yes, your Honor. I have one preliminary matter.
Your Honor, there's one line of questioning that Mr. Dowd pursued yesterday. And I'd just like to hand up to the Court -- and a copy to Mr. Dowd -- the items that relate to it. I'm happy to take this up on the break, your Honor, if it would be more convenient; but I wanted the Court to know exactly what the background is.
THE COURT: Okay.
(Tendered.)
THE COURT: That's a lot of background there.
MR. SLOANE: I can point out to you where it occurs. Your Honor, the first document is your Honor's own decision in one of the Daubert motions respecting the expert Mr. Devor, who is one of the experts for the plaintiffs.
The issue concerned Mr. Devor's proposed testimony with respect to false reports or allegedly false report of revenues because the revenues included money obtained from predatory lending. I'm referring to the third paragraph of

your Honor's opinion. And your Honor goes on -- and I don't need to read it to the Court -- but essentially determines that the plaintiffs were not making such an allegation, and that such allegations were not appropriately part of the case. And you cite several cases there.
Yesterday, your Honor, at several places during the cross-examination -- or the examination of Mr. Schoenholz -- and I can -- I've highlighted the portions. And I have the unofficial transcript, unfortunately, your Honor. But Mr. Dowd asked questions of the witness concerning revenues which generated income made by various practices which the plaintiffs have characterized as predatory lending, in direct contravention, we submit, your Honor, to your Honor's rulings on the in limine. And I appreciate that we didn't object at the time.
The remedy I seek, your Honor, is, I guess, threefold. One is, I'd certainly like a directive to the plaintiffs' counsel that they not make reference to that in their questioning in the future.
The second is a limiting instruction to the Court -- to the jury, your Honor, that certain testimony took place yesterday and that testimony is not to be considered.
And the third, your Honor, is -- and this could be taken up on Friday -- an instruction to the jury with respect to this issue. And, again, that can be taken up on Friday.

auditors; yes or no?
MR. DOWD: Objection, hearsay.
THE COURT: Overruled.
BY THE WITNESS:
A. Yes.
BY MR. SLOANE:
Q. Now, let me try to understand the reserves or ask you about the reserves on a very basic level.
Suppose you have a thousand dollars or had a thousand dollars of earnings.
All right, for the Court's record, I've written on the board a thousand dollars of earnings.
Do you see that?
A. I do.
Q. And suppose you had a credit reserve of $100. Do you see that?
A. I do.
Q. And what does that mean?
A. That means you would have set aside $100 to cover future credit losses, to absorb future credit losses.
Q. Now, what if you had $200, twice as many, of bad loans, loans that weren't repaid? What would that mean?
A. When did you know you had 200 bad?
Q. Let's assume you knew it after you had set the credit reserve of 100?

A. Then you would have to take another expense to make up the shortfall between the 100 and the 200.
Q. So you'd have to add to your reserves then or take an expense for the miscalculation or the missed expectation?
A. Yes, sir.
Q. Did that ever happen?
A. Never.
Q. Now, let me ask you, you mentioned something called FFIEC in your direct-examination, and I know that we've heard some testimony about this. You were in the back of the room before.
Without getting into what FFIEC stands for, did it apply to household?
A. It applied to our credit card bank, but not to the other parts of the company.
Q. What percentage, if you know, of Household's total receivables did FFIEC apply to?
A. My guess is -- I don't remember exactly, but it was relatively small.
Q. Relatively small.
So what was the concern about FFIEC and the FFIEC rules that we have heard so much testimony about as you've been sitting in the back of the courtroom, what was your concern about FFIEC as it might apply to Household?
A. Well, FFIEC were rules set by banking regulators to apply

to banks, and they set standards on things such as re-age and charge-off.
Q. Was Household International a bank?
A. It was not a bank.
And the concern was if you applied these standards which were meant to apply to a bank's customer base and you applied them to a consumer finance customer base, you would actually increase the amounts of ultimate credit losses within the finance company.
Q. What would it do to your business model in terms of your dealings with your customers?
A. It would really throw the whole model upside down. I mean the reason you had a consumer finance company customer was that they really didn't normally qualify to go to a bank. So it would make no sense to take that customer and now say, well, now I'm going to treat you like a bank customer.
Q. Mr. Dowd and I asked you about a restatement that occurred in connection with certain credit card agreements.
Would you describe the circumstances surrounding the restatement?
A. In -- I think it was in the spring of 2002, the audit committee of the board decided to replace Arthur Andersen and to hire KPMG. KPMG was, therefore, engaged, and they had to re-audit, issue their opinion, on 1991 -- 1999, 2000 and 2001 -- the financial statements in those 10-K documents.

Q. Before KPMG got involved, was Arthur Andersen involved?
A. Arthur Andersen had done the original audit work of those financial statements and had valid audit opinions that were out -- that were in effect for 1999, 2000 and 2001.
Q. What's a valid audit opinion?
A. Well, in terms of financial statements included in the 10-K, you have to have an auditor's report that is current, and there were rules about what current meant; but you had to have a set of audited financial statements on file with the SEC in order to conduct transactions in the securities markets, trading stock or, for us, going in to borrow money which we would then lend to customers.
So you had to have a valid set of audited financial statements on file with the SEC to conduct your business.
Q. Now, Mr. Dowd showed you a bunch of 10-Ks for various years, 2000, 2001 and 2002. As best you understood it, did those include opinions from your outside auditors?
A. Yes.
Q. Is that something that you drew comfort from --
A. Yes.
Q. -- in certifying the documents after the Sarbanes-Oxley rules came into effect?
A. Well, and even before Sarbanes-Oxley came into effect. The fact that I had to sign the documents.
Q. Now, we saw on the board, if you put up that demonstrative

IN THE UNITED STATES DISTRICT COURT
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EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN,)
on behalf of itself and all)
others similarly situated,)
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Plaintiff,)
)
vs.) No. 02 C 5893
)
HOUSEHOLD INTERNATIONAL, INC.,)
et al.,) Chicago, Illinois
) April 21, 2009
Defendants.) 9:00 a.m.

VOLUME 15
TRANSCRIPT OF PROCEEDINGS - TRIAL
BEFORE THE HONORABLE RONALD A. GUZMAN, and a ju

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THE CLERK: 02 C 5893, Jaffe v. Household International, Incorporated.

MR. DROSMAN: Good morning, your Honor.

MR. KAVALER: Good morning, your Honor.

THE COURT: Good morning.

Folks, we've already told the jury, but I have a naturalization proceeding I have to preside over right now. It should take about ten minutes. I'll be back here then and we'll start the proceedings at that time. I apologize, but there's nothing -- I tried to get out of it. There's no way I can get out of it.

(Recess taken.)

THE CLERK: 02 C 5893, Jaffe v. Household.

THE COURT: Ready for the jury?

MR. BURKHOLZ: Your Honor, one issue before we rest today. We wanted a clarification from the Court on something. We have a statement of uncontested facts that the parties stipulated to as part of the March 30 PTO. Then we modified that on -- I'm sorry, January 30, 2009. Then we modified that on March 25, 2009. And the question is do we have to publish it to the jury since, in the document, it clearly says that the uncontested facts will become a part of the evidentiary record in the case. It may be read to the jury by the Court or any party. So before we rest, we wanted to understand the protocol of what we're supposed to do.

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THE COURT: Well, it's really a question of your trial strategy. I mean, I can say it's part of the record from now until the sun no longer comes up. If the jury doesn't know the stipulated facts, they can't take those facts into account in their deliberations. So unless you feel that the facts have somehow come into -- come before the jury in some other way during the course of the trial, the only way to get them before the jury is to publish the stipulation to the jury.

Now, most likely what I suspect is that some of those facts have already been testified to in one form or another and some haven't. And how you want to get the remainder of those facts to the jury is pretty much up to you. You're clearly entitled -- both sides are clearly entitled to publish all or any part of the stipulated facts you wish to publish to the jury. If you want me to publish the facts to the jury, I will do that, although why you as a trial attorney would want anyone else to publish facts to the jury is beyond me; but that's entirely up to you.

MR. BURKHOLZ: Thank you, your Honor.

MR. KAVALER: Your Honor, my only comment is I don't know what he has got in his hand there. I'm a little leery because I have a feeling this involves that same stipulation which has attached to it a document which has been revised several times, which is a listing of some statements which

Q. Okay. Mr. Aldinger, in issuing the financial reports that were later restated, in other words, the original reports for all of those years in reliance on the advice of Arthur Andersen, did you have any intent to defraud anybody?
A. No.
Q. Did you have any intent to misstate anything?
A. Never.
Q. Did you have any intent to do anything other than get the numbers right?
A. No.
Q. Did you think you were getting the numbers right?
A. I did think we were getting the numbers right.
Q. Did you have a reasonable level of comfort that all the people involved in this process were on board with you?
A. Yes, I did.
Q. Did anyone ever say to you this is wrong, we shouldn't be saying this?
A. No.
Q. Let's talk a little bit about restructuring.
We've heard a lot about it's either called restructuring or re-aging.
Are you okay?
A. Yes. I'm okay.
Q. Can you tell us why Household engaged in the business practice of restructuring loans in the first place?

A. Re-aging was a process that was -- was going on for decades, 70 or 80 years since the beginning of the company, well before I got there, and it really had two purposes. One was to fulfill our customer proposition; that is, to work with customers, keep them in their houses longer.
Second was to maximize cash flow, and we believed that re-aging did both of those things.
Q. Tell us how -- address each of those things in order. First start with the customers. Tell us how re-aging helps the customers.
A. Well, re-aging in many cases allows the customers to stay in their homes. And, again, I'm not an expert on how we re-age or what the techniques are, what the best approach is; but generally speaking, it allows the customers to continue to pay their loans when they wouldn't be able to do it if we applied bank rules.
Q. When you say bank rules, what are you referring to?
A. Well, bank rules, something called FFIEC, they're much more strict on what you can do in terms of re-aging and how long you can let customers go without paying.
Q. Did they apply to Household's Consumer Lending Unit?
A. They did not.
Q. Did they apply to Wells Fargo?
A. They did.
Q. And the second thing you said is re-aging helps to

maximize cash flow. Please explain what you meant by that, sir.
A. Well, it means we believe that by re-aging, ultimately we get more money than if we didn't re-age.
Q. Explain how that works.
A. By -- by re-aging and allowing the customer to continue to pay his bills as opposed to walking away, we get more money than we would otherwise if he walked away.
Q. My fault for not being clear.
What would the alternative be to re-aging? If you didn't re-age, what would you do?
A. Well, for example, on a home if we didn't re-age, what would happen is you'd have more foreclosures. And from a company -- certainly from a customer standpoint, that's terrible; but from a company's standpoint, it's terrible because you can only lose money on a foreclosure. The way our policy was if there was any gain, it went to the customer. But in 90 percent of the times you ever foreclosed or 99 percent of the times, you basically lost money because you had the cost of selling it and you had the cost of maintaining it.
And so we never wanted to own a home if we could, and to the extent we could re-age, encourage the customer to stay paying, that was a good thing. Good for the customer, they kept their house; good for us, we got more cash flow, and we

didn't get the house back.
Q. Now, again, Mr. Aldinger, you understand that the theory of the people who are suing you is that Household used restructuring policies to conceal its credit quality or manipulate its earnings in some fashion.
Do you understand that's what they say?
A. I understand that that's what they say.
Q. Did Household do any such thing?
A. No. I don't -- I don't agree with that at all.
Q. Are you sure?
A. I'm sure.
Q. How come?
A. Because I have faith in the team that runs the business, because we've seen that the cash flow is maximized by doing re-aging. We know that it certainly helps customers, and it fulfills our goals; and, most importantly, because in the end it's all about reserves, and we reserved for re-age, we reserved enough to protect this company.
Q. So if what investors' counsel is suggesting for the last several weeks had been going on down at the level they like to focus on, down at the low level --
A. Right.
Q. -- how would you have been able to see that up at the level you were at?
A. Well, I wouldn't see what happens day-to-day. You know,