UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, ON BEHALF OF ITSELF AND ALL OTHERS SIMILARLY SITUATED, Plaintiff, - against - HOUSEHOLD INTERNATIONAL, INC., ET AL., Defendants.	Lead Case No. 02-C5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan

MEMORANDUM OF THE NON-SETTLING HOUSEHOLD DEFENDANTS PURSUANT TO THE PSLRA WITH RESPECT TO PLAINTIFFS' PROPOSED SETTLEMENT WITH DEFENDANT ARTHUR ANDERSEN LLP

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This memorandum is respectfully submitted on behalf of non-settling Defendants Household International, Inc., Household Finance Corp., William F. Aldinger, David A. Schoenholz, Gary Gilmer and J.A. Vozar (collectively, "Household" or the "Household Defendants") pursuant to the Private Securities Litigation Reform Act of 1995 ("PSLRA") with respect to Plaintiffs' proposed settlement with Arthur Andersen LLP ("Andersen").

SUMMARY OF THE NON-SETTLING HOUSEHOLD DEFENDANTS' POSITION WITH RESPECT TO THE PROPOSED SETTLEMENT BETWEEN PLAINTIFFS AND ANDERSEN

Plaintiffs and co-defendant Andersen have proposed to settle the Plaintiff class's allegations against Andersen for $1.5 Million in cash. Class counsel has argued to this Court that the amount is reasonable in light of the potential merits, *vel non*, of Plaintiffs' claims, including, *inter alia*, acknowledged concerns regarding proof of scienter. Having considered the proposed settlement and the support therefor proffered in Plaintiffs' notice to absent class members, the Household Defendants have concluded that the proposed amount is not unreasonable for at least two reasons.

First, the $1.5 Million amount, although small, is consistent with a reasonable expectation of the objective value of Plaintiffs' weak claims in this case generally. There are numerous legal and factual defects in Plaintiffs' claims, some of which are identified in a motion now fully submitted and pending before this Court and some of which will be set forth in summary judgment motions which will be filed if necessary. These inherent defects and the absence of any factual development in discovery helpful to Plaintiffs provide little basis for Plaintiffs to expect that any recovery could be had after a trial on the merits, even if they were able to survive summary judgment. The proposed Andersen settlement — minimal as it is — is consistent with this view of the merits of Plaintiffs' claims.

Second, given the historical relationship between the size of settlements paid by auditors and those paid by the companies that they audited, the $1.5 Million amount is also consistent with any settlement which the Class might reasonably hope to reach with the Household Defendants. The analysis set forth herein of settlements of securities fraud claims brought over the past five years against the "Big Five" accounting firms and companies they audited reveals that the auditors on average contribute 23.1% of the total settlement, with a median share of 20.8%. Based upon Plaintiffs' proposed agreement with Andersen, this historical relationship would be consistent with a potential settlement with the Household Defendants on the order of approximately $5 Million *based upon the former five year class period. See* pp. 9-10, *infra.* Because this order of magnitude comports with the Household Defendants' assessment of the realistic settlement value of Plaintiffs' claims against them, Household thus views the proposed settlement with Andersen as reasonable on this basis as well.

It is important to note, however, that one reason for approving the settlement which Plaintiffs orally offered to this Court is patently inaccurate and insupportable. This "reason" asserts that the $1.5 Million reflects the largest amount that Andersen has available to pay. At the outset, Andersen's putative impecuniosity (i) is not reflected in the notice Plaintiffs sent to absent class members, and (ii) was offered by Plaintiffs devoid of any factual support. Indeed, Plaintiffs appear to have conducted no discovery at all into Andersen's financial condition, *vel non*. As this Court appears to have suspected, the assertion that Andersen's cupboard is bare is also demonstrably false as a factual matter — even absent discovery. Notwithstanding large Andersen settlements in Enron and other cases in 2004, in the past year alone Andersen has agreed to well-publicized settlements totaling in excess of $100 Million, with an average in excess of $17 Million *per settlement* in 2005. Plaintiffs' unsupported representations to this Court regarding Andersen's supposed lack of resources (which Class counsel did not share with the Class) carry no weight. Plaintiffs therefore cannot seek to characterize the proposed settlement

with Andersen as anything other than what it transparently is: a settlement of weak claims for a nuisance amount. On that basis, the Household Defendants do not object to it.

ANALYSIS

The PSLRA ordains a regime which governs the analysis and effect of partial settlements and codifies certain aspects of partial settlement caselaw. To protect a settling defendant from potential claims for contribution by non-settling defendants, the PSLRA requires, upon entry of the judgment, the entry of a mutual bar order discharging the settling defendant from all claims for contribution brought by or against any other person. *See* 15 U.S.C. § 78u-4(f)(7)(A). To compensate non-settling defendants for the loss of such contribution claims, the PSLRA reduces the judgment or verdict against non-settling defendants by the greater of (1) the percentage of responsibility of the settling defendant; or (2) the amount paid to the plaintiff by that settling defendant. 15 U.S.C. § 78u-4(f)(7)(B). These rules are intended, *inter alia*, to protect non-settling defendants from the consequences of inadequate settlement payments and to prevent windfall recoveries to plaintiffs. A non-settling defendant who perceives itself prejudiced by a proposed settlement has the right to object to the settlement on that basis. *See Agretti* v. *ANR Freight System, Inc.*, 982 F.2d 242, 247 (7th Cir. 1992) (*citing Quad/Graphics, Inc.* v. *Fass*, 724 F.2d 1230, 1232 (7th Cir. 1983)). Thus, if Household were of the view that the proposed Andersen settlement is inadequate, the PSLRA gives it standing to be heard to object on that ground.

Currently before this Court is the proposal of the Class and co-defendant Andersen to settle the allegations against Andersen in Plaintiffs' Corrected Amended Consolidated Class Action Complaint ("Complaint" or "AC") for $1.5 Million in cash. (Plaintiffs' Stipulation of Settlement with Arthur Andersen LLP ("Stipulation") at 9.) As this Court has noted, if accepted, this sum will not be sufficient to cover the costs of notice and distribution to the absent Class members. (Order Requiring Changes to the Proposed Notice of Pendency and Proposed Partial Settlement of Class Action at 2.) As a result, Plaintiffs proposed that the settlement fund remain

in escrow until such time (if ever) as they reach a settlement with or obtain a judgment against the remaining defendants. (Tr. 6:18-21, Dec. 15, 2005.)

As circulated to absent class members, Plaintiffs' support of the Settlement cites concerns over the general risks of protracted litigation, including the expense, length and ultimate danger of little or no recovery. (Stipulation at 3-4.) Plaintiffs' Stipulation acknowledges, *inter alia*, "the inherent problems of proof under and possible defenses to the securities law violations asserted in the complaint." (Stipulation at 4.) None of the reasons offered by Plaintiffs to absent Class members in support of the proposed settlement asserts that Andersen has no money to pay a larger settlement or suggests that a larger settlement would be warranted by the merits of Plaintiffs' claims.

In colloquy before the Court, however, Plaintiffs suggested that the settlement amount is justified because "Arthur Andersen's financial situation is extremely dire." (Tr. 7:3-4, Dec. 15, 2005.) The Court questioned the basis of this unsupported statement, asking Plaintiffs about the extent of their investigation of Andersen's resources. Plaintiffs responded that the statement was based upon experience from "other cases" as well as Andersen's purported lack of insurance. (Tr. 7:14-8:8, Dec. 15, 2005.) The Court nevertheless noted that "when [Andersen] was financially healthy [it] was bigger than most insurance companies." (Tr. 8:13-16, Dec. 15, 2005.) Anticipating this skepticism, Plaintiffs' counsel also acknowledged that there "could have been some major issues proving up scienter against Arthur Andersen. I know at trial that would have been a major issue for us." (Tr: 7:24-8:2, Dec. 15, 2005.) At no time did Plaintiffs indicate that they had conducted any discovery into Andersen's finances or insurance.

In fact, well-publicized facts contradict Plaintiffs' unsupported assertion about Andersen's resources or ability to pay substantial settlements. Notwithstanding substantial Andersen settlements in cases like Enron in 2004, in the past year alone Andersen agreed to settlements totaling in excess of $100 Million. On average in 2005, Andersen agreed to pay out over $17

Million *per settlement*, or an average amount more than ten times the proposed settlement with Plaintiffs.[1] Media coverage of the size of these settlements has been widespread and is easily available.[2]

There is no basis upon which this Court should credit Plaintiffs' *ipse dixit* that the $1.5 Million figure represents anything other than Class counsel's estimation of the value of Plaintiffs' claims against Andersen. Indeed, the only basis that has been offered to the absent Class members for their consideration is that the merits of Plaintiffs' claims and the expected recovery warrant the amount proposed. (*See* Pls.' Notice of Pendency and Proposed Partial Settlement of Class Action, Ex. A-1, at 1 (noting that the proposed settlement "avoids the risks associated with continued litigation, including the danger of no recovery.").) Plaintiffs' submission freely acknowledges that continued litigation could result in findings that Household securities were not artificially inflated during the Class period and that Defendants did not make false or misleading statements. (Pls.' Notice of Pendency and Proposed Partial Settlement of Class Action, Ex. A-1, at 1-2.)[3] The $1.5 Million proposed settlement with Andersen, and Plaintiffs' support thereof, clearly distinguishes this case from others such as Enron and WorldCom in which Andersen audited the financial statements of those issuers.

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1 In 2005 Andersen settled with Charter Communications, Inc. for $2.25 Million, Dynegy, Inc. for $1.05 Million, Global Crossing, Ltd. for $25 Million, I2 Technologies, Inc. for $2.9 Million, Qwest Communications International, Inc. for $10 Million and WorldCom, Inc. for $65 Million. *See* Stanford Law School Securities Class Action Clearinghouse, http://securities.stanford.edu/.

2 *See, e.g., Judge Approves $3.56 Billion Settlement for WorldCom Investors*, N.Y. Times, Sept. 22, 2005, at C6; Jonathan D. Glater, *Dynegy Agrees to Settlement of Suit by Its Shareholders*, N.Y. Times, Apr. 16, 2005, at C10; *In Brief*, L.A. Times, Aug. 4, 2005, at C4; Dionne Searcey, *Qwest Narrows Its Loss, Offers To Settle Shareholder Lawsuits*, Wall Street Journal, Nov. 2 2005, at B11; Jerri Stroud, *Judge Approves Charter Shareholder Settlement*, St. Louis Post-Dispatch (Missouri), Jul. 7, 2005, at C2.

3 Pls.' Notice of Pendency and Proposed Partial Settlement of Class Action, Ex. A-1, at 1-2 ("The parties disagree about: (1) the method for determining whether Household securities were artificially inflated during the relevant period; (2) the amount of any such inflation; (3) the extent that various facts alleged by Lead Plaintiffs were materially false or misleading; and (4) the extent that various facts alleged by Lead Plaintiffs influenced the trading prices of Household securities during the relevant period.").

In considering the adequacy and fairness of a proposed settlement, the Court of Appeals has stated that the most important consideration is "the relative strength of plaintiffs' case on the merits as compared to what the defendants offer by way of settlement." *Isby* v. *Bayh*, 75 F.3d 1191, 1199 (7th Cir. 1996). In order to be considered fair to the class, a settlement amount must reflect "the expected value of their claim if it went to trial, net of the costs of trial." *Mars Steel Corp.* v. *Continental Illinois National Bank & Trust Co.*, 834 F.2d 677, 682 (7th Cir. 1987). Thus, "'[t]he fact that a proposed settlement may only amount to a fraction of the *potential* recovery does not, in and of itself, mean that the proposed settlement is grossly inadequate and should be disapproved.'" *Goldsmith* v. *Technology Solutions Co.*, No. 92C4374, 1995 U.S. Dist. LEXIS 15093, at *17 (N.D. Ill. Oct. 10, 1995) (emphasis added) (*quoting City of Detroit* v. *Grinnell Corp.*, 495 F.2d 448, 455 (2d Cir. 1974)). Where, as here, a proposed settlement reflects a significant possibility of no recovery, "'there is no reason . . . why a satisfactory settlement could not amount to a hundredth or even a thousandth part of a single percent of the potential recovery.'" *Id.* at *18 n.4 (*quoting Detroit*, 495 F.2d at 455 n.2). *See also EEOC* v. *Hiram Walker & Sons*, 768 F.2d 884, 891 (7th Cir. 1985) ("[G]iven likelihood that plaintiffs would receive nothing if case went to trial, no abuse of discretion in approval of settlement for small percentage of plaintiffs' asserted loss.") (*citing Bryan* v. *Pittsburgh Plate Glass Co.*, 494 F.2d 799, 802 (3d Cir. 1974)).

For these reasons, the fairness of a proposed settlement of a securities fraud case against a company's auditors depends on an evaluation of the merits of the underlying claims of liability against the issuer. Securities fraud claims against a company's auditors generally follow identical legal theories in parallel with the claims against the company. The key questions of fact substantially overlap, including whether the financial statements at issue conform with Generally Accepted Accounting Principles ("GAAP") and the effects, *vel non*, of any public statements on the market.

In this case, the injuries claimed against Household and Andersen are identical — resulting from supposedly "inflated" share prices.[4] (AC ¶ 6.) Plaintiffs' claims against Andersen and Household are based on the same facts and alleged statements, and assert Andersen's "active participation" in the alleged fraud. (AC ¶ 46.) Plaintiffs contend that Andersen did not conduct its audits in compliance with Generally Accepted Auditing Standards ("GAAS") because the Household financial statements it certified were not prepared in conformity with GAAP. (AC ¶ 176.) These claimed violations by Andersen are alleged to have occurred in concert with the Household Defendants. For example, the Complaint asserts: "together with Andersen, Household's senior executives also manipulated the manner in which Household accounted for costs associated with the Company's co-branding agreements, affinity agreements and marketing agreements." (AC ¶ 3.) In supporting these claims against Andersen, Plaintiffs rely principally upon citations to the identical factual allegations asserted against Household. (*See* AC ¶ 176, *citing* AC ¶¶ 102-106 and AC ¶¶ 125-55.)

As reflected by the meager settlement proposed with Andersen, these claims against both Andersen and the Household Defendants are no longer viable under recent federal case law clarified since Plaintiffs filed their Complaint. Currently pending before this Court is Household's motion to dismiss the Complaint. (*See* Defs.' Mot. to Dismiss Pursuant to the Supreme Court's Recent Decision in *Dura Pharmaceuticals, Inc.* v. *Broudo* (the "*Dura* Motion".) This motion is based upon recent Supreme Court authority that rejects the viability of Plaintiffs' Complaint.[5]

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4 This formulation has recently been deemed insufficient under current federal case law to show injury as the Supreme Court has stated in *Dura Pharmaceuticals, Inc.* v. *Broudo*, 125 S. Ct. 1627, 1634-35 (2005) ("*Dura*") (*see also* discussion, *infra*).

5 The Court recently granted Household's motion to dismiss the Complaint in part based upon the Court of Appeals' decision in *Foss* v. *Bear, Stearns Co.*, 394 F.3d 540 (7th Cir. 2005). The Court, in its February 28, 2006 Memorandum Opinion and Order, dismissed the Class' claims arising prior to July 30, 1999 on the grounds that those claims expired. As a result, the class period has been substantially reduced. Instead of a five year class spanning from October 23, 1997 to October 11, 2002, the new class period is the roughly three years running from July 30, 1999 to Octo-

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For example, the Supreme Court in *Dura* foreclosed Plaintiffs' efforts to recover for generalized investor losses arising from allegedly "inflated prices" absent a detailed showing that the alleged fraud actually caused any losses. 125 S. Ct. at 1634-5. As Plaintiffs' counsel discovered in *Dura*, the generalized market decline alleged by Plaintiffs here is no longer sufficient to survive a motion to dismiss. Here, because Plaintiffs lost *less* money investing in Household during the class period covered by the proposed settlement than did investors in the Standard & Poor's ("S&P") 500 Index, their attempt to recover for such "smaller than market" losses cannot be sustained absent an explanation that the Complaint simply does not contain.

Beyond these facial deficiencies in Plaintiffs' Complaint, the allegations are also factually deficient as is presently being borne out by the ongoing discovery process which is now well under way. Plaintiffs' submissions in support of their proposed settlement with Andersen, as well as the settlement proposal itself, reflect this lack of factual support in discovery for Plaintiffs' alleged claims. Of course, Plaintiffs are well aware that these factual deficiencies will eventually be submitted to the Court by way of summary judgment motions if necessary prior to any trial.

These litigation "risks" that have motivated Plaintiffs to settle with Andersen — which include more than justifiable concerns that Household securities were not artificially inflated during the relevant period and that Defendants did not make false or misleading statements, and certainly not with scienter — also stand to preclude any recovery against Household. (*See, e.g.*, Pls.' Notice of Pendency and Proposed Partial Settlement of Class Action, Ex. A-1, at 1-2 (noting concerns regarding the following issues in the case: "(1) the method for determining whether Household securities were artificially inflated during the relevant period; (2) the amount of any such inflation; (3) the extent that various facts alleged by Lead Plaintiffs were materially

Footnote continued from previous page.

ber 11, 2002. Thus, the Class' claims and the Class itself have shrunk by almost 40%.

false or misleading; and (4) the extent that various facts alleged by Lead Plaintiffs influenced the trading prices of Household securities during the relevant period.").)

Given the parallel footing of 10b-5 claims brought simultaneously against a company and its auditor, settlements with auditors can be evaluated by comparing them with the estimated percentage of claimed damages caused by the auditor, as well as by measuring the auditor settlement amount as a percentage of total claimed damages. *See, e.g., In re Cendant Corp. Securities Litigation*, 109 F. Supp. 2d 235, 263-264 (D.N.J. 2000) ("Taken separately, the E&Y settlement, according to Lead Counsel's calculations, represents approximately 5.4% of the $6.2 billion in damages sustained by pre-April 15, 1998 purchasers; and 9.25% of the damages if it is assumed that E&Y and Cendant bear equal responsibility for the $6.2 billion."), *aff'd*, 264 F.3d 201 (3d Cir. 2001). An analysis of such settlements entered into by the "Big Five" accounting firms over the past five years reveals that the auditors on average contributed 23.1% of the settlement; the median value of such settlements is 20.8%.[6] (*See* Appendix A hereto). Valuing Plaintiffs' proposed settlement of auditor claims with Andersen at $1.5 Million would indicate that Plaintiffs' claims against the Household Defendants are worth roughly $5 Million *based upon the former five year class period.*

The Andersen settlement was negotiated and proposed at a time when the class period was approximately 5 years: October 23, 1997 through October 11, 2002. Based upon a five year class, Plaintiffs and Andersen thus valued their settlement at approximately $300,000 per year ($300,000 x 5 = $1,500,000). Subsequently, this Court recently dismissed with prejudice the Class's claims arising prior to July 30, 1999 on the grounds that those claims had expired.

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[6] The average, or mean, auditor contribution reflects the sum of the values from each settlement divided by the total number of settlements assessed. The median auditor contribution reflects the midpoint of the distribution; in half of the settlements auditors contributed a higher percentage than 20.8%, and in half the auditors contributed a smaller portion than 20.8%. Both figures are statistically significant: "medians give less weight to extremes, but means convey more information." *Kulumani* v. *Blue Cross Blue Shield Ass'n*, 224 F.3d 681, 684 (7th Cir. 2000).

See Memorandum Opinion and Order dated February 28, 2006. The new effective class period, then, is July 30, 1999 through October 11, 2002 or roughly three years. Thus, Plaintiffs' claims are approximately 40% less today than what Plaintiffs and Andersen thought they were last Fall when they negotiated their $1.5 Million proposed settlement and in December when they presented that proposed settlement to the Court for preliminary approval. It is reasonable to assume that had Andersen's proposed settlement been negotiated under the current state of affairs, it would have been approximately 40% less — or approximately a $900,000 settlement ($300,000 x 3). Thus, in the context of Plaintiffs' proposed settlement with Andersen, a value of $900,000 for auditor claims *based upon the current 3 year class period* indicates that Plaintiffs' claims against the Household Defendants have a fair settlement value of roughly $3 Million.

This estimated value of $3 Million is consistent with the Household Defendants' view of the reasonable settlement value of Plaintiffs' claims against them. Plaintiffs' proposed settlement with Andersen is therefore: (1) consistent with expected value of the merits of Plaintiffs' claims against Andersen; and (2) consistent with the Household Defendants' estimation of the reasonable settlement value of Plaintiffs' claims against Household. As a result, the Household Defendants do not object to a finding that the proposed settlement is "fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(1)(C).

CONCLUSION

For the foregoing reasons Defendants do not object pursuant to the PSLRA to Plaintiffs' proposed settlement with Andersen.

Dated: March 20, 2006
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Respectfully submitted,

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CERTIFICATE OF SERVICE

Adam B. Deutsch, an attorney, certifies that on March 20, 2006, he caused to be served copies of the Memorandum of the Non-Settling Household Defendants Pursuant to the PSLRA with Respect to Plaintiffs' Proposed Settlement with Defendant Arthur Andersen LLP, to the parties listed below via the manner stated.

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