

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

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

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

I. INTRODUCTION

Lead Plaintiffs' respectfully submit this response to the Memorandum of the Non-Settling Household Defendants Pursuant to the PSLRA with Respect to Plaintiffs' Proposed Settlement with Defendant Arthur Andersen LLP ("Household's Submission" or "Defs' Mem."). As detailed below, the Household Defendants¹ have no standing to present a non-objection. Household's Submission is a transparent subterfuge to present further argument on their motion under *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 125 S. Ct. 1627 (2005), currently pending before this Court.

Moreover, Household's Submission contains a number of inaccurate recitations of fact and law that Lead Plaintiffs address and correct in this response. Accordingly, the Court should strike Household's Submission for lack of standing pursuant to Fed. R. Civ. P. 12(f), or disregard it because it is inaccurate.

II. BECAUSE THE HOUSEHOLD DEFENDANTS LACK STANDING ABSENT EVIDENCE OF PLAIN LEGAL PREJUDICE, THEIR SUBMISSION SHOULD BE STRICKEN

This Circuit recognizes that "non-settling defendants in a multiple defendant litigation context have no standing to object to the fairness or adequacy of the settlement by other defendants." *Agretti v. ANR Freight Sys.*, 982 F.2d 242, 246 (7th Cir. 1992) (citation and internal quotations omitted). The rationale is that in complex litigation with a plaintiff class, "partial settlements often play a vital role in resolving class actions." *Id.* at 247. A non-settling defendant has standing to object to the terms of a partial settlement only if it can show plain legal prejudice. *Id.*; 4 Herbert A. Newberg, *Newberg on Class Actions*, §11:55 at 179 (4th ed. 2002). Here, as the Household Defendants acknowledge, the Private Securities Litigation Reform Act provides a mechanism to

¹ The Household Defendants are Household International, Inc. ("Household" or the "Company"), Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilmer and Joseph A. Vozar.

address claims of prejudice. Defs' Mem. at 3. Because the Household Defendants concede that the proposed settlement is adequate and do not raise any claim of prejudice, they have no standing to comment on the settlement with Arthur Andersen LLP ("Andersen").

Accordingly, Household's Submission is nothing but an attempt to re-argue their *Dura* motion, and should be stricken under Fed. R. Civ. P. 12(f) as redundant and immaterial. Rule 12(f) permits a court to strike assertions that are "devoid of merit, unworthy of consideration, and unduly prejudicial." *Carroll v. Chicago Transit Auth.*, 01 C 8300, 2002 U.S. Dist. LEXIS 2125, at *2 (N.D. Ill. Feb. 7, 2002).

III. HOUSEHOLD'S SUBMISSION CONTAINS INACCURACIES THAT JUSTIFY CORRECTION OF THE RECORD

Apart from Household's lack of standing, their Submission contains a number of transparent inaccuracies that warrant correction.

A. Household's Submission Fails to Present All Components of the Settlement with Andersen

The Class' settlement with Andersen is comprised of a cash component of \$1.5 million plus interest as well as an agreement to provide discovery cooperation. *See* Stipulation of Settlement with Arthur Andersen LLP, §IV.2 (Docket No. 350). In agreeing to the terms of the settlement with Andersen, lead plaintiffs considered numerous factors, including the likely degree of provable auditor liability, the special circumstances surrounding the demise of the Andersen accounting firm, the lack of insurance to cover liability if proven and the possibility that Andersen may be judgment-proof by the time this case goes to trial.²

² *See* Memorandum of Law in Support of Lead Plaintiffs' Motion for Final Approval of Settlement and Declaration of Azra Z. Mehdi in Support of Approval of the Proposed Settlement with Auditor Defendant, Arthur Andersen, LLP, being filed concurrently herewith, for a more complete description of the factors taken into account in agreeing to this settlement.

More significantly, however, the proposed settlement contains an important discovery cooperation component. Although discovery cooperation cannot be defined by tangible dollar value, that aspect of the settlement has already provided a significant benefit to the Class by enabling it to obtain document discovery and other information from Andersen in a less formal manner, thus saving substantial Class resources.

In a partial settlement where a settling defendant agrees to discovery cooperation, courts have noted that such assistance provides “significant non-monetary benefits” whose value was “not negligible.” *Denney v. Jenkins & Gilchrist*, 230 F.R.D. 317, 339 (S.D.N.Y. 2005) (plaintiffs may have more success obtaining information from a cooperative, settling defendant than from an uncooperative defendant through an adversarial discovery process). Here, prior to the mediation between the Class and Andersen on May 23, 2005, the Class was forced to file a motion to compel Andersen to provide document discovery and produce witnesses.³ This motion to compel was withdrawn after the mediation because the Class and Andersen had resolved a number of the pending discovery issues in an efficient and inexpensive manner. *See* August 25, 2005 Notification of Docket Entry (Docket No. 285). Indeed, Andersen is continuing to cooperate, voluntarily producing witnesses for depositions in this litigation.

Thus, the Household Defendants’ contention that the \$1.5 million is the only value received by the Class is inaccurate and misleading. Defs’ Mem. at 1, 3.

B. Household’s Submission Incorrectly Links the Settlement to the Pending *Dura* Motion

The Household Defendants also contend that plaintiffs’ claims are no longer viable under *Dura*, and hence inferentially, the Class’ claims have nothing more than nuisance value. Defs’

³ *See* Plaintiffs’ Motion for Order Compelling Defendant Arthur Andersen LLP to Produce Witnesses for Deposition and Documents (Docket No. 210).

Mem. at 1, 7-10. In the process, the Household Defendants improperly supplement, without obtaining the Court's permission, their *Dura* motion which has been fully briefed and submitted.

Lead plaintiffs must therefore respond briefly. Contrary to Household's latest submission, Plaintiffs' Corrected Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws ("Complaint" or "¶__") satisfies, and in fact, exceeds the standard for pleading loss causation outlined in *Dura*. Surpassing the Fed. R. Civ. P. 8(a) notice pleading standard, plaintiffs provided defendants with more than just "some indication" of the "causal connection" between defendants' misrepresentations and the over-arching fraudulent scheme and the corresponding losses incurred by plaintiffs. *Dura*, 125 S. Ct. at 1633-34. The Complaint alleges, for example, that as information leaked out about the true state of Household's operations and financial performance that had been concealed by defendants' fraud, such partial revelations caused Household's stock price to decline from as high as \$63.25 per share to around \$20.00 per share by the end of the class period. ¶¶5-6, 22, 29, 56-57, 140-141, 300, 321, 343-344. Plaintiffs' specific allegations connect Household's stock price declines to numerous revelations of adverse facts concerning defendants' multi-pronged fraud scheme – predatory lending practices, manipulations of delinquency statistics by arbitrary reaging, and other accounting manipulations – the very same issues that defendants had previously misrepresented to the market. *Id.* The Complaint alleges that these partial revelations had the effect of removing the prior inflation from Household's stock price. *Id.* Nothing more is required under *Dura* and the Household Defendants' demand for a "detailed showing" is out of synch with the Rule 8 standard in *Dura*.

Moreover, Household's assertion that the Class' settlement with Andersen negates loss causation under *Dura* is contradicted by Household's own documents produced during discovery. Internally-generated Investor Relations Reports acknowledge that Household had contemporaneous knowledge regarding loss causation that directly refutes their counsel's contentions. *See Exhibits A-*

B, attached hereto. Household's Submission renews a point its lawyers made in the *Dura* motion. Household again claims inaccurately that its stock price did not decline, and in fact increased, and that the Class is attempting to recover for "smaller than market" losses. Defs' Mem. at 8.

In the internal reports, however, Household summarized "significant events affecting the stock price," setting out Household's internal assessment of the impact of discrete public disclosures regarding Household's fraudulent consumer lending practices on the stock price. *Id.* at 1. According to its own statements, Household attributed its 7 point or 15% stock price decline in August 2002 to the numerous negative disclosures, including the August 14, 2002 restatement of earnings, the negative press articles regarding potential threats to Household's business model due to the Company's alleged predatory lending practices, outstanding lawsuits and the Department of Financial Institutions' regulatory report. Ex. A at HHS 02075632.

Household's September-October report confirms the Complaint allegations linking Household's stock price decline during September-October 2002 to the market's awareness of the ongoing multi-state Attorneys-General investigation. Ex. B at HHS 02075738. Household's documents acknowledge that the market became aware and reacted before the October 11, 2002 announcement of the \$484 million settlement. *Id.* Indeed, these internal reports acknowledge that Household stock underperformed the S&P, and S&P Financial indices during the May through October 2002 timeframe.⁴

As shown by the statements in its own internal documents, Household believed that each incremental revelation of the truth led to an incremental diminution in the stock price. Ex. A at

⁴ To the extent that Household stock outperformed the financial indices in the earlier part of the class period, it is entirely consistent with plaintiffs' allegations that Household's stock was artificially inflated at that time as a result of Household Defendants' misrepresentations or omissions regarding Household's true financial condition.

02075630-32; Ex. B at 02075738-39. Thus, Household's own documents show that its lawyers' current assertions that Household's stock price did not decline are incorrect. The Complaint correctly alleges, consistent with *Dura*, that "Household's stock price declined from over \$53.00 per share in June 2002 to approximately \$30.00 per share in late August 2002, as the magnitude and pervasiveness of defendants' fraud leaked to investors." ¶¶21-22.

Alternatively, Household's internal documents demonstrate that the Class can easily amend to explicitly so plead. *See* Fed. R. Civ. P 15(a).

C. Household's Submission Contains Assertions that are Either Plainly Inaccurate or Presented in such a Manner as to be Misleading

In addition to mischaracterizing the proposed settlement and rearguing their *Dura* motion, Household's Submission contains other factual and legal errors.

1. Household's Submission Inaccurately Claims that Plaintiffs' Settlement with Andersen 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

Household's assertions concerning the settlement are serious mischaracterizations. Defs' Mem. at 5. The settlement notice that Household cites as support for plaintiffs' purported "acknowledgements" is simply an explanation to the Class of the risks in litigation "If the Case Against Andersen Had Not Settled." *See* Ex. A-1 at 1, attached to the Stipulation of Settlement with Arthur Andersen LLP (Docket No. 350). Indeed, the specific section referenced in Household's Submission describes the points as to which plaintiffs and Andersen disagree, including the amount and methodology of calculating damages. *Id.* Disagreement does not equal admission.

2. Household's Unsupported Assertions that Securities Fraud Claims Against a Company's Auditors Are on Parallel Footing with Claims Against the Company, Is Misleading

Household's Submission offers a conclusory statement of the law without citation to a single case that the legal test for suits against auditors are identical to those against the company. Defs'

Mem. at 6-7. Although the standard for pleading securities fraud claims against a company and its auditor is similar, securities fraud claims are much harder to establish against an auditor. In order to meet the recklessness standard for auditors, courts in this district (rightly or wrongly) require plaintiffs to produce evidence that the accounting practices amounted to no audit at all, or to an egregious refusal to see the obvious, or to investigate the doubtful, or that accounting judgments made were such that no reasonable accountant would have made the same decision. *See Danis v. USN Commc'ns, Inc.*, 121 F. Supp. 2d 1183, 1194 (N.D. Ill. 2000); *Chu v. Sabratek Corp.*, 100 F. Supp. 2d 815, 823-24 (N.D. Ill. 2000). The Household Defendants remain primarily liable for securities fraud, while the auditors, as secondary actors, can only be liable if plaintiffs can prove they are a primary violator. *See Central Bank, N.A. v. First Interstate Bank N.A.*, 511 U.S. 164, 191 (1994).

3. Household's Submission Distorts Facts Surrounding the Demise of the Andersen Accounting Firm

The Household Defendants inaccurately state that well-publicized facts contradict plaintiffs' description of Andersen's limited resources and inability to pay substantial settlements. Defs' Mem. at 4, attaching Appendix A.

Yet, the Seventh and Fifth Circuits have recognized, consistent with plaintiffs' description, that the Department of Justice's prosecution of Andersen caused the sudden collapse of Andersen's business operations. *Roquet v. Arthur Andersen LLP*, 398 F.3d 585 (7th Cir.) (detailing the hundreds of millions lost in business after the March 14, 2002 indictment of the Andersen firm and the resulting mass lay-offs of Andersen employees), *cert. denied*, 126 S. Ct. 375 (2005); *Newby v. Enron Corp.*, 394 F.3d 296 (5th Cir. 2004) (affirming partial settlement with foreign subsidiaries of Andersen recognizing their financial insolvency and future problems in collecting judgment).

Further, the Enron plaintiffs' \$40 million settlement referenced in Household's Submission was not with Andersen (the defendant here), but with Andersen Worldwide Societe Cooperative

(AWSC) and some of its foreign member firms. *Newby*, 394 F.3d at 300 (noting that the partial settlement excluded Andersen, the defendant in this case).

4. The Household Defendants' Comparison of Auditor vs. Company Settlements and Appendix A Attached to Household's Submission Is Misleading

Based upon the erroneous premise that Rule 10b-5 claims against the auditor and company are on "parallel footing," the Household Defendants proffer statistics out of context in an attempt to contrive a low net settlement value against them. Defs' Mem. at 9-10. Household Defendants' calculations are misleading: (1) they include settlements for other accounting firms whose business and financial well-being is not at issue; and (2) they fail to account for settlements where Andersen had no insurance. The Household Defendants quickly gloss over settlement comparisons such as the one with Dynegy, Inc. where Andersen paid only \$1.05 million, less than the \$1.5 million plus discovery cooperation agreed to here. In comparison, Dynegy paid \$468 million. In *In re Charter Commc'ns, Inc., Sec. Litig.*, MDL Docket No. 1506, 2005 U.S. Dist. LEXIS 14772 (E.D. Mo. June 30, 2005), Andersen paid \$2.25 million versus \$146.3 million by the company; and in *Scheiner v. i2 Techs., Inc.*, Civil No. 3:01-CV-418-H (N.D. Tex.), Andersen paid \$2.9 million versus \$84.9 million by the company. Moreover, the cases cited in Household's Submission (*see* Defs' Mem. at 6) do not stand for the proposition that a partial settlement of claims with an auditor is determinative of the plaintiffs' valuation of the case against the remaining defendants.⁵ Household's Submission and Appendix are, therefore, unreliable measures of comparison for company settlements.

⁵ Household asserts, without any support, that plaintiffs' damages are 40% lower now that the class period has been narrowed by the Court's February 28, 2006 Order. *Id.* at 7, n.5, 10. The determination of the amount of damages always has been a matter for expert analysis. *See Basic Inc. v. Levinson*, 485 U.S. 224, 249 (1988); *In re Sunbeam Sec. Litig.*, 176 F. Supp. 2d 1323 (S.D. Fla. 2001). The percentage of reduction in damages, if any, similarly requires more than Household's counsel's unsupported pronouncements.

IV. CONCLUSION

For the foregoing reasons, Household's Submission should be stricken for lack of standing or disregarded for lack of accuracy.

DATED: March 30, 2006

Respectfully submitted,

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DECLARATION OF SERVICE BY EMAIL AND BY U.S. MAIL

I, the undersigned, declare:

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

2. That on March 30, 2006, declarant served by electronic mail and by U.S. Mail the **LEAD PLAINTIFFS' RESPONSE TO 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 on the attached Service List. The parties' email addresses are as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 30th day of March, 2006, at San Francisco, California.

/s/ Monina Gamboa

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HOUSEHOLD INTERNATIONAL (LEAD)

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