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,

v.

HOUSEHOLD INTERNATIONAL, INC., et al.

Defendants.

Lead Case No. 02-C-5893
(Consolidated)

Judge Ronald A. Guzman
Magistrate Judge Nan R. Nolan

NOTICE OF FILING AND AGREED MOTION

TO: SEE ATTACHED SERVICE LIST

PLEASE TAKE NOTICE THAT, the Household Defendants today filed the attached Household Defendants' Motion to Dismiss the Corrected Amended Consolidated Class Action Complaint, and on **Thursday, May 15, 2003 at 9:30 a.m.**, or as soon thereafter as counsel may be heard, counsel for the Household Defendants will appear before the Honorable Ronald A. Guzman in the courtroom usually occupied by him, Room 1219 of the Dirksen Federal Building, and present the attached Agreed Motion for Leave to File Instanter an Oversized Memorandum of Law in Support of Household Defendants' Motion to Dismiss the Corrected Amended Consolidated Class Action Complaint.

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Dated: May 13, 2003

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Lead Case No. 02-C-5893
(Consolidated)

Judge Ronald A. Guzman
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HOUSEOLD DEFENDANTS' MOTION TO DISMISS
THE CORRECTED AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

Defendants Household International, Inc. ("Household"), Household Finance Corporation, Inc. ("HFC"), William Aldinger, David Schoenholz, Gary Gilmer, J.A. Vozar, Robert J. Darnall, Gary G. Dillon, John A. Edwardson, Mary Johnston Evans, J. Dudley Fishburn, Cyrus F. Freidheim, Jr., Louis E. Levy, George A. Lorch, John D. Nichols, James B. Pitblado, S. Jay Stewart, and Louis W. Sullivan (collectively, the "Household Defendants"), move this Court pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6) and the Private Securities Litigation Reform Act, 15 U.S.C. §§ 78u-4, et seq., to enter an Order dismissing the Corrected Amended Consolidated Class Action Complaint (the "Amended Complaint") for the reasons stated in the accompanying Memorandum of Law.

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Dated: May 13, 2003

Respectfully submitted,

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MEMORANDUM OF LAW IN SUPPORT OF HOUSEHOLD DEFENDANTS' MOTION TO DISMISS THE CORRECTED AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

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May 13, 2003

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The Household Defendants respectfully submit this memorandum in support of their motion to dismiss the Amended Complaint pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6) and the Private Securities Litigation Reform Act, 15 U.S.C. §§ 78u-4 et seq. (the "PSLRA").

PRELIMINARY STATEMENT

On August 14, 2002, Household announced that it was restating its financial statements for the period 1994-2002 because its new auditors disagreed with its previous auditors over certain technical accounting rules. These restatements had no material adverse impact on Household's financial condition. Household's stock price closed higher on the first trading day following the announcement. Nevertheless, as predictably as night follows day, eight class action lawsuits were filed in short order claiming violations of the securities laws. Plaintiffs have now tried to buttress that claim by compiling in a prolix "amended" complaint every unrelated adverse development and unsubstantiated accusation involving Household that they could find.

The PSLRA was enacted to stop

> frivolous "strike" suits alleging violations of the Federal securities laws in the hope that defendants will quickly settle to avoid the expense of litigation. These suits, which unnecessarily increase the cost of raising capital and chill corporate disclosure, are often based on nothing more than a company's announcement of bad news, not evidence of fraud.

S. Rep. No. 104-98, at 4 (1995) (emphasis added). The Amended Complaint is exactly the sort of pleading Congress intended to curtail. Without any coherent theory of wrongdoing, the Amended Complaint simply quotes large sections of virtually every public statement made by Household over the five-year class period and alleges that each of those statements was false and

misleading by virtue of "bad news" announced by Household in 2002 (or, even worse, by allegations against Household that have never been substantiated).

Thus, plaintiffs' prolix and confusing hodgepodge fails to provide the essential detail required by the PSLRA and Federal Rule of Civil Procedure 9(b):

- The Amended Complaint fails to plead any false or misleading statements with the particularity required for Section 10(b) and Rule 10b-5 claims. See Point I, infra.
- The Amended Complaint fails to plead scienter with the particularity required by the PSLRA. See Point II, infra.
- Numerous statements alleged to be false or misleading are not actionable: (1) statements by analysts or third parties for which the defendants cannot be liable, see Part III.A, infra; (2) statements that amount to "puffery," see Part III.B, infra; and (3) forward-looking statements protected by the PSLRA's safe harbor, see Part III.C, infra.

The Amended Complaint is also deficient because

- Certain of plaintiffs' claims under Sections 11 and 12(a)(2) of the Securities Act of 1933 fail to comply with the statute of limitations and lack loss causation (as demonstrated by the face of the Amended Complaint). See Part IV, infra.
- Plaintiffs' "control person" claims lack a predicate violation. See Point V, infra.
- No false or misleading statements are attributable to defendant Gary Gilmer, and the action thus cannot proceed against him. See Point VI, infra.

In short, plaintiffs should not be permitted to impose costly and burdensome discovery on the Household Defendants on the basis of a pleading that, when stripped to essentials, rests on nothing more than the announcement of bad news. The Amended Complaint should be dismissed.

STATEMENT OF FACTS

A. The Named Defendants

Defendant Household is a Delaware corporation headquartered in Prospect Heights, Illinois. Household is primarily a holding company with three operating segments: (i) consumer, which includes consumer lending, mortgage services, retail services and auto finance businesses; (ii) credit-card services, which includes domestic Visa and MasterCard businesses; and (iii) international, which includes operations in the United Kingdom and Canada. Compl. ¶ 37. Defendant HFC is a wholly-owned subsidiary of Household, which engages in the consumer finance business and acts as the Company's "finance arm." Id. On March 28, 2003, Household became a wholly-owned subsidiary of HSBC Holdings, plc ("HSBC") by means of a merger.

The Amended Complaint also names as defendants several of Household's officers and directors. The "Officer Defendants" are William Aldinger, the Chairman and CEO; David Schoenholz, Household's President, COO, and Vice-Chairman; and Gary Gilmer, the Company's former "Vice-Chairman of Consumer Lending" and the Group Executive of U.S. Consumer Finance. Id. ¶ 38-40. Aldinger, Shoenholz, and Gilmer are also named in their capacity as directors of defendant HFC, together with J.A. Vozar (collectively the "HFC Director Defendants"). Id. ¶ 47.

The outside-director defendants (the "Director Defendants"), many of whom no longer serve on Household's board, are: Robert J. Darnall, Gary G. Dillon, John A. Edwardson, Mary Johnston Evans, J. Dudley Fishburn, Cyrus F. Freidheim, Jr., Louis E. Levy, George A. Lorch, John D. Nichols, James B. Pitblado, S. Jay Stewart, and Louis W. Sullivan. Dillon,

Edwardson, Evans, and Levy were members of the Audit Committee, and Levy served as Chairman. Id. ¶ 44.

Defendants Goldman Sachs & Co., Inc. ("Goldman Sachs") and Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") acted as financial advisors to Beneficial Corporation ("Beneficial") in connection with Household's 1998 acquisition of Beneficial, a consumer finance business. Id. ¶¶ 48, 49, 371.

Finally, the Amended Complaint names as a defendant Arthur Andersen LLP ("Andersen"), which served as Household's auditor until early 2002. Id. ¶ 46.

B. Plaintiffs' Factual Allegations

The Amended Complaint mostly consists of block quotes from virtually every one of Household's SEC filings and quarterly press releases, as well as numerous analyst reports about Household, during the five-year period from October 1997 through October 2002. Id. ¶¶ 192-344. The Amended Complaint then alleges that the Officer Defendants and Household knew (or were reckless in not knowing) that all of these statements were false and misleading.

The allegations of falsity rest on three purported undisclosed "schemes": (1) that Household and/or HFC engaged in so-called "predatory lending"; (2) that Household improperly "reaged" past-due loans; and (3) that Household improperly amortized expenses associated with certain credit-card marketing and co-branding agreements.

Plaintiffs' "predatory lending" allegations repeat publicized claims about HFC's lending practices, e.g., that HFC misled customers as to the interest rates on new loans and the potential savings over customers' existing loans (id. ¶¶ 55-60), and concealed prepayment

penalties that could make it difficult for Household borrowers to refinance their loans (id. ¶¶ 68-70). Plaintiffs primarily rest these allegations on the Washington Department of Financial Institutions Expanded Report of Examination for Household Finance Corporation III as of April 30, 2002 (the "WA Report") and a September 2002 Forbes article. See Compl. ¶¶ 56-82. The Amended Complaint alleges that these practices gave rise to an undisclosed contingent liability, pointing to the October 11, 2002 settlement between Household and a multi-state group of attorneys general and regulatory agencies (the "A.G. Settlement"), in which Household agreed to provide up to $484 million to resolve consumer complaints (id. ¶ 97). Importantly, the Amended Complaint does not allege any fact showing that any claim of widespread "predatory lending" was true; that it was foreseeable that any of these alleged practices would have any adverse impact on Household; that any defendant was aware of the alleged practices; or that any defendant ever actually expected that these practices would result in any material liability for Household.

The "reaging" allegations rest on Household's disclosure in April 2002 of statistics on reaged accounts. Id. ¶ 123. Reaging an account permits a lender, upon receipt of partial payment on a delinquent account, to reset the account to current. Plaintiffs contend that, prior to that time, the Officer Defendants somehow caused Household to arbitrarily reage accounts "at any level of delinquency, including accounts that were over 270 days past due, with merely a single payment," sometimes several times in a single year. Id. ¶ 117, 118. There is no allegation as to how many accounts, or which accounts, were reaged improperly, or at what time; no allegation that the number of accounts improperly reaged had a material impact on Household's financial statements; and no particularized allegation showing that any defendant

was aware of or involved in any specific aspect of Household's reaging practices, arbitrary or otherwise.

The cost accounting allegations rest on Household's announcement, on August 14, 2002, that after reviewing its accounting policies with its new auditor, KPMG LLP, Household would restate its 1994-2002 consolidated financial statements by a total of $386 million. Id. ¶¶ 134-35. On KPMG's advice, Household shortened the period amortizing certain expenses associated with its Mastercard and Visa co-branding and affinity card agreements and a credit-card marketing agreement. Id. ¶ 138. Plaintiffs allege that Household adopted the original amortization methods deliberately to overstate its net income, but allege no fact showing that any defendant was aware that the prior methods violated Generally Accepted Accounting Principles ("GAAP"); how or when any particular defendant "caused" the alleged GAAP violations to occur; or that the restatement resulted from anything other than a difference of opinion between auditors.

Plaintiffs attempt to allege scienter by asserting in conclusory fashion that the Officer Defendants participated in or condoned HFC's lending and Household's reporting practices, and then attempt to show that they had a motive to commit fraud. Plaintiffs rest this "motive" on the fact that the Officer Defendants' compensation depended in part on the company's financial performance. Id. ¶¶ 156-162. There is no allegation that the Officer Defendants' compensation arrangements differed from those of thousands of other corporate executives whose pay is tied to corporate performance. Plaintiffs also allege that the Officer Defendants had a motive to commit fraud to facilitate Household's access to financing. Id. ¶¶ 11-12, 108-09. There is no allegation to distinguish this purported motive from that shared by the executives of every corporation that finances its activities. Finally, in an attempt to show that

the Officer Defendants had an opportunity to commit fraud, plaintiffs rely on generic allegations that the Officer Defendants were "hands-on" managers who had access to unspecified internal information. Id. ¶¶ 165-68.

With respect to the Beneficial merger, plaintiffs allege that Household's June 1, 1998, Form S-4 Registration Statement and Joint Proxy Statement-Prospectus (the "Beneficial Registration Statement") for Household's shares issued in the merger was false and misleading because it incorporated by reference Household financial statements and filings between 1994 and 1998 (id. ¶¶ 362-64) and falsely attested to the accuracy of Household's SEC filings and the Company's compliance with applicable laws (id. ¶¶ 365-67, 369).

Additionally, plaintiffs allege that numerous Form S-3 Registration Statements filed by Household and/or HFC with the SEC between February 1999 and April 2002 (collectively, the "Debt Registration Statements") were false and misleading because they contained inflated earnings figures (id. ¶¶ 390-91(a)) and incorporated by reference various Household financial statements and SEC filings from the period 1994-2001 (id. ¶ 391(b)).

C. Plaintiffs' Claims for Relief

The Amended Complaint is pleaded in four Counts: Count I, a claim under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, against Household, the Officer Defendants and Andersen; Count II, a "control person" claim under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), against Household and the Officer Defendants; Count III, claims under Sections 11, 12(a)(2) and 15(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77k, 77l(a)(2), 77o(a), against Household, the Officer Defendants, the Director Defendants, Andersen,

Goldman Sachs, and Merrill Lynch based on the Beneficial Registration Statement; and Count IV, claims under Sections 11 and 15 of the Securities Act against Household, HFC, the HFC Director Defendants, and Andersen based on the Debt Registration Statements. Each of these claims should be dismissed for the reasons stated below.

ARGUMENT

POINT I

THE AMENDED COMPLAINT FAILS TO ALLEGE ANY FALSE OR MISLEADING STATEMENTS WITH PARTICULARITY

The Amended Complaint fails to meet the PSLRA and Federal Rule of Civil Procedure 9(b) standards for particularity. Plaintiffs repeatedly fail to identify the specific statement they allege to have been false or misleading or to explain the reasons why the statement was false or misleading when made. Further, plaintiffs fail to allege particular facts to support various aspects of the underlying "schemes" that purportedly existed at Household during the putative class period. For these reasons, the Court should dismiss plaintiffs' Section 10(b) and Rule 10b-5 claim (Count I).

A. Plaintiffs Fail to Identify Each Misleading Statement and Explain Why the Statement Was False or Misleading

The PSLRA requires that a securities fraud plaintiff identify each allegedly misleading statement and specify the reason each statement was untrue or misleading at the time it was made. 15 U.S.C. § 78u-4(b)(1). More generally, under Rule 9(b), plaintiffs must allege with particularity "in what respects the statements at issue were false." San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., Inc., 75 F.3d 801, 812 (2d Cir. 1996). The Amended Complaint fails to meet these requirements. Rather, it simply lists nearly a

hundred press releases, analyst reports and SEC disclosures concerning general financial performance at Household, and then layers over this list the occurrence of the later accounting restatement and the A.G. Settlement, as well as vague allegations regarding improper reaging. In fact, most of the quoted statements have no logical or even temporal relation to any of those events.

The PSLRA and Rule 9(b) require that a plaintiff do more than juxtapose a recitation of corporate statements against assertions about operational difficulties at the defendant company. "[T]he law now requires a plaintiff to draw a specific nexus between the allegedly fraudulent statements and the facts upon which the allegation of fraud is dependent, or, at least, a clear statement of why and how the plaintiff has reached the conclusion that a particular statement is fraudulent." Havenick v. Network Express, Inc., 981 F. Supp. 480, 526 (E.D. Mich. 1997). The Havenick court dismissed a similar securities fraud complaint, reasoning that "[plaintiffs] have simply compiled a long list of block quotes, many of which contain statements that cannot seriously be regarded as false or misleading, and they line these statements up against a conclusory list of omissions and pronounce that fraud exists. Any notion of particularity and an underlying reason in light of the PSLRA certainly demands more than this." Id.; see also Clark v. TRO Learning, Inc., 1998 WL 292382, at * 4 (N.D. Ill. May 20, 1998)[1] (dismissing complaint that failed to provide an explanation as to why any particular statement was false; "This complaint is justly summarized as a series of quotations from [the defendant's] press releases and analyst statements combined with one general explanation regarding falsity . . . ."); see also In re Capstead Mortgage Corp. Sec. Litig., 2003 WL 1813837,

[1] Copies of unreported cases are included in the attached Appendix of Unreported Cases.

at *14-17 (N.D. Tex. Mar. 31, 2003) (dismissing complaint for, inter alia, failing to identify which statements were false or explain how or why they were misleading; complaint set forth series of statements followed by paragraph with multiple subparts purporting to explain why all the previous statements were false; "[a]ttempting to overwhelm the court with conclusory, garrulous and esoteric allegations simply does not get the job done").[2]

The Amended Complaint runs afoul of these requirements. Plaintiffs compile more than one hundred statements by defendants consisting primarily of block quotes of press releases, SEC filings and analyst reports, organized chronologically from October 1997 to September 2002. Compl. ¶¶ 192-344. These block quotes, in most instances, are not limited to a particular subject, but rather address a variety of topics. See, e.g., id. ¶¶ 197 (January 21, 1998 earnings release providing financial information, including discussion of Transamerica Corporation and ACC Consumer Finance acquisitions), 311 (January 15, 2002 earnings release providing financial information and commenting on business model). At the end of each year's list of statements, plaintiffs then recite a list of alleged operational problems. See id. ¶¶ 196 (1997), 217 (1998), 242 (1999), 271 (2000), 302, 307 (both 2001), 342 (2002). These recitations

[2] Far from meeting the requirements of Rule 9(b) and the PSLRA, the Amended Complaint does not adequately allege falsity even under a notice pleading standard. See Wenger v. Lumisys, Inc., 2 F. Supp.2d 1231, 1243-44 (N.D. Cal. 1998) (dismissing complaint for failure to meet requirements of Federal Rule of Civil Procedure 8 and the PSLRA when plaintiff "merely thr[ew] the statements and the alleged 'true facts' together in an undifferentiated clump and apparently expect[ed] the reader to sort out and pair each statement with a supposedly relevant 'true fact'"); In re Oak Tech. Sec. Litig., 1997 WL 448168, at *4 (N.D. Cal. Aug. 1, 1997) ("group[ing] several allegedly false statements, often citing long passages with little, if any, explanation in the surrounding text of which particular statements were false and why they were false," but only alleging that the statements "'were false and misleading when made' and list[ing] 'material adverse information'" did not satisfy the PSLRA or Rule 8).

are virtually identical from year to year, and do nothing more than refer back to the three purported "schemes" claimed by plaintiffs, without connecting them to the statements at issue.

Indeed, plaintiffs have made no effort to identify which statement within the lengthy block quotes is alleged to be false and misleading or why. Nor do plaintiffs attempt to explain when in the five-year class period the purported "schemes" affected any statement and made it misleading. Apparently, plaintiffs would leave the task of deciphering which of the statements within this 154-page complaint are misleading and why to defendants and the Court. This is impermissible under the PSLRA and Rule 9(b) and mandates dismissal.

B. The Allegedly Undisclosed "Schemes" Lack Sufficient Particularity

The Amended Complaint also fails to plead specifics with respect to the alleged schemes: the allegations are vague as to time and place, specific events, and sources[3] of the allegations. This is an independent basis to dismiss Count I.

(1) "Predatory Lending" Allegations

Plaintiffs' allegations concerning the predatory lending "scheme" lack particular facts to support a conclusion that virtually every statement Household made throughout the putative class period was false or misleading when made. Paragraphs 51-101 of the Amended Complaint, primarily through citation of the WA Report and a September 2002 Forbes article, describe so-called "predatory lending" practices purportedly engaged in by some branch employees of HFC, supposedly beginning in 1997. Plaintiffs then make an untenable leap of

[3] The PSLRA provides that, "if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1).

logic to allege that this conduct caused all of Household's financial statements to violate GAAP throughout the class period. Compl. ¶¶ 102-106. Plaintiffs' theory is as undeveloped as the following:

> GAAP, as set forth in Statement of Financial Accounting Standards ("SFAS") No. 5, Accounting for Contingencies, requires that a company establish a loss contingency, i.e., reserve, when the estimated loss is probable and reasonably estimated . . . . Defendants violated GAAP and SEC rules by failing to disclose the potential loss contingencies resulting from its illegal predatory lending practices that ultimately resulted in a $525 million pre-tax charge during 3Q02. (Compl. ¶¶ 104-105)

This theory rests solely on hindsight, i.e., that because Household incurred a liability in the third quarter of 2002 in connection with the settlement of a potential dispute, it should have disclosed the existence of that contingency as much as five years earlier. Plaintiffs fail to identify facts that show that a loss from "predatory lending" claims was probable and reasonably estimable at any time earlier than the third quarter of 2002 and, if so, when that knowledge would have been fixed or why that conclusion would have been evident. See Greebel v. FTP Software, Inc., 194 F.3d 185, 204 (1st Cir. 1999) (GAAP violations must be pled with particularity).

Far from establishing when a contingent liability could have been fixed, the Amended Complaint fails to establish that the underlying, so-called "predatory lending" practices were illegal. Plaintiffs point to the WA Report, three civil lawsuits, and the A.G. Settlement[4] to support the legal conclusion that Household's lending practices have always been

[4] The Amended Complaint also points out that Household settled unspecified claims with the California Department of Corporations in January of 2002. Compl. ¶ 19. Nowhere do plaintiffs plead any fact to establish that these claims relate to any of the alleged lending practices described in the Amended Complaint. Likewise, plaintiffs allege no facts connecting the allegation that HFC returned $400,000 to Washington borrowers in July of 2002 (id. ¶ 89) to the WA Report or the A.G. Settlement.

self-evidently illegal (presumably in every State in the Union as well).[5] These matters, however, consist of untested adversarial litigation/enforcement positions and a voluntary settlement,[6] and none conclusively establishes the wrongfulness of any of the alleged practices. See Kushner v. Beverly Enters., Inc., 317 F.3d 820, 829-30 (8th Cir. 2003) (rejecting plaintiffs' argument that court could infer a company-wide scheme from assertions in the government's sentencing memorandum in a criminal case against the company's subsidiary).

Furthermore, the A.G. Settlement did not admit the underlying allegations. The Amended Complaint mischaracterizes Household's October 11, 2002 announcement of the settlement, editorializing that Aldinger "admitted that Household had engaged in predatory lending." Compl. ¶ 97. Aldinger merely stated that "For 125 years, we have set high standards for ourselves as a company, and we apologize to our valued customers for not always living up to their expectations." Ex. A.[7] This generic statement is a far cry from an admission that HFC

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[5] Even under the liberal Rule 12(b)(6) standard, the Court is "not obliged to accept as true legal conclusions or unsupported conclusions of fact." Hickey v. O'Bannon, 287 F.3d 656, 658 (7th Cir. 2002).

[6] Plaintiffs may not rely on the A.G. Settlement as proof of the legal validity of underlying claims. A voluntary settlement, like a consent order, is the result of private bargaining and "not the result of an actual adjudication of any of the issues." Lipsky v. Commonwealth United Corp., 551 F.2d 887, 893 (2d Cir. 1976). "Consequently, it can not be used as evidence in subsequent litigation between [the] corporation and another party." Id.; see id. at 893-94 (striking from civil complaint references to SEC consent order and underlying SEC complaint); see Beck v. Cantor, Fitgerald & Co., 621 F. Supp. 1547, 1566 (N.D. Ill. 1985) (striking from civil complaint allegations referring to SEC opinions and defendants' acquiescence in those opinions), disapproved on other grounds, Pinter v. Dahl, 486 U.S. 622 (1988); Shahzad v. H.J. Meyers & Co., 1997 WL 47817, at *13-14 (S.D.N.Y. Feb. 6, 1997) (striking from civil complaint allegations regarding consent orders entered into between the defendant and various state and federal agencies).

[7] "Documents that a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to [his or] her claim." Venture Assocs. Corp. v. Zenith Data Sys. Corp., 987 F.2d 429, 431 (7th Cir. 1993). "This

(footnote continued)

engaged in widespread, specific "predatory lending" practices or that Household viewed its lending practices as illegal. To the contrary, the Form 8-K, publicly filed along with the press release, stated in unambiguous terms that "Household denies the allegations of the [S]tates and believes that if claims or actions were brought based upon the allegations, its lending subsidiaries would have substantive meritorious legal defenses." Ex. A.

The Amended Complaint also fails to allege facts suggesting that the so-called "predatory lending" practices were so widespread or pervasive that the likelihood of substantial civil liability or regulatory sanctions was significant enough to trigger a duty to disclose the practices or account for them as a contingent liability. The WA Report, upon which the plaintiffs base the majority of their claims of wrongdoing, only purports to apply to activities in Washington state, see WA Report, at 1-2, not HFC's activities nationwide. Notably, the Report details only twenty-one complaints, six of which relate to one branch in Bellingham, Washington. See id. at 5-39. Similarly, Minnesota Commissioner Bernstein's conclusory assertions — mentioned in the Amended Complaint — regarding the extent of allegedly abusive practices must be viewed in the context of his limited jurisdictional authority. In any case, his broad assertions about "corporate culture" (Compl. ¶¶ 93, 98) and "the whole orchard [being]

(footnote continued)

includes the full text of SEC filings, prospectuses, analysts' reports, and statements that are integral to the complaint." Abrams v. Van Kampen Funds, Inc., 2002 WL 1160171, at *2 (N.D. Ill. May 30, 2002). "[A]ctual documents will override inconsistent descriptions of those documents alleged in the body of the complaint." Id. Additionally, this Court may take judicial notice of documents publicly filed with the SEC, the contents of which are not reasonably subject to dispute. Id.; In re Spyglass, Inc., Sec. Litig., 1999 WL 543197, at *5 (N.D. Ill. July 21, 1999).

rotten" (id. ¶ 98), as well as his remark that "[w]hen we talked with regulators in other states, the story was the same" (id. ¶ 98), are unsupported by any factual particulars.

(2) Reaging Allegations

Plaintiffs' allegation that Household was engaged in a "scheme" throughout the putative class period to reage loans in an "arbitrary" fashion (Comp. ¶¶ 107-33) also lacks the particularity required by the PSLRA and Rule 9(b). Plaintiffs do not identify specific instances of particular accounts being improperly reaged on specific dates, or even attempt to specify the amount of debt that was allegedly reaged improperly.[8] While the Amended Complaint identifies percentages of loans that "had been previously reaged" (Compl. ¶ 123; see id. ¶ 127), it does not reveal what percentage of these accounts were reaged improperly or in an "arbitrary" fashion, or how it was "arbitrary." Similarly, the Amended Complaint is silent on what, if any, effect the alleged improper reaging had on Household's bottom line. See id. ¶¶ 125, 128.

Nor is there detail regarding how the scheme was carried out. Instead, the Amended Complaint contains only the vague supposition that the Officer Defendants "established procedures whereby accounts were reaged arbitrarily." Id. ¶ 110. Plaintiffs then contradict themselves to allege, again only in the vaguest of terms, that the Officer Defendants "caused Household to violate its own policies and reage accounts at any level of delinquency . . . with merely a single payment." Id. at ¶ 117. Despite the five-year putative class period, no dates, not even approximate ones, are provided for any of these actions.

[8] Reaging of loan accounts is not inherently unlawful.

Significantly, no sources are provided for plaintiffs' allegations about either the internal policy violations or "arbitrary" procedures supposedly at the heart of this scheme. Plaintiffs' citation to Household's April 9, 2002 press release (id. ¶ 123) and the April 10, 2002 analyst reports of Friedman, Billings, Ramsey & Co. and William Blair & Co. (id. ¶ 323) certainly do not provide a basis for these allegations about allegedly illicit actions. The press release merely disclosed reaging statistics, and the reports merely indicated that the data "reflects Household's subprime customer base, which requires more rehabilitation, particularly in tougher economic times." Id. at ¶ 323.

(3) Cost Accounting Allegations

Plaintiffs' allegations regarding cost accounting for Household's credit-card services segment's co-branding, affinity, and marketing agreements are similarly sparse. The Amended Complaint again fails to specify any conduct in furtherance of the alleged "scheme" or provide any specific dates on which the "scheme" was carried out. Instead, the Amended Complaint rests wholly on the fact of the restatement itself and makes legal arguments that the restatement constitutes an admission that GAAP was violated. See id. ¶¶ 142-53. Plaintiffs wholly fail to tie specific aspects of the "scheme," which itself consists of three alleged accounting errors (id. 138), to the myriad quoted statements found in paragraphs 192 through 344 of the Amended Complaint.[9]

[9] Plaintiffs' theory that all of Household's financial statements were rendered materially false or misleading because of the alleged GAAP violation is implausible in view of the insignificance of the amounts involved in the restatement. Calculations based on plaintiffs' own chart (Compl. ¶ 139) reveal that the restatement only reduced earnings per share during the purported class period by the following percentages: .93% for the second quarter 2002; 4.59% for the first quarter 2002; 3.41% for the fourth quarter 2001; 3.7% for the third quarter 2001; 3.2% for the second quarter 2001; 6.6% for the first quarter 2001; 3.8% for the fourth quarter

(footnote continued)

POINT II

THE AMENDED COMPLAINT FAILS TO PLEAD SCIENTER WITH THE PARTICULARITY REQUIRED BY THE PSLRA

The Amended Complaint likewise fails to satisfy the PSLRA's stringent requirements for pleading scienter.[10] This deficiency provides an independent ground for dismissing plaintiffs' Section 10(b) and Rule 10b-5 claim (Count I).

(footnote continued)

2000; 3.2% for the third quarter 2000; 3.75% for the second quarter 2000; 5.1% for the first quarter 2000; 3.9% for the full year 1999; 8.7% for the full year 1998 (includes $751 million after-tax charge related to Beneficial merger, the effect of which was to reduce diluted EPS for the period by $1.27); 3.6% for the full year 1997. Additionally, the cumulative $386 million charge was inconsequential in relation to total common shareholder equity of approximately $7.8 billion and total assets of almost $89 billion. Ex. C, at 14, 16 (Form 10-K/A for 2001).

Misstatements amounting to such de minimus percentages of reported totals, when considered in context, are immaterial as a matter of law. In re Newell Rubbermaid Inc. Sec. Litig., 2000 WL 1705279, at *8 (N.D. Ill. Nov. 14, 2000) (overstatement of income by 10% immaterial as a matter of law; company already experiencing negative performance trend and slight difference could not possibly have been material to reasonable shareholder); Parnes v. Gateway 2000, Inc., 122 F.3d 539, 547 (8th Cir. 1997) (overstatement of assets by 2% of company's total assets immaterial as a matter of law); Shuster v. Symmetricon, Inc., 1997 WL 269490, at *8 (N.D. Cal. Feb. 25, 1997) (overstatement of quarterly revenue by 2% immaterial as a matter of law). The immateriality of the restatement is confirmed by the market's reaction to its disclosure. Household's stock finished up from the prior day on August 14, 2002, the day the restatement was announced. See Compl. ¶ 140; see also In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997) (information disclosed was immaterial as matter of law when it had no effect on company's stock price); Anderson v. Abbott Labs., 140 F. Supp.2d 894, 902 (N.D. Ill.) (market's non-reaction to Bloomberg News disclosure of FDA warning letter showed that letter was immaterial), aff'd without reaching issue sub nom., Gallagher v. Abbott Labs., 269 F.3d 806 (7th Cir. 2001).

[10] Scienter is either the "intent to deceive, manipulate or defraud," Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976), or the "reckless disregard for the truth of the material asserted," whether by act or omission, Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1044 (7th Cir.), cert. denied, 434 U.S. 875 (1977). "Reckless conduct is, at the least, conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious

(footnote continued)

A. The PSLRA Imposes Rigorous Requirements for Pleading Scienter

The PSLRA requires that "the complaint shall, with respect to each act or omission . . . state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (emphasis added). If this requirement is not met, "[t]he court shall" dismiss the complaint. Id. § 78u-4(b)(3)(a). "This language . . . obliterates notice pleading in private securities fraud cases and, by implication, the liberal standards typically used to decide motions to dismiss." Chu v. Sabratek Corp., 100 F. Supp.2d 827, 837 (N.D. Ill. 2000) ("Chu II") (emphasis added).[11] To show reckless or conscious deception, a complaint must plead particularized facts suggesting that a defendant[12] had access to "contradictory crucial information" prior to or contemporaneous with the issuance of an allegedly false or misleading statement. See Kushner v. Beverly Enters., Inc., 317 F.3d

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(footnote continued)

that the defendant must have been aware of it." Rehm v. Eagle Fin. Corp., 954 F. Supp. 1246, 1255 (N.D. Ill. 1997) (internal quotation marks omitted).

[11] See also Kushner v. Beverly Enters., Inc., 317 F.3d 820, 827 (8th Cir. 2003) (to survive motion to dismiss, inferences must be "both reasonable and strong"); Helwig v. Vencor, 251 F.3d 540, 551 (6th Cir. 2001) (same), cert. dismissed, 536 U.S. 935 (2002); In re Rockefeller Ctr. Properties, Inc. Sec. Litig., 311 F.3d 198, 223-24 (3d Cir. 2002) (PSLRA alters inferences plaintiff is entitled to on motion to dismiss); Gompper v. VISX, Inc., 298 F.3d 893, 897 (9th Cir. 2002) (PSLRA requires district courts to consider inferences both favorable and unfavorable to nonmoving party); In re Brightpoint, Inc. Sec. Litig., 2001 WL 395752, at *22 (S.D. Ind. Mar. 29, 2001) (while plaintiff "need not disprove every conceivable rationale a defendant might put forward," if the "facts alleged do not exclude other plausible explanations that would undercut a plaintiff's circumstantial inference of scienter, then that plaintiff's facts cannot be fairly said to raise a 'strong inference' that the defendant acted with the required state of mind").

[12] The PSLRA requires plaintiffs to plead facts giving rise to a strong inference "that a particular defendant made a specific statement with knowledge of its falsity." In re Allscripts, Inc. Sec. Litig., 2001 WL 743411, at *10 (N.D. Ill. June 29, 2001) (emphasis added); see also In re Spyglass, Inc., Sec. Litig., 1999 WL 543197, at *7 (N.D. Ill. July 21, 1999); Holmes v. Baker, 166 F. Supp.2d 1362, 1376 (S.D. Fla. 2001).

820, 829 (8th Cir. 2003); In re Allscripts, Inc. Sec. Litig., 2001 WL 743411, at *11 (N.D. Ill. June 29, 2001). Moreover, plaintiffs cannot create a "strong inference" without pleading "all facts" "in great detail" which form the basis of their allegations about each defendants' mental state, including "adequate corroborating details," the "sources of [their] information," "how [they] learned of the [information]," and "such facts as may indicate their reliability." In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 983, 985 (9th Cir. 1999).[13]

The Seventh Circuit has yet to interpret the "strong inference" standard. Some courts in the Northern District of Illinois have adopted the Second Circuit's approach, under which a plaintiff may meet its burden by alleging either (1) facts showing the defendants had both motive and opportunity to commit fraud, or (2) facts constituting strong circumstantial evidence of conscious misbehavior or recklessness. See, e.g., Fishman v. Meinen, 2003 WL 444223, at *5 (N.D. Ill. Feb. 24, 2003) (Guzman, J.) (collecting cases). A growing number of district courts have eschewed the Second Circuit standard in favor of the fact-specific approach endorsed by the First, Fifth, Sixth, Eighth, Tenth, and Eleventh Circuits. See, e.g., 766347 Ontario Ltd. v. Zurich Capital Mkts. Inc., 2003 WL 164238, at *9 (N.D. Ill. Jan. 23, 2003);

[13] The source of a plaintiff's allegations and that source's reliability are relevant to the scienter inquiry under the PSLRA. See, e.g., Riggs Partners, LLC v. Hub Group, Inc., 2002 WL 31415721, at *7 n.10 (N.D. Ill. Oct. 25, 2002) (discounting allegation related to scienter on ground that the complaint failed to identify its source); In re U.S. Aggregates, Inc. Sec. Litig., 235 F. Supp.2d 1063, 1075 (N.D. Cal. 2002) ("To contribute meaningfully toward a strong inference of scienter, however, allegations attributed to unnamed sources must be accompanied by enough particularized detail to support a reasonable conviction [of] the informant's basis of knowledge."); Holmes,166 F. Supp.2d at 1380-81 (refusing to credit allegation that named defendants "orchestrated" accounting improprieties due to lack of information regarding source of allegation or its reliability); Coates v. Heartland Wireless Communications, Inc., 26 F. Supp.2d 910, 921 (N.D. Tex. 1998) (allegations regarding industry practice insufficient to create strong inference of scienter when complaint "neglect[ed] to identify any source for this alleged practice").

Wafra Leasing Corp. v. Prime Capital Corp., 2002 WL 31664480, at *8 (N.D. Ill. Nov. 26, 2002); Chu v. Sabratek Corp., 100 F. Supp.2d 815, 823 (N.D. Ill. 2000) ("Chu I"); Danis v. USN Communications, Inc., 73 F. Supp.2d 923, 937-38 (N.D. Ill. 1999). Under this approach, motive and opportunity allegations are not necessarily sufficient to establish a strong inference of fraudulent intent. See Kushner, 317 F.3d at 827; Abrams v. Baker Hughes Inc., 292 F.3d 424, 430 (5th Cir. 2002); City of Philadelphia v. Fleming Cos., Inc., 264 F.3d 1245, 1261-62 (10th Cir. 2001); Greebel, 194 F.3d at 196-97; Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1285-86 (11th Cir. 1999); In re: Comsharc, Inc. Sec. Litig., 183 F.3d 542, 551 (6th Cir. 1999).[14] The Amended Complaint fails under either approach.

B. Plaintiffs' "Motive and Opportunity" Allegations Do Not Give Rise to a Strong Inference of Scienter

Plaintiffs allege that the Officer Defendants were motivated to commit fraud because their "annual compensation and incentives were tied to the financial, as well as non-financial, performance of the Company throughout the Class Period" (Compl. ¶ 156(a), 157), and because they wanted to facilitate the Company's access to financing (id. ¶¶ 108, 109).

These allegations are insufficient to establish a motive to commit securities fraud because "were the opposite true, the executives of virtually every corporation in the United States would be subject to fraud allegations." Abrams, 292 F.3d at 434 (executive compensation); accord Kushner, 317 F.3d at 830 (executive compensation); Allscripts, 2001 WL

[14] Even the Second Circuit has retreated from a rigid two-prong test, indicating that "litigants and lower courts need and should not employ or rely on magic words such as 'motive and opportunity.'" Novak v. Kasaks, 216 F.3d 300, 311 (2d Cir. 2000). See also id. at 310 ("we believe that Congress's failure to include language about motive and opportunity suggests that we need not be wedded to these concepts in articulating the prevailing standard").

743411, at *11 (same); Brightpoint, 2001 WL 395752, at *13 (same); Philip Morris Cos., 75 F.3d at 813-14 (desire to maintain a high bond or credit rating insufficient); City of Philadelphia, 264 F.3d at 1269 (debt financing); In re Next Level Sys., Inc., 1999 WL 387446, at *9 (N.D. Ill. Mar. 31, 1999) (same); In re E.Spire Communications, Inc. Sec. Litig., 127 F. Supp.2d 734, 744 (D. Md. 2001) (same).[15]

C. The Amended Complaint Lacks Particularized Allegations Giving Rise to a Strong Inference of Conscious Misbehavior or Recklessness

None of plaintiffs' allegations regarding the alleged undisclosed "schemes" gives rise to a strong inference of conscious misbehavior or recklessness.

(1) "Predatory Lending" Allegations

Plaintiffs' "predatory lending" allegations fit into two categories: first, that Household and the Officer Defendants committed securities fraud, apparently throughout the class period, by failing to disclose the allegedly abusive lending practices or treat them as giving rise to a contingent liability; second, that Household and the Officer Defendants falsely played down these alleged practices in the face of legal and regulatory challenges in early 2002. With respect to both categories, the Amended Complaint's allegations fail to create a strong inference

[15] With respect to the "financing" motive, a strikingly similar allegation was flatly rejected in Mortensen v. AmeriCredit Corp., 123 F. Supp.2d 1018 (N.D. Tex.), aff'd, 240 F.3d 1073 (5th Cir. 2000). There, investors sued a corporation whose primary business was securitizing automobile receivables. The plaintiffs alleged that the company manipulated the delinquency rates in its portfolio by granting "deferrals," id. at 1022, and that the defendants did this in order "to giv[e] the false impression that the Company's loans were more secure than they were" so as to "allow[] the Company to borrow against the loans that had been deferred, instead of being declared delinquent," id. at 1023. The court rejected this proffered motive as an "unsupported, generalized allegation of motive that is insufficient as a matter of law" and concluded that the plaintiffs had "failed to plead scienter based on a motive to commit securities fraud." Id. at 1024.

that any of the Officer Defendants, and thus Household,[16] knowingly or recklessly made any false or misleading public statement.

"[T]o establish scienter in a securities fraud case alleging non-disclosure of potentially material facts, the plaintiff must demonstrate: (1) the defendant knew of the potentially material fact, and (2) the defendant knew that failure to reveal the potentially material fact would likely mislead investors." City of Philadelphia, 264 F.3d at 1261 (emphasis added); see also Schlifke v. Seafirst Corp., 866 F.2d 935, 946 (7th Cir. 1989) ("[I]t is the danger of misleading buyers [that] must be actually known or so obvious that any reasonable man would be legally bound as knowing."). "The requirement of knowledge in this context may be satisfied under a recklessness standard by the defendant's knowledge of a fact that was so obviously material that the defendant must have been aware both of its materiality and that its non-disclosure would likely mislead investors." City of Philadelphia, 264 F.3d at 1261. The Amended Complaint fails to satisfy either prong.

The Amended Complaint fails to show that any "defendant knew of the potentially material fact." The Amended Complaint alleges no particular information regarding the so-called "predatory lending" practices that came to the attention of any particular defendant at any particular time during the putative class period. Rather, plaintiffs' allegations regarding the "predatory lending" practices speak in terms of what "Household," "HFC," "loan officers,"

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16 Household's scienter, if any, is derivative of the scienter of its senior management. See Nordstrom, Inc. v. Chubb & Son, Inc., 54 F.3d 1424, 1435 (9th Cir. 1995) (corporate scienter is derivative of scienter of officers and directors; no case law supports a theory of "collective scienter"); Holmes v. Baker, 166 F. Supp.2d 1362, 1376 (S.D. Fla. 2001) ("The scienter of a corporation's officers may be imputed to the corporation itself under general agency and corporate law principles.").

and "branch managers" did. See Compl. ¶¶ 51-106. Among these allegations about what other people did, the Amended Complaint attempts to allege that the Officer Defendants participated in, authorized, or condoned the alleged "predatory" lending practices. See id. ¶¶ 54, 59, 70, 72, 83, 90, 94-96. For several reasons, these allegations provide none of the detail required by the PSLRA.

First, plaintiffs fail to provide any corroborative details, such as the "sources of [their] information," "how [they] learned of the [information]," and "such facts as may indicate their reliability," Silicon Graphics, 183 F.3d at 983, 985, for any of their allegations regarding the Officer Defendants' purported participation in or authorization of the alleged practices.

Second, broad allegations regarding instructions and training emanating from "corporate headquarters" (id. ¶¶ 54, 59) or "Household" (id. ¶ 70) provide no specifics regarding which defendants participated, what they did, and when they did it. See Kushner, 317 F.3d at 827 ("blanket assertion" that "the defendants designed and implemented the policies of improper allocation of nursing costs" held insufficient to "demonstrat[e] how the defendants knew of the scheme at the time they made their statements of compliance, that they knew the financial statements overrepresented the company's true earnings, or that they were aware of a GAAP violation and disregarded it"). Without any information about when this alleged training or instruction occurred, it is impossible to measure the alleged participation or guilty knowledge of any defendant against any particular public statement. See Allscripts, 2001 WL 743411, at *11; In re Allied Prods. Corp., Inc. Sec. Litig., 2000 WL 1738333, at *4 (N.D. Ill. Mar. 13, 2000) (PSLRA's requirement of pleading scienter with respect to each alleged misrepresentation or omission required dismissal where the plaintiffs "fail[ed] to link each alleged fraudulent

statement with particular facts that would indicate that the Defendants knew better at the time the statement was made").[17]

Third, plaintiffs cannot establish guilty knowledge through generic allegations based upon the Officer Defendants' positions within Household, their "hands-on" management style, or their access to unspecified internal reports or proprietary information. See Compl. ¶¶ 38-41, 165-67, 196, 217, 242, 267, 271, 281, 302, 318, 331, 342. These allegations fail to specify what information regarding the alleged practices was obtained, when it was obtained, or by whom. See, e.g., Abrams, 292 F.3d at 432; In re Vantive Corp. Sec. Litig., 283 F.3d 1079, 1087-88 (9th Cir. 2002); City of Philadelphia, 264 F.3d at 1264; Silicon Graphics, 183 F.3d at 984, 985; In re Advanta Corp. Sec. Litig., 180 F.3d 525, 539 (3d Cir. 1999); Allscripts, 2001 WL

[17] Even plaintiffs' seemingly more specific allegations fail to provide the essential details necessary to give rise to a strong inference of scienter. Plaintiffs seek to impute knowledge of the so-called "predatory lending" practices to the Officer Defendants by alleging that Mr. Aldinger received a letter on January 23, 2001 that indicated that "HFC and Beneficial were engaged in a pervasive predatory lending pattern." Compl. ¶ 83. While this allegation indicates the recipient and date, plaintiffs fail to specify the sender, the content of the letter (beyond plaintiffs' conclusory characterization of it), or any facts suggesting that Mr. Aldinger should have deemed it reliable. See, e.g., In re Sunterra Corp. Sec. Litig., 199 F. Supp.2d 1308, 1325, 1328 (M.D. Fla. 2002) (e-mails from unnamed source failed to raise inference of scienter; complaint failed to describe "the content of the message, who sent it, when it was sent, or why it was reliable").

Likewise, plaintiffs' allegations regarding Southwest Division Manager Hueman's creation and implementation of the EZ Pay "presentation" or "pitch"(Compl. ¶¶ 94-96) fall short. Plaintiffs do not allege that Hueman brought the EZ Pay "effective rate" pitch to any particular defendants' attention: in fact, plaintiffs allege that Hueman "confirmed misleadingly" (i.e., he lied) that he had received approval from Mr. Aldinger for this pitch. Id. ¶ 95. Moreover, from the naked allegation that Mr. Gilmore oversaw the update of a training manual that contained the EZ Pay presentation, it does not follow that the presentation came to his attention, and plaintiffs do not so allege. See, e.g., In re Galileo Corp. Sh. Litig., 127 F. Supp.2d 251, 263-64 (D. Mass. 2001) (allegation that officer had "regular contacts" with company that was experiencing extreme economic difficulties lacked "essential detail" necessary to give rise to strong inference that he had knowledge of the company's serious financial condition).

743411, at *11; cf. Arazic v. Mullane, 2 F.3d 1456, 1467 (7th Cir. 1993) (plaintiffs failed to allege that defendants' predictions lacked reasonable basis when plaintiffs' allegations regarding unreleased internal information failed to indicate "who prepared the projected figures, when they were prepared, how firm the numbers were, or which [company] officers reviewed them"). Plaintiffs' emphasis on Household's "sophisticated" technology (Compl. ¶ 12) and its ability to provide "real-time" information (id. ¶ 111) and "centralize decision-making throughout the loan process" (id. ¶ 167) does not change the analysis. See, e.g., Coble v. Broadvision Inc., 2002 WL 31093589, at *10 (N.D. Cal. Sept. 11, 2002) (allegations that "[d]efendants had real-time information as to the Company's sales performance and prospects using Salesforce.com, a website through which BroadVision employees updated their sales information each week," insufficient to support claim that "officers knew that their statements were false at the time they were made").

Finally, in any event, the Amended Complaint fails to allege facts indicating that the Officer Defendants knew that these practices were material or that any contingent liability was sufficiently certain so as to require disclosure when any particular statement was made. See City of Philadelphia, 264 F.3d at 1265 (even if facts established that defendants had knowledge of pending litigation, complaint alleged "no particular facts on which this court could conclude that Defendants 'must' have known the [litigation] was meritorious, or that the damage award would be substantial, at the time Defendants decided not to explicitly disclose the lawsuits in its SEC filings and Annual Reports"). As explained in Point I.B.1, the untested allegations of the WA Report and some civil lawsuits and the fact of the A.G. Settlement do not even establish that the alleged practices were illegal or widespread, much less that the Officer Defendants knew

them to be so and were capable of estimating a contingent liability at any specific time during the five-year class period.

Plaintiffs' misrepresentation claim based on statements made after regulatory concerns arose in early 2002 fare no better. Plaintiffs claim that defendants' statements in 2002 "downplayed[ed]" the likelihood of liability (Compl. ¶¶ 84, 87), maintained that the alleged violations in Bellingham were isolated occurrences (id. ¶¶ 86, 330, 341), and otherwise falsely asserted that HFC and Household had meritorious defenses to the claims made against them (See id. ¶¶ 317, 320-21, 334, 340). In other words, plaintiffs complain that the Company falsely denied the validity of claims of wrongdoing that have never been determined to be meritorious. Plaintiffs plead no fact suggesting that information came to the attention of the Officer Defendants that caused or should have caused them to know that the Company's denials of liability were unjustified.

If plaintiffs' allegations were sufficient here, then every time a company is subjected to regulatory enforcement proceedings or civil lawsuits, its officers would face the Hobson's choice of either immediately admitting wrongdoing, regardless of their belief in the merits of the company's defense, or facing a securities fraud suit based on their denial of the validity of their adversaries' claims. This is not and should not be the law. See Anderson v. Abbott Labs., 140 F. Supp.2d 894, 906-07 (N.D. Ill. 2001) (company's "maintenance of its innocence is not fraud"; no duty to "confess contested charges" when disputed in good faith), aff'd without reaching issue sub nom., Gallagher v. Abbott Labs., 269 F.3d 806 (7th Cir. 2001).[18]

[18] The Amended Complaint also relies on statements regarding Household's general compliance with the law and with GAAP, apparently in regard to the "predatory lending"

(footnote continued)

(2) Reaging Allegations

Plaintiffs attempt to show guilty knowledge with respect to the alleged reaging "scheme" by asserting in conclusory fashion that the Officer Defendants themselves implemented the scheme. Compl. ¶¶ 109, 110, 113, 117, 121. For example, plaintiffs allege that the Officer Defendants "established procedures whereby accounts were reaged arbitrarily" (Compl. ¶ 110) and "caused Household to violate its own policies and reage accounts at any level of delinquency" (id. ¶ 117). The Amended Complaint contains no further allegation regarding which defendants participated, what they did, and when they did it. This sort of blanket assertion of wrongdoing, lacking any underlying factual detail, is insufficient. See, e.g., Kushner, 317 F.3d at 827; Mortensen v. AmeriCredit Corp., 123 F. Supp.2d 1018, 1027 (N.D. Tex.), aff'd, 240 F.3d 1073 (5th Cir. 2000); In re Sunterra Corp. Sec. Litig., 199 F. Supp.2d 1308, 1329-1330 (M.D. Fla. 2002).

For instance, in Kushner, the plaintiffs alleged that senior management caused Beverly, an operator of health care facilities, to engage in a fraudulent Medicare reimbursement scheme. 317 F.3d at 824-25. In affirming the district court's dismissal of the plaintiffs' Section 10(b) and Rule 10b-5 claim, the appellate court flatly rejected the plaintiffs' "blanket assertion"

(footnote continued)

allegations, as well as the reaging and cost accounting allegations. See, e.g., Compl. ¶¶ 194, 200, 206, 212, 215, 225, 231, 235, 239, 248, 254, 260, 266, 277, 280, 288, 292, 299, 313, 328, 365-67, 369. These statements merely convey management's opinion or belief regarding the legality of the company's actions, and as such are actionable only if made without a reasonable basis. See Kushner, 317 F.3d at 831. "Absent a clear allegation that the defendants knew of the scheme and its illegal nature at the time they stated the belief that the company was in compliance with the law, there is nothing further to disclose. The fact that a defendant's belief or opinion later 'prove[s] to be wrong in hindsight does not render the statements untrue when made.'" Id. (quoting In re Syntex Corp. Sec. Litig., 95 F.3d 922, 934 (9th Cir. 1996)).

that "the defendants designed and implemented the policies of improper allocation of nursing costs." Id. at 827. It did so because there were no "particular facts demonstrating how the defendants knew of the scheme at the time they made their statements of compliance, [or] knew the financial statements overrepresented the company's true earnings, or that they were aware of a GAAP violation and disregarded it." Id. at 827 (emphasis added).

Similarly, in Mortensen, the plaintiffs alleged that "[d]efendants intentionally manipulated the delinquency rate [for the company's automobile receivables] by granting deferrals which were not in accordance with stated Company guidelines and which were made without the customer's knowledge and by manipulating the reporting of vehicle repossessions." 123 F. Supp.2d at 1027. The court granted the defendants' motion to dismiss, concluding that the plaintiffs' "rote and conclusory allegations that AmeriCredit acted with conscious or reckless intent are insufficient to plead scienter." Id.

Plaintiffs' allegations are also insufficient because they fail to provide any corroborative details regarding their sources for these allegations or the reliability of those sources. See Silicon Graphics, 183 F.3d at 983, 985. As explained in Point I.B.2, plaintiffs' citation to Household's April 9, 2002 press release (Compl. ¶ 124) and the April 10, 2002 analyst reports of Friedman, Billings, Ramsey & Co. and William Blair & Co. (id. ¶ 323) certainly do not provide a basis for their allegations regarding internal policy violations or the implementation of "arbitrary" procedures.

Disregarding plaintiffs' conclusory allegations, as well as their generic allegations concerning defendants' positions, "hands-on" management style, and access to the Vision system discussed above, supra Point II.C.1, plaintiffs are left with nothing but an allegation that reaging

violated GAAP. The law is clear, however, that a GAAP violation, standing alone, is insufficient to give rise to a strong inference of scienter. Kushner, 317 F.3d at 831; Abrams, 292 F.3d at 432; Novak v. Kasaks, 216 F.3d 300, 309 (2d Cir.), cert. denied, 531 U.S. 1012 (2000); Comshare, 183 F.3d at 553.

(3) Cost Accounting Allegations

The substantive allegations regarding the cost accounting "scheme" speak almost exclusively in terms of what "Household" did wrong. See Compl. ¶¶ 134-41. The only attempt to connect any of the Officer Defendants to the cost accounting errors is as follows:

> Defendants caused the Company to falsely report its financial results by improperly accounting for its: (a) co-branding agreements, (b) exclusive affinity agreements, and (c) third-party credit card marketing agreements. As a result of the improper accounting for the above, defendants caused Household to overstate its finance income, securitization income and fee income and misstate certain of its expenses, resulting in an overstatement of net income throughout the Class Period.

Id. ¶ 137 (emphasis added). There is not one underlying factual allegation offered to support this conclusory allegation. There is no explanation of how any particular defendant "caused" the GAAP violations to occur -- nor is there even an approximate date on which any one of the defendants took any specific action. See, e.g., In re Pac. Gateway Exch., Inc. Sec. Litig., 169 F. Supp.2d 1160, 1167 (N.D. Cal. 2001) (allegation that company "impaired" its bandwidth assets by selling them but not "reducing the carrying cost of the asset[s] on the balance sheet for the estimated cost of the impairment" failed to give rise to inference of scienter because plaintiffs failed to, inter alia, "indicate how or when each defendant became aware of the allegedly improper accounting practices, []or the extent of each defendant's contribution or involvement") (emphasis added). As noted above, plaintiffs cannot rely on the Officer Defendants' positions within Household, or their access to unspecified corporate reports and information to infer guilty

knowledge. See Point II.C.1. And again, plaintiffs provide not a single corroborating detail, such as the source for this broad, conclusory allegation of wrongdoing or any indicia of that source's reliability.

Nor are any facts alleged that would show that the restatement resulted from anything other than a difference of opinion between Household's auditors. The Amended Complaint acknowledges that Household revised its accounting treatment of these agreements based upon a comprehensive review by its new auditors (Compl. ¶ 134), and the August 14, 2002 press release, relied upon by plaintiffs in the Amended Complaint (id. ¶¶ 134, 136, 336), explained that "[t]hese matters relate to accounting for complex co-branded, affinity, and credit card marketing agreements, which were discussed with, and approved by, our prior auditors. It clearly is a good-faith difference of opinion." Ex. B. Plaintiffs allege not a single fact to call into question this facially reasonable explanation. See Allscripts, 2001 WL 743411, at *11 ("it is difficult to build inferences of scienter upon accounting errors because such errors often involve complex calculations about which reasonable people can differ in opinion.").

Instead, all plaintiffs can muster is the restatement itself. As with GAAP violations in general, this is plainly insufficient. Comshare, 183 F.3d at 553 ("[P]laintiffs' claim that a subsequent revelation of the falsehood of previous statements implies scienter lacks merit, since '[m]ere allegations that statements in one report should have been made in earlier reports do not make out a claim of securities fraud.'");[19] cf. Goldberg v. Household Bank, F.S.B., 890 F.2d 965, 967 (7th Cir. 1989) ("[r]estatements of earnings are common"). Moreover, the size of

[19] See also Galileo Corp., 127 F. Supp.2d at 270; In re E.Spire Communications, Inc. Sec. Litig., 127 F. Supp.2d 734, 745 (D. Md. 2001).

the restatement here militates against an inference of scienter. The $386 million covered by the restatement relates to an eight-year period and pales into insignificance when measured against Household's total assets, shareholder equity, net income and earnings per share for the relevant time periods.[20] Thus, the circumstances of this small restatement relating to complex accounting issues regarding just one of the many aspects of Household's business give rise to no inference of scienter.[21]

POINT III

STATEMENTS ALLEGED TO BE FALSE OR MISLEADING ARE NOT ACTIONABLE ON OTHER GROUNDS

Many of the statements alleged to be false or misleading cannot provide a basis for liability in Count I.[22] These include statements quoted from analyst reports, vague statements

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20 See supra note 9.

21 Compare Greebel, 194 F.3d at 206 (allegations of improper recognition of $416,000 to $1.55 million in revenue for third quarter, when viewed in context of $37.1 million in overall revenue for quarter, did not support strong inference of scienter); Allscripts, 2001 WL 743411, at *11 ("The small magnitude of the error [and] the Company's prompt acknowledgment of the error, [inter alia,] militate against an inference of scienter in this case."); In re SCB Computer Tech., Inc., Sec. Litig., 149 F. Supp.2d 334, 351 (W.D. Tenn. 2001) (size of restatement and lack of "allegations that either the PRI or the Quest contract was a major contract upon which the company's entire financial statement rested" cut against inference of scienter); E.Spire, 127 F. Supp.2d at 747 (size of restatement militated against inference of scienter when it amounted to only 3.7% of the company's third quarter 1999 revenues and less than 1% of its revenues for the entire year), with In re Microstrategy, Inc. Sec. Litig., 115 F. Supp.2d 620, 636 (E.D. Va. 2000) (circumstances surrounding GAAP violation contributed to inference of scienter when, inter alia, accounting errors led to shifting from a reported net income of $18.9 million to a net loss of more than $36 million for the period); Rehm, 954 F. Supp. at 1255-56 (circumstances surrounding GAAP violation contributed to strong inference of scienter when, inter alia, accounting violations led to shifting from reported yearly earnings of $3.530 million to $325,000 and accounting problem pertained to the "defining characteristic" of the company's business).

22 These arguments also apply to plaintiffs' Sections 11 and 12(a)(2) claims to the extent their allegations rest upon the same statements.

of optimism that amount to "puffery," and forward-looking statements that fall within the PSLRA's safe harbor.

A. Defendants Are Not Liable for Statements by Analysts and Other Third Parties

Plaintiffs seek to hold defendants liable for a multitude of statements by analysts or other third parties. See Compl. ¶¶ 193, 195, 198, 203, 205, 213, 216, 220, 222, 228, 230, 234, 236, 251, 255, 256, 257, 259, 261, 265, 270, 274, 275, 280, 284, 291, 294, 296, 297, 300, 301, 303, 304, 306, 317, 320, 323, 327, 329, 330, 335, 337, 339, 340. There are two theories under which a defendant may be liable for such statements under the securities laws: if the defendant (a) endorsed the analyst's statement or was otherwise entangled with its production, see Cooper v. Pickett, 137 F.3d 616, 624 (9th Cir. 1997); Elkind v. Liggett & Meyers, Inc., 635 F.2d 156, 163 (2d Cir. 1980), or (b) "made false and misleading statements to securities analysts with the intent that the analysts communicate those statements to the market," Cooper, 137 F.3d at 624; In re Time Warner Inc. Sec. Litig., 9 F.3d 259, 264 (2d Cir. 1993), cert. denied, 511 U.S. 1017 (1994). Plaintiffs have failed to plead facts sufficient to support a finding of liability under either theory.

Under the "entanglement" theory, "a defendant is sufficiently entangled when he has reviewed the analysts' forecasts, and by his activity, made an implied representation that the information is true or at least in accordance with the company's views." Wenger v. Lumisys, Inc., 2 F. Supp.2d 1231, 1249 (N.D. Cal. 1998). "The complaint must allege a two-way flow of information between the analyst and the insider, such as review and approval of the report by the insider." In re Harmonic, Inc. Sec. Litig., 163 F. Supp.2d 1079, 1095 (N.D. Cal. 2001); see Elkind, 635 F.2d at 163 (company may become responsible for third-party projections and

reports if it involves itself in the preparation of those reports). Here, plaintiffs allege no facts indicating that anyone at Household endorsed, adopted, or otherwise placed their imprimatur on the statements quoted in analyst reports and other third-party sources.[23] At best, plaintiffs allege "a one-way flow of information from [the company's] representatives to analysts and from the analysts to their customers." Harmonic, 163 F. Supp.2d at 1095-96.

Under the "transmission" theory, the relevant statement is the defendant's false or misleading statement to the analyst. Accordingly, "a plaintiff cannot meet the requirements of the PSLRA and Rule 9(b) merely by pleading the specific time, place, and contents of the misleading statements by a specifically identified analyst." Barrie v. InterVoice-Brite, Inc., 2002 WL 1841631, at *3 (N.D. Tex. Aug. 8, 2002). Rather, the plaintiff (a) "must at least identify the defendant who provided the information that the third party made public to the market," Capstead Mortgage, 2003 WL 1813837, at *19; accord Time Warner, 9 F.3d at 265; Barrie, 2002 WL 1841631, at *4; In re Visual Networks, Inc. Sec. Litig., 217 F. Supp.2d 662, 668 (D. Md. 2002), and (b) identify the allegedly false or misleading statement made to the analyst and explain why it was false and misleading when made, 15 U.S.C. § 78u-4(b)(1); In re Pinnacle Sys., Inc. Sec. Litig., 2002 WL 31655187, at *2 (N.D. Cal. Nov. 18, 2002); see also Suna v. Bailey Corp., 107 F.3d 64, 73-74 (1st Cir.1997) (reliance on statements in analyst reports did not

[23] A number of analyst statements quoted in the Amended Complaint can only conceivably be actionable under the entanglement theory, because they obviously represent the opinion of the analyst and do not purport to relay statements or information provided by Household or the Officer Defendants. See Compl. ¶¶ 193 (part of block quote), 195 (part of block quote), 203 (part of Gomberg block quote), 213 (part of block quote), 216 (part of block quote), 222 (part of block quote), 230, 236 (part of Deutsche Banc block quote), 251 (part of Deutsche Banc block quote; part of ABN AMRO block quote; part of Freidman, Billings block quote), 257, 261 (part of block quote), 265 (ABN AMRO), 274, 284 (part of ABN AMRO block quote; part of Legg Mason block quote), 296 (part of block quote), 297 (part of block quote), 300, 327, 335.

satisfy Rule 9(b) because it "failed to identify the statements made by [the defendant] or describe how those statements were false or misleading").

The Amended Complaint lacks sufficient information to determine which of the Officer Defendants supposedly provided the information that was allegedly relayed to the public by analysts or other third parties. Instead, plaintiffs often allege only that "senior management" or "defendants" or groups of defendants met with analysts, without specifying who made any particular statement. Furthermore, plaintiffs fail to identify the content of the alleged misrepresentations. Instead, they merely quote analyst statements that paraphrase information allegedly provided to the authors. See, e.g., Compl. ¶¶ 193, 198, 205, 216, 220, 222, 228, 234, 236, 251, 255, 257, 265, 270, 284, 291, 296, 297, 300, 306, 320, 323, 327, 335, 337. This lack of specificity is lethal to plaintiffs' claims. See Time Warner, 9 F.3d at 264-65; Capstead Mortgage, 2003 WL 1813837, at *19; Pinnacle Sys., 2002 WL 31655187, at *2; Visual Networks, 217 F. Supp.2d at 668; Barrie, 2002 WL 1841631, at *4; Harmonic, 163 F. Supp.2d at 1096; In re Splash Tech. Holdings, Inc. Sec. Litig., 2000 WL 1727377, at *18 (N.D. Cal. Sept. 29, 2000); see also Nursing Home Pension Fund v. Oracle Corp., 242 F. Supp.2d 671, 680 (N.D. Cal. 2002) (paraphrased statements in analyst reports of what defendants allegedly said not actionable); Wenger, 2 F. Supp.2d at 1246-47 (paraphrased statements did not comply with Rule 9(b) because they failed to allege what defendants actually said).[24]

[24] Defendants are aware that certain district courts in the Northern District of Illinois have taken a different approach. See In re Newell Rubbermaid Inc. Sec. Litig., 2000 WL 1705279, at *13-14 (N.D. Ill. Nov. 14, 2000); In re Westell Techs., Inc. Sec. Litig., 2001 WL 1313785, at *9 (N.D. Ill. Oct. 26, 2001). Defendants respectfully submit that these decisions are inconsistent with the enhanced pleading requirements of the PSLRA. By accepting allegations that "management" was the source of the alleged misrepresentations to analysts, these courts essentially adopted an expanded version of the group pleading doctrine. As discussed in Point

(footnote continued)

In fact, the Amended Complaint attributes many of the statements from analyst reports and other third-party sources to persons other than the Officer Defendants. Compl. ¶¶ 256 (conference call with Ken Harvey), 280 (quoting Craig Streem), 294, 303 (both quoting Craig Streem), 317, 329 (both quoting Ms. Hayden and Mr. Streem), 330, 339 (quoting or paraphrasing Ms. Hayden). The Amended Complaint alleges no fact that would indicate that any Officer Defendant should be held responsible for these statements.

B. Various Statements Quoted in the Amended Complaint Are Non-Actionable Puffery

"Mere . . . puffery is not actionable under Rule 10b-5." Eisenstadt v. Centel Corp., 113 F.3d 738, 746 (7th Cir. 1997). The "lack of specificity" in vague statements of optimism "precludes [them] from being deemed material; [the statements] contain[] no useful information upon which a reasonable investor would base a decision to invest." Searls v. Glasser, 64 F.3d 1061, 1066 (7th Cir. 1995). For example, "indefinite predictions of growth," and descriptions of a company as "recession-resistant," constitute non-actionable puffery because they "lack[] the requisite specificity to be considered anything but optimistic rhetoric." Id. So, too, are a company's statements that "it was 'optimistic' about its earnings and 'expected' [a key product] to perform well," Philip Morris Cos., Inc., 75 F.3d at 811, or that a company is "very healthy" or that business is "basically on track" or going "reasonably well,"

(footnote continued)

VI, the better-reasoned view is that this doctrine did not survive enactment of the PSLRA. Moreover, the group pleading doctrine does not apply to oral statements, which is precisely the type of statement allegedly made to analysts here. See In re Enron Corp. Sec., Derivative & ERISA Litig., 2003 WL 230688, at *4 n.8 (S.D. Tex. Jan. 28, 2003). In any event, Newell and Westell relied heavily on the plaintiffs' lack of access to information regarding who made the misleading statements. Here, plaintiffs' allegations suggest that many of the statements were made at public events.

Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1219 (1st Cir. 1996). This rule is "especially robust in cases involving fraud-on-the-market theory of liability" — such as this one — because "[t]he market is not so easily duped." Id. at 1218. "This is particularly so with respect to the securities of an actively traded and closely followed company" like Household. Id.

The myriad block quotes in the Amended Complaint are laced with vague statements of optimism. For example, plaintiffs cite a January 19, 2000 press release, which quotes Mr. Aldinger as stating that "[w]e move into the new year with a real sense of excitement, great momentum throughout the company and strong competitive positions in each of our businesses." Compl. ¶ 243. Similarly, plaintiffs repeatedly quote analyst reports indicating that "management conveyed a positive tone," "management appears optimistic," and the like. See, e.g., Compl. ¶¶ 193, 203, 205, 236, 270, 296.[25] None of these statements is actionable.

C. Numerous Statements Are Forward-Looking Statements Protected By the PSLRA's Safe Harbor

The PSLRA provides a safe harbor from liability for forward-looking statements. 15 U.S.C. § 78u-5(c). A forward-looking statement is not actionable if (1) it is identified as forward-looking and accompanied by meaningful cautionary language, or (2) the plaintiff fails to establish that the statement was made with actual knowledge of its falsity. Id. § 78u-5(c)(1); see also id. § 77z-2(c)(1). A number of statements alleged to be false and misleading fall squarely within this safe harbor. Forward-looking statements include projections of revenues,

[25] See also Compl. ¶¶ 197 ("We expect both acquisitions to contribute to another record year in 1998"), 209 ("I am really excited about the company's prospects. The Beneficial acquisition strengthens many of our key businesses, provides significant opportunities to improve efficiency and gives us a platform for additional revenue growth."), 220 ("[T]he outlook for growth looks strong. The consumer finance operation is doing better than anticipated"), 223, 229, 233, 236, 237, 251, 261, 275, 284, 285, 289, 297, 303 (parts of block quotes).

income, earnings, statements of plans and objectives for future operations, statements of future economic performance, and statements of assumptions underlying any of these. Id. § 78u-5(i)(1). Additionally, numerous courts have held statements of guidance and comfort with analyst expectations to be forward-looking, both before and after the enactment of the PSLRA. See, e.g., In re HealthCare Compare Corp. Sec. Litig., 75 F.3d 276, 281-82 (7th Cir. 1996) (treating statements of comfort with analyst predictions regarding earnings as forward-looking); Grassi v. Info. Res., Inc., 63 F.3d 596, 599 (7th Cir. 1995) (treating statements of projected earnings per share as projections requiring a showing of lack of reasonable basis); In re: Advanta Corp. Sec. Litig., 180 F.3d 525, 536 (3d Cir. 1999) (statement that "[o]ver the next six months Advanta will experience a large increase in revenues" "clearly qualifie[d]" as forward-looking). Furthermore, "a statement about the state of a company whose truth or falsity is discernible only after it is made necessarily refers to future performance" and is thus forward-looking. Harris v. Ivax Corp., 182 F.3d 799, 805 (11th Cir. 1999) (emphasis added).

The Amended Complaint is rife with statements of guidance, comfort, and predictions of future performance.[26] For example, the prediction on April 22, 1999 that the Company was "on track" to meet its earnings and growth targets (Compl. ¶ 229) was a statement

[26] See Compl. ¶¶ 197 (predicting that 1998 would be a "another record year"), 209 (explaining expected benefits of Beneficial merger), 229 ("we are on track to meet our earnings and growth targets"), 233 ("we have excellent momentum"), 237 (confidence in goals), 243 (same), 243 ("sense of excitement" and "great momentum" for coming year), 252 (comfort with growth targets), 258 (same), 263 (same), 272 ("We have built a powerful franchise that is capable of delivering 13 to 15 percent annual earnings per share."), 285 (comfort with growth targets), 289 (stating that company is "positioned . . . well to achieve another record year in 2001"), 298 (confidence in earnings growth), 311 (same), 324 (comfort with 13 to 15 percent earnings projections), 333 ("well positioned" for remainder of year), 336 (businesses "well-positioned for the remainder of the year"; restatement not expected to have "any significant impact on our future results of operation").

of future performance, the truth of which was discernible only after it was made. Similarly, Mr. Aldinger's statement in a July 19, 2000 press release that management was "comfortable in our ability to achieve our 15 percent EPS growth target for 2000" (id. ¶ 258) was a statement of comfort with analysts' financial predictions. The Amended Complaint also relies upon analyst reports of the company's earnings projections and guidance for the future.[27]

The Company's forward-looking statements were accompanied by appropriate cautionary language. Each press release specifically warns that it contains estimates and projections that may be forward-looking in nature and that a variety of factors may cause actual results to differ materially from the results discussed; each then refers the reader to a Household SEC filing for a detailed description of these factors.[28] These filings contain detailed cautionary statements.[29] Courts have approved the reference to other documents (such as SEC filings) as providing adequate cautionary detail. See, e.g., Grossman v. Novell, 120 F.3d 1112, 1122-24 (10th Cir. 1997); In re S1 Corp. Sec. Litig., 173 F. Supp.2d 1334, 1353-55 (N.D. Ga. 2001).[30]

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[27] See Compl. ¶¶ 195, 198, 203, 205, 213, 220, 228, 234, 236, 251, 261, 265, 270, 275, 283, 284, 291, 296, 297, 304, 323, 340.

[28] Attached as group exhibits are copies of the relevant press releases along with the cautionary language from the referenced Household SEC filings. Exs. D-1 to D-2, E-1 to E-5, F-1 to F-5, G-1 to G-5, H-1 to H-3, I-1 to I-2.

[29] The PSLRA safe harbor does not require defendants to specify each and every risk that might adversely affect their predictions. Indeed, defendants' cautionary language need not even "explicitly mention the factor that ultimately belies a forward-looking statement." Harris, 182 F.3d at 807. Rather, "[d]efendants must identify significant factors that may cause results to materially differ — but not all factors." Rasheedi v. Cree Research, Inc., 1997 WL 785720, at *2 (M.D.N.C. Oct. 17, 1997).

[30] The Amended Complaint also quotes a forward-looking statement from Household's Form 10-K for the year ended December 31, 1999, Compl. ¶ 246 (indicating that favorable trends are expected to continue), which was accompanied by cautionary language in that

(footnote continued)

In any event, the Amended Complaint fails to allege particular facts indicating that any of the defendants' forward-looking statements were made with actual knowledge of their falsity. The actual knowledge standard is more demanding than the recklessness standard applicable to false or misleading statements of fact. See Greebel, 194 F.3d at 201 (holding that PSLRA did not abolish recklessness standard for ordinary misstatements or omissions based in part on PSLRA's explicit designation of more demanding "actual knowledge" standard for forward-looking statements). As explained in Point II, the Amended Complaint fails to create a strong inference that any defendant was reckless with respect to the falsity of any of the alleged misstatements or omissions. A fortiori, plaintiffs have failed to meet this higher standard with respect to the forward-looking statements.

POINT IV

PLAINTIFFS' SECTIONS 11 AND 12(a)(2) CLAIMS SHOULD BE DISMISSED

Plaintiffs' Sections 11 and 12(a)(2) claims (Counts III and IV) are premised on many of the same allegations that form the basis of their Section 10(b) and Rule 10b-5 claim in Count I, albeit plaintiffs state that the claims do not sound in fraud. Even so, a plaintiff proceeding under Sections 11 and 12(a)(2) must plead facts demonstrating that the challenged statements were false when made. See 15 U.S.C. 77k(a); 15 U.S.C. § 77l(a)(2); Castlerock

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(footnote continued)

document. See Ex. E-5. Additionally, plaintiffs quote forward-looking statements from a July 17, 2002 conference call. Compl. ¶ 334 (discussing probable impact of changes in lending laws and lawsuits). The conference call transcript (Ex. J) reveals that participants were warned that the presentation would involve forward-looking statements and were referred to Household's recent SEC filings for a detailed discussion of cautionary factors. See Exs. H-3, I-2.

Mgmt. Ltd. v. Ultralife Batteries, Inc., 114 F. Supp.2d 316, 323-25 & n.5 (D.N.J. 2000) (dismissing Sections 11 and 12(a)(2) claims and explicitly rejecting plaintiffs' argument that they need not plead "contemporaneous facts" demonstrating falsity; "That liability cannot be imposed upon the basis solely of subsequent events is no less the case when a plaintiff proceeds under a negligence theory"). Accordingly, to the extent plaintiffs have failed to do so, as demonstrated in Point I, with respect to the alleged misstatements that are the bases of their Sections 11 and 12(a)(2) claims, those claims must be dismissed.

Plaintiffs' Sections 11 and 12(2) claims suffer from other infirmities. Their claims based on the Beneficial Registration Statement and two Debt Registration statements from 1999 should be dismissed as time-barred. Their Beneficial Registration Statement claims should also be dismissed because on the face of the pleadings there is no loss causation.

A. Plaintiffs' Claims Regarding the Beneficial Registration Statement and the 1999 Debt Registration Statements Are Time-Barred

Plaintiffs' Sections 11 and 12(a)(2) claims based on the Beneficial Registration Statement (Count III) and their Section 11 claim based on the February and July 1999 Debt Registration Statements (in Count IV) should be dismissed because they were not filed within the applicable statute of limitations. Under the Securities Act, Sections 11 or 12(a)(2) claims must be "brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence. . . . In no event shall any such action be brought to enforce a liability created under [Section 11] . . . more than three years after the security was bona fide offered to the public, or under section [Section 12(a)(2)] . . . more than three years after the sale." 15 U.S.C. § 77m.

The Beneficial Registration Statement was filed on June 1, 1998. Compl. ¶ 357.

Household acquired Beneficial on June 30, 1998. Id. ¶ 207. Thus, any claim under Sections 11 or 12(a)(2) arising from injury based on allegedly false or misleading statements contained in or documents incorporated by reference into the registration statement or proxy lapsed as of June 30, 2001. Similarly, the 1999 Debt Registration Statements were filed on February 16, 1999 and July 1, 1999. Id. ¶ 384. Any claims under Section 11 based upon these debt registration statements were time-barred as of February 16, 2002 and July 1, 2002 respectively. Plaintiffs' original complaint, which did not even assert Sections 11 and 12(a)(2) claims, was filed on August 19, 2002, well after the last dates on which any of these claims could be asserted.

Plaintiffs refer to a two-year statute of limitations and a five-year statute of repose (see Compl. ¶¶ 381, 394), and apparently derive this period from the recently enacted Sarbanes-Oxley Act of 2002. Section 804 of the Sarbanes-Oxley Act amended the statute of limitations and repose applicable to securities fraud claims by adding the following to 28 U.S.C. § 1658:

> (b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in Section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)[31]), may be brought not later than the earlier of –
>
> (1) 2 years after the discovery of the facts constituting the violation; or
>
> (2) 5 years after such violation.

28 U.S.C. § 1658(b) (emphasis added). Although the terms "fraud, deceit, manipulation or contrivance" are not defined in the Act, the Supreme Court has made clear that these terms are synonymous with "scienter." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976) ("'scienter' refers to a mental state embracing intent to deceive, manipulate, or defraud"). Thus,

Section 804(b) of the Sarbanes-Oxley Act applies only to fraud claims that require proof of scienter. See, e.g., De La Fuente v. DCI Telecommunications, Inc., 2003 WL 832009, at *6 n.5 (S.D.N.Y. Mar. 4, 2003) (Section 804 amended the statute of limitations established for claims under Section 10(b), claims that require scienter).

Sections 11 and 12(a)(2) claims do not require a showing of scienter. Abrams v. Van Kampen Funds, Inc., 2002 WL 1160171, at *7 (N.D. Ill. May 30, 2002). Accordingly, Section 804(b)'s extension of the statute of limitations does not apply to them.

Even if the Sarbanes-Oxley statute of limitations could be applied to Sections 11 and 12(a)(2) claims generally, it clearly would not apply in this case. Here, plaintiffs have expressly disavowed fraud as a basis for these claims. See Compl. ¶ 354 ("Plaintiffs expressly exclude any allegation complained of [in the Amended Complaint] that could be construed to allege intentional or reckless conduct."); id. ¶ 383 ("For purposes of this Claim for Relief, plaintiffs expressly exclude and disclaim any allegations that could be construed as alleging fraud or intentional or reckless misconduct, as this Claim for Relief is based solely on claims of strict liability and/or negligence under the Securities Act."). Plaintiffs have thus precluded themselves from seeking to benefit from the extended statute of limitations period applicable to securities fraud claims.

(footnote continued)

[31] Section 78c(a)(47) defines securities laws as follows: "The term 'securities laws' means the Securities Act of 1933 (15 U.S.C. 77a et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), [and] the Sarbanes-Oxley Act of 2002, ..."

B. Plaintiffs' Sections 11 and 12(a)(2) Claims Regarding the Beneficial Registration Statement Fail for Lack of Loss Causation

Count III asserts claims under Sections 11 and 12(a)(2) on behalf of the West Virginia Laborers' Trust Fund (the "West Virginia Trust"), which converted its Beneficial shares to Household stock in the merger. Under the Securities Act, a plaintiff is not entitled to recover if a defendant can demonstrate that the plaintiff did not experience any loss due to the allegedly false and misleading statements. See 15 U.S.C. §§ 77k(e), 77l(b).[32] Even if the Beneficial Registration Statement was misleading as plaintiffs allege, the Amended Complaint shows that the West Virginia Trust did not suffer any loss as a result of any such alleged misstatement or omission in the Beneficial Registration Statement.

Plaintiffs allege that on June 30, 1998, the West Virginia Trust acquired 1,916 shares of Household stock in connection with the Beneficial merger. See Compl., Ex. 1, Certification of Named Plaintiffs. The West Virginia Trust disposed of all of these shares during the course of 1998, the last sale taking place on October 28, 1998. Id. Plaintiffs do not allege that any relevant corrective disclosure was made until 2002. Thus, any loss that the West Virginia Trust realized on the sale of its Household shares could not have been caused by the alleged misstatements in the Beneficial Registration Statement because the Amended Complaint shows that the market did not become aware of any of the alleged misstatements until well after the sale. See In re McKesson HBOC, Inc. Sec. Litig., 126 F. Supp.2d 1248, 1262 (N.D. Cal.

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[32] See also Bastian v. Petren Res. Corp., 892 F.2d 680, 683 (7th Cir.) (loss causation is the common law concept that "but for the circumstances that the fraud concealed, the investment . . . would not have lost its value"), cert. denied, 496 U.S. 906 (1990); see also AUSA Life Ins. Co. v. Ernst & Young, 206 F.3d 202, 209 (2d Cir. 2000) ("Loss causation is causation in the traditional 'proximate cause' sense — the allegedly unlawful conduct caused the economic harm").

2000) (dismissing Section 11 claim because "the complaint reveals that the Section 11 defendants have an absolute 'negative causation' defense pursuant to Section 11(e) for any HBOC shareholders who disposed of their shares prior to the corrective disclosure"); In re DNAP Sec. Litig., 2000 WL 1358619, at *3 (N.D. Cal. Sept. 14, 2000) (dismissing Section 11 claim because absence of loss causation was "evident on the face of the complaint"); see also, Miller v. Apropos Tech., Inc., 2003 WL 1733558, at *8 n.6 (N.D. Ill. Mar. 31, 2003) (noting that affirmative defenses such as an absence of loss causation may be grounds for Rule 12(b)(6) dismissal of a Section 11 claim, but concluding that the complaint did not sufficiently establish the affirmative defense in that case). Accordingly, Count III should be dismissed for failure to state a claim.

POINT V

PLAINTIFFS' "CONTROL PERSON" CLAIMS IN COUNTS II, III AND IV SHOULD BE DISMISSED

Counts II, III, and IV assert claims under Section 15(a) of the Securities Act, 15 U.S.C. § 77o(a), and Section 20(a), 15 U.S.C. § 78t(a), of the Exchange Act. Both statutes make "controlling persons" jointly and severally liable for primary violations by persons under their control, but only so long as there is a predicate violation of the Securities Act or Exchange Act. To the extent plaintiffs have failed to state a claim for such a predicate violation, these claims must also be dismissed. See, e.g., Cooperman v. Individual, Inc., 171 F.3d 43, 52 (1st Cir. 1999) (Section 15); Harrison v. Dean Witter Reynolds, Inc., 79 F.3d 609, 617 (7th Cir.) (Section 20(a) "requires a predicate securities violation"), cert. denied, 519 U.S. 825 (1996).

POINT VI

THE AMENDED COMPLAINT SHOULD BE DISMISSED AS TO DEFENDANT GILMER BECAUSE NO FALSE OR MISLEADING STATEMENTS ARE ATTRIBUTABLE TO HIM

The Amended Complaint mentions defendant Gary Gilmer a mere five times (Compl. ¶¶ 40, 203, 236, 280 and 297). He is named only in Counts I and II, and there is no allegation that he signed any of Household's public filings or other disclosures. Only two alleged misstatements (id. ¶¶ 203, 280) can be traced to him.[33] Liability cannot be grounded on either statement.

Paragraph 203 alleges that an analyst recounted a presentation that Mr. Gilmer gave on April 6, 1998, relating solely to generic aspects of HFC's consumer lending business. Id. ¶ 203 (discussing strategies for increasing new loan originations and reducing payoffs). Plaintiffs do not even attempt to explain what was false about these statements.

Paragraph 280 alleges that, on March 23, 2001, Gilmer was quoted in Origination News as stating that Household's "position on predatory lending is perfectly clear" and that "[u]nethical lending practices of any type are abhorrent to our company, our employees and most importantly our customers." Id. ¶ 280. Plaintiffs plead no facts demonstrating that this statement did not accurately reflect Household's position (and Mr. Gilmer's belief) when it was made.

Nor should plaintiffs' claims against Mr. Gilmer be permitted to proceed under the "group pleading" doctrine. See id. ¶¶ 41-43. "Under the judicially created 'group pleading'

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[33] See Point III.A supra.

doctrine, a plaintiff may rely on the presumption that higher executives of a corporation directly involved in its day-to-day management may be personally liable for material misrepresentations or omissions in public statements such as prospectuses, registration statements, annual reports, press releases, or other group-published information, attributed to or issued by the corporation." In re Enron Corp. Sec., Derivative & ERISA Litig., 2003 WL 230688, at *6 (S.D. Tex. Jan. 28, 2003). The Seventh Circuit has not ruled on the viability of the group pleading doctrine following the enactment of the PSLRA, and the courts in this district have split on the issue. Compare Danis v. USN Communications, Inc., 73 F. Supp.2d 923, 936-39 (N.D. Ill. 1999), with Chu II, 100 F. Supp.2d at 835-37.

The better-reasoned decisions from this and other Circuits hold that the PSLRA extinguished the "group pleading" doctrine. See, e.g., id. at 837; Enron Corp., 2003 WL 230688, at *6-8; In re Digital Island Sec. Litig., 223 F. Supp.2d 546, 553 (D. Del. 2002); In re Lockheed Martin Corp. Sec. Litig., 2002 WL 32081398, at *4-5 (C.D. Cal. July 22, 2002). These decisions recognize that the doctrine is contrary to the PSLRA's express pleading requirements and its intent.

The PSLRA requires that a plaintiff "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). This provision requires that a plaintiff establish scienter with respect to each defendant. See Allscripts, 2001 WL 743411, at *10. Given this requirement, "[i]t is nonsensical to require that a plaintiff specifically allege facts regarding scienter as to each defendant, but to allow him to rely on group pleading in asserting that the defendant made the statement or omission." Coates v. Heartland Wireless Communications, Inc., 26 F. Supp.2d 910, 916 (N.D. Tex. 1998).

Additionally, as Judge Harmon, the district judge handling the Enron litigation, recently pointed out, application of the group pleading doctrine is completely at odds with the discovery stay that the PSLRA imposes at the outset of a case. Enron Corp., 2003 WL 230688, at *6 (quoting William O. Fisher, Don't Call Me a Securities Law Groupie: The Rise and Possible Demise of the "Group Pleading" Protocol in 10b-5 Cases, 56 Bus. Law. 991, 1053 (2001)). The PSLRA discovery stay was meant to stop "sue first and ask questions later" tactics. Id. "'The reasoning for the stay is unreservedly hostile to the notion of "group pleading," which is precisely that plaintiffs should be able to name defendants without having "actual knowledge" that those defendants made the statements that plaintiffs claim are wrong.'" Id. In short, the group pleading doctrine is inconsistent with the intent of the PSLRA because it gives plaintiffs an avenue for "discovering" their way into a lawsuit. See Tobias Holdings, Inc. v. Bank United Corp., 177 F. Supp.2d 162, 166 (S.D.N.Y. 2001) (among purposes of PSLRA was to protect corporate defendants from "plaintiffs' counsel 'discovering' their way into facts which could allow them to amend an initially frivolous complaint so as to state a claim").

Even if the group pleading doctrine did survive enactment of the PSLRA, it would not apply to Mr. Gilmer with respect to the allegedly misleading SEC filings and press releases. Mr. Gilmer is alleged to have been Household's "Vice-Chairman of Consumer Lending" and the Group Executive of U.S. Consumer Finance. Thus, Mr. Gilmer was outside the narrowly defined group of officers and inside directors who could even be presumed to be liable for information published by the Company. See In re Oak Tech. Sec. Litig., 1997 WL 448168, at *11 (N.D. Cal. Aug. 1, 1997) (plaintiffs failed to establish liability of divisional vice presidents under group pleading doctrine where complaint did not allege that these defendants participated in the preparation or communication of the allegedly misleading information; conclusory

allegations not sufficient for invocation of group pleading doctrine). Plaintiffs have failed to allege any facts indicating any connection between Mr. Gilmer and the preparation or communication of any of the allegedly misleading SEC filings and press releases.

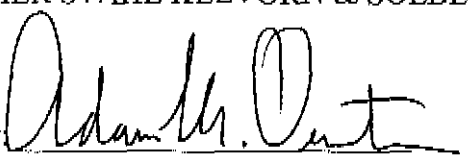
CONCLUSION

For the foregoing reasons, the Household Defendants' motion to dismiss the Amended Complaint should be granted.

Dated: May 13, 2003

Respectfully Submitted,

EIMER STAHL KLEVORN & SOLBERG

By 

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