UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, ON BEHALF OF ITSELF AND ALL OTHERS SIMILARLY SITUATED, Plaintiff, - *against* - HOUSEHOLD INTERNATIONAL, INC., ET AL., Defendants.	Lead Case No. 02-C-5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan

MEMORANDUM OF LAW IN SUPPORT OF THE HOUSEHOLD DEFENDANTS' MOTION TO COMPEL DISCOVERY PURSUANT TO RULE 26(A)(1)(C) AND THIS COURT'S ORDERS, OR IN THE ALTERNATIVE FOR A RECOMMENDATION OF PRECLUSION

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Defendants Household International, Inc., Household Finance Corp., William F. Aldinger, David A. Schoenholz, Gary Gilmer, and J.A. Vozar (referred to collectively herein as "Defendants"), respectfully make this motion to compel Plaintiffs to produce their damages analysis, as required under Fed. R. Civ. P. 26(a)(1)(C) and this Court's Orders of September 20, 2004 and June 29, 2007, or in the alternative, for a recommendation that Plaintiffs be precluded from presenting a calculation of damages in this matter, either directly or in response to any showing by Defendants.

Preliminary Statement

Plaintiffs have failed and refused to provide Defendants with legally-required and court-ordered disclosures regarding their proposed methodology for calculating class-wide damages in this matter. For years Plaintiffs have acknowledged that their disclosures on this subject were deficient, but argued that this was more properly a subject for expert analysis, and assured the Court that they would detail their theory of damages during the expert discovery stage. On this basis the Court twice postponed Plaintiffs' disclosure obligations until expert discovery. Yet on August 15, 2007, when Plaintiffs finally supplemented their contention interrogatory answers and provided their expert reports, they continued to withhold any explanation of their damages claims or the calculations that would produce them.

In refusing to cure this deficiency in response to Defendants' recent inquiries, Plaintiffs vaguely suggested, without explanation, that the missing disclosures can be discerned from the report of their expert witness, Professor Daniel R. Fischel, served on August 15, 2007 (the "Fischel report"). This is not the case. The Fischel report does not purport to be an analysis of alleged damages and does not even include the word "damages". Rather, Professor Fischel says that his assignment was "to analyze the economic evidence as it relates to [Plaintiffs'] claims, determine whether it is consistent with these claims, and, if so, analyze the amount of alleged artificial inflation in Household's stock price during the Class Period attributable to such claims."[1] As the Supreme Court made clear in *Dura Pharmaceuticals, Inc.* v. *Broudo*, "artificial inflation" is just the starting point in calculating recoverable economic loss. *See* 544 U.S. 336, 342 (2005) ("[A]n in-

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[1] *See* Declaration of David R. Owen dated October 5, 2007 ("Owen Decl.") Exhibit 1.

flated purchase price will not itself constitute or proximately cause the relevant economic loss.") Like Plaintiffs' interrogatory answers, the Fischel report does not indicate any amount of damages claimed by Plaintiffs, or provide any method by which they contend damages should be computed, or offer any guidance as to which categories of class members would be eligible to recover in the event that Plaintiffs could prove any of their claims.

Plaintiffs further contend that any further explanation of their damages claims must be postponed again until after liability is established. Contrary to Plaintiffs' most recent argument for further postponement, the required disclosures differ from calculating individual class member damages in a hypothetical post-liability phase. It is a part of their substantive case. Plaintiffs must prove their allegation of class-wide economic loss as an essential element of their liability claim, and tell Defendants and the Court now how they intend to do so. Defendants must not be forced to read between the lines of a report that is silent on that issue to guess what Plaintiffs might later say about the appropriate method of calculating damages, and why.[2]

Defendants obviously need this information now in order for their experts to properly prepare their own submissions, which are currently due on November 5. Plaintiffs' strategic reluctance to reveal the nature, method or amounts of the damages they claim in this case until after Defendants' expert reports have been submitted would seriously prejudice Defendants and should not be countenanced. Plaintiffs' deadline for disclosing their position regarding damages has come and gone, and any further stonewalling on this subject in violation of Rule 26(a)(1) and this Court's orders should be met with a serious penalty.

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[2] Indeed, when Defendants recently made a potentially dispositive motion based on an express conclusion of Professor Fischel on the actual subject of his report, Plaintiffs urged Judge Guzman that Defendants had somehow misinterpreted Professor Fischel's clear language, and that, "[a]s will become clear if ever necessary, the factual and legal issues presented by defendants' motion are infinitely more complex than defendants will represent." *See* Owen Decl. Exhibit 2.

ARGUMENT

I. Plaintiffs Must Disclose Their Class-Wide Damages Theory At This Time, As Required Under Rule 26(a)(1)(C) and the Court's September 20, 2004 and June 29, 2007 Orders

Damages are a required element of any securities fraud claim. *See Dura*, 544 U.S. at 344 (holding that securities fraud actions are rooted in common-law, and contain the common-law requirement that a plaintiff must show actual damages or "economic loss"). Federal Rule 26(a)(1)(C) requires a party, as part of its mandatory initial disclosures, to provide "a computation of any category of damages claimed by the disclosing party" including "the documents or other evidentiary material, not privileged or protected from disclosure, on which such computation is based, including materials bearing on the nature and extent of injuries suffered." Fed. R. Civ. P. 26(a)(1)(C). The accompanying Advisory Committee Notes specify that the Rule "imposes a burden of disclosure that includes the functional equivalent of a standing Request for Production under Rule 34." Fed. R. Civ. P. 26(a) advisory committee's note (1993).[3]

The Rule requires an analysis of "any category of damages claimed." *Design Strategy* v. *Davis*, 469 F.3d 284, 295 (2d Cir. 2006). At a minimum, a plaintiff must explain its methodology for calculating class-wide damages, indicate the amount of class-wide damages claimed, and provide information sufficient to resolve any potential ambiguities regarding the calculations and amounts claimed. *See id.* at 295 (holding that a "simple arithmetic calculation is wholly inadequate" to satisfy Rule 26(a)(1)(C)); *Memry Corp.* v. *Kentucky Oil Technology, N.V.*, No. C04-03843, 2007 WL 39373, at *5 (N.D. Cal. Jan. 4, 2007) ("The 'computation' of damages required by Rule 26(a)(1)(C) contemplates some analysis"); *First National Bank v. Ackerley Communications, Inc.*, No. 94 Civ. 7539, 2001 WL 15693, at *6, n. 6 (S.D.N.Y. Jan. 8, 2001) (calculation of damages requires more than merely setting forth the figure demanded).

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3 Interrogatories No. 2 and No. 15 served by Defendants also seek discovery of subject matter relating to Plaintiffs' damages claims. Plaintiffs resisted responding to both of these on their counsel's representation that substantive responses would be forthcoming during expert discovery. As a result, this motion also seeks an Order compelling substantive responses to those interrogatories as well as in connection with Plaintiffs' Rule 26 obligations.

Compliance with this requirement is particularly important in a securities fraud case, where numerous variables bear directly on the range of possible damages claims. *See, e.g.*, *Dura*, 544 U.S. at 343 ("[T]he most logic alone permits us to say is that the higher purchase price will *sometimes* play a role in bringing about a future loss."). For example, the treatment of so-called "in-and-out" investors, who may have bought and sold their respective shares multiple times throughout the relevant period and may have both profited and lost from these transactions as a result of the alleged fraud, can have a substantial impact on the order of magnitude of a plaintiff's claims. At a minimum, it is essential to establish Plaintiffs' position on such issues prior to Defendants' single opportunity to make expert disclosures.

In their initial Rule 26(a)(1) disclosures — served on June 25, 2004 — Plaintiffs concededly omitted any explanation of their damages theory and represented that this information would be provided later by their experts. In their words, "Plaintiffs have not yet determined the full amount of compensatory damages sustained as a result of defendants' conduct and may not be able to do so until after their expert reports are completed." *See* Plaintiffs' Initial Disclosures Pursuant to Rule 26(a)(1), Owen Decl. Exhibit 3.

After Defendants moved to compel Plaintiffs to comply with Rule 26(a)(1)(C), the Court accepted Plaintiffs' argument "that defendants' motion is premature because (i) damages in securities fraud cases is a matter for expert analysis and opinion, so plaintiffs' damages need not be disclosed until the expert phase of discovery. . . ." Owen Decl. Exhibit 4. In its September 20, 2004 Order, the Court accordingly deferred Plaintiffs' disclosure obligation until expert disclosures were due, noting "that damages in securities fraud cases are generally an issue addressed by experts". *Id.* This Court relied upon a similar representation from Plaintiffs in issuing its June 29, 2007 Order in once again placing the postponed date for disclosure of any claims for damages in the expert discovery phase. *See* Owen Decl. Exhibit 5 ("The parties are to follow this same schedule in providing supplemental responses to discovery requests based upon the expert reports.")

After receiving Plaintiffs' expert reports and supplemental interrogatory answers Defendants complained about Plaintiffs' failure to provide any disclosure on damages. In response, Plaintiffs

insisted without explanation that the Fischel report by itself satisfies their obligations under Rule 26(a)(1)(C), and with respect to the relevant interrogatories.[4] Owen Decl. Exhibit 10.

Plaintiffs' contention finds no support in the Fischel report. Instead, the report estimates only an alleged level of "artificial inflation" in the stock price. Nowhere in the report or its 56 exhibits is there any information on damages, or even a mention of the word "damages". The report is also silent as to any explanation of the methodology that Plaintiffs will ultimately employ to prove class-wide damages from the "artificial inflation" amounts actually contained in the report.

That explanation is by no means self-evident — and not only because the report is completely silent on the subject of damages. For one thing, Professor Fischel concluded in his report that the "artificial inflation" he identifies was already embedded in the stock price on the first day of the class period. Whatever the cause of the pre-class-period inflation Fischel identifies, by definition it occurred prior to the start of the class period. At the very least, claims based upon any pre-class-period inflation identified by Professor Fischel are necessarily time-barred under Judge Guzman's February 28, 2006 Order dismissing Plaintiffs' originally pled claims from that period as time-barred.[5] With respect to Plaintiffs' present claim for damages under *Dura*, however, the report directly raises the question of whether Plaintiffs are asserting damages for the pre-class-period "inflation" under Fischel's analysis—and if so, to what extent?

Yet when Defendants cited the Fischel report in their recent motion to Judge Guzman to implement the February 28, 2006 Order, Plaintiffs' argued that there is more in Professor Fischel's opinion than meets the eye — without even hinting at what that might be. *See* Owen Decl. Exhibit 2 ("As will become clear if ever necessary, the factual and legal issues presented by defendants' motion are infinitely more complex than defendants will represent.") It goes without saying that

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4 Defendants made numerous efforts to obtain this required discovery from Plaintiffs including correspondence dated September 18, 24 and 27. Owen Decl. Exhibits 6, 7 and 8. Defendants also unsuccessfully raised the issue by phone on September 27. Ultimately, Plaintiffs terminated these efforts by letter dated September 28. Owen Decl. Exhibit 9.

5 Defendants recently made a motion to Judge Guzman to this effect. Owen Decl. Exhibit 11. At Plaintiffs' insistence, further briefing and consideration of Defendants' potentially dispositive motion has been deferred until after the close of expert discovery.

Defendants should not have to guess what those "infinite complexities" might be. *See, e.g., Fast Food Gourmet, Inc.* v. *Little Lady Foods, Inc.*, No. 05 C6022, 2007, WL 2156665 (N.D. Ill. July 26, 2007) (holding that disclosure of information under Rule 26(e)(2) "must be clear and unambiguous").

In any event, as the Supreme Court noted in *Dura*, the identification of alleged "artificial inflation" does not by itself satisfy or complete the requisite showing of damages or "economic loss." *See Dura*, 544 U.S. at 342 ("[An] inflated purchase price will not itself constitute or proximately cause the relevant economic loss."). Any explanation of the claimed damages that flow from Fischel's "inflation" analysis must also include, *inter alia*, an explanation of whether investors who bought and sold their stock while the alleged inflation was in place would be excluded from any damages total. The answer ought to be yes, in view of the Supreme Court's observation in *Dura* that "the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent value." *See Dura*, 544 U.S. at 342. However Plaintiffs' theories have not always comported with judicial directions, and if Plaintiffs or their expert do intend to intend to treat such "in and out" investors as eligible to recover damages on some theory, Defendants are entitled to know that now — before the submission of Defendants' expert reports.

Defendants are also entitled to know whether Plaintiffs or their expert would, *inter alia*, net gains and losses resulting from multiple purchases and sales of stock by particular investors or groups of investors. On this subject, for example, Professor Fischel posits an extended time near the end of the Class Period when the price of the stock was allegedly impacted by negative inflation (i.e., less than zero). One possible inference from this estimate is that investors who purchased stock during the period of alleged negative inflation actually *profited* from their transaction during the Class Period. This ambiguity must have some impact on Plaintiffs' class-wide damages computations, but Plaintiffs offer no explanation of how they plan to apply this or any other aspect of Professor Fischel's opinion in proving economic loss at trial.

The time for Plaintiffs to explain the supposedly "infinite" complexities inherent in Professor Fischel's analysis was August 15, 2007, when their expert reports were due and when they were required to honor their commitment, and this Court's expectation, that their damages theory would be revealed at the expert stage. Because Plaintiffs bear the burden of proof on this subject, their

preferred sequence — to force Defendants to guess what they or Professor Fischel had in mind, and take pot shots at whatever Defendants' experts may say and then patch up their own expert opinions as needed — is completely unacceptable.

It is apparent that Plaintiffs are reluctant to take any position that would have the effect of narrowing their options. It is also apparent that Plaintiffs' strategy of withholding this information would severely limit or eliminate Defendants' opportunities to evaluate and address these issues prior to trial. The fact remains, however, that these disclosures cover required components of Plaintiffs' case for securities fraud. They are also the subject of proper interrogatories as well as required disclosures under Rule 26 of the Federal Rules. This Court granted Plaintiffs' requests to defer these basic disclosures in reliance on Plaintiffs' representations that such disclosures would be made after they conferred with their experts. Defendants will be significantly prejudiced if Plaintiffs' time for compliance is extended yet again.

II. In the Alternative, this Court Should Recommend that Plaintiffs Be Precluded From Presenting Any Theory or Calculation of Damages Not Explicitly Specified in the Fischel Report

Fed. R. Civ. P. 37(c)(1) provides that "[a] party that without substantial justification fails to disclose information required by Rule 26(a). . .or to amend a prior response to discovery as required by Rule 26(e)(2), is not, unless such failure is harmless, permitted to use as evidence at trial, at a hearing, or on a motion any witness or information not so disclosed." Fed. R. Civ. P. 37(c)(1). The sanction for failure to comply with Rule 26(a) is "automatic and mandatory" unless Plaintiffs can prove that their Rule 26(a) violations were either justified or harmless. *Salgado* v. *General Motors Corp.* 150 F.3d 735, 741, 742 (7th Cir. 1998)

Plaintiffs can satisfy neither exception, as they have no valid basis for disobeying this Court's Order to satisfy their Rule 26(a)(1)(C) obligation when their expert reports came due. The prejudice to Defendants of having to rebut an unstated and still fluid damages theory is clearly evident. This case has been proceeding for almost five years. Nearly three years ago, Plaintiffs first represented to Defendants and this Court that they would provide the damages disclosures mandated by Rule 26(a)(1) during the expert discovery phase, *see* Owen Decl. Exhibit 3, and this Court's Sep-

tember 20, 2004 Order deferred Plaintiffs' disclosure obligation accordingly. *See* Owen Decl. Exhibit 4. Although the deadline for Plaintiffs' expert disclosure and final contention interrogatory answers expired more than a month and a half ago, Defendants still have not received any meaningful discovery of Plaintiffs' damages claims. Plaintiffs contend that their damages calculations can be intuited from the Fischel report and that no further explanation is required before trial. However, absent an order of preclusion, Defendants will have no protection against the submission of eleventh hour explanations — after Defendants' expert reports have been submitted and perhaps even after Professor Fischel has been deposed — of what Plaintiffs intended to convey by their silence on the subject of class wide damages.

That of course is the problem with Plaintiffs' efforts to depict their expert's silence as an implicit opinion on the proper calculation of damages. It simply leaves an empty placeholder which (if they were allowed) they could later replace with whichever specific approach to damages calculation they may elect after they have learned the views of Defendants on the subject, or after their experts had been deposed about the topics they actually did cover. If Plaintiffs are truly content to rest with the opinions of Professor Fischel as disclosed on August 15, 2007, they have the right to do so, provided that they are held to that election by a recommendation that they be precluded from offering any damages opinion or claim not clearly and unambiguously presented in that report.[6]

Accordingly, Defendants ask this Court to recommend to Judge Guzman that Plaintiffs hereafter be precluded from introducing in any trial or hearing, or in response to or in support of any motion (i) any evidence, (ii) any witness, or (iii) any other support for a claim of "damages" not explicitly specified in the Fischel report. *See Davis* v. *Harris*, No. 03-3007, 2006 WL 3513918, at *3

[6] In response to defense counsel's recent requests for Rule 26(a)(1)(C) discovery, Plaintiffs' counsel represented, "If you are seeking information relating to the computation of class-wide damages, consistent with our Rule 26(a) initial disclosures, this information has been provided to you in the form of the expert report of Daniel R. Fischel, served on August 15, 2007." *See* Owen Decl. Exhibit 10. Therefore, the Court should expect Plaintiffs to cite to the specific language on the specific page of the Fischel report or its exhibits where the amount of Plaintiffs' class-wide damages appears, or where the method of computing such damages is specified. If Plaintiffs fail to direct the Court to such language, but only repeat their assertion that it is somewhere in the Fischel report, they will have conceded the validity of Defendants' assertions in this motion.

(C.D. Ill. Dec. 5, 2006) (excluding Plaintiffs under Rule 37(c)(1) from presenting any computation of the amount of economic damages to the jury where "Plaintiffs did not produce in discovery any computation of the amount of damages, or evidence to support such a computation" under Rule 26(a)(1)(C) and did not supplement their interrogatory answers to provide this information); *Finwall* v. *City of Chicago*, 239 F.R.D. 494, 496, 500 (N.D. Ill. 2006) (granting defendants motion to exclude the opinions of plaintiff's experts under Fed. R. Civ. P. 37(c)(1) where "the plaintiff has ignored the expert discovery deadlines. . . .is unapologetic for its flagrant noncompliance. . . . [is] [u]nwilling to accept the slightest responsibility for its violations of [Magistrate] Judge Manning's deadlines and of the local rules of this court, [and] incredibly seeks to shift the focus to the defendants"); *see also Salgado* v. *General Motors Corp.* 150 F.3d 735, 741, 743 (7th Cir. 1998) (affirming the district court's exclusion of plaintiffs' expert witnesses under Rule 37(c)(1) where "[t]he schedule for discovery was set clearly and [plaintiff] was afforded significant extensions to complete the work" but "[c]ounsel failed to submit the expert witness reports in a timely fashion").

Judge Guzman has himself endorsed the remedy of preclusion (and more) in the context of Rule 37 motion based on a plaintiff's failure to properly disclose the damages claimed during expert discovery. In *Kemper / Prime Industrial Partners* v. *Montgomery Watson Americas, Inc.*, Judge Guzman dismissed all of the plaintiff's claims for failure to make a sufficiently clear disclosure of the claimed damages in expert discovery noting that "appropriate sanctions include those authorized by Rule 37(b)(2)(B), which provides that a court may 'refuse to allow the disobedient party to support or oppose designated claims or defenses, or prohibit[] that party from introducing designated matters in evidence,' and Rule 37(b)(2)(C), which authorizes a court to dismiss the action." No. 97 C 4278, 2004 WL 2534391, at *15 (N.D. Ill. 2004). In dismissing those claims, Judge Guzman noted with particular relevance here that the plaintiff had "failed to produce any evidence in discovery that would allow a trier of fact to determine the existence or extent of its damages." *Id.* at *5 (citation omitted).

The Rules require a disclosure of Plaintiffs' damages claims that explains those claims and includes both the aggregate amount claimed and the methodology by which that figure can be reached by anyone reviewing the Fischel report. Plaintiffs have promised this information for

years. This Court has ordered it twice. Any continued resistance by Plaintiffs can only be fairly addressed with a recommendation to the district court of an order of preclusion.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that this motion to compel be granted and that Plaintiffs be ordered pursuant to Fed. R. Civ. P. 26(a)(1)(C) and this Court's September 20, 2004 and June 29, 2007 Orders to disclose any and all of Plaintiffs' damages claims in a manner that explains those claims and includes both the aggregate amount claimed and the methodology by which that figure can be reached by anyone reviewing the Fischel report. Defendants further request that Plaintiffs be ordered to substantively respond to Interrogatories No. 2 and 15 on the same subject in a similar manner.

Furthermore, in light of Plaintiffs' continuing refusal to comply with this Court's September 20, 2004 and June 29, 2007 Orders, Defendants alternatively seek an order pursuant to Rule 37 precluding Plaintiffs from using at any trial, any hearing, or on any motion: (i) any evidence, (ii) any witness, or (iii) any other support for a claim of "damages" not explicitly specified in the Fischel report.

October 5, 2007
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Respectfully submitted,

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