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

REPLY MEMORANDUM OF LAW IN FURTHER 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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This reply memorandum is respectfully submitted on behalf of Defendants in further support of their Motion To Compel Discovery Pursuant To Rule 26(a)(1)(C) And This Court's September 20, 2004 and June 29, 2007 Orders, Or In The Alternative For A Recommendation Of Preclusion.

INTRODUCTION

Plaintiffs cannot and do not dispute that the report of Professor Fischel does not mention the word damages, quantify claimed losses, or explain any method for doing so. Indeed, Plaintiffs' opposition brief flatly concedes that "Professor Fischel does not opine on aggregate damages." *See* Plaintiffs' Brief ("PB") at 1. Nor did Plaintiffs provide this required information by any other means on their expert disclosure deadline. Although these omissions flout Plaintiffs' disclosure obligations under Rule 26(a)(1)(C) and the Court's related Orders, Plaintiffs' brief barely mentions Rule 26, and does not refer the Court to a single case on the subject. Instead, Plaintiffs rely on arguments from pre-*Dura* case law that the Supreme Court explicitly rejected in that case.

Plaintiffs' central argument is that the "inflation" identified by Fischel "is the damages" and therefore no supplemental explanation is required. PB at 2-3 ("Fischel calculates the artificial inflation for each day of the class period, which is the damages caused by Defendants' fraud.") Plaintiffs' brief quotes from and relies upon Plaintiffs' September 7, 2004 formulation that defines the measure of damages as "the difference between the price of the stock and its value on the date of the transaction. . . ." PB at 2 (quoting Plaintiffs' September 7, 2004 filing).

That formulation, provided some 7 months before the Supreme Court issued its ruling in *Dura,* is not legally viable. In the words of the Supreme Court: "[An] inflated purchase price will ***not*** itself constitute or proximately cause the relevant economic loss. . . ." *See Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336, 342 (2005) (emphasis added). By completely ignoring the Court's analysis in *Dura*, Plaintiffs attempt to evade core questions about how they intend to prove economic loss now that their preferred theory has been rejected as legally insufficient.

To defend their related failure to update interrogatory responses Nos. 2 and 15 as ordered, Plaintiffs offer nonsensical and/or irrelevant excuses — such as the fact that one of the interrogatories was "propounded during the class certification stage" (PB at 6) and the assertion that Defendants "never raised the issue" of supplementation with respect to particular responses (PB at 7). In alternatively seeking to withhold these required disclosures until "rebuttal" (PB at 5), Plaintiffs ignore that the obligation imposed on them by Rule 26(a)(1)(C) is an affirmative one which this Court required Plaintiffs to satisfy in their expert disclosures.

In short, Plaintiffs offer no valid justification for their continued non-compliance with Rule 26(a)(1)(C) and defiance of this Court's September 20, 2004 and June 29, 2007 Orders. Three years ago Plaintiffs bought ample time to develop their theories on economic loss by claiming to need expert input. Now that their deadline for compliance has passed, this Court should compel Plaintiffs to make the required disclosures now, under pain of Rule 37's "automatic and mandatory" sanction of preclusion for unexcused violations of Rule 26.

ARGUMENT

In making this motion, Defendants emphasized the strict requirements of Rule 26, and the preclusive effect of related enforcement provisions set forth in Rule 37. *See* Defendants' Opening Brief ("DB") at 3-4, 7-8. In contrast, Plaintiffs' brief is devoid of any discussion concerning the strict disclosure standards of Rule 26(a)(1)(C), which establish *comprehensive and detailed* disclosure requirements and preclude later claims for damages not identified and explained therein under Rule 37. Plaintiffs merely assert in a footnote that the Rule 26 case law cited by Defendants is somehow "inapposite." PB at 6, n.4. Notably, however, Plaintiffs do not cite a single case regarding the disclosure standards mandated by Rule 26(a)(1)(C), or discuss the requirements of the Rule at all.

A proper disclosure under Rule 26(a)(1)(C) typically consists of the bottom line amounts claimed for damages supported by an explanation of the basis and/or reasoning by which the amounts are "computed." *See Design Strategy, Inc.* v. *Davis*, 469 F.3d 284, 295 (2d Cir. 2006) (holding that a "simple arithmetic calculation is wholly inadequate" to satisfy Rule 26(a)(1)(C)). In securities fraud cases these calculations and explanations can be accomplished without reference to individual class member data by explaining the proposed methodology and, *inter alia*, estimating aggregate damages or identifying categories of eligible claims through the use of what some experts describe as "trading models." *See*, *e.g.*, Daniel R. Fischel, David J. Ross, *The Use Of Trading Models To Estimate Aggregate Damages In Securities Fraud Litigation: A Proposal For Change*, in SECURITIES CLASS ACTIONS: ABUSES AND REMEDIES 131, 132 (National Legal Center for the Public Interest 1994). Professor Fischel has himself noted the importance of having this kind of information about aggregate claims so that the nature and extent of the class wide claims can be evaluated by the parties and the court. *Id.* ("The lack of information about aggregate damages is a major impediment to resolving class action securities fraud cases.")

In this case, not only have Plaintiffs admittedly refused to provide any bottom line damages claim, they have refused to provide any explanation of the methodology they contend should ultimately be used to determine damages. They have disclosed no legally cognizable formula, much less an explanation of that formula. Accordingly, essential questions remain unanswered, including, *inter alia,* (i) which of Professor Fischel's two different "artificial inflation" tables do Plaintiffs propose using as a starting point for calculating damages? (ii) will Plaintiffs seek damages on behalf of class members who sold allegedly inflated shares before the claimed inflation came out of the price? (iii) will Plaintiffs seek damages on behalf of class members who sold during the period of negative inflation that Professor Fischel estimates at the end of the Class Period? (iv) do Plaintiffs claim damages for inflation already present in the stock price on the first day of the class period, and on what basis? and (v) how do Plaintiffs propose treating class members who profited from some trades during the Class Period but suffered losses from others?

Even without the aggregate total of damages that Professor Fischel has written about, ***all*** of these class-wide questions can and should be answered now with an explanation of how Plaintiffs intend to use one or both of Professor Fischel's two "inflation" charts as the basis of a damages model. Rule 26 requires Plaintiffs to provide answers to these kind of questions so that Defendants and the Court can finally obtain basic information as to what is at stake in this action, and Defendants can appropriately respond. Now that their deadline for expert disclosures has come and gone, Plaintiffs should no longer be allowed to deprive Defendants and this Court of the most basic of information as to what is at stake in this action.

I. Plaintiffs' Central Argument Ignores *Dura* and Relies on Pre-*Dura* Case Law

Plaintiffs' only argument that relates to the merits of this motion is that the two sets of "artificial inflation" figures in Exhibits 53 and 56 of the Fischel Report *are their damages.* PB at 3 ("Professor Fischel calculates the amount of artificial inflation for each day of the class period,

which is the damages caused by defendants' fraud. . . .") (emphasis added); *see* PB at Exhibit A.[1] Plaintiffs' brief points to their 2004 pre-*Dura* formula to explain Plaintiffs' position that the damages they seek are calculated as "the difference between the price of the stock and its value on the date of the transaction. . . ." PB at 2 (quoting Plaintiffs' September 7, 2004 filing).

That position is legally insupportable, and therefore cannot satisfy Plaintiffs' disclosure obligations. As the Supreme Court observed in *Dura,* artificial inflation standing alone does not satisfy or complete the requisite showing of damages or "economic loss." *See Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336, 342 (2005). The Supreme Court explained this distinction as follows:

> "[An] inflated purchase price will not itself constitute or proximately cause the relevant economic loss. For one thing, as a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that *at that instant* possess equivalent value. Moreover, the logical link between the inflated purchase price and any later economic loss is not invariably strong. Shares are normally purchased with an eye towards a later sale. But, if say, the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss." *Id.* at 342 (emphasis in original).

Thus the Supreme Court has made clear that the required showing of an *actual economic loss* requires not only an "inflated" purchase price (*i.e.* Fischel Exs. 53 and/or 56), but also *a demonstration that a later sale produced a quantified loss that can be attributed to actionable misrepresentations that inflated the stock price.* That was the whole point of *Dura*. Plaintiffs' claim that inflation "is" the damages does not speak to the proscriptions of *Dura* at all.

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1 Plaintiffs assert that this Court "upheld Lead Plaintiffs' Damages Statement as sufficient in the September 20, 2004 Order." PB at 2. This representation is false—and presumably Plaintiffs know it to be false. The Court's September 20, 2004 Order did not hold that Defendants received the information required by Rule 26(a)(1)(C) or that Plaintiffs September 20, 2004 submission was "sufficient" under Rule 26(a)(1)(C). Rather, the Court's Order deferred Plaintiffs' disclosure obligations under Rule 26(a)(1)(C) until expert discovery, and made clear that Plaintiffs' September 7, 2004 damages submission related only to "class certification issues" — deferring the detailed explanation and computation of damages until expert discovery. *See* Declaration of David R. Owen dated October 5, 2007 ("Owen Decl.") Exhibit 4. Plaintiffs totally ignore the portion of the Court's September 20, 2004 Order which relates directly to this motion, and which expressly accepted Plaintiffs' own argument that "(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." *See id.*

Plaintiffs' reliance on *Stone* v. *Kirk*, 8 F.3d 1079, 1092 (6th Cir. 1993) — which pre-dates *Dura* by over a decade — for the proposition that the Fischel report somehow "meets the requirements of *Dura*" (PB at 2) is illogical nonsense. In fact, Plaintiffs cite to no post-*Dura* case law whatsoever. *See* PB at 2-3. Specifically, *Associated Randall Bank* v. *Griffin, et al.*, 3 F.3d 208 (7th Cir. 1993); *Caremark, Inc.* v. *Coram Healthcare Corp.*, 113 F.3d 645 (7th Cir. 1997) and *Kaufman* v. *Motorola, Inc.*, No. 95 C 1069, 2000 U.S. Dist. LEXIS 14627, at *6 (N.D. Ill. Sept. 19, 2000) all pre-date *Dura* by several years to over a decade. *Id.* Plaintiffs' brief offers these cases to support Plaintiffs' 2004 formulation (now explicitly rejected by *Dura*) that damages may be calculated as "the difference between the price of the stock and its value on the date of the transaction. . . ." PB at 2 (quoting Plaintiffs' September 7, 2004 filing). If Plaintiffs intend to rely solely on that outmoded and legally insufficient approach to proving damages, they should say so formally, and be foreclosed from unveiling other non-disclosed approaches later in these proceedings.

Otherwise, to satisfy Rule 26(a)(1)(C), Plaintiffs' supplemental disclosures must at a minimum explain whether or not class members who sold their stock while the alleged artificial inflation was in place are to be excluded from Plaintiffs' class-wide damages calculations.[2] Further, under *Dura*, Plaintiffs' Rule 26 disclosures must explain whether class members who bought stock during the period of alleged "negative inflation" are excluded from Plaintiffs' damages claims or whether those transactions otherwise reduce class-wide damages.

Plaintiffs' stated measure of damages, Professor Fischel's "inflation" charts (Ex. 53 and 56), leaves open issues that require explanation under Rule 26(a)(1)(C). For example, both charts purport to identify inflation in the stock price as of the first day of the class period. *See* PB at Exhibit A. Yet neither of the charts, nor any other part of the Fischel report attributes this inflation to any particular misrepresentations or omissions during the class period (although it seems axiomatic that such unidentified misrepresentations or omissions must have been made prior to the day in which they turn up in Fischel's charts). This ambiguity directly raises the question of whether Plaintiffs'

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2 Although *Dura* appears to explicitly require a limitation of this kind, Plaintiffs' current disclosures acknowledge no such limitation and/or affirmatively reject it by reciting a pre-*Dura* formulation and relying here on pre-*Dura* case law.

adoption of Fischel's charts has the effect of claiming damages from misrepresentations that were previously dismissed by Judge Guzman.[3]

When Defendants tried to raise the statute of repose implications of Fischel's inflation charts with Judge Guzman, Plaintiffs urged that any consideration of that issue be postponed because expert discovery was ongoing under the supervision of this Court. Without even hinting at what their explanation for this apparent problem might be, Plaintiffs indicated that the issue was "complex" and should await the completion of expert discovery and the submission of a formal summary judgment motion. Plaintiffs' suggestion to Judge Guzman that the issue is too "complex" for resolution prior to the completion of expert discovery cannot be harmonized with their present position to this Court that they need not explain anything at all during expert discovery — the very discovery they invoked to obtain a postponement of Judge Guzman's review of this subject.

The methodology Plaintiffs will adopt with respect to Fischel's "inflation" analysis to show actual loss as required by *Dura* bears directly on the nature and extent of Plaintiffs' class-wide damages claims. This methodology will dictate, *inter alia*, whether multitudes of class members that purchased and/or sold their shares during the purported "artificial inflation", negative inflation and pre-class period inflation are included or excluded from Plaintiffs' aggregate damages calculations, thereby directly affecting the magnitude of Plaintiffs' aggregate damages claims by perhaps billions of dollars.

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3 Plaintiffs contend that "Professor Fischel calculates the amount of artificial inflation for each day of the class period, which is the damages caused by defendants' fraud, and quantifies this amount on a per share basis consistent with the principles of loss causation established in Dura and the case law." PB at 3. In support of this contention, Plaintiffs cite two exhibits to Professor Fischel's report, Exhibits 53 and 56, and claim that in these exhibits "Professor Fischel is able to quantify how much Household's stock was inflated on each day of the class period which is exactly how loss causation is established" PB at 4. The defect in this argument is immediately clear when one considers that Fischel's Exhibits 53 and 56 offer two vastly disparate amounts of per share inflation for each day of the Class Period (except for the very last day when, by coincidence, both Exhibits arrive at zero inflation per share). Plaintiffs' Rule 26 disclosures don't explain if (or how) they work together to produce any particular result. Are they distinct? Is one of them a fallback position? Plaintiffs do not say.

Recognizing that addressing such issues now will force them to take positions that could narrow class-wide damages, Plaintiffs conflate the basic explanations required under Rule 26(a)(1)(C) with the process of evaluating formal claims submissions by individual class members. PB at 4 ("Instead, if Plaintiffs are successful at trial, the total amount ultimately paid by defendants will be based on the number of valid claims filed."). However, it is apparent that none of the issues raised herein requires consideration of individual class members' transactions.

Indeed, Plaintiffs' demand for even further postponement of their initial disclosures is a red herring intended to divert the Court's attention from *Dura's* narrowing impact on class-wide damages. Defendants have been clear from the outset that this motion does do not seek the individualized damages of each class member. *See* Owen Decl. Exhibit 7 ("To be clear, we do not presently seek the individualized damages of each Class member. Rather, Defendants' request Plaintiffs' computation of class-wide damages as required by Federal Rule of Civil Procedure 26(a)(1). . . .").

Plaintiffs adopt a similar ploy with regard to their refusal to fully respond to Interrogatory Nos. 2 and 15. *See* PB at 6 (". . .such individual class member information has no bearing on the class-wide issues currently before the Court. . . ."). Not surprisingly, Plaintiffs' opposition papers make no reference to the Court's June 29, 2007 Order, which made clear that the deadline for Plaintiffs to respond to these interrogatories was to be August 15, 2007, the same day that Plaintiffs' expert reports were due. With respect to Interrogatory No. 15, Plaintiffs assert that they have sufficiently supplemented their answer by incorporation of the Fischel report, and specifically direct the Court to paragraphs 12-21 of the report (*see* PB at 7), even though they are wholly non-responsive to the question at hand.[4] Plaintiffs' brief does not seriously contend otherwise. *See* PB at 6-7.

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4 Paragraphs 12-21 of the Fischel report are entirely non-responsive to Interrogatory No. 15, which requires Plaintiffs to "[i]dentify any loss Plaintiffs' contend they suffered as a result of any alleged 'illegal predatory lending practice, procedure, or other activity identified in response to Interrogatory No. 9." These paragraphs, appended to the Owen Declaration at Exhibit 1, Pages 6-13, are essentially nothing more than Professor Fischel's narrative of certain alleged historic events. These paragraphs (just like the rest of the Fischel report and its 56 exhibits) certainly do not specify any "loss." Therefore, Interrogatory No. 15 remains outstanding, and Plaintiffs remain in violation of this Court's June 29, 2007 Order which required them to supplement their answer to Interrogatory No. 15 by August 15, 2007.

The time for Plaintiffs to update their Rule 26 disclosures and their interrogatory responses under the Federal Rules and the Court's explicit Orders has already run. Plaintiffs' reliance on outdated formulations and stale case law does not discharge these obligations, or diminish the obvious prejudice flowing from their willful non-compliance.

II. Plaintiffs Improperly Seek to Shift Their Disclosure Obligation to Defendants and Deprive Defendants of a Fair Opportunity to Respond to Future "Corrections"

Since Plaintiffs cannot contest the merits of this motion by pointing to any disclosures that comply with Rule 26(a)(1)(C), they fall back on the patently unfair argument that any important substance that has been left out of their Rule 26 disclosures and interrogatory responses can be "corrected" by its inclusion in Plaintiffs "rebuttal" expert reports. PB at 7. This is a transparent attempt to prejudice Defendants by forcing defense experts to take the lead in analyzing the proper scope of damages, while depriving Defendants of the opportunity to comment on Plaintiffs' disclosures on this key substantive issue.

Plaintiffs' proposed sequence will severely and improperly prejudice Defendants. Moreover, it ignores the dictates of Rule 26(a)(1)(C), which expressly charges Plaintiffs with an affirmative obligation to disclose this information "without awaiting a discovery request." *See* Fed.R.Civ.P. 26(a)(1)(C); Fed. R. Civ. P. 26(a) advisory committee's note (1993) (the Rule "imposes a burden of disclosure that includes the functional equivalent of a standing Request for Production under Rule 34"). Rule 26(a)(1)(C) and this Court's discovery Orders obviously do not contemplate having Defendants ferret out core initial disclosures by deposing Plaintiffs' expert after all expert reports have been served. Nor do they allow Plaintiffs to withhold any cogent explanation of their theory of economic loss until after Defendants' experts have furnished an *ex ante* roadmap to guide Plaintiffs and their experts in filling in missing and required information. *Id.*

Plaintiffs' final argument that they should be relieved of their obligations under Rule 26(a)(1)(C) because Defendants have not provided a declaration from any expert "attesting" to the "current need" for the missing explanations is absurd and smacks of bad faith. *See* PB at 8 ("The request made no mention of any need for missing information."). The Federal Rules require no showing of "need" to obtain mandatory Rule 26 disclosures. To the contrary, the Federal Rules mandate that Plaintiffs' obligation to provide this information is an affirmative one that must be fulfilled without awaiting a discovery request. *See* Fed. R. Civ. P. 26(a)(1)(C); Fed. R. Civ. P. 26(a) advisory committee's note. If that weren't enough, this Court ordered Plaintiffs to comply with their Rule 26(a)(1)(C) obligation in their expert disclosures which were due on August 15, 2007. They have produced no satisfactory excuse for their failure to comply.

III. The Sanction of Preclusion Is "Automatic and Mandatory" Because Plaintiffs Offer No Justification For Their Failure To Comply With Rule 26(a)(1)(C)

To avoid the sanction of preclusion, it was Plaintiffs' burden to demonstrate that their failure to comply with Rule 26(a)(1)(C) was substantially justified or harmless. *See* Fed. R. Civ. P. 37(c)(1) ("[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 a trial, at a hearing, or on a motion any witness or information not so disclosed." Fed. R. Civ. P. 37(c)(1); *Salgado* v. *General Motors Corp.* 150 F.3d 735, 741, 742 (7th Cir. 1998) (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).

Rule 37 gives teeth to the principle that Rule 26(a)(1)(C) damages disclosures are mandatory, and that a party omits material from Rule 26(a)(1)(C) disclosures at its peril. This is especially so where a party explicitly refuses to adequately disclose their theories as Plaintiffs have here. Preclusion under the rule is automatic in such circumstances. *See*, *e.g.*, *Salgado*, 150 F.3d at 741, 742; *see also*, *e.g.*, *Kemper / Prime Industrial Partners* v. *Montgomery Watson Americas*, *Inc.* No. 97 C 4278, 2004 WL 2534391 (N.D. Ill. Sept. 27, 2004) (Guzman, J.) (refusing permission to revise theories advanced in past discovery submissions and dismissing plaintiff's claims under Rule 37 for failure to make a proper damages disclosure in discovery).

Plaintiffs do not even attempt to meet their requisite burden under Rule 37, and instead ignore this portion of Defendants' motion entirely. In fact, Plaintiffs' opposition papers support the conclusion that Plaintiffs have the means and ability to comply at this time — but that they are deliberately choosing not to as a matter of strategy. Evidence of Plaintiffs' bad faith approach to Rule 26(a)(1)(C) is also apparent from Plaintiffs' Catch 22 approach to Defendants' motion regarding the time-bar implications of Professor Fischel's inflation figures. Plaintiffs argued that the issue was "complex" and that that there is more in Professor Fischel's opinion than meets the eye. *See* Owen

Decl. Exhibit 2. Having returned to the discovery context before this Court, Plaintiffs now disclaim any need to provide even a hint about what their complex explanation might actually be, even though it is unquestionably their burden to do so. This sequence makes it abundantly clear that Plaintiffs will never disclose their theory as to proving economic loss unless they are ordered to do so under pain of meaningful sanctions.

The opinion in *Kemper / Prime Industrial Partners* v. *Montgomery Watson Americas, Inc.* No. 97 C 4278, 2004 WL 2534391, at *15 (N.D. Ill. Sept. 27, 2004) is instructive in this regard. There, Judge Guzman endorsed the remedy of preclusion under Rule 37 (and ultimately dismissal), where 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). As in *Kemper / Prime Industrial Partners*, Plaintiffs purport to rely on a legally untenable damages theory. Furthermore, Plaintiffs have not taken any position at all with respect to any methodology by which damages can be computed consistent with *Dura*. A Rule 37 recommendation of preclusion is therefore the appropriate remedy, as explicitly authorized by the Federal Rules. *See Salgado*, 150 F.3d at 741; *Kemper / Prime Industrial Partners,* 2004 WL 2534391, at *5.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that this motion to compel be granted pursuant to Fed. R. Civ. P. 26(a)(1)(C) and this Court's September 20, 2004 and June 29, 2007 Orders. Defendants further request that Plaintiffs be ordered to substantively respond to Interrogatories No. 2 and 15 on the same subject. Plaintiffs' Rule 26 disclosures and Interrogatory responses should be supplemented to include the aggregate amounts claimed supported by an explanation of the methodology and reasoning by which the aggregate figures are calculated. Plaintiffs' position with respect to particular issues raised in this motion must be set forth.

In the alternative, the Court should enter an order pursuant to Rule 37 recommending that Plaintiffs be precluded 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 August 15, 2007 Fischel report.

October 16, 2007
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Respectfully submitted,

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