UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION PURSUANT TO FED. R. CIV. P. 37(C) TO EXCLUDE THE TESTIMONY OF JAMES C. BERNSTEIN

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This memorandum is respectfully submitted on behalf of Defendants Household International, Inc., William F. Aldinger, David A. Schoenholz, and Gary Gilmer (collectively, the "Defendants")[1], in support of their motion pursuant to Federal Rule of Civil Procedure 37 for an Order precluding Plaintiffs from offering for any purpose the testimony of James C. Bernstein.

INTRODUCTION

Only a few weeks before the deadline for submitting the [Proposed] Final Pretrial Order, Plaintiffs announced their intention to call a witness they had previously represented would *not* be called at trial in order to avoid his deposition. This motion seeks to bar that prejudicial about-face.

During discovery, Magistrate Judge Nolan Ordered Plaintiffs to identify any witness who may give testimony as to observations or conclusions based on technical or specialized knowledge, even if those observations are intertwined with fact testimony, in accordance with this Court's decision in ***Sunstar, Inc.*** v. ***Alberto-Culver Co.***, Nos. 01 C 736, 01 C 5825, 2006 U.S. Dist. LEXIS 85678 (N.D. Ill. Nov. 16, 2006) (Guzman, J.) ("***Sunstar***"). Pursuant to this Order, Plaintiffs identified, ***inter alia***, James Bernstein, a former Minnesota state bank regulator, as a "witness[] they believe may fall within the purview of ***Sunstar***" that

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[1] This motion premised on Plaintiffs' specific acknowledgment that no claims have been asserted against Defendants Joseph A. Vozar ("Vozar") and Household Finance Corporation ("HFC" and, collectively with Vozar, the "Non-Class Action Defendants") on behalf of the Class, and that no claim or claims that will be at issue in the trial scheduled to begin on March 30, 2009 have been asserted or will be tried against Vozar or HFC. The Non-Class Action Defendants do not waive, but on the contrary, each expressly reserves and intends to preserve, the right to adopt, amend, supplement or re-assert objections to the testimony of James Bernstein to the extent that Plaintiffs at any future time propose to use Mr. Bernstein's testimony in a trial of claims asserted against Vozar and HFC.

"plaintiffs may introduce at trial or otherwise." [2] However, as soon as Defendants made known their intention to depose Mr. Bernstein, Plaintiffs offered to withdraw his name from the witness list in exchange for Defendants' promise not to take his deposition, thereby misleading Defendants into believing that Plaintiffs had decided not to call Mr. Bernstein at trial. Now, with discovery over and trial around the corner, Plaintiffs have reinstated Mr. Bernstein on their list of proposed trial witnesses. This bad faith "sleight of hand" should not be permitted.

Under Fed. R. Civ. P. 37(c)(1), when a party fails to comply with its obligations under Rule 26(a), "the sanction of exclusion is automatic and mandatory unless the sanctioned party can show that its violation . . . was either justified or harmless." *Salgado v. General Motors Corp.*, 150 F.3d 735, 742 (7th Cir. 1998). Plaintiffs' willful violation is neither. First, there can be no justification for purposefully misleading another party or the Court. Second, Defendants should not be subjected to ambush on the eve of trial with "expert" testimony they never expected based on Plaintiffs' prior conduct. This prejudice cannot be "fixed." A deposition and additional discovery of Mr. Bernstein would require reopening discovery to give Defendants' experts an opportunity to respond and amend their reports in light of his testimony based on "specialized knowledge." This would cause considerable delay that neither Defendants nor the Court can afford at this late stage. As one court in this Circuit noted: "[A]t the heart of Rule 37's automatic sanction provision is the recognition that precious time and resources of both opposing counsel and this Court are wasted when faced with unjustified delay. And such waste, when significant enough, constitutes its own kind of harm." *Saudi v. Valmet-Appleton, Inc.*, 219 F.R.D. 128, 134 (E.D. Wis. 2003). Under Rule 37, the sanction of exclusion is the only appropriate remedy.

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[2] Declaration of Landis C. Best ("Best Decl.") dated January 30, 2009, 2008, Exs. A, B.

STATEMENT OF FACTS

On August 15, 2007, pursuant to Rule 26(a)(2), Plaintiffs disclosed to Defendants their list of witnesses they intended to use at trial to present evidence under Fed. R. Evid. 702, 703 or 705. Plaintiffs disclosed, *inter alia*, their retained regulatory expert, Ms. Catherine Ghiglieri, a former Texas state bank regulator. This list did not include James Bernstein, or any witnesses whose testimony may be based on technical or specialized knowledge within the purview of this Court's ruling in *Sunstar* (hereinafter referred to, for convenience, as "*Sunstar* witnesses"). Despite this deficiency, the Court permitted Plaintiffs to file a belated second notice six months later identifying their *Sunstar* witnesses (Best Decl. Ex. A). On February 27, 2008, Plaintiffs filed Lead Plaintiffs' Notice Concerning Expert Testimony Pursuant to the Court's February 26, 2008 Order (Best Decl. Ex. B). Mr. Bernstein, a former Minnesota state bank regulator, was one of the 32 individuals identified in the February 27 notice as "witnesses whose testimony as to opinions developed before or during the Class Period lead plaintiffs may introduce at trial or otherwise" (*Id.* at 1). Also included on that notice was Charles Cross, a former Washington state bank regulator. (*Id*). In a letter sent on February 29, Plaintiffs made clear that Messrs. Bernstein and Cross "would testify as to opinions they developed in real time" and that "they are just like other witnesses identified on plaintiffs' and defendants' lists" as having "specialized knowledge." (Best Decl. Ex. C at 1).

During a meet and confer shortly thereafter, Defendants informed Plaintiffs that they intended to depose each *Sunstar* witness identified in the February 27 notice. (Best Decl., Ex. D at 12). In response, Plaintiffs presented the following *quid pro quo*: "If we took some of the people off the list, would you be amenable to not deposing any of them?" (*Id.* at 13). In a subsequent email correspondence, Defendants informed Plaintiffs that they intended to depose each *Sunstar* witness "who remain on Plaintiffs' list" identified in the February 27 notice. (Best Decl., Ex. E). Mr. Bernstein and Mr. Cross were specifically identified as witnesses that

Defendants intended to depose. (*Id.*) Plaintiffs responded to Defendants' request to depose Mr. Bernstein and Mr. Cross by filing an Amended Notice Concerning Expert Testimony Pursuant to the Court's February 26, 2008 Order in which ***they affirmatively withdrew Mr. Bernstein's name from their list of Sunstar witnesses*** (Best Decl. Ex. F). In reliance on Plaintiffs' representation, Defendants did not depose Mr. Bernstein. Defendants did depose Mr. Cross as they represented they would.

Now, nine months after Plaintiffs withdrew Mr. Bernstein's name from their list of *Sunstar* witnesses, and a few weeks before the pretrial order must be delivered to the Court, Plaintiffs have announced their intention to have Mr. Bernstein testify at trial.

ARGUMENT

Rule 26(a)(2) states that "a party must disclose to the other parties the identity of any witness it may use at trial to present evidence under Federal Rule of Evidence 702, 703, or 705." Fed. R. Civ. P. 26(a)(2)(B). The Rule further provides: "A party must make these disclosures at the times and in the sequence that the court orders." Fed. R. Civ. P. 26(a)(2)(C); *Finwall v. City of Chicago*, 239 F.R.D. 504, 507 (N.D. Ill. 2006) (Manning, J.). The duty to provide full and complete disclosure of witnesses is not a mere formality, but a critical component of the overarching goal of the Federal Rules "to promote liberal discovery in an effort to narrow the issues for trial and to prevent unfair surprise." *Scranton Gillette Communications., Inc. v. Dannhausen*, No. 96 C 8353, 1998 WL 566668, at *1 (N.D. Ill. Aug. 26, 1998) (Urbom, J.).

Rule 26 is designed to prevent "trial by ambush." *Ty, Inc. v. Publications International, Ltd.*, No. 99 C 5565, 2004 WL 421984 at *1 (N.D. Ill. Feb. 17, 2004) (Zagel, J.). Where a party fails to make a timely disclosure of the identity of a witness as required by Rule 26(a), Rule 37 states that "the party is not allowed to use that information or witness to supply

evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless." Fed. R. Civ. P. 37(c)(1). Because Plaintiffs intentionally evaded discovery regarding Mr. Bernstein, and thereby caused substantial prejudice to Defendants, Rule 37 requires that he be excluded from testifying at trial or for any purpose.

I. MR. BERNSTEIN'S ANTICIPATED TRIAL TESTIMONY WOULD NECESSARILY BE RULE 702 TESTIMONY INFORMED BY HIS "SPECIALIZED KNOWLEDGE"

Expert testimony is any testimony based on "scientific, technical, or other specialized knowledge" Fed. R. Evid. 702. In contrast, lay opinion testimony must be "not based on scientific, technical, or other specialized knowledge within the scope of Rule 702." Fed. R. Evid. 701(c). Part c was added to Rule 701 in 2000 to "clarify the distinction between lay and expert testimony." *United States* v. *Garcia*, 291 F.3d 127, 139 n.8 (2d Cir. 2002). The subsection "'ensures that a party will not evade the expert witness disclosure requirements set forth in Fed. R. Civ. P. 26 and Fed. R. Crim. P. 16 by ***simply calling an expert witness in the guise of a layperson.***'" *Chicago Prime Packers, Inc.* v. *Northam Food Trading Co.*, No. 01 C 4447, 2003 U.S. Dist. LEXIS 12628, at *11 (N.D. Ill. Jul. 22, 2003) (Soat Brown, M.J.) (quoting Fed. R. Evid. 701 advisory committee's note) (emphasis added). The Advisory Committee's Notes explain that the distinction between lay opinion testimony and expert opinion testimony is that that "lay testimony 'results from a process of reasoning familiar in everyday life,' while expert testimony 'results from a process of reasoning which can be mastered only by specialists in the field.'" Fed. R. Evid. 701 advisory committee's note (2000) (internal citations omitted).

This Court clarified this distinction in *Sunstar*, finding that a witness who had performed consulting work for a company could testify only as an expert, and not as a purported fact witness, because her specialized knowledge and not her lay perceptions formed her opinions. The opinion states: "If she testifies that DGA was hired by Sunstar and performed research on its

behalf, events that any layman could also recount, she is a lay witness. But that is not the kind of testimony Sunstar seeks to present. Rather, it wants to offer Spencer's testimony about the conclusions DGA drew from the research and the recommendations it made to Sunstar as a result. Those are not subjects about which an untrained layman could opine. Thus, Spencer is an expert witness." *Sunstar*, 2006 U.S. Dist. LEXIS 85678, at *20. *See also Musser* v. *Gentiva Health Services.*, 356 F.3d 751, 756 n.2 (7th Cir. 2004) ("Thus, a treating doctor (or similarly situated witness) is providing expert testimony if the testimony consists of opinions based on 'scientific, technical, or other specialized knowledge' regardless of whether those opinions were formed during the scope of interaction with a party prior to litigation.").

Mr. Bernstein stands in precisely the same position as the consultant in *Sunstar* and the hypothetical treating physician. Although not retained specifically for this action, his qualifications and the context of his interactions with Household render his insights and recollections Rule 702 testimony. Plaintiffs conceded as much when they initially included Mr. Bernstein on their list of *Sunstar* witnesses (before removing him to shield him from deposition) and when they expressly described him as a witness that "would testify as to opinions [he] developed in real time" and that he is "just like other witnesses identified on plaintiffs' and defendants' lists" as having "specialized knowledge." (Best Decl. Ex. C at 1). Plaintiffs should not now be heard to argue, as the party in *Sunstar* attempted to argue, that Mr. Bernstein should be permitted to testify as a "percipient witness" and that his position as a bank regulator does not make him a person whose observations or conclusions are based on technical or specialized knowledge.[3]

[3] Defendants on November 21, 2008 requested that Plaintiffs remove Mr. Bernstein from their witness list. (Best Decl. Ex. I). At a telephonic Meet and Confer on November 25, 2008, Plaintiffs contended that Mr. Bernstein was a "percipient witness" who will not be offering

Footnote continued on next page.

During much of the Class Period, Mr. Bernstein served with the Minnesota Department of Commerce ("DOC"), a regulatory agency responsible for licensing and oversight of Household's consumer lending operations in the state of Minnesota. (Best Decl., Ex. G at ¶1).[4] He was "responsible for developing policies and legislative initiatives, planning, working with the Financial Examinations and Enforcement Divisions of the Department, providing oversight and direction, reviewing investigations, evaluating and making determinations as to penalties to be levied against individuals or firms that were in violation of Minnesota statutes." (*Id*. at ¶2). Mr. Bernstein left government in January 2003 and began working as consultant serving a clientele that he himself describes as "advocacy groups" and "law firms pursuing class action or individual claims on behalf of insurance policyholders and mortgage fraud [sic]." (*Id*. at Tab 1).

Mr. Bernstein's testimony will be based on his specialized professional duties as a bank regulator and the specialized knowledge gained through his performance of those duties. Plaintiffs have indicated that his testimony will concern the following subjects: (1) his agency's

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Footnote continued from previous page.

"opinion testimony" at trial, and stated that that conclusion was why they had removed him from their list of *Sunstar* witnesses (and not to avoid his deposition as Plaintiffs had previously stated). (Best Decl. ¶12).

4 Plaintiffs obtained a declaration from Mr. Bernstein on March 2, 2005, which they provided to Defendants during expert discovery. The declaration itself is inadmissible for several reasons, including that it constitutes opinion testimony by an undisclosed expert. *See Compania Administradora de Recuperacion de Activos Administradora de Fondos de Inversion Sociedad Anonima* v. *Titan International., Inc.*, 533 F.3d 555 (7th Cir. 2008). (Defendant did not disclose the CEO as an expert witness prior to the disclosure deadline, thus portions of affidavit which valued collateral properly excluded as undisclosed expert testimony). Indeed, Plaintiffs removed the declaration from their trial exhibit list, implicitly acknowledging its inadmissibility.

"Investigation into Predatory Lending Allegations Against Household, Inc.", including his review of documents and other materials and his conclusions regarding the legality of Household's lending practices; (2) his agency's parallel investigation into the legality of Household's insurance sales practices; (3) his agency's opinion of Household's cooperation with the investigations, which includes the regulatory charges his agency alleged against Household, and (4) Bernstein's (admittedly limited) role in "shaping the framework" of the Multi-State Attorneys General Settlement, which focused on compliance with various consumer lending laws. (Best Decl., Ex. G). This is precisely the type of Rule 702 testimony that this Court barred the party in *Sunstar* from attempting to offer under the guise of Rule 701. 2006 U.S. Dist. LEXIS 85678, at *20 ("[Sunstar] wants to offer Spencer's testimony about the conclusions DGA drew from the research and the recommendations it made to Sunstar as a result. Those are not subjects about which an untrained layman could opine. Thus, Spencer is an expert witness.")

Plaintiffs' belated attempt to re-characterize Mr. Bernstein as a percipient witness also contradicts other positions Plaintiffs have taken in this case. Mr. Bernstein's qualifications as a former Minnesota state bank regulator are indistinguishable from the qualifications of other professional regulators whom Plaintiffs have put forth as expert witnesses in this matter, including Catherine Ghiglieri, a former Texas state bank regulator who is offered as Plaintiffs' retained regulatory expert, and Charles Cross, a former Washington state bank regulator whom Plaintiffs concede is a *Sunstar* witnesses, and whom Defendants deposed eight months ago in reliance on Plaintiffs' disclosures.

Mr. Cross's testimony focused primarily on (1) an investigation into Household's lending practices that he oversaw while at the Washington Department of Financial Institutions and (2) the preliminary input he contributed to shaping the multistate attorneys general settlement — the exact same two topics contemplated by Mr. Bernstein's testimony. Plaintiffs' own statement of Mr. Cross's Expert Qualifications states: "In the course of his work at the DFI,

Mr. Cross has investigated and assisted in the prosecution of several financial institutions accused of engaging in predatory lending, including First Alliance Mortgage Company (FAMCO) and Ameriquest." (Best Decl., Ex. H at 4). Bernstein played the identical role in Minnesota, stating, "[I] made the decision to send Household a preliminary Consent Order that included the Department's conclusions and findings regarding Household's operations in Minnesota. . . ." (Best Decl., Ex. G at 8). Plaintiffs' position that Mr. Cross is a *Sunstar* witness while Mr. Bernstein is not is illogical and arbitrary.

Indeed, if Plaintiffs' position that Mr. Bernstein may be called as a "percipient" witness were to be accepted, they would have three witnesses with indistinguishable qualifications, discussing the same subject matter, but characterized as three distinct types of witness: one a "retained expert" (Ms. Ghiglieri), one a "*Sunstar* witness" (Mr. Cross), and one a lay "percipient witness" (Mr. Bernstein).[5] Such internal contradiction belies the validity of Plaintiffs' position.

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[5] In addition to shielding him from deposition, Plaintiffs may also be seeking to superficially re-designate Mr. Bernstein as a "percipient witness" instead of a "retained expert" or "*Sunstar* witness" to sidestep their inability to show good cause for having cumulative experts on the same topics. "Only one expert witness on each subject for each party will be permitted to testify absent good cause shown." N.D. Ill. LR Form 16.1.1, fn. 7. *See also Merrill Lynch Business Financial Services, Inc.* v. *Gray Supply Co., Inc.*, Nos. 91 C 1449, 91 C 1554, 1991 WL 278305, at *3 (N.D. Ill. Dec. 23, 1991) (Conlon, J.) (court required defendants to choose one of three proposed experts on loan and banking standards, stating that the "testimony of three expert witnesses on the same subject matter is not acceptable").

Even if Mr. Bernstein were found to be a "percipient witness," it would still be improper to allow him to testify at trial. *See CIVIX-DDI, L.L.C.* v. *Cellco Partnership*, 387 F. Supp. 2d 869, 884 (N.D. Ill. 2005) (St. Eve, J.) ("Whether the Kraft Declaration offers fact testimony, expert testimony, or both, its disclosure is untimely and unfairly prejudices Expedia. Even if Kraft offers solely fact testimony, as Civix argues, Civix neither disclosed Kraft on its initial disclosures pursuant to Rule 26(a)(1) nor supplemented these disclosures to include Kraft. Moreover, Civix offers no justifiable reason for failing to disclose Kraft until this late stage.")

II. PLAINTIFFS' CONCEALMENT OF MR. BERNSTEIN CONSTITUTES CLEAR PREJUDICE TO DEFENDANTS, MANDATING EXCLUSION

Plaintiffs' affirmative withdrawal of Mr. Bernstein as a *Sunstar* witness in order to shield him from deposition prohibits them from using him "to supply evidence on a motion, at a hearing, or at a trial". Fed. R. Civ. P. 37(c)(1). The Court of Appeals has confirmed that "the sanction of exclusion is automatic and mandatory." *Salgado v. General Motors Corp.*, 150 F.3d 735, 742 (7th Cir. 1998), and can be avoided only if Plaintiffs can establish that "the failure was substantially justified or is harmless." Fed. R. Civ. P. 37(c)(1); *NutraSweet Co.* v. *X-L Eng'g Co.*, 227 F.3d 776, 785-86 (7th Cir. 2000). Plaintiffs bear the burden of showing that the belated disclosure would not prejudice Defendants. *Scranton Gillette Communications.*, 1998 WL 566668, at *3. Courts are to consider four factors when determining whether Plaintiffs have carried the burden necessary to prevent exclusion: "(1) the prejudice or surprise to the party against whom the evidence is offered; (2) the ability of the party to cure the prejudice; (3) the likelihood of disruption to the trial; and (4) the bad faith or willfulness involved in not disclosing the evidence at an earlier date." *David v. Caterpillar, Inc.*, 324 F.3d 851, 857 (7th Cir. 2003).

Plaintiffs' eleventh-hour disclosure of their intention to call Mr. Bernstein as a trial witness will result in irreparable prejudice to Defendants if Mr. Bernstein is permitted to testify at trial or otherwise. At this late date, when the parties should be focused on narrowing and refining issues for trial, forcing Defendants to prepare for the testimony of a surprise witness would constitute clear prejudice. The "fundamental purpose of Rule 37" and its exclusion sanction "is to ensure that the merits of the case can be addressed at trial without any party suffering prejudice at trial as a result of nonfeasance or malfeasance during discovery." *Ty, Inc.*, 2004 WL 421984 at *2. "[A]t the heart of Rule 37's automatic sanction provision is the recognition that precious time and resources of both opposing counsel and this Court are wasted

when faced with unjustified delay. And such waste, when significant enough, constitutes its own kind of harm." *Saudi v. Valmet-Appleton, Inc.* 219 F.R.D. 128, 134 (E.D. Wis. 2003)

Because Defendants were not made aware during discovery of Plaintiffs' intent to use Mr. Bernstein, and indeed were led to believe that Plaintiffs had removed him from their witness roster, this not only indicates bad faith on the part of Plaintiffs, requiring exclusion *United States* v. *Dunn*, No. 04 C 50472, 2007 U.S. Dist. LEXIS 27089, at **12-13 (N.D. Ill. Apr. 12, 2007) (Mahoney, J.) (bad faith found where party disclosed witnesses on last day of discovery that they knew about earlier), but also prevented Defendants from tailoring their own discovery efforts to respond to information this new witness might present. For example, because of the timing of Plaintiffs' withdrawal of Mr. Bernstein as a *Sunstar* witness immediately following Defendants' request to take his deposition, Defendants did not pursue this request. With Plaintiffs representing that Mr. Bernstein would not appear at trial, Defendants' experts did not need to consider any implications of his possible testimony, respond to any such testimony in their reports, or assist Defendants in preparing a *Daubert* motion. This Court has held that a last-minute disclosure of expert information is prejudicial where it leaves defendants "with no meaningful opportunity to review the experts' reports, no opportunity to schedule the experts' depositions, and no opportunity to identify and disclose rebuttal experts". *Finwall v. City of Chicago*, 239 F.R.D. 504, 507 (N.D. Ill. 2006) (Manning, J.) (such delay causes harm "both to the defendants and to the court" — "[L]ate disclosure is not harmless within the meaning of Rule 37 simply because there is time to reopen discovery").[6]

[6] For example, Defendants will need to undertake further research into Mr. Bernstein's character and integrity following his recent misdemeanor conviction for making false statements about a political opponent. *See Fine* v. *Bernstein*, 726 N.W.2d 137 (Minn. Ct. App. 2007).

Nor can Plaintiffs show that the prejudice to Defendants could be cured even by re-opening discovery to permit Defendants to depose Mr. Bernstein. In similar circumstances, district courts in this Circuit have held that this costly "remedy" is no remedy at all. *See Saudi*, 219 F.R.D. at 134 (Court declined to reopen discovery for deposition of belatedly disclosed fact witnesses; plaintiff's argument that prejudice was curable through new depositions and deadlines would mean that "the Court could never impose a Rule 37(c) sanction."); *Ty, Inc.*, 2004 WL 421984 at * 4 ("[W]e are well past the discovery cutoff in this case, and I will not permit PIL to use the new witness designations as a backdoor method for reopening discovery."). That Plaintiffs now wish to call Mr. Bernstein's testimony "percipient" after Defendants have been irreversibly prejudiced is of no moment. The sharp tactics and strategic sleight of hand that Plaintiffs have used to mislead Defendants and manipulate discovery should not be rewarded. The testimony of Mr. Bernstein should be excluded for any and all purposes.

CONCLUSION

For the foregoing reasons, the Court should enter an Order precluding Plaintiffs from offering for any purpose the testimony of James C. Bernstein.

Dated: January 30, 2009
New York, New York

Respectfully submitted,

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