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, vs. 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 PLAINTIFFS' MOTION TO EXCLUDE CERTAIN TESTIMONY OF DEFENDANTS' EXPERT JOHN BLEY PURSUANT TO FEDERAL RULE OF EVIDENCE 702

(Exhibits filed separately under seal pursuant to court order)

Restricted Document Pursuant to L.R. 26.2 Filed Under Seal Pursuant to Protective Order Dated November 5, 2004 and the Minute Order Dated October 10, 2006 (Docket 704)

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PLAINTIFFS' MOTION *IN LIMINE* NO. 10

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I. INTRODUCTION

Lead plaintiffs respectfully submit this memorandum of law in support of their motion to exclude portions of the testimony of defendants' proposed expert, John Bley, pursuant to Federal Rule of Evidence 702 ("Rule 702"). Defendants retained Mr. Bley, a former regulator at the Washington Department of Financial Institutions ("Washington DFI"), to rebut the opinions reached by plaintiffs' expert, Catherine Ghiglieri, another former regulator, regarding defendants' use of predatory lending practices. But unlike Ms. Ghiglieri, Mr. Bley engages in inadmissible "talking off the cuff – deploying neither data nor analysis." *Lang v. Kohl's Food Stores, Inc.*, 217 F.3d 919, 924 (7th Cir. 2000). Thus, plaintiffs move to exclude portions of his proffered testimony. Many of these necessarily unreliable opinions rest on mere *ipse dixit*. Some are contrary to the facts of this case or the law. Others rest upon unreliable documents. All should be excluded.

II. SUMMARY OF IMPROPER OPINIONS

Mr. Bley offers several improper and plainly inadmissible opinions. First, Mr. Bley speculates that the Washington DFI Expanded Report of Examination, dated April 30, 2002, is not backed by the "moral authority of the State of Washington" even though the report was signed by the enforcement chief of that department, who was authorized to issue it. Bley Report at 16.[1]

Second, Mr. Bley offers the unsupported opinion that the findings in the Expanded Report and other reports of examination are just like allegations in a civil complaint whose truth and accuracy remain unknown – an assertion flatly contradictory to Fed. R. Evid. 803(8), pursuant to which the reports are considered for the truth of the matter asserted. Bley Report at 10.

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[1] "Bley Report" refers to the Joint Report Pursuant to Federal Rule of Civil Procedure 26 of John L. Bley and Carl A. LaSusa, as amended February 15, 2008. The Bley Report is attached hereto as Exhibit A.

Third, Mr. Bley offers the completely unsubstantiated assertion that "creative" regulatory examiners use "novel" theories in their reports of examination just to see how the company will react. *Id*. at 9. Mr. Bley cites no example of this activity in his report and does not assert that any report at issue in this case suffers from this alleged defect.

Fourth, Mr. Bley opines that Household International, Inc. ("Household") "diligently" tracked customer complaints even though his assertion contradicts the testimony from Household's head of Policy & Compliance, the unit responsible for tracking complaints. *Id*. at 61.

Fifth, Mr. Bley relies upon Household's Effective Rate study, a document that lacks any indicia of reliability as it was prepared under threat of litigation. *Id*. at 40-41.

Sixth, Mr. Bley claims that companies settle disputes with their regulators as "business decisions" where he has no training, education or experience that would permit him to opine on this issue. *Id*. at 10.

Seventh, Mr. Bley asserts that Household's Pay Right Rewards product qualified as an alternative mortgage loan subject to federal preemption under the Alternative Mortgage Transaction Parity Act ("AMTPA") despite the fact that he did not consider evidence that flatly contradicts his conclusion. *Id*. at 22.

Eighth, Mr. Bley opines that Household had adequate internal controls based on the role allegedly played by its legal department in vetting products and policies when plaintiffs were precluded from testing the veracity of this conclusion because defendants withheld Household legal department memoranda on the grounds of attorney-client privilege. *Id*. at 20, 38, 59.

Ninth, Mr. Bley opines on consumer behavior and complaints even though he has no expertise on this subject. *Id*. at 24 n.56, 29, 35.

Finally, Mr. Bley's unsupported opinions as to defendants' state of mind improperly invade the role of the jury to bolster defendants' credibility. *Id*. at 14 n.25, 19, 23.

III. ARGUMENT

A. Legal Standard

As the Supreme Court has noted, "'expert evidence can be both powerful and quite misleading because of the difficulty in evaluating it.'" *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 595 (1993) (citations omitted). Because of this risk, trial judges are charged with the responsibility of acting as gatekeepers to exclude unreliable expert witness testimony. *Id*. at 597; *Dhillon v. Crown Controls Corp*., 269 F.3d 865, 869 (7th Cir. 2001) (emphasizing trial court's "gatekeeper" role). Rule 702, amended in 2000 to reflect the Supreme Court's decision in *Daubert*, sets forth the test for determining the admissibility of proposed expert testimony:

> If scientific, technical, or other specialized knowledge ***will assist the trier of fact to understand the evidence or to determine a fact in issue***, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

Fed. R. Evid. 702 (emphasis added). Thus, to be admissible, the expert must possess "sufficient specialized expertise to render his opinion on the topic . . . reliable, as required by *Daubert*." *Ty, Inc. v. Publications Int'l, Ltd.*, No. 99 C 5565, 2004 WL 2359250, at *5 (N.D. Ill. Oct. 19, 2004); *Tyus v. Urban Search Mgmt.*, 102 F.3d 256, 263 (7th Cir. 1996) (expert testimony must be "tested to be sure that the person possesses genuine expertise in a field"). The Court must then determine whether the expert's testimony is reliable, "that is, whether it is based on a reliable methodology." *Clark v. Takata Corp.*, 192 F.3d 750, 756 (7th Cir. 1999). Finally, the proffered testimony must assist the trier of fact in understanding the evidence or determining a fact in issue. *Id*. at 757; *O'Conner v. Commonwealth Edison Co.*, 13 F.3d 1090, 1106 (7th Cir. 1994) (second prong of the *Daubert* test is determining whether the expert opinion will assist the trier of fact). The burden is on the party offering the expert testimony to establish admissibility. *See* Fed. R. Evid. 104(a); *Bourjaily*

v. United States, 483 U.S. 171, 175 (1987). Defendants cannot meet this burden as to Mr. Bley's proposed testimony, discussed below.

B. Mr. Bley Should Not Be Allowed to Testify that the Washington Department of Federal Institutions Expanded Report of Examination Is Not an Official Report of that Department and Related Assertions Regarding the Reliability of State Agency Reports of Examination

On page 16 of his report, Mr. Bley opines that the Washington DFI Expanded Report of Examination "is not a report backed by the moral authority of the State of Washington." Bley Report at 16. This opinion is a prime example of Mr. Bley's "off the cuff" approach, which is completely devoid of analysis or support. Accordingly, Mr. Bley should be precluded from offering this unsubstantiated opinion.

Experts cannot ignore the evidence before them to reach opinions favoring their client. *Chan v. Coggins*, No. 07-60792, 2008 U.S. App. LEXIS 20987, at *8 (5th Cir. Oct. 2, 2008) (district court properly excluded expert testimony where it lacked a scientific basis and was contrary to the facts in evidence). It is uncontroverted that the Expanded Report of Examination is an official report of the Washington DFI. Charles Cross, the former enforcement chief at the Washington DFI and the author of the Expanded Report of Examination, submitted a declaration in a prior case in which he declared that the "Department considers [the report] to be complete and final." *Luna v. Household Finance Corp., III*, No. C02-1635, Declaration of Chuck Cross, ¶3 (W.D. Wash. Sept. 18, 2002), attached hereto as Exhibit B. (This declaration is Exhibit 8 to Mr. Cross' deposition in this case.) Mr. Cross further declared that he signed the report "in [his] official capacity as the enforcement chief of the State Department of Financial Institutions." *Id.*, ¶4. Indeed, Mr. Bley concedes that examiners have the authority to issue reports of examination on the agency's behalf. *See* Bley Report at 8-9. Significantly, Mr. Bley does not assert (nor could he) that Mr. Cross was not delegated the authority to issue the Expanded Report of Examination. In sum, Mr. Bley's opinion suggesting that the Expanded Report of Examination is not backed by the "moral authority" of the

State of Washington is not the product of "reliable principles and methods" (Fed. R. Evid. 702) and should be excluded.

The Court should similarly exclude two related "off the cuff" unsupported opinions offered by Mr. Bley: 1) that the findings in a regulatory report of examination are just like the allegations in a civil complaint; and 2) that sometimes a "creative" examiner will put a "novel" theory in a regulatory report just to see how the company will respond. Bley Report at 9, 10. Both of these "opinions" are subjective beliefs lacking any analytical support and should be excluded. *O'Connor*, 13 F.3d at 1107 (upholding exclusion of expert testimony where the expert produced no personal study or experiments that would support his asserted opinion); *see also Jackson v. Nat'l Action Fin. Servs., Inc.*, 441 F. Supp. 2d 877, 879 (N.D. Ill. 2006) ("we exclude any testimony that is based on 'subjective belief or unsupported speculation'") (citation omitted).

Additionally, Mr. Bley's opinion that findings in regulatory reports are just like allegations in a civil complaint is incorrect as a matter of law. The Washington DFI is a governmental entity tasked with conducting unbiased, objective investigations and enforcing compliance with consumer protection laws. *See* Bley Report at 8-9. Unlike allegations in a civil complaint, the Washington DFI report is not adversarial in nature, but contains objective findings based on a review of Household's own documents. The Washington DFI report is exactly the type of evidence deemed inherently reliable by the Federal Rules and the findings in that document are admissible for the truth of the matter asserted. *See* Fed. R. Evid. 803(8). Contrary to Mr. Bley's opinion, the law does not treat findings in a report of examination like allegations in a civil complaint. It would be misleading to the jury (and contrary to this Court's instructions to the jury) if Mr. Bley were allowed to suggest that the jurors should not consider the findings in that report or any other regulatory report for the truth of the matter asserted.

As to Mr. Bley's opinion that a "creative" examiner will put a "novel" theory in a report just to see how a company will respond, Mr. Bley does not assert that (or make any effort to determine whether) the reports of examination at issue in this case were authored by "creative" examiners using "novel" theories just to see how the company would react. *See* Bley Report at 9. Mr. Bley is not allowed to offer an opinion not related "to the factual situation at hand." *Porter v. Whitehall Labs., Inc.*, 9 F.3d 607, 616 (7th Cir. 1993). Nothing in Rule 702 "'requires a district court to admit opinion evidence which is connected to existing data only by the *ipse dixit* of the expert.'" *Clark*, 192 F.3d at 758 (citation omitted). Thus, this opinion, too, should be excluded.

C. Mr. Bley Should Not Be Allowed to Offer Any Opinions Predicated Upon Any Alleged Investigation Into Complaints Received by Household or the Number of Complaints Received by Household

Mr. Bley opines that Household "diligently tracked all complaints that were not immediately resolved at the branch level." Bley Report at 61. As this Court noted in *Richman v. Sheahan*, 415 F. Supp. 2d 929 (N.D. Ill. 2006), it is improper for an expert to opine on whether a particular fact actually occurred. *Id*. at 942. Further, Mr. Bley's factual assertion contradicts the testimony of Robin Allcock, head of the Policy and Compliance Group, that there was no effort to track branch level complaints prior to the 2001-2002 timeframe. Allcock Depo Tr. at 216:8-23, attached hereto as Exhibit C. Defendants, therefore, cannot use Mr. Bley to opine (without foundation) as to Household's complaint tracking. *See White v. Gerardot*, No. 1:05-CV-382, 2008 U.S. Dist. LEXIS 72436, at *16-*17 (N.D. Ind. Sept. 23, 2008) (refusing to let expert testify where many of the crucial facts were in dispute because to do so would allow expert to make and relay credibility findings to the jury).

Mr. Bley should also be barred from opining on the reliability of Household's July 2002 internal "Effective Rate" study because it was prepared for purposes of litigation and thus unreliable. Bley Report at 40-41. As this Court noted in *Sommerfield*, the sources of an expert opinion "must be

reliable." *Sommerfield v. City of Chicago*, 2008 U.S. Dist. LEXIS 88760, at *12 (N.D. Ill. Nov. 3, 2008) (citing cases). "[W]hen a document is created for a particular use that lies outside the business's usual operations – especially when that use involves litigation – the[] guarantors of reliability are absent." *Id.* at *19. Defendants' study, which was prepared in July of 2002 under threat of litigation from the Attorneys General, is not reliable and suffers from the same defects discussed in *Sommerfield*. *Id.* at *14-*17.

D. Mr. Bley Should Not Be Allowed to Testify that Companies Settle for Business Reasons or Why Household Settled with the Attorneys General or with the Washington Department of Financial Institutions

In his report, Mr. Bley opines that "in most cases" companies make the "business decision" not to engage in litigation with state or federal regulators with respect to violations identified in regulatory reports. *See* Bley Report at 10. Mr. Bley does not have any expertise in this area and has no reliable basis for determining why companies settle disputes. For example, Mr. Bley cites no analysis, study or article on this subject – he simply asserts it. Nor does Mr. Bley's training or experience as a regulator qualify him to make such unsupported observations. Additionally, this opinion is not tied to the facts of this case, *i.e.*, Mr. Bley does not opine that Household settled with its regulators for this reason. *Whitehall*, 907 F.3d at 615. There may be many reasons for a company to settle. Mr. Bley has performed no analysis nor cited any Household documents to distinguish one reason from another. Thus, this speculative and improper opinion should be excluded.

E. Mr. Bley Should Not Be Allowed to Testify Regarding the Alternative Mortgage Transaction Parity Act and the Pay Rights Reward Product

In his report, Mr. Bley opines – with absolutely no analysis or support – that Household's Pay Right Rewards ("PRR") product qualifies as an "alternative mortgage transaction" under AMTPA. Bley Report at 22. After quoting the relevant regulation, Mr. Bley concludes "Household's Pay Right Reward Program reduced interest rates contingent upon the timely

payments of consumers, thus making these variable rate loans." *Id.* "[A]n expert must 'substantiate his opinion; providing only an ultimate conclusion with no analysis is meaningless.'" *Clark*, *supra*, 192 F.3d at 757 (citing *Huey v. United Parcel Serv., Inc.*, 165 F.3d 1084, 1087 (7th Cir. 1999)); *Rosen v. Ciba-Geigy Corp.*, 78 F.3d 316, 319 (7th Cir. 1996) ("'An expert who supplies nothing but a bottom line supplies nothing of value to the judicial process'") (citation omitted). Accordingly, Mr. Bley's opinion must be excluded.

Additionally, there is an independent reason for excluding Mr. Bley's opinion on this issue. He does not address or consider available contrary evidence, including evidence cited in his own report. Mr. Bley's report cites an e-mail that specifically notes that numerous states, including Illinois, "have argued that our Pay Right Reward program is ***not*** a variable rate loan and thereby does not qualify of [sic] the federal preemption." HHS03443325 (emphasis added), attached hereto as Exhibit D. In his report, Mr. Bley simply ignores the fact that the states challenged the use of AMTPA. "Even in instances where a formal scientific method is not necessary, a purported expert must consider obviously relevant information in forming his opinion." *Klaczak v. Consol. Med. Transp.*, 458 F. Supp. 2d 622, 667 (N.D. Ill. 2006). Mr. Bley did not do so, and his opinions should be excluded.

F. Mr. Bley Should Not Be Allowed to Offer Any Opinion Regarding the Adequacy of Defendants' Internal Controls

In his report, Mr. Bley opines that Household's internal controls were adequate during the Class Period. In support of his conclusion, Mr. Bley asserts that "[n]ew policies and procedures were vetted by Household's legal department." Bley Report at 20; *see also id.* at 38 (quoting Craig Castelein declaration); *id.* at 59 (asserting policy was to develop "legal loan products").

Defendants are barred from offering any testimony via Mr. Bley (or otherwise) regarding any purported reliance upon the Legal Department. Defendants withheld the underlying documents based on privilege grounds and prevented witnesses from providing testimony on that ground as

well. As set forth in plaintiff's concurrently filed motion *in limine* on this issue, which is incorporated herein by reference, this bars defendants and Mr. Bley from testifying on this issue at trial. *See* Memorandum of Law in Support of Plaintiffs' Motion *In Limine* to Exclude Defense Documents or Testimony Which Refer to Advice From Counsel That Defendants Complied with Federal and State Laws, filed concurrently herewith.

G. Mr. Bley Should Not Be Allowed to Testify as to Borrower Behavior

Mr. Bley intends to opine, based on his experience as a regulator, on the type of loans borrowers generally prefer. For example, Mr. Bley opines that in his experience as a regulator, consumers are "particularly sensitive" to the amount of their monthly payment. Bley Report at 29; *see also id.* at 35. Mr. Bley also purports to testify about the reliability of complaints lodged by borrowers with regulatory agencies, opining that, based on his experience, "it is usually inadvisable to reach broad conclusions based solely upon after-the-fact consumer representations when there is an incentive for the consumer to rewrite history." *Id.* at 24 n.56 (also asserting other similar opinions based on his "experience"). Mr. Bley lacks the requisite expertise to offer "expert opinion" on either topic. First, Mr. Bley has absolutely no "knowledge, skill, experience, training, or education" concerning the behavior of subprime lenders. Fed. R. Evid. 702; *F.T.C. v. Amy Travel Service, Inc.*, 875 F.2d 564, 573 (7th Cir. 1989) (affirming holding that "testimony how consumers would react to sales material should be given by an expert in consumer psychology or consumer behavior"). Second, Mr. Bley was never a state or federal regulatory examiner or investigator, and therefore has no "expertise" on the reliability of consumer complaints. *See* Bley Report at 2 (discussing his regulatory positions). Indeed, the summary of "credentials" set forth in Mr. Bley's report make it glaringly obvious that he never even interacted with consumers in his capacity as a regulator. *Id.* His testimony should be excluded at trial for these reasons alone.

Moreover, at no time does Mr. Bley make any attempt to demonstrate (nor can he), how his experience as a regulator actually relates to the opinions he intends to offer at trial. His failure to "explain how [his] experience leads to the conclusion reached," "why [his] experience is a sufficient basis for [his] opinion" and how "that experience is reliably applied to the facts" warrants the exclusion of his testimony at trial. *See, e.g.*, Fed. R. Evid. 702: Advisory Committee Notes to 2000 Amendments.

Furthermore, even if Mr. Bley was qualified to offer expert opinion on consumer behavior – and he clearly is not – he employed no verifiable methodology in reaching his opinions. Mr. Bley conducted no analysis regarding the reliability of customer complaints nor does he support his opinions with studies or articles concerning consumer behavior. His opinion is based on personal anecdotes and nothing more. Throughout his report, Bley repeatedly discounts borrower complaints, opining that the complaints are the result of the borrower's financial motives. Yet, in reaching this opinion, Mr. Bley relies heavily on defendants' one-sided self-serving statements, despite ***their*** financial incentives, even when contrary to fact and common-sense. For instance, Mr. Bley relies on defendant William Aldinger's testimony for the proposition that compliance is "enhanced" when the sales managers are put in charge of compliance and the independent field auditors eliminated. Bley Report at 46. Mr. Bley's opinion concerning the behavior of borrowers and the motive behind customer complaints is unreliable and should be excluded at trial.

H. Mr. Bley Should Not Be Allowed to Offer Any Opinions Regarding Defendants' State of Mind, Including Beliefs Regarding Predatory Lending

In his report, Mr. Bley opines as to defendants' state of mind. For example, he notes "contemporaneous public statements by the Officer Defendants plainly indicate their ***belief*** that the term 'predatory lending' had no standard definition." *Id*. at 14 n.25 (emphasis added). Similarly, he opines that "Household's senior management ***undertook*** to develop legal products and sales

strategies." *Id*. at 19 (emphasis added). And "Plaintiff's Report [Ms. Ghiglieri's Report] nowhere suggests that Household lacked a ***reasonable basis for its view*** that certain products were within the scope of AMTPA." *Id.* at 23. Experts may not opine as to defendants' state of mind. That subject is not a proper one for expert testimony, but rather an attempt to "improperly . . . assume the role of advocate[]" for the defendants' case. *In re Rezulin Prods. Liab. Litig.*, 309 F. Supp. 2d 531, 546 (S.D.N.Y. 2004); *see Apotex Corp. v. Merck & Co.*, No. 04 C 7312, 2006 U.S. Dist. LEXIS 28855, at *23-*24 (N.D. Ill. Apr. 25, 2006) (noting the Seventh Circuit and Northern District of Illinois decisions holding this type of testimony inadmissible), *aff'd*, 507 F.3d 1357 (Fed. Cir. 2007). The determination of defendants' state of mind is solely for the jury. *See, e.g.*, *Klaczak v. Consol. Med. Transp. Inc.*, No. 96 C 6502, 2005 U.S. Dist. LEXIS 13607, at *31 (N.D. Ill. May 26, 2005) ("precedent teaches that proffered expert assertions about another's subjective intent or knowledge are not helpful to the jury, which is equally if not much better suited to make these assessments than the parties' competing paid experts"). Thus, Mr. Bley should be precluded from testifying about defendants' state of mind at trial.

IV. CONCLUSION

For the foregoing reasons, the Court should exclude portions of the testimony of defendants' proposed expert, John Bley, at trial.

DATED: January 30, 2009

Respectfully submitted,

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

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Diego, State of California, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 655 West Broadway Suite 1900, San Diego, California 92101.

2. That on January 30, 2009, declarant served by electronic mail and by U.S. Mail to the parties the **MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION TO EXCLUDE CERTAIN TESTIMONY OF DEFENDANTS' EXPERT JOHN BLEY PURSUANT TO FEDERAL RULE OF EVIDENCE 702**.

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 30th day of January, 2009, at San Diego, California.

/s/ Teresa Holindrake
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