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

DEFENDANTS' REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THEIR *DAUBERT* MOTION TO EXCLUDE THE "EXPERT" TESTIMONY OF CHARLES CROSS

CAHILL GORDON & REINDEL LLP
80 Pine Street
New York, New York 10005
(212) 701-3000

EIMER STAHL KLEVORN & SOLBERG LLP
224 South Michigan Avenue
Chicago, Illinois 60604
(312) 660-7600

Attorneys for Defendants Household International, Inc., Household Finance Corporation, William F. Aldinger, David A. Schoenholz, Gary Gilmer and J. A. Vozar

TABLE OF CONTENTS

This Reply Memorandum is respectfully submitted on behalf of Defendants Household International, Inc., ("Household"), William F. Aldinger, David A. Schoenholz and Gary Gilmer (the "Individual Defendants" and, collectively with Household, the "Household Defendants" or "Defendants"), in further support of their motion to exclude the testimony of Charles Cross, a former state bank regulator whom Plaintiffs proffer as an expert witness.

PRELIMINARY STATEMENT

Defendants' opening brief on this motion identified a number of methodological failings committed by Plaintiffs' purported "expert witness" Charles Cross,[1] all of which Cross himself freely concedes. Among these are the following:

- Cross "would have excluded any of the information that was favorable to Household" because coming to the "fairest overall appraisal" of Household's practices as to borrowers in the State of Washington was not his goal. According to Cross: "That was not the purpose of the report." (Declaration of Thomas J. Kavaler in Support of the Household Defendants' Daubert Motion to Exclude the "Expert" Testimony of Catherine A. Ghiglieri, Charles Cross, and Harris L. Devor, dated January 30, 2009 ("Kavaler Decl.") Ex. 6, Cross Tr. 88:18-89:9; 89:23-90:6)
- Cross disregarded positive aspects of Household's business because, according to Cross: "Unless it was relevant to the argument of the point I was trying to make [that certain 'customers were harmed'], there would be no point to put it in." (Kavaler Decl. Ex. 6, Cross Tr. 88:25-89:5)
- Cross based his conclusions on methods that were, in his words, "woefully inadequate" as a matter of statistics to support the conclusions he drew. (Kavaler Decl. Ex. 6, Cross Tr. 22:6-20)
- Cross expressed opinions about "Household's intentions" based on nothing more than "speculation." (Declaration of David R. Owen in Support of the Household Defendants' Daubert Motion to Exclude the "Expert" Testimony of Catherine A. Ghiglieri, Charles Cross, and Harris L. Devor, dated January 30, 2009 ("Owen Decl.") Ex. 1, Cross Luna Tr. 255:1-5)

[1] Cross testified at his deposition that he refused to serve as an expert witness for Plaintiffs. (Kavaler Decl. Ex. 6, Cross Tr. 102:13-21 ("I will not be an expert for — for a private action. So, if [Plaintiffs' counsel] did ask me that, which is possible, . . . I would have said no.")). Nonetheless, Plaintiffs now offer Cross as an expert witness, apparently against his wishes, via videotaped deposition testimony. (Pl. Br. at 1 n.1 ("Plaintiffs intend to offer both percipient and expert testimony from Mr. Cross in the form of videotaped testimony.")).

Instead of addressing these (and the many other) methodological failings of Cross, Plaintiffs attempt to sidestep the dispositive effect of Cross's concession that his methods are unreliable by misstating the law. The fundamental premise of Plaintiffs' opposition is that "non-scientific testimony need only be linked to somebody of specialized knowledge or skills, and years of experience provide that link." (Lead Plaintiffs' Opposition to Defendants' Daubert Motion to Exclude the Expert Testimony of Charles Cross, ("Pl. Br.") at 3). According to Plaintiffs – notwithstanding Cross's acknowledgement that his methods were speculative, biased, and unreliable – his alleged expertise alone is enough to get him over the *Daubert* hurdle because "his approach does not purport to be scientific." (Pl. Br. at 11). This is not the law. *United States* v. *Moore*, 521 F.3d 681, 683 (7th Cir. 2008) (Easterbrook, J.) ("Rule 702 does not say that any testimony within the scope of a witness's expertise is admissible."); *id.* at 685 ("Good credentials may be a necessary condition for expert testimony but are not a sufficient condition."). Defendants do not in their opening brief question that Cross has some expertise; they demonstrate that his methods in this instance were facially — and admittedly — inadequate. Plaintiffs' attempt to mislead the Court as to the applicable standard is an admission that they cannot satisfy the real standard.[2]

Cross's testimony cannot be introduced to the jury because the sweeping conclusions Cross drew about Household's business, and Household's "intentions," were based on deeply flawed and biased methods. Cross himself admits the manifold limitations of his process. Moreover, Cross's flawed methods led him to draw conclusions based on credibility inquiries and directed to issues Plaintiffs now claim go directly to Defendants' scienter. (Pl. Br. at 10).

---

[2] Nor can Plaintiffs claim that they somehow misunderstood the applicable standard. They correctly stated the applicable standard as recently as January 30, 2009 in the context of their motions to exclude the testimony of certain of Defendants' expert witnesses. *See*, *e.g.*, Memorandum of Law in Support of Plaintiffs' Motion to Exclude Testimony of Defendants' Proposed Expert Dr. Robert Litan Pursuant to Federal Rule of Evidence 702 ,at 2-3.

Such testimony cannot be admitted. For the reasons discussed herein, the "expert testimony" of Cross that Plaintiffs propose to offer at trial should be excluded in its entirety.[3]

ARGUMENT

To be admissible, all expert testimony (whether it be scientific or based on other specialized knowledge) must satisfy Rule 702's prerequisites:

> 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. (emphasis added)

Despite the clear language of Rule 702, Plaintiffs argue that Cross's testimony should be held to a lower standard of reliability because he is not a scientist. (*E.g.*, Pl. Br. at 3 ("defendants ask the Court to apply scientific standards to non-scientific opinions")). The Supreme Court has considered and rejected this very argument. *Kumho Tire Co.* v. *Carmichael,* 526 U.S. 137, 151 (1999) ("We must therefore disagree with the Eleventh Circuit's holding that a trial judge may ask questions of the sort *Daubert* mentioned only where an expert 'relies on the application of scientific principles,' but not where an expert relies 'on skill- or experience-based observation."). Plaintiffs' position is in direct conflict with *Kumho* and Rule 702 itself. It should not be accepted.[4]

---

[3] The testimony at issue is listed in Exhibit A to Plaintiffs' opposition brief. Defendants have moved separately to exclude the report Cross authored (the "DFI Report") and the testimony that Cross gave in a prior litigation.

[4] Even before *Kumho*, courts in this Circuit rejected the false dichotomy Plaintiffs now seek to draw between scientific and non-scientific testimony for Rule 702 purposes. *E.g., Ullman-Briggs, Inc.* v. *Salton/Maxim Housewares, Inc.*, Nos. 92 C 680, 92 C 2394, 1996 WL 535083, at *3 (N.D. Ill. Sept. 17, 1996) (Plunkett, J.) ("For purposes of admissibility, there is no basis for distinguishing between scientific and non-scientific expert testimony.").

Under Rule 702, district court judges are obliged to act as "gatekeepers" for expert testimony. *Dhillon* v. *Crown Controls Corp*., 269 F.3d 865, 869 (7th Cir. 2001) (citing *Daubert* v. *Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 589 (1993)). In exercising this gatekeeping function, district courts conduct a two-pronged analysis when presented with proposed expert testimony, assessing both reliability and relevance. *Smith* v. *Ford Motor Co*., 215 F.3d 713, 718 (7th Cir. 2000) ("'the trial judge must ensure that any and all scientific testimony or evidence admitted is not only relevant, but reliable'") (quoting *Daubert*, 509 U.S. at 589); *see also Chapman* v. *Maytag Corp*., 297 F.3d 682, 686-87 (7th Cir. 2002). Under the first prong of the analysis, which addresses the reliability of the proffered testimony, the court will make "a preliminary assessment of whether the reasoning or methodology underlying the testimony is scientifically valid." The *Daubert* decision included a non-exhaustive set of factors to be considered in evaluating proposed expert testimony. The question of "whether the expert's technique or theory can be or has been tested — that is, whether the expert's theory can be challenged in some objective sense, or whether it is instead simply a subjective, conclusory approach that cannot reasonably be assessed for reliability," Fed. R. Evid. 702 advisory committee's note (2000); *see Daubert*, 509 U.S. at 592–93, is particularly important in Cross's case. The second prong of the analysis addresses the relevance of the proffered expert testimony, by determining whether the testimony will assist the trier of fact "to understand the evidence or to determine a fact in issue." Fed. R. Evid. 702; *Chapman*, 297 F.3d at 687 (citing *Porter* v. *Whitehall Laboratories, Inc*., 9 F.3d 607, 616 (7th Cir. 1993)).

Unless the party proposing the expert testimony can establish by a preponderance of the evidence that it is both relevant and based on reliable methods, the court must exclude it, "'lest apparently scientific testimony carry more weight with the jury than it deserves.'" *Smith*, 215 F.3d at 718 (quoting *DePaeppe* v. *General Motors Corp*., 141 F.3d 715, 720 (7th Cir. 1998)). Instead of carrying their burden to establish the reliability of Cross's methods, however,

Plaintiffs devote the bulk of their argument to simple regurgitation of Cross's conclusions, again missing the point. Under *Daubert*, the Court's focus "must be solely on principles and methodology, not on the conclusions that they generate." 509 U.S. at 595.

I. Cross's Proposed Testimony Is Based on Biased and Unreliable Methods

From his vantage point in the state of Washington, Cross concluded that Household engaged in a nationwide pattern of deceptive and illegal lending practices that permeated the entire company. The "method" he used to reach this conclusion involved nothing more than unsupported extrapolation from 19 customer loans in Washington. Even these 19 loans were not randomly selected; each was the subject of a customer complaint between May 2000 and February 2002. (Kavaler Decl. Ex. 6, Cross Tr. 29:2-30:10; 37:8-11). On the basis of his limited observations about these 19 accounts, Cross not only drew conclusions about Household's operations in Washington (where Household made 31,292 loans during the same May 2000 - February 2002 period), but he also drew nationwide conclusions.

Plaintiffs assert that Cross "does not purport to extrapolate his conclusions from a sample of complaints; his opinions are based on a lengthy and complete investigation of the Company and his experience as a regulator." (Pl. Br. at 19). Cross himself disagrees, conceding that his review of Household training materials and policy updates was neither lengthy nor complete. (Owen Decl. Ex. 1, Cross Luna Tr. at 258: 3-9 ("Q: How much time did you personally spend in connection with writing the report, going through the box or two boxes of documents and policies and training manuals and bulletins of Household? A: I don't recall. I definitely read some of it, scanned some of it, but I can't recall the actual time spent. It wasn't a significant part of the examination.")). The fact that Cross eyeballed or "scanned" certain other documents, and reportedly heard about similar issues in conversations he had with regulators from other states, does nothing to bolster his biased, unreliable methods.

As Cross freely admitted, he had no interest in examining the data that do not support his conclusion that Household was engaged in nationwide "predatory lending." Instead, Cross ignored this information, and admittedly interpreted disputed facts against Household wherever possible (*E.g.*, Kavaler Decl. Ex. 6, Cross Tr. at 88:18-89:8):

> "Q And are you telling me that with respect to those 19 complaints and that analysis, you would have excluded any of the information that was favorable to Household just as you did in the more general discussion about Household? . . .
>
> A Yeah, likely. Unless it was relevant to the argument of the point I was trying to make, there would be no point to put it in.
>
> Q What was the argument of the point you were trying to make?
>
> A That these consumers were harmed. . . .")

Cross's biased "analysis" is neither reproducible nor falsifiable. Plaintiffs fail to establish that Cross undertook any reliable, verifiable method when concluding that a handful of unadjudicated customer complaints in a single state demonstrates a nationwide deceptive scheme at Household. Plaintiffs protest that Cross offers more than his *ipse dixit* to support his conclusion. (*E.g.*, Pl. Br. at 11-12 n.10 ("Mr. Cross's opinion is based on much more than 'say-so.'")). Plaintiffs' argument does nothing but add counsel's "say-so" to Cross's. Even confronted with a *Daubert* challenge, Plaintiffs cannot articulate any reliable method Cross used to form his conclusions.

The closest Plaintiffs come to identifying any method used by Cross other than his extrapolation from 19 customer complaints is their assertion that Cross examined various documents. (*E.g.*, Pl. Br. at 9 (Cross "'spent a lot of time exchanging information, exchanging documents, looking at spreadsheets, that kind of thing.' These documents further supported his opinion that the practices were widespread") (internal citation omitted)). Like Cross, Plaintiffs fail to establish that these documents provided any basis for Cross's sweeping conclusions. More importantly, Plaintiffs fail to identify what method, if any, Cross applied to the selection of

the documents or analysis of the information they conveyed to lead him to his conclusions. This disconnect is fatal under Rule 702. *See, e.g.*, *Huey* v. *United Parcel Service, Inc.*, 165 F.3d 1084, 1086-87 (7th Cir. 1999) (expert opinion excluded because the expert did "not describe the reasoning used to reach his conclusion"); *Brown* v. *Primerica Life Insurance Co.*, No. 02 C 8175, 2006 WL 1155878, at *4 (N.D. Ill. Apr. 29, 2006) (Kocoras, C.J.) (expert affidavit excluded in part because "we have no information that would allow a determination of whether [the expert] employed any methodology at all, let alone whether it could be separated from 'subjective belief or unsupported speculation.'" (quoting *Daubert*, 509 U.S. at 590)); *R.J. Reynolds Tobacco Co.* v. *Premium Tobacco Stores, Inc.*, No. 99 C 1174, 2004 WL 1613563, at *9 (N.D. Ill. July 19, 2004) (Kocoras, C.J.) (excluding expert's damages calculation because "the applicable data and the proffered opinion are separated by an analytical chasm, [which] cannot be bridged solely by the expert's say-so").

Lacking any data to bridge the divide between his review of 19 loan files and his conclusion that Household engaged in nationwide deceptive lending, Cross turns to second- and third-hand allegations of possible violations in other states to support his "conclusion." Cross explained the method underlying his conclusion in the DFI Report as follows:

> "HFC informed the Department that the 'practice' [effective rate] was isolated to a single branch in Washington and that the matter was not a corporate practice. However, the Department has identified the practice to other branches in Washington and ***has even received reports from regulators in other states concerning the practice***." (Owen Decl. Ex. 3, DFI Report at 46. *See also* Kavaler Decl. Ex. 6, Cross Tr. at 145:21-146:16).

That Cross points to uncorroborated multiple hearsay (what Cross heard that other regulators heard from customers in other states) from unidentified sources as support for his conclusions further underscores the unreliability of his methods.[5] Whether any of the single hearsay

[5] Plaintiffs do not dispute that such hearsay is not a proper subject of expert testimony. *See In re James Wilson Associates*, 965 F.2d 160, 173 (7th Cir. 1992) (expert testimony may not be used as a "vehicle for circumventing the rules of evidence.").

in such accounts falls within an exception under Rule 803 as Plaintiffs argue, (Pl. Br. at 17), is beside the point for purposes of the *Daubert* analysis. A fundamental tenet of Rule 702 and the *Daubert* line of cases is that an expert's methods must be replicable for his conclusions based on those methods to be admissible. *See*, *e.g.*, *Moore*, 521 F.3d at 684 (explaining that because the proposed expert "did not describe any data, and his evaluation does not seem to be falsifiable" . . . the expert "does not have — or at least did not explain — any way to avoid the GIGO problem. (Garbage in, garbage out.)").

Cross's report of the multiple hearsay statements, and the conclusion he draws from those statements, cannot be replicated or falsified because Cross fails to provide sufficient information about the sources of those alleged statements. Yet, these multiple hearsay statements stand as the only basis for Cross's conclusion that his observations about 19 loans in the state of Washington (a) were valid and (b) could be generalized to Household's nationwide operations. Plaintiffs' assertion that "[t]his is precisely the type of information regulators rely on," (Pl. Br. at 18), even if true, provides no support for their position that Cross's testimony should be admitted. If it were true that all regulators rely on unreliable methods in forming their conclusions, as Plaintiffs claim, the result would be that testimony by all regulators should be excluded, not that testimony by all regulators should be admitted. These "methods" are not reliable and form no basis for the admission of Cross's proposed "expert" testimony. In any event, by his own admission, whatever expertise Cross may have had in evaluating individual customer complaints under governing regulations in the state of Washington did not extend to the ability to extrapolate such anecdotes to a nationwide conclusion. He understood, however, that his 19 data points were "woefully inadequate" for this purpose.

Because Cross failed to utilize reliable methods, or even adequately to explain how the flawed methods he did use led him to form his conclusions, his testimony cannot properly be admitted under Rule 702.

II. Cross's Proposed Testimony Is Not Relevant to Any Subject That is Properly Within the Scope of Expert Testimony

Based on the conclusions he reached by applying his biased and unreliable methods, Plaintiffs propose for Cross to testify as to what they call "primary questions in this case." (Pl. Br. at 10). These include, according to Plaintiffs:

- did Household engage in predatory lending? and, if so,
- did defendants know or recklessly disregard that fact?

(Pl. Br. at 10). Plaintiffs claim that Cross's testimony and conclusions "clearly are relevant" to these two issues. (*Id.*) While Plaintiffs are to be credited for finally admitting in plain terms the improper uses to which they hope to put Cross's testimony, these topics both implicate "state of mind" issues and thus cannot be the subject of expert testimony.

The question of whether "Household engage[d] in predatory lending" necessarily implicates state of mind issues because Cross, like Plaintiffs' other proposed regulatory "expert" Ms. Ghiglieri, has opined that "predatory lending" requires intent to deceive.[6] The question of whether "defendants [knew] or recklessly disregard[ed]" the alleged "predatory lending" unquestionably relates to Defendants' state of mind. Putting aside the relevance of any "expert" testimony Cross could offer, Plaintiffs have now made clear that he cannot provide relevant testimony on any subject as to which his testimony can be admitted. Plaintiffs have explicitly argued, on motions currently pending before the Court, that expert opinions regarding Defendants' state of mind must be excluded from trial:

> ***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[]'*** *. . .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,

[6] (*See* Kavaler Decl. Ex. 6, Cross Tr. 86:20-97:9, 107:18-108:4 (agreeing that, although no consensus definition exists, the term "predatory lending in Cross's view encompasses 'mortgage fraud'")).

> 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 Klaczak* v. *Consol. Med. Transp. Inc*., No. 96 C 6502, 2005 U.S. Dist. LEXIS 13607, at *31 (N.D. Ill. May 26, 2005) (Filip, J.) ("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").

(Pls. Mem. in Support of Bley Daubert, at 11) (emphasis added). Defendants fully agree that these state of mind determinations are exclusively within the province of the jury.

Cross is also disabled from offering testimony on any relevant issue that is properly within the scope of expert testimony because his conclusions themselves rely on credibility determinations and other determinations of disputed fact that must be left to the jury to decide. *See, e.g., Manning* v. *Buchanan*, 357 F. Supp.2d 1036, 1045 (N.D. Ill. 2004) (Kennelly, J.) ("[A]t least some of [the expert's] opinions amount to assessing the evidence and making 'findings' regarding the inferences and conclusions to be drawn. It is highly doubtful whether such testimony is admissible under Rule 702."). For example, Plaintiffs contend that as part of Cross's process in forming his opinions he "engaged in substantial back and forth with the Company and evaluated the credibility of management's responses." (Pl. Br. at 13). Such credibility determinations are properly left to the jury. *Goodwin* v. *MTD Products, Inc.*, 232 F.3d 600, 609 (7th Cir. 2000) ("[A]n expert cannot testify as to credibility issues. Rather, credibility questions are within the province of the trier of fact, in this case a jury.").

The subjects Plaintiffs have offered to justify the relevance of Cross's testimony reveal that Plaintiffs seek to substitute Cross's judgment and conclusions, based as they are on deeply flawed methods, for those of the jury. Plaintiffs fail to articulate any permissible relevant use for Cross's proposed testimony. The testimony should therefore be excluded.

CONCLUSION

For the foregoing reasons, the Court should exclude in its entirety the testimony of Charles Cross.

Dated: February 13, 2009
New York, New York

CAHILL GORDON & REINDEL LLP

By: /s/ Thomas J. Kavaler
Thomas J. Kavaler
Peter Sloane
Patricia Farren
Susan Buckley
Landis C. Best
David R. Owen

80 Pine Street
New York, New York 10005
(212) 701-3000

-and-

EIMER STAHL KLEVORN & SOLBERG LLP
224 South Michigan Ave.
Suite 1100
Chicago, Illinois 60604
(312) 660-7600

Attorneys for Defendants Household International, Inc., Household Finance Corporation, William F. Aldinger, David A. Schoenholz, and Gary Gilmer