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 MOTION PURSUANT TO FED. R. CIV. P. 37(C) TO EXCLUDE THE TESTIMONY OF JAMES C. BERNSTEIN

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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 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

Plaintiffs devote the first several pages of their Opposition Brief to demonstrating that they disclosed James Bernstein as a fact witness to Defendants in their initial disclosures and that Defendants could have taken his deposition during fact discovery. This is completely beside the point. The point is that when Defendants sought to take depositions of all of Plaintiffs' ***subsequently enumerated*** *Sunstar* witnesses who had not previously been deposed, including Mr. Bernstein, Plaintiffs amended their list to withdraw Mr. Bernstein's name to prevent Defendants from taking his deposition.

Plaintiffs' efforts now that *all* discovery has concluded and on the eve of trial[1] to recharacterize Mr. Bernstein as a fact witness reflect bad faith gamesmanship that should not be countenanced by this Court. 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' deliberate bait-and-switch is neither.

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[1] Plaintiffs' claim that Mr. Bernstein's name was disclosed on their draft witness list on October 31, 2008 and thus "five months before trial" is disingenuous as Plaintiffs subsequently dropped and then re-added his name to revised versions of their witness list as recently as January 17, 2009. Plaintiffs are well aware that this Court advised that the proper time to bring this motion was January 30, 2009, the day the parties submitted their final proposed PTO materials, including witness lists. (*See* Dec. 16, 2008 Tr. 22:14-15).

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 regulator whom Plaintiffs assert will offer expert testimony within the purview of *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*"). In their Opposition Brief, Plaintiffs describe the subjects on which they seek to proffer Mr. Bernstein's testimony. These are the exact same areas on which Plaintiffs wish to offer expert testimony by Ms. Ghiglieri and Mr. Cross, informed by the same type of specialized knowledge of financial institution regulation.

Plaintiffs' last-minute effort to resurrect Mr. Bernstein as a fact witness thus also runs afoul of Rule 701(c)'s requirement that lay opinion testimony must not be based on "specialized knowledge," a requirement enacted in order to prevent a party from "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).

Moreover, Plaintiffs' Opposition reveals exactly why they sought to evade discovery on Mr. Bernstein. The entirety of Mr. Bernstein's proffered testimony will consist of inadmissible hearsay that is prejudicial to Defendants, while irrelevant to Plaintiffs' securities fraud claims.

ARGUMENT

A. Plaintiffs' Bad Faith Conduct Requires Exclusion of Mr. Bernstein's Proposed Testimony

During expert discovery, Plaintiffs listed Mr. Bernstein's name alongside that of Mr. Cross in a belated Rule 26(a)(2) disclosure of expert witnesses whose testimony would fall within the purview of *Sunstar*, and on which they now rely to offer Mr. Cross as an expert wit-

ness. (*See* Declaration of Landis C. Best in Support of Defendants' Motion Pursuant to Fed. R. Civ. P. 37(C) to Exclude the Testimony of James C. Bernstein ("Best Decl.") Ex. B). 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. The fact that this exchange occurred during expert discovery and not fact discovery does not "dispose of defendants' contention that Mr. Bernstein was removed from Plaintiffs' Notice in exchange for an agreement that he not be deposed." (Plaintiffs' Opposition at 3). Plaintiffs' *quid pro quo* offer ("If we took some of the people off the list, would you be amenable to not deposing any of them?" (Best Decl. Ex. D at 13)) and their immediate withdrawal of Mr. Bernstein from their disclosures when Defendants instead requested his deposition (Best Decl. Ex. F) misled Defendants into believing that Plaintiffs had decided not to call Mr. Bernstein at trial, which would result in substantial prejudice to Defendants were he now allowed to so testify. *See* Defendants' Moving Brief. Rule 26 is designed to prevent exactly this type of "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.).

B. Mr. Bernstein's Proffered Testimony Falls Within Rule 702

In their Opposition Brief, Plaintiffs describe the scope of Mr. Bernstein's proffered testimony, based upon a Declaration he signed for them in 2005. (*See* Best Decl. Ex. G ("Bernstein Decl.")). All of Mr. Bernstein's interactions with Household alleged therein, including oversight of a departmental investigation into Household's lending practices and his own purported investigations of Household's lending practices through a review of documents, customer interviews and corporate meetings, were conducted within his official capacity of Commissioner of Commerce of Minnesota. It is clear from the Declaration that the opinions he formed through these interactions are informed by specialized knowledge under Rule 702 within

the purview of ***Sunstar***,[2] and most of these opinions substantially overlap with opinions Plaintiffs seek to offer from their other regulatory experts Mr. Cross and Ms. Ghiglieri.[3]

In this regard, it is disingenuous for Plaintiffs to suggest that Mr. Bernstein will testify to the fact of his Department's investigation but not its conclusions (Plaintiffs' Opposition at 4-5), especially when the portions of his Declaration they reference state: "[b]y the summer of 2001, the Department had accumulated significant evidence of massive fraud and misrepresentation, encouraged and tolerated by a complicit and an out-of-control corporate culture" (Bernstein Decl. ¶ 22) and "[t]he investigation revealed that Household engaged in a systematic pattern and practice of predatory lending." (Bernstein Decl. ¶ 16). *See Sunstar*, 2006 U.S. Dist. LEXIS 85678, at *20 ("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.") (emphasis added). Bernstein's proffered testimony is identical in kind to that described in *Sunstar*, not to mention the proffered testimony of Plaintiffs' other *Sunstar* expert Mr. Cross.

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[2] To say that Bernstein's opinions are based on specialized skill or industry expertise is not to say, however, that the conclusions are either well founded, well reasoned or relevant. For the most part, the expert opinions expressed in the Bernstein Declaration lack any factual foundation.

[3] In addition to shielding him from deposition, Plaintiffs ostensibly may also be seeking to redesignate 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.

C. Mr. Bernstein's Proffered Testimony Is Unfairly Prejudicial and Inadmissible Hearsay

Plaintiffs' own description of Mr. Bernstein's proffered testimony reveals that the contents will be based entirely on inadmissible hearsay, and sometimes double and triple hearsay, that fall within no exception. *See* Fed. R. Evid. 802, 805. Plaintiffs say that Mr. Bernstein's testimony will recount:

- Meetings he attended with Household executives in his position as Minnesota Commissioner of Commerce (Plaintiffs' Opposition at 4)
- Official communications between the Department of Commerce and Household (Plaintiffs' Opposition at 4)
- The Enforcement Division of the Commerce Department's year-long investigation into Household's sales practices (Plaintiffs' Opposition at 4)
- Meetings Bernstein attended with constituents to discuss their complaints and experiences in dealing with lending institutions (Plaintiffs' Opposition at 5)
- Meetings with consumer advocacy groups "to gain an understanding of the group's investigation and evaluation of companies doing business in the state of Minnesota" (Plaintiffs' Opposition at 5-6)

Mr. Bernstein's Declaration reinforces that Plaintiffs will be offering these conversations for the truth of the matters asserted if Mr. Bernstein is allowed to recount the substance of meetings at which advocacy groups allegedly told him about individual customers' alleged complaints about how Household employees allegedly presented loan terms: "In subsequent meetings with ACORN representatives, I reviewed the investigative materials gathered by ACORN documenting a number of abusive lending practices by Household, including among others, prepayment penalties, sale of credit insurance, misrepresentation of the terms of the

loans. I personally reviewed various documents, including copies of different loan transactions given to ACORN by victimized borrowers." (Bernstein Decl. ¶ 4).[4] Plaintiffs also seek to introduce testimony about Mr. Bernstein's own alleged meetings with a handful of Household's borrowers: "Some Minnesota Household borrowers also personally informed Mr. Bernstein of the misrepresentation of the terms of the loans where Household sales personnel frequently gave borrowers a range for the interest rate rather than disclosing the actual interest rate that they would be charged; failed to fill in the interest rate at closing, or convinced the borrower that they could only lock in the loan at the lower range, if the borrower closed the loan by a certain date." (Plaintiffs' Opposition at 6). The customer complaints underlying these conversations are themselves inadmissible hearsay, before even considering Mr. Bernstein's hearing about them from advocacy groups and presenting them second- and third-hand to the jury. *Olson* v. *Ford Motor Co.*, 410 F. Supp. 2d 855, 861 (D.N.D. 2006) (customer complaints are hearsay whether in the company's business records or compiled by another party).

These inflammatory tales of Household's supposed "victims" (Bernstein Decl. ¶¶ 4, 16, 27) would be highly prejudicial to Defendants, while the unreliable and anecdotal evidence offer virtually no probative value as to Plaintiffs' claims that Household was engaged in "a massive predatory lending scheme" on a "systemic" and "company-wide" basis. The alleged complaints Plaintiffs seek to introduce through Mr. Bernstein relate to a handful of borrowers within a single state and represent a statistically insignificant portion of the more than three million open loan accounts that Household Consumer Lending unit managed during the Class Period.

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[4] There are also serious questions about the methodology and accuracy behind Mr. Bernstein's conclusions of wrongdoing at Household which rely on these conversations with ACORN. All customer complaints received by the Department were submitted to a formal and official review process. Mr. Bernstein's Deputy Commissioner reported in a letter the results of the Department's investigation into customer complaints referred by ACORN, concluding, "***we find no evidence of violations of law by Household/Beneficial with respect to these complaints***." (Declaration of David Owen in Further Support of Defendants' Motion In Limine to Exclude or Limit 14 Categories of Evidence and Defendants' Motion Pursuant to Fed. R. Civ. P. 37 (C) to Exclude the Testimony of James C. Bernstein, Exhibit 9) (emphasis added).

See Olson, 410 F. Supp. at 864 ("evidence of the specific details of the customer complaints would not only be a waste of time, it would confuse and mislead the jury and be prejudicial to Ford."); *BASF Corp*. v. *Old World Trading Co.*, No. 86 C 5602, 1992 WL 232078, at *4 (N.D. Ill. Sept. 8, 1992) (Leinenweber, J.) (absent proof of statistical significance, complaint evidence would consume too much time and be irrelevant).

Plaintiffs' proffered testimony would also require Defendants to put on extensive rebuttal witnesses and evidence to respond to collateral issues, such as evidence of their hundreds of thousands of satisfied customers (99.9% of Household's customer base), including witnesses and documents such as Mr. Murphy's letter to ACORN exonerating Household from the very allegations that Mr. Bernstein proposes to convey. In cases such as this, where the admission of certain evidence would consume significant court time and create a series of collateral trials within the trial, the evidence is properly excluded. *See Stopka* v. *Alliance of American Insurers*, 141 F.3d 681, 687 (7th Cir. 1998) (noting "when the evidence appears to be of slight probative value, district courts may properly exclude it under Rule 403 to avoid a series of collateral 'trial[s] within the trial' which would result in confusion and undue delay"); *Sims* v. *Mulcahy*, 902 F.2d 524, 531 (7th Cir. 1990) (noting that from the admission of such evidence a "'trial within a trial' would have consumed a great deal of trial time and would have had slight probative value").

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: February 13, 2009
New York, New York

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