

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

LAWRENCE E. JAFFE PENSION PLAN, On)	Lead Case No. 02-C-5893
Behalf of Itself and All Others Similarly)	(Consolidated)
Situated,)	
) <u>CLASS ACTION</u>
Plaintiff,)	
) Judge Ronald A. Guzman
vs.)	Magistrate Judge Nan R. Nolan
)
HOUSEHOLD INTERNATIONAL, INC., et)	
al.,)	
)
Defendants.)	
_____)	

**REPLY MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION IN
LIMINE TO EXCLUDE TESTIMONY OF DEFENDANTS' PROPOSED EXPERT DR.
ROBERT LITAN PURSUANT TO FEDERAL RULE OF EVIDENCE 702**

[PLAINTIFFS' MOTION *IN LIMINE* NO. 6]

I. INTRODUCTION

This Court should exclude Robert Litan's testimony at trial. Defendants' opposition fails to rebut plaintiffs' challenges to the reliability of Dr. Litan's testimony. Rather than addressing these challenges, defendants' opposition is a continuation of their vitriolic attack on plaintiffs' expert, Catherine Ghiglieri.¹

Dr. Litan's academic qualifications as an economist and his experience as a professional antitrust witness do not compensate for his lack of real world regulatory expertise regarding predatory lending and, indeed, this explains his failure to utilize a reliable methodology to reach his bald conclusions. As further evidence of the unreliability of Dr. Litan's opinions, it is undisputed that:

- Dr. Litan did not review the factual record in this case, not even all of the documents cited by Ms. Ghiglieri, whose report he purported to evaluate;
- Dr. Litan did not independently investigate or analyze Household International, Inc.'s ("Household") sales and lending practices or reaging practices, and did not gain any understanding of the loan process at Household²; and
- Dr. Litan did not verify if the lending and reaging disclosures he claims Household Finance Corporation ("HFC"), Household's subsidiary, made in certain of its securitization documents were accurate or consistent with the practices and policies

¹ For the reasons detailed in plaintiffs' opposition to defendants' motion, Ms. Ghiglieri's testimony withstands scrutiny and her expert opinion should be admitted. Dkt. No. 1445.

² Defendants' position that plaintiffs do not take issue with any of Dr. Litan's conclusions as to Household's restructuring practices, is inaccurate. Defendants' Memorandum of Law in Opposition to Plaintiffs' Motion *in Limine* to Exclude Testimony of Defendants' Proposed Expert Dr. Robert Litan Pursuant to Federal Rule of Evidence 702 ("Defs' Mem.") at 2 n.2. Plaintiffs' criticisms of Dr. Litan's unreliable methodology apply equally to his reaging analysis. Additionally, plaintiffs have pointed out specific flaws in Dr. Litan's reaging analysis. See 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 ("Pls' Mem.") at 8-9.

in place at Household during the Class Period, but simply accepted defendants' representations on these issues.³

These failures make Dr. Litan's opinions unreliable. As a further example of that unreliability, Dr. Litan's stock holding analysis is so defective that defendants make no effort to rehabilitate it after plaintiffs' challenges to that analysis.

Dr. Litan's testimony, which in any event is cumulative to that offered by John Bley, should be excluded at trial.

II. ARGUMENT

A. Dr. Litan's Methodology in Deriving a Complaint Ratio Is Flawed

Dr. Litan purports to undermine Ms. Ghiglieri's opinion that Household's problems with deceptive lending practices were not isolated to a few branches, but "were systemic, widespread and geographically dispersed" by calculating a ratio of the number of complaints to the total number of loans Household originated between 1999 and 2001. Defs' Mem. at 5. Defendants tout this calculation as scientifically sound because it is replicable. *Id.* at 6. Any second grader can take two numbers spoon-fed to him by someone else and do a straightforward calculation. One does not need a Yale degree for that. An expert, however, evaluates the reliability of the data before performing the calculations and arriving at his conclusions. Dr. Litan failed to make that evaluation in arriving at a complaint ratio. Pls' Mem. at 5-6; Pls' Mem., Ex. A (Report of Robert E. Litan) at ¶¶14, 138-139.

Dr Litan failed to consider whether Household's complaint statistics were reliable, comprehensive and accurate. Ms Ghiglieri noted significant deficiencies in Household's complaint tracking system that resulted in the exclusion of the complaints handled by the branch offices and

³ HFC is not a defendant in the Class' §10b case under the Securities Exchange Act of 1934. Although lead plaintiffs continue to have individual §11 claims against HFC, no class has been certified for the §11 claims that have been asserted against HFC.

those not “logged” by senior sales managers. Pls’ Mem., Ex. D (Expert Witness Report of Catherine A. Ghiglieri) at 73-74, *see also* Declaration of Thomas J. Kavalier in Support of the Household Defendants’ Opposition to Plaintiffs’ Motions *in Limine* Nos. 1-10 (“Kavalier Decl.”), Ex. 2 (Rebuttal Report of Catherine A. Ghiglieri) at 50-51; *see also* HHS03208139 (Ex. 50 to Declaration of Azra Z. Mehdi in Support of Lead Plaintiffs’ Motion Requesting Evidentiary Sanctions for Household Defendants’ Destruction of Evidence) (senior management acknowledgement that not all “effective rate” complaints were tracked understating the actual number). Dr. Litan neither reviewed nor considered this document. Pls’ Mem., Ex. A (Litan Report), Appendix 4.

Significantly, because he lacks a regulatory background and does not follow the accepted regulatory methodology, Dr. Litan looked purely at the number of complaints without considering other factors that regulators take into account when evaluating complaints, among other things: (i) complaints represent the “tip of the iceberg” and thus, the number of complaints alone is not determinative; (ii) if the complaint activity relative to its peers is disproportionate; (iii) if there is a disproportionately large increase in the number of complaints within a short period of time; (iv) how geographically dispersed the complaints are; (v) the similarity of the complaints; (vi) the severity of the harm to consumer; and (vii) the effort involved in the consumer actually making the complaint. *See, e.g.*, Kavalier Decl., Ex. 9 (DFI Report) at 3,7; Ghiglieri Depo Tr. at 69:16-70:4, 81:1-5, 106:16-20 (attached hereto as Ex. A); Cross Luna Tr. at 182:10-184:16, 479:17-480:17 (Ex. B hereto); Cross Jaffe Depo Tr. at 163, 75:10-76:23 (Ex. C hereto) (testifying that in the regulatory world, “we don’t live in a vacuum”).

Dr. Litan’s complaint ratio is inherently unreliable.

B. Dr. Litan’s Conclusion that Heightened Media Focus on Predatory Lending Contributed to the Increased Risk of Such Allegations Against Household Is Unsupportable

Dr. Litan’s explanation of the increased regulatory focus on Household coinciding with an increased focus on “predatory lending” in the media, is laughable. The basis of his conclusion is a word search for the terms “predatory lending” in one periodical, without using any of the recognized equivalent terms and phrases, to see how many times it was searched as opposed to an actual evaluation of concrete data of Household’s sales practices, complaints and regulatory investigations. *See* Pls’ Mem. at 6-7. Defendants’ rebuttal to plaintiffs’ challenge is not credible. The fact that this search is reproducible does not make it reliable. Defs’ Mem. at 7-8.

C. Dr. Litan’s Conclusion that HFC Securitization Disclosures Disclosed the Risks of Household’s Loan Products, Its Lending and Reaging Practices Is Flawed and Unreliable

Dr. Litan concludes that defendants in fact publicly disclosed in certain securitization documents various loan products, sales and lending policies and practices, and reaging policies and practices that plaintiffs’ expert Ms. Ghiglieri opines were predatory or wrong and concealed.⁴ Dr. Litan’s conclusion is unreliable. Dr. Litan relied entirely upon defense counsel to review and elicit the disclosures in the prospectuses and accepted them at face value without verifying if the information contained within them accurately represented the lending and reaging policies and practices at Household at the time of the representations. Pls’ Mem. at 7-9; *compare Sommerfield v. City of Chicago*, No. 06 C 3132, 2008 U.S. Dist. LEXIS 88760, at *15-*16 (N.D. Ill. Nov. 3, 2008) (An expert cannot rely upon a party’s summary of depositions).⁵

⁴ Similarly, Dr. Litan’s analysis of Household’s reaging disclosures in the securitization documents is flawed, and should be excluded.

⁵ Emphasis added and internal quotations and citations omitted unless otherwise noted.

As detailed in plaintiffs' motion, the securitization documents were filed by HFC, not by Household. In fact, defendants concede that HFC, a completely separate legal entity, is not a defendant in the §10b portion of this case.⁶ Additionally, the securitization documents only pertained to a limited amount (20%) of Household loans and had a limited distribution that did not include equity investors. *See* Exs. A and B (HHS02893535, HHS03236863) to Plaintiffs' Motion *in Limine* ("MIL") No. 1 Reply. Thus, defendants' assertion that this testimony will assist the jury in understanding the types of disclosures debt investors sought in the securitization document only reinforces the fact that the testimony should be excluded as well. Testimony as to what debt investors sought in terms of disclosures does not "fit" any issue in this case and fails to advance the jury's understanding of any issue. *See O'Conner v. Commonwealth Edison Co.*, 13 F.3d 1090, 1106 (7th Cir. 1994) (The second prong of the *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993) test is determining whether the expert opinion will assist the trier of fact.).

D. Dr. Litan Is Not Qualified to Opine on the Reasons for Household's Settlement with the State Attorneys General

Defendants proffer Dr. Litan as an expert to provide an alternative explanation for why Household entered into the AG Settlement, but fail to support why he is an authority on Household's settlement with the Multi-State Attorneys General.

Dr. Litan's opinion as well as defendants' arguments on this issue are fundamentally flawed. They are premised on a mischaracterization of Ms. Ghiglieri's opinion in relation to the AG Settlement. Ms. Ghiglieri does not rely on Household's AG settlement as an admission of

⁶ Contrary to defendants' assertions, lead plaintiffs do allege that the disclosures in the securitization documents issued by HFC were false and misleading. [Corrected] Amended Consolidated Class Action Complaint, ¶¶383-394. Thus, defendants' contention that plaintiffs somehow concede that the securitization documents are accurate, because they did not list them as false statements in the §10b class case currently scheduled for trial, lacks merit.

wrongdoing, as defendants contend, but rather uses it as one factor, among others, to estimate the dollar impact of Household's predatory lending practices. *See* Kavalier Decl., Ex. 1 (Ghiglieri Report) at 130.

Putting aside whether Ms. Ghiglieri treats the AG Settlement as an admission of wrongdoing by defendants, Dr. Litan's conclusion that Household settled for "legitimate business reason" is rank speculation. Dr. Litan's testimony at his deposition that Household "must have" been concerned about either the "legal fees involved" or the "general uncertainty" to Household's capital undercuts any assertion that this opinion was based on a review of the entire factual record. *See* Pls' Mem. at 10-11 (citing Litan Depo Tr. at 95:9-96:11) ("having been involved in these kind of situations, that I'm sure they must have known the legal fees involved"); *id.* at 91:8-25 ("companies typically in my opinion settle because they want to save money on lawyers"); *id.* at 90:12-14 (conceding he failed to consider alternative explanations for Household's inability to access the capital markets: "All I looked at was the documentary evidence indicating that this was *one* reason why they wanted to settle this case.").

Similarly, defendants' rebuttal to plaintiffs' challenge that Dr. Litan failed to account for the legal reasons for the AG Settlement, is unavailing. Defs' Mem. at 11 n.5. Defendants cannot preclude plaintiffs from obtaining relevant and responsive discovery that they are entitled to by asserting privilege, and then use that information to their advantage. *See* Pls' Mem. at 11-12; *Manning v. Buchan*, 357 F. Supp. 2d 1036, 1048 (N.D. Ill. 2004) ("[W]hen a party asserts a privilege to preclude its opponent from obtaining information in discovery, it relinquishes the ability to use that information in its favor at trial."); *Turner v. Univ. of Wash.*, No. C05-1575 RSL, 2007 U.S. Dist. LEXIS 78281, at *4 (W.D. Wash. Oct. 10, 2007) (excluding from trial materials withheld in discovery based on claims of attorney-client privilege or work product doctrine).

Finally, Dr. Litan's short stint at the Justice Department does not demonstrate that "Dr. Litan is particularly qualified to shed light on the varying reasons for parties' choices to enter settlements," much less establish how Dr. Litan's experience was "reliably [applied] to the facts" at issue here, as required by Fed. R. Evid. 702. Thus, Dr. Litan should be precluded from testifying as to the reasons Household entered into the AG Settlement.

E. Dr. Litan's Conclusion that Household's Application of the Alternative Mortgage Transaction Parity Act Complied with Applicable Laws Is Unreliable

In support of Dr. Litan's opinion that Household did not use the Alternative Mortgage Transaction Parity Act ("AMPTA") to circumvent state law and that Household fully complied with applicable federal law, defendants present no argument. Nor could they. During discovery, defendants successfully prevented plaintiffs from obtaining any discovery as to any legal opinion that Household's Pay Rights Rewards ("PRR") product permitted Household to apply AMPTA. *See* Plaintiffs' MIL No. 4 and Reply in Support of MIL 4. Thus, in order for Dr. Litan to conclude that Household did not use AMPTA to circumvent state laws, Dr. Litan had to either have reviewed these privileged documents (which would contradict defendants' representations to the Court regarding the privilege), or simply relied on defendants' assertions that they relied on advice of counsel that Household's application of AMPTA complied with applicable laws. *Fultz v. Fed. Sign*, No. 94 C 1931, 1995 U.S. Dist. LEXIS 1982, at *4-*5 (N.D. Ill. Feb. 16, 1995) (One cannot assert privilege to keep an opponent from discovering facts that it intends to use at trial as a defense to defeat the opponent's allegations.). Either way, Dr. Litan's subjective and conclusory testimony on this issue must be excluded.

F. Dr. Litan's Conclusion that Individual Defendants' Stock Acquisitions Negates Scienter Should Be Excluded

Defendants do not even attempt to respond to plaintiffs' well-supported challenge that Dr. Litan's "stock holding analysis" is flawed and unreliable. Pls' Mem. at 12-13. Defendants excuse

Dr. Litan's woefully deficient analysis by claiming that Dr. Litan merely evaluated individual defendants' stock acquisitions seeking an alternative explanation for Ms. Ghiglieri's conclusions as to defendants' "state of mind." Defs' Mem. at 12-14. Defendants' excuse does not meet the Fed. R. Evid. 702 standard for admissibility.

Moreover, Ms. Ghiglieri does not testify as to defendants' state of mind with respect to their public statements, *i.e.*, scienter – an element of plaintiffs' securities fraud claim. She will testify, for example, based on her experience and knowledge and relying on the evidence before her, that defendants' acts and conduct caused predatory lending to result from those acts. The statements highlighted by defendants as Ms. Ghiglieri's opinions are such statements of defendants' acts and conduct. Defs' Mem. at 12-13. This is not testifying as to defendants' state of mind. *United States v. Owens*, 301 F.3d 521, 527 (7th Cir. 2002) (expert testimony admissible when it does not "comment[] directly on [the defendant's] state of mind") (alteration added and in original). Thus, Dr. Litan's flawed stock holding analysis and resulting conclusion that defendants did not have the intent to commit securities fraud, must be excluded.

III. CONCLUSION

For the foregoing reasons as well as those articulated in plaintiffs' opening brief (Dkt. No. 1341), the Court should exclude the testimony of defendants' proposed expert, Dr. Robert Litan, at trial.

DATED: February 13, 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 Francisco, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 100 Pine Street, Suite 2600, San Francisco, California 94111.

2. That on February 13, 2009, declarant served by electronic mail and by U.S. Mail to the parties the **REPLY MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION *IN LIMINE* TO EXCLUDE TESTIMONY OF DEFENDANTS' PROPOSED EXPERT DR. ROBERT LITAN 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 13th day of February, 2009, at San Francisco, California.

/s/ Marcy Medeiros

MARCY MEDEIROS