**UNITED STATES DISTRICT COURT**

**NORTHERN DISTRICT OF ILLINOIS**

**EASTERN DIVISION**

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

**REPLY MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION *IN LIMINE* TO EXCLUDE CERTAIN TESTIMONY OF DEFENDANTS' EXPERT ROMAN L. WEIL PURSUANT TO FEDERAL RULE OF EVIDENCE 702**

**[PLAINTIFFS' MOTION *IN LIMINE* NO. 9]**

**[REDACTED VERSION]**

## I. INTRODUCTION

Plaintiffs respectfully request the Court grant plaintiffs' motion to exclude certain testimony of defense expert Roman L. Weil ("Weil") under Fed. R. Evid. 702. Defendants' opposition fails to save the following inadmissible opinions:

- Weil's opinion that Household designed its re-age practices for purely innocent purposes is speculative and unhelpful to the jury (*see* §II.A., *infra*);
- Weil's opinions that Household's loan loss reserves were always adequate based on a "peer" analysis of ***other*** companies' loan loss reserves should be excluded because this "control group" methodology fails to test any variables; fails to adjust for the fact that Household re-aged its loans more often than its competitors; would not be used by any other accountant; assumes what it seeks to prove and is not grounded in fact; and is questioned by Weil himself. (*see* §II.B., *infra*); and
- Weil's opinions concerning what defendants believed in their "heart of hearts" regarding its $386 million after-tax credit card restatement are inadmissible state-of-mind opinions (*see* §II.C., *infra*).

While defendants offer an informative preview of how they plan to present most of Weil's opinions at trial, plaintiffs are not required to eliminate every single one of Weil's opinions under Rule 702 in order to demonstrate the unreliability of the opinions at issue. *See Smith v. Ford Motor Co*., 215 F.3d 713, 721 n.3 (7th Cir. 2000) (noting "it would be appropriate for a district court to apply Rule 702's requirements to individual pieces of proposed testimony"). This reply focuses on defendants' opposition arguments that address the opinions plaintiffs actually moved to exclude.

## II. ARGUMENT

### A. Defendants Fail to Save Weil's Opinion that Household "Thought" Re-Aging Increased Cash Flow Because that Opinion Is Based on Speculation and Is Unhelpful

Plaintiffs moved to exclude Weil's opinions in Questions 6, 7 and 8 of his report in which he concludes that Household's re-age policies and practices increased cash flow. *See* Pltfs' Opening Mem. §II.A. Weil's opinions should be disqualified under Rule 702 because he simply ***speculates*** as to possible theoretical uses of re-aging and describes how ***other*** companies might use re-aging to

infer that Household ***actually*** used re-aging to increase cash flow and never to distort its reported delinquency statistics.

Defendants' opposing positions are:

- "Professor Weil evaluated Household's restructure policies, looking for indications that they were designed for some purpose other than to increase cash flow. He found none." (*See* Defs' Mem. at 5 (citing KPMG document in footnote)); and
- "Professor Weil's analysis of Household's policies and practices demonstrates that restructuring was designed to increase cash flow in the aggregate and not to conceal information from investors. Professor Weil clarified this conclusion at his deposition. He testified:

Defs' Mem. at 5, 7-8 (emphasis added).

Defendants' assertions conflict with Weil's own testimony as to the bases for his ascertaining what ***Household's actual purpose*** was – not the theoretical, academic, and speculative "possible" purpose behind its re-aging policies:

Q:

A:

Q:

A:

Weil Depo. 174:2-15, attached as Ex. B to Pltfs' Opening Mem.

Contrary to defendants' position, the Weil Report and Weil's own testimony demonstrate the fact that Weil's opinions were not based upon "evaluat[ing] Household's restructure policies." Defs' Mem. at 5. Moreover, Weil's block quotations from field "literature" are not reliable (and not helpful) to show what Household ***actually*** did, which is the opinion Weil offers. Weil's opinions are

speculation, plain and simple, and provide nothing to the jury defendants cannot explain without Weil's support. *See O'Neill v. Windshire-Copeland Assocs., L.P.*, 372 F.3d 281, 285 (4th Cir. 2004) (expert opinion based on speculation inadmissible).

**B. Weil's "Peer" Analysis Methodology Flunks Rule 702**

One of the substantive issues the jury will decide is whether Household's policies and practices of reporting non-paying or "delinquent" accounts as paying accounts or "current" accounts were materially misleading to investors. Weil says Household's investors were never misled for a variety of reasons explained in his report. Weil Report at 18-46, attached as Ex. A to Pltfs' Opening Mem.

The methodology at issue is Weil's "peer" analysis. *See* Pltfs' Opening Mem. §II.B. The objective of Weil's peer analysis methodology is to "prove" that no investor could ever be misled by Household's (reported) delinquency statistics, as massaged by their (unreported) re-age practices. That objective is challenging since the Securities and Exchange Commission specifically found "[o]ne of the critical measures of Household's financial performance is the delinquency rate for its loan portfolio and related disclosures and statistics concerning the restructuring (or so-called re-aging) of delinquent accounts"; that Household made "false and misleading disclosures [that were] material in light of the significant volume of Household's loan restructures"; and, "Household knew or was reckless in not knowing that its disclosures regarding restructuring policies were false and misleading." SEC Consent Decree, ¶¶4, 10, 11, attached as Ex. A hereto.

Nonetheless, Weil opines that Household's reported delinquency numbers could be wildly inaccurate and no investor would have been misled ***so long as*** all of Household's ever-changing re-age policies were (i) accurately accounted in Household's loan loss reserves and (ii) those loan loss reserves were "always adequate." Defs' Mem. at 10. Weil purports to "prove" both propositions at once by comparing at Exhibits 3, 3a and 4 of his report Household's loan loss reserve ratios to those

of its "peers." Weil's opinions are inadmissible because this peer comparison is unreliable under Rule 702 for the five independent reasons discussed below.

***First***, Weil's "control group" is invalid not because of the process he used to select companies within that group, but because he did not test any variables those companies used to derive ***their loan loss reserves***. *See* Pltfs' Opening Mem. at 8 (citing ***examples*** of untested variables). Defendants cite *United States ex rel. Tyson v. Amerigroup Ill., Inc.*, 488 F. Supp. 2d 719, 733 (N.D. Ill. 2007) for the proposition that the "mere fact that [expert] failed to consider some . . . variables" is not sufficient grounds for exclusion under Rule 702. Defs' Mem. at 10-11. In that case, the expert "did adjust for some . . . variables." *Tyson*, 488 F. Supp at 733. The present situation is more similar to *Masters v. Hesston Corp.*, 291 F.3d 985, 992 (7th Cir. 2002), where the Seventh Circuit upheld the exclusion of an expert's opinion on a piece of farm equipment because the expert "did not test" the item or offer any "studies on its functioning." *Id.* "Mere" failure to test "some" variables may be insufficient grounds to exclude evidence under Rule 702, but failure to test "any" favors exclusion.

***Second***, in order for Weil to opine that Household's reserves were ***adequate*** based upon his comparative "peer" analysis, it must be the case that all subject companies re-aged their loan populations at the same rate. On this point, defendants cannot dispute the document cited in the Weil Report, which explains

Pltfs' Opening Mem. at 7 (quoting Weil Report at 23).

It appears defendants do not understand the importance of this fact because they misread their own expert's opinion. Defs' Mem. at 10. Exhibits 3 and 3a to Weil's report are based on a simple (and simplistic) ratio or fraction: the numerator [X] is "Year-End Reserves" and the denominator [Y] is "Net Charge-Offs Owned." To start, Weil speculates that [X] is accurate because, as discussed below, he guesses that ***changes*** to Household's re-age policies were included

in that figure. But allowing Weil the benefit of that error, the KPMG study cited above and in the Weil Report states in no uncertain terms that Household re-ages ***more*** than its competitors.

Thus, Household's charge-offs, the denominator [Y] in Weil's ratio, are ***mathematically certain*** to be artificially lower that its competitors' charge-offs. Weil's ratios, therefore, cannot be used to determine Household's reserves are "***always adequate.***" Defs' Mem. at 10 (emphasis added). Weil cannot make this critical assumption (Household re-aged at the same rate as its competitors) because it is not grounded in fact. *See Bluebonnet Sav. Bank, F.S.B. v. United States*, 266 F.3d 1348, 1358 (Fed. Cir. 2001) (affirming the rejection of Weil's opinion because it was based on an assumption unsupported by the record); *cf. Smith v. Biomet, Inc.*, No. 3:01-CV-753 PS, 2004 U.S. Dist. LEXIS 30738 (N.D. Ind. Apr. 12, 2004) (assumptions are acceptable so long as they are grounded in fact) (citing cases).

***Third***, Weil's "peer" analysis fails because no accountant would ever use it to "prove" the adequacy of any company's reserves, a fact Weil admits and defendants ***never dispute***. Defendants simply ignore Weil's deposition testimony in which he answers [REDACTED] in response to plaintiffs' question [REDACTED] Pltfs' Opening Mem. at 8 (quoting Weil Depo. at 125:13-19).

***Fourth***, Weil's "peer" comparison is inadmissible because he makes another assumption not grounded in fact. When Household made changes to its re-age policies – and it frequently did in order to meet quarterly delinquency targets – its ***statistical*** reserves could not adequately account for the affected loans. Weil admits this fact. Pltfs' Opening Mem. at 9-10. Unless the loans that were impacted by those frequent changes are specifically considered in the ***judgmental*** reserves, the total reserves are necessarily understated. The reason why is because Household's "total reserves" consist of just two components: statistical reserves and judgmental reserves. In his deposition, Weil admits he does not know whether Household specifically considered changes to its re-age policies as

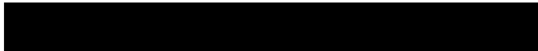
part of the judgmental reserve. Pltfs' Opening Mem. at 10. Further, nothing defendants cite to this Court establishes that Household considered the impact of re-age policy changes in determining the amount of the judgmental reserve. Thus, Weil makes an assumption not grounded in fact. *See Biomet*, 2004 U.S. Dist. LEXIS 30738 (assumptions need to be grounded in fact) (citing cases). Weil's speculation renders the numerator [X] in his ratio analysis ("Year-End Reserves") unreliable. Weil "proves" Household ***adequately*** reserved for re-age changes without knowing whether Household ***actually*** allocated a single penny to its reserves for loans affected by those changes.

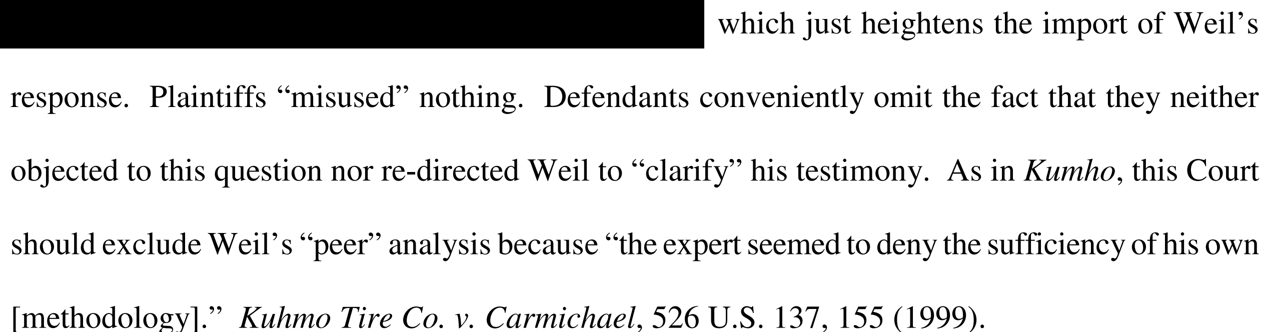
***Fifth***, Weil's "peer" analysis is unreliable because even he questions it. Defendants counter by throwing stones (Defs' Mem. at 11), alleging plaintiffs "misuse" the following testimony from Weil's deposition:

Q:

A:

*See* Pltfs' Opening Mem. at 10 (quoting Weil Depo. at 249:9-22).

The ellipses above "leaves out" the following text: 



which just heightens the import of Weil's response. Plaintiffs "misused" nothing. Defendants conveniently omit the fact that they neither objected to this question nor re-directed Weil to "clarify" his testimony. As in *Kumho*, this Court should exclude Weil's "peer" analysis because "the expert seemed to deny the sufficiency of his own [methodology]." *Kuhmo Tire Co. v. Carmichael*, 526 U.S. 137, 155 (1999).

### C. Defendants Concede that Their Expert Cannot Be Permitted to Testify as to What Defendants Believe in Their "Heart of Hearts"

The Court should preclude Weil from opining that defendants never "intentionally" misstated Household's financial statements in connection with its $386 million (after tax) credit card restatement. Pltfs' Opening Mem. §II.C. The arguments are not repeated here because, after three pages of wandering discourse, defendants finally state in conclusion that "Professor Weil must be permitted to explain to the jury that the relevant accounting literature distinguishes between restatements for error and restatement for fraud, and ***that a restatement does not on its own imply fraud***." Defs' Mem. at 15 (emphasis added).

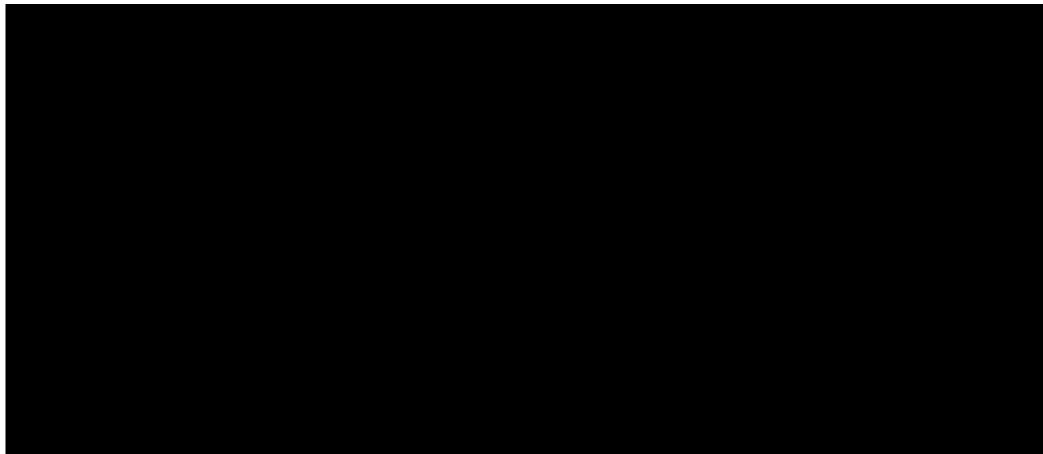
The "opinion" defendants represent Weil will proffer is very different from the one Weil gives in his report and gave during his deposition:

Q:

A:

Q:

A:



Weil Depo. at 219:8-19, attached as Ex. B hereto.

Weil can opine that "a restatement does not on its own imply fraud" under the relevant accounting rules, but Weil must be precluded from testifying as to what defendants believed in their "heart of hearts" or, stated differently, that defendants never "intentionally" misstated Household's financial statements.

## III. CONCLUSION

For the forgoing reasons, plaintiffs respectfully request the Court grant Plaintiffs' Motion to Exclude Certain Testimony of Defendants' Expert Roman L. Weil Pursuant to Federal Rule of Evidence 702.

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 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 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 CERTAIN TESTIMONY OF DEFENDANTS' EXPERT ROMAN L. WEIL PURSUANT TO FEDERAL RULE OF EVIDENCE 702**.

The parties' e-mail addresses are as follows:

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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 Diego, California.

/s/ Teresa Holindrake
TERESA HOLINDRAKE