UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

GMR

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

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF DEFENDANTS' OMNIBUS MOTION *IN LIMINE* TO EXCLUDE OR LIMIT 14 CATEGORIES OF EVIDENCE

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This memorandum is respectfully submitted on behalf of Defendants Household International, Inc. ("Household"), William F. Aldinger, David A. Schoenholz and Gary Gilmer (collectively, the "Defendants"),[1] in further support of their motion *in limine* to preclude Plaintiffs from introducing into evidence at trial all references to certain subject matters as set forth below, including in Plaintiffs' opening statement, weekly summations, questioning of witnesses, exhibits, expert testimony and summation.

PRELIMINARY STATEMENT

Plaintiffs have been consistent in their efforts to cobble unadjudicated allegations, complaints and random violations of Household policies into a securities fraud claim, with no reference to Household policies themselves, no showing of statistical significance, and no consideration of context or proportion. Now that trial is at hand, Plaintiffs are struggling to shoehorn certain of this purported "evidence" into admissible categories or exceptions under the Federal Rules of Evidence. In this endeavor, certain recurring themes across the 14 categories have emerged:

(1) ***"When faced with a hearsay or Rule 408 settlement problem, make a 'notice' argument."*** Plaintiffs seek to vitiate the hearsay rules and Rule 408 by arguing that otherwise inadmissible evidence may be introduced to show "notice." They fall back on this ploy in seven out of 14 sections in their brief. Specifically, they make the "notice" argument in regard to: the SEC consent decree (even though it post-dated the Class Period), regulatory reports of examination, civil complaints, regulatory settlements, refunds and practice changes, and customer complaints. This stratagem serves to illustrate Defendants' point: Because Plaintiffs lack

[1] Defendants Joseph A. Vozar and Household Finance Corporation ("HFC") join in this motion and expressly reserve the right to amend, supplement or re-assert objections to Plaintiffs' proposed "Household International False Statements" to the extent that at any future time Plaintiffs propose to use these statements in a trial of claims asserted against Mr. Vozar and HFC.

a straightforward predicate for securities fraud, they are determined one way or another to expose the jury to a patchwork of prejudicial-sounding allegations and anecdotes, even if not admitted for the truth.

(2) ***"It's not unfair prejudice under Rule 403, it's 'simply one part of the case being tried.'"*** (*See* Plaintiffs' Opposition to Defendants' Omnibus Motion *In Limine* to Exclude or Limit 14 Categories of Evidence ("Pl. Br.") at 9). Plaintiffs make this argument in the sections of their brief addressing their proposed introduction of civil complaints, customer complaints, the Dennis Hueman videotape, the Charles Cross deposition, Andrew Kahr and "Project Whiskey." A corollary is Plaintiffs' argument that it's not their problem if their evidence requires Defendants to waste their scarce trial time on digressive mini-trials to rebut marginally relevant but potentially prejudicial side issues. Plaintiffs tactic throughout is to imply that Defendants are crying "wolf" as to all evidence that is arguably prejudicial to them. Defendants recognize that most opposing evidence is prejudicial by definition, and they have not moved on the ground of prejudice as such. However, Rule 403 exists for a reason, and a great deal of Plaintiffs' proposed evidence epitomizes unfair prejudice and the potential to mislead and confuse. Defendants have properly moved to exclude that evidence. If the scope of such motions seems broad, it is because Plaintiffs' efforts to fabricate a counterfactual company policy from a patchwork of customer complaints, misbehavior or mistakes by a small subset of branch-level personnel, internal efforts to cure exceptions, and third party commentary on all of the above has so far observed no bounds.

(3) ***"We have 'already established the relevance of this evidence.'"*** Plaintiffs make this argument in regard to Reports of Examination. A look beneath Plaintiffs' argument, however, reveals that the supposed "relevance" determination was no more than an instruction that certain "evidence" was discoverable pursuant to the liberal federal discovery rules, which contemplate production of all material which may either be relevant or lead to admissible evidence. Meeting that relatively low hurdle does not give Plaintiffs a free pass now that they

must satisfy the more stringent standards for evaluating the reliability, probative value and potential for undue prejudice of proposed trial evidence under the Federal Rules of Evidence.

(4) ***"The Court has sustained our complaint under the stringent standards of the PSLRA."*** This theme is aired in opposition to Defendants' motion to remove from Plaintiffs' evolving list of alleged misstatements certain categories of statements that are not actionable as a matter of law. The Court's ruling that Plaintiffs' Amended Complaint pleaded alleged fraud with sufficient particularity to satisfy Rule 9(b) and the Private Securities Litigation Reform Act ("PSLRA") was not a ruling that any particular passage within the hundreds of statements referenced in the complaint was fraudulent. That the statements alleged in the 398-paragraph Complaint were deemed sufficient to permit Plaintiffs to proceed with discovery does not suggest that every one of those statements, and every one of the newly added statements, is actionable. *See Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499, 2510 n.5 (2007) ("the test at each stage is measured against a different backdrop"). Now that Plaintiffs have finally specified the particular statements they wish to submit to the jury as the basis for their claims (*see* [Proposed] Final Pretrial Order Ex. B-1, *Jaffe* v. *Household Int'l, Inc.*, No. 02 Civ. 5893 (Jan. 30, 2009)), Defendants have moved to exclude several of the listed statements and portions of statements that are not actionable as a matter of law.

(5) ***"This evidence is 'essential' to our case."*** Plaintiffs make this argument in regard to the Dennis Hueman videotape and settlement evidence, among others. "Essentiality," however, has never been a standard for the admission of evidence under the Federal Rules. If Plaintiffs cannot adduce sufficient admissible evidence to meet their burden of proof at this trial, the fact that they will otherwise lose is no justification for bending the rules of evidence. *See also* paragraph "(1)" above. The fact that Plaintiffs believe they "need" certain facts to sway the jury does not without more render those facts relevant and admissible; if it did, the Federal Rules of Evidence would serve no purpose.

(6) ***"Our expert witnesses 'relied on' the evidence 'as part of the data considered in forming' an expert opinion."*** Plaintiffs make this argument in an attempt to introduce otherwise inadmissible evidence regarding civil complaints, regulatory settlements and individual customer complaints. Plaintiffs incorrectly assume that all evidence "considered" by their experts can be admitted through the back door, ignoring that Plaintiffs bear the burden of demonstrating that the "probative value in assisting the jury to evaluate the expert's opinion *substantially outweighs* [its] prejudicial effect." Fed. R. Evid. 703 (emphasis added). Plaintiffs may not deputize an expert as a "mouthpiece" for introducing otherwise inadmissible evidence.

In addition to these themes, the 14 categories of evidence discussed in this Memorandum are aimed at the jury's emotions, prejudice and bias. They have little, if anything, to do with the elements of securities fraud at issue in this case; and they are not aimed at achieving a reasoned determination of Plaintiffs' securities fraud claims. Granting this motion *in limine* will prevent the evidentiary free-for-all Plaintiffs seek for themselves and will minimize the undue delay that would necessarily follow from the admission of such evidence. Defendants request that this Court exercise its crucial gatekeeper role, and exclude or otherwise limit as requested each of the 14 categories of evidence.

ARGUMENT

EVIDENCE IN THE FOLLOWING 14 CATEGORIES IS PROPERLY EXCLUDED OR LIMITED

A. THE POST-CLASS PERIOD SEC CONSENT DECREE

Plaintiffs concede that neither Household's Consent Decree with the SEC nor the accompanying Offer of Settlement are admissible under Rule 408. (Pl. Br. at 4). They instead contend that they are trying to offer into evidence the SEC's unadjudicated "findings of fact and opinions," which they claim would be probative of the scienter of the Individual Defendants, despite the fact that the Individual Defendants were not even parties to the settlement, the settle-

ment was entered into five months after the close of the Class Period, and Household made no admission of wrongdoing. The findings contained within the Consent Decree, as well as the fact of the settlement itself (and related measures such as an amendment to one securities filing), are similarly inadmissible under Rules 403 and 408, regardless of whether these documents would qualify for the hearsay exception within Rule 803(8)(C).

1. Rule 408 Applies to SEC "Findings" Memorialized in the Consent Decree

Plaintiffs concede that Household's Offer of Settlement and Consent Decree should be excluded under Rule 408: "Rule 408. . . would bar only the offer to settle and the settlement agreement itself" (Pl. Br. at 4). This concession should end the dispute. However, Plaintiffs seek to divorce the settlement's "findings of fact and opinions" from their context by contending that that only these findings and opinions (which conveniently mirror Plaintiffs' allegations) should be admitted. Plaintiffs' distinction is ridiculous.

As Defendants noted in their Omnibus Motion *In Limine* to Exclude or Limit 14 Categories of Evidence ("Defendants' Opening Brief"), courts typically exclude *all* reference to such administrative settlements. *Beck* v. *Cantor, Fitzgerald & Co.*, 621 F. Supp. 1547, 1565 (N.D. Ill. 1985) (Rovner, J.) (allegations based on SEC opinion were "irrelevant and immaterial for several reasons," including that the defendants had not admitted that the SEC was correct and the defendants' acquiescence in the opinion was not admissible under Rules 408 and 410); *In re Cenco Inc. Securities Litigation*, 601 F. Supp. 336, 337 n.3 (N.D. Ill. 1984) (Aspen, J.) (upholding a ruling striking an SEC Accounting Series Release on the grounds that it was analogous to a consent decree, and therefore inadmissible under Rule 408). Plaintiffs' attempts to distinguish *Beck* are unavailing. In *Beck,* the court's decision did not turn on whether the defendants acquiescence with the SEC was "alleged" or on how extensive the SEC's investigation was.

The effect of accepting Plaintiffs' distinction by admitting settlement findings would be to frustrate Rule 408's goal of encouraging settlements and cooperation in the settle-

ment process. *See generally Kritikos* v. *Palmer Johnson, Inc*., 821 F.2d 418, 423 (7th Cir. 1987) (Rule 408's purpose of encouraging settlements "'will be inhibited if the parties know that their statements may later be used as admissions of liability'") (quoting *Central Soya Co., Inc*. v. *Epstein Fisheries, Inc*., 676 F.2d 939, 944 (7th Cir. 1982)).

To support their position that the findings are not covered by Rule 408, Plaintiffs rely on a single outlier case from another Circuit: *Option Resource Group* v. *Chambers Development Co*., 967 F. Supp. 846, 849 (W.D. Pa. 1996). In that case, the court agreed to exclude settlement agreements and enforcement proceedings under Rule 408, but allowed introduction of the SEC's underlying findings for the purposes of summary judgment proceedings. What Plaintiffs fail to mention is that the court expressly deferred the question of admissibility under Rule 403 until trial. *See infra* Part 3.

2. Household's Post-Consent Decree Amended SEC Filings Are Not Admissible to Show Scienter

As Defendants noted in their opening brief, courts have permitted settlement agreements to be admitted under Rule 408 for the limited permissible purposes of showing knowledge of the securities laws, motive, or intent — none of which can be demonstrated by a document created entirely after the close of the Class Period.[2] Plaintiffs argue that the SEC Consent Decree is "probative of . . . scienter" because Defendants *agreed to amend a description in a single prior financial statement as part of the settlement agreement*, (Pl. Br. at 6), though restating no financials nor paying any fine to the SEC.[3] This contention ignores well-settled law that

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2 *See Kloepfer* v. *Honda Motor Co., Ltd*., 898 F.2d 1452, 1456 (10th Cir. 1990) (Where defendants entered into a consent decree regarding all-terrain vehicles "without litigation, adjudication, or any admission of liability" more than two years after the accident in question occurred, the court found the consent decree irrelevant to the intent and knowledge of the defendant as to the accident in question because the consent decree was subsequent to the incident and the sale).

3 Plaintiffs also mischaracterize Defendants' position with regard to this financial statement. Defendants are seeking the exclusion of the portion of the 10-K amended after the close of the Class Period in connection with the SEC agreement.

the mere fact that a financial statement has been amended is not probative of scienter. *See Roth* v. *OfficeMax, Inc*., 527 F. Supp. 2d 791, 797-98 (N.D. Ill. 2007) (Gottschall, J.) ("Importantly, mere allegations of GAAP violations, the restatement of income, or statements regarding the internal controls of a company that are later proven to be false, are not sufficient to demonstrate that those who made the statements committed securities fraud . . . There must also be . . . scienter."); *In re Bally Total Fitness Securities Litigation*, 2006 U.S. Dist. LEXIS 93986, at *24 (N.D. Ill. July 12, 2006) (Grady, J.) ("The Seventh Circuit has observed that even a very large restatement is not itself evidence of scienter."); *Chu* v. *Sabratek Corp*., 100 F. Supp. 2d 815, 824 (N.D. Ill. 2000) (Castillo, J.) ("A company's overstatement of earnings, revenues, or assets in violation of GAAP does not itself establish scienter."). Indeed, Plaintiffs' own accounting expert has similarly acknowledged that the mere fact of a restatement does not imply fraud, (Declaration of David Owen in Further Support of Defendants' Motion *In Limine* to Exclude or Limit 14 Categories of Evidence ("Owen Decl.") Ex. 10, Devor Tr. 98:3–7), and here Household merely amended one policy description and did not even restate financials.

3. The Prejudice Under Rule 403 Substantially Outweighs the Probative Value

The prejudice resulting from introducing the SEC's findings and opinions within the Consent Decree, like the introduction of the Consent Decree itself, would substantially outweigh their probative value, if any.[4] As set forth in Defendants' opening brief, Courts have questioned the relevance of an SEC consent decree in subsequent civil proceedings, particularly where, as here, the defendant had entered into the agreement without admitting fault. *See Beck*,

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[4] Rule 403 also provides for the exclusion of cumulative evidence. Plaintiffs have not responded to Defendants' argument that the Consent Decree is a secondary source that is cumulative of the direct primary evidence provided directly to the SEC and produced to Plaintiffs. See *Young* v. *James Green Management., Inc*., 327 F.3d 616, 624-25 (7th Cir. 2003) (district court did not abuse its discretion in refusing to admit EEOC determinations because, inter alia, "[a]part from Olsen's resignation letter, plaintiffs have pointed to no evidentiary material available to the EEOC that was not otherwise available to the jury during trial").

621 F. Supp. at 1565–66 (allegations based on SEC opinion were "irrelevant and immaterial for several reasons," including that defendants had not admitted that the SEC was correct).

As discussed above, the Consent Decree and its findings can have negligible probative value as to Defendants' scienter five months prior to entering into the agreement. *Abrams*, on which Plaintiffs principally rely, is plainly distinguishable from the present situation because the defendant in that case received the SEC letters at issue during the relevant time period, and the Court thus found that the letters were probative of the defendants' knowledge *before* issuing certain public statements. *Abrams* v. *Van Kampen Funds, Inc.*, No. 01 C 7538, 2005 U.S. Dist. LEXIS 531, at *65 (N.D. Ill. Jan. 12, 2005) (Hart, J.).

Meanwhile, the potential prejudice of introducing the findings and opinions is substantial and unfair. If the Consent Decree were admitted, jurors would likely assign it undue weight, assuming it to reflect legal conclusions reached by a well-known government agency and/or admitted to by the company. It would be particularly prejudicial to the Individual Defendants who did not consent to the agreement and who were never charged by the SEC. *See Beck*, 621 F. Supp. at 1566 ("[N]one of the defendants have admitted that the SEC was correct in its opinion, and defendants have a right to a trial on the issue of the correctness of the financial statements originally submitted").

The Consent Decree consists of mere allegations and the "findings" were not the product of an adjudicated proceeding, but its formal nature and tone, coupled with the perceived authority, could easily mislead a jury as to the significance of its contents. *See Higginbotham* v. *Baxter International, Inc*., 495 F.3d 753, 758 (7th Cir. 2007) (warning against taking regulatory allegations as proof of wrongdoing). This is particularly dangerous here where Household did not *admit* to the findings, but the jury would likely be confused by Household's *consent* to the agreement and by the fact that Household provided to the SEC a document titled "Offer of Settlement." *See Bachenski* v. *Malnati*, 11 F.3d 1371, 1376 (7th Cir. 1993) (affirming district

court's exclusion of settlement where jury might improperly construe such a settlement as admission of fault).

As in *Latigo Ventures* v. *Laventhol & Horwath*, where the court granted the defendants' motion to strike references to a consent decree, Plaintiffs' attempt "to inject part of [defendant's] past litigation history into this lawsuit is both improper and prejudicial." No. 85 C 9584, 1987 U.S. Dist. LEXIS 11225, at *11-12 (N.D. Ill. Nov. 27, 1987) (Duff, J.).

4. Consent Decree Findings are Not Admissible Pursuant to Rule 803(8)(C)

Rule 803(8)(C) provides a hearsay exception for public records and reports except where "the sources of information or other circumstances indicate lack of trustworthiness." Fed. R. Evid. 803(8)(C). In *In re Cenco Inc. Securities Litigation*, 601 F. Supp. 336, 337 (N.D. Ill. 1984) (Aspen, J.), the court found that an Accounting Series Release (an SEC document which the court called analogous to a consent decree) which Defendants had entered without admitting or denying the statements within would not be admissible under Rule 803(8)(C), noting: "the underlying 'facts' Cenco seeks to prove are not based on formal findings by the SEC following a hearing on the record. The ASR recites only unproven allegations developed by the SEC's staff, plus some comments by the Commission." The SEC agreement with Household is similarly lacking such indicia that would indicate that the SEC's statements are true — Defendants consented without admitting or denying the allegations and the settlement stipulated that it would not be binding on the parties in any future proceeding. (Plaintiffs' Revised Exhibit List ("P. Ex.") 1303; Appendix A to Defendants' Opening Brief ("App. A") Tab A-7).[5]

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[5] Whether the findings within the Consent Decree would be considered inadmissible hearsay or fall under the hearsay exception of Rule 803(8)(C) is ultimately irrelevant, however. While Plaintiffs cite *Abrams* for the proposition that SEC findings fall within this hearsay exception, they neglect to cite to the Court's qualification that "[s]tatements that fall within a Rule 803 exception may still be excluded as unduly prejudicial under Rule 403 or as irrelevant." 2005 U.S. Dist. LEXIS 531, at *61. See also *United States ex rel. Robinson* v. *Wilson*, No. 00 C 3598, 2001 U.S. Dist. LEXIS 3400, at *21 (N.D. Ill. Mar. 14, 2001) (Guzman, J.) (While statements made were not

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For the foregoing reasons, the Court should issue an Order precluding Plaintiffs from making any reference to the Consent Decree — including any SEC "findings of fact and opinions" related thereto.

B. FEDERAL AND STATE REGULATORY EXAMINATIONS

During the Class Period, Household's Consumer Lending Business Unit operated more than 1,400 branch offices in 46 different states, and the business was continuously subject to periodic review by the applicable regulatory agency in each of those states. Household's banking subsidiaries, though far smaller and less geographically dispersed, also were regularly reviewed by relevant federal regulatory bodies. Thus, over the period of time relevant to this case, Household's operations were, in the aggregate, the subject of literally hundreds of regulatory examinations, the overwhelming majority of which involved entirely routine periodic inquiries that focused on a small selection of branches and/or a miniscule sampling of transactions. Plaintiffs seek to offer as evidence a small, unrepresentative selection of Reports of Examination selected from the many hundreds of such reports produced (or in many cases withheld from production) by different federal and state regulators and then assert that this skewed selection of documents is probative of the falsity and scienter elements of their securities fraud claim. Part II.B of Defendants' Opening Brief demonstrated the evidentiary deficiencies of this approach.

Plaintiffs argue in opposition that the selective Reports of Examination and excerpts they hope to introduce are relevant circumstantial evidence of Defendants' state of mind,

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> hearsay under Rule 803, "Rule 403 requires exclusion of evidence where its probative value is substantially outweighed by the danger of unfair prejudice."); *Klein* v. *Vanek*, 86 F. Supp. 2d 812, 820 (N.D. Ill. 2000) (Kennelly, J.) ("Even were the Court to conclude that Palahniuk's report was admissible under Rule 803(8)(C), we would exclude the report under Federal Rule of Evidence 403.").

and they accuse Defendants of greatly exaggerating the risk of unfair prejudice and the potential waste of time that will follow from the admission of this evidence. Plaintiffs cannot dispute, however, that this selection of Reports of Examination and excerpts represents a small subset of those issued during the Class Period, that each individual Report of Examination is limited in geographical and substantive scope, that by definition an examiner's "findings" are akin to unadjudicated allegations, and that, as Plaintiffs' own expert conceded, Reports of Examination were focused on complaints lodged against Household and were not intended to offer a balanced picture of Household's overall compliance or to recognize the many positive aspects of Household's compliance record (*see generally* Declaration of Thomas J. Kavaler in Support of Defendants' Omnibus Motion *in Limine* to Exclude or Limit 14 Categories of Evidence ("Kavaler Decl.") Ex. 18, Cross Tr. at 88:9–25 ("'This is not a report about good things Household did or the things that Household and us were in agreement on. Its the things'. . . 'it's about the harmful things Household did and the things' that were — 'that we were in disagreement on.'")). Plaintiffs fail to explain how the introduction of such micro-level evidence of atypical "negative" examination "findings" will be probative of their macro-level claim that Defendants acted with scienter in respect of an alleged systemic and nationwide "predatory lending" scheme. Plaintiffs also have not offered a serious response to the very real concern that the introduction of these Reports of Examination will necessitate a series of mini-trials that can serve only to waste time and confuse the primary issues presented in this case, justifying their exclusion pursuant to Rule 403.

1. The Reports of Examination and Related Documents Are Inadmissible Under Rule 403

Because of the nature and limited scope of the Reports of Examination, any probative value they may have is minimal at best.

As explained fully in Defendants' Opening Brief, the Reports of Examination are limited in scope in that (i) each Report of Examination is limited to a review of, at most, the

branches covered by a particular regulating agency and, often, to a subset of those branches and (ii) the regulating agencies generally conducted examinations by evaluating a limited (and not statistically significant) selection of individual customer loan files. Given the narrow scope of review of these Reports of Examination, such documents are not highly probative, or even helpful in proving that Household's top executives acted with scienter in respect of an alleged nationwide and systemic "predatory lending" scheme during the Class Period. Plaintiffs offer no meaningful response to this reality.

Plaintiffs' argument that the Reports of Examination are probative rests on their assertion that "[t]he reports demonstrate that defendants had knowledge of Household's nationwide predatory lending scheme and therefore acted with scienter when issuing public denials about the Company's involvement in predatory lending." (Pl. Br. at 11) By definition that is wrong, because none of the Reports of Examination are national in scope (in fact most are not even statewide or branch office-wide in scope) and in their effort to accentuate the negative, Plaintiffs have selected only a small number of the available Reports of Examination that even collectively do not cover a broad scope. Unable to explain how a handful of Reports of Examination, each of which relates at most to a non-final review of a small subset of the company's business, will prove the existence of, or Defendants' knowledge of, an alleged systemic, nationwide scheme, Plaintiffs instead make two unavailing arguments: first, they boldly (and incorrectly) state that they "have already established the relevance of the state and federal reports of examination to plaintiffs' claims" (Pl. Br. at 10) and second, they summarize the negative contents of seven selected Reports of Examination in keeping with their persistent litigation strategy of mining prejudicial anecdotes about mistakes or random alleged misdeeds instead of proving a Company-wide policy or "scheme."

Plaintiffs' assertion that they have already established the relevance of the Reports of Examination blatantly misstates the record in this case. In truth, with respect to Plaintiffs' Motion Regarding State Agency Documents, Magistrate Judge Nolan stated "Plaintiffs ar-

gue that the [state reports of examination and related] documents are probative of scienter and falsity . . . . *That is not entirely accurate*." (Memorandum Opinion and Order of Judge Nolan ("Nolan Order") Regarding State Agency Documents Motion, Nov. 16, 2006, at 7-8 (Dkt. # 774) (emphasis added)). The Magistrate Judge went on to hold that "[n]evertheless, *under the liberal federal discovery rules*, the requested documents remain 'relevant' to this litigation." (*Id.* at 9 (emphasis added)). The liberal standard of "relevance" for purposes of discovery is not the standard applied in evaluating the probative value of putative evidence under the Federal Rules of Evidence, in fact it has almost nothing to do with establishing the admissibility of evidence at trial except, on occasion, as a condition precedent, and the record is clear that the Magistrate Judge did not hold that these documents were probative under the standards that govern this motion.

Plaintiffs next attempt to support their argument (or at least engender prejudice against Defendants) by previewing for the Court the "negative" findings they have culled from seven Reports of Examination. This exercise is entirely inapposite and does not begin to establish that the Plaintiffs' cherry-picked selection of certain Reports of Examination, each of which is limited in scope,[6] constitutes probative evidence of Defendants' knowledge of a systemic, nationwide predatory lending scheme.[7] Defendants do not contest that certain of the Reports of

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[6] In an attempt to specifically address the limited scope of the Washington State report (which consisted of a review of only 19 customer complaints) — presumably because its author has already admitted that the scope of the review conducted in connection with that report was "woefully inadequate" to reach any statistically valid conclusions about Household's business (Kavaler Decl. Ex. 18, Cross Tr. at 69:13–70:7) — Plaintiffs make spurious allegations relating to Defendants' complaint tracking mechanisms and alleged destruction of customer complaints. Plaintiffs' allegations are entirely unfounded and unsupported on this motion but, more saliently, are entirely irrelevant because the customer complaints reviewed by the DFI in connection with the Washington State report were complaints that were sent directly from customers to the DFI and Defendants' tracking and/or retention of customer complaints had absolutely nothing to do with the DFI's selection of its paltry review sample.

[7] Plaintiffs cite one case, *Farmers & Merchants National Bank* v. *Bryan*, 902 F.2d 1520 (10th Cir. 1990), for the proposition that reports of examination are admissible under Rule 403 because their

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Examination contained negative assertions relating to Household's compliance with state laws and regulations in a small number of unadjudicated instances. Indeed, as Plaintiffs' proposed expert Cross explained, the very point of such examination is to seek out exceptions. The Reports of Examination were focused on complaints lodged against Household and were not intended to offer a balanced picture of Household's overall compliance or to recognize the many positive aspects of Households compliance record. (*See generally* Kavaler Decl. Ex. 18, Cross Tr. at 88:9–25). Defendants take issue with Plaintiffs' attempt to ask the jury to extrapolate from a misleading sample of atypical and untested "findings" to a broad negative inference about the overall compliance record of Household's entire business during the entire Class Period. Plaintiffs do not cure this shortcoming merely by highlighting a small sample of negative findings in their brief, nor do they explain how their proposed introduction of a small fraction of available Reports of Examination from just a handful of states, given their limited scope, will prove Defendants' knowledge, or even the existence, of an alleged systemic, nationwide scheme.

Defendants demonstrated in their opening brief that the Reports of Examination lack probative value for the additional reason that they do not contain final adjudicated findings. Plaintiffs do not dispute this fact, or that field examinations mark the beginning of an iterative

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> probative value on the issue of defendants' knowledge outweighs their prejudicial impact. However, the *Farmers* Court did not analyze the issues presented by this motion — specifically the diminished probative value of the reports of examination as a result of their limited scope in comparison with the company's overall business. In fact, the banking institution at issue in that case appears to have been a nationally regulated institution accused of violations of federal law and the reports at issue were issued by one centralized national regulator — the Office of the Comptroller of the Currency. The *Farmers* Court was thus not presented with the same concerns regarding the limited scope of the examinations inherent in the Household Defendants' business — which consisted of numerous separate branches and banks separately regulated by one of many different regulating entities. The *Farmers* case is further distinguishable from the case at bar in that the reports at issue there were held to be probative of the knowledge of specifically identified outside directors and specific testimony was offered to establish that those outside directors had direct knowledge of the content of the reports at issue. No such evidence has been presented here.

exchange, or that the vast majority of regulatory observations are resolved before they can be fully adjudicated, with the result that the "findings" remain unadjudicated and unproven and therefore akin to inadmissible allegations in a complaint. Plaintiffs nevertheless assert that the Reports of Examination are probative because (a) they contain "objective" findings based on information provided by Household to the regulators; (b) they do not constitute hearsay under Rule 803; and, (c) Household chose to resolve their disputes with the state regulators rather than exhaust other legal remedies. None of these arguments squarely addresses the issue at hand or explains how the unadjudicated, unproven allegations of a state regulatory body could possibly prove whether Defendants were engaged in, or aware of, an alleged systemic, nationwide predatory lending scheme.

Plaintiffs' first argument — that the "findings" contained in the Reports of Examination are based upon the regulating agencies' review of documents provided by Household and might be categorized as "objective" rather than "adversarial" — is entirely unavailing. As fully explained in the Defendants opening brief (and not disputed by Plaintiffs in their opposition) the examination process is an iterative one which involves the issuance of a Report of Examination containing an examiner's observations based on his unilateral review and interpretation of certain documents and the company's responses thereto. Whether or not such observations are based upon a review of documents provided by Household, and whether or not they are "objective," has no bearing on whether they are final or proven and thus probative of the issue of whether or not the Defendants in fact engaged in, or were aware of, an alleged systemic and nationwide predatory lending scheme. In fact, as evidenced by the company's responses to many of the Reports of Examination issued during the Class Period,[8] Household disagreed with and

[8] *See, e.g.*, Kavaler Decl. Ex. 35 (HHS 03447647-03447673); Kavaler Decl. Ex. 25 (HHS 02859015-02859018); Kavaler Decl. Ex. 36 (HHS 03441952-03441977); Kavaler Decl. Ex. 37 (HHS 03441978-03442010); Kavaler Decl. Ex. 29 (HHS 02858732-02858736); Kavaler Decl. Ex. 30 (HHS 02857447-02857456); Kavaler Decl. Ex. 21 (HHS 02940017-45); Kavaler Decl. Ex. 22 (HHS 02940009-16); Kavaler Decl. Ex. 23 (HHS 03446709-11); Kavaler Decl. Ex. 32 (HHS

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disputed many of the "findings" contained in the Reports of Examination (including many that were based on an interpretation of its documents) and those disputed and unproven allegations alone are not proof that the Defendants violated any law or regulation, much less that Defendants engaged in, or were aware of, an alleged systemic, nationwide predatory lending scheme.

Plaintiffs' argument that the amicable resolution of most regulatory inquiries amounted to a decision by Household not to exhaust its legal remedies, thereby rendering the examiner's "findings" "final" and therefore probative of liability is nonsensical as a matter of fact, wrong as a matter of law, and impossible to reconcile with the polices underlying Rule 408. The vast majority of "findings" contained in Reports of Examination are never fully adjudicated because regulated entities generally choose not to contest the findings or to pursue the full avenue of administrative and legal appeals. (*See generally* Declaration of John L. Bley ("Bley Decl.") ¶¶ 10–11; Pl. Br. at 17 (citing Ghiglieri Rebuttal Report at 61)). The fact that the "findings" are not adjudicated does not render them "final" or constitute proof of their accuracy; rather it "leave[s] the regulatory process frozen in place, leaving a permanent fossil record in the form of a report of examination of an incomplete administrative process. The apparent findings in the report of examination remain apparent, even if the report contains novel or innovative enforcement theories, or enforcement theories that are contrary to law. Regulators have not proven their theories and alleged facts through an adversarial review process, and regulated entities have not gone through the process of disproving those theories and alleged facts." (Bley Decl. ¶ 11).

Finally, Plaintiffs' argument that their cherry-picked Reports of Examination are probative because they do not constitute hearsay is a red herring. Defendants have not moved to exclude the Reports of Examination from evidence based on hearsay and do not, for purposes of

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03452033-03452040); Kavaler Decl. Ex. 26 (HHS 03442422-03442432); Kavaler Decl. Ex. 31 (HHS 02857664-02857675); Kavaler Decl. Ex. 34 (HHS 02982043-02982044).

this motion, dispute that portions of some Reports of Examination may fall within an exception to the hearsay rule.[9] That has no bearing, however, on whether these documents are probative of the issue of whether Defendants engaged in, or were aware of, an alleged systemic, nationwide predatory lending scheme, and if so, whether the prejudice of exposing the jury to a biased, statistically insignificant sample of unadjudicated observations vastly outweighs any marginal probative value they may possess. While it may be true that documents that fall within an exception to the hearsay rule are assumed to have a certain level of reliability — *i.e.*, that the documents are what they purport to be and contain what they purport to contain (in this case, the unproven and unadjudicated findings of an examiner) — this has absolutely no bearing on whether or not they are probative of any particular fact. *See generally United States* v. *Riddle*, 103 F.3d 423, 430-31 (5th Cir. 1997) (holding that OCC reports of examination were properly excluded under Rule 403 "even if the reports fall under a hearsay exception"). Defendants' motion to exclude the Reports of Examination is predicated on Rule 403 and challenges the prejudice and lack of probative value of unadjudicated and unproven observations deliberately focused on exceptions. Even if Plaintiffs were correct that at least the single hearsay aspects of the subject Reports fall under some exception to the hearsay rule, they will have come no closer to demonstrating that the alleged probative value of unadjudicated, limited-scope allegations would outweigh the indisputable prejudice of presenting them to the jury as true.

Defendants also explained in their opening brief that exclusion of the Reports of Examination is appropriate because their introduction into evidence would necessitate a series of

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[9] If the Court were to rule that the Reports of Examination are admissible notwithstanding Rule 403, Defendants would continue to object to the introduction into evidence of certain portions of the Reports of Examination which do contain hearsay (for example, in instances where a Report of Examination purports to summarize the statements made by an individual customer). Even assuming the Reports of Examination themselves fall within the public records exception to the hearsay rule would not, of course, render the hearsay portions contained within those documents admissible. This analysis is not, however, relevant to the inquiry presented by this motion — whether the Reports of Examination are inadmissible in their entirely under Rule 403.

mini-trials that would waste time and confuse the issues. Plaintiffs' cynical response is that the "reports of examination comprise only a small portion of the evidence plaintiffs intend to use" and that it is Defendants' "prerogative" to "waste time rebutting every single finding contained therein." (Pl. Br. at 18–19). Again, Plaintiffs have entirely (or perhaps intentionally) missed the point. The introduction of Plaintiffs' biased selection of Reports of Examination into evidence would necessarily create an incomplete record and mislead the jury because the isolated "negative" "findings" Plaintiffs would seek to introduce are trivial when viewed in context and in comparison to Household's overall record of compliance with state laws and regulations noted in the Reports of Examination. Plaintiffs would of course prefer to rest on the incomplete anecdotal record, but the rule of completeness codified in the Federal Rules of Evidence precludes them from doing so. In fact, Rule 106 provides that the Court *must* allow Defendants to introduce any missing portions of the Reports of Examination that Plaintiffs enter, as well as the complete record of Reports of Examination issued during the Class Period and Household's responses and rebuttals to those Reports of Examination, at the same time as Plaintiffs introduce their incomplete evidence (not, as Plaintiffs' suggest, after they have completed their two week presentation of evidence). *See generally Beech Aircraft Corp*. v. *Rainey*, 488 U.S. 153, 171 n.14 (1988) ("In addition to [the] concern that the court not be misled because portions of a statement are taken out of context, the rule has also addressed the danger that an out-of-context statement may create such prejudice that it is impossible to repair by a *subsequent* presentation of additional material." (emphasis in original); *Dugan* v. *R.J. Corman Railroad Co.*, 344 F.3d 662, 669 (7th Cir. 2003) (stating that "[t]he meaning of quoted phrases often depends critically on the unquoted context" and that such "bad practice . . . will often and here violate . . . the 'completeness' rule of Fed. R. Evid. 106."); *Frymire-Brinati* v. *KPMG Peak Marwick*, 2 F.3d 183, 188 (7th Cir. 1993) (setting aside a jury verdict after trial judge deemed admissible, *inter alia*, unadjudicated administrative "findings" while keeping out evidence showing defendant was exonerated). Effective rebuttal of each of the allegations and exploration of the scope and reliability of each Report of Examination would necessarily be time-consuming. Each of the Reports of Examination would, in effect, be-

come the subject of a separate mini-trial within the trial. It is entirely appropriate for the Court to rule out such diversions — which would necessarily waste time and resources and which would serve only to confuse the jury and obscure the true issues in this already complex securities fraud case. *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"); *Jones* v. *Hamelman*, 869 F.2d 1023, 1027 (7th Cir. 1989); *United States*. v. *Buljubasic*, 808 F.2d 1260, 1268 (7th Cir. 1987) (excluding evidence that the court considered "detours and excursions" as collateral issues under Rule 403).

Introduction of the Reports of Examination and related documents would also create a serious risk of unfair prejudice. Although the documents contain mere allegations, their official source could easily mislead a jury to inflate the significance of their contents. *See Higginbotham* v. *Baxter International, Inc*., 495 F.3d 753, 758 (7th Cir. 2007) (warning against taking regulatory allegations as proof of wrongdoing.); *Doe* v. *Tag, Inc.*, No. 92 C 7661, 1993 WL 524773 (N. D.Ill. Dec. 14, 1993) (Conlon, J.) (excluding evidence of unproven and inflammatory allegations). Because jurors are likely to put undue weight on any findings made by a government agency, even where those "findings" were never adjudicated, and because, as Cross conceded, Reports of Examination are designed to identify alleged exceptions, evidence of those "findings" is unduly prejudicial.

2. The Federal Reports of Examination and Related Documents Are Inadmissible Under Rule 106

Because the Defendants are unable to introduce into evidence or even describe the vast majority of the Reports of Examination issued by the federal regulatory entities during the

Class Period, and because the introduction of just the skewed selection that Plaintiffs intend to introduce would necessarily create an incomplete and misleading record, Rule 106 requires that those documents be excluded from evidence. *See United States* v. *LeFevour*, 798 F.2d 977, 981 (7th Cir. 1986) ("[i]f otherwise inadmissible evidence is necessary to correct a misleading impression, then either it is admissible for this limited purpose by force of Rule 106 . . . or, if it is inadmissible (maybe because of privilege), **the misleading evidence must be excluded too**.") (emphasis added); *see also* Jack B. Weinstein & Margaret A. Berger, *Weinstein's Federal Evidence* § 106.03[1] (2d ed. 2008) ("If any necessary evidence is rule inadmissible, however, the trial court should also exclude the original evidence that would be misleading without the context provided by the excluded evidence."). In response, Plaintiffs erroneously suggest that Defendants are "to blame" for the unavailability of the remaining documents. In fact, the documents are unavailable because the relevant agencies chose not to waive the applicable privileges — privileges that Defendants do not control and cannot waive. (*See* Kavaler Decl. Exs. 2, 3, 4 (Letter from the Office of the Comptroller of the Currency to D. Cameron Baker, Esq. (March 31, 2006); Letter from the Office of Thrift Supervision to D. Cameron Baker, Esq. (April 6, 2006); Letter from the Federal Deposit Insurance Corporation to Azra Medhi, Esq. (April 11, 2006))).

For the foregoing reasons, the Court should issue an Order precluding all references to Reports of Examination and related documents as set forth above.

C. COMPLAINTS IN OTHER LITIGATIONS ARE HEARSAY SUBJECT TO NO EXCEPTION UNDER FED. R. EVID. 801 AND 802 AND ARE INADMISSIBLE UNDER FED. R. EVID. 401, 402, 403 AND 703

Unsubstantiated accusations from other consumer fraud litigations are irrelevant to the elements of Plaintiffs' securities fraud claim and have no place in this case. Plaintiffs concede as much in their Motion *In Limine* No. 7 (Memorandum of Law in Support of Plaintiffs' Motion *In Limine* to Preclude at Trial any Reference to the Unsubstantiated Post-Class Period Allegations of Voter Fraud Against Association of Community Organizations for Reform Now

("ACORN")). Now Plaintiffs' position is clearer: that public accusations leveled against a self-styled consumer advocate are not admissible, but those leveled against Household (often, in fact, by ACORN) are. The Federal Rules of Evidence, however, prevent such a perverse result. Plaintiffs' argument that the complaints are offered for "notice" is a transparent attempt to circumvent the rule barring hearsay. Plaintiffs nowhere address the real risk of unfair prejudice and jury confusion posed by this evidence. Plaintiffs' final attempt to admit this evidence — sneaking it in through their "expert" — is likewise without merit. Defendants' Motion to bar such evidence should be granted.

Plaintiffs do not dispute that the complaints would be hearsay if offered for the truth of the matters alleged therein. Yet despite their protestations to the contrary, Plaintiffs clearly intend to offer the civil action complaints into evidence for their truth. Plaintiffs cannot disguise their hearsay use of this evidence simply by calling such use "notice" — the last resort of a party seeking to prejudice the jury with inadmissible evidence.[10] Plaintiffs' attempt to do so is both an argument of desperation and proves too much. In a securities fraud case, mere notice of allegations of wrongdoing is not enough to support an inference of scienter. *See Pugh* v. *Tribune Co.*, 521 F.3d 686, 695 (7th Cir. 2008). Obviously, notice of filed complaints does not equal notice of actual widespread wrongdoing. If Plaintiffs' actual purpose were limited to demonstrating Defendants' knowledge of allegations, their trial exhibit list would have been limited to documents demonstrating notice of the lawsuits (and there is no shortage of such documents). Indeed, in many instances there is no good faith need to "prove" notice at all, because Household publicly disclosed *the very complaints* Plaintiffs seek to offer, thus providing the best evidence

[10] Plaintiffs cannot even disguise their intentions long enough to finish writing their opposition brief. In the same paragraph in which they profess that they "do not intend to use the complaints for the truth of the matters asserted therein," Pl. Br. at 24, they also let slip the statement that "*defrauded customers* sued Household . . . ," *id.* (emphasis added), assuming the truth of the very allegations they claim will not be offered for their truth. *See also* Pl. Br. at 26 ("consumer complaints filed against Household were brought by *defrauded customers* . . . ." (emphasis added)).

possible that it had "notice" and rendering any offer of the underlying complaints cumulative at best. (*See, e.g.*, Owen Decl. Ex. 3 (Household Press Release dated Nov. 15, 2001: "Household was recently made aware that the California Department of Corporations has filed a lawsuit claiming that the company has engaged in 'willful' lending violations."); Pl. Br., Appendix, Ex. 21 (Household 2001 10-K: "Household has also been named in purported class actions by consumer groups (such as AARP and ACORN) claiming that our loan products or our lending policies and practices are unfair or misleading to customers.")). Instead, Plaintiffs seek to offer the actual complaints containing various inflammatory and highly prejudicial accusations that are the subject of this Motion. Plaintiffs display their real purpose by arguing that the civil action complaints are admissible through the backdoor as the basis for expert Catherine A. Ghiglieri's conclusion that "Household was a textbook case for predatory lending." (Pl. Br. at 25). Because Plaintiffs are offering the allegations contained in civil complaints for their truth, the evidence is inadmissible hearsay.

Allegations contained in various civil complaints cannot constitute evidence of scienter because they were publicly available. If allegations in such lawsuits "were enough to demonstrate fraud, then plaintiffs and other investors could have drawn that inference themselves." *See Higginbotham* v. *Baxter International*, 495 F.3d 753, 759 (7th Cir. 2007). Even if the complaints were evidence of what Plaintiffs consider "notice," their scant probative value is substantially outweighed by the danger of unfair prejudice and jury confusion under Rule 403. Plaintiffs attempt to distinguish the holding of the Court of Appeals in *Pugh*, 521 F.3d at 695 ("After the lawsuits were filed, the defendants had actual knowledge of *accusations* of fraud, not fraud itself.") (emphasis in original), by arguing that Defendants ignored "the red flags raised by the complaints." (Pl. Br. at 27). Plaintiffs' suggestion that because William Aldinger and Gary Gilmer did not specifically recall details concerning certain investigations at depositions four

years after the events at issue, the company did not conduct any such investigation is, at the least, disingenuous.[11] In fact, as Plaintiffs are well aware, the company performed a nationwide investigation into any use of an "effective rate" sales presentation (allegedly a predatory practice). After looking at all customer complaints from 1999–2002, the company identified only forty-two complaints dealing with effective rate. (*See* Owen Decl. Ex. 11). *See Pugh*, 521 F.3d at 695 ("[T]hey promptly commenced an investigation to discover whether the allegations were true."). Much more relevant to this securities fraud case, the market was at all times aware of the allegations against the company, which Plaintiffs cannot dispute. (*See* Pl. Br. at 28) (noting coverage of the ACORN lawsuit in the media, and disclosure of the lawsuit in Household's 2001 10-K)).

On the other side of the Rule 403 equation is the great danger of unfair prejudice and jury confusion. The allegations in the civil action complaints are couched in inflammatory and self-serving language. The complaints bear the identification of the courts in which they were filed. As Plaintiffs' counsel well know, civil complaints are often filed with thin support for the matters asserted. But a jury, on the other hand, might mistakenly conclude that such allegations somehow become more credible once filed with a court. Plaintiffs do not bother to address this very real threat of jury confusion and unfair prejudice, and they cite no case where prior civil complaints were found admissible. One case cited by Plaintiffs, *Olson* v. *Ford Motor Co.*, 410 F. Supp. 2d 855 (D.N.D. 2006), undercuts Plaintiffs' argument on this very point: "[T]he Court finds that the introduction into 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

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[11] Plaintiffs also take the deposition testimony out of context. Aldinger testified: "I remember investigating some sales tactics we had, and we talked about that earlier today. But that's all. No details." *See* Kavaler Decl. Ex. 40, Aldinger Tr. 152:15-17 (Jan. 29, 2007). Gilmer testified that although he did not recall directing a QAC investigation into potential predatory lending, he "probably would have done that in the course of business." *See* Kavaler Decl. Ex. 10, Gilmer Tr. 276:20–277:13 (Jan. 11, 2007).

prejudicial to [defendants]." *Id.* at 864.[12] Even if Plaintiffs' purpose were to demonstrate notice of allegations, they could do so with less inflammatory evidence than the civil complaints, which Plaintiffs admit comprise "only a small part" of their alleged evidence on Defendants' state of mind. (Pl. Br. at 29). If the civil complaints were admitted for any purpose, their highly prejudicial nature would require the Court to issue countless limiting instructions warning the jury how it ought *not* to use such evidence.

Plaintiffs' backdoor attempt to "introduce evidence of the complaints" through their expert witnesses also must fail. Although Plaintiffs correctly quote one portion of one sentence of Federal Rule of Evidence 703, they conveniently omit the preceding clause and very next sentence of the rule. Rule 703 reads in full:

> "The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. *If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject*, the facts or data need not be admissible in evidence in order for the opinion to be admitted. *Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion or inference unless the court determines that their probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect*." Fed. R. Evid. 703 (emphasis added).

Even if an "expert" is allowed to provide an opinion based upon unproven hearsay civil complaints, the underlying facts are not necessarily admitted into evidence. Before a court can allow otherwise inadmissible facts and data into evidence through expert testimony — *Plaintiffs must show* that the probative value of the civil complaints substantially outweighs the

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[12] The only legal authority Plaintiffs offer for the proposition that publicly filed civil complaints are relevant for "notice" are cases addressing the admissibility of summaries or compilations of *individual customer* complaints, which are not the focus of this particular Motion *in limine*. (*See* Section G, *infra*.)

prejudicial effect these inflammatory court-filed accusations would have. Plaintiffs have made no such showing.[13]

Furthermore, an expert cannot be offered merely as a mouthpiece for inadmissible material. As Plaintiffs point out, their proposed expert witness Catherine A. Ghiglieri relies on (hearsay) accusations against Household in other civil complaints to conclude that "Household was a textbook case for predatory lending." (Pl. Br. at 25 (internal citation omitted)). This methodology presents its own problems under *Daubert*,[14] but even if Ghiglieri were permitted to rely on such complaints in forming her opinion, Rule 703 bars Plaintiffs from introducing the civil complaints as evidence. As the Court of Appeals has held, "the judge must make sure that the expert isn't being used as a vehicle for circumventing the rules of evidence." *James Wilson Associates* v. *Metropolitan Life Ins. Co.*, 965 F.2d 160, 173 (7th Cir. 1992). Ghiglieri's proposed opinion, which relies on the truth of the out-of-court accusations, would do just that. Her "use" of the civil complaints — to conclude that Household was a predatory lender because various lawsuits so alleged — is hearsay not within any exception. *See id.* ("If for example the expert witness (call him A) bases his opinion in part on a fact (call it X) that the party's lawyer told him, the lawyer cannot in closing argument tell the jury, 'See, we proved X through our expert witness, A.'"); *see also Loeffel Steel Products, Inc*. v. *Delta Brands, Inc*., 387 F. Supp. 2d 794, 808 (N.D. Ill. 2005) (Cole, M.J.) ("[W]hile Rule 703 was intended to liberalize the rules relating

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13 For example, if permitted to opine on loss causation and damages, Plaintiffs' proposed expert Daniel Fischel would have no need to describe to the jury the specific allegations in civil action complaints except to state that a complaint was filed on a certain day having a certain effect on stock price.

14 *See* Memorandum of Law in Support of Household Defendants' Daubert Motion to Exclude the "Expert" Testimony of Catherine A. Ghiglieri, at 30 ("Real world regulators do not rely upon un-tested accusations of customers . . . as a basis for forming conclusions about a company's entire operations. Allegations such as these form an inherently biased and incomplete record, which is why regulators always conduct additional investigation before making any conclusions about a particular loan, much less a company as a whole . . . .").

to expert testimony, it was not intended to abolish the hearsay rule and to allow a witness, under the guise of giving expert testimony, to in effect become the mouthpiece of the witnesses on whose statements or opinions the expert purports to base his opinion.") (internal citations omitted). Ghiglieri's proposed hearsay use of evidence of civil complaints should be barred.

For the foregoing reasons, Defendants respectfully request an Order precluding all references to the civil action complaints as set forth above.

D. CIVIL AND REGULATORY SETTLEMENTS ARE INADMISSIBLE

Federal Rules of Evidence 403 and 408 require exclusion of the civil and regulatory settlements entered into by Household both during and after the Class Period. Plaintiffs offer four arguments against applying Rule 408 to the use of settlement evidence in this case, namely: (1) some documents on Defendants' list are not actual settlement agreements or offers of settlement; (2) the civil and regulatory settlements relate to other actions and are therefore admissible in this action; (3) the settlements are "inextricably intertwined" with the facts of this case; and (4) the evidence can be admitted to demonstrate loss causation, damages and scienter, which Plaintiffs argue are permissible purposes. Each of these arguments lacks merit and is dealt with below in turn. Plaintiffs barely respond to Defendants' argument that the settlements should be excluded under Rule 403. Defendants' Motion to exclude reference to the civil and regulatory settlements should be granted.

1. Use of Civil and Regulatory Settlement Information Is Prohibited by Rule 408

Plaintiffs first argue that many (though not all)[15] of the documents Defendants seek to exclude are not covered by Rule 408. (Pl. Br. at 32–33). Yet Defendants have specifically identified each of Plaintiffs' proposed exhibits that discuss settlements or settlement negotiations (Defendants' Opening Brief, at App. A, Tabs D-1 - D-78), and described each settlement that these documents relate to. *Id*. at 48–49. Defendants agree that some of these documents contain references to matters that would not be excluded as settlement-related, but these concerns are easily rectified. The settlement-related portions of such documents can be redacted before any other matter contained in those documents is offered by Plaintiffs at trial.

In any event, Plaintiffs' reading of Rule 408 is far too narrow. Plaintiffs suggest that only settlements or actual offers of settlement are covered by the Rule. (Pl. Br. at 32–33). They argue, for instance, that one document prepared by Household employee Carin Rodemoyer is a "calculation of restitution sought by the regulators" in the course of certain negotiations, but is not covered by Rule 408 because "a company's analysis of its exposure does not constitute a settlement." (Pl. Br. at 33). Defendants agree that whatever else Ms. Rodemoyer's calculations represent, they are not "a settlement." But Plaintiffs have admitted that they intend to use the document as evidence of estimated refunds to customers prepared in connection with Household's October 2002 settlement with certain attorneys general. (Owen Decl. Ex. 12).

On this point, the law is clear: Rule 408 requires exclusion not only of settlements but also evidence related to settlement negotiations. Because documents relating to set-

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[15] Plaintiffs implicitly concede that the consent judgments and consent orders entered into with the multistate AG working group are part of the AG settlement and thus barred by Rule 408. (Pl. Br. at 32, n.17 ("Plaintiffs, in all likelihood, will not offer these exhibits in their case-in-chief" as long as evidence relating to the announcement of the AG settlement is received and their "expert" can rely on such materials)).

tlement negotiations also fall under Rule 408, *see Davis* v. *Rowe*, No. 91 C 2254, 1993 WL 34867, at *1-2 (N.D. Ill. Feb. 10, 1993) (Kocoras, J.), a court should consider "whether 'the statements or conduct were intended to be part of the negotiations for compromise.'" *S.J.C. Enterprises* v. *Eikenberry & Associates, Inc.*, No. 04 C 1186, 2006 WL 1235762, at *2 (N.D. Ill. May 2, 2006) (Nolan, M.J.) (internal citations omitted). In *Kritikos* v. *Palmer Johnson, Inc.*, 821 F.2d 418 (7th Cir. 1987), the Court of Appeals held that it was error for the trial judge to rely on letters detailing the potential merits of plaintiff's claims. *Id.* at 423 (noting that the trial court's "use of the contents of the letters violated the objective of Federal Rule of Evidence 408 which we have stated is 'to encourage settlements'") (internal citation omitted). Plaintiffs' exceedingly narrow interpretation of Rule 408 is without basis in law.

2. The Settlements Are Inadmissible Even Though They Relate To Different Claims

Plaintiffs next argue that the civil and regulatory settlements relate to different claims than those presented in this action, and that Rule 408 therefore should not apply. (Pl. Br. at 33–34). Defendants agree that the civil and regulatory settlements relate to allegations of consumer fraud, unlike the securities fraud claim Plaintiffs seek to prove here (which calls into question the relevance of such settlements under Rule 403 in light of their prejudicial nature). But Plaintiffs nevertheless attempt to use Defendants' settlement of various *consumer* fraud claims to prove that Defendants committed *securities* fraud when they denied the underlying consumer fraud allegations in the settled claims. (*See* Pl. Br. at 34 ("[T]he subsequent settlements are relevant to demonstrate that Household's predatory lending practices contributed to its issuance of false financial statements during the Class Period.")). Plaintiffs are thus offering the settlements to show that the Defendants knew the underlying allegations were true. While the civil and regulatory settlements do relate to separate claims, Plaintiffs cannot have it both ways. Either the settlements relate to Plaintiffs' claims such that using the settlements to prove liability for the settled claims is barred by Rule 408, or the settlements of consumer fraud claims are irrelevant to Plaintiffs' claims (as Defendants have long argued). In any event, the purpose of Rule 408, to

encourage settlements, would be eviscerated if it were applied only to settlements in the same case; therefore, Rule 408 bars introduction of settlement evidence even if the settlement involved another case and a different party. *See, e.g.*, *Playboy Enterprises* v. *Chuckleberry Publishing, Inc.*, 687 F.2d 563, 568-569 (2d Cir. 1982); *see also* Fed. R. Evid. 408 advisory committee notes (1972) (Rule 408 applies "when a party to the present litigation has compromised with a third person.").

3. The Settlements Are Not Inextricably Intertwined with the Facts of the Case

Plaintiffs then inconsistently argue that Rule 408 is inapplicable because the settlements are "inextricably intertwined with the facts of the case." (Pl. Br. at 35–36) Plaintiffs cite no civil case in which a court allowed into evidence a settlement of prior claims on the basis that the settlement was "inextricably intertwined" with the facts of the case. Instead, Plaintiffs cite a string of inapplicable criminal cases having nothing to do with Rule 408, but relating instead to a doctrine that applies in criminal cases to determine whether certain evidence falls outside the purview of Rule 404(b)'s prohibition against character/propensity evidence. *See, e.g.*, *United States v. Senffner,* 280 F.3d 755, 764 (7th Cir. 2002). In any event, Plaintiffs cannot tell a "factual story" that impermissibly relies on settlement evidence to prove liability for the settled claims. Plaintiffs also make no effort to explain how *post*-Class Period settlements, some of which occurred more than a year after the Class Period ended, relate to their "factual story." Although Plaintiffs claim that their case depends on describing Household's "interactions with state and federal regulators" (Pl. Br. at 32), it is not the interactions themselves, but the settlements and settlement negotiations with state and federal regulators that implicate Rule 408.

Plaintiffs contend that settlement evidence is a component of loss causation and damages. As for damages, Plaintiffs' Brief belies any such position, conceding that "the restitution amounts calculated by Rodemoyer are not the damages asserted by plaintiffs in this case." (Pl. Br. at 34, n.18). Nor could they be. Damages in a securities fraud case are not based on the

amount of unrelated civil settlements, but are based on changes in the value of securities purchased and sold during the relevant time period. *See, e.g., Dura Pharmaceuticals* v. *Broudo*, 544 U.S. 336 (2005). Defendants concede that Plaintiffs' loss causation expert Daniel Fischel relies on settlement-related information to show the effect of certain disclosures on the price of Household stock. If Plaintiffs actually intended to recount the fact of the settlements merely to test the alleged disclosure effect on stock price, and not impermissibly to show liability for the settled claims, they would have omitted from their trial exhibit list documents such as the consent decrees or the AG settlement that Fischel does not identify as disclosures in his various models. The documents dealing with the settlement negotiations and the settlements themselves are inadmissible.

4. Plaintiffs Do Not Offer the Settlements for Any Permissible Purpose

Finally, Plaintiffs attempt to evade Rule 408 by arguing that they are offering the settlement evidence to prove "knowledge and intent or a continuing course of conduct." (Pl. Br. at 36 (internal citation omitted)). Plaintiffs do not explain how their use of the settlement evidence fits any of these purposes. Indeed, their argument as to the relevance of the settlements makes no sense unless the settlements are used as evidence of the validity of the settled claims. Essentially, Plaintiffs argue that Defendants' denials of various consumer fraud allegations in the face of the settlements and related discussions with regulators support an inference of scienter. For the settlements to show scienter, however, they must be considered admissions of liability. But the agreements themselves make clear that Defendants made no admission whatsoever, and the very point of Rule 408 is to make sure that such impermissible inferences are barred. Publicly disclosed settlements cannot constitute "notice" of predatory lending. Intent, or scienter, is measured at the time the disclosure is made, not after the fact. As the Court of Appeals has explained, "[t]he securities laws approach matters from an *ex ante* perspective: just as a statement true when made does not become fraudulent because things unexpectedly go wrong, so a statement materially false when made does not become acceptable because it happens to come true."

Pommer v. *Medtest Corp.*, 961 F.2d 620, 623 (7th Cir. 1992) (internal citations omitted). In other words, "[t]he truth (or falsity) of defendants' statements, and their materiality, must be assessed at the time the statements are made, and not in the light of hindsight." *Id.* at 625. Plaintiffs' transparent attempt to use settlement evidence as an *ex post* admission of liability is barred by Rule 408.

Moreover, Plaintiffs' thesis that public denials of liability are actionable is legally erroneous in any event. Household was entitled to vigorously defend itself against the allegations made in the civil complaints that it was a "predatory lender" or that its lending practices were illegal, and was not required to admit a disputed liability in order to avoid violating the securities laws. *See, e.g., Anderson* v. *Abbott Laboratories*, 140 F. Supp. 2d 894, 906 (N.D. Ill. 2001) (Moran, J.) ("[A company's] maintenance of its innocence is not fraud. SEC rules do not create a duty to confess contested charges. . . . Where there exists a good faith dispute as to facts or an alleged legal violation, the [law] only requires disclosure of the dispute.") (citation and internal quotation marks omitted), *aff'd sub nom. Gallagher* v. *Abbot Laboratories*, 269 F.3d 806 (7th Cir. 2001).[16] And Household disclosed material litigation and regulatory activity directed against it in its SEC filings, as noted above.

5. Admission of Civil and Regulatory Settlements Would Violate Rule 403

Although they devote considerable attention to their futile attempts to distinguish cases that Defendants cite, Plaintiffs themselves identify no case allowing settlement evidence to be introduced to prove liability for the settled claims under Rule 403.[17] Unless they were offered

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16 "To hold that a legal position taken by a publicly traded company, or an expression of confidence in a legal position, may be converted by hindsight into an actionable misrepresentation if the company later loses the lawsuit would have a chilling effect on publicly traded companies seeking to defend their interests in litigation." *In re Glaxco Smithkline PLC Securities Litigation*, No. 05 Civ. 3751, 2006 WL 2871968, at *10 (S.D.N.Y. Oct. 6, 2006).

17 *Sunstar, Inc.* v. *Alberto-Culver Co.*, No. 01 C 736, 2005 U.S. Dist. Lexis 23098 (N.D. Ill.

Footnote continued on next page.

to prove liability for the settled claims, an impermissible use, the settlements have scant probative value, especially those agreed to after the Class Period. There is ample support for the exclusion of settlement evidence in similar circumstances. (*See* Defendants' Opening Brief, at 52-55). Any relevance of the settlements is substantially outweighed by the danger of unfair prejudice, jury confusion, and waste of time. Contrary to Plaintiffs' assertion, it is no "small step" for Defendants to have to introduce evidence as to the reasons for entering various civil and regulatory settlements. The precious time in this four-week trial would be better spent on the securities fraud claims at issue, rather than lengthy testimony relating to setting the record straight on the merits of and true reasons for settling various unadjudicated consumer claims.

For the foregoing reasons, Defendants respectfully request an Order precluding all references to the civil and regulatory settlements as set forth above.

E/F. EVIDENCE OF, OR REFERENCE TO, HOUSEHOLD'S SETTLEMENT-RELATED POLICY CHANGES AND REFUNDS SHOULD BE EXCLUDED

Despite the strongly worded and overly general statements contained in Plaintiffs' opposition to Defendants' motion to preclude the use of settlement-related policy changes and refunds, Plaintiffs do not offer any substantive reason for the Court to deny Defendants' request

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> Sept. 19, 2005) (Guzman, J.), which plaintiffs rely on for their Rule 403 argument (*see* Pl. Br. at 37), is inapposite. In *Sunstar*, plaintiffs offered evidence of a settlement between Sunstar and plaintiffs for the permissible purpose of proving that Sunstar understood certain terms of their various agreements. *Id*. at *13. The evidence was admitted notwithstanding Rule 408 because of "the parties' long-standing business relationship." *Id*. at *21. Plaintiffs in *Sunstar* were *not* offering the settlement evidence to prove (directly or indirectly) that Sunstar was in fact liable for the claims it had settled. Indeed, this Court noted: "Because the grounds for the two disputes are different, Sunstar's settlement of the 1988 dispute should not give rise to an inference of liability in this case." *Id*. at *18. But here, Plaintiffs admit that they are offering the settlement evidence to prove scienter — that Defendants knew the company was engaged in predatory lending and lied about it to the public. But the settlements support such an inference only if they are used as proof of the validity of the settled claims, which Rule 408 expressly prohibits.

for an Order precluding Plaintiffs from introducing into evidence at trial any reference to changes to Household's policies or practices as a result of settlements.

1. Plaintiffs' Argument Concerning Household's Policy Changes with Respect to Their Sales and Business Practices Fails to Acknowledge that Relevant Changes Were Made Voluntarily

Plaintiffs' opposition to Defendants' argument that Rule 407 precludes their use of policy changes and refunds is misguided because it is premised on the erroneous assumption that Household was *required* to adopt the policy changes. *See* Pl. Br. at 39. Plaintiffs ignore the well-substantiated fact that Household voluntarily changed its policies at various points during the course of the Class Period, and not only in connection with its settlement with the Multi-State Working Group. Plaintiffs support their argument not with the express provisions of Rule 407, but with their own interpretation of the social policy that underlies the Rule. *See id.* Plaintiffs offer no persuasive argument for the admission of information relating to these policy changes and refunds because: (1) Plaintiffs cite to a factually inapposite case in support of their position and (2) Plaintiffs simply ignore the fact that the policy changes and refunds were made voluntarily by Household.

Plaintiffs' principal argument relies on *In re Aircrash in Bali*, 871 F.2d 812 (9th Cir. 1989), for the proposition that nonvoluntary measures do not fall within Rule 407. Pl. Br. at 39. Defendants do not dispute that general proposition; however, the issue in *In re Aircrash in Bali* was the admissibility of an investigative report issued by the Federal Aviation Administration (the "FAA") following a major airplane crash. *Aircrash*, 871 F.2d at 816. Household's policy changes differ both in degree and in kind from the FAA's report. Unlike a compulsory response to an outside agency's investigation, the changes in the products Household offered to its customers and the ways in which those products were sold were internally created and implemented. Furthermore, Household's policy changes were undertaken with the express purpose of offering its customers the best possible loan products and selling them in the clearest way. Policy changes such as eliminating the sale of single premium credit insurance are the financial ser-

vices industry's equivalent of changes made to improve safety by the airline industry and thus are fully protected by Rule 407. *See id.*

Even setting aside these differences, Plaintiffs' argument ultimately fails because Plaintiffs simply ignore that Household made these policy changes beginning in 2001 and entered into the Multi-State Settlement in 2002 on a completely voluntary basis, thereby rendering actions taken pursuant to that Settlement also voluntary. As described in Defendants' Opening Brief, the voluntary AG Settlement contained certain consensual provisions. Opening Br. at 60-61. The policy changes that Plaintiffs describe in their Opposition Brief (at 39) as having been "required" by a "binding consent judgment entered into with state regulatory agencies and the state attorneys general" were, in actuality, aspects of post-Class Period agreements implementing the voluntary AG Settlement. Plaintiffs' support for their argument, that "the underlying social policy of Rule 407 is to encourage voluntary corrections" adds further support for the exclusion under Rule 407 of the changes made as a result of the voluntary AG Settlement. Opening Br. at 60. There can be no question that "a settlement is a compromise voluntarily agreed to by the parties. Each party generally accepts something less than that to which he believes he is entitled based on a decision that the compromise is more advantageous to him than the sum of the risks and the benefits involved in pursuing the claim." *Strozier* v. *General Motors Corp.*, 635 F.2d 424, 425 (5th Cir. 1981). Household was not bound by law to accept any of the terms contained in the AG Settlement and did so solely of its own accord. Plaintiffs simply cannot refute this, so instead they ignore it. Thus they offer no compelling reason why Household's voluntary measures do not fit squarely within the ambit of subsequent remedial measures protected by Rule 407. *See American Hospital Association* v. *Schweiker*, 721 F.2d 170, 182–83 (7th Cir. 1983) (describing a contract as "a voluntary agreement" whose conditions "are the result of a negotiated agreement between parties.")

2. Plaintiffs Have Not Offered a Legitimate Use for These Documents That Does Not Violate the Protections Offered by Rule 408

Plaintiffs attempt to distinguish the Court of Appeal's well-reasoned holding in *Higginbotham* v. *Baxter International Inc*., 495 F.3d 753 (7th Cir. 2007), and, in the process, elevate form over substance by trying to obscure the relevance of the rulings in that case. In *Higginbotham*, the underlying analysis is crystal clear: "[d]rawing any inference from [subsequent efforts to beef up financial controls and upgrading systems] would be incompatible with Fed. R. Evid. 407." *Higginbotham*, 495 F.3d at 760. Such evidence cannot be used to demonstrate scienter. *Id.* Plaintiffs assert that Household's settlement-related policy changes demonstrate that Defendants were on notice of problems relating to sales practices and that "predatory lending" allegations against the Defendants "spanned coast-to-coast."[18] (Pl. Br. at 42–44). Setting aside the fact that Plaintiffs' argument fails to account for the prohibition on the use of subsequent remedial measures (such as policy changes) under Rule 407, Plaintiffs' use of broad, unsubstantiated generalizations regarding Rule 408 is unavailing. Although Plaintiffs devote nearly four pages of their opposition to this subject, they fail to state coherently even one purpose for which they would use these documents that does not violate the protections afforded by Rule 408 by using the documents as supposed evidence that Defendants were liable for the allegations underlying the state settlements. Plaintiffs argue repeatedly that the settlements are "inextricably" tied to their claim of securities fraud, yet they cannot explain the link without falling back on the assumption that the settlements demonstrate Defendants' liability. Indeed, settlement-related policy changes and refunds are properly excluded under Rule 408 precisely *because* they are "inextricably" tied to the settlements at issue. Therefore, the settlement-related policy changes and

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[18] Plaintiffs argument ignores that mere notice of allegations of wrongdoing is not enough to support an inference of scienter as described in Section G, *infra*.

refunds are inadmissible for the same reasons as are the settlement themselves, as described in Section D, *supra*.

Furthermore, these policy changes and customer refunds do not constitute evidence that Defendants were on notice that Household was engaged in predatory lending practices *unless* Plaintiffs' leap of reasoning is accepted — and *unless* it is assumed that the allegations that led to the settlements that occasioned the policy changes were true. Without assuming the truth of the underlying allegations, Plaintiffs have no basis to assert that the policy-change documents constitute "notice" of predatory lending. Moreover, intent, or scienter, is measured at the time the disclosure is made, not after the fact. *Pommer* v. *Medtest Corp.*, 961 F.2d 620, 625 (7th Cir. 1992) ("The truth (or falsity) of defendants' statements, and their materiality, must be assessed at the time the statements are made, and not in the light of hindsight."). Simply put, the settlements can only constitute notice of publicly disclosed statements. Unless used as *ex post* evidence that the allegations underlying the settlements were true, they cannot be used without violating Rule 408.

3. Plaintiffs Have Not Demonstrated that the Probative Value of Information about Refunds and/or Policy Changes Outweighs the Risk of Undue Prejudice

In response to Defendants' Rule 403 argument, Plaintiffs offer little more than a bare conclusory statement that evidence that Household refunded money to customers or changed lending policies in response to certain settlements will not unduly prejudice the jury against the Defendants. As described in Defendants Opening Brief (at 58–59, 63–64), the only plausible use of information related to these settlements, which were publicly disclosed when entered into, would be an *ex post* attempt to prove that the modified practices were somehow improper. The risk that, if admitted into evidence, this information would cause the jury to make a decision based on emotion is too great given the virtually non-existent probative value of the evidence.

Despite their best attempts, Plaintiffs' reliance on *Sunstar* v. *Albert-Culver Company*, No. 01 C. 736, 2005 U.S. Dist. Lexis 23098 (N.D. Ill. Sept. 19, 2005) (Guzman, J.) does not provide a viable solution to this problem. *See* Pl. Br. at 45. The Court's ruling that a limiting instruction was adequate protection in the distinct factual scenario in *Sunstar* in no way indicates that a similar instruction in this case would neutralize the risk that information about refunds or post settlement policy changes could influence the jury to make a decision on an improper basis. The settlement at issue in *Sunstar* was thought to have probative value because it related to a dispute over possible trademark infringement that had arisen out of the same transaction as the litigation, *Sunstar*, 2005 U.S. Dist. Lexis 23098 at *14, whereas the settlements at question here were between parties distinct from those involved in this litigation and related to alleged consumer fraud, a subject matter much more likely to incite the jury to make an emotional decision than the similarities or dissimilarities of corporate marks.

Moreover, Plaintiffs simply ignore the part of the *Sunstar* ruling that is most relevant to the case at hand: the exclusion of the royalty calculation as the basis for determining a reasonable royalty. In *Sunstar*, this Court refused to allow the royalty calculation to be used in determining a reasonable royalty because it had been agreed to under threat of litigation. *Id.* at *18-23. In other words, the Court recognized that the threat of litigation so distorted the agreed-to royalty that it did not accurately reflect a reasonable royalty calculation. *Id*. at *23. It is the decision to preclude the use of the royalty calculation that is the proper analog for the instant situation because there, as here, the result of a settlement was deemed inadmissible.

As discussed above, Plaintiffs have demonstrated no legitimate reasons why their use of post-settlement policy changes and refunds would not violate Fed. R. Evid. 407, 408 or 403. Accordingly, Plaintiffs should be precluded from offering this information into evidence.

G. INDIVIDUAL CUSTOMER COMPLAINTS

1. All Individual Customer Complaints Are Inadmissible Hearsay

Plaintiffs do not dispute that individual customer complaints are inadmissible hearsay if offered for the truth of the matters asserted, but they contend that those *same* hearsay complaints automatically become admissible evidence if they are wrapped in the public records exception to the hearsay rule. Fed. R. Evid. 803(8). Customer complaints should be excluded by the hearsay bar, whether they stand alone or are bundled together in a regulatory examination report. Plaintiffs, who have the burden as the proponent of such evidence, have not demonstrated that the public records exception applies to any of the individual customer complaints at issue on this motion.

Plaintiffs advance an overbroad argument that any individual customer complaints contained in state and federal examination documents are admissible as an exception to hearsay under Rule 803(8),[19] implicitly conceding that all other customer complaints are inadmissible hearsay. However, the public records hearsay exception does not open the door for individual customer complaints merely described in, or appended to, state or federal examinations or to complaints that state regulatory agencies received from third parties and then forwarded to Household. The public records and reports exception relates to matters observed by an agency pursuant to a duty imposed by law or to factual findings resulting from an investigation made pursuant to authority granted in law, but a statement is not automatically exempted from the hearsay rule merely because it was made to a government officer or investigator. *See Stolarczyk* v. *Senator International Freight Forwarding, LLC*, 376 F. Supp. 2d 834, 839 (N.D. Ill 2005) (Filip, J.).

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[19] Defendants have moved separately for the exclusion of Plaintiffs' skewed, misleading selection of state and federal reports of examination. See Part B, *supra*, and Part II.B in Defendants' Opening Brief.

Rule 803(8)(B) permits the introduction of a public record only if it is made from matters within the personal knowledge of a public official or someone with a duty to report the matter to the public official. *See Wetherill* v. *University of Chicago,* 518 F. Supp. 1387, 1390 (N.D.Ill 1981) (Shadur, J.) (government report inadmissible because it was based on evidence from non-official sources). If a government document contains statements by third parties recorded in the state's investigation, each level of hearsay within hearsay requires its own exception. *Means* v. *Cullen*, 297 F. Supp. 2d 1148, 1151 (W.D.Wisc. 2003) (although document resulted from investigation under Rule 803(8), "statements made by third parties recorded in the report are hearsay within hearsay and are inadmissible unless they qualify for their own exception or exclusion to the hearsay rule") (internal citation omitted).

Furthermore, interim agency reports or preliminary memoranda do not fall within the Rule 803(8)(A) or (C) exceptions. *See Smith* v. *Isuzu Motors, Ltd.,* 137 F.3d 859, 862 (5th Cir. 1998). Memoranda that reflect preliminary findings of an agency or agency staff do not reflect "factual findings" of an agency under Rule 803(8)(C). *Smith,* 137 F.3d at 862; *see also U.S.* v. *Peitz*, No. 01 CR 852, 2002 WL 31101681, at *5 (N.D. Ill. Sept. 20, 2002) (Hart, J.) (noting staff recommendations to a commission or agency are not admissible under Rule 803(8)(C), "unless adopted by the commission or agency"). A statement that is not the result of an evaluative process also is not a "factual finding" under 803(8)(C). *See U.S.* v. *Vang*, No. 97-2953, 139 F. 3d 902 (Table), 1998 WL 78991, at *3 (7th Cir. Feb. 19 1998).

Even if a report or investigation is admissible under Rule 803(8), it must be excluded if "the sources of information or other circumstances indicate lack of trustworthiness." Fed. R. Evid. 803(8)(C). Subjective statements and opinions reported by third parties are the kinds of statements excluded as lacking sufficient trustworthiness. *See Chambliss v. Illinois Dept. of Corrections,* No. 05-cv-4175-JPG, 2007 WL 518774, at *3–4 (S.D. Ill. Feb. 15, 2007).

The documents at issue on this motion are filled with third-party statements and summaries of complaints made by others. *See* Defendants' Opening Br., App. A, Tab G-34 (Let-

ter from State of Maryland containing ACORN forwarded complaints); Defendants' Opening Br., App. A, Tab G-42 (Complaint from individual sent to state). Plaintiffs have not met their burden to identify an exception to the hearsay bar that covers the third party statements made in the individual customer complaints attached to Defendants' Opening Brief. Therefore, these documents are inadmissible hearsay and should be excluded.

In addition, Plaintiffs have conceded that the majority of documents put at issue under Defendants' Motion *in Limine* do not fall within any exception to the hearsay rule. The individual customer complaint documents identified by Defendants extend well beyond the realm of state and federal exams, the only category addressed in Plaintiffs' opposition, and include personal emails and letters from customers, internal Household emails discussing customer complaints and in-house compilations of customer complaints. *See e.g.,* Defendants' Opening Br., App. A, Tabs G-49, G-51, G-63. The Rule 803(8) public records exception does not even remotely apply to these categories of documents. Plaintiffs have identified no other hearsay exception, thus conceding that these documents contain inadmissible hearsay and are not admissible for the truth of the matters asserted.

2. Customer Complaints Have Minimal Relevance, If Any, to the Element of Scienter

Plaintiffs argue that "all individual customer complaints and references to customer complaints" are admissible for the nonhearsay purpose of notice. (Pl. Br. at 48). They argue that Defendants' notice or knowledge of individual customer complaints is "circumstantial evidence that defendants acted with scienter." *Id*. Plaintiffs' argument that individual customer complaints can demonstrate scienter, even circumstantially, is unconvincing.

In a securities fraud case, mere notice of allegations of wrongdoing is not sufficient to support an inference of scienter. *See Pugh* v. *Tribune Co*., 521 F.3d 686, 695 (7th Cir. 2008). It is self-evident that notice of complaints having been made does not equal notice that all complaints were true. Plaintiffs' argument that individual customer complaints will support an

inference of scienter depends entirely on the assumption that all of the complaints were true — *e.g.,* that Defendants' denials of "predatory lending" practices were false when made because the complaints gave "notice" that "predatory lending" was actually occurring. The truth of the content of individual customer complaints is critical to Plaintiffs' analysis.

Plaintiffs admit that what Defendants had notice of was "that customers *were complaining of predatory lending practices* in Household's branches across the United States." (Pl. Br. at 46) (emphasis added). But each individual complaint when made was only an allegation and not itself evidence of "predatory lending." Plaintiffs' illogical leap from notice to scienter cannot be bridged without bringing in these complaints as evidence of predatory lending. Except for their half-hearted argument about the public records exception, Plaintiffs have conceded that individual customer complaints are inadmissible hearsay without an exception. *See supra* Part G.1. Their transparent effort to offer this inadmissible hearsay evidence for the truth of the matter asserted should not be permitted. Therefore, all the individual customer complaint documents should be excluded.

3. Plaintiffs Cannot Bring in Inadmissible Hearsay Evidence Through Their Purported Expert

Federal Rule of Evidence 703 does not provide a backdoor for Plaintiffs' purported expert to bring in inadmissible hearsay evidence of individual customer complaints where the probative value of the evidence is substantially outweighed by the prejudicial effect.

Rule 703 reads in full:

> "The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence in order for the opinion to be admitted. *Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion or inference unless the court determines that their probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect*." Fed. R. Evid. 703 (emphasis added).

Plaintiffs argue that their proposed expert, Catherine Ghiglieri, is entitled to rely on customer complaints that formed the basis of her opinion when she testifies to her opinion at trial. (Pl. Br. at 50).[20] As the Court of Appeals has held, "the judge must make sure that the expert isn't being used as a vehicle for circumventing the rules of evidence." *James Wilson Associates* v. *Metropolitan Life Ins. Co.*, 965 F.2d 160, 173 (7th Cir. 1992) (Posner, J.). Ghiglieri's use of individual customer complaints, purportedly to show that Household was a predatory lender because a subset of customers alleged that Household used predatory practices, is a transparent attempt to introduce hearsay not within any exception. *See James Wilson Associates*, 965 F.2d at 173 ("If for example the expert witness (call him A) bases his opinion in part on a fact (call it X) that the party's lawyer told him, the lawyer cannot in closing argument tell the jury, 'See, we proved X through our expert witness, A.'"). Just because an expert wishes to testify about inadmissible hearsay is not sufficient under Rule 703.

Before a court can allow otherwise inadmissible facts and data into evidence through expert testimony, the court must determine that "their probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect." Fed. R. Evid. 703. The burden of proof is reversed from that on Rule 403, and it is *Plaintiffs* who must demonstrate that the probative value of the individual customer complaints substantially outweighs the prejudicial effect of these uninvestigated and unsubstantiated allegations. Plaintiffs cannot carry that burden. The individual customer complaints, as Defendants have argued, have little or no probative value to be weighed against an extraordinarily high risk of unfair prejudice, and Plaintiffs have not shown otherwise. Plaintiffs should not be permitted to introduce inadmissible individual customer complaints by way of the testimony of their proffered expert.

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[20] Plaintiffs' ill-disguised efforts to use their purported "expert" as a vehicle for the introduction of inadmissible, unreliable evidence are discussed in Defendants' Memorandum of Law in Support of Household Defendants' *Daubert* Motion to Exclude the "Expert" Testimony of Catherine A. Ghiglieri, dated January 30, 2009, Docket No. 1365 at Tab A.

4. Individual Customer Complaints Should Be Excluded Pursuant to Fed. R. Evid. 403 Because Their Probative Value Is Substantially Outweighed by the Risks of Waste of Time and Unfair Prejudice

As Defendants demonstrated in their opening memorandum, because individual customer complaints have little, if any, probative value and because the risk of the jury misinterpreting inchoate allegations as truth is extraordinarily high, the risk of unfair prejudice substantially outweighs the probative value of the individual customer complaints. For this reason alone, the evidence should be excluded under Rule 403. Plaintiffs' argument that customer complaint evidence is probative of scienter has been refuted. *See supra* Part G.2. Plaintiffs' citation to *Sheesley* is misplaced. In that products liability action, notice of a product defect was highly probative because a core issue in the case was defective design. *See Sheesley* v. *Cessna Aircraft Co.*, No. CIV. 02-4185-KES, 2006 U.S. Dist. LEXIS 77919, at *36 (D.S.D. Oct. 24, 2006). In a securities fraud case, however, mere notice of allegations of wrongdoing is not sufficient to support an inference of scienter. *See Pugh* v. *Tribune Co.*, 521 F.3d 686, 695 (7th Cir. 2008). It is axiomatic that notice of filed complaints does not equal notice of actual widespread wrongdoing.

Permitting the introduction of individual customer complaints also poses a significant risk of wasting the Court's valuable time and resources. The case law cited by Plaintiffs recognizes that courts have mitigated against that threat by prohibiting the introduction of specific details of individual complaints. In *Olson* v. *Ford Motor Company*, 410 F. Supp. 2d 855, 865 (D.N.D. 2006), although the court allowed the introduction of evidence of complaints generally for notice, the court found under Rule 403 that "the introduction into 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 [the defendant]." *Id.*

The introduction and rebuttal of individual customer complaints, despite being a tiny fraction of the over three million loans that Defendants managed over the Class Period,

would still consume an inordinate amount of time at trial. Plaintiffs could easily compile a summary of complaints for use at trial. Fed. R. Evid. 1006. This was the solution devised by the court in a case cited by Plaintiffs, *FTC* v. *Pioneer Enterprises, Inc.,* No. CV-S-92-615-LDG, 1992 WL 372350, *2-3 (D. Nev. Nov. 12, 1992). The court excluded individual consumer complaints because reviewing such detailed complaints would "place an undue burden on the court, be a waste of the court's time and resources, and delay the trial process" and instead permitted the introduction of summaries of complaints. *Id.* Therefore, should the Court allow Plaintiffs to present evidence of customer complaints to the jury, it should be in the form of a summary exhibit that would prevent unfair prejudice to the Defendants and respect the need for judicial economy.

H. ELAINE MARKELL OPINION

Plaintiffs' Brief provides no adequate justification for permitting Plaintiffs to introduce or elicit, or make any reference to opinion testimony by non-party Elaine Markell. Because Markell's responsibilities were narrowly circumscribed during her brief period of employment at subsidiary HMS, and because she has no first-hand knowledge about the parent company's practices, her proffered opinion testimony is unreliable and will not be helpful to the jury.

1. Plaintiffs Have Conceded That Markell May Not Provide Expert Opinion Testimony

Plaintiffs apparently have conceded that Markell lacks the requisite "specialized knowledge, skill, experience, or education" to provide expert opinion testimony on any matter at issue in this case. Defendants demonstrated in their opening brief that Markell is not qualified to testify as an expert. (Def. Br. at 73–75). Plaintiffs elected not to oppose that demonstration. Moreover, even though Plaintiffs disclosed Markell on February 27, 2008 as a witness who may be called to provide testimony based on specialized knowledge, (Owen Decl. Ex. 8 at 1), they subsequently chose not to designate Markell as a non-retained expert witness on Plaintiffs' Wit-

ness List (*see* [Proposed] Final Pretrial Order, Ex. E-1) or on Plaintiffs' Statement of Qualifications of Expert Witnesses to Be Read to the Jury (*see* [Proposed] Final Pretrial Order, Ex. F-1).

Nonetheless, in Plaintiffs' Brief they attempt to pump up Markell's narrow role on HMS's collection staff during the limited period of her employment at that Household subsidiary. Based solely on testimony that identifies her lengthy string of previous employers before she was hired by HMS, Plaintiffs describe Markell as "a highly skilled individual with over 25 years of experience in the mortgage lending business." Pl. Br. at 54. Plaintiffs assert, however, that they "do not intend for Markell's testimony to 'fall on the expert side of the line,'" only that "Markell's 25 plus years of experience in the mortgage and default servicing industry provides additional foundation for her opinion testimony." Pl. Br. at 58. Passing Markell's lack of qualifications to testify competently about Household's corporate policies, whether Markell's proposed testimony falls within the scope of Rule 702 is not to be determined by what Plaintiffs "intend."[21]

As stated in the advisory committee notes on the 2000 amendments to Rule 701, the distinction is between testimony based on "special knowledge" and testimony that "results from a process of reasoning familiar in everyday life." Fed. R. Evid. 701, 2000 advisory committee note (1992)). Plaintiffs acknowledge that Markell's opinions that she found HMS's delinquency reports "unreliable" are "[b]ased on her prior experience with balancing delinquency numbers" at *other* employers and, in particular, her past experience with the specialized computer system that was used at HMS. Pl. Br. at 58-59 and 59n. Because this would amount to testimony based on "special knowledge" under Rule 702 and Plaintiffs failed to designate Markell

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[21] "Rule 701 has been amended to eliminate the risk that the reliability requirements set forth in Rule 702 will be evaded through the simple expedient of proffering an expert in lay witness clothing." Fed. R. Evid. 701, 2000 advisory committee note.

as a special knowledge witness under *Sunstar* by the deadline for doing so, Markell's opinion testimony must be excluded.

2. Markell's Proposed Testimony Is Inadmissible as Lay Opinion Testimony Under Fed. R. Evid. 701

Plaintiffs cannot meet their burden of establishing an adequate foundation for the admission of Markell's supposedly lay opinion testimony because it is not based on her firsthand knowledge or observation, as required under Rule 701. Plaintiffs try to create the appearance that Markell is competent to testify by reciting that Markell's opinions are based on her exposure to "significant events, documents and conversations within HMS and Household," (Pl. Br. at 56), but they founder when they try to describe "Markell's personal observation of [ ] events." The very first item in their supposed list of personal observations is not an "observation" at all, but rather the very unsupported opinion they are trying to introduce. *See* Pl. Br. at 57. While personal knowledge under Rule 701 may include inferences, "the inferences and opinions must be grounded in observation or other first-hand personal experience. They must not be flights of fancy, speculation, hunches, intuitions, or rumors about matters remote from that experience." *Visser* v. *Packer Engineering Assocs.*, 924 F.2d 655, 659 (7th Cir. 1991) (holding that affidavits supporting an age discrimination allegation engaged in "amateur psychoanalysis" and therefore exceeded the competence of lay witness testimony).

Plaintiffs do not dispute that Markell's opinions are based not on personal knowledge or observation, but on "comments" she claims were made to her by others. *See, e.g.*, Markell Tr. 44:14–17. However, they erroneously contend that the "comments" Markell describes in generalities, and without specific attribution to any particular speaker, should somehow qualify as party admissions and that they will then satisfy the personal knowledge requirement under Rule 701. Plaintiffs name several employees with whom Markell spoke, (Pl. Br. at

62), but Markell's deposition transcript does not attribute specific statements to any particular speakers,[22] which rules out the possibility of qualifying the general hearsay she purports to summarize as a party admission. Plaintiffs try to suggest that Markell had some basis to form opinions about practices of Household by citing testimony in which Markell described a single conversation with an employee in Household's Treasury Department, Phil Kupowicz. Pls. Br. at 61–62, citing Markell Tr. 91:1–12. As the testimony does not attribute even one statement to Kupowicz, however, it is clear that Plaintiffs cannot demonstrate that any party admission was made by Kupowicz.

Plaintiffs' strained attempt to argue, first, that Markell's testimony that delinquency numbers "did affect our stock price" was an opinion, (Pl. Br. at 62), and, second, that it supported by a statement made by Individual Defendant Dave Schoenholz, is simply a disconnect. As the transcript makes clear, Markell testified that the "gist" of the conversation in the one meeting she attended with Schoenholz was "that he wanted the restructures to be minimized to some degree as – as goals had been presented to the various divisions, but that it had to be done gradually so there wouldn't be any large spikes in the delinquency ratios." Kavaler Decl. Ex. 1, Markell Tr. at 81:8–12. Plaintiffs' counsel then asked Markell to explain the testimony, and Markell answered, "We – we report our delinquency ratios to the public at quarter end, and it had -- it did affect our stock price." Id. at 91:18–20. The testimony cannot be fairly read as stating an opinion formed on the basis of Schoenholz's statement.

Even assuming that Plaintiffs could demonstrate that the "comments" Markell relied upon constitute party admissions, they have cited no support for the proposition that opin-

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[22] Markell testified, for example, that her opinion about why HMS restructured accounts was based on "comments" that were "made to [her] by Greg Gibson and Per Ekholdt and other management in the company." Kavaler Decl. Ex. 1, Markell Tr. at 44:14–17. Plaintiffs also strain to link Markell to Household by inaccurately stating that Gibson was "a member of senior management at Household," Pls. Br. at 61, when the testimony makes clear that he was not. *See* Kavaler, Decl. Ex. 1, Markell Tr. at 23:17 – 25:13.

ions formed at second hand on the basis of other people's statements, and not on personal knowledge or observation, are admissible just because those other statements fall outside of the prohibition on hearsay. The "party admission" exception applies to statements, *see* Fed. R. Evid. 801(d)(2), not to opinions or inferences allegedly based on these statements. Plaintiffs' reliance on *Moore* v. *Kuka Welding Systems*, 171 F.3d 1073 (6th Cir. 1999), Pls. Br. at 61, is misplaced (even if the case were binding on this Court), because the case discusses only party admissions, says nothing about Rule 701 or opinion testimony, and does not stand for the proposition that opinions formulated on the basis of party admissions should be admitted.

Based solely on her limited experience, Plaintiffs propose to introduce Markell's opinion testimony imputing the manipulation of delinquency rates to Household. (Kavaler Decl. Ex. 1, Markell Tr. at 43:24-44:2, 44:4) Not only does Markell lack any foundation rationally based in her own perceptions for testifying about the purpose of other employees' actions or their intent, this opinion also requires the inference that the alleged practice of manipulating delinquency rates took place within business units other than HMS. Markell has offered no testimony as to any first-hand knowledge about the account management practices of any other business units or as to the financial reporting procedures even of HMS, much less of Household's corporate finance department. On the contrary, Markell has admitted that nobody ever told her anything about Household's public filings during the period of her employment at HMS. (Kavaler Decl. Ex. 1, Markell Tr. at 186:15-18)

Markell also purportedly concluded that all of Household's business units — beyond HMS, where she worked — manipulated delinquency rates, and did so for the purpose of misrepresenting Household's finances to the public securities markets. As the Court of Appeals stated in *United States* v. *Giovannetti*, a level of inference far removed from facts within a witness's personal knowledge does not satisfy the requirements of Rule 701 and is thus inadmissible. 919 F.2d 1223, 1226 (7th Cir. 1990) ("(a)ll knowledge is inferential, and the combined ef-

fect of Rules 602 and 701 is to recognize this epistemological verity but at the same time to prevent the piling of inference upon inference to the point where testimony ceases to be reliable").

3. Markell's Opinion Testimony Would Not be Helpful to the Jury

Plaintiffs claim that Markell's testimony "will be very useful to the jury in sorting through the facts to be proven at trial," (Pl. Br. at 63), and that she has "the unique ability to opine about the propriety of certain practices," (*id*. at 62). Both assertions ignore the well-established rule that to be helpful, opinion testimony must indicate the facts that caused the witness to arrive at the conclusion. *See United States* v. *Guzzino*, 810 F.2d 687, 699 (7th Cir. 1987). "Lay opinion testimony is admissible only to help the jury or the court to understand the facts about which the witness is testifying." *U. S.* v. *Conn*, 297 F.3d 548, 554 (7th Cir. 2002). If Markell could provide any admissible factual testimony, Plaintiffs have not demonstrated that she would be in any better position than the jury to form conclusions from those facts. *See Nichols* v. *Johnson*, No. 00 C 7785, 2002 U.S. Dist. LEXIS 7745, at *14 (N.D. Ill. Apr. 30, 2002) (Schenkier, J.) (police officer's testimony inadmissible because "(t)o allow someone offered as a lay witness to express an opinion based on the same evidence that the jury has before it would not assist the jury").

Markell's knowledge concerning relevant matters is limited due to her brief employment at HMS, the narrow scope of her responsibilities and the absence of relevant prior experience, as demonstrated by her lack of knowledge regarding basic Household financial information. Here, even more than in *Nichols*, the jury will be able to draw rational inferences based on the facts presented by Markell (if any) and other witnesses. Markell's purported opinion regarding Household's alleged manipulation of delinquency rates will not be helpful to the jury and accordingly is inadmissible.

I. THE UNAUTHORIZED VIDEO CREATED BY DENNIS HUEMAN

Defendants request an Order precluding Plaintiffs from offering into evidence at trial the quickly aborted "training" video (the "Hueman video") that was privately and independently created by former Household employee Dennis Hueman. Plaintiffs oppose that request, arguing that the Hueman video is admissible because it falls within the party admissions exemption to the hearsay rule and because it shows Defendants had notice of the widespread use of sales techniques described therein. (*See* Pl. Br. at 66–67, 68–69). In either event, Plaintiffs argue, the prejudicial effect of introducing the Hueman video does not substantially outweigh the video's probative value. (*Id.* at 69–70.) For the reasons stated below, Plaintiffs' arguments lack merit.

1. The Development and Creation of Training Materials or Techniques Was Not Within the Scope of Hueman's Employment

The Hueman video is hearsay that does not fall within the exemption for party admissions. *See* Fed. R. Evid. 801(d)(2)(D). While Plaintiffs and Defendants agree that the relevant inquiry for hearsay purposes is whether "the subject matter of the admission match[es] the subject matter of the employee's job description," *Aliotta* v. *National Railroad Passenger Corp.*, 315 F.3d 756, 762 (7th Cir. 2003), Plaintiffs fail to recognize that "not everything that relates to one's job falls within the scope of one's agency or employment." *Williams* v. *Pharmacia, Inc.*, 137 F.3d 944, 950 (7th Cir. 1998). As acknowledged in Defendants' opening brief, as a DSM, Hueman did have some responsibilities related to training, but that does not mean that the development and creation of training techniques or materials came within the scope of his employment. As RGM Robert O'Han (Hueman's superior) testified at his deposition:

> And the manager's [BSM's] responsibility was to go through that training with certain stop points to check in the AE and make sure they are retaining the information. And the district managers [DSMs] are required when they are in there [branch offices] to make sure everybody is up to date on their training if they are in some kind of training.

Kavaler Decl. Ex. 5, O'Han Tr. at 49:3–8. Hueman himself confirmed this limited involvement with training account executives ("AEs"):

> Q: Now, if you were going to do some training within this day, would it be in the morning or after you heard the AEs and their presentations?
>
> . . . .
>
> [Hueman]: Typically, if there was to be training done, you know, most of my response throughout the day was listening, not so much training. But it would be either with the [AEs]. You know, if I was sitting right next to them, there could have been some forms of coaching at that point or there may have been, you know, you could have huddled the AEs up together and just do some general training at that point if there was something that I wanted to train on that at that point because of what I heard or didn't hear.
>
> . . . .
>
> Q: As DGM did you have any responsibility for organizing training within your division?
>
> [Hueman]: Yes.
>
> Q: Okay. And what was that responsibility?
>
> [Hueman]: Just to make sure that training was being done. Typically, the district managers would organize it and my part in that would be to see what they're doing on the needs of their associates, no matter what the training would be, if it was policy or compliance or sales or whatever.

Kavaler Decl. Ex. 7, Hueman Tr. at 24:2–25:16. That the scope of Hueman's employment did *not* include the development and creation of training materials is made clear by the deposition testimony of Tom Detelich cited by Plaintiffs themselves: it was not the fact that he created a "bad" training video that earned Hueman a reprimand, but rather the *fact that he created a training video at all*. Kavaler Decl. Ex. 9, Detelich Tr. at 127:21–22, 128:4–16, 129:3–8. (*See* Pl. Br. at 65–66 (acknowledging same)).

Plaintiffs' argument that the scope of Hueman's employment is somehow defined by reference to his own résumé, which indicated that he had been a "key player in company sales training and product development," is laughable. (*See* Pl. Br. at 67). Hueman could have put on his post-Household résumé that he was the King of France, but that would not make it true. Instead, the Court should look to the facts and circumstances of the case, which remain that

(1) Hueman was not authorized to develop or create training techniques or materials, (2) he created his "training" video without suggestion or authorization from anyone at Household, (3) his video was immediately recalled precisely because Hueman had overstepped the bounds of his authority, and (4) he was subsequently reprimanded by Detelich for having violated company policy. There can be no serious argument that Hueman "was authorized by his employer regarding the matter about which he allegedly spoke." *Stagman* v. *Ryan*, 176 F.3d 986, 996 (7th Cir. 1999).

2. Even if the Hueman Video Were Admissible to Show Notice, Which It Is Not, It Should Be Excluded Under Rule 403 in Favor of Deposition Testimony Describing the Video's Creation

Plaintiffs argue that even if the Hueman video is inadmissible hearsay, it should nevertheless by admitted to show Defendants' notice of widespread use of the impermissible sales training techniques described therein by Hueman. (*See* Pl. Br. at 68–69). As Defendants argued in their moving brief, the Hueman video is not competent evidence to show management's notice of widespread use of impermissible sales training techniques because a single unauthorized and immediately recalled video is not representative of the practices used across the company.

Nevertheless, even if the Hueman video were competent evidence to show management's notice, it is hardly probative of that fact. Not only is a single unauthorized and immediately recalled video from one region of the country not illustrative of the company's widespread sales techniques, Plaintiffs do not, because they cannot, point to any evidence in the extensive record of this case that any individual Defendant ever saw the Hueman videotape. Furthermore, as described fully in Defendants' opening brief, whatever scant probative value the video might possess is overwhelmed by the inevitable prejudicial effect that Hueman's inflammatory narrative will have on the jury. *See United States* v. *Pulido*, 69 F.3d 192, 201 (7th Cir. 1995). This calculus is strengthened by the fact that clearly less prejudicial means of proof exist, in the form of deposition testimony from Mesrs. Hueman, Detelich, O'Han, Hennigan and Gil-

mer. In addition, at least two of these witnesses are expected to testify live at trial so, if they choose to do so, Plaintiffs can elicit live further testimony about the videotape. *See* 1 Stephen A. Saltzburg, Michael M. Martin & Daniel J. Capra, *Federal Rules of Evidence Manual* § 403.02[5] (9th ed. 2006) ("A Court should be willing to exclude evidence when there are less prejudicial alternative means to prove the fact in issue"). Plaintiffs advance the perplexing argument that "the Hueman videotape has substantial probative value as to the lack of actions taken by defendants in response to the 'discovery' of the videotape." (Pl. Br. at 70). To the contrary, on that point the videotape itself offers nothing, and *the deposition testimony documenting the defendants' swift reactions is the* ***only*** *probative evidence*.

Indeed, it is difficult to see what picture Plaintiffs seek to paint with "the language used by Hueman in his videotape . . . his demeanor and body language, including how he interacts with the putative customer," *id.,* if not precisely the unfair prejudice prohibited by Rule 403.

J. THE DEPOSITION OF CHARLES CROSS IS INADMISSIBLE PURSUANT TO RULE 403

Plaintiffs' Opposition advances no argument even remotely sufficient to justify wasting the Court's time and resources on the presentation of cumulative testimony from a witness whose videotaped deposition testimony in *this* action has already been designated by the Plaintiffs as expert opinion testimony. Charles Cross is a former Washington state regulator and the principal author in late 2001 and early 2002 of a Washington state regulatory report that remains the centerpiece of Plaintiffs' "predatory lending" theory even though it is based on a unilateral review of only nineteen customer complaints.

1. Plaintiffs May Not Now Seek to Introduce Undesignated Testimony from the Prior Cross Testimony

Cross was deposed in December 2002 and in February 2003 (the "Prior Cross Testimony") in a putative class action brought by a group of HFC customers in Washington state court. When he was deposed again in this action, on April 9, 2008, having been cross-noticed by

both Plaintiffs and Defendants, Cross was re-examined on much of the same subject matter and, indeed, answered many of the exact same questions.

- In preparation for trial, Plaintiffs included Cross on their witness list as an expert witness whom Plaintiffs will call "via video deposition testimony." [Proposed] Final Pretrial Order ("PTO"), Exhibit E-1 at 4, submitted January 30, 2009.[23] (The entry could not have referred to the Prior Cross Testimony, as it was not videotaped.)
- In their listing of deposition designations, Plaintiffs included designations, by page and line number, only from Cross's 2008 deposition. PTO, Exhibit G-1 at 7-24.
- The transcript of Cross's December 2002 deposition was included on Plaintiffs' Exhibit List, initially served on Defendants on October 31, 2008. On December 8, 2008, Defendants served objections to Plaintiffs' Exhibit List, including general and specific objections to the listing of this and other deposition transcripts without designating particular testimony by page and line numbers. Although more than two months have passed since Defendants served their objections, Plaintiffs have not designated any testimony from the Prior Cross Testimony.
- Plaintiffs did not include any designations from the Prior Cross Testimony in the [Proposed] Final Pretrial Order that was submitted to the Court on January 30, 2009. PTO, Exhibit D-1 at 17.

Even though the Prior Cross Testimony is cumulative of Cross's deposition testimony in this case, and even though Plaintiffs did not include the Prior Cross Testimony on their witness list, and even though to this day Plaintiffs have never designated any specific testimony from the Prior Cross Testimony, Plaintiffs nonetheless assert in their Opposition that they are "entitled to introduce Cross's prior deposition testimony, and intend to do so." (Pl. Br. at 71, n.36).[24] The Court should not countenance such gamesmanship. The Prior Cross Testimony should be excluded.

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[23] On their witness list, Plaintiffs also indicated that Cross would be offered as "a non-retained expert." PTO Ex. E-1 at 4.

[24] Plaintiffs' Brief refers to general subject matter in the Prior Cross Testimony, but even in opposing Defendants' motion *in limine*, Plaintiffs do not identify any specific testimony that they maintain should not be precluded.

2. Plaintiffs Have Not Demonstrated that Hearsay Statements in the Prior Cross Testimony Are Admissible

Throughout the Class Period, Cross served as a Washington state regulator, and his personal knowledge extends no further than that state's borders. Plaintiffs nonetheless hope to introduce double and triple hearsay statements contained in the Prior Cross Testimony (and the same statements repeated in the 2008 Cross testimony) as evidence of alleged "widespread predatory lending practices" by Household. Pl. Br. at 71. Plaintiffs contend that "Cross's expert status permits him to rely on hearsay." Pl. Br. at 72.

Passing that Plaintiffs have never designated the Prior Cross Testimony as expert opinion testimony (having never designated it at all), they should not be permitted to employ a belated and untimely "expert testimony" designation as a ploy to evade the restrictions on admissibility of unreliable hearsay evidence. In any event, the challenged testimony consists of Cross's report of statements allegedly made to him by other regulators, purportedly relaying information that had been reported to them by consumers. *See* Defendants' Opening Br. at 87–88, quoting Prior Cross Testimony at 69:19–24, 115:2–6. Even if the Prior Cross Testimony had been designated as expert testimony, the challenged passages contain multiple layers of hearsay. That such "evidence" is unreliable and unverifiable is self-evident, and it is not a proper source for 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 hearsay rule.").

3. The Probative Value of the Prior Cross Testimony Is Substantially Outweighed by the Danger of Unfair Prejudice, Confusion of the Issues, Undue Delay and Waste of Time

In their opening brief, Defendants demonstrated that the Prior Cross Testimony should be excluded pursuant to Federal Rule of Evidence 403, because its probative value is substantially outweighed by the danger of unfair prejudice, waste of time and confusion. Plaintiffs counter that the testimony is "highly probative of a central issue in this action — Household's predatory lending practices, and defendants' knowledge of these practices." Pl. Br. at 74. Plain-

tiffs' conclusory statement completely overlooks the fact that the Prior Cross Testimony is a needless presentation of cumulative evidence and an unnecessary waste of the jury's time because Plaintiffs have already designated testimony from Cross's deposition in this case. *See Merisant Co.* v. *McNeil Nutritionals, LLC*, 242 F.R.D. 303, 311-12 (E.D. Pa. 2007) (granting motions *in limine* excluding evidence of the pleadings in other unrelated litigations, noting that other evidence was available that made the same point).[25] The probative value of repetitive evidence is necessarily *de minimis*.

In addition, because the Prior Cross Testimony relates the "apparent" findings of a statistically insignificant, speculative and biased draft report of examination (which analyzed only 19 Washington state consumer loans out of the tens of thousands issued in the state during the Class Period), Cross's general recollection of a handful of uninvestigated and unverified customer complaints, as well as double or triple hearsay regarding complaints in other states, it has minimal probative value as evidence of Household's alleged "widespread predatory lending practices." Pl. Br. at 71. *See Galarneau* v. *Merrill Lynch, Pierce, Fenner & Smith Inc*., 504 F.3d 189, 205 (1st Cir. 2007) (holding that even evidence that may shed light on the disputed issues will be excluded where the "untoward effects of the proffered evidence [are found] to be so weighty.") (citation and internal quotation marks omitted).

On the other side of the Rule 403 balance, the Prior Cross Testimony poses a substantial risk of unfair prejudice. Despite the statistical insignificance of Cross's analysis (which Cross readily admits), the jury may be unduly swayed by the apparent authority of a former state government official or may be induced to decide the issues on the basis of emotion rather than facts and reason.

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[25] Even if Defendants' separate motion to exclude Cross's designated expert opinion testimony (*See Daubert* Motion to Exclude the "Expert" Testimony of Catherine A. Ghiglieri, Charles Cross and Harris L. Devor, Docket No. 1356) is granted, the Prior Cross Testimony should still be excluded on the other grounds stated herein and in Defendants' opening memorandum.

Plaintiffs' contention that the Prior Cross Testimony is "probative of scienter" (Pls. Br. at 73) ignores Cross's admitted bias in preparing his draft report and his speculation in extrapolating its insignificant findings to all of Household. Cross admitted this much in his deposition:

> Q. Is what you're saying that the purpose of this report is not to come to the fairest overall appraisal of all of Household's practices as to all of its borrowers in the State of Washington? . . .
>
> A. That's not the purpose of this report. . . (Owen Decl. Ex. 7, Cross *Luna* Tr. at 391:21–395:4).
>
> . . .
>
> "Q. Well, you expressed a lot of opinions about Household's intentions in your report. Were those speculation about Household?
>
> A. It's possible at times that it was speculation, yes." (*Id*. at 255:2–5).

Plaintiffs cannot possibly be permitted to try and prove scienter with testimony which is so admittedly flawed and devoid of objectivity.[26]

For the forgoing reasons, the Court should enter an Order precluding all references to the Prior Cross Testimony as set forth above.

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[26] Plaintiffs also allege that the Prior Cross Testimony is "directly probative of, among other things, defendants' May 31, 2002 false and misleading statement that the Company's predatory practices were localized to the Bellingham branch." (Pl. Br. at 73). Plaintiffs misquote the document. The article actually states that Household believed that the issue of customer "***confusion about the rate of their loans***" was "localized to the Bellingham branch. *See* PTO, Exhibit A to Exhibit A at 22. (*American Banker* article) (May 31, 2002) (emphasis added). Nothing in the Prior Cross Testimony suggests that this statement was false when made and, in fact, Cross's testimony indicates that the issue referenced in this article was much smaller than his report indicates. (*See* Kavaler Decl. Ex. 6 (Cross Luna Tr.), at 136:21-24)("Q. When you went to the Household office in August of 2001, was effective interest rate used in your application process or subsequent telephone calls? A. I never heard those words.")(*See also, id.* at 401:13-402:16)("Q. Let me drill down a little deeper then. Exactly how many complaints out of the 19 that are addressed in the report actually involved use of the phrases effective interest rates or equivalent interest rates?. . .A. Two to four. . . . ").

K. MEMORANDA AND TESTIMONY RELATING TO ANDREW KAHR ARE INADMISSIBLE PURSUANT TO FED. R. EVID. 403

Plaintiffs' response on this point perfectly demonstrates why evidence relating to outside consultant Andrew Kahr and the memoranda he authored should be excluded: The probative value of this evidence is nil, but it would permit Plaintiffs to mount an inflammatory, utterly irrelevant and prejudicial sideshow. For example, Plaintiffs open their argument by citing Kahr's purported employment history, asserting that he was "the mastermind of predatory lending practices at another sub-prime lender," Pl. Br. at 75, an allegation neither substantiated nor conceivably relevant in this case, and obviously calculated to evoke prejudice. Plaintiffs then list numerous snippets of memoranda addressed to Household officers and employees as supposed evidence that Kahr's "nefarious initiatives" were willingly embraced by Household. Pl. Br. at 75–76. But suggestions that Kahr offered *to* the Company have no bearing on what was implemented *by* the Company or what criteria the Company applied in evaluating any of these outside-the-box ideas.

Plaintiffs' partial quotations from deposition testimony about Kahr are equally misleading and prejudicial. They purport to quote Household CFO Dave Schoenholz as saying, "Aldinger would 'send a strong signal that he, Andrew [Kahr] was going to be working with the endorsement of the very senior levels of the corporation.'" Pl. Br. at 76 (brackets in Plaintiffs' original). What Schoenholz actually testified was: "He [Kahr] *wanted to in essence report to Bill*, and *have Bill* send a strong signal that he, Andrew [Kahr] was going to be working with the endorsement of the very senior levels of the corporation." Owen Decl. Ex. 7, Schoenholz Tr. at 44. Considerations of candor aside, this attempt to transform the meaning of Schoenholz's testimony from a statement that Kahr craved a sign of recognition from the CEO into a manufactured admission that Bill Aldinger sent such a signal is a perfect example of Plaintiffs' flawed syllogism, namely that evidence that Kahr *desired* something amounts to proof that Household *did* that thing.

The case law that Plaintiffs cite is equally unconvincing. For example, they rely on *United States* v. *Pulido*, 69 F.3d 192 (7th Cir. 1995), an appeal of a drug trafficking conviction in which the relevant standard of review was "a clear showing of abuse of discretion" (*id.* at 201), for the proposition that "most relevant evidence is, by its very nature, prejudicial." Pl. Br. at 77. However, Plaintiffs neglect to include the very next sentence in which the Court points out that evidence is *unfairly* prejudicial if it "will induce the jury to decide the case on an improper basis, commonly an emotional one, rather than on the evidence presented" (*id.* at 201), as is precisely the case here. Plaintiffs also cite *United States* v. *Anderson*, 533 F.3d 623 (8th Cir. 2008), another appeal of a criminal conviction with a standard of review totally different from the one at bar, for the proposition that Rule 403 "does not 'offer protection against evidence that is merely prejudicial in the sense of being detrimental to [defendants'] case.'" Pl. Br. at 77 (brackets in Plaintiffs' original). In that case, the defendant was a founder and officer of a company, accused of insider trading, and the evidence at issue was that company's policy regarding the sale of its stock by officers. *Anderson*, 533 F.3d at 627, 632. The evidence went directly to the issue of scienter and was in no way unfairly prejudicial or confusing. *Id.* at 632.

Finally, and somewhat puzzlingly, Plaintiffs cite *Empire Gas Corp.* v. *American Bakeries*, 646 F. Supp. 269 (N.D. Ill. 1986) (Leighton, J.), Pl. Br. at 77, in which the Court *excluded* evidence of minimal relevance under Rule 403 for precisely the reasons Defendants advance here, namely that "these proceedings will become enmeshed in one of the pitfalls Rule 403 is designed to prevent: confusion of the issues and misleading of the jury. . . . [W]hatever probative weight the proffered testimonial evidence may have is outweighed by the danger of unfair prejudice, confusion of the issues, or misleading of the jury." *Id.* at 276. In that case, the Court noted, "[E]ven though the proffered testimonial evidence may be technically relevant under the broad definition of [Rule 403], it may be excluded if it would be confusing, unduly prejudicial, or involve undue inquiry into collateral matters. In determining the admissibility of evidence, a court must balance its possible relevancy or probative value against traditional countervailing

factors, such as the danger of unfair prejudice, confusion of issues, misleading the jury, undue delay, waste of time, and needless presentation of cumulative evidence. And as the court of appeals for this circuit has held, balancing of the probative value and the unfair prejudice of evidence is within this court's discretion." *Id*. at 275 (internal citations omitted).

If Plaintiffs are permitted to introduce Kahr's irrelevant memoranda, or misleading quotes and innuendo-laden assertions about them, considerable time will be consumed presenting rebuttal witnesses and documentary evidence to establish that most of Kahr's ideas were rejected, and that any ideas that were implemented were thoroughly reviewed and revised to ensure adherence to compliance requirements. However, such a detour would be wasteful and unnecessary: Andrew Kahr is not on trial. That he was one of many sources of ideas considered by Household is completely irrelevant; Household's policies either were or were not consistent with its public disclosures, and the genesis of any given policy is simply not probative as to that or any other issue. This conclusion is not undermined by Plaintiffs' fondness for dredging up lurid anecdotes about Kahr's supposed track record at an unrelated company. Ironically, the same Plaintiffs who argue vigorously that the Lead Plaintiffs should not be tainted by evidence that this lawsuit was the idea of a now convicted felon at the very time he was admittedly defrauding courts in other class actions[27] are perfectly content to pursue a liability-by-association crusade against Household. Defendants have agreed that unless Plaintiffs open the door, they will not seek to explore the genesis of this lawsuit before the jury because, regardless of its parentage, the case is either valid or not. Plaintiffs should be instructed that turnabout is fair play. Their unwillingness to date to litigate this case on the merits is a sure sign that they lack proof that Defendants hatched a "massive illegal predatory lending scheme," but that militates against allow-

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[27] *See* Defs' Mem. in Partial Opp. to Pls' Misc. Mot. *In Limine*, Feb. 10, 2009, at 17-22 (arguing that William Lerach's 2007 felony conviction for conspiracy to obstruct justice and make false statements in numerous federal securities fraud lawsuits is only relevant to this action if Plaintiffs open the door.

ing them to fill the gap with irrelevant tales of an allegedly nefarious consultant This is precisely the kind of minimally probative, highly inflammatory evidence that Rule 403 precludes.

For the foregoing reasons, the Court should enter an Order precluding Plaintiffs from making any references to consultant Andrew Kahr and his memoranda and other documents as set forth above.

L. "PROJECT WHISKEY" DUE DILIGENCE AND RELATED DOCUMENTS SHOULD BE EXCLUDED PURSUANT TO FED. R. EVID. 403

Plaintiffs erroneously insist that the materials relating to a proposed merger by Household and Wells Fargo in 2002 (code-named "Project Whiskey") are not unfairly prejudicial, do not create a risk of confusion of issues, and will not lead to a series of mini-trials and a waste of time. It is clear that Plaintiffs intend to piggy-back off Wells Fargo's opinions (some of which are phrased in off-the-cuff, inflammatory terms, for the author's own reasons) to replace the jurors' own determinations of complex issues with the pre-formed and untestable opinions of one of Household's rival companies.

1. Plaintiffs' Inaccurate Assertion about Wells Fargo's "Offer" Will Require a Series on Mini-Trials on Collateral Issues

Plaintiffs open the Project Whiskey section of their Response with the uncited false statement that "Wells Fargo made an offer to buy Household" in May 2002. (Pl . Br. at 79.) Given the number of times Plaintiffs' counsel asked Wells Fargo's Rule 30(b)(6) deponent, Todd May, about the parties' deal only to be told each time that there was none, it is bewildering that Plaintiffs so completely misinterpreted May's straightforward answer. *See e.g.*, Kavaler Decl. Ex. 39, May Tr. at 54:4 ("First, there was no agreed-upon price . . ."). Throughout his deposition, May made clear that prior to due diligence there were "no detailed discussions on a merger agreement," that the discussions between the parties were "preliminary" (*See* Owen Decl. Ex 4, May Tr. at 65:7–10), and that all the terms and parameters coming into the diligence sessions in

May 2002 were "potential" and subject to alteration. *See* Owen Decl. Ex. 4, May Tr. at 54:4–9; 72:2–14; 75:8-20; 80:5–7.

Plaintiffs' mischaracterization of the Project Whiskey negotiations reaffirms and reinforces Defendants' concerns and the reasons for seeking to exclude Project Whiskey due diligence documents and the accompanying materials. The slippery use of the materials in Plaintiffs' Brief promises similar misuse of these materials at trial, which will require detours and mini-trials just to set the record straight on these collateral issues, precisely the result that Rule 403 is intended to prevent.[28] To rebut Plaintiffs' misuse of the Project Whiskey materials, Defendants would be obliged to introduce accurate interpretations of the Project Whiskey data and evidence of contemporaneous market conditions, ultimately devolving into a dispute over why or why Household and Wells Fargo should or should not have merged their operations in 2002 and distracting the jurors from the securities fraud issues they will be called upon to decide.[29] *See, e.g., U.S.* v. *Seymour,* 472 F.3d 969, 970-71 (7th Cir. 2007); *Wyninger v. New Venture Gear, Inc.,* 361 F.3d 965, 975 (7th Cir. 2004).

Further, Plaintiffs undoubtedly intend that introduction of the Project Whiskey materials will mislead jurors to adopt Wells Fargo's financial approximations, despite evidence that they are based on a unique and idiosyncratic valuation model designed to price "opportunistic" mergers with Wells Fargo's existing operations. *See* Owen Decl. Ex 4, May Tr. at 30:11–16.

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28 The opinions the Wells Fargo due diligence teams expressed among themselves in preparation for merger negotiations are also untested, unreliable hearsay. To overcome the hearsay bar, Plaintiffs have the burden to demonstrate that each piece of evidence offered fits within a hearsay exception. Defendants do not waive their right to object to these materials on such grounds at trial.

29 Contrary to Plaintiffs' assertion, Defendants do not seek to exclude the Project Whiskey materials merely because the complexity of the contents will tend to confuse the jurors. Pl. Br. at 82. Defendants object to the materials because the aggregation of the prejudice of the language and the confusion of superficially similar (and highly complex) concepts far outweighs the probative value of materials developed for the completely different purpose of assessing Household's operations in anticipation of a potential merger.

This adoption would (as intended) unfairly prejudice Defendants by inducing jurors to forgo their own observations and analyses in deference to those of Wells Fargo, a high-profile third party with purported expertise on restructuring and other topics at issue in this matter. Because there is a very high risk that jurors will be unduly influenced by Wells Fargo's opinions and will not analyze the information regarding Household's restructuring practices and disclosures for themselves, the Project Whiskey materials should be excluded from trial.

2. Plaintiffs' Project Whiskey Exhibits Foreshadow the Inflammatory Language Plaintiffs Intend to Use to Confuse and Unfairly Prejudice the Jury

Plaintiffs wrongly allege that Wells Fargo's due diligence documents "reveals that Household public statements were incorrect," supporting that conclusion by citing to a document that offers the opinion of the Wells Fargo due diligence team that various policies of Household's were "aggressive." Pl. Br. at 80 (emphasis omitted). Again, Plaintiffs have tipped their hand as to the prejudicial and confusing misuse they intend for the Project Whiskey materials.

The opinions of the Wells Fargo Finance due diligence team do not reveal, and are not probative of, anything other than the opinions of Wells Fargo during a hasty due diligence review. Plaintiffs plainly intend, however, to put them before the jury in an effort to induce the jurors to infer that Household's reaging practices violated some Wells Fargo-determined standard and were therefore problematic. Plaintiffs' hope is that the legitimacy of Household's reaging policies will be decided based on the inflammatory characterizations contained in some of the due diligence documents — a transparent inducement to the jury to decide key issues for the improper reason that a seemingly neutral non-party used harsh language in criticizing Household's choice of operational policies.

3. The Individual Defendants' Alleged "Ratification" of Wells Fargo's Calculations Are Not Probative of Scienter

Plaintiffs contend that the Project Whiskey opinions are probative of Defendants' state of mind because Bill Aldinger and Dave Schoenholz allegedly "ratified" the opinions. Pl.

Br. at 80–81. Once again, Plaintiffs' fast-and-loose approach to the information contained in Project Whiskey materials will give rise to a substantial risk of prejudice and confusion during trial.

The first document Plaintiffs cite as evidence of so-called ratification is an email authored by Paul Makowski (neither Aldinger nor Schoenholz, as Plaintiffs imply) in which he accepted Wells Fargo's calculations of reaged accounts through 2001 and March 2002 based on "the data they received." Pl. Br. at 81; *see* Defendants' Opening Brief, Appendix, Tab L-4. However, in the very next sentence (but not included in Plaintiffs's quotation), Makowski explains that Wells Fargo "may have extrapolated this trend" to reach their conclusions for the stock of reaged accounts for the end of the year. This extrapolated number appears to have been a source of concern, as it exceeded Household's internal projections, so Aldinger directed a review of the numbers by Corporate Credit Management. *Id.*, Tab L-4. This review culminated in a presentation for Aldinger in which Wells Fargo's extrapolations were hotly disputed for having relied on improper factors and for misunderstanding the role of reaging for Household's customers. [30] *See* Owen Decl. Ex 5 (labeling the attached Presentation "WFA Presentation 7-22-02"); *see* Defendants' Opening Brief, Appendix, Tab L-1 at *01805739-740*.

Household's determined effort to evaluate the integrity of Wells Fargo's assessment is hardly the "ratification" suggested by Plaintiffs but, again, Plaintiffs' misdirection betrays their intentions for trial — and reveals yet again the extent to which mini-trials on collateral issues will occupy the Court's time.

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30 It is also worth noting that according to Wells Fargo's own re-assessment six months after the merger talks collapsed, the large spike in reaged loans that the due diligence team had predicted based on the extrapolated numbers was not materializing and that, in fact, "the percentage of total loans reaged was relatively flat." Defendants' Opening Br., Appendix, Tab L-13. In other words, the Wells Fargo due diligence team turned out to have guessed wrong.

The Court should enter an Order precluding Plaintiffs from introducing into evidence any references and all materials concerning "Project Whiskey."

M. REFERENCES TO PRIVILEGE CONCERNING THE ERNST & YOUNG ENGAGEMENT

Plaintiffs have not shown that the negative inferences they plan to draw, or attempt to induce the jury to draw, either about the substance of any Ernst & Young privileged documents or about Defendants' successful invocation of privilege as to such documents, are permissible at trial. Therefore, Defendants' motion *in limine* to prevent Plaintiffs from attempting to draw those inferences should be granted.

Magistrate Judge Nolan found that certain E&Y Compliance Engagement materials were subject to the attorney-client privilege and Defendants were permitted to withhold those documents from Plaintiffs. *See* Feb. 27, 2007 Order, Nolan, M.J. (Docket No. 999); June 13, 2007 Order, Nolan, M.J. (Docket No. 1109). Defendants do not dispute that the *fact* that attorney-client communications took place is not privileged and that mere references to the attorney-client privilege are not prohibited at trial. What Plaintiffs make clear in their brief, however, is that they intend to go well beyond the mere mention that privileged attorney-client communications took place.

Plaintiffs admit that they intend to "tell the jury that they were unable to obtain information on the total monetary amount of the refunds [that Household purportedly issued to customers] because of defendants' assertion of the attorney-client privilege." (Pl. Br. at 84). Plaintiffs intend to "explain to the jury that defendants withheld documents on privilege grounds relevant to quantifying the amount of customer refunds Household made during the Class Period." *Id.* They intend to inform the jury that those privileged communications are "documents that would assist plaintiffs in determining the amounts refunded." (Pl. Br. at 83). Plaintiffs' statements are nothing more than rank speculation about what is contained in privileged documents Plaintiffs have never seen. If Plaintiffs are permitted to draw or induce such inferences

based on Defendants' invocation of privilege, Defendants cannot refute them without sacrificing the privilege that Judge Nolan has held was properly invoked.[31]

As set forth in Defendants' Opening Brief, the case law is clear that the inferences Plaintiffs seek are prohibited at trial. (Defendants' Opening Br. at 98–98. In fact, the case that Plaintiffs rely on for their position that the jury should be allowed to draw negative inferences from the fact that Defendants withheld documents on privilege grounds, *LA Gear, Inc.* v. *Thom McAn Shoe Co*., 988 F.2d 1117 (Fed. Cir. 1993), has been expressly overruled for that point. As stated in the subsequent case, *Knorr-Bremse Systeme Fuer Nutzfahrzeuge Gmbh* v. *Dana Corp.*, 383 F.3d 1337, 1345 (Fed. Cir. 2005) (en banc), "the assertion of attorney-client and/or work-product privilege and the withholding of the advice of counsel shall no longer entail an adverse inference as to the nature of the advice." In so holding, the Federal Circuit harmonized federal patent law[32] with the general law that an adverse inference may ***not*** be drawn from a party's invocation of the attorney-client privilege. *See id.*

Defendants therefore request from the Court an Order precluding Plaintiffs from (a) introducing into evidence at trial any information concerning, or making any reference to, any documents relating to the E&Y Compliance Engagement that Defendants withheld from production (with the Court's approval) on grounds of privilege and (b) drawing, or attempting to induce the jury to draw, any negative inferences either about the substance of any E&Y Privileged

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31 Defendants do not intend to refer to the Compliance Engagement documents that were withheld pursuant to Judge Nolan's Feb. 27, 2007 and June 13, 2007 Orders. Thus Plaintiffs' argument that Defendants seek to use these withheld documents as both a sword and a shield has no merit.

32 Even if it had not been overruled, *LA Gear* would have been irrelevant in this case. *LA Gear* involved "the assertion of privilege with respect to *infringement and validity opinions of counsel.*" 988 F.2d 1117, 1126 (Fed. Cir. 1993) (emphasis added). This specific application of reliance on counsel in intellectual property law infringement disputes cannot be confused with the attorney-client privilege issues raised here. *See, e.g.*, *TiVo Inc.* v. *Echostar Communications Corp.*, No. 04 Civ. 01, 2005 WL 4131649, at *3 (E.D.Tex. Sept. 26, 2005) ("[T]he advice of counsel defense and the disclosure of an infringement opinion appears to fall within the realm of subjects 'unique to patent cases'"), *rev'd in part on other grounds*, 448 F.3d 1294 (2006).

Documents or about Defendants' successful invocation of privilege as to such documents.

N. PLAINTIFFS SHOULD BE PRECLUDED FROM INTRODUCING THE RESTATEMENT OF EARNINGS ANNOUNCED BY HOUSEHOLD ON AUGUST 14, 2002 TO PROVE SCIENTER

Defendants seek to preclude Plaintiffs from introducing information at trial concerning or making reference to the Restatement as putative proof that Defendants acted with scienter. Plaintiffs' response fails to call into question the validity of this request.

Plaintiffs devote a significant portion of their response to the issue of whether the Restatement is relevant and admissible as proof of falsity and materiality. While Defendants do not concede that the Restatement establishes either of these elements of securities fraud, Plaintiffs, in advancing an argument on these subjects, fail to address the limited nature of Defendants' Opening Brief, which addresses itself specifically to Plaintiffs' now-admitted use of the Restatement as broad proof that Defendants evinced an intent to defraud or deceive.

One of Plaintiffs' three theories of securities fraud is based on Household's August 14, 2002 Restatement. Plaintiffs' only purported evidence of fraud in connection with the Restatement is the Restatement itself. That's it. There's nothing more. And without more, a restatement is inadmissible to prove scienter.

Plaintiffs' efforts to marshal an argument that the Restatement is relevant to the issue of scienter are futile and the cases they proffer are inapposite. While Plaintiffs recite *ad nauseum* language from various cases that they interpret to suggest that the mere fact of a restatement may give rise to an inference of scienter, the cases they cite state in the same breath that an inference of scienter requires not only the fact of a restatement but also the additional factors that serve to meet a plaintiff's burden under the PSLRA. Plaintiffs' legal support for their third theory of securities fraud rests on nothing more, as related to these contracts, than the fact of the restatement. They advance a number of factual claims that they misguidedly contend support their other two legal theories, but because this third theory rests on business matters so unre-

lated to the core operations of the company these facts bear not at all on the propriety of Defendants' accounting decisions as to the affected contracts. In the cases Plaintiffs cite, in contrast, plaintiffs advanced additional facts that actually related to the accounting claims at issue. For example, in *In re Atlas Air Worldwide Holdings, Inc. Securities Litigation*, 324 F. Supp. 2d 474 (S.D.N.Y. 2004), the district court denied a motion to dismiss, finding an inference of scienter based on information from confidential sources that revealed that high-level company officials knew about fundamental problems with the way the company had accounted for "obsolete inventory, bad debt and maintenance expenses" and the fact the company was unable to locate financial records to complete a reaudit, in combination with the restatement. *Id.* at 489 n.7, 492, 494–95. Accordingly, the court concluded plaintiffs had not merely pled "fraud by hindsight," but had "alleged additional facts *besides the restatement* that demonstrate high-level officials within the company ignored red flags that should have alerted them to the fact that the company's reported financials were false when issued." *Id.* at 494–95 (emphasis added). Similarly, the court in *In re Spiegel, Inc. Securities Litigation*, 382 F. Supp. 2d 989 (N.D. Ill. 2004) (Pallmeyer, J.), found an inference of scienter sufficient to survive a motion to dismiss based on a very significant financial restatement combined with "systemic failures resulting from unsound credit policies, which ultimately led to [the defendant's] bankruptcy," difficulties of which officers must have been aware. *In re Spiegel*, 382 F. Supp. 2d at 1020–21.

In contrast, Plaintiffs point to no such red flags that may have alerted Defendants to the need for the Restatement. As explained in Defendants' Opening Brief, the Restatement was a response to a good-faith difference of opinion between Household's newly engaged auditor, KPMG LLC, and the Company's outgoing auditor, Arthur Andersen LLP ("Andersen") regarding years-old recommendations of Andersen on the accounting treatment for four contracts. (Significantly, after conducting a full reaudit of all of Household's operations and public reports, KPMG found no other basis for a restatement.) The difference related to Household's accounting treatment, beginning at least as early as 1994, of its MasterCard/Visa co-branding and affin-

ity credit card relationships and a credit card marketing agreement with a third party. For there to be sufficient additional facts in this case, Plaintiffs would have to come forward with evidence that the Company accounted for these agreements pursuant to Andersen's advice in order to commit fraud, or at the very least that Defendants ignored specific red flags that should have alerted them to the need for the Restatement. *See*, *e.g.*, *In re System Software Associates Securities Litigation*, No. 97C177, 2000 U.S. Dist. LEXIS 3071, at *42 (N.D. Ill. Mar. 8, 2000) (Pallmeyer, J.) ("The mere fact that a company restates its revenue does not establish scienter"); *cf. In re Adaptive Broadband Securities Litigation*, No. C 01-1092 SC, 2002 U.S. Dist. LEXIS 5887, *39 (N.D. Cal. Apr. 2, 2002) (specific evidence of internal discussion of whether to "override internal policies and GAAP restrictions and book the transaction," along with the fact of *several* restatements, found to be sufficient for an inference of scienter). Yet they offer no such evidence.

Moreover, Plaintiffs do not allege any wholesale fabrication of accounting evidence, as was the case in *Miller* v. *Material Sciences Corp.*, 9 F. Supp. 2d 925 (N.D. Ill. 1998) (Gettleman, J.), where assets themselves were fabricated. *See Miller*, 9 F. Supp. 2d at 927-28. In contrast, Plaintiffs do not offer any evidence that Household's reliance on Andersen's opinion was the result of anything other than good faith, let alone the product of a wholesale fabrication.

In fact, many of the factors common to the cases Plaintiffs advance — for example, the magnitude of the restatement *relative to* the overarching scope of operations, the nature of the transactions in the restatement as part of the "core operations" of the relevant company, the presence of significant evidence that invoices, journal entries, and the like were entirely fabricated — are utterly absent in this case. The relatively small fraction of Household's earnings that the Restatement represented (less than 5% of earnings over the course of the eight years affected), and the fact that the agreements at issue in the Restatement were far outside the "core operations" of Household's business, distinguish the present case from those on which Plaintiffs

rely. For example, in *Atlas*, the court relied heavily on the extraordinary effect of the restatement:

> "The effect of the restatement was dramatic for a company of Atlas Air's size: Atlas was transformed from a company with retained earnings of approximately $185 million to a company with an accumulated deficit of approximately $178 million. Accordingly, the size and nature of the restatement suggests that this was no mere error caused by the improper application of hyper-technical accounting rules — it indicates that there were systemic accounting abuses within Atlas that resulted in a serious public misrepresentation of the company's financial condition." *Atlas*, 324 F. Supp. 2d at 489.

Moreover, the court in *Atlas* distinguished cases cited by the defendants by saying that the subject of the restatement in that case was part of the core operations of the company, and statements made relating to core operations support an inference that high-ranking corporate officials knew or should have known that the statements were false. *Id.* Plaintiffs' reliance on *Chu* v. *Sabratek Corp.*, 100 F. Supp. 2d 815 (N.D. Ill. 2000) (Castillo, J.), is similarly misguided, given the relative significance of the restatement where the deal involved in the restatement represented an overall 242% increase in reported intangible assets. *Chu*, 100 F. Supp. 2d at 825.

While Plaintiffs cite the Supreme Court's decision in *Tellabs, Inc.* v. *Makor Issues and Rights, Ltd.*, 551 U.S. 308 (2007), as support for their argument, they fail to address a recent case interpreting *Tellabs*, in which a restatement of earnings was (unlike in *Tellabs*) actually at issue. In *Zucco Partners, LLC v. Digimarc Corp.*, 2009 WL 311070 (9th Cir. Jan. 12, 2009, amended Feb. 10, 2009), the court considered the effect of the *Tellabs* standard for pleading scienter on the proposed use of an accounting restatement. In considering the restatement of earnings in that case, the court reiterated the standard that mere publication of a restatement, and even allegations that the facts were "critical" to core operations or an important transaction, were insufficient proof of scienter. *Zucco Partners*, 2009 WL 311070, at *14. The court found that even in combination with numerous other factors (all more compelling than those that plaintiffs proffer here), the fact of a restatement failed to raise a sufficient inference of scienter under pleading requirements of the PSLRA, because the alternative explanation that these problems

represented a difficult accounting situation was more compelling. The court stated, "Although the allegations in this case are legion, even together they are not as cogent or compelling as a plausible alternative inference — namely, that although [defendant] was experiencing problems controlling and updating its accounting and inventory tracking practices, there was no specific intent to fabricate the accounting misstatements at issue here." *Id.*, at *21.

Further, at least one case cited by plaintiffs concedes the problematic nature of using GAAP violations as evidence of fraud: "GAAP . . . is not 'a canonical set of rules that will ensure identical accounting treatment of identical transactions.' . . . Rather, it 'tolerate [s] a range of "reasonable" treatments' . . . . '[T]he fact that Defendants changed auditors because of a difference in judgment about generally accepted accounting principles does not establish conscious behavior on the part of Defendants." *Chalverus* v. *Pegasystems, Inc.*, 59 F. Supp. 2d 226, 235–36 (D. Mass. 1999) (alterations in original) (citations omitted).

In short, Plaintiffs offer no meaningful opposition to Defendants' motion to preclude them from using the Restatement as putative proof that Defendants acted with scienter. Not a single case that Plaintiffs cite permits a plaintiff even to survive a motion to dismiss on the basis of a restatement alone, nor do any of them support the proposition that a restatement in tandem with the additional factors alleged by Plaintiffs here is sufficient to meet their burden of proof. Therefore, Defendants' motion should be granted in full.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in Defendants' Memorandum of Law in Support of Defendants' Omnibus Motion *in Limine* to Exclude or Limit 14 Categories of Evidence, all references to certain subject matter as set forth above, including in Plaintiffs' opening statement, weekly summations, questioning of witnesses, exhibits, expert testimony and summation, should be precluded.

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