United States District Court, Northern District of Illinois

Name of Assigned Judge or Magistrate Judge	Ronald A. Guzman	Sitting Judge if Other than Assigned Judge	
CASE NUMBER	02 C 5893	DATE	3/17/2009
CASE TITLE	Lawrence E. Jaffe Pension Plan vs. Household International, Inc. et al.		

DOCKET ENTRY TEXT

For the reasons provided in this Minute Order, the Court grants in part and denies in part defendants' omnibus motion in limine to exclude or limit fourteen categories of evidence [doc. no. 1330]. The Court orders defendants to file an index cross-referencing all exhibits submitted with their motions in limine with the trial exhibit identification number or designation. With regard to any exhibit omitted in support of this omnibus motion in limine or labeled with an identifier that was not included in the appendix, the Court deems any argument based on the motion waived because the exhibit and/or label should have been included in the appendix for the Court's consideration.

■[For further details see text below.] Docketing to mail notices.

STATEMENT

A. Household's Offer of Settlement and the SEC Consent Decree

Household moves to preclude plaintiffs from referring to its Offer of Settlement and the SEC Consent Decree at any time during trial. Federal Rule of Evidence ("Rule") 408 bars evidence of "conduct or statements made in compromise negotiations regarding the claim" "when offered to prove liability for . . . a claim that was disputed as to validity or amount, or to impeach through a prior inconsistent statement or contradiction." The purpose of Rule 408 "is to encourage settlements. The fear is that settlement negotiations will be inhibited if the parties know that their statements may later be used as admissions of liability." *Kritikos v. Palmer Johnson, Inc.*, 821 F.2d 418, 423 (7th Cir. 1987) (quotation omitted). However, Rule 408 exclusion does not apply to evidence offered for a purpose other than to prove or disprove the validity of the claims that the negotiation was meant to settle. *See* Fed. R. Evid. 408. Evidence coming out of settlement negotiations has been admitted "for purposes of rebuttal, for purposes of impeachment, to show knowledge and intent, to show a continuing course of reckless conduct, and to prove estoppel." *Zurich Am. Ins. Co. v. Watts Indus., Inc.*, 417 F.3d 682, 689 (7th Cir. 2005). The party seeking to exclude a statement under Rule 408 must make a "substantial showing" that the statement "was, in fact, part of a settlement attempt." *Raybestos Prods. Co. v. Younger*, 54 F.3d 1234, 1241 (7th Cir. 1995).

Defendants have made a substantial showing that Household's Offer of Settlement and the SEC Consent Decree were part of settlement negotiations with regard to whether Household violated SEC regulations when it failed to disclose its practice of reaging accounts, which is part of the claims at issue in the instant case. Household's Offer of Settlement and the SEC Consent Decree are thus inadmissible under Rule 408. *See In re Blech Secs. Litig.*, No. 94 CIV. 7696 (RWS), 2003 WL 1610775, at *11 (S.D.N.Y. Mar. 26, 2003) (holding that SEC consent orders are inadmissible under Rule 408).

Plaintiffs have not established that they seek admission of Household's Offer of Settlement and the

STATEMENT

SEC Consent Decree to prove anything other than Household's liability with regard to the disclosure of its restructuring and reaging of delinquent accounts. Household's state of mind at time of the Offer of Settlement or SEC Consent Decree is immaterial here because the class period ended five months prior to the settlement.

The Court's ruling that Household's Offer of Settlement and the SEC Consent Decree are inadmissible also precludes defendants from making any reference to the fact that Household did not admit or deny any of the allegations contained therein.

However, to the extent that defendants also seek to bar other documents that merely refer to Household's Offer of Settlement and/or the SEC Consent Decree, defendants have failed to make a substantial showing that such these documents in their entirety were intended to be part of the negotiations for compromise. The Court thus bars only those portions of documents in defendants' App. A that either state, restate or paraphrase the contents of Household's Offer of Settlement and/or the SEC Consent Decree, including:

Ex. A-1 (paragraphs 1, 3, 4, 6 and 7 appearing after colon);

Ex. A-2 (HHS 03237842 ¶ 3, HHS 03237844 ¶¶ 2-3);

Ex. A-3 (HHS-E 0012758.0001 ¶¶ 1-3, HHS-E 0012758.0002 ¶¶ 1-2, HHS-E 0012758.0002 ¶¶ 1, 2 phrase "In connection with the foregoing", 4, and item 99.2 listed under Item 7(c) Exhibits, HHS-E 0012758.0004 item 99.2 listed in Exhibit Index, HHS-E 0012760.0002 ¶¶ 1, 2 phrase "In connection with the foregoing", 4, and item 99.2 listed under Item 7(c) Exhibits, HHS-E 0012760.0004 item 99.2 listed in Exhibit Index, HHS-E 0012761.0001 headline "; Enters into Consent Order with SEC without Admitting or Denying Wrongdoing", ¶¶ 2, 3, 5, HHS-E 0012762.0001 through HHS-E 0012762.0008, HHS-E 0012763.0001 through HHS-E 0012763.0007;

Ex. A-4 (HI KPMG 017171.01 last italicized header and last ¶, HI KPMG 017171.02, HI KPMG 017171.03 ¶¶ 1, 2 (and header), 3, 4 (and header), first and second sentence of 5), HI KPMG 017171.04 last paragraph sentence beginning "In making this determination" and sentence beginning "Our conclusion considered", HI KPMG 017171.05 ¶¶ 1 (partial sentence beginning "SEC settlement"), 5 (clause "Household's expected consent to the SEC cease-and-desist order"), 6-7, HI KPMG 017171.06 ¶¶ 2 beginning "We reviewed a letter from WCP", 5, HI KPMG 017171.07 ¶¶ 1 beginning "the KPMG letter", 3 (and header);

Ex. A-5 (HI KPMG 019162.03 ¶¶ 1(and header), 2 (and italicized header);

Ex. A-6 (TEL000329 ¶ 3 beginning "In particular", TEL000332 ¶¶ 2-3; and

Ex. A-7 in its entirety.

To the extent that a portion of a document is not listed above, the motion is denied.

Although defendants only mention Household's amendment of its 2001 Form 10-K in passing, Court disagrees with defendants' assertion that plaintiffs' use of this form in which Household provided additional disclosures regarding its policy of restructuring and reaging of delinquent accounts as mandated by the SEC is barred because it is a subsequent remedial measure within the scope of Rule 407. Rule 407 provides:

STATEMENT

When, after an injury or harm allegedly caused by an event, measures are taken that, if taken previously, would have made the injury or harm less likely to occur, evidence of the subsequent measures is not admissible to prove negligence, culpable conduct, a defect in a product, a defect in a product's design, or a need for a warning or instruction.

Rule 407 applies to voluntary subsequent remedial measures and not corrective actions mandated by a government agency. *Sec. & Exch. Comm'n v. Uzzi*, No. 01-8437-CIV, 2003 WL 1342962, at *1 (S.D. Fla. Jan. 21, 2003) ("The Restatement and Report were not at all voluntary, and thus, neither the intent nor the policy underlying Rule 407 support exclusion of this material."). The Advisory Committee Notes to Rule 407 indicate that the rule largely rests on "a social policy of encouraging people to take, or at least not discouraging them from taking, steps in furtherance of added safety." A defendant cannot be discouraged from voluntarily taking remedial measures if it is required by law to do so. *See, e.g., O'Dell v. Hercules, Inc.*, 904 F.2d 1194, 1204 (8th Cir. 1990); *In re Aircrash in Bali, Indonesia*, 871 F.2d 812, 816 (9th Cir. 1989); *Herndon v. Seven Bar Flying Serv., Inc.*, 716 F.2d 1322, 1331 (10th Cir. 1983); *Rozier v. Ford Motor Co.*, 573 F.2d 1332, 1343 (5th Cir. 1978); *Lolie v. Ohio Brass Co.*, 502 F.2d 741, 744 (7th Cir. 1974). *But see Malone v. Microdyne Corp.*, 26 F.3d 471, 480 (4th Cir. 1994) (affirming district court's exclusion of defendant's Form 10-K but not discussing superior authority exception to Rule 407). The SEC Division of Corporate Finance separately required Household to amend its 2001 Form 10-K, which was not a term of the SEC Consent Decree. Thus, the Court holds that Rule 407 does not bar admission of Household's amendment of its 2001 Form 10-K.

Further, Rule 403 does not require the Court to bar plaintiff's use of Household's amendment of its 2001 Form 10-K. Rule 403 provides: "Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence."

Household's amendment of its 2001 Form 10-K is highly relevant to proving whether there was a misstatement in the original financial statement and whether the misstatement was material. A number of courts have held that a company's issuance of a restatement is an admission by the company as to the inaccuracy of the originally filed financial statement. *See In re Telxon Corp. Sec. Litig.*, 133 F. Supp. 2d 1010, 1025 (N.D. Ohio 2000) (company admitted its prior disclosures were materially misstated when it issued the restatements which gave rise to the litigation); *In re Peritus Software Servs., Inc. Sec. Litig.*, 52 F. Supp. 2d 211, 223 (D. Mass. 1999) ("after-the-fact accounting admissions may suffice to show that material misstatements occurred"); *In re WorldCom, Inc. Sec. Litig.*, No. 02 CIV. 3288 (DLC), 2005 WL 375313, at *8 (S.D.N.Y. Feb. 17, 2005) ("The company's admission of what its financial statements should have been in prior years is highly probative of whether the previously filed documents were false. The magnitude of the corrections speak directly to the issue of materiality."). Further, Household's amendment of its 2001 Form 10-K is admissible as a business record pursuant to Rule 803(6). *See, e.g., Uzzi*, 2003 WL 1342962, at *1 ("[Restated financial statements] are filed by companies as a matter of course when such occurrences arise and fit squarely within the language of the exception in Rule 803(6)."). The Court rejects defendants' argument that Household's amendment of its 2001 Form 10-K is irrelevant.

Although defendants argue that there is a risk of unfair prejudice with regard to Household's Offer of Settlement and the SEC Consent Decree, they do not articulate how the fact that a restatement occurred would create an improper inference that defendants are liable for securities fraud. Defendants may proffer an appropriate limiting instruction to eliminate any improper inference. That highly probative evidence may effect the ease of their defense of plaintiffs' claims does not rise to the level of unfair prejudice. In sum, the Court holds that the probative value of Household's amendment of its 2001 Form 10-K is not substantially

STATEMENT

outweighed by the danger of unfair prejudice.

Therefore, the Court grants Household's motion to bar references to its Offer of Settlement and SEC Consent Decree, grants in part and denies in part the motion as to documents in Def.'s Ex. A, Tab A and denies the motion as to Household's amendment of its 2001 Form 10-K.

B. Federal and State Regulatory Examinations

Defendants move to bar plaintiffs from introducing federal and state regulators' reports of examination and related documents (Defs.' App. A, Exs. B-1 to B-73) ("regulatory documents") pursuant to Rule 403 because they have no probative value, they are limited in scope, they contain no final findings, they would confuse the jury, waste judicial resources and are unduly prejudicial. The Court disagrees.

To state a claim for a violation under Section 10(b) or Rule 10b-5, a plaintiff must prove: "(1) a material misrepresentation (or omission); (2) scienter, *i.e.*, a wrongful state of mind; (3) a connection with the purchase or sale of a security; (4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation"; (5) economic loss; and (6) "loss causation," *i.e.*, a causal connection between the material misrepresentation and the loss." *Ray v. Citigroup Global Markets, Inc.*, 482 F.3d 991, 994 (7th Cir. 2007) (quotations and citations omitted).

The regulatory documents are clearly probative of scienter because they tend to show that, as early as 1998, complaints about Household's lending errors and violations at branches throughout the country had reached a critical mass such that Household was forced to remedy them. Their probative value is not substantially outweighed by the danger of unfair prejudice because at trial Household is free to offer evidence that: (1) the regulatory documents do not present a statistically significant sampling of Household's overall business; (2) the regulatory investigations were limited in scope; and (3) Household responded to the investigations and worked with the regulatory agencies to correct the problems. In other words, Household's arguments go to the weight rather than the admissibility of the regulatory documents. The Court is confident that both parties are capable of addressing these issues in the most expedient manner possible at trial. Allowing both sides to explain these documents will not confuse or mislead the jury, but, rather, will aid it in determining the scienter issue. Because the regulatory documents relate to a core issue in this case, the Court finds that the Rule 403 balance weighs in favor of admitting them.

The Court denies defendants' motion to bar plaintiffs from introducing federal and state regulators' reports of examination and related documents.

C. Complaints in Other Litigations

Defendants argue that plaintiffs should be barred from making any references to complaints filed in other litigation involving defendants during the Class Period of July 30, 1999 to October 11, 2002 because such complaints are inadmissible hearsay. (*See* Defs.' Ex. A, Tab C-3, *Cal. v. Household Fin. Corp.* ("Pl.'s Ex. 234"); *id.*, Tab C-5, *Luna v. Household Fin. Corp.* ("Pl.'s Ex. 287"); *id.*, Tab C-17, *Chenvert v. Household Fin. Corp.* ("Pl.'s Ex. 1312").)

Plaintiffs argue that they are offering these complaints not to prove the truth of the matter asserted therein but to prove that defendants were aware that the State of California, as well as other plaintiffs in Washington and other states, had sued Household based on its abusive lending practices and to prove that defendants had no basis for believing that there was only one rogue Household branch in Washington.

STATEMENT

Defendants argue that plaintiffs are not entitled to rely on complaints filed in other litigation to prove knowledge and rely on *Pugh v. Tribune Co.*, 521 F.3d 686, 695 (7th Cir. 2008). In that case, the Seventh Circuit affirmed the district court's dismissal of a securities fraud complaint as to the individual defendants because of the fact that theTribune company had been sued by advertisers for overstating circulation numbers and the individual defendants promptly investigated the allegations insufficiently alleged a strong inference of scienter as to the individual Tribune defendants. *Id.* In so holding, the *Pugh* court stated that "Managers cannot tell lies but are entitled to investigate for a reasonable time, until they have a full story to reveal." *Id.*

The facts of *Pugh* are distinguishable from this case. In *Pugh*, the individual defendants promptly investigated the claims in the complaints filed in February and as information became available, they disclosed it to the public in June, July and September. *Id.* In the instant case, although the complaints in the other litigation were filed in August 2, 2000 (*Chenvert v. Household Fin. Corp.*), November 9, 2001 (*Cal. v. Household Fin. Corp.*) and May 23, 2002 (*Luna v. Household Fin. Corp.*), plaintiffs plan to offer evidence that the defendants neither investigated the allegations for a reasonable time nor released information as it became available. Moreover, as noted above, in the case at bar the defendants have chosen to argue that they did not have the requisite guilty knowledge because they believed the problem concerned only an isolated rogue Household branch in Washington. Plaintiffs are entitled to rebut this assertion with evidence that tends to show that such a belief was unlikely under the circumstances. Evidence that Household was aware of similar widespread complaints goes directly to rebut Household's single rogue office contention. Accordingly, the Court holds that the complaints in other litigation are relevant to proving defendants' knowledge of the complained of lending practices. Lastly, the probative value of the complaints in other litigation is not outweighed by any prejudice to the defendants. Defendants may propose a proper limiting instruction to eliminate jury confusion and to ensure that the jury considers the complaints for a limited purpose only.

The Court denies defendants' motion to bar plaintiffs from making any references to complaints filed in other litigation involving defendants during the Class Period of July 30, 1999 to October 11, 2002.

D. Civil and Regulatory Settlements

Defendants move to bar plaintiffs from making any references to its settlements in civil lawsuits and regulatory agency actions.

Unlike defendants' motion to bar references to Household's Offer of Judgment and the SEC Consent Decree, the instant motion does not involve settlements of the identical claims at issue in the instant case. "Rule 408 does not require the exclusion of evidence regarding the settlement of a claim different from the one litigated, though admission of such evidence may nonetheless implicate the same concerns of prejudice and deterrence of settlements which underlie Rule 408 [.]" *Towerridge, Inc. v. T.A.O., Inc.*, 111 F.3d 758, 770 (10th Cir. 1997) (citations omitted). Although Household's settlement of civil and regulatory actions arose out of disputes different from this securities fraud dispute, the Court holds that the disputes are similar enough such that the policy concerns underlying Rule 408 preclude their admission. Plaintiffs rely on the settlements to prove that the claims underlying the civil and regulatory actions were valid *and* that Household was aware of them. Whether Household settled claims based on its lending practices may very well lead to the unfair and prejudicial inference that Household failed to disclose material facts regarding its lending practices. This simply is not a case where the settled and currently litigated disputes are so dissimilar that admission of the settlements does not create the danger of unfair prejudice and hindrance of settlements. To the extent that plaintiffs argue that the civil and regulatory settlements prove defendants' knowledge or a course of reckless conduct, the Court holds that reliance on the AG investigatory findings and the civil

STATEMENT

complaints, rather than the civil and regulatory settlements, reduces the risk of unfair prejudice to defendants and promotes the spirit of Rule 408.

Defendants have made a substantial showing that App. A, Exs. D-1, D-6, D-13, D-15 through D-17, D-19, D-22, D-24, D-25, D-27, D-28, D-29, D-31, D-32, D-37, D-42 (as to entries made in 7/9/02, 7/17/02, and all entries from 8/14/02 to and including end of October 2002), D-44 through D-54, D-56 through D-62, D-69 HHS-OTS-000090 last three sentences only, D-70, D-71 PRFLAG0000010-PRFLAG0000058, D-72, D-73 entries for 7/15/02, 9/4-5/02, 9/9/02, 9/13/02, 9/24/02, 9/30/02-10/2/02, D-74 through D-78 were part of the negotiation discussions in settling the civil and regulatory actions (or state the content of those discussions) that claimed Household's lending practices violated consumer fraud and lending laws. As to any exhibit or portion thereof not listed, defendants have failed to make such a showing because they have not provided any indicia that the exhibit or portion thereof was part of the negotiation discussions or states the content of those discussions.

However, plaintiffs have established that they seek admission of the timing and disclosure of certain settlements to prove that they affected the price of Household's stock. Defendants concede that certain limited pertinent information will be admitted:

Defendants recognize that the public disclosure of certain settlements is alleged to have affected the price of Household's stock. To the extent that evidence relating to any of those settlements is relevant to prove, or disprove, the alleged inadequacy of Household's disclosures or the effect or absence of effect on the price of Household's stock price, information sufficient to identify the date, time, means and nature of the disclosure can be introduced into evidence without requiring the introduction of any actual settlement documents or any documents or testimony concerning allegations that were settled or the settlement terms or negotiations.

(Defs.' Mem. Law Support Defs.' Omnibus Mot. Limine Exclude Limit 14 Categories Evidence 49 n.19.) In essence, defendants concede that this information is probative with regard to the issue of damages and that the limited nature of the information minimizes any undue prejudice. The parties shall meet, confer and jointly submit the information sufficient to identify the date, time, means and nature of the disclosures to the Court no later than four days prior to the beginning of voir dire.

E. Settlement-related Refunds

Defendants move to preclude plaintiffs from introducing evidence of, or referring to, Household's settlement-related refunds and policies. Rule 408 provides in pertinent part: "Evidence of the following is not admissible . . . when offered to prove liability for . . . a claim that was disputed as to validity[:] . . . furnishing . . . a valuable consideration in compromising or attempting to compromise the claim . . . ." Fed. R. Evid. 408. The rule further provides that it "does not require exclusion if the evidence is offered for purposes not prohibited by subdivision (a) [*i.e.*,] . . . proving a witness's bias or prejudice; negating a contention of undue delay; and proving an effort to obstruct a criminal investigation or prosecution." *Id.*

Defendants have made a substantial showing that the following exhibits, or portions thereof, contain information about refunds it made in compromising or attempting to compromise claims: Ex. E-2 HHS 02947585 through HHS 02947589; E-4 HHS 03244017 ¶ 1 first two sentences; E-5; and E-6. As to any exhibit or portion thereof not listed, defendants have failed to show that its content is related to settlement refunds. To the extent that plaintiffs argue that the settlement-related refunds prove defendants' knowledge or a course of reckless conduct, the Court reiterates its findings above that plaintiffs' use of the federal and state regulatory examinations and complaints in other litigation, rather than settlement-related refunds,

STATEMENT

accomplishes that goal while promoting the purposes underlying Rule 408 and minimizing any improper inferences a jury might draw from the refunds. The Court thus grants in part and denies in part defendants' motion to preclude plaintiffs from introducing evidence of, or referring to, Household's settlement-related refunds and policies.

F. Settlement-related Policies

Defendant next moves to preclude plaintiffs from making any references to settlement-related policy changes because it would violate Rule 407, Rule 408 and Rule 403.

First, the Court holds that Rule 407 does not bar the settlement-related policy changes. Despite defendants' arguments otherwise, in order to comply with state laws, the state attorneys general required Household to implement the policy changes during and after the regulatory investigations and as part of the consent judgments. (*See, e.g.*, Defs.' App. A, Ex. F-23, Email from Gilmer to Vozar and Allcock of 2/8/02 ("In reality, we have no choice but to comply.")) Thus, the superior authority exception to Rule 407 applies.

Second, pursuant to Rule 408, defendants have made a substantial showing that Household's multi-state settlement with various state attorneys general included terms that required Household to institute policies and practices regarding (1) loan fees, (2) disclosure of rates and point options, (3) good faith estimates, (4) representation regarding interest rates and loan terms, (5) contemporaneous secured second loans, (6) unsecured side loans, (7) balloon payments, (8) canceling home equity lines of credit, (9) independent loan closers, (10) prepayment penalties, (11) net tangible benefits, (12) repeat refinancing, (13) credit insurance sales, (14) "live checks" (unsolicited negotiable checks delivered by Household to a consumer who may receive an unsecured loan by negotiating the check), (15) billing statements, (16) Home Ownership and Equity Protection Act disclosures, (17) best rate available, (18) loan disclosures, (19) Spanish language documents and (20) timely payoff information. Plaintiffs are barred from introducing Exs. F-1 through F-14, F-16 through F-22, F-23 HHS-E 0033406.0001 last full sentence beginning "We received the long awaited" and next partial sentence beginning "They have asked that we immediately cease and", HHS-E 0033406.0002 first partial sentence beginning "desist from this practice", and F-25 through F-27 into evidence. As to any exhibit or portion thereof not listed, defendants have not made a substantial showing of a settlement-related policy.

Plaintiffs again argue that they intend to use the settlement-related policies to show that defendants were on notice of problems in Household branches across the country. However, the danger of the risk that a jury will use the terms of the settlement to find defendants liable in this case outweighs the probative value of the settlement-related policies. (*See supra*, § D ("Although Household's settlement of civil and regulatory actions arose out of disputes different from this securities fraud dispute, the Court holds that the disputes are similar enough such that the policy concerns underlying Rule 408 preclude their admission.").) Once again, plaintiffs may rely on the federal and state regulatory examinations and complaints in other litigation (which targeted the inadequacies of Household's policies) to establish notice and scienter. The Court grants in part and denies in part defendants' motion to preclude plaintiffs from making any references to settlement-related policy changes.

G. Individual Customer Complaints

Defendants seek to preclude plaintiffs from referring to individual customer complaints because they are inadmissible hearsay, have low probative value due to their anecdotal nature and because they are not evidence of materially misleading disclosures, are inflammatory and unproven, require mini-trials that are a

STATEMENT

waste of judicial resources and will cause jury confusion.

Plaintiffs argue that the customer complaints are nonhearsay because they are not offered to prove the truth of the matter asserted, but instead are offered to prove scienter, *i.e.*, Household had knowledge of the customer complaints from around the country about its lending practices, while it reassured the public that it did not engage in predatory lending. The Court agrees with plaintiffs. Household has chosen to rely in part on the argument that it considered any existing problem to be related to isolated rogue practices, it cannot therefore, deny plaintiffs the right to introduce evidence which tends to rebut this contention. Evidence of Household's knowledge of customer complaints from around the country, to the extent it is believed, tends to directly contradict Household's rogue practices theory.

Because the Court's rulings as to §§ B. and C. above apply equally to individual customer complaints, the Court incorporates by reference its analysis therein. The individual customer complaints are nonhearsay and their probative value is not substantially outweighed by the danger of unfair prejudice. The Court denies defendants' motion to bar the individual customer complaints.

H. Elaine Markell Opinion

Defendants move to bar any testimony by non-party Elaine Markell. Plaintiffs concede that they are not relying on Markell to provide expert testimony. Pursuant to Rule 701, Markell's lay testimony "is limited to those opinions or inferences which are (a) rationally based on the perception of the witness, (b) helpful to a clear understanding of the witness' testimony or the determination of a fact in issue, and (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702."

Markell, according to defendant's own exhibit (see Defs.' Ex. H-2), was a "senior level employee in Household's Mortgage Services business unit." In February 2002, she became the Vice President of Default Servicing of Household Mortgage Services. During her nine-month tenure, she oversaw the employees who restructured loans as well as those who collected on loans and she was responsible for balancing delinquency reports for her default area with reports generated by the All Tell system. She complained to Household management about its reporting of delinquencies, illegal contact with certain bankrupt customers and non-compliance with certain re-aging policies. As a lay witness, Markell is allowed to testified to facts that she personally experienced and observed, which includes all of the facts in Defs.' App. A, Exs. H-1, H-3, H-4 and H-5, with the exception of a single phrase "and it had–it did affect our stock price" found on page 81 of Markell's deposition in Ex. H-5 because she is not qualified to testify as to the causal relationship between the public disclosure of a change in delinquency ratios and Household's stock price. Defendants do not explain why a KPMG report (Ex. H-2) that merely mentions Markell's allegations should be barred under Rule 701, and therefore, its admission is not barred by this ruling. Accordingly, for the above reasons, the Court grants in part and denies in part defendants' motion to bar Markell's testimony.

I. Dennis Hueman Video

Defendants seek to bar as inadmissible hearsay a training video created by Dennis Hueman while he was employed as Household's Southwestern Division General Manager.

Plaintiffs first argue that the video is not hearsay because it is offered to prove that Household management, including Tom Detelich, then managing director of Beneficial Sales for Household Finance Corp., was aware of the video and its contents and that division managers were utilizing inappropriate and illegal sales techniques. Household's annual reports state that any managing director is a policy-making

officer and, accordingly, proving that Detelich was aware of that division managers were using these techniques is probative of Household's awareness and policy regarding such techniques.

Next, plaintiffs argue that the video is a party admission pursuant to Rule 801(d)(2)(D). Rule 801(d)(2)(D) provides that an admission by a party-opponent is a statement "offered against a party and is . . . a statement by the party's agent or servant concerning a matter within the scope of the agency or employment, made during the existence of the relationship." "Rule 801(d)(2)(D) admissions can be made 'concerning [any] matter within the scope of the . . . employment.'" *Aliotta v. Nat'l R.R. Passenger Corp.*, 315 F.3d 756, 762 (7th Cir. 2003) (quoting advisory committee note, 1972 Proposed Rules). "[A]dmissible admissions . . . include more than just statements made in the circumstances meeting the usual test of agency." *Id.* (quotation omitted). "The only requirement is that the subject matter of the admission match the subject matter of the employee's job description."

Defendants argue that Hueman was merely a Division General Manager, not the head of Household's training program and Household had a team of other people to create authorized training programs. This argument is based on a crabbed reading of the case law and confuses scope of agency with scope of employment. If the drafters of Rule 801 had meant the two tests to be identical, they would not have included the "scope of agency *or employment*" language. The Court construes Rule 801(d)(2)(D)'s language so that no clause is superfluous. Further, defendants' arguments seem to be addressing Rule 801(d)(2)(C), which requires that a statement be "by a person authorized by him to make a statement concerning the subject," rather than Rule 801(d)(2)(D), which does not.

Hueman's statements were made within the scope of his employment. Hueman, as Division General Manager, was responsible for ensuring that the sales people in forty-nine to one hundred branches in the Southwest Division received sales training. To accomplish that task, he visited branches and spoke to the sales force in those branches about training. Hueman's statements in the video are about sales training. Accordingly, Hueman's statements in the video are admissible under Rule 801(d)(2)(D).

Pursuant to Rule 403, "a trial judge can exclude admission evidence if its probative value is substantially outweighed by the danger of unfair prejudice." *Aliotta*, 315 F.3d at 763. Plaintiffs offer the video to prove that Household management, *e.g.*, Detelich, was aware that its senior sales managers, and the loan officers who reported them, used inappropriate and illegal sales techniques. This evidence is probative as to the scienter element of the securities fraud claim. While it is true that Hueman discusses trapping customers and analogizes sales methods to fishing, the danger of unfair prejudice does not substantially outweigh the clear probative value of this admission. The fishing and trapping language is simply not inflammatory such that it will induce the jury to decide this case on an emotional basis. It is up to defendants how they will use their allotted trial hours and whether they will opt to show the two-hour video in its entirety. In sum, the Court denies defendants' motion to bar the Hueman video.

J. Deposition of Former State Regulator Charles Cross in *Luna* Litigation

Defendants move to bar plaintiffs from introducing into evidence the deposition of Charles Cross taken in the *Luna* litigation, a consumer fraud case filed in Washington. Defendants' *Daubert* motion as to Cross as well as Catherine Ghiglieri will be addressed in a separate order. Plaintiffs represent that they do not intend to offer the deposition into evidence through anyone except Ghiglieri, who wrote a report before Cross was deposed in this instant case and her report cites to and in some cases quotes from Cross' deposition in the *Luna* case.

STATEMENT

Defendants argue that the probative value of Cross' testimony is outweighed by unfair prejudice, waste of time and confusion. The Court disagrees. Cross' deposition testimony in *Luna* is clearly probative of scienter and tends to establish that: (1) Household was aware of a pattern of deceptive lending practices, not only at the Bellingham WA branch, but at other Household branches as well; and (2) despite that awareness Household instituted no controls in the field to prevent it from occurring. Defendants argue that because Cross is a government official, the jury will assume that his opinions and facts have the status of adjudicated facts. However, defendants are free to cross-examine Cross as to his qualifications, bias, as well as the nature and limits of regulatory investigations, to eliminate any jury confusion. Household was a party in the *Luna* litigation and was represented when the Cross deposition was taken in those proceedings. Household's litigation interests and objectives with respect to Cross' testimony were the same then, as they are now. Thus, Household has not been, in any way, deprived of the opportunity to challenge Cross' testimony. Household has, in fact, extensively utilized the *Luna* deposition in its cross examination of Cross in this case. Defendants have failed to establish that Cross' deposition testimony will be unfairly prejudicial. Further, although defendants argue that Cross' deposition testimony would be a waste of time, the Court holds that it will aid the jury in determining an element in plaintiffs' case, not a collateral matter, and thus will not be a waste of time. The Court denies defendants' motion to bar plaintiffs from introducing into evidence the deposition of Charles Cross taken in the *Luna* litigation.

K. Memoranda and Testimony Relating to Andrew Kahr

Pursuant to Rule 403, defendants seek to bar any reference to consultant Andrew Kahr and his suggestions to Household's senior executives to accelerate growth of Household's U.S. Consumer Finance division because plaintiffs offer no proof that his suggestions were ever implemented. Defendants thus argue that Kahr's suggestions have no probative value. Because Kahr was Household's agent for the purpose of creating these initiatives and implementing them, Kahr's statements are admissions by a party-opponent.

Defendants' evidence that they never implemented Kahr's suggestions is equivocal at best. For instance, defendant Gary Gilmer stated: "I don't know of any suggestion made by Kahr that was ever implemented. I could be wrong and it could be possible. But I don't know of one." (Defs.' Kavaler Decl. Ex. 10, Gilmer Dep. at 56.) Further, Paul Creatura, Gilmer's assistant, stated: "A number of these initiatives, which I believe came out of a brainstorming session–in fact, I don't remember if any of them moved forward, quite honestly, because it was felt that it was not consistent with the Compliance and/or Legal guidelines or rules that the company had in place at that time." Creatura's failure to recall is not a denial that the initiatives were implemented. (*Id.* Ex. 6, Creatura Dep. at 32-33.) When asked which initiatives were actually implemented, Creatura responded: "I don't believe any were implemented as described here." Creatura's statement is not an unqualified denial that the initiatives were implemented in some recognizable form. With regard to Kahr's suggestions, Tom Detelich, then managing director of Beneficial Sales for Household Finance Corp., stated that "It goes from the general–you know–ten ideas that were fairly broad, you know, looked interesting, and as they spawned thinking and revisions of what that might mean, is there really indeed anything interesting here. It evolved over time." (*Id.* Ex. 9, Detelich Dep. at 195.) Detelich's statement is not a denial that Kahr's suggestions were never implemented, and to the contrary, implies that at least some of Kahr's suggestions evolved into Household policy.

Plaintiffs point to admissions by Household that some of Kahr's suggestions were, in fact, implemented by Household. In a January 18, 1999 memorandum to Bill Aldinger, Gilmer stated: "[A] number of 'out of the box' initiatives developed by our people in conjunction with Andrew Kahr and Mercer are being implemented." (Defs.' App. A, Ex. K-5, Mem. of 1/18/99 from Gilmer to Aldinger HHS

02904322.) Detelich testified with regard to Kahr's initiatives that "[we] rejected many, and implemented some." (Pl.'s Opp'n Defs.' Omnibus Mot. Limine, Ex. 41, Detelich Dep. at 189.)

Based on these admissions, the Court holds that there is sufficient evidence froim which a reasonalbe juror might conclude that some of Kahr's suggestions became Household's policies such that some of his suggestions (in either original or "evolved" form) are probative of Household's policies during the class period. In addition, Household paid Kahr millions of dollars to create and implement his growth strategies and thus all of his growth strategies are probative of Household's eagerness to accelerate growth which, in turn, plaintiffs allege was a motivating factor behind the emergence of deceptive and abusive lending practices. In short, Kahr's suggested methodologies are evidence from which a reasonable jury could infer Household's intent to engage in predatory lending. The Court denies defendants' motion to bar references to Andrew Kahr.

L. "Project Whiskey" Due Diligence and Related Documents

Defendants move to preclude plaintiffs from making any references to "Project Whiskey," the code name given to a proposed merger explored by Household and Wells Fargo in 2002, including internal Household communications documenting the process of the merger talks as well as documents prepared by Wells Fargo and Household's adviser Goldman Sachs relating to the merger negotiations. Defendants argue that the opinions expressed by the Wells Fargo due diligence teams are hearsay and that the Project Whiskey materials' probative value is substantially outweighed by the risk of prejudice and confusion.

The record before the Court shows that Wells Fargo had concerns about the differences between its own reaging policies and those of Household and this concern caused the merger to fail. Wells Fargo's due diligence team stated: "Unfortunately our investigation revealed some major systemic issues in Blazer's [code name for Household] policies and procedures. To say the least, Blazer's write-off, expense deferral and reaging policies were aggressive. These issues appear to be pervasive in the businesses we reviewed." (Pl.'s Opp'n Defs.' Omnibus Mot. Limine, Ex. 44, WFF Due Diligence Blazer Executive Summary WF 00220.) In addition, with regard to Household's consumer lending divisions, Wells Fargo observed that Household's "[a]ccounting policies significantly overstate earnings." (*Id.* WF 00221.) It is undisputed that Household's senior management, including defendants Aldinger and Schoenholz, participated in Project Whiskey discussions and provided Wells Fargo with Household's financial information that formed the basis of Wells Fargo's conclusions.

Plaintiffs argue that they seek to introduce this evidence, not to prove the truth of the matter asserted, but to prove defendants' scienter during the Class Period, *i.e.*, they knew that another sub-prime lender believed that defendants' aggressive reaging policies overstated earnings but did nothing to disclose their policies. Plaintiffs seek to prove that Household was acutely aware that its aggressive reaging policies violated acceptable industry standards because it was the primary reason why Wells Fargo kiboshed the merger. (*See id.*, Ex. 53, May Dep. at 44.) The Court disagrees. The report with the above observations and conclusion is relevant to show Household's failure to disclose their policies is only relevant if the policies were in fact misleading or deceptive. The report's conclusions go directly to this issue and as such are being offered to prove the truth of the matter asserted as well as, once that is established, Household's knowing failure to disclose that its reporting methods were deceptive and/or misleading. To allow the hearsay report into evidence for proof only one of these intertwined concepts would be unduly prejudicial and also unnecessary, as there is no assertion that the witnesses with first hand knowledge of what Wells Fargo due diligence investigators found are somehow unavailable.

STATEMENT

In addition, the Project Whiskey materials include an admission by Household's Managing Director and Chief Credit Officer Paul Makowski, who stated the following in an email to Aldinger and Schoenholz dated June 19, 2002:

Based on feedback I received from Whiskey [code name for Wells Fargo], I believe they focused on the loans that have been reaged three or more times. These loans are the portion of our portofolio [sic] that is non-compliant with FFIEC reage criteria, which cap reages at two every five years. From the data they received, they calculated correctly that these loans totaled $3.1 billion in 12/01 and $3.4 billion in 03/02. They may have extrapolated this trend and concluded that the total would be $4 billion to $5 billion by year end.

(*Id.*, Ex. 46, Email from Makowski to Aldinger & Schoenholz of 6/19/02 HHS 02914861.) This evidence is probative of the fact that Household was aware that Wells Fargo's calculations as to the total loans as of December 2001 and March 2002 were accurate with regard to reaged loans. Whether Wells Fargo's extrapolation was inaccurate goes to the weight, not the admissibility of this admission. It also is an admission as to knowledge of non-compliance with FFIEC criteria.

The Court holds that the above admissions by Household's officers regarding Project Whiskey materials are highly probative of scienter. Further, the materials are not unfairly prejudicial. Similarly any testimony regarding what Wells Fargo due diligence investigators observed regarding Household's reaging policies or practices, if otherwise admissble, is allowed. Furthermore, opinoins of qualified Wells Fargo due diligence investigators regarding Household's reaging policies based upon what they observed in their due diligence investigations are also admissible. Defendants are free to argue their theory to the jury that the proposed merger failed due to other reasons or that Household had no duty to comply with FFIEC reaging criteria and thus had no duty to disclose its noncompliant reaging policies. The Court is confident that the parties will be able to explain the proposed merger and the associated financial concerns in an expedient manner during trial such that defendants' concerns regarding the time-consuming presentation of complex financial, operational, regulatory and accounting issues will be minimized. The Court denies defendants' motion to bar references to the Project Whiskey materials.

M. References to Privilege Concerning the Ernst & Young Compliance Engagement

Defendants move to bar plaintiffs from introducing, referring to or inviting the jury to draw negative inferences about the substance of, Ernst and Young ("E&Y") documents relating to the E&Y Compliance Engagement that defendants withheld from production and that the Court held were subject to the attorney-client privilege. (*See* Mem. Op. & Order of 12/6/06 (Nolan, M.J.); Minute Order of 2/1/07 (Guzman, J.); Minute Order of 2//27/07 (Nolan, M.J.); Minute order of 3/12/07 (Nolan, M.J.); Minute Order of 4/9/07 (Guzman, J.); Minute Order of 4/12/07 (Nolan, M.J.).) Defendants note that they do not intend to rely on these documents at trial.

Although "mere reference to the fact that a conversation between attorney and client occurred is not privileged," *Beraha v. Baxter Healthcare Corp.*, No. 88 C 9898, 1994 WL 494654, at *3 (Sept. 6, 1994), "[n]o adverse inference may be drawn as a matter of law from the legitimate assertion of the attorney-client privilege," *Ardito v. Johnson & Johnson*, No. 4-81-922, 1985 WL 2461, at *5 (D. Minn. July 22, 1985). "This is so, irrespective of the nature of the proceedings in which the claim is made, since every conscientious lawyer is duty-bound to raise the claim in any proceeding in order to protect communications made in confidence." *A.B. Dick Co. v. Marr*, 95 F. Supp. 83, 101 (S.D.N.Y. 1950).

"There is precedent for the drawing of adverse inferences in circumstances other than those involving

attorney-client relationships; for example when a party's refusal to testify or produce evidence in civil suits creates a presumption of an intent to withhold damaging information that is material to the litigation." *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 383 F.3d 1337, 1345 (Fed. Cir. 2004). "However, the courts have declined to impose adverse inferences on invocation of the attorney-client privilege." *Id.* (citing *Nabisco, Inc. v. PF Brands, Inc.*, 191 F.3d 208, 225-26 (2nd Cir. 1999), *overruled on other grounds sub nom. Moseley v. Secret Catalogue, Inc.*, 537 U.S. 418, 434 (2003); *Parker v. Prudential Ins. Co. of Am.*, 900 F.2d 772, 775 (4th Cir. 1990)).

Plaintiffs intend to argue that the privilege was asserted by defendants as to all documents that would assist plaintiffs in determining the amounts refunded beyond those refunds included in the $464 million settlement with the state attorneys general. Plaintiffs may not speculate or invite the jury to speculate as to what privileged documents would have revealed had they not been deemed privileged and withheld on that basis. Permitting an inference that the documents are adverse to Household merely due to its invocation of the privilege erodes the attorney-client relationship and thwarts open and honest communication between attorneys' agents and clients.

Accordingly, the Court grants defendants' motion. Plaintiffs are precluded from: (1) 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 the grounds of privilege; and (2) drawing, or attempting to induce the jury to draw, any negative inferences either about the substance of any E&Y privileged documents or about defendants' successful invocation of privilege as to such documents.

N. Restatement

Pursuant to Rule 402, defendants move to bar plaintiffs from introducing Household's August 14, 2002 restatement of earnings for the prior eight years, reducing its reported net income by $386 million (out of more than $8.1 billion) for the eight-year period, to establish that defendants acted with the requisite scienter. As a basis for this motion, defendants do not take issue with plaintiffs' use of the August 14, 2002 restatement to establish materiality of the misstatement.

"Restatements of earnings are common . . . only intentional misstatements violate Section 10(b) and Rule 10b-5." *Goldberg v. Household Bank, F.S.B.*, 890 F.2d 965, 979 (7th Cir. 1989). "While it is true that the mere fact that a company's financial reporting was inaccurate does not establish scienter, the magnitude of reporting errors may lend weight to allegations of recklessness where defendants were in a position to detect errors. The more serious the error, the less believable are defendants' protests that they were completely unaware of [the company's] true financial status and the stronger is the inference that defendants must have known about the discrepancy." *Rehm v. Eagle Fin. Corp.*, 954 F. Supp. 1246, 1256 (N.D. Ill. 1997).

Plaintiffs state that they do not intend to rely solely on the restatement itself to establish scienter and will introduce a number of red flags that should have put defendants on notice that they had overstated Household's earnings during the Class Period. It is yet to be seen whether this evidence will be sufficient in combination with the restatement to permit an inference as to scienter. The Court holds that barring this evidence at this point would be premature. Accordingly, the Court denies without prejudice defendants' motion to bar plaintiffs from introducing or referring to Household's August 14, 2002 restatement of earnings to establish scienter.

STATEMENT

Conclusion

In sum, the Court grants in part and denies in part defendants' omnibus motion in limine to exclude or limit fourteen categories of evidence. In particular, the Court: (A) grants the motion to bar references to its Offer of Settlement and SEC Consent Decree, grants in part and denies in part the motion as to documents in Def.'s Ex. A, Tab A and denies the motion as to Household's amendment of its 2001 Form 10-K; (B) denies defendants' motion to bar plaintiffs from introducing federal and state regulators' reports of examination and related documents; (C) denies the motion to bar plaintiffs from making any references to complaints filed in other litigation involving defendants during the Class Period of July 30, 1999 to October 11, 2002; (D) grants in part and denies in part defendants' motion to bar plaintiffs from making any references to its settlements in civil lawsuits and regulatory agency actions and orders the parties meet, confer and jointly submit the information sufficient to identify the date, time, means and nature of the pertinent disclosures to the Court no later than four days prior to the beginning of voir dire; (E) grants in part and denies in part defendants' motion to preclude plaintiffs from introducing evidence of, or referring to, Household's settlement-related refunds and policies; (F) grants in part and denies in part defendants' motion to preclude plaintiffs from making any references to settlement-related policy changes; (G) denies defendants' motion to bar the individual customer complaints; (H) grants in part and denies in part defendants' motion to bar Markell's testimony; (I) denies defendants' motion to bar the Hueman video; (J) denies defendants' motion to bar plaintiffs from introducing into evidence the deposition of Charles Cross taken in the *Luna* litigation; (K) denies defendants' motion to bar references to Andrew Kahr; (L) denies defendants' motion to bar references to the Project Whiskey materials; (M) grants the motion to bar plaintiffs from introducing, referring to or inviting the jury to draw negative inferences about the substance of, E&Y documents relating to the E&Y Compliance Engagement that defendants withheld from production and that the Court held were subject to the attorney-client privilege; and (N) denies without prejudice defendants' motion to bar plaintiffs from introducing or referring to Household's August 14, 2002 restatement of earnings to establish scienter.