

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

LAWRENCE E. JAFFE PENSION PLAN, On) Behalf of Itself and All Others Similarly) Situating,) Plaintiff,) vs.) HOUSEHOLD INTERNATIONAL, INC., et) al.,) Defendants.) _____))	Lead Case No. 02-C-5893 (Consolidated) <u>CLASS ACTION</u> Honorable Jorge L. Alonso
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**PLAINTIFFS' OPPOSITION TO THE INDIVIDUAL DEFENDANTS' MOTION IN
LIMINE TO BAR EVIDENCE REGARDING THEIR FINANCIAL CONDITION**

I. INTRODUCTION

The Individual Defendants' Motion *in Limine* seeks to bar plaintiffs from (1) introducing 13 exhibits; and (2) making any argument or eliciting any testimony about the Individual Defendants' financial condition, including their personal wealth, income, compensation, assets, stock options or benefits. Dkt. No. 2132. Defendants' Motion *in Limine* should be denied for a number of reasons. First, some of the documents (PX772 and PX774) contain peer groups that Household compared itself to when determining the compensation of the Individual Defendants. The proper peer group to use in a loss causation analysis is a disputed issue by the experts in this case. The peer group that Household used is clearly relevant to this issue. These and another document (PX773) also set forth how Household was compensating the Individual Defendants based on reaching certain financial targets which is also relevant to loss causation.

Second, these documents and the Individual Defendants' trading records (Form 4s and a Form 5) are also relevant to the issue of proportionate liability. The financial targets included metrics directly impacted by re-aging, predatory lending and the restatement. The Individual Defendants met these targets, which were used to determine defendants' compensation, by engaging in the fraud. As such, these exhibits show the relative gains by the Individual Defendants from the fraud and their respective conduct in manipulating Household's business to meet financial targets and selling Household stock at inflated prices. Similarly, the internal Household calculation of the golden parachute payouts to the Individual Defendants for the proposed sale of Household to Wells Fargo (PX1038) is also relevant to the issue of proportionate liability. Finally, these exhibits were admitted at the last trial and are inextricably intertwined with the loss causation issues that the jury must determine at the re-trial. Although these documents may show the determination of annual income, bonuses and stock sales, they are not unfairly prejudicial – any more than other evidence of defendants' fraudulent conduct.

II. ARGUMENT

The documents defendants seek to preclude are relevant under FRE 401 to proportionate liability, loss causation and damages. The documents also are not prejudicial under FRE 403. In

fact, seven of the 13 exhibits that defendants now challenge are *their own* exhibits, which were received in evidence at the first trial (D0758, D0759, D0763, D0774, D0775, D0796, and D0797). Defendants made no objections to any of the exhibits (described below) at the first trial.¹ See Exhibit D-1 to 2009 Pretrial Order (Dkt. No. 1545).

As an initial matter, in reaching a verdict with respect to whether Professor Fischel has properly accounted for the effect of non-fraud company specific information, the jurors need to be educated about Household, the underlying fraud, and the reasons why defendants' statements were false or misleading. And, in order to assess the proportionate fault of each defendant, the jury requires an understanding of the nature of the fraudulent conduct and each defendant's role in the fraud. Thus, even if the exhibits defendants seek to preclude were not tied directly to loss causation and proportionate liability, they would be admissible. As the Seventh Circuit stated in *Watts v. Laurent*, 774 F.2d 168 (7th Cir. 1985) on remand for a retrial on damages, "the parties shall have an opportunity to present to the second jury whatever evidence (through testimony, in summary form or as the district court shall permit) from the liability phase of the trial may be regarded as relevant in any way to the question of damages . . . [t]he trial judge *shall apply a broad standard* with respect to the relevance of this sort of evidence and there *shall be a strong presumption* that evidence from the liability phase may be relevant in some way to damages." *Id.* at 181 (emphasis added). Defendants' motion falls short of rebutting that "strong presumption."

A. Compensation Documents

Plaintiffs' PX774 (Household Compensation Committee Meeting, January 28, 2002) and PX772 (Household Compensation Committee Meeting, September 10, 2002) are relevant to loss causation, damages and proportionate liability. Both of these documents show the peer companies that Household used when deciding how to compensate the Individual Defendants and other top executives. Defendants' new experts question whether Professor Fischel has used the correct "peer" index in his loss causation analysis. In conducting a regression analysis for loss causation purposes,

¹ The lone exhibit not offered at the last trial was PX1476 (Aldinger's SEC deposition transcript), which was marked and properly used for impeachment purposes during his trial testimony.

an expert will use both a market variable (such as the S&P 500) and an industry or peer variable (such as the S&P Financials) to exclude market and industry factors from any of the Company's stock price declines. *See* Report of Daniel R. Fischel dated August 15, 2007, ¶¶31-33 (Dkt. No. 2067-3). For the peer group, Professor Fischel selected the S&P Financials Index, a group of large companies that Household compared itself to in its public SEC filings. *Id.*, ¶29 n.10. Defendants' experts claim that Fischel has used the wrong peer index. One of their experts (Ferrell) created his own index from nine companies listed in a single analyst report. *See* Expert Report of Professor Allen Ferrell, ¶42 (Dkt. No. 2060-3). Those companies are much different from the companies that Household compared itself to in its own internal documents, including PX772 and PX774. Defendants' other expert (James) initially opined that Household should be compared to the four companies in the consumer finance subsector of the S&P Financial Index. *See* Expert Report of Professor Christopher M. James, ¶21 and Ex. 4 n.3 (Dkt. No. 2060-4). After Professor Fischel demonstrated that using James' peer group would actually increase damages, Professor James changed his opinion and now opines that four credit card companies and one auto finance company – all much smaller than Household and not representative of Household's overall business – comprise Household's proper peer group. *See* Expert Rebuttal Report of Christopher M. James, ¶13 n.22 (Dkt. No. 2074-4).

None of the peer groups selected by defendants' experts were actually used or identified by Household as peers. In addition to the S&P Financials, Household's internal investor relations report compared itself to nine companies that were included in the S&P Financials, and were mainly large, diversified financial companies, including large banks. *See* PX198 at 6 (listing Citigroup, Wells Fargo, U.S. Bancorp, Bank One and others). In compensating defendants Aldinger, Schoenholz and Gilmer, Household publicly disclosed in its yearly Proxy Statements that it compared itself to "12 companies, all in the S&P Financials Index." *See* PX1275 at 26 (April 9, 2002 Proxy). The 2002 Proxy did not identify these 12 companies by name, but the internal Household compensation documents defendants seek to preclude actually list them. PX774 includes an analysis by Household's compensation consultants that identifies 12 peer companies – including

Citigroup, Wells Fargo, U.S. Bancorp, Bank One, Bank of America, American Express and JP Morgan. *See* PX774 at HHS 03174133. Similarly, PX772, which was created in September 2002, lists those same companies, among others. *See* PX772 at HHS03173755 and 03173774. In sum, these compensation documents, like the Household investor relations documents, are relevant to show the large financial companies Household believed were its peers, which are very different from the peer groups created by defendants' experts. In fact, in responding to Bajaj's six-company peer group, Fischel testified at the first trial that in the Proxy Statements, investor relations reports and the compensation documents defendants seek to exclude, Household compared itself to peers that were "large well-capitalized firms." Tr. 4277:10-4278:25.² These documents are clearly related to the issue of loss causation.

Furthermore, as part of compensating the Individual Defendants and other top executives, Household compared the company's actual performance to its financial plan. PX774 shows how Household met its targets for net income, earnings per share, receivable (loan) growth, revenue growth and reserves to charge-offs, which were some of the metrics used to calculate the 2001 Bonus Pool. PX774 at HHS03174113-114. Defendants' misstatements about predatory lending, re-aging and their financial results are all related to these financial targets. As a result, this document is clearly relevant to proportionate liability since it relates to the conduct of the Individual Defendants, their motivation for committing fraud, and the rewards that they reaped. Each Individual Defendant's motive to commit fraud is relevant to his respective proportionate liability (and not limited just to scienter as defendants argue). Similarly, PX773 is a document supporting proposed salary increases for Household executives in mid-2002. It shows that Household met its Q2 2002 targets by meeting the same type of financial goals, as those set forth in PX774.³ *See* PX773 at HHS03173897. At the first trial, plaintiffs demonstrated that Household and the Individual

² Relevant excerpts from the 2009 Trial Transcript are attached as Ex. 1 to the Declaration of Luke O. Brooks in Support of Plaintiffs' Oppositions to Defendants' Motions *in Limine*, filed herewith.

³ For example, Schoenholz specifically suspended certain reaging policy changes to make certain that the Q2 forecast was met, stating: "I'm not willing to run the risk that we blow our second quarter forecast." PX1117.

Defendants met financial targets through predatory lending, re-aging practices and falsifying the company's financial results. *See, e.g., United States v. Kaiser*, 609 F.3d 556, 561 (2d Cir. 2010) (providing necessary background by stating that defendant had "a powerful motive" "to inflate" income figures because he "only received bonuses when [the company] met these targets," and that schemes implemented by defendant "resulted in" inflated income figures).

It was this inflation that was removed when the truth started coming out. For example, in late 2001 and 2002, market analysts questioned whether Household was manipulating its numbers through its re-aging practices. *See e.g.,* Barron's article (PX1409); Legg Mason December 11, 2001 Report (PX1410); CFRA June 7, 2002 Report (PX515); April 10, 2002 Prudential Report (PX1401). Plaintiffs are entitled to use internal Household evidence of re-aging manipulation, even if it includes evidence of the Individual Defendants' compensation, to demonstrate the link between re-aging, the benefits defendants received as a result, and the subsequent stock price decline.

PX1038 is a Household internal document, which shows the cash distributions and parachute payouts that the Individual Defendants would receive, if the proposed sale of Household to Wells Fargo was completed in May 2002. This document is relevant to loss causation because it reflects what Wells Fargo believed Household's stock was worth and the Individual Defendants' incentive to maintain the artificial inflation in Household's stock price during this time frame by making false statements. PX1038 is also relevant to the issue of proportionate liability because it relates to the respective benefit each defendant would obtain from manipulating Household's re-aging statistics.

The Form 4's and a Form 5 of the Individual Defendants (Defendants' Exs. 758, 759, 763, 774, 775, 796, 797) are exhibits that show the Individual Defendants' stock acquisitions and sales.⁴ These documents are relevant to the issue of loss causation because they demonstrate that Household's stock was artificially inflated at the time defendants sold stock in order to reap the

⁴ Although certain Form 4 and Form 5 exhibits pre-date March 23, 2001, they remain relevant to demonstrate that defendants exercised options to acquire shares that they later sold at market prices.

benefits of their fraud. Again, defendants' Class Period sales are relevant to the benefits each defendant received and thus, are relevant to the issue of proportionate liability.⁵

Finally, in determining loss causation, the jury will be instructed that defendants made false statements; that the false statements were material; and that the false statements were made knowingly or recklessly. That said, if the new jury does not hear the evidence from the first trial as to defendants' motivation – does not hear why defendants lied – the jury cannot understand the case. For example, as the first jury learned, defendants lied about predatory lending, falsified financials and hid their reaging practices because they wanted to cash out – whether through their compensation that was directly tied to Household's financial success, their stock sales, or through an acquisition by Wells Fargo that would net the Individual Defendants in excess of \$100 million. The new jury should be equipped with this motive evidence to better understand that defendants fought to affirmatively deceive the markets, denied predatory lending allegations and misled the investing

⁵ Defendants cite cases for the assertion that “[e]vidence of a party’s wealth is generally inadmissible” on relevancy grounds. Defs’ Mem. at 2 (Dkt. No. 2132). Yet, plaintiffs’ documents do not seek to show defendants’ wealth or net worth. In one case cited, the court merely held that “references to [the particular] [d]efendant’s financial status generally w[ould] not be permitted because it is irrelevant,” while the court **granted** the defendant permission to refer to part of its financial condition with limiting instructions. See *Mountain Funding, Inc. v. Frontier Ins. Co.*, No. 01 C 2785, 2004 WL 868366, at *3 (N.D. Ill. Apr. 22, 2004). Defendants also cite to cases involving evidence regarding a party’s **general** “financial status” or “net worth,” which is not the type of evidence plaintiffs intend to offer here. See *Rush Univ. Med. Ctr. v. Minnesota Mining & Mfg. Co.*, No. 04 C 6878, 2009 WL 3229435, at *3 (N.D. Ill. Oct. 1, 2009) (evidence offered was a party’s “general financial stress”); *Koblosh v. Adelsick*, No. 95 C 5209, 1997 WL 311956, at *1 (N.D. Ill. June 5, 1997) (regarding “evidence of financial status”); *El-Bakly v. Autozone, Inc.*, 04 C 2767, 2008 WL 1774962, at *4 (N.D. Ill. Apr. 16, 2008) (plaintiff offered “financial information related to [the defendant’s] profits and net worth”). The cases defendants cite regarding “unfair prejudice” merely stand for the proposition that counsel may not make egregiously improper comments repeatedly during a trial, and these cases have little to no bearing on the admissibility of trial exhibits. See *Adams Labs., Inc. v. Jacobs Eng’g Co.*, 761 F.2d 1218, 1224-25 (7th Cir. 1985) (counsel violated three separate orders from the court regarding proper argument); *Draper v. Airco, Inc.*, 580 F.2d 91, 95 (3d Cir. 1978) (noting that references to defendants’ wealth “would not require reversal if counsel had not gone beyond the brink of rational argument in other aspects”); *Garcia v. Sam Tanksley Trucking, Inc.*, 708 F.2d 519, 522 (10th Cir. 1983) (finding an “absence of prejudice” because the court found no “other errors . . . to compound the improper remarks”); *Koufakis v. Carvel*, 425 F.2d 892, 904 (2d Cir. 1970) (finding that counsel “persistently and continuously abused the freedom afforded counsel”). Defendants also rely on cases in which the financial evidence was offered as relevant to punitive damages, not an issue in this case. See *Koblosh*, 1997 WL 311956, at *1 (proponent of the evidence argued that “there [was] a possibility of punitive damages in [the] case, and evidence of financial status is admissible to determine punitive damages”); *El-Bakly*, 2008 WL 1774962, at *5 (finding the defendants’ “financial information” was relevant and could be considered if the plaintiff “succeed[ed] in making a showing that he ha[d] a colorable claim for punitive damages”). In contrast, plaintiffs here intend to use these exhibits for entirely different purposes.

public about their reaging practices, so that fraud-related information – often denied by defendants – leaked into the market between November 15, 2001 and October 11, 2002. In other words, defendants, acting because of their financial motives, failed to make honest disclosures, kept the stock price artificially inflated and fought to conceal the truth, which slowly leaked out over time despite their efforts.

In short, defendants’ motives, as demonstrated by this evidence, are inextricably intertwined with the loss causation evidence. The jury should not determine loss causation in a vacuum. Defendants’ motives are part and parcel of the fraud and the slow revelation of that fraud over an eleventh month period in 2001-2002. *See United States v. Senffner*, 280 F.3d 755, 765-66 (7th Cir. 2002) (“His acts were a prelude to the particular crime for which he was charged and were a pattern of conduct in a prolonged (but singular) investment fraud scheme.”). The defendants’ action and the motive evidence “complete the story of the crime on trial; their absence would create a chronological or conceptual void in the story of the crime.” *Id.* at 764. It is for this reason that courts in similar situations have often held that a causation or damages jury should have access to liability evidence from the first trial. *Watts*, 774 F.2d at 181.

III. CONCLUSION

For the reasons set forth above, Individual Defendants’ motion *in limine* should be denied.

DATED: May 6, 2016

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 6, 2016, I authorized the electronic filing of the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses for counsel of record denoted on the attached Service List.

I certify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on May 6, 2016.

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