**UNITED STATES DISTRICT COURT**

**NORTHERN DISTRICT OF ILLINOIS**

**EASTERN DIVISION**

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

**LEAD PLAINTIFFS' MOTION AND MEMORANDUM REQUESTING EVIDENTIARY SANCTIONS FOR HOUSEHOLD DEFENDANTS' DESTRUCTION OF EVIDENCE**

**(REDACTED VERSION)**

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## I. PRELIMINARY STATEMENT

This securities fraud class action was filed on August 19, 2002. Even before this lawsuit was instituted, Household International, Inc. ("Household" or the "Company") and the Individual Defendants were on notice of their duty to preserve potentially relevant documents relating to Household's sales practices because of pending as well as anticipated litigation.[1] Yet, defendants not only stood passively by as crucial documents were destroyed, both prior to and after the initiation of this lawsuit, they affirmatively ordered the destruction of documents on multiple occasions that defendants know and admit were *prima facie* evidence of illegal conduct. Defendants' excuse for their destruction of evidence is that they were eliminating "unauthorized" documents. However, as detailed below, defendants' spoliation of evidence was actually designed to dispose of the documents that exposed them to liability.

By asserting work product protection as grounds for withholding documents in this litigation, defendants have conceded that by March 12, 2001, they anticipated litigation in connection with the Company's lending practices. These documents concern defendants' failed negotiations with the community-based organization Association of Community Organizations for Reform Now ("ACORN")[2] regarding borrower complaints about Household's sales practices, including practices relating to misrepresentations regarding interest rates and loan terms, sales of single premium credit

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[1] Household Chief Executive Officer ("CEO") William F. Aldinger, Chief Financial Officer ("CFO") David A. Schoenholz, CEO of Household's Consumer Lending business unit Gary D. Gilmer and the CFO of Household's Consumer Lending business unit Joseph A. Vozar are the Individual Defendants named in the complaint.

[2] ACORN describes itself as the nation's largest grassroots community organization of low- and moderate-income people. ACORN was founded in 1970 and currently has over 400,000 member families organized into more than 1,200 neighborhood chapters in 110 cities across the country. The members of ACORN take on issues of relevance to their communities, including issues relating to discrimination, affordable housing, a quality education, or better public services. *See* www.acorn.org.

insurance, prepayment penalties and other deceptive practices that made loans to borrowers without regard to their ability to repay such loans. [redacted] This alone required the defendants to immediately institute a litigation hold to preserve all relevant and potentially relevant documents relating to the Company's lending practices.

By May 2001, the states of Washington and Minnesota had launched investigations into Household's branch sales practices in response to an unusually high number of customer complaints. Additionally, ACORN was urging other state regulators to do the same. These state investigations also triggered the Company's duty to preserve documents. At the same time, defendants had been receiving customer complaints relating to the Company's "effective rate" sales pitch. Some of these customers brought individual lawsuits. Defendant Gilmer and Consumer Lending General Counsel Kathleen "Kay" Curtin were informed of regulatory, Attorney General ("AG") and Better Business Bureau ("BBB") complaints where the borrower was quoted or promised a lower "effective rate." *See* Ex. 48 [redacted] These complaints were from Household branches all across the country.[3]

In response to this mounting regulatory and litigation pressure, beginning May 24, 2001, Household sales management, with approval from defendant Gilmer and counsel Kay Curtin, began

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[3] Household conducted its consumer lending operations through a branch network comprised of 1,400 branches. The branch network consisted of branches under the brand names Household Finance Corporation ("HFC") and Beneficial Finance Corporation ("BFC"). Robert O'Han was the Regional Sales Manager ("RGM") for the approximately 500 HFC branches, and Mike Eden (BFC Eastern Region) and Ned Hennigan (BFC Western Region) oversaw the 900 or so BFC branches.

[redacted] Exs. 43-44. The "effective rate" sales pitch involved Household sales employees, falsely claiming that if a customer paid his or her mortgage bi-weekly (rather than once a month), their "effective interest rate" would be much lower, *i.e.*, 7% or 8% rather than the actual 13% or 14% interest rate. ¶¶52(a), 55-60.[4] Several former Household sales employees, including the District Sales Managers ("DSM"), Branch Sales Managers ("BSM") and Account Executives ("AEs") stated under penalty of perjury that until they received orders to destroy the "effective rate" sales presentations, not only was this sales pitch encouraged, it was mandated.[5] *See generally* Exs. 93-99.[6] Indeed, Household's computer system – Vision – was programmed to print two amortization schedules with "effective rate" on it already. Ex. 96, ¶6; Ex. 99, ¶6; Ex. 98, ¶10.

[redacted]

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[4] All paragraph references herein ("¶__" or "¶¶__") are to the [Corrected] Amended Consolidated Class Action Complaint for Violation of the Federal Securities Laws, filed on March 13, 2003.

[5] The HFC and BFC sales offices were each run by a BSM. The offices were organized geographically into districts, each of which was run by the DSM. Each DSM reported to a Division General Manager ("DGM"), who in turn reported to a Regional General Manager ("RGM"). During the Class Period, the RGMs, of which there were three, reported to Tom Detelich, who had overall responsibility for managing the branch office operations. During most of the Class Period, Detelich reported directly to defendant Gilmer, the head of the consumer lending business unit.

[6] The declarant, Curtis A. Howrey (Ex. 93) produced a video tape as an exhibit to his declaration, which is not currently being submitted to the Court, but will be served on defendants. If the Court wishes to have a copy, it will be provided.

[redacted] Ex. 1. [redacted]

After the June 2001 destruction, other events further emphasized defendants' duty to preserve documents. In late 2001 and early 2002, several state regulatory lawsuits and private class actions were filed alleging that Household engaged in deceptive sales practices. Exs. 18, 65-66, 68, 70-71, 77. State regulatory authorities had also issued subpoenas demanding information relating to the Company's sales practices. Despite these facts (or because of them), defendants continued to destroy incriminating documents. In April 2002, defendants implemented another round of destructions aimed at the purge of completed forms and materials evidencing the "effective rate" EZ Pay scam, including WORDPAD and computer-generated documents.

Defendants also ordered the destruction of another set of incriminating materials authored by Household's highly paid [redacted] consultant, Andrew Kahr. Mr. Kahr, the controversial founder of Providian Financial Corporation ("Providian"), had been hired by defendants Aldinger and Schoenholz to "initiate growth" at Household in 1999. Kahr wrote hundreds of memos, and the Company adopted a number of his suggestions. However, with increasing pressure from regulators and consumers, and with litigation pending against Kahr's former company Providian for deceptive practices – litigation in which Kahr's role was a key issue – Household senior management decided that it could not risk retaining evidence of Kahr's influence on the Company's policies.

On March 12, 2001, following Providian's $405 million settlement of predatory lending claims, defendant Schoenholz wrote a memo to file noting [redacted] Ex. 30. Accordingly, in order to avoid similar legal difficulties, Schoenholz instructed that [redacted]

[redacted]

*Id.* at HHS 03680480. Subsequently, on June 24, 2002, just as Household was in the midst of negotiating with a multistate group of AGs and state regulators regarding the Company's deceptive lending practices, and having received a data request from this group, defendant Schoenholz ordered another round of destruction of Kahr's incriminating memos.

Addressing the impact of spoliation of evidence, a federal court recently observed:

> Aside perhaps from perjury, no act serves to threaten the integrity of the judicial process more than the spoliation of evidence. Our adversarial process is designed to tolerate human failings – erring judges can be reversed, uncooperative counsel can be shepherded, and recalcitrant witnesses compelled to testify. But, when critical documents go missing, judges and litigants alike descend into a world of *ad hocery* and half measures – and our civil justice system suffers.

*United Med. Supply Co. v. United States*, 77 Fed. Cl. 257, 258-59 (2007). As a result of defendants' misconduct, plaintiffs are deprived of critical evidence demonstrating that the "effective rate" EZ Pay Plan and other deceptive practices were condoned by the Company and practiced nationwide. Similarly, because defendants destroyed the Kahr memos, plaintiffs have lost important evidence linking senior management to the Company's widespread abusive sales practices. Because of defendants' destruction of evidence, the law requires that the Court assume that they would have provided adverse evidence and should issue appropriate jury instructions to remedy the prejudice to plaintiffs.

Accordingly, in the interest of fairness and in order to level the playing field, plaintiffs respectfully request that the Court administer the following sanctions:

(1) a jury instruction that during the Class Period, Household engaged in a nationwide deceptive sales practice of selling loans based on the misleading sales pitch that the borrowers would pay an "effective interest rate" that was almost half the actual or contract rate;

(2) a jury instruction that during the Class Period, prepayment penalties were not affirmatively disclosed to borrowers, but were buried in loan documents "not highly visible" to customers;

(3) a jury instruction that during the Class Period, various deceptive and illegal sales practices were practiced nationwide in all Household branches;

(4) a jury instruction that defendants intentionally destroyed evidence of their deceptive and illegal branch sales practices;

(5) a jury instruction that Household senior management, including defendants Aldinger, Schoenholz, Gilmer and Vozar, knew during the Class Period that the Company was engaged in widespread deceptive and illegal branch sales practices and encouraged their use; and

(6) an order precluding defendants from cross-examining plaintiffs' expert Catherine Ghiglieri in connection with plaintiffs' proof of the above five facts.

## II. APPLICABLE LEGAL STANDARD

This Court has the inherent power to impose sanctions where necessary to prevent abuses of the judicial process and to promote the efficient administration of justice. *Barnhill v. United States*, 11 F.3d 1360, 1367 (7th Cir. 1993); *see also Chambers v. NASCO*, 501 U.S. 32, 45-46 (1991). "These powers are 'governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.'" *Chambers*, 501 U.S. at 43 (quoting *Link v. Wabash R.R. Co.*, 370 U.S. 626, 630-31 (1962)). This power includes the discretion to sanction parties for failure to preserve potential evidence that is properly discoverable. *See id.* at 45-46 (under its inherent power to control the judicial process, the Court may enter sanctions for litigation misconduct, including spoliation); *Wiginton v. CB Richard Ellis*, No. 02 C 6832, 2003 U.S. Dist. LEXIS 19128, at *11 n.5, *12-*14 (N.D. Ill. Oct. 27, 2003). "In determining whether sanctions are appropriate for spoliation, the court is guided by whether (1) there was a duty to preserve the specific documents; (2) that duty or obligation was breached; (3) there was willfulness, bad faith, or fault; (4) [plaintiff] was prejudiced; and (5) an appropriate sanction can ameliorate the prejudice from the breach." *Wells v. Berger, Newmark & Fenchel, P.C.*, No. 07 C 3061, 2008 U.S. Dist. LEXIS 21608, at *18 (N.D. Ill. Mar. 18, 2008).

Parties to a lawsuit have a duty to preserve admissible evidence as well as evidence that is discoverable because it is "reasonably calculated to lead to the discovery of admissible evidence." Fed. R. Civ. P. 26(b)(1); *APC Filtration, Inc. v. Becker*, No. 07 C 1462, 2007 U.S. Dist. LEXIS 76221, at *6-*8 (N.D. Ill. Oct. 12, 2007). Furthermore, the duty to preserve extends to "'evidence that [the party] has notice is reasonably likely to be the subject of a discovery request.'" *APC Filtration*, 2007 U.S. Dist. LEXIS 76221, at *7 (quoting *Wiginton*, 2003 U.S. Dist. LEXIS 19128, at *13). Notice need not take the form of a formal discovery request. *Wells*, 2008 U.S. Dist. LEXIS 21608, at *18-*19 (citing *Cohn v. Taco Bell Corp.*, No. 92 C 5852, 1995 U.S. Dist. LEXIS 12645, at *13-*15 (N.D. Ill. Aug. 30, 1995) (Nordberg, J.)). Notice may be received "***before*** a complaint is filed if it is known that litigation is likely to begin, or a party is alerted that certain information is likely to be sought in discovery." *Id.* (emphasis in original);[7] *see also Larson v. Bank One Corp.*, No. 00 C 2100, 2005 U.S. Dist. LEXIS 42131, at *26 (N.D. Ill. Aug. 18, 2005).

Courts all over the country agree that "[t]he duty to preserve evidence 'arises not only during litigation but also extends to the period before the litigation when a party reasonably should know that the evidence may be relevant to ***anticipated litigation***.'" *Rambus, Inc. v. Infineon Techs. AG*, 222 F.R.D. 280, 288 (E.D. Va. 2004) (emphasis in original) (quoting *Silvestri v. Gen. Motors Corp.*, 271 F.3d 583, 591 (4th Cir. 2001)); *Turner v. Hudson Transit Lines, Inc.*, 142 F.R.D. 68, 73 (S.D.N.Y. 1991) ("the obligation to preserve evidence [may] arise[] prior to the filing of a complaint where a party is on notice that litigation is likely to . . . commence[]"); *Beil v. Lakewood Eng'g & Mfg. Co.*, 15 F.3d 546 (6th Cir. 1994) (discussing various sanctions for pre-litigation destruction of evidence); *St. Cyr v. Flying J Inc.*, No. 3:06-cv-13-33TEM, 2007 U.S. Dist. LEXIS 42502, at *9 (M.D. Fla. June 12, 2007) ("the duty to preserve evidence may arise prior to commencement of

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[7] Emphasis is added and citations are omitted, unless otherwise stated.

litigation"); *Fitting v. Dell, Inc.*, No. CV 06-23-S-LMB, 2008 U.S. Dist. LEXIS 41946, at *16 (D. Idaho May 21, 2008) ("'[P]re-litigation destruction can constitute spoliation when litigation was "reasonably foreseeable" . . . .'"); *Escobar v. City of Houston*, No. 04-1945, 2007 U.S. Dist. LEXIS 72706, at *50 (S.D. Tex. Sept. 29, 2007) ("'The obligation to preserve evidence arises when the party has notice that the evidence is relevant to litigation or when a party should have known that the evidence may be relevant to future litigation.'").

Under the law of this Circuit, "contumacious conduct merits strong sanctions, and when the court uses its inherent power to root out contumacious conduct, ***no showing of willfulness, bad faith, fault or even prejudice is required***." *Large v. Mobile Tool Int'l, Inc.*, No. 1:02cv177, 2008 U.S. Dist. LEXIS 42253, at *22 (N.D. Ind. May 20, 2008) (citing *Marrocco v. Gen. Motors Corp.*, 966 F.2d 220 (7th Cir. 1992); *Langley by Langley v. Union Elec. Co.*, 107 F.3d 510 (7th Cir. 1997); *Newman v. Metro. Pier & Exposition Auth.*, 962 F.2d 589, 591 (7th Cir. 1992) ("The cases in this circuit . . . do not set up a row of artificial hoops labeled 'bad faith' and 'egregious conduct' . . . ."); *Patterson v. Coca-Cola Bottling Co.*, 852 F.2d 280, 283 (7th Cir. 1988); *Hal Commodity Cycles Mgmt. Co. v. Kirsh*, 825 F.2d 1136, 1138 (7th Cir. 1987)); *see also Cohn*, 1995 U.S. Dist. LEXIS 12645 (a finding of bad faith is not a necessary prerequisite to the imposition of sanctions).

"[T]he Seventh Circuit recognizes that, with regard to the Court's inherent authority, 'the rules do not state the limits of judicial power . . . judges retain authority, long predating the Rules of Civil Procedure.'" *Larson*, 2005 U.S. Dist. LEXIS 42131, at *26 (quoting *Langley*, 107 F.3d at 514 n.4) (citing Fed. R. Civ. P. 37(b)(2)). "Thus, when weighing sanctions in response to a party's misconduct, the Court has broad discretion to fashion an appropriate sanction." *Id.* at *27. "[Plaintiffs] must show by a preponderance of the evidence that a sanction is warranted." *Wells*, 2008 U.S. Dist. LEXIS 21608, at *17-*18; *Larson*, 2005 U.S. Dist. LEXIS 42131, at *29 (an

"'issue-related'" sanction as opposed to default judgment or dismissal with prejudice requires only a "'preponderance of the evidence"').

Plaintiffs should be granted the relief they seek. Although proof of bad faith is not necessary under the law of this Circuit, the evidence here demonstrates intentional and bad faith destruction of documents and the resulting prejudice to plaintiffs' claims. Further, the sanctions that plaintiffs seek here, relative to the conduct at issue, are modest.

## III. ARGUMENT

### A. Defendants Anticipated Litigation in May-June 2001 and Hence Breached Their Duty to Preserve Relevant Evidence by Ordering the Nationwide Destruction of Documents Related to the Company's Sales Practices in June 2001

The duty to preserve documents attaches "'when a party should have known that the evidence may be relevant to future litigation.'" *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 216 (S.D.N.Y. 2003); *see also Krumwiede v. Brighton Assocs., L.L.C.*, No. 05 C 3003, 2006 U.S. Dist. LEXIS 31669, at *22 (N.D. Ill. May 8, 2006). As noted above, "the obligation to preserve evidence may arise prior to the filing of a complaint where a party is on notice that litigation is likely to commence." *Cohn*, 1995 U.S. Dist. LEXIS 12645, at *15; *Wells*, 2008 U.S. Dist. LEXIS 21608, at *18-*19 ("Notice may be received ***before*** a complaint is filed if it is known that litigation is likely to begin, or a party is alerted that certain information is likely to be sought in discovery.") (emphasis in original). The future litigation must be "probable," which has been held to mean "more than a possibility." *Hynix Semiconductor, Inc. v. Rambus Inc.*, No. C-00-20905 RMW, 2006 U.S. Dist. LEXIS 30690, at *57 (N.D. Cal. Jan. 5, 2006).

Defendants' duty to preserve was triggered long before their intentional document destruction campaigns which began in May-June 2001 and continued into 2002. As early as September 2000, Household counsel learned of [redacted] Ex. 20 at HHS 02936416; *see, e.g., M & T Mortgage Corp. v. Miller*, No.

CV2002-5410 (NG) (MDG), 2007 WL 2403565, at *5-*13 (E.D.N.Y. Aug. 17, 2007) (allowing adverse inference as a sanction for spoliation where the duty to preserve evidence arose nearly three years before plaintiffs filed their complaint); *Keithley v. Home Store.com, Inc.*, No. C-03-04447 SI (EDL), 2008 U.S. Dist. LEXIS 61741, at *47-*52 (N.D. Cal. Aug. 12, 2008) (recommending an adverse inference instruction for spoliation of evidence where duty to preserve documents arose almost two years prior to litigation).

By asserting the work product privilege over March 2001 communications made in anticipation of that class action, defendants concede they were anticipating imminent litigation by that date, thereby triggering their duty to preserve. The work product privilege only provides protection to documents "prepared in anticipation of litigation." *See* Fed. R. Civ. P. 26(b)(3)(A).[8] Defendants' assertion of the work product privilege constitutes an admission that as of March 2001, litigation with ACORN is imminent and probable. Once litigation is anticipated, a party has a duty to preserve all potentially relevant documents. *See, e.g., Anderson v. Sotheby's Inc. Severance Plan*, No. 04 Civ. 8180 (SAS), 2005 U.S. Dist. LEXIS 23517, at *17 (S.D.N.Y. Oct. 11, 2005) (concluding that the duty to preserve documents for purposes of spoliation claim arose as of the date the plan administrator first claimed that the evidence was entitled to work product protection because that was the date on which litigation was anticipated).

Accordingly, Household and the Individual Defendants were '"under a duty to preserve what [they] know[], or reasonably should know, is relevant to the action, is reasonably calculated to lead to the discovery of admissible evidence, is reasonably likely to be requested during discovery and/or

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[8] Although a lawsuit need not have been filed in order to trigger a claim of work product, there must be some likelihood that litigation will follow. *See, e.g., Binks Mfg. Co. v. Nat'l Presto Indus., Inc.*, 709 F.2d 1109, 1118 (7th Cir. 1983) ("'The work product rule does not come into play merely because there is a ***remote*** prospect of future litigation.'").

is the subject of a pending discovery request.'" *Zubulake*, 220 F.R.D. at 217. The duty to preserve "extends to 'evidence that [the party] has notice is reasonably likely to be the subject of a discovery request.'" *Wells*, 2008 U.S. Dist. LEXIS 21608, at *18; *Wiginton*, 2003 U.S. Dist. LEXIS 19128, at *13 (duty to preserve "evidence that it has notice is reasonably likely to be the subject of a discovery request even before a request is actually received").

Documents establishing the Company's sales practices such as the "effective rate" sales pitch would be highly relevant to the ACORN litigation as well as to this litigation. Nonetheless, these are precisely the documents that defendants destroyed starting in late May 2001 and continuing past the filing date of this lawsuit.

### 1. Beginning in 2000, Household Had Begun Negotiations with ACORN Regarding Allegations that the Company Engaged in Predatory Lending Practices and by March 2001, Defendants Were Anticipating Litigation with ACORN

[redacted] These practices included the misrepresentation regarding interest rates and loan terms, sales of single premium credit insurance, prepayment penalties and other deceptive practices that made loans to borrowers without regard to their ability to repay such loans. ACORN actively pressed Household, as a major lender in the sub-prime market, to change its misleading sales practices.

[redacted] This

suggestion came from the public relations firm Edelman in mid-2000, at a cost of millions,[9] to manage the external perception of the Company in that regard.[10] Defendants had reason to be concerned. According to the public testimony of Ellen Seidman, the then-Director of the Office of Thrift Supervision ("OTS") on Predatory Lending, "a predatory loan typically combines several of the following features: interest rates significantly higher than justified by the relative risk profile of the borrower; financing of high fees and points and of a single-payment credit life insurance premium, often called 'packing'; a balloon payment; negative amortization; and prepayment penalties." Ex. 16 at HHS 03117369. Almost all of Household's loans combined several of these features.[11] Defendants Gilmer and Schoenholz received a copy of this testimony in a May 25, 2000 memo.

The "conflict" with ACORN was fraught with the risk of litigation and defendants, as well as Consumer Lending General Counsel Kay Curtin, were aware of this. On September 14, 2000, [redacted] Ex. 20. The conflict with ACORN

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9 [redacted] Ex. 19 at HHS 03472133.

10 In a September 11, 2000 memo addressed to defendant Gilmer and others, [redacted] Ex. 19. The cover highlighted in bold noted: [redacted] *Id.* at HHS 03472123.

11 Defendant Schoenholz forwarded the memo to Household's Chief Accounting Officer Steve McDonald with a handwritten note: [redacted] Ex. 16 at HHS 03117367.

continued to escalate. An internal November 24, 2000 e-mail highlighted [redacted] protests organized by ACORN on November 21, 2000 in 14 different Household branch locations throughout the country. Ex. 22.

Vice-Chairman and member of Household's Responsible Lending Committee Larry Bangs headed the negotiations with ACORN and apprised Household senior management, including Household General Counsel Ken Robin of the status of these discussions. *See* Ex. 23 [redacted] ACORN sent a letter to Bangs on January 8, 2001 outlining a list of issues that ACORN had encountered in its review of HFC/BFC customers. Ex. 25 at HHS 02905404-05. Bangs forwarded this letter to various lawyers at Household, including Kay Curtin, Janet Burak and Ken Robin.[12] These discussions resulted in ACORN sending Household a proposed agreement that addressed, among other things, the misrepresentations of the terms and conditions of the loans. *See* Exs. 103-104.

It is clear that no later than March 2001, these Household-ACORN discussions took place in context of anticipated litigation between the parties. Defendants have claimed work product privilege over two documents dated March 12, 2001, both with the subject entitled "Response to ACORN Concerns." Ex. 101 at ##5628-29. The description provided for entry #5628 is "Attorney-Client Privilege and ***Work Product***; Email from Household employee to attorneys and employees requesting suggestions and feedback, including legal advice, re: draft response letter to ACORN

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[12] On March 15, 2001, defendant Aldinger informed Household's Board of Directors of the formation of a Consumer Advisory Board. Ex. 31 (attaching *American Banker* article "Household Brings Big Guns into Image War," by Robert Julavits, Feb. 5, 2001). While ACORN dismissed the move was nothing more than "window dressing," the director of the Atlanta Legal Aid Society "encourage[d] Household to come up with a program of reform of abusive subprime mortgage lending practices," noting that the formation of a board was "great, but if it doesn't prohibit the types of abuses we're seeing . . . then the reform is meaningless." *Id.* at HHS 03149240A.

plaintiffs." *Id.* at #5628. Similarly, the privilege description provided for entry #5629 is "Attorney-Client Privilege and ***Work Product***; Draft response to ACORN plaintiffs sent as an attachment to above e-mail for attorney review and legal advice." *Id.* at #5629; *see also id.* at ##5630-31, #7086 (same). Defendants' assertion of work product over these documents constitutes an admission that as of March 2001, litigation between the parties was imminent. Defendants could not have designated the documents as work product had they not truly believed litigation was impending.[13] *See, e.g., AAMCO Transmissions, Inc. v. Morgan Indus.*, Nos. 88-5522, 88-6197, 1991 U.S. Dist. LEXIS 13326, at *14 (E.D. Pa. Sept. 24, 1991) (threatening to deny motion to exclude privilege evidence unless party claiming the privilege could make a good faith showing as to how each document was protected).

Further, by May 17, 2001, [redacted] (Ex. 38), [redacted] *Id.* at HHS 03454631. [redacted] *See id.* at HHS 03454633 [redacted]

Clearly, by March 12, 2001 at the latest, defendants were on notice that ACORN was likely to pursue legal action against Household for predatory lending. Similarly, by May 17, 2001, Household and defendants Gilmer, Aldinger and Schoenholz were [redacted] A corporation's duty to preserve documents in the face of pending litigation is not

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[13] As noted in §III.C below, ACORN did in fact file a class action lawsuit on February 6, 2002.

a passive obligation. *Larson*, 2005 U.S. Dist. LEXIS 42131; *see also Marrocco*, 966 F.2d at 224-25; *In re Prudential Ins. Co. of Am. Sales Practices Litig.*, 169 F.R.D. 598, 615 (D.N.J. 1997). Defendants, therefore, had a duty to act affirmatively to preserve potentially relevant documents, including documents evidencing the communications between sales employees and customers. Such documents would include any sales materials, HOLPs, worksheets, letters, etc. used in loan sales to customers. *See, e.g., Cyntegra, Inc. v. Idexx Labs., Inc.*, No. CV06-4170PSG(CTX), 2007 WL 5193736 (C.D. Cal. Sept. 21, 2007) (sanctioning plaintiffs for spoliation of evidence and noting that as the party contemplating litigation, plaintiffs are in control of when the litigation is to be commenced, necessarily anticipate litigation, and have a duty to preserve evidence at that time). Instead, as detailed *infra* in §III.B and C, Household management was sending out memos instructing all branches across the country to destroy documents that would evidence the interest rate misrepresentations made to Household customers in connection with the Company's "effective rate" Bi-Weekly EZ Pay Plan.

Additional assertions of the work product privilege confirm that defendants expected widespread litigation over their branch sales practices prior to the June 2001 document destruction campaign. Defendants also claim work product privilege over a document dated May 4, 2001, the subject of which is "Policy and Procedures Regarding Predatory Lending." Ex. 101 at #3511. Defendants describe the document as a "Typed draft from Legal Department with Lisa Sodeika's handwritten notes, responding to article and customer complaint, and discussing Household's position on predatory lending." *Id.* Defendants' "Explanation of Privilege" is "***Work Product***; Typed draft from Legal Department and client's handwritten comments regarding Household's position, policy, and procedures regarding predatory lending, drafted in response to consumer complaint and anticipated litigation arising out of it." *Id.* Despite the Company's duty to preserve

evidence, only one week later, the Company's 1,400 branches began their [redacted] destroying documents that were clearly detrimental to the Company's image as a "responsible lender."[14]

Privilege log entry #2117 describes "Revisions to Draft Letter to ACORN" and is dated June 19, 2001, prior to the BFC destruction campaign completed by June 27, 2001. Ex. 101 at #2117. The author of the communication, Ken Robin, was Household's General Counsel and Secretary. The explanation for the privilege claim is "***Work Product*** Attorney-Client Privilege; Document contains client request for attorney's legal advice regarding attached draft letter to ACORN re: agreement on lending practices, and contains handwritten legal advice of attorney provided to client in response." *Id.* Again, by asserting the work product privilege over these documents, defendants concede that they anticipated litigation stemming from Household's predatory lending practices.

All of the above documents were created before May-June 2001. Household's claim of work product privilege to these documents clearly demonstrates Household "anticipated litigation" at the time these documents were created.[15] Because the Company anticipated potential lawsuits stemming from its illegal lending practices as early as March 2001, Household had a duty to preserve all potentially relevant information, including EZ Pay and "effective-rate" documentation at that time.

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[14] It should be noted that the terms [redacted] was not coined by plaintiffs' counsel, but rather used by Household senior manager Hennigan to refer to the mass-scale destruction of documents in the entire branch network. *See* Ex. 54 at HHS 02868145.

[15] In addition to assertion of work product in March 2001 over communications concerning the ACORN negotiations, defendants also asserted work product over a draft letter dated March 27, 2001, in which a Household attorney addressed concerns regarding the propriety of Household's EZ Pay program under Illinois law. *Id.* at #2886. The privilege was described as "***work product***; document is a draft letter to a state regulatory official addressing concerns regarding propriety of the EZ Pay program under IL law." *Id.* Another example is defendants' claim of work product privilege over a document dated April 26, 2001, the subject of which is the "Mabel Yancey Complaint." *Id.* at #2094. Defendants describe the document as a "Facsimile to attorney in which client requests legal advice regarding predatory lending complaint filed by customer Mabel Yancey." *Id.* Defendants' "Explanation of Privilege" is "***Work Product*** and Attorney-Client Privilege; Redacted fax to attorney in which client requests legal advice regarding customer predatory lending complaint." *Id.*

*Samsung Elecs. Co. v. Rambus Inc.*, 439 F. Supp. 2d 524, 542 (E.D. Va. 2006) (noting that the standard for anticipation for litigation under the work product doctrine is helpful in determining when a party anticipated litigation with regard to preservation and spoliation), *rev'd*, 523 F.3d 1374 (Fed. Cir. 2008).

Given all the facts above that put defendants on notice of [redacted] defendants' destruction of documents after May 2001 was intentional and amounted to an attempt to eliminate evidence relevant to claims.

**2. By May 2001, Defendants Were on Notice of Their Duty to Preserve Evidence Related to Household's Sales Practices Because of State Regulatory Investigations, Customer Complaints and Warnings by the Company's Own Consultants of the Potential for Class Actions Arising Out of Deceptive Sales Practices**

In addition to the ACORN-related issues, state regulatory investigations and individual lawsuits were also red flags to defendants that litigation was imminent. By May 2001, state regulatory authorities were increasing their scrutiny of Household's sales practices. There were two primary states, Washington and Minnesota, with others also showing interest. Many customers had already filed either individual or class action lawsuits, or threatened litigation against Household beginning as early as August 2000, triggering defendants' duty to preserve all evidence related to the Company's sales practices.

In addition to the individual complaints that the Washington State Department of Financial Institutions ("DFI") forwarded to Household's Policy & Compliance Department from time to time (*see* Ex. 74 at HHS 03455573-74 *and* Ex. 32), the DFI shared a May 17, 2001 DFI internal memo prepared for Chuck Cross by Patrick Hardiman on a number of complaints, which was then circulated within Household. Exhibit 39 is a May 21, 2001 fax from Tom Schneider (head of Policy & Compliance) to Craig Castelein (DGM for HFC Washington branch offices) attaching a copy of

that memo.[16] On May 21, 2001, Tom Schneider, Robin Allcock and Carla Madura participated in an e-mail chain regarding the DFI's concern regarding the [redacted] Ex. 37 at HHS 02943990-91.

On May 25, 2001, the Minnesota Department of Commerce ("DOC") forwarded Head of Policy & Compliance Tom Schneider the complaints received by that agency from ACORN. The DOC letter attached copies of documents from the complainants including a good faith estimate ("GFE") with a $0-$12,000 range for points, a HOLP (Gaspars) with handwriting indicating that the bi-weekly rate with rewards was 7.15% and a completed "effective rate" worksheet. Ex. 47.

Other state regulatory agencies were also probing complaints about Household's lending practices. According to a June 23, 2001 article, ACORN had filed complaints against Household in seven states and the District of Columbia. Ex. 56.

An internal May 25, 2001 memo from Carla Madura to Vice President of Operations Support Robin Allcock and Director of HFC Policy & Compliance Tom Schneider summarized [redacted] Ex. 48 at HHS 03208011. [redacted] *Id.* at HHS 03208017 [redacted] The memo goes on to state that [redacted] *Id.* Ms. Madura's memo notes specifically that:

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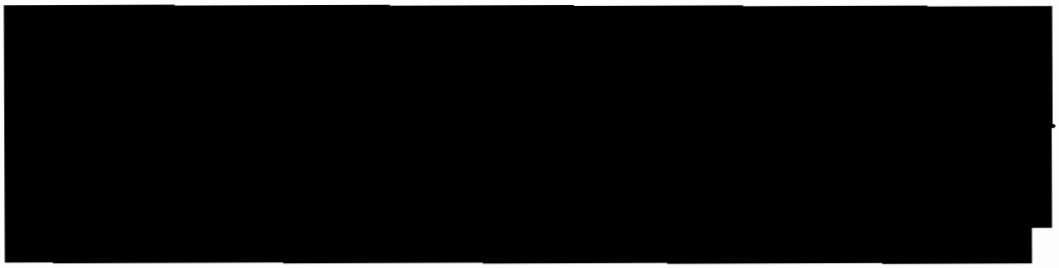
[16] Indeed, by virtue of defendants' assertion of work product protection for two documents dated September 28, 2000 on draft letters to the DFI responding to that agency's allegations that Household's lending practices – specifically prepayment penalties – violated Washington state law, defendants were on notice by late September of anticipated litigation with the Washington regulatory agency. Ex. 101 ##2818, 2826.



*Id.* Significantly, Ms. Madura's memo, copied to both defendant Gilmer and counsel Kay Curtin, does not state that this practice is "unauthorized."

Courts in this District recognize that the existence of other litigation can trigger a defendants' duty to preserve relevant evidence. *See Larson*, 2005 U.S. Dist. LEXIS 42131, at *34. A timeline of lawsuits filed against Household which triggered Household's duty to preserve relevant evidence relating to the Company's sales practices, particularly those relating to the "effective rate" EZ Pay sales presentation, sales of single premium credit insurance and prepayment penalties, among others, began as early as August 2000. On August 2, 2000, Raymond and Alisa Chenvert filed a lawsuit against Household alleging that they were misled and induced to refinance their existing lower interest loans to two Household loans at an annual percentage rate ("APR") of 15.154% and 24.9% respectively, under the false representation that if they signed up for EZ Pay, they would get an "equivalent interest rate" of 8%. Ex. 18. Another Washington customer, Julian Johnston, threatened Household with a class action lawsuit after complaining to the Washington DFI in December 2000 that he was misled about the terms of his Household loans. Ex. 75 at HHS 02981178. In a letter to the Office of the Attorney General for Washington, Mr. Johnston complained that Household "said that they would supply us with [a] loan at 7% interest if we paid twice monthly payments, thus saving us approximately $800 [a] month." Ex. 74 at HHS 03455566.[17] A January 9, 2001 e-mail

[17] The Washington Report states that "The Department can find no other word to describe this loan other than, 'predatory.'" Ex. 75.

exchange between Thomas Detelich, Craig Castelein, Carla Madura and Marc Giacovelli (Policy and Complaint Specialist), indicates that [redacted] Ex. 74 at HHS 03455564-65. Detelich replied [redacted] *Id.*

Defendants also claimed work product privilege over a document dated April 26, 2001, the subject of which is the [redacted] Complaint." Ex. 101 at #2094. Defendants describe the document as a "Facsimile to attorney in which client requests legal advice regarding predatory lending complaint filed by customer [redacted] *Id.* Defendants' "Explanation of Privilege" is "Work Product and Attorney-Client Privilege; Redacted fax to attorney in which client requests legal advice regarding customer predatory lending complaint." *Id.*

Defendants were well aware of the exposure to class actions posed by deceptive lending practices. In an October 31, 2000 presentation entitled "Predatory Lending – Responding to the Risks" obtained by Household [redacted] Ex. 21 at HHS 03238073. [redacted] (*see infra* §III.C.2. regarding the relevance of this to defendants' June 2002 destruction of Kahr documents), [redacted] *Id.* [redacted]

- [redacted]
- [redacted]
- [redacted]

*Id.*

On March 6, 2001, the FTC sued Citi/Associates First ("Associates") alleging that Associates engaged in "widespread deceptive practices." Ex. 29. The FTC Complaint alleged that Associates "hid essential information from consumers, misrepresented loan terms, flipped loans, and packed optional fees to raise the costs of the loans." *Id.* At defendant Gilmer's instructions, a group headed by his assistant, Lisa Sodeika, and other high-ranking members of management, including defendant Vozar, Tom Detelich and counsel Kay Curtin, among others, [redacted] Ex. 33 at HHS 02878802. In preparing for the meeting, the group specifically compiled and reviewed Household's sales and marketing practices, including [redacted] *Id.*

### B. In May-June 2001 Defendants Ordered the "Purge-Blitz" of Sales and Marketing Materials Related to Household's "Effective Rate" EZ Pay Plan

Notwithstanding all of the above facts that alerted defendants of their duty to preserve all relevant evidence relating to the Company's sales practices, defendants Gilmer and other high-ranking management instructed all 1,400 branches to destroy all evidence of the "effective rate" sales pitch that was used to promote Household's bi-weekly EZ Pay Plan. The purged documents included sales tools, training and other solicitation materials relating to the use of the "effective rate" sales pitch from Household branches throughout the nation.[18]

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[18] Robert O'Han sent the bulletin as the RGM for HFC branches and Mike Eden (BFC RGM, Eastern Region) and Ned Hennigan (BFC RGM, Western Region), sent the bulletin to BFC branches.

[redacted] Ex. 49 and Ex. 41 at HHS 02183779.[19] The RGMs were referring to the bi-weekly EZ Pay sales pitch whereby Household sales employees would misleadingly induce potential borrowers to take out a Household residential loan even though it had a higher interest rate than the customer's existing loan, falsely claiming that if they paid their mortgage bi-weekly under the EZ Pay Plan (rather than once a month), their "effective interest rate" would be much lower, *i.e.*, 7% or 8% rather than 13% or 14%. ¶¶52(a), 55-60.[20] In the May 24, 2001 bulletins, the RGMs noted that [redacted] Exs. 41-42.[21]

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[19] Significantly, a May 22, 2001 e-mail exchange between Head of Policy & Compliance Tom Schneider and National Quality Assurance Manager Ken Walker, discussing [redacted] Ex. 44.

[20] The terms "equivalent rate" or "comparative rate" were also employed, although they came later in time and were advocated for use instead of the terms "effective rate." *See infra* p. 37, 43-45.

[21] Coincidentally, on May 24, 2001, Senator Paul S. Sarbanes became the Chair of the Senate Banking Committee and announced his intention to address predatory lending practices. *See* Ex. 46. At the press conference, Senator Sarbanes stated that "I think as many of you would have anticipated, we want to look at consumer and investor protections. . . . That would include such matters as predatory lending, which I think is crying out for examination and for remedy." *Id.* Putting predatory lending at the top of his list, Senator Sarbanes discussed the role of the sub-prime lending market in making credit more readily accessible, but went on to say that "there are certain restrictions now in the law, but there's a deep concern [that] they're not adequate in terms of the practices that are taking place." *Id.* To implement his goal of addressing abusive lending practices, he said that he hoped to "develop a series of hearings that would examine these issues and would then see what would be reasonable and appropriate steps to take in order to deal with them." *Id.*

By June 14, 2001, Household management went on the offensive, planning [redacted] Ex. 50 at HHS 03208139-40. [redacted] *Id.* [redacted] *Id.*[22] [redacted] Ex. 50 at HHS 03208139-40. [redacted] *Id.*

On June 15, 2001, defendant Gilmer sent an e-mail regarding "Unauthorized Materials" to a large distribution list, including DSMs, DGMs and RGMs, O'Han, Hennigan and Eden. Ex. 52 at HHS 03208070. He indicated that [redacted] *Id.* [redacted] *Id.* [redacted]

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[22] Household's internal May 25, 2001 memo (copied to defendant Gilmer and counsel Kay Curtin) [redacted] *Id.*

[redacted]

*Id.* at HHS 03208071-74. [redacted]

[redacted]

*Id.* at HHS 03208070. In fact, HFC Southwestern Division DGM Dennis Hueman, who had created and disseminated a video about a sales practice called [redacted]

Ex. 53. [redacted]

Ex. 51 at HHS 02868225. O'Han further stated [redacted]

[redacted]

[redacted] *Id.*

With respect to execution of these instructions, O'Han was emphatic that the destruction not appear to be a [redacted] *Id.* at HHS 02868226. [redacted] *Id.* at HHS 02868225. The Housemail responses by some of the HFC DGMs on Monday, June 18, 2001, set forth below illustrate the nature of that conference call and highlight the objective of the call, *i.e.*, to destroy evidence of wrongdoing:

[redacted]

*Id.* at HHS 02868224.

[redacted]

*Id.* at HHS 02868227.

[redacted]

*Id.* at HHS 02868228.

[redacted]

Significantly, at this time, O'Han was aware that numerous documents evidencing predatory lending practices would be destroyed. *See, e.g.*, Ex. 40 at HHS 03418078 [redacted]

[redacted]

[redacted] Ex. 45 [redacted]

[redacted] Ex. 40 at HHS 03418079-80 [redacted]

*id.* at HHS 03418081-83 [redacted]

[redacted] Ex. 48 [redacted]

[redacted] *see also* Ex. 40 at HHS 03418084-87 [redacted]

[redacted]

[redacted]

[redacted] Ex. 54 at HHS 02868137, HHS 02868141-42, HHS 02868145.

[redacted] *Id.* at HHS 02868142.

[redacted]

[redacted] *Id.* [redacted]

[redacted]

[redacted] *Id.* at HHS 02868135.

Exhibit 54 at HHS 02868137-47 is a copy of the slide presentation at the [redacted] *See* Ex. 88 at 147:2-9. The handouts corresponding to the slide presentation are compiled together as Ex. 1.[23] Handouts 6 and 7 reference unapproved materials. Ex. 54 at HHS 02868141. Cross-referencing these with the examples of unapproved materials collected at Ex. 49 at HHS 02868214-20 demonstrates that these are the very same types of forms, proposals, letters and HOLPs disseminated by corporate trainer Lew Walter, which were approved sales tools, at least until May-June 2001 when employees were ordered to engage in the mass destruction of these documents. *See infra* §III.B-C.

On June 22, 2001, Tom Detelich sent an e-mail to a large group of attendees at the [redacted] including counsel Kay Curtin and defendant Gilmer, noting that [redacted] Ex. 59 at HHS 03208095-8100. [redacted] recognized that [redacted] *Id.* at HHS 03208097-99 (emphasis in original). [redacted] *Id.* at HHS 03208099.

Numerous e-mails confirm that the [redacted] was completed and critical evidence relating to the Company's widespread use of the misleading "effective rate" bi-weekly EZ Pay Plan was intentionally destroyed with the knowledge of defendant Gilmer and Household's General Counsel group. Ex. 55. Following the [redacted]

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[23] The references to the handouts on the slide presentation match the handwritten notation made at the top of the compilation. For example, the slide presentation refers to Handouts 1-3 as loan proposals, solicitation letters and trusts letters, respectively. Ex. 54 at HHS 02868138. The handwritten notations made at the top right hand corner of Ex. 1 match these references on Ex. 54 precisely. Ex. 1 at HHS 02868170 (Loan Proposals 1), HHS 02868182 (Solicitation 2) and HHS 02868202 (Trust Letters 3).

[redacted] *Id.* The purge directive from the Southwest Team acknowledges that the materials being purged had [redacted] but were [redacted] *Id.* at HHS 03208249.

When BFC RGMs Hennigan and Eden sent out their bulletin, they, like HFC RGM O'Han, knew that it would result in destruction of evidence of predatory lending sales practices. Ex. 50 at HHS 03208149 [redacted] *id.* at HHS 03208144-45 [redacted] *id.* at HHS 03208146-48 [redacted] Ex. 48 [redacted] The destruction of documents was heavily monitored and there was written follow-up with those branch managers who failed to send confirmatory e-mails attesting that their branch had completed the purge. Ex. 58. By June 27, 2001, all 1,400 HFC and BFC branches had completed the [redacted] Ex. 55.

Numerous former employees attest that the Company directive to shred or otherwise destroy all sales materials that included the term "effective rate," included ***completed*** sales and marketing forms, proposals (such as HOLPs) and solicitation letters from customer files, thus directly contradicting defendants' purported reason for the destruction – to avoid use of "unauthorized" forms in the future – and indicates the real reason was to minimize or avoid liability for the Company's widespread deceptive practices. *See, e.g.*, Ex. 96, ¶13 (stating that pursuant to the

summer 2001 directive, employees in the Lafayette, Colorado branch removed completed HOLPs containing the "effective rate" presentation from loan files and turn down files, erased all documents referring to the "effective rate" (*i.e.*, templates for the "effective rate" presentation) from the branch computers, destroyed sales materials that had been used to present the "effective rate" pitch to borrowers and purged the branch of anything referring to the term "effective rate" without saving copies of anything); Ex. 97, ¶11 (Ohio BSM Dorsey corroborated the summer 2001 directive to get rid of all materials relating to the "effective rate" presentation, including materials contained in the customer files); Ex. 98, ¶12 (Utah branch DSM Robert Feifer stated that he complied with a mid-2001 Company-wide directive and instructed all of his BSMs to purge their offices, customer loan files and computers of all such materials, including materials that had been previously shared with customers such as HOLPs); Ex. 95, ¶8 (California BSM John Buwalda also confirmed the summer 2001 directive that all branches in the district were to destroy/shred all documents relating to the "effective rate" sales pitch). If the purge were truly intended to contain their improper practices going forward, ***there would be no reason to destroy forms which already had been used with customers***. Further, defendants' excuse does not explain why these documents – completed loan proposals evidencing misleading sales practices – were destroyed rather than collected. Finally, as discussed below, defendants' excuse for the destruction fails for the additional reason that the practices were not "unauthorized."

### 1. The "Effective Rate" Bi-Weekly EZ Pay Plan Sales Pitch Was Authorized and Company-Sanctioned Before the June 2001 Nationwide "Purge-Blitz"

The "effective rate" sales pitch that management was claiming was unauthorized in May-June 2001 had previously been disseminated nationwide to all the branches by management as part of the Company's growth initiative in late 1998-early 1999. As Ronald Davis, DGM for HFC's Southeastern Division stated in an e-mail to RGM O'Han on November 15, 2001:

[redacted]

Ex. 63 at HHS 02868090. The March 26, 2001 letter is signed and dated by both the AE and BSM. The loan was made in Florida on March 26, 2001 and states: [redacted] *Id.* at HHS 02868094 (emphasis in original).

Household's own National Quality Assurance Officer Ken Walker testified regarding the "unauthorized effective rate" sales pitch: [redacted] Ex. 90 at 126:23-127:7. Whether authorized or not, because defendants anticipated litigation, the June 18-20, 2001 document destruction would still amount to spoliation.

The complaints on pre-June 2001 loans also bear out the Company's approval of the use of HOLPs to present this misleading sales pitch. For example, an attorney for the Chenverts wrote to Household on July 24, 2000, detailing the misleading information contained on the HOLPs:

> The Equity Proposal bears several handwritten false and/or misleading misrepresentations made by Ms. Guglomo. In particular, these false and/or misleading misrepresentations are as follows:
>
> 1. How Much Can I Save By Consolidating My Debts? "Save: $3,648 per year!"
> 2. All of the Chenverts' outstanding debts were listed, and beside of these, Ms. Guglomo wrote, "Paid Off!"
> 3. Equivalent Interest Rate = 8%.
> 4. Save: $257,931 in interest expenses.

Ex. 17 at HHS 02193537. The actual interest rate on the loan was 13.99%, but the HOLP did not contain the true rate or the APR for either the Chenverts' first or second mortgage (which was 24.9%).[24] *Id.*

Management's approval of the "effective rate" pitch is further supported by declarations of a number of former BSMs in both HFC and BFC branches from across the country:

**BSM Chantel Dorsey (BFC branches, Grove City, Dayton and Columbus, Ohio)**

BSM Dorsey stated that during 2000 and 2001, she was "trained by DSM Paul Scott on how to make an 'effective' rate presentation." Ex. 97, ¶3.[25] She stated that "Mr. Scott was very enthusiastic about using the presentation as a principle sales tool to see real estate loans. As part of this training session, I along with other BSMs from BFC branch offices in Ohio and [in] other states were taught to use an 'effective rate' presentation involving a biweekly payment plan." *Id.* "The training I received from Mr. Scott also included the use of worksheets to demonstrate this alleged lower interest rate to potential customers, including what was known at BFC offices as a 'biweekly HOLP.'" *Id.*, ¶4.

Dorsey further declared that Scott held regular weekly conference calls with other BSMs in his district – calls which were attended by her Division General Manager. *Id.*, ¶8. During these calls, the use of the "effective rate" presentation and the bi-weekly HOLPs was discussed in a

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[24] Defendants will no doubt assert that the Chenverts were customers of the Bellingham branch, which defendants have admitted misled customers using the EZ Pay "effective rate" pitch. Defendants made this same assertion to the multi-state group of AGs whose response was: "Bellingham was not an aberration, in part because – as former employees are telling us – HFC management held up Bellingham as a role model to underperforming offices, at least that is until Bellingham's problems started making the newspapers" and "I'm not sure how many times we've all told them that the problems are nationwide." Ex. 83.

[25] DSM Paul Scott, who was Dorsey's immediate supervisor, was responsible for the approximately 11 branch offices in the Dayton, Ohio Division of BFC and had been a BSM in Florida prior to that. *Id.*

manner to lead Dorsey to conclude that the use of these sales tools was prevalent and occurred throughout the district. *Id.*

The "effective rate" presentation sales tools and bi-weekly HOLPs were discussed at annual meetings of BFC BSMs held at the Marriott Hotel in Columbus, Ohio, where 300-400 sales personnel from Ohio, Kentucky, Indiana and/or Michigan were in attendance. *Id.*, ¶9. Gary Gilmer, Tom Detelich, various human resources personnel, DSMs and DGMs were also present at the meetings, which lasted about two to three days. *Id.* At the meetings, BSMs were encouraged to later train their AEs on the "effective rate" presentation and the bi-weekly HOLP. *Id.*

At these annual meetings, Dorsey "heard BSMs from BFC and their supervisors discussing the use of the "effective rate" presentation and the biweekly HOLP and how effective these sales tools were in getting customers to accept a loan from BFC." *Id.*, ¶10. Based on what she heard and saw during those meetings, she understood that BFC branch offices throughout Ohio and in states other than Ohio, including in the Florida branches where Scott was a BSM, were also using the "effective rate" presentation and the bi-weekly HOLPs to solicit loan customers. *Id.*

**BSM Seth Callen (BFC branches in Kansas, Oklahoma and Colorado)**

BSM Callen describes in his declaration the widespread and accepted use of the "effective rate" sales pitch or its equivalent in all of the HFC and BFC offices in the three states where he worked as an AE and/or BSM. Ex. 96, ¶7. He observed other AEs and BSMs in the Lawton, Oklahoma, Hays, Kansas and Lafayette, Colorado branches use the "effective rate" sales pitch, and used it himself claiming that the "[u]se of the effective rate sales pitch in my branches was instrumental in achieving the aggressive sales targets set by corporate headquarters." *Id.*

Callen stated that sometime in early 2001, a training manual was put together by the corporate offices in Illinois and distributed to the BFC branch offices, including the branch where he worked, that contained forms and instruction on how to use the "effective rate" sales presentation.

*Id.*, ¶9. Callen stated that his DSMs insisted that BSMs provide new AEs with "effective rate" training, and pursuant to this policy, he regularly trained the newly-hired AEs in his branches on how to utilize the "effective rate" pitch and ensured that all of his subordinates were utilizing the sales tactic in their loan presentations. *Id.*, ¶7.

When he was promoted to BSM in late 1999, Callen traveled to the Elmhurst, Illinois headquarters and received BSM training for one week. *Id.*, ¶10. Callen testified that the "[t]raining was attended by approximately 40-50 other newly promoted BSM's from around the country. We received training from Corporate Trainers, including Jeff London. During the week, the BSM's discussed the "effective rate" pitch extensively in the presence of Mr. London. The various BSM's from around the country were familiar with the "effective rate" pitch prior to their arrival." *Id.*

Callen also attended several training sessions for BSMs and DSMs from his district that were conducted at hotels in Denver, Colorado and Wichita, Kansas that covered the "effective rate" sales pitch. *Id.*, ¶11. DGM Steve Hill and Corporate Trainers, including Jeff London, from the home office in Illinois attended some of these sessions where the "effective rate" sales pitch was taught. *Id.* He also attended similar regional training sessions (where all DSM's and BSM's within the Midwest Region were present), where the attendees were taught how to utilize the "effective rate" sales pitch. *Id.*

Callen stated that in addition to the training sessions, the "effective rate" sales pitch was consistently discussed during monthly in-person district meetings and regular district conference calls. *Id.*, ¶12. He understood from statements made by other BSMs on those calls that other branches in all the districts in the three states where he worked also relied heavily on the "effective rate" presentation to sell loans. *Id.* His DSMs stressed the "effective rate" pitch during these meetings and calls and were adamant that all AEs use the "effective rate" pitch. *Id.* In addition to the branches where he worked, he observed the "effective rate" pitch used with customers in several

other branches where he provided relief branch management and in branches in Wichita, Kansas where they were given insurance training. *Id.* He also saw HOLPs from several different branches had the "effective rate" printed on them. *Id.*

**Kimberly McNeal (AE in Hammond, Indiana, BSM in Chicago, Illinois)**

Kimberly McNeal stated that she understood based on the regional meetings and regular conference calls with other BSMs that the "effective rate" sales pitch was used throughout Indiana and Illinois. Ex. 99, ¶9. McNeal's DGM Ron Ferrari frequently visited both the Hammond, Indiana office and the Stony Island, Chicago office to go over the offices' sales numbers and do training, including on the "effective rate" pitch. *Id.*, ¶5.

**BSM John Buwalda (HFC branch, Visalia, California)**

John Buwalda corroborated the use of the "effective rate" sales pitch. Ex. 95, ¶7. Steve Turner, the DSM for Buwalda's district, conducted training sessions at his Fresno, California branch for all of the BSMs in his district. *Id.* Because Buwalda was so successful with the "effective rate" sales pitch, he was instructed by Turner to conduct several continuing training sessions of the "effective rate" sales pitch with several BSMs and AEs in his district. *Id.* In addition to the formal training, Buwalda also provided guidance over the telephone to other BSMs and AEs within Turner's district who had questions about the best way to implement the "effective rate" sales pitch, sometimes even conferencing him on sales calls so that he could help close a customer using the "effective rate" sales pitch. *Id.*

**BSM Robert Kuhn (Two New England BFC/HFC branches)**

Robert Kuhn also stated that "the effective rate sales pitch was used throughout New England in both the BFC and HFC branch offices." Ex. 94, ¶11. He traveled to numerous other HFC and BFC branches in New England to obtain "the tips and tricks" they were using to meet management's unrealistic sales targets, including Raynam, Massachusetts; Waterbury, Connecticut; West Hartford,

Connecticut; East Hartford, Connecticut; Meriden, Connecticut; Woonsocket, Rhode Island; Warwick, Rhode Island; and Dartmouth, Massachusetts. *Id.* At each office he visited, he personally saw AEs as well as BSMs using the "effective rate" sales pitch. *Id.*

Kuhn stated that the use of the bi-weekly "effective rate" sales pitch was also discussed at regular monthly, quarterly and annual company meetings of sales management held in various locations throughout the country. *Id.*, ¶12. During these meetings, many BSMs openly discussed and even bragged about how they were able to "take a customer out of an existing 9% loan, and set them up with a 12% loan, by using the bi-weekly payment plan and the 'effective' rate to suggest that the Household loan had an interest rate lower than the original 9%." *Id.*

**DSM Robert Feifer (Supervising offices in Utah, Idaho and Montana)**

Robert Feifer stated: "Based on my observations at various branch offices as well as my interactions with Mr. Walter, Mr. Castelein and other DSMs, as well as conversations I had with other DSMs and BSMs at the 'town hall' meetings, the effective rate sales pitch was used throughout the Northwest Division." Ex. 98, ¶11.

As a DSM, Feifer participated in regular conference calls with Craig Castelein and other DSMs in his division to discuss the division's progress in meeting its sales goals. *Id.*, ¶9. Mr. Castelein was a vigorous proponent of the use of the "effective rate" presentation during these conference calls, as well as during the monthly in-person meetings that took place in the division headquarters in San Ramon, California. *Id.* Lew Walter, the Household corporate trainer, who was tasked with training sales employees across the country in the "effective rate" bi-weekly EZ Pay sales pitch, was often present at these meetings and would illustrate the sales pitch at these meetings. *Id.* Castelein would direct the various DSMs to ensure that their districts were using the "effective rate" pitch. *Id.*

These same sales employees stated that the systemic acceptance and promotion of the "effective rate" pitch continued at least until mid-2001 when defendants ordered the destruction of all "effective rate" materials. For example, DSM Feifer confirmed the June 2001 destruction, stating: "In approximately mid-2001, HFC issued a company-wide directive to stop using the term 'effective rate' and to 'dispose of all materials containing that term.'" Ex. 98, ¶12. Buwalda also confirmed that it was not until the summer of 2001, when "Turner issued a directive that all branches in the district were to destroy [or] shred all documents relating to the effective rate sales pitch and that [they] were to cease using the pitch altogether." Ex. 95, ¶8. Even while carrying out the orders to destroy "effective rate" materials, some BSMs and DSMs encouraged the continued use of the same sales pitch, albeit without using the word "effective" and instead using "equivalent" or "comparative" rate. BSM Dorsey stated that in the summer of 2001 she and other BFC BSMs received directives that the term "effective rate" was not be used. Ex. 97, ¶11. She was informed, however, that other terms, such as comparable rate and equivalent rate, could be used as long as they were not put in writing. *Id.* BSM McNeal stated that she was informed in an e-mail from Mr. Ferrari in mid-2001 that they could no longer use the term "effective rate." Ex. 99, ¶8. However, in that same e-mail, Mr. Ferrari indicated it was acceptable to continue this same presentation using different words.[26] *Id.* As a result, after this, McNeal stated that Mr. Ferrari and other management sales personnel modified the sales pitch to describe the Household loan as "like" the lower interest rate loan or as having an interest rate that was "equivalent" or "comparable" to the lower interest rate. *Id.* An e-mail from DSM for the Northeastern District to RGM O'Han details an "effective rate" calculation saying: "This is a scenario that my group has been using. They have been terming it equivalent rate. Which I thought was ok." Ex. 45.

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[26] Plaintiffs have been unable to locate this e-mail in defendants' production.

### 2. Household Required HOLPs for Every Residential Loan Which Was a Company-Approved Sales Tool Designed to Facilitate Household's "Effective Rate" Sales Pitch

Household's own internal manuals belie defendants' justification for the "Purge-Blitz" and further demonstrate that until the nationwide destruction, Household management approved of, even mandated, the various sales tools that it suddenly condemned as "unauthorized." For example, a [redacted] Ex. 8 at HHS 02175806-07. [redacted] *Id.* at HHS 02175807, HHS 02175809.[27]

Until the June 2001 destruction, using and customizing HOLPs was not optional to the Household sales employees. [redacted] Ex. 3. [redacted] Ex. 26; Ex. 35 at HHS-ED 481924 [redacted] Ex. 34 at HHS-ED 481989 [redacted]

Various former Household employees corroborate that not only did the Company sanction the use of HOLPs to present the "effective rate" bi-weekly EZ Pay Plan, it programmed it into the much-touted Vision system so that the computer-printout to the customer would show the "effective rate."

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[27] It was not until the June 20, 2001 "Responsible Lending Summit" that a "go forward process flow to get forms approved on a national basis" was even established. Until that time, sales were encouraged to create and customize their own sales tools. Ex. 50 at HHS 03208137-38.

BSM Seth Callen stated in his declaration that:

> The ***effective rate was printed by the system directly on the HOLP*** which was then presented to the customer during the sales meeting. The AE's would go to great lengths to focus the customer's attention on the effective rate. AE's were instructed by their BSM's to (and which they did) include comments that would draw the customers' attention to the lower effective rate, such as "isn't this a great rate?!?" These comments would be coupled with arrows pointing to the effective rate, underlining, and other markings that would make this information stand out on the HOLP.

Ex. 96, ¶6.

BSM Kimberly McNeal stated in her declaration that:

> The training I received emphasized the use of worksheets and calculators as part of the presentation to the customer. ***In 1999, it became possible to print out a Homeowner Loan Proposal (HOLP) from the Vision computer system used in the HFC sales offices, which HOLP included the effective rate printed out on the form***. We were required to present every customer with a HOLP and to keep copies of the HOLP in the customer's file.

Ex. 99, ¶6.

BSM Curtis Howrey stated in his declaration that:

> At some point in time, Mr. Hueman issued a directive that required each sales office to conduct no less than five T sale presentations per day. To monitor this quota, BSMs were required to fax copies of the five presentations to Mr. Hueman's office in Pomona, California. Additionally, prior to Mr. Brabyn's directive to shred the T-sale materials, when my DSM would audit my branch, his audit would include a review of the T-sale presentation forms in the office files.

Ex. 93, ¶10.

BSM Robert Kuhn stated in his declaration that:

> During the period I was a Beneficial BSM, it was required to present every customer with a HOLP and there had to [be] a HOLP in every loan file.

Ex. 94, ¶6.

DSM Robert Feifer stated in his declaration that:

> At some point in time, I believe ***in 1999, improvements were made to the VISION system, which was part of the computer software used in the branch offices, that enabled the VISION system to print out a HOLP that included the effective rate precalculated.*** It was required under HFC policy at the time for the

> HOLP to be placed in the customer file. As a BSM and later as a DSM, one of my responsibilities was to ensure that the AEs were following this policy, which I did by checking the loan files for HOLPs.

Ex. 98, ¶10.

BSM Chantel Dorsey stated in her declaration that:

> Up until approximately June of 2001, it was required to present every potential customer with a HOLP, generally the biweekly HOLP, and to keep a copy of the HOLP in that customer's file. At this time, each customer, pending or actual, had a paper file maintained in the branch office. This file would include materials, including the biweekly HOLPs, that had been presented to the customer. During this time period, whenever the district sale[s] manager (DSM) who was my supervisor audited the office, it was an element of the audit that he would check a certain number of customer files to confirm that the customer had received a HOLP.

Ex. 97, ¶6.

It was these HOLPs – required by the Company to be used with customers and kept in loan files, but not imaged and sent to central storage at Household headquarters – that were destroyed in the purge.

### C. Post-June 2001 Events Establish Defendants' Continued Duty to Preserve Evidence

By June 28, 2001, defendants had rejected ACORN's draft memorandum of understanding ("MOU"). Although the parties' negotiations continued, it was inevitable that litigation would result, which it did. ACORN filed a series of class actions cross the country. In the meantime, state regulators began issuing subpoenas.

A timeline of some of the events includes:[28]

- September 26, 2001 – The Minnesota Department of Commerce sent Household a subpoena seeking [redacted]

[28] Household's own internal chronologies confirm that the Company already been sued or began receiving subpoenas from various state regulators and AGs beginning September 2001, including Minnesota, Washington, Florida, Arizona and Illinois, among others. Ex. 100.

[redacted]
Ex. 60.

- November 15, 2001 – The California Department of Corporations filed a lawsuit against Household for violations of state law relating to fair lending practices. Ex. 64. January 2002 – Household agreed to a $12 million settlement with California Department of Corporations, $9 million of which comprised penalties. ¶19.

- February 22, 2002 – Household received a subpoena from the Washington DFI. Ex. 67. The subpoena stated numerous requests with respect to specific customers' loans including: "all disclosures for any loans," "all notes for any loans," "all documentation relative to any insurance added to the most recent loans," and "all documentation relative to any payment plans (*e.g.* EZ Pay)." *Id.* at HHS 02946479. In addition to requests regarding specific loans, the Washington DFI more broadly demanded copies of "any sales or solicitation manuals or scripts or training materials for the solicitation of loans"; "any closing manuals or scripts or training materials for the closing of loans"; and "any manuals, scripts or training materials for the sale of insurance products," used since January 1, 1999. *Id.* at HHS 02946480; *see also* Ex. 100 at HHS-E 0003253.0001.

- March 18, 2002 – Household received two further subpoenas from Minnesota DOC: one seeking [redacted]
Ex. 69.

- May 23, 2002 – Tom Detelich, Robin Allcock and Kay Curtin met with representatives from the Washington DFI to discuss Washington's "concerns" including misrepresentation of discount fees, effective interest rate, prepayment penalties and insurance packing. Ex. 78. At this meeting, Household learned that "a multistate working group of attorneys general and state regulators [was] interested in speaking with Household." *Id.*

- May 31, 2002 – A Notice of Complaint in Arizona was sent to Household from the Office of the Attorney General for Arizona alleging discriminatory and predatory practices. Ex. 80.

- June 4, 2002 – Household received a Civil Investigative Demand from the State of Arizona requesting copies of all documents related to [redacted]
Ex. 79 at HHS 02407030. [redacted]
*Id.* at HHS 02407035.

By January 2002, class action complaints were being filed all over the country against Household alleging that the Company defrauded borrowers into loans they could ill-afford by engaging in deceptive sales practices:

- January 24, 2002 – Household was sued in Massachusetts in connection with HFC/BFC's lending practices in the case of *Masterson v. Beneficial Massachusetts, Inc.*, Case No. 02-0359 (Mass. Super. Ct. Middlesex County) (Ex. 65), removed to the Disstrict of Massachussetts, Case No. 02-0CV-10647 RCL. The suit alleged violations of HOEPA, the Consumer Credit Cost Disclosure Act ("CCCDA"), G.L c 93A and misrepresentation and fraud for, among other things, "misrepresenting or failing to provide accurate information about loan terms and rates," "using an excessive and unjustified prepayment penalty as a means to prevent the Mastersons from obtaining better terms from another lenders," and "providing in the loan for "discount" points without providing a *bona fide* discount." *Id.* at 1-2, 11-14.

- February 6, 2002 – ACORN filed a putative class action complaint in California, entitled *ACORN v. Household Int'l, Inc.*, No. 2002-040064 (Cal. Super. Ct. Feb. 6, 2002) (Ex. 66), alleging among other things, that Household's EZ Pay bi-weekly payment plan would produce lower effective interest rates, failure to disclose the amount of finance charges, failure to disclose the existence of prepayment penalties, and failure to disclose critical information about credit insurance. *Id.*

- February 27, 2002 – Joseph and Jeanie Luna filed a class action complaint in Washington for fraud, damages and seeking permanent preventative injunctive relief and mandatory injunctive relief (or in the alternative class action status). *Luna, et al. v. Household Fin. Corp., III, et al.*, No. CS-02-0116-RHW (Wash. Super. Ct. Feb. 27, 2002) (Ex. 68). The *Luna* complaint alleged that defendants misrepresented that their first mortgage would have an interest rate of 6.99% and a second mortgage would have a rate of 12.45%, which would be reduced each year if they made on time bi-weekly payments. *Id.* at HHS 02485042-43.

- March 15, 2002 – Household was sued in California by plaintiffs on behalf of a putative class of California borrowers challenging HFC/BFC's lending policies and practices, claiming that they were deceptive. *Vega v. Household Int'l, Inc.*, No. C2002-044158 (Cal. Super. Ct. Mar. 15, 2002) (Ex. 70).

- March 21, 2002 – Household was sued in California by plaintiffs on behalf of a putative class of California borrowers challenging HFC/BFC lending practices also alleging that it was defendants' standard practice to "tell potential borrowers that making bi-weekly payments with Defendants' EZ Pay Plus Bi-Weekly Payment Plan will produce lower effective interest rates than if payments are made monthly, when it will not"; "Fail[] to disclose the existence or amount of up-front finance charges (including fees and points) or the rates of interest (which are substantially higher than the average interest rate on the borrowers' existing debt"; "Fail[] to disclose that many of the loans contain prepayment penalties and that those penalties reduce the borrowers' ability to refinance the loan"; and fail to disclose that "borrowers are

paying additional upfront points based on the cost of insurance, which are not refunded even if the insurance is cancelled." *Thomason, et al. v. Household Int'l, Inc. et al.*, Case No. 2002-044921 (Cal. Super. Ct. Mar. 21, 2002) (Ex. 71, ¶¶13-18).

- May 15, 2002 – Household was sued in Illinois on behalf of a putative nationwide class of borrowers challenging HFC/BFC lending practices. *Bell, et al. v. Household Int'l Inc., et al.*, Case No. 02CH8640 (Ill. Cir. Ct. Cook Co. May 15, 2002) (Ex. 77). Plaintiffs in *Bell* made allegations almost identical to those made in *Thomason*, including allegations that defendants' nationwide practice was to not disclose interest rates, fees, finance charges or prepayment penalties. *Id.*, ¶¶13-18.

Despite these lawsuits and governmental investigations, defendants continued ordering the destruction of additional relevant evidence throughout the 1,400 branch networks, and even expanded the scope of destruction to include their computer files and consultant memos that would shed light on the Company's abhorrent use of deceptive lending practices in order to achieve its goals of 15% growth.

### 1. In April 2002, Household Ordered the Destruction of the Electronic and Any Remaining Hard Copy Evidence of the "Effective Rate" EZ Pay Scam

Not satisfied with the purge of the paper copies of materials adverse to them, Household management ordered the destruction of any remaining electronic and hard copy evidence of their "effective rate" sales solicitation and training materials in April 2002. The destruction also extended to solicitations that used the term "comparative" rate, which had come into vogue after the Company restricted the use of the magic "effective rate" phrase.

On April 2, 2002, HFC RGM O'Han posted a bulletin to "All HFC Sales Employees" which stated that [redacted]

[redacted] Ex. 72.[29] The bulletin mandates that [redacted] *Id.* [redacted] *Id.* [redacted] *See supra* III.A.2. Significantly, defendants again destroyed not only blank templates, but completed letters or filled out forms that had already been sent to customers during the loan solicitation process.

Former employee Robert Feifer, a BSM of a BFC branch in Utah, confirmed this destruction directive stating: "In approximately April 2002, I received a directive from Rob O'Han, who was the Regional General Manager for HFC and Mr. Castelein's supervisor, to again purge computer files of any effective rate materials. At that point, the DSM audit included checking to see if computers in the branch offices had Wordpad, a word processing program. If they did, the DSM was supposed to ensure that the Wordpad program was removed and all associated computer files deleted." Ex. 98, ¶13.

Melissa Rutland-Drury, a BSM in the Bellingham, Washington branch, corroborated this destruction: "[I]n April of 2002, we received another directive. Mr. Mielitz and Jon Shrum, Policy & Compliance Manager, required us to delete everything on our personal computers. Although the sales materials and forms were already gone, we still had word processing files such as game plans, information about leads, training documents, and letters written to HFC Policy & Compliance about

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[29] Presumably there were parallel instructions given by the BFC RGMs Hennigan and Eden. However, such documents were not found in the discovery provided to plaintiffs.

customer interactions in response to customer complaints. Mr. Shrum personally deleted such items from the computers of the AEs in the office." Ex. 84, ¶150. The destruction of computer files began earlier in the Bellingham branch. On July 5, 2001, DSM Beth Hansgen sent out a Housemail memo instructing Drury and other BSMs to "delete all letters written to customers that were on our computers. HFC clarified that all word processing documents used with our customers had to be destroyed." *Id.*, ¶147. Hansgen's memo, which bore the subject line "Very important to do today" and was directed to her reports including Melissa-Rutland Drury, stated: "Please check each PC in your office to see if there are any letters that have been written by AE's to customers. These are unauthorized letters that must be deleted immediately." Ex. 57. Drury noted in her declaration: "Prior to this, Ms. Hansgen had instructed us to write personal letters to our customers to follow up on sales prospects. We frequently did not in our Branch. In fact, I had developed some form letters in the process and Ms. Hansgen asked me to share them with corporate HFC's marketing department, which I did. . . . It was also our practice to use the word processor to draft summaries of the comparative interest rate, term and interest expense savings which were then copied on the HOLP and calendars." *Id.* We followed Ms. Hansgen's direction and destroyed the customer letters and sales materials on every computer in the Bellingham Branch." Ex. 84, ¶149. Rutland-Drury also testified that "Other branch offices also implemented the central direction to shred all documents, including customer-related materials. Some offices, such as the Everett HFC branch, had a shredding company pick up boxes because there was so much information to be destroyed." *Id.*, ¶146.

On the BFC side, RGMs Hennigan and Eden took the more drastic measure of [redacted] Ex. 73. The bulletin issued on April 16, 2002 stated that [redacted] *Id.* The bulletin also reiterated that

[redacted] *Id.* The fact that the bulletin announced the elimination ***after*** access had been taken away also demonstrates an enhanced level of bad faith. Household management was taking steps to ensure that no one had the ability to print and save evidence that could incriminate or expose the Company to liability.

All of the facts detailed above – both pre-June 2001 and post-June 2001 – put defendants on notice of the need to preserve evidence relevant to the Company's sales practices. Yet, Household management undertook repeated efforts to wipe out any trace of its misconduct.

**2. In June 2002, Household General Counsel, with the Knowledge and Consent of Individual Defendants Aldinger and Schoenholz, Ordered the Destruction of Evidence Related to a Household Consultant, Andrew Kahr, Critical to Devising Numerous Misleading Policies and Practices for Household**

In addition, defendants tried to eliminate all traces of their decision to hire Andrew Kahr to [redacted] at Household. Ex. 4 at HHS 02861365; Ex. 92.

Andrew Kahr was the founder and later a consultant for Providian, a credit card company notorious for its incredibly aggressive and deceptive marketing strategies. Ex. 76. While at Providian, Kahr wrote numerous memoranda, strategy and training materials and was credited as the "genius behind Providian's success." *Id.* Kahr's memos – "full of ideas on how to mask the costs of products and services" – were used in a 1999 trial of a lawsuit against Providian and became public in 2002. *Id.*

In lending to the kinds of high-risk customers Providian specialized in, Andrew Kahr stressed the guiding principle that made Providian one of the nation's most profitable consumer-finance operations: The "problem is to squeeze out enough revenue and get customers to sit still for the squeeze." *Id.* Notably, Providian and Household shared the same subprime customer base –

individuals who have limited credit histories, modest incomes, high debt-to-income ratios, high loan-to-value ratios or who have experienced credit problems caused by occasional delinquencies, prior charge-offs or have credit related actions. Underlying Kahr's philosophy was the realization that many of Providian's high-risk customers were desperate for credit and easily taken advantage of. *Id.* In a March 1999 memo to Providian Executive Vice President David Alvarez, who had day-to-day responsibility for Providian's credit card business, Kahr wrote: "Making people pay for access to credit is a lucrative business wherever it is practiced. . . . Is any bit of food too small to grab when you're starving and when there is nothing else in sight? The trick is charging a lot, repeatedly, for small doses of incremental credit." *Id.*

By December 2000, the practices conceived of by Kahr and implemented by Providian resulted in Providian paying over $400 million in settlements related to charges that Providian had deceived customers about fees and interest rates and agreements with law-enforcement agencies to cease and desist from engaging in unfair business practices. Ex. 76. On January 22, 2001, Hearst Corporation, the parent company of *The Chronicle* newspaper, filed a motion to unseal 12 Kahr memos in the Providian case.

Kahr was credited as a financial innovator who "helped shape the way the credit card business works." Ex. 86. For example, Kahr convinced banks to reduce the minimum payment from 5% of the balance to 2%, resulting in interest being charged on a higher balance. *Id.* Kahr also believes more disclosure is useless, claiming: "This is a fascination that every now and then, someone with an axe to grind or someone who think he's going to help consumers has on his mind." *Id.* at 16. Kahr also convinced banks to introduce a 0% introductory offer for a limited period loaded with fine print knowing that customers would be "attracted to the bait"; or as Kahr put it "When you're getting something in the mail several times a week that offers you zero percent for six months – they look at the headlines of the solicitation in the mail, they spend 30 seconds on it, and, 'OK, I'm

going to be better off at the beginning. They're going to give me something. They're going to give me a zero percent rate.' People believe what they want to believe." *Id.* at 8.

Defendants used Kahr in the same manner, *i.e.*, figuring out how to keep their customers still during the "squeeze." A January 27, 1999 memo from defendant Gilmer to defendants Aldinger, Schoenholz and Vozar, among others, announcing Kahr's retention, states that [redacted] Ex. 4 at HHS 02861365. The list of the ten initiatives referred to in the memo included: [redacted] *Id.* at HHS 02861369-70. [redacted] *Id.* at HHS 02861369.

Kahr's ideas on how to get Household customers to sit still for the squeeze were memorialized in a series of memos to Household senior executive management, including the Individual Defendants and Household counsel. *Id.*; Ex. 5. The limited Kahr memos that were produced to plaintiffs in this litigation contain the same direct and offensive language Kahr employed in his Providian memos.

Defendants have attempted to downplay Kahr's role by claiming that his initiatives were not adopted. Defendants are back-pedaling. Documentary evidence indicates and defendant Schoenholz

admits that several of Kahr's initiatives and ideas were in fact implemented at Household.[30] *Compare* Ex. 5, which lists the ten Kahr initiatives that were selected by defendants for [redacted] *with* the memos written by Kahr, some of which were produced to plaintiffs. Kahr wrote his memos by cross-referencing them to the initiative number on defendants' memo. For example, Initiative No. 10 relates to [redacted] while Initiative No. 7 relates to [redacted] Ex. 4 at HHS 02861369-70. The subject line of Kahr's memos (Exs. 7 and 9), corresponds to the Initiative he wrote about, *i.e.*, Nos. 10 and 7, respectively.

In connection to Project No. 10, in Kahr's memo entitled "Redoing HFC Mortgage Forms To Impose High Prepayment Penalties," he proposed that Household make changes to its [redacted] in order to qualify the Alternative Mortgage Transaction Parity Act and [redacted] Ex. 7 at HHS 02923887. Kahr was of the opinion that [redacted] *Id.* [redacted] Exs. 7, 13, 15. [redacted] Ex. 13.

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[30] Plaintiffs undertook diligent efforts to locate and serve Mr. Kahr upon discovery of his role in implementing various business practices at Household during the Class Period, even filing a motion to serve Mr. Kahr under the Walsh Act. Dkt. No. 793. Interestingly, Mr. Kahr has eluded service of subpoenas or testimony thus far. In an October 10, 2004 Frontline interview, Mr. Kahr only agreed to be interviewed on the condition that neither his location, nor the names of his clients would be revealed. Ex. 86.

[redacted] Ex. 14. [redacted] Ex. 27. In a description of the program, Household documents note that the PRR program [redacted] *Id.* at HHS 03356421. The state of New Jersey had serious issues with Household's use of the PRR program to circumvent state laws against the imposition of prepayment penalties. Then in early-2000, Kahr reported to CFO defendant Schoenholz that [redacted] Ex. 15. Kahr emphasized to defendant Schoenholz that [redacted] *Id.* at HHS 02927473. Schoenholz agreed with Mr. Kahr's sense of urgency on this project. Defendant Schoenholz handwrote a note on this memo agreeing with Kahr's recommendation. *Id.*

Knowing that, if unsealed, the Providian memos would reveal the true nature of Kahr's advice to Household, defendant Schoenholz wrote a memo to file on March 12, 2001, noting that [redacted] Ex. 30 at HHS 03680479.[31] Schoenholz indicated in the memo that Kahr [redacted]

[31] Interestingly, defendants only produced this document after the close of discovery.

[redacted] *Id.* Defendant Schoenholz instructed that [redacted] *Id.* at HHS 03680480.

Defendant Schoenholz's memo evidences his awareness that: [redacted] Incredibly, defendants continued to consult with Kahr and to pay him tens of thousands of dollars on a monthly basis. To be sure, Kahr's ideas were not so abhorrent to Household and the defendants until they became aware that there was significant risk associated with the disclosure of Household's relationship with Kahr, particularly given the higher scrutiny that predatory lending issues were receiving at the time. Under these circumstances, defendant Schoenholz's instructions to destroy the Kahr memos can only be viewed as an intentional act to destroy adverse evidence.

The May 5, 2002 article on Providian and Kahr's Providian memos cited in it provide significant insight into precisely why defendants did not want either public exposure of Household's relationship with the notorious Andrew Kahr or to retain the memos memorializing Kahr's role in Household's growth. The article notes that "The Providian documents, including ten Kahr memos plus strategy and training materials dating from the late 1990s portray a company bent on misleading and manipulating its customers in order to soak as much money from them as possible." Ex. 76. The article specifically noted a number of Kahr's strategies which sound remarkably similar to the predatory lending strategies implemented at Household. *Id.* (referring to the "penalty trap," forced purchase of credit protection, deliberate lack of disclosure, and "misleading wording"). Kahr was quoted in the article stating that "If disclosure tended to distract from marketing and reduce the

response rate, then the heck with the disclosure." *Id.* "One of Kahr's favorite strategies was to trap customers with penalty fees." *Id.* Another Household practice "straight out of Kahr's playbook" was a program in which "customers were never told what interest rate they would be charged" and "forced customers to buy credit protection." *Id.* As noted above, Household paid Andrew Kahr over $2 million for a two-year period to come up with similar ideas to "accelerate growth" at Household. Ex. 24.

On June 19, 2002, the California Supreme Court denied Providian's Petition for Review of the Appellate Court's Order granting *The Chronicle* access to the Providian Kahr memos. By this time, defendants had a group of 20 AGs breathing down their necks demanding that Household cease its predatory lending practices and provide restitution to borrowers. On June 24, 2002, Household's Chief Information Officer Ken Harvey sent an e-mail to defendants Schoenholz and Aldinger as well as Household General Counsel Ken Robin, marked "COMPANY CONFIDENTIAL," the subject of which was "Kahr Memos." Ex. 81.[32] In the e-mail, Ken Harvey informed defendants and Ken Robin that "[w]e will be deleting 620 e-mails from over 90 employee mailboxes shortly. Most of these were forwarded internally after being received. We will also block all incoming memos from that e-mail account. Mr. Kahr could still send e-mail from another account should he figure out that he is blocked. We have created a database containing all these notes and will work with Ken Robin on the disposition." *Id.*

That same day, June 24, 2002, Household's counsel Kay Curtin received from the multistate group of AGs a data request in advance of the general meeting that was to be held on July 9, 2002.

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[32] In a large company like Household with over 32,000 employees, the personal involvement of senior executive officers in the destruction of documents must be viewed with greater scrutiny. *United States v. Philip Morris USA, Inc.*, 327 F. Supp. 2d 21, 25 (D.D.C. 2004) ("[I]t is astounding that employees at the highest corporate levels in Philip Morris, with significant responsibilities pertaining to issues in this lawsuit, failed to follow . . . the document retention policies.").

Ex. 2. A month before, on May 23, 2002, Household, including Kay Curtin and Tom Detelich, was already aware that a multistate working group of AGs and state regulators were interested in speaking with Household regarding the Company's lending practices. *Id.*

On June 28, 2002, defendant Schoenholz directed Robin to deal with Kahr memos as follows: "I think you should send out a note on disposing of all memos." Ex. 81.[33] On July 1, 2002, Household Assistant General Counsel Mark Leopold sent an e-mail to defendant Schoenholz, Ken Robin and Harvey stating that he gathered all Kahr memos on Lotus Notes, put them all into a single database, printed off a list of the documents and circulated them to "Ken's other direct reports." Ex. 82. He noted that [redacted]

*Id.*

Again, on the very day that Leopold sent out this e-mail, his boss Robin was hiring Ernst & Young LLP ("E&Y") to do a compliance study in response to threatened AG litigation over Household's predatory lending practices, the subject of Kahr's memos. In a declaration submitted to this Court to support defendants' assertion of work product over the E&Y compliance engagement, Robin stated "The Compliance Engagement was triggered by a lawsuit brought [on November 14, 2001] by the State of California. . . . Household was concerned that other states and/or class action plaintiffs lawyers would bring similar claims, and also had received formal inquiries

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[33] Interestingly, despite the fact that Household paid Kahr over [redacted], during his deposition, Robin could not recall if there had been any discussion within the Board about Kahr, or even what kind of consulting Kahr did. Ex. 89 at 66:24-67:15; Ex. 24. Nor did Robin have any recollection of whether he destroyed or ordered the destruction of Kahr's memos. Ex. 89 at 60:3-61:18.

from the Attorneys General of the states of Arizona and Washington." Declaration of Kenneth H Robin in Opposition to Plaintiffs' Motion to Compel the Production of Documents Pertaining to Household's Consultations with Ernst & Young LLP at 2, Dkt. No. 749, filed November 3, 2006. At the time it retained E&Y, Household was preparing for its first negotiation session with a Multistate Working Group of state AGs ("the Working Group") regarding threatened claims arising from its consumer lending practices. *Id.*

Given Robin's knowledge of this anticipated litigation, all the Kahr memos should have been saved. More to the point, since Leopold had responsibility for overseeing litigation for Household, presumably he was aware of the E&Y Compliance Engagement and the reasons for instituting it and since he had already communicated with Robin on the subject of saving the Kahr memos, his e-mail seems disingenuous to say the least.[34] The parallel timing of the destruction of the Kahr memo with the AG litigation further ends the plausibility of defendants' alleged "reason" for destroying the Kahr memos.

Additionally, although defendants claim that plaintiffs have received all the Kahr documents, this is belied by two facts: (1) defendants have never produced the list of Kahr documents that Ken Harvey printed out and circulated to Robin's other reports; and (2) Kahr was in the practice of designating his memos in a specific fashion – one or two alphabet characters followed by sequential numbers. *See, e.g.*, Ex. 9 ("L46") [HHS 03243101-05]; Ex. 11 ("L55"); Ex. 10 ("L56"); Ex. 12 ("L57"). Based on his numbering pattern, it appears that Kahr authored at least 266 memos, if not more. *See* Ex. 28 ("LS266"). The scattered and haphazard production plaintiffs have received is

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[34] Even if Leopold was not aware, an implausible notion given Leopold's responsibilities, Robin himself knew that the Kahr memos should be saved because of the anticipated litigation that he himself knew of and that served as the basis for his hiring E&Y – which again renders Leopold's e-mail an absurdity. Why ask Robin directly what Robin himself knows and presumably already told Leopold?

incomplete and almost entirely produced from someone's hard copy files. *See, e.g.*, *Nursing Home Pension Fund v. Oracle Corp.*, No. C 01-00988 SI, 2008 U.S. Dist. LEXIS 66740, at *21 (N.D. Cal. Sept. 2, 2008) (sanctioning defendants for destruction of evidence where it became clear that e-mails were not produced from defendants' e-mail files because some e-mails were produced from a different source).

### D. Defendants' Own Internal Policies Required Them to Retain Documents in Anticipation of Litigation or Regulatory Investigation

Household's internal document retention policies required defendants (and Household employees) to retain documents based on litigation or governmental investigation. [redacted] Ex. 62 at HHS 02169581.[35] Notwithstanding this paper policy, which constitutes conscious recognition of defendants' legal duty to preserve records, defendants took no steps to retain records in the face of the litigation and governmental investigations detailed above. To the contrary, as noted above, Household management, including defendants Gilmer and Schoenholz, affirmatively sent out directives to destroy documents that were not only relevant to the litigation and governmental investigations, but highly damaging to defendants in those matters as well as this one.

While in some cases the official document retention policy may shield a corporation from spoliation, that situation is not applicable here where the official policy is nothing but worthless paper. Under that policy, Household's Legal Department, headed by General Counsel Ken Robin,

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[35] This Manual is undated. However, it was in effect during the Class Period. According to Household records, the introduction from Bob Finnigan (*see* Ex. 62) was last updated in July 26, 2000. *Id.* (HouseNet printout as of August 31, 2005). Similarly, there is handwriting on the cover indicating that the Manual was in effect by at least November 2001. Ex. 62 at HHS 02169555. An earlier version of the Manual, which was in effect in September 1999, does not include the "foreseeable" language.

and his department heads, including General Counsel for HFC, Kay Curtin, was responsible for issuing directives for retaining documents and specifying what documents were to be retained. Ex. 87 at 109:5-20. Both Mr. Robin and Ms. Curtin were involved in the ACORN negotiations and indeed, it is their involvement that serves as the basis for the assertion of work product protection over a draft March 2001 letter to ACORN and a draft June 19, 2001 letter, discussed in §III.A.1 herein. Ex. 101 at ##5628-5631, 2117. Notwithstanding their personal involvement and their personal knowledge of the anticipated litigation with ACORN, neither Mr. Robin nor Ms. Curtin sent out a directive to retain documents at that time. *See* Ex. 89 at 98:16-99:6, 100:2-8.

Ms. Curtin's testimony on this point is intriguing to say the least. She testified that she had a role in the June 2001 purge, which was [redacted] Ex. 91 at 125:13-20. [redacted] *Id.* at 125:16-127:6. In response to the critical question, "Did you determine that any of the documents should not be destroyed because of possible litigation?," Ms. Curtin demurred, stating "I don't recall." *Id.* at 127:14-17. Yet, as noted above, just a few months before the purge, Ms. Curtin was herself involved in preparing for anticipated litigation with ACORN. Ex. 101 at ##5628-5631.

The absence of any directive to retain documents is also conspicuous with regard to the ongoing Washington DFI investigation, which commenced no later than May 17, 2001 and melded into the Minnesota investigation, the AGs' investigation in May 2002 or any of the subsequent class actions. It wasn't until August 2002 – after the destruction of relevant evidence – that any directive to retain documents in response to the ACORN lawsuits was issued even though clearly called for by the official policy. Ex. 102. Indeed, as one Household officer testified, there was no directive to

retain documents even after the *Luna* class action was filed in February 2002. Ex. 85 at 111:5-114:6-12, 131:6-133:21, 145:16-149:7 (testifying that directives to destroy documents were issued, and were not modified, despite knowledge of Washington complaints and DFI investigation, *Cabral* lawsuit and *Luna* class action).

Even if this passivity were not enough, which it is under the case law, *see supra* p. 15, there was affirmative action by the Legal Department to enable the document purges in mid-2001 and June 2002. As a matter of procedure, the Legal Department had to approve the sending out of bulletins to the branch offices. Household's records show that the May 24, 2001 bulletins directing branch offices to destroy "unauthorized" materials were approved by the Legal Department. Ex. 43; Ex. 44. Moreover, these bulletins were drafted by the head of Household's Policy & Compliance Department, Tom Schneider. Significantly, like the Legal Department, the Compliance Department had responsibilities under the official document retention policy. Ex. 62 at HHS 02169604 (where applicable, the subsidiary's Audit or Compliance Department responsible for enforcing compliance with Manual). This willful disregard and indeed, violation of the official document retention policy by the officers responsible for overseeing and implementing it alone demonstrates that its existence was a sham, yet another example of defendants' propensity to create and maintain exculpatory documents.

However, there is one additional point to be considered on the official policy – one that concerns the actual efficacy of the policy even if implemented correctly. According to the official policy, correspondence having "evidentiary value" were records that were to be retained. *Id.* at HHS 02169577 [redacted] Yet Household did not retain the HOLPs or any other marketing materials, including letters, provided to the customer once the loan was funded. The ostensible reason was that such customer correspondence had no value after the

loan was funded. This reason is facially invalid – the customer correspondence had value not only to the customer but to Household itself when responding to customer complaints that sales branch employees were misrepresenting the terms and conditions of the loan. Indeed, for a company that publicly stated its abhorrence of unethical lending, it is remarkable that it did not retain these documents as the means to pursue internal investigations into customer complaints. To the contrary, these documents were immediately destroyed to erase the hard evidence of deceptive lending, leaving the customer in a "he said, she said" situation rendered more untenable by the retention of Household's nice, clean loan documents.

Courts in this District have awarded sanctions for a failure to place a litigation hold on relevant documents. *See, e.g.*, *In re Old Banc One S'holders Sec. Litig.*, No. 00 C 2100, 2005 U.S. Dist. LEXIS 32154, at *13-*14 (N.D. Ill. Dec. 8, 2005) (court there sanctioned Banc One by prohibiting the company from cross-examining plaintiffs' expert witness at trial because Banc One did not implement a litigation hold, resulting in the destruction of potentially relevant document). Here, the conduct is much more egregious – defendants and Company counsel were intimately involved in the decision to intentionally destroy documents that were relevant and harmful to defendants. Accordingly, sanctions are appropriate.

### E. Defendants Willfully and with Bad Faith Breached Their Duty to Preserve Relevant Evidence Despite Being on Notice of Their Obligation to Preserve Potentially Relevant Evidence

"The prevailing rule is that bad faith destruction of a document relevant to proof of an issue at trial gives rise to a strong inference that production of the document would have been unfavorable to the party responsible for its destruction." *Coates v. Johnson & Johnson*, 756 F.2d 524, 551 (7th Cir. 1985); *see also Partington v. Broyhill Furniture Indus., Inc.*, 999 F.2d 269, 272 (7th Cir. 1993) ("[I]f, being sensitive to the possibility of a suit, a company then destroys the very files that would be expected to contain the evidence most relevant to such a suit, the inference arises that it has

purged incriminating evidence."); *accord Crabtree v. Nat'l Steel Corp.*, 261 F.3d 715, 721 (7th Cir. 2001); *see also Mathis v. John Morden Buick, Inc.*, 136 F.3d 1153, 1155 (7th Cir. 1998) ("That the documents were destroyed ***intentionally*** no one can doubt, but 'bad faith' means destruction for the purpose of hiding adverse information.") (emphasis in original).

Defendants will likely claim that their instructions to destroy documents in May-June 2001 and later was nothing more than an attempt to rid the Company of unauthorized forms, thereby preventing potential incidents of deceptive sales practices. However, this justification is not credible. First, there is an abundance of evidence that the sales practices complained of, including specifically the "effective rate" sales pitch, were in fact approved by and implemented by the Company. Second, even if true, the "unauthorized" materials should have been gathered and saved.

Third, further, defendants' justification is also not credible in connection with documents that had already been sent to customers, such as those involved in the early "Purge-Blitz" and the April 2002 destruction of computer files. Destroying sales presentations already made to customers when the Company was mired in allegations that it misrepresented the terms of loans it made to customers, is simply unsupportable. *See Brown & Williamson Tobacco Corp. v. Jacobson*, 827 F.2d 1119, 1134-36 (7th Cir. 1987) (applying presumption that the destroyed documents would be unfavorable to the party destroying the evidence where employee engaged in selective destruction of documents he knew were relevant to the litigation against defendant, where employee violated employer's retention policy, and where he offered noncredible justification for destruction).

Likewise, the destruction of the Andrew Kahr documents cannot be supported. Household will attempt to justify it – as numerous employees have attempted during depositions – contending that Kahr's initiatives were not implemented in the manner presented in the memos, or mimic defendant Schoenholz's attempt to portray Kahr's comments as offensive and [redacted]

[redacted] Ex. 30 at HHS 03680479-80. Schoenholz's explanation that those memos needed to be destroyed because future employees would be unable to comprehend [redacted] by defendants strains credulity. *Id.* Defendants could have simply terminated Kahr instead of continuing to pay him over [redacted] over a period of three years. Ex. 24. Given Kahr's self-professed principle of "squeezing the customer and making him sit for the squeeze" as well as his distaste for clear disclosure, the truth is that the Kahr memos contained incriminating evidence of defendants' involvement in promoting predatory lending practices in order to achieve their goal of growth.

In *Partington* (an age discrimination case), when Partington was dismissed he was offered severance pay if he would sign a release of his right to sue under the age discrimination law. 999 F.2d at 271. Pretrial discovery turned up a list of salesmen with their ages written next to their names. *Id.* By itself, the court found that no inference of guilt can be drawn from awareness of one's legal obligations. *Id.* However, because the company ordered a "purge" of the files of its terminated salesmen (most of whom were over the age of 40 and thus potential age discrimination plaintiffs), the innocuous evidence of age awareness became significant in conjunction with evidence of the purge. *Id.* Although the company presented evidence that the purpose was merely to eliminate duplicates, the purge came to light only because pretrial discovery turned up from other sources documents that should have been in the terminated employees' files but were not. *Id.* at 272. The court found that although a company cannot be faulted for being sensitive, "[b]ut if, being sensitive to the possibility of a suit, a company then destroys the very files that would be expected to contain the evidence most relevant to such a suit, the inference arises that it has purged incriminating evidence." *Id.* Similarly, here, Household withheld documents in discovery under the umbrella of

work product, *i.e.*, in anticipation of litigation, but engaged in intentional destruction of documents at the same time.

In light of all the facts noted above, defendants' destruction of relevant evidence on numerous occasions was willful and designed to prevent the truth of their wrongful conduct from being revealed. The only conclusion that can be drawn is that defendants destroyed evidence for the purpose of hiding adverse information.

### F. Plaintiffs Are Prejudiced by Defendants' Willful Breach of Their Duty to Preserve Relevant Evidence

As an initial matter, the "Seventh Circuit has held that a finding of prejudice is not required before a court dismisses or enters judgment as a sanction under its inherent power." *Diersen v. Walker*, No. 00 C 2437, 2003 U.S. Dist. LEXIS 9538, at *10-*11 (N.D. Ill. June 5, 2003) (citing *Barnhill*, 11 F.3d at 1368). "Where the defendant shows that plaintiff is responsible for spoliation of evidence, the court must determine the degree of prejudice to the defendant caused by the spoliation before it fashions a remedy." *Lekkas v. Mitsubishi Motors Corp.*, No. 97 C 6070, 2000 U.S. Dist. LEXIS 12016, at *10-*11 (N.D. Ill. Aug. 17, 2000); *Kronisch v. United States*, 150 F.3d 112, 126 (2d Cir. 1998). '"The test for prejudice is whether there is a reasonable possibility, based on concrete evidence, that access to the evidence which was destroyed or altered, and which was not otherwise attainable, would produce evidence favorable to the objecting party.'" *Lekkas*, 2000 U.S. Dist. LEXIS 12016, at *10-*11 (citing *Nationwide Mut. Fire Ins. Co. v. Ford Motor Co.*, 174 F.3d 801, 804 (6th Cir. 1999)). The court's inquiry into prejudice in the spoliation context is "unavoidably imperfect, inasmuch as, in the absence of the destroyed evidence, [the court] can only venture guesses with varying degrees of confidence as to what that missing evidence may have revealed." *Kronisch*, 150 F.3d at 127.

Internal documents describe what relevant evidence was intentionally destroyed by defendants. [redacted]

[redacted] (Ex. 50 at HHS 03208139), [redacted]

- [redacted]
  - [redacted]
  - [redacted]
  - [redacted]

*Id.* Under the bullet point for "Anecdotal," the outline lists:

- [redacted]
  - [redacted]
  - [redacted]
  - [redacted]

*Id.*

The sales materials destroyed in the [redacted] included HOLPs, marketing and sales tools, comparison charts, customer correspondence, and training materials. The HOLP is a critical part of every single loan offer made by Household's employees and was a primary document used during the loan sale process. As noted above, the HOLP included explicit references to effective rates or equivalent rates. Importantly, the HOLPs were not among the documents Household required be imaged and sent to corporate to be maintained in the official loan document file. Instead, the branches maintained the HOLPs, along with other materials, worksheets, charts and notes, within the branch offices. That is, they maintained them in the branches until they were ordered to destroy them starting with the 2001 [redacted]

The destroyed HOLPs and other sales tools would have provided highly relevant evidence regarding the widespread uniformity of defendants' predatory lending practices throughout the nation. As discussed above, these documents were destroyed because they constituted evidence regarding the widespread use of the effective rate presentation. However, they also evidenced the use of other predatory lending practices, such as Household's use of "discount points" commencing in 1999. Ex. 61. Legitimate discount points are negotiated with the customer to "buy down" the customer's interest rate. At Household, there was no negotiation and customers were routinely charged the maximum points applicable – so that discount points were in truth origination fees. However, at the same time, defendants' GFE disclosures would show the discount fee as a range of potential fees, often starting at $0, so that the customer would have no idea as to the actual points being charged until the closing. The HOLP played its part in this scheme because it would present an interest rate that "assumed" the maximum points. The maximum points should, therefore, have been disclosed on the GFE, but were not. Accordingly, the destroyed HOLPs also constitute evidence of defendants' predatory practices with respect to discount points and GFE disclosures.

Similarly, training materials destroyed in the purge would have provided evidence of defendants' deceptive sales practices, specifically as to the use of practices on a nationwide basis and to the involvement of mid-level branch management, such as the DGM and DSM, in fostering such practices. The important role of the DSM in training is highlighted by the declarations of the former BSMs submitted with this motion.

Finally, the Kahr memos would have provided evidence regarding Household's senior management's knowledge of, and role in, promoting predatory lending practices as "growth initiatives." As noted above, Kahr's initiatives included the increased use of prepayment penalties and hiding loan details, such as prepayment penalties, in the fine print. These topics are central to both to the ACORN/AG litigation as well as this case.

In sum, the destroyed materials would have substantiated plaintiffs' allegations that: (1) Household engaged in various deceptive and illegal lending practices and abusive sales techniques including the "effective rate" bi-weekly EZ Pay sales pitch; (2) the misleading and deceptive sales practices were employed by Household's officers and employees nationwide; (3) Household senior management, including the Individual Defendants, knew about and encouraged such practices to meet their growth objectives; and (4) Household had a corporate culture of predatory lending practices that subjected it to substantial risks, undisclosed to investors.

### G. Defendants' Intentional Destruction of Evidence Mandates the Evidentiary Sanctions Requested by Plaintiffs

Due to defendants' intentional destruction of crucial evidence, plaintiffs seek sanctions that will, as much as is possible, level the playing field before the jury. *E*Trade Sec., LLC v. Deutsche Bank AG*, 230 F.R.D. 582, 577-94 (D. Minn. 2005) (Pre-litigation spoliation of relevant evidence resulted in the following recommendation for an adverse inference instruction to jury: "[I]t may infer that the information that [the] Nomura Canada and NSI [defendants] failed to preserve would have been advantageous to plaintiffs and disadvantageous to the Nomura Defendants."). Plaintiffs seek:

> (1) a jury instruction that during the Class Period, Household engaged in a nationwide deceptive sales practice of selling loans based on the misleading sales pitch that the borrowers would pay an "effective interest rate" that was almost half the actual or contract rate;
>
> (2) a jury instruction that during the Class Period, prepayment penalties were not affirmatively disclosed to borrowers, but were buried in loan documents "not highly visible" to customers;
>
> (3) a jury instruction that during the Class Period, various deceptive and illegal sales practices were practiced nationwide in all Household branches;
>
> (4) a jury instruction that defendants intentionally destroyed evidence of their deceptive and illegal branch sales practices;
>
> (5) a jury instruction that Household senior management, including defendants Aldinger, Schoenholz, Gilmer and Vozar, knew during the Class Period that the Company was engaged in widespread deceptive and illegal branch sales practices and encouraged their use; and

(6) an order precluding defendants from cross-examining plaintiffs' expert Catherine Ghiglieri in connection with plaintiffs' proof of the above five facts.

*See Old Banc*, 2005 U.S. Dist. LEXIS 32154, at *13-*14 (defendant bank's destruction of potentially relevant documents as part of the corporation's normal operating procedure resulted in a sanction prohibiting the company from cross-examining plaintiffs' expert witness at trial and explaining the reason for the limitation to the jury).

## IV. CONCLUSION

Based on the foregoing, as well as any further submissions or oral arguments presented, plaintiffs respectfully request that the Court should grant the relief sought in order to ameliorate the prejudice suffered by the Class due to defendants' willful and bad faith destruction of relevant evidence.

DATED: November 26, 2008

Respectfully submitted,

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DECLARATION OF SERVICE BY ELECTRONIC MAIL AND BY U.S. MAIL

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Francisco, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 100 Pine Street, Suite 2600, San Francisco, California 94111.

2. That on November 26, 2008, declarant served by electronic mail and by U.S. Mail to the parties the **LEAD PLAINTIFFS' MOTION REQUESTING EVIDENTIARY SANCTIONS FOR HOUSEHOLD DEFENDANTS' DESTRUCTION OF EVIDENCE**:

The parties' email addresses are as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 26th day of November, 2008, at San Francisco, California.

/s/ Marcy Medeiros
MARCY MEDEIROS