UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

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

LEAD PLAINTIFFS' REPLY IN FURTHER SUPPORT OF THEIR MOTION REQUESTING EVIDENTIARY SANCTIONS FOR HOUSEHOLD DEFENDANTS' DESTRUCTION OF EVIDENCE

REDACTED VERSION

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I. INTRODUCTION

Lead plaintiffs respectfully submit that the evidentiary sanctions against defendants in the form requested are warranted here.[1] Defendants do not dispute that evidence was destroyed and plaintiffs have demonstrated that by late-2000 and no later than March 12, 2001, defendants were on notice of their duty to preserve documents related to Household's sales and lending practices as well as complaints resulting from allegations that such practices were deceptive and predatory. Defendants have also failed to justify their assertions of the work-product privilege on ACORN-related complaints from March 2001 – a privilege that only protects documents prepared because of ongoing or anticipated litigation.

Defendants' post-destruction explanations and self-serving declarations that the destroyed documents were "unauthorized" or that the Company was only required to save the actual customer loan documents, and not the documents used to solicit the loans, are unconvincing and inconsistent with the factual record. Defendants' admission that the destruction was to insulate customers and employees from deceptive practices only bolsters the conclusion that the missing documents were adverse to defendants.

Defendants could have put in the record document holds they issued in response to ACORN complaints they were receiving beginning August 2000, or the document holds they issued in response to the complaints they received from the Washington and Minnesota state regulators. At the December 2, 2008 presentment hearing on plaintiffs' current motion, counsel for defendants indicated that plaintiffs had failed to provide the Court with these documents. Declaration of Landis Best in Support of the Household Defendants' Opposition to Lead Plaintiffs' "Spoliation" Motion

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[1] Defendants here are Household International, Inc. ("Household" or the "Company"), CEO William F. Aldinger, CFO David A. Schoenholz and CEO of Consumer Lending Gary D. Gilmer.

("Best Decl."), Exhibit 23 at 18. As detailed below, defendants did not produce any such document holds issued in response to any prior investigations and litigations to plaintiffs, and in fact, successfully prevented plaintiffs from obtaining any information regarding defendants' efforts to preserve documents in the earlier cases. *See* Magistrate Judge Nan R. Nolan Minute Entry (Dkt. No. 341) November 30, 2005. Incredibly, defendants now claim that this November 2005 order – that had nothing to do with a request for adverse inferences or evidentiary sanctions – now bars plaintiffs' present motion. Yet, defendants themselves have not submitted any of these previously issued documents holds in connection with this motion.

Similarly, defendants have no answer for why defendant David Schoenholz gave instructions on March 12, 2001 to destroy memos written by Household's consultant Andrew Kahr, while in the same memo he acknowledges that similar memos written by Andrew Kahr had gotten his other client – a consumer finance company called Providian Corporation – in legal trouble leading to fines and settlements in the hundreds of millions of dollars. Defendants continued to use Kahr's services and pay him $60,000 per month until June 2002, by which time Household was in hot water with regulatory actions and class action lawsuits over the Company's predatory lending practices. Defendants' silence on this issue is deafening. In June 2002, defendant Schoenholz issued another instruction to destroy Kahr memos. Notwithstanding this destruction orders, defendants posit that plaintiffs have not shown that these orders were implemented. Defendants are wrong. The factual record is clear that Kahr wrote over 200 memos for Household and plaintiffs were only provided 23 memos. Defendants' alternative justification is that the Kahr memos were destroyed to protect Household employees from Kahr's ideas. This position, of course, is nonsensical. Why pay a consultant millions of dollars when the company has no intention of using his ideas.

Plaintiffs have more than sufficiently met their burden on this motion of showing that they are entitled to the evidentiary sanctions they seek because (i) defendants had notice of the relevance

of the Company's sales and lending documents, complaints relating to allegations that Household engaged in deceptive and predatory lending practices, and the Kahr documents; (ii) defendants had a duty to preserve these documents; (iii) defendants violated that duty by destroying relevant documents; (iv) the destruction was done with knowledge of the relevance of these documents to potential adversaries, and thus in bad faith, or at a minimum, defendants were at fault for the destruction; and (v) plaintiffs are limited in their ability to present direct evidence of portions of their claims, and thus have been prejudiced. Accordingly, plaintiffs respectfully submit that the Court should grant this motion.

II. ARGUMENT

A. Plaintiffs Have Presented Uncontroverted Evidence that Defendants Had Notice and Thus the Duty to Preserve Documents Concerning Household's Sales Practices and Any Resulting Complaints Before the June 2001 Company-Wide Destruction of Sales and Marketing Materials

1. Defendants' Assertions of Work-Product Privilege Over Documents in This Litigation in March 2001 Triggered Their Duty to Preserve Documents Relating to the Company's Lending Practices

Plaintiffs have demonstrated based on entries in defendants' privilege logs that defendants had a duty to preserve documents relating to Household's sales and lending practices beginning at least on March 12, 2001. *See* Ex. 101 to the Declaration of Azra Z. Mehdi in Support of Lead Plaintiffs' Motion Requesting Evidentiary Sanctions for Household Defendants' Destruction of Evidence ("Mehdi Decl.") (All exhibit references herein are to the Mehdi Decl. unless otherwise noted.).[2] It is well-established that the work-product doctrine is only applicable where a document is

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[2] Plaintiffs' use of the March 12, 2001 date is conservative. As outlined in plaintiffs' opening brief in support of its spoliation motion ("Pls' Mot."), an argument can be made that defendants were on notice even earlier, on September 28, 2000, when they were responding to Washington state's challenge of Household's

created in anticipation of litigation. *See* Fed. R. Civ. P. 26(b)(3); *Binks Mfg. Co. v. Nat'l Presto Indus., Inc.*, 709 F.2d 1109, 1118 (7th Cir. 1983) (Although a lawsuit need not have been filed, there must be some likelihood that litigation will follow.); *United States v. Roxworthy*, 457 F.3d 590, 597-98 (6th Cir. 2006) (Legal opinion was prepared in anticipation of litigation even though no adverse action had been taken against company.); *Kronisch v. United States*, 150 F.3d 112, 126 (2d Cir. 1998) (A party has a duty to preserve evidence during litigation and at any time before the litigation "when a party should have known that the evidence may be relevant to future anticipated litigation.").

Thus, defendants' assertion of the work-product privilege on documents relating to the Company's sales and lending practices constitutes an admission that as of March 2001, litigation with ACORN was imminent and probable. *Samsung Elecs. Co. v. Rambus, Inc.*, 439 F. Supp. 2d 524, 542 (E.D. Va. 2006) (The standard for anticipation of litigation under the work-product doctrine is useful in determining when a party anticipated litigation with regard to preservation and spoliation.). 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).

In their lengthy opposition, defendants have not, because they cannot, rebut this admission. Either defendants were in fact anticipating litigation by that date – triggering their duty to preserve

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imposition of prepayment penalties, if not by August 2000 when ACORN exerting pressure on defendants to change the Company's sales practices. Ex. 101 at ##2818, 2826; *see also* Pls' Mot. at 11-13.

documents related to Household's sales practices and any complaints as a result of such practices – or defendants have withheld numerous documents from plaintiffs in this litigation on false pretenses. *Jackson v. County of Sacramento*, 175 F.R.D. 653, 656 (E.D. Cal. 1997) (A lawyer's statement that information is being withheld under the "assertion of attorney work product protection carries its own implicit assertion about the factual predicate for the claim."). Defendants gloss over this admission by speculating on the "impossibility of discerning an actor's state of mind in 2001." Memorandum of Law in Opposition to Plaintiffs' "Spoliation" Motion ("Defs' Opp.") at 56. Defendants' argument lacks merit. The assertion of work-product protection must be made in good faith based upon the contents of the document, at the time the document was created. *Kent Corp. v. Nat'l Labor Relations Board*, 530 F.2d 612, 623 (5th Cir. 1976) (Materials qualify as work product if prospect of litigation identifiable when materials are prepared.). In withholding responsive discovery from plaintiffs, defendants are required to make good faith assertions of privilege. *See AAMCO Transmissions, Inc. v. Marino*, No. 88-5522, 1991 U.S. Dist. LEXIS 13326, at *14 (E.D. Pa. Sept. 24, 1991) (threatening to deny motion to exclude privileged evidence unless party claiming the privilege could make a good faith showing as to how each document was protected).

Defendants' reliance on dicta in *Chemcentral/Grand Rapids Corp. v. United States Environmental Protection Agency*, No. 91 C 4380, 1992 WL 724965 (N.D. Ill. Aug. 20, 1992) (Weisberg, Mag. J.), is also unavailing. Defs' Opp. at 57. They do not – and cannot – assert that they withheld any of the 2001 documents at issue in this litigation because of settlement negotiations. That would contradict the explanation they provided in their privilege logs. *See* Ex. 101. Moreover, even if that were the case, settlement documents must pertain to foreseeable litigation in order to be protected under work product. *See Coastal States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 865 (D.C. Cir. 1980). Additionally, documents prepared with the objective of

avoiding a possible suit are still deemed to be prepared "with an eye towards litigation." *Cities Serv. Co. v. FTC*, 627 F. Supp. 827, 832 (D.D.C. 1984).[3]

Similarly, defendants' reliance on *In re Kmart Corp.*, 371 B.R. 823, 842 (N.D. Ill. 2007), to quibble about the relevant date for notice purposes in this case, is misplaced. Defs' Opp. at 57. In *Kmart*, the court noted that "although Ellis was the highest level employee in Kmart's management chain that had dealings with Global, the evidence does not show that anyone other than Ellis and Andresen recognized the possibility of legal action by Global." 371 B.R. at 844.

Significantly, the e-mails that defendants have withheld from March 12, 2001 relate to "legal advice re: draft response letter to ACORN ***plaintiffs***." *See* Ex. 101 at ##5628, 5630. The only plausible conclusion that can be drawn from defendants' reference to "plaintiffs" is that by March 12, 2001, defendants believed litigation with ACORN was imminent and foreseeable and were already identifying ACORN as the adverse party. *See also id.* at #5631 (asserting work product over March 15, 2001 letter described as "draft" response to ACORN ***plaintiffs***"). It is implausible to find more concrete evidence of notice of the duty to preserve documents relating to Household's sales practices. But here there is more. Contrary to the facts in *Kmart* (where the e-mails were only exchanged between two individuals), the e-mails here were circulated widely between defendant Gary Gilmer; General Counsels of several different business units at Household, including Kenneth Robin, the Executive Vice President and Household General Counsel; Kay Curtin, HFC General Counsel; Dennis O'Toole, the Senior Vice President of Government Relations and Director of Employee Communications; and the Vice President of Corporate Relations, as well as several

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[3] All citations are omitted and emphasis is added unless otherwise noted.

individuals from an outside public relations firm, Edelman. *Id.*[4] Incredibly, defendant Aldinger even acknowledged in his deposition that he believed it was part of ACORN's "playbook" to sue. Ex. 1 at 144:25-145:11 to the Declaration of Azra Z. Mehdi in Support of Lead Plaintiffs' Reply in Further Support of Their Motion Requesting Evidentiary Sanctions for Household Defendants' Destruction of Evidence ("Reply Decl."), filed herewith. Plaintiffs have thus indisputably demonstrated defendants' belief that litigation with ACORN surrounding Household's sales and lending practices was imminent at least as of March 12, 2001.[5]

Additional assertions of the work-product privilege further bolster plaintiffs' spoliation claims. *See, e.g.*, Ex. 101 at #3511 (defendants explain their privilege on a May 4, 2001 document regarding "Policy and Procedures Regarding Predatory Lending" as "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.* at #2094 (asserting work product over April 26, 2001 fax regarding predatory lending complaint filed by customer Mabel Yancey); *id.* at #2117 (June 19, 2001 document authored by Ken Robin describes "Revisions to Draft Letter to ACORN" explains 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.").

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[4] *See* Pls' Mot. at 11-13 (detailing defendants William Aldinger, Gilmer and David Schoenholz's awareness and concern beginning in mid-2000 about the level of scrutiny that predatory lending issues and in particular, Household, were receiving and the Company's retention of the public relations firm Edelman, at a cost of many millions, to manage the external perception of the Company in that regard).

[5] This conclusion is further bolstered by Household counsel's instructions in this case not to answer questions related to the potential for a lawsuit being filed by ACORN beginning January 2001 based on the work-product privilege. Reply Decl., Ex. 2 at 71:9-14; 86:6-24; 87:8-88:1.

Defendants' only factual counter is Larry Bangs' testimony that he was not concerned in or around May 2001 that ACORN was going to sue Household. Defs' Opp. at 20-21. As an initial matter, Mr. Bangs during his deposition had very little recollection of a number of events. Second, the documents withheld by defendants based on work product dated March 12, 2001 and March 15, 2001 contradict Mr. Bangs' testimony regarding his personal belief, six years later, the very real concerns defendants had in the 2000-2001 timeframe of the impact of ACORN's activism against Household. Other documents also contradict Mr. Bangs: A November 2000 e-mail exchange between defendant Gilmer's assistant Lisa Sodeika, Tom Detelich, Consumer Lending General Counsel Kay Curtin as well as Mike Eden, Ned Hennigan and Robert O'Han (the RGMs for the Household branches) indicates that Household was receiving customer complaints through ACORN about various issues from all over the country. *See* Reply Decl., Ex. 21 (listing 30 complaints). Additionally, contrary to defendants' criticism of ACORN's role and intent in their papers, Household undertook a study of ACORN's complaints and found that although ACORN's reports were generalized and exaggerated, their "findings were not false." *See* Reply Decl., Ex. 22. In fact, Household changed the manner in which it investigated and reported complaints, in part because of ACORN's involvement in providing customer complaints. *See* Reply Decl., Ex. 23. Significantly, Mr. Bangs did recall that in June 2001, ACORN and Household negotiated a Memorandum of Understanding to attempt to reach agreement on changing certain aspects of Household's sales practices. Reply Decl., Ex. 3 at 67:12-68:14. Defendants have asserted the work-product privilege over this document as well. Ex. 101 at 2117.

Further, defendants' own contemplation of litigation or some legal strategy against ACORN memorialized in defendant Gilmer's May 17, 2001 memo also mandated the preservation of documents related to the Company's sales and lending practices. *See* Ex. 38 at HHS 03454631 (memo from defendant Gilmer to, among others, defendants Aldinger and Schoenholz, and General

Counsel Ken Robin, entitled [redacted] which highlighted [redacted] as the first point of discussion). A specific action item in Gilmer's memo was [redacted] *See id.* at HHS 03454633. This also triggered a duty to preserve documents relevant to the Company's sales practices. *See, e.g., Cyntegra, Inc. v. Idexx Labs., Inc.*, No. CV 06-4170 PSG (CTX), 2007 WL 5193736, at *3 (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). Defendants' 70-page opposition fails to rebut this fact entirely.

2. Plaintiffs Have Demonstrated that Investigations of Various State and Federal Regulators Regarding Specific Complaints Put Defendants on Notice of Their Duty to Preserve Documents Relevant to Household's Sales Practices

Plaintiffs have detailed in their opening brief specific facts regarding various state and federal and customer complaints detailing when and how defendants were on notice of their duty to preserve documents relevant to predatory lending and Household's sales practices. Pls' Mot. at 17-21. At least by mid-May 2001, defendants had specific notice that both Washington and Minnesota were investigating Household's sales practices because of a significant rise in their constituent complaints relating to, among other things, the "effective rate" sales pitch, credit insurance sales, and prepayment penalties. *See* Exs. 32, 37, 39, 47, 74.[6] Additionally, defendant Gilmer was aware as early as March 14, 2001 that the regulators in Washington state intended to support aggressive

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[6] Defendants place heavy reliance on a 2002 study they did of the number of "effective rate complaints," and arrive at a figure of only 42 complaints all across the country. Defs' Opp. at 40, 65; Detelich Decl. ¶¶16, 20. This 2002 study is inaccurate and unreliable. Household was not tracking complaints as "effective rate" complaints specifically, but lumping them in the category of misrepresentation of loan terms. Ex. 48; Reply Decl., Ex. 23.

enforcement against lenders and mortgage brokers that violate the law or regulations. Reply Decl., Ex. 4; *see also* Ex. 101 at #2886 (March 27, 2001 draft letter addressing concerns regarding the propriety of Household's EZ Pay program under Illinois law). This documentary evidence directly contradicts defendants' unsupported assertions that the Washington and Minnesota investigations were part of the "regular oversight" of Household as a licensee.

The judicial record in the *Luna v. Household Finance Corp., III*, No. C02-1635L (W.D. Wash.), class certification proceedings further bolsters the conclusion that defendants were on notice of their duty to preserve documents due to "Attorney General and customer complaints regarding using effective rate or biweekly rate." Reply Decl., Ex. 5 at 39 and Ex. 6 at H003573. Defendants' characterization of Washington state's May 2001 communication listing complaints as nothing more than "standard" or "routine" and not signaling "impending litigation" is also belied by the following uncontroverted facts:

- According to the *Luna* class certification transcript, it appears that Household acknowledged an increased number of complaints in Washington relating to the Company's loan practices – listing 64 complaints in their interrogatory responses. Reply Decl., Ex. 5 at 38-39.

- The testimony of Jon Shrum, Household's Quality Assurance & Compliance Manager for the Northwest Division (including Washington) in the *Luna* litigation that he was informed by Tom Schneider (Household Head of Policy & Compliance) and Craig Castelein (DGM for HFC Washington branches) in early-May 2001 that "the state was concerned about the number of complaints from Household branches." Ex. 85 at 110:12-112:6; 114:13-22 (referring to Exs. 32 and 74).

- The WA DFI Examiner's deposition testimony in *Luna* that Household was unresponsive to complaints listed in the May 17, 2001 communication, which resulted in several [redacted] meetings (including with Tom Detelich and Robin Allcock) where the WA DFI informed Household that if the Company continued to be unresponsive, the [redacted] would be stepping it up to the [redacted] Reply Decl., Ex.7 at HHS 02498432.

- The WA DFI's March 14, 2001 communication to defendant Gilmer demonstrates that he was aware that the regulators in Washington state intended to support aggressive enforcement against lenders and mortgage brokers that violate the law or regulations. Reply Decl., Ex. 4.

By late-2000, in addition to complaints received through ACORN, Household internal memos show that the Company was noticing an increase in the number of complaints tracked at the AG, Better Business Bureau (BBB) and executive level from all across the country. In a January 6, 2001 memo copied to defendant Gilmer and Consumer Lending General Counsel Kay Curtin, among others, Carla Madura notes this regarding November and December 2000 complaints: [redacted] Reply Decl., Ex. 23. With respect to complaints regarding misunderstanding in final loans terms (the category under which "effective rate" complaints fell), Ms. Madura notes that while 32% of the complaints were received in October 2000, this number increased to 34% in November and 36% in December. *Id.* The May 2001 memo shows an acknowledgment of [redacted] and an increasing number of complaints from all across the country where [redacted] and their belief that [redacted] Ex. 48 at HHS 03208011, 8017 (acknowledging that 25% of the AG, BBB and regulatory complaints were "effective or equivalent rate" complaints). Defendant Gilmer and Consumer Lending General Counsel Kathleen "Kay" Curtin were copied on these memos and were aware of these complaints.

Further, contrary to defendants' assertions, the May 25, 2001 communication from the Minnesota Department of Commerce to Head of Policy & Compliance Tom Schneider was not a routine communication. Ex. 47. It listed several of the complaints received by that agency from ACORN, including specifically complaints about sales presentations using a completed "effective rate" worksheet. *Id.*

When the above facts are viewed cumulatively, it is clear from defendants that they were on notice at least by early-May 2001 of the need to preserve documents related to the Company's sales

practices, including specifically, sales made using the "effective rate" pitch as well as any complaints made in connection with loan sales.

Defendants' efforts dismissing plaintiffs' listing of various post-2001 events as irrelevant to the Court's consideration of this motion, must also fail. All of those events demonstrate a heightened level of scrutiny by states all across the nation into Household's sales practices, as well continued pressure from ACORN compounded only by the onslaught of consumer class action lawsuits. Pls' Mot. at 39-42. Further, post-June 2001 e-mails are relevant to the Court's consideration of notice for the April 2002 and June 2002 document destructions.

3. Plaintiffs Have Demonstrated that Spoliation of Documents Relevant to This Litigation Is Actionable Even Where the Destruction Occurred Prior to the Filing of This Lawsuit

Recognizing that plaintiffs has unequivocally demonstrated that defendants did in fact have notice of their duty to preserve documents related to Household's sales and lending practices, defendants contend that the Class in this case may not raise document destruction issues because the spoliation did not occur in connection with this litigation. Defs' Opp. at 14-18, 50-55. Defendants' attempts to parse out their preservation obligations based on the potential adversary (investor vs. consumer vs. regulator) or the nature of the claim (securities fraud vs. consumer fraud vs. action by the state) must be rejected outright. Defendants have cited no authority for these artificial distinctions.

A party has a duty to preserve evidence over which it had control and "reasonably knew or could reasonably foresee was material to a potential legal action." *China Ocean Shipping (Group) Co. v. Simone Metals Inc.*, No. 97 C 2694, 1999 WL 966443, at *3 (N.D. Ill. Sept. 30, 1999) (collecting cases); *Wiginton v. CB Richard Ellis, Inc.*, No. 02 C 6832, 2003 U.S. Dist. LEXIS 19128, at *12 (N.D. Ill. Oct. 24, 2003).

Defendants take the entirely unsupportable position that even if they had destroyed documents, so long as it was not in connection with this litigation, their conduct is somehow to be excused. There is no question that 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, Inc.*, 501 U.S. 32, 45-46 (1991). This power includes the discretion to sanction parties for failure to preserve potential evidence that is properly discoverable. *See Chambers*, 501 U.S. at 45-46 (under its inherent power to control the judicial process, the Court may enter sanctions for litigation misconduct, including spoliation); *Wiginton*, 2003 U.S. Dist. LEXIS 19128, at *11 n.5, *12-*14.[7]

Defendants also suggest that because there was no finding of document destruction by another court or state regulatory body, this Court should ignore the spoliation record presented by plaintiffs here. Defs' Opp. 18-19. However, the only instance defendants cite of the spoliation issue ever being presented to a court in another proceeding is that of the *Luna* litigation. In *Luna*, former Household branch manager Melissa Rutland-Drury filed a declaration on February 21, 2003 discussing the June 2001 document destruction. Ex. 84. This declaration and attached exhibits – a number of which reflected Household's deceptive sales practices – were filed under seal and some of these documents were not unsealed until July 8, 2003. The spoliation issue was orally raised by the

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[7] Defendants' reliance on *Degen v. United States*, 517 U.S. 820 (1996), to challenge this Court's authority to rule on this motion is an exercise in futility. The facts of *Degen* are distinguishable. In *Degen*, the Supreme Court was faced with the question whether it was a proper exercise of the district court's inherent authority to strike the filings of a claimant in a civil forfeiture suit and grant summary judgment against him for failing to appear in a related criminal prosecution based on the "'fugitive disentitlement doctrine.'" *Id.* at 823. The Court found that because the district court had the means to resolve discovery related dilemmas (*i.e.*, issuing a protective order to prevent civil discovery from being used to evade restrictions on discovery in criminal cases as well as the possibility of sanctions for non-compliance with legitimate orders of the court respecting pleading, discovery, the presentation of evidence, or other matters, including dismissal if appropriate) without resorting to a rule forbidding all participation by the absent claimant, the district court's striking plaintiff's civil suit was improper. *Id.* at 826.

Luna plaintiffs at the class certification hearing held on April 16, 2003 to address defendants' challenge that plaintiffs did not have evidence of the "effective rate" misrepresentations. Reply Decl., Ex. 5 at 38-44; *see also* Declaration of Robert L. Parlette ("Parlette Decl."), filed herewith.

Contrary to defendants' assertions the *Luna* plaintiffs did not drop the inquiry into the destruction and the court never ruled on the spoliation issue because that issue was mooted by the court's denial of class certification in light of the $484 million multi-state Attorney General settlement, which the court felt was a superior method to remedy the wrong to Washington state's Household customers. Reply Decl., Ex. 8; Parlette Decl. Thus, defendants' proclamation of innocence based on the lack of a spoliation finding by another regulatory or judicial agency is disingenuous and misleading.

Further, cases cited by defendants in support of their contention that pre-complaint filing destruction of documents is not actionable, are distinguishable because those cases dealt with discrimination or civil rights issues where there were federal regulations for document retention and the destruction occurred in the ordinary course of business before the destroying party had notice of the grievance.[8]

Defendants also mischaracterize Judge Nordberg's findings and legal conclusions in *Cohn v. Taco Bell Corp.*, No. 92 C 5852, 1995 WL 519968 (N.D. Ill. Aug. 30, 1995). In *Cohn*, Judge Nordberg specifically acknowledges that "the obligation to preserve evidence may arise prior to the

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[8] *See, e.g., Clara v. City of Chicago*, No. 99 C 7052, 2002 WL 1553419, at *10 (N.D. Ill. July 15, 2002); *Park v. City of Chicago*, 297 F.3d 606, 616 (7th Cir. 2002) (documents destroyed pursuant to established document retention policies and well before the obligation to preserve documents under the EEOC record retention regulation (29 C.F.R. §1602.1) arose); *Fucarino v. Thornton Oil Corp.*, No. 98 C 1429, 1999 WL 691820, at *8 (N.D. Ill. Aug. 23, 1999) (in gender discrimination case, where cash shortage reports were discarded without exception pursuant to established policy within 30 to 60 days of date of report, no adverse inference of destruction); *Szymanska v. Abbott Labs.*, No. 93 C 3033, 1994 WL 118154 (N.D. Ill. Mar. 29, 1994) (in civil rights litigation, where company's standard document retention policy and EEOC records retention regulations followed, no duty to keep documents involving employees other than the complainant).

filing of a complaint where a party is on notice that litigation is likely to commence." *Id.* at *5 (citing *Turner v. Hudson Transit Lines, Inc.*, 142 F.R.D. 68, 72 (S.D.N.Y. 1991)). Further, Judge Nordberg does not limit the notice requirement to pending litigation, but rather to any litigation. *Id.* ("[T]he Court notes that it does have the authority to sanction a party where such party fails to produce documents because it has discarded them even though it knew they were relevant to issues involved in litigation."). The crucial distinguishing factor in *Cohn* is that there was no other prior litigation where the same documents were shown to be relevant. Here, plaintiffs have identified ongoing litigation, pending state and federal regulatory investigations as well as consumer complaints regarding Household's lending practices that put defendants on notice of the need to preserve such documents. *See* Pls' Mot. at 9-20. Significantly, Judge Nordberg did not "refuse to sanction" the spoliating party, but rather felt compelled to award a sanction of attorneys fees and costs because the court did "not intend to condone the destruction of documents, however few, known to be relevant." *Cohn*, 1995 WL 519968, at *10.

Here, plaintiffs have demonstrated that defendants had notice (a) of the relevance of documents relating to its sales and lending practices at least as early as March 12, 2001 (if not earlier); (b) of an increasing number of customer and regulatory complaints relating to Household's sales practices; (c) of the potential for legal actions relating to the Company's sales and lending practices; and (d) that litigation was foreseeable. Yet, defendants ordered a nationwide purge of such relevant documents. Pls' Mot. at 21-50.

Defendants' efforts to conjure a narrow carve-out for the preservation duty for pre-complaint preservation – *i.e.*, only where the prior litigation or other form of notice was related in a meaningful and substantial way to the litigation at issue – also fails. Defs' Opp. at 53-54. In short, defendants contend that plaintiffs may not raise document destruction issues because the originally filed complaint on August 19, 2002, did not specifically reference Household's sales and lending

practices, or complaints arising from such practices. *Id.* Defendants' contentions are nothing short of absurd. It is clear that "[a] party cannot destroy documents based solely on its own version of the proper scope" of its document retention responsibilities. *Diersen v. Walker*, No. 00 C 2437, 2003 U.S. Dist. LEXIS 9538, at *15 (N.D. Ill. June 5, 2003). Moreover, plaintiffs' original complaint alleges that defendants issued false and misleading financial statements that failed to accurately portray Household's business operations and financial condition. The original complaint contained allegations relating to Household's restatement of its financial results going as far back as 1994 that resulted in a reduction in previously reported net income of $386 million. Additionally, the class period in the original complaint began October 23, 1997 which also put defendants on notice that all matters concerning Household's financial statements beginning at least on that date would be at issue, including specifically Household's sales practices, which are the core of Household's revenues and income. Accordingly, plaintiffs have demonstrated that defendants had notice of the need to preserve documents relating to the Company's sales and lending practices.

4. Defendants' Attempts to Excuse Their Document Destruction by Pointing to Subsequently Issued Litigation Holds Are Not Relevant to the Court's Consideration of Plaintiffs' Spoliation Motion

In their zealousness to overwhelm the Court with reams of paper, defendants have filed several declarations and exhibits to show that they issued document holds in this litigation.[9] Household General Counsel Ken Robin states that the Legal Department was "scrupulous in creating

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[9] In addressing the declarations filed by defendants in support of their opposition, plaintiffs expressly reserve their right to challenge both the admissibility as well as the underlying factual contentions outlined in the declarations. *See* Fed. R. Evid. 602; *Butts v. Aurora Health Care, Inc.*, 387 F.3d 921, 925 (7th Cir. 2004) ("self-serving statements in affidavits ***without factual support in the record*** carry no weight") (emphasis in original). All of the declarations, with the exception of Ken Robin, state that they are made on the basis on personal knowledge as well as a "review of relevant documents." However, the declarations, in most instances, are deficient for failing to distinguish where the declarant was making statements based upon personal knowledge and where the statement was based upon a review of documents. They are also deficient for their failure to identify or attach all of the relevant documents reviewed.

and enforcing appropriate document holds upon receiving notice of actual or ***probable litigation*** or regulatory action (except where the matter was of such limited scope and duration as to obviate the need for one)." Robin Decl., ¶5. Mr. Robin, thus, concedes that a document hold is triggered by probable litigation, which supports plaintiffs' motion.

In spite of this, and in spite of the fact that the thrust of plaintiffs' motion concerns spoliation occurring prior to initiation of this lawsuit, Mr. Robin's declaration identifies only document holds that were issued as a result of this lawsuit or the subsequent SEC investigation. Robin does not identify any document hold issued by the Office of General Counsel prior to September 20, 2002 (a month after Household was sued on August 19, 2002).[10] However, as detailed in plaintiffs' opening brief, Mr. Robin himself (as well as Consumer Lending General Counsel Kay Curtin) were on notice as of March 12, 2001 of possible litigation with ACORN regarding its allegations of nationwide predatory lending practices. Pls' Mot. at 9-20, 54-57; Ex. 101 at ##5628-5630. Likewise, the Office of General Counsel, through General Counsel Kay Curtin, was aware of regulatory investigations in Washington and Minnesota concerning the use of the effective rate presentations as well as the fact that customers across the nation, including Illinois, had complained about the effective rate presentation. *See* Ex. 48; Reply Decl., Ex. 23. Despite this, the Office of General Counsel was aware of the blitz purge and raised no objection. Pls' Mot. 54-56. Ms. Curtin appears to have attended the Responsible Lending Summit where the completion of the company-wide purge of documents was announced which Tom Detelich acknowledged would [redacted] Ex. 59 at HHS 03208095-100.

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[10] Several of the declarants assert, without any support, their belief that the destruction of documents was not to hide or conceal documents that might be needed for ongoing or future litigation. *See* Detelich Decl. ¶21; O'Han Decl. ¶13; Eden Decl. ¶14; Hennigan Decl. ¶11; Mello Decl. ¶15; Clamage Decl. ¶12.; Mello Decl., ¶13. Significantly though, they do not assert that they were aware of or in the ordinary course of business routinely made aware of the actual or potential litigations.

On these points, all of which were pointedly made in plaintiffs' opening brief, Mr. Robin professes to be outraged by any allegation that the Household Legal Department would eschew its duties but never denies these basic facts, including that his department failed, in fact, to issue the requisite document holds in various litigations. *See* Pls' Mot. at 54-57.

At the December 2, 2008 presentment hearing on this motion, defense counsel claimed that plaintiffs had failed to include in the record "the document . . . from general counsel's office that says but preserve any that may be needed for litigation." Best Decl., Ex. 23 at 18. Plaintiffs did not include any such documents because plaintiffs do not have any documents demonstrating that document holds were issued in the context of any of the prior litigations, state regulatory investigations, the anticipation of the ACORN suit or even Household's contemplation of a lawsuit against ACORN. Ironically, it was defendants who successfully precluded plaintiffs from obtaining any of these documents as part of the motion practice that culminated in the November 2005 Order by Magistrate Nolan. *See infra*, §II.C. Moreover, plaintiffs contend that there was no directive to retain documents in connection with any of the above-referenced matters. Jon Shrum, Household's Quality Assurance & Compliance Manager, testified in the *Luna* litigation on February 21, 2003 (the same day as Melissa Rutland-Drury filed under seal her declaration discussing Household's directive to destroy documents in June 2001) that there was no directive to retain documents and 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. Ex. 85 at 111:5-114:6-12, 131:6-133:21, 145:16-149:7.[11]

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[11] Defendants challenge plaintiffs' recitation of Mr. Shrum's testimony. Defs' Opp. at 29-30. Not surprisingly, they offer Mr. Shrum's testimony on cross-examination by Household's lawyers and his March 24, 2003 declaration in the *Luna* litigation in support of their challenge. Such self-serving statements are subject to judicial skepticism and are entitled to little weight when they conflict with the facts. *Koffski v. Village of N. Barrington*, No. 91 C 4366, 1991 WL 235250 (N.D. Ill. Oct. 30, 1991). The Seventh Circuit has

Although plaintiffs do not have the prior litigation hold documents, defendants could very well have attached the document holds that were issued in connection with the ACORN complaints, the WA DFI complaints and investigations, the Minnesota complaints, the *Luna* litigation and the ACORN litigation. They did not, which only begs the question. In fact, defendants have presented no contrary evidence to dispute plaintiffs' assertion that it was not 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 defendants were on notice by March 12, 2001 that ACORN was likely to commence litigation and in fact filed a complaint on February 6, 2002. Ex. 102; *see, e.g.*, *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 218 (S.D.N.Y. 2003) (A party has a duty to initiate a "litigation hold" and preserve potentially responsive documents once it has notice that litigation is likely, and at least when a complaint is filed.).

Moreover, issuing a document hold after wide-scale destruction of evidence does not satisfy a party's document preservation obligations. *See Capellupo v. FMC Corp.*, 126 F.R.D. 545 (D. Minn. 1989) (sanctions appropriate where a senior official of the defendant employer was warned by an employee that she intended to file a class action gender discrimination suit resulting in the implementation of a broad policy of document destruction on the day before the lawsuit and causing the destruction of material evidence; the court found that defendant's purge was intentionally tailored to make forever unavailable records and documents which defendant knew or should have known would be pertinent to the suit). Thus, defendants' post-spoliation efforts to demonstrate

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thus held that an affidavit can be self-serving if it does not contradict earlier deposition testimony and is otherwise admissible. *See Rogers v. City of Chicago*, 320 F.3d 748, 751 (7th Cir. 2003); *see also Paz v. Wauconda Healthcare & Rehab. Ctr. LLC*, 464 F.3d 659, 664-65 (7th Cir. 2006). The record demonstrates that Mr. Shrum's testimony on Household's document retention policies and the document destruction on direct examination by the *Luna* plaintiffs (taken on the same day that Ms. Drury filed her declaration describing the destruction) contradicts his testimony on cross-examination as well as his subsequent declaration. Hence, the Court should give little weight to Mr. Shrum's subsequent self-serving contradictory assertions.

compliance with their duty to preserve only underscores their state of mind in ordering or allowing the earlier document destruction.

B. Defendants Do Not Dispute the Destruction of Documents But Offer Various Justifications for Their Conduct

Defendants' voluminous oppositions and declarations do not dispute that documents were in fact destroyed. They do not dispute the infamous spring 2001 scrubbing of all 1,400 branches. *See* Defs' Opp. at 35, 38, 62.[12] Defendants contend, however, that (i) only "unauthorized" documents were destroyed; (ii) copies of some of the "unauthorized" documents were produced to plaintiffs; and (iii) that Household's retention of the actual customer loan files that it was legally required to maintain absolves defendants of any misconduct. Defs' Opp. at 35-38. These justifications fail to remedy the grievous wrong perpetrated on the Class in the loss of relevant evidence. In any event, defendants' justifications are contradicted by the record.

1. Defendants' Excuse that Only Unauthorized Materials Were Destroyed Is Inconsistent with the Record

As an initial matter, plaintiffs have presented an abundance of evidence to support their assertion that the "effective rate" biweekly deceptive sales practice was authorized and encouraged by defendants until the June 2001 destruction. *See* Pls' Mot. at 29-37; *see also* Exs. 93-99.[13]

Defendants' post-destruction explanation that certain conduct was simply not permitted is contradicted by the record. Plaintiffs highlight some of the factual inconsistencies relying on Mr.

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[12] *See also* Clamage Decl., ¶¶11-12, Hennigan Decl., ¶¶11-13, 16; Nesbitt Decl., ¶6; Detelich Decl., ¶¶17, 19-21; Mello Decl., ¶13; O'Han Decl., ¶13; Harvey Decl., ¶¶9-10; Barnes Decl., ¶13; Eden Decl., ¶¶12-15.

[13] Although plaintiffs do not rely exclusively on the declarations of the former Household branch managers to support their assertions that certain deceptive sales practices, including specifically the "effective rate" biweekly sales pitch, were authorized, these declarations corroborate the documentary evidence. *See* Opposition to Defendants' Cross-Motion Pursuant to Fed. R. Civ. P. 37(c) to Exclude Declarations of Branch Sales Managers (Dkt. No. 1310).

Detelich's declaration, however, the reasoning applies equally to similar averments in other declarations.

a. Thomas Detelich Declaration, Managing Director of the HFC and BFC Branches and Later Group Executive of Consumer Lending (Replacing Defendant Gilmer)

In his declaration, Mr. Detelich asserts that it was always Household policy not to quote any rate other than the contract rate or the APR. Detelich Decl., ¶12.[14] As support for this statement, Mr. Detelich points to a July 22, 1998 bulletin board he issued and two May 24, 2001 bulletin boards issued pursuant to his direction. Detelich Decl., ¶¶12, 15.[15] Mr. Detelich further declares "The use of 'effective rate' comparisons had been brought to my attention on several occasions, and we worked hard to stamp out the practice every time." Detelich Decl., ¶14.[16]

The Court cannot rely upon Mr. Detelich's or any other declarant's self-serving statements, even as to the actions that they took, regarding this "stamping out."[17] Even after issuing the July 22,

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[14] *See also* Eden Decl. ¶11; Hennigan Decl. ¶17; O'Han Decl. ¶10; Mello Decl. ¶11; Clamage Decl. ¶9; Barnes Decl. ¶9.

[15] *See also* Barnes Decl. ¶10; Clamage Decl. ¶¶9-11, 14; Eden Decl. ¶12; Hennigan Decl. ¶10; O'Han Decl. ¶12.

[16] Jo Ann Barnes, a DSM, stated that she "never witnessed any Household training sales employees to quote an 'effective rate,'" or that if she "had learned that after senior management reissued its policy against quoting and 'Effective rate' an employee in my division nevertheless used [comparable] phrases, I would have taken immediate corrective action." Barnes Decl., ¶¶10-11. Yet, in the attached e-mail string (the entire string was copied to both Robert O'Han and Thomas Detelich) from July 12, 2002, Ms. Barnes concluded:

[redacted] Barnes Decl., Ex. A at HHS 02868009-10. Memorializing her earlier investigation, she states:

[redacted]

Id. at HHS 02868010.

[17] Ned Hennigan, an RGM, states that there was a "continual effort to be on the look out for any unauthorized or outdated sales and marketing materials in the branches so they could be taken out of circulation." Hennigan Decl., ¶11. Yet, he only discusses the one time he sent out a bulletin to destroy such materials – his May 24, 2001 bulletin. Hennigan Decl., ¶10. Moreover, in addressing the June 2001

1998 bulletin prohibiting the use of "effective rate," Mr. Detelich himself witnessed sales training by Lew Walter in early-1999 where he saw a document "similar" to the effective rate worksheet. Reply Decl., Ex. 9 at 209:22-210:17. He testified that his response to this document was to direct his RGMs to change the training. *Id.* As reflected in other documents, there was a change in the Selling First Mortgages' training in approximately September 1999 when the "effective rate" worksheet was removed.

However, Mr. Detelich's "change the training" directive is not an action directed toward "stamping out" the use of the effective rate. To do that, Mr. Detelich should have sent out a bulletin board akin to what he did in July 1998. But he did not. *See also* Nesbitt Decl., ¶9 (stating that the Lew Walter "effective rate" training was pulled, but does not describe what, if any, efforts were undertaken to send out a follow-up bulletin in 1999 saying that the training was unapproved and sales employees should not use it anymore).

Put differently, changing the training without notification that the earlier training was not to be used is not the course that one would take if he or she were really interested in "stamping out" the practice. Changing the training without the notification is the proper course, however, if one wants to make sure that there is no paper trail showing corporate-wide training on this practice. Household training manuals acknowledge that [redacted] Reply Decl., Ex. 10 at

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document destruction, Mr. Hennigan unwittingly admits that the intention was to eliminate evidence of deceptive sales practices: "The spirit was not to destroy pertinent information but to ***get it out of the network and eradicate potentially deceptive sales methods*** . . . to prevent other employees from discovering and inadvertently using unapproved and outdated materials." Hennigan Decl., ¶11. Mr. Hennigan describes no efforts undertaken to seek out the customers who had already been wronged by these deceptive sales practices, because no such efforts were undertaken unless it was in response to a regulator, BBB or customer complaint.

HHS 02221952-53 (practice Household subsequently claims was unauthorized). Rather than memorializing in written form the proper way for sales personnel to explain biweekly payments, the training manual refers them to a Housemail on the topic, which has not been produced to plaintiffs in discovery, further bolstering the conclusion that Household management did not wish to have a paper trail.[18]

Mr. Detelich's indifference to whether sales personnel continued to use the effective rate presentation was matched by other Household sales management, including Human Resources personnel. Robert O'Han, another declarant and then a DGM, testified that he also witnessed a Lew Walter effective rate training sometime in 1999. Reply Decl., Ex. 12 at 67:6-68:6, 73:24-75:5. In attendance with him at that training was someone from Household's Human Resources. *Id.* at 69:17-20. Mr. O'Han did not issue a directive not to use "unauthorized" materials until May 24, 2001, which is one of the bulletin boards cited by Mr. Detelich. *See* O'Han Decl., ¶12; Hennigan Decl., ¶10.

Another telling point in Mr. Detelich's declaration concerns the Dennis Hueman videotape. Plaintiffs note but will not dwell on the dispute as to whether Mr. Detelich actually reprimanded Mr. Hueman – Mr. Detelich says yes, Mr. Hueman says no. *See* Reply Decl., Ex. 13 at 79:16-80:8. More significant for purposes of this motion is what Mr. Detelich says about the reprimand. As hinted in the declaration and revealed clearly in his deposition, it was the act of making the video that was the problem, not the training itself. In his deposition, Mr. Detelich emphasized that the video was unapproved and that he did not judge whether it had deceptive practices on it. Reply

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[18] Tellingly, Household's training manuals did not focus on compliance with laws. Instead salespeople were evaluated based on branch results and AE results. The criteria used to rank branches was volume, new money, LA gain, credit penetration, NIM% of benchmark, while the criteria used to rank the AEs were volume, new money, credit penetration and total points. Reply Decl., Ex. 11 at HHS 02175128.

Decl., Ex. 9 at 127:8-128:16; *see also* Reply Decl., Ex. 13 at 41:3-16 (video recalled because it had not been approved through legal).[19] He went further stating, [redacted] Reply Decl., Ex. 9 at 128:14-16. This makes it clear that it was the production of an unauthorized video rather than the training techniques described in that video that concerned Mr. Detelich. Significantly, Mr. Hueman did not in fact send out any bulletins not to use the sales techniques taught in the video. Reply Decl., Ex. 13 at 237:4-12; *see also* Ex. 93, ¶8. This point is significant because as Mr. Hueman testified and as is clear from the video itself, Mr. Hueman had previously taught such sales techniques to branches within his division for many years and only made the video because he could not always do the training in person. Reply Decl., Ex. 13 at 47:9-24; Reply Decl., Ex. 14 at 3.

b. Other Inconsistencies in the Declarations

A number of declarants claim that "employees were not permitted to write an 'effective rate' anywhere on the HOLP" (Budish Aff., ¶8; Clamage Decl., ¶10; Hennigan Decl., ¶15; Mello Decl., ¶12; O'Han Decl., ¶15), or create their own homemade sales or training materials. Eden Decl., ¶13; Nesbitt Decl., ¶5. However, in Household's Training & Development manual, in the Advanced Sales Training module for the 90-day TRUST Training for all sales personnel, under the section on "Advanced sales Techniques," the manual encourages the use of sales tools such as "homemade" illustrations. Reply Decl., Ex. 11 at HHS 02175054. Household's Leadership Guide Workshop for sales personnel indicates that as late as 2002 making personal notes on the HOLP was not only permitted, it was encouraged: [redacted]

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[19] The document attached to Ronald Clamage's declaration confirms that there was no list of "approved" in-branch marketing and sales materials until after the June 2001 document destruction. [redacted] Clamage Decl., Ex. A at HHS 03208257.

[redacted] Reply Decl., Ex. 15 at HHS 02831320 (emphasis in original); *see, e.g.*, Reply Decl., Ex. 11 at HHS 02175106-07, HHS 02175115; Reply Decl., Ex. 16 at HHS 02823626-27; Reply Decl., Ex. 17 at HHS 02395505-06, HHS 02395508 (encouraging and training AEs to create their own sales tools, including a variation of the "T" sale); Reply Decl., Ex. 16 at HHS 02823612 (identifying and encouraging use of [redacted] as sales tools). Mr. Hennigan concedes that WordPad was eliminated in spring 2002 to ensure that branch employees did not make their own sales materials. Hennigan Decl., ¶17.[20]

Regardless of whether the materials and sales techniques were authorized, the mere fact that defendants were on notice that there was an increasing number of complaints as a result of Household's sales practices mandated that they preserve them. To justify the imposition of a sanction for spoliation, the non-spoliator does not have to show that the evidence would have been favorable to his case; it is enough to show that the evidence "'naturally would have elucidated a fact at issue.'" *See Nucor Corp. v. Bell*, 251 F.R.D. 191, 195 (D.S.C. 2008).

In *Allstate Ins. Co. v. Sunbeam Corp.*, 53 F.3d 804, 807 (7th Cir. 1995), the Seventh Circuit discussed the application of Illinois law to spoliation and ascertained that the test was whether a party "was deprived of the ability to establish its case." The court found that where a party had limited the ability of the other party to present, *inter alia*, theories as to alternative causes of the fire, sanctions barring the plaintiff from presenting expert testimony were appropriate. *Id.* (resulting in

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[20] Defendants concede that documents were destroyed in April 2002 from the WordPad program, but dispute why and claim that all documents were produced to plaintiffs. Defs' Opp. at 39-40. For all the reasons outlined above in connection with the June 2001 destruction, as well as detailed in plaintiffs' opening brief (Pls' Mot. at 39-45), defendants were on notice of the need to preserve documents prior to this destruction: there was ongoing litigation and the implementation of another round of destructions aimed at purging completed forms and materials evidencing the "effective rate" EZ Pay scam, including WordPad and computer-generated documents, reeks of bad faith punishable by the most severe sanctions.

dismissal of the case due to plaintiff's inability to present a *prima facie* case of liability). "Allstate failed to preserve evidence, some of which was part of the alleged defective product itself and some of which was evidence which might itself have been, or shed light upon, an alternative cause of the fire." *Id.* The court rejected Allstate's argument that the destroyed items were not relevant or material to the fire investigation because at the time the items were destroyed, even Allstate was not sure of the actual cause of the fire. *Id.*

Similarly here, defendants' nationwide destruction has seriously impaired plaintiffs' ability to present direct evidence showing that defendants' condoned and even encouraged the Company's sales personnel to engage in deceptive selling techniques in order to maximize loan growth and hence revenue and income.

2. Defendants Have Not Produced All the "Unauthorized" Documents to Plaintiffs in Discovery

Next, defendants claim that plaintiffs have all of the "unauthorized" documents. Plaintiffs do not. This is, in part due to the destruction of the evidence, and in part due to defendants' refusal to turn over the documents collected as part of the June 2001 "Blitz-Purge." During the discovery phase of this case, plaintiffs requested a copy of "A sample of each type of document or an index of documents directed to be destroyed in the "blitz purge" that occurred throughout Household branches and headquarters in mid-2001." Reply Decl., Ex. 18. Although defendants responded that they would produce documents subject to their objections, no responsive documents were produced, and plaintiffs filed a motion to compel production responsive to Request No. 35. In response to plaintiffs' motion, defendants claimed that such documents "simply do not exist." Dkt. No. 583 at 7. On August 10, 2006, Magistrate Nolan, accepted defendants' representation and concluded that "[t]he court obviously cannot order Defendants to produce documents that do not exist," and ordered defendants to "submit an affidavit setting forth the efforts they made to locate the documents and

confirming that none could be found." August 10, 2006 Order at 8 (Dkt. No. 631). Defendants never submitted an affidavit.

On September 18, 2006, plaintiffs moved to compel defendants' compliance with Magistrate Judge Nolan's August 10, 2006 Order which required defendants to direct plaintiffs to responsive documents in the production or submit an affidavit regarding the non-existence of documents regarding Request Nos. 10, 24, 27, 30 and 35, among others. Dkt. No. 670. Defendants opposed the motion claiming that they were not required to file an affidavit "with respect to the non-existence of documents." Dkt. No. 686 at 8-9. Having already filed two motions on this subject and not wishing to raise the ire of the Magistrate, plaintiffs did not pursue the matter further. Accordingly, defendants have neither furnished a sample of these documents to plaintiffs, nor have they supplied the requisite affidavit. To date, and even in their opposition to this motion, defendants fail to provide a Bates range corresponding to the production of these documents to plaintiffs.[21]

3. Defendants' Retention of Actual Loan Documents Does Not Insulate Them from Liability for Intentional Spoliation

Finally, defendants' claim that the Company's retention of official loan files, and not the HOLPS or sales and marketing materials used to make those loans, demonstrates that they were in compliance with their document retention obligations. Budish Aff., ¶9; Hennigan Decl., ¶15; O'Han Decl., ¶15; Eden Decl., ¶16; Detelich Decl., ¶26. This position is disputed by the regulators reviewing Household's sales practices. They found that deceptive practices were prevalent at Household despite the fact that the documents signed by the borrowers in customers loan files appeared to comply with applicable federal and state laws. Reply Decl., Ex. 19 at 181:10-184:6.

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[21] Similarly, several declarants assert that they understand all unauthorized forms were collected and have been produced to plaintiffs, but provide no Bates numbers or other identifying information to verify this assertion. *See, e.g.*, Hennigan Decl., ¶13.

Mr. Cross, who prepared the WA DFI report outlining Household's predatory lending practices in Washington, stated that initially the regulators did rely upon the customers loan files provided by Household to conclude that no deceptive practices were occurring at the Company. He testified:

Id. at 182:4-182:22.

Mr. Cross further testified that:

Id. at 183:3-184:6.

Moreover, both Mr. Cross and defendants' expert John Bley cited the FTC's predatory lending case against FAMCO as an example of their experience where the paper files looked clean, but deceptive lending practices were nonetheless taking place during the sales process. *Id.* at 184-185; Reply Decl., Ex. 20 at 76:21-80:15.

Defendants' stance that "the HOLP was a non-binding loan proposal used merely for informational purposes" and hence there was no legal requirement to retain copies of the HOLP form in the customer's file," seems counterintuitive. Budish Aff., ¶9; Hennigan Decl., ¶15; O'Han Decl., ¶15; Eden Decl., ¶16; Detelich Decl., ¶26. Why destroy the most significant document that you are using in the sales process if there is nothing to hide? In fact, defendants' own expert John Bley testified that from a regulatory perspective, if it's a document that was specific to a customer transaction, referring to a loan proposal, it should be part of the loan file. Reply Decl., Ex. 20 at 154:18-155:12.[22]

Moreover, even Household's 2002 version of its training manual highlights the importance of the HOLP in the sales process as follows: [redacted] Reply Decl., Ex. 15 at HHS 02831320; *see also* Pls' Mot. at 37-39 (describing the significance placed by Household on the HOLP).

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[22] Prior to being retained as a paid consultant for Household, Mr. Bley testified before the Federal Reserve Board that "Federal disclosures are too complex for many borrowers and the borrowers turn to loan officers to explain the terms of their loan. Thus, predatory lending is an abuse of misplaced trust. Predatory lending becomes possible when a borrower trusts a loan officer to explain the terms of a loan and the loan officer commits deception by abusing this trust." Reply Decl., Ex. 4 at HHS 03244455. Coincidentally, the core of Household's training documents was how to build trust with customers based on the recognition that [redacted] Reply Decl., Ex. 10 at HHS 02221947; *see also* Reply Decl., Ex. 11 at HHS 02175048 (Household's training manuals and guides were entitled TRUST 90-Day Training Program, BSM ExSELLerated Guide through TRUST); Reply Decl., Ex. 10 at HHS 02221940-42 (Household Training & Development Manual from September 1998 outlining training exercises for "building trust and rapport" to keep customers); *id.* at HHS 02221946 (detailing [redacted] using with customers while building their trust, including insurance, balloon payment, rescission, piggy back, LTV, HOLP, etc.).

4. Plaintiffs Have Demonstrated that Defendants Intentionally Destroyed the Andrew Kahr Documents Despite Undisputed Evidence of Defendants' Knowledge that Kahr's Memos and Ideas About Lending Led to Legal Troubles for Kahr's Client Providian

With respect to the Kahr memos, defendants admit that in 2001, defendant Schoenholz ordered that Kahr memos "be collected in one place for disposal." Defs' Opp. at 32. As detailed in plaintiffs' opening brief, this instruction was given by Schoenholz with knowledge of Providian's high profile "legal difficulties" and hundreds of millions of dollars in settlements [redacted] Ex. 30 at HHS 03680479; Pls' Mot. at 49-50. Schoenholz further acknowledged that there were "a large quantity of Andrew Kahr memoranda," in the Company's files and ordered that "all copies of all Andrew Kahr memoranda (both paper and electronic versions) be collected by the Office of General Counsel and thereafter destroyed." Ex. 30 at HHS 03680480.

Defendants do not dispute that the order to destroy documents was given. Rather, they dispute whether this order was implemented, yet slip in the possibility that "some cumulative Kahr memoranda were lost or destroyed in the normal course of business in the years before the 'predatory lending' phase of this case began." Defs' Opp. at 33-35. Coincidentally, plaintiffs are asserting that the destruction of the Kahr memos occurred before this case began and have indisputably demonstrated that defendants were on notice of the relevance of the Kahr memos to potential litigation.

Although it is not plaintiffs' burden to show whether a destruction order was implemented, by Schoenholz's own acknowledgement, Kahr was a prolific writer of memos, yet only 23 Kahr memos were produced and 32 listed on Household's privilege log, while it appears that Kahr may well have written over 266 memos for Household during his almost three-year retention by the Company. Defendants' explanation that the gap in numbering could be attributable to memos

written for other clients, lacks merit and is unsupported by the record. Kahr wrote his memos by cross-referencing them to the initiative number on Household's memo relating to the ten Kahr initiatives that defendants selected for implementation. For example, Initiative No. 10 relates to "lock-in (prepayment) provisions," while Initiative No. 7 relates to "performance[-]based pricing." 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. *See also* Pls' Mot. at 53. Plaintiffs have sufficiently demonstrated both defendants' duty to preserve as well as defendants' intent to spoliate relevant evidence. Under these circumstances, there can be no other conclusion drawn than defendants' desire to rid all adverse evidence to evade liability.

C. Plaintiffs' 2005 and 2007 Discovery-Related Motions Are Unrelated to the Sanctions Motion Presently Before the Court

Neither Judge Nolan's November 30, 2005 Order, nor the January 2007 order addressed defendants' destruction of relevant evidence in June 2001, April 2002 and June 2002. Plaintiffs' discovery motions that resulted in those orders did not demand an adverse inference. Defendants falsely suggest that plaintiffs twice sought and were denied sanctions for spoliation of evidence by Magistrate Judge Nolan. Defs' Opp. at 40-42. Defendants' inaccurate recitation of the record and the 2005 and 2007 discovery disputes before Judge Nolan requires clarification.

After the PSLRA discovery stay was lifted in this case, plaintiffs issued a Rule 30(b)(6) notice covering many areas, including topics dealing with defendants' efforts at document preservation for this litigation.[23] In 2005, Magistrate Judge Nolan granted plaintiffs permission to depose a Household representative concerning Household's proprietary e-mail system, "Housemail." Dkt. No. 331. Plaintiffs also sought information about Household's document retention policies,

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[23] Such topics are covered by Rule 30(b)(6) depositions in all litigations. Thus, defendants' assertion and related rhetoric that the spoliation issue has been an "opening ploy" by plaintiffs, is absurd.

generally, as well as information concerning the specific efforts undertaken by the Company to preserve Housemails. *Id.* After Judge Nolan granted permission for plaintiffs to take an additional 30(b)(6) deposition (Dkt. No. 341), a dispute arose between the parties concerning the proper scope of that deposition. Best Decl., Ex. 4. Judge Nolan subsequently confirmed that the 30(b)(6) deposition was limited to examination about Household's document preservation efforts in this litigation and that plaintiffs were not "permitted to inquire about Household's preservation of documents as a result of other litigation or investigations," as such inquiries were beyond the proper scope of the 30(b)(6) deposition. *See* Best Decl., Ex. 4. At no time did plaintiffs present or Judge Nolan rule on the specific facts and law currently before the Court. Significantly, Judge Nolan's November 2005 order did not rule "spoliation issues were beyond the scope of this case," as defendants wish this Court to believe. *See* Defs' Opp. at 42. Indeed, Judge Nolan's ruling was clearly limited to the proper scope of the specific 30(b)(6) deposition at issue and was not meant to be a conclusive or overarching decision concerning defendants' spoliation of relevant evidence in this case. The very documents that defendants cite bear this out.

Defendants also contend that plaintiffs previously sought and were denied an adverse inference instruction on the destruction of Andrew Kahr documents. Again, defendants' misleading and inaccurate account of plaintiffs' motion to compel the withheld Andrew Kahr documents resulting in the January 2007 order requires explanation. During discovery, defendants produced an extremely small number of Andrew Kahr memos (23 to be precise) and a handful of other e-mails discussing Andrew Kahr and his proposed initiatives. *See* Dkt. No. 895 at 13. The remainder of the Kahr-related documents were withheld by defendants on grounds of attorney-client privilege. *Id.*

at 1. When plaintiffs became aware of Kahr's role in devising Household's growth initiatives, they successfully obtained an order to serve Kahr under the Walsh Act. Dkt. No. 824.[24]

Plaintiffs subsequently moved to compel the production of the "privileged" Kahr documents and sought relief from the court in the form of an order compelling defendants to produce the 32 Kahr documents listed in their privilege logs. *Id.* In the alternative, plaintiffs sought an order compelling an attested explanation by defendants of the fate of the Kahr documents in the database accumulated in June 2002 by Kenneth Harvey at defendant Schoenholz's instructions. *See* Dkt. No. 895 at 2. Plaintiffs also urged Judge Nolan to examine the issue of the destruction of the Kahr documents very seriously, but made no requests concerning the type of remedy Judge Nolan should fashion.

In opposition to plaintiffs' motion, defendants refused to explain what had happened to the missing Kahr documents. Only after defendants' refusal did plaintiffs suggest to Judge Nolan that an adverse inference may be warranted under the circumstances – at no time did plaintiffs move for or demand an adverse inference instruction. *See* Dkt. No. 929. On January 25, 2007, the court denied plaintiffs' motion to compel. *See* Dkt. No. 933 (Jan. 25, 2007 Order). *In dicta*, Judge Nolan commented that the court was unable to determine, based on the current record, whether plaintiffs were entitled to an adverse inference based on the destruction of Kahr-related documents. *Id.* at 6. Judge Nolan did not hold that plaintiffs were not entitled to an adverse inference, but merely that the record before her was inconclusive in that regard. *Id.* at 6. Indeed, the record before Judge Nolan concerning defendants' destruction of Kahr documents was extremely limited, as the crux of plaintiffs' motion to compel addressed defendants' assertion of the attorney-client privilege over the

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[24] Plaintiffs continued their search for and attempts to serve Kahr, who has thus far evaded service of the subpoena.

withheld Kahr documents. Thus, neither the 2005 nor the 2007 orders have any bearing on plaintiffs' current motion for evidentiary sanctions. Accordingly, plaintiffs have not waived their right to raise defendants' destruction of evidence since the November 2005 and January 2007 orders were non-dispositive discovery rulings.

1. The Law of the Case Doctrine Is Entirely Inapplicable as Neither the 2005 Nor the 2007 Orders Actually Decided Whether Plaintiffs Are Entitled to Evidentiary Sanctions Due to Defendants' Intentional Destruction of Evidence

Based on the flawed premise that Magistrate Judge Nolan's 2005 and 2007 orders address the spoliation issues raised by this motion, defendants contend that plaintiffs should be precluded from bringing this motion under the "law of the case doctrine." Under the law of the case doctrine, a court generally should not re-open issues decided in earlier stages of the same litigation. *United States v. Harris*, 531 F.3d 507, 513 (7th Cir.), *cert. denied*, 129 S. Ct. 588 (2008). "In order for a ruling to constitute the law of the case, the question of law presented in the current action must have been actually decided in the former proceeding." *PaineWebber, Inc. v. Farnam*, 870 F.2d 1286, 1290 (7th Cir. 1989). Mere "observations or commentary touching upon issues not formally before the reviewing court do not constitute binding determinations." *Creek v. Village of Westhaven*, 144 F.3d 441, 445 (7th Cir. 1998). The law of the case doctrine is entirely inapplicable here, because neither the 2005 nor the 2007 rulings by Judge Nolan actually decided whether plaintiffs are entitled to evidentiary sanctions in the form of adverse jury instructions due to defendants' intentional spoliation of evidence.

At the November 30, 2005 status conference hearing, the only issue before Judge Nolan and the only issue of law she decided was the proper scope of the 30(b)(6) Housemail deposition. Dkt. No. 341. Judge Nolan made absolutely no determination on the issue of defendants' intentional spoliation of evidence. Likewise, the only issue of law Judge Nolan ruled on in the January 25, 2007 order concerned the applicability of the attorney-client privilege to documents created by or referring

to Andrew Kahr. Dkt. No. 933. Judge Nolan's one-sentence dicta that "Plaintiffs' evidence . . . is not sufficient to establish all of the elements required to justify an adverse inference" is not a final decision on a question of law and is nothing more than "observations or commentary." *Id.* at 6; *Creek*, 144 F.3d at 445. Moreover, Judge Nolan even noted that the court was "unable to determine," based on the current record, "whether Plaintiffs [were] entitled to an adverse inference in this case." Dkt. No. 933 at 6. Judge Nolan's inability to rule one way or another is inconsistent with any finding that the January 25, 2007 order represents an actual decision that plaintiffs are not entitled to an adverse inference instruction. *Id.*; *see, e.g.*, *PaineWebber*, 870 F.2d at 1292 (holding that a vague, one-sentence stay order prevented the court from applying the law of the case doctrine to preclude litigation of the matter in federal forum); *Klingman v. Levinson*, 114 F.3d 620, 628 (7th Cir. 1997) (noting that law of the case doctrine did not apply because the prior decision was *dicta*).

Significantly, however, the Seventh Circuit has ruled that "the law of the case doctrine is a discretionary doctrine that does not limit the district court's power to reopen what already has been decided." *See Menzer v. United States*, 200 F.3d 1000, 1004 (7th Cir. 2000) (law of the case doctrine does not bar a trial court from revisiting its own evidentiary rulings); *Avitia v. Metro. Club*, 49 F.3d 1219, 1227 (7th Cir. 1995) (The doctrine of the law of the case is "no more than a presumption, one whose strength varies with the circumstances; it is not a straitjacket."). Thus, even if Magistrate Nolan had already ruled on the precise subject matter of plaintiffs' current motion – which she did not – this Court has discretion to reopen the inquiry based on the current record.

2. Plaintiffs' Motion for Evidentiary Sanctions Is Timely

Finally, defendants' argument that the present motion is untimely as it was "apparently prepared more than a year ago," deserves short shrift. Defs' Opp. at 48. A request for sanctions, regardless of when made, is a dispositive matter capable of being referred to a magistrate judge only under 28 U.S.C. §636(b)(1)(B) or §636(b)(3) where the district judge must review the magistrate

judge's report and recommendations *de novo*. *See Alpern v. Lieb*, 38 F.3d 933, 935 (7th Cir. 1994) (holding that a district judge may not refer a dispute regarding sanctions to a magistrate judge under 28 U.S.C. §636(b)(1)(A) because the grant or denial of a request for sanctions constitutes a dispositive matter); *Gorbitz v. Corvilla, Inc.*, 196 F.3d 879, 883 (7th Cir. 1999) ("[A] magistrate judge is without the authority to award sanctions."); *see also Royal Maccabees Life Ins. Co. v. Malachinski*, No. 96 C 6135, 2001 U.S. Dist. LEXIS 3362, at *18-*19 (N.D. Ill. Mar. 19, 2001) (A magistrate judge is only authorized to make decisions on nondispositive matters that have independent effect in order to assure that he or she does not dispose of the merits of any civil case without the parties' consent.).

Plaintiffs, recognizing the seriousness of the remedy they seek, waited until they developed enough evidence to decisively demonstrate to the Court defendants' branch-wide "Blitz-purge" and Andrew Kahr document destruction. This included obtaining adequate corroborating testimony from former Household employees who personally participated in the destruction of documents.

Thus, plaintiffs' decision and timing in bringing this motion before the Court, upon the development of an appropriate record, is entirely proper.

D. Plaintiffs Have Satisfied All Remaining Elements for Demonstrating Spoliation

1. Bad Faith Is Not an Essential Element for Demonstrating Spoliation – Plaintiffs Can Show Bad Faith, Willfulness or Fault

"[A] finding of bad faith is not a necessary prerequisite to the imposition of sanctions. A court can impose sanctions against a non-complying party who acted either with willfulness, bad faith or fault." *Cohn*, 1995 WL 519968, at *9 (citing *Marrocco v. Gen. Motors Corp.*, 966 F.2d 220, 224 (7th Cir. 1992)). Yet, as plaintiffs anticipated and argued in their opening papers (Pls' Mot. at 57-60), defendants claim that a finding of bad faith is required before a court can impose sanctions for spoliation. Defs' Opp. at 58-60. Further, as expected, defendants argue that the purge of

unauthorized materials or the disposition of the Kahr memos was not to deprive a potential adversary of relevant discovery, but rather to protect customers from risk of confusion, deception or mistake and insulate employees from unvetted or unapproved ideas. *Id.* at 59.

Defendants' post-destruction justifications are weak and fail to withstand scrutiny. The objective of protecting customers from risk of confusion, deception or mistake would only apply to future customers. Elimination of deceptive sales materials did not rectify the millions of loans that had already been made using such deceptive sales practices. 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 and where he offered non-credible justification for destruction).

Similarly, defendants' justification – also anticipated by plaintiffs (Pls' Mot. at 58-59) – that the Kahr documents were disposed of to insulate employees from unvetted or unapproved ideas, does not hold water. First, Kahr only communicated with very senior executives at Household, including the individual defendants, and did not like dealing with low-level employees. *See* Exs. 4, 7, 9-15, 27-28.[25] Second, if the goal was to insulate employees from Kahr's ideas, then defendants would have terminated his consulting arrangement, rather than paying him over $1.8 million for ideas that the Company was not interested in implementing. Indeed, the excerpts that defendants cite as examples of Kahr's trademark investive and acerbic and adversarial ad hominem style are

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[25] The Kahr memos that Mr. Harvey attaches as exhibits bear this out – they are all directed at the most senior level of Household executives. Thus, Mr. Harvey's insinuation that that these senior executives needed protection from Kahr, is nothing short of ludicrous.

primarily from early-1999. *See* Harvey Decl., ¶7 and attached Exhibits A-B and D-E. Defendants did not end Kahr's consulting arrangement and continued to pay him about $60,000 per month until May or June 2002. Pls' Mot. at 4; Ex. 24.

Rather than helping defendants, their arguments and the contrary record further reinforce the conclusion that defendants' destruction of documents was indeed intentional and designed to deprive potential adversaries of incriminating evidence.

Even if the Court were to find that the record does not establish bad faith or willfulness, plaintiffs easily meet the standard of "fault," which also permits the imposition of sanctions. Fault, as the Seventh Circuit has explained, "'does [not] speak to the noncomplying party's disposition at all, but rather only describes the reasonableness of the conduct – or lack thereof – which eventually culminated in the violation.'" *Long v. Steepro,* 213 F.3d 983, 987 (7th Cir. 2000) (citing *Marrocco*, 966 F.2d at 224) (alteration in original). The Second Circuit has held that "a finding of bad faith or intentional misconduct is not a *sine qua non* to sanctioning a spoliator with an adverse inference instruction." *Reilly v. NatWest Mkts. Group Inc.*, 181 F.3d 253, 268 (2d Cir. 1999). The court described its rationale, which is equally applicable here, as follows:

> Our case-by-case approach to the failure to produce relevant evidence seems to be working. Such failures occur along the continuum of fault – ranging from innocence through the degrees of negligence to intentionality. Trial judges should have the leeway to tailor sanctions to insure that spoliators do not benefit from their wrongdoing – a remedial purpose that is best adjusted according to the facts and evidentiary posture of each case. As other Circuits have recognized, it makes little sense to confine promotion of that remedial purpose to cases involving only outrageous culpability, where the party victimized by the spoliation is prejudiced irrespective of whether the spoliator acted with intent or gross negligence.

Id. at 267-68 (internal quotations omitted).

Here, plaintiffs have more than sufficiently demonstrated both fault as well as relevance of the documents. The requested sanctions should, therefore, be granted.

2. Plaintiffs Will Be Prejudiced by Their Inability to Use the Documents Destroyed by Defendants' Spoliation

Contrary to defendants' contention, the law in the Seventh Circuit is that prejudice is not an element to imposing sanctions. *See, e.g.*, *Marrocco*, 966 F.2d at 225; *Barnhill*, 11 F.3d at 1368; *Cohn*, 1995 WL 519968, at *9 (One "need not show prejudice prior to requesting a dismissal as a sanction under the Court's inherent power."). The Seventh Circuit has simply indicated that courts should consider the prejudice to the non-offending party's claim in fashioning a remedy for the spoliation. *Id.*

Defendants' assertion that plaintiffs have not suffered any prejudice because they have not listed any of the "effective rate" or Kahr documents on their trial exhibit list is pure fabrication. Attached hereto as Appendix A is a listing of the documents that plaintiffs referenced in their motion that they also included on Plaintiffs' Trial Exhibit List; and attached hereto as Appendix B is a listing of documents that plaintiffs intend to put forward to prove that Household's financial statements were false and misleading because they reflected revenues and income generated as a result of the Company's deceptive sales practices.

Like defendants do here, the defendants in *Larson v. Bank One Corp.*, No. 00 C 2100, 2005 U.S. Dist. LEXIS 42131 (N.D. Ill. Aug. 18, 2005), argued that (1) the data it has produced is sufficient for the plaintiffs to make out their case; and (2) further information would not help plaintiffs prosecute their case. *Id.* at *19-*20. The court rejected both arguments finding that Bank One had no right to limit the scope of its document retention policies at will. *Id.* at *39. "[A] party has the right to prosecute its case in the way it deems fit based on all available relevant evidence." *Bank One*, 2005 U.S. Dist. LEXIS 42131, at *42-*43 (acknowledging that the destruction of "evidence that is crucial to one side's chosen theory, but not to the other side's theory, is rife with material prejudice"); *Hickman v. Taylor*, 329 U.S. 495, 507 (1947) (stating "mutual knowledge of all the relevant facts . . . is essential to proper litigation").

In *Bank One*, a class action for violations of the Securities Act of 1933, the court found that without the destroyed evidence, plaintiffs' expert could not precisely estimate how much the company's financial statements were overstated in SEC filings, and thus were "substantively prejudiced" with regard to the determination whether Bank One materially misstated FUSA's financial well-being, *i.e.*, in proving materiality – an element of their securities claim. 2005 U.S. Dist. LEXIS 42131, at *43-*44. Although Bank One's expert argued that plaintiffs had ample data to conduct their "own accurate analysis and challenge the materiality of Bank One's financial statements," the court rejected this argument finding that parties must be allowed to prosecute a case based on their chosen theory in light of all relevant evidence. *Id.* at *44-*45.

The *Bank One* court's reasoning is particularly poignant here. Here, plaintiffs contend that defendants condoned and encouraged sales employees through compensation incentives to engage in various deceptive sales techniques in order to maximize loan growth at Household. Plaintiffs also contend that defendants eliminated the QAC and delegated the function of compliance to the very sales management who directly benefitted from the predatory lending tactics. Further, defendants designed a complaint resolution infrastructure that was fundamentally flawed, in as much as, complaints were handled at the branch level and there was no record of the complaint or its resolution unless it was elevated to the regulatory or executive level. Not surprisingly, Household's own documents contradict the results of the 2002 complaint study that defendants tout as supporting their defense. For example, one of defendants' declarant's, Ned Hennigan, the RGM for BFC Western Region, in preparing for the Responsible Lending Summit, acknowledged that figures in Household's complaint tracking understated the magnitude of the existing complaints since the information only concerned complaints that had been elevated to the level of AG, BBB or regulatory level, and did not include complaints received at the branch level. Ex. 50 at HHS 03208139-40.

When the scrutiny relating to Household's predatory lending practices reached a peak in summer 2001, hiding behind the justification of ridding the offices of date or unauthorized materials, defendants went on a "Blitz-purge" to destroy all incriminating documents. Now, defendants intend to use the lack of a record of complaints as a sword to defend themselves. Although, plaintiffs need not show prejudice, there can be no greater demonstration of prejudice that a party destroying documents and then using the dirth of evidence to support its defense.

III. CONCLUSION

Courts have broad discretion in deciding the appropriate sanction for a party's discovery violation, and the type of sanction administered generally depends on the unique factual circumstances of the case. *Kucala Enters. v. Auto Wax Co.*, 2003 U.S. Dist. LEXIS 8833, at *12 (N.D. Ill. May 23, 2003), citing, *Nat'l Hockey League v. Metro. Hockey Club, Inc.*, 427 U.S. 639, 642, 49 L. Ed. 2d 747, 96 S. Ct. 2778 (1976). Under the facts and circumstances detailed in plaintiffs' opening brief and reply, plaintiffs could easily have sought the ultimate sanction of default judgment. This Court has the inherent authority to award such a sanction. "[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.'" *Bank One*, 2005 U.S. Dist. LEXIS 42131, at *26 (quoting *Langley by Langley v. Union Elec. Co.*, 107 F.3d 510, 514 n.4 (7th Cir. 1997) (citing Fed. R. Civ. P. 37(b)(2)). However, plaintiffs are only seeking sanctions that would level the playing field and put plaintiffs in a position they would have been in had defendants not embarked upon the spoliation mission. Accordingly, plaintiffs respectfully submit 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 Joseph 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.[26]

DATED: February 6, 2009

Respectfully submitted,

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[26] Alternative to this instruction, plaintiffs request that defendants be precluded from submitting evidence of their inherently unreliable statistical compilation of complaints or the Effective Rate Complaint Study.

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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 February 6, 2009, declarant served by electronic mail and by U.S. Mail to the parties the **LEAD PLAINTIFFS' REPLY IN FURTHER SUPPORT OF THEIR MOTION REQUESTING EVIDENTIARY SANCTIONS FOR HOUSEHOLD DEFENDANTS' DESTRUCTION OF EVIDENCE (Redacted Version)**:

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 6th day of February, 2009, at San Francisco, California.

/s/ Marcy Medeiros
MARCY MEDEIROS