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' OPPOSITION TO DEFENDANTS' *DAUBERT* MOTION TO EXCLUDE THE EXPERT TESTIMONY OF CHARLES CROSS

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I. INTRODUCTION

Charles Cross is an independent third party witness formerly employed by the Washington State Department of Financial Institutions ("DFI"). He is a percipient witness whose experience and specialized knowledge qualify him to offer expert opinion testimony regarding Household International, Inc.'s ("Household" or the "Company") lending practices throughout the Class Period.[1] It is clear defendants do not like Mr. Cross's conclusions; however, this is not a basis to exclude his testimony. Mr. Cross's credentials are unassailable, his testimony is unquestionably relevant, and the methodologies he employed are valid – Mr. Cross's opinions are admissible under the Federal Rules of Evidence and *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993).[2]

While at Washington State DFI, Mr. Cross developed opinions regarding defendants' consumer lending practices through his investigation of Household. Some of Mr. Cross's findings are contained in the April 30, 2002 Washington DFI Expanded Report of Examination ("DFI Report") (attached hereto as Ex. C), which was prepared in the course of his duties as Washington DFI Supervisor of Investigatory Enforcement and delivered to Household on May 15, 2002. Following issuance of the DFI Report, Mr. Cross continued his investigation into Household as a key member of the Multi-State working group of attorneys general and regulators from across the country ("Multi-State Group"). Household ultimately paid the Multi-State Group $484 million in restitution for predatory lending. Mr. Cross's observations and opinions regarding Household – before and after the DFI Report was written – are based on the same methodology, *i.e.*, the work of a state financial regulator.

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[1] Plaintiffs intend to offer both percipient and expert testimony from Mr. Cross in the form of videotaped testimony. For the Court's convenience, plaintiffs attach as Exhibit A the portion of Mr. Cross's deposition testimony they will introduce at trial.

[2] All citations, internal quotations and footnotes are omitted and all emphasis added unless otherwise noted.

Although Mr. Cross is a percipient witness, he is also a qualified expert due to his specialized knowledge as a finance company regulator. Defendants do not dispute – because they cannot – that Mr. Cross's 13 years as a consumer fraud regulator, including more than ten years as a regulator in Washington State, render him more than qualified to provide expert testimony regarding Household's lending practices. Memorandum of Law in Support of Household Defendants' *Daubert* Motion to Exclude the "Expert" Testimony of Charles Cross ("Defs' Mem.") at 1 n.37; *Gipson v. Wells Fargo Bank N.A.*, 460 F. Supp. 2d 9, 10-11 (D.D.C. 2006) (holding that expert testimony as to lending industry practices and standards based upon personal experience was admissible); *Hangarter v. Provident Life & Ins. Co.*, 373 F.3d 998, 1017-19 (9th Cir. 2004) (permitting an expert to testify on insurance industry standards because of the witness's knowledge of and experience within the insurance industry). Rather, defendants – resorting to a massive distortion of the record – challenge the way Mr. Cross performed his job, asserting that he did not apply the proper "methodology" in carrying out his duties for the Washington DFI. The thrust of defendants' motion is that Mr. Cross's examination and investigation of Household was not sufficiently scientific to admit his opinions under Fed. R. Evid. 702 ("Rule 702"). This argument fails for several reasons.

First, defendants' challenges to Mr. Cross's methodology and conclusions go to the weight of his testimony, not its admissibility. *Drago v. Aetna Plywood, Inc.*, No. 96 C 2398, 1998 U.S. Dist. LEXIS 12249, at *11 (N.D. Cal. July 31, 1998) (challenges to aspects of methodology and certain of the findings go to weight not admissibility); *see also Trs. of E. Cent. Ill. Pipe Trades Health & Welfare Fund v. Airport Plumbing & Heating Inc.*, No. 04-1059, 2006 U.S. Dist. LEXIS 787, at *8-*9 (C.D. Ill. Jan. 5, 2006) (same). Such attacks are for cross-examination. Indeed, the attacks in

defendants' motion are all derived from Household's extensive questioning of Mr. Cross during three days of deposition.[3]

Second, defendants ask the Court to apply scientific standards to non-scientific opinions. The reason defendants do this is obvious – as the Supreme Court observed in *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137 (1999), where expert testimony is not based in scientific expertise, but rather in specialized knowledge, skill or experience, the *Daubert* factors are difficult, if not impossible, to apply. *Id.* at 150. Defendants' attempt to compare apples to oranges should be rejected. While scientific conclusions must be linked in some fashion to the scientific method, non-scientific testimony need only be linked to somebody of specialized knowledge or skills, and years of experience provide that link. *Thomas v. Newton Int'l Enters.*, 42 F.3d 1266, 1270 (9th Cir. 1994); *Groobert v. President & Dirs. of Georgetown Coll.*, 219 F. Supp. 2d 1, 7 (D.D.C. 2002) ("[P]ersonal experience can be a reliable and valid basis for expert testimony. This is particularly true with non-scientific testimony . . . .") (citing *Kumho*, 526 U.S. at 149, 151).

Third, defendants fabricate the basis for their contentions by purposefully misrepresenting to the Court the methodology Mr. Cross followed and the support for his opinions. Mr. Cross did not "impermissibly extrapolate" broad conclusions based on 19 customer complaints in Washington, "triple hearsay" and "untested complaints." Defs' Mem. at 5. In forming his opinions, Mr. Cross reviewed and analyzed internal documents produced by Household (Cross Jaffe Depo Tr. at 118:12-15, 119:1-9, 142:7-21, 178:24-179:7, 16:12-19)[4]; solicited and evaluated responses from Household

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[3] Mr. Cross was deposed for one day in this case, and two days in the *Luna v. Household Finance Corp. III*, No. C02-1635L (W.D. Wash.) action.

[4] "Cross Jaffe Depo Tr." refers to the Transcript of Deposition of Charles Cross, dated April 9, 2008 (Ex. A hereto). All objections and attorney colloquy have been omitted unless otherwise noted. "Cross Luna Depo Tr." refers to the Transcript of Charles Cross, dated December 19, 2002, taken in the *Luna* action (Ex. B hereto).

regarding the various issues raised (DFI Report at 4; Cross Jaffe Depo Tr. at 135:23-137:10, 182:2-184:6); evaluated Household's products and policies (DFI Report at 63, 65-66; Cross Jaffe Depo Tr. at 145; Cross Luna Depo Tr. at 149-150); interviewed witnesses (Cross Jaffe Depo Tr. at 117:22-117:25); engaged in "mystery shopping" (118:4-11); assessed the impact of Household's compensation scheme on lending practices (DFI Report at 63, 66); and considered input from other state regulators throughout the country who were having similar experiences with Household (Cross Luna Depo Tr. at 480, 486).

Simply put, Mr. Cross (and the Washington DFI and Multi-State Group) conducted a long-term, multi-faceted, in-depth investigation of Household, and his opinions, including that Household engaged in widespread "deception, misrepresentation, confusion, [and] up-selling borrowers unnecessarily" (Cross Jaffe Depo Tr. at 126:14-127:4), are reliable and admissible under Rule 702.

II. ARGUMENT

A. Mr. Cross's Testimony Is Plainly Admissible Under Federal Rule Evidence 702

The admissibility of expert testimony is governed by Rule 702, which the Supreme Court analyzed in its landmark decision, *Daubert*, 509 U.S. 579. In *Daubert*, the Supreme Court held that Rule 702 actually ***lowered*** the admissibility standard for expert testimony and rejected the prior more stringent admissibility standard utilized by some lower courts relying on *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923). *See Daubert*, 509 U.S. at 588. Under *Daubert*, the Court applies a three-step analysis for determining the admissibility of expert opinion testimony: (1) is the expert qualified?; (2) is the expert's reasoning or methodology reliable?; and (3) does the testimony help the trier of fact understand the evidence or determine a fact in dispute? *Ervin v. Johnson & Johnson, Inc.*, 492 F.3d 901, 904 (7th Cir. 2007). The first two prongs of this framework evaluate the reliability of the proposed testimony and the third prong evaluates the relevance of the proposed testimony. *Ammons v. Aramark Unif. Servs.*, 368 F.3d 809, 816 (7th Cir. 2004). The overall

approach is one that excludes patently unreliable expert testimony and relies upon cross-examination and other traditional methods to undercut shaky, but admissible expert testimony. *Daubert*, 509 U.S. at 595.

In this Circuit, "[a]nyone with relevant expertise enabling him to offer responsible opinion testimony helpful to judge or jury may qualify as an expert witness." *Tuf Racing Prods., Inc. v. Am. Suzuki Motor Corp.*, 223 F.3d 585, 591 (7th Cir. 2000). "Rule 702 specifically contemplates the admission of testimony by experts whose knowledge is based [solely] on experience." *Smith v. Ford Motor Co.,* 215 F.3d 713, 718 (7th Cir. 2000). As stated in the Advisory Committee Notes to Rule 702, "[i]n certain fields, experience is the predominant, if not sole, basis for a great deal of reliable expert testimony." Advisory Comm. Notes on Rules-2000 Amendment; *United States v. Conn*, 297 F.3d 548, 556 (7th Cir. 2002) (citing same).

The second test for "reliability" is also lenient, merely requiring that the "***reasoning or methodology underlying the testimony . . . [be] valid***." *Daubert*, 509 U.S. at 592-93. This is a limited inquiry: "[T]he court's gatekeeping function focuses on an examination of the expert's methodology. The soundness of the factual underpinnings of the expert's analysis and the correctness of the expert's conclusions based on that analysis are factual matters to be determined by the trier of fact. . . ." *Smith*, 215 F.3d at 718.

The final prong, that expert testimony be "relevant," is met whenever such testimony "will assist the trier of fact to understand the evidence or to determine a fact in issue." Fed. R. Evid. 702. As noted by the Seventh Circuit, this standard is met where the testimony at issue "will assist the trier of fact with its analysis of ***any of the issues involved in the case.***" *Smith,* 215 F.3d at 718.

The analysis is more liberal where expert testimony, such as Mr. Cross's testimony, is based upon judgments and assessments derived from professional experience and knowledge. As the court in *In re Masella*, No. 05-24302, 2007 Bankr. LEXIS 2719 (D. Conn. Aug. 7, 2007) explained:

> Experts in disciplines that require the use of professional judgment are ***less likely candidates for exclusion*** because challenges may be ultimately viewed as matters in which reasonable experts may differ in exercising their judgment as to the appropriate methodology to employ or the appropriate variable to plug into a calculation.

Id. at *7; *see also In re Joy Recovery Tech. Corp.*, 286 B.R. 54, 70 (N.D. Ill. 2002).

In sum, "[t]he permissible scope of expert testimony is quite broad, and district courts are vested with broad discretion in making admissibility determinations." *Hill v. Reederei F. Laeisz G.M.B.H.*, 435 F.3d 404, 423 (3d Cir. 2006). Consequently, "***the rejection of expert testimony is the exception rather than the rule***." Fed. R. Evid. 702, Advisory Comm. Notes (2000) (emphasis added); *see also Spearman Indus., Inc. v. St. Paul Fire & Marine Ins. Co.*, 128 F. Supp. 2d 1148, 1150 (N.D. Ill. 2001) (quoting same). "Vigorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional and appropriate means of attacking shaky, but admissible evidence." *Daubert*, 509 U.S. at 595.

B. Mr. Cross Is Qualified to Offer Expert Opinions on Household's Predatory Lending Practices

A witness may be qualified as an expert if he possesses specialized "knowledge, skill, experience, training, or education." Fed. R. Evid. 702. The qualification standard under Rule 702 is to be applied liberally. *Thomas*, 42 F.3d at 1269. "Anyone with relevant expertise enabling him to offer responsible opinion testimony helpful to judge or jury may qualify as an expert witness." *Tuf*, 223 F.3d at 591.

Significantly, defendants do not dispute that Mr. Cross is an expert qualified to render the opinions set forth in his testimony – nor could they. Mr. Cross is an experienced bank examiner, who worked for the Washington DFI Division of Consumer Services for more than ten years. The Consumer Services Division is responsible for regulating financial institutions, including Household Finance Corporation ("HFC") and Beneficial Finance Corporation ("Beneficial"), for compliance with state and federal consumer protection laws. In 1996, Mr. Cross became the Supervisor of

Investigation/Enforcement in the Consumer Services Division and he was promoted to Enforcement Chief in May of 2002. In the course of his work at the Washington DFI, he investigated and assisted in the prosecution of several financial institutions accused of engaging in predatory lending, including First Alliance Mortgage Company (FAMCO), Ameriquest and Household. Prior to working at the Washington DFI, Mr. Cross served for three years as a federal bank examiner for the Federal Deposit Insurance Corporation (the FDIC).[5]

Mr. Cross's professional experience and certifications leave no doubt that he is sufficiently qualified as an expert under Rule 702, especially with respect to his own investigation into Household. *See Martinez v. Sakurai Graphic Sys. Corp.*, Case No. 04 C 1274, 2007 U.S. Dist. LEXIS 65132, at *7 (N.D. Ill. Aug. 30, 2007) ("The Court 'consider[s] a proposed expert's full range of practical experience as well as academic or technical training when determining whether that expert is qualified to render an opinion in a given area.'") (quoting *Smith*, 215 F.3d at 718). On this basis alone, Mr. Cross' opinion should be deemed reliable. *Fid. Nat'l Title of New York v. Intercounty Nat'l Title Ins. Co.*, No. 00 C 5658, 2003 U.S. Dist. LEXIS 7207, at *31 (N.D. Ill. Apr. 29, 2003) (Where defendants challenge methodology but not qualifications of expert, "***the motion must be denied on this basis***.") (quoting *Stutzman v. CRST, Inc.*, 997 F.2d 291, 296 (7th Cir. 1993) ("'Experience and knowledge establish the foundation for an expert's testimony; the accuracy of such testimony is a matter of weight and not admissibility.'"). *Hangarter*, 373 F.3d at 1015 (quoting

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[5] Additionally, at the time Mr. Cross authored the DFI Report, he was chairman of the Mortgage Fraud Committee and a member of the Training Committee for the American Association of Residential Mortgage Regulators ("AARMR"), a national association of state regulators. Mr. Cross also served as an instructor and subject matter expert in financial and white collar crimes for the National White Collar Crimes Center (funded by the U.S. Department of Justice) and was a member of the Research Committee for the King County Coalition for Responsible Lending. Mr. Cross has received numerous awards related to his regulatory work, including 2001 AARMR examiner of the year and 2000 National Association of Mortgage Brokers columnist of the year. Mr. Cross is a Certified Fraud Examiner (the CPA of the fraud arena) and a Certified Government Financial Manager (the government equivalent of a CPA). Cross Luna Depo Tr. at 34:3-37:19.

Rule 702 Advisory Committee notes) ("In certain fields, experience is the predominant, if not sole, basis for a great deal of reliable expert testimony."); *see also Pipitone v. Biomatrix, Inc.*, 288 F.3d 239, 247 (5th Cir. 2002) (explaining that "an expert [may] draw [his] conclusion[s] from a set of observations based on extensive and specialized experience").

C. Mr. Cross' Opinions Are Relevant

In late 2001, the Washington DFI, and specifically Mr. Cross and his boss Consumer Division Director, Mark Thompson, made a decision to investigate Household and prepare an expanded report of examination. Cross Jaffe Depo Tr. at 111:15-113:16; 125:9-126:13. The Washington DFI had observed a disconnect between the rising level and seriousness of consumer complaints it was receiving against HFC and Beneficial in Washington and the results of its routine examinations of HFC loan files. Cross Jaffe Depo Tr. at 111:15-113:16. As the DFI Report stated, the "large number of complaints" against HFC was "comparable only to the number filed against Beneficial." DFI Report at 3. The DFI Report also noted that "the complaint activity relative to its peers ***is disproportionate,*** and a ***large increase*** in the last two years is cause for concern." *Id.* Additionally, the examination staff (different from Mr. Cross's enforcement staff) had communicated that the Company had become more and more adversarial. Cross Jaffe Depo Tr. at 163:5-20. In this context, Mr. Cross and Mr. Thompson determined to conduct a statutorily authorized expanded examination of HFC. Cross Jaffe Depo Tr. at 190:14-16. The results of the investigation are memorialized in the DFI Report, which identifies seven discreet types of widespread predatory practices. DFI Report at 43-66; Cross Jaffe Depo Tr. at at 127:19-128:18.

Following completion of the DFI Report in April of 2002, Mr. Cross worked closely with regulators and attorneys general from the Multi-State Group who also were investigating

Household's predatory lending practices.[6] Mr. Cross was one of three examiners who provided all of the technical support to the Multi-State Group. Cross Jaffe Depo Tr. at 142:7-21. In that role, Mr. Cross was charged with "analyzing all of the documentation that was coming in from all of the states into this multistate" and "spent a lot of time exchanging information, exchanging documents, looking at spreadsheets, that kind of thing." *Id.* These documents further supported his opinion that the practices were widespread. Cross Jaffe Depo Tr. at 178:24-179:7. Mr. Cross's work with the Multi-State Group bolstered his original conclusions as set forth in the DFI Report and provided further evidentiary support for the opinions plaintiffs seek to introduce at trial:

> Q: You're familiar that – with the fact that subsequent to – or about the time of the issuance of this report, the Washington State Attorney General was conducting her own investigation into Household?
>
> A. I was involved in their investigation, so, yes, I was aware of it.
>
> Q. Okay. And, in the course of that investigation, did you learn additional information about Household's practices within the state of Washington?
>
> A. Yes.
>
> Q. (BY MR. BAKER:) ***And did the information that you learned as a result of participating in the AG investigation reinforce the conclusions that you reached as a result of your own investigation reflected in Exhibit 3 [DFI Report]?***
>
> A. ***Yes***.

Cross Jaffe Depo Tr. at 120:13-121:23.

Mr. Cross's testimony also establishes that the members of this group, which grew over time, corroborated his findings on Household's specific predatory practices.[7] *See, e.g.*, Cross Jaffe Depo

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[6] On May 23, 2002 Mr. Cross met with Household to discuss various predatory practices found by the DFI, and informed Household of the Multi-State Group investigation. Cross Jaffe Depo Tr. at 176-177.

[7] Defendants, without citation, disingenuously argue in a footnote that opinions not contained in the DFI Report cannot be considered. However, the testimony plaintiffs offer contains testimony relating to events occurring after he wrote the report, but during the relevant timeframe of this action, including

id. at 144:12-146:16 (deceptive prepayment practices found in all states except New York); 150:4-150:12 ("100 percent" consensus regarding deceptive practices involving discount points); 138:8-140:24 (effective rate misrepresentations found by 15-20 states).

Mr. Cross's testimony that the Multi-State Group of Attorneys General reached a consensus on the widespread nature of Household's predatory lending is based on his attendance at meetings where the various deception practices were discussed by regulators. *Id.* at 145:21-146:16 ("I remember two physical meetings we were all in the same room. The first meeting, I think there were about 25 states, and then the next meeting grew to about 40 states."). Ultimately, Household paid the Multi-State Group $484 million to compensate borrowers for predatory lending.[8] The testimony plaintiffs seek to introduce at trial relates to findings made during Mr. Cross's investigation of Household, including preparation of the DFI Report and Mr. Cross's involvement with the Multi-State Group. Ex. A. Mr. Cross's testimony regarding his involvement in the investigation and his conclusions about the nature and breadth of Household's predatory practices clearly are relevant to establishing primary questions in this case: "did Household engage in predatory lending?" and, if so, "did defendants know or recklessly disregard that fact?" *See, e.g.*, *Smith*, 215 F.3d at 721 (Expert testimony need not go to the ultimate issue, but "need only be relevant to ***an*** issue in the case.")

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testimony corroborating the opinion defendants seek to exclude – that Household was engaged in a massive predatory lending scheme. Defendants' unsupported argument should not be countenanced, and defendants should not be permitted to argue the issue on reply. Plaintiffs properly notified defendants of their intent to introduce such testimony in their notice: "Mr. Cross' opionions are memorialized ***in his testimony at his April 9, 2008 deposition in this case*** and the Washington State DFI reports, principally that report is dated April 30, 2002, which was marked as Exhibit 3 at his April 9, 2008 deposition in this case." Ex. F-1 at 1 to plaintiffs' [Proposed] Final Pretrial Order. Any substantive argument to preclude that deposition testimony should have been included in defendants' opening brief.

[8] The reason the Washington DFI did not file formal charges against Household was because they joined the Multi-State Group and subsequently settled. Cross Jaffe Depo Tr. at 179-181.

Plaintiffs now turn to defendants' attack on the reliability of Mr. Cross's opinions, which, even if accurate, goes to the weight given his opinions, not the admissibility.

D. Mr. Cross Utilized a Reliable Methodology Under Fed. R. Evid. 702

1. Mr. Cross's Opinions, Based on His Experience as a Regulator, Are Not Held to a Scientific Standard

Defendants primary contention is that Mr. Cross's methodology is "scientifically invalid."[9] Defs' Mem. at 4-13. However, Mr. Cross's opinions were formed in the course of his work for the Washington DFI, and his approach does not purport to be scientific. Such a methodology is entirely permissible as "personal experience can be a reliable and valid basis for expert testimony. ***This is particularly true with non-scientific testimony***. . . ." *Groobert*, 219 F. Supp. 2d at 7 (citing *Kumho*, 526 U.S. at 149, 151); *see also Gipson*, 460 F. Supp. 2d at 10-11 (D.C. Cir. 2006). Where expert testimony is not based in scientific expertise, but rather in technical knowledge, skill or experience, the *Daubert* factors are difficult to apply. *Kumho*, 526 U.S. at 150. Thus, while scientific conclusions must be linked in some fashion to the scientific method, non-scientific testimony need only be linked to somebody of specialized knowledge or skills, and years of experience provide that link.[10] *Thomas*, 42 F.3d at 1270; *Drago*, 1998 U.S. Dist. LEXIS 12249, at *10-*11 (holding

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[9] Although defendants' motion is to exclude Mr. Cross's video deposition testimony, they focus most of their attacks on the DFI Report itself. However, defendants do not (and cannot) dispute that the DFI Report is a public report containing: (1) matters observed pursuant to a duty imposed by law; and (2) factual findings pursuant to authority granted by law. Declaration of Chuck Cross (Ex. D hereto), ¶3 ("I reviewed the report . . . and can verify that it is an authentic copy of this report, which ***the Department considers to be complete and final***.") Accordingly, pursuant to Fed. R. Evid. 803(8)(B) and (C), the DFI Report is admissible non-hearsay and presumed reliable. *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 161-70 (1988). Defendants do not argue otherwise, and have made no attempt to demonstrate that the DFI Report is untrustworthy either in this motion or in their motion to exclude state and federal examinations, which does not address the DFI Report. Instead defendants argued that the examination reports, collectively, should be excluded on relevance and prejudice grounds. Having failed to argue the DFI Report itself is untrustworthy, defendants should not be permitted to raise this argument for the first time on reply.

[10] Because, Mr. Cross's opinions are derived from his investigator, percipient observations and substantial experience as a regulator, *United States v. Mikos*, No. 02 cr 137, 2003 U.S. Dist. LEXIS 22069

accountant qualified to calculate lost wages based on his skill "in the techniques used to calculate elements of economic loss and his knowledge of this area distinguishes him from the ordinary person"). Because defendants' attacks are not suited to non-scientific opinions, their motion rests on a faulty legal foundation and should be denied.

2. Mr. Cross's Opinions are Based on a Complete and Thorough Investigation of Household

As noted above, the expanded examination of Household was precipitated by alarming increases in complaints against HFC and Beneficial and because these Household subsidiaries had far more complaints against them than any other lender in the state. DFI Report at 7; Cross Jaffe Depo Tr. at 163. Based on his experience as a regulator, Mr. Cross selected 19 of those complaints for close review. Mr. Cross's *Luna* testimony explains why regulators commonly rely on complaint analysis in the course of examining consumer lending companies, and conclusively refutes defendants' specious contention that Cross "acknowledged . . . his analysis was inconsistent with the accepted method for examining financial institutions." Defs' Mem. at 1-2.

> Q: Okay. Then let's go back to the question about whether or not in your and the Department's experience receiving complaints sometimes or often indicates a problem more widespread than the sheer number of complaints.
>
> A. ***The answer is, yes, emphatically yes***. It is one of the ***chief indicators*** we use to make a determination whether to ***move forward*** with greater scrutiny on a company.
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> Q: And what is your experience with that?
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> A: That complaints are – what we refer to as tip of the iceberg. The complaints are always the tip of the iceberg in any case I've ever worked. I've never

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(N.D. Ill. Dec. 5, 2003); *Gen. Elec. Co. v. Joiner*, 522 U.S. 136 (1997); and *Fuesting v. Zimmer, Inc.*, 421 F.3d 528 (7th Cir. 2005), *vacated in part on other grounds on reh'g*, 448 F.3d 936 (7th Cir. 2006), which all evaluate the admissibility of experts seeking to offer expert opinions grounded in science are inapplicable. Further, as discussed in detail herein, Mr. Cross's opinion is based on much more than "say-so"; thus *R.J. Reynolds Tobacco Co. v. Premium Tobacco Stores, Inc.*, No. 99 C 1174, 2004 WL 1613563 (N.D. Ill. July 19, 2004) is equally inapplicable.

> worked a complaint – I mean, I've never worked a case where there were just a few complaints. Every time we start the case because there's a few complaints, and it's one of those where there's smoke, there's fire thing, and we find that ***those people who take the time and the energy to complain are a very small percentage of consumers***.
>
> Q: And is that what you believe to be the case here?
>
> A: ***Yes. And after spending six months with regulators and the AG's from 49 other states, that's what they all indicated they believed as well.***

Cross Luna Depo Tr. at 479:17-480:17. Contrary to defendants' contention, moreover, Mr. Cross' investigation was significantly broader than investigating 19 complaints. Significantly, the DFI subpoenaed documents which Mr. Cross reviewed and considered in his analysis. Cross Jaffe Depo Tr. at 118:12-15; 119:1-7. Mr. Cross also evaluated Household's responsiveness to the Washington DFI, observing that "[f]ailure to provide an adequate response to a directive has been a repetitive pattern with HFC." DFI Report at 4. Mr. Cross also engaged in substantial back and forth with the Company and evaluated the credibility of management's responses.[11] Cross Jaffe Depo Tr. at 182:2-184:6. In formulating his conclusions on defendants' individual predatory practices, Mr. Cross went several steps beyond simply evaluating complaints.

In concluding that Household was engaged in widespread insurance packing, for example, Mr. Cross spoke to borrowers who consistently confirmed that Household stuck customers with unwanted insurance (Cross Jaffe Depo Tr. at 131:7-19); analyzed the insurance penetration data for every HFC branch in Washington[12] (Cross Jaffe Depo Tr. at 130:5-131:19, DFI Report at 65); and

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[11] Mr. Cross and the examiners working for him also did a "mystery shopper" test. In each of the three "tests the Department found that HFC representatives misrepresented or withheld information, failed to comply with state and federal law and regulations, and did not follow the policy and practice that HFC corporate claimed." DFI Report at 56. Defendants' attempts to distort Mr. Cross's testimony in this regard should be rejected.

[12] As Mr. Cross testified insurance penetration analysis is a "pretty routine" step in assessing whether "the company was packing or getting insurance into the transaction, either through an overly convincing sales pitch or out-and-out misrepresentation or deception to the customer." Cross Jaffe Depo Tr. at 129:19-131:19;

evaluated the Company's incentive compensation scheme[13] (DFI Report at 63); *see also* Cross Luna Depo Tr. at 111:5-17; Cross Jaffe Depo Tr. 160:4-161:13. Defendants do not dispute this sound methodology, they simply ignore it.

With respect to discount points, Mr. Cross found two major problems both supported by much more than 19 complaints. Mr. Cross found that the points did not buy down the customer's interest rate, as Household claimed. This conclusion was corroborated by, among other things, Mr. Cross's review of internal Household documents[14]; a study of 259 loans made in May 2001; the "mystery shopper" investigation and the "100 percent" consensus of every state in the Multi-State Group (approximately 40 states). Cross Jaffe Depo Tr. at 147, 150; DFI Report at 54, 57-58. Mr. Cross also found the Company improperly disclosed a range of points on their Good Faith disclosures, and customers were routinely charged points at the top of the range. Cross Jaffe Depo Tr. at 147, 150. Defendants' "improper extrapolation" argument is completely inapplicable to this conclusion as Household did not dispute that they commonly offered a wide range of points; instead, they gave Mr. Cross a series of implausible excuses as to why they were allowed to do so. DFI Report at 55. The Washington DFI first raised Household's improper disclosure of a range of points

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see also DFI Report at 64 ("In determining whether requiring insurance or hiding insurance is a practice, regulators may look to a company's rate of penetration of certain insurance products."). Cross described HFC's insurance notes as "incredible" and "extremely uncommon."

[13] The Washington DFI concluded "HFC's employee compensation program provides incentive for its representatives to include insurance on a borrower's loan, despite a borrower's wish or need, and avoid the borrower learning of the inclusion." DFI Report at 63. Mr. Cross's evaluation of HFC's incentive compensation scheme also provided support for his opinion that Household's general practice was to obtain through a variety of predatory means "maximum revenue from consumers regardless of any actual benefit to the consumer." DFI Report at 66.

[14] Internal company documents also revealed prepayment penalties were hidden in the loan terms. Mr. Cross's conclusions with respect to prepayment penalties were confirmed by every member of the Multi-State Group, save one. For these states, prepayment penalties were "a very big point that was discussed over and over and over." Cross Jaffe Depo Tr. at 145.

in 1999, and over a two-and-a-half year timeframe repeatedly informed Household that this practice was prohibited. Cross Luna Depo Tr. at 132:13-133:4; Cross Jaffe Depo Tr. at 150:22-151:19. The Company did not deny the practice, but instead sought to defend it shifting legal grounds.[15] *Id.*; DFI Report at 55. Ultimately, Mr. Cross's expert interpretation was affirmed by HUD. Cross Jaffe Depo Tr. at 151:20-152:13. These facts do not constitute "unsupported extrapolation" but instead form the reasonable basis of Mr. Cross's expert opinion.[16]

Defendants also ignore the support for Mr. Cross's conclusion that Household loan officers often misled borrowers by representing that accepting the bi-weekly payment program would effectively reduce the interest rate on their loan from approximately 14% down to 7%. DFI Report at 46. Contrary to defendants' assertions, this opinion was based on much more than the review of "two to four" complaints. Defs' Mem. at 7. The Washington DFI contacted Household regarding this practice in mid-2001, and management responded that the practice was isolated to a single branch. DFI Report at 46. However, the effective rate practice was identified in several Washington branches and Mr. Cross received reports from regulators in other states concerning the practice, leading him to conclude Household's claims that the practice was isolated were false. DFI Report at 41; Cross Jaffe Depo Tr. at 138:8-140:24. In his deposition Mr. Cross testified that the effective rate pitch was used "fairly frequently" both in and outside Washington:

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[15] First, Household falsely claimed it had an exemption from the Office of Housing and Urban Development ("HUD"); however, the Washington DFI queried HUD and determined that no lender had been given an exemption. *Id.* Ultimately, Household then prevaricated further, claiming that their staff of attorneys had researched the issue, and then admitting it was a single lawyer, and there was no written documentation supporting that claim. DFI Report at 55.

[16] Given Mr. Cross's extensive, multi-faced investigation defendants' cases regarding the weight afforded to allegations do not impact the analysis. *See* Defs' Mem. at 11-12, citing *Naugles v. Sheahan*, No. 98 C 6637, 2000 WL 1700131 (N.D. Ill. Oct. 16, 2000); *City of Austin Police Ret. Sys. v. ITT Educational Servs., Inc.*, 388 F. Supp 2d 932 (S.D. Ind. 2005); *Gong v. Hirsh*, 913 F. 2d 1269 (7th Cir. 1990).

Q: Did it appear to you based on the information you obtained in connection with your investigation that those terms [equivalent rate, effective rate] had been used by Household in a way that was common to a number of borrowers? [objection omitted]

A: We heard it ***fairly frequently*** in conjunction with the Household transactions and the Household borrowers, not just in this state, but in other states, enough to make, not just myself, but, you know, ultimately it wasn't just me. ***It's a whole bunch of assistant AG's and regulators having to be as convinced as I was convinced in each of their jurisdictions.*** And so, yes, within this state David Hughey [sic] and I both felt that ***we'd seen equivalent or effective interest rate enough times to believe that it was some part of this company***, and then it was just supported from state to state to state by our counterparts in other states. So we were – we were pretty confident that we had that figured out.

Cross Luna Depo Tr. at 486:2-21.

In responding to a follow-up question by Household's counsel, Mr. Cross specifically refuted defendants' characterization that his conclusions regarding use of the effective rate scam were based on "two or four" complaints:

Q: Let me quickly follow-up. You just said that you heard it fairly frequently that somebody in the company used effective or equivalent interest rate presentations. Do you consider two to four times in the complaints that were reviewed in connection with the report fairly frequently?

A: ***I didn't say exactly what you just said. But what I consider two to four times being fairly frequently, no.*** What I said is that, I said, we, and I said the AG's office and me and regulators and other AG's from across the country. So I think there's a significant amount of evidence that it was used fairly frequently. I'll tell you I – [witness is cut off]

Cross Luna Depo Tr. at 488:8-20. In fact, at least 15 to 20 other states confirmed to Mr. Cross that Household was using the same deceptive sales pitch in their states.[17] Cross Jaffe Depo Tr. at 138:8-

[17] Mr. Cross's opinion regarding Household's widespread use of the effective rate presentation is also supported by Household's reaction to his inquiries on the topic, and months of interaction with the Company. Cross Jaffe Depo Tr. at 135:18-137:10. As the DFI Report states, Household evidenced "knowledge of the disclosures and sales practices when responding to complaints." DFI Report at 59.

140:24. Mr. Cross also looked at documents produced by the other states, which corroborated his conclusions:

> Q: Were the documents and materials you received with respect to Household's practice in other states consistent with what – with the findings that you made in Exhibit 3?
>
> A. Much – Much of what the other states found and produced in our, you know, exchange of materials, and so forth, was consistent with what we found in Washington.

Cross Jaffe Depo Tr. at 178:24-179:7. Defendants attempt to discount this evidence by labeling it "triple hearsay." Defs' Mem. at 12. This line of attack fails for several reasons. First, experts are permitted to rely on hearsay.[18] *Thomas v. Sheahan*, 514 F. Supp. 2d 1083, 1093 (N.D. Ill. 2007) ("An expert may even rely on hearsay evidence if the data is 'of a type reasonably relied upon by experts in the particular field in forming opinions or inferences on the subject.'") (quoting *Daubert*, 509 U.S. 592, 595). This is especially true where the hearsay is recorded in an official government report, like the DFI Report which is deemed reliable as a matter of law. *Clark v. Clabaugh*, 20 F.3d 1290, 1294 (3rd Cir. 1994) (Admitting official report pursuant to FRE 808, because "[w]e are quite satisfied that the district court exercised sound discretion in admitting for consideration the PSP Report, which is indeed unsworn, authored by an investigator who did not have personal knowledge, and which contains opinion based on hearsay."); *see also Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 161-70 (1988) (conclusions and opinions in government reports are generally admissible and reliable). Rule 803(8) specifically exempts official findings from the hearsay rule, because they are inherently trustworthy. *Id.*

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[18] Testimony regarding the other regulators' findings is admissible for non-hearsay purposes; however, the question of whether the Multi-State Group's consensus is hearsay is irrelevant to this motion, as defendants contend only that an expert cannot rely on hearsay and do not seek to exclude the testimony on hearsay grounds. Defendants should be barred from raising this issue on reply.

Significantly, defendants have made no showing that the "reasoning . . . underlying the testimony" is flawed, *i.e.*, that a reasonable regulator would not rely on identical findings reported by officials in dozens of different states in concluding the practice was widespread. *Daubert*, 509 U.S. at 592-93. Indeed, in a different brief, defendants criticized plaintiffs' retained expert Catherine Ghiglieri for ***not*** speaking directly to, and relying on, ***these very same examiners***. Memorandum of Law in Support of Household Defendants' *Daubert* Motion to Exclude the "Expert" Testimony of Catherine A. Ghiglieri at 18. Defendants have made no showing that the consensus of other examiners is so unreliable that a reasonable examiner would not consider it. *Thomas*, 514 F. Supp. 2d at 1093. Nor can they show why Mr. Cross's reliance on documents produced in an information exchange between cooperating states is unreasonable for a regulator. This is precisely the type of information regulators rely on, and its accuracy is bolstered even further by the fact that the Multi-State Group ultimately acted on its collective findings leading to the $484 million settlement.

3. Statistical Testing Is Not Required

Defendants also have no basis to assert that Mr. Cross should have performed statistical testing to support his conclusions. Where the expertise at issue derives from personal experience, this Court has not required "scientific" testing. *Amakua Dev. LLC v. Warner*, No. 05 C 3082, 2007 WL 2028186, at *8 (N.D. Ill. July 10, 2007). During his deposition, Mr. Cross explained why statistical sampling in the manner suggested by defendants is inappropriate in the regulatory context:

> So, in a – if we were to hire a statistician – which wouldn't be me – if we were to hire a statistician to do some analysis, they would – they would probably come back with some numbers that show that the number of complaints I was looking at in this report were very, very, very, very small in relation to the population of complaints, but ***we don't – the regulatory world, we don't live in a vacuum. We measure things like are the complaints with this company greater than with a peer company and are they increasing at a greater rate, are they more egregious than other types of complaints, these types of things.***
>
> ***In that sense, they may not be a classic statistical indicator for us, but they are, nevertheless, important in us forming our decisions.***

* * *

> And that's what we're – In this report, when we're dealing with 19 complaints, that's – that's what we're saying, is these 19 complaints were egregious acts against consumers. ***And we never tried to argue that they make up a huge percentage of – of the total loans in the company***. What we say is we find these practices within these complaints – we find them to be egregious. We communicate with – with many of the states across the country. ***We find that they have similar complaints in their files, that their examination findings are similar to the things that we're finding in our examination.*** And, therefore, we feel comfortable in saying that, when we look at the company, we – we do not like the practices we're seeing here. That's what that report does."

Cross Jaffe Depo Tr. at 75:10-76:23.

Furthermore, while defendants' expert John Bley ("Bley") opines that the examination process "may involve interviewing the institutions [sic] personnel and, on occasion, consumers," he says nothing about any statistical testing. *See* Declaration of John L. Bley ("Bley Decl.") (Ex. E hereto), ¶5. In any event, defendants' arguments here go to weight, not admissibility. *Arias v. Allegretti*, No. 05 C 5940, 2008 U.S. Dist. LEXIS 4352, at *10 n.1 (N.D. Ill. Jan. 22, 2008). In *Arias*, the court held that defendant City of Chicago's argument than an expert's "conclusions are unreliable because he relied on a *de minimis* sample goes to the weight of his testimony, not its admissibility." *Id.*

The cases cited by defendants on this point are inapposite. As discussed above, Mr. Cross does not purport to extrapolate his conclusions from a sample of complaints; his opinions are based on a lengthy and complete investigation of the Company and his experience as a regulator. By contrast, in *Mikos*, relied on heavily by defendants, the proffered expert sought to offer an "opinion as to [the] probability" that bullets came from the same batch. 2003 U.S. Dist LEXIS 22069, at *8, *13. This Court found that such an opinion must have some support "that a statistician or mathematician would consider to be at least arguably scientifically valid." *Id.* at *13. The Court also was concerned that because the testimony would come from "an expert in chemical analysis," the jury would assume the scientific validity of his probability opinion, despite its deficiencies. *Id.* at

*14, *16. None of these concerns apply here. Mr. Cross is not being presented as a scientist and his conclusions are not founded in science – there is no danger that the jury will believe his opinions arise from the "application of rigorous scientific standards." *Id.* at *14. Statistical analysis, thus, is not necessary.

4. Mr. Cross Followed the Routine Course of Business – Random Samples Are Not Required

Defendants also fault Mr. Cross for failing to base his report on randomly sampled documents, and claim he admittedly failed to follow the routine examination procedure. Defs' Mem. at 8. As with defendants' statistical testing argument, this criticism goes to the weight of Mr. Cross's testimony, not its admissibility. *Richman v. Sheahen*, 415 F. Supp. 2d 929, 942 (N.D. Ill. 2006) (If there is some factual support for opinion, "it is for the jury, properly instructed, to determine the credibility of the witness and thus the weight to be given to the expert opinion.") Defendants' argument also rests on a fundamentally flawed assumption – that regulators only conduct one type of examination. The testimony from which defendants purport to derive Mr. Cross's "admission" says nothing of the sort. Defs' Mem. at 2 (citing Cross Jaffe Depo Tr. at 93:10-94:15). Instead, it stands for the proposition that regularly scheduled examinations (performed in Washington once every 24 months) usually involve random loan samples. This does not apply to Mr. Cross's expanded examination which was undertaken by the enforcement (as opposed to examination) division due to the dramatic year-over-year increase in complaints against HFC and Beneficial, and because those Household subsidiaries had significantly more customer complaints than their peers. DFI Report at 7. Defendants offer no support for the illogical suggestion that such an investigation should proceed on a random basis. Nor do they suggest how it would be useful or even possible to "randomly" sample customer complaints. *See, e.g.*, *McCloud v. Goodyear Dunlop Tires N. Am., Ltd.*, 479 F. Supp. 2d 882, 892 (C.D. Ill. 2007) (holding expert did not have to do the impossible or perform the "ideal" test).

There is no dispute, moreover, that Mr. Cross's investigation was conducted in the course of his duties, and the DFI Report was ***statutorily authorized***. Cross Jaffe Depo Tr. at 190; *see also* Bley Decl., ¶6. Nor is there any dispute that Mr. Cross's job duties included evaluating complaints. Cross Jaffe Depo Tr. at 134:23-135:17. Defendants' own expert, Bley, states in his declaration that "examinations are performed by reviewing loan files and ***reviewing complaints*** (which may involve interviewing the institutions [sic] personnel and, on occasion, consumers, to assess how loan transactions are being handled)." Bley Decl., ¶5. With respect to "interim examinations [that] may precipitate from consumer complaints," Bley concedes they "are often limited in scope and focused ***on evaluating the merits of specific complaints***." *Id.* at ¶6. As discussed above, the Washington DFI expanded examination focused on much more than complaints; however, Bley's declaration makes clear that interim investigations which focus on the merits of specific complaints – as opposed to randomly selected loan files – are entirely proper, and within the scope of a regulator's job. Defendants' contention that Mr. Cross's "analysis was inconsistent with the accepted method for examining financial institutions" (Defs' Mem. at 1-2) is squarely refuted both by logic and the sworn declaration of their own expert, and should be rejected.

5. Mr. Cross Accounts for Alternative Explanations

Defendants' contention that Mr. Cross failed to consider alternative explanations is an attack on Mr. Cross's conclusion, not his reliability. *Richman*, 415 F. Supp. 2d at 943 ("Credibility determinations, which encompass questions of bias, are for the jury based upon their assessment of those parties, not for the court under its gatekeeping function."); *Kunz v. City of Chicago*, No. 01 C 1753, 2006 U.S. Dist. LEXIS 41897, at *14 (N.D. Ill. Jan. 31, 2007) (failure to consider alternatives goes to weight of expert testimony, not its admissibility). In any event, like defendants' other arguments, this one too is factually flawed.

In conducting his examination, Mr. Cross reviewed and considered documents produced by Household, evaluated management's responses and viewed the complaints in a neutral manner. Cross Jaffe Depo Tr. at 118:12-15, 119:1-9, 125:15-19, 135:23-137:10. Ultimately, however, Household's credibility eroded:

> A. In the early days, I think we did. In the very early days of complaints coming in – and if I could roll the clock back, I would – ***but, in the early days, the company's arguments had been somewhat convincing for us, and I think that we – we had a little bit of trouble coming to grips with what the consumers were telling us***. It didn't – It didn't make sense, early on, that this would be happening, that – that a – such a big company, such a well-structured, well-organized, well-funded company, would be doing these things to consumers. It didn't – didn't make a lot of sense. But, over a period of time, we – we – we changed our belief on that.
>
> So, in the early days, there were documents that were coming in. Company would – would send us the disclosures from their files, or whatever, and we'd look at them and say, "Ah, well, consumer must have," you know, "ignored them," or, "Maybe a consumer isn't telling the full story," or whatever, and we would – ***we would largely discount the consumer and – and close out the complaint***.
>
> ***We reached a tipping point*** where we just, for lack of a better description, sort of stood around, looking at each other, saying, you know, at some point, you know, we're having trouble believing this any longer, the answers we were getting. And, so, there became – There was a point in time – late 2001, early 2002 – ***where we felt we were getting a lot of disinformation from the company, a lot of – We were – We were extremely unhappy with the response we were getting from the company. We stopped trusting the response***. And we started more and more believing what we saw from the consumers, what the consumers were telling us.
>
> Documentation is one part of a case, and regulators do have a tendency to sort of get blinders on, saying, "Well, it's in the file. It must be true. Hey, it came out of a computer. It's there. Somebody must have gotten it." But you hear enough stories about consumers saying, "I never saw it," or, "That's not how it was explained to me," and so forth, and you start to change your mind over time.
>
> That's how all these predatory lending cases come about. If you – you take almost any predatory lending case, that I can think of, and you go back to the start of time, the regulators were not saying, you know, consumers were harmed, here. ***It always kind of starts off with not really believing that what people are saying is it, and then you – it grabs traction with time and your – your mind has changed.***
>
> ***And it was no different with this case, so –***

> So, we reached a point where – where the relationship seemed to be so disingenuous that – it was almost like stuff was being fabricated to convince us, and we didn't believe it any longer.

Cross Jaffe Depo Tr. at 182:2-184:6.

In sum, Mr. Cross cannot be accused of bias. He considered all the factors and concluded based on his investigation and Household's response, that Household's predatory lending was widespread. Of course, defendants may raise issues of bias with the jury if they so desire, but they are not a basis to exclude Mr. Cross's testimony. *Richman*, 415 F. Supp. 2d at 943.

III. CONCLUSION

For the foregoing reasons Defendants' Motion to Exclude the Expert Testimony of Charles Cross should be denied in full.

DATED: February 10, 2009

Respectfully submitted,

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

I, the undersigned, declare:

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

2. That on February 10, 2009, declarant served by electronic mail and by U.S. Mail to the parties the **LEAD PLAINTIFFS' OPPOSITION TO DEFENDANTS' *DAUBERT* MOTION TO EXCLUDE THE EXPERT TESTIMONY OF CHARLES CROSS**:

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I declare under penalty of perjury that the foregoing is true and correct. Executed this 10th day of February, 2009, at San Francisco, California.

/s/ Marcy Medeiros
MARCY MEDEIROS