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, - against - HOUSEHOLD INTERNATIONAL, INC., ET AL., Defendants.	Lead Case No. 02-C5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman

DEFENDANTS' REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF HOUSEHOLD DEFENDANTS' *DAUBERT* MOTION TO EXCLUDE THE "EXPERT" TESTIMONY OF CATHERINE A. GHIGLIERI

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PRELIMINARY STATEMENT

Most of Plaintiffs' defense of their wide-ranging "expert" Ghiglieri does not speak to, much less refute, the serious methodological, reliability and expertise problems identified in the *Daubert* motion to which it responds. Instead of explaining how Ms. Ghiglieri has actually produced an objective report using generally accepted and replicable methods, as the federal rules require, Plaintiffs' response seeks to slide her testimony past the Court's review by asserting that the bar for admitting expert testimony is so low that only "patently unreliable" testimony should be excluded. (*See, e.g.*, PB[1] at 9).

Plaintiffs' denigration of the relevant legal standard and the Court's gatekeeper role is outrageous, not to mention incorrect. (*See* DB[2] at 5-10). On one point, however, Defendants and Plaintiffs are in complete agreement. Plaintiffs' opposition correctly asserts that any opinion that speaks to the legality of Defendants' conduct or to Defendants' state of mind is inappropriate expert testimony. The problem for Plaintiffs is that these admittedly improper conclusions permeate Ghiglieri's proposed testimony.

The cornerstone of Ghiglieri's opinion is that Household deliberately and systematically engaged in what she calls "predatory lending." Ghiglieri freely admits that her definition has not been adopted by any other regulator, lending institution, consumer advocate group, legislator or expert in the field. Instead, she admits it to be a purely personal and subjective standard of "I know it when I see it" that she crafted for use in this litigation. As if to deliberately place her "punch lines" above criticism, the reports offer no criteria upon which another expert could even evaluate her work.

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1 Lead Pls.' Mem. in Opp'n to Household Defs' Mot. to Exclude the Expert Test. of Catherine A. Ghiglieri (hereinafter PB).

2 Consolidated Mem. of Law in Supp. of Household Defs.' *Daubert* Mot. to Exclude The "Expert" Test. of Catherine A. Ghiglieri, Charles Cross, and Harris L. Devor (hereinafter DB).

In addition to being personally subjective and not subject to review by others, Ghiglieri concedes that her "definition" of predatory lending implicitly includes and implies her conclusion of "illegality" and intentional "deception" by the Defendants. Throughout her Reports, she repeatedly concludes that various practices by the company were "predatory" or "illegal" and that Defendants violated particular lending laws "knowingly," "deliberately" and with "intent." As Plaintiffs have themselves conceded in their briefs, such testimony as to the law and Defendants' state of mind must be excluded.

The rest of Plaintiffs' opposition reads much like Ghiglieri's Reports — sweeping subjective conclusions with no context or comparison to generally accepted standards. Plaintiffs fail to cite any case law permitting the "method" that they admit that Ghiglieri employed -- looking at documents, taking a "holistic" (i.e., subjective) view of the record, and then providing the bottom line conclusion that Plaintiffs' claims are proven by the (mostly inadmissible) "evidence" she "considered."

Defendants are willing to confront any admissible evidence that Plaintiffs can marshal at trial for the jury to weigh. However, Defendants should not be required to refute a hired gun whose dual role is to act as a mouthpiece for Plaintiffs' version of the evidence and as a back door vehicle for marshalling inadmissible hearsay evidence, and evidence of unproven allegations and settlements. The Court's Rule 702 gatekeeping function prohibits such attempts to hijack the proceedings.

ARGUMENT

A. Ghiglieri's Opinions are Based on the Term "Predatory Lending," Which Plaintiffs Concede Improperly Opines on Defendants' Mental State and the Law

Plaintiffs provide no response to the fundamental problem with Ghiglieri's proposed testimony -- that every one of her opinions hinges on her definition of "predatory lending," a term that (1) she admits she concocted specifically for Plaintiffs in this litigation, (2) she ad-

mits is a subjective standard on which no one else agrees, and (3) she admits requires a determination of mental state as well as law. The unreliability and irrelevance of any opinion based on this "definition" is obvious.

1. Plaintiffs' Characterization of Ghiglieri's Definition of "Predatory Lending" is Nonsensical and False

Ghiglieri admitted in her deposition that there was no consensus during the Class Period as to what the term "predatory lending" meant or what practices and policies fell within that definition. She stated that it is a completely subjective evaluation: "It's like I think pornography, you know it when you see it." (Decl. of Thomas J. Kavaler in Supp. of Household Defs.' *Daubert* Mot. to Exclude the "Expert" Testimony of Catherine A. Ghiglieri, Charles Cross and Harris L. Devor ("Kavaler Decl.") Ex. 3 (Tr. of Dep. of Catherine A. Ghiglieri, Feb. 13, 2008 ("Ghiglieri Tr.")) 48:20–50:10).

Attempting to salvage Ghiglieri's doomed opinion, Plaintiffs now confusingly claim that her definition is "a definition consistent with the consensus." (PB at 20). Query, whose "consensus" are Plaintiffs referring to? Consumer advocates? Industry executives? Regulators who never enforce against the term? Legislators with differing policy agendas? Of course, Ghiglieri doesn't say and neither does Plaintiffs' opposition.

Plaintiffs' latest position is palpable nonsense and inconsistent with the extensive record on the subject. Both parties and every proposed regulatory expert in this case agree that there is no consensus as to the definition of "predatory lending."

- Plaintiffs' counsel has represented to the Court in resisting discovery into Plaintiffs' definition: "[A]s defendants are aware, predatory lending, like fraud is a term not susceptible to the concise inflexible definition that defendants seek to extract from Lead Plaintiffs." (Lead Pls.' Resp. to the Household Defs.' Second Set of Interrs. 9, Dkt. No. 582).
- Plaintiffs' expert Catherine Ghiglieri testified that "[i]t's like I think pornography, you know it when you see it." (Kavaler Decl. Ex. 3 (Ghiglieri Tr.) at 48:20–50:10).

- Plaintiffs' expert Charles Cross testified that "[t]here's no one universal accepted definition of predatory lending" (Kavaler Decl. Ex. 6 (Tr. of Dep. of Charles Cross, Apr. 9, 2008 ("Cross Tr.")) at 109:18 - 19; 96:20 - 97:9);
- Defendants' expert John Bley testified that everyone has their own subjective definition of "predatory lending." (Decl. of Thomas J. Kavaler in Further Supp. of Household Defs.' *Daubert* Mot. to Exclude the "Expert" Testimony of Catherine A. Ghiglieri, Charles Cross and Harris L. Devor ("Kavaler Reply Decl.") at Ex. 1 (Tr. of Dep. of John Bley, Mar. 14, 2008) at 58:5 - 59:11).
- Defendants' expert Dr. Robert Litan testified that "there was no consensus on what practices and how many of them would constitute predatory lending" (*Id*. at Ex. 10 (Tr. of Dep. of Robert Litan, Feb. 27, 2008 ("Litan Tr.") at 38:12-25; (Kavaler Reply Decl. Ex. 2 (Litan Tr.) at 77:4-6).

It is axiomatic that one person cannot provide a "consensus definition" of a term that indisputably has no accepted definition. Nevertheless, Plaintiffs' counsel now asserts that contrary to the consistent, bipartisan testimony in this case -- including from the very witness they are attempting to salvage -- there *was* a consensus as to the definition of predatory lending. (PB at 21 n.15). Plaintiffs' counsel now baldly asserts that "there is a consensus amongst regulators as to whether a practice is predatory or not. Numerous regulators have analogized predatory lending to pornography in that "you know it when you see it." (*Id.*) (citations omitted).

A consensus that "you know it when you see it" is no consensus at all.[3] As demonstrated more fully in Defendants' opening brief, the absence of a consensus definition prevents Ghiglieri from satisfying the fifth factor enunciated in *Daubert*: widespread, general acceptance within the pertinent community of experts. *See Daubert* v. *Merrell Dow Pharm., Inc.*, 509 U.S. 579, 594 (1993); *Kumho Tire Co., Ltd.* v. *Carmichael*, 526 U.S. 137, 156 (1999). Moreover, by using a completely subjective standard, Ghiglieri's opinions that Household's practices were

[3] If everyone is free to apply his own definition, how dare Plaintiffs sue Defendants for what they say are billions in damages for allegedly lying when they made statements based on their *own* understanding of the term -- especially when their "expert" concedes that the components of her "holistic" understanding were *not* the same as those considered by Defendants? And what expertise or guidance to the jury would Ghiglieri deliver if allowed to share her irrelevant and litigation-driven views? The controlling case law confirms that the answer is none.

"predatory" cannot be reproduced, verified, or meaningfully disputed by another expert, and cannot be used by the jury to evaluate her testimony in any rational way. Specifically, since her definition is concededly broader than the definition used by Defendants during the Class Period, her testimony is not relevant to whether Defendants were lying when they said that they did not believe Household was engaged in "predatory lending". Moreover, even if Plaintiffs' absurd "consensus" position were accepted, Ghiglieri's testimony still must be excluded. If "everyone knows it when they see it," then why does the jury need Ghiglieri?

In a final effort to, at least, limit the scope of required exclusion, Plaintiffs offer the novel suggestion (nowhere reflected in their "expert's" own testimony or Reports) that "Ms. Ghiglieri's definition was developed for one purpose, to show that Defendants' definitions were outside the consensus, and does not bear on the remainder of Ms. Ghiglieri's predatory lending analysis." (PB at 21). Plaintiffs provide no citation for this assertion because it is demonstrably false. Ghiglieri uses the term "predatory lending" to describe and formulate conclusions about every aspect of Household's lending practices and policies. Conclusions relying on this term are not limited to the few pages discussing Defendants' definition. (Kavaler Decl. Ex. 2 (Rebuttal Report of Catherine A. Ghiglieri, Feb. 1, 2008 ("Rebuttal Report")) at 19-20). Rather "predatory lending" opinions permeate Ghiglieri's Reports, appearing on almost every single page. Appendix 1 is an non-exhaustive list of the places in Ghiglieri's Reports that she concludes that some aspect of Defendants conduct satisfied her definition of "predatory lending". Indeed, in her "Summary of Opinions" on page 2 of her Report, Ghiglieri identifies her major opinions in this case:

> "Summary of Opinions
>
> 1. Household engaged in numerous, systemic, and company-wide **predatory lending** practices.
>
> 2. Household's systemic weaknesses provided the atmosphere for **predatory lending** practices to occur and flourish.
>
> 3. The financial impact to Household of its **predatory lending** practices was significant."

(Kavaler Decl. Ex. 1 (Report of Catherine A. Ghiglieri, Aug. 15, 2007 ("August 15 Report")) at 2) (emphasis added). The very essence of her proposed testimony (when not parroting selective prejudicial anecdotes that cannot be admitted as direct evidence) is to tell the jury that Household was predatory to the core. This testimony must be excluded because, as Plaintiffs themselves now appear to concede, any conclusions based on the term "predatory lending" going beyond a supposed critique of Defendants' definition is inadmissible. Since Plaintiffs did not proffer Ghiglieri for even that purpose, and since the "consensus" against which she would purportedly weigh Defendants' definition is her variable and subjective "I know it when I see it" standard, it goes without saying that even that exercise would be inadmissible under *Daubert.*

2. The Entirety of Ghiglieri's Opinions Must Be Excluded Because She Repeatedly Opines as to the Law and Defendants' State of Mind

In opposing this motion and in attempting to exclude certain testimony of Defendants' counter-expert on regulatory issues, John Bley, Plaintiffs have expressly conceded that any testimony that speaks to a defendant's state of mind or the legality of a defendant's conduct is inadmissible. (PB at 22 n.19; Pls.' Mem. of Law in Supp. of Their Mot. to Exclude Expert Test. of John Bley 11). Defendants could not agree more. Unfortunately for Plaintiffs, this uncontested principle requires the exclusion of Ghiglieri's entire proposed testimony because every one of her conclusions regarding Defendants' lending practices opines on both the legality of Defendant's practices and Defendants' state of mind.

As Ghiglieri has testified, her definition of "predatory lending" requires a determination that the practice be illegal or deceptive.

> "Q. [Defense Counsel] Now, as part of your definition you said something needs to be either illegal or deceptive; correct?
>
> A. [Ghiglieri] Yes. . . . [U]nder my view it's all predatory lending activities are illegal, either specifically by statute or under the Deceptive Trade Practices Act."
>
> (Kavaler Decl. Ex. 3 (Ghiglieri Tr) at. 86:8-12; 89:13-15).

Applying this definition, Ghiglieri proposes to testify that various Household practices were "predatory," that is illegal and/or the result of deception. As discussed above, these conclusions permeate her report and are the basis for each of her major opinions in this case. (*See also* App. 1).

Plaintiffs have acknowledged that such opinions as to state of mind and legality should be excluded. In their confusing attempt to apply *Daubert* to particular opinions expressed by Defendants' expert John Bley (which were made in response to Ghiglieri's repeated conclusions regarding Defendants' "deception," "knowledge," and "intent"), Plaintiffs have explicitly argued that opinions regarding Defendants' state of mind must be excluded from trial:

> "Experts may not opine as to defendants' state of mind. That subject is not a proper one for expert testimony, but rather an attempt to 'improperly . . . assume the role of the advocate[]'. . . ." *In re Rezulin Products Liability Litig.*, 309 F. Supp. 2d 531, 546 (S.D.N.Y. 2004); *see Apotex Corp.* v. *Merck & Co.*, No. 04 C 7312, 2006 U.S. Dist. LEXIS 28855, at *23-*24 (N.D. Ill. Apr. 25, 2006) (noting the Seventh Circuit and Northern District of Illinois decisions holding this type of testimony inadmissible), *aff'd*, 507 F.3d 1357 (Fed. Cir. 2007) The determination of defendants' state of mind is solely for the jury. *See Klaczak* v. *Consolidated Medical Transport, Inc.*, No. 96 C 6502, 2005 U.S. Dist. LEXIS 13607, at *31 (N.D. Ill. May 26, 2005) (Filip, J.) ("precedent teaches that proffered expert assertions about another's subjective intent or knowledge are not helpful to the jury, which is equally if not much better suited to make these assessments than the parties' competing paid experts".)."

(Pls' Mem. of Law in Supp. of Their Mot. to Exclude Expert Test. of John Bley 11). Plaintiffs likewise concede that experts cannot opine as to legal conclusions. As Plaintiffs state in their opposition to this very motion:

> In *In re Ocean Bank*, 481 F. Supp. 2d 892 (N.D. Ill. 2007), this Court noted that "experts 'cannot testify about legal issues on which the judge will instruct the jury.' As a result, courts will not admit testimony on purely legal matters and comprised solely of legal conclusions." *Id.* at 898 (quoting *United States v. Sinclair*, 74 F.3d 753, 757 n.1 (7th Cir. 1996).
>
> (PB at 22 n.19).[4]

[4] Plaintiffs attempt to validate Ghiglieri's legal conclusions by asserting that Defendants' experts Bley and Litan also make legal conclusions. (PB at 23). However, Defendants' experts are merely responding to Ghiglieri's inadmissible testimony. If the Court permitted Ghiglieri to instruct the jury as to the law and whether Defendants intentionally violated the law then Defen-

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Plaintiffs attempt to side step the necessary consequence of this case law by baldly asserting that "Ms. Ghiglieri does not testify as to defendants' state of mind with respect to their public statements." (PB at 33). Once again, Plaintiffs newly-minted assertion is proven false by the contents of Ghiglieri's Reports and deposition testimony. The very thesis of Ms. Ghiglieri's Reports is her opinion that Defendants not only violated the law (on which she purports to instruct the jury) but also that they did so intentionally. Her 200 page *magnum opus* repeatedly contends that Defendants deliberately engaged in and encouraged "predatory lending". For example, Ghiglieri also expresses the following supposedly expert opinions regarding Defendants' state of mind:

- "Household and its senior executives knew what **predatory lending** was and engaged in it anyway." (Kavaler Decl. Ex. 1 (August 15 Report) at 15) (emphasis added).
- "Household senior management ***knew***, based on the actions they took in 1999, that predatory lending was going to occur throughout the company." (Kavaler Decl. Ex. 2 (Rebuttal Report) at 4) (emphasis added).
- "Household senior management ***purposefully encouraged*** predatory lending. . ." (*Id*.) (emphasis added).
- " [S]enior management ***knowingly*** created a company structure, culture and products that inevitably resulted in predatory lending." (*Id*. at 6) (emphasis added).

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dants must be permitted to respond. However, if the Court were to exclude Ghiglieri's testimony regarding the legality of Household's practices and Defendants' alleged commission of deliberate illegal acts and deception, then Defendants will have no need for those portions of their experts' testimony. And to the extent that "deceptive" and "unfair" have no legal meaning then the jury does not need Ghiglieri to tell them what is and is not "fair." Such determinations of reasonableness are the exclusive province of the jury. In *Thompson* v. *City of Chicago*, 472 F.3d 444, 458 (7th Cir. 2006), the Court of Appeals affirmed the District Court's exclusion of the testimony of two expert witnesses on whether an officer used excessive force, stating that such a determination "is a fact-intensive inquiry turning on the reasonableness of the particular officer's actions in light of the particular facts and circumstances" and that "[w]hat is reasonable under any particular set of facts is 'not capable of precise definition or mechanical application.'" *Id*. (citation omitted). The Court held the experts' testimony "would have been of little value except as to possibly causing confusion and bore a substantial risk of prejudice." *Id.* The Court held that the jury was perfectly capable of determining whether the officer's conduct was reasonable based on the facts, and the introduction of expert testimony on the subject would have caused the jurors to automatically adopt the expert's opinion rather than develop their own conclusions. *Id.*

- "Household's senior management could not have incentivized their branch employees on the five 1999 incentive components . . . without ***knowing and intending*** that it would result in the predatory lending sales practices." (*Id.*) (emphasis added).
- "Household ***knew and intended*** that predatory lending practices would occur throughout the system because of their actions taken or inaction in 1999." (*Id.* at 13) (emphasis added).

Using these conclusions as support, Ghiglieri makes her ultimate opinion regarding this federal securities fraud case, that "Household contended that it did not engage in predatory lending, however, its actions did not support its words." (*Id.* at 81). Plaintiffs' representations to this Court that Ghiglieri makes no conclusions regarding Defendants' state of mind is simply false.

Plaintiffs also represent without basis that Ghiglieri does not opine on the law, claiming that she opines only as to "how regulators determine whether a lender is engaging in deceptive or unfair practices." (PB at 22). Plaintiffs provide no citation to Ghiglieri's Report or testimony, because they do not contain and they certainly do not support this revisionist description of Ghiglieri's mission and view. Instead, Plaintiffs cite to statements made by Defendants' expert Bley (not Ghiglieri) explaining how the regulatory system works, which Ghiglieri did not even try to do. (PB at 22). Unlike Mr. Bley, who will educate the jury as to the regulatory process, Ghiglieri provides only her own legal opinion that Defendants systematically violated the law. For example, she testified, "They [Defendants] were trying to figure out a way to do some of the things that were prohibited by state law by falling under this federal statute . . . . And unfortunately they didn't do it the right way, so it came back to state law. (Kavaler Decl. Ex. 3 (Ghiglieri Tr.) at 350:6-351:14).

Plaintiffs' position that Ghiglieri's opinions do not offer legal conclusions is simply indefensible. *See also, e.g.*, App. 1. For an expert witness to opine on pure questions of law invades the province of the court. *See, e.g.*, *United States* v. *Caputo*, 517 F.3d 935, 942 (7th Cir. 2008) (affirming the exclusion of proffered expert testimony interpreting statutes and regulations

because "[t]he only legal expert in a federal courtroom is the judge"); *Bammerlin* v. *Navistar Int'l Transp. Corp*., 30 F.3d 898, 900 (7th Cir. 1994).

Separate from her conclusions regarding "predatory lending," Ghiglieri also various other opinions of the "legality" of Defendants' conduct. For example, Ghiglieri makes the following conclusions:

- "Household's **predatory lending** practices and products were illegal." (Kavaler Decl. Ex. 2 (Rebuttal Report) at 21) (emphasis added).
- "This led to the Pay Rights Reward program, or PRR, which Household's used in an attempt to ***circumvent State laws*** that prohibited the imposition of a prepayment penalty on traditional mortgages." (Kavaler Decl. Ex. 1 (August 15 Report) at 30) (emphasis added)
- "Household did not make required disclosures ***in compliance with federal and state laws***, or if disclosures were made, they were often inaccurate or misleading." (*Id*. at 105) (emphasis added).
- "Household often did not provide Good Faith Estimates (GFE) ***as required by law***." (*Id.* at 105) (emphasis added).
- "Household failed to provide timely disclosures and often failed to provide any disclosures, ***in violation of federal and state laws***." (*Id*. at 118) (emphasis added)
- "These points together with the consumer complaints demonstrate that Household engaged in ***illegal*** insurance packing." (Kavaler Decl. Ex. 2 (Rebuttal Report) at 28) (emphasis added)
- "It is both ***illegal*** and an unsound lending practice to make a loan to a borrower whom the lender knows will not be able to repay." (*Id*. at 31) (emphasis added)
- "Regulators all over the country agree with me that the manner in which Household engaged in these practices was ***illegal*** and subjected Household to enforcement actions." (*Id.* at 21) (emphasis added)
- "Household reage and related policies, such as charge-off time periods, were generally ***not compliant with the FFIEC guidelines***." (Kavaler Decl. Ex. 1, (August 15 Report) at 137) (emphasis added).

Indeed, in her Rebuttal report, Ghiglieri goes so far as to actually criticize Defendants' experts Bley and Litan for ***not*** explicitly opining on the legality of Defendants' conduct as

she repeatedly did, stating: "The Bley and Litan Reports fail to consider the fact that Household's activities were illegal and fail to analyze the manner in which Household conducted its predatory lending practices." (Kavaler Decl. Ex. 2 (Rebuttal Report) at 21; *see also id.* at 25 ("Neither the Bley nor the Litan Report suggests that such practices were legal, and indeed, they are not.").

Finally, Plaintiffs *Daubert* response offers no comment of any kind to the most telling defect in Ms. Ghiglieri's definition noted by Defendants -- that Ghiglieri made up her definition of "predatory lending" specifically for this litigation and that she did not settle upon her definition until ***8 months after she wrote her report***. (Kavaler Decl. Ex. 3 (Ghiglieri Tr.) at 50:24–51:13, 85:1–16). Despite using the term over 350 times in her reports, repeatedly concluding that Household's practices were "predatory," she did not decide what the word meant until after both of her reports (and both of Defendants' experts' responses) were completed. Plaintiffs argue now that Ghiglieri "carefully crafted this definition." (PB at 20). That is precisely the problem. She "carefully crafted" (and re-crafted) the definition ***after*** discovery was over. Such gamesmanship not only reveals the unreliability of Ghiglieri's reports but also the spuriousness of Plaintiffs' claims as a whole.

B. Ghiglieri Has Applied No Accepted Method

Plaintiffs make no substantive attempt to defend Ghiglieri's flawed methodology of listing anecdotal allegations of wrongdoing, parroting the inadmissible opinions of others, and concluding (without any independent analysis, context, or measurable standards) that Defendants' were "predatory lenders." Instead, Plaintiffs misstate the law, attempting to shift the burden onto Defendants. Plaintiffs' also claim that *Daubert* does not "really" apply to Ghiglieri, and that because this "black box" method is the best she could do, the Court should just let it all slide, irrespective of the court's gatekeeper role.

To defend the indefensible, Plaintiffs seek to lower the Court's expectations. Plaintiffs offer the following outrageous characterizations of the law:

- "The overall approach is one that excludes [only] patently unreliable testimony and relies upon cross-examination and other traditional methods to undercut shaky, but admissible testimony." (PB at 9)
- The "test for 'reliability' is also lenient, merely requiring that the 'reasoning for methodology underlying the testimony [be] scientifically valid.'" (PB at 10).
- "[C]hallenges to aspects of methodology and certain of the findings go to weight, not admissibility." (PB at 16).
- The *Daubert* factors are irrelevant to Ghiglieri's opinion because "[w]here the expertise at issue derives from personal professional experience, this Court has not required 'scientific' testing." (PB at 18).
- Defendants' "attack [of] Ms. Ghiglieri for engaging in 'unsupported extrapolation' . . . goes to the weight of Ms. Ghiglieri's opinions and not their admissibility." (PB at 23).

Unsurprisingly, such a "lenient" Rule 702 and *Daubert* standard was nowhere to be found in Plaintiffs' motions to exclude Defendants' experts. This is because it is not the law. The Rule 702 analysis is not "lenient." The party offering a putative expert's testimony must establish by a preponderance of the evidence that the expert testimony is admissible. *See Daubert* v. *Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 592 n.10 (1993); *accord Muzzey* v. *Kerr-McGee Chemical Corp.*, 921 F.Supp. 511, 518 (N.D. Ill. 1996) (Bucklo, J.) (the proponent of proffered expert testimony "bears the burden of establishing its admissibility by a preponderance of proof"). In *Daubert*, the Supreme Court "interpreted [Rule 702] to require that 'the trial judge must ensure that any and all scientific testimony or evidence admitted is not only relevant, but reliable.'" *Smith* v. *Ford Motor Co.*, 215 F.3d 713, 718 (7th Cir. 2000) (quoting *Daubert*, 509 U.S. at 589). A district judge is vested with the duty to act as a "gatekeeper" for expert testimony, "only admitting such testimony after receiving satisfactory evidence of its reliability." *Dhillon* v. *Crown Controls Corp.*, 269 F.3d 865, 869 (7th Cir. 2001) (citing *Daubert*,

509 U.S. at 589). The mandated gatekeeping function applies to ***all forms*** of expert testimony, not only pure scientific testimony. *Kumho,* 526 U.S. at 151.

The first prong of the analysis, which addresses the reliability of the proffered testimony, compels the Court to make "a preliminary assessment of whether the reasoning or methodology underlying the testimony is scientifically valid." *Daubert*, 509 U.S. at 592–93. Despite Plaintiffs' bald assertions to the contrary that "challenges to aspects of methodology and certain of the findings go to weight, not admissibility" (PB at 16), the Supreme Court has stated the exact opposite: "***The focus, of course, must be solely on the principles and methodology***, not on the conclusions they generate." *Id.* at 595 (emphasis added).

Nevertheless, Plaintiffs claim that the *Daubert* factors are irrelevant to Ghiglieri's opinion because "[w]here the expertise at issue derives from personal professional experience, this Court has not required 'scientific' testing." (PB at 18). Plaintiffs' blatant misstatement of the law is obvious once one realizes that nowhere in their 34 page brief do they even acknowledge the Supreme Court's subsequent opinion in *Kumho,* which established that the court's gatekeeping function applies to ***all forms*** of expert testimony, and affirmed that the five *Daubert* factors, rather than an exhaustive or exclusive series of prerequisites, are guides to be applied and augmented "depend[ing] upon the particular circumstances of the particular case at issue." *Kumho,* 526 U.S. at 150. When the 2000 Amendments to Rule 702 were adopted, the Advisory Committee specifically endorsed the use of additional factors as appropriate, including ***whether the conclusion results from an unsupported extrapolation from an accepted premise***. *Id.* (citing *General Electric Co.* v. *Joiner*, 522 U.S. 136, 146 (1997)). Plaintiffs' representation that Defendants' attack on Ms. Ghiglieri's unsupported extrapolation "goes to the weight of Ms. Ghiglieri's opinions and not their admissibility" (PB at 23) is decidedly not the law.

Likewise, Plaintiffs' assertion that the *Daubert* analysis is a "lenient" standard that the Court may ignore, is precisely the position that one would expect from a proponent of inadequate expert testimony. It is also ***not the law.*** The "extra-*Daubert* factors" set forth in

Kumho are designed to root out expert opinions manufactured for the sake of the litigation in which they are advanced (for example an expert that concocted a definition specifically for the litigation), on the presumption that litigation-driven opinions are insufficiently reliable to be admissible under Rule 702. *Kumho*, 526 U.S. at 152 (the objective of the gatekeeping requirement is to "***make certain*** that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field") (emphasis added). As stated by the Court of Appeals, "In all cases, [ ] the district court must ensure that it is dealing with an expert, not just a hired gun." *Tyus* v. *Urban Search Management*, 102 F.3d 256, 263 (7th Cir. 1996).

Precedent in this Circuit emphasizes the importance of the court's gatekeeping duties under *Daubert* and *Kumho*, "'lest apparently scientific testimony carry more weight with the jury than it deserves.'" *Smith*, 215 F.3d at 718 (quoting *DePaeppe* v. *General Motors Corp.*, 141 F.3d 715, 720 (7th Cir. 1998)). Plaintiffs election to ignore Supreme Court and Court of Appeals precedent in favor of self-serving, out of context fragments of dicta from various other courts is inexcusable and only serves to highlight Plaintiffs' inability to deny Ghiglieri's fundamental methodological failings.

Having premised their argument on the wrong standard, Plaintiffs fail to respond in any serious way to Defendant's arguments on this subject. Plaintiffs concede that Ghiglieri's "method" was the result of no more than looking at portions of the discovery record and then providing her bottom line conclusion. Plaintiffs' first response is that any flaws in this method do not go to admissibility. (PB at 15-16, 23). As discussed above, this is the exact opposite of what the law says. Plaintiffs fallback position is to excuse Ghiglieri's failing, asserting that "it would have been impossible for Ms. Ghiglieri to calculate a reliable complaint ratio" because Household's complaint tracking system did not identify every single complaint ever brought to a branch employee's attention. Passing for the moment the irrationality of tracking every complaint that was immediately resolved to the customer's satisfaction at the branch level, neither

Plaintiffs nor Ghiglieri explain why attempting to test the number of unresolved complaints against some measure of total loan activity would be ***less*** reliable than reviewing one side of the handful of anecdotal complaints from which she extrapolates a global conclusion.

Tripping over this inherent inconsistency in their position, Plaintiffs proclaim that "complaints are a chief indicator of widespread predatory practices" (PB at 19) while arguing "the number of complaints (or the related percentage) is not determinative." (PB at 19) This illogical premise is the very problem with Ghiglieri's non-methodical approach. She *assumes,* without taking any steps to verify, that the small number of customer complaints that she reviewed or read about second-hand indicate a pervasive and nationwide predatory lending scheme. In other words, she assumes the very conclusion she was purportedly retained to test. Arguing that reviewing a small and biased sample of complaints is a reliable method for identifying Household's authorized policies and practices (and that numbers are not "determinative") is just as preposterous as arguing that one can conclude that Michael Jordan was a terrible basketball player by looking at a reel of some of his missed shots. A basketball expert may know a missed shot when he sees one, but if he has deliberately ignored Jordan's good plays, and has made no study of the frequency of hits versus misses in some relevant context, that's all he knows, and he would have no business opining on the big picture. That inherent lack of reliability is why such unsupported extrapolation as Ghiglieri offers here is prohibited under Rule 702. *See General Electric Co.,* 522 U.S. at 146 ("nothing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert."); *Fuesting* v. *Zimmer, Inc*., 421 F.3d 528, 536 (7th Cir. 2005) (affirming the exclusion of expert testimony on the grounds that, *inter alia*, the expert did not undertake the "tests, experiments or studies" necessary to "bridge the analytical gap between [ ] basic principles and his complex conclusions"), *vacated in part on other grounds on rehearing*, 448 F.3d 936 (7th Cir. 2006).

Conceding that Ghiglieri's method was an extrapolation, Plaintiffs nevertheless assert that Ms. Ghiglieri's methodology of "merely reviewing documents and deposition testimony" is among "traditional regulatory methods." (PB at 17). In this regard, Plaintiffs point out that Defendants' expert, Mr. Bley, has acknowledged that "regulators do consider consumer complaints." (PB at 25). Plaintiffs miss the point. The problem with Ghiglieri's approach is not that she considered consumer complaints, it is that she accepted all the complaints as true, without independently investigating the validity of any of them, and went on to assume that they were at all times and places representative of Household's corporate policy -- again without conducting any analysis to test that bald assumption. Having performed zero independent analysis, Ghiglieri offers nothing more than a recitation of selective consumer allegations, vested with the false (but highly prejudicial) authority of her regulatory "expertise." This is not allowed. *Durkin* v. *Equifax Check Services, Inc*., 406 F.3d 410, 420–22 (7th Cir. 2005) (upholding the exclusion of testimony in which an adequately credentialed expert "recited" and "endorsed" the plaintiffs' claims without articulating a method for validating them, because such conclusions amounted to no more than "untestable say-so").

Significantly, Plaintiffs ignore the very next sentence of the Bley Declaration where he explicitly states that "[c]onsumer complaints are never taken as true without first reviewing the loan in question and considering the entity's response." (Kavaler Decl. Ex. 8 (Decl. of John L. Bley) at ¶6). Reading consumer complaints is where a regulator's job begins, not ends. While regulators may review documents and consider customer complaints, there is a set method for doing so. Another of Plaintiffs' proposed experts, Charles Cross, testified explicitly that it is the practice of regulators of consumer finance companies to "employ[] a random sampling selection method developed [] by the Federal Reserve Board." (Kavaler Decl. Ex. 6 (Cross Tr.) at 93:10-94:15). Plaintiffs concede that Ghiglieri did not do this, nor did she even attempt to. *See Loeffel Steel Products, Inc.* v. *Delta Brands, Inc.*, 387 F.Supp.2d 794, 808 (N.D.Ill. 2005) (It is the expert's burden to prove by a preponderance of the evidence that the information

given to her is the kind "reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject.") (internal citations omitted). Plaintiffs do not contest either Mr. Bley's or Mr. Cross's statements of how examinations should take place. Instead, Plaintiffs have chosen to pretend that those facts (like *Kumho*) never existed.

Even if Plaintiffs were able to validate Ms. Ghiglieri's regulatory approach as to one or more individual complaints that she reviewed (although it is hard to believe that a responsible regulator would not take the lender's explanation into consideration), it bears repeating that Ms. Ghiglieri's principal opinion is not that this or that particular complaint was valid under the prevailing standards in a given state; it is that the mere existence and/or settlement of a relatively small number of unadjudicated complaints proves that across the board, in every state where it did business, as a matter of corporate policy affecting all loans over a multi-year period, Household deliberately set out to harm customers. Surely that quantum leap (a) is not within the normal purview of a regulator and (b) requires *some* analysis and explanation of how the regulator added two and two and got a million. Even if Plaintiffs agree that regulators do not normally sample loans (even in a non-biased, statistically significant manner) to draw company-wide conclusions about a lending institution, this concession defeats their position that Ghiglieri should be cut some slack in view of her regulatory expertise.

It is beyond contention that the compliance or complaint rate of a company that makes literally millions of loans is the type of thing that is capable of being analyzed in a systematic, reliable manner. If Plaintiffs' position is that regulators do not conduct such an analyses, then the result under Rule 702 is that regulators should not serve as expert witnesses on this issue. The application of Ghiglieri's "holistic," "I know it when I see it" approach to a small and biased slice of the record is simply not the proper stuff of expert testimony.

The remainder of Plaintiffs' brief makes no attempt to address any of Defendant's arguments or supporting case law. Instead, Plaintiffs repeatedly imply that because Ghiglieri has provided "two voluminous reports that together aggregate over 300 pages" (PB at 16), the Court

should just assume that there must be some valid analysis in there somewhere. Plaintiffs then proceed to list the types of documents upon which Ghiglieri relied, proclaiming that she "carefully assessed" these documents "prior to developing her opinion." (PB at 24 n.20). Plaintiffs once again miss the point and evade the issue. The non-expert "method" they tout is inherently flawed. Regardless of what documents Ghiglieri looked at, her conclusions are not admissible because she did not apply any method that is reliable, verifiable and reproducible, and Plaintiffs do not contend that she did. Nowhere in her Report, her Rebuttal, her deposition, or Plaintiffs' brief does she identify how another expert could validate (or invalidate) her opinions.

Plaintiffs' final defense of Ghiglieri's method is that "defendants improperly limit the evidentiary foundation of her testimony to 'untested accusations of customers, preliminary findings of examiners and settlement agreements.'" (PB at 25). Plaintiffs do not refute the abundant case law the Defendants identify that such unreliable documents can provide no basis for any expert opinion. (DB at 26-33). Instead, they claim that Ghiglieri never actually relied on these documents even though they make up the vast majority of her Report and comprise several appendices attached thereto. Plaintiffs assert that these documents merely "corroborate the conclusions Ms. Ghiglieri reached based on [] other factors." (PB at 25).

When put to the test, this assertion falls flat. By way of example, consider Ghiglieri's opinion that "the financial impact to Househld of its predatory lending practices was significant and material to its financial condition." (Kavaler Decl. Ex. 1 (August 15 Report) at 124). This section of her Report is nothing more than a list of documents from Household's production that identify settlement agreements and refunds paid to customers and or regulators over disputed issues. No liability is ever acknowledged. Nevertheless, Ghiglieri adds up all these numbers and concludes, without any analysis of the underlying claims, settlements or legal or factual positions of the company or the customers, that Household made these payments because they were "predatory lenders."

Indeed, Ghiglieri rarely even identifies what issues were even at dispute or whether they are the same issues she discusses in her Report. Each complaint, lawsuit, settlement or refund relates to specific customers who raised a unique (and not always valid) complaint. Without an analysis of each issue, Ghiglieri cannot conclude that any such payment was the result of "predatory lending" according to her definition in that particular case, or simply reflected a decision to resolve a nuisance inquiry for prudential reasons, or the recognition of a good-faith mistake or clerical glitch, or numerous other possible explanations. Ghiglieri's choice to make her result-oriented and untested assumption is precisely what is forbidden by the Federal Rules of Evidence. *See Grant* v. *Chemrex Inc.*, No. 93 C 0350, 1997 WL 223071 at *8 (N.D.Ill. 1997) ("An expert witness must rely on his own expertise in reaching his opinion and may not simply repeat the opinions of others.") (internal quotations omitted); *Loeffel Steel Products, Inc.*, 387 F.Supp.2d at 808 (excluding evidence, stating that Rule 703 "was not intended to abolish the hearsay rule and to allow a witness, under the guise of giving expert testimony, to in effect become the mouthpiece of the witnesses on whose statements or opinions the expert purports to base his opinion.").

Plaintiffs' position is not even internally consistent. For example, they admit that Ghiglieri is using Household's settlement with certain state attorneys' general "to determine dollar impact of predatory lending" while in the same sentence asserting that "Ghiglieri does not rely upon it to form an opinion as to the underlying transgression." (PB at 26). The absurdity of this position is self-evident.[5]

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[5] Plaintiffs continue to falsely assert that their reliance on examination reports is permissible because the "apparent violations" within the examination reports are in fact final agency rulings. (PB at 26 n.22). Ghiglieri supports this misleading conclusion by deceptively citing an excerpt from prior testimony of Mr. Cross (another of Plaintiffs' proffered experts) in which (according to Ms. Ghiglieri) he states "'we [in Washington State] use the term 'apparent violation' prior to actually filing charges…'" (Kavaler Decl. Ex. 2 (Rebuttal Report) at 60). The full text that Ms. Ghiglieri replaced with an ellipsis is illuminating, both substantively and as a vivid demonstration of Ms. Ghiglieri's "expert" "method." Mr. Cross's full statement is exactly the opposite of the impression Ms. Ghiglieri tries to convey. He said: "We use the term 'apparent violation' prior to actually filing charges ***because they are essentially initial findings***. It is just a term of art to al-

Footnote continued on next page.

The very suggestion that the voluminous material Ghiglieri recites in her Report is not, in fact, the basis of her conclusions, reinforces the inescapable impression that this witness's main function at trial would be to inject through the back-door (under the guise of "reinforcing" a conclusory "expert" opinion) a vast array of prejudicial-sounding material that most likely would never be admitted through the front. In any event, Plaintiffs' strategic effort to disassociate Ghiglieri from the patently unreliable bases she cites in her Reports throws the baby out with the bathwater, because it leaves Ghiglieri with only unsupported bottom line conclusions, which plainly should not be allowed.

C. Plaintiffs Have Not Met Their Burden to Demonstrate the Ghiglieri is Qualified to Opine On the Lending Practices of a Consumer Finance Company

Plaintiffs try to shift the burden of disproving Ghiglieri's suitability as an expert witness onto Defendants, proclaiming that Ghiglieri is a former bank regulator and that it is Defendants' burden to prove that her experience as such is not relevant to this case. Once again, this is an erroneous account of the law. Under the Federal Rules of Evidence the party offering a putative expert's testimony must establish by a preponderance of the evidence that the expert is qualified. *See Daubert* v. *Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 592 n.10 (1993).

While acknowledging that Ghiglieri has no background or expertise in regulating a consumer finance company, and that her "method" here was a non-systematic extrapolation to global conclusions from untested and un-quantified assumptions of fact, they continue to cling to the fictions that because Defendants' made a single call to Ghiglieri during a preliminary screening of potential experts and because banks are "like" consumer finance companies, Ghiglieri

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Footnote continued from previous page.

> low the process, the understanding, that, you know***, it's not a finding by the director that a violation has occurred. It's a finding by an examiner who is not in a position to commit the Department to charges for those violations***." (Kavaler Decl. Ex. 6 (Cross Tr.) at 31:11-17). (emphasis added).

meets what they erroneously characterize as *Daubert*'s "lenient" standards. The former premise requires no response as it is facially irrelevant. The latter observation is invalid.

Plaintiffs' own argument proves Defendants' point. Attempting to support their assertion that consumer finance companies and banks are the same because they are regulated by the same laws, Plaintiffs argue that "a third defense expert, Roman Weil, cited OCC and the Federal Financial Institutions Examination Council ("FFIEC") documents describing bank reaging policies as support for his assertion that reaging was a common practice in the industry." (PB at 13). The irony of this example is that FFIEC regulations are reage and charge-off guidelines that ***only apply to banks, not to consumer finance companies***. This is of particular significance because this goes directly to Ghiglieri's opinion that "Household's policies regarding restructuring and reaging of accounts did not comport with industry standards" (Kavaler Decl. Ex. 1 (August 15 Report) at 131) and that "Household manipulated delinquencies in Household Bank f.s.b. by selling delinquent loans to HFC in order to avoid complying with the FFIEC guidelines." (*Id.* at 160). If Ghiglieri had expertise in the regulation of non-depository consumer finance companies, she would have known that the cited federal guidelines have no application here.

This confusion goes to the heart of another reason why Ghiglieri's testimony must be excluded. Banks are more strictly regulated than consumer finance companies because they are depository institutions. Ghiglieri's ignorance as to issues unique to consumer finance companies will result in her inappropriately applying too strict (or simply wrong) standard to Household under the "aura" of expertise, misleading and confusing the jury and irretrievably prejudicing Defendants. *See Sports Arena Management, Inc.* v. *K&K Insurance Group, Inc.*, No. 06 C 6290, 2008 U.S. Dist. Lexis 51431 at *6-*7 (N.D. Ill. June 26, 2008) (Guzman, J.) (excluding testimony of proffered expert because although he had 30 years of experience in the insurance industry, his experience was in claims, not underwriting, which was the subject of the offered opinion).

D. Plaintiffs Have Conceded the Inadmissibility of Ghiglieri's Reage Opinions

Aside from a passing mention in their preliminary statement, Plaintiffs' opposition brief does not respond to a single argument regarding the inadmissibility of Ghiglieri's reaging and restructuring opinions. Plaintiffs' failure even to address their burden of proof on this issue, provides another conclusive basis for excluding her proposed testimony on this subject, which is summarized at pages 131- 169 of her August 15 Report under the heading "Household masked delinquencies and charge-offs in a variety of ways" and at pages 52-58 of her Rebuttal Report. By way of example, Plaintiffs ignore the following arguments from Defendants' brief:

> "To arrive at her opinion that "Household masked delinquencies and charge-offs," Ghiglieri ignored vital distinctions among different business units at Household, opined that testimony given by one of the Individual Defendants in this case is not credible, speculated about Household's motivation for using various account management practices and, with no analysis or explanation of her reasoning, concluded that she "concurs" with the denied and unadjudicated "findings" set forth in a post–Class Period settlement document. (*See id.* at 131–68)." (DB at 17).
>
> "Ghiglieri's testimony that Household used restructuring and other account management techniques to manage delinquency, charge-offs and foreclosure would seem to be intended as the basis for an argument that Household's financial statements and other public disclosures were false and misleading. But none of the issues on which Ghiglieri opines will contribute to the resolution of any disputed issue. There is no dispute about whether Household used restructuring, or about the number of accounts restructured during the Class Period. If there were any disputed issues concerning the impact of reaging on the company's accounting and financial statements, or the adequacy of its disclosures, Ghiglieri would certainly not be qualified to provide any assistance. There is no dispute that Household did not follow, and was not required to follow, FFIEC guidelines in recording and reporting charge-offs. It appears that Plaintiffs will offer Ghiglieri's testimony not to prove any issue relating to Household's actual use or effect of reaging and other account management techniques, but only to convey Plaintiffs' unfounded contention that the purpose and intent behind Household's use of reaging was "to mask delinquencies." (Kavaler Decl. Ex. 1 (August 15 Report) at 138, 151).
>
> For this purpose as well, Ghiglieri's testimony should be excluded. *See, e.g.*, *Salas* v. *Carpenter*, 980 F.2d 299, 305 (5th Cir. 1992) (affirming the exclusion of an expert opinion regarding defendant's state of mind because jurors can make their own determinations on the matter and, therefore, the proffered opinion fails to satisfy the demands of Rule 702 that expert evidence assist the trier of fact); *Drebing v. Provo Group, Inc.*, 519 F. Supp. 2d. 811, 816 n. 5 (N.D. Ill. 2007) (Bucklo, J.) (improper for plaintiff's expert to opine on the defendant's state of mind and his intent in structuring various defendant companies in the way he did); *United States* v. *Libby*, 461 F. Supp. 2d 3, 7 (D.D.C. 2006) (listing opinions as to

> the defendant's state of mind amongst the expert opinions that are precluded because they "usurp the jury's role as the final arbiter of the facts"); *cf*. Fed. R. Evid. Rule 704 advisory committee's notes (1972) (general admissibility of expert opinions pertaining to the ultimate issues in a case does not admit opinions "which would merely tell the jury what result to reach")." (DB at 42-43).
>
> "To advance her speculation regarding Defendants' intent, Ghiglieri asserted that Individual Defendant William Aldinger's testimony on measuring delinquencies was "an incredible statement." (Kavaler Decl. Ex. 1 (August 15 Report) at 132). The credibility of another witness is generally not an appropriate subject for an expert witness, as such opinions invade the province of the fact finder and, thus, this assertion, and all conclusions generated therefrom, should be excluded. ***Thomas*** v. ***Sheahan***, 514 F. Supp. 2d 1083, 1095 (N.D. Ill. 2007) (Castillo, J.) (citing ***United States*** v. ***Hall***, 165 F.3d 1095, 1107 (7th Cir. 1999))." (DB at 43 n.36).

All of these arguments regarding Ghigleri's opinions on Household's restructure policies and delinquency statistics stand uncontested by Plaintiffs. Thus, Ghiglieri's opinions on the subject of Household's restructure practices and delinquency statistics must be excluded.

CONCLUSION

For the foregoing reasons, the Court should exclude in whole, or alternatively in any defective part, the testimony of Catherine A. Ghiglieri.

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Appendix 1

Expert Witness Report of Catherine A Ghiglieri (8/15/2007)

Page	Quote
2	Household engaged in numerous, systemic, and company-wide **predatory lending** practices.
2	Household's systemic weaknesses provided the atmosphere for **predatory lending** practices to occur and flourish.
2	The financial impact to Household of its **predatory lending** practices was significant.
6	Household engaged in a number company-wide **predatory lending** practices to entice borrowers into accepting loans and ancillary products, including the following: • Loan splitting; • Improper disclosure of estimated closing costs; • Misrepresentation of interest rates; • Insurance packing; • Failure to make required disclosures or providing misleading disclosures; • Loan flipping • Equity stripping or equity based lending; and • Excessive prepayment penalties or improper disclosure of prepayment penalties.
6	Trapping the borrower by using **predatory lending** techniques helped prevent borrowers from refinancing or prepaying with a loan from another lender.
6	Household's focus on sales and profitability to the detriment of compliance and fair dealing with customers contributed to the atmosphere of **predatory lending** that pervaded the Company.
6	There was a disconnect between Household employee testimony denying that Household engaged in **predatory lending**, the memos sent out by Gary Gilmer instructing employees not to engage in certain **predatory lending** practices, and the actions of those who in fact did engage in **predatory lending** practices.
7	It was not until complaints from borrowers, and pressure from regulators, States' Attorneys General, the Better Business Bureau, ACORN, Congress and state legislatures became so intense, that Household ceased some of these **predatory lending** practices.
7	Household paid a significant price for engaging in **predatory lending**.
7	Household paid $484 million to the States' Attorneys General for refunds to borrowers who were victims of its **predatory lending** practices.
7	In addition, Household estimated lost revenue from discontinuing certain **predatory lending** practices at $184 million.
7	And lastly, Household paid regulatory penalties for **predatory lending** practices of $21 million.
9	I was asked to opine on whether or not Household engaged in **predatory lending** practices as alleged in the plaintiff investors' complaint, as well as review and opine on delinquency and charge-off practices during the 1999-2002 timeframe.
12	In order to put my opinions regarding Household's **predatory lending** practices in context, a survey of regulatory and banking materials regarding **predatory lending** is helpful.

12	*What is **predatory lending**?* The term "**predatory lending**" is used to describe a wide variety of lending practices used to deceive and defraud borrowers, or otherwise take advantage of them.
15	A review of the **predatory lending** materials in this report shows that lending does not have to be illegal or intentionally deceptive in order to be predatory.
15	Instead, **predatory lending** can be based upon: • The particular sum of the loan terms; • The absence of the disclosure of loan terms; and/or • The status of the borrower.
15	Household and its senior executives knew what **predatory lending** was and engaged in it anyway.
19	As the regulators stated above, it fostered **predatory** pricing and steered borrowers to subprime loans for reasons other than the borrowers' creditworthiness.
19	Because Household did not have adequate compliance and oversight functions, **predatory lending** flourished.
21	Household and its management, including William Aldinger, Gary Gilmer, David Schoenholz, and Joe Vozar, were knowledgeable about the public discussions about **predatory lending**.
22	The regulatory and banking literature noted above and in Appendix D indicates that conduct by a lender that results in manipulating the borrower through sales techniques or taking advantage of the borrower's lack of understanding about the terms of the loan constitutes **predatory lending**, even though it may not be intentionally illegal or intentionally deceptive.
23	I was asked to review Household's lending practices and determine if Household engaged in **predatory lending** as alleged in the plaintiff investors' complaint.
23	The record is replete with examples of how Household engaged in almost every form of **predatory lending** that has been written about in regulatory and banking literature, including the following: • Household tried to make the sale at any cost, even if it meant lying to the customer. • Household packed the loan contract full of unnecessary products, often without disclosure and without the customer's knowledge. • Household charged the highest price they it could get away with to maximize revenues. • Household packed the contract so full of fees and product costs (often without appropriate disclosures) that the customer was "upside down," meaning that the equity in the house was less than the loan amount, and/or the prepayment penalty was insurmountable, thereby trapping the customer in the loan.
24	My opinions focus on the structural weaknesses within Household that allowed **predatory lending** practices to exist, followed by the individual **predatory lending** practices in which Household engaged, and the significant impact to Household's earnings of discontinuing the **predatory lending** practices and paying refunds and regulatory fines.
24	Lastly, there is a discussion of the reaging and restructuring practices in which Household engaged in order to conceal the impact of their **predatory lending** activi-

	ties.
24	Household's systemic weaknesses provided the atmosphere for **predatory lending** to occur and flourish.
25	Household's product development focused on **predatory lending** products.
25	In 1998, Household began offering **predatory lending** products.
33	Household's sales training focused on **predatory lending** tactics.
34	Included in Mr. Walter's "First Mortgage Sales HFC" was training on the following **predatory lending** practices: • benchmark pricing, • effective interest rates, • effective blended rates, • effective tax rates, and • low interest rates/high discount points.
44	Household modified the compensation plans to focus employees on certain **predatory lending** practices, such as exceeding benchmark pricing and engaging in insurance packing.
46	These incentives encouraged **predatory lending** practices by rewarding sales staff for insurance packing, stripping and over-priced loans.
56	State Regulators criticized Household's **predatory lending** practices and took enforcement actions and levied penalties to halt the **predatory lending** practices.
56-57	Regulators became aware of the Company's **predatory lending** practices, and criticized it for its failure to comply with respective state and federal regulations.
57	However, instead of responding to regulatory criticisms and researching its lending practices to determine if it was engaged in **predatory lending**, Household management chose instead to put its resources towards trying to defuse **predatory lending** legislation and regulations actions under consideration.
57	On May 2, 2000, a **Predatory Lending** Task Force was formed to make policy recommendations to senior management on legislative and regulatory changes that Household could embrace that would defuse the **predatory lending** legislation and regulatory actions being considered.
57	On May 2, 2000, the newly-established **Predatory lending** Task Force met for the first time. (HHS 02911263-02911271)
57	Minutes from the **Predatory lending** Task Force meetings show that the focus of the Task Force was almost entirely on the public relations aspects of **predatory lending**, instead of being focused on reviewing Household's processes and procedures to determine if they were engaged in **predatory lending** and the steps necessary to stop it and prevent it in the future.
57	Household expended significant resources in trying to sway public opinion to become more favorable regarding its **predatory lending** practices.
62	Regulators from the states where Household did business were concerned about a variety of **predatory lending** practices.
62	Appendix E contains a state-by-state discussion of their concerns, enforcement actions they took to force Household to cease their **predatory lending** practices, including requiring refunds to consumers, and the fines they assessed.

62	The types of **predatory lending** practices that the State regulators criticized included the following: • Excessive administrative fees • Excessive late fees • Insurance packing • Excessive recording fees • Improper prepayment penalties • Excessive interest • Missing or improper HUD and TILA disclosures • Improper GFE disclosures and estimates • Unearned insurance premiums • Loans written under the Pay Right Rewards program not considered to be alternative mortgage transactions and not covered under AMPTA • Inaccurate disclosure of interest rates • Excessive finance charges • Late charge violations/application of payments • Improper document preparation fees • Improper prepaid finance charges • Excessive closing fees • Improper prepayment penalty disclosures
63	On October 11, 2002, there was a public announcement that an agreement in principle had been reached to resolve charges of **predatory lending** including a settlement of $484 million.
63	On December 16, 2002, the Multistate Working Group entered into a Consent Judgment with Household addressing Household's **predatory lending** activities and requiring Household to do the following:
72	There was a lack of internal control processes in place to handle the consumer complaints, to track the complaints, to analyze the complaints so that they would not recur, and to investigate which consumers had been harmed because of Household's **predatory lending** practices.
73	A Responsible Lending Rapid Response Team was formed in May 2001 to respond to media inquiries regarding **predatory lending**.
74	Despite the fact that complaints were escalating, little or no investigation was performed on trends in consumer complaints to determine the causes of the complaints and ways to eliminate them, nor was there any investigation performed to determine which consumers were harmed because of Household's **predatory lending** practices, but who had not yet complained.
74	Gary Gilmer testified that he did not recall ever directing an investigation into customer complaints, or recall instructing someone to investigate **predatory lending**. (Gilmer Deposition pgs. 248, 276-277)
74	Mr. Gilmer testified that he did not recall QAC doing any work to detect potential **predatory lending**, nor did he recall specifically asking any of his direct reports to investigate **predatory lending**."
74	Mr. Gilmer testified that he would have asked Ms. Sodeika, his assistant, to look into any issues with respect to **predatory lending**.

76	David Schoenholz, Chief Financial Officer for Household International, testified that he did not recall any investigation into • **predatory lending**; or • whether the company was overcharging fees in other states, after the California Department of Corporations settlement.
81	10. Household contended that it did not engage in **predatory lending**, however, its actions did not support its words.
81	Bulletins were issued on **predatory lending**; however, no follow-up was done to ensure compliance with the policies.
81	Household issued many bulletins to deal with the **predatory lending** complained of by consumers, ACORN, regulators, and States Attorneys General.
81	Gary Gilmer issued a number of memos to employees regarding **predatory lending** and how Household did not engage in **predatory lending**.
81	For example, on May 1, 2000, he issued a memo describing various **predatory lending** activities. (Hennigan Exhibit 27, H008124)
81	These memos, however, did not receive appropriate follow-up to ensure that **predatory lending** was not, in fact, occurring.
83	The following email from the Iowa Attorney General's Office best describes the disconnect between Household's claims that it was not engaging in **predatory lending**, and its actions that demonstrated that is was, in fact, engaging in **predatory lending**.
85	Household had systemic weaknesses, which provided the atmosphere for **predatory lending** to take root and flourish.
85	Household had systemic weaknesses, which provided the atmosphere for **predatory lending** to take root and flourish.
85-87	Those systemic organizational weaknesses included the following: • A corporate culture which emphasized growth, at the cost of compliance. • Product development which focused on **predatory lending**, such as: *** • Lack of internal control processes to handle, track, and analyze consumer complaints, as well as investigate which consumers were harmed because of their **predatory lending** practices. *** • Household actions did not support it contentions that it did not engage in **predatory lending**. o No follow-up on bulletins issued on **predatory lending** to ensure compliance.
87	Household's systemic organizational weaknesses provided a fertile field for **predatory lending** to flourish within Household, and flourish it did.
87	B. Household engaged in numerous, systemic, and company-wide **predatory lending** practices.
87	Household engaged in **predatory lending** practices to entice borrowers into accepting loans, including the following: • Loan splitting • Loan flipping/equity stripping/equity based lending • Excessive prepayment penalties or improper disclosure of prepayment penalties • Insurance packing

	• Improper disclosure of fees and costs • Misrepresentation of interest rates • Failure to make required disclosures or providing misleading disclosures
89	Turning now to the specific **predatory lending** practices in which Household engaged, they can be grouped into two major categories: (1) Structure of the predatory loans, and (2) Disclosure or nondisclosure of the attributes of the predatory loans.
89	Household structured loans in a predatory manner.
89	Household engaged loan splitting, a **predatory lending** practice.
93	Household engaged in loan flipping, a **predatory lending** practice.
95	Household engaged in equity based lending or equity stripping, a **predatory lending** practice.
96	Household imposed excessive prepayment penalties, and often did not properly disclose prepayment penalties to the customer, both of which constitute **predatory lending**.
97	Not only did this **predatory** prepayment penalty lock the borrower into the loan, but it was profitable to Household when the borrower did pay off the loan early.
99	Household engaged in insurance packing, a **predatory lending** practice.
100	Earlier OTS examinations also found evidence of **predatory lending** practices respecting insurance sales.
104	Household assessed **predatory** fees in a number of ways.
104	Household engaged in a number of practices in which **predatory** interest rates and fees were assessed on the borrowers including the following:
105	Household engaged in other **predatory lending** practices.
120	Consumer complaints described Household's **predatory lending** practices.
120	Consumer complaints escalated during 2000-2002, with consumers complaining about the **predatory lending** practices in which Household was engaged.
122	Negotiations between ACORN and Household to obtain a halt to the **predatory lending** practices broke down, and on February 6, 2002, ACORN filed a lawsuit against Household.
122	*Forbes Article, "Home Wrecker," highlights Household's system-wide predatory lending practices.*
122	On September 2, 2002, Forbes published an article that described Household's **predatory lending** practices entitled "*Home Wrecker*."
123	*SUMMARY OF **PREDATORY LENDING**:*
123	Household was a textbook case for **predatory lending**.
123	They engaged in almost every form of **predatory lending** that is discussed in regulatory and banking literature.
123	While Household contended that the problems were isolated to a few branches, the documents and testimony show that the **predatory lending** practices were systemic, widespread and geographically dispersed.
123	The initiatives that were adopted to increase income and were **predatory** in nature, and were implemented at a time when controls and compliance were deemphasized, turnover was high, and computer systems could not keep up. It was a recipe for disaster.

123	Household engaged in the following **predatory lending** practices:
124	Household's **predatory lending** practices were described in the consumer complaints discussed in this report.
124	The **predatory lending** practices were also discussed in detail in regulatory examination reports and in the enforcement actions that the regulators took against Household.
124	The financial impact to Household of its **predatory lending** practices was significant and material to its financial condition.
124	The financial impact to Household of its **predatory lending** practices was significant.
124	In a strategic planning session for senior management on August 14-17, 2000, **predatory lending** pressures were discussed as a risk to Household's strategic positioning.
124	When discussing challenges that Household faced, defusing **predatory lending** was discussed as one of the main challenges.
124	There was a personal impact of the **predatory lending** practices to Household officials.
124-125	The retirements also took place just months after a May 23, 2002 meeting with Washington State DFI in which Household learned of a multistate working group of attorneys general and state regulators from 14 States concerned about Household's **predatory lending** practices.
125	While there is no one document that shows the total dollar impact on Household because of the **predatory lending** practices, the documents below show the significant financial impact of discontinuing these practices, of issuing refunds, and of paying regulatory fines.
125	Lost revenue from discontinuing **predatory lending** practices:
125	The financial impact of discontinuing **predatory lending** practices is shown as follows:
126	Household estimated that the refunds for certain **predatory lending** practices would reach $3.2 billion.
127	However, on October 11, 2002, Household agreed to pay $484 million in restitution per their agreement with the States Attorneys General to settle charges of **predatory lending**.
127	Non-AG refunds for **predatory lending** practices:
127	Household made refunds for **predatory lending** practices that were in addition to those practices criticized by the States Attorneys General, such as:
128	No memo is available which contains the final numbers paid for refunds for **predatory lending** practices.
128	Total used for estimate of refunds paid for **predatory lending** practices: $37 million or $66 million
129	Regulatory penalties for **predatory lending** practices:
129	Household paid the following fines to the states listed below for engaging in **predatory lending** practices.
129	Total regulatory penalties for **predatory lending** practices: $20.7 million
130	The financial impact of Household's foray into **predatory lending** is summarized by Curt Cunningham in a January 18, 2003 email as follows:
130	The total estimated impact on Household was $726,000,000 to $755,000,000 in penalties, refunds, and the lost revenue from discontinuing these **predatory lending** prac-

	tices as summarized below.
130	The total financial impact on Household for its **predatory lending** practices was between $726 million and $755 million, which was significant.
149	Skip-a-pay programs also had **predatory lending** implications.
158	During 2002, periodic meetings were held between Fitch and Household to discuss credit quality, **predatory lending** litigation, liquidity and regulatory and management updates.
181	APPENDIX D **PREDATORY LENDING** BACKGROUND MATERIALS
181	The following are other articles, speeches, regulatory pronouncements, and other materials concerning **predatory lending**, which were in the public domain, issued by Household's regulators or otherwise available to Household before and during the class period.
192	On November 9, 2001, the California Department of Corporations sued Household for $8.5 million in civil penalties for a variety of **predatory** practices.
207	Washington State began an investigation after receiving 180 complaints regarding Household's **predatory lending** practices. (Press Release dated August 14, 2003, *12,000 Washington Consumers*
208	The FDIC and OTS conducted a joint examination of Household Bank f.s.b. on August 27, 2001 and criticized the following practices: *** • **Predatory lending** practices with Household named the "2001 predatory Shark Lender of the Year" by a consumer advocacy group. *** • Predatory insurance sales practices
208-209	The OTS conducted a special compliance examination of both Household Bank, f.s.b. (HB) and HFC on June 3, 2002. The OTS criticized both HB and HFC for the following practices: *** •Insurance packing: the OTS stated Household engaged in this **predatory lending** practice. • Misinformation about EZ Pay Plus: OTS stated that EZ Pay Plus has been a factor in many of the cases alleging predatory practices. OTS stated that borrowers do not understand that EZ Pay Plus does not help to reduce their interest rate.
210	The following are examples of consumer complaints that illustrate Household's **predatory lending** practices.
221	Household focused on a public relations campaign to influence public opinion regarding **predatory lending**, instead of correcting their compliance issues directly.
221	Another Edelman initiative was to reach out to academics to communicate Household's position on **predatory lending**.
222	In June 2002, Household was still trying to sway public opinion regarding **predatory lending** as shown in an email dated June 17, 2002 from Megan Hayden

4	The Bley and Litan Reports fail to address the critical substantiveevidence that demonstrates Household senior management purposefully encouraged **predatory lending** with the actions they took in 1999.
4	The Bley and Litan Reports criticize bits and pieces of my report to suggest that Household senior management acted reasonably to prevent **predatory lending** within the Consumer Lending business unit of Household International, Inc. (Household or the company).
4	If they had done so, they would have concurred with my prior opinion that Household senior management knew, based on the actions that they took in 1999, that **predatory lending** was going to occur throughout the company.
5-6	During 1999, Household senior management took the following actions: a. They introduced new **predatory lending** products based in part on the McKinsey & Company study and recommendations from Andrew Kahr
6	This conduct cannot be analyzed in isolation but must be viewed together as a comprehensive attempt by senior management to grow Consumer Lending's revenues and receivables by actions known to constitute **predatory lending**.
6	Given these actions, an independent expert would conclude, as I did, that senior management's conduct with respect to **predatory lending** was not reasonable and that senior management knowingly created a company structure, culture and products that inevitably resulted in **predatory lending**.
6	Household's senior management could not have incentivized their branch employees on the five 1999 incentive components, i.e. new money, loan volume, loan account gain, margin, and insurance, without knowing and intending that it would result in the **predatory lending** sales practices.
6	The Account Executive or AE who earned bonuses under each of the specific 1999 sales incentive components was doing exactly what the Washington AG and other regulators characterized as **predatory lending**:
7	That the specific components of the incentive plans drove **predatory lending** practices is readily apparent.
7	The compensation plan achieved its intended effect of encouraging **predatory lending** by the branch sales staff, i.e. increasing interest rates over the benchmark in order to increase their own compensation and thereby increase the profitability of the loans.
7	Indeed, the document I cite provides an example of this type of **predatory lending**.
9	The evidence before me (and defendants' experts) contains many other examples of training sales staff on **predatory lending** practices.
10	The "free look" was, however, not without cost to a borrower and in fact, was a **predatory lending** practice.
10	Two components of the incentive plans rewarded the sales staff for this type of **predatory lending** behavior.
11	An AE who was hitting on all cylinders did what the Washington AG and other regulators said not to do and was engaged in **predatory lending**.
12	Household could not realistically have eliminated the field auditors (the QAC) and added their responsibilities to the District Sales managers (DSMs) without knowing

	that these **predatory lending** practices would be encouraged rather than exposed and halted.
12	The DSMs were not independent and Household senior management could not reasonably have believed that the DSMs would control **predatory lending** practices at the branch offices.
12	To the contrary, the DSM had financial incentives to encourage **predatory lending** or at least turn a "blind eye" to such practices.
12	Giving DSMs the responsibility for compliance audits in 1999 can only be understood as a part of a conscious effort to promote the **predatory lending** sales practices necessary to achieve the company's aggressive financial targets.
13	What the Bley and Litan Reports do not address in a macro way is that Household senior management had to know that **predatory lending** would result from the introduction of **predatory lending** products and practices, from the changes in incentives that rewarded **predatory lending** practices, from training that focused on **predatory lending** practices, and from compliance reviews by DSMs marred by conflicts of interest.
13	The Bley and Litan Reports opinions with respect to the definition of "**predatory lending**" are not valid.
13	The Bley Report is misguided in insisting that a legislatively mandated definition of "**predatory lending**" is required before regulators have the authority to halt **predatory lending** sales practices.
14	The Bley Report erroneously concludes that since the term "**predatory lending**" was not used in the statutory language, no state had passed statutes prohibiting **predatory lending** and no state regulator could prohibit **predatory lending** practices. This is an absurd conclusion.
14	A statute does not have to contain the words "**predatory lending**" before it makes **predatory lending** an illegal practice or gives regulators the power to stop it.
14	For example, the North Carolina Commissioner of Banks has a link on the Department's website entitled "NC **Predatory lending** Laws (NCGS 24-1.1E), even though a review of the specific statutory provisions reveal no reference to the term "**predatory lending**."
14	Notwithstanding this fact, the Commissioner characterizes the statutes as the "**predatory lending** laws."
14	In his testimony before the Federal Reserve Board's Hearing on Home Equity Lending on September 7, 2000, Mr. Bley used **predatory lending** as an enforcement term and gave a working definition of that term:
15	The conclusion offered in the Bley Report also contradicts Mr. Bley's July 3, 2000 letter to the OTS wherein Mr. Bley again defines **predatory lending** and describes how the Washington State DFI has investigated and stopped **predatory lending** practices:
16-17	As Mr. Bley testified, **predatory lending** really is just a new name for old practices known as mortgage fraud, and regulators have been taking enforcement action against mortgage fraud for years under existing state and federal law notwithstanding the absence of the phrase **predatory lending** in those laws.
17	And as the Bley Report notes, regulators did have the discretion to interpret such stat-

	utes to prohibit **predatory lending** practices:
17	This statutory provision gives the Washington State Director of the Department of Financial Institutions the authority to halt **predatory lending**, as Mr. Bley noted in his letter to the OTS.
17	The North Carolina Commissioner of Banks has similar enforcement powers against **predatory lending** under the broad consumer protection statutes.
17	The Bley Report's preoccupation with a statute defining "**predatory lending**" is in contradiction to well-accepted notions within the regulatory community.
18	The OCC also recognized the need for a flexible approach to combating **predatory lending** as follows:
18	Given Mr. Bley's testimony and letter as Director of the Washington State Department of Financial Institutions, the question of whether there is or is not a concise legislatively-mandated definition for "**predatory lending**" does not lead to the opinions offered by defendants' experts.
18	The authority of each state to prohibit Household's **predatory lending** practices is reflected in their consent decrees with Household entered into as part of the AG settlement.
18	These decrees, which cover Household loans originated from 1999 to 2002, identify the state statutes and regulations that were violated as a result of Household's **predatory lending** practices.
19	Household's definition of the term "**predatory lending**" is too narrow.
19	The Bley and Litan Reports suggest that Household management acted reasonably because of controversy over the definition of **predatory lending**.
19	However, there was wide consensus as to the meaning of the term and the specific practices falling within its ambit. Household's definition of **predatory lending** was unreasonably narrow in light of the consensus and failed to encompass unfair and deceptive practices, which Household officials knew to be predatory.
19	Household's official definition of "**predatory lending**" was included in the 2001 Operating Plan provided to Household's Board of Directors, wherein the Glossary of Terms defined **predatory lending** as "the term used to define unscrupulous lending practices of select lenders."
19	Defining **predatory lending** to encompass only other lenders and to exclude any such lending by Household is unreasonable.
19	When asked about the meaning of this definition, specifically the reference to "select lenders," Mr. Aldinger replied, "I assume it meant to competitors because we didn't engage in **predatory lending**."
19	This circular definition is not reasonable, but does reflect Household's mindset that no matter what they did, by definition, it was not **predatory lending**.
19	The definitions used by many of Household's senior managers reflect a similarly unreasonable view by suggesting that **predatory lending** had to be intentionally illegal or deceptive such as the following:
19 n.70	The Bley Report also raises the issue of the definition of **predatory lending** in my initial report. Bley Report at 1.
19 n.70	My comment was meant to state that **predatory lending** did not need to be "*intentionally* illegal or intentionally deceptive."

19 n.70	As made clear earlier, I do view **predatory lending** practices, specifically the Household practices I discuss in this report and in my initial report, to be illegal.
20	These definitions of **predatory lending** as given in deposition testimony are only lightly more reasonable than the "official definition" but still outside the commonly accepted understanding of this term.
20	Neither intent to violate the law nor intent to deceive is necessary for **predatory lending**.
20	In a February 2001 article, Mr. Litan characterized **predatory lending** as "mortgages extended under terms that are more onerous to borrowers than if they were more fully informed about the loans themselves and the alternative sources of finance that may be open to them…**predatory lending**…is inherently abusive and already punishable under federal law…."
21	Household's definition of **predatory lending** is too narrow and unreasonable in light of the definitions and statements above from Mr. Bley, Mr. Litan and Treasury/HUD.
21	The Bley and Litan Reports fail to consider the fact that Household's activities were illegal and fail to analyze the manner in which Household conducted its **predatory lending** practices.
21	Likewise, the Litan Report, based on an equally superficial analysis, states that many of the practices I characterize as **predatory** were legal.
21	Household's **predatory lending** practices and products were illegal.
22	In a February 2001 article for the American Bankers Association Magazine, Mr. Litan stated the following regarding **predatory lending** practices:
22	Mr. Litan acknowledges while context is relevant to whether some practices are **predatory lending**, "other practices may be deemed unacceptable in all contexts."
25	There are many **predatory lending** issues concerning Household's insurance sales.
25	The Bley and Litan Reports do not evaluate these issues in any structured manner, but nonetheless suggest that Household's insurance sales were not predatory.
26	The FDIC and the OTS performed a Joint Examination of Household f.s.b on August 27, 2001 and criticized insurance sales as **predatory** with high penetration rates.
26	Because of this, the selling of single premium insurance has long been considered **predatory** and many states have banned it outright.
27	This 5 year life of the insurance combined with the premium payment period over 30 years renders these insurance products to be worse in terms of **predatory lending** than normal single premium insurance.
29	The States Attorneys General gave the following examples of how HFC could meet the tests while engaging in **predatory lending**
31	The first line of defense against **predatory lending** is to ensure the borrower's ability to repay.
32	Mr. Bley attached this broader meaning to the term **predatory lending** when he was Director of the Washington State DFI.
36	In concluding that there was no **predatory lending**, both the Bley and Litan Reports failed to discuss other systemic **predatory lending** practices.
36	Neither the Bley nor the Litan Reports mentioned other **predatory lending** practices that were discussed in Household's memos such as the following:
36	Both the Bley and Litan Reports excuse Household's **predatory lending** practices by

	characterizing them as unauthorized and isolated acts.
36	This conclusion does not take into consideration the widespread extent of House-hold's **predatory lending** practices.
37	It also fails to recognize that the **predatory lending** practices were widely dispersed geographically as indicated by the complaints and regulatory documents I reviewed.
37	The Litan Report attempts to dilute the widespread nature of the **predatory lending** practices by dividing the number of complaints discussed in my report by the number of states to arrive at a small number.
37	These complaints, combined with internal evidence, shows how widespread the **predatory lending** practices were.
42	This change corresponded with a decrease in the Internal Audit Department of branch controls and created a substantial risk that **predatory lending** would occur in the branches.
44	Household's compensation plans for the sales staff were such that they created finan-cial incentives for **predatory lending** and overrode the value, if any, of policies and procedures discussing "ethical" behavior by the sales staff.
45	In other words, all sales employees were compensated based upon the **predatory lending** practices discussed in this Rebuttal Report and in my initial report.
45	That Household's compensation plans promoted specific **predatory lending** prac-tices that took place at Household are critical factors in any objective analysis.
46	Additionally, while numerous bulletins and memos were issued regarding **predatory lending**, the follow-up was inadequate to ensure compliance.
46	For example, a purge of the effective rate presentations (HOLP) was ordered one year after Gary Gilmer's memo describing **predatory lending** practices.
50	The suggestion in the Bley Report that the GFE **predatory lending** practices resulted from human error is an example of this.
51	The Bley Report did not consider that little or no investigation was performed of the trends in complaints to determine the causes and ways to eliminate them, or of how many customers were harmed because of **predatory lending** practices but who had not yet complained.
52	For the reasons noted above, it is a conflict of interest for the sales group to investi-gate allegations of **predatory lending**.
52	The flaws are considered significant, thereby rendering internal controls to be inade-quate to prevent and detect **predatory lending**.
58	Household Faced Real Financial Risks Based on Their **Predatory lending** Practices
58	This was a risk that Household knew from the onset of its actions in 1999 and that was reinforced by the PriceWaterhouseCooper's **predatory lending** study referenced in my initial report.
61	I find the DFI reports of examination to be especially credible and important in my consideration of whether or not Household was engaged in **predatory lending**.
62	Refinancing such a loan is never legally correct because it is **predatory** and unfair to the consumer.
66	Another factor, although not a dispositive one, is the attitude Mr. Gilmer displayed toward regulators looking at Household's **predatory lending** practices.
68	Lending institutions, whether banks or finance companies, need to assess this repay-

	ment capabilities, which has implications both for compliance issues (**predatory lending**) and safety and soundness.
68	There is a direct connection between **predatory** loans and poor credit quality: loans that are beyond a borrower's ability to repay are loans that will go delinquent.

Transcript of Deposition of Catherine A. Ghiglieri (2/13/2008)

38:17-20	I was asked to look at whether or not Household engaged in **predatory lending** practices, and I was asked to look at their reage policies, reaging and restructure policies.
49:23-50:3	Well, I mean, I think that's a good characterization of why it's difficult to -- to put a box around it. You know, these sales practices are considered **predatory lending**, and then somebody will come up with the next one, the next fraud that needs to go in to the box.
53:7-13	Well, I think as I discussed in both my report, my initial report and in my rebuttal, there's no legislatively mandated definition, but that doesn't preclude the fact that people understand what "**predatory lending**" is or that they don't characterize their laws as **predatory lending** laws, as I gave the example of North Carolina in my rebuttal report.
53:19-21	I think I just answered that there's no legislative -- legislatively mandated definition of "**predatory lending**."
54:5-9	Well, if you read my report, my initial report and my rebuttal, you'll see that I quoted many examples of what -- including Mr. Bley was saying with the definition of "**predatory lending**," and none of them used the exact words, but all of them had similar ideas.
56:10-11	I don't think it's broad enough to cover "**predatory lending**."
88:10-13	But the -- the sales practices and the loans terms cannot be deceptive, and it could not be specifically banned by a statute, and if that's the case, then I would consider it not to be **predatory**.
89:13-15	Yes, under -- under my view it's all **predatory lending** activities are illegal, either specifically by statute or under the Deceptive Trade Practices Act.
89:21-24	Well, I don't think so, because you could have a violation of Regulation O, and that's not -- that's illegal, but it's not **predatory**, so I -- I don't think that you can say that.
92:14-16	Okay. Intentionally illegal, so a person doesn't have to intentionally violate the law for it to be **predatory** --
93:15-22	And what I was trying to respond to here were the stricter, narrower definitions of the Household senior management where they were -- they had a very narrow definition of "**predatory lending**," and based on what I can see during the class period it was broader than that. Activities that were outside of their narrow definition were considered **predatory** by the regulators.
107:19-	So I don't know if it necessarily follows that just because you made the disclosure,

22	if you didn't make it accurately or not timely it could still be considered **predatory**.
108:11-15	Then I wouldn't think that there would be anything in violation of the statute, which would be a requirement before it could be considered **predatory** unless it was deceptively given or fall within the Deceptive Trade Practices section of it.
109:11-17	Now, there was a quarrel with Household in this particular case about the range that they use, you know, from zero to $6500 or whatever, and so there's probably something -- there are probably examples that we could come up with that would fall under deceptive that would put this in to **predatory**, even though the disclosures were made.
110:3-5	Well, of course the -- the conduct would have to be deceptive, some sort of deceptive sales practice, for it to be in the **predatory** category.
243:8-12	I think the compensation plans for the various issuers helped drive that behavior in a large part because employees were compensated based on in engaging in **predatory lending** practices.
353:4-6	This list is meant to summarize the **predatory lending** practices that I discussed in this report, that's right.
354:17-21	So there are some issues, some **predatory lending** issues, surrounding benchmark pricing here, just like prepayment penalties may or may not be **predatory**, but how I've discussed them in these two reports I considered it **predatory**.
356:5-8	That was not of benefit to the customer. So benchmark pricing in and of itself would have been okay, but the fact that it was being increased was what was considered, **predatory** in my mind.
360:10-11	That to me is **predatory**. So the length of it to me was **predatory**.