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Randomly Distributed Trial Court Justice: A Case Study and Siren from the Consumer Bankruptcy World

Gary G. Neustadter

Santa Clara University School of Law, gneustadter@scu.edu

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RANDOMLY DISTRIBUTED TRIAL COURT JUSTICE: A CASE STUDY AND SIREN FROM THE CONSUMER BANKRUPTCY WORLD

GARY NEUSTADTER^{*}

ABSTRACT

Between February 24, 2010 and April 23, 2012, Heritage Pacific Financial, L.L.C. ("Heritage"), a debt buyer, mass produced and filed 218 essentially identical adversary proceedings in California bankruptcy courts against makers of promissory notes who had filed chapter 7 or chapter 13 bankruptcy petitions. Each complaint alleged Heritage's acquisition of the notes in the secondary market and alleged the outstanding obligations on the notes to be nondischargeable under the Bankruptcy Code's fraud exception to the bankruptcy discharge. The notes evidenced loans to California residents, made in 2005 and 2006, which helped finance the purchase, refinancing, or improvement of California residential real property. When issued, the notes were secured by junior consensual liens on the real property, but subsequent foreclosure of senior consensual liens, precipitated by the mid-decade burst of the housing bubble, left the notes unsecured.

This Article reports an empirical study of these bankruptcy adversary proceedings. Because the proceedings were essentially identical, they offer a rare laboratory for testing the extent to which our entry-level justice system measures up to our aspirations for "Equal Justice Under Law." We are unlikely to find many conditions better suited to empirical exploration of that question: (1) civil litigation filed during a relatively brief time span by one plaintiff against 266 defendants (including co-defendant spouses); (2) some defendants defaulting, some defendants appearing pro se, and some represented by an attorney; (3) dispersal of the litigation among forty-seven different bankruptcy court judges, all sitting in one state (and thus, where applicable, required to apply the relevant substantive law of a single state); and (4) legal claims and factual allegations by the plaintiff so nearly identical that each dispute is resolvable on the basis of one obvious and straightforward factual question (reliance by an originating lender on a borrower's misrepresentations) or on the basis of three less obvious and more complex legal rules (a California statutory limitation on fraud claims and two alternative varieties of a standing defense).

^{*} Professor of Law, Santa Clara University School of Law. I am grateful to law student Megan Gritsch and graduate fellow Steve Horner for their assistance in gathering and recording some of the data used in this study, to colleagues Patricia Rauch, Kandis Scott, and William Woodward for their continuing interest in and intellectual contributions to this study, to Professor Eleanor Willemsen for her assistance with statistical analysis, and to colleagues Kerry Macintosh, Kenneth Manaster, and David Yosifon for helpful comments on portions of a draft of this Article.

The author supervised law students representing defendants in three of the 218 adversary proceedings that are the subject of this Article, serving as attorney of record in each.

The results in the Heritage adversary proceedings evidence a stunning and unacceptable level of randomly distributed justice at the trial court level, generated as much by the idiosyncratic behaviors of judges, lawyers, and parties as by even handed application of law. We anticipate some randomly distributed justice as the inevitable byproduct of disparities in economic and other resources of the parties and disparities in the knowledge, capabilities, and attitudes of even well-meaning attorneys and judges acting reasonably in an imperfect system. We aspire, nonetheless, to equal justice under law. The findings of this study reflect a departure from that ideal on a scale both larger than we may have expected and larger than we should tolerate.

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INTRODUCTION

Heritage Pacific Financial, L.L.C. ("Heritage"), formed in 2009 as a Texas limited liability company,¹ was a debt buyer.² Preceding its January 2014 financial demise,³ it actively invoked California and federal judicial systems, seeking to collect on unpaid promissory notes with face amounts aggregating in the hundreds of millions of dollars that it had purchased for at most pennies on the dollar.⁴ The notes, issued by California residents to institutional lenders in 2005–06, promised

¹ Heritage filed a certificate of formation as a limited liability company with the Texas Secretary of State on March 26, 2009. For formation information, *see* TEX. SEC'Y OF STATE, <http://www.sos.state.tx.us/corp/sosda/index.shtml> (last visited Feb. 14, 2015).

² I use the term "debt buyer" advisedly, because Heritage asserted in one court submission that it stopped purchasing loans in mid-2009, choosing instead to take a temporary assignment of a one percent ownership in the loans from a third party on whose behalf it would service the loans or litigate to collect on them. *See* Plaintiff Heritage Pacific Financial, L.L.C.'s Response in Opposition to Defendant's Motion for Contempt and Sanctions at 6, *In re Montano*, No. 11-04008 (Bankr. N.D. Cal. Nov. 7, 2013), ECF No. 265. Yet, in each of the adversary proceedings that are the subject of this study, all initiated after 2009, Heritage alleged in each of its complaints that originating lenders or their assignees had duly assigned loan obligations to Heritage and that Heritage was the "current owner and/or holder" of those loan obligations. *E.g.*, Plaintiff's Complaint to Determine Dischargeability of Debt at 4, *In re Adams*, No. 11-02127 (Bankr. E.D. Cal. Feb. 24, 2011), ECF No. 1. In one, Ben Ganter, self-described director of client relations, custodian of records, and director of the legal department for Heritage, testified at trial that Heritage generally bought loans in default and then made efforts to collect on them and that Heritage generally had approximately 50,000 loans in its portfolio at any one time. *See* Transcript of Trial at 6, 44–45, *In re Adrian*, No. 10-01334 (Bankr. C.D. Cal. Mar. 18, 2013), ECF No. 59. In any event, the findings and conclusions of this study do not depend on whether one characterizes Heritage as debt buyer, servicer, or debt collector.

For a detailed description and empirical assessment of the debt buying industry, *see* FED. TRADE COMM'N, THE STRUCTURE AND PRACTICES OF THE DEBT BUYING INDUSTRY (2013), <https://www.ftc.gov/sites/default/files/documents/reports/structure-and-practices-debt-buying-industry/debtbuyingreport.pdf>. The Federal Trade Commission derived its empirical data from information furnished to it by six of the nation's largest debt buyers. *Id.* at 8–9. In the study, credit card receivables constituted sixty-two percent of the portfolios purchased by debt buyers. *Id.* at 14. Those debt buyers were thus institutional debt buyers attempting in the main to collect a recurring type of debt. Heritage, in contrast, was a situational debt buyer, formed at least in part with a view to acquiring and profiting from debt generated by specific historical circumstances.

³ Heritage filed a voluntary chapter 7 petition in the United States Bankruptcy Court for the Eastern District of Texas. *See* Petition of Heritage Pacific Financial, L.L.C., *In re Heritage Pac. Fin., L.L.C.*, No. 14-40107 (Bankr. E.D. Tex. Jan. 14, 2014), ECF No. 1.

⁴ It purchased the notes from multiple entities. For example, in January 2009, Heritage appears to have purchased notes with a face amount of \$69,327,453 from Promor Investments, L.L.C., for one-half cent on the dollar. In summer 2009, Heritage appears to have purchased notes with a face amount of approximately \$116,961,649 from Anson Street L.L.C. for .97 of one cent on the dollar. In February 2010, Heritage appears to have purchased notes with a face amount of \$104,561,120 from Dreambuilder Investments, L.L.C. for approximately 1/5th of a cent on the dollar. For these three purchases, then, Heritage appears to have purchased notes with a face amount of approximately \$290,850,222 for approximately \$1,690,287.

In each of these three agreements, Heritage acknowledged that the debt purchased was delinquent, that the purchase price had been adjusted accordingly, and that it was purchasing the debt "as is." Copies of each of the three agreements pursuant to which it made these purchases are on file with the author.

Copies of notes and allonges gathered for this study reflect indorsement of notes to Heritage from many additional entities. I did not have access to the agreements pursuant to which these other entities sold notes to Heritage and thus can only infer that those agreements provided pricing and other provisions roughly comparable to those in the three foregoing examples.

repayment of loans that helped finance the purchase, refinancing, or improvement of California residential real property.⁵ At issuance, the notes were secured by junior consensual liens on the real property, but subsequent foreclosure of senior consensual liens, in many cases probably precipitated by the mid-decade burst of the housing bubble, left the notes unsecured.⁶

In late 2009 and early 2010, Heritage sued makers of 157 of these notes for the outstanding balances, joining seemingly random groups of them in three separate actions filed in the Federal District Court for the Central District of California.⁷ During the balance of 2010, in a veritable avalanche of litigation, Heritage filed at least 534 additional lawsuits in California Superior Court against makers of some of the notes it had purchased.⁸ And, between February 24, 2010 and April 23, 2012, Heritage filed 218 adversary proceedings in California bankruptcy courts against makers of these notes who had filed chapter 7 or chapter 13 bankruptcy petitions, alleging the outstanding obligations on the notes to be nondischargeable under the Bankruptcy Code's fraud exception to the bankruptcy discharge.⁹ This Article, drawing mostly from PACER-accessible records,¹⁰ reports on a study of these bankruptcy adversary proceedings, all but one of which has been closed.¹¹

⁵ For convenience, "notes" includes a very small number of home equity line of credit agreements and other non-negotiable instruments. A few of the notes subject to this study were secured by liens on real property located outside California.

⁶ Deposition testimony and declarations of Ben Ganter, a Heritage principal, and declarations of Mark Schuerman, an expert witness retained by Heritage, make clear that Heritage sought to collect on notes originally secured by junior liens on real property. See, e.g., Oral Deposition of Benjamin A. Ganter at 13–15, 17–18, 21–22, 30, *In re Gonzalez*, No. 11-cv-173203 (Cal. Super. Ct. Oct. 18, 2011) (on file with author); Plaintiff's Trial Brief, Declarations of Ben Ganter and Mark Schuerman in Support at 12, 18–19, *In re Mabson*, No. 10-02445 (Bankr. C.D. Cal. July 19, 2011), ECF No. 20. Foreclosure of a senior consensual lien on real property extinguishes junior liens on the property, leaving a "sold-out junior." *Bank of Am. v. Graves*, 59 Cal. Rptr. 2d 288, 291 (Cal. Ct. App. 1996).

⁷ For a discussion of these three federal district court actions, see *infra* Part II.A.1.

⁸ For a discussion of some of the state actions, see *infra* Part II.A.2.

⁹ An adversary proceeding is a lawsuit filed in bankruptcy court that is largely governed by Federal Rules of Civil Procedure and Federal Rules of Evidence. See FED. R. BANKR. P. 7001–87, 9017. Because of bankruptcy's automatic stay, Heritage could not initiate suit against makers of notes in either federal district court or state court after a maker had filed a bankruptcy petition, and it could not continue a federal district court or state court action initiated against such a maker prior to the bankruptcy filing. See 11 U.S.C. § 362(a)(1) (2012). Broadly speaking, an individual's discharge of debt in bankruptcy does not discharge a debt incurred by fraud if the creditor timely files an adversary proceeding and thereafter obtains a bankruptcy court judgment that the debt is nondischargeable. See *id.* § 523(a)(2), (c)(1) (2012); FED. R. BANKR. P. 4007(c). For a discussion of the adversary proceedings, see *infra* Part III.A.

¹⁰ Electronic versions of the dockets and all relevant documents filed in each of the 218 adversary proceedings, written summaries of each proceeding, Excel spreadsheets recording fifty-seven discrete data points as to each proceeding, and tables generated from the spreadsheets are on file with the author. The author expresses his appreciation to Bankruptcy Judges Carroll, Jaroslovsky, Klein, and Taylor, Chief Judges of the Bankruptcy Courts for the Central, Northern, Eastern, and Southern Districts of California, respectively, for PACER fee exemption orders that enabled free access to these records. The relevant documents consist of pleadings, entries of default, most motions, memoranda of points and authorities and declarations in support of and in opposition to motions, transcripts of hearings, some status reports, referrals to mediation and mediators' reports, settlement stipulations, orders, judgments, and, for the very few cases in which there was a trial or appeal, exhibit and witness lists, trial briefs and transcripts, and appellate briefs. Except where helpful to an understanding of the proceeding, I have not saved any summonses, certificates of

Heritage mass produced most of the significant records that it filed in the adversary proceedings and its attempted *prima facie* showing in each was identical in every material respect—identical in legal theory, identical in critical factual allegations, and identical in the kind of evidence offered to support those allegations:

1. Using a uniform residential loan application (Fannie Mae Form 1033),¹² individuals applied for residential real property secured loans, mostly through mortgage loan brokers dealing with wholesale lenders, but occasionally directly with an originating lender.¹³
2. The loan applications, signed by prospective borrowers beneath warnings of civil and criminal liability for knowingly false statements, misrepresented the prospective borrower's income, employment, or intended use of the real property, or, in a few cases, the nature or extent of the borrower's liabilities.
3. Originating lenders relied on the misrepresentations in making what Heritage's expert identified as "stated income" loans and what others have less charitably identified as "liar loans."¹⁴
4. Originating lenders sold the notes, secured by junior liens on real property, in the secondary mortgage market.¹⁵

service, or notices of mailing, and have not saved most status reports, scheduling and other miscellaneous orders, or civil minutes. For adversary proceedings commenced in the Northern District of California, records also include audio files of hearings, made available because of the Northern District's participation in PACER's Digital Audio Recording Project. *See Digital Audio Recording Project*, PUBLIC ACCESS TO COURT ELECTRONIC RECORDS (PACER), https://www.pacer.gov/announcements/general/audio_pilot.html (last visited Feb. 16, 2015). The Central, Eastern, and Southern Districts of California did not participate in the audio recording project at the time of the adversary proceedings.

¹¹ One proceeding remained open as of April 5, 2016. In that proceeding, the bankruptcy court entered a judgment in favor of the defendant on his motion for summary judgment. Entry of Final Judgment, *In re Montano*, No. 11-04008 (Bankr. N.D. Cal. Oct. 19, 2012), ECF No. 166. The court thereafter awarded attorney's fees to the defendant, Order on Defendant's Motion for Attorney's Fees and Costs, *In re Montano*, No. 11-04008 (Jan. 25, 2013), ECF No. 198, an award that Heritage appealed to the Ninth Circuit Bankruptcy Appellate Panel, *see infra* text accompanying notes 345–46. The Panel affirmed the attorney's fee award in *In re Montano*, 501 B.R. 96, 112–19 (B.A.P. 9th Cir. 2013), but the proceeding remains open because of the defendant's extended and extraordinary efforts to enforce the attorney's fees judgment. Some of those efforts are briefly described *infra* note 353.

¹² *Uniform Residential Loan Application*, FANNIE MAE (revised June 2009), https://www.fanniemae.com/content/guide_form/1003rev.pdf.

¹³ Unlike a direct lender, a wholesale lender does not conduct the loan origination process directly with the borrower; instead, it solicits and acts upon loan applications submitted by mortgage brokers or other intermediaries. Loan applications and promissory notes available from PACER typically show that the loan application was taken by an "interviewer" working for an entity other than the entity identified on the promissory note as the lender. *See, e.g.*, Plaintiff's Complaint to Determine Dischargeability of Debt at 11, 14, *In re Cervantes*, No. 11-01733 (Bankr. C.D. Cal. Mar. 4, 2011), ECF No. 1. A few loan applications were taken directly by the entity identified in the promissory note as the lender. *See, e.g.*, Exhibits A and B to Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Alejandre*, No. 11-02349 (Bankr. E.D. Cal. June 19, 2011), ECF No. 1. Shortly after funding a loan, a wholesale lender typically sells the loan in the secondary mortgage market.

¹⁴ *E.g.*, *In re Machuca*, 483 B.R. 726, 730 n.4, 731 n.5 (B.A.P. 9th Cir. 2012).

5. Borrowers defaulted in payments on the notes, typically leaving a balance equal or nearly equal to the face amount of the note. Foreclosure of a senior lien extinguished the junior lien, leaving the notes unsecured.
6. Heritage acquired the notes, in some cases directly from the originating lenders and in other cases from the last in a chain of intermediate transferees. None of its complaints alleged that Heritage relied on the misrepresentations,¹⁶ but, under Ninth Circuit authority, Heritage's claim under the fraud exception to the bankruptcy discharge could rest on the reliance of the originating lender.¹⁷

Despite the undifferentiated nature of Heritage's legal theory, allegations, and supporting evidence, this study reveals significant and unjustified disparity in adjudicated outcomes among the many bankruptcy judges who heard the adversary proceedings. It also reveals that most attorneys representing defendants did not plead defenses that might have defeated liability, that defendants represented by attorneys did not necessarily fare better than pro se defendants or defendants who defaulted, and that represented defendants in the Northern District of California generally fared better in settlement of the Heritage claims than represented defendants in the other three California federal districts. The study also suggests that the Bankruptcy Code's attorney fee shifting provision,¹⁸ intended to deter adversary proceedings alleging fraud that are not substantially justified, does not function effectively.

Taken together, these findings advance our understanding of debt buyer initiated litigation, studied by others primarily in the context of much smaller contract claims filed by institutional debt buyers in state court.¹⁹ More importantly,

¹⁵ See, e.g., Declaration of Mark G. Schuerman in Support of Plaintiff's Motion for Default Judgment at 3–4, *In re Frutos de Espinoza*, No. 10-09078 (Bankr. E.D. Cal. Mar. 25, 2011), ECF No. 31.

¹⁶ Heritage nonetheless frequently submitted a standardized declaration of Ben Ganter in which he identified himself as Director of Client Relations of Heritage and asserted that Heritage relied only on information provided in a loan application when purchasing loans on the secondary market. E.g., Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment at 1–2, *In re Calderon*, No. 10-09077 (Bankr. E.D. Cal. Aug. 16, 2011), ECF No. 57.

¹⁷ See *Boyajian v. New Falls Corp.* (*In re Boyajian*), 564 F.3d 1088 (9th Cir. 2009) (holding that in an action under 11 U.S.C. § 523(a)(2)(B) the assignee need not demonstrate its own reliance on a misrepresentation if it can demonstrate reliance by the original lender).

¹⁸ 11 U.S.C. § 523(d) (2012).

¹⁹ The most recent published study, of lawsuits filed by debt buyers in Maryland, identifies, summarizes, and contrasts the results of prior studies. See Peter A. Holland, *Junk Justice: A Statistical Analysis of 4,400 Lawsuits Filed by Debt Buyers*, 26 LOY. CONSUMER L. REV. 179, 198–202, 225–29 (2014). Holland's study randomly selected 4400 lawsuits filed in Maryland collection courts by eleven debt buyers with the highest volume of filings, over one thousand each, in 2009–2010. *Id.* at 185–86, 203. The lawsuits primarily involved attempts to collect relatively small amounts of credit card debt, typically less than five thousand dollars and averaging less than three thousand dollars. *Id.* at 193, 205. Holland's study and previous studies all revealed high rates of default, high rates of judgments against defendants (either by default or otherwise), and very low rates of attorney representation. *Id.* at 225–28. Each of these findings contrast sharply with the findings reported in this Article, likely because of the significantly greater amounts sought by Heritage in its adversary proceedings. In Holland's study, defaulting defendants fared worst, pro se defendants fared better

these findings reflect what may collectively and colloquially be described as randomly distributed justice at the trial court level—outcomes driven at least as much by luck as by the inherent merits of the case. We anticipate some randomly distributed justice as the byproduct of disparities in economic and other resources of the parties and disparities in the knowledge, capabilities, and attitudes of even well-meaning attorneys and judges acting reasonably in an imperfect system. We aspire nonetheless to equal justice under law. The findings of this study reflect a departure from that ideal on a scale both larger than we may have expected and larger than we should tolerate.

To develop this thesis and to foreshadow the description of disparate outcomes in the adversary proceedings, Part II describes salient features of Heritage's (non-bankruptcy) lawsuits in the United States District Court for the Central District of California and in the California Superior Court. Part III describes the Heritage adversary proceedings in California bankruptcy courts, focusing on one factual and two legal issues whose disparate resolution generated disturbingly different adjudicated outcomes. Part IV explains how Heritage played with a deck stacked in its favor—the beneficiary of information asymmetry, mass production of documents, the complexity of the legal issues, and the impotence of the Bankruptcy Code's attorney fee shifting provision. Part IV also describes wild cards randomly undermining Heritage's advantages. Part V offers suggestions for reform and Part VI concludes.

I. HERITAGE LAWSUITS IN UNITED STATES DISTRICT COURT AND CALIFORNIA SUPERIOR COURT

A. *The District Court Actions*

Heritage's initial litigation foray in California appears to have been in the United States District Court for the Central District of California, where it filed three actions. The remarkably inconsistent outcomes in these three essentially identical actions foreshadow the randomly distributed justice in its subsequently filed adversary proceedings.

Each of the complaints alleged diversity jurisdiction,²⁰ and each joined multiple individuals as defendants, presumably to save filing fees. Heritage filed the first of these actions ("*Chao*") on December 11, 2009, joining fifty individuals as

but still poorly, and defendants represented by attorneys fared best. *Id.* at 210–13, 223–24. Those findings too contrast sharply with the findings reported in this Article.

²⁰ Heritage, a limited liability company, alleged that it organized under Texas law and had its principal place of business in Texas, that each of the defendants resided in California, and that the amount in controversy for each defendant exceeded \$75,000. *E.g.*, Complaint for Damages, Specific Performance, & Other Equitable Relief at 2–3, *Heritage Pac. Fin., L.L.C. v. Chao*, No. 09-01466 (C.D. Cal. Dec. 11, 2009), ECF No. 1. Heritage failed to allege the citizenship of each of its owners or members, and its later failure to offer evidence of that citizenship proved fatal in one of the three actions. See *infra* notes 26–28 and accompanying text.

defendants, the second ("*Cole*") on January 20, 2010, joining fifty-five individuals as defendants, and the third ("*David*") on February 4, 2010, joining fifty-two individuals as defendants.²¹ It filed *Chao* and *David* in the Santa Ana Division of the Central District, where each was assigned to a different judge, and it filed *Cole* in the Los Angeles Division of the Central District, where it was assigned to a third judge.

The complaints in the three actions were virtually identical. All three alleged that each defendant had misstated income on a residential loan application, had caused the misleading loan application to be transmitted to prospective lenders, had thereby obtained a loan, had signed a note promising repayment, and had defaulted on the note. Heritage alleged that it was the holder of each note through assignment from an originating lender or intervening assignee. Each complaint also alleged the possibility that one or more of the defendants may have also misrepresented an intention to use the real property as a primary residence. One of the three complaints also alleged that each defendant had misrepresented the nature and history of his or her employment. One of the complaints alleged that each defendant had sought the loan for purchase of real property; the other two complaints alleged that some defendants had sought the loan to purchase and others to refinance real property.

Each complaint pleaded causes of action for intentional and negligent misrepresentation and breach of contract, and two of the three added a cause of action for fraudulent concealment. In each, Heritage sought actual damages from each defendant equal to the face amount of the relevant note plus twice that amount in punitive damages.²²

Following sua sponte orders to show cause why multiple defendants had not been improperly joined, the court in both *David* and *Cole* dismissed all but one defendant because of improper joinder.²³ But because dismissal of the entire action is not the proper remedy for improper joinder,²⁴ the court in *David* left the case pending against defendant Susana David, apparently only because her name, although not alphabetically first, appeared first among fifty-two defendants in the caption of the complaint. The court in *Cole* left the case pending against defendant Hector Hernandez, the one defendant unlucky enough to have filed an answer to the complaint prior to the court's order dismissing the remaining defendants.²⁵ But

²¹ See Complaint for Damages, Specific Performance, & Other Equitable Relief, *supra* note 20; Complaint for Damages, Specific Performance, & Other Equitable Relief, Heritage Pac. Fin., L.L.C. v. Cole, No. 10-00394 (C.D. Cal. Jan. 20, 2010), ECF No. 1; Complaint for Damages, Specific Performance, & Other Equitable Relief, Heritage Pac. Fin., L.L.C. v. David, No. 10-00133 (C.D. Cal. Feb. 4, 2010), ECF No. 1.

²² None of the complaints sought interest that had accrued on the obligations following the borrowers' defaults.

²³ See Civil Minutes – General, *Cole*, No. 10-00394 (May 3, 2010), ECF No. 54; Civil Minutes – General, *David*, No. 10-00133 (May 14, 2010), ECF No. 67.

²⁴ A federal court may not dismiss an action for improper joinder but may drop parties to cure the improper joinder. See FED. R. CIV. P. 21.

²⁵ See Civil Minutes – General at 4, *Cole*, No. 10-00394 (May 3, 2010), ECF No. 54; Defendant Hector Hernandez' Answer to Plaintiff's Complaint for Damages, *Cole*, No. 10-00394 (Mar. 4, 2010), ECF No. 41.

serendipity saved Mr. Hernandez from this misfortune. The court's sua sponte order in *Cole* had also required Heritage to show cause why the case should not be dismissed for lack of subject matter (diversity) jurisdiction.²⁶ Heritage probably could have responded successfully by offering evidence that the sole member of Heritage (an L.L.C.) was a citizen of Texas, thus establishing diversity of citizenship, but it misread the law and failed to do so.²⁷ The court therefore dismissed the action against Mr. Hernandez.²⁸

Susana David was not so fortunate; the court's sua sponte order in her case had not raised the jurisdictional issue.²⁹ Ms. David had not appeared in the action, and Heritage moved for a default judgment against her on both its contract and fraud claims after procuring entry of default.³⁰ The court denied the motion, having properly concluded that California legislation, section 726(g) of the California Code of Civil Procedure,³¹ barred an action *for fraud* by a holder of a note if the note evidenced a loan that was secured, as it was in Ms. David's case, by single-family, owner-occupied residential real property actually occupied by the borrower and if the loan was for less than \$150,000 (adjusted for inflation).³² But the court left Heritage the option of reinstating a *breach of contract claim* that the court believed Heritage had abandoned.³³

The court should have dismissed with prejudice instead, because relevant law also barred the breach of contract claim asserting default on the note. California anti-deficiency legislation, section 580b of the California Code of Civil Procedure, precludes recovery "[u]nder a deed of trust or mortgage on a dwelling of not more than four families given to a lender to secure repayment of a loan that was used to pay all or part of the purchase price of that dwelling, occupied entirely or in part by the purchaser."³⁴ The legislation applies to an action on a note held by a sold out

²⁶ Civil Minutes – General at 1–2, *Cole*, No. 10-00394 (Mar. 8, 2010), ECF No. 44.

²⁷ In the Ninth Circuit, an L.L.C. is a citizen of every state in which its owner/members are citizens. *Johnson v. Columbia Props. Anchorage, LP*, 437 F.3d 894, 899 (9th Cir. 2006) (joining five other circuits that had addressed the issue). Heritage's later filed voluntary bankruptcy petition identified Christopher D. Ganter as its sole member and its attached Schedule H stated his address to be in Frisco, Texas. Petition of Heritage Pacific Financial, L.L.C., *supra* note 3, at 3, 44. Heritage's response to the order to show cause asserted that "each of Plaintiff's members is a citizen of the State of Texas," but Heritage failed to include with its response any evidence to that effect (e.g. a declaration of Christopher Ganter stating his residence). Instead, its response argued, incorrectly, that its Texas organization and Texas principal place of business determined its citizenship. Response to Order to Show Cause and Request to Discharge the Court's Order to Show Cause at 3–4, *Cole*, No. 10-00394 (Mar. 23, 2010), ECF No. 46.

²⁸ Civil Minutes – General, *Cole*, No. 10-00394 (June 7, 2010), ECF No. 57.

²⁹ Civil Minutes – General, *Heritage Pac. Fin., L.L.C. v. David*, No. 10-00133 (C.D. Cal. Apr. 28, 2010), ECF No. 61.

³⁰ Notice of Application and Application for Final Default Judgment Against Defendant Susana David, *David*, No. 10-00133 (Aug. 18, 2010), ECF No. 74; Plaintiff's Memorandum of Points and Authorities in Support of Plaintiff's Application for Final Default Judgment Against Defendant Susana David, *David*, No. 10-00133 (Aug. 18, 2010), ECF No. 74-1.

³¹ CAL. CIV. PROC. CODE § 726(g) (2012).

³² Civil Minutes – General at 2–5, *David*, No. 10-00133 (Oct. 17, 2011), ECF No. 108.

³³ *Id.* at 6.

³⁴ CAL. CIV. PROC. CODE § 580b (2012).

junior lienholder³⁵ and therefore should have barred Heritage, a subsequent holder of Ms. David's note, from recovery. In focusing on section 726(g) of the California Code of Civil Procedure, the court overlooked the underlying prohibition on the collection of a deficiency.³⁶ As we shall see, in one adversary proceeding, a bankruptcy court did the opposite (properly acknowledging the anti-deficiency rule but overlooking section 726(g)).³⁷

Heritage didn't look a gift horse in the mouth. It amended its complaint against Ms. David, reinstating its breach of contract claim, and renewed its motion for a default judgment.³⁸ The court granted the motion, saddling Ms. David with a \$144,434 default judgment on a deficiency claim barred by California law.³⁹ Even more troubling, the court's correct ruling on the fraud claims did not deter Heritage from filing three subsequent adversary proceedings invoking the fraud exception to the bankruptcy discharge,⁴⁰ and no document that Heritage filed in its still pending adversary proceedings acknowledged the ruling of the court in *David* that section 726(g) of the California Code of Civil Procedure barred certain fraud claims. To the contrary, many of the complaints that Heritage filed in its adversary proceedings (i.e. in other courts) alleged: "Plaintiff is not barred from pursuing this action by any anti-deficiency statute or rule. Plaintiff does not seek a deficiency judgment for the balance of a promissory note following foreclosure, but rather seeks a judgment for Defendant's fraud in connection with their loan application, as alleged herein."⁴¹

³⁵ See *Spangler v. Memel*, 498 P.2d 1055, 1059 (Cal. 1972); see also *Kurtz v. Calvo*, 89 Cal. Rptr. 2d 99, 100 (Cal. Ct. App. 1999).

³⁶ In reaching its conclusion, the court relied exclusively on three cases identified by Heritage that addressed the effect of California's one form of action rule on a sold out junior lienholder but none of which involved the type of purchase money loan addressed by California's anti-deficiency rule. See Civil Minutes – General, *supra* note 32, at 4–5 (discussing *Nat'l Enters., Inc. v. Woods*, 115 Cal. Rptr. 2d 37 (Cal. Ct. App. 2001), *Bank of Amer. v. Graves*, 59 Cal. Rptr. 2d 288 (Cal. Ct. App. 1996), and *Roseleaf Corp. v. Chierighino*, 378 P.2d 97 (Cal. 1963)).

The United States Bankruptcy Appellate Panel for the Ninth Circuit provided the correct analysis in affirming a judgment against Heritage in one of the subsequently filed Heritage adversary proceedings. See *In re Montano*, 501 B.R. 96, 105–12 (B.A.P. 9th Cir. 2013). For further discussion of that proceeding, see *infra* text accompanying notes 241–44.

³⁷ See *infra* text accompanying notes 249–53.

³⁸ Plaintiff's Third Amended Complaint for Breach of Contract Against Defendant Susana David, *David*, No. 10-00133 (Dec. 21, 2011), ECF No. 110; Motion for Final Default Judgment Against Defendant Susana David, *David*, No. 10-00133 (May 10, 2012), ECF No. 123.

³⁹ Order of Judgment Against Defendant Susana David After Default, *David*, No. 10-00133 (July 23, 2012), ECF No. 130. Because judgment on the fraud claim was denied and entered instead on the contract claim, Ms. David could discharge the claim in bankruptcy because exceptions to the bankruptcy discharge do not include claims for breach of contract. 11 U.S.C. § 523(a) (2012). A PACER search on Ms. David's name revealed no bankruptcy filing in California.

⁴⁰ Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Dekoekkoek*, No. 11-90491 (Bankr. S.D. Cal. Oct. 21, 2011), ECF No. 1; Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Nsahlai*, No. 11-02983 (Bankr. C.D. Cal. Nov. 11, 2011), ECF No. 1; Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Palines*, No. 12-03063 (Bankr. N.D. Cal. Apr. 23, 2012), ECF No. 1. In each, Heritage alleged that it was not seeking a deficiency judgment but was instead seeking a judgment for fraud in connection with the defendant's loan application.

⁴¹ See, e.g., Plaintiff's Complaint to Determine Dischargeability of Debt at 4, *In re Alabsi*, No. 11-03019 (Bankr. N.D. Cal. Feb. 4, 2011), ECF No. 1.

In *Chao*, the third of the three federal district court actions, the court did not question either joinder or subject matter jurisdiction. Instead, in advance of ruling on Heritage's motions for default judgments against multiple defendants, it expressed concern about two issues: (1) whether Heritage, as successor-in-interest on a note, could invoke the originating lender's reliance on alleged borrower misrepresentations in support of its fraud claims; (2) whether the defendants might be protected by anti-deficiency legislation.⁴² In supplemental briefing, Heritage addressed the first issue but not the second.⁴³ The court nonetheless must have resolved its misgivings about potential application of anti-deficiency legislation and may have been unaware of section 726(g) of the California Code of Civil Procedure, because it entered default judgments in favor of Heritage totaling \$1,841,363 against twenty-three individuals (ranging from \$43,380 to \$145,273, with a median judgment of \$87,833).⁴⁴ Although the judgments mention that Heritage waived its right to punitive damages,⁴⁵ they do not state whether they were based on Heritage's contract or fraud claims, or both. Thus, unlike Susana David, none of the *Chao* defendants against whom default judgments were entered could know whether the judgments against them were, like the default judgment against Susana David, based only on a contract claim dischargeable in bankruptcy.⁴⁶

⁴² Civil Minutes – General at 1–2, *Heritage Pac. Fin., L.L.C. v. Chao*, No. 09-01466 (C.D. Cal. May 25, 2010), ECF No. 123.

⁴³ Plaintiff Heritage Pacific Financial's Supplemental Brief in Support of its Application For Entry of Final Default Judgments, *Heritage Pac. Fin., L.L.C. v. Chao*, No. 09-01466 (C.D. Cal. June 14, 2010), ECF No. 133.

⁴⁴ Judgments Against Defendants, *Chao*, No. 09-01466 (Dec. 7, 2010, June 13, 2011, and June 14, 2011), ECF Nos. 177, 205, 206, 208, 209. No PACER-accessible document explains the court's thinking on the anti-deficiency issues. We have only a transcript of a hearing on the motions for default judgments in which the judge comments: "And I've thrown a lot of things at you, including antideficiency issues and other issues." Reporter's Daily Transcript of Pretrial Proceedings at 6, *Chao*, No. 09-01466 (Dec. 6, 2010) (on file with author).

⁴⁵ Plaintiff Heritage Pacific Financial's Supplemental Brief in Support of its Application For Entry of Final Default Judgments, *supra* note 43.

⁴⁶ The fate of the *Chao* defendants, Susana David, and other defendants against whom Heritage obtained judgments in subsequent state actions or bankruptcy adversary proceedings is fertile soil for study. Here is one example. At least one of the twenty-three *Chao* defendants against whom Heritage obtained a default judgment, Jennie Arizmendez, filed a chapter 13 bankruptcy petition on January 4, 2012, just over a year after the entry of the default judgment against her. See Petition of Jennie Arizmendez at 3, *In re Arizmendez*, No. 12-10200 (Bankr. C.D. Cal. Jan. 4, 2012), ECF No. 1. She listed Heritage's claim as \$97,959.60, Schedule F – Creditors Holding Unsecured Nonpriority Claims at 13, *In re Arizmendez*, No. 12-10200 (Jan. 18, 2012), ECF No. 11, the exact amount of the default judgment against her, and noted wage garnishment by Heritage in July 2011, Statement of Financial Affairs at 21, *In re Arizmendez*, No. 12-10200 (Jan. 18, 2012), ECF No. 11. Her other debt schedules reveal this claim to have constituted ninety percent of her total priority and non-priority unsecured debt. Schedule F, *supra*, at 13; Schedule E – Creditors Holding Unsecured Priority Claims at 12, *In re Arizmendez*, No. 12-10200 (Jan. 18, 2012), ECF No. 11. The Heritage wage garnishment therefore played heavily in her decision to file. At the time of her petition, she stated that she was married, had one dependent daughter, was employed as a cashier at Target (for thirteen years) with a net monthly take home pay of \$1,153.73, received an additional \$800 per month from a combination of rental income and "family contribution," and that her husband received \$1,367.16 per month from social security and pension or retirement income. Schedule I – Current Income of Individual Debtor(s) at 16, *In re Arizmendez*, No. 12-10200 (Jan. 18, 2012), ECF No. 11. She listed average monthly expenses of \$2,856.29, including \$1,726.57 as rent or a home mortgage payment. Schedule J – Current Expenditures of Individual

Sections 580b⁴⁷ and 726(g) of the California Code of Civil Procedure⁴⁸ may well have barred both the contract and fraud claims upon which many of these judgments were based. The court dismissed all but three of the remaining twenty-seven defendants upon Heritage's request.⁴⁹

To recapitulate this remarkable set of disparate outcomes among three identical lawsuits: (1) Susana David, fortuitously the first of fifty-two co-defendants named in a Heritage lawsuit filed in the Santa Ana Division of the Federal District Court for the Central District of California, suffered a \$144,434 deficiency judgment based on a misreading of California law after the judge sua sponte had dismissed her fifty-one co-defendants for improper joinder; (2) Hector Hernandez, fortuitously the only defendant among fifty-five co-defendants to have filed an answer, escaped a similar fate in a Heritage lawsuit filed in the Los Angeles Division of the Federal District Court for the Central District of California, if only because the judge sua sponte dismissed the lawsuit against him for lack of diversity jurisdiction after having sua sponte dismissed his co-defendants for improper joinder; (3) twenty-three other defendants, among fifty sued by Heritage in a second lawsuit filed in the Santa Ana Division of the Federal District Court for the Central District of California, suffered default judgments totaling nearly two million dollars

Debtor(s) at 18, *In re Arizmendez*, No. 12-10200 (Jan. 18, 2012), ECF No. 11. She indicated her sole ownership of a single-family residence in Chino, California, subject to a secured claim of \$399,451.66 and estimated to be underwater by \$119,451.66. Schedule A – Real Property at 5, *In re Arizmendez*, No. 12-10200 (Jan. 18, 2012), ECF No. 11. The judge confirmed a five-year chapter 13 plan calling for payments of \$465 per month based on disposable income of \$27,900 over the period of the plan. Order Confirming Chapter 13 Plan, *In re Arizmendez*, No. 12-10200 (Mar. 21, 2012), ECF No. 28. Heritage filed a claim for \$97,959.60. Proof of Claim at 1, *In re Arizmendez*, No. 12-10200 (Mar. 9, 2012), Claim 3-1. An entity known as VAK M12 FUND, L.L.C. later filed notice that Heritage had assigned the claim to VAK, Transfer of Claim Other Than For Security, *In re Arizmendez*, No. 12-10200 (Mar. 7, 2013), ECF No. 36, suggesting that Heritage may have sold to others at least some of the judgments it had obtained. Ms. Arizmendez converted the case to chapter 7 on December 31, 2013. Notice That The Case Has Been Converted to Chapter 7 from Chapter 13, *In re Arizmendez*, No. 12-10200 (Jan. 2, 2014), ECF No. 50. The court thereafter granted her a chapter 7 discharge. Discharge of Debtor, *In re Arizmendez*, No. 12-10200 (Apr. 15, 2014), ECF No. 69. VAK M12 FUND, L.L.C. did not file an adversary proceeding to determine the dischargeability of the debt assigned to it by Heritage. Docket, *In re Arizmendez*, No. 12-10200 (Jan. 4, 2012).

PACER searches on the other *Chao* defendants against whom default judgments were entered revealed either no bankruptcy filing or a bankruptcy filing by more than one person with the same name.

⁴⁷ See CAL. CIV. PROC. CODE § 580b (2012).

⁴⁸ See *id.* § 726g.

⁴⁹ Analysis of the docket indicates that Heritage requested dismissal of many defendants for whom it had not filed a proof of service of summons and complaint and against whom it therefore had not requested or obtained a default; as to these defendants it was presumably unable to effectuate service. Heritage requested dismissal of a few other defendants after obtaining their default and naming them in its initial but not in its second motion for default judgment. Heritage requested dismissal of a few other defendants who had filed answers (one of whom had filed a motion for summary judgment, one of whom had filed a third party complaint, and one of whom had filed a counterclaim) and one who had filed bankruptcy. The court ordered dismissal in response to all of these requests except as to the defendant who had filed bankruptcy, a second defendant jointly sued with her spouse, and a third defendant as to whom Heritage had filed a stipulation to dismiss. The case was closed with no further docket entries as to the three remaining defendants. See Docket, *Chao*, No. 09-01466 (Dec. 11, 2009).

notwithstanding the same infirmities that led two other judges to dismiss 107 defendants in the other two Heritage lawsuits.

B. *The California Superior Court Actions*

Notwithstanding its success against twenty-three defendants sued in *Chao*, Heritage filed no further actions in any California federal district court. Instead, Heritage began filing actions in California Superior Court as early as March 2010.⁵⁰ A detailed analysis of those lawsuits is beyond the scope of this Article, in part because there are so many of them and in part because obtaining the relevant records would be extraordinarily time-consuming and expensive.⁵¹ But a brief survey of some of the easily accessible data about some of those lawsuits provides additional important context for analysis of the adversary proceedings.

Heritage filed at least 534 civil actions in California's ten most populous counties.⁵² There is ample reason to believe that the core allegations of most if not

⁵⁰ Heritage may have filed some of these actions against defendants dismissed from the federal district court actions because of improper joinder, but discovering the extent to which it did so is beyond the scope of this study.

⁵¹ The California Superior Court operates at the county level. California has fifty-eight counties, many of which do not provide for online retrieval of either basic case information or records filed in a case. Some larger California counties provide for online name searches and some provide for online retrieval of basic case information (party names, case numbers, nature of the case, names of documents filed, and identification of rulings, judgments, and other events), either for a nominal fee or for free. A few also provide for online retrieval of images of some records filed in some cases, typically only for a fee.

⁵² Heritage filed 195 actions in Los Angeles County (civil party name search function available at SUPERIOR COURT OF CAL., CNTY. OF L.A., *Party Name Search*, <https://www.lacourt.org/paonlineservices/civilindex/cipulbicmain.aspx?> (last visited Mar. 2, 2015)), 81 actions in Orange County (case index search function available at SUPERIOR COURT OF CAL., CNTY. OF ORANGE, *Case Index*, <https://ocapps.occourts.org/CourtIndex/> (last visited Mar. 2, 2015)), 74 actions in Riverside County (civil case name search function available at RIVERSIDE SUPERIOR COURT, PUB. ACCESS, *Civil Main Menu*, <http://public-access.riverside.courts.ca.gov/OpenAccess/CivilMainMenu.asp> (last visited Mar. 2, 2015)), 51 actions in Sacramento County (civil party name search available at SACRAMENTO SUPERIOR COURT, PUB. CASE ACCESS, *Search by Name - Civil*, <https://services.saccourt.ca.gov/PublicCaseAccess/Civil/SearchByName> (last visited Mar. 2, 2015)), 47 actions in San Bernardino County (civil party name search available at SUPERIOR COURT OF CAL., CNTY. OF SAN BERNARDINO, *Court Case Information and Document Sales*, <http://www.sb-court.org/Divisions/Civil/CaseInformationOnline.aspx> (last visited Mar. 2, 2015)), 39 actions in San Diego County (civil party name search available at SUPERIOR COURT OF CAL., CNTY. OF SAN DIEGO, *Party Name Search*, <http://courtindex.sdcourt.ca.gov/CISPublic/namesearch> (last visited Mar. 2, 2015)), 24 actions in Contra Costa County (civil party name search available at SUPERIOR COURT OF CAL., CNTY. OF CONTRA COSTA, *Online Case and Calendar Information*, <http://www.cc-courts.org/index.cfm?fuseaction=Page.ViewPage&pageId=6736> (last visited Mar. 2, 2015)), 11 actions in Santa Clara County (civil party name search available at SUPERIOR COURT OF CAL., CNTY. OF SANTA CLARA, *Public Access Civil Case Information Website*, http://www.sccaseinfo.org/pa6.asp?display_name=index_party (last visited Mar. 2, 2015)), 9 actions in Fresno County, (civil party name search available at SUPERIOR COURT OF CAL., CNTY. OF FRESNO, *Smart Search*, <https://publicportal.fresno.courts.ca.gov/FRESNOPORTAL/> (last visited July 13, 2015)), and 3 actions in Alameda County (civil party name search available at SUPERIOR COURT OF CAL., CNTY. OF ALAMEDA, *DomainWeb*, <https://publicrecords.alameda.courts.ca.gov/PRS/Home/Disclaimer> (last visited Mar. 2, 2015)).

all of those actions mimicked those in the district court actions. First, several online indices identify these actions as seeking relief for fraud, a description consistent with the nature of the claims asserted in the district court actions, and some of the online indices identify the actions as being unlimited civil cases (cases in which the claim exceeds \$25,000),⁵³ an amount consistent with the amount of the claims asserted in the district court actions. Second, online indices indicate that Heritage filed all of these actions between March 9, 2010 and October 22, 2010, suggesting the likelihood of boilerplate allegations in identical lawsuits. Reinforcing this inference, online records for which the information is available identify the law firm that represented Heritage in the state court proceedings as either of the two law firms that represented Heritage in the district court proceedings. Third, the time period during which Heritage filed these actions in part slightly overlaps but in larger part slightly precedes the time period during which Heritage filed the adversary proceedings.⁵⁴ That timing suggests that Heritage sued individuals in state court and thereafter filed adversary proceedings against state court defendants who filed bankruptcy (hence invoking the automatic stay) during the pendency of the state court action.⁵⁵ Finally, the complaints filed in a small sample of these actions mimic one another and largely mimic the complaints in the district court actions, and some of them, like the district court actions, join multiple defendants and include the same boilerplate allegations against each defendant.⁵⁶

⁵³ See CAL. CIV. PROC. CODE §§ 85–88 (2012).

⁵⁴ Heritage filed 42 of the 218 adversary proceedings within the same time period. With the exception of one adversary proceeding filed in April 2012, Heritage filed all of the remaining adversary proceedings between October 22, 2010 and November 11, 2011.

⁵⁵ Cases involving defendants Javier Tovar and Jesus Montano exemplify this pattern. Heritage sued Javier Tovar on February 4, 2010, in one of its three district court actions. See Complaint for Damages, Specific Performance, & Other Equitable Relief at 2, 7, Heritage Pac. Fin., L.L.C. v. David, No. 10-00133 (C.D. Cal. Feb. 4, 2010), ECF No. 1. The district court dismissed him and others for improper joinder on May 14, 2010. See Civil Minutes – General, *David*, No. 10-00133 (May 14, 2010), ECF No. 67. Heritage then sued him in Los Angeles County Superior Court on June 11, 2010. Civil party name search function available at SUPERIOR COURT OF CAL., CNTY. OF L.A., *Party Name Search*, <https://www.lacourt.org/paonlineservices/civilindex/cipublicmain.aspx?> (last visited Mar. 2, 2015). He filed a bankruptcy petition on July 30, 2010. See Petition of Javier Tovar, *In re Tovar*, No. 10-41664 (Bankr. C.D. Cal. July 30, 2010), ECF No. 1. Heritage filed an adversary proceeding against him on November 5, 2010. See Complaint to Determine Dischargeability of Debt, *In re Tovar*, No. 10-03016 (Nov. 5, 2010), ECF No. 1.

Heritage joined Jesus Montano as one of several defendants in an action filed in Alameda County Superior Court on May 6, 2010. See Complaint for Damages at 1–2, Heritage Pac. Fin., L.L.C. v. Cloird, No. 10514182 (Cal. Super. Ct. May 6, 2010) (on file with author). He filed a bankruptcy petition on October 13, 2010. See Petition of Jesus Montano, *In re Montano*, No. 10-71788 (Bankr. N.D. Cal. Oct. 13, 2010), ECF No. 1. Heritage filed an adversary proceeding against him on January 9, 2011. See Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Montano*, No. 11-04008 (Jan. 9, 2011), ECF No. 1.

⁵⁶ The sample, on file with the author, consists of complaints in: Heritage Pac. Fin., L.L.C. v. Cloird, No. 10514182 (Cal. Super. Ct. May 6, 2010); Heritage Pac. Fin., L.L.C. v. Duran, No. 30-2010-00372102 (Cal. Super. Ct. May 13, 2010); Heritage Pac. Fin., L.L.C. v. Aquino, No. CIV 495303 (Cal. Super. Ct. May 20, 2010); Heritage Pac. Fin., L.L.C. v. Bulan, No. CIV 495304 (Cal. Super. Ct. May 20, 2010); and Heritage Pac. Fin., L.L.C. v. Salvi, No. CIV 497206 (Cal. Super. Ct. July 26, 2010). The sample also consists of "previews" of portions of five complaints filed in the County of Sacramento, in which the names of the defendants, the case numbers, and the filing dates are obscured unless downloaded for a fee, and the first

Judges in at least two of these actions, both presiding in the Santa Clara County Superior Court, entered summary judgment against Heritage on the basis of the limitation on fraud claims in section 726(g) of the California Code of Civil Procedure.⁵⁷ That conclusion replicated the conclusion reached by the federal district court judge in *David*, previously discussed,⁵⁸ but, as we shall see, rescued a defendant in only one of the 218 adversary proceedings.⁵⁹ And in the only one of the Heritage state court actions that reached the appellate level, a California court of appeal affirmed a trial court judgment against Heritage on the basis of what amounted to a lack of standing defense that had not surfaced in any of the district court actions and surfaced only rarely in the adversary proceedings.⁶⁰

The court of appeal's description of the alleged facts typifies the facts alleged in both the district court actions and in the adversary proceedings. In 2006, Maribel Monroy purchased her son's residence in Richmond, California for \$425,000.⁶¹ WMC Mortgage Corp. ("WMC") financed 100 percent of the purchase price with two loans, one for \$340,000 secured by a senior deed of trust and a second for \$85,000 secured by a junior deed of trust.⁶² After her default in mortgage payments, the holder of the senior mortgage foreclosed.⁶³ Heritage thereafter acquired the sold out junior note as part of its acquisition of a larger pool of notes.⁶⁴

Heritage filed its superior court action against Ms. Monroy on June 1, 2010, alleging her misrepresentation of income on her loan application and pleading causes of action for intentional and negligent misrepresentation, fraudulent concealment, and promissory fraud.⁶⁵ It did so after its apparently common, but in her case unsuccessful, pre-litigation collection activities.⁶⁶ It had sent Ms. Monroy an initial notice that it had purchased her unpaid junior note, attempted to speak with her, sent her a second notice of its ownership of the note, and sent her a third notice asserting her obligation to pay Heritage on the note.⁶⁷ Shortly after filing the

page of five complaints filed in the County of Riverside. The complaints in the state law sample differ from the complaints in the three district court proceedings in two principal respects: they substitute for breach of contract a cause of action for promise without intent to perform and they seek prejudgment interest and an unspecified amount of punitive damages.

⁵⁷ See Order Re: Motion for Summary Judgment and Summary Adjudication, *Heritage Pac. Fin., L.L.C. v. Pena*, No. 1-10-CV-173402 (Cal. Super. Ct. Mar. 20, 2012) (on file with author); Order Re: Motion for Summary Judgment and Summary Adjudication, *Heritage Pac. Fin., L.L.C. v. Jiminez*, No. 1-10-CV-171231 (Cal. Super. Ct. Mar. 19, 2012) (on file with author).

⁵⁸ See *supra* text accompanying notes 30–32.

⁵⁹ See *infra* text accompanying notes 241–44.

⁶⁰ *Heritage Pac. Fin., L.L.C. v. Monroy*, 156 Cal. Rptr. 3d 26 (Cal. Ct. App. 2013), *petition for review denied*, 2013 Cal. LEXIS 6631 (Cal. July 31, 2013).

⁶¹ *Id.* at 33.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ See *Monroy*, 156 Cal. Rptr. 3d at 33.

⁶⁷ *Id.* Deposition testimony in another case, by Ben Ganter, self-described managing partner and head of the legal department of Heritage, suggests that Heritage typically pursued this type of pre-litigation activity. It would "[s]end them letters, try and dig any more information out of them, you know, find out their ability

action, Heritage sent her a copy of the complaint and summons together with a letter advising her, among other things, that it had filed the action and encouraging her to contact Heritage to try to resolve the matter short of litigation.⁶⁸

The court of appeal agreed with the trial court's conclusion that Heritage had failed, in three attempts, to adequately allege the originating lender's assignment of a fraud claim to Heritage.⁶⁹ Indorsement of the note to Heritage from the originating lender assigned only a contract claim (barred by anti-deficiency legislation).⁷⁰ Neither an allegation of an industry custom and practice to assign a fraud claim with assignment of a note, nor a declaration from a representative of the originating lender two years after the sale of the notes, was sufficient to show an intention to assign a fraud claim.⁷¹ The trial court had invited Heritage to attach to an amended complaint a copy of any written assignment by the originating lender.⁷² Instead of doing so, Heritage's second amended complaint alleged that the "loan sell agreement" implied assignment of the fraud claim by using the following language: "Seller does hereby sell, assign and convey to Buyer, its successors and assigns, all right, title and interest in the loan."⁷³ That allegation was insufficient to plead the originating lender's intent to assign a fraud claim.⁷⁴

In other words, Heritage lacked standing to assert the fraud claim because it did not own it. This defense, standing alone (no pun intended), likely would have defeated many if not all of Heritage's actions, in district court, in state court, and in the adversary proceedings, but the March 29, 2013 decision in *Monroy* came too late for perhaps hundreds of other defendants sued by Heritage and an unknown number of others who may have settled with Heritage in response to its pre-litigation collection activities.⁷⁵

to pay and come up with settlement agreements." Oral Deposition of Benjamin A. Ganter, *supra* note 6, at 19 (on file with author).

⁶⁸ *Id.* at 34. A copy of what appears to be an identical (and therefore form) letter sent by Heritage to another individual on July 26, 2010 is on file with the author.

⁶⁹ *Monroy*, 156 Cal. Rptr. 3d at 42.

⁷⁰ *Id.* at 42.

⁷¹ *Id.* at 41, 43.

⁷² *Id.* at 34.

⁷³ *Id.* at 35. Copies of each of the three loan sale agreements on file with the author contain comparable language.

⁷⁴ *Id.* at 36.

⁷⁵ The *Monroy* decision did not come too late to rescue defendant Mary Aquino, sued by Heritage in another state court action. Complaint for Damages, Heritage Pac. Fin., L.L.C. v. Aquino, No. CIV 495303 (Cal. Super. Ct. May 20, 2010) (on file with author). Following the court's denial of Ms. Aquino's earlier, pre-*Monroy*, motion for summary judgment on the ground that "the lender's mortgage fraud claims passed, as a matter of course, with the transfer of the note to Plaintiff," Order Denying Motion for Summary Judgment by Defendant Mary Aquino at 3, *Aquino*, No. CIV 495303 (July 30, 2012) (on file with author), Ms. Aquino's counsel renewed the motion after the *Monroy* decision. In response, the court, citing *Monroy*, dismissed the complaint with prejudice, stating: "Neither the November 2, 2007, Sale and Assignment Agreement between WMC Mortgage Corporation [the originating lender] and Mountain View Capital Mortgage Trust [the initial assignee], nor the January 20, 2009, Mortgage Loan Sale Agreement between Promore Investments, L.L.C. and HERITAGE PAC. FIN., L.L.C., manifest an intent to transfer tort claims." Judgment of Dismissal With Prejudice at 2, *Aquino*, No. CIV 495303 (Dec. 19, 2013) (on file with author).

Moreover, the *Monroy* decision does not offer enduring protection against fraud claims asserted by debt buyers. It teaches future debt buyers to insist on express assignment of fraud claims in future debt purchase agreements. When debt buyers purchase note pools from intermediate assignees, the assignment of fraud claims would also have to be expressed in each previous assignment up the line to the originating lender. It would not be surprising if this lesson were to penetrate the market sufficiently to prompt originating lenders and intermediate assignees to include the necessary boilerplate language in all future debt purchase agreements, thus obviating this standing defense.

II. HERITAGE ADVERSARY PROCEEDINGS IN CALIFORNIA BANKRUPTCY COURTS

A. *An Overview*

Between February 24, 2010 and April 23, 2012, Heritage filed 218 adversary proceedings in California bankruptcy courts against individuals who had filed chapter 7 or chapter 13 bankruptcy petitions.⁷⁶ It filed 40 in the Bankruptcy Court for the Northern District of California, 37 in the Bankruptcy Court for the Eastern District of California, 125 in the Bankruptcy Court for the Central District of California, and 16 in the Bankruptcy Court for the Southern District of California.⁷⁷ Forty-seven different bankruptcy judges presided in these proceedings, ten in the Northern District, seven in the Eastern District, twenty-five in the Central District,

⁷⁶ Debtors named in eighteen of the adversary proceedings had filed chapter 13 petitions, either individually or jointly with a spouse; the debtor in one of them converted to a chapter 7 proceeding. The balance of the debtors had filed chapter 7 petitions, either individually or jointly with a spouse. Bankruptcy courts dismissed three adversary proceedings following dismissal of the underlying chapter 13 proceeding and three other adversary proceedings following dismissal of the underlying chapter 7 proceeding.

⁷⁷ PACER's Bankruptcy Party Search in each of these districts under the name "Heritage Pacific Financial" revealed more than 218 entries for adversary proceedings, but many of the entries were duplicates.

Jurisdiction of the Northern District, allocated among four divisions, covers Northern California coastal counties from Monterey County in the South to Del Norte County at the Oregon border. See U.S. DIST. COURT, N. DIST. OF CAL., *Jurisdiction Map*, <http://www.cand.uscourts.gov/jurisdictionmap> (last visited Mar. 4, 2015). Jurisdiction of the Eastern District, allocated among three divisions, covers counties, largely in California's Central Valley, from Kern County in the South to Siskiyou and Modoc Counties at the Oregon border. See U.S. BANKR. COURT, E. DIST. OF CAL., *District Map*, <http://www.caeb.uscourts.gov/Locations/DistrictMap.aspx> (last visited Mar. 4, 2015). Jurisdiction of the Central District, allocated among five divisions, covers Los Angeles, Orange, Riverside, San Bernardino, San Luis Obispo, Santa Barbara, and Ventura counties. See U.S. DIST. COURT, C. DIST. OF CAL., *Jurisdiction Map for the Central District of California*, <http://www.cacd.uscourts.gov/jurisdiction> (last visited Mar. 4, 2015). Jurisdiction of the Southern District, allocated to one division, covers San Diego and Imperial counties in the southern end of the state. See U.S. MARSHALS SERV., *Southern District of California, Area of Service*, <http://www.usmarshals.gov/district/ca-s/general/area.htm> (last visited Mar. 4, 2015). For division locations in each district, see U.S. BANKR. COURT, E. DIST. OF CAL., *United States Bankruptcy Courts Within California*, <http://www.caeb.uscourts.gov/documents/Forms/EDC/EDC.002-070.pdf> (last visited Mar. 4, 2015).

and five in the Southern District.⁷⁸ Twenty-three of the judges presided in at least five separate proceedings.

As in its federal district court and state court actions, Heritage alleged in each adversary proceeding that a lender had loaned the defendant⁷⁹ money relying on a defendant's intentional misrepresentations in a loan application and that Heritage owned the relevant promissory note.⁸⁰ Virtually every complaint alleged on information and belief that the defendant's loan application had misrepresented the defendant's employment, income, or intended use of the property as a primary residence; a few alleged the loan application's misrepresentation of the defendant's liabilities.⁸¹ Each complaint sought a judgment that the unpaid debt was nondischargeable in the debtor's bankruptcy because the debt was for money obtained on the basis of one or both of the species of fraud described in section 523(a)(2) of the Bankruptcy Code: (A) false pretenses, a false representation, or actual fraud other than a statement respecting the debtor's financial condition;⁸² (B) a materially false statement in writing respecting the debtor's financial condition, made with the intent to deceive, upon which the creditor to whom the debtor is liable reasonably relied.⁸³

In the 218 proceedings, Heritage sued 266 individuals⁸⁴ for claims totaling \$21,267,016. The claims in each of the adversary proceedings were substantial, ranging from \$11,773 to \$458,596,⁸⁵ with a median claim of \$89,363. Figure 1 depicts the number of claims by amount (grouping the amounts in \$15,000 increments starting with the lowest claim of \$11,773). Claim distributions in each of the four federal districts roughly mirror this distribution among all districts combined.⁸⁶

⁷⁸ Because of judicial reassignments, two judges presided successively in seventeen of the proceedings and three judges presided successively in three of the proceedings.

⁷⁹ For convenience, this Article uses the singular "defendant" or its singular possessive even though Heritage joined co-defendants in forty-eight of the proceedings.

⁸⁰ See, e.g., Complaint to Determine Dischargeability of Debt at 2–4, *In re Countouriotis*, No. 10-02774 (Bankr. E.D. Cal. Nov. 30, 2010), ECF No. 1.

⁸¹ For a discussion of five iterations of the complaint, see *infra* note 112.

⁸² See 11 U.S.C. § 523(a)(2)(A) (2012).

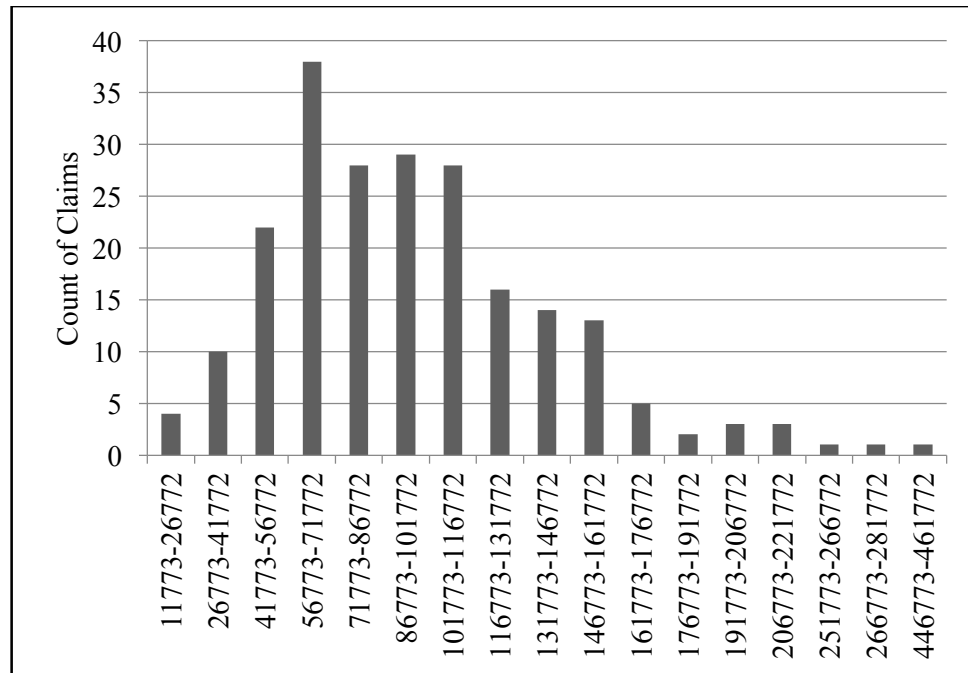
⁸³ See *id.* § 523(a)(2)(B).

⁸⁴ In forty-eight of the proceedings, Heritage joined co-borrowers, typically spouses at the time of the loan application.

⁸⁵ The largest note was for \$200,000. The \$458,596 claim appeared in a complaint asserting liability on three separate notes.

⁸⁶ Figures depicting the claim distribution for each of the four federal districts are available from the author.

FIGURE 1: Claim Distribution



In almost every proceeding, Heritage's claim equaled or was only slightly lower than the face amount of the note, both because defendants had purportedly failed to make any payments, or only nominal payments, on the notes, and because Heritage did not pursue any claim to accumulated and unpaid interest on the notes. Heritage also did not pursue any claim to its attorney's fees although its complaints in the adversary proceedings included both a prayer requesting attorney's fees and an allegation that its damages included attorney's fees.⁸⁷

⁸⁷ Heritage may not have been entitled to a judgment that included attorney's fees even though all but a handful of the 175 notes available through PACER included boilerplate language entitling the lender to attorney's fees. At least in the Ninth Circuit, a creditor obtaining a judgment of nondischargeability under section 523(a)(2) of the Bankruptcy Code would be entitled to attorney's fees for the adversary proceeding only if it would have been entitled to such fees in a non-bankruptcy court. See *In re Pham*, 250 B.R. 93, 97–99 (B.A.P. 9th Cir. 2000), relying on *Cohen v. de la Cruz*, 523 U.S. 213, 224 (1998). In California, a party may recover its attorney's fees in litigating a tort claim if the parties had so agreed in a contract between them. See *In re Chen*, 345 B.R. 197, 200 (N.D. Cal. 2006) (citing CAL. CIV. PROC. CODE § 1021 (2012)). The wording of an attorney's fee provision in a contract determines whether there is a contractual right to recover attorney's fees in litigating a tort claim. See *Santisas v. Goodin*, 951 P.2d 399, 405 (Cal. 1998). The author did not examine the attorney's fees provisions in the notes on which Heritage sued to assess whether they were worded broadly enough to encompass recovery of attorney's fees in an action for fraud, but a bankruptcy court did so in one of the adversary proceedings. Relying on *Chen*, it denied a motion for attorney's fees in part because of its conclusion that the language of the note was not broad enough to encompass a fraud claim. See Docket Text Order, *In re Palines*, No. 12-03063 (Bankr. N.D. Cal. Jan. 15, 2013). Paragraph 4(D) of the relevant promissory note (incorrectly referred to in the Docket Text Order as

An attorney represented the defendant throughout a proceeding in 51.4 percent of the proceedings and for only portions of a proceeding in another 11.5 percent of the proceedings.⁸⁸ Defendants represented themselves in 21.1 percent of the proceedings and failed to appear in 16 percent of the proceedings.

Information about the amount of Heritage's recovery from a defendant is available for 210 of the 218 proceedings. It recovered nothing in ninety-four of those 210 proceedings (45 percent).⁸⁹ It suffered seven judgments of dischargeability, four on summary judgment and three following trial.⁹⁰ It acquiesced to dismissal with no payment to Heritage, based on mutual releases, in forty-nine filed written settlement agreements. Bankruptcy courts dismissed twenty-six other proceedings on Heritage's unilateral requests for dismissal,⁹¹ and dismissed, or entered a judgment against Heritage, in twelve proceedings for other reasons.⁹²

In the remaining 116 adversary proceedings for which the information is available (55 percent), Heritage recovered at least \$2,142,561 in aggregate (approximately 10 percent of its total claims), consisting of \$1,138,564 owing by

"para. 5D") provided simply for the note holder's recovery of attorney's fees for the borrower's failure to pay the note holder as required. See Plaintiff's Complaint to Determine Dischargeability of Debt at 13, *In re Palines*, No. 12-03063 (Apr. 23, 2012), ECF No. 1.

⁸⁸ An attorney substituted in for a pro se defendant at various stages in eighteen proceedings and substituted out in favor of a pro se defendant in four proceedings. In two proceedings, an attorney substituted out in favor of a pro se defendant who later retained a second attorney, and in one proceeding an attorney substituted in for a pro se defendant but later substituted out in favor of the pro se defendant.

⁸⁹ This includes one proceeding in which the parties settled for payment of one dollar to Heritage.

⁹⁰ Heritage appealed one of the four summary judgments of nondischargeability, probably because it was based on an issue of law—the applicability of section 726(g) of the California Code of Civil Procedure—the resolution of which was critical to its chances in many other cases. The Ninth Circuit Bankruptcy Appellate Panel affirmed the summary judgment and Heritage did not appeal further. See *In re Montano*, 501 B.R. 96 (B.A.P. 9th Cir. 2013). For a discussion of this proceeding, see *infra* text accompanying notes 241–44.

Heritage appealed one of the three trial judgments of nondischargeability, rendered in a proceeding in which the defendant had, through trial, represented himself pro se. The Ninth Circuit Bankruptcy Appellate Panel affirmed the judgment and Heritage did not appeal further. See *In re Trejo*, Ch. 7 No. NC-11-1652-HPaMk, 2012 Bankr. LEXIS 5881, at *20 (B.A.P. 9th Cir. Dec. 20, 2012).

⁹¹ A court order of dismissal followed each request except in one case in which the court simply closed the proceeding without an order of dismissal. Although the available records do not reveal reasons for these Heritage requests, some of the requests likely reflected its assessment of ultimate success or failure before the judge involved. For example, one request followed a court's denial of a Heritage motion for a default judgment in the proceeding. See, e.g., Request for Dismissal of Adversary Proceeding Against Defendant, *In re Cox*, No. 11-90357 (Bankr. S.D. Cal. May 18, 2012), ECF No. 24, following two weeks after the court denied a motion for default judgment for insufficient evidence of a false representation or materiality of the representation, Memo re Order: Request for further documentation or further action, *In re Cox*, No. 11-90357 (May 4, 2012), ECF No. 20.

⁹² A court dismissed four proceedings for failure to prosecute. See, e.g., Order Dismissing Adversary Proceeding for Failure to Prosecute, *In re Diaz*, No. 10-01335 (Bankr. C.D. Cal. Oct. 10, 2011), ECF No. 19. It dismissed one for failure to timely schedule a default prove-up hearing. See *infra* notes 369–74 and accompanying text. It dismissed six because of dismissal of the underlying chapter 7 or chapter 13 proceeding. See, e.g., Order Dismissing Adversary Proceeding, *In re Dominguez*, No. 11-01646 (Bankr. C.D. Cal. July 11, 2011), ECF No. 5. It entered a judgment against Heritage in one proceeding for unspecified "good cause" on the day of trial. See Civil Minute Order, *In re Mindt*, No. 11-02217 (Bankr. E.D. Cal. Oct 5, 2011), ECF No. 12.

virtue of ten default judgments, one summary judgment, two judgments following trial,⁹³ and \$1,003,997 pursuant to 103 filed written settlement agreements.⁹⁴ The default judgments, summary judgment, and judgments following trial ranged in amounts from \$49,721 to \$147,710.⁹⁵ Table 1 summarizes this data.

TABLE 1: Recovery by Heritage
(210 of 218 adversary proceedings)

	<i>Filed Settlement Agreements</i>	<i>Heritage Requests Dismissal</i>	<i>Dismissal for Other Reasons</i>	<i>Default Judgments</i>	<i>Summary Judgments</i>	<i>Trials</i>
\$0 recovery by Heritage	49	26	12	Eight motions denied*	4	3
>\$0 recovery by Heritage	103 (\$1,003,997)	N/A	N/A	10** (\$867,996)	1 (\$61,417)	2 (\$209,151)

* Excludes one proceeding in which evidence in support of motion for default judgment not available from PACER.

** Excludes default judgment in one proceeding in which default (and hence default judgment) was later set aside.

Each of the written settlement agreements calling for payment to Heritage provided for payment of significantly less than the amount of Heritage's claim against the settling defendant, typically through installment payments. Figures 2 and 3 depict the range of amounts defendants agreed to pay by way of settlement, expressed first in absolute numbers (ranging from \$500 to \$32,000) and second as a percentage of Heritage's claim against each defendant (ranging from .9 percent to 48.3 percent).⁹⁶

⁹³ A defendant in one of the two proceedings in which the court entered a judgment of nondischargeability following trial appealed the judgment. The Ninth Circuit Bankruptcy Appellate Panel affirmed the judgment and the defendant did not appeal further. *See In re Tovar*, Ch. 7 No. CC-11-1696-MkDKi, 2012 Bankr. LEXIS 3633 (B.A.P. 9th Cir. Aug. 3, 2012). For a discussion of this proceeding, *see infra* text accompanying notes 199–213.

⁹⁴ Ninety-four of the settlement agreements called for and resulted in entry of money judgments of nondischargeability under section 523(a)(2)(A) or 523(a)(2)(B) of the Bankruptcy Code, or both (or in one case entry of a monetary judgment without a judgment of nondischargeability). Ten of the settlement agreements resulted in the court's dismissal of the adversary proceeding without entry of judgment (or in one case closing of the proceeding without entry of an order of dismissal), based on money paid or promised to Heritage.

⁹⁵ Courts awarded Heritage 100% of its claim in twelve of these thirteen proceedings and, for unexplained reasons, only 95% of its claim in the other.

⁹⁶ Eleven settlement agreements provided a relatively small discount for early payment that is not reflected in the ensuing figures.

FIGURE 2: Settlement Amounts Owing in Installments

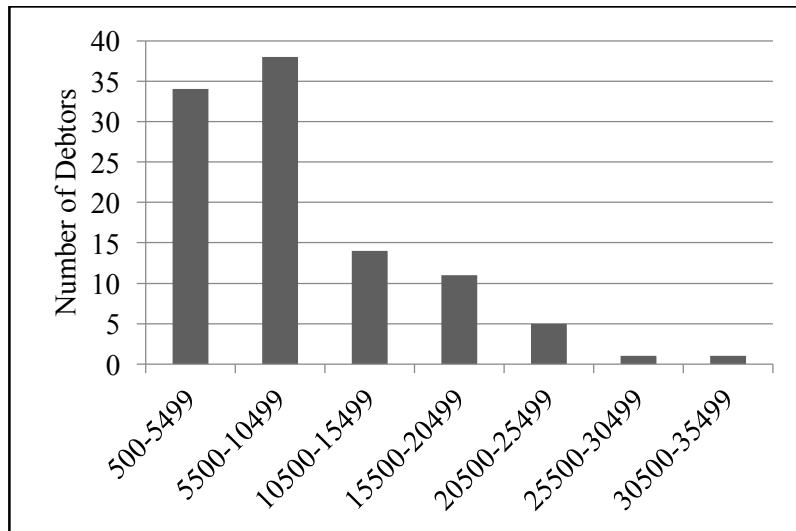
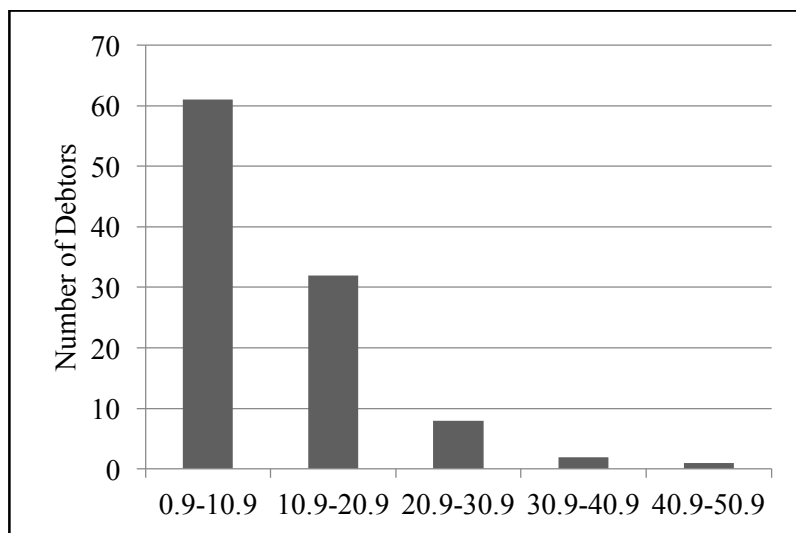


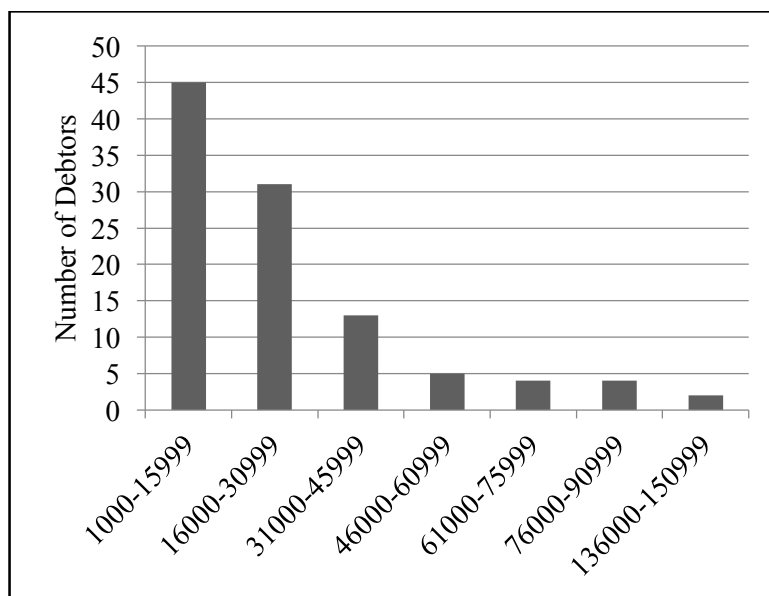
FIGURE 3: Percentage of Claim Owing in Installments



In seventy-eight of these settlement agreements, however, the defendant became liable for a larger sum, often a significantly larger sum, upon default in

installment payments.⁹⁷ The risk of default was not insignificant, given both the necessitous financial circumstances in which many debtors continue to find themselves after bankruptcy⁹⁸ and the often lengthy duration of the installment payments.⁹⁹ Figures 4 and 5 depict the range of amounts defendants agreed to pay upon default in installment payments, expressed first in absolute numbers (ranging from \$1000 to \$149,855) and second as a percentage of Heritage's claim against each defendant (ranging from 2.9 percent to 170 percent). Were every defendant to default in installment payments, Heritage (or its successor-in-interest) would become entitled to collect \$2,853,883 on the basis of settlement agreements.

FIGURE 4: Settlement Amounts Owing If Default in Installment Payments

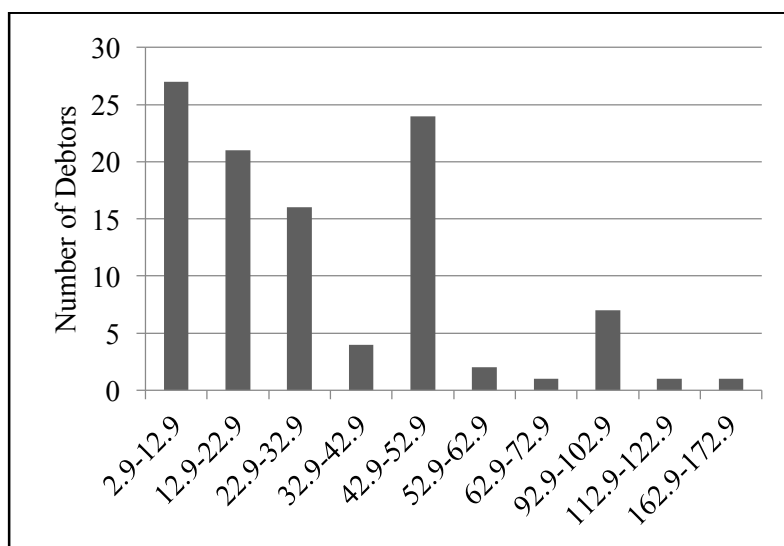


⁹⁷ These settlement agreements typically provided for entry of a judgment of nondischargeability for the larger amount that would not be enforced if the defendant timely made the agreed installment payments. *See, e.g.,* Stipulation for Judgment in Favor of Plaintiff, *In re Antunez*, No. 11-01569 (Bankr. C.D. Cal. Oct. 12, 2011), ECF No. 18. Bankruptcy courts would then enter a judgment of nondischargeability in accordance with the stipulation. *See, e.g.,* Judgment at 1–2, *In re Antunez*, No. 11-01569 (Oct. 19, 2011), ECF No. 19. A term in a settlement agreement stipulating to a later entry of a judgment in a larger amount if a party defaults in making installment payments totaling a smaller amount constitutes an unlawful and hence unenforceable liquidated damages term under California law. *See Greentree Fin. Grp., Inc. v. Execute Sports, Inc.*, 78 Cal. Rptr. 3d 24 (Cal. Ct. App. 2008) (decided before the Heritage adversary proceedings); *see also Purcell v. Schweitzer*, 169 Cal. Rptr. 3d 90 (Cal. Ct. App. 2014) (decided after the Heritage adversary proceedings). The same might be true when the settlement agreement provides for immediate entry of judgment for the larger amount not to be enforced absent default in installment payments. *See Chambreaux v. Coughlan*, 69 Cal. Rptr. 783 (Cal. Ct. App. 1968).

⁹⁸ *See* Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 CORNELL L. REV. 67, 88–93 (2006) (discussing financial plight of substantial minority of families after filing bankruptcy).

⁹⁹ Repayment periods ranged from a low of one month (seven defendants) to a high of fifteen years (one defendant), with a mean repayment period of 50.9 months and a median repayment period of sixty months.

FIGURE 5: Percentage of claim owing if default in installment payments



Heritage did not collect all of the money owing prior to its January 2014 bankruptcy filing, in part because some of the promised installment payments had not yet become due and in part because it claimed to own only a percentage interest in some of the judgments.¹⁰⁰ But defendants who have not yet paid Heritage could be pursued for payment by a debt collector employed by Heritage's bankruptcy trustee on a fifty percent commission basis.¹⁰¹

¹⁰⁰ In its bankruptcy schedules, Heritage lists as assets hundreds of unpaid judgments, discounts the face amount of each judgment 98% to reach an estimated fair market value of the judgments, and then claims only a 30% ownership in that market value. See Petition of Heritage Pacific Financial, L.L.C., *supra* note 3, at 9 (Schedule B), 17–21 (Attachment B-18). Reversing that mathematical process, one derives \$27,451,435 as the total face amount of unpaid judgments, much no doubt attributable to its state court actions. Heritage's Schedule B includes at least three judgments, one for \$120,000 against Javier Tovar, and two totaling \$144,037.51 against Maria Taraz, Petition of Heritage Pacific Financial, L.L.C., *supra* note 3, at 18, 20 (Attachment B-18), equal to the amount of the judgments rendered against them in an adversary proceeding. See Judgment, *In re Tovar*, No. 10-03016 (Bankr. C.D. Cal. Dec. 21, 2011), ECF No. 44; Judgment by Default, *In re Taraz*, No. 10-90456 (Bankr. S.D. Cal. Aug. 31, 2011), ECF No. 25 (judgment on two separate notes). Heritage's claim to 30% ownership seems consistent with its position, asserted elsewhere, that as to notes on which it filed suit, it owned only a temporary 1% ownership that reverted to a third party after judgment but as to which Heritage was entitled to a thirty percent fee on amounts collected. See Plaintiff Heritage Pacific Financial, L.L.C.'s Response in Opposition to Defendant's Motion for Contempt and Sanctions, *supra* note 2, at 6.

¹⁰¹ See Order Approving the Employment of Debt Collector, *In re Heritage Pac. Fin., L.L.C.*, No. 14-40107 (Bankr. E.D. Tex. Nov. 18, 2014), ECF No. 63. Amounts to be collected may include unlawful liquidated damages. See *supra* note 97. Such collection efforts might be minimal, however. Heritage's bankruptcy trustee recently wrote: "I hired Commercial Recovery Systems and they have collected \$0. Before I hired them I was assured how good at collecting they were. Once hired, they claim that the debts

B. Deconstructing the Outcomes

To deconstruct these starkly different outcomes in proceedings that were at core legally and factually identical, this section of the Article first briefly reviews two key elements of the *prima facie* case under section 523(a)(2) of the Bankruptcy Code: misrepresentations made with intent to deceive a creditor and a creditor's actual and either reasonable or justifiable reliance on the misrepresentations. It then discusses three findings in depth: (1) the dramatic differences in judicial response to Heritage's claim of reliance on misrepresentations by the originating lender; (2) the extent to which defendants failed to invoke the benefit of California's prohibition of the fraud claim Heritage was asserting; (3) the extent to which defendants overlooked two distinct arguments that Heritage lacked standing to assert its fraud claim.

Section 523(a)(2) of the Bankruptcy Code divides in two the universe of nondischargeable fraud claims: (1) false written statements about a debtor's or insider's financial condition,¹⁰² and (2) all other types of fraud, excluding both written and oral statements about a debtor's or insider's financial condition.¹⁰³ Although the two are mutually exclusive,¹⁰⁴ most elements of each claim are the same,¹⁰⁵ and all must be proved by a preponderance of the evidence.¹⁰⁶ In either case, the defendant must communicate a misrepresentation to a creditor intending to deceive the creditor and the creditor must rely on the misrepresentation.¹⁰⁷ The nature of the misrepresentation and the nature of the creditor's reliance distinguish the two. For a false written statement of financial condition, reliance must be reasonable; for all other kinds of fraud, reliance need only be justifiable.¹⁰⁸

are too old and too difficult to collect." E-mail from bankruptcy trustee Christopher Moser to author (Feb. 4, 2016) (on file with author).

¹⁰² See 11 U.S.C. § 523(a)(2)(B) (2012).

¹⁰³ See *id.* § 523(a)(2)(A).

¹⁰⁴ See *Eugene Parks Law Corp. Defined Benefit Pension Plan v. Kirsh (In re Kirsh)*, 973 F.2d 1454, 1457 (9th Cir. 1992).

¹⁰⁵ Section 523(a)(2)(A) requires proof of the traditional elements of common law fraud: a debtor's misrepresentation, fraudulent omission, or fraudulent conduct, knowledge of the falsity or deceptiveness, intent to deceive, justifiable reliance by the creditor, and damage to the creditor proximately resulting from such reliance. See *Turtle Rock Meadows Homeowners Ass'n v. Slyman (In re Slyman)*, 234 F.3d 1081, 1085 (9th Cir. 2000) (internal citations omitted) (indicating that creditor must establish these five elements to prevail). Except for the nature of the misrepresentation and the nature of reliance, section 523(a)(2)(B) requires proof of the same elements. See *Siriani v. Nw. Nat'l Ins. Co., of Milwaukee, Wis. (In re Siriani)*, 967 F.2d 302, 304 (9th Cir. 1992), *as amended* (June 29, 1992) (concluding that since sections 523(a)(2)(A) and 523(a)(2)(B) are "substantially similar," adoption of the same test is appropriate for both).

¹⁰⁶ See *Grogan v. Garner*, 498 U.S. 279 (1991); *Deitz v. Ford (In re Deitz)*, 760 F.3d 1038, 1050 (9th Cir. 2014).

¹⁰⁷ See *supra* note 105.

¹⁰⁸ Section 523(a)(2)(B) explicitly refers to *reasonable* reliance. 11 U.S.C. § 523(a)(2)(B) (2012). Section 523(a)(2)(A) is silent on the nature of the reliance required, *id.* § 523(a)(2)(A), but the Supreme Court of the United States held that the creditor's reliance under that section need only be *justifiable*. See *Field v. Mans*, 516 U.S. 59, 69–75 (1995). The Court's opinion explains the likely justification for requiring reasonable instead of justifiable reliance in the context of section 523(a)(2)(B):

To determine if a creditor's reliance was reasonable, a court must determine if the "creditor exercised the same degree of care expected from a reasonably prudent person entering into the same type of business transaction under similar circumstances."¹⁰⁹ Courts can make that determination, the Ninth Circuit has said, "without additional help."¹¹⁰ To determine if a creditor's reliance was justifiable, a court must consider the qualities and characteristics of the particular creditor and the circumstances of the particular case rather than a community standard of conduct.¹¹¹

Because the nature of the required reliance differs, it would have seemed significant for Heritage to have assessed whether alleged debtor misrepresentations about the defendant's income, employment, liabilities, or intended use of property qualified as false written statements of financial condition or rather as other types of fraud. Heritage seemed to struggle with that question, because its complaints evolved through several iterations reflecting seemingly different positions.¹¹² In the

The House Report on the Act suggests that Congress wanted to moderate the burden on individuals who submitted false financial statements, not because lies about financial condition are less blameworthy than others, but because the relative equities might be affected by practices of consumer finance companies, which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their own claims from discharge.

Id. at 76–77.

¹⁰⁹ *In re Machuca*, 483 B.R. 726, 736 (B.A.P. 9th Cir. 2012).

¹¹⁰ *Candland v. Ins. Co. of N. Am. (In re Candland)*, 90 F.3d 1466, 1471 (9th Cir. 1996).

¹¹¹ *See Field*, 516 U.S. at 71 (citing RESTATEMENT (SECOND) OF TORTS § 545A cmt. b (AM. LAW INST. 1976)).

¹¹² Heritage's first complaint, used in only the first two adversary proceedings, filed in February and March 2010, pleaded one claim for relief, alleging misrepresentations of income, employment, and intended use of the property, that relied exclusively on section 523(a)(2)(A). *See, e.g.*, Complaint to Determine Dischargeability of Debt, *In re Vega*, No. 10-01101 (Bankr. C.D. Cal. Mar. 10, 2010), ECF No. 1. Heritage may have abandoned this format so quickly upon realizing that misrepresentations about income might be governed instead by section 523(a)(2)(B). The second and third iterations of the complaint, used in adversaries filed from May through early December 2010 (thirty-one percent of the proceedings), pleaded one claim for relief, alleging the same misrepresentations, based on both section 523(a)(2)(A) and section 523(a)(2)(B), without distinguishing between the types of misrepresentations actionable under section 523(a)(2)(A) from those actionable under section 523(a)(2)(B). *See, e.g.*, Complaint to Determine Dischargeability of Debt, *In re Orozco*, No. 10-01599 (Bankr. C.D. Cal. Oct. 11, 2010), ECF No. 1. The third iteration added to the second only an allegation that Heritage had attempted to resolve the matter before filing suit by contacting the defendant's attorney. *See, e.g.*, Complaint to Determine Dischargeability of Debt at 2, *In re Birch*, No. 10-01480 (Bankr. C.D. Cal. Oct. 11, 2010), ECF No. 1. The fourth iteration of the complaint, used in proceedings filed from December 2010 through August 2011 (sixty-four percent of the proceedings), pleaded two claims for relief, one under section 523(a)(2)(A) for misrepresentations of intended use of the property, and the other under section 523(a)(2)(B) for misrepresentations of employment and income. It also added an allegation that Heritage's claims were not barred by anti-deficiency legislation. Unlike earlier iterations, it also attached a copy of the loan application and note as exhibits. *See, e.g.*, Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Vicente*, No. 11-02016 (Bankr. E.D. Cal. Jan. 9, 2011), ECF No. 1. It also added an allegation that Heritage's claims were not barred by anti-deficiency legislation. *Id.* at 4.

Heritage used another variation of its complaint in six of the last seven adversary proceedings that it filed, alleging in each only a misrepresentation of a defendant's liabilities. Five of them pleaded a claim for relief

proceedings in which the parties agreed to a dismissal with no payment to Heritage, the distinction obviously was moot. Even in the proceedings in which a defendant agreed to pay Heritage something, the defendant, Heritage, and the bankruptcy judges would have been indifferent to the distinction. In fact, most of the stipulated judgments of nondischargeability, drafted by Heritage and signed by a bankruptcy judge, stated that the debt was excepted from discharge "pursuant to 11 U.S.C. § 523(a)(2)(A)-(B)."¹¹³ Preceding such a settlement, however, the distinction might have been relevant if the parties perceived the distinction to be pertinent to the settlement value of the proceeding.

In all but a few cases, the defendants sued by Heritage had applied for loans via a Fannie Mae Uniform Residential Loan Application, a form that calls for information about a debtor's intended use of the real property subject to a contemplated mortgage and about a debtor's employment, monthly income, monthly housing expenses, assets, and liabilities.¹¹⁴ Clearly, a misrepresentation about a debtor's intended use of the property would not be a false written statement about the debtor's financial condition, so that claim should have proceeded exclusively on the basis of section 523(a)(2)(A), requiring only justifiable reliance by the lender. But misrepresentations in a loan application about income and liabilities constitute misrepresentations about a debtor's financial condition, so those claims should have proceeded exclusively on the basis of section 523(a)(2)(B), requiring reasonable reliance by the lender.¹¹⁵

under section 523(a)(2)(B). *See, e.g.*, Plaintiff's Complaint to Determine Dischargeability of Debt, *In re* Nsahlai at 4–5, No. 11-02983 (Bankr. C.D. Cal. Nov. 11, 2011), ECF No. 1. One pleaded a claim for relief under both section 523(a)(2)(A) and section 523(a)(2)(B). *See* Plaintiff's Complaint to Determine Dischargeability of Debt at 4, 5–6, *In re* Bettencourt, No. 11-01224 (Bankr. E.D. Cal. Aug. 28, 2011), ECF No. 1.

¹¹³ *E.g.*, Order (Settlement Agreement and Stipulation for Entry of Judgment) at 2, *In re* Agsalud, No. 10-90597 (Bankr. S.D. Cal. Jan. 19, 2012), ECF No. 18. At least one bankruptcy judge was more attentive to the distinction. In his order approving a settlement agreement, he struck the reference to section 523(a)(2)(A) but not the reference to 523(a)(2)(B). *See* Order (Stipulation for Entry of Judgment and Settlement) at 2, *In re* Torell, No. 11-01080 (Bankr. E.D. Cal. Nov. 30, 2011), ECF No. 47.

¹¹⁴ *See, e.g.*, Plaintiff's Complaint to Determine Dischargeability of Debt at 10–13, *In re* Castaneda, No. 10-01749 (Bankr. C.D. Cal. Dec. 14, 2010), ECF No. 1.

¹¹⁵ Courts differ on the meaning of a "statement . . . respecting the debtor's . . . financial condition." Some take the broad view that it encompasses any written statement that reflects the financial condition of the debtor, while others take the narrow view that it encompasses only written statements that provide information about the debtor's overall financial health. *See* *Schneiderman v. Bogdanovich* (*In re* *Bogdanovich*), 292 F.3d 104, 112–13 (2d Cir. 2002) (listing cases). The Ninth Circuit adopted the narrower view. *See In re Belice*, 461 B.R. 564, 573–78 (B.A.P. 9th Cir. 2011). Although Heritage filed all but one of its adversary proceedings before the December 2011 decision in that case, misrepresentations in a loan application of income and liabilities would seem to present a picture of the debtor's overall financial health. In two appeals to the Ninth Circuit Bankruptcy Appellate Panel involving a Heritage adversary proceeding, both decided after the court's decision in *Barnes*, the Panel did not consider the question. *See In re Tovar*, Ch. 7 No. CC-11-1696-MkDKi, 2012 Bankr. LEXIS 3633, at *30 (B.A.P. 9th Cir. Aug. 3, 2012) (assuming written statement regarding debtor's financial condition because not contested by appellant); *In re Trejo*, Ch. 7 No. NC-11-1652-HPaMk, 2012 Bankr. LEXIS 5881, at *11–19 (B.A.P. 9th Cir. Dec. 20, 2012) (affirming trial court conclusion that reliance was neither justifiable nor reasonable). Misrepresentations about the nature of one's employment may not qualify under the narrow view. *See, e.g., In re Carlson*, Ch. 7 No. WW-

Whatever the misrepresentations alleged, every defendant answering a complaint denied having made misrepresentations, or at least denied having made them with intent to deceive a creditor. Most did so in their answers with a simple denial;¹¹⁶ some added a boilerplate affirmative defense alleging fault of unnamed "others."¹¹⁷ Answers from other defendants more explicitly blamed a broker or real estate agent, as in the following three unedited excerpts from the answers of pro se debtors:

When I applied for a loan for the purchase of my house, all documentation was made by the sales agent, he only said to me: SIGN HERE, I wanted to have a home to live in with my family and fulfill my American dream, in no time I had the intension [sic] of doing some fraud on my behalf.

But the bad economic situation around world, affected my economy, I lost my job, I could not make monthly loan payments and lost my house.

I have never altered documents to make fraud; I don't speak or write English, everything was made by the sales agent.¹¹⁸

Because I am not well versed in purchasing property, I trusted my broker to provide me with accurate information. I signed the loan papers as instructed and the broker had completed the rest of it. Since that time, I have learned that the broker I used was indicted [sic] and convicted in federal court for fraud. I am a victim of his illegal activities and was none the wiser.¹¹⁹

I Oscar Villatoro pleading that all of this is not a fraud. Yes I did sign the paper but I did not know the real estate agent had put my income really high. I didn't realize what I was signing I gave all my

11-1486-KiJuH, 2012 Bankr. LEXIS 2304, at *22 (B.A.P. 9th Cir. May 22, 2012) ("[R]epresentations about sources of income that could be looked to for repayment are not statements of financial condition.").

¹¹⁶ See, e.g., Answer to Complaint to Determine Dischargeability of Debt, *In re Gomez*, No. 10-03197 (Bankr. N.D. Cal. Jan. 25, 2011), ECF No. 6.

¹¹⁷ See, e.g., Answer to Complaint at 3-4, *In re Taber*, No. 10-05395 (Bankr. N.D. Cal. Jan. 12, 2012), ECF No. 24.

¹¹⁸ Answer, *In re Barahona*, No. 11-02210 (Bankr. C.D. Cal. Aug. 1, 2011), ECF No. 8.

¹¹⁹ Notice of Motion and Motion to Set Aside Entry of Default Pursuant to Fed. R. Civ. P. 55(c) at 11, *In re Fontenot-Kenney*, No. 11-01953 (Bankr. C.D. Cal. Dec. 28, 2011), ECF No. 8.

information and paystubs to the agent so I trusted him. Should I have check [sic] what I was saying "yes", was I stupid for not checking "yes". Honestly I don't know what else to say, if Heritage Pacific Financial want [sic] to sue me, well I don't know how much they will get because I have nothing I don't make much. So this is my plea.¹²⁰

Bankruptcy courts found intentional misrepresentation in five of the seven proceedings in which they adjudicated that issue.¹²¹ The remaining adversary proceedings settled, were resolved by a bankruptcy court on other grounds, or were dismissed at Heritage's request. For most of the proceedings, therefore, we cannot assess the accuracy of Heritage's claims of intentional misrepresentations. But even assuming intentional misrepresentations of income or employment in every proceeding, it is nonetheless possible to compare results across a significant number of the proceedings, because intentional misrepresentation alone, without the appropriate degree of reliance, is insufficient to sustain a *prima facie* case. It is therefore to the question of reliance by the originating lender that this Article now turns.

1. Reliance, Like Beauty, is in the Eye of the Beholder

Heritage submitted evidence purporting to demonstrate reliance by the originating lender in twenty-nine proceedings: in a motion for default judgment in at least eighteen of nineteen proceedings,¹²² in support of or in opposition to a motion for summary judgment in six proceedings, and in five trials. In each of those contexts, some bankruptcy judges found the evidence sufficient and others found it insufficient to demonstrate the requisite reliance of the originating lender, even though, as detailed below, the evidence in most was either identical or functionally equivalent.

¹²⁰ Answer, *In re Villatoro*, No. 11-01315 (Bankr. C.D. Cal. May 31, 2011), ECF No. 5.

¹²¹ See Order Following Trial at 2, 4–5, *In re Trejo*, No. 10-05392 (Bankr. N.D. Cal. Nov. 2, 2011), ECF No. 33 (misrepresentations of income and employment deemed admitted from unanswered Request for Admissions); Order Granting Motion for Summary Judgment, *In re Gonzalez*, No. 11-02088 (Bankr. E.D. Cal. Sept. 20, 2011), ECF No. 19 (defendant encouraged by another to misrepresent income); Transcript of Trial, *supra* note 2, at 119–20 (misrepresentations of income, employment, and intended use of property); Transcript of Trial at 16–17, *In re Mabson*, No. 10-02445 (Bankr. C.D. Cal. Aug. 3, 2011), ECF No. 21 (misrepresentations of income and intended use of property); Findings of Fact and Conclusions of Law at 2, *In re Tovar*, No. 10-03016 (Bankr. C.D. Cal. Dec. 21, 2011), ECF No. 43 (unspecified false representations); Memorandum of Decision Re Defendant's Motion for Summary Judgment at 4, 7, 9, *In re Martinez*, No. 11-01131 (Bankr. C.D. Cal. Oct. 12, 2012), ECF No. 35 (misrepresentation of income, no misrepresentation of intended use of property or ownership of restaurant, and unresolved issue of material fact concerning intent to misrepresent income); Memorandum at 8–10, 12–13, *In re Vasquez*, No. 10-01663 (Bankr. C.D. Cal. Mar. 13, 2012), ECF No. 47 (insufficient evidence of false representations and insufficient evidence of intent to deceive).

¹²² Documents are not available from PACER for one of the nineteen motions for default judgment.

a. *In Motions for Default Judgment*

The troubling differences in outcome are most evident in the resolution of Heritage's motions for default judgment, each filed following a defendant's default. In support of each of its motions for default judgment, Heritage offered the declaration of Ben Ganter. Describing himself as Heritage's Director of Client Relations, Mr. Ganter declared his familiarity with Heritage's regular course of business and with its operations in the secondary mortgage market, which included the purchase of notes.¹²³ His declarations typically attached the defendant's loan application and promissory note as exhibits,¹²⁴ and routinely asserted that Heritage relied on the truthfulness of loan applications when it purchased loans.¹²⁵ This implausible assertion was in any event irrelevant because Heritage neither pleaded nor argued its own reliance as a predicate for its fraud claims.¹²⁶ His declarations did not claim his employment by or other association with any originating lender or any other basis to establish his personal knowledge of an originating lender's underwriting practices or its reliance on a specific loan application.¹²⁷ For that reason, some bankruptcy judges found his declaration insufficient to establish the originating lender's reliance. One bankruptcy judge put this bluntly in granting a judgment for the defendant after trial:

¹²³ See, e.g., Declaration of Ben Ganter in Support of Motion for Default Judgment at 1, *In re Wilson*, No. 10-01291 (Bankr. E.D. Cal. Apr. 14, 2011), ECF No. 17. In another proceeding, Mr. Ganter testified that he was a managing partner and custodian of records of Heritage. See Transcript of Trial, *supra* note 121, at 9. In testimony in a state law proceeding, Mr. Ganter described himself as managing partner and head of the legal department of Heritage, but not a lawyer. See Oral Deposition of Benjamin A. Ganter, *supra* note 6, at 8–9.

¹²⁴ See, e.g., Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment at 4, *In re Arana*, No. 10-01575 (Bankr. C.D. Cal. Feb. 1, 2011), ECF No. 8-2.

¹²⁵ See, e.g., Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment, *supra* note 124, at 3.

¹²⁶ Proof of Heritage's own reliance (in lieu of proof of reliance by the originating lender) would have sufficed to satisfy the reliance requirement of section 523(a)(2)(B) of the Bankruptcy Code, *In re Machuca*, 483 B.R. 726, 731 n.6 (B.A.P. 9th Cir. 2012), but Mr. Ganter's assertion that Heritage relied on representations in loan applications was implausible for several reasons. As previously indicated, *supra* note 4, Heritage purchased blocks of notes for at most pennies on the dollar several years after defendants represented income and employment in loan applications. Both the purchase price and timing of these purchases reflect the implicit understanding of seller and buyer that many of the notes will be uncollectible, either because of inaccuracy in income or employment information stated in the loan application or because of a subsequent change in the borrower's financial circumstances. Moreover, Mr. Ganter testified that when a portfolio of loans became available for purchase, and before bidding on the portfolio, a Heritage representative would visit the facility at which the loan files were stored, verify the existence of loan files, but not look at the loan application or other documents in the loan files. See Deposition of Benjamin Alan Ganter at 18–23, *Heritage Pac. Fin., L.L.C. v. Aquino*, No. CIV-495303 (Cal. Super. Ct. Nov. 16, 2011) (on file with author). One bankruptcy court commented on both the irrelevance and implausibility of Mr. Ganter's assertion of reliance by Heritage, noting that Heritage had not alleged that it had been defrauded but, had it done so, the court would not have been persuaded by Heritage's "blind reliance on the loan application" Civil Minutes at unnumbered fourth page, *In re Calderon*, No. 10-09077 (Bankr. E.D. Cal. Sept. 28, 2011), ECF No. 68.

¹²⁷ See Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment at 2, *In re Medrano*, No. 10-03142 (Bankr. C.D. Cal. Aug. 17, 2012), ECF No. 30-3 (failing to establish any personal knowledge of originating lender's underwriting practices).

However, the Ganter Declaration provides no evidence of the original lender's reliance on the statements within the Loan Application. Mr. Ganter provides no personal knowledge as to the reliance undertaken by the original lender. The Ganter Declaration claims that the original lender approved the Loan based on the Defendant's misrepresentations. This is a bald, unsupported statement, without personal knowledge of the original lender's reliance or state of mind.¹²⁸

Yet in three proceedings in which Heritage offered Ben Ganter's declaration as the only evidence of the originating lender's reliance, two bankruptcy judges granted Heritage's motion for default judgment, commenting in one, without elaboration, that "[t]he motion is supported by competent evidence."¹²⁹

Heritage also offered the declaration of Mark Schuerman, an expert witness, in support of sixteen of the nineteen motions for default judgment.¹³⁰ Each of his declarations recited his credentials and extensive experience in the real estate and mortgage industries.¹³¹ The most common form of his declaration, used in support of ten motions for default judgment, stated that originators of stated income loans expected to hold notes for thirty to ninety days before selling them to an investor and that "[t]he buyers of these notes rely on the stated income and representations made in the 1003 Applications when purchasing these notes from the original lenders."¹³² It then quoted a paragraph of those applications in which the loan applicant represents the truthfulness of information in the application to lenders and their successors in interest and described that paragraph as crucial to the viability of the lending industry.¹³³ It concluded that holders of notes secured by a second deed of trust heavily rely on income, employment, assets, and debts stated in the loan application because they are at the mercy of foreclosure by the holder of a first deed of trust on the same property.¹³⁴

The second most common form of his declaration, used in support of six motions for default judgment, described the defendant's loan as a stated income loan

¹²⁸ Memorandum, *supra* note 121, at 11.

¹²⁹ Civil Minutes, *In re* Wilson, No. 10-01291 (Bankr. E.D. Cal. May 18, 2011), ECF No. 22. Two months later, the same court granted Heritage's motion for default judgment in another proceeding, without comment. *See* Civil Minutes, *In re* Phillips, No. 10-01308 (Bankr. E.D. Cal. July 27, 2011), ECF No. 29. In the third of the three proceedings, discussed more fully *infra* note 153, another bankruptcy court granted Heritage's motion for default judgment without comment on the evidence. Order and Judgment of Nondischargeability in Favor Heritage Pacific Financial, L.L.C. and Against Daniel Hawker Taber, *In re* Taber, No. 10-05395 (Bankr. N.D. Cal. July 5, 2011), ECF No. 16.

¹³⁰ For simplicity, this presumes that Heritage submitted this declaration in support of a motion for default judgment in one proceeding for which relevant documents are not available from PACER.

¹³¹ *See, e.g.*, Declaration of Mark Schuerman in Support of Plaintiff's Motion for Default Judgment at 1–2, *In re* Calderon, No. 10-09077 (Bankr. E.D. Cal. Mar. 9, 2011), ECF No. 30.

¹³² *Id.* at 3.

¹³³ *See id.*

¹³⁴ *See id.* at 3–4.

and offered greater detail about the standards of practice and customs in the lending industry for stated income loans from 2005 to 2007, the period of the loans in question.¹³⁵ The practice, he said, was to obtain a borrower's loan application and rely on the borrower's FICO score and debt-to-income ratio in approving loans.¹³⁶ At the time, he stated, "[t]he stated income loan was favored . . . as it sped up the underwriting and closing processes."¹³⁷

Notably absent from both forms of Mr. Schuerman's declaration was any statement that a specific originating lender actually relied, justifiably relied, or reasonably relied on income, employment, or other information in a specific defendant's loan application. Presumably he could not have made any such statement, because none of his declarations claimed his employment by or other association with an originating lender or claimed any other basis to establish his personal knowledge of an originating lender's underwriting practices or reliance on a specific loan application. Neither of these two forms of his declaration mentioned the defendant's name, enabling Heritage to duplicate it, attach a cover page with a caption that included the defendant's name, and file it in more than one proceeding, sometimes months after Mr. Schuerman's signed it.¹³⁸

Some bankruptcy judges found the Schuerman declaration insufficient to establish reliance by an originating lender. In one proceeding, against defendant Maria Becerra, Heritage offered both the Ganter declaration and the more frequently used form of the Schuerman declaration.¹³⁹ The judge declined to enter a default judgment but gave Heritage the opportunity to submit additional evidence after making the following comments:

This . . . loan was made in 2006, when home lending practices in California and the nation as a whole were sloppy at best. The court has a substantial question whether any underwriting due diligence was performed by lenders Given the industry practices at the time, the court is unwilling to presume that anyone even looked at the financial statements and other documents submitted in support of loan applications. In other words, this court will not presume justifiable reliance by the originating creditor, even if the

¹³⁵ See, e.g., Declaration of Mark Schuerman in Support of Plaintiff's Motion for Default Judgment at 4–5, *In re Medrano*, No. 10-03142 (Bankr. C.D. Cal. Aug. 17, 2012), ECF No. 30-2.

¹³⁶ See *id.* at 4–5.

¹³⁷ *Id.* at 4.

¹³⁸ See, e.g., Declaration of Mark Schuerman in Support of Plaintiff's Motion for Default Judgment, *In re Calderon*, *supra* note 131, which Mr. Schuerman had signed on October 1, 2010, and which was duplicated off-center and at an angle distinct from a covering caption page.

¹³⁹ See Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment, *In re Becerra*, No. 10-01517 (Bankr. C.D. Cal. Apr. 29, 2011), ECF No. 12-1; Declaration of Mark G. Schuerman in Support of Plaintiff's Motion for Default Judgment, *In re Becerra*, No. 10-01517 (Apr. 29, 2011), ECF No. 12-5.

representations in the financial statement were materially false. Evidence of reliance by the original lender is required.¹⁴⁰

The judge's reference to sloppy home lending practices in 2006 is arresting. Ms. Becerra had defaulted and therefore offered no such evidence; Heritage had not submitted any such evidence and would have been foolish to do so. Perhaps the bankruptcy judge took judicial notice of sloppy home lending practices *sub silentio*. A court may *sua sponte* take judicial notice of a fact not subject to reasonable dispute if it is generally known within the court's territorial jurisdiction.¹⁴¹ The bankruptcy judge would be in good company were that her justification. The Bankruptcy Appellate Panel for the Ninth Circuit effectively did likewise one year later in affirming a defendant's attorney fee award in another Heritage proceeding:

By identifying his Loan as a stated income loan . . . [the defendant] implicated the now-discredited practice of indiscriminately making mortgage loans without verifying the income stated on the loan application. Lenders who made these so-called "liar's loans" often did not care what income the borrowers listed and sometimes actively encouraged misstatements of income. Indeed, the economic incentives associated with originating such high-risk, high-interest rate loans led some brokers to falsify loan applications without the borrower's knowledge or active participation.¹⁴²

Offered the opportunity to submit additional evidence against Ms. Becerra after the court denied its motion, Heritage submitted the declaration of a vice-president of a successor-in-interest to the originating lender stating that the originating lender, consistent with industry practices, had relied on information provided by "an applicant/borrower in his/her loan application through all stages of the underwriting process."¹⁴³ The judge again denied the motion for default judgment, finding the supplemental declaration insufficient to establish the declarant's familiarity with the

¹⁴⁰ Court's Request for Supplemental Brief on Justifiable Reliance in Motion for Default Judgment at 3, *In re Becerra*, No. 10-01517 (Aug. 18, 2011), ECF No. 19. To demonstrate misrepresentation, Heritage had submitted a tax transcript showing that Ms. Becerra's earnings for 2006 were lower than earnings for that year stated in her loan application. See Exhibit C to Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment, *In re Becerra*, No. 10-01517 (Apr. 29, 2011), ECF No. 12-4. The tax transcript had been requested in January 2011, probably by Heritage. See *id.* at 2. Submission of a tax transcript requested in 2011 suggests that the loan file did not contain a tax transcript ordered by the originating lender prior to making the loan in 2006; that, in turn, implies that the originating lender, WMC Mortgage Corp. ("WMC"), may not have taken any steps to verify Ms. Becerra's stated income. The implication is fortified by the contents of WMC loan files that Heritage offered into evidence in two other proceedings discussed *infra* notes 183–92 and accompanying text.

¹⁴¹ See FED. R. EVID. 201(b)(1), (c)(1), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 9017.

¹⁴² *In re Machuca*, 483 B.R. 726, 730 n.4 (B.A.P. 9th Cir. 2012). The court cited three law review articles following its description of lending practices. *Id.*

¹⁴³ Declaration of Robert Rothleder at 2, *In re Becerra*, No. 10-01517 (Sept. 19, 2011), ECF No. 20-1.

loan in question because the declarant had not been employed by or been an officer of the originating lender at the time the loan was made.¹⁴⁴ Undeterred, Heritage then submitted additional briefing and the less frequently used form of the Schuerman declaration.¹⁴⁵ The judge again denied the motion, with the following comments:

Plaintiff's attempt to prove reliance by expert testimony is insufficient to prove that the actual lender on the loan in question followed any industry standard or relied on anything when the loan was made. The only competent admissible evidence sufficient to establish reasonable reliance in this case would be testimony from an employee or underwriter of this loan by . . . [the originating lender] in the relevant time frame. Plaintiff presents no such evidence.¹⁴⁶

The same bankruptcy judge denied a Heritage motion for default judgment in another proceeding for the same reason.¹⁴⁷ Two other bankruptcy judges shared the same view. One denied a Heritage motion for default judgment in part because he concluded that the Ganter and Schuerman declarations failed to demonstrate reliance of the originating lender.¹⁴⁸ Another continued a hearing on a Heritage motion for default judgment with the comment that Heritage's evidence, which had included the Ganter and Schuerman declarations, had not demonstrated reliance.¹⁴⁹ Heritage requested dismissal of each of these proceedings thereafter, presumably because it didn't wish to speculate on and invest in the possibility of identifying, locating, and procuring favorable testimony from someone personally

¹⁴⁴ Denial of Judgment Against Defendant Maria Becerra at 2, *In re Becerra*, No. 10-01517 (Dec. 20, 2011), ECF No. 21.

¹⁴⁵ See Plaintiff's Second Supplemental Brief in Support of its Application for Default Judgment Against Defendant Maria R. Becerra, *In re Becerra*, No. 10-01517 (Apr. 3, 2012), ECF No. 22; Supplemental Brief of Mark G. Schuerman in Support of Plaintiff's Second Supplemental Brief in Support of its Application for Default Judgment Against Defendant Maria R. Becerra, *In re Becerra*, No. 10-01517 (Apr. 3, 2012), ECF No. 22-1.

¹⁴⁶ Order Denying Entry of Default Judgment Against Defendant Maria Becerra at 2, *In re Becerra*, No. 10-01517 (Sept. 7, 2012), ECF No. 25.

¹⁴⁷ See Order for Judgment Against Defendant Domingo Castaneda – Denied, *In re Castaneda*, No. 10-01749 (Bankr. C.D. Cal. Apr. 17, 2012), ECF No. 26. In a third proceeding pending before the same judge, Heritage moved for a default judgment without a hearing. Plaintiff's Notice of Motion for Default Judgment by the Court, *In re Villegas*, No. 10-01526 (Bankr. C.D. Cal. May 24, 2011), ECF No. 13. The docket in the proceeding reflects no ruling on the motion. See Docket, *In re Villegas*, No. 10-01526 (Aug. 31, 2010). Twenty-two months later, the court issued an order to show cause why the matter should not be dismissed for failure to prosecute. See Order to Show Cause Re Dismissal for Failure to Prosecute, *In re Villegas*, No. 10-01526 (Mar. 20, 2013), ECF No. 18. In response, Heritage moved to dismiss the case, presumably because of the judge's earlier rulings denying a motion for default judgment in both the *Becerra* and *Castaneda* adversary proceedings. See Request for Dismissal of Defendant Jose Asuncion Villegas, *In re Villegas*, No. 10-01526 (Mar. 25, 2013), ECF No. 21.

¹⁴⁸ See Civil Minutes, *supra* note 126, at unnumbered pages 4–5.

¹⁴⁹ See Calendar Notes, *In re Moreno*, No. 10-01685 (Bankr. C.D. Cal. Apr. 20, 2012), ECF No. 22.

knowledgeable about underwriting procedures of the originating lender many years earlier, at the time the loan was made.¹⁵⁰

In striking contrast, eight bankruptcy judges granted a Heritage motion for default judgment in eleven proceedings. As a result, Heritage obtained default judgments, ranging from \$49,722 to \$147,710, totaling \$867,996, approximately forty-one percent of its recovery in the 117 proceedings in which it became entitled to recover something.¹⁵¹ Heritage submitted the Ganter declaration alone in support of three of the motions (as noted earlier) and also submitted the Schuerman declaration, but no other evidence, in support of eight of the motions.¹⁵² Two of these eight judges later seem to have changed their evaluation of the evidence, concluding in Heritage proceedings against other defendants that the Ganter and Schuerman declarations did not demonstrate the requisite reliance.¹⁵³

¹⁵⁰ Heritage requested dismissal of four other proceedings in which it had filed a motion for default judgment, one before a hearing on the motion, one in which a bankruptcy judge denied the motion for undisclosed reasons, one in which the bankruptcy judge denied the motion on grounds other than lack of proof of reliance, and one in which the bankruptcy judge required additional briefing on issues not described in the PACER-accessible documents.

¹⁵¹ The total excludes a default judgment for \$147,500 later set aside after the defendant appeared, discussed *infra* note 153.

¹⁵² See, e.g., Declaration of Mark Schuerman, *In re Arana*, No. 10-01575 (Bankr. C.D. Cal. Feb. 1, 2011), ECF No 8-1.

¹⁵³ In one proceeding, Heritage submitted the Ganter declaration (attaching the loan application, note, and tax transcripts, requested in 2011, reflecting the defendant's income for 2005–2007) and the Schuerman declaration. See Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment, *supra* note 124; Exhibits A–C to Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment, *In re Arana*, No. 10-01575 (Feb. 1, 2011), ECF Nos. 8-3, 8-4, 8-5; Declaration of Mark Schuerman, *supra* note 152. The court entered a default judgment for Heritage. Order of Judgment Against Josefina Arana, *In re Arana*, No. 10-01575 (Apr. 18, 2011), ECF No. 12.

One month after that order, in another proceeding before the same judge, Heritage submitted identical evidence (except that the tax transcripts, requested in 2011, covered only 2005–2006). See Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment, *In re Moreno*, No. 10-01685 (May 10, 2011), ECF No. 13-1; Exhibits A–D to Declaration of Ben Ganter in Support of Plaintiff's Motion for Default Judgment, *In re Moreno*, No. 10-01685 (May 10, 2011), ECF Nos. 13-2, 13-3, 13-4, 13-5; Declaration of Mark Schuerman in Support of Plaintiff's Motion for Default Judgment, *In re Moreno*, No. 10-01685 (May 10, 2011), ECF No. 13-6. The docket reflects denial of the motion. Docket, *In re Moreno*, No. 10-01685 (Nov. 19, 2010). Heritage renewed the motion eight months later, Plaintiff's Motion for Default Judgment by Court, *In re Moreno*, No. 10-01685 (Jan. 9, 2012), ECF No. 17. Just before the hearing on the motion Heritage filed the alternative form of the Schuerman declaration in support of the motion. See Supplemental Declaration of Mark G. Schuerman in Support of Plaintiff's Motion for Default Judgment Against Defendant Joel R. Moreno, *In re Moreno*, No. 10-01685 (Apr. 4, 2012), ECF No. 21-3. The judge continued a hearing on the motion with notes indicating that the supplemental papers did not demonstrate actual reliance. Calendar Notes, *supra* note 149, at 2. In July 2012, Heritage again renewed its motion, adding the declaration of an account executive working for the originating lender at the time of the loan to Mr. Moreno who stated that the originating lender relied on the information provided by the "applicant-borrower" in the loan application. See Declaration of Richard Turner in Support of Plaintiff's Amended Default Judgment Against Defendant Joel R. Moreno at 2, *In re Moreno*, No. 10-01685 (July 9, 2012), ECF No. 27-3. For unknown reasons, Heritage requested dismissal of the action before a hearing on the renewed motion. See Request for Dismissal of Defendant Joel R. Moreno, *In re Moreno*, No. 10-01685 (Oct. 3, 2012), ECF No. 35.

In another proceeding, before a different bankruptcy judge, Heritage submitted only the Ganter declaration (attaching the loan application and note). See Declaration of Ben Ganter in Support of Motion for Default

Records from the eleven proceedings in which the court granted a Heritage motion for default judgment reveal nothing about the judges' view of the declarations or thinking on the issue of reliance.¹⁵⁴ Perhaps some of these judges thought a default judgment justified on the basis of Heritage's complaint, because federal law permits default judgments on the basis of well pleaded complaints alone.¹⁵⁵ If so, that would have been inconsistent with the decision of another bankruptcy judge who dismissed a like Heritage complaint in another proceeding for failure to plead fraud with the requisite particularity:

Plaintiff alleges that Defendant misrepresented her income and/or employment status and that the loan application submitted by Defendant was "false." Again, however, the complaint is completely devoid of any factual support for these conclusions. In fact, it appears to the Court that Plaintiff has utilized a "canned" complaint, which simply recites the elements of the causes of action, and then concludes, without an iota of factual support, that Defendant's conduct is wrongful and that the debt owed to Plaintiff should be determined nondischargeable. While this method of practice may save time and allow Plaintiff to file multiple complaints against various defendants with little work, it is ineffective in the face of a motion to dismiss. Thus, because the complaint only offers "threadbare recitals of the elements of a cause of action, supported by mere conclusory statements," it is

Judgment, *In re Taber*, No. 10-05395 (Bankr. N.D. Cal. May 13, 2011), ECF No. 10-2. At the hearing on the motion, with respect to the issue of reliance, the judge stated only: "The creditor maintains that they reasonably relied on it and there is a declaration to support that." Oral Argument at 1:35–1:41, *In re Taber*, No. 10-05395 (June 30, 2011), ECF No. 15. The court then entered a \$147,500 default judgment for Heritage. Order and Judgment of Nondischargeability in Favor of Heritage Pacific Financial, L.L.C. and Against Daniel Hawker Taber, *supra* note 129. The defendant thereafter moved to vacate the default and default judgment on the grounds that he mistakenly believed that his bankruptcy counsel would be responsible for responding to the complaint in the adversary proceeding. *See* Notice of Motion; Motion to Vacate Default and Default Judgment; Memorandum of Points and Authorities at 4, *In re Taber*, No. 10-05395 (Nov. 18, 2011), ECF No. 19. The court granted the motion, vacated the judgment, and permitted the defendant to answer the complaint. *See* Order Vacating Default Judgment, *In re Taber*, No. 10-05395 (Jan. 11, 2012), ECF No. 22.

Two months after having granted a default judgment in the proceeding against Mr. Taber, the same bankruptcy judge denied a Heritage motion for summary judgment against defendant Oscar Trejo. *See* Order Denying Plaintiff's Motion for Summary Judgment, *In re Trejo*, No. 10-05392 (Bankr. N.D. Cal. Sept. 8, 2011), ECF No. 20. In his order, the judge found the Ganter declaration (the only declaration offered in support of the motion for default judgment against Mr. Taber) showed reliance only by Heritage and not by the originating lender. *See id.* at 6. In the order, the judge also commented on the insufficiency of the Schuerman declaration to demonstrate reliance by the originating lender, and also noted that the defendant had signed the loan application one day after having signed the note, thus suggesting the possibility that the originating lender had not relied on the loan application. *See id.* at 5–6.

¹⁵⁴ *See, e.g.,* Order of Judgment Against Josefina Arana, *supra* note 153; Order Granting Motion for Summary Judgment, *supra* note 121.

¹⁵⁵ *See In re McGee*, 359 B.R. 764, 772 (B.A.P. 9th Cir. 2006).

insufficient and must be dismissed for failure to state a claim upon which relief can be granted.¹⁵⁶

Ipso facto judges granting a motion to dismiss for this reason would not have entered a default judgment on the basis of the complaint alone, because the complaint was not well pleaded. And those judges who denied a Heritage motion for default judgment necessarily must have found allegations of like complaints insufficient in themselves to establish liability because a claim for relief based on a complaint that does not allege fraud with sufficient particularity may not support a default judgment.¹⁵⁷

b. In Motions for Summary Judgment

Resolution of six motions for summary judgment reflect differences on the issue of reliance comparable to those we have seen in resolution of Heritage's motions for default judgment. Each of four bankruptcy judges considering a *defendant's* motion for summary judgment found insufficient evidence of reliance. Three of them granted the motion on that ground;¹⁵⁸ a fourth granted the motion on another ground¹⁵⁹ but later awarded attorney's fees to the defendant because of insufficient evidence of reliance.¹⁶⁰ One of two bankruptcy judges considering a *Heritage* motion for summary judgment likewise found insufficient evidence of reliance and denied the motion, but a sixth bankruptcy judge granted the same Heritage motion in another proceeding.¹⁶¹

Consider first the irreconcilable outcomes in the two proceedings in which Heritage moved for summary judgment, one involving defendant Oscar Trejo and the other involving defendant Yazmin Gonzalez. Heritage submitted the identical Ganter and Schuerman declarations in each.¹⁶² In each, Heritage also submitted virtually identical unanswered requests for admissions.¹⁶³ Factual statements made

¹⁵⁶ Order Granting Motion to Dismiss With Leave to Amend and Without Oral Argument at 3, *In re Ferreira*, No. 11-04053 (Bankr. N.D. Cal. Sept. 6, 2011), ECF No. 25 (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)).

¹⁵⁷ See *In re Kubick*, 171 B.R. 658, 661 (B.A.P. 9th Cir. 1994).

¹⁵⁸ See Memorandum of Decision Re Defendant's Motion for Summary Judgment, *supra* note 121, at 9–10; Transcript of Oral Argument on Defendant's Motion for Summary Judgment at 5–8, *In re Machuca*, No. 10-05301 (Bankr. N.D. Cal. Mar. 29, 2012), ECF No. 51. The third of these three proceedings, involving defendant Garrett Palines, is discussed *infra* note 192.

¹⁵⁹ See *infra* text accompanying notes 241–44.

¹⁶⁰ See *infra* text accompanying notes 170–75.

¹⁶¹ See *infra* text accompanying notes 162–69.

¹⁶² Compare Declaration of Ben Ganter in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment, *In re Trejo*, No. 10-05392 (Bankr. N.D. Cal. May 27, 2011), ECF No. 9-3, with Declaration of Ben Ganter in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment, *In re Gonzalez*, No. 11-02088 (Bankr. E.D. Cal. Aug. 22, 2011), ECF No. 14 and Declaration of Mark Schuerman in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment, *In re Gonzalez*, No. 11-02088 (Aug. 22, 2011), ECF No. 14.

¹⁶³ Compare Heritage Pacific Financial's First Set of Requests for Admission to Defendant Oscar Trejo, *In re Trejo*, No. 10-05392 (July 25, 2011), ECF No. 15, with Heritage Pacific Financial's First Set of Requests

in an unanswered request for admissions are deemed admitted absent an answer or objection to the request.¹⁶⁴ The pro se defendants in each may have failed to answer or object to the requests for admissions because of their ignorance of the manner or importance of responding. Neither of the requests asked the defendant to admit reliance by the originating lender. Instead, both requests, tracking the language of section 523(a)(2) of the Bankruptcy Code, asked the defendant to admit obtaining the relevant loan by false pretenses, through false representations, and through fraud.¹⁶⁵ But, as the Ninth Circuit Bankruptcy Appellate Panel held in an appeal of a subsequent trial judgment in one of the two proceedings, those requests improperly called for a legal conclusion and, in any event, failure to respond to them did not establish reliance of the originating lender.¹⁶⁶

Heritage submitted no other evidence in either proceeding. Neither pro se defendant responded to the Heritage motion for summary judgment. One bankruptcy judge denied the motion, finding neither the Ganter nor the Schuerman declaration probative on the question of the originating lender's reliance.¹⁶⁷ Heritage fared no better at trial later in the same proceeding.¹⁶⁸ The other bankruptcy judge granted the motion without discussion of reliance, commenting instead that the defendant had conceded all the essential elements for a claim under section 523(a)(2) (presumably because of a failure to respond to the request for admissions) and that it was unfortunate, but no defense, that the defendant had been encouraged by someone else to make false statements regarding her income.¹⁶⁹

Consider next the conclusion of another bankruptcy judge in granting a defendant's motion for attorney's fees after having granted the defendant's motion for summary judgment on another ground. Attorney's fees are available to a defendant in a section 523(a)(2) adversary proceeding if, among other things, the position of the creditor (in this case Heritage as successor-in-interest to the originating lender) was not substantially justified.¹⁷⁰ Discussion of the issue of reliance first arose at a hearing on a much earlier defense motion to dismiss the complaint conducted by another bankruptcy judge to whom the proceeding originally had been assigned. Although denying the motion to dismiss, that bankruptcy judge cautioned Heritage that it would have to provide evidence of the originating lender's *actual* reliance on misrepresentations in the loan application and

for Admission to Defendant Yazmin Gonzalez, Exhibit A to Declaration of Brad A. Mokri in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment, *In re Gonzalez*, No. 11-02088 (Aug. 22, 2011), ECF No. 14.

¹⁶⁴ See FED. R. CIV. PROC. 36(a)(3), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. PROC. 7036.

¹⁶⁵ See, e.g., Heritage Pacific Financial's First Set of Requests for Admission to Defendant Oscar Trejo, *supra* note 163, at 7.

¹⁶⁶ See *In re Trejo*, Ch. 7 No. NC-11-1652-HPaMk, 2012 Bankr. LEXIS 5881, at *9–10 (B.A.P. 9th Cir. Dec. 20, 2012).

¹⁶⁷ See Order Denying Plaintiff's Motion for Summary Judgment, *supra* note 153, at 6.

¹⁶⁸ See Order Following Trial, *supra* note 121, at 6–9.

¹⁶⁹ See Order Granting Motion for Summary Judgment, *supra* note 121.

¹⁷⁰ See 11 U.S.C. § 523(d) (2012).

that it faced formidable obstacles in doing so because the originating lender was defunct.¹⁷¹ Heritage assured the court that it intended to do so.¹⁷² In opposition to the defendant's later motion for summary judgment, Heritage offered the Ganter and Schuerman declarations and the declaration of an assistant secretary to the originating lender's successor-in-interest who stated that the originating lender relied on information supplied by a borrower in a loan application.¹⁷³ Several months later, at the hearing on the motion for attorney's fees, the second bankruptcy judge assigned to the proceeding concluded that none of that evidence demonstrated the originating lender's actual reliance.¹⁷⁴ The Ninth Circuit Bankruptcy Appellate Panel affirmed, stressing that justifiable or reasonable reliance necessarily required a predicate showing of actual reliance.¹⁷⁵ It is simply impossible to reconcile the finding in this proceeding that Heritage had failed to demonstrate actual reliance of the originating creditor with contrary implicit or explicit conclusions on the issue of reliance previously discussed.

c. At Trial

Comparing decisions on the issue of reliance in the five trials is more difficult because the evidence of reliance in some differed from the evidence of reliance in others. Heritage submitted the Ganter declaration and one of the two Schuerman declarations in four of the five trials.¹⁷⁶ Mr. Ganter testified in each of the five trials; Mr. Schuerman did not appear at any of the five trials.¹⁷⁷ Judges in two of the proceedings excluded Mr. Schuerman's declaration either because of Heritage's failure to timely disclose him as a witness or because he failed to appear at trial for cross-examination.¹⁷⁸ Judges in two other proceedings discounted but did not technically exclude his declaration.¹⁷⁹ Mr. Schuerman's absence from trial probably reflected Heritage's decision not to pay travel expenses and expert witness fees. More importantly, Heritage's failure to present him for trial reflected both its

¹⁷¹ Neither an audio recording nor a transcript of the hearing is available from PACER, but the Ninth Circuit Bankruptcy Appellate Panel's opinion affirming the defendant's later motion for attorney's fees mentions that caution. *See In re Montano*, 501 B.R. 96, 115 (B.A.P. 9th Cir. 2013).

¹⁷² *Id.*

¹⁷³ *See* Declaration of Ben Ganter in Support of Plaintiff's Opposition to Summary Judgment, *In re Montano*, No. 11-04008 (Bankr. N.D. Cal. Mar. 7, 2010), ECF No. 65-1; Declaration of Mark G. Schuerman in Support of Plaintiff's Opposition to Defendant's Motion for Summary Judgment, *In re Montano*, No. 11-04008 (Mar. 7, 2010), ECF No. 65-2; Declaration of Diane Taylor, *In re Montano*, No. 11-04008 (Mar. 7, 2010), ECF No. 65-12.

¹⁷⁴ *See* Transcript of Oral Argument on Motion to Reconsider of [sic] Court's Order Denying Request for an Award Filed by Jesus Montano at 42–45, *In re Montano*, No. 11-04008 (Jan. 25, 2013), ECF No. 197.

¹⁷⁵ *See In re Montano*, 501 B.R. at 115.

¹⁷⁶ *See, e.g.*, Plaintiff's Trial Brief, Declarations of Ben Ganter and Mark Schurmen [sic] in Support, *supra* note 6. Heritage submitted the declarations in response to pretrial orders requiring that direct testimony be given by declaration. *See, e.g.*, Order Setting Trial Date and Establishing Procedures for Conduct of Trial at 1–2, *In re Mabson*, No. 10-02445 (Bankr. C.D. Cal. Apr. 26, 2011), ECF No. 18.

¹⁷⁷ *See, e.g.*, Transcript of Trial, *supra* note 121, at 3.

¹⁷⁸ *See, e.g.*, Memorandum, *supra* note 121, at 4–5.

¹⁷⁹ *See, e.g.*, Order Following Trial, *supra* note 121, at 3 n.3.

implicit contention that his declaration in support of motions for default or summary judgment had been unnecessary (as in the three motions for default judgment granted without his declaration) and at the same time an implicit if unintended concession that his declaration in support of motions for default or summary judgment was either irrelevant or unpersuasive (as in other proceedings in which bankruptcy judges found it insufficient).

Bankruptcy judges rendered a judgment for the defendant following trial in three proceedings. Two of them found misrepresentations by the defendant in a loan application but concluded that the originating lender's reliance on them was not reasonable given its failure to heed "red flags" evident either from the loan application or from other information obtained by the lender. Neither bankruptcy judge explicitly addressed the predicate issue of actual reliance.¹⁸⁰ In the third proceeding, involving defendant Rosa Vasquez, the bankruptcy judge found insufficient proof of misrepresentations, insufficient proof of either actual or reasonable reliance, and insufficient proof of intent to deceive.¹⁸¹

WMC Mortgage Corporation, an originating lender identified in many of the Heritage adversary proceedings, made the loan to Ms. Vasquez.¹⁸² Its loan file reveals significant details that confirm the judge's conclusion on the issue of reliance.¹⁸³ Ms. Vasquez's loan application represented that she was self-employed as the manager and partner of Nellie's Beauty Salon and earned \$8200/month.¹⁸⁴ The loan file included WMC's "Notice of Conditional Approval – Underwriting Requirements," which required two sources of satisfactory evidence of a two-year history of self-employment as a condition to approval of the loan.¹⁸⁵ The loan file also contained handwritten notes of an unidentified person on a "Pre-Funding Self-Employment Audit" form that implied a telephone call to Nellie's Beauty Salon, but nothing on the form identified the person called or the information gleaned from the telephone conversation.¹⁸⁶ The audit form also indicated an online verification of a

¹⁸⁰ See Order Following Trial, *supra* note 121, at 7–9; Transcript of Trial, *supra* note 2, at 118–20.

¹⁸¹ See Memorandum, *supra* note 121, at 8–13.

¹⁸² See Exhibit B to Plaintiff's First Amended Complaint to Determine Dischargeability of Debt at 2, *In re Vasquez*, No. 10-01663 (Bankr. C.D. Cal. Feb. 7, 2011), ECF No. 9-2.

¹⁸³ Heritage submitted the loan file in advance of trial. See Exhibit Register and Notice Re Disposition of Exhibits, *In re Vasquez*, No. 10-01663 (Feb. 23, 2012), ECF No. 41. The judge excluded the loan file from evidence for failure to disclose it in a Joint Pretrial Order, Memorandum, *supra* note 121, at 5, and thus did not consider the loan file in reaching her conclusion on the issue of reliance.

Contemporary news reports also suggested that employees of WMC may have knowingly approved loans based on falsified paperwork and documentation. See, e.g., Michael Hudson, *Fraud And Folly: The Untold Story Of General Electric's Shady Subprime Debacle*, DAILY BAIL (Jan. 19, 2012, 5:10 PM), <http://dailybail.com/home/fraud-and-folly-the-untold-story-of-general-electrics-shady.html>; Michael Hudson & E. Scott Reckard, *GE lending unit said to be target of U.S. probe*, L.A. TIMES (Jan. 20, 2012), <http://articles.latimes.com/2012/jan/20/business/la-fi-mortgage-probe-20120120>.

¹⁸⁴ See Exhibit Register and Notice Re Disposition of Exhibits, *supra* note 183, at 3–4.

¹⁸⁵ See *id.* at Bates Stamp 000151.

¹⁸⁶ See *id.* at Bates Stamp 000175. The audit form indicated a call to the telephone number that Ms. Vasquez had provided on her loan application for Nellie's Beauty Salon. It hardly seems satisfactory verification of self-employment to contact the very number given by the applicant for her place of self-

"Beauty Salon" license,¹⁸⁷ but separate documents in the file showed an online verification only of Ms. Vasquez's cosmetology license and a copy of the cosmetology license.¹⁸⁸ No document in the loan file demonstrated, as WMC's underwriting requirements required, that Ms. Vasquez owned Nellie's Beauty Salon or that she had a two-year history of self-employment.

WMC's notice of conditional approval also required that "INCOME MUST BE CONSISTENT WITH PROFESSION AND EXPERIENCE."¹⁸⁹ The loan file contained a copy of an IRS form 4506-T, authorizing the IRS to supply a tax transcript for Ms. Vasquez.¹⁹⁰ Line 5 of the form, authorizing mailing of the transcript to a third party, was blank,¹⁹¹ and the loan file contained no tax transcript. The loan file thus suggested that WMC did not use the transcript request form to verify her income prior to approving the loan. Nor is there any evidence in the loan file to suggest that WMC attempted to verify that her stated income was consistent with her experience as a cosmetologist or with her ownership of a beauty salon.¹⁹²

employment unless the verification indicates that the caller in fact reached a business named by the loan applicant and spoke with someone other than the applicant (e.g. an employee). The audit form did neither.

¹⁸⁷ *See id.*

¹⁸⁸ *See id.* at Bates Stamp 000167, 000178.

¹⁸⁹ *Id.* at Bates Stamp 000151.

¹⁹⁰ *Id.* at Bates Stamp 000114.

¹⁹¹ Exhibit Register and Notice Re Disposition of Exhibits, *supra* note 183, at Bates Stamp 000114.

¹⁹² A notice of conditional loan approval and a pre-funding audit form from yet another WMC loan file, submitted by Heritage in an adversary proceeding against defendant Garrett Palines, influenced the decision of another bankruptcy judge to grant the defendant's motion for summary judgment for failure of Heritage to demonstrate reliance by the originating lender. Mr. Palines' loan application had claimed employment as an administrator, at \$18,869/month, by Primetimers Senior Resources. *See* Exhibit A to Declaration of James Michel in Support of Defendant's Motion for Summary Judgment on Claim of Plaintiff Heritage Pacific Financial at 3, *In re Palines*, No. 12-03063 (Bankr. N.D. Cal. Sept. 21, 2012), ECF No. 27-4. WMC's conditional loan approval required that his income be consistent with his profession and experience and also that it must be validated. *See* Exhibit B to Declaration of Diane Taylor for WMC Mortgage Corporation in Support of Plaintiff's Opposition to Defendant's Motion for Summary Judgment at 2, *In re Palines*, No. 12-03063 (Oct. 11, 2012), ECF No. 33-2. Handwritten entries in WMC's pre-funding audit form implied a telephone contact with Mr. Palines' employer to verify his stated income, Exhibit D to Declaration of Ben Ganter in Support of the Opposition to Defendant's Motion for Summary Judgment at 2, *In re Palines*, No. 12-03063 (Oct. 5, 2012), ECF No. 30-4, but, as the bankruptcy judge noted, those entries neither responded to a preprinted question on the form asking whether the information agreed with the information stated in the "1003" (the loan application) nor stated Mr. Palines' income. *See* Oral Argument at 19:25–20:25, *In re Palines*, No. 12-03063 (Oct. 19, 2012), ECF No. 36. Heritage submitted no other evidence from the loan file demonstrating either verification of income or that the stated income was consistent with Mr. Palines' profession and experience. Heritage did submit the declaration of a person employed by WMC at the time of the loan who stated that she was fully familiar with its business operations. *See* Declaration of Diane Taylor for WMC Mortgage Corporation in Support of Plaintiff's Opposition to Defendant's Motion for Summary Judgment at 2, *In re Palines*, No. 12-03063 (Oct. 11, 2012), ECF No. 33. She had reviewed the loan application and notice of conditional loan approval and stated that WMC, consistent with standard practices in the loan industry at the time and with its own business practices, had relied on the information in the loan application. *See* Declaration of Diane Taylor for WMC Mortgage Corporation in Support of Plaintiff's Opposition to Defendant's Motion for Summary Judgment, *supra*, at 2. The bankruptcy judge was not persuaded, concluding from the other evidence that WMC had not followed its own procedures. *See* Oral Argument, *supra*, at 11:20–11:40.

The evidence from the Vasquez loan file suggesting WMC's failure to adhere to the requirements of its own conditional loan approval is reminiscent of comparable evidence evaluated in an adversary proceeding filed several years earlier that a California bankruptcy court termed "a poster child for some of the practices that have led to the current crisis in our housing market."¹⁹³ The court concluded that the borrowers had misrepresented their financial condition to National City Bank, that their representations were material, and that they had made the representations with knowledge of their falsity and intent to deceive.¹⁹⁴ But the court entered judgment for the borrowers because of its conclusion that the bank's reliance on the misrepresentations was not reasonable, including because the bank deviated from its own internal guidelines on loan approval.¹⁹⁵

The guidelines called for a third party vendor to evaluate the reasonableness of stated income based on job type, tenure, and geographical location, but the bank submitted no evidence that such an evaluation had been undertaken.¹⁹⁶ The guidelines also permitted the bank to verify self-employment with a letter from a CPA.¹⁹⁷ The bank introduced such a letter, on the letterhead of a CPA, but the court found it insufficient because the bank presented no evidence verifying the identity or credentials of the person signing the letter.¹⁹⁸

Bankruptcy judges rendered a judgment for Heritage following trial in two proceedings. Each of them inferred both actual and reasonable reliance of the originating lender. In one, the court found that defendant Julian Tovar falsely represented self-employment as the owner of a landscaping business, falsely represented his income, and falsely represented his intention to occupy real property being purchased with the loan proceeds, and did so with intent to deceive.¹⁹⁹ WMC made the loan to Mr. Tovar.²⁰⁰ Heritage had not attempted at trial to demonstrate WMC's stated underwriting practices or its compliance with them in processing Mr. Tovar's loan application,²⁰¹ even though Heritage bore the burden of proof on the issue of reliance.²⁰² Its only witness was Ben Ganter.²⁰³ Neither his declaration

¹⁹³ *In re Hill*, Ch. 7 No. 07-41137 TT, 2008 Bankr. LEXIS 1668, at *1 (Bankr. N.D. Cal. May 28, 2008).

¹⁹⁴ *Id.* at *10.

¹⁹⁵ *Id.* at *13-17.

¹⁹⁶ *Id.* at *5, 14.

¹⁹⁷ *Id.* at *5-6.

¹⁹⁸ *Id.*

¹⁹⁹ *See In re Tovar*, Ch. 7 No. CC-11-1696-MkDKi, 2012 Bankr. LEXIS 3633, at *35 (B.A.P. 9th Cir. Aug. 3, 2012).

²⁰⁰ *Id.* at *2.

²⁰¹ *See* Transcript of Trial, *In re Tovar*, No. 10-03016 (Bankr. C.D. Cal. Dec. 6, 2011), ECF No. 36.

²⁰² Mr. Tovar's counsel argued at trial that Heritage failed to introduce evidence demonstrating that WMC took any steps to verify information provided by Mr. Tovar in connection with his loan application. *See* Transcript of Trial, *supra* note 201, at 61-62. At trial, Mr. Tovar's counsel did not introduce any evidence of WMC's underwriting procedures or any evidence from the loan file that might have proven WMC's failure to comply with its underwriting procedures. *See* Transcript of Trial, *supra* note 201, at 61-62. There are no PACER-accessible records that would reflect whether Mr. Tovar's counsel requested or was provided a copy of the loan file in discovery.

²⁰³ Transcript of Trial, *supra* note 201, at 6-32.

(submitted in lieu of direct examination) nor his subsequent in-person testimony claimed any personal knowledge of those underwriting practices.²⁰⁴ The bankruptcy judge nonetheless inferred WMC's actual and reasonable reliance on Mr. Tovar's misrepresentations from four documents that Heritage introduced into evidence at trial, or so the Ninth Circuit Bankruptcy Appellate Panel concluded in affirming the judgment on appeal.²⁰⁵

Heritage had introduced an occupancy statement, indicating Mr. Tovar's intention to occupy the real property, a bank statement, a "Latin Services" statement, and a landscaping brochure.²⁰⁶ The "Latin Services" statement was a letter from an alleged tax preparer describing preparation of Mr. Tovar's tax returns and describing Tovar's self-employment for two years in the landscaping business under the name Tovar Landscaping Design.²⁰⁷ It did not refer to a CPA, was signed by a person whose printed name and signature was illegible, and was unsupported by any evidence that the originating lender had verified the nature of "Latin Services" or the identity or credentials of the person signing the letter,²⁰⁸ gaps in evidence that had led another bankruptcy judge to find a comparable letter inadequate proof of reliance.²⁰⁹ The landscaping brochure advertised Tovar's alleged landscaping business.²¹⁰ To the bankruptcy judge, the mere presence of these documents in the loan file must have indicated that the originating lender actually looked at and relied on the documents. This inference stands in marked contrast to the contrary view of another bankruptcy judge, noted earlier, who denied a Heritage motion for default judgment because, given industry practices at the time, she was unwilling to presume that anyone even looked at documents submitted in support of loan applications.²¹¹

In affirming the judgment against Mr. Tovar, the Bankruptcy Appellate Panel stated that a creditor's actual verification of information is not an explicit requirement of reasonable reliance,²¹² but nonetheless seemed to require a lender's compliance with its own underwriting practices when it also noted that "[n]othing in the record suggests that WMC did not adhere to normal business practices"²¹³ In so commenting, the Bankruptcy Appellate Panel appears to have implicitly, and incorrectly, shifted the burden of proof on that factual question to Mr. Tovar.

²⁰⁴ See Declaration of Ben Ganter, *In re Tovar*, No. 10-03016 (Sept. 7, 2011), ECF No. 22; Transcript of Trial, *supra* note 201, at 6–32.

²⁰⁵ See *In re Tovar*, 2012 Bankr. LEXIS 3633, at *32–34.

²⁰⁶ *Id.* at *5.

²⁰⁷ See Plaintiff's [Amended] Exhibit List and Exhibits 1–13 at 47, *In re Tovar*, No. 10-03016 (Bankr. C.D. Cal. Sept. 8, 2011), ECF No. 26.

²⁰⁸ Plaintiff's [Amended] Exhibit List and Exhibits 1–13, *supra* note 207, at 47.

²⁰⁹ See *supra* note 197–98 and accompanying text.

²¹⁰ Plaintiff's [Amended] Exhibit List and Exhibits 1–13, *supra* note 207, at 49.

²¹¹ See *supra* text accompanying note 140.

²¹² *In re Tovar*, Ch. 7 No. CC-11-1696-MkDKi, 2012 Bankr. LEXIS 3633, at *33 (B.A.P. 9th Cir. Aug. 3, 2012).

²¹³ *Id.* at *34.

A second bankruptcy judge rendering judgment for Heritage following trial, against defendant Duane Mabson, drew an inference of reasonable reliance from evidence less compelling than the evidence submitted in the trial involving Mr. Tovar. Heritage again submitted the declaration of Ben Ganter, through which it introduced the loan application and promissory note,²¹⁴ and made Ben Ganter available for cross-examination.²¹⁵ It submitted no other documents from the loan file. It also submitted the declaration of Mark Schuerman,²¹⁶ but the court excluded his declaration because Heritage did not present him for cross-examination at trial.²¹⁷ Heritage called Mr. Mabson as a witness to admit that he was a straw buyer.²¹⁸ Heritage also submitted an unanswered request for admissions, but, like the requests for admissions earlier discussed,²¹⁹ they did not include a request to admit that the originating lender had relied on misrepresentations.²²⁰ On the issue of reliance, the bankruptcy judge said only that "[t]he creditor's reliance was reasonable under the circumstances," and "these representations [of income and intended use of the property] were of a type that would be reasonably relied upon by a lender in the original transaction"²²¹ Necessarily the judge also inferred actual reliance. Mr. Mabson did not appeal.

The Ninth Circuit Bankruptcy Appellate Panel has stated that "[t]o sustain . . . an inference [of actual reliance], an inquiry must be made concerning the extent to which the creditor considered the misrepresentation a substantial factor in influencing its decision (i.e., actual reliance or reliance in fact)."²²² It is difficult to reconcile that requirement with the inferences of actual reliance drawn by the bankruptcy judges in the proceedings against Mr. Tovar and Mr. Mabson. We might nevertheless attribute affirmance of the judgment against Mr. Tovar to the standard of appellate review requiring that an appellate court affirm a factual finding unless clearly erroneous.²²³

²¹⁴ See Plaintiff's Trial Brief, Declarations of Ben Ganter and Mark Schurman [sic] in Support, *supra* note 6, at 11–14.

²¹⁵ See Transcript of Trial, *supra* note 121, at 8–129.

²¹⁶ See Plaintiff's Trial Brief, Declarations of Ben Ganter and Mark Schurman [sic] in Support, *supra* note 6, at 15–20.

²¹⁷ See Transcript of Trial, *supra* note 121.

²¹⁸ *Id.* at 12–13.

²¹⁹ See *supra* text accompanying notes 163–66.

²²⁰ The Request for Admissions, submitted as a trial exhibit, is not available from PACER. Heritage referred to it in its trial brief and stated that the defendant did not respond to the requests. See Plaintiff's Trial Brief, Declarations of Ben Ganter and Mark Schurman [sic] in Support, *supra* note 6, at 9. The trial brief thereafter included a document captioned "Facts Admitted Into Evidence." *Id.* at 21–24. The thirty-two facts recited in that document conform to Requests for Admission used in other proceedings that are on file with the author. It is unclear whether the bankruptcy judge credited the admissions on the issue of reliance. He stated: "The requests for admissions admit . . . virtually all of the salient facts necessary to establish a claim of nondischargeability under section 523(a)(2)(B)." Transcript of Trial, *supra* note 121, at 15.

²²¹ Transcript of Trial, *supra* note 121, at 17.

²²² *In re Montano*, 501 B.R. 96, 117 (B.A.P. 9th Cir. 2013).

²²³ See *In re Tovar*, Ch. 7 No. CC-11-1696-MkDKi, 2012 Bankr. LEXIS 3633, at *12 (B.A.P. 9th Cir. Aug. 3, 2012).

2. California's Limitation on Fraud Claims

We have previously seen that the prohibition of deficiency judgments in section 580b of the California Code of Civil Procedure should have defeated Heritage's *contract* claim in its (non-bankruptcy) federal district court action against Susana David and that the preclusion of certain fraud claims in section 726(g) of the California Code of Civil Procedure properly defeated its *fraud* claim against her.²²⁴ Section 726(g) likewise should have defeated every Heritage adversary proceeding in which the loan to the defendant was secured by single-family, owner-occupied residential real property occupied by the defendant.

Sections 726(f) and (h) of the California Code of Civil Procedure permit the real property secured lender or its successor in interest to assert a fraud claim against a borrower notwithstanding any anti-deficiency rule,²²⁵ but section 726(g) of the California Code of Civil Procedure precludes such fraud claims unless the loan exceeds \$150,000 as adjusted annually, commencing on January 1, 1987, to the U.S. Department of Labor Consumer Price Index.²²⁶ As of February 24, 2010, the date on which Heritage filed its first adversary proceeding in a California bankruptcy court, the inflation-adjusted amount was \$287,926.06.²²⁷ None of the notes on which Heritage sued exceeded that amount. Because "[t]he validity of a creditor's claim is determined by rules of state law,"²²⁸ Heritage did not have a legitimate fraud claim under section 523(a)(2) of the Bankruptcy Code in any case subject to the protection of section 726(g) of the California Code of Civil Procedure.

Yet defendants failed to claim the protection afforded by section 726(g) in all but a few of the very large number of adversary proceedings in which it was

²²⁴ See *supra* text accompanying notes 30–36.

²²⁵ See CAL. CIV. PROC. CODE § 726(f), (h) (2012).

²²⁶ See *id.* § 726(g). A California court of appeal has held that California's anti-deficiency statutes did not preclude actions for fraud. See *Guild Mortg. Co. v. Heller*, 239 Cal. Rptr. 59, 63–64 (Cal. Ct. App. 1987). In 1985, the California legislature codified that result in section 7460 of the California Financial Code (with respect to state or federally chartered savings and loan associations), in section 779 of the California Financial Code (now section 1301 of the California Financial Code) (with respect to state and nationally chartered banks), and in section 15102 of the California Financial Code (with respect to credit unions). *Id.* at 64–65. Each of those provisions, however, included the same exception, described by the court in *Guild Mortg.*: "Because of evidence that fraud was most prevalent in loans for large, single-family dwellings, multiple-unit dwellings and commercial property, the legislation exempted loans secured by single-family residential real property, when the property is *actually occupied by the borrower* and the loan is for \$150,000 or less." *Id.* at 64; CAL. FIN. CODE §§ 7460(b), 1301(b), 15102(b) (2012). Sections 726(f) and (g) of the California Code of Civil Procedure apply the same rules, including the same exception, to other persons and entities authorized by California to make or arrange loans secured by real property who originate any loan secured directly or collaterally, in whole or in part, by a mortgage or deed of trust on real property. CAL. CIV. PROC. CODE § 726(f), (g) (2012). The 1987 *Guild Mortg.* opinion did not mention sections 726(f) and (g) because the legislature added those sections that very year. Act of July 22, 1987, 1987 Cal. Legis. Serv. 117–20 (West) (codified at CAL. CIV. PROC. CODE § 726).

²²⁷ CPI Inflation Calculator, BUREAU OF LABOR STATISTICS, http://www.bls.gov/data/inflation_calculator.htm (accessed Feb. 18, 2015).

²²⁸ *Grogan v. Garner*, 498 U.S. 279, 283 (1991).

potentially applicable. PACER-accessible records displayed loan applications in 175 of the 218 adversary proceedings. Loan applications in ninety-four of them stated an intention to use loan proceeds to purchase a primary residence,²²⁹ loan applications in two others stated an intention to use loan proceeds to construct a primary residence,²³⁰ a loan application in one concerned the purchase of a manufactured home,²³¹ and a loan application in one other stated an intention to use loan proceeds for debt consolidation.²³²

Defendants failed to claim the protection against fraud claims in all but three of this subset of ninety-eight proceedings. An attorney represented the defendant in sixty-two of this subset of proceedings, asserting an anti-deficiency defense in thirteen of them. This defense was technically inapplicable because Heritage was claiming fraud, not a deficiency, but at least the defense aimed in the right direction. Only three attorneys referred to a bar on fraud claims.²³³ One of twenty pro se defendants in this subset of proceedings asserted an anti-deficiency defense but none of them asserted the bar on fraud claims.²³⁴ Sixteen defendants in this subset of proceedings failed to appear.²³⁵

Defendants also failed to claim the protection against fraud claims in all fifty-nine proceedings in which the loan application stated an intention to use loan proceeds to refinance a primary residence. An attorney represented the defendant in thirty-seven of these proceedings, asserting an anti-deficiency defense in four of

²²⁹ See, e.g., Plaintiff's Complaint to Determine Dischargeability of Debt at 10, *In re Alcala*, No. 10-72258 (Bankr. N.D. Cal. Jan. 22, 2011), ECF No. 1; Plaintiff's Complaint to Determine Dischargeability of Debt at 9, *In re Garcia*, No. 11-41772 (Bankr. N.D. Cal. May 13, 2011), ECF No. 1.

²³⁰ See Exhibit A to Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Needham*, No. 11-02562 (Bankr. E.D. Cal. Aug. 12, 2011), ECF No. 1; Exhibit A to Exhibit Index, *In re Thomas*, No. 10-02716 (Bankr. E.D. Cal. July 1, 2011), ECF No. 26.

²³¹ See Plaintiff's Complaint to Determine Dischargeability of Debt at 9–13, *In re Hernandez*, No. 11-05058 (Bankr. N.D. Cal. Feb. 24, 2011), ECF No. 1.

²³² See Exhibit A to Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Moreno*, No. 11-01113 (Bankr. E.D. Cal. Apr. 15, 2011), ECF No. 1.

²³³ In one proceeding, the defendant, pro se through trial, first claimed the protection on appeal after retaining counsel. See Appellee's Brief at 28–33, *In re Trejo*, No. 11-1652 (B.A.P. 9th Cir. Mar. 7, 2012), ECF No. 20. In a second, the defendant erroneously relied on the comparable protection of section 7460(b) of the California Financial Code (applicable to savings and loan associations but not to the loan originator involved in the proceeding). See First Amended Answer at 5–6, *In re Rodriguez*, No. 11-05222 (Bankr. N.D. Cal. Jan. 19, 2012), ECF No. 17. In a third, the defendant also initially relied on the protection of section 7460(b) of the California Financial Code, Memorandum in Support of Defendant's Motion for Summary Judgment at 12–14, *In re Montano*, No. 11-04008 (Bankr. N.D. Cal. Feb. 21, 2012), ECF No. 57-1, but discussed section 726(g) in oral argument on a motion for summary judgment. See Transcript of Oral Argument on Motion for Summary Judgment at 43–49, *In re Montano*, No. 11-04008 (Feb. 23, 2013), ECF No. 206.

²³⁴ See, e.g., Exhibit A to Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Heng*, No. 11-02255 (Bankr. E.D. Cal. Apr. 11, 2011), ECF No. 1 (indicating intent to purchase primary residence) and Answer, *In re Heng*, No. 11-02255 (May 19, 2011), ECF No. 3 (asserting anti-deficiency defense).

²³⁵ See, e.g., Exhibit A to Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Phillips*, No. 10-62464 (Bankr. E.D. Cal. Dec. 28, 2010), ECF No. 1 (indicating intent to purchase primary residence), and Entry of Default and Order Re: Default Judgment Procedures, *In re Phillips*, No. 10-62464 (Mar. 28, 2011), ECF No. 11 (indicating failure to appear).

them. Although anti-deficiency legislation arguably did not, at the time, apply to loans used to *refinance* a primary residence and thus may not have protected these defendants against a bankruptcy dischargeable contract claim,²³⁶ section 726(g) is not so limited. It bars fraud claims without regard to the purpose of the loan as long as the loan to the defendant is secured by single-family, owner-occupied residential real property occupied by the defendant at the time of loan origination. None of the fourteen pro se defendants in this subset of proceedings asserted the section 726(g) protection. Eight defendants in this subset of proceedings failed to appear.

In sum, defendants failed to claim the section 726(g) protection against fraud claims in 154 of the 157 proceedings in which it was potentially available, not counting an additional unknown number of the forty-three proceedings in which information about use of the real property used to secure the loan was unavailable through PACER.²³⁷

There may have been good reason not to do so in some of the proceedings. Recall that in most of its complaints Heritage alleged *on information and belief* that the defendant had misstated employment, income *and/or intended use of the property as a principal residence*.²³⁸ The protection against fraud claims would have been unavailable to those whose loan applications misrepresented the defendant's occupancy of the residence. Indeed there were at least four such defendants.²³⁹ Attorneys representing some defendants may have learned these

²³⁶ Frequently cited dictum from one California appellate court decision states the inapplicability of the purchase money anti-deficiency rule to such loans. See *Bank of Am. v. Wendland*, 126 Cal. Rptr. 549, 553–54 (Cal. Ct. App. 1976). That dictum has been subject to scholarly criticism, Charles B. Sheppard, *California Code of Civil Procedure 580b, Anti-Deficiency Protection Regarding Purchase Money Debts: Arguments for the Inclusion of Refinanced Purchase Money Obligations Within the Anti-Deficiency Protection of Section 580b*, 6 S. CAL. INTERDISC. L.J. 245 (1997), and was disapproved in *Helvetica Servicing, Inc. v. Pasquan*, 277 P.3d 198, 203–04 (Ariz. Ct. App. 2012) (criticizing what it termed the "flawed" reasoning of *Wendland*). In 2012, California legislation explicitly extended anti-deficiency protection to credit transactions involving the refinancing of a purchase money loan that would have been protected under section 580b of the California Code of Civil Procedure. 2012 Cal. Stat., Ch. 64, § 1 (originally adding 580b(c)), and then 2013 Cal. Stat., Ch. 65, § 2 (SB 426) (renumbering 580b(c) as 580b(b)), now codified at CAL. CIV. PROC. CODE § 580b(b) (2012).

²³⁷ Loan applications in fifteen proceedings specified an investment purpose for the loan, loan applications in two proceedings did not specify a purpose for the loan, and the loan application erroneously attached to the complaint in one proceeding pertained to a person other than the named defendant.

²³⁸ See, e.g., Complaint to Determine Dischargeability of Debt at 3, *In re Alvarez*, No. 10-01575 (Bankr. C.D. Cal. Nov. 23, 2010), ECF No. 1.

²³⁹ In each of two proceedings in which the loan application represented a defendant's intention to use the loan proceeds for purchase of the defendant's primary residence, the defendant admitted to having acted as a straw buyer on behalf of a third person. See Stipulation for Mutual Release and Dismissal of All Claims Against Defendant Evaristo Aguirre at 2, *In re Aguirre*, No. 10-05371 (Bankr. N.D. Cal. Mar. 6, 2012), ECF No. 30; Deposition of Vien Keomeuangson, Exhibit E in Support of Plaintiff's Motion for Summary Judgment or in the Alternative for Partial Summary Judgment at 20, 29, 32, *In re Keomeuangsong*, No. 11-02525 (Bankr. E.D. Cal. Mar. 27, 2012), ECF No. 15.

In a third proceeding, a defendant declared that he purchased the subject real property for his sister. See Declaration of Garrett Palines in Support of Defendant's Motion for a Reasonable Attorney's Fee at 1–2, *In re Palines*, No. 12-03063 (Bankr. N.D. Cal. Nov. 2, 2012), ECF No. 39-1. Mr. Palines' loan application had represented his intention to purchase a primary residence. See Plaintiff's Complaint to Determine Dischargeability of Debt, *supra* note 40, at 8.

disqualifying facts from their clients and thus properly decided not to claim the protection afforded by section 726(g). The data does not reveal the number of other defendants whose loan applications falsely represented the defendant's intended use of the property and we thus cannot know the extent to which the actual adversary proceeding outcomes diverged from outcomes that section 726(g) would have commanded had it been asserted, pursued, and factually substantiated. It seems reasonable to suppose, however, that the loan applications of at least some, perhaps many, defendants, including those represented by an attorney, truthfully represented the defendant's intended use of the property as a personal residence.²⁴⁰ In every such proceeding, if the property was a single-family residence, the section 726(g) protection should have been claimed and, if pursued, should have led to dismissal without any payment to Heritage.

The section 726(g) protection led to dismissal of only one adversary proceeding, involving defendant Edgar Montano. Heritage's complaint included its standard information and belief allegation that the defendant's loan application had misstated employment, income, or intended use of property as a primary residence.²⁴¹ The bankruptcy court found that Mr. Montano used the property as a primary residence²⁴² and granted Mr. Montano summary judgment on the basis of section 726(g).²⁴³ The Ninth Circuit Bankruptcy Appellate Panel affirmed the judgment on appeal in an opinion both describing the relationship between section 726(g) and California's anti-deficiency legislation and rejecting Heritage's

In a fourth proceeding, the defendant admitted that the residence was not his primary residence and that his brother and brother's family lived in the property. See Joint Pretrial Order at 2, *In re Tovar*, No. 10-03016 (Bankr. C.D. Cal. Aug. 3, 2011), ECF No. 18.

In two other proceedings, Heritage submitted evidence that the defendant had applied for multiple loans within a short period of time yet had represented in each loan application an intention to use loan proceeds to purchase a primary residence. From that evidence, it drew the reasonable inference that the defendant used loan proceeds from at least one of the loans to acquire investment property. See Plaintiff's Memorandum of Points and Authorities in Support of Motion for Final Default Judgment by the Court Against Defendant Emmanuel Kongnyuy Nsahlai at 6, *In re Nsahlai*, No. 11-02983 (Bankr. C.D. Cal. Mar. 29, 2012), ECF No. 11-1; Plaintiff's Memorandum in Support of Its Motion for Final Default Judgment by the Court Against Maria Taraz at 5, *In re Taraz*, No. 10-90456 (Bankr. S.D. Cal. July 29, 2011), ECF No. 21-1.

In yet another proceeding, Heritage's complaint for recovery on two separate loans attached two loan applications, each signed by the defendant on December 5, 2006. One loan application stated a purpose to purchase a primary residence located at one address and the other loan application stated a purpose to purchase a primary residence located at another address. See Plaintiff's Complaint to Determine Dischargeability of Debt at 9–18, *In re Rodriguez*, No. 11-05222 (Bankr. N.D. Cal. July 24, 2011), ECF No. 1.

²⁴⁰ For example, one bankruptcy court found the defendant to have truthfully represented his intention to use loan proceeds to purchase a primary residence in a proceeding in which Heritage attempted to prove the contrary. See, e.g., Memorandum of Decision Re Defendant's Motion for Summary Judgment, *supra* note 121, at 4.

²⁴¹ See Plaintiff's Complaint to Determine Dischargeability of Debt at 2–3, *In re Montano*, No. 11-04008 (Bankr. N.D. Cal. Jan. 9, 2011), ECF No. 1.

²⁴² Transcript of Oral Argument on Motion for Summary Judgment, *supra* note 233, at 106–07.

²⁴³ *Id.* at 104–08; see Order on Defendant's Motion for Summary Judgment, *In re Montano*, No. 11-04008 (June 5, 2012), ECF No. 121.

arguments that section 726(g) was inapplicable.²⁴⁴ The bankruptcy court's order granting summary judgment, entered on June 5, 2012,²⁴⁵ and the Bankruptcy Appellate Panel's opinion, filed on November 1, 2013, came too late to offer ammunition to the many defendants whose adversary proceedings had already been resolved.

For example, we may infer that section 726(g) might have rescued at least one pro se defendant from the \$61,417 summary judgment entered against her on September 20, 2011. The bankruptcy court's judgment rested on its finding that Heritage had established a *prima facie* case based on misrepresentation of income.²⁴⁶ Heritage's moving papers evidenced only misrepresentation of income and employment but did not include evidence of a false representation about the intended use of the real property securing the loan.²⁴⁷ The absence of any such evidence lent credence to the defendant's prose addendum to her pro se answer to the complaint, in which she described her agent's advice to her about funding the purchase of a home.²⁴⁸ She didn't oppose the motion for summary judgment, likely unaware of how to do so or what to argue.

In contrast, the failure of another pro se defendant to assert the protection afforded by section 726(g) proved harmless because a different bankruptcy court concluded after trial that Heritage had failed to establish the requisite reliance on misrepresentations of income and employment.²⁴⁹ Prior to reaching that conclusion, the court sua sponte addressed and dismissed an anti-deficiency defense after finding that the defendant had truthfully represented his intention to live in the property purchased and had in fact lived in the property for an extended period of time.²⁵⁰ It correctly stated that Heritage would have no right to a deficiency under section 580b of the California Code of Civil Procedure absent a claim for fraud.²⁵¹ It was unaware, however, that section 726(g) of the California Code of Civil Procedure limited fraud claims and thus incorrectly concluded that Heritage's fraud

²⁴⁴ See *In re Montano*, 501 B.R. 96, 106–12 (B.A.P. 9th Cir. 2013).

²⁴⁵ See Order on Defendant's Motion for Summary Judgment, *In re Montano*, No. 11-04008 (June 5, 2012), ECF No. 121.

²⁴⁶ See Order Granting Motion for Summary Judgment, *supra* note 121.

²⁴⁷ See Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment at 5–6, *In re Gonzalez*, No. 11-02088 (Bankr. E.D. Cal. Aug. 22, 2011), ECF No. 14. Heritage's memorandum claimed that the defendant admitted a false representation concerning her intended use of the property to be acquired with loan proceeds by failing to respond to Heritage's request for admissions. See *id.* Although a matter is deemed admitted if the party to whom a request for admissions is directed fails to timely respond to them, FED. R. CIV. P. 36(a)(3), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 7036, Heritage's request for admissions, attached as an exhibit to its memorandum, had not asked the defendant to admit that she misrepresented her intended use of the property. See Plaintiff Heritage Pacific Financial's First Set of Requests for Admission to Defendant Yazmin Gonzalez, Exhibit A to Declaration of Brad A. Mokri in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment, *supra* note 163.

²⁴⁸ See Answer to Complaint to Determine Dischargeability of Debt and for Judgment at unnumbered third page, *In re Gonzalez*, No. 11-02088 (Mar. 10, 2011), ECF No. 7.

²⁴⁹ Order Following Trial, *supra* note 121, at 6–8.

²⁵⁰ *Id.* at 2, 4.

²⁵¹ *Id.* at 4.

claim could survive the defense.²⁵² Recall that the federal district court in the *David* case made the opposite error: it was aware of the limit on fraud claims and dismissed Heritage's fraud claim but overlooked the basic protection of section 580b and granted Heritage a judgment on a contract claim.²⁵³

The dispositions in the remaining proceedings involving pro se defendants who might have asserted but did not assert the protection afforded by section 726(g) were mixed.²⁵⁴ The defendant was absolved of any payment obligation in ten of these proceedings, primarily through a stipulated settlement with Heritage. In sixteen others, however, pro se defendants stipulated to pay various amounts to Heritage in settlement of its claims. Agreed amounts, payable in monthly installments, ranged from a low of \$2,000 in one proceeding to a high of \$25,000 in another proceeding and ranged as a percentage of Heritage's claim from a low of 2.6 percent in one proceeding to a high of 23.4 percent in another proceeding. In nine of these proceedings, however, the defendant also agreed to liability in a greater amount upon default in installment payments, ranging in amount from a low of \$20,000 in one proceeding to a high of \$77,677 in another proceeding and ranging as a percentage of Heritage's claim from a low of 20.3 percent in one proceeding to a high of 51 percent in another proceeding.²⁵⁵

The mix of dispositions in the proceedings in which an attorney represented a defendant²⁵⁶ and in which the protection afforded by section 726(g) might have been but was not asserted resembles the mix of dispositions in proceedings involving pro se defendants. The defendant was absolved of any payment obligation in twenty-nine such proceedings, primarily through a stipulated settlement with Heritage, but in two proceedings by summary judgment²⁵⁷ and in a

²⁵² *Id.*

²⁵³ See *supra* text accompanying notes 30–36.

²⁵⁴ The number of dispositions reported here and in the ensuing two paragraphs of the text excludes dispositions of proceedings for which PACER-accessible documents did not provide information about a defendant's represented use of the real property securing the loan.

²⁵⁵ Bankruptcy courts dismissed two other such proceedings upon Heritage's request based on settlements for undisclosed amounts and dismissed two others whose underlying bankruptcy case had been dismissed. Heritage obtained a \$59,154 default judgment of nondischargeability in another such proceeding against a defendant who failed to cooperate or appear after having informally agreed to a settlement in mediation.

²⁵⁶ These proceedings include eighty-one proceedings in which an attorney represented the defendant throughout the proceeding and thirteen others in which an attorney represented the defendant for only a portion of the proceeding.

²⁵⁷ In one of these two proceedings, the defendant submitted as an exhibit a mortgage interest statement showing the address of the defendant to be the same as the property identified in his loan application, evidence that would have supported a defense based on section 726(g). See Exhibits A and C to Declaration of Debtor in Support of Motion for Summary Judgment, *In re Machuca*, No. 10-05301 (Bankr. N.D. Cal. Oct. 27, 2011), ECF No. 24-3. But neither the defendant's answer nor his motion for summary judgment had asserted the defense. See Answer, *In re Machuca*, No. 10-05031 (Aug. 2, 2011), ECF No. 18; Motion for Summary Judgment, *In re Machuca*, No. 10-05031 (Oct. 27, 2011), ECF No. 24. In ruling on an appeal from a later order granting the defendant's motion for attorney's fees, the Bankruptcy Appellate Panel noted that the bankruptcy court had granted the summary judgment because of insufficient evidence of the originating lender's actual or reasonable reliance on alleged misrepresentations in the loan application. See *In re Machuca*, 483 B.R. 726, 731–32 (B.A.P. 9th Cir. 2012).

third proceeding following trial.²⁵⁸ In sixty others, however, the defendants agreed to pay various amounts to Heritage in settlement of its claims. Agreed amounts, payable in monthly installments, ranged from a low of \$500 in one proceeding to a high of \$32,000 in another proceeding and ranged as a percentage of Heritage's claim from a low of 0.9 percent in one proceeding to a high of 48.3 percent in another proceeding. In forty-eight of these proceedings, however, the defendant also agreed to liability in a greater amount upon default in installment payments, ranging in amount from a low of \$5,000 in one proceeding to a high of \$143,693 in another proceeding and ranging as a percentage of Heritage's claim from a low of 7.6 percent in one proceeding to a high of 100 percent in three other proceedings.²⁵⁹

We see a similar mix of dispositions in twenty-two proceedings in which a defendant failed to appear and in which the protection afforded by section 726(g) might have been but was not asserted. Bankruptcy courts entered a default judgment in the amount of Heritage's claim in six such proceedings, ranging in amount from \$51,710 to \$147,710. Heritage dismissed seven other such proceedings after the bankruptcy court either denied a motion for default judgment, required additional evidence or briefing in support of a motion for default judgment, or took no action in response to a motion for default judgment. Bankruptcy courts dismissed eight such proceedings upon Heritage's unexplained request for dismissal and one such proceeding when the underlying bankruptcy case was dismissed.

3. Heritage's Standing to Sue

A defense asserting Heritage's lack of standing to assert a fraud claim would have been available to every defendant whose note was acquired through agreements that did not also expressly assign a claim for fraud, regardless of the purpose for which the defendant used the loan funds. Although derived from California common law long predating the adversary proceedings, this defense did

In the other proceeding, neither the defendant's answer nor his motion for summary judgment asserted a defense based on section 726(g). See Answer to Complaint for Determination of Dischargeability of Debt, *In re Martinez*, No. 11-01131 (Bankr. C.D. Cal. Mar. 15, 2011), ECF No. 4; Notice of Motion and Motion for Summary Judgment, or in the Alternative, Partial Summary Adjudication of the Facts, *In re Martinez*, No. 11-01131 (Jan. 30, 2012), ECF No. 12. In granting the defendant's motion for summary judgment, the bankruptcy court acknowledged the defendant's evidence that the defendant had used the subject property as his primary residence but did not consider the protection afforded by section 726(g). See Memorandum of Decision Re Defendant's Motion for Summary Judgment, *supra* note 121, at 4.

²⁵⁸ In this proceeding, neither the defendant's answer nor her trial brief asserted the defense afforded by section 726(g). See Answer to Adversary Proceeding, *In re Vasquez*, No. 10-01663 (Bankr. C.D. Cal. Feb. 28, 2011), ECF No. 12; Defendant's Trial Brief, *In re Vasquez*, No. 10-01663 (Jan. 5, 2012), ECF No. 26. In the party's joint pre-trial order, Heritage indicated an intention to prove the defendant's misrepresentation of income but not any misrepresentation of her intent to use loan proceeds to purchase a primary residence. See Joint Pretrial Order, *In re Vasquez*, No. 10-01663 (Oct. 7, 2011), ECF No. 22. In granting judgment for the defendant following trial, the bankruptcy court found insufficient evidence to support several of the elements of a claim under section 523(a)(2) of the Bankruptcy Code, but did not consider the protection afforded by section 726(g). See Memorandum, *supra* note 121, at 7–13.

²⁵⁹ In one outlier, for reasons not evident from PACER-accessible documents, the defendant stipulated to pay Heritage 170% of its claim upon his default in monthly payments.

not gain traction publically until the California appellate court's *Monroy* decision in March 2013, discussed previously,²⁶⁰ resolving one of the Heritage lawsuits in state court.

In 1941, the California Supreme Court stated in *National Reserve Co. v. Metropolitan Trust Co.* that the unqualified assignment of a contract with no indication of the intent of the parties vests in the assignee the assigned contract "and all rights and remedies incidental thereto."²⁶¹ It continued:

Unless an assignment specifically or impliedly designates them, accrued causes of action arising out of an assigned contract, whether *ex contractu* or *ex delicto*, do not pass under the assignment as incidental to the contract if they can be asserted by the assignor independently of his continued ownership of the contract and are not essential to a continued enforcement of the contract.²⁶²

In *Monroy*, Heritage could not demonstrate that assignment of a note to it also specifically assigned a fraud claim first held by the originating lender. That left for resolution the question of whether the fraud claim represented a right incidental to the note or whether the fraud claim could be asserted independently by the originating lender and was not essential to enforcement of the note. The *National Reserve* opinion did not answer that question because the plaintiff in that case, an assignee of contract rights, was not asserting a fraud claim.²⁶³ Prior to *Monroy*, no reported California opinion had considered the question in the context of assignment of a note. The closest analogy, perhaps, was either a 1936 opinion holding that assignment of a note and chattel mortgage did not assign a right to recover for conversion of some of the collateral prior to the assignment²⁶⁴ or a 2005 opinion holding that a divorce agreement awarding a husband's interest in a diamond ring to the wife did not transfer to the wife the husband's claim for fraud against a jeweler.²⁶⁵

Only two bankruptcy judges considered this lack of standing defense. One took the matter under submission following a hearing, but the parties settled soon thereafter, making a ruling on the motion unnecessary.²⁶⁶ The other bankruptcy

²⁶⁰ See *supra* text accompanying notes 61–75.

²⁶¹ *Nat'l Reserve Co. of Am. v. Metro. Trust Co. of Cal.*, 112 P.2d 598, 602 (Cal. 1941).

²⁶² *Id.*

²⁶³ *Id.* at 599–600.

²⁶⁴ See *Millner v. Lankershim Packing Co.*, 56 P.2d 1295 (Cal. Ct. App. 1936).

²⁶⁵ See *Schauer v. Mandarin Gems of Cal., Inc.*, 23 Cal. Rptr. 3d 233, 237–38 (Cal. Ct. App. 2005).

²⁶⁶ Defendant Rosa Ortiz had filed a motion to dismiss that raised the standing issue. See Defendant Rosa Maria Ortiz's Notice of Motion and Motion to Dismiss for Lack of Subject Matter Jurisdiction; Memorandum of Points and Authorities in Support Thereof at 9–10, *In re Ortiz*, No. 11-01018 (Bankr. C.D. Cal. Oct. 20, 2011), ECF No. 19. The court held a hearing on the motion. See Docket, *In re Ortiz*, No. 11-01018 (Jan. 10, 2011). Before the court ruled on the motion, the parties stipulated to a judgment of

judge considered the defense in two separate proceedings, both before publication of the *Monroy* decision. In the first, involving defendant Elia Garcia, the judge rejected the defense, ruling that assignment of the note carried with it assignment of the fraud claim.²⁶⁷ A year later, in the *Montano* proceeding previously discussed,²⁶⁸ the judge lent a more sympathetic ear to the defense in a hearing on a defendant's motion for summary judgment, but granted the motion for summary judgment on another ground.²⁶⁹ In one proceeding, the Ninth Circuit Bankruptcy Appellate Panel declined to consider the defense because the pro se defendant had not raised it at trial.²⁷⁰ In all but one of the other proceedings in which a defendant had explicitly articulated the defense, the parties settled before its consideration by the court.²⁷¹

Whether one is persuaded by the bankruptcy judge's rejection of the defense or by the California appellate court's later vindication of the defense in *Monroy*, the truly remarkable fact is that defendants articulated the defense so rarely by way of answer, motion, or otherwise. They did so in only six of the 137 adversary proceedings in which an attorney represented a defendant. Not surprisingly, only one of forty-six pro se defendants raised the defense.²⁷² To be sure, twenty-eight other defendants represented by attorneys and two pro se defendants asserted lack of standing as an affirmative defense in an answer, but one cannot determine whether the boilerplate language used to express the defense in these additional proceedings derived from the specific theory described here, from some other theory, or simply from a form book or standardized answer.²⁷³

Had it been pressed with the defense in each proceeding, Heritage might not have produced documents that assigned a claim for fraud to Heritage. It failed to do

nondischargeability and installment payments from Ms. Ortiz to Heritage totaling \$6000. See Stipulation for Entry of Judgment and Settlement Agreement, *In re Ortiz*, No. 11-01018 (Jan. 11, 2012), ECF No. 34.

²⁶⁷ See Order Denying Motion for Reconsideration at 2–4, *In re Garcia*, No. 11-04150 (Bankr. N.D. Cal. Jan. 10, 2012), ECF No. 47.

²⁶⁸ See *supra* text accompanying notes 241–44.

²⁶⁹ See Transcript of Oral Argument on Motion for Summary Judgment, *supra* note 233, at 85–89, 104–08.

²⁷⁰ See *In re Trejo*, Ch. 7 No. NC-11-1652-HPaMk, 2012 Bankr. LEXIS 5881, at *19–20 (B.A.P. 9th Cir. Dec. 20, 2012).

²⁷¹ See, e.g., Joint Pretrial Order at 2, *In re Navarette*, No. 11-01167 (Bankr. C.D. Cal. Apr. 3, 2012), ECF No. 15 (raising defense) and Stipulation for Settlement and Dismissal of the Adversary Proceeding, *In re Navarette*, No. 11-01167 (Sept. 10, 2012) (settlement of \$4,500).

²⁷² See Answer at 4 (6th page of document), *In re Heng*, No. 11-02255 (Bankr. E.D. Cal. May 19, 2011), ECF No. 7.

²⁷³ Typical of the boilerplate language is the following: "AS A SEPARATE AND DISTINCT AFFIRMATIVE DEFENSE, Debtor alleges that plaintiff lacks standing to bring the causes of action asserted in the complaint." Answer to Complaint to Determine Dischargeability of Credit Card Debt at 6, *In re Garcia*, No. 11-04150 (Bankr. N.D. Cal. June 14, 2011), ECF No. 6. One suspects that the defense, when first asserted in that answer, was drawn simply from a standardized answer, because the caption of the answer had not been edited to reflect its probably more common use in defending against a claim for fraud in the use of a credit card. See *id.* at 1. Yet the defendant's attorney was one of the few who later relied on the specific theory described in the text. See Motion Setting Aside Order Denying Motion for Summary Judgment and Entering Order Granting Summary Judgment Pursuant to 11 U.S.C. § 105 and/or FRBP 9024 at 3–8, *In re Garcia*, No. 11-04150 (Nov. 22, 2011), ECF No. 37.

so in *Monroy* even though directed to do so by the trial court judge.²⁷⁴ Its unwillingness to do so in that case might have reflected the existence of a non-disclosure covenant in a written agreement between it and its immediate transferor.²⁷⁵ Or, more generally, the agreements between Heritage and its immediate transferors simply might not have included language expressly assigning fraud claims.²⁷⁶ Moreover, in the many cases in which Heritage obtained a note from entities other than the originating lender, it may not have even been able to locate and retrieve documents reflecting transfer of the notes from the originating lender to an initial transferee or between intermediate transferees. Unless and until Heritage produced documents reflecting transfers of both the notes and associated fraud claims, every defendant should have asserted and pursued the defense.

Yet even if one assumes that Heritage's right to enforce a note implicitly carried with it a right to assert an associated fraud claim, Heritage would still have lacked standing to assert its fraud claim if it could not prove a "right to enforce" the note within the meaning of Article 3 of the California Commercial Code.²⁷⁷ Heritage had a right to enforce a note if it was either a holder of the note or, under a shelter principle, if it was a non-holder in possession of the note who had the rights of a holder.²⁷⁸ It might have had difficulty doing so in the many proceedings involving notes that passed from an originating lender to Heritage through intermediate parties.

In many proceedings, Heritage submitted copies of a note or an allonge suggesting that it did not qualify as a holder of the note in its own right. Consider the following example. In a proceeding against defendants Numan and Lynda Ilayan, Heritage attached to its complaint a copy of a note issued by the Ilayans to First Magnus Financial Corporation (the originating lender) and a copy of an allonge showing an indorsement of the note from Cadlerock Joint Venture, L.P. ("Cadlerock") to Heritage.²⁷⁹ Nothing on either the note or the allonge showed an

²⁷⁴ See *Heritage Pac. Fin., L.L.C. v. Monroy*, 156 Cal. Rptr. 3d 26, 34–35 (Cal. Ct. App. 2013), *petition for review denied*, 2013 Cal. LEXIS 6631 (Cal. July 31, 2013).

²⁷⁵ Copies of each of three agreements pursuant to which Heritage purchased loan obligations, on file with the author, contain identical provisions prohibiting the parties from disclosing terms of the transaction (other than the identity of the seller and general nature of the transaction) without the written consent of the other except to the extent, among other things, that disclosure is required under applicable court order.

²⁷⁶ See *supra* text accompanying notes 69–74.

²⁷⁷ A few defendants obligated themselves through contracts, such as a home equity line of credit, that did not constitute negotiable instruments. In such cases, Heritage would still have had to demonstrate its right to enforce the contract by virtue of one or more transfers of rights under the contract. See *Cockerell v. Title Ins. & Trust Co.*, 267 P.2d 16, 20–21 (Cal. 1954). Such a transfer could be made by indorsement even though the contract was not a negotiable instrument. CAL. CIV. CODE § 1459 (2012).

²⁷⁸ See CAL. COM. CODE § 3301 (2012) (defining a person who is entitled to enforce an instrument). A promissory note is an instrument. *Id.* § 3104(a), (b), (e). The Commercial Code also gives certain persons without possession of an instrument a right to enforce it, *id.* § 3301, but Heritage seems to have had possession of the relevant notes.

²⁷⁹ See Plaintiff's Complaint to Determine Dischargeability of Debt at 13–16, *In re Ilayan*, No. 11-04079 (Bankr. N.D. Cal. Mar. 16, 2011), ECF No. 1.

indorsement by the originating lender.²⁸⁰ Absent such an indorsement, neither Cadlerock nor Heritage became a holder of the note.²⁸¹

Heritage held possession of the note, however, and would still have been entitled to enforce the note were it able to demonstrate that it held the rights of a holder deriving from a transfer from the originating lender to Cadlerock. Unlike negotiation, "transfer" does not require indorsement but does require delivery of the note for the purpose of giving the person receiving delivery the right to enforce the note.²⁸² Transfer even without negotiation vests in the transferee any right of the transferor to enforce the instrument.²⁸³ Suppose for example that the originating lender, a holder of the note and therefore someone with a right to enforce it, had without indorsement delivered the note directly to Heritage for the purpose of giving Heritage the right to enforce the note. Ben Ganter's declaration or testimony about Heritage's acquisition of the note would have sufficed to establish those facts because he was personally familiar with Heritage's business practices involving the purchase of notes.²⁸⁴ Heritage would thus have taken the rights of the originating lender to enforce the note. But assuming that Mr. Ganter lacked personal knowledge of how or from whom Cadlerock acquired the note, his testimony could not establish that Cadlerock took the rights of the originating lender through transfer. Heritage might have been unable to locate a witness with the relevant personal knowledge or unable to obtain documentary evidence demonstrating transfer from the originating lender to Cadlerock. Missing that link, as to which it had the burden of proof,²⁸⁵ it could not have established that Cadlerock and in turn Heritage took the rights of the originating lender to enforce the note. Without the right to enforce the note, either as a holder in its own right or as transferee from someone entitled to enforce the note, Heritage could not have demonstrated that it was the real party in interest and thus would have lacked prudential standing to assert its claim.²⁸⁶

²⁸⁰ See *id.*

²⁸¹ The originating lender was a holder of the note because the note was issued to it. CAL. COM. CODE § 3201; U.C.C. cmt. 1 (2012). A person acquiring the note from the originating lender could only itself become a holder through negotiation of the note by a holder. CAL. COM. CODE § 3201(a) (2012). Unless payable to bearer, negotiation requires indorsement by the holder. *Id.* § 3201(b). None of the notes held by Heritage were payable to bearer. Accordingly, Cadlerock was not a holder, and Heritage was not a holder because Cadlerock's indorsement was not an indorsement by a holder.

²⁸² CAL. COM. CODE § 3203(a).

²⁸³ *Id.* § 3203(b).

²⁸⁴ See *In re Tovar*, Ch. 7 No. CC-11-1696-MkDKi, 2012 Bankr. LEXIS 3633, at *27–28 (B.A.P. 9th Cir. Aug. 3, 2012).

²⁸⁵ CAL. COM. CODE § 3308; U.C.C. cmt. 2.

²⁸⁶ See *In re Veal*, 450 B.R. 897 (B.A.P. 9th Cir. 2011). Heritage likely derived ownership rights in the notes it purchased, but ownership rights alone would not have given it rights to enforce the notes against the defendants. For an explanation of that distinction and for discussion of the relevant provisions of Articles 3 and 9 of the Commercial Code, see James M. Davis, *Paper Weight: Problems in the Documentation and Enforcement of Transferred Mortgage Loans, and a Proposal for an Electronic Solution*, 87 AM. BANKR. L. J. 305, 322–30 (2013).

Not a single defendant articulated this version of the lack of standing defense in any of the adversary proceedings in which it would have been appropriate, although, as noted earlier, a relatively small number of defendants asserted what likely was a boilerplate lack of standing defense.²⁸⁷ The oversight was harmless in the forty-nine proceedings in which Heritage and the defendant settled for no payment to Heritage.²⁸⁸ Mr. and Mrs. Ilayan, however, agreed to a \$30,000 judgment of nondischargeability, as to which Heritage would refrain from execution if the Ilayans timely paid \$4000 through eight monthly installment payments.²⁸⁹ At least fourteen other defendants who could have asserted this lack of standing defense nonetheless entered settlement agreements with Heritage, in amounts ranging from \$5,000, satisfied by timely installment payments totaling \$500,²⁹⁰ to \$30,000, satisfied by timely installment payments totaling \$10,000.²⁹¹ One additional defendant who could have asserted the defense suffered a default judgment of \$77,037.62,²⁹² but a defense asserting lack of prudential standing is waived if not asserted.²⁹³ Conceivably, the defense may also have been available to multiple other defendants who agreed to judgments of nondischargeability, but PACER-accessible documents do not provide information sufficient to reach that conclusion.²⁹⁴

²⁸⁷ See *supra* note 273 and accompanying text.

²⁸⁸ See, e.g., Plaintiff's Complaint to Determine Dischargeability of Debt at 16–19, *In re Mena*, No. 11-05239 (Bankr. N.D. Cal. Aug. 13, 2011), ECF No. 1 (incomplete chain of indorsements), Answer to Complaint to Determine Dischargeability of Debt, *In re Mena*, No. 11-05239 (Sept. 9, 2011), ECF No. 4 (no standing defense plead), and Stipulation for Dismissal of all Claims Against Defendants Joaquin Mena and Rafaela Mena, *In re Mena*, No. 11-05329 (Apr. 9, 2012), ECF No. 17 (mutual releases).

²⁸⁹ See Settlement Agreement and Stipulation at 1–2, *In re Ilayan*, No. 11-04079 (Bankr. N.D. Cal. Sept. 27, 2011), ECF No. 13.

²⁹⁰ See Settlement Agreement and Stipulation at 1, 3, *In re Gomez*, No. 10-03197 (Bankr. N.D. Cal. Sept. 12, 2011), ECF No. 17. Ms. Gomez had signed a note payable to Oak Hill Mortgage, Inc.; an allonge showed an indorsement to Heritage from Argent Mortgage Co., L.L.C., but neither the note nor the allonge showed an indorsement by Oak Hill Mortgage, Inc. or anyone else to Argent. See Plaintiff's Exhibit List at 9–11, *In re Gomez*, No. 10-03197 (Sept. 6, 2011), ECF No. 14.

²⁹¹ See Stipulation for Entry of Judgment and Settlement Agreement at 3, *In re Han*, No. 11-02042 (Bankr. E.D. Cal. July 14, 2011), ECF No. 18. Mr. Han and his spouse had signed a note payable to Ownit Mortgage Solutions, Inc.; an allonge showed an indorsement to Heritage from Cadlerock Joint Venture, L.P., but neither the note nor the allonge showed an indorsement by Ownit Mortgage Solutions, Inc. or anyone else to Cadlerock. See Plaintiff's Complaint to Determine Dischargeability of Debt at un-paginated Exhibit B, *In re Han*, No. 11-02042 (Jan. 20, 2011), ECF No. 1.

²⁹² See Order for Judgment Against Defendant Manuel Orozco, *In re Orozco*, No. 11-02166 (Bankr. C.D. Cal. Nov. 15, 2011), ECF No. 15. Mr. Orozco had signed a note payable to Mortgage Lenders Network USA, Inc.; an allonge showed an indorsement to Heritage from Cadlerock Joint Venture, L.P., but neither the note nor the allonge showed an indorsement by Mortgage Lenders Network USA, Inc. or by anyone else to Cadlerock. See Plaintiff's Complaint to Determine Dischargeability of Debt at 11–13, *In re Orozco*, No. 11-02166 (May 5, 2011), ECF No. 1.

²⁹³ See *Pershing Park Villas Homeowners Ass'n v. United Pac. Ins. Co.*, 219 F.3d 895, 899 (9th Cir. 2000).

²⁹⁴ To be conservative in counting the number of proceedings in which this standing defense could have been successfully asserted, this Article did not count those proceedings in which the note included no indorsement whatsoever, either in its body or in an allonge. In those proceedings, the defense would have been unavailable if the originating lender had delivered the note directly to Heritage and this Article assumes that it did so. This Article also excludes from the count those proceedings in which an allonge may not have

III. PLAYING WITH A STACKED DECK

A. *Heritage's Hand*

Heritage acquired debt for a song and then litigated with a deck stacked in its favor. A paradigm "repeat player,"²⁹⁵ it litigated with superior information and litigated efficiently by mass-producing documents for filing. Given its apparent acquisition and litigation costs, it offered attractive settlements to defendants faced with the prospect of significant attorney's fees and ruinous liability.

Two attorneys in one law firm (assisted by an unknown number of special appearance attorneys and office staff) represented Heritage in virtually all of the adversary proceedings. Another attorney represented Heritage throughout five of the adversary proceedings and represented Heritage only initially in fifteen other adversary proceedings. In contrast, one hundred twenty-six different attorneys represented defendants in the roughly sixty-three percent of proceedings in which the defendant was represented by counsel (either throughout the proceeding or in part of the proceeding).²⁹⁶ The consolidation of representation on one side and dispersal of representation on the other afforded Heritage the advantage of superior information as the filings unfolded over time. With each additional filing, Heritage could learn from and adapt to defense positions and arguments advanced or judicial reactions expressed, whereas almost every attorney representing a defendant appeared in only one adversary proceeding and thus confronted issues posed by the litigation only once.²⁹⁷

Many attorneys may have been unaware of Heritage's comparable proceedings against others either in bankruptcy court, federal district court, or state court. Sound representation might have counseled a PACER name search for Heritage in one or more California federal district or bankruptcy courts, but an attorney's time gathering, sorting, reviewing, assimilating, and evaluating information and ideas available from PACER-accessible records filed in other Heritage adversary proceedings would have been prohibitively expensive to most defendants. Even if somehow affordable, the attorney could not assure the client in advance that the attorney's fees to be incurred for that work would be a good investment because the

been effective to show a complete chain of indorsements. An allonge is effective only if affixed to the note. CAL. COM. CODE § 3204(a) (2012). In one Heritage proceeding, the Ninth Circuit Bankruptcy Appellate Panel expressed some skepticism about whether the allonge was affixed to the note. *See In re Tovar*, Ch. 7 No. CC-11-1696-MkDKi, 2012 Bankr. LEXIS 3633, at *17–20 (B.A.P. 9th Cir. Aug. 3, 2012).

²⁹⁵ Professor Marc Galanter coined this term in Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95, 97 (1974).

²⁹⁶ When a law firm of two or more attorneys represented a defendant, this figure counts only one attorney even if more than one attorney associated with the firm appeared in the proceeding.

²⁹⁷ Only eleven attorneys represented a defendant in two of the adversary proceedings and two other attorneys represented a defendant in three of the proceedings. The nature and range of results in those twenty-eight adversary proceedings resemble the nature and range of results in the adversary proceedings generally.

attorney could not know in advance what a PACER search might reveal. Moreover, an attorney could not have learned of Heritage's state court actions through PACER. Learning about them would have been serendipitous and learning from them would have been extraordinarily time consuming and expensive.

This information asymmetry might have been mitigated somewhat in an unknown number of cases in which, through professional associations, ad hoc informal networks, or other communication, a defendant's attorney obtained information and ideas from attorneys representing other defendants.²⁹⁸ But that benefit to any one defendant would have been random and almost certainly would have been unavailable to pro se defendants. Many if not most pro se defendants would have been unaware of the PACER resource, unable to afford the cost of downloading records (typically \$.10/page),²⁹⁹ or unable to recognize, sift through, understand, or effectively utilize relevant PACER documents filed by Heritage in other adversary proceedings. In proceedings in which defendants appeared pro se, therefore, Heritage benefitted from vastly superior information.

One example of the information asymmetry is particularly noteworthy. Recall that in one of Heritage's federal district court actions the court ruled on October 17, 2011 that Heritage's fraud claim was barred by California's limitation on fraud claims.³⁰⁰ Heritage did not mention that unpublished (but PACER-accessible) ruling in any document filed in the three adversary proceedings it initiated after October 17, 2011 or in the many adversary proceedings still open on that date, but the failure of its attorneys to do so did not violate California's rules of professional responsibility.³⁰¹ Likely no defendant's attorney was aware of the ruling because none mentioned it in any document filed in any adversary proceeding. The absence of a professional obligation of Heritage's lawyers to disclose that ruling exacerbated the information asymmetry.

Consider another subtler example, derived from four Heritage adversary proceedings pending before the same judge. In two of them, the bankruptcy judge either denied a Heritage motion for default judgment or required Heritage to

²⁹⁸ The author, for example, supervised law students representing three such defendants and in the process soon learned of the mass filings and gained useful insights from two acquaintances, one a local bankruptcy attorney and the other a local consumer law attorney.

²⁹⁹ See PACER POLICIES AND PROCEDURES, https://www.pacer.gov/documents/pacer_policy.pdf (last updated Aug. 18, 2014).

³⁰⁰ See *supra* notes 30–32 and accompanying text.

³⁰¹ California's rules of professional conduct prohibit only citation of a decision that has been overruled, knowing its invalidity. See CAL. RULES OF PROF'L CONDUCT R. 5-200(D) (1992). American Bar Association Model Rules of Professional Conduct prohibit a lawyer from knowingly failing "to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel" MODEL RULES OF PROF'L CONDUCT R. 3.3(a)(2) (2002). Putting aside the question of whether an unpublished federal district court ruling was legal authority in the controlling jurisdiction, California lawyers may consider but are not bound by the A.B.A. Model Rules. See CAL. RULES OF PROF'L CONDUCT R. 1-100(A) (1992). Moreover, the limitation on fraud claims may not have been available in some of those proceedings, as discussed *supra* text accompanying notes 238–40.

provide further briefing in support of its motion.³⁰² In each, Heritage thereafter requested dismissal of the proceeding.³⁰³ In the other two, defendants represented by attorneys stipulated to judgments of nondischargeability and payments to Heritage, in one of them agreeing to pay \$18,000 in installments (9 percent of the claim) or \$36,000 (18 percent of the claim) upon default in installment payments.³⁰⁴ One wonders whether the attorneys representing the two defendants who settled were aware of the settlement leverage to be derived from the judge's skepticism in response to the two motions for default judgment.

Consider a final example of the information asymmetry. In his deposition in a state court action, Ben Ganter testified that in acquiring portfolios of loans he (perhaps he meant Heritage) did not inquire of the originating lenders what they relied upon in making loans.³⁰⁵ From this obscure testimony, known to Heritage and the deposing attorney, but likely by few others, it might be reasonably (if not conclusively) inferred that Heritage had no evidence of reliance by originating lenders when it filed its adversary proceedings. If Heritage were thereafter unable to acquire and present such evidence and the adversary proceeding were to be dismissed for that reason, Heritage might be liable for the defendant's attorney's fees because it lacked substantial justification for initiating the proceeding.³⁰⁶ Knowledge of that evidence would therefore have provided additional powerful settlement leverage to defendants.

In addition to its informational advantage, Heritage's mass production of pleadings, motions, legal memoranda, and declarations afforded Heritage economies of scale unavailable to defendants. Its mass production is evident from comparison of documents it filed in any one proceeding with corresponding documents that it filed in other proceedings,³⁰⁷ from obvious errors in some

³⁰² See Minute Order, *In re Garibay*, No. 10-90480 (Bankr. S.D. Cal. Feb. 24, 2012), ECF No. 28; Memo re Order: Request for further documentation or further action, *supra* note 91.

³⁰³ See Request for Dismissal of Adversary Proceeding Against Defendant Antonio Anguiano Garibay, *In re Garibay*, No. 10-90480 (Mar. 15, 2012), ECF No. 29; Request for Dismissal of Adversary Proceeding Against Defendant Darrell E. Cox, *supra* note 91.

³⁰⁴ See Settlement Agreement and Stipulation for Entry of Judgment, *In re Calderon*, No. 11-90402 (Bankr. S.D. Cal. June 5, 2012), ECF No. 18; Settlement Agreement and Stipulation for Entry of Judgment, *In re Dekoekkoek*, No. 11-90491 (Bankr. S.D. Cal. Oct. 17, 2012), ECF No. 16.

³⁰⁵ See Oral Deposition of Benjamin A. Ganter, *supra* note 6, at 47.

³⁰⁶ See *infra* notes 326–29 and accompanying text.

³⁰⁷ As we have seen, Heritage mass produced complaints. See *supra* note 112. With minor adjustments to each, Heritage also filed other documents multiple times, including memoranda in support of motions for default or summary judgment, pre-trial conference statements, trial briefs, settlement agreements, and judgments. Compare Plaintiff's Motion for Default Judgment by the Court, *In re Garibay*, No. 10-90480 (Aug. 19, 2011), ECF No. 17, with Plaintiff's Motion for Default Judgment by the Court, *In re Cox*, No. 11-90357 (Bankr. S.D. Cal. Apr. 3, 2012), ECF No. 17; compare Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment, *In re Lemus*, No. 10-01092 (Bankr. C.D. Cal. Sept. 16, 2010), ECF No. 13, with Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment, *In re Hellawell*, No. 10-03100 (Bankr. C.D. Cal. May 27, 2011), ECF No. 11-1; compare Plaintiff's Trial Brief, Declarations of Brad A. Mokri, Ben Ganter and Mark Schuerman in Support Thereof, *In re Villatoro*, No. 11-01315 (Bankr. C.D. Cal. Nov. 15, 2011), ECF No. 8, with Plaintiff's Trial Brief, *In re Mercado*, No. 10-02770 (Bankr. E.D. Cal. Sept. 28, 2011), ECF No. 21.

documents that might naturally have resulted from mass production,³⁰⁸ and by the sheer volume of documents, numbering in the thousands, filed by the three lawyers representing Heritage over a twenty-six month period. The mass production prompted one bankruptcy judge to express his concern, at an initial status conference, about "boilerplate language" in form complaints and to allude to similar concerns shared by his colleagues.³⁰⁹ The mass production probably also extended to written discovery propounded by Heritage, as is suggested by its apparent use of a standardized request for admissions as a device to prove its allegations.³¹⁰ As

³⁰⁸ Examples of errors abound. Most troubling are the multiple instances in which Heritage named a husband and wife even though only one of the parties had applied for the loan and signed the loan application and promissory note. *See, e.g.*, Plaintiff's Complaint to Determine Dischargeability of Debt at 1, 19, 22, 25, *In re Driscoll*, No. 11-02333 (Bankr. C.D. Cal. June 10, 2011), ECF No. 1 (signatures on loan application and note by Robert Driscoll but not by co-defendant Darlene Driscoll). That error was compounded in the multiple instances in which both such co-defendants stipulated to entry of a judgment against both, even if represented by an attorney. *See, e.g.*, Settlement Agreement and Stipulation for Entry of Judgment, *In re Driscoll*, No. 11-02333 (Dec. 8, 2011), ECF No. 10. This error might or might not be harmful, depending upon whether the person applying for the loan and signing the loan documents did so prior to his or her marriage to the co-defendant and whether the spouse who did not apply for the loan or sign the loan documents had separate property. In California, the community estate of the spouses is liable for the debts of either spouse incurred prior to or during marriage, CAL. FAM. CODE § 910 (2012), but the earnings of a married person are not liable for a debt incurred by the person's spouse prior to marriage, *id.* § 911(a), and the separate property of a spouse is not liable for a debt incurred by the other spouse either prior to or during the marriage. *Id.* § 913(b)(1).

One complaint alleged defendant Eduardo Guerrero's misrepresentations in an attached loan application but attached a loan application signed by Eduardo Ramirez. *See* Plaintiff's Complaint to Determine Dischargeability of Debt at 2–3, 10–13, *In re Guerrero*, No. 11-01223 (Bankr. C.D. Cal. Jan. 22, 2011), ECF No. 1.

In another complaint, Heritage alleged the defendant's misstatement of income on an attached loan application that included no statement of income. *See* Plaintiff's Complaint to Determine Dischargeability of Debt at 3, 10, *In re Chacon*, No. 11-05133 (Bankr. N.D. Cal. Apr. 21, 2011), ECF No. 1.

In three other complaints, Heritage alleged that the defendant misrepresented an intention to purchase property as a primary residence (a standard allegation) even though the attached loan application clearly stated only an intention to refinance investment property. *See, e.g.*, Plaintiff's Complaint to Determine Dischargeability of Debt at 4, 9, *In re Louie*, No. 11-01128 (Bankr. C.D. Cal. Feb. 10, 2011), ECF No. 1.

In another proceeding, Heritage supported its motion for summary judgment against defendant Miguel Arredondo with an alleged unanswered request for admissions served on him in which Request for Admission No. 17 asked the defendant to admit execution of a promissory note by a person named Yolanda Lemus. *See* Exhibit A, Plaintiff Heritage Pacific Financial's First Set of Request [sic] for Admissions to Defendant Miguel Arredondo at 4, *In re Arredondo*, No. 10-09065 (Bankr. E.D. Cal. Apr. 1, 2011), ECF No. 20.

Heritage also mass-produced proposed orders submitted to the court for signature on the basis of a stipulated judgment. One entered judgment "for the principal amount of fifteen-thousand dollars (\$52,000)." Order (Settlement Agreement and Stipulation for Entry of Judgment) at 1, *In re Diaz*, No. 11-02682 (Bankr. C.D. Cal. Nov. 1, 2011), ECF No. 6. Yet the settlement agreement called for a judgment of \$25,000, less payments made by the defendant pursuant to the stipulation, but provided that Heritage would not enforce the judgment if the defendant timely paid installments totaling \$4320. *See* Stipulation and Settlement at 1–2, *In re Diaz*, No. 11-02682 (Oct. 24, 2011), ECF No. 5.

³⁰⁹ *See* Case Management Conference at 2:45–3:06, *In re Makmuri*, No. 11-04111 (Bankr. N.D. Cal. Sept. 6, 2011), ECF No. 12.

³¹⁰ PACER typically does not capture discovery documents because the parties file neither discovery requests nor discovery responses unless in support of or in opposition to a motion or as trial exhibits. Heritage filed them in several such instances. *See, e.g.*, Plaintiff Heritage Pacific Financial's First Set of

noted earlier, Heritage also submitted multiple boilerplate declarations of an expert opining about lending practices relating to stated income loans.³¹¹

B. The Defendants' Hand

Attorneys representing defendants were not without benefit of some boilerplate of their own. Answers filed by many included affirmative defenses, bereft of factual detail, ranging from the plausible (statute of limitations, laches) to the expected (waiver, estoppel, unclean hands) to the irrelevant (accord and satisfaction, arbitration and award, contributory negligence, license, statute of frauds).³¹² At the extreme, one attorney filed an answer listing thirty-four affirmative defenses, the last preserving unknown latent defenses.³¹³ This standardized, over inclusive (and thus protective) response to a complaint is understandable given the short time period within which a defendant must file an answer to a complaint. Even when a plaintiff stipulates to an extension of time (a typical professional courtesy), the defendant's attorney has insufficient time and information to thoroughly consider the nature of appropriate defenses to be pleaded. After issuance of summons, a thirty-day clock starts ticking.³¹⁴ Once served, the defendant may need time to decide whether to retain an attorney and time to find a suitable attorney willing to schedule an appointment. The attorney may not be able to schedule an immediate initial appointment and the defendant may need time after the appointment to digest information (including information about attorney's fees) and choose among options. Once retained, the attorney may be adding the matter to an already crowded professional calendar, limiting the amount of time that can initially be devoted to the matter. Discovery that might reveal the most appropriate defenses cannot begin until after the parties have conferred and developed a proposed discovery plan.³¹⁵

But front-end time constraints and lack of information do not explain, or at least do not justify, an attorney's failure to aggressively dispute the originating lender's reliance or to discover and pursue defenses based on California's limitation on fraud claims or Heritage's lack of standing. We must look elsewhere for explanation.

Requests for Admission to Defendant Yazmin Gonzalez, Exhibit A to Declaration of Brad A. Mokri in Support of Plaintiff's Motion for Summary Judgment or in the Alternative, Partial Summary Judgment, *supra* note 163.

³¹¹ See *supra* text accompanying notes 130–37.

³¹² See Answer at 5, *In re Ballesteros*, No. 11-04045 (Bankr. N.D. Cal. May 9, 2011), ECF No. 7.

³¹³ See Answer at 2–9, *In re Chepetsky*, No. 10-90443 (Bankr. S.D. Cal. Feb. 1, 2011), ECF No. 14. This answer included the following potpourri of clearly irrelevant defenses: plaintiff's consent to the defendant's actions; plaintiff's failure to mitigate damages; res judicata; lack of consideration for contractual claims; lack of definite terms in a contract between plaintiff and defendant; assumption of the risk; set off; plaintiff's previous rejection of defendant's tender of performance; the defendant's conduct was privileged or justified; contracts between plaintiff and defendant have been rescinded. *Id.* at 2–8.

³¹⁴ See FED. R. BANKR. P. 7012(a).

³¹⁵ See FED. R. CIV. P. 26(d)(1), (f), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 7026.

Least flattering would be that some attorneys may lack the degree of knowledge or skill necessary to discover, formulate, or effectively communicate relatively obscure and complex legal arguments. This probably would not explain an attorney's failure to aggressively dispute the originating lender's reliance but might explain the failure to discover and pursue the two defenses. The law governing the reliance requirement in dischargeability actions under section 523(a)(2) of the Bankruptcy Code is relatively uncomplicated,³¹⁶ and discovery of the underwriting practices applied by an originating lender to a specific defendant's loan application would require only a request for production of the relevant loan file and perhaps a deposition of the originating lender's person most knowledgeable.

California's limit on fraud claims, however, is buried, incongruously, at the end of a lengthy section in a chapter of the California Code of Civil Procedure devoted to actions for the foreclosure of mortgages,³¹⁷ and a clear understanding of its scope and ramifications requires an understanding of what the Ninth Circuit Bankruptcy Appellate panel described as a "maze of elaborate and interrelated foreclosure and antideficiency statutes in California relating to the enforcement of obligations secured by interests in real property."³¹⁸ One lack of standing defense required a carefully crafted argument based on obscure California common law,³¹⁹ the other required understanding and application of interrelated provisions of Article 3 of the Commercial Code,³²⁰ and both required an understanding of federal procedural law governing prudential standing.³²¹ We can readily imagine that a legal team drawn from a blue chip law firm representing a Heritage defendant pro bono would have discovered and advanced these defenses. We can reasonably question whether every attorney could do so.

The cost of legal representation offers a second, hopefully more common, explanation. Given financial constraints on a defendant's ability to fund litigation, it would not have been surprising for a defendant's attorney to have allocated most of a limited amount of billable time to settlement negotiations and little to detailed legal research, analysis, or briefing. At least some of the defendants in the adversary proceedings likely would have been unable to fund extensive litigation; a significant number of debtors continue to experience financial distress following bankruptcy³²² and the potential attorney's fees could have been substantial.³²³

³¹⁶ We have seen, however, that the relevant analysis requires an understanding of the right of an assignee to assert the reliance of the originating lender, *see supra* note 17, an understanding that the nature of the required reliance (reasonable or justifiable) depends upon the nature of the misrepresentation claimed, *see supra* notes 108–11 and accompanying text, and an understanding of the applicable burden of proof, *see supra* note 106 and accompanying text.

³¹⁷ *See* CAL. CIV. PROC. CODE § 726 (2012) (in Part 2, Title 10, Chapter 1).

³¹⁸ *In re Montano*, 501 B.R. 96, 107 (B.A.P. 9th Cir. 2013).

³¹⁹ *See supra* notes 261–65 and accompanying text.

³²⁰ *See supra* notes 277–85 and accompanying text.

³²¹ *See supra* note 286 and accompanying text.

³²² *See* Porter & Thorne, *supra* note 98, at 88–93.

³²³ One defendant's attorney reported charging his client \$1750 for seven hours of work on a discovery motion (\$250/hr.). *See* Notice of Motion and Motion to Compel [sic] Answers to Discovery and for

Confronted with the possibility of liability on a five or six-figure claim and substantial attorney's fees fighting the claim, burdened with the emotional weight of the litigation, and seeking finality, represented defendants more often than not settled with Heritage well before trial for a small percentage of its claim.³²⁴ Heritage surely recognized the leverage this afforded.

Pro se defendants, in contrast, needn't have worried about attorney's fees. Perhaps for that reason, or others, pro se defendants among all districts obtained no-payment settlements at a slightly higher rate (thirty-six percent) than defendants among all districts represented by attorneys (thirty-one percent).³²⁵ Heritage may

Attorney's Fees at 3, *In re Gutierrez*, No. 10-03250 (Bankr. C.D. Cal. Sept. 18, 2011), ECF No. 26. Another defendant's attorney reported charging his client \$1375, at a rate of \$250/hr., for preparing a motion for sanctions under Rule 9011 of the Federal Rules of Bankruptcy Procedure. See Defendant's Notice of Motion and Motion for Sanctions under FRBP 9011 at 11, *In re Louie*, No. 11-01128 (Bankr. C.D. Cal. Aug. 25, 2011), ECF No. 9. He also reported a total of \$9,737.95 in attorney's fees and costs incurred from the inception of the case. See *id.*

A third defendant's attorney explained that his standard practice in representing defendants sued in adversary proceedings is to charge a \$2500 retainer to be charged at an hourly rate of \$300/hr., which he described as \$75–\$100 below the going market rate in the Central District of California. See Telephone Interview (June 25, 2014) (attorney's name withheld to protect anonymity). He commented that this retainer would typically cover work for sixty to ninety days. *Id.* Thereafter, he attempts to keep his receivables below \$2000/client, including by offering small discounts for prompt payment. *Id.* About four to six months before an anticipated trial, pursuant to his retainer agreement, he requires clients to pay an additional retainer for trial. If the clients can't or won't pay, he substitutes out or, if necessary, files a motion to withdraw. *Id.*

³²⁴ The attorney for one defendant reported: "[T]hough I was looking forward to trial against Heritage for my Bankruptcy clients, they recently decide [sic] to settle their claim at \$8000 no interest, payable at \$167.00 per month. Given the total claim was about \$127,000, I guess the settlement was reasonable." E-mail from attorney Peter Manning to attorney William Kennedy (Feb. 2, 2012) (on file with author). Conversations with three defendants revealed the same story. One defendant who vehemently denied misrepresenting his income and who had sent Heritage relevant tax transcripts as proof, nonetheless settled a \$140,662 claim for \$20,016 payable over five years, because his attorney had advised that attorney's fees could well exceed the amount of the settlement offer and had advised that Heritage had a small chance of prevailing in the proceeding. See Telephone Interview with Defendant (Aug. 29, 2014) (name withheld to preserve anonymity). A second defendant retained an attorney for a \$1000 initial retainer. Heritage, believing the defendant to be unrepresented, telephoned the defendant to offer a twelve percent settlement on a \$65,895 claim. In a five minute conversation, the parties settled the claim for \$6000, payable over forty-two months. The defendant believed the proceeding to lack merit, but settled because he believed he would have to pay at least the settlement amount in attorney's fees and that he could conceivably lose in the litigation. See Telephone Interview with Defendant (Oct. 7, 2014) (name withheld to preserve anonymity). A third defendant settled a \$124,555 claim for \$30,000 payable over ninety months for the same reasons. See Telephone Interview with Defendant (Aug. 22, 2014) (name withheld to preserve anonymity).

³²⁵ Likewise, two researchers studying litigation before the United States Tax Court found "lack of any statistically significant effect of counsel on the IRS's recovery ratio in settled cases," a finding suggesting that counsel do not obtain better settlements than pro se taxpayers. Leandra Lederman & Warren B. Hsung, *Do Attorneys Do Their Clients Justice? An Empirical Study of Lawyers' Effects on Tax Court Litigation Outcomes*, 41 WAKE FOREST L. REV. 1235, 1264 (2006). More recently, however, two Harvard researchers concluded that observational studies of case files, of which the tax court study and this study are examples, cannot validly measure the effects of legal representation on outcome because of inherent methodological limitations, including the failure to account for selection effects. See D. James Greiner & Cassandra Wolos Pattanayak, *Randomized Evaluation in Legal Assistance: What Difference Does Representation (Offer and Actual Use) Make?*, 121 YALE L.J. 2118, 2176–96 (2012) (reviewing literature on dozens of observational studies of case files in a wide range of civil contexts, including bankruptcy). This Article therefore makes no general claim about the effect of representation on outcome. Nonetheless, it may be of interest to note the

have recognized some pro se defendants to be both judgment proof and incapable of making installment payments (they couldn't even afford an attorney) and may therefore have agreed to no-payment settlements with them to avoid wasted additional expense. Conceivably, then, retaining an attorney diminished a defendant's chances of a no-payment settlement by signaling to Heritage the possibility that a defendant could afford installment payments in settlement of its claim.

Heritage's potential liability for a defendant's attorney's fees conceivably could have offset Heritage's litigation advantages to some extent. Section 523(d) of the Bankruptcy Code directs a bankruptcy court to award the debtor a reasonable attorney's fee incurred in an adversary proceeding in which a creditor requests a determination of the dischargeability of a consumer debt under section 523(a)(2), the debt is discharged, and the court finds that the creditor's position was not substantially justified, unless the court finds that special circumstances would make such an award unjust.³²⁶ The creditor bears the burden of proving that its claim was substantially justified,³²⁷ and to sustain its burden the creditor must establish that its claim had a reasonable basis both in law and in fact, a standard derived from the showing required for attorney's fees under the federal Equal Access to Justice Act.³²⁸ Substantial justification must persist through trial.³²⁹

Fear of incurring liability for a defendant's attorney's fees might have deterred Heritage from filing adversary proceedings against some potential defendants when it considered even colorable claims of misrepresentation or reliance to have been weak. Likewise, fear of incurring such liability might have contributed to Heritage's decision to dismiss forty-four of the adversary proceedings in which an attorney represented a defendant through a stipulation calling for a mutual release of all claims.³³⁰ We cannot learn whether either is true absent knowledge of Heritage's internal deliberations or its privileged communications with its attorneys.

further finding of this study that represented defendants in the Heritage adversary proceedings who agreed to installment payments to Heritage in settlement of its claim fared no better, on average, than pro se defendants who agreed to installment payments to Heritage in settlement of its claim. On average, represented defendants agreed to installment payments totaling 11.9% of Heritage's claim, with the median total of installment payments equal to 9.9% of its claim, whereas on average pro se defendants agreed to installment payments totaling 9.38% of Heritage's claim, with the median total installment payments equal to 7.6% of its claim. In contrast, in those settlements in which the defendant agreed to a larger liability upon default in installment payments, represented defendants agreed, on average, to liability equal to 39.3% of Heritage's claim, with the median liability equal to 30.3% of its claim, whereas pro se defendants, on average, agreed to liability equal to 47.4% of Heritage's claim, with the median liability equal to 49.9% of its claim.

³²⁶ See 11 U.S.C. § 523(d) (2012).

³²⁷ See, e.g., *In re Montano*, 501 B.R. 96, 114 (B.A.P. 9th Cir. 2013).

³²⁸ See *First Card v. Hunt (In re Hunt)*, 238 F.3d 1098, 1103 (9th Cir. 2001).

³²⁹ See *In re Harvey*, 172 B.R. 314, 318–19 (B.A.P. 9th Cir. 1994).

³³⁰ See, e.g., *Stipulation and Settlement, In re Flores*, No. 10-05400 (Bankr. N.D. Cal. Oct. 11, 2011), ECF No. 19; *Stipulation and Settlement, In re Barocio*, No. 11-05009 (Bankr. N.D. Cal. Oct. 4, 2011), ECF No. 19.

Absent conversations with defendants represented by an attorney, we also cannot learn their fee arrangements with their attorneys or why, after securing representation, those who settled for a mutual release of all claims thereby abandoned a claim for attorney's fees. We can speculate with some confidence on both questions, however. A few attorneys might have been willing to represent a defendant pro bono (either before or after the fact). A few attorneys might have been willing to condition the defendant's obligation to pay attorney's fees on an attorney's fees award, but that would have been a blind and therefore precarious and rare gamble. Heritage could escape liability for attorney's fees by demonstrating that even its losing position was substantially justified or that special circumstances made an attorney's fee award unjust. An attorney could not possibly have predicted at the outset whether the debt would be dischargeable or whether, even if dischargeable, Heritage could escape liability for attorney's fees. The "substantial justification" and "special circumstances" components of section 523(d), therefore, compound an attorney's uncertainty and undermine the incentive to undertake contingent representation. Accordingly, most attorneys likely charged their clients an initial retainer and thereafter billed for time.³³¹ It thus would be no surprise that a defendant would be amply motivated to stipulate to mutual releases when offered the opportunity to avoid a very large adverse judgment and the outlay of additional attorney's fees, even if, at the time of a Heritage settlement offer, the defendant's attorney had a better sense of the prospect for recovering attorney's fees. Heritage was certainly wise enough to understand and capitalize on that motivation.³³² It was also interested in protecting its own purse; it did not stipulate to pay a defendant's attorney's fees in any of the adversary proceedings.

Only five defendants represented by an attorney, each appearing before a different bankruptcy judge, sought to recover attorney's fees.³³³ Each had obtained a judgment of dischargeability (one predicate for an award of attorney's fees), four through summary judgment³³⁴ and one following trial.³³⁵ Three of the five prevailed

³³¹ Had a defendant sought representation from an attorney who had represented the defendant in the underlying chapter 7 proceeding, the attorney's fees charged for that earlier representation would not typically have covered representation in a subsequent adversary proceeding. See, e.g., *Guidelines for Legal Services to be Provided by Debtors' Attorney in Chapter 7 Cases*, U.S. BANKR. COURT, N. DIST. OF CAL., <http://www.canb.uscourts.gov/procedure/guidelines-legal-services-be-provided-debtors-attorney-chapter-7-cases> (last visited Apr. 29, 2015).

³³² It should be noted, however, that Heritage denied in one adversary proceeding that it was filing the proceeding in the hope of extracting a settlement from an honest debtor hoping to save attorney's fees. See Plaintiff Heritage Pacific Financial's Opposition to Defendant's Motion for Attorney's Fees at 7, *In re Palines*, No. 12-03063 (Bankr. N.D. Cal. Nov. 16, 2012), ECF No. 41.

³³³ One other defendant, Rosa Vasquez, prevailed at trial, without making an appearance at trial, shortly after the judge granted her attorney's motion to withdraw as counsel. Memorandum, *supra* note 121, at 4, 13. Her attorney's declaration in support of his motion to withdraw cited Ms. Vasquez's failure to pay attorney's fees, failure to keep an appointment, and failure to otherwise cooperate. See Notice of Motion for Withdrawal [sic] of Counsel at 7, *In re Vasquez*, No. 10-01663 (Bankr. C.D. Cal. Jan. 19, 2012), ECF No. 28. Neither she nor her former attorney thereafter sought an award of attorney's fees. Docket, *In re Vasquez*, No. 10-01663 (Nov. 8, 2010).

³³⁴ See Summary Judgment Determining Dischargeability of Debt, *In re Machuca*, No. 10-05301 (Bankr. N.D. Cal. Dec. 21, 2011), ECF No. 37; Summary Judgment in Favor of Defendant, *In re Martinez*, No. 11-

on the motion, obtaining attorney fee judgments of \$8,975.00,³³⁶ \$69,782.19,³³⁷ and \$40,000,³³⁸ respectively.

One bankruptcy judge denied the motion of a fourth defendant on multiple grounds.³³⁹ Another bankruptcy judge denied the motion of a fifth defendant on grounds stated on the record but not in the judge's order.³⁴⁰ The defendant's attorney in that proceeding later explained that the judge found substantial justification for the adversary proceeding because the defendant had failed to list his ownership of a restaurant on his bankruptcy schedules and Heritage could therefore reasonably argue that the loan application's reference to ownership of a restaurant was a misrepresentation.³⁴¹ If that explanation is correct, the judge's finding of substantial justification is puzzling.

The judge earlier had found that the defendant had not in fact misrepresented his ownership of a restaurant;³⁴² the originating lender therefore could not possibly have erroneously relied on that truthful representation. The judge also found that the lender had not conducted even a minimal amount of due diligence before approving the defendant's loan and had also not demonstrated that the defendant's failure to include an additional source of income on his loan application could have adversely affected the lender.³⁴³ It is thus difficult to see how Heritage could have been substantially justified in believing that it could demonstrate reliance by the originating lender. A similar failure to demonstrate reliance by the originating lender led other bankruptcy judges to make two of the three attorney's fee awards mentioned above.³⁴⁴ Here too, then, we see disparate outcomes, but the disparity is

01131 (Bankr. N.D. Cal. Oct. 29, 2012), ECF No. 37; Order on Defendant's Motion for Summary Judgment, *In re Montano*, 11-04008 (Bankr. N.D. Cal. June 5, 2012), ECF No. 121; Order Granting Defendant Garrett Palines' Motion for Summary Judgment on Claim of Plaintiff Heritage Pacific Financial, *In re Palines*, No. 12-03063 (Oct. 30, 2012), ECF No. 38.

³³⁵ See Judgment After Trial, *In re Adrian*, No. 10-01334 (Bankr. C.D. Cal. Dec. 6, 2012), ECF No. 49.

³³⁶ Order Awarding Attorneys Fees at 2, *In re Machuca*, No. 10-05301 (Jan. 28, 2012), ECF No. 43.

³³⁷ Order on Defendant's Motion for Attorney's Fees and Costs at 3, *In re Montano*, No. 11-04008 (Jan. 25, 2013), ECF No. 198.

³³⁸ Order on Motion for Attorney Fees and Costs at 1, *In re Adrian*, No. 10-01334 (Mar. 28, 2013), ECF No. 62.

³³⁹ See Order Denying Motion for Attorneys' Fees, *In re Palines*, No. 12-03063 (Dec. 3, 2012), ECF No. 51; Oral Argument at 13:20–16:30, *In re Palines*, No. 12-03063 (Dec. 4, 2012), ECF No. 48 (capturing judge's conclusion that the debt, incurred to purchase a home for the defendant's sister, was not a consumer debt, that the creditor may have been substantially justified in pursuing the proceeding, and that, in any event, special circumstances justified denial of attorney's fees because of the defendant's unclean hands).

³⁴⁰ See Order Denying Defendant's Motion for Attorney's Fees, *In re Martinez*, No. 11-01131 (Bankr. C.D. Cal. Jan. 29, 2013), ECF No. 47.

³⁴¹ See Telephone Interview with Donna Dishbak, Attorney for Defendant Rolando Martinez (June 14, 2014).

³⁴² See Memorandum of Decision Re Defendant's Motion for Summary Judgment, *supra* note 121, at 7.

³⁴³ See *id.* at 10.

³⁴⁴ See Transcript of Defendant's 523(a) Motion for Award of Attorney's Fees at 4–8, *In re Machuca*, No. 10-05301 (Bankr. N.D. Cal. Mar. 29, 2012), ECF No. 52; Transcript of Oral Argument on Motion to Reconsider of [sic] Court's Order Denying Request for an Award Filed by Jesus Montano, *supra* note 174, at 30–49.

easier to justify than disparity in findings about actual reliance because of the subjective and flexible nature of the "substantial justification" standard.

Heritage appealed each of the three adverse attorney fee judgments to the Ninth Circuit Bankruptcy Appellate Panel. Heritage neither moved to stay the judgments pending appeal³⁴⁵ nor stayed their enforcement by supersedeas bond.³⁴⁶ The Panel affirmed two of the judgments. In December 2012, it affirmed the \$8,975 judgment rendered in and unpaid since January 2012.³⁴⁷ In November 2013, it affirmed the \$69,782.19 judgment rendered in and unpaid since January 2013.³⁴⁸ Heritage paid neither judgment after losing the appeals.³⁴⁹ In January 2014, the Bankruptcy Appellate Panel suspended hearing of the third appeal, from the \$40,000 judgment rendered in and unpaid since March 2013,³⁵⁰ upon Heritage's January 2014 filing of a chapter 7 bankruptcy petition. It later dismissed the appeal for failure of Heritage or its chapter 7 trustee to file required status reports.³⁵¹

Heritage's filing of a chapter 7 petition following its extended failure to pay the three judgments highlights the potential impotency of section 523(d) of the Bankruptcy Code.³⁵² Prior to Heritage's chapter 7 filing, only one of the three defendants attempted to enforce his judgment. The long and continuing saga of his attorney's extraordinary but mostly unsuccessful attempts to collect both his \$69,782.19 attorney's fees judgment and a subsequent attorney's fees award of \$59,555.63 for attempting to enforce that initial judgment merit a separate article.³⁵³

³⁴⁵ A party may by motion seek a stay of a bankruptcy court judgment pending appeal. *See* FED. R. BANKR. P. 8007.

³⁴⁶ A party may by supersedeas bond stay enforcement of a judgment pending appeal. *See* FED. R. CIV. P. 62(d), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 7062.

³⁴⁷ *See In re Machuca*, 483 B.R. 726, 728–29 (B.A.P. 9th Cir. 2012).

³⁴⁸ *See In re Montano*, 501 B.R. 96, 114–19 (B.A.P. 9th Cir. 2013).

³⁴⁹ *See* Interview with Stanley Zlotoff, Attorney for Defendant Raul Machuca, Jr., in San Jose, Cal. (Feb. 11, 2014); Telephone Interview with Tessa Santiago, Attorney for Defendant Jesus Montano (Jan. 12, 2015).

³⁵⁰ *See* Order Suspending Prosecution of Appeal, *In re Adrian*, No. 13-1175 (B.A.P. 9th Cir. Jan. 21, 2014), ECF No. 22.

³⁵¹ *See* Order Dismissing Appeal, *In re Adrian*, No. 13-1175 (Apr. 30, 2015), ECF No. 28.

³⁵² The same problem also attends mandatory fee shifting statutes (i.e. those in which a court must award attorney's fees to a prevailing consumer irrespective of the plaintiff's justification for the action). For example, a California appellate court affirmed an attorney's fee judgment of \$87,525 against Heritage under the mandatory fee shifting provision of the Fair Debt Collection Practices Act (15 U.S.C. § 1692k(a)(3) (2012)). *See, e.g.,* *Heritage Pac. Fin., L.L.C. v. Monroy*, 156 Cal. Rptr. 3d 26, 49–56 (Cal. Ct. App. 2013), *petition for review denied*, 2013 Cal. LEXIS 6631 (Cal. July 31, 2013). In its subsequent bankruptcy filing, Heritage listed the judgment creditor, Maribel Monroy, as holding a \$190,000 non-priority unsecured claim. *See* Petition of Heritage Pacific Financial, L.L.C., *supra* note 3, at 37 (Schedule F).

³⁵³ Since at least February 12, 2013, when the defendant filed a motion for leave to file post-judgment interrogatories designed to elicit information about the location, nature, and extent of Heritage's ability to pay the judgment, the defendant has attempted to enforce its judgment for attorney's fees against Heritage, against alleged assignees of Heritage, and against persons and entities alleged to be alter egos of or otherwise closely aligned with Heritage. *See* Defendant's Rule 26(b) Motion for Additional Interrogatories, *In re Montano*, No. 11-04008 (Bankr. N.D. Cal. Feb. 12, 2013), ECF No. 202. The bulk of the next 203 docket entries in the proceeding, dating through June 10, 2015, concern the defendant's ongoing efforts to enforce its original and subsequent attorney's fee awards. *See, e.g.,* Order Fixing Fees Incurred in Enforcing the January 25, 2013 Order Awarding Fees, *In re Montano*, No. 11-04008 (May 19, 2014), ECF No. 388 (awarding \$55,362.10 in attorney's fees and costs incurred in enforcing the original judgment); Defendant's

The failure of any of the three defendants to collect the judgments (except to the extent Heritage's chapter 7 trustee may pay a dividend to unsecured creditors) also highlights either the altruistic or the speculative efforts of the attorneys representing the defendants, each of whom appears either to have undertaken the representation on contingency or written off the fees.³⁵⁴

C. *Wild Cards*

The foregoing portrait of Heritage's stacked deck captures much of what Professor Marc Galanter described in his influential theoretical essay on the general features of an American-like legal system.³⁵⁵ Professor Galanter's essay included a detailed portrait of litigation between what he termed "repeat players," those engaging in similar litigation over time, and "one-shotters," those drawn only occasionally into court.³⁵⁶ He described the "ideal type" of repeat player as "a unit which has had and anticipates repeated litigation, which has low stakes in the outcome of any one case, and which has the resources to pursue its long-run interests."³⁵⁷ The repeat player's multiple strategic advantages therefore include advance intelligence, developed expertise, ready access to specialists, economies of scale, low startup costs for any case, the likelihood that the one-shotter will adopt a strategy that will minimize the probability of maximum loss, and the ability of the repeat player to forego tangible gain in one case, such as by settling a case where it expects an unfavorable outcome, while spending resources in another regarded as more likely to produce a favorable generally applicable rule.³⁵⁸ Galanter speculated that legal services amplify these strategic advantages. The repeat player, he suggested, may obtain better legal services than many a one-shotter in part because of the repeat player's ability to pay higher rates for a large quantity of continuing work and because its attorneys benefit from accumulated information and

December 23, 2014 Status Report—Collections on Judgment, *In re Montano*, No. 11-04008 (Dec. 23, 2014), ECF No. 400. Ironically, the defendant recovered \$59,555.63 of the attorney's fee award through enforcement proceedings only to surrender that amount to Heritage's chapter 7 bankruptcy trustee in settlement of the trustee's subsequent action to set aside that recovery as a preferential transfer. *See id.* at 2.

³⁵⁴ At the hearing on the attorney's fee application of defendant Leidy Adrian, Mr. Adrian's attorney commented to the court that her client had paid her only \$500 to help pay for a transcript. *See* Transcript of Oral Argument on Motion for Attorney's Fees and Costs at 40, *In re Adrian*, No. 10-01334 (Bankr. C.D. Cal. July 18, 2013), ECF No. 74. In the author's telephone conversations with attorneys for two other defendants, the confidentiality of communications between attorney and client prevented the attorney's disclosure of the amount of attorney's fees, if any, actually paid by each defendant. Speculation that those defendants have not paid attorney's fees derives both from the amount of attorney's fees involved in each proceeding and from reading between the lines of what each attorney was able to disclose.

³⁵⁵ *See* Galanter, *supra* note 295.

³⁵⁶ *Id.* at 97.

³⁵⁷ *Id.* at 98.

³⁵⁸ *Id.* at 98–101.

experience.³⁵⁹ Cases often "take the form of stereotyped mass processing with little of the individuated attention of full-dress adjudication."³⁶⁰

Wild cards muddy this portrait. The exercise of discretion by trial court judges is one wildcard. As we have seen, some judges took a more inquisitive or active role in the litigation, or a more skeptical view of Heritage's position, than others. On functionally identical facts and issues, some denied and others granted motions for default judgment. Although default judgments are ordinarily disfavored, a court may, in the exercise of its discretion, enter a default judgment after considering one or more of several factors: the possibility of prejudice to the plaintiff; the merits of the plaintiff's substantive claim; the sufficiency of the complaint; the sum of money at stake in the action; the possibility of dispute concerning material facts; whether the default was due to excusable neglect; the strong policy favoring decisions on the merits.³⁶¹ The differences in outcome in resolution of motions for default judgment are to some extent enshrined by procedural rules: denial of a motion for default judgment is generally not a final, appealable order,³⁶² and entry of a default judgment may only be undone if a defendant appears and successfully moves to set aside the judgment, such as for inadvertence, surprise, or excusable neglect.³⁶³

On functionally identical facts and issues, some judges granted a defendant's motion for summary judgment or denied a Heritage motion for summary judgment but one granted a Heritage motion for summary judgment. Although appellate review of the grant of a motion for summary judgment is *de novo*,³⁶⁴ neither side on the losing end of a summary judgment appealed. For Heritage, appeal may not have been worth the expense. The pro se defendant suffering a summary judgment may have lacked the resources or sophistication to appeal. Decisions in the few trials diverged, but here too inconsistency will often be sanctioned because a trial court's factual findings are reversible only if clearly erroneous.³⁶⁵

Heritage faced additional isolated instances of unpredictable judicial activism, skepticism, or lack of tolerance. After a defendant had filed an answer to Heritage's complaint, one judge *sua sponte* dismissed the complaint with leave to amend for failure to plead fraud claims with particularity, ordered Heritage to file and serve proof of its status as real party in interest, and stayed until further court order all

³⁵⁹ *Id.* at 114.

³⁶⁰ *Id.* at 108–09.

³⁶¹ *See* Eitel v. McCool, 782 F.2d 1470, 1471–72 (9th Cir. 1986).

³⁶² *See In re Lee*, 186 B.R. 695, 697 (B.A.P. 9th Cir. 1995).

³⁶³ *See* FED. R. CIV. P. 55(c), 60(b)(1), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 7055.

³⁶⁴ *See* SNTL Corp. v. Ctr. Ins. Co. (*In re SNTL Corp.*), 571 F.3d 826, 834 (9th Cir. 2009).

³⁶⁵ The Ninth Circuit Bankruptcy Appellate Panel articulated that same standard of review in both upholding a trial court judgment of nondischargeability in favor of Heritage against defendant Javier Tovar and in upholding a trial court judgment of dischargeability in favor of defendant Oscar Trejo against Heritage. *See In re Tovar*, Ch. 7 No. CC-11-1696-MkDKi, 2012 Bankr. LEXIS 3633, at *12 (B.A.P. 9th Cir. Aug. 3, 2012); *In re Trejo*, Ch. 7 No. NC-11-1652-HPaMk, 2012 Bankr. LEXIS 5881, at *6 (B.A.P. 9th Cir. Dec. 20, 2012).

discovery other than that relating to Heritage's status as real party in interest.³⁶⁶ In one of the twenty-three proceedings in which Heritage and a pro se defendant filed a settlement stipulation calling for the defendant to pay money to Heritage, the judge, prior to entering judgment, ordered a hearing, to be attended by the defendant, to consider the circumstances leading to the stipulation and to assess whether the defendant understood the consequences of entry of a judgment based on the stipulation.³⁶⁷ In one of seventy-nine proceedings in which Heritage and a represented defendant filed such a settlement stipulation, the judge ordered a hearing on the settlement agreement and requested production of the full loan file.³⁶⁸ At a status conference following the clerk's entry of another defendant's default, one judge required that Heritage notice a hearing on a motion for default judgment on one of three specified days and ordered Heritage to notify the court of the date chosen within seven days of the status conference.³⁶⁹ In doing so, the court apparently voiced concerns about the credibility of the claim.³⁷⁰ Heritage's specially appearing attorney failed to timely communicate the message to Heritage's regular counsel.³⁷¹ The judge dismissed the adversary proceeding when Heritage failed to notify the court of a date chosen for the hearing.³⁷² Heritage's subsequent motion to vacate the dismissal for mistake and excusable neglect, noticed for a date "[t]o be determined,"³⁷³ went unheard.³⁷⁴

The contrasting nature of settlements between Heritage and many of the defendants suggests additional wildcards at work. Heritage and a defendant filed a written settlement stipulation in 152 of the 218 adversary proceedings. Attorneys represented defendants in 116 of these proceedings;³⁷⁵ defendants represented

³⁶⁶ See Civil Minute Order, *In re Torell*, No. 11-01080 (Bankr. E.D. Cal. May 11, 2011), ECF No. 14. After Heritage filed its amended complaint, which included as an exhibit a copy of a note from the defendant to an originating lender and the lender's indorsement of the note to Heritage, the judge, seemingly unsatisfied that the indorsed note sufficed, ordered Heritage to file and serve a copy of documents showing that plaintiff was the real party in interest. See *id.*

³⁶⁷ See Notice of Hearing on Pro Se Stipulation for Entry of Judgment, *In re Ramirez*, No. 11-01545 (Bankr. C.D. Cal. Aug. 19, 2011), ECF No. 12.

³⁶⁸ See Order Setting Hearing on Stipulation for Entry of Judgment and Settlement Agreement, *In re Salas*, No. 10-01574 (Bankr. C.D. Cal. Dec. 29, 2011), ECF No. 21; Declaration of Ben Ganter Re: Production of Full Bank File, *In re Salas*, No. 10-01574 (Feb. 22, 2012), ECF No. 28-4.

³⁶⁹ See Docket, *In re Rodas*, No. 10-04182 (Bankr. N.D. Cal. July 22, 2010).

³⁷⁰ See Amended Declaration of Brad A. Mokri in Support of Plaintiff Heritage Pacific Financial, L.L.C.'s Motion for an Order to Set Aside Court's Order of October 1, 2010, Dismissing the Adversary Proceeding at 3, *In re Rodas*, No. 10-04182 (Nov. 18, 2010), ECF No. 15.

³⁷¹ See *id.* at 2.

³⁷² See Order Dismissing Adversary Proceeding, *In re Rodas*, No. 10-04182 (Oct. 4, 2010), ECF No. 9.

³⁷³ Heritage Pacific Financial, L.L.C.'s Notice of Motion and Motion for an Order to Set Aside Court's Order of October 1, 2010, Dismissing the Adversary Proceeding, at 1, *In re Rodas*, No. 10-04182 (Nov. 18, 2010), ECF No. 12.

³⁷⁴ See Docket, *In re Rodas*, No. 10-04182 (July 22, 2010).

³⁷⁵ This number includes nineteen proceedings in which an attorney substituted in for a previously pro se defendant. In one of these nineteen proceedings, the defendant's attorney signed the settlement stipulation but had not appeared in the proceeding.

themselves in the remaining thirty-six proceedings.³⁷⁶ Data presented in Table 2 indicates that, when represented by an attorney, defendants sued in the Northern District who thereafter settled with Heritage obtained dismissals of the proceedings with no payment to Heritage ("no-payment settlements") much more frequently than represented defendants sued in the other three districts. Applying the Chi-Square test of independence to that data reveals that this disparity among districts for represented defendants is statistically significant.³⁷⁷ The disparity is therefore almost certainly attributable to some underlying cause or causes.

TABLE 2: Stipulated Settlements with Represented Defendants
(Where "O" = observed frequency of settlements
and "E" = expected frequency of settlements)³⁷⁸

	<i>Northern District</i>	<i>Eastern District</i>	<i>Central District</i>	<i>Southern District</i>	<i>Total</i>
\$0 to Heritage	O = 20 E = 8.0690	O = 7 E = 6.8276	O = 9 E = 18.3103	O = 0 E = 2.7931	O = 36
>\$0 to Heritage	O = 6 E = 17.9310	O = 15 E = 15.1724	O = 50 E = 40.6897	O = 9 E = 6.2069	O = 80
Total	O = 26	O = 22	O = 59	O = 9	O = 116

This disparity among districts in no-payment settlements for represented defendants might be the result, in part, of what others have called local legal culture:

[S]ystematic and persistent variation in local legal practices as a consequence of a complex of perceptions and expectations shared by many practitioners and officials in a particular locality, and differing in identifiable ways from the practices, perceptions, and expectations existing in other localities subject to the same or a

³⁷⁶ This number includes two proceedings in which a defendant initially represented by an attorney was acting pro se at the time of the settlement.

³⁷⁷ The chances that the disparity is the result of random distribution are less than one in a hundred. In technical terms, $\chi^2(3) = 36.50$, $p < .01$, where $\chi^2 = \sum (O - E)^2/E$. One reaches the same conclusion even when excluding the small Southern District sample (where the expected frequency < 5).

The sample size for settlements with pro se defendants is too small to justify either a similar or contrary conclusion about the distribution of no-payment settlements among districts. But the data in that small sample at least suggests that there may be no statistically significant disparity among districts for pro se defendants, and there is no intuitive reason to think otherwise.

³⁷⁸ Expected frequencies of settlements are derived by multiplying the total of a row by the total of a column and dividing that product by the total population (e.g., $36 \times 26/116$).

similar formal legal regime.³⁷⁹

For example, judicial pressure to use mediation, or the amenability of attorneys to mediation,³⁸⁰ a potential feature of local legal culture, might explain some of the disparity. Represented defendants mediated most frequently in the two districts, Central and Southern, with the highest percentage of settlements requiring payment to Heritage. Nineteen represented defendants in the Central District and six represented defendants in the Southern District settled the litigation through mediation. Twenty-one of the twenty-five who did so settled for some payment to Heritage. In contrast, only one represented defendant in the Northern District mediated the dispute. Heritage dismissed that proceeding without filing a written settlement agreement but a status conference statement filed shortly before dismissal refers to a tentative settlement agreement for an unstated amount.³⁸¹ Yet differences among districts in the frequency of mediation by represented defendants do not explain all of the disparity and might not explain any of it. Only two represented defendants in the Eastern District settled the litigation through mediation. Both agreed to some payment to Heritage, but so did a majority of those who settled without mediation. Likewise, many represented defendants in the Central District agreed to some payment to Heritage without having mediated the dispute.

Absent additional data, we can only speculate about other potential reasons for the generally more advantageous settlement outcomes accruing to represented defendants in the Northern District. Without exhausting the possibilities, perhaps attorneys who represented defendants in the Northern District adversary proceedings more frequently perceived that the assigned bankruptcy judge would be especially exacting in considering Heritage's fraud claims—another potential feature of local legal culture. Communicating that perception to Heritage's out-of-the-area attorneys might have provided the defendants with more effective settlement leverage.³⁸² Perhaps more attorneys who represented defendants in

³⁷⁹ Teresa Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *The Persistence of Local Legal Culture: Twenty Years of Evidence from the Federal Bankruptcy Courts*, 17 HARV. J. L. & PUB. POL'Y 801, 804 (1994). Professor Jean Braucher earlier described local legal culture somewhat more narrowly as the context created by local administrative practices of judges and trustees and prevailing professional attitudes. See Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L. J. 501, 503 (1993).

³⁸⁰ Mediation of adversary proceedings is available in all four districts. See, e.g., Bankr. N.D. Cal. R. 9040-1 to 9050-1.

³⁸¹ See Joint Status Report at 2, *In re Hernandez*, No. 11-04007 (Bankr. N.D. Cal. Sept. 1, 2011), ECF No. 13.

³⁸² The progress of two adversary proceedings before the same judge in the Central District illustrates how Heritage might have been influenced to settle or abandon an adversary proceeding because of its perception of a judge's proclivity. The progress of those two adversary proceedings also supports this Article's claim that Heritage's adversary 218 proceedings were functionally identical.

In a proceeding involving non-appearing defendant Maria Becerra, Heritage filed a motion for default judgment in April 2011. Plaintiff's Motion for Default Judgment and Memorandum in Support of its Motion for Final Default Judgment by the Court Against Maria R. Becerra, *In re Becerra*, No. 10-01517 (Bankr.

Northern District adversary proceedings, in contrast to their counterparts in other districts, had created or joined an effective network of communication with one another (by happenstance or otherwise) and utilized that network in the Heritage adversary proceedings for the exchange of information, ideas, work product, or simply moral support.³⁸³ Perhaps, fortuitously, more attorneys who represented defendants in Northern District adversary proceedings, in contrast to their counterparts in other districts, provided representation pro bono or at reduced rates. Communicating that information to Heritage would diminish Heritage's settlement leverage because Heritage would know that the defendant's continuation of litigation would be less expensive to the defendant than Heritage might otherwise anticipate. Whether for these or other reasons, most represented defendants in the Northern District who settled with Heritage were more fortunate than represented defendants in other districts.

IV. RESHUFFLING THE STACKED DECK

The Heritage adversary proceedings in California bankruptcy courts were not unique. It also filed fifty adversary proceedings in the bankruptcy courts of Florida, Nevada, and Arizona in 2011 and 2012.³⁸⁴ Waugh Real Estate Holdings, another

C.D. Cal. Apr. 29, 2011), ECF No. 12. Following a hearing on the motion in June 2011, the court requested supplemental briefing on the issue of reliance. Court's Request for Supplemental Brief on Justifiable Reliance in Motion for Default Judgment, *supra* note 140. After Heritage submitted supplemental briefing, the court denied the motion. Denial of Judgment Against Defendant Maria Becerra, *supra* note 144. After Heritage submitted additional supplemental briefing, the court again denied the motion. Order Denying Entry of Judgment Against Defendant Maria Becerra, *supra* note 146. In a second proceeding before the same judge involving non-appearing defendant Jose Villegas, Heritage filed a motion for default judgment in May 2011, three weeks after filing the same motion in the *Becerra* adversary proceeding, but sought a judgment without hearing. See Plaintiff's Notice of Motion for Default Judgment by the Court, *In re Villegas*, *supra* note 147. The court took no action on the motion, but Heritage, presumably awaiting the court's decision on its earlier filed motion in *Becerra*, also took no further action on the motion (other than seeking a protective order). See Docket, *In re Villegas*, No. 10-01526 (Bankr. C.D. Cal. Aug. 31, 2010). In March 2013, the court issued an order to show cause why the action should not be dismissed for failure to prosecute. See Order to Show Cause Re Dismissal for Failure to Prosecute, *supra* note 147. Shortly thereafter Heritage requested dismissal of the proceeding. Request for Dismissal of Defendant Jose Asuncion Villegas, *supra* note 147. The court then dismissed the action. See Order on Dismissal of Defendant Jose Asuncion Villegas, *In re Villegas*, No. 10-01526 (Mar. 27, 2013), ECF No. 22.

³⁸³ The geographically more compact dimensions of the Northern District might facilitate the formation and effectiveness of such a network because of the increased likelihood of personal interaction at professional gatherings or in court. Although the Northern District stretches along the California coast from Monterey County in the south to Del Norte County in the north, a distance of approximately 400 miles, Heritage filed adversary proceedings exclusively in the San Francisco, Oakland, and San Jose divisions of the Bankruptcy Court for the Northern District of California. The dimensions of the San Francisco Bay area are considerably smaller than those of the Central District, where filings occurred in divisions as distant from one another as Santa Barbara and Riverside Counties, and also considerably smaller than those of the Eastern District, where filings occurred in divisions as distant from one another as Fresno and Sacramento Counties.

³⁸⁴ PACER searches revealing these filings are on file with author. Review of the documents filed in these fifty proceedings was beyond the scope of this study. Complaints in three of them, one chosen at random from the filings in each of the three states, mimic the complaints Heritage filed in California bankruptcy

debt buyer, filed nine adversary proceedings in Nevada bankruptcy courts in 2011, 2012, and 2013, each comparable in factual allegations and theory to those filed by Heritage.³⁸⁵ Nor are such adversary proceedings likely to be exceptional given continuing securitization of some revenue streams that may derive from dubious lending practices, borrower fraud, or both.³⁸⁶ There is thus good reason to consider reshuffling the stacked deck in anticipation of future opportunities for repeat filing debt buyers or other plaintiffs who are not the originating creditor ("covered entity").³⁸⁷ Easier and less expensive access to information, procedures for transfer and consolidation of related adversary proceedings, and amendments to the Bankruptcy Code's attorney fee shifting statute would mitigate the advantages of covered entities, increase the consistency of trial court decisions, and reduce unnecessary duplication of both attorney and judicial effort.

A. Reducing Information Asymmetry

Local bankruptcy rules in each of California's four federal districts require that a plaintiff initiating an adversary proceeding file an Adversary Proceeding Cover Sheet ("Cover Sheet") with the complaint.³⁸⁸ Among other things, the Cover Sheet, an official bankruptcy form, requires the plaintiff to provide information about any related adversary proceeding.³⁸⁹ Heritage filed a Cover Sheet in all but three of the

courts. See Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Rey*, No. 11-01764 (Bankr. S.D. Fla. Mar. 7, 2011), ECF No. 1; Complaint to Determine Dischargeability of Debt, *In re Spartacus*, No. 11-01145 (Bankr. D. Nev. June 6, 2011), ECF No. 1; Plaintiff's Complaint to Determine Dischargeability of Debt, *In re Williams*, No. 11-01159 (Bankr. D. Ariz. June 28, 2011), ECF No. 1.

³⁸⁵ Copies of each complaint are on file with author. In one of these adversary proceedings, the defendant prevailed at trial upon the court's finding that Heritage had failed to sustain its burden of proving both defendant's knowing or intentional misrepresentations and reliance by the originating lender. See *In re Daecharkhom*, 481 B.R. 641 (Bankr. D. Nev. 2012), *rev'd in part*, *In re Daecharkhom*, 505 B.R. 898 (B.A.P. 9th Cir. 2014) (reversing limitation on award of defendant's attorney's fees).

³⁸⁶ For example, potentially dubious lending practices in generating securitized subprime auto loans have prompted Justice Department coordination of a nationwide investigation of whether loans were based on falsified income or employment information. See Michael Corkery & Jessica Silver-Greenberg, *Investment Riches Built on Auto Loans to Poor*, N.Y. TIMES, Jan. 27, 2015, at A1; see also Al Yoon & Katy Burne, *Investors Clamor for Risky Debt Offerings*, WALL ST. J., Apr. 3, 2014, at C1 (strong demand for high yield investments has led to loosening of some underwriting standards).

³⁸⁷ A debt buyer could be defined, as it is in California, as "a person or entity that is regularly engaged in the business of purchasing charged-off consumer debt for collection purposes, whether it collects the debt itself, hires a third party for collection, or hires an attorney-at-law for collection litigation." CAL. CIV. CODE § 1788.50(a)(1) (2012). Heritage disputed its characterization as a debt buyer, claiming instead an intricate relationship with the owner of the claims that it was asserting. See *supra* note 2. Accordingly, to prevent evasion of the procedures, covered entities could be defined more broadly, as suggested in the text.

³⁸⁸ See Bankr. N.D. Cal. R. 7003-1; Bankr. E.D. Cal. R. 7003-1; Bankr. C.D. Cal. R. 7003-1; Bankr. S.D. Cal. R. 7003-1.

³⁸⁹ *Adversary Proceeding Cover Sheet* at 2 (revised Aug. 2007), ADMIN. OFFICE OF U.S. COURTS, <http://www.uscourts.gov/forms/bankruptcy-forms/adversary-proceeding-cover-sheet> (last visited Feb. 2, 2016). This form of the Adversary Proceeding Cover Sheet (Form 104) was replaced effective December 1, 2015 by a revised form (Form 1040) that revised only its number. *Adversary Proceeding Cover Sheet* (revised Dec. 2015), ADMIN. OFFICE OF U.S. COURTS, <http://www.uscourts.gov/forms/bankruptcy-forms/adversary-proceeding-cover-sheet-0> (last visited Feb. 2, 2016).

adversary proceedings (presumably inadvertently failing to do so in those three). In the portion of the Cover Sheet calling for information about a related adversary proceeding, Heritage provided no information about comparable adversary proceedings it had filed. Instead, it consistently identified the very adversary proceeding that it was filing as "related to" the debtor's underlying bankruptcy case.³⁹⁰ That surely is not the meaning of "related adversary proceeding." An adversary proceeding ipso facto arises in and is related to the underlying bankruptcy case, and the Cover Sheet also requires the plaintiff to separately provide information about the underlying bankruptcy case.³⁹¹ To re-identify the adversary proceeding being filed as related to the underlying bankruptcy case thus provides no additional information. Bankruptcy local rules for the Northern District of California make this clear, defining a "related adversary proceeding" as those in which *both* adversary proceedings concern some of the same parties and are based on the same or similar claims or when both "appear likely to involve duplication of labor or might create conflicts and unnecessary expenses if heard by different judges."³⁹²

Heritage may have overlooked that definition, considered it inapplicable, or deliberately ignored it. But no one seems to have noticed. PACER documents reveal no instance in which any defendant raised this issue; they also reveal no instance in which any bankruptcy judge criticized or sanctioned Heritage for improper completion of the Cover Sheet even though at least some of the judges were aware that Heritage had filed comparable actions in the same division, the same district, or other districts.³⁹³ The Cover Sheet may simply be so pro forma that attorneys and judges pay insufficient attention to its proper completion. Moreover, given the format of the Cover Sheet, it is not surprising and probably not blameworthy for Heritage to have completed the form as it did, unless it deliberately refrained from identifying the other adversary proceedings that it had filed. The Cover Sheet provides space for information about only one related adversary proceeding (without inviting an attachment to list additional related adversary proceedings), calls for that information in the same outlined box in which the plaintiff is required to identify the underlying bankruptcy proceeding, and offers no guidance on the subject in its instructions.³⁹⁴ It certainly does not seem to have been designed to alert defendants or the court to a covered entity's mass filing of comparable adversary proceedings.

³⁹⁰ See, e.g., Adversary Proceeding Cover Sheet at 2, *In re Gonzalez*, No. 11-02088 (Bankr. E.D. Cal. Feb. 7, 2011), ECF No. 2.

³⁹¹ See *id.*

³⁹² See Bankr. N.D. Cal. R. 7042-1(a). Bankruptcy local rules for the Eastern District of California offer a nearly identical definition of related cases. See Bankr. E.D. Cal. R. 123(a). Bankruptcy local rules for the Southern District of California offer a somewhat less expansive definition. See Bankr. S.D. Cal. R. 7003-2. Bankruptcy local rules for the Central District of California do not define a related adversary proceeding. See Bankr. C.D. Cal. R. 7003-1–7069-2.

³⁹³ See *supra* text accompanying note 156.

³⁹⁴ *Adversary Proceeding Cover Sheet*, *supra* note 390, at 1–2.

Revised instructions on and formatting changes to the Cover Sheet (or an alternative form of Cover Sheet for covered entities) could insure increased disclosure of related adversary proceedings if proper completion of such a revised Cover Sheet were to be enforceable by sanctions. Alternatively, or in addition, federal procedural rules could be amended to require that a covered entity furnish information about related adversary proceedings in the mandatory initial disclosures already required without a discovery request.³⁹⁵ The covered entity would be required to supplement these disclosures as it filed additional related adversary proceedings.³⁹⁶

Better still, a covered entity could be required to establish, maintain, and regularly update a website, searchable by district and time of filing, listing all of its related adversary proceedings. To save defendants and their attorneys the significant cost of searching PACER for potentially helpful information from each proceeding so listed, the covered entity could also be required to upload to the website, and link to, each dispositive court order rendered in response to identified types of motions (e.g. a motion for default judgment, a motion to dismiss, or a motion for summary judgment) or rendered following trial.³⁹⁷ The covered entity would also be required to identify and provide the URL for the website in its Cover Sheet. Free open source software is available to create the website and the expense of hosting the website would be trivial.³⁹⁸ An employee's time in creating the website and uploading dispositive court orders would add to the expense, but probably in an amount only marginally increasing the covered entity's cost of doing business.

B. A Better Mechanism for Transfer and Consolidation

Beyond simple disclosure of information about "related" proceedings, the likely purpose of the Cover Sheet is to alert defendants or judges to the possibility of either consolidation of adversary proceedings pending before the same judge or transfer of an adversary proceeding to another judge before whom a related adversary proceeding is then pending. Federal rules authorize consolidation of

³⁹⁵ See FED. R. CIV. P. 26(a)(1), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 7026. A party failing to provide mandatory initial disclosures is subject to a wide variety of sanctions, including dismissal of the action. See FED. R. CIV. P. 37(c)(1), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 7037.

³⁹⁶ A party must supplement its initial disclosures in a timely manner if its initial disclosures are incomplete in some material respect. See FED. R. CIV. P. 26(e)(1), made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 7026.

³⁹⁷ Similar websites have been utilized in connection with management of a class action. See, e.g., *Vibram FiveFingers Class Action*, HEFFLER CLAIMS GROUP, <https://www.fivefingerssettlement.com/> (last visited June 4, 2015).

³⁹⁸ Free open source software to create the website is available at WORDPRESS.COM, <https://wordpress.com/> (last visited June 4, 2015). Low cost hosting of a website is available at BLUEHOST, <http://www.bluehost.com/> (last visited June 4, 2015).

actions involving a common question of law or fact³⁹⁹ for the purpose, among others, of conserving the resources of the court and the parties and to avoid inconsistent or conflicting results.⁴⁰⁰ But consolidation simply brings together proceedings then pending before a single judge.⁴⁰¹ Local bankruptcy rules in the Northern District of California go further, authorizing transfer of an adversary proceeding to another judge in the district for the same reasons.⁴⁰² Local bankruptcy rules in the Central and Southern Districts are either less expansive or less explicit on the subject but nonetheless seem to comprehend the same general theme: two or more adversary cases presenting issues that can more consistently and efficiently be resolved by one judge should be resolved by one judge.⁴⁰³ Local bankruptcy rules for the Eastern District do not provide for such a transfer, but the Eastern District requirement to file a Cover Sheet that lists a related adversary proceeding implies that a judge in that district is empowered to order such a transfer.

No defendant or judge sought transfer of any Heritage adversary proceeding to another judge hearing another Heritage adversary proceeding. The intra-district transfer procedure alone is in any event ill-suited to bringing together before a single judge a multitude of related adversary proceedings filed by a covered entity over time in multiple districts and multiple divisions within each district. Heritage filed the adversary proceedings over a roughly two-year period. No one (perhaps not even Heritage) could have predicted at the outset how many proceedings it would file in each division or each district. Spotting the pattern of virtually identical proceedings would take time. By the time someone spotted the pattern, some of the proceedings earlier initiated would have been closed. Even putting these practical obstacles aside, it would not have been feasible to transfer a large number of the Heritage adversary proceedings to one judge without an overarching mechanism for adjusting distribution of caseloads and dealing with a variety of procedural issues.⁴⁰⁴

Concepts and procedures identified in the Federal Judicial Center's Manual for Complex Litigation ("Manual")⁴⁰⁵ and in the federal multi-district litigation

³⁹⁹ See FED. R. CIV. P. 42, made applicable to bankruptcy adversary proceedings by FED. R. BANKR. P. 7042.

⁴⁰⁰ See 8 JAMES WM. MOORE ET AL., *MOORE'S FEDERAL PRACTICE* ¶ 42.10[4] (3d ed. 2015).

⁴⁰¹ *Id.* § 42.11[1].

⁴⁰² See Bankr. N.D. Cal. R. 7042-1(d). Because local bankruptcy rules of the Bankruptcy Court for the Northern District of California govern each of its four divisions (San Jose, Oakland, San Francisco, and Santa Rosa), this rule presumably authorizes transfer of a proceeding not simply within a division but also to another division in the same district.

⁴⁰³ See Bankr. S.D. Cal. R. 7042-1(a) 7003-2, 7042-1; Bankr. C.D. Cal. R. 1073-1.

⁴⁰⁴ Although it might have been feasible to transfer the six Heritage adversary proceedings filed in the San Francisco Division of the Northern District to one judge sitting in that division or the seven Heritage adversary proceedings filed in the Santa Ana Division of the Central District to one judge sitting in that division, it would not have been feasible to transfer the forty-seven Heritage adversary proceedings filed in the Los Angeles Division of the Central District to one judge in that division, or the 125 Heritage adversary proceedings filed in the Central District to one judge sitting in that district.

⁴⁰⁵ See *MANUAL FOR COMPLEX LITIGATION (FOURTH)* (2004).

statute⁴⁰⁶ suggest a mechanism that could make such transfers feasible, either across divisions or across districts. Both contemplate consolidation of actions before a single judge (or in some cases more than one judge) to foster consistent outcomes and conserve judicial resources,⁴⁰⁷ but neither applied to the Heritage adversary proceedings. The Manual applies to complex litigation; the Heritage adversary proceedings, viewed individually, were not complex. The federal statute applies only if civil actions in multiple districts involve one or more common questions of fact.⁴⁰⁸ The Heritage adversary proceeding raised separate questions of fact: Did the defendant misrepresent salient facts to a specific lender? Were the misrepresentations intentional? Were they material? Did the lender actually and either reasonably or justifiably rely on those misrepresentations?

Selected features from both, however, could be adapted to the context of related adversary proceedings initiated by a covered entity. Without exhausting or refining the possibilities here, we may imagine several potential features of this new mechanism:

1. A revised Cover Sheet defining a related adversary proceeding, requiring a covered entity to so identify itself, inviting attachments in which the covered entity identifies related adversary proceedings, including those already dismissed or terminated, and including a statement, if applicable, that the covered entity contemplates the filing of additional related adversary proceedings within the ensuing year.⁴⁰⁹ In lieu of attachments, the Cover Sheet could require a covered entity to identify the address of a website established by the covered entity that provides information about related adversary proceedings, as suggested above.⁴¹⁰
2. A procedure for determining whether to transfer multiple qualifying adversary proceedings to a single judge and for identifying the judge, triggered, perhaps, by the filing of at least a minimum number of related adversary proceedings each of whose claims exceed a minimum amount (e.g. five related adversary proceedings each with claims exceeding \$10,000).⁴¹¹

⁴⁰⁶ See 28 U.S.C. § 1407 (2012).

⁴⁰⁷ See MANUAL FOR COMPLEX LITIGATION, *supra* note 405, §§ 10.1, 20.13, 20.131; JAMES WM. MOORE ET AL., *supra* note 400, §§ 112.02[1][a], 112.04[1][a].

⁴⁰⁸ JAMES WM. MOORE ET AL., *supra* note 400, § 112.04[1][b].

⁴⁰⁹ For an example of a rule requiring disclosure of related federal district court actions, including those "about to be filed" and those that may have already been dismissed or otherwise terminated, see D. Alaska Civ. R. 40.2, <http://www.akd.uscourts.gov/reference/rules/lr/civil.pdf> (last visited June 2, 2015).

⁴¹⁰ See *supra* text accompanying notes 397–98.

⁴¹¹ The Northern District of California offers a procedural model for transfer of related adversary proceedings within a district. See *supra* note 402. The federal multidistrict litigation statute offers a procedural model (use of a judicial panel on multidistrict litigation) applicable to multidistrict litigation involving common questions of fact. 28 U.S.C. § 1407 (2012). Federal law authorizes the appointment of retired district or circuit court judges who might serve, *id.* §§ 294–96, and that authority could be expanded to include retired bankruptcy judges. If transfer is to be made to a sitting bankruptcy judge, each district

3. When a large number of adversary proceedings warrant (as in the Heritage example), a procedure for transferring the proceedings to a three-judge panel.⁴¹²
4. Authority of the transferee judge(s) to decide common questions of law such as, in the Heritage cases, the applicability of California's limitation on fraud claims or Heritage's standing to pursue fraud claims.
5. Deferral of any default judgment until common questions of law are resolved in contested proceedings.

Use of such a mechanism would both increase the consistency of dispositive rulings and conserve judicial and party resources in related bankruptcy adversary proceedings initiated by covered entities. There was much consistency to be gained and many resources to conserve in the 218 Heritage adversary proceedings, which, in pursuit of \$21,267,016, occupied the time of forty-seven bankruptcy judges, four bankruptcy appellate panels, and 126 attorneys for defendants.

This proposed mechanism would not address the much more extensive inconsistencies and inefficiencies likely generated by a covered entity's litigation of functionally identical claims in both federal and state judicial forums. Recall that Heritage filed three lawsuits joining multiple non-bankruptcy defendants in federal district court and hundreds of lawsuits against non-bankruptcy defendants in California's state courts. The lawsuits in federal district court pursued claims functionally identical to those asserted in the Heritage adversary proceedings and the lawsuits in California's state courts likely did so as well. Discussion of potential mechanisms for consolidation of actions filed in both federal and state judicial forums or coordination of discovery, settlement, pre-trial and other proceedings in such actions is beyond the scope of this Article, but others have considered such mechanisms.⁴¹³

C. *Amendment of the Attorney Fee Shifting Provision*

Three amendments to section 523(d) of the Bankruptcy Code, made applicable to covered entities, would sharpen its teeth. First, covered entities claiming nondischargeability for fraud could be required to post a bond to secure payment of an attorney's fee judgment. Heritage did not pay attorney's fees judgments entered against it, even after losing appeals of those judgments and well before it filed

could determine for itself how caseloads should be adjusted, as suggested for complex civil litigation. *See* MANUAL FOR COMPLEX LITIGATION, *supra* note 405, § 10.12.

⁴¹² The federal multidistrict litigation statute contemplates the possibility of transferring litigation to more than one judge. *See* 28 U.S.C. § 1407(b) (2012). To avoid inconsistent rulings, the majority of a three-judge panel could adopt a ruling applicable to all proceedings.

⁴¹³ *See, e.g.,* AMERICAN LAW INSTITUTE, COMPLEX LITIGATION: STATUTORY RECOMMENDATIONS AND ANALYSIS (1994); FEDERAL JUDICIAL CENTER AND NATIONAL CENTER FOR STATE COURTS, COORDINATING MULTIJURISDICTION LITIGATION, A POCKET GUIDE FOR JUDGES (2013); William W. Schwarzer, Nancy E. Weiss, & Alan. Hirsch, *Judicial Federalism in Action: Coordination of Litigation in State and Federal Courts*, 78 VA. L. REV. 1689 (1992).

bankruptcy.⁴¹⁴ Together with amendments suggested below, the bond's assurance of payment of an attorney's fee judgment might encourage more contingent fee representation of defendants sued by covered entities.

Second, upon suffering a judgment that a debt is discharged, such creditors could be made liable for a defendant's attorney's fees whether or not the creditor's claim was substantially justified, reverting to a standard applicable before a 1984 amendment to section 523(d). When originally enacted in 1978, substantial justification for a creditor's claim did not protect the creditor from an award of attorney's fees to the debtor. If a consumer debt were discharged in an adversary proceeding, the section directed the bankruptcy court to award attorney's fees to the debtor unless "clearly inequitable."⁴¹⁵ The current version of the section, enacted by as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984,⁴¹⁶ aimed to strike "the appropriate balance between protecting the debtor from unreasonable challenges to dischargeability of debts and not deterring creditors from making challenges when it is reasonable to do so."⁴¹⁷ Findings of this study suggest that, at least in the case of covered entities, the 1984 amendment may have tipped the balance too far in the creditor's direction.⁴¹⁸

Finally, covered entities could also be made liable for a defendant's additional attorney's fees incurred in response to a covered entity's unsuccessful appeal from a judgment that a debt subject to section 523(d) has been discharged or from a judgment awarding attorney's fees to the defendant under section 523(d). In the Ninth Circuit at least, section 523(d) does not authorize attorney's fees to a

⁴¹⁴ See *supra* notes 345–54 and accompanying text.

⁴¹⁵ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 523(d), 92 Stat. 2549, 2592 (current version at 11 U.S.C. § 523(d) (2012)).

⁴¹⁶ Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 307(b), 98 Stat. 333.

⁴¹⁷ S. REP. NO. 98-65, at 9–10 (1983) (accompanying the Omnibus Bankruptcy Improvements Act of 1983, S. 445, 98th Cong. § 209(b) (1983), the predecessor bill to the Bankruptcy Amendments and Federal Judgeship Act of 1984).

⁴¹⁸ In a May 30, 1997 memorandum to the National Bankruptcy Review Commission, Judge Samuel Bufford, Professor Margaret Howard, Professor Jeffrey Morris, and Judge Eugene Wedoff recommended even more drastic amendment of section 523(d), for similar reasons:

Costs and fees may be awarded only if 'the position of the creditor was not substantially justified' and may not be awarded if 'special circumstances would make the award unjust.' These conditions have resulted in a reluctance by many courts to award fees and costs to prevailing debtors, with the result that debtors cannot be assured of recovering their costs of litigation when they prevail. This, in turn, provides a substantial incentive to debtors to agree to settlements even of nondischargeability claims that are not well founded. To encourage adequate representation of consumer debtors, we strongly recommend that, as to debtors with primarily consumer debts, the award of costs and attorneys' fees be mandatory.

defendant in these circumstances.⁴¹⁹ Only an appellate court may award such fees and only for a frivolous appeal.⁴²⁰ This limitation imposes upon defendants a potentially significant, perhaps insurmountable, economic burden of defending against a non-frivolous appeal by a covered entity, with no prospect of reimbursement for attorney's fees if successful.

V. CONCLUSION

In economic, political, or philosophical debates, Heritage might well be praised, defended, or vilified for its lawsuits. It might be praised for seeking to redress prevarication that contributed to an economic crisis. It might be defended for contributing to the availability of credit at lower prices by purchasing and thereby reducing losses from stale debt.⁴²¹ It might be vilified for scavenging among the financial ruins of individuals duped and exploited by greedy and mendacious brokers or enabled by devil-may-care lenders.

Those debates aside, the Heritage adversary proceedings described here offer a rare laboratory for testing the extent to which our entry-level justice system measures up to our aspirations for "Equal Justice Under Law." We are unlikely to find many conditions better suited to empirical exploration of that question: (1) civil litigation filed during a relatively brief time span by one plaintiff against 266 defendants (including co-defendant spouses); (2) some defendants defaulting, some defendants appearing pro se, and some represented by an attorney; (3) dispersal of the litigation among forty-seven different bankruptcy court judges, all sitting in one state (and thus, where applicable, required to apply the relevant substantive law of a single state); and (4) legal claims and factual allegations by the plaintiff so nearly identical that each dispute is resolvable on the basis of one obvious and straightforward factual question (reliance by an originating lender on a borrower's misrepresentations) or on the basis of three less obvious and more complex legal rules (a California statutory limitation on fraud claims and two alternative varieties of a standing defense). The results in the Heritage adversary proceedings evidence an unacceptable level of randomly distributed justice at the trial court level, generated as much by the idiosyncratic behaviors of judges, lawyers, and parties as by even handed application of law.

Appellate decision making is well documented, in both reported and unreported opinions that are easily accessible. It therefore garners ongoing attention and reams of published analysis. Trial court justice, exponentially more frequent and less well documented is largely hidden from view.

⁴¹⁹ See *Vasseli v. Wells Fargo Bank (In re Vasseli)*, 5 F.3d 351, 353–54 (9th Cir. 1993); *contra In re Wiencek*, 58 B.R. 485, 489 (Bankr. E.D. Va. 1986).

⁴²⁰ See FED. R. APP. P. 38. An appeal is frivolous when the result is obvious or the appellant's arguments are wholly without merit. *E.g.*, *Bell v. City of Kellogg*, 922 F.2d 1418, 1425 (9th Cir. 1991).

⁴²¹ The Federal Trade Commission cited several empirical studies in support of this proposition in a 2013 report of its study of the debt buying industry. See FED. TRADE COMM'N, *supra* note 2, at 11 n.48.

PACER helps us peel back some of the layers of federal trial court justice but it is an imperfect research tool. Unless supplemented by digital recording of hearings and trials (as in the Northern District of California⁴²²), it does not capture what sometimes may be important exchanges between attorneys and judges or explanations for a judge's written orders. It obviously does not purport to capture critical communications between the attorneys and their clients or communications between attorneys for each party.⁴²³ This study's extensive reliance on PACER-derived data thus necessarily paints an incomplete, perhaps occasionally flawed, picture of the adversary proceedings it has described and analyzed.

The data from this study nonetheless offer a revealing and sobering view of the nature, quality, and value of legal representation in civil litigation and the contours of justice dispensed by trial court judges. It suggests and warns that the justice delivered by our litigation system falls well short of our aspirations, not simply in the relatively narrow context of bankruptcy adversary proceedings or actions by debt buyers, but, by implication, more broadly, in all trial level contexts.

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⁴²² See *supra* note 10.

⁴²³ Interviews with defendants would have enriched this study but attempts to contact a large number of the defendants were unsuccessful. Using addresses listed on the docket of the relevant adversary proceeding, the author wrote to defendants in 136 of the adversary proceedings requesting an interview, enclosing a consent form mandated by a Human Subjects Committee and a stamped envelope addressed to the author. The postal service returned twenty-six interview requests as undeliverable. Of the remainder, only three responded (2.2% of those mailed and 2.7% of those presumed delivered), each consenting to an interview on the consent form. Conversations with those three defendants are described *supra* note 324. Given the meager response rate, requests for an interview of defendants in the remaining eighty-two proceedings were not mailed. In a recent study of bankruptcy stigma, the researcher reported essentially identical results when soliciting interviews of 2,822 bankruptcy debtors who were to indicate consent to an interview by returning a pre-paid addressed postcard listing contact information. See Michael D. Sousa, *Bankruptcy Stigma: A Socio-Legal Study*, 87 AM. BANKR. L. J. 435, 462 (2013) (2.1% of those mailed and 2.5% of those presumed deliverable).