CONSUMER BANKRUPTCY

Study Shows Disparity of Justice in Bankruptcy Court

By Craig D. Robins

Bankruptcy attorneys can often be found discussing their cases with their fellow attorneys while waiting at court for their matters to be called. Upon mentioning an interesting set of facts that they are currently litigating, the first question often heard is: "Who is the judge on your case?"

We all know that each judge develops his or her own unique approach to handling and deciding various issues. Some attorneys think certain judges may be more predisposed to rule in a certain way on a particular issue. Indeed, different judges will reach different determinations on similar issues.

So, imagine if one could come up with a certain type of legal proceeding in bankruptcy court involving identical facts and issues, and then present this to dozens of different judges in real and genuine court proceedings to see how each judge would rule. Well, that's exactly what happened in California.

From 2010 to 2012, Heritage Pacific Financial, L.L.C., a debt buyer, essentially filed 218 identical adversary proceedings in California bankruptcy courts against Chapter 7 or Chapter 13 consumer debtors, whose debts included obligations on certain promissory notes. In each complaint, Heritage alleged that it acquired the note in the secondary market and that the outstanding obligation on the note was non-dischargeable under the Bankruptcy Code's fraud exception to the bankruptcy discharge.

The debtors who had taken these loans were California residents who used the proceeds to finance real estate purchases or improvements in 2005 and 2006. When issued, the notes were secured by second mortgages on the real property, but subsequent foreclosures of the first mortgages, precipitated by the mid-decade housing bubble burst, left the notes unsecured.

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This was the scenario that Law Professor Gary Neustadter, of Santa Clara University School of Law, discovered, which enabled him to conduct an empirical study of these proceedings which led to an incredibly fascinating law review article, entitled, "*Randomly Distributed Trial Court Justice: A Case Study and Siren from the Consumer Bankruptcy World*," (24 Amer. Bankr. Inst. L. Rev. 351 (Summer 2016) Santa Clara Univ. Legal Studies Research Paper No. 1-16). This 81-page study revealed, according to the author, 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 evenhanded application of law.

The alleged grounds for seeking a determination of non-dischargeability in all of the proceedings was that the debtors intentionally made material misrepresentations concerning their employment, income or intended use of the property as a primary residence, or that the debtors misrepresented their liabilities.

The study revealed that out of 218 proceedings, Heritage recovered nothing in 94 cases; it obtained seven adverse rulings that the debt was dischargeable, four on summary judgment and three after trial; it agreed to dismiss 49 cases with no payment, based on mutual releases; bankruptcy courts dismissed 26 cases based on Heritage's unilateral requests for dismissal; and in 12 proceedings, the courts dismissed the cases for various reasons or even entered judgment against Heritage.

In the remaining 116 proceedings, Heritage recovered at least $2.1 million, based on 10 default judgments, one summary judgment, two judgments after trial, and 103 written settlement agreements. There were also a handful of cases where the outcomes were not available.

The study showed a "significant and unjustified disparity" in how 47 different judges adjudicated outcomes. It further demonstrated that most attorneys representing the defendant debtors did not plead defenses that might have defeated liability.

Professor Neustadter devoted a good amount of time to deconstructing the outcomes. He found most troubling the differences in outcome on Heritage's motions for default judgments. Apparently some judges found Heritage's supporting documents and affidavits to be sufficient, whereas others did not. Some judges found the supporting affidavits to be woefully deficient and discussed the reasons why in great detail, whereas other judges, in granting the relief, commented that the motion was supported by competent evidence.

Professor Neustadter concluded what may be collectively and colloquially 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. This is a scary thought for all of us as prevailing in a case can be, to a certain extent, a matter of luck.

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