

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION**

IN RE:

ITT EDUCATIONAL SERVICES, INC.,
Debtor.

Chapter 7

Case No. 16-07207-JMC-7A

Jointly Administered

JORGE VILLALBA, JAMES ERIC
BREWER, JOSHUA CAHILL, JUAN
HINCAPIE, and CHERYL HOUSE, on their
own behalf and on behalf of all other persons
similarly situated,

Plaintiffs,

v.

ITT EDUCATIONAL SERVICES, INC. et al.,

Defendants.

**STUDENT CLAIMANTS' MOTION SEEKING
CLASS TREATMENT OF STUDENT CREDITORS' CLAIMS**

Student Claimants Jorge Villalba, James Eric Brewer, Joshua Cahill, Juan Hincapie, and Cheryl House, on behalf of themselves and all other similarly situated class members make the within motion pursuant to Federal Rule of Bankruptcy Procedure ("FRBP") 9014 seeking application of FRBP 7023 to permit class filing of student claimants' attached Proofs of Claim and preliminary certification, subject to any further factual development necessary to establish a basis for certification, for resolution of the contemporaneously filed Adversary Complaint ("Complaint") regarding students' claims. Additionally, Movants seek appointment of the Legal

Services Center of Harvard Law School as class counsel to represent their interests in this proceeding.

PRELIMINARY STATEMENT

The debtors' failed business model was predicated on deceiving and indebting students to generate revenue for shareholders. ITT¹ maintained itself as an ongoing business concern by facilitating student debt pursuant to a carefully managed fraud. Student debt, underwritten by taxpayers in the form of federal loans, and by ITT's investors, associates, and alter egos in the form of private loans, accounted for nearly all of ITT's pre-filing revenue and continues to account for a significant portion of ITT's assets. ITT lied to students to about receiving a high-quality education that employers and other schools recognized and respected, being trained and placed in jobs in their field of study, and increasing their earning potential with ITT's education and job placement services. Student claimants lost the significant investments they made in pursuit of educational advancement.

Although ITT's deceptive practices were complex and well-concealed, they were substantively uniform across all ITT locations. These practices violate the laws of each and every state where ITT operated a campus. ITT's deceptive practices are the subject of public enforcement actions, yet students have interests in pursuing their claims that are distinct from those of attorneys general and other agencies. In any event, to date, those public enforcement actions have been stayed by this proceeding.

Class treatment of student claims will allow for an efficient resolution of the contingent but important claims of hundreds of thousands of student claimants. The students whose debt kept ITT afloat for decades are ITT's true creditors. To date, students have factored into this

¹ Throughout "ITT" refers to the debtors in this case and their alter egos.

bankruptcy proceeding as further sources of income to the estate, but notice has not been effective at reaching this broad class of contingent claimants. Without class representation, students' claims will be effectively extinguished and the debtors' estates will continue to treat defrauded students as mere sources of revenue, rather than as creditors with claims based on ITT's unlawful practices against them. Collective resolution of students' claims will allow for an efficient and equitable distribution of ITT's resources to and among these injured former students.

JURISDICTION

1. This Court has jurisdiction to consider this Motion pursuant to 28 U.S.C. §§ 157 and 1334 and venue is proper pursuant to 28 U.S.C. sections 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. section 157(b). The statutory bases for the relief requested herein are Bankruptcy Code sections 105(a), 501 and 502. The relief requested herein may be granted by the bankruptcy court consistent with Article III of the United States Constitution.

PROCEDURAL BACKGROUND

2. ITT filed for Chapter 7 bankruptcy on an emergency basis on September 16, 2016. [Doc 1].

3. Notice procedures for the jointly administered case were set on October 4, 2016, when the Court issued an Order Establishing Certain Notice, Case Management and Administrative Procedures (the "Case Procedures") [Doc 220].

4. The Case Procedures established November 1, 2017 as the date for meeting of creditors pursuant to Bankruptcy Code 341, and January 30, 2017 as the deadline for creditors to file proofs of claim ("claim bar date"). Pursuant to the Case Procedures, Claims Administrator Rust Consulting/Omni Bankruptcy ("Administrator") was charged with service of the 341 Notice to claimants and parties in interest, including a group of potential student claimants.

5. On October 10, 2016 the Trustee of ITT's estate sought a stay of all regulatory actions [Doc 294], which was granted by the Court. As a result of this stay, regulators have not been permitted to pursue findings regarding ITT's fraudulent behavior.

6. On October 28, 2016, the Trustee submitted Schedules of Assets and Liabilities ("Schedules") and Statements of Financial Affairs ("Statements") on behalf of the debtors and in accordance with 11 U.S.C. section 521 and FRBP 1007. [Doc 523].

7. ITT's itemized accounts receivable include nearly \$73 million in PEAKS Loan Securities and \$8.4 million in Student CU Connect ("CUSO") Student Loan securities. At a 341 meeting of creditors held November 1, 2016, only one student creditor was in attendance.

8. As of December 23, 2016, approximately 1,800 claims had been filed.

I. FACTS SUPPORTING RELIEF

9. Putative class claimants request an order pursuant to FRBP 9014, substantively similar to the attached proposed order, applying FRBP 7023 to permit class filing of student claimants' attached Proofs of Claim and preliminary certification, subject to any further factual development necessary to establish a basis for certification, for resolution of the contemporaneously filed Adversary Proceeding Complaint ("Complaint") regarding students' claims.

10. The current scope of the proposed class includes all individuals who attended any ITT campus, regardless of how long they were enrolled, from at least 2006 up until ITT's closure in 2016.

A. STUDENT CLAIMS AGAINST DEBTOR

11. As detailed in the Adversary Complaint filed contemporaneously with this Motion, ITT unfairly deceived students and breached contractual obligations, including the duty of good faith and fair dealing.

12. ITT's deceptive business practices were carefully orchestrated through uniform policies and practices and concealed by ITT's central governance.

13. ITT's fraudulent business practices lasted over a decade and affected hundreds of thousands of students, destroying their financial stability, educational opportunities, and personal and familial wellbeing.

14. A minimum estimate of the amount of student loan principal facilitated by ITT is \$7.3 billion. *See* Class Proof of Claim and Attachment (affixed hereto as Exhibit A).

15. Lifetime default rates on these student loans reach as high as 80%. ITT students earn on average the same or less than high school graduates with no college education.

B. CENTRALITY OF STUDENT CLAIMS TO RESOLUTION OF DEBTORS' ESTATE

16. Complaints and civil investigative demands filed against ITT by twenty-one attorneys general, actions and investigations by the Senate, two federal agencies, various accreditors and licensing bodies, and the evidence attached to Class Claimants' proposed Class Proof of Claim and Adversary Complaint, all show that ITT engaged in deceptive and unlawful schemes to the detriment of students.

17. These public enforcement actions have been stayed as result of ITT's bankruptcy petition, and the Court has denied requests from enforcement agencies for relief from the automatic stay. *See* Adversary Case 16-50318 [Doc 294] (Complaint filed by Trustee seeking reinstatement of stay against CFPB, SEC, and Attorneys General of Massachusetts and New Mexico); Minute Entry and Order of December 21, 2016 [Doc 810] (leaving stay in place).

18. In keeping with allegations in these public enforcement actions, students claim that ITT engaged in deceptive conduct by, among other things, forcing students into predatory proprietary student loans.

19. This stay further heightens the need for student claimants to be granted class status so that they may directly seek resolution of their claims.

20. Students have an additional interest in this Court reaching findings of fact and law related to their claims, which partially overlap with the claims of the stayed public enforcement actions. Judicial resolution of their claims may determine whether students can obtain relief from their private and federal student loan debt.

21. ITT now seeks to classify some of these student debts as “assets,” and collection has been ongoing. *See, e.g.*, Form 206A/B [Doc 523] (listing \$80,775,144.00 in student accounts receivable); Order of November 7, 2016 [Doc 580] (granting Trustee Motion to Deposit Student Loan Receivables into a Segregated Account and Payment of Collection Fees from Receivables).

22. There are complex questions around the existence of student claims and the responsibility for paying them.

23. Should student claims be liquidated to an amount that exceeds the amount available for distribution from the bankruptcy estate, any deficiency may be satisfied in the form of loan cancellation.

24. Conversely, the amount of student claims against the ITT estate may be reduced by loan cancellation, although such cancellation may result in an increase in the amount of claims that other creditors, particularly the Department of Education, have against the estate.

25. It is impossible to unwind the Debtors’ estate without reaching resolution of student claims.

26. Students rightly have a role in the resolution of their claims, and recognition of students as a class of claimants will facilitate an efficient and fair resolution.

C. NECESSITY OF CLASS TREATMENT AT CLAIM FILING STAGE

27. Former ITT students are, on the whole, poor and struggling for subsistence.

28. They are unlikely to retain counsel on an individual basis to represent their interests in this proceeding.

29. It is highly unlikely that adequate notice of the claim bar date could be provided to all affected students.

30. There is evidence that the notice provided for in the Case Procedures has not been effective in reaching affected students.

31. The Case Procedures are streamlined, and justifiably so. As the Trustee stated, “Debtors’ bankruptcy cases are large and complex, will be fast-paced and will involve over 200,000 potential creditors.” [Doc 94, ¶ 25]. Frequent mailings to potential creditors would be “extraordinarily costly” and would reduce the resources of the estate. [*Id.* ¶ 26].

32. The Case Procedures identify three groups of individuals who are entitled to ongoing notice of proceedings within this bankruptcy action: (a) the “Core Group;” (b) the “Request for Notice List;” and (c) the “Appearance List.”

33. Students, as a category, are not included within any of the groups who must be served court filings in ITT’s bankruptcy proceeding.

34. In theory, individual student claimants could opt to join the “Request for Notice List;” or the “Appearance List;” but, predictably, few students have taken the steps necessary to receive ongoing notice about this complex bankruptcy action. [Doc 769] (updated service list).

35. Thus, service of the 341 Notice was students’ sole chance of being notified about their rights in this bankruptcy proceeding, and the claim bar date. The 341 Notice advised “Creditors and Former Students” to

[P]lease note that no further notice will be provided in these bankruptcy cases via U.S. Mail, except for the required notices under Bankruptcy Rule 2002(a)(1) and (4) and Bankruptcy Rule 2002(f)(1), (2), (3), (6) and (8). Those who wish to

receive notice can file a Request for Notice, under Bankruptcy Rule 2002, or have an attorney enter an appearance.

Rust Omni served the 341 Notice in accordance with the Case Management Procedures.

36. This notice to student creditors was insufficient. The Case Procedures failed to identify for receipt of Notice most of the students with potential claims.

37. On October 7, 2016, the Administrator served copies of the 341 Notice to 164,523 students whose information has been filed under seal. [Doc 296, Ex. B] (Certificate of Service). Supplemental certificates of service indicate that between October 14 and November 18, 2016, the Administrator served 341 Notices on approximately 4,340 additional individuals whose names were kept confidential and who may or may not have been former ITT students. [Docs 508, 557, 560, 628, 658]. Even assuming that all individuals who were served under seal were students, the Administrator has served 341 Notices to fewer than 170,000 former ITT students.

38. By contrast, ITT enrolled approximately 50,000 new students each year. Thus, the number of former students who were served the 341 Notice is comparable to the number of students ITT enrolled over the past three years alone.

39. Additionally, the 341 Notice was ineffective because the Administrator provided information that is not likely to apprise potential student claimants of the need to file a proof of claim. Further, even students who receive the 341 Notice may not realize that they have a claim against ITT.

40. Many students do not understand the difference between filing a Proof of Claim in this bankruptcy proceeding and filing a borrower defense to repayment application with the Department of Education. The Administrator's "Frequently Asked Questions" (FAQ) webpage

devotes thirty times as much space to describing how to file a defense to repayment application with the Department of Education as it does to explaining how to file a Proof of Claim.²

41. Further, claimants who call the Administrator's phone hotline are unable to reach a live representative to ask questions. Instead, the hotline plays a recording that contains outdated information, such as that, "no bar date deadlines for the filing of the proof of claims has been set. Nor has a 341a meeting of the creditors been set."

42. As discussed above, student claims are central to the resolution of the Debtors' estate, and notice has been ineffective as to these creditors.

II. LEGAL BASIS FOR THE REQUESTED RELIEF

43. Pursuant to FRBP 9014(c) and 7023, bankruptcy courts may allow for the class treatment of claims in a bankruptcy proceeding. *See In re American Reserve Corp.*, 840 F.2d 487, 493 (7th Cir. 1998); *In re Charter Co.*, 876 F.2d 866 (11th Cir. 1989); *In re Birting Fisheries, Inc.*, 92 F.3d 939, 940 (9th Cir. 1996); *Reid v. White Motor Corp.*, 886 F.2d 1462 (6th Cir. 1989); *In re Corinthian College, Inc.*, 15-10952, Order Granting Committee of Student Creditors' Motion For an Order Allowing Student Committee to File a Collective Proof of Claim [Doc. 707], (Bankr. D. Del., Aug. 13, 2015).

44. Courts permitting class proofs of claim typically apply the elements of Bankruptcy Rule 7023 to determine whether such relief is warranted. *See, e.g., American Reserve Corp.*, 840 F.2d at 48-89.

45. In addition to reviewing a putative claim for compliance with the requirements of Federal Rule of Civil Procedure 23, bankruptcy courts applying FRBP 7023 also consider whether class treatment is consistent with "bankruptcy needs and concerns." *Motors Liquidation*

² *See* ITT Chapter 7 Bankruptcy: Frequently Asked Questions, available at http://omnimgt.com/CMSVol2/pub_47137/596475_FAQ.pdf.

Co., 447 B.R. 150, 157 (Bankr. S.D.N.Y. 2011). Students' claims in this case satisfy both standards.

A. FRCP 23 Requirements Are Satisfied

46. Rule 23(a) establishes four prerequisites for class certification: numerosity, commonality, typicality and adequacy. *See* Fed. R. Civ. P. 23(a) (2012). Additionally, the party seeking certification must meet one of the three criteria set forth in Rule 23(b).

1. Numerosity

47. The number of students harmed by ITT's deceptive practices renders individual filings by all students impracticable. The precise size of the class is known only to ITT. However, according to ITT's own SEC filings, over 750,000 students have attended ITT from 2006 until ITT closed its doors in September 2016. This volume of students suggests that class treatment, rather than individual adversary proceedings, would be the most efficient resolution for this volume of potential claims.

2. Common Questions of Law and Fact

48. Many questions of law and fact are common to the proposed class of student claimants. Questions of fact common to members of the proposed class including: (1) whether ITT misrepresented that ITT adequately trained students for entry-level positions in technical fields that are in demand from employers; (2) whether ITT deceptively misrepresented that ITT provided students any return on their investments in the form of wages sufficient to repay their debt; (3) whether ITT employed abusive, unfair and deceptive recruiting and retention strategies; (4) whether ITT misrepresented that ITT credentials were respected by employers and that ITT graduates were in demand; (5) whether ITT employed abusive, unfair, and deceptive financial aid practices; and (6) whether ITT fraudulently concealed its unfair and deceptive practices. ITT's corporate headquarters dictated policies and procedures at all ITT campuses, from

program offerings and curriculum, faculty hiring, staffing levels, and policies and procedures for recruitment, financial aid, and career services departments. Thus, the same acts and practices were implemented throughout all of ITT's campuses and in every state where they operated.

49. Each and every one of the deceptions described above violate the state consumer protection statutes that apply in each of the 38 states in which ITT operated schools. Thus, there are questions of law common to members of the class including: (1) whether ITT violated state and federal consumer protection statutes; (2) whether ITT committed breach of contract; and (3) whether, by reason of ITT's violations of consumer protection and contract laws, ITT should be required to provide an equitable distribution to student claimants. Claimants assert that ITT's deception was so egregious as to be unlawful under the consumer protection laws of each state where ITT operated. Complaints and civil investigative demands filed against ITT by twenty-one attorneys general further support claimants contention that ITT's conduct falls within the core prohibitions of state consumer protection laws.

3. Typicality

50. The claims of the Named Plaintiffs are typical of the claims of all members of the proposed class of former ITT students. The Named Plaintiffs, like all members of the class, have experienced deceptive misrepresentations, abusive, unfair and deceptive recruitment and retention practices, abusive, unfair and deceptive financial aid practices, breach of contract, and have been victims of illegal concealment practices, all at the hands of ITT. *See generally* Class Proof of Claim and Attachment (affixed hereto as Exhibit A).

4. Adequacy of Representation

51. Named Plaintiffs will adequately and fairly represent and protect the interests of the proposed class because they have the requisite personal interest in the outcome of this

litigation and have no interests antagonistic to those of the class. The claims of each proposed class representative are set out in detail in the Attachment to the Class Proof of Claim, filed concurrently with this Motion.

52. Named Plaintiffs are represented by counsel, the Legal Services Center of Harvard Law School, experienced in class action litigation and litigation to enforce the rights of consumers, particularly individuals who have incurred student loan debt to attend for-profit schools.

5. Injunctive and Declaratory Relief Under FRCP 23(b)(2)

53. Injunctive and declaratory relief are appropriate with respect to the class of student claimants as a whole, as required by Federal Rule 23(b)(2).

54. Because ITT maintained centralized control of all its campuses across states, ITT has acted, or failed to act, on grounds generally applicable to the entire proposed class of student claimants.

55. ITT's student creditors seek an injunction against further collection of private loan debt generated pursuant to ITT's deceptive practices and currently held by alter egos of ITT, including creditors in this bankruptcy proceeding.

56. ITT's student creditors seek declaratory relief in this proceeding for the purposes of determining, in an efficient and comprehensive manner, the exact nature of Defendant's wrongdoing towards them, and consequently determining the loan relief available in collateral administrative proceedings.

6. Predominance and Superiority Pursuant to FRCP 23(b)(3)

57. Common issues of law and fact presented predominate over any individual issues that may arise, as required by FRCP 23(b)(3). Although state consumer protection laws vary,

ITT's practices violate the core prohibitions that are central to each and every state's consumer protection laws.

58. Individualized questions of damages do not and need not predominate in this proceeding. Given the limited nature of ITT's estate, student claimants are likely to have a deficiency judgment. Under these circumstances, apportionment of damages according to a formula may be appropriate, resolving the need for individualized damages inquiries.

59. A class proceeding is the superior method for a fair and efficient adjudication of this matter because ITT has acted in a manner generally applicable to the class, joinder of all members of the class is impracticable, and a class action will avoid numerous separate actions by class members that would unduly burden the bankruptcy proceeding.

60. Furthermore, this is clearly the "superior" forum for resolution of student claims, as that term is construed in FRCP 23(b)(3). This is the last and only forum in which students can raise claims directly against ITT.

B. Class Treatment of Student Claimants is Consistent with the Purposes of Bankruptcy

61. Allowing students to file a collective proof of claim and pursue their Complaint against ITT as a class would be wholly consistent with the "bedrock" goals of the Bankruptcy Code—efficiently facilitating creditor compensation and achieving equitable distribution in a unitary proceeding. *See In re Chateaugay Corp.*, 104 B.R. 626, 632 (S.D.N.Y. 1989); *see also In re Charter Co.*, 876 F.2d 866, 871 (11th Cir. 1989).

1. Efficiency

62. Class treatment of student claims is an efficient remedy that would allow the Court to resolve the Debtor's estate.

63. The Michigan bankruptcy case of a subprime mortgage lender that was under investigation by a state Attorney General provides an analogous situation. There, the court described the class treatment of approximately 2,500 individual borrowers with potential consumer deception claims as “an effort to bring about an efficient, expeditious, and orderly resolution of possible claims and defenses,” certified separate classes for defrauded borrowers and investors, and entered proposed Consent Judgments on behalf of both classes within the bankruptcy proceeding. *In re Salem Mortg. Co.*, 34 B.R. 902, 903 (Bankr. E.D. Mich. 1983), *aff’d against jurisdictional challenges*, 783 F.2d 626 (6th Cir. 1986).

64. Rather than individually adjudicating numerous individual or subclass claims, student claimants and the Trustee can work towards an efficient resolution of claims on behalf of the entire class of students who were harmed by ITT’s unlawful and deceptive practices.

2. Equitable Distribution

65. Bankruptcy law “contemplates that all legal obligations of the debtor no matter how remote or contingent, will be able to be dealt with in the bankruptcy court” and seeks to provide potential claimants “the broadest possible relief in the bankruptcy court.” H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1977), U.S. Code Cong & Admin. News 1978, pp. 5787, 6266 (reprinted in notes following 11 U.S.C.A. §101 (1979)).

66. Class treatment in a bankruptcy court is particularly appropriate when claims arise from the debtor’s fraudulent activities. Recognizing that “[t]he principal function of bankruptcy law is to determine and implement in a single collective proceeding the entitlements of all concerned,” the Seventh Circuit held in *American Reserve Corp.* that, “[i]f [the debtor] is liable for fraud, the victims are entitled to recovery—according to their entitlements under substantive

law—just as the firm’s landlords and vendors . . . are entitled to recovery.” 840 F.2d 487, 489 (7th Cir. 1998).

67. Further, bankruptcy courts are sensitive to the need to allow for class treatment in cases where many individuals with small contingent claims may otherwise forfeit their entitlements. This concern is particularly animating here because, ITT’s former students, like the defrauded consumers in *American Reserve Corp.*, are “holders of contingent claims . . . [who] may not recognize their entitlement to file unless some champion appears.” 840 F.2d at 489; *see also* *In re REA Express, Inc.*, 10 B.R. 812, 813 (Bankr. S.D.N.Y. 1981) (“a unified response appears to be the only means by which all non-union employees may meaningfully participate” in the claim process).

CONCLUSION

For the reasons stated above, the court should grant the proposed order exercising its discretion under FRBP 9014 to apply class treatment pursuant to FRBP 7023 to permit class filing of student claimants’ attached Proofs of Claim and preliminary certification, subject to any further factual development necessary to establish a basis for certification, for resolution of the contemporaneously filed Adversary Proceeding Complaint (“Complaint”) regarding students’

claims. Additionally, the Court should appoint the Legal Services Center of Harvard Law School as class counsel to represent the interests of student claimants in this proceeding.

Dated: January 3, 2017

Respectfully submitted,

/s/ Eileen M. Connor

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