Bankruptcy, Out-of-Court Options and the Student Loan Debt Problem

The Chapter 13 Option

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Student Loans in Chapter 13

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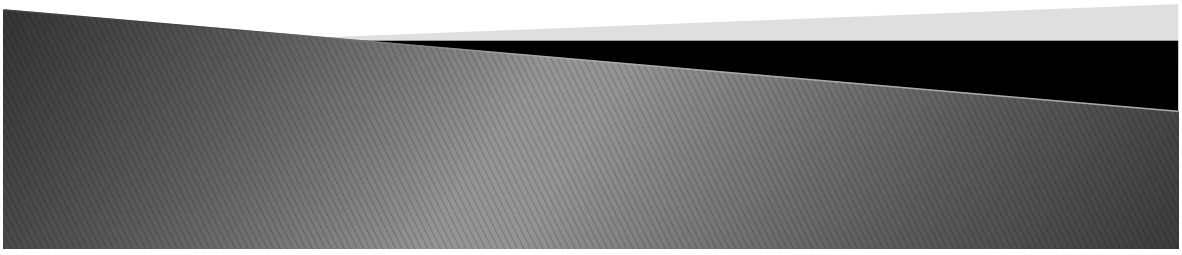
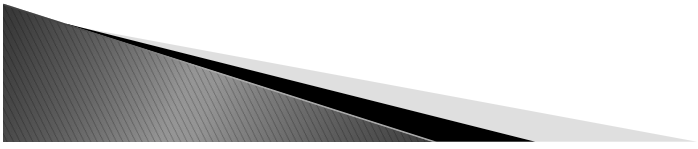


CHAPTER 13 – IF TWEETED

- THE CASE BEGINS – the Debtor files a petition to start the bankruptcy case
- THE PLAN - The Debtor files a plan with the petition or within 14 days after the petition is filed
- MAKING PAYMENTS - The Debtor must start making payments to the Trustee within 30 days after the petition is filed. The Trustee will pay creditors once the Plan is confirmed (3 – 9 months after petition usually)



THE TWEET GETS LONGER . . .

- CHAPTER 13 PLAN REQUIREMENTS – 3 years minimum – 5 year maximum EXCEPT "above median debtor" – 5 year minimum.
  - "above median debtor" is a debtor with income above the median income for the state in which the debtor resides
- PAYMENT MINIMUMS – total payments must equal or exceed what creditors would receive in a chapter 7 liquidation AND the debtor must pay her projected disposable income over the life of the plan
  - Calculated income is reduced by certain expenses
    - For above-median debtors expenses are determined by a fixed formula based on IRS guidelines

Procedural Issues in Undue Hardship Litigation – AP required?

- A judicial determination of undue hardship is required: 11 U.S.C. § 523(a)(8)
- Fed. Rule Bankr. P. 7001(6): makes actions to determine the dischargeability of debt adversary proceedings and requires a summons and complaint be served on the non-moving party

Procedural Issues in Undue Hardship Litigation – AP required?

- Effect of a provision in a confirmed plan purporting to discharge otherwise non-dischargeable student loan debt. Can confirmation be voided? Is the creditor entitled to any relief?
- *In re Espinosa,* 559 U.S. 260 (2010)
  - Summons and complaint: No
  - Hearing: No
  - Judicial determination of undue hardship: No
  - Notice: Yes

Procedural Issues in Undue Hardship Litigation – AP required?

- Rule 60(b)(4) allows a party to seek relief from a final judgment that "is void," but only in the rare instance where a judgment is premised either on a certain type of jurisdictional error or on a violation of due process that deprives a party of notice or the opportunity to be heard.
- Because § 523(a)(8) and Bankruptcy Rule 7001(6) are not jurisdictional, an order confirming a chapter 13 plan that modifies the creditor's claim is not void, and Rule 60(b)(4) may not later be used to set it aside.

Procedural Issues in Undue Hardship Litigation – AP required?

- Legal errors are corrected on appeal
- A confirmation order is binding despite legal error; however,

  "…[T]he Code makes plain that bankruptcy courts have the authority--indeed, the obligation--to direct a debtor to conform his plan to the requirements of §§ 1328(a)(2) and 523(a)(8).

  …

  We acknowledge the potential for bad-faith litigation tactics. But expanding the availability of relief under Rule 60(b)(4) is not an appropriate prophylaxis."

Procedural Issues in Undue Hardship Litigation – Timing of AP

- When is an undue hardship AP ripe?
  - Statutory text
  - Chapter 13 vs. chapter 7
  - Early in a case, a discharge is remote and speculative
  - Until a chapter 13 discharge has occurred or is imminent, is there a case or controversy relating to discharge that a bankruptcy court may decide
  - Change in circumstances – relevant time for examination
  - Is feasibility of a plan relevant
  - Debtor's counsel considerations

Proposed Chapter 13 plan form

Chapter 13 Plan 12/15

Part 1: Notice to Interested Parties

Check all that apply:

- ☐ The plan seeks to limit the amount of a secured claim, as set out in Part 3, Section 3.2, which may result in a partial payment or no payment at all to the secured creditor.
- ☐ The plan requests the avoidance of a judicial lien or nonpossessory, nonpurchase-money security interest as set out in Part 3, Section 3.4.
- ☐ The plan sets out nonstandard provisions in Part 9.

Important Notice: Your rights may be affected. Your claim may be reduced, modified, or eliminated.

Part 9: Nonstandard Plan Provisions

Under Bankruptcy Rule 3015(c), nonstandard provisions are required to be set forth below. These plan provisions will be effective only if the applicable box in Part 1 of this plan is checked.

Classification in Chapter 13

- CLASSIFICATION RULES APPLY IN CHAPTER 13
  - Only substantially similar claims may be classified together
  - Substantially similar claims may also be classified separately
  - If claims are separately classified the debtor may not "discriminate unfairly" among the separate classes

Separate Classification of Student Loan Debt

- Debtors sometimes use Chapter 13 to treat student loans debts more advantageously than other unsecured debts:
  - Classifying the student loan claims separately from other unsecured claims; then…
  - Making the full contract payment directly to the student loan creditor while…
  - Making a reduced pro rata payment to other unsecured creditors through the plan
    - Ex: In re Webb, 370 B.R. 418 (Bankr. N.D. Ga. 2007), proposed to maintain their regular monthly payments to student loan creditors, while making only 1% payout to other unsecured creditors.

Section 1322(b)(1)

- § 1322(b)(1)—allows a Ch. 13 plan to "designate a class or classes of unsecured claims, as provided in [§] 1122 of this title," with the proviso that classification "may not discriminate unfairly" against any class.

Section 1322(b)(5)

- § 1322(b)(5)—permits a Ch. 13 plan to "provide for the curing of any default…and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."
  - Permits debtor to maintain contract payments while relegating other unsecured debts to a lower pro rata payment as a separate class
    - This creates an issue: preferential treatment to student loan creditors arguably conflicts with "unfair discrimination" provision in § 1322(b)(1).

Balancing 1322(b)(1) and (b)(5)

- **Minority View:** Finds that subsection (b)(5) trumps (b)(1), thereby completely excepting long-term debt payments from the unfair discrimination analysis of subsection (b)(1).
  - Allows the plan to cure defaults and maintain payments on student loans w/o regard for the position of other unsecured creditors.
    - In re Johnson, 446 B.R. 921 (Bankr. E.D. Wisc. 2011); In re Truss, 404 B.R. 329, 333 (Bankr. E.D. Wisc. 2009).
- **Majority View:** Subsection (b)(5) must be read in conjunction with (b)(1), with the result that a plan that provides for full payment of student loan obligations under (b)(5) must then be analyzed for unfair discrimination as required by (b)(1).
  - In re Zeigafuse, 2012 WL 1155680 (Bankr. W.D. Wyo. 2012); In re Pracht, 464 B.R. 486 (Bankr. M.D. Ga. 2012); In re Harding, 423 B.R. 568 (Bankr. S.D. Fla. 2010); In re Simmons, 288 B.R. 737 (Bankr. N.D. Tex. 2003).

Unfair Discrimination Defined

- LOTS OF TESTS!!!!!
- *In re Orawsky*, 387 B.R. 128 (Bankr. E.D. Pa. 2008). Outlines them.
- THE BENTLEY TEST (*In re Bentley,* 266 B.R. 229 (1st Cir. BAP 2001).
  - **Equality of distribution** reflects the general expectation that, absent an express grant of priority, unsecured creditors will share equally in any dividend.
  - **Nonpriority of student loans** incorporates the notion that the Code does not grant student loans priority status. The baseline expectation here is simply that nothing in the Code mandates treating student loans more favorably than general unsecured claims
  - **Contributions: mandatory v. optional** expresses the chapter 13 requirement that a debtor devote all of his or her projected disposable income to a plan if the plan does not pay the full amount of allowed unsecured claims. The expectation emanating from that requirement is that unsecured creditors would share pro rata from distributions funded with the debtor's mandatory contributions.
  - **A fresh start for honest debtors** is one of the Bankruptcy Code's fundamental purposes. This baseline is tempered against the notion that Chapter 13 does not contemplate that debtors "will necessarily emerge from Chapter 13 entirely free of student loan obligations."

Unfair Discrimination "Defined" contd.

- THE LESER/WOLFF TEST
  - Whether the discrimination has a reasonable basis
  - Whether the debtor can carry out a plan without the discrimination
  - Whether the discrimination is proposed in good faith
  - Whether the degree of discrimination is directly related to the basis or rationale for the discrimination

Mickelson v. Leser (In re Leser), 939 F. 2d 669 (8th Cir. 1991); *Amfrac Distrib. Corp. v. Wolff (In re Wolff),* 22 B.R. 510 (9th Cir. BAP 1982).

In re Husted, 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992) added a 5th factor: an examination of "the difference between what the creditors discriminated against will receive as the plan is proposed, and the amount they would receive if there were no separate classification."

Unfair Discrimination "Defined" contd.

- THE "OBSCENITY TEST" (CASE BY CASE)
  - "[T]he facts and circumstances of each case dictate whether the proposed discrimination is unfair." This requires a fair balancing of "(1) The Debtor's fresh start; (2) the clear legislative objective of student loan repayment; and (3) fair treatment of creditors as a whole."

In re Harding, 423 B.R. 568, 574-575 (Bankr. S.D. Fla. 2010).

  - "In determining whether any such discrimination is fair or not, courts consider various factors, applied to the circumstances of each particular case. These factors are variously formulated but bear upon the equitable allocation of plan resources and the furtherance of underlying policy objectives."

In re Machado, 378 B.R. 14, 16 (Bankr. D. Mass.2007).

Separate Classification Of Student Loans

DIFFERENT TREATMENT IS NOT UNFAIR DISCRIMINATION

- The Debtor is an above-median debtor and the payment to the student loan lender is from "excess income" (all PDI is being paid to unsecured creditors).

See, e.g., In re Abaunza, 452 B.R. 866 (Bankr. S.D. Fla. 2011)

- There is a benefit to the other creditors for the separate treatment (e.g., if student loan is not paid on time the debtor could lose her professional license necessary to work and make her plan payments).

See, e.g., In re Kalfayan, 415 B.R. 907 (Bankr. S.D. Fla. 2009)

Separate Classification contd.

- Cure and maintain – The student loan is a long term loan. The Code allows the debtor to cure any default and maintain payments on any secured or unsecured claim if the last payment is due after the last payment under the plan is due. The Code allows separate classification of these claims (but NOTE some cases hold that the debtor must still show different treatment is not unfair)

Compare Labib-Kiyarsh v. McDonald (In re Labib-Kiyarash), 271 B.R. 189 (9th Cir. BAP 2001) *with In re Truss,* 404 b.r. 329 (Bankr. E.D. Wis. 2009).

Separate Classification contd.

- Co-debtor loans – The Code allows a debtor to treat differently a 'consumer debt' if there is another individual liable on the debt with the debtor. However, courts also require a showing that the different treatment is not "unfair".

In re Lewman, 157 B.R. 134 (Bankr. S.D.Ind. 1992)

DIFFERENT TREATMENT IS UNFAIR DISCRIMINATION

- Different treatment only because the student loan is NOT dischargeable constitutes unfair discrimination.
  - But the non-dischargeability of the loan is a factor that may be considered.

Protecting The "Code"

- Accrual of any charges other than the contract rate of interest (e.g. late fees, penalties, collection fees, or default interest) during the chapter 13 case is a violation of the automatic stay AND any attempt to collect anything other than the accrued contract rate of interest after the Chapter 13 case is concluded is a violation of the discharge injunction.

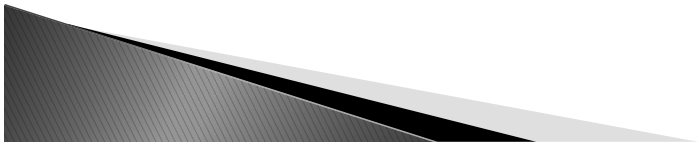
In re Harding, 423 B.R. 568 (Bankr. S.D. Fla. 2010); *see In re Boscaccy,* 442 B.R. 501 (Bankr. N.D. Mass. 2010)

Effect of an Objection to a Student Lender's POC

- Disallowance from payment through the estate vs. a decision on the merits
- Substantive vs. non-substantive objections
- Disallowance by default and proposed orders

Student Loans And The Cost Of Chapter 13

- Student loans accrue regular interest plus late fees, penalties, collection fees and default rate interest if the student loan is not paid on time and in the required monthly amount.
  - When the Chapter 13 case is over, the student loan debt may even be higher than when the case was filed.
  - This result is inconsistent with the purpose of the Bankruptcy Code (fresh start) and the 2005 BAPCPA push to Chapter 13 rather than Chapter 7



Special Issues in Chapter 13 Cases

Professor Susan E. Hauser[1*]

This manuscript provides a basic introduction to chapter 13 of the Bankruptcy Code and describes the special educational loan issues that can arise in conjunction with chapter 13 cases. Like a debtor in chapter 7, a chapter 13 debtor may file an adversary proceeding under § 523(a)(8) seeking to have her student loans discharged as an undue hardship.[2] Although adversary proceedings are governed by a uniform set of rules, the debtor's choice of chapter 13 raises several distinct issues. These include the points addressed by the Supreme Court in *United Student Aid Funds, Inc. v. Espinosa*,[3] as well as the proper time for filing the adversary complaint during the long life of the chapter 13 plan. The manuscript explores these unique issues that arise in § 523(a)(8) adversary proceedings connected to chapter 13 cases.

In chapter 13, however, the most intricate questions relating to educational debt frequently occur in the case itself, and not in an adversary proceeding filed under § 523(a)(8). These issues concern the debtor's ability (or inability) to use the chapter 13 plan to pay or adjust his student loans. This set of topics includes: (1) the accrual and payment of post-petition interest on student loan claims, (2) the use of separate classification to provide more favorable treatment to nondischargeable student loan claims, and the related use of § 1322(b)(5) to cure defaults through the plan, while maintaining regular payments outside the plan, (3) whether student loan payments can be considered special circumstances justifying a downward adjustment in the debtor's projected disposable income, and (4) whether a debtor who devotes all projected disposable income to the plan is free to pay student loan creditors with his remaining surplus income.

A. A Brief Introduction to Chapter 13

A chapter 13 case is commenced by filing a petition with the court, along with schedules and statements explaining the debtor's financial picture. However, instead of receiving a prompt discharge, the chapter 13 debtor must submit a plan of reorganization under which he devotes all of his "projected disposable income" to repay a percentage of unsecured debt by making plan payments to the trustee over a period of three to five years.[4] To be confirmed, the plan must also propose to distribute property equal

1 * This manuscript is based on material developed by Professor Susan E. Hauser for her book *Graduating with Debt: Student Loans under the Bankruptcy Code*, co-authored with Prof. Daniel A. Austin (American Bankruptcy Institute 2013).

2 11 U.S.C. § 1328(a)(2) provides that student loan debts covered by § 523(a)(8) are excepted from discharge in chapter 13.

3 130 S. Ct. 1367 (2010).

4 11 U.S.C. § 1322(a)(4). The duration of the debtor's plan is controlled by 11 U.S.C. § 1325(b)(4)(A). Under this section, if the plan pays unsecured creditors less than 100%, a chapter 13 plan must last 5 years if the debtor's

to the amount that all unsecured claims would be paid if the debtor's estate were liquidated under chapter 7 on the effective date of the plan.[5] If the plan payment satisfies these two tests and the plan is confirmed, the debtor will be permitted to retain nonexempt property that a trustee would liquidate in chapter 7.[6]

After BAPCPA, a mechanical formula similar to the chapter 7 means test is used to determine the amount of a chapter 13 debtor's "disposable income" that must be paid each month to fund the chapter 13 plan.[7] The test is calculated on Official Bankruptcy Form 22C, which requires the debtor to enter income and expenses according to certain statutory formulae and allowances. The resulting amount is the debtor's "disposable income" for purposes of the statute. For some debtors, the disposable income calculated on Form 22C may be less than the debtor's actual net income.[8]

Under the plan of reorganization, the debtor makes a single monthly payment to the chapter 13 trustee, and the trustee distributes the payment to creditors with claims included in the plan.[9] Failure to make plan payments is grounds for dismissal of the case.[10] Unless a secured claim is modified in the plan, the debtor must remain current on payments for secured debt, such as a house or vehicle, if the debtor wishes to retain the collateral.[11] A chapter 13 plan must also provide for the full payment of all priority claims filed in the case.[12] Finally, a chapter 13 plan must be feasible and proposed by the debtor in good faith.[13]

At least one chapter 13 trustee is appointed in every federal district to oversee chapter 13 cases filed in the district.[14] The primary duties of a chapter 13 trustee are to receive monthly payments made by debtors,[15] and to distribute the proceeds to creditors as provided in the plan.[16] The trustee ensures that the debtor commences payments under the plan, ensures that the plan meets the confirmation requirements of the Code, and may move to dismiss the case if the debtor defaults on plan payments. Some bankruptcy

current monthly income is equal to or greater than the median income in the debtor's state.

5 11 U.S.C. § 1325(a)(4).

6 *Id*. at § 1327(b). "[T]he confirmation of a plan vests all of the property of the estate in the debtor."

7 *Id*. at § 1325(b)(2) and (3).

8 *See*, *e.g.*, *In re* Abaunza, 452 B.R. 866 (Bankr. S.D. Fla. 2011) (Form 22C projected disposable income provided a dividend of only 0.86 percent to unsecured creditors, although debtor's actual net income was substantially higher).

9 The debtor's obligation to make payments to the chapter 13 trustee begins no later than 30 days after the filing of the plan or 30 days after the order for relief, whichever is earlier. *Id*. at § 1326(a).

10 *Id*. at § 1326(c)(4) and (6).

11 *Id*. at § 1325(a)(5).

12 *Id*. at § 1322(a)(2).

13 *Id*. at § 1325(a)(3), (6), and (7).

14 *Id*. at § 1302.

15 *Id*. at §§ 1302(b)(5), 1326.

16 *Id*. at § 1326(a)(2).

courts and chapter 13 trustees allow debtors to pay secured or long-term debts (debts with payments that extend beyond the duration of the plan) directly to the creditor and outside the plan.[17]

A chapter 13 debtor does not receive a discharge until after payments are complete under the plan.[18] Unless a prior bankruptcy case has been dismissed within the preceding year, a chapter 13 debtor will receive the benefit of the automatic stay until she receives a discharge in the case.[19] Unlike any other chapter, the filing of a petition under chapter 13 creates a codebtor stay that enjoins creditors from taking action against any nonfiling individual who is liable on the debt with the chapter 13 debtor.[20]

Finally, chapter 13 has restrictive eligibility limits. A chapter 13 case may only be filed by an individual debtor who has regular income to fund the plan.[21] In addition, the debtor's liabilities must fall below the debt limits stated in § 109(e) of the Code. A debtor is eligible to file chapter 13 only if, as of the petition, her noncontingent, liquidated secured debts are less than $1,149,525 and noncontigent, liquidated, unsecured debts are less than 383,175.[22]

B. Undue Hardship Determinations in Chapter 13

Bankruptcy Rule 7001(6) provides that the dischargeability of a student loan debt must be determined in an adversary proceeding governed by the rules in Part VII of the Federal Rules of Bankruptcy Procedure.[23] Although the same general procedures apply in § 523(a)(8) cases filed in connection with cases under all chapters, a few distinct issues have arisen in connection with chapter 13. The first such issue is whether the chapter 13 plan confirmation process can be used in lieu of an adversary proceeding to determine dischargeability of a student loan debt. The second issue is whether a chapter 13 debtor is required to wait until near the end of his plan to file a complaint under § 523(a)(8).

1. *United Student Aid Funds, Inc. v. Espinosa*: Discharge by Confirmation

The debtor in *Espinosa* filed a chapter 13 plan that listed his student loans as his only debts.[24] The plan proposed to pay only the $13,500 principal on those debts, stating that the accrued interest would be

17 Renton Persaud, *Achieving Aims of Bankruptcy by Allowing Direct Payments under Chapter 13,* 1 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 30, at 1 (2009), http://www.stjohns.edu/academics/ graduate/law/journals/abi/sjbrl_main/volume/v1/Persaud.stj (follow "View Full PDF").

18 11 U.S.C. § 1328(a). Note, however, that § 1328(b) allows the court to grant an earlier "hardship discharge" in some circumstances.

19 *Id*. at § 362(c)(2)(C).

20 *Id*. at § 1301.

21 *Id*. at § 109(e).

22 *Id*. The chapter 13 debt limits are adjusted every three years pursuant to 11 U.S.C. § 104, and were most recently adjusted on April 1, 2013.

23 Part VII of the Federal Rules of Bankruptcy Procedure incorporates the Federal Rules of Civil Procedure and makes them applicable in bankruptcy adversary proceedings.

24 130 S. Ct. 1367 (2010).

discharged upon completion of the plan. The student loan creditor (United) was given notice of the plan, and filed a proof of claim for $17,832, the amount of the principal and accrued interest. United did not file an objection to the plan's proposed discharge of the interest on the debtor's student loans and did not object to the debtor's failure to file an adversary proceeding to determine undue hardship under § 523(a)(8).[25]

One month after Espinosa's plan was confirmed, the trustee mailed United a notice that the amount of the claim filed differed from the amount proposed for payment in the plan. The notice stated that the claim would be paid as listed in the plan and requested United to notify the trustee within 30 days if it wished to dispute the plan payment. United again failed to object. Espinosa ultimately completed payments on his plan and was granted a discharge of the interest on his student loans in 1997.

Three years later, in 2000, the creditor took steps to collect the unpaid interest.[26] These efforts continued until 2003, when Espinosa filed a motion asking the bankruptcy court to enforce the discharge order entered in 1997. United responded by filing a cross-motion under Rule 60(b)(4) seeking to set aside the confirmation order as void. United argued that Espinosa's plan was inconsistent with the Bankruptcy Code's requirement that a court find undue hardship before discharging a student loan debt. United also claimed that it had been denied due process because Espinosa failed to file an adversary proceeding and serve United with a summons and complaint as required by the Bankruptcy Rules.

In a unanimous opinion, the Supreme Court held that the confirmation order was a final judgment and was not rendered void by the bankruptcy court's error in discharging a student loan obligation without a finding of undue hardship.[27] The bankruptcy court's error was not jurisdictional and did not violate the creditor's due process rights.[28] Instead, § 523(a)(8)'s undue hardship requirement is a statutory precondition to discharge that does not limit the court's jurisdiction.[29] And, despite the absence of a summons and complaint, due process was satisfied by the creditor's actual notice of the bankruptcy case and contents of the plan.[30]

In reaching this holding, the Court stated that the bankruptcy court had an obligation to avoid this type of error by independently determining undue hardship in a chapter 13 case, even without objection or

25 *Id*. at 1374.

26 Espinosa's student loans were held at various times by United Student Aid Funds, Inc. and by the United States Department of Education. The collection effort in 2000 was launched by the Department of Education; however, the loans were later transferred back to United. *Id*.

27 The specific issue in *Espinosa* was "whether an order that confirms the discharge of a student loan debt in the absence of an undue hardship finding or an adversary proceeding, or both, is a void judgment for Rule 60(b)(4) purposes." *Id*. at 1373.

28 *Id*. at 1380.

29 *Id*. at 1377-78.

30 *Id*. at 1378.

appearance by the creditor.[31]

> Neither the Code nor the Rules prevent the parties from stipulating to the underlying facts of undue hardship, and neither prevents the creditor from waiving service of a summons and complaint. But, to comply with § 523(a)(8)'s directive, the bankruptcy court must make an independent determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding.[32]

Finally, the Court noted that this holding created some incentive for debtors and their attorneys to use the plan confirmation process in bad faith. To obviate this potential, the Court closed its opinion with a short discussion of sanctions available to "deter bad faith attempts to discharge student loan debt without the undue hardship finding Congress required."[33]

Espinosa has implications for both debtors and creditors. First, debtors and their attorneys have an obligation to follow the procedures set forth in the Bankruptcy Code and Rules when seeking to discharge educational debt. Debtors should file an adversary proceeding pursuant to § 523(a)(8), and may be subjected to sanctions if they attempt to use the plan confirmation process as a *sub silencio* substitute for an adversary determination of undue hardship.

Creditors, on the other hand, are left with the consequences of the Court's refusal to find these requirements jurisdictional. Because § 523(a)(8) and Bankruptcy Rule 7001(6) are not jurisdictional, an order confirming a chapter 13 plan that modifies the creditor's claim is not void, and Rule 60(b)(4) may not later be used to set it aside. As a result, prudent student loan creditors will want to monitor chapter 13 plans and should not assume that their claims will be protected in the absence of a summons and complaint. Creditors who are dissatisfied with the treatment provided in a chapter 13 plan must object to confirmation to preserve their rights. Although debtors may be sanctioned for ignoring the requirement for an adversary proceeding, due process is probably satisfied by a confirmed plan that flouts this requirement if the creditor has actual notice of the bankruptcy case and plan that alters the creditor's rights.

2. Timing the § 523(a)(8) Complaint in Chapter 13

Bankruptcy Rule 4007(b) provides that a complaint to determine the dischargeability of educational debt may be filed at any time.[34] This works well in chapter 7 cases, since a chapter 7 discharge is usually entered within a period of months after the petition date. However, in chapter 13, § 1328 delays the discharge until the debtor completes all payments under the plan, three to five years after the petition

31 *Id*. at 1380.

32 *Id*. at 1381. (Citations omitted.)

33 *Id*. at 1382.

34 Fed. R. Bankr. P. 4007(b). "A complaint [to determine dischargeability] other than under § 523(c) may be filed at any time." Section 523(c) provides a shorter period for filing complaints under §§ 523(a)(2), (4), or (6).

date.

The delay in the chapter 13 discharge has prompted student loan creditors to object to § 523(a)(8) complaints filed early in a chapter 13 case on grounds of ripeness.

The doctrine of ripeness prevents courts "from entangling themselves in abstract disagreements" by prematurely adjudicating a case "anchored in future events that may not occur as anticipated, or at all."[35] The doctrine has two components, constitutional ripeness and prudential ripeness. Constitutional ripeness looks to whether an actual case or controversy is before the court and, hence, impacts a federal court's subject matter jurisdiction under Article III. Prudential ripeness allows a court with jurisdiction to refuse to exercise that jurisdiction for prudential reasons. Prudential ripeness allows a court to "exercise its discretion to determine if judicial resolution would be desirable under all of the circumstances."[36]

Although Rule 4007(b) allows a § 523(a)(8) complaint to be filed at any point in the case, creditors have used the ripeness argument to argue that it is inappropriate for the bankruptcy court to find a student loan debt dischargeable, when the discharge itself will not be entered for years to come. This argument was summarized in *In re Hoffer* as follows:

> The determination of dischargeability of the Debtor's student loans is an issue not ripe for adjudication until the Debtor obtains her discharge or discharge is imminent; if the discharge is not imminent, there is no case or controversy relating to discharge and the Court could only render an advisory opinion, which it is precluded from doing. Thus, this court is without subject matter jurisdiction, and the Complaint must be dismissed.[37]

This argument has been raised with some frequency and has resulted in a split among the circuits. To date, this argument has been addressed by the Fourth, Fifth, Eighth, and Ninth Circuits, as well as by the Bankruptcy Appellate Panel of the Sixth Circuit, and a number of lower federal courts.

The Fifth and Eighth Circuits have agreed with the ripeness argument, holding that § 523(a)(8) decisions "should take place relatively close" to the date of discharge "so that the court can make its determination in light of the debtor's actual circumstances at the relevant time."[38] These decisions cite the ripeness doctrine, but offer little nuanced discussion of its application. For example, it is not clear whether these decisions are applying constitutional ripeness or prudential ripeness.

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35 Cassim v. Educational Credit Management Corp. (*In re* Cassim), 395 B.R. 907, 911 (6th Cir. B.A.P. 2008), *quoting* Ky. Press Ass'n, Inc. v. Ky., 454 F.3d 505, 509 (6th Cir. 2006).

36 *Id*.

37 Hoffer v. American Educ. Servs. (*In re* Hoffer), 383 B.R. 78, 80 (Bankr. S.D. Ohio 2008). *Hoffer* rejects this argument.

38 Bender v. Educational Credit Management Corp. (*In re* Bender), 368 F.3d 846, 848 (8th Cir. 2004). *Accord* Rubarts v. First Gibraltar Bank (*In re* Rubarts), 896 F.2d 107 (5th Cir. 1990). *See also In re* Pair, 269 B.R. 719 (Bankr. N.D. Ala. 2001); *In re* Soler, 250 B.R. 694 (Bankr. D. Mi. 2000); *In re* Raisor, 180 B.R. 163 (Bankr. E.D. Tex. 1995).

In *In re Bender*, the Eighth Circuit noted that any discharge of the debtor's student loans would necessarily be delayed for more than three years and that a determination of undue hardship so far in the future would "require a degree of judicial prescience."[39] Finding that a delay in its determination would not prejudice the debtor, the court found it preferable to defer the decision. "Deferring a decision until the case is ripe will allow a court to make its undue hardship determination on the basis of real rather than speculative circumstances."[40] One key to this decision is the circuit court's view that undue hardship should be determined at the date of discharge, not when the complaint is filed.[41]

Bender's approach has not been followed in the Fourth and Ninth Circuits, or by the Sixth Circuit's Bankruptcy Appellate Panel.[42] In *Ekenasi*, the Fourth Circuit "decline[d] to adopt a hard and fast rule which would preclude bankruptcy courts from ever entertaining a proceeding to discharge student loan obligations until at or near the time the debtor has completed payments under a confirmed chapter 13 plan."[43] Although it might be difficult for a debtor to prevail years before his discharge, such an action is permitted by the Code and Rules, and the court could envision facts on which a debtor could win.

In *Coleman*, the Ninth Circuit provided a detailed analysis of both constitutional and prudential ripeness, concluding that neither component of ripeness prevented a bankruptcy court from determining undue hardship well before the debtor's discharge. For purposes of constitutional ripeness, the court found that the controversy with the student loan creditor arose when the debtor filed bankruptcy. Although the uncertainty that the debtor would complete her plan and receive a discharge created a factual contingency, this did not make the case so speculative that it was not a "case or controversy."[44]

Turning to prudential ripeness, the Ninth Circuit found that many of the relevant facts must also be determined by the bankruptcy court during plan confirmation and would necessarily require the bankruptcy court to "speculate on the debtor's financial situation years into the future."[45] Nothing in § 523(a)(8) requires "undue hardship to exist exactly at the time of discharge," and the timing choice made by the drafters of Rule 4007(b) favored a finding of prudential ripeness.[46]

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39 *Bender*, *supra* note 37 at 848.

40 *Id*.

41 The Ninth Circuit appeared to disagree with this point in Educational Credit Management Corp. v. Coleman (*In re* Coleman), 560 F.3d 1000 (9th Cir. 2009). See note 45 and accompanying text *infra*.

42 Ekenasi v. Educ. Resources Inst. (*In re* Ekenasi), 325 F.3d 541 (4th Cir. 2003); Educational Credit Management Corp. v. Coleman (*In re* Coleman), 560 F.3d 1000 (9th Cir. 2009); *Cassim*, *supra* note 34.

43 *Ekenasi*, *supra* note 41 at 547.

44 *Coleman*, *supra* note 41, at 1005.

45 *Id*. at 1009. *See also Cassim*, *supra* note 41, at 913 (noting that confirmation of the debtor's chapter 13 plan required the bankruptcy court to find that she will be able to make all payments and complete the plan).

46 *Id*. at 1010.

B. Plan Treatment Issues in Chapter 13

The debtor's choice to file chapter 13 creates strategic opportunities for debtors and creditors. This section of the chapter begins with an examination of the treatment of post-petition interest in chapter 13, an area where the rules tend to favor creditors. The section then covers the possibility that the debtor may obtain an advantage by separately classifying his student loan debts, or by effecting a cure of default through § 1325(b)(5). Finally, the section concludes with an examination of the ways that a debtor's student loan payments may interact with the debtor's projected disposable income to impact the amount of the debtor's plan payment, or the amount the debtor is allowed to pay on student loans.

1. Post-Petition Interest

Unsecured claims may include principal and pre-petition interest, but § 502(b)(2) of the Code provides that an unsecured creditor may not include "unmatured" or post-petition interest in its claim.[47] As a result, post-petition interest on unsecured claims is not paid through the case and is normally discharged. When, however, the unsecured claim is nondischargeable, post-petition interest on that unsecured claim is also nondischargeable.[48] Thus, post-petition interest on student loan claims continues to accrue over the life of the chapter 13 case and may be collected from the debtor after the conclusion of the case.[49]

In *Kielish*, the student loan creditor filed proofs of claim for principal and pre-petition interest. The debtors' plan proposed to pay these claims in full, but did not mention post-petition interest. After the debtors received a discharge, the creditor attempted to collect the post-petition interest. During the litigation that followed, the debtors learned that the creditor had also applied the debtors' plan payments to postpetition interest while they were in chapter 13, thereby increasing the amount they would ultimately owe.[50]

The Fourth Circuit approved the creditor's application of payments, noting that § 502 "does not 'freeze' the debt of the student loan debtor" and did not bar the creditor from applying the debtors' plan

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47 11 U.S.C. § 502(b)(2). Kielish v. Educational Credit Management Corp. (*In re* Kielish), 258 F.3d 315, 323 (4th Cir. 2001). "Section 502 bars creditors from making *claims* from the bankruptcy estate for unmatured interest; it is undisputed, therefore, that ECMC could not have included the Debtor's postpetition interest in its proofs of claims to their bankruptcy estates."

48 *In re* Girard, 243 B.R. 894 (Bankr. M.D. Ala. 1999); Jordan v. Colorado Student Loan Program (*In re* Jordan), 146 B.R. 31 (D. Colo. 1992) (adopting the reasoning of Bruning v. United States, 376 U.S. 358 (1964), a pre-Code case involving nondischargeable taxes)).

49 *Kielish*, *supra* note 46; Leeper v. Penn. Higher Educ. Assistance Agency, 49 F.3d 98 (3d Cir. 1995).

50 *Kielish*, *supra* note 46, at 324. "[A]llowing [the debtors] to pay off loan principal without first permitting the application of the payment . . . to satisfy postpetition interest would reduce the overall amount that the Debtors would have to pay as a result of their debts and would also prevent the accumulation of interest that would have accrued but for their bankruptcies."

payments to postpetition interest.[51] The court noted that creditors are generally required to apply student loan payments to pay interest before principal.[52] Thus, § 502 impacted the creditor's ability to file a proof of claim for postpetition interest, but did not restrict the creditor's ability to apply payments made through the chapter 13 plan to accrued interest, including nondischargeable postpetition interest.[53]

In re Pardee,[54] a decision from the Ninth Circuit Bankruptcy Appellate Panel, offers an interesting gloss on the holding in *Kielish*. As in *Kielish*, the debtors in *Pardee* proposed a 100% payout of the creditor's claim for principal and prepetition interest. Here, however, the debtors' attorney included language in the plan providing that "any remaining unpaid amounts, if any, including any claims for interest, shall be discharged by the plan."[55] As in *Kielish*, the debtors completed their plan, received a discharge, and then faced the creditor's attempt to collect postpetition interest on their student loans.

Like the Fourth Circuit, the Ninth Circuit BAP in *Pardee* held that the full payment of the creditor's claim through the plan did not preclude the creditor from collecting postpetition interest. Section 502(b)(2) prevents the creditor from recovering postpetition interest from the estate; however, it "does not proscribe recovery from the debtor personally for nondischargeable debts that are not paid from the bankruptcy estate."[56]

Here, however, the debtors had included a plan provision that specifically denied postpetition interest to the student loan creditor. The creditor had failed to object to this language and, after confirmation, this plan provision became binding on the creditor through principles of res judicata. Although the BAP recognized that earlier decisions from other courts had reached different conclusions on this point, the Supreme Court's subsequent holding in *United Student Aid Funds v. Espinosa* indicates that the BAP likely reached the correct conclusion.[57]

Section 1322(b)(10) of the Code, added by BAPCPA, raises one final, and very different, point about postpetition interest. Section 1322(b)(10) allows a chapter 13 plan to:

> (10) provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are nondischargeable under section 1328(a), *except that such interest may be paid only to the extent that the debtor has disposable income available to pay such*

51 *Id*. at 321.

52 *Id*. at 325, *citing* 34 C.F.R. § 682.404(f).

53 *See also* United States Dept. of Educ. v. Harris, 339 B.R. 673 (W.D. Tenn. 2006). Following *Kielish*, the court found that DOE had properly applied the debtor's chapter 13 plan payment first to collection costs, next to interest (including postpetition interest), and last to principal. The court noted that application in this order was required by 34 C.F.R. § 682.404(f).

54 Great Lakes Higher Educ. Corp. v. Pardee (*In re* Pardee), 218 B.R. 916 (9th Cir. B.A.P. 1998).

55 *Id*. at 918.

56 *Id*. at 921.

57 *See* Part A.1. *supra*.

interest after making provision for full payment of all allowed claims.[58]

This section permits the chapter 13 debtor to pay post-petition interest through the plan, but conditions this payment on the debtor's full repayment of *all* other allowed claims.

Section 1322(b)(10) impacts the payment of postpetition interest on student loan debt in several ways. Because student loan debt is nondischargeable under §§ 523(a)(8) and 1328(a), debtors have a strong incentive to repay as much of this debt as possible through the chapter 13 plan. Chapter 13 debtors who wish to avoid negative amortization of their student loans will look for ways to pay postpetition interest while the case is pending. The best mechanism for doing this is usually § 1322(b)(5), which allows the debtor to cure defaults and maintain regular payments on long-term debt.[59] However, long term debts repaid using § 1322(b)(5) are made nondischargeable in chapter 13 by § 1328(a)(1). It follows that a debtor who attempts to cure and maintain student loan debt through § 1322(b)(5), which necessarily involves payment of postpetition interest, must also deal with the 100% repayment rule imposed by § 1322(b)(10).

Several decisions have addressed this problem. The first, *In re Freeman*, concluded that §§ 1322(b)(5) and (10) simply could not be harmonized and held that "Congress intended to permit the cure and maintenance of long-term unsecured debts, notwithstanding the applicability of section 1322(b)(10)."[60] Two, more recent, decisions have reached the opposite conclusion. *In re Stull* applies the plain language of § 1322(b)(10) to hold that, "in the absence of 'full payment of all allowed claims,' an unsecured nondischargeable claim may not receive interest."[61] *Stull* followed *In re Kubeczko*,[62] a 2012 decision finding that "the later-enacted and very specific terms of (b)(10) trump the earlier and more general provisions of § 1322(b)(5)."[63]

2. Separate Classification of Student Loan Debt in Chapter 13

Education loans are listed on Schedule F as non-priority unsecured claims. These claims are paid pro-rata throughout the duration of the plan, but unlike other non-priority unsecured

58 11 U.S.C. § 1322(b)(10). (Emphasis added.)

59 11 U.S.C. § 1322(b)(5). For purposes of this section, long term debt means the debtor's liability on "any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."

60 *In re* Freeman, 2006 WL 6589023 at *2 (Bankr. N.D. Ga. 2006). Since long-term debts cured and maintained under § 1322(b)(5) are both nondischargeable and debts on which postpetition interest must be paid, *Freeman* reasoned that § 1322(b)(10) would make it impossible for debtors to use § 1322(b)(5). Because Congress could not have intended this result, the court applied § 1322(b)(5) in preference to (b)(10) – finding it the more specific provision.

61 489 B.R. 217, 223 (Bankr. D. Kan. 2013).

62 2012 WL 2685115 (Bankr. D. Colo. 2012).

63 *Stull*, *supra* note 60, at 223.

claims, education loans will not be discharged upon plan completion. This means that an education loan will accumulate unpaid principal and interest during the plan, and the debtor will owe far more in student loans after the plan than when the plan started.[64] This result can be avoided if the debtor is allowed to classify education debt separately from other Schedule F debt in her plan, and then make the full monthly payment on that debt for each month during the chapter 13 plan.

Section 1322(b)(1) provides that a chapter 13 plan may "designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated."[65] Because education loans are not dischargeable and in most cases extend beyond the three- or five-year duration of the plan, they are logically distinct and can be classified separately from types of Schedule F non-priority unsecured debt.[66] However, whether a debtor may pay education loans at a higher amount may depend upon whether the court finds that separate classification violates the prohibition against unfair discrimination.

A number of courts have considered whether separate classification of chapter 13 debt constitutes unfair discrimination. The Eighth Circuit in *In re Leser*, a case dealing with separate classification of delinquent child support claims, adopted this four-part test: (1) whether there is a rational basis for the classification; (2) whether the classification is necessary to the debtor's rehabilitation under Chapter 13; (3) whether the discriminatory classification is proposed in good faith; and (4) whether there is meaningful payment to the class discriminated against.[67] A number of bankruptcy courts have used the *Leser* test.[68] The bankruptcy court in *In re Husted* (which also addressed child support claims) used the same four factors and added a fifth: (5) the difference between what the creditors discriminated against will receive as the plan is proposed, and the amount they would receive if there was no separate classification.[69] The Ninth Circuit BAP has used similar elements,[70] as have other courts.[71]

The First Circuit BAP has established a baseline test to determine whether separate clas-

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64 If student loan debt is not dischargeable, then post-petition interest on the debt is likewise not dischargeable. *In re* Kielisch, 258 F. 3d 315 (4th Cir. 2001); *In re* Pardee, 218 B.R. 916 (B.A.P. 9th Cir. 1998), *aff'd*, 187 F. 3d 648 (9th Cir. 1999).

65 11 U.S.C. § 1322(b)(1) (2012).

66 *In re* Potgieter, 436 B.R. 739, 743 (Bankr. M.D. Fla. 2010) ("[T]he separate classification of the debtor's student loan obligations does not violate Section 1122."); *In re* Coonce, 213 B.R. 344, 345 (Bankr. S.D. Ill. 1997) (separate classification of student loan debt is permissible).

67 Mickelson v. Leser (*In re* Leser), 939 F.2d 669, 672 (8th Cir. 1991).

68 *In re* Sperna, 173 B.R. 654 (B.A.P. 9th Cir. 1994); *In re* Tucker, 130 B.R. 71, 73 (Bankr. S.D. Iowa 1991) (plan that proposed to pay 100% to student loans and 13% to other unsecured creditors lacked a reasonable basis for discrimination); *In re* Saulter, 133 B.R. 148, 149 (Bankr. W.D. Mo. 1991) (proposed 100% payment to student loans and 10% to other unsecured creditors unfairly discriminated).

69 *In re* Husted, 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992).

70 Amfac Distrib. Corp. v. Wolff (*In re* Wolff), 22 B.R. 510 (B.A.P. 9th Cir. 1982).

71 *See, e.g., In re Birts*, No. 11-15918-BFK, 2012 Bankr. LEXIS 727, at *8 (Bankr. E.D. Va. 2012) (using the first three factors of *Leser*—rational basis, necessary to reorganization of debtor, and good faith—plus *Husted's* fifth factor—difference to creditors if no separate classification); *In re* Mason, 456 B.R. 245, 252 (Bankr. N.D. W.Va. 2011) (holding that Chapter 13 allows separate treatment of unsecured claims, but requiring debtor to demonstrate at confirmation hearing that seventy-two percent distribution to student loan debts and eight percent distribution to other unsecured creditors is not unfairly discriminatory); *In re* Potgieter, 436 B.R. 739 (Bankr. M.D. Fla. 2010) (adopting the four elements of *Leser*).

sification in chapter 13 is fair.[72] The elements include: (1) fairness in the equality of distribution; (2) nonpriority of student loans under the Code; (3) whether dischargeable unsecured creditors receive their full pro rata distribution under chapter 13; and (4) Chapter 13 exempts student loans from discharge, therefore the debtor does not have an unlimited expectation of a fresh start.[73] While not widely followed, some courts have cited this test with approval.[74]

The problem inherent in any multi-factor test is that "unfairness is ultimately a discretionary determination, subject to individual judgment."[75] Courts have struggled to articulate specific criteria, and some have found simply that what is unfair is best left to the "first-line decision maker, the bankruptcy judge."[76] In the end, whether a debtor can classify and treat education debt and general unsecured debt differently really depends upon the jurisdiction and court in which the case was filed, as the following cases show.

a. Cases Allowing Separate Classification

In *In re Pracht*, the debtor owed $115,934 in student loan debt, and $102,000 in general unsecured debt.[77] The debtor, a special education teacher, was eligible to participate in the Public Service Loan Program.[78] She reached agreement with the U.S. Department of Education whereby she would make 120 consecutive monthly payments of $532.12, after which the remaining amount (approximately $50,000) would be forgiven. In order to obtain the loan forgiveness, she would have to make the payments during her chapter 13 plan. The other unsecured creditors, separately classified, would receive a distribution of only 15%. If the student loan debt was classified and paid with the other claims, then all unsecured creditors would receive approximately 20% pro rata.[79]

The chapter 13 trustee objected to the plan on the grounds that the separate classification and higher payment for education loans impermissibly discriminated against the other nonpriority creditors. In considering the objection, the court noted that because the Code does not define the term "discriminate unfairly," the determination must be left to the "first-line decision maker, the bankruptcy judge."[80] The court must balance the "fresh start" purpose of bankruptcy with fairness to creditors.[81] In that case, the benefit to the debtor was the opportunity to write off $50,000, whereas the benefit to the other creditors if the education loan was not separately classified would be an increase of only $5000, which the court found to be a "modest difference."[82] Thus, the plan did not unfairly discriminate against other nonpriority debtors.

Similarly, the court in *In re Birts* confirmed a debtor's plan that paid only 7% of allowed unsecured claims (a total of $4,299 over sixty months) while keeping current on the debtor's

72 *In re* Bentley, 266 B.R. 229 (B.A.P. 1st Cir. 2001).

73 *Id.* at 240–42.

74 *See, e.g.*, *In re* Crawford, 324 F.3d 539, 542 (7th Cir. 2003) (plan that proposed to pay two-thirds of nondischargeable debt while unsecured creditors received nothing unfairly discriminated); *In re* Mason, 300 B.R. 379, 386–87 (Bankr. Kan. 2003) (baseline test used to determine that debtor's proposed plan to pay 17% of student loan claims and nothing to dischargeable creditors was unfair).

75 *In re* Mason, 456 B.R. at 251.

76 *In re* Pracht, 464 B.R. 486, 492 (Bankr. M.D. Ga. 2012) (quoting *In re* Crawford, 342 F.3d 539, 542 (7th Cir. 2003)).

77 *In re Pracht*, 464 B.R. at 492.

78 *Id.* at 487.

79 *Id.*

80 *Id.* at 492 (quoting *In re* Crawford, 324 F.3d 539, 542 (7th Cir. 2003)).

81 *Id.*

82 *Id.*

monthly student loan payment of $271 per month, even though paying the student loan debt pro rata with the other unsecured debts would more than double the percentage of payment to unsecured creditors to 16%.[83] The court was particularly compelled by weighing the very positive benefits to the debtor against the marginal real dollar improvement in payments to the creditors, a difference of $92.17 per month divided among all creditors, whose claims totaled over $93,000. "Under the circumstances, the Court finds that the difference of what the creditors are to receive under the Plan, as proposed, and what they would receive if student loan debt were not separately classified, is not so great as to compel a denial of confirmation."[84] The court cautioned, however, that any such finding would be on a case-by-case basis, balancing the "greater disparity between what the creditors are being paid under the [p]lan and what they would receive if the student loan debt [was] not separately classified." The court did not say exactly what the balance might be, except that "a zero percent plan, and one hundred percent payment to student loans may not be a confirmable plan."[85]

In another case, the potential increase from 4.14% to 6.76% payment to all unsecured claims if student loan debt was not separately classified was not enough to warrant a finding of unfair discrimination.[86] Yet another court found that separate treatment of education loans and general unsecured was not unfair discrimination when it was necessary for the debtor to maintain her student loan payments to keep her professional license and thus make her plan payments.[87]

There sometimes is a difference between the amount of disposable income calculated using Form 22C and the debtor's *actual* income. This is because Form 22C uses statutory amounts for expenses. Some are based upon IRS allowances, and others are based on Department of Labor statistics, such as state and local median income figures.[88] This means that some debtors may actually have higher incomes than the amount calculated using Form 22C. In these circumstances, debtors have successfully proposed plans in which all of their disposable income, as calculated under Form 22C, is used to pay general unsecured creditors, and the excess amount is used to pay education debt.[89]

Another line of cases has found that where educational debt is payable beyond the life of the plan, the unfair discrimination test of § 1322(a)(1) does not apply. This is based upon an expansive reading of § 1322(b)(5) –the so-called "cure and maintain" provision--which states that a Chapter 13 plan shall "provide for the curing of any default . . . and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."[90] So, if payments on the student loan debt extend beyond the five years of the plan, then the plan can provide for maintenance

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83 *In re* Birts, No. 11-15918-BFK, 2012 Bankr. LEXIS 727, at *8 (Bankr. E.D. Va. 2012).

84 *Id.*

85 *Id.*

86 *In re* Machado, 378 B.R. 14, 17 (Bankr. D. Mass. 2007).

87 *In re* Kalfayan, 415 B.R. 907 (Bankr. S.D. Fla. 2009).

88 11 U.S.C. § 707(b)(2)(A)(ii)(I).

89 *In re* Abaunza, 452 B.R. 866 (Bankr. S.D. Fla. 2011); *In re* King, 460 B.R. 708, 713–14 (Bankr. N.D. Tex. 2011) (unfair discrimination test allows for higher payments to certain creditors as long as unsecured creditors receive pro rata share of statutory projected disposable income); *In re* Sharp, 415 B.R. 803, 812 (Bankr. D. Colo. 2009) (§ 1325(b) does not require debtors to pay more to creditors than the statutory projected disposable income); *In re* Orawsky, 387 B.R. 128, 148–56 (Bankr. E.D. Pa. 2008) (payments to education creditor came from funds the debtor is not obligated to commit to the plan). *Contra In re* Cooper, 2009 WL 1110648 at *5 (Bankr. N.D. Tex. April 24, 2009) (above-median income debtor may not discriminate among non-priority unsecured creditors).

90 11 U.S.C. § 1322(b)(5) (2012).

of the regular loan payments.[91] A number of courts have adopted this view.[92] For example, a Massachusetts debtor's plan proposed to pay $17,900 over five years to maintain full payment of student loan debt, but only $6,851 to general unsecured creditors whose claims totaled $107,000. Adding the $17,900 to unsecured creditors would increase the dividend from 6.39 to 21.73. Nevertheless, the plan was confirmed pursuant to § 1322(b)(5), notwithstanding the chapter 13 trustee's objection of unfair discrimination.[93]

b. Cases Disallowing Separate Classification

A Wisconsin bankruptcy court did not allow separate treatment of education debt in *In re Edmonds*.[94] In that case, the debtor proposed to treat her three education loans as a separate class and to pay the contract rate of principal and interest. At the end of the five-year plan, education creditors would have received a 53% dividend, while the other unsecured creditors would receive only 18% and their claims would be discharged. If the payments to education creditors were included in the same class as the other creditors, the dividend to all unsecured creditors would be 28%. The chapter 13 trustee objected to the plan on the grounds of unfair discrimination. In sustaining the objections, the court stressed that it was not holding that student loans could *never* be separately classified. However, because the debtors were fully employed and had a good income, "[t]here is nothing in the case at bar which establishes that the debtors are unable to formulate a plan that provides for equal treatment of unsecured debtors. Student loan debts should not be paid at the expense of the other general unsecured creditors."[95] For the *Edmonds* court, because the debtors had sufficient income to carry out a plan without discrimination, they must do so.

In another case, the First Circuit BAP affirmed a bankruptcy court ruling disallowing debtor's proposed plan to pay student obligations in full while paying other unsecured creditors only 3%.[96] The BAP held that the principal of equality of distribution for unsecured creditors mandated that the debtor could not favor certain creditors without providing a correlative benefit to other unsecured creditors.[97] A Colorado bankruptcy court found unfair discrimination where debtor's plan proposed to pay student loan claims at 64% while other unsecured claims received only 1%.[98] The court required the debtor to pay student loan payments pro rata with other claims, resulting in a distribution of 12% to all unsecured creditors. Other courts have rejected separate classification and payment of education debt in chapter 13 plans.[99]

3. Education Debt as Special Circumstances

Under § 707(b), a chapter 7 petition filed by a debtor whose income is above the state median will be subject to the "presumption of abuse" and will be dismissed unless the debtor can satisfy the "means" test of income and allowable expenses set out in § 707(b)(2). In the event that

91 *In re* Johnson, 446 B.R. 921, 926 (Bankr. E.D. Wis. 2011) ("Section 1322(b)(5) expressly permits a debtor to cure and maintain payments on a long-term debt; and the Debtor's student loans qualify.").

92 *See, e.g.*, *In re* Truss, 404 B.R. 329 (Bankr. E.D. Wis. 2009); *In re* Knight, 370 B.R. 429 (Bankr. N.D. Ga. 2007); *In re* Machado, 378 B.R. 14, 16 (Bankr. D. Mass. 2007); *In re* Hanson, 310 B.R. 131 (Bankr. W.D. Wis. 2004); *In re* Williams, 253 B.R. 220 (Bankr. W.D. Tenn. 2000); *In re* Chandler, 210 B.R. 898 (Bankr. D.N.H 1997); *In re* Christophe, 151 B.R. 75 (Bankr. N.D. Ill. 1993).

93 *In re* Tanzie, Case No. 12-17152, Doc. (Bankr. D. Mass., January 17, 2013).

94 *In re Edmonds*, 444 B.R. 898 (Bankr. E.D. Wisc. 2010).

95 *Id.* at 902.

96 *In re* Bentley, 266 B.R. 229 (B.A.P. 1st Cir. 2001).

97 *Id.* at 243.

98 *In re* Renteria, 2012 WL 1439104 at *5 (Bankr. Colo. Apr, 26, 2012).

99 *See, e.g.*, *In re* Zeigafuse, 2012 WL 1155680 at *3 (Bankr. D. Wyo. 2012) (interpreting § 1322(b)(5) to allow for full payment of student loan debt while other general unsecured debt is paid pro rata is minority view).

the debtor's income exceeds the maximum allowed amount, § 707(b)(2)(B) permits the debtor to rebut the presumption of abuse by demonstrating "special circumstances . . . that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative."[100] Examples of "special circumstances include "a serious medical condition or a call or order to active duty in the Armed Forces."[101]

In chapter 13, debtors must devote all of their "projected monthly income" (PMI) to paying their unsecured debts under a plan. PMI is calculated by taking monthly income and subtracting the same statutory expenses set forth in § 707(b)(2)(A),[102] so deductions for expenses resulting from "special circumstances" apply as well in chapter 13.

The question is whether the non-dischargeable nature of student loan debt constitutes "special circumstances" so that the full monthly payment of student loan debt can be included as an allowable expense for means testing in chapter 7, or for calculating PMI in chapter 13. Some courts have held that since the debtor has no reasonable alternative but to pay nondischargeable student loans, the loans constitute special circumstances.[103] One court reasoned that hardship would result from the accumulation of interest if the education loans were treated the same as other undersecured debt.[104] Still another court ruled that education loans could constitute special circumstances, depending on the debtor's motivation in incurring the student debt.[105] In that case, the court held that pursuit of higher education solely for increased earning potential or career advancement could not constitute special circumstances, but that educational loans incurred for education and training "necessitated by permanent injury, disability or an employer closing," could constitute the requisite special circumstances.[106] Other courts have found that a parent's obligation to pay for their children's loans constitute special circumstances.[107] The analysis may also hinge upon whether the debtor is doing all he can to reduce expenses.[108]

Many courts have taken the opposite view, holding that the nondischargeability of student loan debt does not, without more, justify preferential treatment.[109] Indeed, some courts have opined that because borrowing to fund an education is almost universal, student loans are not special and therefore not dischargeable.[110] Moreover, since students generally know that student

100 *Id.* § 707(b)(2)(B)(i).

101 *Id.*

102 *Id.* § 707(b)(2)(A).

103 *In re* Knight, 370 B.R. 429 (Bankr. N.D. Ga. 2007) (chapter 13 debtor would default on his student loans and face future wage and tax garnishments if PDI not reduced by amount of student loan payment); *In re* Delbecq, 368 B.R. 754, 759 (chapter 7 debtor disposable income reduced by monthly student loan payment); (Bankr. S.D. Ind. 2007); *In re* Templeton, 365 B.R. 213 (Bankr. W.D. Okla. 2007).

104 *In re* Martin, 371 B.R. 347, 356 (Bankr. C.D. Ill. 2007).

105 *In re* Pageau, 383 B.R. 221 (Bankr. D.N.H. 2008).

106 *Id.* at 228.

107 *In re* Sanders, 454 B.R. 855 (Bankr. M.D. Ala. 2011); *In re* Haman, 366 B.R. 307 (Bankr. D. Del. 2007).

108 *In re* Edwards, 2012 WL 3042233 (Bankr. D. Ala. July 25, 2012) (education debt may constitute special circumstances in some cases, but not here because debtor incurred other high unnecessary expenses).

109 *In re* Campbell, 2012 WL 162287 (Bankr E.D. Ky, Jan 18, 2012) (no special circumstances where debtor offered no evidence other than the nondischargeable nature of student loan debt); *In re* Thompson, 457 B.R. 872 (Bankr. M.D. Fla. 2011) (debtor failed to show student loan debt as necessary expense); *In re* Conlee, 435 B.R. 490 (Bankr. N.D. Ohio 2010); *In re* Willis, 197 B.R. 912 (N.D. Okla. 1996) (nondischargeability by itself is insufficient for preferential treatment of student loan debt over other debt); *In re* Colfer, 159 B.R. 602, 608–09 (Bankr. Me. 1993).

110 *See, e.g.*, *In re* Johnson, 446 B.R. 921, 925 (Bankr. E.D. Wis. 2011) ("The commonplace nature of student loans to fund higher education suggests that they are not 'special,' as they are part of the financial picture of many Americans."); *In re* Carrillo, 412 B.R. 540 (Bankr. D. Ariz. 2009) (finding that ordinary course student loans are

loans are nondischargeable in bankruptcy before they incur them, it can be hard to argue that payment of the loans constitutes a *special* circumstance. Thus, for some courts, in order for the student loan to constitute special circumstances, it must be a result of hardship or other circumstances that the debtor could not control.[111]

4. Debtor's Use of Excess "Discretionary" Income

As noted above, BAPCPA requires above-median income chapter 13 debtors to calculate projected disposable income with reference to the "means test" of § 707(b)(2), which requires the debtor to use hypothetical amounts specified in National and Local Standards issued by the IRS.[112] These hypothetical amounts will almost always differ from the true budget numbers reflected on the debtor's schedules I and J. This creates the possibility that a debtor's projected disposable income under § 707(b)(2) will be less than his actual discretionary income.

When this occurs, it may be possible for the above-median debtor to devote 100% of his projected disposable income to unsecured creditors in the chapter 13 plan and still retain significant excess "discretionary" income. Student loan debtors have taken advantage of this anomaly to propose chapter 13 plans that satisfy the requirements of the Code, while simultaneously proposing to continue contract payments on student loans outside the plan. This strategy has withstood challenge in some cases, even when student loans are paid in full and the dividend to other unsecured creditors is as low as 0.86%.[113]

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not special circumstances); *In re* Vaccariello, 375 B.R. 809, 816 (Bankr. N.D. Ohio 2007).

111 *In re* Pageau, *supra* note 104.

112 Note 88 and accompanying text, *supra*.

113 *In re* Abaunza, 452 B.R. 866 (Bankr. S.D. Fla. 2011) (plan did not unfairly discriminate when projected disposable income resulted in dividend of only 0.86%); *In re* King, 460 B.R. 708 (Bankr. N.D. Tex. 2011); *In re* Sharp, 415 B.R. 803 (Bankr. D. Colo. 2009); *In re* Orawsky, 387 B.R. 128 (Bankr. E.D. Penn. 2008).

These decisions must be read in light of *Hamilton v. Lanning*, where the Supreme Court adopted a forward-looking approach to "projected disposable income" in chapter 13 cases.[114] *Lanning* holds that "when a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation."[115] *Lanning* disapproves the debtor's ability to manipulate the calculation of projected disposable income by selecting the most advantageous point for filing her petition. It does not, however, address the problem that occurs when the debtor's actual expenses are significantly less than the hypothetical expenses assumed by § 707(b)(2). For this reason, *Lanning* is not completely on point with the facts in this line of cases.

114 130 S. Ct. 2464 (2010).

115 *Id*. at 2478.