Income Driven Repayment Plans in Chapter 13

By Ed Boltz

Income Driven Repayment (IDR) plans for student loans became available to borrowers with the Income Drive Repayment plan in 2009. Subsequent plans, such as Pay As You Earn (PAYE) and Revised Pay As You Earn (REPAYE), were modeled after it 2014 and 2015. Payments under these payment are based on 10-15% of the borrower's household discretionary income,[1] without regard to assets, and can be as low as $0.00 a month. Depending on the plan, after 20 or 25 years of payments, any remaining balance will be cancelled.[2] If the borrower works for a governmental entity or a qualified non-profit, after 10 years of payments, the student loans will be forgiven.[3]

Prior to 2015, the Department of Education, its Guaranty Agencies and Student Loan Servicers would place all student loans for Chapter 13 Debtors in an administrative forbearance, which was colloquially called "putting the loan on the shelf." During the bankruptcy, no collection actions were taken, but interest continued to accrue. As Albert Einstein called "compound interest the most powerful force in the universe," this can mean a Chapter 13 plan has a devastating effect on student loans. For example, if nothing is paid on $100,000 of student loans during a 60-month Chapter 13 Plan, at 8% interest at the end of the bankruptcy the debtor will owe $148,984.57. For a Debtor with student loans, the "fresh start" becomes a "false start."[4] The Department of Education steadfastly refused to allow Chapter 13 Debtors to participate in the various income driven repayment plans.

When pressed, both at a policy level in Washington, D.C. by the National Association of Consumer Bankruptcy Attorneys (NACBA) and in specific cases starting in North Carolina,[5] with the argument that 11 U.S.C. § 525(c)[6] prohibited such discrimination, the Department of Education eventually relented and began quietly allowing Chapter 13 Debtors to participate in IDRs if Chapter 13 plans. To avoid objection, the Department of Education required the following provisions (which are interspersed with my comments) from the *Buchanan* case:

- The Debtor is not seeking nor does this Plan provide for any discharge, in whole or in part, of her student loan obligations.

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[1]The amount of the monthly payment can be determined using the Repayment Estimator found at: https://studentloans.gov/myDirectLoan/mobile/repayment/repaymentEstimator.action

[2]Under current law, cancelled student loans will be reported as taxable income for the year in which the loan is finally cancelled.

[3]Forgiven student loans are, unlike those that are cancelled, are not reported as taxable income.

[4]In fact, a Debtor with $250,000 in student loans (a high but not unheard of amount) will likely have a balance so high upon exiting a Chapter 13, that he or she would exceed the debt limits of 11 U.S.C. §109(e) and never be able to file another Chapter 13 case.

[5]One of the first cases in which this was allowed was In re Buchanan, from the Middle District of North Carolina, case number 14-51161. With the provisions included in the Confirmation Order, dated June 13, 2015, and available as Docket Item 45.

[6]11 U.S.C. 525(c) provides that "A governmental unit that operates a student grant or loan program… may not deny a student grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title …, because the debtor or bankrupt is or has been a debtor under this title … or during the pendency of the case but before the debtor is granted or denied a discharge …."

The over-arching concern of the Department of Education was that, following *United Student Aid Funds, Inc. v. Espinosa*,[7] "unscrupulous debtors [will] abuse the Chapter 13 process by filing plans proposing to dispense with the undue hardship requirement in the hopes the bankruptcy court will overlook the proposal and the creditor will not object."[8] This concern was addressed directly and repeatedly, both by specifically disavowing any present attempt at discharge and by asking that the Plan be specially set for a Confirmation Hearing.[9]

- The Debtor shall be allowed to seek enrollment in any applicable income-driven repayment ("IDR") plan with the U. S. Department of Education and/or other student loan servicers, guarantors, etc. (Collectively referred to hereafter as "Ed"), without disqualification due to her bankruptcy.
- Ed shall not be required to allow enrollment in any IDR unless the Debtor otherwise qualifies for such plan.

This was the fundamental change in practice by Ed. and its servicers, which, as stated above, had previously refused to consider applications by Chapter 13 debtors for IDRs, instead placing student loans into an "administrative forbearance." Debtors would only be allowed the appropriate IDR without any special preference.

- The Debtor may, if necessary and desired, seek a consolidation of her student loans by separate motion and subject to subsequent court order.

Consolidation of several student loans may be necessary for enrollment in a specific IDR or if the debtor was in default on her student loans.[10] The plan provides that this will be approved by separate motion, but relief from the automatic stay is not necessary.[11]

- Upon determination by Ed of her qualification for enrollment in an IDR and calculation of any payment required under such by the Debtor, the Debtor shall, within 30 days, notify the Chapter 13 Trustee of the amount of such payment. At such time, the Trustee or the Debtor may, if necessary, file a Motion to Modify the Chapter 13 Plan to allow such direct payment of the student loan(s) and adjust the payment to other general unsecured claims as necessary to avoid any unfair discrimination.
- The Debtor shall re-enroll in the applicable IDR annually or as otherwise required and shall, within 30 days following a determination of her updated payment, notify the Chapter 13 Trustee of such payment. At such time, the Trustee or the Debtor may, if necessary, file a Motion to Modify the Chapter 13 plan to allow such direct payment of the student loan(s) and adjust the payment to other general unsecured claims as necessary to avoid any unfair discrimination.

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[7] 559 U.S. 260 (2010).

[8] *Id*. at 16.

[9] In fact, in additional to treating the Confirmation as a contested matter, with service on the United States, pursuant to Bankruptcy Rule 7004(c), to the Department of Education, the Attorney General, and the local U.S. Attorney, contacts at both the Department of Education and the U.S. Attorney's office were called and alerted to this requested departure from the practice of placing loans in administrative forbearance.

[10] It is important to note that in regards to student loans, "delinquent" is not be the same as "default", which requires that no payments have been made for more than 270 days. See 34 C.F.R. § 685.102. Outside of bankruptcy, default carries with it severe consequences including administrative wage garnishment, seizure of tax refunds, loss of eligibility for new student loans, etc.

[11] 11 USC § 362(b) (16) provides that it is not a stay violation to determine the eligibility of a debtor to participate in student loan programs, including repayment plans.

Once the monthly payment under an IDR is determined, the debtor will notify the Chapter 13 Trustee, who would then have an opportunity to decide whether that requires a higher dividend to unsecured creditors to avoid "unfair discrimination"[12] as to other unsecured claims and if the IDR should be made directly or by "conduit." This is also meant to provide a bit of a "carrot" for the Chapter 13 Trustee in consenting to the plan, in that the debtor will annually notify the Trustee of changes in the monthly IDR, which could result in a higher dividend to other unsecured creditors.[13]

- During the pendency of any application by the Debtor to consolidate her student loans, to enroll in an IDR, direct payment of her student loans under an IDR, or during the pendency of any default in payments of the student loans under an IDR, it shall not be a violation of the stay or other State or Federal Laws for Ed to send the Debtor normal monthly statements regarding payments due and any other communications including, without limitation, notices of late payments or delinquency. These communications may expressly include telephone calls and e-mails.
- In the event of any direct payments that are more than 30 days delinquent, the Debtor shall notify her attorney, who will in turn notify the Chapter 13 Trustee, and such parties will take appropriate action to rectify the delinquency.

After fears of discharge through a Confirmation Order, the second greatest concern of the Department of Education appears to be that this plan is a devious attempt to trick student loan servicers into violating the automatic stay. The communications allowed are patterned on those with mortgage servicers, but stop short of allowing non-bankruptcy garnishment or other involuntary collection. Notice to the Trustee of a delinquency, is meant to allow for monitoring of the IDR payments if made directly by the debtor.

- The Debtor's attorney may seek additional compensation by separate applications and court order for services provided in connection with the enrollment and performance under an IDR.

Most courts would recognize that assisting a Chapter 13 debtor with an IDR for student loan is an additional service outside of any presumptive "No Look" fee and Chapter 13 can, in fact, be an ideal

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[12]While a full discussion of the separate classification of student loans is outside the scope of this article, it should be noted that in effect every Chapter 7 (except that vanishingly rare case where student loans are discharged) separately classifies student loans, as the Debtor will, after discharge, either make voluntary payments or face the full brunt of the collection powers of the Department of Education. Options for separate classification can include:

- Fair Discrimination, see *In re Leser*, 939 F.3d 669 (8th Cir. 1991);
- Co-Sign Protection (when applicable);
- Above-median debtor paying student loan from discretionary income, i.e. Social Security or belt-tightening, earned in excess of PDI;
- Below-median debtor extends plan to five years;
- Pro-Rated Distribution to Other General Unsecured Claims;
- Filing of a Chapter 20, i.e. a Chapter 7 to discharge all other unsecured debts followed by a Chapter 13.

[13]Even though most jurisdictions have some requirement that debtors notify the Chapter 13 Trustee of substantial changes in financial circumstances, it must be admitted that this obligation is "More honor'd in the breach than the observance…." Hamlet, Act 1, scene 4, line 16.

venue for this often necessary legal representation[14] as any attorney's fee can be paid through the plan, without delaying providing the debtor relief.[15]

- <u>Notice of Final Plan Payment.</u> In Chapter 13 cases, within 30 days after the Debtor completes all payments under the plan, the Chapter 13 Trustee shall file and serve on the Required Parties a notice stating that the Debtor has paid in full the amount required to cure any default on the claim and has paid all payments due to Creditor during the Chapter 13 plan. The notice shall also inform the Creditors of its obligation to file and serve a response under subdivision (f). If the Debtor contends that final cure payment has been made and all plan payments have been completed, and the Trustee does not timely file and serve the notice required by this subdivision, the Debtor may file and serve the notice.
- <u>Response to Notice of Final Cure Payment.</u> In Chapter 13 cases, within 21 days after service of the notice under subdivision (e), the Creditor shall file and serve on the Debtor, debtor's counsel, and the Trustee a statement indicating (1) whether it agrees that the Debtor has paid in full the amount required to cure the default on the claim, (2) whether the Debtor has otherwise made all payments due during consistent with § 1322(b)(5) of the Code, and (3) whether payments made during the plan were applied towards any period of forgiveness or cancellation of the Eligible Loan. The statement shall itemize the required cure or post-petition amounts, if any, that the Creditor contends remain unpaid as of the date of the statement. The statement shall be filed as a supplement to the holder's proof of claim and is not subject to Rule 3001(f).

These last two provisions, while not included in the *Buchanan* Order, have been proposed elsewhere to take steps to ensure that IDR payments made during the bankruptcy are credited towards the period of cancellation or forgiveness.[16] This language is again patterned on the Notice of Final Cure for long-term non-dischargeable claims against a debtor's principal residence in Bankruptcy Rule 3002.1(f) and (g).

With the often insurmountable challenge of satisfying the *Bruner* test to discharge student loans and the total student loan debt in the United States exceeds $1.4 trillion (only surpassed by mortgage debt), it is increasingly necessary that debtors be given options in Chapter 13 for dealing with those student loans. To meet this debtor's attorneys will need to be creative and Chapter 13 Trustees (to say nothing of bankruptcy judges) will need show flexibility and accommodate the current state of affairs. Allowance of IDRs in Chapter 13 through adoption of the *Buchanan* provisions is a reasonable and fair solution that is become more common throughout the country.

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[14]In the event that the difficulties debtors face in successfully navigating the student loan Income Driven Repayment plans is unclear, the report from the Consumer Financial Protection Bureau Student Loan Ombudsman <u>Transitioning From Default to an Income-Driven Repayment Plan</u> discusses how "a series of administrative, policy and procedural hurdles may limit access to or enrollment in IDR for borrowers with previously defaulted federal student loans."
[15]See *In re Coleman*, 560 F.3d 1000 (9th Cir. 2009), which held that even an "Attorney Fee Only" plan can be appropriate as a debtor often "cannot finance … undue hardship litigation up-front, she would have to proceed with the undue hardship litigation pro se, if at all." The same should hold for IDR representation.
[16]Application of IDR payments to these periods of cancellation or forgiveness have been problematic outside of bankruptcy, see <u>Panicked Borrowers, and the Education Department's Unsettling Silence</u>, The New York Times (April 7, 2017).