

STUDENT LOANS AND BANKRUPTCY: WHEN WORLDS NEED NOT COLLIDE

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1. Federal Student Loan Collections

The government has extraordinary powers to collect student loan debt.¹ Federal student loan collection powers have grown so much over time that the government rarely sues borrowers, opting instead for an array of extra-judicial collection tools. These options include tax refund offsets, federal benefit offsets, and administrative wage garnishments.

While a relatively small portion of the government's overall collection effort, there are some indications that the U.S. Department of Education is increasing its litigation efforts. According to Bloomberg, in the fiscal year ended September 30, 2012, the government filed 4841 student loan collection lawsuits, almost three times the number from the previous year. Private lawyers filed about 90% of the lawsuits, handling the suits on a contingent fee basis.² Student loan litigation is even greater in certain jurisdictions, due at least in part to a private counsel program in these areas.³

In addition to these powerful collection tools, both the government and guaranty agencies rely heavily on the use of private collection agencies and other more "traditional" collection efforts. According to a Department of Treasury report in 2009, the Department of Education refers every eligible defaulted debt to one of its private collection agencies.⁴ In fact, according to industry insiders, the Department contract is "[t]he most sought after contract within this industry" because of the ever-increasing volume of debt that is extremely difficult to discharge in bankruptcy.⁵ In 2014, the government is projected to pay about \$1 billion in commissions to private collection agencies in 2014, growing to over \$2 billion by 2016.⁶

¹ This discussion of student loan collection is derived from NCLC's *Student Loan Law*, which should be reviewed for a more detailed discussion of this and other student loan topics.

² John Hechinger, *Teacher's Wages Garnished as U.S. Goes after Loan Default*, www.Bloomberg.com (July 2, 2012).

³ See Ron French, *Michigan Goes Hard after Student Loan Defaulters*, *Bridge Magazine*, May 16, 2012.

⁴ U.S. Dep't of the Treasury, *U.S. Government Receivables and Debt Collection Activities of Federal Agencies: Fiscal Year 2009 Report to the Congress 15* (Mar. 2010), *available at* <http://fmsq.treas.gov>.

⁵ See Mark Russell, *Student Loans: The ARM Industry's New Oil Well?*, www.insideARM.com (Oct. 20, 2011).

⁶ Presentation of Dwight Vigna, U.S. Educ. Dep't, 2013 Knowledge Symposium (Nov. 2013).

Total defaulted student loan receivables (principal and interest) serviced by the Department of Education's Default Resolution Group (DRG) increased from \$17.4 billion at the end of fiscal year 2005⁷ to \$170.8 billion at the end of fiscal year 2013.⁸ Collections increased from \$2.082 billion in fiscal year 2005⁹ to \$12.010 billion in fiscal year 2013.¹⁰

According to estimates in 2015, the government is expected to collect roughly \$108.58 on every \$100 of defaulted subsidized Stafford loans and \$105.40 on every \$100 of unsubsidized Stafford loans in 2013.¹¹ These estimates, however, do not take into account collection costs or inflation. Even after factoring in collection costs and inflation, the recovery rate on default student loans is still very high. According to the president's fiscal year 2015 budget request, the federal government expects to eventually recover about 81.8% of the principal and interest due at the time of default on subsidized Stafford loans made in fiscal year 2013 that go into default at any point during repayment.¹²

It is estimated that outstanding student loan debt is approaching \$ 1.2 trillion – it now surpasses credit cards as the second-largest form of consumer debt behind home mortgages.¹³

2. Revisiting the *Brunner* Standard

The *Brunner* standard used by most courts in applying the undue hardship provision in section 523(a)(8) was developed over twenty-five years ago.¹⁴ The nature of individual student

⁷ U.S. Dep't of the Treasury, U.S. Government Receivables and Debt Collection Activities of Federal Agencies: Fiscal Year 2009 Report to the Congress 15 (Mar. 2010), *available at* <http://fmsq.treas.gov>.

⁸ U.S. Dep't of the Treasury, U.S. Government Receivables and Debt Collection Activities of Federal Agencies, Fiscal Year 2013, Report to the Congress (July 2014).

⁹ U.S. Dep't of the Treasury, U.S. Government Receivables and Debt Collection Activities of Federal Agencies: Fiscal Year 2009 Report to the Congress 15 (Mar. 2010), *available at* <http://fmsq.treas.gov>.

¹⁰ U.S. Dep't of the Treasury, U.S. Government Receivables and Debt Collection Activities of Federal Agencies, Fiscal Year 2013, Report to the Congress (July 2014).

¹¹ New Am. Found., Fed. Educ. Budget Project, Federal Student Loan Default Rates (Sept. 25 2014); *see also* Kelly Field, *Government Vastly Undercounts Defaults*, Chron. of Higher Educ., July 11, 2010.

For a discussion of why it is important to consider collection costs and the depreciation of money over time in evaluating the "true" collection recovery rate, see Jason Delisle, *Misleading Numbers: Feds Don't Profit on Student Loan Defaults*, Higher Ed Watch Blog (Jan. 18, 2011); Ben Miller, *Important Default Rate Truths*, The Quick and the Ed Blog (July 12, 2010).

¹² *See generally* New Am. Found., Fed. Educ. Budget Project, Federal Student Loan Default Rates (Sept. 25 2014).

¹³ Rohit Chopra, *Student Debt Swells, Federal Loans Now Top a Trillion*, CONSUMER FINANCIAL PROTECTION BUREAU (July 17, 2013), www.consumerfinance.gov/newsroom/student-debt-swells-federal-loans-now-top-a-trillion/.

¹⁴ *Brunner v. N.Y. State Higher Educ. Servs. Corp. (In re Brunner)*, 46 B.R. 752 (S.D.N.Y. 1985), *aff'd*, 831 F.2d 395 (2d Cir. 1987).

loan debt, the structure of the loan programs, and the Bankruptcy Code itself have all changed significantly since 1987. These changes have given some courts cause to question the continued utility of the *Brunner* standard.¹⁵

The following factors should be considered in arguing for change in the undue hardship standard:

- At the time *Brunner* was decided, debtors could discharge a student loan without proving undue hardship by simply by waiting five years after the loan came due;¹⁶
- At the time *Brunner* was decided, debtors could discharge a student loan in a chapter 13 case without proving undue hardship and without waiting five years after the loan came due;¹⁷
- The facts in *Brunner* case were extreme – the debtor sought to discharge student loans just a few months after she received a master’s degree (might explain why the *Brunner* court added a good faith prong to the test despite lack of any textual basis for this in § 523(a)(8));
- When the *Brunner* test was adopted, the time period for reviewing factors such as the likelihood that the debtor’s hardship will persist or the debtor’s good faith (the second and third prongs of the test) was simply the five-year period after the loan came due;
- Congress subsequently eliminated all waiting periods for discharge without proving undue hardship and expanded the discharge exception in 2005 to include private student loans;¹⁸

This test requires debtors to show: (1) the student loans prevent the debtor and the debtor’s dependents from maintaining a “minimal” standard of living; (2) additional circumstances exist indicating that the hardship is likely to continue for a “significant portion of the repayment period;” and (3) the debtor has made a good-faith effort to repay the loans (and to maximize income and limit expenses).

¹⁵ See e.g., *In re Roth*, 490 B.R. 908, 920/-/23 (B.A.P. 9th Cir. 2013) (Pappas, B.J., concurring); *Krieger v. Educ. Mgmt. Corp.*, 713 F.3d 882, 884 (7th Cir. 2013) (noting it is important not to allow “judicial glosses” of the statutory language, such as found in *Brunner*, to supersede the statute itself); *In re Myhre*, 503 B.R. 698, 702-703 (Bankr. W.D. Wis. 2013) (noting that when it was decided *Brunner* “only applied to a small subsection of student loans” and the Code and the nature of student loan borrowing have changed significantly since then); *In re Wolfe*, 501 B.R. 426, 434-35 (Bankr. M.D. Fla. 2013) (“There is merit to the argument that the rigors of the *Brunner* test are no longer appropriate to curb borrower abuse from a premature discharge amidst only temporary financial distress.”).

¹⁶ In 1990, Congress extended the five-year discharge exception period to seven years.

¹⁷ Until 1990, section 523(a)(8) only applied to chapter 7 cases, so chapter 13 debtors were able to discharge their student loans after completing a chapter 13 plan. Congress amended the Code in 1990 to make section 523(a)(8) applicable in chapter 13 cases.

¹⁸ In 1998, Congress eliminated the then existing seven-year waiting period. Higher Education Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1581 (1998). Subsection 523(a)(8)(B) dealing with private student loans was added in 2005 by BAPCPA.

- Congress also added in 2005 a definition of “undue hardship” in an unrelated Code section,¹⁹ for purposes of reviewing reaffirmation agreements, that is far more lenient than the *Brunner* test;²⁰
- Many debtors 20 to 30 years ago were able to repay modest amounts of student loan in a reasonable time; debtors now carry exorbitant debt for life;
- Extreme collection tools now exist (administrative wage garnishment; tax refund and benefits offset; no statute of limitations for government loans; excessive collection fees);
- The *Brunner* test fails to account for debt cancellation tax consequences of administrative discharges.

3. **Administrative Repayment Plans: Should They Be a Substitute For Bankruptcy Discharge?**

Student loan creditors will almost certainly argue that the debtor cannot prove undue hardship because the debtor is eligible for (or did not apply for) an administrative repayment plan, such as an income-contingent repayment plan (ICRP), income-based repayment plan (IBR), or Pay as You Earn plan (“PAYE”). Courts generally have held that the availability of administrative plans is a factor to be considered in the undue hardship evaluation, particularly under the “good faith” test.²¹ At the same time, all courts agree that participation in an income-based plan is not required to satisfy the “good faith” standard.²² The following factors should be considered in weighing the relevance of such plans:

- IBR and other administrative repayment plans are not available for private student loans;
- Debtors need to recertify and make required payments for IBR and other plans every year for 20-25 years to avoid redefault (no statistics currently available on plan re-defaults);
- Foreseeable inability to repay even under *Brunner* second prong should be

¹⁹ 11 U.S.C. §521(m), which presumes a reaffirmation is an is “an undue hardship on the debtor if the debtor’s monthly income less the debtor’s monthly expenses ... is less than the scheduled payments on the reaffirmed debt.”

²⁰ See e.g., Hansen v. Sallie Mae Inc., 2014 U.S. Dist. LEXIS 113998 (W.D. Wash. Aug. 14, 2014) (even if § 521(m) served as new definition for “undue hardship”, the debtor had excess income.)

²¹ *In re Nys*, 446 F.3d 938, 947 (9th Cir. 2005) (debtor’s consideration of ICRP option is an important indicator of good faith); *In re Frushour*, 433 F.3d 393, 402 (4th Cir. 2005) (important component of good faith inquiry); *In re Alderete*, 412 F.3d 1200, 1206 (10th Cir. 2005) (carries “significant weight” in evaluating good faith); *In re Tirch*, 409 F.3d 677, 682 (6th Cir. 2005) (decision not to take advantage of ICRP probative of debtor’s intent to repay).

²² *In re Mosley*, 494 F.3d 1320 (11th Cir. 2007) (rejecting a per se rule that debtor cannot show good faith if debtor did not enroll in ICRP); *In re Barrett*, 487 F.3d 353, 364 (6th Cir. 2007); *In re Nys*, 446 F.3d 938, 947 (9th Cir. 2006); *In re Alderete*, 412 F.3d 1200, 1206 (10th Cir. 2005); *In re Frushour*, 433 F.3d 393, 402 (4th Cir. 2005).

- loan term (10 years), not 20-25 years;²³
- Plans can lead to negative amortization;²⁴
- Administrative repayment plans should not be sole determinant of good faith under *Brunner* third prong;²⁵
- Discharge under plans can lead to tax consequences;²⁶
- Debtors are not always eligible for administrative repayment plans (debtor must get out of default by consolidation or rehabilitation).

4. Co-Borrowers as Creditors

Dischargeability disputes occasionally arise between different individuals who were responsible for paying the same student loan. For example, one co-borrower who paid off a student loan may assert a claim for reimbursement from the non-paying co-borrower. If the non-paying co-borrower files for bankruptcy relief, does the co-borrower who paid off the loan have a claim that fits within the discharge exception of § 523(a)(8)?

Subsection (A)(i) of § 523(a)(8) would not apply because such a claim is not a benefit overpayment or loan made in connection with a non-profit or government entity.²⁷ Nor is the

²³ *Krieger v. Educ. Credit Management Corp.* 713 F.3d 882, 884 (7th Cir. 2013) (responding to longer term repayment plan option, court notes that if good faith entailed commitment to future efforts to repay, “no educational loan ever could be discharged, because it is always possible to pay in the future should prospects improve”).

²⁴ *See e.g., Keilisch v. Educ. Credit Mgmt. Corp. (In re Kielisch)*, 258 F.3d 315 (4th Cir. 2001) (§ 502 does not freeze the student loan debt nor bar the creditor from applying the plan payments towards post-petition interest.)

²⁵ *See e.g., Bene v. Educational Management Corp. (In re Bene)*, 474 B.R. 56 (Bankr. W.D. N.Y. 2012) (debtor was not required to indenture herself for 25 years under the William D. Ford repayment program.)

²⁶ *In re Coco*, 335 Fed. Appx. 224, 2009 WL 1426757, at *4 (3d Cir. May 22, 2009) (unpublished decision) (reversing finding of nondischargeability and ruling, inter alia, that lower court gave too much weight to debtor’s refusal to enroll in ICRP, noting “her participation in the ICRP could ultimately result in her simply trading a student loan debt for an IRS debt”); *In re Brooks*, 406 B.R. 382, 394-95 (Bankr. D. Minn. 2009) (potential tax liability after extended repayment period is a significant drawback to ICRP option); *In re Durrani*, 311 B.R. 496, 508 (Bankr. N.D. Ill. 2005), *aff’d*, 320 B.R. 357 (N.D. Ill. 2005) (court must take into account considerable tax burden debtor will face at end of twenty-five-year repayment period); *In re Brunell*, 356 B.R. 567 (Bankr. D. Mass. 2006); *In re Allen*, 324 B.R. 278, 282 (Bankr. W.D. Pa. 2005). *But see* *Educational Credit Mgmt. Corp. v. Jespersen*, 571 F.3d 775, 782 (8th Cir. 2009) (tax liability from possible future debt forgiveness is speculative); *Educational Credit Mgmt. Corp. v. Rhodes*, 464 B.R. 918 (W.D. Wash. 2012) (minimizing debtor’s concerns over tax consequences, noting that cancellation of debt at end of long-term repayment plan only results in tax liability if borrower’s assets exceed liabilities at time of cancellation).

²⁷ *In re Corbin*, 506 B.R. 287, 295 (Bankr. W.D. Wash. 2014) (co-borrower who paid of student loan not covered by § 523(a)(8)(A)(i)); *In re Rust*, 510 B.R. 562, 571 (Bankr. E.D. Ky. 2014) (not reaching coverage under § 523(a)(8)(i) but suggesting co-borrower with subrogation rights could

claim a qualifying educational loan under the IRS definition incorporated into § 523(a)(8)(B). This leaves subsection (A)(ii) of § 523(a)(8), which preserves from discharge “an obligation to repay funds received as an educational benefit.” Some courts have applied this provision to declare nondischargeable the claim filed by a co-borrower who paid off a student loan.²⁸ According to these courts, any “educational benefit” that the debtor receives triggers the barriers against discharge, and it does not matter who the creditor is.

This is an extremely broad view of subsection (A)(ii) of § 523(a)(8). The legislative history suggests that the “educational benefit” language was not intended to cover loan transactions.²⁹ Construing subsection (A)(ii) of § 523(a)(8) to apply to loans would render much of the remaining portions of the subsection superfluous.³⁰ In fact, if all loans were “educational benefits,” there would have been no reason for Congress to add § 523(a)(8)(B) in 2005 making private student loans nondischargeable. Based on this and other reasoning, several courts have appropriately excluded obligations to co-borrower’s from § 523(a)(8)’s protections.³¹

5. Private Student Loans and Co-Borrowers: Automatic Default Clauses

Private student loan contracts typically provide that the filing of bankruptcy by the borrower or any co-borrower is an event of default that will trigger acceleration of the loan.³² These contract provisions are routinely enforced by private student loan creditors upon the filing

potentially claim protected status); *In re Posner*, 434 B.R. 800 (Bankr. E.D. Mich. 2010) (§ 523(a)(8) not intended to cover anyone who pays off a student loan, co-signor is not a lender).²⁸ *In re Corbin*, 506 B.R. 287, 295 (Bankr. W.D. Wash. 2014) (§ 523(a)(8)(ii) applies whenever debtor received an educational benefit, regardless of who provided it); *In re Rust*, 510 B.R. 562, 571 (Bankr. E.D. Ky. 2014) (construing ambiguous terms of loan agreements as if they created right of subrogation for co-borrower who paid off loan, giving co-borrower all rights of original lender of former loan). Both decisions erroneously state that the text of § 523(a)(8)(A)(ii) appeared as part of the 2005 BAPCPA amendments. *Rust*, 510 B.R. at 570; *Corbin*, 506 B.R. at 296. Congress added the current (A)(ii) language to § 523(a)(8) in 1990. *See In re Segal*, 57 F.3d 342 (3d Cir. 1995) (discussing enactment of what is now § 523(a)(8)(A)(ii)).

²⁹ The legislative history states that the language “extends the Bankruptcy Code’s nondischargeability of student loans to debts which are similar in nature to student loans.” 136 Cong. Rec. H 13288 (Oct. 27, 1990).

³⁰ *In re Scott*, 287 B.R. 470, 474 (Bankr. E.D. Mo. 2002) (applying pre-2005 version of § 523(a)(8), court held that if the “educational benefit” language “were interpreted to mean that all educational loans were excepted from discharge then the first two categories ... would certainly be rendered meaningless and superfluous”).

³¹ *In re Posner*, 434 B.R. 800 (Bankr. E.D. Mich. 2010); *In re Pryor*, 234 B.R. 716 (Bankr. W.D. Tenn. 1999). *See also In re Walker*, 439 B.R. 854 (W.D. Pa. 2010) (debtor who took over obligation to pay student loan as part of marital agreement may discharge debt; creditor ex-spouse not entitled to protections under § 523(a)(8) simply because obligation is student loan).

³² The Consumer Financial Protection Bureau reports that approximately 90% of private student loans were co-signed in 2011. *See CFPB Mid-year Update on Student Loan Complaints*, April, 2014.

of a bankruptcy even if the non-filing borrower is current on the loan and intends to continue making payments. For example, many private student loan creditors will refuse to accept installment payments from a student borrower when his or her parent/co-borrower files bankruptcy, and will demand that the full loan balance be paid. Many debtors are unaware that their children's student loans will be put in default because of their bankruptcy filing.

Section 365(e) of the Bankruptcy Code addresses whether these bankruptcy or "ipso facto" clauses are enforceable in bankruptcy. Because that section expressly provides that such clauses are not enforceable with respect to executory contracts and unexpired leases, many courts have held that they are not invalid under the Code with respect to other debts.³³ However, some courts have found that the Code invalidates ipso facto clauses other than those specifically mentioned in section 365(e)(1).³⁴ At least in those jurisdictions with favorable law, debtors may argue that these automatic default clauses in private student loans are not enforceable.

If the co-borrower (often a parent) files a chapter 13 case, the codebtor stay under Code section 1301 protects the non-filing co-borrower. It prevents creditors from taking any action to collect the debt against co-borrowers who have not filed for bankruptcy, if the debt is being paid under the debtor's chapter 13 plan. Even if the debtor's plan does not provide for payment of the debt, the codebtor stay remains in effect until it is lifted by the court upon a creditor's request. If the student loan creditor invokes the bankruptcy clause against the non-filing borrower by accelerating the note and demanding full payment while the codebtor stay is in effect, this would be an attempt to collect the debt in violation of the codebtor stay. Courts have generally permitted either (or both) the debtor and the non-filing co-borrower to file motions for contempt seeking sanctions against a creditor who violates the codebtor stay.³⁵

If either the student or the co-borrower files a chapter 13 case, they can propose a plan provision enjoining the private student loan creditor from enforcing the bankruptcy clause or seeking collection from the non-filing student or co-borrower. Bankruptcy Rule 7001(7) provides that an adversary proceeding is not needed if a request for injunctive relief is made in a plan. In districts that have model chapter 13 plans, this may be added as a non-standard provision.

6. Student Loan Collection Costs

In addition to "special" incentives for good performance, student loan collectors receive a commission on a payment made by the borrower as long as the collector has been assigned the file, whether or not the borrower's payment was instigated by that collector's actions. The

³³ *E.g.*, *In re AMR Corp.*, 485 B.R. 279, 296-97 (Bankr. S.D.N.Y. 2013) *aff'd*, 730 F.3d 88 (2d Cir. 2013); *In re Yates Dev., Inc.*, 241 B.R. 247, 253 (Bankr. M.D. Fla. 1999), *aff'd*, 256 F.3d 1285 (11th Cir. 2001).

³⁴ *Riggs Nat. Bank of Washington, D.C. v. Perry*, 729 F.2d 982 (4th Cir. 1984); *General Motors Acceptance Corp. v. Rose*, 21 B.R. 272, 276 (Bankr. D. N.J. 1982).

³⁵ *In re Juliao*, 2011 WL 6812542 (Bankr. E.D. Mich. Nov 29, 2011) (motion filed by both debtor and codebtor); *In re Bertolami*, 235 B.R. 493, 495 (Bankr. S.D. Fla. 1999) (motion filed by debtor); *In re Hughes*, 2005 WL 1293982 (Bankr. M.D. N.C. May 2, 2005) (same).

Department of Education then deducts an amount roughly equal to the commission it has paid its collector from the borrower's payment. Only the amount left over after the commission is paid is applied to interest and then principal, in that order.³⁶ The Higher Education Act provides that collection fees must be "reasonable."³⁷ The Department claims that this provision applies to all loans, whenever made.³⁸

Collection costs should be recalculated each year after a loan goes into default. As to each loan in default, the amount of the previous year's collection costs should be removed from the balance of the loan and the newly calculated rate should be applied. Rates should also be recalculated each time the loan is transferred from one entity to another.³⁹

There have been several challenges brought by bankruptcy trustees alleging that student loan collection costs are unreasonable because they are not related to actual costs incurred in the particular borrower's case. To date, these cases have been unsuccessful, and the courts have upheld the Department's regulations.⁴⁰

These cases did not address the practice of including in a bankruptcy proof of claim a lump-sum amount for prepetition collection costs.⁴¹ Student loan collectors are not permitted to assess an amount in advance for collection fees but must instead apportion a percentage of each payment toward collection fees.⁴² In an effort to prevent up-front loading of collection costs, the

³⁶ 34 C.F.R. § 682.404(f) (payments are applied first to collection costs and then to other incidental charges such as late charges, then to interest and principal); *see* Padilla v. Payco Gen. Am. Credits, Inc., 161 F. Supp. 2d 264 (S.D.N.Y. 2001) (defendant's summary judgment motion denied on plaintiff's claim that debt collector induced borrower to make a down payment by agreeing to apply, in violation of federal law, the payment toward principal only).

³⁷ 20 U.S.C. § 1091a(b)(1); 34 C.F.R. § 682.410(b)(2).

³⁸ U.S. Dep't of Educ., PCA Procedures Manual: 2009 ED Collections Contract, version 1.2 at 23 (last updated July 12, 2012).

³⁹ *See generally* *In re* Evans, 322 B.R. 429 (Bankr. W.D. Wash. 2005).

⁴⁰ *See, e.g.*, Educational Credit Mgmt. Corp. v. Barnes, 318 B.R. 482 (S.D. Ind. 2004), *aff'd*, Black v. Educational Credit Mgmt., 459 F.3d 796 (7th Cir. 2006); *In re* Evans, 322 B.R. 429 (Bankr. W.D. Wash. 2005); *see also* United States v. Larson, 2010 WL 76433 (D. Minn. Jan. 5, 2010) (agreeing with *Black* and affirming the Department's use of a cost averaging basis for calculating collection fees; noting that this method is possibly unfair but is a "public policy issue").

⁴¹ For example, in *In re* Martish, 2015 WL 167154 (Bankr. E.D. N.C. Jan 12, 2015), the debtor had a federal consolidation student loan in the amount of \$11,202.95, with a 9% interest rate. After filing an initial chapter 7 case, and making approximately \$39,835 in payments on the loan, a proof of claim was filed in the subsequent chapter 13 case asserting that the debtor still owed \$27,021.57, including \$5,289.57 in prepetition collections costs.

⁴² 34 CFR § 682.404(f). The Department has taken the position that a borrower is not legally obligated to pay costs that have not been incurred. Memorandum of Points and Authorities Supporting Motion to Dismiss, *Hutchins v. U.S. Dep't of Educ.*, No. CV-F-02-6256-OWW-DLB, at 31 (E.D. Cal. filed Apr. 25, 2003) (citing H.R. Res. 300, 99th Cong. at 396 (1986), *reprinted in* 1986 U.S.C.C.A.N. 977). The agencies can charge the borrower only those costs that

Department has clarified that the borrower is not legally obligated to pay costs that have not been incurred. The Department has recognized that the practice of loading fees up-front can actually discourage repayment and in any case does not reflect actual costs.⁴³ Although the Department's regulation preventing advance assessment of collection costs was not addressed in the opinion, one court has held that a lump-sum amount for collection costs could be included in a prepetition claim against the debtors as it was neither unmatured nor contingent as of the petition date.⁴⁴

Courts generally have held that collection costs are part of the total student loan obligation, similar to interest charges, and therefore are nondischargeable.⁴⁵ However, a few courts have held that the automatic stay prohibits student loan creditors from charging late fees, collection costs, and penalties to debtors during a chapter 13 bankruptcy case, and that the debtors' chapter 13 discharges prevent student loan creditors from ever attempting to assess them in the future.⁴⁶

7. Treatment of Student Loan Debt in Chapter 13

a. Cure of a Default on a Long-Term Student Loan Debt in Chapter 13

In those jurisdictions where it is difficult to obtain confirmation of a plan providing for separate classification of student loan debt, which is discussed below, a useful alternative is to cure a default on the student loan pursuant to 11 U.S.C. § 1322(b)(5). This section permits the chapter 13 debtor to “cure a default and maintain payments on long term debts on which the final payment is due after the final payment of the plan.” This definition clearly applies to any student loan with scheduled payments that will be due after the end of the chapter 13 plan period. A number of courts have permitted chapter 13 debtors to direct ongoing monthly payments to a student loan creditor under § 1322(b)(5).⁴⁷

have been incurred as allocated to the particular payment.

⁴³ See 61 Fed. Reg. 60,482 (Nov. 27, 1996).

⁴⁴ *In re Evans*, 322 B.R. 429, 438 (Bankr. W.D. Wash. 2005) (“ECMC's calculation of those costs as a matter of preparation of its claims was not an assessment of a postpetition claim; it was merely a calculation of what the debtors owed as of the petition date”).

⁴⁵ E.g., *In re Belton*, 337 B.R. 471 (Bankr. W.D. N.Y. 2006).

⁴⁶ *In re Boscaccy*, 442 B.R. 501 (Bankr. N.D. Miss. 2010) (adopting reasoning in *In re Harding*); *In re Harding*, 423 B.R. 568 (Bankr. S.D. Fla. 2010).

⁴⁷ *In re Johnson*, 446 B.R. 921 (Bankr. E.D. Wis. 2011); *In re Webb*, 370 B.R. 418 (Bankr. N.D. Ga. 2007) (debtor may pay general unsecured creditors a 1% dividend through plan payments while making regularly scheduled student loan payments directly to student loan creditor pursuant to 11 U.S.C. § 1322(b)(5); *In re Machado*, 378 B.R. 14, 17 (Bankr. D. Mass. 2007) (in providing for cure and maintenance of payments, chapter 13 plan can allow for current payments to be paid by debtor directly to creditor, while only payments to cure prebankruptcy arrearage need be paid through trustee and subject to trustee's commission); *In re Knight*, 370 B.R. 429 (Bankr. N.D. Ga. 2007) (payment of student loan under section 1322(b)(5) permitted despite BAPCPA changes to disposable income test under section 1325(b)(1)(B)); *In re Williams*, 253 B.R. 220, 227-28 (Bankr. W.D. Tenn. 2000); *In re Chandler*, 210 B.R. 898 (Bankr. D.N.H.

Other courts refuse to give effect to § 1322(b)(5) as a distinct Code provision and have required debtors proposing to pay ongoing student loan payments directly from current income to satisfy the unfair discrimination test under § 1322(b)(1).⁴⁸

Some courts have interpreted a provision added to the Code by the 2005 amendments as limiting the right to cure and maintain payments on a nondischargeable student loan in chapter 13. Section 1322(b)(10) states that if a chapter 13 plan provides for the payment of ongoing post-petition interest on a nondischargeable debt, the interest “may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims.”⁴⁹ Some courts have interpreted this amendment to require the debtor to propose to pay all creditors’ claims in full during the chapter 13 case if the debtor wishes to continue making student loan payments that include interest.⁵⁰ Other courts reject this view, finding that § 1322(b)(5) is a specific provision that can be read consistently with the more general language of § 1322(b)(10).⁵¹

1997); *In re Sullivan*, 195 B.R. 649, 658 (Bankr. W.D. Tex. 1996) (pursuant to § 1322(b)(5) debtor may maintain current payments while curing default without running afoul of § 1322(b)(1)); *In re Cox*, 186 B.R. 744, 746-47 (Bankr. N.D. Fla. 1995); *In re Benner*, 156 B.R. 631, 634 (Bankr. D. Minn. 1993)(using cure and maintain provisions of § 1322(b)(5) is a form of separate classification that meets the fairness standard of § 1322(b)(1)).

⁴⁸ *In re Labib-Kiyarash*, 271 B.R. 189 (B.A.P. 9th Cir. 2001) (use of section 1322(b)(5) is subject to debtor showing that classification is fair under section 1322(b)(1)); *In re Kubeczko*, 2012 WL 2685115 (Bankr. D. Colo. July 6, 2012); *In re Zeigafuse*, 2012 WL 1155680 (Bankr. D. Wyo. Apr. 5, 2012); *In re Pracht*, 464 B.R. 486, 490 (Bankr. M.D. Ga. 2012); *In re Boscaccy*, 442 B.R. 501 (Bankr. D. Miss. 2010) (applying §1322(b)(1) to cure classification); *In re Harding*, 423 B.R. 568 (Bankr. S.D. Fla. 2010); *In re Kruse*, 406 B.R. 833 (Bankr. N.D. Iowa 2009); *In re Pora*, 353 B.R. 247 (Bankr. N.D. Cal. 2006)(fairness standard applies to cure classification); *In re Simmons*, 288 B.R. 737 (Bankr. N.D. Tex. 2003); *In re Edwards*, 263 B.R. 690 (Bankr. R.I. 2001); *In re Thibodeau*, 248 B.R. 699 (Bankr. D. Mass. 2000).

⁴⁹ 11 U.S.C. § 1322(b)(10).

⁵⁰ *In re Stull*, 489 B.R. 217, 223/-/24 (Bankr. D. Kan. 2013) (§ 1322(b)(10) prohibits payment of interest on nondischargeable student loan claim in chapter 13 unless all unsecured claims paid in full); *In re Precise*, 501 B.R. 67, 72 (Bankr. E.D. Pa. 2013) (agreeing with *Stull* in dicta); *In re Kubeczko*, 2012 WL 2685115 *7 (Bankr. D. Colo. July 6, 2012)(in enacting § 1322(b)(10) Congress intended broad restriction on cure and maintenance of payments under § 1322(b)(5) for unsecured debts).

⁵¹ *In re Brown*, 500 B.R. 255, 266 (Bankr. S.D. Ga. 2013) (§ 1322(b)(5) specifically applies to a cure in chapter 13 and is not subject to the limits on payment of post-petition interest found in § 1322(b)(10)); *In re Webb*, 370 B.R. 418, 422 (Bankr. N.D. Ga. 2007) (§ 1322(b)(5) is a specific provision applicable to cure of a default in a long term debt and is not controlled by the more general terms of § 1322(b)(10)); *In re Freeman*, 2006 WL 6589023 (Bankr. N.D. Ga. 2006) (§ 1322(b)(10) not applicable when debtor implementing cure and maintain provision of § 1322(b)(5)); *In re Williams*, 253 B.R. 220, 227 (Bankr. W.D. Tenn. 2000) (pre-BAPCPA decision, “The maintenance of ongoing payments necessarily involves the payment of post-petition interest.”).

b. Curing Defaults and/or Maintaining Payments on Administrative Repayment Plans

A “cure” in chapter 13 under § 1322(b)(5) pays ongoing scheduled installments as they come due on the long-term debt while simultaneously making monthly payments to pay back any pre-bankruptcy arrearage. The “cure” nullifies the contractual consequences of any pre-bankruptcy default and restores the pre-default status quo.⁵² The debtor’s plan can additionally provide that any prepetition default is being “waived” pursuant to § 1322(b)(3). This means, for example, that debtors who file for chapter 13 relief after defaulting on a long-term student loan repayment plan should be able to reinstate and maintain participation in such a repayment plan.⁵³ This can be very helpful for a debtor who has defaulted on an income-based repayment plan (IBR) and is not eligible for loan rehabilitation or consolidation as a way to remedy the default under the Department of Education (DOE) regulations, because for example they have had a prior rehabilitation or consolidation or are subject to a wage garnishment.

Confirmation of the debtor’s plan will prevent the federal student loan creditor from treating the student loans as in default or forbearance during the chapter 13 plan or from denying the debtor any benefits under the IBR or other repayment plan (such as credit towards the required payment period for discharge). Section 525(c) will also prevent the federal student loan creditor from discriminating against the debtor before and after the chapter 13 case based on the bankruptcy filing.

A chapter 13 filing can protect the debtor in this situation even if the debtor is not in default prepetition. If the debtor has entered into a modification or forbearance agreement on a private student loan, or an IBR or other administrative repayment plan in the case of a federal loan, and performance by the parties remains due at the time the bankruptcy is filed, it can be argued that the modified loan agreement is an executory contract.⁵⁴ While it is generally accepted that an agreement where the only remaining obligation is the payment of money, such as promissory note, is not an executory contract,⁵⁵ an administrative repayment plan (such as PAYE or IBR) involves continuing performance by the borrower, creditor and Department of

⁵² *In re Taddeo*, 685 F.2d 24, 27 (2d Cir. 1982).

⁵³ See e.g. *In re Ward*, 392 B.R. 788 (Bankr. W.D. Mo. 2008) (debtor may cure arrearage on modified mortgage); *In re Gellerman*, 263 B.R. 691 (Bankr. D.R.I. 2001) (debtor permitted to cure mortgage default based on prepetition repayment agreement with HUD that did not require payment of securitized arrearage amount); *In re Epps*, 110 B.R. 691, 707 (E.D. Pa. 1990) (debtor may cure mortgage default based on terms of government-sponsored payment plan).

⁵⁴ An executory contract is “a contract where the obligation of both the bankrupt and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.” See Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1974).

⁵⁵ See *Matter of Rose*, 21 B.R. 272, 275 (Bankr. D.N.J. 1982) (quoting House Report No. 95-595, 95th Cong., 1st Sess. 347 (1977); See Senate Report No. 95-989, 95th Cong., 2d Sess. 58 (1978)).

Education (beyond simply making and receiving payments). This continuing performance includes the annual certification of income and adjustment of payments based on income changes, and the discharge of the obligation after 20 to 25 years of participation on the plan.⁵⁶

In a chapter 13 case, the debtor can assume the modified student loan contract, including the terms of any PAYE or IBR. Section 365(e) will prevent the student loan creditor or servicer from invoking any contract term or “applicable law” (including DOE regulations) against the debtor that would prevent payments from being applied properly under the repayment plans. In other words, the bankruptcy cannot be the basis for the debtor to lose any rights under the repayment plans, and all payments made during the chapter 13 plan should count towards the forgiveness or discharge rights under the federal repayment plans as if there has been no prepetition default.

c. Separate Classification

Absent a finding of undue hardship under 11 U.S.C. § 523(a)(8), debtors are obligated to pay upon completion of their chapter 13 bankruptcy the amount owed on student loan debt that has not been paid during the plan. This includes any unpaid interest on the debt that has accrued during the plan.⁵⁷ When that is the case, it is often in the debtor’s interest to pay off as much of the student loan debt in the chapter 13 plan as is permissible.

One way to pay more on the student loan than on other unsecured debts is to separately classify the student loan for payments at a higher percentage than other unsecured debts pursuant to 11 U.S.C. § 1322(b)(1). Recent cases have been divided, both in the means of analysis and the result, as to whether students can separately classify student loans. Debtors are permitted to discriminate among similar classes of creditors in a plan. The issue is whether a separate classification for one creditor discriminates unfairly against other creditors.

The following are case summaries illustrating arguments favoring separate classification of student loan debt:

- **Debtor would lose discharge under Public Loan Forgiveness program; Discrimination advances the goal of fresh start and the public policy objective of paying off student loan debts.**

In re Pracht, 464 B.R. 486 (Bankr. M.D. Ga. 2012) (separate classification and higher payment rate for student loan debt not unfairly discriminate because it allowed debtor to participate in the Public Loan Forgiveness program and gave her the chance to write off approximately \$50,000 of student loan debt. Such discrimination advanced the goal of a

⁵⁶ See *In re Ward*, 392 B.R. 788 (Bankr. Ct. W.D. Mo. 2008) (forbearance agreement on mortgage loan was executory contract that could be assumed by the debtor).

⁵⁷ If the student loan debt is nondischargeable, postpetition interest will not be discharged. See *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); *In re Jordan*, 146 B.R. 31 (D. Colo. 1992).

fresh start for the debtor and the public policy objective of payment of student loan debts. The cost of this discrimination to unsecured creditors was 5%, or a total of only \$5,000).

- **Discrimination not unfair when there is no harm to the unsecured creditors.**

In re Potgieter, 436 B.R. 739 (Bankr. M.D. Fla. 2010) (chapter 13 plan that separately classified student loan obligation and proposed to pay it at the contract rate outside of the plan did not unfairly discriminate because the plan provided for full repayment of all general unsecured claims; the student loan obligation was non-dischargeable such that the debt would be fully repaid at some point; and the debtor had the right, under § 1322(b)(4), “to provide for payments on any unsecured claim to be made concurrently with payments on any secured claim”).

- **There is a reasonable basis and/or a less discriminatory approach would leave the debtor or creditors worse off.**

In re Mason, 456 B.R. 245 (Bankr. N.D. W. Va. 2011) (separate classification to allow student loan creditor to receive a higher percentage payment than other unsecured creditors may be allowed if the debtor can articulate a non-arbitrary reason why the discrimination is necessary and demonstrate that a less discriminatory approach is not advisable).

In re Boscaccy, 442 B.R. 501 (Bankr. N.D. Miss. 2010) (in consolidated bankruptcy cases, debtors’ separate classification for long-term student loan debt to allow for cure and maintenance not unfairly discriminatory when such classification reduced payments to other unsecured creditors by 21% and 26% because failure to maintain payments on student loan debts would leave debtors in a much worse position than they were in prior to filing; separate classification was unfair discrimination where equal treatment of all unsecured creditors would reduce the student loan payment by 20% while increasing the distribution to other creditors by 80%).

In re Kalfayan, 415 B.R. 907 (Bankr. S.D. Fla. 2009) (separate classification of student loans to allow for maintenance of payments not unfairly discriminatory because it benefited the very creditors who were being discriminated against; debtor risked losing her optometry license, under state law, if she fell behind on her student loan payments which would jeopardize her ability to pay other unsecured creditors).

In re Webb, 370 B.R. 418 (Bankr. N.D. Ga. 2007) (direct payments to student loan creditors in accordance with contract terms is not unfair discrimination because general unsecured creditors would realize only an additional .2% dividend in the absence of such discrimination while debtors would otherwise suffer needless accrual of interest and penalties and may face the consequences of default upon completion of the chapter 13 plan).

In re Freshly, 69 B.R. 96 (Bankr. N.D. Ga. 1987) (discrimination not unfair where separate classification of student loan from other unsecured debt was necessary for the debtor’s rehabilitation under chapter 13, i.e. it would allow him to return to university

and earn a degree and in light of the public policy goal of insuring repayment of student loans; plan proposed to full pay student loan debt of \$2,258.00 while paying 1% of \$5,314.53 of remaining unsecured debt).

- **Payment of student loans, ahead of other unsecured debt, not unfair discrimination**

In re Foreman, 136 B.R. 532 (Bankr. S.D. Iowa 1992) (debtor's plan, which proposed concurrent payment of student loans and a secured claim, to be followed by full payment of the remaining unsecured claims did not unfairly discriminate under the test set forth in *Matter of Tucker* because the plan provided for full repayment of all unsecured claims; the student loan obligations were non-dischargeable; and the debtor had a right to under § 1322(b)(4) to propose this repayment structure).

- **Funds used are in excess of projected disposable income.**

In re Stull, 2013 WL 1279069 (Bankr. D. Kan. Mar. 27, 2013) (distinguishing this case from *In re Kubezcko*, which involved a below median debtor, court holds that an above-median debtor's chapter 13 plan to separately classify and pay a non-dischargeable obligation from income earned in excess of the projected disposable income committed to pay unsecured debt does not unfairly discriminate; plan in this case ultimately rejected because it proposed to pay interest on the student loan, which is prohibited by § 1322(b)(10) absent provision to pay all allowed claims in full).

- **Discrimination not unfair so long as unsecured creditors receive at least as much as they would in chapter 7 proceeding**

In re Tucker, 159 B.R. 325 (Bankr. D. Mont. 1993) (plan that proposed to pay nondischargeable student loan debt in full while only paying 29% dividend to other unsecured creditors did not unfairly discriminate because creditors would otherwise receive little or no payment under a Chapter 7 filing; the discrimination had a reasonable basis, i.e. allows full repayment of student loans; allows for a fresh start; the discrimination was not proposed in bad faith; and the degree of discrimination was directly related to the rationale for the discrimination).

In re Boggan, 125 B.R. 533 (Bankr. N.D. Ill. 1991) ("chapter 13 plan may provide for a greater percentage payment to an educational lender than to other unsecured creditors, but not by reducing the payments to those other creditors to a level below what they would get in a Chapter 7 liquidation of the debtor's assets"; plan that proposed to pay student loan debts in full but only 15% of other unsecured debts approved).

The following are case summaries in which separate classification of student loan debt was not permitted:

- **Nondischargeability, by itself, does not justify discrimination**

In re Groves, 39 F.3d 212 (8th Cir. 1994) (nondischargeability of student loans does not, by itself, justify “substantial” discrimination against general unsecured debt; additionally, a debtor’s interest in a fresh start does not justify separately classifying student loans for the sole purpose of paying those debts in a manner that prejudices other unsecured claims).

In re Sperna, 173 B.R. 654 (B.A.P. 9th Cir. 1994) (nondischargeability, on its own, is not a reasonable basis for preferential treatment of student loans and does not demonstrate that such discrimination is necessary; record in these cases did not provide a sufficient evidence to determine if discrimination in favor of student loans was unfair; at issue were two chapter 13 plans that proposed to pay student loans in full while paying other unsecured debt lesser amounts, i.e. 1.4% and 12.21%)

McCullough v. Brown, 162 B.R. 506 (N.D. Ill. 1993)(chapter 13 plans that proposed to pay nondischargeable student loans in full and other unsecured claims between 10% and 20% could not be confirmed on the basis of nondischargeability; court holds that for a plan to pass the unfair discrimination test “debtor must place something material onto the scales to show a correlative benefit to the other unsecured creditors”).

- **Student loans co-signed by parents for children do not fall into the consumer debt exception and thus must meet the unfair discrimination requirement**

In re Santana, 480 B.R. 222 (Bankr. D.P.R. 2012) (limiting the application of the § 1322(b)(1) consumer debt exception to co-signed debt acquired for the benefit of the debtor rather than a co-signer, court holds that a student loan co-signed by debtor father for his son did not fall within the exception because students loans generally benefit the co-signer and not the debtor).

- **Fresh start and/or public policy in favor payment of student loans is not reasonable justification for discrimination**

In re Birts, 2012 WL 3150384 at 4 (E.D. Va. Aug. 1, 2012) (reversing bankruptcy court approval of chapter 13 plan that proposed to pay student loans outside of the plan thereby allowing the student loan lender to be paid more than three times as much as other unsecured creditors even though the student loan debt comprised a third of total unsecured debt. Debtor’s status as a single mother with three children, her generic interest in a “fresh start” and a strong public policy in favor of the federal student loan program were insufficient to justify discrimination in favor of the non-dischargeable student loan debt; no case law supported this first reason while the other reasons were not unique and exist in every bankruptcy case involving student loans).

In re Bentley, 266 B.R. 229 (B.A.P. 1st Cir. 2001) (chapter 13 plan to pay debtors’ student loan debt in full but a 3.6% dividend to other unsecured creditors was unfair discrimination; debtors’ interest in a fresh start did not justify discrimination in a plan that proposed to pay only the minimum required into the plan, i.e. projected disposable income over three years. Court holds that where a plan redistributes benefits and burdens

to benefit the debtor but burden the credit, it can only be found fair if there is some other correlative benefit to the unsecured creditors).

- **Avoiding harm to the debtor is not a reasonable basis for discrimination**

In re Kubezko, 2012 WL 2685115 (Bankr. D. Colo. July 6, 2012) (unfair discrimination in a chapter 13 plan that separately classified student loan debt and proposed to pay a 48.86% dividend on that claim while remaining unsecured creditors would be paid a dividend of 0.27%. Absent the separate classification, all unsecured creditors would receive a dividend of approximately 8.06%. The fact that separate classification and payment of the student loan would have prevented debtor's default on student loans and the accrual of substantial interest was not enough to justify the discrimination).

In re Knecht, 410 B.R. 650 (Bankr. D. Mont. 2009) (debtor failed to demonstrate, under the four-factor *Wolff* test, chapter 13 plan that proposed to pay more than \$36,000 to student loan debt and nothing to general unsecured creditors did not unfairly discriminate; debtor's sole basis for the discrimination was not knowing if he would live or work long enough to repay his student loan debt because of health issues but he failed to link his health issues to his life span or his ability to earn a respectable wage after completion of the plan; debtor admitted that he could carry out the plan without the discrimination; there was no evidence that the plan was proposed in good faith; and no evidence that the proposed discrimination was related to the basis or rationale for the discrimination).

- **Discrimination unfair in the absence of proof that it is necessary or reasonable**

In re Thibodeau, 248 B.R. 699 (Bankr. D. Mass. 2000) (debtor failed, under *Leser* test, to demonstrate that plan to separately classify and fully pay student loan arrearages, maintain student loan payments outside of plan and pay a 27% dividend on other general unsecured claims, while devoting less than the full amount of debtor's net disposable income to payments under the plan, did not unfairly discriminate).

In re Gonzalez, 206 B.R. 239 (Bankr. S.D. Fla. 1997) (chapter 13 plan that proposed to pay student loan debt in full and a 6% dividend to unsecured creditors could not be confirmed because debtor's offered no proof of the discrimination being "fair" or "necessary").

In re Renteria, 2012 WL 1439104 (Bankr. D. Colo. Apr. 26, 2012) (below median income debtors' chapter 13 plan to separately classify student loans to allow for 64% repayment of those claims over 60 month period versus a 1% repayment of all other unsecured claims constituted unfair discrimination under the *King/Simmons* test and *Machado* framework. The Plan failed under *King/Simmons* because the general unsecured creditors would receive less than they would absent the separate classification, i.e. 1% versus 12%. It also failed under *Machado* because the debtors did not propose to cure student loan arrearages and there was no evidence that the discriminatory treatment was necessary to ensure the debtors would not be worse off at the end of the Plan).

d. Avoiding Unfair Discrimination by filing “Chapter 20”

An option for avoiding the “unfair discrimination” argument would be for the debtor to first file a chapter 7 case, obtain a discharge of all other general unsecured claims, and then file a chapter 13 to deal with the non-dischargeable student loans. This is colloquially known as a “chapter 20” case.⁵⁸ In the second bankruptcy, there would be no other unsecured claims against which to unfairly discriminate. Confirmation of the debtor’s chapter 13 plan in this situation may be subject to greater court scrutiny as to whether the plan was filed in good faith.⁵⁹

e. Preferential Treatment Allowed for Debts with Co-Signors

Section 1322(b)(1) of the Code contains two distinct clauses. The first clause allows the debtor to designate a class of unsecured claims for favorable treatment, provided that the beneficial classification does not discriminate unfairly against other unsecured claims. The second clause of § 1322(b) (1) creates a specific exception to this general rule. It states, “however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims.” Congress added this second clause in 1984 amendments to the Code. The purpose of the amendment was to protect non-filing co-obligors on debts of the debtor. Otherwise these co-obligors could face ramped-up collection actions, leading potentially to their filing their own bankruptcy petitions.⁶⁰ In fashioning the amendment, Congress intended to overrule decisions that would have prevented the chapter 13 debtor from continuing to pay a creditor on the joint consumer debt the amount that creditor would have continued to receive absent the bankruptcy filing.⁶¹

Certain courts construing the second clause of § 1322(b)(1) have implied into the text an obligation that the debtor must also show a lack of unfair discrimination in the treatment of the co-signed debt.⁶² There is no basis for this requirement, as the plain language of the second clause gives the debtor an unrestricted right to classify certain co-debtor claims separately.⁶³ The distinction created by the second clause makes little sense if the unfair discrimination test applies under the second clause in the same manner that it does under the first. Separate classification should be permitted so long as the debt is a consumer debt and was incurred for the benefit of the

⁵⁸ The Bankruptcy Code does not prohibit a debtor from filing a chapter 13 case after receiving a discharge in an earlier chapter 7 case. *See Johnson v. Home Bank*, 501 U.S. 78 (1991).

⁵⁹ *In re Metz*, 67 B.R. 462 (9th Cir. B.A.P. 1986) (chapter 20 is not a per se bad faith filing). *See also Branigan v. Davis (In re Davis)*, 716 F.3d 331 (4th Cir. 2013).

⁶⁰ *See In re Russell*, 503 B.R. 788, 796 (Bankr. S.D. Ohio 2013) (discussing legislative history of amendment).

⁶¹ *In re Renteria*, 470 B.R. 838, 844-46 (B.A.P. 9th Cir. 2012); *In re Russell*, 503 B.R. 788, 796 (Bankr. S.D. Ohio 2013).

⁶² *See e.g. In re Linton*, 2011 WL 3207366 (Bankr. E.D. Va. July 27, 2011) (agreeing with courts that require some consideration of degree of discriminatory treatment, but finding 100% payment of student loan debts while other unsecured creditors receive 5% to 6% to be acceptable).

⁶³ *In re Rivera*, 490 B.R. 130 (B.A.P. 1st Cir. 2013); *In re Renteria*, 470 B.R. 838, 845-46 (B.A.P. 9th Cir. 2012).

debtor.⁶⁴

f. Graduated Payment Structures for Student Loans in Chapter 13 Plans

Another approach might be to establish a five-year plan, not separately classify the student loan for the first three years of the plan, and then classify it for greater payment during the plan's final two years.⁶⁵ The basis for this approach is the Bankruptcy Code provision that requires disposable income only to be paid out over three years.⁶⁶ Any amount that creditors receive in the final two years would be a bonus in any event. Courts have split on whether they will allow this separate classification of student loans in years four and five of a chapter 13 plan.⁶⁷

As a related option, if the plan is voluntarily extended, for example from 36 to 60 months, the plan could provide for preferentially high payments to the student loan creditor during the first 36 months. Any shortfall to non-student loan creditors occurring during the first three years could be made up by directing additional payments to them during the fourth and fifth years.⁶⁸ This would allow for a consistently higher payment to the student loan creditor throughout the entire plan period.

g. Over-Median Income Debtors May Designate All Their Discretionary Income for Student Loan Payments

The means testing calculation can work to the benefit of an above-median-income chapter 13 debtor who wishes to continue making regular payments on a nondischargeable student loan. Where the debtor's "monthly disposable income" amount from his or her Form 22C is \$0 or a negative number, bankruptcy courts have generally allowed above-median income chapter 13 debtors to use as much of their discretionary income as they wish to pay

⁶⁴ See *In re Santana*, 480 B.R. 222 (Bankr. D. P.R. 2012) (debtor-parent who co-signed student loan for benefit of son could not separately classify debt under second clause of section 1322(b)(1) because loan not for benefit of parent).

⁶⁵ *In re Simmons*, 288 B.R. 737 (Bankr. N.D. Tex. 2003) (plan providing for 100% repayment of student loan and zero percent to general unsecured creditors may be confirmed when all of debtor's disposable income paid into plan for first thirty-six months and student loan creditor paid in months forty-one through forty-eight of plan); *In re Strickland*, 181 B.R. 598 (Bankr. N.D. Ala. 1995) (holding that nondischargeable student loan debt could not be treated more favorably than other unsecured claims for first thirty-six months of chapter 13 plan, but remaining twenty-four months could be devoted solely to payment of student loan).

⁶⁶ 11 U.S.C. § 1325(b)(1)(B).

⁶⁷ Compare *In re Stickland*, 181 B.R. 598 (Bankr. N.D. Ala. 1995) (allowing separate treatment in years four and five), and *In re Rudy*, 1993 WL 365370 (Bankr. S.D. Ohio 1993) (same), with *In re Sullivan*, 195 B.R. 649 (Bankr. W.D. Tex. 1996) (not allowing separate classification).

⁶⁸ See e.g. *In re Perrine*, 2001 WL 34076434 (Bankr. C.D. Ill. July 13, 2001) (suggesting debtor could minimize disparity in treatment of student loan and non-student loan unsecured creditors by extending plan term six months beyond the proposed 36 months).

student loan creditors at a rate greater than other unsecured creditors.⁶⁹

h. Student Loan Payments As “Special Circumstances” Under the Means Test

In order to reduce current monthly income under the means test, an above-median-income debtor will want to show the maximum allowable expenditures and expenses. Student loan payments would appear to be an obvious choice to apply toward this reduction. Unfortunately, student loan debt payments, like most general unsecured debts, are not allowable deductions from current monthly income for the means test calculation.⁷⁰ Yet, there is still a way in which the debtor may use student loan payments to reduce current monthly income and avoid the presumption of abuse. After deductions for allowed expenditures, the Code permits the debtor to rebut the presumption of abuse by demonstrating “special circumstances” that may bring the debtor’s disposable income under the presumed abuse tolerance level set by the means test formula.⁷¹ The Code defines these “special circumstances” only generally. The circumstances must “justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.”⁷² As examples of acceptable “special circumstances,” the Code mentions “a serious medical condition or a call or order to active duty in the Armed Forces.”⁷³

Several courts have said that an obligation to pay a nondischargeable student loan can be a “special circumstance” similar to a serious medical condition or a call to military service.⁷⁴ For

⁶⁹ *In re Knowles*, 501 B.R. 409, 412 (Bankr. D. Kan. 2013) (above-median chapter 13 debtor’s direct payment of ongoing contractual payments to student loan creditor using funds not required by Code to be committed to plan did not constitute unfair discrimination under § 1322(b)(1)); *In re King*, 460 B.R. 708 (Bankr. N.D. Tex. 2011) (not unfair discrimination to pay student loan directly to creditor using income in excess of the amount mandated by the projected disposable income calculation); *In re Abaunza*, 452 B.R. 866 (Bankr. S.D. Fla. 2011) (using discretionary income, above-median debtor may pay student loan debt in full over the sixty months of the plan, while other unsecured creditors will receive a dividend of less than 1%); *In re Sharp*, 415 B.R. 803 (2009) (following *Orawsky*, above-median-income chapter 13 debtor’s discretionary payments to student loan creditors not unfairly discriminatory). *But see In re Stull*, 489 B.R. 217 (Bankr. D. Kan. 2013) (allowing above-median income chapter 13 debtor to pay student loan in full with discretionary income, but holding § 1322(b)(10) precludes payment of interest on claim under plan).

⁷⁰ 11 U.S.C. § 707(b)(2)(A)(ii)(I) (“other necessary expenses” “shall not include any payments for debts”); *see also In re Thompson*, 457 B.R. 872 (Bankr. M.D. Fla. 2011) (student loan debt not an allowed priority expense under section 707(b)(2)(A)(ii), (iv), for Official Form 22A).

⁷¹ 11 U.S.C. § 707(b)(2)(B)(i); *see National Consumer Law Center, Consumer Bankruptcy Law and Practice* § 13.4.6.2 (10th ed. 2012 and Supp.).

⁷² 11 U.S.C. § 707(b)(2)(B)(i).

⁷³ *Id.*

⁷⁴ *In re Howell*, 477 B.R. 314, 316/-/17 (Bankr. W.D.N.Y. 2012) (debtor rebutted presumption of abuse when magnitude of student loan debt would allow only nominal payments to other unsecured creditors); *In re Edwards*, 2012 WL 3042233 (Bankr. D. Ala. July 25, 2012) (agreeing that in some cases student loan payments may constitute special circumstances, but not in this

example, in *In re Delbecq*, the means test left the debtor with \$304 in disposable monthly income, and she faced a trustee's motion to dismiss asserting the presumption of abuse. In response, the debtor argued that her monthly student loan payment of \$350 was a "special circumstance" that rebutted the presumption.⁷⁵ If her disposable income was reduced by the amount of her student loan payments, she would have no disposable income under the means test formula. The court agreed with the debtor and denied the trustee's motion to dismiss.⁷⁶

In holding that the obligation to pay the student loans was a "special circumstance" under section 707(b)(2)(B)(i), the court in *Delbecq* looked to the legislative history of the means test. Congress intended that the means test bar from chapter 7 those debtors who had a meaningful ability to pay their debts. According to the court, forcing the debtor into chapter 13 would do nothing to further this intent. Because separate classification of student loan debts was permitted in a chapter 13 plan in the district, the non-student-loan creditors would receive nothing under any plan the debtor was likely to propose.⁷⁷ The student loan creditor would receive all disbursements under her plan. The student loan debt was presumed to be nondischargeable, so the debtor had no alternative but to pay it. Thus, the debtor did not have any meaningful ability to repay her non-student-loan debts either inside or outside of bankruptcy. This amounted to special circumstances that placed the debtor in clear need of chapter 7 relief and required adjustments to her income and expenses based upon the student loan debt. The obligation to make significant student loan payments may also be a basis for opposing a motion to dismiss a chapter 7 case under a claim of general abuse of chapter 7 or lack of bad faith.⁷⁸

A similar issue involving student loans and the debtor's projected disposable income has arisen in chapter 13 cases. If the student loan payments can be excluded from projected disposable income as a "special circumstance," the payment of the regular monthly installments on the long-term debt directly to the creditor would be appropriate. This should be allowed, because the same "special circumstances" standard of section 707(b)(2)(B)(i) that reduces current monthly income under the means test for chapter 7 applies to adjustments to disposable income in chapter 13.

case because debtors incurred other high unnecessary expenses); *In re Sanders*, 454 B.R. 855 (Bankr. M.D. Ala. 2011) (debtors who "either directly or on guarantor basis" were responsible for their son's student loan could claim the expense as a "special circumstance" under section 707(b)(2)(B)); *In re Martin*, 371 B.R. 347 (Bankr. C.D. Ill. 2007); *In re Delbecq*, 368 B.R. 754 (Bankr. S.D. Ind. 2007); *In re Haman*, 366 B.R. 307 (Bankr. D. Del. 2007) (debtor's obligation to pay as co-signor on son's student loan is "special circumstance"); *In re Templeton*, 365 B.R. 213 (Bankr. W.D. Okla. 2007); see Anthony P. Cali, *The "Special Circumstance" of Student Loan Debt Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 52 Ariz. L. Rev. 473 (Summer 2010) (reviewing decisions and policies related to issue and generally supporting treatment of student loans payments as "special circumstance").

⁷⁵ *In re Delbecq*, 368 B.R. 754 (Bankr. S.D. Ind. 2007).

⁷⁶ *Id.*

⁷⁷ See § 10.9.1, *supra* (discussing chapter 13 plan classification issues related to student loans).

⁷⁸ 11 U.S.C. § 707(b)(1) and (3); see *In re Thurston*, 2008 WL 3414138 (Bankr. N.D. Ohio Aug. 8, 2008).

At least one court has agreed with this analysis in the context of chapter 13.⁷⁹ Finding that monthly payments of \$450 toward a nondischargeable student loan were “special circumstances,” the court in *In re Knight* held that a downward adjustment of the debtor’s projected disposable income in the full amount of his scheduled student loan payments was appropriate. The court found that the debtor had no reasonable alternative to payment of his student loans. There would be a demonstrable economic unfairness to the debtor if completion of a chapter 13 plan left him in default on his student loans and subject to garnishment or tax offsets.⁸⁰ This would be inconsistent with the intent of BAPCPA to encourage debtors to complete chapter 13 repayment plans. As an alternative basis for its decision, the court in *In re Knight* found that the debtor was permitted to make payments on the student loans under section 1322(b)(5).

Some courts have rejected the view that the obligation to pay a nondischargeable student loan debt is, per se, a “special circumstance” that justifies additional deductions from monthly income under the means test.⁸¹ A per se rule that any specific debt within a general category of expenditures will always qualify for the “special circumstances” deduction is not a tenable position, and it is not one that any courts have endorsed. Under a fair reading of the statute, the debtor must make some particularized showing that, in his or her case, there is no alternative to payment of the student loan debt.⁸² However, in rejecting debtors’ arguments that student loan payments were “special circumstances,” some recent decisions endorsed a line of reasoning that

⁷⁹ *In re Knight*, 370 B.R. 429 (Bankr. N.D. Ga. 2007).

⁸⁰ *Id.* at 437. See generally *In re Howell*, 477 B.R. 314, 317 (Bankr. W.D.N.Y. 2012) (discussing the negative impact of chapter 13 on debtor’s student loan debt as factor under section 707(b)(2)(B)(i) rebutting claim of abuse of chapter 7).

⁸¹ *In re Martin*, 505 B.R. 517, 522 (Bankr. S.D. Iowa 2014) (agreeing with line of cases that hold that student loans are not typically special circumstance); *In re Brown*, 500 B.R. 255, 263 (Bankr. S.D. Ga. 2013) (paying student loan debt not “special circumstance” unless debtor can show incurring loans was due to job loss, required to maintain job, or similar necessity); *In re Maura*, 491 B.R. 493, 512/-/13 (Bankr. E.D. Mich. 2013) (incurring student loan debt is voluntary, foreseeable, and not unusual); *In re Campbell*, 2012 WL 162287 (Bankr. E.D. Ky. Jan. 18, 2012) (rejecting special circumstances treatment when debtor presented no evidence beyond nondischargeable nature of student loan debt); *In re Thompson*, 457 B.R. 872 (Bankr. M.D. Fla. 2011) (debtors did not establish student loan expense was necessary and could not be deferred under long-term payment options); *In re Johnson*, 446 B.R. 921 (Bankr. E.D. Wis. 2011) (student loan taken out voluntarily for career enhancement can never support “special circumstances” treatment, but debtor may classify student loan payments separately under section 1322(b)(5) to maintain payments); *In re Harmon*, 446 B.R. 721 (Bankr. E.D. Pa. 2011) (proceeding under chapter 13 would not impose unduly severe consequences upon debtor); *In re Conlee*, 435 B.R. 490 (Bankr. N.D. Ohio 2010); *In re Siler*, 426 B.R. 167 (Bankr. W.D.N.C. 2010); *In re Carillo*, 421 B.R. 540 (Bankr. D. Ariz. 2009); *In re Pageau*, 383 B.R. 221 (Bankr. D.N.H. 2008); *In re Lightsey*, 374 B.R. 377, 382 n.3 (Bankr. S.D. Ga. 2007).

⁸² See *In re Champagne*, 389 B.R. 191 (Bankr. D. Kan. 2008) (emphasizing fact-intensive nature of special circumstances determination; rejecting view that nondischargeable student loan obligation is per se a special circumstance but also rejecting view that student loan debt burden can never satisfy this requirement).

deviates from the statutory language as widely as does the view that student loans should always be treated as a “special circumstances.” These courts adopted the position that “special circumstances” must be the result of some involuntary hardship that befell the debtor.⁸³ According to these courts, student loans are a routine obligation that individuals take on voluntarily. Under this view, payments toward a nondischargeable student loan would almost never be a special circumstance reducing disposable income under section 707(b)(2)(B).

The decisions that give substantial weight to the reasons why the debtor incurred a particular debt, such as a student loan, ignore the relevant statutory language.⁸⁴ By its terms, the statute requires only that the debtor demonstrate that certain circumstances are “special” to the extent that they require additional expenditures from current monthly income and there is no reasonable alternative to payment for these expenditures. There is nothing in the statutory language suggesting that anything about the past circumstances which created the obligation is relevant. The only criterion is that there presently be no reasonable alternative to the expenditure.⁸⁵ The standard should be met when there is nothing within the debtor’s power to reduce or otherwise avoid the additional expense of the student loan.⁸⁶ The means testing system was intended to be a process to direct debtors with some truly discretionary income or an extravagant lifestyle into some form of debt repayment. The lack of alternatives for repayment of student loan debt should focus on the debtors’ resources and expenses and not on whether student loans are a common or “voluntary” form of debt.⁸⁷

i. Objections to Claims

Even though non-dischargeable, student loans are subject to the claims objection

⁸³ *In re Zahringer* (Bankr. E.D. Wis. May 30, 2008); *In re Pageau*, 383 B.R. 221 (Bankr. D.N.H. 2008) (there must be “special circumstances” in the reasons that led debtor to incur education loan).

⁸⁴ 11 U.S.C. § 707(b)(2)(B).

⁸⁵ *See In re Haman*, 366 B.R. 307, 313/-/14 (Bankr. D. Del. 2007) (rejecting view that circumstances must result from events outside debtor’s control).

⁸⁶ *In re Hammock*, 436 B.R. 343 (Bankr. E.D.N.C. 2010) (need for education credentials for job advancement not sufficient to show “special circumstances” and lack of reasonable alternatives); *In re Templeton*, 365 B.R. 213 (Bankr. W.D. Okla. 2007); *see also In re Knight*, 370 BR. 429, 439/-/40 (Bankr. N.D. Ga. 2007) (a “reasonable alternative” is not to pay a miniscule percentage to student loan creditor along with all general unsecured creditors in chapter 13 plan and have debtor owe more on student loan after bankruptcy than before). *But see In re Pageau*, 383 B.R. 221 (Bankr. D.N.H. 2008) (in districts that allow separate classification of student loans in chapter 13 plans, treatment of student loan debt in this manner under a plan is reasonable alternative for dealing with expense, precluding finding of special circumstances for chapter 7 debtor); *In re Lightsey*, 374 B.R. 377, 382 n.3 (Bankr. S.D. Ga. 2007) (same).

⁸⁷ *In re Sanders*, 454 B.R. 855 (Bankr. M.D. Ala. 2011) (student loan repayment is “special circumstance” rebutting presumption of abuse; allowing indebtedness to increase under long-term payment program not a reasonable alternative); *In re Delbecq*, 368 B.R. 754 (Bankr. S.D. Ind. 2007).

process.⁸⁸ For example, while federally guaranteed student loans are never barred by a statute of limitations, private student loans are, likely based on the debtor's state of residence. Parties attempting to collect a student loan must show that they are the proper party.⁸⁹ Additionally, student loans may be subject to the protections under other laws, including the FDCPA, state unfair collection laws, etc., which raised defensively in objecting to claims even beyond those laws statutes of limitations.

Proofs of claim can also be scrutinized to determine if the obligations meet the criteria to be non-dischargeable "student loans."⁹⁰ The claim should evidence either that the obligations was "an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution", "an obligation to repay **funds** received as an educational benefit, scholarship or stipend"⁹¹, or "qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual."⁹²

8. Preferences

Garnishments for student loans within in 90-days of filing of a debtor's bankruptcy can be considered preferential transfers.⁹³ There is no exception for avoidance of transfers for nondishargeable debts, such as student loans, and, because such garnishments are not voluntary, a chapter 13 debtor can both recover the garnished amounts and, assuming available exemptions, retain those funds.⁹⁴ Any recovery would still be non-dischargeable in the long run, but the debtor may benefit more from the immediate return of garnished funds.

⁸⁸ See e.g., 11 U.S.C. §502(b) and Federal Rule of Bankruptcy Procedure 3007. See also, Hann v. Educ. Credit Mgmt. Corp. (In re Hann), 476 B.R. 344 (B.A.P. 1st Cir. 2012) (after thorough review of claim objection by the bankruptcy court, the balance on the student loan claim was determined to be zero.)

⁸⁹ See e.g., Dudley v. S. Va. Univ. (In re Dudley), 502 B.R. 259 (Bankr. W.D. Va.2013) (University was required to show that it was entitled to enforce the note against the debtor.)

⁹⁰ 11 U.S.C. §523(a)(8). See Rumer v. Am. Educ. Servs. (In re Rumer), 469 B.R. 553, 561(Bankr. M.D. Pa. 2012) (cases interpreting § 523(a)(8) have held that the initial burden is on the lender to establish the existence of the debt and to demonstrate that the debt is included in one of the four categories enumerated in § 523(a)(8)).

⁹¹ See e.g., Inst. of Imaginal Studies v. Christoff (In re Christoff), 510 B.R. 876, 876 (Bankr. N.D. Cal. 2014) (tuition credits which a chapter 7 debtor received from a private university that was licensed under California's Private Postsecondary Education Act of 2009 were dischargeable in bankruptcy under 11 U.S.C.S. § 523(a)(8) because they did not involve a third-party loan or an exchange of funds.)

⁹² 26 U.S.C. § 221(d)(1).

⁹³ 11 U.S.C. § 541.

⁹⁴ 11 U.S.C. §522(g), (h) and (i).