Comments

HEAVY BACKPACKS: RES JUDICATA AND APPROPRIATE NOTICE TO CREDITORS DURING A STUDENT LOAN DISCHARGE IN BANKRUPTCY

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I. INTRODUCTION

A. Discharge-by-Declaration: Res Judicata and Notice Requirements When Showing Undue Burden

Recently, the Ninth Circuit Court of Appeals contentiously reaffirmed its split with five other circuits regarding both the res judicata effects of a bankruptcy discharge for a creditor seeking repayment of a student loan purportedly discharged in a confirmed bankruptcy plan and the notice requirements a student debtor must satisfy when showing that his or her student loan is an undue burden during a bankruptcy petition.[1] Congress requires a student seeking to discharge his or her loan through bankruptcy

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1. *See* Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1205 (9th Cir. 2008) ("What appears to be going on is that courts are re-casting what may be a simple statutory violation as a denial of due process so that they can set aside judgments with which they're unhappy. This approach is not consistent with the theory of objective judging.").

to show that the loan would pose an undue burden if the loan is excluded from the bankruptcy petition—if there is no showing of undue burden, the loan remains enforceable against the debtor.[2] The specific contentions concern what is known as discharge-by-declaration and also concern the creditor's subsequent due process rights.[3] In discharge-by-declaration, a student may show undue burden when: (1) the student includes a declaratory statement in his or her bankruptcy petition that his or her student loan is an undue burden, and (2) the creditor does not object.[4] An objection to the discharge of a loan by the creditor triggers an adversarial proceeding during the bankruptcy petition and, as will be seen, the debtor then has to satisfy either the *Brunner* test or the *totality of the circumstances* test to show undue hardship.[5] These two tests measure the burden of the loan on the student seeking to prove undue burden through an adversarial process. The student may also initiate an adversarial proceeding before the creditor objects, but this situation is beyond the scope of the circuit split examined here because res judicata and appropriate notice by the student are not issues once the adversarial proceeding occurs during the bankruptcy proceeding, assuming appropriate notice is served to the creditor and the other requirements of res judicata have been fulfilled.[6] This circuit split contains two areas ripe for examination: (1) whether a creditor that ignores a declaration of undue burden is later precluded from litigating the existence of undue burden on the student debtor (and thus whether the loan was discharged by the bankruptcy plan),[7] and (2) whether the debtor violates the due process

2. *See* 11 U.S.C. 523(a)(8) (2006)

> (A discharge . . . does not discharge an individual debtor from any debt . . . unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor . . . for 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; or an obligation to repay funds received as an educational benefit.).

3. *Compare In re* Mersmann, 505 F.3d 1033, 1038 (10th Cir. 2007) (describing former agreement with the Ninth Circuit on discharge-by-declaration); Whelton v. Educ. Credit Mgmt. Corp., 432 F.3d 150, 155 (2d Cir. 2005) (requiring an adversarial proceeding for res judicata to attach to a showing of undue burden); *In re* Hanson, 397 F.3d 482, 486 (7th Cir. 2005) (same); Ruehle v. Educ. Credit Mgmt. Corp. (*In re* Ruehle), 412 F.3d 679, 682-83 (6th Cir. 2005) (same); Banks v. Sallie Mae Servicing Corp. (*In re* Banks), 299 F.3d 296, 302-03 (4th Cir. 2002) (same), *with Espinosa*, 553 F.3d at 1205 (allowing discharge-by-declaration to be sufficient for res judicata to attach to a showing of undue burden).

4. *See, e.g.*, Educ. Credit Mgmt. Corp. v. Repp (*In re* Repp), 307 B.R. 144, 151-52 (B.A.P. 9th Cir. 2004) (explaining the process for a Chapter 13 discharge and the lessened notice requirements compared to a typical adversarial civil proceeding).

5. *See infra* Part I.C (discussing these two tests).

6. *See infra* Part III.B (examining *Tennessee Student Assistance Corporation v. Hood*, 541 U.S. 440).

7. This is essentially a res judicata argument. *Espinosa*, 553 F.3d at 1199.

rights of the creditor by failing to serve the creditor with the complaint and summons to an adversarial proceeding, as required by other provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure.[8]

This paper examines two possible resolutions to the circuit split. The Supreme Court has hinted at how it might rule to resolve the split in dictum of *Tennessee Student Assistance Corporation v. Hood*.[9] It seems likely, given *Hood*, that the Ninth Circuit's decision is an outlier, likely to be overruled. This position is further bolstered by congressional intent and legislative history underlying the undue burden provision. The second potential resolution to the split can be drawn out of two First Circuit cases which will be examined.[10] These cases essentially apply the terms of the twenty-five-year Income Contingent Repayment Plan (ICRP), an alternative repayment plan offered to low-income students by the U.S. Department of Education (the "Department"), to a bankruptcy discharge, effectively turning the proceeding into a twenty-five-year bankruptcy discharge. Though the First Circuit cases were not concerned with res judicata or notice to creditors, their rulings unwittingly posit a scenario where neither res judicata nor notice to the creditors matter, thus presenting a second possible solution to the circuit split. Applying the ICRP terms to student loan bankruptcy petitions addresses the concerns of both the debtor and creditor properly.[11] However, before examining these solutions, it is necessary to outline the current problem in more detail.

B. Background: The Current State of Student Loan Discharge and the Department's ICRP

Student loans are big business. The Department guaranteed $98.3 billion loaned by private lenders through the Federal Family Education Loan Program (FFELP)[12] and provided an additional $16.5 billion in direct loans to students in federal fiscal year 2007 alone.[13] The loans made through FFELP are originated and serviced by private lenders, who then

8. *See infra* Part III.A (discussing the notice requirements of Fed. R. Bankr. P. 7001(6), 7003 and 7004).

9. 541 U.S. 440 (2004).

10. *See In re* Brunell, 356 B.R. 567, 581 (Bankr. D. Mass. 2006) (discharging a student loan after the expiration of the Income Contingent Repayment Plan's twenty-five-year repayment term rather than at the end of the typical three to five year term of a Chapter 13 plan); Austin v. Educ. Credit Mgmt. Corp. (*In re* Austin), No. 03-18868-WCH 2005 Bankr. LEXIS 2425, at *3-4 (Bankr. D. Mass. 2005) (same).

11. *See infra* Part III.C (examining *Brunell* and *Austin*).

12. U.S. Department of Education, Funding Status - - Federal Family Education Loan (FFEL) Program, http://www.ed.gov/programs/ffel/funding.html (last visited Oct. 4, 2009).

13. U.S. Department of Education, *Funding Status - - William D. Ford Federal Direct Loan Program*, http://www.ed.gov/programs/wdffdl/funding.html (last visited Oct. 4, 2009).

profit from the repayment of the loans with interest.[14] Thus, the private lenders have an incentive to ensure that students make timely repayments, or, at the very least, the lenders will try to collect as much as they can from the student if the loan goes into bankruptcy or otherwise becomes non-performing, as they would with any other loan. Students are often younger individuals with short or non-existent credit histories, and, lacking significant assets to use as collateral, student loans are often originated on an unsecured basis. Thus, there is nothing for the creditor to repossess once the student stops repaying the student loan. Also, unlike most loans, lenders have additional difficulties collecting upon student loans because "the capital improvement bestowed upon the debtor exists in an amorphous and intangible state when compared to the traditional loan . . . [the improvement bestowed] is beyond seizure, garnishment, or repossession."[15] Ben Franklin accurately stated the case when he said that the best place to hide one's fortune is in one's head, where it cannot be taken by anybody, especially a jilted lender attempting repossession.[16]

Despite these impediments to lending, student loan origination remains a multi-billion-dollar industry, measured by funds available for students to borrow per year.[17] What, other than proscribed usurious rates, could explain handing billions of dollars over to borrowers with limited credit histories and few assets to put up as collateral to secure the loans made for an asset from which it is nearly impossible to forcibly collect the proceeds? The size and growth of the student loan industry over the recent decades is essentially a result of government policy.[18] To promote its policy of expanded access to education, the federal government, through the Department, guarantees interest and principal on loans made by private lenders, thereby encouraging those lenders to extend credit to borrowers who may not normally qualify.[19] However, the government has not issued a blank check to students (and lenders), and perceived abuses in the repayment system has led Congress to enact the "undue hardship," or

14. United Student Aid Funds, Inc., *The Federal Family Education Loan Program*, http://www.usafunds.org/about_usa_funds/student_loan_program/ffelp.htm (last visited Oct. 4, 2009).

15. Kevin C. Driscoll Jr., *Eradicating the "Discharge by Declaration" for Student Loan Debt in Chapter 13*, 2000 U. ILL. L. REV. 1311, 1315 (2000).

16. DICTIONARY OF QUOTATIONS FROM ANCIENT AND MODERN ENGLISH AND FOREIGN SOURCES 171 (James Wood, ed., 1899) ("If a man empties his purse into his head, no man can take it away from him.").

17. *Cf.* U.S. Department of Education, *supra* note 12. ("FFEL loan volume (aid available) . . . was $119.2 billion in FY 2006, $98.3 billion in FY 2007, and is estimated to be $90.2 billion in FY 2008.").

18. 4 COLLIER ON BANKRUPTCY P 523.14[1] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev.) [hereinafter COLLIER].

19. *Id.*

undue burden, exception to discharge of a student loan in bankruptcy.[20] This clause purportedly prevents students from discharging their loans by filing for bankruptcy immediately upon graduation and also ensures the financial integrity of the loan system.[21] As mentioned above, the student seeking discharge of his student loan, often through a Chapter 7 or Chapter 13 bankruptcy filing, must show that continuing to pay the loan will prove to be an undue burden were the loan exempted from the bankruptcy repayment plan. However, Congress left the courts to define what constitutes an undue burden and determine the scope of its application.

C. Undue Burden: The Brunner Test and the Totality of the Circumstances Test

Though there is an additional minor circuit split on the precise factual situation that will prove to be an undue burden on the student, a brief recitation of the two tests used by the various circuits illuminates what is usually considered to be an undue burden and will suffice to describe the conditions under which courts will find an undue burden. This proves important when considering the potential solution drawn out of the bankruptcy courts of the First Circuit applying the twenty-five-year term of the ICRP repayment to a bankruptcy discharge because the tax effects of ICRP forgiveness are a major component of an undue burden determination.

The test to determine what constitutes an undue burden used in *Brunner v. N.Y. State Higher Educ. Services Corp.* prevails in most of the circuit courts.[22] The *Brunner* test requires the debtor seeking discharge to show:

> (1) that the debtor cannot maintain, based on current income and expenses, a 'minimal' standard of living for herself and her dependents if forced to repay the loans;
> (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and
> (3) that the debtor has made good faith efforts to repay the loans.[23]

The Eighth Circuit applies a *totality of the circumstances* test, which examines "(1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependent's

20. *Id.* at P 523.LH.

21. *Id.* at P 523.14.

22. *Id.*

23. Brunner v. N.Y. State Higher Educ. Services Corp., 831 F.2d 395, 396 (2d Cir. 1987).

reasonable necessary living expenses; and (3) any other relevant facts and circumstances."[24] While a debtor must meet all three prongs of the *Brunner* test to prove undue hardship, the *totality of the circumstances* test is more flexible and fact-dependent.[25] The two tests essentially differ over what constitutes a good faith effort to repay an educational loan. However, under either test, the debtor still must show a sufficiently undue burden to have the educational loan included in the bankruptcy discharge.[26]

The Department's ICRP further complicates matters for both the debtor seeking discharge of his or her student loan through bankruptcy and the bankruptcy courts attempting to determine an undue burden. The Department provides the ICRP as a relief option for a debtor who is unable to pay the full amount of his or her loan; the ICRP allows the debtor to put twenty percent of his or her discretionary income toward the repayment of the loan while unpaid interest accrues and is added to the original principal, up to ten percent of the original principal amount, further interest being deferred during the twenty-five-year repayment period, after which the entire remaining amount is discharged.[27] Some courts require a student debtor to explore the option of entering the ICRP as an alternative means of discharge before granting a bankruptcy discharge of the student loan; other courts, noting that the Internal Revenue Service (IRS) imposes tax upon an ICRP discharge but not upon a bankruptcy discharge, have not made the exploration of entering the ICRP a prerequisite of the student debtor's bankruptcy discharge.[28] Thus, at least in some circuits, a debtor must meet a fairly high burden to show not only that the debtor's financial situation is penurious and is likely to remain so, but also that the debtor has explored a range of options to have the loan otherwise forgiven. Though the

24. Long v. Educ. Credit Mgmt. Corp. (*In re* Long), 322 F.3d 549, 554 (8th Cir. 2003). The bankruptcy courts of the First Circuit are free to choose between the *Brunner* test and the *totality of the circumstances* test. *See, e.g.*, *In re* Brunell, 356 B.R. 567, 575-76 (Bankr. D. Mass. 2006) (noting that the "absence of controlling authority" in the First Circuit leaves "courts . . . free to choose [their] own approach in evaluating undue hardship.").

25. *In re* Long, 322 F.3d at 554.

26. *See also In re* Brunell, 356 B.R. at 581 (imposing the twenty-five-year term of the ICRP on the repayment of a loan discharged through bankruptcy to avoid tax liability upon discharge of the loan); *Compare* Thomsen v. Dep't of Educ. (*In re* Thomsen), 234 B.R. 506, 509-510 (Bankr. D. Mont. 1999) (finding good faith under the third prong of the *Brunner* test by a debtor who did not seek to enter the Department's ICRP due to potential tax liability accruing to an individual whose loan is discharged through the ICRP), *with In re* Tirch, 409 F.3d 677, 682-83 (6th Cir. 2005) (requiring a debtor seeking bankruptcy discharge of a student loan to have first attempted to have the loan discharged through the ICRP), *and In re* Burton, 339 B.R. 856 at n.48 (Bankr. E.D. Va. 2006) (same, basing its reasoning on the speculative nature at the time of the bankruptcy petition of the tax liability when a loan is discharged through the ICRP twenty-five-years later).

27. 34 C.F.R. § 685.209 (2008).

28. *See* COLLIER, *supra* note 18, at P 523.14[2] (describing the interaction between the ICRP and bankruptcy discharge vis-à-vis taxable income).

Department is currently working on regulations that, if recognized by the IRS, would allow a loan discharged through the ICRP to be counted as non-taxable income, debtors in the meantime are best served financially by trying to discharge their loans through the bankruptcy process, for both finality and tax purposes.[29]

However, even under current regulations, this split may be resolved by other means.[30] The resolution of this circuit split will have a significant impact upon the method most likely to be used by students to discharge their student loans. Lenders will pay particular attention to the resolution of this split and will adjust the cost of student borrowing accordingly. Additionally, if the First Circuit method described below is expanded to include all student debtors seeking a bankruptcy discharge, the real-world impact of the current circuit split is marginalized. The final point to examine before the possible resolutions of this circuit split is the actual split itself.

II. THE ADVERSARIAL PROCEEDING: RES JUDICATA, NOTICE REQUIREMENTS AND DISCHARGE-BY-DECLARATION

A. Res Judicata: The Statutory Arguments Regarding Whether a Loan Discharged-by-Declaration is a Final Order which Precludes Further Collection Efforts and Lawsuits by Creditors against Student Debtors

Res judicata ensures that issues decided in litigation are not endlessly re-litigated between the parties in new lawsuits.[31] The principle also effectively eliminates the ability of one party to challenge a decided issue except when that party claims the deciding court committed an error. The losing party may only challenge the decision on the basis that it is void and thus could be of no effect once the party foregoes a direct appeal.[32] *Nwosun v. General Mills Restaurants, Inc.*, a widely-cited case, succinctly defines the four elements usually required for an issue to be subject to res judicata:

(1) the prior suit must have ended with a judgment on the merits;

29. Internal Memorandum from the U.S. Department of Education (Aug. 15, 2008) (on file with the author). The developing regulations may also seek to eliminate the income qualifications for student debtors seeking to enter the ICRP. *Id.*

30. *See infra* Part III.C (describing the application of the ICRP offered by the Department to the bankruptcy discharge).

31. Restatement of Judgments (Second) § 17 (1980) (defining the two components, issue and claim preclusion, of res judicata); *See also* New Hampshire v. Maine, 532 U.S. 742, 748 (2001) (endorsing the definition in the Restatement of Judgments (Second)).

32. Fed. R. Civ. P. § 60(b)(4) ("[T]he court may relieve a party . . . from a final judgment, order, or proceeding for the following reason[] . . . [if] the judgment is void.").

> (2) the parties must be identical or in privity; (3) the suit must be based on the same cause of action; and (4) the plaintiff must have had a full and fair opportunity to litigate the claim in the prior suit.[33]

The circuit split between the Ninth Circuit and the others centers first on whether the elements of res judicata, as applied within the specific chapters of the Bankruptcy Code, are fulfilled by a discharge-by-declaration. The second issue is whether res judicata principles are appropriate to apply in a bankruptcy proceeding due to the unique nature of such a proceeding within the court system and the specific positive law of the Bankruptcy Code. Thus, it is important to outline the provisions of the Bankruptcy Code and Federal Bankruptcy Rules of Procedure (which often incorporate the Federal Rules of Civil Procedure as binding) at issue.

Almost all student debtors, indeed almost all real (as opposed to corporate) persons, file bankruptcy under either Chapter 7 or Chapter 13 of the Bankruptcy Code.[34] For most purposes, courts do not seem to distinguish between these two chapters when determining the applicability of persuasive or precedential authority in relation to student loans discharged in bankruptcy.[35] Both Chapter 7[36] and Chapter 13[37] contain

33. 124 F.3d 1255, 1257 (10th Cir. 1997).

34. *Cf.* Riva D. Atlas & Eric Dash, *Bracing for a Bankruptcy Rush*, N.Y. TIMES, Mar. 11, 2005, at C1 (explaining that most individuals file Chapter 7 bankruptcies but noting that the new means test requirement for Chapter 7 will force individuals to declare Chapter 13 bankruptcy more often). Chapter 7 is the liquidation chapter. Administrative Office of the U.S. Courts, U.S. COURTS - BANKRUPTCY - BASICS - PROCESS, http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/process.html (last visited Oct. 16, 2009). Chapter 13 allows for a fixed term repayment plan determined by the bankruptcy court in which a reduced repayment plan is produced and, if followed by the debtor, allows discharge of the debts at the end of the repayment term, usually three to five years. *Id.* The other chapters of the Bankruptcy Code, other than Chapter 11 (reorganization), deal with specific situations which could not apply to individual students seeking discharge of student loans. *Id.* Chapter 11 is rarely used by real persons, unless they own significant assets, as it allows creditors to receive partial repayment from the reorganization (sale or continued use) of the individual's assets before discharge of the debts and gives the creditors much more control over discharge of the debtor's debts. *Id. See also*, Administrative Office of the U.S. Courts, U.S. COURTS - BANKRUPTCY - BASICS - CHAPTER 11, http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter11.html#background (last visited Oct. 16, 2009). Chapters 1, 3, and 5 contain general provisions applicable to the later chapters. COLLIER, *supra* note 18, at P 1.01.

35. The courts routinely cite to case law as binding, controlling, or otherwise persuasive—even when the citation is to a bankruptcy case filed under a different chapter of the Bankruptcy Code—provided the applicable provisions are either similar between the chapters or refer to general provisions of the Bankruptcy Code contained in Chapters 1, 3, or 5. *See generally*, *In re* Mersmann, 505 F.3d 1033, 1048 (10th Cir. 2007) (citing approvingly to a Chapter 7 case even though the debtor in question filed under Chapter 13).

36. 11 U.S.C. 727(a) (2006).

37. 11 U.S.C. 1327(a) (2006).

general provisions describing a discharge as a final binding order to which res judicata would apply. The penalty imposed on a creditor violating the discharge by trying to collect a discharged debt – either judicially or extra-judicially – is a civil contempt citation.[38] However, each chapter also has a provision which can be read either to limit the general discharge provision or can be read alongside it to operate in a separate sphere. In Chapter 7, the specific provision at issue states: "Except as provided in section 523 of this title, a discharge under [Chapter 7] discharges the debtor from all debts."[39] Chapter 13 contains slightly different wording: "[T]he court shall grant the debtor a discharge of all debts provided for by the plan . . . except any debt . . . of the kind specified in . . . section 523(a)."[40] Much like the precedential authority of bankruptcy cases decided by the Supreme Court, courts seem to treat these as distinctions without differences, and apply the same reasoning whether the case is a Chapter 13 or a Chapter 7 case. While much could be made of a potential difference between the two sections, the following analysis comports with the courts that lump Chapter 7 and Chapter 13 cases together.

The core of the disagreement between the circuit courts centers on whether the undue hardship requirement of 11 U.S.C. § 523(a)(8) requires an adversarial proceeding for the discharge to have res judicata effect.[41] Those courts proscribing discharge-by-declaration look to congressional intent and the operation of 11 U.S.C. § 523(a)(8) in conjunction with §§ 727(b) and 1328(a)(2) and with the procedural rules of bankruptcy.[42] The Ninth Circuit, however, reads the discharge provisions of the relevant chapter together with 11 U.S.C. § 524(a) in such a way as to construe a discharge, even by declaration, as a final, binding order which may not be challenged unless the order is void.[43] The Ninth Circuit also does not believe that the principles of res judicata are even the appropriate principles to apply due to the equitable nature of a bankruptcy discharge.[44]

38. *See* COLLIER, *supra* note 18, at P 524.02[2][c] ("Civil contempt is the normal sanction for violations of the discharge injunction."); COLLIER also notes that discharge "provides for a broad injunction against not only legal proceedings, but also any other acts to collect a discharged debt as a personal liability of the debtor"). *Id.* at P 524.02[2]

39. 11 U.S.C. 727(b) (2006).

40. 11 U.S.C. 1328(a)(2) (2006).

41. The circuit split on the amount of notice required of student debtors to their creditors is contained within this disagreement. If an adversarial proceeding is required, a student must serve a complaint and a summons on the creditor, rather than simply notifying the creditor that there is a bankruptcy proceeding and that the debt relevant to that creditor is included in the petition. *See* Fed. R. Bankr. P. 7003; Fed. R. Bankr. P. 7004; *see also infra* Part II.B (providing an extended treatment of the notice requirements).

42. *In re Mersmann*, 505 F.3d 1033, 1048 (10th Cir. 2007).

43. 11 U.S.C. § 524(a) describes the effect of a bankruptcy discharge under Chapter 7 and Chapter 13.

44. Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1200 (9th Cir. 2008).

In contrast, the Tenth Circuit, reversing its own earlier precedent, held that there must be an adversarial proceeding to determine undue hardship for res judicata to apply.[45] According to the reasoning used by this court, 11 U.S.C. § 523(a)(8) is self-executing, and by operation of Fed. R. Bankr. P. 7001(6), the section requires an adversarial proceeding.[46] Implicit in its decision is the assumption that Congress left the courts to decide how to craft the tests for undue burden and the *Brunner* test requires an affirmative showing; thus, a student loan cannot be discharged by mere declaration. The language in 11 U.S.C. §§ 727(b) and 1328(a)(2) limits the general discharge provisions.[47] The court also noted the inconsistency inherent in confirming a bankruptcy plan that violates other provisions of the Bankruptcy Code.[48] Using similar reasoning, the Second, Fourth, Sixth and Seventh Circuits agree.[49] However, the Ninth Circuit believes that the language of 11 U.S.C. §§ 727(b) and 1328(a)(2) operates in its own sphere; that is, the language operates solely during the discharge petition.[50] Rather than limiting the general provisions allowing discharge to have final, preclusive effect after the discharge has been entered, these provisions are read to apply only *during* the petition itself and do not operate *after* the confirmation of the bankruptcy plan.[51] If the creditor does not object during the proceeding, a debtor who includes a statement that the burden of his or her loan is an undue burden receives a preclusive discharge once the discharge is entered. The discharge provisions of these chapters may be read in conjunction with the provision detailing the effect of a discharge,

45. *See In re* Mersmann, 505 F.3d at 1047-48 ("Congress evinced the unmistakable intent to make student loan debts 'presumptively nondischargeable' and to 'singl[e them] out for an individualized adjudication'" (citing Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 450 (2004))); the Tenth Circuit reversed its decision in Andersen v. UNIPAC-NEBHELP (*In re* Andersen) which had allowed discharge-by-declaration. 179 F.3d 1253, 1258-59 (10th Cir. 1999).

46. Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 451 (2004).

47. *See In re* Mersmann, 505 F.3d at 1048 ("[Section] 1328(a)(2)'s specific pronouncement must be read as limiting § 1327(a)'s broad res judicata effect."); *see also* Whelton v. Educ. Credit Mgmt. Corp., 432 F.3d 150, 155 (2d Cir. 2005) ("A debtor who claims 'undue hardship' to defeat the statutory presumption against a student loan discharge must [satisfy the *Brunner* test]. Under the Bankruptcy Code, discharge of a student loan debt cannot be adjudicated in a summary proceeding.") (internal citations omitted).

48. *In re* Mersmann, 505 F.3d at 1048 (citing 11 U.S.C. § 1325(a)(1)).

49. *See In re* Hanson, 397 F.3d 482, 486 (7th Cir. 2005) (proscribing discharge-by-declaration); *Whelton*, 432 F.3d at 155 (same); Ruehle v. Educ. Credit Mgmt. Corp. (*In re* Ruehle), 412 F.3d 679, 682-83 (6th Cir. 2005) (same); Banks v. Sallie Mae Servicing Corp. (*In re* Banks), 299 F.3d 296, 302-03 (4th Cir. 2002) (same).

50. *Cf.* Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1198 (9th Cir. 2008) (stating that there is no conflict between the Bankruptcy Code's finality provision and the bankruptcy rules requiring an adversarial proceeding).

51. *See id.* ("[A] discharge is a final judgment and cannot be set aside or ignored because a party suddenly claims, years later, that the trial court committed an error.").

whereby a discharge "voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged" and "operates as an injunction against the commencement or continuation of an action . . . to collect . . . any such debt as a personal liability."[52] Further, the Ninth Circuit does not believe that res judicata is even the correct principle to apply.[53] The circuit views the discharge as an absolute, equitable order that can only be challenged on direct appeal.

B. Due Process: Actual Notice to the Student Loan Creditor of the Bankruptcy Proceeding versus Serving a Complaint and a Summons on the Student Loan Creditor

The circuits are similarly split regarding the proper notice requirement students must fulfill in a bankruptcy proceeding to show undue hardship. The notice issue interacts with res judicata and may be the best argument against allowing res judicata to control in a discharge-by-declaration. This is because ineffective notice to the creditor is a reason to set aside confirmation of the bankruptcy plan as void and not having res judicata effect after the discharge has been entered.[54]

The oft-cited description of proper notice promulgated by the Supreme Court is "notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objection."[55] The components relevant to an analysis of notice during a bankruptcy proceeding, as described above, are the "reason[able] calculat[ion], under all circumstances, . . . to apprise interested parties," and "afford them an opportunity to present their objection."[56] The two incompatible strands the circuits pull from the Supreme Court's description focus on separate components.

The Ninth Circuit focuses on the creditor receiving actual notice of the bankruptcy proceeding. The Ninth Circuit relies on a perception that a student loan creditor is a sophisticated party holding "large, unsecured claim[s]" that, once notice of the bankruptcy proceeding is sent via regular mail to the creditor's address by the student debtor, has "sufficient information" such that "any inquiry following receipt of the notice" would

52. 11 U.S.C. § 524 (2006).

53. *Espinosa*, 553 F.3d at 1200 ("A discharge injunction does not operate by way of res judicata; it is, rather, an equitable remedy.").

54. *See, e.g.*, *In re* Hanson, 397 F.3d 482, 487 (7th Cir. 2005) (voiding a bankruptcy discharge due to the debtor's noncompliance with the "heightened degree of notice" required by the Bankruptcy Code).

55. Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950).

56. *Id.*

inform the creditor that it needs to act to protect its interest, even when the bankruptcy plan itself is not sent.[57]

However, the Seventh Circuit reads the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure conjunctively to require more than actual notice of a bankruptcy hearing where the creditor's outstanding loan may or may not be listed in the bankruptcy plan. The Seventh Circuit acknowledged that the due process clause does not require a complaint and a summons, but because the Bankruptcy Code, as interpreted by the Supreme Court in dictum of *Hood*, requires an adversarial proceeding to show undue burden, the procedural rules of bankruptcy require a complaint and a summons.[58] Additionally, at least one other circuit has explicitly held that a student loan could not be discharged without a student debtor serving the creditor with a complaint and a summons to an adversarial proceeding to determine undue hardship.[59]

C. Implications: The Effects of Discharge-by-Declaration on the Debtor/Creditor Relationship

The Ninth Circuit's *Espinosa* decision has significant real-world implications. Akin to the business judgment rule, whereby courts will not second-guess business decisions made in good faith and without a conflict-of-interest,[60] a creditor may decide against litigating the debtor's declaration of undue hardship even when the creditor knows that this will allow a debtor to discharge the student loan through bankruptcy. This is because the creditor may determine that it can net more return from the

57. Matter of Gregory (*In re* Gregory), 705 F.2d 1118, 1123 (9th Cir. 1983). The Ninth Circuit relies on the reasoning in *D.C. Transit Sys., Inc. v. United States*, whereby "when a person has sufficient information to lead him to a fact, he shall be deemed to be conversant of it." 531 F. Supp. 808, 812 (D.D.C. 1982). This could also be termed 'inquiry notice' because it is notice that would lead a party to inquire into the proceeding to determine whether any of its rights will be affected by the pending action.

58. *Hanson*, 397 F.3d at 487:

> We do not hold that the due process clause requires the service of a summons and adversary proceeding prior to the discharge of student loan debt. Rather, we merely confirm that where the Bankruptcy Code and Bankruptcy Rules require a heightened degree of notice, due process entitles a party to receive such notice before an order binding the party will be afforded preclusive effect.

Id. (internal citations omitted).

59. *See In re* Ruehle, 412 F.3d 679, 685 (6th Cir. 2005) ("Due process demands a complaint and a summons. The rule is clear." (quoting *In re* Ruehle, 296 B.R. 146, 165 (Bankr. N.D. Ohio 2003))).

60. *See* EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES, AND LIABILITIES, § 2:10 (2009) ("The business judgment rule, although variously stated, may be expressed as a presumption that directors making a business decision, not involving self-interest, acted in good faith and with due care.").

debtor by the payments received through the bankruptcy discharge than it can by litigating the issue and subsequently trying to collect the full amount.[61] The creditor may consciously refuse to object to the undue hardship declaration, hoping that the debtor will make payments through the bankruptcy discharge but that the bankruptcy plan will eventually fail. The full amount of the loan remains enforceable when a bankruptcy plan fails.[62] The amount of the loan also may be insufficient to justify the cost of litigation.[63] Essentially, the creditor may be making a sound business judgment by initially refusing to object to the debtor's undue burden declaration. The creditor may be allowed to "seek a second bite of the apple by way of a due process argument" unless it is precluded from litigating the issue of undue hardship after the bankruptcy plan is confirmed or the discharge is complete.[64]

III. RESOLVING THE CIRCUIT SPLIT

A. The Ninth Circuit's Conception of Notice is Insufficient Notice for the Determination of Undue Hardship in a Bankruptcy Proceeding

Before examining the likely Supreme Court resolution of this circuit split and the argument to apply the First Circuit's reasoning regarding the twenty-five-year term of the ICRP in the broader context of a bankruptcy discharge, it is necessary to dispense with part of the Ninth Circuit's reasoning. The Ninth Circuit held that actual notice of a student loan being listed in a bankruptcy plan and of a declaration of undue burden is sufficient notice.[65] However, the undue burden exception to discharge, as outlined by the majority of circuits and apparent from congressional intent, suggests that heightened notice is required.

Initially, student loans were dischargeable in bankruptcy as any other loan would be unless "insured or guaranteed" directly by the government.[66] In 1978, Congress passed the Bankruptcy Code (effective in 1979), adding the aforementioned 11 U.S.C. § 523(a)(8) in response to the perceived fraudulent activity by student debtors of declaring bankruptcy immediately after graduation to wipe out their student debts.[67] In 1998,

61. Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1198-99 (9th Cir. 2008).
62. *Id.* at 1199.
63. *Id.* at 1198.
64. Educ. Credit Mgmt. Corp. v. Repp (*In re* Repp), 307 B.R. 144, 156 (B.A.P. 9th Cir. 2004).
65. *Espinosa*, 553 F.3d at 1203 (9th Cir. 2008).
66. COLLIER, *supra* note 18, at P 523.LH.
67. *Id.*

Congress eliminated a provision within 11 U.S.C. § 528(a)(8) that allowed a student loan to be discharged in bankruptcy without a finding of undue hardship once the debtor had been paying the loan for seven years.[68] Further, Congress again revised the Bankruptcy Code in 2005, and, while these amendments did not affect the provision directly relating to student loans, the general perception is that Congress attempted to make it more difficult to successfully complete a bankruptcy petition by lowering the income threshold for individuals seeking to file under the more generous provisions of Chapter 7.[69] This multi-decade trend in congressional intent favors creditors by making it more difficult for debtors in general, and student loan debtors in particular, to file for bankruptcy or discharge their debts once in bankruptcy. Given these congressional actions, it is unlikely that the more lenient notice requirement promulgated by the Ninth Circuit, leading to a preclusive discharge-by-declaration, would be acceptable to Congress.

Additionally, the drafting committee of the Federal Rules of Bankruptcy Procedure, authorized by Congress to draft and implement such rules, promulgated rules interpreted by the Supreme Court[70] in *Tennessee Student Assistance Corp. v. Hood*[71] to require service of a complaint and a summons to the creditor—even though 11 U.S.C. § 523(a)(8) itself does not require this procedure. This argument invokes the majority view of the courts outlined above where conjunctively read sections of the Bankruptcy Code and the procedural rules require first an adversarial proceeding to determine whether undue hardship exists, and an adversarial proceeding requires the service of a complaint and a summons upon the creditor.[72]

The problem with the Ninth Circuit's reasoning in the notice context is that it assumes too much. Furthermore, as described by one

68. *See* Andersen v. UNIPAC-NEBHELP (*In re* Andersen), 179 F.3d 1253, 1260 (10th Cir. 1999) ("We understand that Congress has sought to progressively limit the instances in which student loan debts may be discharged in bankruptcy, and this intent is most recently seen in the 1998 amendments which eliminated the 'seven-year rule' of dischargeability of educational loans.").

69. *Cf.* Joe Lee & Thomas Parrish, *Banks Gone Wild*, N.Y. TIMES, Jan. 13, 2007, at A15 (noting the more difficult threshold for a Chapter 7 filing under the 2005 amendments to the Bankruptcy Code); Timothy Egan, *Debtors in Rush to Bankruptcy as Change Nears*, N.Y. TIMES, Aug. 21, 2005, at A1 (same).

70. *See infra* Part III.B (examining the resolution of the circuit split by Supreme Court ruling).

71. 541 U.S. 440, 453-54 (2004).

72. *Id.*; *see* Fed. R. Bankr. P. 7001(6) (identifying the determination of the dischargeability of a debt as an adversarial proceeding); Fed. R. of Bankr. P. 7003 (incorporating Federal Rule of Civil Procedure 3 in adversarial proceedings, thus requiring a complaint to be filed in an adversarial proceeding); Fed. R. of Bankr. P. 7004 (requiring service of the complaint in an adversarial proceeding).

commentator and one circuit, it poses practical problems in the particular case concerned and poses problems for notice generally. The Ninth Circuit supplies several methods by which the creditor may assume it can collect more from the confirmation of the bankruptcy plan than from objecting to the discharge-by-declaration and, thus, the creditor may consciously decide against objecting to the discharge-by-declaration.[73] While this may factor into a consideration of res judicata, it has no bearing on whether notice was adequate. The Ninth Circuit attempts to save itself by noting that requiring service of a complaint and a summons where the specific rights of the creditor affected are listed is too cumbersome for a debtor and that the creditors are sophisticated parties who know that their rights will be affected by a bankruptcy proceeding when they receive the actual notice that a bankruptcy plan has been filed and the student loan debt the creditor holds is listed.[74] However, this reasoning is flawed for at least three reasons.

First, the Ninth Circuit ignores congressional intent and the Supreme Court's interpretation in *Hood*.[75] Second, this reasoning assumes that creditors can make an orderly and quick answer to notice of a debt discharge. As one commentator notes: Chapter 13 hearings take place quickly and, absent a complaint and a summons, the creditor may not prioritize an answer to a debt discharge to be able to object before the hearing occurs.[76] Third, the *In re Mersmann* court notes that the overarching design of notice requires that a party be informed that *its rights may be affected* by the proceeding at hand and that Congress has specifically accorded certain "heightened notice requirements" in undue hardship proceedings.[77] Curiously, the Ninth Circuit agrees that Congress may give additional rights to notice beyond actual notice, but the circuit apparently fails to grasp the significance of the Federal Rules of Bankruptcy Procedure, or perhaps deems that they go beyond their procedural borders to expand or contract substantive rights, in the context of an undue burden determination.[78] More significantly, if a party did not

73. Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1198-99 (9th Cir. 2008); *see also supra* Part II.C (discussing the business judgment rule).

74. *See id.* at 1203 (holding that actual notice is constitutionally adequate notice for a creditor who faces a debtor seeking a discharge-by-declaration).

75. *See infra* Part III.B (examining the resolution of the circuit split by a Supreme Court ruling).

76. *See Driscoll*, *supra* note 15, at 1320 ("[T]he [Chapter 13] confirmation hearing may have already happened by the time the notice moves from the mailroom to the appropriate office.").

77. *See In re* Mersmann, 505 F.3d 1033, 1043 (10th Cir. 2007) (noting the heightened notice requirement of an undue hardship determination when compared to the notice required to merely confirm a Chapter 13 plan).

78. *Espinosa*, 553 F.3d at 1204.

receive constitutionally adequate notice, res judicata would not apply, and the original judgment would be void.[79]

B. The Requirement of an Adversarial Proceeding

Though there is no explicit language in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure specifically requiring an adversarial proceeding to show undue hardship, the Supreme Court will likely require such an adversarial proceeding once it considers the issue.[80] If mandated by the Supreme Court, the requirement of an adversarial proceeding is a potential resolution of the circuit split regarding res judicata and notice.

Tennessee Student Assistance Corp. v. Hood provides the clearest hint that the Supreme Court is leaning toward the requirement of an adversarial proceeding to show undue hardship.[81] The debtor in this case, Ms. Pamela Hood, brought an adversarial proceeding under Chapter 7, and no party contended that she failed to fulfill the notice requirements.[82] Thus, though the 7 - 2 Supreme Court majority felt the need to outline the requirement of an adversarial proceeding to show undue hardship, this discussion is dictum and is not necessary to the resolution of Ms. Hood's case.[83] However, the ruling is a clear signal from the court as to how it will most likely rule once it considers the *Espinosa* case.

Despite this caveat, which is unmentioned in its ruling, the Supreme Court noted that student loans are not automatically dischargeable.[84] Citing the aforementioned Federal Rules of Bankruptcy Procedure, the Supreme Court majority decided that "the debtor [is required to] file an 'adversary proceeding' . . . to discharge his student loan debt."[85] Citing the same procedural rules as discussed above, the Supreme Court majority also noted that the requirement of an adversarial proceeding further "requires the service of a summons and a complaint."[86] Not only is this language dictum for the broad reason that it simply did not matter in Ms. Hood's case, one could also argue that it is dictum outside the narrow scope of the identity of

79. *See* Fed. R. Civ. P. 60(b)(4) (stating a void judgment as a ground for relief from a "Final Judgment, Order or Pleading"); *see also* In re *Mersmann*, 505 F.3d at 1049 ("[R]es judicata will not apply where there is inadequate notice [to the creditor of an adversarial proceeding to determine undue hardship].").

80. The Supreme Court has granted *certiorari* to hear the *Espinosa* case during its 2009 term. *United Student Aid Funds, Inc. v. Espinosa*, 129 S.Ct. 2791 (2009).

81. 541 U.S. 440 (2004).

82. *Id.* at 444-45.

83. *Id.* at 451-52.

84. *Id.* at 450-52.

85. *Id.* at 451-52 (citing Fed. R. Bankr. P. 7001(6), 7003 and 7004).

86. *Id.* at 452.

the student loan creditor in *Hood*. The creditor in this case was a state actor (the State of Tennessee), and the primary issue in the case was whether an adversarial proceeding under 11 U.S.C. § 523(a)(8) and the procedural rules of bankruptcy is a suit against a state, violating the prohibitions of the Eleventh Amendment.[87]

However, assuming that the requirement of an adversarial proceeding would hold in a broader case brought before the Supreme Court, the circuit split would be resolved. The four required elements for res judicata to attach to the decision would be present by requiring an adversarial proceeding.[88] Further, per the procedural rules of bankruptcy, the student debtor would have to serve a complaint and a summons against the creditor, negating the distinctions between actual or inquiry notice, and constitutional or heightened notice, because the creditor would have constitutionally adequate actual notice.

Additionally, it is interesting to note that the Tenth Circuit, having formerly agreed with the Ninth Circuit, reversed its position on the res judicata effect of an undue burden proved by declaration, relying on the reasoning used in *Hood*.[89] The Tenth Circuit also used the circuits' trend toward requiring an adversarial proceeding to show undue burden and that the inferred policy of Congress is to make it harder for students to discharge debts as reasoning for its reversal.[90] However, the countervailing policy, indeed the policy undergirding the entire bankruptcy system, is to allow the debtor a fresh start and to protect creditors from each other by an orderly and equitable distribution of the debtor's assets as repayment to the creditors.[91] This is true even when the creditors do not participate in the bankruptcy proceeding.[92] Indeed, both sides of the split cite apparently conflicting language in *Hood*.[93] Though it will likely be overturned, the use

87. *Id.*

88. This analysis assumes that the adversarial proceeding would then actually take place. After allowing for that assumption, it is clear that the suit would end with a judgment on its merits, the parties would be identical (or in privity to the original parties) in any future suit, the potential future suit would be based on the same cause of action (an undue burden determination), and the parties would have had a full and fair opportunity to litigate the claim in the prior suit. *See generally Nwosun v. Gen. Mills Rests., Inc.*, 124 F.3d 1255, 1257 (10th Cir. 1997) (describing the four required elements for res judicata to attach).

89. *In re* Mersmann, 505 F.3d 1033, 1038, 1047-48 (10th Cir. 2007) (holding that "[d]ischarge-by-declaration deserves no preclusive effect").

90. *See* Smith v. Rockett, 522 F.3d 1080, 1085 (10th Cir. 2008) (O'Brien, J., dissenting) (calling on Congress, not judges, to make the final policy decision on whether undue burden could be proven by an undisputed declaration in the student debtor's bankruptcy plan while adhering to the precedential authority of *In re* Mersmann).

91. *See* COLLIER, *supra* note 18, at P 1.03 (describing the two general purposes of the Bankruptcy Code).

92. Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 447 (2004).

93. Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1202 (9th Cir. 2008); *In re* Mersmann, 505 F.3d 1033, 1047-48 (10th Cir. 2007).

by the Ninth Circuit of *Hood* in its *Espinosa* reasoning is legitimate for the time being, given that the Ninth Circuit can safely ignore the parts of *Hood* that are *dicta*.

C. Applying the Twenty-Five-Year Repayment Term of the ICRP to a Bankruptcy Discharge

Two cases in the First Circuit develop reasoning under the Bankruptcy Code that proves to be a good solution when applied to the problems of res judicata and appropriate notice in the context of a showing of undue burden, despite the fact that the cases themselves are unconcerned with res judicata and notice.

Austin v. Educational Credit Management Corp. (*In re* Austin)[94] first develops the application of the twenty-five-year ICRP repayment term to a bankruptcy discharge of a student debtor's educational loan. The debtor in this case, Ms. Marcella Austin, filed suit against three student loan creditors that held her educational loans.[95] It is interesting to note that a default judgment was entered against two of the creditors, allowing immediate discharge of her loans with respect to those creditors.[96] However, one of her creditors, Educational Credit Management Corporation (ECMC), objected to the discharge, instigating an adversarial proceeding to show that the loan was an undue burden.[97] Additionally, Ms. Austin claimed that she completely satisfied the prongs of the *totality of the circumstances* test by "suffering from a variety of medical problems" and not having "the current ability to make payments on her remaining student loans."[98] However, the judge noted that Ms. Austin had not met all of the elements of the *totality of the circumstances* test because she had not shown that her medical condition would continue into the future.[99] Despite this setback, Ms. Austin successfully cited the potential tax liability of the discharge of the ECMC loan through the ICRP as a reason that the loan would be an undue burden, even if she paid nothing during the ICRP repayment term.[100] The judge thus ruled that "if there is a balance [at the end of Ms. Austin's ICRP repayment term] . . . payment of the tax on the amount to be forgiven would impose an undue burden . . . and hence [is] dischargeable under 11 U.S.C. § 523(a)(8)."[101] This ruling effectively converted Ms. Austin's ICRP repayment term into a twenty-five-year

94. No. 03-18868 WCH, 2005 WL 3320568 (Bankr. D. Mass. Oct. 19, 2005).
95. *Id.* at *1.
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*

contingent bankruptcy discharge, with the final decision on the discharge of her student loan occurring at the end of the twenty-five years as any tax liability would prove an undue burden. Her student loan itself, the amortized interest, and the accrued interest would be discharged by the ICRP.

The court in *In re Brunell*[102] used similar reasoning, but reserved additional oversight over the discharge during the twenty-five-year ICRP repayment term. The student debtor in this case, Ms. Jennifer Brunell, initially filed a complaint against her student loan creditors to show that her loans were an undue burden under 11 U.S.C. 523(a)(8).[103] Again, several of Ms. Brunell's creditors failed to answer the notice to the adversarial proceeding, and the court entered a default judgment against those creditors.[104] However, ECMC once again intervened on behalf of one of the creditors, presumably to do better than it had against Ms. Austin.[105] In this case, Ms. Brunell owed $200,245.77 on her student loans, and the normal monthly payment over a thirty-year repayment term would be $1,298.77.[106] However, Ms. Brunell earned only $37,000 per year and had a potential earning range of up to $38,000 per year with additional increases likely in the future.[107] Additionally, Ms. Brunell received some of her income, $704 per month, in the form of child support from her ex-husband.[108] After expenses necessary to maintain a minimal standard of living (as required by this court's use of the *totality of the circumstances* test), the court determined Ms. Brunell's disposable monthly income to be $190.54.[109] Even though the ICRP minimum payment would likely be $260.83 per month, slightly more than her disposable monthly income, the judge ruled that Ms. Brunell's student loans were not dischargeable in bankruptcy.[110] The judge relied on the prospect for Ms. Brunell to increase her future income, as well as the proposition that "financial adversity alone is not sufficient to have a student loan debt discharged on the basis of undue hardship."[111] Indeed, "cut[ting] her expenses by approximately $70 to $110 in order to be able to make payments on the student loan" is "a reasonable requirement in order to be able to manage her student loan

102. 356 B.R. 567 (Bankr. D. Mass. 2006).
103. *Id.* at 568.
104. *Id.*
105. *Id.* at n.1.
106. *Id.* at 569.
107. *Id.* at 570-71.
108. *Id.* at 571.
109. *Id.* at 575-77.
110. *Id.* at 578.
111. *Id.* (citing Bourque v. Educ. Credit Mgmt. Corp. (*In re* Bourque), 303 B.R. 548, 550 (Bankr. D. Mass. 2003).

obligations and qualify for the favorable treatment of the ICR Plan."[112] The bankruptcy judge essentially annexed the ICRP as an adjunct of the bankruptcy court. Rather than overseeing a discharge over a period of three to five years, a typical length for a Chapter 13 discharge, the court cited the deferments and forbearances available to the student debtor in the ICRP "should something drastic happen in her circumstances" to maintain, essentially, oversight of a twenty-five-year discharge of the student loan, with the ICRP administering the discharge.[113] This converted the ICRP, with its yearly readjustments for payment based on determinations of a debtor's ability to pay, into a quasi-undue burden determination performed yearly based on changes in Ms. Brunell's circumstances. Also, the court did reserve judgment on two very important aspects of the discharge.[114] The first of these issues, like *Austin*, involved the ICRP discharge and the potential for tax liability as a result of the ICRP discharge being a large amount.[115] The *Brunell* court held that *any* tax liability at the end of the ICRP term, coinciding with the end of Ms. Brunell's working life, would be an undue burden and thus dischargeable at that time.[116] The *Brunell* court also reserved judgment in the circumstance where Ms. Brunell would be unable to enter the ICRP (or otherwise would be adversely financially affected) such that it would reconsider a discharge of her loans by a determination of undue hardship if she could not enter or remain in the ICRP.[117]

While both of these cases involved actual adversarial proceedings, there is no legal or logical barrier to applying the twenty-five-year ICRP term to eligible student debtors and appending an automatic bankruptcy discharge of any remaining liability, tax or otherwise, to the end of the ICRP repayment term. Essentially, a bankruptcy court may invoke the twenty-five-year ICRP term and append it to a bankruptcy discharge of any student loan under its broad equitable powers.[118] Further, this could be applied to any student debtor, not just those eligible for the ICRP, as long as the debtor was not using the bankruptcy code fraudulently.[119] If the

112. *Brunell*, 356 B.R. at 579.

113. *Id.* at 580. The court specifically referenced the possibility that Ms. Brunell would cease to receive child support payments. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *See* 11 U.S.C. § 105 (2006) (describing the power of the courts to issue any order "necessary or appropriate to carry out the provisions of [the] title").

119. However, the bankruptcy court would potentially have to administer the twenty-five-year discharge for debtors who could not directly enter the ICRP due to income-qualification limitations, or who could not remain in the ICRP the full twenty-five years until the ICRP discharge occurs. Such a scenario would likely run afoul of the requirement that a Chapter 13 discharge be limited to no more than five years. 11 U.S.C. 1322(d)

bankruptcy court were to apply the twenty-five-year discharge, res judicata would matter little, for the creditor would have twenty-five years in which to bring an adversarial proceeding against a student debtor attempting a discharge-by-declaration (and would have little incentive to do so after the application of the ICRP terms to the bankruptcy discharge). Additionally, any notice problems would be resolved by the student loan creditor bringing an adversarial proceeding (and having plenty of time in which to do so), or by the creditor receiving notice from the Department that the student debtor had applied for the ICRP. Finally, a twenty-five-year bankruptcy discharge, in most cases, would leave both the student debtor and the creditor in the same position as they would be under the ICRP itself. The IRS is the only party which stands to lose a significant amount under this scenario (an amount that is likely uncollectible, and is certainly highly speculative anyway given the length of the ICRP term and the pending changes to the ICRP regulations). Creditors can fare much better under the ICRP than they do in a bankruptcy discharge, especially given the circuit split, because they will often receive either nothing—if the loan is discharged, or very little—if the debtor is forced into the ICRP outside of bankruptcy.

Additionally, by extending the discharge within bankruptcy to match the twenty-five-year repayment term of the ICRP, the creditor has sufficient time to instigate an adversarial proceeding where undue burden may be litigated, the creditor's rights are no more substantially affected by the bankruptcy determination of undue hardship even if done by declaration, and the long length of the ICRP repayment term as transmogrified into a bankruptcy discharge term mitigates the preclusive effects of res judicata. This creative solution would resolve the circuit split on res judicata and appropriate notice, and also leave the parties as well off as they would be under non-bankruptcy law.

IV. CONCLUSION: WHILE EITHER A RULING BY THE SUPREME COURT OR THE PRINCIPLES DERIVED FROM THE FIRST CIRCUIT BANKRUPTCY COURTS RESOLVE THE CIRCUIT SPLIT, THE LATTER IS PREFERABLE

Student debtors seeking a discharge of their student loans in bankruptcy face the high hurdle of showing that the loans are an undue burden, both at the time of filing and continuing for the life of the loans. The Ninth Circuit's *Espinosa* ruling is a lenient ruling for student debtors, especially considering the legislative history of the undue burden provision, the congressional intent behind the undue burden provision, and the other

(2006). The likelihood of this scenario could be a significant drawback to applying the ICRP to a bankruptcy discharge, unless the Department proves successful in its attempts to relax the qualification requirements of the ICRP.

circuits' opinions. Given the inconsistencies in the Ninth Circuit's opinion and the *dicta* in *Hood*, the Supreme Court is likely to rule against the Ninth Circuit's leniency toward student debtors. Because the Ninth Circuit's opinion is likely out of line with an eventual determination by the Supreme Court, the reasoning used by the First Circuit is a potentially better resolution that appropriately balances the interests of both student debtors and their creditors.

It is certainly in the best interests of student debtors to argue for a bankruptcy discharge under the terms of the ICRP as they stand to avoid both overly burdensome repayments and the potential for the huge tax liability they would face were they to enter directly into the ICRP and have their loans discharged through that mechanism alone. They may also avoid much of the undue burden showing necessary to discharge all of their loans during the bankruptcy proceeding itself. Even if the regulations being developed by the Department to end income tax liability for ICRP loan forgiveness and allow more student debtors to qualify for the ICRP were adopted, the First Circuit's reasoning could apply more directly to all student debtors. Applying this reasoning could also avoid a potential conflict posed by a change in the regulations that the ICRP be available only for low-income students. Though such a bankruptcy discharge entails a lengthy term of repayment, student debtors avoid the uncertainty of a res judicata decision, which may void their student loan bankruptcy discharge years after completion of a bankruptcy plan. Student debtors may also save the cost of litigating an undue burden proceeding. Student loan creditors also are likely better off as they will receive some repayment under the ICRP-like payments made by the student debtor during the twenty-five-year bankruptcy discharge and will also save the costs of litigating an undue burden proceeding, or they will, at the very least, have significant time to determine whether undue burden litigation is worth pursuing despite the cost. Of course, despite the best efforts to balance the rights and positions of the debtor-creditor relationship, the entire analysis of an extended repayment term is subject to the ever-present caveat "creditors have better memories than debtors."[120]

120. Wood, *supra* note 16, at 49 (attributing the quote to Benjamin Franklin).