

# Washington University Law Review

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Volume 73 | Issue 1

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January 1995

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### Recommended Citation

Seth J. Gerson, *Separate Classification of Student Loans in Chapter 13*, 73 WASH. U. L. Q. 269 (1995).  
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# SEPARATE CLASSIFICATION OF STUDENT LOANS IN CHAPTER 13

## I. INTRODUCTION

“One of the primary purposes of the bankruptcy act is to ‘relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.’”<sup>1</sup> The United States Supreme Court has determined that courts should construe the bankruptcy laws so as to effectuate this “fresh start” principle.<sup>2</sup> While most debts are dischargeable, the Bankruptcy Code exempts certain debts from discharge.<sup>3</sup> Educational loans are nondischargeable in both Chapter 7 (“Liquidation Bankruptcy”)<sup>4</sup>

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1. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (quoting *Williams v. U.S. Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915)). Although *Local Loan* involved the Bankruptcy Act, which was replaced by the current Bankruptcy Code in 1978, the primary goals of bankruptcy legislation have remained the same. *See, e.g., Curry v. Metropolitan Dade County (In re Curry)*, 148 B.R. 966, 971 (S.D. Fla. 1992) (citing *Local Loan* for “fresh start” policy).

2. 292 U.S. at 245.

3. 11 U.S.C. § 523 (1988 & Supp. IV 1992) excludes certain taxes, money and credit obtained by false pretenses or actual fraud, child support, alimony, student loans, willful and malicious injury awards, and other debts from discharge in a Chapter 7. *See infra* notes 33-39 and accompanying text. 11 U.S.C. § 1328(a) (1988 & Supp. IV 1992) excludes child support, alimony, student loans, judgments for drunk driving, and restitution payments from discharge in a Chapter 13. The Chapter 13 discharge provision is more liberal than its counterpart in Chapter 7. *See infra* notes 46-50 and accompanying text.

4. Section 523(a)(8) states:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

....  
(8) 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 for an obligation to repay funds received as an educational benefit, scholarship or stipend, unless—

(A) such loan, benefit, scholarship, or stipend overpayment first became due more than 7 years (exclusive of any applicable suspension of the repayment period) before the date of the filing of the petition; or

(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor’s dependents[.]

11 U.S.C. § 523(a)(8) (1988 & Supp. IV 1992).

This Note will not examine the “undue hardship” standard of § 523(a)(8)(B), which allows student loans to be discharged even though they were not repaid. Courts have imposed very strict limitations on a debtor’s use of the “undue hardship” exception. *See In re Roberson*, 999 F.2d 1132, 1135 (7th Cir. 1993) (adopting the undue hardship test promulgated by the Second Circuit in *Brunner v. New York State Higher Educational Services Corp.*, 831 F.2d 395 (2d Cir. 1987)).

According to the Second Circuit, the undue hardship test requires a three-part showing: (1) that

and Chapter 13 (“Wage Earners” Plan).<sup>5</sup> This designation means that a debtor will be burdened by preexisting educational debt even after emerging from bankruptcy.

In an attempt to avoid this outcome, Chapter 13 debtors have frequently tried to classify their nondischargeable student loans separately for full repayment under § 1322(b)(1) of the Bankruptcy Code.<sup>6</sup> Under Chapter 13, the debtor submits to the court a plan for repaying creditors. If the court approves the plan and the debtor makes all payments under the plan, the court will grant a discharge of the debtor’s remaining debts, except those, such as student loans, that are statutorily designated as nondischargeable. If permitted by the courts, many debtors would choose to classify their student debt separately and propose to repay this class of unsecured debt in full, while paying a lesser percentage of the unsecured debt outside of this class.<sup>7</sup> This type of plan allows debtors to exit bankruptcy without continuing debt obligations and preserves their “fresh start.”<sup>8</sup> However, many bankruptcy courts have refused to confirm such Chapter 13 plans because they believe such plans “unfairly discriminate” against other

the debtor cannot maintain, based on current income and expenses, a ‘minimal’ standard of living for himself and his 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. *Brunner*, 831 F.2d at 396.

5. Section 1328(a)(2) states:

(a) As soon as practicable after completion by the debtor of all payments under the plan, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt—

....

(2) of the kind specified in paragraph (5) or (8) of section 523(a) or 523(a)(9) . . . .  
11 U.S.C. § 1328(a)(2) (1988 & Supp. IV 1992).

6. Section 1322(b)(1) states:

(b) Subject to subsections (a) and (c) of this section, the plan may—

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but *may not discriminate unfairly* against any class so designated; 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[.]

11 U.S.C. § 1322(b)(1) (1988) (emphasis added).

Section 1122(a) (1988) states: “(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.” 11 U.S.C. § 1122(A) (1988).

7. See *infra* text accompanying notes 66-71 and accompanying text.

8. See *infra* notes 19-33 and accompanying text (discussing the goal of preserving a “fresh start” for debtors and how the specific provisions of the Bankruptcy Code are designed to achieve this aim).

unsecured creditors.<sup>9</sup>

This Note explores the controversy surrounding separate classification of educational debt by examining, in Part II, the history and policy behind bankruptcy laws generally. Part III addresses relevant provisions of Chapter 13 and the purposes behind Chapter 13. Part IV discusses the educational loan program and its interplay with the Bankruptcy Code. Part V outlines some of the current case law to demonstrate the variety of ways in which courts have handled this issue. In Part VI, the author argues that separate classification of educational debt in Chapter 13 repayment plans should be permitted because the resulting repayment is consistent with both the established nondischargeability of student loans and the fundamental purposes behind the Bankruptcy Code and Chapter 13.

## II. HISTORY AND DOCTRINES BEHIND THE BANKRUPTCY LAWS

Current bankruptcy law is the result of a long evolution that began well before Congress established a federal law of bankruptcy.<sup>10</sup> Debt collection has been one of the cornerstones of bankruptcy law since its origin in Roman jurisprudence.<sup>11</sup> Over time, however, the “fresh start” doctrine has attained increasing importance in bankruptcy law.

The “fresh start” doctrine is a relatively recent addition to the goals of bankruptcy policy.<sup>12</sup> Roman law, for example, permitted a creditor to imprison his delinquent debtors at the creditor’s house, shackled in sixty-pound chains, for sixty days without food.<sup>13</sup> Following this confinement period, the creditor could legally kill his debtor or sell him into slavery.<sup>14</sup> The practice of arresting, imprisoning, and even executing debtors was also an integral part of early English bankruptcy law.<sup>15</sup> Early American

9. See 11 U.S.C. § 1322(b)(1) (1988) (prohibiting unfair discrimination against any particular class of creditors); see also *infra* notes 122-46 and accompanying text.

10. See generally 1 COLLIER ON BANKRUPTCY ¶¶ 0.01-0.07 (14th ed. 1974), describing the development of bankruptcy law in America from the Articles of Confederation through the Bankruptcy Act amendments of 1938. The first concerted attempt to establish a uniform and permanent federal law of bankruptcy came in the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898) (repealed 1978).

11. Michael J. Donovan, Note, *Criminal Restitution and Bankruptcy Code Discharge—Another Case for Defining the Scope of Federal Bankruptcy Law*, 65 NOTRE DAME L. REV. 107, 125 (1989).

12. See *infra* notes 13-17 and accompanying text (discussing prior practices under bankruptcy law that focused on punishing the debtor).

13. Frank R. Kennedy, *Reflections on the Bankruptcy Laws of the United States: The Debtor's Fresh Start*, 76 W. VA. L. REV. 427, 428-29 (1974) (citation omitted).

14. *Id.*

15. *Id.* at 430 (“By the time of Blackstone all common courts were allowing arrest and body execution routinely in civil actions for collection of debts.”). During debate at the American

bankruptcy law, however, rejected the barbaric treatment of debtors and adopted a remedial rather than a punitive approach.<sup>16</sup> The first American bankruptcy act, instituted in 1800, reflected a recognition of bankruptcy's inevitable and intricate relationship to the growing commercial economy.<sup>17</sup> The fresh start concept emerged from the realization that debtors can find themselves, through little personal fault, subject to an insurmountable amount of debt.

In pursuit of its two fundamental goals, federal bankruptcy policy attempts to ensure equitable distribution of a debtor's assets among his creditors,<sup>18</sup> and to afford individual debtors a new financial beginning, a fresh start.<sup>19</sup> The rapid rise of consumer debt in this century has increased the emphasis placed on the fresh start doctrine.<sup>20</sup> For many courts and commentators, the need to give debtors a new lease on life is now the overriding goal of bankruptcy policy.<sup>21</sup>

The Bankruptcy Code of 1978 greatly expanded the scope of the fresh start previously available under the Bankruptcy Act of 1898.<sup>22</sup> The current fresh start policy is primarily embodied in the discharge,<sup>23</sup> automatic stay,<sup>24</sup> and permanent injunction<sup>25</sup> provisions of the Bankruptcy Code.

Constitutional Convention of 1787, representative Roger Sherman observed that bankruptcies were frequently punishable by death under English law. James M. Olmstead, *Bankruptcy A Commercial Regulation*, 15 HARV. L. REV. 829, 831 (1902).

16. See Kennedy, *supra* note 13, at 431 n.15.

17. See Olmstead, *supra* note 15, at 833.

18. ELIZABETH WARREN & JAY L. WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 199 (2d ed. 1991).

19. *Id.*

20. DAVID T. STANLEY & MARJORIE GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 18-40 (1971) (observing the interrelation of the increase of personal bankruptcies, personal debt, and debt income ratio between 1945 and 1970).

21. See WARREN & WESTBROOK, *supra* note 18, at 200.

22. To illustrate this point, compare the discharge provisions of the current Bankruptcy Code, as codified at 11 U.S.C. §§ 523, 727 and 1328 (1988 & Supp. IV 1992) with the discharge provisions of the Bankruptcy Act of 1898, as codified in sections 14-17 of the Act, ch. 541 30 Stat. 544, 550-51 (1898) (repealed 1978).

23. See 11 U.S.C. §§ 523, 727, 1328 (1988 & Supp. IV 1992).

24. See 11 U.S.C. § 362 (1988 & Supp. IV 1992).

25. 11 U.S.C. § 524 provides in relevant part:

(a) A discharge in a case under this title—

....

(2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor . . . ; and

(3) operates as an injunction against the commencement or continuation of an action, . . . to collect or recover from, or offset against, property of the debtor . . . .

11 U.S.C. § 524 (1988).

Although the fresh start doctrine and the policy of debt collection and equitable distribution to creditors are both fundamental purposes of bankruptcy law, the two goals often conflict.<sup>26</sup> The social and economic policy underlying the fresh start doctrine is distinct from the policies underlying the goal of equitable distribution to creditors. The fresh start concept, intended to relieve the debtor of prebankruptcy financial burdens, is debtor-oriented, while the goal of equitable distribution, directed toward helping creditors recoup money owed to them by the bankrupt debtor, obviously favors creditors.<sup>27</sup> Congress' attempt to balance these two opposing interests is manifested in the discharge and automatic stay provisions of the Bankruptcy Code:<sup>28</sup> the provisions affording discharges to individual debtors reflect the "fresh start" policy,<sup>29</sup> while the several exceptions to discharge reflect a desire to protect certain creditors' interests.<sup>30</sup>

An insolvent individual has two alternatives by which to achieve a fresh start through a bankruptcy proceeding: a Chapter 7 liquidation or a Chapter 13 adjustment of debts. Typically, a debtor who files or is involuntarily forced into a Chapter 7 liquidation must relinquish all nonexempt assets to the trustee in bankruptcy.<sup>31</sup> The trustee then sells all of the debtor's assets, distributing the sale proceeds to the creditors who have filed claims against the estate.<sup>32</sup> In most cases, following the distribution of assets, the Bankruptcy Code discharges the debtor from any remaining debt, thereby providing the debtor with an immediate fresh start.<sup>33</sup> For certain classifica-

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26. See Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1395-99 (1985).

27. *Id.* at 1395-96.

28. See 11 U.S.C. §§ 727, 1328, 362 (1988 & Supp. IV 1992). *But see* 11 U.S.C. § 523(a) (1988 & Supp. IV 1992) (limiting scope of fresh start policy through twelve exceptions to discharge).

29. See WARREN & WESTBROOK, *supra* note 18, at 199.

30. *Id.* at 250-51; see also *Boyle v. Abilene Lumber, Inc. (In re Boyle)*, 819 F.2d 583, 587 (5th Cir. 1987) ("The general policy of bankruptcy law favors allowing the debtor to discharge debts and to make a fresh start. This policy, however, is subject to exceptions for certain types of debts . . .") (citation omitted).

31. See 11 U.S.C. § 704(1) (1988). 11 U.S.C. § 522 (1988 & Supp. IV 1992) permits a debtor to exempt from property of the estate certain assets, including a fixed value of the debtor's residence, automobile, household furnishings, and tools of the trade. Section 522 also contains a catch-all exception that covers items not falling under one of the enumerated sections. 11 U.S.C. § 522(b)(2) (1988).

32. Section 704(1) states: "The trustee shall (1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest[.]" 11 U.S.C. § 704(a) (1988).

33. Section 727 is the Chapter 7 discharge section. See 11 U.S.C. § 727 (1988 & Supp. IV 1992).

tions of debt, however, Congress determined that overriding public policy concerns required exclusion of these debts from the general discharge.<sup>34</sup> Consequently, the Code specifically excludes twelve types of debt from discharge in a Chapter 7, including certain tax debts,<sup>35</sup> educational loans,<sup>36</sup> child support and alimony,<sup>37</sup> debt incurred through willful and malicious conduct<sup>38</sup> and through drunk driving accidents.<sup>39</sup> The procedures and policies underlying Chapter 13 warrant separate attention.

### III. POLICY AND PROVISIONS OF CHAPTER 13

Congress enacted Chapter 13 as an alternative to Chapter 7. It was evident from the initial passage of the 1978 Bankruptcy Reform Act (instituting the current Bankruptcy Code) that Congress intended Chapter 13, rather than Chapter 7, to be the chapter of choice for most consumer debtors.<sup>40</sup> The reasons for this now-established preference are well publicized; they include the historically meager return to unsecured creditors in Chapter 7 liquidations,<sup>41</sup> the preservation of the fresh start,<sup>42</sup> and Chapter 13's emphasis upon payment, rather than discharge, of unsecured debt.<sup>43</sup>

34. The public policy concerns behind most of the exceptions relate to the importance of each type of debt. Congress did not want to provide a debtor with the opportunity to evade debt obligations such as child support, alimony, judgments against the debtor for causing willful and malicious injury, and student loans by merely filing for bankruptcy. The economic and social impact of such actions would be devastating. *See* Education Amendments of 1976, Pub. L. No. 94-482, § 439A, 90 Stat. 2081, 2041 (codified at 20 U.S.C. § 1087-3 (1976) (repealed 1978)) (discussing and implementing discharge limitation for educational loans).

35. 11 U.S.C. § 523(a)(1) (1988).

36. 11 U.S.C. § 523(a)(8) (1988 & Supp. IV 1992). *See supra* note 4 for the text of this provision.

37. 11 U.S.C. § 523(a)(5) (1988).

38. 11 U.S.C. § 523(a)(6) (1988).

39. 11 U.S.C. § 523(a)(9) (1988 & Supp. IV 1992).

40. Congress initially appointed the Commission on the Bankruptcy Laws of the United States, an independent group of judges and private citizens, to evaluate the bankruptcy system and make suggestions for reform. The Commission concluded that Chapter 13 bankruptcy should be encouraged as an alternative to Chapter 7. COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. 1, at 157-59 (1973) [hereinafter BANKRUPTCY COMMISSION REPORT].

41. TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 303-04 (1989) (reporting that 87% of Chapter 7 debtors surveyed paid nothing to unsecured creditors from the sale of assets).

42. *See* 5 COLLIER, *supra* note 10, ¶ 1300.02 (15th ed. 1994) (explaining that purpose of Chapter 13 is to give fresh start to debtors).

43. *See* S. REP. NO. 65, 98th Cong., 1st Sess. 22 (1983) ("Chapter 13 relief . . . contemplates a substantial effort by the debtor to pay his debts.").

### A. Congress' Preference for Chapter 13

Congress provided two major statutory incentives to encourage prospective debtors to choose Chapter 13 instead of Chapter 7. First, Chapter 13 allows debtors to retain their assets upon filing for bankruptcy.<sup>44</sup> In contrast, Chapter 7 requires a debtor to surrender all the property of his estate to the trustee.<sup>45</sup> Second, Chapter 13 contains more liberal discharge provisions.<sup>46</sup> Chapter 13 exempts from discharge only long-term obligations running beyond the term of the plan,<sup>47</sup> child support and alimony payments, educational loans, judgments for drunk driving,<sup>48</sup> and criminal restitution payments;<sup>49</sup> Chapter 7 excludes twelve classifications of debt from discharge.<sup>50</sup>

There are also nonstatutory incentives for a debtor to choose Chapter 13. The successful completion of a Chapter 13 plan provides debtors with the psychological satisfaction of repaying at least some portion of their debts.<sup>51</sup> Filing under Chapter 13 rather than Chapter 7 also benefits the debtor's credit rating. Creditors perceive debtors who attempt to repay at least some of their debts as a safer risk than those who completely discharge their debts through liquidation.<sup>52</sup> Finally, some courts have

44. 11 U.S.C. § 1306(b) (1988) ("Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.").

45. 11 U.S.C. § 704(1) (1988).

46. Section 1328(a) states:

(a) As soon as practicable after completion by the debtor of all payments under the plan, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt-

(1) provided for under section 1322(b)(5) of this title;

(2) of the kind specified in paragraph (5) or (8) of section 523(a) or 523(a)(9) of this title; or

(3) for restitution included in a sentence on the debtor's conviction of a crime.

11 U.S.C. § 1328(a) (1988 & Supp. IV 1992). The Chapter 7 discharge provision imposes substantial limitations and restrictions on the granting of a discharge. *See* 11 U.S.C. § 727 (1988).

47. 11 U.S.C. § 1328(a)(1) (1988 & Supp. IV 1992).

48. 11 U.S.C. § 1328(a)(2) (1988 & Supp. IV 1992).

49. 11 U.S.C. § 1328(a)(3) (1988 & Supp. IV 1992).

50. 11 U.S.C. § 523(a)(1)-(12) (1988 & Supp. IV 1992).

51. *See* H.R. REP. NO. 595, 95th Cong., 1st Sess. 118 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6079 ("[Chapter 13] satisfies many debtors' desire to avoid the stigma attached to straight bankruptcy and to retain the pride attendant on being able to meet one's obligations."); *see also* *Ravenot v Rimgale (In re Rimgale)*, 669 F.2d 426, 427 (7th Cir. 1982) (noting that Chapter 13 plans allow debtors to avoid the stigma of straight bankruptcy).

52. H.R. REP. NO. 595, *supra* note 51, at 118, *reprinted in* 1978 U.S.C.C.A.N. at 6079 ("Chapter 13 also protects a debtor's credit standing far better than a straight bankruptcy, because he is viewed by the credit industry as a better risk.").



interpreted § 707(b)<sup>53</sup> of the Code to allow a judge to dismiss a case filed under Chapter 7 if a greater percentage of the debtor's debt could be paid in a Chapter 13 plan.<sup>54</sup>

### B. *Mechanics of Chapter 13*

Although Congress encouraged individual debtors to file under Chapter 13, it also established certain requirements that a debtor must meet to be eligible to file for bankruptcy under Chapter 13. Initially, Chapter 13 requires a debtor to "have regular income."<sup>55</sup> While this income usually comes from wages, practically any source may qualify, including social security payments, unemployment compensation, and welfare benefits.<sup>56</sup> In addition, the debtor must have, on the date of filing, noncontingent, liquidated, unsecured debts amounting to less than \$100,000 and noncontingent, liquidated, secured debts amounting to less than \$350,000.<sup>57</sup> Any debtor who meets these relatively liberal requirements may file a Chapter 13 bankruptcy.

The Chapter 13 debtor must submit a payment plan to the court for approval.<sup>58</sup> While this plan must satisfy numerous requirements, the plan essentially must clear three major hurdles before receiving approval. First, 11 U.S.C. § 1325(a)(3) requires the debtor to propose the plan "in *good faith* and not by any means forbidden by law."<sup>59</sup> Bankruptcy courts apply the "good faith" test differently, but this criterion frequently plays a

53. Section 707(b) states:

(b) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a *substantial abuse* of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. § 707(b) (1988) (emphasis added).

54. See, e.g., *In re Walton*, 866 F.2d 981, 982-85 (8th Cir. 1989) (holding that the filing of a Chapter 7 bankruptcy by a debtor able to pay his debts out of future income constitutes a "substantial abuse" of the provisions of Chapter 7; thus, such a case should be dismissed or converted to a Chapter 13).

55. 11 U.S.C. § 109(e)(1988) states: "(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$100,000 and noncontingent, liquidated, secured debts of less than \$350,000 . . . may be a debtor under Chapter 13 of this title." An individual with regular income is defined as one "whose income is sufficiently stable and regular to enable such individual to make payments under a plan under Chapter 13 of this title, other than a stockbroker or a commodity broker[.]" 11 U.S.C. § 101(30) (1988 & Supp. IV 1992).

56. See S. REP. NO. 989, 95th Cong., 2d Sess. 24, reprinted in 1978 U.S.C.C.A.N. 5787, 5810.

57. 11 U.S.C. § 109(e) (1988); See *supra* note 55 for relevant text of the statute.

58. 11 U.S.C. §§ 1321-1322 (1988).

59. 11 U.S.C. § 1325(a)(3) (1988) (emphasis added).

substantial role in the approval decision. For example, courts will often deny confirmation of a Chapter 13 plan that is obviously filed solely to discharge debts that are nondischargeable in Chapter 7, such as debts for willfully and maliciously injuring another person.<sup>60</sup> Second, the plan must propose to pay unsecured creditors at least as much of their claims as these creditors would have received in a Chapter 7 bankruptcy.<sup>61</sup> This requirement, known as the “best interests” test, assures unsecured creditors that they will fare no worse in a Chapter 13 than they would have fared in a Chapter 7 liquidation.<sup>62</sup> Moreover, the “best interests” test is consistent with Chapter 13’s policy emphasis on payment of debt rather than discharge.<sup>63</sup> Finally, if the trustee or an unsecured creditor objects to confirmation of the debtor’s plan, the court will not approve the plan unless it commits all of the debtor’s disposable income over the duration of the plan to repayment of creditors.<sup>64</sup> The typical Chapter 13 plan extends over a period of three years, although the court can approve a plan extending up to five years if the debtor can establish sufficient cause.<sup>65</sup>

A Chapter 13 debtor need not afford all of his unsecured creditors the

60. See *In re Cole*, 3 B.R. 346 (Bankr. S.D. W. Va. 1980) (denying confirmation of a Chapter 13 plan based on “good faith” test where debtor’s primary debt would have been nondischargeable in Chapter 7 as one arising out of willful injury, and debtor had only one debt of a significant amount).

61. Section 1325(a)(4) states:

[T]he court shall confirm a plan if—

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed *unsecured claim* is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under Chapter 7 of this title on such date[.]

11 U.S.C. § 1325(a)(4) (1988) (emphasis added).

62. See *id.*; see also 2 DAVID G. EPSTEIN ET AL., *BANKRUPTCY* §§ 9-10 (1992).

63. See *supra* note 43 and accompanying text.

64. Section 1325(b)(1)(B) states:

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan-

.....

(B) the plan provides that all of the debtor’s projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(2) For purposes of this subsection, “disposable income” means income which is received by the debtor and which is not reasonably necessary to be expended-

(A) for the maintenance or support of the debtor or a dependent of the debtor; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

11 U.S.C. § 1325(b)(1)(B) (1988).

65. 11 U.S.C. § 1322(c)(1988) states: “(c) The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.”

same treatment.<sup>66</sup> Section 1322(b)(1) of the Bankruptcy Code permits the debtor's plan to "designate a class or classes of unsecured claims, as provided in section 1122 of this title, but [the plan] may not discriminate unfairly against any class so designated."<sup>67</sup> Section 1122(a), in turn, states that "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class."<sup>68</sup> Section 1322(b)(1) allows the debtor to provide unequal percentage repayments to various, separate classes as long as the classification does not "discriminate unfairly against" any of the classes.<sup>69</sup> The option to classify certain unsecured creditors separately can serve as a powerful tool for ensuring a debtor's fresh start after bankruptcy. This strategy might allow the debtor to classify nondischargeable debt obligations for full repayment and relegate other unsecured debts to classes receiving only partial repayment under the plan. For example, the Eighth Circuit recently held that a debtor can classify child support arrearages separately under his Chapter 13 plan and repay such debts in full while paying his other unsecured creditors a lesser percentage.<sup>70</sup> This classification relieves the debtor of nondischargeable child support payments after his discharge and, at the same time, achieves the full repayment under the plan of this particular type of debt.<sup>71</sup>

Courts have differed, however, in deciding under what circumstances discrimination among classes of unsecured claims is unfair. Most courts make this determination based on the facts of each particular case.<sup>72</sup> The

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66. See 11 U.S.C. § 1322(b)(1) (1988) (allowing debtors to designate separate classes of unsecured claims); see *supra* note 6 for text of the statute.

67. 11 U.S.C. § 1332(b)(1) (1988) (emphasis added).

68. 11 U.S.C. § 1122(a) (1988).

69. 11 U.S.C. § 1322(b)(1) (1988).

70. *Mickelson v. Leser (In re Leser)*, 939 F.2d 669, 673 (8th Cir. 1991) (holding that placement of child support arrearages "in a separate class is not an unfair discrimination between these and the remaining unsecured claims"). The *Leser* court also looked to the "overwhelming public policy in favor of providing for support of children." *Id.* at 672 (quoting *In re Storberg*, 94 B.R. 144, 147 (Bankr. D. Minn. 1988)).

71. Because certain debts are nondischargeable under § 1328(a)(2), a debtor would have to repay these debts even after his Chapter 13 plan is completed. Therefore, a debtor will attempt to classify these debts separately under § 1322(b)(1) and provide for complete repayment under the plan. If the court approves this classification, the debtor will not be burdened by these nondischargeable debts after bankruptcy because they have already been paid in full under the plan.

72. See, e.g., *In re Freshley*, 69 B.R. 96, 97 (Bankr. N.D. Ga. 1987) ("[T]he determination of unfair discrimination is to be made on a case-by-case basis. This interpretation provides a flexible standard whereby the Court determines what is equitable based on the particular facts in each case.") (citation omitted); *In re Tucker*, 159 B.R. 325, 327-28 (Bankr. D. Mont. 1993) (suggesting "case-by-

most widely used test consists of a four-part inquiry: “(1) whether the discrimination has a reasonable basis; (2) whether the debtor can carry out a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination.”<sup>73</sup> Other courts reject this four-part test and focus solely on the legitimate interests of the debtor as the basis for a test of fairness.<sup>74</sup> The viability of a debtor’s option to classify nondischargeable student loans separately for payment purposes turns on the judicial determination of whether such a preferential classification “discriminates unfairly against” other unsecured creditors.

#### IV. STUDENT LOAN DEBTS IN BANKRUPTCY

There are two principal federal student loan programs: the Perkins Loan Program<sup>75</sup> and the Stafford Loan Program.<sup>76</sup> Congress established the Perkins Loan program under the National Defense Education Act of 1958.<sup>77</sup> Congress established the Stafford Loan program under the Higher Education Act of 1965.<sup>78</sup> The Education Amendments of 1972<sup>79</sup> consoli-

case” analysis of whether Chapter 13 plan unfairly discriminates).

73. *In re Leser*, 939 F.2d at 672 (citation omitted); see also *In re Storberg*, 94 B.R. 144, 146 (Bankr. D. Minn. 1988) (adopting same test); *Groves v. LaBarge*, 160 B.R. 121, 122 (E.D. Mo. 1993) (same).

74. *In re Lawson*, 93 B.R. 979, 984 (Bankr. N.D. Ill. 1988) (“The relevant interests . . . in considering [unfair discrimination] should be the interests of the debtor . . . .”); *In re Brown*, 152 B.R. 232, 240-41 (Bankr. N.D. Ill. 1993). However, *Brown* was later reversed in an opinion that was very critical of the debtor’s perspective standard. *McCullough v. Brown (In re Brown)*, 162 B.R. 506 (N.D. Ill. 1993).

75. This program was known originally as the National Direct Student Loan (NDSL) program.

76. This program was known formerly as the Guaranteed Student Loan (GSL) program.

77. National Defense Education Act of 1958, Pub. L. No. 85-864, 72 Stat. 1580 (codified as amended at 20 U.S.C. §§ 401-602 (1976) and omitted in 1982 and 1988 versions of U.S.C.). Perkins loans are funded by the federal government but the lending institution must match the government’s loan with one-ninth of the amount the government advances. There are ceilings to the amounts that a student may borrow. Borrowers must repay these loans in full within 10 years after a grace period (9 months after completion of school) has expired. See Darrell Dunham & Ronald A. Buch, *Educational Debts Under the Bankruptcy Code*, 22 MEM. ST. U. L. REV. 679, 684-85 (1992).

78. Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (codified as amended in scattered sections of 20 and 42 U.S.C.). Stafford loans are funded by private and governmental lenders and are guaranteed by the Department of Education. Borrowers must demonstrate financial need to receive Stafford loans. Like the Perkins loans, the Stafford loans have amount ceilings and a time period in which to repay the loans after completion of education, as well as deferment and forbearance features. See Dunham & Buch, *supra* note 77, at 683-84.

79. Pub. L. No. 92-318, § 137(b), 86 Stat. 235, 272-73 (1972).

dated assorted student assistance programs under the Higher Education Act to provide financial assistance to a broader base of high school graduates seeking post-secondary education.<sup>80</sup> The federal government guarantees lenders that the government will repay student loans in the event of a borrower's default, bankruptcy, or death. This guarantee is necessary to fund education because most lenders would otherwise refuse to fund a student's pursuit of higher education.<sup>81</sup>

During the period from 1973 to 1975, government loan programs had a profound effect on financing higher education. With tuition rising at colleges and universities, many students relied on these programs to finance their education.<sup>82</sup> By 1975, federal aid programs accounted for an important part of tuition revenues, and colleges and universities eventually began to depend on the loan programs to maintain their enrollments.<sup>83</sup> While taxpayers funded these loan programs initially, Congress assumed that student borrowers would repay their loans from future earnings attributable to their advanced education.<sup>84</sup> The repayments of current student borrowers would help refinance the program for future student borrowers.<sup>85</sup>

However, as the dollar amount of yearly federal loan expenditures increased into the hundreds of millions, concerns developed about the possibility for abuse of the programs.<sup>86</sup> Critics discerned a "loophole" in the student loan programs that theoretically allowed students to discharge

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80. See Caspar W. Weinberger, *Reflection on the Seventies*, 8 J.C. & U.L. 451, 452 (1981). Caspar Weinberger was Secretary of the Department of Health, Education, and Welfare (HEW) from 1973-1975. His article is devoted to recollections of his tenure as HEW Secretary, including his concerns about the student loan program.

81. *Id.* at 454. The government's guarantee is necessary because lenders cannot require collateral or cosigners from student debtors. See Kurt Weise, *Discharging Student Loans in Bankruptcy: The Bankruptcy Court Tests of "Undue Hardship,"* 26 ARIZ. L. REV. 445, 446 (1984).

82. Weinberger, *supra* note 80, at 452.

83. *Id.* In the business of higher education, maintaining student enrollment levels translates directly into the maintenance of an institution's financial well being. See *id.*

84. See *id.* at 455.

85. See *Garmerian v. Rhode Island Higher Educ. Assistance Auth. (In re Garmerian)*, 81 B.R. 4, 5-6 (Bankr. D.R.I. 1987) (citing 125 CONG. REC. S.9160 (daily ed. July 11, 1979) (statement of Sen. DeConcini)).

86. Weinberger, *supra* note 80, at 452-55. The context in which these events arose provides important background to the debate. Educational institutions were already in a defensive posture during the 1960s and early 1970s because of the turbulence and anti-government activities occurring on college campuses. Furthermore, a severe recession hit the country in the mid-1970s. Consequently, government-subsidized student loan programs were especially prone to scrutiny due to the large amount of money they required. *Id.*

completely their student loan debts under the liberal discharge provisions of the then-governing Bankruptcy Act.<sup>87</sup> Neither the bankruptcy laws nor the laws governing the educational loan programs explicitly forbade the discharge of loans in bankruptcy, so these laws presented no possible impediment to discharge.<sup>88</sup>

In 1973, the Congressional Commission on Bankruptcy Laws<sup>89</sup> examined this “loophole” and found no statistical evidence of a problem with discharged loans.<sup>90</sup> However, the Commission was concerned that even a small percentage of discharges would create a negative public image that would discredit,<sup>91</sup> and eventually even threaten the continuance of, the student loan programs.<sup>92</sup> Therefore, the Commission proposed a discharge limitation prohibiting a student debtor from discharging an educational loan debt unless five years had elapsed from the time the loan first became due, or unless an undue hardship would result if the loan were not discharged within the five-year period.<sup>93</sup>

This “loophole” issue gained public notoriety through press reports of students refusing to repay loans and through gross exaggerations of the number of student abuses.<sup>94</sup> In reality, the student loan discharge rate was nominal. For example, a 1976 General Accounting Office report stated that “less than one percent of all matured student loans [were] discharged in bankruptcy.”<sup>95</sup> Notwithstanding the substantive facts, Congress followed the recommendation of the Commission on Bankruptcy. The Education Amendments of 1976 codified verbatim the Commission’s proposal to

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87. *Id.* at 455.

88. *Id.*; see also *In re Holzer*, 33 B.R. 627, 630 (Bankr. S.D.N.Y. 1983).

89. See *supra* note 40.

90. BANKRUPTCY COMMISSION REPORT, *supra* note 40, pt.1, at 170. The Commission cited statistical data from a Department of Health, Education & Welfare report, which showed that the bankruptcy rate within the GSL program was only 0.23% of the total amount of such loans. *Id.* at 178-79 n.5.

91. *Id.* at 170 (“[S]uch abuses discredit the system and cause disrespect for the law and those charged with its administration.”) (citation omitted).

92. *Id.* at 176-77 (“The Commission is of the opinion that not only is this [practice of avoiding educational debt] reprehensible but that it poses a threat to the continuance of educational loan programs.”).

93. BANKRUPTCY COMMISSION REPORT, *supra* note 40, pt.2, at 140. The Commission noted: [A] loan or other credit extended to finance higher education that enables a person to earn substantially greater income over his working life should not as a matter of policy be dischargeable before he has demonstrated that for any reason he is unable to earn sufficient income to maintain himself and his dependents and to repay the educational debt.

*Id.*

94. See *Weise*, *supra* note 81, at 446.

95. *Id.* (citing H.R. REP. NO. 595, 95th Cong., 1st Sess. 133 (1977)).

make educational loans nondischargeable during the five-year period following commencement of repayment.<sup>96</sup> The primary purpose of the discharge limitation was to prevent abuse of the student loan program, especially by students whose future earnings would be sufficient to repay their debts.<sup>97</sup>

Congress addressed this same issue two years later when it drafted the Bankruptcy Reform Act of 1978.<sup>98</sup> Although the original House bill made no provision for student loan debts,<sup>99</sup> the Senate bill contained the same general rule of nondischargeability as the 1976 Education Amendments.<sup>100</sup> Congress decided to incorporate the Senate's version, with some minor adjustments, into the new Bankruptcy Code in § 523(a)(8).<sup>101</sup> In November 1978, Congress voted the 1978 Bankruptcy Reform Act into law, to become effective October 1, 1979.

While § 523(a)(8) severely restricted the dischargeability of educational loans in Chapter 7 cases,<sup>102</sup> this provision was not originally applicable to Chapter 13 cases.<sup>103</sup> Debtors attempting to discharge educational loans, therefore, had incentive to file under the more liberal discharge provisions of Chapter 13.<sup>104</sup> Student borrowers, in effect, had another "loophole" through which to evade their loan obligations. Some courts allowed these debtors to discharge their student loans under Chapter 13 plans that

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96. Education Amendments of 1976, Pub. L. No. 94-482, § 439A, 90 Stat. 2081, 2141 (codified at 20 U.S.C. § 1087-93 (1976) (repealed 1978)).

97. See *Holzer v. Wachovia Servs., Inc. (In re Holzer)*, 33 B.R. 627, 630 (Bankr. S.D.N.Y. 1983) (finding that Congress enacted bar to discharge of student loans to prevent abuse by students shortly after they graduated).

98. 11 U.S.C. §§ 101-1330 (1988 & Supp. IV 1992) (originally enacted as Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549).

99. Wiese, *supra* note 81, at 451 n.56 (citing H.R. REP. NO. 595, 95th Cong., 1st Sess. 132 (1977)).

100. Wiese, *supra* note 81, at 451 n.58.

101. 11 U.S.C. § 523(a)(8) (1988 & Supp. IV 1992). See *supra* note 4 for the relevant text of § 523(a)(8). The statutory period before the end of which a loan may not be discharged was increased from five to seven years in 1990. This extension provides even greater protection for the educational lender because the debtor must now remain in the workplace two years longer before attempting to evade repayment of student debt. See Pub. L. No. 101-647, 104 Stat. 4789, 4964-65 (1990).

102. 11 U.S.C. § 523(a)(8) (1988 & Supp. IV 1992).

103. Until 1990, student loans were dischargeable in a Chapter 13 bankruptcy. See 11 U.S.C. § 1328(a)(2) (Supp. II 1990) (amending 11 U.S.C. § 1328(a)(2) (1988)) (current version at 11 U.S.C. § 1328(a)(2) (Supp. IV 1992)).

104. See *supra* notes 46-50 and accompanying text (showing the more liberal discharge available in Chapter 13).

provided minimal repayment of their educational loans.<sup>105</sup> Other courts denied confirmation of Chapter 13 plans that primarily served the purpose of discharging education debt. These latter courts considered such plans in violation of the “good faith” test<sup>106</sup> of § 1325(a)(3).<sup>107</sup> In 1990, Congress closed this Chapter 13 “loophole” by amending § 1328(a)(2)<sup>108</sup> to include educational loans as nondischargeable debts.<sup>109</sup>

Congress’ quest to close any “loopholes” attests to its desire for complete repayment of educational loan debt. There is a substantial public interest in recovering the payments that the federal government has been required to make on guaranteed student loans, and this public policy concern plays an important role in the analysis of whether a Chapter 13 debtor should be permitted to classify his student loan debts separately.<sup>110</sup>

#### V. CASES ADDRESSING SEPARATE CLASSIFICATION OF STUDENT LOANS UNDER CHAPTER 13

The only type of debt that the Bankruptcy Code specifically permits to be classified separately is individual consumer debt signed by a codebtor.<sup>111</sup> There is neither legislative history nor clear congressional intent concerning the separate classification of student loan debts.<sup>112</sup> Only a few

105. See, e.g., *Phoenix Inst. of Technology v. Klein (In re Klein)*, 57 B.R. 818, 820-21 (Bankr. 9th Cir. 1985) (upholding confirmation of plan that proposed repayment of 22% to National Direct Student Loan lender); *In re Winthurst*, 97 B.R. 457, 458 (Bankr. C.D. Ill. 1989) (confirming plan that proposed repayment of only 1% to State Scholarship Commission); *In re Owens*, 82 B.R. 960 (Bankr. N.D. Ill. 1988) (confirming plan that proposed repayment of only 15% of educational debt to the Department of Health and Human Services).

106. See, e.g., *Ohio Student Loan Comm’n v. Doersam (In re Doersam)*, 849 F.2d 237, 240 (6th Cir. 1988) (affirming denial of confirmation where plan proposed 19% repayment to unsecured creditors, because court believed plan was not proposed in good faith); *In re Castonguay*, 119 B.R. 256, 259 (Bankr. D. Kan. 1990) (denying confirmation of plan proposing 10% repayment to unsecured creditors where over 94% of debt was student loans; held not proposed in good faith); *In re Carpico* 117 B.R. 335 (Bankr. S.D. Ohio 1990) (holding 8% repayment of unsecured claims, 30% of which was educational debt, not proposed in good faith).

107. 11 U.S.C. § 1325(a)(3) (1988). See *supra* notes 59-60 and accompanying text.

108. See *supra* note 5 for text of the statute.

109. See Student Loan Default Prevention Initiative Act of 1990, Pub. L. No. 101-508, § 3007, 104 Stat. 1388-25, 1388-28 (1990) (codified at 20 U.S.C. § 1085). Section 1328(a)(2) now provides that educational loan debts will not be discharged in a Chapter 13 proceeding. See 11 U.S.C. § 1328(a)(2) (1988 & Supp. IV 1992).

110. See *supra* notes 69-71 and accompanying text (discussing why a Chapter 13 debtor would want to separately classify certain unsecured debts).

111. 11 U.S.C. § 1322(b)(1) (1988). See *supra* note 6 for text of the statute.

112. See *In re Smalberger*, 157 B.R. 472, 475 (Bankr. D. Or. 1993) (noting the absence of legislative history or statutory directive on the issue of classifying unsecured claims).



federal district courts and no federal appeals courts have addressed the issue of separate classification of educational debt.<sup>113</sup> Courts that have addressed the issue have taken a number of different approaches. The majority of courts that have considered this issue have refused to confirm Chapter 13 plans that provide for complete repayment of student loans but a lesser percentage for other unsecured creditors.<sup>114</sup> These courts believe that such a plan constitutes “unfair discrimination” in violation of § 1322(b)(1).<sup>115</sup> Other courts allow a Chapter 13 plan to classify student loans preferentially, but only in the manner specified by § 1322(b)(5)<sup>116</sup> of the Code. This provision allows a debtor to cure any default within a reasonable time and maintain payments during the life of the plan.<sup>117</sup> Finally, a minority of courts have confirmed Chapter 13 plans that provide for student loan claims to be paid at a higher percentage than other unsecured claims if the other requirements for confirmation are met.<sup>118</sup>

The issue is further muddled by the treatment courts have afforded claims for alimony, maintenance, and child support. Like educational loans, these family support claims are excepted from discharge in Chapter 13 by § 1328(a)(2),<sup>119</sup> which incorporates the exceptions of § 523(a)(5).<sup>120</sup>

113. Following completion of this Note, the Eighth Circuit became the first federal appeals court to address this specific issue. *In re Groves*, 39 F.3d 212 (8th Cir. 1994). The court recognized a distinction between student loan debt and child support payments and held that the debtors’ separate classification of educational debt was invalid. *Id.* at 215.

114. See *infra* notes 122-46 and accompanying text (reviewing some of the applicable cases that refused to confirm preferential classification of student loan debt).

115. 11 U.S.C. § 1322(b)(1) (1988). See *supra* note 6 for the text of this provision.

116. Section 1322(b)(5) states:

(b) Subject to sections (a) and (c) of this section, the plan may—

....

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due[.]

11 U.S.C. § 1322(b)(5) (1988). See *infra* notes 147-49 and accompanying text.

117. *Id.* See *supra* note 116 for text of this provision.

118. See *infra* notes 150-57 and accompanying text.

119. Section 1328(a)(2) provides that debts specified in 11 U.S.C. § 523(a)(5) cannot be discharged in a Chapter 13 proceeding. See *supra* note 5 for the relevant text of § 1328(a)(2).

120. Section 523(a)(5) states in relevant part:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt-

....

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that-

However, unlike in the student loan context, courts have almost unanimously approved preferential classification of support claims.<sup>121</sup>

In *In re Chapman*,<sup>122</sup> the debtor proposed a Chapter 13 plan that provided for three classes of unsecured debts.<sup>123</sup> One class consisted of cosigned consumer debts, another included the debtor's student loans, and the third class encompassed the remaining unsecured debt.<sup>124</sup> The debtor proposed to repay the first two classes in full over the duration of the plan, while repaying only ten percent of the value of the unsecured claims in the third class.<sup>125</sup> The court denied confirmation of the plan because it believed the plan unfairly discriminated against the holders of dischargeable unsecured claims in violation of 11 U.S.C. § 1322(b)(1).<sup>126</sup> The court conceded that neither § 1122 nor § 1322(b)(1)<sup>127</sup> requires a debtor to place all substantially similar claims in the same class: these provisions require only that all claims in the same class be substantially similar.<sup>128</sup> Yet, the court still concluded, based on its application of the four-part test for defining "unfair discrimination,"<sup>129</sup> that the debtor had no reasonable basis to discriminate against the general unsecured creditors by repaying them a smaller percentage than that paid to the unsecured student loan creditors.<sup>130</sup> The court remarked, "[w]hat the debtor would be doing is

(B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support;

11 U.S.C. § 523(a)(5)(B) (1988).

121. See, e.g., *In re Benner*, 146 B.R. 265 (Bankr. D. Mont. 1992); *In re Husted*, 142 B.R. 72 (Bankr. W.D.N.Y. 1992); *In re Leser*, 939 F.2d 669 (8th Cir. 1991).

122. 146 B.R. 411 (Bankr. N.D. Ill. 1992).

123. *Id.* at 412.

124. *Id.* Mr. Chapman's unsecured debts consisted of student loans totalling \$10,360, consumer debts cosigned by friends or relatives, and other routine unsecured debts. *Id.*

125. *Id.* The Chapter 13 trustee's objection to the debtor's plan was based solely on the preferential treatment given the unsecured student loan claims. The trustee made no objection to classifying the cosigned consumer debts separately because this classification is expressly allowed by §1322(b)(1). See *id.*

126. *Id.* at 417-19.

127. See *supra* note 6 for the full text of §§ 1122 and 1322(b)(1).

128. 146 B.R. at 417. The court stated that "the debtor can under § 1122 and § 1322 . . . place unsecured student loan obligations in a different class than other unsecured debts." *Id.* (citing *In re Foreman*, 136 B.R. 532 (Bankr. S.D. Iowa 1992)).

See 11 U.S.C. § 1322(a)(3)(1988) which states: "(a) The plan shall . . . (3) if the plan classifies claims, provide the same treatment for each claim within a particular class." *Id.*

129. See *supra* text accompanying note 73.

130. 146 B.R. at 417. To support its position, the court cited *In re Tucker*, 130 B.R. 71 (Bankr. S.D. Iowa 1991) and *In re Saulter*, 133 B.R. 148 (Bankr. W.D. Mo. 1991). In both of these cases, the bankruptcy court held that the nondischargeability of student loans is not a reasonable basis for favoring

equitably subordinating 90% of the claims of those creditors holding dischargeable claims to the nondischargeable student loans."<sup>131</sup> The court apparently did not consider the impact of its decision on the debtor's fresh start, which would be hindered by the significant amount of unpaid, nondischargeable student loan debt that would remain after bankruptcy.<sup>132</sup>

In *In re Smalberger*,<sup>133</sup> the Bankruptcy Court for the District of Oregon refused to confirm a Chapter 13 plan that classified educational debts separately. The court held that the plan, which proposed to prefer student loan claims by paying them in full but making no payment to other unsecured creditors, constituted "unfair discrimination."<sup>134</sup> The court considered the proposed classification from the viewpoint of the unsecured creditors against whom the plan discriminated.<sup>135</sup> The court concluded that it would be unfair to tell creditors holding dischargeable claims that creditors holding otherwise nondischargeable claims will receive preferential treatment, both after the bankruptcy case is completed and during the duration of the plan itself.<sup>136</sup> Furthermore, the court reasoned that Congress could have granted priority to student loan claims under § 507, which would require that these claims be paid in full in a Chapter 13 plan,<sup>137</sup> but Congress did not do so.<sup>138</sup> This omission, the court believed, evidenced congressional intent that student loans should not be classified separately from other unsecured debts and should not be given special treatment.<sup>139</sup> The *Smalberger* court also downplayed the impor-

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unsecured student loan creditors over other unsecured creditors. *Chapman*, 146 B.R. at 417-18 (discussing *Tucker* and *Saulter*).

131. 146 B.R. at 418.

132. For example, if the Chapter 13 plan provided for repayment of all unsecured debt, including student loans in the amount of \$10,360, Mr. Chapman would still be saddled with over \$9,000 in student loan debt after the completion of his Chapter 13 plan payments. *See id.* at 412.

133. 157 B.R. 472 (Bankr. D. Or. 1993).

134. *Id.* at 477. The court held that the debtor's proposal did not meet the fairness standard set forth in 11 U.S.C. § 1322(b)(1) (1988).

135. 157 B.R. at 475 ("If it can be said that such classification is 'unfair' to [other unsecured creditors], it should not be permitted.").

136. *Id.* at 475-76. The court reasoned that, because creditors holding nondischargeable claims can legally take action to collect on their claims after a discharge has been granted, it would be unfair to allow preferential treatment to such claims during the Chapter 13 plan as well. *Id.*

137. Under § 1322(a)(2), all debts entitled to priority under §507 must be paid in full in a Chapter 13 plan. *See* 11 U.S.C. § 1322(a)(2) (1988).

138. *Smalberger*, 157 B.R. at 476 ("If Congress intended to grant a priority for student loan claims, it seems that Congress could have simply included such claims in the list of debts entitled to priority under § 507.").

139. *Id.*

tance of the debtor's fresh start, concentrating instead on achieving equitable distribution to creditors.

In *In re Colfer*,<sup>140</sup> the Bankruptcy Court for the District of Maine refused to confirm a Chapter 13 plan which provided for full payment to student loan creditors but only partial payment to other unsecured creditors.<sup>141</sup> According to the *Colfer* court, the mere fact that educational loan debt would remain undischarged after bankruptcy was not sufficient, by itself, to justify preferentially classifying such claims.<sup>142</sup> Like the court in *Smalberger*, the *Colfer* court examined congressional intent.<sup>143</sup> If the character of educational loan obligations alone justified preferential classification, Congress could have amended § 1322(b)(1) to provide for such treatment, as it did for cosigned consumer debt.<sup>144</sup> The court reasoned Congress' failure to create a statutory priority for educational debts under § 507(a) is further evidence that nondischargeability alone should not be sufficient to allow discrimination against other creditors.<sup>145</sup> To allow this creation of a de facto priority is to oppose Congress' express decision not to grant student loans a § 507 priority.<sup>146</sup>

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140 159 B.R. 602 (Bankr. D. Me. 1993).

141. *Id.* at 611. The *Colfers'* Chapter 13 plan proposed to pay 100% of their educational debt of \$1,825.92 and 17.56% of all other nonpriority unsecured claims. The court observed that if all unsecured creditors were treated the same each creditor would receive over 30% of her claim. But, the court also noted that such a "non-discriminatory" plan would leave a substantial portion of the student loan debts unpaid upon the plan's completion. *Id.* at 603.

142 *Id.* at 609.

143 *Id.* Like the *Smalberger* court, the *Colfer* court interpreted the absence of a Congressional grant of statutory priority under § 507(a) as legislative intent to deny preferential classification of educational loan obligations. *Colfer*, 159 B.R. at 609.

144. *Id.*

Congress could have amended § 1322(b)(1) to provide expressly that such obligations, like cosigned consumer debt, may be separately classified. In the absence of such legislative action, I cannot conclude that Congress intended that educational loans should be paid ahead of other nonpriority unsecured claims within the bankruptcy as well as remain undischarged after the bankruptcy.

*Id.*

145. *Id.* at 610.

146. *Id.* at 609 & n.22 (citing *Chapman*, 146 B.R. at 418).

The *Colfer* court noted that other courts have approved separate classification of alimony and child support arrearages on the basis of public policy favoring repayment of these obligations. *Id.* at 610. *See, e.g., Groves v. Labarge*, 160 B.R. 121, 123 (E.D. Mo. 1993) ("[P]ublic policy can more readily tolerate less than full payment of student loan debt during the life of a Chapter 13 plan, with continued liability thereafter, than it can reduced payment of child support obligations for the duration of a Chapter 13 plan."), *aff'd*, 39 F.3d 212 (8th Cir. 1994). The *Colfer* court opposed distinction on these grounds from student loans, because Congress also failed to establish statutory priority for family support obligations. 159 B.R. at 610. Congress eliminated this debate through the Bankruptcy Reform Act of 1994 by granting a § 507 priority to allowed claims for alimony, maintenance, and support. *See* 11 U.S.C.A.

The majority of courts that have held, or stated in dicta, that a Chapter 13 plan may preferentially classify student loans have limited their approval to classification schemes complying with § 1322(b)(5).<sup>147</sup> Section 1322(b)(5) allows a Chapter 13 debtor to cure any defaults or arrearages within a reasonable time and maintain regular payments during the duration of a Chapter 13 plan.<sup>148</sup> However, in order for a debtor to utilize § 1322(b)(5), the last payment of the relevant debt must be due after the completion of the plan.<sup>149</sup> Therefore, by definition, a student debtor who proposes to pay his student loans under § 1322(b)(5) will still be burdened with some student loan debt after bankruptcy because the last payment of the student loan must occur after the completion of the Chapter 13 plan.

Only a limited number of courts have confirmed Chapter 13 plans that provide for separate classification of student loan debt pursuant to § 1322(b)(1). In *In re Tucker*,<sup>150</sup> the Chapter 13 debtors proposed to allocate twenty-nine percent payment to unsecured creditors with dischargeable claims and one hundred percent payment to unsecured student loan creditors.<sup>151</sup> The Bankruptcy Court for the District of Montana confirmed the plan, concluding that the plan did not discriminate unfairly.<sup>152</sup> The court employed the four-part test to make its determination.<sup>153</sup> In the *Tucker* court's view, the debtor's desire to pay off nondischargeable student loans in full constituted a reasonable basis for discrimination.<sup>154</sup> Furthermore, the court reasoned that if this "discrimination" was not allowed, the

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§ 507(a)(7) (West 1995).

147. See, e.g., *In re Benner*, 156 B.R. 631, 634 (Bankr. D. Minn. 1993) (concluding that student loan debt that is paid in full outside the Chapter 13 plan in accordance with § 1322(b)(5) does not constitute unfair discrimination in violation of § 1322(b)(1)); *In re Saulter*, 133 B.R. 148, 150 (Bankr. W.D. Mo. 1991) (ruling that debtor may formulate a plan which treats her student loans as long-term debt under § 1322(b)(5)); *In re Christopher*, 151 B.R. 475, 480 (Bankr. N.D. Ill. 1993) (stating same in dictum; debtor's plan not approved).

148. See 11 U.S.C. § 1322(b)(5) (1988); *supra* notes 116-17 and accompanying text.

149. 11 U.S.C. § 1322(b)(5) (1988).

150. 159 B.R. 325 (Bankr. D. Mont. 1993).

151. *Id.* at 327. Unsecured claims totalled \$14,208, and \$4,183 of that total was for two student loan claims. All of the debtor's personal property was exempt except for \$180, and all of the real property was either encumbered or exempt. *Id.* Under a Chapter 7 liquidation, all of the "other" unsecured creditors would have received virtually nothing and their claims would have been discharged. *Id.* at 329. Of course, the student loan debts would not be discharged in a Chapter 7, and the debtor would still have to pay the student loan creditors.

152. *Id.* at 329.

153. *Id.* at 327-28 (noting problems with the four-part test but seeing no reason to depart from its use); see *supra* note 73 and accompanying text for an explanation of the four-part test.

154. 159 B.R. at 329.

debtors would be “saddled with” the nondischargeable student loan debt after completing their plan and their opportunity to make a fresh start would be negated.<sup>155</sup> Coupling these factors with the fact that the other unsecured creditors would receive more through this Chapter 13 plan than under Chapter 7,<sup>156</sup> the court concluded that the debtors’ plan did not violate § 1322(b)(1)’s prohibition on unfair discrimination.<sup>157</sup>

Outside of the student loan context, other courts have employed a fairly narrow interpretation of the “unfair discrimination” prong of § 1322(b)(1).<sup>158</sup> In *In re Sutherland*,<sup>159</sup> the Bankruptcy Court for the Western District of Arkansas confirmed a Chapter 13 plan that contained four separate classes of unsecured creditors.<sup>160</sup> One of the classes received no payment under the debtor’s plan.<sup>161</sup> Despite the apparent unfairness of this plan, the court reasoned that “[i]f a plan proposes to pay each unsecured claim at least as much as that claim would receive in liquidation under Chapter 7, the plan can propose to pay additional sums to a single unsecured creditor or classes of other unsecured creditors *without* unfairly discriminating.”<sup>162</sup> Although *In re Sutherland* did not involve student debts, the court’s reasoning does provide support for allowing student loans to be classified separately. All of the debts in *Sutherland* were dischargeable.<sup>163</sup> Thus, the court did not even have to consider the fresh start policy because the debtor’s debts would not continue beyond completion

155. *Id.*

156. *Id.* at 328-29. The court reasoned that preventing the debtor from discriminating in favor of nondischargeable educational loan creditors would induce debtors to use Chapter 7 instead of Chapter 13. *Id.* This would be contrary to the clear Congressional intent to have debtors use Chapter 13 instead of Chapter 7. *Id.* at 329.

157. *Id.*; see also *In re Freshley*, 69 B.R. 96, 98 (Bankr. N.D. Ga. 1987) (confirming Chapter 13 plan that proposed 100% payment of unsecured student loan claim but only 1% payment of other unsecured claims, because the court believed that there was a reasonable basis for the preferential treatment).

158. *In re Sutherland*, 3 B.R. 420 (Bankr. W.D. Ark. 1980). Note that this case occurred before the 1990 amendment to § 1328(a)(2), which made educational loans nondischargeable in a Chapter 13. However, the reasoning of the court is nonetheless applicable to separate classification of student loans.

159. 3 B.R. 420.

160. *Id.* at 421. The four different classes of unsecured creditors were: [(1)] “Medical Debts-persons or firms debtors must continue to receive services from, [(2)] Unsecured bank notes from banks needed, [(3)] Credit accounts desired to be kept for continuation of doing business, and [(4)] All other creditors.” *Id.* The court viewed the classification as rational because the debtors wanted to continue to receive medical care in the future (class 1) and hoped to secure continuing credit for Mr. Sutherland’s business (classes 2 and 3). *Id.* at 421-22.

161. *Id.* at 421.

162. *Id.* at 422 (emphasis added).

163. See *id.* at 421.

of the plan. Even absent this policy consideration, the *Sutherland* court determined that a certain level of discrimination was appropriate under the circumstances of the case.<sup>164</sup> In a case addressing student loans, which are nondischargeable and will follow the debtor out of bankruptcy, courts should be even more receptive to allowing differentiation in payment in order to preserve the debtor's fresh start.<sup>165</sup>

## VI. ANALYSIS OF THE ISSUE

When Congress amended § 1328(a)(2) in 1990<sup>166</sup> to restrict the dischargeability of student loan debt, it failed to anticipate that Chapter 13 debtors would attempt to classify unsecured student loan debt separately pursuant to § 1322(b)(1). Furthermore, the legislative history to section 1322(b) does not elucidate the factors that a court should consider when determining whether a proposed classification discriminates unfairly.<sup>167</sup> Therefore, courts faced with this issue should focus on statutory construction, legislative intent, and public policy in arriving at their decisions. Based on the fundamental bankruptcy ideal of providing a debtor with a fresh start,<sup>168</sup> the public policy underlying the repayment of educational loans,<sup>169</sup> the congressional preference for Chapter 13 over Chapter 7,<sup>170</sup> and an analysis of the statutory provisions of Chapter 13, courts should confirm Chapter 13 plans that preferentially classify nondischargeable student loan debt.

One of the goals of bankruptcy law is to provide a debtor with a new financial beginning.<sup>171</sup> A debtor who remains saddled with

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164. This assumes that all the other requirements for confirmation of a Chapter 13 plan are met. *See supra* notes 55-65 and accompanying text; *see supra* note 61 for the text of § 1325(a)(4).

165. The *Sutherland* court obviously considered the "best interests" test of § 1325(a)(4) as the key requirement. 3 B.R. at 421-22.

166. *See supra* notes 108-09 and accompanying text.

167. "The legislative history to § 1122 (referenced by § 1322(b)(1)) states that [§ 1122] codifies current case law surrounding the classification of claims . . ." H.R. REP. NO. 595, 95th Cong., 1st Sess. 406 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6362.

168. *See supra* notes 19-30 and accompanying text for a discussion of the fresh start principle and how provisions of the Bankruptcy Code reflect this goal.

169. *See supra* notes 75-109 and accompanying text for a historical analysis of the federal student loan programs and Congress' attempts to close "loopholes" through which student borrowers evaded their loan payments.

170. *See supra* notes 40-43 and accompanying text.

171. *See supra* notes 19-21 and accompanying text. The debtor's interest in emerging from bankruptcy free of debt is absolutely consistent with the purposes of Chapter 13. In discussing the need for a limit on the extent of Chapter 13 plans, Congress referred to the fresh start as "the essence of modern bankruptcy law." H.R. REP. NO. 595, 95th Cong., 1st Sess. 117 (1977) *reprinted in* 1978

nondischargeable claims even after the completion of bankruptcy will have a harder time achieving a fresh start. However, for public policy reasons Congress decided that certain debts should be nondischargeable under Chapter 7 and Chapter 13.<sup>172</sup> A Chapter 13 debtor whose plan separately classifies unsecured student loan debt and provides for full repayment of these educational loan obligations fulfills both congressional objectives.<sup>173</sup> The debtor will not be burdened by this nondischargeable debt after completing his Chapter 13 plan and, at the same time, the student loans will be repaid in full.

The public policy behind enforcing the complete repayment of student loans is obvious.<sup>174</sup> Past student borrowers provide financing for the future operation of educational loan programs.<sup>175</sup> By amending § 1328(a)(2), Congress showed its concern with closing a “loophole” that some student borrowers had used to avoid repaying their student loans.<sup>176</sup> Separate classification of student loan debts does not operate as a loophole, however. By allowing Chapter 13 debtors to classify their student loan debts separately under § 1322(b)(1) and provide for full payment of such debt, Congress can achieve its goal of securing complete repayment of student loans without jeopardizing the future of the student loan programs. In fact, a Chapter 13 debtor will have greater incentive to repay student loan debts during a Chapter 13 plan than after its completion. The debtor’s failure to make plan payments might lead a court to refuse to grant the debtor a discharge.<sup>177</sup> The possibility of not receiving a discharge and losing the benefit of the automatic stay will certainly encourage the debtor to make all of the plan payments.<sup>178</sup>

The refusal of courts to permit preferential classification of unsecured

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U.S.C.A.N. 5963, 6078; *see* *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 (1934) (recognizing the fundamental importance of providing a debtor with a fresh start).

172. *See supra* note 34.

173. This assumes that the Chapter 13 plan meets all of the other requirements for plan confirmation. *See supra* notes 55-65 and accompanying text for a discussion of the key requirements for confirmation of a Chapter 13 plan.

174. In 1991, the federal government paid \$3.6 billion as a result of student loan defaults. Matthew Morrissey, *Banking on Students*, NAT’L J., Feb. 6, 1993, at 339.

175. *See supra* notes 84-85 and accompanying text.

176. *See supra* notes 108-09 and accompanying text.

177. *See* 11 U.S.C. § 1328(b) (1988) (providing that debtors who fail to complete payments under the plan will receive a discharge only if they meet certain conditions).

178. If unsecured claims are not discharged and the debtor does not pay such debt after a dismissal, the debtor will still be saddled with debt. However, the only recourse for the creditors is to sue for their money. If the debtor has few assets, a lawsuit may be of little use.



student loan debt defeats Congress' desire for individual debtors to file under Chapter 13.<sup>179</sup> If courts do not allow preferential classification, debtors burdened with nondischargeable debts in Chapter 13 will view Chapter 7 as a less burdensome option.<sup>180</sup> Moreover, Congress placed the right to classify claims preferentially in Chapter 13 as an inducement for debtors to select Chapter 13.<sup>181</sup> The option to pay different amounts to different unsecured creditors encourages debtors to utilize Chapter 13, because the option is unavailable in Chapter 7.

Finally, an analysis of the provisions of Chapter 13 also suggests that courts should allow separate classification of unsecured student loan debt. In order for a Chapter 13 plan to be confirmed, the various statutory requirements of Chapter 13 must be met.<sup>182</sup> In particular, unsecured creditors must receive as much under a Chapter 13 plan as they would receive under a Chapter 7.<sup>183</sup> Therefore, the preferential classification of unsecured student loan creditors does not harm the "other" unsecured creditors. Additionally, the language of § 1322(b)(1)<sup>184</sup> indicates that cosigned consumer obligations and priority claims under § 507<sup>185</sup> are not the only types of unsecured claims that a debtor may classify separately.<sup>186</sup> Courts that refuse to allow preferential classification of unsecured

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179. See *supra* notes 40-43.

180. "[D]ebtors who are obligated to pay debts that are nondischargeable in Chapter 13 will have a strong incentive to use Chapter 7 instead of Chapter 13." *In re Brown*, 152 B.R. 232, 240 (Bankr. N.D. Ill. 1993). Chapter 7 debtors would be able to use all of their postpetition income to pay the nondischargeable debt. *Id.* However, in a Chapter 13 without separate classification of student loan debt, a debtor would be required to devote substantial amounts of postpetition disposable income to *all* the unsecured creditors pro rata, for a minimum of three years. The same debtor could allocate this income exclusively to the nondischargeable debt in a Chapter 7. *Id.* *Brown* was later reversed, *McCullough v. Brown (In re Brown)*, 162 B.R. 506 (N.D. Ill. 1993), but the policy arguments made therein remain valid and should not be ignored by future courts.

A debtor might also first file a Chapter 7 to eliminate any dischargeable debts and then file a Chapter 13 to deal with nondischargeable student loan obligations. Many courts have approved these so-called "Chapter 20" cases. See, e.g., *In re Smalberger*, 157 B.R. 472, 477 n.2 (Bankr. D. Or. 1993) (noting the possibility of such a tactic).

181. The legislative history of Chapter 13 reflects Congress' intent to provide the debtor with "great flexibility in the formulation of the plan." H.R. REP. NO. 595, 95th Cong., 1st Sess. 123 (1977), *reprinted in* 1978 U.S.C.A.N. 5963, 6084.

182. See 11 U.S.C. § 1325 (1988).

183. See 11 U.S.C. § 1325(a)(4) (1988); see also *supra* notes 61-63 and accompanying text.

184. 11 U.S.C. § 1322(b)(1) (1988); see *supra* note 6 for the text of this provision.

185. See 11 U.S.C. § 1322(a)(2) (1988) (requiring full payment of all § 507 priority claims in Chapter 13 plans).

186. *In re Smalberger*, 157 B.R. 472, 475 (Bankr. D. Or. 1993). "If co-signed consumer obligations were the only permitted classification, there would be no need for the first phrase of [§ 1322(b)(1)] which begins 'subject to' and ends 'any class so designated.'" *Id.* See *supra* note 6 for text of 11 U.S.C.

student loan debt because such debt is neither explicitly mentioned in § 1322(b)(1) nor given a priority under § 507 seem to disregard the language of § 1322(b)(1).

## VII. CONCLUSION

Courts should permit Chapter 13 debtors to classify student loans preferentially under § 1322(b)(1). To settle this matter permanently, Congress can amend § 1322(b)(1) to provide expressly for preferential designation of student loans similar to the current treatment given cosigned consumer debt.<sup>187</sup> Although such an amendment is unlikely in the near future, the courts have ample statutory and policy bases to confirm Chapter 13 plans that separately classify nondischargeable unsecured student loan debt.<sup>188</sup>

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§ 1322(b)(1).

187. It is not necessary for Congress to amend the Bankruptcy Code in order for courts to confirm Chapter 13 plans that preferentially classify student loans. However, without such an amendment, bankruptcy courts will likely continue to reach varying results. To prevent such inconsistency and possible "forum-shopping" by debtors, Congress will need to amend the Bankruptcy Code.

188. *See supra* notes 150-86 and accompanying text.

