A FORCED CRISIS: WHY STUDENT LOAN DEBT SHOULD BE SEPARATELY CLASSIFIED UNDER CHAPTER 13 BANKRUPTCY PLANS

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I. INTRODUCTION

In 1961 John W. Gardner[1] said "We don't even know what skills may be needed in the years ahead. That is why we must train our young people in the fundamental fields of knowledge, and equip them to understand and cope with change."[2] In the early 1960s Congress and the President recognized a need for a broad and organized system by which students could obtain financial assistance for post-secondary education,[3] and thus set into motion creating what would become known as the Higher Education Act (referred to henceforth as "HEA").[4] Along with the several benefits discussed below, the HEA created the federal student aid

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[1]Secretary of Health, Education, and Welfare under President Johnson (1965-1968) who was a crucial member of the board responsible for the creation of the Higher Education Act of 1965.

[2]Angelica Cervantes et al., *Opening the Doors to Higher Education: Perspectives on the Higher Education Act 40 Years Later*, TG RES. & ANALYTICAL SERV. 18 (Nov. 2005), https://files.eric.ed.gov/fulltext/ED542500.pdf.

[3]*See* Amanda M. Foster, Comment, *All or Nothing: Partial Discharge of Student Loans is Not the Answer to Perceived Unfairness of the Undue Hardship Exception*, 16 WIDENER L.J. 1053, 1056 (2007).

[4]*See infra* Part II.

program, which is still used in large part today.[5] While this program has permitted millions of students across the country access to higher education opportunities, it has also opened wide the door for a more pressing debt crisis.

With the cost of attending 4-year public state institutes nearly tripling between the period from 1995 to 2015,[6] the dependence on student loan programs has also increased.[7] Between 2001 and 2016, the amount of student debt rose from $340 billion to more than $1.3 trillion,[8] making it now the second highest consumer debt in the United States (just behind mortgage debt).[9] According to Make Lemonade, a web service designed to provide users with free personal finance tools, there are more than 44 million borrowers of student loans, with the average student in the class of 2016 borrowing around $37,172.[10] Unfortunately for students, as the cost of attending post-secondary school has increased, the returns of investment on that education have been unable to keep up. As a result, graduates receive little value from the additional education.[11] As students are encouraged to take on these debts, many are inevitably unable to keep up with the payments. Graduates are forced between a rock and a hard place: either allow the loans to become delinquent or file for bankruptcy. The graduates who adopt the latter option have found that it is a path wrought with obstacles.

From the mid-1980s to the early 2000s, Congress amended the Bankruptcy Code to address the concerns of the consumer credit industry, specifically creating the Means Test for Chapter 7 Bankruptcy and placing

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[5]*See* Cervantes et al., *supra* note 2, at 17.

[6]*Tuition Costs of Colleges and Universities*, NAT'L CTR. FOR EDU. STATS. (2018), https://nces.ed.gov/fastfacts/display.asp?id=76 (The average cost of attending a 4-year public university including tuition, room and board, and fees in 1995 was $6,256, whereas in 2015 it had risen to $16,757.).

[7]*See Understand how interest is calculated and what fees are associated with your federal student loan.*, FED. STUDENT AID (2018), https://studentaid.ed.gov/sa/types/loans/interest-rates (According to the Department of Education, the interest rate of Federal Direct Unsubsidized and Subsidized Loans as of 2018 were 5.05% for undergraduate borrowers.); *cf. The best private student and education loan rates*, STUDENT LOAN HERO (2018), https://studentloanhero.com/marketplace/private-student-loans-new/ (indicating the average interest rate on a private loan ranges from 5.3% up to 14.75%).

[8]Laura Feiveson et al., *Student Loan Debt and Aggregate Consumption Growth*, BD. OF GOVERNORS OF THE FED. RES. SYS. (Feb. 21, 2018), https://www.federalreserve.gov/econres/notes/feds-notes/student-loan-debt-and-aggregate-consumption-growth-20180221.htm.

[9]Zack Friedman, *Student Loan Debt Statistics In 2018: A $1.5 Trillion Crisis*, FORBES (June 13, 2018, 8:32AM), https://www.forbes.com/sites/zackfriedman/2018/06/13/student-loan-debt-statistics-2018/#517490d97310.

[10]*Id.*

[11]*See* Feiveson et al., *supra* note 8.

restrictions on Chapter 13 Bankruptcy filings.[12] The impact on graduates was immediately recognized and the courts are still responding to these issues.

One of the most pressing issues, and the focus of this comment, is whether under a Chapter 13 scheduling payment plan, debtors may classify student loans as a separate class of unsecured debt, thereby discriminating against other unsecured debt. This comment will demonstrate that the language of 11 United States Code ("U.S.C.") § 1322(b)(1) and (b)(5) allows for separate classification of student debt from other unsecured debts in a Chapter 13 scheduling payment plan without unfairly discriminating against the other debts due to the special nature of student loan debt as non-dischargeable debts. While there are arguments on both sides, the ability of a debtor to separately classify their student debt is of utmost importance to achieving the goal of a Chapter 13 plan. Namely, it provides the debtor with the "fresh start" inherent in the design of Chapter 13.

Section II will provide a brief history of the HEA and of the Bankruptcy Act and its amendments. Section III will analyze the test the courts have created to determine whether a debtor has met the requirements to file for Chapter 7 bankruptcy, and if not, whether they satisfy the requirements for a Chapter 13 plan. Section IV will look at the courts' analysis of § 1322 and the split around whether student loan debt may be separately classified from other unsecured debt. The comment concludes by making a prediction on the path that the courts will most likely take in the coming years if the trend of student loan debt continues its current track.

II. HISTORY OF THE HIGHER EDUCATION ACT OF 1965 AND THE CREATION OF THE BANKRUPTCY CODE OF 1978 AND ITS AMENDMENTS

Signed into law by President Lyndon B. Johnson on November 8, 1965, the Higher Education Act established a system of federal financial aid for students seeking a post-secondary education that is still used today.[13] While the HEA provided much more than student loans (including aid to underfunded universities, libraries, and faculties), the core component was Title IV, the Student Assistance Act, specifically Part B,

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[12] *See infra* Section I.
[13] *See* Cervantes et al., *supra* note 2, at 15-17.

which created the Guaranteed Student Loan Program (now the Federal Family Education Loan Program, or "FFELP").[14]

The creation of this program enabled students to apply and receive loans for higher education without first going through the routine credit checks required by private lending organizations.[15] President Johnson, realizing the inherent risk of this program to banks and outside lenders, negotiated that in exchange for a lender's agreement to provide loans for students without going through the normal loan procedure, the federal government agreed to guarantee the loans in case of default, death, disability or bankruptcy.[16] The GLSP, now FFELP, has since been the source of a majority of loans available for student financial aid,[17] and guarantees students that, despite their background, they can secure financial aid.[18] While this program was, and still is, beneficial to lower and middle class students, the problems associated with it were felt almost immediately.

The first major examination of the Bankruptcy Code occurred in the early 1970s, where a commission appointed by Congress to review the existing Bankruptcy Act (adopted in 1898) highlighted the abuse of the student loan program as one of the key areas requiring reform.[19] Under both the HEA and the Bankruptcy Act, dischargeability of student loans was not directly referenced, and therefore allowed for student loans to be discharged in regular bankruptcy proceedings.[20] The commission recommended that federally insured educational loans be exempted from discharge, as their reports anticipated future increases in the default rate of student loans and hoped that this exclusion would prevent potential abuses.[21] Five years after this commissions report, the Bankruptcy Reform Act of 1978 (and through it the Bankruptcy Code) was enacted with a heavy emphasis on discharge provisions.[22]

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[14]*See id.* at 24.

[15]*See* Foster, *supra* note 3, at 1056.

[16]*See* Cervantes et al., *supra* note 2, at 25.

[17]*See id.* at 26.

[18]*See* 20 U.S.C. § 1078(c)(2)(F) (2018) ([G]uaranty agency [outside lenders, banks, etc.] will not engage in any pattern or practice which results in a denial of a borrower's access to loans under this part because of the borrower's race, sex, color, religion, national origin, age, handicapped status, income. . . .).

[19]*See* Foster, *supra* note 3, at 1058.

[20]*See id.*

[21]*Id.* at 1059.

[22]Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 32 (1995) (The Bankruptcy Act of 1978 did not solely focus on abuses and correcting the discharge provisions, but it placed a great emphasis those portions of the original code.).

The 1978 Bankruptcy Code, while an expansive and necessary revision of the previous code, still left open the door for bankruptcy abuse. While the 1978 Code provided that educational loans guaranteed by the government were exempt for discharge unless the debtor could prove "undue hardship,"[23] Congress still encouraged debtors to file for Chapter 13 readjustment plans to limit the liquidation discharge of Chapter 7 as a way to protect both the debtor and the creditor.[24] So, between 1979 and 1980, to the dismay of creditors whose pleas for further reform fell on the deaf ears of Congress, the number of annual personal bankruptcy filings rose from 197,000 to almost 315,000, continuing to trend upwards into the 1980s and 1990s.[25]

Despite amendments to the Code and case law further defining the statutes, the push towards Chapter 13 plans to avoid the abuse of Chapter 7 filings was failing[26] and further reform was deemed necessary. In 1996, lobbyists for the consumer credit industry proposed a bill for a massive reform of the Bankruptcy Code which would in part limit debtors filing for bankruptcy from filing under Chapter 7 if they "had the means to pay back a substantial portion of debt."[27] After years of debate in Congress, a bill was finally introduced in 2005 that catered to the creditors' desires, aptly titled the "Bankruptcy Abuse Prevention and Consumer Protection Act," referred to as BAPCPA.[28] The "means" test lobbied for in the late

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[23]Section 523(a)(8) exempts from discharge any debt:

[U]nless excepting such debt from discharge under [section (a)(8)] would impose an undue hardship on the debtor and the debtor's dependents, for—

(A)(i) 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

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual…

11 U.S.C. § 523(a)(8) (2016).

[24]*See* Tabb, *supra* note 22 at 35.

[25]Jason J. Kilborn, *Governing America: Major Policies and Decisions of Federal, State, and Local Government*, A BRIEF HIST. OF U.S. BANKR. LAW & POL'Y FOR CONSUMERS AND BUS. 5 (Nov. 2008), https://www.researchgate.net/publication/228229136_A_Brief_History_of_US_Bankruptcy_Law_Policy_for_Consumers_and_Businesses.

[26]*See id.* at 6 (suggesting that debtors who choose Chapter 13 were taking advantage of its privileges to keep property purchased on credit without paying full price for it, and that the bankruptcy courts tended to be debtor-friendly and required reform).

[27]*Id.* at 7.

[28]*Id.*

90s had come to fruition in this new act, restricting access to Chapter 7 and forcing consumer debtors into Chapter 13 payment plans.[29] This test was rather complicated:

First, the debtor's income is compared to the annually adjusted median income for households of the same size as the debtor's in the state where the debtor lives. If the debtor's income is below that median figure, the debtor is allowed into Chapter 7. If not, then the above-median income is reduced by deducting living expenses pursuant to detailed guidelines developed by the [IRS]. If the resulting "disposable income" is more than about $200 per month, the debtor is denied access to Chapter 7 and can seek relief, if at all, only under Chapter 13.[30]

This test served its purpose of combatting abuse by the debtor, but as Congress and the courts closed one door, another opened, one that allowed creditors to "regain" lost ground. Since the creation of the Code in 1978, the student-loan exemption process has tended to favor creditors while becoming increasingly harsher on debtors. Most recently, the BAPCPA provided that not only were government-backed loans exempt from discharge but granted § 523(a)(8) protection to private, for-profit lenders, such as banks and organizations like Sallie Mae.[31]

The issue now rested on whether under the Chapter 13 plan, where discharge of loans was not an option, could debtor's with student loan debt classify the student loans as separate debt from other unsecured debt.

III. THE *BRUNNER* TEST AND 11 U.S.C. § 1322

The Bankruptcy Act of 1978 and the Bankruptcy Code established in section 523(a)(8) that personal debt resulting from government-backed education loans were non-dischargeable in either Chapter 7 or Chapter 13 bankruptcy pleadings unless the debtor could prove "undue hardship," yet nowhere in the code is this standard of "undue hardship" defined. This lack of explanation led courts to question what qualifies as "undue hardship." The first working test to determine this standard, and the one in which most courts refer to since, came from the Second Circuit case *Brunner v. New York State Higher Education Services Corporation.*[32]

The *Brunner* test sets forth the minimum requirements necessary to establish "undue hardship" in a three-part showing:

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[29]*See* Kilborn, *supra* note 25, at 11.

[30]*Id.*

[31]*See* Ryan Freeman, *Student-Loan Discharge—An Empirical Study of the Undue Hardship Provision of § 523(A)(8) Under Appellate Review*, 30 EMORY BANKR. DEV. J. 147, 155 (2013).

[32]Brunner v. New York State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987).

> (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.[33]

Under this test, the debtor bears the burden of proof regarding each prong, and each must be satisfied by a preponderance of the evidence. Further, the "minimal" standard of living has been defined in later cases as more than a simple tightening of the debtor's budget.[34] A minimal standard of living includes the necessities such as housing, clothing, and medical expenses, as well as "transportation expenses, food and hygiene expenses, as well as modest recreation expenses."[35] While this standard does not require the debtor to live in poverty, it subsequently does not allow for luxury expenses, and once the debtor had paid all necessary expenses, excess financial resources should be used to satisfy student loan debt.[36] To prove undue burden would occur, debtors can show evidence from: tax returns, W2 forms, bank statements, records of all monthly payments (such as utility and rent bills) reports of necessary items (such as food bills, clothing receipts, etc.), medical records, and a plethora of other itemized receipts.[37] Debtors that fail to meet this standard do not qualify for discharge of student loan debt from either Chapter 7 or 13 bankruptcy claims.

The *Brunner* test and the "means" test of the BAPCPA set the stage for a debtor to file for a Chapter 13 readjustment plan. Chapter 13 of the Bankruptcy Code states, in pertinent part, that an adjustment plan:

> (b) may:
> (1) designate a class or classes of unsecured claims . . . but may not discriminate unfairly against any class so

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[33] *Id.* at 396.

[34] *See, e.g.*, *In re* Kuznicki, Adv. No. 11-02076-BM, 2012 WL 567127, at *2 (Bankr. W.D. Pa. Feb. 21, 2012), *aff'd,* 483 B.R. 296 (W.D. Pa. 2012).

[35] *Id.* (citing *In re Crawley*, 460 B.R. 421 (Bankr. E.D. Pa. 2011)).

[36] *Id.*

[37] *See* Deborah Kurfiss, *Undue Hardship – The Path to Get Student Loans Discharged in Bankruptcy*, STUDENT DEBT RELIEF (July 14, 2018), https://www.studentdebtrelief.us/student-loans/undue-hardship-get-student-loans-discharged-bankruptcy/.

> designated; however, such plan may treat claims for consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims; . . .
> (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.[38]

This language did not provide the courts with an easy solution to debtors filing Chapter 13 plans. Read in conjunction with § 523(a)(8), § 1322 seemed to allow a debtor to separately classify their unsecured debts (student loans, credit card debts, etc.) so long as one class does not "unfairly discriminate" against the others. Yet again, the court was not provided with a working definition of "unfairly discriminate."

IV. THE TEST FOR UNFAIR DISCRIMINATION AND THE COURTS' NEW REACTION

To this day, the courts have not established a definitive test for unfair discrimination. The first problem that the courts had to address was what classified as "unfair discrimination." One of the earliest cases to address this issue and create a semblance of a test was *In re Leser*.[39] In *Leser,* the Eighth Circuit adopted a four-part working test for unfair discrimination. The test stated that discrimination against a class of unsecured creditors is fair if: (1) it has a "reasonable basis," which has come to mean simply that the discrimination furthers a legitimate interest of the debtor; (2) the debtor cannot carry out a plan without it; (3) the discrimination is proposed in good faith; and (4) the degree of the discrimination is directly related to the basis or rationale for the discrimination.[40]

This test provides a starting point for many courts' analysis. Yet it has also been highly criticized for its numerous shortcomings, including the fact that the test relies on "abstract, undefined notions of 'reasonableness,' 'legitimacy,' and 'good faith.'"[41] Furthermore, it "fails to

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[38] 11 U.S.C. § 1322 (2016).
[39] *In re* Leser, 939 F.2d 669 (8th Cir. 1991).
[40] *Id.* at 672.
[41] *In re* Bentley, 266 B.R. 229, 238 (B.A.P. 1st Cir. 2001).

direct the court's analysis and instead creates a vacuum that the court itself must fill."[42]

Courts sympathetic to the debtor's perils quickly came to *Leser*'s defense, including in *In re Brown*,[43] where the court stated that a debtor should be allowed to "make preferential classifications when the resulting discrimination rationally furthers a legitimate interest of the debtor . . . "[44] such as "paying their nondischargeable student loans in full through their Chapter 13 plans, so that they may complete their plans free of debt."[45] The *Bentley* court rejected this proposition, claiming that just because a plan may advance a debtor's legitimate interest does not make it any less of an unfair discrimination against other types of debts.[46] Rather, the court said there should be a balancing of interests between the three parties: the debtor, the class preferred, and the class discriminated against.[47] The four factors for balancing that the *Bentley* court developed were: equality of distribution, nonpriority of student loans, contributions (mandatory or optional), and the fresh start for the debtor.[48]

The first of the *Bentley* factors, equality of distribution, claims that unsecured creditors, absent an express grant of priority, should share equally in any dividend.[49] The general rule that the court developed is that "fairness in Chapter 13 requires equality of distribution among nonpriority unsecured creditors, and the burden of justification is on those who propose plans to the contrary."[50] The second factor, nonpriority of student loans, states that debtor's student loan obligations are not debts which the Code grants priority, and that their nondischargeability status does not confer priority status in the scope of bankruptcy proceedings.[51] The next factor, mandatory versus optional contributions, focuses on the structure of Chapter 13 plans. Under such a plan, a debtor *must* devote all "projected disposable income"[52] toward payment of the debts under the plan. Once

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[42]*Id.*

[43]*In re* Brown, 152 B.R. 232 (Bankr. N.D. Ill. 1993), *rev'd sub nom.* McCullough v. Brown, 162 B.R. 506 (N.D. Ill. 1993).

[44]*Id*. at 244.

[45]*Id.*

[46]*See In re Bentley*, 266 B.R. at 239 n.17.

[47]*See id.* at 239.

[48]*Id*. at 240-42.

[49]*Id.* at 240.

[50]*In re Bentley*, 266 B.R. at 240.

[51]*See id.* at 241.

[52]A debtor's projected disposable income ("PDI") comes from the "means" test of the BAPCPA. Once the debtor fails the means test, their PDI is calculated by taking their "current

debtors meet this minimum standard, they *may* devote more if they have additional income, but this optional payment must be shared on a *pro rata* basis between creditors (both dischargeable and nondischargeable).[53] The *Bentley* court's final factor was the debtor's interest in a fresh start.[54] The court stated that while a fresh start is one of the fundamental purposes of the Bankruptcy Code in general, Chapter 13 "does not contemplate that a debtor will necessarily emerge . . . entirely free of student loan obligations."[55] The court, upon balance of these considerations, creates a baseline where post-bankruptcy balances on student loan debts should be paid by a debtor's outside assets, not by limiting the share that general unsecured creditors are entitled to under a debtor's Chapter 13 plan. The exception the court found to this baseline is where a "debtor 'places something material onto the scales to show a correlative benefit to the other unsecured creditors.'"[56]

While this balancing test has been adopted by some jurisdictions to deny separate classification of debts as standard practice, it is not all encompassing. One of the concerns that grew after *Bentley* was whether, by the language and application of §1322, student loan debts can be classified as a long-term debt under (b)(5), and thereby avoid the debate of unfair discrimination. If (b)(5) is read separately from (b)(1), it seems that debtors may classify any long-term debt separately from simple unsecured debts. Indeed, a minority of courts have permitted such treatment of long-term, unsecured debts at the detriment of other debts, stating instead that "[l]ong-term student loan obligations with payment terms that extend beyond completion of the plan fall squarely within the ambit of section 1322(b)(5)."[57] The court in *Hanson*[58] held that because the language of (b)(5) presumptively trumps the general language against separate classification of (b)(1), if a court finds that "maintenance of regular payments on long term student loan indebtedness apply, then the specific provisions of section 1322(b)(5) supersede the general unfair

monthly income … less amounts reasonably necessary to be expended … for the maintenance or support of the debtor or a dependent of the debtor …." 11 U.S.C § 1325(b)(2).

[53]*See In re Bentley*, 266 B.R. at 241-42.

[54]*See id.* at 242.

[55]*Id*. at 242.

[56]*Id.* at 243 (quoting McCullough v. Brown, 162 B.R. 506, 517-18 (N.D. Ill. 1993)).

[57]*In re* Benner, 156 B.R. 631, 634 (Bankr. D. Minn. 1993).

[58]*In re* Hanson, 310 B.R. 131, 133-135 (Bankr. W.D. Wis. 2004).

discrimination provisions of section 1322(b)(1)."[59] The debtor-friendly *Hanson* standard was quickly refuted by several jurisdictions.[60]

Courts tend to reject the *Hanson* standard and conclude that §§ 1322(b)(1) and (b)(5) must be read together. Does this reading dictate that student loans may never be classified separately? Quite the opposite. Courts have instead held that where a debtor proposes to classify their student loan debt separately from other unsecured debt, they may do so only if the proposed plan does not discriminate against other unsecured debt, and review must be on a case by case basis.[61] In reviewing these types of cases, courts use a variety of factors formulated to "bear upon the equitable allocation of plan resources and the furtherance of underlying policy objectives."[62]

The court in *Machado* relied on four considerations to analyze whether a plan discriminates unfairly, by weighing the legislative intent behind the Bankruptcy Code against the good of equitable results for creditors. The first and second prong of the *Machado* analysis focus on Congress's intent behind the Code. By its exception of student loan obligations from discharge, Congress made clear the objective of student loan repayment. A Chapter 13 plan that uses plan resources toward repayment of student loans therefore follows the legislative intent behind the Code.[63] Furthermore, Congress allows for long-term debts to be cured through separate classification in bankruptcy plans under section 1322(b)(5), specifically where a debtor would emerge from bankruptcy more deeply in arrears than they were before filing for the plan. This is consistent with the legislative intent behind sections 523(a)(8) and 1322(b)(5).[64] The third prong states that where the financial difference between a plan including student loan debt and a plan that separately classifies the student loan debt is modest, unfair discrimination does not

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[59] *In re* Truss, 404 B.R. 329, 334 (Bankr. E.D. Wis. 2009) (citing *In re Hanson*, 310 B.R. at 135).

[60] *See In re* Williams, 253 B.R. 220 (Bankr. W.D. Tenn. 2000) (supporting that if Congress intended § 1322(b)(5) to trump (b)(1), Congress would have specially included that language); *see also In re* Pracht, 464 B.R. 486 (Bankr. M.D. Ga. 2012) (stating that § 1322(b)(5) does not trump (b)(1) and separate classification will not be permissible unless the debtor can show that the classification scheme will not unfairly discriminate against common debts).

[61] *See In re* Zeigafuse, No. 11-20854, 2012 Bankr. LEXIS 1463 1, 10 (Bankr. D. Wyo. 2012).

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

[63] *See id.* at 17.

[64] *Id.*

exist.[65] Finally, the court stated that where there is an absence of objection by any affected creditor, the plan must survive.[66]

A second test the courts use to determine whether separate classification plans cause undue prejudice was developed by the *Simmons* court.[67] The two-factor *Simmons* test first requires that the discrimination serves a rational purpose to the debtor.[68] Most courts have found that separate classification of student loans meets this rational purpose test.[69] The second factor states that the determination is not unfair if the class discriminated against receives no less than the amount it would have been entitled to receive if there was no discrimination, and if 36 months of the debtor's disposable income were applied to the plan.[70] While the *Machado* and *Simmons* tests provide a debtor with a much more favorable outlook, the ability to separately classify their debt is not guaranteed. In applying these two tests, the court in *In re Renteria* held that a debtor's plans that significantly disadvantage the creditor's pool of resources by separately classifying the debts must fail both tests, and therefore invalidate the plan.[71]

With these tests in hand, courts have gone to two extremes in determining whether student loan debt qualifies as a "special circumstance" by which a debtor can tip the scale towards separate classification. At one end, courts have said that "funding higher education through the use of student loans is becoming ubiquitous,"[72] thereby disqualifying them as a special circumstance. These courts have concluded that "discrimination based solely on nondischargeability is unfair."[73] At the other extreme, courts say that the nondischargeable nature of student loans is exactly what makes them a candidate for "special circumstance" treatment.[74] Between these two camps lies a middle ground,

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[65]*Id.* (The court does not define what would constitute a modest financial difference between allowing and denying separately classifying student loans. In the *Machado* case, the difference in what the creditors would receive would be just over two percent if the student loans were included in the plan, giving the creditors just over $700 more. The court found that under these circumstances, separately classifying the student loan debt did not unfairly discriminate.).

[66]*In re Machado*, 387 B.R. at 17.

[67]*In re* Simmons, 288 B.R. 737 (Bankr. N.D. Tex. 2003), *holding modified by In re* King, 460 B.R. 708 (Bankr. N.D. Tex. 2011).

[68]*See id.* at 751.

[69]*Id.* at 752.

[70]*Id.* at 753.

[71]*In re* Renteria, No. 11-25510 MER, 2012 WL 1439104, at *5 (Bankr. D. Colo. Apr. 26, 2012).

[72]*In re* Vaccariello, 375 B.R. 809, 816 (Bankr. N.D. Ohio 2007).

[73]*In re* Kalfayan, 415 B.R. 907, 910 (Bankr. S.D. Fla. 2009).

[74]*See In re* Delbecq, 368 B.R. 754, 759 (Bankr. S.D. Ind. 2007).

in which courts look to the "motivation for the debtor's pursuit of the education tied to the student loan debt."[75]

The current trend is towards allowing student debt to be separately classified. Courts reason that not only does student debt qualify as a special circumstance, but public policy supports the classification, as student loans "adversely affect a debtor's ability to pay debt before and after bankruptcy,"[76] thereby negating one of the main purposes of Chapter 13 bankruptcy (the fresh start the debtor seeks). Furthermore, courts have noted that "the expense of higher education . . . is beyond the means of many without financial assistance, often backed and guaranteed by the government. Public policy encourages the pursuit of higher education because it benefits not only the individual, but society as a whole."[77] These characteristics, says the *Knight* court, qualify student loans for consideration as special circumstances because debtors "may have no reasonable alternative to continuation of the payments in order to avoid unfair economic harm."[78]

The direction is that courts are more lenient on debtors. Courts have said that the nondischargeable nature of student loans allows them special treatment and allows the debtor to classify them separately from their other unsecured debts.[79] This, however, is only possible if a debtor can show that carrying out a plan that does not allow for separate classification would cause them to be saddled with all (or at least a large portion) of their student loan debt at the end of the plan. Courts have also found that where a debtor suggests a separate classification plan in good faith, the plan is presumed to be valid.[80]

Finally, courts have tended to hold in favor of debtors when the plan proposes to pay the full amount of the debtor's PDI to unsecured creditors on a pro rata basis and pay additional funds to student loan payments. The

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[75]*In re* Johnson, 446 B.R. 921, 924 (Bankr. E.D. Wis. 2011); *see In re Kalfayan*, 415 B.R. at 910 (discussing how the Debtor would be deprived of her ability to continue in her profession if she did not stay current on her student loan obligations and therefore allowed for the separate classification of her student loan debt).

[76]*In re* Engen, 561 B.R. 523, 533 (Bankr. D. Kan. 2016).

[77]*In re* Knight, 370 B.R. 429, 438 (Bankr. N.D. Ga. 2007).

[78]*Id.* at 439.

[79]*See In re* Birts, No. 11-15918-BFK, 2012 WL 631875, at *2 (Bankr. E.D. Va. Feb. 27, 2012), *rev'd and remanded,* No. 1:12-CV-427-LMB/TCB, 2012 WL 3150384 (E.D. Va. Aug. 1, 2012).

[80]*See In re* Orawsky, 387 B.R. 128, 154-156 (Bankr. E.D. Pa. 2008) (noting that where there is "no evidence that the Debtor engaged in any conduct that could be characterized as a manipulation of the means test or other Bankruptcy Code provisions in order to obscure or diminish her ability to pay her unsecured creditors," the proposed plan was made in good faith).

debtor in *In re Abaunza* successfully made the claim that "her non-student loan creditors would fare far worse if she included her student loan claim together with the unsecured claims and made payments pro rata to all the unsecured creditors . . . [by] significantly dilut[ing] the funds available to other creditors."[81] Further, a discretionary payment outside of the debtor's plan does not entitle the remaining unsecured creditors to more money, nor does it mean that student loan creditors are unable to receive a pro rata payment from the plan.[82]

V. CONCLUSION

As stated above, courts are heading in a direction that tends to be more sympathetic to debtors, allowing for separate classification of student loan debts in Chapter 13 plans. Under the present balancing schemes, courts can find in favor of debtors while still adhering to the principle that sections 1322(b)(1) and (b)(5) must be read together, in the interest of fairness toward both debtor and creditor. Under this type of test, debtors can classify their debt in a way that ensures that they will exit bankruptcy with the possibility of a fresh start. Under most of these plans, the creditor's loss is minimal, usually around two percent of what they would get if the student loan debt were to be included in the Chapter 13 plan.

Courts have determined that when a plan provides a fair result for both debtor and creditors, even if it discriminates against the non-student loan creditors, it will most likely be upheld unless there is evidence that the debtor is discriminating in a way that is knowingly unfair to the other creditors. "Fair" in this context does not mean that creditors maximize their earnings from the Chapter 13 plan. Rather, "fair" is used as the balancing point for both creditor and debtor. If inclusion of the student loan debt in debtors Chapter 13 would result in considerably higher yields to creditors, while imposing substantially similar results to the debtor, the loans must be included. However, as discussed above, where a court finds that loss to creditors is minimal when student loan debt is separately classified, the plan is assumed to be fair to all parties. If the price of college continues to trend upwards as it has over the last decade, courts will most likely continue with this line of reasoning.

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[81] *In re* Abaunza, 452 B.R. 866, 875 (Bankr. S.D. Fla. 2011).
[82] *See In re* Sharp, 415 B.R 803, 814 (Bankr. D. Colo. 2009).