

Rethinking Unfair Discrimination in Chapter 13

by

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In constructing their Chapter 13 payment plans, debtors are authorized by § 1322(b)(1) to designate different classes of unsecured claims, but are prohibited from “discriminat[ing] unfairly against any class so designated.”¹ This prohibition on “unfair discrimination”—a term left undefined in the Bankruptcy Code—implies that to some extent the debtor may discriminate in the classification and treatment of claims. In other words, by prohibiting only “unfair discrimination,” the Code permits discrimination that is fair.² On the other hand, the prohibition presumably has some relevance beyond the other statutory requirements for confirmation of a Chapter 13 plan.³ Specifically, it should mean more than that claimants receive the liquidation value of their claims,⁴ or that debtors not paying creditors in full allocate all

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¹11 U.S.C. § 1322(b)(1) (1994).

²See *In re Leser*, 939 F.2d 669, 671-72 (8th Cir. 1991); *In re Sperna*, 173 B.R. 654, 658 (9th Cir. BAP 1994) (also noting that the authorization to segregate claims into separate classes would serve no purpose in a Chapter 13 case unless the classes were afforded different treatment); *McCullough v. Brown*, 162 B.R. 506, 508-09 (N.D. Ill. 1993); *In re Davis*, 209 B.R. 893, 895 (Bankr. N.D. Ill. 1997); *In re Gonzalez*, 206 B.R. 239, 240 (Bankr. S.D. Fla. 1997); *In re Coonce*, 213 B.R. 344, 346 (Bankr. S.D. Ill. 1997); *In re Chandler*, 210 B.R. 898, 904 (Bankr. D.N.H. 1997); *In re Colfer*, 159 B.R. 602, 605-06 (Bankr. D. Me. 1993); *In re Storberg*, 94 B.R. 144, 146 (Bankr. D. Minn. 1988); *In re Blackwell*, 5 B.R. 748, 751 (Bankr. W.D. Mich. 1980); CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* § 12.11, at 918 (1997) (“Some discrimination must be allowed, since the statute prohibits only ‘unfair’ discrimination”); 5 WILLIAM L. NORTON, JR., *NORTON BANKRUPTCY LAW & PRACTICE* § 121:4 (2d ed. 1997) (“use of the term ‘unfairly’ to modify the concept of discrimination in Code § 1322(b)(1) suggests that some discrimination among classes of unsecured claims is permitted”); DAVID G. EPSTEIN, STEVE H. NICKLES & JAMES J. WHITE, *BANKRUPTCY* § 9-7, at 680 & 681 (1993) (“Congress must have intended that a certain level of discrimination is to be expected and is acceptable”; “The implication is that the debtor may do some ‘discrimination’ as long as it is not ‘unfair’”).

³Cf. Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L.J. 227, 247 (1998) (making essentially the same point about the prohibition on unfair discrimination in Chapter 11). But cf. G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Unresolved Doctrines of Classification and Unfair Discrimination in Business Reorganization Under the Bankruptcy Code*, 55 BUS. LAW. 1, 37-40 (1999) (concluding that the unfair discrimination standard in Chapter 11 has independent import, but noting some confusing legislative history suggesting that the unfair discrimination standard was intended as a component of the fair and equitable standard, both of which appear in § 1129(b)(1)).

⁴Cf. § 1325(a)(4) (1994).

disposable income to the plan for at least three years.⁵

For more than twenty years, courts have struggled with the meaning of the prohibition on unfair discrimination. They have developed a variety of tests, criticized them, and then continued to apply them. More to the point, they have reached inconsistent results, made prediction and planning by bankruptcy counsel difficult, and given debtors in different jurisdictions significantly different amounts of freedom in devising payment plans.

This Article attempts to cut through the thicket of precedent in this area in order to offer courts a new path, one taking a slightly more consistent and coherent approach to this recurring issue. In doing so, this Article concludes that a majority of courts have reached the wrong result in a significant percentage of the cases involving claims of unfair discrimination, those in which the debtor proposes to favor nondischargeable student loan claims. Before proceeding into the analysis, however, a brief illustration of the issue may be useful.

I. THE PROBLEM

A. AN ILLUSTRATION

Debbie and Doug were college sweethearts who married in their senior year. Doug went to law school and Debbie went to business school. By the time they both finished their studies, they owed collectively just over \$150,000 in student loans for their undergraduate and professional schooling.⁶

When Debbie entered the workforce, she joined the Baltimore office of a large multinational corporation at a starting salary of \$35,000. The following year, Doug was hired by a Baltimore law firm at a starting salary of \$55,000. Over the next two years, they saved enough money—when combined with

⁵Cf. § 1325(b) (1994).

⁶Assuming the loans are repaid over twenty years at nine percent interest, that works out to \$1,350 per month. Although this amount may seem high, it is realistic. For the last three years, 82%-85% of the graduating students at Gonzaga University School of Law have financed their education at least in part through student loans. For them, the average amount of debt at graduation (including debt from undergraduate schooling) was \$71,317. Of course, the individual amounts varied significantly, because the cost of their undergraduate institutions varied and because some of these students had partial law school scholarships.

Bearing in mind that tuition at Gonzaga University School of Law is lower than at many, if not most, other private law schools, even taking Debbie's one less year of schooling into account, the combined debt for Doug and Debbie could easily be \$150,000 without making them exceptional in any way. Cf. *In re Grigas*, 252 B.R. 866 (Bankr. D.N.H. 2000) (single debtor with \$75,000 in student loan debt); *Patterson v. Educational Credit Mgmt. Corp.* (*In re Patterson*), 251 B.R. 866 (Bankr. N.D. Cal. 2000) (same); *Soler v. United States* (*In re Soler*), 250 B.R. 694, 695 (Bankr. D. Minn. 2000) (noting that debtor had \$260,000 in student loan debt despite having already made substantial payments).

some gifts from their parents—for a down payment on a modest home.⁷

The following year, when she was two months pregnant, Debbie decided to change her job, switching to a small start-up tech firm which offers employees flexible hours and greater freedom to work at home. The pay was a little less, but the job still provided medical and similar benefits.

Unfortunately, the pregnancy was plagued by some serious complications and the resulting medical bills totaled \$150,000. Debbie then learned that her new health plan would not cover these expenses because her pregnancy was a preexisting condition. She had no coverage for her temporary disability for the same reason.

On Doug's income alone, it was impossible to pay the home mortgage, the student loans, the car loans, and all other reasonably necessary living expenses, even ignoring the medical bills. Even when Debbie started working again, they had no hope of being able to pay off all their debts.⁸

Debbie and Doug have \$40,000 of equity in their home, about half of which would be salvaged in a forced bankruptcy sale. They are entitled to no homestead exemption in Maryland. If they filed for Chapter 7 bankruptcy relief, they would lose the house. The trustee would sell it and the medical bill claimants and the student loan claimants would split the recovery equally (since the debt owed to them is the same). The remaining medical bills (\$140,000) would be discharged, but the student loan debt would not. Over a period of three years, they should have about \$60,000 in disposable income to pay toward the student loan debt, leaving \$80,000 plus interest due.

⁷They also signed a thirty-year mortgage for a \$150,000. At 8.5% interest, monthly payments would be \$1,150.

⁸Even with both their incomes, their take-home pay would be less than \$5,000 per month. That would be less than their expenses, including debt service:

Monthly Expense	Amount
Mortgage	\$1,150
Student Loans	\$1,350
Medical Bills	\$1,350
Transportation	\$600
Food, Utilities, Clothes, Insurance, Home & Car Maintenance, etc.	\$1,500
Total:	\$5,950.00

Chapter 7

	Medical Bills	Student Loans
	(150,000)	(150,000)
House Proceeds	\$10,000	\$10,000
	<u>(\$140,000)</u>	<u>(\$140,000)</u>
Discharge	\$140,000	\$0
	<u>\$0</u>	<u>(\$140,000)</u>
Payments for 3 Years	\$0	\$60,000
Amount Remaining Due After 3 Years	<u>\$0</u>	<u>(\$80,000) (plus interest)⁹</u>

To keep their home, Debbie and Doug decide instead to seek relief under Chapter 13. They propose a plan that will devote \$60,000 in disposable income to the payment of their creditors (other than the home mortgagee, who is to be paid directly and whose claim is treated as a living expense).¹⁰ The Chapter 13 trustee will take the first cut from that: 10% or \$6,000.¹¹

⁹There is little doubt that the debtor remains liable for postpetition interest on nondischargeable student loans, even though such interest would not be an allowed claim and could not be paid under the plan. See, e.g., *In re Leeper*, 49 F.3d 98 (3d Cir. 1995). This is so even if the debtor pays the principal balance in full under the Chapter 13 plan. See, e.g., *In re Pardee*, 218 B.R. 916 (9th Cir. BAP 1998), *aff'd on other grounds*, 193 F.3d 1083 (9th Cir. 1999); *Lawrence v. Educational Credit Mgmt. Corp.*, 251 B.R. 467 (E.D. Va. 2000).

¹⁰This total is composed of \$1,000 per month for six months while Debbie is temporarily disabled and \$1,800 per month for the next thirty months.

¹¹A standing Chapter 13 trustee's fees may not exceed ten percent of the amounts the trustee distributes to creditors. See 28 U.S.C. § 586(e)(1)(B). However, there is also a cap on a standing Chapter 13 trustee's total annual compensation, set administratively each year. See 28 U.S.C. § 586(e)(1)(A)(i). Because of this, standing Chapter 13 trustees in some districts—particularly large districts with numerous Chapter 13 cases—routinely take less than the ten percent maximum. See, e.g., *In re McNichols*, 249 B.R. 160, 175 (Bankr. N.D. Ill. 2000) (6.6%); *In re Martin*, 233 B.R. 436, 438 (Bankr. D. Ariz. 1999) (7%); *In re Janssen*, 220 B.R. 639, 644 (Bankr. N.D. Iowa 1998) (9%). Nevertheless, for simplicity, the ten percent maximum figure is used in this illustration. See *In re Mathenia*, 220 B.R. 427, 428 n.2 (Bankr. W.D. Okla. 1998) (computing the trustee's take at ten percent to determine feasibility of plan, even though a lower percentage is often charged). See also *In re Chandler*, 210 B.R. 898, 901 (Bankr. D.N.H. 1997) (charging ten percent).

Notice that the trustee's percentage is not applied to the postpetition debt service on the home mortgage, which the debtor will pay directly. Pursuant to 11 U.S.C. § 1326(c), the bankruptcy court may allow the debtor to act as disbursing agent on some claims, and the trustee is not entitled to collect a fee on payments made directly by the debtor. See 28 U.S.C. § 586(e)(2) (2000). Although courts have not reached total agreement about which claims a debtor may pay directly, most allow direct payment of the debtor's current home mortgage payments. See, e.g., *In re Aberegg*, 961 F.2d 1307 (7th Cir. 1992). Some courts allow the debtor to be the disbursing agent on other secured claims as well. E.g., *In re Bradley*, 705 F.2d 1409 (5th Cir. 1983) (auto loan); *In re Evans*, 77 B.R. 457 (E.D. Pa. 1987) (IRS lien). But see *In re Genereux*, 137 B.R. 411 (Bankr. W.D. Wash. 1992) (requiring car payment be made through the trustee even though loan was fully secured). The willingness of courts to allow this practice—which if taken to an extreme could leave the trustee system seriously underfunded—apparently varies significantly from district to district and often depends on whether the plan modifies the obligation. See *In re Fulkrod*, 973

That leaves \$54,000 for creditors. They propose:

Debtors' Chapter 13 Plan

	Medical Bills	Student Loans
	(150,000)	(150,000)
Payments for 3 Years	\$11,450 ¹²	\$42,550
	<u>(\$139,000)</u>	<u>(\$107,450)</u>
Discharge	\$139,000	\$0
Amount Remaining Due After 3 Years	\$0	<u>(\$107,500)</u> (plus interest)

They thus would owe more, but still have their house, with all of its equity and sentimental value. The Chapter 13 trustee—or one of the medical creditors—objects, claiming unfair discrimination because the medical bills and the student loans are not treated equally. If they were, the plan would look more like this:

Trustee's Chapter 13 Plan

	Medical Bills	Student Loans
	(150,000)	(150,000)
Payments for 3 Years	\$27,000	\$27,000
	<u>(\$123,000)</u>	<u>(\$123,000)</u>
Discharge	\$123,000	\$0
Amount Remaining Due After 3 Years	\$0	<u>(\$123,000)</u> (plus interest)

One troubling aspect of such a plan is that the \$9,000 in annual payments on the student loans will not even cover the accruing interest, resulting in negative amortization for that period.¹³ The end result would be that the total

F.2d 801 (9th Cir. 1992) (requiring debtor in Chapter 12—which has provisions identical to Chapter 13—to make payments on modified claims through the trustee). *But cf. In re McCann*, 202 B.R. 824 (Bankr. N.D.N.Y. 1996) (citing Sixth and Eighth Circuit opinions for support for direct payment but ultimately declining permission for lack of a good reason).

In some situations, it may be possible for the debtor to pay student loans directly, particularly if the plan proposes to cure any default and simply maintain the contractual level of payments, which will then continue beyond the life of the plan. *See In re Chandler*, 210 B.R. 898, 904 (Bankr. D.N.H. 1997). This illustration assumes that direct payment is not permitted. That assumption is not critical to the analysis, however.

¹²Section 1325(a)(4) requires that the value, as of the effective date of the plan, of what each unsecured claimant is to receive under the plan, not be less than the liquidation value of the creditor's claim. Based on the first chart above, the liquidation value of these claims is \$10,000. Using a nine percent discount rate, it will take monthly payments of \$318 to pay this debt over three years. That totals approximately \$11,450.

¹³*Cf. In re Coonce*, 213 B.R. 344, 349 (Bankr. S.D. Ill. 1997) (rejecting the debtors' argument that the

student loan debt will actually be greater at the end of the plan than the amount owing on the petition date: approximately \$163,000.

If the trustee wins the argument, as the trustee is likely to do under current judicial rulings,¹⁴ Doug and Debbie might well decide that Chapter 13 does not provide a better alternative than Chapter 7. They would therefore likely convert the case to Chapter 7 (or, if advised properly at the outset, have filed in Chapter 7 originally) and lose their home.

B. MORAL OF THE STORY

No claim is made that Doug and Debbie are representative of many bankruptcy debtors or even that this illustration is realistic.¹⁵ The point is that, for some debtors, application of the unfair discrimination rule in this manner will dissuade them from using Chapter 13 at all, and propel them into Chapter 7.¹⁶ The result is therefore: (1) some creditors whom the rule is designed to protect—such as the medical claimants here—do not end up better off; and (2) some debtors may lose their homes.¹⁷

With such possible repercussions in mind, this Article explores Chapter

negative amortization on nondischargeable student loan debts during a plan that pays claimants ratably justifies favored treatment of the student loans during the plan). See also NATIONAL BANKRUPTCY REVIEW COMMISSION, *BANKRUPTCY: THE NEXT TWENTY YEARS* 290 (1997) ("Because constraints on Chapter 13 plans may preclude the debtor from making full payment of a nondischargeable debt during the life of the plan, and because some courts permit interest to accrue on nondischargeable debts during the time the bankruptcy is pending, debtors sometimes end up owing more nondischargeable debt at the end of a plan than at the beginning"); *In re Soler*, 250 B.R. at 694-95 (debtor who made monthly \$1,400 payments on student loans for seven years still owed \$260,000, a balance which was \$50,000 more than when she started making such payments).

¹⁴See *infra* note 230.

¹⁵That said, it is worth noting that approximately forty percent of consumers who file for bankruptcy protection have had a recent divorce, forty percent have experienced a job loss, and forty percent have incurred major medical expenses for themselves or a dependent. Note, this adds up to more than 100% because some debtors experience more than one of these crises.

¹⁶This assumes, however, that they are not denied Chapter 7 relief by § 707(b), which authorizes courts to dismiss a Chapter 7 case brought by a consumer debtor if it constitutes a substantial abuse of the bankruptcy process. Although there is some dispute over whether a debtor's ability to repay debts out of future disposable income, by itself, renders a Chapter 7 filing a substantial abuse, there is general agreement that it is at least strong evidence of substantial abuse. See *In re Lamanna*, 153 F.3d 1 (1st Cir. 1998).

¹⁷Admittedly, there may be other ways for the debtors to save their home. For example, they could possibly borrow more against the home, leaving themselves with no equity in it, and then file under Chapter 7. The trustee would then abandon any interest in the home and would distribute the loan proceeds to the unsecured creditors according to their relative priorities, which here are equal. The debtors would in essence have more postdischarge debt to pay—although they may be discharged of personal liability, they would have to pay off the increased home mortgage debt in order to retain their home—but probably not an amount in excess of what they proposed to pay to the medical claimants anyway. While there may be transaction costs to such prebankruptcy planning, it has the added advantage of avoiding the fairly significant fees of a Chapter 13 trustee.

While techniques such as this do undermine the argument that the debtors will be worse off if forced into Chapter 7, they do not alter the point that strict application of the prohibition on unfair discrimination may squeeze them out of Chapter 13 and therefore benefit no creditors.

13's prohibition on unfair discrimination. It concludes that courts have not adequately analyzed the phrase or the consequences of their decisions. It therefore proposes that courts abandon their current rules and adopt new ones that evaluate the fairness of any proposed discrimination in reference to the policies implied and rules expressed in the Bankruptcy Code itself. Doing this will produce different results in a substantial number—but still a minority—of unfair discrimination cases.

II. ANALYSIS OF CURRENT LAW

A. ORIGINS OF THE "UNFAIR DISCRIMINATION" PROHIBITION

The origins of the unfair discrimination standard, which Professor Bruce Markell has delineated quite well,¹⁸ provide little illumination of meaning. The phrase was apparently first used legislatively when Congress expanded the scope of the Bankruptcy Act of 1898 to accommodate railroads.¹⁹ It waxed and waned in and out of favor, sometimes being dropped as implicit in the requirement that a reorganization plan be "fair and equitable," or in other words, that the plan comply with the absolute priority rule.²⁰

It reappeared during enactment of the Bankruptcy Code in the House version of the bill, both in Chapter 11 on reorganizations and in Chapter 13 on individual debt adjustment plans.²¹ However, the scant legislative history does not really explain why. In connection with the Chapter 11 provision, the Committee Report accompanying the bill states that "[t]he criterion of unfair discrimination is not derived from the fair and equitable rule,"²² and illustrates its application to cases in which some creditors have contractually agreed to subordinate the obligations owed to them. The floor sponsor merely stated that the standard was added for clarity, but did not explain either what was being clarified or how it was made more clear.²³ With regard to the Chapter 13 provision, both the Committee Report and the statements of the floor sponsors are entirely silent.²⁴

¹⁸See Markell, *supra* note 3, at 228-39. See also Brunstad & Sigal, *supra* note 3, at 37-46.

¹⁹Act of March 3, 1933, § 77(g), 47 Stat. 1467, 1479 (1933). See also Markell, *supra* note 3, at 231.

²⁰See Markell, *supra* note 3, at 232-33 (discussing legislative history from 1938). See also *id.* at 235-36 (quoting a House Report from 1975 which characterized the unfair discrimination requirement as "another aspect of the fair and equitable rule").

²¹See H.R. 8200, 95th Cong. §§ 1129(b) and 1322(b)(1) (as reported by the House Committee on the Judiciary, September 8, 1977), reprinted in COLLIER ON BANKRUPTCY, app. B (Lawrence P. King et al. eds., 15th ed. rev. 1999).

²²H.R. REP. NO. 95-595 at 417 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6373.

²³124 CONG. REC. 32,407 (1978) (statement of Rep. Edwards), reprinted in 1978 U.S.C.C.A.N. 6436, 6474. A similar statement was made by the floor sponsor of the Senate bill. See 124 CONG. REC. 34,006 (statement of Sen. DeConcini), reprinted in 1978 U.S.C.C.A.N. 6505, 6543. See also Markell, *supra* note 3, at 236 ("Just what was clarified is, unfortunately, unclear.").

²⁴The closest the House Report comes to commenting on unfair discrimination in Chapter 13 is to paraphrase the bill's language about the classification of claims: "The plan may designate a class or classes

If the House statement that the prohibition on unfair discrimination was *not* derived from the fair and equitable requirement seems odd, given contrary legislative statements just two years before,²⁵ it is arguably supported by the fact that the Senate bill originally included the prohibition in Chapter 13 cases—to which the fair and equitable requirement does not technically apply²⁶—but not in Chapter 11 cases.²⁷ Unfortunately, the Senate Report is also silent as to the meaning of unfair discrimination in Chapter 13.²⁸

Despite the lack of legislative guidance, it seems fairly clear that the unfair discrimination standard is intended to maintain equity among creditors of the same priority, much as the fair and equitable requirement preserves equity among creditors of different priorities.²⁹ Beyond that level of generality, however, the origins and legislative history of the unfair discrimination rule are not much help.³⁰ To discern the details of this portrait of equity, courts and commentators must look elsewhere.

B. JUDICIAL INTERPRETATION OF “UNFAIR DISCRIMINATION”

As a preliminary matter, because the unfair discrimination standard appears in both § 1129(b) and § 1322(b), many courts have looked to cases interpreting one for assistance in applying the other.³¹ The appeal of doing so is somewhat bolstered by the fact that § 1322(b) expressly references the § 1122 rules on classification of claims.³² Furthermore, several commentators

of unsecured claims, other than priority claims, subject to the provisions of section 1122, relating to classification of claims.” H.R. REP. NO. 95-595 at 429 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6384.

²⁵See Markell, *supra* note 3, at 236.

²⁶The word “technically” is used because even though the “fair and equitable” standard of § 1129(b) is not used in Chapter 13, Chapter 13 does require that all priority claims be paid in full, unless the holder of such a claim agrees to different treatment. 11 U.S.C. § 1322(a)(2) (1994). As a result, a sort of absolute priority rule does exist in Chapter 13 and therefore inclusion of the “fair and equitable” requirement in Chapter 13 would be redundant.

²⁷See S. 2266, 95th Cong. §§ 1130 & 1322(b) (as reported by the Senate Judiciary Committee, July 14, 1978), *reprinted in* COLLIER ON BANKRUPTCY, app. C (Lawrence P. King et al. eds., 15th ed. rev. 1999).

²⁸See S. REP. NO. 95-989 at 12-13, 141 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5798-99, 5927.

²⁹Cf. Markell, *supra* note 3, at 231.

³⁰Professor Markell suggested that “Congress intended nothing novel” with unfair discrimination standard and therefore “the search for the proper limits of the rule ought to canvas the past.” Markell, *supra* note 3, at 238. While there is much to be said for this conclusion in the context of Chapter 11 business reorganizations, for which there is a fair amount of pre-Code history and from which the standard apparently derived, such an inquiry would be largely fruitless in a search for meaning in Chapter 13 cases. See *id.* at 242, 244-46 (noting that Chapter 13 “lacks the historical understandings that shaped unfair discrimination in Chapter 11,” and arguing that the unfair discrimination requirement of § 1129(b) be interpreted independently of the § 1322(b) requirement).

³¹Some courts make this leap with full disclosure of what they are doing and why. See, e.g., *In re Aztec Co.*, 107 B.R. 585, 590 (Bankr. M.D. Tenn. 1989). Far many more simply apply in Chapter 11 cases the multifactor test developed in Chapter 13 cases. See Denise R. Polivy, *Unfair Discrimination in Chapter 11: A Comprehensive Compilation of Current Case Law*, 72 AM. BANKR. L.J. 191, 203 n.102 (1998) (citing cases). See also Markell, *supra* note 3, at 244 n.80.

³²11 U.S.C. § 1322(b)(1) (1994).

seem to agree that this is a proper approach.³³

More recently, however, Professor Markell has attacked this practice. He noted at least three reasons why the Chapter 13 standard should be more lenient than the Chapter 11 standard.³⁴ First, the unfair discrimination standards apply in different procedural settings. In Chapter 13, the prohibition against unfair discrimination appears in § 1322, the provision detailing the permissible contents of a plan. More specifically, it is included in the very provision that authorizes the debtor to classify claims into different groups. In Chapter 11, however, the rule appears in the section on confirmation, and more specifically, on cramdown, and thus is divorced from all language of permissiveness.

More important than placement, the rules operate differently. In Chapter 13, the rule can be invoked by any claimant, and thus protects each *individual creditor*. In contrast, in Chapter 11 the rule applies only to a *class* of claimants (or interest holders) that has rejected the plan. In Chapter 13 unfair discrimination is therefore an absolute rule, while in Chapter 11 it can effectively be waived, even on behalf of an objecting creditor, simply through the process of voting by class. All this suggests that unfair discrimination should be a less strict requirement in Chapter 13, to avoid giving each creditor the power to unduly hold up confirmation.³⁵

Second, the statutory provisions are not identical. Specifically, § 1322(b)(1) expressly permits different treatment of consumer claims on which a codebtor is liable.³⁶ Chapter 11 has no such rule and courts have shown no inclination to permit favored treatment of claims guaranteed by an insider.³⁷

Third, Chapter 13 lacks the requirement in Chapter 11 that a plan be

³³See Scott F. Norberg, *Classification of Claims under Chapter 11 of the Bankruptcy Code: The Fallacy of Interest Based Classification*, 69 AM. BANKR. L.J. 119, 161 (1995) ("Because § 1322(b)(1) is analogous to § 1129(b)(1), Chapter 13 unfair discrimination decisions are instructive on the same issues in Chapter 11."); EPSTEIN et al. *supra* note 2, § 9-5, at 677 (suggesting that the § 1322(b)(1) prohibition on unfair discrimination, coupled with the § 1325 requirement of good faith, "leaves us in the same position we find ourselves in Chapter 11"). But see John C. Anderson, *Classification of Claims and Interests in Reorganization Cases Under the New Bankruptcy Code*, 58 AM. BANKR. L.J. 99, 122 n.115 (1984) (opining that Chapter 13 cases have little precedential value in Chapter 11 cases).

³⁴Markell, *supra* note 3, at 244-46.

³⁵*Id.* at 244-45.

³⁶This language was added to the Code by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353, § 316, 98 Stat. 333, 356.

³⁷See *In re Barney & Carey Co.*, 170 B.R. 17, 25-26 (Bankr. D. Mass. 1994); *In re Creekside Landing, Ltd.*, 140 B.R. 713, 716 (Bankr. M.D. Tenn. 1992).

Professor Markell also noted that the Chapter 11 rule applies to secured claimants, unsecured claimants, and equity holders, while the Chapter 13 standard applies only to unsecured claimants. From this he concluded that the Chapter 11 standard "has to be pliable enough to treat readjustments of those classes." Markell, *supra* note 3, at 246. This is a further reason why the standards need not be applied in the same manner, but it seems to cut in favor a more lenient standard in Chapter 11 rather than in Chapter 13.

“fair and equitable,” the standard out of which the prohibition on unfair discrimination grew. Professor Markell observed: “This means that Chapter 13 plans need not satisfy the absolute priority standard or any other unmodified component of that rule.”³⁸

Professor Markell’s first two points are persuasive. His third is undermined somewhat by the fact that, although there is no absolute priority rule per se in Chapter 13, there is a requirement that all priority claims be paid in full.³⁹ Given this, and the fact that there can be no interest holders in a Chapter 13 case,⁴⁰ all the remaining unsecured claimants—the only entities to which the authority to classify and the unfair discrimination prohibition apply—must be of the same priority. In short, there really is something of an absolute priority rule in Chapter 13.

On the other hand, at least two more reasons support the argument that unfair discrimination need not have the same meaning in Chapters 11 and 13. First, the composition of the bankruptcy estates are different. Postpetition personal earnings of an individual are not part of a Chapter 11 estate but are included in a Chapter 13 estate.⁴¹ In other words, Chapter 13 claimants are permitted to share in assets they could not reach in Chapter 11. Indeed, they may be able to share in assets that they could not reach under nonbankruptcy law.⁴² This, considered along with the fact debtors cannot be involuntarily placed into Chapter 13,⁴³ suggests that debtors should not be *unduly* restricted in how those assets are distributed.

Second, to the extent Chapter 11 is relevant to businesses rather than to

³⁸Markell, *supra* note 3, at 246.

³⁹See 11 U.S.C. § 1322(a)(2) (2000).

⁴⁰Interest holders are those who have ownership rights in the debtor, such as stockholders of a corporation, and their rights are normally subordinate to the rights of claim holders: the creditors of the debtor. Because Chapter 13 is limited to individuals (i.e., human beings) with regular income, see 11 U.S.C. §§ 101(30) & 109(e), and human beings cannot be owned, see U.S. Const. amend. XIII, § 1, there can be no interest holders in a Chapter 13 case.

⁴¹Compare 11 U.S.C. § 541(a)(6) with 11 U.S.C. § 1306(a) (1994).

⁴²Federal law limits the amounts of wages, salary, commissions, and bonuses that a creditor may garnish. See 15 U.S.C. §§ 1671-1677 (1997). Not only that, several courts have ruled that income which is exempt under nonbankruptcy law is nevertheless to be included in the calculation of disposable income, which must be made available to claimants under a Chapter 13 plan, see 11 U.S.C. § 1325(b), because the plan is voluntary and such income is therefore not involuntarily attached or levied upon. See *In re Taylor*, 212 F.3d 395, 397 (8th Cir. 2000) (income from ERISA-qualified pension); *In re Koch*, 109 F.3d 1285, 1289 (8th Cir. 1997) (worker’s compensation benefits); *In re Freeman*, 86 F.3d 478, 480-82 (6th Cir. 1996) (tax refund); *In re Hagel*, 184 B.R. 793, 795-98 (9th Cir. BAP 1995) (social security disability benefits); *In re Schnabel*, 153 B.R. 809, 817-18 (Bankr. N.D. Ill. 1993) (social security and pension income). But see *In re Hunton*, 253 B.R. 580 (Bankr. N.D. Ga. 2000). Cf. *In re Solomon*, 67 F.3d 1128 (4th Cir. 1995) (excusing retired debtor who could withdraw funds from IRA without penalty, but who planned not to, from including funds in computation since they are not a source of regular income).

⁴³See 11 U.S.C. § 303(a) (1994).

individuals,⁴⁴ the allegations of unfair discrimination are likely to involve very different issues than those that arise in Chapter 13 and the results of a refusal to confirm the plan are drastically different. In particular, allegations of unfair discrimination in Chapter 13 cases frequently involve nondischargeable claims.⁴⁵ In Chapter 11 cases, however, the nondischargeability rules are rarely relevant to unfair discrimination issues.⁴⁶ More importantly, if confirmation is denied, a business debtor always has the option of liquidating and ceasing to exist.⁴⁷ An individual debtor in Chapter 13 can liquidate his or her assets, but cannot cease to exist. That individual continues to need food, shelter, clothing, and medical care. This too suggests that debtors in Chapter 13 should be given more flexibility in devising their plans than businesses need receive in Chapter 11.

Moving on to the substance of the matter, courts have developed and applied at least five different tests to evaluate assertions of unfair discrimination.⁴⁸ All have received extensive criticism.

1. *The Strict Approach*

One of the first published decisions to construe the prohibition against unfair discrimination was *In re Iacovoni*.⁴⁹ It was actually a consolidation of eight different cases, two of which posed the question of whether a Chapter 13 plan could favor claims on which a relative or other codebtor was liable. In analyzing the Code, the court concluded that all unsecured, nonpriority claimants have, absent some reason for equitable subordination, equal rights to share in the bankruptcy estate.⁵⁰ Because of that, the court concluded that the only exception to uniform treatment of unsecured claims, other than because of equitable subordination, is for administrative convenience, an exception provided for in § 1122, which is in turn expressly referenced in § 1322(b)(1).⁵¹ Accordingly, the court ruled that favored treatment of claims guaranteed by a codebtor was improper.

A 1984 amendment to § 1322(b)(1) made it clear that separate classifica-

⁴⁴But cf. *Toibb v. Radloff*, 501 U.S. 157 (1991) (ruling that a debtor—albeit one ineligible for Chapter 13—need not have a business to seek relief under Chapter 11).

⁴⁵See *infra* notes 197-247 and accompanying text.

⁴⁶See Denise R. Polivy, *supra* note 31, at 215 & nn.209-10 (noting only three cases involving allegedly unfair discrimination in favor of nondischargeable debts in Chapter 11 cases, only one of which involved a corporate debtor).

⁴⁷See Markell, *supra* note 3, at 254-55 (suggesting that discrimination is never necessary for a nonindividual Chapter 11 debtor and thus necessity should not be a consideration in evaluating the fairness of any disparate treatment proposed). See also *In re Dow Corning Corp.*, 244 B.R. 696, 701-02 (Bankr. E.D. Mich. 1999) (finding merit in Professor Markell's arguments and adopting the analysis he proposed for Chapter 11 cases).

⁴⁸The precise number varies depending on how one categorizes what courts have done.

⁴⁹2 B.R. 256 (Bankr. D. Utah. 1980).

⁵⁰*Id.* at 260.

⁵¹*Id.*

tion of codebtor claims is permissible, at least in some circumstances.⁵² Thus, the precise holding of *Iacovoni* has been overruled by statute. Nevertheless, there may be a court or two that continue to follow its strict approach to disparate treatment of unsecured claims, always deeming it unfair discrimination except in cases of equitable subordination, administrative convenience, or the liability of a codebtor, the latter two being the only types of discrimination expressly authorized in the Code itself.⁵³

The problem with the *Iacovoni* approach is that it effectively eliminates classification of unsecured claims in Chapter 13 cases,⁵⁴ and in that sense fails to give efficacy to the language and meaning of § 1322(b)(1).⁵⁵ Put another way, it essentially reads the provision as if the word “unfairly” were not there, prohibiting all discrimination except to the extent expressly authorized in the Code. Because of that, the approach has not been widely adopted. In fact, the author of the decision quickly retreated from its analysis by suggesting that a Chapter 13 plan could favor a claim for past due spousal support.⁵⁶ What is more, one fairly recent decision analyzing the different approaches to unfair discrimination problems does not even list this approach among the alternatives worthy of discussion.⁵⁷

2. *The Flexible Approach*

In sharp contrast to the strict approach is the approach taken by the court in *In re Sutherland*,⁵⁸ another early decision on this issue. There the court faced a plan that proposed to classify unsecured claims into four separate groups: (1) debts for medical services owed to providers whose services were desired in the future; (2) debts to banks from which credit was needed in the future; (3) debts on credit cards needed for continued business operations; and (4) all other general unsecured claims. The plan proposed to pay

⁵²For discussion of when it is properly permissible to favor codebtor claims, see *infra* notes 151-67 and accompanying text.

⁵³See *In re Hiner*, 161 B.R. 688 (Bankr. D. Idaho 1993).

⁵⁴James B. McLaughlin, Jr. & Robert W. Nelms, *Classification of Unsecured Claims in Chapter 13 of the Bankruptcy Reform Act of 1978: What Is Fair?*, 7 CAMPBELL L. REV. 329, 336-37, 343 (1985) (referring to this approach as “an emasculation of § 1322”).

⁵⁵*In re Cook*, 26 B.R. 187, 190 (D.N.M. 1982); EPSTEIN ET AL., *supra* note 2, § 9-7, at 681.

⁵⁶*In re Adams*, 12 B.R. 540, 543 (Bankr. D. Utah 1981).

Other courts that originally followed such a strict approach have also apparently abandoned it. For example, the bankruptcy court in *In re Stewart*, 52 B.R. 281 (Bankr. W.D.N.Y. 1985) permitted favored treatment of codebtor claims because of the recent amendment to § 1322(b)(1), but refused to permit favored treatment of child support claims because there was no statutory authorization to do so. In subsequent cases, the same court has done precisely the reverse. See *In re Husted*, 142 B.R. 72 (Bankr. W.D.N.Y. 1992) (permitting separate classification and favored treatment of support claims); *In re Strausser*, 206 B.R. 58 (Bankr. W.D.N.Y. 1997) (refusing to permit favored treatment of codebtor claims). More significantly, in neither subsequent case did the court even cite the *Stewart* decision. Instead, in both instances the court purported to follow the multifactor analysis described *infra*.

⁵⁷See *In re Kolbe*, 199 B.R. 569, 571-74 (Bankr. D. Md. 1996).

⁵⁸3 B.R. 420 (Bankr. W.D. Ark. 1980).

some unidentified amount on claims in the first three groups, but nothing to claims in the fourth group. The court permitted the disparate treatment because all creditors were to receive at least what they would get in a Chapter 7 liquidation, which in the case of creditors in the last group, was nothing.⁵⁹

In essence, the court treated the prohibition against unfair discrimination in § 1322(b)(1) as meaning nothing more than the requirement in § 1325(a)(4) that creditors receive at least the liquidation value of their claims.⁶⁰ As many courts and commentators have noted, this effectively renders the prohibition meaningless, reading it out of the Code entirely.⁶¹ Not surprisingly, courts have shown no enthusiasm for this approach, and no other court has adopted it.⁶² Indeed, it no longer appears to be good law in the jurisdiction of its origin.⁶³

The closest another court has come to the approach of *Sutherland* is the decision in *In re Lawson*, in which the Bankruptcy Court for the Northern District of Illinois ruled that discrimination is fair as long as it “rationally furthers an articulated, legitimate interest of the debtor.”⁶⁴ However, the *Lawson* approach too has been criticized for, among other things, improperly focusing the inquiry on the debtor rather than on the disfavored creditors,⁶⁵ and subsequent cases from the same district have expressly rejected it.⁶⁶

3. The Balance Approach

More recent cases from the Northern District of Illinois—which for reasons unknown appears to be very fertile soil for unfair discrimination issues⁶⁷—insist that if the debtor wishes to favor some claims, “the debtor

⁵⁹*Id.* at 421-22.

⁶⁰See McLaughlin & Nelms, *supra* note 54, at 334.

⁶¹See *In re Cook*, 26 B.R. at 189; *In re Dziedzic*, 9 B.R. 424, 426 (Bankr. S.D. Tex. 1981) (suggesting that the *Sutherland* approach treats “unfair discrimination” as irrelevant language); McLaughlin & Nelms, *supra* note 54, at 338 & 342; EPSTEIN ET AL., *supra* note 2, § 9-7, at 681-82. Also, see generally, *supra* note 3.

⁶²See McLaughlin & Nelms, *supra* note 54, at 334-35. Although this article is fifteen years old, this statement remains true.

⁶³See *In re Green*, 70 B.R. 164, 167 (Bankr. W.D. Ark. 1986) (“Nothing in the legislative history of section 1322 suggests that unfairness should be measured by the creditor’s treatment under Chapter 7. Therefore, the plan unfairly discriminates notwithstanding the fact that the objecting creditors are receiving more under the plan than they would in a chapter 7.”).

⁶⁴93 B.R. 979, 984 (Bankr. N.D. Ill. 1988).

⁶⁵See *In re Kolbe*, 199 B.R. 569 (Bankr. D. Md. 1996).

⁶⁶See *McCullough v. Brown*, 162 B.R. 506 (N.D. Ill. 1993), *rev’g In re Brown*, 152 B.R. 232 (Bankr. N.D. Ill. 1993) (decided by the same judge who decided *Lawson* and following the same approach). *But cf. In re Gonzales*, 172 B.R. 320, 326 (E.D. Wash. 1994) (equating the *Lawson* approach with the multifactor approach discussed *infra*).

⁶⁷See *In re McNichols*, 249 B.R. 160 (Bankr. N.D. Ill. 2000); *In re Davis*, 209 B.R. 893 (Bankr. N.D. Ill. 1997); *In re Eiland*, 170 B.R. 370 (Bankr. N.D. Ill. 1994); *In re Christophe*, 151 B.R. 475 (Bankr. N.D. Ill. 1993); *In re Brown*, 152 B.R. 232 (Bankr. N.D. Ill. 1993), *rev’d*, *McCullough v. Brown*, 162 B.R. 506 (N.D. Ill. 1993); *In re Chapman*, 146 B.R. 411 (Bankr. N.D. Ill. 1992); *In re Lawson*, 93 B.R. 979 (Bankr. N.D. Ill.

must place something material onto the scales to show a correlative benefit to the other unsecured creditors."⁶⁸ However, this approach has not received substantial attention outside the district,⁶⁹ nor even full acceptance within it.⁷⁰

Moreover, while *quid pro quo* is undoubtedly an element of fairness, it is not the *sine qua non* of it. For example, there may be situations in which the favored treatment of some creditors does not substantially harm others, perhaps because without it the debtor would be forced out of Chapter 13 and into Chapter 7, where all unsecured creditors may get nothing.⁷¹ In such situations, there may be no need to provide a correlative benefit in order to be fair.⁷²

Perhaps more importantly, this approach of balancing benefits and burdens fails to provide a way to consider other strong public policies that may justify discriminatory treatment. For example, under this approach it would have been improper to favor claims for overdue spousal and child support before they became a priority expense, even though most courts regarded favored treatment of such claims as perfectly appropriate.⁷³

4. *The Multifactor Approach*

The most commonly used approach employs a "test" consisting of four or five parts, referred to variously as the *Kovich*,⁷⁴ *Hosler*,⁷⁵ *Leser*,⁷⁶ *Wolff*,⁷⁷

1988); *In re Todd*, 65 B.R. 249 (Bankr. N.D. Ill. 1986). See also *In re Coonce*, 213 B.R. 344 (Bankr. S.D. Ill. 1997); *In re Chandler*, 210 B.R. 898 (Bankr. D.N.H. 1997); *In re Cheak*, 171 B.R. 55 (Bankr. S.D. Ill. 1994); *In re Ross*, 161 B.R. 36 (Bankr. C.D. Ill. 1993).

⁶⁸*McCullough*, 162 B.R. at 517-18. See also *In re McNichols*, 249 B.R. at 175-79 (applying *McCullough*).

⁶⁹See *In re Kolbe*, 199 B.R. 569, 572 (Bankr. D. Md. 1996) (discussing and rejecting this test in only two paragraphs despite devoting more attention to the other alternatives). But cf. *In re Ponce*, 218 B.R. 571, 579 (Bankr. E.D. Wash. 1998) (requiring a correlative benefit to offset the proposed discrimination, but doing so after purporting to apply the multifactor test discussed *infra*).

⁷⁰See *In re Eiland*, 170 B.R. 370, 378 (Bankr. N.D. Ill. 1994) ("This Court will not, however, necessarily find Judge Shadur's 'correlative benefit' test of creditor fairness to be the only test of fairness.").

⁷¹See *infra* notes 168-96 and accompanying text.

⁷²*In re Davis*, 209 B.R. 893, 896 (Bankr. N.D. Ill. 1997) (quoting *In re Blackwell*, 5 B.R. 748, 751 (Bankr. W.D. Mich. 1980)); *In re Eiland*, 170 B.R. 370, 378 (Bankr. N.D. Ill. 1994). See also *In re Kolbe*, 199 B.R. 569, 572 (Bankr. D. Md. 1996).

⁷³See *infra* note 131 and accompanying text.

⁷⁴See *In re Kovich*, 4 B.R. 403, 407 (Bankr. W.D. Mich. 1980). For references to the "*Kovich* test," see, e.g., *In re Brigrance*, 234 B.R. 401, 406 (W.D. Tenn. 1999).

⁷⁵See *In re Hosler*, 12 B.R. 395 (Bankr. S.D. Ohio 1981). For references to the "*Hosler* test," see, e.g., *Cash in a Flash v. Brown*, 229 B.R. 739, 742-48 (W.D. Tenn. 1999).

⁷⁶See *In re Leser*, 939 F.2d 669 (8th Cir. 1991). For references to the "*Leser* test," see, e.g., *In re Thibodeau*, 248 B.R. 699, 704 (Bankr. D. Mass. 2000); *In re Kolbe*, 199 B.R. 569, 571-72 (Bankr. D. Md. 1996); *In re Sullivan*, 195 B.R. 649, 653, 658 (Bankr. W.D. Tex. 1996); *In re Eiland*, 170 B.R. 370, 374-76 (Bankr. N.D. Ill. 1994); *In re Colfer*, 159 B.R. 602, 607 n.18 (Bankr. D. Me. 1993).

⁷⁷See *In re Wolff*, 22 B.R. 510 (9th Cir. B.A.P. 1982). For references to the "*Wolff* test," see, e.g., *In re Ponce*, 218 B.R. 571, 572 (Bankr. E.D. Wash. 1998); *In re Alicea*, 199 B.R. 862, 866 (Bankr. D.N.J. 1996);

Dziedzic,⁷⁸ *Storberg*,⁷⁹ or *Husted*⁸⁰ test.

This approach originated twenty years ago in *In re Kovich*, a consolidation of two cases involving discriminatory Chapter 13 plans, one favoring a claim guaranteed by the debtor's friend, the other favoring a claim for back rent.⁸¹ In approving both plans, the court ruled that each case of discriminatory treatment must be decided on its own merits, and suggested four inquiries relevant to that determination:

1. Is there a reasonable basis for the classification?
2. Is the debtor able to perform a plan without the classification?
3. Has the debtor acted in good faith in proposing the classification?
4. How are the other claimants being treated? Specifically, are they receiving meaningful payment?⁸²

The court offered no explanation of the origin of these four factors or why they collectively determine when discrimination is unfair. Indeed, it is far from clear that the court intended these questions to become a test of fairness.⁸³ Nevertheless, because the series of inquiries seemed a marked improvement over both the strict approach of *Iacovoni* and the flexible approach of *Sutherland*, courts and commentators quickly embraced it as the proper approach to the issue.⁸⁴ Within a few years, courts started adopting it merely because it represented the path trodden by prior judicial expeditionaries, regardless of whether it was a good route for their journey.⁸⁵

Despite having embraced it, courts and commentators have leveled almost

In re Limbaugh, 194 B.R. 488, 491 (Bankr. D. Or. 1996); *In re Thompson*, 191 B.R. 967, 971 (Bankr. S.D. Ga. 1996); *In re Bernal*, 189 B.R. 507, 509 (Bankr. S.D. Cal. 1995); *In re Whitelock*, 122 B.R. 582, 589 (Bankr. D. Utah 1990); *In re Furlow*, 70 B.R. 973, 977 (Bankr. E.D. Pa. 1987); William Houston Brown & Katherine L. Evans, *A Comparison of Classification and Treatment of Family Support Obligations and Student Loans: A Case Analysis*, 24 MEM. ST. U. L. REV. 623, 626, 635 (1994).

⁷⁸See *In re Dziedzic*, 9 B.R. 424 (Bankr. S.D. Tex. 1981). For references to the "Dziedzic approach," see, e.g., *McLaughlin & Nelms*, *supra* note 54, at 341.

⁷⁹See *In re Storberg*, 94 B.R. 144 (Bankr. D. Minn. 1988). For references to the "Storberg test," see, e.g., *Groves v. LaBarge*, 160 B.R. 121, 122, 124 (E.D. Mo. 1993).

⁸⁰See *In re Husted*, 142 B.R. 72, (Bankr. W.D.N.Y. 1992). For references to the "Husted test" or "Husted factors," see, e.g., *Cash in a Flash v. Brown*, 229 B.R. 739, 744-45 (W.D. Tenn. 1999) (finding no significant difference between the *Husted* and *Hosler* tests); *In re Kolbe*, 199 B.R. at 572-75 (distinguishing the *Husted* test from the *Leser* test); *In re Delauder*, 189 B.R. 639, 644-45 (Bankr. E.D. Va. 1995).

⁸¹4 B.R. at 404-05.

⁸²*Id.* at 407.

⁸³See *In re Brown*, 151 B.R. 232, 237 (Bankr. N.D. Ill. 1993).

⁸⁴See, e.g., *In re Wolff*, 22 B.R. at 512; *In re Dziedzic*, 9 B.R. at 427; *McLaughlin & Nelms*, *supra* note 54, at 341-45.

⁸⁵Thus, for example, many courts faced with an unfair discrimination issue simply note that prior courts have used this multifactor test and then attempt to apply it themselves. E.g., *In re Brigance*, 234 B.R. 401 (W.D. Tenn. 1999); *In re Strausser*, 206 B.R. 58 (Bankr. W.D.N.Y. 1997); *In re Anderson*, 173

nonstop criticism of this approach, not to mention making numerous slight alterations to it. It is doubtful any other legal standard has been so frequently criticized by the same authorities that adopt it. A brief review of these criticisms is in order.

First, on a conceptual level, no legal standard comprised merely of a collection of factors can be applied with any degree of confidence or predictability.⁸⁶ This point was recently made quite forcefully in a related context: the good faith requirement of § 1325(a)(3). A well established line of authority, headed by the decision in *In re Estus*,⁸⁷ uses a collection of some eleven factors to evaluate whether a Chapter 13 plan is proposed in good faith. In the process, according to the Bankruptcy Appellate Panel for the First Circuit, many of the cases reach a result that no theory of statutory construction supports.⁸⁸ The BAP then continued its blistering attack:

Courts use the *Estus* factors as a screen for their real rationale. And they call the good faith issue a question of fact. They employ the clearly erroneous rule to affirm or reverse, whichever is consistent with their notion of the desirable result.

. . . In employing diverse factors and permitting a court to rely upon any one or more of the factors, the standard provides little guidance One court has described working under the *Estus* standard this way: "The trick seems to be in not placing too much weight on any single factor, but in the court's looking at how a number of factors in any given case operate together to betray a plan proposed in bad faith." The public and the bar deserve something better than this legerdemain. To the extent the nature of a question allows, the rule of law should be a law of clear rules.⁸⁹

As merely a collection of factors for consideration, the *Kovich* "test" functions in much the same manner as the *Estus* factors do, and thus does little to focus the inquiry.⁹⁰ This point is bolstered by the fact that the factors listed are

B.R. 226 (Bankr. D. Colo. 1993); *In re Ross*, 161 B.R. 36 (Bankr. C.D. Ill. 1993); *In re Saulter*, 133 B.R. 148 (Bankr. W.D. Mo. 1991).

⁸⁶In contrast, many other legal standards are comprised of series of rules or determinations. Such standards are tests, while often still difficult to use, more capable of being applied with some fidelity. For example, in the area of constitutional law there is the *Lemon* test for evaluating Establishment Clause problems and the *O'Brien* test for evaluating governmental restrictions on expressive conduct. See *Lemon v. Kurtzman*, 403 U.S. 602 (1971); *O'Brien v. United States*, 391 U.S. 367 (1968).

⁸⁷695 F.2d 311 (8th Cir. 1982).

⁸⁸*In re Keach*, 243 B.R. 851, 868 (1st Cir. B.A.P. 2000).

⁸⁹*Id.* at 869-70 (quoting *In re McLaughlin*, 217 B.R. 772, 775-76 (Bankr. W.D. Tex. 1998)).

⁹⁰At least two courts have described the multifactor approach as a "test," using quotation marks to express some derision. See *McCullough v. Brown*, 162 B.R. 506, 509 (N.D. Ill. 1993); *In re Sullivan*, 195

apparently not intended to be exhaustive of appropriate considerations.⁹¹

Second, again like many multifactor tests, the relationship among the factors is unclear. For example, after concluding that a plan failed the first prong, because the proposed discrimination was unreasonable, one Bankruptcy Appellate Panel nevertheless went on to analyze the remaining prongs.⁹² In contrast, a district court recently concluded there was no need to evaluate the other factors after concluding that a proposed plan failed the first prong.⁹³ Similarly, courts apparently cannot agree on whether the second prong's inquiry into necessity is meant to impose an independent, absolute requirement or merely be one of several factors to be evaluated collectively.⁹⁴

Third, on a more specific level, the interrelationship of at least three of the factors makes the test quite redundant. For example, the reasonableness of a plan's discrimination (factor one) will necessarily be affected and informed by the necessity of that discrimination (factor two),⁹⁵ as well as by how the disfavored claims are treated (factor four).⁹⁶ Perhaps for that reason several courts have altered the first factor to inquire whether the disparate

B.R. 649, 654 (Bankr. W.D. Tex. 1996); *In re Furlow*, 70 B.R. 973, 977 (Bankr. E.D. Pa. 1987). See also *In re Whitelock*, 122 B.R. 582, 589 (Bankr. D. Utah 1990) ("The third factor of the test has become convoluted as a result of the plethora of cases that have attempted to define good faith.").

⁹¹*In re Regine*, 234 B.R. 4, 6 (Bankr. D.R.I. 1999).

⁹²*In re Sperma*, 173 B.R. 654, 658-60 (9th Cir. B.A.P. 1994). See also *In re Kolbe*, 199 B.R. 569, 575-76 (Bankr. D. Md. 1996) (doing the same); *In re Whitelock*, 122 B.R. 582, 589-91 (Bankr. D. Utah 1990) (doing the same); *In re Leser*, 939 F.2d 669, 672 (8th Cir. 1991) (expressing satisfaction with the bankruptcy court's conclusion despite its failure to apply each part of the test).

⁹³*In re Brigance*, 234 B.R. 401, 408 (W.D. Tenn. 1999). See also *In re Limbaugh*, 194 B.R. 488, 492, 494 (Bankr. D. Or. 1996) (concluding that because the proposed discrimination failed the first and third prongs, whether it satisfied the second was immaterial and the court need not address the fourth); *In re Sauter*, 133 B.R. 148, 149-50 (Bankr. W.D. Mo. 1991) (concluding that because the proposed plan failed the first and second prongs, the court need not address the third or fourth). But cf. *Cash in a Flash v. Brown*, 229 B.R. 739, 749 (M.D. Tenn. 1999), a case decided two months before *Brigance* in which another judge in the same district went on to apply the last three factors after concluding that a proposed plan failed to satisfy the first.

⁹⁴See *In re Brown*, 152 B.R. 232, 236 (Bankr. N.D. Ill. 1993); Polivy, *supra* note 31, at 206. See also *In re Delauder*, 189 B.R. 639 (Bankr. E.D. Va. 1995) (concluding that proposed discrimination was not necessary but nevertheless ruling it was fair and therefore permissible). Put another way, it is unclear how "necessary" the discrimination must be. In that sense, the issue is reminiscent of the dispute over whether it was "necessary and proper" for Congress to establish the first Bank of the United States. See *McCulloch v. Maryland*, 17 U.S. (Wheat) 316 (1819).

⁹⁵See Markell, *supra* note 3, at 242-43; Polivy, *supra* note 31, at 206.

⁹⁶*McCullough v. Brown*, 162 B.R. 506, 509 n.7 (N.D. Ill. 1993); *In re Brown*, 152 B.R. at 235; *In re Green*, 70 B.R. 164, 166 (Bankr. W.D. Ark. 1986); Polivy, *supra* note 31, at 206.

There may also be some overlap between the second and fourth factors. See Markell, *supra* note 3, at 243. See also *In re Thibodeau*, 248 B.R. 699, 705 (Bankr. D. Mass. 2000) (indicating that the two factors could be considered together); *In re Christophe*, 151 B.R. at 479 (noting that the second and fourth factors "seem to be two ways of asking the same question"); *In re Anderson*, 173 B.R. 226, 230 (Bankr. D. Colo. 1993) (same).

treatment is "rational," rather than "reasonable,"⁹⁷ although at least one other court has suggested that this change is not significant.⁹⁸

Fourth, each of the individual factors is itself unclear, suspect or circular. The first factor's requirement of reasonableness depends upon the interests advanced in support of the discrimination, but makes no effort to identify what interests can justify it.⁹⁹ As a result, it lacks precision and leaves the issue to the court's subjective discretion.¹⁰⁰ The second factor strikes many courts as improper, at least to the extent it is intended to impose an independent requirement of necessity. They believe that the debtor's ability to propose an alternative, nondiscriminatory plan should not alone be sufficient to render the proposed discrimination unfair.¹⁰¹ The third factor's inquiry into good faith is completely redundant of § 1325(a)(3), which always requires the debtor show good faith as a requirement of confirmation.¹⁰² It therefore adds nothing to the analysis. Beyond that, it is circular to measure fairness in relation to good faith, since good faith itself requires a substantial measure of fairness.¹⁰³

The fourth factor—whether the disfavored creditors are receiving a meaningful recovery—is outdated. The court in *Kovich* used this factor at a time before the Code required debtors to either pay all claims in full or devote all their disposable income to the plan for at least three years.¹⁰⁴ Because there is now a statutory standard for confirmation that deals with the amount the debtor contributes to the plan, the factor no longer has any proper relevance.¹⁰⁵ Perhaps because of this, several courts have rephrased

⁹⁷See *In re Husted*, 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992) (failing to comment on this change, and possibly making it inadvertently); *In re Kolbe*, 199 B.R. 569, 574-75 (Bankr. D. Md. 1996) (adopting the *Husted* approach).

⁹⁸See *Cash in a Flash v. Brown*, 229 B.R. 739, 744 (M.D. Tenn. 1999).

⁹⁹*In re Brown*, 152 B.R. 232, 235 (N.D. Ill. 1993).

¹⁰⁰*In re Kolbe*, 199 B.R. 569, 571 (Bankr. D. Md. 1996).

¹⁰¹*Cash in a Flash v. Brown*, 229 B.R. at 745; *McCullough v. Brown*, 162 B.R. 506, 510 (N.D. Ill. 1993); *In re Kolbe*, 199 B.R. at 571; *In re Furlow*, 70 B.R. 973, 977 (Bankr. E.D. Pa. 1987) (agreeing that necessity should not be required but also indicating that necessity "cannot justify otherwise impermissible discrimination").

¹⁰²See *In re Kolbe*, 199 B.R. at 571; *In re Alicea*, 199 B.R. 862, 866 (Bankr. D.N.J. 1996); *In re Brown*, 152 B.R. 232, 236 (Bankr. N.D. Ill. 1993); *In re Lawson*, 93 B.R. 979, 982 (Bankr. N.D. Ill. 1988); *In re Furlow*, 70 B.R. 973, 977 (Bankr. E.D. Pa. 1987); *In re Green*, 70 B.R. 164, 166 (Bankr. W.D. Ark. 1986); *Markell*, *supra* note 3, at 243; *Polivy*, *supra* note 31, at 206.

A few courts have "modified" the third factor so to inquire whether the discrimination "manipulates the bankruptcy system and thereby abuses the provisions, purpose, or spirit of Chapter 13." *In re Whitelock*, 122 B.R. 582, 589 (Bankr. D. Utah 1990); *In re Limbaugh*, 194 B.R. 488, 491 (Bankr. D. Or. 1996).

¹⁰³See *McCullough v. Brown*, 162 B.R. at 510.

¹⁰⁴See the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353, § 317, 98 Stat. 333, 356, (adding § 1325(b) to the Code).

¹⁰⁵See *In re Brown*, 152 B.R. at 237 n.5; *In re Chapman*, 146 B.R. 411, 420 n.4 (Bankr. N.D. Ill. 1992). See also *In re Smith*, 848 F.2d 813, 820 (7th Cir. 1988); *Education Assistance Corp. v. Zellner*, 827 F.2d

the fourth factor as whether the degree of discrimination is directly related to the basis or rationale for the discrimination.¹⁰⁶ Several other courts have simply added a highly related fifth factor: the difference between what those creditors will receive under the discriminatory plan and what they would get if the plan did not discriminate.¹⁰⁷ Although some have questioned whether such tinkering has really effected a substantive change,¹⁰⁸ in either case the inquiry is necessarily subsumed by factor one's review of the reasonableness of the classification scheme.

In the final analysis, the multifactor test really provides no guidance. The courts that use it are fond of saying that it requires a case-by-case analysis.¹⁰⁹ As in other contexts, however, this is merely a euphemism. While seemingly a statement about the care and intensity with which courts examine the evidence, a court's use of the phrase is really a signal to the reader not to rely too heavily on precedent or to expect consistency in result. Indeed, numerous authorities have noted that the multifactor approach produces inconsistent results.¹¹⁰ Worse, though, these results are apparently the product of the purely subjective views of the judge or judges deciding each case.¹¹¹

1222, 1224, 1227 (8th Cir. 1987); *In re Keach*, 243 B.R. 851, 861-63 (1st Cir. BAP 2000); *In re Easley*, 72 B.R. 948, 954-55 (Bankr. M.D. Tenn. 1987); *In re Gathright*, 67 B.R. 384 (Bankr. E.D. Pa. 1987), all suggesting that the addition of § 1325(b) eliminated some of the factors traditionally used to evaluate the debtor's good faith.

¹⁰⁶See, e.g., *In re Leser*, 939 F.2d 669, 672 (8th Cir. 1991); *In re Wolff*, 22 B.R. 510, 512 (9th Cir. BAP 1982).

¹⁰⁷See *In re Strausser*, 206 B.R. 58, 60 (Bankr. W.D.N.Y. 1997); *In re Kolbe*, 199 B.R. 569, 574-75 (Bankr. D. Md. 1996); *In re Husted*, 142 B.R. 72, 74 (Bankr. W.D. N.Y. 1992); *In re Moore*, 31 B.R. 12, 17 (Bankr. D.S.C. 1983).

¹⁰⁸See *In re Leser*, 939 F.2d at 672 n.5 (suggesting that the rephrasing of the fourth factor was a semantic difference without substantive import); *Cash in a Flash v. Brown*, 229 B.R. at 744 (concluding that the fifth inquiry was already part of the fourth *Kovich* factor).

¹⁰⁹See *Barnes v. Whelan*, 689 F.2d 193, 202 (D.C. Cir. 1982); *Cash in a Flash v. Brown*, 229 B.R. at 746 (W.D. Tenn. 1999); *In re Brigrance*, 234 B.R. 401, 406 (W.D. Tenn. 1999); *In re Gonzales*, 172 B.R. 320, 328 (E.D. Wash. 1994); *In re Cook*, 26 B.R. 187, 190 (D.N.M. 1982); *In re Chacon*, 223 B.R. 917, 921 (Bankr. W.D. Tex. 1998), *aff'd*, 202 F.3d 725 (5th Cir. 1999); *In re Smith*, 222 B.R. 846, 855 (Bankr. N.D. Ind. 1998); *In re Applegarth*, 221 B.R. 914, 916 (Bankr. M.D. Fla. 1998); *In re Janssen*, 220 B.R. 639, 643 (Bankr. N.D. Iowa 1998); *In re Kolbe*, 199 B.R. 569, 575 (Bankr. D. Md. 1996); *In re Delauder*, 189 B.R. 639, 644 (Bankr. E.D. Va. 1995); *In re Cheak*, 171 B.R. 55, 58 (Bankr. S.D. Ill. 1994); *In re Eiland*, 170 B.R. 370, 378 (Bankr. N.D. Ill. 1994); *In re Colfer*, 159 B.R. 602, 611 (Bankr. D. Me. 1993); *In re Dodds*, 140 B.R. 542, 544 (Bankr. D. Mont. 1992); *In re Whitelock*, 122 B.R. 582, 588 (Bankr. D. Utah 1990); *In re Kovich*, 4 B.R. 403, 407 (Bankr. W.D. Mich. 1980).

¹¹⁰See *In re Brigrance*, 234 B.R. at 406 (noting that the application of this test is far from uniform); *In re Husted*, 142 B.R. at 74; *Furlow*, 72 B.R. 973, 977 (Bankr. E.D. Pa. 1987) (noting the varying results reached by the courts adopting this approach); *In re Green*, 70 B.R. 164, 166 (Bankr. W.D. Ark. 1986) (noting that application of the factors has not been uniform); *Brunstad & Sigal*, *supra* note 3, at 47 (noting this approach has produced widely disparate holdings in Chapter 11 cases involving substantially similar facts); *Polivy*, *supra* note 31, at 206; *EPSTEIN ET AL.*, *supra* note 2, § 9-7, at 683.

¹¹¹See *McCullough v. Brown*, 162 B.R. at 509 ("a judge who applies such an amorphous 'test' wields a nearly unchecked discretion, implementing his or her personal preferences"); *Brunstad & Sigal*, *supra* note 3, at 47 (suggesting this approach leaves the determination to consideration of factors that are highly

5. *The Reasonableness Approach*

A few courts, disenchanted with the multifactor approach, have condensed the test down merely to whether the proposed discrimination is reasonable.¹¹² This removes some of the problems with the multifactor approach, such as redundancy, but probably represents no real change in methodology or outcome.¹¹³ It still leaves the matter to the personal views and values of the judges without providing any real guidance, predictability, or consistency. In short, this approach simply replaces the vague term "unfair" with the equally vague term "reasonable." It is therefore really not a discernable test at all.

In sum, all of the different unfair discrimination standards employed by the courts are weeds in the garden of Chapter 13 jurisprudence. Judges, despairing that this is the only garden around, look for a small bare patch in which to plant each case so that it may ripen to decision. Instead, a little weeding is in order.¹¹⁴

III. PROPOSAL FOR A NEW DIRECTION

Several courts have noted that the unfairness of any proposed discrimination in a Chapter 13 plan must be viewed from the perspective of the class or classes of claimants discriminated against.¹¹⁵ In other words, the question for the court is whether the plan is unfair to the class or classes of disfavored claimants. To the extent this is relevant, such a perspective is undoubtedly a

subjective in nature); Polivy, *supra* note 31, at 206 & 207; EPSTEIN ET AL., *supra* note 2, § 9-7, at 683 ("many judges use these tests simply to indulge their own views about what is fair and what is not"); Marie Adamson, Note, *A Separate Classification for Criminal Debt in Chapter 13*, 62 IND. L.J. 383, 393 (1987) ("Judges inject their own personal philosophies into their Chapter 13 decisions which results in arbitrary injustices and inconsistency in the law"). See also *In re Groves*, 39 F.3d 212, 214 (8th Cir. 1994) (suggesting that the unfair discrimination standard itself may call for "little more than exercise of the bankruptcy court's broad discretion").

¹¹²See, e.g., *In re Alicea*, 199 B.R. 862, 866 (Bankr. D.N.J. 1996); *In re Lackey*, 148 B.R. 626, 632 (Bankr. N.D. Ala. 1992); *Lawson v. Lackey* (*In re Lawson*), 93 B.R. 979, 982 (Bankr. N.D. Ill. 1988); *In re Furlow*, 70 B.R. 973, 978 (E.D. Pa. 1987). A few others ask whether "the plan reflects a reasonable balance in the relative benefits allocated to the debtor and creditors from the proposed discrimination." *In re Bentley*, 250 B.R. 475, 477 (Bankr. D.R.I. 2000) (quoting *In re Chapman*, 146 B.R. 411, 419 (Bankr. N.D. Ill. 1992)).

¹¹³Numerous authorities have suggested that the multifactor test boils down to nothing more than a test of reasonableness. See, e.g., *In re Thompson*, 191 B.R. 967, 971 (Bankr. S.D. Ga. 1996); *Lawson v. Lackey* (*In re Lackey*), 148 B.R. 626, 632 (Bankr. N.D. Ala. 1992); *In re Green*, 70 B.R. 164, 166 (Bankr. W.D. Ark. 1986). See also Markell, *supra* note 3, at 243-44 (making this point in reference to the application of the multifactor approach in Chapter 11 cases).

¹¹⁴It is worth noting that one court, following the suggestion of Professor Markell, has repudiated the multifactor approach in Chapter 11 cases. *In re Dow Corning Corp.*, 244 B.R. 696 (Bankr. E.D. Mich. 1999).

¹¹⁵See, e.g., *McCullough v. Brown*, 162 B.R. 506, 511-13 (N.D. Ill. 1993). *In re Smalberger*, 157 B.R. 472, 475 (Bankr. D. Or. 1992), *aff'd*, 170 B.R. 707 (D. Or. 1994).

proper one.¹¹⁶ However, the answer to the question does not and should not depend on whether the problem is viewed from the perspective of the debtor—as in this Article’s introductory illustration—or the viewpoint of the favored or disfavored claimants. Fairness, unlike beauty, is not simply in the eye of the beholder. Quite the contrary, fairness is a relative term. There needs to be some reference point from which to evaluate alleged unfairness: unfair in relation to what?

Courts are fond of saying that bankruptcy is an equitable proceeding.¹¹⁷ Indeed, the equitable origins of bankruptcy relief are centuries old.¹¹⁸ It would be surprising, then, if the Bankruptcy Code were not filled with rules that attempt to achieve fairness, both on a systemic level and for individual cases. In short, reference to the Bankruptcy Code alone should provide enough guidance on what types of discrimination are “unfair.” Resort to other sources of law or to the sensibilities of judges should be avoided.¹¹⁹ Thus, the unfairness of any proposed discrimination should be analyzed in reference to the rules expressed and the policies implied in the Bankruptcy Code.¹²⁰

Certainly one of these policies is equality of creditor treatment. It is a principle expressed in the distribution rules of the Code,¹²¹ is arguably im-

¹¹⁶See H.R. REP. NO. 95-595 at 417 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6373 (the unfair discrimination standard in § 1129(b)(1) “preserves just treatment of a dissenting class from the class’s own perspective”). But cf. *In re Alicea*, 199 B.R. at 866 (indicating that this should not be the *only* perspective considered).

¹¹⁷See, e.g. *In re SGL Carbon Corp.*, 200 F.3d 154, 160 (3d Cir. 1999); *In re Mendoza*, 111 F.3d 1264, 1269 (5th Cir. 1997); *In re Cascade Roads, Inc.*, 34 F.3d 756, 758 (9th Cir. 1994); *In re Chestnut Hill Mort. Corp.*, 158 B.R. 547, 551 (D. Mass. 1993); *In re Cheatham*, 91 B.R. 382, 388 (E.D.N.C. 1988) all treating the equitable nature of bankruptcy as relevant in resolving various issues. See also *Katchen v. Landy*, 382 U.S. 323, 336 (1966) (noting that bankruptcy “converts the creditor’s legal claim into an equitable claim to a pro rata share of the res,” and that “the proceedings of bankruptcy courts are inherently proceedings in equity”).

¹¹⁸See Vern Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226 (1976).

¹¹⁹Judge Wedoff hinted that judges’ personal attitudes may be affecting their decisions on issues of unfair discrimination when he noted:

A decision allowing preferential classification of family support, *In re Storberg*, 94 B.R. 144, 147 (Bankr. D. Minn. 1988), refers to the debtor’s plan as “an admirable endeavor.” A decision denying preferential classification of student loans, *In re Saulter*, 133 B.R. 148, 149 (Bankr. W.D. Mo. 1991), refers to the debtor’s plan as an attempt “to exit bankruptcy free of student loan liability at the expense of other unsecured creditors.”

In re Brown, 152 B.R. 232, 242 (Bankr. N.D. Ill.), *rev’d sub nom. McCullough v. Brown*, 162 B.R. 506 (N.D. Ill. 1993).

¹²⁰See *In re Colfer*, 159 B.R. 602, 607-08 (Bankr. D. Me. 1993) (requiring any proposed discrimination “be undertaken in light of the impact of the discrimination on Congress’ chosen statutory definition of the legitimate interests and expectations of parties-in-interest to Chapter 13 proceedings”). This is not to say the rules expressed and policies implied in the Bankruptcy Code are the only appropriate referents for unfairness, merely that they are necessary referents.

¹²¹See 11 U.S.C. § 726(b) (1994).

plied by both the system of priorities¹²² and the provisions for avoidance of preferential transfers,¹²³ and is probably fundamental to the whole notion of an orderly bankruptcy system.¹²⁴ Treating creditors equally is simply a central tenet of bankruptcy. Because of this, disparate treatment is presumptively unfair,¹²⁵ and the debtor properly has the burden of proving otherwise.¹²⁶

However, while equality of treatment is a core principle of bankruptcy law, it is not the only one implicated in this analysis. If the fairness of any proposed discrimination is evaluated solely in relation to a pro rata share of the bankruptcy estate, if the *only* referent is a presumption of equality of treatment, then the congressionally bestowed right to classify and treat claims—one which Congress apparently included in the Code to entice debtors to file for Chapter 13 relief¹²⁷—becomes virtually meaningless. If the

¹²²By establishing a detailed series of relative priorities, see 11 U.S.C. §§ 507(a), 510(a) & 726(a)(1) (1994), Congress has impliedly made an exhaustive list of the differences warranting different treatment of claims, at least in Chapter 7 cases. But cf. 11 U.S.C. § 510(c) (1994) (authorizing bankruptcy courts to subordinate other claims for equitable reasons).

¹²³See 11 U.S.C. § 547(b) (1994) (allowing recovery of prepetition transfers that, if left alone, would alter bankruptcy's distribution scheme).

¹²⁴In describing the common characteristics of various English and American bankruptcy statutes, Professor Radin wrote:

whatever else was present or absent, there was always some method by which all the creditors were compelled to accept some arrangement or some disposition of their claims against the bankrupt's property, whether they all agreed to it or not. . . . whatever happens to the debtor, in every case the creditors have been assembled in some formal way, their claims examined and classified, and assigned for satisfaction in definite proportions to an existing or prospective fund.

Max Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1, 3-4 (1940).

¹²⁵See Markell, *supra* note 3, at 228, 249 (advocating that disparate treatment in Chapter 11 plan of claims with the same priority should be presumptively unfair). Indeed, even if a discriminatory plan proposes to pay all claimants more than they would receive in a Chapter 7 liquidation, unless some bankruptcy rule or policy would support the particular discrimination proposed, the plan would be unfair. *In re Green*, 70 B.R. at 167.

¹²⁶See *In re Groves*, 39 F.3d 212, 214 (8th Cir. 1994); *In re Wolff*, 22 B.R. 510, 512 (9th Cir. BAP 1982); *In re Brigrance*, 234 B.R. 401, 406 (W.D. Tenn. 1999); *In re Gonzales*, 172 B.R. 320, 326 (E.D. Wash. 1994); *McCullough v. Brown*, 162 B.R. 506, 516 (N.D. Ill. 1993); *In re Cook*, 26 B.R. 187, 190 (D.N.M. 1982); *In re Bentley*, 250 B.R. 475, 477 (Bankr. D.R.I. 2000); *In re Thibodeau*, 248 B.R. 699, 704 (Bankr. D. Mass. 2000); *In re Burnip*, 229 B.R. 904, 906 (Bankr. S.D. Ohio 1999); *In re Smith*, 222 B.R. 846, 854 (Bankr. N.D. Ind. 1998); *In re Janssen*, 220 B.R. 639, 643 (Bankr. N.D. Iowa 1998); *In re Alicea*, 199 B.R. 862, 866 (Bankr. D.N.J. 1996); *In re Kolbe*, 199 B.R. 569, 570 (Bankr. D. Md. 1996); *In re Delauder*, 189 B.R. 639, 644 (Bankr. E.D. Va. 1995); *In re Gregg*, 179 B.R. 828, 830 (Bankr. E.D. Tex. 1994); *In re Anderson*, 173 B.R. 226, 229 (Bankr. D. Colo. 1993); *In re Colfer*, 159 B.R. 602, 608 (Bankr. D. Me. 1993); *In re Foreman*, 136 B.R. 532, 534 (Bankr. S.D. Iowa 1992); *In re Scheiber*, 129 B.R. 604, 606 (Bankr. D. Minn. 1991); *In re Rivera Echevarria*, 129 B.R. 11, 12 (Bankr. D.P.R. 1991); *In re Whitelock*, 122 B.R. 582, 588 (Bankr. D. Utah 1990); *In re Furlow*, 70 B.R. 973, 977-78 (Bankr. E.D. Pa. 1987); *In re Harris*, 62 B.R. 391, 394 (Bankr. E.D. Mich. 1986); *Brown & Evans*, *supra* note 77, at 628.

¹²⁷See *In re Janssen*, 220 B.R. 639, 641 (Bankr. N.D. Iowa 1998) (quoting *In re Thompson*, 191 B.R. 967, 969 (Bankr. S.D. Ga. 1996)); *In re Brown*, 152 B.R. 232, 238-39 (Bankr. N.D. Ill.), *rev'd sub nom.*

courts are guided solely by this principle, virtually all discrimination will be judicially struck down.¹²⁸ More to the point, other important bankruptcy rules, principles, and policies would be improperly ignored.

Courts have recognized this in at least one context. While they have shown little willingness to permit favored treatment of nondischargeable claims generally, they have almost universally permitted favored treatment of nondischargeable claims for spousal or child support arrearages. Although this is no longer an issue since the 1994 amendments made support a priority claim¹²⁹ to be paid in full in any Chapter 13 plan,¹³⁰ prior to that time courts almost universally permitted favored plan treatment of such claims.¹³¹ They did so because of "society's strong interest in having . . . support paid in full."¹³² These courts did not need to divine that interest; it was expressed

McCullough v. Brown, 162 B.R. 506, 512 (N.D. Ill. 1993) (quoting this part of bankruptcy court's opinion approvingly). See also Lynn M. LoPucki, *Common Sense Consumer Bankruptcy*, 71 AM. BANKR. L.J. 461, 475 (1997) ("Congress deliberately established economic incentives to file under Chapter 13"); Seth J. Gerson, Note, *Separate Classification of Student Loans in Chapter 13*, 73 WASH. U. L.Q. 269, 292 (1995) ("Congress placed the right to classify claims preferentially in Chapter 13 as an inducement for debtors to select Chapter 13"); McLaughlin & Nelms, *supra* note 54, at 346 (the ability to classify claims "is a carrot designed to encourage debtors to file Chapter 13 proceedings instead of Chapter 7"). Cf. *In re Colfer*, 159 B.R. 602, 605 (Bankr. D. Me. 1993) (suggesting that Congress included the permission to separately classify and treat unsecured claims in Chapter 13 to enhance the debtor's ability to propose and complete a feasible plan).

¹²⁸Cf. *In re Green*, 70 B.R. 164, 167 (Bankr. W.D. Ark. 1986) (stating that materially different treatment of substantially similar claims "seems inherently unfair" and going on to suggest that therefore, in this context, "fair discrimination" is a contradiction). Cf. *In re Gonzalez*, 206 B.R. 239, 241 (Bankr. S.D. Fla. 1997) (describing "fair discrimination" as a codified oxymoron).

¹²⁹See The Bankruptcy Reform Act of 1994, Pub. L. 103-394, § 304, 108 Stat. 4106, 4132-33 (adding § 507(a)(7) to the Bankruptcy Code) If a support claim is assigned to a governmental unit, it remains nondischargeable under § 523(a)(5) but loses its priority status under § 507(a)(7). See *In re Burns*, 216 B.R. 945 (Bankr. S.D. Cal. 1998).

¹³⁰See 11 U.S.C. § 1322(a)(2) (1994). See also *In re Beverly*, 196 B.R. 128 (Bankr. W.D. Mo. 1996) (denying confirmation of plan that failed to pay child support arrearages in full).

¹³¹See *In re Leser*, 939 F.2d 669 (8th Cir. 1991); *In re Gonzales*, 172 B.R. 320 (E.D. Wash. 1994); *In re James*, 150 B.R. 479 (Bankr. M.D. Ga. 1993); *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 Whittaker*, 113 B.R. 531 (Bankr. D. Minn. 1990); *In re Storberg*, 94 B.R. 144 (Bankr. D. Minn. 1988); *In re Haag*, 3 B.R. 649 (Bankr. D. Or. 1980); *In re Curtis*, 2 B.R. 43 (Bankr. W.D. Mo. 1979). See also *In re Harris*, 132 B.R. 166 (Bankr. S.D. Iowa 1989); *In re Davidson*, 72 B.R. 384 (Bankr. D. Colo. 1987) (both permitting favored treatment of support claims but denying confirmation on other grounds). Cf. *In re Burns*, 216 B.R. at 947-48 (denying favored treatment of a support claim assigned to a governmental unit); *In re Warner*, 115 B.R. 233 (Bankr. C.D. Cal. 1989) (suggesting that a Chapter 13 plan favoring support claims discriminated unfairly and denying confirmation for lack of good faith).

¹³²*In re Gonzales*, 172 B.R. at 327 (also regarding nondischargeability and the debtor's need for a fresh start as reasons to permit favored treatment); *In re Storberg*, 94 B.R. 144, 146-47 (Bankr. D. Minn. 1988) (identifying numerous state and federal statutes evincing an "overwhelming public policy in favor of providing for support of children"). See also *In re Whittaker*, 113 B.R. 531, 534 (Bankr. D. Minn. 1990) (treating the debtor's interest in not being burdened with a substantial support debt at the conclusion of the Chapter 13 plan as a basis for permitting favored treatment of the support claim).

throughout the Bankruptcy Code.¹³³

Admittedly, however, a directive to simply evaluate the fairness of proposed discrimination in relation to the rules expressed and the policies implied in the Bankruptcy Code provides little concrete guidance to the bankruptcy courts. Accordingly, the remainder of this Article seeks to provide that guidance by analyzing the types of discriminatory treatment a Chapter 13 debtor is likely to propose.

A. CLAIMS WITH DIFFERENT DISTRIBUTION RIGHTS

Although every Chapter 13 plan must provide for full payment of all priority claims, it is still possible that other unsecured claimants will have different distribution rights. When this occurs, discriminatory treatment is permissible. For example, the Bankruptcy Code expressly mandates the enforcement of subordination agreements.¹³⁴ If a creditor has contractually agreed to subordinate its rights to those of another, it is not unfair for the debtor to separately classify the subordinated creditor's claim and treat it less favorably. Indeed, the scant legislative history uses this very example as discriminatory treatment that not only is fair, but that would be unfair to omit from a plan.¹³⁵ In other words, because only claims that are "substantially similar" may be classified together,¹³⁶ claims with different distribution rights must be placed in different classes.

Similarly, it would be perfectly appropriate—probably required—for a debtor in a community property jurisdiction to devise a plan that separately classifies and treats community claims and separate claims, to account for the fact that such claims would have differing distribution rights to separate and community property, both under nonbankruptcy law and, more importantly, in Chapter 7.¹³⁷

¹³³Support claims are accorded favored treatment in several places in the Bankruptcy Code. In fact, they now receive every type of special treatment that the Code bestows: they are a priority claim, *see* 11 U.S.C. § 507(a)(7); they are nondischargeable in Chapters 7, 11, 12 and 13, *see* 11 U.S.C. §§ 523(a)(5), 1141(d)(2), 1228(a)(2) & 1328(a)(2); they have immunity from exemptions, *see* 11 U.S.C. § 522(c); and they have immunity from preference attack, *see* 11 U.S.C. § 547(c)(7).

¹³⁴*See* 11 U.S.C. § 510(a) (1994).

¹³⁵*See* H.R. REP. NO. 95-595 at 417-18 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6372-73 (referring to "unfair discrimination" in § 1129(b)(1)).

¹³⁶*See* 11 U.S.C. §§ 1122(a), 1322(b)(1) (1994).

¹³⁷*See* 11 U.S.C. § 726(c) (1994) (establishing a series of four "substates" and providing rules on how the property in each is to be distributed). *See also In re Whitus*, 240 B.R. 705, 710 (Bankr. W.D. Tex. 1999) (finding debtor's Chapter 13 plan may legitimately place into a separate class all claims against a nondebtor spouse that may be satisfied out of community property, for treatment consistent with the best interest of creditors test of § 1325(a)(4); it may even provide for such claims to receive nothing under the plan if that result is the application of the best interest of creditors test); *In re Chandler*, 148 B.R. 13 (Bankr. E.D.N.C. 1992) (allowing debtors whose principal asset was residence held by the entireties, and which under state law was exempt as to individual creditors but not as to joint creditors, to pay joint

B. CLAIMS FAVORED OUT OF ADMINISTRATIVE CONVENIENCE

Section 1322(b)(1) authorizes the debtor to designate classes of unsecured claims as provided in § 1122. Section 1122(a) provides the general rule on classification: only claims that are substantially similar may be classified together.¹³⁸ Section 1122(b) then adds a special rule: a plan may create a separate class consisting only of claims less than or reduced to an amount approved by the court “as reasonable and necessary for administrative convenience.”¹³⁹ Facially, then, a class of small claims segregated for administrative convenience—and presumably paid in full—would seem to be authorized in Chapter 13.¹⁴⁰

However, one treatise has described such a classification scheme in Chapter 13 as “curious, if not unlikely.”¹⁴¹ Given the fairly small limit on unsecured debt in Chapter 13 cases,¹⁴² the computerization of most Chapter 13 trustees’ offices, the relatively small number of creditors in most Chapter 13 cases, and the consumer orientation of the chapter, it is unlikely that it would ever be necessary to have a class of small claims for administrative convenience in Chapter 13.¹⁴³ Indeed, while many courts have indicated that the separate classification and favored treatment of small claims for administrative convenience is permissible in Chapter 13,¹⁴⁴ one must search hard to find any courts that have actually approved of a plan doing this.¹⁴⁵

creditors in full while paying only a 9.6% dividend to other unsecured claimants; no claim of unfair discrimination was made).

The same may be true for claims for which a proof of claim is filed late, and which would therefore be subordinated under § 726(a). See *In re Gullatt*, 164 B.R. 279, 282-83 (Bankr. M.D. Tenn. 1994).

¹³⁸11 U.S.C. § 1122(a) (1994).

¹³⁹11 U.S.C. § 1122(b) (1994).

¹⁴⁰See, e.g., *In re Chapman*, 146 B.R. 411, 416 (Bankr. N.D. Ill. 1992) (“Section 1122 (and thus Section 1322), specifically allows for separate classification and disparate treatment of smaller claims for purposes of administrative convenience”); *In re Storberg*, 94 B.R. 144, 146 (Bankr. D. Minn. 1988) (“It does not constitute unfair discrimination to pay more to small claims [f]or administrative convenience”). See also *In re Leser*, 939 F.2d 669, 671 n.4 (8th Cir. 1991) (citing *Storberg* approvingly for this point); EPSTEIN ET AL., *supra* note 2, § 9-7, at 680 (“Presumably a Chapter 13 plan that fully paid every claim under \$50 but paid only 60 percent of claims over \$50 would be permissible under section 1322(b)(1).”).

¹⁴¹NORTON, *supra* note 2, § 121:4. See also *In re Harris*, 62 B.R. 391, 396 n.3 (Bankr. E.D. Mich. 1986) (expressing skepticism about whether the administrative convenience exception of § 1122 is carried over into Chapter 13 cases).

¹⁴²The limit is currently \$269,250. See 11 U.S.C. § 109(e). This amount is adjusted every three years to account for inflation, and the next scheduled increase will go into effect on April 1, 2001. See 11 U.S.C. § 104(b).

¹⁴³NORTON, *supra* note 2, § 121:4. See also McLaughlin & Nelms, *supra* note 54, at 337 (“Administrative convenience is not normally a consideration in a Chapter 13 case”).

¹⁴⁴See cases cited *supra* note 140. See also *In re Iacovoni*, 2 B.R. 256, 260 (Bankr. D. Utah 1980) (suggesting even under its very strict approach that a separate classification of small claims—found to be reasonable and necessary for administrative convenience—is an authorized reason for discriminating among unsecured claims).

¹⁴⁵Only two cases have been found in which the court confirmed a plan that separately classified small claims and paid them in full. *In re Terry*, 78 B.R. 171 (Bankr. E.D. Tenn. 1987); *In re Ratledge*, 31 B.R.

Certainly at some level, separate classification of small claims makes perfect sense. If, for example, a claim was so small that the periodic disbursements by the Chapter 13 trustee would cost more to mail or otherwise administer than the payment itself, then some favored treatment would presumably be appropriate in order to avoid even higher additional costs. However, such favored treatment need not and should not be full payment. Two reasons support that conclusion.

First, the other claimants are unlikely to benefit from the expenses saved. Unless the trustee's compensation is going to be reduced, and it presumably would not be,¹⁴⁶ the remaining unsecured claimants receive no benefit from the separate classification. The only effect on them is that their recoveries will be reduced by the excess needed to pay the small claims in full. Note, this is different than in Chapter 11 cases, where, because there generally is no trustee, savings arising from a classification of small claims for administrative convenience would inure to the benefit of other classes of claimants or interest holders.

Second, the administrative expenses could be reduced without increasing the percentage of recovery by simply providing that the small claimants get paid first, perhaps in one lump sum. In short, disparate treatment of very small claims in Chapter 13 may, on rare occasions, be desirable for administrative reasons, but that disparity should generally consist of the timing of payment, rather than the percentage of recovery.¹⁴⁷

897 (Bankr. E.D. Tenn. 1983). However, neither court based its decision on administrative convenience or treated administrative convenience as an exception to the unfair discrimination standard; instead both analyzed the unfairness of the discrimination under the multifactor test that many courts use. The court in *Terry* accepted the debtors' argument that because the small claims were held by local creditors, payment in full would facilitate the debtors' ability to deal with these creditors in the future. 78 B.R. at 174. The *Ratledge* court implied much the same. 31 B.R. at 899-900.

¹⁴⁶The trustee's compensation is based on the amount received from the debtor for distribution, not on the amount of the expenses incurred. See 28 U.S.C. § 586(e)(2) (2000).

¹⁴⁷See *In re Crosscreek Apartments, Ltd.*, 213 B.R. 521, 537-38 (Bankr. E.D. Tenn. 1997) (Chapter 11 debtor could pay small claims of trade creditors earlier than large deficiency claim of major creditor, but could not pay them at greater rate); *In re Foreman*, 136 B.R. 532 (Bankr. S.D. Iowa 1992) (permitting plan to pay student loan claims first because all claims were to be paid in full). But see *In re Williams*, 253 B.R. 220, 231-32 (Bankr. W.D. Tenn. 2000) (rejecting plan that paid student loan claims before other claims, even though all were to be paid in full); *In re Eiland*, 170 B.R. 370, 377-78 (same).

Of course, earlier recovery can be more favorable, both because of the time value of money and because of the risk that the debtor will fail to complete the plan after the small claimants receive their recovery. The former can be taken into account in computing the percentage to be paid to each class. The latter should not be too much of a concern given the amount of money at stake is likely to permit payment of these claims very quickly and the fact that the debtor is unlikely to receive a discharge if the debtor fails to complete the plan. See 11 U.S.C. § 1328(b), (c) (1994).

C. CLAIMS FAVORED OUT OF FRIENDSHIP OR DISFAVORED OUT OF ENMITY

If a Chapter 13 debtor proposes to favor a friend or family member's claim because of affection or to disfavor an enemy's claim because of personal animus, the resulting discrimination would be unfair.¹⁴⁸ In such cases, the principle of equal treatment is countered only by the debtor's personal feelings, not by any commensurate rule or policy embedded in the Bankruptcy Code. Such treatment would amount to nothing more than a postpetition preference.¹⁴⁹ In other words, the policies implicit in § 547, which renders avoidable prepetition transfers to preferred creditors, counsel against permitting disparate postpetition treatment for such reasons. Indeed, in at least one respect the Code treats friends and family creditors *less* favorably than other creditors: they are subject to an extended preference period.¹⁵⁰

¹⁴⁸*In re Brown*, 152 B.R. 232, 239 (Bankr. N.D. Ill.) ("Plainly, a debtor should not be allowed to penalize certain creditors for purely subjective reasons . . . [or] to pay friends and family members more than commercial creditors because of personal affection."), *rev'd sub nom. McCullough v. Brown*, 162 B.R. 506 (N.D. Ill. 1993); *In re Whitelock*, 122 B.R. 582, 590 (Bankr. D. Utah 1990) ("Fair discrimination requires more justification than simply the personal preference of the debtor."); *In re Storberg*, 94 B.R. 144, 146 (Bankr. D. Minn. 1988) ("Those cases that involve some sort of personal animus . . . almost always constitute unfair discrimination."); *In re Lawson*, 93 B.R. 979, 984 (Bankr. N.D. Ill. 1988) ("[I]t could hardly be contended that . . . a debtor may . . . discriminat[e] on purely personal grounds, like family relationship and friendship."); *In re Freshley*, 69 B.R. 96, 98 (Bankr. N.D. Ga. 1987) ("[V]alid classifications require more than the personal preference of the debtor."); *In re Kovich*, 4 B.R. 403, 407 (Bankr. W.D. Mich. 1980) ("Certainly the debtor should not be permitted to pay a creditor less because of ill will.").

The same result applies in Chapter 11. See *In re Graphic Communications, Inc.*, 200 B.R. 143, 149 (Bankr. E.D. Mich. 1996); *ARN LTD. Ltd. Partnership*, 140 B.R. 5, 13 (Bankr. D.D.C. 1992); *In re Baugh*, 73 B.R. 414, 417 (Bankr. E.D. Ark. 1987).

¹⁴⁹See 11 U.S.C. § 547(b) (1994) (avoiding prepetition preferences). See also 11 U.S.C. § 549 (1994) (invalidating unauthorized postpetition transfers).

Prepetition payments are generally avoidable preferences only if they both enhance the transferee's recovery vis-à-vis Chapter 7, and decrease the recovery of others. See 11 U.S.C. § 547(b) (1994) (requiring that the transfer be from the debtor's assets) & (b)(5) (requiring that the transferee benefit by the transfer). See also *In re Bohlen Enterprises, Ltd.*, 859 F.2d 561, 566 (8th Cir. 1988) (applying the "earmarking" doctrine, which denies avoidance to transfers of funds supplied by one lender specifically to pay off another because the estate has not truly been diminished). Because all Chapter 13 claimants are guaranteed—assuming a discharge is to be granted—at least what they would receive in Chapter 7, the reference to the policies implicit in § 547 may not apply with full force. However, it is worth noting that some prepetition transfers avoidable as preferences are not ones that decrease the recovery of others. If a debtor voluntarily transfers exempt assets to a creditor prepetition, even the remaining creditors are better off because their claims share with fewer other claims in an undiminished estate. Nevertheless, the transfer is avoidable and the debtor is prohibited from claiming an exemption in the recovered assets. See 11 U.S.C. §§ 547(b) & 522(g)(1)(A).

¹⁵⁰See § 547(b)(4) (1994) (making a transfer to an "insider" vulnerable for one year rather than ninety days). Although "insider" is defined to include relatives of an individual, 11 U.S.C. § 101(31)(A)(i), because "including" is not a limiting term, see 11 U.S.C. § 102(3), courts have shown no hesitancy to rule that intimate friends constitute insiders. *Gennet v. Docktor (In re Levy)*, 185 B.R. 378 (Bankr. S.D. Fla. 1995) (treating male debtor's live-in female lover who provided substantial part of couple's financial needs as an insider); *Freund v. Heath (In re McIver)*, 177 B.R. 366 (Bankr. N.D. Fla. 1995) (holding a male

D. CLAIMS ON WHICH A CODEBTOR IS LIABLE

If a creditor cannot be treated more favorably merely because of familial affection, one would assume that a creditor could not be treated more favorably merely because a relative of the debtor is also liable for the debt and the debtor wishes to shield that relative from the creditor's collection efforts. The principle is the same. Indeed, prior to 1984, this was the view of many, perhaps most, of the courts to rule on the issue, although the two circuit courts considering the issue were split.¹⁵¹

However, in 1984 Congress amended the Bankruptcy Code to expressly authorize different treatment of claims on which a codebtor is liable.¹⁵² Specifically, § 1322(b)(1) now provides that the debtor's plan may

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.¹⁵³

A reasonable person might interpret this statute to allow a plan to discriminate against codebtor claims on the theory that they will be paid from another source: the codebtor. However, there is no guaranty that the codebtor will actually come through with payment and the bankruptcy court has no jurisdiction over the codebtor to compel payment. Thus, disfavoring the codebtor claim might well place that claim in a far more precarious position.¹⁵⁴ Accordingly, courts have uniformly ruled that the authorization to treat codebtor claims differently permits favoring such claims, not disfavoring them.¹⁵⁵

debtor's live-in girlfriend to be an insider); *Wiswall v. Tanner* (*In re Tanner*), 145 B.R. 672, 677-78 (Bankr. W.D. Wash. 1992) (treating debtor's homosexual lover as an insider). Cf. *In re Reinbold*, 182 B.R. 244 (D.S.D. 1995) (friend and mentor not an insider).

¹⁵¹For cases denying favored treatment of codebtor claims, see *Barnes v. Whelan*, 689 F.2d 193 (D.C. Cir. 1982); *In re Cook*, 26 B.R. 187 (D.N.M. 1982); *In re Barker*, 7 B.R. 707 (Bankr. W.D. Mo. 1980); *In re Crago*, 4 B.R. 483 (Bankr. S.D. Ohio 1980); *In re Nickels*, 4 B.R. 481 (Bankr. S.D. Ohio 1980); *In re Wade*, 4 B.R. 98 (Bankr. M.D. Tenn. 1980); *In re McKenzie*, 4 B.R. 88 (Bankr. W.D.N.Y. 1980); *In re Utter*, 3 B.R. 369 (Bankr. W.D.N.Y. 1980); *In re Iacovoni*, 2 B.R. 256 (Bankr. D. Utah 1980). See also *In re Girardeau*, 35 B.R. 9 (Bankr. D.S.C. 1983) (denying proposed favored treatment of codebtor claims because the debtor failed to demonstrate any need for it); *In re Moore*, 31 B.R. 12 (Bankr. D.S.C. 1983) (same).

For cases permitting favored treatment of codebtor claims, see *Public Fin. Corp. v. Freeman*, 712 F.2d 219 (5th Cir. 1983); *In re Vanleeuwen*, 17 B.R. 189 (Bankr. S.D. Ohio 1982); *In re Hill*, 4 B.R. 694, 699 (Bankr. D. Kan. 1980) (dicta); *In re Kovich*, 4 B.R. 403 (Bankr. W.D. Mich. 1980).

¹⁵²See *supra* note 35 and accompanying text.

¹⁵³11 U.S.C. § 1322(b)(1) (1994).

¹⁵⁴See *In re Markham*, 224 B.R. 599, 601 (Bankr. W.D. Ky. 1998).

¹⁵⁵E.g., *In re Campbell*, 242 B.R. 547, 549 (Bankr. S.D. Ga. 1999) (dicta); *In re Burnip*, 229 B.R. 904, 906 (Bankr. S.D. Ohio 1999); *In re Markham*, 224 B.R. 599 (Bankr. W.D. Ky. 1998); *In re Davis*, 101 B.R.

Such rulings are consistent with the small amount of legislative history that exists concerning this amendment.¹⁵⁶ This history indicates that permitting favored treatment of codebtor claims is intended to help prevent the debtor's bankruptcy from prompting a filing by the codebtor, and then perhaps in domino fashion the bankruptcy of others.¹⁵⁷ This provision was also premised on the concern that the debtor may feel a moral obligation to pay codebtor claims beyond the extent provided for in the plan, and that such payments might jeopardize the success of the plan.¹⁵⁸

In fact, no empirical evidence can be found to support either of these congressional concerns. Nevertheless, the statutory authorization for according different, apparently favorable, treatment of codebtor claims remains. That said, it is important to note that the two clauses of amended § 1322(b)(1) speak to different things: unfair discrimination and disparate treatment. In other words, Congress did not amend § 1322(b)(1) to specify that "a plan may not discriminate unfairly, but favored treatment of codebtor claims is not unfair discrimination." The statute provides that a plan may not discriminate but it may treat codebtor claims differently. As a result, the exact meaning of the amendment is unclear.

Most courts regard favored treatment of codebtor claims as authorized but still subject to the unfair discrimination standard, and thus decline to confirm a plan that discriminates excessively.¹⁵⁹ A few other courts regard

505, 507 (Bankr. S.D. Ohio 1989); *In re Diaz*, 97 B.R. 903, 904-05 (Bankr. S.D. Ohio 1989); *In re Dondero*, 58 B.R. 847, 848 (Bankr. D. Or. 1986); *In re Perkins*, 55 B.R. 422 (Bankr. N.D. Okla. 1985).

¹⁵⁶Neither the Senate nor House report relating to the Bankruptcy Amendments and Federal Judgeship Act of 1984 contain any reference to § 1322(b). However, this portion of the Act was derived from a prior bill, S. 445, 98th Cong. (1983), the Senate report on which contains an explanation. See S. REP. NO. 98-65 at 17-18 (1983).

¹⁵⁷*Id.* The court in *In re Harris*, 62 B.R. 391 (Bankr. E.D. Mich. 1986) suggested a completely different rationale. It noted that creditors with very small claims would find the cost of litigation to exceed the amount of their claim, and that in a practical sense they therefore have fewer remedies against the debtor under nonbankruptcy law than do other creditors. *Id.* at 395. The court offered no explanation as to why such creditors should therefore have greater rights against the debtor in bankruptcy than other creditors.

¹⁵⁸*Id.* However, just as the codebtor stay does not apply to debts incurred for the benefit of the codebtor, see 11 U.S.C. § 1301(c)(1), favored treatment of a codebtor claim is apparently available only if the debtor, not the codebtor, was the one who benefitted from the loan. *In re McKown*, 227 B.R. 487, 492 (Bankr. N.D. Ohio 1998); *In re Janssen*, 220 B.R. 639, 642 (Bankr. N.D. Iowa 1998) (*dicta*); *In re Gonzales*, 172 B.R. 320, 329-30 (E.D. Wash. 1994); *In re Hamilton*, 102 B.R. 498, 502 (Bankr. W.D. Va. 1989). Thus, if the debtor guaranteed the obligation of another, the debtor would not normally feel the moral duty to protect the other, a desire that might prompt voluntary payment beyond what the plan provides for and thereby jeopardize the debtor's ability to consummate the plan. *Gonzales*, 172 B.R. at 329; *McKown*, 227 B.R. at 492. However, if a third person, such as the debtor's employer, has guaranteed the debt, the debtor might feel obligated to pay and favored treatment of the claim is permissible. *Gonzales*, 172 B.R. at 330.

¹⁵⁹See, e.g., *In re Ramirez*, 204 F.3d 595 (5th Cir. 2000) (interpreting some rather contradictory statements in *In re Chacon*, 202 F.3d 725 (5th Cir. 1999)); *In re McNichols*, 249 B.R. 160 (Bankr. N.D. Ill. 2000) (denying confirmation of plan that paid 100% of codebtor claims but only 10% of other unsecured claims); *In re Regine*, 234 B.R. 4 (Bankr. D.R.I. 1999) (denying confirmation of plan that paid 100% of

avored treatment of disparate claims as wholly exempt from unfair discrimination analysis,¹⁶⁰ although even they would presumably prohibit a debtor from discriminating among different codebtor claims.¹⁶¹ In fact, it may well be that courts are actually less willing to permit favored treatment of codebtor claims now than they were before the amendment, even though the amendment—whatever it means—was surely designed to provide debtors with more flexibility.¹⁶²

codebtor claims but only 17% of other claims); *In re McKown*, 227 B.R. 487 (Bankr. N.D. Ohio 1998) (denying confirmation of plan that paid 100% of codebtor claims but only 10% of other claims); *In re Strausser*, 206 B.R. 58 (Bankr. W.D.N.Y. 1997) (denying confirmation of plan that paid codebtor claims in full but only 5-19% of other claims); *In re Battista*, 180 B.R. 355 (Bankr. D.N.H. 1995) (denying confirmation of plan that paid 100% of codebtor claims but only 6% of other claims); *In re Martin*, 189 B.R. 619 (Bankr. E.D. Va. 1995) (denying confirmation of plan that paid 100% of codebtor claims but only 6.5% of other claims); *In re Cheak*, 171 B.R. 55 (Bankr. S.D. Ill. 1994) (denying confirmation of plan that paid 100% of codebtor claims but only 10% of other claims); *In re Lewman*, 157 B.R. 134 (Bankr. S.D. Ind. 1992) (denying confirmation of plan that paid 100% of son's educational loan debt but only 10% of other claims); *In re Whitelock*, 122 B.R. 582 (Bankr. D. Utah 1990); *In re Easley*, 72 B.R. 948 (Bankr. M.D. Tenn. 1987) (denying confirmation of plan that paid 100% of codebtor claim but only 12% of other claims). See also *In re Applegarth*, 221 B.R. 914 (Bankr. M.D. Fla. 1998) (ruling that the prohibition on unfair discrimination applies to codebtor claims and setting hearing on whether plan paying 100% of codebtor claims but only 10% of other claims constitutes unfair discrimination); *In re Birriel Gonzalez*, 73 B.R. 259 (Bankr. D.P.R. 1987) (ruling that a Chapter 13 plan may not discriminate unfairly in favor of codebtor claims but then confusing the prohibition on unfair discrimination with the § 1325(b)(1) requirement that creditors receive at least the liquidation value of their claims); DAVID L. BUCHBINDER, *FUNDAMENTALS OF BANKRUPTCY: A LAWYER'S GUIDE* § 23.4 (1991) (paying codebtor claims at a rate of 50% while paying only 10% of other claims constitutes unfair discrimination). But cf. *In re Janssen*, 220 B.R. 639 (Bankr. N.D. Iowa 1998) (applying unfair discrimination analysis but nevertheless confirming plan that paid 100% of codebtor claims and only 13% of other claims); *In re Perkins*, 55 B.R. 422 (Bankr. N.D. Okla. 1985) (confirming plan that paid 100% of codebtor claim but only 22% of other claims after concluding that such discrimination was not unfair).

¹⁶⁰*In re Hill*, 255 B.R. 579, 580-81 (Bankr. N.D. Cal. 2000); *In re Coonce*, 213 B.R. 344, 348 (Bankr. S.D. Ill. 1997) (dicta); *Lawson v. Lackey* (*In re Lackey*), 148 B.R. 626, 632 (Bankr. N.D. Ala. 1992) (dicta); *In re Chapman*, 146 B.R. 411, 416 (Bankr. N.D. Ill. 1992) (dicta); *In re Riggel*, 142 B.R. 199, 204 (Bankr. S.D. Ohio 1992) (dicta); *In re Dornon*, 103 B.R. 61, 64 (Bankr. N.D.N.Y. 1989). See also *In re Thompson*, 191 B.R. 967 (Bankr. S.D. Ga. 1996) (ruling that the unfair discrimination requirement has no application to codebtor claims independent of the other confirmation requirements, but denying confirmation of plan that paid 100% of codebtor claims but nothing on other claims for lack of good faith).

Some courts even permit the debtor to pay postpetition interest on codebtor claims while other claims are not paid in full. *In re Butler*, 242 B.R. 553 (Bankr. S.D. Ga. 1999) (but requiring that such interest be paid last); *In re Austin*, 110 B.R. 430 (Bankr. E.D. Mo. 1990) (not mentioning the degree of discrimination). *Contra In re Alls*, 238 B.R. 914 (Bankr. S.D. Ga. 1999) (decided by a different judge than the *Butler* case). Cf. *In re Chacon*, 202 F.3d 725, 726 (5th Cir. 1999) (suggesting that it would be improper for the plan to pay unmatured interest); *In re Janssen*, 220 B.R. 639, 645-46 (Bankr. N.D. Iowa) (permitting favored treatment of codebtor claim after applying unfair discrimination analysis, but refusing to also allow payment of postpetition interest).

¹⁶¹See *In re Janssen*, 220 B.R. 639, 643 (Bankr. N.D. Iowa 1998); *In re Young*, 102 B.R. 1022, 1023 (Bankr. W.D. Mo. 1989). See also *In re Gregg*, 179 B.R. 828 (Bankr. S.D. Tex. 1994) (permitting student loan claims to be favored over general claims, but not permitting discrimination among different student loan creditors).

¹⁶²This may simply be attributable to the fact that there has been significantly more time and more opportunities for the case law to develop after the 1984 amendment than there was before it.

It may be possible to harmonize the case law in this area with the Code's rather cryptic authorization to treat codebtor claims more favorably. As a general rule, discrimination in favor of codebtor claims should be viewed with disdain. It runs contrary to several basic rules of and policies underlying the Bankruptcy Code. Moreover, a friendlier attitude toward such discrimination could give rise to a ridiculous anomaly: debtors would be permitted to favor a claim on which a codebtor—typically a family member—is liable, but would not be allowed to favor a creditor who is a family member. In essence, the debtor would be permitted to do indirectly what the debtor was not permitted to do directly. One could even imagine situations in which, immediately before filing for bankruptcy protection, the debtor canvasses aunts, uncles, and cousins in search of one willing to guaranty the debtor's outstanding obligation to the debtor's parents, just so that the debtor would be permitted to pay that claim in full in Chapter 13.¹⁶³

However, when favored treatment would truly be necessary to prevent the codebtor from seeking bankruptcy relief, favored treatment should be permitted to the extent necessary to avoid such consequences.¹⁶⁴ Similarly, when circumstances convince the court that the debtor is truly likely to jeopardize the success of the plan by making additional payments to a particular creditor outside the plan, discriminatory treatment should be permitted. Thus, for example, a debtor should be allowed to favor a claim guaranteed by the debtor's employer if fear of retaliation would prompt the debtor to try to pay it anyway.¹⁶⁵ A police officer should be permitted to favor a claim guaranteed by the officer's partner, in order to maintain confidence and harmony among them, given their daily reliance upon each other in the scope of dangerous police work, and to prevent pressure to pay the claim outside the plan.¹⁶⁶

Such situations are likely to be rare.¹⁶⁷ Nevertheless, this approach promotes the purpose of the 1984 amendment without undermining basic bank-

¹⁶³Of course, the requirement of good faith in 11 U.S.C. § 1325(a)(3) may be sufficient to prevent such abuses. See *In re Ramirez*, 204 F.3d 595, 600 (5th Cir. 2000) (Benavides, J., concurring).

¹⁶⁴See *In re McNichols*, 249 B.R. at 165-66, 176 (denying confirmation of plan that favored codebtor claim in part because the codebtor, whose monthly take-home pay was almost \$7,500, clearly had the ability to pay his share of the debt). Cf. *In re Thompson*, 191 B.R. 967, 974 (Bankr. S.D. Ga. 1996) (denying confirmation of plan, albeit under the rubric of "good faith" rather than "unfair discrimination," because its favored treatment of a wealthy codebtor was not necessary to avoid the ripple effect of the codebtor's bankruptcy).

¹⁶⁵See *In re Ross*, 161 B.R. 36, 38 (Bankr. C.D. Ill. 1993) (not discussing whether § 362(a) or § 525(b) prohibit such retaliation). See also *In re Janssen*, 220 B.R. 639, 644 (Bankr. N.D. Iowa 1998) (failing to explain why, the court was satisfied that the debtor could not carry out the plan without discriminating in favor of claims guaranteed by her father because she "may" attempt to pay the creditors outside the plan to protect him from creditor pressure, lessening the likelihood of the plan's success).

¹⁶⁶See *In re Todd*, 65 B.R. 249, 253 (Bankr. N.D. Ill. 1986).

¹⁶⁷Cf. *Barnes v. Whelan*, 689 F.2d 193, 202 (D.C. Cir. 1982) (noting that nothing in record suggested that the debtor would be unable to consummate the plan if the cosigned obligations were not paid in full).

ruptcy policy. It also gives meaning to both clauses of § 1322(b)(1): the prohibition on unfair discrimination and the authorization to treat codebtor claims differently.

E. NECESSITY

Occasionally, a debtor needs to pay a claim in full in order to receive or retain something necessary to consummate the plan. In other cases, the debtor may need to favor a particular claim in order to maintain a relationship, such as with a medical provider, that is essential to the success of the plan.¹⁶⁸ While assertions of such necessity should be and are viewed with skepticism, a verifiable need of this type provides justification for treating some claims more favorably than others.

The easiest cases arise when the favorable treatment actually enhances the recovery of other claimants. In most Chapter 13 cases, the debtor is unable to pay all creditors in full and is allocating all disposable income to payment of creditors for a period of three to five years.¹⁶⁹ There is, in essence, a fixed pot of money available for creditors, and every extra dime paid to one favored creditor is one less that goes to other creditors.¹⁷⁰ However, in rare instances favored treatment of one creditor may actually increase the size of the pot.

For example, if the debtor is in arrears on the rent on a government-subsidized apartment, payment of the arrears in full may be necessary to prevent eviction.¹⁷¹ That in turn may allow the debtor to avoid renting a much more costly apartment, which would then reduce the debtor's disposable income committed to creditors under the plan. In short, the excess paid to the landlord may be more than recouped through lower living expenses, with the

¹⁶⁸On rare occasions this rationale can apply to student loans. If the debtor has returned to school, it may be impossible to obtain more federally guaranteed student loans if the debtor is in default on existing, nondischargeable ones. See *In re Freshley*, 69 B.R. 96 (Bankr. N.D. Ga. 1987), cited in Oliver B. Pollak & David G. Hicks, *Student Loans, Chapter 13, Classification of Debt, Unfair Discrimination and the Fresh Start After the Student Loan Default Prevention Initiative of 1990*, 1993 DETROIT COLL. OF L. REV. 1617, 1633 (1993); EPSTEIN ET AL., *supra* note 2, § 9-7, at 681. Cf. 11 U.S.C. § 525(c) (1994) (prohibiting discrimination in the making of student loans on the basis of a prior bankruptcy or failure to pay a discharged or dischargeable indebtedness).

¹⁶⁹Debtors who do not pay claims in full must allocate all disposable income to the plan for three years. 11 U.S.C. § 1325(b) (1984). A plan may, for cause, extend beyond three years, but it cannot last longer than five years. 11 U.S.C. § 1322(d) (1994).

¹⁷⁰*In re Lackey*, 148 B.R. 626, 631 (Bankr. N.D. Ala. 1992); *In re Colfer*, 159 B.R. 602, 609 (Bankr. D. Me. 1993); *In re Chapman*, 146 B.R. 411, 415 (Bankr. N.D. Ill. 1992); TABB, *supra* note 2, § 12.11 at 919; EPSTEIN ET AL., *supra* note 2, § 9-7, at 680.

¹⁷¹Sections 365 and 1322(b)(7) authorize the debtor to assume an unexpired lease provided all arrearages will be paid under the plan. Presumably, though, because the lessor is a prepetition creditor, this authorization is subject to the prohibition on unfair discrimination. See *infra* note 268 and accompanying text, making a similar point with respect to the authorization in § 1322(b)(5) to pay long-term debts under the plan.

result that all creditors are better off. Even if the apartment is not subsidized, the costs of moving upon eviction might by themselves exceed the amount lost to other creditors by paying the arrearages in full.¹⁷² It is difficult to see how favored treatment of one creditor that benefits all general creditors is unfair.¹⁷³

The next easiest cases involve favorable treatment that is necessary for the debtor to complete the plan which in turn pays unsecured claimants more than they would receive in a Chapter 7 liquidation. Here, while the discrimination does not actually increase the pot of money available to creditors, it nevertheless provides an indirect benefit to unsecured creditors. A stark example of this is when the debtor must pay one or more claims in full to avoid incarceration and retain the ability to earn income to pay into the plan. This most frequently occurs when the debtor fears prosecution for writing bad checks or needs to comply with a judicial restitution order.¹⁷⁴

Courts have actually shown little sympathy for debtors in such circumstances, typically because the debtor was unable to convince the court that the threat of incarceration was substantial.¹⁷⁵ If a debtor can make that showing, however, favored treatment of the claim should not constitute unfair discrimination.¹⁷⁶ Allowing such discrimination facilitates the debtor's

¹⁷²In other words, the amount of the arrearages minus the amount that the landlord would receive in a pro rata distribution.

¹⁷³See *In re Ford*, 221 B.R. 749, 755 (Bankr. W.D. Tenn. 1998); *In re Davis*, 209 B.R. 893 (Bankr. N.D. Ill. 1997). See also *In re Delauder*, 189 B.R. 639, 646 (Bankr. E.D. Va. 1995) (observing that if discrimination actually enhances the recovery of other creditors that fact militates against it being unfair). Cf. *In re Ratledge*, 31 B.R. 897, 900 (Bankr. E.D. Tenn. 1983) (suggesting in dicta that it may be appropriate to favor landlords); *In re Kovich*, 4 B.R. 403, 407 (Bankr. W.D. Mich. 1980) (same). But cf. *In re Liggins*, 145 B.R. 227, 231 (Bankr. E.D. Va. 1992) (indicating that the debtor failed to demonstrate the necessity for favoring the claim for arrearages on a subsidized apartment); *In re Blackwell*, 5 B.R. 748 (Bankr. W.D. Mich. 1980) (rejecting a plan that paid rental arrearages in full but only five percent of other claims as not filed in good faith, and suggesting that the debtor extend the three-year duration of the plan).

¹⁷⁴The prevailing view is that the automatic stay does not insulate the debtor from criminal sanction for his or her conduct, even if the criminal proceeding is commenced or pursued to aid in debt collection. See 11 U.S.C. § 362(b)(1); *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000) (en banc).

¹⁷⁵See *In re Limbaugh*, 194 B.R. 488, 492 (Bankr. D. Or. 1996) (the debtors "have presented no evidence to support th[e] assertion" that they would be incarcerated if they failed to pay \$300 per month to the county pursuant to a restitution order); *In re Bowles*, 48 B.R. 502, 509 (Bankr. E.D. Va. 1985) (involving a restitution order for a debt incurred under false pretenses; the court found "no evidence . . . that the debtors could not propose a viable plan which did not unfairly discriminate"); *In re Gay*, 3 B.R. 336, 338 (Bankr. D. Colo. 1980) ("It would be speculation to conclude that a criminal action would arise from the failure to pay the holders of the checks in full or that such a proceeding would impair the Debtors' ability to perform under their plan"). See also *In re Hiner*, 161 B.R. 688 (Bankr. D. Idaho 1993) (not discussing the possibility of prosecution and incarceration for failing to pay in full debts arising from bad checks).

¹⁷⁶See *In re Ratledge*, 31 B.R. at 900 (dicta); *In re Lawson*, 93 B.R. 979, 983-84 (Bankr. N.D. Ill. 1988) (noting some legislative history mildly suggesting that favored treatment of an NSF check for which the debtor was subject to prosecution would not be unfair discrimination); *In re Smalberger*, 157 B.R. 472, 477 (Bankr. D. Or. 1993), *aff'd*, 170 B.R. 707 (D. Or. 1994) (suggesting that discrimination would be fair if without it the debtor would be imprisoned and the plan would fail). See also *In re Kolton*, 1990 WL

fresh start, encourages use of Chapter 13, and most importantly, enhances the recovery of all creditors, even the disfavored ones. It therefore effectuates several strong policy goals of the Bankruptcy Code. Collectively, these benefits outweigh the general policy of equality of treatment. In fact, this was the view of the *Kovich* court,¹⁷⁷ the progenitor of the multifactor test that most courts use.

Some courts reject this conclusion, noting that "the nature of these debts is punishment of the criminal and not the criminal's creditors."¹⁷⁸ What these courts fail to realize, however, is that by denying confirmation it is they who are injuring the other creditors. Even if allowing the debtor to favor these claims somehow undermines their punitive purpose, a point which surely could be debated,¹⁷⁹ it is sheer sophistry to suggest that a plan providing general claimants more than they would receive under any realistic alternative somehow discriminates unfairly against them.¹⁸⁰ If the price of equality of treatment is less recovery for everyone, then that price is simply too high.

If favorable treatment of a creditor is necessary for the debtor to complete the plan, but that plan pays other unsecured creditors only the liquida-

87007 (Bankr. W.D. Tex. Apr. 4, 1990), in which the court treated direct payment in full of a restitution order as a reasonable living expense because otherwise the debtor would be incarcerated and the other claimants would get nothing. Much of the court's analysis was premised on its conclusion that the restitution order was not a "debt," and therefore could not be treated under the plan, a point expressly rejected a few months later both by the Supreme Court in *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552 (1990), and by Congress in the Crime Control Act of 1990, Pub. L. 101-647, 104 Stat. 4789, which added § 1328(a)(3) to the Code. Moreover, the *Kolton* court suggested in dicta that if the restitution obligation were a debt, the plan would unfairly discriminate if it provided favored treatment of it. The court offered no explanation why such discrimination would be unfair if indeed all other creditors would get nothing without the discrimination. *But cf. In re Williams*, 231 B.R. 280 (Bankr. S.D. Ohio 1999) (rejecting plan because debtor failed to prove that incarceration would result from nonpayment of a restitution order, but suggesting in dicta that it would deny confirmation even if the debtor had made such a showing).

¹⁷⁷See 4 B.R. at 407 (employing classifications that provide some creditors be paid a greater percentage of their claims "may not be unfair to other unsecured creditors because if they are not permitted the debtor may be forced into Chapter 7 and they may receive nothing"). See also *In re Husted*, 142 B.R. 72, 75 (Bankr. W.D.N.Y. 1992) (citing *Kovich* and making the same point).

¹⁷⁸*In re Williams*, 231 B.R. at 282 (quoting *In re Ponce*, 218 B.R. 571, 575 (Bankr. E.D. Wash. 1998)).

¹⁷⁹See *In re Limbaugh*, 194 B.R. at 493, where the court indicated that two purposes of criminal sanctions—deterrence and punishment—are undermined when innocent creditors are required to help pay for a debtor's criminal sanctions. The court failed to explain how such creditors are "paying" at all if the only alternative to the debtor's discriminatory plan is incarceration and liquidation in Chapter 7, which would yield the creditors nothing.

¹⁸⁰*Cf. In re Tucker*, 159 B.R. 325 (Bankr. D. Mont. 1993) (permitting favored treatment of student loans largely because the disfavored general creditors were to get a twenty-nine percent recovery under the plan but would have received nothing if the debtor liquidated in Chapter 7); *In re Dodds*, 140 B.R. 542 (Bankr. D. Mont. 1992) (permitting favored treatment of student loans in part because debtor's fifty-four month discriminatory plan provided general creditors a greater recovery than they would receive in a thirty-six month nondiscriminatory plan).

tion value of their claims, then the other creditors are not made better off by either the Chapter 13 plan or the discrimination. Indeed, to the extent the plan provides for any payment to them at all, they may be marginally worse off because even though they may effectively get interest on the liquidation value of their claims,¹⁸¹ they must accept the substantial risk that the debtor will in fact not complete the payments under the plan.¹⁸² This type of situation can arise in cases involving the threat of incarceration.¹⁸³ It can also arise in other instances, such as when a debtor's driving license has been suspended for nonpayment of criminal traffic fines, the debtor needs to drive to either get to work or as part of the debtor's employment, and the license will be reinstated if the plan provides for full payment of the fines.

These were the facts of *In re Games*.¹⁸⁴ There the court expressly concluded that the proposed discrimination was necessary.¹⁸⁵ As a result, the court permitted the debtor to pay off the fines in full while paying less on other claims, provided the debtor extended the duration of the plan from forty-nine to sixty months.¹⁸⁶ This extension enabled other creditors to receive at least some distribution under the plan, whereas under both the debtor's proposal and in Chapter 7 they would have received nothing. Putting aside for the moment the court's requirement that the debtor extend the

¹⁸¹See 11 U.S.C. § 1325(a)(4), requiring that the payments to an unsecured claimant have a value, "as of the effective date of the plan," at least equal to the amount the creditor would receive in a Chapter 7 liquidation. This present value requirement essentially mandates that interest be paid on any portion of the claim paid after the effective date of the plan.

¹⁸²Two-thirds of all Chapter 13 plans fail before the debtor completes payment. NATIONAL BANKRUPTCY REVIEW COMMISSION, *BANKRUPTCY: THE NEXT TWENTY YEARS* 233 (1997). See also Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 439-40 (1999) (discussing a recent study of all Chapter 13 cases closed within a six-month period in one federal district; in only 32.4% did the debtor complete the plan and receive a discharge; in 49.3% the case was dismissed after confirmation of a plan, and the remaining 18.3% were dismissed before a plan was confirmed). Apparently the rate of failure varies significantly from state to state. See Gordon Bermant & Ed Flynn, *Measuring Projected Performance in Chapter 13, Comparisons Across the States*, AM. BANKR. INST. J., July/Aug. 2000, 22, 35 (indicating that, of the cases terminating in fiscal year 1998, the percentage ending because of successful completion of the plan varied from a high of forty-seven percent in West Virginia to a low of eleven percent in Florida).

¹⁸³See *In re Burns*, 216 B.R. 945 (Bankr. S.D. Cal. 1998) (involving a claim for child support assigned to a governmental unit, which the debtor proposed to pay in full to avoid potential criminal charges while paying nothing to general creditors); *In re Limbaugh*, 194 B.R. 488 (Bankr. D. Or. 1996) (involving a claim for restitution which the debtors proposed to pay in full, to avoid incarceration, while paying nothing to other unsecured claimants).

¹⁸⁴213 B.R. 773 (Bankr. E.D. Wash. 1997).

¹⁸⁵*Id.* at 778. Note, had the fines been of a civil nature, the state would not have been permitted to deny the debtor driving privileges simply because the debtor had not paid the fines. *Id.* at 776-77.

¹⁸⁶*Id.* at 778-81. In a later case, the same court rejected a plan that proposed to pay criminal traffic fines in full but only fifteen percent of other unsecured claims. *In re Ponce*, 218 B.R. 571 (Bankr. E.D. Wash. 1998). However, there the debtor apparently tried to justify the discrimination not on the basis of necessity, but on the nondischargeability of the fines. See *id.* at 573 & 577. The court went on to suggest, however, that the debtor could discriminate after the first thirty-six months of the plan. *Id.* at 578.

plan, the court's method of analysis was essentially correct. It implicitly recognized that if discrimination is truly necessary to the success of a plan, fairness is better evaluated in reference to the alternative of recovery under Chapter 7, not to a Chapter 13 plan without discrimination. In that sense the court's analysis is consistent with the point of the illustration involving Doug and Debbie at the beginning of this Article. It is also consistent with the legislative history of the amendment regarding codebtor claims. To the extent that amendment was grounded in the concern that the debtor would attempt to pay the codebtor claim out of the debtor's own living expenses, thereby jeopardizing the success of the plan, that history implicitly suggests that fairness cannot be judged by comparing the proposed discriminatory plan to one without discrimination, because the latter is an unrealistic alternative.¹⁸⁷

This same rationale supports favored treatment based on other claims of necessity. For example, several courts have suggested that a debtor may favor the claim of health care providers whose continued services and goodwill the debtor will need during the plan.¹⁸⁸ To the extent that these concerns stem from the assumption that the debtor will endeavor to pay these claims regardless of what the plan provides, thus jeopardizing the success of the plan,¹⁸⁹ it is proper to conclude that the discrimination is not unfair if the disfavored creditors will not be better off under any realistic alternative.

For precisely the same reasons, it is not unfair for the debtor to favor the claim of a lender or supplier whose credit or materials the debtor will need to complete the plan,¹⁹⁰ a situation that arises more commonly in Chapter 11 cases than in Chapter 13 proceedings. Of course, this applies only when the debtor truly lacks adequate access to alternative sources.¹⁹¹ It is worth not-

¹⁸⁷See 8 COLLIER ON BANKRUPTCY ¶ 1322.05[2][b] (Lawrence P. King et al. eds., 15th ed. rev. 1999) ("In the legislative history of the 1984 amendments, Congress agreed that practical necessity can be a proper reason for separate classification of claims.").

¹⁸⁸See *In re Terry*, 78 B.R. 171, 173-74 (Bankr. E.D. Tenn. 1997); *In re Ratledge*, 31 B.R. 897 (Bankr. E.D. Tenn. 1983); *In re Hill*, 4 B.R. 694 (Bankr. D. Kan. 1980); *In re Sutherland*, 3 B.R. 420 (Bankr. W.D. Ark. 1980). Cf. *In re Hosler*, 12 B.R. 395 (Bankr. S.D. Ohio 1981) (refusing to permit favored treatment of claims held by physicians involved in ongoing treatment of the debtors' family because there was no evidence that the physicians would refuse to provide treatment if the plan did not discriminate in their favor).

¹⁸⁹This appears to be one of the concerns in *Hill*. See 4 B.R. at 699 (questioning whether refusal to permit separate classification would really result in nonpayment). See also *In re Benner*, 146 B.R. 265, 267 (Bankr. D. Mont. 1992) (permitting favored treatment of a nondischargeable support claim because without it the claimant would pursue collection efforts that would scuttle the plan; it was therefore not possible to devise a more fair Chapter 13 plan).

¹⁹⁰See, e.g., *In re Freshley*, 69 B.R. 96, 98 (Bankr. N.D. Ga. 1987); *In re Perskin*, 9 B.R. 626, 632 (Bankr. N.D. Tex. 1981); *In re Sutherland*, 3 B.R. 420, 422 (Bankr. W.D. Ark. 1980). See also *In re Furlow*, 70 B.R. 973, 976-79 (Bankr. E.D. Pa. 1987) (citing *Freshley* approvingly on this point).

¹⁹¹See *In re Wolff*, 22 B.R. 510 (9th Cir. B.A.P. 1982) (refusing favored treatment of a Chapter 13 debtor's insurance carrier and materials supplier because there was no proof that such discrimination was

ing that Professor Markell has argued that such a situation does not justify discrimination in Chapter 11.¹⁹² His argument rests on the rationale that preferred treatment could never truly be necessary because the debtor could always simply liquidate and then cease to exist. While that may be true for corporations, it is not true for individuals, who are the only ones permitted to file under Chapter 13. Public policy supports making sure that such individuals receive necessary medical care and are self-supporting members of society rather than drains on the public purse. If favored treatment of one creditor is really necessary to achieve this, such discrimination should not be regarded as unfair.

One last claim of necessity deserves mention. Several courts have indicated that a debtor should not be permitted to use Chapter 13 if the primary purpose is to avoid payment of claims for willful and malicious injury.¹⁹³ If the debtor therefore proposes to give favored treatment to such claims in order to ensure that the plan is proposed in good faith, perhaps that should be permitted.¹⁹⁴ The few courts presented with this argument seem to accept it, although they denied confirmation anyway.¹⁹⁵ If this approach is truly necessary for the plan to satisfy the requirement of good faith, then it should be permitted for the reasons discussed above. However, if, as is likely, the good faith requirement can be satisfied in other ways, such as by lengthening

necessary; the debtor never even contacted any alternative insurers or suppliers). This point is made frequently in Chapter 11 cases. See *In re Greystone III Joint Venture*, 948 F.2d 134, 141 (5th Cir. 1991), cert. denied, 506 U.S. 821 (1992); *In re Boston Post Road Ltd. Partnership*, 21 F.3d 477, 483 (2d Cir. 1994) (noting that the trade creditors were few and nonessential); *In re Graphic Communications, Inc.*, 200 B.R. 143 (Bankr. E.D. Mich. 1996) (noting that the debtor offered no proof why trade creditors needed 100% recovery while other claimants were to get only 10%); *In re North Washington Center Ltd. Partnership*, 165 B.R. 805, 809 (Bankr. D. Md. 1994) (noting that existence of replaceable trade creditors undermined the need to classify and treat trade creditors separately, and consequently not permitting a separate class); *In re ARN LTD. Ltd. Partnership*, 140 B.R. 5, 12 (Bankr. D.D.C. 1992) (concluding that discrimination in favor of trade creditors cannot be justified by the "bald speculation" that it is necessary); Polivy, *supra* note 31, at 212 ("most courts insist that the debtor substantiate its claim that its survival requires discrimination in favor of trade creditors"). See also *In re Tuscon Self-Storage, Inc.*, 166 B.R. 892 (9th Cir. B.A.P. 1994) (concluding that separate classification and favored treatment of trade creditors constituted unfair discrimination under § 1129(b)(1)—no evidence of business necessity was discussed).

¹⁹²See Markell, *supra* note 3, at 254-55.

¹⁹³E.g., *Noreen v. Slaatengren*, 974 F.2d 75, 76-77 (8th Cir. 1992).

¹⁹⁴Cf. *In re Smith*, 848 F.2d 813, 817 (7th Cir. 1988) (suggesting in dicta that a Chapter 13 plan could favor creditors with claims for willful and malicious injury without unfairly discriminating); *In re Rimgale*, 669 F.2d 426, 433 (7th Cir. 1982) (same). But cf. *In re Chapman*, 146 B.R. 411 (Bankr. N.D. Ill. 1992) (rejecting that dicta); *In re Lawson*, 93 B.R. 979, 989 (Bankr. N.D. Ill. 1988) (criticizing that dicta in the context of student loan claims before they were made nondischargeable in Chapter 13); *In re Johnson*, 69 B.R. 726 (Bankr. W.D.N.Y. 1987) (refusing to permit favored treatment of claim apparently covered by § 523(a)(2)).

¹⁹⁵See *In re Lawson*, 93 B.R. 979 (concluding that good faith would not have been an impediment to confirmation if the claims were all paid ratably); *In re Johnson*, 69 B.R. 726 (apparently concluding that good faith would not have been a problem if the plan proposed equal treatment of all unsecured claims).

the plan from three years to five,¹⁹⁶ then the discrimination is not necessary and should therefore not be permitted under this rationale. Put another way, if good faith can be demonstrated without violating the policy of equal treatment, then there is no true necessity to discriminate. That being the case, the proper referent for unfairness is not a Chapter 7 liquidation, but a Chapter 13 plan without discrimination.

F. NONDISCHARGEABLE CLAIMS

There are three main types of nondischargeable claims that a debtor may wish to favor in a Chapter 13 plan: criminal fines and restitution orders, liability for drunk driving, and educational loans.¹⁹⁷ Courts have been generally unreceptive to plans that propose to favor any of them, particularly if the discrepancy in treatment is substantial.¹⁹⁸

This hostility seems a bit odd for two reasons. First, it results in a situation in which debtors are permitted to favor claims on which a codebtor is liable, at least if failure to do so would force the codebtor into bankruptcy, but are not permitted to favor claims on which they themselves will remain liable, regardless of their need for relief. This despite the fact that it is the debtor for whom bankruptcy relief is designed.

Second, nondischargeable debts are—by their very definition—claims that Congress has chosen to favor. In particular, Congress has permitted such claims to be satisfied out of a debtor's postpetition earnings, a right that the holders of dischargeable claims do not have if the debtor liquidates in Chapter 7.¹⁹⁹ Given that several year's worth of the debtor's postpetition earnings are brought into Chapter 13 proceedings and made available there to prepetition claimants,²⁰⁰ favoring nondischargeable claims in a Chapter 13 plan would seem to be consistent with congressional goals. At a minimum, such discrimination is not so intuitively inconsistent with the congressional scheme as to justify the strong negative response of the courts.²⁰¹

¹⁹⁶See *In re Todd*, 65 B.R. 249 (Bankr. N.D. Ill. 1986).

¹⁹⁷See 11 U.S.C. § 1328(a)(2), (3) (1994). Also nondischargeable are debts with long-term payment schedules, extending beyond the three- to five-year duration of the plan, which the debtor proposes to maintain. See 11 U.S.C. § 1328(a)(1).

¹⁹⁸See, e.g., *In re Groves*, 39 F.3d 212 (8th Cir. 1994) (denying confirmation of a plan that favored nondischargeable educational loans over other unsecured debts).

¹⁹⁹See 11 U.S.C. § 541(a)(6) (1994) (defining the bankruptcy estate to exclude such income).

²⁰⁰See 11 U.S.C. § 1306(a)(2) (1994) (defining a Chapter 13 estate to include postpetition earnings from personal services). See also 11 U.S.C. § 1325(b) (requiring debtors to either pay all claims in full or allocate all disposable income to the plan for at least three years).

²⁰¹See NORTON, *supra* note 2, § 121:4.

That a claim is nondischargeable in Chapter 13 supports conflicting policy arguments in the "unfair discrimination" calculus. To favor a creditor with special treatment at discharge is indicative of congressional intent that the nondischargeable claim is to be favorably treated through the plan. On the other hand, a creditor

This latter point is supported by the judicial treatment of child or spousal support arrearages, which are also nondischargeable in Chapter 13.²⁰² Because the 1994 amendments to the Bankruptcy Code made matured support obligations a priority claim, and under Chapter 13 all priority claims must be paid in full,²⁰³ discriminatory treatment of support claims is now not merely permitted, it is statutorily required. Nevertheless, even before that legislative change, most courts permitted favored treatment of support claims in Chapter 13.²⁰⁴

This is not to say that all nondischargeable claims should be treated alike. Quite the contrary. There are important differences among them. For example, while all nondischargeable claims are favored by Congress to some extent, support claims are the only ones for which public policy demands current payment.²⁰⁵ The point is that favored treatment might be appropriate for some of them, and that the propriety of such treatment must be evaluated separately for each of them, an approach courts followed with respect to support claims. For each type of claim, the place to start is with the reasons behind their nondischargeability, compared to the reasons Congress has chosen to favor other claims in other manners.

The Bankruptcy Code accords several different types of claims a priority within the distribution scheme. Generally, this is because of the perceived need of the creditor, which is sometimes the government itself.²⁰⁶ Thus, there are priorities for: (1) certain employee claims for wages and benefits, limited by dollar amount;²⁰⁷ (2) certain claims of farmers and fishermen

with a nondischargeable claim already has special treatment not available to other claim holders Is it "fair" to other claim holders to use the debtor's income and assets during the life of the Chapter 13 plan to pay a claim holder that can also collect its claim after discharge?

²⁰²See 11 U.S.C. § 1328(a)(2) (1994).

²⁰³See *supra* notes 129-30 and accompanying text.

²⁰⁴See *supra* note 131.

²⁰⁵*In re Groves*, 39 F.3d at 215 (distinguishing support claims from educational loan claims by noting that public policy does not dictate that the latter be paid "during the life of the plan"); *In re Sullivan*, 195 B.R. 649, 655 (Bankr. W.D. Tex. 1996) (noting that merely having a support claim survive the discharge does not feed the children today). See also 11 U.S.C. § 362(b)(2) (providing that the automatic stay does not prohibit efforts to collect support debts from nonestate property while the bankruptcy case is pending).

²⁰⁶Administrative expenses and postpetition "gap" claims in an involuntary case are also accorded priority, see 11 U.S.C. § 507(a)(1) & (2), but for a different reason. Administrative expenses are given this treatment to facilitate the bankruptcy process itself. Involuntary gap creditors are given priority in order to protect the debtor and the debtor's business while the court reviews the petition, by ensuring the availability of credit.

²⁰⁷See 11 U.S.C. § 507(a)(3) & (4) (1994).

This priority could be based on the belief that the employees are contributing to the debtor's business by providing their services, and thus enhancing what will become the estate. However, that would not explain the fairly low per-employee dollar limitation. Moreover, it would suggest that a back pay award could not be a wage priority claim because no services were in fact provided. What little law exists

against silo operators and processing facilities;²⁰⁸ (3) certain consumer deposits, limited by dollar amount;²⁰⁹ (4) claims for matured spousal or child support;²¹⁰ and (5) certain taxes.²¹¹

In contrast, while some claims are made nondischargeable because of concern for the creditor—such as taxes,²¹² support claims,²¹³ and marriage dissolution claims,²¹⁴—most nondischargeable claims result from misconduct by the debtor: (1) claims for misrepresentation;²¹⁵ (2) claims for fiduciary fraud, defalcation, embezzlement or larceny;²¹⁶ (3) claims for willful and malicious injury;²¹⁷ (4) government fines and penalties;²¹⁸ and (5) liability for death or personal injury caused by driving while intoxicated.²¹⁹

Only the last two of these are nondischargeable in Chapter 13,²²⁰ and it would be difficult to contend that liability for them necessarily involves more heinous conduct than fraud, embezzlement, or willful and malicious injury. Nevertheless, the fact remains that fines, restitution obligations, and drunk driving debts are nondischargeable in Chapter 13 because of the debtor's misconduct. In other words, the purpose of the nondischargeability rule is not to protect the creditor but to ensure deterrence or punishment of the debtor. Allowing the debtor to favor these claims in a Chapter 13 plan might facili-

suggests the opposite, implying that the priority is based on the perceived need and vulnerability of this class of creditors. See, e.g., *In re Sher-Del Foods, Inc.*, 186 B.R. 358 (Bankr. W.D.N.Y. 1995) (ruling that a NLRB back pay award was entitled to wage priority); *In re Riker Indus., Inc.*, 151 B.R. 823 (Bankr. N.D. Ohio 1993) (holding that a Worker's Adjustment Retraining Notification Act back pay award was entitled to wage priority); *In re Palau Corp.*, 139 B.R. 942 (9th Cir. B.A.P. 1992) (treating a postpetition back pay award covering both pre- and postpetition periods as a wage priority for the prepetition portion).

²⁰⁸See 11 U.S.C. § 507(a)(5) (1994).

²⁰⁹See 11 U.S.C. § 507(a)(6) (1994).

²¹⁰See 11 U.S.C. § 507(a)(7) (1994). See also *In re Bentley*, 250 B.R. 475, 478 (Bankr. D.R.I. 2000) ("Public policy normally favors discriminating in favor of child support claims because a child's needs generally exceed those of the unsecured creditors.").

²¹¹See 11 U.S.C. § 507(a)(8) (1994).

²¹²See 11 U.S.C. § 523(a)(1) (1994).

²¹³See 11 U.S.C. § 523(a)(5) (1994).

²¹⁴See 11 U.S.C. § 523(a)(15) (1994).

²¹⁵See 11 U.S.C. § 523(a)(2) (1994).

²¹⁶See 11 U.S.C. § 523(a)(4) (1994).

²¹⁷See 11 U.S.C. § 523(a)(6) (1994).

²¹⁸See 11 U.S.C. § 523(a)(7) (1994).

²¹⁹See 11 U.S.C. § 523(a)(9) (1994).

²²⁰Actually, the scope of the Chapter 7 rule regarding fines and penalties, 11 U.S.C. § 523(a)(7), does not match the scope of the similar Chapter 13 rule, 11 U.S.C. § 1328(a)(3). Both cover restitution orders, § 1328(a)(3) expressly and § 523(a)(7) by implication. See *Kelly v. Robinson*, 479 U.S. 36 (1986) (discussing historical practice and federalism concerns). See also 11 U.S.C. § 523(a)(13) (added in 1994 to make clear that restitution ordered in a federal proceeding is nondischargeable). However, whereas § 1328(a)(3) is limited to fines arising out of a criminal conviction, § 523(a)(7) covers fines and penalties of either a civil or criminal nature. See *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 490 U.S. 552, 562 (1990) (dicta); *United States Dep't of Hous. & Urban Dev. v. Cost Control Marketing & Sales Mgmt. of Va.*, 64 F.3d 920 (4th Cir. 1995); *United States v. WRW Corp.*, 986 F.2d 138 (6th Cir. 1993).

tate the debtor's fresh start, but would not necessarily serve these goals. Indeed, allowing the debtor's own pecuniary interests to justify favoring a claim arising from such misconduct might actually undermine these goals. Therefore, the fact that these claims are nondischargeable is not a reason that supports allowing the debtor to favor them in Chapter 13.²²¹

Educational loans are different however. They are not excepted from the discharge because of the debtor's misconduct in acquiring the education without paying for it. Although there may be a sense that it would be wrongful for the debtor to maintain the benefit of the education while simultaneously discharging the duty to pay for it, any such "wrongdoing" is a function of the discharge itself, it was not what created the debt.²²² Moreover, such a notion proves too much, since nothing prohibits debtors generally from keeping property or services they acquired on unsecured credit.²²³ What is more, if notions of misconduct were the reason for the nondischargeability of student loans, the nondischargeability rule would not be limited—as it is—to loans made by nonprofit institutions or guaranteed by a governmental agency.²²⁴ It

²²¹Cf. Adamson, *supra* note 111, at 393-95, advocating for a congressional amendment to permit separate classification and favored treatment of fines and restitution orders, largely premised on the concern that without it the debtor would be incarcerated. To the extent the threat of incarceration is real, this Article analyzes the issue of discrimination as a claim based on necessity, not on nondischargeability. See *supra* notes 168-96 and accompanying text.

²²²Cf. 11 U.S.C. § 523(a)(2), (4), (6) (1994) (dealing with debts that arose out of the debtor's misconduct). Educational loans are arguably different from most consumer credit because they are made without collateral when the debtor is likely to be insolvent; the parties anticipate that payment will be made not from existing assets but from future earnings. Query, though, if this is really different from a lot of start-up financing for businesses, which generally is dischargeable.

²²³Certainly there is a sense of wrongdoing in some commentary about the dischargeability of student loans. For example, a congressional commission on bankruptcy law characterized as "reprehensible" the fact that "[s]ome individuals have financed their education and upon graduation have filed petitions under the Bankruptcy Act and obtained a discharge without any attempt to repay the educational loan and without the presence of any extenuating circumstance, such as illness." 1 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. 93-137 at 187 (1973). However, the example apparently refers to a debtor who took out student loans without ever expecting to repay them, and such debts would be nondischargeable under § 523(a)(2) without regard to their educational character.

²²⁴Indeed, not even all credit provided by nonprofit institutions to students is nondischargeable. The Bankruptcy Code refers only to "loans," see 11 U.S.C. § 523(a)(8), which has prompted a majority of courts to conclude that it does not cover the provision of goods or services on credit, for which the creditor may incur no marginal cost. See *In re Renshaw*, 222 F.3d 82 (2d Cir. 2000) (providing tuition, room, and board on credit is not a loan and is not part of a funded "program," but rejecting notion that money need actually change hands); *College of Saint Rose v. Regner*, 229 B.R. 270 (N.D.N.Y. 1999) (tuition on credit is not a loan); *Johnson v. Virginia Commonwealth Univ.* (*In re Johnson*), 222 B.R. 783 (Bankr. E.D. Va. 1998) (same); *New Mexico Inst. of Mining and Tech. v. Coole* (*In re Coole*), 202 B.R. 518 (Bankr. D.N.M. 1996) (same); *In re Nelson*, 188 B.R. 32 (D.S.D. 1995) (holding tuition, room, and board are neither funds received as an educational benefit nor a loan, and thus debts for them are dischargeable). *Contra In re DePasquale*, 225 B.R. 830 (1st Cir. B.A.P. 1998) (allowing the debtor to attend classes and pay later is a "loan"); *In re Johnson*, 218 B.R. 449 (8th Cir. B.A.P. 1998) (ruling that a debt for tuition and books was a nondischargeable "loan" even though no funds actually changed hands).

would, however, be restricted to loans used for the debtor's education, rather than encompassing—as it apparently does—loans cosigned or guaranteed by the debtor to finance the education of another.²²⁵

The real reasons why educational loans are nondischargeable have little to do with the debtor at all. Student loans are nondischargeable both because the government wishes to protect its own fiscal health as a guarantor of them,²²⁶ and because of a process concern: if these debts were dischargeable, the availability of educational loans might drastically decline.²²⁷

Because the conduct of the debtor is the same whether the credit is provided in cash or in kind, the fact that nondischargeability of educational debt is limited to the former is further evidence that the policy underlying it is not premised on the debtor's misbehavior.

²²⁵Most of the courts dealing with the issue have ruled that § 523(a)(8) applies and educational debts are nondischargeable even if the debtor was not the student who benefitted directly from the loan, but was a relative or friend who borrowed money or guaranteed a debt to help finance the student's education. See, e.g., *In re Pelkowski*, 990 F.2d 737 (3d Cir. 1993); *In re Norris*, 239 B.R. 247 (M.D. Ala. 1999); *James v. United Student Aid Funding, Inc.* (*In re James*), 226 B.R. 885 (Bankr. S.D. Cal. 1998) (rule applies to nonstudent who is the sole obligor); *Stein v. Bank of New England, N.A.* (*In re Stein*), 218 B.R. 281 (Bankr. D. Conn. 1998) (same); *Salter v. Education Res. Inst., Inc.* (*In re Salter*), 207 B.R. 272 (Bankr. M.D. Fla. 1997) (same); *Uterhark v. Great Lakes Higher Educ. Corp.* (*In re Uterhark*), 185 B.R. 39 (Bankr. N.D. Ohio 1995) (rule applies to a parent, at least if the parent is the only obligor); *Palmer v. Student Loan Fin. Corp.* (*In re Palmer*), 153 B.R. 888 (Bankr. D.S.D. 1993); *Dull v. Ohio Student Loan Comm'n* (*In re Dull*), 144 B.R. 370 (Bankr. N.D. Ohio 1992); *Hammerstrom v. Education Res. Inst., Inc.* (*In re Hammarstrom*), 95 B.R. 160 (Bankr. N.D. Cal. 1989); *Patricia Somers & James M. Hollis, Student Loan Discharge Through Bankruptcy*, 4 AM. BANKR. INST. L. REV. 457, 467 & n.96 (1996). Some other courts disagree. See, e.g., *Pryor v. H & W Recruiting Enterprises, L.L.C.* (*In re Pryor*), 234 B.R. 716 (Bankr. W.D. Tenn. 1999); *Kirkish v. Meritor Sav. Bank* (*In re Kirkish*), 144 B.R. 367 (Bankr. W.D. Mich. 1992).

²²⁶See *In re Brown*, 152 B.R. 232, 241 n.11 (Bankr. N.D. Ill.) ("there is a substantial public interest in recovering the payments that the federal government has been required to make on guaranteed student loans in default"), *rev'd sub nom. McCullough v. Brown*, 162 B.R. 506 (N.D. Ill. 1993). Further support for this point is implicit in the fact that the extension of the nondischargeability of student loans to Chapter 13 cases was accomplished as part of the Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508, § 3007, 104 Stat. 1388, 1388-28. Finally, in recommending that student loans be made dischargeable, the National Bankruptcy Review Commission wrote:

The government guarantees the loans and makes laws that treat its guaranteed loans as more obligatory than other loans, defining them to be as compelling as debts arising from turpitude. Students are not criminals, however, and debts owed to the United States should be no more sacred than other personal obligations.

NATIONAL BANKRUPTCY REVIEW COMMISSION, *BANKRUPTCY: THE NEXT TWENTY YEARS* 207-08 (1997) (quoting Arthur Ryman, *Contract Obligation: A Discussion of Morality, Bankruptcy, and Student Debt*, 42 DRAKE L. REV. 205, 219 (1993)).

The nondischargeability provision, 11 U.S.C. § 523(a)(8), also protects the fiscal health of nonprofit organizations that make student loans.

²²⁷See 1 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. 93-137 at 180-89 (1973) (noting the extremely small percentage of student loans discharged in bankruptcy but nevertheless expressing concern that even such a small percentage would create a negative public image that would discredit and eventually threaten continuation of student loan programs); *In re Sullivan*, 195 B.R. 649, 655 (Bankr. W.D. Tex. 1996); *In re Willis*, 189 B.R. 203, 205 (Bankr. N.D. Okla. 1995), *rev'd*, 197 B.R. 912 (N.D. Okla. 1996). See also Gerson, *supra* note 127, at 281-82 (discussing the 1973 report and its role in the legislation that followed); NATIONAL BANKRUPTCY REVIEW COMMISSION, *BANKRUPTCY: THE NEXT TWENTY*

Nothing in either of these underlying rationales is undermined or inconsistent with favoring such claims in Chapter 13. Indeed, quite the contrary. Both rationales are furthered by separate classification and favored treatment in a Chapter 13 plan.²²⁸ Thus, to the extent that courts regard efforts to favor student loans as focusing “solely on the interests of the debtor,” and the debtor’s fresh start²²⁹ they miss the point. Such discriminatory plans are also in the interests of the student loan creditors and it is their interests that the nondischargeability rule is designed to serve.

In spite of this, a clear majority of courts dealing with this issue have rejected favored treatment of student loan claims.²³⁰ While many of these

YEARS 209-10 & 213 (1997) (also discussing the 1973 report and noting the frequent argument “that student loans must remain presumptively nondischargeable to ensure that those with promising future income streams remain liable to preserve student loan funding in the future”); H.R. REP. NO. 95-595 at 537 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6424 (supplemental views of Rep. Ertel).

A process concern also underlies § 523(a)(3), which renders unscheduled claims nondischargeable in some circumstances. That concern has no relevance, however, to favorable treatment of a creditor in a Chapter 13 plan. If the plan provides for such a claim, the debt cannot be unscheduled.

²²⁸Gerson, *supra* note 127, at 291 (“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.”); Brown & Evans, *supra* note 77, at 649 (“The congressional policy in favor of payment is clear from the nondischargeability of these debts. One may question whether it is necessary to further justify discrimination with other policy arguments”); Craig A. Gargotta, *Preferentially Paying Student Loans in Chapter 13 Cases: A Survey*, 13 AM. BANKR. INST. J. 19, 36 (Apr. 1994) (suggesting that the public fisc is disserved by not allowing student loans to be favored in Chapter 13 plans).

²²⁹*See In re Willis*, 197 B.R. 912, 915 (N.D. Okla. 1996). *See also In re Chandler*, 210 B.R. 898, 902-03 (Bankr. D.N.H. 1997) (indicating that the unfair discrimination rule is designed to protect creditors, that therefore only discrimination that substantially benefits creditors can be fair, and thus that favoring student loans is not fair because the purpose of such discrimination is to facilitate the debtor’s fresh start).

²³⁰For cases refusing to permit favored treatment of educational debt, see *In re Sperna*, 173 B.R. 654 (9th Cir. BAP 1994); *In re Willis*, 197 B.R. 912 (N.D. Okla. 1996); *McCullough v. Brown*, 162 B.R. 506 (N.D. Ill. 1993); *In re Bentley*, 250 B.R. 475 (Bankr. D.R.I. 2000); *In re Thibodeau*, 248 B.R. 699 (Bankr. D. Mass. 2000); *In re Coonce*, 213 B.R. 344 (Bankr. S.D. Ill. 1997); *In re Gonzalez*, 206 B.R. 239 (Bankr. S.D. Fla. 1997); *In re Kolbe*, 199 B.R. 569 (Bankr. D. Md. 1996); *In re Bernal*, 189 B.R. 507 (Bankr. S.D. Cal. 1995); *In re Goewey*, 185 B.R. 444 (Bankr. N.D.N.Y. 1995); *In re Gregg*, 179 B.R. 828 (Bankr. E.D. Tex. 1995); *In re Colfer*, 159 B.R. 602 (Bankr. D. Me. 1993); *In re Smalberger*, 157 B.R. 472 (Bankr. D. Or. 1993), *aff’d*, 170 B.R. 707 (D. Or. 1994); *In re Lewman*, 157 B.R. 134 (Bankr. S.D. Ind. 1992); *In re Tucker*, 150 B.R. 203 (Bankr. N.D. Ohio 1992); *In re Eitemiller*, 149 B.R. 626 (Bankr. D. Idaho 1993) (Chapter 11 case); *In re Chapman*, 146 B.R. 411 (Bankr. N.D. Ill. 1992); *In re Liggins*, 145 B.R. 227 (Bankr. E.D. Va. 1992); *In re Keel*, 143 B.R. 915 (Bankr. D. Neb. 1992); *In re Taylor*, 137 B.R. 60 (Bankr. W.D. Okla. 1992); *In re Cronk*, 131 B.R. 710 (Bankr. S.D. Iowa 1990); *In re Tucker*, 130 B.R. 71 (Bankr. S.D. Iowa 1991); *In re Scheiber*, 129 B.R. 604 (Bankr. D. Minn. 1991).

For cases permitting favored treatment of educational debt, see *In re Sullivan*, 195 B.R. 649 (Bankr. W.D. Tex. 1996); *In re Willis*, 189 B.R. 203 (Bankr. N.D. Okla. 1995), *rev’d*, 197 B.R. 912 (N.D. Okla. 1996); *In re Gregg*, 179 B.R. 828 (Bankr. E.D. Tex. 1995) (but not permitting discrimination among different student loan creditors); *In re Tucker*, 159 B.R. 325 (Bankr. D. Mont. 1993); *In re Brown*, 152 B.R. 232 (Bankr. N.D. Ill. 1993) *rev’d sub. nom.*, *McCulloch v. Brown*, 162 B.R. 506 (N.D. Ill. 1993); *In re Foreman*, 136 B.R. 532 (Bankr. S.D. Iowa 1992) (permitting student loans to be paid before other unsecured claims; all were to be paid in full); *In re Boggan*, 125 B.R. 533 (Bankr. N.D. Ill. 1991); *In re Freshley*, 69 B.R. 96

courts have analyzed the issue in a thoughtful and articulate manner, none of the reasons offered for their conclusion is ultimately persuasive.

For example, several courts have relied upon a negative inference arising from the fact that Congress did not make student loan claims an exception to the unfair discrimination standard as it arguably did for cosigned consumer obligations.²³¹ In essence, this is an application of the maxim *expressio unius, exclusio alterius*: the express exception from the unfair discrimination standard of codebtor claims implies the absence of any unexpressed exception, such as for student loans. There are several problems with this argument.

The exception for codebtor claims—if indeed it is an exception²³²—was not part of the original version of § 1322(b)(1). Thus, it really says little about what the provision was intended to mean in its original form. Second, the reference to codebtor claims was added in response to a split among circuit courts, and was apparently directed at *Barnes v. Whelan*,²³³ which had rejected favored treatment of codebtor claims. It may have been intended as a change or a clarification of the law, but in either case “nothing in the legislative history . . . indicates[s] that Congress intended its amendment of Code § 1322(b)(1) to restrict otherwise permissive classifications of unsecured claims.”²³⁴ Certainly, Congress could have added another express rule on student loans to § 1322(b)(1) in 1990, when it made such debts nondischargeable in Chapter 13 cases. However, inferring any intent from such silence is highly problematic. Congress could have clarified the law in any number of ways at any number of times. Its failure to do so hardly compels or even suggests a particular resolution to this issue.

The only legislative history that is arguably relevant has actually been ignored by the courts. Prior to the 1984 amendments, which added the requirement that debtors devote three years of disposable income to the

(Bankr. N.D. Ga. 1987). See also *In re Strickland*, 181 B.R. 598 (Bankr. N.D. Ala. 1995) (permitting favored treatment only after the first three years of the plan).

Several other courts do not generally allow favored treatment of education debt, but have ruled or suggested in dicta that favored treatment is permissible as a long-term debt: that is, to the limited extent of curing any default and remaining current on the periodic payments. See *In re Groves*, 39 F.3d 212, 214 (8th Cir. 1994); *In re Williams*, 253 B.R. 220, 227-28 (Bankr. W.D. Tenn. 2000); *In re Chandler*, 210 B.R. 898, 903-04 (Bankr. D.N.H. 1997); *In re Cox*, 186 B.R. 744, 747 (Bankr. N.D. Fla. 1995); *In re Anderson*, 173 B.R. 226, 230 n.8 (Bankr. D. Colo. 1993); *In re Eiland*, 170 B.R. 370, 379-80 (Bankr. N.D. Ill. 1994); *In re Benner*, 156 B.R. 631, 633-35 (Bankr. D. Minn. 1993); *In re Christophe*, 151 B.R. 475, 479-81 (Bankr. N.D. Ill. 1993); *In re Dodds*, 140 B.R. 542, 543-44 (Bankr. D. Mont. 1992); *In re Saulter*, 133 B.R. 148, 150 (Bankr. W.D. Mo. 1991). See also *In re Sullivan*, 195 B.R. at 657-59. *Contra In re Thibodeau*, 248 B.R. 699; *In re Coonce*, 213 B.R. 344.

²³¹See *In re Sperna*, 173 B.R. 654, 659 (9th Cir. BAP 1994); *In re Smalberger*, 157 B.R. at 476; *In re Colfer*, 159 B.R. 602, 609 (Bankr. D. Me. 1993); *In re Chapman*, 146 B.R. 411, 416, 418-19 (Bankr. N.D. Ill. 1992).

²³²See *supra* notes 159-161.

²³³689 F.2d 193 (D.C. Cir. 1982).

²³⁴NORTON, *supra* note 2, § 121:4.

plan,²³⁵ a proposed change to § 1328 would have made all debts of a kind specified in § 523(a) nondischargeable in Chapter 13.²³⁶ In attempting to explain the bill, the accompanying Senate Report noted “because nondischargeable claims are not allowed special treatment in chapter 13, § 1322(b) probably forbids the creditor with a nondischargeable claim from being treated differently from other unsecured creditors.”²³⁷ Of course, this statement does not even purport to be about what Congress intended § 1322(b)(1) to mean, only about prevailing interpretations of it. Beyond that, it is equivocal and, taken in context, is really about claims that are nondischargeable in Chapter 7 cases but dischargeable in Chapter 13 cases.²³⁸ It provides remarkably little help in analyzing or applying the unfair discrimination standard to student loans that are now nondischargeable in Chapter 13 cases.

Second, several courts have relied on another negative inference: that Congress has not granted student loan claims a priority in the bankruptcy distribution scheme, but it did bestow such status on support claims.²³⁹ However, there are many reasons why Congress might have wanted not to make educational debts priority claims that have no bearing on whether a debtor should be permitted to give them favored treatment in a Chapter 13 plan. Foremost among these is that priorities apply in Chapter 7 cases as well as in Chapter 13, and priority in Chapter 7 may not be appropriate.²⁴⁰ Moreover, priority claims must be paid in full in Chapter 13, and it would be impossible for many debtors with outstanding student loans to pay them all off during a three-year or five-year plan.²⁴¹ Thus, priority treatment would

²³⁵See *supra* note 104.

²³⁶See S. 2000, 97th Cong. (1981).

²³⁷S. REP. NO. 97-446 at 27 (1982).

²³⁸The statement was offered as a partial explanation of why Chapter 13 was arguably undermining § 523(a). The Senate was noting that the creditors with such claims were getting paid little in Chapter 13 cases but their claims are nevertheless being discharged.

²³⁹See *In re Sperna*, 173 B.R. 654, 659 (9th Cir. B.A.P. 1994); *In re Coonce*, 213 B.R. 344, 348 (Bankr. S.D. Ill. 1997); *In re Kolbe*, 199 B.R. 569, 573 (Bankr. D. Md. 1996); *In re Sullivan*, 195 B.R. 649, 655 (Bankr. W.D. Tex. 1996); *McCullough v. Brown*, 162 B.R. 506, 513-14 (N.D. Ill. 1993); *In re Colfer*, 159 B.R. 602, 609 (Bankr. D. Me. 1993); *In re Smalberger*, 157 B.R. 472, 476 (Bankr. D. Or. 1993); *In re Chapman*, 146 B.R. 411, 418-19 (Bankr. N.D. Ill. 1992). See also *In re Burns*, 216 B.R. 945, 947-48 (Bankr. S.D. Cal. 1998) (apparently using the same rationale for denying favored treatment of a support claim that had been assigned to the government, and which thereby lost its priority status even though it remained nondischargeable).

²⁴⁰For example, if educational debts were a priority in Chapter 7 cases, their size would frequently overwhelm the estate, leaving general creditors with no recovery. Those general creditors would then have their claims discharged. They thus would frequently enter bankruptcy with no hope of ever obtaining any recovery.

²⁴¹In this connection, note that other Chapter 13 priorities—support and taxes, for example—are generally incurred in a manner that is within the debtor’s ability to pay. Support obligations are created under judicial auspices after taking into account the debtor’s income and expenses. Income taxes necessarily represent a fraction of income. While arrearages on either type of obligation over a lengthy period can

actually foreclose many debtors from seeking Chapter 13 relief. Beyond that, the reason Congress made support claims a priority had nothing to do with whether they could be favored in a Chapter 13 plan; recall that most courts permitted favored treatment of support claims before they were accorded priority.²⁴² Thus, the vast majority of courts have recognized that at least in some contexts a nonpriority claim may be favored in Chapter 13. Indeed, because priority claims must be paid in full, the unfair discrimination standard—and its implication that claims may be favored in a fair manner—has relevance only among different nonpriority claims. In short, there is simply no reason to regard lack of priority status as foreclosing the possibility of favored treatment.

Third, several courts have mistakenly focused on the fact that Congress in 1990 expressly decided to make student loans generally nondischargeable in Chapter 13,²⁴³ and interpreted from this that the debtor's fresh start is subordinated to other goals.²⁴⁴ Certainly this action reflects a decision to place repayment of such loans ahead of the debtor's fresh start, but favored treatment in Chapter 13 is not inconsistent with that. The fairness issue is not about balancing the debtor's fresh start against the nondischargeability of the claim, or even about the fresh start versus the general policy of equal treatment. The issue is about balancing the general policy of equal treatment against the proposed discrimination and any policies that support it. These courts are simply off the mark.

Finally, some courts have argued that "it would be patently unfair for creditors holding nondischargeable claims—who may thus pursue post-bankruptcy collection efforts against the debtor—to be preferred not only after the bankruptcy case is completed but also during the time payments are being made to the creditors."²⁴⁵ This is a powerful point because it gets to the

total a substantial sum, such should not be the norm. Student loans, on the other hand, are usually incurred without regard to the debtor's current budget and may well prove to be beyond the debtor's short-term budget once the education is over.

²⁴²See *supra* note 131.

²⁴³The Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508, § 3007, 104 Stat. 1388, 1388-28 (1999) (adding a reference to student loan debts to § 1328(a)(2)). The original October 1, 1996 sunset for this provision was repealed by the Higher Education Amendments of 1992, Pub. L. 102-325, § 1558, 106 Stat. 448, 841.

²⁴⁴See *In re Sperna*, 173 B.R. 654, 659 (9th Cir. BAP 1994); *McCullough v. Brown*, 162 B.R. 506, 514, 516 (N.D. Ill. 1993). See also *In re Willis*, 197 B.R. 912, 914 (N.D. Okla. 1996) (quoting *McCullough*); *In re Eiland*, 170 B.R. 370, 380 (Bankr. N.D. Ill. 1994) ("To allow debtors to obtain a more valuable 'fresh start' than Congress permitted by preferring student loan creditors would be giving debtors what was taken away by § 523(a)(8)."); *In re Saulter*, 133 B.R. 148, 149-50 (Bankr. W.D. Mo. 1991) (favoring nondischargeable student loan claims in Chapter 13 "runs contrary to the plain meaning" of §§ 1328(a)(2) & 523(a)(8), which, absent undue hardship, hold the Chapter 13 debtor fully responsible for student loan indebtedness); *In re Chapman*, 146 B.R. 411, 417 (Bankr. N.D. Ill. 1992) (citing *Saulter* with approval).

²⁴⁵*In re Coonce*, 213 B.R. at 346. See also *supra* note 201; *In re Smalberger*, 157 B.R. at 475-76.

heart of the reason behind the general requirement of equal treatment. Moreover, it is true that student loan claimants do not have the same need for current payment that spousal and child support claimants do, and that favored treatment of their claims in a Chapter 13 plan may not be necessary to achieve the congressional goal of ensuring repayment.

However, the courts relying on this argument overlook the fact the nondischargeability of student loan debts does not ensure their payment; the reality is many will never be paid if not paid in bankruptcy.²⁴⁶ More importantly, these courts overlook the fact that “post-bankruptcy” collection efforts refers to something very different in the context of a Chapter 13 case than in Chapter 7. In Chapter 7, “post-bankruptcy” means “post-petition”: if the debtor liquidates in Chapter 7, the student loan claimant with a nondischargeable claim will have recourse to the debtor’s postpetition earnings, whereas creditors with dischargeable claims will not. In Chapter 13, by contrast, “post-bankruptcy” means “post-plan”: the nondischargeability rule permits student loan claimants to pursue only the debtor’s post plan earnings, and there is a delay of three to five years before the benefit of nondischargeability kicks in. If the nondiscrimination rule does not allow favorable treatment of student loan claims during the life of the plan, those claimants may be worse off than if the debtor had liquidated under Chapter 7.

Moreover, it would be an anomaly indeed for a nondischargeability rule designed to protect one class of claimants—student loan creditors—to be used to enhance the recovery of other claimants. While one can argue that it is not the nondischargeability rule that produces this effect, but the prohibition against unfair discrimination, it is vital to remember that requiring similar treatment may make Chapter 13 too expensive and force the debtor to choose Chapter 7. This is certainly the case for Debbie and Doug, the hypothetical debtors in the illustration at the beginning of this Article. They want to use Chapter 13 to save their home. However, they are likely to forfeit their equity in their home if they are compelled to pay so much to other creditors that they end up owing more on their student loans after completion of their plan than before filing for Chapter 13 relief. If the prohibition on unfair discrimination prompts the debtor to stay out of Chapter 13, it benefits no one.²⁴⁷

G. SOME INTERMEDIATE STRATEGIES

Some courts, struggling to balance the admittedly competing public poli-

²⁴⁶Gargotta, *supra* note 228, at 36.

²⁴⁷Cf. *In re Ponce*, 218 B.R. 571, 578 (Bankr. E.D. Wash. 1998), which noted that, having chosen Chapter 13 because it was to his advantage, the debtor cannot argue that unsecured claimants are not harmed because they got more than they would have in Chapter 7. However, this ignores the fact that the ruling itself may affect whether the debtor attempts a Chapter 13.

cies at stake,²⁴⁸ and constrained by the weight of precedent that prohibits favored treatment of student loan debts or other nondischargeable claims, have seized upon alternative strategies debtors may use to favor these claims at least to a limited extent. These include: (1) extending the plan term beyond the three-year requirement, thereby increasing the pot of money available to claimants, and then discriminating throughout the life of the plan; (2) favoring such claims but only out of disposable income generated after the first three years of the plan; and (3) treating the debt as a long-term obligation under § 1322(b)(5), curing any default, and continuing to make the periodic contractual payments, whatever they may be.²⁴⁹ Although there is some merit in each of these approaches, none fully resolves the problems courts have created by their resistance to plans favoring student loan indebtedness.

1. *Extending the Plan*

Recall that in *In re Games*, the court refused to permit favored treatment of a debt for criminal traffic fines unless the debtor extended the plan from forty-nine to sixty months.²⁵⁰ At least one other court has suggested such a course of action as a way to deal with student loans.²⁵¹ This approach certainly provides more recovery to the disfavored creditors than a shorter, discriminatory plan, and in that sense is more fair to them. It does not necessarily mean, however, that the plan as originally proposed was unfair.

In fact, a few courts have indicated that lengthening a plan is not an appropriate way to deal with the fairness issue.²⁵² Indeed, a plan may extend beyond three years only for cause,²⁵³ and it is far from clear that adequate cause would exist to extend the plan simply in order to address the fairness issue.²⁵⁴

Perhaps more to the point, there are significant drawbacks to lengthening

²⁴⁸See *In re Sullivan*, 195 B.R. at 655 (indicating that the public policy considerations are not "dispositive").

²⁴⁹One court, recognizing the conflicting policy arguments but also the need for some guidance, simply advised trustees not to object to a plan if the discriminatory scheme does not reduce by more than twenty percent the percentage the disfavored creditors would recover if the plan did not discriminate. *In re Sullivan*, 195 B.R. 649, 656 (Bankr. W.D. Tex. 1996). There is, of course, no principled basis for this twenty percent rule.

²⁵⁰See *supra* note 184 and accompanying text.

²⁵¹See *In re Thibodeau*, 248 B.R. 699, 706 (Bankr. D. Mass. 2000).

²⁵²See *In re Bernal*, 189 B.R. 507, 509-10 & n.1 (Bankr. S.D. Cal. 1995) (questioning whether lengthening the plan really increased the recovery to other creditors, in present value terms, but in any event rejecting the plan as discriminating unfairly); *In re Christophe*, 151 B.R. B.R. 475, 478 (Bankr. W.D. Ill. 1993) (concluding that increasing the pot of money available to creditors by lengthening the plan does not alter the requirement that the pot be distributed on a pro rata basis).

²⁵³11 U.S.C. § 1322(d).

²⁵⁴Compare *In re Games*, 213 B.R. at 780-81 (addressing the court's concerns about good faith and unfair discrimination is cause for extending the duration of the plan), with *In re Taylor*, 137 B.R. 60, 65 (Bankr. N.D. Okla. 1992) (wishing to pay student loans in full is not cause for lengthening the plan).

the plan. Only about one-third of all Chapter 13 plans are completed.²⁵⁵ In addition, it is quite possible that lengthening the plan will increase likelihood that the debtor will fail to complete it and will therefore receive no discharge.²⁵⁶ Courts should therefore be quite reluctant to effectively force the debtor into a longer plan.

Another, more complicated, problem with this approach is that it does not really help determine the level of permissible discrimination. Perhaps the purpose of lengthening the plan is to make sure other creditors receive at least what they would get in a nondiscriminatory three-year plan. However, if that were correct, the court in *Games* need not have insisted on a sixty-month plan; fifty-seven months would have sufficed.²⁵⁷ Moreover, nothing in the court's analysis is specifically directed at ensuring such a recovery; the court seemed primarily concerned with ensuring some recovery for general claimants, rather than in setting a threshold for fairness. In short, there does not appear to be a principled basis for the court's decision on how much to lengthen the plan.

Even if the duration of the plan is extended to ensure payments are made to creditors to at least equal what a nondiscriminatory three-year plan would produce, in present value terms, the level of discrimination permitted may not be enough to keep the debtor in Chapter 13. That would be the situation for Doug and Debbie. By lengthening their plan to sixty months—the longest period permitted under the Bankruptcy Code²⁵⁸—they would be unable to pay their medical claimants the sum called for in the trustee's proposed thirty-six-month plan without having negative amortization on their student loan debts for the entire duration of the plan. They would therefore be forced to emerge from a five-year plan owing more student loan debt than they started with, or to forego Chapter 13 relief and lose their house. In all probability, they would elect the latter, in which case this interpretation of the unfair discrimination rule would have benefitted no one.

2. Discriminate After Third Year

Several courts have permitted or suggested in dicta that a debtor may favor nondischargeable student loan claims out of disposable income gener-

²⁵⁵See *supra* note 182.

²⁵⁶Cf. Norberg, *supra* note 182, at 447 (indicating that the data from a study of cases in one district "suggest that the longer the proposed length of a plan, the lower the chance of completion," but noting that statistical significance was not achieved).

²⁵⁷In *Games*, if the original forty-nine month plan had not discriminated in favor of the traffic fine creditors, general unsecured claimants would have received approximately \$1,820. Because the debtors were paying \$280 per month into the plan, extending the plan to sixty months would add \$3,080 to the plan. Because all other creditors were to have been paid off after forty-nine months, all of this increase—minus the trustee's fee—would go to general claimants. This would leave them substantially better off, even in present value terms, than if a nondiscriminatory plan had lasted for forty-nine months.

²⁵⁸See 11 U.S.C. § 1322(d) (1994).

ated after the third year of the plan.²⁵⁹ They extract this approach from the requirement that debtors allocate three years of disposable income to the plan, concluding from this that creditors have no right to expect a share of income after the third year. While this approach is inventive, it has several problems.

First, while no doubt its advocates would say that it is a matter of how the unfair discrimination standard is applied, the approach simply regards the unfair discrimination standard as inapplicable after the first three years of the Chapter 13 plan. Of course, nothing in the text of the Code supports this construction.²⁶⁰

Second, this approach is subject to at least two of the same criticisms reviewed above concerning extending the plan: (1) there may not be sufficient cause to extend the plan;²⁶¹ and (2) extending the plan may make it more likely that the debtor will never complete the plan or get a discharge.

Third, even acknowledging the possibility that the debtor may later be able to modify the plan or obtain a hardship discharge if adverse circumstances arise,²⁶² the debtor may nevertheless suffer substantial harm from the inability to discriminate during the first three years. Specifically, if the debtor is unable to complete the plan, all postpetition disposable income earned prior to dismissal or conversion remains property of the estate.²⁶³ This means that all the amounts paid out of postpetition income to general creditors with dischargeable claims will be retained by them. Debtors who fail to complete their plans—in other words, most Chapter 13 debtors—would therefore be worse off than by filing under Chapter 7 to begin with, thereby allocating all postpetition disposable income to creditors holding non-

²⁵⁹See *In re Thibodeau*, 248 B.R. at 707; *In re Ponce*, 218 B.R. 571, 578 (Bankr. E.D. Wash. 1998); *In re Strickland*, 181 B.R. 598 (Bankr. N.D. Ala. 1995); *In re Rudy*, 1995 WL 365370 (Bankr. S.D. Ohio Nov. 16, 1993) (en banc). See also *In re Williams*, 231 B.R. 280, 283 (Bankr. S.D. Ohio 1999) (suggesting favored treatment of a restitution claim would be permissible after the first three years of the plan); *In re McKown*, 227 B.R. 487, 494 n.6 (Bankr. N.D. Ohio 1998) (suggesting disparate treatment of a codebtor claim in the latter part of a five-year plan to avoid the unfairness in the debtor's proposed plan); Somers & Hollis, *supra* note 225, at 464 (suggesting that student loan creditors urge that a plan favor them after thirty-six months).

²⁶⁰See *In re Sullivan*, 195 B.R. at 657. See also *In re Christophe*, 151 B.R. 475, 478 (Bankr. N.D. Ill. 1993), in which the court rejected rather summarily the debtor's argument that by extending the plan to fifty-six months she was not really taking anything away from the disfavored creditors. Instead, the court focused on the amount allocated in the plan to the favored student loan creditor and pointed out that it could have been distributed ratably. In essence, the court suggested that even if extending the plan increases the pot of money for claimants, the entire, augmented pot must be disbursed in a manner that does not discriminate unfairly, and the augmentation itself, even though voluntary, does not affect the analysis of what is fair.

²⁶¹See *In re Taylor*, 137 B.R. 60 (denying confirmation of a plan that discriminated in favor of student loan claims after the first three years, after concluding that there was no cause for extending the plan).

²⁶²See 11 U.S.C. §§ 1329 & 1328(b) (1994), respectively.

²⁶³11 U.S.C. § 1306(a)(2) (1994).

dischargeable claims. Chapter 13 would become a sort of temporary trap for the unwary debtor—where postpetition earnings are extracted—before resort is made to Chapter 7.

Fourth, it remains highly questionable whether the approach will in fact achieve its desired effect. Unless the debtor has some other specific need for being in Chapter 13, a debtor with nondischargeable claims may simply choose to liquidate in Chapter 7. This would allow the debtor to allocate all postpetition disposable income to the nondischargeable claims, and avoid having some syphoned off to pay either creditors with dischargeable claims or a Chapter 13 trustee's fees. The end result may therefore be that the main benefit of such an approach—increasing the payout to creditors with dischargeable claims—is therefore not achieved because debtors will stay out of Chapter 13.

For debtors who do have a reason to be in Chapter 13, the ruling creates a disincentive to be there. For people such as Debbie and Doug, who wish to use Chapter 13 to save their home, the approach remains ironic: rules designed to ensure payment of some claims (i.e., nondischargeable claims) have the effect of increasing the payout to other creditors. More importantly, for creditors who wish to be in Chapter 13 to save their home, the decision is more than ironic; it makes their financial rehabilitation more costly. This seems contrary to public policy.²⁶⁴

Finally, and perhaps most importantly, to the extent the rules excepting certain debts from discharge are intended to favor the creditor out of postpetition income, this approach does not achieve that objective for at least three years. Postponing favored treatment of creditors with nondischargeable claims may therefore frustrate one of the primary goals of the nondischargeability rules.

3. *Treat as Long-Term Debt*

Another approach advocated by some commentators, and adopted or suggested by an increasing number of courts, permits the debtor to deal with nondischargeable debt under § 1322(b)(5).²⁶⁵ This provision allows the

²⁶⁴The main group of debtors for whom this approach works well are those with nondischargeable claims who opt for Chapter 13 because they also have claims that are dischargeable in Chapter 13 but which would be nondischargeable in Chapter 7. This approach should be limited to such circumstances.

²⁶⁵See *In re Groves*, 39 F.3d 212, 215 (8th Cir. 1994) (quoting and expressing agreement with the bankruptcy court's statements on this issue); *In re Williams*, 253 B.R. 220, 227-28 (Bankr. W.D. Tenn. 2000); *In re Chandler*, 210 B.R. 898, 903-04 (Bankr. D.N.H. 1997); *In re Sullivan*, 195 B.R. 649, 657-59 (Bankr. W.D. Tex. 1996); *In re Cox*, 186 B.R. 744, 746-47 (Bankr. N.D. Fla. 1995); *In re Anderson*, 173 B.R. 226, 230 & n.8 (Bankr. D. Colo. 1993); *In re Eiland*, 170 B.R. 370, 379-80 (Bankr. N.D. Ill. 1994); *In re Benner*, 156 B.R. 631, 634 (Bankr. D. Minn. 1993); *In re Christophe*, 151 B.R. 475, 480 (Bankr. N.D. Ill. 1993); *In re Dodds*, 140 B.R. 542, 543-44 (Bankr. D. Mont. 1992); *In re Saulter*, 133 B.R. 148, 150 (Bankr. W.D. Mo. 1991); *Somers & Hollis*, *supra* note 225, at 462-64. See also *In re McKinney*, 118 B.R. 968, 971 (Bankr. S.D. Ohio 1990); *In re Newberry*, 84 B.R. 681, 684 (Bankr. E.D. Cal. 1988); *In re Geehan*, 59 B.R.

debtor to cure a default and remain current on a debt on which the last payment would otherwise come due after completion of the plan. During the life of the plan, payments to such creditors may be funneled through the trustee or, particularly if there has been no prepetition default, the debtor may be permitted to make them directly, thereby avoiding the trustee's fees on these disbursements.

If the debtor elects to treat a debt as such a long-term obligation under § 1322(b)(5), the debt will not be discharged.²⁶⁶ In other words, by treating a creditor's claim in this fashion, the debtor effectively waives the dischargeability of the obligation. For that reason, this provision is most commonly employed for home mortgages or other secured loans, where the debtor's incentive for remaining personally liable is retention of the collateral. However, § 1322(b)(5) is not limited to secured obligations; it expressly extends to unsecured claims. And, of course, if the claim is already nondischargeable, the debtor loses nothing by using this provision.

Most of the courts dealing with plans that treat student loans as long-term debts have interpreted § 1322(b)(5) as overriding the unfair discrimination prohibition of § 1322(b)(1). In other words, advocates of this approach seem to regard long-term debts as immune from the unfair discrimination standard.²⁶⁷ This is simply not true.

First, from a textual standpoint, § 1322(b)(5) begins with the phrase "notwithstanding paragraph (2) of this subsection." In other words, paragraph (5) purports to trump paragraph (2), dealing with which secured claimants' rights the plan may modify. However, paragraph (5) is silent as to paragraph (1). The strong implication is, therefore, that paragraph (5) does not trump paragraph (1).²⁶⁸ Perhaps for this reason, in cases not involving student loans, courts have uniformly regarded long-term obligations dealt

600, 603 (Bankr. S.D. Ohio 1986) (all suggesting long-term treatment of student loan debts at a time when they were dischargeable in Chapter 13 as a way of demonstrating good faith; none of these courts discussed the unfair discrimination standard). *Contra In re Thibodeau*, 248 B.R. at 706; *In re Coonce*, 213 B.R. at 346-49; *In re Taylor*, 137 B.R. at 64 n.6.

²⁶⁶See 11 U.S.C. § 1328(a)(1) (1994).

²⁶⁷See *In re Cox*, 186 B.R. at 747 (§ 1322(b)(5) prevents a finding of unfair discrimination as a matter of law); *In re Benner*, 156 B.R. 631, 634 (Bankr. D. Minn. 1993) ("student loan debt which is properly treated outside the plan in accordance with section 1322(b)(5), does not result in unfair discrimination in violation of section 1322(b)(1)"). See also *In re Sullivan*, 195 B.R. at 658; *In re Eiland*, 170 B.R. at 379-80 (quoting *Benner*); Somers & Hollis, *supra* note 225, at 463 (suggesting that compliance with § 1322(b)(5) "is an acceptable way to avoid the issue of unfair discrimination").

²⁶⁸See *In re Chandler*, 210 B.R. at 903-04.

For the same reason, § 1322(b)(5) is not an exception to the requirement that all disposable income be allocated to the plan for three years. A debtor simply may not cure a default and continue payments on a secured loan to maintain a luxurious house, car, or boat. *But see In re Sullivan*, 195 B.R. at 658 (suggesting that payment of student loans as a long-term obligation reduces disposable income; the court did not address whether such payments are reasonably necessary for the support of the debtor under § 1325(b)(2)(A)).

with under § 1322(b)(5) as nevertheless subject to the unfair discrimination standard.²⁶⁹ Even in cases in which favored treatment of student loans was at issue, some courts recognize that dealing with those loans under § 1322(b)(5) does not insulate them from the unfair discrimination requirement.²⁷⁰

Second, such an interpretation is not needed, as some courts have suggested, to harmonize paragraphs (1) and (5) of § 1322(b). These courts argue that unless long-term debts are immune from the unfair discrimination requirement, § 1322(b)(5) would be rendered ineffective as to unsecured claims, even though it expressly applies to them.²⁷¹ However, even if treatment of long-term debts are subject to the prohibition on unfair discrimination, § 1322(b)(5) would still have meaning. Paragraph (5) would be fully effective with regard to secured claims, which are its primary focus. Even as to unsecured claims, it would be necessary to prevent the claimant from accelerating the debt and demanding payment the moment the plan is completed and the stay lifted because of a prepetition default. Such import must be enough to satisfy any canon of statutory construction that seeks to provide every part of a statute with meaning.²⁷²

²⁶⁹See *In re Gunn*, 37 B.R. 432, 435 (Bankr. D. Or. 1984) (dealing with undersecured creditors to be paid directly by the debtor); *In re Blevins*, 1 B.R. 442, 444 (Bankr. S.D. Ohio 1979) (same); EPSTEIN ET AL., *supra* note 2, § 9-7, at 683 ("the debtor cannot evade the discrimination rule by proposing to pay certain creditors outside the plan"). See also *In re Ford*, 221 B.R. 749, 754-55 (Bankr. W.D. Tenn. 1998) (permitting the debtor to pay a long-term obligation directly after concluding that the resulting disparate treatment was not unfair, largely because it actually enhanced the recovery of other creditors); *In re Delauder*, 189 B.R. 639, 643-47 (Bankr. E.D. Va. 1995) (same).

²⁷⁰See *In re Thibodeau*, 248 B.R. at 703-04 (concluding plan was unfair); *In re Coonce*, 213 B.R. at 347 (same). See also *In re Dodds*, 140 B.R. 542 (apparently subjecting the plan to unfair discrimination analysis but concluding it was fair because in a 36-month plan that did not deal with the educational loans under § 1322(b)(5), other creditors would actually get less, presumably because the trustee's fees would increase by virtue of his being the disbursing agent on the student loan debts); NORTON, *supra* note 2, § 121:4 (because use of § 1322(b)(5) is permissive, electing it "does not automatically justify the fairness of a discrimination under § 1322(b)(1)").

²⁷¹See, e.g., *In re Chandler*, 210 B.R. at 904; *In re Benner*, 156 B.R. at 634.

²⁷²While this canon may make sense when applied to separate provisions, see UNIF. STATUTORY CONSTR. ACT § 13(2) (indicating that the "entire statute" is presumed to be effective), it is nonsensical to apply it to every word. The notion that each word of a legislative enactment must have independent meaning and effect is premised on the idea that legislatures take great care and use great economy in crafting their enactments. Even accepting this highly dubious proposition, the canon would remain suspect when applied at the microscopic level. Most statutes are drafted by lawyers—either the legislators themselves or their aides—and most lawyers employ redundancy and draft for all sorts of unlikely contingencies. This is a way of ensuring that nothing is overlooked and reflects a cautious approach to drafting. To presume that legislatures never employ redundancy or include words that may not have any current independent meaning is to presume precisely what the canon is designed to reject: that legislatures are sloppy and do not take great care in their work. Cf. Richard A. Posner, *Statutory Interpretation in the Classroom and in the Courtroom*, 50 U. Chi. L. Rev. 800, 812 (1983):

An example of a canon founded on the assumption of legislative omniscience is the canon that every word of a statute must be given significance; nothing in the stat-

Moreover, it is worth remembering that prior to the 1990 amendments, student loans, drunk driving liability, criminal fines, and restitution orders were all dischargeable in Chapter 13. The only unsecured claims that were nondischargeable in Chapter 13 were support claims. But these claims were not candidates for long-term debt treatment because only the prepetition arrearages constitute allowable claims; support obligations maturing postpetition could not—and still cannot—be paid under the plan.²⁷³ Thus, if § 1322(b)(5)'s reference to unsecured claims can only have meaning if nondischargeable claims are exempted from the unfair discrimination requirement, then that reference necessarily would have had no meaning for the first twelve years of the Code. Thus, interpreting § 1322(b)(5) as creating an exception to § 1322(b)(1) is misguided.

With that said, the salient point of the last few paragraphs is merely that a plan treating student loans as a long-term debt under § 1322(b)(5) must not discriminate unfairly. The question remains, is such treatment unfair? The answer is no.

Long-term debt treatment allows the debtor to favor student loan creditors out of postpetition income, which is precisely what § 523(a)(8) was designed to do. Although the amount of discrimination possible under this approach may be limited, the student loan creditors get payment in exactly the same manner for which they bargained in their contracts with the debtors. And, while the nondischargeability rule is designed to ensure the payment of student loans, it is not necessarily designed to ensure payment during the limited life of a Chapter 13 plan.²⁷⁴

Indeed, for most debtors, this approach should provide the relief they need to keep them in Chapter 13. For Doug and Debbie, the subjects of the introductory illustration, this approach actually entails a bit more discrimina-

ute can be treated as surplusage. No one would suggest that judicial opinions or academic articles contain no surplusage; are these documents less carefully prepared than statutes? There is no evidence for this improbable proposition; what evidence we have, much of it from the statutes themselves, is to the contrary. True, statutory language is in an important sense more compact than the language of judicial opinions and law-review articles. Every word in a statute counts—every word is a constitutive act—whereas much in a judicial opinion will merely be explanatory of its holding, and much in an academic article merely explanatory of its thesis or findings. But it does not follow that statutes are more carefully drafted, or even that greater care assures greater economy of language; a statute that is the product of compromise may contain redundant language as a by-product of the strains of the negotiating process.

²⁷³See 11 U.S.C. § 502(b)(5) (1994). Of course, support obligations maturing postpetition are expenses that decrease the debtor's disposable income, see 11 U.S.C. § 1325(b)(2)(A), and in that sense sort of come off the top and thereby reduce the recovery of creditors with allowable claims.

²⁷⁴See *supra* note 205 and accompanying text.

tion than the Chapter 13 plan they proposed.²⁷⁵

So, if the debtor is not in default on student loan obligations and the payments would otherwise extend beyond the life of the plan, allowing the debtor to favor them as long-term debt is fair. In addition, such treatment is likely more appropriate than permitting the debtor to accelerate the debts and treat them even more favorably under the plan by, in effect, paying them before they were due. If, however, the debts are already due, the debtor should be permitted to favor them directly under the plan in order to effectuate the congressional purpose of ensuring payment of these claims.²⁷⁶

H. A PROCEDURAL HURDLE

One potential problem with favoring a student loan claim in a Chapter 13 plan is that, at the time of confirmation, the dischargeability of the claim may be both unknown and unknowable. For example, a student loan will be discharged if repayment of the debt imposes an undue hardship on the debtor.²⁷⁷ This in turn depends on the debtor's situation at the time of the discharge. Because a discharge is not granted until the debtor makes all payments called for under the plan,²⁷⁸ some courts have ruled that the dischargeability of the student loan indebtedness cannot be determined at the time of plan confirmation; the issue may simply not be ripe.²⁷⁹

On top of that, dischargeability issues are supposed to be resolved through an adversary proceeding, not through the process of plan confirmation.²⁸⁰ In the context of a discriminatory plan in which the debtor claims a student loan is in fact nondischargeable, it is unclear who, if anyone, would prosecute such an adversary proceeding. Also unclear is what effect a decision made at the time of confirmation would have if the same issue were to

²⁷⁵Their plan proposed paying \$42,550 to their student loan creditors. This approach would allow them to pay as much as \$48,600 over a three-year plan. In fact, even assuming that they save trustee's fees by paying such creditors directly, *see supra* note 11, they would still have a problem paying that amount while giving their medical claimants the liquidation value of their claims. This could be solved by extending the plan an extra month or two or by using a bit of their home equity for a loan to make up the difference.

²⁷⁶*See In re Chandler*, 210 B.R. at 904; *In re Cox*, 186 B.R. at 746; *In re Christophe*, 151 B.R. at 480. *But see In re Williams*, 253 B.R. at 230-31 (permitting favored treatment of long-term student loans but not of student loan debts that have fully matured or otherwise would be fully due before completion of the plan).

²⁷⁷*See* 11 U.S.C. §§ 523(a)(8) & 1328(a)(2) (1994).

²⁷⁸*See* 11 U.S.C. § 1328(a). A more limited discharge may be granted at an earlier time if the debtor is unable to complete the plan for reasons beyond the debtor's control, *see* 11 U.S.C. § 1328(b), however such hardship discharges are fairly rare.

²⁷⁹*See, e.g., In re Soler*, 250 B.R. 694 (Bankr. D. Minn. 2000). *Contra In re Taylor*, 223 B.R. 747, 750-52 (9th Cir. BAP 1998).

²⁸⁰*See, e.g., In re Webber*, 251 B.R. 554 (Bankr. D. Ariz. 2000); *In re Mammel*, 221 B.R. 238 (Bankr. N.D. Iowa 1998).

arise later, at the time of discharge.²⁸¹

At least one court has treated these procedural problems as serious impediments to permitting a debtor to favor a student loan claim in a Chapter 13 plan.²⁸² Although that case involved an effort to favor student loan claims directly in the plan, the concerns would appear to apply in equal force to efforts to treat student loans as long-term debt under § 1322(b)(5).

Nevertheless, these procedural hurdles should not be permitted to become roadblocks in the debtor's path to a fresh start in a fair manner. If the discrimination is fair, these procedural issues can be resolved. For example, if a creditor or the trustee wishes to challenge proposed discrimination as unfair, the creditor or trustee should be permitted to submit evidence at the confirmation hearing to show that the debtor would be entitled to a discharge of student loan obligations upon completion of a nondiscriminatory plan. The debtor, who would of course have the burden of proof regarding the plan's confirmability,²⁸³ should be permitted to offer evidence on whichever side of that issue the debtor thinks best serves his or her interests. No matter what result is reached, all parties should be free to relitigate this issue at the time of discharge, to account for any circumstances that may have changed. In other words, *res judicata* need not apply. The court would not be determining the dischargeability of the claims at the confirmation hearing, merely the likelihood of dischargeability. A strong likelihood that the debts would be nondischargeable should be sufficient to justify discrimination in their favor.

In many respects, this is not much different from the way motions for relief from the stay are treated. Even if such a motion is denied, it may be brought again later, as circumstances change, and relitigated.²⁸⁴ The parties are free to alter their positions on the issue because of such changed circumstances, without being estopped by their earlier arguments.

Perhaps more to the point, if the debts are determined to be dischargeable because of undue hardship, that conclusion would not impair the policy favoring payment of this type of claim. The determination would result from the debtor's unusually strong need for relief. Thus, the matter would relate more to whether the debtor had a motive for favoring such claims than to the fairness in doing so. In fact, if the debtor's student loans are dischargeable

²⁸¹See *In re Chapman*, 146 B.R. 411, 415 (Bankr. N.D. Ill. 1992).

²⁸²*Id.* ("The list of procedural questions raised by the notion that claims not dischargeable in Chapter 7 or 13 should be preferred in a Chapter 13 plan is endless.").

²⁸³See, e.g., *In re Chinichian*, 784 F.2d 1440, 1443-44 (9th Cir. 1986); *In re McNichols*, 254 B.R. 422, 427 (Bankr. N.D. Ill. 2000); *In re McMillan*, 251 B.R. 484, 486 (Bankr. E.D. Mich. 2000); *In re Mattson*, 241 B.R. 629, 635 (Bankr. D. Minn. 1999); *In re Allen*, 240 B.R. 231, 241 (Bankr. W.D. Va. 1999).

²⁸⁴See, e.g., *In re Johns-Manville Corp.*, 40 B.R. 219, 228 (S.D.N.Y. 1984); TABB, *supra* note 2, § 3.17, at 188; S. Rep. No. 95-989 at 54 (1978).

because of undue hardship, the congressional policy underlying the nondischargeability rule generally—ensuring payment—becomes even more strong. The public fisc would now be in even greater jeopardy. Thus, a ruling that a debtor's student loan obligations are or are likely to be dischargeable actually provides greater justification for favoring the claims in a Chapter 13 plan, not less.

I. A CAVEAT

If the fairness of proposed discrimination is to be evaluated in reference to the rules and policies of the Bankruptcy Code, it is essential that the status of disfavored claimants be examined just as closely as the status of the claimants the debtor proposes to favor. Put another way, if the rule or policy supporting favored treatment of one creditor or group of creditors would also apply to one or more members of the disfavored group, the discrimination would not be appropriate.

For example, a debtor may propose to favor a student loan claim over a debt dischargeable in Chapter 13, that would be nondischargeable in Chapter 7. Recall that such debts often involve misconduct by the debtor,²⁸⁵ and are to some extent ones that Congress has also chosen to protect. Discrimination against these claims is unfair and should not be allowed.²⁸⁶ These claims too are favored under the law. More importantly, by virtue of the superdischarge, these are the creditors who truly pay for the debtor's choice of Chapter 13 relief. In that sense, they have a more compelling claim to the debtor's postpetition income than general creditors do, since those earnings would not be part of a Chapter 7 estate. In other words, to the extent one of the reasons for permitting favored treatment of student loan claims is that they have a claim to postpetition income of a Chapter 7 debtor that general unsecured claims do not, that reason does not apply against claims that are dischargeable in Chapter 13 but nondischargeable in Chapter 7.²⁸⁷

²⁸⁵See, e.g., 11 U.S.C. § 523(a)(2), (4) & (6) (1994).

²⁸⁶See *In re Sperna*, 173 B.R. 654, 660 n.4 (9th Cir. B.A.P. 1994) (noting that the unfairness involved in favoring student loan creditors would be more evident if the disfavored creditors included those with claims for fraud, false representations, or willful and malicious injury); *In re Easley*, 72 B.R. 948, 956 (Bankr. M.D. Tenn. 1987) ("It is unfair to discriminate against the victim of the debtor's prepetition misconduct," in this case a guard the debtor assaulted while in custody). See also *In re Bowles*, 48 B.R. 502, 508 & n.9 (Bankr. E.D. Va. 1985) (noting, in denying confirmation to a plan that proposed to favor a criminal restitution order, that some of the disfavored claims would be nondischargeable in a Chapter 7 case pursuant to § 523(a)(10)).

²⁸⁷Perhaps the debtor should be permitted to deal with this by bumping into the favored class any creditors whose claims would be nondischargeable in Chapter 7. However, that could just exacerbate the problem, by leaving the remaining disfavored creditors even worse off and by, in essence, bootstrapping the one type of discrimination on another. A complete analysis of this difficult question must await another article.

If the debtor proposes to favor a codebtor claim in order to protect the codebtor from bankruptcy, the

Although there may be some procedural problems in determining whether a disfavored claim truly falls within § 523(a)(2), (4) or (6),²⁸⁸ given the infrequency with which this issue is likely to arise, courts and trustees could simply rely on the creditors allegedly holding such claims to raise the issue at the confirmation hearing and, if necessary, receive evidence relating to the matter at that time.

CONCLUSION

In enacting the restriction against unfair discrimination in Chapter 13 plans, Congress imported a concept from business reorganizations that has no clear meaning in the context of individual debt adjustment plans. The lack of a statutory definition for this vague term has left courts struggling to understand and apply it. Unfortunately, in their efforts to do so, many courts have adopted a multifactor analysis that represents only an illusion of a standard. This “test” provides no guidance in applying the law to specific facts, and allows judges to imbue the statutory phrase “unfair discrimination” with their own personal sense of fair play.

While courts are resolving some issues of unfair discrimination appropriately, in a few contexts—most notably with respect to plans favoring student loans—courts have lost sight of the policies expressed and implied in the Bankruptcy Code, and have unnecessarily and improperly restricted the debtor’s freedom to construct a workable debt repayment plan. In the process, those courts have made Chapter 13 less attractive for debtors, a result which works to the detriment of creditors as well.

This Article offers courts a new approach to applying the unfair discrimination standard which seeks to harmonize the standard with the remainder of the Bankruptcy Code. Courts are invited to give it a try.

basis for doing so is different than for favoring a student loan debt. That basis—the amended text of § 1322(b)(1)—is not in direct conflict with disfavoring a debt arising out of misconduct. Nevertheless, it may be that such discrimination should still be prohibited.

²⁸⁸Cf. *In re Chapman*, 146 B.R. 411, 415 (Bankr. N.D. Ill. 1992) (noting the procedural problems associated with favoring claims allegedly protected by § 523(a)(2), (4), or (6) or student loan obligations that may or may not be nondischargeable under § 523(a)(8)).