

11 USC §1322(b)(1)  
11 USC §1328(a)  
11 USC §1122  
Discriminate Unfairly

In re Smalberger

Case No. 393-32040-H13     HLH

8-12-93

The debtor proposed a plan that would pay certain potentially non-dischargeable unsecured student loan debts in full while paying other dischargeable unsecured claims nothing. One of the creditors holding a dischargeable unsecured claim objected on the ground the proposed classification unfairly discriminated against the class of dischargeable unsecured claims in violation of §1322(b)(1).

The court held that the classification was unfair and denied confirmation of the plan. Section 1322(b)(1) requires the court to look at the proposed classification from the perspective of the class discriminated against - not from the debtor's perspective. The class discriminated against (general unsecured creditors holding dischargeable claims) holds dischargeable claims while the preferred class (student loan claimants) holds potentially non dischargeable claims. The preferred class may be legally entitled to attempt to collect on its claims after the plan is completed while the other class cannot. Given this fact, it seemed to the court unfair to prefer the class holding potentially non dischargeable claims during the pendency of bankruptcy case as well as after bankruptcy while the other class receives nothing during the case and cannot take action after the plan is completed.

Further, confirming the debtor's plan would result in a de facto granting of priority to the student loan claims while no such priority exists in the statutes. Congress could have granted a priority to the student loan claims but did not.

Finally, the court rejected the debtor's argument that the "fresh start" policy of the Code weighed in favor of the proposed classification. The court noted that the so-called "fresh start" is not truly "fresh" because of the numerous exceptions to dischargeability. Also, the student loan claims might ultimately be discharged under the "undue hardship" exception. Finally, the court felt that the fresh start argument, if accepted, would result in many permitted classifications where it appeared that Congress intended the permitted classifications to be limited in scope.

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**UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON**

In Re )  
JoANN C. SMALBERGER ) Case No. 393-32040-H13  
Debtor(s). ) OPINION

This matter came before the court upon the objection of St. Vincent Portland Federal Credit Union ("creditor") to confirmation of the debtor's proposed chapter 13 plan. The debtor is represented by Michael Blaskowsky and the creditor is represented by Michael Caro, both of Portland, Oregon.

The debtor's plan separately classifies certain student loan obligations and proposes to pay them in full while paying nothing to other unsecured creditors. The creditor objects on the ground this classification is unfair under §1322(b)(1).<sup>1</sup>

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<sup>1</sup> The creditor also objects on the ground "that by paying the unsecured student loan obligations the debtor is not using all her disposable income to make payments under the plan in violation of 11 USC §1325(b)(1) and (2) ... ." Creditor's Letter Memorandum, p.1, ¶1, dated June 22, 1993.

This objection is not well taken. The creditor has not objected to the debtor's budget. Thus, there is no dispute that the debtor is contributing all the disposable income to the plan. The creditor's only complaint is that the plan proposes to distribute the

1           The creditor argues that the student loan debts are simply  
2           unsecured claims that should not be preferred. The debtor points  
3           out that the student loan debts are non-dischargeable under  
4           §1328(a) unless the failure to discharge them would impose an  
5           "undue hardship" under that statute. Thus, the debtor argues she  
6           should be able to pay the student loan debts to protect her  
7           "fresh start."

8           The court is aware of no binding authority on this issue.  
9           The primary statute in question, §1322(b)(1), provides:

10                   "Subject to subsections (a) and (c) of this  
11                   section, the plan may designate a class or  
12                   classes of unsecured claims, as provided in  
13                   section 1122 of this title, but may not

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disposable income in an improper manner.

The creditor also objects on the ground the plan violates §1322(a)(3) which provides: "The plan shall - if the plan classifies claims, provide the same treatment for each claim within a particular class." Again, this objection is not well taken. The debtor's proposed plan classifies claims. Specifically, the plan separately classifies the student loan claims and the other non-priority unsecured claims. The plan proposes that the student loan claims will be paid in full while the other non-priority unsecured creditors will be paid nothing. Thus, while the treatment provided to each class of claims is different, the treatment provided to each claim within each class is the same. This complies with §1322(a)(3) and is, in fact, the basis for the creditor's objection.

The plan proposes to pay one student loan claimant directly and the other through the plan. This distinction is insignificant, however, since both claims will be paid in full and neither student loan claimant has objected to this proposal. So far as the objecting creditor is concerned, this distinction is meaningless. Further, the reason for this difference is adequately explained in the debtor's Memorandum in Opposition (dated June 4, 1993) at p.3, footnote 2.

1 discriminate unfairly against any class so  
2 designated; however, such plan may treat  
3 claims for a consumer debt of the debtor if  
4 an individual is liable on such consumer  
5 debt with the debtor differently than other  
6 unsecured claims... ."  
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8 From this language, it is apparent that co-signed consumer  
9 obligations are not the only type of unsecured claims which may  
10 be separately designated. If co-signed consumer obligations were  
11 the only permitted classification, there would be no need for the  
12 first phrase of the quoted language which begins "subject to" and  
13 ends "any class so designated."

14 The legislative history to §1322(b) does not specify the  
15 grounds upon which a court should determine whether a proposed  
16 classification is unfair. The legislative history to §1122  
17 states that §1122: "[C]odifies current case law surrounding the  
18 classification of claims ... ." H.R. Rep. No. 595, 95th Cong.,  
19 1st Sess. 406 (1977). Many opinions have been written in this  
20 area but they are not particularly helpful in this court's  
21 opinion. Collier's agrees. See Colliers on Bankruptcy, 15th  
22 Ed., ¶1322.05[2] and the comments and cases cited therein. Since  
23 a court's function in statutory construction is to glean the  
24 intent of the legislature, the analysis should focus on  
25 Congressional intent.

26 From the language of §1322(b)(1), it is apparent that the  
27 court should consider the proposed classification from the

1 viewpoint of the creditors who are discriminated against. If it  
2 can be said that such classification is "unfair" to them, it  
3 should not be permitted. By using the concept of "fairness,"  
4 Congress has left this determination to the discretion of the  
5 court. This court believes that, to the extent possible, legal  
6 issues should be determined on an objective - rather than a  
7 subjective - basis. Thus, the following analysis attempts to  
8 analyze the issue at hand and derive a rule that can be  
9 objectively and consistently applied regardless of the individual  
10 judge or litigants involved.

11 In 1990, Congress amended §1328(a) to restrict the  
12 dischargeability of certain student loan debts such as these and  
13 to except from discharge certain criminal restitution debts and  
14 certain debts arising from the operation of a vehicle while  
15 intoxicated. Pub. L. No. 101-508 (1990). The legislative  
16 history surrounding these amendments does not specify the reason  
17 for the inclusion of student loans in the amendments.

18 After these amendments, creditors holding non-dischargeable  
19 student loan claims may legally take action to collect on their  
20 claims after a chapter 13 case is completed and a discharge has  
21 been granted. Obviously, those creditors holding discharged  
22 claims may not. Thus, a creditor holding a non-dischargeable  
23 student loan claim is more likely to be repaid than a creditor  
24 holding a dischargeable, unsecured claim.

1           It would seem unfair to tell creditors holding dischargeable  
2       claims that other creditors who hold non-dischargeable claims  
3       (and who may thus pursue post-bankruptcy collection efforts  
4       against the debtor) are to be preferred not only after the  
5       bankruptcy case is completed but also during the time payments  
6       are being made to creditors. To put it colloquially, receipt of  
7       payments under the chapter 13 plan is the only shot at collecting  
8       from the debtor for those creditors holding dischargeable claims  
9       while student loan creditors may have more than one shot at  
10      collection. This fact would seem to argue against allowing a  
11      debtor to separately classify non-dischargeable student loan  
12      debts for preferential treatment.

13           Student loan debts can be viewed differently from  
14      restitution and "drunk driving" debts. Congress could have had  
15      dual purposes in excepting criminal restitution and drunk driving  
16      debts from discharge. One would be to improve the victim's  
17      chances of payment and the other would be to discourage  
18      individuals from engaging in such behavior. In re Hudson, 859  
19      F.2d 1418 (9th Cir. 1988); 136 Cong. Rec. S9663 (7-12-1990).

20           It is extremely doubtful that the purpose of excepting  
21      certain government-insured student loan debts from discharge was  
22      to discourage students from borrowing money. If this were the  
23      case, Congress could simply discontinue the student loan  
24      guarantee programs. On the other hand, it would seem that one of

1 the purposes of the amendment which makes certain student loan  
2 debts non-dischargeable was to improve the chances that  
3 government-guaranteed loans would be repaid. This obviously is  
4 beneficial to taxpayers and future students who need to borrow  
5 money for schooling.

6 Another way that Congress could have improved the chances  
7 that government-guaranteed loans would be repaid would be to  
8 grant a priority to student loan claims. Under §1322(a)(2), a  
9 plan must provide for payment in full of all debts entitled to  
10 priority under §507. Certain income tax debts, for example, are  
11 specified in §507(a)(7). The provisions of §1322(a)(2) help  
12 insure that those income tax debts are paid in chapter 13 cases.  
13 If Congress intended to grant a priority for student loan claims,  
14 it seems that Congress could have simply included such claims in  
15 the list of debts entitled to priority under §507. Another  
16 possibility is that Congress could have specifically included  
17 student loans in §1322(b)(1) as it did for co-debtor claims.

18 The fact that Congress has not provided priority treatment  
19 for student loan debts either in §507 or §1322(b)(1) is some  
20 indication that Congress did not intend such debts to be  
21 separately classified from other unsecured debts and be given  
22 preferential treatment.

23 The debtor argues that the policy favoring a "fresh start"  
24 supports the proposed classification. This argument is too

1 broad. Logically applied, this argument would mean that the  
2 debtor should be permitted to separately classify not only  
3 student loan debts but also any debt declared to be non-  
4 dischargeable in §1328(a). Also, there would seem to be less  
5 need to separately classify student loan claims than to  
6 separately classify other non-dischargeable debts since an escape  
7 valve is provided for in the "undue hardship" language in  
8 §523(a)(8). Under that statute, a debtor can discharge a student  
9 loan debt if the failure to discharge the debt would work an  
10 undue hardship on the debtor or the debtor's dependents. This  
11 provision can assist in protecting the debtor's "fresh start."

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13 There is no "undue hardship" provision with respect to  
14 claims entitled to priority under §507. The plan must provide  
15 for payment in full of all debts entitled to priority under that  
16 section or the plan cannot be confirmed regardless of the  
17 hardship this may impose on a debtor or the debtor's dependents.  
18 This indicates that the collection of student loan debts is not  
19 as high a priority with Congress as the collection of the  
20 specified priority claims.

21 It could be argued that the only appropriate use of  
22 classification under §1322(b)(1) is when it is necessary to do so  
23 in order for the plan to succeed. Under this rationale, it would  
24 be appropriate to prefer an unsecured trade creditor which enjoys



1 a monopoly on a needed product or service but refuses to continue  
2 supplying the product or service to the debtor unless its  
3 unsecured claim is paid in full. For example, assume that ABC  
4 Corp. holds an allowed unsecured claim against a debtor and the  
5 debtor must have widgets for his plan to succeed. If only ABC  
6 Corp. supplies widgets, it might be appropriate to confirm a plan  
7 that proposed to prefer ABC Corp. over other unsecured claim  
8 holders if ABC Corp. would otherwise refuse to continue supplying  
9 widgets.

10 Under this "viability-of-the-plan" theory, it might be  
11 appropriate to prefer a claim for restitution or familial support  
12 if the alternative is that the debtor will be sent to jail and  
13 the plan will therefore fail. But this rationale would not seem  
14 to apply to student loan claims since the failure to pay such a  
15 claim would not normally interfere with the debtor's livelihood.

16 Classification of claims for different treatment will always  
17 intrude upon one of the fundamental principles of bankruptcy:  
18 similar treatment for similarly situated creditors. The theory  
19 that classification may only be permitted in order to protect the  
20 viability of the plan, however, limits the extent of the  
21 intrusion. Such a limited intrusion seems more consistent with  
22 Congressional intent than an approach that would allow many  
23 permitted classifications, thus, more intrusion.

24 Although it is not entirely clear, this court believes it

1 was not Congress's intent in excepting certain student loans from  
2 discharge to thereby allow such loans to be separately classified  
3 under §1322(b)(1) for preferential treatment to the detriment of  
4 other non-priority, unsecured claim holders. It seems unfair to  
5 the creditors in the objecting creditor's class to receive  
6 nothing under the plan on account of their dischargeable  
7 unsecured claims while creditors holding potentially non-  
8 dischargeable unsecured claims are to be paid all of the debtor's  
9 disposable income (after administrative, secured and priority  
10 claims are paid).

11 Therefore, the court concludes that the debtor's proposal to  
12 prefer the student loan claims does not meet the "fairness" test  
13 prescribed by Congress in §1322(b)(1).<sup>2</sup> The creditor's  
14 objections will be sustained.

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16 DATED this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

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19 \_\_\_\_\_  
20 Henry L. Hess, Jr.  
21 Bankruptcy Judge

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The court notes that a debtor might accomplish the result sought here by filing a chapter 7 case and then a chapter 13 case to deal with the nondischargeable obligations. Such "chapter 20" cases are not per se impermissible. See Johnson v. Home state Bank, 111 S. Ct. 2150 (1991).

For another interesting approach to this problem, see In re Dodds, 140 B.R. 542 (Bankr. Mont. 1992), which holds it is permissible to separately classify student loan debts and pay them in full if other unsecured claims are to receive what they would receive in a 36 month plan without separate classification.

1 cc: Michael Blaskowsky  
2 Michael Caro  
3 Robert W. Myers, Trustee