STUDENT NOTE: THE CHANGING CHAPTER 13 PROCEDURAL LANDSCAPE AFTER *ESPINOSA* AND CONSEQUENCES

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I. Introduction

The Supreme Court's decision in *United Student Aid Funds, Inc. v. Espinosa*[1] ("Espinosa") may give debtors and creditors in a chapter 13 proceeding greater latitude in discharging student loan debt through out-of-court agreements. In *Espinosa*, Justice Thomas, writing for the Court, affirmed a Ninth Circuit case[2] upholding a confirmed chapter 13 plan that purported to discharge a debtor's student loan interest if the plan were successfully consummated, even though no adversary proceeding had been commenced and no undue hardship determination had been made by the bankruptcy court.[3] Known as a "discharge by declaration" provision, these clauses within a chapter 13 plan provide for the discharge of a specific outstanding debt, in this case student loan interest, once debtors have successfully finished their plan. With the *Espinosa* decision, these provisions may grow more commonplace as debtors with student loans face insolvency and search for means to resolve their debt without incurring the time, effort, and expense of pursuing an adversarial proceeding.

Prior to *Espinosa*, federal circuit courts were split on how to handle discharge by declaration provisions, some of which can contain language inconsistent with Bankruptcy Code § 523(a)(8), which mandates a finding of undue hardship before a student loan may be discharged in whole or in part.[4] Some circuits found them objectionable per se while others allowed those discharge provisions to stand if the creditor did not object during confirmation proceedings or appeal the confirmation order. The Tenth Circuit found that a creditor lacked any

* University of Tennessee, College of Law, Candidate for Juris Doctor, May 2016. I would like to thank Professors Joan M. Heminway, Thomas Plank, and George Kuney for their inimitable, and boundless, assistance through the developmental, writing, and editing process.

[1] United Student Aid Funds, Inc. v. Espinosa, 559 U.S. 260 (2010).

[2] Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193 (9th Cir. 2008) (holding that student loan debts can be discharged in a Chapter 13 plan if the creditor does not reject it after receiving notice of the proposed plan).

[3] *Espinosa*, 559 U.S. at 276-78.

[4] 11. U.S.C. 523(a)(8) (2010).

right to challenge such a provision after confirmation if it had not objected to the provision in the confirmation process or later appealed the order, heavily emphasizing the importance of finality to an order confirming a plan.[5] Similarly, in the Ninth Circuit, the court upheld a confirmed plan because of the creditor's failure to object or to later appeal the order.[6] However, the Fourth, Sixth and Seventh Circuits decided differently, holding that a discharge by declaration provision in a chapter 13 plan violated a creditor's due process for lack of adequate notice when the debtor did not serve the creditor with a summons and complaint in an adversary proceeding, but instead merely provided notice of the plan's confirmation proceedings and the opportunity to object to confirmation.[7]

With the *Espinosa* decision, the Supreme Court clarified how a discharge by declaration provision should be treated by circuit courts. The Court stressed that the parties to a chapter 13 agreement can, outside of the confines of a courtroom, decide and agree among themselves which of the debtor's loans would constitute an undue hardship.[8] These arrangements directly benefit debtors: they are shorn of at least a part of their debts. Similarly, creditors may value these out-of-court agreements for the economy of avoiding both financially costly and time-consuming litigation, in addition to the uncertainty of a judicial proceeding. The creditor who approves such an agreement is analogous to the prosecutor who approves a plea bargain, or a litigant who approves of an out-of-court settlement. These alternatives to litigation are less expensive, offer a degree of certainty and insulate the parties from risk of an in-court loss.

II. Student Loan Landscape

There will be no shortage of student debtors in the future. In recent years, national student loan debt has passed $1 trillion dollars, held by 38 million students borrowing for college-related expenses.[9] With tuition and fees rising 3.7 percent at private nonprofit colleges and

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[5] *See generally* Andersen v. UNIPAC-NEBHELP (*In re* Andersen), 179 F.3d 1253 (10th Cir. 1999).

[6] *See generally* Great Lakes Higher Educ. Corp. v. Pardee (*In re* Pardee), 193 F.3d 1083 (9th Cir. 1999).

[7] *See e.g.*, Ruehle v. Educ. Credit Mgmt. Corp. (*In re* Ruehle), 412 F.3d 679 (6th Cir. 2005); *In re* Hanson, 397 F.3d 482 (7th Cir. 2005); Banks v. Sallie Mae Servicing Corp. (*In re* Banks), 299 F.3d 296 (4th Cir. 2002).

[8] *Espinosa*, 559 U.S. at 278.

[9] Rohit Chopra, *Student Debt Swells, Federal Loans Now Top a Trillion*, CONSUMER FIN. PROT. BUREAU (July 17, 2013), http://www.consumerfinance.gov/newsroom/student-debt-swells-federal-loans-now-top-a-trillion/.

2.9 percent for in-state residents at four-year public schools in 2014,[10] student debt will likely continue to increase in coming years and continue to remain an economic problem. As students take out more debt, discharge by declaration provisions may grow more widespread as a viable option for student loan debtors hoping to restore their financial situation.

Student loan debt impairs a borrower's ability to participate as a consumer—borrowers are less likely to purchase homes and less likely to hold other classes of debt.[11] There is some promise, though, as the national student loan default rate has decreased to 13.7 in 2014, from 14.7 the year before.[12] Furthermore, a range of repayment options are available to student loan debtors, ranging from a monthly payment fixed according to the debtor's adjusted gross income[13] to the more conventional standard repayment option.[14] Unfortunately, those are neither salve nor panacea. The greater a graduate's debt burden, the greater it will "impair the ability of recent college graduates to qualify for a loan"[15] and impact risk taking in small business formation.[16]

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[10] Janet Lorin, *College Tuition in the U.S. Again Rises Faster than Inflation*, BLOOMBERGBUSINESS (Nov. 13, 2014, 12:01 AM), http://www.bloomberg.com/news/articles/2014-11-13/college-tuition-in-the-u-s-again-rises-faster-than-inflation.

[11] CONSUMER FIN. PROT. BUREAU, STUDENT LOAN AFFORDABILITY: ANALYSIS OF PUBLIC INPUT ON IMPACT AND SOLUTIONS 7 (2013) ("Between 2007 and 2010, the average student loan balance for households with student debt climbed by nearly 15 percent, even as households have deleveraged and other classes of consumer debt have declined.") [hereinafter STUDENT LOAN REPORT].

[12] Nick Anderson, *National student loan default rate dips to 13.7 percent; still "too high," official says*, WASH. POST (Sept. 24, 2014), http://www.washingtonpost.com/local/education/national-student-loan-default-rate-declines-to-137-percent/2014/09/24/d280c8bc-43ee-11e4-b437-1a7368204804_story.html.

[13] *Repayment Plans*, FED. STUDENT AID (2013), http://www.direct.ed.gov/RepayCalc/dlindex2.html (last updated Oct. 28, 2015) (stating that under the income contingent repayment, borrowers are capped at 20% of their discretionary monthly income).

[14] *Id.*

[15] STUDENT LOAN REPORT, *supra* note 11, at 8.

[16] *Id.* ("[S]tudent debt may suppress risk-taking and innovation by discouraging the formation of new businesses by young entrepreneurs").

III. Implicated Rules, Statutes, and Holdings

Realistically, for most filers, the possibility of discharging student loans pursuant to a chapter 13 bankruptcy plan is remote.[17] For student loans to be discharged, a debtor must show that the debt is an undue hardship.[18] The Federal Rules of Bankruptcy Procedure ("FRBP") require an adversary proceeding to establish the dischargeability of a student loan debt.[19] For most would-be chapter 13 filers trying to rid themselves of their student debts, the debtor must initiate litigation against their creditor, serving a complaint and summons, engaging in discovery, motion practice, and, if there are disputes of material fact, trial and the potential for appeals.

In a chapter 13 proceeding, the court must hold a confirmation hearing for the chapter 13 plan, during which any party in interest may object.[20] If there are no objections to the plan, the court will confirm the plan provided three criteria are met. Most noteworthy for the *Espinosa* decision that "the plan complies with the provisions of this chapter and with the other applicable provisions of this title"[21] and "the plan has been proposed in good faith and not by any means forbidden by law."[22]

The FRBP governing an adversary proceeding are largely identical to the Federal Rules of Civil Procedure ("FRCP") that govern civil litigation in the district courts. FRBP 7003[23] is the analog of FRCP 3, which requires that a plaintiff commence a civil action with a complaint.[24] Meanwhile, FRBP 7008[25] is the analog of FRCP 8, which governs the form and content a pleading must take.[26] Despite these similarities, there are some differences, particularly regarding service of a

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[17] 11 U.S.C. § 1328(a)(2) (2005) (precluding student loan debt from discharge after completion of a Chapter 13 payment plan).

[18] 11 U.S.C. § 523(a)(8) (2005) (Allowing student loans to be discharged provided that "unless excepting such debt from discharge . . . would impose an undue hardship on the debtor and the debtor's dependents.").

[19] FED. R. BANKR. P. 7001(6) (2010).

[20] 11 U.S.C. § 1324 (2005) ("[T]he court shall hold a hearing on confirmation of the plan. A party in interest may object to confirmation of the plan.").

[21] 11 U.S.C. § 1325(a)(1) (2005). This relates to one of the first issues in the *Espinosa* decision, in which the proposed chapter 13 plan was itself inconsistent with the Bankruptcy Code.

[22] 11 U.S.C. § 1325(a)(3) (2005).

[23] FED. R. BANKR. P. 7003 (2014) ("Rule 3 . . . applies in adversary proceedings.").

[24] FED. R. CIV. P. 3 (2007).

[25] FED. R. BANKR. P. 7008 (2014) ("Rule 8 . . . applies in adversary proceedings.").

[26] FED. R. CIV. P. 8 (2010).

summons. Under FRCP 4, a nonparty who is at least 18 years old must serve a summons with a copy of the complaint,[27] unless the defendant chooses to waive service of process.[28] Under FRBP 7004, the same is true[29] except that a plaintiff may initiate service by prepaid first class mail.[30] Instead of being an alternative to physical service, the FRBP allow a plaintiff to establish service of process with prepaid certified mail *in addition* to physical service of process.[31]

Service of process is an integral part of due process.[32] Insufficient service implicates fundamental constitutional rights.[33] In *Mullane v. Central Hanover Bank & Trust Co.*,[34] the Supreme Court held that "notice [must be] reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."[35] Notice itself must rise above "a mere gesture" to meet due process,[36] and it "must be of such nature as reasonably to convey the required information, . . . and it must afford a reasonable time for those interested to make their appearance."[37] Notice for notice's sake is insufficient, and it must take into account the defendant's circumstances to properly meet due process.

Failure to satisfy due process in a court proceeding can lead to a court's judgment being voided.[38] Under FRCP 60 or FRBP 9024,[39] a

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27 FED. R. CIV. P. 4(c) (2015).

28 FED. R. CIV. P. 4(d) (2015).

29 FED. R. BANKR. P 7004(a) (2014) ("Personal service under Rule 4(e)–(j) F.R.Civ.P. may be made by any person at least 18 years of age who is not a party, and the summons may be delivered by the clerk to any such person.").

30 FED. R. BANKR. P 7004(b) (2014) ("[I]n addition to the methods of service authorized by Rule 4(e)–(j) F.R.Civ.P., service may be made within the United States by first class mail postage prepaid . . . .").

31 *See id.*

32 *See generally* Pennoyer v. Neff, 95 U.S. 714 (1877) (stating that due process required either personal appearance or personal service of process before a defendant could be bound by a rendered judgment).

33 *See also* FED. R. CIV. P. 12(b)(5) (2009) (allowing a party to submit a motion to dismiss for insufficient service of process).

34 339 U.S. 306 (1950).

35 *Id.* at 314.

36 *Id.* at 315.

37 *Id.* at 314 (citations omitted).

38 FED. R. CIV. P. 60 (2007).

39 FED. R. BANKR. P. 9024 (2014).

party on motion can challenge a judgment as void. A court can declare a judgment void if the court rendering judgment lacked subject matter jurisdiction[40] or if a constitutional right is infringed upon, such as a due process violation because of inadequate or lack of service of process.[41] On the other hand, an erroneous judgment is not a valid basis for a void judgment.[42]

IV. *Espinosa*

In *Espinosa*, Justice Thomas delivered a unanimous decision affirming a lower court decision that discharged student loan interest without commencing an adversarial proceeding and without an undue hardship determination by the bankruptcy court.[43] In the late 1980s, Francisco Espinosa took out federal student loans with a total principal of $13,250.[44] Later, he submitted a chapter 13 plan proposing to repay only the principal on his debts, but not the accrued interest, and providing that the plan's completed expiration would discharge the interest.[45] The court clerk then mailed a copy of Espinosa's plan to United Student Aid Funds Inc. ("United"), Espinosa's creditor, which did not object to the plan or its proposed discharge of Espinosa's student loan interest, even though there was no adversarial proceeding initiated or determination of undue hardship.[46] Afterward, the bankruptcy court confirmed the plan.[47]

Espinosa completed the plan's payments in 1997, and the bankruptcy court discharged his student loan interest.[48] Three years later, United sought to collect the interest on Espinosa's loans.[49] After Espinosa filed a motion seeking to enforce the 1997 discharge, United filed a cross-motion under Federal Rule 60(b)(4) to void the bankruptcy

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[40] 11 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2862 (3d ed. 2015) ("[A judgment] is void only if the court that rendered it lacked jurisdiction of the subject matter . . . .").

[41] *Id.* ("[I]f [the court] acted in a manner inconsistent with due process of law.").

[42] *Id. See also* Ingvoldstad v. Kings Wharf Island Enters., 593 F. Supp. 997, 1004 (V.I. 1984). ("[A] judgment is not void and is therefore not within the ambit of Rule 60(b)(4) simply because it is erroneous.") (citation omitted).

[43] *See Espinosa*, 553 F.3d at 1205.

[44] *Espinosa*, 559 U.S. at 264.

[45] *Id.*

[46] *Id.* at 265.

[47] *Id.*

[48] *Id.* at 265-66.

[49] *Id.* at 266.

court's confirmation of Espinosa's plan on two claims: (1) the provision in Espinosa's plan discharging his student loan interest was inconsistent with the FRBP, and (2) United's due process rights were violated because Espinosa failed to serve it with a summons and complaint.[50]

The Court stated that for a judgment to be rendered void under Rule 60(b)(4), the judgment must have been "premised either on a certain type of jurisdictional error or on a violation of due process that deprives a party of notice or the opportunity to be heard."[51] However, failing to serve United with a summons and a complaint amounted to inadequacy only of a procedural right guaranteed by the FRBP, not a constitutional one.[52] Due process need only be tailored to the *Mullane* standard.[53] In this case, due process was met when United received actual notice from the bankruptcy court concerning the filing and contents of Espinosa's plan.[54] As for the court's failure to find undue hardship, that amounted to, at most, legal error not warranting a voided judgment.[55] United, after receiving notice, had opportunity to object or timely appeal and should not have slept on its rights.[56]

The Court's holding went further. In discussions between creditors and debtors concerning student loans, the parties "may agree that payment of a student loan debt will cause the debtor an undue hardship sufficient to justify discharge," thereby mutually consenting to undue hardship without initiating an adversary proceeding.[57] A bankruptcy court would still have to make a determination of undue hardship to satisfy § 523(a)(8),[58] but debtors would no longer need to

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[50] *Id.*

[51] *Id.* at 270.

[52] *Id.* at 272 ("Espinosa's failure to serve United with a summons and complaint deprived United of a right granted by a procedural rule . . . [t]his deprivation did not amount to a violation of United's constitutional right to due process.") (citation omitted).

[53] *See supra* note 34 and accompanying text.

[54] *Espinosa*, 559 U.S. 272.

[55] *Id.* at 274-75.

[56] *Id.*

[57] *Id.* at 278 ("Neither the Code nor the Rules prevent the parties from stipulating to the underlying facts of undue hardship, and neither prevents the creditor from waiving service of a summons and complaint.").

[58] *Id.* ("[T]o comply with § 523(a)(8)'s directive, the bankruptcy court must make an independent determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding.").

initiate litigation against their creditors provided the two can agree that paying an outstanding student loan would constitute undue hardship.[59]

V. CONSEQUENCES

With *Espinosa*'s holding, the Supreme Court has refined its interpretation of when due process is satisfied in relation to an adversarial proceeding regarding student loan creditors. Three other circuits previously held that a student loan creditor was denied due process when debtors failed to serve a complaint and summons to their creditors.[60] Writing for the Ninth Circuit, Judge Kozinski reasoned that the "constitutional standard, as we understand it, requires that a party affected by the litigation obtain *sufficient notice*,"[61] as opposed to the heightened, and stricter, standard promulgated by the FRBP requiring a summons and complaint that other circuits have claimed was due to a creditor.[62] The *Espinosa* Court stated that due process merely required notice reasonably calculated under all the circumstances, echoing the *Mullane* standard, and that actual notice satisfied the constitutional requirement.[63] The rules requiring a summons and complaint enumerated within the FRBP, however, were procedural rules, not constitutional ones.[64]

The *Espinosa* decision has made it easier for debtors who are interested in a chapter 13 plan but may be wary of initiating an adversarial proceeding. The requirements of the FRBP to discharge student loans are still applicable. In most cases, a debtor wanting to commence chapter 13 will still have to initiate an adversarial proceeding and request that a bankruptcy court hold a hearing to create a plan agreed upon by all interested parties. However, the *Espinosa* decision has bolstered the procedural legitimacy of discharge by declaration provisions by ensuring that a court upholding such a provision will not

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[59] *Id.*

> We thus assume that, in some cases, a debtor and creditor may agree that payment of a student loan debt will cause the debtor an undue hardship sufficient to justify discharge. In such a case, there is no reason that compliance with the undue hardship requirement should impose significant costs on the parties or materially delay confirmation of the plan.
> *Id.*

[60] *See supra* notes 5, 6 and accompanying text.

[61] *Espinosa*, 553 F.3d at 1204 (emphasis added).

[62] *See supra* notes 5, 6 and accompanying text. These circuits required a complaint and notice served upon a creditor.

[63] *Espinosa*, 559 U.S. at 272.

[64] *Id. See also* FED. R. BANKR. P 7004 (2014).

automatically be a void judgment merely because a creditor was not served with a summons and complaint.

At least one commentator has stated that the lack of clear approval or disapproval of a discharge by declaration provision, and the mere sanction of a court judgment's finality of ruling concerning the declaration, may lead to some confusion among the circuits in future proceedings.[65] At the very least, the *Espinosa* decision will not require a court to hold as void a provision within a debtor's confirmation plan discharging student loans, or similar debt, after successful completion of the plan provided the creditor had sufficient notice under the *Mullane* standard. Nor, for that matter, would a court be required to hold as void under 60(b)(4) a lower court decision upholding a debtor's chapter 13 plan even where the creditor is not served with a summons or complaint. Furthermore, inconsistencies between the chapter 13 plan's provisions and the Bankruptcy Code are not themselves sufficient to overturn a judgment confirming a plan.

The *Espinosa* decision may allow for underhanded, bad-faith tactics by practitioners seeking to "slip in" a discharge by declaration provision, a fear United expressed in *Espinosa*.[66] The Court, however, dismissed fears of rampant lawyer misconduct by citing the available recourse against dishonest advocates and how they "face penalties under various provisions for engaging in improper conduct in bankruptcy proceedings."[67] Attorney wrongdoing is procedurally constrained by FRBP 1008,[68] which requires lawyers to verify any statement they make,[69] and sanctions for misrepresentations are enumerated under FRBP 9011.[70] Courts may sanction lawyers who make improper claims,

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[65] Ralph Brubaker, *Supreme Court Upholds "Discharge by Declaration" of Student Loan Debts in Chapter 13 (or Does It?)*, 30 N. 6 BANKR. LAW LETTER 1, 1 ("With respect to whether the practice itself is or is not appropriate, though, the Court sent mixed signals that will likely perpetuate extreme nonuniformity in the prevalence of and attitudes toward discharge-by-declaration.").

[66] *Espinosa*, 559 U.S. at 278 ("United argues that our failure to declare the Bankruptcy Court's order void will encourage unscrupulous debtors to abuse the Chapter 13 process by filing plans proposing to dispense with the undue hardship requirement in the hopes the bankruptcy court will overlook the proposal and the creditor will not object.").

[67] *Id.* (quoting Taylor v. Freeland, 503 U.S. 638, 644 (1992)).

[68] FED. R. BANKR. P 1008 (1991).

[69] "All petitions, lists, schedules, statements and amendments thereto shall be verified or contain an unsworn declaration as provided in 28 U.S.C. §1746." *Id.*

[70] FED. R. BANKR. P 9011 (1997). Attorneys are required to sign any "petition, pleading, written motion, and other paper, except a list, schedule, or statement, or amendments." *Id.* After notice and reasonable opportunity to respond, the court may

frivolous or unwarranted claims or defenses, or factual claims without evidentiary on either the opposing counsel's initiative or the court's.[71] Additional reproof is available beyond in-court sanctions, such as professional reprimand by the bar for violating Rule 3.1 of the Model Rules of Professional Conduct.[72] Lawyers who would rely on *Espinosa*'s holding as a way to surreptitiously advance an insincere chapter 13 plan on their client's behalf, while confounding the due process of the creditor, are subject to very real and deterring admonishments from a variety of sources.

Notwithstanding a lawyer's malfeasance, the *Espinosa* decision provides a new method of discharging loans to debtors entertaining the idea of chapter 13 bankruptcy. Those debtors wary of an adversarial proceeding may negotiate with their creditor to establish a plan that could mitigate their student loan burden. Additionally, the *Espinosa* decision is an opportunity for debtors and creditors to voluntarily remove the uncertainty inherent in litigation, specifically that which arose from the circuit split concerning judicial determinations of undue hardship. Student loan creditors can now negotiate with debtors a favorable plan that can help creditors better recoup a portion of the outstanding debt while letting debtors and creditors avoid the additional expense of litigation. By upholding discharge agreements between parties in interest without recourse to an adversarial proceeding or undue hardship determination, debtors and creditors can agree among themselves on an appropriate plan concerning loans and whether discharge is practicable.

VI. Conclusion

Student loan debt is a rising problem that seriously affects spending decisions by debtors. Fewer graduates are able to purchase a house or participate in forming businesses when loan payments replace a part of their discretionary spending. Repayment options are available, but do little to help debtors whose loans may be wildly out of proportion to their income. The Bankruptcy Code provides for the discharge of student loans under chapter 13, but only if the debtor is willing to enter into an adversarial proceeding and all parties in interest

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impose sanctions on motions or sua sponte. *Id.* These sanctions, however, are "limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated" and may be monetary or otherwise. *Id.*

[71] *Id.*

[72] MODEL RULES OF PROF'L CONDUCT 3.1. *See also* MODEL RULES OF PROF'L CONDUCT 1.3 cmt. 1 ("The lawyer's duty to act with reasonable diligence does not require the use of offensive tactics or preclude the treating of all persons involved in the legal process with courtesy and respect.").

can agree on a proposed payment plan. With the Supreme Court's decision in *Espinosa*, creditors and debtors can avoid the uncertainty of litigation and agree among themselves as to whether a certain student loan constitutes undue hardship.