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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	CASE NO. 04-81390
James Singleton Mulkey and Uraina Uridacy Powell-Mulkey,	CHAPTER 13
Debtors.	JUDGE MASSEY

ORDER DENYING CONFIRMATION OF AMENDED CHAPTER 13 PLAN

In this Chapter 13 case, Debtors have proposed a plan, which they have twice amended, providing for disparate treatment of unsecured creditors. The plan, as amended, proposes to pay in full claims held by "Devry," and "Great Lakes." On their Schedule F, Debtors state that the consideration for each of these debts was an educational loan. Devry has filed a proof of an unsecured claim; Great Lakes has not, unless Educational Credit Management Corporation ("ECMC"), which filed a proof of an unsecured claim, is the assignee of Great Lakes. The plan provides that the allowed claims of all other unsecured creditors would be paid only 1% of the amount of those claims. The debts owed to Devry and apparently to ECMC as well are nondischargeable educational loans; all other allowed general unsecured claims against Debtors are dischargeable. Nancy J. Whaley, the Chapter 13 Trustee in this case, objects to the confirmation of Debtors' plan filed on the ground that the plan discriminates unfairly against the holders of general unsecured claims.

Section 1322 of the Bankruptcy Code ("Code") deals with the contents of a Chapter 13 plan. Subsection (a) provides for what a plan must contain, while subsection (b) is permissive. Section 1322(b)(1) provides:

> (b) Subject to subsections (a) and (c) of this section, the plan may--
>
> > (1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims[.]

11 U.S.C. § 1322. Section 1122 provides that "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." All that § 1122 and § 1322 require is that claims within a class be substantially similar, not that similar claims cannot be placed in different classes. *In re Chapman*, 146 B.R. 411, 417 (Bankr. N.D.Ill. 1992). Accordingly, debtors may classify educational loans separately from other unsecured claims regardless of whether educational loans are "different" from other unsecured claims. Nevertheless, § 1322(b)(1) prohibits debtors from discriminating unfairly against any class of claims. The only question to be decided, then, is whether Debtors' proposal to pay in full nondischargeable educational loans while paying only 1% of other unsecured claims unfairly discriminates in violation of § 1322(b)(1).

The Code does not define what "discriminate unfairly" means, and courts have formulated a number of tests. *See In re Crawford*, 324 F.3d 539, 541-2 (7th Cir. 2003) (spelling out various tests). The most widely used test is the four-factor test, also known as the *Leser* test: (1) whether the discrimination has a reasonable basis; (2) whether the debtor can carry out a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination. *In re Leser*, 939 F.2d 669, 672 (8th Cir. 1991). The four-factor test has been widely criticized, however, with the most powerful criticism being that it requires a determination of "reasonable basis," a determination just as amorphous as the determination of "unfair discrimination." *See In re Bentley*, 266 B.R. 229, 238 (B.A.P. 1st Cir. 2001) ("[I]nsofar as the [four-factor] test relies upon abstract, undefined notions of 'reasonableness,' 'legitimacy,' and 'good faith,' it fails to direct the court's analysis."); *In re McCullough*, 162 B.R. 506, 509-10 (N.D. Ill. 1993) ("[T]he 'reasonable basis' formulation is no more useful than the undefined statutory concept of 'discriminate unfairly.'"). *Cf. In re Crawford*, 324 F.3d at 542 ("With respect, [the four-factor] test is empty except for point 2...."). Some courts have proposed a balancing approach where the interests of the relevant parties are balanced to determine if a proposed plan is fair. *In re Bentley*, 266 B.R. at 239 ("Fairness...is a matter of balancing correctly the interests of two or more parties."). *See In re McCullough*, 162 B.R. at 517 (stating that a plan proposing to benefit the debtor must "place something material onto the scales to show a correlative benefit to the other unsecured creditors"). Both the four-factor test and the balancing approach point courts in the right direction. Fairness is a matter of necessity and balancing of interests.

Debtors' proposed plan cannot be confirmed because the proposed discrimination is neither necessary to the Debtors proceeding under Chapter 13 nor supported by the balancing of relevant parties' interests in light of the purposes of the Code. Debtors have not made any showing that the discrimination proposed would have any effect on the total amount of money made available to unsecured claims. Therefore, Debtors are not alleging that a nondiscriminatory plan is not possible, nor are they alleging that if allowed to discriminate between the classes of claims, the total amount of money made available to unsecured claims would be greater than that available under a nondiscriminatory plan. Accordingly, any additional money paid on the educational loans would result in correspondingly less money paid on the other unsecured claims. The reason for debtors wanting to pay a higher amount on educational loans is that educational loans are made nondischargeable by § 523(a)(8) and therefore survive a discharge under § 1328.

Debtors assert that they should be allowed to discriminate in favor of educational loans as, otherwise, their "fresh start" would be impeded. But giving debtors a fresh start is not the only purpose of the Code. Another equally important policy embodied in the Code is the fair treatment and strict prioritization of claims. *In re Ponce*, 218 B.R. 571, 577 (Bankr. E.D. Wa. 1998). *See In re Chapman*, 146 B.R. at 416 (stating that the Code offers debtors a fresh start, while offering creditors fair treatment of their claims). In addition, "nothing in the Code or case law...defines 'fresh start' as the emergence from bankruptcy completely free of all debt." *In re Sperna*, 173 B.R. 654, 659 (B.A.P. 9th Cir. 1994). Even without discrimination in favor of the educational loans, Debtors could emerge from bankruptcy with dischargeable debts discharged. Indeed, the very fact that some types of claims are not nondischargeable shows that the fresh start policy cannot trump the policies leading to the decisions to make such debts nondischargeable. *See, e.g., In re Groves*, 39 F.3d 212, 215 (8th Cir. 1994) ("While...the debtor [may] emerg[e] from his Chapter 13 plan with a continuing obligation which may impede the debtor's fresh financial start, such an imposition may be the result envisioned by Congress in amending § 1328(a)(2) to make student loans nondischargeable."); *In re McCullough*, 162 B.R. at 514 ("[T]he very Congressional decision that rendered student loans nondischargeable...reflected Congress' policy decision that excluded such debts from a pure fresh-start analysis[.]").

In making educational loans nondischargeable, Congress has promulgated the policy that those who benefitted from the loans should not be allowed to avoid the burden of repayment (except in the most dire circumstances). *See In re McCullough*, 162 B.R. at 516. Thus, as a general proposition, courts may not allow Chapter 13 debtors to shift the burden of nondischargeability to the holders of dischargeable claims. *See In re Colfer*, 159 B.R. 602, 610 (Bankr. D.Me. 1993) (stating that "courts should not approve as 'fair' discriminatory classification schemes 'needed' only for the purpose of mitigating the consequences of statutory discharge exceptions"); *In re McCullough*, 162 B.R. at 516. If Congress wanted to shift the burden of nondischargeability to holders of dischargeable claims, it could have granted educational loans a statutory priority. *In re Sperna*, 173 B.R. at 659; In *re Colfer*, 159 B.R. at 609; *In re McCullough*, 162 B.R. at 513-4. To allow debtors to discriminate in favor of educational loans would be to grant a de facto priority to educational loans, but this is a power that bankruptcy courts do not have. *Cf. U.S. v. Noland*, 517 U.S. 535, 536 (1996) (holding that "the bankruptcy court may not equitably subordinate claims on a categorical basis in derogation of Congress's scheme of priorities).

In addition, any argument that any degree of discrimination is fair as long as each class of claims would get at least as much as what they would get under Chapter 7 is without merit. Having chosen to proceed under Chapter 13, debtors may not seek to avoid the statutory requirements of Chapter 13, including the § 1322(b)(1) requirement against unfair discrimination. *See In re Ponce*, 218 B.R. at 578; *In re Williams*, 253 B.R. 220, 231 (Bankr. W.D. Tenn. 2000). The Court recognizes that debtors may seek to avoid the requirements of § 1322(b)(1) through a serial filing of Chapter 7 and Chapter 13. However, any such attempt by debtors would be subject to Code provisions designed to prevent abuse of the Code. *See In re Groves*, 39 F.3d at 215. Presumably, debtors file under Chapter 13 because it is to their advantage. *See, e.g., In re Ponce*, 218 B.R. at 578.

As mentioned, this is not a case in which the total amount of money payable under the plan depends on the debtors being allowed to discriminate. There may be cases in which a debtor could increase the aggregate amount of payments to holders of unsecured claims only if permitted to discriminate in favor of a particular holder of an unsecured claim. For example, the payment in full of a debt might be the prerequisite to obtaining a software license with which the debtor would be able to generate funds sufficient to pay a higher percentage of other unsecured claims than if the debtor lost the license, but not enough to pay one hundred percent of such claims. Such a plan would discriminate in favor of the licensor, but the discrimination would not be unfair because it would be calculated to increase the percentage of distributions to all creditors, albeit not equally. In such cases, the court could confirm the plan if it met other confirmation requirements.

There could be other situations in which a debtor could make a case for discriminating in favor of a particular creditor. For example, suppose an elderly parent of a debtor cosigned a nonconsumer debt that the debtor could not pay in full unless there were discrimination in favor of the creditor holding the claim against the debtor and the parent. Assume further that the parent could not maintain an adequate standard of living if he had to pay the portion of the debt that the debtor did not pay and that the debtor would be exposed to the risk of having to care for that parent. In that situation, discrimination might be deemed fair, particularly if the debtor's expenses could rise as a result of having to care for the parent by an amount greater than the differential between the amounts to be paid on the cosigned debt and the other unsecured debts.

Here is a harder case. Suppose that a debtor has ten unsecured creditors, nine of which hold dischargeable claims totaling in the aggregate $1,000, and one of which holds a nondischargeable claim in the amount of $1,000. Assume that the debtor can make plan payments that would permit payments on the unsecured claims totaling $1,000. Under a nondiscriminatory plan, each creditor would receive 50% of its claim. Suppose further that if allowed to pay the nondischargeable claim in full, the debtor could generate sufficient additional income to raise the distributions on all unsecured claims from $1,000 to $1,400. The debtor proposes to pay the nondischargeable claim of $1,000 in full and to pay to holders of dischargeable claims a total of $400 or 40% of each such claim, instead of 50%. Finally, assume that in a Chapter 7 case, the debtor's unsecured creditors would receive nothing. Would the proposed discrimination be "unfair?"

In this hypothetical, the holder of the nondischargeable claim and the debtor would both benefit if discrimination were allowed, and the plan proposes a higher total payout with respect to the aggregate amount of all unsecured debt. The unsecured creditors holding dischargeable claims would, however, receive as a group $100 less than they would if discrimination were not allowed. Would they, having a reasonable opportunity to receive 40% of their claims, instead of nothing in a Chapter 7 case, prefer the somewhat more certain but smaller payout or would they view the plan as unfair? If some of them expressed their preference for the smaller but more certain distribution, would that matter under the Code? At the very least, determining what is fair, under such circumstances, would require a court to carefully balance the interests of the parties in light of the purposes behind the Code. Indeed, the four-factor test, by asking the question of necessity, and the balancing approach, by asking the question of relevant parties' interests, both point courts in the right direction. Presently, the Court is not faced with a situation requiring such analysis.

The Court can think of no situation in a Chapter 13 case in which it would be fair to pay nondischargeable, nonpriority unsecured debt more than dischargeable, nonpriority debt merely because the former is nondischargeable.

Debtors have proposed a discriminatory plan that they have not contended or shown is necessary in order for them to have a Chapter 13 plan confirmed or that would enable them to pay more than what they could pay under a nondiscriminatory plan. Further, Debtors' interest in a fresh start completely free of educational loans is outweighed by the interests of holders of dischargeable claims in fair treatment of their claims according to the scheme of dischargeability and priority set up by Congress. Accordingly, Debtors' proposed plan discriminates unfairly against unsecured dischargeable claims and is therefore not confirmable.

For these reasons, it is

ORDERED that confirmation of Debtors' plan is DENIED. The Clerk is directed to serve a copy of this Order on Debtors, their counsel, the Trustee, and all creditors and other parties in interest in this case.

Dated: September 28, 2005.

James E. Massey

JAMES E. MASSEY
U.S. BANKRUPTCY JUDGE