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Jacob Burns Institute for Advanced Legal Studies
July 2010
Working Paper No. 302

The Federal Rules of Bankruptcy Procedure in Reorganization Cases: Do They Have a Constitutional Dimension?

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The Federal Rules of Bankruptcy Procedure in Reorganization Cases: Do They Have a Constitutional Dimension?

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84 Am. Bankr. L. Rev. No. 3 (2010)

Do the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules") have a constitutional dimension? If so, a reorganization plan that is confirmed in violation of the procedural rules is "void," within the meaning of Rule 60(b)(4) of the Federal Rules of Civil Procedure.[1]

Many courts of appeals so believed prior to March 2010.[2] The belief that the Bankruptcy Rules set the minimum due process in a bankruptcy case arguably found support in *City of New York v. New York, New Haven & Hartford R.R.*[3] In *City of New York*, a reorganization plan was held not to be binding on a secured creditor, because the creditor (the City of New York) had not received notice of an earlier bar date. Accordingly, the property of a reorganized entity created by a chapter 11 plan was not cleansed of the City of New York's tax liens. This "collateral attack" on the plan[4] might be explained if the confirmation order was unconstitutional for violating due process rights. But, then again, the City of New York has no due process rights. The City *is* the government. It owes due process rights to others but does not itself have such a right.[5] The status of *City of New York* has therefore always been most vague.

With *United Student Aid Funds, Inc. v. Espinosa*,[6] the mystery of due process in bankruptcy cases has been partially clarified. The Supreme Court has now laid to rest the theory that the Bankruptcy Rules have a constitutional dimension. Instead, the *Espinosa* court has made clear that due process for bankruptcy reorganization cases is defined (at most) by the minimalist standard of

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[1] Fed. Rules Bankr. P. 9024 makes Federal Rule of Civil Procedure Rule 60 applicable in bankruptcy proceedings.

[2] *E.g.*, Banks v. Sallie Mae Serv. Corp., 299 F.3d 296, 303 n. 4 ("We do not today hold that the Constitution in itself requires a summons and service of process to discharge student loan debt. We merely confirm that where the Bankruptcy Code and Rules require a heightened degree of notice, due process entitles a party to receive such notice before an order binding the party will be afforded preclusive effect.")

[3] 344 U.S. 293 (1953).

[4] Actually, the entity created by the plan sought declaratory relief that the City had no tax liens. So the City's "collateral attack" was defensive in nature.

[5] United States v. Cardinal Mine Supply, 916 F.2d 1087, 1090 (6th Cir. 1990) ("not decided upon due process grounds, for the city of New York . . . does not have a constitutional right to due process"); *but see* United States v. Hairopoulos (In re Hairopoulos), 118 F.3d 1240 1244 n.3 (8th Cir. 1997) (while *City of New York* is not technically a constitutional case, "courts have construed the notice requirement of the Bankruptcy Code to apply to 'all creditors,' vesting the government 'with a right akin to due process'") (citation omitted); *accord*, Joye v. Franchise Tax Board (In re Joye), 578 F.3d 1070, 1079 (9th Cir. 2010) ("In [*City of New York*], the Court extended this constitutional guarantee to governmental entities").

[6] 130 S. Ct. 1367 (2010).

Mullane v. Central Hanover Bank & Trust Co.[7] As every first year law student knows, *Mullane* bars notice by publication where the plaintiff knows the defendant's name and address.[8]

In depriving the Bankruptcy Rules of their lofty pretension to constitutional dignity, the Supreme Court has also implied that the *res judicata* power of plans confirmed in bankruptcy reorganizations is very absolute. It might have been possible, prior to *Espinosa*, to construct a statutory argument that at least some illegal plans have no *res judicata* worth. But that argument is rather more difficult, perhaps impossible, to sustain today. The strengthened role for *res judicata* will especially have an impact in chapter 13 cases, where courts had previously found a great many exceptions to *res judicata*.

In assessing the meaning of *Espinosa* for bankruptcy litigation, this Article unfolds in five parts. First, it describes the law prior to *Espinosa*, with special attention to lien avoidance. *Espinosa* is a discharge case involving a student loan. It involved a chapter 13 plan that purported to declare the student loan discharged, because its repayment would constitute an "undue hardship" within the meaning of Bankruptcy Code § 523(a)(8). Such plans are nicknamed declaration-by-discharge plans.[9] The true significance of *Espinosa*, however, far exceeds the not-unimportant context of student loans. The ability of a reorganization plan to scour property of liens is where *Espinosa* will have its largest impact. Part II discusses *City of New York*--a lien avoidance case which may or may not have been intended to be a constitutional pronouncement. Part III follows the *Espinosa* litigation through the appeals process and describes the Supreme Court's opinion, which, I will show, is covertly rife with contradiction. Part IV describes the probable impact of the case. Discussed here is the Supreme Court's ruling that lenders who do not show up to protest the plan do not waive their underlying substantive right to a nondischargeable claim. This right the bankruptcy courts are required to vindicate through increased vigilance. Argus-eyed judges are urged to impose sanctions on debtors who propose illegal plans. But the *Espinosa* court undercuts any sanction by authorizing the bankruptcy court to confirm a plan without an adversary proceeding whenever the court "determines" that confirmation is appropriate. This invitation suggests that declaration-by-discharge plans are not *per se* wrong and therefore are not usually sanctionable. Finally, Part V suggests that, in bankruptcy cases, *Mullane* is not even the minimum standard. In chapter 13 cases, thanks to some 2005 amendments to the Bankruptcy Code, creditors are on mere inquiry notice of plan confirmation. *City of New York* held otherwise in a pre-Code chapter 11 case, but *Espinosa* seemingly overrules *City of New York*, throwing open the door to even less due process than *Mullane* minimally requires.

I. The Law Prior to *Espinosa*

The dirty secret of bankruptcy litigation is that the procedures are so confusing, litigation is so rushed, and the stakes are so small that illegal plans are confirmed because creditors do not show up

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[7] 339 U.S. 306 (1950).

[8] In Mennonite Board of Missions v. Adams, 462 U.S. 79 (1983), a mortgage lender's name and city (but not exact street address) was known to the foreclosing party. This was held enough to trigger the letter requirement of *Mullane*.

[9] Educational Credit Management Corp v. Mersmann (In re Mersmann), 505 F.3d 1033, 1038 (10th 2007) (en banc).

to object. If they do show up and object, and if the plan is nevertheless confirmed, they may, of course, appeal. But if they never show up or never appeal, the plan supposedly becomes binding. Courts sometimes call this "practice by ambush."[10]

The binding nature of plans is broadly proclaimed in the bankruptcy reorganization chapters. In chapter 11, Bankruptcy Code § 1141(a) states:

> the provisions of a confirmed plan bind the debtor [and] any creditor . . . whether or not the . . . such creditor . . . is impaired under the plan and whether or not such creditor . . . has accepted the plan.

In chapter 13, § 1327(a) provides:

> [t]he provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.[11]

These are very categorical statements--so much so that courts have not taken them literally. Suppose, for instance, a plan invites the debtor to murder a creditor. Surely this is beyond the jurisdiction of a bankruptcy reorganization plan.[12] If so, there *are* limits to §1141(a) and § 1327(a). We simply don't yet know what they are.

The test of these *res judicata* provisions is the confirmation of an admittedly illegal reorganization plan. Confirmation itself requires notification to the creditors.[13] Notice of this sort, if done clearly and correctly, satisfies the minimal criteria of *Mullane*.

Yet, according to the Bankruptcy Rules, certain actions can only be accomplished in an adversary proceeding.[14] Salient on the list is the avoidance of liens. According to Rule 7001, "[t]he following are adversary proceedings: . . . (2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property."[15] So, depending on what "validity, priority or extent" of a lien means,[16]

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[10] Educational Credit Management Corp v. Mersmann (In re Mersmann), 505 F.3d 1033, 1048 (10th 2007) (en banc); Whelton v. Educational Management Corp., 432 F.3d 150, 153 (2d Cir. 2005).

[11] In this Article, I will ignore chapter 12, pertaining to farmers and anglers. The reader may presume that what is true for chapter 13 is true for farmers and fishermen, who have irregular income.

[12] *See generally* David Gray Carlson, *The* Res Judicata *Worth of Illegal Bankruptcy Reorganization Plans*, 82 TEMPLE L. REV. 351 (2009).

[13] According to Bankruptcy Rule 2002(b)(2), the clerk must send notice to all parties of the "time fixed for . . . confirmation of a . . . chapter 11, or chapter 13 plan." In a chapter 11 case, the plan (or a summary of the plan) must be distributed to creditors before votes may be solicited. 11 U.S.C. § 1125(b). In a chapter 13 case, the notice to creditors must include a copy of the plan. Fed. Rules Bankr. P. 3015(d). Only 20-day notice is required for confirmation in chapter 12. Fed. Rules Bankr. P. 2002(a)(8).

[14] Fed. Rules Bankr. P. 7001.

[15] On what these words mean, see Carlson, *Res Judicata*, *supra* note ---, at 366-67. Basically, these words do not encompass the value of the collateral, which might be ascertained in the absence of a adversary proceeding. *Id*. at 387-90.

lien avoidance requires an adversary proceeding. Also on the adversary proceeding list is "(6) a proceeding to determine the dischargeability of a debt." This was the provision that figured in *Espinosa*, in which a chapter 13 plan discharged a student loan--dischargeable only if payment would impose an "undue hardship" on the debtor.[17]

What is an adversary proceeding? Basically, it resembles civil litigation in federal district court,[18] though the adversary proceeding "is considered part of the original bankruptcy case and still within the bankruptcy court's *in rem* jurisdiction . . . ."[19] A complaint must be filed[20] and process must be served.[21] Time is given to answer.[22] A great many of the Federal Rules of Civil Procedure are incorporated into the bankruptcy equivalents.[23] An adversary proceeding therefore has more vigorous procedural protection than are accorded creditors in the context of plan confirmation.

In contrast, plan confirmation does not even require a motion. In chapter 13, the Bankruptcy Code simply instructs the court to hold a confirmation hearing. After the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), a deadline is set: the confirmation hearing must be held "not later than 45 days after the date of the meeting of creditors under section 341(a) . . . "[24] The first creditors' meeting, in turn, must be scheduled no more than 40 days after the bankruptcy petition.[25] As we shall see, this deadline has the arguable (and surprising) effect of reducing the due process bar even below the already minimal *Mullane* standard.[26]

May plan confirmation eliminate a lien without commencing an adversary proceeding? Basically, the Bankruptcy Code *invites* this. Both chapters 11 and 13 have a provision that describes what a plan may do, and this includes modifying the rights of holders of secured claims.[27] But this invitation is much tempered by cram down protection. In chapter 11 cases, this only occurs if a secured creditor is a member of a class that voted no on the plan.[28] In chapter 13 cases, there is no voting. All secured

[16] *See* Carlson, *Res Judicata*, *supra* note ---, at 366-68.

[17] 11 U.S.C. § 523(a)(8).

[18] Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 450, 451 (2004) ("this 'adversary proceeding' has some similarities to a traditional civil trial . . . ").

[19] *Id*.

[20] Rule 7003.

[21] Rule 7005.

[22] Rule 7007.

[23] Rule 7008, 7010, 7026-27 (incorporating various Federal Rules of Civil Procedure). On the differences between confirmation procedure and adversary proceedings, see Educational Credit Management Corp v. Mersmann (In re Mersmann), 505 F.3d 1033, 1042-43 (10th 2007) (en banc).

[24] 11 U.S.C. § 1324(b). The court is given discretion to hold an earlier hearing, but only if no one objects. There is no discretion to delay the hearing. *Id*.

[25] Fed. R. Bankr. P. 2003(a).

[26] *See infra* text accompanying notes ---.

[27] 11 U.S.C. §§ 1123(b)(5), 1322(b)(2).

[28] 11 U.S.C. § 1129(b)(2)(A).

creditors, however, are entitled to the value of their collateral, unless they consent to different treatment.[29]

Suppose, taking up this invitation, a debtor writes a plan that eliminates a lien (in whole or part) *without* honoring the cram down rules. Such a plan is typically not confirmable. Yet in the hurly burly of bankruptcy practice, often these plans are confirmed nevertheless, where the creditor forgets to show up and object. Especially in chapter 13 cases, where a plan avoids a lien, pre-*Espinosa* courts increasingly held that the plan has no *res judicata* worth where an adversary proceeding should have filed but was not.[30] In short, where the Bankruptcy Rules have been violated by failing to bring an adversary proceeding, the reorganization plan was thought to be nonbinding on the secured creditor, in spite of the Bankruptcy Code's broad "finality" provisions. Such a view coheres with the view that the adversary proceeding is the due process minimum--not *Mullane*. It equally coheres with the view that the broad finality provisions are in fact tempered by implicit exceptions intended (but not expressed) by Congress. Courts have previously agreed that plans do not always bind, but they have disagreed precisely as to why not. Some think the constitutional standard of due process deprives the plan of its *res judicata* worth. If so, the confirmation order is "void" as a judgment within the meaning of Federal Rules of Civil Procedure 60(b)(4).[31] Other courts think that, as a matter of statutory construction, the absolutist finality provisions in the Bankruptcy Code are riddled with implied exceptions and are not to be read literally.[32]

Although many chapter 13 cases protect lien creditors from the binding effect of the plan, chapter 11 case law has developed a different rule. Many courts have held that chapter 11 plans are binding on secured creditors who lose rights, even though no adversary proceeding was conducted. The leading case on that proposition is *In re Penrod*,[33] where an Article 9 security interest was eliminated with no adversary proceeding. But even the *Penrod* court added a nonstatutory rule that the secured creditor must have "participated" in the chapter 11 case.[34] "Participation" seemed to mean more than passively receiving notice of the confirmation hearing. The implication was that, where a creditor is duly notified of the plan but declines to participate, the plan cannot be binding on the creditor. Be that as it may, *Penrod* and its progeny never explained how an adversary proceeding is required in chapter 13 but not in chapter 11. If adversary proceedings are *constitutionally* required, are they not required *both* in chapters 11 and 13? Surely the Constitution does not alter its meaning, like Juliet's moon,[35] from chapter to chapter in bankruptcy cases.

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[29] 11 U.S.C. § 1325(a)(5).

[30] *E.g.,* SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin), 530 F.3d 230, 234 (3d Cir. 2008).

[31] *E.g.,* United States v. Hairopoulos (In re Hairopoulos), 118 F.3d 1240, 1244 (11th Cir. 1997).

[32] Educational Credit Management Corp v. Mersmann (In re Mersmann), 505 F.3d 1033, 1047-48 (10th 2007) (en banc).

[33] 50 F.3d 459 (7th Cir. 1995).

[34] 50 F.3d at 463 (chapter 11 confirmation destroys liens, "provided, we emphasize, that the holder of the lien participated in the reorganization").

[35] "O, swear not by the moon, th'inconstant moon, That monthly changes in her circled orb, Lest that thy love prove likewise variable." William Shakespeare, Romeo and Juliet.

The Fourth Circuit has attempted to distinguish the chapter 11 rule from the chapter 13 rule, based on the precise wording of the relevant finality statutes. In *Universal Suppliers, Inc. v. Regional Building Systems, Inc. (In re Regional Building Systems, Inc.)*,[36] the court found:

> Section 1327(c) states that the property covered by a Chapter 13 plan is free and clear of only those claims of creditors that the plan addresses. Under the plain terms of the statute, therefore, property of a Chapter 13 debtor can be subject to the continuing claims of creditors so long as those claims were not 'provided for' the debtor's Chapter 13 reorganization plan.[37]

Under 1141(c), the plan need only deal with property of the bankruptcy estate. If it does, then the property is scoured clean of all liens, unless the plan says otherwise. But in chapter 13, this is true only if the secured creditor's claim is "provided for" in the plan. The distinction between the chapters, the *Regional Building* court concluded, is "quite sensible."[38] Chapter 13 is a consumer chapter. Chapter 13 debtors don't (typically) operate a business. Chapter 13 creditors don't vote on the plan.[39] Chapter 13 invites plans to "ignore" secured claims (which then pass through the bankruptcy unaffected). Chapter 11 does not permit the plan to ignore secured claims. Because creditors vote in chapter 11, they need definitive information about property of the estate. All of this was supposedly the intent of Congress as wisely and skillfully embodied in the wording differences in § 1327(c) and § 1141(c).

This distinction, however, is one between § 1327(c) and § 1141(c). Independently, § 1327(a) and § 1141(a) provide that confirmation of a plan binds the creditors. According to § 1141(a):

> the provisions of a confirmed plan bind the . . . any creditor . . . whether or not the claim . . . of such creditor . . . is impaired under the plan and whether or not such creditor . . . has accepted the plan.

Section 1327(a) states:

> [t]he provisions of a confirmed plan bind . . . each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

Whatever differences exist in § 1327(c) and §1141(c), these differences are erased by the two above-quoted statutes, which make the plan binding on debtors. But even if we ignore § 1141(a) and 1327(a) and put on Fourth-Circuit-style blinders to examine § 1141(c) and § 1327(c) only, the distinction proposed in *Regional Building Systems* is simply not believable. If a chapter 13 plan

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[36] 254 F.3d 528 (4th Cir. 2001).

[37] *Id.* at 531. The Fourth Circuit similarly interpreted § 1327(c)'s "provided for" in Cen-Pen Corp. v. Hanson, 58 F.3d 89 (4th Cir. 1995).

[38] *Id*.

[39] *But see* In re Chappell, 984 F.2d 775, 778 (7th Cir. 1993) ("Failure to object to the confirmation of a Chapter 13 plan is deemed acceptance").

describes that a claim as unsecured,[40] why is not that claim "provided for by the plan," within the meaning of § 1327(c)? The Supreme Court itself has implied as much.[41] If a claim is "provided for" when it is deemed unsecured, the plan has killed off the lien.

II. *City of New York*

Many bankruptcy courts have held that, at least in chapter 13 cases and where the Bankruptcy Rules require it, an adversary proceeding is the constitutional infimum if a confirmation order is to avoid a lien.[42] This view is arguably grounded in a half-century old Supreme Court opinion, *City of New York v. New York, New Haven & Hartford R.R.*[43] In *City of New York*, the City had tax liens against property of the debtor railroad, which had filed for bankruptcy. At that time, the Bankruptcy Act instituted a bar date (to be set by the judge) that could destroy liens.[44] Today, under the Bankruptcy Code, missing the bar date could not have so devastating an effect on secured creditors.[45] But in the 1950's, the bar date had real fangs.

Given the City's failure to meet the bar date, the debtor-in-possession sponsored a plan whereby the debtor-in-possession would sell all assets to a new entity that would operate the railroad. Under the plan, confirmed by the district court, the City was deprived of its tax liens. The City never appeared to object to the loss of their liens. Later the new entity sought a declaration that the City had forfeited liens by not filing a proof of claim by the bar date and that the confirmation order had the effect of terminating the tax liens.[46]

The Bankruptcy Act at that time required that "[t]he judge shall cause *reasonable* notice of the period in which claims may be filed . . . by publication or otherwise."[47] Meanwhile, the Bankruptcy Act instructed the district court to require "proper persons to file in the court a list of all known creditors."[48] The purpose of this list was to facilitate notice by mail to all creditors of important

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[40] As it was in *Cen-Pen*, *supra*, a case that denied *res judicata* worth to a chapter 13 plan.

[41] In Rake v. Wade, 508 U.S. 464 (1993). the Supreme Court interpreted "provided for by the plan" means simply that the plan "'makes a provision' for, 'deals with,' or even 'refers to' a claim." *Id*. at 473-74. If the plan describes a creditor as unsecured, it "provides for" that claim. Hence § 1327(c) applies to kill off the lien (unless due process says otherwise).

[42] SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin), 530 F.3d 230, 234 (3d Cir. 2008), *citing* In re Harbor Tank Storage Co., 385 F2d 111, 115-116 (3d Cir. 1967).

[43] 344 U.S. 293 (1953).

[44] According to Bankruptcy Act § 77(c)(7), the "judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown . . . "

[45] 11 U.S.C. § 506(d)(2).

[46] 105 F. Supp at 414.

[47] 77(c)(8), 11 U.S.C. § 205(b) (repealed) (emphasis added).

[48] 11 U.S.C. § 205(c)(4) (repealed).

events in the bankruptcy proceeding. In *City of New York*, the district court had not performed this duty.[49] The City appeared on no matrix of creditors and so the City never received notice by mail of the bar date. Instead there was only publication of a notice in the *Wall Street Journal* and some out-of-state newspapers--the very mode of publicity condemned as inadequate by *Mullane v. Central Hanover Bank & Trust Co.*[50]

The Supreme Court, overruling the lower courts, held that the City was not on inquiry notice to discover what was occurring in the proceeding that could affect its rights:

> Nor can the bar order against New York be sustained because of the city's knowledge that reorganization of the railroad was taking place in the court. The argument is that such knowledge puts a duty on creditors to inquire for themselves about possible court orders limiting the time for filing claims. But even creditors who have knowledge of a reorganization have a right to assume that the statutory "reasonable notice" will be given them before their claims are forever barred.[51]

This last sentence has been taken to mean that the procedural rules governing in bankruptcy set the constitutional minimum for creditors.[52]

If I may digress briefly about *City of New York*, the Supreme Court mysteriously concerned itself solely with the bar date. Yet the confirmation order was an independent reason to believe that the City of New York had no liens on railroad property. If the City had received adequate notice of the confirmation hearing, it would seem irrelevant whether it had notice of the bar date. It could have raised the due process failure concerning the bar date as a reason not to confirm the plan. Indeed, the district court insinuated that it would have permitted the City to file a late proof of claim had it intervened in the confirmation proceeding.[53] We are given no facts on the quality of the City's

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[49] Judge Jerome Frank, who dissented in the affirmance by the Second Circuit, apologizes for dwelling on this judicial failing. "I must add parenthetically, that, in referring to the trial judge's neglect, I am not taking a superior attitude: Any judge, being a man [sic], may err at times, and certainly my memory of my own judicial career shows me that I have done so. But all that is beside the point here." 197 F.2d at 434.

[50] 339 U.S. 306 (1950). According to the *Mullane* court:

> It would be idle to pretend that publication alone, as prescribed here, is a reliable means of acquainting interested parties of the fact that their rights are before the courts. It is not an accident that the greater number of cases reaching this Court on the question of notice have been concerned with actions founded on the process constructively served through local newspapers. Chance alone brings to the attention of even a local resident an advertisement in small type inserted in the back pages of a newspaper, and if he makes his home outside the area of the newspaper's normal circulation the odds that the information will never reach him are large indeed. The chance of actual notice is further reduced when, as here, the notice required does not even name those whose attention it is supposed to attract, and does not inform acquaintances who might call it to attention. In weighing its sufficiency on the basis of equivalence with actual notice, we are unable to regard this as more than a feint.

Id. at 315.

[51] 344 U.S. at 297.

[52] *E.g.*, Paging Network, Inc. v. Nationwide Paging, Inc. (In re Arch Wireless, Inc.), 534 F.3d 76, 84 (1st Cir. 2008).

[53] In re New York, New Haven & H.R. Co., 105 S. Supp. 413, 420 (D. Conn. 1951).

knowledge of the confirmation hearing,[54] though it is impossible to believe that the City was unaware of the contents of the plan prior to confirmation, as the railroad was of considerable importance to the City.[55] Presumably, as it was not on the creditor matrix, the City received no *Mullane*-minimal letter about the confirmation hearing.

The District Court strongly asserted that the plan was clear; it eliminated the City's liens. Yet the Supreme Court denied *res judicata* respect to the plan because the logically separate bar date order had not been adequately noticed. The fact that a plan was confirmed is not even mentioned.[56] What are we to make of this?

One possibility is that the Supreme Court *sub silentio* viewed the plan as unclear, although the District Court had lengthily praised its crystalline transparency. A slender piece of evidence of this is the dissenting opinion from Judge Jerome Frank in the Second Circuit's affirmance of the District Court opinion. According to Judge Frank, the plan itself was confusing. It indicated that taxes were to be paid, which may have lulled the City that never sleeps into soporific indolence. "In any case," Judge Frank wrote, "whatever the proper construction of the plan, the questions were close enough, I think, to excuse the City from jumping from the knowledge of the proceedings to the knowledge that it must file a claim."[57]

Perhaps the Supreme Court meant to incorporate these thoughts in its holding. If so, the plan as confirmed did not, by its terms, destroy the City's lien, but the bar date might have done so independently. Accordingly, it became necessary for the Supreme Court to hold that the bar date had no effect on the City, as the procedure followed did not comport with the *Mullane* minimum.[58]

Is *City of New York* a due process case? The *City* Court cites *Mullane* for the proposition that notice by publication does not suffice where the court is apprised of the creditors' name and address. Citation of *Mullane* has been taken as evidence that the Court thought it was making a constitutional point.[59] The court also remarks that "[t]he statutory command for notice embodies a basic priority of justice--that a reasonable opportunity to be heard must precede judicial denial of a party's claimed

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[54] Judge Frank, in dissent, complains: "After the expiration of the period fixed in the bar order, the City (in some way not explained) heard of the pending reorganization proceedings, but never learned of the bar order." 197 F.2d at 429.

[55] *See generally* New Haven Inclusion Cases. 399 U.S. 392, 401 (1970) ("About 30,000 commuters used the line every day to reach work in New York City alone"). The plan was written by the Interstate Commerce Commission, which held substantial hearings concerning the valuation of railroad properties. In re New York, N.H.&H.R. Co., 54 F. Supp. 595 (D. Conn. 1943), *modified*, 147 F.2d 40 (2d Cir.), *cert. denied*, 325 U.S. 884 (1945). Could the entire government of the City of New York have been oblivious of these lengthy and painful proceedings?

[56] In a footnote, the Court noted, "The city has contended that the decree [*i.e.*, confirmation order] should not be so construed, but we find it unnecessary to discuss the question," 344 U.S. at 295 n.1.

[57] 197 F.2d at 434.

[58] Incidentally, it may be pointed out that the plan in the *New Haven* case was confirmed in 1945, long before the Supreme Court issued its opinion in *Mullane*. Judge Frank, however, was of the opinion that *Mullane* simply "summarized what the Supreme Court had been saying a long time before." 197 F.2d at 431.

[59] Eric S. Richards, Due Process Limitations on the Modification of Liens Through Bankruptcy Reorganization, 71 Am. Bank. L.J 43, 48 (1997).

rights."[60] It will be recalled that the Bankruptcy Act of the time provided that "[t]he judge shall cause *reasonable* notice of the period in which claims may be filed . . . by publication or otherwise."[61] The judge did indeed order mailings to the listed creditors. The City, however, simply was not on the list.

One possible reading of the case is that the City did not receive the *Mullane* minimum. The district court could not rely on notice by publication when the debtor knew the address of City Hall. The remark about creditors having the right to rely on adherence to procedural rules was merely a reference to the statue's requirement of "reasonable notice." The statute merely repeated the constitutional premise of *Mullane*. But the statute was not the determining ground for the Court's ruling. Rather, the due process clause of the Fifth Amendment grounded the Court's ruling. And *Mullane*, not the statutory procedures, set the due process minimum.

Some courts have indeed read *City of New York* as a due process case.[62] Some have cited *City of New York* outside of the bankruptcy context, indicating that the decision is of a constitutional dimension.[63] Meanwhile, some courts have held that, *City of New York* is not technically a constitutional case because the City is not a "person" within the meaning of the Fifth Amendment to the Constitution. Nevertheless, "courts have construed the notice requirement of the Bankruptcy Code to apply to 'all creditors,' vesting the government 'with a right akin to due process.'"[64] This warrants borrowing the rule of *City of New York* as the constitutional standard for bankruptcy cases.

On the other hand, could *City of New York* be explained as a statutory interpretation? That is, the Bankruptcy Act of that age made plans binding in very sweeping language, but hidden in the broad statement were implicit exceptions the Congress intended but forgot to set forth. Some courts have asserted that *City* is not a constitutional case; governmental entities do not have due process rights.[65]

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[60] 344 U.S. at 297.

[61] 77(c)(8), 11 U.S.C. § 205(b) (emphasis added).

[62] Paging Network, Inc. v. Nationwide Paging, Inc. (In re Arch Wireless, Inc.), 534 F.3d 76, 84-85 (1st Cir. 2008); United States v. Hairopoulos (In re Hairopoulos), 118 F.3d 1240, 1244 (11th Cir. 1997) ("The constitutional component of notice is based upon the recognition that creditors have a right to adequate notice and the opportunity to participate in a meaningful way in the course of bankruptcy proceedings"); In re Republic Trust & Sav. Co., 897 F.2d 1041, 1045 (10th Cir. 1990); Reliable Elec. Co. v. Olson Constr. Co., 726 F.2d 620, 622 (10th Cir. 1984); Frank Kennedy & Gerald K. Smith, *Postconfirmation Issues: The Effects of Confirmation and Postconfirmation Proceedings*, 44 S.C.L. REV. 621, 656-64 (1993).

[63] United States v. 125.2 Acres of Land, 732 F.2d 239, 242 (1st Cir. 1984); Smith v. United States, 403 F.2d 448, 450 (7th Cir. 1968); Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 569 (2d Cir. 1968); In re 1977 Mercury Coupe, 129 Ariz. 378, 631 P.2d 533 (1981).

[64] United States v. Hairopoulos (In re Hairopoulos), 118 F.3d 1240 1244 n.3 (8th Cir. 1997) (citation omitted); *accord*, Joye v. Franchise Tax Board (In re Joye), 578 F.3d 1070, 1079 (9th Cir. 2010) ("In [*City of New York*], the Court extended this constitutional guarantee to governmental entities").

[65] GAC Enters. v. Medaglia (In re Medaglia), 52 F.3d 451, 456 (2d Cir. 1995) ("It is apparent that the Court was construing what was then § 77 of the Act, dealing with railroad reorganizations, and not the Constitution"); Sequa Corp. v. Christopher (In re Christopher), 28 F.3d 512, 516 (5th Cir. 1994) ("the Court apparently decided the case on statutory rather than constitutional grounds"); United States v. Cardinal Mine Supply, 916 F.2d 1087, 1090 (6th Cir. 1990) ("not decided upon due process grounds, for the city of New York . . . does not have a constitutional right to due process"); In re Penn Central Transp. Co., 771 F.2d 762, 769 (3d Cir. 1985) ("The Supreme Court held that the city did not receive

On this view, *City* is a statutory construction case; the seemingly sweeping statutes that bind creditors to the terms of a confirmed plan had hitherto unknown implied exceptions.

According to Bankruptcy Act § 77(f)(7), as then in force:

> Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon . . . all creditors secured or unsecured, whether or not adversely affected by the plan, and whether or not their claim shall have been filed, and, if filed, whether or not approved including creditors who have not, as well as those who have, accepted . . . The property dealt with by the plan, when transferred and conveyed to the debtor . . . shall be free and clear of all claims of . . . creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer.[66]

Read literally, this provision means that the City would have lost its liens because they were not provided for in the plan, even if the City had filed a timely proof of claim. Yet the Supreme Court reversed the lower courts that had tried to enforce this language. *Ex hypothesi*, the confirmation order was not *constitutionally* void. It was merely *statutorily* void. The phrase "property dealt with by the plan . . . shall be free and clear" had within it an unstated assumption: failure to give the property owner the procedural protections the statute elsewhere required would be fatal to the "free and clear" effect of confirmation. Of course, this interpretation is compromised by the fact that the Supreme Court never refers to the bindingness of plan confirmation, or even to the plan at all, but only to the bindingness of the earlier bar date, about which the City never received a *Mullane*-minimal letter.

To summarize, there were three logical possibilities for interpreting *City of New York*. First, it could be taken to stand for the proposition that the procedural rules were irrelevant to the case. Rather, due process was violated because the procedure (which also happened to violate the rules) did not meet the *Mullane* standard. Second, it is possible that the case was simply about the procedural rule and made no constitutional holding at all. And third, the case constitutionalized the rules in the context of bankruptcy, so that failure to follow a procedural rule is *per se* a denial of due process.

If *City of New York* ever was a constitutional case, then it is surely overruled in *Espinosa*. If *City of New York* was a statutory case, *Espinosa* likewise overrules it. *Espinosa* therefore commences a new chapter in the story of due process in bankruptcy reorganization proceedings.

III. *Espinosa*

A. In the Lower Courts

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reasonable notice under section 77(c)(8) . . . ").

[66] In re New York, New Haven & H.R. Co., 105 S. Supp. 413, 417 (D. Conn. 1951).

One major feature of modern American life is access by students to loans in order to finance education.[67] Without inducement, lenders would not dream of lending students the funds for tuition.[68] So part of the post-New Deal program of the federal government has been to guarantee student loans. But this in turn created a bankruptcy worry. Upon graduating, and even if a lucrative job opportunity has been obtained, why shouldn't these students file for bankruptcy and have their student loans discharged (leaving the federal government holding the bag)?[69]

As originally promulgated in 1978, the Bankruptcy Code prohibited chapter 7 discharge of student loans for the first five years after a student loan became due.[70] Even this was later judged to be too generous. In subsequent amendments, the period was increased to seven years. Eventually, the time limit was entirely eliminated.[71] Meanwhile, discharge was available in chapter 13.[72] This invitation was closed in 1990 with an amendment to §1328(a)(2).[73]

Throughout this history of the tightening vice around the student neck, students could always obtain a bankruptcy discharge if repayment was an "undue hardship."[74] The Bankruptcy Code does not define this term, but case law has developed to require that the student debtor show:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.[75]

According to Bankruptcy Rule 7001(6), "The following are adversary proceedings: . . . (6) a proceeding to determine the dischargeability of a debt." Many debts, of course, are never dischargeable. When that is the case, the courts term the anti-discharge provision "self-executing."[76]

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[67] See generally Anthony P. Cali, Note, The "Sepcial Circumstance" of Student Loan Debt Under the Bankruptcy Abse Prevention and consumer protection Act of 2005, 52 ARIZ. L. REV. 473 (2010); For a history, see Nickolas Karavolas, Note, Heightened Notice Means Heightened Problems: Due Process Notice Concerns When Discharging Student Loan Debts Under Chapter 13, 37 HOFSTRA L. REV. 225, 227-29 (2008).

[68] Though undoubtedly they would be glad to advance subprime mortgage loans.

[69] As they would if students were given subprime mortgage loans.

[70] The five-year rule dates back to legislation promulgated in 1976. 20 U.S.C. §1087-3(a)(1976) (repealed).

[71] Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971. 112 Stat. 1581, 1837 (1998) (eliminating seven-year rule).

[72] Education Assistance Corp. v. Zellner, 827 F.2d 1222, 1224 (8th Cir. 1987).

[73] Student Loan Default Prevention Initiative Act of 1990, Pub. L. No. 101-508, 3007, 104 Stat. 1388-25, 1388-28 (1990).

[74] 11 U.S.C. § 523(a)(8).

[75] Brunner v. New York State Higher Ed. Servs. Corp., 831 F.2d 395, 396 (2d Cir. 1987).

[76] Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 450 (2004) ("Section 523(a)(8) is "self-executing. Unless the debtor affirmatively secures a hardship determination the discharge order will not include a student loan debt.").

When a discharge or anti-discharge rule self-executes, no adversary proceeding need be commenced. But sometimes a creditor must step forward to prevent discharge. Otherwise, a discharge can and even must be ordered.[77] In the case of student loans, the *debtor*, supposedly, must step forward to achieve the discharge.[78] In either case, when someone must step forward to reverse the discharge rule, an adversary proceeding is required.

In *Espinosa v. United States Aid Funds, Inc*.,[79] a bankruptcy court confirmed a plan that called for a student loan to be discharged at the end of the plan (even though discharge is prohibited by § 1328(a)(2)).

Can a plan validly achieve such an end? We saw earlier that both chapter 11 and 13 invite modification of liens (though subject to minimal cram down protections).[80] But neither chapter invites discharge of an otherwise undischargeable claim. Rather, discharge is achieved by a statutory provision that stands apart from the content of a confirmed plan. In chapter 11, corporate or partnership debtors are discharged by the very fact of plan confirmation, but discharge is unaffected by anything *in* the plan. For individuals, "confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge upon completion of all payments under the plan."[81] Even then, no claim of any sort described in § 523(a) is discharged.[82] This includes student loans and a great many other things. So chapter 11's discharge is narrower than the chapter 13 discharge.[83] In chapter 13, discharge is governed by § 1328(a), which requires a court to grant the debtor a discharge of all debts "as soon as practicable after completion by the debtor of all payments under the plan . . . " But expressly prohibited is the discharge of any debt described in §523(a)(8)[84]--to wit, student loans.

Prior to *Espinosa*, most courts thought that a plan may *not* provide for the discharge of a student loan. But what if an illegal plan was nevertheless confirmed because the student lender did not object to the plan? It is easy to see that such a plan has no *res judicata* value, if there is a constitutional dimension to the Bankruptcy Rules. If discharge must be "determined," an adversary proceeding is required by Bankruptcy Rule 7001(6). Any failure to proceed in this way would be, on this line of thinking, a due process violation. Accordingly, the plan would have no *res judicata* worth against the

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[77] 11 U.S.C. § 523(c)(1) (listing claims that are discharged unless the creditor objects).

[78] *Id*. at 451. As a thought experiment, I will question whether such an assumption can be grounded in the actual language of the Bankruptcy Code. *See infra* text accompanying notes ---.

[79] 130 S. Ct. 1367 (2010).

[80] *See supra* text accompanying notes ---.

[81] 11 U.S.C. § 1141(d)(5).

[82] 11 U.S.C. § 1141(d)(2).

[83] As originally enacted, section 1141(a) provided for discharge when a plan is confirmed, not when the plan is completed. BAPCPA, however, deferred the individual's discharge to the completion of the plan, so that, on this score, chapter 11 for individuals now comports with chapter 13.

[84] 11 U.S.C. § 1325(a)(2).

student lender.[85]

In *Espinosa*, following confirmation of the plan and discharge of the student loan debt, the student lender intercepted the debtor's tax refunds. The debtor claimed this to be a violation of the discharge injunction of § 524(a)(3). But such a claim required the view that the student loan was really discharged by the terms of the plan. In any case, the student lender cross-moved under Rule 60(b)(4) to have the confirmation order revoked as "void." And it could only be void if it was unconstitutionally entered in violation of the lender's due process rights. In effect, the *Espinosa* case turned on whether the plan was entitled to *res judicata* respect.

The district court expressly held that failure to hold the adversary proceeding violated the constitutional rights of the student lender.[86] The Ninth Circuit reversed, however. True, the plan should not have been confirmed in the absence of an adversary proceeding to determine undue hardship. Failure to bring the adversary proceeding requires a bankruptcy court to deny confirmation of the plan.[87]

But, even though error had occurred, there was no violation of the lender's due process rights.[88] So where the student lender failed to make an objection, and where the plan was confirmed, and where the minimal notice rules for confirmation were met, the plan discharging the student debt was binding on the student lender.

The Ninth Circuit went further. It ruled that, where the student loan creditor did not object, the bankruptcy court was *obliged* to confirm the plan. This was because the student lender's failure to object was to be equated with consent to the plan: "If the creditor fails to object, it is doubtless the result of a careful calculation that this course is the one most likely to yield repayment of at least a portion of the debt. In such circumstances, bankruptcy courts have no business standing in the way."[89] In short, students lenders were seen to be rational actors weighing the benefits of objecting to the plan against the cost of doing so.

B. The Supreme Court Opinion

On further appeal, the Supreme Court put to rest the venerable suspicion that the Bankruptcy Rules have a constitutional dimension. Although the Rules bestowed upon the lender a right to an adversary proceeding, the lender did not thereby have a due process claim upon being deprived of it. At best, the student lender "could have timely objected to this deprivation and appealed from an

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[85] Ruehle v. Educational Credit Management Corp. (In re Ruehle), 412 F.3d 679 (6th Cir. 2005).

[86] 130 S. Ct. at 1375.

[87] 545 F.3d at 1118 ("If a debtor proposes to discharge a student loan debt without invoking the special procedures applicable to such debts, the creditor can object to the plan until the debtor shows undue hardship in an adversary proceeding").

[88] *Id*. at 1123 ("we find it both wrong and dangerous to hold that the standard for what amounts to constitutionally adequate notice can be changed by legislation").

[89] *Id*. at 1125.

adverse ruling on its objection.[90] But this deprivation did not amount to a violation of [the lender's] constitutional right to due process."[91] So long as the minimal *Mullane* standard was met, the Court reasoned, due process was mollified.[92] Accordingly, the confirmed plan was worthy of *res judicata* respect.[93]

How can *Espinosa* be reconciled with *City of New York*? Emulating President Ford,[94] the *Espinosa* Court did not even acknowledge the existence of *City of New York*. Perhaps the reason why is that the Court implicitly thought *City* never was a constitutional case. Hence, there was no reason to announce its supersession.[95]

If the constitutional argument has disappeared, has the statutory construction argument survived? Do the absolute finality provisions of chapters 11 and 13 contain implicit exceptions that Congress intended but forgot to set forth? Prior to *Espinosa*, courts thought that, constitutional considerations to one side, the very meaning of § 1327(a) was subject to implicit limitations. For instance, in *In re McKay*,[96] a debtor sought to avoid liens in a chapter 13 plan without the adversary proceeding and cited § 1322(b)(11) as authorizing "any other appropriate provision not inconsistent with this title."[97] The debtor admitted violating the Rules, but insisted that such conduct was sanctified by § 1322(b)(11). According to the *McKay* court, "we do not believe that a substantive catch-all provision such as section 1322(b)(11) contains the required specificity or force to suggest that Congress intended it to override the [Bankruptcy Rules]." [98] In other words, the *McKay* court simply didn't think Congress intended to be taken literally. If the Bankruptcy Rules can override § 1322(b)(11) on grounds of congressional intent, then certainly they can do so with regard to § 1327(a), which is equally categorical.[99] The premise is that, when Congress makes broad categorical statements like those in § 1322(b)(11) or § 1327(a), it did not seriously intend to invite the bankruptcy courts to

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[90] Presumably by this the Court means that the lender could have appealed *and won*. The Court makes Glendower's mistake. Glendower claims, "I can call spirits from the vasty deep." But Hotspur responds, "Why, so can I, or so can any man; But will they come when you do call for them?" WILLIAM SHAKESPEARE, HENRY IV (PT. 1), Act 3 Sc. 1.

[91] 130 S. Ct. at 1378.

[92] *Id*.

[93] The Ninth Circuit had denied that the case turned on *res judicata* of the confirmation order. 454 F.3d at 1119. Rather, it thought that the issue was whether the discharge order was entitled to *res judicata*. The Supreme Court, properly, saw the issue as whether the confirmation order could be overturned. 130 S. Ct. at 1376; Walker v. Sallie Mae Servicing Corp. (In re Walker), In re 427 B.R. 471 (Bankr. 8th Cir. 2010).

[94] Ford to New York: Drop Dead. Vows He'll Veto Bail-Out, N.Y. Daily News p. 1 (1975).

[95] It was cited as such by the lender's brief to the Court. Appellant-Petitioner Reply Brief, at 26 ("Rather, the Code and Rules establish heightened procedural protections for the discharge of student loan debts, and due process requires that those protections be given full force") (*citing City of New York*).

[96] 732 F.2d 44 (3d Cir. 1984).

[97] In 1984, this was enumerated as § 1322(b)(1).

[98] 732 F.2d at 48.

[99] SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin), 530 F.3d 230, 236 (3d Cir. 2008) (citing *McKay*).

ignore the Bankruptcy Rules.[100]

Any such theory based on what Congress intended are negated by *Espinosa*, which implies that § 1327(a) is to be read without implicit exceptions. Debtors are protected by § 1327(a) whether or not the plan is illegal by statute or by Bankruptcy Rule.

IV. Impact

A. Judicial Duty to Deny Confirmation in the Absence of an Objection

Although the *Espinosa* court made itself clear enough on the constitutional status of the Bankruptcy Rules, the Court was oddly ambiguous on the substantive law of chapter 13. Are declaration-by-discharge plans confirmable? In one passage, the Court appears to suggest that student lenders may insist that the debtor bring an adversary proceeding against them--and if they do, the plan must not be confirmed.[101] But where the lady doth not show up to protest too much, the bankruptcy court is invited to confirm the plan anyway.[102] That is to say, a student lender waives its procedural right to an adversary proceeding when it does not show up.[103]

Yet even while insinuating that the bankruptcy court can skip the adversary proceeding if the

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[100] In Educational Credit Management Corp v. Mersmann (In re Mersmann), 505 F.3d 1033, 1047-48 (10th 2007) (en banc), the Tenth Circuit ruled as a statutory matter that "discharge-by-declaration" terms were never binding on creditors, in spite of the broad language of § 1327(a). *See also* Whelton v. Educational Management Corp., 432 F.3d 150 (2d Cir. 2005) (holding the discharge-by declaration clause is void, though not on unconstitutional grounds).

Even apart from § 1327(a), the *Mersmann* court thought that, apart from § 1327(a), the common law of *res judicata* does not bind student lenders to the terms of a confirmed plan. The posture of this argument is that, even if debtors may not rely on § 1327(a) to bid the creditor, perhaps they might still be entitled to claim *res judicata*. The *Mersmann* court found plan confirmation as generally not worthy of common law *res judicata*:

> Res judicata requires the satisfaction of four elements: (1) the prior suit must have ended with a judgment on the merits; (2) the parties must be identical or in privity; (3) the suit must be based on the same cause of action; and (4) the party must have had a full and fair opportunity to litigate the claim in the prior suit.

Plan confirmation supposedly fails the first and fourth premises. First, if the student lender failed to show up, plan confirmation is not an adjudication on the merits. Here the Tenth Circuit inexplicably ignores the fact that the student lender *could* have shown up to litigate, which it admits is enough to satisfy the first requirement.

With regard to the fourth premise, because the debtor did not commence an adversary proceeding, the student lender has not received a full and fair opportunity to litigate. But this just repeats the now-discredited theory that the Bankruptcy Rules constitute the minimal criteria of fairness. Certainly the meaning of *Espinosa* is that *Mullane* describes of what a full and fair opportunity to litigate consists.

[101] *Id* at 1371 ("United could have timely objected to this deprivation [of an adversary proceeding], and appealed from an adverse ruling on its objection").

[102] *Id*. at 1377 ("§ 523(a)(8)'s statutory requirement that a bankruptcy court find undue hardship before discharging a student loan debt is a precondition to obtaining a discharge order . . . ").

[103] In re Ginthier, 427 B.R. 450, --- (Bankr. ND. Ill. 2010).

debtor does not show up, the *Espinosa* Court strongly disapproved of Ninth Circuit dictum requiring a bankruptcy court to approve a "discharge-by-declaration" plan where the student lender is a no-show. Such a plan, supposedly, does not comply with § 1325(a), which requires a bankruptcy court to confirm a chapter 13 plan if, among other requirements, "the plan complies with the provisions" of the Bankruptcy Code.[104] A declaration-by-discharge plan, the Court suggested, does not comply with the Bankruptcy Code § 523(a).[105] "Given the Code's clear and self-executing requirement for an undue hardship determination, the Bankruptcy Court's failure to find undue hardship before confirming Espinosa's plan was a legal error."[106] Significantly, the Court goes on to state that, even where the student lender does not object,

> the Code makes plain that bankruptcy courts have the authority--indeed, the obligation--to direct a debtor to conform his plan to the requirements of §§ 1328(a)(2) and 523(a)(8) . . . [T]he 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.[107]

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[104] *Id*. at 1381. *Espinosa* should, at last, put an end to a theory recently asserted in the Third and Seventh Circuits that a bankruptcy court has discretion to confirm a plan *even if it does not conform* to § 1325(a). SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin), 530 F.3d 230, 238 (3d Cir. 2008); In re Szostek, 886 F.2d 1405, 1411 (3d Cir. 1989); In re Burgess, 143 Fed. Appx. 692 (7th Cir. 2005). This theory is based on the notion that § 1325(a) requires confirmation if the plan complies with all the subparagraphs of § 1325(a). It supposedly says nothing about plans that *do not* conform. Under this view, courts have discretion to confirm such plans (so long as the plan conforms to § 1322(a)'s mandatory requirements). Meanwhile, § 1129(a), the comparable chapter 11 provision, states that "only if" all the different subparagraphs of § 1129(a) are met may the court confirm a plan. Accordingly, the theory continues, Congress must have intended to grant discretion to confirm nonconforming plans in chapter 13 cases. In *Espinosa*, however, the court makes clear (perhaps not for the first time) that courts have a *duty* not to confirm plans that fail to meet one or more of the requirements of § 1325(a). Associates Commercial Corp. v. Rash, 520 U.S. 681 (1997) ("To qualify for confirmation under Chapter 13, the [debtors] plan had to satisfy the requirements set forth in § 1325(a) of the Code"); *see* Universal American Mortg. Co. v. Bateman (In re Bateman), 331 F.3d 821, 832 n.7 (11th Cir. 2003) ("this question appears to be settled by [*Rash*]").

[105] According to this provision:

> A discharge under section 727, 1141, 1328(a), 1228(b), or 1328(b) of this title does not discharge an individual d from any debt . . .
>
> (8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for [enumerated student loans].

Note that the preamble to §523(a) fails to enumerate § 1328(a). This failure is based on the initial congressional intent to make student loans dischargeable in chapter 13 case. But § 1328(a) excludes from discharge "any debt . . . (2) of the kind specified in paragraph (8) of section 523(a)." It is clear, then, that a chapter 13 discharge cannot affect a student loan.

Section 1328(b), however, is cross-referenced. This refers to the so-called hardship discharge. If a debtor defaulted on the plan "due to circumstances for which the debtor should not just be held accountable" and has paid at least what the creditors would have received in a chapter 7 case, the court may grant what is basically the chapter 7 discharge, which expressly excludes student loans.

[106] *Id*. at 1375.

[107] *Id*. at 1381.

Nevertheless, the Court invites bankruptcy judges to confirm declaration-by-discharge plans, once they determine that the failure to get a discharge would constitute an undue hardship on the debtor.[108] Such a determination may be made at the confirmation hearing, in violation of the Bankruptcy Rules. If the undue hardship is found to exist, the plan is confirmable.

The following observations may be made about this advice. First, the Court states that bankruptcy judges are *obliged* to direct a debtor to conform the plan to comply with §523(a)(8) and § 1326(a): "contrary to the Court of Appeals' assertion, the Code makes plain that bankruptcy courts have the authority--indeed, the obligation--to direct a debtor to conform his plan to the requirements of §§ 1328(a)(2) and 523(a)(8)."[109] Presumably this means only that the court is to refuse confirmation and is then to inform the debtor that the price of confirmation is an amendment of the plan. Chapter 13 is premised on the debtor's authorship of the plan.[110] Surely, the court cannot cram down a plan against the debtor's wishes.[111]

Second, suppose a plan proposes to discharge a student loan. The *Espinosa* Court authorizes the bankruptcy court to "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."[112] Does the Court mean to suggest that, instead of an adversary proceeding, a bankruptcy court may hold a hearing on undue hardship at the confirmation hearing? If so, the *Espinosa* Court is amending the Bankruptcy Rules, which currently require the debtor to commence an adversary proceeding in order to obtain the discharge.

On this last point, the Court is taking a rather contradictory position. On the one hand, a student lender has a right against discharge in any case where there is no hardship. If the lender does not bother to show up at the confirmation hearing, the lender has not waived this right. On the other hand, the student lender has the right to litigate the hardship question *in an adversary proceeding*.[113]

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[108] *Id*. at 1372 ("§ 523(a)(8) requires a court to make a certain finding before confirming the discharge of a student loan debt").

[109] 130 S. Ct. at 1381.

[110] This is so because chapter 13 seems to smack of peonage, where a plan requiring the debtor to pay wages is imposed on the debtor against his will. H.R. Rep. No. 95-595, at 120 (1977) ("Though it has never been tested in the wage earner plan context, it has been suggested that a mandatory chapter 13, by forcing an individual to work for creditors, would violate this prohibition").

[111] But see In re Webber, 251 B.R. 554, 558 (Bankr. D. Ariz. 2000) ("Debtor's counsel is directed to file an amended plan that eliminates the provision attempting to establish the basis for discharge of the student loans"). One of the shadowy questions about chapter 13 cases is whether courts may impose plan terms on debtors in confirmation orders. There is some authority that this may not be done. Anderson v. Satterlee (In re Anderson), 21 F.3d 355 (9th Cir. 1994). On the other hand, § 1327(a) states that property of the bankruptcy estate is conveyed back to the debtor "[e]xcept as otherwise provided in the plan *or in the order confirming the plan* . . . " The italicized language could be read as giving the court discretion to impose plan terms on the debtor with which the debtor does not agree. Presumably, the italicized words are limited to the case where the debtor has *agreed* with the merits of the extra terms imposed by means of the confirmation order. David Gray Carlson, *Modified Plans of Reorganization and the Basic Chapter 13 Bargain*, 83 AM. BANKR. L.J. 585, 626 (2009).

[112] *Id*. at 174.

[113] As the Supreme Court affirms. 130 S. Ct. at 1378 (student lender "could have timely objected to this deprivation

This right, it appears, is waived if the lender does not show up at the confirmation hearing and insist upon the procedures attendant to an adversary proceeding. Failing to show up is no waiver of the underlying right to resist discharge-by-declaration, but it *is* a waiver of the right to an adversary proceeding. Not showing up means waiver and no waiver simultaneously.

Third, a question arises as to the evidence required for a court to determine whether an undue hardship exists. Must the bankruptcy court insist on evidence on the record? If not, the requirement of a determination is empty. Basically, it just means that the confirmation order must recite the fact of the undue hardship. The Court might be read as requiring a determination, but not necessarily evidence to support it.[114]

Absurd, you may say, but any different conclusion puts the Supreme Court at odds with the Bankruptcy Rules. According to Rule 3015(f)(2):

> If no objection [to confirmation] is timely filed, the court may determine that the plan has been proposed in good faith and not by any means forbidden by law without receiving evidence on such issues.

Does not this rule absolve the bankruptcy court from taking evidence at all? Or shall we read the Supreme Court as overriding the Bankruptcy Rules a second time[115]in order to demand evidence in spite of Rule 3015(f)(2)? We may also note that the word "evidence" nowhere appears in the Supreme Court opinion. So, given Rule 3015(f), a bankruptcy court is justified in taking no evidence on the question of undue hardship. If that is the case, the all the Supreme Court is demanding is the court's standard-form confirmation order must make reference to the existence of a hardship (even though there is no evidence on the record to support it).

Yet it is hard to accept the fact that the Supreme Court is not demanding evidence in contravention of the Rules. The Court writes: that "bankruptcy courts have the authority--indeed, the obligation--to direct a debtor to conform his plans to the requirements of §§ 1328(a)(2) and 523(a)(8)."[116] A declaration-by-discharge plan conforms to § 523(a)(8), if indeed there is an undue hardship. How can the court do its duty *unless* it demands evidence and finds no hardship? If this follows, the court has a duty to demand evidence. Yet imposition of such a duty violates the Bankruptcy Rules.

A complicating factor about Rule 3015(f)(2) must be acknowledged. According to § 1325(a), the court must confirm if

> (1) the plan complies with the provisions of this chapter and with the other applicable

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[of an adversary proceeding] and appealed from an adverse ruling on its objection").

[114] For that matter, if no evidence is required, why can't the mere confirmation of a declaration-by-discharge plan constitute the required finding? Perhaps the *Espinosa* Court wants a signal that the bankruptcy judge is paying attention.

[115] The first time being suspending the requirement of an adversary proceeding for student hardship discharges. *See supra* text accompanying notes ---.

[116] 130 S. Ct. at 1381.

> provisions of this title ; . . .
>
> (3) the plan has been proposed in good faith and not by any means forbidden by law . . .

One can see that, in chapter 13, the requirement of *legality* is twice stated. First, the plan must be legal under the Bankruptcy Code. Second, the plan must be legal under "law." The third subparagraph seems to swallow whole the first subparagraph.

It is palpable that the sentence from Rule 3015(f)(2) is keyed to the language of § 1325(a)(3), not subparagraph (a)(1). Meanwhile, the Supreme Court grounded the bankruptcy court's independent duty to block illegal plans as based on (a)(1). Here is how the Court describes this judicial duty:

> [A] Chapter 13 plan that proposes to discharge a student loan debt without a determination of undue hardship violates §§ 1328(a)(2) and 523(a)(8). Failure to comply with this self-executing requirement should prevent confirmation of the plan even if the creditor fails to object, or appear in the proceeding at all. That is because § 1325(a) instructs a bankruptcy court to confirm a plan only if the court finds, *inter alia*, that the plan complies with the "applicable provisions" of the Code.[117]

This duty to deny confirmation is keyed to the language of § 1325(a)(1), whereas Rule 3015(f)(2) is keyed to the language of § 1325(a)(3). Yet even though the language of Rule 3015(f)(2) *resembles* the language of (a)(3), its terms are not exclusively limited thereto. It would seem to dispense with the need for evidence with regard to *any* showing of legality, whether it be Bankruptcy Code legality or legality under nonbankruptcy law.[118]

Not only does the Supreme Court seem to be undercutting the Bankruptcy Rules, but it seems to be doing so without much justification from the Bankruptcy Code. Where is it written that a judge must *determine* that an undue hardship exists? The Supreme Court has previously assumed so,[119] though Justice Clarence Thomas (author of *Espinosa*) has, in a dissent, assumed otherwise when an adversary proceeding is actually commenced.[120] The Bankruptcy Code, however, never says expressly that undue hardship must be *found* or *determined* by a court.

As a thought experiment, let us examine an alternative reading of the Bankruptcy Code--one that

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[117] *Id*. at 1381.

[118] What if a student lender actually *agrees* that the debtor has a hardship. This the *Espinosa* Court concedes is a possibility. "Neither the Code nor the Rules prevent the parties from stipulating to the underlying facts of undue hardship." 130 S. Ct. at 1381. What the Court seems to have in mind is that the debtor provide evidence of the stipulation. The student lender's mere failure to object cannot be taken as consent to the plan, under the Court's dicta.

[119] Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 444 (2004) (reading § 523(a)(8) as "providing that a discharge under § 727(a) discharges the debtor from all prepetition debts except as listed in § 523(a)"), 453 ("the Bankruptcy Court cannot discharge her debt without making an undue hardship determination").

[120] *Id*. at 459 ("Here, if the State [as student lender] does not oppose the debtor's claim of undue hardship, the Bankruptcy Court is authorized to enter a default judgment *without making an undue hardship determination*") (emphasis in original).

is actually followed with regard to certain creditors who are not student lenders but who are similarly treated by the Bankruptcy Code.

In chapter 7 and 13, a discharge must be *granted* in a court order.[121] In chapter 7 cases, creditors are given a short 60 day limitation period in which to challenge the debtor's right to a discharge.[122] If there are no objections, the debtor still has some obstacles to the grant of discharge. These impediments include, first, that there must be no motions to dismiss the chapter 7 case under § 707,[123] and the time period for filing such motions must have lapsed.[124] Fees must have been paid.[125] Tax returns have been filed.[126] And, irksomely, the debtor must have "filed with the court a statement regarding completion of a course in personal financial management as required by Rule 1007(b)(7)."[127] Once these and a few other obstacles have been cleared away, "the court shall forthwith grant the discharge."[128]

So much for chapter 7 discharges, but how do these rules translate to chapter 13 cases? They don't. Suppose a chapter 13 debtor deliberately transfers, mutilates or conceals property of the bankruptcy estate,[129] destroys and falsifies financial records,[130] knowingly makes a false oath,[131] bribes a court officer,[132] and refuses to obey various court orders.[133] Any one of these acts would cause the loss of a chapter 7 discharge. Suppose further that, in spite of these acts, the court confirms a plan and the debtor has completed it.[134] None of these bad acts justifies a denial of a chapter 13 discharge.[135] Therefore, the chapter 7 rules described above typically do not apply in chapter 13 cases. There is some method to this madness. Most of the sins listed in § 727(a) are designed to

[121] 11 U.S.C. §§ 727(a), 1328(a).

[122] Fed. Rules Bankr. P. 4004(a).

[123] Fed. Rules Bankr. P. 4004(c)(1)(D).

[124] *Id*. 4004(c)(1)(E) & (F).

[125] *Id*. 4004(c)(1)(G).

[126] *Id*. 4004(c)(1)(K).

[127] *Id*. 4004(c)(1)(H). This bit of torture stems from BAPCPA. 11 U.S.C. § 727(a)(12).

[128] Fed. Rules Bankr. P. 4004(c)(1).

[129] 11 U.S.C. § 727(a)(2),.

[130] 11 U.S.C. § 727(a)(3).

[131] 11 U.S.C. § 727(a)(4)(A).

[132] 11 U.S.C. § 727(a)(C).

[133] 11 U.S.C. § 727(a)(6)(A).

[134] This would imply that the bankruptcy court could not revoke confirmation on the ground of fraud, as a request for revocation must come within 180 days of confirmation. 11 U.S.C. § 1330(a). Since a plan must last a minimum of three years, 11 U.S.C. § 1325(b)(1), (4), its completion suggests revocation is impossible. I am ignoring modification under § 1329(a)(2), wherein the time of payment may be shortened.

[135] According to § 1328(e), chapter 13 discharges may be revoked if "(1) such discharge was obtained by the debtor through fraud; and (2) the requesting party did not know of such fraud until after such discharge was granted." My examples presuppose bad acts not related to actual obtainment of the discharge.

punish assaults on the integrity of the bankruptcy estate. But in chapter 13, the debtor is entitled to retain the bankruptcy estate[136] in exchange for disposable income in the future. Any assault on the bankruptcy estate is an assault on the debtor's own self, not on the unsecured creditors, who look to the future disposable income for compensation.

Section 523(a) includes many claims that are never discharged, but some of the listed items are not so absolute. Student loans are one example. These are not discharged, "unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents . . . "[137] But before we explore the procedural implications of this phrase, we shall examine a different class of claims that are conditionally dischargeable. According to § 523(c) a debtor *is* discharged from any claim described by §523(a)(2), (4), or (6), "unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6)." In short, the claims described in these paragraphs[138] are presumed discharged unless the creditor steps forward to request otherwise.

Compare this rule to the student loan. Nothing in the Bankruptcy Code expressly requires the debtor to step forward to reverse the presumption of § 523(a)(8). Congress knew how to force the hand of creditors claiming fraud or malicious injury. But they did not expressly require students to step forward and obtain a discharge. Why then must we presume that a student loan is *not* discharged, when the debtor has not stepped forward to seek a determination that undue hardship exists? Why assume anything at all about the meaning of the discharge order, as it applies to student loans? Perhaps the discharge order means that the student loan is discharged depending on whether the underlying undue hardship exists.

At least in one other circumstance, we are to presume nothing about the meaning of the discharge, until the occasion arises to test its existence. According to § 523(a)(3), claims are not discharged if

> neither listed nor scheduled under section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit
>
> (A) . . . timely filing of a proof of claim, unless such creditor had notice or actual condition of the case in time for such timely filing . . . [139]

Suppose a creditor is not listed and a discharge order ensues. We do not know whether the creditor's claim is discharged or not. If the creditor knew of the bankruptcy in general, the claim is discharged. Or, if the creditor did not know and if the debtor in turn did not know of the creditor,[140]

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[136] 11 U.S.C. § 1306(b).

[137] 11 U.S.C. § 523(a)(8).

[138] These subparagraphs involve obtaining loans on false pretenses, breach of fiduciary duty and willful and malicious injury.

[139] A slightly different rule of the same sort is provided for creditors with claims under § 523(a)(2), (4) or (6), but I omit this rule as not needed to make my point.

[140] An "unknown creditor" is one whose "interests are either conjectural or future or, although they could be

the claim is nevertheless discharged. The discharge depends on facts that the bankruptcy court never determines. So, in this one case, discharge is expressed in the future anterior tense. Only when some court (perhaps only when a *bankruptcy* court)[141] later determines the matter will we know whether an earlier bankruptcy resulted in discharge of a claim by a "creditor who knows."

So where does an unlisted creditor stand in light of the discharge order? A discharge consists in a dissolution of all prepetition judgments[142] and an injunction against any postpetition act to collect.[143] So the unlisted creditor only finds out whether his claim is discharged when he tries to collect. If he knew of the bankruptcy, or if the debtor did not know of the creditor, everything the creditor does is a violation of the discharge injunction. But this can only be determined later, when the creditor undertakes the dicey potentially prohibited action.[144]

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discovered upon investigation, do not in due course of business come to knowledge [of the debtor]." Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 317 (1950).

[141] It appears increasingly likely that nonbankruptcy courts have no jurisdiction even to say that the claim was *not* discharged. *See* Benjamin Margulis, Note, *The Bankruptcy Hegemon: Section 524(a) and Its Effect on State and Federal Comity*, 31 CARDOZO L. REV. 905 (2010).

[142] 11 U.S.C. § 524(a)(1).

[143] 11 U.S.C. § 524(a)(2).

[144] A striking example of creditors who may or may not know of the bankruptcy is Massa v. Addona (In re Massa), 187 F.3d 292 (2d Cir. 1999). In *Massa*, a creditor brought suit in state court (sounding in fraud) against the debtor, who then filed a bankruptcy petition in chapter 13. The debtor never listed the creditor on the required schedules. The debtor's attorney sent letters to the judge and the creditor's attorney informing them of the chapter 13 proceeding. The case was later converted to a chapter 7 liquidation case. Somehow state action continued, resulting in a default judgment for the creditor. In the course of collecting on the judgment, the creditor sought to take the debtor's deposition and obtained the levy of the debtor's automobile. After the levy, the debtor filed a new chapter 7 petition. In spite of this, the creditor sought contempt penalties against the debtor for failing to show up at the deposition. The debtor moved to dismiss on the basis of the discharge injunction. The state justice refused the debtor's motion on the ground that the creditor "didn't know" within the meaning of § 523(a)(3)(A). The debtor then re-opened the first bankruptcy case in order to obtain contempt penalties against the creditor. The bankruptcy court ruled that, thanks to *res judicata* from the state justice's determination, the creditor's claim was not discharged. The Second Circuit affirmed, though not on *res judicata* grounds. The Second Circuit determined from the appellate record that the creditor didn't know of the first bankruptcy. True, the creditor received a letter announcing the chapter 13 case. But the creditor received no notice of the conversion to chapter 7. *Compare* 11 U.S.C. § 348(c) ("Section [] 342 . . . applies . . . as if the conversion order were the order for relief") *with id*. § 342(a) ("there shall be given [notice] of an order for relief in a case under this title") *and* § 301(b) ("The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter"). The creditor's claim (sounding in fraud) was dischargeable in chapter 13 (as it existed at the time). It was not dischargeable in chapter 7 (if the creditor brought a timely adversary proceeding to establish the fraud). *Id*. § 523(a)(2), (c)(1). In the chapter 7 proceeding, the creditor would have been entitled to extra time to object to the discharge. But this was denied to the creditor for want of notice of the conversion to chapter 7.

While there is a certain sense to this holding, § 523(a)(3)(A) refers to the creditor's "actual condition of the case" in time to file a proof of claim." Is the chapter 13 case the same "case" as the converted chapter 7 case? According to § 348(a) "[c]onversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief under the chapter to which the case is converted." This is some evidence that the chapter 7 case is a new case. Knowledge of the chapter 13 case would therefore not be knowledge of the new case. This is an important refinement for "creditors who know," especially where conversion to chapter 7 is the rule, not the exception, for chapter 13 cases. Till v. SCS Credit Corp, 541 U.S. 465, 493 n.1 (1999) (Scalia, J. dissenting).

What can't student loans be viewed the same way? In other words, given a discharge order, the student lender *never* knows whether its claim has been discharged. This only becomes revealed when the lender tries to collect. So the student lender could be like the unlisted "creditor who knows"--in a state of uncertainty. Of course, the requirement of an adversary proceeding removes the student lender from that uncertainty. But this requirement does not come from the Bankruptcy Code. It finds its mediocre origin in the Rules, which have never been ennobled by congressional enactment.

It must be conceded, however, that the creditor who knows knows that he knows. Such a creditor then knows not to violate the discharge injunction. The student lender typically does not know that the debtor suffers from undue hardship. Such a lender is not in a position to avoid violating the injunction. While this psychological point cannot be denied, it is not outcome determinative, as our thought experiment is based on reading the plain meaning of the Bankruptcy Code.

It turns out that there is no time limit on debtors to seek a hardship finding. Student debtors can re-open cases at any time in order to start an adversary proceeding on the student loan.[145] The Rules say this expressly: "A case may be reopened without payment of an additional filing fee for the purpose of filing a complaint to obtain a determination" of undue hardship of a student.[146] This Rule coheres with the view that the student loan is not discharged until a bankruptcy court makes a finding of undue hardship. But this possibility also coheres with the view that the student lender *has* been discharged unknowingly even without the adversary proceeding. The opportunity to re-open the case and start the adversary proceeding might simply be a mode of obtaining declaratory relief for a right that already exists. So, even though the Supreme Court has assumed in dictum a court determination of hardship is required, it is possible that a court determination might be deferred until the student lender actually tries to collect. At that point, a judge will have occasion to determine what the discharge order will have meant at the time the order was issued. The Bankruptcy Rules may try to change this state of affairs, but they could well be *ultra vires*, given the exact content of the Bankruptcy Code.

If this thought experiment has merit, then the Bankruptcy Code does not require a determination of undue hardship. If so, the Supreme Court is wrong to insist that, in chapter 13 cases, a determination nevertheless must be made in order to confirm a discharge-by-declaration plan. If such plans do not violate the Bankruptcy Code, then, assuming the plan otherwise complies with § 1325(a)(5), the bankruptcy court's duty is quite the opposite of what the Supreme Court has decreed.

Nevertheless, the Supreme Court is the Supreme Court. And whatever the Bankruptcy Code actually says, one can well imagine bankruptcy judges following Supreme Court dictum, however ungrounded in the Bankruptcy Code it may be.

B. Sanctions

After BAPCPA, fraud claims described by Bankruptcy Code § 523(a)(2) are no longer dischargeable in chapter 13. *Id*. § 1328(a)(2).

[145] Educational Credit Mgmt. Corp. v. Mosley (In re Mosley), 494 F.3d 1320 (11th Cir. 2007); Walker v. Sallie Mae Servicing Corp. (In re Walker), In re 427 B.R. 471 (Bankr. 8th Cir. 2010).

[146] Fed. Rules Bankr. P. 4007(c).

An obvious problem with the *Espinosa* holding is that debtors are given an incentive to file illegal plans in the hope that no one will object and the court will not fulfill its duty to police the confirmation process by weeding out such plans.

The problem is quite similar to another bad incentive created by the Supreme Court in 1992 with its holding in *Taylor v. Freeland & Kronz*.[147] In *Taylor*, a debtor listed an obviously non-exempt cause of action as an exemption. The trustee did not challenge it because he did not believe the cause of action had value. Later, the debtor settled the cause of action for more than enough to pay all creditors in full. The trustee attempted to recover these proceeds in a turnover proceeding. The Supreme court eventually ruled that the trustee's claim was time-barred. The obvious problem in *Taylor* was the incentive for debtors to claim obviously non-exempt assets in the hope that no one would object within the quite short limitations period.[148] In *Taylor*, the Court countered this claim of bad incentive by intoning a list of penalties, including Rules 11 sanctions, in cases where a debtor (successfully) obtained non-exempt property by knowingly claiming it was exempt.[149] And in *Espinosa* those same penalties are invoked again to assuage the fear that practice by ambush will befall student lenders.[150]

We may ask, then, how penalties have fared in the context of *Taylor*. I have not been able to find an example of a penalty actually imposed, once the period for challenging the exemption had lapsed,[151] though instances of sanctions when the exemption is successfully blocked can be cited.[152] By itself this proves nothing, as the sanction may have so intimidated lawyers that outrageous exemption claims are not actually being made very often. Or, perhaps bankruptcy lawyers are simply ethical and are not inclined to make outrageous exemption claims, whether there be penalties or not.

There is, however, a contradiction in repeating the Rule 11 threat in the context of plan

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[147] 503 U.S. 638 (1992).

[148] Fed. Rules Bankr. P. 4003(b) (party in interest must object within 30 days after the debtor files schedule C).

[149] The Supreme Court may have borrowed this notion from the Third Circuit's opinion in the same case:

> The courts departing from the statutory language have also expressed concern that a literal reading would lead to a system of "exemption by declaration" whereby the debtor would have incentive to claim all property as exempt in the hope that no party in interest would object. Inserting an exception into section 522 in order to achieve this policy goal ignores two safeguards that already ensure that debtors have little or no incentive to claim all of their property as exempt. First and most importantly, Bankruptcy Rule 9011, which is analogous to Rule 11 of the Civil Rules, forbids bad faith exemption claims and authorizes sanctions for violation of this prohibition. Rule 9011 should act as the primary deterrent against debtors engaging in bad faith exemption claims.

Taylor v. Freeland & Kronz, 938 F.2d 420 (3d Cir. 1991), *aff'd*, 503 U.S. 638 (1992).

[150] *Id* at 1382 ("As we stated in Taylor . . . , "[d]ebtors and their attorneys face penalties under various provisions for engaging in improper conduct in bankruptcy proceedings") (citations omitted).

[151] See Perkins Coie v. Sadkin (In re Sadkin, 36 F.3d 473 (5th Cir. 1994) (upholding bankruptcy court's decision not to sanction, because the claim to exemption was colorable); Grueneich v. Doeling (In re Grueneich), 400 B.R. 680 (Bankr. 8th Cir. 2009); see also In re Smith, 1992 Bankr. LEXIS 1288 (Bankr. D. Neb. 1992) (lawyers admonished, but not clear whether exemptions were successful due to lapse of limitations period).

[152] In re Slentz, 157 B.R. 418 (Bankr. N.D. Ind. 1993).

confirmation. In the case of exemptions wrongfully claimed (but nevertheless successfully obtained), these claims constitute clearly illegal behavior, which is sanctified by the lapse of the statute of limitations. But, according to the *Espinosa* court, discharge-by-declaration plans are quite legal, so long as the court actually determines that the hardship exists. True, it is not proper for a court to confirm a plan where a student lender shows up to protest the want of an adversary proceeding. But the lender's failure to show up constitutes a waiver of that right (though not a waiver of the right to an undischargeable claim where no undue hardship exists). Given that the student lender does not show up, a declaration-by-discharge plan can be properly confirmed (if the court determines the undue hardship exists). At best, sanctions seem limited to those chapter 13 cases where the student debtor has not the slightest colorable claim to a discharge. Beyond that, the Supreme Court has probably undercut the Rule 11 sanction in student loan cases by intimating that declaration-by-discharge are indeed confirmable.

Prior to *Espinosa*, courts occasionally rattled the Rule 11 sabre at the sight of a declaration-by-discharge plan.[153] But now that we know declaration-by-discharge are perfectly confirmable (if the lender does not show up and the court finds undue hardship at the confirmation hearing), such penalties seem singularly inappropriate, except in the most outrageous cases.

C. Loopholes

In any case, it is possible that students can circumvent the *Espinosa* Court's directive. Suppose the plan says nothing about discharge or undue hardship. Rather, it states that the student loan is allowed for $X and will be deemed *paid* when $X are paid to the student lender. Payment of a debt is presumably not discharge of a debt. A discharge order under § 1328(a) cannot discharge an unpaid student loan (where undue hardship is missing). But if the plan states the loan is fully paid, the claim has already been discharged before a hearing under § 1328(a) can be held. The debt disappears through payment, not § 1328(a) discharge. The plan in question might be confirmed because it does not violate § 523(a)(8). In general, plans can contradict proofs of claim. Creditors whose claims are adjusted by the plan itself are expected to show up at the confirmation hearing and object, or forever be barred from protesting.[154] It cannot reasonably be expected that a bankruptcy court will investigate whether the debtor has properly reported the actual amount due to the student lender. Indeed, if this duty exists, it cannot be cabined to student lenders but must be extended to any unsecured creditor. So if the Supreme Court's admonition is about discharge, not allowance of

[153] In In re Lemons, 285 B.R. 327 (Bankr. W.D. Okla. 2002), a student lender showed up to complain about the discharge-by declaration term in a chapter 13 plan. The court admonished the debtor's attorney and threatened sanctions "next time." *Accord*, In re Hensley, 249 B.R. 318, 323 (Bankr. W.D. Okla. 2000). happened. In In re Evans, 247 B.R. 407 (Bankr. S.D. Ohio 1999), the student lender did not show, but the court, after denying confirmation, scheduled a Rule 9011 hearing later.

[154] Litton Loan Servicing, L.P. v. Ephraim, 2008 U.S. Dist. LEXIS 62308 (N.D. Ill. August 14, 2008). Similarly, if the debtor writes a plan that sets an amount of interest to which the creditor is entitled, and if the plan is confirmed, the debtor cannot later seek a disgorgement. Ruehl v. HSBC Mortg. Servs., 2008 U.S. Dist. Wis. 104713 (E.D. Wis. 2008); llinois Department of Revenue v. Ayre (In re Ayre), 360 B.R. 880 (C.D. Ill. 2007); In re King, 290 B.R. 641, 648 (Bankr. C.D. Ill. 2003).

claims, a loophole exists for students to take advantage of lender apathy.[155]

D. Increased Strength of Res Judicata Worth of Confirmation Orders

The *Espinosa* court imposes on courts a duty to review plans for conformity to the Bankruptcy Code, even if no one objects. And what if a court confirms the plan in spite of the admonition? Obviously, from the holding of *Espinosa,* the plan will have *res judicata* worth, so long as the clerk has done his duty and has notified the creditors of the confirmation hearing. So there is nothing the student lender can get by way of remedy if an illegal plan is confirmed. Perhaps, after confirmation, the student lender might complain to the court of appeals that the bankruptcy judge has violated his duty, and perhaps this can justify removal of the bankruptcy judge for malfeasance.[156] But the confirmation order is given vigorous *res judicata* worth by the *Espinosa* court.[157]

1. *Motions Under Rule 60(b)(6)*

A faint hope of creditors harmed by the *res judicata* bite of the plan is to make a motion under Rule 60(b)(6), which permits relief "for any other reason" not enumerated in the first five subparagraphs of Rule 60(b). The *Espinosa* court limited its holding to motions under Rule 60(b)(4)("the judgment is void").[158] According to Rule 60(b)(6), the court may relieve a party from a final judgment for "a reason." One "reason" for relieving the creditor from the confirmation order is that confirmation orders are incapable of discharging student loans in the absence of an adversary proceeding--that is, § 1327(a) has implicit exceptions in it. On this view, the Supreme Court did not mean to suggest that the student lender was really discharged. It only meant to hold that the confirmation order (whatever it meant) was final. It is therefore open, so the faint hope continues, for a court to hold that the student loan was never discharged, as confirmation orders are jurisdictionally incapable of doing so.

This faint hope must be rejected as an untenable reading of what the Supreme Court intended. The court clearly implied that a confirmation order *can* discharge a student loan in the absence of an

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[155] *See* In re Martin, 2010 Bankr. LEXIS 946 (Bankr. W.D. Va. April 13, 2010) (citing *Espinosa,* confirmed plan that proclaimed a secured claim "paid in full" by virtue of surrending collateral was *res judicata*).

[156] According to 28 U.S.C. § 152(e):

> A bankruptcy judge may be removed during the term for which such bankruptcy judge is appointed, only for incompetence, misconduct, neglect of duty, or physical or mental disability and only by the judicial council of the circuit in which the judge's official duty station is located.

[157] Increased *res judicata* strength might not be limited plan confirmation cases. In In re Hanson, 397 F.3d 482 (7th Cir. 2005), the debtor's plan had no declaration-by-discharge clause but the discharge order erroneously discharged the student lender. The discharge order was given no *res judicata* effect because there was no adversary proceeding. Perhaps this holding is overruled by *Espinosa* as well.

[158] 130 S. Ct. at 1376 n.8 ("Because United brought this action on a motion for relief from judgment under Rule 60(b)(4), our holding is confined to that provision. We express no view on the terms upon which other provisions of the Bankruptcy Rules may entitle a debtor or creditor to postjudgment relief.").

adversary proceeding, when it ruled that bankruptcy courts have jurisdiction to order the discharge.

> This case presents no occasion to . . . define the precise circumstances in which a jurisdictional error will render a judgment void . . . Such an argument would fail in any event. First, § 523(a)(8)'s statutory requirement that a bankruptcy court find undue hardship before discharging a student loan debt is a precondition to obtaining a discharge order, not a limitation on the bankruptcy court's jurisdiction. Second, the requirement that a bankruptcy court make this finding in an adversary proceeding derives from the Bankruptcy Rules, see Rule Proc. 7001(6), which are "procedural rules adopted by the Court for the orderly transaction of its business" that are "not jurisdictional."[159]

If courts have jurisdiction for the purposes of Rule 60(b)(4), they surely have it for purposes of Rule 60(b)(6) ("any other reason justifying relief"). Rule 60(b)(6) has been read as *not* permitting relief when the reason in question is covered under one of the first five enumerated subsections to Rule 60(b). Since "jurisdiction" is the province of (b)(4), it cannot serve as pretext for relief under (b)(6).[160]

2. *Clarity of the Plan*

If the plan is somehow insufficiently clear to put the student lender on notice, it is still possible that courts can refuse to give *res judicata* respect to the plan.[161] Perhaps the burden of clarity will shift against student debtors, thereby giving lenders due process objections to confirmation after all. Indeed, now that the Supreme Court has denounced declaration-by-discharge plans, courts entertaining Rule 60(b)(4) motions against confirmation (or, generally, venues in which it is necessary to interpret the meaning of a confirmed plan)[162] could announce that a chapter 13 plan must be interpreted very heavily against the student's discharge. After *Espinosa*, such a plan can only be properly confirmed if the confirming court makes a determination of undue hardship. Failure to make the determination in the confirmation order might then be taken as evidence that the plan was insufficiently clear in its intent; otherwise the court would have made an undue hardship finding.[163]

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[159] 130 S. Ct. at 1377 (citations omitted).

[160] *See* United States. Int'l Bhd. of Teamsters, 247 F.3d 370, 391-92 (2d Cir. 2001) (noting that Rule 60(b)(6) will not apply if "reasons offered for relief from judgment can be considered in one of the more specific clauses of Rule 60(b)").

[161] Educational Credit Mgmt. Corp. v. Whelton (In re Whelton), 312 B.R. 508, 517 (D. Vt. 2004), *aff'd*, 432 F.3d 150 (2d Cir. 2005).

[162] For example, a debtor may seek sanctions against a lender for violating a discharge. But if the meaning of the plan is that it does *not* discharge the creditor (because the plan is insufficiently clear), obviously sanctions cannot be awarded.

[163] In Poland v. Educational Credit Management Corp. (In re Poland), 382 F.3d 1185 (10th Cir. 2004), a plan stated that a student loan was discharged, but it did not say "because it would constitute an undue hardship to repay it." If these words had been added, plan confirmation would have *res judicata* worth. But because those words were absent, plan confirmation was disentitled to *res judicata* respect. Why should these words make a difference? Because the Tenth Circuit had upheld *res judicata* of declaration-by-discharge plans in Andersen v. UNIPAC-NEBHELP (In re Andersen), 179 F.3d 1253 (10th Cir. 1999), where the plan included those words. To uphold *res judicata* without those words would

Opacity of the plan itself could give rise to a due process violation, even after *Espinosa*. An important opinion on the unclarity of plans is *In re Linkous*,[164] where a plan bifurcated an undersecured claim into its secured and unsecured parts, pursuant to § 506(a). The creditor never showed up to protest and the plan was confirmed. A collateral attack was later permitted, because the plan was not clear enough in notifying the creditor of its rights. The court of appeals ruled that the secured creditor's due process rights had been violated. According to Bankruptcy Rule 3012, "The court may determine the value of a claim secured by a lien on property in which the estate has an interest on motion of any party in interest and after a hearing on notice to the holder of the secured claim . . . " Therefore, said the *Linkous* court, any notice of the confirmation hearing that did not also expressly note that a 506(a) valuation will occur at the hearing pursuant to Rule 3012 is insufficiently clear notice to satisfy due process.

Espinosa, it is true, holds that nothing can be learned from the Bankruptcy Rules about minimal due process. So that part of the *Linkous* holding that requires express reference to Rule 3012 can no longer be sustained. But still the general principle is one even the Supreme Court can endorse: when the plan itself is insufficiently clear as to the creditor's rights, it is a due process violation to enforce a plan against the creditor.[165]

Still, one must perhaps acknowledge a paradox. If the plan really is not clear, and if it is to be interpreted against the drafter of the plan (*i.e.*, the debtor),[166] then the very meaning of the plan is that it does not prejudice the creditor. How can the plan both be prejudicial to the creditor *and* so unclear as to count as a due process violation to enforce it? But if courts can get past this paradox, unclarity of the plan itself becomes a means to evade the holding of *Espinosa*.

3. *Lien Avoidance*

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be to *expand Andersen*. 382 F.3d at 1189. *Andersen*, the *Poland* court thought, was wrongly decided. *Id*. at 1189 n.2. But rather than overrule *Andersen*, the court simply refused to expand it. Now that the Supreme Court has informed us that *Andersen* was right all along, the expansion would seem to be required. Accordingly, it is appropriate to note that the so-called expansion is no expansion at all. It is simply a straightforward application of § 1327(a). If the plan says that the student loan is discharged, even if no hardship exists, then the debt is discharged, because the plan is binding on the student lender.

[164] 990 F.2d 160 (4th Cir. 1993).

[165] An early interpretation of *Espinosa* holds that *Linkous* is overruled. In re Martin, 2010 Bankr. LEXIS 946 (Bankr. W.D. Va. April 13, 2010). According to the *Martin* court:

> The Supreme Court's ruling in *Espinosa* . . . appears to trump *Linkous*, which held that the failure to file an adversary proceeding and serve the requisite summons and complaint deprived a creditor of adequate notice. Therefore this Court holds that Espinosa controls on the issue of adequacy of notice for purposes of preclusion in this case.

Id. at *17-*18. In fact, *Linkous* does not mention adversary proceedings, but motions under Rule 3012. Although, after *Espinosa*, failure to comply with the Bankruptcy Rules generally does not spoil the finality of a confirmation order, *Linkous* still survives for the proposition that, when the plan is unclear, it cannot serve as the minimum notice that Due Process requires.

[166] So courts have held. In re Harvey, 213 F.3d 318, 320 (7th Cir. 2000); In re Ventura, 2010 Bankr. LEXIS 594 (Bankr. N.D. Cal. February 24, 2010); In re Penrod, 169 B.R. 910, 916 (Bankr. N.D. Ind. 1994).

Probably the biggest victims of increased *res judicata* worth of illegally confirmed plans are not student lenders, who at least won the concession that court should not confirm declaration-by-discharge plans, even if the student lender does not object to the plan (unless it also finds undue hardship). Surely the biggest losers are secured creditors. Heretofore, at least in chapter 13 cases, every court of appeals that considered the matter thought the plan confirmation was incapable of lien avoidance in the absence of an adversary proceeding. But this holding was often premised on the constitutional status of the adversary proceeding. Now that such a premise is no longer tenable, illegal plans destroying liens or mortgages are entitled to full *res judicata* respect.

Espinosa is bad news for home mortgage lenders. Suppose a plan crams down a mortgage in violation of § 1322(b)(2). The plan is confirmed because the mortgage lender did not object. Some courts have ruled that the plan is incompetent to modify such a mortgage.[167] This latter position was endorsed in a rather unique way in *Universal American Mortg. Co. v. Bateman (In re Bateman)*,[168] where a mortgage lender filed a proof of claim for arrearages and the debtor wrote a plan awarding the lender considerably less. The court confirmed the plan when the lender filed no objection. Later, at the instigation of the chapter 13 trustee, the debtor objected to the proof of claim on the grounds that the confirmed plan set the amount of the arrearage claim. The *Bateman* court ruled that the plan had no *res judicata* worth in extinguishing the lender's claim for arrearage. Rather, the unpaid portion of the lender's claim survived confirmation. Presumably, under this holding, debtors can object to the claim after confirmation on the merits, but *res judicata* could play no role in determining the amount of the claim.

The *Bateman* court, however, refused the mortgage lender's motion to dismiss the entire chapter 13 case. As a result, the automatic stay[169] would prevent the lender from enforcing its claim for arrearages until the end of the plan.[170] But after the lapse of the automatic stay, the mortgage lender could enforce its claim in full by foreclosing on its mortgage.

Cases like *Bateman*, however, must be taken as overruled by *Espinosa*, which upholds the *res judicata* effect of blatantly illegal chapter 13 plans.

Even chapter 11 secured creditors are affected by *Espinosa*. As stated earlier,[171] chapter 11 case law holds that confirmed plans can eliminate liens without an adversary proceeding. The ability of a chapter 11 plan to kill a lien is founded on the exact language of § 1141(c), which provides in

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[167] In re Carr, 318 B.R. 517 (Bankr. W.D. Wis. 2004); In re Kincaid, 316 B.R. 735, 741 (Bankr. E.D. Cal. 2004); *but see* In re Turner-Mayo, 2007 Bankr. LEXIS 466 (Bankr. S.D. Tex. 2007); In re Miller), 2007 Bankr. LEXIS 31 (Bankr. W.D. Pa. 2007); In re Coss, 2005 Bankr. LEXIS 3182 (Bankr. N.D.N.Y. 2005); In re Thaxton, 335 B.R. 372 (Bankr. E.D. Ohio 2005); In re Bryant, 323 B.R. 635 (Bankr. E.D. Pa. 2005); In re Stiller, 323 B.R. 199 (Bankr. W.D. OR. 2005).

[168] 331 F.3d 821, 832 n.7 (11th Cir. 2003).

[169] 11 U.S.C. § 362(a)(6) (barring "any act to collect . . . a claim against the debtor that arose before the commencement of the case . . . ")..

[170] For a contrary view, see Litton Loan Servicing, L.P. v. Ephraim, 2008 U.S. Dist. LEXIS 62308 (N.D. Ill. August 14, 2008).

[171] *See supra* text accompanying notes ---.

pertinent part:

> [E]xcept as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors . . .

Led by *In re Penrod*,[172] courts have added the requirement of participation by the secured creditor above and beyond mere receipt of notification of the confirmation hearing.

Espinosa makes clear that a lack of participation cannot stand in the way of the *res judicata* worth of plan confirmation. In *Espinosa*, the student lender had filed a proof of claim. Let us stipulate that this constitutes participation within the meaning of the *Penrod* holding.[173] The lender in *Espinosa* sought relief from the confirmation order under Rule 60(b)(4) on the theory that the confirmation order was a void judgment. This relief was denied, because the student lender received minimal *Mullane*-style notice of the confirmation hearing. Had the student lender never filed a proof of claim, the result would surely have been the same. Due process has to do with notice received, not with participation after notice was received. If this were not true, the passive defendant who defaults on a complaint for judgment has more constitutional rights than a defendant who resists before giving up.

If so, even chapter 11 secured creditors, who did not have very good rights in chapter 11, have been adversely affected by the implications in *Espinosa*.

3. *Tax Collection*

Espinosa also adversely impacts the Internal Revenue Service and other tax collectors. In *In re Escobedo*.[174] the Seventh Circuit permitted a collateral attack on a plan that failed to comply with § 1322(a)(2), requiring priority claimants to be paid in full. Said the *Escobedo* court, "A bankruptcy court lacks the authority to confirm any plan unless it 'complies with the provision of this chapter and with the other applicable provisions of this title.'"[175]

But where the tax collector receives the bare minimum notice required by *Mullane*, it is hard to see that *Escobedo* has survived *Espinosa*. In *Escobedo*, the court may not have had discretion to confirm a plan that paid tax claims less than in full. But in *Espinosa*, the court had no discretion in

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[172] 50 F.3d 459 (7th Cir. 1995).

[173] 50 F.3d at 461 (A secured creditor "may want to participate in the bankruptcy proceeding (and so may decide to file a claim) . . . ")

[174] 28 F.3d 34 (7th Cir. 1994).

[175] 28 F.3d at 35, *citing* § 1325(a)(1). Ironically, the court also intimated that nothing in § 1325(a) is mandatory. The cite to § 1325(a)(1) is therefore contradictory. *Escobedo* has not been well received, and lower courts have attempted to limit its effect by emphasizing that, in *Escobedo*, the IRS never submitted a proof of claim (*i.e.*, did not "participate" in the *Penrod* sense). In *Illinois Department of Revenue v. Ayre (In re Ayre)*, 360 B.R. 880 (C.D. Ill. 2007), proof of claim of was submitted. A plan contradicting it was later confirmed. Even though the tax creditor had a § 507(a) priority, the plan was *res judicata* as to the tax creditor.

confirming a plan that proclaimed the student loan a hardship (without making an explicit finding to that effect). Nevertheless, the illegal plan in *Espinosa* was given *res judicata* respect. It is hard to see how tax collectors can claim otherwise, where they were notified of the terms of the plan.

4. *Proofs of Claim*

In chapter 13 cases, the bar date for claims often occurs *after* the plan is confirmed.[176] Some courts believe that plan confirmation has no *res judicata* worth if a timely filed proof of claim contradicts the plan.[177] Perhaps this holding is no longer tenable after *Espinosa*. If so, the controversial case of *Factors Funding Co. v. Fili (In re Fili)*[178] is vindicated after the fact. In *Fili*, a plan was held binding on a secured creditor, where confirmation preceded the bar date. There, the court ruled that "the creditor may not ignore the confirmation process and fail to object simply because the bar date for filing a proof of claim has yet to expire."[179] As applied to unsecured creditors, *Fili* is problematic, because Rule 9006(c)(2) states that a bankruptcy court "may not reduce the time for taking action under Rule 3002(c)--*i.e.*, the bar date. *Espinosa*, however, stands for the proposition that a confirmation order can run roughshod over the Bankruptcy Rules, and so *Fili* is upheld even as applied to unsecured creditors.

5. *Modification of Chapter 13 Plans*

Espinosa strengthens the *res judicata* worth of reorganization plans, but in chapter 13, plans may be modified,[180] in spite of the finality promised in § 1327(a). The question arises whether creditors who failed to show up to protest confirmation can simply move to modify the plan after the fact to achieve the same thing that a collateral attack would have accomplished.[181]

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[176] In re Cason, 190 B.R. 917, 920 n.1 (Bankr. N.D. Ala. 1995) (claiming that one-third of chapter 13 plans are confirmed before the bar date); *see generally* Arpan K. Punyani, Note, *Debtor-Filed Acknowledgements of Creditors' Claims: An Alternative Approach to Proof of Claim in Chapter 13*, 28 CARDOZO L. REV. 511 (2006). The Federal Rules set the chapter 13 bar date at 90 days after the first creditors' meeting. Fed. R. Bankr. P. 3002(c). The first creditors' meeting in turn must be scheduled no more than 40 days after the bankruptcy petition. Fed. R. Bankr. P. 2003(a). According to Bankruptcy Rule 3015(b), "The debtor may file a chapter 13 plan with the petition. If a plan is not filed with the petition, it shall be filed within 15 days thereafter . . . If a case is converted to chapter 13, a plan shall be filed within 15 days thereafter . . ." Meanwhile, the court is enjoined to hold the confirmation hearing not later than 45 days after the first creditors' meeting is scheduled. 11 U.S.C. § 1324(b). All of this adds up to the common situation of plan confirmation before the bar date has lapsed.

[177] Ruhl v. HSBC Mortg. Servs., 2008 U.S. Dist. Wis. 104713, at *9 (E.D. Wis. 2008); Aubain v, LaSalle Nat'l Bank (In re Aubain), 296 B.R. 624, 626 (Bankr. W.D. Mo. 1998) (where debtor does not object to the proof of claim, the proof of claim supersedes the plan); In re Grogan, 158 B.R. 197, 199 (Bankr. E.D. Cal. 1993).

[178] 257 B.R. 370 (Bankr. 1st Cir. 2001).

[179] *Id*. at 374.

[180] 11 U.S.C. § 1329(a).

[181] See generally David Gray Carlson, Modified Plans of Reorganization and the Basic Chapter 13 Bargain, 83 AM. BANKR. L.J. 585 (2009).

There are many impediments to such a strategy. First, standing is denied to secured creditors; only the debtor, the trustee, or the holder of an allowed unsecured claim are granted standing.[182] Secured victims of illegal plans will therefore not be able to escape *res judicata* of the plan through modification.

Second, by case law, some courts have insisted that modification is inappropriate unless the moving part demonstrates a substantial and unanticipated post-confirmation change in the debtor's financial condition.[183] Such a court-made requirement is controversial, as § 1329(a) states that modification may occur "at any time."[184] If modification is limited to changed circumstances of the debtor's financial condition, the victim of an illegal plan will have no ability to insist on a modification. Nor will the victim be able to hold up a modification proposed by a debtor, on the ground that some term of the original plan is illegal. Whereas modification must comply with § 1322 and § 1323(c),[185] only the modified term must comply. The unmodified part of the plan need not, and therefore cannot serve as grounds to block the complying modified term.[186]

Third, the modifications permitted are strictly limited. The moving party can seek modification to

> (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;
>
> (2) extend or reduce the time for such payments; or
>
> (3) alter the amount of the distribution of a creditor whose claim is provided for by the plan tothe extent necessary to take account of any payment of such claim other than under the plan . . . .[187]

Many victims of illegal plans will not be able to bring their grievances under one of these permitted purposes. For example, a student lender seeking relief from a declaration-by-discharge plan has no plausible case that the relief increases plan payments or affects the time of payment through the plan.

One possible victim of a bad plan might seemingly qualify for modification. Suppose a plan is confirmed requiring the debtor to pay some fixed amount over time. The creditor fails to object to confirmation and, dissatisfied by the amount of his plan entitlement, the creditor files a post-

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[182] 11 U.S.C. § 1329(a).

[183] Arnold v. Weast (In re Arnold), 869 F.2d 240, 243 (4th Cir. 1989); Coastal Credit v. Mellors (In re Mellors), 372 B.R. 763, 769 (Bankr. W.D. Pa. 2007); In re Belcher, 369 B.R. 465, 467 (Bankr. E.D. Ark. 2007).

[184] In re Witkowski, 16 F.3d 739, 743-44 (7th Cir. 1994).

[185] 11 U.S.C. § 1329(b)(1).

[186] Carlson, *Res Judicata*, *supra* note ---, at 430-31.

[187] *Id*. I omit § 1328(a)(4), which permits chapter 13 debtors to divert wages from paying claims to buying medical insurance. This last item was added in BAPCPA.

confirmation proof of claim in a timely matter. The plan is *res judicata* against the proof of claim.[188] Is modification an option?

The argument in favor of the victim is that, if the plan is modified to allow the victim's claim at a larger amount, the modification would reduce payments to all the other creditors, which arguably brings the modification under the terms of § 1329(a)(1). The exact language of § 1329(a)(1), however, permits changing the amount of payments on claims of a particular class *provided for by the plan*."[189] Where the plan does not allow a certain claim, it exceeds the purview of § 1329(a)(1) to change the claim that the plan allows. Only payment on a *fixed* claim can be changed. This was the holding in the leading case of *Chrysler Financial Corp. v. Nolan (In re Nolan)*.[190] If *Nolan* is good law (which some courts would dispute),[191] then unsecured creditors who timely file after a plan is confirmed will not penetrate the *res judicata* tent via the camel nose of modification.

In *In re Ryan*,[192] the court acknowledged that *Espinosa* prevented collateral attacks on confirmation when creditors filed timely post-confirmation proofs of claim. But the same challenge was allowed in ths guise of modification. *Ryan* contradicts the notion adopted in *Nolan* that increasing or decreasing claims is *never* a valid purpose in modification, even if it has the indirect effect of changing "the amount of payments on claims."[193]

Modification was permitted in a mirror-opposite case to *Ryan*. As in *Ryan*, the bankruptcy court in *In re Witkowski*[194] confirmed a "percentage plan." In a percentage plan, the debtor pays until each creditor receives the percentage stipulated in the plan.[195] Also as in *Ryan*, confirmation of the *Witkowski* percentage plan occurred before the bar date.[196] Many creditors in *Witkowski* forgot to file proofs of claim by the bar date, and so the debtor looked forward to saving money by ending the plan early. The chapter 13 trustee, however, moved to modify to increase the percentage each of the surviving creditors would receive, thereby preventing the debtor from ending the plan earlier than originally conceived.

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[188] Or so I have argued. *See supra* text accompanying notes ---.

[189] Emphasis added.

[190] 232 F.3d 528 (6th Cir. 2000).

[191] *See* Carlson, *Modification*, *supra* note ---, at 654-57.

[192] 2010 Bankr. LEXIS 1685 (Bankr. D. Mass. 2010).

[193] 11 U.S.C. § 1329(a)(1).

[194] 16 F.3d 739 (7th Cir. 1994).

[195] The opposite of a percentage plan is a "pot" plan--the debtor must pay a stipulated amount of dollars. *See* Arnold B. Cohen, *Pot Plans Should Be Replacing Percentage Plans*, 4 J. BANKR. L. & PRAC. 305 (1995). After 1984, percentage plans could not be confirmed where a chapter 13 trustee or unsecured creditor objected. In re Bass, 267 B.R. 812 (Bankr. S.D. Ohio 2001); In re Martin, 232 B.R. 29, 35 (Bankr. D. Mass. 1999). Given an objection, a debtor was required to pay disposable income for at least three years, resulting in the "pot" concept. *Id*. at 313. After BAPCPA, above-median debtors must stay in a minimum of five years, providing a larger pot for the creditors. 11 U.S.C. § 1325(b)(1)(B). The period is three years for debtors below the median income. 11 U.S.C. § 12325(b)(4).

[196] *See* David Gray Carlson, *The* Res Judicata *Worth of Illegal Bankruptcy Reorganization Plans*, 82 TEMPLE L. REV. (2009) (forthcoming).

The debtor objected on the ground that *res judicata* prohibits modification in the absence of "unanticipated, substantial changes in the debtor's financial situation."[197] The *Witkowski* court ruled that *res judicata* was no bar to a motion to modify.[198]

Witkowski has to be viewed in conflict with *Nolan*. *Witkowski*, in effect, permitted the chapter 13 trustee to kick creditors out of the plan for failing to meet the bar date. *Ryan* allows creditors to weasel their way into the plan, contrary to the *res judicata* effect of plan confirmation. So in this one narrow area, using modification to attack the plan collaterally will depend on whether *Nolan* or *Witkowski* is the correct interpretation of § 1329(a)(1).[199]

V. Is *Mullane* Constitutional Minimum for Plan Confirmation?

We learn in *Espinosa* that the current rules for notifying creditors of plan confirmation "more than satisfied . . . due process rights."[200] Does this imply that something *less* than these rules might *still* satisfy dues process rights? What if the rules are not followed? No notice is sent and a creditor has not received a copy of the plan. Nevertheless the plan is confirmed. Is due process thereby violated?

Espinosa cites *Mullane* only once, but enough to indicate that, where the debtor or plan proponent knows of a creditor, the creditor is entitled to notification by mail of the confirmation hearing. But what if a creditor has never been notified and nevertheless knows of the bankruptcy in general. One possible argument is that the "creditor who knows" has no constitutional right to notice, just because he knows already that there is a bankruptcy. This is the concept of inquiry notice. The idea of inquiry notice is that the creditor who knows has no right to be notified. Such a creditor is expected to research the status of the case to see if its rights are adversely affected. Plan confirmation would then be binding on the creditor who knows.

Inquiry notice is precisely what the Supreme Court in *City of New York* rejected as inadequate:

> Nor can the bar order against New York be sustained because of the city's knowledge that reorganization of the railroad was taking place in the court. The argument is that such knowledge puts a duty on creditors to inquire for themselves about possible court orders limiting the time for filing claims. But even creditors who have knowledge of a reorganization have a right to assume that the statutory "reasonable notice" will be given them before their claims are forever barred. When the judge ordered notice by mail to be given the appearing creditors, New York City acted

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[197] Arnold v. Weast (In re Arnold), 869 F.2d 240 (4th Cir. 1989). It may be noted that the debtor hoped to benefit from *res judicata* with regard to the plan, but it was taken for granted that the creditors who were provided for by the plan were *not* entitled to *res judicata* (where they did not subsequently files proofs of claim). On whether creditors are entitled to rely on the terms of a confirmed plan, see Carlson, *Res Judicata Worth*, *supra* note ---, at ---.

[198] *Accord*, Meza v. Truman (In re Meza), 467 F.3d 874, 876 (5th Cir. 2006); Powers v. Savage (In re Powers), 202 B.R. 618 (Bankr. 9th Cir. 1996); In re Sutton, 303 B.R. 510 (Bankr. N.D. Ala. 2003).

[199] For the argument that *Nolan* is correct, see Carlson, *Modification*, *supra* note ---, at 648-52.

[200] 130 S. Ct. at 1378.

> reasonably in waiting to receive the same treatment.[201]

City of New York, however, has not been read to obliterate the concept of inquiry notice. The court in *Grossie v. Sam (In re Sam)*[202] suggested, for example, that, since the chapter 11 bar date was set according to the discretion of the judge, it was unreasonable to conclude that the City had a duty to inquire constantly whether the court had issued a bar date order yet.[203] But where a bar date was not within the discretion of the court--where it may be calculated mechanically--actual knowledge negates a creditor's claim that due process had been violated. In other words, a creditor who knows has no right to receive a letter (where mechanical deadlines govern the rights of the creditor).

Under this reasoning, inquiry notice could displace actual notice in chapter 13 cases. As originally enacted, the Bankruptcy Code did not set a date by which a confirmation hearing must be held. BAPCPA has changed that.

> The hearing on confirmation of the plan may be held not earlier than 20 days and not later than 45 days after the date of the meeting of creditors under section 341(a), unless the court determines that it would be in the best interests of the creditors and the estate to hold such a hearing at an earlier date and there is no objection to such earlier date.[204]

Since the confirmation hearing must be held within a narrow range of dates, any party with knowledge of the chapter 13 case might have a duty to inquire as to the confirmation hearing. If so, then *Mullane* does *not* set the minimum due process standard for chapter 13 cases. Rather, where a creditor "knows" (in time to inquire), the creditor has no due process complaints if the plan is never sent to him. In short, perhaps *Mullane* is *not* the minimum for plan confirmation in chapter 13 cases--for creditors who know.

Judicial concern to defend inquiry notice against charges of unconstitutionality are no doubt spurred by the Bankruptcy Code's direct invocation of it § 523(a)(3)(B)--creditors who know are discharged even though not listed on a schedule by the debtor. Typically, the challenge is made by creditors with claims under § 523(a)(2), (4), or (6). These claims are discharged unless the creditor steps forward pursuant to § 523(c) to prevent the discharge. Typically a creditor has missed the short 60-day limit for objecting to discharge found in Rule 4007(c). And typically these creditors are told that, since they "knew" of the bankruptcy, they have no due process claim for relief from the 60 day

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[201] 344 U.S. at 297. The last remark is odd. If New York City knew that the judge had ordered notices of the bar date to be sent, then it obviously knew about the bar date. How could it be reasonable for New York to do nothing in light of such knowledge?

[202] 894 F.2d 778 (5th Cir. 1990).

[203] *Id*. at 781 ("The reason that the [*City*] Court held that the creditor was entitled to actual notice of the bar date was because, under the Bankruptcy Act of 1898, the setting of the bar date was left to the discretion of the bankruptcy judge. Thus, the imposition of a duty on the part of creditors to inquire continually into "possible court orders" was too burdensome.").

[204] 11 U.S.C. § 1324(b).

statutory period.[205]

Troubling for this line of cases is *Reliable Electric Co. v. Olson Construction Co.*[206] In this chapter 11 case, a creditor knew of the bankruptcy but was not listed as a creditor.[207] The creditor's attorney was notified by telephone of the bankruptcy case, but no notice was sent to the creditor. The creditor, in apparent violation of the automatic stay, began litigating against the debtor in state court. This action was removed from state court to bankruptcy court, after which the debtor-in-possession filed a counterclaim against the creditor. Eventually, the bankruptcy court ruled in favor of the creditor and awarded it a judgment for about $10,000. A disclosure statement and notice of a bar date was mailed to the listed creditors, but the unlisted litigating creditor never received this notice. The plan was confirmed. After confirmation, the debtor filed a proof of claim on behalf of the unlisted creditor, which apparently would have entitled the creditor to a dividend pursuant to the confirmed plan. The debtor then moved for a declaration that the creditor was subject to the plan and discharged for any amount not paid through the plan.

This motion was denied. The unlisted creditor had never received notice of the confirmation hearing (even though the creditor was litigating in the bankruptcy court). Therefore, to subject the creditor to the plan was to deny the creditor due process of law. Relying on *City of New York*, the *Reliable* court held that the unlisted creditor "acted reasonably when it expected the same formal notice of the confirmation hearing which was sent to other identifiable creditors."[208] So *Reliable* is a case in which inquiry notice was not imposed on a creditor, with regard to plan confirmation.

There is an odd feature about *Reliable*. Even if we concede that inquiry notice does not work for plan modification, what about § 523(a)(3)(B), which indicates that unlisted creditors are discharged, if the creditors knew of the bankruptcy? Even if the plan was not binding, the unlisted creditor is nevertheless discharged, just for being a creditor who knows. Furthermore, in chapter 11, corporate debtors (such as Reliable Electric Co.) are discharged even from §523(a) claims of any sort.[209] But this discharge required *confirmation of a plan*.[210] To be specific, discharge does not depend upon what the plan says. But discharge does require that some plan be confirmed. If the plan was not confirmed (as against the unlisted creditor) for due process reasons, then the discharge can have no effect against the unlisted creditor, even though the creditor is described by § 523(a)(3)(B). In short, unlisted "creditors who know" have a duty to inquire in chapter 13 cases and in chapter 11 cases involving an individual, but not in chapter 11 cases involving a corporate debtor.[211] Where

[205] GAC Enters. v. Medaglia (In re Medaglia), 52 F.3d 451, 456 (2d Cir. 1995); Grossie v. Sam (In re Sam), 894 F.2d 778 (5th Cir. 1990); In re Green, 876 F.2d 854 (10th Cir. 1989); In re Price, 871 F.2d 97 (9th Cir. 1989); Byrd v. Alton (In re Alton), 837 F.2d 457 (11th Cir. 1988) (chapter 11 case).

[206] 726 F.2d 620 (10th Cir. 1984).

[207] It was, however, listed as an account debtor that owed a receivable. *Id.* at 621.

[208] 726 F.2d at 622.

[209] 11 U.S.C. § 1141(d)(2).

[210] 11 U.S.C. § 1141(d)(1).

[211] Paging Network, Inc. v. Nationwide Paging, Inc. (In re Arch Wireless, Inc.), 534 F.3d 76, 86 (1st Cir. 2008) ("a creditor of an individual debtor is on notice of the burden-shift tat requires him to actively participate once he has general

individuals are involved, discharge is not accomplished by plan confirmation, but by a separate court order.[212]

In *In re Green*,[213] the Tenth Circuit upheld inquiry notice on unlisted creditors who know in chapter 7 cases. How could this be justified in light of *Reliable Electric*? The *Green* court remarked, "we held the single telephone call to the creditor's counsel by the debtor's attorney was insufficient to constitute actual knowledge."[214] This overlooks the fact that the creditor in *Reliable* had lived through a litigation in bankruptcy court with respect to its claim. The creditor must have had very abundant knowledge well beyond the initial phone call. But, more convincingly, the *Green* court also noted that the specific language of § 1141(d) was pertinent to the *Reliable* result. That section makes discharge depend on confirmation alone.

So does *Reliable* mean that inquiry notice won't work for chapter 13 plans? As the *Sam* court emphasizes, the constitutionality of § 523(a)(3)(B) turns on the highly mechanical nature of the deadlines on challenging a discharge. But, in light of new § 1324(b), the confirmation schedule in chapter 13 has become highly mechanical. And so inquiry notice provides the rule for creditors who know.

Occasionally cited is Judge Frank's dissenting opinion in *City of New York* to this effect:

> Now such a constructive-notice clause is contained in Sec. 17, sub. a(3) of the Bankruptcy Act, 11 U.S.C.A. 35, which specifically provides that, although a creditor's claim is not scheduled by the bankrupt or filed by the creditor, it is barred by a discharge, if the creditor had actual knowledge of the proceedings. I shall assume the validity of Sec. 17 sub a(e), despite the *Mullane* case. But that provision is not applicable to Sec. 77, which contains no equivalent. I think that, especially as Congress deliberately omitted it from Sec. 77, the courts may not read in such a constructive-notice clause. For such a clause--the consequence of which is that knowledge of a fact is fictionally imputed to one who has no actual knowledge of that fact--is ordinarily a creature of statute; courts usually will not impose the onerous burden of constitutive notice on a litigant when it has not been imposed by the legislature. A court certainly should hesitate to do so when in the light of the *Mullane* case, the validity of such an explicit legislative provision would be doubtful.[215]

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condition of the proceedings. No such statutory burden-shift is present for a creditor of a corporation. As a result, the due process requirements may vary as between creditors of individuals and corporations because the statute itself puts creditors on notice of this variance.").

[212] 11 U.S.C. § 1141(d)(5)(A) (in the case of an individual, "confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge on completion of all payments under the plan"). This provision was added in 2005 by BAPCPA. At the time of *Reliable Electric*, an individual discharge also depended on plan confirmation. So the *Reliable* result would have been reached in an individual as well as a corporate case.

[213] 876 F.2d 854 (10th Cir. 1989).

[214] 876 F.2d at 854 (footnote omitted).

[215] 197 F.2d at 433. This remark is quoted in Paging Network, Inc. v. Nationwide Paging, Inc. (In re Arch Wireless,

One can imagine courts seizing upon this thought to hold that, since neither the Bankruptcy Code nor Bankruptcy Rules authorize inquiry notice in any context other than discharge, inquiry notice will not operate for plan confirmation. But is this not once again stating that the statutes or Bankruptcy Rules supply the constitutional minimum? And is this not precisely what the *Espinosa* court denies? So perhaps, given the premise of *Espinosa*, courts will have to decide whether § 523(a)(3)(B) is unconstitutional, on the theory that inquiry notice never suffices for due process, or alternatively, at least in chapter 13 cases, which involve mechanical deadlines, inquiry notice is the constitutional minimum for plan confirmation with regard to "creditors who know."

At least one court has found inquiry notice to be the constitutional minimum outside the context of the Bankruptcy Code. In *Elmco Properties v. Second National Federal Savings Ass'n*,[216] the creditor of a bank a claim against a bank receiver. The Financial Institutional Reforms, Recovery and Enforcement Act of 1989 (FIRREA) established a bar date.[217] The receiver published newspaper notice of the bar date, but it knew of creditor and never sent a letter, as *Mullane* instructs. The *Elmco* court held that inquiry notice, not *Mullane*, was the constitutional minimum:

> Nevertheless, Elmco may not complain of its lack of formal notice if it actually knew enough about the situation to place it on "inquiry notice" as to the details of the administrative process. Some courts have held that a claimant's knowledge that a bank has entered receivership triggers such inquiry notice.[218]

In so deciding, the *Elmco* court cited the bankruptcy cases upholding §523(a)(3)(B) in order to justify this view. It is striking that FIRREA has no inquiry notice provision. *Elmco* even involves a bar date, just as *City of New York* did. Nevertheless, the due process bar was lowered from what *Mullane* demands. Perhaps inquiry notice will serve as the constitutional minimum in chapter 13 cases, given the mechanical nature of the deadlines involved.

Conclusion

Due process of law is like pornography; the Supreme Court knows it when it sees it,[219] but cannot precisely ever say what it is. "Representing as it does a living principle, due process is not confined within a permanent catalogue of what may at a given time be deemed the limits or the essentials of fundamental rights."[220] Due process invokes "traditional notions of fair play and substantial justice,"[221] whatever these may mean. Furthermore, due process conveys a meaning "differing according to the basic nature of the proceeding but always including that which is fair and

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Inc.), 534 F.3d 76, 86 (1st Cir. 2008); GAC Enters. v. Medaglia (In re Medaglia), 52 F.3d 451, 456 (2d Cir. 1995).

[216] 94 F.3d 914 (4th Cir. 1996).

[217] 12 U.S.C. § 1821(d)(3)(B)(i).

[218] *Id*. at 921.

[219] Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

[220] Wolf v. Colorado, 338 U.S. 25 (1949).

[221] International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945).

decent accortding to the standards of our social order and time."[222] As a practical matter, we are dependent on the Supreme Court to find or perhaps legislate what due process is. The Supreme Court is not to be gainsaid on this matter.

United Student Aid Funds, Inc. v. Espinosa[223] opens a new chapter in the history of due process in the bankruptcy courts. It clearly overrules *City of New York v. New York, New Haven & Hartford R.R,*[224] which may have held that the procedural rules of bankruptcy set the constitutional minimum for due process. In *Espinosa*, the Supreme Court indicates that *Mullane v. Central Hanover Bank & Trust Co.*[225] sets the minimum. *Mullane* requires notice by mail whenever the plaintiff knows the name and location of a defendant. The due process standard may in fact be even lower in chapter 13 cases, given the mechanical nature of the deadlines for plan confirmation. There, inquiry notice--that is to say, no notice at all--suffices for creditors who know of the bankruptcy.

Meanwhile, *Espinosa* has importance consequences for the substantive law of chapter 13. Although student lenders still have the right to an adversary proceeding wherein a determination of undue hardship might be made,[226] the Supreme Court has authorized bankruptcy judges to suspend the Bankruptcy Rules and dispense with the adversary proceeding, when the student lender does not show up to object. Although the Bankruptcy Rules expressly dispense with the need for evidence to determine that a plan is lawful, bankruptcy judges will have to make a determination of undue hardship if they wish to confirm a chapter 13 plan that discharges a student loan. Presumably, this calls for evidence, even if the Bankruptcy Rules dispense with the need for evidence. But, should a bankruptcy judge default on this duty, the Supreme Court has also made clear that the confirmed plan has *res judicata* worth against any collateral attack the strident lender may mount after confirmation. Whereas collateral attacks were commonly permitted prior to *Espinosa*, such attacks may now be harder to justify.

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[222] Wisconsin v. Federal Power Commn., 303 F.2d 380, 388 (D.D.C. 1961).

[223] 130 S. Ct. 1367 (2010).

[224] 344 U.S. 293 (1953).

[225] 339 U.S. 306 (1950).

[226] Here I waive my thought experiment suggesting that student lenders do not have any such right, given the exact wording of the Bankruptcy Code.