SECTION NOTE

OBA Bankruptcy and Reorganization Section:

Creditors Beware: The 10th Circuit Holds That Confirmed Plan Language Is *Res Judicata* Even When Contrary to the Bankruptcy Code

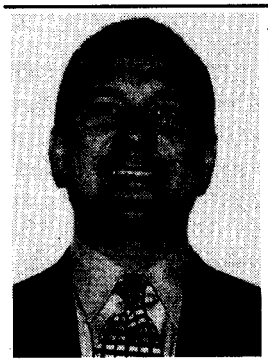
By Gary D. Hammond and Jeffrey E. Tate

On June 7, 1999, the 10th Circuit Court of Appeals announced that it will uphold confirmed Chapter 13 Plans, even when provisions of the plans are contrary to the Bankruptcy Code. In *Anderson v. UNIPAK-NEBHELP (In re Anderson)*, 179 F.3d 1253, 1258, (10th Cir. 1999), the Tenth Circuit Court of Appeals held that inclusion of appropriate language in a confirmed Chapter 13 Plan constitutes a finding of undue hardship, justifying the discharge of student loans.[1]

To understand the importance of the *Anderson* case, one must consider the language of the relevant provisions of the Bankruptcy Code (the "Code").[2] Before October, 1998, the Code allowed debtors to discharge student loans (1) that first became due more than seven (7) years before the date of the filing of the petition, or (2) where excepting the student loan from discharge would impose an undue hardship on the debtor. In October 1998, Congress amended the Code by denying discharge of student loans in all cases but undue hardship.[3] The burden to prove undue hardship always rests squarely on the shoulders of the debtor attempting to discharge student loans.[4] As a general rule, a debtor must bring an adversary proceeding in order to obtain a finding of undue hardship.[5] In *Anderson*, the Tenth Circuit recognized an exception to the general rule.

In *Anderson*, Doreen Ann Anderson ("Debtor" or "Anderson") incurred four (4) student loans. On December 27, 1990, Debtor filed for relief under Chapter 13 of the Code. Subsequently, the Higher Education Assistance Foundation ("HEAF"), the guaranty agency for the student loans, filed proofs of claims on three of the four student loans. The Debtor proposed a plan that would pay only 10 percent (10%) of the debtor's outstanding student loans (the "Plan"). Furthermore, the Plan included the following language:

> Pursuant to 11 U.S.C. § 523(a)(8), excepting the aforementioned education loans from discharge will impose an undue hardship on the debtor and the debtor's dependents. Confirmation of the debtor's plan shall constitute a finding to that effect and that said debt is dischargeable.



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HEAF filed an untimely objection to the Plan. HEAF's objection was denied because it was untimely. Thereafter, the bankruptcy court entered an order confirming the Plan. HEAF, for whatever reason, failed to appeal the order of confirmation. Ultimately, the debtor successfully completed the Plan and was granted a discharge on December 22, 1994.

After discharge, HEAF resumed its efforts to collect the remaining balances on the student loans. On September 25, 1995, Anderson reopened her bankruptcy case and filed an

adversary proceeding against HEAF to determine the dischargeability of the student loans. The bankruptcy court framed the issue as "whether a debtor may, by including language in a plan, discharge an otherwise nondischargeable debt in Chapter 13."[6] The bankruptcy court, however, noted that the real issue was "whether the plan provisions here constitute a binding adjudication of hardship."[7] The bankruptcy court concluded that insertion of language such as that included in Anderson's Plan was not sufficient to overcome the presumption of nondischargeability of student loan debts.[8] The bankruptcy court also stated that student loans may only be discharged after the successful conclusion of an adversary proceeding.[9]

Anderson appealed the bankruptcy court's decision to the 10th Circuit Bankruptcy Appellate Panel (the "BAP"). In a published decision, the BAP reversed the bankruptcy court, holding that confirmation of the Plan constituted a finding of undue hardship, rendering the student loans dischargeable.[10] HEAF then appealed the BAP decision to the 10th Circuit Court of Appeals.

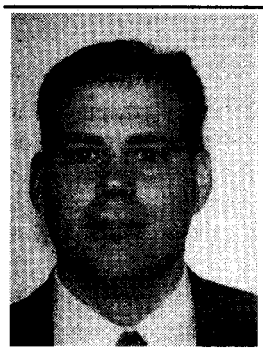
After reciting the facts of the case, the 10th Circuit Court of Appeals reiterated the fact that debtors bear the burden of demonstrating undue hardship required to discharge student loans.[11] A creditor never has the burden of showing a lack of undue hardship.[12] The *Anderson* Court went on, however, to state that the "real issue here is not whether Andersen properly met her burden of proving an undue hardship, which she clearly did not, but whether confirmation of the plan constitutes a binding adjudication of hardship."[13] In its final analysis, the *Anderson* Court affirmed the BAP decision and held that confirmation of the Plan did constitute a binding adjudication of hardship.[14]

In reaching its conclusion, the *Anderson* Court weighed a debtor's duty to satisfy its burden of proof against a creditor's absolute duty to take an active role in protecting its own interests. In the end, the *Anderson* Court concluded that if a creditor fails to make timely objections to damaging plan provisions, the creditor cannot complain about such terms after confirmation of the plan, even if the provision is inconsistent with the bankruptcy code.[15]

The *Anderson* Court based its conclusion upon two factors. First, the *Anderson* Court noted that a creditor has the absolute duty to protect its own interests.[16] In *Anderson*, HEAF failed to file a timely objection to the Plan, and also failed to appeal the order confirming the Plan. As stated by the *Anderson* Court, creditors who fail to protect their own interests are "in a poor position to later complain about an adverse result."[17]

Second, the *Anderson* Court discussed the strong judicial policy of finality, stating:

> While Anderson did not properly prove undue hardship pursuant to the requirements of the Code, we agree with the Third Circuit that, 'after the plan is confirmed the policy favoring the finality of confirmation is stronger than the bankruptcy court's and the trustee's obligations to verify a plan's compliance with the Code.'[18]



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The published decisions regarding this case are important for several reasons. First, as the BAP pointed out, a Chapter 13 Plan is considered an offer to contract from the debtor.[19] Failure to object will result in a binding agreement between the debtor and creditor if the Plan is ultimately confirmed.[20] Second, the BAP, and the 10th Circuit,[21] apparently will take a very narrow view of "due process" requirements in these matters. Consequently, a creditor's due process includes only the **opportunity** to object to the Plan before confirmation, and possibly to appeal confirmation of such an order. It is important to know that creditors are not guaranteed a trial. In the 10th Circuit, "due process

requires only that there be notice and a meaningful opportunity to be heard – no more, and no less.[22]

Third, neither the BAP nor the 10th Circuit took any steps to limit what language could potentially be inserted into a Chapter 13 Plan. Both courts did make it painfully clear that language in a Plan will be upheld and considered *res judicata* after confirmation, even when such language violates the Code.[23] Thus, it is unclear just how far a debtor may go to impair secured liens or to discharge debts adjudicated to be non-dischargeable in a pre-conversion Chapter 7 case. Importantly, the BAP did note that a Chapter 13 Plan, if confirmed, may extinguish security interests,[24] and may bar collection from a third-party guarantor.[25]

Clearly, creditors must be actively involved in the confirmation process. Creditors may not sit on their rights in anticipation that their interests will be fully protected by the bankruptcy court or the trustee.[26] Failure to scrutinize each line of a proposed plan could lead to harsh results for the unwary creditor, as well as for the unwary attorney who must explain to the client how a "nondischargeable" debt has been discharged without a trial.

1. 179 F.3d at 1258.
2. All references to the Code are to 11 US.C. § 101 *et seq.*
3. 11 US.C. § 523(a)(8).
4. 179 F.3d at 1256.
5. *Id.*
6 179 F.3d at 1255.
7. *Id.*
8. *Id.*
9. *Id.*
10. *In re Anderson,* 215 B.R. 792, 796 (10th Cir. BAP 1998).
11. 179 F.3d at 1256.
12. 179 F.3d at 1257.
13. 179 F.3d at 1256.
14. 179 F.3d at 1258.
15. 179 F.3d at 1257. (citing *Lawrence Tractor Co. v. Gregory,* 705 F.2d 1118, 1121 (9th Cir. 1983)).
16. *Id.* at 1257.
17. *Id.*
18. *Id.* (citing *In re Szostek,* 886 F.2d 1405, 1406 (3rd Cir. 1989)).
19. 215 B.R. at 795. (citations omitted)
20. *Id.*
21. The 10th Circuit did not specifically discuss the BAP's views of the due process
22. 215 B.R. at 795. (citing *Turney v. FDIC,* 18 F.3d 865 (10th Cir.1994).)
23. 215 B.R. at 795; 179 F.3d at 1257-1258.
24. 215 B.R. at 794 (discussing *American Bank and Trust Co. v. Jardine Insurance Services Texas, Inc. (In re Barton),* 104 F.3d 1241 (10th Cir. 1997).
25. 215 B.R. at 794 (discussing *Landsing Diversified Properties-II v. first Nat'l Bank and Trust Co. (In re Western Real Estate Fund, Inc.),* 922 F.2d 592 (10th Cir. 1990), modified on other grounds sub nom. *Abel v. West,* 932 F.2d 898 (10th Cir. 1991.))
26. 179 F.3d at 1256.