No. 08-1134

In The
Supreme Court of the United States

UNITED STUDENT AID FUNDS, INC.,

Petitioner,

v.

FRANCISCO J. ESPINOSA,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF *AMICUS CURIAE* EDUCATIONAL CREDIT MANAGEMENT CORPORATION IN SUPPORT OF PETITIONER

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AMICUS CURIAE BRIEF OF EDUCATIONAL CREDIT MANAGEMENT CORPORATION IN SUPPORT OF PETITIONER

Educational Credit Management Corporation submits this *amicus curiae* brief in support of Petitioner United Student Aid Funds, Inc.[1]

STATEMENT OF IDENTITY AND INTEREST OF *AMICUS CURIAE*

Amicus curiae Educational Credit Management Corporation (ECMC) is a private, nonprofit corporation and guaranty agency in the Federal Family Education Loan (FFEL) Program, one of two federally-insured student loan programs.[2] The federal

[1] Pursuant to Sup. Ct. R. 37.3(a), counsel of record states that all parties have consented to the filing of this brief by *amicus curiae*, and their consent letters are on file with the Clerk's Office. Pursuant to Sup. Ct. R. 37.6, *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no person other than *amicus* has made a monetary contribution to the preparation or submission of this brief.

[2] The Federal Government operates two student loan programs: The Federal Family Education Loan (FFEL) Program and the William D. Ford Federal Direct Loan (DL) Program. Both programs are regulated by the United States Department of Education (ED) and are federally-insured.

financial interest at stake in the federal student loan program is paramount, totaling $525 billion.[3]

ECMC is also a specialized guarantor designated by the United States Department of Education (ED) to receive assignment of chapter 13 accounts when a borrower has filed bankruptcy. Twenty-six of the 35 FFEL Program guaranty agencies as well as ED assign their chapter 13 bankruptcies to ECMC for servicing during the bankruptcy. ECMC guarantees or services approximately 65% of the total FFEL Program loan volume currently in bankruptcy. In the Ninth Circuit alone, ECMC manages the accounts of 6,600 chapter 13 bankruptcy debtors who have FFEL student loans, totaling over $148 million and an additional 53,000 chapter 13 bankruptcy cases nationwide, representing almost $1.1 billion.

[3] The most current dollar amount publicly available indicates that, as of September 2008, there is approximately $415 billion of student loans in the FFEL Program and $109.9 billion in the DL Program. *See* http://www.ed.gov/about/reports/annual/2008report/report.pdf, at 32, 144. The actual current total dollar amount is likely much higher. FY2009 loan volume has in fact, exceeded the FY2010 budget projections: "Overall federal education loan volume increased by $7.3 billion to a total of $28.0 billion in the first six months of FY2009 as compared with the first six months of FY2008, a 35% year-over-year increase. This compares with the 13.6% increase assumed by the president's FY2010 budget." *See* http://www.finaid.org/loans/fy2009v2008loanvolume.txt.

To survive, the FFEL Program relies on loan repayments to fund new student loans. Because collecting student loans assures the program will continue, Congress has repeatedly passed legislation to minimize the loss of federal funds due to student loan defaults, collection failures, and especially discharge in bankruptcy. In addition to increasingly stricter bankruptcy legislation, this Court has promulgated specific bankruptcy processes to effect congressional intent and to create uniform bankruptcy practices.

The federally-mandated regulatory claims process and the sheer volume of bankruptcy claims has the potential of effectively limiting a guaranty agency's meaningful participation in chapter 13 cases, at least in the plan confirmation process. For example, when a borrower files a chapter 13 bankruptcy, the lender receives general notice of filing from the bankruptcy clerk; the lender then files a claim for the student loan with the guaranty agency, who then, in the majority of cases, assigns the account to ECMC for handling. It is not uncommon for these transfers to exceed the time set by the rules to object to confirmation of the plan.

As the primary chapter 13 bankruptcy processer, servicing $1.25 billion, ECMC receives 18,537 bankruptcy documents monthly by U.S. mail. Of this monthly number, nearly 20% or 3,587 alone are chapter 13 plans. In many cases, by the time the bankruptcy claim is processed, the chapter 13 plan may already have been confirmed before the guaranty agency has received actual notice or had a realistic opportunity to respond. Through legislation, Congress has addressed these pragmatic and administrative burdens facing student loan creditors by requiring debtors to provide heightened notice to the loan holders when seeking to discharge student loan debt.

Only the Ninth Circuit stands at odds with Congress, this Court, and five circuit courts that have affirmed the very specific rules and process debtors must follow to discharge their student loan debt. Because ECMC plays an integral role in the federal student loan program, it brings a practical perspective that may assist the Court in its decision.

SUMMARY OF ARGUMENT

The Ninth Circuit's *Espinosa*[4] decision is an aberration that defies Congress's pragmatic student loan discharge process. This decision, which validates the deliberately illegal practice of discharging student loans by declaration in a chapter 13 plan, invites debtors and their counsel to lay a trap for their student loan creditor. If the debtor slips a single sentence into his chapter 13 plan and if the student loan creditor does not carefully police every plan and catch this single sentence, then the debtor has craftily avoided his burden to file an adversary proceeding and prove undue hardship as expressly required by Congress and this Court. The debtor has dodged repaying his federally-insured debt with the stroke of a pen, and, by sneaking a single sentence into an administrative document, thousands of which are mailed to creditors every day, the debtor has avoided every obligation placed on him by statute. This is simply not the law as set forth by Congress in the Bankruptcy Code or the process prescribed by this Court.

In weighing a debtor's right to a fresh start against future students' right to student loans, Congress chose to protect the federal student loan program. It did so by making the debtor act, not the creditor. This dichotomy, which this Court has

[4] *Espinosa v. United Student Aid Funds, Inc.*, 553 F.3d 1193 (9th Cir. 2008).

affirmed, is set forth in the Bankruptcy Code and Federal Rules of Bankruptcy Procedure:

Debtors' Obligations:

- Debtors alone have the burden to prove entitlement to a discharge of their student loan debt.
- Debtors' burden is heavy because student loans are presumptively nondischargeable.
- Debtors can only satisfy this burden by filing an adversary proceeding, which is a federal court action separate from the main bankruptcy case, and proving undue hardship.
- Filing an adversary proceeding requires a summons and complaint and service of process, i.e., notice above mailing to a post office box.
- Absent debtors taking all of these required steps and satisfying the legal standard for undue hardship, the bankruptcy court's discharge order will not include a discharge of the student loan debt.

Student Loan Creditors' Rights:

- Creditors' status as holder of a nondischargeable debt is established by statute.
- Creditors do not need to take any steps to "obtain" nondischargeable status because nondischargeability status is "self-executing."
- Creditors can expect to receive notice through service of a summons and complaint of an adversary proceeding if the nondischargeability status of the debt is contested.
- Nothing in the Bankruptcy Code or Rules leads creditors to believe their nondischargeable debt can be eliminated by illegal language stuck in a plan.
- Creditors expect that, absent action by debtor, the student loan debt will not be included in the standard discharge order.

Tenn. Student Assistance Corp. v. Hood, 541 U.S. 440, 450-53 (2004). This practical, procedural process is what Congress intended, what this Court has affirmed is due, and what the student loan creditors have a right to expect.

Adopting *Espinosa*'s approach has significant financial and practical consequences for the federal government, the student loan industry, and the legal processes governing bankruptcy courts. It also sanctions a dangerous path for debtors to discharge other nondischargeable debts like child support, spousal maintenance, tax debt, and personal injury and wrongful death judgments through their chapter 13 plans. *Espinosa* reduces the bankruptcy process to gamesmanship and condones and encourages unethical, sanctionable practices by debtors' attorneys. ECMC urges this Court to reverse the Ninth Circuit's *Espinosa* decision.

ARGUMENT

I. Orders Discharging Student Loan Debt Through the Plan Confirmation Process Violate Creditors' Right to Due Process and Are Void.

A. This Court has specifically delineated the process that is due.

The Constitution vests Congress with plenary power to legislate "uniform laws on the subject of Bankruptcies." U.S. CONST. art. I, § 8, cl. 4. In turn, pursuant to 28 U.S.C. § 2075, Congress imbued this Court with the mandate "to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under title 11." In promulgating the Federal Rules of Bankruptcy Procedure, this Court specifically delineated the process that is due to student loan creditors before student loan debt may be discharged. It is this specific process – established by this Court –

that the Ninth Circuit ignores, without legal or factual justification.

1. *Mullane* establishes the process that is due.

More than five decades ago, this Court held that due process requires that "deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing *appropriate to the nature of the case*." *Mullane v. Cen. Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950) (emphasis added). Critically, the Ninth Circuit misses or improperly dismisses this key phrase: "appropriate to the nature of the case." To accord finality to a bankruptcy court's plan confirmation order, *Mullane* requires that the notice be

> reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.
>
> . . .
>
> But when notice is a person's due, process which is a mere gesture is not due process. The means employed must be such as one desirous of actually informing the absentee might reasonably adopt to accomplish it.

Id. at 315.

Significantly, Congress expressly incorporated the *Mullane* standard in the Bankruptcy Code:

> In this title –
>
> (1) "after notice and a hearing," or a similar phrase –
>
> (A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances.

11 U.S.C. § 102(1). This provision, read together with 11 U.S.C. § 523(a)(8), leaves little doubt that the process due in student loan discharge matters is "heightened" to afford "greater procedural protections" to student loan creditors. *See Hood*, 541 U.S. at 451 (Rehnquist, C.J.) ("Because student loan debts are not automatically dischargeable . . . the Federal Rules of Bankruptcy Procedure provide creditors greater procedural protection.").

2. *Hood* prescribes precisely which bankruptcy rules must be followed to satisfy *Mullane*'s due process requirements in the student loan discharge context.

This Court stated that, "unless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." *Hood*, 541 U.S. at 449 (Rehnquist, C.J.) (citing 11

U.S.C. § 523(a)(8)). As Chief Justice Rehnquist explained, § 523(a)(8) is “self-executing,” requiring the debtor – not the creditor – to seek the dischargeability determination through an adversary proceeding as required by Fed. R. Bankr. P. 7001(6). *Id.* at 450.

Further, Chief Justice Rehnquist noted that, absent Rule 7001(6), debtors could affirmatively seek discharge of their student loan debt by motion under Rule 9014 without raising constitutional concerns. *Hood*, 541 U.S. at 453; *but see* Fed. R. Bankr. P. 9014(b) (requiring Rule 9014 motion “shall be served in the manner provided for service of a summons and complaint under Rule 7004”). Under 7001(6), debtors must initiate an adversary, file a complaint, and serve a summons on the student loan creditor pursuant to Fed. R. Bankr. P. 7004. *Hood*, 541 U.S. at 450-51.

In this case, the bankruptcy court clerk mailed the general notice of the bankruptcy filing to USA Funds. Given the unique “nature of the [bankruptcy] case” in student loan discharge matters, sending general notice to a post office box address, addressed to no particular person cannot be construed – at any level – as notice “appropriate to the nature of the case.”

B. The Ninth Circuit's conclusion that notice under Fed. R. Bankr. P. 2002 satisfies a creditor's due process is contrary to this Court's decisions in *Mullane* and *Hood*.

Long ago, this Court recognized that "[e]ven 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." *City of New York v. New York, New Haven & Hartford R.R. Co.*, 344 U.S. 293, 297 (1953). *Hood* specifically outlined what rules debtors must follow to satisfy the "greater procedural protection" student loan creditors enjoy in bankruptcy settings. *Hood*, 541 U.S. at 550-52.

Curiously, Espinosa himself never served any type of notice, let alone service of process, on USA Funds, and there is no dispute that the only notice provided to USA Funds was mailed to a post office box pursuant to Fed. R. Bankr. P. 2002 by the bankruptcy court clerk. The Fourth Circuit explained the difference between Rule 2002 notice and Rule 7004 notice in bankruptcy:

> Fed. R. Bankr. P. 2002(b) does not require specific notice of plan provisions affecting a particular creditor, nor does it require the notice to be served in any particular manner or upon any particular person. "[T]here are many aspects to and actions that may be taken in bankruptcy cases which affect the general administration of the case and all

> creditors generally, but none specifically." Generally, such matters require "notice," but not service of process. When the rights of specific parties become an issue, however, service of the initiating motion or objection on the affected party is required. Fed. R. Bankr. P. 7003, 7004. Mailing the proposed plans, the hearing notice, and the confirmation order satisfies the "notice" requirement under Rule 2002, but not the service and summons requirements of Rule 7004.

Banks v. Sallie Mae Serv. Corp. (*In re Banks*), 299 F.3d 296, 301 (4th Cir. 2002) (internal citation omitted); *see also Ruehle v. Educ. Credit Mgmt. Corp.* (*In re Ruehle*), 412 F.3d 679, 684 (6th Cir. 2005); *Hanson v. Educ. Credit Mgmt. Corp.* (*In re Hanson*), 397 F.3d 482, 486-87 (7th Cir. 2005); *Repp v. Educ. Credit Mgmt. Corp.* (*In re Repp*), 307 B.R. 144, 152-56 (B.A.P. 9th Cir. 2004) (holding that "notice less than that which results from compliance with Rule 7004's requirement for serving a complaint on a corporate defendant flunks due process").

The Ninth Circuit's assertion that the plan itself or the Trustee's general warning letter, both which were mailed by the court's clerk to a general post office box, were sufficient notice falls wide off the *Mullane* mark. *See Espinosa*, 553 F.3d at 1200, n.4. That USA Funds received general notice or that "nobody-in-particular" at USA Funds may have received actual notice is also not the specific, appropriate notice this Court, the Bankruptcy Code, or the Bankruptcy Rules require.

Here, the process – or lack thereof – chosen by Espinosa was substantially less likely to "bring home notice" than the "feasible," "customary," and legally required alternative: summons and complaint, delivered to a registered agent or corporate officer. *See Repp*, 307 B.R. at 149 ("The nub of the problem . . . is that the method chosen for notice was calculated to minimize the chance that it would come to the attention of persons in the position to make litigation decisions for the creditor.").

If Espinosa had actually desired to notify USA Funds of his intent to discharge his student loan, he could easily have served the corporate officer or registered agent of the student loan creditors with a summons and complaint as required by the Bankruptcy Rules. Instead, he served no notice at all of his intent to discharge his student loan debt by less than payment in full but rather relied on the court clerk to mail general notice under Rule 2002. This practice places the student loan creditor in an unfair position:

> It is black-letter law that [student loan creditors] are not required to respond per Rule 7012 until they have been "duly served" in accordance with Rule 7004 and need not fear a default judgment if they have not been "duly served." Yet – Catch-22 – if they do not respond to notice of a plan mailed in accordance with Rule 2002 to nobody-in-particular at a

> payment lockbox, they stand to lose their rights by default to an "illegal" plan provision that they – double Catch-22 – are entitled to expect the court, in the exercise of its independent duty, to reject in the first place.

Repp, 307 B.R. at 153.

The form of notice served on USA Funds was not "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Mullane,* 339 U.S. at 314. In this case, Espinosa never issued a summons or complaint and the issue of undue hardship was never litigated.[5]

While not every procedural rule violation offends due process, *Hood*'s explicit recitation of procedural requirements in student loan discharge matters is not mere dicta as Espinosa argued below. Rather, *Hood*'s discussion about the procedural rules at issue here is fundamental to all of the Bankruptcy Code, whether the issue is sovereign immunity or student loan

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[5] Indeed, Espinosa did not attempt to plead or prove in his plan that payment of the full amount of his student loan debt would constitute an undue hardship.

discharge.[6] 11 U.S.C. § 102 embodies the *Mullane* standard for notice. *Hood* reaffirms the specific notice appropriate in student loan discharge matters as required by § 102 and the Bankruptcy Rules. Under *Hood*, the appropriate notice is a heightened notice, to afford a greater procedural protection to effect Congress's explicit intent to prevent discharge of student loan debt, except upon proof of undue hardship under § 523(a)(8). *Hood*, 541 U.S. at 451.

The bankruptcy rules do not invoke or create a constitutional due process notice standard, but they do require a certain specific process, just like service of process rules in the Federal Rules of Civil Procedure. And it is reasonable for any bankruptcy

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[6] The Ninth Circuit wrongly suggests that, in the student loan context, *Hood* narrowly stands for the proposition that "an adversary proceeding initiated by complaint and summons is not a statutory or constitutional prerequisite to an adjudication of student loan discharge." *Espinosa*, 553 F.3d at 1202 (citing Keith M. Lundin, *Chapter 13 Bankruptcy* § 229.1 (3d ed. 2000 & Supp. 2004)). Actually, *Hood*'s point is broader and simpler and does not "undermine[ ] Fund's argument." In *Hood*, Tennessee Student Assistance Corporation (TSAC), a state-based guaranty agency, invoked sovereign immunity from the student loan discharge action. This Court disagreed that the discharge action was an affront to TSAC's sovereignty on the ground that the discharge action was an *in rem* action and the court's jurisdiction was premised on the *res* not the person or the State. Thus, the form of pleading by which the sovereign was brought into the proceeding, i.e., a Summons and Complaint, did not change the fact that the bankruptcy proceeding was an *in rem* proceeding, and, therefore, the "undue hardship determination . . . is not a suit against a State for purposes of the Eleventh Amendment." *Hood*, 541 U.S. at 451 & n.5.

litigant to rely on and expect that *all* of the rules will be followed. Even the Ninth Circuit agrees that Congress intended for there to be a heightened notice standard to discharge student loan debt *but only when* a debtor files an adversary proceeding. Circularly, the Ninth Circuit reasons that, because Espinosa never filed an adversary proceeding, the creditor was not entitled to heightened notice. *Espinosa*, 553 F.3d at 1204. The Ninth Circuit did not and cannot relieve a debtor from following specific bankruptcy procedural rules that plainly require a debtor to file an adversary proceeding to discharge student loan debt.

Reversing *Espinosa* does not require drawing a constitutional due process bright line for student loan cases. Reversing *Espinosa* ensures that the simple notice standard and well-functioning procedural processes in the Bankruptcy Code and Rules are enforced. Reversing *Espinosa* ends the gamesmanship and forces debtors to follow the same rules as all litigants must do.

II. Confirmation Orders Containing Discharge-by-Declaration Provisions Have No Preclusive Effect.

In its wholesale rejection of this Court's precedent and the creditor's due process concerns, the Ninth Circuit relied primarily on its earlier plan language decision, *Great Lakes Higher Educ. Corp. v. Pardee* (*In re Pardee*), 193 F.3d 1083 (9th Cir. 1999).

Although *Andersen*,[7] the early case that *Pardee* relied on had been reversed by the Tenth Circuit, the Ninth Circuit determined that *Pardee* and the overruled *Andersen* were still the right approach. The Ninth Circuit concluded it had not "strayed off course" and reaffirmed its *Pardee* decision, holding that

> *Pardee* and *Andersen* stand soundly for the better-reasoned principle that notice of how the Chapter 13 plan affects creditors' rights is all that the Constitution, the Bankrutpcy Code and the Bankruptcy Rules require to bind creditors to the provisions of a confirmed plan under § 1327(a).

Espinosa, 553 F.3d at 1202.

A. When two statutory provisions conflict, the specific statutory provision will prevail over the general statutory provision.

In concluding discharge-by-declaration provisions are not entitled to preclusive effect, the Tenth Circuit relied, in part, on the inherent statutory conflict between 11 U.S.C. § 1327(a) and 11 U.S.C. § 1328(a)(2). *Educ. Credit Mgmt. Corp. v. Mersmann* (*In re Mersmann*), 505 F.3d 1033 (10th Cir. 2007) (en

[7] *See Andersen v. UNIPAC-NEBHELP* (*In re Andersen*), 179 F.3d 1253 (10th Cir. 1999), *overruled by Educ. Credit Mgmt. Corp. v. Mersmann* (*In re Mersmann*), 505 F.3d 1033 (10th Cir. 2007) (en banc).

banc). In overruling its earlier *Andersen* case, the Tenth Circuit noted "[g]iving preclusive effect to the [general] discharge-by-declaration through § 1327(a) renders [the specific exception] of § 1328(a)(2) nugatory." *Mersmann*, 505 F.3d at 1048.

Under statutory construction principles, when general and specific statutory provisions contradict, the "specific pronouncement [of § 1328(a)(2)] must be read as limiting § 1327(a) broad *res judicata* effect." *Id.* In other words, the specific language of the § 1328 discharge order that specifically excepts student loan debt from bankruptcy discharge limits the broader reach of the plan confirmation order that binds creditors who fail to object to illegal plan language. *Id.*; *see also Whelton v. Educ. Credit Mgmt. Corp.*, 432 F.3d 150, 155-56 (2d Cir. 2005) (expressly rejecting the Ninth Circuit's reliance on the general preclusive effect of 11 U.S.C. § 1327(a)).

In a footnote, the Ninth Circuit dismissed the import of the Tenth Circuit's statutory ground because "it proves something that is both obvious and beside the point." *Espinosa*, 553 F.3d at 1199, n.3. While *Mersmann*'s holding is obvious, it is also "the point" the Ninth Circuit missed. Section 1327 and its general binding effect cannot control or dictate the specific exception for student loan debt contained in the general discharge provision of § 1328.

Moreover, the Tenth Circuit also noted that discharge-by-declaration language violates 11 U.S.C. § 1325's requirement that chapter 13 plans comply with the Bankruptcy Code. Therefore, allowing a plan with illegal language to be confirmed "violates the general maxim that the Bankruptcy Code and Rules 'be construed so that their provisions are harmonious with each other.'" *Id.* Thus, giving "preclusive effect to a confirmation order based solely on § 1327(a) deprives the Bankruptcy Code and Rules of a coherent reading, fails to give full effect to all of their provisions, and undermines the clear will of Congress." *Id.* Section 1327 is not controlling in this instance; it simply has no preclusive effect on the student loan creditor who fails to object to an illegal plan confirmation order.

B. *Travelers v. Indemnity Co.* is immaterial to this case.

1. *Travelers* is inapposite.

While this Court's recent *Travelers*' decision discusses the finality of orders in bankruptcy cases, it is inapposite to the issue before this Court. *See Travelers Indemnity Co. v. Bailey*, 129 S. Ct. 2195 (2009). *Travelers* does not support Espinosa's position for two reasons: First, *Travelers* did not address the tension between the finality of orders and orders entered in violation of a party's due process rights. In fact, this Court left Respondent Chubb's due process challenge to the bankruptcy court's 1986 Orders to the Second Circuit on remand because the Second Circuit had not previously considered it. *Travelers*, 129 S. Ct. at 2207; *see also Espinosa*, 553 F.3d at

1203-04 (noting that *Pardee* did not address due process and now rejecting three other circuit courts' due process holdings, finding the analysis "novel" and "unpersuasive"). Irrespective of *Travelers*' finality rule, *Espinosa* can and should be reversed independently on due process grounds. And, unlike *Travelers*, that issue is squarely before this Court and is ripe for decision.

2. At best, *Travelers* merely offsets the conflicting final orders.

Second, *Travelers* as much supports the finality of the plan confirmation order against USA Funds as it does the finality of the discharge order against Espinosa. Espinosa received his general discharge in 1997. The discharge order provided:

> Pursuant to 11 USC §1328(a), the debtor(s) are discharged from all debts provided for by the plan or disallowed under 11 USC § 502, ***except any debt***
>
> . . . .
>
> (c) for a student loan or educational benefit overpayment as specified in 11 U.S.C. § 523(a)(8).

Jt. App. at 46. This order clearly excepted from discharge "any amounts remaining" on Espinosa's student loan debt. It is undisputed that Espinosa never challenged this discharge order or appealed the fact that the discharge order did not discharge "any amounts remaining" on his student loan debt as proclaimed in his chapter 13 plan. Under this Court's *Travelers* decision, the bankruptcy court's 1997 discharge order was *res judicata* against Espinosa. *See Travelers*, 129 S. Ct. at 2205. Even the Ninth Circuit found that

> [c]uriously, the discharge order provided that Espinosa was "discharged from all debts provided for by the plan . . . except any debt . . . for a student loan," which contradicted the terms of the plan and pretty much rendered the whole exercise pointless from Espinosa's point of view. Curiouser[8] still, Espinosa did not seek reconsideration of the discharge order, nor did he appeal.

Espinosa v. United Student Aid Funds, Inc., 530 F.3d 895, 896 (9th Cir. 2008). Most important, however, the Ninth Circuit recognized that, rather than asking the bankruptcy court to modify the discharge order or moving for relief under Rule 60, Espinosa

> allowed the bankruptcy court's discharge to become final, and the time to appeal lapsed long ago. . . . Instead, Espinosa sought to enforce the discharge injunction against [USA Funds]. The obvious problem, of course, is that the discharge injunction simply does not run against [USA Funds] because the bankruptcy court's discharge

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[8] The Ninth Circuit's reference to *Alice in Wonderland* no doubt foreshadowed what was to come for the student loan industry.

> order did not cover its debt. [USA Funds] was thus free to collect its debt, and the bankruptcy court seems to have misread its own order when it held otherwise.

Id. at 898-99. Under *Travelers*, even if the discharge order failed to give Espinosa the "benefit of his bargain" as illegally provided for in his chapter 13 plan, the discharge became "final on direct review (whether or not proper exercises of the bankruptcy court jurisdiction and power), [and] it became *res judicata*" against Espinosa. *See Travelers*, 129 S. Ct. at 2205.

Despite conceding the finality of the discharge order, the consequences of Espinosa's failure to appeal, and the bankruptcy court's legally erroneous decision against USA Funds, the Ninth Circuit remanded the case to the bankruptcy court with "our express leave to consider whether its discharge order . . . was entered as a result of a clerical error [under Rule 60(a)]." *Id.* at 899.[9]

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[9] In remanding to the bankruptcy court, the Ninth Circuit noted that the Tenth Circuit approved the bankruptcy court's use of Rule 60(a) in *Mersmann* to amend an identically-styled discharge order. *Espinosa*, 530 F.3d at 899 (citing *Educ. Credit Mgmt. Corp. v. Mersmann* (*In re Mersmann*), 505 F.3d 1033, 1039-40 & n.5 (10th Cir. 2007)). The noted comment in *Mersmann* is dicta, at best, and is superfluous to the Ninth Circuit's use of Rule 60(a) here. The conflicting discharge order was not at issue in *Mersmann*. Moreover, *Mersmann* overruled its earlier *Andersen* decision, thereby forbidding the dischargeby-declaration practice in the Tenth Circuit. Had the

(Continued on following page)

3. The corrected 2008 discharge order was void because the court altered the parties' substantive rights.

Rule 60(a) allows a bankruptcy court to correct a clerical mistake, oversight, or omission in a judgment, order, or other part of the record, whenever one is found. Correction of "[e]rrors that affect substantial rights of the parties, however, are beyond the scope of rule 60(a)." *Mullins v. Nickel Plate Mining Co., Inc.*, 691 F.2d 971, 973 (11th Cir. 1982). Here, the bankruptcy court exceeded its authority under Rule 60(a) because the corrected discharge order completely changed USA Funds' substantive rights, rights that had vested a decade before in reliance on the order. *See id.*

Courts "plainly ha[ve] jurisdiction to interpret and enforce [their] own prior orders." *Travelers*, 129 S. Ct. at 2205. But the bankruptcy court's alteration of its 1997 discharge order went well beyond "interpretation" and was per se improper under Rule 60(a). Rule 60(a) "is concerned primarily with mistakes that do not really attack the party's fundamental right to the judgment at the time it was entered. It permits the correction of irregularities which becloud but do not impugn it." *United States v.*

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discharge order ***not*** been altered in *Espinosa*, Espinosa's contempt motion and the appeal to the Ninth Circuit would have been "pointless." *Espinosa*, 530 F.3d at 896. And had the discharge order ***not*** been altered, presumably the Ninth Circuit would not have ultimately ruled as it did.

Stuart, 392 F.2d 60, 62 (3d Cir. 1968). In this instance, USA Funds had the fundamental right to rely on the discharge order that was entered by the bankruptcy court in 1997 – an order that was entered in full compliance with the law and was never challenged by Espinosa.

Even the Ninth Circuit acknowledged that it is "an open question" as to whether, in 1997, the bankruptcy court could have entered an order giving effect to Espinosa's illegal plan. *Espinosa*, 553 F.3d at 898. Nonetheless, the Ninth Circuit remanded with express leave to do just that.

On remand, the bankruptcy court corrected the discharge order to include discharge of the student loans, noting that "it was the clear intent of the court, as reflected in the chapter 13 Plan, as approved by the court that all student loan-related obligations were to be discharged if the debtor successfully completed and performed the Plan."[10] Espinosa never challenged or appealed the order, and the bankruptcy court failed to correct it in 2003 even when that order was the basis of Espinosa's contempt motion. The bankruptcy court's alteration five years later and,

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[10] The judge who "corrected" the order to reflect the bankruptcy court's "clear intent" was not the judge who purportedly reviewed Espinosa's chapter 13 plan in 1992, signed the plan confirmation order in 1993, and signed the discharge order in 1997. The original judge passed away in 2001, seven years before the clerical error issue was even raised.

then only with nudging from the Ninth Circuit, is untenable under Rule 60(a).

Finally, while the bankruptcy court below may have "corrected" the discharge order to give effect to the factual language in the plan, it would be absurd to allow a bankruptcy court to make a lawful, final order unlawful under Rule 60(a). *Cf. Warner, III v. City of Bay St. Louis*, 526 F.2d 1211, 1212 (5th Cir. 1976). Such license "would significantly weaken the policy of finality as embodied in the Federal Rules." *Id*. (citing Moore, Federal Practice, Vol. 6(a), at 4043 (1973)).[11]

The bankruptcy court's alteration of a lawful, final discharge order "'concern[s] the outer reaches of a bankruptcy court's jurisdiction.'" *Travelers*, 129 S. Ct. at 2203 (citing *In re Johns-Manville Corp.,* 517 F.3d 52, 55 (2d Cir. 2008)). Undoubtedly, a bankruptcy court has jurisdiction to enter discharge orders and to interpret and enforce its prior orders. *Travelers*, 129 S. Ct. at 2205. But a bankruptcy court exceeds its jurisdiction by entering a discharge order in violation of the Bankruptcy Code, and that order

[11] Such a challenge to the court's 1997 discharge order by Espinosa would have been appropriate under Rule 59 or Rule 60(b). But Espinosa's time to challenge the 1997 discharge order under these rules lapsed more than a decade ago. *Cf. Warner, III*, 526 F.2d at 1213, n.4.

is therefore void. *Windsor v. McVeigh*, 93 U.S. 274, 282-83 (1876). In *Windsor*, this Court stated that

> [t]hough the court may possess jurisdiction of a cause, of the subject-matter, and of the parties, it is still limited in its modes of procedure, and in the extent and character of its judgments. It must act judicially in all things, and cannot then transcend the power conferred by law. [Judgments so entered] would not be merely erroneous; they would be absolutely void; because the court in rendering them would transcend the limits of its authority in those cases.

Id.; *see also Gagnon v. United States*, 193 U.S. 451, 457 (1904) (holding courts have authority to amend "any defect in the process or pleadings, upon such conditions as it shall, in its discretion and *by its rules*, prescribe" (emphasis addded)).

For the same reasons the plan confirmation order was void, *supra*, the bankruptcy court here lacked authority, by statute and "by its rules," to enter a discharge order that discharged student loan debt without a showing of undue hardship. *See generally Am. Trucking Ass'ns v. Frisco Transp. Co.*, 358 U.S. 133, 146 (1958). By rewriting its lawfully entered discharge order more than a decade later to give effect "to the clear intent of the court as reflected in the chapter 13 plan," the court used Rule 60(a) as a guise to alter its previous order to reflect the subsequently condoned illegal discharge practice sanctioned in *Pardee*. This renders the 2008 altered discharge order void. *Cf. id*.

Nothing in the Bankruptcy Code or Rules compels a bankruptcy court to enter an unlawful discharge order simply because it confirmed an unlawful plan, notwithstanding 11 U.S.C. § 1327. An illegal order at one stage of the bankruptcy process cannot dictate an illegal order at the end of the process. The discharge order cannot be the "getaway car" for the illegal plan confirmation order, especially in the same litigation. And even if the bankruptcy court intended to give effect to the illegal plan and confirmation order, the court lacked authority under Rule 60(a) and under the Bankruptcy Code to correct a lawful discharge order 11 years later. The 2008 altered discharge order is void. The 1997 discharge order became final and was *res judicata* against Espinosa.

Travelers does not save either party in this case.[12] At best, it offsets the finality of the two conflicting

[12] In the duel of conflicting final orders, however, the discharge order would win as the order having the final say. While a plan confirmation order is a final order for the purposes of appeal, the actual discharge of debt is consummated only by the discharge order. In other words, without the discharge order, the plan confirmation order has no legal effect. *See Educ. Credit Mgmt. Corp. v. Coleman* (*In re Coleman*), 560 F.3d 1000, 1005 (9th Cir. 2009); *In re Jones*, 352 B.R. 813, 819-20 & n.13. (Bankr. S.D. Tex. 2006) (discharge order, not plan confirmation order, is the final order in a chapter 13 because plan confirmation order can be modified at any time under 11 U.S.C. § 1329).

orders. More importantly, it does not provide the answer to fixing the practical problem at hand here, that is, debtors should not be allowed to avoid their statutorily-imposed burden by slipping a sentence into an administrative document and avoiding basic procedural rules that every other litigant must follow. *Espinosa* is an aberration. It validates a practice that violates Congressional intent and this Court's precedent.

C. A plan confirmation order is not *res judicata* to issues that were not actually litigated.

Two circuits also rely on a *res judicata* analysis to conclude that a plan confirmation order has no preclusive effect on an issue that could not or should not have been litigated at the plan confirmation hearing. As a general matter, *res judicata* will be invoked only if there is (1) an adjudication on the merits, (2) the parties are identical or in privity, and (3) the claims were or could have been raised in that action. *Allen v. McCurry*, 449 U.S. 90, 94 (1989); *see also Mersmann*, 505 F.3d at 1049; *Whelton*, 432 F.3d at 154-55.

Discharge-by-declaration provisions fail *res judicata* elements for at least two reasons: First, failure to provide specific notice under Fed. R. Bankr. P. 7004 effectively denies the student loan creditor a full and fair opportunity to litigate the claim. *Mersmann*, 505 F.3d at 1049. Second, plan confirmation is a narrow forum, limited to confirming those plans specified in 11 U.S.C. § 1325(a)(1) ("court shall confirm a plan if the plan complies with the provisions of this chapter"). Thus, courts cannot confirm a plan that violates § 1325.

Student loan debt is specifically excepted from the discharge under 11 U.S.C. § 1328(a)(2) unless the debtor makes "a specific factual showing" of undue hardship. *Whelton*, 432 F.3d at 155. Slipping illegal language into a chapter 13 plan violates these provisions because undue hardship cannot and is not proved through the chapter 13 plan itself. Moreover, in the plan confirmation process, the court never actually adjudicates the issue of undue hardship on the merits. *Mersmann*, 505 F.3d at 1050; *Whelton*, 432 F.3d at 155. Under the Bankruptcy Code, the dischargeability of student loan debt cannot be litigated at the plan confirmation stage; plan provisions purporting to discharge by declaration are "mere trespassers" and cannot and do not enjoy the statutory *res judicata* effect of § 1327. *Educ. Credit Mgmt. Corp. v. Whelton* (*In re Whelton*), 299 B.R. 306, 315 (Bankr. Vt. 2003) ("The Confirmation Order enforces only those provisions of the Plan that are required or permitted to be there by the Bankruptcy Code and cannot be usurped to validate or enforce provisions that were never properly lodged in the Plan.").

The Ninth Circuit considered but rejected this *res judicata* analysis, stating that the *Mersmann* and *Whelton* decisions do not offer any persuasive reasons why the discharge-by-declaration provisions should not be given full preclusive effect. *Espinosa*, 553 F.3d at 1200. Foremost, the Ninth Circuit rejected the application of *res judicata* principles because a "discharge injunction does not operate by way of *res judicata*," but is "an equitable remedy." *Id.*

The Ninth Circuit's fractured analysis and its conclusion violate this Court's precedent. That is, even if *res judicata* principles do not apply because a discharge injunction is an equitable remedy, that equitable remedy is still confined to the Bankruptcy Code. As this Court stated in *Norwest Bank Worthington v. Ahlers*, "[w]hatever equitable powers remain in the Bankruptcy Courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206-07 (1988). Thus, a discharge injunction cannot be exercised in contravention of another section of the Code. *Id.*

Espinosa erred by continuing to follow the rationale of *Pardee*, a case that has become an outlier. *Pardee*'s analysis is wrong: it cannot stand on *res judicata* grounds because the issue of undue hardship – or even the broader issue of the dischargeability of student loan debt of any sort – cannot, should not, and was not litigated at the plan confirmation hearing. *Espinosa*'s analysis is irreconcilable with the Bankruptcy Code and this Court's precedent and must be reversed.

III. The Ninth Circuit's Decision Paves the Path for Debtors to Discharge Child Support, Spousal Maintenance, Tax Debt, and Wrongful Death Judgments Through Chapter 13 Bankruptcies.

Espinosa's aberrant holding is dangerous because it could easily extend beyond the context of student loan undue hardship cases into other presumptively nondischargeable debts. Its harm is immeasurable. Under the Ninth Circuit's rationale, debts such as child support, spousal maintenance, tax debt, court-ordered restitution, criminal fines and penalties, and others would all be susceptible to discharge via plan language. *See generally* 11 U.S.C. §§ 523(a), 1328(a).

This result directly contravenes the important public policy choices Congress made in declaring these debts presumptively nondischargeable. *See Cohen v. De La Cruz,* 523 U.S. 213, 222 (1998) ("The various exceptions to discharge in § 523(a) reflect a conclusion on the part of Congress 'that the creditors' interest in recovering full payment of debts in these categories outweigh[s] the debtors' interest in a complete fresh start.") (citing *Grogan v. Garner*, 498 U.S. 279, 287 (1991)). The Ninth Circuit's approach allows all debtors to circumvent rules promulgated by this Court pertaining to notice and service in initiating dischargeability proceedings for other types of nondischargeable debt. It also undermines the stability these rules are meant to provide, Congress's intent that these debts be nondischargeable in bankruptcy proceedings, and the uniform application of bankruptcy laws.

IV. The Ninth Circuit's Decision Makes a Mockery of Bankruptcy Process and Encourages Unethical Conduct.

Even as limited to the student loan context, the Ninth Circuit's decision will have an enormous impact on the uniform application of the Bankruptcy Code, the student loan industry, the federal financial interest, and the efficiency of bankruptcy courts' process. If this Court were to adopt the Ninth Circuit's approach giving preclusive effect to discharge-by-declaration plan language, every student loan debtor will attempt it. Indeed, it would cost nothing for the debtor to slip a sentence in a chapter 13 plan purporting to discharge student loans. Debtors and their counsel would not even be subject to sanctions if they modified their plans within 21 days of the sanction motion, even though, as the Ninth Circuit acknowledges, the provision is unquestionably illegal. Fed. R. Bankr. P. 9011; *see also Espinosa*, 553 F.3d at 1202. Bankruptcy attorneys would face an ethical conundrum between zealous advocacy on behalf of their clients and ensuring that their clients meet the elements of an undue hardship in good faith. *See Mersmann*, 505 F.3d at 1050 ("Bankruptcy attorneys may be caught on the horns of a dilemma between aggressively pursuing a discharge-by-declaration on behalf of clients and ensuring that their clients meet the elements of an 'undue hardship' in good faith.").

In contrast, student loan creditors would be required to hire local counsel to file objections to every chapter 13 plan in which a student loan is involved. The attorney fees and costs incurred by creditors would be extraordinary. The system would be clogged with plan objections, withdrawals of motions to modify, and sanctions requests. Yet the bankruptcy system would enjoy no benefit or gain from this meaningless practice.

This futile process will only inundate the bankruptcy courts with pointless objections that would always be successful because there is no question that student loan creditors are entitled by statute and rule to an adversary proceeding to determine undue hardship, as the Ninth Circuit has acknowledged. *See Espinosa*, 553 F.3d at 1202 (stating that if the creditor were to object, the bankruptcy court would be required to force the debtor to initiate an adversary proceeding and amend his plan).

Adopting the Ninth Circuit's approach will cause bankruptcy courts and creditors to be overly burdened in a futile exercise of entertaining and granting countless objections to confirmation. Some loans will be discharged by use of plan language. Some loans will not. Some attempts will be caught by the trustee. Some will be caught by the court. Some will be held to their statutory burden of proof of establishing undue hardship. Some will not have to prove anything. The better outcome would be to prohibit this practice rather than rewarding it.

CONCLUSION

Only this Court can stop the illegal discharge of student loan debt through the chapter 13 plan confirmation process. Unless *Espinosa* is reversed, the certain consequences will be the rise of gamesmanship, mockery of bankruptcy process, and serious damage to the federal financial interest. Countenancing the practice of discharge-by-declaration, at any level, erodes the fundamental processes that embody this Court's jurisprudence. This Court should reverse the Ninth Circuit to restore certainty and consistency formulated by the Bankruptcy Code and Rules.

Respectfully submitted,

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