No. 081134 MAR 10 2009

In The

Supreme Court of the United States

UNITED STUDENT AID FUNDS, INC.,

Petitioner,

v.

FRANCISCO J. ESPINOSA,

Respondent.

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Student loans are statutorily non-dischargeable in bankruptcy unless repayment would cause the debtor an "undue hardship." Debtor failed to prove undue hardship in an adversary proceeding as required by the Bankruptcy Rules, and instead, merely declared a discharge in his Chapter 13 plan. Are the orders confirming the plan and discharging debtor void?

2. Bankruptcy Rules permit discharge of a student loan only through an adversary proceeding, commenced by filing a complaint and serving it and a summons on an appropriate agent of the creditor. Instead, debtor merely included a declaration of discharge in his Chapter 13 plan and mailed it to creditor's post office box. Does such procedure meet the rigorous demands of due process and entitle the resulting orders to respect under principles of res judicata?

RULE 29.6 STATEMENT

Petitioner United Student Aid Funds, Inc. is a private nonprofit corporation established under the laws of the State of Delaware. It has no parent company, and no publicly held company holds any membership interest in it. Its members are the individuals on its Board of Trustees.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner United Student Aid Funds, Inc. respectfully prays that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Ninth Circuit, filed in the above-entitled proceeding on December 10, 2008.

OPINIONS BELOW

The memorandum decision of the United States Bankruptcy Court for the District of Arizona (App. 71, *infra*) and the order of the United States District Court for the District of Arizona (App. 60, *infra*) are unreported. The opinion of the court of appeals remanding for additional findings (*Espinosa I*, App. 51, *infra*) is reported at 530 F.3d 895. The opinion of the court of appeals following remand (*Espinosa II*, App. 28, *infra*) is reported at 545 F.3d 1113. The amended opinion of the court of appeals following denial of rehearing (*Espinosa III*, App. 1, *infra*) is reported at 553 F.3d 1193.

JURISDICTION

The original opinion of the Court of Appeals for the Ninth Circuit was filed on October 2, 2008. A timely petition for rehearing *en banc* was denied and an amended opinion was filed on December 10, 2008.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

11 U.S.C. § 1325. Confirmation of plan.

(a) [T]he court shall approve a plan if –

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

11 U.S.C. § 1327. Effect of confirmation.

(a) The 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 U.S.C. § 1328. Discharge.

(a) As soon as practicable after completion by the debtor of all payments under the plan, . . . the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt –

. . . .

(2) of the kind specified in paragraph . . . (8) . . . of section 523(a) of this title. . . .

11 U.S.C. § 523. Exceptions to discharge.

(a) . . . (8) for an educational . . . loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, . . . unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

STATEMENT OF THE CASE

This case raises an important question, which courts have observed is recurring with increasing frequency, regarding the propriety of the debtor-created tactic for obtaining a bankruptcy discharge of a student loan, known as a "discharge-by-declaration," without proving "undue hardship" as required by statute, and without commencing an adversary proceeding and giving the creditor individual notice by service of a summons and complaint as required by bankruptcy court rules.

In 1988-89, respondent Francisco J. Espinosa obtained four student loans totaling $13,250 through the Federal Family Education Loan Program ("FFELP"). His loans were government guaranteed. In 1992, Espinosa filed a Chapter 13 bankruptcy petition that listed his student loans as his only debts. At that time, Espinosa's notes were held by petitioner United Student Aid Funds, Inc. ("USA Funds").

Espinosa's proposed plan provided for payment over time of only the principal amount of his loans, and declared that "[a]ny amounts or claims for student loans unpaid by this Plan shall be discharged." In other words, all accrued and post-petition interest would be discharged under the plan. Although student loans are non-dischargeable except in circumstances of "undue hardship," which the Federal Rules of Bankruptcy Procedure require the debtor to prove in an adversary proceeding, Espinosa failed to commence an adversary proceeding to seek a discharge of his student loan interest debt. The plan made no mention that Espinosa would suffer "undue hardship" if the accrued and accruing interest on his debt was not discharged. It simply declared a discharge.

Notice of the case and the plan was given to USA Funds only by mail at the post office box address used to receive loan payments. Espinosa did not serve the plan on a USA Funds' officer, managing or general agent, or other agent authorized to receive service of process, as a summons and complaint in an adversary proceeding against a corporation must be served.

USA Funds filed a proof of claim for $17,832, to which Espinosa did not object. USA Funds did not object to the plan, which the court confirmed in 1993 without any finding of undue hardship. The confirmation order made no express mention of Espinosa's student loan debt. After confirmation of the plan, the trustee gave notice to USA Funds that its claim differed from the amount listed in the plan and would

be paid according to the plan unless such treatment was disputed.

Espinosa paid pursuant to the plan, and a standard discharge order was entered in 1997. That order excepted from discharge any debt "for a student loan . . . as specified in 11 U.S.C. § 523(a)(8)."

Espinosa's loans were subrogated to the United States Department of Education pursuant to a reinsurance agreement. In 2000, the Education Department commenced collection efforts, and caused the Treasury Department to intercept Espinosa's income tax refunds. In 2003, Espinosa filed a motion alleging violation of the discharge injunction. USA Funds recalled the loans from the Education Department and moved under FED. R. CIV. P. 60(b)(4) for relief from the confirmation order on the ground it is void. The bankruptcy court ruled for Espinosa. USA Funds appealed to the district court, which reversed, ruling that the confirmation order is void for lack of due process and therefore had no res judicata effect.

Espinosa appealed to the Ninth Circuit. That court remanded to the bankruptcy court for a determination whether exclusion of Espinosa's student loan debt from the discharge order was a clerical error. (*Espinosa I.*) The bankruptcy court ruled that it was. (App. 4-5, *infra.*) The court of appeals then reversed the district court. In an opinion authored by Chief Judge Kozinski, it was held that a debtor may obtain discharge of a student loan by merely including it in a Chapter 13 plan, without proving undue

hardship in an adversary proceeding, if the creditor fails to object to the plan. Therefore, the orders confirming Espinosa's plan and discharging his debt were held to be valid and final. (*Espinosa II.*) USA Funds petitioned for rehearing *en banc*, which the court denied with an order amending its opinion. (*Espinosa III.*)

Jurisdiction in the proceedings below was granted to the bankruptcy court by 28 U.S.C. §§ 151 and 157(b), to the district court by 28 U.S.C. § 158(a)(1), and to the court of appeals by 28 U.S.C. §§ 158(d)(1) and 1291.

REASONS FOR GRANTING THE WRIT

The decision of the Ninth Circuit allows student loan debtors to discharge their debts in bankruptcy without proving "undue hardship," contrary to the statutory requirement recognized by this Court. The Ninth Circuit is the only court of appeals to permit this result; five others reach the opposite conclusion on indistinguishable facts. The decision below is not merely erroneous, it is intolerable given the necessity of national uniformity in bankruptcy law. In view of the circuit split and the Ninth Circuit's refusal to adopt the prevailing view, only this Court can resolve this recurring issue.

I. The Ninth Circuit's decision conflicts with principles expressly recognized in this Court's ruling in *Tennessee Student Assistance Corp. v. Hood.*

This Court has previously recognized that Congress intended to make it more difficult for debtors to discharge student loans, and that the statutes and Bankruptcy Rules provide that such loans are not discharged unless the bankruptcy court, through an adversary proceeding, expressly determines that excepting the debt from discharge would impose an "undue hardship":

> Student loans used to be presumptively discharged in a general discharge. But in 1976, Congress provided a significant benefit to the States by making it more difficult for debtors to discharge student loan debts guaranteed by States. That benefit is currently governed by 11 U.S.C. § 523(a)(8), which provides that student loan debts guaranteed by governmental units are not included in a general discharge order unless excepting the debt from the order would impose an "undue hardship" on the debtor.
>
> 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.
>
> . . . .
>
> Creditors generally are not entitled to personal service before a bankruptcy court

> may discharge a debt. Because student loan debts are not automatically dischargeable, however, the Federal Rules of Bankruptcy Procedure provide creditors greater procedural protection. The current Bankruptcy Rules require the debtor to file an "adversary proceeding" against the State in order to discharge his student loan debt. . . . [A]s prescribed by the Rules, an "adversary proceeding" requires the service of a summons and a complaint.

Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 449-452 (2004) (internal citations omitted).[1]

While the Ninth Circuit recognized that USA Funds was making precisely the same "statutory" argument found in *Hood*, it held that its own decision in *Great Lakes Higher Educ. Corp. v. Pardee* (*In re Pardee*), 193 F.3d 1083 (9th Cir. 1999), "forecloses this argument." App. 6-8, *infra*. The essence of *Pardee*, as the Ninth Circuit states, is that a discharge order is a final judgment. *Id.*

The Ninth Circuit also recognized that USA Funds relied "heavily" on *Hood*, but dismissed that authority because "the Supreme Court recognized in

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[1] Certiorari was granted in *Hood* to determine whether the Bankruptcy Clause gives Congress the authority to abrogate States' immunity from private suits. 541 U.S. at 443. Without reaching that question, *Hood* upheld the application of the Bankruptcy Code to adversary proceedings initiated by a debtor against a state guaranty agency to determine the dischargeability of a student loan debt. 541 U.S. at 451.

Hood that an adversary proceeding initiated by complaint and summons is not a statutory or constitutional prerequisite to adjudication of the discharge of a student loan." App. 17-18, *infra*, quoting KEITH M. LUNDIN, *Chapter 13 Bankruptcy* § 346.1 (3d ed. 2000 & Supp. 2004).

Although *Hood* observed that "[t]he text of § 523(a)(8) does not require a summons, and absent Rule 7001(6) a debtor could proceed by motion, . . . which would raise no constitutional concern," 541 U.S. at 453, what the court of appeals failed to recognize is that *Hood* does not sanction discharge-by-declaration and instead affirmed that "the Bankruptcy Court cannot discharge [student loan] debt without making an undue hardship determination." 541 U.S. at 453-454. "[T]he *Hood* Court's suggestion, in an entirely different context, that a debtor could proceed by motion in the absence of the Bankruptcy Rules does not authorize debtors to ignore the requirements of the Rules." *In re Hanson*, 397 F.3d 482, 487 (7th Cir. 2005).

It is therefore clear that the Ninth Circuit has decided an important and recurring federal question in a way that conflicts with a relevant decision of this Court. However that result occurred, whether through misconstruction, misapplication, or misconception of *Hood*, it cannot stand.

II. The Ninth Circuit has decided an important and recurring issue of bankruptcy law in a manner that conflicts with rulings of the Second, Fourth, Sixth, Seventh and Tenth Circuits.

A. The circuits expressly acknowledge the conflict.

By its decision, the Ninth Circuit has isolated itself and created a geographically-based dual system of bankruptcy law in which student loan debtors and creditors have different rights, and may or must use different procedures, regarding the discharge of student loan debt, depending on where the debtor is located.[2]

The conflict was expressly recognized by the Ninth Circuit: "Two circuits [citing the Second and Tenth] have disagreed with *Pardee*, and accepted USA Funds's statutory argument." (App. 8, *infra*.) "While we are bound by *Pardee*, we have taken a close look at the contrary holdings of our sister circuits. . . ." (App. 17, *infra*.) "Three circuits [citing the Fourth, Sixth and Seventh] have held . . . that a student loan debtor's failure to commence an adversary proceeding

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[2] The decisions in conflict with the Ninth Circuit are *Banks v. Sallie Mae Servicing Corp.* (*In re Banks*), 299 F.3d 296 (4th Cir. 2002); *In re Hanson,* 397 F.3d 482 (7th Cir. 2005); *Ruehle v. Educational Credit Mgmt. Corp.* (*In re Ruehle*), 412 F.3d 679 (6th Cir. 2005); *Whelton v. Educational Credit Mgmt. Corp.*, 432 F.3d 150 (2d Cir. 2005); and *Educational Credit Mgmt. Corp. v. Mersmann* (*In re Mersmann*), 505 F.3d 1033 (10th Cir. 2007).

by serving the student loan creditor with a complaint and summons, denies the creditor due process." (App. 18, *infra*.) "It is thus fair to say that our position in *Pardee* is in the minority; indeed, among the circuits we now stand alone." (App. 56, *infra*.)

In re Mersmann, the most recent of the conflicting decisions cited by the Ninth Circuit, observes that "only [the Ninth Circuit] . . . permit[s] discharge-by-declaration." 505 F.3d at 1045 (citing *Pardee*). In opposition, according to *Mersmann's* survey of the cases, stand the Second, Fourth, Sixth, and Seventh Circuits. *Id.* at 1046-47. The Tenth Circuit joined that majority in *Mersmann* by adopting the reasoning of the other circuits and rejecting discharge-by-declaration. *Id.*

Express recognition of the conflict within the circuits as it was emerging and widening is also found in *In re Banks,* 299 F.3d at 299, 301; *In re Repp*, 307 B.R. 144 (B.A.P. 9th Cir. 2004), *rev'd, Espinosa II* and *III*; *In re Hanson,* 397 F.3d at 485; *In re Ruehle,* 412 F.3d at 683-84 (stating that *Banks* and *Hanson* "represent an evolving majority view"); and *Whelton*, 432 F.3d at 153.

The conflict between the Ninth and five other circuits is therefore clearly pronounced.

The fact pattern of the cases across the circuits parallels the facts here. Each case involved a Chapter 13 bankruptcy in which the debtor proposed a plan that would, by varying language, effect a discharge of student loan debt by mere declaration.

Notice of the plans was given to creditors, who did not object. No adversary proceedings were commenced, and no showing or ruling of undue hardship was made. Despite the obvious violations of the Bankruptcy Code and Rules, the plans were confirmed. No appeal was taken from the confirmation orders or the subsequent discharge orders. Thus, the Ninth Circuit characterizes the cases as "similar." App. 23, *infra*. Indeed, they are substantially indistinguishable.

Notably, *Mersmann* overruled *Andersen v. UNI-PAC-NEBHELP* (*In re Anderson*), 179 F.3d 1253 (10th Cir. 1999), the seminal case the Ninth Circuit followed in *Pardee*. Given the Ninth Circuit's refusal in this case to overturn *Pardee*, as the Tenth Circuit did *Andersen*, there is no point in waiting any longer for the Ninth Circuit to eliminate the conflict with its sister circuits.

Neither is there reason to await future cases in other circuits before resolving the clearly existing conflict. Every circuit that has considered the issue of discharge-by-declaration since *Andersen* and *Pardee*, except the Ninth, has rejected that debtor's ploy. It is therefore clear that a prevailing rule has emerged.

B. The issue presented by the conflict is recurring and of substantial national importance.

The Ninth Circuit's decision has set the national stage for continued disparate treatment of the significant issue of discharge of student loans by declaration. Student loans are prevalent and their total dollar magnitude is substantial.[3] At the same time, personal bankruptcy filings are escalating.[4] Recurrence of the issue is therefore certain. Indeed, experience teaches that debtors in circuits that have yet to decide the issue will seek to discharge student loan debt through the gambit of discharge-by-declaration. As the Fourth Circuit observed in *Banks*: "The number of Debtors seeking to improperly discharge nondischargeable debt increased significantly following the decisions of our sister Circuits in *In re Andersen* and *In re Pardee*. *See* [*In re Evans*, 242 B.R. 407 (Bankr.S.D. Ohio 1999)] (citing cases and noting

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[3] "The federal student financial assistance programs involve more than 6,200 postsecondary institutions, more than 3,100 lenders, 35 guaranty agencies, and many third-party servicers. During FY 2008, Federal Student Aid (FSA) provided $96 billion in awards and oversaw an outstanding loan portfolio of more than $500 billion." U.S. DEPT. OF EDUC., FINANCIAL AND PERFORMANCE QUARTERLY UPDATE, Issue 2008-2, at 7 (Sept. 30, 2008).

[4] Non-business bankruptcy filings increased 31 percent in 2008 compared to 2007, and also increased in 2007 over 2006. ADMIN. OFFICE OF THE U.S. COURTS, News Release, BANKRUPTCY FILINGS UP IN CALENDAR YEAR 2008 (Mar. 5, 2009), www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsDec2008.cfm.

frustration with the trend)." 299 F.3d at 301. Needless to say, this situation will persist until this Court settles the question.

In addition to the fact that issues of bankruptcy law are, by their very nature, of national importance, the significance of the current conflict among the circuits is underscored by the Bankruptcy Clause of the Constitution, which gives Congress the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4. This Court monitors those laws for uniformity. *See Hanover Nat'l Bank v. Moyses*, 186 U.S. 181 (1902). Likewise, the Court should monitor and ensure that the uniform laws are uniformly applied. "The Constitutional requirement of uniformity . . . is wholly satisfied when existing obligations of a debtor are treated alike by the bankruptcy administration throughout the country. . . ." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 172 (1946).

The discharge of student loan debt is also a matter of public importance. The improper discharge of non-dischargeable student loan debt harms the public in general because unpaid government guaranteed student loans are ultimately paid by all of us as taxpayers.

Finally, the tactic of discharge-by-declaration threatens to transcend its application to student loans. If not abolished, use of the tactic could spread to other presumptively non-dischargeable debts such as child support, alimony, fines, and taxes. *Pardee*

avoided addressing the issue in such other contexts. 193 F.3d at 1087, n. 6.

III. The decision below is incorrect.

A. Discharging student loan debt through mere declaration in a Chapter 13 plan without proving "undue hardship" through an adversary proceeding violates the Bankruptcy Code and Rules and is therefore void.

Although Espinosa proposed a plan that did not comply with the Bankruptcy Code, and the bankruptcy court's approval of the noncompliant plan was also contrary to the Code, the Ninth Circuit nevertheless held that the discharge order was not void because USA Funds had not objected to the plan. App. 8, *infra*. That decision is erroneous because it ignores Congress' clear intent to severely restrict student loan discharges and prohibit approval of Chapter 13 plans that do not comply with that restriction. *In re Mersmann*, 505 F.3d 1033; *Whelton*, 432 F.3d 150.

To fully appreciate and give effect to the intent of Congress, it bears repeating that educational loans, which formerly were readily dischargeable, are now presumptively non-dischargeable in bankruptcy. Since 1976, Congress has made it increasingly more difficult to discharge student loan debts. *Hood*, 541 U.S.

at 449, citing statutory amendments.[5] The objective is to preserve the student loan program and "assure future generations of students will also have an educational loan available. . . ." 125 CONG. REC. S. 9160 (daily ed. July 11, 1979) (remarks of Sen. DeConcini). The Bankruptcy Code now allows discharge for one – and only one – reason, namely, that "excepting such debt from discharge . . . will impose an undue hardship on the debtor." 11 U.S.C. § 523(a)(8).

This Court has recognized that § 523(a)(8) is "self-executing." *Hood*, 541 U.S. at 450. Therefore, "[u]nless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." *Id.* "Simply embedding a 'meaningless incantation of undue hardship' in a confirmation plan falls short of the 'affirmative' action required by Congress and the Supreme Court." *In re Mersmann*, 505 F.3d at 1048. Likewise, any reason for discharge that is merely proclaimed in a plan is ineffective.

The exclusive procedure for determining the dischargeability of a debt is an adversary proceeding. FED. R. BANKR. P. 7001(6). In other words, "under 11 U.S.C. § 1328(a) the Bankruptcy Court lack[s] the authority to grant a discharge of . . . student loan

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[5] A review of the "progressively more restrictive" requirements for student loan discharge is found in *In re Mersmann*, 505 F.3d at 1042.

debt through the ordinary confirmation process." *Whelton*, 432 F.3d at 154-55.

Because post-petition interest on student loan debt is also non-dischargeable, *Bruning v. United States*, 376 U.S. 363 (1964), a debtor seeking its discharge must also bring an adversary proceeding. *E.g.*, *In re Banks*, 299 F.3d at 300.

"An adversary proceeding is treated as a separate dispute between the Debtor and Creditor. . . ." *In re Banks*, 299 F.3d at 296. It is an "individualized determination." *Hood*, 541 U.S. at 450. The adversary proceeding is modeled on the traditional civil litigation format, either incorporating or adapting most of the Federal Rules of Civil Procedure. FED. R. BANKR. P. 7001, Advisory Committee Notes. Accordingly, an adversary proceeding is commenced by the filing of a complaint, *id.*, R. 7003 (incorporating FED. R. CIV. P. 3), which must then be served with a summons, *id.*, R. 7004.[6]

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[6] The burden of proving undue hardship is on the debtor. *E.g., Rifino v. United States* (*In re Rifino*), 245 F.3d 1083, 1087-88 (9th Cir. 2001). To determine if excepting student loan debt from discharge will impose an undue hardship, most circuits apply the three-part test first enunciated in *In re Brunner*, 831 F.2d 395, 396 (2d Cir. 1987), and adopted by the Ninth Circuit in *United Student Aid Funds, Inc. v. Pena* (*In re Pena*), 155 F.3d 1108, 1112 (1998). Under the *Brunner* test, the debtor must prove that (1) he cannot maintain, based on current income and expenses, a "minimal" standard of living for himself and his dependents if required to repay the loans; (2) additional circumstances exist indicating that this state of affairs is likely to

(Continued on following page)

Because student loan debts may only be discharged upon a finding of undue hardship, a plan that merely declares that such a debt will be wholly or partially discharged upon completion of the plan does not comply with the Code and the Rules, and therefore may not be confirmed. Congress has expressly instructed that plans that do not comply with the Code are not to be approved:

> [T]he court shall approve a plan if –
>
> (1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title.

11 U.S.C. § 1325(a). *Accord*, *In re Mersmann*, 505 F.3d at 1048 ("§ 1325(a)(1) of [the] Code permits the confirmation of a plan *only* if it is consistent with the rest of the Code"). *Mersmann* therefore concluded that "a bankruptcy court lacks authority to confirm a plan provision that seeks to discharge a student loan debt without an adversary proceeding proving 'undue hardship.'" *Id.*, at 1049.

Failure to comply with the Code has been said to render the plan and any confirming order "nugatory." *In re Hanson*, 397 F.3d at 487, citing *In re Escobedo*, 28 F.3d 34, 35 (7th Cir. 1994). Otherwise stated, the

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persist for a significant portion of the repayment period; and (3) the debtor has made good faith efforts to repay the loan. Thus, the barriers to discharge of student loan debt are high, no doubt explaining why debtors attempt to discharge student loan debt by declaration.

offending provision for discharge of student loan debt is "void *ab initio*." *Whelton*, 432 F.3d at 156, n. 2.

Likewise, the subsequent discharge order is also void. "A discharge obtained in this manner [by declaration], *i.e.*, 'without filing an adversary proceeding to establish undue hardship,' is plainly 'contrary to the express language of the Bankruptcy Code and Rules.' Thus, it is properly treated as 'void.'" *Whelton*, 432 F.3d at 154, quoting *In re Hanson* (internal citations omitted).

Finally, giving finality to a confirmation order premised upon a discharge-by-declaration puts two statutes in needless conflict and renders one of them partially ineffective. Specifically, applying 11 U.S.C. § 1327(a) to give finality to such a confirmation order conflicts with 11 U.S.C. § 1328(a)(2), which provides for discharge of all debts upon completion of the debtor's plan, except, *inter alia*, student loans. As stated in *Mersmann*, "[g]iving preclusive effect to a discharge-by-declaration through § 1327(a) renders part of § 1328(a)(2) nugatory." 505 F.3d at 1048. Because discharge-by-declaration violates the Code, the statutes must be harmonized by allowing § 1328(a)(2)'s specific pronouncement to limit § 1327(a)'s broad effect. *Id.*

For these reasons, the Ninth Circuit's decision is incorrect.

B. Discharging student loan debt through mere declaration in a Chapter 13 plan, rather than an adversary proceeding, is void for lack of the prescribed notice to the creditor.

Significant to this case is that, as noted above, an adversary proceeding is commenced by the filing of a complaint. Because a complaint must comply with Federal Rule of Civil Procedure 8(a), it must "show[ ] that the [debtor] is entitled to relief" and demand the relief sought. FED. R. BANKR. P. 7008 (incorporating FED. R. CIV. P. 8). Therefore, a complaint seeking to discharge a student loan debt upon grounds of undue hardship must allege facts satisfying the requisite elements (n. 6, *supra*) and pray for a discharge of the subject student loan debt. Moreover, the complaint must then be served with a summons. *Id.*, R. 7004. Service upon a corporation, such as USA Funds, must be made upon "an officer, a managing or general agent, or to any agent authorized by appointment or by law to receive service of process. . . ." *Id.*, R. 7004(b)(3).

In comparison, to confirm a Chapter 13 plan, notice of a proposed plan need only include a summary of the plan, not the actual plan. *Id.*, R. 3015(d). Furthermore, notice need only be sent by mail to creditors at the addresses provided by the debtor on his or her list of creditors. *Id.*, R. 2002(g)(2).

Accordingly, notice of a proposed plan does not require specific notice of the effect of the plan on each

creditor, and does not require notice to be served on a person of any particular level of responsibility. *In re Mersmann*, 505 F.3d at 1043; *In re Banks*, 299 F.3d at 301. Thus, the notice requirements to initiate an adversary proceeding are more exacting than the notice required for confirmation of a Chapter 13 plan. *In re Mersmann*, 505 F.3d at 1043.

In this case, Espinosa's plan (which made no mention of undue hardship or its requisite elements and was by no measure the functional equivalent of an adversary complaint) was merely mailed to USA Funds at the post office box address at which it received loan payments.[7] Nevertheless, because USA Funds received notice of Espinosa's case, and could have inquired into the effect of the proposed plan and objected to it, the Ninth Circuit held that USA Funds was not denied due process. That conclusion is incorrect. *In re Ruehle*, *supra*; *In re Hanson*, *supra*; *In re Banks*, *supra*.

While a confirmation order is generally binding, 11 U.S.C. § 1327(a), it does not have that effect when it is not preceded by the required notice. As this

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[7] Student loan lenders, like USA Funds, receive "tidal waves of mail." "The quantity 'of notice' that is issued by the bankruptcy system is so overwhelming that it is necessary to have clear rules in order for creditors to know what notices to notice as opposed to the notices that are deafening legal background noise. The Code and the Rules set forth those clear standards and it is up to the courts to ensure that the lines are not blurred." *In re Ruehle*, 412 F.3d at 684.

Court has stated, "[a]n elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice 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 v. Central Hanover Bank & Trust*, 339 U.S. 306, 314 (1950) (citations omitted).

Applying that principal in the bankruptcy context, "[w]here the Bankruptcy Code and Bankruptcy Rules specify the notice required prior to entry of an order, due process generally entitles a party to receive the notice specified before an order binding the party will be afforded preclusive effect." *In re Banks*, 299 F.3d at 302 (citing *Mullane* and others). Alternatively stated, "[e]very person and entity is entitled to the *prescribed* level of notice for the process to be due. . . ." *In re Ruehle*, 412 F.3d at 684-85 (emphasis added). Anything less is "winking at due process, which is the cornerstone of justice." *Id.*, at 684. "In the end, . . . [d]ue process is not to be sliced, diced and disguised with sauce. Due process must be served whole, without garnish." *Id.*, at 685 (internal quotation and citation omitted).

Therefore, "where an adversary proceeding is required to resolve the disputed rights of the parties, the potential defendant has the right to expect that the proper procedures will be followed." *In re Banks*, 299 F.3d at 302 (citation and internal quotation omitted). Likewise stated, "[t]he creditor has a right to assume that he will receive all of the notices

required by statute before his claim is forever barred." *In re Mersmann*, 505 F.3d at 1049 (citation and internal quotation omitted). Accordingly, this Court has said that "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." *City of New York v. New York, New Haven & Hartford R.R.*, 344 U.S. 293, 297 (1953).

In conclusion, "due process entitles creditors to the heightened notice provided by the Bankruptcy Code and Rules, and the dictates of due process trump policy arguments about finality." *In re Hanson*, 397 F.3d at 486, citing *Mullane*. Therefore, the decision of the Ninth Circuit is incorrect.

C. An order confirming a plan providing for discharge of student loan debt without proof of undue hardship in an adversary proceeding, and the subsequent discharge order, are not res judicata.

The confirmation and discharge orders herein, obtained as they were without proof of undue hardship in an adversary proceeding upon proper notice to USA Funds, violate the Bankruptcy Code and Rules and are not deserving of finality and preclusive effect.

Although the Ninth Circuit bases its ruling, in part, on the finality of discharge orders, the Second and Tenth Circuits disagree that such orders are entitled to preclusive effect in cases such as this.

Whelton, *supra*; *In re Mersmann*, *supra*. As explained by the Tenth Circuit in *Mersmann*, bankruptcy court orders premised upon a discharge-by-declaration fail several of the requirements of res judicata:[8]

> First of all, proper notice is the linchpin of a party's "full and fair opportunity to litigate" a claim. Res judicata will not apply where there is inadequate notice. Simply put, the failure to sufficiently apprise a creditor of a pending action which could eliminate the creditor's interest is a "deficiency that would undermine the fundamental fairness of the original proceedings."

505 F.3d at 1049 (citation omitted).

Such is the case here. USA Funds never had "proper notice" of Espinosa's desire to discharge his student loan debt. There was no adversary complaint to attract attention to his objective, and the plan itself was not served in a manner designed to do so. Thus, "the principles of res judicata must yield where the failure to follow the Code and Rules goes to the heart of the creditor's notice of the bankruptcy plan itself." 505 F.3d at 1050.

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[8] 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. *E.g.*, *In re Mersmann*, 505 F.3d at 1049.

The Tenth Circuit also ruled that discharge of student loan debt without an adversary proceeding is not a judgment on the merits:

> Discharge-by-declaration also fails the first element of res judicata – whether the claim was "adjudicated on the merits." Res judicata only bars a collateral attack on claims that were "actually litigated and those that were or could have been raised in the first action."
>
> . . . .
>
> In short, if an issue must be raised through an adversary proceeding it will not have a preclusive effect unless it is actually litigated.

505 F.3d at 1050 (footnote omitted).

Others agree that res judicata is no bar to setting aside an illegal discharge of student loan debt. *Whelton*, *supra*; Kevin J. Driscoll Jr., *Eradicating the "Discharge by Declaration" for Student Loan Debt in Chapter 13*, 2000 U. Ill. L. R. 1311, 1329-31 (2000).

Finally, the original discharge order herein cannot bar USA Funds' attack on the discharge of Espinosa's student loan debt because that order specifically excepted such debt from discharge. Although the bankruptcy court, on remand, ruled that exclusion of Espinosa's student loan debt from the discharge order was a clerical error, the materially amended discharge order does not relate back to operate retroactively. *See Federal Trade Comm'n v.*

Minneapolis-Honeywell Regulator Co., 344 U.S. 206 (1952).

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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