

How will my student loans be treated in a chapter 13 bankruptcy?

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This is a good question and is of some dispute in the legal field. We start with the rule that people generally know; student loans are not dischargeable in bankruptcy (with rare exceptions). Another general rule for chapter 13 filers is that unsecured creditors are usually paid a percentage of the total amount they are owed during the chapter 13 plan. (At the end of the plan, if the debtor has done everything right, any remaining balance owed to an unsecured creditor is discharged.) And a general rule for all people filing under any bankruptcy chapter is that once the bankruptcy petition is filed, the automatic stay goes into place and most creditors have to stop collection activity. With these rules in mind, it is natural to wonder how student loans are treated during the chapter 13 plan, specifically if they get paid during the plan, and if so, how and how much?

First, understand what happens with student loans in a chapter 13 plan is a bit odd. They are kind of in their own category. As stated, the automatic stay is in place, so all direct collection activity towards the debtor stops. However, since student loans are not discharged, even though they cannot actively pursue you during the plan, the balance still accrues, including interest. In a chapter 13 plan, creditors are entitled to the debtor's disposable income (calculated in different ways for different debtors), so almost all plans provide for a monthly payment to a trustee. (This is the most notable and apparent difference between a chapter 13 and a chapter 7.) So, yes, student loans will be paid, provided a claim is filed, some of the amount that the debtor pays to the chapter 13 trustee. The problem is that the amount paid for the student loans may not be enough to stop the total outstanding balance from increasing. Specifically, the interest could accrue faster than the percentage payment coming in reduces the balance. (This is what happens with "negative amortization.") This possibility has led many a debtor's attorney to try to find some way to avoid this.

Since student loans will remain after the chapter 13 plan is completed, but your other unsecured debts will be discharged, it is in the chapter 13 debtor's interest find a way to directly pay the usual and regular amounts due towards the student loans during the chapter 13 plan. Overall, in layman terms, it would be beneficial for the debtor to treat the student loans special, like a preferred creditor, and pay them "outside" the chapter 13 plan.

Debtor's attorneys have tried to present plans that do just this. However, paying the student loans directly during the chapter 13 plan would be to treat them better than other creditors in their class, which is not allowed because 11 U.S.C. § 1322(b)(10) does not allow a debtor to pay the student loans during the plan, unless all unsecured creditors are paid in full.

However, depending on where you live, there could be a ray of hope. Recently, a bankruptcy court in Georgia allowed direct payment towards a student loan during a chapter 13 plan. *In re Freeman*, Case No. 06-10651-WHD, 2006 WL 6589023 at *1 (Bankr. N.D. Ga. 2006). This decision has been criticized and is not binding on any future case. Thus, it would pay to engage a competent bankruptcy lawyer who knows how this issue is dealt with in your locality/jurisdiction if you are considering a chapter 13 bankruptcy and owe student loans.

Feel free to give us a call to discuss.

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