Classification of Unsecured Claims in Chapter 13 of the Bankruptcy Reform Act of 1978: What is Fair?

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CLASSIFICATION OF UNSECURED CLAIMS IN CHAPTER 13 OF THE BANKRUPTCY REFORM ACT OF 1978: WHAT IS FAIR?

JAMES B. McLAUGHLIN, JR.* and Robert W. Nelms**

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I. INTRODUCTION

The subject of the classification of unsecured claims in Chapter 13 is a subject which has been written about before.¹ There have also been several informative and well written articles dealing with Chapter 13 in general, which also refer to the problem of classification of claims in Chapter 13.² This article will not attempt to reiterate the principles and concepts stated in those articles.

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Life is not easy. No one ever promised that it would be. Anyone attempting to write an article dealing with the Bankruptcy Reform Act of 1978\textsuperscript{3} certainly knows the true meaning of the phrase "life is not easy."\textsuperscript{4} This article began as an article proposing reform for § 1322(b)(1) of the Code.\textsuperscript{5} Before this article could be published, § 1322(b)(1) was amended. The section as amended reads as follows:

(b) subject to subsections (a) and (c) of this section, the plan may -

(1) designate a class or classes of unsecured claims, as provided in § 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims.\textsuperscript{6}

This is a significant change from old Chapter XIII of the Bankruptcy Act of 1898.\textsuperscript{7} In essence, a Chapter 13 debtor may now designate a class or classes of unsecured claims, but may not discriminate unfairly against any class.

II. General Comments

A. The Problem

With this ability to designate a class or classes of unsecured claims under the present Chapter 13 provisions, the problem being confronted by the courts, debtors, and creditors is in determining how one discriminates against a class or classes of unsecured claims without being unfair. This is especially true in light of the fact that most people with a fundamental understanding of the English language often equate discrimination with unfairness. The cases have approached this problem in several different ways. There are many reasons why a debtor might wish to classify un-


\textsuperscript{4} Which reminds one of the saying often attributed to "Momma" that "Life ain't easy, but even worse, it ain't fair either." Or, "Momma said there would be bad days, but she never said they would come in bunches."

\textsuperscript{5} 11 U.S.C. § 1322(b)(1) (Collier 1985).


\textsuperscript{7} Bankruptcy Act of 1898, 30 Stat. 544 (1898) (repealed 1978).

http://scholarship.law.campbell.edu/clr/vol7/iss3/2
secured claims so as to allow differing treatment among the various holders of such claims. Some of the more obvious reasons include: the existence of a co-signer on a note; various business reasons; job security where an employer is a creditor of the debtor; the necessity of continued medical treatment from a particular physician; the desirability, perhaps necessity, of maintaining a good relationship with one's landlord; and the difficulty of paying a non-dischargeable debt in full. Undoubtedly, other reasons also exist. To date, it is not clear just what the Code allows in the way of classification, although the 1984 amendment makes it clear that the existence of a co-signer is one legitimate reason for classification of a claim. Nevertheless, the other legitimate reasons which a debtor might have for classifying claims are not necessarily allowable reasons under the present case law.

B. The Statutory Provisions

In addition to present § 1322(b)(1) which is set forth above, it is obviously necessary to look at § 1122 which is cited in § 1322(b)(1). Section 1122 is entitled "classification of claims or interests" and reads as follows:

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for

8. See In re Wolfe, 22 Bankr. 510 (Bankr. App. Panel, 9th Cir. 1982) wherein the debtor proposed to pay two of his unsecured creditors in full while paying all others substantially less. Debtor's reason for the discriminatory treatment was that he would be unable to do business in the future without the cooperation of the two creditors. Although the court disallowed the proposed classifications because the debtor failed to produce evidence in support of the stated reason, it indicated such a classification is allowed by § 1322 under certain circumstances. See also, In re Perskin, 9 Bankr. 626 (Bankr. N.D. Tex. 1981) wherein the debtor was allowed to discriminate in favor of a creditor because of the debtor's need to use credit cards in his work as a traveling salesman.

While §1122 is helpful in Chapter 11 proceedings, its usefulness in Chapter 13 is questionable. Nevertheless, Congress has seen fit to refer to §1122 in trying to guide the courts and others in what sort of classification is proper in a Chapter 13 proceeding. As a result, some courts have found themselves compelled to base their interpretation of §1322(b)(1) on the meaning of §1122. Such an interpretation leads to strange results indeed.

C. Purpose of this Article

This article will attempt to analyze some of the cases interpreting §1322(b)(1). This analysis will also look at the legislative history of §1322(b)(1). The ultimate purpose is to attempt to inform the reader what Congress apparently intended in drafting and passing into law §1322(b)(1). The authors are cognizant of the difficulty of attempting to say what Congress had in mind in passing any piece of legislation. The difficulty here is perhaps even greater than usual when one considers the problems the courts have had with this particular provision of the Code. Nevertheless, the present confusion as evidenced by the cases seems to make the difficulty of the task worthwhile. A proposed statutory provision consistent with the apparent purposes of Chapter 13, which is readable and understandable, is set forth.

III. Classification of Unsecured Claims

A simple reading of §1322(b)(1) makes it clear that classification of unsecured claims is optional. Substantial amounts of litigation have developed concerning exactly what constitutes unfair discrimination and what the Code drafters intended by the


14. Naturally, there are other reasons why such an article is being written, such as the "necessity" of such an article in the world of the modern (?) law school setting, in one's rise through such titles as Assistant Professor of Law, Associate Professor of Law and Professor of Law. Perhaps even more important than the journey from Assistant to Full Professor is the ability to enter into the mystical world of secret meetings open only to the "tenured faculty member."

15. Based upon prior struggles with such legislation as the Internal Revenue Code and the Bankruptcy Code, such a task is not only obviously difficult, but perhaps contrary to generally accepted legislation drafting procedures. Of course this raises the question as to whether there is in fact any such thing as a "generally accepted legislation drafting procedure" or a GALDP.
The ambiguous phrase “substantially similar” in § 1122 of the Code. The legislative history surrounding both § 1322 and § 1122 and the key elements contained in each is less than illuminating. In fact, the legislative notes following § 1322(b) make no mention whatsoever of the intended construction of “unfair discrimination” and contain only a recitation of the section’s language providing no helpful insight. The Judiciary Committee Notes regarding § 1122 are similarly unenlightening. In an effort to give some explanation to the phrase “substantially similar,” the Notes state:

It requires classification based on the nature of the claims or interests classified, and permits inclusion of claims or interests in a particular class only if the claim or interest being included is substantially similar to the other claims or interests of the class.

With the arguably confusing language of the Code sections themselves and their attendant Committee Notes providing little guidance in this area, the courts, practitioners, and debtors have had to look to the development of case law in an attempt to understand what is in fact allowed by way of classification of unsecured claims in a Chapter 13 case. The result has been the rise of three schools of thought or theories.

A. The Liquidation Test

This test can be aptly named the “almost anything goes” test. It finds its origin in the case of In Re Sutherland. This case represents a liberal construction of § 1322(b)(1). The debtor sought confirmation of a Chapter 13 plan that classified unsecured creditors into four separate categories as follows:

Class Three - Medical debts - persons or firms debtors must continue to receive services from;
Class Four - Unsecured bank notes from banks needed to stay in business;
Class Five - Credit accounts desired to be kept for continuation of doing business; and
Class Six — All other creditors.

The debtor’s plan provided for sums to be paid to classes

17. Id. at 5904.
three, four and five but nothing to class six. The issue before the court was whether the classification of claims was unfairly discriminatory under § 1322. The court said no. It held that when a creditor or class of creditors is not legally entitled to receive anything under a Chapter 7 type liquidation, it cannot be classified in an unfairly discriminatory manner in a Chapter 13 plan. In other words, any claim that would receive zero in a Chapter 7 proceeding is subject to any manner of classification, no matter how ridiculous.¹⁹

The Sutherland court read § 1322(b)(1), § 1122, and § 1325(a)(4) together. Section 1325(a)(4) states in part that an unsecured claim must be paid “... not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under Chapter 7.”²⁰ Therefore, according to Sutherland, as long as an unsecured creditor is receiving at least as much as that creditor would receive in a Chapter 7 case there can be no unfair discrimination against that creditor. In essence, Sutherland reduces § 1322(b)(1) to saying that as long as § 1325(a)(4) is satisfied so is § 1322(b)(1). Such a result does not appear to reflect the intent of Congress. The court went on to say that the rationality of the classification is not a proper consideration under the Code.²¹

The court stated:

The question under 11 U.S.C. § 1322(b)(1) is not “rationality” of the classification. The question is whether there is “unfairness” between the classes. When a creditor or a class of creditors are [sic] not legally entitled to receive anything, they [sic] cannot be classified in an unfairly discriminatory manner. If a plan proposes to pay each unsecured claim at least as much as that claim would receive in liquidation under Chapter 7, the plan can propose to pay additional sums to a single unsecured creditor or classes of other unsecured creditors without unfairly discriminating. The debtors are paying more than is legally required and the courts should not discourage such plans.²²

At first blush, one tends to laugh at the simplicity of the reasoning in Sutherland. However, upon further reflection, one may ask, “isn’t Sutherland actually correct?” In any event, the Sutherland approach stands alone and has not been adopted by any other

¹⁹. Id. at 422.
²⁰. Id.
²¹. Id.
²². Id.
B. *Strict Construction Approach*

Anyone familiar with the law of bankruptcy is very familiar with the opinions of Judge Ralph R. Mabey, former Bankruptcy Judge for the District of Utah. Most bankruptcy practitioners, as well as law professors, would undoubtedly agree that Judge Mabey's leaving the bench to enter into the world of private practice has been the practitioners' gain and the courts' loss. It is of little surprise that Judge Mabey's decision in this area is one of the more persuasive and widely adopted ones. Judge Mabey set forth his analysis of § 1322(b)(1) in the case of *In re Iacovoni.* Iacovoni consisted of eight factually similar Chapter 13 cases which, if filed under Chapter 7, would result in zero distribution to unsecured creditors, i.e. all were "no asset" cases. The issue to be decided was "whether an unsecured debt for which there was a co-debtor may, by reason of the co-debtor, be classified separately and treated differently from other secured debtors." Even though the 1984 amendments make it clear that classification is presently allowed in such situations, Judge Mabey's analysis of whether or not classification was allowed under old § 1322(b)(1) is still very pertinent to the question of whether or not classification will be allowed for other reasons under the present § 1322(b)(1).

Judge Mabey answered the issue with a definite no. He first turned to an analysis of the operative Code sections. He correctly concluded that § 1322 allows the debtor to designate "a class or classes of unsecured claims, as provided in § 1122 of this title, but such designations can not discriminate unfairly against any class so designated." He further pointed out that § 1122 provides that "a plan may place a claim or an interest in a particular class only as such claim or interest is substantially similar to the other claims or interest of the class." After examining the legislative history, Judge Mabey correctly concluded that the substantially similar language contained in § 1122 was simply a codification of case law requiring "classification based on the nature of the claims or interests classified." Judge Mabey also cited favorably to *Collier on*

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24. Id. at 260.
27. 2 Bankr. at 260.
Bankruptcy construing “substantially similar” to be similar in legal character or effect as a claim against the debtor’s assets or as an interest in the debtor. The position of Judge Mabey regarding § 1122(a) is that only debts which have identical legal rights in the debtor’s or estate’s assets may be classified together. Judge Mabey’s analysis in this regard seems to be, from a technical reading of the statute, imminently correct.

The difficulty with following Judge Mabey’s approach is that it results in limiting the classifications possible under § 1322 to the “administrative convenience” exception set forth in § 1122(b). In other words, any other type of discrimination in the treatment of unsecured claims in Chapter 13 is unfairly discriminatory unless the creditors in question actually have different legal rights against the debtor or the debtor’s estate. Of course, Judge Mabey correctly concluded that the presence of a co-debtor in no way affects the legal relationship of the claim in question vis-a-vis the debtor’s estate or the debtor. Therefore, to prefer this creditor over other unsecured creditors is unfairly discriminatory.

Obviously, Judge Mabey’s analysis is a 180 degree change from the opinion of In re Sutherland. Judge Mabey in essence held that Chapter 13 requires the debtor to “propose a legitimate or substantial repayment of unsecured claims.” The effect of this determination is to absolutely foreclose the possibility of confirmation to a no asset debtor proposing a minimum or zero payment plan in Chapter 13, if the debtor has the ability to pay some unsecured creditors all or a high percentage of their claim because of compelling business reasons, etc. Judge Mabey holds that you must pay all unsecured creditors the same amount unless they have some different legal rights against the debtor or the debtor’s estate itself. Of course, most general unsecured creditors will not have any special rights against the debtor or the debtor’s estate which other general unsecured creditors do not also possess. Therefore, the conclusion is that if Judge Mabey’s analysis is followed to the technical extreme there will be no classification in a Chapter 13 case other than an administrative convenience type ex-

28. 5 Collier On Bankruptcy ¶ 1122.03 (15th ed. 1979).
29. 2 Bankr. 256.
30. 11 U.S.C. § 1122(b) (Collier 1985). Of course, the administrative convenience exemption has historically been normally limited to use in Chapter 11 reorganization cases.
32. 2 Bankr. at 267.
ception as set forth in § 1122(b). Administrative convenience is not normally a consideration in a Chapter 13 case as it is in a Chapter 11 case. Therefore, Judge Mabey’s reading of § 1322(b)(1) virtually eliminates classification of unsecured claims in a Chapter 13 case. Of course, this is the exact opposite of the In re Sutherland\textsuperscript{33} approach which allows classification in every instance as long as the discriminated-against creditors are at least receiving as much as they would receive in a Chapter 7 liquidation.\textsuperscript{34}

In light of present § 1325(b)(1),\textsuperscript{35} Judge Mabey’s analysis is perhaps even more palatable in that it is now clear that a debtor should propose a plan commensurate with his ability to pay. Clearly, a debtor’s ability to pay one creditor, or certain creditors in full, is evidence of his ability to make meaningful payments to others. However, this does not answer the question of what type of classification is actually permissible. In fact, this seems to only address the overall validity of the plan itself. Clearly, the debtor proposing a plan should be required to make meaningful payments to all creditors if he has the ability to do so.\textsuperscript{36} That same debtor should also be allowed to treat certain unsecured claims differently if he has legitimate reasons for doing so. The present provision may not allow such different treatment, as Judge Mabey has so eloquently shown. The point being that the classification question should be a distinct and separate issue from the overall validity of the plan itself.

C. The Practicality Approach

In re Dziedzic\textsuperscript{37} represents a synthesis of two complementary rationales expressed most clearly in In re Kovich\textsuperscript{38} and In re Blackwell.\textsuperscript{39} Rejecting the very narrow interpretation of Judge Mabey in Iacovoni,\textsuperscript{40} yet not prepared to adopt the “anything goes”

\begin{enumerate}
\item \textsuperscript{33} 3 Bankr. 420.
\item \textsuperscript{34} The Code is clear on the point that the plan must also be filed in good faith and represent a meaningful effort by the debtor to pay all debtors in accordance with his ability to do so. See 11 U.S.C. § 1325(a)(3) (Collier 1985) and 11 U.S.C. § 1325(b)(1) and (2) (Collier 1985).
\item \textsuperscript{35} 11 U.S.C. § 1325(b)(1) (Collier 1985).
\item \textsuperscript{36} In fact, he must do so. See 11 U.S.C. § 1325(b)(1) (Collier 1985).
\item \textsuperscript{37} 9 Bankr. 424.
\item \textsuperscript{38} 4 Bankr. 403.
\item \textsuperscript{39} 5 Bankr. 748 (Bankr. W.D. Mich. 1980).
\item \textsuperscript{40} 2 Bankr. 256.
\end{enumerate}
policy of *Sutherland*, adopts a position that analyzes § 1322 and § 1122 “with an eye towards what is practical for the debtor.”

*In re Dziedzic* involved two issues: may a creditor with an unsecured claim ever receive different treatment from that of like creditors; and if so, what are the appropriate circumstances, if any, for granting such treatment? Cognizant of the chaotic case law and the failure of the major treatises to do little more than straddle the fence, the opinion grapples with these issues with candor.

In order to resolve the issue presented, the court analyzed past decisions of other courts. *In re Iacovoni* was correctly interpreted as allowing only minimal classification so that § 1322 is rendered virtually meaningless except for the statutory exceptions contained in § 1122. *In re Sutherland* was incorrectly found to be too broad holding that “any sort of standard, claiming that no such animal as ‘unfair discrimination’ could exist when the debtor was not obligated to pay the creditors anything more than they would receive under a Chapter 7.” *Sutherland*, in effect, read unfair discrimination out of the Code under its holding.

The *Dziedzic* court cites with approval the analyses and conclusions reached by *In re Kovich* and *In re Blackwell*. *In re Kovich* decided two cases factually similar. In both cases the value of assets and equities were less than the general exemption allowed the debtor under the Code, and if the estates were liquidated under Chapter 7, the debtors could distribute nothing to unsecured creditors. The repayments amounted to 10% and 5% respectively; however, the court did not comment on the propriety or sufficiency of these amounts. The issue before the court for reso-

41. 3 Bankr. 420.
42. 9 Bankr. 424.
43. *Id.* at 426.
44. *Id.*
45. *Id.* at 424-45.
46. *Id.* at 426.
47. 2 Bankr. 256.
48. 9 Bankr. at 426.
49. 3 Bankr. 420.
50. 9 Bankr. at 426.
51. 3 Bankr. 420.
52. 4 Bankr. 403.
53. 5 Bankr. 748.
54. 4 Bankr. 403.
55. *Id.* at 404-05.
lution was "whether the plans must fail because of separate classification accorded the obligations involving a creditor and landlord which would result in full payment while other unsecured creditors are paid only a portion of their debts." After reviewing authority on both sides of the question the court held that separate classifications for debts which are substantially similar are not forbidden by the Code. The court correctly determined that § 1122(a) requires all claims classified together to be substantially similar but also found that § 1122(a) did not require all substantially similar claims to be grouped together in the same class.

Kovich held that although some unsecured creditors receive more than other unsecured creditors with similar claims in legal character or effect vis-a-vis the debtor's assets, it is not per se unfair discrimination. Here the court deviates from other courts' decisions and looks to the real world effect of its decision, stating:

The fact that these creditors receive more than other unsecured creditors, certainly is a form of discrimination. But it is not necessarily unfair. It may be that in order for a debtor to avail himself of a Chapter 13 instead of Chapter 7 liquidation, he will have to make special arrangements in the plan for an obligation that a friend or relative co-signed. If he proposes to pay only a percentage of that debt, the creditor can obtain a lift of stay and proceed against the co-debtor under Section 1301(c). Likewise, because of a debtor's financial and family situation and the availability of other housing, it may be necessary to make a special provision for past due rent. Such classifications may not be unfair to other unsecured creditors because if they are not permitted the debtor may be forced to file under Chapter 7 and they may receive nothing. Therefore, the classifications are not unfair discrimination.

The court also found that each case should be decided on its own merits. The court proposed five elements or guidelines in determining what is unfair discrimination:

1. Is there a reasonable basis for the classification?
2. Is the debtor able to perform a plan without classification?
3. Has the debtor acted in good faith in the proposed classification?

56. Id. at 405.
57. Id. at 407.
58. Id.
59. Id.
4. The treatment of the class discriminated against.
5. Are creditors receiving a meaningful payment or is the plan just a sham? 60

The court found that separate classification of unsecured claims with similar legal rights or interests vis-a-vis the debtor's estate is permissible and enumerated the above criteria for purposes of determining when classifications are unfairly discriminatory.

The Dziedzic court was not convinced that Kovich 61 contained a sufficient statement of the policy concerns involved. The final link in the analysis was In re Blackwell. 62 Factually, this case is very similar to those discussed in Kovich, 63 one unsecured creditor receiving 100% repayment while other similarly situated unsecured creditors received a nominal 5% under the plan. 64 While Blackwell adopts the analysis and guidelines of Kovich and adds nothing new, it does provide a different perspective. The major emphasis of the Blackwell court was the effect of the debtor's actions upon the affected unsecured creditors. This was the light in which the Dziedzic court read Blackwell and is clearly reflected in the criteria set forth in Blackwell's good faith analysis. 65 Applying this new good faith standard of Blackwell 66 to the facts before it, the Dziedzic court found the plan deficient because the debtor had failed to provide adequate evidence demonstrating the need for

60. Id. See also In re Gibson, 45 Bankr. 783 (Bankr. N.D. Ga. 1985) wherein Judge W. Homer Drake listed the first four factors set forth above as being the four factors which should be considered by a court in assessing the question of whether or not a classification is unfairly discriminatory. Judge Drake's analysis appears to be sound and will be helpful to the reader in analyzing other discrimination cases.
61. 4 Bankr. 403.
62. 5 Bankr. 748.
63. 4 Bankr. 403.
64. 5 Bankr. at 750.
65. Id. at 751. Notice that the court adopts a stringent standard for good faith which goes beyond simple honesty. The court stated at page 751:
In determining whether a plan is proposed in good faith several factors must be considered; the debtor's ability to pay, prior petitions in bankruptcy courts, extent and nature of the debts, division by classes and the extent of preferential treatment between classes, the inability to obtain a discharge or the extent of questionable dischargeability of large claims in Chapter 7, the relationship of attorney fees and administrative costs to the distribution to unsecured creditors, and particularly, whether the proposed distribution to unsecured creditors is meaningful.
66. Id.
this classification. The court felt the debtor had offered only “flimsy evidence of consequences.” However, the court was not very informative as to what degree or how much evidence would be sufficient to convince the court in this respect. The second defect was the disparity between the 100% repayment and the 30% repayment to different classes with essentially identical legal entitlements. The Dziedzic court found that the “Kovich guidelines coupled with Blackwell’s concern for the impact on the other creditors strikes a good balance between the clashing concepts.”

The Dziedzic approach does not ignore the realities of Chapter 13 cases. It seems to expose the flaw of the In re Sutherland approach in that the Dziedzic court did not ignore the fact that a Chapter 13 plan must be offered in good faith. It would not appear to be good faith where a debtor is offering to pay 100% to certain unsecured creditors because of compelling reasons on behalf of the debtor to do so, and at the same time pay five or ten percent to remaining creditors. Before this issue can be decided, however, the court must look at the ability of the debtor to make higher payments across the board. Obviously, if the debtor has the ability to make more than five or ten percent payments to the remaining unsecured creditors the plan should not be confirmed, even under the pre-1984 amendments to the Code. On the other hand, In re Dziedzic is preferable to the reasoning of In re Iacovoni in that it does allow for reasonable classification of claims which should encourage debtors to file more Chapter 13 plans, which is consistent with the intent of Congress in adopting Chapter 13 under the 1978 act.

D. The Three Approaches Compared

The above three interpretations of § 1322 and § 1122 re-

67. 9 Bankr. at 427.
68. Id. The court was extremely summary in this analysis, again offering no insight into what would be an acceptable amount of disparity.
69. Id.
70. 3 Bankr. 420.
72. 11 U.S.C. § 1325(b)(1) and (2) (Collier 1985). Please note that these requirements do not apply unless the trustee or the holder of an allowed unsecured claim objects to the plan’s confirmation. Under the pre-1984 Code, it would appear that § 1325(a)(3)’s good faith requirement would require this anyway.
73. 9 Bankr. 424.
74. 2 Bankr. 256.
present the mainstream approaches to the problem of classification of unsecured claims in Chapter 13. While each attempts to grapple with the shortcomings and ambiguities of the Code, each has its own particular strengths and weaknesses.

_In re Sutherland_\textsuperscript{75} appears to run afoul of the legislative intent of Chapter 13. As Senator DeConcini said in the final Senate debates surrounding these two Code sections:

Debtors under this Chapter will be able to voluntarily pay off their debts while being under the protection of the court. This allows for greater pay outs to creditors than would probably occur if the debtor took straight bankruptcy, and it preserves the debtor's self-esteem by permitting him to pay his debts using his best efforts without incurring undue hardships.\textsuperscript{76}

Congress did not intend Chapter 13 to effect an end run around the disadvantages of liquidation while at the same time sanctioning nominal repayment to creditors. _Sutherland_\textsuperscript{77} does not really confront the discrimination issue squarely. The _Sutherland_ approach assumes that because the creditor stands to benefit more under the Chapter 13 plan than under a hypothetical Chapter 7 liquidation, no unfair discrimination exists.\textsuperscript{78} This analysis begs the question posed by § 1322(b)(1). It is clear from a reading of § 1322 that classification of claims is sanctioned.\textsuperscript{79} It is unfair discrimination that is prohibited and _Sutherland_\textsuperscript{80} fails to address this issue. This essentially has the effect of rendering § 1322 as "an unnecessary restatement of § 1325(a)(4)."\textsuperscript{81} The _Sutherland_\textsuperscript{82} decision is consistent with the overall liberal construction to be accorded the Chapter 13 provisions but fails to consider the underlying purposes of Chapter 13 and the chapter's provisions as an integrated unit. Rather, it focuses narrowly on one subsection.

The interpretation advanced by _In re Iacovoni_\textsuperscript{83} no doubt owes much of its widespread acceptance to the stature of its proponent, Judge Ralph Mabey. However, this restrictive view of debt classification has met with increasing hostility in light of the liberal

\textsuperscript{75} 3 Bankr. 420.
\textsuperscript{76} 124 Cong. Rec. S17403-4 (Oct. 6, 1978).
\textsuperscript{77} 3 Bankr. 420.
\textsuperscript{78} Id. at 422.
\textsuperscript{80} 3 Bankr. 420.
\textsuperscript{81} In re Perskin, 9 Bankr. 626, 632 (Bankr. N.D. Tex. 1981).
\textsuperscript{82} 3 Bankr. 420.
\textsuperscript{83} 2 Bankr. 256.
intent of Congress in enacting Chapter 13. One of the purposes of the 1978 changes in Chapter 13 of the bankruptcy law was to increase the flexibility permitted to Chapter 13 debtors. 84 Iacovoni 85 has just the opposite effect. In fact, the only criteria for debt classification that could be confirmed would be either claims with dissimilar legal entitlement to debtor’s assets vis-a-vis the other creditors or de minimis claims or interests dispatched for administrative convenience. 86 The interpretation is an emasculation of § 1322. 87 Judge Mabey relies extensively on Collier’s 88 interpretation of the “substantially similar” language contained in § 1122. 89 However, contained in the same passage of Collier’s is language to the effect that “... there is no requirement that all claims which are ‘substantially similar’ be placed in the same class.” 90 Judge Mabey does not address this section and goes on to state that the “only apparent exception to a uniform classification of unsecured creditors, ... is found in § 1122(b) which codifies the ‘administrative convenience exception’ ...”. 91 Judge Mabey has in fact retreated from this position somewhat in In re Adams, 92 where the court held that an alimony-child support payment was properly classified separately from other unsecured creditors solely due to its nondischargeability. While this is a correct reading of the Code as to dischargeability this does not alter the legal character or effect as a claim against the debtor’s assets. This claim had identical legal rights in the debtor’s assets as to all other unsecured

85. 2 Bankr. 256.
86. Id. at 260.
88. 5 Collier ¶ 1122.03.
89. In re Iacovoni, 2 Bankr. 256, 260.
90. 5 Collier ¶ 1122.03.
91. In re Iacovoni, 2 Bankr. at 260.
92. 12 Bankr. 540. The recent case of In re Caswell, (No. 84-1502 (4th Cir. 1985)) provides a possible basis for holding that child support claims do not in fact have additional rights vis-a-vis the debtor's estate. The Fourth Circuit refused to allow the debtor to even include such a claim in the debtor’s Chapter 13 plan. The court preferred to have the state courts retain control over such claims. This approach makes sense, and if followed by other courts would appear to eliminate the possibility of paying claims for child support through a Chapter 13 plan. It is unclear whether consent by the claim holder(s) in such cases would be allowable. Can a minor consent? Can the custodial parent consent to such an arrangement? The authors feel that such consent would be ineffective.
creditors, which directly conflicts with the *Iacovoni* interpretation. Collier’s further comments:

Unfair discrimination against a class of claims would therefore seem to have reference either to the order of distribution or the percentage to be paid the particular class. If courts were to construe as unfair discrimination a proposal to pay a particular class of claims a greater percentage than some other class, section 1322(b)(1) would be deprived of most of its meaning.\(^93\)

This language is directly at odds with Judge Mabey’s rationale underlying *Iacovoni*.\(^94\) In fact, the rationale underlying *Iacovoni*\(^95\) appears to contravene the entire liberal construction Congress intended for Chapter 13 and such inconsistency will continue to hamper or even retard the growth of acceptance for this position.

Between the extremes of *Sutherland*\(^96\) and *Iacovoni*\(^97\) lies *In re Dziedzic*.\(^98\) *Dziedzic*, as discussed above, is a compilation of two cases: *In re Kovich*\(^99\) and *In re Blackwell*,\(^100\) where amalgamation has yielded a workable and practical alternative best described as:

... somewhere between total whim and an Act of God lies the answer to what justification is needed to hew out a particular class of unsecured creditors. Such classification should be based upon guidelines flexible and practical enough to be adapted to the circumstances of every case yet definitive enough to provide assistance to debtors and their attorneys when formulating a plan.\(^101\)

The benefit of this type of analysis is obvious to debtor and creditor alike especially in light of the “fresh start” purpose of bankruptcy law. This method would allow the debtor to pay unsecured creditors essential to reorganization such as landlords and banks. It also benefits creditors by saving the liquidation under Chapter 7 where unsecured creditors routinely receive zero payment. Unlike *Sutherland*\(^102\) and *Iacovoni*,\(^103\) which in their own

\(^{93}\) 5 Collier ¶ 1322.01.
\(^{94}\) 2 Bankr. 256.
\(^{95}\) Id.
\(^{96}\) 3 Bankr. 420.
\(^{97}\) 2 Bankr. 256.
\(^{98}\) 9 Bankr. 424.
\(^{99}\) 4 Bankr. 403.
\(^{100}\) 5 Bankr. 748.
\(^{101}\) *In re Hill*, 4 Bankr. at 698.
\(^{102}\) 3 Bankr. 420.
\(^{103}\) 2 Bankr. 256.
way attempt to read sections of the Code out of existence or ignore them completely, *Dziedzic*\(^{104}\) would appear to read sections *into* the Code. The elemental guidelines proposed by *Kovich*\(^{105}\) and adopted in *Dziedzic*\(^{106}\) have no statutory authorization or basis in the Code.

*Dziedzic* speaks of a "rational basis" for the classification and support for this requirement is extensive.\(^{107}\) No authority is cited for this position. Neither the Code itself nor the legislative history contains such terminology. The *Dziedzic* guidelines are without statutory precedent and amount to little more than judicial legislation.

All three of these interpretations attempt to solve a very difficult problem posed by the classification of unsecured claims. All three opinions are inconsistent with the language of the Code. This difficulty of reaching uniform results under the Code cannot be said to be the fault of the jurists who mediate these controversies nor the practitioners who litigate them. This situation points its finger directly at the one clear source of this confusion and very likely its only hope of resolution—the Code and its drafter—Congress.

### IV. Proposal for Change

Lawyers, scholars, commentators, and others could argue at length as to whether the approach taken in the case of *In re Sutherland*,\(^{108}\) or that taken in the case of *In re Iacovoni*,\(^{109}\) or that taken in the case of *In re Dziedzic*\(^{110}\) is a correct interpretation of § 1322(b)(1).\(^{111}\) However, which of these is the correct interpretation of § 1322(b)(1) is not extremely important. A simple reading of the statute indicates that Judge Mabey's analysis in *Iacovoni* most closely parallels the statutory language. For that reason alone, it is arguably the correct analysis. However, the reasoning of the *Dziedzic* court is closer to what Congress envisioned in light of

104. 9 Bankr. 424.
105. 4 Bankr. 403.
106. 9 Bankr. at 427.
108. 3 Bankr. 420.
109. 2 Bankr. 256.
110. 9 Bankr. 424.
the overall purposes and goals of Chapter 13. Even Sutherland's wide open approach possibly has some support.\textsuperscript{112}

The real question which should be asked is: "why do we allow classification in Chapter 13 cases in the first place." It is well established that Chapter 13 is the preferred proceeding for consumer debtors as far as Congress is concerned.\textsuperscript{113} The authors view the purpose of classification as making Chapter 13 flexible and more attractive to debtors. In other words, this provision, like the "super-discharge" provided by § 1328(a),\textsuperscript{114} is a carrot designed to encourage debtors to file Chapter 13 proceedings instead of Chapter 7.\textsuperscript{115} Everything under the present Code indicates that Chapter 13 is the preferred proceeding. This leads one back to the present problem of what type of classification is appropriate under § 1322(b)(1). An examination of the cases reveals the ambiguities inherent in the statutory language. Since Chapter 13 is the preferred bankruptcy proceeding for consumer debtors, it seems appropriate to amend § 1322(b)(1) to more closely reflect this preference. It is believed the following suggested statutory language would not only be more consistent with the underlying goals and purposes of Chapter 13, but that it would also remove some of the ambiguity which is currently being caused by the present statutory language:

Subject to § 1325 and subsections (a) and (c) of this section, the plan may place unsecured claims in separate classes if separate classification aids the debtor in proposing and carrying out the plan. No classification shall be considered to be unfair as long as there is a reasonable basis for the classification, and the classification is advantageous to the debtor's successful completion of the plan. Subject to Section 1325 and subsections (a) and (c) of this section, a plan may always treat claims for a consumer debt of the debtor differently than other unsecured claims if an individual is liable on such consumer debt with the debtor.

\textsuperscript{112} The position seems less viable in light of the 1984 amendments found in 11 U.S.C. § 1325(b) (Collier 1985).
\textsuperscript{113} McLaughlin, \textit{Lien Avoidance by Debtors in Chapter 13}, 58 AM. BANKR. L.J. 45 n.139 (1984) and accompanying discussion.
\textsuperscript{114} 11 U.S.C. § 1328(a) (Collier 1985).
\textsuperscript{115} After the 1984 amendments to the Code it is even clearer that Congress prefers debtors to file Chapter 13 if at all possible. \textit{See} 11 U.S.C. § 704(b) which allows the court to dismiss consumer bankruptcy cases commenced under Chapter 7 under certain circumstances. For a case applying the new provisions in dismissing a case, see In re Bryant, 11 Collier Bankr. Cas. 2d (MB) 987 (Bankr. W.D. N.C. 1984).
The authors do not believe that the above proposal will solve all the problems involved in classification of claims in Chapter 13. Nevertheless, this proposal, or one similar to it, should certainly remove some of the ambiguities which presently plague the courts and the practitioners in this area.