Student Loan Relief — In and Out of Bankruptcy

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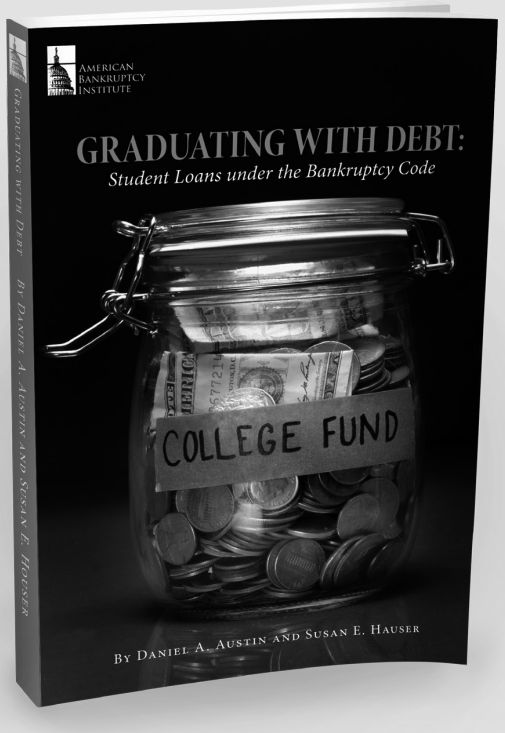

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COMMENTARY ON FINANCING AN EDUCATION AND THE UNDUE HARDSHIP DISCHARGE

Judge Paulette J. Delk
United States Bankruptcy Judge
Western District of Tennessee

§ 523 Exceptions to Discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for –

(A) (1) an educational benefit overpayment or 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; or

(2) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.

11 U.S.C. § 523(a)(8) (2014).

COMMENTARY ON FINANCING AN EDUCATION AND THE UNDUE HARDSHIP DISCHARGE

It has been noted that student loan debt in the United States exceeds one trillion dollars, an astronomical amount that tops both credit card and auto debt.[1] Why are so many students borrowing against future earnings ? For starters, financial barriers to higher education are at an all-time high, as tuition costs and expenses have risen an astounding 1120% over the past 25 years.[2] This increase in tuition and fees has been attributed to several factors. First and perhaps foremost, the flailing economy has eroded state and private funding, resulting in increased tuition costs[3], and the competition for prestige among institutions has driven up the internal costs of faculty salaries and benefits.[4] In addition, more colleges are hiring "non-instructional staff, mostly at the executive managerial level," who receive large salaries and benefit packages that contribute to higher tuition costs for students. [5] Further, in order to increase appeal to students and parents, many institutions are taking on debt in order to provide "lavish physical facilities like 'student unions with movie theaters and wine bars; workout facilities with climbing walls and lazy rivers; and dormitories with single rooms and private baths,' " [6] as well as strong athletic programs and state-of-the-art technology.[7] These costs are all passed on to students in the form of higher tuition.

The relatively loose application procedures for obtaining student loans has undoubtedly also contributed to the immense amount of student loan debt in the United States. An online loan application can be approved with an electronic signature in a matter of minutes**,** even when the applicant is an unemployed, unsophisticated student borrower, and perhaps, given the current state of

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1 Amanda Harmon Cooley, *Promissory Education: Reforming the Federal Student Loan Counseling Process to Promote Informed Access and to Reduce Student Loan Debt Burdens,* 46 Conn. L. Rev. 119 (2013), *citing* Josh Mitchell & Maya Jackson-Randall, *Student Loan Debt Tops $1 Trillion,* Wall St. J., Mar. 22, 2012, at A5.

2 Cooley, at 134. (citation omitted).

3 *Id.* at 135.

4 *Id.* at 136.

5 *Id.* at 137.

6 *Id.* at 137-38, *quoting* Andrew Martin, *Building a Showcase Campus, Using an I.O.U.,* N.Y.Times, Dec, 14, 2012, at A1.

7 Cooley, at 138.

the nation's economy, has a bleak earning potential after graduation. Applications may then continue to be renewed with the click of a button, as the student loan debt continues to mount through undergraduate and graduate school.

Once a student loan debtor graduates or drops out of school, the student loans soon go into repayment. The average student loan debt for a four-year college graduate in the class of 2010 was more than $25,250, and students in graduate school averaged loans of more than $43,500. [8] Loan debt of more than $150,000 is not uncommon,[9] especially for students awarded professional degrees. This can be a staggering amount, especially if the graduate is unable to find employment with sufficient income to begin repayment. Unfortunately, bankruptcy court may seem like the only option for some student loan borrowers, who may also be faced with newly-acquired auto debt, credit card debt, and living expenses.

8 Daniel A. Austin, *The Indentured Generation: Bankruptcy and Student Loan Debt,* 53 Santa Clara L. Rev. 329, 332 (2013)(Footnotes omitted).

9 *Id.*

If a student borrower lands in bankruptcy court, in order to discharge a student loan, the Bankruptcy Code requires the debtor to show that excepting the debt from discharge would impose an undue hardship on the debtor and the debtor's dependents.[10] The Code, however, fails to define "undue hardship," and bankruptcy courts are left to struggle with an undue hardship test.

The majority of courts addressing the undue hardship issue have fashioned standards based on the decision of the Second Circuit Court of Appeals in *Brunner v. New York State Higher Education Services Corp. (In re Brunner)*[11]. Under the *Brunner* test the court considers:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.[12]

The debtor must meet the first prong of the *Brunner* test before the court evaluates the additional *Brunner* requirements.[13] In order to meet the first prong of the *Brunner* test, the debtor must show that she has minimized living expenses and maximized personal and professional resources.[14] Although the debtor must show more than mere tight finances, the debtor is not required to live at or below poverty level.[15]

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10 11 U.S.C. ' 523(a)(8) (2014).

11 831 F.2d 395 (2d Cir. 1987).

12 *Id.* at 396.

13 *See In re Roberson,* 999 F.2d 1132 (7th Cir. 1993); *In re Kettler,* 256 B.R. 719 (Bankr. S.D. Tex. 2000).

14 *In re Muto,* 216 B.R. 325 (Bankr. N.D.N.Y. 1996).

15 *See In re Afflito,* 273 B.R. 162 (Bankr. W.D. Tenn. 2001); *In re Lebovits,* 223 B.R. 265 (Bankr. E.D.N.Y. 1998).

In *In re Ivory,*[16] the bankruptcy court listed six specific items necessary for a minimal standard of living:

> This Court believes that a minimal standard of living in modern American society includes these elements: 1. People need shelter, shelter that must be furnished, maintained, kept clean, and free of pests. In most climates it also must be heated and cooled. 2. People need basic utilities such as electricity, water, and natural gas. People need to operate electrical lights, to cook, and to refrigerate. People need water for drinking, bathing, washing, cooking, and sewer. They need telephones to communicate. 3. People need food and personal hygiene products. They need decent clothing and footwear and the ability to clean those items when those items are dirty. They need the ability to replace them when they are worn.
> 4. People need vehicles to go to work, to go to stores, and to go to doctors. They must have insurance for and the ability to buy tags for those vehicles. They must pay for gasoline. They must have the ability to pay for routine maintenance such as oil changes and tire replacements and they must be able to pay for unexpected repairs. 5. People must have health insurance or have the ability to pay for medical and dental expenses when they arise. People must have at least small amounts of life insurance or other financial savings for burials and other final expenses. 6. People must have the ability to pay for some small diversion or source of recreation, even if it is just watching television or keeping a pet.[17]

The second prong of the *Brunner* test requires the debtor to demonstrate that special circumstances exist indicating that the debtor's current inability to repay will persist for a significant portion of the repayment period. "[T]his test is one of whether a debtor has the 'potential ability to repay the loan" or a significant portion of it."[18] Under this prong of the *Brunner* test, the debtor must prove that she will be unable to earn more money in the future and the debtor's overall financial status is unlikely to improve in the foreseeable future.[19] Special circumstances include illness, lack of job skills, and existence of a large number of dependants.[20]

The final prong of the *Brunner* test asks whether the debtor has made a good faith effort to repay student loans. "It is not so much whether a debtor has made a good faith effort to repay as it is a question of overall good faith in regard to the student loan."[21] In order to satisfy the third prong

16 *Ivory v. U.S. (In re Ivory),*269 B.R.890, 899 (Bankr. N.D. Ala. 2001).
17 *Id.* at 899.
18 *In re Afflito,* 273 B.R. at 171 (quotation omitted).
19 *In re Mallinckrodt,* 274 B.R. 560 (S.D. Fla. 2001).
20 *In re Brunner,* 46 B.R. 752 (S.D.N.Y. 1985), *aff'd,* 831 F.2d 395 (2d Cir. 1987).
21 *In re Afflito,* 273 B.R. at 171.

of the *Brunner* test, the debtor does not have to show that she actually made payments on her debt, because the debtor may not have had funds to make payments.[22] When determining good faith the court may look to factors such as number of payments made, negotiations with the lender, proportion of loans total debt, and potential abuse of the Bankruptcy Code.[23]

With little guidance from the Circuits, bankruptcy courts have taken several approaches to the discharge of student loan debt. On one side are those courts who take the "all or nothing" approach, determining either student loan debt is dischargeable due to undue hardship or is nondischargeable because the undue hardship standard is not met.[24] On the other extreme are those courts who apply a flexible, partial discharge standard and determine that whether or not the undue hardship standard is met, it is nevertheless within the court's equitable power under § 105(a) to partially discharge the debt.

Among courts adopting the flexible approach, many different routes are taken to partially discharge the debtor's student loan debt. As stated by the Sixth Circuit Court of Appeals in *In re Hornsby*, courts have effectuated partial discharge "by discharging an arbitrary amount of the principal, interest accrued, or attorney's fees; by instituting a repayment schedule; by deferring the debtor's repayment of the student loans; or by simply acknowledging that a debtor may reopen bankruptcy proceedings to revisit the question of undue hardship."[25] Under the flexible approach there is little guidance in determining the method of accomplishing the partial discharge. *In re DeMatteis*[26] addressed the unequal treatment of the student loan creditors by the bankruptcy court in fashioning an equitable remedy. The *DeMatteis* Panel noted that "the general distribution scheme in bankruptcy is pro rata: a creditor receives distribution of any assets of the estate in proportion to

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22 *See In re Ivory,* 269 B.R. at 913 ; *In re Mallinckrodt,* 274 B.R. at 568.

23 *In re Wallace,* 259 B.R. 170 (C.D. Cal. 2000).

24 *See Grigas v. Sallie Mae Servicing Corp. (In re Grigas),* 252 B.R. 866, 870-72 (Bankr. D. N.H. 2000); *Lamanna v. EFS Servs., Inc. (In re Lamanna),* No. 01-10522, A.P. Nos. 01-1043, 01-1044, 2002 WL 31477861,*2 - 3 (Bankr. D. R.I. October 15, 2002).

25 *Tenn. Student Assistance Corp. v. Hornsby (In re Hornsby),* 144 F.3d 433, 440 (6th Cir. 1998).

26 *DeMatteis v. Pennsylvania Higher Education Assistance Agency (In re DeMatteis),* No. 01-8022, slip op. (B.A.P. 6th Cir. Nov. 30, 2001).

its allowed claim as compared to the claim of others.[27] Consequently, student loan debts "should be subject to the same considerations in regard to determinations of their dischargeability or non-dischargeability." [28]

Recently, a third, middle ground "hybrid" approach has arisen under which courts draw on the strict and flexible approaches and apply the standard to each of the debtor's loans separately.[29] *Hinkle v. Wheaton College (In re Hinkle),* [30] was the one of the first cases to address the hybrid approach. The *Hinkle* court determined that "[w]hile a bankruptcy court cannot restructure the loans, there is no reason that it cannot treat each one separately for the purpose of dischargeability, if the loans have not been consolidated by agreement of the parties."[31] The *Hinkle* court addressed each loan separately and discharged only those student loans that constituted an undue hardship on the debtor and the debtor's dependents.[32]

A recent Supreme Court case, *United Student Aid Funds v. Espinosa*, [33] may have opened the door to a trend towards more lenient treatment of student loan debt for borrowers in bankruptcy. In *Espinosa*, the Court permitted discharge of some student loan debt without a finding of undue hardship. The case, however, was decided on narrow grounds.[34]

In reality, most student loan borrowers intend to repay their student loans, and few seek a discharge in bankruptcy. Perhaps this is due, at least in part, to the fact that an adversary proceeding to discharge the student loans must be commenced, thereby increasing the amount of attorney's fees and litigation costs for bankruptcy debtors already in financial distress. In 2008, only 29 of 72,000 student loan borrowers in bankruptcy received a discharge of their student loans.[35] "Recent research indicates that the extent of relief obtained by those few debtors is heavily contingent on extralegal factors: a debtor's inability to repay her loans was less of a factor affecting whether she obtained re-

27 *DeMatteis,* at 10.
28 *Id.*
29 *See Grigas,* 252 B.R. at 872-73; *Lamanna,* at *4.
30 200 B.R. 690 (Bankr. W.D. Wash. 1996).
31 *Id.* at 693.
32 *Id.* at 692.
33 130 S.Ct. 1367 (2010).
34 *See* Brendan Baker, *Deeper Debt, Denial of Discharge: The Harsh Treatment of Student Loan Debt in Bankruptcy, Recent Developments, and Proposed Reforms,* 14 U. Pa. J. Bus. L. 1213, 1215 (Summer 2012).
35 *Id.* at 1214.

lief than her attorney's level of experience or the past tendencies of the bankruptcy judge presiding over her case." [36] The "undue hardship" requirement for discharge of student loans in bankruptcy has been met with much criticism, calling undue hardship discharge litigation "a crapshoot [that] produces noise rather than clarity."[37]

Student borrowers who do not seek a discharge of student loan debt or do not meet the "undue hardship" requirement may still have several attractive options for repayment. The William D. Ford Federal Direct Loan Program provides the following options:[38]

(1) Standard Repayment Plan - requires fixed monthly payments over a 10-year period until the loans are repaid in full.

(2) Extended Repayment Plan - available for debtors with greater than $30,000 in federal student loans, and allows up to 25 years for repayment with fixed or adjusted monthly payments.

(3) Graduated Repayment Plan – allows payments to increase every two years, with repayment to be completed within 10 years.

(4) Income Contingent Repayment Plan – monthly payments are calculated based on adjusted gross income, family size and total amount of federal student loans, with payments being the lesser of 20% of monthly discretionary income or amount paid if one repaid the loan in 12 years, multiplied by an income percentage factor. The loan must be repaid within 25 years.

(5) Income-based Repayment Plan – monthly payments can be adjusted annually, based on income during any period when the borrower experiences partial financial hardship. The loan must be repaid within 25 years.

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36 *Id.*

37 Rafael I. Pardo & Michelle R. Lacey, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation,* 83 Am. Bankr. L. J. 179, 190 (Winter 2009) (citation omitted).

38 *See* Mark S. Zuckerberg & Amanda K. Quick, *Reducing the Burden of Student Loan Debt,* 57 Dec. Res Gestae 24 (Dec. 2013).

(6) Pay-as-you-earn Repayment Plan – monthly payments are made over 20 years and increase or decrease annually based on income and family size. The borrower must be experiencing a partial financial hardship.[39]

It is also possible in some circumstances to have federal student loan debt forgiven under such programs as the Public Service Loan Forgiveness Program, the Teacher Loan Forgiveness Program, or Victims of September 11 Student Loan Forgiveness Program.[40]

The recent federal legislation providing alternative repayment plans are deemed by some to be insufficient to address the tremendous debt load of American students.[41] Many advocates for reform suggest, rather than limiting access to funds or addressing the problem after the loans have gone into repayment, that "more needs to be done to help students have informed access and avoid leveraging their entire future financial livelihoods by acquiring such significant student loan debts." [42] Many students incur large amounts of student loan debt with the best intentions of repayment, only to leave school prior to graduation, with little or no change in their earning potential. Perhaps requiring lenders to have mandatory face-to-face entrance and exit loan counseling as a condition of making the loan, as well as interim counseling prior to each subsequent disbursement would make a significant improvement to educate the unsophisticated, first-time student borrower about the pitfalls of student loan debt.[43] "The current lack of understanding of the gravity of the obligations tied to the acquisition of student loans, and the problems that have resulted due to increasing debt loads, must be considered the newest battleground in terms of access."[44]

There is also a cry for reform in the bankruptcy "undue hardship" arena, as some stress the need for more leniency in the discharge of student loans, similar to what debtors enjoy with other forms of unsecured debt. Commentators contend that "[t]hese are the hallmarks of a system that has run amok. The time has come for Congress to recognize that our higher education finance system suffers from schizophrenia "namely, a public-orientated approach to student-loan origination but a business-oriented approach to student-loan collection. Undue hardship litigation is merely

39 *See Id.* at 24-25 for a detailed discussion of each payment option listed.
40 *Id.* at 25-26.
41 *See* Cooley, *supra* note 1, at 144.
42 *Id.* at 144-45.
43 *Id.* at 153.
44 *Id.* at 154.

a symptom of this pernicious discord. If we are to restore the higher education finance system to a harmonious state, congressional reform efforts need to begin by giving student-loan debtors in bankruptcy unfettered access to a fresh start." [45]

At least one commentator suggests a repeal of the 2005 Bankruptcy Code amendments, which extended protections not only to private lenders but to government loans as well, and suggests instead amendments to reinstate time limitations for collection, similar to treatment of tax debt (i.e., a period after which time loans would be dischargeable), limiting the loans protected from discharge, and softening the standards for undue hardship.[46]

Another suggests an amendment of the Code to allow a student loan to be revalued to the actual fair market value of the loan, which amount would then be nondischargeable, and the remaining loan balance would be dischargeable as an unsecured debt.[47] Regardless of the means to the end, the student loan debt dilemma is ripe for reflection and reform.

45 Pardo & Lacey, *supra* note 38, at 235 (citation omitted).
46 Baker, *supra* note 35, at 1232-33.
47 Austin, *supra* note 8, at 333.

Lawyers? Who Needs Lawyers?

Administrative Alternatives to Bankruptcy Discharge of Student Loan Debt

June 6, 2014

Julie K. Swedback, Senior Attorney
ECMC

Oakdale, MN

I. GENERAL OVERVIEW OF STUDENT LOANS

A. Higher Education Act of 1965: In 1965, Congress, in response to a perceived need for financial assistance to students in higher education, passed the Higher Education Act of 1965 (HEA). The purpose of the HEA is to "keep the college door open to all students of ability," regardless of socioeconomic background.

B. (There Were) Two Federal Student Loan Programs: The HEA governs two federally-backed student loan programs: the Federal Family Education Loan Program (FFEL Program) and the William D. Ford Federal Direct Loan Program (Direct Loan Program). Under the Health Care and Education Reconciliation Act of 2010, Congress eliminated the FFEL Program, effective July 1, 2010. Currently, the total debt at stake in the two federal student loan programs tops one trillion dollars.

1. FFEL Program: Under the FFEL Program, eligible lenders make guaranteed loans on favorable terms to students or parents to help finance student education. The loans are guaranteed by guaranty agencies (state agencies or private non-profit corporations), which are ultimately reinsured by the United States Department of Education (ED).

2. The Direct Loan Program: Under the Direct Loan Program, ED makes

loans directly from the federal treasury to student and parent borrowers. Thus ED is both the lender and the guarantor.

C. Types of Federal Loans:

1. HEA: Loans under the HEA include Perkins Loans, Stafford (subsidized and unsubsidized) Loans, parent PLUS Loans, graduate PLUS Loans, and Consolidation Loans. Grants include Pell Grants and Supplemental Education Opportunity Grants. The terms of Stafford, parent PLUS, graduate PLUS, and Consolidation loans in both the FFEL Program and the Direct Loan Program are similar except that the Direct Loan Program offers a Public Service Loan Forgiveness Program and offers both and an income based and an income contingent repayment option. *See infra* at III.B.3.

2. Health and Human Services Loans: The United States Department of Health and Human Services (DHHS) also administered a student loan program, Health Education Access Loan program, (HEAL), for borrowers engaged in health-related studies. This program is no longer active. Like FFEL Program loans, HEAL loans are also presumptively nondischargeable. Courts have construed the HEAL dischargeability standard of "unconscionability" as being a "higher standard" than that of FFEL Program/Direct Loan Program loans, which require a showing of "undue hardship." Even though HEAL loans are administered by DHHS, HEAL loans are eligible for consolidation along with FFEL Program loans in the Direct Loan Program.

D. Non-HEA Loans: Private Loans: Private loan programs have also emerged on the scene to provide educational funds to students who have exhausted their federal loan limits or are otherwise ineligible to borrow under the federal loan programs. Since 2005, private loans that are "qualified education loans" under 26 I.R.C. § 221(d)(1) enjoy the presumption of nondischargeability under 11 U.S.C. § 523(a)(8). Private loans are not eligible for administrative relief discussed below. Although private loans cannot be consolidated under federally-backed consolidation programs, there are private loan consolidation programs available. *See* http://www.finaid.org/loans/privateconsolidation.phtml.

II. ADMINISTRATIVE REMEDIES

There are numerous administrative remedies for student loan borrowers to consider in lieu of seeking discharge through bankruptcy. Unlike relief under 11 U.S.C § 523(a)(8), borrowers may be entitled to administrative relief irrespective of whether they've filed bankruptcy.[1]

Borrowers who want to challenge or appeal from a ruling on an administrative remedy must seek relief though the HEA, the Administrative Procedures Act, or federal district court. Bankruptcy courts generally do not have jurisdiction to decide matters arising under the HEA. *See Williams v. Nat'l Sch. of Health Tech. Inc.,* 836 F. Supp. 273, 279 (E.D. Penn.1993), *cited in In re Bega*, 180 B.R. 642, 643 (Bankr. Kan. 1995).

1 The discharge provisions described here are illustrative only of the administrative relief available under the HEA. For full detail of requirements necessary for relief, see 34 C.F.R. §§ 682.100 *et seq.*, 685.100 *et seq.* These administrative options are available for both FFEL Program and Direct Loan Program loans unless otherwise noted.

A. Total and Permanent Disability Discharge (TPD): Borrowers may be eligible to have their federal student loan debt discharged because of a total and permanent disability.

1. Eligibility Criteria: TPD means that an individual (1) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that (i) can be expected to result in death, (ii) has lasted for a continuous period of not less than 60 months, or (iii) can be expected to last for a continuous period of not less than 60 months; or (2) has been determined by the Secretary of Veterans Affairs to be unemployable due to a service-connected disability. 34 C.F.R. § 682.200(b).

2. Requesting a TPD Discharge: There are two ways to request agency review for a TPD discharge:

a. Doctor certification on a TPD application: A medical doctor or doctor of osteopathy must certify that the borrower meets the definition of TPD as described in § 682.200(b).

b. Certification with a social security award letter: As of July 1, 2013, borrowers who receive Social Security Disability Income (SSDI) or Supplemental Security Income (SSI) benefits may use their SSA award letter in lieu of obtaining a separate certification from a physician on the TPD discharge application. The SSA award letter must state that the borrower's next scheduled disability review will be within ***5 to 7 years*** from the date of the most recent SSA disability determination.

Borrowers may also submit a Benefits Planning Query (BPQY) if the SSA award letter is unavailable. The BPQY must also state that the next disability review will be within ***5 to 7 years***. A BPQY summary can be obtained by calling 800.772.1213.

Borrowers must still complete their section of the TPD application and submit it with their SSA award letter or their BPQY summary.

3. Veterans with service-connected disabilities: Veterans who have been determined by the U.S. Department of Veterans Affairs (VA) to be unemployable due to a service-connected disability or have a service-connected disability that is 100% disabling are eligible for immediate discharge of their federal student loans. They need only provide their VA disability paperwork along with their TPD application.

4. Agency review of TPD discharge request: ED has designated Nelnet as its disability servicer for all TPD applications submitted after July 1, 2013. Under the new TPD process, borrowers must submit a single TPD discharge application directly to ED/Nelnet rather than to their individual loan holders. Borrowers may initiate the TPD process by going to www.disabilitydischarge.com. Once informed of a TPD request, ED/Nelnet will notify the loan holders and place an automatic 120-day hold on collection activity.

If the TPD request is approved, the account is immediately discharged by ED.[2] There is

2 Under the Internal Revenue Code, student loan debt forgiven or discharged by TPD may constitute a taxable event. This is a nonissue in most cases because any forgiven debt is taxable only to the extent the borrower is solvent. Thus, it is unlikely that borrowers with large student

still a three-year post-discharge monitoring period. During this three-year period, borrowers cannot earn more than 100% of the federal poverty guidelines for a family of two (in 2014 = $15,730) and cannot have obtained any new federal student loans. Borrowers must notify Nelnet of any address change during the three-year period. Typically, Nelnet will contact the borrower when the three-year mark is approaching to update the disability status and financial status to ensure that the borrower's discharge criteria have not changed. Borrowers who fail to respond with updated information will have their TPD request cancelled and their loans reinstated until they comply with the request for updated information so their account can be finally reviewed.

B. Loan Rehabilitation: Federal regulations allow borrowers who default on repayment of their loan a one-time opportunity to bring their loans out of a default status. Payment amounts are set at a reasonable rate and borrowers must make nine on-time payments over a 10-month period.[3]

Successfully completing a loan rehabilitation program restores loans to their pre-default status, it reestablishes eligibility for deferment, forbearance, alternative repayment options, title IV financial aid, and shows positive payment progress on a borrower's credit report, which may repair some of the damage done by default.

C. Closed School Discharge: Borrowers whose school closed before they could complete the program of study may be eligible for discharge. The borrower must show they were enrolled at the time of closure or that they withdrew from the school not more than 90 days prior to the date the school closed and that they were unable to complete the program of study through a teach-out at another school or by transferring academic credits or hours earned at the closed school to another school.

D. False Certification Discharge: A borrower's student loans can be discharged if a school falsely certified the student's eligibility for a federal student loan on the basis of ability to benefit from the education, signed the borrower's name without authorization by the borrower on the loan application or promissory note, or someone else obtained a federal student loan because of identity theft.

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loan debts will have assets that exceed the debt discharged by TPD.

3 New regulations regarding the federal loan rehabilitation program will go into effect on July 1, 2014. Relevant changes include the calculation of a borrower's reasonable and affordable (R&A) rehabilitation payment. For rehabilitation agreements entered into after July 1, 2014, the borrower's R&A will be based on the 15% rule, which means that the R&A payment will be 15% of the amount that the borrower's AGI exceeds 150% of the federal poverty level for the borrower's family size. The minimum payment is $5.00.

If the borrower objects to the 15% rule payment, then the borrower must complete the Financial Disclosure form and the agency will determine the new R&A payment. Borrowers who reject both payment options or timely fail to provide any required documentation will not be eligible to rehabilitate their loans.

Additionally, the new regulations provide that borrowers who are in an active wage garnishment may have their garnishment suspended after making five qualifying payments under a rehabilitation agreement.

E. Death Discharge: If an individual borrower dies or the student for whom a parent received a PLUS loan dies, the obligation of the borrower and any endorser to make any further payments on the loan is discharged.

F. Teacher Loan Forgiveness Program: Teachers who meet the requirements in 34 C.F.R. § 685.217 are eligible for forgiveness of up to $17,500. Typically, this provision is for teachers in low-income areas and those who teach math or science at schools designated eligible by the U.S. Department of Education. (Direct Loan Program loans only).

G. Public Service Loan Forgiveness Program (PSLFP) (Direct Loan Program only): Borrowers who make 120 qualifying payments under the IBR, ICR, or 10-year fixed payment schedule while employed in the public sector are eligible to have any balance remaining on their student loan debt forgiven. Public service includes employment with most local, state, federal, tribunal nation, or § 501(c)(3) corporations. Borrowers who have FFEL Program loans and wish to take advantage of this program may consolidate their FFEL Program loans into the Direct Loan Program to become eligible for the PSLF Program. *See* 34 C.F.R. § 685.219.

H. September 11 Survivors Discharge: Survivors of or eligible victims of the September 11 attacks may request discharge of their student loan debt. (Direct Loan Program loans only).

III. FLEXIBLE, AFFORDABLE PAYMENT OPTIONS: INSIDE OR OUTSIDE OF BANKRUPTCY

Both the FFEL Program and the Direct Loan Program have flexible, affordable payment options for borrowers who have financial hardship. These payment options are available whether or not the borrower has filed bankruptcy. ECMC will always rely on the most affordable payment amount available to the borrower when defending undue hardship discharge cases.

A. Consolidation: Consolidation benefits a borrower by spreading the payments over a term of up to 30 years, depending on the total loan balance.[4] Since July 1, 2010, new consolidation loans are available only through the Direct Loan Program. Borrowers who have previously consolidated their loans in the FFEL Program may reconsolidate their loans (even if defaulted) into the Direct Loan Program but not vice-versa.

B. Income-Driven Payments: In addition to fixed, amortized extended and graduated payment terms, there are two payments options that are based on a borrower's income and family size: the Income Based Repayment plan (IBR) (available in both the FFEL Program and Direct Loan Program) and the Income Contingent Repayment (ICR) plan (available only in the Direct Loan Program).

1. Income Based Repayment:

a. Eligible Loans: Most federally-backed, ***nondefaulted*** loans are eligible for the IBR:

- Direct Subsidized Loans
- Direct Unsubsidized Loans
- Direct PLUS loans made to graduate or professional students
- Direct Consolidation Loans *without* underlying parent PLUS loans
- Subsidized Federal Stafford Loans
- Unsubsidized Federal Stafford Loans
- FFEL Program PLUS loans made to graduate or professional students
- FFEL Program Consolidation Loans *without* underlying parent PLUS loans
- Perkins loans that are or have been consolidated into a new consolidation loan.

b. Ineligible Loans: Defaulted student loans, parent PLUS loans, or

4 *See* 34 C.F.R. § 685.208(j).

Loan Balance	Maximum Loan Term
Less than $7,500	10 years
$7,500 to $9,999	12 years
$10,000 to $19,999	15 years
$20,000 to $39,999	20 years
$40,000 to $59,999	25 years
$60,000 or more	30 years

federal consolidation loans that contain underlying parent PLUS loans or a mix of Stafford loans and parent PLUS loans are not eligible for the IBR in either the FFEL Program or the Direct Loan Program. Private loans that are not federally-backed are not eligible. Stand-alone Perkins loans are also not eligible for the IBR, unless they are included in a consolidation loan that is IBR-eligible.

c. Restoring IBR eligibility to defaulted loans: Borrowers who have defaulted FFEL Program loans and want to opt into the IBR may re-consolidate their defaulted loans into the Direct Loan Program and elect the IBR in the Direct Loan Program. (Re-consolidating removes the default because the borrower has a new loan). Borrowers who have defaulted FFEL Program *and* Direct Loan Program loans may consolidate both sets of loans into a new Direct consolidation loan. Borrowers with defaulted loans also have a one-time opportunity to rehabilitate their loan to remove the default status and regain eligibility for the IBR in either federal student loan program. *See supra* II.B.

d. Partial Financial Hardship Threshold: Borrowers who have IBR-eligible loans and want to elect the IBR must first demonstrate partial financial hardship (PFH). Borrowers can demonstrate PFH if the annual amount due on all eligible student loans under a 10-year repayment schedule is more than 15% of their adjusted gross income (AGI). Most borrowers whose total loan balance exceeds their annual earnings will usually satisfy the PFH requirement.

e. IBR Calculation and Terms: The IBR payment is calculated using the borrower's AGI, from the most recent federal tax return or alternative documentation of income, and family size. The required monthly loan payment under the IBR is capped at 15% of annual household earnings above 150% of the applicable poverty level divided by 12 months. The IBR payment is recalculated annually and updated to reflect in changes in household AGI and family size. Borrowers who earn less than 150% of the poverty level for their family size will have a $0 IBR payment but will still be considered "in repayment" and in good-standing.

Borrowers may contact their lender/servicer at any time if they experience a change in financial circumstances that could impact their required IBR payment. The IBR repayment term for most loan balances is 25 years. At the conclusion of the 25-year repayment period, any remaining balance is forgiven.[5] *But see infra* III.B.3 (discussing 10-year repayment term for the Public Service Loan Forgiveness Program).

Although interest continues to accrue at the contract rate in the IBR, the government will pay unpaid accrued interest on FFEL Program subsidized loans to the loan holder or will not charge the borrower interest on Direct Loan Program subsidized loans for up to three consecutive years from the date the borrower enters the IBR.

i. Documenting income: Borrowers who do not file, or are not required to file, a federal tax return may provide alternative documentation of their income such as pay stubs, letter(s) from employer(s) stating income, bank statements, etc. Untaxed income such as SSDI, SSI, child support, federal or state public assistance is not included in the IBR calculation. Borrowers who have no income or have only untaxed income may self-certify their income on the

5 Under the Internal Revenue Code, student loan debt forgiven at the end of the IBR (and ICR, unless it is forgiven under the Public Service Loan Forgiveness Program, discussed *infra*) term may constitute a taxable event. This is a nonissue in most cases because any forgiven debt is taxable only to the extent the borrower is solvent. Thus, it is unlikely that borrowers with large student loan debts will have assets that exceed the debt forgiven 25 years into the future.

IBR request form at Section 5.10.

ii. Special income rule for married borrowers: Married borrowers who file separate tax returns may have their IBR payments based on their own respective incomes but may still count each other and any dependents in the family size.

2. Income Contingent Repayment (Direct Loan Program only)**:** The ICR is the only income-driven payment option available to parent PLUS loan borrowers, who consolidated their PLUS loans into a Direct Consolidation Loan on or after July 1, 2006.

a. Terms and conditions: The required monthly loan payment under the ICR is capped at 20% of annual household earnings above 100% of the applicable poverty level divided by 12 months. Like the IBR, the ICR is recalculated annually. If the AGI is below 100% of the poverty level for the borrower's family size, then the ICR payment is $0, but the borrower is still considered "in repayment" and in good-standing. For most balances, the term is 25 years. At the conclusion of the 25-year repayment period, any remaining balance is forgiven.[6] *But see infra* III.B.3 (discussing 10-year repayment term for the Public Service Loan Forgiveness Program).

Interest continues to accrue at the contract rate and is capitalized until the loan balance is 10% higher than the original loan balance when the borrower entered repayment. After that, interest continues to accrue but is not capitalized. Interest that accrues during forbearance or deferment does not count toward the 10% capitalization rule.

b. Special rule for married borrowers: Married borrowers who file separate tax returns may have their ICR payments based on their own respective incomes but may still count each other and any dependents in the family size. 34 C.F.R. § 685.209(b).

3. Public Service Loan Forgiveness Program (PSLFP) (Direct Loan Program only)**:** Borrowers who make 120 qualifying payments under the IBR, ICR, or 10-year fixed payment schedule while employed in the public sector are eligible to have any balance remaining on their student loan debt forgiven. Public service includes employment with most local, state, federal, tribunal nation, or § 501(c)(3) corporations. Borrowers who have FFEL Program loans and wish to take advantage of this program may consolidate their FFEL Program loans into the Direct Loan Program to become eligible for the PSLF Program. *See* 34 C.F.R. § 685.219. There is specific language in this regulation that exempts any forgiven debt from constituting a taxable event.

C. Alternative Payment Arrangements: Borrowers who believe that none of the payment options are suitable may request an alternative repayment plan from the Secretary of Education. *See* 34 C.F.R. § 685.208(l).

D. Suspension of Payments: In addition to the different types of repayment plans, borrowers may seek deferment or forbearance. Deferment or forbearance may be granted for spe-

6 Under the Internal Revenue Code, student loan debt forgiven at the end of the IBR (and ICR, unless it is forgiven under the Public Service Loan Forgiveness Program, discussed *infra*) term may constitute a taxable event. This is a nonissue in most cases because any forgiven debt is taxable only to the extent the borrower is solvent. Thus, it is unlikely that borrowers with large student loan debts will have assets that exceed the debt forgiven 25 years into the future.

cific bases stated in federal regulations, which include, but are not limited to, poor health, economic hardship, federal student loan payments equal to or greater than 20% of monthly gross income, or other reasons acceptable to ED.

During a deferment period, the government pays the interest accruing on subsidized loans. The borrower is responsible for interest that accrues on unsubsidized loans during a deferment. The borrower may pay the accruing interest on any unsubsidized loans or have it added to the principal when the deferment expires.

Forbearance postpones or reduces the monthly repayment for a limited, specific period, during which interest on subsidized and unsubsidized loans continues to accrue and is owed by the borrower. If the interest is not paid during the forbearance, it is added to the principal balance when the forbearance period ends.

IV. ADMINISTRATIVE REMEDIES v. § 523(a)(8): IS THERE COMMON GROUND?

A. Exhaustion of Administrative Remedies: In general, individuals must exhaust all administrative remedies available under a statute before resorting to judicial review. *See, e.g.*, *Myers v. Bethlehem Shipbuilding Corp.,* 303 U.S.41, 50-51 (1938). This rule both protects administrative authority and promotes judicial efficiency. *McCarthy v. Madigan,* 503 U.S. 140, 145 (1992) ("Agencies, not the courts, ought to have primary responsibility for the programs that Congress has charged them to administer.").

B. Interplay of Administrative Remedies and the Bankruptcy Code: There is tension in the courts regarding the significance that administrative remedies should play in a bankruptcy court's judicial determination of student loan dischargeability matters. Some courts view administrative options as improperly usurping their judicial authority. *See* Terrence L. Michael & Janie M. Phelps, "*Judges?!- - We Don't Need No Stinking Judges!!!": The* Discharge *of Student Loans in Bankruptcy Cases and the Income Contingent Repayment Plan,* 38 Tex. Tech L. Rev. 73 (Fall 2005); *see also In re Todd*, 473 B.R. 676 (Bankr. Md. 2012) (noting that "[t]here is no indication that Congress intended to supplant this unambiguous directive [to discharge loans based on a showing of undue hardship] with the Ford Program and its existence should not be treated as an implicit repeal of Section 523(a)(8).").

The majority view, however, incorporates fundamental principles of statutory construction that require courts to construe statutes (the Bankruptcy Code and the Higher Education Act) harmoniously to avoid absurd results:[7]

7 The following circuit-level cases have held that administrative options, specifically the IBR and ICR, are an important considerations in the undue hardship analysis: *Educ. Credit Mgmt Corp. v. Jesperson (In re Jesperson)*, 571 F.3d 775, 783 (8th Cir. 2009) ("When a debtor is eligible for the ICR, the court in determining undue hardship should be less concerned that future income may decline. The ICR formula adjusts for such declines, without regard to the unpaid student loan balance, which in most cases will avoid undue hardship"); *Educ. Credit Mgmt Corp. v. Mason (In re Mason)*, 464 F.3d 878, 885 (9th Cir. 2006) (debtor failed good faith prong in part because of failing to pursue the alternative payment arrangements with sufficient diligence); *Educ. Credit Mgmt Corp. v. Frushour (In re Frushour)*, 433 F.3d 393, 396-397 (4th Cir. 2005) (failure to seek

> If a literal construction of the words of a statute be absurd, the act must be so construed as to avoid the absurdity. The court must restrain the words. The object designed to be reached by the act must limit and control the literal import of the terms and phrases employed.

Rector, etc. of Holy Trinity Church v. United States, 143 U.S. 457, 460 (1892).

It is unlikely that Congress intended administrative remedies to supplant legal remedies in § 523(a)(8). But ignoring or disregarding flexible administrative repayment programs in a bankruptcy context may defy basic statutory construction rules and lead to absurd results. Rather, in line with the majority view, administrative programs under the HEA should be important considerations in courts' undue hardship analysis.

V. TWO TESTS: ONE LEGAL STANDARD FOR UNDUE HARDSHIP

Because the bankruptcy code does not define "undue hardship," courts have developed two tests to construe what Congress intended debtors to prove before they were entitled to discharge their federally-backed student loans:

A. The *Brunner* Test: Nine circuit courts of appeal have adopted the *Brunner* test,[8] which requires the debtor to demonstrate:

> (1) an inability to maintain, based on current income and expenses, a "minimal" standard of living if forced to repay the loans;
>
> (2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of

out loan consolidation options and income-driven repayments which make the debt less onerous is an important inquiry in good faith); *Tirch v. Pa. Higher Educ. Assistance Agency (In re Tirch)*, 409 F.3d 677, 682 (6th Cir. 2005) (although not necessarily a per se indication of bad faith, failure to take advantage of the ICR is certainly probative of his intent to repay and is a "difficult, although not necessarily insurmountable burden" to overcome); *Alderete v. Educ. Credit Mgmt Corp. (In re Alderete)*, 412 F.3d 1200, 1206 (10th Cir. 2005) (failing to consider alternative repayment options indicative of bad faith).

8 *See Frushour v. Educ. Credit Mgmt. Corp. (In re Frushour)*, 433 F.3d 393 (4th Cir. 2005); *Oyler v. Educ. Credit Mgmt. Corp. (In re Oyler)*, 397 F.3d 382 (6th Cir. 2005); *Educ. Credit Mgmt. Corp. v. Polleys (In re Polleys)*, 356 F.3d 1302 (10th Cir. 2004*); Hemar Ins. Corp. of Am. v. Cox (In re Cox),* 338 F.3d 1238 (11th Cir. 2003); *U.S. Dep't of Educ. v. Gerhardt* (*In re Gerhardt)*, 348 F.3d 89 (5th Cir. 2003);*United Student Aid Funds, Inc. v. Pena (In re Pena)*, 155 F.3d 1108 (9th Cir. 1998); *Pa. Higher Assistance Found. v. Faish* (*In re Faish),* 72 F.3d 298 (3d Cir. 1995); *In re Roberson,* 999 F.2d 1132 (7th Cir. 1993); *Brunner v. N.Y. State Higher Educ. Servs. Corp*., 831 F.2d 395 (2d Cir. 1987). The First Circuit is the only circuit that has not formally adopted a particular test for undue hardship determinations.

the student loans; and,

(3) good faith efforts to repay the loans.

See Brunner v. N.Y. State Higher Educ. Servs. Corp. (In re Brunner), 831 F.2d 395 (2d Cir. 1987), affirming *Brunner v. N.Y. State Higher Educ. Servs. Corp. (In re Brunner)*, 46 B.R. 752, 753 (S.D.N.Y. 1985).

B. The "Totality of the Circumstances" test: The Eighth Circuit rejected the *Brunner* test and instead adopted the so-called "totality of the circumstances" test to determine undue hardship under § 523(a)(8). The totality test requires a bankruptcy court to consider:

(1) the debtor's past, present, and reasonably reliable future financial resources;

(2) the debtor's and her dependent's reasonable necessary living expenses; and

(3) any other relevant facts and circumstances surrounding each particular bankruptcy case.

Long v. Educ. Credit Mgmt. Corp. (In re Long), 322 F.3d 549, 553, 554 (8th Cir. 2003). The Eighth Circuit summed up this test: "Simply put, if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt—while still allowing for a minimal standard of living—then the debt should not be discharged." *Id.* at 554-55; *see generally* Julie Swedback & Kelly Prettner, *Discharge or No Discharge? An Overview of Eighth Circuit Jurisprudence in Student Loan Discharge Cases*, 36 Wm. Mitchell L. Rev. 1679 (2010).

The First Circuit has declined to adopt any formal test:

> We see no need in this case to pronounce our views of a preferred method of identifying a case of "undue hardship." The standards urged on us by the parties both require the debtor to demonstrate that her disability will prevent her from working for the foreseeable future. Appellant has a formidable task, for Congress has made the judgment that the general purpose of the Bankruptcy Code to give honest debtors a fresh start does not automatically apply to student loan debtors. Rather, the interest in ensuring the continued viability of the student loan program takes precedence.

Nash v. Conn. Student Loan Found. (In re Nash), 446 F.3d 188, 190-91 (1st Cir. 2006). Most bankruptcy courts in the First Circuit apply the Totality test.

C. *Brunner* v. Totality: Does Really It Matter?

Courts using the Totality test claim that a "case-by-case approach that is fact sensitive . . .

affords a determination that contextually considers both the debtor's situation and the policies underlying § 523(a)(8) [and] ensures an appropriate, equitable balance [between] concern for cases involving extreme abuse and concern for the overall fresh start policy." *In re Hicks,* 331 B.R. 18 (Bankr. D. Mass. 2005) (internal citations omitted).

Courts using *Brunner* test claim "it provides a workable, easily articulated framework for courts and parties to follow while still allowing for a fact- and case-sensitive determination." Also, *Brunner* courts claim "that adopting the *Brunner* test will 'create[] more certainty and predictability by establishing concrete factors.'" *Id*.

Although two tests have emerged, both generally consider the same criteria: ability to pay now and in the future, whether the debtor has maximized income and minimized expenses, and attempts to repay the debt a/k/a the "good faith" prong, which requires both looking back and looking forward to decide if the debtor has made a good faith effort to repay the debt. In Totality test jurisdictions, courts will generally consider criteria related to *Brunner*'s "good faith" prong under the Totality test's "any other relevant facts" prong. But, ultimately, because there is one legal standard, it may not matter which test is applied.

D. The Demise of *Brunner*: Brave New World?

After nearly three decades of construing the statutory undue hardship legal standard and creating an epic body of case law, a few courts have begun questioning *Brunner*'s viability. Contributing to this growing dissent is the fact that Congress repealed the "time in repayment" provision of § 523(a)(8), leaving undue hardship as the only means of discharging student loan debt in bankruptcy. *See In re Roth*, 490 B.R. 908 (B.A.P. 9th Cir. 2013) (Pappas, J., concurring) (comparing *Brunner*'s harshness to lesson learned from "America's experience in the recent 'mortgage crisis'" and urging the 9th Circuit to re-visit its adherence to the *Brunner* test, specifically the "good faith" prong.); *In re Bene*, 474 B.R. 56 (Bankr. W.D.N.Y. 2012).

At the same time it is restricting options under the bankruptcy code, however, Congress has increased the availability of administrative options, including flexible, income driven repayment plans. As noted above, Congress has not changed the legal standard of undue hardship discharges in bankruptcy, but its creation of new administrative options signals an effort to provide repayment options—some that have a built in component of debt forgiveness—outside of the bankruptcy arena.

V. PRACTICE TIPS

A. Who Has My Loans? ED maintains an information repository called National Student Loan Data Systems (NSLDS). NSLDS is a database that contains information, including chain of custody, interest rate, loan type, loan status, etc., regarding every *federal* student loan a person has borrowed. Lenders, servicers, and guarantors have access to borrowers' NSLDS reports if they hold the loan. Borrowers may access their own NSLDS reports by going to www.nslds.ed.gov. They must first obtain a PIN at www.pin.ed.gov.

B. Know *Who* to Name: When initiating a dischargeability action, debtors should consult NSLDS to determine what entities hold a valid interest in their federally-backed loans. Debtors often mistakenly name their student loan servicers in lieu of ED, the lender, and/or the guarantor likely because the servicer was the last entity that contacted them. Because servicers do

not hold any right, title, or interest in the loans, servicers are not proper parties in dischargeability proceedings.

For federally-backed loans obtained through the Direct Loan Program, ED is usually—if not always—the only party to hold a valid interest in a Direct Loan. But, in the FFEL Program, debtors who have nondefaulted loans should be sure to name both the lender *and* the guarantor. Naming just the lender will be problematic because the guarantor has a contingent interest in the student loan debt and is a creditor in its own right. Thus, the guarantor is entitled to separate notice and a right to defend its rights separate and apart from the lender. *See Alfes v. Educ. Credit Mgmt Corp. (In re Alfes),* 709 F. 3d 631 (6th Cir. 2013). In *Alfes*, the 6th Circuit held that student loan guarantors had rights separate and apart from those received by assignment from the original lender. In affirming the district court, the Court ruled that these guarantor rights were not extinguished by a default judgment against the lender while the lender held the loan.

VI. INDUSTRY RESOURCES

- National Student Loan Data System: www.nslds.ed.gov
- ED PIN website: www.pin.ed.gov
- Federal Student Aid: https://studentaid.ed.gov; https://studentloans.gov.
- Finaid (consumer financial aid website): www.finaid.org
- Department of Education www.ed.gov
- Department of Education Ombudsman Office www.ombudsman.ed.gov
- William D. Ford Federal Direct Loan Program: www.direct.ed.gov
- National Counsel of Higher Education Resources (www.ncher.us)
- Educational Credit Management Corporation (www.ecmc.org)
- FFEL Program Forms: (http://www.ecmc.org/topic/mainForms.html)
- Direct Loan Forms: https://studentloans.gov or contact your federal loan servicer

VIII. CONTACT INFORMATION

Julie K. Swedback
Senior Attorney
Educational Credit Management Corp.
1 Imation Place, Building 2
Oakdale, MN55128

jswedback@ecmc.org
(651) 325-3088 (direct)

2014 MEMPHIS BANKRUPTCY BAR
SEMINAR MATERIAL

I. Discharge of Student Loans in Bankruptcy

A. The Bankruptcy Code limits the discharge of student loans only to those circumstances where repayment "will impose an undue hardship on the debtor and the debtor's dependents." 11 U.S.C. § 523(a)(8).

B. "Undue Hardship" is not defined in the Bankruptcy Code. The three prong "Brunner test" named for the case from which it originated, has been adopted in the Sixth Circuit as the test to determine whether "undue hardship" is sufficient to justify if the discharge of a student exists. Oyler v. Educational Credit Management Corporation, 397 Fed. 3rd. 382 (Sixth Cir. 2005), The Bruner test requires that the debtor prove by a preponderance of the evidence: (1) that the debtor cannot maintain based upon his current income and expenses a minimal standard of living for himself and his dependents if forced to repay the student loans; (2) that additional circumstances exists indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the debtor's student loans; and (3) that the debtor has made a good faith effort to repay the student loans.

(1) "[T]he debtor cannot maintain based upon his current income and expenses a minimal standard of living for himself and his dependents if forced to repay the student loans" Generally speaking, the courts have focused upon the debtor's efforts and ability to maximize income and minimize expenses.

"The essence of the minimal standard of living requirement is that a debtor, after providing for his or her basic needs, may not allocate any of his or her financial resources to the detriment of their [sic] student loan creditor(s)." Mitcham v. U.S. Dep't of Educ. (In re Mitcham), 293 B.R. 138, 144 (Bankr.N.D.Ohio 2003) (citing Rice v. United States (In re Rice), 78 F.3d 1144, 1149 (6th Cir.1996)). " '[A] court should not expect a debtor to live in abject poverty. On the other hand, the minimal standard of living requirement of the Brunner Test may require that a debtor make some major sacrifices, both personal and financial, with respect to their [sic] current style of living.' " Id. at 145 (quoting Flores v. U.S. Dep't of Educ. (In re Flores), 282 B.R. 847, 854 (Bankr.N.D.Ohio 2002)

(2) "[A]dditional circumstances exists indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the debtor's student loans". Such circumstances must be indicative of a "certainty of hopelessness, not merely a present inability to fulfill financial commitment." They may include illness, disability, a lack of useable job skills, or the existence of a large number of dependents. And, most importantly, they must be beyond the debtor's control, not borne of free choice. Oyler

The center of gravity of the second prong of the Brunner test is permanency or, what can be termed, an involuntary inability to improve one's financial circumstances. Stemming from the principle, this Court has consistently espoused the maxim ... that (1) a debtor's distressed state of financial affairs must be the result of events which are clearly out of their control, and (2) the debtor must have done everything within their power to improve their financial situation. Although sine quo non, the often used explanation, and a common paradigm for an "undue hardship" case, is the existence of a permanent disability, whether physical and/or mental. In re Campton, 405 B.R. 887 (Bankr. N.D. Ohio 2009).

(3) "[T]he debtor has made a good faith effort to repay the student loans. Primary consideration under the third, or "good faith," prong of Brunner test for dischargeability of student loans is extent to which any voluntary payments were made toward student loans; however, because good faith is fact-specific analysis, whether debtor has made payments on student loans will not always be dispositive.

Student loan obligor's decision not to participate in the income contingent repayment plan (ICRP) or income-based repayment plan (IBRP) is not per se indication of lack of good faith, but is probative, under the final prong of Brunner "undue hardship" test for dischargeability of student loans, of obligor's intent to repay loans.

C. A new look at the "Third Prong" - Hedlund v. ECMC 718 F. 3d, 848 (9th Circuit, 2013). While the Court adhered to the "Brunner test", it discussed the issue of what standard of review to apply to the good faith prong of the test. The court held that "good faith" includes both legal and factual elements. The relevant legal factors include the debtor's efforts to obtain employment, maximize income and minimize expenses, and to negotiate acceptable, alternative payments terms. Upon review of a trying court's legal conclusions, a *de novo* standard is proper. The bankruptcy court found that Helund's situation was not self-imposed and that he had carried his burden of proof as to his good faith effort to repay. On appeal the district court reviewed the good faith ruling *de novo* and reversed. In reversing the District Court, the 9th Circuit Court of Appeals held that because good faith is "an essentially factual inquiry" the standard of review to be applied is the more deferential "clear error" standard whereby reversal is not appropriate unless the trier of fact was clearly erroneous in its findings. Using this standard, the court while the evidence viewed "with a less compassionate eye" could have supported a different conclusion, the bankruptcy courts finding of good faith was not clearly erroneous.

II. **Alternative Repayments Plans** various alternative repayment plans are available for debtors whose income is insufficient relative to their current student loan debt.

A. An **Income Based Repayment (IBR)** is a repayment option based upon the debtor's income and family size. For most, IBR payments will be less than 10% of the debtor's income. IBR would also forgive any remaining debt after 25 years of qualifying payments although the IRS does treat any forgiven loan amount as taxable income.

- IBR is available to Direct Loan Program and FEEL Program Borrowers.
- You must apply for IBR each year that you participate.
- You must demonstrate partial financial hardship, i.e., the monthly amount you would be required to pay on your IBR eligible loans under a ten (10) year standard repayment plan is higher than the monthly amount you would be required to pay under the IBR.
- Monthly IBR payments are based upon income, family size and the poverty guidelines applicable for the debtor's state.
- There is no minimum payment. Payments do not have to cover accruing interest.
- The government may pay accruing interest for the first three years of the debtor's participation in IBR.
- Loans may be forgiven for the Direct Loan Program Borrowers after ten (10) years for those debtors who worked in public service or other qualifying careers. Loans may be forgiven after twenty-five (25) years for all borrowers.

B. The **Income Sensitive Repayment (ISR)** is available to Stafford, Plus or Grad Plus Loans under the FEEL Program for debtors desiring to lower their payments for relative brief period of time. Under the ISR plan, the lender determines monthly payments based upon adjusted gross income and readjust the debtor's payments annually based upon the debtor's reported earnings.

- The debtor's monthly loan payment is based upon annual income; as debtor's income increases or decreases, so do monthly payments.
- The maximum repayment period is ten (10) years.
- The debtor must reapply for income sensitive repayment each year.
- ISR is available for FEEL Program Stafford Loan, Plus Loan and Grad Plus Loan Borrowers.
- Generally speaking ISR is geared toward debtors facing a temporary income shortfall; debtors needing more extended relief may want to consider extended or graduated repayment.

C. Under the **Income Contingent Repayment (ICR**), monthly payments are calculated based upon debtor's income, family size and the total amount borrowed. Debtors who remain in the ICR Plan for 25 years will receive forgiveness of any remaining debt, although the IRS does retreat any forgiven loan amount as taxable income.

- ICR is available for direct loan program borrowers of Stafford loans and Grad Plus

loans.

- Payments are based upon income, family size and total student debt. The debtor's payment amount adjusts annually based upon debtor's adjusted gross income. Discretionary income available for the payment of loans determined by the debtor's adjusted gross income minus the property guidelines applicable to the debtors for his state and family size.
- Payments do not have to cover interest, but unpaid interest does accrue; accrued interest caps at 10% of the original loan amount, after which the federal government subsidizes interest beyond 10% cap.
- If the debtor pays the loan early or switches to an alternative repayment plan, all accrued interest, including federally subsidized interest, is added to the principal.
- The maximum loan term is twenty-five (25) years, after which any remaining unpaid portion of the debt is forgiven; forgiven debt may be treated as taxable income.

III. **Public Service Loan Forgiveness Programs**.

To encourage students to pursue certain careers, the federal government has created many programs that can forgive some or all of the student borrower's student loan debt. Debtors should consult the Federal Student Aid website to determine if their loans are eligible for forgiveness. Debtors may qualify for loan forgiveness by:

(1) volunteering with Americorp, Peace Corp, or VISTA;
(2) join the military;
(3) working for the federal government or any state, local or tribal government;
(4) working for a non-profit organization;
(5) teaching in under-served communities;
(6) providing childcare services in under-served communities; or
(7) serving in an area of national need as designated by the U.S. Congress.

IV. **Loan Cancellation**. Certain student loans are eligible for cancellation based upon events such as fraud, school closings and a permanent disability or death of the student loan debtor.

A. **False Certification: Cancellation due to fraudulent activity**.

False certification cancels any loans that were fraudulently originated by the debtor's school to the extent that such loans were disbursed after January 1, 1986. False certification is narrowly defined to cover the following specific situations:

1. **The Ability to benefit** - every school must certify that students are eligible for a federal student loan. For students without a high school diploma or GED, this means the school must demonstrate that the student is academically able to benefit from the school's programs before the student can take out a loan. If a school falsely certified a debtor for a program for which he or she did not qualify, the debtor may be eligible for loan cancellation.

2. **Unauthorized Signature**. In rare cases, someone at a school may sign a borrower's name on a financial aid application without authorization, receive a borrower's loan funds and the borrower receives no benefits from these funds. In circumstances where a school may have forged a borrower's signature on a promissory note or loan application, the student loan debtor may be eligible for loan cancellation.

3. **Disqualifying Status**. If a school certifies a debtor's eligibility to study for a field in which he or she couldn't work, the debtor may be entitled to a loan cancellation. Barriers could include physical and mental conditions, legal status or other conditions that would legally bar employment in your field of study. An example of this is a school knowingly admitting a felon into law school.

4. **Closed School: Cancellation due to a school closing within ninety (90) days of debtor's enrollment**. If a debtor's school closed while he was enrolled and before he completed his or her program, said debtor may be eligible for loan cancellation. The U.S. Department of Education has an on-line closed school search page where you or a debtor can confirm school closings. Closed school cancellation applies to loans disbursed after January 1, 1986.

B. **Total and Permanent Disability**. If a student loan debtor becomes totally and permanently disabled, student loans may be cancelled. To qualify, the debtor must have a physician certify that he or she is totally and permanently disabled and unable to work as the result of the disability. Total and permanent disability is defined as a condition of the individual who:

(1) is unable to engage in any substantial gainful activity by reason of any medically determined physical or mental impairment that can be expected to result in death; has lasted for a continuous period of not less than 60 months; or can be expected to last for a continued period of not less than 60 months, or

(2) has been determined by the Secretary of Veterans Affairs to be unemployable due to service connected disability.

C. **Death**. Upon death, a student loan borrower's remaining student loans are cancelled and no future payments are necessary. The same applies to the death of student owned Plus loans. To validate the death of a student/borrower, an original death certificate, a certified copy of clear, accurate and complete photocopy are required.