

CARE Track

**Pomp and Circumstances:
The Student Loan Crisis —
Who Borrows, How Much,
Delinquency and Default Trends**

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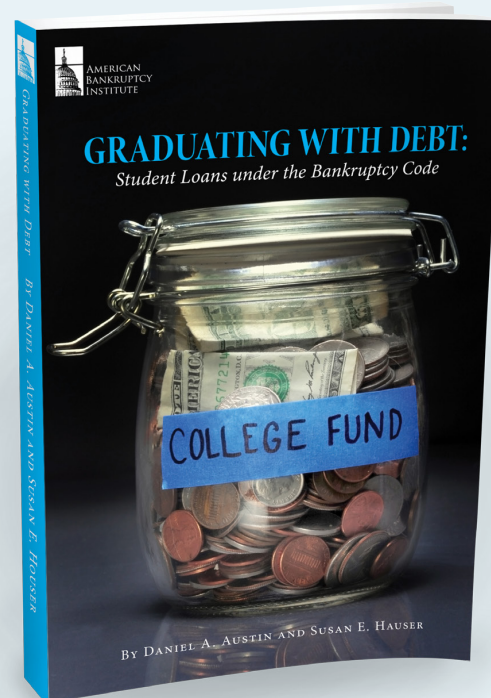
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Graduating with Debt

Student Loans under the Bankruptcy Code

Student loan debt in the U.S. exceeds \$1.1 trillion — more than any other type of consumer debt except for mortgage loans — while new education lending continues at an explosive pace. This book will enable bankruptcy and consumer credit professionals to assist clients in dealing with student loan debt. Written with both borrowers and creditors in mind, *Graduating with Debt: Student Loans under the Bankruptcy Code* introduces readers to the basics of student loan debt, including different types of loans and loan-forgiveness programs, delinquency and default, and administrative and nonjudicial remedies for borrowers having trouble repaying their loans. The book also includes extensive appendices replete with sample pleading and discovery forms.



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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. Direct Loan Program (Direct Loan Program). Under the Health Care and Education Reconciliation Act of 2010, Congress eliminated new loans under the FFEL Program, effective July 1, 2010. Currently, the total debt at stake in the two federal student loan programs is over \$1 trillion.

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.

C. Types of Federal Loans:

1. HEA: Loans under the HEA include Perkins Loans, Stafford (subsidized and unsubsidized) Loans, PLUS Loans and Consolidation Loans. Grants include Pell Grants and Supplemental Education Opportunity Grants. The terms of Stafford, 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 two income-related payment options (income based and income contingent). *See infra* at II.G., III.B.

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 dischargeability standard of “unconscionability” for HEAL loans as being a “higher standard” than that of FFEL Program/Direct Loan 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. Private loans are not eligible for administrative relief discussed below and may not be consolidated under federally-backed consolidation programs. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, however, expressly included private loans in the presumption of nondischargeability under 11 U.S.C. §

523(a)(8).

II. NONBANKRUPTCY RELIEF

There are numerous administrative remedies for student loan borrowers to consider in lieu of seeking discharge under § 523(a)(8). Unlike relief under 11 U.S.C § 523(a)(8), borrowers may be entitled to administrative relief regardless of whether they've filed bankruptcy. But these administrative options require administrative determinations and, thus, should not be the basis for claim objections or adversary proceedings in a bankruptcy context.¹

A. Total and Permanent Disability Discharge (TPD):

1. Eligibility Criteria: Borrowers may be eligible to have their federal student loan debt discharged because of a total and permanent disability.

a. TPD application: A medical doctor or doctor of osteopathy must certify that the borrower (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.

b. Social security award letter: As of July 1, 2013, borrowers who receive Social Security Disability Insurance (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 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) that can be obtained by calling 800.772.1213.

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.

If the TPD request is approved, the account is immediately discharged by ED.² But a three-

¹ 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.

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

year post-discharge monitoring period remains in effect. 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. 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.

2. Veterans with service-connected disabilities: Veterans who have a 100% service-connected disability are immediately eligible for discharge of their federal student loan debt without further certification under the TPD regulation. They need only provide their Veteran's Administration disability rating paperwork to the loan holder who will process the discharge.

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 and repair the negative credit information reported to credit bureaus. Payment amounts are set at a reasonable rate and borrowers must make nine consecutive on-time payments over a 10-month period. Completing rehabilitation restores a borrower's loans to good standing and helps to repair credit. Entering a loan rehabilitation agreement has immediate effect on a borrower's defaulted loans: it stops all collections activity and legal proceedings, prevents wage garnishment, and it may protect a borrower's federal tax refunds from IRS offsets. After successfully completing a loan rehabilitation, a borrower will be entitled to enter into deferments, forbearances, and income-sensitive repayment plans.

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 120 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.

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. Public Service Loan Forgiveness: 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, tribal nation, or § 501(c)(3) corporations. (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. After July 1, 2010, consolidations have been available only in 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.

B. Income-Driven Payments: In addition to fixed, amortized extended 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 and Direct Loan Program) and the Income Contingent Repayment plan (ICR) (available only in the Direct Loan Program).

1. Income Based Repayment:

a. Eligibility for IBR: Defaulted student loans, PLUS loans, or federal consolidation loans that contain underlying PLUS loans or a mix of Stafford loans and PLUS loans are not eligible for the IBR in either the FFEL Program or the Direct Loan Program. Stand-alone Perkins loans are also not eligible for the IBR. But a borrower may include a Perkins loan in a consolidation loan that will be IBR-eligible.

Borrowers who have defaulted FFEL Program loans 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 also have a one-time opportunity to rehabilitate their loan to remove the default status and be eligible for the IBR in either federal student loan program. *See supra* II.B.

b. Borrowers who have IBR-eligible loans 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 satisfy the PFH requirement.

The IBR payment is calculated using the borrower's AGI and family size. If the borrower earns less than 150% of the poverty level for their family size, the IBR payment will be \$0. The required annual loan payment under the IBR is capped at 15% of earnings above 150% of the applicable poverty level. Because the monthly IBR payment is calculated as a percentage of the borrower's income, if the borrower's income drops, the monthly payment is reduced accordingly.

The IBR payment is recalculated annually based on household income. Married borrowers who file separate tax returns have their IBR payments based on their own respective incomes but may still count each other and any dependents in the family size. 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 period is 25 years. At the conclusion of the 25-year repayment period, any remaining balance is forgiven.³ *But see infra* III.B.3 (discussing 10-year

3 Under the Internal Revenue Code, student loan debt forgiven at the end of the IBR

repayment term for the Public Service Loan Forgiveness Program).

2. Income Contingent Repayment: Like the IBR, the ICR is recalculated annually and the payment amount is based on 20% of the difference between a borrower's AGI and 100% of the federal poverty level for the family size. If the AGI is below 100% of the poverty level for the borrower's family size, then the ICR payment is \$0. The ICR is the only income-driven payment option available to PLUS loan borrowers or to borrowers who have defaulted loans in the Direct Loan Program. The ICR is always based on household income regardless of tax filing status. After 25 years, any balance that is remaining is forgiven by the Secretary of Education. *See* Note 3.

3. Public Service Loan Forgiveness: 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, tribal nation, or § 501(c)(3) corporations. There is specific language in this regulation that exempts any forgiven debt from constituting a taxable event. (Direct Loan Program loans only).

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

During a deferment period, no interest accrues on subsidized loans, but interest continues to accrue on unsubsidized loans. 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. 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?**

1. Failure to consider or pursue IBR/ICR favors nondischargeability:⁴

a. Fifth Circuit:

(and ICR, 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.

⁴ The following circuit-level cases have held that the IBR and ICR are an important consideration in the undue hardship analysis: *Educ. Credit Mgmt. Corp. v. Jespersen (In re Jespersen)*, 571 F.3d 775, 783 (8th Cir. 2009); *Educ. Credit Mgmt. Corp. v. Mason (In re Mason)*, 464 F.3d 878, 885 (9th Cir. 2006); *Educ. Credit Mgmt. Corp. v. Frushour (In re Frushour)*, 433 F.3d 393, 396-397 (4th Cir. 2005); *Tirch v. Pa. Higher Educ. Assistance Agency (In re Tirch)*, 409 F.3d 677, 682 (6th Cir. 2005); *Alderete v. Educ. Credit Mgmt. Corp. (In re Alderete)*, 412 F.3d 1200, 1206 (10th Cir. 2005).

Educ. Credit Mgmt. Corp. v. Young, 376 B.R. 795 (E.D. Tex. 2007). Debtor, an attorney, who owed nearly \$235,000 was unable to establish good faith efforts because among other things he had failed to investigate the Ford consolidation plan, but instead researched bankruptcy discharge.

Jones v. Bank One Tex., 376 B.R. 130 (W.D. Tex. 2007). Although debtor has no legal obligation to apply to the ICR, the debtor's effort to pursue options to make her debt less onerous is an important indicator of good faith. "Debtor's reason that she does not have disposable income to make payments under the ICR lacks merit because at this time she would owe zero dollars (\$0)."

b. Sixth Circuit:

In re Gibson, 428 B.R. 385 (Bankr. W.D. Mich. 2010). Debtor failed the third prong because she refused the consolidation options, particularly the ICR "explaining that she regarded the repayment trigger levels as 'arbitrary'" The court found that "In other words, she believes that her obligation to begin repaying the loans would commence, under the programs, before her income would support a middle class lifestyle *and* repayment." The court held that these repayment plans are a product of regulation, not negotiation. The debtor also found a 25-year repayment period contrary to a "fresh start." The court rejected this stating, this "ignores the fact that student loans are excepted from the Chapter 13 discharge." Finally, the court rejected the debtor's concerns regarding the possible tax implications of the ICR's forgiveness of debt.

c. Seventh Circuit:

Educ. Credit Mgmt. Corp. v. Vargas, 2010 WL 5395142 (C.D. Ill. 2010). The district court reversed the lower court's discharge, finding that the debtor failed the good faith prong because he "did not explore, much less take advantage of, one of the alternative repayment plans available to him even when able to do so." The District Court further stated "[e]ven if no payment was required under the plan and the amount due would have essentially remained unchanged, signing up for one of the repayment alternatives would have demonstrated a continued acknowledgement of the debt and some intent to repay.

d. Eighth Circuit:

In re Sederlund, 440 B.R. 168 (B.A.P. 8th Cir. 2010). The debtor’s payment under either the ICR or IBR, at her current income level, would be zero. She refused to apply because of her believed tax consequences. The Court, citing *Jespersion*, rejected this, stating “while there is some question as to whether borrowers whose student loans are forgiven are subject to tax liability, the Eighth Circuit... appeared to reject the argument that such potential tax liability is a basis for a finding of undue hardship under §523(a)(8).”

Educ. Credit Mgmt. Corp. v. Jesperson (In re Jesperson), 571 F.3d 775, 783 (8th Cir. 2009). The Eighth Circuit found, “[w]hen 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.” The court further held that “a student loan should not be discharged when the debtor has ‘the ability to earn sufficient income to make student loan payments under the various special opportunities made available through the Student Loan Program.’” *Jespersion*, 571 F.3d at 781.

e. Ninth Circuit:

Educ. Credit Mgmt. Corp. v. Beattie, 490 B.R. 581 (W.D. Wash. 2012). The District Court reversed the bankruptcy court’s ruling granting the debtor a partial discharge of her student loan debt. In so doing, the District Court evaluated the existence of undue hardship by applying the IBR payment amount, not the original, higher contract payment amount. The court stated that “Congress’s creation of the flexible income-based repayment options . . . reflects an intent that debtors not be automatically or easily excused from their student loan obligations.”

In re Dimoyannis, 2010 WL 1780098 (Bankr. N.D. Cal. Apr. 29, 2010). The debtor failed the first prong of the undue hardship test because of the availability of the IBR plan, under which debtor would be required to make payments of \$0 to \$47, amounts that were less than debtor’s monthly surplus. Although the court held that the second and third prongs of the *Brunner* test were moot as a result of debtor’s failure to satisfy the first prong, it went on to state that the debtor’s “failure to renegotiate his debt through the Department of Education’s IBR program would weigh against a finding that he has made a good faith effort to repay the debt.”

f. Tenth Circuit:

Buckland v. Educ. Credit Mgmt. Corp. (In re Buckland), 424 B.R. 883 (Bankr. D. Kan. 2010). The debtor's refusal to consider the ICR or IBR supports a finding he did not make a good faith effort. The debtor's stated reasons for not entering the ICR – he would be 72 years old and the potential tax consequences – were rejected by the court.

Robinson v. Educ. Credit Mgmt. Corp. (In re Robinson), 390 B.R. 727 (Bankr. W.D. Okla. 2008). A 52-year-old debtor had accumulated \$120,000 in student loans earning a B.A, M.A., and an Ed.D. The court found that she had not made good faith efforts because she failed to minimize her expenses, failed to make any payments on her student loan since earning her doctoral degree, 81% of her total unsecured debt was student loan debt, and she failed to take advantage of the ICR. The court rejected the debtor's two excuses for refusing participation in the ICR: (1) she would be too old and still making payments; and (2) there was a potential for tax consequences. The court held that "while it is true that the ICR's 25-year term would result in the plaintiff's being obligated to make student loan payments until she is nearing the age of eighty, this result is simply a function of the plaintiff's age at the time she obtained her degrees and executed the Consolidation Note and her exercise of forbearances prior to filing her bankruptcy case." Second, "[w]hile the possible tax implications of the ICR are not to be ignored, they are of much lesser importance than the plaintiff's showing of good faith in repayment of her student loans."

g. Eleventh Circuit:

Groves v. Citibank, 398 B.R. 673 (Bankr. W.D. Mo. 2008). The bankruptcy court, utilizing the loan-by-loan analysis of partial discharge, determined that Sallie Mae's private loans imposed a greater hardship because they were not eligible for the ICR. Only a portion of the ECMC loans were discharged because they were eligible for the ICR. "[I]t is the availability of the income contingent option that makes a portion of the ECMC loans nondischargeable because that option allows the Debtor the ability to find employment with an annual salary in line with what she is capable of earning."

2. ICR/IBR Criticized:

a. First Circuit:

Educ. Credit Mgmt. Corp. v. Bronsdon, 435 B.R. 791 (B.A.P. 1st Cir. 2010). In a case involving a 64-year-old debtor, the BAP, which affirmed the bankruptcy court's discharge, stating, "a debtor's eligibility to participate

in the ICR may be considered by the court when applying the totality of the circumstances test, but it is not determinative” and found that the bankruptcy court’s analysis of the ICR was sufficient this time.

b. Second Circuit:

In re Bene, 474 B.R. 56 (Bankr. W.D.N.Y. 2012). The bankruptcy court discharged a 64-year-old debtor’s student loan. In doing so, it offered a lengthy critique of the current applicability of *Brunner* in light of the development of the Ford Program, as well as the evolution of the Bankruptcy Code’s provisions for discharge.

c. Third Circuit:

In re Crawley, 460 B.R. 421 (Bankr. E.D. Pa. 2011). Fact that Chapter 7 debtor had elected not to participate in income contingent repayment plan (ICR), pursuant to which debtor’s payment obligation would have been \$0.00 per month, was irrelevant to whether debtor satisfied “minimal standard of living,” prong of *Brunner*. “To hold otherwise would make eligibility in the ICR outcome determinative in undue hardship determinations under § 523(a)(8) and would result in the delegation to an administrative agency, the Department of Education, the authority to determine the dischargeability of certain student loans.” As to the role of the ICR in the good faith analysis, the court stated “consideration of the significance, if any, of the debtor’s failure to participate in the ICR must be tailored based on the individualized circumstances of the debtor who is before the court.”

d. Fourth Circuit:

In re Todd, 473 B.R. 676 (Bankr. D. Md. 2012). Mere fact that debtor declined the “meaningless gesture” of participating in ICR, under which her payment obligation would be \$0.00, did not prevent her from satisfying “good faith” test. The court was very critical of the ICR and noted “[t]o hold that good faith will only be found if [debtor] agrees to a repayment program that will not require her to make any payments—\$0.0 “monthly payments” for twenty-five years—would be the height of Kafka-esque logic.”

e. Sixth Circuit:

Marshall v. The Student Loan Corp. (In re Marshall), 430 B.R. 809 (Bankr. S.D. Ohio 2010). Debtor’s decision to not enroll in the IBR was reasonable. The court stated “There is more to student loan debt than merely the monthly payment to be made.” First, the court held, even if the debtor was not required to make monthly payments, the “debt is still hanging over her head, it will affect her credit and cause a ‘psychological and emotion toll.’” Second, there would be tax consequences at the end of the 25 years and these could be “devastating.”

f. Seventh Circuit:

Larson v. United States of Am., 426 B.R. 782 (Bankr. N.D. Ill. 2010) The bankruptcy court spent time addressing why the ICR is only marginally relevant in undue hardship proceedings, explaining that (1) Congress could have easily drafted it into the legislation if it had desired for it to restrict the judge’s discretion in 523(a)(8) actions; (2) the standards, while related are not the same because the ICR solely looks at income and the published poverty level, whereas the *Brunner* test compares the debtor’s income to actual expenses (such as extensive medical expenses) that are not routinely considered in ICR calculations; (3) the ICR does not take into account the “emotional” and “social” toll caused by the debt remaining hanging over their heads and affecting their credit; and (4) the tax implications.

g. Eighth Circuit:

Wallace v. Educ. Credit Mgmt. Corp. (In re Wallace), 2007 WL 4210450 (Bankr. E.D. Mo. Nov. 27, 2007). In this totality analysis, the argument that Debtor’s failure to take part in the ICR precludes an undue hardship was rejected by the court for three reasons. First, the undue hardship analysis focuses on the debtor’s reasonable and necessary expenses and the ICR ties payments to income in excess of federal poverty standards. “[B]ecause it is unlikely that a person could pay her reasonably necessary living expenses if her income is at the federal poverty level...the ICR is of limited probative value.” Second, the Debtor was 58 years old and would be 83 when the payments would cease. Last, there was “a very real possibility of a significant tax liability” at age 83.

h. Ninth Circuit:

In re Roth, 490 B.R. 908 (B.A.P. 9th Cir. 2013). The bankruptcy court denied debtor’s student loan discharge, concluding that she failed to show she made a good faith effort under prong three. The BAP reversed, holding that debtor’s refusal to enroll in the IBR should not be weighed against her where the evidence showed that she currently would not be required to make a payment under the IBR and that “it is more probable than not she would never

be required to make a payment,” especially given her age, poor health, and limited income or prospects.” The BAP also noted the “[p]otentially disastrous tax consequences” awaiting the debtor at the conclusion of the 25-year IBR period and observed that the “IBR was set up to allow borrowers to pay an affordable amount toward retirement of their student loan debt. However, when absolutely no payment is forecast, the law should not impose negative consequences for failing to sign up for the program. This is consistent with the general maxim that the law does not require a party to engage in futile acts.”

V. 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 and has increased the availability of administrative options, including flexible, income driven repayment plans.

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 § 523(a)(8) “allows debtors to discharge their student loans upon a showing that repaying them would be an ‘undue hardship.’ There is no indication that Congress intended to supplant this unambiguous directive with the Ford Program and its existence should not be treated as an implicit repeal of § 523(a)(8)”).

The bankruptcy court in the Western District of New York, recently indicted *Brunner* with these observations:

- The “bargain” has changed. In 1987, student loans were dischargeable under a “time in repayment” provision as well as undue hardship. Students whose loans pre-date the changes in the Bankruptcy Code cannot be said to have agreed to this bargain.
- The *Brunner* decision used words like “poverty” and “minimal standard of living,” words which have a different meaning today.
- The term “repayment period” as used in *Brunner* envisioned a maximum repayment term of 10 years—not the 25 years contemplated under income-driven repayment terms.
- Repayment options under William D. Ford Direct Loan Program were not available when the *Brunner* case was decided.
- “Satisfaction” of the debt after 25-years of successful payments under the ICR/IBR

is not the same as “repayment” of the debt.

- “But if Congress ever were to require this writer to instruct a student loan debtor that he or she must carry the burden of proving that he or she has a ‘certainty of hopelessness,’ this writer would retire.”
- The case of Marie Brunner did not require the court to apply all three prongs of what is now referred to as the “*Brunner* test” because Marie Brunner failed the first prong. “[F]ormulation of a three-prong test applicable to every student loan debtor who has ever sought relief in the bankruptcy courts of the Second Circuit since *Brunner* was not required under the facts of Ms. Brunner’s case.”
- Marie Brunner was pro se—and the holding is now binding upon every student loan borrower who ever sought bankruptcy relief in the 2nd Circuit since 1987. “It is time for a student loan debtor’s counsel to present these matters to the Circuit Court.”

In re Bene, 474 B.R. 56 (Bankr. W.D.N.Y. 2012); see also *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 Cummings*, 2007 WL 3445912 (Bankr. N.D.Cal.2007) (“This court has long been spitting into the wind by noting that the [*Brunner*] test is a terrible example of judge-made law which gives no real guidance to a court in determining what undue hardship is. . . . “The worst part of the *Brunner* test is the requirement that a debtor has to have made a good faith effort to pay the loans. Congress said nothing about such a requirement in the Bankruptcy Code, and Congress knows how to draft a good faith requirement when it wants one. An effort to repay has absolutely nothing to do with hardship.”).

VI.

PRACTICE TIPS

A. Who’s Got My Loans? The single most important inquiry in the student loan industry is “who’s got my loan?” 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 borrower NSLDS reports if they hold the loan. Borrowers may access their own NSLDS reports by going to www.nslsds.ed.gov. They must first obtain a PIN at www.pin.ed.gov.

B. Industry resources:

- National Student Loan Data System (www.nslsds.ed.gov)
- ED PIN website: (www.pin.ed.gov)
- Federal Student Aid (government website): (<http://studentaid.ed.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 Direct Loan Program (www.loanconsolidation.ed.gov)

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- National Counsel of Higher Education Resources (www.ncher.us)
- Educational Credit Management Corporation (www.ecmc.org)
- FFEL Forms: (<http://www.ecmc.org/topic/mainForms.html>)
- Direct Loan (Ford program) Forms: (<https://www.dl.ed.gov/borrower>)

VII.

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Student Loan Debt in Bankruptcy: An Overview

By Prof. Susan E. Hauser¹

I. Section 523(a)(8): Treatment of Educational Debt Under the Bankruptcy Code

Section 523(a)(8) of the Bankruptcy Code excludes public and private student loans from discharge in bankruptcy unless “excepting such debt from discharge . . . would impose an undue hardship on the debtor or the debtor’s dependents.”² The present statute is the product of a series of amendments to the Bankruptcy Code that roughly parallels the development of the modern student loan industry.³

A. The Development of the Current Statute

Before 1976, educational loans were completely dischargeable in bankruptcy. The first provision restricting the discharge of educational loan debt appeared in 1976, when the former Bankruptcy Act was amended to make most government-backed student loans nondischargeable for a period of five years after the date the loan first became due.⁴ During this five-year period, student loans continued to be dischargeable if disallowing the discharge would impose an undue hardship on the debtor or his dependents.

When the Bankruptcy Code was adopted in 1978, these provisions were carried forward, and the five-year provision was expanded in 1979 to apply to any educational loan funded, made, insured or guaranteed by a governmental unit or funded by a “nonprofit institution of higher education.”⁵ In 1984, the statute was amended to include private student loans funded or guaranteed by a governmental or non-profit entity.⁶ Congress increased the five-year limit to seven years in 1990.⁷ The seven-year rule was eliminated completely in 1998, leaving undue hardship as the only avenue for the discharge of most educational debt.⁸ The most recent amendment to the statute came in 2005 when BAPCPA extended the application of § 523(a)(8) to “any qualified educational loan,” making student loans originated by private lenders nondischargeable even when these loans are not backed by a governmental entity.⁹

B. The Current Statute

In its present form, § 523(a)(8) excludes both public and private student loans from discharge in bankruptcy, subject only to an “undue hardship” exception. In its entirety, the statute

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2 11 U.S.C. § 523(a)(8).

3 See, e.g., *Cox v. Hemar Ins. Corp. of Am. (In re Cox)*, 338 F.3d 1238, 1242-43 (11th Cir. 2003) (detailing the evolution of § 523(a)(8)).

4 Education Act Amendments of 1976, Pub. L. 94-482, 90 Stat. 2081, cited in Alan M. Ahart, *Discharging Student Loans in Bankruptcy*, 52 AM. BANKR. L.J. 201, fn. 1 (1978).

5 Act of Aug. 14, 1979, Pub. L. No. 96-56, 93 Stat. 387.

6 Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333.

7 Crime Control Act of 1990, Pub. L. No. 101-647, 104 Stat. 4789.

8 Higher Education Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1581.

9 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.

now reads:

(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)

(i) 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

(ii) 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

Section 523(a)(8) applies to all cases filed under chapters 7, 11, 12, or 13 of the Bankruptcy Code and prevents an individual debtor from discharging most types of education debt absent a showing of undue hardship.

The broad scope of the present statute places a heavy emphasis on the debtor’s ability to prove undue hardship. However, several preliminary considerations may allow the debtor to exclude some obligations from the operation of the statute and discharge these debts without reference to undue hardship. First, not every obligation is considered a loan or an “educational benefit” for purposes of § 523(a)(8). Second, although § 523(a)(8) applies to educational loans from most sources, it does not apply to loans from every possible source. These initial questions of scope may excuse some debts from the operation of § 523(a)(8).

1. Obligations Within the Operation of § 523(a)(8)

Four broad categories of debts are made nondischargeable by the three subsections of § 523(a)(8).¹⁰ First, § 523(a)(8)(A)(i) applies to an “educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit.” The same subsection also makes an overpayment or loan nondischargeable if “made under any program funded in whole or in part by a governmental unit or nonprofit institution.” Third, § 523(a)(8)(A)(ii) excepts from discharge any “obligation to repay funds received as an educational benefit, scholarship, or stipend.” Finally, § 523(a)(8)(B) excepts from discharge “any other educational loan that is a qualified educational loan” as defined in § 221(d)(1) of the Internal Revenue Code.

a. Section 523(a)(8)(A)

Section 523(a)(8)(A)(i) makes all federal loans nondischargeable, including Stafford Loans, PLUS Loans (Parents Plus), and Consolidation Loans. The phrase “governmental unit” extends nondischargeability to any loan made, insured, guaranteed, or funded by a state agency or other non-federal governmental entity.¹¹ Section 523(a)(8)(A)(i) also applies to any loan funded

¹⁰ These were outlined by the court in *In re Rumer* as: “(1) loans made, insured, or guaranteed by a governmental unit; (2) loans made under any program partially or fully funded by a government unit or nonprofit institution; (3) loans received as an educational benefit, scholarship, or stipend; and (4) any ‘qualified educational loan’ as that term is defined in the Internal Revenue Code.” *Rumer v. American Educ. Servs. (In re Rumer)*, 469 B.R. 553 561 (M.D. Pa. 2012).

¹¹ 11 U.S.C. § 101(27) defines “governmental unit” to include the United States, States, municipalities, and any department, agency, or instrumentality thereof.

by a nonprofit organization, a term that includes most educational institutions.¹² This subsection specifically applies to overpayments, in addition to loans.

Section 523(a)(8)(A)(ii) further extends nondischargeability to any obligation to repay funds received, from any source, as an educational benefit, scholarship, or stipend. Because § 523(a)(8)(A)(ii) applies to credit from *any* source and uses the expansive term “educational benefit,” it has been used to extend nondischargeability in unexpected directions.¹³ For example, a loan obtained by a law student to pay for a bar review course was held nondischargeable under § 523(a)(8)(A)(ii).¹⁴ In addition, neither subsection of § 523(a)(8)(A) is limited to loans connected to post-secondary or higher education. This, combined with the expansive language of subsection (A)(ii), has supported the nondischargeability of the debtor’s obligation to pay for tutoring services provided to her child,¹⁵ as well as an unsecured line of credit used to pay for tuition and books for the debtor’s children.¹⁶

Because of the broad language used in § 523(a)(8)(A), a long list of obligations is clearly included in its coverage. However, debtors have still found ample room to argue that particular obligations are outside the scope of this section. The cases in this area divide into two broad categories. First, debtors have questioned whether the debt at issue is properly categorized as a loan. Second, debtors have contended that particular debts are not properly categorized as “educational.” If the obligation fails to meet either of these requirements, it falls outside the scope of § 523(a)(8)(A) and will be discharged without any need for the debtor to prove undue hardship.

b. Section 523(a)(8)(B)

Section 523(a)(8)(B) was added in 2005 when the statute was amended by BAPCPA, and it dramatically expanded the scope of the statute. Subsection (B) acts as a dragnet, extending nondischargeability to any educational loan not covered in subsection (A), so long as that loan is a “qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code,” and is incurred by an individual. Section 523(a)(8)(B) makes most private student loans nondischargeable, even if not funded or backed by the government or a nonprofit institution, subject only to the debtor’s ability to prove undue hardship. Unlike § 523(a)(8)(A), however, the operation of subsection (B) is limited to loans connected to the debtor’s post-secondary education.

The key to § 523(a)(8)(B) is its expansion of nondischargeability to the specific subset of educational loans from any source that are also *qualified education loans* under the Internal Revenue Code. Practically speaking, for purposes of tax law, a qualified education loan is any student loan on which a taxpayer is allowed to claim a deduction for interest paid on the loan.¹⁷ Thus, § 523(a)(8)(B) extends nondischargeability to any student loan, even a purely private loan, if the interest paid on the loan would be deductible by a taxpayer.

Section 523(a)(8)(B) references § 226(d)(1) of the Internal Revenue Code, which defines a qualified education loan as:

Any indebtedness incurred by the taxpayer solely to pay qualified higher education

12 See, e.g., *Busson-Sokolik v. Milwaukee School of Engineering (In re Busson-Sokolik)*, 635 F.3d 261 (7th Cir. 2011) (school was a § 501(c)(3) non-profit institution); *Andrews Univ. v. Merchant*, 958 F.2d 738 (6th Cir. 1992) (private university was nonprofit institution for purposes of this section).

13 Because of the breadth of this language, § 523(a)(8)(A)(ii) has been used as a fallback provision when the facts of a particular case fail to satisfy the more precise language of the other parts of § 523(a)(8). For example, in *Carow v. Chase Student Loan Serv. (In re Carow)*, 2011 WL 802847 (Bankr. D.N.D. 2011), loans were found nondischargeable under § 523(a)(8)(A)(ii) even though the court could not conclusively find they were “qualified educational loans” as required by § 523(a)(8)(B).

14 *Skipworth v. Citibank Student Loan Corp. (In re Skipworth)*, 2010 WL 1417964 (Bankr. N.D. Ala. 2010).

15 *Roy v. Sallie Mae (In re Roy)*, 2010 WL 1523996 (Bankr. D.N.J. 2010).

16 *Liberty Bay Credit Union v. Belforte (In re Belforte)*, 2012 WL 4620987 (Bankr. D. Mass. 2012).

17 26 U.S.C. § 221(a) (2013).

expenses –

(A) which are incurred on behalf of the taxpayer, the taxpayer’s spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred,

(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

(C) which are attributable to education furnished during a period during which the recipient was an eligible student.¹⁸

The term “qualified education loan” specifically includes any debt incurred to refinance another debt that is a qualified education loan.¹⁹

Section 226(d)(1) includes the dependent term *qualified higher education expenses*, which is defined separately to encompass the cost of attendance at an institution that is an “eligible educational institution” for purposes of Title IV of the Higher Education Act of 1965.²⁰ Thus, a nondischargeable qualified education loan is a loan obtained by a taxpayer or taxpayer’s spouse or dependent solely to pay qualified higher education expenses, a category of expenses limited to (1) the cost of attendance, (2) at an eligible educational institution.

2. Creditors Within the Protection of § 523(a)(8)

With very few exceptions, nearly all student loan creditors will be protected by one or more subsections of § 523(a)(8). Subsection 523(a)(8)(A)(i) shields governmental units and nonprofit institutions that engage in the specified transactions. Subsection 523(a)(8)(B) protects any creditor that makes a qualified education loan. And, subsection 523(a)(8)(A)(ii) is catchall provision that applies to the obligation to repay funds received as a scholarship, stipend, or “educational benefit” from any source.

Because of the breadth of the statute, a creditor will typically be excluded from the statute only if the debt it holds is not an educational loan or qualified education loan. These debts may be bills for tuition with no accompanying promissory note, post-education “buyout” loans, or loans that fail the statutory definitions in some other way.²¹

One final line of cases involves family members or friends who offer financial assistance to the student loan debtor, and then seek to have the assistance declared a nondischargeable debt.²² The creditor in *In re Posner* was a family friend who co-signed several student loans for the debtor. After the debtor defaulted on the loans, the creditor paid the lenders and obtained a judgment of \$112,322 against the debtor. This balance had increased to \$170,799 by the time the debtor filed chapter 7 in 2009. The judgment creditor later filed an adversary proceeding seeking to have the state court judgment declared nondischargeable under § 523(a)(8).

The court in *Posner* began with an examination of the policy considerations underlying the statute and found that these “necessarily limit the parties who may take advantage of the stat-

18 *Id.* at § 221(d)(1).

19 *Id.*

20 *Id.* at § 221(d)(2).

21 For example, in *S.B.R. Investments, Ltd. v. Luxa-LeBlanc (In re LeBlanc)*, 404 B.R. 793 (Bankr. M.D. Pa. 2009), the loan was not a “qualified education loan” for purposes § 523(a)(8)(B) because it was not made to a “taxpayer.”

22 *Gorosh v. Posner (In re Posner)*, 434 B.R. 800 (Bankr. E.D. Mich. 2010); *In re Reis*, 274 B.R. 46 (Bankr. D. Mass 2002) (educational loan made by debtor’s grandparents was dischargeable); *but cf. Wills v. Sallie Mae Serv. (In re Wills)*, 2010 WL 1688221 (S.D. Ind. 2010). The bankruptcy debtor in *Wills* was a 68 year old grandfather who mistakenly became the sole obligor on private student loans taken to enable his grandson to attend Nashville Auto-Diesel College. The grandson was unable to complete the program, had not worked for the past 5 years, and suffered from mental illness. Despite these highly sympathetic facts, the court traced the requirements of the statute and concluded this was a nondischargeable qualified education loan under § 523(a)(8)(B). The debtor claimed his grandson as a dependent for tax purposes, and the College was an eligible educational institute.

ute's protections."²³ The court concluded that the plaintiff co-signer did not qualify as a person whose claim was protected by § 523(a)(8). This conclusion was based on a "recognition of the Congressional purpose of § 523(a)(8), namely to insure the availability of educational financing." Here, the plaintiff was not a lender because she never loaned money to the defendant; instead, she co-signed a loan. Although she subsequently paid off the debtor's student loans, she remained a general unsecured creditor, not a lender protected by § 523(a)(8). Finally, the court found no support for the debtor's argument that she was equitably subordinated to the rights of the original lender.²⁴

C. Policy Arguments Supporting the Nondischargeability of Student Loan Debt

The fundamental purpose of bankruptcy law is to provide a procedure that provides the debtor "a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."²⁵ Section 523(a)(8) is an exception to this general policy and is based on independent policy considerations that, in the view of Congress, are sufficiently strong to outweigh the benefits obtained by providing the debtor with a fresh start.

Section 523(a)(8) was added to the Bankruptcy Code in response to Congressional concern that students were abusing bankruptcy by attempting to discharge student loans immediately after graduation.²⁶ The perception of abuse was fueled by the fact that student loans are generally unsecured and frequently written with little regard to the debtor's current financial circumstances, instead looking to the debtor's future income for repayment.²⁷ Quelling this perceived abuse by debtors was certainly one of the original policies supporting the nondischargeability of student loans.²⁸

A second original purpose of § 523(a)(8) was "rescuing the student loan program from fiscal doom"²⁹ by protecting the solvency of educational loan programs and ensuring these programs would be available for future students. At the most fundamental level, the nondischargeability of student loans is justified by the strong public interest in ensuring educational loans will be available to future students. Protecting the financial viability of the student loan system is, in turn, linked to a related policy interest in ensuring that education is equally available to students from all socio-economic backgrounds.

Finally, § 523(a)(8) has been justified by the policy that it is more appropriate to place the risk of default on the student/borrower, rather than on taxpayers.

The government is not twisting the arms of potential students. The decision of whether or not to borrow for a college education lies with the individual; . . . the government does not guarantee the student's future financial success. If the leveraged investment of an education does not generate the return the borrower anticipated, the student, not the taxpayers, must accept the consequences of the decision to borrow.³⁰

23 *Id.* at 803.

24 *See also* Resurrection Medical Center v. Lakemaker (*In re* Lakemaker), 241 B.R. 577 (Bankr. N.D. Ill. 1999) (rejecting a similar equitable subordination argument brought by a former employer that obtained a judgment after advancing funds to pay off debtor's student loans).

25 Grogan v. Garner, 111 S. Ct. 654, 659 (1991).

26 Andrews Univ. v. Merchant (*In re* Merchant), 958 F.2d 738, 740 (6th Cir. 1992), *citing* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 466-75 *reprinted in* 1978 U.S. Code Cong. & Admin. New 5787.

27 *In re* Roberson, 999 F.2d 1132, 1135-36 (7th Cir. 1993) ("the loan is viewed as a mortgage on the debtor's future").

28 *In re* Pelkowski, 990 F.2d 738, 744 (3d Cir. 1993) (noting that "legislative history reveals a clear congressional intent to prevent debtor abuse of the program and depletion of the Program's resources").

29 *Id.* at 743.

30 *Roberson*, *supra* note 27, at 1137.

This policy works well in the context of student loans that are made or backed by a governmental unit or non-profit. However, it loses its force when applied to private student loan debt that, for purposes of this policy argument, is indistinguishable from any other general unsecured debt.

II. Undue Hardship

Nine circuits follow the three-pronged test for undue hardship given by the Second Circuit Court of Appeals in *Brunner v. New York State Higher Education Services Corp.*³¹ To establish undue hardship under the *Brunner* test, the debtor must prove:

- (1) She 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) 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) she has made good faith efforts to repay the loan.³²

The *Brunner* test, which poses difficult proof issues for the debtor, remains the majority rule despite recent criticism suggesting that it should be revised to reflect changes in the statute and in educational lending practices since 1987.³³

Only the First and Eighth Circuits have declined to adopt *Brunner*. The Eighth Circuit uses a “totality of the circumstances” test that considers (1) the debtor’s past, present, and reasonably reliable future financial resources; (2) a calculation of the reasonable living expenses of the debtor and her dependents; and (3) “any other relevant facts and circumstances surrounding each particular bankruptcy case.”³⁴ The First Circuit has not adopted either test,³⁵ although bankruptcy courts within the First Circuit have adopted the totality of the circumstances test.³⁶

Although they continue to follow *Brunner*, the Sixth, Ninth, Tenth, and Eleventh Circuits have softened its effect by adopting a doctrine of partial discharge.³⁷ Partial discharge allows the debtor to discharge part of his student loan debt while remaining obligated to repay the remainder. Analytically, partial discharge is justified by using the bankruptcy court’s equitable powers under § 105(a) to apply the *Brunner* or totality of the circumstances test to only part of the student loan debt. Partial discharge, which is not within the literal language of § 523(a)(8), has been disallowed in the Third Circuit and many bankruptcy courts.

III. Proof Issues in Student Loan Litigation

31 831 F.2d 395 (2d Cir. 1987). *Brunner* has been adopted in eight other circuits: the Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth, and Eleventh Circuits. See *Pa. Higher Educ. Assistance Agency v. Faish (In re Faish)*, 72 F.3d 298 (3d Cir. 1995); *Ekenasi v. United Student Educ. Res. Inst. (In re Ekenasi)*, 325 F.3d 541 (4th Cir. 2003); *U.S. Dept. of Educ. v. Gerhardt (In re Gerhardt)*, 348 F.3d 89 (5th Cir. 2003); *Oyler v. Educ. Credit Mgmt. Corp. (In re Oyler)*, 297 F.3d 382 (6th Cir. 2005); *In re Roberson*, 999 F.2d 1132 (7th Cir. 1993); *United Student Aid Funds, Inc. v. Pena (In re Pena)*, 155 F.3d 1103 (9th Cir. 1998); *Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302 (10th Cir. 2004); *Hemar Ins. Corp. v. Cox (In re Cox)*, 338 F.3d 1238 (11th Cir. 2003).

32 *Brunner*, at 396.

33 See, e.g., *Roth v. Educational Credit Management Corp. (In re Roth)*, 490 B.R. 908 (9th Cir. BAP 2013), Pappas, J., concurring.

34 *Long v. Educ. Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549 (8th Cir. 2003); *Walker v. Sallie Mae Servicing Corp. (In re Walker)*, 650 F.3d 1227 (8th Cir. 2011).

35 *Nash v. Conn. Student Loan Found. (In re Nash)*, 446 F.3d 188 (1st Cir. 2006).

36 See, e.g., *Bronsdon v. Educ. Credit Mgmt. Corp. (In re Bronsdon)*, 435 B.R. 791 (1st Cir. BAP 2010).

37 *Tenn. Student Assistance Corp. v. Hornsby (In re Hornsby)*, 144 F.3d 433 (6th Cir. 1998); *Miller v. Pa. Higher Educ. Assistance Agency (In re Miller)*, 377 F.3d 616 (6th Cir. 2004); *Saxman v. Educ. Mgmt. Corp. (In re Saxman)*, 325 F.3d 1168 (9th Cir. 2003); *Alderete v. Educ. Credit Mgmt. Corp. (In re Alderete)*, 412 F.3d 1200 (10th Cir. 2005); *Hemar Ins. Corp. v. Cox (In re Cox)*, 338 F.3d 1238 (11th Cir. 2003).

A. Burdens of Proof

In a § 523(a)(8) adversary proceeding, the debtor/plaintiff has the burden of proving that repayment of his student loans would impose an undue hardship on the debtor and his dependents.³⁸ It follows that the debtor/plaintiff has the burden of proving every element of the undue hardship test by a preponderance of the evidence.³⁹

Conversely, the creditor has the initial burden of proving the validity of its claim against the debtor.⁴⁰ For purposes of § 523(a)(8) litigation, this means that the creditor has the burden of establishing the existence of the debt by a preponderance of the evidence. The creditor also has the burden of proving that its debt is based on an educational loan or qualified educational loan, so that the debt falls within one of the various categories of debt made nondischargeable by § 523(a)(8).⁴¹

B. Discovery

Because of the fact-intensive nature of the undue hardship question, the parties' ability to use discovery to marshal supporting evidence may ultimately prove one of the keys to success in a § 523(a)(8) action. At trial, the judicially developed tests for undue hardship may require the debtor to prove specific facts about his current income and expenses, employment history, family circumstances, and student loan payment history. The parties will also need predictive evidence relevant to the debtor's future financial condition, a category of information that potentially includes evidence of the debtor's employment prospects, mental health status, or physical condition. Much of this information will be in the debtor's possession, and the student loan creditor can use discovery to obtain documents, depose the debtor and the debtor's witnesses, and explore other potential evidence relative to these questions.⁴² The creditor, on the other hand, may have superior or differing information about the debtor's payment history and outstanding loan balance. The debtor can use interrogatories and requests for production to uncover this information through discovery.⁴³

C. Motions for Summary Judgment

The debtor/plaintiff has the burden of proof in actions seeking to discharge student loan debt under § 523(a)(8). Therefore, if the creditor files a motion for summary judgment, it is incumbent on the debtor to respond with specific evidentiary submissions creating a genuine issue of material fact as to each element of the undue hardship test. Undue hardship determinations are fact-dependent, and summary judgment offers the defendant a way to test the plaintiff's case and terminate insubstantial claims short of trial. The fact-intensive nature of undue hardship indicates

38 *In re Pena*, 155 F.3d 1108 (9th Cir. 1998); *Penn. Higher Educ. Assis. Agency v. Faish (In re Faish)*, 72 F.3d 298, 301 (3d Cir. 1995).

39 *Brightful v. Penn. Higher Educ. Assistance Agency (In re Brightful)*, 267 F.3d 324 (3d Cir. 2001); *Educ. Credit Mgmt. Corp. v. Frushour (In re Frushour)*, 433 F.3d 393 (4th Cir. 2005); *O'Hearn v. Educ. Credit Mgmt. Corp. (In re O'Hearn)*, 339 F.3d 559 (7th Cir. 2003); *Walker v. Sallie Mae Serv. Corp. (In re Walker)*, 650 F.3d 1227, 1230 (8th Cir. 2011) ("The debtor has the burden of establishing undue hardship by a preponderance of the evidence.").

40 *See, e.g., In re Mehta*, 310 F.3d 308 (3d Cir. 2002); *In re Renshaw*, 222 F.3d 82 (2d Cir. 2000); *In re Nies*, 334 B.R. 495 (Bankr. D. Mass. 2005).

41 *Rumer v. American Educ. Servs. (In re Rumer)*, 469 B.R. 553, 561 (Bankr. M.D. Pa. 2012); *Raymond v. Northwest Educ. Loan Ass'n (In re Raymond)*, 169 B.R. 67 (Bankr. W.D. Wash. 1994); *In re Stone*, 199 B.R. 753 (Bankr. N.D. Ala. 1996).

42 *In re Williams*, 492 B.R. 79 (Bankr. M.D. Ga. 2013) (debtor's expenses reported on Schedule J were supplemented by her responses to the defendant's discovery requests); *Educ. Credit Mgmt. Corp. v. McLeroy (In re McLeroy)*, 250 B.R. 872 (N.D. Tex. 2000) (discovery requests sought documentation of debtor's church contributions and history of tithing); *cf. Joyce v. Mountain Peaks Fin. Servs. (In re Joyce)*, 342 B.R. 385 (Table), 2005 WL 3946869 (1st Cir. B.A.P. 2005) (discovery issue not addressed because raised on appeal for first time).

43 *United Student Aid Funds, Inc. v. Roberts (In re Roberts)*, 376 Fed. Appx. 398 (5th Cir. 2010) (discovery request sought to substantiate the amount of the debt).

that cases are likely to survive to trial, however, if the plaintiff can proffer credible submissions in support of his claim.⁴⁴

Summary judgment is always a two-pronged inquiry, gauging (1) whether there is a genuine dispute as to any material fact, and (2) whether the moving party is entitled to judgment as a matter of law. In adversary proceedings filed under § 523(a)(8), both of these questions require the court to refer to the substantive law of undue hardship. Depending on the district, this means that the court must determine whether it appears that the plaintiff will be able to satisfy either the totality of the circumstances test used in the First and Eighth Circuits,⁴⁵ or the three elements of the *Brunner* test adopted in nine other circuits.⁴⁶

In courts that apply the widely-used *Brunner* test, the debtor/plaintiff has the burden of substantiating the following at summary judgment:

- (1) she cannot maintain a minimal standard of living and repay the loans;
- (2) additional circumstances exist that illustrate she will not be able to repay the loans for a substantial part of the repayment period;
- (3) she attempted to repay the loans in good faith.⁴⁷

The first *Brunner* factor looks to the debtor's current income and expenses, a straightforward set of facts that may be difficult to dispute. In *In re Wills*, for example, the court considered the debtor's bankruptcy schedules and discovery responses and found "no doubt" that the plaintiff had the current financial ability to repay his student loans and maintain his current standard of living.⁴⁸ The second and third *Brunner* factors require a more detailed and uncertain factual inquiry and are, accordingly, more likely to preclude the entry of summary judgment.

The second *Brunner* factor requires the debtor to prove additional circumstances indicating that his straitened circumstances are likely to persist into the future. These additional circumstances "may include illness, disability, a lack of useable job skills, or the existence of a large number of dependents," or other circumstances beyond the debtor's control.⁴⁹ At summary judgment, evidence of the debtor's age, health, education, and employment history will likely be relevant to this factor.⁵⁰ And, because this factor is forward-looking, the debtor will be required to show that these conditions will not improve over the life of the loan. Not only will this be difficult for the debtor to show, courts have been willing to grant summary judgment for the creditor when the debtor's showing

44 *Traversa v. Educ. Credit Mgmt. Corp.*, 386 B.R. 386 (D. Conn. 2008) (appellate court recounted that bankruptcy judge had denied summary judgment for plaintiff "because determinations of undue hardship under 11 U.S.C. § 523(a)(8) 'are highly fact sensitive'").

45 *See Lovell v. Iowa Student Loan Liquidity Corp. (In re Lovell)*, 2012 WL 1252594 (Bankr. N.D. Iowa 2012) (denying creditor's motion for summary judgment because genuine issues of material fact existed under the totality of the circumstances test).

46 *See* note 31 and accompanying text, *supra*.

47 *Educ. Credit Mgmt. Corp. v. Frushour (In re Frushour)*, 433 F.3d 393, 398 (4th Cir. 2005).

48 *Wills v. Sallie Mae Servicing (In re Wills)*, 2010 WL 1688221, at *4 (S.D. Ind. 2010) (granting defendant's motion for summary judgment).

49 *Oyler v. Educ. Credit Mgmt. Corp. (In re Oyler)*, 397 F.3d 382, 386 (6th Cir. 2005).

50 For example, in *Geyer v. U.S. Dept. of Educ. (In re Geyer)*, 334 B.R. 129 (S.D. Cal. 2006), the court cited the second *Brunner* prong and granted the defendant's motion for summary judgment. The parties' submissions showed that the debtors were well-educated, in good health, and had no dependents. The female debtor spoke three languages and had published two books. Both debtors had an academic bent and "less than complete dedication to retaining employment," having voluntarily given up jobs to volunteer on an archeological dig in Israel. In addition, they had entered an Income Contingent Repayment Plan that required no payments at all.

is weak.⁵¹

The third *Brunner* factor requires a debtor to show that she has made good faith efforts to repay her student loans. Good faith is typically determined by looking at the debtor's past payment history on the loans. At summary judgment, this may require the debtor to show that she has made payments during periods of employment.⁵² In a number of recent cases, courts have also examined whether the debtor has applied for an income contingent or other alternative repayment plan.⁵³ Although most courts do not require a debtor to participate in an alternative payment plan, they have found the debtor's repayment choices relevant to good faith on summary judgment.⁵⁴

D. Evidence Issues at Trial

If the case survives summary judgment and goes to trial, the plaintiff debtor will have the burden of proving every element of undue hardship by a preponderance of the evidence. The Federal Rules of Evidence apply in bankruptcy adversary proceedings, and many of the distinctive issues that arise in the trial of a § 523(a)(8) claim will involve evidentiary questions that arise as the debtor attempts to prove undue hardship. Typically, the debtor will offer his own testimony as evidence, but the outcome of the trial is likely to depend on the debtor's ability to support and corroborate his own testimony with other forms of evidence.

Fact issues about the debtor's current income and expenses, as well as the debtor's student loan payment history, can be addressed by the debtor's testimony and bolstered with documentary evidence. For example, in *Barrett*, the bankruptcy court heard testimony from the debtor and also admitted the following documents: the debtor's tax returns from three preceding years, Schedules I and J filed with his petition, a print-out of a search result from the Department of Education's Interactive Repayment Calculator, and a copy of the Poverty Guidelines published in the Federal Register.⁵⁵ This type of evidence is particularly well-suited to meet the debtor's burden under the first and third prongs of the *Brunner* test, as well as under the first and second components of the totality of the circumstances test.

More difficult evidentiary issues have arisen in conjunction with the second prong of the *Brunner* test, which requires the debtor to prove additional circumstances indicating that the inability to repay will persist for a significant portion of the repayment period. Although *Brunner* is not followed in the First and Eighth Circuits, debtors there have a similar burden of showing that the "current inability to maintain a minimal standard of living, if forced to repay the debt, will continue into the future."⁵⁶ Debtors typically try to satisfy the burden of proving the persistence of conditions into the future with evidence of physical illness or another medical condition, psychiatric disorder, or some other special situation that will continue to interfere with the debtor's ability

51 *Marlow v. U.S. Dept. of Educ. (In re Marlow)*, 2013 WL 3515726 (E.D. Tenn. 2013). (Debtor was a healthy, 31-year old, law school graduate who had been barred from practice on character and fitness grounds. The court found him capable of future gainful employment and noted that the denial of his law license was the result of his own action). *Duval v. IRS (In re Duval)*, 2012 WL 1123041 (Bankr. S.D.N.Y. 2012). (Dentist claimed that his income was lower than expected because his practice primarily accepted Medicaid patients. The court found it possible he could move to a high-paying practice in the future).

52 *Wills, supra* note 48 (debtor's minimal payments on her student loans did not show good faith effort to repay).

53 *See, e.g., Barrett v. Educ. Credit Mgmt. Corp. (In re Barrett)*, 487 F.3d 353 (6th Cir. 2007) (declining to adopt a per se rule); *Educ. Credit Mgmt. Corp. v. Mosley (In re Mosley)*, 494 F.3d 1320 (11th Cir. 2007) (accord).

54 *Straub v. Sallie Mae (In re Straub)*, 435 B.R. 312, 317 (Bankr. D.S.C. 2010). "Evidence of good faith may be found where a debtor has sought consolidation offered a compromise payment, or otherwise offered to pay or settle the obligation in a meaningful manner." *See also Marlow, supra* note 51 (because debtor had declined to apply for an income contingent repayment plan, he had not used all available recourses to repay the loans).

55 *Barrett v. Educ. Credit Mgmt. Corp. (In re Barrett)*, 487 F.3d 353, 358 (6th Cir. 2007).

56 *Nash v. Conn. Student Loan Found. (In re Nash)*, 446 F.3d 188, 192 (1st Cir. 2006).

to earn a living.⁵⁷

When the debtor's future mental or physical condition is an issue, her case becomes much stronger when she is able to corroborate her own testimony with testimony from an expert witness. Although the debtor may be competent to testify to her present condition, expert testimony is helpful in establishing the debtor's future prognosis, a key to showing that her condition is likely continue during the repayment period.⁵⁸

In re Reynolds, from the Eighth Circuit, illustrates the value of expert testimony.⁵⁹ In *Reynolds*, the debtor's psychiatric expert testified about her illness, and then gave additional testimony that her student loans "caused her stress," left her "overwhelmed by indebtedness," and "made it harder for her to sustain improvement in her depressive illness."⁶⁰ Based on this testimony, the bankruptcy court found that "the mere existence of this debt burden clearly is a significant block to the debtor's recovery from mental illness."⁶¹ This judgment was affirmed on appeal.

Despite the desirability of expert testimony as a way to bolster the debtor's case, the cost of retaining an expert places this type of evidence beyond the means of many debtors. For this reason, most courts do not impose a per se requirement that debtors substantiate medical conditions with expert testimony in § 523(a)(8) actions. In *Barrett*, for example, the Sixth Circuit agreed with the Bankruptcy Appellate Panel that "a requirement of corroborating evidence 'when Plaintiff is unable to afford expert testimony or documentation imposes an unnecessary and undue burden on Plaintiff in establishing his burden of proof,' if corroborating evidence is understood to be limited to expert medical testimony."⁶² Many courts have echoed this view.⁶³

Although expert testimony may not be a requirement, most courts look for corroborating evidence beyond the debtor's own testimony. In *Barrett*, the bankruptcy court described Barrett as "credible" and found that he "testified informatively and cogently about his medical history," explaining in "great detail . . . how his condition affects his health and prevents him from working."⁶⁴ His testimony, however, had certain limits. Although he was competent to testify about his diagnosis and how his condition impacted his life and work, he was not competent to testify about medical issues like his prognosis and the cause of his illness.

To prevail, it was necessary for Barrett and his counsel to provide the court with additional evidence to corroborate his testimony. In the absence of an expert witness, the court accepted a properly authenticated letter from his treating physician. The debtor also proffered tax returns that substantiated his persistent inability to earn income because of his health problems, as well as evidence of economic hardship deferments on his student loans for four consecutive years. This evidence was not contradicted by the creditor, prompting the Sixth Circuit to hold: "[w]here, as here, the debtor testifies credibly and without rebuttal about his medical history, his current health,

57 Educ. Credit Mgmt. Corp. v. Mason (*In re Mason*), 464 F.3d 878 (9th Cir. 2006) (debtor cited learning disability as "additional circumstances").

58 *Nash*, *supra* note 56, at 194. The court noted that the debtor had submitted no expert evidence to support her own prognosis that her bipolar illness was unlikely to abate. The First Circuit affirmed the bankruptcy judge's finding that the debtor's evidentiary showing was insufficient. See also *Kelsey v. Great Lakes Higher Educ. Corp.* (*In re Kelsey*), 287 B.R. 132 (Bankr. D. Vt. 2001).

59 *Reynolds v. Penn. Higher Educ. Assistance Agency* (*In re Reynolds*), 425 F.3d. 526, 528-29 (8th Cir. 2005).

60 *Id.* at 528.

61 *Reynolds v. Penn. Higher Educ. Assistance Agency* (*In re Reynolds*), 303 B.R. 823, 837 (Bankr. D. Minn. 2004).

62 *Barrett v. Educ. Credit Mgmt. Corp.* (*In re Barrett*), 487 F.3d 353, 360 (6th Cir. 2007) (emphasis added).

63 *Educ. Credit Mgmt. Corp. v. Mosley* (*In re Mosley*), 494 F.3d 1320 (11th Cir. 2007); *Burton v. Educ. Credit Mgmt. Corp.* (*In re Burton*), 339 B.R. 856 (Bankr. E.D. Va. 2006); *Swinney v. Academic Fin. Servs.* (*In re Swinney*), 266 B.R. 800 (Bankr. N.D. Ohio 2001).

64 *Barrett*, *supra* note 62, at 361.

his employment history, and his ability to perform work functions – and that testimony is corroborated in part by a letter from the debtor’s treating physician and tax records – the debtor has offered proof sufficient to support a finding of undue hardship.”⁶⁵

The Eleventh Circuit adopted and arguably expanded *Barrett*’s holding in *In re Mosley*.⁶⁶ Mosley had incurred \$45,000 in student loans while in college. As a student, he had joined the Reserve Officers’ Training Corps and was injured when he fell from a tank. He was forced to resign his commission and failed to complete college. He testified that the physical limitations from his injury led to depression and heavy drinking. He had been hospitalized for depression and Veteran’s Affairs had placed him on medication that left him “unable to function.” His monthly income was \$210 in VA disability, he had been homeless for years, and he had no car.

Mosley, who was not represented by counsel, was the only witness at his § 523(a)(8) trial. In addition to his own testimony, he offered a letter from an Emory University professor stating Mosley’s medical diagnosis. The bankruptcy judge excluded several other doctors’ letters that Mosley attempted to introduce because they had not been properly authenticated. The court found little probative value in the one letter admitted and, instead, primarily relied on the debtor’s testimony to conclude that his illnesses were likely to impair his future ability to repay the loans.

On appeal, the creditor argued that corroborating medical evidence beyond the debtor’s testimony is required when medical conditions are used as “additional circumstances” under the second prong of *Brunner*. The Eleventh Circuit held that additional evidence was not necessary, and declined “to adopt a rule requiring Mosley to submit independent medical evidence to corroborate his testimony that his depression and back problems were additional circumstances likely to render him unable to repay his student loans.”⁶⁷ The court noted that the debtor did not testify about his medical prognosis, but instead testified from personal knowledge about how his condition and medications have made it difficult for him to work.

The evidentiary record in *Mosley* is slender, consisting only of the debtor’s testimony, one supporting letter, and Social Security earnings statements that corroborated that he had not held a job. Despite this, the Eleventh Circuit found

“the bankruptcy court had before it sufficient evidence to support a finding that there is no reason to believe that Mosley’s condition will improve in the future. Mosley’s evidence of medical problems, lack of skills and dire living conditions support the bankruptcy court’s finding that it is highly unlikely he will become unable to repay his loans.”⁶⁸

The opinions in *Mosley* and *Barrett* are attributable in part to the “clear error” standard of review that appellate courts must apply to the bankruptcy judge’s findings of fact in these cases. Under this standard, the appellate court is likely to defer to the lower court’s findings of fact unless the appellate court is willing to announce a new, and stricter, evidentiary rule that will apply to all future cases. In declining the invitation to adopt a per se evidentiary requirement in § 523(a)(8) cases, the appellate courts may be reflecting the fact that bankruptcy courts are, in fact, already quite demanding in their assessment of the debtor’s evidentiary submissions.⁶⁹

65 *Id.* at 363.

66 *Mosley*, *supra* note 63.

67 *Id.* at 1325.

68 *Id.* at 1327.

69 In a majority of reported cases, the debtor’s evidentiary submissions are found insufficient. *See, e.g.*, *Traversa v. Educ. Credit Mgmt. Corp.* (*In re Traversa*), 2010 WL 4683920 (D. Conn. 2010); *Joyce v. Mountain Peaks Fin. Servs.* (*In re Joyce*), 2005 WL 3946869 (1st Cir. B.A.P. 2005); *Pobiner v. Educ. Credit Mgmt. Corp.* (*In re Pobiner*), 309 B.R. 405 (Bankr. E.D.N.Y. 2004); *Burkhead v. U.S.* (*In re Burkhead*), 304 B.R. 560 (Bankr. D. Mass. 2004); *Pace v. Educ. Credit Mgmt. Corp.* (*In re Pace*), 288 B.R. 788 (Bankr. S.D. Ohio 2003); *Daugherty v. First Tenn. Bank* (*In re Daugherty*), 175 B.R. 953 (Bankr. E.D. Tenn. 1994).

IV. Adjusting Student Loan Debt Outside of Section 523(a)(8)

This section examines three ways in which judges have pushed the law in new directions to afford relief to student loan debtors: (1) partial discharge of educational debt, (2) separate classification of student loan debt in chapter 13 plans, and (3) the possibility of using plan confirmation to obtain a discharge “by declaration.”

A. Partial Discharge

A number of courts have been willing to discharge part of a debtor’s student loan obligations when the facts do not support a finding that the entire obligation poses an undue hardship on the debtor. These cases are fact-driven. As the Sixth Circuit explained in *Hornsby v. Tennessee Student Assistance Corp. (In re Hornsby)*, a partial discharge of student loan debt may be appropriate “where facts and circumstances require intervention in the financial burden on the debtor, [and] an all-or-nothing treatment thwarts the purpose of the Bankruptcy Act.”⁷⁰

Hornsby was the first circuit court decision upholding the bankruptcy courts’ equitable power to grant a partial discharge of student loan debt under § 105(a)’s authority to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”⁷¹ *Hornsby*, however, did not squarely address the relationship between § 105(a) and § 523(a)(8). The Sixth Circuit revisited this issue in *Miller v. Pennsylvania Higher Education Assistance Agency (In re Miller)*, clarifying that § 105(a) provides no “independent rubric” and must be read in conjunction with § 523(a)(8) to evaluate when a partial discharge is appropriate.⁷²

A similar approach has been adopted in the Ninth, Tenth, and Eleventh Circuit Courts of Appeal.⁷³ While recognizing that the bankruptcy court’s equitable powers do not allow it to ignore the specific statutory language found in § 523(a)(8), these four circuits hold that “§ 105(a) authorizes a bankruptcy court to grant a partial discharge where the undue hardship requirement of § 523(a)(8) is met as to part but not all of a student loan.”⁷⁴

Under these decisions, the bankruptcy court may not use its equitable powers to grant a partial discharge unless § 523(a)(8) has been satisfied as to some portion of the obligation. “To allow the bankruptcy court, through principles of equity, to grant any more or less than what the clear language of § 523(a)(8) mandates would be tantamount to judicial legislation and is something that should be left to Congress, not the courts.”⁷⁵

Lower courts outside these four circuits have been less uniform in their approach, with a number finding that the Code does not permit a partial discharge of student loan debt.⁷⁶ These

70 144 F.3d 433, 439 (6th Cir. 1998).

71 11 U.S.C. § 105(a). A number of bankruptcy courts had previously used § 105(a) to grant a partial discharge of student loan debt – sometimes with no reference to § 523(a)(8). *See, e.g., Griffin v. Eduserv (In re Griffin)*, 197 B.R. 144 (Bankr. E.D. Okla. 1996) (relying on § 523(a)(8)); *In re Brown*, 18 B.R. 219 (Bankr. D. Kan. 1982) (no reference to § 523(a)(8)); *In re Albert*, 25 B.R. 98 (Bankr. D. Ohio 1982) (no reference to § 523(a)(8)).

72 377 F.3d 616, 622 (6th Cir. 2004).

73 *Saxman v. Educational Credit Management Corp. (In re Saxman)*, 325 F.3d 1168 (9th Cir. 2003); *Alderete v. Educational Credit Management Corp. (In re Alderete)*, 412 F.3d 1200 (10th Cir. 2005); *Hemar Ins. Corp. of Am. v. Cox (In re Cox)*, 338 F.3d 1238 (11th Cir. 2003). The Third Circuit reversed the bankruptcy court’s grant of a partial discharge in *Faish v. Penn. Higher Educ. Assistance Agency (In re Faish)*, 72 F.3d 298 (3d Cir. 1995), however, it did so on factual grounds without discussion of the related law in an opinion devoted to the adoption of the *Brunner* test.

74 *Miller*, 377 F.3d at 621, quoting *Nary v. Complete Source (In re Nary)*, 253 B.R. 752, 767 (N.D. Tex. 2000).

75 *Cox*, 338 F.3d at 1207.

76 *Pincus v. Graduate Loan Center (In re Pincus)*, 280 B.R. 303 (Bankr. S.D.N.Y. 2002); *Young v. PHEAA (In re Young)*, 225 B.R. 312 (Bankr. E.D. Penn. 1998) (partial discharge sought by creditor to avoid discharge *in toto*); *Skaggs v. Great Lakes Higher Educ. Corp. (In re Skaggs)*, 196 B.R. 865 (Bankr. W.D. Okla. 1996); *Hawkins v. Buena Vista College (In re Hawkins)*, 187 B.R. 294 (Bankr. N.D. Iowa 1995). *And see Andreson v. Nebraska Student Loan Program, Inc. (In re Andreson)*, 232 B.R. 127 (8th Cir. B.A.P. 1999) (finding no authority in the Code for partial discharge, but declining to decide the issue).

decisions apply a strict approach and find that § 105(a) does not authorize the bankruptcy court “to use its equitable powers to achieve a result not contemplated by the Code, particularly where a specific section of the Code squarely addresses the issue before the court.”⁷⁷ Courts that have allowed partial discharge without circuit authority have generally followed the approach of the circuits, looking to § 105(a) as a source of equitable authority to soften the application of § 523(a)(8).⁷⁸ A small minority of courts, however, has been willing to draw the power for partial discharge solely from the language of § 523(a)(8).⁷⁹

In courts that allow partial discharge, a final issue is the form that the partial discharge will take. When, as is typical, debtors owe more than one student loan, some decisions frame the partial discharge as a complete release from liability on some loans, while leaving the debtor entirely liable on the remaining loans.⁸⁰ Some courts have followed this “loan by loan” pattern without regarding this as a partial discharge, holding instead that each loan can be treated as a singular entity.⁸¹ Still others reject this approach entirely, holding that student loans must be treated in the aggregate.⁸²

Another set of courts has been willing to grant a partial discharge that is effectively a loan modification. These decisions either reduce the principal balance on the loans to a more manageable amount,⁸³ relieve the debtor from liability on interest and fees while leaving the debtor liable on the principal,⁸⁴ impose a deferral,⁸⁵ or fashion another appropriate equitable remedy.⁸⁶ The variability of the remedy in partial discharge cases illustrates the difficulty that arises when courts fashion equitable amendments to the Code.

B. Separate Classification in Chapter 13

As in chapter 7, student loan debt is generally nondischargeable in chapter 13 cases and

⁷⁷ *Pincus*, *supra* note 9, at 312.

⁷⁸ *Stevenson v. Educational Credit Management Corp.* (*In re Stevenson*), 463 B.R. 586 (Bankr. D. Mass. 2011) (looking to § 105(a)); *Fraley v. U.S. Dept. of Ed.*, 247 B.R. 417 (Bankr. N.D. Ohio 2000); *Fox v. Student Loan Mktg. Ass’n* (*In re Fox*), 189 B.R. 115 (Bankr. N.D. Ohio 1995).

⁷⁹ *See, e.g.*, *Rivers v. United Student Aid Funds, Inc.* (*In re Rivers*), 213 B.R. 616 (Bankr. S.D. Ga. 1997).

⁸⁰ *Hinkle v. Wheaton College* (*In re Hinkle*), 200 B.R. 690 (Bankr. W.D. Wash. 1996); *Coutts v. Mass. Higher Educ. Corp.* (*In re Coutts*), 263 B.R. 394 (Bankr. D. Mass. 2001); *Gharavi v. U.S. Dept. of Educ.* (*In re Gharavi*), 335 B.R. 492 (Bankr. D. Mass. 2006); *Ledbetter v. U.S. Dept. of Ed.* (*In re Ledbetter*), 254 B.R. 714 (Bankr. S.D. Ohio 2000) (following *Andreson*, *supra* note 9). *Cf. Young*, *supra* note 9, at 318 (“If a holder of student loans is prepared to stipulate that certain student loans are unconditionally dischargeable, leaving only a limited number of loans remaining as particularly nondischargeable, there would seem to be no way of stopping it from doing so.”)

⁸¹ *See Andreson*, *supra* note 9 (although 2 of 3 student loans were discharged, the B.A.P held that this was not a partial discharge because each loan could be treated separately); *Hollister v. University of N.D.*, 247 B.R. 485 (Bankr. W.D. Okla. 2000) (adopting the reasoning of *Andreson*); *Grigas v. Sallie Mae Servicing Corp.* (*In re Grigas*), 252 B.R. 866 (Bankr. D.N.H. 2000).

⁸² *Pincus*, *supra* note 9 (rejecting the “loan by loan” approach); *Young*, *supra* note 9; *Raimondo v. New York State Higher Educ. Serv. Corp.* (*In re Raimondo*), 183 B.R. 677 (Bankr. W.D.N.Y. 1995) (holding that equity requires equal treatment among student lenders).

⁸³ *Hedlund v. Educational Resources Inst., Inc.* (*In re Hedlund*), 468 B.R. 901 (D. Or. 2012). The bankruptcy court discharged all amounts owed in excess of \$32,080. The district court reversed on the ground that debtor had failed to establish good faith as required by Brunner and *In re Pena*, 155 F.3d 1108 (9th Cir. 1998).

⁸⁴ *Alderete*, *supra* note 6; *Griffin v. Eduserv*, 197 B.R. 144 (Bankr. E.D. Okla. 1996).

⁸⁵ *Cheesman v. Tennessee Student Assistance Corp.* (*In re Cheesman*), 25 F.3d 356 (6th Cir. 1994) (student loans nondischargeable, but order stayed for 18 months); *In re Roberson*, 999 F.2d 1132 (7th Cir. 1993) (bankruptcy court’s order deferring student loan payments for 2 years affirmed without discussion); *Dennehy v. Sallie Mae* (*In re Dennehy*), 201 B.R. 1008 (Bankr. N.D. Fla. 1996).

⁸⁶ *In Stevenson*, *supra* note 11, the court granted the debtor a prospective discharge of whatever debt remained at the conclusion of her participation in the Ford Program’s Income Based Repayment Plan.

does not have priority status.⁸⁷ Despite this, debtors have sometimes used chapter 13 to treat student loan debts more advantageously than other unsecured debts. This is typically accomplished by classifying the student loan claims separately from other unsecured claims, then making the full contract payment directly to the student loan creditor while making a reduced pro rata payment to other unsecured creditors through the plan.⁸⁸

The relevant provisions of the Code for this purpose are §§ 1322(b)(1) and (5).⁸⁹ Section 1322(b)(1) allows a chapter 13 plan to “designate a class or classes of unsecured claims, as provided in section 1122 of this title,” with the proviso that classification “may not discriminate unfairly” against any class. Section 1322(b)(5) permits a chapter 13 plan to “provide for the curing of any default . . . and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.”

Because most student loans are long-term debts with payments extending beyond the life of the plan, they fall within the subset of obligations governed by § 1322(b)(5). Read in isolation, this subsection permits the debtor to maintain contract payments on her student loans, while relegating other unsecured debts to a lower pro rata payment as a separate class. Because this provides preferential treatment to student loan creditors, however, the issue then becomes whether § 1322(b)(5) controls over the conflicting “unfair discrimination” provision found in § 1322(b)(1).

This problem has been addressed by a number of courts, with a minority of reported decisions finding that subsection (b)(5) trumps (b)(1), thereby completely excepting long-term debt payments from the unfair discrimination analysis of subsection (b)(1).⁹⁰ Courts that accept this position allow the plan to cure defaults and maintain payments on student loans without regard for the position of other unsecured creditors. Under the majority view, however, subsection (b)(5) must be read in conjunction with (b)(1), with the result that a plan that provides for full payment of student loan obligations under (b)(5) must then be analyzed for unfair discrimination as required by (b)(1).⁹¹

The Code does not define “unfair discrimination,” and courts have developed several multi-factor tests to enable this analysis. The most widely used test, stated by the Eighth Circuit in *In re Leser*,⁹² has four components: “(1) whether the discrimination has a reasonable basis, (2) whether the debtor can carry out a plan without the discrimination, (3) whether the discrimination is proposed in good faith, and (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination.”⁹³ A variation of the *Leser* test was adopted in *In re Husted*, which added a fifth factor: an examination of “the difference between what the creditors discriminated against will receive as the plan is proposed, and the amount they would receive if there were no separate classification.”⁹⁴

87 11 U.S.C. §§ 507 and 1328(a)(2).

88 For example, the debtors in *In re Webb*, 370 B.R. 418 (Bankr. N.D. Ga. 2007), proposed to maintain their regular monthly payments to student loan creditors, while making only a 1% payout to other unsecured creditors.

89 11 U.S.C. § 1322(b)(10), a provision added by BAPCPA that limits the payment of interest on nondischargeable unsecured claims in chapter 13, is also a factor in some cases.

90 See, e.g., *In re Johnson*, 446 B.R. 921 (Bankr. E.D. Wisc. 2011); *In re Truss*, 404 B.R. 329, 333 (Bankr. E.D. Wisc. 2009). (“If the plan provides for the cure of a default and maintenance of payments on a debt, the terms of which extend beyond the term of the plan, it is not for the court to determine whether this is fair to the other creditors or not.”)

91 See, e.g., *In re Zeigafuse*, 2012 WL 1155680 (Bankr. W.D. Wyo. 2012); *In re Pracht*, 464 B.R. 486 (Bankr. M.D. Ga. 2012); *In re Harding*, 423 B.R. 568 (Bankr. S.D. Fla. 2010); *In re Simmons*, 288 B.R. 737 (Bankr. N.D. Tex. 2003).

92 *Mickelson v. Leser (In re Leser)*, 939 F.2d 669 (8th Cir. 1991).

93 *In re Webb*, 370 B.R. 418, 423 (Bankr. N.D. Ga. 2007).

94 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992).

The *Leser* test has been criticized as offering “no real direction for determining the fairness of discrimination in any given instance,”⁹⁵ and other courts have attempted to develop more concrete alternatives.⁹⁶ The most prominent of these alternatives is the “baseline” test enunciated by the First Circuit BAP in *In re Bentley*.⁹⁷ *Bentley* looks to the “principles and structure of Chapter 13” as the “baseline against which to evaluate discriminatory provisions for unfairness.”⁹⁸ The decision then enunciates four core principles: (1) absent an express grant of priority, unsecured creditors should share equally, (2) student loan obligations are not priority debts, (3) unless unsecured creditors are paid in full, the chapter 13 debtor must devote all disposable income to the plan, and (4) do the facts indicate that the debtor’s interest in a “fresh start” trump the creditors’ claim to a pro rata share.

Regardless of the test that is applied, most courts have concluded that discrimination based on nothing more than nondischargeability is unfair.⁹⁹ However, “if the discrimination in question benefits the very creditors who are being discriminated against,” for example, by enabling the debtor to work, it may be considered fair.¹⁰⁰ Some courts have also found discrimination justifiable when, absent direct payments, the debtor would emerge from chapter 13 owing more on their student loans than they did before the case was filed.¹⁰¹

BAPCPA added a new wrinkle to this analysis by requiring that the projected disposable income of above-median income chapter 13 debtors be calculated with reference to the “means test” of § 707(b)(2), as opposed to the real numbers reflected on the debtor’s schedules I and J. Section 707(b)(2) requires the debtor to use hypothetical amounts specified in National and Local Standards issued by the IRS, creating the possibility that a debtor’s projected disposable income under § 707(b)(2) might be less than his actual discretionary income. When this occurs, it is possible for the above-median debtor to devote 100% of his projected disposable income to unsecured creditors in the plan and still retain sufficient excess “discretionary” income to make contract payments on his student loans. This strategy has withstood challenge, even when student loans are paid in full and the dividend to other unsecured creditors is as low as 0.86%.¹⁰²

C. *United Student Aid Funds, Inc. v. Espinosa*: Discharge by Declaration

Espinosa presents one final (albeit improper) strategy for dealing with student loan debt.¹⁰³ The debtor in *Espinosa* discharged the interest on his student loan debt in a chapter 13 plan without filing an adversary proceeding. Although the creditor had notice of the plan treatment, it did not file an objection to confirmation. The creditor then attempted to collect the interest three years after the debtor’s discharge, and the debtor filed a motion asking the bankruptcy court to enforce

95 *Bentley v. Boyajian (In re Bentley)*, 266 B.R. 229 (1st Cir. B.A.P. 2001).

96 *See, e.g., In re Brown*, 152 B.R. 232 (Bankr. N.D. Ill.), *rev’d*, 162 B.R. 506 (N.D. Ill. 1993); *In re Colfer*, 159 B.R. 602 (Bankr. D. Me. 1993). The issue was approached by the Seventh Circuit in *In re Crawford*, 324 F.3d 539, 542 (7th Cir. 2003), which opined: “We haven’t been able to think of a good test ourselves. We conclude, at least provisionally, that this is one of those areas of the law in which it is not possible to do better than to instruct the first-line decision maker, the bankruptcy judge, to seek a result that is reasonable in light of the purposes of the relevant law, which in this case is Chapter 13 of the Bankruptcy Code.”

97 *Supra* note 28.

98 *Id.* at 240.

99 *Groves v. LaBarge (In re Groves)*, 39 F.3d 212 (8th Cir. 1994); *In re Gonzalez*, 206 B.R. 239 (Bankr. S.D. Fla. 1997).

100 *In re Kalfayan*, 415 B.R. 907, 910 (Bankr. S.D. Fla. 2009) (debtor’s license to practice optometry was contingent on remaining current on her student loans).

101 *Webb, supra* note 26.

102 *In re Abaunza*, 452 B.R. 866 (Bankr. S.D. Fla. 2011) (plan did not unfairly discriminate when projected disposable income resulted in dividend of only 0.86%); *In re King*, 460 B.R. 708 (Bankr. N.D. Tex. 2011); *In re Sharp*, 415 B.R. 803 (Bankr. D. Colo. 2009); *In re Orawsky*, 387 B.R. 128 (Bankr. E.D. Penn. 2008).

103 130 S. Ct. 1367 (2010).

its discharge order. The creditor responded with a cross-motion under Rule 60(b)(4) asking that the court to set aside the confirmation order as void.

In a unanimous opinion, the Supreme Court held that the confirmation order was a final judgment that was not rendered void by the bankruptcy court's "legal error" in discharging a student loan obligation without a finding of undue hardship. The bankruptcy court's error was not jurisdictional and did not violate the creditor's due process rights.¹⁰⁴ In reaching this holding, the Court stated that the bankruptcy court had an obligation to avoid this type of error by independently determining undue hardship, even without objection or appearance by the creditor. The Court also stressed that the specter of sanctions should deter "bad-faith" practices by debtors and their counsel.

¹⁰⁴ Section 523(a)(8)'s undue hardship requirement is a statutory precondition to discharge that does not limit the court's jurisdiction. And, despite the absence of a summons and complaint, due process was satisfied by the creditor's actual notice of the contents of the plan.

I. OVERVIEW OF LOANS THROUGH THE TEXAS HIGHER EDUCATION COORDINATING BOARD

- A. The Texas Higher Education Coordinating Board (“THECB”) makes its loans under the Hinson-Hazlewood College Student Loan Program. THECB lends to Texas residents who are eligible to pay in-state tuition. THECB holds and services each loan it makes (i.e., the loans are not sold).
- B. THECB offers the College Access Loan, Texas Armed Services Scholarship Program, and the Texas B-On-Time loan program. Interest rates range from 0% to 5.25% and the origination fee ranges from 0% to 5%.
- C. For more information, please visit <http://www.hhloans.com/>

II. SEEKING TO DISCHARGE THECB LOANS UNDER 523(a)(8)

A. *Brunner and Gerhardt*

An action in Texas to discharge student loans under section 523(a)(8) must address the Brunner test, which is found in *Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987).

Under *Brunner*, a debtor seeking to discharge his or her student loans must show: an undue hardship which in turn requires a showing of: 1) 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; and 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. *Brunner v. New York State Higher Educ. Services Corp.*, 831 F.2d 395, 396 (2d Cir. 1987).

The *Brunner* test is the controlling test in Texas as it was adopted by the Fifth Circuit in *U.S. Dep’t of Educ. v. Gerhardt*, 348 F.3d 89 (5th Cir. 2003).

B. Communicating with the THECB regarding your or your client’s situation

If you believe your client satisfies the elements of *Brunner* and *Gerhardt* and I am involved in the matter, please communicate the facts as you understand them as soon as possible.

C. Pleading *Brunner* and *Gerhardt*

If you file an Adversary Proceeding seeking to have your client’s loans discharged pursuant to 523(a)(8), ensure that you detail in the Adversary Proceeding facts that at least could colorably meet *Brunner* and *Gerhardt*.

D. Filing Suit Hoping for Settlement

Plaintiffs often file suit hoping that THECB will take litigation risk into account and settle the matter, effectively granting the debtor a partial discharge. As stated earlier, if your client meets *Brunner* and *Gerhardt*, please communicate the relevant facts to the attorney with whom you are dealing. However, if your client does not meet *Brunner* and *Gerhardt*, do not expect or count on THECB settling the matter for less than the full amount of the loan.

E. Partial Discharge

Although some circuits allow partial discharge (6th, 9th, 10th, and 11th), the Fifth Circuit has not yet addressed the issue. The majority of bankruptcy courts in Texas do not even address partial discharge in their written opinions. *See, e.g., In re Pratt*, 375 B.R. 753, 763 (S.D. Tex. 2007); *In re Gerhardt*, 348 F.3d 89, 92 (5th Cir. 2003); *In re Stebbins-Hopf*, 176 B.R. 784, 788 (Bankr. W.D. Tex. 1994); *In re Coveney*, 192 B.R. 140, 144 (Bankr. W.D. Tex. 1996); and *In re Russ*, 365 B.R. 640 (Bankr. N.D. Tex. 2007) (debtor had \$123,957.98 in student loan debt, the family of four had an average monthly gross income of \$2,840, and the debtor had an inoperable brain mass that precluded her from working full time in any position of responsibility. However, the debtor's failure to make payments or seek an income contingent repayment plant indicated a lack of a good faith effort to repay the loan); *Jones v. Bank One Texas*, 376 B.R. 130, 143 (W.D. Tex. 2007). Nonetheless, some Texas bankruptcy courts have adopted the partial discharge approach.¹

However, partial discharge could be viewed as favoring the creditor as a debtor must still satisfy all three prongs of *Brunner* and *Gerhardt* before receiving a partial discharge. *See Educ. Credit Mgmt. Corp. v. Young*, 376 B.R. 795, 801 (E.D. Tex. 2007).

CONTACT INFORMATION

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¹ *In re Nary*, 253 B.R. 752, 767 (N.D. Tex. 2000); *In re Harmon*, 03-51117-RLJ-7, 2005 WL 6443617 (Bankr. N.D. Tex. Aug. 11, 2005); *In re Hollins*, 286 B.R. 310, 317 (Bankr. N.D. Tex. 2002); *In re Barron*, 264 B.R. 833, 846 (Bankr. E.D. Tex. 2001).