REMARKS ON BANKRUPTCY AND EDUCATION

ADA MELOY*

Thank you very much. That is a far too generous introduction that you have given me. You will notice the word "bankruptcy" was not featured in that introduction. I am not a bankruptcy professor or a bankruptcy scholar. I am rather a very different sort of panelist here. Not only am I providing what I hope is a welcome modicum of diversity in the speakers today, but I am providing commentary on the history and recent developments in the area of bankruptcy and higher education.

I have had a little bankruptcy experience, but not enough to call it "expertise." When I was serving as counsel at New York University ("NYU"), I litigated several cases in bankruptcy court. These were cases that arose because graduates of the institution were attempting to discharge their student loan debts and there were lacunae in the authorities on the particular topics coming up in the cases.

The first such case that I actually litigated for NYU was called *In re Scher*.[1] That case was filed in 1980 by a 1977 graduate of Brooklyn College who then got a master's degree in social work from NYU.[2] He was employed following his graduation in 1979 and filed for bankruptcy less than a year later.[3] He actually filed under chapter 13, which at the time was a relatively new way to partially pay and reorganize personal debts and the like.[4] We reviewed his petition and plan, and we saw that of his reported debts of about $13,000, $10,000 (or 82%) were education loans that he was hoping to discharge through very limited repayment over the time of the chapter 13 plan.[5] In other words, a massive amount of his debt was actually education debt. He had received his graduate education and had his professional degree. He was employed and indications were that he was on his way to a career in social work. Considering these facts and the fact that to the extent that debts were not repaid to the educational institution the funds were lost to future students, it was decided to contest that chapter 13 proceeding. We argued that this was not a petition brought in good faith because it clearly was to avoid the general provisions of section 523(a)(8) regarding dischargeability of education loans.

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* [Eds. note – This piece is a lightly edited and footnoted transcription of Ada Meloy's remarks at the October 24, 2014 symposium. Sadly, Ms. Meloy passed away shortly after the symposium. Ms. Meloy had an opportunity to review and edit an earlier version of this piece prior to her tragic passing. We are grateful to include Ms. Meloy's remarks with the permission of her family. At the time of the October 24, 2014 symposium, Ms. Meloy was general counsel of the American Council on Education. Prior to joining ACE, Ms. Meloy worked at New York University's Office of Legal Counsel, serving as deputy general counsel for over ten years and as acting general counsel for NYU in 2005-06. A synopsis of the history of the student loan bankruptcy exception can be found at http://www.finaid.org/questions/bankruptcyexception.phtml. The staff of the *American Bankruptcy Institute Law Review* extend our deepest sympathies to the family and friends of Ada Meloy.]

[1] 12 B.R. 258 (Bankr. S.D.N.Y. 1981).

[2] *See id.* at 259.

[3] *See id.*

[4] *See id.* at 265–68 (discussing genesis and applicable provisions of chapter 13 post-1978 Bankruptcy Reform Act).

[5] *See id.* at 259.

Unfortunately, Bankruptcy Judge Babitt at the time did not see it that way. He wrote a very long opinion, rejecting our arguments and I lost that case.[6] Having reminded myself of the case as I was thinking about what I might talk about today, I thought, "Hey, I wonder whatever happened to that debtor who got his master's from NYU," so I went on Google yesterday to see what I might learn. And it turns out—according to internet sources—that in 1981 he moved to Maine. He appears to have been gainfully employed throughout and he ran for the Maine Senate in 2012. He is now Executive Director of a charity in Biddeford, Maine. What I was not able to pursue was—did he ever make any contributions back to NYU to make up for the fact that he shorted the university on his education loans? I ask that as an advocate for an institution looking at this issue.

The second case, I do not have quite as long a story to tell you about. *In re Alibatya*,[7] was in 1995 when again I lost because Bankruptcy Judge Feller did not agree that debt to the university arising from unpaid room and board charges constitutes a loan, benefit, scholarship or stipend subject to the non-dischargeability provisions.[8] So I do not have a very sterling career as a practitioner in bankruptcy court, which I learned from talking with some of the esteemed panelists here, is really quite a different place to practice compared to other courts. I commonly represented NYU for many years with success in New York Supreme Court, the Appellate Division, the Court of Appeals and the federal courts. So I stand here in this bankruptcy symposium humbled by my lack of experience—or success—in the field.

In refreshing my spotty knowledge of bankruptcy law over my four decades of practice, I looked at the American Council on Education's ("ACE") position over the years on these issues, focusing on the non-dischargeability of student loans and the student loan/debt problem. In 1976, ACE put out a formal statement to the Senate Judiciary Committee's Subcommittee on Improvements in Judicial Machinery (at that time Vice President Biden was a Senator on that Subcommittee).[9] What ACE said is that "the proposed statutory amendment for a limited dischargeability of education loans is an equitable and flexible solution to a complex situation. Suspending dischargeability for [five] years presents a realistic time frame for meeting and enforcing obligations"[10] and discharge due to undue hardship within the five year period is a useful added safeguard.[11] So, as opposed to what Steven Harper was saying, it made sense at the time to have this non-dischargeability for a period of time of education loans because of the unique nature of the loans: the fact that one is getting a loan without an employment history, without an income history, without security for the loan, and the purpose of the loan is to undertake higher education. As we saw on the charts in the earlier presentation, one's likely income following higher education will be

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[6] *See id.* at 280 (overruling objections to plan confirmation).

[7] 178 B.R. 335 (Bankr. E.D.N.Y. 1995).

[8] *Id.* at 336 (concluding "unpaid pre-petition room and board charges owing to NYU . . . are not excepted from discharge pursuant to 11 U.S.C. § 523(a)(8)").

[9] *The Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Machinery of the S. Comm. on the Judiciary*, 94th Cong. 216–22 (1975) (statement of Sheldon Steinbach, Assistant Director of Governmental Relations, American Council on Education).

[10] *Id.* at 216–17.

[11] *See id.*

vastly improved.[12] So there was a legitimate reason for the imposition of limited dischargeability.

Years later, the set time of non-dischargeability had grown to seven years as a result of an amendment in 1990.[13] In 1998, the provisions regarding the period of time that loans were non-dischargeable was deleted.[14] Initially student loans were only subject to non-dischargeability if they were from the educational institution or from the government, or guaranteed by the government or a non-profit organization.[15] That was changed in 2005 when this non-dischargeability was extended to all private education loans.[16] That was opposed by ACE at the time and ACE opposes now. A change in the law to end non-dischargeability with regard to the private label loans was included in the proposed amendments to the Higher Education Act, which Senator Harkin released over the summer.[17] It will likely be included in a bill when it is introduced probably early next year, unless change in the leadership of the Senate alters the dynamics around the issue. I do not know if some of the other provisions in the Higher Education Act that have been discussed by other panelists will be coming up at that time, but it is something that ACE will certainly be watching, and I will try to help ACE to hone its position on those provisions as well.

The other major change over time in the student loan situation was in 2010 when the direct loan program was implemented so that the federal government can make student loans.[18] It essentially got out of the business of guaranteeing private loans. All became direct loans or simply commercial private bank loans. I expect that the loans you have received for law school now are either private label loans or are government loans directly from the government.

Those of us who follow the major higher education issues in Washington recognize that the massive amounts of student debt are a cause for concern, and that something needs to be done to try to remedy that situation. However, it is a very complex calculus. ACE has to navigate what we see can happen through the federal administration, through Arne Duncan's Department of Education, through Congress, and the like—what is realistic, what can actually happen. One hears a lot of criticism of the for-profit segment of the higher education sector. Much of it justified, but the for-profit industry actually has a lot of money to spend on lobbying and on litigation and is quite different

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[12] *See Education Still Pays*, U.S. BUREAU LABOR STAT. (Sept. 2014), http://www.bls.gov/careeroutlook/2014/data-on-display/education-still-pays.htm (demonstrating higher weekly earnings at each level of higher education).

[13] *See* Crime Control Act of 1990, Pub. L. No. 101-647, § 3621(2), 104 Stat. 4964 (1990); *see also* 11 U.S.C. § 523(a)(8)(A) (1994).

[14] *See* Higher Education Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1581 (1998); *see also* 11 U.S.C. § 523(a)(8) (2000).

[15] *See* § 3621, 104 Stat. at 4964–65.

[16] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23 (codified at 11 U.S.C. § 523(a)(8)(B) (2012)).

[17] *See* Higher Education Affordability Act, S. 2954, 113th Cong. § 1031 (2nd Sess. 2015); *see also News From the Senate Health, Education, Labor and Pensions Committee*, HELP.SENATE.GOV 2 (2015), http://www.help.senate.gov/imo/media/doc/Higher%20Education%20Affordability%20Act%20Summary%20Final.pdf (detailing Senator Harkin's proposals located within proposed Higher Education Affordability Act, which included discharging all private student loans in bankruptcy).

[18] Tamar Lewin, *House Passes Bill to Expand College Aid*, N.Y. TIMES, Sept. 17, 2009, at A15 (describing shift to federal direct lending).

from the traditional non-profit higher education sector. In other words, they have a lot of power with certain constituencies because of their for-profit status and the money that they are able to dedicate to lawyers and lobbyists in Washington.

That is a little history of our position on the student loan issue. I will be happy to answer questions later about that, but another subject I wanted to bring to your attention is a report that came out this month from the Consumer Financial Protection Board Ombudsman. This was issued October 16, 2014, the Annual Report of the CFPB Student Loan Ombudsman.[19] It talks about and asks whether changes to the treatment of private student loans in bankruptcy proceedings are reducing incentives for lenders and servicers to help borrowers avoid default.[20] That is one of the prime questions addressed in the very beginning of the report. There are various charts in the report that tend to lead it to certain conclusions. It notes that for private student loan borrowers who default early in their lives, "the negative impact on their credit report can make it more difficult to pass employment screenings or buy a home."[21] It can make it difficult to get any kind of loan for years and even affect a borrower's job prospects. Because private student loans are difficult to discharge in bankruptcy, the debt can be very difficult to recover from.

This was brought home to me recently when I had dinner with a young couple who graduated from the School of the Visual Arts in Manhattan. Both are employed in their chosen field of the arts but feel that they are so swamped by their student loans that there is really no way they can ever have children or buy a home. They are twenty-seven years old at this time, so it is really a life-changing tragic situation for some graduates who, perhaps through a lack of initial planning, find themselves in a really, really difficult situation. We hope that there might be a way for that to change, perhaps through income based repayment expansion or other vehicles to ease the burdens felt by those with significant student loan debts.

I am going to cut myself a little short here because I promised I would. This report is a recommendation to seven different offices of the government, so we will see where any of the recommendations in this report go. It goes to the Senate Committee on Banking, Housing and Urban Affairs; the Senate Committee on Health, Education, Labor, and Pensions; the House Committee on Financial Services; the House Committee on Education in the Workforce; the Secretary of the Treasury; the Director of the Consumer Financial Protection Bureau, and the Secretary of Education. So you can see that there will be lots of different actors in Washington with all kinds of different agendas that will be looking at the recommendations. The recommendations in very brief are: "[To] determine whether changes to the Bankruptcy Code might motivate lenders to constructively work with borrowers to modify loan terms[,]"[22] because they are pointing out that the private lenders are much less flexible in working with students or graduates who find themselves in financial difficulty than is the federal government itself.

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[19] *See* CONSUMER FIN. PROT. BUREAU, ANNUAL REPORT OF THE CFPB STUDENT LOAN OMBUDSMAN (2014), *available at* http://files.consumerfinance.gov/f/201410_cfpb_report_annual-report-of-the-student-loan-ombudsman.pdf.

[20] *See id.* at 29–30.

[21] *Id.* at 23.

[22] *Id.* at 29.

The Ombudsman recommends that the government "[d]etermine whether lenders and servicers provide adequate and timely disclosures to borrowers about repayment options, particularly in times of financial hardship,"[23] and that the government "[a]ssess the impact of the tax treatment of principal forgiveness on loan modification activity."[24] As you may be aware, if you actually have your loan principal forgiven, under the current tax code it is treated as a blast of income to you in that year and you will then owe income taxes on the amount that was forgiven. That is also a very troubling impact of resolution of excessive debts.

Another point I wanted to bring up that I do not know concerns others as much as I because of my background, is the attempt to claw back tuition in bankruptcy cases. This is an issue with a very limited number of reported cases. In *Gold v. Marquette University*,[25] the court held that more than $20,000 in college tuition that parents made on behalf of their eighteen-year-old son would constitute avoidable fraudulent transfers because the parents themselves received no economic benefit in exchange for the payments.[26]

This is something that I, as someone who has for most of my legal practice represented and advised higher education institutions, see as a real problem. Years after the student has graduated, just because of the way that the money came into the institution, it can be clawed back in bankruptcy. That is quite troubling. It also is something that I find interesting because it has different effects in different states because of the way the Bankruptcy Code, as I understand it, interacts with fraudulent conveyance laws in the states. It can have very different, in a sense, statutes of limitations on how far back the bankruptcy trustee might go to try to get the tuition back from the institution even though the student has received the education and has no other standing or claim to seek a judgment against the institution.

That is another topic that I find quite interesting and troubling. I hope that some of the actual bankruptcy experts here may have comments on that as well as the other issues that have come up. I think I stayed within my committed short time, and I look forward to any questions. Thank you.

[23] *Id.* at 30.
[24] *Id.* at 32.
[25] 454 B.R. 444 (Bankr. E.D. Mich. 2011).
[26] *See id.* at 457–59 (noting intangible "peace of mind" benefits "are not 'economic' benefits to the Debtors").