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SURVEY 2014: BANKRUPTCY + STUDENT LOAN DEBT CRISIS

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INTRODUCTION

In 2014, a college degree is a must. With the rising cost of tuition, to get that college degree you will likely need a loan. Lucky for you, private lenders will almost always give you AS MUCH AS YOU WANT! Now you have your degree. For some reason you still cannot quite avoid being underemployed, despite having said degree. Unfortunately, that student loan debt is truly beginning to weigh on you and your family. You cannot make your mortgage payments for fear of missing a student loan payment or two. You struggle to make your car payments, too. Alas, you seek the relief of the Bankruptcy Court. Mortgage discharge? Check. Auto loan discharge? Check. Student loan discharge? Probably not. Your "fresh start" under the Bankruptcy Code is not looking so fresh anymore.

The student loan burden in America has caught the attention of politicians, economists, professors, and reporters. Second only to home mortgages, student loan debt remains one of the largest forms of consumer debt in America.[1] The Bankruptcy Code's unwavering treatment of student loan debt has come under scrutiny, as many

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[1] Rohit Chopra, *Student Debt Swells, Federal Loans Now Top a Trillion*, CONSUMER FINANCIAL PROTECTION BUREAU (July 17, 2013), http://www.consumerfinance.gov/newsroom/student-debt-swells-federal-loans-now-top-a-trillion/.

search high and low for aide in what many proclaim to be the next fiscal "crisis." This article takes a snapshot of student loans and bankruptcy's treatment of student loans in 2014.

Part I of this article will survey the present state of the student loan debt crisis in America. Part II will survey how the student debt burden intersects with the Bankruptcy Code. Part III will highlight the general effects of filing a petition for bankruptcy relief. Lastly, Part IV will evaluate proposed changes to the bankruptcy code in light of the student debt crisis.

I. STUDENT LOANS IN 2014 AMERICA

A. Student Loan Burden – The Facts

As it stands, the U.S. Department of Education has guaranteed roughly $1 trillion in outstanding student loan debt.[2] About 37 million people have "student loan debt."[3] Total student loan debt has increased by over 300 percent over the last eight years.[4] Student loan default rates have nearly doubled over the past five years.[5]

In August 2013, the New York Federal Reserve released its Quarterly Report on Household Debt and Credit for the second quarter of 2013. Bloomberg stated that according to this report:

> Student loan indebtedness was the second leading category of debt during the quarter, trailing only mortgages. Student indebtedness totaled $994 billion and accounted for 9 percent of all outstanding debt, a greater percentage of outstanding debt than auto loans ($814 billion, 7 percent) or credit cards ($668 billion, 6 percent), the report said.[6]

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[2] *Id.*

[3] Meta Brown et al., *Grading Student Loans*, FEDERAL RESERVE BANK OF NEW YORK (Mar. 5, 2012), http://libertystreeteconomics.newyorkfed.org/2012/03/grading-student-loans.html.

[4] *Shocking Student Debt Statistics*, FASTWEB (Apr. 15, 2013), http://www.fastweb.com/financial-aid/articles/3930-shocking-student-debt-statistics.

[5] *See FY 2011 2-year National Student Loan Default Rates*, FED. STUDENT AID, http://www.ed.gov/offices/OSFAP/defaultmanagement/defaultrates.html (last visited May 2, 2014) (showing that the default rate in 2006 was 5.2% and 10.0% in 2011).

[6] Stephen Joyce, *Debt, Delinquencies Generally Decrease But Student Loans Problematic*, BLOOMBERG BNA (Aug. 19, 2013), http://www.bna.com/debt-delinquencies-generally-decrease-but-student-loans-problematic-report-says// (citing *Quarterly Report on Household*

In November 2013, the New York Law Federal Reserve's Quarterly Report on Household Debt and Credit revealed that the national consumer debt rose by 1.1 percent.[7] America's total consumer indebtedness rose from $127 billion to $11.28 trillion in the third quarter, the biggest increase since the first quarter of 2008; of that total was an increase in student loan debt in the amount of $33 billion.[8]

The Consumer Financial Protection Bureau found that the total student loan debt hit $1.2 trillion in 2012, which exceeded credit card debt by more than 28 percent.[9] "Forty-five percent of all American families now have student loans," according to a report released by David Bergeron and Joe Valenti from the Center for American Progress, a progressive think tank.[10] These numbers are sure to put the student loan debt "crisis" on the front of our newspapers and on the top of our legislative bills as many try to deflate what is being referred to as the next "bubble" to burst.[11] Many believe the culprit to be the soaring cost of higher education.[12] The cost of college beats inflation by 71 percent.[13] As an example of graduate schools, law school tuition has outdone inflation by 317% in only ten years' time.[14]

What does a bursting bubble look like? Too many students

Debt and Credit, FEDERAL RESERVE BANK OF NEW YORK 1 (Aug. 2013), *available at* http://www.newyorkfed.org/research/national_economy/householdcredit/DistrictReport_Q22013.pdf).

[7] *Household Debt and Credit Report*, FEDERAL RESERVE BANK OF NEW YORK, http://www.newyorkfed.org/householdcredit/2013-Q3/index.html (last visited May 2, 2014) (citing *Quarterly Report on Household Debt and Credit*, FEDERAL RESERVE BANK OF NEW YORK 1 (Nov. 2013), *available at* http://www.newyorkfed.org/research/national_economy/householdcredit/DistrictReport_Q32013.pdf).

[8] *Id.* (citing *Quarterly Report on Household Debt and Credit*, FEDERAL RESERVE BANK OF NEW YORK 1 (Nov. 2013), *available at* http://www.newyorkfed.org/research/national_economy/householdcredit/DistrictReport_Q32013.pdf).

[9] Joe Valenti & David Bergeron, *How Qualified Student Loans Could Protect Borrowers and Taxpayers*, CENTER FOR AMERICAN PROGRESS (Aug. 20, 2013), http://www.americanprogress.org/issues/higher-education/report/2013/08/20/72508/how-qualified-student-loans-could-protect-borrowers-and-taxpayers/.

[10] *Id.*

[11] *See generally Legislative Highlights*, 32 AM. BANKR. INST. J. 12 (2013) ("[S]enate Democrats have again sponsored a bill (S. 114) to discharge private student loans in bankruptcy.").

[12] Note, *Ending Student Loan Exceptionalism: The Case for Risk-Based Pricing and Dischargeability*, 126 HARV. L. REV. 587, 587-88 (2012) [hereinafter *Ending Student Loan Exceptionalism*].

[13] *Id.* at 587.

[14] *Id.*

falling delinquent and/or defaulting on their student loans, thereby crippling the money market. In fact, the third quarter of 2013 saw delinquencies increase to their highest level of 11.8 percent.[15] Exacerbating the problem of the exuberant price tag on higher education, the value of this education does not meet the rise in tuition costs. Tuition rates have increased four times that of inflation over the last two decades.[16] This is not to say students will not continue to seek higher education and take out loans to finance it, because while colleges might under deliver, the fact remains that those who have graduated from college fair better than those who have not.[17]

1. Classification of Loans

Options for financing a student's education varies. Students can take out federal or private loans. Federal Loans make up the majority of the debt amount in recent years and the numbers are on the rise.

Federal financing has been around for over fifty years. The Higher Education Act of 1965 ("HEA") was created to "extend the benefits of college education to more students."[18] From this came the Federal Family Education Loan Program ("FFEL") through which the federal government guaranteed student loans made by states and private institutions.[19] In 1993, the government amended the HEA to create the Federal Direct Student Loan Program ("FDSL").[20] After June 30, 2010, the Health Care and Education Reconciliation Act of 2010 terminated the FFEL Program, leaving only the FDSL Program.[21]

Currently, on average, students have borrowed "about three

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[15] *Quarterly Report on Household Debt and Credit*, FEDERAL RESERVE BANK OF NEW YORK 1, 1 (Nov. 2013), *available at* http://www.newyorkfed.org/research/national_economy/householdcredit/DistrictReport_Q32013.pdf.

[16] Joseph Marr Cronin et al., *Will Higher Education Be the Next Bubble to Burst*, THE CHRONICLE OF HIGHER EDUC. (May 22, 2009), http://chronicle.com/article/Will-Higher-Education-Be-the/44400.

[17] Peter Coy, *Student Loans: Debt for Life*, BLOOMBERG BUSINESSWEEK (Sept. 18, 2012), http://www.businessweek.com/articles/2012-09-06/student-loans-debt-for-life.

[18] 111 CONG. REC. 22, 662 (1965) (statement of Sen. Randolph).

[19] Higher Education Amendments of 1992, PUB. L. NO. 102-325, § 411, 106 STAT. 448.

[20] Omnibus Budget Reconciliation Act of 1993, PUB. L. NO. 103-66, § 4021, 107 STAT. 312, 451-54.

[21] Health Care and Education Reconciliation Act of 2010, PUB. L. NO. 111-152, 124 STAT. 1029.

times more per year from the federal government in 2010 than in 1990."[22] In 2010-2011, 93 percent of all lending was federally supported.[23] College Board reports that federal financing increased to 96 percent in 2012-2013, as compared to 2002-2003, while the increase was 86 percent strictly for federal loans.[24] "Students and parents borrowed $110.3 billion in education loans in 2012-[20]13, down from a peak of $120.1 billion (in 2012 dollars) in 2010-[20]11."[25] Despite the decline, the total outstanding debt in 2012 remains "twice as large as it [was] in 2005 ($962 billion compared to $461 billion)."[26]

Federal loans do come in different shapes and sizes. Direct subsidized loans, for students with financial need, offer loans where interest does not accrue while students are enrolled in college.[27] Direct subsidized loans are able to offer no interest because the "[United States] Department of Education pays the interest on [the students' behalf]."[28] Direct unsubsidized loans do not have a "financial need" requirement, however interest begins to accrue from the time the loan is taken.[29] The federal government also offers Perkins Loans and PLUS loans which have proved desirable to borrowers. A Perkins Loan offers federal student loans for undergraduate and graduate students with "exceptional financial need" with an interest rate as low as 5 percent.[30] While favorable in terms, "not all [institutions] participate in the Federal Perkins Loan Program."[31] "PLUS loans are federal loans that graduate or professional degree students and parents of dependent undergraduate students can use" to supplement "expenses not covered by other financial aid," to reduce the need to seek out private lending.[32] Federal Grants and Federal Work-Study are also types of financing for students, but they do not require debtors to re-

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[22] *Ending Student Loan Exceptionalism*, *supra* note 12, at 592.

[23] *Trends in Student Aid 2011*, THE COLL. BD. 1, 10, http://trends.collegeboard.org/sites/default/files/Student_Aid_2011.pdf (last visited May 2, 2014).

[24] *Id.*

[25] *Id.* at 17.

[26] *Id.* at 22.

[27] *Subsidized and Unsubsidized Loans*, FED. STUDENT AID, http:// http://studentaid.ed.gov/types/loans/subsidized-unsubsidized#what's-the-difference (last visited May 2, 2014).

[28] *Id.*

[29] *Id.*

[30] *Perkins Loans*, FED. STUDENT AID, http://studentaid.ed.gov/types/loans/perkins (last visited May 2, 2014).

[31] *Id.*

[32] *PLUS Loans*, FED. STUDENT AID, http://studentaid.ed.gov/types/loans/plus (last visited May 2, 2014).

pay the amount provided.[33] As expected, the amounts of such grants available are much smaller than that of federal loans.[34]

Private loans have traditionally served as a supplement to federal loans in the student debt market. Private student lending, like most other consumer lending, is "heavily influenced" by the credit markets.[35] When asset-backed securitization became popular, lenders used it to fund student loans.[36] As a result, the standards for loan issuance dropped and the annual issuance rose from "$3 billion to [] $21 billion."[37] When the credit market took its notorious hit, "private lenders cut annual student loan origination by 70 [percent] . . . sharply tighten[ing] their lending standards" by evaluating borrower risk to a higher degree.[38] "Private lenders examine creditworthiness both in deciding whether to [lend] and in setting the terms of the loan . . . ."[39] Private lenders are also more likely to evaluate the cohort default rate ("CDR") of the educational institution in which the student is applying.[40] The CDR is a "three-year default rate defined, as the percentage of students 'who default before the end of the second fiscal year following the fiscal year in which the students entered repayment.' "[41] Private loans are particularly unattractive to most borrowers due to the likelihood of higher interest rates, some exceeding 18 percent, and unforgiving repayment programs. That being said, many debtors take these loans despite the risk of detrimental consequences, with hope that a valuable education will provide a true benefit for their bargain.

2. Student Loan Debt in Other Developed Countries

To put the state of America's "investment" in education into perspective, it may be worthwhile to quickly compare our predica-

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[33] *Work-Study Jobs*, FED. STUDENT AID, http://studentaid.ed.gov/types/work-study (last visited May 2, 2014); *Federal Pell Grants*, FED. STUDENT AID, http://studentaid.ed.gov/types/grants-scholarships/pell (last visited May 2, 2014).

[34] *Grants and Scholarships*, FED. STUDENT AID, http://studentaid.ed.gov/types/grants-scholarships (last visited May 2, 2014).

[35] *Ending Student Loan Exceptionalism*, *supra* note 12, at 593.

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] *Id.* at 594.

[40] *Ending Student Loan Exceptionalism*, supra note 12, at 594.

[41] *Id.* at 594 n.57.

ment to that of other developed countries. The amount of debt incurred through and by student loans in America far exceeds that of any other developed country, as many Americans must borrow to achieve higher education.[42] Fewer students in other countries are forced to borrow to reach their educational goals. According to data reports by U.S. News, for a private college in America the average price is in the range of $30,500, public in-state tuitions prices around $8,400 for 2013-2014, with out of state prices around $19,100.[43] In Japan, however, the "[a]verage tuition at the country's public universities is roughly $5,400."[44] Argentina, Norway, Sweden, and Iceland currently offer public university education at no cost.[45]

Our most similar counterparts are seen in the United Kingdom. In the U.K., the average cost of higher education is around "$13,500, according to the U.K.'s Office for Fair Access."[46] Nevertheless, the repayment of student loan debt is quite different. Debt is repaid through withholdings through your employer.[47] After a student reaches a certain income level, the loan amount is deducted similar to Social Security or taxes here in the United States.[48] When students reach the threshold earning that qualifies them to repay their loans, it is done at a flat rate of "9 percent of any income" over the threshold amount.[49] In the U.K., "98 percent of [students] are meeting their obligations."[50]

By contrast, here in the United States, far fewer individuals

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[42] Kelsey Sheehy, *Undergrads Around the World Face Student Loan Debt*, US NEWS (Nov. 13, 2013), http://www.usnews.com/education/top-world-universities/articles/2013/11/13/undergrads-around-the-world-face-student-loan-debt.

[43] *Id.*

[44] *Id.*

[45] *Id.*

[46] *Id.* (citing *Quick Facts*, OFFICE FOR FAIR ACCESS, http://www.offa.org.uk/press/quick-facts/#key-facts (last visited May 2, 2014)).

[47] Sheehy, *supra* note 42; *Student Loan Repayment*, STUDENT LOANS CO., http://www.studentloanrepayment.co.uk/portal/page?_pageid=93,6678726&_dad=portal&_schema=PORTAL (last visited May 2, 2014).

[48] Sheehy, *supra* note 42; *Student Finance*, GOV.UK, https://www.gov.uk/student-finance/repayments (last visited May 2, 2014).

[49] Sheehy, *supra* note 42; STUDENT LOANS CO., *supra* note 47.

[50] Sheehy, *supra* note 42 (quoting *Petri Introduces Bill to Simplify and Improve Federal Student Loans*, CONGRESSMAN TOM PETRI (Apr. 24, 2013), http://petri.house.gov/press-release/petri-introduces-bill-simplify-and-improve-federal-student-loans). United States Representative Tom Petri of Wisconsin made a statement on April 23, 2013, announcing the Earnings Contingent Education Loans Act which calls for universal income-based repayment on all federal student loans and automatic payments via employer withholding. *Id.*

are meeting their student loan obligations, which frequently results in an unwanted education in our nation's bankruptcy system.

B. Student Loan Indebtedness Meets Bankruptcy

The student loan crisis is two-fold: lending practices on the front end and the discharging of oppressive debt on the back end. While the public pressures Congress to get creative with higher education financial reform, that pressure has also spilled into the world of bankruptcy. Naturally, any and all consumer debt finds its way into the Bankruptcy Court. However, while debtors[51] may be aware of the general benefits of bankruptcy relief, debtors also appear to be generally aware that student loans are typically not dischargeable.[52] This conclusion is supported by evidence of the rather low percentage of debtors attempting to discharge their student loan debts in bankruptcy.[53] A study from 2007 showed that of the 169,774 debtors in bankruptcy with student loans, only 217 made an effort to challenge the dischargeability of their student loan debt.[54] That same study showed that one-tenth of one-percent of student loan debtors attempted to discharge their student loans.[55] With that said, the law is starting to change. Bankruptcy judges have begun to shift in their chairs as the state of student loan burden in America becomes a more visible issue.

As the amount of indebtedness incurred per individual skyrockets with the rise of tuition costs, there are calls to remodel our approach to paying for education by changing the Bankruptcy Code. On one hand, commentators argue that, despite rising student loan burdens, courts should stand firm in the current strict standard on discharging student loans because to do otherwise, would result in a grave abuse of the bankruptcy process. This is the fear that informed the historical treatment of student loans in bankruptcy, that students will discharge large amounts of debt to the detriment of lenders. It

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[51] 11 U.S.C. § 101 (2010). Hereinafter, "*Debtors*" refers to individuals petitioning for bankruptcy relief under the Bankruptcy Code.

[52] Ron Lieber, *Last Plea on School Loans: Proving a Hopeless Future*, N.Y. TIMES (Aug. 31, 2012), http://www.nytimes.com/2012/09/01/business/shedding-student-loans-in-bankruptcy-is-an-uphill-battle.html.

[53] *Id.*

[54] Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard*, 86 AM. BANKR. L.J. 495, 505 (2012).

[55] *Id.* at 499.

cannot be ignored that, similar to the mortgage crisis, wide-spread dischargeability could affect student loan asset-backed securities, while a decrease in value would create another economic fallout much like that seen when mortgage-backed securities plummeted.[56] Based off of the research conducted by Jason Iuliano, preventing student loan discharges have presumably saved American taxpayers "more than four billion dollars [per] year."[57] On the other hand, some have argued that, in the face of lenient student lending, the prospect of discharge will prompt lenders, specifically private lenders, to take greater caution before lending, thereby reducing overall indebtedness and loan defaults. If student loans became as dischargeable as home mortgages or auto loans, notorious private lenders who generally have no cap on how much students can borrow, along with their variable and double-digit interest rates, may employ greater discretion as the exercise would transfer the risk back to the private lender.[58] This article first steps back into the basics of bankruptcy and its treatment of educational loans through the years.

II. BANKRUPTCY CODE + STUDENT LOANS

A. What The Heck Is Bankruptcy?

Indebtedness has been a part of society for about as long as money has been around. Gone are the days where indebtedness was solved by uncivilized means. Today, imprisonment, and even dismemberment, have been replaced with very technical laws and procedures for repayment of debts and/or discharge of said liabilities.

The Bankruptcy statutes are codified in title 11 of the United State Code.[59] For most of the twentieth century, that statute was the Bankruptcy Act of 1898.[60] This law was replaced by the Bankruptcy

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[56] Andrew Woodman, *The Student Loan Bubble: How the Mortgage Crisis Can Inform the Bankruptcy Courts*, 6 ALB. GOV'T L. REV. 179, 181-82 (2013).

[57] Iuliano, *supra* note 54, at 524.

[58] *The Student Loan "Debt Bomb": America's Next Mortgage-Style Economic Crisis?*, NACBA 2 (Feb. 7, 2012), http://nacba.org/Portals/0/Documents/Student%20Loan%20Debt/020712%20NACBA%20student%20loan%20debt%20report.pdf.

[59] 11 U.S.C. §§ 101-112 (2010).

[60] The Managing Editor, *Historical Background of Bankruptcy Law*, BANKR. L. REV. 1-2 (June 24, 2012, 6:44 PM), http://www.bankruptcylawreview.com/learning-modules/historical-background-bankruptcy-law.

Reform Act of 1978 ("Bankruptcy Code").[61] Since then, Congress has made numerous amendments, the most extensive and significant of which were made in the Bankruptcy Abuse Prevention Consumer Protection Act of 2005 ("BAPCPA").[62] The Bankruptcy Code is accompanied by the Federal Rules of Bankruptcy Procedure,[63] which generally parallels the Federal Rules of Civil Procedure.[64]

The Bankruptcy Code is comprised of nine chapters, with each designated to enumerate specific types of bankruptcy relief and the requisite definitions and procedures that accompany them. The most common chapter under which prospective consumer debtors may petition for relief is Chapter 7, which provides for the liquidation of a consumer debtor's non-exempt assets (if any) owned at the time of the bankruptcy filing and distribution of the net proceeds of the sale to creditors pro rata, in accordance with the provisions of the Bankruptcy Code.[65] Once the debtor's non-exempt assets have been distributed to repay creditors, the debtor is released, or discharged, from liability of any and all remaining debts owed.[66] Debtors who seek to reorganize their debts, typically because they have the ability to repay most debts or because they want to retain certain assets (such as a home), generally file Chapter 13. A Chapter 13 debtor must propose a plan, which the Court must approve, through which the debtor will make steady payments to creditors in an amount they can afford, for a pre-determined amount of time.[67] At the conclusion of repayment, through this contractual agreement, the debtor may then be discharged from any remaining liability.[68] Chapter 11 also involves repayment through a plan process, although this chapter is generally only utilized by high net worth individuals due to the significant administrative costs associated with the Chapter 11 plan process.[69] The Chapter 11 plan process differs from Chapter 13 in that

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[61] *Id.* (citing Act of Nov. 6, 1978, Pub. L. No. 95-598, 92 STAT. 2549).

[62] *Id.* at 2 (citing Act of Apr. 20, 2005, Pub. L. No. 109-8, 119 STAT. 23).

[63] *See generally* FED. R. BANKR. P. 1001.

[64] *See generally* FED. R. CIV. P. 1.

[65] 11 U.S.C. § 726 (2010).

[66] 11 U.S.C. § 727(b) (2014).

[67] 11 U.S.C. § 1321 (2014); *see also* 11 U.S.C. § 1326 (2010) (discussing the debtor's repayment plan).

[68] 11 U.S.C. § 1328(a) (2014); *see also* 11 U.S.C. § 109(e) (2010) (instituting caps on the amount of both secured and unsecured debts owed by the debtor. If the debtor owes more than the set amount, they are ineligible to file under Chapter 13.).

[69] 11 U.S.C. § 503(b)(1)(A) (2014).

creditors in Chapter 11 have the right to vote for or against the debtor's proposed repayment plan.[70] The more uncommon chapters under which consumer debtors may use include Chapter 15, which is reserved for international bankruptcy cases,[71] and Chapter 12, which provides relief for family farmers and fishermen with regular income.[72]

The bankruptcy process is designed to achieve twin objectives: (1) provide a fresh start for the debtor through the hallowed discharge of personal or legal liability on their dischargeable debts, and (2) repayment of creditors of equal priority, known as "equality of distribution." "[T]o relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh . . . ." debtors are willing to liquidate their assets to achieve this fresh start of their financial situation through the discharge.[73] It is well recognized that without a means to relieve one's self of financial burdens that will never be satiated, the economy as a whole would suffer. Correspondingly, creditors must have a reasonable assurance that they will be paid to preserve their incentive to lend. If every debt can and will be discharged at a moment's notice, our credit-based economy would be crippled. A fresh start through liquidation, reorganization and discharge cannot be without its limitations. The fight rages on as to which limitations should stand firm and why; now with regard to the growing burden of student loan debt for millions of individuals. Not every individual will receive a discharge or the confirmation of a plan to reorganize debt. Not every debt will be treated equally under the color of law. At least not in 2014.

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[70] 11 U.S.C. § 1126(a) (2014).

[71] *See generally* 11 U.S.C § 1501 (2014). It remains to be seen whether, from a practical perspective, an individual debtor can avail himself or herself of Chapter 15. *See, e.g.*, In re Kemsley, 489 B.R. 346, 349 (Bankr. S.D.N.Y 2013) (denying an individual Debtor's Chapter 15 petition for recognition of a foreign main proceeding or foreign non-main proceeding where the Debtor could not prove that his "center of main interests" existed outside the United States).

[72] 11 U.S.C. § 1203 (2014).

[73] Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (quoting Williams v. United States Fid. & Guar. Co., 236 U.S. 549, 554-55 (1915)).

B. How Bankruptcy Treats Student Loans

1. Exception to Discharge

In 2014, it is particularly difficult to discharge federal or private student loans in a Chapter 7 bankruptcy or to include them in a reorganization plan under Chapter 13. Student loan debt continues to be an exception to discharge under the bankruptcy code pursuant to 11 U.S.C. section 523(a)(8).[74] Section 523(a)(8) of the bankruptcy statute on the dischargeability of student loans 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.[75]

Before the enactment of the Bankruptcy Code, student loans were dischargeable.[76] However, section 523(a)(8) was added to the Bankruptcy Code in 1978 after Congress feared students would abuse the bankruptcy system.[77] At the time "80 [percent] of the bankruptcy

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[74] 11 U.S.C. § 523(a)(8) (2014).

[75] *Id.*

[76] *Ending Student Loan Exceptionalism*, *supra* note 12, at 595.

[77] Jennifer Grant & Lindsay Anglin, *Student Loan Debt: The Next Bubble?*, 32 AM.

petitions that sought relief of federal student loans were brought within three years of completing a college education."[78] At the time, there were numerous media reports of doctors, lawyers, and other professionals obtaining student loans to fund their education and then attempting to "shirk" their responsibilities through a bankruptcy discharge.[79] This pressure prompted Congress to address what was seen as a hole in the system.[80]

Over the next three decades, Congress made a series of amendments to federal bankruptcy law to restrict this perceived abuse of the bankruptcy process. In 1979, the exception to discharge was extended "to educational loans 'made, insured, or guaranteed by a governmental unit, or made under any program funded . . . by a governmental unit or a nonprofit institution of higher education.' "[81] In 1984, it was further extended "to educational loans made under programs financed by any nonprofit institution."[82] In 1990, the exception was extended to "educational benefit overpayments."[83] Finally, in 2005, the exception was expanded to include "all qualified educational loans, including those made by for-profit private lenders."[84]

2. Interpreting Undue Hardship

The Bankruptcy Code and its various amendments abstained from defining the undue hardship requirement of section 523(a)(8).[85] Accordingly, section 523(a)(8) has since been interpreted by case law to reflect current standards for defining "undue hardship." These various cases have enumerated tests to determine whether debtors would be subjected to undue hardship if forced to repay their student loans.

i. The *Johnson* Test

The Third Circuit's decision in *Pennsylvania Higher Educa-*

BANKR. INST. J. 44, 44-5 (2013).

[78] Kevin J. Smith, *Should the "Undue Hardship" Standard for Discharging Student or Education Loans Be Expanded?*, 18 BARRY L. REV. 333, 337 (2013).

[79] *Id.* at 337-38.

[80] *Id.* at 338.

[81] *Ending Student Loan Exceptionalism*, *supra* note 12, at 596 (quoting Act of Aug. 14, 1979, Pub. L. No. 96-56, § 3(1), 93 STAT. 387, 387).

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] 11 U.S.C. § 523(a)(8).

tion Assistance Agency v. Johnson[86] established the first test to assist courts in adjudicating, at that time, the newly enacted and undefined, undue hardship provision.[87] That court devised the use of three tests: (1) the Mechanical Test, (2) the Good Faith Test, and (3) the Policy Test, all of which would be utilized to determine the existence of an undue hardship.[88] The Mechanical Test compared the current and future income of the debtor over the defined life of their payment obligations.[89] These income analyses along with other relevant factors were reviewed to assess whether the debtor was capable of "maintaining a minimal standard of living."[90] The Good Faith Test was used to determine whether the debtor "made a bonafide attempt to repay" their loans.[91] The Policy Test, notwithstanding the results of the previous two tests, examined whether discharging the student loans would effectively benefit the debtor's financial situation, or would it simply serve as a mechanism for the debtor to discharge their obligation.[92]

ii. The *Bryant* Test

The Third Circuit, in its 1987 decision of *Bryant v. Pennsylvania Higher Education Assistance Agency*,[93] seemingly attempted to simplify the understanding of the undue hardship provision.[94] The court applied "federal poverty guidelines" in their attempts to better define the undue hardship provision.[95] Debtors incapable of sustaining income over the "federal poverty guidelines" were presumably unable to meet their student loan obligations and therefore eligible to receive a discharge.[96] Inversely, debtors capable of sustaining income over the "federal poverty guidelines" were presumably able to meet their student loan obligations and therefore ineligible for a dis-

[86] No. 77-2033 TT, 1979 U.S. Dist. LEXIS 11428 (E.D. Pa. June 27, 1979).

[87] *Id.* at *61-62; *see also* Bankruptcy Reform Act of 1978, PUB. L. NO. 95-598, 92 STAT. 2549, 2591 (1978), codified as 11 U.S.C. § 523(a)(8).

[88] *In re Johnson*, 1979 U.S. Dist. LEXIS 11428, at *59-61.

[89] *Id.* at *60.

[90] Adam J. Williams, *Fixing the "Undue Hardship" Hardships: Solutions for the Problem of Discharging Educational Loans through Bankruptcy*, 70 U. PITT. L. REV. 217, 223 (2008).

[91] *Id.*

[92] *Id.* at 224.

[93] 72 B.R. 913 (Bankr. E.D. Pa. 1987).

[94] *Id.* at 914-15.

[95] *Id.* at 915.

[96] *Id.*

charge.[97] However, the *Bryant* test did not foreclose the opportunity of a discharge for debtors capable of sustaining income over the federal poverty guidelines, but with "*unique* or *extraordinary* circumstances" hindering their ability to repay.[98]

iii. The *Brunner* Test

A little over five months after the *Bryant* decision, the Second Circuit announced its interpretation of the undue hardship provision in its 1978 decision in *Brunner v. New York State Higher Education Service Corporation*.[99] The *Brunner* test defined undue hardship by measuring (1) whether "current income and expenses" prevent the debtor from "maintain[ing] a *minimal* standard of living . . . if forced to repay the loans," (2) whether the debtor's current financial "state of affairs is likely to persist for a significant portion of the repayment period," and (3) whether the debtor engaged in prior "good faith efforts to repay the [student loans]."[100]

iv. The "Totality of the Circumstances" Test

Most recently, the Eighth Circuit formally adopted the "totality of the circumstances" approach to the undue hardship provision in *Long v. Educational Credit Management Corporation.*[101] The court proposed and employed the broad examination of facts and circumstances surrounding a debtor's inability to repay, while also analyzing the debtor's financial resources, expenses and other relevant facts to properly ascertain the existence of an undue hardship.[102]

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[97] *Id.*

[98] *In re Bryant*, 72 B.R. at 915, 918 (citing In re Clay, 12 B.R. 251, 255 (Bankr. N.D. Iowa 1981)).

[99] 46 B.R. 752, 756 (S.D.N.Y. 1985), *aff'd*, 831 F.2d 395 (2d Cir. 1987).

[100] *Id.*

[101] 322 F.3d 549, 553 (8th Cir. 2003) (indicating that the court in *Long* adopted the "totality of the circumstances test" by reaffirming their previous decision in Andrews v. S.D. Student Loan Assistance Corp., 661 F.2d 702 (8th Cir. 1981)).

[102] Julie Swedback & Kelly Prettner, *Discharge or No Discharge? An Overview of Eighth Circuit Jurisprudence in Student Loan Discharge Cases*, 36 WM. MITCHELL L. REV. 1679, 1685 (2010).

3. The Application of Brunner

The *Brunner* test has been adopted in whole or in part by nine circuits.[103] Although it is not the first or only test used to analyze the undue hardship provision, the elements enumerated in *Brunner* have been the subject of much scrutiny.

The Eighth Circuit's decision in *Long* created a circuit split in 2003 with its adoption of the totality of the circumstances test.[104] That court opined that strict adherence to the elements of the *Brunner* test "would diminish the inherent discretion contained in § 523(a)(8)."[105] The *Long* Court, wanting to provide more flexibility in ascertaining a debtor's undue hardship, distinguished itself by opting to focus on the "totality of the circumstances" test.[106]

The First Circuit, which uses the totality of the circumstances test, weighed in on *Brunner* with its 2010 decision in *Bronsdon v. Educational Credit Management Corporation.*[107] The court noted that the "totality of the circumstances" test *allows* courts to examine "facts and circumstances unique to the case . . . [whereas] the *Brunner* test imposes two additional requirements" that the debtor *must* meet.[108] The court focused on these additional prongs and their subsequent treatment by other courts.[109] The First Circuit took issue with other courts' interpretations of the second prong, specifically their textually unsupported creation and adherence to a requirement that debtors "demonstrate 'additional extraordinary circumstances' that establish a 'certainty of hopelessness' " to meet the undue hardship requirement.[110] The court also weighed in on the good faith prong of the *Brunner* test. The court noted that section 523(a)(8) makes no mention of a "good faith" requirement.[111] Accordingly, the First Circuit declared that the *Brunner* test incorrectly requires the debtor to provide evidence of good faith, where in fact, the party opposing dis-

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[103] *Id.* at 1682.

[104] *Id.*

[105] *Long*, 322 F.3d at 554.

[106] *Id.*

[107] 435 B.R. 791 (B.A.P. 1st Cir. 2010).

[108] *Id.* at 799.

[109] *Id.*

[110] *See id.* (quoting In re Hicks, 331 B.R. 18, 27-28 (Bankr. D. Mass. 2005) (stating that many courts "place dispositive weight on the debtor's ability to demonstrate 'additional extraordinary circumstances' that establish a 'certainty of hopelessness' ")).

[111] *In re Bronsdon*, 435 B.R. at 800.

charge "has the burden [to present] evidence" of bad faith.[112]

The Seventh Circuit, which applies the *Brunner* test, took subtle aim at one of its elements in its 2013 decision in *Krieger v. Educational Credit Management Corporation*.[113] In *Krieger*, the debtor appealed the District Court's denial of her student loan discharge previously granted by the bankruptcy court.[114] The Seventh Circuit Court of Appeals reversed the District Court's decision in a manner that highlighted inherent issues with faulty interpretations of the good faith portion of the *Brunner* test and potential for unjust results.[115] The Court of Appeals focused on the District Court's incorrect proposition that the good faith test required the debtor to *commit* to future payments despite the showing of good faith in the past.[116] The Court of Appeals concluded that denying the discharge would result in an "undue hardship" based on the facts presented.[117] The Court of Appeals stated that "[i]t is important not to allow judicial glosses, such as the language in . . . Brunner, to supersede the statute itself."[118] *Krieger* did not specifically conclude that the good faith requirement was unsupported by the bankruptcy code as did the court in *Bronsdon*. However, the Seventh Circuit seemed to suggest that the good faith test requires a more dynamic analysis than a rigid adherence to a legal proposition unsupported by the text of section 523(a)(8).[119]

The Ninth Circuit's Bankruptcy Appellate Panel, which also applies the *Brunner* test, recently analyzed the good faith provision in *Roth v. Educational Credit Management Corporation.*[120] In *Roth,* the bankruptcy court denied the discharge due to the debtor's inability to show past acts of good faith.[121] The bankruptcy court, despite denying the discharge, highlighted its issue with the good faith test in *Brunner*, thereby allowing the panel to provide an opinion on their

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[112] *Id.*

[113] 713 F.3d 882 (7th Cir. 2013).

[114] *Id.* at 883.

[115] *Id.* at 884.

[116] *Id.*

[117] *Id.* at 885.

[118] *Krieger*, 713 F.3d at 884.

[119] *Id.* ("[good faith] standard combines a state of mind (a fact) with a legal characterization (a mixed question of law and fact).").

[120] 490 B.R. 908 (B.A.P. 9th Cir. 2013).

[121] *Id.* at 913-14.

precarious situation.[122] Both courts recognized the potential unfair results stemming from strict adherence to the requirement that the debtor show past acts of good faith.[123] They recognized that an "undue hardship" would persist for the debtor regardless if the debtor had put forth a good faith effort in the past or committed to giving her best good faith effort in the future. [124]

III. EFFECTS OF FILING FOR BANKRUPTCY

A. Fresh Start: A Basic Tenet of Bankruptcy

The majority, if not all debtors and potential debtors, know that bankruptcy defines their path to a *fresh start*. Bankruptcy provides debtors with the opportunity to strengthen their personal economy, while also giving them the opportunity to participate in their local, regional and the national economy.[125]

B. Bankruptcy Protections Affect on Student Loans

Filing for bankruptcy protection will inevitably affect a debtor's future loan eligibility. A debtor's student loan eligibility, along with other credit-based lending, is subject to the harsh side effects of filing for Bankruptcy protection. As such, debtors with dependents preparing for their undergraduate years, or debtors considering graduate schooling, must know that the protections afforded by bankruptcy may restrict access and eligibility. Accordingly, these debtors must analyze the effects of filing for bankruptcy protection.

Access to the FDSL program is determined by a borrower's credit history.[126] Accordingly, parent-debtors with adverse credit his-

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[122] *Id.* at 913.

[123] *Id.* at 916.

[124] *Id.* at 913; *see also In re Roth*, 490 B.R. at 918 (explaining that the Bankruptcy Appellate Panel noted that, other than two years within the years being reviewed, the Debtor was financially incapable of making any payments thereby making it almost impossible for her to meet the good faith standard).

[125] Null, *Americans Owe More: Record High Student Loan Delinquency*, NBC NEWS (Nov. 14, 2013, 9:46 AM), http://www.nbcnews.com/business/personal-finance/americans-owe-more-record-high-student-loan-delinquency-f2D11591451.

[126] *PLUS Loans*, *supra* note 32; *see also Eligibility Criteria*, FED. STUDENT AID, http://studentaid.ed.gov/eligibility/basic-criteria (last visited May 2, 2014). *But see Stafford Loan FAQ's*, STAFFORDLOAN.COM, http://www.staffordloan.com/stafford-loan-info/faq/can-i-receive-a-stafford-loan-with-bad-credit.php (last visited May 2, 2014) (explaining that federal Stafford Loans do not determine eligibility based on credit history); *Perkins Loans*, *su-*

tories[127] are effectively precluded from receiving assistance under the Parent PLUS FDSL program for up to five years.[128] An adverse credit history includes, among other things, a bankruptcy discharge.[129] Such ineligibility, however, may result in the distribution of increased funds to their dependent's financial reward under the Stafford loan program.[130] Private lenders also apply eligibility requirements. Accordingly, parent-debtors will be ineligible from anywhere between seven to ten years.[131] Therefore, potential debtors must take into account the potential timing issues of their bankruptcy filing and subsequent ineligibility issues under various loan programs.

Debtors concerned with financing their graduate or professional schooling endeavors must also take into consideration the effects of receiving a bankruptcy discharge under any Chapter of the bankruptcy code. These debtors will be deemed ineligible for the FDSL program for a total of five years after their discharge,[132] along with the seven to ten year ineligibility status from private lenders.[133]

Debtors contemplating filing for Chapter 13 protection must take extra care in the picture they paint for their fresh start. All Chapter 13 debtors will still be deemed ineligible under the FDSL program and private lending programs for the specified time period. These debtors must understand that they will be subjected to restrictions embodied within the Chapter 13 plan rules. As in all bankruptcy filings, debtors are required to list all of their financial liabilities.[134] Herein lays the predicament awaiting these Chapter 13

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pra note 30); *Credit Scores*, FINAID, http://www.finaid.org/loans/creditscores.phtml (last visited May 2, 2014) (explaining that the Perkins loan program does not determine eligibility based on credit history).

[127] *Glossary*, FED. STUDENT AID, http://studentaid.ed.gov/glossary#Adverse_Credit_History (last visited Apr. 3, 2014).

[128] *PLUS Loans*, *supra* note 32; *see also Direct Loan Basics for Parents*, FED. STUDENT AID, http://www.direct.ed.gov/pubs/parentbasics.pdf (last visited May 2, 2014); *see also* Kelsey Sheehy, *How Bankruptcy Affects College, Grad School Financing*, US NEWS & WORLD REPORT (Nov. 14, 2013), http://www.usnews.com/education/best-colleges/paying-for-college/articles/2013/11/14/how-bankruptcy-affects-college-grad-school-financing.

[129] *Glossary*, *supra* note 127.

[130] Sheehy, *supra* note 128.

[131] *Bankruptcy and Financial Aid*, FINAID, http://www.finaid.org/questions/bankruptcy.phtml (last visited May 2, 2014).

[132] *Questions and Answers About Direct PLUS Loans for Graduate and Professional Students*, FED. STUDENT AID, http://www.ifap.ed.gov/dlbulletins/attachments/DLB0703Attach.pdf (last visited May 2, 2014).

[133] Sheehy, *supra* note 128.

[134] 11 U.S.C. § 521(a)(1)(B)(i) (2014); FED. R. BANKR. P. 1007(b)(1)(A) (2013).

debtors. Student loans are considered Nonpriority Unsecured Debts.[135] Accordingly, debtors with student loan debts must list these obligations on Schedule F of their petition. Schedule F is where debtors list "Creditors Holding Unsecured Nonpriority Claims".[136] Priority of distribution rules in Chapter 13 cases generally restricts debtors from making full payments on Nonpriority Unsecured Debts during the plan's life.[137] Furthermore, the Bankruptcy Code allows creditors to object to a debtor's attempt to make payments, whether partial or full, on Nonpriority Unsecured Debts.[138] A Chapter 13 plan may last anywhere between three and five years.[139] Accordingly, a Debtor's inability to fully service their student loan liabilities may result in late fees, penalties and an increased bill as a result of the accrued interest, despite their desire to pay such a debt.[140]

IV. PROPOSED CHANGES TO THE BANKRUPTCY CODES TREATMENT OF STUDENT LOANS

The non-exhaustive list of issues presented above, such as BAPCPA amendments and current economic conditions, have provided scholars, politicians and others with talking points to continue the tug-o-war with respect to section 523(a)(8)'s treatment of student loans. These issues have provided substantial talking points and the pushing for amendments to the treatment of student loans within the Bankruptcy Code.

The student loan debt bubble has made for substantial talking points especially in light of the staggering figures presented in Part I. Proponents of debtor friendly changes have utilized these numbers

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[135] 11 U.S.C. § 507(a)(1)(B) (2014); 11 U.S.C. § 1322(b)(1) (2014).

[136] *Schedule F- Creditors Holding Unsecured Nonpriority Claims*, U.S. COURTS, http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK_Forms_1207/B_006F_1207f.pdf (last visited May 2, 2014).

[137] *Chapter 13*, U.S. COURTS, http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter13.aspx (last visited May 2, 2014).

[138] Fed. R. Bankr. P. 3015(f); *How Cases Move Through Federal Courts: Chapter 13 Bankruptcy Cases*, FEDERAL JUDICIAL CENTER, http://www.fjc.gov/federal/courts.nsf/autoframe!openform&nav=menu1&page=/federal/courts.nsf/page/275 (last visited May 2, 2014).

[139] 11 U.S.C. § 1322(d)(1) (2014).

[140] Katy Stech, *Student Loan Straitjacket: Filing for Bankruptcy Usually Ends Up Increasing School-Debt Balances*, WALL ST. J. (Sept. 30, 2013, 8:15 PM), http://online.wsj.com/news/articles/SB10001424052702303983904579095262035350296?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB10001424052702303983904579095262035350296.html#articleTabs%3Darticle.

along with more detailed analysis to push for amendments to section 523(a)(8) and lending habits.

Senator Dick Durbin, along with support from eleven other senators, re-introduced the Fairness for Struggling Students Act (FSSA) on January 23, 2013.[141] Based on the plain reading of the proposed bill, the FSSA would amend the language of section 523(a)(8)(a) by removing the protections afforded to non-profit student loan lenders, while also effectively removing subsection (b), which protects private student loan lenders.[142]

Representative Steve Cohen re-introduced the Private Student Loan Bankruptcy Fairness Act of 2013 on February 6, 2013.[143] Accumulating thirty-four co-sponsors as of December 12, 2013, this Act would effectively amend section 523(a)(8) by removing the protections afforded to private lenders by striking subparagraph B.[144]

The Center for American Progress (CAP) proposes a categorization of student loans that would alter lending practices while amending section 523(a)(b).[145] Similar to the propositions made in the Note, *Ending Student Loan Exceptionalism: The Case For Risk Based Pricing and Dischargeability*, contained inside the Harvard Law Review,[146] CAP would categorize loans as "Qualified" or "Nonqualified."[147] Qualified student loans would be characterized by lower interest rates, beneficial forbearance options as well as "income based repayment" options.[148] These loans would be available for institutions that have successful track records with respect to post-graduation employment rates, thereby signifying to the consumer a reasonable chance of repayment.[149] Qualified student loans would remain subject to the "undue hardship provision" of section 523(a)(8).[150] "Nonqualified student loans" would consist of loans that fail to provide reasonable repayment options and that are utilized

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[141] Fairness for Struggling Students Act, S. 114, 113th Cong. (1st Sess. 2013), *available at* http://www.gpo.gov/fdsys/pkg/BILLS-113s114is/pdf/BILLS-113s114is.pdf.

[142] *Id.*

[143] Private Student Loan Bankruptcy Fairness Act of 2013, H.R. 532, 113th Cong. (1st Sess. 2013), *available at* http://www.gpo.gov/fdsys/pkg/BILLS-113hr532ih/pdf/BILLS-113hr532ih.pdf.

[144] *Id.*

[145] Valenti & Bergeron, *supra* note 9.

[146] *Ending Student Loan Exceptionalism*, *supra* note 12, at 595-98.

[147] Valenti & Bergeron, *supra* note 9, at 11, 12.

[148] *Id.* at 11.

[149] *Id.* at 12.

[150] *Id.* at 4.

by institutions with unfavorable post-graduation employment statistics.[151] Nonqualified loans would be subject to bankruptcy discharge after "a specified waiting period."[152] CAP's proposition, along with similar based propositions, highlights an understanding that a one-size-fits-all approach may not be the proper prescription for the many dynamic issues.

The most comprehensive and ambitious proposal by far is that suggested by CAP. Such a proposal ambitiously moves to remove the one-size fits all discrimination that private lenders are currently subjected to, while requiring both federal and private lenders, to utilize more discretion when lending to particular borrowers and institutions. Representative Cohen's plan would remove private lenders from the protections provided by the exception, while keeping the protections for non-profit lenders. Senator Durbin's Bill would altogether remove protections for nonprofit and private lenders.

V. CONCLUSION

The American student loan debt crisis is a reality. That reality – the dynamic interplay between the debt load, the state of the law, as well as social and economic policies - proves that bankruptcy is not and cannot be the only reform necessary. The tangled web of debt and credit will almost guarantee difficult questions with difficult answers; which came first, the chicken or the egg? Are lenient lending practices to blame for high education costs? Or have education costs required lenders to loosen standards to keep up with demand? Will abusive discharges of student loans bankrupt the economy? Or will it be the burdened debtor's inability to participate that bankrupts the economy? That being said, proposed changes in the legislature and debtors' willingness to challenge section 523(a)(8) in the judiciary are positioning themselves to change the statutory treatment of student loan debt in bankruptcy courts. Will CAP's proposal protect *all* diligent lenders and borrowers, while equalizing the risk between less diligent borrowers and lenders? Or will private lenders be singled out to their detriment by the other proposals? The answers to these questions will continue to be hashed out in blogs, debates and congressional hallways. However, the fact remains that student loans receive special treatment in the bankruptcy code. The chronicle continues.

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[151] *Id.*

[152] Valenti & Bergeron, *supra* note 9, at 12.