



AMERICAN  
BANKRUPTCY  
INSTITUTE

## 2017 Midwestern Bankruptcy Institute

### **Dealing with Student Loans in Bankruptcy: Direct Assault on *Brunner*, or Ways Around It?**

Hon. Eugene R. Wedoff (ret.)  
*Oak Park, Ill.*

**Student Loans and the ABI Commission on Consumer Bankruptcy:  
An Outline of Issues**

*1. The ABI Commission on Consumer Bankruptcy*

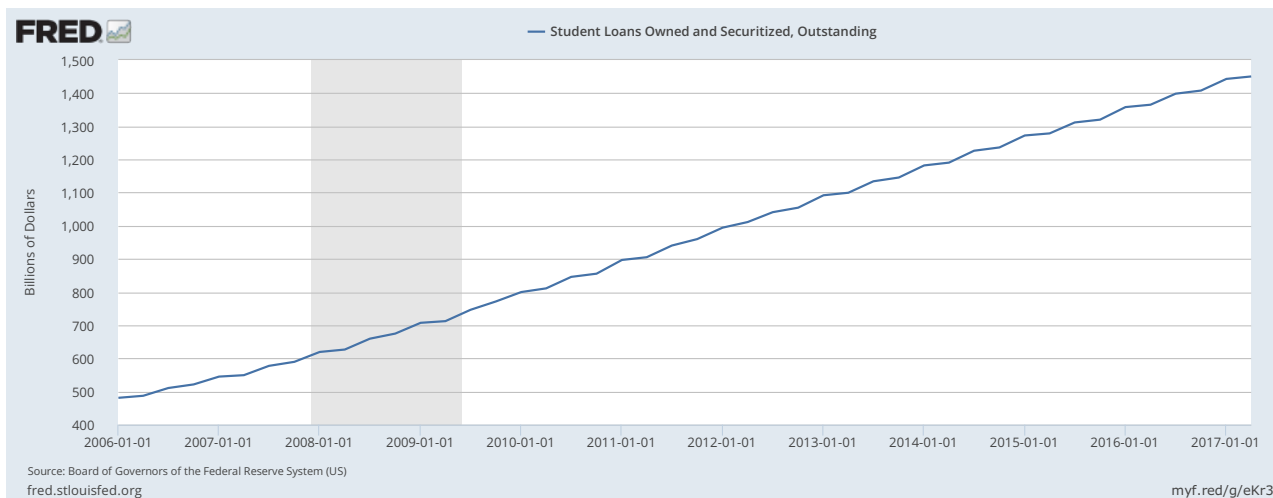
- a. The Commission is charged with researching and recommending improvements to the consumer bankruptcy system that can be implemented within its existing structure. These changes might include:
- amendments to the Bankruptcy Code,
  - changes to the Federal Rules of Bankruptcy Procedure, administrative rules or actions,
  - recommendations on proper interpretations of existing law, and
  - other best practices that judges, trustees and lawyers can implement.
- b. Commission structure:
- 17 voting members, 5 ex officio members, representing the full range of groups affected by consumer bankruptcy;
  - headed by two co-chairs, retired bankruptcy judges William Houston Brown and Elizabeth Perris;
  - assisted by a reporter, Robert Lawless, the Max L. Rowe Professor of Law and co-director of the Program on Law, Behavior & Social Science at the University of Illinois College of Law; and
  - supported by three committees, each composed of five commissioners and ten other bankruptcy experts, focusing on issues in Chapter 7, Chapter 13, and matters common to both.
  - Committee recommendations that are approved by a two-thirds majority of the Commission will become part of the Commission's final report.
  - The final report will be released at ABI's Winter Leadership Conference in December 2018 in Scottsdale, Ariz.
- c. Public input:
- All interested individuals or groups may submit comments, suggestions and information through the Commission's website, <http://consumercommission.abi.org/> or by emailing the Commission at [ConsumerCommission@abiworld.org](mailto:ConsumerCommission@abiworld.org).
  - The Commission and its committees have held public hearings at several locations. Future hearings of the Commission will be held on
    - November 10, 2017, at the ABI Seventh Circuit Consumer Bankruptcy Conference in Chicago;
    - December 1, 2017, at the ABI Winter Leadership Conference in Palm Springs, CA); and
    - April 22-24, 2018, at the ABI Annual Spring Meeting in Washington, DC.
  - Any individual wishing to address the Commission at any of these hearings, on any consumer bankruptcy issue, may register through Calls for

Participation set out on the Commission's website,  
<https://consumercommission.abi.org/>

d. The treatment of student loan indebtedness is one of the most significant issues being addressed by the Commission.

*2. Student loan debt—a major issue for the national economy*

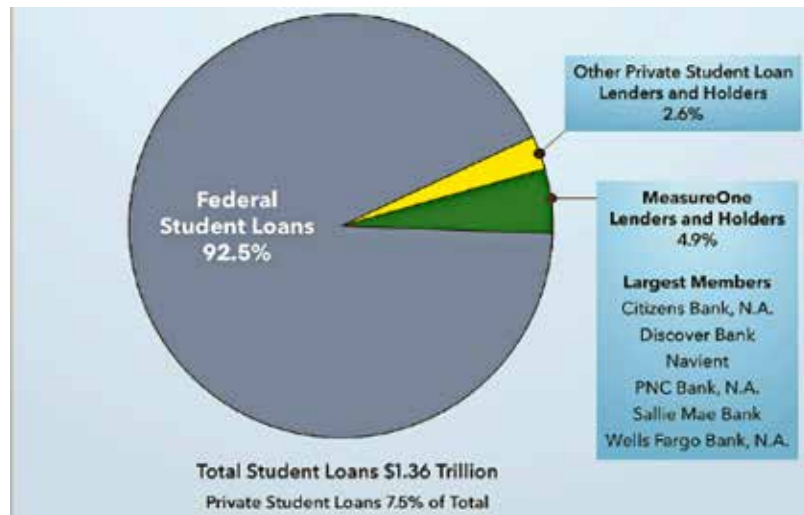
a. The Federal Reserve Bank of St. Louis recently reported that outstanding student loan debt in the United States has tripled since 2006, from under \$500 billion to over \$1.4 trillion:



b. Student debt is owed by 44.2 million Americans; 2016 graduates had average student loan debt of over \$37,000. <https://studentloanhero.com/student-loan-debt-statistics/>

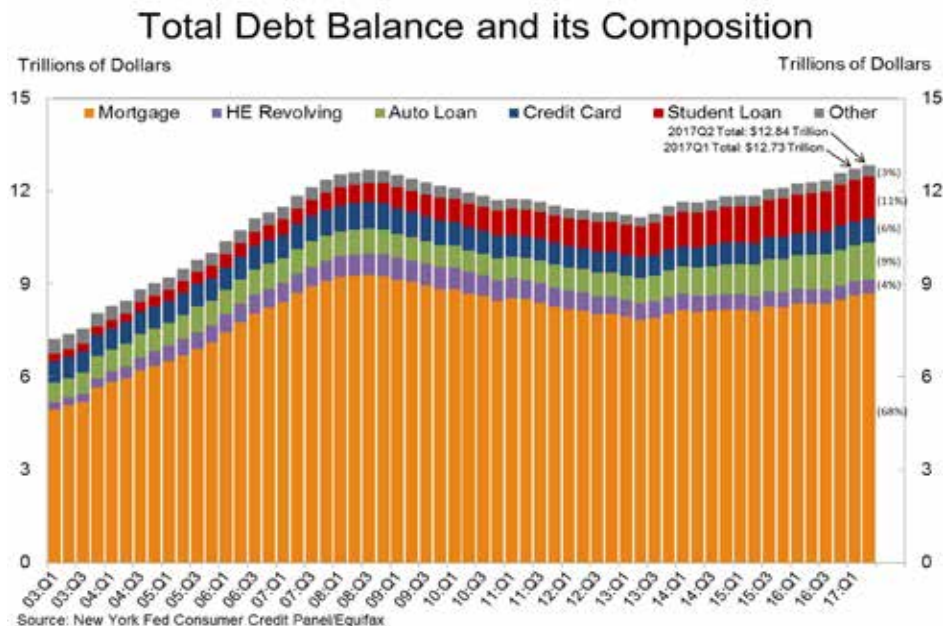
c. Of outstanding student loan indebtedness, over 90% is owed to the federal government, but private student loans still total over \$100 billion. See Student Debt: Private Loans, Bankruptcy Get Attention on Hill, Bankruptcy Law Reporter (BNA), Sept. 19, 2017 (reporting data from December 2016 of the MeasureOne Private Student Loan Consortium):

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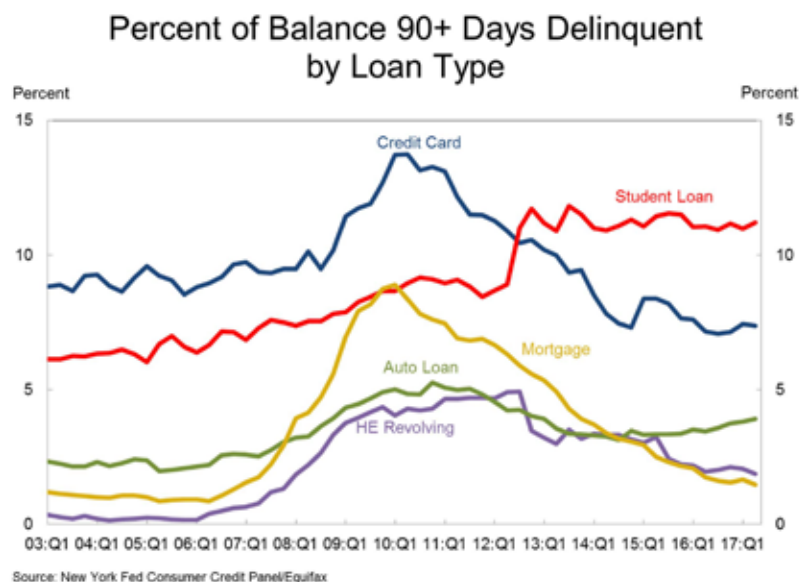


Student Loan Debt Statistics 2017, <https://lendedu.com/blog/student-loan-debt-statistics>. Private student loan borrowing declined after the 2007-08 recession, but has been increasing more recently, with an annual volume of \$7.8 billion in 2014-15. Institute for College Access & Success, Private Loans: Facts and Trends (June 2016), [https://ticas.org/sites/default/files/pub\\_files/private\\_loan\\_facts\\_trends.pdf](https://ticas.org/sites/default/files/pub_files/private_loan_facts_trends.pdf)

d. Student loan indebtedness is now 11% of total debt in the United States, the second highest type of outstanding debt. In 2003, both credit card and auto loan indebtedness were several times the amount of student loan debt. The New York Federal Reserve Bank reports that student loan indebtedness now greatly exceeds them both (Quarterly Report on Household Debt and Credit, 2017:Q2).



e. Student loans are now much more likely to be seriously in default than any other type of indebtedness. The following chart, from the same report of the New York Federal Reserve Bank, shows student loans in default at 11.2% of student loans that are in repayment, but the report warns that this is an artificially low percentage: “[H]alf of these loans are currently in deferment, in grace periods or in forbearance and therefore temporarily not in the repayment cycle. This implies that among loans in the repayment cycle delinquency rates are roughly twice as high.”

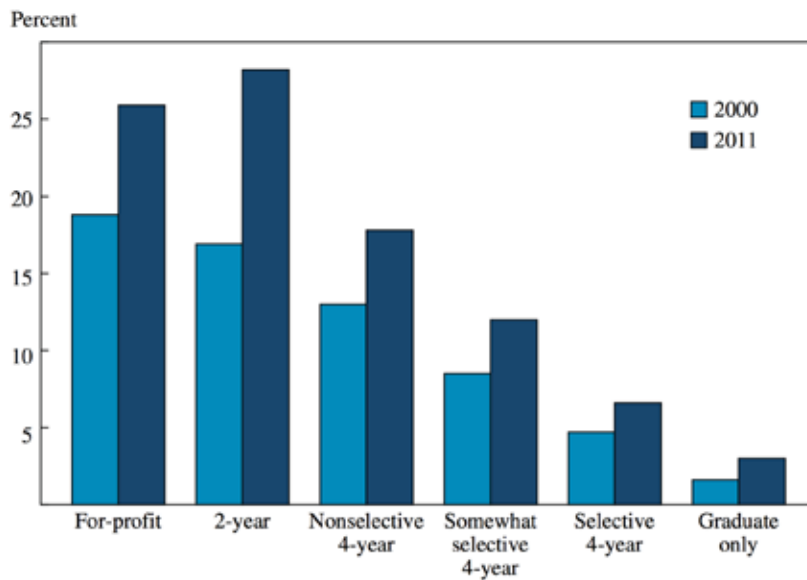


f. Student loan debt for private education and two-year institutions is particularly likely to result in default. See Adam Looney & Constantine Yannelis, *A crisis in student loans? How changes in the characteristics of borrowers and in the institutions they attended contributed to rising loan defaults*, Brookings Papers on Economic Activity 63 (2015) (attributing a large portion of the student loans in default to students who “borrowed substantial amounts to attend institutions with low completion rates and, after enrollment, experienced poor labor market outcomes that made their debt burdens difficult to sustain”). A paper from the Obama Council of Economic Advisors, *Investing in Higher Education: Benefits, Challenges, and the State of Student Debt* 60 (July 2016), [https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160718\\_cea\\_student\\_debt.pdf](https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160718_cea_student_debt.pdf), makes a similar point about for-profit institutions:

Under the Gainful Employment regulation ... [career college] programs are deemed to have failed the requirements if their graduates have annual loan payments greater than 12 percent of total earnings and greater than 30 percent of discretionary earnings. ... Based on available data, the Department of Education estimates that about 1,400 programs serving 840,000 students—of which 99 percent are at for-profit institutions—would not pass the accountability standards.

A chart in the Looney & Yannelis paper shows substantial variance in defaults within three years after loan payments begin, depending on the type of educational institution:

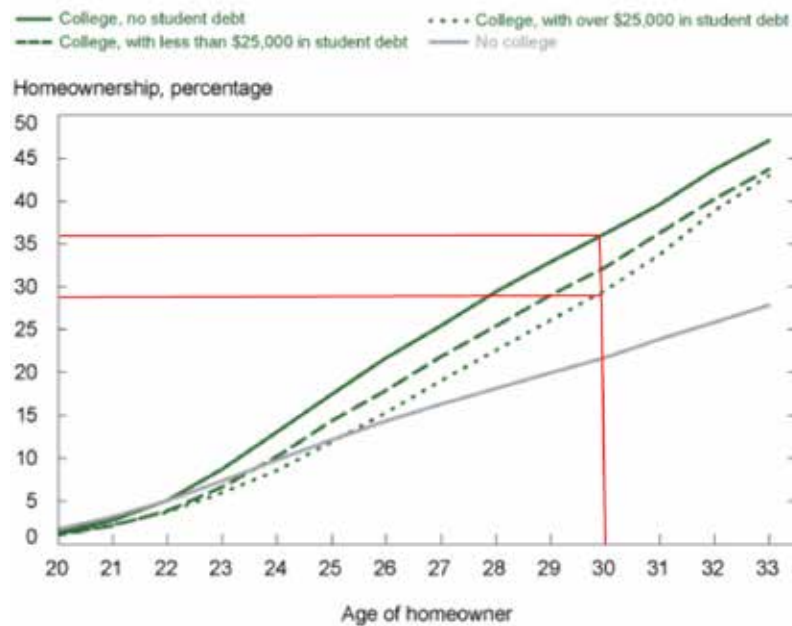
**Figure 8. Increases in 3-Year Cohort Default Rates by Institution Type, 2000 and 2011 Cohorts<sup>a</sup>**



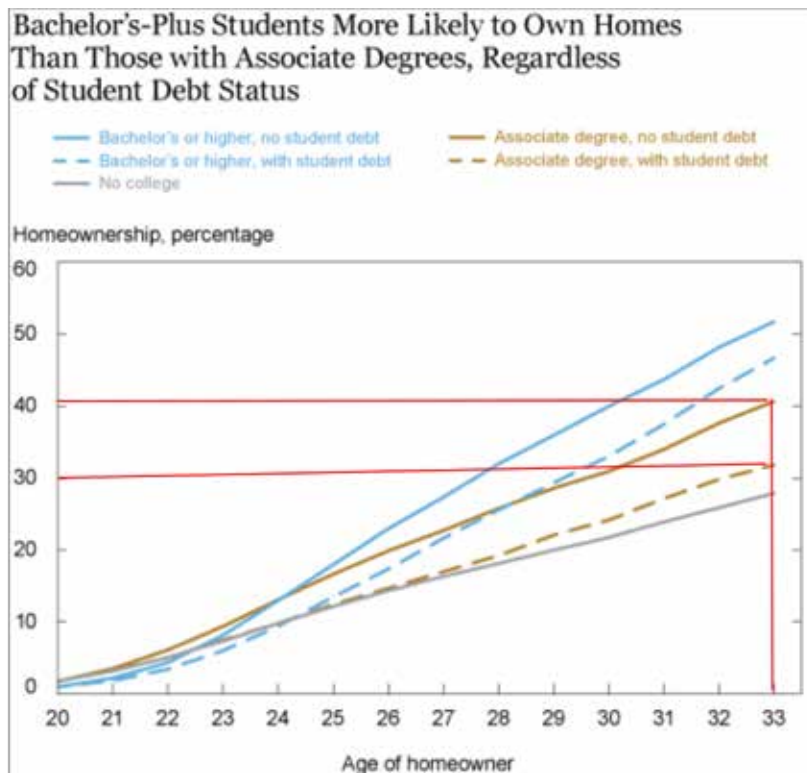
Source: U.S. Treasury tabulations of 4-percent NSLDS sample.

g. Graduates with higher student loan debt engage in lower economic activity. At age 30, graduates with more than \$25,000 in student debt buy homes at only 80% of the rate of debt-free students, as shown in a chart from Diplomas to Doorsteps: Education, Student Debt, and Homeownership, Liberty Street Economics 9/10/17, <http://libertystreeteconomics.newyorkfed.org/2017/04/diplomas-to-doorsteps-education-student-debt-and-homeownership.html>:

### Higher Student Debt Balance Is Associated with Lower Homeownership Rates



h. Student debt for lower quality education results in even lower economic activity. Even at age 33, graduates with associate degrees and student loan debt purchase homes at less than 75% the rate of debt-free holders of associate degrees.



i. This data suggests that outstanding student loan indebtedness is a limiter of economic activity, and that students with lower quality education are particularly likely to default. A 2015 survey of 1220 college graduates, reported at <https://studentloans.net/impact-report-july-2016/> confirmed the negative economic effect of outstanding student loan indebtedness:

63% of respondents reported that student debt was affecting their decision or ability to buy a home.

73% of respondents reported that student debt was affecting their decision or ability to save for retirement.

47% of respondents reported that student debt was affecting their decision or ability to purchase a car.

28% of respondents reported that student debt has forced them to put off or delay marriage.

34% of respondents reported that student debt has forced them to put off or delay starting a family.

41% of respondents reported that student debt is making it difficult to keep up with daily expenses.

32% of respondents reported that student debt has hindered their ability to go to social events with friends or family.

### *3. Non-bankruptcy responses to student loan indebtedness*

a. CARE, <https://care4yourfuture.org/>, is a volunteer organization with special emphasis on educating high school students on the proper use of credit. It offers programs on student loans in both English and Spanish, designed to—

- Identify ways students can reduce the amount of money borrowed for college
- Describe the differences between scholarships, grants, and loans
- Develop a logical argument for using student loans
- Recognize differences between public loans and private loans
- Explain the consequences of not paying student loans back on time

b. Consumer Financial Protection Bureau. This agency has substantial website material on both types of student loans available—including the differences between federal and private loans—and the methods for dealing with payment of the loans. See <https://www.consumerfinance.gov/ask-cfpb/category-student-loans/>:



## Student loans

Student loans are complicated. We have answers to questions about how to pay off your loans and the repayment programs available to you.

### What is your question about?

Understanding student loans

Getting a student loan

Co-signing a student loan

Repaying a student loan

Consolidating or refinancing a loan

Postponing student loan payments

Cancelling a loan

Debt collection and rehabilitation

Discrimination

Other questions

Protections and benefits for servicemembers

### Should I choose federal student loans or private student loans?

**Answer:** If you must take out student loans, federal student loans are the best option for the vast majority of borrowers.

It is best to max out your federal student loan options before you borrow any private student loans. Federal student loans usually carry more flexible protection if you run into difficulty in repaying your loans, and all new federal student loans have fixed interest rates, meaning the rate does not change over the life of your loan. Private student loans generally have variable interest rates, which can reset every month or quarter, causing your monthly payments to change.

c. Other internet advice on student loans. Googling “student loan advice” produces a very large response. A Dave Ramsey site, <https://www.daveramsey.com/blog/9-lies-college-student-loans>, has a number of pages under the heading “Is College Worth It?” It presents advice to consider not attending college, to avoid taking out student loans, and to pay outstanding student loans as quickly as possible. The Institute for College Access & Success, Private Loans: Facts and Trends (June 2016), [https://ticas.org/sites/default/files/pub\\_files/private\\_loan\\_facts\\_trends.pdf](https://ticas.org/sites/default/files/pub_files/private_loan_facts_trends.pdf), sets our particular warnings about private student loans:

Private loans are one of the riskiest ways to finance a college education. Like credit cards, they typically have variable interest rates. Both variable and fixed rates are higher for those who can least afford them — as high as 13.74% in June 2016. Private loans are not eligible for the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans. Private loans are also much harder than other forms of consumer debt to discharge in bankruptcy.

d. Administrative discharges. Various federal statutes allow for discharge or cancellation of student loan indebtedness under certain conditions. These include:

- The school's closure while the student borrower was still enrolled;
- The school's false certification of the student borrower's eligibility (including false certification due to forgery or identity theft);
- The school's failure to pay a refund owed to a student borrower;
- The borrower's permanent and total disability;
- The borrower's death; and
- The borrower's profession, such as teaching or military service in limited circumstances and public service jobs.

NCLC, Student Loan Law, § 10.1 Statutory Discharges of Federal Student Loans: Introduction.

e. Income based repayment programs. Before a federal student loan goes into default, several income-based repayment plans allow the debtor to lower monthly repayment and obtain forgiveness of any balance still owing after a period of repayment (20 or 25 years, depending on the plan). However, these programs have drawbacks. Interest accrues during the repayments period and may result in negative amortization; missed payments may result in default and termination of the plan, and—at least under current law—the amount of any loan forgiveness is taxable. Accordingly, “[t]hese repayment plans do not provide as complete a relief as bankruptcy or administrative discharges.” NCLC, Student Loan Law, § 3.3 Income-Driven Repayment Plans.

#### *4. Best general resources for student loans and bankruptcy*

a. Susan E. Houser and Daniel A. Austin, *Graduating with Debt: Student Loans under the Bankruptcy Code* (2d ed. 2016)

b. National Consumer Law Center, *Student Loan Law* (5th ed. 2015), updated at <http://www.nclc.org/library>.

#### *5. Discharge of student loans in bankruptcy*

a. Current statute. 11 U.S.C. § 523(a)(8):

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 . . . .

This provision starts with the determination that all “educational loans” are excepted from discharge, subject to an affirmative showing by the debtor that leaving the loan in place “would impose an undue hardship.” There is no definition of “undue hardship” in the Bankruptcy Code.

b. In applying the “undue hardship” exception from nondischargeability, most courts—including every circuit other than the First, Eighth, and D.C. Circuits, apply the three-part test set out in *Brunner v. New York State Higher Education Services*, 831 F.2d 395, 396 (2d Cir. 1987):

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

The second factor has often been described as requiring the debtor to establish a “certainty of hopelessness” regarding payment of the student loan sought to be discharged. See, e.g., *Educ. Credit Mgmt. Corp. v. Frushour (In re Frushour)*, 433 F.3d 393, 401 (4th Cir. 2005).

c. The Eighth Circuit applies a totality of circumstances test that does not expressly require consideration of good faith and allows consideration of other relevant factors, but its effect is similar to *Brunner*: “[I]f the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt—while still allowing for a minimal standard of living—then the debt should not be discharged.” *Long v. Educ. Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549, 554-55 (8th Cir. 2003).

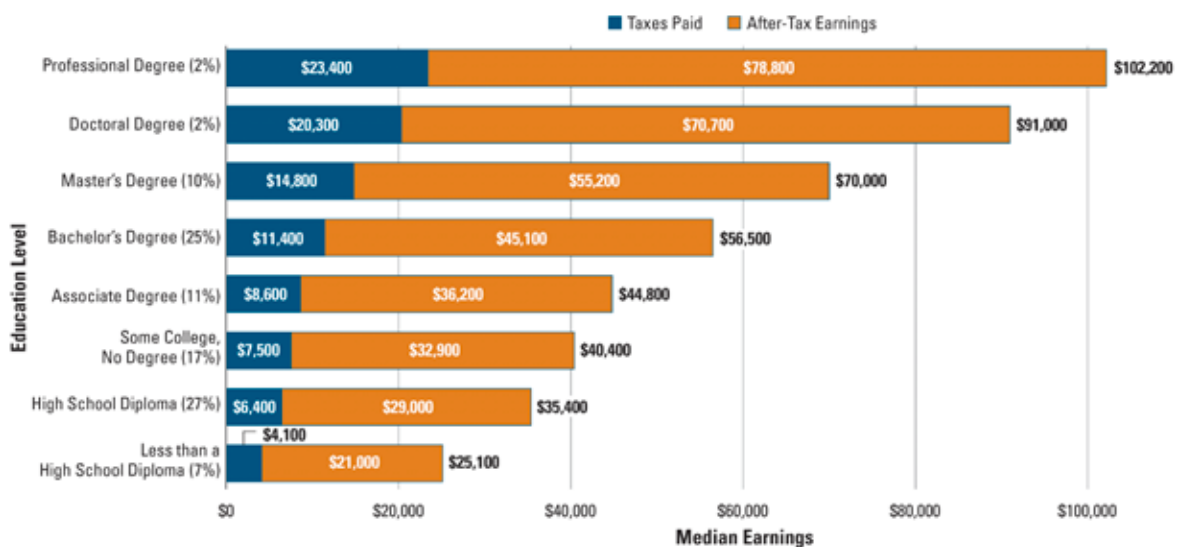
d. Very few debtors have sought discharge of student loans under § 523(a)(8). See *Jason Iuliano, An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard*, 86 Am. Bank. L. J. 495, 499 (2012): “[B]arely 0.1 percent of student loan debtors in bankruptcy sought to discharge their educational debts. This figure illustrates the central flaw in the system: 99.9 percent of bankrupt student loan debtors do not even try to discharge their student loans.”

f. If a debtor cannot obtain a discharge of student loans, bankruptcy relief under Chapter 7 is likely preferable to relief under Chapter 13. A Chapter 7 case results in immediate discharge of other unsecured debts, allowing the debtor’s future income to be used for student loan payments. The debtor’s future income in Chapter 13, by contrast, is frequently required to be paid pro rata to all unsecured claims, diluting payments to student loan debt, on the ground that paying more to student loan creditors would “discriminate unfairly” against the other creditors, in violation of § 1322(b)(1). See, e.g., *In re Bentley*, 266 B.R. 229, 243 (B.A.P. 1st Cir. 2001) (“[T]he postbankruptcy balance due on student loans should be paid by the Debtors out of assets that they are not required to commit to the plan, not by general unsecured creditors out of their share of the Debtor’s minimum contribution.”).

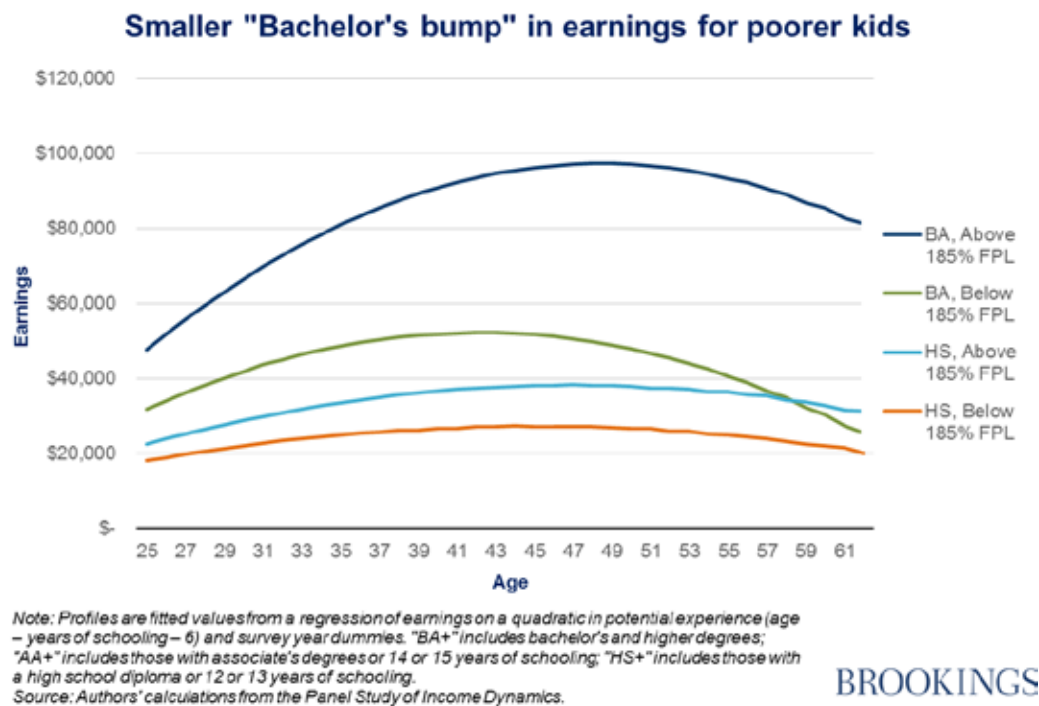
#### 6. Rationales for the restricted bankruptcy discharge

a. The general rationale for nondischargeability of student loans is that the increase in earning capacity a debtor obtains through a student loan should be used to repay the loan if possible. Higher education does in fact result in higher earnings. See Sandy Baum Jennifer Ma Kathleen Payea, *Education Pays 2013*, <https://trends.collegeboard.org/sites/default/files/education-pays-2013-full-report.pdf>:

Median Earnings and Tax Payments of Full-Time Year-Round Workers Ages 25 and Older, by Education Level, 2011



However, the extent of the increase in earnings may depend on the income level of the students' families. A Brookings Institute blog sets out the following chart, showing a much lower increase in earnings from bachelor's degrees earned by students in poorer families.



Case law reflects the view that the increase in earnings resulting from education requires that loans supporting the education should be excepted from discharge. See, e.g., *In re Roberson*, 999 F.2d 1132, 1135-36 (7th Cir. 1993):

As the proponents of a higher standard for dischargeability recognized: "Educational loans are different from most loans. They are made without business considerations, without security, without cosigners, and rely[] for repayment solely on the debtor's future increased income resulting from the education. In this sense, the loan is viewed as a mortgage on the debtor's future." H.R. Rep. No. 595, 95th Cong., 1st Sess. 133 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6094.

*In re Pelkowski*, 990 F.2d 737, 742 (3d Cir. 1993):

It is undisputed that section 523(a)(8) was enacted in response to the belief that students were taking advantage of the loan program. In the early 1970's, there was concern by legislators and the public about the perceived rise in bankruptcy filings by students on the brink of lucrative careers.

b. A second rationale is that payment of student loans is necessary to sustain the federal loan programs. *Pelkowski*, 990 F.2d at 743 (“Patently, an unrepaid loan will adversely affect the financial integrity of the educational loan program . . .”).

*7. Currently pending legislative proposals for more effective bankruptcy relief*

a. H.R. 137, Stopping Abusive Student Loan Collection Practices in Bankruptcy Act of 2017, introduced on January 3, 2017, would allow debtors to recover court costs and attorney's fees if the court finds that the position of the creditor opposing the debtor's request for discharge of a student loan was not substantially justified. Skopos Labs rates its likelihood of enactment at 1%.

<https://www.govtrack.us/congress/bills/115/hr137>.

b. H.R. 2366, the Discharge Student Loans in Bankruptcy Act, was introduced on May 4, 2017. It would completely remove § 523(a)(8), and so allow discharge of student loans on the same basis as other unsecured debts. The bill is sponsored by John Delaney (D-MD) and co-sponsored by John Katko (R-NY). Skopos Labs rates its likelihood of enactment at 2%. See

<https://www.govtrack.us/congress/bills/115/hr2366>.

c. H.R. 2527, the Private Student Loan Bankruptcy Fairness Act of 2017, introduced on May 18, 2017, would amend § 523(a)(8) to exclude private student loans from the discharge exception. Earlier versions of this legislation were introduced in 2010, 2011, 2013, and 2015. Skopos Labs rates its likelihood of enactment at 1%. See <https://www.govtrack.us/congress/bills/115/hr2527>.

d. S.1521: Student Loan Relief Act of 2017, introduced on July 10, 2017, would reduce interest on federal student loans and provide for refinancing of existing loans. Skopos Labs rates its likelihood of enactment at 3%.

<https://www.govtrack.us/congress/bills/115/s1521>.

*8. Consideration of student loan indebtedness by the Commission.*

The matters as to which a recommendation may include both proposals for amending the Bankruptcy Code and suggestions for the best resolution of disputed legal issues.

a. Legislative proposals may include—

- Support for any of the pending bills.
- Eliminating the discharge exception for private loans. Repayment of private student loans is not necessary to sustain the student loan system, and these loans themselves—more burdensome to students than federal loans— may be

overused. See The Institute for College Access & Success, Private Loans: Facts and Trends (June 2016), [https://ticas.org/sites/default/files/pub\\_files/private\\_loan\\_facts\\_trends.pdf](https://ticas.org/sites/default/files/pub_files/private_loan_facts_trends.pdf) (“[A]most half (47%) of private loan borrowers in 2011-12 borrowed less than they could have in safer federal Stafford loans.”). Finally, the bank consortium holding the large majority of private student loans reports very low default rates: “[C]redit-based underwriting and a high percentage of cosigners leads to positive trends in terms of repayment, delinquencies and charge-offs . . . .” MeasureOne Private Student Loan Report, Q1 2017, <https://www.measureone.com/psl.php>.

- Setting a period from the commencement of repayment, after which student loans would be fully dischargeable, as under the original version of § 523(a)(8).
- Making student loans dischargeable in Chapter 13, again as under the original version of § 523(a)(8), which was not changed until 1990.

b. Recommendations for resolution of disputed legal issue may include—

- Rejection of “certainty of hopelessness” as an accurate characterization of the *Brunner* test. See *Krieger v. Educ. Credit Mgmt. Corp.*, 713 F.3d 882, 884-85 (7th Cir. 2013) (stating that certainty of hopelessness “sounds more restrictive than the statutory ‘undue hardship,’” and that “[i]t is important not to allow judicial glosses, such as the language in . . . *Brunner*, to supersede the statute itself”).
- Granting deference to bankruptcy court findings regarding the *Brunner* factors. See *ECMC v. Acosta-Conniff (In re Acosta-Conniff)*, 686 F. App’x 647, 2017 U.S. App. LEXIS 6746 at \*5 (11th Cir. 2017) (“A bankruptcy court’s findings as to each of the three prongs of the *Brunner* test are factual findings that should be reviewed by the district court for clear error; not under a *de novo* standard of review.”).
- Allowing preferential classification of student loan debt in Chapter 13, as—
  - consistent with the result of a “Chapter 20” filing,
  - fair to unsecured creditors protected by the best interests requirement of § 1325(a)(4),
  - protective of the need for funding of the student loan system, and
  - requiring use of disposable income to pay the debt.

See *In re Brown*, 500 B.R. 255, 265-66 (Bankr. S.D. Ga. 2013) (allowing preferential classification of student loan debt in Chapter 13, and discussing relevant case law).
- Even if preferential classification is not generally allowed, providing for—
  - preferential payments of co-signed student loans under § 1322(b)(1) (allowing for treatment of co-signed debt “differently than other unsecured claims”), see *In re Russell*, 503 B.R. 788 (Bankr. S.D. Ohio

2013) (holding that payment of co-signed debt is excepted from the unfair discrimination limitation of § 1322(b)(1) and discussing the conflicting case law);

- payment of student loans to the extent necessary to cure any default, and maintain current contractual obligations under § 1322(b)(5) (allowing cure and maintenance of claims, not limited to secured claims), *see In re Johnson*, 446 B.R. 921, 925 (Bankr. E.D. Wis. 2011) (“[A] debtor's maintenance of the full monthly payments on a long-term debt under § 1322(b)(5) supersedes the requirement of equal treatment for all creditors under § 1322(b)(1).”)