2019 Annual Spring Meeting

AMERICAN BANKRUPTCY INSTITUTE

*Consumer*

# Let's Talk Student Loans (but Not Undue Hardship): Other Solutions to Help Your Clients and Get You Paid


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CONCURRENT SESSION

2019

# LET'S TALK STUDENT LOANS (BUT NOT UNDUE HARDSHIP)

# OTHER SOLUTIONS TO HELP YOUR CLIENTS AND GET YOU PAID

## ABI ANNUAL SPRING MEETING

## APRIL 13, 2019

## WASHINGTON, DC

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## Income Driven Repayment Plans*

Borrowers must repay their loans even if they do not complete their education, cannot find a job related to their program of study, or are unhappy with the education they paid for with their loan. However, certain circumstances might lead to their loans being forgiven, canceled, or discharged. The list below is a quick view of the types of forgiveness, cancellation, and discharge.

*The following chart was adopted from: Student Loans: An Overwhelming Problem in Need of Some Solutions presented at 2018 Hon. Steven W. Rhodes Consumer Bankruptcy Conference the with permission from the authors: PAULA HALL and ALEXANDRA STAN; Brooks Wilkins Sharkey & Turco PLLC Birmingham, Michigan.

| Type of Forgiveness, Cancellation or Discharge | Direct Loans | FFEL Program Loans | Perkins Loans |
|---|---|---|---|
| Total and Permanent Disability (TPD) Discharge | x | x | x |
| Death Discharge | x | x | x |
| Discharge in Bankruptcy (in rare cases) | x | x | x |
| Closed School Discharge | x | x | |
| False Certification of Student Eligibility or Unauthorized Payment Discharge | x | x | |
| Teacher Loan Forgiveness | x | x | |
| Public Service Loan Forgiveness | x | | |
| Perkins Loan Cancellation and Discharge (includes Teacher Cancellation) | | | x |

## OVERVIEW OF REPAYMENT PLANS

| Repayment Plan | Eligible Loans | Monthly Payment and Time Frame | Quick Comparison |
|---|---|---|---|
| Standard Repayment Plan | • Direct Subsidized and Unsubsidized Loans<br><br>• Subsidized and Unsubsidized Federal Stafford Loans<br><br>• All PLUS loans | Payments are a fixed amount of at least $50 per month.<br><br>Up to 10 years. | You'll pay less interest for your loan over time under this plan than you would under other plans. |

| Repayment Plan | Eligible Loans | Monthly Payment and Time Frame | Quick Comparison |
|---|---|---|---|
| Extended Repayment Plan | • Direct Subsidized and Unsubsidized Loans<br><br>• Subsidized and Unsubsidized Federal Stafford Loans<br><br>• All PLUS loans | Payments may be fixed or graduated.<br><br>Up to 25 years. | • Your monthly payments would be lower than the 10-year standard plan.<br><br>• If you are a -<br>◦ Direct Loan borrower, you must have more than $30,000 in outstanding Direct Loans.<br>◦ FFEL borrower, you must have more than $30,000 in outstanding FFEL Program loans.<br>‣ For example, if you have $35,000 in outstanding FFEL Program Loans, and $10,000 in Direct Loans, you can use the extended repayment plan for your FFEL Program loans, but not for your Direct Loans.<br><br>• For both programs, you must also be a new borrower as of October 7, 1998.<br><br>• You'll pay more for your loan over time than under the 10-year standard plan. |
| Graduated Repayment Plan | • Direct Subsidized and Unsubsidized Loans<br><br>• Subsidized and Unsubsidized Federal Stafford Loans<br><br>• All PLUS loans | Payments are lower at first and then increase, usually every two years.<br><br>Up to 10 years. | You'll pay more for your loan over time than under the 10-year standard plan. |

| Repayment Plan | Eligible Loans | Monthly Payment and Time Frame | Quick Comparison |
|---|---|---|---|
| Income-Contingent Repayment Plan | • Direct Subsidized and Unsubsidized Loans<br><br>• Direct PLUS loans made to students<br><br>• Direct Consolidation Loans | • Payments are calculated each year and are based on your adjusted gross income, family size, and the total amount of your Direct Loans.<br><br>• Your payments change as your income changes.<br><br>• Up to 25 years. | • You'll pay more for your loan over time than you would under the 10-year standard plan.<br><br>• If you have not repaid your loan in full after making the equivalent of 25 years of qualifying monthly payments, any outstanding balance on your loan will be forgiven.<br><br>• You may have to pay income tax on any amount that is forgiven. |
| Income-Based Repayment Plan (IBR) | • Direct Subsidized and Unsubsidized Loans<br><br>• Subsidized and Unsubsidized Federal Stafford Loans<br><br>• All PLUS loans made to students<br><br>• Consolidation Loans (Direct or FFEL) that do not include Direct or FFEL PLUS loans made to parents. | • Your maximum monthly payments will be 15 percent of discretionary income, the difference between your adjusted gross income and 150 percent of the poverty guideline for your family size and state of residence (other conditions apply).<br><br>• Your payments change as your income changes.<br><br>• Up to 25 years. | • You must have a partial financial hardship.<br><br>• Your monthly payments will be lower than payments under the 10-year standard plan.<br><br>• You'll pay more for your loan over time than you would under the 10-year standard plan.<br><br>• If you have not repaid your loan in full after making the equivalent of 25 years of qualifying monthly payments, any outstanding balance on your loan will be forgiven.<br><br>• You may have to pay income tax on any amount that is forgiven. |
| Income-Sensitive Repayment Plan | • Subsidized and Unsubsidized Federal Stafford Loans<br><br>• FFEL PLUS loans<br><br>• FFEL Consolidation Loans | • Your monthly payment is based on annual income.<br><br>• Your payments change as your income changes.<br><br>• Up to 10 years. | • You'll pay more for your loan over time than you would under the 10-year standard plan.<br><br>• Each lender's formula for determining the monthly payment under this plan can vary. |

| Repayment Plan | Eligible Loans | Monthly Payment and Time Frame | Quick Comparison |
|---|---|---|---|
| Pay As You Earn Repayment Plan | • Direct Subsidized and Unsubsidized Loans<br><br>• Direct PLUS loans made to students<br><br>• Direct Consolidation Loans that do not include (Direct or FFEL) PLUS loans made to parents | • Your maximum monthly payments will be 10 percent of discretionary income, the difference between your adjusted gross income and 150 percent of the poverty guideline for your family size and state of residence (other conditions apply).<br><br>• Your payments change as your income changes.<br><br>• Up to 20 years. | • You must be a new borrower on or after October 1, 2007, and must have received a disbursement of a Direct Loan on or after October 1, 2011.<br><br>• You must have a partial financial hardship.<br><br>• Your monthly payments will be lower than payments under the 10-year standard plan.<br><br>• You'll pay more for your loan over time than you would under the 10-year standard plan.<br><br>• If you have not repaid your loan in full after making the equivalent of 20 years of qualifying monthly payments, any outstanding balance on your loan will be forgiven.<br><br>• You may have to pay income tax on any amount that is forgiven. |

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**PRESENTATION on PARTIAL DISCHARGE OF STUDENT LOANS**

Several categories of debt are excepted from discharge under section 523 of the Bankruptcy Code.

Section 523(a)(8) generally excepts student loans from discharge. However, Congress included in section 523(a)(8) an exception to the general rule of nondischargeability, in cases where a debtor could prove that his or her student debt imposed an "undue hardship."

**Purposes of section 523(a)(8)**

-to prevent recent graduates from exploiting the bankruptcy system by discharging their loans when they are on their way to lucrative careers.[1]

-to prevent those who borrow to obtain the benefit of a superior education from receiving a discharge of the obligation to repay the loan

- to keep our student loan programs intact[2]

- "to preserve the financial integrity of the loan system by assuring the availability of monies to students in the future." [3]

Section 523(a)(8) provides:

> **(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--

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[1] Long v. Educ. Credit Mgmt. Corp. (In re Long), 322 F.3d 549, 553–54 (8th Cir. 2003); Correll v. Union Nat'l Bank of Pittsburgh (In re Correll), 105 B.R. 302, 304 (Bankr.W.D.Pa.1989)("[L]egislative history indicates a Congressional policy of excepting discharge in those inequitable situations where debtors with superior education and employment skills were intentionally abusing the fresh start policies ... [of] the bankruptcy laws.").
[2] In re Karben, 201 B.R. 681, 684 (Bankr. S.D.N.Y. 1996).
[3] In re Wells, 380 B.R. 652, 659 (Bankr. N.D.N.Y. 2007); In re Hamblin, 277 B.R. 676, 682 (S.D. Miss 2002).

> **(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[.]

11 U.S.C. § 523(a)(8).

Bankruptcy Code section 523(a)(8) applies to individual debtors in chapter 7 cases, chapter 11 cases and chapter 13 cases.

Note re Chapter 11: Bankruptcy Code section 1141(d)(2) provides "A discharge under this chapter does not discharge a debtor who is an individual from any debt excepted from discharge under section 523 of this title."

Note re Chapter 13: A discharge under Chapter 13 is broader than the discharge received in any other chapter, but Chapter 13 nevertheless restricts or prohibits entirely the discharge of certain types of debts. Under Bankruptcy Code section 1328(a), a Chapter 13 discharge does not discharge debts that are excepted from discharge under section 523(a)(8).

The Federal Rules of Bankruptcy Procedure require a party seeking to determine the dischargeability of a student loan debt to commence an adversary proceeding by serving a summons and complaint on affected creditors. See Bankruptcy Rule 7001(6).

**Establishment of "undue hardship" and the Brunner test**

Bankruptcy Code section 523(a)(8) permits the discharge of student loans only when a failure to discharge this debt would impose an undue hardship on the debtor.

The Bankruptcy Code does not define "undue hardship" so courts have had to develop their own tests. A majority of circuits have adopted the test laid out in Brunner v. New York State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987). [4]

[4] The Eighth Circuit, however, follows the less demanding "totality of the circumstances" test. In re Kinney, 593 B.R. 618, 622 (Bankr. N.D. Iowa 2018)(citing In re Conway, 495 B.R. 416, 419 (B.A.P. 8th Cir. 2013); Martin v. Great Lakes Higher Educ. Group (In re Martin), 584 B.R. 886, 891 (Bankr. N.D. Iowa 2018); In re Kemp, 588 B.R. 226 (B.A.P. 8th Cir. 2013)(In deciding whether Chapter 7 debtor was entitled to "undue hardship" discharge of her student loan debt under § 523(a)(8), bankruptcy court properly considered the various loan repayment programs available to debtor as part of its review of other relevant facts and circumstances, as required by the totality-of-the-circumstances test.).

Kinney states:

To establish "undue hardship" under the three-part test enunciated in Brunner, the debtor must prove:

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

A debtor seeking to obtain an "undue hardship" discharge of student loan obligations under the Brunner test has the burden of establishing each of the 3 elements, by a preponderance of the evidence.[5]

Under the Brunner undue hardship test, if any one of the 3 requirements is not met, the bankruptcy court's inquiry must end there with a finding of nondischargeability. [6]

**1. Minimal Standard of Living**

This prong has been described as prescribing the “minimum necessary to establish ‘undue hardship’” and that it “comports with common sense.” In re Pena, 155 F.3d 1108, 1111 (9th Cir. 1996); McDowell, 549 B.R. at 766.

Maximization of income by the debtor is not necessary to satisfy this prong. Educ. Credit Mgmt. Corp. v. Mason (In re Mason), 464 F.3d 878, 882 n. 3 (9th Cir.2006); McDowell, 549 B.R. at 766.

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> Under the “totality of the circumstances” test the Court examines “the unique facts and circumstances that surround the particular bankruptcy.” Long, 322 F.3d at 554. The Court evaluates the debtor's undue hardship argument in light of three factors: “(1) the debtor's past, present, and reasonably reliable future financial resources; (2) the debtor's reasonable and necessary living expenses; and (3) any other relevant facts and circumstances.” Id. The debtor has the burden to prove by a preponderance of the evidence that not discharging their student loan obligation would cause undue hardship. Educ. Credit Mgmt. Corp. v. Jesperson, 571 F.3d 775, 779 (8th Cir. 2009)Under the “totality of the circumstances” test the Court examines “the unique facts and circumstances that surround the particular bankruptcy.” Long, 322 F.3d at 554. The Court evaluates the debtor's undue hardship argument in light of three factors: “(1) the debtor's past, present, and reasonably reliable future financial resources; (2) the debtor's reasonable and necessary living expenses; and (3) any other relevant facts and circumstances.” Id. The debtor has the burden to prove by a preponderance of the evidence that not discharging their student loan obligation would cause undue hardship. Educ. Credit Mgmt. Corp. v. Jesperson, 571 F.3d 775, 779 (8th Cir. 2009).

Kinney, 593 B.R. at 622-23.

[5] See, e.g. In re Regan, 590 B.R. 567, 573 (Bankr. D.N.M. 2018); In re McDowell, 549 B.R. 744, 766 (Bankr. D. Idaho 2016).
[6] See, e.g. McDowell, 549 B.R. at 766.

Calculating the debtor's appropriate cost of living is factual in nature and "is a matter properly left to the discretion of the bankruptcy court." In re Jorgensen, 479 B.R. 79, 87 (BAP 9th Cir. 2012) (citing Pena, 155 F.3d at 1112); McDowell, 549 B.R. at 766.

### 2. Additional Circumstances

The second prong of the Brunner test requires the debtor to prove that his or her present inability to pay will likely persist through a substantial portion of the loan's repayment period.[7]

Due to the difficulty of predicting future income, courts have required debtors to demonstrate that "additional circumstances" exist to prove that their present financial situation will persist well into the future.[8]

It has been held that to satisfy this second element (that a debtor's current state of affairs is likely to persist for a significant portion of the repayment period of the student loans), the debtor must precisely identify the debtor's problems and explain how that condition would impair the debtor's ability to work in the future. [9]

The debtor must present evidence of additional, exceptional circumstances, strongly suggestive of a continuing inability to repay over an extended period of time.[10]

### 3. The "Good Faith" Requirement

To satisfy the "good faith" requirement for the discharge of student loan debts, the debtor must seriously pursue loan consolidation options.[11]

A debtor's good faith efforts to repay student loans are measured by the debtor's ability to obtain employment, maximize income and minimize expenses, and demonstrate efforts to pay off existing student loans.[12]

In deciding whether a debtor has made good faith effort to repay his student loans, as required by the third prong of the Brunner "undue hardship" test, the bankruptcy court may consider whether the debtor has in fact made payments on the loans; however, this factor is not *per se* determinative. The court should look at debtor's financial history and employment history to attempt to figure out why no payments were made.[13]

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7 In re Nys, 446 F.3d 938, 945 (9th Cir. 2006).
8 Nys, 446 F.3d at 945.
9 In re Tirch, 409 F.3d 677 (6th Cir. 2005).
10 Goulet v. Educational Credit Management Corp., 284 F.3d 773 (7th Cir.2002).
11 See Stitt v. United States Department of Education, 532 B.R. 638 (D. Md. 2015), aff'd, 621 Fed. Appx. 262 (4th Cir. 2015); In re Lepre, 466 B.R. 727 (Bankr. W.D. Pa. 2012), subsequently aff'd, 530 Fed. Appx. 121 (3d Cir. 2013) (good faith effort not shown).
12 See Tetzlaff v. Educational Credit Management Corp., 794 F.3d 756 (7th Cir. 2015), cert. denied,136 S. Ct. 803 (2016).
13 In re Cleveland, 559 B.R. 265 (Bankr. N.D. Ga. 2016).

**PARTIAL DISCHARGE**

Section 523(a)(8) of the Bankruptcy Code provides for the complete discharge of educational loans whose repayment would impose an "undue hardship" on the debtor.
Section 523(a)(8) doesn't explicitly authorize a partial discharge.

However, debtors who can't show undue hardship to discharge their total student loan debts may try to seek a discharge of only a portion of their student loan debts.
This is often referred to as a "partial discharge."

The law regarding whether a court may grant a partial discharge of student loans is "unsettled."[14] While "not all courts have agreed to consider a partial discharge of a student loan obligation ... other courts have found authority pursuant to Code § 105(a) to allow a partial discharge of student loans provided that the debtor is able to establish undue hardship as to that portion of the debt sought to be discharged." In re Wells, 380 B.R. 652, 662–63 (Bankr. N.D.N.Y. 2007) (citations omitted) (internal quotations omitted).

The burden of demonstrating a right to a partial discharge is on the debtor. In re Carnduff, 367 B.R. 120 (B.A.P. 9th Cir. 2007).

**Application of Partial Discharge Remedy**

Partial discharges have been given under a few different approaches.

1. **Some courts have viewed the undue hardship analysis as applying to each loan separately, and thereby in effect create a "partial" discharge by forgiving the debt on certain individual loans, while denying a finding of dischargeability on others.**

See, e.g. In re Grigas, 252 B.R. 866, 874 (Bankr. D.N.H. 2000) ("although § 523(a)(8) does not allow a single debt to be partially discharged, individual educational loans may be discharged while others may be declared non-dischargeable depending on whether each loan, on a cumulative basis, imposes an undue hardship on the debtor and his or her dependents. Consequently, in the instant case, the Court shall independently determine whether each of the Debtor's 15 individual loan obligations imposes an undue hardship under § 523(a)(8), taking into consideration whether the remaining loan obligations are dischargeable.")

**8th Cir.**
In the Eighth Circuit, the courts hold that discharging student loan debt is an all-or-nothing proposition, and that "partial discharge is not an accepted practice" in that jurisdiction. In re Kinney, 593 B.R. 618, 622 (Bankr. N.D. Iowa 2018). However, courts in the 8th Circuit hold that, while the Court cannot discharge only part of a student loan, it can and must examine each loan separately. Andresen v. Nebraska Student Loan Program, Inc. (In re Andresen), 232 B.R. 127, 137 (8th Cir. B.A.P. 1999). In doing so, the court can conclude that one or more loans is

[14] In re Hixson, 450 B.R. 9, 20 (Bankr. S.D.N.Y. 2011).

dischargeable. See In re Conway, 495 B.R. 416 (B.A.P. 8th Cir. 2013)(While bankruptcy court did not have authority to modify payment terms of student loan, or to grant debtor an "undue hardship" discharge of partial amount of principal or accrued interest on student loan, it should have performed separate "undue hardship" discharge analysis as to each of the 15 separate student loans that Chapter 7 debtor was seeking to discharge); In re Andresen, 232 B.R. 127 (B.A.P. 8th Cir. 1999) (abrogated on other grounds by, In re Long, 322 F.3d 549, (8th Cir. 2003))("In this case, we hold that the bankruptcy court did not grant Andresen a 'partial discharge' of her student loan debt, at least not in the sense contemplated by NSLP or contained by the term of art definition of partial discharge as it has developed over the last twenty years. The language of § 523(a)(8) expressly refers to a student loan, an overpayment, or any obligation. The words provided in the section are clearly singular. The Code does not refer to a debtor's sum of student loans, aggregate student loan debt, or other accumulated, consecutive, or consolidated loan obligations."); In re Martin, 584 B.R. 886, 890–91 (Bankr. N.D. Iowa 2018) ("While the Court does not have the authority to partially discharge student loan debt or renegotiate the terms of a debtor's student loan repayment, the Court is not required to view the debtor's student loan obligation as one lump sum. The Court must determine whether each loan, separately, imposes an undue hardship and may discharge some loans while declining to discharge others.") (citing Conway, 495 B.R. at 423 ("'[A]pplication of § 523(a)(8) to each of ... the loans separately was not only allowed, it was required.'") (quoting Andresen v. Neb. Student Loan Program, Inc. (In re Andresen), 232 B.R. 127, 137 (8th Cir. BAP 1999)).

2. **Rather than holding the entire student loan debt nondischargeable, some courts have granted a partial discharge (while acknowledging the Bankruptcy Code does not explicitly authorize that kind of relief) based on the rationale that "an all-or-nothing approach to the dischargeability of student debt contravenes Congress' intent in granting bankruptcy courts equitable authority" to enforce the Code. Saxman v. Educ. Credit Mgmt. Corp. (In re Saxman), 325 F.3d 1168, 1174 (9th Cir. 2003).**

    a. **Some courts have invoked the equitable powers vested in bankruptcy courts under Bankruptcy Code section 105 to justify allowing a partial discharge, but only where the debtor proves undue hardship.**

See, e.g.

**6th Cir.**
In re Tirch, 409 F.3d 677, 680 (6th Cir. 2005) (reversing grant of partial discharge because debtor failed to demonstrate that her circumstances meet the Brunner standard to qualify for an "undue hardship" partial discharge of her student loans).

In re Miller, 377 F.3d 616, 622 (6th Cir.2004) (holding that "the requirement of undue hardship must always apply to the discharge of student loans in bankruptcy-regardless of whether a court is discharging a debtor's student loans in full or only partially.")

**9th Cir.**
In re Saxman, 325 F.3d 1168 (9th Cir. 2003)("before the bankruptcy court can partially discharge student debt pursuant to § 105(a), it must first find that the portion being discharged satisfies the requirements under § 523(a)(8)"; holding that the bankruptcy court should determine how much of the loan would create an undue hardship, and only the portion that results in undue hardship should be discharged.)

**10th Cir.**
In re Alderete, 412 F.3d 1200, 1207 (10th Cir. 2005) ("We agree with our sister circuits that a bankruptcy court cannot exercise its § 105(a) powers to grant a partial discharge of student loans unless § 523(a)(8) has been satisfied.").

In re Regan, 590 B.R. 567, 576 (Bankr. D.N.M. 2018) ("the Court does not have the discretion to grant a partial discharge of Ms. Regan's student loans when she has not demonstrated that an undue hardship exists.")

**11th Cir.**
In re Bumps, No. 6:11-BK-06677-ABB, 2014 WL 185336, at *3 (Bankr. M.D. Fla. Jan. 15, 2014) (granting partial discharge where Brunner test was satisfied; "Considering the duration Debtor will likely remain in the workforce, along with her earning capacity, given her current and most recent work history, $12,000.00 of the Loan is due to be discharged and the remaining balance is due to be determined nondischargeable.").

b. **Where the debtor fails to establish undue hardship, some courts have invoked the equitable powers vested in bankruptcy courts under Bankruptcy Code section 105 to justify allowing a partial discharge. These courts have granted the "partial discharge" remedy without requiring the test of undue hardship to be satisfied as to any portion of the debt.** [15]

See, e.g.

[15] **However, this approach has been criticized.** See, e.g. In re Alderete, 412 F.3d 1200, 1207 (10th Cir. 2005)(emphasizing that a bankruptcy court may not exercise its §105 equitable powers to grant a partial discharge of student loans unless the requirements of § 523(a)(8) are also satisfied—a restriction that appears to render the court's equitable powers superfluous in such circumstances since this authority is resorted to in precisely those cases when the undue-hardship test is not satisfied.); In re Fields, 286 Fed. Appx. 246 (6th Cir. 2007); Hemar Ins. Corp. v. Cox (In re Cox),338 F.3d 1238 (11th Cir.2003), cert. denied, 541 U.S. 991, 124 S.Ct. 2016, 158 L.Ed.2d 496 (2004) ("Because the specific language of § 523(a)(8) does not allow for relief to a debtor who has failed to show 'undue hardship,' the statute cannot be overruled by the general principles of equity contained in § 105(a)."); In re Miller, 377 F.3d 616 (6th Cir. 2004) (holding modified on other grounds by, In re Oyler, 397 F.3d 382 (6th Cir. 2005)); In re Davis, 373 B.R. 241 (W.D. N.Y. 2007); In re Fraley, 247 B.R. 417, 422 (Bankr. N.D. Ohio 2000)(court reasoned that merely establishing that a debtor will benefit from a partial discharge does not suffice to warrant invoking the court's equitable powers under § 105(a) since all debtors would benefit by having their student loan debts partially discharged. Instead, the court reasoned, a bankruptcy court may act only if it finds that the equities of the situation tip distinctly in favor of the debtor.); In re Modeen, 586 B.R. 298 (Bankr.W.D. Wis. 2018).

Tenn. Student Assistance Corp. v. Hornsby (In re Hornsby), 144 F.3d 433, 440 (6th Cir. 1998). The Sixth Circuit endorsed a partial discharge in Hornsby, ruling that even if a debtor fails to meet her burden under section 523(a)(8), the debt may be partially discharged "where facts and circumstances require intervention in the financial burden on the debtor." Id. at 439. In doing so, the court found debtors had not minimized expenses in every way possible and their financial prospects would likely improve with time. Id. The Sixth Circuit ruled the **bankruptcy court had the discretion under section 105 to grant a partial discharge even where the debtor had not proved all the elements of an undue hardship.** In Hornsby, the 6th Circuit stated:

> Where a debtor's circumstances do not constitute undue hardship, some bankruptcy courts have thus given a debtor the benefit of a "fresh start" by partially discharging loans, whether by discharging an arbitrary amount of the principal, interest accrued, or attorney's fees; by instituting a repayment schedule; by deferring the debtor's repayment of the student loans; or by simply acknowledging that a debtor may reopen bankruptcy proceedings to revisit the question of undue hardship. We conclude that, pursuant to its powers codified in § 105(a), the bankruptcy court here may fashion a remedy allowing the Hornsbys ultimately to satisfy their obligations to TSAC while at the same time providing them some of the benefits that bankruptcy brings in the form of relief from oppressive financial circumstances.

Hornsby, 144 F.3d at 440 (6th Cir. 1998)[16]

In re Kapinos, 243 B.R. 271 (W.D. Va. 2000)("If the bankruptcy court finds that the Brunner standard has been met, it may, in exercise of its equitable power, discharge all of Kapinos' loans or only a portion of them. Likewise, the bankruptcy court may exercise its equitable power under § 105 to discharge a portion of Kapinos' student loans even if it finds that the Brunner standard has not been satisfied."). The bankruptcy court's findings of fact were insufficient to determine whether the first or third prongs of Brunner —inability to maintain a minimal standard of living and good faith—have been met. The District Court therefore remanded the matter to the bankruptcy court for additional findings of fact, to identify the particular monthly expenses that the debtor could reduce and the total amount of reducible expenses, and to determine whether the debtor has satisfied the "good faith" standard of Brunner.

Miller v. Pa. Higher Educ. Assistance Agency (In re Miller), 377 F.3d 616, 620 (6th Cir.2004) ("when a debtor does not make a showing of undue hardship with respect to the entirety of her student loans, a bankruptcy court may—pursuant to its § 105(a) powers—contemplate granting the various forms of relief discussed in Hornsby, including granting a partial discharge of the debtor's student loans.")

[16] Hornsby has been criticized for "seem[ing] to swallow the statutory exception to discharge mandated by Congress in the case of student loans." Saxman, 325 F.3d at 1174. "Taken at face value, the ruling in Hornsby gives courts license to sidestep the explicit language in section 523(a)(8) by discharging a student loan where a debtor has demonstrated no 'undue hardship.'" In re Modeen, 586 B.R. 298,306 (Bankr.W.D. Wis. 2018).

In re Stevenson, 463 B.R. 586 (Bankr. D. Mass. 2011)(applying section 105 - While 50-plus-year-old Chapter 7 debtor, due to housing subsidy that she received that reduced her monthly rental payments from $1,109 to $409, actually had slight income surplus and was not entitled to "undue hardship" discharge of her $114,680.69 in student loan debt, especially considering her eligibility to participate in Income Contingent Repayment Plan (ICRP), bankruptcy court, in recognition of debtor's precarious situation and of fact that loss of subsidy or other benefits might once again render her homeless and impact on her payment of her debt through the ICRP, would grant debtor a prospective discharge of whatever student loan debt she still had at expiration of the ICRP)

In re Modeen, 586 B.R. 298 (Bankr.W.D. Wis. 2018): While Chapter 7 debtor's failure to satisfy the second, or "additional circumstances," prong of Brunner test for whether she was entitled to "undue hardship" discharge of her student loan debt prevented her from obtaining "undue hardship" discharge of her entire $34,231.55 in student loan debt, equities of case, in which debtor lacked present ability to pay more than $208 per month on her student loans, and in which debtor had made good faith effort to maximize her income and minimize her expenses, favored the grant of partial "undue hardship" discharge of so much of this debt as debtor could not pay off by paying $208 per month for 20 years. In Modeen, the Bankruptcy Court stated:

> There are no clear guidelines on when a court should grant a partial discharge on student loans. In general, it should be "reserved for appropriate circumstances" when "the equities of the situation weigh distinctly in favor of the debtor." …
> The Court finds the equities of this case favor the granting of a partial discharge. The Court finds the as-written terms of the student loan would impose an undue hardship. Defendant simply does not have room in her budget to pay the balance of $34,231.55 that is due in full, nor could she reasonably be expected to pay $694.47 per month. The parties agree she cannot continue to make that monthly payment. Defendant lives paycheck to paycheck and has minimal savings.
> Given her age and earning potential, the Court finds Defendant could reasonably repay some portion of the loan. She is employed and has marketable experience. Her income will increase to some extent as she gains more experience. Though her daughter is still young enough to rely on her for financial help, her expenses will eventually decrease as her daughter becomes more independent. Her daughter could certainly seek some employment—even part-time—to contribute something toward expenses.
>
> ****
>
> Modeen has failed to demonstrate an undue hardship for a full discharge under Brunner. Her Schedules suggest she cannot meet a minimal standard of living, but it also seems some of her expenses could reasonably be reduced. Even with a reduction in expenses, however, Defendant will not be able to make the full payment on the loan when due. Debtor is granted a partial discharge to give her the opportunity to satisfy the portion of the loan she can pay.

Modeen, 586 B.R. at 306–08 (Bankr. W.D. Wis. 2018) [footnotes omitted]

In Modeen, the loans were refinanced, and were therefore no longer eligible for federal repayment programs. Thus, the court distinguished Modeen from other cases where those repayment programs were available. "Without the availability of a repayment program, her plea to this Court may be her last chance to obtain relief from a crushing financial quagmire." Modeen, 586 B.R. at 307.

The Modeen court used federal repayment plans as a guideline for determining how much the debtor could reasonably pay. Under one payment plan, the debtor's monthly payment would be determined by applying her tax filing status, adjusted gross income, family size, geographic area and estimated income growth. The court also considered evidence of what the daughter could reasonably contribute toward expenses (even with the daughter's medical condition).

Ultimately, the court determined that the debtor must pay $208 per month for 154 months, which would be recalculated annually based on income, tax-filing status and family size. Any unpaid debt on the student loan would be discharged if the debt was not repaid in full after 20 years.

**Remedies Other Than Partial Discharge**

**Some courts have modified loan repayment schedules to ease the financial burden of monthly payments at least where the debtor is able to make some payment.**

See, e.g.

In re Wells, 380 B.R. 652, 663 (Bankr. N.D.N.Y. 2007) (declining to grant the debtor a partial discharge and adjudging debtor's student loan obligation nondischargeable pursuant to Code § 523(a)(8) but ordering that "it is appropriate to allow the Debtor a year's deferment, without further accumulation of interest for that year, before he has to begin making payments on the student loan obligation. Hopefully, this will allow the Debtor's spouse to obtain additional or alternative employment, thereby increasing their income combined to allow for such payments.")

In the Matter of Roberson, 999 F.2d 1132 (7th Cir. 1993) (payments deferred for two years)

In re Conner, 89 B.R. 744 (Bankr. N.D. III. 1988) (discharge denied, but payment deferred until expenses reduced when daughters graduated from college).

# On the Edge

By Vincent J. Roldan and Elizabeth L. Gunn

## Trekking Through the Quagmire

### A Creative Discharge Solution to the Student Loan Crisis

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**Editor's Note:** *For more on this topic, purchase* Graduating with Debt: Student Loans under the Bankruptcy Code (2nd Edition)*, now available in the ABI Store (store.abi.org). Members must log in first to obtain reduced pricing.*

There is about $1.41 trillion in outstanding student loan debt — more than total credit card debt and more than auto loan debt, according to the Federal Reserve Bank of New York's quarterly report on household debt and credit.[1] More than 10 percent of this debt is delinquent or in default. There are about 44 million student loan borrowers, the average amount of debt per borrower is $39,400,[2] and the level of debt has grown significantly in recent years. Since 2008, student loan debt relative to overall household debt has grown from 5 percent to 30 percent.[3] This growth has some commentators predicting that the student loan industry is the next economic "bubble" that will burst.[4]

One congressman has introduced legislation to assist borrowers with burdensome student loan debt.[5] For the time being, student loan borrowers must evaluate their repayment options in the context of the current environment in which bankruptcy and discharge is likely not an option for the large majority of these borrowers. However, bankruptcy courts might be increasingly willing to relax the standard to discharge governmental student loans, or at least a portion thereof. The recent case *In re Modeen*[6] is an example.

## The Standard

Although individuals with mounting debt might seek relief under the Bankruptcy Code and use the discharge provisions to help obtain a "fresh start," individuals with student loan debt face an uphill battle. Section 523(a)(8) of the Bankruptcy Code denies such individuals the benefit of a discharge.

Section 523(a)(8) provides that a bankruptcy discharge does not discharge "an educational ... 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."[7] Individual debtors generally receive no discharge for "any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986."[8] As pointed out in *Modeen*, the Bankrupcy Code denies the discharge of student loan debt "unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents."[9]

The term "undue hardship" is not defined in the Bankruptcy Code. The *Modeen* court, like many other courts, cited to *Brunner v. New York State Higher Educ. Servs. Corp.*, which held that in order to support a finding of undue hardship, the court must find:

> (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.[10]

The debtor has the burden of establishing each element of the *Brunner* test by a preponderance of the evidence.[11]

## *Modeen* Facts

In *Modeen*,[12] the debtor was an individual in her mid-30s who worked full-time as an office manager and a few hours per week at a second job. She had an 18-year-old daughter whom she supported. Between her two jobs, she earned about $688 per week net of taxes, and her 2017 adjusted gross income was $40,997. She had $34,231.55 in student loan debt, and her required monthly payments were $694.47. She argued that her income and expenses

1 "Total Household Debt Rises for 15th Straight Quarter, Led by Mortgages, Student Loans," Federal Reserve Bank of New York (May 17, 2018), *available at* newyorkfed.org/newsevents/news/research/2018/rp180517 (unless otherwise specified, all links in this article were last visited on Oct. 29, 2018).

2 "A Look at the Shocking Student Loan Debt Statistics for 2018," Student Loan Hero (May 1, 2018), *available at* studentloanhero.com/student-loan-debt-statistics.

3 Noah Smith, "The Financial Crisis Isn't Over for Students," Bloomberg (March 27, 2018), *available at* bloomberg.com/view/articles/2018-03-27/financial-crisis-is-over-for-housing-but-not-for-student-loans.

4 Jim Rogers and Robert C. Baum, "This Economic Bubble Is Going to Wreak Havoc When It Bursts," *Fortune* (July 10, 2017), *available at* fortune.com/2017/07/10/higher-education-student-loans-economic-bubble-federal.

5 "Rep. Peter DeFazio Introduces Legislation to Improve Student Loan Assistance and Expand College Access," Press Release (April 18, 2018), *available at* defazio.house.gov/media-center/press-releases/rep-peter-defazio-introduces-legislation-to-improve-student-loan.

6 *In re Modeen*, 586 B.R. 298 (Bankr. W.D. Wis. 2018).

7 11 U.S.C. § 523(a)(8)(A)(i).

8 11 U.S.C. § 523(a)(8)(B).

9 *Modeen* at 302.

10 *Id.* (citation omitted).

11 *Id.* (citation omitted).

12 *Id.* at 301.

*continued on page 98*

## On the Edge: Trekking Through the Quagmire: The Student Loan Crisis

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were such that payment of her student loans would be an undue hardship on her and her dependent daughter. What made the debtor's loans unique was that she refinanced the loans with an individual lender. Due to the refinancing, the debtor was not able to take advantage of federal student loan repayment programs.

The *Modeen* court quickly considered the first and third *Brunner* prongs, and found that the debtor would not be able to maintain a minimal standard of living if compelled to make her monthly payments of $694.47.[13] Even without including her student loan payments, her monthly income enabled her to barely cover her living expenses. In addition, the court found that the debtor made a good-faith effort to repay her loans, her expenses were not outrageous, and she sought a second job, which indicated that she had made efforts to repay her creditors.[14]

The court then examined the second *Brunner* prong: whether there were "additional circumstances" making it improbable that she would ever be able to repay her student loans. The *Modeen* court pointed out that in the Seventh Circuit, the bar for the second prong was set rather high.[15] Courts consider factors such as "psychiatric problems, lack of usable job skills, and severely limited education."[16] Then the court referenced two examples:

> In *Goulet*, a convicted felon with alcohol and substance abuse problems did not establish "additional, exceptional circumstances" necessary to satisfy this prong. Instead, he was "an intelligent man" who did not lack usable job skills and could "apply himself when he desire[d]." He had "simply failed to diligently pursue employment such that he would be able to alleviate his financial burdens." In *Roberson*, the debtor had "a bleak forecast for the near future" as he was unemployed, had lost his driver's license after a second drunk driving conviction, and had wrist and back injuries. However, those circumstances were only temporary, as his medical condition was not "insurmountable," he would be able to regain his driver's license, and neither the injuries nor the loss of license prevented him from finding employment in the future.[17]

The *Modeen* court then considered the debtor's circumstances and found that she had not shown "exceptional hopeless circumstances."[18] She was employed, had held various jobs for the past five years, and had marketable skills in human resources and health care. She had an associate of arts degree from the University of Phoenix, a technical diploma, with honors, certificates in gerontology, and was qualified to provide care to aging adults.[19] She showed persistence in finding and obtaining employment.[20]

13 *Id.* at 302.
14 *Id.* at 305.
15 *Id.* at 303.
16 *Id.* (citation omitted).
17 *Id.* (citing *Goulet v. Educ. Credit Mgmt. Corp.*, 284 F.3d 773, 778 (7th Cir. 2002); *In re Roberson*, 999 F.2d 1132, 1135 (7th Cir. 1993)).
18 *Id.*
19 *Id.* at 303.
20 *Id.*

The *Modeen* court also noted that while there are many cases where a court discharges student loans of a debtor is near retirement age or is handicapped, the debtor in *Modeen* was neither.[21] The debtor asserted that her dependent daughter made her circumstances unique.[22] However, the court was persuaded by cases that criticize debtors who claim expenses for the care of adult live-in children.[23]

### Partial Discharge

Even though the debtor in *Modeen* did not meet the *Brunner* elements, the court analyzed whether the debtor was eligible for a partial discharge. Courts acknowledge that the Bankruptcy Code does not explicitly authorize a partial discharge, but they recognize that "an all-or-nothing approach to the dischargeability of student debt contravenes Congress's intent in granting bankruptcy courts equitable authority" to enforce the Code.[24] The *Modeen* court surveyed decisions in the Sixth, Seventh and Ninth Circuits and concluded:

> There are no clear guidelines on when a court should grant a partial discharge on student loans. In general, it should be "reserved for appropriate circumstances" when "the equities of the situation weigh distinctly in favor of the debtor."[25]

The *Modeen* court found that the equities favored the granting of a partial discharge. The debtor simply did not have enough "room in her budget" to repay the balance of the $34,231.55 loan, nor could she reasonably be expected to pay $694.47 per month.[26] Since the loans were refinanced, the loans were also no longer eligible for federal repayment programs.[27] Thus, the court distinguished *Modeen* from other cases where those repayment programs were available.[28] Without the ability to use a repayment program, "her plea to this Court [might] be her last chance to obtain relief from a crushing financial quagmire."[29]

The court used federal repayment plans as a guideline for determining how much the debtor could reasonably pay.[30] Under one payment plan, the debtor's monthly payment would be determined by applying her tax-filing status, adjusted gross income, family size, geographic area and estimated income growth.[31] The court also considered evidence of what the daughter could reasonably contribute toward expenses (even with the daughter's medical condition).[32]

Ultimately, the court determined that the debtor must pay $208 per month for 154 months, which would be recalculated each year based on income, tax-filing status and family size.[33]

21 *Id.* at 304.
22 *Id.*
23 *Id.*
24 *Id.* at 305.
25 *Id.* at 306.
26 *Id.*
27 *Id.*
28 *Id.* at 307.
29 *Id.*
30 *Id.* at 308.
31 *Id.*
32 *Id.*
33 *Id.*

Any unpaid debt on the student loan would be discharged if the debt was not repaid in full after 20 years.[34]

## Practical Considerations

The court's discharge of the balance of the student loan debt in *Modeen* is dependent upon a 20-year period of repayment. However, what is not clear is how this discharge will be practically enforced or completed.

Can the debtor pre-pay the debt? What happens if a payment is late; can she cure the default? What is the process to certify the completion of the payments after 20 years; will she need to reopen her bankruptcy case and request entry of the discharge, or is it self-executing? What remedy would she have if the student loan lender continues to report the debt to reporting agencies after 20 years? Could the student loan lender request a modified review of the partial discharge after 10 years if the debtor's financial circumstances change, similar to a chapter 13 trustee's motion to modify a plan during the case for increased financial circumstances?

The *Modeen* decision suggests that had the debtor been able to use a federal repayment plan, she would have been denied even a partial discharge. However, the decision does not address the effectiveness of any particular program. The news is full of reports on the difficulties faced by student loan borrowers participating in federal repayment or forgiveness programs. For example, a recent NPR story highlighted the Public Service Loan Forgiveness (PSLF) program, which was promulgated in 2007.[35] The requirements appear to be simple:

> The PSLF Program was established by Congress with the passage of the College Cost Reduction and Access Act of 2007, and was created to encourage individuals to enter lower-paying but vitally important public-sector jobs such as military service, law enforcement, public education, and public health professions. The PSLF Program allows eligible borrowers to qualify for forgiveness of the remaining balance of their William D. Ford Federal Direct Loan ... Program loans after they have served full time at a public service organization for at least 10 years, while making 120 qualifying payments.[36]

According to the NPR article, 99 percent of applicants under the PSLF program who have completed 10 years of public-service employment are denied any relief.[37] In many cases, the individuals completed all of the steps and made all 120 monthly payments, but were still denied any form of relief.[38] This issue is just now coming to the forefront because the PSLF program was passed in 2007, resulting in the first applications for relief being filed in the past approximately 12 months.

## Conclusion

The *Modeen* decision is a recent case that, at first blush, appears to represent a trend toward a more relaxed standard for "undue hardship" under § 523(a)(8). The case might be of limited precedential value because the facts were unique: The debtor did not qualify for any federal student loan repayment program.

The mere existence of a possible repayment plan does not automatically disqualify a debtor from discharge. One court recognized that "[h]olding that eligibility for [an income-based repayment plan] *ipso facto* leads to denial of an undue hardship discharge would deprive the Court of the discretion granted by § 523(a)(8)."[39] It remains to be seen whether courts will be critical of programs such as PSLF such that in the future, decisions might become more lenient toward discharge. abi

34 *Id.* The court did not articulate whether there would be any payments due between the 154-month mark (12 years and 10 months) and year 20. The court considered a similar payment plan under a particular federal repayment program, under which there was a 15-year repayment and any remaining debt would be forgiven after 25 years. *Id.* at 308.

35 Cory Turner, "Why Public Service Loan Forgiveness Is So Unforgiving," NPR (Oct. 17, 2018), *available at* npr.org/2018/10/17/653853227/the-student-loan-whistleblower.

36 "Public Service Loan Forgiveness Program," Federal Student Aid (November 2014), *available at* studentaid.ed.gov/sa/sites/default/files/public-service-loan-forgiveness-employment-certification-borrower-letter.pdf.

37 *See* Turner, *supra* n.35.

38 *Id.*

39 *Fern v. Fedloan Servicing (In re Fern)*, 553 B.R. 362 (Bankr. N.D. Iowa 2016) (discharging student loans at issue even though debtor was eligible for plan under which debtor would pay $0 per month, after considering mounting indebtedness due to unpaid interest and emotional burden on debtor).

April 16, 2016

# Lower Courts Split on Nondischargeability of Education-Related Loans

## New York judges narrowly define 'educational benefit' to discharge student loans.

Disagreeing with several other lower courts, two bankruptcy judges from the Eastern District of New York held within the last month that some types of education loans are not excepted from discharge as an "educational benefit" under Section 523(a)(8)(A)(ii).

The first case, decided on March 24 by Chief Bankruptcy Judge Carla E. Craig of Brooklyn, N.Y., held that a bar loan is an ordinary consumer loan, not an "educational benefit" that would be nondischargeable.

In her case, a student in law school got a $15,000 bar loan in 2009 from a commercial lender. She paid the loan until 2012 and filed a chapter 7 petition in 2014. After receiving a discharge, she sued the lender, seeking a declaration that the loan was discharged. The lender filed a motion to dismiss and lost.

The loan would not have been nondischargeable under Section 523(a)(8)(A)(i) because it was neither guaranteed by the government nor made by a nonprofit institution. Consequently, the lender contended that the loan was an "educational benefit" excepted from discharge under subsection (a)(8)(A)(ii).

Judge Craig said that some courts have held that an "educational benefit" includes "any loan which relates in some way to education." She said such a "broad interpretation" would "render superfluous most of the other provisions in Section 523(a)(8)."

"Educational benefit," she said, must be read in tandem with "scholarship or stipend," the other descriptive words in the subsection, and that those words must refer to "something other than a loan." In her view, subsection (a)(8)(A)(ii) refers to "types of conditional grants."

Judge Craig disagreed with bankruptcy courts elsewhere that explicitly hold that bar loans are nondischargeable. She also disagreed with those courts holding that 2005 amendments to the subsection no longer limit nondischargeability to loans made or guaranteed by "governmental units or non-profits."

Bankruptcy Judge Robert E. Grossman of Central Islip, N.Y., agreed with Judge Craig's analysis in his opinion on April 4. Judge Grossman's case involved a woman with $160,000 in loans incurred to secure a "degree" from an unaccredited, unlicensed foreign medical school. He held that the loan was dischargeable because it did not fall within the exception to discharge under subsection (a)(8)(A)(ii).

Judge Grossman read the statute to mean that an “educational benefit” excepted from discharge in the subsection “refer[s] to educational debts other than loans.” He said that the subsection “is not a ‘catch-all’ provision designed to encompass any educational claim arising out of any transaction that bestows an educational benefit on a debtor.”

The loan in Judge Grossman’s case did not fall within any of the other categories that would render the debt nondischargeable because the loan was not a “qualified education loan,” nor was it made or guaranteed by the government or a nonprofit institution.

Because she held that a bar loan is not an “educational benefit,” Judge Craig did not go so far as other courts by holding that obligations under subsection (ii) must meet one of the requirements in subsection (i).

Educational Benefit on Appeal

- *In re McDaniel*, 590 BR 537 (Bankr. D. Colo. 2018): Navient's Petition For Direct, Interlocutory Appeal to 10th Circuit Court of Appeals granted (Order attached).

- *In re Homaidan*, 2019 WL 442047 (Bankr. E.D.N.Y. Jan. 31, 2019): Application to Request Certification of Direct Appeal to Court of Appeals filed.

- *In re Crocker*, 585 BR 830 (Bankr., S.D. Tex. 2018): 2/5/19 – Oral Argument Heard by 5th Circuit Court of Appeals

**UNITED STATES BANKRUPTCY COURT**
**SOUTHERN DISTRICT OF NEW YORK**

**FOR PUBLICATION**

| | |
|---|---|
| In re:<br><br>BRUCE STERMAN and LUBA PINCUS,<br><br>Debtors. | Case No. 16-10378 (MG) |
| ROBERT GELTZER, as Chapter 7 Trustee of BRUCE STERMAN and LUBA PINCUS<br><br>Plaintiff,<br><br>v.<br><br>OBERLIN COLLEGE, OBERLIN STUDENT COOPERATIVE ASSOCIATION, NELNET, INC., ALEXANDRA STERMAN, and SAMANTHA STERMAN,<br><br>Defendants. | Adv. Pro. Case No. 18-01015 (MG) |

**MEMORANDUM OPINION AND ORDER GRANTING IN PART AND DENYING IN PART CROSS-MOTIONS FOR SUMMARY JUDGMENT**

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**MARTIN GLENN**
**UNITED STATES BANKRUPTCY JUDGE**

The Chapter 7 Trustee, Robert L. Geltzer (the "Trustee"), seeks to recover as constructive fraudulent transfers amounts paid by the Chapter 7 co-debtors, Luba Pincus and Bruce Sterman (the "Debtors"), to or for the benefit of their two daughters, defendants Alexandra Sterman and Samantha Sterman (the "Defendants"), allegedly for college tuition, books and supplies, and room and board while they were students at Oberlin College. The Trustee and the Defendants filed cross-motions for summary judgment (the "Trustee's Motion," ECF Doc. # 24; the "Defendants' Motion," ECF Doc. # 22 at 11). The Defendants' Motion is supported by the affidavits of debtor Luba Pincus (the "Pincus Affidavit," ECF Doc. # 22 at 1) and debtor Bruce Sterman (the "Sterman Affidavit," ECF Doc. # 22 at 5).

The parties also entered a stipulation of undisputed facts (the "Stipulated Facts," ECF Doc. # 21). The Stipulated Facts indicate that some of the transfers to or for the benefit of Samantha were made while she was a college student *before* she was 21 years old and some were made while she was a college student *after* she was 21 years old. The Stipulated Facts indicate that the transfers to or for the benefit of Alexandra were made *after* she was 21 years old and *had already graduated from college*. According to the Stipulated Facts, since Alexandra graduated college in 2009, she has been "financially independent." (Stipulated Facts ¶ 15.)

The parties limit their cross motions to a request that the Court rule whether the Debtors received "reasonably equivalent value" for the transfers for college tuition and expenses; if the Debtors received reasonably equivalent value, the transfers would not be avoidable as constructive fraudulent transfers even if the Debtors were insolvent at the time of the transfers. There are two questions presented: first, did the Debtors receive reasonably equivalent value for their daughters' college educations and related expenses because their daughters' education will enhance their self-sufficiency; and second, does it matter whether the daughters were younger or older than 21 when the transfers were made?

For the reasons explained below, the Court grants the Trustee's Motion in part and denies it in part with respect to the transfers to or for the benefit of Samantha. The Trustee's Motion is granted with respect to the transfers to or for the benefit of Alexandra, as she was older than 21 and no longer a student when the transfers were made.

## I. BACKGROUND

The Debtors, Luba Pincus and Bruce Sterman, filed a joint chapter 7 petition on February 19, 2016 (the "Petition Date"). (The Stipulated Facts ¶ 2.) The Trustee filed an adversary proceeding to recover allegedly constructively fraudulent transfers made by the Debtors to or for the benefit of their daughters. (*Id.* ¶ 11-12.)[1]

Alexandra attended Oberlin College from 2005-2009; Samantha attended Oberlin College from 2009-2013. (*Id.* ¶ 15-19.) In the six years prior to the Petition Date, the Debtors made several transfers to or for the benefit of their daughters. The parties stipulate that the transfers were made in connection with the Defendants' "college educations at Oberlin College and related expenses, including school books and supplies, meals, campus housing/rent/utilities, transportation and birthday presents." (*Id.* ¶ 12.)

The Stipulated Facts state that Alexandra Sterman reached age 21 on January 12, 2008 and graduated from Oberlin College in 2009. (Stipulated Facts ¶¶ 13 & 14.) Exhibit A to the Complaint (ECF Doc. # 1) indicates that transfers to or for the benefit of Alexandra, totaling

[1] The Complaint also seeks to recover conveyances made to Oberlin College, Oberlin Student Cooperative Association, Navient Corporation, and Nelnet, Inc. The Trustee entered into a stipulation dismissing the Complaint against Nelnet, Inc. on September 24, 2018 (ECF Doc. # 30), and has since reached settlement agreements with Oberlin College, Oberlin Student Cooperative Association, and Navient Corporation. (ECF Doc. # 31-33.) Accordingly, the only remaining defendants are Alexandra and Samantha Sterman.

$15,675.00, were made between August 13, 2010 and October 13, 2015. Paragraph 12 of the Stipulated Facts states that "[t]he schedules of transfers that are attached to the Complaint as Exhibits A and B accurately describe the transfers to and/or for the benefit of the Defendants that are the subject of the Complaint." Those two exhibits list transfers between 2010-2015. Both the Stipulated Facts and the Pincus Affidavit state that Alexandra attended college between 2005 and 2009, and graduated in 2009, so it is clear under the Stipulated Facts that the transfers to or for the benefit of Alexandra all were made after she was 21 years old and after she graduated from Oberlin. The Pincus Affidavit also makes clear that "[s]ince graduation [Alexandra] has been fully employed, self sufficient and tax paying adult." (Pincus Affidavit ¶ 9.)

The Trustee claims that the transfers are constructively fraudulent. The Trustee seeks to recover $15,675.00 from Alexandra for transfers "while she was of majority age." (Stipulated Facts ¶ 16.) The Trustee seeks to recover $9,952.00 from Samantha; $2,276.00 of those transfers were made "in respect of college tuition and living expenses . . . while she was a minor, and $7,676.00 were made while she was of majority age."[2] (*Id.* ¶ 18.)

For purposes of the summary judgment motions, "the parties have agreed not to put solvency at issue." (Trustee's Motion ¶ 12, ECF Doc. # 11.) Therefore, the sole question is whether the Debtors received reasonably equivalent value for the transfers to or for the benefit of their daughters.[3]

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[2] Settled New York law recognizes parents' obligation to provide minor children with housing, food, education and healthcare. "[I]t is axiomatic that parents are obligated to provide for their children's necessities, such as food, clothing, shelter, medical care, and education." *In re Michel*, 572 B.R. 463, 475 (Bankr. E.D.N.Y. 2017) (quoting *In re Akanmu*, 502 B.R. 124, 132 (Bankr. E.D.N.Y. 2013). The age of majority in New York is 21 years old. *Columbia Cty. Dep't of Soc. Servs. ex rel. William O v. Richard O*, 262 A.D.2d 913, 914, 692 N.Y.S.2d 496, 498 (1999) ("As a general rule, parents are required to support a child until the child attains the age of 21 (*see,* Family Ct Act § 413 [1][a] ).").

[3] The Complaint also includes a claim for unjust enrichment. (Complaint ¶¶ 45-49.) The parties' summary judgment papers are silent on the unjust enrichment claim and only consider whether the conveyances were constructively fraudulent. Accordingly, the unjust enrichment claim is not presently before the Court.

## II. LEGAL STANDARD

### A. Summary Judgment

Rule 56(a) of the Federal Rules of Civil Procedure, made applicable by Bankruptcy Rule 7056, states that "[t]he court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a). To successfully assert that a fact is not in dispute or cannot be disputed, a movant must:

> cit[e] to particular parts of materials in the record, including depositions, documents, electronically stored information, affidavits or declarations, stipulations (including those made for purposes of the motion only), admissions, interrogatory answers, or other materials; or show[] that the material cited do not establish the absence or presence of a genuine dispute, or that an adverse party cannot produce admissible evidence to support the fact.

FED. R. CIV. P. § 56(c)(1).

"The party seeking summary judgment bears the burden of establishing that no genuine issue of material fact exists and that the undisputed facts establish [the movant's] right to judgment as a matter of law." *In re Soliman*, 515 B.R. 179, 185 (Bankr. S.D.N.Y. 2014), (citing *Rodriguez v. City of New York*, 72 F.3d 1051, 1060–61 (2d Cir. 1995)).

### B. Fraudulent Transfers

The Trustee claims that the transfers were constructively fraudulent pursuant to Bankruptcy Code § 544. Section 544 provides that the trustee may avoid a transfer of a debtor's property interest that is voidable under state law by a creditor holding an allowed unsecured claim. *See* 11 U.S.C. § 544(b)(1); *see also Banner v. Lindsay (In re Lindsay)*, Adv. Proc. No. 08-9091, 2010 WL 1780065, at *5 (Bankr. S.D.N.Y. 2010). The Trustee alleges that the transfers in question were fraudulent under the New York Debtor and Creditor Law ("NYDCL").

Under the NYDCL, a conveyance is fraudulent if it is incurred without "fair consideration." NYDCL §§ 273 and 275. "Fair consideration" is defined by the NYDCL as follows:

> fair consideration is given for property, or obligation,
> a. When in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or
> b. When such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained.

NYDCL § 272.

Ordinarily, the plaintiff bears the burden of proving a lack of fair consideration but where, as here, "the facts regarding the nature of the consideration are within the transferee's control, the burden of proving the fairness of consideration shifts to the transferee." *Ackerman v. Ventimiglia (In re Ventimiglia)*, 362 B.R. 71 (Bankr. E.D.N.Y. 2007).

The Trustee also argues that the conveyances were constructively fraudulent under Bankruptcy Code § 548. Under that provision, a trustee may avoid a transfer made by the debtor within two years of the filing of the petition if the debtor did not receive "reasonably equivalent value" in the exchange. 11 U.S.C. § 548(a)(1)(b). The Bankruptcy Code defines the term "value" as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." 11 U.S.C.A. § 548(d)(2)(A). The Bankruptcy Code does not define the term "reasonably equivalent value." *In re Gonzalez*, 342 B.R. 165, 169 (Bankr. S.D.N.Y. 2006). Courts have found that the term does not require the exchange to be "mathematically equal" but "[p]urely emotional benefits, such as love and affection" will not suffice. *Id.* at 169, 173. Both direct and indirect benefits flowing to the debtor may be considered. *In re Akanmu*, 502 B.R.

124, 130–31 (Bankr. E.D.N.Y. 2013) (quoting *Liquidation Trust v. Daimler AG (In re Old CarCo LLC)*, No. 11 Civ. 5039(DLC), 2011 WL 5865193, at *7 (S.D.N.Y. Nov. 22, 2011)). "Fair consideration" under the NYDCL and "reasonably equivalent value" under section 548(a)(1)(B)(i) have substantially the same meaning. *Id.* (citing *Picard v. Madoff (In re Bernard L. Madoff Inv. Sec. LLC)*, 458 B.R. 87, 110 (Bankr.S.D.N.Y.2011)).[4]

## III. DISCUSSION

The conveyances in this case must be broken down into three categories: (A) transfers made for education-related expenses to or for the benefit of both daughters after they reached the age of majority so that they could attend Oberlin College,[5] (B) transfers made for education-related expenses to or for the benefit of Samantha when she was a minor, and (C) transfers to Alexandra after she graduated from college. Summary judgment should be granted to the Trustee with respect to categories (A) and (C) and denied with respect to category (B). Summary judgment should be denied to Alexandra and Samantha with respect to category (A) and (C) and granted to Samantha with respect to category (B).[6]

### A. The Education Related Transfers Made after the Defendants Reached the Age of Majority

There is a developing body of law regarding whether college tuition payments made by parents for the education of their children after they reach the age of majority are constructively

4 Both section 548 of the Bankruptcy Code and the NYDCL require that the trustee establish that the Debtors were insolvent when the transfers were made. Whether the Debtors were insolvent at the times of the transfers remains unresolved.

5 All the challenged transfers to or for the benefit of Alexandra were made *afte*r reached the age of majority (21) and *after* she graduated from college in 2009, and while she was working and "financially independent." It is unclear how these transfers after Alexandra graduated were made so that Alexandra could attend Oberlin College from which she had already graduated. In any event, as explained below, the Court concludes that the Debtors did not receive reasonably equivalent value for transfers made to or for the benefit of Alexandra or Samantha after they reached the age of 21.

6 The Complaint also seeks to recover $700 in cash gifts to Alexandra and Samantha. The Stipulated Facts do not provide any details about those gifts. Nothing in this Opinion addresses the issues concerning the cash gifts.

fraudulent. The Trustee points to several decisions where courts held that pre-petition college tuition payments are avoidable because the debtor parents did not receive reasonably equivalent value in exchange for the tuition payments. *See Boscarino v. Bd. of Trs. of Conn. State Univ. Sys. (In re Knight*), 2017 WL 4410455 (Bankr. D. Conn. 2017); *Roach v. Skidmore Coll. (Matter of Dunston),* 566 B.R. 624, 636-37 (Bankr. S.D. Ga. 2017); *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444 (Bankr. E.D. Mich. 2011); *Lindsay*, 2010 WL 1780065. The Defendants counter by pointing to case law holding that parents did receive reasonably equivalent value in exchange for college tuition payments. *See Lewis v. Penn. St. Univ. (In re Lewis)*, 574 B.R. 536, 541 (Bankr. E.D. Pa. 2017); *DeGiacomo v. Sacred Heart Univ., Inc. (In re Palladino)*, 556 B.R. 10, 16 (Bankr. D. Mass. 2016); *Trizechahn Gateway, LLC v. Oberdick (In re Oberdick)*, 490 B.R. 687, 712 (Bankr. W. D. Pa. 2013); *Sikirica v. Cohen (In re Cohen)*, 2012 WL 5360956, at *10 (Bankr. W. D. Pa. 2012).[7]

Whether insolvent parents receive reasonably equivalent value for college tuition payments made for the benefit of their adult children is a culturally and socially charged issue. With the greatest respect for the courts that have found reasonably equivalent value for such tuition payments, the Court is constrained by the language of the Bankruptcy Code and the NYDCL—those statutes define the terms "value" and "fair consideration" to require either the transfer of property or the satisfaction of an antecedent debt in return for an insolvent debtor's payments. 11 U.S.C.A. § 548(d)(2)(A); NYDCL § 272. The Debtors received neither in this

[7] The recent decision by the district court in *Pergament v. Brooklyn Law School*, 18-CV-2204 (ARR), 2018 WL 6182502 (E.D.N.Y. November 27, 2018), is inapposite. The court reversed the bankruptcy court's grant of summary judgment on constructive fraudulent transfer claims in favor of three universities that received tuition payments from a chapter 7 debtor for two of his children. The issue addressed by the district court was whether the colleges were initial transferees, or subsequent transferees that took the tuition payments in good faith. The issue whether the debtor received reasonably equivalent value for the tuition payments is not addressed.

case with respect to transfers made to or for the benefit of Alexandra and Samantha after they reached the age of majority—21 years old in New York State.[8]

Alexandra and Samantha argue that their parents received reasonably equivalent value because the transfers made after they were adults increased the likelihood that they would be self-sufficient. (Pincus Affidavit ¶ 23.) The Massachusetts bankruptcy court reached that conclusion in *In re Palladino*, 556 B.R. at 16. In that case, the debtors made pre-petition tuition payments so that their daughter could attend college. *Id.* at 12. The Trustee attempted to set aside the tuition payments on a theory of constructive fraud. *Id.* at 13. The court ruled against the trustee because it found that the parents received an economic benefit from the tuition payments. The court stated:

> I find that the [debtors] paid [the college] because they believed that a financially self-sufficient daughter offered them an economic benefit and that a college degree would directly contribute to financial self-sufficiency . . . A parent can reasonably assume that paying for a child to obtain an undergraduate degree will enhance the financial well-being of the child which in turn will confer an economic benefit on the parent. This, it seems to me, constitutes a *quid pro quo* that is reasonable and reasonable equivalence is all that is required.

*Id.* at 16.

The court's conclusion is supported by studies on the value of a college education to a family. *See* Brief *Amici Curiae* of American Council on Education, and 19 Other Education Associations in Support of Sacred Heart University, Inc. and Affirmance, at 4-7, *Degiacomo v.*

8 State law determines the age of majority. It defines the age below which parents are required to provide financial support for their children. The State law requirement to provide financial support establishes the antecedent debt that is satisfied by the payment for tuition and related expenses. As already indicated, New York law sets the age of majority at 21. *See supra* n.3. *In re Knight*, 2017 WL 4410455, one of the best reasoned decisions concluding that tuition payments for adult children does not provide reasonably equivalent value arose from transfers for college tuition for a child over 18 years of age in Connecticut. Unlike New York which defines the age of majority as 21, Connecticut defines the age of majority as 18. *See Spencer v. Spencer*, 10 N.Y.3d 60, 63 (2008).

*Sacred Heart University*, No. 17-1334 (1st Cir. Jul. 27, 2017) (citing studies showing that a college degree improves an individual's chances of gaining employment, increases their average income, and decreases the chances that they will live with their parents).

The Court does not question whether the Debtors' decision to send money to or for the benefit of their adult daughters for their college education was economically prudent. But, unfortunately, the economic "benefit" identified by the Defendants does not constitute "value" under the NYDCL or the Bankruptcy Code.

In *In re Lindsay*, 2010 WL 1780065*,* Judge Morris ordered avoidance, as constructively fraudulent transfers, of college tuition payments made for the benefit of the debtors' son. It is unclear whether the tuition payments were made before or after the son turned 21. The opinion only refers to the "adult son" living with his parents. *Id.* at 1. The court rejected the defendants' argument that a legal obligation to pay the tuition existed.[9] The defendants argued that they had a legal and moral obligation to pay for their child's education. *Id.* at *9. But the defendants did not point to any authority supporting these arguments. *Id.* ("The Court is not aware of any law requiring a parent to pay for a child's college education. Defendants do not offer any authority in support of their argument that a judgment debtor's 'moral obligation' to pay for a child's college education is a defense to [the NYDCL]."). To the extent that *Lindsay* is read to require avoidance for tuition and education-related expenses for adult children, this Court agrees with the decision. *See also Knight*, 2017 WL 4410455*,* at *5 ("While such support is unquestionably

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[9] *In re Lindsay*, No. 06-36352 (CGM), 2010 WL 1780065, at *9 (Bankr. S.D.N.Y. May 4, 2010) ("Defendants admit that they transferred proceeds of certain assets sales to a university for their son's education. The Court notes at the outset that Defendants produce no evidence of their alleged legal obligation to pay their son's tuition, such as a promissory note in favor of the university or a lender. The Court is not aware of any law requiring a parent to pay for a child's college education.").

admirable . . . it is undisputed that the Debtor had no legal obligation [to] pay for her adult son's college education.").[10]

The Defendants here also argue that the Debtors received "psychic and other intangible benefits" from the conveyances. (Defendants' Opposition Brief, at 12.) The Defendants explain:

> The debtors benefited when they paid rent by knowing their daughters had a roof over their heads on campus. The debtors benefited when they paid utilities by knowing their daughters has [sic] heat and light to read their books on campus. The debtors benefited when they paid health insurance by knowing their daughters could receive medical care. The debtors benefitted when they paid for transportation to and from Oberlin by knowing their daughters were travelling safely to and from campus.

(*Id.* at 11.) The Defendants support this argument by citing to *In re Gonzalez*, 342 B.R. 165. In that case, the debtor had a son out of wedlock with a woman named Karen. *Id.* at 167. Although he had no legal obligation to do so, the debtor made regular monthly payments on a mortgage for the home where his son and Karen lived. *Id.* The debtor claimed "that he made the payments to support his son . . . and because Karen was unable to keep current on the note and could not otherwise provide a proper home for [their son]." *Id.* The debtor spent "all of his weekends" at the home with Karen and his son. *Id.* at 167. The trustee argued that the mortgage payments made by the debtor were avoidable because they were constructively fraudulent. *Id.* at 168. The court ruled against the trustee. The Defendants correctly point out that the *Gonzalez* court's ruling was based in part because the debtor received "psychic" and "other intangible benefits" from the mortgage payments. *Id.* at 172. The Defendants ignore, however, that the court found that these benefits were "in addition to" the debtors' use of the property on a weekly basis. *Id.*

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[10] To the extent that *Lindsay* is read to require avoidance for tuition and education-related expenses for adult children, I agree with the decision. As explained in the next section of this Opinion, however, I reach a different result for transfers for tuition and education-related expenses for minor children, which I conclude may be supported by reasonably equivalent value.

Thus, *Gonzalez* does not stand for the proposition that "psychic" benefits alone constitute reasonably equivalent value, as the Defendants portend.

Accordingly, the Trustee's summary judgment motion with respect to the transfers made after Alexandra and Samantha reached the age of 21 is granted**.**

**B. Education Related Conveyances before Samantha Reached the Age of Majority**

The Stipulated Facts indicate that $2,276.00 of the transfers to or for the benefit of Samantha were made while she was a minor. (Stipulated Facts ¶ 18.) The Stipulated Facts also state that the transfers were made for her "college education[ ] at Oberlin College and related expenses, including school books and supplies, meals, campus housing/rent/utilities, transportation and birthday presents." (*Id.* ¶ 12.) While the case law does not *require* that parents pay for college tuition for a minor child at a private college to satisfy the parents' obligation to provide a minor child with education, the issue rather is whether the parents receive reasonably equivalent value when they do pay for such an education. On this issue, the Court agrees with Chief Judge Craig, writing in *In re Akkanmu:*

> The Trustee argues that New York law does not require the Debtors to provide parochial or private school education, and that the Debtors could have satisfied their obligation at no cost by sending the children to public school. This argument misses the point. The fact that the Debtors chose to educate their children in parochial school rather than public school, arguably exceeding the "minimum standard of care," does not change the fact that, by doing so, they satisfied their legal obligation to educate their children, thereby receiving reasonably equivalent value and fair consideration. It is irrelevant to this determination whether the Debtors could have spent less on the children's education, or, for that matter, on their clothing, food, or shelter. To hold otherwise would permit a trustee to scrutinize debtors' expenditures for their children's benefit, and seek to recover from the vendor if, in the trustee's judgment, the expenditure was not reasonably necessary, or if the good or service could have been obtained at a lower price, or at no cost, elsewhere. For example, a trustee could seek to avoid a debtor's payments to a restaurant for a meal purchased for the debtor's child, or payments

> to a department store for clothing purchased for the child, on a theory that adequate food or clothing could have been obtained at lower cost. A trustee could sue the vendor to recover the cost of a computer or other electronic device purchased pre-petition by a debtor for his child, on the theory that the item was not reasonably necessary. . . . . The absurdity of this scenario is obvious.
>
> A trustee is not granted veto power over a debtor's personal decisions, at least with respect to pre-petition expenditures. "[A] trustee's powers are not limitless." *In re Thompson*, 253 B.R. 823, 825 (Bankr. N.D. Ohio 2000). "[T]he 'Bankruptcy Code confers absolutely no power upon the trustee to make decisions concerning how a debtor manages his everyday affairs such as where the debtor will live or work.'" *French v. Miller (In re Miller)*, 247 B.R. 704, 709 (Bankr. N.D. Ohio 2000) (determining whether a chapter 7 trustee may waive the attorney-client privilege of a debtor). This is equally applicable to a debtor's decisions concerning where and how to educate his children.

*In re Akanmu*, 502 B.R. at 132–33; *Graves v. Graves*, 675 N.Y.S.2d 843, 846-47 (Sup. Ct. 1998) (requiring father to pay for child's college education).

Therefore, barring facts showing egregious conduct by debtors (which has not been shown here with respect to these Debtors),[11] the Court concludes that Samantha is entitled to summary judgment dismissing the portion of the Trustee's claim seeking to recover $2,276.00 of the transfers to or for the benefit of Samantha made while she was a minor; the Trustee's cross motion to recover this portion of the transfers is denied.

**C. Transfers to Alexandra After She Graduated from College**

The Court has already concluded in Section A above that the Debtors did not receive reasonably equivalent value in return for the transfers made to or for the benefit of Alexandra and Samantha after they were 21. The Stipulated Facts show that all the transfers to or for the benefit of Alexandra were *after* she graduated college, *after* she reached the age of 21, and *after*

[11] One could postulate egregious facts—such as a distressed debtor making a lump sum transfer of several years of tuition payments and expected related expenses before filing a bankruptcy case—that could lead a court to conclude that the transfer is avoidable as an actual or constructive fraudulent transfer.

she was financially independent. Even if any argument could support paying college tuition and related expenses for an adult child while still in school, if the student started college while still a minor, no argument has been made that would immunize from avoidance transfers made after graduation once the adult child has become financially independent.

## IV. CONCLUSION

For the reasons explained above, the Court concludes that transfers to or for the benefit of Alexandra and Samantha after they reached the age of 21 for college tuition and related expenses are avoidable as constructive fraudulent transfers if the Debtors were insolvent at the times the transfers were made. On the other hand, on the record before the Court, transfers to or for the benefit of Samantha while she was a minor for college tuition and related expenses were supported by reasonably equivalent value and, therefore, are not avoidable.

**IT IS SO ORDERED.**

Dated: December 4, 2018
New York, New York

*Martin Glenn*
MARTIN GLENN
United States Bankruptcy Judge

## Avoidance of tuition payments as fraudulent transfers: In re Palladino, 556 B.R. 10, 14 (Bankr. D. Mass. 2016).

***Mark G. DeGiacomo, Esq., Murtha Cullina LLP, Boston, MA***

Steven and Lori Palladino (the "Debtors") ran a Ponzi scheme from their home in West Roxbury, Massachusetts. Over several years, the Palladinos took in over $10 million, promising investors that their money would be used to finance short-term loans at high interest rates to local businesses and developers. Instead, new funds were used to repay earlier investors and to finance the Palladinos' exorbitant lifestyle. Per the Suffolk County District Attorney, the Palladinos used investor funds to pay for luxury cars, vacations to the Bahamas, trips to casinos, and rent for Steven's mistress. They also paid for daughter Nicole Palladino's college tuition at Sacred Heart University in Connecticut.

The Palladinos plead guilty to state criminal charges in early 2014 and filed for bankruptcy shortly thereafter. I was appointed the Chapter 7 trustee of their bankruptcy estate, as well as the estate of the Ponzi scheme's corporate entity. Among the various actions I brought to avoid certain prepetition transfers was an adversary proceeding against Sacred Heart University in which I sought to recover nearly $65,000 that the Debtors had paid for their daughter's education.

Bankruptcy trustee actions to claw back college tuition payments made for the benefit of the debtor's children are not new. Nearly a dozen such cases have resulted in written decisions since 2010 and many more were settled prior to the issuance of any court decision.[1] However, the Courts' rulings on this issue are far from uniform.

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[1] *See*, *e.g.*, *In re Hamadi*, 2019 WL 414336 (Bankr. D. Conn. Jan. 31, 2019); *In re Adamo*, 582 B.R. 267 (Bankr. E.D.N.Y. 2018); *Chorches v. Catholic Univ. of Am.*, 2018 WL 3421318 (D. Conn. July 13, 2018); *Boscarini v. Bd. of Trs. Of Conn. Univ. Sys. (In re Knight)*, 2017 WL 4410455 (Bankr. D. Conn. 2017); *Geltzer v. Oberlin College (In re Sterman)*, 2018 WL 6333588 (Bankr. S.D.N.Y. December

Multiple trial courts have reached opposite conclusions on substantially identical questions of law. The case that I brought against Sacred Heart is currently on appeal with the First Circuit. When decided, this will be the first appellate court to address this question of national significance: Do parents receive “reasonably equivalent value” within the meaning of the Bankruptcy Code, for college payments made on their children’s behalf?

The Bankruptcy Code provides that prepetition transfers can be avoided if they are shown to have been either actually fraudulent or constructively fraudulent.[2] In general, transfers may be avoided as constructive fraudulent conveyances if they were made when the debtor was insolvent and the debtor did not receive reasonably equivalent value in exchange. While the Code does not define “reasonable equivalent value”, it does define “value” as meaning “property, or satisfaction or securing a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor.”[3] While courts may construe

4, 2018; *Roach v. Skidmore Coll. (In re Dunston)*, 566 B.R. 624, 636-37, (Bankr. S.D. Ga. 2017); *Eisenberg v. Penn. State Univ (In re Lewis)*, 547 B.R. 536, 541 (Bankr. E.D. Pa. 2017); *DeGiacomo v. Sacred Heart Univ. (In re Palladino),* 556 B.R. 10 (Bankr. D. Mass. 2016); *Trizecahn Gateway LLC, v. Oberdick (In re Oberdick)*, 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013); *Sikirica v. Cohen (In re Cohen)*, 2012 WL 5360956 (Bankr. W.D. Pa. 2012); *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444, 457 (Bankr. E.D. Mich. 2011); *Banner v. Lindsay (In re Lindsay)*, 2010 WL 1780065 (Bankr. S.D.N.Y. 2010).

[2] 11 U.S.C §§ 548(a)(1)(A),(B). Our case was unique among this genre of cases in that we also asserted that the disputed tuition payments were avoidable as actual frauds, based on the availability of the so-called “Ponzi scheme presumption” that all payments made by the perpetrator of such a fraud are made with intent to further the scheme. Judge Hoffman adopted a narrower construction of the presumption, and we have not pursued this argument on appeal.

[3] 11 U.S.C. § 548(d)(2)(A)

the definition of value broadly, they are constrained to recognize that value must be primarily economic and not emotional.[4]

Our position throughout the litigation has been straightforward: the value of Nicole Palladino's Sacred Heart education was enjoyed only by Nicole Palladino. Although most states require that parents provide an education to their minor children, Nicole was 18 years old when she started college. The funds paid to the college to pay for Nicole's education were simply gifts. This type of gift, even if it is a gift that many parents make or hope to make to their children, can be recovered by a bankruptcy trustee if made at a time when the parents are insolvent.

Our case was heard in Massachusetts bankruptcy court before the Judge Melvin Hoffman. On cross-motions for summary judgment, the Court ruled in favor of Sacred Heart on all claims. In his decision, the Court agreed that "Ethereal or emotional rewards, such as love and affection, do not qualify for the purposes of defeating a constructive fraudulent conveyance claim."[5] But Judge Hoffman went on to find that the Palladinos' hope that their daughter's degree would enable her to become more economically self-sufficient constituted reasonably equivalent value.

> "I find that the Palladinos paid SHU because they believed that a financially self-sufficient daughter offered them an economic benefit and that a college degree would directly contribute to financial self-sufficiency. . . . A parent can reasonably assume that paying for a child to obtain an undergraduate degree will enhance the financial well-being of the child which in turn will confer an economic benefit on the parent. This, it seems to me, constitutes a *quid pro quo* that is reasonable and reasonable equivalence is all that is required."[6]

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[4] See, e.g., *Wilkinson v. Wiley & Son (In re Wilkinson)*, 196 F. App'x 337, 342 (6th Cir. 2006); *Zubrod v. Kelsey (In re Kelsey)*, 270 B.R. 776, 781 (9th Cir. BAP 2001); *Walker v. Treadwell (In re Treadwell)*, 699 F.2d 1050, 1051 (11th Cir. 1982).

[5] *In re Palladino*, 556 B.R. 10, 15 (Bankr. D. Mass. 2017)

[6] *Id*.

Judge Hoffman *sua sponte* certified his decision for direct appeal, and the First Circuit accepted the case for direct appellate review.

Prior to Judge Hoffman's decision, only four courts had ruled on this issue, and they had split down the middle. One court had found that tuition payments for the benefit of an adult child did not create reasonably equivalent value for the parent because the parent had no legal obligation to provide the support.[7] Another Court correctly found that tuition payments were avoidable because the benefit to the debtor parent was not "concrete" or "quantifiable."[8] Two bankruptcy courts (both in the Western District of Pennsylvania) had found that tuition payments for adult children could not be avoided by a trustee. Those courts held that such payments were "reasonable and necessary for the maintenance of the Debtor's family,"[9] or found "value" in the satisfaction of "societal expectations" that parents will contribute to college expenses.[10] Judge Hoffman's decision improved on these two earlier, clearly erroneous decisions by at least framing his holding around the concept of the parents' anticipated economic return on investment. He nevertheless erred, we have argued, by failing to assess the issue of reasonable value from the *creditor's* perspective. The economic benefit received by a debtor must be one that would be of use to a creditor, and Judge's Hoffman's speculative future benefit to the parent does not qualify.[11]

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[7] *Banner v. Lindsay (In re Lindsay)*, 2010 WL 1780065 (Bankr. S.D.N.Y. 2010)
[8] *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444, 457 (Bankr. E.D. Mich. 2011)
[9] *Sikirica v. Cohen (In re Cohen),* 2012 WL 5360956 (Bankr. W.D. Pa. 2012), rev'd in part on other grounds, 487 B.R. 615 (W.D. Pa. 2013)
[10] *Trizecahn Gateway LLC, v. Oberdick (In re Oberdick)*, 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013)
[11] See *Zeddun v. Griswold*, 830 F.3d 683, 689 (7th Cir. 2016)

The First Circuit heard oral arguments on our appeal in October 2017. A decision has yet to be issued. In the interim, a number of lower courts have had the opportunity to review Judge Hoffman's order and, in almost all cases, these Courts have expressly disagreed with Judge Hoffman.

In the District of Connecticut, Bankruptcy Judge Tancredi agreed that parents might reasonably expect to benefit in the future from having a college educated child but "piling one reasonable inference upon another, however, is little more than wishful thinking. Moreover, such speculation about another's ability to repay in the future and their willingness to do so, however reasonable, does not amount to a *quid pro quo* and certainly does not provide economic value to current creditors."[12] In another case, a District Court judge (having previously withdrawn the reference from the bankruptcy court) denied a university's motion to dismiss a tuition clawback complaint finding that Judge Hoffman's articulated economic benefit was "speculative" and "unpersuasive."[13] Likewise, Bankruptcy Judge Coleman of the Southern District of Georgia expressly broke with Judge Hoffman, finding that a hoped-for future economic benefit could not be quantified, and "did not increase [the debtor's] assets in any way that could be used to pay her creditors."[14] Most recently a bankruptcy court in the Southern District of New York also broke with Judge Hoffman and found that payment for a child's college tuition,

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[12] *Boscarini v. Bd. of Trs. Of Conn. Univ. Sys. (In re Knight),* 2017 WL 4410455 (Bankr. D. Conn. 2017).
[13] Chorches v. Catholic Univ. of Am., 2018 WL 3421318 (D. Conn. July 13, 2018).
[14] *Roach v. Skidmore Coll. (In re Dunston)*, 566 B.R. 624, 636-37, (Bankr. S.D. Ga. 2017).

even if "economically prudent," does not create value within the meaning of the Bankruptcy Code.[15]

Since Judge Hoffman's ruling, only one other court has held that tuition payments made by insolvent debtors for the benefit of adult children create "reasonably equivalent value" for the debtor. That court did not discuss or even cite *In re Palladino,* but tersely adopted the earlier cases from Pennsylvania to find that "payment of undergraduate expenses is reasonable and necessary . . . for maintenance of the family and preparing family members for the future," and the parent "therefore receives reasonably equivalent value in exchange for the tuition payment."[16]

Where once courts appeared evenly split on the question of whether tuition payments were recoverable in bankruptcy, the weight of authority appears to be trending in our direction.

More recently, and perhaps in response to the emerging trend discussed above (and an article in the ABI Journal)[17] defendant universities have attempted to sidestep the issue of reasonably equivalent value altogether. In this emerging line of cases, universities have claimed that they were not, in fact, the initial transferee of certain tuition payments – notwithstanding the fact that the payments were made from the debtors' accounts directly to the university. This argument has met with some initial success.

[15] *Geltzer v. Oberlin College (In re Sterman)*, 2018 WL 6333588 (Bankr. S.D.N.Y. December 4, 2018).

[16] *Eisenberg v. Penn. State Univ (In re Lewis)*, 547 B.R. 536, 541 (Bankr. E.D. Pa. 2017).

[17] James M. Wilton & William A. McGee, *Robbing Peter to Pay for College? A Good-Faith Defense in Tuition Clawback Fraudulent Transfers*, Am. Bankr. Inst. J., November 26, at 32.

While the Bankruptcy Code does not contain any “good faith” defense for initial transferees, it does provide such a defense to a subsequent transferee who takes for value. For example, while a gift of real estate from a debtor to his or her child might be voidable, the trustee may not be able to claw back the same transfer from a third party who had subsequently purchased the land in good faith from the child. Along these lines, universities have begun to argue that students are in fact the initial transferees of tuition payments. If universities are subsequent transferees then they are entitled to present a good faith defense.

In the first case decided on such grounds, the debtor had stolen more than $16 million from his victims in a phony rare coin scheme. The trustee filed suit seeking to avoid over $350,000 in combined payments to Hofstra University, Fairfield University, and Brooklyn Law School that the debtor had made for the benefit of his adult children. Although it was undisputed that all of the payments had been made directly to the universities, the Bankruptcy Court entered summary judgment in the universities’ favor.[18]

The Bankruptcy Court’s decision hinged on the refundability of tuition payments after receipt by the universities. On cross motions for summary judgment, the record showed the following: When tuition payments are received by each of the universities, the funds are “credited” to an individual student’s account. The student accounts are accessible through web portals using logins created by the individual student. Parents may only view these accounts if they have been specifically authorized to do so by the student. The funds are applied toward tuition and released to the university’s general

[18] *In re Adamo*, 582 B.R. 267 (Bankr. E.D.N.Y. 2018), vacated and remanded sub nom. *Pergament v. Brooklyn Law Sch.*, 595 B.R. 6 (E.D.N.Y. 2019).

account only after the student registers for classes or the deadline for withdrawal has passed. Critically, if a student withdraws from the university prior to registration, the refund is paid directly to the student.

On these facts, the bankruptcy court held that that the schools had acted as mere conduits, akin to a bank, in processing initial transfers from the debtor parent to his children. Because the students could in theory have withdrawn from the universities and pocketed their parent's cash, the students had "dominion and control" over the tuition payments and it was therefore the students who subsequently chose to transfer the funds to the university in exchange for their education.

The bankruptcy court's *Adamo* decision was subsequently vacated and remanded on appeal, but the District Court emphasized that the initial "analysis of this thorny issue was sound," and that it largely "agree[d] with the bankruptcy court's reasoning."[19] Remand was ordered only so that further facts could be developed as to the timeline of when tuition payments became nonrefundable, on the theory that any payments made after the student's withdrawal deadline had passed would have been made directly to the university as an initial transfer. A few weeks prior to the writing of this article, another bankruptcy court expressly endorsed and adopted the original *Adamo* decision's logic on similar facts to find that a university was a subsequent transferee of funds which had been paid to it directly.[20] That decision was issued by Bankruptcy Judge Tancredi, who had previously authored perhaps the most convincing

[19] *Pergament v. Brooklyn Law Sch.,* 595 B.R. 6, 19 (E.D.N.Y. 2019).
[20] *In re Hamadi*, 2019 WL 414336 (Bankr. D. Conn. Jan. 31, 2019)

decision to find that debtors did not receive reasonably equivalent value for factually indistinguishable tuition payments.[21]

Early signs indicate that courts may be receptive to arguments that students are in fact the initial transferees of tuition payments made on their behalf. Rather than turning on a legal determination as to the meaning of "reasonably equivalent value," tuition clawback cases may begin to turn on facts concerning timelines and transfer dates. Room and board may be nonrefundable after classes begin; tuition may be paid in installments; fees may accrue after classes begin; and tuition may be partially refundable in decreasing amounts as the semester progresses. Calculating who is the initial transferee of which portion of a transferred payment may become a byzantine endeavor. Courts' willingness to invite this undertaking may stem from the same place as some courts' willingness to strain the meaning of reasonably equivalent value: a policy-based distaste for tuition clawbacks.

If that is the case, there is an easier fix: legislation. "Not long ago, courts across the country divided over whether tithes and other donations to religious institutions were recoverable as constructively fraudulent transfers, given the absence of economic value that parishioners received in exchange for their donations."[22] In response, Congress passed a statute specifically exempting charitable contributions to qualified religious organization from trustee avoidance actions. Recently, federal legislation has been proposed to provide similar protection to college tuition payments. Some states have

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[21] *Boscarini v. Bd. of Trs. Of Conn. Univ. Sys. (In re Knight)*, 2017 WL 4410455 (Bankr. D. Conn. 2017)

[22] *Id.* at *5.

likewise moved to amend their versions of the Uniform Fraudulent Transfer Act to do the same.

Absent legislation, trustees will continue to exercise their powers under the Bankruptcy Code as written and courts, in turn, will grapple with the meaning of "reasonably equivalent value" and determining for each transfer whether the university was the initial transferee.

**SO ORDERED: November 16, 2018.**

**Jeffrey J. Graham**
**United States Bankruptcy Judge**

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

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|---|---|
| IN RE:<br><br>MATTHEW RICHARD ROTH,<br><br>Debtor. | Case No. 17-04109-JJG-7 |
| MATTHEW RICHARD ROTH,<br><br>Plaintiff,<br><br>v.<br><br>BUTLER UNIVERSITY,<br>DISCOVER FINANCIAL SERVICES, INC., and<br>SALLIE MAE BANK,<br><br>Defendants. | Adversary No. 18-50097 |

**ORDER DENYING MOTION TO COMPEL ARBITRATION AND DISMISS OR STAY PENDING ARBITRATION**

The motion before the Court asks if an arbitration clause in a student loan contract is enforceable in the context of a dischargeability action. For the reasons stated below, the Court answers that question in the negative.

JURISDICTION

Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. The issue of whether a debt is dischargeable is a core matter pursuant to 28 U.S.C. § 157(b)(2)(I). Both parties consent to this Court's entry of final orders or judgments. *See Wellness Int'l Network, Ltd. V. Sharif*, -- U.S. --,125 S.Ct. 1932, 191 L.Ed.2d 911 (2015). The Court, at least initially, has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334, subject to the determination of whether the arbitration agreement removes this matter from the Court's bailiwick.

BACKGROUND

Plaintiff/Debtor Matthew Richard Roth ("Roth") attended Butler University in Indianapolis, Indiana. While attending Butler, Roth obtained a student loan in the amount of $32,800 from Defendant Sallie Mae Bank ("Sallie Mae"). Roth's promissory note with Sallie Mae contained an arbitration provision that allowed either party to elect to arbitrate any claim arising under the note, including "the imposition or collection of principal, interest, attorneys' fees, collection costs or other fees or charges relating to this Note[.]"

Roth filed a chapter 7 bankruptcy and scheduled a debt to Sallie Mae in the amount of $36,927.88. Roth received a discharge and his case was closed. Roth later moved to reopen his case and filed *Plaintiff Matthew Roth's Amended Complaint Regarding Dischargeability of "Private" Student Loans* (the "Amended Complaint"), seeking to discharge his student loan debt to Sallie Mae (among other lenders) pursuant to 11 U.S.C § 523(a)(8). Specifically, Roth alleges that his loan with Sallie Mae is not a "qualified educational loan" and, alternatively, that the loan debt should be discharged as its repayment constitutes an undue hardship.

In lieu of an answer Sallie Mae filed its *Motion to Compel Arbitration and Dismiss or Stay Pending Arbitration* (the "Motion to Compel"). In the Motion to Compel, Sallie Mae argues that the Court should compel arbitration of the Amended Complaint in compliance with the Federal Arbitration Act (the "FAA"), 9 U.S.C. §§ 2-3, and dismiss the claims against Sallie Mae for lack of subject matter jurisdiction pursuant to Federal Rule of Civil Procedure 12(b)(1), made applicable to this proceeding pursuant to Federal Rule of Bankruptcy Procedure 7012. Alternatively, Sallie Mae asks the Court to stay Roth's claims as to Sallie Mae to allow an arbitrator to decide the issues.

Roth counters by arguing that the promissory note's arbitration provisions are critically vague and unenforceable. Roth further argues that the Court should deny arbitration because the proceeding involves a core matter and that a debtor's discharge is a matter of paramount concern for the bankruptcy court. For the purposes of this opinion, the Court will assume that the promissory note's arbitration provision is clear and enforceable, focusing instead on the question of whether the Roth's claims against Sallie Mae should be subject to arbitration.

DISCUSSION

Roth and Sallie Mae contractually agreed to arbitrate issues regarding claims relating to the promissory note. The FAA, 9 U.S.C. §§ 1 *et seq.*, places arbitration agreements on equal ground with other contractual provisions and makes them valid, irrevocable and enforceable absent some contrary legal or equitable ground for revocation. *Epic Sys. Corp. v. Lewis*, -- U.S. --, 138 S.Ct. 1612, 1622 (2018). The Supreme Court has read the FAA as establishing "a liberal federal policy favoring arbitration agreements." *Id.* (citations omitted). Furthermore, courts are to "rigorously enforce agreements to arbitrate." *Shearson/American Exp., Inc. v. McMahon*, 482 U.S. 220, 226 (1987). This is true even when the claims at issue are statutory rights. *Id.*

The Supreme Court's decision in *Epic* is the most recent case to explore the alleged conflict between the FAA and another federal statute. There, the Supreme Court was asked to determine if the Fair Labor Standards Act and the National Labor Relations Act overrode an arbitration agreement. When reviewing an alleged conflict between the FAA on the one hand and the FLSA and NLRA on the other, the Supreme Court noted that the party asserting a conflict "bears a heaving burden of showing "a clearly expressed congressional intention' that such a result should follow" and that there is a "'stron[g] presum[ption]' that repeals by implication are 'disfavored' and that 'Congress will specifically address' preexisting law when it wishes to suspend its normal operations in a later statute." *Id.* at 1624 (citations omitted). Moreover, the language must be "clear and manifest" for the FAA's mandate to arbitrate to be overridden. *Id.*

Sallie Mae points to the language in *Epic* and notes that nothing in § 523 of the Bankruptcy Code contains a clear and manifest Congressional intent to override an agreement to arbitrate. Were *Epic* the only Supreme Court to case to address the interplay of federal statutes and the FAA, Sallie Mae might prevail. But *Epic* does not stand alone on this issue.

In 1987 the Supreme Court tackled the issue of whether the Securities Exchange Act and the Racketeer Influenced and Corrupt Organizations Act rendered a matter non-arbitrable in *Shearson/American Exp., Inc. v. McMahon*, 482 U.S. 220 (1987). Acknowledging that the FAA mandated the enforcement of arbitration agreements, the Supreme Court held that "[l]ike any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command." *Id.* at 226. The Supreme Court then set forth a test for determining whether a contrary congressional command existed: (1) the statute's text; (2) the statute's legislative history; or (3) an inherent conflict between arbitration and the statute's underlying purpose. *Id.* at 227.

This approach makes sense. The FAA was intended to put arbitration agreements "upon the same footing as other contracts." *McMahon*, 482 U.S. at 225-26 (citations omitted); *see also Volt Info. Sci., Inc. v. Bd. of Tr. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 478 (1989) (FAA "simply requires courts to enforce privately negotiated settlements to arbitrate, like other contracts, in accordance with their terms."). But the FAA did not make arbitration agreements more enforceable than other contracts. *See Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) *and In re Brown*, 354 B.R. 591, 600 (D.R.I. 2006). Similarly, arbitration agreements have been held akin to contractual forum selection clauses, privately negotiated provisions meant to be enforced according to their terms. *Id.* (collecting cases).

Federal bankruptcy law also is a fundamental public policy, one that is grounded in the Constitution. *Moses v. CashCall, Inc.*, 781 F.3d 63, 72 (4th Cir. 2015). The very purpose of the Bankruptcy Code is to modify the rights – contractual and otherwise – of debtors and creditors. *See In re D&B Swine Farms, Inc.*, 430 B.R. 737, 744 (Bankr. E.D.N.C. 2010). So it should come as no surprise that a bankruptcy court could, in certain circumstances, override a contractual agreement such as an arbitration provision or a forum selection clause. *See In re Anderson*, 884 F.3d 382 (2d Cir. 2018) (upholding decision not to enforce arbitration provision) *and In re Dozier Fin., Inc.*, Adv. Pro. No. 17-80113-HB, 2018 WL 2386812 (Bankr. D.S.C. May 24, 2018) (declining to enforce a forum selection clause in adversary proceeding). The *McMahon* framework provides a way for courts to balance the competing public policies of enforcing arbitration agreements and bankruptcy court's ability to alter the contractual rights of debtors and creditors. To take away this framework and rely solely on an explicit textual override would elevate arbitration agreements over other contractual provisions and unfairly diminish the Bankruptcy Code.

The High Court's decision in *McMahon* has never been overruled, and in fact the case was cited in the *Epic* decision. Supreme Court precedent is only overruled after "appropriate consideration and clarity[.]" *In re Williams*, 564 B.R. 770, 777 (Bankr. S.D. Fla. 2017) (collecting cases). Because *Epic* is silent as to any attempt to overrule *McMahon*, the Court will treat *McMahon* as good law and will apply it to the matter at hand. *See In re Golden*, 587 B.R. 414, 424 (Bankr. E.D.N.Y. 2018) (applying *McMahon* after *Epic* was decided).

No appellate court has found that either the text of the Bankruptcy Code or its legislative history suggests that Congress intended to have the Bankruptcy Code override the FAA. *In re Eber*, 687 F.3d 1123, 1129 (9th Cir. 2012) (collecting cases). The analysis therefore hinges on a single question: whether arbitration would create an inherent conflict with the purposes of the Bankruptcy Code. *Id.*

Although the Seventh Circuit has yet to opine on this issue, several Courts of Appeals have tackled *McMahon*'s inherent conflict inquiry. Most courts have held that bankruptcy courts have discretion to decline arbitration if the matter is a core proceeding and arbitration would frustrate or conflict with the purposes of the Bankruptcy Code. *See Anderson*, 884 F.3d at 387; *In re EPD Inv. Co., LLC*, 821 F.3d 1146, 1150 (9th Cir. 2016); *Whiting-Turner Contracting Corp. v. Elec. Mach. Enters. Inc.*, 479 F.3d 791, 796 (11th Cir. 2007); *In re White Mountain Mining Co., L.L.C.*, 403 F.3d 164, 169 (4th Cir. 2005); *but see In re Mintze*, 434 F.3d 222, 229 (3rd Cir. 2006) (focusing not on core vs. non-core but instead whether the matter was a statutory right under the Bankruptcy Code).

The issues subject to arbitration here are: (1) whether Roth's loan with Sallie Mae is a qualified educational loan under § 523(a)(8) of the Bankruptcy Code; and (2) if so, whether such loan may be discharged as an undue hardship under § 523(a)(8). Both issues are included in the text of the Bankruptcy Code, satisfying

*Mintze*. The issue of dischargeability is a core proceeding under 28 U.S.C. § 157(b)(2)(I), thereby satisfying *Anderson* and related cases. The Court therefore has the discretion to not enforce the promissory note's arbitration provision if it finds arbitration would conflict with the purposes and policies of the Bankruptcy Code under any test utilized by the various Courts of Appeals.[1]

Sallie Mae argues that there is no inherent conflict present here, pointing to *Williams* as support. There, the debtor sought to avoid arbitration of claims under §§ 523(a)(8) and 524(a)(2) of the Bankruptcy Code. The court enforced the arbitration provision at issue, reasoning that there was no inherent conflict with the Bankruptcy Code as: (1) the debtor had already received a discharge; (2) arbitration would not interfere or affect distribution of the estate or an ongoing reorganization; (3) there was no interference with the preservation of estate assets or the determination of the priority of claims; and (4) the debtor was asserting claims on behalf of a class action. *Williams*, 565 B.R. at 783. Sallie Mae points out that Roth has received his discharge, that this is a chapter 7 liquidation with no reorganization, and that resolution of the claim will not affect estate assets. This, Sallie Mae posits, shows there is no conflict with the Bankruptcy Code and that the arbitration provision should be enforced.

Roth counters by arguing that the Court should follow the reasoning employed in *Golden* and find an inherent conflict exists. Similar to *Williams*, the court in *Golden* had to determine whether claims brought under §§ 523(a)(8) and

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[1] The Court specifically reserves any decision as to whether a different result would occur if the matter at issue were a non-core proceeding.

524 of the Bankruptcy Code should be subject to arbitration. Unlike *Williams*, the court in *Golden* found that arbitrating claims under those sections did create in inherent conflict with the Bankruptcy Code because: (1) the fundamental purpose of bankruptcy law was to give debtors a fresh start and that purpose was impeded by arbitrating potential violations of discharge; and (2) Congress specifically allowed bankruptcy courts the power to enforce their own orders and arbitrating violations of the discharge injunction impeded that goal. *Golden*, 587 B.R. at 427-28.

The Court, having considered the issue, believes that *Golden* contains the sounder reasoning of the two cases put forth by the parties. The Supreme Court has recently reiterated that "[o]ne of the main purposes of the federal bankruptcy system is to aid the unfortunate debtor by giving him a fresh start[.]" *Lamar, Archer & Cofrin, LLP v. Appling*, --U.S.--, 138 S.Ct. 1752, 1758 (2018) (citations omitted). The primary tool for effectuating a debtor's fresh start is the discharge. *Anderson*, 884 F.3d at 390. Allowing an arbitrator to determine dischargeability creates an inherent conflict with the Bankruptcy Code because it would remove an essential function of bankruptcy law from bankruptcy courts. *See Eber*, 687 F.3d at 1131 (allowing arbitrator to decide issues of dischargeability conflicts with the underlying purposes of the Bankruptcy Code) *and In re Koper*, 516 B.R. 707, 719 (Bankr. E.D.N.Y. 2014) (dischargeability of debt is an essential function of bankruptcy courts). Really it is more than inherent conflict. Allowing arbitration of dischargeabilty – the central purpose of the Bankruptcy Code according to *Anderson*

– would effectively allow parties to contractually overrule the application of federal bankruptcy law. Bankruptcy without the discharge is like a car without an engine; a useful tool rendered ineffective. The Court is unwilling to do that, and finds that the arbitration of dischargeability issues creates an inherent conflict with the Bankruptcy Code.

Another pillar of federal bankruptcy law is Congress' intention to centralize disputes about a debtor's legal obligations for prompt and efficient resolution in bankruptcy courts. *See Moses*, 781 F.3d at 72 *and White Mountain*, 403 F.3d at 169-170. Were Sallie Mae to prevail, Roth's claims against it would be decided by an arbitrator. However, Roth's claims against the other two defendants would be decided in this proceeding. Roth would have to argue undue hardship on the same set of facts in two forums, incur the cost of two separate proceedings, and face potentially different outcomes were the arbitrator and the Court to rule differently. This dual forum litigation would be inefficient, costly, and time consuming.

The Court finds that enforcing the arbitration of the claims presented by Roth would be inconsistent with the Bankruptcy Code's purpose of centralizing litigation before a bankruptcy court for efficient resolution.[2] *See Brown*, 453 B.R. at 603; *see also Moses*, 781 F.3d at 73 (holding arbitration of a core claim is an inherent conflict with the purposes of the Bankruptcy Code).

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[2] It is interesting that the *Williams* opinion – the decision on which Sallie Mae relies – notes that "[i]t seems doubtful that arbitration will present a more efficient resolution of the matter than continued litigation in this adversary proceeding." *Williams*, 564 B.R. at 784 n.3.

CONCLUSION

Based on the foregoing, the Court finds it has jurisdiction over Roth's claims against Sallie Mae. Furthermore, the Court declines to enforce the arbitration agreement between Sallie Mae and Roth or stay this proceeding to allow such arbitration to go forward. The Court does so because enforcement in this case would create an inherent conflict with the Bankruptcy Code's fundamental policies of affording debtors a fresh start and centralizing disputes about a debtor's obligations for efficient resolution. The Court therefore SUSTAINS Roth's objection and DENIES the Motion to Compel in its entirety.

Having ruled on the Motion to Compel, the Court hereby dissolves the stay on all pending discovery imposed by the Court's Order dated September 7, 2018. The Court will reschedule the pretrial conference on this adversary via separate order.

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