Student Loans A-Z

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Legislative updates - Student loans

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I. U.S. House of Representatives

1. **H.R. 449 – <u>Discharge Student Loans in Bankruptcy Act of 2015</u>**. This Bill seeks to amend title 11 of the United States Code to make student loans dischargeable.

   Status:

   January 21, 2015 – Introduced by Rep. John Delaney [D-MD].
   February 5, 2015 - Referred to subcommittee on Regulatory Reform, Commercial and Antitrust Law.
   Currently still in committee

2. **H.R. 1352 - <u>Student Loan Borrowers' Bill of Rights Act</u>.** This Bill seeks to establish student loan borrowers' rights to basic consumer protections, reasonable and flexible repayment options, access to earned credentials, and effective loan cancellation in exchange for public services and for other purposes. For example:

   A. Remove educational loans from the list of debts that are non-dischargeable in bankruptcy.
   B. Reinstatement of the 6 year statute of limitations for student loans.
   C. Amend the IRS Code to exclude discharged student loan debt from an individual's gross income.
   D. The cancellation of 50% of the balance of the interest and principal due on Direct loans that are not in default for borrowers who are employed in a public service and make 60 monthly payments on such loans after October 1, 2015.
   E. Reinstate a 6 year statute of limitations.

   Status:

   March 10, 2015 – Introduced by Frederica Wilson [D – FL].

   This bill was assigned to a congressional committee, which will consider it before possibly sending it on to the House or Senate as a whole. The majority of bills never make it past this point.

3. **H.R. 1434 – <u>Bank on Students Emergency Loan Refinancing Act</u>**.

Bill summary – This legislation would allow those with outstanding student loan debt to refinance at the interest rates that were approved last year for new borrowers.

March 18, 2015 – Introduced by Joe Courtney [D. CT]. [Note: Also introduced by Elizabeth Warren in the Senate – S. 793].

This bill was assigned to a congressional committee, which will consider it before possibly sending it on to the House or Senate as a whole. The majority of bills never make it past this point.

II. U.S. Senate

1. **S. 793 – <u>Bank on Students Emergency Loan Refinancing Act</u>**.

Bill summary – This legislation would allow those with outstanding student loan debt to refinance at the interest rates that were approved last year for new borrowers.

Status:

March 18, 2015 – Introduced by Elizabeth Warren [D. MA] [Note: Also introduced by Joe Courtney in the House of Representatives - H.R. 1434].

This bill was assigned to a congressional committee, which will consider it before possibly sending it on to the House or Senate as a whole. The majority of bills never make it past this point.

2. **S. 840 – <u>Student Loan Borrower Bill of Rights</u>.** This Bill seeks a variety of requirements, including:

A. Postsecondary educational lenders to disclose to borrowers at least 30 days before the first fully amortized payment on their loan is due certain information regarding the terms of the loan, the date on which the first payment is due, the name of the lender and servicer with certain contact information and a description of alternative repayment plans.

B. Post secondary educational lenders to disclose to borrowers who become 30 days delinquent on their loans the date on which the loan will be charged off or assigned to collection, including the consequences of those actions, the minimum payment that the borrower needs to make to avoid the loan from being charged off or assigned to collection, the minimum payment that the borrower must make to bring the loan current and the statement informing the borrower that paying less than the minimum could result in the loan being charged off or assigned for collection.

C. Post secondary educational lenders, when a borrower becomes 60 days delinquent or provides notice that the borrower is having difficulty making payment to complete a full review of the loan and make a reasonable effort to determine if the borrower is eligible for an alternative repayment plan or service member or veteran benefit related to the postsecondary loans, inform the borrower about alternative repayment plans and give the borrower at least 30 days to apply for such benefit.

D. Requires student loan servicers to designate a single point of contact for certain borrowers who: (1) are delinquent on their postsecondary education loan; (2) seek information regarding, seek to enter into an agreement for, or seek to resolve an issue under, a repayment option; or (3) seek to modify repayment terms due to hardship.

Status:

March 23, 2015 – Introduced by Sen. Richard Durbin [D. IL]

This bill was assigned to a congressional committee, which will consider it before possibly sending it on to the House or Senate as a whole. The majority of bills never make it past this point.

3. The Fairness for Struggling Students Act of 2015.

Bill summary: To amend the bankruptcy code to hold private student loans in the same regards as other private unsecured debt.

Status:

March 2015 - Introduced by Dick Durbin [D – IL], and co-sponsored by senators Sheldon Whitehouse (RI), Al Franken (MN), Richard Blumenthal (CT), Patty Murray (WA), Jack Reed (RI), Elizabeth Warren (MA), Ron Wyden (OR), Barbara Boxer (CA), Tim Kaine (VA), Brian Schatz (HI), Kirsten Gillibrand (NY) and Mazie Hirono (HI).

4. Federal Adjustment in Reporting (FAIR) Student Credit Act.

Bill summary: Provide seriously delinquent <u>private</u> loan borrowers a second chance to repair their credit score after a series of nine months of payments. Currently, federal loans may be rehabilitated one time and borrowers can repair their credit, while private lenders do not have the ability to remove negative credit information.

Status:

May 11, 2015 – Introduced by Gary Peters [D – MI].

5. The Access to Fair Financial Options for Repaying Debt (AFFORD) Act.

Bill summary: Would guarantee that all students are able to affordably pay off their student loans by making an income-based repayment option available to all student borrowers. Under the AFFORD Act, students would have a simple choice when they enter into repayment between:

a. A Fixed Repayment Plan – borrower makes monthly payments of the same amount sufficient to repay the loan and any accrued interest over a period of time determined by their loan amount.

b. An Income-Based Repayment Plan – borrower pays 10% of discretionary income (gross income that exceeds 150% of the federal poverty level) and remaining debt is forgiven after 20 years.

Status: Introduced by Jeff Merkley (D – Oregon) on August 5, 2015.

Elements of hardship discharge under 11 U.S.C. §523(a)(8)

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I. Statutory authority:

The U.S. Bankruptcy Code [11 U.S.C. §523(a)(8)] provides that student loans can be discharged in bankruptcy only if excepting the debt from discharge would impose an "undue hardship" on the borrower:

11 U.S.C. §523 Exceptions to Discharge

(a) A discharge under…this title does not discharge an individual debtor from any debt –

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for-

(A)

(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or
(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;

II. "Undue Hardship" Case Law:

Undue Hardship allows for the discharge of student loans under certain circumstances, decided on a case by case basis, and only under very limited circumstances.

Congress has never defined "undue hardship" in the Bankruptcy Code. Federal courts have established the legal standard for a student loan debtor to prove "undue hardship". In general, the courts have used the Brunner test to analyze whether undue hardship is proven.

A. Under the Brunner test, the debtor must show that:

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

B. "Totality of the Circumstances test".

1. Although the Brunner test is still the majority view, some courts have expressed their reluctance to apply the test due to its rigid and somewhat inflexible nature.

2. Adopted by the First, Seventh, Eighth and Ninth Circuits

3. The "Totality of the Circumstances" approach requires the bankruptcy court to consider:

   a. The debtor's past, present, and reasonably reliable future financial resources;
   b. A calculation of the debtor's and her dependent's reasonable necessary living expenses; and
   c. Any other relevant facts and circumstances surrounding each particular bankruptcy case.

   See: Long v. Educ. Credit Mgmt. Corp. (In re Long), 322 F.3d 549, 554 (8th Cir. B.A.P. 2003); See also Andrews v. South Dakota Student Loan Assistance Corp. (In re Andrews), 661 F.2d 702, 704 (8th Cir. 1981); Bronsdon v. Educ. Credit Mgmt. Corp. (In re Bronsdon), 435 B.R. 791 (1st Cir. B.A.P. 2010)

4. The main difference between the Brunner test and the Totality of the Circumstances test is that the latter does not include the good faith requirement.

III. Litigation Issues:

A. Creditor's Burden of Proof:

1. Creditor has the initial burden of proving the existence / validity of a debt and that it falls within 11 USC §523(a)(8).

2. Standard: preponderance of the evidence.

B. Debtor's Burden of Proof:

1. The burden of proof is on the debtor to prove undue hardship.

2. Standard: preponderance of the evidence.

C. Expert testimony:

1. Many consumer debtors cannot even afford the costs needed to file the underlying bankruptcy case, even without considering the additional costs for the hardship discharge proceeding.

2. Not required. In the matter In re Barret, the creditor argued that the debtor did not meet prong two of Brunner because the debtor did not present expert testimony supporting his medical condition. The court rejected the argument and held that since the debtor testified clearly and cogently about his medical past and present medical conditions, present a letter from his doctor in support of his assertions, and detailed how his ailment prevents him from holding a job worthy enough to repay his loans, he satisfied the second prong of Brunner. In re Barret, 487 F.3d 353 (6th Cir. 2007).

WE DON'T NEED NO EDUCATION! OR DO WE? AVOIDANCE OF PREPETITION TUITION PAYMENTS

11th Annual Detroit Consumer Bankruptcy Conference

American Bankruptcy Institute

Detroit, Michigan

November 11, 2015

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United States Bankruptcy Court
Western District of Michigan
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WE DON'T NEED NO EDUCATION! OR DO WE?
AVOIDANCE OF PREPETITION TUITION PAYMENTS

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Western District of Michigan

Recently, commentators and the media have suggested that a trend is emerging in consumer bankruptcy cases that is causing great consternation among parents, students and educational institutions.[1] During the last five years, bankruptcy trustees have begun to seek to avoid tuition payments made by debtors for their children's education as fraudulent transfers.[2] The purpose of these materials is to objectively examine decisions regarding attempts to avoid tuition payments and the reasoning employed therein, keeping in mind that fraudulent transfer actions are fact specific endeavors.[3] These materials also briefly discuss proposed legislation intended to amend section 548 of the Bankruptcy Code to preclude trustees from avoiding tuition payments by debtors to educational institutions for their children.

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1 Several of the newspaper articles to date cite to matters around the country where trustees have sought to avoid and recover tuition payments, notwithstanding the lack of written decisions by the courts in those matters. *See, e.g.*, Katy Stech, *New England Colleges Team Up to Fight Controversial Tuition Lawsuits*, The Wall Street Journal, Sept. 9, 2015; Katy Stech, *In Rare Fight, Johnson & Wales Battles to Keep Tuition Money*, Bankruptcy Beat – Wall Street Journal, July 27, 2015; Katy Stech, *Bill Proposes Ban on Tuition Clawbacks in Bankruptcy*, The Wall Street Journal, May 12, 2015; Katy Stech, *Bankruptcy Trustees Claw Back College Tuition Paid for Filers' Kids*, The Wall Street Journal, May 5, 2015. The newspaper articles have spawned numerous "alerts" and "updates" from law firms on this issue.

2 In addition, at least one court has held that the debtors were required to turnover under section 542 prepaid tuition that was transferred prepetition to a private school where the tuition was fully refundable to the debtors on the petition date. *Rice v. Johnson (In re Johnson)*, 371 B.R. 380 (Bankr. E.D. Ark. 2007).

3 For additional discussion of recent decisions addressing attempts by trustees to avoid and recover tuition payments as fraudulent transfers, *see* Bonnie C. Mangan, *Recovery of Tuition Payments as Fraudulent Conveyances*, Am. Bank. Inst. J. (Jan. 2015).

A. *Tuition Payments for Minor Children*

Although authority is limited, it is safe to say that trustees have not been successful when attempting to avoid alleged fraudulent transfers made by parents for the education of their minor children. *See Geltzer v. Xaverian High School (In re Akanmu)*, 502 B.R. 124 (Bankr. E.D.N.Y. 2013); *McClarty v. University Liggett School (In re Karolak)*, 2013 WL 4786861 (Bankr. E.D. Mich. Sept. 6, 2013). Both courts that were confronted with this factual scenario held that because debtor-parents have a statutory duty to educate children under applicable state law, the transfers to educational institutions conferred a direct, if not indirect, benefit to the debtors.

In *In re Akanmu*, the Chapter 7 trustee commenced an adversary proceeding against two private, parochial schools seeking to avoid and recover prepetition tuition payments that the debtors had made to the schools for the education of the debtors' minor children. In his complaint, the trustee alleged that the payments constituted both actual and constructive fraudulent transfers under section 544 (utilizing New York law) and section 548 of the Bankruptcy Code. As an alternative form of relief, the trustee sought a judgment against the schools for unjust enrichment.[4]

Prior to their bankruptcy, the debtors had sent their children to two private schools in the State of New York. Over a six year period, the debtors paid tuition in the aggregate amount of approximately $46,000. The trustee contended that because the debtors' children, and not the debtors, received the education, the debtors did not receive reasonably equivalent value (or "fair consideration" under New York law) from the schools in exchange for the tuition payments.

[4] The trustee's unjust enrichment claim was dismissed because the court found that the transfers were not unfair as between the debtors and the schools.

In connection with the schools' motion to dismiss under Fed. R. Civ. P. 12(b)(6)[5], the court concluded that the trustee's allegations were without any support in the law.[6] The court noted that although a debtor's payment of another person's debt may be avoided as a constructively fraudulent transfer, a debtor may be found to have received an indirect benefit by paying a debt for which he or she is not liable. *See*, *e.g.*, *Rubin v. Mfrs. Hanover Trust Co.*, 661 F.2d 979 (2d Cir. 1981). The court highlighted various instances where indirect benefits have been found, including payments to an adult child's wedding planner, payments on a mortgage for a home in which a child and the child's mother lived, payments for a friend's boat where the debtor also used the boat, and payment of rent for a third party because such payment preserved the debtor's option to purchase.

The *Akanmu* court concluded that the debtors received both a direct and an indirect benefit by paying for their children's education. The court first emphasized that under New York law, parents are obligated to provide necessities such as food, clothing, shelter, medical care and education to their children. In addition, the court noted that New York law requires parents to ensure that their children actually attend school. In the event that a parent does not comply with this obligation, New York law provides for remedial sanctions such as forfeiture of custody and criminal penalties. As such, the court found that the debtors were performing their duties under applicable law when they paid for their children's education, and thus had provided reasonably equivalent value.

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5 One of the schools also argued that the tuition payments should be considered charitable contributions and thus exempt under section 548(a)(2). Because the court concluded that the education of the debtors' children constituted reasonably equivalent value, the court declined to consider this alternative argument.

6 A review of the preamble reveals just how unpalatable the court found the trustee's position when the court stated, "[t]he trustee's claims are based on a fundamentally flawed legal theory that is, moreover, at odds with common sense."

The court rejected the trustee's argument that reasonably equivalent value was not received because the debtors were not required to send their children to *parochial* or *private* school. According to the court, the fact that the debtors decided to educate their children at non-public schools revealed that they simply chose to exceed the minimum standard of care required by New York law. By exceeding this standard, the court observed, the debtors more than satisfied their obligation.

The court favorably cited to two decisions where other courts also considered the value of tuition payments. In one of those cases, *In re Karolak*, 2013 WL 4786861 (Bankr. E.D. Mich. Sept. 6, 2013), the court found that reasonably equivalent value had been provided, relying in part on the fact that state law imposed a legal duty on the debtors to provide for the education of their minor children. *See infra* at pp. 5-7. In the other decision, the court declined to characterize tuition payments as charitable contributions under section 1325. *Watson v. Boyajian (In re Watson)*, 309 B.R. 652 (B.A.P. 1st Cir. 2004). Rather, the court found that the debtors and their children highly valued the education the children received, which was indicative of a direct benefit. The court distinguished decisions where the education of a child did not constitute reasonably equivalent value because in those cases, the children were not minors. *See infra* at pp. 13-14.[7] Further, the court found unpersuasive the trustee's attempt to analogize reasonably equivalent value with a determination of reasonably necessary expenses for purposes of calculating projected disposable income in connection with a Chapter 13 plan.

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7 The court commented that even college tuition payments by parents for non-minor children might not be avoidable as constructively fraudulent transfers. While citing to two recent decisions from the Bankruptcy Court for the Western District of Pennsylvania for this proposition, the *Akanmu* court did not need to provide substantive analysis from its own perspective given the discrete issue before it. *See infra* at pp. 14-17.

As a matter of policy, the court criticized the trustee's overall argument. If the trustee's position were adopted, the court suggested that it would be encouraging trustees to scrutinize all expenditures made for the benefit of children, such as for clothes, food, or educational items like a computer. The court commented that "[t]he absurdity of this scenario is obvious."

Finally, the court stressed that minor children and their parents must be considered as one entity under the law:

> The Debtors received reasonably equivalent value and fair consideration for the Tuition Payments for their children's education, not only because the Debtors satisfied their legal obligations to educate their children, but also because the Debtors and their minor children must be viewed as a single economic unit for these purposes. In other words, goods and services purchased by parents for their minor children should generally be treated, for purposes of constructive fraudulent conveyance analysis, as though they had been purchased by the parents for themselves.
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> Put differently, dependent minor children have no separate economic life from their parents; they have no independent means of support and no control over the economic choices made on their behalf. Conversely, parents' economic lives cannot be meaningfully separated from those of their dependent minor children, whose assets are generally inextricably commingled with their parents', who generally have no liabilities, and who are wholly dependent upon their parents for all of the goods and services they receive.

These strong comments indicate that the court viewed the education received by the children to be, first and foremost, a direct benefit to the debtors. Although the *Akanmu* court seems to have contemplated an indirect benefit as well, the court did not need to provide any in-depth discussion in light of its finding of a direct benefit.

As noted above, the Bankruptcy Court for the Eastern District of Michigan reached a similar conclusion in an unpublished decision cited favorably in *Akanmu*. *See In re Karolak*, 2013

WL 4786861 (Bankr. E.D. Mich. Sept. 6, 2013).[8] In *Karolak*, one of the debtors made payments in the aggregate amount of approximately $16,000 to a private school over a three year period for the education of her three minor children. Because the debtor was a teacher at the school, her children received a reduction in their tuition. The reduced tuition was paid through a regular deduction of the debtor's paycheck.

After the debtor and her husband filed for bankruptcy, the Chapter 7 trustee commenced an adversary proceeding to avoid and recover the tuition payments as fraudulent transfers under section 544, utilizing applicable Michigan law, and section 548. The trustee did not allege that any of the payments were actual fraudulent transfers, and instead relied solely on a theory of constructive fraud. The trustee argued on summary judgment that the debtor did not receive any reasonably equivalent value because the debtors' children, not the debtors, received the education. According to the trustee, at most, the benefit was indirect. Moreover, the trustee contended that the benefit was not economic, and, therefore it did not constitute reasonably equivalent value. The school filed a cross-motion for summary judgment in which it argued that reasonably equivalent value was provided, at a discount, in the form of education to the debtor's children. The school asserted that a direct benefit had been received, but even if the benefit was indirect, it was an economic benefit, no less.

After considering the definition of reasonably equivalent value and noting that it should be determined based on the circumstances of each case, the court briefly set forth indirect benefit principles. The court noted, however, that the case before it was not a case where value is derived from a person other than the recipient of the transfers. Instead, the court stressed, the school

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[8] It should be noted that the court's written decision supplements a previously given bench opinion. The written decision appears to be driven, in large part, by the need to address the court's constitutional jurisdiction before *Wellness Int'l Network, Ltd. v. Sharif*, ___ U.S. ___, 135 S. Ct. 1932 (2015). For this reason, the court likely chose not to restate the reasoning of its bench opinion in great detail.

provided education to the debtor by educating her minor children. Because the debtor purchased the education for her children, the court found that the debtor received a *direct* benefit from the purchase.

Moreover, much like in *Akanmu*, the court recognized that in the State of Michigan, parents have a legal obligation to provide education for their minor children. By making the tuition payments, the court found that the debtor fulfilled her statutory duty, which resulted in a direct benefit to the debtors. The court noted that it did not matter whether the debtors could have provided a less expensive form of education – they nonetheless received reasonably equivalent value in exchange for the tuition payments. The court observed that the debtors actually received more than reasonably equivalent value, because they were able to obtain private school education at a discount.

Finally, the court rejected the trustee's reliance on *Gold v. Marquette University (In re Leonard)*, 454 B.R. 444 (Bankr. E.D. Mich. 2011), because it involved college tuition payments for an adult child. *See infra* at pp. 10-14. The court therefore found that the school was entitled to summary judgment as a matter of law.

The decisions in *Akanmu* and *Leonard* are well-reasoned and deferential to public policy and state law. Both New York and Michigan, as well as numerous other states, have prioritized the education of minor children by enacting legislation imposing affirmative duties on parents. As the two decisions indicate, tuition payments should not be subject to avoidance where the debtors complied with applicable state law. Moreover, the strongly worded comments in *Akanmu* embrace the practical reality of the relationship between a parent and a minor child. The relationship is, in large part, inseparable, at least for purposes of fraudulent transfer law.

Based on the facts in *Akanmu* and *Leonard*, one might conclude that tuition payments to a private school for the education of a minor child should never be subject to avoidance as a fraudulent transfers. However, such a conclusion would be premature and perhaps overly-broad given the fact intensive analysis required by fraudulent transfer law. For example, a set of facts may exist where a trustee satisfies numerous badges of fraud for purposes of actual fraudulent transfers. Or, a trustee may pursue avoidance of tuition payments made by a debtor for the benefit of a minor who is not recognized by law as a "child" of the debtor, but who nonetheless is a member of the debtor's household. Finally, a trustee might argue that, notwithstanding *Karolak*, private education was wholly-unnecessary because the public school district was not only adequate, but exceptional.

Regardless, *Akanmu* and *Leonard* are likely to quell any alleged "emerging trend" with respect to avoidance of tuition payments made for the benefit of minor children.

B. *Tuition Payments for Adult Children*

While at least two courts have held that reasonably equivalent value was received by debtors in exchange for tuition payments for their *minor* children, the courts are somewhat divided with respect to tuition payments for *adult* children. Compare *Gold v. Marquette University (In re Leonard)*, 454 B.R. 444 (Bankr. E.D. Mich. 2011); *Banner v. Lindsay (In re Lindsay)*, 2010 WL 1780065 (Bankr. S.D.N.Y. May 4, 2010) with *Shearer v. Oberdick (In re Oberdick)*, 490 B.R. 687 (Bankr. W.D. Pa. 2013); *Sikirica v. Cohen (In re Cohen)*, 2012 WL 5360956 (Bankr. W.D. Pa. Oct. 31, 2012), *aff'd in part*, *rev'd in part*, 487 B.R. 615 (W.D. Pa. 2013). The split of authority is due to applicable state law and "societal expectations."

For example, in *Lindsay*, the Bankruptcy Court for the Southern District of New York considered a situation where the debtors made college tuition payments for the debtors' son. *In re*

Lindsay, 2010 WL 1780065 (Bankr. S.D.N.Y. May 4, 2010). The debtors made the payments with the proceeds from three separate sales of personal property and the proceeds from a loan given by a financial institution to the debtors in exchange for a security interest on a previously unencumbered asset. At the time the payments were made, the debtors were subject to state court judgments obtained by third party creditors.[9]

The Chapter 7 trustee commenced an adversary proceeding to avoid and recover the tuition payments, as well as numerous other transfers to third parties, as actual and constructive fraudulent transfers under section 544 (relying New York debtor/creditor law) and 548 of the Bankruptcy Code.[10] In his motion for summary judgment, the trustee asserted that the debtors had not received "fair consideration" when they made the college tuition payment.[11] The court agreed. Unlike in *Karolak* and *Akanmu* where the interests of minors were implicated, the court in *Lindsay* noted that the debtors had no legal duty under applicable state law to pay their adult son's college tuition. Similarly, the court found compelling the fact that the debtors were unable to demonstrate a legal obligation, such as a promissory note in favor of the college or the financial institution, requiring them to satisfy their son's tuition bill.

The court also rejected the debtors' argument that a "moral obligation" to provide a college education to a child is a defense under New York law. The court noted that in the context of a

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9 This is an important fact under New York debtor/creditor law, which provides that a transfer made without fair consideration is fraudulent without regard to actual intent where the transferor is a defendant in an action for money damages or is a judgment debtor as a result of such act. N.Y. Debt. & Cred. § 273-a; *see* N.Y. Debt. Cred. § 273 (fraudulent transfer without regard to intent so long as insolvent and lack of fair consideration).

10 It does not appear as though the trustee relied on section 548 with respect to the tuition payments, all of which were made more than two years prior to the petition date. *See* 11 U.S.C. § 548(a) – (b). In addition, the trustee did not name the college as a defendant. Instead, the trustee sought to avoid and recover the tuition payments from the debtors and their non-debtor son. It is unclear if the court found the debtors and the non-debtor son, or only the non-debtor son, to be liable for the college tuition payment.

11 The New York fraudulent transfer statute does not use the term "reasonably equivalent value" and instead uses "fair consideration." *See*, *e.g.*, N.Y. Deb. & Cred. § 273-a.

substantial abuse determination under section 707, debtors have no responsibility to pay for the college education of their children. The court found this rationale equally persuasive in the context of a fraudulent transfer analysis.

Finally, the court was not convinced by the debtors' argument that because the sales of personal property and the loan allegedly resulted in "fair value," fair consideration was given. The court stressed that the true issue is not whether the sales and the loan yielded a fair price; rather it is whether the debtor properly transferred the proceeds from the sales and the loan to the college. According to the court, it was not. The court therefore found the debtors and their son liable for the tuition payments as constructively fraudulent transfers.[12]

Approximately one year later, the Bankruptcy Court for the Eastern District of Michigan considered a similar issue as that in *Lindsay*. *See In re Leonard*, 454 B.R. at 444. However, the court also considered the separate argument as to whether proceeds of a loan obtained by the debtors for their adult son's education were held in trust, and thus not subject to avoidance.

In *Leonard*, the Chapter 7 trustee commenced an adversary proceeding against a university which had allegedly received constructively fraudulent transfers in the aggregate amount of approximately $21,000 from the debtors for their son's tuition.[13] At the time of the transfers, the debtors' son was 18 years old. Prior to any of the transfers being made, the debtors' son had applied for a student loan in the amount of $35,000 from a lender. The debtors' son was designated

[12] The court did not find the tuition payments, or any other transfers for that matter, to constitute actual fraudulent transfers. The debtor was suffering from liver disease and simply sought to educate his son. According to the court, "[w]ishing to provide for one's family is not the same thought as intending to hinder creditors." With that said, the court expressly declined to find that paying for their son's education was the actual motive of the debtor, instead relying on the trustee's failure to satisfy his burden as to actual intent. The *Lindsay* decision was silent as to whether the debtors received their discharge. Assuming that they did, the debtors' son, and not the debtors, was presumably left to satisfy the judgment as it pertained to the tuition payments.

[13] As the court notes, because one of the transfers was made after the petition date, it could not have been a fraudulent transfer under section 544 or section 548.

as the borrower, while the debtor-father was designated as the co-signer. Both the debtors' son and the debtor-father signed the application, which was approved by the lender. Thereafter, a check from the lender was made payable to the son and the father. The son, but not the father, indorsed the check and gave it to the debtor-mother for deposit into the joint bank account of the debtors.

The parties filed cross-motions for summary judgment.[14] The university first contended that no transfers were made, because the debtors did not have an interest in the property – it was subject to either an oral express trust or a constructive trust under Michigan law. Specifically, the university argued that when the check was deposited into the debtors' account, the debtors' son and the debtors understood that the funds were to be held in trust, solely for the purpose of educational expenses for the son and also the debtors' two daughters, at least one of whom was in high school at the time. Alternatively, the university asserted that the debtors received reasonably equivalent value in exchange for the tuition payment in the form of their child's education.

The court first considered the university's argument that the tuition payments were impressed with an oral express trust, noting that when property is held in trust for another and that property is transferred, the transfer is not avoidable as a fraudulent transfer. The court observed that the principle is the same regardless of whether the issue is considered under section 544 or section 548. Both sections, by their express terms, require a transfer of an interest of the debtor in property.

However, property interests are generally determined by state law, and with respect to oral express trusts, Michigan courts require "clear and satisfactory" parol evidence. As such, some support must be found in the surrounding circumstances and conduct of the parties. The court

[14] The trustee did not seek summary judgment with respect to his claims for actual fraudulent transfers.

stressed that under Michigan law, a trust is created only when the settlor manifests an intent to create a trust pursuant to an explicit declaration of trust accompanied by a transfer to one for the benefit of another.

The university argued that a trust relationship existed due to the parent-child relationship, and that the debtor-mother undertook an affirmative duty to pay for her children's education. Although the university's position was supported by affidavits from the debtors and their son, the court concluded that the trustee introduced circumstantial evidence sufficient to create a genuine issue of material fact. According to the court, because the debtor held a one-half interest in the loan proceeds, the debtor could not have been a settlor for purposes of establishing a constructive trust over the other half. In addition, because the loan proceeds were deposited into the debtors' account, the court recognized a rebuttable presumption under Michigan law that such funds were property of the debtors. The university failed to rebut this presumption by showing "clear and perfect title" in the name of the son.

The court also noted that the debtors' actions were inconsistent with those of a trustee. The loan proceeds were commingled with other funds in the debtors' account. No separate account had been created. Moreover, the court was concerned with the debtors' use of the loan proceeds for their own benefit by paying the property taxes on their home, notwithstanding the fact that one of the debtors and the son testified that an agreement for the repayment of the funds through a tax refund was made and fully performed.

The court next addressed the university's argument that the loan proceeds were impressed with a constructive trust. Similar to its oral express trust argument, the university asserted that the existence of a constructive trust prevented the trustee from satisfying a prima facie element – that the transfer was of an interest in property of the debtors. The court rejected this argument outright.

Relying on Sixth Circuit precedent, the court noted that only property already impressed with a constructive trust by a court in a separate proceeding may be excluded from a bankruptcy estate. *See McCafferty v. McCafferty (In re McCafferty)*, 96 F.3d 192 (6th Cir. 1996); *XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.)*, 16 F.3d 1443 (6th Cir. 1994). Because no prepetition judicial action imposed a constructive trust over the loan proceeds, the court found the university's argument misplaced.

Finally, the court considered the university's argument that it provided reasonably equivalent value to the debtors. The court first noted that the Sixth Circuit has instructed trial courts to examine whether a debtor received any value in exchange for the transfer and, if so, whether such value was reasonably equivalent. *See Lisle v. John Wiley & Sons, Inc. (In re Wilkinson)*, 196 Fed. Appx. 337 (6th Cir. 2006). The court further noted that although value can be direct or indirect, it must be economic. Under the circumstances, the court found that the benefit was not direct, because any benefit to the debtors was derived from the benefit to the son.[15] The court also recognized that where the benefit to a transferor is indirect, the transferee has the burden of demonstrating that the benefit is both "concrete and quantifiable."

The university suggested that by paying for their son's education, the debtors would be relieved of any obligation to support their son. As such, the debtors contended that they received an economic benefit. The court rejected this argument, however, stressing that the debtors had no legal obligation (contractual or otherwise) to support their 18 year old son. Moreover, even if such obligation existed, it would be a non-sequitur to conclude that by paying the first month's tuition, the debtors would not need to assist their son in the future. Similarly, the court observed that

[15] The court also pointed out that the tuition payments did not satisfy an antecedent debt owed by the debtors to the university. If they had, the court surmised, the tuition payments might have provided a direct economic benefit to the debtors.

satisfaction of a "moral obligation," providing "love and affection," or obtaining "spiritual fulfillment," does not rise to the level of an economic benefit. Quite simply, the court stated that such concepts are of no use to creditors of the debtors' estate. Finally, the university failed to demonstrate any concrete and quantifiable benefit, which the court noted requires a precise calculation. In sum, the court found a genuine issue of fact, but only with respect to the oral express trust agreement. The court granted summary judgment to the trustee with respect to reasonably equivalent value and the constructive trust.[16]

The decisions in *Lindsay* and *Leonard* regarding reasonably equivalent value are based, in large part, on the lack of any legal duty imposed upon parents under applicable state law to provide post-secondary education to adult children. Both courts rejected any suggestion that a moral obligation could constitute reasonably equivalent value.

However, in two separate decisions, the Bankruptcy Court for the Western District of Pennsylvania concluded that a trustee was not entitled to recover under section 544 and the Pennsylvania fraudulent transfer statute college tuition payments made from entireties accounts for the benefit of their adult children. Because such payments satisfied a "societal expectation" and fulfilled a "parental obligation," they were necessities not subject to avoidance. *See In re Oberdick*, 490 B.R. at 687; *In re Cohen*, 2012 WL 5360956 (Bankr. W.D. Pa. Oct. 31, 2012).

In *Cohen*, the first of the two decisions, one of the debtors was a partner in law firm which defaulted on its commercial lease obligations to the law firm's landlord. After the law firm dissolved, the landlord commenced an action in state court against the law firm and its partners, including the debtor in his individual capacity. The state court found the law firm and several of

[16] A review of the docket reveals that the parties settled shortly before trial.

its partners liable, including the debtor. Shortly thereafter, the debtor and his wife jointly filed for relief under Chapter 7.

Throughout the debtor's career of thirty-five years, the debtor consistently had his paycheck deposited into a marital entireties account. Similarly, the debtor's spouse, who also filed for bankruptcy, had consistently deposited her paycheck and, upon retirement, her pension checks, into the entireties account. An entireties account is considered to be a separate legal entity under Pennsylvania law.

The trustee sought to hold the *debtors* liable because the debtors allegedly caused the transfers to be made into the entireties account while the debtors were insolvent and without reasonably equivalent value. The debtors then made numerous transfers from the entireties account, including transfers in the aggregate amount of approximately $102,000 for their son and daughters' post-secondary education.[17]

Citing to Pennsylvania law, the trustee contended that parents have no legal duty to provide for the education of their children beyond the latter of (i) age eighteen, or (ii) the completion of high school. According to the debtors, the legislature did in fact impose such a duty on separated, divorced or unmarried parents to provide post-secondary education pursuant to a specific act passed by the legislature.[18]

The court held that *undergraduate* tuition payments are reasonable and necessary for the maintenance of a family for purposes of fraudulent transfers. The court was not willing to extend

[17] The court identified the first transfer to be from the debtors to the entireties account, and the second transfer from the entireties account to the educational institutions. Therefore, while not exactly clear, the trustee was likely seeking to hold the debtors' entireties account liable for the tuition payments.

[18] The Pennsylvania Supreme Court declared the act to be unconstitutional on equal protection grounds. The *Cohen* court did not seem to directly rely on the act when it determined that providing an undergraduate education to children provides reasonably equivalent value.

this holding to tuition payments for *graduate* education, as "children in graduate school are well into adulthood."[19] Nonetheless, the court found that the trustee had failed to satisfy his burden with respect to the tuition payments for graduate education.

Less than one year after *Cohen*, the Bankruptcy Court for the Western District of Pennsylvania considered a similar issue in *Oberdick*. Much like in *Cohen*, the debtors deposited their earnings into an entireties account. These deposits were challenged as fraudulent transfers intended to evade collection attempts by the same landlord-creditor as in *Cohen*. After the debtors filed for relief under Chapter 7, the trustee sought to avoid tuition payments in the aggregate amount of approximately $82,000.

After trial, the *Oberdick* court found in favor of the debtors because post-secondary education of a child constitutes a necessity. Relying in large part on *Cohen*, the court stated:

> What is a "necessity" for purpose of family obligation law is not necessarily congruent with what should be considered a necessity for purposes of an action under [the UFTA]. Even though there may not strictly speaking be a legal obligation for parents to assist in financing their children's undergraduate college education, in following . . . the *Cohen* case, this Court has little hesitation in recognizing that there is something of a societal expectation that parents will assist with such expense if they are able to do so. If there were some evidence that the [debtors] had made the educational expenditures in question as a part of a strategy or with an ulterior motive to shield the funds from the reach of [the landlord], the Court might view this differently. The evidence, however, points to the contrary, *i.e.*, that the expenditures were made out of a reasonable sense of parental obligation. Thus, the Court concludes that payments out of the Entireties Account used toward the undergraduate college education of the [debtors'] children were for necessities. . .

Interestingly, the court also addressed whether certain expenses paid from the entireties account related to the education of the debtors' children were also "necessities," and thus not

[19] The court seemed to rely on the act to differentiate between undergraduate and graduate education, as it noted in a footnote that the act was limited to requiring payment for the costs of undergraduate or vocational education, not graduate education.

subject to avoidance. The court found the following to be unnecessary and not a reasonable educational expense:

- a gift of $1,000 to a friend of the debtors' son to assist with college education;
- payments in excess of $4,500 for high school trips taken by the debtors' children to Italy;
- payments of $155 as alumni contributions;
- a payment of $560 to a fraternity; and
- travel expenses to and from college in Chicago by the debtors' son.

The decisions to date reveal that courts are likely to carefully consider not only applicable state law, but also underlying policy when deciding whether to avoid tuition payments for the benefit of adult children. While attempts to avoid tuition payments for adult children may be viewed as offensive to the moral sense, such actions have support in the law. Again, it is worth noting that none of the courts considered whether the tuition payments should be avoided as actual fraudulent transfers based on badges of fraud, although the *Lindsay* court may have come close. *See supra* at n. 12. Moreover, in both *Oberdick* and *Cohen*, the trustees do not appear to have sought avoidance from the educational institutions, although the trustees may have later attempted to recover from those institutions. Instead, the trustees focused on avoidance of the transfers from the exempt entireties accounts. Finally, *Leonard* seems to offer some instruction to parents by leaving open the possibility of a trust-based defense. In the future, parents would be wise to take advantage of protections under section 541(a)(5)-(6) of the Bankruptcy Code.

C. *Proposed Legislation*

In reaction to fraudulent transfer actions seeking to avoid tuition payments (or maybe in reaction to the media reports on the same), Representative Chris Collins, Republican from the State of New York, has introduced "The PACT (Protecting All College Tuition) Act of 2015." H.R. 2267, 114th Cong. (2015). The relatively short substantive text of the current proposed bill is as follows:

> Section 548 of title 11, United States Code, is amended by adding at the end of the following:
>
> (f) A payment of tuition by a parent to an institution of higher education (as defined in either section 101 or 102 of the Higher Education Act) for the education of that parent's child is not a transfer covered under paragraph (1)(B).

If enacted, the legislation would protect tuition payments made by debtors for their children. Notably, the proposed legislation would not protect defendants from avoidance and recovery of fraudulent transfers under section 544(b)(1) and applicable state law. Nor would it necessarily protect mediate transferees under section 550, or even immediate transferees such as the entireties accounts in *Cohen* and *Oberdick*, thereby resulting in liability to educational institutions as mediate transferees. Moreover, and perhaps rightly so, the proposed legislation would not protect any tuition payments from avoidance as actual fraudulent transfers, where an intent to hinder, delay or defraud is based on badges of fraud. Finally, the proposed legislation leaves many open-ended issues, such as, among other things, the scope of "tuition," whether it excludes related expenses like those at issue in *Oberdick*, and whether tuition payments for non-adopted children living under the same roof would be protected.

Although the bill was referred to the House Judiciary Committee on May 12, 2015 and thereafter to the Regulatory Reform, Commercial and Anti-Trust Law subcommittee on June 1, 2015, the proposed legislation does not appear to have much traction to date. As of September 15, 2015, no amendments appear to have been made, nor has the bill advanced beyond the subcommittee.[20]

[20] For additional discussion of the proposed legislation and other laws related to tuition and education, including protection for education savings plans under section 541(b) of the Bankruptcy Code and 26 U.S.C. § 529, *see* Lynne B. Xerras, *PACT: Will Congress Except College Tuition Payments from Avoidance?*, Am. Bankr. Inst. J. (July 2015).

STUDENT LOANS A-Z

NON-BANKRUPTCY ALTERNATIVES TO ADDRESS STUDENT LOAN DEBT

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Student Loans are presumptively excluded from discharge under **any** Chapter of Title 11, unless the debtor can establish that the student loans in question impose an "undue hardship." See ***11 U.S.C. §523(a)(8)***. A bankruptcy debtor must file an adversary proceeding (See FRBP 7001, *et. Seq.*) to obtain a determination of undue hardship and a discharge of a particular student loan (or loans). This applies to both publically owned and/or insured student loans, as well as student loans originating from private lenders. The Supreme Court unequivocally held in 2010 that an adversary proceeding is required to obtain a hardship discharge of a student loan, and a hardship discharge may not be achieved through the terms of a bankruptcy plan. See *United Student Aid Funds v. Espinosa*, 130 S. Ct. 1367 (2010). While not *impossible*, given the legal standard for discharge student loans adopted in the majority of Circuits in the country (including the 6th Circuit), debtors seeking a bankruptcy hardship discharge of their student loan(s) face an uphill battle. Moreover, it is *very* likely that any lender, regardless if it is it a public or private student loan(s) at issue, will vigorously oppose any such relief. Therefore, it is vital that any bankruptcy practitioner: a) obtain adequate information on any potential education loan(s) from clients to have a **COMPLETE** picture of all applicable student loan debt; b) be aware of and advise clients on the potential costs of prosecuting an adversary proceeding seeking a hardship discharge of student loans; and c) most importantly, be adequately informed and prepared to counsel clients on alternatives to seeking bankruptcy relief from student loans.

I. Federal Student Loans[1]:

A. Most common types of federally insured student loans include, but are not necessarily limited to:

1. **Perkins Loans:** need based student loans available to both under-graduate and graduate students; loans issued by individual educational institutions; loan amounts are capped ($5,500 annually; $27,500.00 for under-graduate students, and $8,000.00 annually; $60,000.00 total for graduate students)
2. **Direct Subsidized Loans**: United States Dept. of Education is the direct lender of these loans. For under-graduate students based upon financial need. During enrollment periods of at least 50% and during grace and deferment periods, no interest is charged to the borrower.
3. **Direct Unsubsidized Loans**: Available to under-graduate, graduate and professional students. Showing of financial need is NOT required. Unlike subsidized loans, interest is charged to the borrower even during periods of enrollment and deferment.
4. **Direct PLUS Loans**: Available for graduate and professional students, and also, for parents of dependant under-graduate students. Showing of financial need is likewise NOT required. Interest is also charged to the borrower during all periods of enrollment and deferment.
5. **Direct Consolidation Loans**: Available to student and parent borrowers who wish to consolidate multiple loans into a single payment. May also be available for borrowers with only one student loan that is currently in default. "Consolidation" of the loan may assist the borrower to become eligible for certain repayment options, listed below. Most types of Federal Direct Loans are eligible for consolidation.

[1] **NOTE: For a complete synopsis of federal student loans, visit the United States Department of Education Website: http://www.direct.ed.gov/; see also www.studentaid.ed.gov**

B. Repayment Options[2]-Common repayment plans available through Direct Loans include:

1. **Standard Repayment**: Fixed monthly payment plan over a 10-year period. Payments are calculated to pay loan in **full**. All Direct Subsidized and Unsubsidized, as well as PLUS loans qualify for this option.
2. **Extended Repayment**: Eligible borrowers with direct loans in excess of $30,000.00 may be eligible. Qualified borrowers are allowed a 25-year period to repay loans. Available in either fixed or graduated monthly repayment schedule). All Direct Subsidized and Unsubsidized, as well as PLUS loans qualify for this option.
3. **Income Contingent Repayment:** based upon financial need, with payments based upon AGI of household, family size and amount of qualified Direct Loans. Qualified borrowers will have balance of unpaid loans discharge if all required payments made for a 25 period; however, borrowers may have tax consequences on any unpaid and discharged balances of student loans under this option. All Direct Subsidized and Unsubsidized, Direct Consolidation Loans, as well as PLUS loans made to student borrowers (but NOT parent borrowers) qualify for this option.
4. **Income Based Repayment**: similar to income contingent repayment, although eligibility contingent upon income and financial hardship, and payments may be adjusted annually. Eligible borrowers may be eligible for loan forgiveness at end of repayment period, which can last up to 25 years. All Direct Subsidized and Unsubsidized, Direct Consolidation Loans, as well as PLUS loans made to student borrowers (but NOT parent borrowers) qualify for this option.
5. **Pay as You Earn:** Based upon borrower's income and family size, and may increase or decrease each year based upon fluctuations in income. At least partial financial

[2] For more complete information on Direct Loan Re-payment Options, visit the Dept. of Education Website: http://www.direct.ed.gov/RepayCalc/dlindex2.html; see Also Appendix A-Flow Chart of Student Loan Re-Payment Options for Federal Loans

hardship required to qualify for option. Financial hardship determined if borrower's payment under standard 10-year repayment would be greater than based upon borrower's ability to pay. All Direct Subsidized and Unsubsidized, Direct Consolidation Loans, as well as PLUS loans made to student borrowers (but NOT parent borrowers) qualify for this option.

C. Other Available Options:

1. **Total and Permanent Disability Discharge**[3]: borrowers that demonstrate not only need, but a total and permanent disability, may be eligible for this option. Availability for this type of relief includes any Direct Federal Loans and Perkins Loans. Borrowers may demonstrate total and permanent disability either with documents from the Social Security Administration (if social security disability has been awarded) or with a certification from a borrower's physician. Moreover, in most, if not all cases, a borrower's income cannot exceed poverty guidelines to qualify. In some instances, there is a 3-year probationary period before permanent discharge of loans is granted.
2. **Death:** in most instances, if a borrower dies during a repayment period, any loans will be cancelled if family or heirs can provide sufficient documentation of death.
3. **Public Service Cancellation**: borrowers working in public service who make 120 consecutive payments without default may likewise be eligible for cancellation of remaining student loan debt.

[3] For more complete information on the TPD process and eligibility requirements see: https://www.disabilitydischarge.com/TPD-101/; for more information on other cancellation options, see: http://www.direct.ed.gov/cancellation.html

II. Private Student Loans:

These types of loans originate with private lenders and terms and conditions will vary depending on the lender. Some private student loan lenders include, but are not limited to: **Wells Fargo Bank, Navient (may also service federal loans); Sun Trust Bank and PNC Bank.** Searching the web will also reveal a plethora of other private lenders that finance student loans. Private student loans are still subject the undue hardship provisions of 11 U.S.C. §523(a)(8), which was amended in 2005 and included with the amendments passed with BAPCPA. Private student loans are generally not eligible for consolidation with federally insured or issued loans and therefore do not qualify for administrative relief programs available through the United States Department of Education.

A. Non-Bankruptcy Options for Private Student Loans

1. Lump Sum Settlement
2. Court Ordered Installment Agreements
3. Consolidation with other private loans (for better interest rate(s) or reasonable monthly payments).
4. Other?

.

APPENDIX A

OVERVIEW OF REPAYMENT PLANS

Repayment Plan	Eligible Loans	Monthly Payment and Time Frame	Quick Comparison
Standard Repayment Plan	• Direct Subsidized and Unsubsidized Loans • Subsidized and Unsubsidized Federal Stafford Loans • All PLUS loans	Payments are a fixed amount of at least $50 per month. Up to 10 years.	You'll pay less interest for your loan over time under this plan than you would under other plans.
Extended Repayment Plan	• Direct Subsidized and Unsubsidized Loans • Subsidized and Unsubsidized Federal Stafford Loans • All PLUS loans	Payments may be fixed or graduated. Up to 25 years.	• Your monthly payments would be lower than the 10-year standard plan. • If you are a - ◦ Direct Loan borrower, you must have more than $30,000 in outstanding Direct Loans. ◦ FFEL borrower, you must have more than $30,000 in outstanding FFEL Program loans. ▸ 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. • For both programs, you must also be a new borrower as of October 7, 1998. • 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
Graduated Repayment Plan	• Direct Subsidized and Unsubsidized Loans • Subsidized and Unsubsidized Federal Stafford Loans • All PLUS loans	Payments are lower at first and then increase, usually every two years. Up to 10 years.	You'll pay more for your loan over time than under the 10-year standard plan.
Income-Contingent Repayment Plan	• Direct Subsidized and Unsubsidized Loans • Direct PLUS loans made to students • 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. • Your payments change as your income changes. • Up to 25 years.	• You'll pay more for your loan over time than you would under the 10-year standard plan. • 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. • You may have to pay income tax on any amount that is forgiven.
Income-Based Repayment Plan (IBR)	• Direct Subsidized and Unsubsidized Loans • Subsidized and Unsubsidized Federal Stafford Loans • All PLUS loans made to students • 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). • Your payments change as your income changes. • Up to 25 years.	• You must have a partial financial hardship. • Your monthly payments will be lower than payments under the 10-year standard plan. • You'll pay more for your loan over time than you would under the 10-year standard plan. • 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. • You may have to pay income tax on any amount that is forgiven.

Repayment Plan	Eligible Loans	Monthly Payment and Time Frame	Quick Comparison
Income-Sensitive Repayment Plan	• Subsidized and Unsubsidized Federal Stafford Loans • FFEL PLUS loans • FFEL Consolidation Loans	• Your monthly payment is based on annual income. • Your payments change as your income changes. • Up to 10 years.	• You'll pay more for your loan over time than you would under the 10-year standard plan. • Each lender's formula for determining the monthly payment under this plan can vary.
Pay As You Earn Repayment Plan	• Direct Subsidized and Unsubsidized Loans • Direct PLUS loans made to students • 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). • Your payments change as your income changes. • 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. • You must have a partial financial hardship. • Your monthly payments will be lower than payments under the 10-year standard plan. • You'll pay more for your loan over time than you would under the 10-year standard plan. • 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. • You may have to pay income tax on any amount that is forgiven.

STUDENT LOANS A-Z

CHAPTER 13 TREATMENT OF STUDENT LOANS

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Debtors may have legitimate reasons for filing for bankruptcy, and Chapter 13 in particular. A Chapter 13 debtor may be seeking to cure a mortgage arrearage or delinquent property taxes; seek to lower monthly payments in order to feasibly retain an automobile; or simply may be required to file Chapter 13 due to his or her income level. However, how does a Chapter 13 filing affect a debtor's outstanding student loans? Can a Chapter 13 Plan treat a student loan different, or with a higher priority over, a debtor's other debt? A clear understanding of what a debtor can, and more importantly, CAN'T propose in a Chapter 13 plan to address student loan debt is important to adequately counsel clients seeking to utilize Chapter 13 to provide relief from student loan debt.

I. Statutory Provisions in Chapter 13 Relevant to Student Loans

A. 11 U.S.C. §1322(b)(1): the [Chapter 13] plan may designate a class or classes of unsecured claims, as provided in section 1122 of this title, but **may not *discriminate unfairly* against any class so designated…** 11 U.S.C. §1322(b)(1) (***emphasis added***).

Why is this relevant? "Like other general unsecured debts, student loans are largely unsecured and are not accorded priority treatment under the Bankruptcy Code." *In re Baker*, 400 B.R. 594, 600 (Bankr. N.D. OH 2009). Therefore, in spite of the fact that student loans, even for Chapter 13 debtors, are presumptively non-dischargeable absent a showing of undue hardship pursuant to 11 U.S.C. §523(a)(8), student loans have no greater priority than other general unsecured debts, such as those that stem from credit card usage or medical treatment.

B. 11 U.S.C. §1322(b)(5): (a) the [Chapter 13] plan may provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending ***on any unsecured claim*** or secured claim on which the last payment is due after the date on which the final payment under the Plan is due. 11 U.S.C. §1322(b)(5)(a). (***emphasis added***)

Why is this relevant? Some courts have suggested that, depending on the specific circumstances of a particular loan, that though the non-dischargeable nature of student loans, without more, is insufficient to justify disparate treatment from other unsecured debtors, student loans could be treated as "long term debts" that would allow a debtor to cure a delinquency and maintain ongoing payments of his or her student loans; this might allow a debtor to treat a student loan differently without running afoul of §1322(b)(1). The benefit of this option is that it might allow a debtor to, in the least, keep student loans in good standing while in bankruptcy and avoid unnecessary interest from accruing on the loans. See for example, *In re Sullivan*, 195 B.R. 649 (Bankr. W.D. TX 1996) that discusses this potential option for debtors; see also *In re Saulter*, 133 B.R. 148 (Bankr. W.D. MO 1991), which likewise endorses the notion that this option may be available for debtors without violating 11 U.S.C. §1322(b)(1).

C. 11 U.S.C. §1322(b)(10): the [Chapter 13] plan may provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are non-dischargeable under section 1328(a), except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest ***after* making *provision for full payment of all allowed claims***. 11 U.S.C. §1322(b)(10) (***emphasis added***).

Why is this relevant? As a presumptively non-dischargeable debt, there does not appear to be any great dispute that interest can and will continue to accrue on a debtor's student loan debt post-petition. See *Leeper v. Pennsylvania Higher Education Asst. Agency*, 49 F.3d 98 (3rd Circuit 1995); see also *United States Dept. of Education v. Harris*, 339 B.R. 673 (Bankr. W.D. TN 2006). Therefore, it is crucial that any bankruptcy practitioner be prepared to adequately advise a debtor on the potential impact of interest accrual on student loans while in bankruptcy if the Plan does not provide for full repayment of the student loan and any accruing interest.

Moreover, even if the Plan provides for full payment of a student loan debt, on the balance owed as of the petition date, debtors may still owe a balance to their student loan lender after exiting bankruptcy. "The student loan creditor cannot compel the payment of post-petition interest on its claim from the bankruptcy estate, ***but may compel the payment of interest from the debtor after completion of the Chapter 13 plan because interest on nondischargeable debts is a nondischargeable***." *In re Williams*, 253 B.R. 220, 227 (Bankr. W.D. TN 2000) (***emphasis added***), citing *Leeper v. Pennsylvania Higher Education Asst. Agency*, 49 F.3d 98, 101-103 (3rd Circuit 1995).

Question: Does Section 1322(b)(10) preclude a debtor from utilizing Section 1322(b)(5) to maintain contractual student loan payments, including interest, during the life of a Chapter 13 Plan absent full repayment of other unsecured debt? Courts appear to be split on this issue. For example, see *In re Brown*, 500 B.R. 255 (Bankr. S.D. GA 2013)-ruled allowing debtor to maintain direct student loan payments on a long-term debt did not conflict with Section 1322(b)(10) nor unfairly discriminate against general unsecured creditors; contrast with *In re Kubeczko*, 2-12 Bankr. LEXIS 3081, which unequivocally rejected this approach.

II. **"Unfair Discrimination": What Does It Mean?**

A. General Elements of "Unfair Discrimination"

There is no general consensus among bankruptcy Court as to what constitutes fair vs. unfair discrimination. A review of relevant case law reveals there are essentially three (3) accepted approaches in addressing this issues:

1. *Leser* Test: named after the 8th Circuit's holding in *In re Leser*, 939 F.2d 669 (8th Cir. 1991), this approach address four (4) specific factors, to wit: a) whether the discrimination has a reasonable basis; b) whether the debtor can carry about a chapter 13 plan without the discrimination; c) whether the discrimination is proposed in good faith; and d) whether the degree of discrimination is directly related to the basis or rational for the discrimination.
2. "Legitimate interests of the debtor" test (i.e. whether the discrimination furthers rational and legitimate interests of a debtor. See *In re Lawson*, 93 B.R. 979 (Bankr. N.D. ILL 1988)
3. *Bentley* test (adopted by the First Circuit B.A.P) in *In re Bentley*, 266 B.R. 229 (1st Circuit B.A.P. 2001) (Note: unlike the *Leser* test, which considers, in part, "the legitimate interests of the debtor,"[4] this test instead focuses on fairness to a debtor's creditors. In furtherance of this consideration, the *Bentley* court suggested a baseline test that likewise considered four factors: a) the principle of equality of distribution; b) the non-priority status of student loan debts; c) the mandatory nature of the debtor's obligations to devote disposable income to pay of an unsecured debt, like student loans; and d) the Bankruptcy Code's "fresh start" policy, tempered by the nondischareability of certain debts, including student loans.

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[4] *In re Bentley* 266 B.R. 229, 238 (1st Cir. B.A.P. 2001)

B. Majority View:

The overwhelming majority of courts ruling on Chapter 13 plans that propose to treat student loans disparately from other unsecured debts have generally held debtors must first demonstrate that any proposed discrimination of student loan debt vs. non-student loan debt is "fair" before consideration of payment of student loan debt as "long term debt" under Section 1322(b)(5). See, for example, *In re Jordahl*, 516 B.R. 573 (Bankr. D. Minn 2014)-includes good synopsis of Courts that adopt this rationale vs. those courts that adopt the minority view.

C. Minority View

Some Courts nonetheless have held that Section 1322(b)(5) can be enforced separately from Section 1322(b)(1); meaning that even discrimination, which might otherwise be considered "unfair" if such debt is not treated as "long term" debt, may still be permissible. See *In re Brown*, 500 B.R. 255 (Bankr. S.D. GA 2013)

***Note: there is no published decisions in the Eastern District of Michigan regarding this specific legal issue; however, Court's within this District have ruled that student loans are not considered "special circumstances" for purposes of completing the Means Test and/or overcoming a presumption of abuse in Chapter 7. See, for example, *In re Maura*, 491 b.R. 493 (Bankr. E.D. MI 2013)**

D. Burden of Proof:

1. Debtor has the burden to demonstrate the discriminate is not "unfair." See, for example, *In re Williams*, 253 B.R. 220 (Bankr. W.D. TN 2000).
2. What constitutes "unfair" discrimination, may ultimately rest within the discretion of the individual judge evaluating the particular case at hand. See, *In re Williams*, 253 B.R. 220, 226 (Bankr. W.D. TN 2000), citing *In re Groves,* 39 F.3d 212, 214 (8th Cir. 1994).