3-26-2019

Discharging Student Loans in Bankruptcy

Zachary Langrehr

Discharging Student Loans in Bankruptcy

By Zachary Langrehr*

THE PRIVATE STUDENT LOAN BANKRUPTCY FAIRNESS ACT OF 2019

The Private Student Loan Bankruptcy Fairness Act of 2019, H.R. 885, was introduced in the United States House of Representatives on January 30, 2019.[1] This bill, if enacted, would provide that privately-issued student loans are dischargeable in bankruptcy without the current requirement that a debtor must prove that repayment would impose an "undue hardship" on the debtor and the debtor's dependents to receive a discharge of privately-issued student loans.[2] Representative Steve Cohen of Tennessee, one of the Representatives who introduced the bill, spoke in favor of the bill, stating that it "would provide critical relief to Americans in severe financial distress who are struggling with overwhelming private student loan debt."[3]

Representative Cohen stated that, prior to 2005, private student loans issued by for-profit lenders were treated similarly to most other unsecured consumer debt.[4] Additionally, he stated that the Private Student Loan Bankruptcy Fairness Act of 2019, if enacted, would provide that private student loans would once again be treated like other consumer debt and be dischargeable in bankruptcy.[5] Representative Cohen stated that student loans and other consumer debts, such as credit cards and subprime mortgages, are analogous.[6] For example, private student loans often have high-interest rates, and may include significant fees and "hidden charges," similar to credit cards and subprime mortgages.[7] Representative Cohen

* J.D. Candidate, 2020, Saint Louis University School of Law

[1] Private Student Loan Bankruptcy Fairness Act of 2019, H.R. 885, 116th Cong. (2019).

[2] *Id.*; 11 U.S.C. § 523(a)(8) (2012).

[3] 165 Cong. Rec. E110 (daily ed. Jan. 30, 2019) (statement of Rep. Cohen).

[4] *Id.* at E110-11.

[5] *Id.* at. E111.

[6] *Id.*

[7] *Id.*

stated that these similarities support treating private student loans like other consumer debt in bankruptcy.[8]

Furthermore, Representative Cohen stated that "[a] hallmark of our nation's bankruptcy law is to give an honest but unfortunate debtor a chance to obtain meaningful relief."[9] He continued, stating that "[c]urrently, the Bankruptcy Code prohibits the discharge of private educational debt unless the debtor, in addition to meeting the stringent requirements for personal bankruptcy, proves that repayment would impose an 'undue hardship,' on the debtor and the debtor's dependents," and this standard is difficult to meet.[10] Therefore, according to Representative Cohen, the Private Student Loan Bankruptcy Fairness Act is necessary to provide debtors with private educational debt a chance to obtain meaningful relief.[11]

HOW TO DISCHARGE PRIVATE EDUCATIONAL DEBT NOW

Currently, it is difficult to receive a discharge of educational debt in bankruptcy.[12] Section 523(a)(8) of the Bankruptcy Code provides that student loans, benefits, scholarships, or stipend overpayments made, insured, or guaranteed by a governmental unit or funded by a governmental unit or non-profit institution are nondischargeable absent a showing of undue hardship.[13] Further, loans or educational benefit overpayments for educational purposes do not have to be made or funded by a governmental unit to be nondischargeable because Section 523(a)(8) also provides that any other educational loan that is a "qualified education loan" pursuant to § 221(d)(1) of the Internal Revenue Code incurred by a debtor who is an individual is nondischargeable absent a showing of undue hardship.[14]

---

[8] 165 Cong. Rec. E111.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] Robert E. Ginsberg, Robert D. Martin, and Susan V. Kelley, Ginsberg and Martin on Bankruptcy § 11.06 (5th ed. 2019); 11 U.S.C. § 523(a)(8) (2012).

[14] Ginsberg, Martin, and Kelley, supra note 13; 11 U.S.C. § 523(a)(8).

According to Robert Ginsberg, Robert Martin, and Susan Kelley, "[t]he undue hardship provision permits a debtor to discharge an otherwise nondischargeable student loan if excepting the debt from discharge would impose an undue hardship on the debtor and dependents."[15] "Undue hardship" is not defined in the Bankruptcy Code.[16] Nine circuit courts have adopted the Second Circuit's test set forth in Brunner v. New York State Higher Education Servs. Corp.[17] to determine undue hardship.[18] The Eighth Circuit, however, has adopted the totality-of-the-circumstances test to determine undue hardship.[19]

In Brunner, the Second Circuit:

adopted a standard for "undue hardship" requiring a three-part showing: (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 of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.[20]

The Eighth Circuit declined to adopt the Brunner test in In re Long[21] when it reaffirmed the totality-of-the-circumstances test set forth in Andrews v. South Dakota Student Loan Assistance Corp. (In re Andrews).[22] The Eighth Circuit stated that it preferred "a less restrictive approach" than the Brunner test to the "undue hardship" inquiry.[23] Moreover, the Eighth Circuit set forth its totality-of-the-circumstances test again, stating that "[i]n evaluating the totality-of-the-circumstances, our bankruptcy reviewing courts should consider: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependent's reasonable necessary living expenses; and (3) any other

[15] Ginsberg, Martin, and Kelley, supra note 13; 11 U.S.C. § 523(a)(8).
[16] Ginsberg, Martin, and Kelley, supra note 13.
[17] 831 F.2d 395, 396 (2d Cir. 1987).
[18] Ginsberg, Martin, and Kelley, supra note 13.
[19] *Id*.
[20] 831 F.2d at 396.
[21] 322 F.3d 549, 553 (8th Cir. 2003).
[22] 661 F.2d 702, 704 (8th Cir. 1981).
[23] *Long*, 322 F.3d at 554.

relevant facts and circumstances surrounding each particular bankruptcy case."[24]

CONCLUSION

While the Private Student Loan Bankruptcy Fairness Act of 2019 appears to have good intentions,[25] the proposed bill would not be without its drawbacks. Jennifer Frattini opines that "[t]hose advocating [for] the non-dischargeability of educational loans have a common goal—to prevent abuse of the student loan program by the dishonest borrower who deliberately sought to procure a free college education by filing for bankruptcy shortly before or immediately after graduation, thus discharging all student loans."[26] Making discharges of private educational debt easier to obtain could result in high levels of abuse and could harm the private student loan market. Further, the proposed bill could increase the costs of private loans causing fewer students to choose to attend college due to the higher costs.[27] Judge Posner, for example, supported this view, and he opined "that 'by increasing the rights of creditors in bankruptcy[,] . . . bankruptcy reform [(making private student loans nondischargeable absent a showing of undue hardship in 2005)] should reduce interest rates and thus make borrowers better off.'"[28]

Therefore, there are valid arguments both for and against the proposed Private Student Loan Bankruptcy Fairness Act of 2019. With educational

[24] *Id.* (citing *Andrews*, 661 F.2d at 704).
[25] 165 Cong. Rec. E111 (daily ed. Jan. 30, 2019) (statement of Rep. Cohen).
[26] Jennifer L. Frattini, *The Dischargeability of Student Loans: An Undue Burden?*, 17 Bankr. Dev. J. 537, 546 (2001).
[27] *See* Alexei Alexandrov, Dalié Jiménez, *Lessons from Bankruptcy Reform in the Private Student Loan Market*, 11 Harv. L. & Pol'y Rev. 175, 178 (2017) (stating that "[t]he rationale for BAPCPA's special treatment of private student loans [(making private student loans nondischargeable absent a showing of undue hardship)] . . . consisted of . . . expect[ing] that the law would lower the cost of private loans and that more students would choose to attend college due to the lower costs").
[28] *Id.* (quoting Richard Posner, *The Bankruptcy Reform Act—Posner*, Becker-Posner Blog (Mar. 27, 2005), http://www.becker-posner-blog.com/2005/03/the-bankruptcy-reform-act--posner.html).

debt at significant levels,[29] the Private Student Loan Bankruptcy Fairness Act of 2019, if enacted, would likely have substantial effects.

Edited by Carter Gage

[29] *See* Prof. Robert M. Lawless, *Hardship Discharge: Abi Consumer Commission Weighs in on Rfi*, Am. Bankr. Inst. J. 84 (2018).