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TREATMENT OF STUDENT LOANS IN BANKRUPTCY – THE BASICS

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I. "UNDUE HARDSHIP:" THE STATUTES AND JUDICIAL GLOSS

A. THE STATUTES

11 U.S.C. §523(a)(8):

"(a) A discharge under §727, 1141, 1228(a), 1228(b), or 1328(b) of this Title does not discharge an individual debtor from any debt –

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

(A)(i) an educational benefit or overpayment or loan made, insured, were guaranteed by a governmental unit, or made under any program funded inn whole or in part by a governmental unit or non-profit 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 §221(d)(i) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;"

11 U.S.C. §1328(a)(2):

(a) The court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under §502 of this Title, except any debt - …

(2) of the kind specified in §507(a)(8)(C) of in paragraph (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of §523(a);"

11 U.S.C. §1141(d)(2):

"A discharge under this Chapter does not discharge a debtor who is an individual from any debts excepted from discharge under §523 of this Title."

11 U.S.C. §1228(a)(2):

"(a) After completion by the debtor of all payments under the Plan…the court shall grant the debtor a discharge of all debts provided for by the Plan and allowed under §503 of this Title or disallowed under §502 of this Title, except any debt –

(2) of the kind specified in §523(a) of this Title.

B. THE JUDICIAL GLOSS

1. "Undue Hardship" Defined.

- Not defined in the statute.

- Test first announced in Bruner v. New York State Higher Educ. Serv. Corp., 831 F.2d 395, (2nd Cir. 1987):

  "(1) That the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans;

  (2) That additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and

  (3) That the debtor has made good faith efforts to repay the loans."

- Adopted in the Sixth Circuit in In re Oyler, 397 F.3d 382, 385 (6th Cir. 2005).

- Burden of Proof on Debtor to prove all three prongs by preponderance, In re Barrett, 487 F, 3d 353, 359 (6th Cir, 2007); In re Oyler, *supra.*

- Applies to partial discharge, Miller v. Pennsylvania Higher Education Assistance Agency, 377 F. 3d 616 (6th Cir. 2004).

- Applies to student loans where the Debtor is not the student (i.e. parent loans), Pelkowski v. Ohio Student Loan Commission, 990 F. 2d 737 (3rd Cir. 1993); In re Cockels, 414 B. R. 149 (E.D. MI 2009).

- **(A) Prong I – Maintaining a Minimal Standard of Income.**

  - Not abject poverty, In re Hornsby, 144 F.3d 433, 438 (6th Cir. 1998).

  - Spousal income is considered (whether or not spouse is obligated on the loan), In re Buchanan, 276 B.R. 744 (N.D. W.V. 2002); In re Mitchell, 2010 B.R. 105 (Bankr. N.D. Ohio 1996).

  - Court is under duty to scrutinize and adjust a debtor's income and expenses to ensure that such accurately reflect the debtor's financial situation, In re Flores, 282 B.R. 847, 854 (Bankr. N.D. Ohio 2002).

  - Under-employment – In re Oyler, 397 F.3d 382 (6th Cir. 2005); In re Melton, 187 B.R. 98 (Bankr. W.E. N.Y. 1995); In re Grigas, 252 B.R. 866 (Bankr. N.H. Aug. 2000); In re Zierden-Lendmesser, 249 B.R. 65 (.M.D. Pa. 2000) (unwillingness of debtor to relocate to better job market).

- **(B) Prong II – Additional Circumstances Likely to Persist.**

  - "Certainty of hopelessness, not merely a present inability to fulfill financial commitment," In re Roberson, 999 F.2d 1132, 1136 (7th Cir. 1993), cited in In re Oyler at 397 F.3d 386.

  - Children grow up. In re Goodman, 449 B.R. 287 (Bankr. N.D. Ohio 2011); In re Flores, 282 B.R. 847, 854 (Bankr. N.D. Ohio 2002); In re Hoyle, 199 B.R. 518, 521 (Bankr. N.D. Pa. 1996).

- **(C) Prong III – Good Faith Efforts to Repay the Loans.**

  - Fact specific: "Whether a debtor has made payments on a student loan obligation will not always be dispositive," In re Roberts, 442 B.R. 116, 120 (Bankr. N.D. Ohio 2010) citing In re Grant, 398 B.R. 205, 212 (Bankr. N.D. Ohio 2008).

  - Failure to participate in income sensitive repayment programs. See In re Tirch, 409 F.3d 677, 682 (6th Cir. 2005):

    > "While not a per se indication of a lack of good faith…Tirch's decision not to take advantage of the ICR is probative of her intent to repay her

loans…in cases involving a partial discharge of student loans, "it is a difficult, although not necessarily an insurmountable burden for a debtor who is offered, but then declines the government's Income Contingent Repayment Program, to come to this court and seek an equitable adjustment of their student loan debt."" [Citations omitted.]

- See also In re Grove, 323 B.R. 216 (Bank. N.D. Ohio 2005) (court found that the debtor could maintain a minimal standard of living and repay his student loans if he participated in the Income Contingent Repayment Program – failure to meet Prong I).

- In re Wolph, 479 B.R. 725, 733 (Bankr. N. D. OH 2012): "Particularly in light of those other considerations already discussed, this approach of the Plaintiff, of first seeking to roll the dice in this Court, by not first attempting to participate in a non-bankruptcy repayment program, is not consistent with the idea that bankruptcy should be used only as a last resort."

II. PAYMENT PROGRAMS AND OTHER ALTERNATIVES TO UNDUE HARDSHIP BANKRUTPCY DISCHARGE UNDER 11 U.S.C. §523(a)(8).[1]

- Limited to "public" loans (i.e., FFELP Loans, Direct Loans with the Department of Education, Consolidation Loans with the Department of Education) incorporating FFELP Loans.

  Eligible Loans vary from program to program, but generally Direct and FFELP Stafford Loans, FFELP Grad PLUS Loans, Consolidation Loans that did not repay parent PLUS Loans.

- Ineligible loans: defaulted loans and Parent PLUS Loans (original or consolidated).

- Not applicable to private student loans (i.e., banks and loan companies).

[1] The attached chart is reprinted courtesy of Navient.

I. INCOME CONTINGENT REPAYMENT PROGRAM (ICR) – 34 C.F.R. §285.2009.

- Available for loans held by the Department of Education and other "public loans" consolidated with the Department of Education under the W.D. Ford Program, 34 C.F.R. §685.209.

- Requires monthly payment equal to lesser of 20% of the amount by which adjusted gross income exceeds the Federal Poverty Level, divided by 12 or a 12 year standard repayment multiplied by the income percentage factor. The Income Repayment Program can last 25 years.

II. INCOME BASED REPAYMENT (IBR) – 34 C.F.R. §685 AND 20 U.S.C. §1098(e).

- Requires showing of partial financial hardship: annual amount due on the eligible loans, calculated under the 10 year standard repayment plan, must exceed 15% of the borrower's discretionary income (AGI less 150% of the applicable poverty standard).

- Repayment is calculated as 15% of adjusted gross income less Discretionary Income divided by 12.

- Eligibility can cease if PFH ceases to exist.

III. PAY AS YOU EARN (PAYE).

- Applicable only to borrowers who had no outstanding student loan debt as of October 1, 2007, and received a disbursement on a Direct Loan (Department of Education) on or after October 1, 2011.

- PFH of 10 year payment amount exceeding 10% of Discretionary Income (AGI less 150% of poverty level).

- Need to be in income sensitive payment program (as above).

- Payment is 10% of AGI less Discretionary Income divided by 12.

- Payment period up to 20 years (240 qualifying payments).

IV. PUBLIC SERVICE JOB LOAN FORGIVNESS (PSLF) – 20 U.S.C. §1087(e); 34 C.F.R. §685.219.[2]

- Borrower must be employed and continue to be employed in a "public service job" as defined by the statute:

e.g. ,Healthcare, Public Education, Social Work, Public Interest Law Services, Early Childhood Education, Public Service for the Elderly or those with Disabilities, Public Library, or an Organization Exempt from Tax Under 501(c)(3) of the Internal Revenue Code.

- Balance of student loan is forgiven after 120 monthly payments.

V. DISABILITY – ADMINISTRATIVE DISCHARGE (TPD)[3]

- Applies to FFELP, Direct Loans, Federal Perkins Loans, TEACH loans
- Mental or physical impairment (as certified by medical professional) that –
  - Can be expected to result in death,
  - has lasted for a continuous period of at least 60 months, or
  - can be expected to last at least 60 months
  - that enables the borrower unable to engage in any *substantial gainful activity*
- VA determination of total or 100% disability suffices
- SS disability alone is insufficient – needs certification
- Form and rules available online at:
  http://disabilitydischarge.com/Pages/Users.aspx?id=35

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[2] A detailed description of this program is attached.

[3] A copy of the application form, outlining the requirements, is attached.

D. CHAPTER 13 ISSUES.

I. UNITED STUDENT AID FUNDS v. ESPINOSA, 599 U.S. 260, 130 S. Ct. 1367 (2010) – "DISCHARGE BY DECLARATION" CASE.

- A Chapter 13 Plan that proposes to discharge a student loan debt without a determination of undue hardship violates §§1328(a)(2) and 523(a)(8): "Failure to comply with this self-executing requirement should prevent confirmation of the Plan even if the creditor fails to object, or appear in the proceeding at all." 130 S. Ct. 1380.

- "We acknowledge the potential for bad-faith litigation tactics…. As we stated in Taylor v. Freeland & Kronz, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280 (1992), "Debtors and their attorneys face penalties under various provisions for engaging in improper conduct in bankruptcy proceedings"…the specter of such penalty should deter bad-faith attempts to discharge student loan debt without the undue hardship finding Congress required." 130 S. Ct. 1382.

- The Court allowed the "Discharge by Declaration," only because the student loan creditor had ample notice of the discharge provision of the Plan and failed to timely object or file a 60(b) Motion in a timely manner.

- The Sixth Circuit had previously held in In re Ruehle, 412 F. 3d 679 (6th Cir. 2005), that "discharge by declaration" in a Chapter 13 Plan, absent the kind of notice that properly served summons and an adversary complaint provide, violated due process.

II. ACCRUAL OF INTEREST

The Chapter 13 Plan may address Pre-petition interest, but Post-petition interest on the non-dischargeable loan will continue to accrue, U.S. Dept. of Education v. Harris, 339 B.R. 673, 677 (W.D. TN 2006); In re Wagner, 200 B.R. 160, 163 (Bankr. N.D. OH 1996).