DISCHARGEABILITY OF STUDENT LOANS

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Moderator: Kent V. Snyder, Snyder and Associates, Portland, Oregon

Panel Members:

Hon. William Houston Brown, Western District of Tennessee

Thomas H. Keyse, Block, Markus & Williams, LLC, Denver, Colorado

Curtis P. Zaun, Educational Credit Management Corporation, St. Paul, Minnesota

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DISCHARGEABILITY OF STUDENT LOANS

Curtis P. Zaun
Senior Partner
Educational Credit Management Corporation

I. GENERAL OVERVIEW OF STUDENT LOANS

In 1965, Congress, in response to a perceived need for financial assistance to students in higher education, passed the Higher Education Act of 1965 (HEA). The purpose of the HEA is to "keep the college door open to all students of ability," regardless of socioeconomic background. Under the HEA, there are two loan programs, the Federal Family Education Loan Program (FFELP) (20 U.S.C. § 1071, *et seq*., and 34 C.F.R. § 682.100, *et seq*.) and the William D. Ford Federal Direct Loan Program (DLP) (20 U.S.C. § 1087a, *et seq*., and 34 C.F.R. § 685.100, *et seq*.). Under the FFELP, eligible lenders make guaranteed loans on favorable terms to students or parents to help finance student education. The loans are guaranteed by guaranty agencies (state agencies or private non-profit corporations) and ultimately by the United States Department of Education (ED). Under DLP, ED makes loans directly to student and parent borrowers.

Loans under the HEA include Perkins Loans, Stafford (subsidized and unsubsidized) Loans, PLUS (Parent) Loans and Consolidation Loans. Grants include Pell Grants and Supplemental Education Opportunity Grants. The terms of Stafford, PLUS and Consolidation loans are nearly identical under both the FFELP and DLP, except that DLP has two additional repayment plans that are not available under the FFELP.

The United States Department of Health and Human Services (DHHS) administers a student loan program, Health Education Access Loan program, (HEAL), for borrowers engaged in health related studies. The United States Department of Justice defends the DHHS's HEAL loans interest in bankruptcy situations. Like FFELP and DLP loans, HEAL loans are also presumptively nondischargeable. Courts have construed the dischargeability standard of "unconscionability" for HEAL loans as being a "higher standard" than that of FFELP loans, which require a showing of "undue hardship." *Cf.* 42 U.S.C. § 294f(g) *with* 11 U.S.C. § 523(a)(8). Even though HEAL loans are administered by DHHS, HEAL loans are eligible for consolidation along with FFELP loans in ED's Ford program.

Private label loan programs have also emerged on the scene to provide educational funds to students who have exhausted their loan limits or are otherwise ineligible to borrow under the federal loan programs. Private label loans are not eligible for administrative relief discussed below and may not be consolidated under federally-sponsored consolidation programs. Private label loans, however, do enjoy a presumption of nondischargeability under 11 U.S.C.§ 523(a)(8). *HEMAR Serv. Corp. v. Pilcher,* 149 B.R. 595 (B.A.P. 9th Cir. 1993); *In re Bolen,* 287 B.R. 127 (D. Vt. 2002).

II. ADMINISTRATIVE REMEDIES

Most debtors who have trouble paying their student loans resort to bankruptcy to seek relief because they are unaware of the numerous administrative remedies that are available to them. Before turning to bankruptcy, the debtor's situation should be examined to determine whether one of these administrative options could resolve the debtor's situation. Not only is this advisable, but many courts will consider a failure to look into these less drastic options when considering a claim of undue hardship. *See, e.g., Penn. Higher Educ. Assist. Agency v. Birrane (In re Birrane),* 287 B.R. 490 (B.A.P. 9th Cir. 2002) (debtor's failure to pursue repayment options considered in applying undue hardship test); *Archibald v. United Student Aid Funds (In re Archibald),* 280 B.R. 222, 229 (Bankr. S.D. Ind. 2002) (same); *Scholl v. NSLP (In re Scholl),* 259 B.R. 345 (Bankr. N.D. Iowa 2001) (undue hardship action dismissed without prejudice for failure to exhaust administrative remedies). Administrative remedies include:

A. Deferments.

Pursuant to 34 C.F.R. § 682.210, debtors are entitled to deferments under certain specified situations, e.g., full or half-time study; conscientiously seeking, but unable to find, full-time employment for up to two years; on active duty in the armed forces; full-time volunteer for a tax-exempt organization for up to three years; temporarily totally disabled or unable to secure employment because the borrower is caring for a spouse or other dependent who is disabled and requires continuous nursing or similar services for up to three years; full-time volunteer under the Peace Corps Act for up to three years; economic hardship; and, several others. During periods of deferments, the government pays interest on subsidized loans. Debtors who default on their student loans lose their eligibility for deferments.

B. Forbearances.

34 C.F.R. § 682.211 states, "The Secretary encourages a lender to grant forbearance for the benefit of the borrower or endorser in order to prevent the borrower or endorser from defaulting on the borrower's or endorser's repayment obligation, or to permit the borrower or endorser to resume honoring that obligation after default." Generally, unlike a deferment, the decision whether to grant a deferment is discretionary. Interest continues to accrue during any period of forbearance and is capitalized if it is not paid. Once a borrower has defaulted and his or her loans have been transferred to a guaranty agency, he or she is no longer able to get a forbearance.

C. Consolidation.

A borrower can consolidate his student loans regardless of whether they are defaulted. However, a borrower who defaulted must either have a satisfactory repayment arrangement, which is three consecutive on-time reasonable and affordable payments, or, if the borrower is consolidating with DLP, choose the Income Contingent Repayment Plan (ICRP). A reasonable and affordable payment is based on the borrower's total financial circumstances, which includes a borrower's and his spouse's disposable income and reasonable and necessary expenses. Consolidation benefits a borrower by spreading the payments over a term of up to 30 years, depending on the

total loan balance. Loans can be consolidated under the FFELP or DLP, and loans already consolidated under the FFELP can be consolidated with DLP. Both programs have similar repayment options, including a standard repayment term (10 years), an extended repayment term (12 to 30 years) and a graduated repayment term (12 to 30 years, with lower initial payments and higher later payments).

DLP has two additional repayment options, the ICRP and an Alternative Repayment Plan. The ICRP payment is 20 percent of a borrower's disposable pay, which is defined as the borrower's Adjusted Gross Income, minus the poverty guidelines for his family size. *See* 34 C.F.R. § 685.209. The maximum term under this plan is 25 years and any balance remaining at the end of the term is discharged. If none of the other repayment plans are "adequate to accommodate the borrower's exceptional circumstances," borrowers may request an alternative repayment plan from the Secretary of Education. *See* 34 C.F.R. § 685.208(g).

Private label loans are not eligible for consolidation under the federally sponsored consolidation loan programs.

D. Rehabilitation.

Once a borrower has defaulted on his student loans, the only way to remove the default is to rehabilitate his student loans. Under 34 C.F.R. § 682.405, a borrower must make twelve consecutive reasonable and affordable payments within 15 days of the scheduled due date. After this is completed, the loans are purchased by an eligible lender, the default status is removed and the borrower starts repayment with the new lender.

E. Total and permanent disability discharge.

In order to have their student loans cancelled for total and permanent disability pursuant to 34 C.F.R. § 682.402(c), a borrower must have a physician certify that the borrower is unable to work and earn money, even on a limited basis, because of an injury or illness that is expected to continue indefinitely or result in death. If the borrower's application is approved, the borrower's loans are conditionally discharged and assigned to ED. After three years from the date that the borrower became totally and permanently disabled, if the borrower satisfies the criteria for discharge (not earning more than 100 percent of the poverty line for a family of two and not receiving a new student loan), then the balance of the borrower's student loans is discharged and any payments made by the borrower after the date of disability are refunded.

F. Closed school discharge.

Pursuant to 34 C.F.R. § 682.402(d), if a borrower could not complete the program of study for which he received his student loans because the school at which the borrower was enrolled closed or the borrower withdrew from the school not more than 90 days prior to the date the school closed, as determined by the Secretary, then the borrower's student loans are discharged and any payments received are refunded.

G. False certification discharge.

Pursuant to 34 C.F.R. § 682.402(e), a borrower's student loans can be discharged if a school falsely certified the borrower's eligibility to benefit from the education or signed the borrower's name without authorization by the borrower on the loan application or promissory note.

H. Death discharge.

Pursuant to 34 C.F.R.§ 682.402(b)(1), "If an individual borrower dies, or the student for whom a parent received a PLUS loan dies, the obligation of the borrower and any endorser to make any further payments on the loan is discharged."

It is important to note that administrative remedies require administrative determinations and thus should not be the basis for claim objections or adversary proceedings in a bankruptcy context. Student loan creditors have successfully dismissed actions that seek relief from student loan debt on the basis of an administrative remedy. *See, e.g., Barton v. Educ. Credit Mgmt. Corp. (In re Barton)*, 266 B.R. 922 (Bankr. S.D. Ga. 2001) (administrative remedies do not provide a private cause of action); *Bega v. Dept. of Educ. (In re Bega)*, 180 B.R. 642, 644 (Bankr. D. Kan. 1995) (same).

III. BANKRUPTCY

If none of the administrative remedies provide the debtor with sufficient relief, then his last alternative is bankruptcy. Student loans are presumptively non-dischargeable. *See* 11 U.S.C. §§ 727, 1328, & 523(a)(8). Thus, to have student loan debt discharged, the debtor must initiate an adversary proceeding. *See* F. R. Bankr. P. 7001(6). An adversary proceeding is initiated by filing a complaint and servicing it on the creditor with a summons. *See* F. R. Bankr. R. 7003 & 7004. When to sue and who to sue are the first questions that must be answered.

A. When to Sue

The issue of when to sue was discussed in a September 2003 Norton Bankruptcy Article entitled *Timing is Everything: When to Commence an Adversary Proceeding Under Section 523(a)(8)*, which is included in these materials. To briefly summarize the article, a student loan adversary proceeding should be brought at or near the time the bankruptcy discharge is granted.

1. Too Early

Because an undue hardship determination only discharges a student loan debt if a discharge is received, most courts have ruled that undue hardship cases are not ripe until at or near the time that the discharge is obtained. This conserves judicial resources. It also makes it easier for the court to apply the undue hardship test because the debtor's current and future situation is less speculative than it was at the beginning of the debtor's case, which could have been 3 to 5 years prior. Of course, undue hardship cases in Chapter 7 bankruptcies are ripe almost immediately. The leading cases that have addressed ripeness include:

***Bender v. Educ. Credit Mgmt. Corp. (In re Bender), 297 B.R. 126* (Bankr. D. Neb. 2003) (appeal pending)**
Chapter 13 debtor initiated adversary proceeding four months after she filed for bankruptcy. Bankruptcy Court determined that student loan debt was dischargeable and creditor appealed. District court *sua sponte* determined that issue is not ripe for adjudication. "The ripeness doctrine is invoked to determine whether a dispute has yet matured to a point that warrants decision. The determination is rested both on Article III concepts and on discretionary reasons of policy. There are two factors relevant to a ripeness decision: the fitness of the issue for judicial resolution and the hardship to the parties of withholding court consideration. . . . Neither factor supports an immediate determination as to the dischargeability of the student loan debt this case," the court stated. Accordingly, the Court dismissed the debtor's action without prejudice.

***Ekenasi v. The Educ. Resource Insti. (In re Ekenasi)*, 325 B.R. 541 (4th Cir. 2003)**
Bankruptcy Court discharged student loans of attorney who brought undue hardship case three months after filing bankruptcy and district court affirmed. On appeal, despite noting the inherent difficulties in applying the undue hardship test during the pendency of a Chapter 13 case, the Fourth Circuit declines to adopt "a hard and fast rule" that would preclude a debtor from bring an adversary during a Chapter 13. However, after the Court implies that it will be more difficult for a debtor to establish undue hardship during a plan, it reverses the undue hardship discharge finding that the lower court's determinations were clearly erroneous.

***Pair v. Dept. of Ed. (In re Pair)*, 269 B.R. 719 (Bankr. N.D. Ala. 2001)**
Chapter 13 debtor filed adversary complaint seeking discharge of her student loan obligation. Creditor filed motion to dismiss, asserting that, because plan payments were not yet completed, the issue was not ripe for adjudication at this time. The Bankruptcy Court agreed, holding that the issue of whether debtor could establish an "undue hardship" was not ripe for adjudication until the end of her case when her financial circumstances would be clearer.

***In re Soler*, 250 B.R. 694 (Bankr. D. Minn. 2000)**
Chapter 13 debtor brought adversary proceeding for determination of dischargeability of her student loan obligations. The Bankruptcy Court, dismissed without prejudice, holding that the adversary proceeding was premature and not yet ripe for decision prior to debtor's successful completion of her plan payments.

2. Too Late

An action brought too late may be barred by laches. While there is no published case on this issue, this defense appears available to student loan creditors. As the courts noted in *Bugos v. MIT* (*In re Bugos)*, 288 B.R. 435 (Bankr. E.D. Va. 2003) and *In re Kapsin*, 265 B.R. 778 (Bankr. N.D. Ohio 2001) whether repayment of a student loan debt would impose an undue hardship on a debtor must be considered based on the debtor's situation at the time the debtor receives her discharge. Laches bars an action when the delay is prejudicial to the other party. Accordingly, if the basis for the debtor's undue hardship is an event that occurred after the discharge was granted or that the passage of time has increased the debt or decreased the debtor's remaining wage earning years, then the delay is likely prejudicial.

***Bugos v. MIT (In re Bugos)*, 288 B.R. 435 (Bankr. E.D. Va. 2003)**
Bankruptcy Court denies motion to reopen stating, "It is not appropriate for the court to reopen the case to grant relief on undue hardship for circumstances that arose after the filing of the petition and that were not foreseeable at that time." According to the court, "There needs to he some reasonable relationship of the undue hardships to the time when the bankruptcy case was filed."

***In re Kapsin*, 265 B.R. 778 (Bankr. N.D. Ohio 2001)**
Debtors moved to reopen their bankruptcy case one and a half years after it was closed so that they could initiate an undue hardship action. The Bankruptcy Court held that significant change in debtors' circumstances since their bankruptcy case was closed, which included the loss of a job and pregnancy, did not constitute "cause" for reopening case. The need for finality outweighs the debtor's need to have their student loans discharged, the court states.

B. Who to Sue

Who to sue depends on what type of student loans the debtor has. Identifying the holder of an FFELP student loan is typically the hardest because of how the program is set up. When a FFELP student loan borrower files for bankruptcy, 34 C.F.R. § 682.402(f), et seq., dictates the actions that must be taken by lenders and guaranty agencies. If the debtor has not defaulted and files a Chapter 7, but does not bring an adversary proceeding, the loans will remain with the lender. If the debtor files a Chapter 13 or an adversary proceeding is initiated, then the loans will be assigned to a guaranty agency. While both the lender and the guaranty agency hold rights to the debt, in order to discharge the debt, the debtor must name the guaranty agency that holds the debtor's loans. *See Miller v. Penn. Higher Educ. Assist. Foundation (In re Miller),* 275 B.R. 271 (Bankr. E.D. Tenn. 2002) (guarantor holds a claim with rights separate from its claim by assignment from the lender and, as guarantor, is not bound by the previous default judgment against lender); *Garmhausen v. Sallie Mae (In re Garmhausen),* 262 B.R. 217 (Bankr. E.D.N.Y. 2001) (same). A judgment against a lender alone will not discharge a debtor's student loan debt. *Id*. A judgment against a servicer or collection agency will also not discharge a student loan debt because those entities never hold any right, title or interest in a student loan.

Other student loans holder are usually much easier to identify. Direct loans are held by ED. HEAL loans are held by DHHS. Perkins loans will typically be held by the institution that provided the loan, though they assigned to ED. Private label loans will be held by lender that funded them unless they have been sold to another party.

C. Undue Hardship Test

To discharge student loan debt, the debtor must prove, by a preponderance of the evidence, that "excepting such debt from discharge . . . will impose an undue hardship on the debtor and the debtor's dependents." *See* 11 U.S.C. § 523(a)(8). The most widely adopted test is the Brunner test, established by *Brunner v. New York State Higher Educ. Servs. Corp.,* 831 F.2d 395 (2d Cir. 1987). This test requires the debtor to prove: (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; and, (3) that the debtor has made good faith efforts to repay the loans. The debtor bears the burden of proof on each prong. If the debtor fails to meet any prong, the analysis ends.

The "totality of circumstances" test. requires a bankruptcy court to 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 relevant facts and circumstances surrounding each particular bankruptcy case *See Long v. Educ. Credit Mgmt. Corp.,* 322 F.3d 549 (8th Cir. 2003).

Whether there is a difference in these tests is a topic of a forthcoming article in the Norton Bankruptcy Advisor. One could argue that there cannot be a difference in the tests because they are applying the same standard. "[A]t the end of the day, even if you put a calico dress on it and call it Florence, a pig is still a pig." *Bradshaw v. Unity Marine Corp., Inc.,* 147 F.Supp.2d 668, 671 (S.D. Tex. 2001). The tests may have different dresses and different names, but they are still applying the same standard. Somewhat different outcomes are expected, significantly different outcomes should not be possible. If significantly outcomes are possible, then, for all practical purposes, the courts are applying two different Bankruptcy Codes.

The Tenth Circuit's recent observation that the two tests "often consider similar information" is correct. Broken down to their essence, both tests are essentially asking the same two questions; can and why not? First, can the debtor maintain a minimal standard of living and pay their student loans, now or in the future? If the answer to that questions is no, then the court must consider why the payment cannot be made. These questions are consistent with Congressional intent and equity. Congress intended student loans to be more difficult to discharge than other debts. And equity requires that those who ask for equity must do so with clean hands. Accordingly, as many courts have observed, a debtor cannot cause his own hardship. His situation must result from factors outside of his control. If his situation is not the result of factors outside of his control, then it would be hard to characterize him as the "honest, but unfortunate debtor." Because, as a threshold matter, every debtor asking for an undue hardship discharge should not be able to make their student loan payment now or in the future, the inquiry should naturally focus on the more difficult why question.

1. Brunner Case Law

***Brunner v. New York State Higher Educ. Servs. Corp.,* 831 F.2d 395 (2nd Cir. 1987)**

The seminal case. Requires the debtor to prove: (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; and, (3) that the debtor has made good faith efforts to repay the loans. In discussing this test, the court stated, "Requiring evidence not only of current inability to pay but also of additional, exceptional circumstances, strongly suggestive of continuing inability to repay over an extended period of

time, more reliably guarantees that the hardship presented is 'undue.' In applying this factor, the court noted that she is not disabled, nor elderly, has no dependents and "[n]o evidence was presented indicating a total foreclosure of job prospects in her area of training." And the court found her attempt to discharge her student loans without first trying a "less drastic remedy" evidenced a lack of good faith.

***In re Faish,* 72 F.3d 298 (3rd Cir. 1995)**
After considering the three most prominent tests, Johnson, Bryant and Brunner, the Third Circuit adopts the Brunner test. In so doing the court states, "Equitable concerns or other extraneous factors not contemplated by the *Brunner* framework may not be imported into the court's analysis to support a finding of dischargeability." Accordingly, the Court affirmed the District Court's reversal of the Bankruptcy Court's decision to partially discharge the student loans of a debtor who did not meet the undue hardship test.

***In re Brightful,* 267 F.3d 324 (3rd Cir. 2001)**
Third Circuit reversed the District Court's affirmance of the Bankruptcy Court's discharge of debtor's student loans. The Court finds that the lack of a sufficient evidentiary record made the Bankruptcy Court's findings clearly erroneous. According to the Court, the debtor "is intelligent, physically healthy, currently employed, possesses useful skills as a legal secretary, and has no extraordinary, non- discretionary expenses."

***In re Gerhardt,* 348 F.3d 89 (5th Cir. 2003)**
Fifth Circuit adopts Brunner test and affirms the District Court's reversal of the discharge of a concert cellist's student loan debt. The court notes that "nothing in the Bankruptcy Code suggests that a debtor may choose to work only in the field in which he was trained, obtain a low-paying job, and then claim that it would be an undue hardship to repay his student loans."

***In re Hornsby*, 144 F.3d 433 (6th Cir. 1998)**
While declining to adopt any specific test, the Sixth Circuit reviewed the Bankruptcy Court's application of the Brunner test. The Court held that the "bankruptcy court's analysis simply was not thorough enough to support a finding of undue hardship." The Court noted that the family lived well in excess of the poverty guidelines for its size, had a budget surplus of $200 per month, had an exorbitant long distance bill, spent $100 per month on cigarettes, had not made a single payment on the student loans, and the Hornsbys were young and healthy. However, the court stated, "Although the bankruptcy court should not have discharged the Hornsbys' entire student loans, we believe it had the power to take action short of total discharge." Accordingly, the Court reversed and remanded.

***Goulet v. Educ. Credit Mgmt. Corp.*, 284 F.3d 773 (7th Cir. 2002)**
The court held that the debtor, a 55-year-old man who failed to complete his master's degree in psychology, was not entitled to a discharge of nearly $80,000 in student loans. The court held that, despite the long history of drug and alcohol dependency issues and an annual income below the poverty level, the debtor did not present additional exceptional circumstances needed to qualify for a discharge. The court noted that many of the debtor's circumstances, particularly the chemical dependency, existed at the time he took out the loans.

In re Roberson, **999 F.2d 1132 (7th Cir. 1993)**
The Seventh Circuit adopts the Brunner test and reverses the District Court's discharge of debtor's student loans. In so doing, the Court states, "The government is not twisting the arms of potential students. The decision of whether or not to borrow for a college education lies with the individual; absent an expression to the contrary, the government does not guarantee the student's future financial success. If the leveraged investment of an education does not generate the return the borrower anticipated, the student, not the taxpayers, must accept the consequences of the decision to borrow."

In re Rifino**, 245 F.3d 1083 (9th Cir. 2001)**
The court held that a 41-year old social worker with $69,000 in debt and only 3 years into her career as a social worker was not entitled to a discharge of her student loans. The court based its findings on the second prong of the test. Because the debtor was just starting her career, she necessarily would start at a lower than average salary and she could not prove that this salary level would remain throughout her career. The student loan creditor called a witness to discuss the future earning potential of social workers and the Ninth Circuit noted the significance of the unrebutted expert witness testimony.

In re Pena, **155 F.3d 1108 (9th Cir.1998)**
Ninth Circuit adopts the Brunner test and affirms undue hardship determination of Bankruptcy Court. Court found the test was met because the debtor's income was not sufficient to meet their expenses, one debtor suffered from serious psychological problems, other debtor had limited job potential and the debtors had made a good faith effort to repay their loans by making payments and requesting a deferment.

Educ. Credit Mgmt. Corp. v. Polleys**, -- F.3. --, 2004 WL 206322 (10th Cir. 2004)**
The Tenth Circuit formally adopts Brunner. In rejecting the totality of the circumstances test, the courts states, "Laundry lists, which may show ingenuity in imagining what *could* be relevant but do not assign weights or consequences to the factors, flunk the test of utility." However, concerned about what it viewed as harsh results, the court stated that "to better advance the Bankruptcy Code's 'fresh start' policy, and to provide judges with the discretion to weigh all the relevant considerations, the terms of the test must be applied such that debtors who truly cannot afford to repay their loans may have their loans discharged. Additionally, we think that the good faith portion of the *Brunner* test should consider whether the debtor is acting in good faith in seeking the discharge, or whether he is intentionally creating his hardship."

Hemar Ins. Corp. of Am. v. Cox (In re Cox), **338 F.3d 1238 (11th Cir. 2003)**
Eleventh Circuit adopts Brunner test. Even though the debtor's current inability to pay was not permanent, the Bankruptcy Court had partially discharged the debtor's student loans because of the magnitude of the debt. The District Court reversed and the Fourth Circuit affirmed. Addressing the debtor's argument that Brunner causes harsh results, the Fourth Circuit stated that the Brunner test "is an effective tool for identifying those debtors whose earning potential and circumstances make it unlikely that they will produce the means necessary to repay the student loans while maintaining a minimal standard of living. This situation, in essence, is what

constitutes an 'undue hardship'--not the mere inability to pay, but an inability to pay that is likely to continue for a significant time."

2. Totality of the Circumstances Case Law

***In re Long,* 322 F.3d 549 (8th Cir. 2003)**
Eighth Circuit reaffirms the totality of the circumstances test adopted in *In re Andrews*, 661 F.2d 702 (8th Cir. 1981). Also states that standard of review for undue hardship determinations is de novo rather than clearly erroneous standard used by B.A.P. In discussing the test, the court states, "Simply put, if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt-while still allowing for a minimal standard of living-then the debt should not be discharged." On remand, with new standard of review, the B.A.P. reverses Bankruptcy Court because ICRP payment fits within budget. *In re Long*, 292 B.R. 635 (B.A.P. 8th Cir. 2003).

***Oyler v. Educ. Credit Mgmt. Corp. (In re Oyler)*, 300 B.R. 255 (B.A.P. 6th Cir. (2003) (appeal filed)**
The Sixth Circuit B.A.P. determines that the bankruptcy court properly considered the totality of the debtor's circumstances in discharging his nearly $40,000 in student loan debt. The most significant circumstance was that debtor was a Messianic Jewish minister earning less than $10,000 per year. The B.A.P. rejected the creditor's argument that debtor could look for a higher paying job stating, "debtor's choice to work in a low paying field is not by itself an indication of bad faith, nor should it be used against a debtor in an evaluation of undue hardship."

***Bourque v. Educ. Credit Mgmt. Corp. (In re Bourque)*, 303 B.R. 548 (Bankr. D. Mass. 2003)**
Bankruptcy Court applied totality of the circumstances test and determined that the student loan debt of a health 29-year old debtor should not be discharged because, even there though there is a present inability to pay, there is no reason why the debtor will not be able to earn more in the future. And the medical condition of debtor's spouse is not sufficient to justify discharge of debtor's student loan debt.

***In re Lamanna*, 285 B.R. 347 (Bankr. D. R.I. 2002)**
The Bankruptcy Court, applying the totality of the circumstances test, discharges a portion of the debtor's student loan debt. After reducing expenses that the debtor could not explain the necessity of and adding the significant tax returns debtor had received into her monthly income, the court determined that debtor had $516 a month in disposable income with which to pay a portion of her student loan debt until she retired.

***Kopf v. Dept. of Ed. (In re Kopf),* 245 B.R. 731 (Bankr. D. Me. 2000)**
After discussing the various undue hardship tests, the Bankruptcy Court adopts the totality of the circumstances test, but notes that the other tests "have much in common" with this test. In determining that no undue hardship exists, the court stated, "This is a close call, but I am constrained to conclude that Kopf has not proved her case. Although her lifestyle is hardly opulent, and there is no room to cut expenses, the budget she has proffered holds a surplus from

which a meaningful monthly payment may be made."

IV. DUE PROCESS

Courts are currently considering due process in two contexts, plan language and discharge orders. In both contexts, courts are considering what process is due and whether it is met through the language in plans or discharge orders. Courts that are finding a violation of due process focus on the fact that the only way to discharge a student loan is through an adversary proceeding and anything less is simply insufficient. Other courts focus on the importance of finality.

A. Plan Language

In the past few years, debtors have increasingly attempted to discharge their student loans by including language in the plans that state their student loan debt is discharged. The results of these attempts have been mixed. All courts that have addressed the issue of attempting to discharge student loans through plan language have considered the language to be improper and inconsistent with the Bankruptcy Code. Some, however, have said that *res judicata* is more important than legality. Others have stated that including such language is sanctionable conduct and ordered the language removed from the plan. The most recent courts to address this issue, with the exception of one, have said that, because it does not provide sufficient notice, including improper language in a plan violates a student loan creditor's due process rights, and, therefore, cannot be given *res judicata* effect.

Educ. Credit Mgmt. Corp. v. Boyer (In re Boyer), **2004 WL 235380 (Bankr. D. Kan. 2004) (appeal filed)**
Student loan creditor sought relief from improper plan language in several cases. The cases were consolidated and the District Court determined that even though the plan language was improper, pursuant to *Andersen*, it was binding. The court rejected the creditor's attempt to distinguish *Andersen* on due process grounds, stating, "Although perhaps ECMC did not place as much emphasis on this argument in *Andersen* as it does in each of these cases, this issue was, in fact, raised and decided. Admittedly, the Tenth Circuit chose to address the due process argument in a footnote, rather than in text, but it did, in fact, consider the same due process argument that ECMC makes here." The footnote the court was referencing state that "given the fact that [the creditor] does not complain that it lacked adequate notice of Andersen's plan prior to confirmation, 'it appears that due process has been accorded.'" However, the court did go on to state, "If it were writing on a clean slate, this Court would hold that where an adversary proceeding is required by the Bankruptcy Rules, as it is when a debtor desires to seek discharge of a student loan, and where the Bankruptcy Code and Rules specify the kind of notice that must be given prior to entry of an order, due process entitles a party to receive that kind of notice before an order binding the party will be afforded preclusive effect."

***Educ. Credit Mgmt. Corp. v. Whelton (In re Whelton)*, 299 B.R. 306 (Bankr. D. Vt. 2003) (appeal filed)**
Creditor brought adversary proceeding for determination that student loan debt had not been discharged by plan lanugage. The Bankruptcy Court held that plan language purporting to discharge student loan debt was inconsistent with provisions of the Bankruptcy Code, such that plan should never have been confirmed; provision which has no proper place in Chapter 13 plan, such as one which provides that confirmation of plan will operate as determination that debtor's student loan debt is discharged, has no eligibility for *res judicata* status; and merely providing student loan creditor with copy of his proposed plan, without serving summons and complaint as required, was insufficient to satisfy creditor's due process rights.

***In re Ruehle,* 296 B.R. 146 (Bankr. N.D. Ohio 2003) (appeal filed)**
Creditor moved to vacate, as void for lack of due process, the improper language contained in debtor's confirmed plan. After a very thorough discussion of the case law on this issue, the court determined that because due process had not been afforded the language could not be given *res judicata* effect. In discussing this issue, the court noted that the approach taken by the Ninth and Tenth Circuits "embodies many of the dangers inherent in winking at due process, which is the cornerstone of justice." Quoting Justice Frankfurter, the court stated, "The history of American freedom is, in no small measure, the history of procedure." "Due process demands a complaint and a summons. The rule is clear. The rule is no less clear with regard to student loans, and so, we must not engage in complex rationalizing to dignify a denial of fundamental rights. Due process is not to be sliced, diced and disguised with sauce. Due process must be served whole, without garnish."

***Banks v. Sallie Mae Servs. Corp.,* 299 F.3d 296 (4th Cir. 2002)**
The Bankruptcy Court held that the terms of a confirmed plan, which provided that postpetition interest would be tolled during the pendency of the plan, were res judicata. The District Court, reversed, holding that the language in Chapter 13 plan purporting to discharge postpetition interest on the nondischargeable student loan debt was improper and was not res judicata because the confirmed Chapter 13 plan, containing the improper language, failed to provide for proper notice to the student loan creditor and, therefore violated the creditor's due process rights. The debtor appealed and the 4th Circuit affirmed, stating "where the Bankruptcy Code and Rules require a heightened degree of notice, due process entitles a party to receive such notice before an order binding the party will be afforded preclusive effect." The Fourth Circuit reiterated that a determination of dischargeability of any part of the student loan debt required an adversary proceeding pursuant to Fed. R. Bankr. P. 7001(6), with proper service of process and notice to the student loan creditor in the form of a Summons and Complaint. The Fourth Circuit acknowledged that its decision was contrary to decisions rendered in the Ninth and Tenth Circuits but held that neither of its sister circuits had addressed the due process violation.

***In re Lemons,* 285 B.R. 327 (Bankr. W.D. Okla. 2002)**
The Bankruptcy Court held that a debtor's counsel who put improper language in his Chapter 13 plan should be sanctioned for his conduct. As sanctions, the court admonished counsel and ordered him to remove any offending language in all pending cases. The court also published its order as a deterrent.

Educ. Credit Mgmt. Corp. v. Gardner (In re Gardner), **287 B.R. 822 (D. Kan. 2002)**
Student loan creditor objected to improper plan language. The Bankruptcy Court, while agreeing that the offending language should be stricken from plan, declined to adopt per se ruling that inclusion of such language in future Chapter 13 plans would result in automatic imposition of sanctions. The District Court held that inclusion of improper plan language will, in the absence of a good faith basis for such language, warrant imposition of sanctions; but, declined to adopt a per se rule.

Poland v. Educ. Credit Mgmt. Corp. (In re Poland), **276 B.R. 660 (D. Kan. 2001) (appeal filed)**
Debtor included language in Chapter 13 plan that discharged student loan debt. Discharge order also stated that student loan debt was discharged. The Bankruptcy Court, relying on *In re Andersen*, found that although the plan should not have been confirmed with the provision discharging the student loans, that provision and the discharge order were nonetheless binding on the parties under principles of finality and res judicata and the student loan was discharged. The District Court, rejecting numerous arguments made by the creditor, affirmed.

***El Khabbaz v. Sallie Mae (In re El Khabbaz)*, 264 B.R. 204 (Bankr. N.D. Iowa 2001)**
Court recognized plan language discharging student loans was improper and that including it may be sanctionable. Nonetheless, it held that plan was binding on student loan creditor.

***In re Patton*, 261 B.R. 44 (Bankr. E.D. Wash. 2001)**
Debtors in five unrelated Chapter 13 cases sought declaratory judgment that, pursuant to the improper plan language in their confirmed plans, their student loan obligations would be discharged upon successful completion of their respective plans. The Court held that because the creditors neither objected to confirmation, appealed the confirmation orders, nor attempted to revoke the confirmation orders, the confirmation orders in each case were *res judicata* even though the language was improper. The Court, however, made a point of stating that its ruling should not be interpreted as an approval or validation of the plan language and that inclusion of such provisions may be sanctionable.

***In re Hensley*, 249 B.R. 318 (Bankr. W.D. Okla. 2000)**
On creditors' motions to dismiss Chapter 13 cases that included illegal plan language in an attempt to discharge student loan debt through the Chapter 13 plan, the Bankruptcy Court found such conduct violates Rule 9011 and is sanctionable. The court ordered each debtor's attorney to eliminate the provision from their client's respective plan and any other plans containing similar language in cases currently on file and awaiting confirmation by the court.

Andersen v. UNIPAC (In re Andersen), **179 F.3d 1253 (10th Cir. 1999)**
The debtor put a provision in his Chapter 13 plan stating that confirmation of his plan constituted a finding that excepting his student loan debt from discharge would impose and undue hardship on him and his dependents. Andersen's plan was confirmed and he received his discharge. Because collection continued after he received his discharge, Andersen reopened his bankruptcy. The Court recognized that including such language in a bankruptcy plan was improper but stated

that the finality of confirmation order was more important than their legality. As such, Anderson's student loans were discharged.

***Great Lakes Higher Educ. Corp. v. Pardee (In re Pardee)*, 193 F.3d 1083 (9th Cir. 1999)**
The Ninth Circuit Court of Appeals acknowledged that plan language expressly discharging post petition interest violated the Bankruptcy Code but held that held that creditor's failure to object to plan or to appeal order confirming plan waived creditor's right to assert post confirmation collateral attack against plan on basis that interest discharge provision violated Bankruptcy Code.

B. Discharge Order Language

Unlike plans, discharge orders are typically boilerplate documents that merely recite the relevant discharge provision of the Bankruptcy Code. However, like the language in a plan, the language of a discharge order, even if inconsistent with the law, can be binding. Recently, numerous courts around the country have been using discharge orders that do not accurately reflect the law.

1. Sunset Provision

When the law was changed to extend 523(a)(8) to Chapter 13s, it contained what is called a sunset provision, which means that it expires at a certain time without any additional act on the part of the legislative body. When the law was changed in 1990, the sunset provision was set for October 1, 1996. However, in 1992, long before the law was set to expire, Congress repealed the sunset provision, thereby permanently establishing the law. When the law was passed in 1990, discharge orders were issued that reflected the sunset provision However, some courts did not amend this language when the sunset provision was repealed in 1992. Several courts have addressed this issue, finding that the incorrect discharge orders are void.

***Educ. Credit Mgmt. Corp. v. Doane (In re Harig),* 302 B.R. 177 (W.D. Va. 2003)**
Debtor's discharge order purported to discharge student loan debt in a manner inconsistent with the current provisions of the Bankruptcy Code. Because the discharge order violated the Bankruptcy Code, the court was required to determine whether to accord the discharge order *res judicata,* or as the creditor argued, vacate the judgment as void. The Bankruptcy Court upheld the order, but the District Court reversed because "the bankruptcy court entered it in a manner inconsistent with the requirements of due process of law." The court stated, "In the context of student loan debt, discharge requires a showing of undue hardship. To that end, the debtor must satisfy the heightened notice requirements of an adversary proceeding by filing a complaint and by serving process upon the appropriate creditor-defendant."

***Pearson v. Dept. of Ed.*, 279 B.R. 612 (Bankr. M.D. Ga. 2002)**
Bankruptcy case was reopened to obtain determination that Chapter 13 debtor's student loan debt had been discharged by terms of discharge order, and creditor moved for relief from order. The Bankruptcy Court held that, pursuant to express terms of order, which failed to reflect Congress' repeal of sunset provision, debtor's student loan debt had been discharged. The Court also denied creditor's motion for relief from discharge order, and creditor appealed. The District

Court remanded. On remand, the Bankruptcy Court held "that the Court's discharge order is void as to Defendant because Defendant did not have notice and a meaningful opportunity to be heard prior to the discharge of Plaintiff's student loan."

***In re Hanson*, 2003 WL 23009457 (Bankr. W.D. Wis. 2003) (appeal filed)**
Bankruptcy Court determines that discharge order that purports to discharge student loan debt is void because the "discharge order in this case was incorrect and misstates the law."

2. Lack of Reference to 523(a)(8)

Some discharge orders simply do not reference 523(a)(8) While this should not affect the student loan debt, some debtors have argued that the lack of reference to 523(a)(8) effectively discharges the student loan. Consistent with the analysis referenced above, the courts that have addressed this issue disagree.

***In re Amos*, 283 B.R. 684 (Bankr. W.D. Ky. 2002)**
Discharge order did not explicitly state that student loan debt was excepted from discharge. When student loan creditor attempted to collect debt, debtor moved for sanctions. The motion was granted by default. The case was subsequently reopened and Bankruptcy Court vacated the prior order stating, "The law in effect at the time Debtor's Petition was filed did not provide for the discharge of Debtor's student loans absent an adversary proceeding by the Debtor. Debtor has not taken steps to have ASLC's debt discharged. The Court, therefore, had no authority to issue the Contempt Order."

***In re Tyler*, 285 B.R. 635 (Bankr. W.D. Tex. 2002)).**
Debtor argued that discharge order that lacked reference to student loan exception effectively discharged student loan debt. Creditor argued that lack of reference did not discharge debt, or, in the alternative, for relief from order. The Bankruptcy Court determined that order did purport to discharge student loan debt and that error in discharge order was not mere clerical error of kind that could be corrected under Rule 60(b). The court, however, noted that the Debtor was required to file an adversary proceeding, which he did not do. "[T]herefore ECMC had no notice prior to the entry of the Discharge Order that the student loans would be discharged. This was a violation of due process. As such, the Discharge Order entered is void and the Debtor's student loans are non-dischargeable," the court stated. "Further, the Discharge Order issued in this case can only apply to discharges authorized by the Bankruptcy Code. The Bankruptcy Code did not authorize discharges of student loans through the Discharge Order. This Court therefore was basically powerless to enter such a Discharge Order."

V. AFTER BANKRUPTCY

At the conclusion of the bankruptcy and/or if the loans are found to be nondischargeable, non defaulted student loans that were assigned to guaranty agencies will be repurchased by the original lender, and the lender will begin collecting pursuant to the terms of the debtor's promissory note. *See* 34 C.F.R. §§ 682.208, .411. If the debtor's loans were in default when the debtor filed bankruptcy, then the loans will remain with the guaranty agency, and it will begin

collection. *See* 34 C.F.R. § 682.410(b)(6). It the debtor does not make voluntary payments, then, as required by federal regulations, the guaranty agency will attempt administrative wage garnishment; annually certify the debtor for offset of Federal payments, which include tax refunds; and, if garnishment is not possible and the debtor has sufficient attachable assets, civil litigation. *Id*.

PARTIAL DISCHARGE OF STUDENT LOANS
Update of Caselaw after January 1, 2003

Thomas H. Keyse
Donald J. Quigley
Block Markus & Williams, LLC
1700 Lincoln Street, Suite 4000
Denver, CO 80203
Phone: 303-830-0800
Fax: 303-830-0809
E-Mail: tkeyse@bmwllc.com

A. *Saxman* Line

In re Cox, 338 F.3d 1238 (11th Cir. 2003): because bankruptcy court found no undue hardship it could not grant partial discharge [this leaves door open to partial discharge in proper case].

In re Blair, 301 B.R. 181 (D.Md. 2003): bankruptcy court found debtor failed to meet *Brunner* test but still imposed two-year moratorium on interest accrual and repayments; district court reversed: moratorium is in effect partial discharge, which cannot be granted absent required showing of undue hardship: *Cox*; *Saxman*.

In re Marks, 2003 WL 22004844 (N.D.Cal. 2003): bankruptcy court found *Brunner* satisfied and granted full discharge; district court affirmed finding of undue hardship but reversed full discharge and remanded for calculation and entry of partial discharge: relying on district court decision in *Saxman* and analogy from *Myrvang*, it was "error" to fail to consider partial discharge; on remand, discharged amount should be calculated per debtor's monthly "surplus."

In re Mason, 303 B.R. 459 (Bankr. D.Idaho 2004): notes *Saxman* left many open questions (citing Wanslee article); can do partial discharge only if debtor fails to meet *Brunner* test for total discharge; solution: two-year moratorium on interest accrual and principal payments; estimate payment ability over 25 years at 8% and discharge remainder; if debtor's financial situation improves, creditor can come back and seek acceleration of repayment schedule.

It may strike some bankruptcy courts as unjust that debtors who were formerly entitled to a complete discharge may now (post-*Saxman*) receive only a partial discharge. The following courts, while recognizing the Saxman rule, discharged the debt entirely by making a factual finding that the debtor could not pay off any of it: *In re Adler*, 300 B.R. 740 (Bankr. N.D.Cal. 2003); *In re Williams*, 301 B.R. 62 (Bankr. N.D.Cal. 2003); *In re Marks*, 301 B.R. 563 (Bankr. N.D.Cal. 2003); *In re Cota*, 298 B.R. 408 (Bankr. D.Ariz. 2003).

B. *Hornsby* Line

Hafner v. Sallie Mae Servicing Corp., 303 B.R. 351 (Bankr. S.D.Ohio 2003): states that law is that partial discharge is possible even if debtor cannot meet *Brunner* test; discharged 50% of loans.

In re Stupka, 302 B.R. 236 (Bankr. N.D.Ohio 2003): debtor who fails "good faith" prong of *Brunner* can still get partial discharge per *Hornsby* because equitable standard under § 105 is lower.

In re Chime, 296 B.R. 439 (Bankr. N.D.Ohio 2003): although partial discharge permitted per § 105/*Hornsby*, debtors failed to show any hardship.

In re Ciesicki, 292 B.R. 299 (Bankr. N.D.Ohio 2003): per *Hornsby*, debtor who fails second *Brunner* prong can still get partial discharge if "equities" are in debtor's favor.

In re Pace, 288 B.R. 788 (Bankr. S.D.Ohio 2003): same as *Chime*.

C. Partial Discharge Not Legally Permissible

In re VerMaas, 302 B.R. 650 (Bankr. D.Neb. 2003): absent 8th Cir. authorization, partial discharge not permissible.

In re Merriwether, 2003 WL 22722036 (Bankr. E.D.Wis. Nov 05, 2003): plain language of § 523(a)(8), plus strict attitude of 7th Cir. in *O'Hearn*, prohibits partial discharge.

In re Johnson, 299 B.R. 676 (Bankr. M.D.Ga. 2003): per binding district court case, partial discharge not permissible.

In re McGinnis, 289 B.R. 257 (Bankr. M.D.Ga. 2003): same as *Johnson*.

In re Roach, 288 B.R. 437 (Bankr. E.D.La. 2003): per plain language of Code, partial discharge not permissible.

NINTH CIRCUIT EMBRACES PARTIAL DISCHARGE OF STUDENT LOANS

Madeleine Wanslee
Gust Rosenfeld P.L.C.
Phoenix, AZ

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Following the lead of the Sixth Circuit in **In re Hornsby,** 114 F.3d 433 (6th Cir. 1998), and expanding on its analysis in **In re Myrvang,** 232 F.3d 1116 (9th Cir. 2000), the Ninth Circuit has rejected the use of an "all or nothing" approach to the dischargeability of student loans under 11 U.S.C. § 523(a)(8). **In re Saxman,** 325 F.3d 1168 (9th Cir. 2003). This important decision clarifies that a debtor in the Ninth Circuit must first meet the substantive requirements for an undue hardship discharge before partial discharge is permissible. Once the undue hardship test is satisfied, the court must then evaluate the debtor's expenses and disposable income to determine ability to pay the student loan debt. Unfortunately, **Saxman** did not develop standards or a protocol for granting partial discharge once undue hardship is established.

The Ninth Circuit found authority for partial discharge in 11 U.S.C. § 105(a), the general empowerment of bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [Title 11]." The Supreme Court has cautioned that "whatever equitable powers remain in bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." **Norwest Bank Worthington v. Ahlers,** 487 U.S. 197, 206, 108 S. Ct. 963, 968 (1988). Equitable powers "'[do] not give the judge a free-floating discretion to redistribute rights in accordance with his [or her] personal views of justice and fairness, however enlightened those views may be.'" **In re Kaplan,** 104 F.3d 589, 597-98 (3d Cir. 1997).

Because § 523(a)(8) represents Congress' conscious choice to except student loan debt from the fresh start in bankruptcy, and the plain language of § 523(a)(8) does not authorize partial discharge, the Ninth Circuit Bankruptcy Appellate Panel concluded in **In re Taylor,** 223 B.R. 747 (B.A.P. 9th Cir. 1998), that partial discharge of student loans was not permissible. **Saxman** rejects the BAP's analysis in **Taylor.**

Saxman began as a typical "undue hardship" adversary proceeding. The debtor sought to discharge $88,691 in student loan debt—$4,764 owing to the United States Department of Education ("Education") and $83,927 owing to Educational Credit Management Corporation ("ECMC"). The debtor's monthly income was $2,900, leaving disposable income of $1,000 each month. Applying the standard 10-year repayment schedule required by most student loan notes, the combined debt would require payments of $1,100 per month—more than **Saxman** could pay. Believing itself constrained by **Taylor,** the bankruptcy court rejected ECMC's suggestion that it discharge only that portion of the debt that the debtor was unable to pay.

On appeal, the district court vacated and remanded for further proceedings consistent with the intervening decision of the Ninth Circuit in **Myrvang.** In **Myrvang,** the Ninth Circuit permitted the partial discharge of marital debt pursuant to 11 U.S.C. § 523(a)(15). Although § 523(a)(15) uses a different test for dischargeability than the "undue hardship" test for student loans, the district court in **Saxman** ordered the bankruptcy court to determine how much of the student loan owed to ECMC would create an undue hardship, and to discharge only that potion of the debt. The district court reasoned:

> The **Myrvang** court ruled that bankruptcy judges may partially discharge education loans if only a portion of the loan would result in undue hardship. (citation omitted) Any other interpretation of 523(a)(8) would lead to inequitable results, because debtors would only be required to repay small loans even if capable of partially repaying large debts.

In re Saxman, 263 B.R. 342, 342-45 (W.D. Wash. 2001).

Saxman appealed. The district court's remand required the Ninth Circuit to first determine whether it had a final order for purposes of appellate jurisdiction. Over the adamant dissent of Senior Judge Wallace, a majority of the panel concluded that because the appeal presented an independent question of law and the remand only required calculation of the partial discharge, judicial efficiency and finality weighed in favor of resolving the question on appeal.

The Ninth Circuit then reaffirmed that Congress' use of the adjective "undue" demonstrates "'Congress viewed garden-variety hardship as insufficient excuse for a discharge of student loans . . . .'" **In re Pena,** 155 F.3d 1108, 1111 (9th Cir. 1998) (quoting **In re Brunner,** 46 B.R. 752, 753 (S.D.N.Y. 1985), *aff'd,* **Brunner v. New York State Higher Educ. Serv. Corp.,** 831 F.2d 395 (2d Cir. 1987)).

In **Brunner,** the Second Circuit established a three-part test to determine if repayment of a student loan will impose an undue hardship on the debtor; this test has been adopted by the Third, Seventh and Ninth Circuits. *See* **Brunner,** 831 F.3d 395, at 396; **In re Pena,** 155 F.3d 1108, at 1112; **In re Faish,** 72 F.3d 298 (3d Cir. 1995); and **In re Roberson,** 999 F.2d 1132 (7th Cir. 1993). The **Brunner** test requires the debtor to prove:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living 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.

Brunner, 831 F.2d 395, at 396. "If the debtor fails to satisfy any one of these [undue hardship] requirements, 'the bankruptcy court's inquiry must end there, with a finding of no dischargeability.'" **In re Rifino,** 245 F.3d 1083, 1088 (9th Cir. 2001) (quoting **In re Faish,** 72 F.3d 298, 306 (3d Cir. 1995)).

In **Myrvang,** the Ninth Circuit considered whether § 523(a)(15) imposed an all-or-nothing choice with respect to discharge of marital debt. In analyzing that issue, the Ninth Circuit reviewed decisions involving dischargeability under other subsections of § 523(a), and acknowledged **Taylor**'s holding that "the plain language of § 523(a)(8) . . . prohibit[s] partial discharge." **Myrvang,** 232 F.3d 1116, at 1123.

But the Ninth Circuit noted that **Taylor** had been criticized because the all-or-nothing approach to dischargeability rewards irresponsible borrowing as large debts are more likely to

meet the undue hardship test and be discharged. **Myrvang,** 232 F.3d 1116, at 1123 (discussing **In re Brown,** 239 B.R. 204 (S.D. Cal. 1999)). A debtor who amassed enormous student loan debt, perhaps irresponsibly, would not be required to pay anything under the all-or-nothing approach, but more responsible borrowers might be required to pay their entire student loan debt. The district court in **Brown** concluded that Congress could not have intended such an incongruous result. In **Brown,** the district court determined that repayment of the entire debt would impose an undue hardship, but entered a partial discharge of only that portion of the debt that would be an undue hardship to repay.

A first reading of **Hornsby** from the Sixth Circuit and **Myrvang** from the Ninth might suggest that partial discharge of student loan debt is an option separate from the undue hardship test in § 523(a)(8). After **Myrvang,** however, most lower courts sought to harmonize § 523(a)(8) with § 105 by permitting partial discharge of student loans *only* after undue hardship was established, and then *only* with respect to that portion of the debt that imposed an undue hardship on the debtor. *See* **In re Mort,** 272 B.R. 181 (W.D. Va. 2002); **In re East,** 270 B.R. 485, 493 (E.D. Cal. 2001); **Saxman,** 263 B.R. 342, at 345; **In re Afflitto,** 273 B.R. 162 (Bankr. W.D. Tenn. 2001); **In re Yapuncich,** 266 B.R. 882, 895 (Bankr. Mont. 2001). These courts first determined that the debtors established undue hardship. They then analyzed financial burden to determine the amount of student loan debt that the debtor could repay without undue hardship. Only that portion of the debt that imposed an undue hardship was dischargeable. These courts reasoned that any other interpretation of **Hornsby** and **Myrvang** would substitute the judgment of individual bankruptcy judges for the will of Congress and would generate inconsistent results. **East,** 270 B.R. 485, at 493.

Notwithstanding rejection of the all-or-nothing approach in **Hornsby, Myrvang** and **Saxman,** the circuit courts have all failed to provide useful guidance for the bankruptcy courts when considering a partial discharge of § 523(a) debt.

In **Hornsby,** the Sixth Circuit held that the bankruptcy court "did not engage in the meaningful inquiry required to evaluate either the Hornsbys' expenses or the extent to which their discretionary income could be applied to their student loans," and its analysis "simply was not thorough enough to support a finding of undue hardship." **Hornsby,** 144 F.3d 433, at 438. Instead, the bankruptcy court found that the Hornsbys had not minimized their expenses in every way possible, and in any event were operating with a budget surplus. Consequently, the Sixth Circuit held that "[a]lthough the bankruptcy court should not have discharged the Hornsbys' entire student loan debt, . . . it had the power to take action short of total discharge." **Hornsby,** 144 F.3d 433, at 438. It should be noted that in contrast to the Ninth Circuit, the Sixth Circuit declined to adopt the **Brunner** test for "undue hardship" under § 523(a)(8), and instead held that the bankruptcy courts should "look to many factors." **Hornsby,** 144 F.3d 433, at 437.

Recognizing that the "scope of equitable power in student-loan discharge cases is as yet undefined," the Sixth Circuit merely gave examples of ways that a bankruptcy court might grant partial relief from student loan debt. In one example, the court observed that "[w]here a debtor's circumstances do not constitute undue hardship as to part of the debt but repayment of the entire debt would be an undue hardship, some bankruptcy courts have partially discharged student loans even while finding the student loans nondischargeable." **Hornsby,** 144 F.3d 433, at 440. Although this language in **Hornsby** suggests that partial discharge may be appropriate even when undue hardship does not exist, it seems more likely from the entire text that the Sixth Circuit did not intend that result. The admonition in **Hornsby** that equitable powers must be

exercised within the confines of congressional intent, supports the view that the Sixth Circuit intended to sanction partial discharge only when repayment of the entire debt would cause an undue hardship. The methodology for decision is revealed only in the ambiguous examples.

Other than scrutinizing whether discretionary income is available to pay student loan debt, the Ninth Circuit in **Saxman** left open how a bankruptcy judge should determine what portion of the debt is dischargeable. Should the court start by discharging certain types of loans (i.e., federally subsidized or unsubsidized loans, supplemental loans where the funds are disbursed directly to the borrowers vs. direct loans disbursed to the schools), the oldest loans, the newest loans, the largest loan, the smallest loans, the loans held by guarantors or proprietary holders other than the Department of Education, or discrete components of each debt, such as principal, interest, collection costs, etc.? Or should partial discharge with respect to several creditors be *pro rata*, in keeping with the typical distribution scheme in bankruptcy? **Saxman** does not answer these difficult questions.

Further complicating this analysis is a common factual distinction between § 523(a)(15) and § 523(a)(8). Martial debt under § 523(a)(15) typically is owed to just one creditor—the former spouse. Student loan debt under § 523(a)(8) is frequently owed to multiple creditors, as in **Saxman.** The bankruptcy court in **Saxman** analyzed whether the debtor's disposable income could repay the aggregate debt over ten (10) years. The court found that the amortized monthly payment of $1,100.00 exceeded the debtor's disposable income by $100.00, and thus the whole of ECMC's large debt was beyond the debtor's ability to pay and was dischargeable. It is questionable whether a 10-year repayment test is appropriate in light of the Department of Education's alternative repayment programs allowing debt restructure for up to 30 years (the William D. Ford Direct Loan Program), and the fact that there is no statute of limitation for the collection of student loan debt. 34 C.F.R. § 682.100. Under the **Saxman** facts, it seems probable that the debtor could repay the entire $83,927.00 debt to ECMC and the $4,764.00 debt to the Department of Education with a repayment plan extending beyond 10 years.

Consider also the nasty ethical problems lurking in this partial discharge litigation. Lenders' counsel are accustomed to representing more than one defendant in undue hardship adversary proceedings. Though cost effective and efficient, multiple representation must be reconsidered early in student loan litigation when the prospect of partial discharge pits one student loan lender against another, based on less than clear factors such as age or type of loan.

After **Saxman,** bankruptcy courts in the Ninth Circuit must first make findings that all three undue hardship prongs have been satisfied, and then meaningfully evaluate the debtor's income and expenses to determine the extent to which disposable income can be applied to student loan debt. Then comes the murky part: What components, characteristics and methodology will the Ninth Circuit (and other courts of appeal) select to determine the partial discharge of student loans?

IT'S ALL ABOUT TIMING: WHEN TO COMMENCE AN ADVERSARY PROCEEDING UNDER SECTION 523(A)(8)

Curtis P. Zaun
Associate Attorney
Educational Credit Management Corporation

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As the old adage goes, "timing is everything." Leave the wedding reception too soon and you don't meet your future spouse. Start a company too late and it fails. And so it goes with student loan adversary proceedings as well. Commence an adversary proceeding under Section 523(a)(8) too soon and it could be dismissed on ripeness grounds. Bring the complaint too late and it could be dismissed based on laches. The case law on this issue can be boiled down to one sentence: Complaints should be filed at or around the time the bankruptcy discharge is granted. Yes, some legal answers are that simple.

It is axiomatic that debts are not discharged in bankruptcy until the debtor receives the discharge. *See, e.g.,* 11 U.S.C. §§ 727, 1328. Student loans are excluded from discharge "unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents." 11 U.S.C. § 523(a)(8). Undue hardship is not defined by the Code, but most courts apply the three-part test established by **Brunner v. New York State Higher Education Services Corp.,** 831 F.2d 395, 396 (2d Cir. 1987), that requires the debtor to establish: (1) that he cannot maintain, based on current income and expenses, a minimal standard of living for himself and his dependents if he is required to repay the loans; (2) that additional circumstances indicate that his inability to do so is likely to persist for a significant portion of the repayment period; and (3) that he has made a good faith effort to repay his loans. *See, e.g.,* **Pennsylvania Higher Educ. Assistance Agency v. Faish (In re Faish),** 72 F.3d 298, 303-05 (3d Cir. 1995); **Education Res. Inst. v. Ekenasi (In re Ekenasi),** 325 F.3d 541, 546 (4th Cir. 2003); **In re Roberson,** 999 F.2d 1132, 1135 (7th Cir. 1993); **In re Pena,** 155 F.3d 1108, 1111 (9th Cir. 1998). The burden of proof is on the debtor to establish each element of this test by a preponderance of the evidence. **Goulet v. Educational Credit Management Corp.,** 284 F.3d 773, 777 (7th Cir. 2002) (citing **Grogan v. Garner,** 498 U.S. 279, 291, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991) ("standard of proof for the dischargeability exceptions in 11 U.S.C. § 523(a) is the ordinary preponderance-of-the-evidence standard")).

If a debtor meets the undue hardship test, then his student loan debt becomes dischargeable, or, if he has already received his discharge, is discharged. If he does not receive a discharge, then the debtor remains liable for the student loan debt. When a court is considering whether ripeness or laches applies to a particular case, it must analyze how the timing of the case affects the application of this test under the Code.

The Fourth Circuit's recent decision in **Ekenasi** highlights the ripeness issue. Ekenasi obtained over $90,000 in student loans to complete his law school education at West Virginia University College of Law, where he graduated in 1995. **Ekenasi,** 325 F.3d 541, at 543. In August 1997, he filed a Chapter 13 petition. Ekenasi's 60-month plan was confirmed in February 1998 and, three months later, he filed a complaint seeking to discharge his student loan debt. In January 2001, approximately two years before Ekenasi's Chapter 13 plan was scheduled to conclude, the bankruptcy court granted Ekenasi a complete discharge of his student loan debt. The district court affirmed this decision and the case was appealed to the Fourth Circuit Court.

In the appeal, the student loan creditor argued that Ekenasi's case was not ripe for adjudication because it was not at or near the time that he would receive his discharge. Ekenasi claimed that, as the debtor, he could choose the date of the snapshot that the court examines for undue hardship purposes. In analyzing this issue, the court first discussed how the difference between Chapter 7 and Chapter 13 affected the timing of the undue hardship analysis. Despite noting the inherent problem in applying the test early in a Chapter 13, the court declined to adopt "a hard and fast rule" that would preclude bankruptcy courts from hearing § 523(a)(8) cases until at or near the time the debtor's plan is complete. But the court stated,

> [w]hile we do not preclude debtors from seeking a discharge determination of student loan debts prior to the completion of payments under a confirmed Chapter 13 plan, our cognizance of those policy concerns also counsels us to emphasize that it will be most difficult for a debtor, who has advanced his education at the expense of government-guaranteed loans, to prove with the requisite certainty that the repayment of his student loan obligations will be an "undue burden" on him during a significant portion of the repayment period of the student loans when the debtor chooses to make that claim far in advance of the expected completion date of his plan.

Ekenasi, 325 F.3d 541, at 547.

The court then analyzed the bankruptcy court's application of the **Brunner** test and found the bankruptcy court's findings clearly erroneous. "The evidence of Ekenasi's projected income and expenses is simply too speculative to substantiate the findings made by the bankruptcy court on this issue," the court stated. **Ekenasi,** 325 F.3d 541, at 548. Although Ekenasi made payments on his student loans prior to his bankruptcy, his failing to make payments on the loans outside of his plan payments to the trustee, as the plan provided, and filing the adversary proceeding within three months after confirmation made the bankruptcy court's finding that Ekenasi had made a good faith effort to repay his student loans also clearly erroneous. So while the court refused to create a bright-line rule, it appeared to make a very high standard even higher.

The Fourth Circuit focused its analysis on the application of the test, but did not consider the legal implications of making the determination before the discharge was granted, which was considered in **Pair v. United States (In re Pair),** 269 B.R. 719 (Bankr. N.D. Ala. 2001); **Soler v. United States (In re Soler),** 250 B.R. 694 (Bankr. D. Minn. 2000); and **Raisor v. Educ. Loan Servicing Ctr., Inc. (In re Raisor),** 180 B.R. 163 (Bankr. E.D. Tex. 1995). Those courts also recognized the difficulty in applying the undue hardship test early in a Chapter 13 because of the uncertainty of the debtor's situation several years in the future. *See* **Raisor,** 180 B.R. 163, at 166-67 ("First, although the Debtors' current income and expenses may prohibit them from repaying the [student loans], it is speculative at this time what the Debtors' income and expenses will be at the time the Plan is scheduled for completion.…Secondly, because other unsecured debts will be discharged after completion of the Plan, the elimination of these debts could facilitate the Debtors' ability to repay the [student loans]."); **Soler,** 250 B.R. 694, at 697 ("Soler's circumstances today may not be the same in five years at the end of her yet unproposed and unconfirmed plan.…[W]ere I to entertain her complaint now, I would be speculating."); **Pair,** 269 B.R. 719, at 721 ("[T]he issue is not ripe for adjudication until the end of a Chapter 13 case when the debtor's financial circumstances are clearer."). Several courts, like the Fourth Circuit, recognized the good faith implications of bringing an action during the pendency of the plan. According to the court in **Raisor:**

> [B]y attempting to discharge the [student loans] prior to the completion of the Plan, the Debtors are not demonstrating a good faith effort to repay the obligation. A good faith effort under Chapter 13 requires, at a minimum, an effort by the Debtors to first repay at least some of the [student loans] under the Plan and then perform an examination of their financial condition near the completion of the Plan to determine whether they can either repay some or all of the outstanding balances of the [student loans].

Raisor, 180 B.R. 163, at 166-67; *see* **Pair,** 269 B.R. 719, at 721 (quoting **Raisor** and adopting its analysis).

But what the courts noted, which the Fourth Circuit failed to consider, was that it was a waste of judicial resources to consider the debtor's complaint at the present time because, should the case be dismissed, as many are, the court's decision would then be moot. **Raisor,** 180 B.R. 163, at 167 ("[P]roceeding further at this time is an inefficient use of very limited judicial resources. If the Plan fails and the case is dismissed, a judgment discharging the [student loans] would become moot and the trial would have been unnecessary."); **Soler,** 250 B.R. 694, at 697 ("A dischargeability determination is only necessary if there is a discharge. Under the current circumstances, the debtor's discharge is not only remote in time, it is speculative.").

The most recent case to consider ripeness, **Bender v. Educational Credit Management Corp. (In re Bender),** __ B.R. __, 2003 WL 21554476 (D. Neb. May 5, 2003) (appeal filed), focused its analysis on the appropriateness of making an undue hardship determination before a discharge was granted. The Benders filed for bankruptcy under Chapter 13 in February 2001 and just four months later initiated an undue hardship adversary proceeding. The creditor did not raise ripeness as a defense. After the bankruptcy court discharged the student loans, the creditor appealed. Raising the issue of ripeness sua sponte, the district court stated, "[w]hether the dischargeability issue is ripe for decision is, of course, also a legal question, and one which may be raised *sua sponte* at any stage of the proceedings." **Bender,** 2003 WL 21554476, at *2 (citations omitted).

> The ripeness doctrine is invoked to determine whether a dispute has yet matured to a point that warrants decision. The determination is rested both on Article III concepts and on discretionary reasons of policy. There are two factors relevant to a ripeness decision: the fitness of the issue for judicial resolution and the hardship to the parties of withholding court consideration. The first factor of "fitness for judicial resolution" generally "safeguards against judicial review of hypothetical or speculative disagreements." The second factor of "hardship to the parties" involves a determination that delayed review will result in significant harm, with "harm" including both the traditional concept of damages and also the heightened uncertainty and resulting behavior modification that may result. Neither factor supports an immediate determination as to the dischargeability of the student loan debt in this case.

Bender, 2003 WL 21554476, at *4 (internal quotations and citations omitted). The district court in **Bender** recognized that the undue hardship analysis necessarily involves a certain amount of speculation, but concluded that a determination made two-and-a-half years before the discharge "entails unnecessary guesswork" and presupposes the debtors will receive their discharge. **Bender,** 2003 WL 21554476, at *4. Accordingly, the court reversed the bankruptcy court's discharge and remanded for a dismissal of the complaint without prejudice. **Bender,** 2003 WL 21554476, at *4.

The Ninth Circuit Bankruptcy Appellate Panel reached a contrary conclusion on the ripeness issue, but its analysis rests on a shaky foundation. In **Taylor v. United Student Aid Funds, Inc. (In re Taylor),** 223 B.R. 747 (B.A.P. 9th Cir. 1998), the court stated, "[t]he filing of a complaint at any time to discharge a student loan based on undue hardship does not conflict with any statutory right or procedure or with public policy. Furthermore, FRBP 4007(b) expressly permits the filing of a § 523(a)(8) complaint at any time." **Taylor,** 223 B.R. 747, at 751; cf. **Goranson v. Pennsylvania Higher Educ. Assistance Agency (In re Goranson),** 183 B.R. 52 n.1 (Bankr. W.D.N.Y. 1995) (rejecting **Raisor** in a footnote based on its disagreement with arguably the least important of five reasons cited by **Raisor** for applying the ripeness doctrine). However, as the court noted in **Pair,** "[t]he fact that a complaint can be filed under § 523(a)(8) at any time under Rule 4007(b) does not mean that such a complaint is actually ripe for adjudication." **Pair,** 269 B.R. 719, at 721. "Bankruptcy Rule 4007(b) does not determine whether a proceeding is ripe

for adjudication but merely permits the filing of certain types of proceedings when the matter *is* ripe." **Raisor,** 180 B.R. 163, at 168. This analysis appears to be more consistent with recent Ninth Circuit case law on laches.

The Ninth Circuit has recently considered the effects of the "at any time" language of Rule 4007(b) on laches. In **Staffer,** the bankruptcy court denied a creditor's motion to reopen a case for the purpose of filing a dischargeability complaint under § 523(a)(3)(B) because it was untimely. The Ninth Circuit BAP reversed based on its holding that Rule 4007(b) allows a complaint to be filed "at any time." **Predovich v. Staffer (In re Staffer),** 262 B.R. 80, 83 (B.A.P. 9th Cir. 2001). The Ninth Circuit affirmed the BAP, but clarified that Staffer could assert laches as a defense. **Staffer v. Predovich (In re Staffer),** 306 F.3d 967, 973 (9th Cir. 2002). As it stated in its **Beaty** decision, "the equitable doctrine of laches, which has as its goal the prevention of prejudicial delay in the bringing of a proceeding, is a relevant and necessary doctrine in the bankruptcy context." **Beaty v. Selinger (In re Beaty),** 306 F.3d. 914, 922 (9th Cir. 2002) (providing an in-depth analysis of why the "at any time" language of Rule 4007(b) does not prohibit laches as a defense). *See also* Thomas J. Yerbich, *Unscheduled Creditors and Rule 4007(b): What Role for Laches?*, Norton Bankr. Law Adviser (Jan. 2003) (discussing **Beaty** and **Staffer**). The court, however, recognized that given Rule 4007(b), "there is a strong presumption that a delay is reasonable for purposes of laches," but stated that a court could bar an action if there was "a particularized showing of demonstratable prejudicial delay." **Staffer,** 306 F.3d 967, at 973 (citing **Beaty,** 306 F.3d. 914, at 926). If Rule 4007(b) does not preclude laches as a defense, then, by analogy, it should not preclude ripeness as a defense.

While ripeness may bar a complaint that is brought too early, laches may bar one that is brought too late. Although there are no published cases applying laches in the student loan context, two cases are instructive. In **In re Kapsin,** 265 B.R. 778 (Bankr. N.D. Ohio 2001), the debtors sought to reopen their bankruptcy case so they could seek a discharge of their student loans. The basis for their hardship was a change in circumstances that had occurred since their bankruptcy case was closed. **Kapsin,** 265 B.R. 778, at 779. In denying their motion to reopen, the court acknowledged the competing interests of the debtor's fresh start and the finality of disputes between debtors and creditors. **Kapsin,** 265 B.R. 778, at 780.

> [I]f a change of circumstances were, standing alone, sufficient to reopen a case for the sole purpose of discharging a student loan obligation, then any debtor who filed for bankruptcy relief could at any time—say even ten or twenty years later—invoke the jurisdiction of this Court for solely that purpose. This, of course, would create the anomalous situation of a perpetual Chapter 7 case.

Kapsin, 265 B.R. 778, at 781. Of course, a debtor is not without relief. If debtors want to attempt to discharge their student loans, they can simply file another bankruptcy petition, assuming that they are not otherwise prohibited from doing so by court order or the Code. *See* **Kapsin,** 265 B.R. 778, at 781 (discussing section 523(b)).

Reopening a closed case was also prohibited in **Bugos v. MIT Bursar's Office (In re Bugos),** 288 B.R. 435 (Bankr. E.D. Va. 2003), where the Chapter 7 debtor also sought to discharge her student loans based on post-discharge circumstances. Since her discharge almost three years earlier, the debtor had purchased a home, acquired new debt, lost her job and suffered injuries from a car accident. **Bugos,** 288 B.R. 435, at 436. In denying her request for relief, the court stated, "[t]he court is satisfied that if a dischargeability complaint had been brought when the bankruptcy was filed in 1998, that the debts would have been determined to be non-dischargeable." **Bugos,** 288 B.R. 435, at 437. The court noted, "[i]t is not appropriate for the court to reopen the case to grant relief on undue hardship for circumstances that arose after the filing of the petition and that were not foreseeable at that time." **Bugos,** 288 B.R. 435, at 437.

In the student loan context, laches appears to be a possible defense. Because laches is an affirmative defense, it must be stated in the first responsive pleading or it will be deemed waived. *See* FED. R. CIV. P. 8(c) (incorporated by FED. R. BANKR. P. 7008). Laches "'requires proof of (1) lack of diligence by the

party against whom the defense is asserted, and (2) prejudice to the party asserting the defense.'" **Kansas v. Colorado,** 514 U.S. 673, 687, 115 S. Ct. 1733, 131 L. Ed. 2d. 759 (1995). The focus of the courts' analysis in **Kapsin** and **Bugos,** like the analysis by the courts on the ripeness issue, is on the debtor's situation at the time of the bankruptcy discharge. If the basis for a claim of undue hardship is based on post-discharge events, for example, the loss of a job, a change in family situation or a debilitating accident, then a student loan creditor should be able to demonstrate prejudice as a result of the delay. The longer the delay, the greater the reliance on post-discharge circumstances and the greater the prejudice to the creditor. This prejudice could bar the debtor's dischargeability action.

What are the practical implications of these decisions? A debtor who brings his case too early will simply be told to come back later. A debtor who brings it after his discharge based on post-discharge circumstances is not entitled to have his student loans discharged and will have to file another bankruptcy. The courts and opposing litigants are significantly impacted. The time and expense of this litigation are significant and unnecessary. The solution is simple. File complaints to determine the dischargeability of student loans at or around the time the debtor receives his bankruptcy discharge. Then the real challenge of proving undue hardship begins.