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Looking Forward

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Notice to Clients and Friends

Bankruptcy and Creditor's Rights Department

Student Loan Dischargeability or Lack Thereof

Experts warn that a new wave of bankruptcies is on the horizon. COVID-19 has ravaged the United States' economy, leaving millions out of work, drowning in debt, and struggling financially. For millions already suffering from the economic effects of the pandemic, student loans have become an additional concern.

Student Loan Dischargeability. One of the main purposes of the federal bankruptcy system is "to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character."[1] The U.S. Bankruptcy Code contains various provisions for the discharge of debts, subject to certain exceptions. One such exception is found in Section 523(a)(8), which provides that a general discharge under Chapters 7, 11, 12, or 13 of the Bankruptcy Code does not discharge an individual debtor from three categories of educational debt **unless** their continued payment would "**impose an undue hardship on the debtor** and the debtor's dependents".[2] Among the three types of educational debt excepted from discharge are: educational benefit overpayments or loans made, insured, or guaranteed by a governmental unit or made under any program funded in whole or in part by a governmental unit or nonprofit institution; obligations to repay funds received as an educational benefit, scholarship, or stipend; and any "qualified education loan".[3]

Which Educational Debt, if Any, May be Discharged in Bankruptcy? If a debt does not qualify as an "educational debt" under Section 523(a)(8), it may be dischargeable through the normal bankruptcy process. Otherwise, it may only be discharged upon a showing of "undue hardship".

On August 31, 2020, the U.S. Court of Appeals for the Tenth Circuit provided some clarity on the controversial and longstanding precedent that *all student loans* are presumptively nondischargeable absent "undue hardship". In *McDaniel v. Navient Solutions*,[4] the Court of Appeals held that a debtor's obligation to repay almost $200,000 in **private student loan debt** was dischargeable without a showing of undue hardship. In reaching its conclusion, the Court of Appeals emphasized that the three exceptions to discharge outlined in Section 523(a)(8) should be construed narrowly in favor of the debtor so as to remain consistent with the public policy of providing debtors a "fresh start." Applying the principals of statutory construction, the Court of Appeals determined that because the loans in question were private, as opposed to government or nonprofit-backed, and were neither an "educational benefit, scholarship, or stipend", they could not be considered an educational debt under Section 523(a)(8)(A). The Court of Appeals reasoned that unlike "loans", an educational benefit, scholarship, or stipend was akin to a conditional grant of money that generally does not need to be repaid by its recipients. According to the Court of Appeals, the loans did not qualify as an "educational benefit" under the statute because they were not a conditional grant of money. Instead, they were similar to "credit–card debt used to buy textbooks", and thus dischargeable without a showing of undue hardship.

Showing of "Undue Hardship". While the Bankruptcy Code neither defines the phrase "undue hardship" nor

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[1] *Lamar, Archer & Cofrin, LLP v. Appling*, —— U.S. ——, 138 S. Ct. 1752, 1758 (2018), quoting *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918).
[2] 11 U.S.C. § 523(a)(8).
[3] To understand what a "qualified education loan" entails requires a journey through multiple statutes to understand its meaning. A partial explanation is that the Internal Revenue Code defines a "qualified education loan" as, among other things, "any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses," along with other conditions. 26 U.S.C. § 221(d)(1). These qualified higher education expenses are "the cost of attendance" at the eligible education institution, reduced by scholarships and other payments. 26 U.S.C. § 221(d)(2). An eligible institution is in turn defined as one "which is eligible to participate in a program under Title IV" of the Higher Education Act, and "an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training". 26 U.S.C. §§ 221(d)(2), 25A(f)(2).
[4] *McDaniel v. Navient Solutions (In re McDaniel)*, 973 F.3d 1083, 1094 (10th Cir. 2020).

provides guidance on how to interpret it, Courts have underscored that the burden placed on the debtor is rigorous and the hardship alleged must be more than mere financial adversity.

In the absence of controlling authority, Courts are free to choose their own approach to assess undue hardship. As noted by the Bankruptcy Appellate Panel for our First Circuit ("BAP"), an "undue hardship" determination requires Courts scrutinize whether a debtor may "**now, and in the foreseeable future, maintain a reasonable, minimal standard of living for the debtor and the debtor's dependents and still afford to make payments on the debtor's student loans**".[5] By focusing on this central question, the BAP highlighted the importance that each individual case be evaluated in its context. On that vein, the BAP embraced a fact-intensive "totality of circumstances" approach which required it consider: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) the reasonable, necessary living expenses of the debtor's and the debtor's dependents; and (3) any other relevant facts and circumstances surrounding the debtor's particular bankruptcy case. As part of its analysis, the BAP emphasized that Courts should consider *all relevant evidence*, including the debtor's income and expenses, the debtor's health, age, education, number of dependents and other personal or family circumstances, the amount of the monthly student loan payments required, the debtor's ability to find a higher-paying job, move or cut living expenses, debtor's choice of home, its size, and the percentage of income spent on that home, debtor's lack of assets, exempt or otherwise, and the impact of a general discharge.[6]

Looking Towards the Future. U.S. Senator Elizabeth Warren and House Judiciary Committee Chairman Jerrold Nadler introduced the *Consumer Bankruptcy Reform Act of 2020* on December 8, 2020, the first major consumer bankruptcy reform legislation to be introduced into Congress since 2005.[7] Among other things, the bill proposes to eliminate the exception of educational debt from discharge. On that same vein, President Joseph R. Biden Jr. has endorsed educational debt forgiveness through legislation.

We are seeing considerable changes in the way student loan debt is perceived from all three branches of government. For now however, the arbitrability of educational loan dischargeability will likely depend on a mastery of Section 523(a)(8) of the Bankruptcy Code and applicable caselaw.

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[5] *In re Schatz*, 602 B.R. 411, 422 (1st Cir. BAP 2019), quoting *Nash v. Conn. Student Loan Found. (In re Nash)*, 446 F.3d 188, 191 (1st Cir. 2006) (internal quotations omitted).
[6] *Id.*, at 422, quoting *Hicks v. Educ. Credit Mgmt. Corp. (In re Hicks)*, 331 B.R. 18, 31 (Bankr. D. Mass. 2005).
[7] *Consumer Bankruptcy Reform Act of 2020, H.R.* 8902, 116th Cong. (2nd Sess. 2020), https://www.congress.gov/bill/116th-congress/house-bill/8902.