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Student Loans in Bankruptcy: The Undue Hardship Test is an Unnecessary Burden

James M Leiby

STUDENT LOANS IN BANKRUPTCY:
THE UNDUE HARDSHIP TEST IS AN UNNECESSARY BURDEN

James M. Leiby

INTRODUCTION

The last decade has seen a remarkable growth in the volume of student loans taken out to pay for college education. Federal loans have increased from around thirty-seven billion dollars in the 1996–97 school year to nearly sixty billion dollars for the 2006–07 school year. The increase in private lending has been even more dramatic, rising from two and a half billion dollars in 1997–98 to nearly eighteen billion dollars in 2006–07.[1] Unfortunately, a number of

[1] COLLEGE BOARD, TRENDS IN STUDENT AID 6 (2007).

students find themselves unable to pay off their loans and resort to bankruptcy in an attempt to make a fresh start.[2] It is exceedingly difficult to have a student loan discharged, however, and many students come out of bankruptcy still saddled with their education loans.[3] The lack of relief results because the Bankruptcy Code does not treat student loans like many other forms of unsecured debt.[4] In order to have a student loan discharged, a debtor must show that it would be an undue hardship to pay the loan.[5] Prior to 2005, the undue hardship standard applied only to loans made or guaranteed by the federal government, but the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) amended the law to include private loans as well.[6]

The BAPCPA resulted from a decade-long effort, strongly supported by banks and credit card companies, to tighten the bankruptcy rules in certain areas.[7] This movement focused on the rising number of citizens filing for bankruptcy each year and the perception that bankruptcy had become a simple financial tool rather than a last resort.[8] Creditors made much out of a few debtors who gamed the system to have debts discharged when they did not deserve protection, as well as the "bankruptcy tax"—the estimated increase in the price of goods caused by debts being written off in bankruptcy.[9]

Not only were many of these concerns overblown, but Congress also disregarded a number of important factors militating against making private student loans dischargeable. The

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[2] *See, e.g.*, Jonathan D. Glater, *That Student Loan, So Hard to Shake*, N.Y. TIMES, Aug. 23, 2008, at BU1 (describing several students who went through bankruptcy, but were unable to have their student loans discharged).
[3] *Id.*
[4] *See* 11 U.S.C. § 523(a)(8) (2006). Other types of unsecured debt, such as medical or credit card bills, may be discharged in bankruptcy. *Id.*
[5] *Id.*
[6] *Id.*; *see also* Amanda M. Foster, *All or Nothing: Partial Discharge of Student Loans Is Not the Answer to Perceived Unfairness of the Undue Hardship Exception*, 16 WIDENER L.J. 1053, 1065 (2007) (discussing the BAPCPA and the reasoning behind the amendment).
[7] *See* Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 498 (describing the Bankruptcy Issues Council, one of a number of groups specifically founded to push for creditor friendly bankruptcy reform).
[8] *Id.* at 488–89.
[9] *Id.*

primary purposes of the Bankruptcy Code are to provide honest, unfortunate debtors with a fresh start so that they are not perpetually buried under their debts and to distribute their assets equally among their creditors.[10] Making educational loans nondischargeable directly contradicts both of these principles.[11] Furthermore, private student loans are different in key respects from the other types of unsecured debt that are nondischargeable.[12] Nondischargeability of student loans—even loans insured by the government—is simply not justified.[13] Therefore, Congress should amend 11 U.S.C. § 523 to allow the discharge of all student loans.

Part I of this Comment sketches the growth of educational lending in the United States and the development of the bankruptcy rules on student loans prior to 2005. Part II details the changes brought about by the BAPCPA, describes how they affect debtors with private education loans, and explains the two undue hardship tests. Part III lays out the arguments against nondischargeability and Part IV presents a few possible alternatives to the current rules.

I. Background: The Origins of the Situation

Both the extent and nature of student lending have changed substantially over the last fifty years.[14] The bankruptcy laws that affect student loans have undergone extensive changes as well.[15] As the amount of money lent to students has expanded, the bankruptcy laws governing loans to students have gradually tightened.[16] Student loans were almost exclusively federal until the 1990s, when private loans for students began growing rapidly to help students fill the gap

[10] Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 367 (2007); Seth J. Gerson, Note, *Separate Classification of Student Loans in Chapter 13*, 73 WASH. U. L.Q. 269, 272 (1995).
[11] *See infra* Section III.C (arguing that the current law inhibits equitable distribution and prevents debtors from making a fresh start).
[12] *See* 11 U.S.C. § 523 (2006) (Compare private student loans with, inter alia, government guaranteed student loans, child support payments, taxes, and money obtained by fraud).
[13] *See infra* Part III (presenting several arguments against nondischargeability of student loans).
[14] *See infra* Section I.A (detailing the growth of the student loan industry).
[15] *See infra* Section I.B (describing the gradual tightening of restrictions on the discharge of student loans).
[16] *See infra* Sections I.A & I.B.

between federal aid and the rising cost of tuition.[17] By the 2006–07 school year, private loans constituted twenty-four percent of all loans, up from six percent just ten years earlier.[18]

A. The Growth of Educational Lending

The growth of student loans began with the National Defense Education Act (NDEA) of 1958.[19] Congress passed the NDEA in response to the launch of Sputnik, which had caused many Americans to view higher education as a national security issue.[20] To allow more Americans to attend college, the NDEA created the National Direct Student Loan program (NDSL), the first federally funded student loan program.[21] Prior to this point, large scale educational lending did not exist.[22]

A few years later, Congress created another loan program, the Guaranteed Student Loan program (GSL), as part of the Higher Education Act of 1965.[23] President Johnson proposed the GSL in his State of the Union address on January 4, 1965, as a part of his plan to build a Great Society.[24] In creating the GSL, Congress and President Johnson aimed to fill a shortage in the workforce of college-educated workers by using a broad system of financial aid to allow a larger number of qualified students to attend college.[25]

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[17] COLLEGE BOARD, *supra* note 1, at 9.
[18] *Id.*
[19] National Defense Education Act, Pub. L. No. 85-864, 72 Stat. 1581 (1958) (codified as amended at 20 U.S.C. §§ 401–602 (2000)); *see* Janice E. Kosel, *Running the Gauntlet of "Undue Hardship"- The Discharge of Student Loans in Bankruptcy*, 11 GOLDEN GATE U.L. REV. 457 (1981) (outlining the NDEA).
[20] *See* Robert C. Cloud, *When Does Repaying a Student Loan Become an Undue Hardship?*, 185 W. EDUC. L. REP. 783, 786–87 (2004) ("In October 1957, the USSR successfully orbited its unmanned space vehicle, Sputnik, prompting an intense debate in the United States about national defense and the state of American higher education.").
[21] Pub. L. No. 85-864, 72 Stat. 1581 (1958) (codified as amended at 20 U.S.C. §§ 401–602 (2000)); *id.*
[22] Cloud, *supra* note 20, at 787; COLLEGE BOARD, *supra* note 1, at 5.
[23] Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (1965) (codified as amended at 20 U.S.C. §§ 1071 to 1087-4 (2000)).
[24] AM.'S STUDENT LOAN PROVIDERS, 2007 STUDENT LOAN FACT BOOK 2 (2007), *available at* http://www.nchelp.org/elibrary/ReferenceMaterials/GeneralReference/ASLP%20Fact%20Book%202007.pdf
[25] S. Rep. No. 89-673, pt. 2 (1965), as reprinted in 1965 U.S.C.C.A.N. 4027, 4053.

By the time Congress passed the first limitation on discharge of student loans in bankruptcy in 1976, both the GSL and NDSL programs had already grown dramatically. Between the fiscal years of 1960 and 1975, NDSL spending rose from forty million dollars to three hundred forty-five million dollars.[26] GSL loans reached three hundred thirty-nine million dollars by 1975, up from twenty-nine million in 1968.[27]

Today, the NDSL program is known as the Perkins Loan program.[28] Funds for Perkins Loans are distributed to colleges and universities, which then loan the money directly to qualifying students.[29] The GSL program, carried on today by Stafford and PLUS loans made through the Federal Family Education Loan (FFEL) program, is more relevant to this Comment because it involves loans made by private lenders.[30] In Subsidized Stafford Loans, the government pays the interest on the loan while the student is in school, and for all Stafford Loans the government guarantees payment to the private lender, so that if the student defaults the government must pay the loan.[31]

The guaranteed loan program's purpose is to encourage private lenders to grant loans at reasonable interest rates to students who would otherwise be unable to afford college tuition.[32] The government, by guaranteeing the loans, assumes the private lenders' risk in making loans to individuals with bad credit history.[33] Both the government and the students are betting on the students' ability to earn enough money to pay off the loans in the future, because no collateral is

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[26] Kosel, *supra* note 19, at 461 n.20 (citing American Statistical Index, Digest of Educ. Statistics 4564-1, 172 (1979)).
[27] *Id.*
[28] *See* 34 C.F.R. § 674.1 (2008) ("The Federal Perkins Loan Program, . . . previously named the National Direct Student Loan (NDSL) Program, is a continuation of the National Defense Loan Program authorized by Title II of the National Defense Education Act of 1958.")
[29] U.S. DEP'T OF ED., FUNDING EDUCATION BEYOND HIGH SCHOOL: THE GUIDE TO FEDERAL STUDENT AID 2008–2009 10 (2008).
[30] *Id.* at 9. There are also Direct Stafford and PLUS loans in which the loans are made directly from the Department of Education. Again, this Comment is more interested in loans made through private lenders.
[31] 20 U.S.C. § 1071 (2000).
[32] *Id.*; Foster, *supra* note 6, at 1057.
[33] 20 U.S.C. § 1071 (2000); Foster, *supra* note 6, at 1057.

required for student loans.[34] This type of transaction is sometimes referred to as "mortgaging the student's future."[35] The government is willing to do this in order to help build an educated workforce.[36]

As the cost of attending college has risen, greater numbers of students have turned to loans to cover the gap between their income and the level of tuition. By 1976, over eight hundred thousand students were receiving loans through the GSL program.[37] In the 1994–95 school year, 4.4 million students and parents took out federal loans.[38] Although grant aid more than doubled from 1991–92 to 2007–08, the increase could not keep pace with rising tuition.[39] The percentage of funding for undergraduate students represented by grant aid fell from sixty-three percent to forty-four percent in this period, as more of the increased tuition costs were covered by loans.[40]

Measured in constant dollars, total education loans more than doubled from forty-one billion dollars (in 2007 dollars) in the 1997–98 school year to eighty-five billion dollars in 2007–08.[41] However, because there is a limited amount of money available to each student through federal loan programs,[42] private loans grew the fastest from 1997–98 to 2007–08.[43] Private loans made up a mere seven percent, or $2.9 billion in 2007 dollars, of the total loan volume in 1997.[44]

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[34] J. Leland Murphree, Note, *The Solomonic Choice: Sixth Circuit Developments on the Role of Partial Discharge of Student Loans in Bankruptcy and the Beginning of the End of the Full Discharge of Student Loans Under the "Undue Hardship" Standard*, 37 U. MEM. L.R. 351, 359 (2007).
[35] *Id.*
[36] *Id.*
[37] Thad Collins, Note, *Forging Middle Ground: Revision of Student Loan Debts in Bankruptcy as an Impetus to Amend 11 U.S.C. § 523(a)(8)*, 75 IOWA L.R. 733, 738 (1990) (outlining the growth of student loans).
[38] AM.'S STUDENT LOAN PROVIDERS, *supra* note 22, at 3.
[39] COLLEGE BOARD, *supra* note 1, at 12.
[40] *Id.*
[41] *Id.*
[42] FUNDING EDUCATION BEYOND HIGH SCHOOL, *supra* note 27, at 11.
[43] COLLEGE BOARD, *supra* note 1, at 9.
[44] *Id.*

By 2007–08 private loans made up twenty-three percent, or $19.6 billion, of the money lent to students.[45]

Many of the students who received these loans are still in school, but over the next few years they will leave school and begin making payments. Some of these students, unfortunately, will be unable to meet their obligations, and the number of people in bankruptcy with private student loans is likely to climb. As this happens, the bankruptcy rules regarding private loans will take on added significance. Now is the time, therefore, to revisit the amendments to the Bankruptcy Code made by the BAPCPA.

B. Brief History of Bankruptcy and Student Loans in the United States

The United States' first bankruptcy act, passed in 1800, was a departure from the more traditional sources of American law.[46] Roman law allowed a creditor to keep his debtors chained up in the creditor's house with sixty-pound shackles for sixty days and did not require the creditor to feed the debtors.[47] Similarly, early English bankruptcy policy, for example, included jailing and even executing debtors.[48] At the end of the sixty-day period, the creditor could have his debtors executed or sold into slavery.[49]

Early American law rejected the traditional punitive approach to bankruptcy, instead opting for a remedial approach.[50] This choice led to the development by the end of the 1800s of the "fresh start" policy, under which the honest, unfortunate debtor who enters bankruptcy may have his debts discharged, with a few exceptions.[51] The Supreme Court recognized the "fresh

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[45] *Id.*

[46] Gerson, *supra* note 10, at 271 (citing Frank R. Kennedy, *Reflections on the Bankruptcy Laws of the United States: The Debtor's Fresh Start*, 76 W. VA. L. REV. 427, 428–29 (1974) and James M. Olmstead, *Bankruptcy A Commercial Regulation*, 15 HARV. L. REV. 829, 831 (1902).).

[47] Kennedy, *supra* note 46, at 428–429.

[48] Gerson, *supra* note 10, at 271.

[49] Kennedy, *supra* note 46, at 428–429.

[50] Gerson, *supra* note 10, at 271.

[51] *Id.*; *see* Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, 550–51 (1898) (repealed 1978).

start" policy as "[o]ne of the primary purposes of the Bankruptcy Act."[52] The other primary purpose of bankruptcy laws is to promote equitable distribution of the debtor's assets among his creditors.[53] These different purposes often come into conflict with each other.[54]

Under the Bankruptcy Act of 1898, debtors could not discharge tax debts, outstanding judgments from tort lawsuits, debts not listed in the bankruptcy filings, and debts created by the debtor's fraud or theft.[55] Unsurprisingly, since student loans did not come into wide use until the 1950s, the 1898 Bankruptcy Act does not discuss student loans.[56] Since educational loans were not listed in the exceptions from discharge under the Bankruptcy Act of 1898, students who were forced into bankruptcy could discharge them.[57]

With the advent of the NDSL and GSL programs in the 1950s and 60s, the amount of money being invested in educational loans grew substantially, and a number of people became concerned about the possibility for exploitation of the system.[58] In 1970, Congress created a Commission on Bankruptcy Laws to review the Bankruptcy Act of 1898 and propose reforms.[59] Despite embracing the general policy of allowing debtors to discharge their debts, the Commission found it necessary to add educational debt to the types of debt exempted from discharge.[60] The Commission's report, issued in 1973, focused on abuses of the student lending

[52] Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (citing a line of cases that goes back to *Wetmore v. Markoe*, 196 U.S. 68, 77 (1904) ("Systems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive, and to permit him to have a fresh start in business or commercial life, freed from the obligation and responsibilities which may have resulted from business misfortunes.")).
[53] Gerson, *supra* note 10, at 273; Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1395 (1985).
[54] Gerson, *supra* note 10, at 273.
[55] Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, 550–51 (1898) (repealed 1978).
[56] *Id.*; *see* Section I.A (detailing the growth of student lending).
[57] Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, 550–51 (1898) (repealed 1978).
[58] Collins, *supra* note 37, at 739.
[59] Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 U. CIN. L. REV. 405, 420 (2005); Pub. L. No. 91-354, 84 Stat. 468 (1970).
[60] *See* H.R. Doc. No. 93-137, pt. 1, at 169–170 (1973).

programs and the bankruptcy laws.[61] Lender representatives worried that students would graduate from college "with a diploma in one hand and a bankruptcy petition in the other."[62] Because there was no limitation on discharging student debt, a student might graduate from college, then get his loans discharged in bankruptcy shortly before beginning a lucrative job which would have allowed him to pay his loans.[63] This loophole was also the subject of a number of newspaper articles that helped turn public opinion against the "deadbeat" students whose loans were discharged.[64]

Congress acted on the Commission's recommendation in 1976, amending the Higher Education Act to make federally insured and guaranteed student loans nondischargeable for the first five years after the loans became due unless the debtor could show that repayment would cause an undue hardship on himself or his dependents.[65] This amendment was set to take effect one year later, to give Congress time to reconsider the legislation based on a forthcoming General Accounting Office (GAO) study of discharges of federally guaranteed loans in bankruptcy.[66]

The findings of the GAO report demonstrated that less than one percent of all federal loans were discharged in bankruptcy, in spite of the "loophole" in the bankruptcy laws.[67] The report showed the increase in student loans discharged in bankruptcy was in keeping with the

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[61] *Id.* at 11, 170, 176–77.
[62] Robert J. Cole, *Personal Finance: Students' Defaults*, N.Y. TIMES, Mar. 30, 1972, at 55.
[63] *See* Guaranteed Student Loan Amendments of 1976, H.R. 1232, 94th Cong. 2d Sess. 13–14 (1976).
[64] *See Time of Reckoning for Student Deadbeats*, U.S. NEWS & WORLD REP. 21 (July 18, 1977); *Study Now, Pay Never*, NEWSWEEK 95 (March 7, 1977); *Student Loan Mess*, TIME 8 (Dec. 8, 1975); for general discussion of media views on student loan policy, *see* Collins, *supra* note 37 at 741, and Foster, *supra* note 6, at 1059–1060 (both noting that media coverage of the student loan programs was generally negative).
[65] Higher Education Amendments of 1976, Pub. L. No. 94-482, §127(a), 90 Stat. 2081, 2141 (codified at 20 U.S.C. §1087-3 (1976)), repealed by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, §316, 92 Stat. 2549, 2678 (effective Oct. 1, 1979); Pardo & Lacey, *supra* note 59, at 420–421 ("And so it was that educational debt came to be anointed with conditionally dischargeable status.").
[66] H.R. Rep. No. 95-595, at 132 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6093.
[67] H.R. Rep. No. 95-595, at 133, reprinted in 1978 U.S.C.C.A.N. 5963, 6094.

increase in the number of student loans coming due.[68] Proponents of allowing dischargeability argued that a high default rate had been confused with a high bankruptcy rate.[69] Nevertheless, Congress allowed the amendments to the Higher Education Act to take effect, in part because an effort to reinstate dischargeability might have prevented the renewal of one of the student loan programs.[70]

Before the Higher Education Act amendments took effect, Congress had already begun acting on the legislation that was to become the Bankruptcy Code.[71] The initial formulation of the bankruptcy bill, which enjoyed the unanimous support of the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary and the near-unanimous support of the House Judiciary Committee, would have restored the dischargeable status of student loans.[72] However, Representative Allen E. Ertel strongly opposed this formulation of the bill and argued that allowing dischargeability would teach American students that they were better off if they did not honor their legal obligations.[73] With predictions of dire fiscal consequences if the bill remained unchanged, Ertel pushed through an amendment to keep federal student loans nondischargeable for the first five years after becoming due.[74] Thus the Bankruptcy Code which took effect in 1978 did not allow discharge of student loans owed to "a governmental unit, or nonprofit institution of higher education for an educational loan" in the first five years after the loans came due.[75]

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68 *Id.*
69 *Id.*
70 *Id.* at 132, reprinted in 1978 U.S.C.C.A.N. 5963, 6093; *see also* Pardo & Lacey, *supra* note 59, at 421–422 (describing how student loans first became nondischargeable in "do-or-die" fashion).
71 Pardo & Lacey, *supra* note 59, at 423.
72 H.R. Rep. No. 95-595, at 132 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6093.
73 *Id.* at 536–37, reprinted in 1978 U.S.C.C.A.N. 5963, 6424. Part of Rep. Ertel's argument was that a student who went through bankruptcy would emerge with excellent credit, which is simply not true.
74 S. Rep. No. 95-989, at 79 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5865.
75 11 U.S.C. § 523(a)(8) (1978).

Over the next few years, Congress made minor modifications to the law, affecting which loans were excepted from discharge. In 1979, Congress expanded the exception to include 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 a nonprofit institution of higher education."[76] The legislature refined the language again in 1984 by removing the words "of higher education."[77] This modification extended the nondischargeability to student loans made by non-profit institutions unconnected with higher education.

Under the Bankruptcy Code passed in 1978 and the 1979 and 1984 modifications, student loans were only excepted from discharge in Chapter Seven proceedings, not Chapter Thirteen cases.[78] Debtors were required to pay as little as one percent of their loans in some Chapter Thirteen cases.[79] Courts did, however, strike down Chapter Thirteen plans that they found to have been proposed in bad faith.[80] Since Chapter Thirteen plans generally did not discharge the entire loan, the situation was not the same as when Congress first made student loans nondischargeable in Chapter Seven proceedings. Nevertheless, Congress perceived Chapter

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[76] Pub. L. No. 96-56, § 3(1), 93 Stat. 387 (1979).

[77] Pub. L. No. 98-353, § 454(a)(2), 98 Stat. 333, 375–76 (1984).

[78] *See, e.g.*, Phoenix Inst. of Technology v. Klein, 57 B.R. 818, 820–21 (BAP 9th Cir. 1985) (upholding confirmation of a Chapter 13 repayment plan that proposed discharging eighty-eight percent of a National Direct Student Loan). For a brief overview of Chapter Seven and Chapter 13 bankruptcies, *see* ADMINISTRATIVE OFFICE OF THE U.S. COURTS, BANKRUPTCY BASICS (3d ed. 2006), *available at* http://www.uscourts.gov/bankruptcycourts/bankruptcybasics.html. A Chapter Seven bankruptcy is a liquidation, in which the bankruptcy trustee sells the debtor's nonexempt property and distributes the proceeds to his creditors. *Id.* Any debts not covered by selling the debtor's property are discharged. *Id.* Under Chapter 13 the debtor proposes a plan to repay part of his debts from his wages. *Id.* Upon completion of the plan the debtors remaining debts are discharged. *Id.* A debtor may be able to keep his house under Chapter 13. *Id.*

[79] *See, e.g.*, *In re* Winthurst, 97 B.R. 457, 458 (Bankr. C.D. Ill. 1989) (allowing repayment of one percent of student loan in a Chapter 13 bankruptcy, despite charge of bad faith from the lender).

[80] *See, e.g.*, Ohio Student Loan Comm'n v. Doersam, 849 F.2d 237, 240 (6th Cir. 1988) (rejecting confirmation of a plan which proposed nineteen percent repayment to unsecured creditors, because court believed plan was not proposed in good faith where debtor sought bankruptcy protection before the loan had come due); *In re* Castonguay, 119 B.R. 256, 259 (Bankr. D. Kan. 1990) (rejecting plan proposing ten percent repayment to unsecured creditors where over ninety-four percent of debt was student loans; held not proposed in good faith, solely motivated to discharge student loans); *In re* Carpico 117 B.R. 335 (Bankr. S.D. Ohio 1990) (holding eight percent repayment of unsecured claims not proposed in good faith where debtor had achieved degree as pharmacist and was likely to see increased income, and where repayment was limited to forty-seven rather than sixty months).

Thirteen to be a loophole in the restrictions on student loans, and in 1990 student loans were excepted from discharge in both chapters.[81] Furthermore, Congress extended the period of nondischargeability from five to seven years after a loan becomes due.[82]

In 1998, Congress once again amended the Bankruptcy Code, this time removing completely the provision limiting nondischargeability to the first seven years after a student loan becomes due.[83] Since 1998, federal student loans can only be discharged in bankruptcy if the debtor can show that repayment of the student loans would constitute an undue hardship on the debtor and his dependents.[84] Thus Congress rejected its prior judgment that a five- or seven-year waiting period was sufficient to balance the policy goals of preventing abuse of the system with the fresh start policy of the Bankruptcy Code.[85] Note, however, that none of the pre-BAPCPA changes to the section preventing discharge of federal loans, 11 U.S.C. § 523(a)(8), made mention of private loans.[86] These could still be discharged.

II. THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

The BAPCPA is the most recent amendment of the Bankruptcy Code that affects student loans.[87] The BAPCPA extended nondischargeability to private loans, so that all student loans are treated the same under the Bankruptcy Code.[88] The Code is not applied the same way in every

[81] Student Loan Default Prevention Initiative Act of 1990, Pub. L. No. 101-508, § 3007(b), 104 Stat. 1388-28 (1990).
[82] Crime Control Act of 1990, Pub. L. No. 101-647, § 3621(2), 104 Stat. 4789, 4965 (1990).
[83] Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971, 112 Stat. 1581, 1837 (1998).
[84] *Id.; see also infra* Section II.B.
[85] Gerson, *supra* note 10, at 1065.
[86] 11 U.S.C. § 523(a)(8) (1978); Pub. L. No. 96-56, § 3(1), 93 Stat. 387 (1979); Pub. L. No. 98-353, § 454(a)(2), 98 Stat. 333, 375–76 (1984); Student Loan Default Prevention Initiative Act of 1990, Pub. L. No. 101-508, § 3007(b), 104 Stat. 1388-28 (1990); Crime Control Act of 1990, Pub. L. No. 101-647, § 3621(2), 104 Stat. 4789, 4965 (1990); Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971, 112 Stat. 1581, 1837 (1998).
[87] Pub. L. No. 109-8, 119 Stat. 23 (2005).
[88] 11 U.S.C. § 523(a)(8) (2006).

Circuit though; there are two tests followed in different jurisdictions for determining when student loans are dischargeable.[89]

A. Ten Years in the Making: A Long Road on the Way to Reform

The history of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 really began in 1994 with the establishment of the National Bankruptcy Review Commission, which spurred the lobbying efforts of the consumer credit industry.[90] Congress assigned the Commission to review issues involving the Bankruptcy Code, evaluate proposed changes and the status quo, and to submit a report within two years.[91] Congress instructed the Commission not to upset the basic tenets and balance of the existing law, but to restrict itself to improving and updating the Code.[92] Because of an initial delay caused by a lack of funding, the Commission did not release its report until 1997.[93]

The most hotly contested provisions in the report concerned consumer bankruptcy.[94] Among these provisions, the Commission recommended the repeal of section 523(a)(8), which would have removed the restrictions on discharging federal student loans.[95] The Commission argued that educational debts should not be treated differently than other consumer debts, such as credit card or small business loans, which could be discharged in bankruptcy.[96] The Commission did not believe that debtors would rush to abuse the system if student loans were made

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[89] *See infra* Section II.B (explaining the majority and minority tests used to determine whether a debtor would face "undue hardship" if not granted a discharge).
[90] Jensen, *supra* note 7, at 486.
[91] Pub. L. No. 103-394, § 603, 1994 U.S.C.C.A.N. (108 Stat.) 4106, 4147.
[92] H.R. Rep. No. 103-835, at 59 (1994).
[93] NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS (1997); Jensen, *supra* note 7, at 487.
[94] Jensen, *supra* note 7, at 487–88; David J. Morrow, *5 on Bankruptcy Panel Cleared in Conference-Call Case*, N.Y. TIMES, Sept. 23, 1997, at D17 ("While the commission, which was established by Congress in 1994, has reviewed the entire bankruptcy process, the toughest debates have apparently occurred over consumer bankruptcy.").
[95] NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 207 (1997) (Commission's Final Report).
[96] *Id.*

dischargeable again.[97] Nor did the majority of commissioners believe that a repeal of section 523(a)(8) would be inconsistent with the policy of encouraging young people to go to college.[98]

Four of the nine commissioners issued a lengthy dissent which argued, among other things, that the majority's recommendations did not move strongly enough to stop abuse of the system.[99] Abuse of the system, of course, is the same fear which had led to previous restrictions on the discharge of student loans in bankruptcy.[100] The dissenting commissioners were particularly concerned by data showing a general rise in the number of individuals filing for bankruptcy despite a good economy, and the diminishment of the stigma attached to bankruptcy, allowing it to be used as a first resort.[101] The views of the dissenting commissioners eventually shaped the resulting legislative efforts.

One month before the final report was released, Representatives Bill McCollum (R-FL) and Rick Boucher (D-VA) introduced legislation that generally reflected the views of the dissenting commissioners that Congress should tighten the bankruptcy rules to prevent abuse.[102] Despite the creditor-friendly nature of this bill, it did not make any provision for extending nondischargeability in student loans to private loans.[103] It did not, however, follow the majority-commissioners' recommendation to repeal section 523(a)(8).[104] The last fact is unsurprising, given that repealing section 523(a)(8) would have made abuse of the system easier, rather than

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97 *Id.* at 213–216.
98 *Id.* at 216.
99 NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS at ch. 5 (Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissions, at 2-4.) (1997).
100 *See supra* Section I.B (describing how fears of students gaming the system led to tighter control over student loan discharges).
101 Jensen, *supra* note 7, at 488–89.
102 H.R. 2500, 105th Cong. (1997).
103 *Id.*
104 *Id.*

harder. This bill was never formally considered, as it was buried behind other legislation, but it was an indication of things to come.[105]

The day after the Commission released its report, a different bill was introduced in the Senate, calling for a more even mixture of pro-debtor and pro-creditor changes.[106] The Senate version of the bill would have modified section 523 to allow a debtor to recover attorney's fees when certain discharges were wrongfully challenged by creditors, but would not have removed student loans from the types of debt excepted from discharge.[107]

The next year Representative George Gekas (R-PA) took the lead in a new attempt at bankruptcy reform.[108] This bill, affecting both consumer and business bankruptcy law, would eventually form the basis of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[109] In its original form, this bill, like those introduced in 1997, did not call for any change in the status of student loans, whether federal or private.[110] Democrats John Conyers, Jr. of Michigan and Jerrold Nadler of New York introduced a competing bill on the same day.[111] Their bill, though generally more favorable to debtors than the bill introduced by Rep. Gekas, similarly made no provision for amending section 523(a)(8).[112] Representative Gekas's bill passed the House by a vote of 306 to 118,[113] but the Senate passed a different version of the bill, and the differences were not resolved before the end of the 1998 term.[114]

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105 H.R. 3150, 105th Cong. (1998).
106 S. 1301, 105th Cong. (1997).
107 *Id.* at § 202.
108 H.R. 3150, 105th Cong. (1998).
109 Jensen, *supra* note 7, at 496.
110 H.R. 3150, 105th Cong. § 202 (1998).
111 H.R. 3146, 105th Cong. (1998).
112 *Id.* at §§ 4, 13. This bill again provided for attorneys fees to be levied against a creditor making an improper claim for nondischargeability, but did not alter the types of nondischargeable debts.
113 144 Cong. Rec. H4442 (daily ed. June 10, 1998).
114 144 Cong. Rec. S10767 (daily ed. Sept. 23, 1998); Jensen, *supra* note 7, at 515.

Shortly after the 106th Congress convened in 1999, Representative Gekas submitted a bill essentially the same as the one passed in the previous Congress.[115] In its original form, this version of the bill, like its predecessors, did not alter the status of student loans.[116] However, Representative Lindsey Graham (R-SC) introduced an amendment to the bill which proposed to amend section 523(a)(8) to exempt from discharge "any other educational loan that is a qualified education loan, as that term is defined in section 221(e)(1) of the Internal Revenue Code of 1986, incurred by an individual debtor."[117] This version of the bill passed the House by a vote of 313 to 108.[118]

Meanwhile, the Senate considered another version of the legislation.[119] This version did not foresee any changes to the status of student loans.[120] The Senate bill also passed,[121] but there was trouble reconciling it with the House version.[122] In the end, both the House and the Senate passed a version of the legislation which included the provision making private student loans nondischargeable.[123] All this was for naught, however, as President Clinton pocket-vetoed the bill in December of 2000.[124]

Attempts to pass bankruptcy legislation continued over the next four years, with each house of Congress passing multiple bills, but the two houses unable to reach a compromise.[125] The houses were not split over student loans—each version of the legislation now included

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[115] H.R. 833, 106th Cong. (1999).
[116] H.R. REP. NO. 106-123 (1999).
[117] H.R. REP. 106-126 (1999); H.R. 833, 106th Cong. § 220 (1999).
[118] 145 Cong. Rec. H2771 (daily ed. May 5, 1999).
[119] S. 625, 106th Cong. (1999).
[120] *Id.*
[121] 146 Cong. Rec. S255 (daily ed. Feb. 2, 2000).
[122] *See* Jensen, *supra* note 7, at 531–536 (describing several impediments that prevented the two houses from reaching an agreement).
[123] S. 3186 106th Cong. § 220 (2000) and H.R. 2415 106th Cong. (2000) ("The provisions of S. 3186 of the 106th Congress, as introduced on October 11, 2000, are hereby enacted into law.")
[124] Jensen, *supra* note 7, at 539.
[125] *See, e.g.*, S. 420, 107th Cong. (2001); H.R. 333, 107th Cong. (2002); H.R. 975, 108th Cong. (2003) (bankruptcy bills which failed to pass both houses).

Representative Graham's language amending section 523(a)(8).[126] Congress finally made some headway after the 2004 elections, in which the Republicans gained a majority in the Senate. On February 1, 2005, Senator Chuck Grassley (R-IA) introduced S. 256, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[127] Representative James Sensenbrenner (R-WI) introduced identical legislation in the House a week later.[128] These bills, like the last few attempts in both the House and the Senate, included the provision to make private student loans nondischargeable in bankruptcy.[129]

Unlike the previous attempts, however, this one was not doomed to failure. The Senate passed the BAPCPA on March 10, 2005.[130] The House Judiciary Committee reported the bill favorably, and all attempts to amend it were defeated.[131] The House then passed the bill on April 14, 2005, and President George W. Bush signed it into law on April 20th.[132]

B. Treatment of Private Student Loans in Bankruptcy Before and After BAPCPA

Prior to the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, the process for private student loans in bankruptcy was simple. At that time, section 523(a)(8) excluded from discharge educational loans made under a program funded by the government or by a nonprofit organization.[133] Private student loans were not listed in any of the exceptions to discharge, so debtors shed these debts along with other non-secured debts like loans from credit cards.[134]

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[126] *Id.*
[127] S. 256, 109th Cong. (2005).
[128] H.R. 685, 109th Cong. (2005).
[129] *Id.*
[130] 151 Cong. Rec. S2474 (daily ed. Mar. 10, 2005).
[131] H.R. Rep. No. 109-31, at 22, 373–535 (2005).
[132] 151 Cong. Rec. H2076 (daily ed. Apr. 14, 2005); Pub. L. No. 109-8, 119 Stat. 23 (2005).
[133] Taratuska v. Education Resources Institute, Inc., 374 B.R. 24, 29n.11 (Bankr. D.Mass. 2007).
[134] *See, e.g.*, *id.* at 29 (holding that private loan from a bank did not fall within the exception to discharge then contained in § 523(a)(8) and discharging that loan). There does seem to have been some question as to which loans were private and which were not. *Compare id.* (holding that a loan guaranteed by a nonprofit was not "funded" by a

Any distinctions between private and public loans are obsolete in the wake of the BAPCPA. Now, any loan that qualifies as an educational loan under the rules of the Internal Revenue Service is nondischargeable.[135] The only way a debtor can get such a loan discharged is to show that payment of the loan would constitute an "undue hardship" on the debtor and his dependents.[136] Unfortunately, none of the various pieces of legislation Congress has passed amending this section ever defined the term "undue hardship."[137] Therefore, the courts have been left to interpret this part of the statute on their own.

1. *The Majority Rule*

The Second Circuit decided *Brunner v. New York Higher Education Services Corp.* in 1987.[138] In *Brunner*, the court laid out a three part test to determine when a debtor faces undue hardship.[139] In order to receive a discharge of a student loan, the debtor must show (1) that based on her current income she will not be able to preserve a "minimal" standard of living for herself and her dependents if she is forced to repay the loan; (2) that other evidence indicates that the debtor's inability to maintain a minimal standard of living is likely to continue for a significant part of the repayment period; and (3) that the debtor has made good faith attempts to repay the loans.[140]

A majority of circuits has adopted the *Brunner* test, including the Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth, and Eleventh Circuits.[141] It is a demanding test, as a debtor must

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nonprofit, and thus was dischargeable) *with* O'Brien v. First Marblehead Educ. Res., Inc., 419 F. 3d 104, 106 (2d Cir. 2005) (holding that the term "funded" did not require the nonprofit institution guaranteeing the loan to actually supply any of the funding for the loan, thus making loans guaranteed by nonprofits exempt from discharge).

[135] 11 U.S.C. § 523(a)(8) (2006).

[136] *Id.*

[137] *Id.*

[138] *Id.*

[139] *Id.* at 396.

[140] *Id.*

[141] *See* Pa. Higher Educ. Assistance Agency v. Faish, 72 F.3d 298, 305–06 (3d Cir. 1995); Educ. Credit Mgmt. Corp. v. Frushour, 433 F.3d 393 (4th Cir. 2005); U.S. Dep't of Educ. v. Gerhardt, 348 F.3d 89, 91–92 (5th Cir. 2003);

meet all three prongs of the test in order to receive a discharge.[142] In most cases, the *Brunner* test produces results that strictly limit the discharge of student loans.[143]

The Second Circuit found that Brunner, the debtor, was not entitled to a discharge because she could not pass either the second or third prong of the test.[144] With regard to the second prong, the court held that although Brunner had thus far been unable to find work after completing her Master's degree, there was no reason to believe that she could not find a job if she kept looking.[145] There was no evidence of a dearth of jobs in her field, and she was not disabled or elderly, and had no dependents.[146]

The court also found that Brunner had not made a good faith attempt to repay her loan.[147] First, she had filed for bankruptcy within a month of the date her first loan payments had come due.[148] Furthermore, she had not sought a deferment on the loan, a remedy often available to those who are unable to make payments because of extended unemployment.[149]

Hemar Insurance Corp. v. Cox exemplifies another circuit's application of *Brunner*.[150] In *Cox*, the Eleventh Circuit adopted the *Brunner* test and overturned a grant of partial discharge where the debtor did not meet the second prong of that test.[151] Cox earned a J.D. from Cooley

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Oyler v. Educ. Credit Mgmt. Corp., 397 F.3d 382, 385 (6th Cir. 2005); O'Hearn v. Educ. Credit Mgmt. Corp., 339 F.3d 559, 564 (7th Cir. 2003); United Student Aid Funds, Inc. v. Pena, 155 F.3d 1108, 1112 (9th Cir. 1998); Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302, 1309 (10th Cir. 2004); Hemar Ins. Corp. v. Cox, 338 F.3d 1238, 1241 (11th Cir. 2003).

[142] *See, e.g.*, Wells v. Sallie Mae, 380 B.R. 652 (Bankr. N.D.N.Y. 2007) (holding that although Wells met the first prong of the *Brunner* test, he failed the second prong, and the court therefore did not need to reach the third prong.)

[143] *See, e.g.*, Educ. Credit Mgmt. Corp. v. Blake, 377 B.R. 502 (E.D. Tex. 2007) (refusing discharge where debtor was unable to show additional circumstances to meet the second prong), Hemar Ins. Corp. v. Cox, 338 F.3d 1238, 1241 (11th Cir. 2003) (overturning grant of partial discharge where debtor did not meet second prong); *but see* United Student Aid Funds, Inc. v. Pena, 155 F.3d 1108, 1112 (9th Cir. 1998) (granting discharge where debtor had been laid off, wife was disabled, and debtor had made payments prior to losing his job).

[144] 831 F.2d at 396–397.

[145] *Id.*

[146] *Id.*

[147] *Id.* at 397.

[148] *Id.*

[149] *Id.*

[150] 338 F.3d 1238 (11th Cir. 2003).

[151] *Id.* at 1240.

Law School and an L.L.M. in taxation from the University of Alabama, while racking up student loan debt of over $100,000.[152] When his private practice failed, he was forced to take a job with his brother's landscaping company for $24,000 per year, and he filed for bankruptcy.[153] The Eleventh Circuit held that although Cox was legitimately unable to make payments at the time he filed for bankruptcy, and had demonstrated good faith by making payments when he was able, the fact that he was licensed to practice law in both Michigan and Georgia meant that his situation was unlikely to be permanent.[154] The court stated that undue hardship is "not the mere inability to pay, but an inability to pay that is likely to continue for a significant time."[155] This is a difficult standard to meet.

United Student Aid Funds, Inc. v. Pena is one of the rare cases in which an appellate court upheld a bankruptcy court's discharge of a student loan.[156] It illustrates the dire straits a debtor must be in before a court will grant discharge of his student loan debts. Ernest Pena incurred $9,399.60 in federally guaranteed loans while attending ITT Technical Institute in Phoenix, Arizona.[157] ITT awarded Mr. Pena a credential as an "Associate of Specialized Technology."[158] The Ninth Circuit bluntly stated that this credential was useless to Mr. Pena.[159] It did not help him in his job and it was not accepted for course credit at other universities.[160] His wife had a severe mental disability, which prevented her from holding down a job and had required her to be hospitalized.[161] The Penas' average monthly expenses exceeded their average

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[152] *Id.*
[153] *Id.*
[154] *Id.* at 1241–42.
[155] *Id.* at 1242.
[156] 155 F.3d 1108 (9th Cir. 1998).
[157] *Id.* at 1110.
[158] *Id.*
[159] *Id.*
[160] *Id.*
[161] *Id.*

monthly income by forty dollars.[162] Furthermore, the court found that the Penas' circumstances were not likely to improve.[163] The ITT credential did not improve Mr. Pena's job prospects, and Mrs. Pena's illness amounted to a permanent disability.[164] This is the sort of lasting inability to make payments which is required to pass the first two prongs of the *Brunner* test. But even those circumstances would be insufficient if the court did not also find evidence of a good faith attempt to pay off the loans.[165] In this case, the Penas had made payments before Mr. Pena lost his job, and then sought a deferment.[166]

2. *The Minority Rule*

A few jurisdictions have bucked the trend of the *Brunner* test. The Eighth Circuit and some courts in the First Circuit have adopted the "totality of the circumstances" test.[167] Under this test, the court looks at all of the facts surrounding a case, including the debtor's past, present, and likely future income, reasonable living expenses for the debtor and his dependents, and any other relevant facts unique to the debtor's situation. [168]

The Eighth Circuit took the first step toward the totality of the circumstances test in *Andrews v. South Dakota Student Loan Assistance Corp.*, a case decided in 1981.[169] In *Andrews*, the Eighth Circuit chastised the bankruptcy court for granting a discharge without conducting any investigation into the debtor's monthly expenses and whether she would be able to make

[162] *Id.* at 1113.
[163] *Id.*
[164] *Id.*
[165] *Id.* at 1114.
[166] *Id.*
[167] *See, e.g.* Brown v. Am. Educ. Servs., 378 B.R. 623, 626 (Bankr. W.D. Mo. 2007); Bourque v. Educ. Credit Mgmt. Corp., 303 B.R. 548 (Bankr.D.Mass.2003); For more in depth discussion of the totality of the circumstances test, *see* Sarah Edstrom Smith, Note, *Should the Eighth Circuit Continue to be the Loan Ranger? A Look at the Totality of the Circumstances Test for Discharging Student Loans Under the Undue Hardship Exception in Bankruptcy*, 29 HAMLINE L. REV. 602 (2006) (arguing that the totality of the circumstances test is superior to the *Brunner* test because of its greater flexibility).
[168] Brown v. Am. Educ. Servs., 378 B.R. 623, 626 (Bankr. W.D. Mo. 2007).
[169] 661 F.2d 702.

payments of thirty dollars per month.[170] In reality, the *Andrews* court was not laying out a test so much as pointing out that the lower courts had overlooked some potentially crucial information, but later cases cite to *Andrews* when discussing the test.[171]

The Eighth Circuit formally adopted the totality of the circumstances test in *Long v. Educational Credit Management Corp.*[172] Up until 2003, some courts in the circuit had been following the *Brunner* test, but in *Long* the Eighth Circuit decided to beat its own path.[173] The Eighth Circuit found the *Brunner* test too restrictive, because a debtor has to survive all three prongs of that test to be granted a discharge.[174] Instead, the Eighth Circuit chose to embrace the totality of the circumstances test, in the belief that "fairness and equity require each undue hardship case to be examined on the unique facts and circumstances that surround the particular bankruptcy."[175]

Under the totality of the circumstances test, courts look at the debtor's past, present, and reasonably reliable future resources, the debtor's reasonable necessary living expenses, and any other relevant facts.[176] Essentially, if the debtor's future resources will allow him to pay off the debt while maintaining a minimal standard of living, then his student loans should not be discharged.[177] The Eight Circuit did not apply the test in *Long*, instead remanding it to the bankruptcy appellate panel.[178]

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[170] *Id.* at 704.
[171] *See, e.g.*, Brown v. Am. Educ. Servs., 378 B.R. at 626.
[172] 322 F.3d 549, 554 (8th Cir. 2003).
[173] *Id.* at 554.
[174] *Id.*
[175] *Id.*
[176] *Id.*
[177] *Id.* at 554–555.
[178] *Id.* at 555.

Brown v. American Education Services provides an example of the totality of the circumstances test in action.[179] In *Brown*, the debtor was 64 years old and living on unemployment benefits (which would soon run out) and social security.[180] Her student loans amounted to $103,609 for a bachelor's degree in psychology and a master's degree in criminal justice.[181] Even taking the highest level of income she had made while still employed, her monthly income had only been $1,873.[182] Her necessary monthly expenses were $1,883, and subject to rise again because she had a variable rate mortgage.[183] She had been unable to find a job in her field of education despite extensive efforts.[184] She had three basic repayment options for her student loans, the least of which called for her monthly payments of $552.[185] With no disposable income, these options were clearly not feasible.

Ms. Brown was also eligible for the Income Contingent Repayment Plan (ICRP), which would set her payments according to her income, subject to reevaluation on a yearly basis.[186] At the level of income the court was assuming, her payment under the ICRP would be $186 per month or less.[187] But under the circumstances, she could not afford to pay anything at all. It is possible for the ICRP to produce a monthly payment of $0, but in *Brown*, the court found there would be no reason to tie her to the program.[188] Instead, the court chose to grant a discharge of Ms. Brown's student loans.[189]

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[179] 378 B.R. 623 (Bankr. W.D. Mo. 2007).
[180] *Id.* at 625.
[181] *Id.*
[182] *Id.* at 627.
[183] *Id.* at 628.
[184] *Id.* at 625.
[185] *Id.* at 629.
[186] *Id.* Any amount of the loan that remains unpaid after 25 years in the ICRP would then be discharged, but the amount discharged would qualify as taxable income, which can lead to significant tax liabilities. *See* http://www.ed.gov/offices/OSFAP/DirectLoan/RepayCalc/dlindex2.html.
[187] 378 B.R. at 629.
[188] *Id.*
[189] *Id.* at 630.

Although more flexible than the *Brunner* test, the totality of the circumstances test still requires a debtor to be in serious financial difficulty, like Ms. Brown, before a court may grant a discharge. In *Shadwick v. United States Deptartment of Education*, another debtor with over $100,000 in student loans was unable to win a discharge.[190] Mr. Shadwick had racked up his debts earning bachelor and law degrees, but he had failed the bar exam and was unemployed when he filed for bankruptcy.[191] The debtor and his wife had three children, including one who was severely autistic.[192] There was also evidence that his wife had mental health problems, though she was still capable of holding at least part-time employment.[193]

Despite the large amount of debt and the need to care for three dependents, including one with a serious mental illness, the court found that Mr. Shadwick would not suffer undue hardship if forced to repay his loans.[194] One factor was his strong earning potential, which he could further improve if he were to retake and pass the bar.[195] Another important factor was the lack of good faith demonstrated by the fact that he applied for bankruptcy protection before some of his loans had even come due, which suggested to the court that his primary goal in filing for bankruptcy was to escape his student loans "on the eve of a lucrative career."[196]

In the First Circuit, *Hicks v. Educational Credit Management Corp.* also demonstrates the difficulty of the totality of the circumstances test.[197] The debtor in that case had no problem with good faith. In fact, the court held that the language in the Bankruptcy Code did not support a good faith requirement.[198] Rebecca Hicks suffered from multiple sclerosis, seizures, and

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190 341 B.R. 6 (Bankr. W.D. Mo. 2006).
191 *Id.* at 9.
192 *Id.*
193 *Id.*
194 *Id.* at 14.
195 *Id.*
196 *Id.*
197 331 B.R. 18 (Bankr. D. Mass. 2005).
198 *Id.* at 28.

rheumatoid arthritis.[199] She was unable to work more than sixteen hours per week.[200] Furthermore, of the debtors' two children, the five-year-old son required therapy treatment for Tourette's Syndrome, and the four-year-old daughter had Lyme disease.[201] In addition, the debtors' house, built in the 1850s or 60s, had a leaky roof that was coming completely off in places, broken windows, and moldy insulation, which the debtors hoped to repair.[202] Still, after calculating their income and expenses, the court found a surplus of a few hundred dollars per month with which the debtors could make loan payments, and therefore refused to grant the Hicks a discharge.[203]

Although the totality of the circumstances test is more flexible than the *Brunner* test, neither is particularly debtor-friendly. The two tests are similar enough that they need not be treated separately in the rest of this Comment. The key fact is that under the current formulation of the Bankruptcy Code, it is extremely difficult to have student loans discharged in any jurisdiction.

III. NONDISCHARGEABILITY OF STUDENT LOANS IS UNJUSTIFIED

The current rules regarding student loans in bankruptcy are ill-conceived. The rationales behind many of the changes that Congress has made over the last few decades were empty or unnecessary. Furthermore, the gradual removal of dischargeability from student loans does not fit the core purposes of the Bankruptcy Code.

A. Abuse of the System: a Persistent Myth

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[199] *Id.* at 32.
[200] *Id.* at 33.
[201] *Id.* at 32.
[202] *Id.*
[203] *Id.* at 37–38.

Each tightening of the restraints on student loan discharges has come on the heels of talk about debtors exploiting the bankruptcy laws for their own advantage.[204] However, the evidence to support these fears is nonexistent. Shortly after the Higher Education Amendments of 1976 first made federal student loans nondischargeable for five years, the General Accounting Office released a study that revealed that less than three quarters of one percent of all education loans were discharged in bankruptcy.[205] This study shows that the situation was far from an epidemic of newly graduated students rushing to the courthouse to get rid of their debts before starting lucrative careers. Unfortunately, the GAO study did not convince Congress to reverse or even halt the expansion of nondischargeability.[206] Regardless, the fact that there was no flood of abusive bankruptcy filings when student loans were automatically dischargeable is a strong rejoinder to the argument that removing the restrictions now might cause such a deluge.

Nor is there evidence of a change in the decades since the GAO study was conducted. Professors Pardo and Lacey reviewed 261 bankruptcy cases decided between 1993 and 2003, and made several discoveries involving student loans that are relevant to this Comment.[207] For instance, the average age of the debtors trying to discharge student loans in bankruptcy between 1993 and 2003 was 41.5 years old and the median age was forty-one.[208] As Pardo and Lacey point out,[209] this data does not fit the alarmists' stereotype of a fresh-faced college grad seeking to escape his debts so that he can spend his future income on a nicer car. Rather, it is more likely that these debtors have been out of school for some time, and eventually found themselves unable, for one reason or another, to keep up with the payments on their student loans.

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[204] *See, e.g.*, *supra* note 49 for several articles from the 1970s trumpeting fears of "deadbeat" student debtors.
[205] H.R. Rep. No. 95-595, at 132 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6094.
[206] *See supra* Parts I–II.
[207] Pardo & Lacey, *supra* note 59, at 435.
[208] *Id.* at 442–443.
[209] *Id.*

Pardo and Lacey's data reveal that fifty-six percent of the debtors in their study had at least one dependent, and of those households with dependents, sixty-three percent had at least one dependent who was unhealthy.[210] Furthermore, approximately sixty-two percent of the debtors themselves suffered from one or more physical or mental conditions.[211] Again, this information does not fit the negative stereotype that critics have repeatedly played upon to help pass restrictions on discharging student loans.

There is even some evidence that the situation has improved in the last few decades. According to the Department of Education, the default rate on student loans peaked at around twenty-two percent in 1989 before falling sharply over the next several years.[212] The record low of 4.5% percent was set in 2003, and the most recent data shows a rate of 5.2% percent, which the Department called "historically low."[213] The fact that Congress has been operating under a faulty assumption strongly suggests that it did not need to restrict student loan discharges in the first place.

Ironically, the Bankruptcy Abuse Prevention and Consumer Protection Act itself simultaneously tightened those restrictions and made them less necessary. One of the main areas of contention as Congress hammered out the BAPCPA was whether it should adopt a means test to prevent abuse of Chapter Seven bankruptcy.[214] In the end, the BAPCPA did include a means test.[215] Under the BAPCPA, if the debtor's monthly disposable income is equal to or greater than $182.50, or between $109.58 and $182.50 but sufficient to pay twenty-five percent of the debtor's unsecured claims over a period of sixty months, then there is a presumption that

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[210] *Id.* at 446–447.
[211] *Id.* at 447.
[212] DEP'T OF EDUCATION, STUDENT LOAN DEFAULT RATES REMAIN LOW, Sept. 16, 2008, *available at* http://www.ed.gov/news/pressreleases/2008/09/09162008a.html.
[213] *Id.*
[214] *See* Jensen, *supra* note 7, at 489–496 (describing the political battles waged over including means testing in the BAPCPA).
[215] 11 U.S.C. § 707(b)(2).

allowing the debtor to go forward with a Chapter Seven bankruptcy would be an abuse of Chapter Seven.[216] Unless the debtor can overcome this presumption, the case is either dismissed or converted to Chapter Thirteen bankruptcy in which even unsecured debts must be paid in part.[217]

Even if Congress were to remove student loans from the types of debt subject to discharge, debtors with student loans would still have to go through the means test in order to receive a full discharge of their debts. For example, the bankruptcy judge found that the debtors in *Hicks* had at least five hundred dollars in monthly disposable income.[218] Although the methods of calculating necessary expenses for the means test and for the undue hardship test are not the same, they should produce somewhat similar results.[219] Unless the means test calculation allowed expenses four hundred dollars per month greater than the Hicks were allowed under the undue hardship test, the Hicks would not have been eligible for Chapter Seven bankruptcy if they had filed after the BAPCPA took effect. Under Chapter Thirteen they would have been required to pay at least part of their student loan debt over the next three to five years.[220] The companies that held the Hicks' student loans surely prefer the way things turned out, but there is no real reason to treat student loans differently than other unsecured debt, and the purposes behind the Bankruptcy Code as a whole also demand a more debtor-friendly system.

B. Encouraging Loans to Students

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[216] Ned W. Waxman & Justin H. Rucki, *Chapter Seven Bankruptcy Abuse: Means Testing is Presumptive, But "Totality" is Determinative*, 45 HOUS. L. REV. 901, 905–06 (2008) (breaking down the means test in § 707(b)(2)).
[217] *Id.*; 11 U.S.C. § 707(b)(1).
[218] Hicks v. Educ. Credit Mgmt. Corp 331 B.R. 18, 37–38 (Bankr. D. Mass. 2005).
[219] The means test uses standard deductions for expenses based on where the debtor lives and how many dependents he has. The undue hardship test looks at the actual expenses of the debtor. *Compare id.* (investigating the debtor's actual monthly expenses) *with* the Department of Justice's explanation of the means test, *available at* http://www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm (providing tables of allowable expenses for food, clothing, health care, housing, etc). Unfortunately the cases do not generally reveal the specific area in which the debtor resides, which makes it impossible to determine what the actual result of the means test would have been for the Hicks family. *See Hicks*, 331 B.R. at 20.
[220] For an overview of Chapter 13 bankruptcy information s*ee* http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html.

One of the main arguments advanced by those in favor of preventing the discharge of student loans in bankruptcy is that stopping discharges will encourage lenders to make more loans to students, thereby allowing more students to go to college.[221] This sounds perfectly reasonable, in theory. If the lenders lose less money on discharged loans, they should have more money available to lend or be able to provide loans with lower interest rates.

But the actual evidence does not reveal much, if any, increase in private student lending attributable to the changes implemented by the BAPCPA. Private student loans had already increased from two and a half billion dollars in the 1997–98 school year to over fourteen billion dollars in the 2004–05 school year, the last school year before the BAPCPA passed.[222] The boom was already well under way before Congress changed the Bankruptcy Code. The two years after the BAPCPA was enacted saw further private loan growth to nearly 18 billion dollars in the 2006–07 school year, but in 2007–08 the amount of money in private loans actually declined by nearly three hundred million dollars.[223] One study completed in 2007 found only a slight increase in the availability of private loans to students with credit scores of 650 or less.[224] The credit scores required by Sallie Mae and First Marblehead, two of the largest providers of private student loans, remained essentially unchanged after BAPCPA.[225]

Any improvements in the student lending market spurred by the BAPCPA quickly disappeared with the onset of the credit crunch in 2008. Credit score requirements, which remained stable after the BAPCPA, were projected to rise around thirty points in 2008.[226] As of

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[221] *See, e.g.*, Glater, *supra* note 2 (outlining the argument for nondischargeability of student loans).
[222] COLLEGE BOARD, *supra* note 1, at 6.
[223] *Id.*
[224] MARK KANTROWITZ, IMPACT OF THE BANKRUPTCY EXCEPTION FOR PRIVATE STUDENT LOANS ON PRIVATE STUDENT LOAN AVAILABILITY 1 (2007) *available at* http://www.finaid.org/educators/20070814pslFICOdistribution.pdf.
[225] *Id.* at 5.
[226] Robert Tomsho & Keith Winstein, *Credit Crunch Hits Private Student Loans*, Wall St. J., April 9, 2008, at D1, *available at* http://online.wsj.com/article/SB120770089129599963.html?mod=googlenews_wsj.

April 2008, interest rates had already risen about a full percentage point since the previous October.[227] So the BAPCPA neither spurred lending in a smooth economic climate nor prevented the constriction of the student lending market in troubled times.

Given the extent of the troubles in the financial sector in 2008, perhaps it is not fair to expect anything more from private lenders. Yet if anyone should have been able to weather the storm, it would be an industry that receives special treatment in the bankruptcy laws. If the bankruptcy restrictions on private student loans are not enough to make much of a difference in good economic times or bad, that may be a sign that the lack of restrictions is worth more to borrowers than the presence of the restrictions is worth to the lenders. The BAPCPA's negligible impact on the student loan market means that nondischargeability can no longer be justified on the grounds that it will allow greater numbers of students to attend college.

C. Purposes of the Code

As recently as 2007, the Supreme Court stated that "[t]he principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor."[228] The Court was not stating a new principle. It was reiterating what has been a core purpose of the Bankruptcy Code since its inception. Proponents of the first bankruptcy laws in the early 1800s realized that there needed to be some remedy for merchants who, through no fault of their own, lost all of their money because of the risks associated with trade.[229] The antebellum statesman Daniel Webster articulated the need for the fresh start while supporting the Bankruptcy Act of 1840, stating:

> [m]any of these insolvent persons are young men with young families. Like other men, they have capacities both for action and enjoyment. Are we to stifle all these

[227] *Id.*
[228] Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 367 (2007).
[229] Olmstead, *supra* note 46, at 837.

> for ever? Are we to suffer all these persons, many of them meritorious and respectable, to be pressed to the earth for ever, by a load of hopeless debt?[230]

Aside from this more humanitarian argument, there is also the argument that in many cases discharging a debtor's debts may actually be more economically efficient. Excessive debt might so inhibit an individual's productivity that society would be better off excusing the debtor and giving him a second chance.[231] If he is unable to escape his mountain of bills, the debtor may devote more of his efforts and resources to leisure, so that his creditors cannot reach the fruits of his labor.[232] The Supreme Court has shown consistent support for the fresh start principle.[233] Though the BAPCPA primarily favored creditors, the debtor-friendly fresh start principle remains one of the guiding purposes of the Bankruptcy Code.[234]

The other primary purpose of the code is to secure fair and even distribution among creditors of the debts collected.[235] The idea is to avoid a situation where the debtor's resources are distributed among his creditors on a first-come, first-serve basis.[236] Instead, different types of unsecured debts are usually recovered evenly, so that, for example, the credit card company will not get its loan to the debtor paid completely while the debtor's medical bills are left unpaid.[237] This principle suggests that student loans, which are generally made without

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[230] Kennedy, *supra* note 46, at 439.
[231] Jackson, *supra* note 53, at 1420.
[232] *Id.*
[233] *See, e.g.* Wetmore v. Markoe, 196 U.S. 68, 77 (1904) ("Systems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive, and to permit him to have a fresh start . . . ."); Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) ("One of the primary purposes of the Bankruptcy Act is to relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh . . . ."); Grogan v. Garner, 498 U.S. 279 (1991) ("[A] central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'" (citing Local Loan Co. v. Hunt, 292 U.S. at 244)).
[234] *See Marrama*, 549 U.S. at 367. *Marrama* was decided two years after Congress passed the BAPCPA.
[235] Gerson, *supra* note 10, at 273.
[236] Jackson, *supra* note 53, at 1396.
[237] *See generally* Gerson, *supra* note 10, at 272-73. Secured debts receive priority over unsecured debts, but student loans are unsecured, so secured loans need not be considered here.

collateral, should not be given preference over other unsecured debts like medical or credit card bills.

Nondischargeability of student loans, especially private student loans, promotes neither of the Code's goals. Nondischargeability makes it harder for the debtor to get a fresh start, especially today when the average amount of student loan debt has risen dramatically.[238] It also violates the principle of equitable distribution by preserving the student loan companies' claims after other unsecured debts are wiped out by discharge. Conversely, restoring student loans to dischargeable status would fit with both of the main purposes of the Code.

D. Student Loans Compared to Other Dischargeable and Nondischargeable Debts

There are of course justifications for overlooking the central purposes of the Code. Lenders argue that certain characteristics of education loans make them deserving of special treatment. However, there are also reasons why student loans—especially private student loans—should not be treated differently than other types of unsecured debt.

1. *Government Loans v. Private Loans*

The one similarity between student loans and other nondischargeable debts is specific to government-guaranteed student loans and taxes. For both of these types of debt, the taxpayers are on the hook if the debtor does not pay.[239] Therefore the government has an added incentive to restrict discharges for government-backed loans. These were the first types of loans which Congress restricted from discharge in bankruptcy.[240]

This is not a perfect justification for exempting government-backed student loans from discharge. The reasons that militate in favor of discharging student loans in general, such as the

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[238] The average amount of debt among bachelor's degree recipients who took out loans to fund their education reached $22,700 in 2006–07. COLLEGE BOARD, *supra* note 1, at 11.

[239] *See supra* notes 28-31 (describing the operation of the Guaranteed Student Loan Program, now known as the Stafford Loan Program).

[240] *See supra* note 53 (debts caused by the debtor's torts, fraud, or theft could not be discharged either).

core purposes of the Bankruptcy Code, still apply. Furthermore, government-backed loans are unlike taxes in that they have value beyond their enforceable contractual obligations. The purpose of income taxes is to fund the government, but the purpose of the student loan programs is to increase access to higher education.[241] If the government cannot collect its taxes, the tax program has failed completely, but when a debtor is unable to pay off their student loans, the loan program has still provided that person with the opportunity to get an education. That education cannot be lost, and in fact should increase the debtor's future earnings potential over what it otherwise would have been. These increased future earnings will themselves be taxed, so the government has not even lost all of the monetary benefit of the program.

Private loans cannot even claim the meager justification that they are subsidized by the government. Whereas loans through government programs have set interest rates regardless of the individual student's credit history, private lenders can adjust to the risk posed by each debtor with different interest rates, or by requiring a certain credit score, or a cosigner.[242] That is, they can spread the risk of failure among the students taking out loans, rather than passing it on to all taxpayers.

Private lenders have nonetheless attempted to argue that defaults on private loans burden all citizens. Lenders and their supporters in Congress suggest that all Americans are subject to a "bankruptcy tax"—an increase in prices necessitated when creditors are unable to collect on their loans.[243] But one of the differences between private loans and government loans is that private lenders are able to account for the risk of nonpayment by requiring higher credit scores and charging higher interest rates, so the lenders are not in need of government protection.

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[241] *See supra* Section I.A (discussing the genesis of student loan programs).
[242] *See, e.g.*, Tomsho & Winstein, *supra* note 226 (reporting how lenders have adjusted interest rates and required higher credit scores as a result of the credit crunch).
[243] *See* Jensen, *supra* note 7, at 489 (outlining the arguments for restricting access to bankruptcy).

Therefore, although there is one factor that may provide some small justification for the nondischargeability of government-insured student loans, it does not apply to private loans.

2. *Student Loans, Credit Card Debt, and Child Support*

One of the primary arguments in favor of nondischargeability for student loans is that student loans have more value to society than other types of debt, and therefore the government should encourage lenders to make these loans available.[244] However, as discussed above, the Bankruptcy Code has not proven to be the most effective mechanism for increasing educational lending. Consequently, the greater value to society of educational loans does not provide a reason to treat these loans differently than other types of loans.

It may also be instructive to look at the situation from the debtor's point of view, rather than the creditors. Instead of considering what type of lending is more valuable to society, ask what type of borrowing is more valuable to society. Assume Johnny Spirit has one hundred thousand dollars in student loans and Sally Spender has a similar amount of credit card debt that she racked up at the mall. Johnny took out loans to finance his education, which increases Johnny's value to society. Sally's spending supports the economy, but so does Johnny's. In fact, while much of Sally's money may have ended up in the hands of foreign corporations, Johnny's tuition money supports the growth of knowledge at his university by helping to keep professors employed. But the way the law stands, only Sally can have her debt discharged without showing undue hardship. It does not make sense that society should be more forgiving of credit card debt than student loans.

A comparison of student loans with the other types of nondischargeable debt further highlights the idea that student loans do not belong in this category. Other nondischargeable debts include things like debts from taxes, child support, alimony, the debtor's willful and

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[244] *See supra* Section III.B (explaining why this argument is ineffective).

malicious torts, or debts caused by the debtor's fraud.[245] Student loans, especially private loans, just do not fit here. For child support and alimony, the debtor has a special obligation to the creditor. Child support and alimony are based on familial relationships that are vastly different from the relationship the debtor has with his student loan company. There is also a moral element attached to those debts and to debts caused by the debtor's fraud or torts that is not found with student loans. With debts caused by the debtor's fraud or willful and malicious torts, the debt has arisen out of actions that are fundamentally different from signing a contract. The student loan contract is a relationship entered voluntarily by both parties, whereas the person against whom a debtor commits a tort is not a voluntary party. There may be an element of punishment in preventing a debtor from discharging these debts. There is no reason to punish the honest debtor who is unable to pay his student loans.

IV. ALTERNATIVES TO THE CURRENT RULE

The first option for addressing the situation is to repeal the change made by the BAPCPA. This choice represents the bare minimum. It would only repeal the undue hardship requirement for loans issued by private, for-profit companies. Private student loans issued by non-profit groups would still be nondischargeable, so merely repealing the BAPCPA is unlikely to provide much relief to borrowers.[246]

The next option would be to make all non-government loans dischargeable. This is a possible compromise position, which would at least remove the dischargeability of those loans which have no justification for being nondischargeable. However, since even government-

[245] 11 U.S.C. § 523 (2006).
[246] Kantrowitz, *supra* note 224, at 5.

backed loans were made nondischargeable on the basis of arguments that have consistently proven to be empty,[247] this is not the best choice.

The best option is to remove all restrictions on discharging student loans. The evidence does not show that debtors are abusing the system, whether they have federal or non-federal loans. Furthermore, the principle purposes of the Bankruptcy Code are to grant honest debtors a fresh start and distribute their assets equitably among the creditors, and student loans are fundamentally different than other types of nondischargeable debt.[248] It follows logically that student loans should be dischargeable in bankruptcy. This solution also has the added bonus of relieving courts of the burden of dealing with the vague undue hardship standard, which would lead to more uniform application of the Bankruptcy Code.[249]

Perhaps the most practical option is to allow discharge of all types of student loans, but only after five or seven years. In the first few years discharge would only be allowed only if the debtor can pass the undue hardship standard. This compromise would help ensure that debtors make a good faith effort to repay their loans before filing for bankruptcy. For example, the debtors in *Shadwick* would still have faced the undue hardship standard because they filed for bankruptcy within two years of the husband's graduation from law school.[250] Such a concession might allow bankruptcy reform to gain the support, or at least the acquiescence, of the lending industry. A spokesman for Sallie Mae, one of the biggest sources of private student loans, told the New York Times in 2008 that Sallie Mae would be open to a change in the Bankruptcy Code

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[247] *See supra* Section III.A (describing how the evidence does not support fears that students will abuse the bankruptcy system).

[248] *See supra* Part III (presenting several arguments in favor of allowing student loans to be discharged).

[249] *See* Murphree, *supra* note 34, at 360–66 (discussing differences among the circuit courts). There is no nationwide standard for undue hardship. *Id.* Although most jurisdictions use the *Brenner* test, they do not apply it the same. *Id.* Some jurisdictions allow partial discharge, others do not. *Id.* Cases with similar facts may be decided differently in different jurisdictions. *Id.*

[250] 341 B.R. at 9.

that would allow students to discharge their loans after the students have made an effort to pay the loans for a specific number of years.[251]

Allowing discharge after a few years would not completely remove the problem of uneven application of the undue hardship standard, but Congress could give additional guidance on that point if it were to amend the law. There is no evidence that large numbers of students are abusing the system in the first few years any more than at later points, so such a measure should not theoretically be necessary, but this option does at least represent a substantial step towards the best case scenario. If Congress were to implement this measure as the best possible compromise, it could then revisit the issue in a few years. At that point there would presumably be new data to further discredit the fears of students abusing the system, which in turn might allow Congress to make all student loans dischargeable without the need for a waiting period.

CONCLUSION

Bankruptcy certainly should not provide an avenue for debtors to throw off their debts any time they want, but the evidence shows that fears of students gaming the system have always been overblown. Nor does it seem that tightening the bankruptcy rules significantly improved the availability of private loans for students. Furthermore, private student loans in particular are unlike any of the other forms of nondischargeable debt. The basic premises behind the Bankruptcy Code do not call for students to be treated in the same manner as deadbeat parents who have not made their child support payments, or to be treated worse than debtors with unpaid credit card or medical bills. There is only slightly more justification for the nondischargeability of government insured loans. Congress should act to restore the dischargeability of all student loans including those insured by the government. If any additional safeguard is necessary to secure the passage of bankruptcy reform, then a five or seven year period of nondischargeability

[251] Glater, *supra* note 2.

subject to the undue hardship exception should be sufficient to prevent the worst cases of abuse. At an absolute minimum, all private loans should be dischargeable, because there is no real justification for them not to be dischargeable, and several reasons why they should be.