STUDENT LOAN HARDSHIP DISCHARGE - THE BASICS

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[1] **Trial experience** in the following counties: Dallas, Tarrant, Collin, Denton, Rockwall, Johnson, Somervell, Bandera, Gregg, Potter, Ector, El Paso, Kaufman, Houston, Belton, Smith, Harris, Bexar, Wise and Travis, among others. **Appellate experience** in and before the El Paso, Houston [14th Dist.], San Antonio, and Dallas Courts of Appeals, and the Texas Supreme Court.

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STUDENT LOAN HARDSHIP DISCHARGE - THE BASICS

I. The Relevant Statute: 11 U.S.C. §523(a)(8)

A. Statutory Basis for Nondischargeability

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -

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

(A)(i) an educational benefit overpayment oor loan 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; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified educational loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual

(Subsection (B) was added by BAPCPA in 2005 to except qualified *private* student loans from discharge)

B. "Undue hardship" is not defined in the Bankruptcy Code, but the legislative history suggests that the sometimes competing policy purposes were:

1. to set a high bar for discharge for educational loans to protect the solvency of the educational loan program (*Educational Credit Mgmt. Corp. v. McLeroy (In re McLeroy)*, 250 B.R. 872, 878 (N. D. Tex. 2000; Cummings, J.), citing *McClure v. Action Career Training (In re McClure)*, 210 B.R. 985, 986-87 (Bankr. N. D. Tex. 1997; Akard, J.));

2. to maintain and foster the Code's policy of providing honest, but unfortunate, debtors with a fresh start (*see* H.R. Rep. No. 595, 95th Cong., 1st Sess. 133 (1977); *Douglas v. Educ. Credit Mgmt. Corp.*, 366 B.R. 241, 263 (Bankr. M. D. Ga. 2007) (holding that "[t]he discharge of student loans is reserved for those most extreme instances of financial destitution."));

3. to avoid abuse of the student loan system "in those inequitable situations where debtors with superior education and employment skills were intentionally abusing the resh start policies . . . of the bankruptcy laws" (*Kidd*

v. Student Loan Xpress, Inc. and Xpress Loan Servicing, 458 B.R. 612 (Bankr. N. D. Ga. 2011); *In re Hornsby*, 144 F.3d 433, 436-37 (6th Cir. 1998)); and

4. to further "Congress' determination 'that the creditors' interest in recovering full payment of debts . . . outweighed the debtors' interest in a complete fresh start.'" *Nary v. Complete Source (In re Nary)*, 235 B.R. 752, 764, 767 (N. D. Tex. 2000; Fitzwater, J.), citing *In re McLeroy*, 250 B.R. *supra* at 878.

II. Procedural Issues - Adversary Proceedings

A. Self-Executing Exception to Discharge - Debtor Must File: An adversary proceeding need not be filed by the student loan lender for the loan to be exempted from discharge; rather, the exception is "self-executing" and thus requires the debtor to seek a determination of dischargeability under 11 U.S.C. §523(a)(8). *See Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 124 S. Ct. 1905 (2004).

B. An Adversary Proceeding is Required to Obtain Discharge: Under FRBP Rule 7001(6), "[t]he following are adversary proceedings: (6) a proceeding to determine the dischargeability of a debt." *See also United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 263-64, 130 S. Ct. 1367 (2010) (however, in *Espinosa*, the Supreme Court held that provisions of a confirmed Chapter 13 plan - - in which the student loan lender participated but did not object and slept on its rights, the discharge provisions of 11 U.S.C. §1328, and rules of finality of judgments precluded the lender from collecting a student loan debt where the debtor did not bring an adversary proceeding but purported (improperly) to discharge the loan through the confirmed Chapter 13 plan).

III. Procedural Issues - Burdens of Proof

A. Burdens of Proof in Adversary Cases - "Preponderance of the Evidence." *Grogan v. Garner*, 498 U.S. 279, 290, 111 S. Ct. 654 (1991).

B. Initial Burden - Lender Must Prove that the Debt is Owed and Qualified for the Exception to Discharge. *In re Wright*, 2014 Bankr. LEXIS 1266 (Bankr. N. D. Ala. April 2, 2014); *Roe v. The Law Unit, et al. (In re Roe)*, 226 B.R. 258, 268 (Bankr. N. D. Ala. 1998); *In re Rumor*, 469 B.R. 553 (Bankr. M. D. Pa. 2012).

1. A qualified educational loan is any indebtedness incurred solely to pay qualified higher education expenses of the debtor, his or her spouse, or any other dependent of the debtor when the debt was incurred. 26 U.S.C. §221(d)(1)(A).

2. The expenses must be paid or incurred within a reasonable time before or after incurring the indebtedness. 26 U.S.C. §221(d)(1)(B).

3. The loan must be attributable to education provided while the recipient was an eligible student. 26 U.S.C. §221(d)(1)(C).

4. However, a recent Texas case held that student loan debt incurred by a debtor's friend and co-signed by the debtor was not dischargeable in the co-signer's bankruptcy, and that the dischargeability provisions of §523(a)(8) "applied to cosigners with no filial relationship with the debtor." *Corletta v. Tex. Higher Educ. Coordinating Bd.*, 517 B.R. 708 (Bankr. W. D. Tex. 2014, Gargotta)

C. The Evidentiary Burden Then Shifts to the Debtor to Prove "Undue Hardship." *In re Wright, In re Roe, id.*; *In re Faish*, 72 F.3d 298, 301 (3d Cir. 1995); *In re Eskenasi*, 325 F.3d 541 (4th Cir.)

IV. Proving "Undue Hardship" - The *Brunner* Test (adopted in the Fifth Circuit)

A. To Prove "Undue Hardship" and Receive a Discharge of a qualified student loan, the debtor bears the burden of proving all three prongs of "The *Brunner* Test."

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

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 loan(s); and

3. That the debtor has made good faith efforts to repay the loan.

Brunner v. New York State Higher Educ. Svcs. Corp., 831 F.2d 395 (2d Cir. 1987); "expressly adopted" by the Court of Appeals for the Fifth Circuit in *U. S. Dept. of Educ. v. Gerhardt (In re Gerhardt)*, 348 F.3d 89, 91 (5th Cir. 2003). *See also Ostrom v. Educ. Credit Mgmt. Corp.*, 293 Fed. Appx. 283, 285-86 (5th Cir. 2008) and *Hough v. Pa. Higher Educ. Assistance Agency (In re Hough)*, 128 Fed. Appx. 369, 371 (5th Cir. 2005).

(In the 1st and 8th Circuits, courts have applied a "totality of the circumstances test" in lieu of The *Brunner* Test (*see, e.g., In re Long*, 322 F.3d 549 (8th Cir. 2003)), and in the 6th and 9th Circuits, partial discharge may be permissible (*see, e.g., In re Miller*, 377 F.3d 616 (6th Cir. 2004) and *In re Saxman*, 325 F.3d 1168 (9th Cir. 2003). It may also be possible in the Northern District of Texas. *See In re Nary*, 235 B.R. *supra* at 764, 767, a pre-*Brunner* case applying *Brunner* and affirming a partial discharge "where the undue hardship requirement of §523(a)(8) is met as to part but not all of the student loan.")

B. Specifics - Debtor Cannot Maintain Minimal Standard of Living if Forced to Repay

1. A "minimal standard of living" includes what is minimally necessary to see that the needs of the debtor and dependents are met, including food, shelter,

clothing and medical treatment. . *In re Nary*, 235 B.R. *supra* at 764, citing *In re Rice*, 78 F.3d 1144, 1151 (6th Cir. 1996). Courts outside the Northern District of Texas have articulated a slightly different formulation which adds, basic utilities, personal hygiene products, vehicles (and related costs), health insurance, and some source of recreation. *See Ivory v. United States*, 269 B.R. 890, 899 (Bankr. D. Ala. 2001). However, over-expenditure by a debtor for lifestyle or specific items will likely result in the debt being nondischargeable. *Douglas v. Educ. Credit Mgmt Corp. (In re Douglas)*, 366 B.R. 241, 254 (Bankr. M. D. Ga. 2007).

2. Debtor's failure to attempt to secure a reduced monthly payment through available debt reduction or forbearance programs (such as the Ford Program) have been held fatal to a finding of inability to meet minimal living standards because the court could not determine what the debtor would have been able to afford. *Wieckiewicz v. Educ. Credit Mgmt. Corp.*, 2011 U. S. App. LEXIS 21051 (11th Cir. 2011).

3. In making this determination, it is proper to consider the income of a non-borrower spouse. *In re Nary*, 235 B.R. *supra* at 764, citing *Commonwealth of Va. State Educ. Assistance Auth. v. Dillon*, 189 B.R. 382, 384-85 (W. D. Va. 1995).

4. However, to meet the requirements of the first *Brunner* element, the debtor needn't "live in abject poverty to obtain relief." *In re Nary*, 253 B. R. *supra* at 763, citing *In re Hornsby*, 144 F.3d *supra* at 438.

C. Specifics - Debtor's Inability Likely to Persist Through Repayment Period

1. This second prong of The *Brunner* Test is "meant to be "a demanding requirement.'" *In re Gerhardt*, 348 F.3d *supra* at 92, quoting *In re Brightful*, 267 F.3d 324, 328 (3d Cir. 2001)

2. Proving "additional circumstances" "encompasses 'circumstances that impacted on the debtor's future earning potential but which [were] either not present when the debtor[] applied for the loans or [have] since been exacerbated.'" *In re Gerhardt*, 348 F.3d *supra* at 92, quoting *In re Roach*, 288 B.R. 437, 445 (Bankr. E. D. La. 2003).

3. Proving that the debtor is "currently in financial straits" is by itself insufficient. *In re Gerhardt*, 348 F.3d *supra* at 92.

4. "Instead, the debtor must specifically prove 'a total incapacity . . . in the future to pay [his] debts for reasons not within [his] control.'" *In re Gerhardt*, 348 F.3d *supra* at 92, quoting *In re Faish*, 72 F.3d 298, 307 (3d Cir. 1995). This has sometimes been described to require proof that the inability to pay "must be 'likely to continue for a significant time,' . . . such that there is a 'certainty of hopelessness' that the debtor will be able to repay the loans

within the repayment period." *Educ. Credit Mgmt. Corp. v. Mosley (In re Mosley)*, 494 F.3d 1320, 1326 (11th Cir. 2007); *In re Downey*, 255 B.R. 72, 76-77 (Bankr. N. D. Fla. 2000) (denying discharge where a public defender failed to put on evidence her financial situation was unlikely to improve). It has also been held to require proof of "a total incapacity . . . in the future to pay [her] debts for reasons not within her control." *In re Mallinckrodt*, 274 B.R. 560, 566-67 (S. D. Fla. 2002). A "'bleak forecast of the near future . . . [where] the debtor's straits are only temporary is insufficient to demonstrate undue hardship under the second prong of *Brunner*.'" *In re Douglas*, 366 B.R. at 255-56 (footnotes omitted).

5. Thus, a debtor may not satisfy the "additional circumstances" prong when his/her financial distress is self-imposed. *In re Gerhardt*, 348 F.3d *supra* at 92, quoting *Grigas v. Sallie Mae Servicing Corp. (In re Grigas)*, 252 B.R. 866, 875 (Bankr. D.N.H. 2000). The *Gerhardt* court held the debtor failed to satisfy this prong because he failed to produce evidence eliminating other options the court saw as viable means within his control, and which the court concluded, because not followed, "perpetuate[d] his inability to repay his student loans." *See also Matthews-Hamad v. Educ. Credit Mgmt. Corp. (In re Matthews-Hamad)*, 377 B.R. 415, 422 (Bankr. M. D. Fla 2007) (citing numerous cases for the holding that a debtor may not choose to work only in the field in which he/she was trained, obtain a low-paying job, then claim undue hardship to secure a discharge where other options exist).

6. Generally, Expert Testimony is Not Required from Debtor - *In re Mosley*, 494 F.3d *supra* at 1325-26; *Barrett v. Educ. Credit Mgmt. Corp. (In re Barrett)*, 487 F.3d 353, 359-60 (6th Cir. 2007). Two Texas cases, though not from the Northern District of Texas, have adopted *Mosley* and *Barrett*. *See White v. Educ. Credit Mgmt. Corp. (In re White)*, 2008 Bankr. LEXIS 4617 (Bankr. E. D. Tex. 2008, Rhoades, J.) and *O'Donohoe v. Panhandle Plains Higher Educ. Auth. (In re O'Donohoe)*, 2013 Bankr. LEXIS 2415 (Bankr. S. D. Tex. 2013, Jones, J.) *But see Ostrom v. Educ. Credut Mgmt. Corp.*, 283 Fed. Appx. *supra* at 286, citing the fact that the debtor "presented no evidence, other than his own testimony, that any impairments to his earnings are likely to persist into the future," in affirming the bankruptcy court's finding that the second *Brunner* prong was not satisfied.

7. *Pro se* Debtors Beware - Do Not Represent Yourselves TOO Competently - *In re Hough*, 128 Fed. Appx. *supra* at 371: the bankruptcy court stated that debtor's evidence of negative future employment prospects was "questionable at best," citing the debtor's "laudible courtroom activities" in representing himself. "Debtor has legal, evidentiary and organizational skills. If he is not able to, or not interested in, work as a lawyer, he may be able to use his skills in debt collection, or as a paralegal, where the stress level would be less. Such a finding also precludes a finding by the Court of the second prong of the *Brunner* test."

D. Specifics - That the Debtor Has Made a Good Faith Effort to Repay

1. The court must consider the debtor's "efforts to obtain employment, maximize income and minimize expenses." *Russ v. Tex. Guar. Student Loan Corp. (In re Russ)*, 365 B.R. 640, 645 (Bankr. N. D. Tex. 2007, Houser, J.).

2. Thus, harkening to language in *Gerhardt* concerning self-imposed poverty used in connection with the second *Brunner* prong, "good faith 'encompasses a notion that the debtor may not willfully or negligently cause [her] own default, but rather [her] condition must result from factors beyond [her] reasonable control.'" *In re Russ*, 365 B.R. *supra* at 645, citing *In re McMullin*, 316 B.R. 70, 78 (Bankr. E. D. La. 2004) and *In re Roberson*, 999 F.2d 1132, 1136 (7th Cir. 1993). Thus, in *Russ*, Judge Houser found for the reasons discussed below that, while the debtor "made significant efforts to obtain employment and maximize her income," she failed to prove she made sufficient efforts to minimize her expenses, such that her loan was declared to remain nondischargeable. *Id.*

   a. In *Russ*, the debtor failed to explain why her son was enrolled in a private school, the costs of which were impeding her ability to repay the student loan. *Id*. A debtor's decision to send children to private school without evidence of a compelling reason "indicates the debtor consciously made a decision to place herself in a position where she is unable to repay her student loan debt." *Id*., citing *In re Miller*, 254 B.R. 200, 205 (Bankr. N. D. Ohio 2000); *In re Conner*, 89 B.R. 744, 748-49 (Bankr. N. D. Ill. 1988); *In re Savage*, 311 B.R. 835, 841-42 (B.A.P. 1st Cir. Mass. 2004).

   b. Steps taken to repay the loan prior to bankruptcy are also relevant to a determination of good faith. *Id*., citing *In re Alderete*, 412 F.3d 1200, 1206 (10th Cir. 2005).

      1) While failure to make any payments is relevant, it is not by itself dispositive proof of bad faith. *In re Burton*, 339 856, 882 (Bankr. E. D. Va. 2006).

      2) In the absence of any payments, courts may consider whether the debtor had funds with which to pay the loan. *Id*.

      3) Also relevant is whether or not the debtor pursued a forbearance or deferment, or attempted to renegotiate terms of the loan through an income contingent repayment program. *In re Russ*, 365 B.R. *supra* at 646.

         a) Such requests, or efforts to keep the loan out of default, support a finding of good faith. *In re Alderete*, 412 F.3d *supra* at 1206;*In re McMullin*, 316

B.R. *supra* at 79; *In re Shankwiler*, 208 B.R. 701, 708 (Bankr. C. D. Cal. 1997).

b) And the failure to make such a request can support a finding of the absence of good faith. *In re Alderete*, 412 F.3d *supra* at 1206; *In re Frushour*, 433 F.3d 393, 403 (4th Cir. 2005). Judge Houser cited cases finding bad faith where the debtor's stated motivation for failure to pursue an ICR was discharge or where the debtor's attempts to pursue it seemed insincere).

4) Courts also weigh the ratio of student loan debt to the debtor's total indebtedness, where a high ratio of student loan debt to the whole indicates a lack of good faith. *In re Russ*, 365 B.R. *supra* at 647; *In re Alderete*, 412 F.3d *supra* at 1206; *In re Kelly*, 351 B.R. 45, 55 (Bankr. E.D.N.Y. 2006).

(Finding in *Russ* that the debtor never attempted to renegotiate the loan and did not seriously consider an ICR - - having filled out the paperwork but having done little inquiry into its effects - - the court declined to find good faith. *In re Russ*, 365 B.R. *supra* at 647.)

3. Editor's Note - There are ample cases bearing upon economic decision-making by debtors in Chapter 13 that could conceivably be relevant to the good faith and/or "circumstances beyond debtor's control" analysis in a dischargeability proceeding under 11 U.S.C. §523(a)(8), pertaining to luxury cars, excessive living expenses, and unnecessary obligations that should be examined.