Barry Law Review

Volume 18
Issue 2 *Spring 2013*

Article 5

2013

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SHOULD THE "UNDUE HARDSHIP" STANDARD FOR DISCHARGING STUDENT OR EDUCATIONAL LOANS BE EXPANDED?

Kevin J. Smith *

In recent years, we have seen waves of economic discord in the United States.[1] The collapse of the housing market and its continuous effects on the American economy[2] and the world's economy[3] was just the first wave of economic discord. Many Americans' lives were severely disrupted by this economic collapse, and America will be recovering from this event for many years or even decades. The economic events that followed were not as readily apparent—such as the collapse of the credit card market, which was the second wave of economic discord.[4] The reality was that when homeowners were forced out of their homes due to foreclosure, they also were not able to pay their credit card debt.[5] Credit cards were what they used as a means of avoiding losing their homes for as long as possible, in the hopes that their economic situation would improve.[6] This situation became evident in the increased number of bankruptcy filings that followed the mortgage collapse.[7] Furthermore, this was, in part, the reason for the bank bailout that followed.[8]

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1. *See, e.g.*, *The Impact of the September 2008 Economic Collapse*, PEW CHARITABLE TRUSTS (Apr. 28, 2010), http://www.pewtrusts.org/our_work_report_detail.aspx?id=58695 (discussing some of the reasons for the economic collapse in the United States); Dennis Keegan, *At the Intersection of Global Economics and Politics*, 8 J. INT'L BUS. & L. 1 (2009) (describing the impact that the United States' economic problems have had globally).

2. *See, e.g.*, *Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps Are Not Taken*, REUTERS.COM (Feb. 27, 2009, 10:22 AM), http://www.reuters.com/article/pressRelease/idUS193520+27-Feb-2009+BW20090227. Many people noticed and recognized the credit card collapse as the banking collapse. *Id.*

3. *See, e.g.*, Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 31–51 (2009) (discussing in great detail the factors that led to the housing collapse in the United States and the effect it had on the world financial system); Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1509 (2011) (discussing how the world has tried to figure out the reasons for the collapse of the mortgage market and who to blame).

4. *See, e.g.*, Patrick M. Emery, *Dilatory Tactics in Credit Card Cases: Why Plaintiff-Creditors File Objectionable Complaints & What Can Be Done to Encourage Procedural Compliance*, 22 LOY. CONSUMER L. REV. 183, 183–85 (2009) (describing the increase of credit card balances due the economic collapse). It must be noted that the economic collapse in the United States also includes a record number of job losses in 2008. *See id.* at 184.

5. Americans who knew they could not afford to keep their homes tried to keep their credit cards in good standing before their mortgages. Kathy Chu, *More Americans Using Credit Cards to Stay Afloat*, USA TODAY (Mar. 30, 2008), http://www.usatoday.com/money/perfi/credit/2008-02-28-credit-cards_N.htm.

6. *Id.*

7. *See, e.g.*, Sara Murray & Conor Dougherty, *Personal Bankruptcy Filings Rising Fast*, WALL ST. J. (Jan. 7, 2010), *available at* http://online.wsj.com/article/SB126263231055415303.html (stating that as of 2009,

The author suggests that a third wave of financial problems facing Americans will be federal student loan debts.[9] This overlooked segment of our economy is going to be a significant problem at some point in the near future. College tuition continues to rise at a greater rate than the country's inflation rate.[10] More and more students increasingly rely on federal and private student loans to finance college educations,[11] and there seems to be no indication that this trend will cease to continue. If the issue of the federal student loan debt is left unaddressed, it will become a crippling issue for our country in the very near future.[12]

For the last few decades, the trend has been to make it more difficult for student-debtors to discharge their federal or private student loans in a Chapter 7 bankruptcy or to include them in a reorganization plan under a Chapter 13 bankruptcy.[13] This trend must be reversed if we are to prevent a third wave of financial crisis in this country. It is not a matter of "if," it is a matter of "when" this student loan debt crisis will occur.

The author is not proposing to limit the availability of federal student loans to qualifying students or that student-debtors be given a "free" pass to have their federal student loans forgiven through bankruptcy. The author is proposing that the current use of the "undue hardship" provision[14] be expanded to give the student-debtor a means of obtaining a fresh start—which is the original purpose of the

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1.41 million parties filed bankruptcy in the United States, which was an increase of 32% from 2008); Mark Goldman, *The Rising Number of Chapter 7 Filings*, 2010 WL 1976163 (ASPATORE) (discussing the causes of the increased number of bankruptcy filings). In addition, the percentage of people choosing to file a Chapter 7 over a Chapter 13 has increased. *See* Katie Porter, *Today's Consumers Prefer Chapter 7 Bankruptcies 3 to 1*, CREDIT SLIPS, http://www.creditslips.org/creditslips/2010/03/todays-consumers-prefer-chapter-7-bankruptcy-3-to-1.html (last visited Mar. 27, 2013) (noting that the percentage of Chapter 13 filings in comparison to Chapter 7 filings was 38% in 2006–2007, 31% in 2008 and 26.5% in 2009).

8. *See, e.g.*, Moran, *supra* note 3, at 89 (discussing the relationship between the housing crisis and the credit card crisis).

9. Debra Cassens Weiss, *Senator Seeks Support for Bill to Allow Discharge of Private Student Loan Debt in Bankruptcy*, A.B.A. J. (Mar. 21, 2012), http://www.abajournal.com/news/article/senator_seeks_support_for_bill_to_allow_discharge_of_private_student_loan_d/.

10. This has been a historical trend since the 1980s. *See, e.g.*, Jean Evangelauf, *Tuition May Outpace the Rate of Inflation for 10th Year in Row*, CHRON. HIGHER EDUC., Feb 14, 1990, at A1; Jonathan D. Glater, *Tuition Again Rises Faster Than Inflation*, N.Y. TIMES (Oct. 25, 2006), http://www.nytimes.com/2006/10/25/education/25tuition.html?_r=1&adxnnl=1&adxnnlx=1348776728-towyGRb9+8EJggYKQkcTpA.

11. Ryan G. Milligan, Note, *Financial Band-Aid: Reactionary Fixes to Federal Family Education Loan Program Inducement Guidelines Solve Some Problems, Raise Others*, 34 J.C. & U.L. 717, 717–18 (2008).

12. *See generally Removing a Generation of College Educated Graduates from Purchasing Homes—Higher Education Bubble Will Force Many Students to Hold Off on Buying a Home to Service College Loan Debt. Renters Take Brunt of Household Correction. Demographic Trends Will Put Pressure on Home and Stock Prices*, DR. HOUSING BUBBLE, http://www.doctorhousingbubble.com/removing-a-generation-of-college-educated-graduates-from-purchasing-homes-student-loan-and-mortgage-bubbles-collide/ (last visited Mar. 30, 2013) (discussing how the student loan debt will force many either not to buy, or will not be able to buy homes because of the debt).

13. The latest significant change Congress made to the Bankruptcy Code came through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Adam J. Williams, *Fixing the "Undue Hardship" Hardship: Solutions for the Problem of Discharging Educational Loans Through Bankruptcy*, 70 U. PITT L. REV. 217, 222 (2008) (citing Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified as amended in scattered sections of 11 U.S.C.)). It was through BAPCPA that non-federal student loans became non-dischargeable through bankruptcy. *Id.*

14. 11 U.S.C.A. § 523(a)(8) (West 2010).

Bankruptcy Code.[15] Furthermore, the author proposes treating private non-federal student loans as any other unsecured debt in a bankruptcy proceeding.

This article will discuss a brief history of federal student loans within the Bankruptcy Code.[16] First, it will address the method by which we arrived at today's undue hardship standard and how that standard has been applied in various jurisdictions.[17] This article will then address the public policy arguments for allowing federal student loans to qualify for discharge through Chapter 7 or 13 bankruptcy.[18] Finally, the author will suggest alternatives allowing the discharge of federal student loans, and how these loans should be treated in both Chapter 7 and 13 bankruptcy proceedings.[19] The problem of federal student loan debt is not going away and could be an inhibitor to this country's economic recovery, or even be the cause of another financial crisis in the future.

I. HISTORY OF STUDENT LOANS AND THE BANKRUPTCY CODE

The federal student loan program began with the passage of the Higher Education Act of 1965 (HEA).[20] The HEA was a part of President Lyndon B. Johnson's War on Poverty policy.[21] The purpose of this Act was to ensure that all students wishing to attend college would be financially able to attend by providing financial assistance for education to students that had no means to do so, other than grants.[22] Federal student loans were intended to be used merely as a supplement to grants for those who qualified for those programs.[23] This meant only the neediest of students would actually qualify for the federal student loan program.[24] Thus, the federal student loan program was intended to be used as a means of reducing financial barriers created by an inequality of opportunities among students in the United States, not as a primary means of funding college education.

The federal student loan program was designed to provide low interest loans by banks and other lending institutions that would be insured by the United States

15. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

16. The author will also discuss the private student loan. The private student loan is not federally subsidized or guaranteed in any form and is originated usually as any other personal loan would be through a private lending institution.

17. *See infra* Section II.

18. *See infra* Section IV.

19. *See supra* Section IV.

20. Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (1965). In 1958, the Perkins Loan program began as part of a national defense measure. Pub. L. No. 85-864, 72 Stat. 1580 (1958) (codified as amended at 20 U.S.C. §§ 401–602) (subsequently repealed).

21. President Lyndon Baines Johnson, State of the Union Address (Jan. 4, 1965); Peter Zamora, *In Recognition of the Special Educational Needs of Low-Income Families?: Ideological Discord and its Effects Upon Title I of the Elementary and Secondary Educational Acts of 1965 and 2001*, 10 GEO. J. POVERTY L. & POL'Y 413, 415 (2003).

22. *See* Richard Fossey, *"The Certainty of Hopelessness:" Are Courts Too Harsh Toward Bankrupt Student Loan Debtors?*, 26 J.L. & EDUC. 29, 31 (1997) (referring to the Congressional intent to make federal student loans a "last resort").

23. Jodi L. Edelson, Note, *Higher Education to Higher Default: A Re-Examination of the Guaranteed Student Loan Program*, 11 ANN. REV. BANKING L. 475, 478–79 (1992).

24. *Id.*; Timothy Naegele, *The Guaranteed Student Loan Program: Do Lenders' Risks Exceed Their Rewards?*, 34 HASTINGS L.J. 599, 601 (1983).

Department of Education.[25] The insurance gave banks and other lending institutions an incentive to approve student loans in situations where otherwise the student-debtor would most likely not qualify.[26] Thus, if the student-debtor was unable to repay the federal student loans, the lender would be entitled to reimbursement by the federal government.[27] The lending institutions were guaranteed payment if the student filed for bankruptcy protection or in the event of the student's death.[28]

After the beginning of the federal student loan program, many middle-class Americans voiced concerns that they were being left out.[29] The very poor could get federal student loans but a middle-class student was not presented the same opportunity.[30] Thus, in 1978, Congress passed the Middle Income Student Assistant Act (MISAA) which made federal student loans available to virtually any college student regardless of their financial need.[31] MISAA is obviously contrary to the original purpose of the federal student loan program.

MISAA did not create any new programs, it merely extended the existing federal subsidized loan program to include any student that requested federal assistance.[32] Under the original HEA, only families with an income less than $25,000 were eligible, whereas now any student with any income is eligible.[33] MISAA simply removed the income requirement.[34] It was after the passage of MISAA that the public concern over bankruptcy petitions and the discharge of federal student loans grew.[35]

In the 1960s and early 1970s, the Bankruptcy Code viewed federal student loans no differently than any other unsecured debt in bankruptcy proceedings.[36] This could be a result of, in part, the fact that the federal student loan program was new, it was not widely used, and that Congress had not considered any alternatives. However, in the late 1970s this view began to change dramatically.[37] The author believes this was due, in part, to the expansion of the federal student loan program with the passage of MISAA in 1976.

25. Robert F. Salvin, *Student Loans, Bankruptcy and the Fresh Start Policy: Must Debtors Be Impoverished to Discharge Educational Loans?*, 71 TUL. L. REV. 139, 144–45 (1996).

26. *Id.* at 145.

27. Marilyn Yarbrough, *Financing Legal Education*, 51 J. LEGAL EDUC. 457, 459 (2001).

28. *See* 20 U.S.C. § 523(b)(8)(B) (West 2010) ("[E]xcepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents . . . .").

29. Robert C. Cloud, *Offsetting Social Security Benefits to Repay Student Loans: Pay Us Now or Pay Us Later*, 208 ED. LAW REP. 11, *13–14 (West 2006).

30. *Id.* at *13.

31. *Id.* at *14.

32. *See generally* Pub. L. No. 95-566, 93 Stat. 2402 (1978).

33. *Id.*

34. *Id.*

35. *See, e.g.*, H.R. REP. NO. 95-595, at 132 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6093 (explaining that the purpose of the legislation is to prevent the abuse of the federal student loan program); Pelkowski v. Ohio Student Loan Comm'n (*In re* Pelkowski), 990 F.2d 737, 742 (3d Cir. 1993) (stating that in the 1970s both Congress and the public were concerned about the perceived rise in bankruptcy filings by student-debtors).

36. B.J. Huey, *Undue Hardship or Undue Burden: Has the Time Finally Arrived for Congress to Discharge Section 523(A)(8) of the Bankruptcy Code?*, 34 TEX. TECH L. REV. 89, 97 (2002).

37. *Id.*

During that period of eligibility requirement expansion, as one would expect, the country saw a dramatic increase in federal student loan funding.[38] In just a five-year period from 1975 to 1979, the program increased by two billion dollars.[39] In fact, by the late 1970s, schools were receiving most of their tuition payments through the federal student loan program.[40] By 1976, Congress began the process of considering changes to the Bankruptcy Code pertaining to federal student loans.[41] The first change was a requirement for the debtor to wait at least five years into the repayment of their federal student loans before qualifying for discharge under the Bankruptcy Code.[42]

The Bankruptcy Reform Act of 1978 amended the Bankruptcy Code by making federal student loans virtually non-dischargeable.[43] This modification was due to apparent abuses of the Bankruptcy Code by student-debtors.[44] The abuse was apparent when the statistics estimated that 80% of the bankruptcy petitions that sought relief of federal student loans were brought within three years of completing a college education.[45] Thus, this modification to the Bankruptcy Code would seem to have been a positive solution.

The media also played an important factor in this apparent perception of student loan abuse.[46] The media used stories from the early 1970s about students-debtors abusing the federal student loan program that angered the public and added to the public's already perceived notion of a loophole in the Bankruptcy Code that allowed the discharge of the federal student loans.[47] The media reported cases involving lawyers, doctors, and other professionals who obtained federal student loans to attend college and then filed for bankruptcy protection to avoid paying

38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.* at 98.
42. Bd. of Regents of Univ. Sys. of Ga. V. Williamson (*In re* Williamson), 665 F.2d 683, 684 (5th Cir. 1982) (citing Guaranteed Student Loan Amendments of 1976, Pub. L. No. 94-482 § 127(a), 90 Stat. 2081, 2141 (codified at 20 U.S.C. § 1087-3 (1976) (repealed 1978)). Title 20 U.S.C. provides:

> A debt which is a loan insured or guaranteed under the authority of this part may be released by a discharge in bankruptcy under the Bankruptcy Act only if such discharge is granted after the five-year period . . . beginning on the date of commencement of the repayment period of such loan, except that prior to the expiration of the five year-period, such loan may be released only if the court in which the proceeding is pending determines that payment from future income or other wealth will impose an undue hardship on the debtor or his dependents.

Id.

43. *See generally* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).
44. Seth J. Gerson, Note, *Separate Classification of Student Loans in Chapter 13*, 73 WASH. U. L. Q. 269, 282 (1995).
45. H.R. REP. NO. 95-595, 137, 156–57 (1977).
46. Jennifer L. Frattini, Note, *The Dischargeability of Student Loans: An Undue Burden?*, 17 BANKR. DEV. J. 537, 541 (2001).
47. *Id.* at 541–42; Gerson, *supra* note 44, at 280–81.

their student loans back.[48] Reports during that period indicated that one out of every five student-debtors defaulted on federal students loans.[49]

These media reports pressured Congress to fix the perceived problem with the federal student loan program and the Bankruptcy Code.[50] Congress formed a Commission on Bankruptcy Law to research and analyze the federal student loan problem, and to devise revisions to the Bankruptcy Code to resolve the problem.[51] First, the General Accounting Office (GAO) conducted a study to determine the actual abuse that was occurring within the federal student loan program.[52] Interestingly, the result of the GAO research did not correspond with the problem the media reported to the public.[53]

The GAO proved that as of the early 1970s, the default rate on federal student loans was 18%.[54] Only 3–4% of that number was discharged in bankruptcy proceedings.[55] Thus, less than 1% of all federal student loans during that period were actually discharged in bankruptcy proceedings.[56] Less than 1% does not appear to be an abusive number, and it did not appear to be an abusive number to the Commission.[57] The Commission acknowledged that the fear of federal student loan abuse was more perception than reality.[58]

Nonetheless, the Commission still recommended that the restriction on the discharge of federal student debt be included in the Bankruptcy Code.[59] The GAO decision was based upon the perception created by the media.[60] The Commission warned against students-debtors filing for bankruptcy protection because such petitions could put the future integrity of the federal student loan program in jeopardy.[61]

With all of this concern over federal student loan defaults, Congress continued to pass legislation in the 1990s making it even easier for students to obtain federal loans and increasing loan amounts.[62] Every time Congress took this action, it was

48. *See* Frattini, *supra* note 46, at 542.

49. Huey, *supra* note 36, at 98. For examples of media misdirection of statistics, see generally Frattini, *supra* note 46, at 541–43 (containing examples of how the media distorted facts about student loan discharges through bankruptcy).

50. Frattini, *supra* note 46, at 542.

51. *See* S. REP. NO. 95-989, at 1–4 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5787–90 (describing the Commission's job and purpose).

52. Frattini, *supra* note 46, at 542.

53. *Id.* at 542–43.

54. *Id.* at 543.

55. *Id.*

56. *Id.*

57. *Id.*

58. Huey, *supra* note 36, at 98.

59. *Id.* at 98–99.

60. Frattini, *supra* note 46, at 541–44.

61. Report of the Commission on the Bankruptcy Laws of the United States, H.R. DOC. NO. 93-137, pt. I, at 141 (1973); *see also* Brunner v. N.Y. State Higher Educ. (*In re* Brunner), 46 B.R. 752, 754 (S.D.N.Y. 1985) (noting that the commission argued that the rising incidences of student loan discharges harmed the federal student loan program).

62. Terry W. Hartle, *Student Loan Program Tells a Success Story*, N.Y. TIMES, Jan. 5 1995, at A26 (stating that rates of student borrowing have increased every time Congress raised loan limits). This was not the first time Congress has increased the amount students can borrow. *See generally* Pub. L. No. 99-498, § 402(a), 100 Stat. 1359 (1986). The Higher Education Act of 1986 made several changes to the federal student loan program. *Id.* The

generally popular with the public because student-debtors would borrow to the limit.[63] Thus, giving more money to increase the federal student loan debt problem was permissible, while the possible discharge of those same loans was not. In just five years, student borrowing of federal student loans increased by more than 50% from 1992 to 1996.[64] During that period, government costs increased to fund the federal student loan program to more than $23 billion annually.[65] Increased funding caused the federal student loan program to be the primary means for students to attend school.[66]

II. CURRENT STANDARD FOR STUDENT LOAN DISCHARGE

Since 1978, whether federal student loans are dischargeable in bankruptcy is determined under the undue hardship standard.[67] This harsh standard requires the bankruptcy court to look at the student-debtor's current and possible future income to determine whether an undue hardship exists, and whether it would continue to exist into the future.[68] This standard is designed to be harsh.[69] It prevents the discharge of federal student loans except in extreme cases.[70] Court cases indicate that the more educated you are, the less likely the court would ever grant a discharge unless there was some form of disability.[71]

The courts have found that undue hardship exists in several cases.[72] First, the court found undue hardship where there was no projected enhancement of earning capacity for the debtor.[73] For example, when the debtor was employed at the

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legislation raised the annual and aggregate loan limits for both undergraduate and graduate students. *Id.; see also* Pub. L. No. 100-50 § 10(a), 101 Stat. 341 (1987) (containing the amendments to the Higher Education Act of 1986).

63. *See* Hartle, *supra* note 62.

64. Ian William, *The Indentured Class: Student Loans are Robbing Us of Our Future*, PROVIDENCE PHOENIX, Sept. 20, 1996, at 8.

65. *Id.*

66. Sandy Baum, *Rising College Costs: A Federal Role?, Losing Ground*, N.Y. TIMES (Feb. 3, 2010), http://roomfordebate.blogs.nytimes.com/2010/02/03/rising-college-costs-a-federal-role/.

67. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2591 (1978) (codified as amended at 11 U.S.C. § 523(a)(8)(1994)); H.R. REP. NO. 95-595, at 132 (1977).

68. Long v. Educ. Credit Mgmt. Corp. (*In re* Long), 322 F.3d 549, 554 (8th Cir. 2003); Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987).

69. *See In re Long*, 322 F.3d at 554 (stating the *Brunner* test has strict parameters).

70. *See infra* notes 101–63 and accompanying text.

71. *See* Rafael I. Pardo, *Illness and Inability to Repay: The Role of Debtor Health in the Discharge of Educational Debt*, 35 FLA. ST. U. L. REV. 505, 506–10 (2008) (discussing the history of cases where undue hardship was found).

72. *See* Zook v. Edfinancial Corp. (*In re* Zook)), No. 05 10019, 2009 WL 512436, at *1 (Bankr. D.D.C. Feb. 27, 2009); Robbins v. Educ. Credit Mgmt. Corp. (*In re* Robbins), 371 B.R. 372 (Bankr. E.D. Ark. 2007); Loftus v. Sallie Mae Servicing (*In re* Loftus), 371 B.R. 402 (Bankr. N.D. Iowa 2007); Jackson v. Educ. Resources Inst. (*In re* Jackson), No. 06 01433, 2007 WL 2295585, at *3 (Bankr. S.D.N.Y. Aug. 9, 2007); McGinnis v. Pa. Higher Educ. Assistance Agency (*In re* McGinnis), 289 B.R. 257 (Bankr. M.D. Ga. 2003); Mayer v. Pa. Higher Educ. Assistance Agency (*In re* Mayer), 198 B.R. 116 (Bankr. E.D. Pa. 1996); O'Brien v. Household Bank (*In re* O'Brien), 165 B.R. 456 (Bankr. W.D. Mo. 1994).

73. *See, e.g., In re Robbins*, 371 B.R. at 380 (holding an undue hardship existed because the earning capacity of the mentally ill debtor was limited); *In re Loftus*, 371 B.R. at 411 (holding an undue hardship existed for a recently divorced woman with no marketable skills); *but see In re* Roberson, 999 F.2d 1132, 1137 (7th Cir. 1993) (holding there was no undue hardship even though debtor had no current income and his earning capacity was not projected to improve in the near future); *see also* Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in*

highest and best-paying position for which he or she was qualified, and no increase in income was foreseeable, the debtor was entitled to an undue hardship discharge of their federal student loans.[74] In such cases, the court would determine that the debtor's income would not increase in the future.[75] Second, undue hardship existed in a case where the debtor lacked assets that could be sold to repay the federal student loans.[76] Third, undue hardship existed in a case of poor economic conditions with no sign of immediate improvement[77]—in a case of an unemployed debtor with little hope of employment.[78] With the economic condition in this country, it is surprising that more attorneys have not used a debtor's unemployment to discharge their client's federal student loans.

Fourth, undue hardship existed in a case where the student-debtor had certain medical conditions that prevented employment or only allowed employment that would not enable them to pay their loans.[79] Lastly, undue hardship was found in a case where the student-debtor was employed but the chance of their earnings exceeding their expenses was remote.[80] This usually refers to unskilled labor, which seems to be contrary to the concept of going to school for an education anyway.

Most cases of student-debtors requesting a discharge are denied.[81] Student-debtors have been denied a discharge even when the employment market was optimistic.[82] Other reasons for the denial are that the debtor had skills in demand in a job market; the expectancy of a wage or salary increase; obtaining a license that would likely increase income; and even a debtor's child reaching school age so as to permit the debtor or the debtor's spouse to seek work.[83] Finally, a discharge was denied to a debtor who did not work full-time.[84]

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the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt, 74 U. CIN. L. REV. 405, 443–44 (2005) (discussing the decline in income as one ages).

74. *In re Loftus*, 371 B.R. at 411.

75. *Id.*

76. *See In re* Hamilton, No. 07 68258, 2009 WL 6499258, at *1–2 (Bankr. N.D. Ga. Mar. 23, 2009) (listing several reasons courts have used to discharge student loans).

77. *In re McGinnis*, 289 B.R. at 265–67.

78. *See In re* Mayer, 198 B.R. 116, 126 (Bankr. E.D. Pa. 1996) (holding the debtor "totally unemployable").

79. This actually seems to be the most acceptable form of undue hardship to get federal student loans discharged. *See, e.g.*, *In re* Zook, No. 05 10019, 2009 WL 512436, at *1 (Bankr. D.D.C. Feb. 27, 2009) (holding debtor's mental disorder and the student loan debt combines constituted an undue hardship allowing the debt to be discharged); *In re* Jackson, No. 06 01433, 2007 WL 2295585, at *9 (Bankr. S.D.N.Y. Aug. 9, 2007) (finding bipolar disorder an undue hardship for the discharge of student loans); *In re* O'Brien, 165 B.R. 456, 458, 460 (Bankr. W.D. Mo. 1994) (holding debtor that suffered from chronic fatigue syndrome received a discharge).

80. *See* Siebert v. U.S. Dep't of Health (*In re* Siebert), 10 B.R. 704, 705 (Bankr. S.D. Ohio 1981) (discharging student loans when the court found the debtor had few usable job skills).

81. *See supra* notes 101–08 and accompanying text; *see also infra* notes 110–63 and accompanying text.

82. Albert v. Ohio Student Loan Comm'n (*In re* Albert), 25 B.R. 98, 101–02 (Bankr. N.D. Ohio 1982); N.Y. State Higher Educ. Services Corp. v. Henry (*In re* Henry), 4 B.R. 495, 497–98 (Bankr. S.D.N.Y. 1980).

83. *See, e.g.*, Wilson v. Educ. Credit Mgmt. Corp. (*In re* Wilson), 270 B.R. 290, 294–95 (Bankr. N.D. Iowa 2001) (holding there was no undue hardship because debtor's earning capacity exceeded their current income); McLeod v. AFSA Data Corp. *(In re* McLeod), 197 B.R. 624, 629 (Bankr. N.D. Ohio 1996) (holding an undue hardship did not exist because debtor's son's income would allow debtor and her son to maintain a minimal standard of living); Rappaport v. Orange Savings Bank (*In re* Rappaport), 16 B.R. 615, 617 (Bankr. D.N.J. 1981) (holding no undue hardship existed because of the debtor's future income potential); Warren v. Univ. of Ill. (*In re*

The most concerning situations regarding the denial of discharge are when the debtor's current income is inadequate to maintain even a minimal standard of living; a federal student loan will be non-dischargeable unless the debtor can demonstrate with certainty that the debtor cannot and will not earn more income in the future.[85] This appears to be against the jurisprudence of the Bankruptcy Code.

Commentators often cite criticism from the courts towards debtors seeking a bankruptcy discharge of educational debt too soon after graduation.[86] The court's consideration of time is a holdover concept from the changes in 1976 to the Bankruptcy Code requiring the minimum five-year waiting period.[87] The criticism is based on the idea that the debtor has not allowed enough time to obtain employment in their field, or in a field different from the one in which they earned their education.[88]

The current interpretation of the undue hardship standard is predictive.[89] This is contrary to bankruptcy principles because it does not look at the debtor's current financial situation.[90] For example, in Chapter 7 bankruptcy petitions, the court applies the "means test."[91] This test looks at the debtors' current income, rather than their future income projections.[92] There is no requirement to look ten years into the future to determine a discharge.[93]

Likewise, in Chapter 13 bankruptcy petitions, the court assesses the debtors' current income to see if a reorganization plan will work.[94] The court will not look into future income for payment ability other than to maintain the five-year plan established at the time of the re-organization.[95] The five-year plan is determined on the current income to debt ratio.[96] Looking into the future requires predicting the future. Is that really how we want the Bankruptcy Code to proceed—predicting the future?

Warren), 6 B.R. 233, 234 (Bankr. S.D. Fla. 1980) (holding no undue hardship existed because mere unemployment of the debtors is not enough to grant a discharge of their student loans).

84. *See* Williams v. Access Grp. Inc. (*In re* Williams), No. 02 023942004, WL 2475568, at *4 (Bankr. D. Haw. Oct. 28, 2004) (holding that student loans are not dischargeable because the debtor's decision not to obtain additional and available work was not a factor beyond her control).

85. *See generally* Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 AM. BANKR. INST. L. REV. 665 (2005).

86. *See generally* Abbye Atkinson, *Race, Educational Loans & Bankruptcy*, 16 MICH. J. RACE & L. 1, 36–37 (2010); *see also* Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395, 397 (2d Cir. 1987) (noting that the debtor filed bankruptcy within a month after her loans became due).

87. *See generally* Atkinson, *supra* note 86, at 17.

88. *See In re* Brunner, 46 B.R. 752, 757 (S.D.N.Y. 1985).

89. *See supra* notes 101–17 and accompanying text; *see also infra* notes 119–63 and accompanying text.

90. *In re* Henry, 4 B.R. 495, 497 (Bankr. S.D.N.Y. 1980).

91. There is also a Means Test for Chapter 13. For a discussion of both Means Tests, see generally Culhane & White, *supra* note 85, at 672–77.

92. 11 U.S.C. § 707(b)(2)(A)(i) (West 2010).

93. *Id.*

94. 11 U.S.C. § 1322(d)(1) (West 2010); *see* Katherine A. Jeter-Boldt, *Good in Theory, Bad in Practice: The Unintended Consequence of BAPCPA's Credit Counseling Requirement*, 71 MO. L. REV. 1101, 1103–04 (2006) (discussing Chapter 13 bankruptcy petitions).

95. 11 U.S.C. §§ 1322(d)(1), 1327(b) (West 2010); Robert W. Rieder, *Student Loans and Bankruptcies: What Can a University-Creditor Do?*, 56 ED. LAW REP. 691, 691–92 (1990).

96. Rieder, *supra* note 95, at 698.

Debtors were refused a discharge of their federal student loans because, looking toward the future, the debtor's expenses would be reduced because the debtor's minor child would reach the age of majority.[97] In addition, if the debtor had an installment loan that would be satisfied in the future, that satisfaction would work against the discharge.[98] If the courts are going to look into the future, then it would be prudent for the courts to also consider possible expenses that would arise in the future. What happens if the student-debtor has more children in the future? That would increase future expenses and thereby decrease the debtor's ability to make future payments. What if the debtor needs a second vehicle and the only way to accomplish that is to obtain an installment loan? It would only be prudent to consider the likelihood that debtors could incur more expenses in the future, as well as less.

The current approach to the question of the dischargeability of federal student loans is not practical. It just does not make sense. If the worry is an abundance of bankruptcy petitions for discharge, then restrictions should be placed on the institutions providing the federal student loans. Generally, the author does not support this concept. The other alternative is to expand the current undue hardship standard to allow those who are in dire need of relief to be able to discharge their federal student loans. Nonetheless, this article will discuss three predominantly used tests to determine undue hardship.

III. COURT "TESTS" USED TO DETERMINE UNDUE HARDSHIP

A. The *Brunner* Test

To begin the discussion of the three primary tests courts use to determine whether federal student loans are, it is important to note that these tests were judicially created but not legislatively enacted.[99] These tests were applied in such a strict and unreasonable way that it led to public perception that federal student loans are never dischargeable.[100]

97. *See In re* McLeod, 197 B.R. 624, 629 (Bankr. N.D. Ohio 1996) (stating that debtor did not qualify for undue hardship because her obligation to care for her son would terminate in three years); Simons v. Higher Educ. Assistance Found. (*In re* Simons), 119 B.R. 589, 593 (Bankr. S.D. Ohio 1990) (finding debtor's circumstances will improve because their 16 year-old son was close to age of majority).

98. *See, e.g.*, Bossardt v. Educ. Credit Mgmt. Corp. (*In re* Bossardet), 336 B.R. 451, 455, 458 (Bankr. D. Ariz. 2005) (inferring that the second prong of the *Brunner* test can be interpreted as a review of the entire loan period). This approach would include such items as installment loans being satisfied, thus freeing money to pay student loans. *Id.*

99. *See* Andresen v. Neb. Student Loan Program (*In re* Andresen), 232 B.R. 127, 137–41 (B.A.P. 8th Cir. 1999).

100. *See* Hedlund v. Educ. Res. Inst., Inc. (*In re* Hedlund), 468 B.R. 901, 909 (D. Or. 2012) (stating that student loans are "presumptively nondischargeable in bankruptcy"); Ballard v. Virginia (*In re* Ballard), 60 B.R. 673, 675 (Bankr. W.D. Va. 1986) ("A finding of undue hardship is reserved for the exceptional case and requires the presence of 'unique' or 'extraordinary' circumstances which would render it unlikely that the debtor ever would be able to honor his obligations.").

The test most widely used to determine whether student loans are dischargeable because of undue hardship is the *Brunner* test.[101] In *Brunner v. New York State Higher Education Services Corp.*, the Second Circuit developed a test consisting of three prongs, which are used to determine whether the debtor's petition qualifies for undue hardship.[102] The debtor must prove each prong by a preponderance of the evidence.[103] If the debtor fails to prove undue hardship under any one of the three prongs, then the student loans will not be discharged.[104]

First, based on current income and expenses, if forced to repay their federal student loan, the debtor cannot maintain a "minimal" standard of living for themselves and their dependents, if applicable.[105] Implicit in this first factor is that the student-debtor demonstrate that they are trying to minimize current household living expenses while attempting to maximize income.[106] This first step is a standard bankruptcy approach in determining whether the petitioner qualifies for bankruptcy protection.[107]

The second prong is whether additional circumstances exist to indicate that the current situation for the student-debtor is likely to persist throughout a significant portion of the repayment period of the federal student loan.[108] This is a look into the future to determine worthiness to qualify for discharge of federal student loans.[109] Future employment possibilities are considered.[110] Thus, the court makes a

101. *See, e.g.*, Educ. Credit Mgmt. Corp. v. Rhodes (*In re* Rhodes), 464 B.R. 918, 922 (W.D. Wash. 2012) (stating the Ninth Circuit has adopted the *Brunner* test); Oyler v. Educ. Credit Mgmt. Corp. (*In re* Oyler), 397 F.3d 382, 385 (6th Cir. 2005) (stating the Sixth Circuit adopts the *Brunner* test in place of the previously used hybrid test); U.S Dep't of Educ. v. Gerhardt (*In re* Gerhardt), 348 F.3d 89, 91 (5th Cir. 2003) (following the *Brunner* test because other circuit courts use the test); Hernar Ins. Corp. of Am. v. Cox (*In re* Cox), 338 F.3d 1238, 1240 (11th Cir. 2003) (formally adopting the *Brunner* test); Ekenasi v. Educ. Res. Inst. (*In re* Ekenasi), 325 F.3d 541, 546–47 (4th Cir. 2003) (using the *Brunner* test and stating most courts follow this test); Goulet v. Educ. Credit Mgmt. Corp. (*In re* Goulet), 284 F.3d 773, 777 (7th Cir. 2002) (stating the 7th Circuit has adopted the *Brunner* test); Brightful v. Pa. Higher Educ. Assistance Agency (*In re* Brightful), 267 F.3d 324, 327 (3d Cir. 2001) (applying the three-part *Brunner* test).

102. Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395, 396 (2d Cir. 1987); *see* O'Hearn v. Educ. Credit Mgmt. Corp. (*In re* O'Hearn), 339 F.3d 559, 564 (7th Cir. 2003) (referring to the three-part test established in *Brunner*).

103. *See* Grogan v. Garner, 498 U.S. 279, 291 (1991) (stating that the standard of proof for the dischargeability exceptions of Section 523(a) of the Bankruptcy Code is by a preponderance of the evidence standard); Thoms v. Educ. Credit Mgmt. Corp. (*In re* Thoms), 257 B.R. 144, 148 (Bankr. S.D.N.Y. 2001) (stating the borrower must prove each element by the preponderance of the evidence standard); Fowler v. Conn. Student Loan Found. (*In re* Fowler), 250 B.R. 828, 830 (Bankr. D. Conn. 2000).

104. Wetzel v. N.Y. State Higher Educ. Services Corp. (*In re* Wetzel), 213 B.R. 220, 225 (Bankr. N.D.N.Y. 1996) (citing *In re* Faish, 72 F.3d 298, 306 (3d Cir. 1995)).

105. *Brunner*, 831 F.2d at 396.

106. Terrance L. Michael & Janie M. Phelps, *Judge?!—We Don't Need No Stinking Judges!!!: The Discharge of Student Loans in Bankruptcy Cases and the Income Contingent Repayment Plan*, 38 TEX. TECH L. REV. 73, 87–88 (2005).

107. *In re Wetzel*, 213 B.R. at 225.

108. Educ. Credit Mgmt. Corp. v. Nys (*In re* Nys), 446 F.3d 938, 946–47 (9th Cir. 2006); *see also* Alderete v. Educ. Credit Mgmt. Corp (*In re* Alderete), 412 F.3d 1200, 1205 (10th Cir. 2005) (stating that as long as the debtor can demonstrate the circumstances that would make it unlikely they could pay their loans for a significant period of time, then the second factor of the *Brunner* test is satisfied).

109. *See* Ga. Higher Educ. Assistance Corp. v. Bell (*In re* Bell), 5 B.R. 461, 463 (Bankr. N.D. Ga. 1980) (denying discharge of student loans because the debtor's financial future looked better).

110. *See, e.g.*, Vt. Student Assistance Corp. v. Ewell (*In re* Ewell), 1 B.R. 311, 313 (Bankr. D. Vt. 1979) (denying discharge because the wife was expecting employment).

determination at the time of the bankruptcy petition whether the debtor would ever have any hope of being able to pay off the student loans.[111] Essentially, there cannot be any glimmer of hope. Courts have referred to this as a certainty of hopelessness.[112] Even if the debtor satisfies the other two factors but not this certainty of hopelessness, the federal student loans are not dischargeable.[113]

A debtor must also show additional circumstances in order to satisfy this second factor, such as persistent inability to pay the student loan for a significant time during the repayment period.[114] This includes illness, lack of job skills (again which seems contrary to acquiring an education), large numbers of dependents, or some combination of these.[115] The circumstances must be exceptional, such as serious illness, and beyond a mere current inability to pay back the federal student loan.[116] With this approach, it shows that the inability to pay the student loan is likely to persist for a significant portion of the student's loan repayment period.[117] In determining whether these additional circumstances exist, the courts base their estimation of a debtor's prospects on specific identifiable facts.[118] Furthermore, the courts have stated that the inquiry into future circumstances should be limited to the foreseeable future, at most over the term of the loan.[119] Depending on the term of the loan, this could be thirty years. Thus again, this is the court's pure estimation. Going as far as thirty years into the future to predict the circumstances is beyond the debtor's control or the court's ability to determine.

The last prong to consider is whether the debtor has made a good faith effort to repay the loans.[120] This usually implies that a long period of time has elapsed since the loans came due for repayment.[121] This prong not only requires evidence of current inability to pay, but also that the debtor shows circumstances that would prevent the debtor from being able to pay the loan over an extended period.[122] Many courts have also applied this test as the definitive and exclusive authority in

111. *See In re Alderete*, 412 F.3d at 1205 (discussing the plaintiffs' current circumstances do not hamper their inability to pay the loans in the foreseeable future).

112. Hart v. Educ. Credit Mgmt. Corp. (*In re* Hart), 438 B.R. 406, 411–12 (Bankr. E.D. Mich. 2010).

113. *See, e.g.*, Wallace v. Educ. Credit Mgmt. Corp. (*In re* Wallace), 443 B.R. 781, 793–95 (Bankr. S.D. Ohio 2010).

114. Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395, 396 (2d Cir. 1987).

115. Kraft v. N.Y. State Higher Educ. Services Corp. (*In re* Kraft), 161 B.R. 82, 84–85 (Bankr. W.D.N.Y. 1993).

116. *In re* Nys, 446 F.3d 938, 945 (9th Cir. 2006).

117. *In re* Brightful, 267 F.3d 324, 328 (3d Cir. 2001).

118. *See, e.g.*, Cal. Student Aid Comm'n v. Williams (*In re* Williams), 9 F. App'x 696, 698 (9th Cir. 2001) (stating no factual findings supported discharge of debtor's student loans).

119. *See, e.g.*, U.S. Aid Funds Inc. v. Pena (*In re* Pena), 155 F.3d 1108, 1113–14 (9th Cir. 1998) (granting a discharge of the debtor's student loans where one of the debtors was declared permanently mentally disabled and incapable of holding a job for more than six months to a year); *In re* Roberson, 999 F.2d 1132, 1137 (7th Cir. 1993) (denying discharge of student loans where the debtor's current impediments to employment, including lack of transportation and wrist and back injuries, would not preclude gainful employment in the future).

120. Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395, 396 (2d Cir. 1987).

121. *See generally id.*

122. *See In re* Brunner, 46 B.R. 752, 758 (S.D.N.Y. 1985) (holding that debtor did not prove "'a total incapacity now and in the future to pay [her] debts for reasons not within [her] control'") (quoting *In re* Rappaport, 16 B.R. 615, 617 (Bankr. D.N.J. 1981)). *But see* Lawson v. Hemar Service Corp. of America (*In re* Lawson), 190 B.R. 955, 958 (Bankr. M.D. Fla. 1995) (refusing a discharge of students where the debtors suffered from permanent mental illness because debtors did not try to negotiate terms of the student loan).

determining the existence of undue hardship.[123] This third prong seems to be more reliable in determining whether a debtor would ever be able to repay the loans.

The following are some examples that the courts have used in determining whether the debtor has satisfied the "good faith" factor of the *Brunner* test. The court contemplates the actions of the debtor before filing for bankruptcy protection.[124] This includes the debtor's efforts to obtain employment that would maximize income.[125] Furthermore, the court considers whether the debtor has taken steps to reduce their expenses.[126] The debtor could not have willfully or negligently caused the default.[127] The debtor's issues must be due to circumstances beyond the debtor's control.[128] The *Brunner* test is similar to the original dischargeability standard because it has a timeframe repayment period component.[129] Under the *Brunner* test for determining undue hardship, if the court finds against the debtor on any of the three parts, the inquiry ends and the student loan is not dischargeable.[130]

B. The Totality-of-the-Circumstances Test

Another test used to determine if a debtor could discharge their student loans is the totality-of-the-circumstances test.[131] Under this test, the court again considers three factors in determining the student-debtor's worthiness of discharge.[132]

The first factor is the debtor's past, present, and future financial resources.[133] The second factor is the debtor's and the debtor's dependents' reasonable and necessary living expenses.[134] The last factor looks at any other relevant circumstances particular to that student-debtor. Essentially, whether denying a discharge of the federal student loans would prevent the debtor from maintaining a minimum standard of living.[135]

In applying the totality-of-the-circumstances approach, the court must determine whether there would be anything left from the debtor's estimated future income to enable the debtor to make some payment on his or her student loan without reducing what the debtor and the debtor's dependents need to maintain a

123. Michael & Phelps, *supra* note 106, at 88.
124. *Id.* at 87–88.
125. *Id.* at 87.
126. *Id.* at 88.
127. *Id.*
128. *See In re* Brunner, 46 B.R. 752, 756 (S.D.N.Y. 1985).
129. Atkinson, *supra* note 86, at 17.
130. *See, e.g.*, Flickinger-Luther v. Educ. Credit Mgmt. Corp. (*In re* Flickinger-Luther), 462 B.R. 157, 165 (Bankr. W.D. Pa. 2012) (stating that the debtor met the first and third prong of the *Brunner* test, but failed on the second prong of the test thus denying the discharge of the student loans).
131. *In re* Andresen, 232 B.R. 127, 140 (B.A.P. 8th Cir. 1999).
132. *Id.*
133. Denittis v. Educ. Credit Mgmt. Corp. (*In re* Denittis), 362 B.R. 57, 63 (Bankr. D. Mass. 2007).
134. *Id.*; Andrews v. S.D. Student Loan Assistance Corp. (*In re* Andrews), 661 F.2d 702, 704 (8th Cir. 1981).
135. *In re Andrews*, 661 F.2d at 704 (citing *In re* Wegfehrt, 10 B.R. 826, 830 (Bankr. N.D. Ohio 1981)); *see also In re Andresen*, 232 B.R. at 140.

minimal standard of living.[136] This approach also looks into the future to predict what could happen.

C. The *Johnson* Test

The third undue hardship test is used less than the other two.[137] This test was one of the first established tests used to determine whether undue hardship existed.[138] The test consists of three independent sub-tests:[139] the mechanical test, the good faith test, and the policy test.[140] Some courts focus on just one of the tests, while other courts use a combination of all three.[141] If the debtor fails one test, the court is not required to consider the other sub-tests.[142]

The mechanical test focuses on the debtor's expenses and future financial resources.[143] Under this test, the court compares the debtor's present and future income with their necessary expenses and surrounding circumstances to determine whether it is reasonable to require the debtor to repay the loan completely or in part.[144] The court also considers the health status, age, and education level of the debtor.[145] While considering these circumstances, the court must allow the debtors and their dependents to maintain a subsistence or poverty level standard of living while repaying their federal student loan.[146] If the student-debtor passes this test then the student-debtor must address the second sub-test.[147]

The next sub-test is the good faith test, which employs factors such as the student-debtor's efforts to obtain employment, minimize their expenditures, and

136. *See In re Andresen*, 232 B.R. at 140.

137. *Id.*; Binder v. U.S. Dep't of Educ. (*In re* Binder), 54 B.R. 736, 739 (Bankr. D.N.D. 1985).

138. *Andresen*, 232 B.R. at 137–38.

139. *See generally* Higher Educ. Assist. Agency v. Johnson (*In re* Johnson), No.77-2033, 1979 U.S. Dist. LEXIS 11428 (Bankr. E.D. Pa. June 27, 1979). This test is referred to by some courts as the "*Johnson* test". *See* Miller v. Benton State Bank (*In re* Miller), No. 96-1510, 1997 WL 160432, at *1 (Bankr. W.D. Ark. Feb. 19, 1997).

140. Feenstra v. N.Y. State Higher Educ. Services Serv. Corp. (*In re* Feenstra), 51 B.R. 107, 112 (Bankr. W.D.N.Y. 1985).

141. *See, e.g.*, Roberson v. Ill. Student Assistance Comm'n (*In re* Roberson), 138 B.R. 885, 888 (N.D. Ill. 1992) (stating that if the debtor satisfies the first two tests, then the court need not consider the third test); Mayes v. Okla. State Regents for Higher Educ. (*In re* Mayes), 183 B.R. 261, 263 (Bankr. E.D. Okla. 1985) (stating that most courts just use the mechanical test to determine undue hardship).

142. Ohio Student Loan Comm'n v. Kammerud (*In re* Kammerud), 15 B.R. 1, 10 (Bankr. Ohio 1980). *But see* Roe v. The Law Unit (*In re* Roe), 226 B.R. 258, 274 (N.D. Ala. 1998) (stating that the debtor failed all three tests).

143. *In re Miller*, 1997 WL 160432, at *1.

144. *See, e.g.*, Price v. Bureau of Student Fin. Assistance of the Dep't of Health, Educ. & Welfare (*In re* Price), 25 B.R. 256, 258 (Bankr. Mo. 1982) (stating that even without paying the student loans, at best the debtor could only barely keep up with expenses).

145. Vaughn v. Ill. State Scholarship Comm'n (*In re* Vaughn), 151 B.R. 481, 485 (C.D. Ill. 1993); Gammoh v. Ohio Student Loan Comm'n (*In re* Gammoh), 174 B.R. 707, 710 (Bankr. N.D. Ohio 1994); *see also* Craig v. Pa. Higher Educ. Assistance Agency (*In re* Craig), 64 B.R. 854, 856 (Bankr. W.D. Pa. 1986) (stating that the debtor did not claim any physical impairment that would have prevented her from finding employment); Taylor v. Ill. Student Assistance Comm'n (*In re* Taylor), 198 B.R. 700, 702 (Bankr. N.D. Ohio 1996).

146. Erickson v. N.D. State Univ. (*In re* Erickson), 52 B.R. 154, 157 (Bankr. N.D. 1985); Boston v. Utah Higher Educ. Assistance Auth. (*In re* Boston), 119 B.R. 162, 165 (Bankr. W.D. Ark. 1990).

147. *See In re Erickson*, 52 B.R. at 157; *In re Boston*, 119 B.R. at 165. For examples of debtors that passed this first test, see Smith v. N.Y. State Higher Educ. Serv. Corp. (*In re* Smith), 45 B.R. 711, 714 (Bankr. N.Y. 1985). *See also In re* Binder, 54 B.R. 736, 740 (Bankr. D.N.D. 1985).

maximize their resources.[148] Under this test, the court inquires as to whether the debtor has made a good faith effort to begin repayment of the loan.[149] Similar to the previously discussed standard, this includes efforts to renegotiate the terms of the loan.[150]

To show good faith under this standard, the student-debtor has to show efforts to maximize income.[151] In addition, the debtor must take advantage of opportunities for work and diligently seek employment.[152] The work does not have to be in the chosen field or the field in which the debtor was educated.[153] The requirement that the debtor show good faith attempts to repay loans requires that the debtor has made payments when the debtor was in a position to make such payments.[154]

The third and last sub-test is the underlying policy test.[155] This test considers the amount of federal student loan debt and compares that to the percentage of indebtedness.[156] It also considers the benefit from the education that the student-debtor received.[157] Under this test, the court determines whether discharging part of or the entire student loan obligation would constitute an abuse of bankruptcy.[158] This approach was derived from the Congressional concern that recent college graduates who were extended federal student loans based on their future earnings ability should not be able to file bankruptcy primarily for the purpose of discharging these loans and thereafter pocketing the benefit derived from the loans.[159] Only those student-debtors who had truly fallen on difficult times after incurring their federal student loans, and who would likely never derive any future benefit from the education financed with these loans, could qualify for the undue hardship exception.[160]

IV. PUBLIC POLICY ARGUMENTS FOR INCLUSION OF STUDENT LOANS INTO DEBTS THAT ARE DISCHARGEABLE

The author believes the most important factor to consider is the economic climate of this country over the past few years. Since the collapse of the housing

148. *In re* Johnson, No.77-2033, 1979 U.S. Dist. LEXIS 11428, at *41–50 (Bankr. E.D. Pa. June 27, 1979).
149. *Id.* at *41.
150. Pa. Higher Educ. Assistance Agency v. Birrane (*In re* Birrane), 287 B.R. 490, 499 (9th Cir. 2002).
151. *In re Johnson*, 1979 U.S. Dist. LEXIS 11428, at *46–47.
152. *Id.* at *47–50.
153. *See, e.g.*, Evans v. Higher Educ. Assistance Found. (*In re* Evans), 131 B.R. 372, 376 (Bankr. S.D. Ohio 1991) (discharging student loans because student did not receive the skills necessary to leave McDonald's).
154. For examples of debtors satisfying the second test, see *In re* Smith, 45 B.R. 711, 714–15 (Bankr. N.Y. 1985); *In re* Binder, 54 B.R. 736, 740 (Bankr. D.N.D. 1985).
155. *In re Johnson*, 1979 U.S. Dist. LEXIS 11428, at *52–57.
156. *Id.* at *54–55.
157. *Id.* at *55–57.
158. Foreman v. Higher Educ. Assistance Found. (*In re* Foreman), 119 B.R. 584, 587 n.3 (Bankr. S.D. Ohio 1990) (citing *In re* French, 62 B.R. 235, 241 (Bankr. Minn. 1986)).
159. *In re Johnson*, 1979 U.S. Dist. LEXIS 11428, at *52–53.
160. For examples of debtors that satisfied the third test, see *In re* Smith, 45 B.R. 711, 715 (Bankr. N.Y. 1985); *In re* Binder, 54 B.R. 736, 740 (Bankr. D.N.D. 1985).

market, many Americans have had to modify their living styles.[161] In addition, with oil prices on the rise, many Americans are facing a shrinking income.[162] This is leading to the federal student loan crises that the author believes are inevitable.

As one would expect, many people chose to go to school to get a degree in hopes of bettering their financial position. This was in part a result of the recent explosion of unemployment rates, which peaked at 10% in October 2009.[163] This rate was more than double the average unemployment rate for 2006.[164] The average unemployment rate in 2012 was 8.3%.[165] Even with Americans gaining employment again, that does not mean they have the ability to pay for the federal student loan they acquired before the economy went into recession.[166] Furthermore, if the debtor acquired the loan in an attempt to obtain employment again, there is no guarantee that the debtor is going to be able to repay it in today's economic climate.[167]

One congressman has noticed the looming student loan problem.[168] Senator Durbin of Illinois noticed that private student loans have doubled from $11.8 billion in 2005 to $23 billion in just four years.[169] Again, these types of student loans are not federally subsidized or guaranteed in any way.[170] Senator Durbin also mentions the fact that many students are struggling to make the payments, owing tens of thousands or even hundreds of thousands of dollars on federal and private student loans.[171]

These types of student loans are not the federal student loans that this article has been discussing thus far. However, it shows how extreme the bankruptcy rules have become in not allowing the discharge of any type of loan used for educational purposes.[172] Now, predatory lenders have become aware of the bankruptcy rule and have targeted students in need of more money than the federal student loans would allow.[173] If Senator Durbin's initiative is successful, this would be the first step in the right direction in allowing student loans to be discharged again in bankruptcy.

161. William Alden, *Oil Prices Raise Cost Of Homeownership, Threatening Housing Recovery*, THE HUFFINGTON POST (Mar. 08, 2011 2:09 PM), http://www.huffingtonpost.com/2011/03/08/oil-prices-housing-market_n_832973.html.

162. *Id.*

163. Bureau of Labor Statistics, *Labor Force Statistics from the Current Population Survey—Unemployment Rate*, U.S. DEP'T OF LABOR (Apr. 3, 2013), http://data.bls.gov/timeseries/LNS14000000.

164. *Id.*

165. *Id.*; *see State Unemployment Rates for February 2013*, NAT'L CONF. OF STATE LEGISLATURES (Mar. 29, 2013), http://www.ncsl.org/issues-research/labor/state-unemployment-update.aspx (showing each state's unemployment rates with Nevada, California, and Mississippi being the highest at 9.6% and North Dakota being the lowest at 3.3%).

166. *Compare Labor Force Statistics, supra* note 163, *with State Unemployment Rates, supra* note 165.

167. *Id.*

168. *See* Senator Dick Durbin, *Saving Students from Debt* (Feb. 1, 2012), http://durbin.senate.gov/public/index.cfm/hot-topics?ContentRecord_id=495c2802-609c-46df-bfa5-e28de0b41f30.

169. *Id.*

170. *Federal Versus Private Loans*, U.S. DEP'T OF EDUC., http://studentaid.ed.gov/types/loans/federal-vs-private (last visited Feb. 27, 2013).

171. Durbin, *supra* note 168.

172. *See* Tyler Kingkade, *Private Student Loan Bankruptcy Rule Traps Graduates With Debt Amid Calls For Reform*, THE HUFFINGTON POST (Aug. 15, 2012), http://www.huffingtonpost.com/2012/08/14/private-student-loans-bankruptcy-law_n_1753462.html.

173. *See id.*

If there is a concern over students filing for bankruptcy protection to discharge their federal student loans, then should we not address the fact that we are throwing money at students to attend whatever college they choose since they can just get the loans to attend? We, as a country, are more than willing to extend federal or private student loans to anyone. However, we are not making the college or educational institution accountable for the loan money and to whom they give the loan money. This, however, is an issue for another article.

V. PROPOSED CHANGES FOR STUDENT LOANS

The author believes that changes are necessary to the Bankruptcy Code to accommodate dischargeable federal student loans. The author does not propose that federal student loans be dischargeable in Chapter 7 bankruptcy petitions. This step would be too much too fast, and perhaps not even necessary. However, the author does support the idea that privately funded, non-federal, student loans should be dischargeable in a Chapter 7 petition. This would simply be returning to the pre-BAPCPA days.[174]

The author agrees with the recent Congressional efforts to allow private student loans to be dischargeable in bankruptcy and hopes that effort will be successful very soon.[175] These private student loans are different from the traditional federal student loans.[176] The author agrees with Congressmen Durbin's attempt to differentiate these loans from the federally sponsored student loans in the Bankruptcy Code.[177] Often, these private student loans are provided through very expensive for-profit schools that lure low-income students into their ranks.[178] These students need additional protection to begin with because of their circumstances. The author does not want to see their access to education cut-off, but rather have them be able, if necessary, to discharge those loans in a Chapter 7 bankruptcy.

Nonetheless, in the case of traditional federal student loans, there are two possible approaches that can work for the bankruptcy system and all interested parties. This section will first address the plan President Obama has introduced.[179] It will then discuss the approach in considering the federal student loan as a priority unsecured claim. This approach will be similar to the way back-taxes are classified in a Chapter 13 petition.[180] The last approach discussed, and the one the author supports the most, is to consider the federal student loan as an unsecured debt after a minimal repayment period has elapsed. The author believes that either of these

174. *See generally supra* note 13 (BAPCPA made nonfederal student loans non-dischargeable as well); *see also* Durbin, *supra* note 168.

175. Durbin, *supra* note 168.

176. U.S. DEP'T OF EDUC., *supra* note 170.

177. *See generally* Durbin, *supra* note 168.

178. *See, e.g.*, Kingkade, *supra* note 172.

179. *See generally* Office of the Press Secretary, *Fact Sheet: "Help Americans Manage Student Loan Debt"*, THE WHITE HOUSE (Oct. 25, 2011), http://www.whitehouse.gov/the-press-office/2011/10/25/fact-sheet-help-americans-manage-student-loan-debt.

180. *See* Baran Bulkat, *What is a Priority Claim in Chapter 13 Bankruptcy?*, NOLO LAW FOR ALL, http://www.nolo.com/legal-encyclopedia/what-priority-claim-chapter-13-bankruptcy.html (last visited Apr. 3, 2013).

approaches could be useful in making sure there is little abuse of the federal student loan program, but at the same time ensure that those student-debtors in need of assistance from the Bankruptcy Code are able to obtain assistance.

Both approaches discussed apply the same premise; federal student loans can only be discharged through a Chapter 13 petition.[181] This would ensure that there would only be limited abuse, but as mentioned above, there was never any evidence of widespread abuse before student loans could not be discharged.[182] Nonetheless, for now there should be no relief under a Chapter 7 petition except for those student loans that are not federal student loans.

A. President Barack Obama's Initiative

In 2011, President Obama implemented the "Pay As You Earn" initiative to assist student-debtors with their loan obligations.[183] This is a good plan and the author applauds the President for this initiative. However, the plan assists only a segment of society.

The author believes the plan will assist many with their federal student loan problems. This plan will allow debtors who have taken out recent student loans to be required to pay a capped percentage of their loan every month and be able to discharge the loan after a specified period of time.[184] The cap begins at 15 % of their discretionary income.[185] Beginning in 2014, the cap will be lowered to only 10%.[186] This plan is also going to be available to those who have existing federal student loans as well.[187]

The "Pay As You Earn" concept started with the College Cost Reduction and Access Act of 2007 (CCRAA) and became available on July 1, 2009.[188] The CCRAA created the Income Based Repayment Plan, which is the basis of President Obama's "Pay As You Earn" plan.[189] Under CCRAA, the debtor's student loan payment was capped at 15% of their disposable income based on federal poverty rates.[190] Under the President's plan, the payment would be reduced to 10% as mentioned above.[191] Furthermore, after twenty-five years of repayment, the debt is forgiven.[192]

This plan recognizes the fact that many student-debtors just cannot pay the amount of federal student loans they incurred to get their education. What plans like these mainly accomplish is the delay of the discharge of the federal student

181. *Id.*
182. *See generally* Frattini, *supra* note 46.
183. Office of the Press Secretary, *supra* note 179.
184. *Id.*
185. *Id.*
187. *Id.*
187. *Id.*
188. *Income-Based Repayment*, FINAID, http://www.finaid.org/loans/ibr.phtml (last visited Apr. 3, 2013). There is a public service loan forgiveness program within this Act. *See id.*
189. FINAID, *supra* note 188.
190. *Id.*
191. Office of the Press Secretary, *supra* note 179.
192. FINAID, *supra* note 188. To understand how the IBR is to be calculated, see generally *id.*

loan until later. Nevertheless, just as the initiative started by Senator Durbin mentioned previously, this is a step in the right direction.[193]

B. Priority Unsecured Claim

This approach would classify the traditional federal student loan in a similar manner to how we currently classify federal back-taxes on Chapter 13 reorganization petitions.[194] It would provide the student-debtor with the ability to enter into a payment plan that would freeze any additional interest from accruing and remove any previously capitalized interest from any unsubsidized federal student loans.[195] Furthermore, all payments made would be entirely applied to the principal only.[196] This would essentially bring the federal student loan amount back down to the original principal amount the student obtained to go to school. In effect, this would make the federal student loan an interest free loan to the student.

This approach would have limited applications for student-debtors. This approach would be for the student-debtors who have paid the majority of their federal student loans and have fallen on hard times. This would permit the court to remove all of the interest that the student-debtor had paid over the years and apply those payments made solely to the principal of their federal student loans. If there were any remaining principal, then that amount would be treated the same as a Priority Unsecured Creditor in the Chapter 13 bankruptcy reorganization plan.[197]

This approach would make the payment of the principal federal student loan amount the priority of all of the previous payments made by the student-debtor.[198] For example, if a student acquired $45,000 in federal student loans during their college career and they have been paying on those loans for seventeen years,[199] and now their financial status has gotten to the point that bankruptcy is their only option, this plan would be great for them. Under this scenario, the student-debtor has made payments of just under $35,000 to their federal student loans, including interest.[200]

Under the author's proposal, the student-debtor would have the entire $35,000 that has been paid applied directly to the principal, leaving just over $10,000 remaining on their federal student loans. Then the court would apply the remaining $10,000 loan balance to the Chapter 13 reorganization payment plan, which would require the student to pay approximately the same amount each month for the federal student loans as they were paying before the petition.[201] However, under the

193. *See generally* Durbin, *supra* note 168.
194. *See* Bulkat, *supra* note 180.
195. *Id.*
196. *Id.*
197. *Id.*
198. *Id.*
199. In my example, the student-debtor chose a twenty-five year repayment plan. All of the loans are subsidized federal student loans. At 9% interest, the payment would be $171.23 for the twenty-five year period.
200. This number is achieved by seventeen years of payments times $171.23 a month.
201. Under the original payment structure of the student's loan plan, then payment was $171.23 and under the reorganization plan, the payment would be $167.83.

protection of the Chapter 13 reorganization plan, those payments made by the student-debtor are interest free. As a result, in this scenario, the principal of the federal student loan is paid in its entirety. No interest would be paid to any lending institution, but the taxpayer would be reimbursed completely on the principal.

Other beneficiaries would be the student-debtors who have paid the original principal of their federal student loans in full.[202] Using the same example as above, the student-debtor would have paid the $45,000 in less than twenty-two years. Thus, if the student-debtor filed for bankruptcy protection after that point, then the remaining amount not paid would be classified as interest and thus be treated as any other unsecured creditor in a Chapter 13 plan. It would work the same as the example above, but the difference is that once all of the payments made by the student-debtor are applied to the principal there is no more principal to pay. Thus, the principal amount is once again paid and the federal student loan becomes, in effect, an interest free loan.

C. Unsecured Debt Approach

This approach is less complicated than the previous approach suggested by the author. This approach takes some of the changes made in 1976 and expands upon them.[203] In this approach, the student-debtor must wait ten years before attempting to discharge the federal student loans. Under the 1976 changes to the Bankruptcy Code, the student-debtor has to wait five years after the repayment period had begun.[204] Under the author's approach, the student-debtor would have to wait ten years, but the ten years would have to be in actual repayment status, not deferral status.

Using the same scenario used for the previous approach, this is how the following approach would work: The author would again apply all $20,000 to the principal and discharge the remaining $25,000 of principal. Using this approach, the principal of the federal student loans would obviously not be repaid in full. However, it would guarantee that at least 40% of the federal student loan's principal would be satisfied.

In theory, if a student-debtor would be required to wait the ten-year period before being able to file for the discharge of the federal student loans, it would most likely ensure that the majority of the student-debtors would pay further into their student loans before, if ever, considering bankruptcy protection. The author does not believe the average student-debtor would be counting the days until the tenth year of repayment had passed and then run to the courthouse to file for bankruptcy.

Although this approach has limited applications, by benefitting a few student-debtors this approach still lives up to the original purpose of the Bankruptcy Code. Furthermore, this approach is adjustable by the length of years if there were an

202. Using the amounts from the previous example; a student-debtor obtaining $45,000 in federal student loans and selecting to pay those loans over a twenty-five year period.

203. 11 U.S.C. § 523 (West 2010).

204. *Id.*

unacceptable number of filings to discharge federal student loans. The length of the years requirement could easily be increased or decreased depending upon economic conditions in the country.

This approach is very similar to the 1976 change to the Bankruptcy Code's time requirement.[205] The author's suggestion is just to extend the time requirement and make possible a flexible time requirement as mentioned. Neither of the suggested approaches are perfect. There will never be a perfect approach or solution, to the federal student loan problem that is looming. However, the country must prepare for the eventuality of the federal student loan problem that is just getting bigger every year.

VI. CONCLUSION

We, as a country, have been ignoring the issue of federal student loan default and the amount of student loan debt that exists. Throughout the period of federal bailouts and the mortgage market collapse, nothing was ever mentioned about the federal student loan issue. President Obama, as mentioned above, has made some efforts to address the looming issue, but it is just a "band-aid."[206] His plan, which lowers the monthly payments for the student-debtor, recognizes that our country has the problem looming in the background.[207] It appears as if there are no congressional members willing to put the issue on the table for discussion.

Nonetheless, the author suggests that we must loosen the undue hardship standard to make federal student loans dischargeable in Chapter 13 bankruptcy proceedings. This article has proffered two possible solutions that would at least move us in the right direction.[208] These two solutions would be beneficial to a limited number of student-debtors, but the author's solutions would strike a workable balance between those who do not want federal student loans to be dischargeable under any circumstance, and those who want an unlimited availability of discharge in the Bankruptcy Code.

We must continue to make it difficult to discharge the federal student loans. It would not benefit society to have students obtaining loans from the federal government thinking they will never pay them back. However, the need exists for the availability to those who qualify under either of these plans to be able to do so. By incorporating either of these plans, we as a society will be following the basic principle of the Bankruptcy Code and allow the debtor a fresh start.

205. *Id.*
206. *See generally* Office of the Press Secretary, *supra* note 179.
207. *See generally id.*
208. *See supra* section V.B–C.