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The Possibility of Discharging Student Loan Debt and Assessing the Differing Standards Applied by the Courts

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INTRODUCTION

Discharging student loan debt under the United States Bankruptcy Code (the "Bankruptcy Code") is more difficult than attempting to discharge other types of debt.[1] Although discharging student loan debt is not a simple hurdle to surpass, it is possible in certain circumstances.[2] Under the Bankruptcy Code, student loan debt may not be discharged "unless excepting such debt from discharge . . . would impose an undue hardship on the debtor and the debtor's dependents . . . ."[3] The Bankruptcy Code does not define undue hardship.[4] Congress "left it up to the various Bankruptcy Courts to utilize their discretion in defining what that term

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[1] *See* Brunner v. N.Y. State Higher Educ. Servs. Corp. 831 F.2d 395, 396 (2d Cir. 1987). Prior to 1976, student loans were not distinguished from other dischargeable debt in bankruptcy, and debtors were permitted to routinely discharge student loan debt. *See* Johnson v. Mo. Baptist Coll. (*In re* Johnson), 218 B.R. 449, 451 (B.A.P. 8th Cir. 1998). However, that categorization changed over time due to fear of students abusing the system, and the discharge exception for educational loans was enacted to prevent most debtors from discharging their student loan debt. *See* Cazenovia College v. Renshaw (*In re* Renshaw), 222 F.3d 82, 87 (2d Cir. 2000).

[2] *See, e.g.*, Fern v. FedLoan Servicing (*In re* Fern), 553 B.R. 362 (Bankr. N.D. Iowa 2016), *aff'd*, 563 B.R. 1 (B.A.P. 8th Cir. 2017).

[3] 11 U.S.C. § 523(a)(8).

[4] *See In re* Fern, 553 B.R. at 367.

means after an analysis of the statute and a review of applicable legislative history."[5] This created an imbalance between the circuits, and courts have implemented a variety of tests throughout the years to decide undue hardship cases.[6] Presently, all student loans are subject to the undue hardship standard, and the two main tests applied by the courts are the Brunner test and the totality of the circumstances test.[7]

Because the undue hardship standard was enacted without guidance on how to evaluate it, two questions arise: (1) whether it is possible to discharge student loan debt, and (2) how have courts applied the differing standards in determining whether to discharge student loan debt? This memorandum will examine the two undue hardship standards. Part I discusses both the Brunner test and totality of the circumstances test. Part II assesses how the standards compare to each other.

I. The Two Undue Hardship Standards

A. The Brunner Test

The Second Circuit first adopted the Brunner test in *Brunner v. N.Y. State Higher Educ. Servs. Corp.*,[8] and the standard is currently the majority view.[9] Under Brunner, a court will consider the following three elements: "(1) that the debtor cannot maintain, based on current income and expenses, a 'minimal' standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the

[5] Fox. v. Pa. Higher Educ. Assistance Agency (*In re* Fox), 163 B.R. 975, 978 (Bankr. M.D. Pa. 1993).
[6] *See id.* at 102.
[7] *See In re* Fern, 553 B.R. at 366–67.
[8] 831 F.2d 395 (2d Cir. 1987).
[9] Educ. Credit Mgmt. Corp. v. Frushour (*In re* Frushour), 433 F.3d 393, 400 (4th Cir. 2005).

debtor has made good faith efforts to repay the loans."[10] If a court finds that the debtor has not satisfied any of the three prongs of the test, the student loan is not dischargeable.[11]

B. Application of the Brunner Test

Applying the Brunner standard for the first time, the Second Circuit denied a discharge of the debtor's student loan debt.[12] Specifically, the debtor obtained a Master's degree and owed $9,000 in student loans.[13] She filed for bankruptcy seven months after receiving her Master's degree.[14] Two months later, as soon as the grace period on her loans had expired, she filed an adversary proceeding seeking discharge of her student loans.[15] She was unemployed and receiving government assistance.[16] Furthermore, she alleged that she sent her resume to more than one hundred places in her field of study, and she was seeing a therapist for depression and anxiety.[17]

The bankruptcy court found that, although the debtor was unemployed and unable to obtain employment in her field of study, she had no dependents or other burdens hindering her from finding other work and paying off her loans.[18] The court further found that an inability to pay the loans or meet minimal expenses at the time was not enough to find undue hardship, and it was unlikely that her inability would extend for a significant part of the repayment period.[19] Moreover, the court found that the debtor had not demonstrated a good faith effort to pay her

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[10] *Brunner*, 831 F.2d at 396.
[11] *See id.*
[12] *See id.*
[13] Brunner v. N.Y. State Higher Educ. Servs. Corp. (*In re* Brunner), 46 B.R. 752, 753 (Bankr. S.D.N.Y. 1985), *aff'd*, 831 F.2d 395 (2d Cir. 1987).
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id.* at 757.
[18] Id.
[19] *Id.* at 757–58.

loans.[20] The court emphasized the fact that she filed for a discharge within one month of when her first payment was due, and she did not request a deferment, which was the "less drastic remedy" available to her.[21]

In contrast, *Educ. Credit Mgmt. Corp. v. Polleys*[22] demonstrates a successful discharge case under the Brunner analysis.[23] The debtor in *Polleys* was a 45-year-old single mother who owed approximately $51,000 in student loans.[24] She was unable to maintain employment using her degree, and she suffered from a mental illness.[25] The court rejected the totality of the circumstances test, stating that the test "has an unfortunate tendency to generate lists of factors that . . . grow ever longer as the case law develops."[26] The court held that the debtor was entitled to a discharge under the Brunner test primarily because of her mental health issues, which prevented her from maintaining steady employment.[27]

C. The Totality of the Circumstances Test

The Eighth Circuit introduced the totality of the circumstances test in *Andrews v. S.D. Student Loan Assistance Corp.* (*In re Andrews*),[28] where the court expressed its preference for a less restrictive standard.[29] The test includes an evaluation of: "(1) the debtor's past, present, and reasonably reliable future financial resources; (2) the debtor's reasonable and necessary living

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[20] *Id.* at 758.
[21] *Id.*
[22] 356 F.3d 1302 (10th Cir. 2004).
[23] *See id.* at 1309.
[24] *Id.* at 1309–10.
[25] *Id.* at 1305.
[26] *Id.* at 1309.
[27] *See id.* at 1310–11.
[28] 661 F.2d 702 (8th Cir. 1981).
[29] *See id.* at 704.

expenses; and (3) any other relevant facts and circumstances."[30] Only the First and Eighth Circuits currently apply this minority standard.[31]

When analyzing the first and second factors of the totality of the circumstances test, debtors are expected to present evidence showing "that they have done everything possible to minimize expenses and maximize income . . . ."[32] Overall, if a debtor's future financial resources will adequately cover payment of the student loans while still providing the debtor with a minimal standard of living, then the debt will not be discharged.[33] This analysis requires the court to consider a range of facts, including the debtor's current employment and financial situation as well as the possibility of future changes in the debtor's situation.[34] Additionally, a court will consider the debtor's health, age, education, number of dependents, and other personal circumstances.[35] No factor is dispositive under the totality of the circumstances standard.[36]

Under the third part of the totality of the circumstances test, when considering other relevant facts and circumstances, a court can consider a broad range of relevant information "that would be persuasive to overcome the income and expense analysis of undue hardship under the first two factors . . . ."[37] Courts have considered the following under this inquiry:

> (1) total present and future incapacity to pay debts for reasons not within the control of the debtor; (2) whether the debtor has made a good faith effort to

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[30] Fern v. FedLoan Servicing (*In re* Fern), 553 B.R. 362, 367 (Bankr. N.D. Iowa 2016), *aff'd*, 563 B.R. 1 (B.A.P. 8th Cir. 2017).
[31] *See* Bronsdon v. Educ. Credit Mgmt. Corp. (*In re* Bronsdon), 435 B.R. 791, 800 (B.A.P. 1st Cir. 2010); Andrews v. South Dakota Loan Assistance Corp. (*In re* Andrews), 661 F.2d 702, 704 (8th Cir. 1981).
[32] United States Dept. of Educ. v. Rose (*In re* Rose), 227 B.R. 518, 526 n. 11 (W.D. Mo. 1998), *aff'd in part*, *remanded in part*, 187 F.3d 926 (8th Cir. 1999).
[33] *See In re* Long, 322 F.3d at 554–55.
[34] *See id.* at 555.
[35] *See* Hicks v. Educ. Credit Mgmt. Corp. (*In re* Hicks), 331 B.R. 18, 31 (Bankr. D. Mass. 2005).
[36] *See* Morgan v. United States Dept. of Higher Educ. (*In re* Morgan), 247 B.R. 776, 782 (Bankr. E.D. Ark. 2000).
[37] Fern v. FedLoan Servicing (*In re* Fern), 563 B.R. 1, 4–5 (B.A.P. 8th Cir. 2017).

> negotiate a deferment or forbearance of payment; (3) whether the hardship will be long-term; (4) whether the debtor has made payments on the student loan; (5) whether there is permanent or long-term disability of the debtor; (6) the ability of the debtor to obtain gainful employment in the area of the study; (7) whether the debtor has made a good faith effort to maximize income and minimize expenses; (8) whether the dominant purpose of the bankruptcy petition was to discharge the student loan; and (9) the ratio of student loan debt to total indebtedness.[38]

D. Application of the Totality of the Circumstances Test

Demonstrating how a court applies the totality of the circumstances test, the Eighth Circuit allowed a debtor to discharge her student loan debt in *In re Fern*.[39] The case involved a debtor, Sara Fern, who owed $27,000 in student loans that she borrowed for two separate educational programs.[40] One of the programs she did not complete, and the other program did not lead to profitable employment.[41] Fern was a single mother of three children, received no financial support from their fathers, and often lived at a deficit.[42] Consequently, she contended that the student loan debt was a mental and emotional burden.[43] Additionally, Fern was receiving food stamps and rental assistance from the government.[44] The court found that Fern was maximizing her current earning potential and did not have any unnecessary expenses for a mother raising three children on her own.[45] Conversely, the creditors argued that because there were income-based repayment plans available to Fern, a finding of undue hardship was not

[38] *Id.* at 4.
[39] Fern v. FedLoan Servicing (*In re* Fern), 553 B.R. 362, 369 (Bankr. N.D. Iowa 2016), *aff'd*, 563 B.R. 1 (B.A.P. 8th Cir. 2017).
[40] *Id.* at 364–65.
[41] *Id.* at 364.
[42] *Id.* at 364–65.
[43] *Id.* at 364.
[44] *Id.* at 365.
[45] *Id.* at 368–69.

warranted.[46] The court disagreed, however, holding that the payment plans imposed an additional burden on Fern.[47]

Applying the totality of the circumstances test, the *Fern* court found that the debtor's past, present, and reasonably reliable future financial resources supported a finding of undue hardship.[48] Fern never earned more than $25,000 a year and was relying on family support and government assistance.[49] Furthermore, there was sufficient evidence showing that she was maximizing her income.[50] The court also found that her expenses were reasonable and necessary, weighing in favor of discharge.[51] In addition, the court concluded that the repayment plans proposed by the creditors would impose hardship, and there was a very low probability that Fern would ever make significant payments.[52] Accordingly, the court held that, under the totality of the circumstances test, Fern was entitled to a discharge of her student loan debt.[53]

E. Bankruptcy Appellate Panel Affirming In re Fern and Contrasting an Unsuccessful Discharge Case

The Unites States Bankruptcy Appellate Panel of the Eighth Circuit affirmed the lower court's decision in *In re Fern*, holding that under the totality of the circumstances, Fern's student loans were dischargeable based upon undue hardship.[54] The court explained that the Eighth Circuit "follows a more flexible approach under a totality of the circumstances test" and has "expressly rejected" the Brunner test.[55] Further, the court contrasted *Educ. Credit Mgmt. Corp.*

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[46] *Id.* at 369.
[47] *Id.*
[48] *Id.* at 368.
[49] *Id.* at 367.
[50] *Id.* at 368.
[51] *Id.* at 369.
[52] *Id.* at 369–71.
[53] *Id.* at 371.
[54] Fern v. FedLoan Servicing (*In re* Fern), 563 B.R. 1, 5 (B.A.P. 8th Cir. 2017).
[55] *Id.* at 3.

v. Jesperson,[56] where the United States Court of Appeals for the Eighth Circuit reversed a finding of undue hardship, applying the totality of the circumstances test.[57] *Jesperson* involved a lawyer who owed more than $300,000 in student loans.[58] The Court of Appeals examined many facts to determine that the debtor did not qualify for a discharge.[59] Most importantly, the debtor could afford a monthly payment of $629 under a repayment plan, and he did not have any dependents.[60] Moreover, the court held that there were "self-imposed conditions which limited his monthly income and a failure to pay any amount on the student loan when he had sufficient income to do so."[61]

Conversely, Fern was never required to make a payment due to her circumstances, and her monthly payment would remain zero under a repayment plan.[62] Accordingly, the court refused to interpret *Jesperson* to hold that a monthly payment obligation of zero per month constituted an ability to pay.[63] The *In re Fern* decision ascertains that a discharge of student loan debt is possible under the totality of the circumstances standard; however, the debtor's situation must warrant a discharge.[64] The courts will look at a variety of factors and will only grant a discharge if it is sufficiently justified.[65]

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[56] 571 F.3d 775 (8th Cir. 2009).
[57] *In re* Fern, 563 B.R. at 5.
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *Id.*
[62] *Id.*
[63] *Id.*
[64] *See id.*
[65] *See id.* ("The Court of Appeals identified numerous grounds in reaching its conclusion that Jesperson's circumstances did not qualify for an undue hardship discharge of his student loan debt.").

II. Comparing the Undue Hardship Standards

The Brunner test and the totality of the circumstances test have some similarities.[66] Specifically, both standards focus on the same main concepts: the debtor's ability to repay and the debtor's conduct.[67] However, the totality of the circumstances test is viewed as less restrictive because it permits a consideration of a wide range of factors.[68] In contrast to the Brunner test, no factor is dispositive under the totality of the circumstances standard.[69] Furthermore, unlike the Brunner standard, a court applying the totality of the circumstances test is not required to consider whether the debtor made good faith efforts to pay the loans.[70] Under the good faith analysis of the Brunner test, courts have considered the following factors:

> (1) whether the failure to repay the student loan was due to circumstances beyond the debtor's reasonable control; (2) whether the debtor has used all available resources to repay the loan; (3) whether the debtor is using her best efforts to maximize her earnings potential; (4) how long after the loan was incurred did the debtor seek to discharge the debts; (5) what the overall percentage of the student loan debt is compared to debtor's overall debt; and (6) whether or not the debtor has gained tangible benefits of the student loan.[71]

Bankruptcy courts have analyzed both tests and many have held that the Brunner test is too strict and certain aspects are not supported by the text of section 523(a)(8), which was enacted to prevent abuses of the educational loan system and to protect the viability of student

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[66] *See* Brunner v. N.Y. State Higher Educ. Servs. Corp. 831 F.2d 395, 396 (2d Cir. 1987); Fern v. FedLoan Servicing (*In re* Fern), 553 B.R. 362, 367 (Bankr. N.D. Iowa 2016), *aff'd*, 563 B.R. 1 (B.A.P. 8th Cir. 2017).
[67] *See* Weir v. Paige (*In re* Weir), 296 B.R. 710, 716 (Bankr. E.D. Va. 2002) ("Regardless of the test used in determining whether repayment of student loans constitutes undue hardship under § 523(a)(8), at a minimum the court must focus on two issues: (1) the economic prospects of the debtor and (2) whether the conduct of the debtor disqualifies the debtor from taking advantage of the exception.").
[68] *See In re* Fern, 553 B.R. at 367.
[69] *See* Morgan v. United States Dept. of Higher Educ. (*In re* Morgan), 247 B.R. 776, 782 (Bankr. E.D. Ark. 2000).
[70] *See id.*
[71] Hart v. ECMC (*In re* Hart), 438 B.R. 406, 413 (E.D. Mich. 2010).

loan programs.[72] Specifically, under the second prong of the Brunner test, courts have required the debtor to prove that there are "unique" or "extraordinary" circumstances establishing a "certainty of hopelessness."[73] Circumstances have included the debtor's age, sickness, disability, large number of dependents, absence of practical job skills, and limited education.[74] Some courts have held that a debtor who is unable to show one of these extraordinary circumstances fails on the second prong of the test and, therefore, the student loans will not be discharged.[75]

Additionally, the totality of the circumstances test and the Brunner test both result in a substantial amount of discretion and subjectivity by the courts.[76] Courts have rejected the totality of the circumstances test, explaining that the analysis does not necessarily avoid the Brunner test's harsh standard.[77] Moreover, courts have adopted the Brunner standard with modifications.[78] Particularly, in *Polleys*, the Tenth Circuit adopted the Brunner test, but distinguished its test from the Second Circuit by stating that under the second element, the debtor does not need to demonstrate a "certainty of hopelessness."[79]

CONCLUSION

Although the totality of the circumstances test is less restrictive, discharging student loan debt is possible under both the totality of the circumstances standard as well

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[72] *See e.g.*, Bronsdon v. Educ. Credit Mgmt. Corp. (*In re* Bronsdon), 435 B.R. 791, 800 (B.A.P. 1st Cir. 2010); Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302, 1306 (10th Cir. 2004).
[73] *See In re* Bronsdon, 435 B.R. at 799.
[74] *See id.*
[75] *See id.*
[76] *See* Houshmand v. Mo. Student Loan Program (*In re* Houshmand), 320 B.R. 917, 920 (Bankr. W.D. Mo. 2004); Grine v. Tex. Guar. Student Loan Corp. (*In re* Grine), 254 B.R. 191, 198 (Bankr. N.D. Ohio 2000).
[77] *See Polleys*, 356 F.3d at 1309.
[78] *See id.* at 1310.
[79] *See id.* at 1310.

as the Brunner standard.[80] Furthermore, the two tests overlap and consider some of the same factors.[81] The Brunner standard is the majority approach, but the test varies in each circuit's application.[82] Therefore, a successful discharge case in one circuit does not necessarily mean that a similar case will be successful in another circuit that also applies the Brunner standard.[83] Regardless of whether a court applies the totality of the circumstances test or the Brunner test, each case will depend on that specific circuit's application of the undue hardship analysis.

[80] *See* Fern v. FedLoan Servicing (*In re* Fern), 553 B.R. 362, 367–69 (Bankr. N.D. Iowa 2016), *aff'd*, 563 B.R. 1 (B.A.P. 8th Cir. 2017); *Polleys*, 356 F.3d at 1310.
[81] *See In re* Fern, 553 B.R. at 367; *Brunner*, 831 F.2d at 396.
[82] *See Polleys*, 356 F.3d at 1310.
[83] *See id.*