



Student Loans in Bankruptcy: What's on the Horizon?

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11:30 – 12:30pm CST

Presented by: Keith Anderson, Alex Dugan, and Chris Hawkins

Agenda

- Introduction
- Background
- Student Loans in Bankruptcy Cases and Plans
- ABI Report
- Legislation Introduced
- Questions

Introduction

Introduction

- Continues to be a topic of activity
- Differing views on practical effects
- Organizations need to assess impact and be prepared

Background

History of Student Loans in Bankruptcy

- Education Amendments of 1976
 - Discharge available only if:
 - From certain financial institutions (i.e. bank, state agency, higher ed. institution or vocational school)
 - Insured by federal gov't, state gov't, or nonprofit private institutions; and
 - 5 years passed since beginning of repayment period (not counting any suspension of repayment)
 - **Unless** showed “undue hardship” to debtor or debtor’s dependents
- Bankruptcy Code Amendments (1978)
 - Eliminated requirement that loan be insured
 - Undue hardship standard on debtor and his dependents
 - 5 year period ran from date loan “first became due”, did not toll running of period during any suspension
 - Dischargeable in Ch. 13 if loan was provided for in plan

History of Student Loans in Bankruptcy

- *Brunner* (1987)
 - 2nd Circuit rejected debtor's attempt to get early discharge of debt
 - Standard for “undue hardship”: (1) debtor cannot maintain, based on current income and expenses, a “minimal” standard of living for herself/dependents if forced to repay loans; (2) add'l circumstances exist indicating that this state of affairs is likely to persist for significant portion of repayment period; and (3) debtor has made good faith efforts to repay loans
- Bankruptcy Code Amendments (1990)
 - Increased time period from 5 to 7 years for loans to become freely dischargeable
 - Removed ability to obtain early discharge if loan was included in Ch. 13 plan
- Bankruptcy Code Amendments (1998)
 - Eliminated time period for loans to become freely dischargeable, unless there was showing of undue hardship
- Bankruptcy Code Amendments (2005)
 - For the first time, private educational loans became non-dischargeable

Dept. of Ed. Guidance: Undue Hardship

- Requires lenders to concede an undue hardship after examining several factors, including:
 - (1) Whether the borrower's hardship results from physical or mental disability
 - (2) Whether borrower's bankruptcy is a result of factors beyond borrower's control such as protracted physical or mental illness, reduction income from divorce
 - (3) Whether borrower pursued available income-driven repayment plans
 - (4) Payments the borrower made on the loan
 - (5) Borrower's other debts
 - (6) Age
 - (7) Borrower's expenses
- Dept. of Ed. Comment Solicitation
 - May just be seeking one uniform test

Student Loans in Bankruptcy Cases and Plans

Student Loan Modifications in Bankruptcy Court

- Case Law
 - Hardship Discharge: The *Brunner* Test
 - Debtor cannot maintain, based on current income and expenses, a minimal standard of living if forced to repay the loans
 - Additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the loans
 - Debtor has made good faith efforts to repay the loans
 - Case predated the current version of the Bankruptcy Code, making its application somewhat incompatible
 - Litigation on hardship discharge is expensive and time-consuming

Student Loan Modifications in Bankruptcy Court

- Case Law
 - Partial Discharge: *Modeen* (Bankr. W.D. Wis. 2018)
 - Court found sufficient evidence to support a hardship discharge under Brunner's first and third prongs
 - Court struggled with second prong: "Additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the loans"
 - Court found that equities supported granting of partial discharge, using federal repayment plans as a guideline for determining how much the debtor could reasonably pay

Student Loan Modifications in Bankruptcy Court

- Case Law
 - Educational Benefit: *McDaniel* (Bankr. D. Colo. 2018)
 - Court found that specific language in 523(a)(8)(A)(ii) excludes “loans” such that “educational benefit” only includes scholarships and stipends
 - Practical effect of this finding is that a private loan (i.e., a loan that is not made, insured or guaranteed by government units, or under programs funded by government units of nonprofit institutions) can be discharged notwithstanding Section 523(a)(8) of the Bankruptcy Code
 - Similar holdings in bankruptcy courts in PA, NY, CA, TX, and MD
 - Multiple cases are on appeal

Student Loan Modifications in Bankruptcy Court

- Case Law
 - Fraudulent Transfer: *Sterman* (Bankr. S.D.N.Y. 2018)
 - Court found that payments made by debtor parents for daughters' college tuition and fees constituted constructive fraudulent transfers that could be recovered by the Ch. 7 bankruptcy trustee
 - Holding was limited to transfers made on behalf of daughter when, at the time of the transfer, daughter was older than 21
 - Parents did not receive “reasonably equivalent value” for such transfers
 - Opposite holding in *Palladino* (Bankr. D. Mass. 2016)

Student Loan Modifications in Bankruptcy Court

- Administrative Orders in Individual Jurisdictions
 - Middle District of Florida
 - Administrative Order FLMB-2019-1
 - Effective August 1, 2019
 - Establishes procedures for student loan modifications in bankruptcy cases under any chapter of the Bankruptcy Code
 - Very similar to mortgage modification procedures, including exchange of information via portal
 - Process is intended to take 180 days or less
 - Based on income-driven repayment plan, which would be incorporated into a modified plan in Ch. 13 cases

ABI Report

ABI Consumer Law Commission

- December 2016 – Executive Committee of the American Bankruptcy Institute approved the creation of a commission on consumer bankruptcy
 - Commission composed of retired judges, creditor attorneys, debtor attorneys, law professors, Chapter 13 trustees, United States Trustees
- April 2017 to April 2019 – Commission meetings (6 in-person, 28 by phone) including public hearings
- April 2019 – Final Report published

Report Overview

- Commission was charged with recommending improvements to consumer bankruptcy system
 - Amendments to Bankruptcy Code
 - Amendments to Bankruptcy Rules
 - Recommendations on proper interpretations of existing law
 - Best practices
 - Identifying areas where further study is needed

Recommended Bankruptcy Code Amendments

- When/what type of student loans can be freely discharged?
 - Private student loans
 - Third parties who did not benefit from the loans
- Otherwise, student loans should not be discharged if the loan first became payable **less than 7 years** before bankruptcy case was filed (regardless of any suspension in payments)
 - Exception: “showing of undue hardship”

Recommended Bankruptcy Code Amendments

- Establish priority status for student loan debt exempt from discharge
 - Permit debtor to separately classify student loan debt to provide for greater payment as compared to other unsecured debt
- Permit debtor to pay interest on exempt student loan debt if it is being paid pursuant to Ch. 13 plan

Proposed Dep't of Ed. Regulatory Changes

- Brightline rules as to when creditor should not oppose discharge proceedings
 - Disability-based guidelines
 - Receiving disability benefits under Social Security Act or
 - 100% disability rating or determination of individual unemployability under disability compensation program of Dep't of Veterans Affairs
 - Poverty-based guidelines
 - In 7 years before BK, borrower's household income averaged less than 175% of federal poverty guidelines;
 - At time of BK, household income is less than 200% of federal poverty guidelines

Proposed Dep't of Ed. Regulatory Changes

- Only source of income is from SS benefits or retirement fund or
 - Provides support for elderly, chronically ill, or disabled household member or immediate family
- Avoiding unnecessary cost
 - If debtor shows proof-based on above criteria, creditor should not engage in formal discovery
- Paying loans in bankruptcy as alternative payment plan
 - Satisfy period of forgiveness or cancellation under income-driven repayment plan
 - Rehabilitate loan in default
 - In Ch. 13, prevent imposition of collection costs and penalties

Best Interpretation: Undue Hardship Standard

- Under *Brunner*, debtors only needs to establish:
 - Cannot pay according to standing 10-year contractual schedule while maintaining reasonable standard of living
 - Will not be able to pay loan in full within initial contractual payment period during balance of contractual term, while maintaining reasonable standard of living; and
 - Has not acted in bad faith in failing to pay prior to bankruptcy filing
- Each factor requires proof by preponderance of evidence
- Determination as to each factor is finding of facts, subject to deference in appellate review, and considered by lenders or related parties in determining whether to appeal

Best Interpretation: Treatment in Chapter 13

- Best interpretation of Bankruptcy Code would still permit separate classification of student loans
- If precedent requires rejection of the above, higher payments for student loan debt could be allowed where
 - There is a co-signer or guarantor
 - Last payment is due after BK case; debt would be treated as “cure and maintenance” claim in plan

Legislation Introduced

Proposed Legislation

- Student Borrower Bankruptcy Relief Act of 2019
 - Eliminate the section of the Bankruptcy Code that makes federal and private student loans non-dischargeable
 - 15 additional Democratic co-sponsors, and the House bill has 12 additional Democratic co-sponsors
- House Judiciary Committee hearing on 6/25: “Oversight of Bankruptcy Law & Legislative Proposals”

Questions?



Keith Anderson
kanderson@bradley.com
205.521.8714



Alex Dugan
adugan@bradley.com
615.252.4638



Chris Hawkins
chawkins@bradley.com
205.521.8247