STUDENT LOANS

SEPARATE CLASSIFICATION IN CHAPTER 13

UNDUE HARDSHIP DISCHARGE

SPECIAL CIRCUMSTANCES

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A few facts to consider at the outset.

- Total outstanding student loan debt recently passed $1,000,000,000,000 for the first time. (That's one trillion dollars.)
- Total outstanding student loan debt now exceeds total outstanding revolving credit card debt.
- Total outstanding student loan debt now exceeds total outstanding secured consumer debt. (Cars, furniture, appliances, etc.)
- The average student loan debt obligation for 2011 graduates was $26,600, (but one third of the graduates had no student loan debt.)
- More than 5,000,000 student loan borrowers are in default. (The highest rate in 15 years.)
- Student loan borrowing rates (as a percentage of students), debt levels (debt per student), and default rates (as a percentage of outstanding loans) are higher at private for-profit colleges than at public or private not-for-profit colleges.
- Prior to BAPCA, private student loans were dischargeable, and student loans made or guaranteed by a governmental unit or non-profit were dischargeable if they had been in repayment for 7 years. The Brunner test was adopted in this context - it only applied if a debtor was trying to discharge a "public" student loan which had been in repayment for less than 7 years.

Separate Classification of Student Loans in Chapter 13

There are three subsections of 1322(b) that have at least some application to separate classification of student loans in Chapter 13 cases. These subsections provide that a plan "***may***:

> (1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;…
>
> (5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;…
>
> (10) provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are nondischargeable under section 1328(a), except that such payments may be paid only to the extent that the debtor has

> disposable income available to pay such interest after making provision for full payment of all allowed claims;" …

As an initial observation, debtors, through their attorneys, have argued several grounds for unfairly discriminating in favor of student loan debt. These include:

- * The debtor's interest in obtaining a "fresh start", emerging from Chapter 13 current on student loan payments.
- * The fact that student loan debt is nondischargeable; See, generally, In re Groves, 39 F.3d 212 (8th Cir.1994); In re Sperna, 173 B.R. 654 (9th Cir. BAP 1994); McCullough v. Brown, 162 B.R. 506 (D.N.D.Ill,1993).
- * The public interest in debtors making their student loan payments to continue availability of funding to future borrowers.
- * The interplay of 1322(b)(5), which allows a debtor to cure and continue payments on long term debt (specifically including unsecured debt) and 1322(b)(1) which allows a debtor to separately classify unsecured creditors, but prohibits unfair discrimination between classes separately classified.

In this paper, I will not recite whether or the extent to which each court has analyzed these issues. Suffice it to say, courts generally have rejected all of these arguments. If there is a notable exception, it will be noted.

The test adopted by most courts in considering whether a plan unfairly discriminates in favor of student loan creditors is commonly referred to as the Wolff or Leser test. (Or the Wolff/Leser test.) Those cases are In re Wolff, 22B.R. 510 (9th Cir. BAP 1982) and In re Leser, 939 F.2d 669 (8th Cir.1991) The Wolff/Leser test identifies four factors to be considered by a court in making a determination of whether a plan ***unfairly*** discriminates:

> "(1) whether the discrimination has a reasonable basis;
> (2) whether the debtor can carry out a plan without the discrimination;
> (3) whether the discrimination is proposed in good faith; and
> (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination. Restating the last element, does the basis for the discrimination demand that this degree of different treatment be imposed."

Neither Wolff nor Leser are student loan cases. Wolff is an important vendor case and Leser is an assigned support claim. Both are pre-BAPCPA.

Pay particular attention to the dates of opinions. I would strongly contend that pre-BAPCPA cases are of questionable precedential value.

Cases approving (?) separate classification

<u>Texas cases</u>

<u>Pre-BAPCPA</u>

* <u>In re Simmons</u>, 288 B.R. 737 (Bankr.N.D.Tex. 2003). (Judge Lynn) This is THE Texas case pre-BAPCPA. This is actually four cases consolidated for hearing because the issue (separate classification of student loan debt) existed in all four cases. In determining whether the plans unfairly discriminated, the court applied a two-prong test:

1. The discrimination must serve a rational, legitimate purpose of the debtor; and
2. The amount to be received by the class discriminated against must not be less than the class would have been entitled to receive had there been no discrimination between classes.

It is very significant that the court initially observed that **a debtor was only required to submit three years of his/her disposable income to fund a plan**, which "suggests that a class of creditors is not unfairly discriminated against if it receives the same share of only three years (as opposed to the term of the plan) of the debtor's disposable income that it would have received absent the discrimination." This analysis would obviously change post-BAPCPA based upon the new formula for determining the "applicable commitment period." The court confirmed or denied confirmation in each case as follows:

1. <u>Simmons</u> (60 month plan): The court denied confirmation because the plan did not commit 36 months of projected disposable income to the plan, so the court was not required to address the unfair discrimination issue.
2. <u>Schockey</u> (60 month plan): The court confirmed the debtor's plan which proposed to pay 100% of the amount of student loan debt while paying nothing to general unsecured creditors. The court found that the plan violated its test, but confirmed it nonetheless because the debtors proposed to pay ***more than*** the minimum base amount into the plan. The court stated that a debtor "may, within reason, do anything they wish with disposable income in excess of their Minimum Base Amount."
3. <u>Bruchey/Crnkovic</u> (36 month plan): The court denied confirmation because the plan did not commit 36 months of disposable income to the plan, resulting from the debtors listing a $138 per month student loan payment as an expense on schedule J. The court denied confirmation but indicated that the debtors could submit an amended plan which added the $138 to the base. (The implication being that the court would confirm such a plan.)
4. <u>Goodwin</u> (60 month plan): The court confirmed the debtor's plan because although it paid nothing to general unsecured creditors and made some distribution to the student loan debt, there was nothing left under the Minimum Base Amount available for unsecured creditors so they were not unfairly discriminated against.

<u>In re Sullivan</u>, 195 B.R. 649 (Bankr.W.D.Tex.1996). (Judge Clark) Judge Clark opined "Unfortunately, there can be no bright line test, as what constitutes "unfair"

discrimination will be a function not only of the status and position of the creditor sought to be favored but a function as well of the extent of the discrimination proposed." In response to a request from the Chapter 13 trustee for "some minimal guidance", Judge Clark did articulate a bright line test, one assumes subject to the circumstances of the case. He indicated "if a given discrimination scheme results in a disparity of treatment such that unsecured creditors will receive not more than 20% less than they would have received in the absence of the proposed discrimination, then the Trustee need not object to the proposal or bring it to the court's attention. If the 'swing' is greater than 20%, however, then the Trustee should not recommend confirmation and let the court decide the matter."

Judge Clark also held that 1322(b)(5) allowed a debtor to cure and continue student loan payments, but that such classification was still subject to the unfair discrimination analysis in 1322(b)(1). Finally, Judge Clark addressed the issue of whether a plan may dedicate 100% of the debtor's disposable income to payment of all creditors during the first 36 months of a plan and then discriminate in months 37 though 60. He expressed a valid concern that a debtor might "stretch" the payments that would have been required during the first 36 months over the remaining months of the plan. Given that concern, he indicated that he would review that issue on a case by case basis. (This writer would suggest that B22C resolves this issue for above-median income debtors.)

Post-BAPCPA

In re King, 460 B.R. 708 (Bankr.N.D.Tex 2011). (Judge Lynn) In this case Judge Lynn was called upon to determine the continuing validity of his opinion in Simmons. Judge Lynn concluded:

> "The second prong of the Simmons Test need only be modified to mirror the 2005 Amendments. Thus, a plan does not discriminate unfairly if the class discriminated against receives no less than it would have received if there was no discrimination and 60 months (or 36 months for below-median income debtors) of the debtor's disposable income were applied to the plan. This modification does not change the principle of the Simmons Test – as long as the class discriminated against receives its fair share of the UCP [unsecured creditors' pool], the discrimination is not unfair, and not in violation of section 1322(b)(1). After all, the Code requires only that a debtor pay the full amount of the UCP. Where, as here, the Plan so provides and otherwise meets the requirements of section 1325, the court is required to confirm the Plan ("**the court shall confirm**" – Code Sec. 1325(a) (emphasis added.)) If a debtor chooses to contribute income in addition to the mandatory contributions, then discrimination in the distribution of that amount does not diminish the return to other creditors and is not unfair."

All of this is based upon the new statutory calculation of disposable income. As noted by Judge Lynn, "Section 707(b)(2) directs a debtor to use the amounts specified in the National Standards and Local Standards issued by the IRS, rather than his or her actual expenses, to calculate projected disposable income. This change allows for a potential discrepancy between the debtor's projected disposable income under the Code and his or her actual disposable income, meaning that a debtor could actually have more income than the Code requires him or her to contribute."

Elsewhere

Post-BAPCPA

* In re Orawsky, 387 B.R. 128 (Bankr.E.D.Pa.2008). This is THE post-BAPCPA case on separate classification. The court undertakes a thorough review of pre-BAPCPA case law on separate classification including a review of the various "tests" adopted by the courts. (And rejected the Wolff/Leser test.) The court adopted the test articulated in Bentley, 266 B.R.229 (1st Cir.2001) and concluded that the plan was not unfairly discriminatory. The focus of the Orawsky court was whether contributions to the plan were "mandatory" or "optional." In this case, form B22C reflected ***no*** disposable income so her unsecured creditors were not "entitled" to any distribution under her plan.

The court concluded: "The Debtor has chosen to voluntarily contribute $317 a month, for a total of $19,020.00, to her Plan. This funding is derived entirely from income that she is not legally obligated to commit to the Plan. She seeks to utilize this income, not to improve a moderate standard of living or indulge in luxuries, but to make some effort to repay her creditors. In doing so, she is not proposing to accelerate her student loan indebtedness and pay that accelerated amount at the expense of her other unsecured creditors. Rather, she seeks to continue to pay Sallie Mae only its monthly contractual due in the ordinary course, a result that is consistent with Congressional policy favoring the repayment of student loans even after the grant of bankruptcy relief to a student loan borrower. Further, the Debtor is proposing to use a significant portion of her voluntary monthly contribution, not earmarked for student loan debt repayment, to repay her general unsecured creditors. As a result, the unsecured creditors other than Sallie Mae benefit materially from the Debtor's Plan. They are obtaining a 12.6% dividend where they might otherwise obtain a 5.7% dividend or, in the worse case scenario, nothing. In terms of the Bentley analysis, the Debtor's Plan provides a tangible benefit to the disfavored class that bears a reasonable relationship to the deviation from the relevant Chapter 13 baseline."

Orawsky was followed in large part by In re Sharp, 415 B.R.Colo.2009) which went through the same analysis and reached the same result – as long as the debtor was paying "projected disposable income" as determined by B22C to the unsecured creditor class (including the student loans), the debtors' plans did not unfairly discriminate by paying an additional amount outside the plan directly to the student loan creditors.

In re Boscaccy, 442 B.R. 501 (Bankr.N.D.Miss.2010) Like Simmons, this is an opinion which analyzes three separate Chapter 13 plans which separately classified student loan debt. In two of the three cases, the court held that a debtor could separately classify student loan debt under the cure and maintain provision, in part because the distribution to unsecured creditors in a hypothetical Chapter 7 case would be zero.

1. Boscaccy (36 months). The debtors proposed to pay $325 per month to maintain the payments on their student loan debt. The distribution to other unsecured creditors was 0%. If the debtors paid the $325 per month pro rata to all unsecured creditors, the distribution would be 21%. The court noted that in a hypothetical Chapter 7 case, the distribution would likely be 0%. The court found that if the debtors were not permitted to maintain their student loan payments, the interest accrual on the debt would render their bankruptcy filing "meaningless." Under the totality of the circumstances, the court found that the discrimination was not unfair.
2. George (36 months). The debtors proposed to pay $374 per month to maintain the payments on her student loan debt. In addition, the debtors proposed to pay enough to equal a 10% distribution to unsecured creditors. If the debtors paid all of the funds to be paid pro rata, the distribution to all creditors would be 36%. The court noted that in a hypothetical Chapter 7 case, the distribution would likely be 0%. The court found that if the debtor was not permitted to maintain her student loan payments, she would "emerge from bankruptcy, insofar as this nondischargeable debt is concerned, in a much worse position than the debtor was in prior to filing." Under the circumstances, the court found that the discrimination was not unfair.
3. Nunnally (60 months). The debtor proposed to pay $155 per month to pay his student loan debt in full. If the debtor paid all of the funds to be paid pro rata, the distribution to all creditors would be 80%. (With only a 20% reduction to the student loan creditor.) Under the circumstances, the court found that the discrimination was unfair.

With respect to all three cases, the court concluded that the automatic stay prohibited the student loan creditor from assessing penalties for payment shortfalls during the pendency of the cases and that the Chapter 13 discharge would relieve them of any personal liability for those penalties after discharge.

In re Freeman, 2006 WL 6589023 (Bankr.N.D.Ga.2006). The court held that the cure and maintain provision of 1322(b)(5) was in conflict with the no interest unless unsecured creditors are paid in full provision of 1322(b)(10), but that 1322(b)(5) was more specific than 1322(b)(10). Because maintaining payments on long term debt would necessarily include the payment of interest, prohibiting the payment of interest would make maintaining payments on long term debt impermissible, a result Congress clearly could not have intended. (This was a 36 month plan with a 1% distribution to unsecured creditors.)

In re Webb, 379 B.R. 428 (Bankr.N.D.Ga.2007). Citing Freeman, the judge held that the cure and maintain provision of 1322(b)(5) was more specific than the no interest unless unsecured creditors are paid in full provision of 1322(b)(10) and that if the debtors were not allowed to cure and maintain their long term student loan debt, with interest and collection costs they would owe more after completion of their plan than they did when they started. In this case, if the debtors were to pay their disposable income pro rata to all unsecured creditors, it would only increase the dividend to the other unsecureds by .2%.

In re Kalfayan, 415 B.R. 907 (Bankr.S.D.Fla.2009). This case is ***potentially*** important as the court approved a plan which separately classified student loan debt holding that the plan could be confirmed either under 1322(b)(5) or because the debtor's failure to pay her student loan debt could potentially cause her to lose her professional license. Loss of that license would significantly decrease her income to the detriment of all of her creditors. Judges should stop reading here. There does not appear to be any evidence in the record that the state was actually planning/threatening/oreventalkingabout terminating her license, but it was a ***possibility*** under Florida law. Based on my limited experience, I would suspect that most judges would require something more than a non-specific possibility of a license suspension. A threatening letter might be helpful. (I would note that Texas law provides for suspension of a concealed handgun permit for failure to pay student loan debt. Is that sufficient basis for separate classification? This is Texas. Set your priorities.)

In re Machado, 378 B.R.14 (Bankr.D.Mass.2007) is a frequently cited case allowing separate classification. The focus of the Machado court was on the difference between the plans as proposed (a 60 month plan paying 4.14% to unsecured creditors) and the result if the below-median income debtor proposed to pay all of her disposable income pro rata among her unsecured creditors for 36 months. (A 6.76% distribution to unsecured creditors.) Because this was a "cure and maintain" plan, the difference was "modest", and no unsecured creditor objected to the plan, the court held that the plan did not unfairly discriminate.

Pre-BAPCPA

In re Benner, 156 B.R. 631 (Bankr.D.Minn,1993). The court approved confirmation of a plan which proposed to treat student loan debt as long term debt under 1322(b)(5) and resulted in payment of 57% of the student loan debt while paying only 19% to other unsecured creditors.

In re Foreman, 136 B.R. 532 (Bankr.D.Iowa 1992). This court approved confirmation of a Chapter 13 plan which separately classified student loan debt to be paid concurrently with secured debt, but paid other unsecured creditors after secured debt was paid. Because the other unsecured creditors would be paid in full, the fact that payment was delayed was not unfairly discriminatory.

Cases denying (?) separate classification

Texas cases

Post-BAPCPA

In re Cooper, 2009 WL 1110648 (Bankr.N.D.Tex.2009) (Judge Jones) This is not a student loan case, but it appears that the analysis might be the same, so I mention it. In this case, the debtors contended that they were entitled to separately classify the debts owed to two creditors because they might be sanctioned for one and there were potential criminal issues with the other. (Judge Jones notes that there was no evidence presented, just the debtor's concerns.) The court denied confirmation as the plan unfairly discriminated against the student loan creditor who would be paid in full while other unsecured creditors would receive nothing. Significantly, Judge Jones notes "The debtors have not contended that their plan payment exceeds the minimum that would be required under the Bankruptcy Code." This fact alone makes this case distinguishable from the case where the debtor is dedicating "excess" or "discretionary" funds to a plan.

In re Redmond, 2008 WL 1752133 (Bankr.S.D.Tex.2008) (Judge Clark) The debtors plan provided that they would continue to pay their student loans directly outside of the plan. The court concluded that whether the debtors would be permitted to make the continued payments turned on whether those amounts constituted projected disposable income. Because the debtors offered no evidence of whether the continued payments were reasonably necessary for the support of the debtor or a dependent of the debtor, the court had to conclude that all projected disposable income for the applicable commitment period was not being dedicated to the plan.

Pre-BAPCPA

In re Ramirez, 204 F.3d 595 (5th Cir.2000). In this case, the debtor proposed a plan which would play a single cosigned consumer debt in full with 12% interest prior to any payment to general unsecured creditors who would receive only about 20% of their claims. The Bankruptcy Court held that the plan could not be confirmed as there was no showing of justification for the discrimination. The District Court and Fifth Circuit affirmed. The Fifth Circuit relied on its prior opinion in In re Chacon, 202 F.3d 725 (5th Cir.1999) which was also a cosigned debt case. It appears that the court would have approved the separate classification and allowed the discrimination but for the payment of interest.

Neither Ramirez nor Chicon involved student loans. It is significant that 1322(B)(1) has a significant "however": it concludes: "however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims." (The deciding issue in these cases seems to be more that the creditor was not only being paid in full, but was being paid in full with interest.) These cases are both pre-BAPCPA.

In re Gregg, 179 B.R. 828 (Bankr.E.D.Tex.1995). (Judge Sharp) I'm not sure where this case goes on the list as it is a truly unique (odd, crazy) case. The plan provided for separate classification of student loans held by one creditor, but did not provide for separate classification of student loan debt held by another creditor. Judge Sharp held that separate classification of student loans did not unfairly discriminate against other unsecured creditors, but it did unfairly discriminate against the other student loan creditor.

Elsewhere

Post-BAPCPA

* In re Sutton, 2012 WL 433480 (Bankr.E.D.N.C.2012) This is a Chapter 11 case in which the debtor separately classified student loan debt from general unsecured claims and proposed to continue the regular monthly payments of $1,479 on the student loan while paying only 3.8% to unsecured creditors. 1129(b)(1) contains a prohibition similar to 1322(b)(1) as a Chapter 11 plan may not "discriminate unfairly" with respect to an impaired class of creditors which has not accepted the plan. The court concluded that the debtor had offered no evidence supporting separate classification so it was unable to conclude that the four part test adopted by the Fourth Circuit was satisfied. This case is important to bankruptcy practitioners as it explains what you need to offer as evidence to support separate classification. The court goes through an extensive litany of "the debtor contends" but notes little evidence in support and the court goes through its own "list" of "what I didn't hear."

In re Renteria, 2012 WL 1439104 (Bankr.D.Co.2012). In this Chapter 13 case, the debtors proposed to pay $550 per month outside the plan to maintain student loan payments while paying only 1% to unsecured creditors. Because the debtor was a below-median income debtor, B22C was not used to calculate projected disposable income, but the court was effectively left with Schedule I and J. The court relied upon and distinguished King (an above-median income case) and Machado (a below-median income case) and concluded that the debtor's failure to include the $550 per month that would be available for all unsecured creditors and dedicating it exclusively to the student loan debt resulted in unfair discrimination. I would suggest that the court was at least partially incorrect. Because the debtor was below-median income, her applicable commitment period was only 36 months. Assuming that the $550 per month had to be included in projected disposable income, the payments from month 37 through month 60 should be allocable however the debtor saw fit.

In re Zeigafuse, 2012 WL 1155680 (Bankr.D.Wyo.2012). Applying the Leser/Mason test, the court rejected the debtors' contention that 1322(b)(5) trumps 1322(b)(1) and concluded that read together, the debtors were required to and failed to establish a reasonable basis for the separate classification. (21% to student loan debt, 1.2% to other unsecured creditors.) It is perhaps significant in this case that the debtors' non-student loan debt was only $14,004 and as part of its conclusion the court noted that the debtors were not proposing any additional contribution to "square-up" the disproportionate distribution. Doing the math, it appears that if the debtors would increase the distribution to the unsecured creditor class by only $1,300 or $22 per month, the general unsecured creditors would receive the same percentage distribution as the student loan creditor. The court does not say, but seems to imply, that if the debtors would propose that payment, he would find that there was no discrimination.

In re Lilley, 2010 WL 5462519 (Bankr.D.Iowa 2010). Applying the Wolf/Leser/Groves test, the court held that there was no showing of a reasonable basis for discrimination in favor of the student loan debt. In this case, the debtor was proposing to pay a student loan debt he co-signed for his daughter outside the plan. The offered justification was the *potential* harm to her credit rating if he did not make the full payment. (43% to student loan debt, 20% to other unsecured creditors.)

In re Harding, 423 B.R. 568 (Bankr.S.D.Fla.2010). This debtor separately classified her student loan and proposed to maintain regular payments under 1322(b)(5). (There were apparently no arrearages.) She contended that the specific provisions of 1322(b)(5) should trump the more general language of 1322(b)(1). The court rejected that argument and stated that it was required to consider three factors in determining whether a plan unfairly discriminates: (1) the debtor's fresh start; (2) the clear legislative objective of student loan repayment; and (3) fair treatment of creditors as a whole. The court found that although the plan satisfied the first two factors, the detriment to the other unsecured creditors outweighed the other two factors. The debtor had the at least original argument that if she did not maintain the scheduled payments, the student loan creditor would assess her with collection costs of 25% or more of the outstanding loan balance. The court expressed concern for that prospect, but held that although a student loan creditor may charge interest, it is stayed from trying to collect for "penalties" as there is no specific exception from the stay. The court went on to hold that if the student loan creditor attempted to collect such penalties after the debtor's discharge, it would violate the discharge injunction. (FYI, this is the same judge as (Kalfayan.)

In re Edmonds, 444 B.R. 898 (Bankr.E.D.Wis.2010). These debtors separately classified three student loans and proposed to cure the arrearages and maintain regular payments under 1322(b)(5). They contended that the specific provisions of 1322(b)(5) should trump the more general language of 1322(b)(1). The court rejected that argument and found that the plan unfairly discriminated. The court also held that the plan violated 1332(b)(10). (53% dividend to student loan creditors, 18% to other unsecured creditors.)

In re Parrott, 2009 WL 5215043 (Bankr.E.D.Tennn.2009). These debtors separately classified three student loans and proposed to cure the arrearages and maintain regular payments under 1322(b)(5). They contended that the specific provisions of 1325(a)(5) should trump the more general language of 1322(b)(1). The court rejected that argument and found that the plan unfairly discriminated. The court concluded that although the discrimination was "good planning for the debtors, it provided no benefit to general unsecured creditors. (78% payout on two student loans, 96% on the third student loan, and 53% to other unsecured creditors.)

Pre-BAPCPA

In re Groves, 39 F.3d 212 (8th Cir.1994). The court affirmed orders of the bankruptcy and district courts which rejected confirmation of plans which proposed to pay student loan debt in full while paying between 10% and 40% to other unsecured creditors. (These were three cases which were consolidated for hearing.) One of the debtors argued that she could simply file a Chapter 20 (a Chapter 7 filed immediately by a Chapter 13) and her unsecured creditors would receive nothing, so her plan which proposed at least some distribution to unsecured creditors achieved a better result. The court concluded "it is irrelevant whether or not there exists an undesirable end-run around an otherwise correct ruling." The court went on to state: "Debtors should not assume that the classification restrictions of 1322(b)(1) could be evaded in this manner."

Although I defer to the court in the result, I take exception to the court's characterization of a Chapter 20 as "an undesirable end-run." Unless I mis-remember, the role of Congress is to decide what results are desirable and craft laws to achieve those results. It is the role of the courts to interpret and enforce the laws Congress passes. It is ***not*** the proper function of the courts to decide which results are desirable. It is worthy of note that despite numerous amendments to the Bankruptcy Code, Congress has not chosen to prohibit Chapter 20's. In fact, Congress has enacted provisions which limit Chapter 20 filings [362(c)(3) and (4), 1328(f)], and apparently made the conscious decision to not prohibit Chapter 20 filings.

In re Crawford, 324 F.3d 539 (7th Cir.2003). This is an assigned child support case, not a student loan case, but it addressed the unfair discrimination issue. The court declined to specifically adopt any of the "tests" it reviewed, but concluded: "…this is one of those areas of the law in which it is not possible to do better than to instruct the first-line decision maker, the bankruptcy judge, to seek a result that is reasonable in light of the purposes of the relevant law, which in this case is Chapter 13 of the Bankruptcy Code; and to uphold his determination unless it is unreasonable (an abuse of discretion)." An honest answer, although not particularly instructive. The court did hold that a plan which would pay 2/3 to the nondischargeable county tax claim while paying nothing to unsecured creditors did unfairly discriminate.

In re Thibodeau, 248 B.R. 699 (Bankr.D.Mass.2000). This debtor classified a HEAL loan with a balance of $61,064 as non-dischargeable and separately classified it proposing to cure an arrearage pursuant to 1322(b)(5) and maintain regular payments outside the plan. For reasons unclear to me and the judge, she treated her $109,900 SMART loan as a dischargeable debt and classified it along with her other unsecured debt and proposed a prorated distribution of 27% to that class. Applying the Leser test, the court found that the plan unfairly discriminated and was not proposed in good faith. The court also noted that this was a 36 month plan and if she extended it to 60 months and did not discriminate she would only be approximately two payments behind on the HEAL loan when her case was discharged. The court indicated that she could propose a 60 month plan which would not discriminate during the first 36 months and then pay 100% of her disposable income to the student loan debt for the last 24 months. (Payments on student loan paid according to loan terms, 29.3 % to her other unsecured creditors.)

In re Colley, 260 B.R. 532 (Bankr.M.D.Fla.2000). This debtor proposed to cure and continue her long term student loan debt under 1322(b)(5) while only paying 2% to her other unsecured creditors. In denying confirmation, the court first stated that 1322(b)(1) is a "creditor-protection provision." It then held "any discrimination under 1322(b)(1) should provide a substantial benefit to the disfavored creditors, even if that benefit provides some concurrent benefit to a debtor. Therefore, any discrimination, no matter the proportions, that harms, or does not benefit, disfavored creditors is unfair and must be removed in order for a court to confirm a plan." The court used an example of a hypothetical plan which provides a 36% distribution to student loan creditors, but only a 35% distribution to other unsecured creditors and states flatly that such a plan cannot be confirmed. ["There is no de minimis exception to 1322(b)(1)."]This is the one case which offers an example of a plan which discriminates but not unfairly stating: "The most obvious situation arises where the disfavored creditors receive full payment of their claims through pro rata distribution." Seriously? How is a creditor who receives full payment "disfavored"? Maybe if the payments to the student loan creditor started earlier in the plan and other creditors started receiving payments later, but ultimately receive full payment? (But those facts are not suggested in the example.)

In re Christophe, 151 B.R. 475 (Bankr.N.D.Ill.1993). The court denied confirmation of a plan which separately classified student loan debt and proposed to pay 100% on student loan debt and 32% to other unsecured creditors. The court concluded that the debtor's interest in staying current on nondischargeable debt was a reasonable basis for discrimination and if the final payment came due after completion of the plan, the student loans could be separately classified under 1322(b)(5).

In re Saulter, 133 B.R. 148 (Bankr.W.D.Mo.19991). This court rejected confirmation of a plan which provided for full payment of student loan debt through the plan but proposed to pay only 10% to other unsecured creditors. The court did hold, however, that 1322(b)(5) is "directly applicable" to student loans where the final payment falls after the end of the Chapter 13 plan and gave the debtor 30 days to amend her plan to separately classify the student loan debt as long term debt.

In re Colfer, 159 B.R. 602 (Bankr.D.Me.1993) (100% to student loan, 17.5% to other unsecured creditors). The court denied confirmation because the debtors relied solely on the nondischargeable nature of the debt as the basis for discrimination, but the court undertakes a fairly detailed analysis of the case law.

See, also, In re Scheiber, 129 B.R. 604 (Bankr.D.Minn.1991) (100% to student loans, 3.5% to other unsecured creditors); In re Renteria, 2012 WL 1439104 (Bankr.D.Colo.2012) (100% to student loans, 1% to other unsecured creditors)

Practice Tip

To avoid the separate classification fight, I typically try to satisfy each of the factors articulated by Orawsky (and Simmons) through a plan which provides:

* The debtor will pay to the unsecured creditor class (***including*** the student loan creditor) ***at least*** the disposable income determined under B22C.
* The debtor will make an additional payment (through the Chapter 13 trustee) in an amount ***up to*** the amount of the student loan payment which will be dedicated to the student loan payment.
* It is always a good idea to dedicate some portion of the "optional" payment to the general unsecured creditor class, so the distribution to the non-student loan creditors is higher than the minimum amount due under B22C. (The increase in Orawsky was from 5.7% to 12.6%.)
* This all assumes that the debtor lives a frugal lifestyle. The only reason the debtor has more disposable income on schedule J than on B22C is because the debtor's expenses are less than the IRS collection guidelines.
* Be very careful about attempting to accelerate the payments to the student loan creditor. Cure and maintain is not the same as paying extra. (Let me be clear, based on Orawsky and Simmons, as long as the general unsecured creditor class receives the debtor's disposable income under B22C, there is no "legal" reason why the debtor cannot accelerate payments to the student loan creditor, but it is one of those basic "fairness" issues.)

Hardship Discharge

Proposed "bonus" question which I submitted for the Texas Board of Legal Specialization paralegal certification in bankruptcy law.

In order to obtain a discharge of a student loan debt due to "undue hardship" under 523(a)(8), the debtor must prove:

1. that he is deaf, dumb, mute and a quadriplegic, and that his condition is likely to persist throughout the repayment period of the loan;
2. that he is in a chronic vegetative state, and that his condition is likely to persist throughout the repayment period of the loan;
3. that he has been dead for at least three years, and that his condition is likely to persist throughout the repayment period of the loan;
4. the world has ended, and that condition is likely to persist throughout the repayment period of the loan

523(a)(8) provides that a discharge does not discharge an individual from any debt "unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents for –

(A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

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

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

The Second Circuit in Brunner v. New York State Higher Ed. Serv. Corp., 831 F. 2d 395 (2d Cir.1987) articulated a three past test for evaluating whether a debtor should be granted a discharge of student loan debt based on an undue hardship. This test has been adopted (in some cases with modifications) by most courts considering granting a hardship discharge. The test is:

(1) that the debtor cannot maintain, based on current income and expenses, a minimal standard of living for himself and his dependents;

(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 debtor has made good faith efforts to repay the loans.

There was a very recent petition for writ of certiorari in Traversa v. Educational Credit Management Corp., No. 11-1359, at the Supreme Court in which the petitioner sought reconsideration of the second prong of the Brunner test. The judges considered the petition at their weekly conference on September 24, 2012 and denied the petition one week later. (That didn't take long.)

Fifth Circuit

* THE Fifth Circuit case on hardship discharge is In re Gerhardt, 348 F.3d 89 (5th Cir.2003). The debtor was employed as a cellist and worked part time as a cello teacher, making about $1,700 per month. The debtor had approximately $77,000 in student loan debt. The Fifth Circuit expressly adopted the test articulated in Brunner. With respect to the first prong of the Brunner test, the court held that the debtor did not have the present ability to repay the loans and maintain a minimal standard of living. With respect to the second prong, the court held that the debtor failed to establish additional circumstances which demonstrated a persistent undue hardship. Specifically, 'the debtor must prove "a total incapacity … in the future to pay [his] debts for reasons not within [his] control."' The debtor was 43, healthy, and had no dependents. Although it was unlikely that he could obtain a higher paying job as a cellist, the court noted that he "could attempt to teach full-time, obtain night-school teaching jobs, or even work as a music store clerk." Because the court resolved the case based upon the second prong of the Brunner test, it was not necessary for the court to analyze the third prong – whether the debtor has made a good faith attempt to repay the loan.

The Fifth Circuit revisited the issue in an unpublished opinion in In re Ostrom, 283 Fed. Appx. 283 (5th Cir.2008). The court affirmed the holdings of the bankruptcy and district courts which held that the debtor failed to satisfy the second prong of the Brunner test. The debtor incurred just under $70,000 in student loans while obtaining bachelors and masters degrees in social work and counseling. While in school, the debtor was diagnosed with sleep apnea. After graduation, the debtor was employed for approximately six months making $18,000. After that, the debtor chose not to pursue any further employment in the field of counseling and served as the caretaker for his elderly mother. The bankruptcy court noted there was no evidence that the debtor's impairments were likely to persist into the future, there was no evidence that his disorder prevented him from serving as a counselor, and that he managed to obtain a master's degree and work as a counselor despite his disorder.

There are several Texas district court opinions which address hardship discharge. In In re Pratt, 375 B.R. 753 (D.S.D.Tex.2007), the district court reversed the bankruptcy court's finding that the debtor was entitled to a hardship discharge. The debtors had six children, three of which were born after the debtor wife incurred roughly $37,000 in student loan debt. Although the cost of daycare would exceed any income she could earn working outside the home, it was likely that the daycare expense would decrease over time. The court stated that proving that the debtor is "currently in financial straits" is not sufficient. The court noted that "this is a young, educated, healthy couple at the beginning of their respective career paths and with almost certain income increases." The court also held that the debtor failed to satisfy the good faith effort to repay prong because she had not made any payments on the loans and had not attempted to seek loan payment reductions. As an aside, the court declined to reverse the bankruptcy court's holding that a 15% tithe to charity was a valid expense for the purposes of obtaining an undue hardship discharge, finding no clear authority on point.

Texas District Courts

In re Jones, 376 B.R. 130 (D.W.D.Tex.2007) the court stated that the additional circumstances under the second prong of the Brunner test must impact the debtor's future earning potential and which were not present when the debtor obtained the loans or have been exacerbated since then. The court held that none of the following constituted additional circumstances: failure to obtain a college degree, the fact that she had a child since the student loans were obtained, her age where she had chosen to go to school later in life, that there was a residency requirement imposed by her divorce decree, that she drove an older high mileage car, or that she was currently unemployed while attending school. In finding that the debtor had not satisfied the third prong of the Brunner test, the court noted that seeking out a loan consolidation or a repayment plan, "while not always dispositive," was illustrative that the debtor took the repayment obligation seriously.

More significantly, the Jones court stated that the additional circumstances necessary to prove an undue hardship must be a "result of factors over which he or she has no control." Several courts have made similar rulings based upon the two examples contained in 707(b)(2)(B) – "a serious medical condition or a call to active duty in the

Armed Forces." Several courts have noted that military service in the U.S. has been entirely voluntary for about 35 years and that many serious medical conditions are the result of voluntary lifestyle choices.

In In re Young, 376 B.R. 795 (D.E.D.Tex.2007), the court reversed the bankruptcy court's holding that the debtor was entitled to a partial discharge of his $235,000 in student loan debt. Although the court found that the debtor did not satisfy all three prongs of the Brunner test, the opinion focused on the third prong of the test finding that the debtor did not minimize his expenses and maximize his income, including: he was continuing $220 per month in voluntary retirement contributions, he was spending $650 per month for food for himself and his son including eating out, he failed to obtain a law license in Texas, and he offered to renegotiate his loans only on terms which were acceptable to him.

In In re Blake, 377 B.R. 502 (D.E.D.Tex.2007), the court reversed the bankruptcy court's holding that the debtor was entitled to a partial discharge of her student loan debt. The court held that the debtor failed to satisfy the second prong of the Brunner test and that the debtor's age (48 at the time of trial) and the fact that she took several over the counter pain medications did not qualify as additional circumstances. The court noted that the debtor was not only working, but that she routinely worked overtime. The court rather casually concluded that future uncertainty about the availability of overtime or her ability to work overtime was also not an additional circumstance. The court also rejected the contention that supporting her 18 year old daughter was an additional circumstance as the court could not discharge student loans to allow the debtor to support her "independent" daughter at the expense of her creditors.

In one of those cases where the court eloquently sums up the case law without really helping, there is a pre-Gerhardt opinion from the Northern District which states "Courts universally require more than temporary financial adversity and typically stop short of utter hopelessness." In re Nary, 253 B.R. 752 (Bankr.N.D.Tex.2000).

Texas bankruptcy courts

In re Smith, 2010 WL 3724828 (Bankr.S.D.Tex.2010). In an odd procedural twist, the debtor consolidated her student loans after discharge, then filed an adversary seeking a hardship discharge. The court held there was a sufficient factual question so that summary judgment for the creditor was denied.

In re Henslee, 2010 WL 1372483 (Bankr.S.D.Tex.2010). Chapter 7 debtor could not maintain minimal standard of living if required to repay student loans. Debtor was diagnosed with degenerative joint disease, high blood pressure, high cholesterol, sleep apnea, allergic rhinitis, and then with prostate cancer for which he had undergone 47 radiation treatments (so far.) Then his home was destroyed by Hurricane Ike. He was diagnosed with severe depression. (Really?) He was unable to work due to his "deteriorated psychiatric condition" and his only income was various forms of public assistance.

In re Gil, 2008 WL 155544 (Bankr.E.D.Tex.2008). Debtor failed to satisfy good faith effort to repay requirement where there were no payments on the loan since consolidation five years earlier, the debtor's expenses indicated the debtor had not made a serious effort to minimize those expenses, and the debtor had not attempted alternative repayment options, such as income contingent repayment plan.

In re White, 2008 WL 141926 (Bankr.E.D.Tex.2008). Pro se debtor with net monthly household income failed to satisfy all three prongs of the Brunner test.

In re Russ, 365 B.R. 640 (Bankr.N.D.Tex.2007). Debtor failed to establish good faith effort to repay where she was paying for private school for her son, had never made a payment on the student loan, had made no attempt to modify the loans or apply for income contingent repayment plan, and student loan debt was 90.8% of all of the debt listed.

In re Hernandez, 2005 WL 1000059 (Bankr.S.D.Tex.2005). Not on point, but the court held that a university's refusal to provide a transcript due to non-payment of tuition violated the automatic stay.

Elsewhere

There are dozens of reported circuit court student loan hardship cases. These are very fact specific. Many affirm the lower courts' findings as not being clearly erroneous. Many simply opine that the debtor has not produced sufficient evidence to obtain a hardship discharge (without addressing whether a hardship discharge would be available with sufficient evidence). Following is a list of the circuit court undue hardship cases for the last ten years with a very brief synopsis for each. They are listed by Circuit - First through Eleventh. (The "Fed.Appx." cases are cases which were not selected for publication.)

In re Nash, 446 F.3d 188 (1st Cir.2006). Debtor failed to show that level 2 bipolar disorder would likely continue for requisite time into the future.

In re Traversa, 444 Fed.Appx. 472 (2d Cir.2011). Debtor failed to prove alleged medical conditions would render him unable to pay over an extended period of time.

In re Coco, 335 Fed.Appx. 2009 (3d Cir.2009). Fact issue whether debtor made good faith effort to repay precluded summary judgment for creditor.

In re Frushour, 433 F.3d 393 (4th Cir.2005). Debtor who was in her forties with one dependent child, educated, and healthy did not meet second or third prongs of Brunner test. Failure to seek income contingent repayment plan evidenced lack of good faith effort to repay.

In re Mosko, 515 F.3d 319 (4th Cir.2008). Debtors who were underemployed did not meet good faith effort to repay prong of Brunner test.

In re Spence, 541 F.3d 538 (4th Cir.2008). Debtor who was in her mid-sixties failed to satisfy second and third prongs of Brunner test. Notwithstanding her age, she worked full time but had failed to seek employment with higher pay.

In re Lokey, 98 Fed.Appx. 938 (4th Cir.2004). Court of Appeals reversed, finding that bankruptcy and district court rulings that debtor had not established undue hardship was clearly erroneous. Debtor was employed but had only $75 per month disposable income and no unnecessary or frivolous expenses, it was not feasible for her to obtain a second job, and even after possible loan consolidation she would be unable to make payments.

In re Miller, 377 F.3d 616 (6th Cir.2004). The court held the debtor failed to satisfy the second and third prongs of the Brunner test so the bankruptcy court improperly granted her a discharge of one-half of her student loan debt.

In re Oyler, 397 F.3d 382 (6th Cir.2005). Debtor who chose to work as pastor of a small start up church making only $10,000 per year failed to satisfy third prong of Brunner test as he failed to maximize his earnings.

In re Tirch, 409 F.3d 677 (6th Cir.2005). Debtor failed to satisfy second and third prongs of Brunner test where she failed to prove that her medical conditions would prevent her from working for a significant portion of loan repayment period (the court required a "certainty of hopelessness") and did not seek consolidation of her loans under federal income contingent repayment plan.

In re Barrett, 487 F.3d 353 (6th Cir.2007). Debtor satisfied second prong of Brunner test by evidence that he had a serious medical condition that made it unlikely he would be able to repay for a significant portion of the repayment period. Debtor did not have to present expert medical evidence. His detailed testimony (which was uncontroverted by the creditor) was sufficient. Debtor's failure to participate in income contingent repayment plan did not per se prevent him from establishing good faith attempt to repay.

In re DeMatties, 97 Fed.Appx.6 (6th Cir.2004). The court affirmed a granting of a partial discharge where the debtor's budget "surplus" was entirely the result of gifts from her parents and debtor would be unable to make payments even if she entered into 30 year repayment plan.

In re Fields, 286 Fed.Appx. 246 (6th Cir.2007). The court held that the debtor failed to satisfy the good faith effort to repay prong when she filed bankruptcy after making only two payments on her student loan debt and did not apply for income contingent repayment plan.

In re O'Hearn, 339 F.3d 559 (7th Cir.2003). Court reversed bankruptcy grant of undue hardship of 50 year old debtor with no dependents making $43,000 per year. Remanded for further proceedings. (The debtor was living with his girlfriend and the issue was whether he could actually reduce his living expenses by finding cheaper housing.)

In re Kuehn, 563 F.3d 289 (7th Cir.2009). Not on point, but the court held that a university's refusal to provide a transcript to debtor was an action to collect a debt in violation of discharge injunction. The debtor offered to pay for the transcripts and the only stated reason for the refusal was non-payment of a tuition debt.

In re Reynolds, 425 F.3d 526 (8th Cir.2005). Hardship discharge granted to debtor with mental illness and $142,000 in student loan debt. Court may consider non-pecuniary effects of student loan debt including effect on debtor's mental health.

In re Jesperson, 571 F.3d 775 (8th Cir.2009). A bad facts case. The debtor, a 43 year old attorney with $350,000 in student loan debt, was denied a hardship discharge where he had sufficient income to make payment required under income contingent repayment plan. (The bankruptcy court found a "record of work experience besmirched by a patent lack of ambition, cooperation and commitment.")

In re Walker, 650 F.3d 1227 (8th Cir.2011). Debtor with $300,000 in student loan debt and five children, including autistic twins, was entitled to hardship discharge where husband's income left a deficit each month and it was unlikely debtor would be able to work until twins reached age of majority, if then.

In re Nys, 446 F.3d 938 (9th Cir.2006). The court reversed, holding that the debtor is only required to show that present inability to pay her student loan debt will likely persist for a substantial portion of the repayment period. The debtor does not have the burden of proving "additional circumstances" beyond inability to pay. Although the debtor must show her circumstances beyond the "garden variety", they are only required to be exceptional in the sense that they demonstrate insurmountable barriers to financial recovery and ability to pay. The court lists twelve factors for courts to consider in determining whether the debtor's inability to pay will likely persist.

In re Mason, 464 F.3d 878 (9th Cir.2006). Undue hardship discharge denied to law school graduate with $100,000 in student loan debt. Debtor's learning disability satisfied the second prong of the Brunner test. But the court found that the debtor did not satisfy the third prong of the Brunner test where the debtor did not obtain full time employment, did not intend to take the bar exam a second time, and did not make adequate effort to negotiate repayment of the debt, including an income contingent repayment plan.

In re Craig, 579 F.3d 1040 (9th Cir.2009). An odd case where the debtor was granted a partial discharge of student loan debt. The case was reversed and remanded for further analysis of whether debtor's voluntary $68 retirement contribution was an expense necessary to maintain a minimal standard of living.

In re Moore, 97 Fed.Appx 88 (9th Cir.2004). Granting of a partial discharge was reversed because the court did not apply the Brunner test in granting the discharge.

In re Mendoza, 182 Fed.Appx. 661 (9th Cir.2006). The court reversed a denial of a hardship discharge where the debtor suffered from severe ADHD, he had lived near or below the poverty level for several years, and there was nothing in the record to suggest that the debtor's ability to pay his student loan would improve during the repayment period for the loans.

In re Mandighomi, 242 Fed.Appx. 401 (9th Cir.2007). The court held that although the bankruptcy court may have relied "too heavily" on the IRS collection guidelines for utility expenses, any excess utility expense were insignificant given the size of the debtor's budget deficit. In a case of overreaching, the creditor unsuccessfully argued that the debtor had not made sufficient effort to maximize income (he debtor was working two jobs and working and/or commuting 70 hours per week) and any of the repayment options suggested by the creditor were still beyond the debtor's ability to pay.

In re Hedlund, 368 Fed.Appx. 819 (9th Cir.2010). The court remanded for more complete findings on whether debtor satisfied the third prong of the Brunner test.

In re Polleys, 356 F.3d 1302 (10th Cir.2004). Discharge of student loan debt upheld. Showing of a "certainty of hopelessness" is not required. Bankruptcy courts should consider the debtor's ability to provide adequate shelter, nutrition and other necessities. The inquiry into the debtor's likely future circumstances should be limited to the foreseeable future, not to exceed the repayment period for the loan(s). Although the debtor had a permanent debilitating medical condition, it was not necessary to demonstrate that condition if the debtor's situation was already "bleak." (Debtor had lived below the poverty level for several years, qualified for food stamps, had virtually no assets, and lived rent free in property owned by her parents.) The court also held that the failure to make a single payment on the debt did not, by itself, preclude finding of good faith intent to pay.

In re Alderete, 412 F.3d 1200 (10th Cir.2005). The court held the debtors failed to establish the second and third prongs of the Brunner test. The debtors were young and healthy and their expenses would be reduced as their three children reached adulthood. In addition, the debtors had not made an effort to increase their income or to seek to minimize their student loan expense through alternative repayment programs. In addition, their student loan debt equaled 98% of their unsecured debt so that all of the debt they were seeking to discharge was student loan debt.

In re Woody, 494 F.3d 939 (10th Cir.2007). This is s HEAL loan case where the standard for discharge is that it would be "unconscionable" to require the debtor to repay his loans. 58 year old debtor with no dependents, $40,000 annual income, discretionary income which would allow the debtor to make at least minimal payments, and "apparent lack of repayment efforts" over the life of the loans did not establish unconscionability.

In re Roe, 295 Fed.Appx. 927 (10th Cir.2008). Debtor failed to establish second and third prongs of Brunner test. Debtor failed to produce any evidence of diagnosis or prognosis of claimed medical conditions or that her impoverished lifestyle was likely to continue.

Debtor had not applied for a job in eleven years, had never made a payment on her student loans and declined to consolidate her loans to reduce her monthly payments.

In re Wieckiewicz, 443 Fed.Appx. 449 (11th Cir.2011). The bankruptcy court did not abuse its discretion by dismissing adversary complaint where debtor refused to comply with the court's order to apply for a federal loan consolidation program, which the court considered to be a "substantial factor" in whether the debtor could establish undue hardship.

In re Mosley, 494 F.3d 1320 (11th Cir.2007). Debtor was not required to produce medical testimony independent from the debtor's own testimony. Debtor did not purport to give medical testimony, but testified from personal knowledge about how he struggled with depression, back pain and the side effects of medication. Although the debtor had never made a payment on his student loans, his testimony made clear that he had tried to secure employment, that he did not own a home or car, and that his income was below the poverty line. Although the debtor had not applied for the income contingent repayment plan, the court held that was not a per se requirement to show good faith.

For a few stray cases of potential interest, see:

In In re Miller, 409 B.R. 299 (Bankr.E.D.Pa.2009) the court denied a hardship discharge although the debtor was totally disabled and would never be able to work. Although the debtor's only income was Social Security disability, she was married and her husband was gainfully employed. The court stated that the IRS collection guidelines were not controlling as to what constitutes a minimal standard of living, but they were some evidence of what expenses are reasonable. The court stated that "minimal standard of living lies somewhere between poverty and mere difficulty." Although the debtors' expenses exceeded their income by $205, 70% of their income was spent on housing costs including a five bedroom house for a family of four. (With minimal or no equity.)

In re Todd, 2012 WL 1862341 (Bankr.D.Md.2012) involved a debtor who went to school for approximately twenty years, obtained a bachelor's degree, two masters degrees, and worked toward a doctorate, accruing $320,000 in student loan debt. The court held that even if the debtor could further reduce some of her already frugal living expenses ($1906 per month), her expenses would still exceed her income. Given medical/psychological conditions, the court held that the debtor met the "certainty of hopelessness" necessary. to establish undue hardship. This is one of those cases that convince you that we need to reform student loan lending. The debtor had the medical condition the entire time she was going to school and it seems clear that she would never be employable and never be able to repay her student loans.

To see how far courts go in determining whether the debtor has minimized expenses, see In re Shank, 2008 WL 3166492(Bankr.E.D.Va.2008), which found that the debtor could cut her telephone expense (she didn't need to call family in Canada), that she didn't need a landline and cell phones ((including one for her father), and that she didn't need cable or high speed internet. This case is not exceptional.

Practice Tip

There are several consistent themes articulated by the courts with respect to each of the three elements of the Brunner test. There is rarely one issue which sways a court, so a practitioner should attempt to build a case which addresses as many of these issues as possible in a way that is favorable to the client. Many of the fact specific issues addressed by the courts overlap.

"(1) that the debtor cannot maintain, based on current income and expenses, a minimal standard of living for himself and his dependents;"

* Courts commonly review the debtor's income and expenses, frequently by comparing those expenses to the IRS guidelines, to determine whether the debtor's expenses are excessive.

* Expenses which might seem common may not be necessary to maintain a "minimal standard of living." These include cable, internet, cell phones (particularly where there is a land line), voluntary retirement contributions, mortgage/rental costs, auto ownership expenses, vacations,

* This prong of the Brunner test is often given short shrift because the courts focus on the second and third prongs. **Don't forget that the debtor has the burden of proof on all three elements of the Brunner test.** "Best two out of three" doesn't get the debtor where he needs to be.

"(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"

* Courts struggle with this one, but the consensus seems to be that the circumstances the debtor is required to show are that the debtor will not be able to make any meaningful repayment on the student loans during the ***entire*** repayment period. Forget the language in the "test" about a "***significant portion*** of the repayment period." If the remaining repayment period is 23 years, you need to convince the court that nothing is going to change for the better for 23 years, not 10 years. (This is, of course, nonsense, because how does anybody prove what is likely to happen in the next 20+ years?)

* With that said, there are several cases where a fairly young debtor graduated from school, had a couple of kids, and is now complaining that he can't repay his student loans based on his "current income and expenses." BUT his current income and expenses include a hefty daycare expense, and summer camps, and …… Those expenses will NOT continue for the next 15 years.

* “Abnormal” expenses for kid’s activities are generally not allowable. You don’t get to pay the expenses for select soccer and not pay your bills. Your kid doesn’t get to go to private school.

* You should introduce competent evidence that the debtor’s circumstances are not going to change. This can be a huge obstacle. There is a case where a debtor with bipolar disorder did not get a hardship discharge because he did not prove that his condition would continue. There is no cure for bipolar disorder. Period. Should a debtor really have to prove that? Is the PDR enough, or does he need a doctor to testify? How does the debtor prove he has bipolar disorder without testimony from a doctor? Does the debtor have to prove that there will not be a cure for bipolar disorder in the next 25 years?

“(3) that the debtor has made good faith efforts to repay the loans.”

* If the debtor has ***never*** made a payment on the student loan, the court will mention this when it denies the hardship discharge.

* If the debtor made a payment or two or three but the payments were made several years ago, the court will mention this when it denies the hardship discharge.

* If the court determines that the debtor is “underemployed” or “less than fully employed”, the debtor loses.

* If the debtor has held a part time job in the past to try to boost income, it helps his case.

* If the court determines that the debtor just has a bad attitude, the debtor loses.

* The courts look at household income and expenses, not just the debtor’s income and expenses. If an unemployed debtor or underemployed debtor still has disposable income on Schedule J, the fact that the income is not the “debtor’s” income will not decide the issue.

* Judges ***really*** don’t like lawyers who don’t want to pay their student loans. (Doctors come in a close second.)

* IF the debtor’s student loans are subject to the federal income repayment plan, the debtor should absolutely apply. The court will ask. If the debtor never tried, that is likely to irk the court. If the debtor applied and the results were a payment the court perceives the debtor could have made (at least based on the debtor’s current income and expenses), he isn’t getting a discharge. On the flip side, if the ICRP says the debtor can/should pay $500 and the court is convinced that number isn’t realistic, it will help the debtor’s case. There are several government websites which supply

information with respect to these plans. Google "student loan income contingent repayment" and you will find most of them.

* One of the key issues with respect this factor (and to a lesser extent, the first factor) is whether the debtor has attempted to maximize income and minimize expenses. ***This is very fact specific.***

* Courts will engage in a ***very*** subjective (and nitpicky) analysis of the debtor's income and expenses. If the debtor has an (any) expense which is discretionary, it is not likely to be allowed. (This is also an issue under the first prong.)

Discharge of Private Student Loans

As an aside, there has been some discussion lately about discharge of private student loans which were used at least in part for living expenses rather than for strictly "educational" expenses. The basis for this discussion arose prior to BAPCPA when Congress amended the Code in 1990 to add 523(a)(8)(A)(ii). In In re Murphy, 282 F.3d 868 (5th Cir.2002), the Fifth Circuit held that the purpose of the loan, not the actual use controlled. "Educational" was not defined prior to 2005, so the court looked to the broader purpose of what is "educational." The court specifically noted that "stipend" is defined as a regular allowance to defray living expenses.

More recently, In re Rogers, 374 B.R. 510 (Bankr.E.D.N.Y.2007) addressed the issue of whether "student loans" used primarily for living expenses were excepted from discharge. The debtor signed a master loan agreement pursuant to which she had advances made to the Allied Institute of Medical Professions totaling $130,000. It was not disputed that only $15,000 of that amount was used as tuition. The balance was used for basic living expenses – rent, food, utilities, etc.

The debtor filed an adversary seeking declaratory relief that the entire amount of the debt was dischargeable because it was not a "qualified education loan" because the IRC defines that term as "an indebtedness incurred by the taxpayer solely to pay qualified education expenses." 221(d)(1).

221(d)(2) defines "qualified higher education expense" as "the cost of attendance… at an eligible education institution."

26 U.S.C. 108711 defines "cost of attendance" as:

(1) tuition and fees normally assessed a student carrying the same academic workload as determined by the institution, and including costs for rental or purchase of any equipment, materials, or supplies required for all students in the same course of study; and

(2) an allowance for books, supplies, transportation, and miscellaneous personal expenses for a student attending the institution on at least a half-time basis, as determined by the institution."

The court in Rogers denied the debtor's motion for summary judgment because there was no evidence submitted regarding what or whether the institution made any determination regarding whether expenses not directly related to attending school were, nonetheless, a "cost of attendance."

I have a couple of problems with this analysis. First, it abdicates all responsibility to the institution to make the determination of what portion of a loan is a cost of attendance. There is a clear conflict of interest here as a private, for-profit institution has a strong motive to "determine" whatever the private, for-profit lender asks for as a condition of making the loan. Second, look at the examples of expenses identified as "cost of attendance" in 26 USC 108711 – they include tuition, fees, books, supplies, and similar expenses. The only expenses not directly related to attending school are transportation. There is not even a vague reference to housing, utilities, food, etc.

Just to see what happened, I checked the docket in Rogers. Two months after the court denied the debtor's motion, a consent judgment was entered which found that the debt in question was discharged as excepting it would be an undue hardship. Which was not plead as a ground for relief in the debtor's complaint.

In In re Wills, 2010 WL 1688221 (Bankr.S.D.Ind.2010), the court ruled that student loans obtained by the debtor for his son to attend diesel mechanic school were "qualified education loans" as they were used for "cost of attendance". (The court does not specifically state that the loan proceeds were used for tuition, but the amount of the loan -- $15,237 - suggests that it would have been insufficient to also pay room and board.)

In In re Carow, 2011 WL 802847 (Bankr.D.N.D.2011) the court states that "cost of attendance" includes "room and board", citing 20 U.S.C. 108711, so the loans in dispute were qualified education loans and were subject to the hardship discharge standard. The versions of 20 U.S.C. 108711 I found online make no mention of room and board.

Student Loan Debt as "Special Circumstances"

Cases which find that student loan payments may be or are a special circumstance:

In re Templeton, 365 B.R. 213 (Bankr.W.D.Okla.2007). In Templeton, the first reported case on the issue, the court first states that special circumstances is a "fact-specific consideration" and that courts are "given broad discretion" in making a determination if a particular case presents "special circumstances."' The court concludes: "The key issue remaining is whether the Debtors are left without a reasonable alternative, and the Court concludes that the Debtors do not have any reasonable alternative other than to pay the student loans. It is undisputed that the student loans are non-dischargeable, that the

Debtors are not eligible for consolidation, and that they are not eligible for deferment of the student loans. **In short, there is nothing within the Debtors' power to reduce or otherwise avoid the additional expense of the student loans**." [Emphasis added.]
In re Haman, 366 B.R. 307 (Bankr. D.Del.2007). Haman is a somewhat odd case as the student loans in question were not the debtor's student loans, but loans which she had co-signed for her son. (The son has a medical condition which prevented him from repaying the loans.)

* In re Delbecq, 368 B. R. 754 (Bankr.S.D.Ind.2007) rejected the debtor's contention that payments on federally insured student loans constitute an "other necessary expense." Notwithstanding Chapter 5.15.1.10 of the Internal Revenue Manual which provides that such payments are an other necessary expense, 707(b)(2)(A)(ii)(I) provides that other necessary expenses "shall not include any payments for debts." The court held, however, that student loan repayments may constitute a special circumstance. The court first concluded that "special circumstances" is ambiguous and analyzed the legislative history of the "special circumstances" exception to 707(b)(2)(B). Significantly (at least to this court) were the statements of Sen. Jeff Sessions, who introduced the amendment, that it was intended to protect military personnel from the effects of the means test. Based on the Committee Report to the bill, the court concluded that "special circumstances" requires a fact specific, case by case inquiry into whether a debtor has a "meaningful ability" to pay his or her debts in light of an additional expense or adjustment to income not otherwise reflected in the means test calculation." Analyzing the debtor's financial situation, the court found that the debtor would have no alternative but to defer her student loan payments, thereby incurring additional interest and potential collection costs. The court concluded that the debtor had no meaningful ability to repay her debts because of her student loan debt. The court rejected the holding of other courts that a 0% Chapter 13 was a reasonable alternative, concluding "there is simply no logic to essentially forcing a debtor into a Chapter 13 case if the distribution in that case will yield nothing to unsecured creditors." In a footnote, the court states that it "cannot conclude, and the trustee does not contend, that Debtor maintains an extravagant lifestyle."

In re Knight, 370 B. R. 429 (Bankr.N.D.Ga.2007). (Citing Templeton, Haman and Delbecq) The Knight court concluded: "A Debtor's desire to continue to make payments on long-term, nondischargeable student debt represents neither a lifestyle choice nor a use of discretionary income that should be directed in a different way. A debtor in such circumstances has no realistic choice, and the required payments do not in any true sense represent discretionary income. To the contrary, **paying a substantial nondischargeable student loan is an economic and legal necessity**." [Emphasis added.] BUT the court remanded for a determination of whether the student loan payments constituted a special circumstance under the facts of the case. The court concluded: " The price of Chapter 13 relief should not be the creation of yet another default situation and unavoidable financial distress at the end of the chapter 13 case on account of debts legitimately incurred and in fact encouraged as a matter of public policy."

In re Martin, 371 B.R. 347 (Bankr.C.D.Ill.2007) (Citing Templeton, Haman and Delbecq) The Martin Court found: "Here, the Debtors have acknowledged the nondischargeability of their student loan debt and they have no reasonable alternative other than to pay the debt. Chapter 13 is not a reasonable alternative. A Chapter 13 filing would result in only partial payment of the student loan during the term of the Chapter 13 case and, most likely, a substantial balance would still be due upon completion of the case. Student loan debt is non-dischargeable and, as such, must be paid. **The existence of this debt is a distinct, particular, additional, and extra factor which this Court should consider in determining whether abuse exists here.** This Court finds that the Debtors' obligation to pay their student loan debt is a "special circumstance" and that the Debtors are entitled to an expense adjustment of $178 for their monthly student loan payment." [Emphasis added.]

In re Robinette, 2007 WL 2955960 (Bankr.D.N.M.2007) (Citing Templeton and Haman) finding that the debtor had no reasonable alternative other than to pay their student loan debt.

There are apparently no published opinions from Texas with respect to whether student loan payments can constitute "special circumstances." See In re Tamez, 2007 WL 2329805 (Bankr.W.D.Tex.2007) which cites Haman with approval for the proposition that 'The term "special circumstances" is not limited to circumstances outside of a debtor's control, thus, it is possible for situations within the debtor's control to be a special circumstance.' and "Thus, special circumstances are not limited to those narrow and defined categories of special circumstances described in section 707(b)(2)(B)," such as "a serious medical condition or a call or order to active duty in the Armed Forces."

Cases which found that student loan payments are not a special circumstance.

In re Pageau, 383 B.R. 221 (Bankr.D.N.H.2008) held that student loans necessitated by permanent injury, disability or an employer closing might constitute special circumstances, but that student loans incurred in the ordinary course of acquiring an education could not constitute special circumstances. The court also held that the debtor's contention that she had no reasonable alternative was "unavailing" where Chapter 13 was an option. The court was careful to note that in their district, the debtor could cure and maintain payments on long term debt in Chapter 13, but then noted that it was not appropriate for the court to consider what the return might be to unsecured creditors in the event the debtor converted to Chapter 13. (Essentially "holding" that a 0% Chapter 13 was a reasonable alternative.)

In re Harmon, 446 B.R. 721 (Bankr.E.D.Pa.2011). This case is significant as it was decided by the same judge as Orawsky. In this case, the court held that student loans were not a special circumstance where they were not incurred "due to some sort of life adversity" and the debtor failed to show that requiring her to pay her student loan debt on a pro rata basis in Chapter 13 would have any serious adverse consequence to the debtor other than a slight delay in repayment of her student loans. (From 8 to 11 years.)

In re Sanders, 454 B.R. 855 (Bankr.M.D.Ala.2011). The court held that student loan debt which was incurred as cosignors for their son could constitute special circumstances where neither debtors nor their son could establish the requirements to obtain a hardship discharge, debtors would only incur more debt through consolidation of deferment or forebearance and neither debtors nor their son had sufficient disposable income to make payments on the loans.