UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF POSTSECONDARY EDUCATION

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Subject: Undue Hardship Discharge of Title IV Loans in Bankruptcy Adversary Proceedings

Summary: This letter provides guidance to guarantors and educational institutions participating in the Federal Family Education Loan Program (FFELP) and Federal Perkins Loan Program (Perkins), hereinafter "holder[s]," as they continue to implement U.S. Department of Education (Department or Education) regulations (at 34 C.F.R. § 682.402(i)(1)(ii) & (iii)) (FFELP) and 34 C.F.R. § 674.49(c)(Perkins)), which govern their actions in defending bankruptcy adversary proceedings seeking discharge of student loans authorized by Title IV of the Higher Education Act of 1965, as amended (hereinafter Title IV), on the basis that excepting the loans from discharge would impose undue hardship upon the borrowers. [1]

The Department is providing this guidance to assist loan holders in fulfilling their regulatory duty to protect the integrity of taxpayer dollars provided through student loans while consenting to and/or not opposing undue hardship discharge of student loans where repaying the loan would impose an undue hardship on the debtor. While this letter addresses the holders of FFELP and Perkins loans, the Department follows the same two-step analysis when evaluating whether to consent or not object to a borrower's claim of undue hardship for the William D. Ford Federal Direct Loan Program (Direct Loans), or for FFELP and/or Perkins loans the Department holds.

In responding to adversary proceedings seeking Title IV loan discharges on the basis of undue hardship over the past thirty or more years, the Department and holders have had to balance their obligation to collect debts with judging whether the repayment of loans would constitute an undue hardship to borrowers in the bankruptcy discharge process. Recently, the Department has received questions about the ability of Title IV student loan borrowers to obtain an undue hardship discharge and about the process that loan holders must follow when determining whether to object to attempts to discharge Title IV loans in bankruptcy.

Department regulations currently allow loan holders the ability to consent to and/or not oppose a borrower's claim of undue hardship in appropriate cases if they follow a two-step analysis. First, a holder must evaluate a borrower's undue hardship claim and determine whether the holder

[1] Including Parent PLUS loans.

believes that repayment would constitute an undue hardship according to the legal standards set by the Federal courts. If the holder determines that requiring repayment would impose an undue hardship, the holder can consent to or not oppose the discharge. If, however, the holder determines that requiring repayment would not impose an undue hardship, the holder must then evaluate the cost of objecting to the borrower's claim of undue hardship in court. This letter provides guidance to loan holders primarily on the first step—determining whether the facts of an adversary proceeding support a holder's decision to consent or not object to a borrower's claim of undue hardship. However, this guidance also recognizes that under the second step loan holders will evaluate and weigh the costs of opposing the borrower's undue hardship claim in their decision about whether or not to proceed with the opposition to undue hardship discharge.

I. Background--Student Loans in Bankruptcy

Any discussion of the undue hardship analysis must include the statutory, regulatory, and procedural elements of the legal framework currently in place.

a. Statutory Authority

The U.S. Bankruptcy Code (11 U.S.C. § 523(a)(8)), provides that student loans can be discharged in bankruptcy only if excepting the debt from discharge would impose an "undue hardship" on the borrower:

> § 523 Exceptions to Discharge
>
> (a) A discharge under ... this title does not discharge an individual debtor from any debt—
> *(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—*
> *(A)*
>
> > *(i) an educational benefit overpayment 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 education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.*

Congress has amended the student loan bankruptcy discharge provisions several times, tightening the restrictions on discharge in every instance. Appendix A describes the legislative history applicable to each change.

b. "Undue Hardship" Case Law

Congress has never defined "undue hardship" in the Bankruptcy Code and has not delegated to the Department the authority to do so. Federal courts have established the legal standard for a student loan debtor to prove "undue hardship" as authorized by Congress. In general, the courts have used one of two tests to analyze whether undue hardship is proven: the Brunner test (named after the case in which that test was first articulated) or the Totality of the Circumstances test.

Under the Brunner test, the debtor must show that: (1) he or she cannot maintain, based on current income and expenses, a "minimal" standard of living for himself or herself and any dependents if forced to repay the loans; (2) 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) he or she has made good faith efforts to repay the loans. Under the Totality of the Circumstances test, the court examines (1) the debtor's past, present and likely future financial resources; (2) his or her reasonably necessary living expenses; and (3) "any other relevant facts and circumstances."

Regardless of which test is used, the burden of proof is on the debtor to meet the standard and prove undue hardship. The case law interpreting undue hardship in adversary proceedings in bankruptcy student loan cases is extensive. Appendix B includes a more thorough (though not exhaustive) discussion of that case law—and a listing of which Circuits have adopted the Brunner test v. the Totality of the Circumstances test.

c. Regulatory Requirements: FFELP 34 C.F.R. § 682.402(i)(1) & Perkins 34 C.F.R. § 674.49(c)

Department regulations currently require holders to evaluate each undue hardship claim to determine whether requiring repayment would constitute an undue hardship. Any such determination would necessarily be made according to the legal standards set by the Federal courts. If a holder determines that requiring repayment would not impose an undue hardship, the holder must then evaluate the cost of undue hardship litigation. If the costs to pursue the matter in bankruptcy court are estimated to exceed one-third of the total amount owed on the loan (including the current principal balance, any unpaid accrued interest, and current, unpaid accrued collection costs), the holder may accept

and/or not oppose an undue hardship claim by the borrower in an adversary proceeding. The complete FFELP and Perkins regulations in this area are in Appendix C.

d. Other Legal and/or Internal Procedural Requirements and Considerations

Any holder's decision to consent to, not oppose, or oppose an undue hardship claim is subject to an audit or program review by the Department to ensure compliance with the requisite statutory and regulatory requirements. Consequently, any such decision must have a reasonable, properly documented basis. At the same time, the Department recognizes that the evaluations of undue hardship cases often are difficult and require the exercise of judgment by the holder. Acting consistently with the guidance in this DCL would safeguard holders against the denial of claim payment or adverse findings in program reviews or audit determinations.

II. Undue Hardship Analysis

a. Balancing Duties: Protecting the Public Fiscal Interests and Consenting to Undue Hardship Discharge

Any discharge of Title IV student loans, including FFELP or Perkins, has a cost to the Federal Government and the American taxpayer. Litigation in opposition to an undue hardship claim also has a cost to the Federal Government. Congress has determined that student loans should not generally be discharged in bankruptcy, but enacted a statutory provision to allow discharge in cases of undue hardship. The Department, by regulation, has established a standard (the two-step analysis set out above) holders must use to determine whether to oppose an undue hardship claim by a student loan borrower.

Department regulations give FFELP and Perkins holders the responsibility to assess all relevant factors in an adversary proceeding in order to determine whether to consent to or not oppose an undue hardship claim, as well as the authority to discharge part of a student loan debt in order to avoid a full discharge. 34 C.F.R. §§ 682.402(i)(1)(ii-v) & 674.49(c)(6). Department regulations, therefore, allow holders to balance the interests involved and avoid inefficient use of taxpayer resources through protracted or unnecessary litigation.

b. Case-by-Case Undue Hardship Analysis: Examples of Relevant Factors to be Considered

Evaluation of an undue hardship claim is rarely completed on the basis of a single factor, but rather requires consideration of a combination of factors. The list below is by no means an exhaustive list of factors that are appropriate for consideration when making that decision, nor is it a determination as to how much, if any, discovery is needed to conduct the analysis required. Each factor references the element(s) of the Brunner and/or Totality test to which such factor might relate.

1. Whether a debtor who asserts undue hardship due to physical or mental impairment may qualify for Total and Permanent Disability Discharge (TPD)[2] and/or other administrative discharges available.[3] This includes any individuals who may qualify to obtain a certification by a physician that the borrower is totally and permanently disabled. 34 CFR 682.402(c)(2). In addition, the following categories of individuals automatically qualify for TPD discharge of their student loans, which once obtained negates the need for discharge of their student loans in bankruptcy:
    a. Veterans who have been determined by the Department of Veterans Affairs to be unemployable due to a service-connected disability. 34 CFR §682.402(c)(9).
    b. Individuals who received SSA notice of award for Social Security Disability Insurance or Supplemental Security Income benefits indicating that the borrower's next scheduled disability review will be within five to seven years. 34 CFR §682.402(c)(2).

    Pursuit of administrative remedies conserves scarce judicial resources and costs while providing qualifying borrowers with equally effective remedies authorized by Congress through the Higher Education Act. Holders with any basis for determining that a borrower seeking undue hardship discharge in bankruptcy may qualify for an administrative discharge, including a TPD discharge, must advise borrowers to apply for such relief, and in fact regularly do so. [Brunner 1, 2 & 3; Totality 1 & 3]

2. Whether a debtor has filed for bankruptcy due to factors beyond his or her control and the impact such factor(s) have on debtor's ability to repay the student loan debt. Examples might include a protracted and

[2] Amounts discharged through TPD are included in the borrower's taxable income.

[3] For a list of available administrative discharge options, see Appendix D.

ongoing physical or mental illness of a borrower or a borrower's family member or a divorce resulting in diminution of family income, which will not realistically be reestablished. [Brunner 1, 2 & 3; Totality 1, 2 & 3]

3. Whether a debtor pursued available income-driven repayment plans.[4] In 1998 Congress passed the Higher Education Amendments of 1998, Section 971 of which amended Section 523(a)(8) of the Bankruptcy Act to further restrict the ability of student loans to be discharged. The legislative history of this amendment specifically mentioned the ability of borrowers to rely on income-based repayment plans "to increase the affordability of student loan debt." H.R. Rep. No. 105-750, Title IX, pt. G, at 408 (1998). Borrowers now have access to even more income-driven repayment plans (listed in more detail in Appendix D). Thus, consideration of any available repayment options is appropriate in any undue hardship analysis. If the monthly repayment under any available income-driven plan is within the debtor's means, the ability to prove undue hardship should be correspondingly more difficult, though not impossible. [Brunner #1, 2, & 3; Totality #1 & 3]

4. Whether a debtor has made any payments on his or her student loan debt when the debtor had the resources to do so. [Brunner #3; Totality #3]

5. Whether a student loan debt is a debtor's only debt and/or whether the student loan debt has been owed for a long period of time. Filing a bankruptcy adversary proceeding solely to obtain a discharge of student loans could be indicative of a preplanned financial management strategy aimed at avoiding repayment. Similarly, filing a bankruptcy adversary proceeding shortly after the debt enters repayment could be indicative of a preexisting lack of intent to repay. In either of these situations, the holder would want to examine the facts closely to ascertain whether circumstances beyond the borrower's control led to the bankruptcy filing and whether the various repayment plans available would not be sufficient to ensure that requiring

[4] Amounts not repaid by the end of the repayment terms for Income-Based and Income-Contingent Repayment plans, with the notable exception of the Public Service Loan Forgiveness program, are currently included in the borrower's taxable income.

repayment would not impose an undue hardship. See Appendix B. [Brunner # 3; Totality #3]

6. Whether a debtor has reaffirmed other debts that are dischargeable in bankruptcy. Reaffirmation of dischargeable debt(s) indicates a borrower's belief that he or she possesses sufficient funds for at least partial student loan debt repayment, as any payment towards a reaffirmed debt could be applied towards a student loan debt. [Brunner #1 & 3; Totality #1, 2 & 3]

7. Whether a debtor is approaching retirement, taking into consideration debtor's age at the time student loans were incurred, and resources likely to be available to the debtor in retirement to repay the student loan debt. [Brunner #1, 2 & 3; Totality #1, & 3]. Borrowers who choose to incur student loan debt at an older age, whether that debt is for themselves or a dependent (i.e., Parent PLUS loans), should not be able to rely on their age alone and/or their entrance into retirement to prove undue hardship. [Brunner #1, 2 & 3; Totality # 1 & 3]

8. Whether a debtor's health has materially changed since the student loan debt was incurred. [Brunner #1 & 3; Totality #1, 2 & 3]

9. Whether significant time has elapsed since the debt was incurred. [Brunner #1 & 3; Totality #1, 2 & 3]

10. Whether a debtor's expenses are reasonable and indicate minimization of unnecessary expenses to provide funds for student loan repayment. [Brunner #1, 2, & 3; Totality # 2]

11. Whether a debtor had the mental and/or physical capacity to pursue administrative discharge options and/or income-driven repayment plans, if those options were not pursued, or whether a debtor had any physical or psychological factors that would have made the administrative process more burdensome to the borrower.

c. <u>The Interplay Between Undue Hardship Analysis and the Cost Assessment of Opposing Undue Hardship Discharge</u>

The two-step analysis in Department regulations recognizes that the evaluation of the borrower's undue hardship claim does not occur in a vacuum: the strength or weakness of the undue hardship claim is directly related to the costs of opposing the discharge.

Ultimately, if Step 2 is reached, the regulations require loan holders to evaluate the litigation costs against the outstanding loan balance and determine if the debtor's request for undue hardship discharge should be opposed.[5]

III. Hypothetical Examples with Analysis of Undue Hardship Factors

This letter provides several hypothetical fact patterns in student loan borrowers' bankruptcy adversary proceedings. These examples are not intended to be, nor should they be interpreted to be, binding, as each borrower's case will have unique factors that are appropriately considered in the undue hardship analysis.

Example 1.

Facts: Borrower obtains student loans in order to complete a Master's degree. Upon graduation she starts working and making payments. A few years after her graduation, her child becomes seriously ill, with no prospect of recovery, requiring round-the-clock care. The child's illness is followed by a divorce, with no child support or alimony forthcoming. This set of circumstances makes the borrower unable to work full-time due to child care obligations. She works part-time, bringing in only a fraction of her full-time income. Her child's medical expenses are also extremely high.

Analysis: Example 1 shows that debtor demonstrated willingness to repay her loans and did so when her resources permitted, and that her bankruptcy filing and circumstances were a result of circumstances beyond her control. Furthermore, the circumstances that caused her financial difficulties are likely to persist. The Department believes that a pattern such as this would warrant exploring some of the income-driven repayment options. If these options are not available and/or do not alleviate the financial hardship, a consent to undue hardship discharge, either in full or part, may be appropriate.

Example 2.

Facts: Borrower obtains student loans in order to complete a bachelor's degree in nursing. He appears to experience undiagnosed mental health concerns soon after completing his studies and obtaining his first professional position. He is

[5] Department regulations requiring the assessment of costs to litigate pertain to the initial adversary proceeding, not the costs of any subsequent appeal. Department personnel are available to discuss any proposed appeal with loan holders.

subsequently fired and is unable to secure other work. Even though the borrower never obtains a formal diagnosis, the holder is able to observe the degree of his mental impairment. The debtor could, himself or through a designated representative, apply for Total and Permanent Disability Discharge, but has serious difficulty completing or receiving help in completing the required paperwork and obtaining the requisite physician certification.

Analysis: In this example, the borrower's inability to pay is involuntary, caused by his apparent undiagnosed mental illness, which also makes it extremely difficult for borrower to complete his TPD application, either independently or with assistance through a designated representative. A close look at his employment history and some degree of personal interaction to assess the degree of impairment and how long it has been present would be appropriate before consenting to full or partial undue hardship discharge.

Example 3.

Facts: A parent borrower takes out PLUS loans to help put two of her children through college. She never makes any payments on the loans, requesting forbearances while her children are at school. She files for bankruptcy soon after her youngest child graduates, claiming that her husband's illness, which pre-existed the loans, and her own advanced age, are the basis for her undue hardship claim. Her household expenses show regular expenditures, either isolated or in a pattern, for nonessential items.

> Examples of Nonessential Expenditures: making payments for debts on which one has no legal obligation, providing for an adult child who is capable of working and contributing to household expenses (room, board, cell, cable, electric, water, car), excessive expenses for "desired" items vs. needed items, including, but not limited to, restaurant expenses, personal massages, gym memberships, manicures, "name label" clothing, vacations, luxury automobiles.

Analysis: This borrower's failure to make any voluntary payments on her PLUS loans, combined with the timing of her request for undue hardship, clearly weigh against consenting to undue hardship discharge. The age of a borrower should not favor a discharge when the time elapsed between the borrowing and repayment is minimal. Similarly, an illness of a family member should not serve as the basis for discharge when the illness pre-existed the loan and/or the illness does not prevent the borrower from working to obtain funds to repay the student loan.

Consequently, barring additional extenuating circumstances, such as the severity of the preexisting illness changing, this fact pattern does not warrant consent to full or partial discharge.

Example 4.

Facts: A student loan borrower becomes seriously ill with cancer after taking on a significant student loan debt. The student then makes a full recovery with an excellent prognosis, and continues to be gainfully employed, earning a healthy salary, buying a new car, travelling for work, and training for a sporting event.

Analysis: Example 4 presents a scenario where a borrower, while previously ill, is no longer suffering from that health condition. This borrower's healthy income and pattern of expenditures suggests that requiring repayment would not impose an undue hardship and that he or she has the ability to proceed with his or her loan repayment.

IV. Conclusion

The Department provides this guidance to assist loan holders in fulfilling their regulatory duty to protect the integrity of taxpayer dollars provided through student loans while consenting to and/or not opposing the undue hardship discharge petition of a student loan borrower where appropriate. To achieve this balance the holder should work with the borrower to collect the necessary facts needed to determine whether undue hardship exists. All relevant facts must be considered to protect the integrity and the efficiency of both the student loan programs (funded by taxpayer dollars) and the undue hardship process in bankruptcy, and the borrower is typically in the best position to supply the facts. If this consideration leads to the conclusion that repayment would impose an undue hardship, the holder should consent to, or not oppose the discharge, as authorized by the

governing statute and regulations. Alternatively, if this consideration does not lead to the clear conclusion that repayment would impose an undue hardship, the holder must oppose the discharge unless the cost of opposing it warrants otherwise, as set forth in 34 CFR §§674.49(c) and 682.402(i)(1).

Sincerely,

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APPENDIX A: LEGISLATIVE HISTORY OF 11 U.S.C. § 523(a)(8)

Education Debt Discharge prior to 1977

Prior to 1977, the Bankruptcy Code allowed educational loans to be discharged by general discharge order.[6] The Code excepted only a few debts from discharge, including certain taxes, criminal liabilities, alimony, and employment wages.[7]

Restricting Bankruptcy Discharge of Student Debt in 1977

In 1976, Congress amended the Higher Education Act to limit the circumstances in which an individual could discharge an educational loan in bankruptcy. Under Public Law 94-482, an insured or guaranteed educational loan could only be discharged in bankruptcy if one of two criteria were met: (1) five years had passed since the commencement of the repayment period; or (2) a court determined that requiring future payments on the loan would impose an "undue hardship" on the debtor or his dependents.[8] The original Senate Committee report explained the rationale behind the five-year provision:

"The Committee bill seeks to eliminate the defense of bankruptcy for a five-year period, to avoid the situation where a student, upon graduation, files for a discharge of his loan obligation in bankruptcy, then enters upon his working career free of the debt he rightfully owes. After a five-year period, an individual who has been faithfully repaying his loan may really become bankrupt."[9]

The changes were made effective September 30, 1977.[10]

Congress later repealed that provision in 1978, choosing instead to insert it into the Bankruptcy Code.[11] Under § 523(a)(8) of the amended Bankruptcy Code, a discharge under §§727, 1141, or 1328(b) generally did *not* discharge educational loans owed to the government or to a nonprofit institution of higher education.[12] The Code, though, retained both exceptions previously codified in the Higher Education Act.[13]

Expanding the Scope of Non-Dischargeable Student Debt from 1979-1990

In 1979, Congress amended the language of § 523(a)(8), from debts "to a governmental unit, or a nonprofit institution of higher education, for an educational loan" to debts "for an educational loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by

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[6] 11 U.S.C. §§ 32, 35 (1977).

[7] *Id.*

[8] Education Amendments of 1976, Pub. L. No. 94-482, § 439A, 90 Stat. 2081, 2141 (1976).

[9] S. Rep. No. 94-882, at 32 (1976).

[10] *Supra* note 3.

[11] Bankruptcy Reform Act of 1978, Pub. L. No. 95–598, §§ 317, 523, 92 Stat. 2549, 2574-2591 (1978);

[12] *Id.*

[13] *See id.*

a governmental unit or a nonprofit institution of higher education."[14] A Senate report explained the change in language:

"Because . . . [§] 523(a)(8) applied only to debts for educational loans *owing to* a governmental unit or to a nonprofit institution of higher education, it has a very uneven effect upon the student loan programs *administered* by the Department of Health, Education, and Welfare. For example, National Direct Student Loan (NDSL) funds are administered by both nonprofit and profit-making institutions of higher education. Under the [current law], a student who obtained an NDSL loan from a profit-making institution of higher education would be free to have that loan discharged in bankruptcy. In contrast, a student who obtained an NDSL loan from a nonprofit institution of higher education would be subject to the prohibitions contained [under § 523(a)(8)]. [The report continues to describe similar inconsistencies with respect to the administration of Guaranteed Student Loans.][15]

Thus, Congress altered the language to ensure that *all* government- and nonprofit-sponsored student debts would be subject to the non-dischargeability provision in bankruptcy. Congress went one step further in 1984 by eliminating the modifier "of higher education" from § 523(a)(8).[16]

Extending the Repayment Period Exception and Expanding Non-Dischargeability after 1990

In 1990, Congress further limited the ability to discharge education debts by amending both § 523(a)(8) and § 1328(a) of the Bankruptcy Code. In addition to covering educational loans, the scope of § 523(a)(8) was expanded to include educational benefit overpayments and repayable scholarships/stipends.[17] Moreover, the five-year repayment period exception was extended to seven years.[18] The changes were made effective May 28, 1991.[19]

The record from one House hearing simply notes that "educational funds received in the form of benefits (such as VA benefits), scholarships (such as medical service corps scholarships) and stipends . . . are often very sizeable and should receive the same treatment as a 'student loan' with regard to restrictions on dischargeability in bankruptcy."[20] The extension of the repayment period to seven years, however, was "in recognition of the lengthy processing and enforcement requirements."[21]

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[14] An Act to Amend the Bankruptcy Act , Pub. L. No. 96-56, §3(1), 93 Stat. 387 (1979).

[15] S. Rep. No. 96-230, at 1 (1979).

[16] An Act to Amend Title 28, Pub. L. No. 98-353, § 454(a)(2), 98 Stat. 333(1984).

[17] Crime Control Act of 1990, Pub. L. No. 101-647, § 3621, 104 Stat. 4789, 4964-65 (1990).

[18] *Id.*

[19] Crime Control Act of 1990 § 3631.

[20] *Federal Debt Collection Procedure: Hearing on P.L. 101-647 Before the H. Subcomm. on Economic and Commercial Law of the H. Comm. on the Judiciary*, 101st Cong. 74-75 (1990) (Mr. Brooks' Questions for the Record for Mr. Wortham).

[21] *Id.*

Separately, Congress amended § 1328(a) so that a court was no longer required to discharge a debtor's educational debt once he or she completed all payments under the confirmed bankruptcy plan.[22] In effect, this made discharging educational debts more difficult by broadening the scope of § 523(a)(8) even further. Although this amendment was set to expire in 1996,[23] Congress repealed the sunset provision in 1992.[24]

Striking the Seven-Year Repayment Exception after 1998

In 1998, Congress eliminated the seven-year repayment period exception altogether.[25] Once this provision was enacted, individual debtors could discharge their educational debts only by showing that a failure to do so would impose an undue hardship on them and their dependents. The Congressional Record provides a partial explanation for eliminating this exception:

"I recognize that particular concern has been raised about provisions in the bill which eliminate a provision of the bankruptcy law that permits individuals filing for bankruptcy to have their student loans canceled if the loans have been in repayment for seven years or longer. Individuals who file for bankruptcy may still have their student loans canceled if the bankruptcy court determines that repaying the loans would cause undue hardship. . . [which currently] accounts for 70 percent of all student loan discharges. In addition, a number of options are available to assist borrowers who are having difficulties repaying their loans, including deferment, forbearance, cancellation and extended, graduated, income-contingent and income-sensitive repayment options. In just about every case, these options are preferable to declaring bankruptcy."[26]

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)

In 2005, Congress further expanded nondischargeable debts through the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). Now, nondischargeability under § 523(a)(8) applies to both *private* student loans, as well as government and nonprofit student loans.[27]

Debtor Bears the Burden of Proving Undue Hardship

The legislative history makes clear that § 523(a)(8) is self-executing, and that the lender does not need to file a complaint to render a student loan nondischargeable.[28] Furthermore, courts uniformly accept that the debtor bears the burden of demonstrating that undue hardship exists.[29] In 1991, the Supreme Court held

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[22] Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 3007, 104 Stat. 1388, 1388-28 (1990).

[23] Omnibus Budget Reconciliation Act of 1990 § 3008.

[24] Higher Education Amendments of 1992, Pub. L. No. 102-325, § 1558, 106 Stat. 841 (1992).

[25] *See* Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971, 112 Stat. 1581, 1837 (1998).

[26] 144 Cong. Rec. S11071 (daily ed. Sep. 29, 1998) (statement of Sen. James Jeffords).

[27] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, § 220, 119 Stat. 23, 59 (2005).

[28] S. Rep. No. 95-989, at 79 (1978).

[29] *See, e.g.*, *Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 450 (2004); *In re Woodstock*, 45 F.3d 363 (10th Cir. 1995); *In re Roberson*, 999 F.2d 1132, 1137 (7th Cir. 1993)

that the proper standard of proof for warranting an undue hardship discharge is "preponderance of the evidence."[30]

[30] *Grogan v. Garner*, 498 U.S. 279, 286 (1991).

APPENDIX B: COURTS' INTERPRETATION OF UNDUE HARDSHIP DISCHARGE

CIRCUIT APPLICATION OF §523(a)(8)

***Brunner* Test**	
Second Circuit	*Brunner v. New York State Higher Educ. Services Corp.*, 831 F.2d 395 (2d Cir. 1987).
Third Circuit	*In re Faish*, 72 F.3d 298 (3d Cir. 1995).
Fourth Circuit	*In re Frushour*, 433 F.3d 393, 400 (4th Cir. 2005) (adopting the *Brunner* test for Chapter 7); *Ekenasi v. Educ. Res. Inst.*, 325 F.3d 541, 546-49 (4th Cir. 2003) (applying the *Brunner* test in Chapter 13).
Fifth Circuit	*In re Gerhardt*, 348 F.3d 89, 91 (5th Cir. 2003).
Sixth Circuit	*Oyler v. Educ. Credit Mgmt. Corp.*, 397 F.382, 385 (6th Cir. 2005).
Seventh Circuit	*Matter of Roberson*, 999 F.2d 1132, 1135 (7th Cir. 1993); *but see Krieger v. Educational Credit Management Corp.*, 713 F.3d 882 (7th Cir. 2013) (referring to language in *Roberson* and *Brunner* as "judicial glosses" on § 523(a)(8)).
Ninth Circuit	*Hedlund v. Educational Resources Institute Inc.*, 718 F.3d 848, 851 (9th Cir. 2013).
Tenth Circuit	*Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1308-1309 (10th Cir. 2004) (adopting a version of the *Brunner* test where "the terms of the test must be applied such that debtors who truly cannot afford to repay their loans may have their loans discharged").
Eleventh Circuit	*In re Cox*, 338 F.3d 1238, 1241 (11th Cir. 2003).
Totality of the Circumstances Test	
Eighth Circuit	*Long v. Educ. Credit Mgmt. Corp.*, 322 F.3d 549 (8th Cir. 2003).
Unknown	
First Circuit	*In re Nash*, 446 F.3d 188, 190 (1st Cir. 2006) (refusing to adopt definitively either the *Brunner* or the totality of the circumstances test).

Brunner Test

The Second Circuit first articulated the "*Brunner* test" to analyze undue hardship in 1987.[31] Under *Brunner*, the debtor must show: (1) he or she 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) 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) he or she has made good faith efforts to repay the loans.[32]

1. Inability to Maintain Minimal Standards of Living

Courts have held the following circumstances as sufficient to meet the first prong of the *Brunner* test:

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[31] *Brunner v. New York State Higher Educ. Services Corp.*, 831 F.2d 395 (2d Cir. 1987).

[32] *Id.*

- Being unemployed, living with parents, and having a sole income consisting of Social Security benefits.[33]
- Having reasonable recurring expenses and/or total debt (excluding student loan debt), which outweigh income and/or total assets.[34]
- Living consistently below the poverty line.[35]

Courts have been careful to note, however, that the first prong does not require the debtor to live in abject poverty.[36] Nonetheless, it "requires more than a showing of tight finances," and is not met "merely because repayment of the borrowed funds would require some major personal and financial sacrifices."[37]

<u>2. Circumstances Indicating the State of Affairs Are Likely to Persist</u>

Courts have found the following situations as adequate to meet the second prong of the *Brunner* test:

- Suffering from serious medical conditions such as avascular necrosis,[38] or chronic depression and back problems,[39] which make employers reluctant to hire the debtor.
- Experiencing a sudden change in circumstances rendering the debtor unable to reenter his or her previous career.[40]

Courts have held that the following circumstances do *not* meet the second prong:

- Where there is evidence of a prior ability to work while suffering from the same medical condition that allegedly precludes the debtor from working now.[41]
- An employment history of "good jobs" without an indication of why the debtor could not return to those jobs.[42]

<u>3. Good Faith Efforts to Repay</u>

Courts have examined the following factors in analyzing the third prong of the *Brunner* test:

- Consistent efforts to obtain employment.[43]

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[33] *In re Traversa*, 444 Fed.Appx. 472 (2d Cir. 2011).

[34] *In re Mason*, 464 F.3d 878 (9th Cir. 2006) (prong met where $1,300-1,340 in monthly expenses, excluding student loan payments, outweighed $1,000-1,200 in monthly income); *Goulet v. Educational Credit Management Corp.*, 284 F.3d 773 (7th Cir. 2002) (prong met where $5,904 in annual expenses, excluding student debt, outweighed $1,490 in annual income); *In re Roberson*, 999 F.2d 1132 (7th Cir. 1993) (prong met where unemployed debtor had $34,395 in debt compared to $18,357 in shared assets with an ex-spouse).

[35] *In re Mosley*, 494 F.3d 1320, 1325 (11th Cir. 2007).

[36] *In re Hornsby*, 144 F.3d 433, 438 (6th Cir. 1998); *In re Nary*, 253 B.R. 752, 763 (N.D. Tex. 2000); *In re Lebovits*, 223 B.R. 265, 271 (Bankr. E.D.N.Y. 1998).

[37] *In re Faish*, 72 F.3d 298, 306 (3d Cir. 1995).

[38] *Barrett v. Educational Credit Management Corp.*, 487 F.3d 353, 356 (6th Cir.2007).

[39] *Mosley*, 494 F.3d at 1326.

[40] *U.S., U.S. Dept. of Educ. v. Al-Riyami*, No. 3:14–CV–73–WKW, 2014 WL 1584481 (M.D. Ala. Apr. 21, 2014).

[41] *In re Traversa*, 444 Fed.Appx. 472, 475 (2d Cir. 2011).

[42] *In re Frushour*, 433 F.3d 393, 401 (4th Cir. 2005).

[43] *Mosley*, 494 F.3d at 1327.

- Efforts to maximize income and minimize expenses.[44]
- Whether the debtor willfully or negligently caused the default, or if it resulted from factors beyond his or her own control.[45]
- Timing of the bankruptcy filing (e.g. immediately after the education was completed).[46]

Participating in the Income-Contingent Repayment Program (ICRP) is also a factor in determining good faith efforts to repay.[47] However, courts are divided as to how important the factor is.[48] Some have apparently accepted it as a requirement,[49] whereas most others have explicitly rejected such a per se rule, even where the monthly payment would be $0.00.[50] At least three reasons are commonly advanced to explain why a per se requirement would be inappropriate:

- *Tax Implications*: Several courts have noted that, even with $0.00 monthly repayments, the debt forgiveness at the end of plan would create a significant tax debt obligation on the debtor, and thus contravene the "fresh start" policy underlying bankruptcy.[51] Others, however, have refused to consider the future tax implications.[52]
- *Congressional Intent*: Courts have also invoked congressional intent to justify rejecting ICRP enrollment as dispositive of the good faith inquiry. Specifically, courts have argued that creating a per se rule requiring ICRP participation would deprive bankruptcy courts of their proper discretion, effectively transferring the power instead to an administrative agency.[53]

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[44] *Tetzlaff v. Educational Credit Management Corp.*, 521 B.R. 875, 880 (E.D. Wis. 2014) (holding that debtor did not meet the good faith prong because his "energy over the last several years has been directed at making excuses for failure-far in excess of what would be reasonable and not very convincing ones-rather than securing appropriate employment.").

[45] *In re Coco*, 335 Fed.Appx. 224, 226-227 (3d Cir. 2009).

[46] *In re Fields*, 286 Fed.Appx. 246, 250 (6th Cir. 2007); *In re Ekanasi*, 325 F.3d 541, 547-548 (4th Cir. 2003).

[47] *See, e.g.*, *In re Mason*, 464 F.3d 878 (9th Cir. 2006); *In re Tirch*, 409 F.3d 677 (6th Cir. 2005).

[48] *See* Terrence L. Michael & Janie M. Phelps, *"Judges?!--We Don't Need No Stinking Judges!!!": The Discharge Of Student Loans In Bankruptcy Cases And The Income Contingent Repayment Plan*, 38 Tex. Tech L. Rev. 73 (2005-2006).

[49] *See, e.g.*, *In re DeRose*, 316 B.R. 606, 609 (Bankr. W.D.N.Y. 2004).

[50] *In re McLaney* 375 B.R. 666 (M.D. Ala. 2007); *In re Johnson*, 299 B.R. at 676 (Bankr. M.D. Ga. 2003); *see also In re Durrani*, 311 B.R. 496, 506 (Bankr. N.D. Ill. 2004).

[51] *In re Coco*, 335 Fed.Appx. 224, 228 (3d Cir. 2009) ("[A]ny discharged portion of [the debtor's] loan would be treated as taxable income at the time of the discharge, [meaning that] participation in the ICRP could ultimately result in [the debtor] simply trading a student loan debt for an IRS debt."); *In re Rutherford*, 317 B.R. 865, 881 (Bankr. N.D. Ala. 2004) ("[E]ven if the remaining loan balance is cancelled . . . the unpaid amount including interest is then treated as taxable income to the borrower, which may result in a large amount of nondischargeable tax debt.").

[52] *DeRose*, 316 B.R. at 608 ("[T]he Court will not address what the IRS might make of the tax consequence of the loan 'cancellation'").

[53] *In re Crawley*, 460 B.R. 421, 483 (Bankr. E.D. Pa. 2011) ("To hold otherwise would make eligibility in the ICRP outcome determinative in undue hardship determinations . . . and would result in the delegation to an administrative

- *Psychological Burden*: A few courts have also acknowledged the psychological burden that student debts may produce, even absent any monthly payment.[54]

Totality of the Circumstances Test

The Eighth Circuit first developed the "totality of the circumstances" test as a more flexible alternative to the *Brunner* test for undue hardship.[55] It is the only circuit to have explicitly adopted the test, which examines: (1) the debtor's past, present and likely future financial resources; (2) her reasonably necessary living expenses; and (3) "any other relevant facts and circumstances."[56]

Courts have reiterated that, under this test, "fairness and equity require each undue hardship case to be examined on the unique facts and circumstances that surround the particular bankruptcy."[57] Thus, the elements are better characterized as aspects that must be viewed together, rather than individual prongs that must each be met. Still, courts have provided some guidance on what they look for under each part of the test.

1. Past, Present and Likely Future Financial Resources

Courts have held the following conditions as indicative of undue hardship:

- Lack of valuable, liquid assets.[58]
- Inability to maintain reliable employment.[59]

Courts have been unpersuaded on the question of undue hardship by the following situations:

- Income surpluses (above reasonable living expenses).[60]
- Past medical problems that no longer preclude employment.[61]

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agency, the Department of Education, the authority to determine the dischargeability of certain student loans."); *In re Johnson*, 299 B.R. 676, 682 (Bankr. M.D. Ga. 2003) ("If the . . . willingness to participate in the IRCP [sic] were determinative of good faith, the careful reasoning and consideration the Court is required to give a Section 523(a)(8) analysis would be replaced by an administrative agency's formula that would attempt to account for the specific circumstances of individual debtors.").

[54] *Durrani*, 311 B.R. at 508 ("The psychological and emotional toll on a debtor that results from adding 25 years to the life of a student loan should not be overlooked."); *In re Fahrer*, 308 B.R. 27, 36 (Bankr. W.D. Mo. 2004) ("Another factor which this Court may take into consideration . . . is the psychological and emotional impact of the Debtor's continuing liability for the repayment of such a large sum of money over such an extended period of time.").

[55] *Long v. Educ. Credit Mgmt. Corp.*, 322 F.3d 549, 554 (8th Cir. 2003).

[56] *Id.*

[57] *Id.*

[58] *In re Pollard*, 306 B.R. 637, 649 (Bankr. D. Minn. 2004).

[59] *In re Strand*, 298 B.R. 367, 374 (Bankr. D. Minn. 2003).

[60] *Pollard*, 306 B.R. at 648.

2. Reasonably Necessary Living Expenses

Eighth Circuit courts have expressed discomfort with the following expenses, which might be considered excessive:

- New cars.[62]
- Home additions.[63]
- Cable television.[64]
- Dining out excessively.[65]

3. Any Other Relevant Facts and Circumstances

The third element under the totality of the circumstances test serves as a general catchall, and often intertwines with considerations from the other two elements. Some issues that courts have discussed include:

- Youth and physical health.[66]
- Substantial obligations to dependents.[67]
- Mental health.[68]

Eighth Circuit courts appear to agree that ICRP participation is only one among many factors that should be considered when analyzing undue hardship.[69] Of the courts that have expressly rejected a per se rule, many have employed similar rationales to those in other circuits.[70]

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[61] *In re Parker*, 328 B.R. 548, 553 (B.A.P. 8th Cir. 2005).

[62] *In re Walker*, 650 F.3d 1227, 1234 (8th Cir. 2011).

[63] *Id.*

[64] *See In re Johnson*, No. 5:12–bk–74167, 2014 WL 7011097, at *5 (Bankr. W.D. Ark. April 30, 2014); *but see In re Frushour*, 433 F.3d 393, 400-401 (4th Cir. 2005) (holding that a per se bar against internet or cable expenses would be too harsh under the *Brunner* test).

[65] *Id.*

[66] *Educational Credit Management Corp. v. Jesperson*, 571 F.3d 775, 780 (8th Cir. 2009).

[67] *Id.*

[68] *In re Reynolds*, 425 F.3d 526, 533 (8th Cir. 2005).

[69] *See, e.g.*, *In re Cumberworth*, 347 B.R. 652, 661 (B.A.P. 8th Cir. 2006) ("[T]he debtor's ability or inability to take advantage of an income contingent repayment plan is simply one of many factors that the bankruptcy court should consider."); *In re Strand*, 298 B.R. 367, 376 (Bankr. D. Minn. 2003) (rejecting a bright line rule requiring ICRP participation).

[70] *In re Limkemann*, 314 B.R. 190, 195-196 (Bankr. N.D. Iowa 2004) (noting that a per se rule would eliminate the court's discretion in an undue hardship determination); *In re Fahrer*, 308 B.R. 27, 36 (Bankr. W.D. Mo. 2004) (noting the emotional and psychological impact of the continuing liability for a large debt); *Strand*, 298 B.R. at 376-377 (acknowledging the enormous tax liability remaining at the end of the ICRP).

APPENDIX C: FFELP and Perkins Regulations for Undue Hardship Adversary Proceedings

FFELP loans 34 C.F.R § 682.402(i)(1)

Education regulations currently require Title IV guarantors and schools to evaluate undue hardship requests filed by borrowers in bankruptcy:

(ii) In all other cases, the guaranty agency must determine whether repayment under either the current repayment schedule or any adjusted schedule authorized under this part would impose an undue hardship on the borrower and his or her dependents.

(iii) If the guaranty agency determines that repayment would not constitute an undue hardship, the guaranty agency must then determine whether the expected costs of opposing the discharge petition would exceed one-third of the total amount owed on the loan, including principal, interest, late charges, and collection costs. If the guaranty agency has determined that the expected costs of opposing the discharge petition will exceed one-third of the total amount of the loan, it may, but is not required to, engage in the activities described in paragraph (i)(1)(iv) of this section.

(iv) The guaranty agency must use diligence and may assert any defense consistent with its status under applicable law to avoid discharge of the loan. Unless discharge would be more effectively opposed by not taking the following actions, the agency must—

(A) Oppose the borrower's petition for a determination of dischargeability; and

(B) If the borrower is in default on the loan, seek a judgment for the amount owed on the loan.

(v) In opposing a petition for a determination of dischargeability on the grounds of undue hardship, a guaranty agency may agree to discharge of a portion of the amount owed on a loan if it reasonably determines that the agreement is necessary in order to obtain a judgment on the remainder of the loan.

Perkins loans 34 CFR §674.49(c)

Education regulations similarly require institutional Title IV guarantors and schools to evaluate undue hardship requests filed by borrowers in bankruptcy:

(1) The institution must use due diligence and may assert any defense consistent with its status under applicable law to avoid discharge of the loan. The institution must follow the procedures in this paragraph to respond to a complaint for a determination of dischargeability under 11 U.S.C. 523(a)(8) on the ground that repayment of the loan

would impose an undue hardship on the borrower and his or her dependents, unless discharge would be more effectively opposed by avoiding that action.

(2) [omitted]

(3) In any other case, the institution must determine, on the basis of reasonably available information, whether repayment of the loan under either the current repayment schedule or any adjusted schedule authorized under subpart B or D of this part would impose an undue hardship on the borrower and his or her dependents.

(4) If the institution concludes that repayment would not impose an undue hardship, the institution shall determine whether the costs reasonably expected to be incurred to oppose discharge will exceed one-third of the total amount owed on the loan, including principal, interest, late charges and collection costs.

(5) If the expected costs of opposing discharge of such a loan do not exceed one-third of the total amount owed on the loan, the institution shall—

(i) Oppose the borrower's request for a determination of dischargeability; and

(ii) If the borrower is in default on the loan, seek a judgment for the amount owed on the loan.

(6) In opposing a request for a determination of dischargeability, the institution may compromise a portion of the amount owed on the loan it if reasonably determines that the compromise is necessary in order to obtain a judgment on the loan.

APPENDIX D: STUDENT LOAN REPAYMENT AND ADMINISTRATIVE DISCHARGE OPTIONS

a. Repayment Options (all options not available for all loans depending on loan origination and/or loan type) 34 C.F.R. §§ 682.209 & 685.208
    i. Standard Repayment 34 C.F.R. § 685.208(b, c & j)
    ii. Extended Repayment 34 C.F.R. § 685.208(d, e & i)
    iii. Graduated Repayment 34 C.F.R. § 685.208(f, g, h, I & j)
    iv. Income-Driven Repayment
        1. Income-Sensitive Repayment 34 C.F.R. § 682.209(m)
        2. Income-Contingent Repayment 34 C.F.R. § 685.208(k) & 685.209(b)
        3. Income-Based Repayment 34 C.F.R. §§ 682.215 & 685.208(m)
        4. Pay As You Earn (PAYE) 34 C.F.R. § 685.209(a)
    v. Alternative Repayment 34 C.F.R. § 685.208(l)

b. Administrative Discharge Options (esp. TPD)
    i. Death Discharge 34 C.F.R. § 682.402(b); 34 C.F.R. § 685.212(a)
    ii. Total and Permanent Disability Discharge (TPD) 34 C.F.R. § 682.402(c); 34 C.F.R. § 685.213
    iii. Closed School Discharge 34 C.F.R. § 682.402(d); 34 C.F.R. 685.214
    iv. False Certification Discharge 34 C.F.R. § 682.402(e); 34 C.F.R. § 685.215 (to include False Certification Ability to Benefit, Unauthorized Signature or Identity Theft)
    v. Unpaid Refund Discharge 34 C.F.R. § 682.402(l); 34 C.F.R. § 685.216
    vi. Borrower Defense 34 C.F.R. § 685.206

c. Forbearance, Deferment and Rehabilitation