


INCONSISTENCY IN JUDICIAL INTERPRETATIONS OF UNDUE HARDSHIP

The complications of student loan discharge through bankruptcy

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THE LANDSCAPE OF STUDENT LOAN DEBT

- National Student Loan Debt has surpassed \$1 trillion
 - FY 2009 national student loan cohort default rate rose to 8.8% (Dept. of Ed.)
 - Public Colleges/Universities - 7.2%
 - For-profit colleges - 15%
 - ECMC study of 72,000 student loans
 - 276 - attempted loan discharge
 - 29 - granted successful partial or total discharge
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METHODOLOGY

- **51 US Court of Appeals Cases from 1981-2011**
- **Exploratory Legal Analysis :**
 - Which party won cases? (Creditor or debtor)
 - What undue hardship test was used?
 - Nuances from district to district?
 - Problems and conflicts? Successes?

HISTORY OF BANKRUPTCY AND STUDENT LOANS

- **Bankruptcy Act 1898 – “Fresh Start Principle”**
- **Bankruptcy Code of 1978 – “Undue Hardship”**
 - 11 USC 523 (a)(8)
- **Bankruptcy Abuse Prevention and Consumer Protection Act - 2005**
 - Private Loans Included in Bankruptcy Code

CONTROVERSY: SHOULD STUDENT LOANS BE TREATED DIFFERENTLY FROM OTHER DEBT?

LENDER RIGHTS

- Lenders should be paid back
- Don't force students to go to college
- Students should consider what debt is manageable

STUDENT RIGHTS

- Bankruptcy – “fresh start”
- Cost of college increasing, financial aid shrinking
- Student loan debt greater than credit card debt

WHAT IS UNDUE HARDSHIP?

- Congress left definition open to judicial interpretation
- 4 tests have emerged to measure “undue hardship”
 - 1979, 3rd Circuit - Johnson Test (5 Bankr. Ct. Dec 532)
 - 1981, 8th Circuit - Andrews/Totality of Circumstances Test (661 F. 2d 702)
 - Apr. 1987, 3rd Circuit – Bryant Poverty Test (72 B.R. 913)
 - Oct., 1987, 2nd Circuit – Brunner Test (831 F.2d 395)

CURRENT UNDUE HARDSHIP TESTS

BRUNNER

3 prong test:

1. Minimum standard of living and ability to pay loan on current income/expenses
2. Evidence ability to pay will not change over time
3. Good faith effort to repay loans

ANDREWS TOTALITY OF CIRCUMSTANCES

- Holistic examination of debtor's ability to repay loans
- Current income, health, overall finances, earning potential, good faith efforts, unique circumstances, educational debt compared to total debt

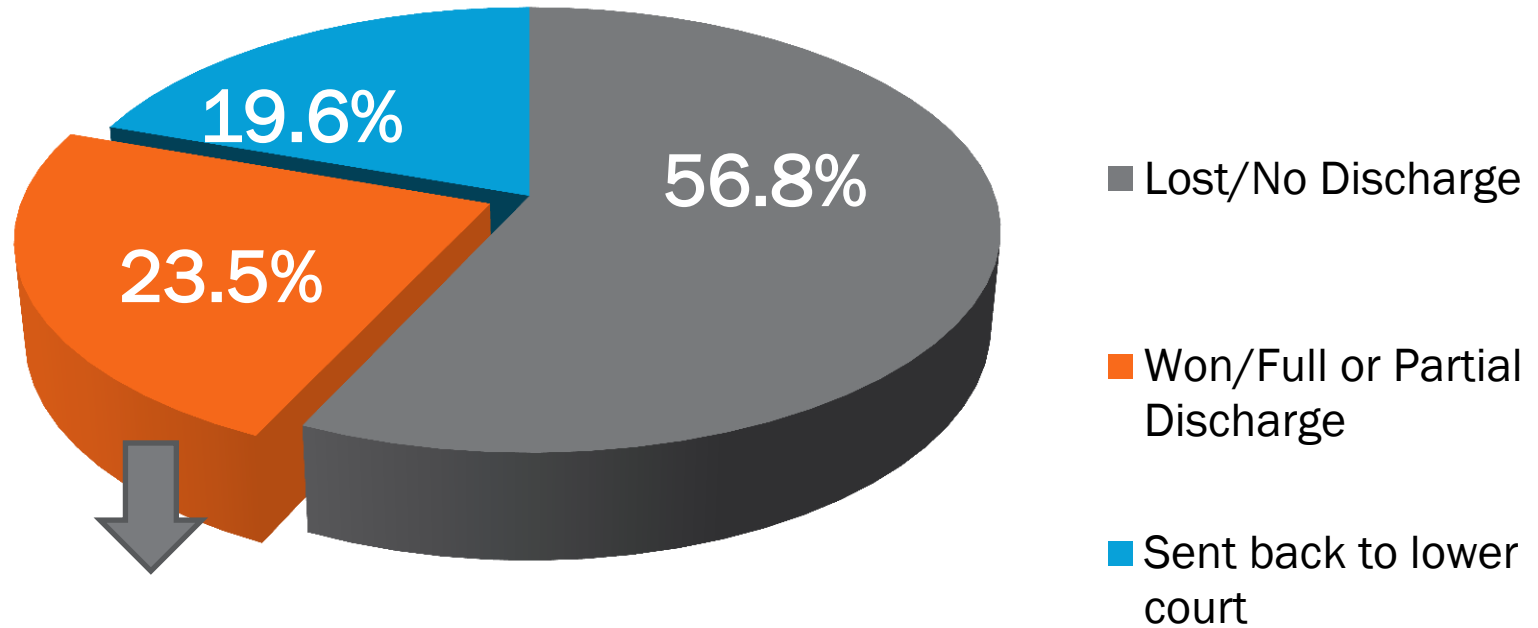
SAMPLE UNDUE HARDSHIP CASES

- Educational Credit Management Corporation v. Mark A. Jespersen, 2009, 571 F. 3d 775 (**Totality of Circumstances**)
- Noreen E. Nash v. Connecticut Student Loan Foundation et al. 2006, 446 F. 3d 188 (**Totality of Circumstances**)
- Jerry L. Roberson v. Illinois Student Assistance Corporation, 1993, 999 F. 2d 1132 (**Brunner**)
- Roger J. Traversa v. Educational Credit Management Corporation, 2011, U.S. App. Lexis 21938 (**Brunner**)

PROBLEM 1 – THERE IS NO UNIVERSAL STANDARD FOR MEASURING STUDENT LOAN ELIGIBILITY FOR BANKRUPTCY.

- **Circuit Split between Totality of Circumstances and Brunner Tests**
 - 1st Circuit and 8th Circuit – Totality of Circumstances
 - This includes 11 out of the 50 states
 - 1st Circuit – ME, NH, MA, RI
 - 8th Circuit – ND, SD, MN, NE, IA, MO, AR
 - All other Circuits – Brunner
 - This includes other 39 states

FINAL RULINGS OF APPEALS CASES




Full 15.7%
Partial 7.8%

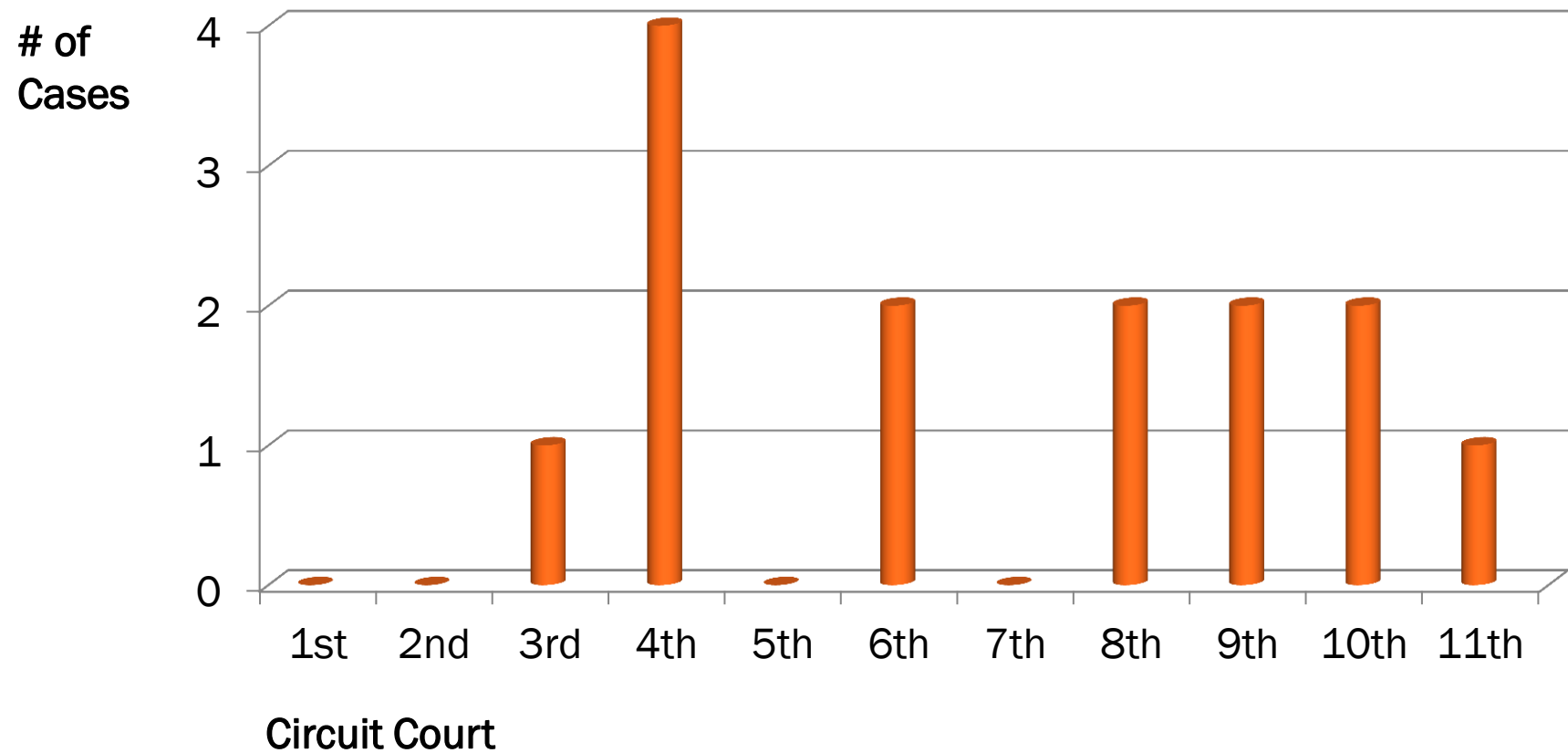
PROBLEM 2 – SOME COURTS ALLOW PARTIAL LOAN DISCHARGE WHILE OTHERS TAKE ALL OR NOTHING APPROACH

- 2 philosophies on loan discharge:
 - If there is undue hardship, all of the loan is discharged
 - If there is undue hardship, court can determine if part or all of the loan should be discharged


PROBLEM 3 – JUDGES HAVE PLACED A HIGHER BURDEN ON DEBTORS TO PROVE GOOD FAITH ATTEMPTS DUE TO NEW LOAN REPAYMENT PROGRAMS

- Debate over whether IBR/ICRP/Consolidation should be good faith factor
 - These programs do not address private loan debt
 - IBR with loan forgiveness is a new program, will not see actual discharge until 2034
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IBR/ICR/CONSOLIDATION IN GOOD FAITH CONSIDERATION SINCE 2004-2011 (28 CASES)



RECOMMENDATIONS

- Further discussion needed on where student loans belong in bankruptcy law.
 - Current tests for undue hardship need to be re-evaluated for fairness and consistency (i.e. “certainty of hopelessness” and “good faith standard”)
 - There should be one national test for undue hardship and the test should be applied consistently.
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FRAMEWORK OF ACCOUNTABILITY

