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The indentured generation: bankruptcy and student loan debt

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THE INDENTURED GENERATION: BANKRUPTCY AND STUDENT LOAN DEBT

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INTRODUCTION

A generation of Americans has borrowed heavily for their education, and hundreds of thousands of them are deeply in debt. Some 37 million Americans owe a total of approximately $1 trillion dollars in student loans.[1] They constitute an Indentured Generation as many of them will be burdened with student loan debt for much of their lives.[2] Some will eventually pay their loans, many will default, and others will receive loan modification or partial loan forgiveness. By and large, their participation in the credit economy will be severely limited. Members of the Indentured Generation who are in particularly dire circumstances will turn to bankruptcy for a "fresh start." But, with few exceptions, student loan debtors will not get relief through bankruptcy. The relief that is provided for most debts under the United States Bankruptcy Code ("Code") is not available for student loan debt. Because of this, education debt servitude will last a lifetime for tens of thousands of Indentured Generation.

Some experts warn of a "student loan bubble,"[3] while others downplay the potential of a mortgage-loan style meltdown.[4] Nonetheless, the numbers associated with education debt are

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[1] *Student loan debt surpasses $1 trillion*, USA Today, October 19, 2011, at 1.

[2] The concept of student borrowers becoming an indentured class is not new. Rep. William D. Ford (D.Mich) may have first coined the term during the passage of the 1965 Higher Education Act: "We are producing a class of indentured servants who must work to free themselves from the bondage of educational debts. How will the next generation afford a home or car if their disposable income is committed to paying off student loans?" (Cited in Janet Lorin *Indentured Students Rise As Loans Corrode College Ticket*, Bloomberg.com, July 9, 2012, *available at* http://www.bloomberg.com/news/2012-07-09/indentured-students-rise-as-loans-corrode-college-ticket.html. (accessed July 12, 2012)). In 1989, Senator Claiborne Pell, Chairman of the Labor and Human Resources Subcommittee on Education, Arts, and Humanities, warned that students who completed college with large debts were at risk of becoming a "new class of indentured servants." (Cited in Catherine M. Millett, *How Undergraduate Loan Debt Affects Application and Enrollment in Graduate or First Professional School*, Journal of Higher Education, Vol. 74, No. 4 (Jul. – Aug., 2003) at 386-427, *available at* http://www.jstor.org/stable/3648243 (accessed on January 16, 2012)).

[3] *See, e.g.*, *Student Loan Debt Crises Survey*, National Association of Consumer Bankruptcy Attorneys, February 7, 2012, *available at* http://www.nacba.org/Legislative/StudentLoanDebt.aspx (accessed April 19, 2012). The report notes that 81% of consumer bankruptcy attorneys say that clients with student loan debt have increased noticeably within the past four years, and that the effective lack of bankruptcy discharge for these debts prevents debtors from obtaining a financial fresh start. *See also*, Daniel Wagner, CFPB: Private Student Loans Parallel Subprime Mortgage Lending, Huffpost, July 20, 2012 *available at* http://www.huffingtonpost.com/2012/07/20/cfpb-private-student-loans-subprime-mortgage_n_1688771.html (accessed August 17, 2012). The article states that private student loan lenders gave loans without regard to whether students could pay, then bundled and resold the loans. Of course, the federal government also makes loans for education without regard to whether the borrower can repay.

[4] *See, e.g.*, Morgan Housel, *Student Loan Bubble: Not as Bad as it Looks*, The Motley Fool, June 1, 2012, *available at* http://www.dailyfinance.com/2012/06/01/student-loan-bubble-not-as-bad-as-it-looks/ (accessed July 9, 2012) . The article states that from 2000 to 2010, that average debt per borrower at public college bachelor's degree recipients increased only 1.1% above inflation, and 2.2% above inflation at private nonprofit colleges. In contrast, mortgage debt during the housing bubble increased at 10% above the rate of inflation. *See also*, Tami Luhby, *There is no student loan 'crises.'* CNN Money, March 30, 2012, available at

staggering. Thirty-seven million Americans--some 19.9% of American households—owe student loans.[5] The average debt load for a four-year college graduate in the class of 2010 was more than $25,250.[6] Students in graduate school borrow much more, averaging over $43,500[7] and individual loan debt exceeding $150,000 is not uncommon.[8] Many middle-aged and senior citizens also have student loan debt, in addition to parents and relatives who have co-signed student loans.[9] As of 2012, less than 40% of student loan debt was in repayment status according to the original terms, and a recent study finds that approximately 21% of current student loans are delinquent or in default.[10]

Compounding the problem is that new graduates are entering one of the worst job markets in decades. The unemployment rate in 2009 for college graduates was 8.7%, but by 2010 it was at 9.1%.[11] Unable to find jobs, unprecedented numbers of young people are moving in with parents, postponing marriage and children, working unpaid, temporary, or part-time jobs, and taking similar steps that would have been unthinkable for prior generations. As a result of financial stress, student loan debtors experience high levels of personal depression, family dysfunction, and adverse health effects, and are delaying or forgoing marriage, children, and major purchases.[12]

While federal repayment and loan forgiveness programs can help some borrowers, for many debtors these measures fall far short of addressing the crushing burden of student loan debt. But there is an effective means to address the problem. Consumer bankruptcy under the Code adjudicates millions of dollars of debt each day.[13] But the Code excludes education loans from discharge unless the debtor proves that paying the debt would result in "undue hardship."[14]

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http://money.cnn.com/2012/03/30/news/economy/student-loans/index.htm (accessed March 30, 2012). The article asserts that most student loan debt is manageable, and that only 10% of borrowers have more than $45,000 in loans.

[5] Meta Brown, et al, "Grading Student Loans," http://libertystreeteconomics.newyorkfed.org/2012/03/grading-student-loans.html/ (July 9, 2012). A chart showing the increase in households with education loan debt is in Federal Reserve Bank 2010 Survey of Consumer Finances (SCF) Chartbook, p. 1082, *available at* http://www.federalreserve.gov/econresdata/scf/files/2010_SCF_Chartbook.pdf. http://www.federalreserve.gov/econresdata/scf/files/2010_SCF_Chartbook.pdf

[6] Student Debt and the Class of 2010, The Institute for College Access & Success, November 3, 2011, *available at* http://projectonstudentdebt.org/pub_view.php?idx=791 (accessed August 17, 2012).

[7] Annamarie Andriotis, Grad School: Higher Degrees of Debt, Wall Street Journal, May 16, 2012, *available at* http://online.wsj.com/article/SB10001424052702304192704577406652556893064.html (accessed August 17, 2012).

[8] For example, medical students graduating in 2011 had average debt of $162,000. AAMC Medical Student Education: Costs, Debt, and Loan Repayment, October 2011, available at https://www.aamc.org/download/152968/data/debtfactcard.pdf (accessed August 17, 2012). Law school grads the same year averaged $100,584, with some schools as high as $165,000. Sam Favate, *Law Students, How Much Debt Do You Want?* Wall Street Journal, March 23, 2012, available at http://blogs.wsj.com/law/2012/03/23/law-students-how-much-debt-do-you-want/ (accessed on August 17, 2012).

[9] *See infra* notes 40-43 and accompanying text.

[10] Brown, *supra* note 5. This does not include loans that have already been charged off.

[11] Student Loan Project, *Student Loan Debt and the Class of 2010*, The Institute for College Access & Success, November 2011 at 1, available at http://projectonstudentdebt.org/files/pub/classof2010.pdf (accessed July 20, 2012).

[12] *See infra* notes 411-418 and accompanying text.

[13] Over 1.4 million consumer bankruptcy cases were filed in FY 2011. http://www.uscourts.gov/News/NewsView/11-11-07/Bankruptcy_Filings_Down_in_Fiscal_Year_2011.aspx (accessed August 17, 2012).

[14] 11 U.S.C. §523(a)(8).

The purpose of this policy is to prevent students from fraudulently obtaining student loans and then speedily discharging them upon graduation, as well as to ensure that there is a pool of funds for access to higher education.[15] Consequently, courts have found that "undue hardship" is a very strict standard for which few debtors qualify.[16]

Consumer bankruptcy can serve an important role in addressing the problem of student loan debt, while at the same time remaining true to the purposes behind the no-discharge policy. The Bankruptcy Code should be amended to allow a student loan to be revalued to the actual fair market value of the loan. The fair market value would be nondischargeable, and the remaining balance of the loan would dischargeable as general unsecured debt. This ensures that debtors who can pay their student loans will do so, and it will help alleviate some of the misery of the Indentured Generation.

The article will proceed as follows: Part I introduces the "Indentured Generation," including an overview of the student loan industry, repayment and forgiveness programs, current repayment and default trends, and profiles of individual debtors. Part II looks at how student loan debt is treated in bankruptcy, including the various tests developed by courts to determine "undue hardship." Part III considers the economic and social implications of a student loan indentured class. Part IV offers a partial solution to the student loan crises by amending the Code to allow education loan debt to be modified to its fair market value, with the remainder treated as dischargeable debt.

I. THE INDENTURED GENERATION

A. Mortgaging the Future: Education Cost and Education Debt

Since 1990, the cost of education has mushroomed far in excess of the cost of living. In 1990-91, the cost of tuition, room, and board at an average four-year public college was $8,403, and $21,218 for a private four-year college.[17] As of 2000-01, this increased to $10,609 for a public college, and $26,795 for a private one.[18] By 2011-12, these numbers were $17,131 and $38,589, respectively.[19] For another perspective, in January 2000 the cost of education and the consumer price index were both at 100. As of July 2012, CPI stood at 135, while the cost of education had increased to 196.[20] The cost of a college education has risen by three times the

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[15] *See infra* notes 217-223 and accompanying text.
[16] *See infra* notes 243-306 and accompanying text.
[17] National Center for Education Statistics, Fast Facts, *available at* http://nces.ed.gov/fastfacts/display.asp?id=76, accessed on February 28, 2012.
[18] *Id*.
[19] Standard & Poor's, *Student Loan ABS Trends, Outlook and Panel Discussions*, June 19, 2012 at 11 *available at* http://www.standardandpoors.com/spf/upload/Events_US/US_SF_Event_61912slides.pdf (accessed July 20, 2012). The source of this data is The College Board, Trends in College Pricing 2011.
[20] S & P Student Loan ABS Trends, *supra* note 19 at 11. The data is from Bureau of Labor Statistics. *See also*, Department of Education, *Student Loans Overview , Fiscal Year 2013 Budget Request*, at R-18, *available at* http://www2.ed.gov/about/overview/budget/budget13/justifications/r-loansoverview.pdf (accessed July 11, 2012). For the period 2000-01 to 2010-11 (in constant 2011 dollars) private 4-year college increased by 27%, and public 4-year college increased by 49%.

cost of inflation since 1983.[21] Overall, the cost of higher education in America is among the highest in the world.[22]

To keep pace with skyrocketing education costs, students have been borrowing in ever greater numbers. In 1990 students that year took out $11.7 billion in loans to fund their educations.[23] By 2000-01, total education loan debt had risen to $43,453,000,000.[24] As of the first-quarter 2012, federal student loan debt stood at approximately $904 billion with private loans adding another $150 billion, surpassing both consumer credit card debt ($679 billion) and auto loan debt ($737 billion).[25] Students borrowed $103.9 billion in 2010-11 alone.[26] As of 2011, borrowing for education at non-profit schools averaged 42% of the cost of an education,[27] while the borrowing rate at 2-year for-profit schools may be as high as 98%.[28] The Department of Education expects new federally guaranteed student loans in 2013 to total $154.4 billion.[29] The fastest growth is for students at for-profit schools, even though students at these schools have a lower graduation rate, higher debt, and higher tendency to default on loans.[30]

The percentage of students borrowing for education has also expanded dramatically. In 1989-1900, students graduating from public four-year colleges averaged $8,200 in debt, while average debt at private colleges was $10,600.[31] In 1999-2000 the amounts increased to $15,100 and $16,500, respectively.[32] But over the decade 2000-02 through 2010-11, federal loans per full-time undergraduate student shot up at an average rate of 5% a year after adjusting for inflation, for a total increase of 57% for the decade.[33] As of 2010, 54% of students at public four-year colleges had borrowed for education, with an average debt of $22,000.[34] Of students earning bachelor's degrees at private non-profit institutions, about 66% had borrowed for their education, and the typical debt load was $28,100.[35] Averaging all four-year non-profit schools,

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[21] *The college-cost calamity*, The Economist, August 4, 2012, p. 57.
[22] *The indebted ones*, The Economist, October 29, 2011, p. 16.
[23] United States General Accounting Office, *Report to the Secretary of Education, Federal Student Aid: Timely Performance Plans and Reports Would Help Guide and Assess Achievement of Default Management Goals* (GAO-03-348, February 2003).
[24] The College Board *Trends in Student Aid* 2011, p. 10, *available at* http://trends.collegeboard.org/student_aid/ (accessed August 17, 2012).
[25] Standard & Poor's, "Student Loan ABS Trends, Outlook and Panel Discussions, p. 5 (June 19, 2012), *available at* http://www.standardandpoors.com/spf/upload/Events_US/US_SF_Event_61912slides.pdf (accessed July 20, 2012). The source of this data was FRBNY Consumer Credit Panel/Equifax. *See also*, Meta Brown, et al, "Grading Student Loans," http://libertystreeteconomics.newyorkfed.org/2012/03/grading-student-loans.html/ (July 9, 2012) for third quarter 2011 data; "Student loan debt surpasses $1 trillion," USA Today. October 19, 2011, p.1.
[26] Trends in Student Aid 2011, *supra* note 24 at 10.
[27] *Id.* at 17.
[28] Student Loans Overview, *supra* note 20, at R-18.
[29] *Id.* at R-17.
[30] *US Student Loan ABS Issuance Is Ticking Up, But the Future Is Uncertain Say Conference Speakers*, S & P Ratings Direct, June 26, 2012, p. 2 , *available at* http://www.standardandpoors.com/spf/upload/Events_US/US_SF_Event_619abs10.pdf (accessed July 20, 2012).
[31] Heather Boushey, *The Debt Explosion Among College Graduates*, Center for Economic and Policy Research, March 2003, p. 2, *available at* http://nces.ed.gov/pubsearch/getpubcats.asp?sid=013 (accessed August 17, 2012).
[32] *Id.*
[33] Trends in Student Aid, *supra* note 24, at 3, 4;
[34] *Id*. at 4.
[35] *Id.* at 4

the mean debt per student in 2010 was $25,250.[36] A typical undergraduate student received $4,907 in federal loans in 2010-11, while the average graduate student received $16,423 in federal loans during the same period.[37] For graduates obtaining professional degrees, the borrowing rate was much higher, with some 79% having obtained loans for school as of 2007-2008.[38] The plight of law school graduates, with an average debt load of $98,500 at graduation in 2010, has been well-noted in the press.[39] And none of the numbers cited here include private loans, which are more difficult to track.

It is not just younger people who go into debt for education. In recent years, education borrowing by people ages 35 to 49 has also grown rapidly.[40] In addition, parents are incurring debt to cover college costs for their children. In 1992-93, 5.6% of parents took out loans for their children's education. By 2010, that number had risen to 17%.[41] Loans to parents for their children's college education account for approximately $100 billion, or about 10% of the estimated $1 trillion in education debt.[42] And many older people remain saddled with debt from their own college years. One study finds that people aged 60 and older hold $36 billion in student loan debt, of which some 10% is delinquent.[43]

Borrowing rates are different for-profit programs than at public and private institutions.[44] For example, as of 2009, only 15% students who started post-secondary studies at a four-year for-profit institution had earned a degree. And of those graduates, two-thirds had debt over $28,000.[45] In contrast, for dependent students who started at a public four-year institution, 64% had earned a bachelor's degree, but only 14% of them borrowed more than $28,000.[46] In 2008, students at proprietary schools studying for an associate's degree had median federal debt of approximately $14,045, compared to median debt level of $7,125 for students at private, not-for-

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[36] Student Debt Project, *Student Debt and the Class of 2010*, The Institute for College Access & Success, News Release, November 3, 2011, *available at* http://projectonstudentdebt.org/pub_view.php?idx=791 (accessed July 20, 2012).
[37] Trends in Student Aid, *supra* note 24 at 3.
[38] Jennie Woo, *The Expansion of Private Loans in Postsecondary Education*, National Center for Education Statistics, October 2011, p. 13, *available at* http://nces.ed.gov/pubs2012/2012184.pdf (accessed July 20, 2012).
[39] Lincoln Caplan, *An Existential Crises for Law Schools*, New York Times, July 14, 2012, *available at* http://www.nytimes.com/2012/07/15/opinion/sunday/an-existential-crisis-for-law-schools.html?src=recg&pagewanted=print (accessed July 19, 2012).
[40] Mitch Lipka, *Middle-aged borrowers piling on student debt*, Reuters, December 27, 2011, *available at* http://www.reuters.com/article/2011/12/27/us-studentdebt-middleage-idUSTRE7BQ0T620111227 (accessed July 19, 2012).
[41] Janet Lorin, *Parents Snared in $100 Billion College Debt Trap Risk Retirement*, Bloomberg, February 2, 2012, *available at* http://bloomberg.com/news/2012-02-02/parents-snared-in-100-billion-u-s-college-debt-trap-risking-retirement.html (accessed July 19, 2012).
[42] *Id*.
[43] Karen Datko, *Over 60 and still paying student loans*, MSN Money, April 5, 2012, available at http://money.msn.com/saving-money-tips/post.aspx?post=d921ed1b-2cda-4cdf-8289-9b6ec2ccc309&_blg=35 (accessed May 14, 2012).
[44] The New York Times maintains an interactive chart of average costs and average student debt based upon the university at http://www.nytimes.com/interactive/2012/05/13/business/student-debt-at-colleges-and-universities.html?ref=business. All cost data on the chart is provided by the respective schools, and many schools do not participate.
[45] Trends in Student Aid, *supra* note 24 at 18.
[46] *Id*. at 18.

profit schools.[47] Similarly, students seeking a bachelor's degree at proprietary four-year schools had median debt of $23,874, more than double the debt level of $11,580 for students at private non-profit schools, and five times the debt of $4,968 for students at public schools.[48]

Student loan debt is clearly concentrated in young adults. As of the third-quarter 2011, the total number of people in the U.S. with student loan debt was approximately 37 million.[49] Of people under the age of thirty, 40.1% have student loan debt, while among people between the ages of thirty and thirty-nine, 25.1% have student loan debt.[50] In contrast, only 7.4% of people over forty have student loan debt.[51] Overall, $580 billion of the $870 billion federal student loan balance is owed by people under the age of forty.

B. The Student Loan Industry

The student loan industry is a massive, profit-making enterprise. With loan assets of $1 trillion, and lending in 2013 exceeding $150 billion, the student loan business eclipses almost any private industry in annual sales.[52]

1. Federal Loan Programs

Federal funding for student loans began as a response to the Cold War and the launch of the Soviet Sputnik satellite in 1957.[53] Subsequent expansion included grants and loans to assist medical and health program students, the Guaranteed Student Loan Program (GLS) (1965),[54] Higher Education Amendments of 1972 (1972) to provide grants and loans for junior colleges, trade schools, and career colleges,[55] the Middle Assistance Act (1978) offering education grants and loans to middle-class families,[56] and the Parent Loans for Undergraduate Students Program (1981) which allowed families of all income levels to obtain loans for dependent students, albeit at higher interest rates. The GSL program was revised in 1988 to become the Federal Stafford Loan Program.[57] Its primary purpose was to provide low-cost loans guaranteed by the U.S. government. In 2007, the College Cost Reduction and Access Act[58] increased Pell grant amount, reduced interest rates on subsidized student loans, and capped loan repayment at 15% of discretionary income. One of the basic policies of federal education grant and loan programs is to make college accessible regardless of economic background.[59]

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[47] Department of Education Fiscal Year 2013 Request, *supra* note 20 at R-22.
[48] *Id.*
[49] Brown, *supra* note 5.
[50] *Id.*
[51] *Id.*
[52] Department of Education Fiscal Year 2013 Request, *supra* note 20 at R-3. New loans will be $121 billion, consolidations will be $28 billion, and private loans (15% of all student loans) will constitute the rest.
[53] Gareth Marples, *The History of Student Loans—Financial Aid for Economic Competition, available at* http://thehistoryof.net/history-of-student-loans-html (accessed on February 2, 2012)
[54] Higher Education Act of 1965. Pub. L. No. 89-329. Section 430(a), 79 Stat. 1219 (1965).
[55] Pub. L. 92-318.
[56] Middle Income Student Assistance Act, Pub. L. No. 95-566, 02 Stat. 2402 (1978).
[57] 20 U.S.C. §1071-87-4.
[58] College Cost Reduction and Access Act, Pub. L. No. 110-83, 121 Stat. 784 (2007).
[59] Roger Roots, *The Student Loan Debt Crises: A Lesson in Unintended Consequences,* 29 Sw. U. L. Rev. 501, 524 (2000) ("Far from the egalitarian results contemplated by the original proponents of the guaranteed student loan

Through 1993, private banks made student loans under the Stafford program, and the Department of Education would subsidize loans and reimburse banks if borrowers defaulted. The Stafford program was modified in 1993 with the creation of the Federal Family Education Loan Program (FFELP)[60] and the William D. Ford Federal Direct Loan program. FFELP continued the policy of students obtaining federally guaranteed loans through banks. However under the Ford loan program, students borrowed funds directly from participating schools, which received funds from the Department of Education. From 1993 to 2010, applicants for a Stafford loan could get their loans through either the Ford program or FFELP. Approximately 80% of all federal student loans were made through FFELP. Lenders under FFELP made loans without regard to the student's creditworthiness.[61] The federal government guaranteed the loan against default.[62] Today, federal loans constitute about 75% of all education loans, and 93% of all new loans made in 2010-2011.[63]

To entice private lenders to make loans to students, FFELP lenders were promised a guaranteed rate of return called the "special allowance rate." The special allowance rate was based upon an average of 3-month commercial paper rates, plus certain factors for loans in repayment or in deferment or grace.[64] This was in addition to the federal loan guarantee if the borrower defaulted.

A major restructuring of student loans took place in 2010 with the enactment of the Health Care and Education Reconciliation Act.[65] That act contains the Student Aid and Fiscal Responsibility Act ("SAFRA").[66] A key provision of SAFRA is to remove private banks as middlemen in the student loan process, which is intended to save the cost of subsidies and guarantees paid to banks, and then redirect that savings to need-based grants.[67] Loans are now made directly to students through the U.S. Department of Education, ending the FFELP program. For loans made before 2010, lenders receive the higher of the special allowance rate or the student interest rate set by the government for new student loans.[68] If the student rate is lower than the special allowance rate, the government makes up the difference. In the event that the student rate is higher, the lender pays the difference to the government.[69]

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program, the final effect of the program has been the growth, rather than the reduction, of socio-economic disparity between races, classes, and ethnic groups").

[60] 34 CFR 682.100 et seq.

[61] 20 U.S.C. §1078(c)(2)(F)(2000); 34 C.R.F. 682.404(h)(1)(2005).

[62] 20 U.S.C. §1071 (2000).

[63] Private Student Loans, Consumer Financial Protection Bureau, July 20, 2012, p. 9, *available at* http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf (accessed July 19, 2012).

[64] Department of Education Fiscal Year 2013 Budget Request, *supra* note 20 at R-8, R-9. While the specific rate could change for some loans, interest was capped at 8.25% for Stafford and Consolidation loans, and 9% for PLUS loans. *Id.*

[65] Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

[66] Student Aid and Fiscal Responsibility Act of 2009, H.R. 3221, 111th Cong. (2009).

[67] Under SAFRA, the role of private banks will be to service loans. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 2201-05, 124 Stat. 1029, 1074-75 (2010).

[68] Department of Education Fiscal year 2013 Budget Request, *supra* note 20 at R-8.

[69] *Id.* at R-8, R-9.

Currently, the federal government originates four types of loans: Subsidized Stafford, Unsubsidized Stafford, PLUS and Consolidation loans. The Subsidized Stafford loan offers the lowest interest rate, presently at 3.4%.[70] Borrowers must meet a financial needs test based on family income, and after July 1, 2012 graduate and professional students were no longer eligible for these loans.[71] The three other types of loans are available to borrowers at any income level.[72] Previously, the government paid the interest on the loan during the time the student was in college, as well as a six-month grace period following graduation, and for any deferment periods. However, as of July 1, 2012 students are charged interest immediately following graduation.[73]

Unsubsidized Stafford loans are made without regard to financial need. The interest rate was fixed at 6.8% for loans made after July 1, 2006, and the government does not pay any of the interest.[74] Students can defer payment of interest while in school, but accrued interest will be capitalized at the start of repayment.[75] PLUS Loans (Parents Plus) are available to parents with dependant undergraduate, graduate, and professional degree students. Interest is 7.9% and accrues immediately upon disbursement of the loan.[76] Plus Loan applicants may not have any adverse credit history.[77] Consolidation Loans are available for borrowers with existing loans in order to combine the loans and extend payment schedules and terms based on their total existing loans.[78] The interest on a Consolidation Loan is based upon the weighted average of all loans being consolidated, rounded up to the nearest 1/8 of 1%.[79]

Subsidized and Unsubsidized Stafford Loan amounts are capped as follows:

	Annual Limits	Annual Limits
Dependant Undergraduates	**Stafford**	**Total (Stafford & Unsubsidized Stafford)**
First-Year Student	$3,500	$5,500
Second-Year Student	$4,500	$6,500
Third-Year Student	$5,500	$7,500
Independent Undergraduates		
First-Year Student	$3,500	$9,500
Second-Year Student	$4,500	$10,500
Third-Year Student	$5,500	$12,500

[70] *Id.* at R-4. This rate was part of a phased reduction in rates from 6.8% in 2007 to 3.4% from July 1, 2011 to July 1, 2012. The rate was scheduled to revert to 6.8%, but a last-minute agreement to extend that 3.4% rate for one year was reached in Congress shortly before on the rate increase was to take effect. Reuters, *No more grace period on student-loan interest*, Chicago Tribune, June 28, 2012, available at http://www.chicagotribune.com/business/breaking/chi-no-more-grace-period-on-student-loans-20120628,0,4384922.story (accessed July 10, 2012).
[71] Department of Education, Fiscal Year 2013 Budget Request, *supra* note 20 at R4-R6.
[72] *Id*. at R-4.
[73] Reuters, *supra* note 70.
[74] Department of Education Fiscal Year 2013 Budget Request, *supra* note 20 at R-6.
[75] *Id.*
[76] *Id.*
[77] *Id.* at R-6.
[78] *Id.*
[79] *Id.*

Graduate Students	$8,500	$20,500
	Aggregate Limits	Aggregate Limits
Dependant Undergraduates	$23,000	$31,000
Independent Undergraduates	$23,000	$57,500
Graduate Students	$65,500	$138,500

Source: Department of Education, Student Loans Overview, Fiscal Year 2013 Budget Request at R-7

Education lending is an income-producing endeavor for the federal government. Profit is made on the spread between the government's borrowing rate, presently around 1%, and the subsidized lending rate, currently at 3.4% for the lowest rate Subsidized Stafford loan and increasing with other types of loans.[80] This is in addition to the origination fee of 1%.[81] The Department of Education anticipates that federal subsidized student loan activity (including new loans and consolidation of existing loans) will generate $38.9 billion in revenue for the government in 2012, and approximately $36.8 billion in 2013.[82] The federal government expects to earn 20.08% on each dollar of loans originated in 2013.[83]

2. Non-federal Student Loans

In addition to federal education loans, private lenders also loan money to students. About 2.9 million students currently have private loans.[84] Private loans peaked at $22 billion in 2007-2008, but dropped to $6 billion in 2010-2011 due to increased caps on federal loans and tighter lending standards.[85] Currently, private loans constitute approximately 14% of total student borrowing.[86] The total of private loans is $150 billion.[87]

A student might take out a non-federal loan if he has reached the annual or aggregate federal loan cap. Unlike federal loans, most of these are priced according to credit-worthiness standards, and there is no cap on interest rates.[88] Interest rates on private loans are usually much higher than federal loans,[89] with some as high as 15% or more.[90] Many private loans include

[80] *Id*. at R-3, R-4.
[81] *Id*. at R-4.
[82] *Id.* at R-2. The Congressional Budget Office estimates that 2012 loans and consolidations will generate $37 billion in revenue, which is slightly less than the Department of Education estimate. CBO Memorandum, March 13, 2012 Table 1, *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/43054_StudentLoanPellGrantPrograms.pdf (accessed July 9, 2012).
[83] Department of Education Fiscal Year 2013 Request, supra note 20 at R-14.
[84] Janet Lorin, *Students Pay SLM 9.25 on Exploitive Loans for College*, Bloomberg, June 5, 2012, *available at* http://www.bloomberg.com/news/print/2012-06-05/students-pay-slm-9-25-on-exploitive-loans-for-college.html (accessed June 6, 2012).
[85] *Id*.
[86] Standard & Poor's, *supra* note 19 at 7. The source of this data is The College Board, Trends in Student Aid 2011.
[87] Blake Ellis, *Private student loan debt reaches $150 billion*, CNN Money, July 20, 2012. http://money.cnn.com/2012/07/20/pf/college/private-student-loan-debt-cfpb/ (accessed July 20, 2012).
[88] NACBA Report, *supra* note 3 at 4.
[89] Lorin, *supra* note 84.

adjustable interest rates without caps that can be adjusted without notice.[91] There are no loan limits, but there also no deferments, income-contingent repayment, or any of the other relief available in federal loan programs. Private loans are considered riskier than federally guaranteed loans, yet more than half of student borrowers fail to max out government loans before incurring private loans.[92] Overall, student lending is a highly profitable business.[93]

The largest private lender is Student Loan Marketing Association (Sallie Mae). Established in 1972, Sallie Mae is financed by borrowing money, then relending to students at a higher rate.[94] Student Loan Asset Backed Securities ("SLABS") were invented by Sallie Mae in the early 1990s. These are securitized portfolios of student loans, similar to Fannie Mae securities backed by home mortgages. The assets behind the securities are the loans themselves. In 1990 there were $75.6 million Sallie Mae securities in circulation, in 2010 annual trading was $250 billion.[95] Up to 30% of student debt is securitized.[96]

Private lenders have been accused of offering schools incentives such as paid trips for financial aid officials and guests to conferences in vacation spots, gifts awarded through raffles, "set-asides" (loans for international students and those with poor credit), and even cash payments directly to schools in order to encourage schools to steer students to a lender's loan programs.[97] Reform measures subsequently curbed some, but not all of these abuses.[98]

3. Student loans and higher education costs: cause, effect, and cause again

Some commentators assert that the broad availability of education credit has itself fueled the increase in education costs. Known as the "Bennett Hypothesis," it postulates that increases in education credit creates more students with funds to go to college, so schools raise tuition in order to capture the increase in federal money.[99] It was first articulated by William Bennett, Education Secretary under Ronald Reagan, who wrote in a 1987 op-ed piece, "[i]ncreases in financial aid in recent years have enabled colleges and universities to raise their tuitions,

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[90] Sue Shellenbarger, *To Pay Off Loans, Grads Put Off Marriage, Children*, Wall Street Journal, April 17, 2012, *available at* http://online.wsj.com/article/SB10001424052702304818404577350030559887086.html (accessed, April 18, 2012).
[91] Woo, *supra* note 39 at 5.
[92] Shellenbarger, *supra* note 90.
[93] Lorin, *supra* note 84.
[94] William S. Howard, *The Student Loan Crises and the Race to Princeton Law School*, 7 J. L. Econ. & Pol'y 485 (2011) at 503.
[95] Malcolm Harris, *Bad Education*, in Generation of Debt: the university in default & the undoing of campus life, Reclamations Journal 8-41 at 9 (September 2011), *available at* http://nplusonemag.com/bad-education (accessed April 19, 2012).
[96] *Id.*
[97] Jonathan D. Glater, *Offering Perks, Lenders Court Colleges' Favor*, New York Times, October 24, 2006, *available at* http://www.nytimes.com/2006/10/24/education/24loans.html?_r=1&pagewanted=print (accessed July 27, 2012); Kelly Field, *The Selling of Student Loans*, Chronicle of Higher Education, June 1, 2007 at A15, *available at* http://chronicle.com/article/The-Selling-of-Student-Loans/12437/ (accessed July 27, 2012).
[98] Jonathon D. Glater, *The Other Big Test: Why Congress Should Allow College Students to Borrow More Through Federal Aid Programs*, 14 N.Y.U.J. Legis. & Pub. Pol'y 11 at 51-54 (2011).
[99] *See* Paul Kix, *Does Financial Aid Make College More Expensive?* Boston Globe March 25, 2012, *available at* http://articles.boston.com/2012-03-25/ideas/31228641_1_financial-aid-federal-aid-college-tuitions (accessed March 30, 2012). The article discusses the Bennett Hypothesis and its critics.

confident that the Federal Government loan subsidies would help cushion the increase."[100] As colleges charge more, school loan credits must increase in order to keep pace with education costs, and the cycle repeats.[101] Higher tuition and loans to pay them have spurred building booms at universities across the U.S.[102] and allowed programs that utilize federal loan funds to charge far more than programs that do not.[103] Proponents of the Bennett Hypothesis assert that the upward trend in education costs will not be contained as long as low-cost student loans are available.[104]

C. Repayment and Forgiveness of Student Loans

Stafford loans allow for a grace period of 6 months after graduation, or if the student leaves the program or drops below part-time. Upon expiration of the grace period, it's time to repay.[105] There are different modes for doing so.

The Standard Repayment program requires a fixed amount per month of at least $50, and allows up to ten years to repay a loan.[106] This gives the shortest repayment period but the highest monthly amount. Students with federal loans in excess of $30,000 may qualify for Extended Repayment. This allows up to 25 years for repayment, with the option of either fixed or graduated repayment. Fixed repayment is same amount each month, while graduated

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[100] William J. Bennett, *Our Greedy Colleges*, New York Times, February 18, 1987, available at http://www.nytimes.com/1987/02/18/opinion/our-greedy-colleges.html (accessed on July 12, 2012). Another commentator has colorfully opined: "Colleges 'suddenly saw the government as this giant wobbling teat just waiting to be sucked, and started a spastic race towards Who Cold Charge the Most Ludicrous Tuition For Four Years…" Ian William, *The Indentured Class: Student Loans Are Robbing Us of Our Future*, The Providence Phoenix, Sept. 20, 1996, at 8.

[101] Katharina Ley and Jussi Keppo, *The Credits that count: How credit growth and financial aid affect college tuition and fees*, unpublished manuscript, March 3, 2012 at 20-21. Electronic copy available at http://ssrn.com/abstracts=1766549. The authors conclude that increased loan funds and grants allow schools to charge more, which in turn feeds demand for additional loans and aid.

[102] Janet Lorin, *Indentured Students Rise As Loans Corrode College Ticket*, Bloomberg, July 9, 2012, *available at* http://www.bloomberg.com/news/2012-07-09/indentured-students-rise-as-loans-corrode-college-ticket.html (accessed July 20, 2012). The article asserts that as borrowing for college soared in the 2000s, universities began a multi-billion dollars building boom. Concurrently, the debt of some 500 colleges and universities rated by Moody's Investor Services rose from $91 billion in 2002 to $211 billion by 2011.

[103] Kix, *supra* note 99. The article mentions that according to one study, tuition at for-profit schools that offer federal loans is 75% more than expensive that schools with no federal loans. http://www.standardandpoors.com/spf/upload/Events_US/US_SF_Event_619abs10.pdf;

[104] *See, e.g.*, Andrew Gillen, *Introducing Bennett Hypothesis 2.0*, February 2012, *available at* http://centerforcollegeaffordability.org/uploads/Introducing_Bennett_Hypothesis_2.pdf (accessed August 1, 2012). Gillen purports to draw a clear line between federal education loan credits and increased college tuition, and asserts that the only way to avoid increases in education costs is to limit education loans to only students with demonstrable financial need. *Id.* at 7, 15. *See also*, Howard, *supra* note 94 at 505 ("As long as student loans are made without any analysis of ability to repay, more and more money will flood the system and inflate the prices").

[105] There are a number of online calculators to determine monthly payments on a loan. The Department of Education calculator for federally guaranteed loans is at http://www.direct.ed.gov/calc.html.

[106] *See Repayment Plans*, Department of Education, *available at* http://www.direct.ed.gov/RepayCalc/dlindex2.html (accessed April 19, 2012) (discussing repayment options).

repayment starts lower, but increases in amount every two years.[107] Repayment may take up to ten years, and no single payment will ever be more than three times any other payment.[108]

For students struggling to meet any of the above repayment options, there is the Income Contingent Repayment program. This is only available for loans made under the Federal Direct Loan Program, so a Parent Plus loan is not eligible.[109] Each year, the monthly payment amount is calculated based on adjusted gross income (AGI) (including spouse's income if the borrower is married), family size, and total amount of Direct Loans.[110] A set formula determines the amount of the monthly payment, but it is not more than 20% of the debtor's monthly "discretionary income," which is calculated based on AGI minus poverty levels for the debtor's state of residence and family size, divided by 12.[111] If the payments are not large enough to cover the accumulated interest on the loan, the interest is capitalized once a year. However, capitalization of the interest will not exceed 10% of the original amount owed when the debtor entered repayment. Interest will continue to accrue thereafter, but will not be capitalized.[112] The maximum payment time is 25 years, and then the unpaid portion is forgiven.[113] Any time spent in deferment or forbearance does not count towards the 25 years.[114] And, any amount that is forgiven can potentially be treated taxable income to the debtor.[115]

Another option is Income-Based Repayment (IBR). A debtor is eligible for IBR if she would have to pay more under a standard ten-year repayment plan than under the IBR formula.[116] The required payment is 1/12 of the annual payment, and the annual payment is 15% of the borrower's discretionary income, as defined by the borrower's adjusted gross income (AGI), minus 150% of the federal poverty level for a family that is the size of the borrower's family.[117] For example, a single borrower with no dependents, debt of $123,000 at 6.8%, and annual income of $50,000 would pay $421 per month, rather than $1,417 per month on a ten-year repayment plan.[118] However, a borrower with two dependants making less than the poverty line of $27,795 will not have to make any payments. Interest continues to accrue, but after 25

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[107] *Id.*
[108] *Id.*
[109] *Id.*
[110] *Id.*
[111] *Id.*
[112] *Id.*
[113] *Id.*
[114] *Id.*
[115] 26 U.S.C. §108 provides that cancellation of certain types, including loan forgiveness, is taxable as income. However, under §108(a)(3), debt forgiveness is not taxable as income to the extent the debtor is insolvent at the time of cancellation.
[116] *Income-Based Repayment Plan*, Department of Education, *available at* http://studentaid.ed.gov/PORTALSWebApp/students/english/IBRPlan.jsp (accessed July 1, 2012). An on-line calculator is provided for borrowers to determine if they are eligible.
For a comprehensive discussion of IBR, *see* Philip G. Schrag and Charles Pruett, *Coordinating Law School Loan Repayment Assistance Programs with New Federal Loan Repayment and Forgiveness Legislation*, Georgetown Public Law and Legal Theory Research Paper No. 10-77 at 9, *available at* http://scholarship.lwa.georgetown.edu/facpub/484 (accessed July 1, 2012).
[117] Schrag and Pruett, *supra* note 116.
[118] *Id.* If married borrowers file a joint tax return, the income of the borrower's spouse is included in the AGI threshold. Therefore, borrowers considering IBR may need to file separately in order to qualify. *Id.*

years, the entire remaining balance is forgiven.[119] Borrowers working in public service jobs may be eligible for loan forgiveness after 10 years, with certain limitations.[120]

All Stafford, PLUS, and Consolidation Loans made under the Direct Loan or FFELP are eligible for repayment under IBR, except for loans in default, parent PLUS loans (PLUS loans that were made to parent borrowers) or Consolidation Loans that repaid Parent Plus Loans.[121] For borrowing that begins in 2014, payments are capped at 10% of income, and the loan balance will be forgiven after 20 years.[122] As with income contingent repayment, the amount that is forgiven is potentially taxable as income.[123] Borrowers in IBR must submit annual documentation of their continued eligibility for the program and meet other requirements.[124]

There is a special Public Service Loan Forgiveness program for Stafford loans.[125] This allows a debtor to teach for five consecutive years in schools that serve low-income families and receive up to $17,500 in loan forgiveness on FFELP and/or Direct Loan program loans.[126] In addition, some debtors may apply for a FFELP Disability Discharge. To qualify for the discharge, a physician must certify that the borrower is unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that (1) can be expected to result in death; (2) has lasted for a continuous period of not less than 60 months; or (3) can be expected to last for a continuous period of not less than 60 months.[127]

There are several specialized loan forgiveness programs, such as the Veterinary Medicine Loan Repayment Program (VMLRP), which provides for partial loan forgiveness if a veterinary medicine graduate serves in a designated shortage situation.[128] There are loan repayment programs for law graduates who enter into public or low-income service.[129] In addition, military branches have loan repayment programs. The U.S. Army offers up to $65,000 in qualified loan

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[119]Department of Education, *supra* note 116. For borrowers in public service

[120] *Public Service Loan Forgiveness*, Department of Education, *available at* http://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/public-service (accessed August 18, 2012).

[121] Department of Education, *supra* note 116. Public service loan forgiveness is only available for William Ford Direct loans. Department of Education, *supra*, note 120.

[122] Ben Steverman, *Student Loan Debt Leads to Despair – and Defaults*, Bloomberg, Oct. 24, 2011, *available at* http://www.bloomberg.com/news/2011-10-21/student-loan-debt-leads-to-confusion-protests-and-many-defaults.html (accessed July 19, 2012).

[123] *See supra* note 115. However, public service loan forgiveness is not taxable. Department of Education, *supra* note 120.

[124] Department of Education, *supra* note 116.

[125] 34 C.F.R. § 685.219 (July 1, 2010).

[126] Department of Education, *Stafford Loan Forgiveness Program for Teachers*, *available at* http://studentaid.edu.gov/PORTALSWebApp/students/english/cancelstaff.jsp (accessed January 19, 2012).

[127]Department of Education, FFELP Disability Discharge, *available at* http://www2.ed.gov/offices/OSFAP/DCS/forms/disable.pdf (accessed January 19, 2012).

[128]United States Department of Agriculture, *VMLPR General Information*, *available at* http://www.nifa.usda.gov/nea/animals/in_focus/an_health_if_vmlrp_geninfo.html (accessed January 19, 2012).

[129] American Bar Association, *Law School Public Interest Programs – Loan Repayment Assistance Programs*, *available at* http://apps.americanbar.org/legalservices/probono/lawschools/pi_lrap.html (accessed January 19, 2012). In addition, some law schools administer loan deferral and forgiveness funds for students to pursue public interest work. *See, e.g.*, Hudson Sangree, *To Forgive is Divine*, Northeastern Law Magazine, Winter 2012, at 19-23 (describing special funds and assistance given to law graduates engaged in public interest law).

repayment for enlistees, as does the U.S. Navy, while the Air Force offers up to $10,000.[130] Only federal loans are eligible, the loan cannot be in default, and the request must be made at the time of enlistment or re-enlistment.[131]

Federal student loans are not subject to any statute of limitations.[132] Private and non-federal loans are subject to regular statute of limitations.[133] A student loan obligation ends if the borrower dies, and her estate is not liable for any balance owed.[134] However, the situation may be different if there is a cosigner. The federal government forgives all education debts if the borrower dies and does not hold the cosigner liable.[135] Private student loan lenders are not required to forgive the co-signer, and while some may do so, other lenders demand payment even if the student borrower has died.[136]

D. Debt and Desperation In The Indentured Generation

1. People You May Know

There is no shortage of wrenching accounts from people struggling under mountains of student loan debt. There are any number of online sites where commentators and student debtors chronicle their experiences.[137] Undoubtedly the poster-child for crushing student loan debt is a family practitioner in Columbus, Ohio, whose $250,000 in loans for medical school eventually mushroomed to $550,000 after deferments for her residency, missed payments with late fees, and compounding interest.[138] A more typical situation is a student who borrowed $79,000 in loans to

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[130] Army Education Center, *Loan Repayment Program FAQ, available at* http://www.eustis.army.mil/Education_Center/loan_repayment_program.htm (accessed January 19, 2012).
[131] *Id.*
[132] Higher Education Technical Amendments Act of 1991, Public Law 102-26, codified at 20 U.S.C. §1091a(a). The act originally had a sunset for November 15, 1992, but the Higher Education Amendments Act of 1992 made the termination of statute of limitations permanent. Higher Education Amendments Act of 1992 § 1551, codified at 20 U.S.C. §1091a.
[133] New Jersey Higher Educ. Student Assistance Auth. v. Colgan, 2010 WL 3075562 (N.J. Super. App. Div., Aug. 9, 2010) (ten-year state statute of limitations applies to action to collect non-federal student loan).
[134] 20 U.S.C. §1091a(d).
[135] Karen Datko, *Bank finally forgives dead student's loan*, MSN Money, May 1, 2012, *available at* http://money.msn.com/saving-money-tips/post.aspx?post=42205751-ea78-4308-8f3e-2707074e816d (accessed on May 2, 2012).
[136] *See id*. (private lender forgives cosigner of loan six years after student debtor's death after cosigner collects 75,000 signatures on an on-line petition). *See also*, Karen Datko, *Dad overwhelmed by dead student's loans*, MSN Money, June 15, 2012, *available at* http://money.msn.com/saving-money-tips/post.aspx?post=76403ee4-9604-480e-ad05-9f2cf2292cce (accessed July 30, 2012) (co-signer dad who earns $21,000 liable for student loans of $167,000 after son died in car crash).
[137] Lorin, *supra* note 2. The author relates how a mother in the 1960s incurred $5000 in debt for her nursing degree, which she paid off within three years after graduation, while her 38-year old son incurred $85,000 in debt for a master's degree, can't find work, and lives at home. See also, Andrew Martin and Ander W. Lehren, *Degrees of Debt: A Generation Hobbled by the Soaring Cost of College*, New York Times, May 12, 2012, *available at* http://www.nytimes.com/2012/05/13/business/student-loans-weighing-down-a-generation-with-heavy-debt.html?pagewanted=all (accessed May 12, 2013). The article profiles a 2012 graduate of Ohio Northern University works two jobs to pay off $120,000 loan and lives at home with his parents.
[138] Mary Pilon, *The $550,000 Student-Loan Burden*, Wall Street Journal, February 13,2010, *available at* http://online.wsj.com/article/SB10001424052748703389004575033063806327030.html#printMode (accessed August 17, 2012).

study interior design at a for-profit college.[139] By graduation, her debt had grown to over $100,000. She could not find a job in her field and obtained several forbearances, incurring additional interest and fees. She eventually landed a job in a different field and after making timely payments for five years, she still owes $98,000. When the loans are paid in 25 years, she will have paid $211,000. She figures that for now she cannot afford to study for a business degree, start her own business, own a house, or have children.[140] Below are profiles of four student loan debtors who were interviewed for this article.[141]

1. Debtor 1

Debtor 1 is in her mid-30s and has dual degrees in music education and music therapy from a private non-profit music school, which she attended over 14 semesters from 2003 to 2008. With tuition costs of $10,000 per semester, living costs of $13,000 per year, and fees, insurance, instruments, a computer, and other items required by the school, she borrowed $202,600, including $138,500 in private loans and $64,000 in state and federal loans. Debtor 1 had no music training before she enrolled, and no audition was required. Admissions personnel assured her she could readily find contract work in music therapy at $60 per hour, but no such jobs have ever materialized. And, she cannot work in music education because she cannot afford to perform the four-months of unpaid internship plus purchase the six credits that state licensing would require. Unable to find work in her field after graduation, Debtor 1 is employed as a switchboard operator for a large company where she makes $29,800 per year. After taxes and modest living expenses, she has $124 per month for debt service. For years following graduation, she struggled to make loan payments and worked with her lenders to restructure payments. Finally, after going into default on her private loans and with judgments looming, she filed Chapter 13 bankruptcy in 2011. As of the petition date, with interest the debt had mushroomed to $248,600. During her bankruptcy she will not be making regular loan payments, so interest on the debt will continue to accumulate.

When asked about how she could have allowed so much debt to accumulate, Debtor 1 has several answers. First, coming from a blue-collar background, she knew essentially nothing about finances, making a living, and paying back debt. Higher education was perceived as the key to a meaningful career and lifetime earning potential. It did not occur to her to consider the amount of debt she was accumulating until she was several years into her program, and by then, with so much invested, it was unthinkable not to continue. Second, borrowing, especially from private sources, was absurdly easy. Two loan sources, Citibank and TERI, supplied all of her private loans, and it took only ten minutes online per semester to borrow anywhere from $10 to $20 thousand. She was not even required to provide her real signature. One lender required a parent to co-sign each loan, but after obtaining an initial electronic signature from her father, the lender did nothing to verify that the parent had, in fact, agreed to co-sign subsequent loans. It was only after Debtor 1defaulted that the father who had electronically co-signed one loan learned about the other loans for which he was obligated. Tragically, her father has not communicated with her since that time.

[139] Shellenbarger, *supra* note 90.
[140] *Id*.
[141] These accounts are from my correspondence with the debtors, in my possession.

Debtor 1 compartmentalizes the fact that she owes so much, and while she imagines that she will one day be out of debt, there seems to be no feasible way this will ever happen. In the meantime, she has friends, a pet, and a very modest social life. She does not own a home or a car, nor does she have credit cards. She does not expect her situation to change to any time in the foreseeable future.

2. Debtor 2

Debtor 2 is in her mid-30s and has three children under the age of 15. Her annual income of $30,700 comes from social security disability, child support, and food stamps, and is well below the state minimum where she lives. Her rental payment of $550 a month is half the IRS average for a family of four in her area, and all her other allowable expenses (food, clothing, medical, utilities, etc.) are at or below the IRS guidelines. Nevertheless, Debtor 2's allowed expenses of $2,565 per month exceed her monthly income by $2.00. Additionally, two of her children have special medical conditions that require frequent hospitalization, and Debtor 2 must care for them around the clock.

Debtor 2 enrolled in a medical training program, but was unable to complete it because of parenting demands. Unfortunately, she borrowed $17,200 in student loans when she was in the program. With expenses in excess of her social security income, Debtor 2 is unable to pay any of her debt. When she filed for bankruptcy, she also filed an adversary proceeding to have the student loan debt discharged. The creditor answered the complaint and started discovery, including a deposition and interrogatories and requests for production of documents. Among the information requested were documents regarding her medical condition and that of her children. Debtor 2 could not afford the cost to copy all the records, and through her lawyer, offered to provide authorization for the creditor to obtain its own copies. At the conclusion of her deposition, counsel for the creditor told Debtor 2's attorney that as it appeared that she was disabled and unable to pay the debt, he would recommend that his client agree to the discharge and therefore it was not necessary for Debtor 2 to provide any documents or even to proceed with administrative remedies such as income contingent repayment. However, the creditor later refused to agree to the discharge, in part because Debtor 2 had failed to provide documents to establish her medical condition. Ultimately, Debtor 2 entered into an income based repayment program. Based on her income, her payments are $0, so the result is might seem the same as discharge of the debt. However, under IBR, Debtor 2 must provide extensive medical and financial information to prove her condition each year. For her it would have been far easier and less stressful for her if the creditor had agreed to the discharge.

3. Debtor 3

Debtor 3 is in her late 40s and lives in a modest condominium in a Midwestern city. She received a BFA degree at a prestigious university in 1989, for which she incurred a loan for $11,000 from the Department of Education. In addition, she used credit cards to supplement college costs, and, as she says, "to have a bit of fun during the summers." Debtor 3's first job after college was working in a diner, but eventually she found work in electronic printing. Still, the salary was low and she did not make many payments on her loan. Financially strapped with student loans and credit card debt, Debtor 3 filed a pro se bankruptcy in 1990. She received a

discharge in 1991. Debtor 3 says that the standard discharge order was confusing, so she wrote to the judge to confirm that all claims on the list of creditors had been discharged. He returned a handwritten response at the bottom of her letter that said simply "your case was granted," which she took to mean in the debts had been discharged.

Following the bankruptcy, and assuming that her student loan debt had been discharged, and Debtor 3 made no further payments. She even got all references to the loan removed from her credit report, which to her confirmed that the debt was discharged. Nevertheless, student loan collectors continued to call and send collection letters. Sometimes Debtor 3 responded with snarky letters of her own, but she continued to assume that the debt had been discharged. However, in 1998 the Department of Education levied on her tax return, and it has continued to do so ever since. A collection agency began pursuing her in earnest starting in 2006, eventually garnishing her wages. For a time, the Department of Education granted her requests for a hardship deferral, but after two years refused to allow any further deferment. Along the way, Debtor 3 studied for and received an MFA in the hopes that it would improve her career prospects. That resulted in an additional $5,000 student loan owed to a private lender, but the new degree did not enhance her career prospects.

In recent years Debtor 3 has taught part-time and worked in a variety of temporary jobs, but has been unable to find permanent work. She earns sporadic income from process serving, selling art, and even paid medical testing. Debtor 3 has also used credit cards to purchase basic necessities. When her unemployment benefits ran out in 2011, Debtor 3 filed a second pro se Chapter 7. By that time, her federal student loan debt had grown to $25,000, and she still owed $2,000 in private student debt. She filed a pro se adversary proceeding against both lenders seeking discharge for undue hardship under the *Brunner* criteria. The private lender did not respond, so the court granted default judgment. This is not a surprising, given that the cost of retaining counsel and responding to the complaint would cost more than the amount owed. But the Department of Education has respond to Debtor 3's complaint, discovery is on-going.

4. Debtor 4

Debtor 4 is a recent law school graduate. Unlike the other debtors profiled above, he has not filed bankruptcy and does not anticipate doing so. But his story is typical of tens of thousands of recent law grads,[142] so it is worthwhile presenting it here. Debtor 4 had no undergraduate student debt and worked at a steady job in business making $50,000 per year for five years before starting law school. He was not dissatisfied with that income, but was bored and felt his upside prospects were limited, so he decided to attend law school. To pay for law school, Debtor 4 incurred between $189,000 and $191,000 in debt (he is not certain of the exact amount). He received two loans each year during law school: a Grad Plus loan of $40,000 per year that went directly to the law school, and a Stafford loan of $21,000 per year, which covered his living and other expenses. The amount of his debt is so large that it feels amorphous and almost unreal. He currently has a deferment, but Debtor 4 calculates that when it runs out his

[142] *See, e.g.*, Lincoln Caplan, *An Existential Crises for Law Schools*, New York Times, July 14, 2012, *available at* http://www.nytimes.com/2012/07/15/opinion/sunday/an-existential-crisis-for-law-schools.html (accessed July 19, 2012) (discussing high debt levels and doubtful employment prospects for current law graduates).

payments will be $1,200 to $1,500 per month. Right now, however, he is just worried about paying rent and other basic expenses. Despite solid grades in law school, works two temporary legal jobs netting $2,000 per month. Debtor 4 will take a permanent position wherever he can get it. When asked if he is glad he went to law school, Debtor 4 says yes, but that he is "one of the few who is." Notwithstanding his financial worries, Debtor 4 enjoys legal studies and law work, and is confident that his training and abilities portend a bright future.

2. The Logic and Illogic of College Education

The debtors described above may have been imprudent in incurring their student loans, but each did so with the expectation that an education would enable them to earn a living. Investment in education is prudent if the borrower can utilize that education to make sufficient income to pay off the debt within a reasonable period. But this depends upon two assumptions. First, the amount of debt is proportionate to the income that can reasonably be expected in the career for which the student has trained. Second, that there will be sufficient employment opportunities after graduation. Increasingly, these assumptions are not valid for many student borrowers.

The first assumption, that the amount of education debt is proportional to expected income, is undermined by the skyrocketing cost of education in recent years. Increases in tuition, fees, and other expenses of higher education have outstripped inflation in every other major sector of the economy, such as energy, food, healthcare, and even housing during the time when housing itself was experiencing a bubble.[143] The cost of tuition alone has ballooned from 23% of median annual earnings in 2001 to 38% in 2010.[144] To illustrate the difficulty of managing student loan debt, let's assume a four-year college graduate named Joan gets a job in Dallas with a salary of $41,701, which was the prototypical average salary for 2011 graduates.[145] Fortunately, Texas has no state income tax, so Joan's tax home pay after federal taxes (but with no other deductions such as retirement, health insurance, etc.) is $34,377.15 per year[146] or $2,864.75 per month. Average apartment rent outside the expensive Dallas City Center is $679 per month, but Joan is frugal and takes the cheapest place she can find at $595 per month.[147] Using standard cost of living percentages, Joan will pay $2,975 per month for housing, food, transportation and other expenses.[148] Ouch! Joan is already in trouble because her monthly living expenses exceed her monthly-take home pay. Somehow she gets by for awhile, but after six months her student loan repayment kicks in. If Joan has $27,000 in student loan debt (the national average for a 4-year college graduate) and wants to use the standard repayment plan, she

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[143] *Is student loan, education bubble next?* Boston Globe, November 6, 2011, *available at* http://articles.boston.com/2011-11-06/news/30367269_1_student-loan-federal-stafford-bubble (accessed on November 10, 2011).
[144] The Economist, *The college-cost calamity*, August 4, 2012, p.57.
[145] National Association of Colleges and Employers Salary Survey (Winter 2012) at 3, *available at* http://www.naceweb.org/uploadedFiles/NACEWeb/Research/Salary_Survey/Reports/SS_January_exsummary_4web.pdf (accessed August 17, 2012).
[146] Payroll Guru, Texas Payroll Check Calculator, *available at* http://www.payrolltexas.com/PayrollCheckCalculator.aspx (accessed August 17, 2012).
[147] Information regarding standard cost of living in the Dallas area is from Numbeo.com, *available at* http://www.numbeo.com/cost-of-living/city_result.jsp?country=United+States&city=Dallas%2C+TX (accessed August 18, 2012).
[148] *Id.*

will have to pay $310.72 per month.[149] How will she get by and keep up with her student loan repayments? Joan is not sure, but somehow she will find a way. Fortunately, she has no dependents or medical expenses, and she will probably get a raise after her first year. But many borrowers do have dependants, medical expenses, insurance and payroll deductions, or won't get a raise. Some of them don't even have jobs.

Despite Joan's problems, the downside of not attending college may be worse. On average, a person with a bachelor's degree will earn one-third more over their lifetime than those with only a high school diploma.[150] Median weekly earnings in 2011 for a person with a bachelor's degree was $1,053, compared to $768 for a person with an associate degree, and $638 for a person with only a high school diploma.[151] As of January 2012, the unemployment rate for people with a bachelor's degree or higher was approximately 4%, compared to 8% for people with a high school degree and no college.[152] So, students may feel they have no choice but to incur debt for post-secondary education.[153]

The second assumption, that graduates can find a job in the field for which they have studied, is also increasingly tenuous. It has long been true that post-graduate students working on a master's and doctoral degree in the humanities and social sciences take a significant risk that they will be unable to find jobs once they obtain their degrees (which can take seven to ten years of study and research). This is part of the culture of graduate education in these fields.

But there are increasingly fewer jobs for graduates in such formerly reliable areas as business, accounting, law, and education.[154] Don't want to go to grad school? The slowest job

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[149] This is calculated using the Department of Education online loan repayment calculator, available at http://www2.ed.gov/offices/OSFAP/DirectLoan/RepayCalc/dlentry1.html.

[150] Jennifer Cheeseman Day and Eric C. Newberger, *The Big Payoff: Educational Attainment and Synthetic Estimates of Work-Life Earnings*, United States Census Bureau at 3, *available at* http://www.census.gov/prod/2002pubs/p23-210.pdf. Average weekly earnings for less than high school diploma is $545, high school graduate is $626, and some college no degree is $699. Average unemployment rate for 20- to 24-year olds with just high school education was 20.4% in 2010. Id. at 1. *See also*, Derek Thompson, *The Incredible Shrinking Work Force*, The Atlantic, December 8, 2011, *available at* http://www.theatlantic.com/business/archive/2011/12/the-incredible-shrinking-work-force/249688/ (accessed July 19, 2012).

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[151] S & P Student Loan ABS Trends, *supra* note 19 at 15. The data is from the Department of Labor, Bureau of Labor Statistics, Current Population Survey.

[152] Id. at 13. The data is from the Department of Labor, Bureau of Labor statistics.

[153] "Paying for one's education … is a toll imposed on workers in exchange for the possibility, not even the certainty, of employment." George Caffentzis, The student loan abolition movement in the united states, in Generation of Debt: The university in default and the undoing of campus life, Reclamation Journal, August/September 2011 at 39, *available at* http://libcom.org/library/generation-debt-university-default-undoing-campus-life (accessed July 20, 2012).

[154] *See, e.g.*, Steven Greenhouse, *Jobs Few, Grads Flock to Unpaid Internships*, New York Times, May 5, 2012, available at http://www.nytimes.com/2012/05/06/business/unpaid-internships-dont-always-deliver.html?pagewanted=all (accessed May 6, 2012) (noting growth of unpaid internships as the only opportunity for new college grads); Blake Ellis, *Class of 2011 scores higher-paying jobs*, CNN Money, January 12, 2012, *available at* http://money.cnn.com/2012/01/12/pf/college/salaries/index.htm (accessed May 19, 2012) (the author states that while engineering and computer science graduates have higher starting salaries, MBA and law degrees are increasingly viewed as commodities).

growth is among people with a four-year college degree, but nothing else.[155] For newer graduates age 24 or younger, the unemployment rate as of May 2012 was 7.6%,[156] just barely above that of high school graduates. For new graduates who do get jobs, starting out in tough economic times can often mean lower earnings over a lifetime since the average worker gets 70% of their pay raises during the first decade of employment.[157] That can translate into earning 10% less than those starting their careers during good economic times.

The twin components of high education debt and limited of career opportunities sentence tens of thousands of young adults to lifelong financial servitude. They will find themselves working for creditors from decades past and their personal choices will be highly constrained.

II. BANKRUPTCY AND STUDENT LOAN DEBT

A. The Purpose and Procedures of Consumer Bankruptcy

The purpose of consumer bankruptcy is to allow "the honest but unfortunate debtor" to receive a fresh start and not be burdened for life with the financial consequences of misfortune or bad choices.[158] A bankruptcy is commenced by filing a bankruptcy petition,[159] schedules of assets, liabilities, income, expenses, and other information.[160] Once the petition is filed, any action to collect or enforce a debt against the debtor is stayed.[161] All of the debtor's assets become "property of the estate"[162] and are thereafter are subject to court supervision and control until the case is closed.

In Chapter 7 bankruptcy, a trustee is appointed to secure and sell the debtor's non-exempt assets[163] and to use the proceeds to pay claims of unsecured creditors.[164] Exemptions allow a consumer debtor to retain personal property up to a certain value.[165] The debtor's remaining unsecured debt is discharged.[166] If a debtor is current on his or her secured obligations, such as a mortgage or car payment, the debtor may retain the collateral[167] and continue making payments.[168] However, if the debtor is in default, the creditor may obtain relief from stay and

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[155] Don Peck, *Can the Middle Class be Saved?*, The Atlantic, September 2011, *available at* http://www.theatlantic.com/magazine/print/2011/09/can-the-middle-class-be-saved/8600/ (accessed May 6, 2012).
[156] S & P Student Loan ABS Trends, *supra* note 19 at 14. The data is from the Department of Labor, Bureau of Labor Statistics.
[157] Daniel Gross, *The Economic Agony of Today's Twenty-Somethings*, Yahoo! Finance, October 26, 2011, available at http://finance.yahoo.com/blogs/daniel-gross/economic-agony-today-twenty-somethings-143010262.html (accessed February 23, 2012).
[158] Grogan v. Garner, 498 U.S. 279, 286-87 (1991).
[159] 11 U.S.C. §301.
[160] *Id.* §521(a)(1)-(2).
[161] *Id.* §362(a).
[162] *Id.* §541(a).
[163] *Id.* §704.
[164] *Id.* §726
[165] *Id.* §522(b)-(d).
[166] *Id.* §727
[167] *Id.* § 521(a)(2)(A)
[168] *Id.* §522(c)(1)

pursue whatever remedies are allowed under state law, such as foreclosure or a levy and sheriff sale.[169] Some debts, such as domestic support orders,[170] debt incurred by fraud,[171] and certain taxes[172] are not dischargeable. Although Chapter 7 is often referred to as "liquidation," most debtors retain some or all of their property through exemptions.[173]

As with Chapter 7, a Chapter 13 bankruptcy is also commenced by filing a petition, along with schedules of assets and liabilities. However, instead of receiving a prompt discharge, the debtor must submit a "plan of reorganization" under which she devotes all of her monthly "projected disposable income" to repay a percentage of unsecured debt over a period of three to five years.[174] The debtor makes a single monthly payment to the Chapter 13 trustee, and the trustee distributes the payment to creditors. The debtor must remain current on any payments for secured collateral that debtor wants to retain.[175] A Chapter 13 trustee in each federal district oversees Chapter 13 cases in the district.[176] The primary duty of a Chapter 13 trustee is to receive monthly payments made by debtors,[177] and to distribute the proceeds to creditors as provided under the plan.[178] Some Chapter 13 trustees allow debtors to pay secured or long-term debts (debts with payments that extend beyond the duration of the plan) outside the plan.

In 2004, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)[179] after decades of complaints by creditor interests it was too easy for consumers to walk away from debt in bankruptcy.[180] BAPCPA's controversial centerpiece is a complex "means testing" formula used to determine whether the debtor may file a Chapter 7 or if she must seek relief under Chapter 13. If the debtor's gross income is above the forum state median, then the debtor will be presumed to have abused the bankruptcy process if she files a Chapter 7 bankruptcy.[181] For Chapter 13 debtors, a formula similar to means testing is used to determine the amount of the debtor's "disposable income" that must be paid each month to fund the Chapter 13 plan.[182] The test is done on Official Bankruptcy Form 22C, which requires the debtor to enter income and expenses according to certain statutory formulae and allowances. The resulting amount is the debtor's "disposable income." For many debtors, the disposable income calculated on Form 22C is different from the debtor's actual income.

As noted, a debtor must file schedules of liabilities. Secured debt is listed on Schedule D. With certain exceptions, a security interest is not affected by bankruptcy, and secured creditors

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[169] *Id.* §362(d)
[170] *Id.* §523(a)(5)
[171] §523(a)(4)
[172] §523(a)(1)
[173] *Id.* §522(b)(1) – (3).
[174] *Id.* §1322(a)(4); §1325(b)(4)(a).
[175] *Id.* §1322(b)(5).
[176] *Id.* §1302(b).
[177] *Id.* §1302(b)(5); §1326(a)(2).
[178] *Id.* §1326(a)(2).
[179] Pub. L. No. 109-8, 119 Stat. 23 (2005).
[180] Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,* 79 AM. BANKR. L.J. 485 (2005).
[181] 11 U.S.C. §707(b)(1). Debtors with primarily business debts are not subject to means testing.
[182] *Id.* §1325(b)(2)-(3).

ultimately have recourse to their collateral. If the debtor intends to retain property subject to a security interest, the debtor generally continues paying the creditor as per the security agreement.

As provided in § 523 of the Code, certain types of unsecured debt are classified as "priority" unsecured debt and are not dischargeable in bankruptcy. These include debts such as tax debt incurred in the two years immediately before filing, or tax debt for which returns were never filed,[183] domestic support obligations,[184] and certain types of government fines and other penalties.[185] These debts are listed on Schedule E and must be paid in full before any non-priority unsecured claims may be paid.

For a typical consumer debtor, the majority of their unsecured debt is dischargeable in bankruptcy. These types of debt are referred to as non-priority "general" unsecured debt, and are filed on Schedule F. General unsecured debt is paid pro-rata so that each creditor receives the same percentage of any distributions. There are certain types of debt that are listed on Schedule F as non-priority that are potentially non-dischargeable, but only if the creditor objects to the discharge, and after a hearing and determination by the court.[186] These include certain types of fraud,[187] embezzlement,[188] larceny,[189] and willful injury to property.[190]

B. Student Loan Debt and Bankruptcy

1. Statutory: Bankruptcy Code Provisions

The Bankruptcy Code took effect in 1978. Under its predecessor, the Bankruptcy Act,[191] student loans were not treated differently from any other dischargeable debt until the passage of the Education Amendments Act of 1976.[192] Section 439A of the Act prohibited discharge of student loans in bankruptcy for the first five years of loan repayment unless the debtor could establish "undue hardship." The 1978 Code continued the five-year bar to discharge of student debt. In 1990 the student loan discharge exception was extended to seven-years.[193] In 1998, the Code was amended to provide that federally-guaranteed student loans could not be discharged at all unless the debtor could prove undue hardship.[194] However, starting in 2005 under BAPCPA, the discharge exception was extended to include all education loans, including loans with no federal guaranty.[195]

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[183] *Id. §*523(a)(1).
[184] §523(a)(5).
[185] §523(a)(7).
[186] §523(c)(1).
[187] §523(a)(2) and (4).
[188] §523(a)(4).
[189] §523(a)(4).
[190] §523(a)(6).
[191] Ch. 541, 30 Stat. 54, *amended by* Chandler Act of 1938, ch. 575, 52 Stat. 840 (repealed 1978).
[192] Education Amendments Act of 1976, Pub. L. No. 94-482, 90 Stat. 2081, 2141 (codified at 20 U.S.C. §1087-3 (1976 (repealed 1978)).
[193] Student Loan Default Prevention Initiative Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388, 1388-28 to 1388-29.
[194] Higher Education Amendments Act of 1998, § 971, Pub. L. No. 105-244, 112 Stat. 1581, 1837 (1998).
[195] 11 U.S.C. §523(a)(8).

At present, § 523(a)(8) of the Code provides that a Chapter 7 bankruptcy discharge 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;[196]

In Chapter 13 bankruptcy, § 1328(a)(2) provides that a discharge does not discharge a debt "of the kind specified in … (8)… of section 523(a)."[197] Accordingly, education loan debt is not dischargeable in a Chapter 13 case without the same undue hardship showing as in a Chapter 7 case.[198] Co-signers and co-guarantors on a student loan are also subject to § 523(a)(8).[199]

Congress did not define "undue hardship," so courts have had to determine what it means in this context. A threshold question is whether the debt in question is even subject to the rule. Section 523(a)(8) specifies four types of loans: (1) loans made, insured, or guaranteed by a governmental unit; (2) loans made or funded in whole or in part by a governmental unit or nonprofit institution; (3) loans received as an educational benefit, scholarship, or stipend, and (4) any qualified educational loan, as defined in the Internal Revenue Code.[200]

The lender has the initial burden to establish the existence of the debt and that it falls within one of the four categories of nondischargeable debt.[201] Courts determine the educational nature the loan based on the "substance of the transaction creating the obligation."[202] The "substance of the transaction test" looks to the stated purpose for which the loan was obtained, and not how the proceeds were actually used.[203] Thus, a court does not ask whether a computer purchased with loan money was used for schoolwork or personal use, but instead, "need only ask

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[196] *Id.*
[197] *Id.* §1328(a)(2).
[198] United States Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1378 (2010).
[199] *In re* Pelkowski, 990 F. 2d 737 (3d Cir. 1993) (parent debtor comes within discharge exception).
[200] *In re* Weldon, 2008 WL 4527654, *2 (Bankr. W.D. Wash. Oct. 1, 2008).
[201] Brodson v. Educ. Credit Mgmt. Corp. (*In re* Brodson), 435 B.R. 791, 796 (1st Cir. BAP 2010) ("The creditor bears the initial burden of establishing that the debt is of the type excepted from discharge under § 523(a)(8)"). *See also* Rumer v. American Educ. Services, 469 B.R. 553, 561 (Bankr. M.D. Pa. 2012) and cases cited therein. *But see, In re* Skipworth, 2010 WL 1417964 (Bankr. N.D. Ala April 1, 2010) (debtor failed to meet burden of proof that debt at issue was not a school loan); *In re* Carow, 2011 WL 802847 (Bankr. D. N.D. March 2, 2011)("debtor failed to establish that the debt to Chase is not an obligation to repay funds received as an 'educational benefit').
[202] Rumer, 469 B.R. at 562.
[203] *In re* Sokolik, 635 F. 3d 261, 266 (7th Cir. 2011); Murphy v. Penn. Higher Educ. Assistance Agency (*In re* Murphy), 282 F. 3d 868, 870 (5th Cir. 2002).

whether the lender's agreement with the borrower was predicated on the borrower being a student who needed financial support to get through school."[204]

Loans that are federally guaranteed such as Stafford Loans or Federal Direct Loans are clearly nondischargeable under §523(a)(8)(A)(i), as are loans from state agencies and non-profit organizations,[205] as well as educational benefit overpayments, such a Pell grant or GI benefits overpayment.[206] Obligations to repay an educational benefit, such as a grant to finance training in return for agreement to work in a designated sector upon graduation are also nondischargeable.[207]

Most private education loans are nondischargeable under §523(a)(8)(B). Also nondischargeable are certain higher education loans as defined under § 221(d)(1) of the IRS Code. Section 221(d) allows the taxpayer to claim a deduction in interest paid on an education loan if the loan meets the criteria of IRC §221(d)(1). That section defines a "qualified education loan" as a loan incurred by the taxpayer "solely to pay qualified higher education expenses" which are incurred on behalf of the taxpayer, spouse or dependant for "education furnished during a period during which the recipient was an eligible student."[208] This in turn raises four additional definitions. First, "qualified higher education expenses" is defined as "the cost of attendance…at an eligible educational institution…"[209] Second, an "eligible student" is a student, inter alia, "carrying at least ½ the normal full-time work load for the course of study the student is pursuing."[210] Third, an "eligible educational institution" is a post-secondary school authorized to participate in the U.S. Department of Education Student Loan program, which includes almost any post-secondary school, but would not include unaccredited schools or diploma mills.[211] Finally, "cost of attendance" includes tuition, fees, books, equipment, room & board, and miscellaneous personal expenses as determined by the specific school.[212]

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[204] *In re* Sokolik, 635 F. 3d at 266. *See also, In re* Murphy, 282 F. 3d at 870 ("Section 523(a)(8) does not expressly state that only loans 'used for tuition' are nondischargeable. Nor does it define educational loans as excluding living or social expenses").

[205] *In re* Roberts, 149 B.R. 547 (C.D. Ill. 1993)(loan made by nonprofit credit union is nondischargeable).

[206] In re Coole, 202 B.R. 518 (Bankr. D.N.M. 1996) (nondischargeable overpayment includes GI payments received by the student after leaving school).

[207] Omaha Joint Electrical Apprenticeship Training Committee v. Stephens (*In re* Stephens), 2011 WL 1395502 at *2 (Bankr. D. Neb. 2011) (debtor owed education reimbursement to union when debtor took a job with non-union employer); *In r*e Burks, 244 F. 3d 1245 (11th Cir. 2001) (debtor must repay grant after failing to satisfy obligation of stipend to teach at "other race" school).

[208] IRS Code Section 221(d)(1)(C). The term "qualified education loan" does not include any indebtedness owed to a person who is related to the taxpayer or recipient or under certain employer plans. Id.

[209] IRS Code Section 221(d)(2)

[210] IRS Code 221(d)(3) and 25A(b)(3)

[211] 26 U.S.C. §25A(f)(2) provides the following: "Eligible educational institution - The term "eligible educational institution" means an institution - (A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this section, and (B) which is eligible to participate in a program under title IV of such Act." In addition, IRS publication 907, p. 37, states that an eligible educational institution is "any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution."

[212] 20 U.S.C. § 1087*ll* defines "cost of attendance" as

Although the sweep of §523(a)(8)(B) is broad, it is not infinite. For example, while §523(a)(8)(A) covers all loans for education (including secondary school), §523 (a)(8)(B) only excludes loans for higher education from discharge. And even then, the debt must be incurred "solely to pay qualified higher education expenses." Mixed-use loans and credit card debt are generally not considered qualified education loans.[213] Nevertheless, it is the *purpose* and not the actual use of the funds that will govern if the loan is an education loan.[214]

As for refinancing and education loan consolidation, as provided under IRC §221(d)(1), a "qualified education loan" includes "indebtedness used to refinance indebtedness which qualifies as a qualified education loan."[215] On the other hand, tuition and other education debts that were not incurred as loans are not covered by § 523(a)(8). Thus, debt owed to a university for unpaid tuition, board or fees is dischargeable.[216]

2. Policy: Reasons for Nondischargeability of student loan debt

There may be several explanations for the policy of nondischargeability of student debt. One is that without the discharge exception, lenders would unwilling to lend to students with little or no credit history. The discharge exception therefore makes it possible for lenders to provide funds for education without regard to the creditworthiness of the borrower. Indeed, student loan lenders may not refuse to lend to a prospective borrower on account of a prior bankruptcy.[217] In theory, this should democratize education by making school loans available to

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(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 of all students in the same course of study;
(2) an allowance for books, supplies, transportation, and miscellaneous personal expenses, including a reasonable allowance for the documented rental or purchase of a personal computer, for a student attending the institution on at least a half-time basis, as determined by the institution;
(3) an allowance (as determined by the institution) for room and board costs incurred by the student which - (A) shall be an allowance determined by the institution for a student without dependents residing at home with parents;
(B) for students without dependents residing in institutionally owned or operated housing, shall be a standard allowance determined by the institution based on the amount normally assessed most of its residents for room and board;
(C) for students who live in housing located on a military base or for which a basic allowance is provided under section 403(b) of title 37, shall be an allowance based on the expenses reasonably incurred by such students for board but not for room; and
(D) for all other students shall be an allowance based on the expenses reasonably incurred by such students for room and board.

[213] 26 C.F.R. 1.221-1; 64 Fed. Reg. 3257, 3258 [DATE].
[214] *In re* Busson-Sokolik, 635 F. 3d 261, 266 (7th Cir. 2011) (using the "purpose driven test," the court will look to whether the lender agreement to make the loan "was predicated on the borrower being a student who needed financial support to get through school"); *In re* Murphy, 282 F. 3d 868 (5th Cir. 2002) (a student loan is nondischargeable even if part of the loan was used by the debtor to pay for a car and living expenses).
[215] United States v. DeKellis, 2010 WL 3521916 (E.D. Cal. Sept. 8, 2010) (a loan that consolidates prior student loan remains nondischargeable).
[216] *In re* Chambers, 348 F.3d 650 (7th Cir. 2003) (tuition and other unpaid charges are not a loan).
[217] 11 U.S.C. §525(c).

students of all socio-economic backgrounds. However, presently 85% of all education loans are federal loans, therefore, student lending is more of a political venture than a financial one.

A second argument is the need to ensure a pool of loan money for future students. This rests on the logic that if education loans are readily dischargeable in bankruptcy, then borrowers will have greater incentive to file for bankruptcy and more education loans will be discharged. This, in turn, will deplete federal and private funds available for new student loans.[218] So, the interest in ensuring the continued viability of the student loan program takes precedence.[219]

A third concern is that student borrowers will abuse student loan programs by filing bankruptcy after graduation, getting a discharge, and then enjoying a lifetime of income that education provides, but without the expense of paying back the loans.[220] Such conduct would be outright fraud if the student borrower planned to do so at the time he took out the loans. Or, it might be "soft fraud" if the student did not overtly plan to discharge the loans after graduation, but upon experiencing the difficulty of repaying, seeks for an easier way to deal with the debt than years of repayment.[221] However, there is no evidence of significant deliberate or soft fraud on the part of student loan borrowers.[222]

Finally is the theory that students themselves have taken on the debt burden and therefore should be responsible for repaying the debt. As one court stated,

> The government is not twisting the arms of potential students. The decision of whether or not to borrow for a college education lies with the individual; absent an expression to the contrary, the government does not guarantee the student's future financial success. If the leveraged investment of an education does not generate the return the borrower anticipated, the student, not the taxpayers, must accept the consequences of the decision to borrow.[223]

The last argument is that a debtor's misfortune should not be borne creditors. However, this argument could be made with respect to any debt, and if practiced consistently, would effectively end consumer bankruptcy.

3. Procedural: Procedures for discharge of student loan debt

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[218] William D. Henderson and Rachel M. Zahorsky, *The Law School Bubble: How Long Will It Last If Law Grads Can't Pay Bills?*, ABA Journal, January 2012, at 30-35 at 35. See also, Pottow at 261.
[219] TI Fed. Credit Union v. DelBonis, 72 F. 3d 921, 937 (1st Cir. 1995).
[220] *See, e.g.*, the comments of Rep. Allen E. Ertel: "At a time when political, business, and social morality are major issues, it is dangerous to enact a law that is almost specifically designed to encourage fraud." H.R. Rep. No. 95-595, at 536-37 (1977).
[221] John Pottow, *The Nondischargeability of Student Loans in Personal Bankruptcy Proceedings: The Search for a Theory*, U of Michigan Public Law Working Paper No. 75, U of Michigan Law & Economics, Olin Working Paper No. 07-005, March 2007, at 252-255, *available at* http://ssrn.com/abstract=967379 (accessed May 9, 2012).
[222] Teresa A. Sullivan et al., The Fragile Middle Class: Americans in Debt (New Haven, Conn. 2000); Richard Fossey, *"The Certainty of Hopelessness:" Are Courts Too Harsh Toward Bankrupt Student Loan Debtors?* 26 J.L. & Educ. 29, 34 (July 1997).
[223] *In re* Roberson, 999 F. 2d 1132, 1137 (7th Cir. 1993).

Education loan debt must be listed by the debtor on Schedule F along with other general unsecured debt.[224] In a Chapter 7 case, education loan claims receive the same distribution as general unsecured debt. However, while general unsecured debt is discharged, student loan debt is not. After the Chapter 7 case is closed, usually in four to six months, the debtor continues making payments the creditor.[225] A typical Chapter 13 is quite different. Payments to general unsecured creditors can extend for up to five years. If the debtor pays a monthly amount for distribution to unsecured creditors, then education loan creditors may receive some money during the plan, but unless the plan provides for 100% payment to unsecured creditors (which seldom happens), then the education loan creditor will not be receiving full amount it is owed each month, and principal and interest will accrue during the Chapter 13 bankruptcy. At the end of the plan, while other unsecured debt is discharged, the student loan debt will have actually increased during the time of the plan. Thus, debtors in Chapter 7 do much better in regards to student loan payments because they will not have been in default for the 3 to 5 years.[226]

In order to obtain discharge of a student debt, the debtor must file an "adversary proceeding" in accordance with Federal Bankruptcy Rule 7001 *et seq*. An adversary proceeding is litigation within the bankruptcy case. The debtor must serve a complaint and summons upon the lender,[227] and the lender must answer the complaint within 30 days.[228] The case then proceeds with pleadings, motions, and discovery similar to the Federal Rules of Civil Procedure. At trial, the bankruptcy court must find that payment of the debt would impose an undue hardship upon the debtor and/or dependants.[229] A Chapter 13 the debtor may bring the adversary proceeding at any time during the case, and need not wait until all payments have been made.[230]

A nuance to student loan discharge litigation is whether an adversary complaint to discharge student loan debt may be brought after the court has entered the discharge order. Section 350(b) allows the court *sua sponte* or on motion of a party to reopen a case for cause, including to accord relief to the debtor.[231] The longer the time the case has been closed, the greater the burden on the moving party to demonstrate sufficient cause to reopen the case.[232] Generally, courts have not allowed debtors to reopen a case to seek discharge of student loan debt where the circumstances giving rise to undue hardship occurred after the case was closed.[233] For example, a debtor reopened her Chapter 7 case three years after date of the discharge in order to seek discharge of her student loans retroactive to the petition date.[234] Her inability to pay the

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[224] 11 U.S.C. §521(a)(1)(B)(i); Fed. R. Bankr. P. 1007(a)(1).
[225] Some debtors may continue payments while the Chapter 7 case is pending, but many lenders will not accept the payments because of concern for violating the automatic stay under §362.
[226] *In re* Mason, 456 B.R. at 251.
[227] Fed. R. Bankr. P. 7004.
[228] Fed. R. Bankr. P. 7012.
[229] *In re* Espinosa, 130 S. Ct. 1367, 1375 (2010).
[230] *In re* Cassim, 594 F. 3d 432 (6th Cir. 2010).
[231] 11 U.S.C. §350(b). Whether a case should be open is committed to the discretion of the court. Arleaux v. Arleaux, 210 B.R. 148, 149 (8th Cir. BAP 1997).
[232] *In re* Jackson, 144 B.R. 853, 854-55 (Bankr. W.D. Ark. 1992) (finding a strong policy of bankruptcy laws to ensure prompt and effectual administration of the estate).
[233] *See, e.g., In re* Kapsin, 265 B.R. 778, 781 (Bankr. N.D. Ohio 2001)(allowing a debtor to reopen years later would create a "perpetual Chapter 7 case"); *In re* Root, 318 B.R.. 851, 854 (Bankr. W.D. Mo. 2004) (denying motion to reopen case 13 years after entry of discharge).
[234] Zygarewicz v. Educ. Credit Mgmt. Corp. (*In re* Zygarewicz), 423 B.R. 909 (Bankr. E.D. Cal. 2010).

loans arose from injuries sustained in an accident after entry of the discharge order.[235] The court ruled that the circumstances must arise before entry of the original discharge order "[b]ecause the accident had no casual link to the misfortune prompting the debtor to seek bankruptcy relief in the first instance…."[236]

However, in a recent case, a debtor who received a Chapter 7 discharge filed to reopen her case four years later in order to discharge student loan debt.[237] The creditor did not oppose the motion and the issue before the court was whether the debtor's post-discharge circumstances could be considered in making an undue hardship determination.[238] The court held that post-discharge circumstances were relevant because the test for undue hardship requires the court to predict the debtor's future circumstances.[239] The court reasoned that it makes no sense for a court to go back to the time before the case was closed to predict the debtor's future circumstances when it is has the present facts before it.[240]

The fact that the debtor must prosecute an adversary proceeding to discharge student debt discourages debtors from seeking discharge of their debt. By definition, debtors file bankruptcy because they do not have enough money to meet their expenses. Discharge litigation costs thousands of dollars,[241] which bankruptcy few debtors can afford irrespective of the merits of their case.

4. Substantive: Education debt discharge in the courts

The term "undue hardship" is not defined in the Code. The inability to pay one's debts does not alone establish undue hardship, otherwise almost all bankruptcy debtors would meet the standard.[242] Bankruptcy courts have devised different tests to determine whether a debtor's circumstances constitute undue hardship.

(i) The *Brunner* Three-Part Test

The majority of courts have adopted the "*Brunner* test" to determine undue hardship. The test is from the Second Circuit case of Brunner v. New York State Higher Educ. Servs. Corp.[243] *Brunner* set forth a three-part test under which the debtor must prove:

(1) That the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the

[235] *Id.* at 912.
[236] *Id.* at 913.
[237] Crawley v. Educ. Credit Mgmt. Corp. (*In re* Crawley), 460 B.R. 421 (Bankr. E.D. Pa. 2011).
[238] *Id.* at 434.
[239] *Id.* at 435.
[240] *Id.* at 435, citing *In re* Walker, 427 B.R. 471, 483-84 (6th Cir. BAP 2010). Accord In re Sederland, 440 B.R. 168, 171 (8th Cir. BAP 2010). The court in *Crawley* noted that had the creditor presented arguments against reopening the case, the case may have been decided differently. *Id.* at 434.
[241] Student loan litigation can cost from $3,500 to $15,000 or more.
[242] Educ. Credit Mgmt. Corp. v. Frushour (*In re* Frushour), 433 F. 3d 393, 399 (4th Cir. 2005).
[243] 831 F. 2d 395 (2d Cir. 1987).

> loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor had made good faith efforts to repay the loan.[244]

The *Brunner* prongs are conjunctive, so that judgment must be entered against the debtor if he fails any one of the three requirements, even if any of the others are satisfied.[245] Most jurisdictions have adopted the *Brunner* test, including the Third,[246] Fourth,[247] Fifth,[248] Sixth,[249] Seventh,[250] Ninth,[251] Tenth,[252] and Eleventh Circuits.[253]

Brunner first prong:

The first prong of *Brunner* is that the debtor must prove that with his current income and expenses, he cannot maintain a "minimal standard of living" if forced to repay student loans. One factor in this determination is whether the debtor is maximizing his income and minimizing expenses.[254] As part of maximizing income, the debtor must look for a job in any field, not just the one for which the debtor trained or prefers.[255] In considering whether the debtor has minimized expenses, courts look to whether the debtor is in "self imposed hardship" due to unnecessary expenses – *i.e.*, the extent to which the debtor's inability to pay creditors is caused by the debtor's own spending on extraneous expenses.[256] Luxury spending or unreasonable amounts spent on otherwise reasonable expenses (including food) may show that the debtor is able to maintain a minimal standard of living even with loan payments.[257] The relevant date for determining the minimal-standard-of-living element is the date of trial.[258]

The Bankruptcy Code does not define what constitutes a "minimal standard of living." An oft-cited opinion, *In re* Ivory,[259] defines it as follows: (1) shelter (including heating and

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[244] *Id*., 831 at 396.
[245] Fabrizio v. U.S. Dept. of Educ. Borrower Services (In re Fabrizio), 369 B.R. 238, 244 (Bankr. W.D. Pa. 2007).
[246] Pa. Higher Educ. Assistance Agency v. Faish (*In re* Faish), 72 F. 3d 298, 306 (3d. Cir. 1995); *cert denied*, 518 U.S. 1009 (1996).
[247] *In re* Frushour, 433 F. 3d 393 (4th Cir. 2005); United Student Educ. Res. Inst. (*In re* Ekenasi), 325 F. 3d 541, 546 (4th Cir. 2003).
[248] U.S. Dept. of Educ. v. Gerhardt (*In re* Gerhardt), 348 F. 3d 89, 51 (5th Cir. 2003).
[249] Oyler v. Educ. Credit Mgmt. Corp. (*In re* Oyler), 397 F. 3d 382, 385 (6th Cir. 2005).
[250] *In re* Roberson, 999 F. 2d 1132 (7th Cir. 1993).
[251] United Student Aid Funds, Inc., v. Pena (*In re* Pena), 155 F. 3d 1108, 1112 (9th Cir. 1998).
[252] Educ. Credit Mgmt. Corp. v. Polleys, 356 F. 3d 1302, 1309 (10th Cir. 2004).
[253] Hemar Ins. Corp. v. Cox (*In re* Cox), 338 F. 3d 1238, 1241 (11th Cir.), *reh'g denied*, 82 F. App.'x 220 (11th Cir. 2003), *cert. denied*, 541 U.S. 991 (2004).
[254] Nixon v. Key Educ. Resources (*In re* Nixon), 453 B.R. 311, 327-328 (S.D. Ohio 2011).
[255] Tirch v. Penn. Higher Educ. Assistance Agency (*In re* Tirch), 409 F. 3d 677, 681 (6th Cir. 2005) ("Tirch should have sought employment in another field when the stress of clinical social work became debilitating"); *In re* Healey, 161 B.R. 389, 395 (E.D. Mich. 1993) (a debtor cannot ignore reasonable options in other fields in order to work in one's "field of dreams").
[256] Educational Management Corp. v. DeGroot, 339 B.R. 201, 208 (D. Ore. 2006). The court also found that as the debtor had a three-bedroom house and no dependents, she should have taken on a roommate to share expenses. *Id.* at 210.
[257] Mandala v. Educ. Credit Mgmt. Corp. (*In re* Mandala), 310 B.R. 213, 221-22 (Bankr. D. Kan. 2004) (holding that debtors could maintain minimal standard of living if they adjusted expenses, including food expenses).
[258] *In re Nixon*, *supra*, 453 B.R. at 326.
[259] Ivory v. United States (*In re* Ivory), 269 B.R. 890 (Bankr. N.D. Ala. 2001).

cooling); (2) basic utilities such as electricity, water, natural gas, and telephones; (3) food and personal hygiene products; (4) vehicles, along with insurance, gas, licenses, and maintenance; (5) health insurance or money to pay for healthcare; (6) some amount of entertainment or diversion, even if only a television or a pet.[260] While the *Ivory* list is often referenced by other courts, it need not be applied mechanically:

> Rather, in appropriate circumstances, the court must be prepared to depart from the list based on its own experiences, common sense, knowledge of the surrounding area and culture, and assessment of the reasonableness of what debtor claims he or she needs. In addition, what is minimal can and probably should change over time, *e.g.*, with new technology driving down the cost of things that might have previously been cost prohibitive.[261]

Although "minimal standard of living" is not supposed to mean that the debtor live in poverty, "it does mean that the debtor is expected to do some financial belt-tightening and forgo amenities to which he may have become accustomed."[262] But standards can change with time. In recent years, courts have found that standard expenses for cell phones, cable and internet are basic and reasonable expenses.[263]

Brunner second prong

To meet the second prong of *Brunner*, the debtor most present "additional circumstances" that show the state of affairs is likely to persist for a significant portion of the repayment period. In essence, the debtor must demonstrate that "circumstances indicate a certainty of hopelessness, not merely a present inability to fulfill financial commitment."[264] This has been described as "the heart of the *Brunner* test… and is difficult to prove because it requires the debtor to show that she will be unable to repay her student loan debt in the future for reasons outside her control."[265]

The debtor may try to show a variety of causes, such as illness, disability, lack of job skills, or a large number of dependants. The most common type of additional circumstance supporting undue hardship discharge appears to be medical-related issues, such as chronic mental or physical ailments that interfere with the debtor's ability to work and generate income.[266] Depression caused by debt, without more, generally does not suffice.[267] Ultimately,

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[260] *Id*. at 899.
[261] Miller v. Sallie Mae, Inc. (*In re* Miller), 409 B.R. 299, 312 (Bankr. E.D. Pa. 2009).
[262] Campton v. U.S. Dept. of Educ. (*In re* Campton), 405 B.R. 887, 891 (Bankr. N.D. Ohio 2009).
[263] *See e.g., In re* Nixon, *supra*, 354 B.R. at 329 (holding that telecommunications expenses are reasonable to permit debtors to have a source of entertainment, apply for employment online, and to communicate).
[264] Barrett v. Educ. Credit Mgmt. Corp. (*In re* Barrett), 487 F. 3d 353, 359 (6th Cir. 2007).
[265] *In re* Matthews-Hamad, 377 B.R. 415, 422-23 (Bankr. M.D. Fla. 2007).
[266] Rafael I. Pardo and Michelle R. Lacey, *The Real Student Loan Debt Scandal: Undue Hardship Litigation*, 83 Amer. Bankr. L. J. 179, 205 (2009). Cases confirming this include *In re* Todd, 2012 WL 1862341 (Bankr. Md. 2012) (loans discharged for 63-year old debtor with lifetime Asperger's syndrome, osteoporosis, and post-traumatic stress disorder resulting from subdural hematoma); *In re* Barrett, 487 F. 3d 353 (6th Cir. 2007) (debtor diagnosed with avascular necrosis and stage IV Hodgkin's lymphoma requiring multiple future surgeries); *In re* Larson, 426 B.R. 782 (Bankr. N.D. Ill. 2010) (debtor suffered from diabetes, total blindness caused by diabetes, medication for

however, "the most important factor in satisfying the second prong is that the additional circumstances must be beyond the debtor's control, not borne by free choice."[268] A debtor's decision to become poor or to remain poor after bankruptcy while better earning options are available indicates that the debtor's circumstances are a result of his own decisions.[269] A debtor who left a well-paying nursing career at age 45 to enter chiropractic school could not complain that, at age 54, the profession did not provide enough income for her to repay her student loan debts within her lifetime.[270] In another case, a debtor, an adjunct professor, refused to apply for permanent work at other schools because she deemed them too far from her home, even though the increased income would more than offset extra transportation costs.[271]

But not all choices are necessarily *free* choice. Where a debtor discontinued her studies twenty-five years previous in order to care for her infirm parents, the court characterized her decision as a *moral* choice, not a choice to be poor:

> [t]he *Brunner* test looks to the present and future, not to the distant past. The test requires that the court determine whether present circumstances will continue for a time into the future for reasons outside a debtor's control. A moral choice that some debtor made 24 or more years ago to forgo opportunities she then had to improve herself, and thus to optimize her potential to earn enough money to repay her student loan debt, is not relevant to a *Brunner* analysis.[272]

In another case, a debtor incurred $200,000 of student loan debt for undergraduate and medical school, but by the time of her bankruptcy petition, had became a full-time stay at home mother with five young children, including two special needs children.[273] The debtor met the second prong of *Brunner*. As the court stated, "[t]his is not a case in which a debtor willfully chose to avoid payments that could have been made or was underemployed or unemployed for no discernible reason. Caring for her five young children has become Walker's full-time occupation."[274]

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diabetes, treatment for heart condition that required quadruple bypass, and medication for kidney failure that required kidney transplant).

[267] Katheryn E. Hancock, *A Certainty of Hopelessness: Debt, Depression, and the Discharge of Student Loans Under the Bankruptcy Code*, 33 Law & Psychcol. Rev. 151, 162 (2009) (analyzing mental health as a factor in student loan debt discharge cases).

[268] *In re* Barrett, *supra*, 487 F. 3d at 359.

[269] *In re* Bene, 2012 Bankr. LEXIS 2914, *10-*11 (Bankr. W.D.N.Y., June 26, 2012).

[270] *In re* DeRose, 316 B.R. 606 (Bankr. W.D.N.Y. 2004)

[271] *In re* Gipson, 2012 Bankr. LEXIS 2745 at *7-*9 (Bankr. D.Md. 2012). The debtor also refused to reactivate her law license to seek work in law, which would provide more income, for the reason that "I'm not interested in being an attorney. I do not consider myself an attorney. I am an educator." *Id.* at *11. *See also*, *In re* Nixon, *supra* 453 at 331 (Bankr. S.D. Ohio 2011) (holding that debtor could not satisfy the second prong of Brunner without looking for all possible teaching positions).

[272] *In re* Bene, *supra*, 2012 Bankr. LEXIS 2914 at *11-*12.

[273] Sallie Mae v. Walker (*In re* Walker), 650 F. 3d 1227 (8th Cir. 2011).

[274] *Id.* at 1234.

The distinguishing element in these cases is whether the debtor has options that could increase income or decrease expenses.[275] Changing patterns of income to care for elderly parents or raise children were found to not constitute free choice, whereas personal career changes or preferences were. In addition, the time frame of the choice, *i.e.*, a recent choice of the debtor or one in the distant past, can also be a consideration.[276]

Less frequently, the *Brunner* second prong can also be met where a debtor has been unable to find employment despite sustained and diligent efforts. The standard is strict. In one case, a pro se debtor had trained a paralegal, but for ten years had sought unsuccessfully to land any type of a job.[277] The court, having the observed at trial the debtor's demeanor, body language and overall attitude, could not help but be moved: "[s]he has clearly been worn down by the difficulties she has experienced, and it shows."[278] The court then noted the exceptional circumstances in which a debtor's history of failure to secure employment might justify a finding that the second prong of *Brunner* was met:

> Rarely has the Court seen the kind of persistent search efforts in which the debtor has engaged over the past decade. Never had the court seen such utter futility be the result of a debtor's job search efforts. This debtor is truly destitute and has been in these straits for many years without respite. *** If the term "certainty of hopelessness" is to ever have any application, it is in this case.[279]

It is unclear the extent to which a debtor's advanced age may constitute an "additional circumstance" to satisfy the second prong of *Brunner*. In *Brunner*, the court held that no additional circumstances exist where the debtor "is not disabled *nor elderly*."[280] One court cited the debtor's age (early fifties) as limiting her earning capacity and thus her ability to afford loan repayment.[281] However, other courts have held that people who take on education debt at an older age do not suffer undue hardship because they owe debt into their retirement age,[282] even if the debtor asserts he will be unable to pay the loan in their lifetime.[283]

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[275] *See In re* Bene, *supra* 2012 Bankr. LEXIS 2914 at *36-*37 (noting that moral choices made a long time ago are different from lifestyle options that the debtor can feasibly modify after bankruptcy).
[276] *Id. at* *36. In *Bene*, the debtor, who was 64, had worked on an assembly line for 12 years, but with the plant closing and no other skills or degree, the court found that the debtor "had no choice, and has not had a choice for a very long time." *Id.* at *36.
[277] Krieger v. Educ. Credit Mgmt. Corp. (*In re* Krieger), 2012 WL 1155687 *5 (Bankr. C.D. Ill. 2012) ("the [*Brunner* second prong] determination is based on the Court's judgment about whether and where this particular debtor is likely to work in the future and what she is likely to earn in the future").
[278] *Id*. at *6.
[279] *Id.* at *6.
[280] Brunner, 831 F. 2d at 396 (emphasis added).
[281] Hinckle v. Wheaton College (In re Hinckle), 200 B.R. 690, 694 (Bankr. W.D. Wash. 1996).
[282] *See e.g.*, Educational Credit Management Corp. v. Degroot, 339 B.R. 201, 212 (D. Ore. 2006)("where debtors choose to incur educational debt later in life, the fact that they will reach retirement age during the loan repayment period is not enough alone to justify discharge…."); Mandala v. Educ. Credit Mgmt. Corp. (*In re* Mandala), 310 B.R. 213, 222 (Bankr. D. Kan. 2004) (where the debtor chose to return to school late in life on borrowed money, "that student loan payment may progress beyond a borrower's retirement age, standing alone, should not skew the second *Brunner* test against lenders").
[283] Fabrizio v. U.S. Dept. of Educ. Borrower Services (*In re* Fabrizio), 369 B.R. 238, 245-246 (Bankr. W.D. Pa. 2007) ("Debtor's personal belief as to the effect of payment is totally irrelevant on this issue").

Brunner third prong

The third prong of *Brunner* is whether the debtor has made good faith efforts to repay the loan. As a starting point, failure by the debtor to make a payment does not of itself establish a lack of good faith.[284] Rather, a debtor's good faith is measured by his "efforts to obtain employment, maximize income, and minimize expenses."[285] So, where a debtor attempted unsuccessfully find work while living with his mother, and while at the same time suffering from debilitating medical conditions, the third prong of *Brunner* was satisfied.[286] On the other hand, a debtor's failure to make *any* payments when earning an income can be evidence of lack of good faith efforts.[287]

Some courts consider whether the debtor has participated in alternative repayment options.[288] Creditors may argue that this means the debtor must have negotiated a repayment plan under the Income Contingent Repayment Program. However, in *In re* Mosley, the Eleventh Circuit rejected a per se test.[289] In that case, although the debtor's payment under an income contingent repayment plan would be zero, interest on the debt would continue to accrue and the amount forgiven at the end of 25 years could be treated as taxable income. As the court pointed out, this is not always a viable option for debtors because it would require them to "'trade one dischargeable debt for another.'"[290]

The Sixth Circuit has also refused to hold that the good faith prong of *Brunner* requires the debtor to participate income contingent repayment, noting that, inter alia, such a rule would in effect eliminate the discharge of student loans for undue hardship from the Bankruptcy Code.[291] The majority of courts agree.[292]

Overall, the difficulty in meeting the *Brunner* standard is exemplified by the case of *In re* Fields, in which debtor filed a pro se adversary proceeding to discharge $115,000 of student loan debt.[293] He had been diagnosed as paranoid schizophrenic and adjudicated disabled by the social

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[284] Educ. Credit Mgnt. Corp. v. Polleys (*In re* Polleys), 356 F. 3d 1302, 1311 (10th Cir. 2004) (holding that the debtor's "failure to make a payment, standing alone, does not establish a lack of good faith").
[285] Educ. Credit. Mgnt. Corp. v. Mosley (*In re* Mosley), 494 F. 3d 1320, 1327 (11th Cir. 2007).
[286] *In re* Mosley, *supra*, 494 F. 3d at 1327.
[287] *In re* Fabrizio, 369 B.R. 238, 245 (W.D. Pa. 2007) (finding lack of good faith where debtor who made $37,000 per year failed to make any payments for two years).
[288] Hertzel v. Educ. Credit Mgmt. Corp. (*In re* Hertzel), 328 B.R. 221, 233-34 (B.A.P. 6th Cir. 2005).
[289] *In re* Mosley, *supra*, 494 F. 3d 1320.
[290] *Id*. at 1327 (quoting *In re* Barrett, *supra*, 487 F. 3d at 364 (6th Cir. 2007). *See also, In re* Brodson, *supra*, 435 B.R. at 802 ("the [income contingent repayment program] might be beneficial for a borrower whose inability to pay is temporary and whose improvement is anticipated, however, such programs may be detrimental to the borrower's long-term financial health").
[291] *In re* Barrett, *supra*, 487 F. 3d 364.
[292] *See, e.g., In re* Brodson, supra, 435 B.R. 791; *In re* Crawley, 40 B.R. 421 (Bankr. E.D. Pa. 2011); *In re* Benjumen, 408 B.R. 9 (Bankr. E.D.N.Y. 2009); *In re* Bene, *supra*, 2012 Bankr. LEXIS 2914, *3 (holding that requiring income contingent repayment would effect a repeal of (523(a)(8)); Allen v. Amer. Educ. Services (*In re* Allen), 324 B.R. 278, 281 (Bankr. W.D. Pa. 2005) (whether debtor has participated in deferment or restructuring program "is but one of the factors for the court to consider"); Cagle v. Education Credit Management Corp. (*In re* Cagle), 2011 WL 614087 (Bankr. KS 2011).
[293] Fields v. Educ. Credit. Mgmt. Corp. (*In re* Fields), 2012 Bankr. LEXIS 1280 *7 (Bankr. N.D. Ala. 2012).

security administration.[294] The debtor's monthly social security income was just barely above the poverty income threshold, and he had held a string of short-term jobs for ten years, unable to stay in any position for long because of his disorder.[295] And, despite his willingness to work at any type of job, not just the legal field for which he had trained, his efforts to obtain employment was unsuccessful after three years.[296] This was sufficient evidence to establish undue hardship under the *Brunner* test.[297]

(ii) Totality of the Circumstances Test

The Eighth Circuit uses a "totality of the circumstances test" under which the court considers "(1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependant's reasonable necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case."[298] Thus, the court found undue hardship where the debtor cared for five children, including two autistic children, and her spouse's income as a police officer was insufficient to meet their reasonable expenses, much less pay anything towards her $300,000 student loan debt.[299]

The First Circuit has not adopted a specific test, but instead focuses on the debtor's ability to earn an income in the future: "We see no need in this case to pronounce our views of a preferred method of identifying a case of 'undue hardship.' The standards urged on us by the parties both require the debtor to demonstrate that her disability will prevent her from working for the foreseeable future."[300]

In absence of specific instructions from the First Circuit Court of Appeals, the First Circuit BAP and bankruptcy courts in Massachusetts employ a "totality of the circumstances test." Courts adopting this approach find that the second and third prongs *Brunner* go beyond what is required under §523(a)(8). In Bronsdon v. Educ. Credit Mgmt. Corp. (*In re* Bronsdon)[301] the First Circuit BAP rejected the second prong of *Brunner*, which requires a showing that the debtor's state of affairs is likely to persist for a significant portion of the repayment period:

> Many courts interpreting and applying the second *Brunner* prong, however, place dispositive weight on the debtor's ability to demonstrate "additional extraordinary circumstances" that establish a "certainty of hopelessness." The has led some courts to require that the debtor show the existence of "unique" or "extraordinary" circumstances, such as the debtor's advanced age, illness or disability, psychiatric problems lack of usable job skills, large number of dependents or severely limited education…. And, in the absence of such a showing, the court may conclude that the debtor has failed the second *Brunner* prong and the student loans will not be

[294] *Id.* at *2 - *3.
[295] *Id.* at *12-*13, *19.
[296] *Id.* at *23.
[297] *Id.* at *28 -* 29.
[298] Walker v. Sallie Mae Serv. Corp. (*In re* Walker, 650 F. 3d 1227, 1230 (8th Cir. 2011); Long v. Educ. Credit Mgmt. Corp. (*In re* Long), 322 F. 3d 549, 554 (8th Cir. 2003).
[299] *In re* Walker, *supra*, 650 F. 3d at 1234-35.
[300] TI Fed. Credit Union v. DelBonis, 72 F. 3d 921, 937 (1st Cir. 1995).
[301] *In re* Bronsdon, *supra*, 435 B.R. 791.

> discharged. Requiring the debtor to present additional evidence of a "unique" or "extraordinary" circumstances amounting to a "certainty of hopelessness" is not supported by the text of §523(a)(8). The debtor need only demonstrate "undue hardship."[302]

The BAP also took issue with the third prong of *Brunner*, which requires the debtor to affirmatively prove good faith in attempting to repay the loan:

> Ultimately, the debtor must establish by a preponderance of the evidence that her present and future actual circumstances would impose an undue hardship if her debts are excepted from discharge. * * * The party opposing the discharge of a student loan has the burden of presenting evidence of any disqualifying factor, such as bad faith. The debtor is not required under the statute to establish prepetition good faith in absence of a challenge. The debtor should not be obligated to prove a negative, that is, that he did not act in bad faith, and, consequently, in good faith.[303]

The *Bronsdon* court found that debtor's efforts to repay a loan is just one of the elements in the totality of the circumstances test, and not a dispositive requirement on its own. For example, income contingent or IBR programs allow for suspension or reduction of payments, but can result in the continued accrual of interest. Such "negative amortization" in fact increases the debtor's ultimate debt burden.[304] In addition, federal loan forgiveness effectively trades nondischargeable loan debt for nondischargeable tax debt.[305] Accordingly, many loan repayment programs may not be suitable for debtors, and should not be taken into consideration when determining whether the debtor should be allowed a discharge.[306]

(iii) Partial Discharge of Education Debt

Some courts permit a debtor to discharge part of an education debt using *Brunner* or the "totality of the circumstances" criteria. Whether this is allowed under the Code may be unclear. On its face, §523(a)(8) refers to discharge of "an educational benefit overpayment or loan…."[307] This can be construed to mean discharge of a loan in its entirety, and not a discharge of a part of a loan. Other provisions of the Code expressly provide for adjustment of a portion of a debt. For example, §506(a)(1) allows for partial modification (bifurcation) of a secured debt into secured and unsecured components "to the extent of the value of such creditor's interest in [the collateral]."[308] In consumer cases, the debtor may avoid a judgment lien against property of the debtor "to the extent that such lien impairs an exemption to which the debtor would have been

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[302] *In re* Bronsdon, *supra*, 435 B.R. at 801, *citing* Hicks v. Educ. Credit Mgmt. Corp. (*In re* Hicks), 331 B.R. 18, 27-28 (Bank. D. Mass. 2005).
[303] *Id.* at 800-801.
[304] *Id.* at 802.
[305] *Id.* at 802-803.
[306] *Id.*
[307] 11 U.S.C. §523(a)(8).
[308] *Id.* §506(a)(1).

entitled…."[309] In these provisions, the words "*to the extent*" show that partial treatment of the claim is allowed. There is no such language with respect to treatment of education debt.

In absence of express language allowing for partial discharge of education debt, some courts grant partial discharge pursuant to §105.[310] That section provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[311] Thus, courts have granted partial discharge of student loan debt by discharging part of the principal, accrued interest or attorney's fees,[312] instituting a repayment schedule, deferring repayment, or even by allowing a debtor to reopen bankruptcy proceedings to revisit the question of undue hardship.[313]

The Sixth Circuit has held that partial discharge is permitted under §105(a)[314] using the three-part *Brunner* criteria.[315] To receive the discharge, the debtor must satisfy each prong of the *Brunner* test with respect to the portion of the debt to be discharged, and the discharge is allocated pro rata among the debtor's loans.[316] In one case, a bankruptcy court applied the three-part *Brunner* test in discharging all but $8,045.02 of the debtor's total student loan debt of $36,284.81.[317] "The debtor's inability to repay the student loans must result from factors beyond the debtor's reasonable control…."[318] The court found that the most important element causing the debtor's financial problem was her cancer, and that because of this, "it is highly likely that [debtor's] financial predicament will persist for many years, and possibly the rest of her life."[319]

Courts in the Tenth Circuit,[320] Eleventh Circuit,[321] and lower courts in the Ninth Circuit[322] also grant partial discharge of student loans using the *Brunner* criteria. Other courts

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[309] *Id.* §522(f)(1)(A).
[310] *Id.* §105(a).
[311] *Id.*
[312] Griffin v. Eduserv (*In re* Griffin), 197 B.R. 144, 147 (Bankr. E.D. Okla. 1996)("[I]t would be an 'undue hardship' for the debtors to pay any of the accrued interest and attorneys' fees associated with … student loans.")
[313] *See infra*, notes 231-236 and accompanying text.
[314] Tenn. Student Assistance v. Hornsby (*In re* Hornsby), 144 F. 3d 433, 440 (6th Cir. 1998). *See also*, Miller v. Pa. Higher Assistance Agency (*In re* Miller), 377 F. 3d 616, 620 (6th Cir. 2004)("when a debtor does not make a showing of undue hardship with respect to the entirety of her student loans, a bankruptcy court may – pursuant to its §105(a) powers—contemplate granting … a partial discharge of the debtor's student loans.").
[315] *In re* Oyler, 397 F. 3d 382 (6th Cir. 2005); *In re* Nixon, *supra*, 435 B.R. 311, 336 (Bankr. S.D. Ohio 2011)(court may grant partial discharge of student loan debt).
[316] *In re* Nixon, *supra*, 435 B.R. at 336 (debtor with education debt of more than $270,000 may discharge any amounts in excess of $214,200, based upon *Brunner* criteria).
[317] Jorgensen v. Educational Credit Mngmt. Corp. (*In re* Jorgensen), 2012 Bankr. LEXIS 254 (Bankr. HI, Jan. 19, 2012).
[318] Id. at *14.
[319] Id. at *13.
[320] Alderete v. Educational Credit Management Corp. (*In re* Alderete), 412 F. 3d 1200 (10th cir. 2005).
[321] Hemar Ins. Corp. v. Cox (*In re* Cox), 338 F. 3d 1238 (11th Cir. 2003), cert. denied, 541 U.S. 991 (2004)("Because the specific language of §523(a)(8) does not allow for relief to a debtor who has failed to show 'undue hardship,' the statute cannot be overruled by the general principals of equity contained in §105(a).").
[322] Saxman v. Educ. Mgmt. Corp. (*In re* Saxman), 325 F. 3d 1168, 1173 (9th Cir. 2003) ("bankruptcy courts may exercise their equitable authority under 11 U.S.C. §105(a) to partially discharge student loans."); Educational Credit Mgmt. Corp. v. Jorgensen (*In re* Jorgensen), 2012 Bankr. LEXIS 4303 (B.A.P. 9th Cir., Sept. 11, 2012) (partial undue hardship discharge of student loan debt affirmed as challenged expenses were justified by debtor's medical condition).

have ordered partial discharge under the "totality of the circumstances" test. For example, a Massachusetts bankruptcy court held that although the debtor had not proven undue hardship at trial, her long-term income prospects were dubious given her advanced age and history of poor health. Therefore, the court held that if the debtor participated in the Ford Program and abided by the income-based option, the court would discharge whatever portion of the debt remained at the expiration of the repayment program.[323]

A hybrid approach was taken by the court in *In re* Hinkle.[324] In that case, the court ruled that there was no authority under the Code to a grant partial discharge of any education debt, but that where a debtor had multiple debts, the court could grant a full discharge to some of the debts while leaving the others nondischargeable, based upon the *Brunner* criteria.[325] Thus, of the debtor's six student loans, the court found that the three loans that had been in repayment the longest time, totaling $18,143, were dischargeable, but that the debtor would be able to pay the three remaining loans totaling $10,014.[326] Other courts use a similar loan-by-loan approach.[327]

One problem with the loan-by-loan approach is that it requires a court to decide which loan(s) which will be paid and which ones discharged. There is nothing in the Bankruptcy Code that addresses this type of prioritization, and several courts have held that loan-by-loan discharge is inappropriate for this reason.[328]

A number of courts have held that the Bankruptcy Code does not allow for partial discharge. These include the Third Circuit[329] and many bankruptcy courts.[330] Some commentators have criticized the use of § 105(a) to grant partial discharge.[331]

(iv) Discharge of Debt Because of Creditor's Failure to Respond

A Chapter 13 debtor must serve a copy of her proposed plan on each of her creditors, with a notice of the objection deadline.[332] Creditors who fail to object to the plan are bound by

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[323] Stevenson v. Educ. Credit Mgmt. Program (*In re* Stevenson), 2011 WL 3420428 (Bkrtcy D. Mass. 2011).
[324] In re Hinkle, *supra*, 200 B.R. 690.
[325] *Id.* at 693.
[326] *Id.* at 694. *See also*, *In re* Gharavi, 335 B.R. 492, 501 (Bankr. D. Ma. 2006) (debtor who suffered from fatigue due to MS established undue hardship in showing that she only had enough income to afford payments on the oldest of four loans).
[327] Ledbetter v. United States Dep't of Educ. (*In re* Ledbetter), 254 B.R. 714 (Bankr. S.D. Ohio 2000); Hollister v. Univ. of N.D. (*In re* Hollister) 247 B.R. 485 (Bankr. W.D. Okla. 2000); *In re* Gharavi, 335 B.R. 492 (Bankr. D. Mass. 2006) (court discharged three out of four student loans, but debtor remained liable on one of them).
[328] Pincus v. Graduate Loan Center (*In re* Pincus) 280 B.R. 303, 313 (Bankr. S.D.N.Y. 2002); Young v. PHEAA (*In re* Young), 225 B.R. 312 (Bankr. E.D. Pa. 1998).
[329] *In re* Faish, *supra*, 72 F. 3d at 307.
[330] *See, e.g.*, *In re* Pincus, supra 280 B.R. at 311 ("The Bankruptcy Code does not permit a court to discharge in part a single student loan obligation").
[331] Daniel B. Bogart, *Resisting the Expansion of Bankruptcy Court Power Under Section 105*, 35 Ariz. St. L. J. 793 (2003*). See also*, Amanda M. Foster, *All or Nothing: Partial Discharge of Student Loans Is Not the Answer to Perceived Unfairness of the Undue Hardship Exception*, 16 Widener L.J. 1053, 1084 (2007) (asserting that partial discharge is not permitted because under § 523(a)(8), "the entire debt must create an undue hardship").
[332] 11 U.S.C. §1321 and Fed. R. Bankr. P. 3015(b).

the terms of a confirmed Chapter 13 plan.[333] Some debtors have tried to modify their education loans by simply providing for modification of the loans in their plan without filing an adversary proceeding. This tactic, known as "discharge by declaration," first appeared in the 1990s and a number of courts confirmed such plans, considering it a matter of *res judicata* if the creditor did not timely object.[334] Other courts pushed back against what one opinion called "a trap for unwary creditors,"[335] finding that using plan confirmation as a means to avoid an adversary proceeding to discharge student debt was unethical and could subject debtors' counsel to sanctions.[336]

The issue came to a head in the case of United Student Aid Funds, Inc. v. Espinosa (*In re* Espinosa).[337] In *Espinosa*, the debtor included payment of student loan principal in his plan, but not payment of interest.[338] The creditor was served with a copy of the plan at the address of its payment drop box, and although an employee of the creditor saw the plan, no objection was filed and the plan was confirmed.[339] Years later, when the creditor attempted to collect the debt, the debtor asserted that the debt had been discharged.[340] The Court held that the creditor had received sufficient notice and was bound by the terms of the plan because it failed to object or appeal the confirmation order.[341] But the Court also ruled that because the Code requires a finding of undue hardship in order to discharge student loan debt, attempting to do so by means of a plan alone was improper and could subject debtors and their counsel to penalties.[342] Accordingly, bankruptcy courts should not confirm a plan modifying student loan debt if the debtor has not established undue hardship through an adversary proceeding.[343]

(v) Separate classification of student loan debt in Chapter 13

Chapter 13 debtors in some jurisdictions have other alternatives to discharge education debt. Section 1322(b)(2) provides that a Chapter 13 plan may "[d]esignate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly

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[333] 11 U.S.C. § 1327(a) provides, "[t]he provisions of a confirmed plan bind the debtor and each creditor, whether or not…such creditor has objected to, accepted, or has rejected the plan."
[334] Anderson v. UNIPAC-NEBHELP (*In re* Anderson), 179 F. 3d 1253 (10th Cir. 1999) (debtor's plan provided that paying more than 10 percent of the education loan would be a hardship); Great Lakes Higher Educ. Corp. v. Pardee (*In re* Pardee), 193 F. 3d 1083 (9th Cir. 1999) (plan discharged post-petition interest); *In re* Machado, 378 B.R. 14, 17 (Bankr. Ma. 2007) (the fact that no unsecured creditors objected to favorable treatment of student loan debt showed that the plan did not unfairly discriminate).
[335] *In re* Mammel, 221 B.R. 238, 243 (Bankr. N.D. Iowa 1998).
[336] *In re* Evans, 242 B.R. 407, 411 (Bankr. S.D. Ohio 1999) (court issued rule to show cause why provision did not violate Bankruptcy Rule 9011); *In re* Lemons, 285 B.R. 327, 333 (Bankr. W.D. Okla 2002) (counsel sanctioned for including discharge provision in plan); *In re* Wright, 279 B.R. 886, 889 (Bankr. D. Kan. 2002) (including student loan discharge provision in order to trap unwary creditor should result in sanctions).
[337] *Supra*, 130 S. Ct. 1367.
[338] *Id*. at 1374.
[339] *Id*.
[340] *Id*.
[341] *Id*. at 1380.
[342] Id. at 1382
[343] *In re* Kinney, 456 B.R. 748, 753 (Bankr. E.D. N.C. 2010) (holding that "inclusion of student loan discharge provisions as part of a Chapter 13 plan without filing an adversary proceeding….and without consideration of whether facts exist to support undue hardship will not be allowed by this court").

against any class so designated."[344] This is similar to §1122 in Chapter 11 business bankruptcy which provides that "a plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interests in such class."[345] While this prohibits dissimilar claims from being placed in the same class, §1122 does not require that all similar claims to be placed in the same class.[346] In Chapter 11 cases, debtors commonly place nonpriority unsecured claims in different classes for purposes of voting on a plan of reorganization. For example, a business debtor may place trade vendors in a different class than claims arising from breach of a collective bargaining unit or claims based upon the unsecured portion of a secured creditor's claim. The interests of these creditors under a plan may be very different, so it makes sense to allow them to vote separately by classes. In addition, for a plan to be confirmed, the proponent needs at least one impaired class to vote to accept the plan.[347] In many instances, a debtor will, in fact, designate a class of similar claims in order to ensure a favorable vote by at least one class.[348]

In contrast to Chapter 11, creditors in a Chapter 13 case do not vote to accept or reject the plan.[349] Therefore the "gerrymandering" logic that might drive designation of classes in Chapter 11 does not apply in Chapter 13. And while a Chapter 13 debtor can create separate classes of general unsecured claims, she "may not discriminate unfairly against any class so designated."[350] Education loans, which are not dischargeable and which usually extend beyond the three- or five-year duration of the plan, are logically distinct from other general unsecured claims which are discharged upon completion of the plan. Therefore, education loans may logically be classified separately from other general unsecured debt.[351] Moreover, "not all discrimination among classes is prohibited-it is only unfair discrimination that is impermissible."[352] Thus, whether a debtor may classify and treat education loans separately from general unsecured debt depends upon whether the separate classification violates the prohibition against unfair discrimination.

A number of courts have considered whether separate classification of Chapter 13 debt constitutes "unfair discrimination." The Eighth Circuit in *In re* Leser, a case dealing with separate classification of delinquent child support claims, adopted this four-part test: (1) whether there is a rational basis for the classification; (2) whether the classification is necessary to the debtor's rehabilitation under Chapter 13; (3) whether the discriminatory classification is proposed in good faith; (4) whether there is meaningful payment to the class discriminated against.[353] A number of bankruptcy

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[344] 11 U.S.C. §1322(b)(1).
[345] *Id.* §1122(a). The Code does not define "substantially similar," but appears to require "classification based on the nature of the claims or interests of classified…." H.R. Rep. No. 595, 95th Cong. 1st Sess. 406 (1977); S. Rep. No. 989, 95th Cong. 2d Sess. 118 (1978).
[346] Travelers Ins. Co. v. Bryson Props., XVIII (*In re* Bryson Props., XVIII), 961 F. 2d 496, 502 (4th Cir. 1992).
[347] 11 U.S.C. §1129(a)(10).
[348] §1129(b)(1) provides that the court shall confirm a plan over the objections of one or more class of creditors as long as the plan is "fair and equitable" and at least one class of impaired creditors has voted to accept the plan.
[349] §1325(a).
[350] *Id.* §1322(b)(1).
[351] *In re* Potgieter, 436 B.R. 739, 743 (Bankr. M.D. Fla. 2010)("[T]he separate classification of the debtor's student loan obligations does not violate Section 1122."); *In re* Coonce, 213 B.R. 344, 354 (Bankr. S.D. Ill. 1997)(separate classification of student loan debt is permissible).
[352] *In re* Mason, 456 B.R. 245, 249 (Bankr. N.D. W.Va. 2011).
[353] Mickelson v. Leser (In re Leser), 939 F. 2d 669, 672 (8th Cir. 1991).

courts have used the *Leser* test.[354] The bankruptcy court in *In re* Husted (which also addressed child support claims) used the same four factors and added a fifth: (5) the difference between what the creditors discriminated against will receive as the plan is proposed, and the amount they would receive if there was no separate classification.[355] The Ninth Circuit BAP has used similar elements,[356] as have other courts.[357] One court even found that separate classification of student loan debt furthers the "legislative objective of student loan payment."[358]

The First Circuit BAP has established a "baseline test" of Chapter 13 guiding principles to determine the baseline from which departures can be evaluated for fairness.[359] The considerations include: (1) fairness in the equality of distribution; (2) nonpriority of student loans under the Code; (3) whether dischargeable unsecured creditors receive their full pro rata distribution under Chapter 13; and (4) Chapter 13 exempts student loans from discharge, therefore the debtor does not have an unlimited expectation of a "fresh start."[360] While not widely followed, some courts have cited *Bentley* with approval.[361]

The problem inherent in any multi-factor test is that "unfairness is ultimately a discretionary determination, subject to individual judgment…."[362] Courts have struggled to articulate specific criteria, and some have found simply that what is unfair is best left to the "first-line decision maker, the bankruptcy judge."[363] In the end, whether a debtor can classify and treat education debt and general unsecured debt differently really depends upon the jurisdiction and court in which the case was filed, as the following cases show.

(a) Cases in which separate classification was allowed

In *In re* Pracht,[364] the debtor owed $115,934.98 in student loan debt, and $102,000 in general unsecured debt. The debtor, a special education teacher, was eligible to participate in the

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[354] *In re* Sperma, 173 B.R. 654 (9th Cir. BAP 1994); *In re* Tucker, 130 B.R. 71, 73 (Bankr. S.D. Iowa 1991) (plan that proposed to pay 100% to student loans and 13% to other unsecured creditors lacked a reasonable basis for discrimination); *In re* Saulter, 133 B.R. 148, 149 (Bankr. W.D. Mo. 1991) (proposed 100% payment to student loans and 10% to other unsecured creditors unfairly discriminated).

[355] *In re* Husted, 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992).

[356] Amfac Distrib. Corp. v. Wolff (*In re* Wolff), 22 B.R. 510 (9th Cir. 1982).

[357] The court in *In re* Birts, 2012 Bankr. LEXIS 727 at *8 (E.D. Va. 2012) used the first three factors of Leser (rational basis, necessary to reorganization of debtor, and good faith) plus Husted's fifth factor (difference to creditors if no separate classification). The court in In *In re* Potgieter, 436 B.R. 739 (Bankr. M.D. Fla. 2010) adopted the four elements of *Leser*. *See also, In re* Mason, 456 B.R. 245, 252 (Bankr. N.D. W.Va. 2011)(holding that Chapter 13 allows separate treatment of unsecured claims, but requiring debtor to demonstrate at confirmation hearing that 72% distribution to student loan debts and 8% distribution to other unsecured creditors is not unfairly discriminatory).

[358] *In re* Machando, *supra*, 378 B.R. at 17.

[359] *In re* Bentley, 266 B.R. 229 (1st Cir. BAP 2001).

[360] *Id.* at 240 – 242.

[361] *See, e.g., In re* Crawford, 324 F. 3d 539, 542 (7th Cir. 2003) (plan that proposed to pay two-thirds of nondischargeable debt while unsecured creditors received nothing unfairly discriminated); *In re* Mason, 300 B.R. 379, 386-387 (Bankr. Kan. 2003) (baseline test used to determine that debtor's proposed plan to pay 17% of student loan claims and nothing to dischargeable creditors was unfair).

[362] *In re* Mason, *supra*, 456 B.R. at 251.

[363] *In re* Pracht, 2012 Bankr. LEXIS 43 at *13 (Bankr. M.D. Ga. 2012), quoting judge Posner *In re* Crawford, 342 F. 3d 539, 542 (7th Cir. 2003).

[364] *In re* Pracht, *supra*, 2012 Bankr. LEXIS 43.

Public Service Loan Program. She reached agreement with the U.S. Department of Education whereby she would make 120 consecutive monthly payments of $532.12, after which the remaining amount (approximately $50,000) would be forgiven. In order to obtain the loan forgiveness, she would have to make the payments during her Chapter 13 plan. This meant that her other unsecured creditors, separately classified, would receive a distribution of only 15%. However, if the student loan debt was classified and paid with the other claims, then all unsecured creditors would receive approximately 20% pro rata.[365]

The Chapter 13 trustee objected to the plan. The court found that the plan unquestionably met the requirements of §1325(b), which requires all of the debtor's projected disposable income be paid to the debtor's unsecured creditors during the plan.[366] The only question was whether the separate classification and higher payment for education loans impermissibly discriminated against the other nonpriority creditors. First, the court noted that the Code does not state *how* the debtor's projected disposable income is to be allocated,[367] nor does the Code define the term, "discriminate unfairly."[368] Second, the court observed that courts have struggled to reach quantifiable definition of the term, and that ultimately, the determination appears to be subjective and best left to the "first-line decision maker, the bankruptcy judge."[369]

In absence of a binding, quantifiable test, the bankruptcy court reasoned that the purpose of bankruptcy is to "to grant a fresh start to the honest but unfortunate debtor."[370] However, this must always be balanced with fairness to creditors.[371] In weighing that balance, the court found in favor of the debtor and approved the plan. The benefit to the debtor was the opportunity to write off $50,000, whereas the benefit to the other creditors if the education loan was not separately classified would be an increase of only $5,000, which the court found to be a "modest difference."[372] Thus, the plan did not unfairly discriminate against other nonpriority debtors.

Similarly, the court in *In re* Birts confirmed debtor's plan that paid 7% of allowed unsecured claims (a total of $4,299 over 60 months) while keeping current on the debtor's monthly student loan payment of $271 per month, even though paying the student loan debt pro rata with the other unsecured debts would more than double the percentage of payment to unsecured creditors to 16%.[373] The court was particularly compelled by weighing the very

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[365] *Id.* at *2.

[366] 11 U.S.C §1325(b)(1) provides:

If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—

(A) The value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

[367] *In re* Pracht, *supra*, 2012 Bankr. LEXIS at *5.

[368] *Id.* at *8-*9.

[369] *Id.* at *13, quoting *In re* Crawford, *supra*, 342 F. 3d at 542.

[370] *Id.* at *13, citing Grogan v. Garner, *supra*, 498 U.S. at 286-87.

[371] *Id.* at *14.

[372] *Id.* at *15.

[373] *In re* Birts, *supra*, 2012 Bankr. LEXIS 7272012 at *8.

positive benefits to the debtor against the marginal real dollar improvement in payments to the creditors, a difference of $92.17 per month divided among all creditors, whose claims totaled over $93,000.[374] "Under the circumstances, the Court finds that the difference of what creditors are to receive under the Plan, as proposed, and what they would receive if student loan debt were not separately classified, is not so great as to compel a denial of confirmation."[375] The court cautioned, however, that any such finding would be on a case-by-case basis, balancing the "greater disparity between what the creditors are being paid under the plan and what they would receive if the student loan debt was not separately classified."[376] The court did not say exactly what the balance might be, except that "a zero percent plan, and one hundred percent payment to student loans may not be a confirmable plan."[377] In another case, the potential increase from 4.14% to 6.76% payment to all unsecured claims if student loan debt was not separately classified was not enough to warrant a finding of unfair discrimination.[378] Yet another court found that separate treatment of education loans and general unsecured was not unfair discrimination as it was necessary for the debtor to maintain her student loan payments to keep her professional license and thus make her plan payments.[379] Of course, if the plan proposes to pay 100% of unsecured claims, then separate classification and fully payment of student debt is always permissible.[380]

As noted previously, there is sometimes a difference between the amount of disposable income calculated using Form 22C and the debtor's *actual* income. This is because Form 22C uses statutory amounts for expenses. Some are based upon IRS allowances, and others based on Department of Labor statistics, such as state and local median income figures. This means that some debtors may actually have higher income than the amount calculated using Form 22C. In these circumstances, debtors have successfully proposed plans in which all of their disposable income, as calculated under Form 22C, is used to pay general unsecured creditors, and the excess amount was used to pay education debt.[381]

A third line of cases has found that where the school debt is payable beyond the life of the plan, then the unfair discrimination test of §1322(a)(1) does not apply. This is based upon an expansive reading of §1322(b)(5), which states that a Chapter 13 plan shall "provide for the

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[374] *Id.*
[375] *Id*. at *9.
[376] *Id*.
[377] *Id*.
[378] *In re* Machando, *supra*, 378 B.R. at 17.
[379] *In re* Kalfayan, 415 B.R. 907 (Bankr. S.D. Fla. 2009).
[380] *In re* Potgieter, 436 B.R. 739 (Bankr. M.D. Fla. 2010). *See also*, Cameron M. Fee, *An Attempt at Post-Mortem Revival: Has §1322(b)(10) Been Euthanized?*, American Bankruptcy Institute Journal, Vol. XXXI, No. 6, July 2012, at 38. Fee asserts that §1322(b)(10) appears to provide that post-petition interest on nondischargeable unsecured claims may only paid after making provision for full payment of all allowed claims. However, Fee points out, the only published opinion to address §1322(b)(1) found it unenforceable as inconsistent with §1322(b)(5). *Id.*
[381] *In re* Abaunza, 452 B.R. 866 (Bankr. S.D. Fla. 2011); *In re* King, 460 B.R. 708, 713-714 (Bankr. N.D. Tex. 2011) (unfair discrimination test allows for higher payments to certain creditors as long as unsecured creditors receive their pro rata share of statutory projected disposable income); *In re* Orawsky, 387 B.R. 128, 148-156 (Bankr. E.D. Pa. 2008) (payments to education creditor came from funds the debtor is not obligated to commit to the plan); *In re* Sharp, 415 B.R. 803, 812 (Bankr. D. Colo. 2009) (finding that §1325(b) does not require debtors to pay more to creditors than the statutory projected disposable income). *Contra: In re* Cooper, 2009 WL 1110648 at *5 (Bankr. N.D. Tex. April 24, 2009) (above-median income debtor may not discriminate among non-priority unsecured creditors).

curing of any default. . . 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."[382] So, if payments on the student loan debt extend beyond the five years of the plan, then the plan can provide for maintenance of the regular loan payments.[383] For courts adopting this view, the authority to continue payments on long-term debt under §1322(b)(5) trumps the unfair discrimination criteria of §1322(b)(1).[384] This approach has been rejected by a number of courts and is a minority view.[385]

(b) Cases in which separate classification was not allowed

Separate treatment of education debt was not allowed by a Wisconsin bankruptcy court in *In re* Edmonds.[386] In that case, the debtor proposed to treat her three education loans as a separate class and to pay the contract rate of principal and interest. At the end of the five-year plan, education creditors would have received a 53% dividend, while the other unsecured creditors would receive only 18% and their claims would be discharged. If the payments to education creditors were included in the same class as the other creditors, the dividend to all unsecured creditors would be 28%. The Chapter 13 trustee objected to the plan on the grounds of unfair discrimination. In sustaining the objections, the court stressed that it was not holding that student loans could *never* be separately classified. However, because the debtors were fully employed and had a good income,

> [t]here is nothing in the case at bar which establishes that the debtors are unable to formulate a plan that provides for equal treatment of unsecured debtors. Student loan debt should not be paid at the expense of other general unsecured creditors.[387]

For the *Edmonds* court, because the debtors had sufficient income to carry out a plan without discrimination, they must do so.

In another case, the First Circuit BAP affirmed a bankruptcy court ruling disallowing debtor's proposed plan to pay student obligations in full while paying other unsecured creditors only 3%.[388] The BAP held that the principal of equality of distribution for unsecured creditors mandated that the debtor could not favor certain creditors without providing a "correlative benefit" to other unsecured creditors.[389] A Colorado bankruptcy court found unfair discrimination where debtor's plan proposed to pay student loan claims at 64% while other

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[382] 11 U.S.C. §1322(b)(5).
[383] *In re* Johnson, 446 B.R. 921, 926 (Bankr. E.D. Wisc. 2011) ("Section 1322(b)(5) expressly permits a debtor to cure and maintain payments on a long-term debt; and the Debtor's student loans qualify").
[384] *See, e.g., In re* Truss, 404 B.R. 329 (Bankr. E.D. Wisc. 2009); *In re* Knight, 370, B.R. 429 (Bankr. N.D. Ga. 2007); *In re* Hanson, 310 B.R. 131 (Bankr. W.D. Wisc. 2004); *In re* Machado, *supra*, 378 B.R. at 16.
[385] *See, e.g., In re* Zeigafuse, 2012 WL 1155680 *3 (Bankr. D. Wyo. 2012) (finding that interpreting 1322(a)(5) to allow for full payment of student loan debt while other general unsecured debt is paid pro rata is minority view). *See also, In re* Edmonds, 444 B.R. 898, 900 (Bankr. E.D. Wisc. 2010) and cases cited therein.
[386] 444 B.R. 898 (Bankr. E.D. Wisc. 2010).
[387] *Id.* at 902.
[388] *In re* Bentley, *supra*, 266 B.R. 229.
[389] *Id.* at 243.

unsecured claims received only 1%.[390] The court required the debtor to pay student loan payments pro rata with other claims, resulting in a distribution of 12% to all unsecured creditors.[391]

(vi) Education debt as "special circumstances"

Another line of cases permits the debtor to deduct his monthly student loan payments from expenses for purposes of Form 22C in determining the debtor's monthly projected disposable income. This is based upon the §707(b), which is the means test for Chapter 7 debtors. Section 707(b)(1) provides that the court shall dismiss a Chapter 7 case (or convert it to Chapter 13 with the debtor's permission), if granting relief under Chapter 7 would constitute an "abuse" of the Chapter 7 process.[392] Section 707(b)(2)(A) sets forth the types of expenses that may be deducted from the debtor's income in order to calculate the debtor's monthly disposable income. It provides that the court shall presume abuse if the debtor's monthly income, minus allowed deductions, exceed certain statutory maximum amounts.[393] In the event that the debtor's income exceeds the maximum amount, §707(b)(2)(B) allows the debtor to rebut the presumption of abuse by demonstrating "special circumstances . . . to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative." [394]

For debtors with income above the state median, §1325(b)(3) incorporates the Chapter 7 means test into the disposable income test for Chapter 13.[395] Therefore, courts can consider whether the nondischargeable nature of student loan debts constitutes the requisite "special circumstances" that permit the payments to be deducted as allowable expenses under a Chapter 13 plan. So, some courts have held that since the debtor has no reasonable alternative but to pay nondischargeable student loans, such loans constitute special circumstances.[396] Another court reasoned that hardship would result from the accumulation of interest if the education loans were treated the same as other undersecured debt.[397] Still another court ruled that education loans could constitute special circumstances, depending on the debtor's motivation in incurring the student debt. In that case, the court held that pursuit of higher education solely for increased earning potential or career advancement could not constitute special circumstances, but that educational loans incurred for education and training "necessitated by permanent injury, disability or an employer closing," could constitute the requisite special circumstances.[398]

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[390] *In re* Renteria, 2012 WL 1439104 at *5 (Bankr. Colo., April 26, 2012).
[391] *Id.*
[392] 11 U.S.C. §707 (b)(1) provides that the court may dismiss a Chapter 7 case "if it finds that the granting of relief would be an abuse of the provisions of this Chapter."
[393] §707(b)(2)(A).
[394] §707(b)(2)(B).
[395] *Id.* §1325(b)(3) provides that "amounts reasonably necessary to be expended [for purposes of determining disposable income] shall be determined in accordance with . . . section 707(b)(2)" if the debtor's income exceeds the state median income.
[396] *In re* Templeton, 365 B.R. 213 (Bankr. W.D. Okla. 2007; *In re* Delbecq, 368 B.R. 754, 759 (Bankr. S.D. Ind. 2007); *In re* Knight, 370 B.R. 429 (Bankr. N.D. Ga. 2007).
[397] *In re* Martin, 371 B.R. 347, 356 (Bankr. C.D. Ill. 2007).
[398] 383 B.R. at 228.

This line of cases is a minority view. Most courts have held that the fact that student loan debt is not dischargeable does not, without more, justify separate classification.[399] Indeed, some courts have opined that because borrowing to fund an education is almost universal, student loans are not special and therefore not dischargeable.[400]

B. Student Loan Debt in Bankruptcy – Quantitative Data

To better understand the incidence of education loan debt in bankruptcy, I obtained data from 50 consumer Chapter 7 and Chapter 13 cases filed each year in ten randomly selected jurisdictions from 2004 through 2011.[401] Of the approximately 3,750 cases that I reviewed, 814 reported student loan debt. The table below shows the percentage of cases in which the debtor(s) reported student loan debt for each year, and the average amount of student loan debt per case.

	Chapter 7		**Chapter 13**	
Year	Percent w/ student debt	Average student loan debt	Percent w/ student debt	Average student loan debt
2004	18.0	$18,484	14.6	$13,332
2005	18.9	$12,545	14.7	$23,208
2006	19.0	$16,644	22.2	$16,304
2007	23.2	$21,055	22.1	$21,699
2008	19.9	$28,213	19.1	$17,497
2009	21.8	$29,992	22.0	$26,908
2010	21.3	$21,360	24.2	$24,396
2011	24.3	$25,096	22.3	$26,483

There are some anomalous results. For example, there was a significant decline in student debt reported in Chapter 13 cases in 2006. In addition, the amount of debt per case peaked in 2009, the height of the recession. And while it eased back in 2010, by 2011 the average of student loan debt was again on the rise. Cleary, student loan debt is an increasing factor in consumer bankruptcy.

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[399] *In re* Colfer, 159 B.R. 602, 608-609 (Bankr. Me. 1993); *In re* Willis, 197 B.R. 912 (N.D.Okla. 1996) (nondischargeability by itself is insufficient for preferential treatment of student loan debt over other debt).

[400] *See, e.g., In re* Johnson, 446 B.R. 921, 925 (Bankr. E.D.Wisc. 2011) ("The commonplace nature of student loans to fund higher education suggests that they are not 'special,' as they are part of the financial fixture of many Americans"); *In re* Vaccariello, 375 B.R. 809, 816 (Bankr. N.D. Ohio 2007); *In re* Carrillo, 412 B.R. 540 (Bankr. D. Ariz. 2009) (ordinary course student loans are not special circumstances).

[401] The jurisdictions include Arkansas Eastern District, Arizona, California Southern District, Georgia Middle District, Indiana Southern District, New York Northern District, Oklahoma, Oregon, Pennsylvania Western District, and Wisconsin Eastern District. Electronic filing was not fully available in Georgia, Indiana, and Wisconsin in 2004, so these jurisdictions were not included for that year. This data is based on amounts reported by debtors on Schedules E (priority unsecured debt) and Schedule F (general unsecured debt). The data presents a general view of student loan debt, and does not purport to be an exact accounting of student loan debt. For example, many student loan debts were listed in round numbers (i.e., $15,000) whereas the actual amount owed was likely not such a simple number. In addition, as with many debts, debtors may have estimated the amount. Also, the data does not differentiate between debtors filing singly and those filing jointly. Finally, the data adjusts for a statistical anomaly in a 2004 Chapter 7 case.

My review of bankruptcy cases also revealed that debtors overwhelmingly self-select to not discharge student loan debt in bankruptcy. Of the 814 cases with student loan debt, only two Chapter 7 debtors and one 13 Chapter debtor filed adversary proceedings to have their student loans discharged. In a 2009 Chapter 7 case, the debtor obtained a discharge of $79,000 in student loans by establishing undue hardship as a result of severe injuries received in a car accident. The debtor in a 2011 Chapter 7 case withdrew her adversary proceeding to discharge $15,000 in private student loan debt upon after a settlement with the creditor to pay most of her debt. In the Chapter 13 case, the debtor listed a student loan claim of $47,890 on Schedule F, but asserted in his adversary proceeding that his signature on the loan was a forgery and that had been unaware of it until the debtor defaulted and the creditor sought to collect against him. The court ultimately entered an order that the debt not be excepted from discharge, and the debt was discharged.

Even in seemingly plausible cases the debtors did not attempt to have the debt discharged. In one case for example, married debtors had an income consisting of the husband's modest salary as a pressman which put them below the state median income. With expenses, including student loan payments of $218 per month, the debtors showed negative monthly income of $267.26 per month. They live in a home valued at $149,000 against which there are two mortgages, the second one being mostly unsecured. Yet their combined education debt is $71,000, with an additional $25,000 of general unsecured debt. The debtors clearly cannot afford to repay the student loan debt, yet they elected not to attempt to discharge the debt. A number of the cases I reviewed showed debtors with high five-figure or six-figure student loan debt and modest income, but they did not attempt to have the debt discharged. It seems likely that at least some of these debtors will never be able to pay their student debt, but seemingly the "undue hardship" standard is out of reach for them.

Two recent studies of student loan debt in bankruptcy provide additional insight into the treatment of student loans in bankruptcy.[402] Rafael Pardo and Michelle Lacey examined published 261 hardship opinions from 1993 to 2003. Pardo and Lacey concluded that nearly half (45%) of debtors who filed an adversary proceeding for an undue hardship discharge were successful in obtaining some relief.[403] Furthermore, debtors who did obtain a student loan debt discharge had lower monthly incomes, lower monthly expenses, and were more likely to have a medical problem or a dependant with a medical problem.[404] More recently, Jason Iuliano examined 207 cases, finding that whether the debtor has a medical hardship, whether the debtor is employed, and the debtor's income in the year prior to filing bankruptcy are predictive of discharge.[405]

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[402] Rafael I. Pardo and Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Education Debt*, 74. U. of Cinn. L. Rev. 405. (Winter 2005); Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Bankruptcy Undue Hardship Standard* (2011) Electronic copy available at: http://ssrn.com/abstracts=1894445.

[403] Pardo & Lacy, *supra* note 401, at 479.

[404] *Id.* at 481-86. However, Pardo and Lacy later suggest that the specific judge deciding the case and the experience of the debtor's lawyer may be equally important variables in the outcome of the case. *See*, Rafael I. Pardo and Michelle R. Lacey, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation*, 83 Am. Bankr. L. J. 179, 196-200 (2009).

[405] Iuliano, *supra* note 401, at 19-20, 26.

III. EDUCATION DEBT: FINANCIAL AND MORAL QUAGMIRE

A. Distress, Delinquency, and Default

1. Distress

The American middle class is in severe economic distress and likely to stay that way for a long time. Foreclosures, underwater mortgages, job losses, income stagnation, and other factors are taking a huge toll on the ability of Americans to afford such basics as housing, education, and health care.[406] The problems of education debt are likely to grow more acute due to lower government funding for education and stagnating income in a tough economy.[407] A recent report concludes that rising levels of student debt cause many Americans to delay events such as buying a car, purchasing a home, getting married, and even having children.[408] As one borrower puts it, "[h]ow could I consider having children if I can barely support myself?"[409]

People under crushing debt burdens suffer long-term adverse health effects. Financial stress "can…contribute to a sense of continuing entrapment and hopelessness that can in turn serve to extend an episode."[410] People with serious debt are more likely to suffer from a multitude of health problems including migraines and headaches, stomachaches, back pains, increase risk of cardiovascular disease, and hypertension, as well as psychological disorders, such as depression.[411] High debt is also associated with incidence of higher mortality, including suicide.[412] And, it affects individual health in that debtors are more likely to avoid or delay medical and dental care.[413] Other effects include lower self-esteem, social isolation, chronic tension, and family problems including higher divorce rates.[414] A 2004 study of debt and depression[415] concludes that severe and prolonged economic stress causes biomedical,

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[406] Katherine Porter, *Bankruptcy and Financial Failure in American Families*, in Katherine Porter, ed., Broke: How Debt Bankrupts the Middle Class (2012) at 6.
[407] Chris Staiti, *Student Loan Debt Could Become the Next Financial Bubble, S & P Says*, Bloomberg, February 9, 2012, *available at* http://mobile.bloomberg.com/news/2012-02-09/student-loan-debt-could-become-next-financial-bubble-s-p-says (accessed July 9, 2012).
[408] The Student Loan Debt Bomb, *supra*, note 3, at 2.
[409] Shellenbarger, *supra* note 90.
[410] George W. Brown, *Social Roles, Context and Evolution in the Origins of Depression*, 43 J. Health & Soc. Behav. 255, 269 (2002).
[411] Mechele Dickerson, *Vanishing Financial Freedom*, University of Alabama, Meador Lecture Series 2009-10: Freedom , at 63 (summarizing multiple studies on debt and health); Patricia Drentea, *Age, Debt and Anxiety*, 41 J. Health & Soc. Behav. 437, 437 (2000) (noting correlation between high debt-to-income ratio and anxiety).
[412] *Id.* In a well-publicized incident, the husband of a star on the reality TV show "Housewives of LA" committed suicide in part because of extreme indebtedness. Emily Starbuck Gerson, *Emily's List: Debt and Depression Edition*," *available at* http://blogs.creditcards.com/2011/09/emilys-list-debt-and-depression.php(accessed January 31, 2012).
[413]Melissa B. Jacoby, *Health, Law, and Everyday Life: Does Indebtedness Influence Health?* A Preliminary Inquiry, 30 J. L. Med. & Ethics 560, 560 (2002).
[414] *Id.* at 64.
[415] Christopher G. Davis and Janet Mantler, *The Consequences of Financial Stress for Individuals, Families, and Society* (2004), *available at* http://doylesalewski.ca/wp-content/uploads/Carleton%20Report%20-%20Financial%20Distress.pdf?phpMyAdmin=d3062932296aa4d592c757936733fff8&phpMyAdmin=DsWwS7g4UVLBVi3NJBYbNwQsDA2. (accessed August 17, 2012).

physiological, cognitive, and behavioral changes.[416] Consequences for families in financial stress include hostility and increased risk of divorce among parents, depression, bad behavior, and poor school performance in children.[417]

Numerous blogs deal with student loan debt, depression, and other social problems caused by crushing student loan debt.[418] In a recent account, a law graduate who was unable to pass the bar took a string of different jobs, but eventually defaulted on his loan.[419] Although the loans are presently in deferment status, interest is adding $2,000 to the balance each month. His loan debt destroyed his marriage and eroded his mental outlook. His student loan debt will be with him his entire life. Debt levels of this nature will prevent graduates from pursuing public interest careers, or lower paying but socially important jobs such as teaching.[420]

2. Delinquency and Default

Education loan delinquency and default is on the rise.[421] Until 2012, the U.S. Department of Education tracked student loan default in units of "two-year cohorts"; *i.e.*, the default rate of borrowers who have been in repayment for two years. For borrowers who entered repayment in 2009, 8.8% (320,000 borrowers) had defaulted by the end of 2010. This was an increase from 7% for borrowers who entered repayment in 2008. For-profit schools have the highest two-year default rate at 15%, while the rate at public colleges is 7.2% and the rate at private non-profit is 4.6%.[422]

But the two-year default analysis may hide the actual reality. Most students who default do so after the two-year window is over. Currently, some 14% of all student borrowers default on their loans within 3 years of graduation.[423] For some programs, the default rate is much higher. For example, fifteen year defaults on loans made to students at community colleges are

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[416] *Id.* at 2.
[417] *Id.* at 8.
[418] Two of these include "All Education Matters" at http://alleducationmatters.blogspot.com/ and "B$ in Debt" at http://bsindebt.com/.
[419] Debra Cassens Weiss, *Law Grad's Ballooning Student Debt Will Exceed $1.5M by the Time He Retires*, ABA Journal, February 28, 2012, *available at* http://www.abajournal.com/news/article/law_grads_ballooning_student_debt_will_exceed_1.5m_by_the_time_he_retires/ (accessed March 2, 2012).
[420] Baum, S. & Saunders, D., Life after debt: Results of the national student loan survey. Braintree, MA: Nellie Mae Foundation. The Education Resources Institute, & the Institute for Higher Learning Policy (1995).
[421] A borrower is delinquent if she misses one payment. After nine months of delinquency a borrower is in default. *See*, Alisa F. Cunningham and Gregory S. Kienzl, *Delinquency: The Untold Story of Student Loan Borrowing*, Institute for Higher Education Policy, March 2011, at 8, *available at* http://www.ihep.org/Publications/publications-detail.cfm?id=142 (accessed July 19, 2012).
[422] The Project on Student Debt, *Sharp Uptick in Student Loan Default Rates*, September 12, 2011, available at http://projectonstudentdebt.org/files/pub/Sept_2011_CDR_NR.pdf (accessed July 20, 2012).
[423] Nearly 14% of student loan borrowers default within 3 years. This average is skewed by 25% default rate for borrowers who attended "for-profit" colleges with programs such as auto mechanics, criminal justice, and medical technology. Default rate for students at public schools is 10.8%, and for students at private nonprofit schools is 7.6%. Len Boselovic, *Newly Minted Grads Face Loan Loads*, Pittsburgh Post-Gazette, Marcy 30, 2012, available at http://www.post-gazette.com/stories/business/heard-off-the-street/newly-minted-grads-face-loan-loads-294820/ (accessed May 2, 2012).

31%.[424] At for-profit schools, 96% of students take out education loans,[425] but only 36% are currently paying down the principal on their student loans, and 22% of the loans are in default within 3 years of leaving school.[426] Analysis by the Federal Reserve Bank of New York for third quarter of 2011, taking deferral and other factors into consideration, suggests that loan repayment problems may be even greater. It calculates that overall, 47% of student loan borrowers were in deferral or forbearance and that 27% of borrowers had a past due balance, with 21% of total loans delinquent or in default.[427]

In 2012, U.S. Department of Education switched to reporting rates for three years of repayment. It is expected that the 2008 default number will double to 13.8%.[428] When looked at for a longer period of time, the default rate is even higher. For graduates who entered loan repayment in 2005, 25% have been delinquent at some point, and 15% have defaulted. Only 40% of borrowers are in repayment as agreed.[429] Others are in deferment or default. According to one source, one in every five loans in repayment since 1995 may be in a default, with the number for non-profit schools at 40%.[430]

A 2011 study by the Institute for Higher Education Policy examined federal student loan repayment history for borrowers who entered repayment between 2004 and 2009, and in particular, focusing on borrowers whose repayments date from 2005.[431] (That study did not include private loan repayment.) The study looked at 8.7 million borrowers, representing 27.5 million loans totaling $148 billion. Of the 2005 group (1.8 million borrowers with $38.4 billion in loans), only 37% of borrowers (667,000 borrowers with $13.1 billion in loans) were repaying their loans on time and without deferrals or restructuring as of 2009.[432] About 23% were in forbearance or deferment, 26% were delinquent but had not defaulted, and 15% had defaulted.[433] Default rates are much lower for students who graduate from four-year public or non-profit institutions, with close to half making timely payments, whereas only 25% of the borrowers who attended for-profit and two-year colleges were making timely payments, and more than 50% of the borrowers in these sectors had defaulted.[434]

Young student borrowers will eventually become middle-age student borrowers, and far more of them carry far more student loan debt than their parents. A potential harbinger of things to come may be discerned in the experience of today's middle-aged (over age 50) generation, of

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[424] Kelly Field, *Government Vastly Undercounts Defaults*, Chronicle of Higher Education, July 11, 2010, available at http://chronicle.com/article/Many-More-Students-Are/66223 (accessed January 31, 2012)
[425] College Board Advocacy & Policy Center, Trends in College Pricing 2011, College Board, p. 13 (2011), http://trends.collegeboard.org/downloads/College_Pricing_2011.pdf (accessed August 7, 2012).
[426] United States Senate, *For Profit Education: The Failure to Safeguard the Federal Investment and Ensure Student Success*, http://www.help.senate.gov/imo/media/for_profit_report/PartI.pdf (accessed August 7, 2012).
[427] Brown, *supra* note 5. These numbers exclude loans that have been charged off on the credit report.
[428] Harris, *supra* note 95.
[429] Cunningham and Kienzel, *supra* note 420, at 8.
[430] Field, *supra* note 423.
[431] Cunningham and Kienzl, *supra* 420, at 8.
[432] *Id*. at 18.
[433] *Id*. at 19.
[434] *Id*. at 21.

whom 16% of people have student loan debt.[435] The delinquency rate for all borrowers is 8.7%, but for borrowers aged 40 to 49, it is 11.9%[436] and for those aged 50-59 the delinquency rate is even higher at 15.5%.[437] Many people later in life are still paying balances from college at a time when the value of homes and investments has declined.[438] Moreover, nonfederal lenders almost always require parents or others to cosign. Currently 90% of private loans require parents to co-sign, up from 50% in 2008,[439] thus linking generations together in student loan debt.

For-profit schools have a particularly poor repayment record. On Monday, July 30, 2012, the Senate Committee on Health, Education, Labor, and Pensions released a scathing report dealing with for-profit schools.[440] At for-profit schools, over 54% of students who commence full-time studies do not complete their programs.[441] This is far higher than the 35% of students at non-profit schools who fail to do so, and leaving a program significantly increasing the probability of defaulting on student loans.[442] The Department of Education estimates that 46.3% of dollars lent to for-profit students who entered repayment in 2008 will default.[443] The number for 2-year public and non-profit colleges is 31.1%.[444] One for-profit school even estimates its own student default rates may be as high at 77%.[445] Overall, for-profit students constitute approximately 10% of all higher education students, but account for 25% of all education loans, and almost 50% of education loan defaults.[446]

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[435] Kristen Stenerson, *Nearly 16 Percent Of Post 50s Are Carrying Student Loan Debt*, Huffpost, *available at* http://www.huffingtonpost.com/kristen-stenerson/ (accessed July 14, 2012).
[436] Josh Mitchell, *Student Debt Hits the Middle-Age*, Wall Street Journal, July 17, 2012 http://online.wsj.com/article/SB10001424052702303612804577533332860797886.html (accessed July 20, 2012).
[437] Stenerson, *supra* note 434.
[438] *Id.*
[439] AnnaMaria Andriotis, *Student Loans Sink Mom and Dad*, MSN Money Partner, July 19, 2012, *available at* http://money.msn.com/saving-money-tips/post.aspx?post=24383a62-f419-471b-a45f-b882fe0c3741 (accessed July 20, 2012).
[440] Senate Committee on Health, Education, Labor and Pensions, *For-Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success*, July 2012, at 73. http://www.help.senate.gov/imo/media/for_profit_report/Contents.pdf (accessed August 2, 2012).
[441] *Id.* at 73.
[442] Satyajit Chatterjee and Felicia Ionescu, *Working Paper No. 10-31 Insuring Student Loans Against the Risk of College Failure*," Research Department, Federal Reserve Bank of Philadelphia, Oct. 4, 2010, at 2, *available at* http://ssrn.com/absract=1687999 (accessed July 9, 2012).
[443] Senate Committee report, *supra* note 439 at 116.
[444] *Id.* at 116.
[445] *Id.* at 117. One commentator critical of for-profit student loan lenders states that any lender that anticipates a default rate of 50% or more "is just a con artist bent on ripping people off. Period." Mike Whitney, *An Orgy of Speculation*, Phil's Stock World, March 1, 2011, *available at* http://articles.businessinsider.com/2011-03-02/markets/30075693_1_hedge-fund-managers-qe2 (accessed August 16, 2011).
[446] Alison O'Brien, *Investigation reveals claims of unmanageable debt by 'for-profit' college students*, MSNBC, July 20, 2012, *available at* http://rockcenter.msnbc.msn.com/_news/2012/07/19/12842350-investigation-reveals-claims-of-unmanageable-debt-by-for-profit-college-students?lite (accessed July 20, 2012). The article includes comments by former employees of one of the second largest for-profit education corporations, Education Management Corporation, to the effect that student recruiting was little more than a siphon for federal student loan dollars. The article and the Comments section also claim that many for-profit schools admit students with scant regard for academic qualifications and that instructors are pressured not to fail students. As one commentator, a former instructor, said, "if they have a 'pell (grant) and a pulse' they are in." *Id.*

There are plenty of negative consequences for debtors who default. For those with federal student loans, the government can seize wages, tax refunds, earned income tax credits, and social security payments.[447] Defaulters are liable for the original principal balance, all accrued interest, court costs, and any collection fees, which are all added to the outstanding balance.[448] In addition, the negative credit rating that results from default may make it harder to obtain mortgages, car loans, and credit cards, and possibly even apartments or jobs. When they do get loans, they will pay higher interest rates.[449] Unlike any other type of debt, there is no statute of limitations.[450]

Experts who follow student loan delinquencies are increasingly pessimistic about the health of student loan portfolios. In a survey of bank risk professionals in the last quarter of 2011, 67% expected student loan delinquencies to rise, up from 48% in the third quarter 2011.[451]

Student loan debt collecting can be a lucrative business. Companies such as Education Management Corporation work under contract with the U.S. Department of Education to service loans and collect on defaulted accounts.[452] The companies charge fees to borrowers and earn commissions from taxpayers of up to 31% for collecting on defaulted loans.[453] Collectors can garnish wages, taking a percentage as a fee before forwarding the rest to the government.[454] Executive salaries and employee bonuses at collection firms can run into six- and seven-figures.[455] Private debt collection agencies recovered $11.3 billion in defaulted loans in 2011, approximately 85 cents on every dollar that defaults.[456] For their efforts, debt collectors received about $1 billion.[457] During the same time, however, the Federal Trade Commission received some 181,000 complaints—more than any other industry-- about abusive debt collection practices.[458] While this number includes all types of debt collection (credit cars, late auto loan payments, etc.[459]) student loan debtors often experience abusive debt collection, including

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[447] Steverman, *supra* note 122.
[448] Cunningham and Kienzl, *supra* note 420, at 15.
[449] Field, *supra* note 423.
[450] *Supra* note 132.
[451] *Student Loans Seen as Next Casualty of Sluggish Economy, FICO Quarterly Survey Find*, FICO, January 11, 2012, *available at* http://www.fico.com/en/Company/News/Pages/01-11-2012a.aspx (accessed February 23, 2012). As one analyst noted, "Evidence is mounting that student loans cold be the next trouble spot for lenders. A significant rise in defaults on student loans would impact lenders as well as taxpayers, who could be facing big losses due to these defaults." *Id*.
[452] John Hechinger, Taxpayers fund $454K for Chasing Student Loans, Businessweek, May 15, 2012, *available at* http://www.businessweek.com/news/2012-05-15/taxpayers-fund-454-000-pay-for-collector-chasing-student-loans (accessed August 1, 2012).
[453] *Id*.
[454] *Id*. In one case ECMC seizes $600 per month from the pay of a 61-year old teacher, but keeping $96 (16%) as a fee. *Id*.
[455] *Id*.
[456] John Hechinger, *Obama Relies on Debt Collectors Profiting From Student Loan Woe*, Bloomberg, March 26, 2012, http://www.bloomberg.com/news/2012-03-26/obama-relies-on-debt-collectors-profiting-from-student-loan-woe.html (accessed July 19, 2012).
[457] *Id*.
[458] *Id*.
[459] *See, e.g.,* Allie Johnson, *True debt collection horror tales*, CreditCards.com, July 24, 2012, *available at* http://www.creditcards.com/credit-card-news/true-debt-collection-horror-tales-1282.php?a_aid=9fc4cb60 (accessed July 24, 2012) (giving examples of abusive debt collection practices).

incessant phone calls to home and work numbers at all hours, bullying, misrepresentation, and threats.[460]

The Department of Education has sought to restrict participation in Title IV access to education loans for non-degree granting vocational programs that fail to meet certain threshold repayment requirements. Under regulations promulgated in June 2011 (known as the "Debt Measure Rule"), the Department established a minimum standard of 35% for loan repayment rate, and a maximum standard of 30% discretionary income and 12% of annual earnings for debt-to-earnings ratios.[461] The purpose of the regulation was to ensure that government-guaranteed loans only went to programs that prepared students for gainful employment in a recognized occupation.[462] A program would be considered failing if its debt measures did not meet any of the minimum standards.[463] Such institutions would be required to warn current and perspective students, and to describe the actions that the institution planned to take to improve its performance.[464] A program that failed the debt measure in any two out of three years would be required to provide additional warnings to current and prospective students, including "[a] clear and conspicuous statement that a student who enrolls or continues in the program should expect to have difficulty repaying his or her loans."[465] If a program failed to satisfy the debt measure in three out of any four years it would lose its Title IV eligibility[466] and be barred from seeking to reestablish the program, or a "substantially similar" program for three years.[467]

In July 2011, The Association of Private Sector Colleges and Universities filed suit in the District Court for the District of Columbia to enjoin enforcement of the Debt Measure Rule.[468] On June 30, 2012, the District Court entered its opinion in the case. The court held that although the agency has authority to issue rules such as the debt-to-earnings ratio,[469] the agency failed to establish a reasoned basis for the debt-repayment benchmark, which the court found was "arbitrary and capricious."[470] Since the repayment test could not be severed from the other debt measures, the court vacated the entire debt measure rule.[471] In the short term, for-profit schools were clearly the winners of the ruling, as many of their programs would have failed the test.[472]

B. Moral Morass

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[460] Kelly Field, *Complaints Soar Over Student-Loan Collections*, The Chronicle of Higher Education, May 6, 2012, *available at* http://chronicle.com/article/Complaints-Soar-Over/131781/ (accessed July 27, 2012).
[461] Debt Measure Rule, 76 Fed. Reg. at 34,395 (describing 34 C.F.R. § 668.7(a)(1)).
[462] 34 C.F.R. § 600.10(c)(1).
[463] *Id*. at § 668.7(h).
[464] § 668.7(j)(1).
[465] §668.7(j)(2)(i)(D).
[466] §668.7(i).
[467] §668.7(1)(2)(ii).
[468] Assoc. of Private Colleges and Universities v. Duncan, D. C. for the District of Columbia, Civil Action 11-1314 (RC) (2012).
[469] Id. at *15.
[470] Id. at *15.
[471] Id. at *16.
[472] Goldie Blumenstyk and Charles Huckabee, *Judge's Ruling on 'Gainful Employment' Give Each Side Something to Cheer* , The Chronicle of Higher Education, July 2, 2012, *available at* http://chronicle.com/article/Ruling-on-Gainful-Employment/132737/ (accessed July 12, 2012).

1. Education Debt As Moral Malfeasance

Debtors' prisons were common in colonial America.[473] Under English law and in the early American republic, punishment for debt was punishment as much against the person of the debtor, and not just against his property. Over time, debtor's prisons were abolished in America and debt became resolved through insolvency laws—first under individual state insolvency laws, and then under federal bankruptcy laws.[474] With debt as a financial "offense," society could construct a financial resolution. Through discharge of debts, debtors and their families could resume productive lives in society, and avoid becoming a public charge. To achieve this, bankruptcy law shifts the risk of default to the debtor's creditors, allowing the "honest but unfortunate debtor" a fresh start.[475]

There are several types of financial obligations from which there is no fresh start. Tellingly, a number of these obligations arise from moral culpability of the debtor. Thus, debts incurred by fraud,[476] breach of fiduciary trust,[477] willful acts causing bodily harm,[478] death or injury caused while intoxicated,[479] and taxes the debtor has tried to evade by not filing a tax return[480] are not dischargeable in bankruptcy. Also nondischargeable are domestic support obligation owed to spouses or children.[481] These obligations reflect deep social and personal duties, not just financial ones, and their nondischargeability represents a social consensus that bankruptcy cannot discharge moral commitments. A bankruptcy "fresh start" is meant for the "*honest*, but unfortunate debtor."[482] In this manner, the Code incorporates moral culpability as grounds for denial of discharge.

By making education debt nondischargeable, Congress has linked student loan default together with offenses such as fraud, willful injury, and failure to pay child support.[483] Debtor 1, above, explained how easy it was for her to obtain student loans. All she needed was 10 minutes and some computer clicks to become fully funded with loans at the start of each semester. Multiply that by eight semesters and a student borrower can easily incur a lifetime of debt servitude. For Debtor 1, there was a Grand Canyon gap between the ease of incurring her education debt, and her ability to repay it. This situation and hundreds of thousands of others like it segue into the responsibility of creditors in making loans. As Bruce Mann has observed, "[i]f debtors have moral obligations, so much do creditors." [484]

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[473] Bruce Mann, Republic of Debtors: Bankruptcy in the Age of American Independence, at 78-108 (2002).
[474] Charles Jordan Tabb, *The History of Bankruptcy Laws in America*, 3 Am. Bankr. Ins. L. Rev 5, 13-14 (Spring 1995).
[475] Grogan v. Garner, *supra*, 498 U.S. at 286-86.
[476] 11 U.S.C. §523(a)(2)(A) and(B).
[477] §523(a)(4)
[478] §523(a)(6)
[479] §523(a)(9).
[480] §523(a)(1).
[481] §523 (a)(5) and (15)
[482] Grogan v. Garner, *supra*, 498 U.S. 286-87.
[483] *See* Fossey, *supra* note 222 at 33 (Congress placed education debtors in class of fraud, embezzlement, breach of fiduciary duty, moral turpitude, etc.).
[484] Bruce H. Mann, *Failure in the Land of the Free*, 77 Am. Bnkr. L. J. 1, 7(Winter 2003).

Douglas Baird sees no problem in distinguishing student loans from standard consumer debt because, "unlike ordinary extensions of consumer credit, someone who takes an education loan before going away to college is not making a decision casually. The decision to incur the loan is part of a larger decision…that is made only after considerable thought and care."[485] For Baird, it is the aspect of "reflection and deliberation" that allows for the special status of student loans.[486] However, my interviews with student loan debtors convinces me that students do not comprehensively "reflect and deliberate" when incurring education debt, and that their failure to do so is caused by two key but flawed perceptions: (1) students substantially *underestimate* the difficulty in repaying large sums of money, probably because they lack experience in earning and managing a standard adult income and expenses; and (2) students substantially *overestimate* their prospects for getting tops grades in school and getting a well-paying job upon graduation.[487] It is not just the imprudent or statistical outliers that do so. Increasingly, the majority of students at many programs make these assumptions, then find themselves in serious debt trouble when they graduate with huge student debt and few job prospects.

If a borrower incurred a student loan debt intending to not repay it, the debt would properly be non-dischargeable as a debt incurred by fraud. But Debtor 1, above did not incur her student loan debt with the intent to not repay it, nor did Debtor No. 2, 3, 4, and nearly every other student loan debtor. Ironically, debtors might almost be better off if they had committed some fraud, rather than incur student loan debt, because there is no statute of limitations for education loan debt. There are state and federal statutes of limitations for almost every type of debt and almost every type of crime, the rare exceptions being crimes punishable by death, including murder, espionage and treason. And education debt. Education debt is viewed through the lens of moral malfeasance in American law. It is unlikely that any student borrowers are considering this perspective when they incur their loans to obtain an education.

2. Debtor's Prisons Redux

As the stories of Debtors 1 to 4 attest, education debt represents exceptionally large debt, and for most debtors, incurred at a relatively young age. Other than a home, few people are likely to ever again purchase any single thing that is as costly as an education.

For many student borrowers, the same hefty investment required to get an education to earn a livelihood correspondingly creates a lifetime of debt service. The Indentured Generation will be under monthly loan obligations that for decades will preclude purchasing anything comparable in price to the cost of their education. Of course debtors are obligated to repay debts they incur, but our society sees merit in allowing people in serious, debilitating financial distress to discharge debts in bankruptcy. By excepting education debt from bankruptcy discharge, debtors are given no escape from the financial stresses that would otherwise qualify them for discharge. It is disconcerting that the first and second of *Brunner* together inherently countenance that a debtor go without a "minimal" standard of living--no adequate housing,

[485] Douglas G. Baird, *Discharge, Waiver, and the Behavioral Undercurrents of Debtor-Creditor Law*, 73 U. Chi. L. Rev. 17, 28 (2006).
[486] *Id.*
[487] As one maxim has it, 100% of new students are sure they will be in the top 10% of their class, and 90% are wrong.

clothing, food, etc.—for an indeterminate period unless he proves that his situation will never rise above the low minimal standard.[488] This is a coherent description of deprivation. Student borrowers in the Indentured Generation, starting from a young age, will become permanent members of an economic underclass. They are living in American society but, from a financial perspective, always on the outside looking in.

An indenture class is not a good thing for our society to create. As Bruce Mann states, "[w]hether a society forgives its debtors and how it bestows or withholds forgiveness are more than matters of economic or legal consequence. They go to the heart of what a society values."[489] Elizabeth Warren puts it another way:

> Americans need a safety valve to deal with the financial consequences of the misfortunes they may encounter. They need a way to declare a halt of creditor collection actions when they have no reasonable possibility of repaying. They need the change to remain productive members of society, not driven underground or into joblessness by unpayable debt.[490]

It is fortunate that debtors' prisons are no more, because there would be tens of thousands of potential student loan debtor inmates ready to be sentenced. Yet as a society, we sentence them to a lifelong form of house arrest. It is still an incarceration, one that is not necessarily more moral than a prison of bars and walls.

3. Participation in economic life

Aside from moral or psychological aspects of debt relief, some commentators argue that to forgive student loan debt and return consumers debtors to normal economic life is an economic imperative. Margaret Howard asserts that student loan debt is not by nature different from any other unsecured debt,[491] that student loan debtors are no more likely than other debtors to abuse the bankruptcy process,[492] and that bankruptcy serves a critical economic purpose in restoring debtors to participation in the "open credit economy."[493] John M. Czarnetsky finds that bankruptcy resolves the tension between "freedom of contract and freedom of action in the market,"[494] and gives debtors a renewed incentive to engage in entrepreneurship and social improvement.[495] John D. Sousa offers a social utility theory to discharge, combining the economic participation arguments of Howard and Czarnetsky, with curing the social malaise caused by severe economic distress:

> [c]onsumers who are freed of constricting debt obligation can take that portion of their incomes once dedicated to attempting to fruitlessly repay their creditors and

[488] *See supra*, notes 252-269 and accompanying text.
[489] Mann, *supra* note 483, at 1.
[490] Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 Am. Bankr. L.J. 483, 92 (1997).
[491] Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 Ohio St. L. J. 1047, 1086.
[492] *Id*. at 1087.
[493] *Id*. at 1048.
[494] John M. Czarnetzky, *The Individual and Failure: A Theory of Bankruptcy Discharge*, 32 Ariz. St. L. J. 393, 428 (2000).
[495] *Id*. at 412.

> place this income into the stream of economic commerce. Moreover, freed of this indebtedness, debtors will have every incentive to resume productivity, rather than contemplate idleness if working only produces a return for the creditors.[496]

IV. AMEND THE BANKRUPTCY CODE

A number of solutions have been proposed to address the problem of student loan debt. Many commentators have recommended that student debt be returned to the list of nonpriority general unsecured debt,[497] and a bill has been introduced in Congress to do just that.[498] Even without the student loan discharge exception, bankruptcy courts have discretion to dismiss a petition filed in bad faith,[499] or to deny discharge of a debt incurred by fraud.[500] Restoring the student loan debt discharge would certainly enhance the "fresh start" purposes of the Code. But allowing student loans to be dischargeable as general unsecured debt could potentially cost the federal government tens of billions of dollars to make good on loan guarantees, so any such action in Congress is unlikely for the foreseeable future.[501]

What about allowing only private student loans dischargeable? This might strike a useful middle ground, as there are no modification or forgiveness programs for private loans, and lenders can refuse to make new loans if they do not deem the borrower to be creditworthy. The Consumer Financial Protection Bureau has recommended that private student loans be dischargeable,[502] and legislation has been introduced in Congress for this purpose.[503] However, because most loans are federal loans, and in addition, private loans usually require a co-signer, it is unclear how much of an impact this would have on most borrowers.[504]

Another possibility is that Congress could reinstate a time-lapse discharge. From 1978 to 1990, unless they could prove undue hardship, debtors had to wait five year between when a loan first became due before discharging the debt, and from 1990 to 1998 that was lengthened to seven years.[505] One commentator has likened time-lapse discharge to discharge of tax debt,

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[496] Michael D. Sousa, *The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge*, 58 U. Kan. L. Rev. 553, 597 (2010).
[497] The Student Loan Debt Bomb, supra note 3 at 5; Sarah Edstrom Smith, *Should the Eighth Circuit Continue To Be the Loan Ranger? A Look at the Totality of the Circumstances Test for Discharging Student Loans Under the Undue Hardship Exception in Bankruptcy*, 29 Hamline L. Rev. 601, 616-18 (2006).
[498] H. Res. 365, introduced by Rep. Hansen Clarke (D-MI). A petition was circulated online for supporters to sign. http://signon.org/sing/want-a-real-economic?source=s.em.mt&r_by=95356.
[499] 11 U.S.C. §707(b)
[500] *Id.* §523(a)(2)(A).
[501] Karen Weise, *Bankruptcy Shift Wouldn't Ease Much Student Debt*, Bloomberg July 27, 2012, *available at* http://www.businessweek.com/articles/2012-07-26/bankruptcy-shift-wouldnt-ease-much-student-debt (accessed July 30, 2012).
[502] Private Student Loans Report, Consumer Financial Protection Bureau, July 20, 2012, *available at* http://www.consumerfinance.gov/reports/private-student-loans-report/ (accessed August 1, 2012).
[503] H.R. 2028: Private Student Loan Bankruptcy Fairness Act of 2011.
[504] Weise, *supra* note 502 (the author predicts that because most private debt now requires a co-signer, it is not likely that both the borrower and co-signer will file bankruptcy to get rid of the debt).
[505] 11 U.S.C. §523(a)(8), amended by Pub. L. No. 101-647, § 362(1)-(2) (1990).

noting that most tax debt can be discharged after three years of its accrual, thus mitigating the "soft fraud" of new graduates filing for bankruptcy promptly upon graduation.[506]

A more radical idea for funding education is for students to sell an interest in their future earnings either to the institution providing the education[507] or to private equity investors.[508] The repayment period might expire after a set number of years, or not kick in until a certain income threshold is hit.[509] There might even be an "Equity College," whose survival depends entirely on the success of its students, which in turn would be based upon how well the college prepared the students.[510] On the one hand, this avoids the problem of the debtor being required to pay the lender a disproportionate share of income in comparison to the debtor's essential living expenses. On the other hand, it creates many concerns. First, although it may be the functional equivalent of some student loan debts, it feels a lot like personal servitude. Second, lenders will seek to make loans to students who (1) have already shown higher potential, (2) in institutions with stronger reputations, and (3) pursuing programs with higher earning capacity. This is, in effect, a front-loaded creditworthiness analysis, which is at odds with the current philosophy of making federal student loans irrespective of creditworthiness. Third, lenders cannot really know the potential and intentions of student borrowers, and higher earning borrowers will end up subsidizing lower earning ones.[511]

Discharge education loan debt is not likely in the foreseeable future, and as yet, the market place has not come up with a solution to student debt that matches the demand for education loans. In the meantime, the Indentured Generation continues to stumble. I propose a solution by amending the Bankruptcy Code in a manner that encourages education lending but that is also true to the Bankruptcy Code's fundamental purposes.

When a debtor with education loans files bankruptcy, the debtor will note on a statistical summary that there is education debt, as is currently done. And, the debtor will list the debt on Schedule F, and the debt, without more, will not be dischargeable. This is also the same as current practice. However, if the debtor wants any of his education debt discharged, then instead of filing an adversary proceeding to establish undue hardship under §523(a)(8), the debtor will file a motion to determine the fair market value of each student loan debt, similar to motion to determine the value of a secured interest under the current §506. Section 523(a)(8) will be deleted, and a new section added that provides that a claim for an education benefit or loan is nondischargeable to the extent of the value of the claim. This provision would become a new §512, Claims for education loans. A §512 motion would be raised as a contested matter under Bankruptcy Rule 9014 in a Chapter 7 or Chapter 13 case.

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[506] Abbye Atkinson, *Race, Education Loans, & Bankruptcy*, 16 Mich. J. Race & L. 1, 36-37 (2010).
[507] *Selling a piece of your future*, The Economist April 9, 2012, http://www.economist.com/comment/1354410 (accessed August 8, 2012).
[508] David Bornstein, *Instead of Loans, Investing In Futures*, Opinionator May 30, 2011, 2011 WLNR 10797026; Evan Soltas, *The Human Startup*, July 16, 2012, *available at* http://esoltas.blogspot.com/2012/07/human-startup.html (accessed August 8, 2012).
[509] Soltas, *supra* note 507.
[510] *Id*.
[511] Soltas notes the problem of asymmetry of information, and suggests that borrowers might actively conceal information from potential lenders. Evan Soltas, More on the 'Equity College', *available at* http://esoltas.blogspot.com/2012/07/more-on-equity-college.html (accessed August 8, 2012).

Pursuant to the new §512, the claim of a education loan or education benefit creditor could be modified by order of the court to reflect the actual fair market value of the claim. The amount of claim equal to the fair market value would be nondischargeable, while the remaining balance of the claim would be treated as dischargeable, general unsecured debt. In this context, "fair market value" means the amount that an investor would pay to purchase the respective student loan obligation. The court would fix the fair market value of the debt based upon evidence presented by the debtor and creditor at a hearing. Fair market valuation is commonly used to determine the value of secured debt as well as interest rates in Chapter 11 cases, and in some Chapter 13 cases.

It would not be difficult for bankruptcy courts to determine the fair market value of a student loan or benefit claim. There is an active secondary market in bonds backed by bundles of student loans, currently trading $240 billion in loans annually.[512] Market players have their own formulae for deciding how to value loans. Factors such as finishing with a degree, the type and length of a program, and even graduating on time are variables used by investors in calculating the value of the loan.[513] For example, the historic default rate for many student loans is presumed to be 25% to 30%, but investors in this market calculate that defaults will be 30% to 40% for current graduates.[514] For new private loans there is also a credit analysis as part of the underwriting process.[515] One particular nuance in the student loan context is that experts in a student loan discharge hearing should account for the fact that a debtor's other general unsecured debt will be discharged, which may improve the debtor's ability to repay and hence the market value of the loan. All together, most of the factors used by investors on a daily basis to value billions in student loans on the secondary market can readily be utilized by bankruptcy courts to establish the fair market value of student loan debt in bankruptcy.

This approach offers some important advantages over current practice. First, it substitutes a bankruptcy court's subjective determination for that of the market-place in determining what portion of student loan debt can feasibly be repaid and what portion should be discharged. Thus, judges will not have to decide how much debtors and their families need to

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[512] Matt Wirz, *Why Student Loans are Riskier Bets*, Wall Street Journal, November 12-13, 2011. The secondary student loan market continues to be active. New securitization of student-loan asset backed securities (SLABS) in 2011 was $12 billion, and that number is expected to increase for 2012. Standard & Poors, *supra* note 19, at 21. Private student loan ABS for 2012 was $2.8billion as of June 2012, while $7.8billion was issuance of term securitizations of pre-2010 loans under U.S. Department of Education Straight-A Conduit and FFELP refinancing. Standard & Poor's Ratings Direct, *U.S. Student Loan ABS Issuance Is Ticking Up, But the Future's Uncertain, Say Conference Speakers,* June 26, 2012 at 1, *available at* http://www.standardandpoors.com/spf/upload/Events_US/US_SF_Event_619abs10.pdf (accessed July 10, 2012).

[513] Wirz, *supra* note 511. For example, graduates of technical two-year colleges have far less debt, and skills that may be more employable, making them a better credit risk. *Id.*

[514] *Id.* Investors continually review student loan securities, and their value and increase or decrease, based upon such factors as increased rates of default among borrowers in a particular tranche. *See, e.g.*, *Fitch Affirms Sr Note and Downgrades Sub and Jr. Sub Notes for PARTS Student Loan Trust 2007-CT1*, Business Wire, July 1, 2011 (downgrade due to increased in defaults at 12.87%), *available at* http://www.businesswire.com/news/home/20110701006015/en/Fitch-Affirms-Sr-Note-Downgrades-Jr.-Notes (accessed July 7, 2012) and *Fitch Affirms All Bonds of SLM Student Loan Trust 2002-7*, CNBC, July 6, 2012 , available at http://www.cnbc.com/id/48099895 (accessed July 10, 2012) (affirmed based upon sufficient level of credit to cover risk).

[515] *Id.*

live on.[516] This will lessen the burden on bankruptcy courts and do away with complicated and inconsistent case precedent. Most important, the proposal will prevent capable debtors from discharging loans that they are able to repay, while at the same time providing a means of escape and financial rehabilitation for student loan debtors facing lifelong debt servitude. Thus, this approach honors the Bankruptcy Code's fundamental purpose of providing the "honest but unfortunate debtor" a financial fresh start.

There are likely to be a number of outcomes in the near future if the Bankruptcy Code is revised in this manner. The first is that most education loans will be partially, but not fully dischargeable in bankruptcy. This is because a debtor who qualifies for discharge of debt in bankruptcy is by definition in financial distress and unable to meet his financial obligations. But many loans will not be fully dischargeable because many debtors, such as chapter 13 debtors, are able to repay at least a portion of their debt. In addition, debtors obtain relief from student loan debt generally become an improved their credit risk. Therefore, there is unlikely to be a wholesale repudiation of all student loan debt in bankruptcy.

Allowing loans to be dischargeable in bankruptcy based on fair market value will certainly impact the student loan industry. Private student loan lenders will be more credit-sensitive about making loans, and this may impact the availability of non-federal student loan credit. The "fair market value" test is, in effect, a credit-worthiness test made after a debtor has incurred loans. Faced with that potential, lenders will have incentive run similar calculations before making the loan. Lenders may become more selective about making loans to students in specific fields or in specific programs if there are fewer jobs for that field or if the dropout rate in that program is high. This may indirectly result in fewer entrants into over-crowded professions or few funds for lower-quality education programs. Market-place Darwinism such as this may well be preferable to a lifetime of insurmountable debt.

With respect to federal loans, lawmakers will have to face a political decision regarding funding and conditions for student loans if the balance in excess of fair market value can be discharged in bankruptcy. This will spark tension with the democratizing premise of the current federal student loan program. There is no evidence that borrowers abused the right to discharge student loan debt in the past, but education costs and student loan debt were a mere fraction of what they are today. Therefore, the past may not be a reliable guide to what could happen in the future. If there should be a tidal wave of student loan discharge (assuming §512 takes effect), Congress would have to consider at that point whether to adjust funding for education loans. If the "Bennett Hypothesis" theorists are correct, then reduced federal student loan credits might be the only thing that could force education costs to level-off, or, optimistically, even decrease. With stable or even lower education costs, education should become more accessible, more democratic. That would be an ironic turn of events, and good news for the Indentured Generation.

[516] Elizabeth Warren & Jay Lawrence Westbrook, The Law of Debtors and Creditors: Text, Cases, and Problems 297 (3d ed. 1996).