

Student Loans and Bankruptcy

An Update in the Midst of a Pandemic

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Types of Student Loans

There are two types of student loans:

1. Federal Student Loans
2. Private Student Loans

A student loan is either one or the other; not both, although many borrowers have both federal student loans and private student loans

Federal Student Loans

- Federal student loans are made by the government, with terms and conditions that are set by law.
- Some of these terms and conditions include fixed interest rates (which are usually lower than private student loans) and income-driven repayment plans.
- Federal student loans (other than PLUS loans) do not require a credit check.
- Federal student loans are eligible for administrative remedies, such as administrative discharge and loan forgiveness

Types of Federal Student Loans

The types of federal student loans available now include:

- Direct Subsidized Loans (available to undergraduate students with financial need)
- Direct Unsubsidized Loans (available to undergraduate, graduate and professional students regardless of financial need)
- Direct PLUS Loans (available to graduate and professional students and parents of dependent undergraduate students; eligibility not based on financial need but a credit check is required)
- Direct Consolidation Loans (consolidated loans for eligible federal student loans into a single loan with a single servicer)

Private Loans

- Private student loans are non-federal loans, made by a lender such as a bank, credit union, state agency or school.
- Terms and conditions are set by the lender; usually the interest rate is higher for private student loans.
- Any forbearances, loan forgiveness or other remedies are pursuant to the loan agreement and state law.
- Private student loans usually require a credit check.
- There are many reported decisions that discuss whether a particular private student loan is subject to 11 U.S.C. § 523(a)(8); the analysis is very fact-intensive.

Administrative Discharge

1. Closed school discharge

You may qualify if:

Your school was shut down while you were enrolled or recently after you left the program, you can apply to have the Department of Education discharge the balance of the federal loans you took out to pay for that program.

2. False certification or unauthorized payment discharge

You may qualify if:

Your school mistakenly issued a federal student loan when you weren't eligible. Someone stole your identity and took out a federal loan in your name. Your school forged your signature on federal loan in your name. You were eligible for a federal loan, but couldn't meet state requirements for the career you were being trained for.

3. Unpaid refund discharge

You may qualify if:

You withdrew from school before completing your program while you still had loans.

4. Borrower defense discharge

You may qualify if:

All or part of your student loans discharged if your school broke state laws when it issued your loan or misled you about the educational services it offered. You can't qualify for other legal violations such as personal injury or harassment.

Administrative Discharge

5. Total and permanent disability discharge

You may qualify if:

You have a long-term disability that affects your ability to work. You need to submit documentation from one of these organizations to qualify: US Department of Veterans Affairs, Social Security Administration, or your Physician.

There is also a three-year postdischarge period where you will be required to submit documentation of your annual income to Nelnet to make sure that you are still eligible.

6. Death discharge

You may qualify if:

You or the loan holder dies after a family member presents a death certificate.

7. Bankruptcy Discharge

You may qualify if:

You file for chapter 7 or chapter 13 bankruptcy and a judge rules that paying off your student loans would cause undue hardship.

Educational Loans Under the Bankruptcy Code

11 U.S.C. §523(a)(8)

A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents for –

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

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

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

What About Private Loans and §523(a)(8)?

- There are three Circuit Court opinions holding that private educational “loans” are **not** within the presumption of non-dischargeability under §523(a)(8)(A)(ii) because the word “loan” is not included in that sub-section.
 - a. Homaidan v. Sallie Mae, Inc.*, 3 F.4th 595 (2nd Cir. 2021);
 - b. In re McDaniel*, 973 F.3d 1083 (10th Cir. 2020);
 - c. In re Crocker*, 941 F.3d 206 (5th Cir. 2019).
- Therefore, to be considered presumptively non-dischargeable under this line of cases, private educational loans would need to fall within the ambit of §523(a)(8)(B), *i.e.* a “qualified education loan” within the parameters of section 221(d)(1) of the Internal Revenue Code.

Private Loans – *In re Cardona*

Judge Isicoff has held that funds that were provided to a debtor pursuant to Line of Credit with an Addendum specifically reflecting that the loan was an “Education Line of Credit” was within the ambit of §523(a)(8)(A)(ii).

See In re Cardona, 2015 WL 9459883 (Bankr. S.D. Fla. Feb. 23, 2015).

Note: Judge Isicoff’s decision in *Cardona* pre-dates each of the decisions from the 2nd, 5th, and 10th Circuits.

Private Loans – §523(a)(8)(B)

1. Two Middle District of Florida decisions addressing private student loans have examined whether the underlying loans met the non-dischargeability requirements of a “qualified education loan” under §523(a)(8)(B) and the Internal Revenue Code:
 - a. *In re Quintenilla*, 2020 WL 7333590 (Bankr. M.D. Fla. Nov. 20, 2020)(Judge Colton).
 - a. *In re Mallett*, 625 B.R. 553 (Bankr. M.D. Fla. 2021)(Judge Williamson).
2. Judge Colten noted that determining whether a particular loan is a “qualified education loan” requires “a trip through a series of nested definitions located in different titles, chapters, and sections of the United States Code.”
3. Both Judge Williamson and Judge Colton made clear that the key is whether the purpose of the loan was educational, NOT whether the debtor actually used the funds for his or her education or for educational related expenses.
 - **Note:** Judge Isicoff in *Cardona* came to that same conclusion with respect to her analysis under §523(a)(8)(A)(ii).

Undue Hardship Discharge

Undue Hardship: Brunner Three-Prong Test

The Eleventh Circuit has adopted the following three-pronged test, first established by the Second Circuit, that a debtor must meet in order to discharge an otherwise non-dischargeable student loan as an undue hardship:

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

In re Cox, 338 F.3d 1238, 1241 (11th Cir. 2003) quoting *Brunner v. New York State Higher Educ. Services*, 831 F.2d 395, 396 (2nd Cir. 1987).

Undue Hardship Discharge

Undue Hardship + Brunner: Eleventh Circuit Decisions

1. *In re Cox*, 338 F.3d 1238, 1241 (11th Cir. 2003)(court specifically adopts *Brunner* three prong test as appropriate standard for undue hardship).
2. *Mosley v. ECMC*, 494 F.3d 1320, 1324 (11th Cir. 2007)(“this Circuit has joined several other circuits in adopting the standard set forth in *Brunner*”).
3. *Wieckiewicz v. Educational Credit Management Corporation*, 443 Fed.Appx. 449, 451 (11th Cir. Oct. 17, 2011)(“we have adopted the standard set forth in *Brunner*”).
4. *ECMC v. Acosta-Conniff*, 2017 WL 1396164, *1 (11th Cir. April 19, 2017)(“this court has adopted the test set out in *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987)(the ‘*Brunner* test’).”).
5. *In re Graddy*, 852 Fed. Appx. 509, 512 (11th Cir. June 2, 2021) (“In *In re Cox*, this Circuit adopted the test from *Brunner* . . .”).

S.D.F.L Student Loan Program (SLP)

- The Student Loan Program (SLP) was implemented by the Court on March 30, 2021 by Administrative Order 2021-02.
- The SLP Procedures and Forms can be found here:
<https://www.flsb.uscourts.gov/student-loan-program-slp>
- The primary purpose of the SLP is to assist Chapter 13 debtors by facilitating mediation of private student loans and by encouraging debtors with federal student loans to take advantage of available federal repayment programs before filing, or during, their Chapter 13 cases
- From May 3, 2021 through February 28, 2022, there were a total of 50 SLP Notices/Motions filed in the Southern District of Florida. More are anticipated after the federal student loan moratorium is scheduled to end on August 31, 2022

Other Considerations/Practice Strategies

- Proper Service
- Objections to Claims in Chapter 13 Cases

Legislative Developments

- The FRESH START Through Bankruptcy Act of 2021
 - Bipartisan – Senators Durbin and Cornyn
 - **Make Federal Student Loans Eligible for Discharge in a Bankruptcy Proceeding** ten years after the first loan payment is due.
 - As part of the bankruptcy proceedings, certain IHEs, who receive a certain amount of federally backed student loans, would be required to repay a portion of discharged federal student loans to the taxpayer, in a new cost-sharing structure.
 - **Retain the Existing Undue Hardship Option** for private student loans and for federal student loans that have been due for less than ten years.
 - **Increase Institutional Accountability** by creating provisions that require colleges with more than one-third of their students receiving federal student loans to partially refund the government if a student's loan is later discharged in bankruptcy.
 - This provision would apply if a school had consistently high student loan default and low repayment rates at the time of a student's attendance.
 - **Provide an Option for Student Borrowers** who have no realistic path to pay back their overwhelming student loan debt by allowing bankruptcy to be an option to help them get back on their feet. o Filing for bankruptcy is not a step that student borrowers take lightly, and the strict means test for bankruptcy filing that Congress imposed in 2005 would ensure that borrowers who have the means to repay student debts cannot simply liquidate them in bankruptcy.
- Public Service Loan Forgiveness.
 - Limited time waivers through October 31, 2022.