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Evaluating the Availability of an Income-Driven Repayment Plan Under the Two Doctrinal Tests for Undue Hardship

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Introduction

A fundamental goal of bankruptcy is to give the debtor a "fresh start" by discharging their debts.[1] For student loan debtors in bankruptcy, the opportunity of a "fresh start" is limited. Under title 11 of the United States Code (the "Bankruptcy Code"), student loans are not dischargeable unless excepting such debt from discharge would impose an undue hardship on the debtor and the debtor's dependents.[2] Without guidance from the statutory text, the definition of undue hardship is left up to judicial interpretation, giving rise to much litigation.[3]

An issue that frequently arises when undue hardship is litigated is the availability of an Income-Driven Repayment ("IDR") plan. These plans allow a debtor to pay a percentage of their income for twenty-five years and provide for cancellation of any outstanding balance at the end of the repayment period.[4] By making student loan repayment more affordable, IDR plans can lessen the burden of student loan debt.[5] In student loan bankruptcies, creditors frequently argue

[1] *See* Grogan v. Garner, 498 U.S. 279, 286–87 (1991).
[2] *See* 11 U.S.C. § 523(a)(8) (2018).
[3] *See* Krieger v. Educ. Credit Mgmt. Corp. (*In re* Krieger), 713 F.3d 882, 885 (7th Cir. 2013).
[4] 20 U.S.C. § 1087e(d)-(e) (2018).
[5] *Id.*

that, due to the availability of an IDR plan, the non-discharge of a student loan can never constitute undue hardship.[6] There is no statute or regulation that explicitly requires IDR plans to be considered in student loan bankruptcy cases, however, the majority of appellate courts have unanimously treated the availability of IDR plans as relevant in assessing undue hardship.[7]

This memorandum addresses the relationship between the discharge of student loans in bankruptcy upon a finding of undue hardship and the availability of an IDR plan. Part I outlines two doctrinal tests used by courts to determine whether the repayment of student loans imposes an undue hardship on a debtor. Part II then examines how courts have adapted the tests when a debtor is eligible for an IDR plan, and the role eligibility plays in determining undue hardship and the dischargeability of student loans.

I. The Prevailing Standards for Determination of Undue Hardship

Although Congress created one legal standard for student loan discharge, two tests have emerged to determine whether a debtor has proved undue hardship. Nine out of the eleven circuit courts use the three-prong *Brunner* test created by the Second Circuit.[8] The Eighth Circuit is the only circuit to formally reject the *Brunner* test by creating the "totality of the circumstances test."[9] The First Circuit has declined to adopt either test, but most bankruptcy courts in the First

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[6] *See, e.g.*, Rutherford v. William D. Ford Direct Loan Program (*In re* Rutherford), 317 B.R. 865, 877 (Bankr. N.D. Ala. 2004).

[7] *See* Hedlund v. Educ. Res. Inst., Inc., 718 F.3d 848, 851 (9th Cir. 2013); Krieger v. Educ. Credit Mgmt. Corp., 713 F.3d 882, 883–84 (7th Cir. 2013); Coco v. N.J. Higher Educ. Student Assistance (*In re* Coco), 335 F. App'x 224, 227–28 (3d Cir. 2009); Roe v. College Access Network (*In re* Roe), 295 F. App'x 927, 931 (10th Cir. 2008); Educ. Credit Mgmt. Corp. v. Mosley (*In re* Mosley), 494 F.3d 1320, 1327 (11th Cir. 2007); Barrett v. Educ. Credit Mgmt. Corp. (*In re* Barrett), 487 F.3d 353, 363–64 (6th Cir. 2007); Educ. Credit Mgmt. Corp. v. Frushour (*In re* Frushour), 433 F.3d 393, 402–03 (4th Cir. 2005).

[8] *See* Brunner v. N.Y. State Higher Educ. Servs. Corp. *(In re* Brunner*)*, 831 F.2d 395 (2d Cir. 1987); *see also.*, Oyler v. Educ. Credit Mgmt. Corp. (*In re* Oyler), 397 F.3d 382, 385 (6th Cir. 2005); Frushour, 433 F.3d at 400; Educ. Credit Mgmt. Corp. v. Polleys (*In re* Polleys), 356 F.3d 1302, 1309 (10th Cir. 2004); U.S. Dep't of Educ. v. Gerhardt (*In re* Gerhardt), 348 F.3d 89, 91 (5th Cir. 2003); United Student Aid Funds, Inc. v. Pena (*In re* Pena), 155 F.3d 1108, 1112 (9th Cir. 1998); Pa. Higher Educ. Assistance Agency v. Faish (*In re* Faish), 72 F.3d 298, 305–06 (3d Cir. 1995); *In re* Roberson, 999 F.2d 1132, 1136–37 (7th Cir. 1993).

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

Circuit apply the totality of the circumstances test.[10] This part outlines the doctrinal structure of the two predominant tests for determination of undue hardship: the *Brunner* test and the "totality of the circumstances test."

A. The Majority Test: The Brunner Test

Most courts evaluate undue hardship under the three-prong test established in *Brunner v. New York State Higher Educ*.[11] To receive a discharge of student loans under the *Brunner* test, a debtor must establish the following three elements:

> (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) that the debtor has made good faith efforts to repay the loans.[12]

Under the first prong of *Brunner*, the court will evaluate the debtor's current standard of living and determine whether forcing the debtor to repay the student loans will prevent her from maintaining a minimal standard of living.[13] Generally, maintaining a minimal standard of living means a debtor can afford "basic necessities."[14] What qualifies as a basic necessity varies among courts. Some courts take a more generous approach and allow expenses for transportation, hygiene, and modest recreation.[15] Other courts adopt a narrower view and restrict necessities to only food, clothing, housing, and medical treatment.[16] The debtor doesn't need to show that repayment of the loan would cause the debtor to live at or below the poverty level.[17] However,

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[10] *See* Nash v. Conn. Student Loan Found. (*In re* Nash), 446 F.3d 188, 190–91 (1st Cir. 2006).
[11] 46 B.R. 752, 756 (Bankr. S.D.N.Y. 1985), *aff'd*, 831 F.2d 395 (2d Cir. 1987).
[12] *In re* Brunner, 831 F.2d at 396.
[13] *Id.*
[14] *Id.*
[15] *See* Kuznicki v. Educ. Credit Mgmt. Corp. (*In re* Kuznicki), 483 B.R. 296, 300–01 (W.D. Pa. 2012).
[16] *See* Crawley v. Educ. Credit Mgmt. Corp. (*In re* Crawley), 460 B.R. 421, 436 (E.D. Pa. 2011).
[17] *See* Pa. Higher Educ. Assistance Agency v. Faish (*In re* Faish), 72 F.3d 298, 305 (3d Cir. 1995).

the debtor cannot dismiss their loan obligation simply because repayment would require significant personal or financial sacrifices.[18]

If the debtor proves their inability to maintain a minimal standard of living, the court moves on to the second prong of the *Brunner* test.[19] The second prong requires the debtor to demonstrate that additional circumstances exist indicating "that [the debtor's] state of affairs is likely to persist for a significant portion of the repayment period of the student loan."[20] A debtor must show that extenuating circumstances affect their future earning potential and their ability to make payments on the loan.[21] These circumstances must be unique or extraordinary and "may include, but are not limited to, illness, disability, a lack of useable job skills, or the existence of a large number of dependents."[22] Most importantly, a debtor's additional circumstances must be beyond their control and not borne of free choice.[23]

If a debtor can prove the second prong of *Brunner*, the third and final prong of the test is an inquiry into whether or not the debtor has made good faith efforts to repay the student loans.[24] When a debtor receives a student loan, they become obligated to make a good faith effort to repay the loan in full.[25] Therefore, a court will evaluate the number of payments a debtor has made on the student loan.[26] Making some payments can demonstrate good faith, but failure to make a payment, standing alone, does not establish a lack of good faith.[27] Courts also acknowledge that a debtor may not have the funds available to make payments.[28] In these

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[18] *Id.* at 306.
[19] *Brunner*, 831 F.2d at 396.
[20] *Id.*
[21] *Id.*
[22] Barrett v. Educ. Credit Mgmt. Corp. (*In re* Barrett), 487 F.3d 353, 359 (6th Cir. 2007).
[23] *Id.*
[24] *Brunner*, 831 F.2d at 396.
[25] *See* Roberson v. Illinois Student Assistance Comm. (*In re* Roberson), 999 F.2d 1132, 1136 (7th Cir. 1993).
[26] *See* Educ. Credit Mgmt. Corp. v. Mosley (*In re* Mosley), 494 F.3d 1320, 1327 (11th Cir. 2007).
[27] *See* Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302, 1311 (10th Cir. 2004).
[28] *Id.*

circumstances, courts have found a debtor's efforts to defer the loan or enroll in a payment plan sufficient to demonstrate good faith.[29]

B. The Minority Test: The Totality of the Circumstances Test

In adopting the "totality of the circumstances test," the Eighth Circuit articulated their belief that fairness and equity require each undue hardship case to be examined based on the unique facts and circumstances surrounding the particular bankruptcy.[30] In evaluating the totality of the circumstances, bankruptcy courts consider: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependent's reasonable and necessary living expenses; and (3) any other relevant facts and circumstances surrounding the particular bankruptcy case.[31] Under this test, if the debtor's reasonable future financial resources will sufficiently cover their student loan debt while still allowing for a minimal standard of living, the debt is non-dischargeable.[32] Courts give special consideration to the debtor's present employment and financial situation, including assets, expenses, and earnings, along with the prospect of future changes, positive or adverse, in the debtor's financial position.[33]

The Eighth Circuit believed that requiring bankruptcy courts to adhere to the strict parameters of the *Brunner* test diminished the inherent discretion Congress gave to courts to determine undue hardship.[34] Use of the totality of the circumstances test has allowed bankruptcy courts to consider various factors beyond the presence of excess income over expenses.[35] Factors such as the effect refusing discharge has on the mental health of the debtor, the physical

[29] *Id.* at 1312.
[30] *In re* Long, 322 F.3d at 554–55.
[31] Andrews v. S.D. Student Loan Assistance Corp. (*In re* Andrews), 661 F.2d 702, 704 (8th Cir. 1981).
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*

conditions that impair the debtor's ability to maintain employment, and a debtor's good faith effort to repay the loan.[36]

II. Incorporating an IDR Plan into the Doctrinal Tests for Undue Hardship

The U.S. Department of Education enacted regulations that allow student loan borrowers to enroll in IDR plans.[37] IDR plans allow for the adjustment of monthly payments based on the income of the student loan debtor.[38] Creditors frequently argue that, due to the availability of IDR plans, the non-discharge of a student loan can never constitute undue hardship.[39] The majority of courts reject the argument that IDR plans should preempt judicial determination of the dischargeability of student loans.[40] Thus, it is important to examine how courts have incorporated the availability of an IDR plan under the two doctrinal tests for undue hardship.

A. Evaluating the Availability of an IDR Plan Under the Brunner Test

For courts applying the *Brunner* test, the question arises as to which part of the test to evaluate the availability of an IDR plan. The majority of courts have treated IDR as one factor to consider in determining whether the debtor has made a good faith effort to repay the loans, thus satisfying the third prong of the *Brunner* test.[41] A debtor's willingness to participate in an IDR plan can often demonstrate good faith.[42] The majority of courts do not require a debtor to participate in an IDR plan to satisfy the good faith requirement, but a debtor's failure to participate in a plan is relevant.[43]

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[36] *See, e.g.*, Reynolds v. Pa. Higher Educ. Assistance Agency (*In re* Reynolds), 303 B.R. 823, 826–27 (Bankr. D. Minn. 2004); Limkemann v. U.S. Dept. of Educ. (*In re* Limkemann), 314 B.R. 190, 194–95 (Bankr. N.D. Iowa 2004); Faktor v. United States (*In re* Faktor), 306 B.R. 256, 264 (Bankr. N.D. Iowa 2004).
[37] *See* 20 U.S.C. § 1087e(d)–(e) (2018).
[38] *Id.*
[39] *In re* Rutherford, 317 B.R. at 877.
[40] *See, e.g.*, Hedlund v. Educ. Res. Inst., Inc., 718 F.3d 848, 851 (9th Cir. 2013).
[41] *See, e.g.*, Pa. Higher Educ. Assistance Agency v. Birrane (*In re* Birrane), 287 B.R. 490, 500 n.7 (B.A.P. 9th Cir. 2002).
[42] *See Polleys*, 356 F.3d at 1310.
[43] *See In re* Birrane, 287 B.R. at 500 n.7.

Evaluating the availability of an IDR plan under the third prong of the *Brunner* test, the bankruptcy court for the Northern District of Texas granted a discharge of student loan debt despite a debtor's failure to enroll in an IDR plan.[44] The court rejected the argument that failure to participate in an IDR plan is per se bad faith.[45] Even though the debtor's IDR plan would have resulted in a zero-dollar payment plan, the court determined that a refusal to discharge student loans would still result in an undue hardship on the debtor and her dependents.[46] While failure to enroll in an IDR plan weighed against a finding of good faith, it did not outweigh other factors, such as the debtor's continuous efforts to seek deferment and forbearance of her loans.[47]

A minority of courts will consider the availability of the IDR plan under the second prong of the *Brunner* test, whether additional circumstances exist indicating that a debtor's financial condition is likely to persist for a significant portion of the repayment period.[48] Taking this approach, the bankruptcy court for the Northern District of Texas denied a debtor discharge of her student loans.[49] In reaching its decision, the court relied on the availability of an IDR plan allowing the debtor to make income-contingent monthly payments and canceling her loans after twenty-five years.[50] For this reason, the court found that the debtor's situation was unlikely to persist throughout the foreseeable future, thus failing the second part of the *Brunner* test.[51]

Adopting a similar approach, an Indiana bankruptcy court considered the availability of an IDR plan under both the second and third prongs of the *Brunner* test.[52] In this case, a debtor's

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[44] *See* Trejo v. Navient (*In re* Trejo), 17-42439-MXM-7, 2020 WL 1884444, at *10 (Bankr. N.D. Tex. Apr. 15, 2020).
[45] *Id.* at *9.
[46] *Id.*
[47] *Id.*
[48] *Brunner*, 831 F.2d at 396.
[49] *See* Hollins v. U.S. Dept. of Educ. (*In re* Hollins), 286 B.R. 310, 316 (Bankr. N.D. Tex. 2002).
[50] *Id.*
[51] *Id.*
[52] *See* Archibald v. United States (*In re* Archibald), 280 B.R. 222, 227–28 (Bankr. S.D. Ind. 2002).

nonparticipation in an IDR plan weighed against a finding of good faith.[53] The debtor's ability to consolidate her loans over twenty-five years under the IDR plan prevented a showing of "certainty of hopelessness," the standard employed by the Seventh Circuit under the second part of *Brunner*.[54] Since the debtor could afford monthly payments under the IDR plan, the court concluded this was a practical alternative to discharge.[55]

Finally, a minority of courts address the availability of an IDR under the first prong of the *Brunner* test, whether the debtor can maintain a minimal standard of living.[56] Since payments under an IDR plan are based on a debtor's income, courts taking this approach often reason that the monthly payments are unlikely to prevent a debtor from maintaining a minimal standard of living.[57] This conclusion is common when a debtor's enrollment in an IDR plan would result in a zero-dollar monthly payment.[58] However, other courts have recognized that the formula for determining monthly payments is strictly based on income and does not account for expenses arising from dependents or medical conditions.[59] Thus, if a debtor cannot afford the payments, some courts have also granted or upheld a discharge despite a debtor's nonparticipation in an IDR plan.[60]

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[53] *Id.* at 229.
[54] *Id.* at 228–29.
[55] *Id.*
[56] *Brunner*, 831 F.2d at 396.
[57] *See e.g.*, Thomsen v. Dept. of Educ. (*In re* Thomsen), 234 B.R. 506, 512 (Bankr. D. Mont. 1999).
[58] *See e.g.*, Thoms v. Educ. Credit Mgmt. Corp. (*In re* Thoms), 257 B.R. 144, 149 (Bankr. S.D.N.Y. 2001).
[59] *See, e.g.*, McLaney v. Ky. Higher Educ. Assistance Auth. (*In re* McLaney), 375 B.R. 666, 671–72, 678 (M.D. Ala. 2007).
[60] *See e.g.*, Educ. Credit Mgmt. Corp. v. Durrani (*In re* Durrani), 311 B.R. 496, 505 (Bankr. N.D. Ill. 2004), *aff'd*, 320 B.R. 357 (N.D. Ill. 2005).

B. Evaluating the Availability of an IDR Plan Under the Totality of the Circumstances Test

When applying the totality of the circumstances test, the majority of courts have rejected a per se rule that participation in an IDR plan is required to reach a finding of undue hardship.[61] Courts note that treating the availability of an IDR plan as outcome determinative would effectively override the individualized determination of undue hardship mandated by Congress in § 523(a)(8).[62] Instead, under the totality of the circumstances test, the availability of an IDR plan is one factor to consider in evaluating the totality of a debtor's circumstances.[63]

In *Lee v. Regions Bank Student Loans*, the United States Bankruptcy Appellate Panel of the Eighth Circuit upheld a discharge of the debtor's student loans.[64] The debtor, a single mother of two children, owed over $47,000 in student loans and received no child support from her ex-husband.[65] The bankruptcy court determined that under an IDR plan, the debtor could not afford the monthly payments without causing undue hardship on herself and her dependents.[66] In this case, the creditors appealed, arguing the bankruptcy court had failed to consider the IDR plan's availability adequately.[67] Affirming the discharge, the Eighth Circuit held that under the totality of the circumstances analysis, the availability of an IDR plan should not be given undue weight.[68] The court explained that while an IDR plan may provide temporary relief, it does not

[61] *See In re* Long, 322 F.3d at 552.
[62] *Id.*; 11 U.S.C. § 528(a)(8) (2018).
[63] *See In re* Long, 322 F.3d at 552.
[64] *See* Lee v. Regions Bank Student Loans *(In re* Lee*),* 352 B.R. 91, 96–97 (B.A.P. 8th Cir. 2006).
[65] *In re* Lee, 345 B.R. 911, 913 (Bankr. W.D. Ark. 2006).
[66] *Id.* at 914, 919.
[67] *In re* Lee, 352 B.R. at 91.
[68] *Id.* at 97.

offer a fresh start.[69] Aspects of an IDR plan such as negative amortization and a potentially significant tax bill are inimical to the goal of bankruptcy.[70]

Availability of an IDR plan becomes more relevant to a totality of the circumstances analysis when the size of the debtor's student loan debt is the primary basis for claiming undue hardship.[71] In *Jesperson*, the Eighth Circuit reversed a finding of undue hardship entitling a debtor to a discharge of more than $350,000 in student loans.[72] In this case, the debtor had never made any payments on the loans despite a monthly surplus of $900 in income.[73] Given the debtor's earning potential and lack of substantial obligations to dependents or mental or physical impairments, the court concluded the only possible basis for granting an undue hardship discharge would be the "sheer magnitude of his student loan debts."[74] Because the debtor had an income surplus sufficient to satisfy the IDR plan's monthly payment, the Eighth Circuit reversed the discharge.[75] The majority opinion in *Jesperson* does not stand for the proposition that a debtor's eligibility for an IDR plan automatically precludes an undue hardship discharge.[76] Rather, a debtor with surplus income sufficient to satisfy the monthly payment required under an IDR plan is not entitled to a discharge.[77]

Conclusion

When an IDR plan is available, creditors frequently argue that excepting a student loan from discharge can never constitute an undue hardship. However, most bankruptcy courts have reasoned that IDR plans do not automatically foreclose the opportunity of a "fresh start" through

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[69] *Id*.
[70] *Id.*
[71] *See* Educ. Credit Management Corp v. Jesperson, 571 F.3d 775, 779 (8th Cir. 2009).
[72] 571 F.3d at 779.
[73] *Id.*
[74] *Id.* at 780–81.
[75] *Id.*
[76] *Id.* at 786–90.
[77] *Id.*

bankruptcy. Instead, courts continue to make determinations of undue hardship, treating the availability of IDR as one factor in their analysis. When applying the *Brunner* test or the totality of the circumstances test, courts typically focus on whether the IDR plan offers the debtor a viable choice for repayment without causing undue hardship.