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Private Student Loans may be Dischargeable in Bankruptcy Without Meeting the Undue Hardship Requirement and if not, there are two Ways to Prove Undue Hardship

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Introduction

Section 523 of title 11 of the United States Code (the "Bankruptcy Code") prevents former students from discharging certain educational debts in bankruptcy, unless the failure to discharge "would impose an undue hardship on the debtor and the debtor's dependents."¹ Typically, it is a debtor's burden to show that their loans may be discharged on the grounds of "undue hardship."² However, Congress has not defined "undue hardship" leaving jurisdictions divided regarding the appropriate test.³ Most courts have followed the *Brunner* three-prong test, while only the First and Eighth Circuits use the totality of the circumstances test.⁴

Additionally, section 523(a)(8) of the Bankruptcy Code does not explicitly state that *all* student loans are excepted from discharge; thus, courts are split on whether private student loans

¹ 11 U.S.C. § 523(a)(8).

² *In re Love*, No. 13-41680, 2021 WL 1732255, at *2 (Bankr. D. Kan. Apr. 29, 2021).

³ See *In re Nary*, 253 B.R. 752, 761 (N.D. Tex. 2000).

⁴ See, e.g. *Bronsdon v. Educ. Credit Mgmt. Corp. (In re Bronsdon)*, 435 B.R. 791, 800 (B.A.P. 1st Cir. 2010); *Andrews v. S. D. Student Loan Assistance Corp. (In re Andrews)*, 661 F.2d 703 (8th Cir. 1981); U.S. Dep't of Educ. v. *Gerhardt (In re Gerhardt)*, 348 F.3d 89, 91 (5th Cir. 2003); *Hemar Ins. Corp. of Am. v. Cox (In re Cox)*, 338 F.3d 1238, 1241 (11th Cir. 2003).

are non-dischargeable. Recent case law suggests that certain private student loans may be dischargeable.⁵

This memorandum explores whether private student loans can be discharged under section 523(a)(8) of the Bankruptcy Code without meeting the undue hardship requirement and if not, the two ways a debtor can prove undue hardship. Part I discusses (a) an overview of section 523(a)(8); (b) the general reasons why courts have held that the private student loans are non-dischargeable absent a showing of undue hardship; and (c) the growing trend toward permitting a debtor to discharge certain private student loans. Part II describes the different standards used to determine whether excepting a debt from discharge will impose an undue hardship on the debtor and its dependents.

Discussion

I. Certain Private Student Loans may be Dischargeable Under Section 523(a)(8) of the Bankruptcy Code.

Over the years, courts have found educational debts to be presumptively non-dischargeable because they fell within one of section 523(a)(8)'s three categories. However, after analyzing the language of the statute, some circuit courts have determined that certain private student loans can be discharged without meeting the undue hardship requirement.

A. Overview of Section 523(a)(8)

One of the main purposes of the federal bankruptcy system is to “aid the unfortunate debtor by giving him a fresh start in life, free from debts.”⁶ However, Congress enacted section 523(a)(8) as a policy matter to prevent students who, immediately upon graduating would file

⁵ See *McDaniel v. Navient Sols. LLC (In re McDaniel)*, 973 F.3d 1083 (10th Cir. 2020); *Crocker v. Navient Sols. LLC (In re Crocker)*, 941 F.3d 206 (5th Cir. 2019); *Homadian v. Sallie Mae, Inc.*, 3 F.4th 595 (2d Cir. 2021).

⁶ See *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752, 1758 (2018).

petitions for bankruptcy and obtain a discharge of their educational loans.⁷ Section 523(a)(8) of the Bankruptcy Code provides that three categories of educational debt cannot be discharged: (1) government and nonprofit-backed loans and educational benefit overpayments; (2) obligations to repay funds received as an educational benefit, scholarship, or stipend; and (3) qualified education loans.⁸ Therefore, educational debt is dischargeable through the normal bankruptcy process unless it falls within one of these three categories.⁹

B. The Presumption that all Student Loans are Non-dischargeable.

Some courts have interpreted Congress's amendment to section 523(a)(8) to signify that all student loans are presumptively non-dischargeable. In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), which made significant changes to the Bankruptcy Code.¹⁰ One change included amending section 523(a)(8) to broaden the types of educational debt that could not be discharged absent proof of "undue hardship."¹¹ Originally, section 523(a)(8) only prohibited federal loans from discharge; however, after the BAPCPA amendment, section 523(a)(8)(B) states that "any other educational loan that is a *qualified education loan*" is non-dischargeable.¹² The Internal Revenue Code defines a "qualified education loan" as "any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses."¹³ The Internal Revenue Code defines "qualified expenses" as "the cost of attendance" at the eligible education institution, reduced by scholarships and other payments.¹⁴ Therefore, because of BAPCPA's change to section 523(a)(8), some courts have

⁷ *See id.*

⁸ 11 U.S.C. § 523(a)(8).

⁹ *See id.*

¹⁰ *See Student Loans: Path to Success or Road to the Abyss? An Argument to Reform the Student Loan Discharge Exception*, 89 TEMP. L. REV. 155, 170 (2016).

¹¹ *See* 11 U.S.C. § 523(a)(8)(B).

¹² *Id.* (emphasis added).

¹³ 26 U.S.C. § 221(d).

¹⁴ *Id.*

interpreted it to signify that *all* student loans –public and private– are presumptively non-dischargeable.¹⁵

For example, the Second Circuit held that private student loans are “excepted from discharge under 11 U.S.C. §523(a)(8)(A)(ii)” because student loans are presumptively non-dischargeable.¹⁶ Under section 523(a)(8)(A)(ii) “an obligation to repay funds received as an educational benefit, scholarship, or stipend” are non-dischargeable absent a showing of undue hardship. However, most courts have found *In re Desormes* unpersuasive because it did not consider whether private student loans fell under the language of section 523(a)(8)(A)(ii).¹⁷ The Second Circuit simply rejected the debtor’s argument that his loans did not fall within the statute because he did not receive them directly and relied on the principle that “[s]tudent loans are presumptively non-dischargeable in bankruptcy” without further analysis.¹⁸

Given *In re Desormes*’s lack of connection between the language of section 523(a)(8)(A)(ii) and how private student loans fall within its textual language, subsequent Second Circuit cases have held that certain private loans are dischargeable without meeting the undue hardship requirement.¹⁹

C. The Fifth, Tenth, and Second Circuits Have Held that Certain Private Student Loans are Dischargeable Without Meeting the Undue Hardship Requirement.

Recently, the Fifth, Tenth, and Second Circuits have determined that private student loans do not fall within the meaning of section 523(a)(8)(A)(ii) and therefore, are dischargeable

¹⁵ See *Easterling v. Collecto, Inc.*, 692 F.3d 229, 232 (2d Cir. 2012) (stating that “student loans are presumptively non-dischargeable in bankruptcy”).

¹⁶ *Desormes v. United States (In re Desormes)*, 569 Fed. Appx. 42, 43 (2d Cir. 2014).

¹⁷ See *In re Crocker*, 941 F.3d at 222; *Homadian*, 3 F.4th at 601 n.4; *In re McDaniel*, 973 F.3d at 1099.

¹⁸ See *In re Crocker*, 941 F.3d at 222 n.12 (noting that “[t]he opinion [in *In re Desormes*] was quite brief” and, more specifically, that “[t]here was no analysis of how to interpret the three-item statutory list of § 523(a)(8)(A)(ii)”).

¹⁹ See *infra* Part C; *In re McDaniel*, 973 F.3d at 1099 (stating that “the [*In re Desormes*] order does not indicate that the panel even considered whether a student loan constitutes ‘an obligation to repay funds received as an educational benefit’ for purposes of § 523(a)(8)(A)(ii)”).

without meeting the undue hardship requirement.²⁰ To reach this conclusion, courts have found that student loans are not “educational benefits” within the meaning of section 523(a)(8)(A)(ii) because an “educational benefit” is “a conditional grant of funding for education—akin to a stipend and scholarship—as opposed to a loan of funds for education.”²¹ To include private student loans within such definition would render subsections 523(a)(8)(A)(i) and (B) superfluous because defining “educational benefit” to incorporate loans would unnecessarily encompass the public loans referred to in subsections 523(a)(8)(A)(i) and (B).²²

Additionally, courts have found that private student loans do not fall within section 523(a)(8)(A)(i) if they are not government-backed loans.²³ Nor do private student loans fall under section 523(a)(8)(B) if they are not “qualified education loans” meaning that they are loans used “solely for the cost of attendance.”²⁴ Therefore, private student loans can be discharged absent a showing of undue hardship if the loan is not (1) a government-backed loan; (2) a loan that is used “solely for the cost of attendance; or (3) a conditional grant of funding for education.

II. If the Educational Debt Falls Within Section 523(a)(3), then the Debtor can Seek Discharge by Proving “Undue Hardship” with one of two Approaches.

If a court finds that the debtor’s educational debt falls under section 523(a)(8) of the Bankruptcy Code, then it is up to the debtor to prove that excepting such a debt from discharge “would impose an undue hardship on the debtor and the debtor’s dependents.”²⁵ The Circuits are divided on what is the appropriate test for determining “undue hardship.”²⁶ As of June 2021, the United States Supreme Court has not resolved the circuit split regarding the appropriate test for

²⁰ See *In re McDaniel*, 973 F.3d at 1104–05; *In re Crocker*, 941 F.3d at 224; *Homadian*, 3 F.4th at 605.

²¹ *In re McDaniel*, 973 F.3d at 1098.

²² *Id.* at 1101–02.

²³ See *id.* at 1094.

²⁴ *Id.* at 1088.

²⁵ 11 U.S.C. § 523(a)(8).

²⁶ *In re Nary*, 253 B.R. at 761.

evaluating “undue hardship.”²⁷ Therefore, both the *Brunner* 3-prong test and the Totality of the Circumstances tests remain.

A. *Brunner* 3-Prong Test

The majority of courts use the *Brunner* test which was adopted in *Brunner v. New York State Higher Educ. Servs. Corp.*, and is currently used by nine circuits.²⁸ Under the *Brunner* test to prove “undue hardship” the debtor must satisfy three prongs: (1) the debtor cannot maintain, based on current income and expenses, a “minimal” standard of living if forced to repay the loans; (2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) the debtor has made good faith efforts to repay the loans.²⁹

i. *Prong 1: “Minimal Standard of Living”*

While the *Brunner* court set out the standard that a debtor must meet to prove “undue hardship,” it failed to define what constitutes as a “minimal standard of living” to satisfy the first prong of the test.³⁰ In the absence of a bright line rule, most courts have found that borrowers do not have to be at poverty level income to prove “undue hardship.”³¹ For example, a bankruptcy court in the Third Circuit has described a “minimal standard of living” as somewhere between poverty and “mere difficult.”³² While the “minimal standard of living” is a factual inquiry determined on a case-by-case basis, a court may consider the debtor’s (1) shelter that is

²⁷ See *McCoy v. United States (In re McCoy)*, 810 F. App’x 315, 317 (5th Cir. 2020), *cert. denied sub nom. McCoy v. United States*, 141 S. Ct. 2794, 210 L. Ed. 2d 927 (2021).

²⁸ See, e.g., *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987); *Educ. Credit Mgmt. Corp. v. Frushour (In re Frushour)*, 433 F.3d 393, 400 (4th Cir. 2005); *Oyler v. Educ. Credit Mgmt. Corp. (In re Oyler)*, 397 F.3d 382, 385 (6th Cir. 2005); *Educ. Credit Mgmt. Corp. v. Polleys (In re Polleys)*, 356 F.3d 1302, 1309 (10th Cir. 2004).

²⁹ See *Brunner*, 831 F.2d at 396.

³⁰ *Id.*

³¹ See *In re Miller*, 409 B.R. 299, 311 (Bankr. E.D. Pa. 2009); *In re Ivory*, 269 B.R. 890 (Bankr. N.D. Ala. 2001).

³² *In re Miller*, 409 B.R. at 311.

furnished, clean, free of pests and climate-regulated with heating and cooling; (2) basic utilities such as electricity, water, gas, and telephone; (3) food and personal hygiene products; (4) transportation or vehicles; (5) life insurance and health insurance (or the ability to pay for medical and dental expenses); and (6) modest recreation.³³

Furthermore, courts have stated that a minimal standard of living does not include “luxury type expenses.”³⁴ Additionally, excessive amounts spent on otherwise reasonable expenses may establish that a debtor is able to maintain a minimal standard of living.³⁵ Therefore, a court must evaluate a debtor's income and expenses to determine whether there are expenditures in excess of the minimal standard of living that can be reallocated to payment of the debtor's student loans.³⁶

ii. *Prong 2: “Additional Circumstances”*

A finding under the “additional circumstances” prong of the *Brunner* test depends on which circuit the debtor files in because like the “minimal standard of living” prong, there is no bright line rule on what courts consider. Some courts consider a “certainty of hopelessness” standard while other courts take “a realistic look . . . into [a] debtor’s circumstances”³⁷ Under the “certainty of hopelessness” standard courts do not consider the present inability to fulfill financial commitments but rather consider “circumstances indicative of a certainty of hopelessness.”³⁸ This can include “illness, disability, lack of useable job skills, or the existence of a large number of dependents.”³⁹ Furthermore, the circumstances must be beyond the debtor’s

³³ *Id.*

³⁴ *See In re DeGroot*, 339 B.R. 201, 209 (D. Or. 2006).

³⁵ *Id.*

³⁶ *See In re Miller*, 409 B.R. at 312.

³⁷ *See In re Oyler*, 397 F.3d at 385; *In re Mosley*, 494 F.3d 1320, 1325 (11th Cir. 2007); *In re Roberson*, 999 F.2d 1132, 1136 (7th Cir. 1993).

³⁸ *In re Oyler*, 397 F.3d at 386.

³⁹ *Id.*

control, not borne of free choice.⁴⁰ Therefore, “choosing a low-paying job cannot merit undue hardship relief.”⁴¹

Under the “realistic look into a debtor’s circumstances” standard, the Tenth Circuit has stated that the court should not only make a “realistic look into a debtor’s circumstances” but also consider the debtor’s “ability to provide for adequate shelter, nutrition, health care, and the like.”⁴² The Tenth Circuit further notes that courts should “base their estimation of a debtor’s prospects on specific articulable facts, not unfounded optimism” and the inquiry into future circumstances should be limited to the “foreseeable future, at most over the term of the loan.”⁴³

iii. *Prong 3: “Good Faith Efforts to Repay”*

Finally, an inquiry into a debtor’s good faith will also depend on which circuit the debtor is in. Some courts like the Tenth Circuit have held that the inquiry should “focus on questions surrounding the legitimacy of the basis for seeking a discharge.”⁴⁴ However, this inquiry should not be used as a means for courts to impose their own values on a debtor’s life choices.⁴⁵ Other courts have explained that the analysis of this prong is “essentially an inquiry into whether the debtor has consciously or irresponsibly disregarded his or her repayments obligation—or, instead, whether there is some justification for the debtor’s default and ongoing inability to repay the loan.”⁴⁶ Ultimately, like the other two prongs of the *Brunner* test, sufficient “good faith efforts” will vary depending on the jurisdiction.

B. Totality of the Circumstances

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *In re Polleys*, 356 F.3d at 1310.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *In re Hutsell*, 620 B.R. 604, 604 (Bankr. N.D. Ohio 2020).

The Totality of the Circumstances test is only used by the First and Eighth Circuits.⁴⁷ Under the Totality of the Circumstances test a court considers “(1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependent's reasonable necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case.”⁴⁸ The Eighth Circuit explains that the test focuses on determining whether a debtor’s reasonable future financial resources will sufficiently cover payment of the student loan debt, while also allowing for a minimal standard of living.⁴⁹ If a court finds this to be true, then the debt should *not* be discharged.⁵⁰ Ultimately, this test requires “a special consideration of 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.”⁵¹

Conclusion

The Bankruptcy Code prevents former students from discharging certain educational debts in bankruptcy absent a showing of undue hardship on the debtor and its dependents. Since Congress enacted the BAPCPA, Courts have been divided over whether private student loans fall within section 523(a)(8) and are therefore non-dischargeable. Some courts have held that private student loans cannot be discharged because they fall within section 523(a)(8)(A)(ii), accepting the presumption that all student loans are non-dischargeable. Other courts have held that certain private student loans do not fall within section 523(a)(8)(A)(ii) because a “loan” does not qualify as an “educational benefit.” Therefore, private student loans that are not government backed

⁴⁷ See *In re Bronsdon*, 435 B.R. 791, 794 (B.A.P. 1st Cir. 2010); *Long v. Educ. Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549, 554 (8th Cir. 2003).

⁴⁸ *In re Long*, 322 F.3d at 554.

⁴⁹ *Id.* at 554–55.

⁵⁰ *Id.*

⁵¹ *Id.* at 555.

loans, used exclusively for the cost of education, or a conditional grant of funding for education may be dischargeable in bankruptcy proceedings.

Still, when a debtor finds themselves in a jurisdiction that considers private student loans to fall within one of the categories of section 523(a)(8), they have the burden to prove that non-dischargeability would subject them to “undue hardship.” Undue hardship can be proven by either the majority *Brunner* 3-prong test or the minority Totality of the Circumstances. Which test applies and how to apply it will depend on the jurisdiction.