

Discharging Student Loan Debt – A History

11 U.S. Code § 523 - Exceptions to discharge

- (a) 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;

To discharge student loan debt in a bankruptcy, the bankruptcy code requires a finding by the court of “undue hardship on the debtor and the debtor’s dependents.” 11 U.S.C. 523(a)(8). Two legal tests have emerged to assist the courts with the determination of student loan undue hardship discharges: the *Brunner* Test, from the Second Circuit, and the Totality of the Circumstances Test, from the Eighth Circuit.

The Undue Hardship tests

***Brunner Test - Brunner v. New York State Higher Educ. Serv. Corp.*, 831 F.2d 395 (2d Cir. 1987)**

The *Brunner* Test is comprised of a three-prong test, looking at whether

- (1) 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.

Thus, if the bankruptcy court finds against the debtor on any of the three prongs, the inquiry ends, and the student loan is not dischargeable.

The harshness of the *Brunner* test has been criticized by many because most debtors are unable to successfully meet the second and/or third prongs of the test. The *Brunner* test has also been criticized because there is no statutory predicate in the language of section 523(a)(8) for the second and third prongs.

The *Brunner* Test is the governing law in the Second, Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth, and Eleventh circuits.

Totality of the Circumstances Test – *Long v. Educ. Credit Management Corp.*, 322 F.3d 549 (8th Cir. 2003)

The Totality of the Circumstances test looks to whether the reasonable future financial resources of a debtor will sufficiently cover payment of his or her student loan debt, while still allowing for a minimal standard of living. If the answer is yes, then it would be inappropriate to discharge the debt.

The Totality of the Circumstances test considers

- (1) the debtor's past, present, and reasonably reliable future financial resources;
- (2) a calculation of the debtor's and her dependent's reasonably necessary living expenses;
- (3) any other relevant facts and circumstances surrounding each particular bankruptcy case.

The second inquiry of the Totality of the Circumstances test is a number-crunching calculation, requiring the court to go through every line item of a debtor's income and expenses to make a finding of fact. The courts ultimately make significant adjustments up and down of a debtor's net budget through this process.

The Totality of the Circumstances has been adopted by the First and Eighth circuits.

Section 523(a)(8) – The Metamorphosis

Prior to 1978 – All student loans were dischargeable.

1976 – “Undue hardship” is added as a condition of discharge.

1978 Bankruptcy Code – Education loans made by the government, colleges, and universities are not dischargeable if the debt came due less than five years prior to the petition date.

October 14, 1987 - *Brunner v. New York Higher Education Services Corp.*, 831 F.2d 395, 396 (2nd Cir. 1987) is decided.

1990 Amendment to the Bankruptcy Code – The five year period is extended to seven years.

1998 Amendment to the Bankruptcy Code – Congress removes the seven year horizon so that the only basis to discharge a student loan is to prove “undue hardship” in an adversary proceeding.

2005 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 – Private loans are added to the list of nondischargeable student loans.