DISCHARGING STUDENT LOAN DEBT IN BANKRUPTCY

GENERAL FACTS

1. Americans owe over $1.4 trillion in student loan debt.
2. Average of $37,172.00 per student.
3. Delinquency rate of 11.2% of 44 million Americans.
4. Average monthly student loan payment is $351.00.

Source: www.studentloanhero.com

5. Average college graduate has a starting salary of $50,556.00.

Source: www.time.com

6. Median starting salary for lawyers is $68,300.00.*

Source: www.usnews.com

*Of ranked law schools in the private sector.

BANKRUPCY CODE

11 U.S.C. § 523(a) states:

"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;"

UNDUE HARDSHIP

The term "undue hardship" is not defined by the Bankruptcy Code, so many Circuits have adopted the three-part *Brunner* test.

Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987).

The Second Circuit adopted the following test in 1987 to determine "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.

3. That the debtor has made good faith efforts to repay the loans.

The Eleventh Circuit adopted the *Brunner* test in 2003 in *In re Cox*, 338 F.3d 1238.

1. First Prong – Minimal Standard of Living

A "minimal standard of living" is not such that a debtor must live a life of abject poverty, but it does require "more than a showing of tight finances". *In re Faish*, 72 F.3d 298, 306 (3d Cir. 1995).

A "minimal standard of living" lies somewhere between poverty and mere difficulty. *In re McLaney*, 314 B.R. 228, 234 (Bankr.M.D.Ala. 2007).

Courts conduct an analysis by comparing a debtor's disposable income, determined as the difference between his monthly income and his reasonable and necessary monthly expenses, with the monthly payment necessary to repay the student loans. *In re Ivory*, 269 B.R. 890 (Bankr.N.D.Ala. 2001).

A court making this determination must apply its common sense knowledge gained from ordinary observations in daily life and general experience to determine

whether a debtor's expenses are reasonable and necessary. If the debtor expends funds for items not necessary for the maintenance of a minimal standard of living or if the debtor expends too much for an item that is needed to maintain that minimal standard, then it is unlikely that, given the debtor's present circumstance, the first prong of the Brunner test is satisfied where such overpayment would permit the debtor to cover the expense of her student loan debt without sacrificing a minimal standard of living. *In re Douglas*, 366 B.R. 241, 253-54 (Bankr.M.D.Ga. 2007).

Expenses are calculated at the time of trial, not at the time of filing of the bankruptcy (See *In re Walker*, 650 F.3d 1227, (8th Cir. 2011).

Cable television and pets can be considered reasonable necessary expenses; "people must have the ability to pay for some small diversion or source of recreation, even if it just watching television or keeping a pet" *In re Ivory*, 269 B.R. 890, 899 (Bankr.N.D.Ala. 2001).

Cell phones can be considered reasonable necessary expenses; allowing cell phone expense so debtor could keep in contact with her children. (See *In re Jackson*, No. 06-01433, 2007 WL 2295585, at *3, *5, (Bankr.S.D.N.Y. 2007).

Expenses not considered can be considered as reasonably necessary expenses. "As the bankruptcy court pointed out, the McLaneys did not include budgeted expenses for clothing, laundry and dry cleaning, or recreation. They also have a low mortgage payment of $348 and their food budget is an almost impossible $1.30 per meal. Nor did they include expenses for other items, such as personal or real property taxes, medical or dental expenses not covered by insurance, or attorney's fees." *In re McLaney*, 375 B.R. 666, 675 (M.D.Ala. 2007).

Tithing can be considered as a reasonably necessary expense. "This court does not hesitate to conclude that if bankrupt families are allowed to indulge a family pet or watch *The Sopranos* in the comfort of their homes on their cable television, surely a bona fide tithe to their church may at least be considered as a proper expense. Therefore, bona fide tithing or charitable contributions are to be examined under the same reasonableness standard as other reasonable and necessary expenses under a §523(a)(8) undue hardship analysis". *In re McLaney*, 375 B.R. 666, 682 (M.D.Ala. 2007).

It can be appropriate to include those other unanticipated expenses which seem, for every family, to inevitably pop-up each month but defy neat categorization". *In re McLaney*, 375 B.R. 666, 675 (M.D.Ala. 2007).

Evidence of an income-based repayment plan of a low amount, even zero, does not necessarily negate the minimal standard of living prong.

"There are numerous published cases where a debtor's monthly payment under the ICRP would be $0.00 – obviously an amount that any debtor can pay while maintaining a minimal standard of living – yet the court found the existence of undue hardship and determined that the student loan was dischargeable." *In re Durrani*, 311 B.R. 496, 506 (Bankr.N.D.Ill. 2004).

"Even though the debtors' monthly payment would be zero under an income-based repayment program, the first *Brunner* element "requires simply that the Debtors show they cannot repay the loans and maintain a minimal standard of living"". *In re Thompsen*, 234 B.R. 506, 512 (Bankr.D.Mont. 1999).

Second Prong – Persistent Circumstances

A Debtor must prove that the inability to pay must be likely to continue for a significant time such that there is a certainty of hopelessness that the debtor will be able to repay the loans within the repayment period. *In re Mosely*, 494 F.3d 1320, 1324 (11th Cir. 2007).

The Debtor is not required to prove that her financial situation will persist due only to a serious illness, psychological problem, disability, or other exceptional circumstance; other types of circumstances could apply as well. *In re Douglas*, 366 B.R. 241, 256 (Bankr.M.D.Ga. 2007).

Other factors to considered are the debtor's age, age of the debtor's dependents, debtor's education, work and income history, physical and mental health, and other relevant circumstances. *In re Douglas*, 366 B.R. 241, 253-54 (Bankr.M.D.Ga. 2007).

The Debtor may testify as to various medical conditions without corroborating medical evidence. The court reasoned that requiring corroborating evidence when the debtor cannot afford expert testimony or documentation

imposes an unnecessary and undue burden on the debtor in establishing his burden of proof. As the court explained, the crucial requirement is that the debtor show how his medical conditions prevent him from working, and this can be accomplished by an array of evidence, including the debtor's credible testimony. *In re Mosely*, 494 F.3d 1320 (11th Cir. 2007); citing *Barrett v. Educational Credit Management Corp*., 487 F.3d 353, 356 (6th Cir. 2007).

Third Prong – Good Faith Attempt to Repay

A debtor's failure to make a payment, standing alone, does not establish a lack of good faith. *In re Mosely*, 494 F.3d 1320 (11th Cir. 2007).

Good faith is measured by the debtor's efforts to obtain employment, maximize income, and minimize expenses; his default should result, not from his choices, but from factors beyond his reasonable control. *In re Douglas*, 366 B.R. 241, 259 (Bankr.M.D.Ga. 2007).

A lack of bad faith is not the applicable test. *In re Douglas*, 366 B.R. 241, 259 (Bankr.M.D.Ga. 2007).

Actual payments are not required to prove good faith. *In re Douglas*, 366 B.R. 241, 259 (Bankr.M.D.Ga. 2007).

Enrolling in an Income Contingent Repayment Program is not required to prove good faith. *In re Mosely*, 494 F.3d 1320 (11th Cir. 2007).

CONCLUSION

Bankrupt debtors are not normally allowed to discharge their student loans. The narrow exception of "undue hardship" is a difficult, but not impossible standard to achieve. Attorneys with debtors who have student loan debt should scrutinize their client's situations on a case by case basis, and carefully select those who appear to meet each of the three prongs of the *Brunner* standard before filing an adversary proceeding to determine discharge under 11 U.S.C.§523(a)(8).