The Future of Student Loans:

The *Brunner* Test in the 21st Century and The Consumer's Hunger for Change

by Christina T. Parrish

The mention of the term "student loan" is rarely met with smiles or happy thoughts. Instead, it will likely elicit anger and disdain. According to the Pew Research Center, student loans accounted for more than $1.3 trillion in debt in the United States at the end of June 2017.[1] Moreover, this debt burdens about four-in-ten adults under the age of 30, and roughly one-in-five adults between the ages of 30 and 40.[2] The Pew Research Center also reports that 73 percent of young college graduates with student loan debt are not living comfortably or, in other words, they are struggling financially.[3] As of June 30, 2017, 8.5 million federal student loan borrowers were in default, including 500,000 consumers who defaulted in the first six months of 2017.[4]

We are facing a financial crisis triggered by student loans.

When consumers are not living comfortably, or when a consumer faces insurmountable financial problems, he or she often considers whether the bankruptcy system can provide relief. A discharge in bankruptcy will often alleviate a debtor's obligation to repay a debt, barring specific exceptions. While student loan debt is categorized as an unsecured debt[5], and thus in the category of debt which is usually discharged in whole or in part through bankruptcy, student loans have long enjoyed enhanced statutory protections making a discharge in bankruptcy more challenging.

Since 1985, courts have used the *Brunner* test[6] to assess the dischargeability of student loans despite their enhanced statutory protection. In recent years, an emerging shift in case law has developed. Several courts suggest the *Brunner* test is antiquated and should be adjusted. In fact, one recent decision demonstrates willingness by at least one court to re-evaluate dischargeability in the context of an increased cost of higher education and the modern-day trend towards extended repayment terms.

The History of Student Loan Dischargeability

Approximately 30 years ago, student loans did not enjoy the exclusive treatment they currently utilize in our bankruptcy system. Prior to 1985, federal student loans were generally dischargeable. Pursuant to 11 U.S.C. § 523 (a)(8) at that time, student loans were ripe for discharge if the debtor could demonstrate five years of repayment.[7] After all, the ten-year standard repayment period was commonplace, unlike the thirty-or-more-year plans of present-day. In that context, five years of repayment was viewed as substantial. If a debtor sought to discharge student loans before five years of repayment, the law required a demonstration of "undue hardship."[8] The term "undue hardship" is not defined in the Federal Bankruptcy Code. As such, the Southern District of New York developed a three-prong test known as the *Brunner* test that became the majority approach for determining whether an undue hardship exists.[9]

Today, the Bankruptcy Code no longer provides for the discharge of student loans after a set term of repayment. Instead, the Bankruptcy Code states that government-issued student loan debt can only be discharged upon a debtor's demonstration that the failure to discharge student loan debt would impose an "undue hardship" on the debtor.[10] Thus, while bankruptcy provides relief from a large variety of consumer debt, bankruptcy has been an unhelpful tool in eliminating student loan debt since the late 1980s.

A Rise in Judicial Relief

Despite the explicit exception to discharge in 11 U.S.C. § 523 (a)(8), consumers may find help, hope, and some relief in Virginia bankruptcy courts. The case of *Erbschloe v. U.S. Department of Education*[11] provides an excellent example of how courts evaluate whether the exclusion of a debtor's student loans from their discharge in bankruptcy would inflict an undue hardship on the debtor. Amber Erbschloe (the Debtor) sought the discharge of her student loan debt under 11 U.S.C. § 523 (a)(8). The debtor graduated from Virginia Tech in 2009 and incurred $17,000 in student loan debt, which grew to $19,300 as of the date of the hearing.[12] Throughout her time of study, she voluntarily repaid small amounts towards her account balance.[13] After graduating, the debtor developed a rare physical disability that left her unable to engage in heavy lifting and strenuous activity.[14]

The evidence demonstrated that, despite the debtor's best efforts, her disability prevented her from working in her field. Furthermore, her disability prevented her from maintaining her student loan obligations.[15] At the time of the trial to determine the dischargeability of the debtor's student loans, the debtor worked at an auto shop in an administrative capacity for 25 to 40 hours per week at a rate of $9.00 per hour.[16] According to the debtor's testimony, her monthly expenses came very close to exceeding her monthly income.[17]

Pursuant to the *Brunner* test, a debtor must prove, by a preponderance of the evidence, three factors in order to establish 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) that the debtor has made good faith efforts to repay the loans."[18]

The court thoroughly considered the evidence in evaluating the three prongs of the *Brunner* test. The court determined that the debtor presented evidence to satisfy the first prong of the inquiry. The debtor's evidence established an inability to maintain a minimal standard of living for herself and her dependents, as her income fell below 150 percent of the poverty line.[19] In evaluating the second prong, and pursuant to the analytical approach traditionally applied in precedent, the court determined that the debtor failed to provide the court with evidence sufficient to establish, by a preponderance of the evidence that her financial hardship was likely to persist for a significant portion of the repayment period of the student loans.[20] Without evidence sufficient to satisfy the second prong, the court could not grant a full discharge of her student loans. Yet, the court did not end its inquiry there. As requested by the debtor, the court went further to consider partial discharge of her student loan obligation.

The court acknowledged that the Fourth Circuit had not yet adopted a test for undue hardship in the partial discharge context. Guided by a decision from the District Court for the Western District of Virginia, the court adopted the third prong of the *Brunner* test as the prerequisite for obtaining a partial discharge of student loan debt: a debtor's good faith effort to repay the student loan obligation.[21] Upon the court's review of the evidence, it found that the debtor made a good faith effort to repay her student loan obligation and therefore satisfied the prerequisite for partial discharge of student loan debt.[22]

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In granting the debtor's prayer for a partial discharge of her student loan obligation, the court noted an observation of first impression. The court evaluated the applicability of the second prong of the *Brunner* test given the recent inception of income-based repayment plans. In the court's decision to essentially nullify the second prong of the *Brunner* test, the court noted that "courts must apply the Brunner test within the context of income-based and extended repayment plans that allow borrowers to extend their repayment periods for twenty or more years, all the while making monthly payments as low as $0. As such, courts are taking a test that was designed to look at a debtor's short-term ability to repay fixed amounts and applying it to determine whether a debtor's circumstances may change at some time in the next twenty or more years."[23]

The court granted Amber Erbschloe a partial discharge of her student loan obligation upon condition of her qualification for, and participation in, an Income Based Repayment Program.[24] The court further concluded that any balance due and owing at the end of the 25-year repayment period represents the portion of her student loan debt that would impose an undue hardship. As such, the court discharged that amount prior to its expected forgiveness.[25] Provided Amber Erbschloe's monthly student loan obligation is $0 per month, her partial discharge would have the effect of a total and complete discharge of her debt. While the result in *Erbschloe* is not typical, it—coupled with an income-based repayment program—may provide a viable solution for those crippled with student loan debt.[26]

The Legislative Outlook

Despite an adjustment to the second prong of the *Brunner* test by the *Erbschloe* court, relief from student loan debt using the bankruptcy system remains tenuous at best. Many courts around the nation continue to adhere to the rigorous application of the *Brunner* test. As such, some argue that the best opportunity for relief must include the legislature. Earlier this year, the United States House of Representatives introduced two pieces of legislation aimed at facilitating relief: H.R.2366 and H.R. 2527.

H.R. 2366 is also known as the Discharge Student Loans in Bankruptcy Act of 2017. Sponsored by Representative John K. Delaney of Maryland, the bill sought to eliminate 11 U.S.C. § 523 (a)(8) in its entirety.[27] Plainly speaking, the bill would enable unrestricted discharge of all student loans. The bill stalled in its subcommittee and failed to gain any momentum.

H.R. 2527 is a related bill and is also known as the Private Student Loan Bankruptcy Fairness Act of 2017.[28] Sponsored by Representative Steve Cohen of Tennessee, the bill does not attempt to facilitate the unrestricted discharge of all student loans. Instead, the bill sought to eliminate subparagraph (B) of 11 U.S.C. § 523 (a)(8), a "catch all" section for educational loans stemming from sources other than a governmental or nonprofit unit.[29] This bill also stalled in its subcommittee and failed to gain any momentum. There has been no further action on either bill and the success of either bill is highly unlikely. While the introduction of these bills certainly signals recognition of the rallying cry of struggling consumers, legislators are evidently concerned with potential consequences that may ensue.

Consequences of Dischargeability

Student loans are the bedrock of the American higher education system. If the pathway to student loan dischargeability becomes wider, positive and negative consequences may result. Some critics of student loan dischargeability contend that a change in the law will cripple the student loan industry. If student loans become dischargeable in bankruptcy, similar to their treatment pre-1985, it is quite plausible that student lending will cease or become virtually unattainable. Government lending would crumble and private lending would rise rapidly, coupled with the risk of harsh market rates. Without reasonable student loan lending, millions of young Americans may be priced out of higher education.

However, the positive consequences may outweigh this negative forecast. First, young Americans will once again have an opportunity to realize true relief from one of the largest and most cumbersome forms of debt. This would enable a rebirth of homeownership and family expansion. Similarly, a decrease in student loan lending may serve as a catalyst for tuition restructuring. As colleges and universities compete for the best and the brightest, campuses are exploding with increased amenities and offerings that inflate tuition. Without the ease of access to the capital that students have traditionally enjoyed, there will be decreased demand for this ballooning supply from the modern university. A decreased enrollment will have a trickledown effect upon institutions nationwide, leaving them with no other choice but to alter their approach to regaining the students upon which they depend. So, if the legislature refuses to intervene, perhaps a renewed perception of consumer bankruptcy alongside a fresh application of the *Brunner* test may be what our society really needs to alleviate the pressure stemming from $1.3 trillion in student loan debt.

Conclusion

The unrestricted discharge of student loan debt via a legislative amendment to 11 U.S.C. § 523 (a)(8) appears unlikely, at least in the interim. Forward looking courts may, therefore, prove to be the best avenue for consumers burdened with student loan debt. While the courts continue to align the *Brunner* test with modern developments in the student loan industry, consumers are encouraged to take advantage of lenders' alternative repayment options until the law evolves over time.

Endnotes:

1 Anthony Cilluffo, *5 Facts About Student Loans, Factank News in the Numbers* (Aug. 24, 2017) http://www.pewresearch.org/fact-tank/2017/08/24/5-facts-about-student-loans/
2 *Id.*
3 *Id.*
4 Tyler Roberts, *Law Schools with the Highest Student Loan Default Rates* (Sept. 29, 2017) http://www.nationaljurist.com/national-jurist-magazine/law-schools-highest-student-loan-default-rates
5 At a very basic level, an unsecured debt is a financial obligation whose repayment is not secured by a lien on collateral. Other common types of unsecured debt are credit card debts, medical debts, and personal unsecured loans.
6 *In re Brunner*, 46 B.R. 752 (S.D.N.Y.1985).
7 11 U.S.C. § 523(a)(8) (West 1985)
8 *Id.*
9 *See supra* note 6.
10 11 U.S.C. § 523(a)(8) (2017)
11 *Erbschloe v. U.S. Dep't of Educ. (In re Erbschloe)*, 502 B.R. 470 (Bankr. W.D. Va. 2013).
12 *Id.*
13 *Id.*
14 *Id.* at 475.
15 *Id.*
16 *Id.*
17 *Id.*
18 *Id.* at 476-477. *See also Brunner v. N.Y. State Higher Educ. Servs. Corp. (In re Brunner)*, 831 F.2d 395 (2nd Cir.1987).
19 *Erbschloe*, 502 B.R. at 478.
20 *Id.* at 478, 480.
21 *Id.* at 482. *See also Tennessee Student Assistance Corp. v. Mort (In re Mort)*, 272 B.R. 181 (W.D. Va. 2002).
22 *Erbschloe*, 502 B.R. at 482.
23 *Id.* at 481.
24 *Id.* at 483.
25 *Id.*
26 See also *Roth v. Educ. Credit Mgmt. Corp.* (In re Roth), 490 B.R. 908, 920 (B.A.P. 9th Cir., 2013) ("I concur that the bankruptcy court erred in declining to grant a hardship discharge of the student loan debt to Debtor under § 523(a)(8). However, because I understand how the bankruptcy court felt restricted by precedent in reaching its decision, I write separately to highlight that the analysis required by Pena/Brunner to determine the existence of an undue hardship is too narrow, no longer reflects reality, and should be revised by the Ninth Circuit when it has the opportunity to do so. Put simply, in this era, bankruptcy courts should be free to consider the totality of a debtor's circumstances in deciding whether a discharge of student loan debt for undue hardship is warranted.")
27 Discharge Student Loans in Bankruptcy Act of 2017, H.R. 2366, 115th Cong. § 2 (2017)
28 Private Student Loan Bankruptcy Fairness Act of 2017, H.R. 2527, 115th Cong. § 2 (2017)
29 *Id.*

Christina T. Parrish began practicing bankruptcy law after several years of practice in business litigation, commercial real estate, and consumer financial compliance. Her practice primarily focuses on the evaluation and defense of matters arising during and after the confirmation of Chapter 13 plans. She is a frequent presenter for seminars and training offered by local community organizations, as well as small to mid-sized businesses. She lives in Richmond with her twin daughters.