STUDENT LOAN VICTIMS –
"LET THEM EAT CAKE"

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Several recent articles in the *American Bankruptcy Law Journal* and the American Bankruptcy Institute's *Bankruptcy Brief,* as well as a seminar at the recent Annual Debtor-Creditor Section CLE and Annual Meeting, dispassionately describe the statutory and case law on student loans in the United States. This article is not such an endeavor. Rather, it examines how we got here and considers some of the political and economic issues related to what has rightly been called the student loan crisis.

Numerous sources report that total student loan debt is now in excess of one trillion dollars. *See., e.g.*, http://www.consumerfinance.gov/newsroom/studentdebtswellsfederalloansnowtopatrillion/. About 10% of this amount is private student loans, with the rest being federally insured student loans of various kinds. *Id.* The differences between the two types of loans are significant, both in and out of the bankruptcy courts. This article will briefly describe how student loans work and their history, then analyze the impact student loan debt has on individuals and on society. Finally it will discuss the inadequate remedies available to deal with the problem.

Student Loan History

In the beginning there were student loans and they were good. The initial student loan program was inspired by the very successful GI bill, which guaranteed up to 48 months of higher education to qualified veterans. The Federal Family Education Loan Program (FFEL) began in 1965. It allowed middle-class and working-class families to borrow money without regard to their creditworthiness and repay the loans, usually over a 10-year period after graduation, at a low fixed interest rate. Due to the reluctance of banks to take any risks, such loans were later guaranteed by the federal government. When the banks were still reluctant to take on risk, Congress created Sallie Mae as a secondary market for guaranteed loans. During the 1990s, purely private loans became more common and students were directed to these loans even when they would have qualified for more favorable federal programs. The full history is available in many sources, including the excellent *Student Loan Law,* National Consumer Law Center (4th ed. & Supp. 2012).

In the early years of student loans (before 1976), they were treated like any other debt and were dischargeable in bankruptcy. Following some questionable stories told to Congress about rich doctors and lawyers ripping off the government for a free education, federally insured student loans were made dischargeable only after five years. The period was extended to seven years in 1990. Finally, in 1998, Congress made federal loans nondischargeable in the absence of a showing of "undue hardship" (undefined in the Bankruptcy Code). With BAPCPA in 2005, the noose was fully tightened – private student loans as well were made nondischargeable. The legislative history of this provision is sparse: at one point (on May 5, 1999) during the tortured eight-year process that led to BAPCPA's ultimate enactment, Senator Lindsey Graham offered an amendment to extend nondischargeabilty to private student loans. A total of three minutes of floor time was devoted to the issue, according to Maureen Thompson, NACBA (Nat'l Assoc. of Consumer Bankruptcy Attorneys) lobbyist. Through all the later debates on BAPCPA, the major concerns were with the means test and changes to chapter 13; this student loan provision was never really addressed again. Even before BAPCPA, though, options were being closed off. In 1991, the statute of limitations was eliminated for collections on federally insured student loans. This provision was later ruled to have retroactive effect, reviving student loan debt that had been previously time barred. *United States v. Phillips,* 20 F3d 1005 (9th Cir 1994). This extraordinary change put most student loan debtors in the same category as murderers and traitors who can be pursued until death.

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During the time that student loans were dischargeable only after five years, the *Brunner* case was decided. *Brunner v New York State Higher Educ. Services, Inc.,* 831 F2d 395 (2d Cir 1987). The *Brunner* test for a hardship discharge (required at the time for discharge without the waiting period) requires proof that: 1) the debtor cannot maintain, based on current income, a minimal standard of living for the debtor and dependents if forced to repay the student loan by its terms; 2) circumstances indicate that this state of affairs is likely to persist for a significant portion of the repayment period; and 3) the debtor has made a good faith effort to repay the loans. This standard was eventually adopted by virtually all of the circuits. In a recent Ninth Circuit BAP case authored by Judge Renn, *In re Roth,* 490 BR 908 (9th Cir BAP 2013), Judge Pappas wrote a concurring opinion in which he explicitly questioned the continuing validity of the *Brunner* doctrine, referring to it as "truly a relic of times long gone." *Id*. at 920. (An interesting side note is that in *Roth,* as in *Brunner,* the debtor was a *pro se* appellant.)

While federally insured student loans have numerous repayment programs available for students facing economic hardship (Income Based Repayment, Income Contingent Repayment, etc.), no such programs exist for private student loans. The federal repayment programs, along with options such as disability discharge, make bankruptcy unnecessary for most people who owe under the federal programs. This is not true for those subject to private student loans, which are vigorously pursued by numerous collection agencies, confident that no matter what else happens, their targets are unlikely to attempt to obtain a hardship discharge. The failure to even consider bankruptcy in these cases is a function of debtor and attorney ignorance, as well as the expense of pursuing student loan hardship discharge. A recent article by an academic found that the odds were reasonably good for those willing or able to pursue a hardship discharge. Iuliano, "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard," *Am Bankr L J* (Volume 86, Issue #3, 2012). In 2007, the year studied, 51 of the approximately 200 people filing for hardship discharges received a full discharge and 30 received a partial discharge, while 25 more received an administrative remedy such as one of the repayment programs mentioned above.

In contrast to these favorable results, some real-life examples show how ruthlessly some agencies and collectors believe *Brunner* should be applied. The creditor in *In re Renville,* 2006 WL 3206126 (D Mont), suggested to the court that in order to have the funds to pay a student loan, the debtor should make a 1600-mile round trip each month so he could buy his prescriptions at lower cost on an Indian reservation. The court discharged the student loans.

The North Dakota court in *In re Lindquist,* 2007 WL 4868312 (Bankr D ND), was urged to require the debtor (who had been employed at several low wage jobs) to open her own beauty salon so she could make the income adequate to pay her loans. This was despite the fact that she suffered from depression, anxiety, scoliosis, obesity and back pain, and had advised the court that she could only do haircuts; she was not good at other salon skills, having once glued herself to a patron while attempting a manicure. The court declined to follow the advice of the collector.

Finally, a debtor with numerous medical issues sought a discharge and the creditor suggested that she eat "dry breakfast cereal several days a week" to save money. The debtor's food costs were high because she needed a diabetic, low sodium and dairy-free diet. The creditor also believed that the debtor could find other gainful employment, contending that the results of her "Functional Capacity Examination" (showing severe limitations) were skewed – the debtor had been in a diabetic coma and suffered from recurring pneumonia before the test. She could do only sedentary work but had no secretarial skills. Discharge granted. *In re Hurley*, 258 BR 15 (Bankr D Mont 2001).

But sometimes the court is equally ruthless. In an Ohio case highlighted in the *New York Times*, the bankruptcy judge opined that the debtor's blindness did not necessarily create a hopeless employment situation, despite the fact that the debtor lived in a rural area and had certain transportation issues. While not requiring the debtor to move to an urban area with more opportunities for employment for the blind, the judge declined to grant a discharge; he set a future date to allow the debtor "additional time to adjust to his situation." *See* Lieber, "Degrees of Debt," *NY Times* Sept 1, 2012, http://query.nytimes.com/gst/fullpage.html?res=9A0DE5DE153CF932A3575AC0A9649D8B63.

Another judge in Illinois addressed a case of a visually impaired man on Social Security Disability. The judge was not prepared to declare his situation hopeless and gave him a two year "window of opportunity" to recover from his financial situation, stating that he believed that the debtor had the potential to obtain "meaningful employment." *Id*.

The Economic Impact

People fighting the burden of $50,000 or $100,000 or more in student loan debt are unable to buy houses, start families, or make many of the normal consumer purchases that drive our economy. A *New York Times* article addressed the problem of people being left out of the mainstream economy and deferring starting families due to their crushing student loan debt.

Lewin, “Burden of College Loans on Graduates Grows,” *NY Times,* April 11, 2011, http://www.nytimes.com/2011/04/12/education/12college.html?_r=0. In a similar vein, the ABI *Bankruptcy Brief* of August 15, 2013, included an article titled “Analysis: Student-Loan Load Kills Startup Dreams,” documenting how the debt load discourages many graduates from becoming entrepreneurs.

At the same time, some private student loan agencies are among the most profitable businesses around, and have highly compensated employees. At one agency, seven employees earned more than $400,000 per year through commissions ranging up to 31%, not to mention the CEO who earned $1.1 million in 2010. http://www.huffingtonpost.com/2012/05/17/studentloandebtcollectorsalaries_n_1525297.html. A scathing commentary by Matt Taibbi that recently appeared in *Rolling Stone* assigned some blame to schools that have little incentive to cut costs when the cash flow from student loans is virtually unlimited, but there is plenty of blame to go around. Taibbi, “Ripping Off Young America: The College-Loan Scandal,” *Rolling Stone* Aug. 15, 2013, http://www.rollingstone.com/politics/news/rippingoffyoungamericathecollegeloanscandal20130815.

The Political Situation

As even the most casual observers of national politics can tell, it is unlikely that Congress in the foreseeable future will have the votes, the will, or the interest to address the growing student debt problem. While some bills have been proposed to change the law, they have gained no traction. Of more impact are the efforts of Senator Elizabeth Warren to shine a light on the issues, including highlighting the fact that the government makes a profit on many student loans. She has also questioned why Sallie Mae was allowed to borrow money from the Federal Home Loan Banks ($8.5 billion dollar line of credit at .23%) to help to fuel its 2012 profit of $2.5 billion, largely from interest income from its private student loan portfolio (June 24th, 2013 letter from Senator Warren to the Director of the Federal Housing Finance Agency). It is ironic that the FHLB was chartered to help people buy homes, but now aids a sector of the economy whose practices prevent people from buying homes.

What Can Be Done

First, everyone concerned – students, former students, their families and their lawyers – must push for changes at the federal level, recognizing that it may be two years or longer before anything happens. The Consumer Finance Protection Bureau, http://www.consumerfinance.gov/, is becoming more active in the area of student loan collection abuse, and its involvement should provide some relief from the most egregious collection abuses.

Second, those concerned should take action on the state level, supporting such measures as the Oregon proposal to “pay it forward” and have repayment based on future income. Locally, attorneys need to make sure their clients understand the dangers of private student loans.

As far as litigation is concerned, remember that but for the nondischargeability protection in bankruptcy, student loans are just as vulnerable to state court defenses and counterclaims as credit card debts. In some cases they are more vulnerable, as the creditor usually cannot use the "account stated" allegation. All such defenses and counterclaims should be considered. In bankruptcy court, attorneys simply need to keep pushing not just on discharge issues, but on chapter 13 classification and use of §1322(b)(5) for dealing with student loans as long term debt.

Of course, there is always the option of the hardship discharge in bankruptcy. As discussed in the companion article by Natalie Scott, "Misconceptions & Muddied Waters," the first major change in hardship cases in years is taking place in the 9th Circuit. The change in the standard of review, along with the greater doubts expressed about the viability of the *Brunner* standards, should give debtors a better chance at a partial or total hardship discharge than they have had since the *Brunner* test was adopted by the 9th Circuit. This does not mean every client will qualify – the *Brunner* test is still there for now. What it does mean is that a larger number of cases should be appropriate for hardship discharge. But counsel must still present the case in such a way as to show the court that a fact based decision can be rendered that will withstand appellate scrutiny. Even if the debtor does not in fact apply for Income Based Repayment or a similar program, counsel must be prepared to show that the option has been explored and what the payments would be under a repayment program. Then, counsel must explain why it is not feasible, perhaps due to the presence of private student loans which have no such programs.

While as attorneys we must press all possible arguments and explore all avenues of relief for our clients, such actions are only a partial solution. Counsel can also be active in contacting the offices of their Senators and Representatives to help educate them about the glaring flaws in the system. Unless the student-loan problem is dealt with on a national policy basis, we face another economic crisis and lasting damage to not just the millions of graduates, but to the entire economy.