INTRODUCTION
BANKRUPTCY
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STUDENT DEBT &
BANKRUPTCY

Disclaimer

This presentation should be construed as an overview of the issues discussed. The presentation is not legal advice to anyone attending the conference or reviewing the materials. Specific legal questions regarding the concepts and any application to your business or school should be directed to your attorney.

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Partnership

Today's Presentation

- What do you know about bankruptcy today?
- What are the basics regarding bankruptcy?
- What needs to be done to protect my institution's debt from discharge?
- What are the current issues and cases relating to bankruptcy and student loans?
- Title IV refunds, the resulting AR, and how can this type of debt be addressed?

Recent Legislation

Shown Here:
Introduced in House (05/04/2017)

115TH CONGRESS
1ST SESSION

H. R. 2366

To amend title 11 of the United States Code to make student loans dischargeable.

IN THE HOUSE OF REPRESENTATIVES

MAY 4, 2017

Mr. DELANEY (for himself, Mr. KATKO, Mr. PERLMUTTER, Mr. LOWENTHAL, Ms. CASTOR of Florida, Mr. VEASEY, Mr. TONKO, Mrs. DINGELL, Ms. SINEMA, and Ms. LOFGREN) introduced the following bill; which was referred to the Committee on the Judiciary

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A BILL

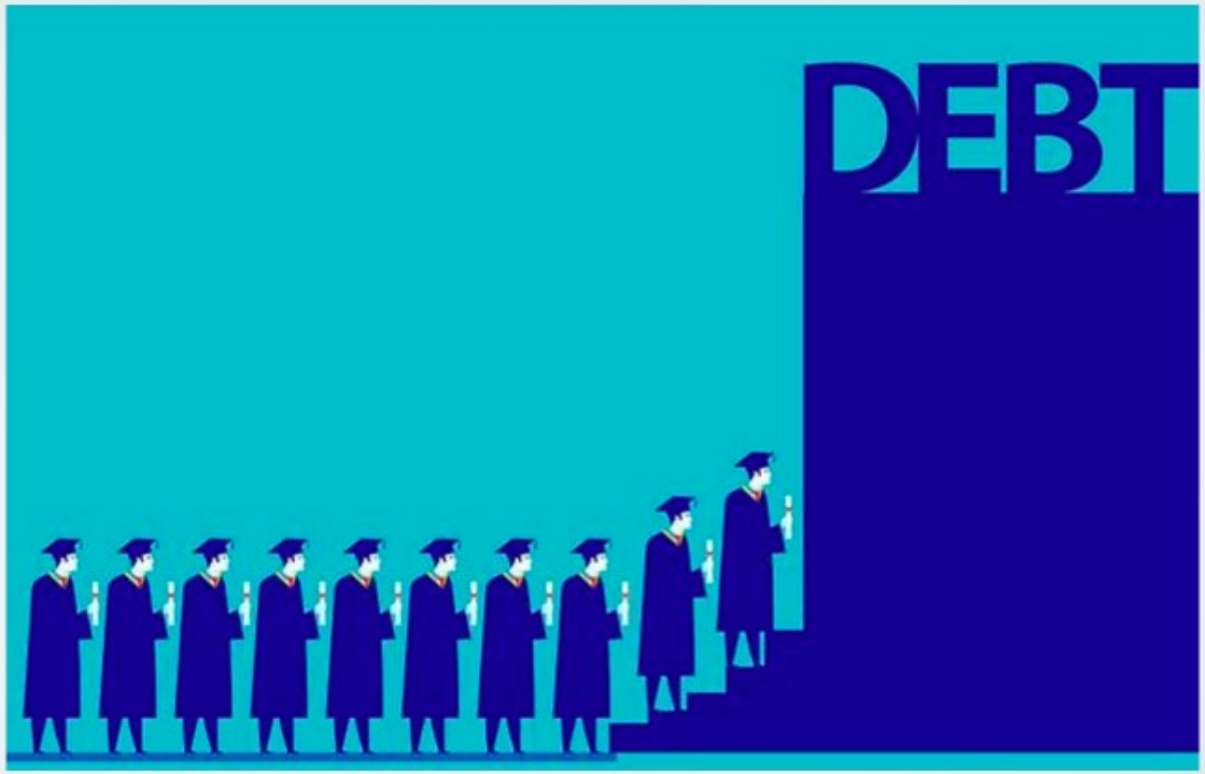
To amend title 11 of the United States Code to make student loans dischargeable.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Discharge Student Loans in Bankruptcy Act of 2017".

The Overall View of Student Debt



Bankruptcy

- The most recent significant legislation in this area is the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" (BAPCA – S. 256)
- Passed - April 14, 2005
- Signed - April 20, 2005

Bankruptcy Basics

- Article I, Section 8 of the U.S. Constitution grants Congress the power to create "uniform Laws on the subject of Bankruptcies throughout the United States."
- The US Constitution completely preempts states from handling bankruptcy issues and therefore all bankruptcy laws are federal and cases are handled by the federal courts.
- The bankruptcy code is found at 11 U.S.C. § 101, et seq.
- Fundamentally bankruptcy is to give debtors a "fresh start" and to place creditors in an appropriate priority for re-payment.

Bankruptcy Statistics

**BUSINESS AND NON-BUSINESS FILINGS,
YEARS ENDING
MARCH 31, 2014-2018**

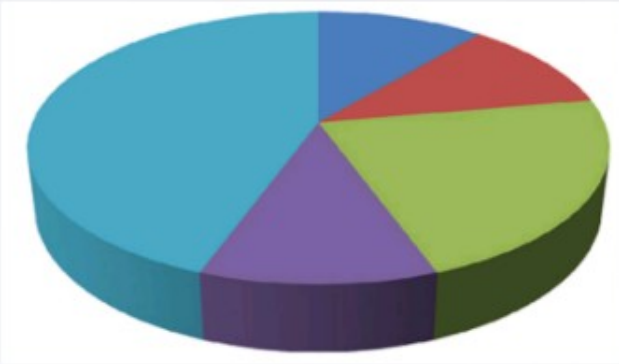
Year	Business	Non-Business	Total
2018	**23,106**	**756,722**	**779,828**
2017	23,591	770,901	794,492
2016	24,797	808,718	833,515
2015	26,130	884,956	911,086
2014	31,671	1,006,609	1,038,280

Source: http://www.uscourts.gov/news/2018/04/26/bankruptcy-filings-continue-decline

Bankruptcy Statistics

- The average filer is married, has a high school education, and makes less than $30,000 a year
  -thebalance.com, April 11, 2018.

- Oct. 2005 prior to new law - 619,322 cases filed, Nov. 2005 - 13,758 cases filed; and monthly filings have risen each month since - CNNMoney.com, June 12, 2006.



Bankruptcy Terms

- **Petition** – A bankruptcy begins when a voluntary or involuntary petition for relief is filed in bankruptcy court.
- **Automatic stay** – 11 U.S.C. § 362 – prohibits "all entities" from "any act to collect" a debt during the bankruptcy.

Trustee – Appointed by the court as the fiduciary of the consumer. They either convert assets to cash and distribute the money, or manage the consumer's repayment plan under Chapter 13.

VCIS

The Voice Case Information System is a FREE way to find out the status of a student's bankruptcy. You may need to simply need to locate the appropriate Bankruptcy Court to obtain the phone number.

VCIS

(866) 222-3034

Any courts not using the general phone number list their number at: pacer.gov/phone_access.html

Bankruptcy Chapters

Chapter 7 - Liquidation

Chapter 11 - Business Reorganization

Chapter 12 - Farm Protection

Chapter 13 - Individual Reorganization

Chapter 7 - Liquidation

- Most common
- Liquidation – there are asset and no asset cases
- Individual may only file once every 8 years. This is an increase from every 6 years and became effective Oct. 17, 2005.
- Priority of payment is established in the code and basically reads that expenses are paid, then secured creditors and finally unsecured creditors.
- Roughly 3-6 months to receive a discharge

Chapter 13 - Wage Earner

- Debtor, with the Trustee, sets up a re-payment plan through Bankruptcy Court.
- Debtor has some regular income.
- There are limits on the amounts of secured and unsecured debt a consumer can have to file under Ch. 13.
- The plan must provide for all future earnings to be subject to the supervision and control of the Trustee and must provide for full payment of all secured claims.
- Nondischargeable student debt remaining unpaid following the discharge survives the bankruptcy and is collectible with allowable interest. See Leeper v. Pa. Higher Educ. Assistance, 49 F.3d 98 (3rd Cir. 1995), Educational Credit Management Corp. v. Kielisch, 252 BR 338 (E.D. Va. 2000).
- Roughly 3-5 years to receive a discharge.

Dismissal

- Trustee or a creditor may petition the Bankruptcy Court for a dismissal.
- Being dismissed means the debtor does not qualify, under the code, as bankrupt.
- Bankruptcy Court may also dismiss a debtor for "substantial abuse" of the Bankruptcy Code.
- The KEY – Dismissal = Discharge

Discharge

- Generally a debtor receives a discharge from Bankruptcy Court when they have met the requirements of the Code under the Chapter in which their bankruptcy was governed. All dischargeable debts are effectively discharged and are no longer owed.
- IMPORTANT – Whether or not a debt is discharged is governed by the Bankruptcy Code and by case law, but not by the debtor or the creditor.
- Have the student look at their Discharge Order with you. Show them that the court has not discharged the student debt owed to your institution.

Standing Order

DISCHARGE OF JOINT DEBTORS

It appearing that the debtors are entitled to a discharge,

IT IS ORDERED:

The debtor is granted a discharge under section 727 of title 11, United States Code, (the Bankruptcy Code).

BY THE COURT

Dated: _____

_____
United States Bankruptcy Judge

SEE THE BACK OF THIS ORDER FOR IMPORTANT INFORMATION.

Standing Order - Back

Debts That are Not Discharged

Some of the common types of debts which are not discharged in a chapter 7 bankruptcy case are:

a. Debts for most taxes;

b. Debts incurred to pay nondischargeable taxes (in a case filed on or after October 17, 2005);

c. Debts that are domestic support obligations;

d. Debts for most student loans;

e. Debts for most fines, penalties, forfeitures, or criminal restitution obligations;

f. Debts for personal injuries or death caused by the debtor's operation of a motor vehicle, vessel, or aircraft while intoxicated;

g. Some debts which were not properly listed by the debtor;

h. Debts that the bankruptcy court specifically has decided or will decide in this bankruptcy case are not discharged;

i. Debts for which the debtor has given up the discharge protections by signing a reaffirmation agreement in compliance with the Bankruptcy Code requirements for reaffirmation of debts; and

j. Debts owed to certain pension, profit sharing, stock bonus, other retirement plans, or to the Thrift Savings Plan for federal employees for certain types of loans from these plans (in a case filed on or after October 17, 2005).

This information is only a general summary of the bankruptcy discharge. There are exceptions to these general rules. Because the law is complicated, you may want to consult an attorney to determine the exact effect of the discharge in this case.

Exceptions to Discharge

11 U.S.C. § 523(a)(8).

This definition changed under the law that became effective Oct. 17, 2005. The change was an important factor that leading to increased private lending in the student loan market.

Pre-2005 11 U.S.C. § 523(a)(8)

"(a) A discharge under … this title does not discharge an individual debtor from any debt—

(8) for 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 for an obligation to repay funds received as an educational benefit, scholarship or stipend, unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents"

11 U.S.C. § 523(a)(8)

"(a) A discharge under … 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 a nonprofit institution; or

11 U.S.C. § 523(a)(8) - cont.

(A)(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."

The difference is the addition of the term "qualified education loan" as defined under federal law and whether this definition will clear some of the current questions in our industry about what type of debt is discharged.

Internal Revenue Code § 221(d)(2)

"qualified higher education expense" is defined to mean –

> "the cost of attendance (as defined in section 472 of the Higher Education Act of 1965 as in effect on the day before the date of enactment of this Act) as an eligible educational institution…"

Section 472 of the HEA 20 U.S.C. 108711

- Cost of Attendance =
- Tuition/Fees normally assessed a student including materials and equipment for students in the same course of study.
- Books/Supplies/Misc. Personal Expenses
- Room & Board
- It is important to understand that this slide does NOT mean these things are nondischargeable. It does mean that "student loans" used for these things are not subject to discharge.

The Chambers Case

Although the term "loan" can be construed broadly under various dictionary definitions, we look to the common law definition of "loan" as articulated in *In re Grand Union Co.*, 219 F. 353, 356 (2d Cir.1914), and as paraphrased in *Renshaw*, 222 F.3d at 88. Under this interpretation, nonpayment of tuition qualifies as a loan "in two classes of cases": " 'where funds have changed hands,' or where 'there is an agreement ... whereby the college extends credit.' " *Mehta*, 310 F.3d at 314 (quoting *Renshaw*, 222 F.3d at 90). The agreement to transfer educational services in return for later payment "must be reached prior to or contemporaneous with the transfer" of those educational services. *Renshaw*, 222 F.3d at 88. This existence of a separate agreement acknowledging the transfer and delaying the obligation for repayment distinguishes a loan from a mere unpaid debt.

In re Chambers, 348 F.3d 650, 657 (7th Cir. 2003)

The Precedent re: 523(a)(8)

- What does the case law say about institutional debt?:
  - *In re Chambers*, 348 F.3d 650 (7th Cir. 2003)
  - *In re Mehta*, 310 F.3d 308 (3rd Cir. 2002)
  - *In re Renshaw*, 222 F.3d 82 (2nd Cir. 2000)

- Basically – Funds need to have changed hands or there should be a signed agreement whereby the school provides services and the student is allowed to pay for the services at a later date.

The only way out!!

When you are holding a non-dischargeable student loan, the only way for the debtor to have that debt discharged is to petition the court for an adversary hearing and then to receive from a judge a finding of "undue hardship."

There is the possibility for a partial discharge based on case law, but this is the minority rule and appears to be a judicially created remedy.

Undue Hardship

- The U.S. Bankruptcy Code has not defined the term "undue hardship" nor provided the U.S. Department of Education the authority to do so
- The federal judiciary has established the legal standard by which borrowers can establish "undue hardship", as authorized by 11 U.S.C. § 523(a)(8)
- Generally, courts have used two tests when deciding whether a borrower has met the burden to establish "undue hardship":
  - The *Brunner* test; or
  - The Totality of Circumstances test

Undue Hardship

- The Majority Test – See B*runner v. New York State Higher Educ. Services Corp.*, 831 F.2d 395 (2d Cir. 1987).
  - Three elements must be proven by a preponderance of the evidence.
    - Based on current income and expenses the debtor cannot maintain a minimal standard of living.
    - This situation is likely to persist for the duration of the repayment period.
    - A good faith effort has been made to repay the loans.

- Often you will see an intervening circumstance that has dramatically affected the debtor's earning potential.

AR after a Title IV Refund

I have found that many schools are struggling with an increase in ARs resulting from the requirement that the school refund the full amount of a loan when the student withdraws and the student remains obligated for the difference between the amount the school retained to pay tuition and the full amount of the loan.

This is a unique type of debt that as an industry we need to work together to recover. A final determination is going to be the result of an individual or collective effort to test the dischargeability of the this debt in court.

Update on the *Brunner* Test

http://www.bakermanock.com/abi-journal-student-loan-discharge-decisions-poke-holes-brunner-test-j-jackson-waste-and-michael-j

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Feature

BY MICHAEL J. FLETCHER AND J. JACKSON WASTE

Student Loan Discharge Decisions Poke Holes in the *Brunner* Test

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The conventional wisdom regarding student loans is that they are in effect nondischargeable. While the Bankruptcy Code allows discharge of student loans upon a showing of "undue hardship," judicial interpretation of that term has set the bar exceptionally high. Specifically, nine circuits evaluate "undue hardship" via the *Brunner* test, named after the 1987 case.[1] In the world of *Brunner*-ployed graduates, has led to growing public awareness, as well as a few abortive attempts at legislative action. Congress proposed student loan relief bills in 2010, 2011 and 2013 that sought to unwind a 2005 amendment that excepted *private* student loans from discharge.[5] None of the bills, however, have survived committee. Given the present congressional gridlock, there is little hope of a legislative band-aid

The Totality of Circumstances

- The Totality of Circumstances Test – See *Long v. Educ. Credit Mgmt. Corp.*, 322 F.3d 549 (8th Cir. 2003).
  - Under The Totality of Circumstances Test, courts will consider three factors when assesing whether a debtor has met their burden of establishing undue hardship:
    - The debtor's past, present, and future fiscal resources;
    - The debtor's necessary living expenses; and
    - any other relevant factors

Burden of Proof: Undue Hardship

- Irrespective of which method the court chooses, the debtor must establish the facts to establish the burden of proof to meet the judicial standard of undue hardship
- Current U.S. Department of Education standards require the loan creditors to evaluate each hardship claim to determine whether requiring repayment would constitute undue hardship
- If the creditor concedes that repaying the loan would impose an undue hardship, the creditor must concede an undue hardship claim by the debtor in an adversary proceeding in bankruptcy court

Some bankruptcy judges search for "wiggle room"

- Though few judges are canceling the debt outright, some are encouraging lawyers to offer pro bono help and others are trying to ease repayment amounts
- Judges are influenced by the situations of their own children and law clerks who are burdened with education debt
- Few individuals seek to cancel their student debt due to the difficulty in proving "undue hardship"
- One study using Westlaw database showed judges issued rulings in 16 cases; only three having their debt canceled and instituted partial relief in another

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

- Passed by Congress on April 14, 2005 and signed by President Bush on April 20, 2005.
- Became effective on October 17, 2005.
- Overhauls many portions of the current bankruptcy code and provides some additional protection for creditors.
- Many in the "consumer bar" remain displeased with the 2005 changes.
- The first major revision to the Bankruptcy Code since 1987.

BAPCA Highlights

- Creditor may challenge a debtor's eligibility under Chapter 7.
- A dismissal may result from debtor abuse.
- Debtors under Ch. 7 must meet the median income test and the means test. Failure to do so creates a presumption of abuse.
- Credit counseling is mandated.
- Broader exemptions for retirement savings.
- Years increased from 6 to 8 for following a Ch. 7 with another Ch. 7.

Transcripts

Does bankruptcy impact our policy of placing holds on transcripts?

This is specific to the jurisdiction of the bankruptcy and the case law should be reviewed to make an informed decision.

Transcript Cases

In re Hernandez, 2005 WL 1000059 (Bankr.S.D.Tex.)

In re Mu'min, 374 B.R. 149 (E.D. Pa. 2007).

These cases provides a clear explanation of the issue and support the majority rule.

QUESTIONS?

In Conclusion....

Thank you very much for your attention today. I hope a better understanding of the topics discussed will assist each institution in improving their overall approach to collcetions. Please feel free to contact me with any additional questions or concerns.

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