

# Insights

## Student Loan Dischargeability: Recent Developments

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Dischargeability of student loans is a "hot button" issue in both the bankruptcy world and mainstream media. In fact, last September another colleague wrote about the history of student loan dischargeability, and the current obstacles borrowers face.<sup>(1)</sup> Since that article, the U.S. Bankruptcy Court for the Southern District of New York issued a controversial decision that discharged a debtor's student loan debt of \$221,385.49.<sup>(2)</sup> Meanwhile, the 2020 presidential election race is underway, and candidates, including President Trump, are offering their own solutions to the issue of student loan dischargeability. Also, the outbreak of the coronavirus pandemic and its economic effects have resulted in increased pressure on policymakers to provide immediate relief to student loan borrowers. Needless to say, there are many developments on this front, and this article touches upon them.

### *In re Rosenberg*, 610 B.R. 454 (Bankr. S.D.N.Y. 2020)

In *Rosenberg*, the debtor filed a voluntary chapter 7 bankruptcy petition on March 12, 2018, and received a discharge on July 26, 2019.<sup>(3)</sup> He also filed an adversary proceeding seeking to have his \$221,385.49 in student loan debt discharged.

After *Rosenberg* filed the adversary proceeding, the parties entered into a consent order that authorized Educational Credit Management Corp. (ECMC) to intervene as the "holder of one ... federal consolidation loan" owed by *Rosenberg*.<sup>(4)</sup> *Rosenberg* then filed a motion for summary judgment, and ECMC filed a cross-motion for summary judgment. The court then held a hearing and asked the parties to provide evidence regarding the underlying promissory note, payment history and current terms of the loan.

Both parties agreed that no genuine issues of material fact existed and that *In re Brunner* applied, but disagreed with the courts' interpretation of the factors.<sup>(5)</sup> The popular *Brunner* test has been applied to determine whether a sufficient "undue hardship" exists under 11 U.S.C. § 523(a)(8) to permit a discharge for a student loan. Under *Brunner*, the court should consider 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) whether 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) whether the debtor has made good-faith efforts to repay the loans.<sup>(6)</sup>

The bankruptcy court first reviewed the decisions that have interpreted and applied *Brunner* over the years, objected to their harsh results and the "punitive standards" they had applied, and took the position that the court would not "participate in perpetuating these myths" and instead would "apply the *Brunner* test as it was originally intended."<sup>(7)</sup>

For the first *Brunner* factor, the court emphasized that it must consider *current* monthly income, which, according to the debtor's schedules, was negative \$1,548.75.<sup>(8)</sup> Thus, it was immaterial whether the debtor, a licensed attorney, would foreseeably have an increase in income in the near future. Moreover, the loan was accelerated, and he was not in repayment anymore. Accordingly, the court concluded that he had negative monthly income and could not pay over \$200,000 for a loan while maintaining a "minimal" standard of living.

The court also found in Rosenberg's favor for the second factor. ECMC argued that instead of pursuing a career in law, Rosenberg chose to pursue positions in the outdoor adventure industry. Thus, ECMC essentially argued that Rosenberg should not benefit under the second factor, since he chose the circumstances as they now existed. The court disagreed and only focused on whether Rosenberg's state of affairs was likely to persist for a significant portion of the "repayment period."<sup>(9)</sup> Because the court found that the repayment period had ended because the loan already had been accelerated, the court again found in favor of Rosenberg.

Considering the third factor, the court limited its consideration of the debtor's payment history to the specific loan, and not whether the debtor had rejected previous repayment options, his reasons for filing bankruptcy, or how much debt he owed overall. The court determined that since the debtor had made approximately 40 percent of his payments when required, he had made a good-faith effort to repay the loan.<sup>(10)</sup> The court gave little weight, if any, to the debtor's multiple forbearance requests and his minimal payments toward the principal balance. As a result, the court found in favor of Rosenberg and discharged his student loan.

Although the decision currently is on appeal, *Rosenberg* represents a growing willingness by the judiciary to discharge student loans in the absence of legislative action to address this problem. The court's application of the *Brunner* test was substantially relaxed, considering that the court gave little weight to the fact that Rosenberg voluntarily decided to forgo law practice, or that he previously missed 16 payments. In the event *Rosenberg* is upheld on appeal, it is foreseeable there will be an uptick in litigation and attempts to discharge student loans across the country.

### Current Proposals

While *Rosenberg* is on appeal, there are many recent policy proposals that also seek to change the landscape of student loan forgiveness and dischargeability. For instance, President Trump recently released his budget for Fiscal Year 2021, which indicates his plans for student loans. While he shortened the undergraduate loan-forgiveness period from 25 to 15 years, he also proposed eliminating both public service forgiveness entirely and subsidized federal loans in an effort to reduce the Department of Education's cost.<sup>(11)</sup> President Trump also has suggested streamlining all of the repayment plans into a single model that would cap payments at 12.5 percent of one's discretionary income, as opposed to the current 10 percent cap.<sup>(12)</sup> In short, President Trump has not proposed any "cancel all student debt" type of policy or any amendments to 11 U.S.C. § 523(a)(8). Rather, he seeks to limit amounts that can be borrowed, shorten the forgiveness period, and combine repayment plans while reducing taxpayer and the Department of Education's costs. Because this plan is based off of President Trump's budget proposal for the Department of Education, it would not apply to private student loans. There are currently no policy proposals from President Trump that address dischargeability or relief for debtors with private student loans.

On the other hand, former presidential contender Bernie Sanders called for cancelling all student loan debt. To be sure, Sanders pledged to cancel all \$1.6 trillion of student loan debt, which seemingly would include both federal and private loans.<sup>(13)</sup> In terms of treatment of student loans in bankruptcy, Sanders's position is unclear.<sup>(14)</sup> This most likely is because he also is promising to guarantee free tuition for all public colleges and universities, which would make student loan debt less prevalent.<sup>(15)</sup>

Although Sen. Elizabeth Warren withdrew from the Democratic Party's presidential nomination race, her plan offered more specifics on the treatment of student loans in bankruptcy. Like Sanders, she proposed the cancellation of public student loan debt up to \$50,000 for every person with household income under \$100,000.<sup>(16)</sup> Cancellation would take place automatically by using available data on household income and outstanding loan debt, and therefore would not require an actual discharge in bankruptcy.<sup>(17)</sup> While this would only be for federal loans, private student loan debt still would be eligible for cancellation, "and the federal government will work with borrowers and the holders of this debt to provide relief."<sup>(18)</sup> To this end, she promised to reform the amendments to the U.S. Bankruptcy Code effected by BAPCPA to ensure that the "undue hardship" standard no longer would apply to private loans.<sup>(19)</sup> In other words, she would get rid of the *Brunner* test and would "end the absurd special treatment of student loans in bankruptcy and make them dischargeable just like other consumer debts."<sup>(20)</sup>

Democratic presidential contender and former Sen. Joe Biden's initial plan was less radical than discharging all student debt, and instead offered a multi-faceted approach. Under his initial plan, any individual making \$25,000 or less annually would not be required to make any payments on undergraduate federal student loans.<sup>[21]</sup> Also, those loans would not accrue interest. Every student loan debtor above the \$25,000 income level automatically would be enrolled in an income-based repayment program that would require payments equal to 5 percent of the individual's discretionary income (which former Sen. Biden defines as "income minus taxes and essential spending like housing and food").<sup>[22]</sup> This paralleled President Trump's proposal in that it sought to reduce income-driven payment plans, but it varied regarding the required percentage of discretionary income to be used for payments. Former Sen. Biden is also calling for legislation to allow private loans to be discharged in bankruptcy.<sup>[23]</sup> However, there are no specifics in his plan as to how he envisions accomplishing this through legislation, such as by amending the Bankruptcy Code.

The dire economic consequences of the coronavirus pandemic intensified the political discourse concerning student loan forgiveness. President Trump signed the Coronavirus Aid, Relief and Economic Security Act (CARES Act) on March 27, 2020, which halted all payments due on federal student loans and froze all interest from accruing until Sept. 30, 2020.<sup>[24]</sup> At the same time, multiple senators, including Sen. Elizabeth Warren, proposed a bill to immediately cancel \$10,000 of federal student loan debt for each borrower and to codify the CARES Act's interest freeze.<sup>[25]</sup> Sen. Biden not only supports the recent bill, he also supplemented his initial plan to make it more aligned with Sen. Sanders's proposal. Specifically, he now proposes to forgive all undergraduate tuition-related federal student loan debt if the student attended a two- or four-year public college or university, a historically black college, or a private underfunded minority-serving institution.<sup>[26]</sup> Instead of erasing all of the federal loan debt, the federal government would assume the borrower's monthly payments during the forgiveness period.<sup>[27]</sup> This relief would only be available to borrowers earning less than \$125,000 annually and would be in addition to the proposals under his initial plan.

The above policy proposals demonstrate that bankruptcy treatment and forgiveness of student loans may change in the imminent future. The *Brunner* test remains the prevailing standard, which sets a high bar for any debtor to overcome, but Rosenberg demonstrates that it is not impossible to surmount. In short, the above discussion underscores the need for practitioners to stay abreast of the changing legal and political landscape, as changes may occur soon.

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<sup>[1]</sup> Michael R. Herz, "Emerging Cracks in the Student Loan Wall," ABI Young & New Members Committee Newsletter (Sept. 10, 2019), available at <https://www.abi.org/committee-post/emerging-cracks-in-the-student-loan-wall> (last visited March 10, 2020).

<sup>[2]</sup> In re Rosenberg, 610 B.R. 454 (Bankr. S.D.N.Y. 2020), leave to appeal granted sub nom., Rosenberg v. Educ. Credit Mgmt. Corp., No. 20-CV-688 (CS), 2020 WL 1048599 (S.D.N.Y. Mar. 4, 2020). [hereinafter Rosenberg Decision].

<sup>[3]</sup> Id. at 456.

<sup>[4]</sup> Id. at 457.

<sup>[5]</sup> See *Brunner v. N.Y. State Higher Educ. Servs. Corp.* (In re *Brunner*), 831 F.2d 395, 396 (2d Cir. 1987).

<sup>[6]</sup> Id.

<sup>[7]</sup> Rosenberg Decision, *supra* note 2 at 459.

<sup>[8]</sup> Id. at 459-60.

<sup>[9]</sup> Id. at 461.

**[10]** Id. at 461-62.

**[11]** Zack Friedman, "Trump: Here's My New Plan for Your Student Loans," *Forbes* (Feb. 10, 2020), available at <https://www.forbes.com/sites/zackfriedman/2020/02/10/student-loans-trump-budget/#2287f93856e2> (last accessed March 10, 2020).

**[12]** Id.

**[13]** College for All and Cancel All Student Debt, Bernie Sanders, available at <https://berniesanders.com/issues/free-college-cancel-debt/> (last accessed March 10, 2020).

**[14]** Sanders's campaign site does call for reforming the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, but the specific changes are aimed at relief of medical debt. See Eliminating Medical Debt, Bernie Sanders, available at <https://berniesanders.com/issues/eliminating-medical-debt/> (last accessed March 10, 2020).

**[15]** College for All and Cancel All Student Debt, Bernie Sanders, available at <https://berniesanders.com/issues/free-college-cancel-debt/> (last accessed March 10, 2020).

**[16]** Affordable Higher Education for All, Elizabeth Warren, available at <https://elizabethwarren.com/plans/affordable-higher-education> (last accessed March 10, 2020).

**[17]** Id.

**[18]** Id.

**[19]** My Plan to Cancel Student Loan Debt on Day One of My Presidency, Elizabeth Warren, available at <https://elizabethwarren.com/plans/student-loan-debt-day-one> (last accessed March 10, 2020).

**[20]** Id.

**[21]** The Biden Plan for Education Beyond High School, Joe Biden, available at <https://joebiden.com/beyondhs/> (last accessed March 10, 2020).

**[22]** Id.

**[23]** Id. (emphasis added).

**[24]** Liz Knueven, "5 Things to Know About Federal Student Loan Forbearance During the Coronavirus Crisis," *Business Insider* (April 4, 2020), available at <https://www.businessinsider.com/personal-finance/student-loan-forbearance-during-coronavirus-2020-4> (last accessed April 20, 2020).

**[25]** Adam S. Minsky, Esq., "Joe Biden Calls for Widespread Student Loan Forgiveness," *Forbes* (April 9, 2020), available at <https://www.forbes.com/sites/adamminsky/2020/04/09/joe-biden-calls-for-widespread-student-loan-forgiveness/#11765c66630d> (last accessed April 15, 2020).

**[26]** Joe Biden, "Joe Biden Outlines New Steps to Ease Economic Burden on Working People," *Medium* (April 15, 2020), available at <https://medium.com/@JoeBiden/joe-biden-outlines-new-steps-to-ease-economic-burden-on-working-people-e3e121037322> (last accessed April 15, 2020).

**[27]** Id.