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The Surprising Possibility of Student Loan Discharges

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A Brief Discussion of the Recently Improved Possibility of Discharging Student Loans in a Brunner and Gerhardt World

I. Introduction

The cumulative impacts of 11 U.S.C. 523(a)(8), the test elucidated in *Brunner v. New York State Higher Educ. Serv. Corp.*[1] (1987) and *United States Dep't of Educ. v. Gerhardt* (*In re Gerhardt*)[2] (2003), the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, and many of the cases decided thereunder have lead many bankruptcy practitioners to the pervasive sense that student debt simply cannot be discharged unless the debtor is facing a situation so dire that it might be framed as a "certainty of hopelessness."[3] Even if a debtor is certainly hopeless, the debtor must also prove (among other things) that he or she made a good faith effort to repay the relevant loans up until the point of the bankruptcy filing. Creditors, often the Department of Education, have often undermined such a showing by simply offering to provide an indefinite reprieve from payments as long as the borrower pledges a percentage of their disposable income for possibly the vast majority of their post-college career to repaying the loan. A failure to make those payments will likely result in collection efforts including garnishment. Some lenders even have the ability to prevent the renewal of occupationally required licenses[4] and/or to prevent the school from releasing college transcripts.[5]

Requiring a debtor to establish that their situations is hopeless or allowing a creditor to unilaterally veto what might otherwise lead to a discharge by offering an income based repayment plan sets 523(a)(8) outside of the most fundamental thesis of the bankruptcy discharge – that society is improved if the honest but unfortunate debtor receives a fresh start. But case law decided under *Brunner* and *Gerhardt* generally concludes that a debtor is not entitled to discharge student loans unless the debtor's situation has become so bleak that a discharge and "fresh start" will essentially provide no relief.

Recently, however, some decisions have illuminated possible lines of analysis that can lead to a discharge of student debt. This paper discusses some of that analysis and recent cases.

II. Trejo v. Navient and the United States Department of Education

Trejo v. Navient (*In re Trejo*)[6], decided by Judge Mark Mullin, involved a debtor, Ms. Trejo, who filed a 523(a)(8) action in her bankruptcy against (among others) the United States Department of Education ("DOE").

Ms. Trejo was a forty-seven-year-old single mother with three daughters: two dependent daughters (12 and 15), and an adult, non-dependent daughter. The dependent daughters had serious

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[1] 831 F.2d 395 (2d Cir. 1987).
[2] 348 F.3d 89 (5th Cir. 2003).
[3] *See, e.g.*, *In re Briscoe*, 16 Bankr. 128, 131 (Bankr. S.D.N.Y. 1981); *see also In re Roberson*, 999 F.2d 1132, 1136 (7th Cir. 1993).
[4] https://www.texastribune.org/2018/03/20/texas-defaulting-student-loans-can-lo/
[5] *See, e.g.*, *Jordon v. Norfolk State Univ.* (*in Re Jordon*), 275 B.R. 755, 757 (Bankr. W.D. Va. 2002); *see also In re Brinzer*, 21 B.R. 545, 546 (Bankr. S.D. W. Va. 1982).
[6] Nos. 17-42439-MXM-7, 17-4052, 2020 Bankr. LEXIS 1030, at *1 (Bankr. N.D. Tex. Apr. 15, 2020).

medical conditions and were receiving SSI. At trial, Ms. Trejo testified that in 2008, "I started college because of my kids, I wanted . . . to show [them] to do better . . . I wanted to do better." She attended college from 2008 to 2013 but ultimately failed to earn her degree and because of her family and financial situation, she did not intend to return.

As of the trial date, Ms. Trejo owed $83,442.65 in principal and $7,156.15 in interest, for a total student loan debt of $90,598.80.40. Further, Ms. Trejo had only been able to work sporadically at a nail salon since she stopped taking college courses in 2013. According to Ms. Trejo's tax returns and bankruptcy schedules, her annual income did not exceed $15,900 in the years preceding the bankruptcy. Ms. Trejo testified that, given the escalation of her daughters' physical, medical, and psychological conditions, she would no longer be able to work even part time.

The court also found that even if Ms. Trejo were to spend less time with her dependent daughters and seek full-time, or even part-time employment, given Ms. Trejo's severely limited education and dearth of job experience and skills, any future financial recovery appeared extremely unlikely.

The Court analyzed Ms. Trejo's facts in light of the standard set out in *Brunner*.[7] Of particular note, the court stated that "[g]iven the absence of 'bright lines,' perhaps the best that can be said is that 'a minimal standard of living lies somewhere between poverty and mere difficulty.'" Further, "[i]f some 'belt-tightening' in the debtor's expenses could create an ability to repay, she cannot satisfy the first prong." Ultimately, the court determined that the debtor was unable to significantly increase her minimal income because of her daughters' health conditions and her own limited experience. Further, the debtor already struggled to meet her already minimal expenses. Thus, the court explained that "there is simply no realistic 'belt tightening' that Ms. Trejo can achieve to create discretionary income that will enable her to pay Education." Therefore Ms. Trejo satisfied the first prong.

In finding that Ms. Trejo satisfied the second prong, 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, the court analyzed two cases, *Jones v. Bank One Texas*[8] and *McMullin v Department of Education*[9], which demonstrate that a court should look at whether a debtor's financial situation is within their reasonable control. Ultimately, the court determined that Ms. Trejo's financial distress was not self-imposed. Rather, her future earnings potential was stalled due to the physical, medical, and psychological challenges of her dependent children, her severely limited education, and the dearth of her usable job skills.

The court also found that Ms. Trejo satisfied the third prong-that the debtor has made good faith efforts to repay the loans. In analyzing this prong, the court noted that its analysis was similar

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[7] In order to satisfy the "undue hardship" standard of 523(a)(8), a debtor must show: (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for himself and his 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.

[8] 376 B.R. 130 (W.D. Tex. 2007).

[9] 316 B.R. 70 (Bankr. E.D. La. 2004).

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