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A Certainty of Hopelessness: Adjustments to Student Exceptionalism in Bankruptcy Law

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In 2011, Susan Krieger filed to discharge $30,450 in bankruptcy, most of which was student debt. In spite of regularly applying for jobs, residing with her 76-year-old mother, and relying on state welfare to meet her basic needs, Krieger was unable to meet any of her monthly loan payments.[3] While Krieger's debt was initially discharged, her collection agency, the Education Credit Management Corporation (ECMC), later appealed the decision to the Bankruptcy Court for the Central District of Illinois. Following an adversary proceeding, the court reversed the discharge and restored Krieger's obligation to pay her outstanding debt.[4] The court stated that they found no evidence that Krieger's circumstances should necessarily persist for the foreseeable future, despite the fact that Krieger had failed to find employment at any of the 180 jobs to which she had applied. Because only a handful of these applications were outside her preferred occupation as a paralegal, the court also claimed that Krieger had made insufficient effort to seek employment outside her chosen field.[5]

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3 *Krieger v. Educational Credit Management Corp.*, 713 F.3d 882 (7th Cir. 2013).

4 *See id*. at 882-885.

5 *See id*. at 885.

While Kreiger went on to successfully challenge the decision before the United States Court of Appeals for the Seventh circuit in *Krieger v. Educ. Credit Mgmt. Corp* and restore her discharge, her extreme difficulty in doing so demonstrates that this case is the exception that proves the rule of student exceptionalism. Student exceptionalism refers to the long-standing doctrine that in bankruptcy, student debt should only be dischargeable in extraordinary circumstances. This doctrine is so universal that even the most desperate students rarely attempt to escape their debt through bankruptcy.[6] A 2015 study by the Federal Reserve estimated that out of 884,956 annual bankruptcy cases, only 674 sought to discharge student debt, most of which failed.[7] Even when student debtors are facing life circumstances as bleak as Krieger's—circumstances which would certainly warrant the discharge of ordinary debt—they are generally not entitled to debt relief. And despite the ubiquity of student exceptionalism, there is still some variation in how different courts interpret the criteria under which debtors qualify for the rare, exceptional discharge.[8] While federal laws and precedent create universal standards that guide courts' rulings, there remains a great deal of ambiguity within these standards, which leads to an inconsistent application of bankruptcy law. More importantly, this ambiguity often leads to courts enforcing standards that are much stricter than the letter of bankruptcy law, resulting in a harsh brand of student exceptionalism that many judges and scholars refer to as "a certainty of hopelessness."[9]

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6 Brook E. Gotberg et al., *A No-Contest Discharge for Uncollectible Student Loans*, 91 University of Colo. L. Rev. 183, 200 (2020).

7 Stefania Albanesi & Jaromir Nosal, *Insolvency after the 2005 Bankruptcy Reform*, Federal Reserve Bank of New York Staff Reports, 16-18 (2015).

8 *Bankruptcy and Student Loans*, congressional research service, 12-15 (2019).

9 Fossey, Richard, *"The Certainty of Hopelessness": Are Courts too Harsh toward Bankrupt Student Loan Debtors?* 26 Journal of Law and Educ. 29-48 (1997).

In this paper, we explore the history of bankruptcy law and the trends which have made it so difficult for debtors to discharge student loans in bankruptcy. We will introduce the concept of undue hardship and the *Brunner* test, a standard created in 1987 which gives courts three criteria for determining whether repaying a student loan constitutes undue hardship.[10] To demonstrate the application and ambiguity of these criteria, we examine several prominent court rulings that reveal an excessively strict standard for allowing discharge. We will then propose specific metrics to add to the *Brunner* test to give courts a clear idea of what qualifies as undue hardship and, under such qualifications, allows a person to discharge student debt.

I. BACKGROUND

A. Establishment of 11 U.S.C. § 523(a)(8)

The current hurdles faced by Americans attempting to discharge their student debt begin with 11 U.S.C. § 523(a)(8). Before § 523(a)(8)'s creation in 1978, discharging student loans in bankruptcy was an almost identical process to discharging any other debt. During this time, however, many lawmakers and policy experts began to worry about the longevity of the federal student loan program, for two reasons: 1) Unlike most loans, lenders cannot take out collateral on student loans. Debt collecting agencies can seize a person's property if they fail to pay a mortgage, but failure to pay student debt cannot result in one's education or degree being taken away. 2) The federal government does not risk rate debtors, meaning that anyone is eligible for a loan regardless of credit history or financial trustworthiness.[11] These two factors make it possible for a critical mass

10 *Brunner v. New York State Higher Educ. Services Corp.*, 831 F.2d 395 (2nd Cir. 1987).

11 Note, *Ending Student Loan Exceptionalism: The Case For Risk-Based Pricing and Dischargeability* 126 HARV. L. REV. 587, 590-593 (2012).

of people to take out loans that they do not have the ability to repay, jeopardizing the entire program.[12]

11 U.S.C. § 523(a)(8) was a response to these concerns. In its infancy, § 523(a)(8) excepted students from discharge during the first five years of repayment, implying that a longer time period from graduation was necessary to prove that the debtor had attempted to repay the loan without resorting to bankruptcy.[13] In the decades following, the bankruptcy code for student loan discharge has grown increasingly stringent. In 1990, the minimum waiting period for discharge was increased from 5 to 7 years,[14] and in 1998, lawmakers removed the option to discharge after a waiting period altogether, opting instead to rely solely on its "undue hardship" requirement.[15]

B. Undue Hardship

Undue hardship describes the circumstances under which a person is exempted from the obligation to repay student debt, due to the extreme and undeserved strain that the obligation would place on the debtor. This standard is inarguably vague. Amendments to § 523(a)(8) and later legislation do not provide a precise or implementable definition of undue hardship, and congressional records of the discussion surrounding these pieces of legislation do not resolve this issue.[16]

The task of interpreting undue hardship therefore fell to the courts. It was not until 1987 that a somewhat universal standard of undue hardship came in the form of the *Brunner* test, a three-pronged approach to determining the impact of student debt on debtors. The *Brunner* test arose from the 1987 student loan bankruptcy case *Marie Brunner v. New York State Higher Education Services Corp*,

12 Susan Dynarski, *An Economist's Perspective of Student Loans in the United States*, Brookings, September 2014, at 9-11.

13 11 U.S.C. § 523 (2) (1988),

14 Crime Control Act of 1990 § 3621(2), 104 Stat. at 4965.

15 Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971(a), 112 Stat. 1581, 1837.

16 National Bankruptcy Review Commission Act, Pub. L. No. 103-394, tit. VI, § 603, 108 Stat. 4106, 4147 (1994).

in which the court determined that a more explicit test was necessary to prove undue hardship. The *Brunner* test describes three requirements under which a debtor qualifies for discharge: 1) The debtor is not able to maintain a basic standard of living while repaying the loans; 2) Circumstances exist that strongly indicate that this state of affairs will continue for the majority of the repayment period; 3) The debtor has made good faith attempts to repay the loan.[17]

C. Application of Brunner

Despite these three requirements, the *Brunner* test's ability to ensure that good-faith debtors receive relief from financial hardship is questionable. Historically, bankruptcy courts have interpreted the *Brunner* test and ruled on student loan cases in a way that goes beyond its original language, as demonstrated in *Krieger*. Exceptions to this excessively strict application of *Brunner* rarely survive appeals to higher courts. For example, in 1993, a bankruptcy court departed from standard procedure and granted Francisco Espinosa discharge of the accrued interest on a student loan, requiring him to only pay the principal debt of $13,250 without making a finding of undue hardship or holding an adversary proceeding with the loan servicer. Espinosa paid off the principal on the debt in 1997, but in 2000, Espinosa's loan servicer, United Student Aid Funds, Inc., came to collect interest on the loan.[18] A district court ruled that United was denied due process in the original case because no adversary proceeding was held, reversing the lower court's decision. Espinosa then appealed his case to the Supreme Court, which opened his case in 2009.

The Supreme Court ruled that the original bankruptcy court's discharge of the debt had been erroneous, maintaining that for discharge, an adversary proceeding must have been held and the debtor must have provided proof of undue hardship. The Court also ruled that since United waited seven years to challenge the bankruptcy

17 *See Brunner*, at 396.

18 *Espinosa v. United Student Aid Funds, Inc.*, 553, 59 F.3d 1193 (9th Cir. 2008).

court's ruling, they could not expect Espinosa to pay the remainder of the debt.[19] While the debt remained discharged, the Supreme Court's ruling against the lower court's original decision further cemented the ubiquity of student exceptionalism and high standards for discharge eligibility.

Since that time, other court rulings have indicated that this stringent interpretation is subject to change, most clearly demonstrated by a 2020 ruling in *Rosenberg v. New York State Higher Education Services*. In 2018, Kevin Rosenberg filed for bankruptcy, attempting to discharge over $220,000 of student debt that he accumulated while attending law school. Having chosen to practice law only briefly upon graduation, he had no means to repay such a large sum. In this case, the court still used the *Brunner* test to evaluate Rosenberg's debt, but with more leniency than is typical, and his debt was discharged in full.[20] In a court opinion, Judge Cecelia Morris explained that the court did not require Rosenberg to provide evidence that his inability to repay the debt would "persist forever," as has often been required of debtors. Additionally, the court did not determine whether Rosenberg's state of affairs was a consequence of choice.[21] Typically, in a case such as this, Rosenberg would have had to account for the fact that he only practiced law very briefly after graduation, as a typical legal salary would have been sufficient to save him from his dire financial straits. The good faith prong of the *Brunner* test would be satisfied only if Rosenberg's departure from practicing law was reasonably outside his control. Judge Morris pointed out that this requirement, while a common application of *Brunner*, is found nowhere in the wording of the *Brunner* test or in § 523(a)(8). In her concluding remarks, Judge Morris states that "The harsh results that often are associated with *Brunner* are actually the result of cases interpreting *Brunner*. Over the past 32 years, many cases have pinned on *Brunner* punitive standards that are not contained therein… They have become a quasi-standard of mythic

19 *See id*. at 558.

20 *Rosenberg v. N.Y. State Higher Education Services Corp., et al.,* Case No. 18-35379 (Bankr. S.D.N.Y. January 7, 2020).

21 *See id.* at 461.

proportions so much so that most people (bankruptcy professionals as well as lay individuals) believe it impossible to discharge student loans."[22] These statements, along with this court's lenient application of *Brunner*, demonstrate how courts have created a harsh precedent that goes against the original language and principles of bankruptcy law. The subjective nature of *Brunner* allows for a concerningly large variety of interpretation; thus, the addition of an objective or quantitative metric to the *Brunner* test could have beneficial effects on courts that use it to determine the existence of undue hardship.

II. Adjusting Brunner And 11 U.S.C. § 523(a)(8)

Current application of § 523(a)(8) and the *Brunner* test reveal that there are three basic issues with how the federal court system handles student debt. The first issue is that the standard for what constitutes undue hardship is too high, barring many debtors from a deserved discharge. The second issue is that courts inconsistently apply the *Brunner* test across federal jurisdictions and between higher and lower courts. The third issue is that the burden of proof placed on the debtor in establishing that they meet the three prongs of *Brunner* is unreasonably high. Introducing new metrics to evaluate a debtor's situation based on these issues will better ensure that courts treat debtors fairly and that consistent standards are applied to all cases.

A. Living Wage

To address the first two issues, we propose amending § 523(a)(8) to resolve the ambiguity of Brunner's first prong, that the debtor cannot maintain a basic standard of living. These adjustments would include a more concrete method of evaluation in determining undue hardship. We propose that the standard of living criterion be determined by a simple threshold of a living wage. If giving up 10% of monthly income to pay off student loans would place debtors under the living wage threshold, their circumstances should satisfy the hardship prong of Brunner and qualify them for discharge of student loans,

22 *See id.* at 459.

provided the other prongs are also satisfied. Using a universally applicable metric such as living wage removes ambiguity, which historically has resulted in an unreasonably high standard applied to debtors, as seen in cases such as in Espinosa.

Currently, courts evaluate debtors' finances to determine if they are responsibly living within their means and if they can maintain a satisfactory standard of living. Under this practice, there is some variation between different courts on the strictness with which they evaluate debtors' finances.[23] Our proposed standard would create an equal and more lenient standard for everyone, better ensuring that debtors receive necessary relief. It should also be noted that the requirement to subtract 10% of monthly income to fall under the threshold comes from current options available to debtors to refinance their loans. Several federal relief programs exist for student loans in which debtors can have a portion of their wages (usually 10%) allocated to paying off student debt for a certain period (usually 25 years). After this time, the remainder of the debt is forgiven.[24] The living wage threshold we propose targets those whose financial hardship is dire enough that they cannot afford to give up even 10% of income for a prolonged period.

Finding where to draw the living wage threshold is difficult. We maintain that the guiding principle of any solution should be balancing fairness between debtor and creditor. Thus, any threshold worth implementing must provide relief to more debtors than is possible under the current system, while also ensuring that the federal student loan program does not come under risk of bankruptcy, per the original rationale behind § 523(a)(8). We submit that the best existing candidate for a specific threshold comes from a method of calculating area-specific living expenses developed by economists at the Massachusetts Institute of Technology. These researchers compiled data from every county and metropolitan area in the United States

23 Aaron N. Taylor & Daniel J. Sheffner, *Oh, What a Relief it (Sometimes) Is: An Analysis of Chapter 7 Bankruptcy Petitions to Discharge Student Loans*, 27 Stan. L. & Pol'y Rev. 295, 319, 331 (2016)

24 Federal Student Aid, US. Department of Education, Repaying Your Loans, 8 (2015).

and determined living expenses based on local prices of necessities. Their calculation also includes other variable factors such as household size and the income of one's spouse or partner. The researchers' criteria for what constitutes a "livable" income is that which is required to be financially independent, or to have basic needs met without additional government or community assistance. A livable income includes the ability to pay expenses for housing, transportation, food, childcare, basic healthcare, and taxes. It does not include expenses such as entertainment, eating out, or savings. As economists designed this standard to be the minimum income required to live without assistance and, as such, cuts out all nonessential expenses, this living wage threshold is analogous to the lowest bar of what can reasonably be considered a threshold for hardship.[25] In other words, if a debtor cannot maintain a living wage while paying off the loan, undue hardship is certainly implied. We therefore assert that any system that explicitly or implicitly creates a harsher standard to meet the undue hardship requirement of § 523(a)(8) violates even the most textual interpretation of this law.

We recognize that extenuating circumstances may exist in which a person may not fall below the living wage threshold but still be living in undue hardship. In the proposed § 523(a)(8) alterations, falling below the living wage line would be a sufficient, not a necessary, condition for discharge. Most exceptions would likely arise from medical conditions for which the normal calculation of healthcare costs is insufficient. In this case, adding the additional healthcare costs to the standard living wage line would be sufficient. In other extenuating circumstances, a debtor could contest their hardship before a bankruptcy court. As these cases are exceptional by nature, we make no proposals for how courts should handle them.

The MIT living wage metric was designed by experts to draw the line at the threshold of what is livable, and, according to many economists, it is the single best system to determine who lives in hardship. This metric fits neatly within the current legal framework,

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25 Carey Nadeau & Amy K. Glasmeier, Minimum Wage: *Can an Individual or a Family Live on It?* LIVING WAGE CALCULATOR, Jan. 16, 2016, https://livingwage.mit.edu/articles/15-minimum-wage-can-an-individual-or-a-family-live-on-it

staying true to the original rationale of student exceptionalism while also fulfilling the classical doctrine of U.S. bankruptcy law, which holds that "the 'honest but unfortunate debtor' has a right to bankruptcy's 'fresh start.'"[26] We do not claim that a living wage threshold is the only necessary measure to fix the student debt crisis. While major reforms to the federal bankruptcy programs may be in order, our primary focus is ensuring that the current body of legislation and precedent accomplishes its stated intentions: in this case, by providing relief to those living in undue hardship.

B. Persistence and Good Faith

The living wage threshold is a necessary tool in determining hardship, but this is only one part of the equation. The other two prongs of *Brunner* provide a framework for determining if the debtor's hardship is undue and persistent, requiring the debtor to demonstrate that his or her state of affairs will continue for the foreseeable future and that he or she has made good faith efforts to repay the loan. As we have discussed previously, the court opinion issued by Judge Morris in *Rosenberg* shows the contrast between the text of the law itself and the extra criteria courts have applied to these tests. For *Brunner's* "persistence of circumstances" prong, Judge Morris points out that most courts place such a high burden of proof on the debtor that he or she effectively has to demonstrate that his or her financial straits will "endure forever." The actual text of this prong of the *Brunner* test, from the official court opinion issued in *Marie Brunner v. New York State Higher Education Services Corp.*, states that it must be the case 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."[27] What constitutes "likely to persist" is open to interpretation, but there is little doubt that the standard, as applied in the cases we have explained above and in countless other unmentioned lesser-known cases, typically goes beyond reasonable

26 Douglas G. Baird, *Symposium, Discharge, Waiver, and the Behavioral Undercurrents of Debtor-Creditor Law*, 73 U. Chi. L. Rev. 17, 17 (2006).

27 *See Brunner*, at 396.

likelihood. Our recommendation is to include a clause in § 523(a)(8) that satisfies this criterion if a debtor has been living below the living wage for a majority of a three-year period, which is the upper limit for how long a debtor can put federal student loans in forbearance and pause repayments. As with the living wage requirement itself, there are many scenarios in which a sudden change in circumstances could cause a person's financial situation to be new yet permanent, in which case he or she would be able to contest that courts waive this three-year requirement.

Brunner's third prong is that the debtor has made a good faith effort to repay their student debt. We have no official proposal for amendments based on this prong; however, we reiterate that as is the case with prongs one and two, courts have long been, in the words of Judge Morris, adding "punitive standards that are not contained [in § 523(a)(8) or *Brunner*]."[28] The most notable departure that *Rosenberg* took from these extra standards, as we have described in the previous section, is that the court did not require Rosenberg to demonstrate that his financial situation was not the foreseeable consequence of his actions. Rosenberg, as well as Krieger, both could potentially have prevented some of their hardship had they pursued different occupations. This is one aspect in which Judge Morris' ruling may have gone too far; while not explicitly stated in statutory bankruptcy law, occupation of choice is naturally a logical consideration for assessing effort made in good faith. Were chosen occupation not grounds for courts denying a discharge, it would be possible and perhaps inevitable for students to accumulate massive debt that they had no intention of repaying, safe in the knowledge that their financial status and frequency of repayments would be sufficient to qualify them as a good-faith debtor in undue hardship. Going forward, courts should continue to consider chosen occupations, but in the context of other factors in the debtor's situation. In other words, choosing a lower paying profession should not automatically be grounds for disqualifying for discharge. Overall, due to the highly circumstantial nature of assessing "good faith," we recommend that this prong remain subject to the court's interpretation, but with a

28 *See Rosenberg*, at 459.

primary focus on the debtor's frequency and total value of repayments relative to his or her financial status.

C. Implementation and Caveats

It is important to note that while the proposed living wage provides a precisely calculated, location-specific metric for the minimum amount necessary to meet basic needs, it is not yet codified into the US legal system. The federal minimum wage, which *is* legally defined, has been insufficient for maintaining living expenses since the 1960's.[29] Likewise, the legally recognized poverty line is far lower than any reasonable interpretation of hardship, as noted by the economists that developed the living wage metric. We therefore recognize that our proposal to incorporate the living wage into bankruptcy courts' decisions regarding the proof of undue hardship faces substantial legal hurdles: while proponents of a legally codified living wage have lobbied the federal government for decades, the minimum wage and poverty line currently remain the only legally recognized minimum standards of living.

The adoption of the living wage as a consideration during bankruptcy proceedings remains a viable option for courts, which are allowed more discretion and flexibility as they examine circumstances on a case-by-case basis. We do not suggest that the addition of a living wage requirement into the *Brunner* test should diminish courts' ability to freely interpret individual situations: rather, we believe that such an added metric will allow the *Brunner* test to be interpreted as originally intended, since those who fall below the living wage are, in most cases, undoubtedly living in hardship. Additionally, our proposal for a three-year time period clause gives courts yet another specific metric to understand if the debtor's situation is a long-term one and thereby judge their situation fairly and accurately. Given such aids, we believe that the courts will be able to perform the *Brunner* test and assess undue hardship accurately and as originally intended, assuaging the important concerns addressed

29 Andrew Bloomenthal, *Can a Family Survive on the U.S. Minimum Wage?*, Investopedia (Nov. 11, 2020), https://www.investopedia.com/articles/personal-finance/022615/can-family-survive-us-minimum-wage.asp.

in *Rosenberg* and allowing for more consistency in court rulings regarding student loan bankruptcy.

III. Conclusion

Once again, we are not arguing for sweeping reforms to the federal student loan program, nor are we necessarily arguing against it. However, given the current difficulty of discharging student debt in bankruptcy, and within the context of current bankruptcy law and doctrine, we maintain that steps must be taken to ensure that the application of law more closely matches the law's intention. These proposals seek to balance principles of fairness between debtor and creditor. One the one hand, it is a tenet of U.S. bankruptcy doctrine that the "honest but unfortunate debtor" has a right to a fresh start through bankruptcy, and courts should seek to achieve this goal for student debtors as much as possible. On the other hand, the economic demands on the federal student loan program and the nature of student loans make realizing this goal unrealistic. Student loans, as we discussed, have no collateral. Universities and creditors cannot demand that debtors return an academic degree or years of education if financial obligations aren't met: thus, there is no way to enforce payment. High default rates—and there is every incentive to default on a loan with no collateral, even among those that began with honest intentions—would place any federal student loan program under constant threat of bankruptcy.

Student exceptionalism in bankruptcy was therefore a necessary step in saving the federal student loan program. But the heavy-handed application of law has swung the pendulum too far in the other direction. Forty-five million American students and graduates collectively hold $1.7 trillion of student debt, a figure that amounts to almost 8% of U.S. GDP.[30] Current bankruptcy law may have saved the student loan program from bankruptcy, but it has also contributed to soaring tuition prices, created a growing debt bubble, and

30 Abigail Johnson Hess, *How student debt became a $1.6 trillion crisis*, CNBC (June 12 2020, 11:33 AM), https://www.cnbc.com/2020/06/12/how-student-debt-became-a-1point6-trillion-crisis.html.

placed inescapable hardship on the backs of millions. Economists disagree on the long-term impact of these policies, but even the most optimistic concede that this is a problem with which citizens and lawmakers will grapple for at least a generation.[31] The proposals we have set forth address a small but crucial part of the student debt crisis. Millions of student debtors qualify for bankruptcy even under the standards of § 523(a)(8) and the *Brunner* test. Most of those that have filed for bankruptcy have nonetheless failed, because, to paraphrase Judge Morris of the Southern District of New York, most courts have applied standards that are not contained in law. It is time for a course correction.

The most important part of these adjustments is giving the law a more precise and equal tool for determining who lives in hardship, a need that we answer through the calculation of living wage. There is then the secondary but still vital issue of determining if a hardship is undue and persistent. We suggest that courts should, in most situations, make this decision based on a simple evaluation of past income and frequency of repayments. There will be exceptions to the rules we have laid out, some of which we have accounted for, but the rest we place in the hands of courts. We regard these proposals as being a tune-up, a refinement of an existing process, rather than a new system altogether. There may be a need for grander policies to address the debt crisis in the future, but we offer these suggestions as a possible first step. Even if amendments to § 523(a)(8) and a reinterpretation of *Brunner* do not go very far in solving a national crisis, it is our hope that these adjustments may save a few from the crushing weight of debt and give a fresh start to those that most deserve it.

31 Lance Lochner & Alexander Monge-Naranjo, *Student Loans and Repayment: Theory, Evidence, and Policy* 8-11 (Nat'l Bureau of Econ. Rsch., Working Paper No. 20849, 2015).