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Student Loan Discharge in Bankruptcy: New Developments

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A recent California Bankruptcy Court decision, *Love v. U.S.* (*In re Love*), contributes to the body of law on the discharge of student loan debt as we have examined in a series of prior client alerts. *Love v. U.S.* (*In re Love*), No. 19-20532-C-7, 2023 WL 2787295 (Bankr. E.D. Cal. April 5, 2023). A review of our previous alerts discussing the dischargeability of student debt provides a helpful background.[1]

Under the Bankruptcy Code, the discharge of debtor liabilities is paramount in providing debtors with a "fresh start," sometimes subject to limitations, as we have routinely seen with student loan debts. While generally, the question of dischargeability of student debt has been grimly resolved, United States Bankruptcy Judge Christopher Klein's decision in *In re Love* appears to be designed to challenge the perception that student loan debt is practically nondischargeable. *In re Love*, 2023 WL 2787295 at *1. In his opinion, Judge Klein takes the opportunity to assess Debtor Christine Love's claim of undue hardship in a virtually appeal-proof decision, paving the way for some certainty in future student loan debt discharges.

In his decision addressing the routine reversals of student loan debt discharges, Judge Klein recognized the paradoxical nature of the preponderance standard of proof for discharge under the "undue hardship" test and the seemingly incompatibly low number of debtors qualifying for such a discharge. In a thorough review of Ninth Circuit caselaw, Judge Klein largely credits this discrepancy to the incorrect appellate standard of review employed for mixed questions of law and fact. *Id.*

For some time before Judge Klein's decision in *In re Love*, appellate courts looked to the legal character of mixed questions in order to unilaterally expand their non-deferential *de novo* review of legal issues to factual issues in dischargeability claims. Putting an end to the unauthorized use of *de novo* review by appellate courts, Judge Klein turned to the Supreme Court's decision in *U.S. Bank National Association v. Village at Lakeridge, LLC*, 138 S. Ct. 960 (2018) to establish the "clear error" standard of review as the proper standard when assessing mixed questions of law and fact where the factual analysis predominates.

Relying on the Supreme Court's distinction between a "question [that] requires courts 'to expound on the law'" and a question that "immerses courts in case-specific factual issues," Judge Klein established that questions of undue hardship would be reviewed under the "clear error" standard. *In re Love*, 2023 WL 2787295 at *7-8. This pivotal conclusion was made in recognition of the reality that questions of undue hardship under section 523(a)(8) of the Bankruptcy Code are characterized by the intense fact-dependent nature of the analysis.

Moving on to analyze the Debtor's undue hardship claim, Judge Klein turned to the well-known *Brunner* test, created by the Second Circuit, and dubbed the *Brunner-Pena* test after its adoption by the Ninth Circuit in *United Student Aid Funds, Inc. v. Pena*, 155 F.3d 1108 (9th Cir. 1998). Underpinning the complex fact-specific nature of the undue hardship analysis, Judge Klein began with an overview of the *Brunner* test as applied to the facts in *Pena*, noting that application of the same test by both the Second and Ninth Circuits led to significantly different outcomes. *Id.* at *3.

As discussed in previous alerts, the *Brunner* test requires that the debtor establish that: (1) the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for him/herself and his/her dependents if forced to repay the loans; (2) 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) the debtor has made good faith efforts to repay the loans. *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395, 396 (2d Cir. 1987).

First, Judge Klein looked to the Debtor's annual gross income of approximately $40,000 in comparison to her annual financial obligations, totaling more than $45,000. When accounting for net income, her monthly expenses overshadowed her income by over $1,000. After establishing that she was living on minimal means, insufficient to afford even her healthcare costs, Judge Klein was thoroughly persuaded that the Debtor met the first part of the *Brunner-Pena* test. *In re Love*, 2023 WL 2787295 at *9.

Next, Judge Klein turned Ms. Love's personal, academic, and professional circumstances in deciding that she had also met the second part of the *Brunner-Pena* test. Judge Klein accepted evidence that the Debtor had effectively reached the pinnacle of her earning potential, particularly in light of the little value provided by her education at a now-defunct institution. *Id.* at *1, 9. Not only was the Debtor out of a degree, as she had not been able to finish the academic program, it was also doubtful whether her progress thus far was valuable, since other institutions were unlikely to accept transfer credits. Judge Klein also considered the Debtor's position as a single mom of two, who had endured domestic violence at the hands of her husband—whose infliction of injuries rendered Ms. Love incapable of completing her academic studies.

Finally, Judge Klein reviewed the Debtor's financial history as it pertained to her student loan debts, finding that she had never defaulted on any payments. *Id.* at *9. In addition, she had made voluntary payments of $3,000 on creditor claims in the beginning of her chapter 7 proceeding, evidencing her intention to honor her financial obligations. Judge Klein rejected the United States' argument that the Debtor's good faith was undercut by virtue of failing to seek "new administrative remedies." *Id.* at *10. Putting a swift end to that argument, Judge Klein emphasized that section 523 of the Bankruptcy Code does not require exhaustion of administrative remedies before an undue hardship claim may be raised. *Id.*

This decision is yet another example of the direction that bankruptcy courts are headed towards in their pursuit to provide all debtors with a fresh start, accounting for circumstances outside of a debtor's control and acknowledging their genuine efforts.

The evolving common law concerning discharge of student debt suggests that, when lenders and borrowers confront such issues, they should consult their legal counsel.

Please note that this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and recipient. If you have questions regarding these provisions, or any other aspect of bankruptcy law, please contact Michael Traison at 312.860.4230.

Thank you to Jennifer Hanna, a Law Clerk pending New York bar admission, who assisted in the preparation of this alert.

Footnotes

[1] [Click here to read our previous legal alerts: Student Loan Debt Discharged in Recent Bankruptcy Court Opinion -Cullen and Dykman LLP (cullenllp.com); Student Loan Debt Discharged in Recent Illinois Bankruptcy Court Opinion - Cullen and Dykman LLP (cullenllp.com); Another Bankruptcy Court Rules in Favor of Discharging Student Loan Debt. - Cullen and Dykman LLP (cullenllp.com); An Update on Student Loan Debt: Interpretation of the Statute is Critical - Cullen and Dykman LLP (cullenllp.com)].

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