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An Update on Student Loan Debt: Interpretation of the Statute is Critical

July 22, 2021

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In prior legal alerts, we have discussed the subject of dischargeability of student loan debt and the factors courts will consider when deciding whether the student loan debts impose an "undue hardship" if forced to repay. [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)].

The basic rule is that when an individual or entity seeks relief under the Bankruptcy Code, the goal is discharge of liabilities to provide a "fresh start." The purpose of the Bankruptcy Code is to aid the honest but unfortunate debtor while treating creditors fairly.

Student loan debt is generally nondischargeable; however, as with many general rules, there are exceptions. In certain circumstances, courts will employ the *Brunner* test to determine whether the debtor would otherwise suffer undue hardship should the student loans not be discharged. *Brunner v. N.Y. Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987).

A recent Court of Appeals for the Second Circuit decision addressed student loan discharge and focused on other issues including the character of a private loan, the proceeds of which are used in whole or in part for educational purposes, and other student loans, such as those provided through an institution's financial aid office. The decision illustrates the role of courts interpreting legislative intent. The Court reminds us that private loans are not necessarily covered by the same parts of the statute making other student loans presumptively nondischargeable. 11 U.S.C. § 523(a)(8)(A)(ii).

In *Homaidan v. Sallie Mae, Inc. et al.*, No. 20-1981 (2d Cir. July 15, 2021), the Second Circuit reviewed a decision by Bankruptcy Judge Elizabeth Stong of the Eastern District of New York concerning the student loan debt of Hilal K.

Homaidan ("Homaidan") who had filed chapter 7 bankruptcy. The issue was whether all of Homadian's student loan debts were dischargeable, including the private loans he received from Navient Solutions, LLC ("Navient").

Following the bankruptcy court's discharge order, Naveint pursued repayment from Homaidan. After Homaidan paid off Navient's loans in full, he reopened his bankruptcy case and commenced an adversary proceeding against Navient for violating the discharge order. The bankruptcy court held that section 523(a)(8)(A)(ii) did not cover private student loans and therefore the loans at issue were subject to discharge.

In affirming the bankruptcy court's decision, the Second Circuit distinguished between private loans issued by a lender which may be used to fund a student's college education, among other expenses, and those made through the college's financial aid office which are made solely to cover a student's cost of attendance.

Navient had argued that section 523(a)(8)(A)(ii) of the Bankruptcy Code applied to private loans. The question was whether the loans at issue constituted "an obligation to repay funds received as an education benefit" which would be excepted from discharge under section 523(a)(8)(A)(ii).

The Second Circuit noted that the discharge exceptions under 11 U.S.C. § 523(a)(8) are "confined to those plainly expressed in the Bankruptcy Code" and, at the outset, emphasized the importance of the plain meaning of the statutory text. The court believed that Navient's interpretation of this provision would render all educational loans excepted from discharge; that was clearly not Congress' intent.

Rejecting Navient's argument, the Second Circuit held that the lender's position "offends the canon against surplusage" because it "would draw virtually all student loans within the scope of § 523(a)(8)(A)(ii)." It highlighted that specific categories of nondischargeable debt delineated within section 523(a)(8) of the Bankruptcy Code were drafted "to have a distinct function and to target different kinds of debt[]." The court did not believe Congress intended this provision to be interpreted as a "catch-all" for any and all student loans.

The Second Circuit decision provides a lesson in interpreting statutes, including the statutory canon of *noscitur a sociis* where a word is given more precise context by neighboring words associated with it.

The court acknowledged that the undefined term, "educational benefit," contained in section 523(a)(8)(A)(ii) of the Bankruptcy Code must be interpreted alongside the accompanying phrases of "scholarship" and "stipend." The latter terms describe payments not generally required to be repaid whereas a loan connotes an unconditional obligation to repay. The court said this provision cannot be expanded to include two terms which describe payments that generally need not be repaid and one that requires repayment. As such, "education benefits" more logically relates to condition grant payments like scholarships and stipends and not student loans, as Navient contends.

Private lenders should know that in the Second Circuit, and elsewhere, private loans like Homaidan's may be deemed dischargeable under section 523(a)(8)(A)(ii).

Based upon the various canons of statutory construction detailed by the Second Circuit, the court upheld the bankruptcy court's decision and deemed Homaidan's private student loans dischargeable under section 523(a)(8)(A)(ii) of the Bankruptcy Code.

It is important to recognize the impact of statutory interpretation and the fact that such interpretations are not entirely uniform but rather subject to a judge's discretion. Previously, we discussed the effect of statutory interpretation on the outcome of a particular issue. [Click here to read our previous legal alert relating to statutory interpretation: Recent Bankruptcy Court Decisions of Statutory Interpretation Reiterate the Importance of Equitable Consideration in Bankruptcy Cases - Cullen and Dykman LLP (cullenllp.com)].

The United States Supreme Court addressed the statutory interpretation in *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989), where an attorney in our bankruptcy group appeared before the Court in "the case of the misplaced comma." This case is often cited for Justice Scalia's phrase "plain meaning of the law." The "plain meaning of legislation" is considered by many judges to be conclusive for interpretation, except in "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters." 489 U.S. at 242.

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, Elizabeth Usinger at 516.357.3869, and/or Amanda Tersigni at 516.357.3738.

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