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# Student Loan Debt Discharged in Recent Bankruptcy Court Opinion

January 13, 2020

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Judge Cecelia Morris of the Bankruptcy Court for the Southern District of New York has recently issued an opinion affecting lenders who offer student loans and respective borrowers.

As described in prior Cullen and Dykman legal alerts earlier this year, the bankruptcy code contains a provision allowing for the discharge of debts in whole or in part as a result of filing bankruptcy. Certain debts and obligations are excepted from this general discharge rule, including debts resulting from fraud, taxes, alimony and child support payments. Student loans have also been identified as debts that are typically non-dischargeable, subject to certain exceptions.

Section 523(a) of the Bankruptcy Code states in relevant part

> "a discharge…does not discharge an individual debtor from any debt… unless excepting such debt from discharge…would impose an undue hardship on the debtor and the debtor's dependents, for… an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or an obligation to repay funds received as an educational benefit, scholarship, or stipend; or any other educational loan that is a qualified education loan… incurred by a debtor who is an individual"

11 U.S.C. § 523.

The Bankruptcy Code does not define "undue burden" and a debtor who seeks to discharge student loan debt bears the burden of demonstrating undue hardship by a preponderance of the evidence. The Second Circuit in *Brunner v. New York State Higher Education Services Corporation*, articulated what has become the standard test for determining whether a debtor would face an undue hardship if his/her student loans were not discharged. 831 F.2d 395 (2d Cir. 1987).

Under the Brunner test, a debtor must make the following three-part showing:(1) that 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) 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. *Brunner*, 831 F.2d at 396.

Oftentimes when Courts apply the Brunner test, judges examine the debtor's particular circumstances, engaging in a fact-intensive assessment, to address each element of the test. Debtors are rarely able to satisfy the requirements needed to prove undue hardship.

Judge Morris' recent opinion rejects the accepted precedent established in *Brunner*. The chapter 7 debtor, Kevin Jared Rosenberg ("Rosenberg") sought to declare his student loan debt dischargeable. Rosenberg began borrowing money to fund educational pursuits in 1993 for an undergraduate degree. After obtaining a Bachelor of Arts degree in history, Rosenberg served in the Navy for five years, and then attended Cardozo Law School, for which additional student loans were taken out in 2004. After completing law school, Rosenberg consolidated his student loans and owed approximately $220,000 with an interest of 3.8%.

Judge Morris examined *Brunner* noting that the test creates too high of a burden for debtors and has been misapplied by courts over the span of 35 years. Judge Morris pointed out that Rosenberg had been struggling with student loan debt for over a decade, drawing a distinction between him and debtors who file bankruptcy mere months after obtaining a degree.

In applying *Brunner*, Judge Morris closely examined each element of the test ultimately ruling that Rosenberg had satisfied all prongs of the Brunner test, enabling him to discharge the full amount of the outstanding student loans.

To determine whether Rosenberg could maintain a minimal standard of living, Judge Morris examined Rosenberg's petition and the means test. Rosenberg had negative income each month evidencing his inability to live. Given that the student loans were in default, there was also no way Rosenberg would be able to immediately pay the full amount owed under the loans given his income. Under the second prong, Rosenberg's inability to pay the full amount owed would be a situation that would persist especially where the repayment period for the loans ended and the full amounts became due. Regarding whether Rosenberg made good faith efforts to repay his student loans, payment history indicated that Rosenberg had only missed 16 payments in 13 years and no fees or payments were charged for 10 years while the student loan had been in deferment or forbearance. Rosenberg had been current on the loan since 2015. When reviewing the specific payments made, Rosenberg demonstrated his good faith efforts to repay the loan. Based on the particular circumstances of Rosenberg's case, the student loan imposed an undue hardship and all elements of the Brunner test had been met, enabling Rosenberg to discharge the debt.

The Bankruptcy Court is a court of equity and the Court's ability to exercise discretion is broad in some cases. In this case several factors, while not directly emphasized in Morris' opinion likely weighed in the Debtor's favor- the date the loan originated was several decades earlier when the debtor was quite young and the debtor filed for bankruptcy relief at a very different point in his life. Moreover, beyond the good faith of the debtor enumerated in the opinion, the court may have looked favorably at the debtor's military service. In other words this case may rest on its very specific facts and other Courts in New York could view situations unlike this quite differently.

While Morris' decision is likely to be appealed by loan service providers, if it is affirmed by the district court, it could have a major impact on the economy, especially for the banking and higher education sectors, as more students will look to bankruptcy as a means of erasing outstanding student loans and respective debt.

Because the issue of relief from student debt has become a political issue and may ultimately be resolved through government action, the Courts' attempts to deal with student loan debt could be resolved through legislation. In any case the "fresh start" fundamental to the bankruptcy process will be under severe scrutiny as a result of this decision. In the meantime lenders should work closely and consult legal counsel regarding rights as related to student loans as more borrowers look to bankruptcy for relief.

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

## Practices

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