# Discharging Student Loans in Bankruptcy: The Bankruptcy Court Tests of "Undue Hardship"

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Post-secondary educational institutions have become dependent upon federally financed student loan programs for their economic well being. As educational costs have risen and funding has decreased, institutions have come to rely on student loans to maintain their enrollment levels and programs.[1] Higher education's reliance on student loans is increasing at a rapid rate. In fiscal year 1981, 3.5 million students borrowed 7.7 billion dollars from the Guaranteed Student Loan (GSL) program, the largest of the federally financed student loan programs.[2] This represents a fifty-two percent increase in the number of student borrowers and a sixty percent increase in the amount of money borrowed as compared to the previous fiscal year.[3]

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1. NATIONAL COMM'N ON STUDENT FINANCIAL ASSISTANCE, GUARANTEED STUDENT LOANS: A BACKGROUND PAPER, REPORT NO. 1, at 36 (1982) [hereinafter cited as GSL PAPER].

The National Commission is a twelve-person panel that includes members of Congress, prominent educators, and community leaders. The National Commission's purpose is to provide Congress with information and policy recommendations regarding student assistance programs. Education Amends. of 1980, Pub. L. No. 96-374, 1980 U.S. CODE CONG. & AD. NEWS (94 Stat.) 1454-58.

The cost of higher education has increased far more than the average rate of inflation. R.B. FREEMAN, THE OVER-EDUCATED AMERICAN 22 (1976). Education costs increase for reasons that have little to do with market forces. For example, a consultant for George Washington University in Washington, D.C. recently advised the university to increase its tuition because "[r]aising tuition especially above the highest undergraduate level charged in that area . . . would bring pride to the entire university community." Noah, *Highbrow Robbery: The Colleges Call it Tuition, We Call It Plunder*, WASH. MONTHLY 17-18 (July/August 1983).

2. *Oversight on Current Status and Administration of Federal Student Assistance Programs: Hearings Before the Subcomm. on Post Secondary Education of the House Comm. on Education and Labor*, 97th Cong. 2d Sess. 26 (1982) (statement of Dr. Edward M. Elmendorf, Deputy Assistant Secretary for Student Financial Assistance) [hereinafter cited as *Oversight Hearings*]. The other large student loan program is the National Direct Student Loan Program. The National Direct Student Loan Program is need-based, and loans are made by educational institutions. *See* 20 U.S.C. §§ 1087dd(b), 1087cc(a)(2) (1983).

Any student attending an eligible institution on a half-time or greater basis can obtain a guaranteed student loan (GSL). Higher Education Act of 1965, Pub. L. No. 89-329, 1965 U.S. CODE CONG. & AD. NEWS (79 Stat.) 1253.

From 1979 to 1981, GSLs were available to any student regardless of financial need. *Pulse: Medical Student Financial Aid Update*, 251 J. AMER. MED. ASS'N D (1984). Currently, students dependent upon their families must meet a needs test if their yearly family income is greater than $30,000. *See* 34 C.F.R. § 682.301 (1983).

3. *Oversight Hearings, supra* note 2, at 26. In 1983, over 70% of medical students obtained GSLs. 251 J. AMER. MED. ASS'N, *supra* note 2, at D.

Even though GSLs are made by private lenders, the federal government is liable when student borrowers die, default, or go bankrupt.[4] In 1976 Congress became concerned with a high default rate on GSLs[5] caused by lenders' mismanagement of their loan portfolios.[6] Congress also was concerned that borrowers were abusing the Bankruptcy Code's liberal discharge provisions.[7] There were reports of students discharging large student loan debts after graduation and subsequently accepting high-paying jobs.[8]

In fact, very few student loan debtors were abusing the Bankruptcy Code. A 1976 General Accounting Office study reported that less than one percent of all matured educational loans had been discharged in bankruptcy.[9] It appears that the problem that concerned Congress was created by the press.[10] Well publicized articles created the impression that students habitually received discharges of their loans.[11]

Congress responded to the publicized abuse of the bankruptcy laws by including a nondischargeability provision for student loans in section 523(a)(8) of the 1978 Bankruptcy Reform Act.[12] This section states that

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4. Higher Education Act of 1965, *supra* note 2, at 1260. The government's guarantee is necessary because lenders cannot require collateral or cosigners. *See* 20 U.S.C. § 1077(a)(2)(A) (1978) (a GSL is insurable only if made without endorsement or security).

There are governmental costs in addition to guarantee payments. The government pays lenders the difference between the market interest rate and the nine percent interest currently paid by borrowers. GSL PAPER, *supra* note 1, at 21. Also, the government pays the loan's interest while the borrower is in school. *Id.*

5. *See generally* Guaranteed Student Loan Amendments of 1976, H.R. 1232, 94th Cong., 2d Sess. (1976) (recent legislation was necessary to lower the GSL program's default and bankruptcy rates).

6. *See id.* at 1-12. Lenders often failed to disclose loan repayment schedules. In some cases they failed to tell the borrower that the money he received was a loan. *See* GSL PAPER, *supra* note 1, at 23. Loan collections also were mismanaged. Lenders often made no effort to collect defaulted loans. *Oversight on Truth in Lending Procedures of the Student Financial Assistance Technical Amendments Act of 1982: Hearings before the Subcomm. on Postsecondary Ed. of the Comm. on Ed. and Labor, House of Reps.*, 97th Cong., 1st Sess. 144 (1982) [hereinafter cited as *Truth in Lending Hearings*].

In 1977 the Department of Health, Education, and Welfare began sending letters to defaulters, hiring bill collectors, and promulgating regulations that required lenders to collect loans with due diligence. These practices lowered the GSL default rate from 13% in 1977 to 8.2% in 1981. *See Oversight on Student Loan Collection: Hearings before the Subcomm. on Postsecondary Ed. of the Comm. on Ed. and Labor, House of Reps.*, 97th Cong., 1st Sess. 2 (1981). In 1982 the GSL program had a 3.2% default rate. *Oversight Hearings, supra* note 2.

7. *See* Guaranteed Student Loan Amendments of 1976, H. R. 1232, 94th Cong. 2d Sess. 13-14 (1976).

8. *Id.*

9. H.R. REP. No. 595, 95th Cong., 1st Sess. 133 (1977). *See infra* note 23 and accompanying text.

10. Articles in the popular press have argued that student loan bankruptcy and default rates are unacceptably high. *See Time of Reckoning for Student Deadbeats*, U.S. NEWS & WORLD REP. 21 (July 18, 1977); *Study Now, Pay Never*, NEWSWEEK 95 (March 7, 1977); *Student Loan Mess*, TIME 8 (Dec. 8, 1975).

11. *See supra* note 10.

12. 11 U.S.C. § 523(a)(8) (1983). GSLs were nondischargeable prior to the passage of section 523(a)(8). The 1976 Education Act Amendments included a provision similar to section 523(a)(8). *See* Education Amendments of 1976, Pub. L. No. 94-482, § 439A, 90 Stat. 2081, 2041 (codified at 20 U.S.C. § 1087-3 (1976)). Section 439A of the Education Amendments provided:

> A debt which is a loan insured or guaranteed under the authority of this part may be released by a discharge in bankruptcy under the Bankruptcy Act only if such discharge is granted after the five-year period (exclusive of any applicable suspension of the repay-

student loans are nondischargeable when the debtor files the bankruptcy petition within five years of the loan's first becoming due, unless denying a discharge would impose an undue hardship upon the debtor.[13]

Most cases decided under section 523(a)(8) involve the undue hardship exception. The exception is difficult to apply because the drafters of the Bankruptcy Code did not define undue hardship.[14] The drafters said that bankruptcy courts must decide undue hardship on a case-by-case basis, considering all of a debtor's circumstances.[15] Looking for guidance in undue hardship cases, the bankruptcy courts have shaped facts and circumstances tests of undue hardship by relying on the legislative history of section 523(a)(8).

The legislative record contains a number of reasons for the passage of section 523(a)(8). Consequently, the bankruptcy courts have developed a number of different undue hardship tests.[16] This Note examines the two undue hardship tests most often used in the bankruptcy courts, the Bankruptcy Commission test, and the test developed in *In re Kohn*.[17] The primary thesis of this Note is that the results of the tests are often unfair and contribute to the waste of societal resources. The Note proposes a more just and efficient alternative to the two principal tests.

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ment period) beginning on the date of commencement of the repayment period of such loan, except that prior to the expiration of that five-year period, such loan may be released only if the court in which the proceeding is pending determines that payment from future income or other wealth will not impose an undue hardship on the debtor or his dependents.

This section was repealed in 1978 by passage of the Bankruptcy Reform Act.

Debtors considering a discharge under section 523(a)(8) also should be aware of the student loan program's deferment and forbearance provisions. *See* 34 C.F.R. §§ 674.34-674.34a (1983) (National Direct Student Loans); §§ 682.508, 682.512 (1983) (GSLs). Deferments are allowed for both illness and unemployment. 34 C.F.R. § 674.34a(b)(5) (illness); § 674.34a(h) (extraordinary circumstances); § 682.508(e) (unemployment); § 682.508(h) (illness).

Student loan debtors intending to apply for the bar should be aware that a student loan debtor has been declared unfit for legal practice because he tried to discharge a student loan. *See* Florida Bd. of Bar Examiners re: G.W.L., 364 So. 2d 454 (Fla. 1978) (bar applicant was morally unfit for legal practice because he filed for discharge of his student loans three days prior to graduation from law school). *Compare* Florida Bd. of Bar Examiners re Groot, 365 So. 2d 164 (Fla. 1978) (bar applicant was morally fit for legal practice when he discharged a student loan debt several years after graduation from college and at a time when his finances were at a low ebb).

13. 11 U.S.C. § 523(a)(8) states that:

(a) A discharge under section 727, 1141 or 1328(b) of this title . . . does not discharge an individual debtor from any debt—

. . .

(8) for an educational 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 a nonprofit institution of higher education, unless—

(A) such loan first became due before five years (exclusive of any appliable suspension of the repayment period) before the date of the filing of the petition; or

(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

14. *See Report of the Commission on the Bankruptcy Law of the United States*, H.R. Doc. No. 137, 93d Cong., 1st Sess., Pt. II, 140 (1973) [hereinafter cited as *Commission Report*].

15. *Id.*

16. Kosel, *Running the Gauntlet of "Undue Hardship"—The Discharge of Student Loans in Bankruptcy*, 11 GOLDEN GATE UNIV. L. REV. 457, 459 (1981).

17. 20 COLLIER BANKR. CAS. 2d (MB) 994 (Bankr. S.D.N.Y. 1979).

## I. THE BANKRUPTCY COURT TESTS FOR UNDUE HARDSHIP

### A. *Tests That Deny Discharges to Bankruptcy Abusers*

#### 1. *The Bankruptcy Commission Test*

In 1970, Congress formed the Commission on the Bankruptcy Laws.[18] Commission members were distinguished jurists and scholars, organized to reform the bankruptcy laws.[19] In 1973, the Commission presented a model bankruptcy code to Congress.[20] The model code's section barring student loans from discharge contained an undue hardship exception.[21]

The Commission's comments indicate that one of the reasons the Bankruptcy Code needed a nondischargeability provision was to protect the public image of the student loan programs.[22] The Commission acknowledged that very few student loans were discharged in bankruptcy.[23] Nonetheless, the Commissioners said that the few cases involving abusive student loan debtors threatened the continuation of the student loan program by tarnishing its image.[24]

The Commission's comments set out a test for undue hardship that is widely followed in the bankruptcy courts.[25] The test identifies bankruptcy abusers by measuring a student loan debtor's ability to repay his loan.[26] Debtors are denied a discharge if they have the present or future ability to repay their loans.[27] Thus, the bankruptcy abusers publicized in the newspapers—ex-students seeking discharge of large loans while on the brink of well-paying careers—cannot claim undue hardship under the Commission test since they have the future ability to repay their loans.

On the other hand, debtors with neither the present nor future ability to repay a student loan will qualify for an undue hardship discharge, provided they have not adopted an extravagant standard of living.[28] For ex-

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18. *Commission Report, supra* note 14.

19. *See id.*

20. *Id.* at Part II.

21. *Id.* at 136. This section provides in part:

> (a) *Exceptions To Discharge.* A discharge extinguishes all debts of an individual debtor, whether or not allowable, except the following: . . .
> (8) any educational debt if the first payment of any installment thereof was due on a date less than five years prior to the date of the petition and if its payment from future income or other wealth will not impose an undue hardship on the debtor and his dependents.

The Commission test differed from current law by making the creditor prove undue hardship. *See id.* at Pt. II § 4-506 n.16 (the creditor must prove that the debtor can pay the debt from future earnings or other wealth). *Compare In re* Norman, 25 Bankr. 545, 548 (S.D. Cal. 1982) (the burden of proving undue hardship is on the debtor).

22. *Commission Report, supra* note 14, at Pt. I p.170.

23. *Id.* The Commission cited an Office of Education study showing that the bankruptcy rate in the GSL program was .23% of all payable loans. *Id.* at n.5.

24. *Id.* at 177-78.

25. *Id.* at Pt. II n.17. For examples of cases that follow this test, *see In re* Boylen, 29 Bankr. 924 (W.D. Ohio 1983); *In re* Birden, 17 Bankr. 891 (E.D. Pa. 1982); *In re* Bell, 5 Bankr. 461 (N.D. Ga. 1980).

26. *See Commission Report, supra* note 14, at Pt. II § 4-506.

27. *See In re* Bell, 5 Bankr. 461, 463 (N.D. Ga. 1980) (debtor was denied a discharge after the court found that he was permanently employed in his chosen field and there was a demand for people with his skills).

28. Some courts express the same idea by saying that the debtor's inability to pay cannot be

ample, in *In re Birden*[29] a debtor borrowed $14,424.10 prior to graduating from Columbia University's law school.[30] Following graduation, he was forced to resign a high-paying job because of marital and emotional difficulties.[31] When he filed for bankruptcy, he was supported by relatives and government assistance and had been unable to find a permanent job. Nondischargeable alimony and child support payments reduced his future ability to repay his student loan.[32] The court applied the Bankruptcy Commission's ability to pay test and granted an undue hardship discharge[33] since the debtor had neither the present nor the future ability to repay his student loan.[34]

2. *The* In Re Johnson *Test*

The court in *In re Johnson*[35] developed a version of the Bankruptcy Commission test. The *In re Johnson* test consists of three parts: a mechanical test, a good faith test, and a policy test.[36] A debtor's student loan is discharged if he passes both the mechanical and the good faith tests.[37] To pass the mechanical test, the debtor must show that he is unable to repay his loan. To pass the good faith test, he must show that his inability to pay is not caused by an extravagant lifestyle or his failure to look for a job.[38] These are essentially the showings that a debtor must make under the Bankruptcy Commission's undue hardship test.[39]

Under the *In re Johnson* test, however, a debtor who has passed the mechanical test may qualify for an undue hardship discharge even though he fails the good faith test. He can still be discharged if he passes the policy test.[40] A debtor passes the policy test by proving that his education has not benefited him economically and that his dominant motive in filing for bankruptcy is not to discharge his student loan.[41]

Bankruptcy courts following *In re Johnson* rarely reach the policy test.[42] They rely on the mechanical test to determine undue hardship. These courts discharge student loans when the debtor shows he is unable to repay the debt and disallow discharges when the debtor is able to repay the debt from present or future income.[43] Hence, the Bankruptcy Commis-

self-imposed. For example, in *In re* Price, 1 Bankr. 768 (D. Hawaii 1980), the debtor was paying $2700 a year for her children's private school tuition. *Id.* at 769. The court found that her economic hardship was self-imposed and denied her discharge request. *Id.*

29. 17 Bankr. 891 (E.D. Pa. 1982).
30. *Id.* at 892.
31. *Id.*
32. *Id.* at 893.
33. *Id.*
34. *Id.*
35. 5 BANKR. CT. DEC. (CRR) 532 (E.D. Pa. 1979). For examples of cases following the *In re* Johnson test, see *In re* Lezer, 21 Bankr. 783, 788-89 (N.D.N.Y. 1982); *In re* Briscoe, 16 Bankr. 128, 131 (S.D.N.Y. 1981).
36. 5 BANKR. CT. DEC. (CRR) at 544-45.
37. *Id.*
38. *Id.*
39. *See supra* notes 25-34 and accompanying text.
40. 5 BANKR. CT. DEC. (CRR) at 544-45.
41. *Id.*
42. *See, e.g.*, cases cited *supra* note 35.
43. *See* cases cited *supra* note 35.

sion and *In re Johnson* tests generally produce the same results.

3. *The* Wegfehrt *Analysis*

Several courts that share the Bankruptcy Commission's view that section 523(a)(8) is intended to bar bankruptcy abusers have adopted an alternative analysis for identifying student loan debtors. These courts decide whether a debtor is a bankruptcy abuser by determining his motive in filing for bankruptcy.[44] The motive analysis is not an undue hardship test but creates an additional consideration for granting or denying a discharge.[45]

These courts consider a debtor's discharge request more favorably if his principal motive in filing for bankruptcy is not to discharge his student loan.[46] The courts presume that a debtor with a large non-student loan debt has a legitimate motive in filing for bankruptcy and hence is probably not a bankruptcy abuser.[47] Thus, the courts focus on the proportion of the debtor's student loan debt to his total debt.[48] If the student loan debt is proportionately small, the courts have considered this a factor favoring discharge of the student loan debt.[49]

The court adopted this analysis in *In re Wegfehrt*,[50] where the debtor's student loan was less than one percent of her total debt.[51] Her largest debt was a $200,000 default claim arising from her liability in an uninsured automobile accident.[52] The court found that the debtor was not a bankruptcy abuser because her sizable non-student loan debt indicated a legitimate need for bankruptcy.[53] The court considered this finding along with its funding of undue hardship and discharged the debtor's student loan.[54]

The court's analysis in *Wegfehrt* presents two problems. First, it allows debtors to benefit from their wrongs. The *Wegfehrt* analysis gives special consideration to debtors who have mismanaged their affairs and incurred large debts in addition to their student loan debt.[55]

Second, the *Wegfehrt* analysis is inconsistent with the legislative record. Congress considered an amendment to section 523(a)(8) that had the same effect and rationale as *Wegfehrt*. The amendment would have al-

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44. *E.g., In re* Ford, 22 Bankr. 442 (W.D.N.Y. 1982); *In re* Wegfehrt, 10 Bankr. 826 (N.D. Ohio 1981); *In re* Fonzo, 1 Bankr. 722 (S.D.N.Y. 1979).

45. *See In re* Ford, 22 Bankr. at 445; *In re* Wegfehrt, 10 Bankr. at 831-32; *In re* Fonzo, 1 Bankr. at 724.

46. *See In re* Wegfehrt, 10 Bankr. at 831-32.

47. *See In re* Ford, 22 Bankr. at 445; *In re* Wegfehrt, 10 Bankr. at 831-32; *In re* Fonzo, 1 Bankr. at 724.

A bankruptcy court has found a legitimate motive for bankruptcy when the percentage of student loan debt was 40% of the total debt. *In re* Armijo, 13 Bankr. 175 (D.N.M. 1981).

48. *See In re* Ford, 22 Bankr. at 445; *In re* Wegfehrt, 10 Bankr. at 830.

49. *See* cases cited *supra* note 48.

50. 10 Bankr. 826, 830 (N.D. Ohio 1981).

51. *Id.* at 828, 830.

52. *Id.* at 828.

53. *Id.* at 830.

54. *Id.* at 831.

55. For example, the court in *Wegfehrt* gave special consideration to the debtor's discharge request where she had caused an automobile accident while driving without insurance. *See id.* at 828-30.

lowed the discharge of student loans when they comprised less than sixty-five percent of the debtor's debt.[56] The amendment's sponsor argued that if only sixty-five percent of a debtor's debt is a student loan, the debtor has a legitimate need for bankruptcy and is not a bankruptcy abuser.[57] Congress, however, rejected the amendment.[58] Thus, Congress has considered and rejected the analysis used by the court in *Wegfehrt.*

### B. *Tests That Emphasize the Value of Education*

The legislative record contains an alternative to the Bankruptcy Commission view that the chief purpose of the nondischargeability provision is to bar bankruptcy abusers. Much of the legislative history of section 523(a)(8) suggests that Congress made student loan debts nondischargeable because student loans support education, a unique and valuable asset.[59]

Congress thought education was unique for several reasons. A debtor's education cannot be seized upon default.[60] Also, the value of an education is not immediately apparent. Thus, a debtor may appear to need bankruptcy upon graduation because his student loan debt exceeds the value of his assets.[61] In fact, student loan debtors may have no need for bankruptcy because they have a high income potential.[62] Consequently, Congress thought that a nondischargeability provision was needed to prevent recent graduates from receiving the benefits of higher education without bearing its costs.[63]

Several courts following *In re Kohn* have used the unique nature of student loans as the rationale for a stringent undue hardship test.[64] These courts have held that a debtor should not be able to avoid paying the cost of his education merely by showing present or future inability to repay his loan.[65] The debtor also is required to show that he has experienced a

56. 124 CONG. REC. 1794 (1978) (remarks of Congressman Cornell). The original version of the Bankruptcy Reform Act did not contain a nondischargeability provision for student loans. *See* H.R. REP. NO. 595, 95th Cong., 1st Sess. 132 (1977). A nondischargeability provision was initially proposed as an amendment to the House version of the Act by Congressman Ertel. *See* 124 CONG. REC. 1791 (1978) (remarks of Congressman Ertel). Congressman Cornell's proposal was an amendment of the Ertel amendment. *Id.* at 1794. Congressman Cornell's proposal was made moot when the House rejected Congressman Ertel's amendment. *Id.* at 1804.

57. *Id.* at 1794 (remarks of Congressman Cornell).

58. The Senate insisted that a nondischargeability provision be included in the Bankruptcy Reform Act, and the House relented by amending its version of the Act. 124 CONG. REC. 32,350-420 (1978). The version adopted by the Congress was that proposed by Congressman Ertel and did not contain Congressman Cornell's amendment. *Id.* at 32,362; *see supra* note 56.

59. H.R. REP. NO. 95-595, 95th Cong., 1st Sess., 133 (1977). *But see id.* at 153 (statement of Congressman Erlenborn) (student loans are no different than medical loans).

60. *See* 124 CONG. REC. 1793 (1978) (statement of Congressman Erlenborn) (a student loan debtor pledges his future earning power when he takes out a loan). Milton Friedman has argued that governmentally financed student loans are necessary because private loans to finance training cannot be adequately secured. *See* M. FRIEDMAN, CAPITALISM AND FREEDOM 102, 104 (1962).

61. H.R. REP. NO. 1232, 94th Cong., 2d Sess. 13-14 (1976).

62. *See* H.R. REP. NO. 95-595 at 133 (the lender relies solely on the debtor's increased earnings for repayment).

63. *See id.*

64. *In re* Rappaport, 16 Bankr. 615, 617-18 (D.N.J. 1981); *In re* White, 6 Bankr. 26, 28 (S.D.N.Y. 1980).

65. *See In re* Rappaport, 16 Bankr. at 617; *In re* White, 6 Bankr. at 29.

unique or exceptional hardship and that the hardship caused his inability to repay the loan.[66] Further, a hardship experienced by recent graduates in general is not considered unique or exceptional.[67] Thus, unemployment or employment in other than the debtor's chosen field will not trigger the undue hardship exception.[68] As a general rule, students are granted discharges only if they show that illness caused their inability to pay.[69]

The above analysis first requires a debtor to show that he is unable to pay his loan. In *In re Andrews*,[70] the Eighth Circuit Court of Appeals held that a debtor does not qualify for an undue hardship discharge merely by showing that he has experienced an extraordinary hardship. The bankruptcy court in *Andrews* had discharged the debtor's loan after finding that she had Hodgkin's disease.[71] On appeal, however, the Eighth Circuit remanded the case, instructing the bankruptcy court to consider whether the debtor was able to pay her loan.[72] The Eighth Circuit found that the debtor's illness was a factor to consider when determining undue hardship.[73] The court held, however, that the undue hardship issue could not be decided until the bankruptcy court determined the debtor's ability to repay her loan.[74]

The bankruptcy court in *In re Kohn*[75] considered the second showing that a debtor must make, the showing of an extraordinary hardship. The debtor in *Kohn* was barely able to pay his modest living expenses when he filed for bankruptcy.[76] His ability to repay his loan in the near future was unlikely.[77] Funding for his job had ended and he had been unable to find a new job.[78] Nonetheless, the court refused to discharge his student loan.[79] The court said that Congress intended student loans to be discharged only when the debtor experiences a hardship that makes repayment hopeless.[80]

The bankruptcy court held that the debtor's imminent unemployment

66. *See In re* Rappaport, 16 Bankr. at 617; *In re* White, 6 Bankr. at 29.

67. *See In re* Rappaport, 16 Bankr. at 617; *In re* White, 6 Bankr. at 29. Courts sometimes say that the requirement of unique or extraordinary circumstances follows from the use of the word "undue" in section 523(a)(8). *In re* Densmore, 8 Bankr. 308, 309 n.1 (N.D. Ga. 1979). Also, the legislative record supports the exceptional circumstances requirement. *See Hearings Before the Subcomm. on Civil and Constitutional Rights of the House Committee on the Judiciary on H.R. 31 and H.R. 32*, 94th Cong., 1st Sess. 1092-93 (1976) (comments of Congressman Erlenborn) (undue hardship is exceptional; it is not what affects the group generally).

68. *In re* Kohn, 20 COLLIER BANKR. CAS. 2d (MB) 994, 1007-09 (S.D.N.Y. 1979).

69. *See In re* Connolly, 29 Bankr. 978, 982 (M.D. Fla. 1983) (the debtor's health has been a primary consideration in numerous cases involving discharge of student loans); *In re* Norman, 25 Bankr. 545, 550 (S.D. Cal. 1982) (debtor's total incapacity is grounds for granting her discharge).

70. 661 F.2d 702, 704-05 (8th Cir. 1981).

71. *Id.* at 703.

72. *Id.* at 705.

73. *Id.* at 704-705. *See infra* note 69 and accompanying text.

74. *Andrews*, 661 F.2d at 705.

75. 20 COLLIER BANKR. CAS. 2d (MB) 994 (S.D.N.Y. 1979).

76. *Id.* at 1008.

77. *Id.* Thus the debtor satisfied the first showing under the *Kohn* analysis. *See supra* notes 70-73 and accompanying text.

78. 20 COLLIER BANKR. CAS. 2d (MB) at 1008.

79. *Id.* at 1009.

80. *Id.* at 1008.

was not such a hardship.[81] The court reasoned that if unemployment were a basis for discharge, debtors would come to court while unemployed, obtain a discharge, and then look for a job.[82] Since the debtor's unemployment was not an extraordinary hardship, the court held that his student loan was exempt from discharge.[83]

## II. EVALUATING THE UNDUE HARDSHIP TESTS

### A. *The Economic Value of Higher Education*

The undue hardship tests are flawed because they overestimate the economic value of higher education. The economic value of higher education has declined over the past ten years.[84] The problem is a glut of college graduates:[85] the estimated surplus of college graduates in the 1980's ranges from 2.7 million to 8 million.[86] While higher education and hard work once assured a rewarding career, many college graduates in the 1980's will be unemployed or employed in jobs that do not require college degrees.[87]

### B. *Evaluating the Bankruptcy Commission Test*

The Bankruptcy Commission's undue hardship test is unfair and contributes to the waste of societal resources. The test is unfair because it is framed too broadly. The test's purpose is to protect the public image of the student loan program by barring bankruptcy abusers from discharging their loans.[88] The test denies discharges to student loan debtors who are able to repay their loans.[89] However, not all students who seek discharges and are able to pay their loans should be considered bankruptcy abusers and denied a discharge.

Student loan debtors filing for bankruptcy should not be considered bankruptcy abusers merely because they are able to repay their loans. As a general rule, the Bankruptcy Code does not consider ability to pay when determining whether a debtor is entitled to a discharge.[90] Thus, student

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81. *Id.* at 1009. The debtor in this case, however, could have qualified for an automatic deferment. *See* 34 C.F.R. § 682, 508 (1983).

82. *Kohn*, 20 COLLIER BANKR. CAS. 2d (MB) at 1009.

83. *Id.*

84. A large number of college graduates could have earned just as much money by attending only high school. Most college graduates would have earned a greater return on the money they spent on a college education by investing it in government securities. Robinson, *Educational Disinvestment*, POLICY REVIEW 60 (Fall 1983). *See also* D.B. JOHNSTONE, STUDENT LOANS: PROBLEMS AND POLICY ALTERNATIVES 32 (L.O. Rice ed. 1977).

85. Clogg & Sullivan, *Labor Force Composition and Underemployment Trends*, 1969-1980, 12 SOC. INDICATORS RESEARCH 117, 128 (1983).

86. H.G. KAUFMAN, PROFESSIONALS IN SEARCH OF WORK; COPING WITH THE STRESS OF JOB LOSS AND UNDEREMPLOYMENT 14 (1983).

87. *Id.* at 1; *see also* Clogg & Shockey, *Mismatch Between Occupation and Schooling: A Prevalence Measure, Recent Trends and Demographic Analysis*, 21 DEMOGRAPHY 235, 246 (1984) (almost 50% of those with sixteen years of schooling—a proxy for college education—had more education than their jobs required).

88. *See supra* notes 22-24 and accompanying text.

89. *See supra* notes 26-27 and accompanying text.

90. Goetz, *Consumer Bankruptcies: Should Ability-to-Pay Condition Bankruptcy Relief?*, 27 N.Y.L. SCH. L. REV. 705, 705-10 (1983).

loan debtors are treated differently from all other debtors because they are denied discharges when they are able to repay their student loan debts.

The Bankruptcy Commission may be correct when it asserts that maintaining the public image of the student loan program requires special treatment for student loan debtors who are able to repay their debts.[91] It does not follow, however, that all student loan debtors who can repay their loans should be denied a discharge. Many student loan debtors with low-paying jobs that do not require a college degree can repay their loans. Hence, they do not qualify for an undue hardship discharge under the Commission test, even though they have not benefited economically from their loans.[92] The Bankruptcy Commission test is unfair because, by denying discharges to all debtors with the ability to repay their loans, the economic burden of supporting the student loan program is in part borne by debtors who have not benefited economically from the program. A better test would deny discharges to debtors who were able to repay their loans *and* who had benefited economically. Some courts have considered economic benefit as a factor in an undue hardship decision.[93] As will be discussed below, however, these courts have taken the minority position on the economic benefit issue.[94]

The main beneficiaries of the Bankruptcy Commission test are colleges and universities which rely on the student loan programs to maintain their enrollments.[95] The Bankruptcy Commission test benefits colleges and universities by shielding the loan programs from public criticism.[96] The student loan programs should not be shielded from criticism. Spending money to encourage high enrollments is a questionable use of societal resources when many fields are glutted with college graduates.[97] Reform of the student loan programs is unlikely, however, as long as the courts apply the Bankruptcy Commission's undue hardship test. The test keeps the loan programs' bankruptcy rate low and thereby forestalls political pressures to improve the efficiency of the student loan program.[98]

### C. *Evaluating the* In re Kohn *Test*

The *In re Kohn* test compounds the unfairness of the Bankruptcy

91. *See supra* notes 22-24 and accompanying text.

92. Bankruptcy courts often hold that employment outside a debtor's chosen field is not grounds for an undue hardship discharge. *See supra* note 68 and accompanying text; *In re* Abrams, 19 Bankr. 64, 65-66 (D. Neb. 1982).

93. *See infra* notes 106-09 and accompanying text.

94. *See infra* notes 106-09 and accompanying text.

95. *See supra* notes 31-33 and accompanying text. Social welfare programs often do not help the program's intended beneficiaries. For example, Tom Wolfe has described how the principal beneficiaries of San Francisco Poverty Programs were those who received jobs implementing the programs. The programs themselves had little effect on poor people. *See* T. WOLFE, RADICAL CHIC AND MAU-MAUING THE FLAK CATCHERS (1970).

96. CARNEGIE COUNCIL ON POLICY STUDIES IN HIGHER EDUCATION, NEXT STEPS IN THE 1980S IN STUDENT FINANCIAL AID 123-25 (1979).

97. *See supra* notes 84-87 and accompanying text.

98. In 1972 and again in 1976, high default rates prompted Congress to authorize reforms in the management of the loan programs by the United States Office of Education. Note, *Skipping Out on Alma Mater: Some Problems Involving the Collection of Federal Student Loans*, 15 COLUM. J.L. & SOC. PROBS. 317, 324-25 (1980).

Commission test. Like the Bankruptcy Commission test, the *In re Kohn* test focuses on a debtor's ability to repay his loan.[99] Under the *In re Kohn* test, however, a debtor does not qualify for a discharge merely by showing a present or future inability to repay his loan.[100] He must also show that his inability to pay is caused by extraordinary circumstances.[101] Debtors who are unable to repay their loans are often denied discharges because they cannot show that extraordinary circumstances caused their inability to pay.[102]

The *In re Kohn* test is based on the assumption that education is an economically valuable asset.[103] This assumption is often false. Many students receive no economic benefit from their education.[104] It is unfair to deny a discharge to a debtor who is unemployed or employed in a low-paying job that does not require a college education by assuming that his education is an economically valuable asset. A fairer approach would be to determine whether in fact the debtor has benefited economically from his education.[105]

## III. ALTERNATIVE UNDUE HARDSHIP TESTS

Two undue hardship tests that are fairer and more efficient than those developed by the Bankruptcy Commission and the *In re Kohn* court are described below. In contrast to the Bankruptcy Commission and *In re Kohn* tests, the two alternative tests are not widely used in the bankruptcy courts. Only one bankruptcy court has used the first test and none has used the second.

### A. *The Economic Benefit Test*

Several bankruptcy courts have rejected *In re Kohn's* presumption that education is a valuable asset.[106] Instead, they examine whether a particular debtor has benefited economically from his education.[107] These courts generally consider lack of economic benefit from an education as a factor favoring an undue hardship discharge.[108]

In *In re Yarber*,[109] however, the court used lack of economic benefit as a test of undue hardship and not merely as a factor favoring discharge. The debtor in *Yarber* completed a drafting curriculum and subsequently

99. *See supra* notes 70-74 and accompanying text.
100. *See supra* note 65 and accompanying text.
101. *See supra* note 66 and accompanying text.
102. *See supra* notes 75-83 and accompanying text.
103. *Id.*
104. *See supra* notes 84-87 and accompanying text.
105. *See infra* notes 106-16 and accompanying text.
106. *See In re* Powelson, 25 Bankr. 274, 276 (D. Neb. 1982) (student loan did not significantly increase the debtor's job skills); *In re* Clay, 12 Bankr. 251, 255 (N.D. Iowa 1981) (the debtor acquired no marketable skills while in college and his job required no college education); *In re* Fonzo, 1 Bankr. 722, 724 (S.D.N.Y. 1979) (college courses did not increase debtor's earnings).
107. *See In re* Powelson, 25 Bankr. at 276; *In re* Clay, 12 Bankr. at 255; *In re* Fonzo, 1 Bankr. at 724.
108. *But see In re* Fischer, 23 Bankr. 432, 434 (W.D. Ky. 1982) (undue hardship claims are not aided by the fact that the debtor has voluntarily chosen an unremunerative occupation).
109. 19 Bankr. 18 (S.D. Ohio 1982).

was unable to find a permanent job.[110] His income from part-time jobs was insufficient to repay his student loan debt and he filed for bankruptcy.[111] The controlling factor in the court's decision was the fact that the debtor had not derived economic benefit from his education.[112] The court held that making the debtor pay for an unmarketable education would be an undue hardship.[113] Hence, the court discharged his loan.[114]

The *In re Yarber* test is fairer than the *In re Kohn* and Bankruptcy Commission tests. Unlike the latter two tests, the *In re Yarber* test discharges debtors who have not benefited economically from their loans.[115] Thus, the *In re Yarber* test does not unfairly impose the economic burden of supporting the student loan program upon students whom the program has not benefited.[116]

The *In re Yarber* test is also more efficient than the *In re Kohn* and Bankruptcy Commission tests. If the bankruptcy courts used the *In re Yarber* test, a student loan would be discharged when the debtor's education did not improve his job prospects.[117] Thus, the student loan program's bankruptcy rates would vary in relation to the economic value of the program. The student loan program's bankruptcy rate would be low when loans enabled students to find better jobs. Conversely, the bankruptcy rate would be high when the job market is saturated with degree holders. In the past, high default rates have prompted Congress to reform the student loan programs.[118] Hence, if the *In re Yarber* test were employed, the bankruptcy rate and pressures for reform of the student loan program would rise when loans were used to provide students with unmarketable degrees.[119]

The *In re Yarber* test also is efficient because it creates an incentive for educational institutions to ensure that loan recipients graduate with marketable degrees. Educational institutions currently are required to maintain low bankruptcy rates for their student loan programs; if a school's bankruptcy rate goes above fifteen percent for its GSL recipients or twenty-five percent for its National Direct Student Loan recipients, the

110. *Id.* at 20.

111. *Id.*

112. *Id.* (the controlling factor was the small amount of present and future income attributable to the debtor's education).

113. *Id.* at 21.

114. *Id.*

115. *See supra* notes 109-14 and accompanying text.

116. *In re Yarber* appears to impose the burden of supporting the student loan program on taxpayers because they ultimately bear the cost of loan guarantee payments. The burden of supporting the student loan program, however, can be shifted to taxpayers only to a limited extent; a school loses its eligibility for the student loan program if too many of its students declare bankruptcy. *See infra* note 126 and accompanying text. Thus, *In re Yarber* shifts much of the burden of supporting the student loan program onto the schools since their student loan eligibility is lost if too many of their graduates default or declare bankruptcy.

117. *See supra* notes 109 and 114 and accompanying text.

118. *See supra* note 98.

119. The current discharge rules sever the connection between the loan programs' economic effectiveness and their bankruptcy rates. Hence, the student loan program's bankruptcy rate is low even though a glut of college graduates has reduced its economic effectiveness. *See supra* notes 9, 23, 84-87 and accompanying text.

school loses its eligibility for the program.[120] Under the *In re Yarber* test, educational institutions which graduate students with marketable degrees can maintain a low bankruptcy rate.[121] Thus, the *In re Yarber* test creates an incentive for schools to grant loans only to students capable of completing marketable degree programs.[122]

The problem with *In re Yarber* is the narrow view it takes of higher education. *Yarber* suggests that only the economic benefits of education are important. Many people argue, however, that the chief benefits of higher education are not economic.[123] Lack of economic benefit should not be a ground for discharge when a student has chosen a curriculum for its noneconomic benefits. Those who derive either economic or noneconomic benefits from their education should bear the economic burden.

### B. *Employment Information and GSLs*

Another rule that would promote fairness and efficiency in the student loan program would grant a GSL debtor a discharge if he could show that he was not provided employment information mandated by the GSL regulations. No bankruptcy court has adopted such a rule. The rule is supported, however, by bankruptcy court decisions affirming the importance of job information and the legislative history surrounding the GSL regulations.

Several bankruptcy courts have found that disclosure of job information is an important factor in determining undue hardship.[124] For example, in *In re Carter*[125] a university administrator encouraged the debtor to earn a master's degree in elementary education.[126] Following graduation, the debtor could obtain only low-paying jobs not requiring a college degree.[127] The court found that the debtor's inability to obtain a job in her chosen field was in part the result of her having a master's degree.[128] Grade schools were reluctant to hire master's degree holders because they had to be paid a higher salary.[129] The school failed to disclose this information to the debtor at the time she was encouraged to enroll in the master's degree program.[130] Hence, after finding that she passed the Bankruptcy Commission's ability to pay test, the court dismissed her student loan debt.[131]

Another case that emphasizes the importance of job information is *In*

120. 34 C.F.R. § 673.6a (1983) (NDSL program); 34 C.F.R. § 682.611 (1983) (GSL program).
121. *See supra* notes 109-14 and accompanying text.
122. At the present time many colleges and universities are recruiting students even though substantial numbers of graduates cannot find jobs. *See* H.G. KAUFMAN, *supra* note 86, at 274.
123. *See, e.g.*, J. NEWMAN, THE IDEA OF A UNIVERSITY 145 (1923) (the only end of liberal education is intellectual excellence).
124. *See infra* notes 125-34 and accompanying text.
125. 29 Bankr. 228 (N.D. Ohio 1983).
126. *Id.* at 231.
127. *Id.* at 230.
128. *Id.* at 231.
129. *Id.*
130. *Id.*
131. *Id.* at 233.

*re Littell.*[132] The debtors, husband and wife, had majored in education and English and planned to teach.[133] Following graduation, they could locate only low-paying, part-time jobs.[134] The debtors were unable to repay their student loans and filed for bankruptcy.[135] A substantial factor in the bankruptcy court's decision to discharge the debtors' student loans was whether the debtors had been inveigled into obtaining a loan and taking classes in a field which college officials knew held few job opportunities.[136] Although the court did not explicitly find that the university had duped the Littells, it partially discharged their student loans.[137]

Congress affirmed the importance of job information in 1976 when it became concerned about institutional abuse of the GSL program.[138] At that time, educational institutions were issuing guaranteed student loans to induce students to enroll in programs that did not provide job skills.[139] As part of its effort to stop educational institutions from baiting students with student loans, Congress authorized the Department of Education (DOE) to write GSL regulations.[140]

The DOE responded by promulgating regulations which require schools that prepare students for a particular trade, vocation, or career field to present prospective students with employment information.[141] A school participating in the GSL program must present each prospective student with a written statement that describes the percentage of former students employed in positions directly related to their enrollment at the school.[142] The statement must also include former students' average starting salaries.[143]

Discharging GSLs when a debtor has not received job information will promote efficiency by encouraging schools to comply with the DOE's job information regulations.[144] If students have information about their job prospects, they will be discouraged from going into debt to enroll in institutions and programs that do not provide marketable skills.[145] Hence,

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132. 6 Bankr. 85 (D. Or. 1980).

133. *Id.* at 86.

134. *Id.* at 87.

135. *See id.*

136. *Id.* at 88.

137. *Id.* at 89.

138. *See Guaranteed Student Loan Amendments of 1976*, H.R. 1232, 94th Cong. 2d Sess. 2-26 (describing abuses in the student loan programs).

139. *Id.* at 2-12.

140. *See supra* note 104 and accompanying text.

141. These regulations are at 34 C.F.R. § 682.602(b) (1983). The regulations list truck driving, teaching, and pharmacy as examples of a particular vocation, trade, or career field. *Id.* This section should be interpreted broadly to carry out the remedial purpose of the regulation. *Cf.* Myzel v. Fields, 386 F.2d 718, 733-38 (8th Cir. 1967) (a section of the Securities and Exchange Act of 1934 designating the class of persons subject to Rule 10b-5 must be interpreted broadly to carry out the remedial purpose of the statute).

142. 34 C.F.R. § 682.602(b)(1) (1983).

143. *Id.*

144. A school's eligibility for the GSL program is terminated if 15% of its former students have defaulted on their loans. *See supra* note 120 and accompanying text. Thus, a school has a strong incentive to disclose the information if nondisclosure is grounds for discharge.

145. *See* R.B. FREEMAN, THE OVER-EDUCATED AMERICAN 39-42 (1976) (there is evidence that students choose their major field in response to changes in the job market).

job information will divert societal resources away from unproductive schools and programs.

A rule making nondisclosure of job information a ground for an undue hardship discharge also would promote fairness by placing the costs of failure to provide mandated job information on the schools. A prospective student often does not know whether it makes good economic sense to borrow money to attend a school.[146] The school has access to this information. The school's failure to provide students with the information often produces a heavy cost: a debtor with a large student loan debt but without the job skills to offset the debt. The school's compliance with the DOE regulations might avoid this cost. Hence, if the cost arises, it should be placed upon the school through discharge of the debtor's student loan debt.[147]

## IV. CONCLUSION

The Bankruptcy Commission and *In re Kohn* tests of undue hardship are, at heart, ability-to-pay tests. These ability-to-pay tests were formulated at a time when a college education and hard work enabled young people to embark upon financially rewarding careers. Many recent graduates are unemployed or are employed in jobs they could have had without post-secondary education. Nonetheless, most bankruptcy courts continue to use the Bankruptcy Commission and *In re Kohn* tests, even though the tests are based on the no longer tenable assumptions that education is an inherently valuable asset and that the student loan program needs to be shielded from public criticism.

Some courts have relied on an alternative test in undue hardship cases. Instead of assuming that education is a valuable asset, these courts inquire into the economic benefit that a debtor has received from his education. This test is fairer to debtors who have not economically benefited from their education and encourages post-secondary institutions to graduate students with marketable degrees.

Bankruptcy courts could also promote fairness and efficiency by granting discharges to students who have not received federally mandated job information. The decision to attend college is arguably the most important investment decision a person can make. Few other decisions call for so vast a commitment of time, effort and money. Few other decisions will have as great an affect on a person's chances for success. Thus, it is imperative that the decision to attend college, and to take out a student loan, is made in the light of post-graduation job prospects. The results of failing to provide students with job information are graduates who are unable to repay their loans and, more importantly, a mass of graduates with high expectations but little chance of accomplishing their goals.

146. *See supra* notes 84-87 and accompanying text.
147. *See supra* note 116.