ST. JOHN'S UNIVERSITY SCHOOL OF LAW

Unqualified Student Loans are Likely Dischargeable in Bankruptcy

2021 Volume XIII No. 5

Unqualified Student Loans are Likely Dischargeable in Bankruptcy

Cristian Catanese, J.D. Candidate 2022

Cite as: *Unqualified Student Loans are Likely Dischargeable in Bankruptcy*, 13 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 5 (2021).

INTRODUCTION

As a general matter, most student loans are excepted from discharge under section 523 of title 11 of the United States Code (the "Bankruptcy Code").[1] The Bankruptcy Code prohibits discharge of certain student loans unless doing so "would impose undue hardship on the debtor and [their] dependents . . . ."[2] Student debtors seeking to discharge student loan debt must file an adversary proceeding and demonstrate "undue hardship" — a difficult burden to meet.[3] However, not all student loans may be subject to this requirement.[4]

Jurisdictions are divided on whether unqualified student loans, i.e., loans outside the cost of tuition for a Title-IV eligible school are dischargeable in bankruptcy.[5] Recent case law, however, suggests that they are.[6] This memorandum explores this issue in a twofold approach. Part I analyzes section 523(a)(8)(A)(ii), the governing provision addressing unqualified loans, as well as

---

[1] 11 U.S.C. §523(a)(8) (2018).
[2] *Id.*
[3] Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard*, 86 AM. BANKR. L.J. 495, 496 (2012).
[4] *See* McDaniel v. Navient Sols. (*In re* McDaniel), 973 F.3d 1083, 1095 (10th Cir. 2020).
[5] *See* Rumer v. Am. Educ. Servs. (*In re* Rumer), 469 B.R. 553 (Bankr. M.D. Pa. 2012).
[6] *See In re* McDaniel, 973 F.3d at 1095.

the two prevailing interpretations and their effect on dischargeability. Part II compares the different interpretations as well as the overall likelihood of discharge.

I. Section 523(a)(8)(A)(ii) of the Bankruptcy Code is the only Provision Applicable to Unqualified Loans.

Section 523(a)(8) of the Bankruptcy Code excepts four types of student loans from discharge. Included under this umbrella are government-backed and government funded educational loans,[7] qualified educational loans,[8] and "obligation[s] to repay funds received as an educational benefit, scholarship, or stipend."[9] The latter phrase was never defined by Congress, and courts have disagreed over its application to unqualified loans.[10] At issue is the phrase "educational benefit."[11] Some courts interpret the phrase as a literal benefit to education (the "Education Approach").[12] Other courts consider this phrase as a type of funding similar to stipends or scholarships (the "Funding Approach").[13] Unqualified loans are only excepted from discharge under the Education Approach.[14]

---

[7] 11 U.S.C. § 523(a)(8)(A)(i)("[A]n 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.").
[8] 11 U.S.C. § 523(a)(8)(B) ("[A]ny other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.").
[9] *See* 11 U.S.C. § 523(a)(8)(A)(ii).
[10] *See* Dufrane v. Navient Sols., (*In re* Dufrane), 566 B.R. 28, 38 (Bankr. C.D. Cal. 2017).
[11] *Id*. at 32.
[12] *See* Roy v. Sallie Mae (*In re* Roy), No. 08–33318, 2010 Bankr. WL 1523996, at *1 (Bankr. D.N.J. Apr. 15, 2010).
[13] *In re* McDaniel, 973 F.3d at 1095.
[14] *See id.*

a. Unqualified Loans are excepted from discharge under the Education Approach because the definition of "educational benefit" allows for a broad interpretation of "funds received."

Under the Education Approach, any funding that contributes to the debtor's education applies to section 523(a)(8)(A)(ii).[15] Included under this umbrella are loans for tutoring services,[16] bar review courses[17], and even ancillary expenses, such as housing and food.[18] The rationale is that the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") should be read as "encompassing a broader range of educational benefit obligations."[19]

The term "funds received" is also accorded its plain meaning.[20] Loans constitute a type of "funds received" because Congress made successive amendments expanding the scope of section 523(a)(8).[21] However, courts differ on whether the purpose of the loan should be considered over the actual use of the funds.[22] Because loans meet the criteria for "funds received," any loan used for an "educational benefit" is excepted from discharge.[23]

[15] *See* Corbin v. Corbin (*In re* Corbin), 506 B.R. 287, 296–97 (Bankr. W.D. Wash. 2014).
[16] *see In re* Roy, 2010 Bankr. WL 1523996, at *1.
[17] *See* Skipworth v. Citibank Student Loan Corp. (*In re* Skipworth), No. 09–83982, 2010 Bankr. WL 1417964, at *2 (Bankr. N.D. Ala. Apr. 1, 2010)
[18] *See* Carow v. Chase Student Loan Service (*In re* Carow)*,* No. 10–30264, 2011 Bankr. WL 802847, at *5 (Bankr. D.N.D. Mar. 2, 2011).
[19] *In re* Roy, 2010 Bankr. WL 1523996, at *1 (*quoting* Sensient Tech. Corp. v. Baiocchi (*In re* Baiocchi), 389 B.R. 828, 831 (Bankr. E.D. Wis. 2008)).
[20] *See In re* Roy, 2010 Bankr. WL 1523996, at *1.
[21] *Id*.
[22] *Compare In re* Baiocchi, 389 B.R. at 832 (holding that the use of the funds is the principal consideration) *with* Juber v. Conklin (*In re* Conklin), 606 B.R. 664 (Bankr. W.D.N.C. 2019) (holding that the purpose of the loan should be considered).
[23] *See In re* Roy, 2010 Bankr. WL 1523996, at *1.

b. Unqualified loans are dischargeable under the Funding Approach because the limited definition of "educational benefit" necessitates a narrow interpretation of "funds received."

Under the Funding Approach, the scope of "funds received" is limited to funds that qualify as educational benefits.[24] Educational benefits, in this context are programs such as the GI Bill, which need not always be repaid.[25] Scholarships and stipends share this same quality, but loans do not.[26] Therefore, unqualified loans are not applicable under the provision.[27] Support for the Funding Approach can be found throughout bankruptcy courts in almost every federal jurisdiction,[28] as well as the Court of Appeals in both the Fifth and the Tenth Circuits.[29]

In *In re Crocker*, two individuals obtained loans from the same private lender to pay for education expenses before they defaulted and filed for bankruptcy.[30] Both parties argued that their unqualified loans did not fall within section 523(a)(8)(A)(ii), and the court agreed.[31] In doing so, the court noted how Congress included the word "loan" in both sections 523(a)(8)(A)(i) and 523(a)(8)(B) but excluded it from section 523(a)(8)(A)(ii).[32] The canon of surplusage therefore precluded its use.[33] Furthermore, educational benefit, scholarship, and stipend all share the same common quality that they need not be repaid, and the principle of *noscitur a sociis* requires that

[24] Crocker v. Navient Sols., L.L.C. (*In re* Crocker), 941 F.3d 206, 217 (5th Cir. 2019).
[25] *See In re* McDaniel, 973 F.3d at 1100–1.
[26] *Id*.
[27] *See id.*
[28] *See* Wiley v. Wells Fargo Bank, N.A. (*In re* Wiley), 579 B.R. 1 (Bankr. D. Me. 2017); Homaidan v. SLM Corp. (*In re* Homaidan), 596 B.R. 86 (Bankr. E.D.N.Y. 2019); Nypaver v. Nypaver (*In re* Nypaver), 581 B.R. 431 (Bankr. W.D. Pa. 2018); Essangui v. SLF V-2015 Trust (*In re* Essangui), 573 B.R. 614 (Bankr. D. Md. 2017); DeWine v. Dudley (*In re* Dudley), 614 B.R. 277 (S.D. Ohio 2020); Swenson v. Swenson (*In re* Swenson), No. 16-10016, 2016 Bankr. LEXIS 3117, at *7 (Bankr. W.D. Wis. Aug. 22, 2016); Accounts Mgmt. v. Vasa (*In re* Vasa), No. 14–40109, 2014 Bankr. LEXIS 4787, at *1 (Bankr. D.S.D. Nov. 19, 2014); Dufrane v. Navient Solutions (*In re* Dufrane), 566 B.R. 28 (Bankr. C.D. Cal. 2017). McDaniel v. Navient Sols. LLC (*In re* McDaniel), 973 F.3d 1083, 1095 (10th Cir. 2020); *In re* Crocker, 941 F.3d 206, 221 (5th Cir. 2019).
[29] *See id.* 1105.
[30] *In re* Crocker, 941 F.3d at 209.
[31] *Id*. at 211, 224.
[32] *Id*. at 219–20.
[33] *Id*. at 220.

words should be limited in context by the company they keep.[34] Because loans must always be repaid, they do not fall within the scope of the provision.[35]

The court supported its determination using legislative history.[36] The language of section 523(a)(8)(A)(ii) was enacted into law in 1990 and generally interpreted to be a new category of nondischargeable debt, despite being part of section 523(a)(8)(A)(i).[37] During the 2005 amendment process, Congress did not alter the express language of (now) section 523(a)(8)(A)(ii), but merely placed it in its own subsection.[38] Therefore, the principle that if a phrase has enjoyed uniform interpretation by the courts, subsequent enactments of the law using the same language shall be construed the same, applied.[39] Finally, the court noted that the express purpose of the 2005 amendment was to encourage an increase in commercial lending through the addition of section 523(a)(8)(B).[40] Therefore, expanding the definition of "educational benefit" is improper.[41]

In the second seminal case, *In re McDaniel*, the 10th Circuit applied the same rationale that the Fifth Circuit outlined in *In re Crocker*.[42] However, the *McDaniel* court also gave credence to the definition of "benefit" by the Supreme Court.[43] A loan is inconsistent with this definition, as well as with the layperson's use of "benefit" in common parlance.[44] Therefore, loans are not applicable to section 523(a)(8)(A)(ii).[45]

---

[34] *Id*. at 219.
[35] *Id*. at 221.
[36] *Id*. at 221–22.
[37] *Id*.
[38] *Id*.
[39] *Id*. at 223.
[40] *Id*.
[41] *Id*. at 224.
[42] *In re* McDaniel, 973 F.3d at 1083–1105.
[43] *Id*. at 1096 (noting that the Supreme Court defined benefit as "something that guards, aids, or promotes the well-being: advantage, good; useful aid; payment, gift [such as] . . . a cash payment or service provided for under an annuity, pension plan, or insurance policy.").
[44] *Id*.
[45] *Id*. at 1096–7.

II. Most Jurisdictions Allow Unqualified Loans to be Discharged.

The differences between the two standards are slight yet significant. The Education Approach does not interpret "educational benefit" as a type of funding, but as a literal benefit to education.[46] Correspondingly, the scope of "funds received" is free from the contextual limitations inherent in the Funding Approach.[47] Adherents essentially read the provision as "an obligation to repay funds received *for* an educational benefit, scholarship, or stipend."[48] Any loan benefiting a debtor's education may be excepted from discharge.

By contrast, the Funding Approach interprets "educational benefit" as a type of funding.[49] Contextual indicators such as the common qualities shared between benefit, scholarship, and stipend are then used to narrow the scope of eligible funds applicable to the provision.[50] Student loans do not share theses same characteristics and are therefore dischargeable.[51]

Recent case law suggests that the Funding Approach is the predominant interpretation of section 523(a)(8)(A)(ii).[52] The Tenth Circuit and the Fifth Circuit Court of Appeals have both adopted this approach,[53] as well as various courts in almost every federal circuit, even where the Education Approach was previously used.[54] While competing interpretations may still be found, almost every decision after 2016 has utilized the Funding Approach.[55]

---

46 *See In re* Roy, No. 08–33318, 2010 Bankr. WL 1523996, at *1.
47 *See In re* Skipworth, No. 09–83982, 2010 Bankr. WL 1417964, at *2.
48 *In re* Crocker, 941 F.3d at 221.
49 *Id*. at 223–24.
50 *In re* McDaniel, 973 F.3d at 1096.
51 *Id*.
52 *See In re* Crocker, 941 F.3d at 223–24; *see also In re* McDaniel, 973 F.3d at 1095.
53 *Id*.
54 *See In re* Baiocchi, 389 B.R. at 832. *Cf*. Swenson v. Swenson (*In re* Swenson), No. 16-10016, 2016 Bankr. LEXIS 3117, at *7 (Bankr. W.D. Wis. Aug. 22, 2016).
55 *Id*.

The one exception are bankruptcy courts within the Eighth Circuit, where two cases have concluded that the Education Approach is correct.[56] However, no court in this jurisdiction has addressed the issue since 2014, and enough case law has since developed to suggest that an argument in favor of the Funding Approach may be successful.

CONCLUSION

The predominant interpretation of section 523(a)(8)(A)(ii) of the Bankruptcy Code suggests that unqualified student loans are dischargeable in bankruptcy absent the undue hardship requirement.[57]

[56] Carow v. Chase Student Loan Service (*In re* Carow), No. 10–30264, 2011 Bankr. WL 802847, at *5 (Bankr. D.N.D. Mar. 2, 2011); Accounts Mgmt. v. Vasa (*In re* Vasa), No. 14–40109, 2014 Bankr. LEXIS 4787, at *1 (Bankr. D.S.D. Nov. 19, 2014).
[57] *In re* McDaniel, 973 F.3d at 1095.