ST. JOHN'S UNIVERSITY
SCHOOL OF LAW

Non-Dischargeability of Foreign Student Loans

2017 Volume IX No. 3

Non-Dischargeability of Foreign Student Loans

Andrew Brown, J.D. Candidate 2018

Cite as: *Non-Dischargeability of Foreign Student Loans*, 9 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 3 (2017).

Introduction

Educational loans made, insured, or guaranteed by a governmental unit are not dischargeable in a bankruptcy case, unless the debtor obtains a hardship determination.[1] This is true even if the loan is made, insured, or guaranteed by a foreign governmental unit.[2] The rationale behind making it difficult to discharge student loans via the United States Bankruptcy Code (the "Code") is to prevent abuses of the educational loan system, specifically students filing for bankruptcy shortly after graduation to discharge their loans.[3]

Various circuit courts have adopted two tests when applying the undue hardship provision of section 532(a)(8).[4] In 1987, the Second Circuit in *Brunner v. New York State Higher Educ. Services Corp*., 831 F.2d 395 (2d Cir. 1987), laid out a three-part test which the majority of other circuits have followed when making a hardship determination under section 523(a)(8).[5]

---

[1] 11 U.S.C. § 523(a)(8); *see also Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 450 (2004).
[2] *In re Mulley,* No. 2:15-AP-01446-RK, 2016 WL 1445800, *1, at *4 (Bankr. C.D. Cal. Apr. 11, 2016).
[3] *See* 4-523 Collier on Bankruptcy ¶ 523.14 (16th 2016).
[4] *See Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1307 (10th Cir. 2004)
[5] *See In re Coco*, 335 F. App'x 224, 226 (3d Cir. 2009) ("[w]e, along with the majority of our sister courts, assess whether a debtor faces undue hardship by employing the three-pronged test set forth in *Brunner*.…")

However, the Eighth Circuit has consistently rejected the *Brunner* test in favor of a less restrictive "totality of the circumstances" test.[6]

The purpose of this memo is to determine which circuit a debtor would have the best chance of having their student loan discharged in bankruptcy. Part I of this memo discusses when section 523(a)(8) applies; Part II analyzes the *Brunner* hardship determination; and Part III explores the Eighth Circuit's "totality of the circumstances" test.

I. Governmental Unit; Loan; Educational Loan -- Does the debt fall within section 523(a)(8)?

Section 523(a)(8) of the Code, provides that a discharge during bankruptcy proceedings will not include an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, unless if excepting such debt from discharge would impose an undue hardship on the debtor and the debtor's dependents. Thus, under section 523(a)(8), a debt that is (1) an educational loan and (2) backed by a governmental unit will not be dischargeable absent a hardship determination.

A. The Debt is an Educational Loan

Because the term "loan" is not defined in the Code, courts have interpreted "loan" with its established meaning.[7] According to the Second Circuit, "[t]o constitute a loan there must be (i) a contract, whereby (ii) one party transfers a defined quantity of money, goods, or services, to another, and (iii) the other party agrees to pay for the sum or items transferred at a later date. This definition implies that the contract to transfer items in return for payment later must be reached prior to or contemporaneous with the transfer."[8] The mere fact that a school has allowed

[6] *See In re Long*, 322 F.3d 549 (8th Cir. 2003).
[7] *See In re Merch.*, 958 F.2d 738, 740 (6th Cir. 1992).
[8] *Cazenovia Coll. v. Renshaw*, 222 F.3d 82, 88 (2d Cir. 2000).

a student to attend classes despite the student's failure to pay tuition does not transform the student's delinquent tuition payments into a loan subject to section 523(a)(8).

A loan is an educational loan if the proceeds are dispensed for educational purposes.[9] Thus, even if the proceeds of the loan are used on something other than educational expenses such as living expenses, travel expenses, etc., it will not render part of the federally guaranteed student loans dischargeable.[10]

B. The Student Loan is Backed or Insured by a Governmental Unit

Section 101(27) of the Code defines the term "governmental unit" as the "United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government." Bankruptcy courts have concluded that, "or other foreign or domestic governments," includes all foreign and domestic governments, not just the ones covered by the "foreign state" clause listed towards the beginning of the section.[11]

II. The *Brunner* Hardship Determination Test[12]

A. Brunner hardship determination test

In *Brunner*, the Second Circuit laid out the majority approach for evaluating the dischargeability of student loan debt.[13] Under the *Brunner* test, student loan debt is

[9] *In re Murphy*, 282 F.3d 868 (5th Cir. 2002).
[10] *See Matter of Barth*, 86 B.R. 146, 148–49 (Bankr. W.D. Wis. 1988).
[11] *See Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055, 1057 (9th Cir. 2004) (explaining how the catch all phrase at the end of section 101(27) means that all foreign and domestic governments are meant to fall within "governmental unit"); *see also Mulley,* 2016 WL 1445800, at *4 (holding a "governmental unit," as defined by section 101(27), included foreign states, including the Canadian government).
[12] The burden of obtaining a hardship determination is on the debtor. *See Hood*, 541 U.S. at 450; *see also* S. Rep. No. 989, 95th Cong., 2d Sess. 79 (1978) (provision intended to be self-executing).
[13] 831 F.2d at 396; *see also Coco*, 335 F. App'x at 226; *Tetzlaff v. Educ. Credit Mgmt. Corp.*, 794 F.3d 756, 758 (7th Cir. 2015), *cert. denied*, 136 S. Ct. 803 (2016); *Polleys*, 356 F.3d at 1309 (adopting *Brunner* framework with qualification that it "must be applied such that debtors who truly cannot afford to repay their loans may have their

dischargeable if: (1) the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living if forced to repay the loans; (2) there are indications that the state of affairs is likely to persist for a significant portion of the repayment period; and (3) the debtor made a good faith effort to repay the loans.[14] The Courts do not construe "undue hardship" lightly, the debtor's situation must be extraordinary and lasting.[15] By applying these factors, a bankruptcy judge can determine whether payment of the debt will cause undue hardship on the debtor, defeating the fresh start concept of the bankruptcy laws.[16] The three prongs of the *Brunner* test are discussed in greater detail below.

(i) The debtor cannot maintain a minimal standard of living based on current income and expenses

Under the first prong of the *Brunner* test, the debtor must show that they cannot maintain, based on current income and expenses, a minimal standard of living for themselves or their dependents if forced to repay the student loan.[17] A court will evaluate the debtor's income and living expenses taking into consideration the particular circumstances of the case, as well as the debtors need for care, including food, shelter, clothing, transportation, medical treatment, and recreation.[18] Bankruptcy courts do not expect the debtor to become destitute to repay an outstanding student loan.[19] Nor will a court go through a debtor's budget dollar-for-dollar

---

loans discharged"); *Hemar Ins. Corp. of Am. v. Cox*, 338 F.3d 1238 (11th Cir. 2003); *In re Pena*, 155 F.3d 1108 (9th Cir. 1998); *Cheesman v. Tennessee Student Assistance Corp.*, 25 F.3d 356 (6th Cir. 1994), *cert. denied,* 513 U.S. 1081 (1995).

[14] *Brunner*, 831 F.2d at 396.

[15] *See U.S. v. Russo*, 708 F.2d 209 (6th Cir. 1983) (holding that undue hardship in the context of section 523(a)(8) exists as a result of unique factors which expectation of repayment virtually non-existent unless by the effort of the bankrupt strips himself of all that makes life worth living).

[16] *See* 4-523 Collier on Bankruptcy ¶ 523.14.

[17] *Brunner*, 831 F.2d at 396.

[18] *See Ivory v. United States*, 269 B.R. 890 (Bankr. N.D. Ala. 2001).

[19] *See Pennsylvania High Educ. Assistance Agency v. Faish*, 72 F.3d 298 (3d Cir. 1995).

attempting to find every possible way to create or increase surplus to pay the student loans back.[20]

(ii) Indications that the state of affairs is likely to persist for a significant portion of the repayment period

The second *Brunner* prong is known as the "additional circumstances" test. This part of the analysis requires the bankruptcy court to predict the likelihood that the debtor's financial hardship will persist for a significant portion of the repayment period.[21] Rather than requiring a "certainty of hopelessness," a court's determination of the debtor's financial situation must be based on realistic factual assessment of the debtor's financial prospects and not on the court's own unfounded optimism that the debtor's fortunes will improve.[22] Under this prong, the court should consider the debtor's education, health, and other relevant circumstances.[23] Additionally, a debtor is not limited to serious illness, psychological problem, disability of the debtor or a dependent but rather it is sufficient for the debtor to establish by any circumstances that his or her financial distress is likely to continue and the inability to pay will likely persist for a significant portion of the repayment period.[24] There has been little discussion on what constitutes "a significant portion."[25]

(iii) The debtor made good faith efforts to repay the loans

The final prong of the *Brunner* test assumes that "undue hardship" encompasses a notion that the debtor's financial distress and default should not have been caused by the debtor's own

[20] *See Cline v. Illinois Student Loan Assistance Ass'n*, 248 B.R. 347 (8th Cir. 2000).
[21] *See Polleys*, 356 F.3d at 1310.
[22] *See id*.
[23] *See* 4-523 Collier on Bankruptcy ¶ 523.14.
[24] *See Nys v. Educational Credit Mgmt. Corp*., 308 B.R. 436 (9th Cir. 2004).
[25] *See Mayer v. Pennsylvania Higher Education Assistance Agency*, 198 B.R. 116 (Bankr. E.D. Pa. 1996) (5 out of 10 years is a significant portion) *cf Educational Credit Mgmt. Corp. v. Coleman*, 560 F.3d 300 (9th Cir. 2009) (for a 30-year loan, five-year duration is not a significant portion of the repayment period).

willingness or negligence, but rather by factors beyond the debtor's control.[26] Good faith is demonstrated by showing that the debtor failed to make payment, through no fault of his or her own, or that he or she never had the ability to pay in the first place.[27] To determine if a debtor is making a good faith effort to repay their loan, the court considers a debtor's efforts to obtain employment, maximize income, and minimize expenses; including the debtor's efforts to minimize student loan repayment.[28]

III. The Minority "Totality of the Circumstances" Test applied by the Eight Circuit

The Eighth Circuit, holding the minority view among the circuits, has consistently rejected the *Brunner* test in favor of a less restrictive "totality of the circumstances" test.[29] *Long* explains, that under *Brunner*, a debtor is required to satisfy all three prongs in order to prove undue hardship, and if a debtor fails to satisfy any of the three prongs, the inquiry ends and the student loan is not dischargeable.[30] Thinking that adhering to such strict parameters would diminish the inherent discretion contained in section 523(a)(8), *Long* embraced a less restrictive "totality of the circumstances" approach to the undue hardship inquiry.[31] The *Lon*g court held that fairness and equity required each undue hardship case to be examined on the unique facts and circumstances surrounding the debtor.[32]

The factors considered pursuant to the "totality of the circumstances" test are: (i) the debtor's past, present, and reasonably reliable future financial resources; (ii) a calculation of the debtor's, and the debtor's dependents, reasonable necessary living expenses; and (iii) any other

---

[26] *See Faish*, 72 F.3d at 305.
[27] *See Great Lakes Higher Education Corp. v. Brown*, 239 B.R. 204 (S.D. Cal. 1999).
[28] *See Hedlund v. Educational Resources Institute, Inc.*, 718 F.3d 848 (9th Cir. 2013); *In re Mosko*, 515 F.3d 319 (4th Cir. 2008).
[29] *See Long*, 322 F.3d at 554; *In re Shaffer*, 481 B.R. 15 (8th Cir. 2012); *see also Polleys*, 356 F.3d at 1307 (explaining that most circuits have adopted the three-factor test in *Brunner* but the Eighth Circuit instead adopted a "totality of the circumstances" test to determine undue hardship).
[30] *See Long*, 322 F.3d at 554.
[31] *See id*.
[32] *See id*.

relevant facts and circumstances surrounding each particular case.[33] The "totality of the circumstances" test considers these factors and determines if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt, while still allowing for a minimal standard of living, if it does than the debt will not be discharged.[34]

IV. Conclusion

Where a debtor files for bankruptcy will have a big effect on whether they will be able to get their outstanding student loans discharged via a hardship determination. The Eight Circuit's threshold for obtaining a hardship determination is more debtor friendly than the *Brunner* test used by the majority of other Circuits.[35] Under the Eight Circuit's examination, there is no "good faith" effort prong for the debtor to satisfy. The Eighth Circuit focuses on the debtor's ability to repay the student loan, rather than on the effort made up to that point. Additionally, instead of adhering to the strict parameters of a particular test, the "totality of the circumstances test" weighs a number factors when making a hardship determination. This means less hoops for a debtor to jump through in order to obtain a hardship determination. Instead of forcing the debtor to satisfy three separate prongs to obtain a hardship determination, the "totality of the circumstances" test applied by the Eighth Circuit allows a debtor to present all the facts and circumstances surrounding the case for the court to consider while making its determination.

---

[33] *See id*.
[34] *See id*. at 554-55.
[35] The states located within the 8th Circuit are Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota. The 8th Circuit is headquartered in St. Louis Missouri, which falls within the Eastern District of Missouri. Venue in a bankruptcy case is governed by 28 U.S.C. § 1408, which provides that a debtor may file his or her bankruptcy case in any district where: (1) the debtor's domicile, residence, principal place of business, or principal assets are located, or (2) an affiliate, general partner or partnership of the debtor has a case pending. 28 U.S.C. § 1412 governs change of venue, stating "A district court may transfer a case or proceeding under title 11 to a district court for another district, in the interest of justice or for the convenience of the parties." A full copy of the Local Rules for The United States Bankruptcy Court in the Eastern District of Missouri can be found on the Court's website at http://www.moeb.uscourts.gov/rules.htm. *Pro Se* Debtors should make sure they note the requirement for Pre-Petition Credit Counseling. 11 U.S.C. § 109(h) requires an individual debtor to obtain a briefing (called credit counseling) within the 180 day period prior to filing a bankruptcy petition, regardless of chapter. A possible consequence of failing to obtain the Pre-Petition Credit Counseling before filing a bankruptcy petition is dismissal of the bankruptcy petition.