

PUNISHING OUR PROFESSIONALS: WHY STUDENT LOANS SHOULD BE NON-CONSUMER DEBT

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I. INTRODUCTION

Education is a double-edged sword. The vast majority of students want to pursue education to its fullest, but must take out loans or seek other financial aid to pay tuition, fees, and living expenses. As a result, “[a]t least half of all students who start a postsecondary education program receive student loans. [Further, t]he likelihood of borrowing depends on the type of educational program attempted.”¹ Students pursuing a graduate school education are especially likely to incur debt; sixty-five percent of 2012 graduates who borrowed \$50,000 or more were graduate students.”² The average graduate student now owes \$57,600, and “[o]ne-quarter of graduate students borrow nearly \$100,000.”³

Student loans mean that knowledge comes at a price: nondischargeable student debt. While many debts are dischargeable, the Bankruptcy Code exempts student loans from discharge unless the

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¹ BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS 92 (Katherine Porter ed., Stanford University Press 2012).

² The Hechinger Report, *Heaviest Debt Burdens Fall On 3 Types of Students*, U.S. NEWS (June 8, 2015, 8:28 AM), <http://www.usnews.com/news/articles/2015/06/08/heaviest-college-debt-burdens-fall-on-3-types-of-students>.

³ Allie Bidwell, *How Much Loan Debt is From Grad Students? More Than You Think*, U.S. NEWS (Mar. 15, 2014, 11:38 AM), <http://www.usnews.com/news/articles/2014/03/25/how-much-outstanding-loan-debt-is-from-grad-students-more-than-you-think>.

debtor faces an “undue hardship” in paying the loan.⁴ Student loans “account for the second highest form of consumer debt behind mortgages,”⁵ and the effects of 1.2 *trillion* dollars of collective nondischargeable student debt burden graduates who are beginning their careers and reduce their ability to participate in our consumer-based economy.⁶ Additionally, if postgraduate students find themselves in bankruptcy after graduate school with outstanding student loans, they may not notice that the student loan debt is most often classified as a “consumer debt.”⁷

When student loans are classified as consumer debt, postgraduate student debtors are often subject to the “means test.” The means test analyzes a debtor’s eligibility for Chapter 7 bankruptcy relief; if the income of the debtor combined with that of his or her spouse is equal to or less than the corresponding median income, then no party may move for dismissal of the debtor’s case based upon a presumption of “abuse.”⁸ However, if the debtor fails the means test, the debtor is forced into a Chapter 13 repayment plan in lieu of a Chapter 7 “liquidation” plan, which is often preferred by debtors.⁹ The U.S. Trustee or the court will file a motion to dismiss the debtor’s case or will convert it to a Chapter 13 case, which can only be done if the debtor consents.¹⁰

The trigger for the applicability of the means test is when the debts are determined to be “primarily consumer” in nature under Section 707(b)(1).¹¹ Student loans are often considered to be consumer debt

⁴ 11 U.S.C. § 523(a)(8) (2010).

⁵ Chris Denhart, *How The \$1.2 Trillion College Debt Crisis Is Crippling Students, Parents And The Economy*, FORBES (Aug. 7, 2013, 12:30 PM), <http://www.forbes.com/sites/specialfeatures/2013/08/07/how-the-college-debt-iscrippling-students-parents-and-the-economy/#1079f5831a41>.

⁶ Laura Lorenzetti, *Students Take to the Streets to Protest Ballooning Debt*, FORTUNE (Nov. 12, 2015, 2:44 PM), <http://fortune.com/2015/11/12/student-debt-protest/>.

⁷ See generally 11 U.S.C. § 101(8) (2010).

⁸ 11 U.S.C. § 707(b)(7) (2010).

⁹ See *id.* § 707(b)(1) – (b)(2).

¹⁰ See *id.* § 707(b)(1).

¹¹ *Id.* § 707(b)(1).

because they are found to be pursued for personal reasons.¹² Thus, postgraduate students' obligations are often found to be "primarily consumer," preventing the postgraduate debtors from filing Chapter 7 bankruptcy. Consequently, Chapter 13 bankruptcy is often the only option for postgraduate debtors. Student loans can be more difficult to pay under a Chapter 13 plan because postgraduate debtors are assigned a strict, three- to five-year debt repayment plan by the Bankruptcy Court.¹³

If student loan debt, particularly student loans for postgraduate and professional degrees that are meant to qualify for a job, profession, or business, could be classified more leniently as "nonconsumer debt,"¹⁴ then postgraduate debtors in bankruptcy would have a better chance to qualify for the more flexible Chapter 7 liquidation plan and not be subject to the means test or other suspicions of abuse. However, protections should exist with this proposal. Not all postgraduate debtors who take out student loans to get a professional degree should be allowed to qualify for this benefit because some postgraduate debtors may attempt to abuse Chapter 7 to wipe out their obligations. Such cases should be converted to Chapter 13. Additionally, postgraduate debtors should have the burden of proof to demonstrate that they pursued their education in good faith as the "honest but unfortunate" debtor for whom Chapter 7 was intended to give a fresh start.¹⁵ This article examines the possibility of allowing such an opportunity to the honest but unfortunate postgraduate debtors.

¹² See BIDWELL, *supra* note 3 (discussing the amount of graduate students' debt).

¹³ 11 U.S.C. § 1322(d) (2010).

¹⁴ See 11 U.S.C. § 101(8) (2010) (a "nonconsumer debt" is not defined in the Bankruptcy Code; it is any debt that is not "consumer debt" under 11 U.S.C. § 101(8)).

¹⁵ *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 192 (1902) (an early case where the Supreme Court of the United States noted that the "honest and unfortunate debtor" is a matter of public concern).

II. STUDENT LOAN BASICS

A. *A Primer on Student Loans*

While students use grants, work study opportunities, scholarships, tax benefits, and family or personal money to help fund school costs, loans typically make up a sizeable portion of higher education funding. Student loans fall into one of two broad categories: federal/public student loans and private student loans made by private third party, like a bank or school.

For federal student loans, the federal government “guarantees lenders that the government will repay student loans in the event of a borrower's default, bankruptcy, or death. This guarantee is necessary to fund education because most lenders would otherwise refuse to fund a student's pursuit of higher education.”¹⁶ Nearly all federal student loans are funded by the federal government through the U.S. Department of Education (“USDE”).¹⁷ There are two main federal student loan programs established by Congress: the Direct Loan Program¹⁸ and the Perkins Loan Program.¹⁹ Various types of loans are funneled through each of these two programs, such as subsidized loans, unsubsidized loans, PLUS loans, and consolidation loans.²⁰ Details about the various types of student loans are outside the scope of this paper, but are discussed further on the USDE’s Federal Student Aid website.²¹ A

¹⁶ Seth J. Gerson, *Separate Classification of Student Loans in Chapter 13*, 73 WASH. U. L. Q. 269, 280 (1995) (citing Caspar W. Weinberger, *Reflection on the Seventies*, 8 J.C. & U.L. 451, 454 (1981)).

¹⁷ A student debtor’s college is the lender for Perkins loans. Office of Federal Student Aid, *Federal Student Loan Programs*, <https://studentaid.ed.gov/sa/sites/default/files/federal-loan-programs.pdf> (October 2015).

¹⁸ Established by the Health Care and Education Reconciliation Act, Pub. L. 111–152, 124 Stat. 1029 (2010).

¹⁹ Formally known as the “National Direct Student Loan” (“NDSL”) program.

²⁰ Office of Federal Student Aid, *Types of Aid*, <https://studentaid.ed.gov/sa/types/loans#types> (last visited October 25, 2016).

²¹ *Id.*

highlight of many federal student loans is that student debtors are generally not required to make payments on the loans while in school while at least a half-time student.²²

There are various reasons why students may not be eligible for a federal loan. Some students may not have an eligible legal immigration status.²³ Some students may not be able to be enrolled at least half-time.²⁴ Some students may not meet the “exceptional financial need” requirement for direct subsidized loans or the Perkins loans.²⁵ Some students’ credit history may not allow them to qualify for a PLUS loan.²⁶ If students are not eligible for a federal loan, they miss out on several benefits: low fixed interest rates, income-based repayment plans, cancellation for certain employment, and deferment (postponement) options.²⁷

If students cannot qualify for a federal loan or if the amount the government lends them maxes out and is not enough to cover the costs of their education, then students’ next option is to seek private loans from a third party, like banks or schools. While these loans can help close the gap to fund students’ educations, the loans provided by private entities generally have higher, variable interest rates; require payments while students are still in school; and may require an established credit

²² Office of Federal Student Aid, *Subsidized and Unsubsidized Loans*, <https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized> (last visited October 25, 2016).

²³ Office of Federal Student Aid, *Basic Eligibility Criteria*, <https://studentaid.ed.gov/sa/eligibility/basic-criteria> (last visited April 26, 2016).

²⁴ *Id.*

²⁵ Office of Federal Student Aid, *Subsidized and Unsubsidized Loans*, <https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized#subsidized-vs-unsubsidized> (last visited October 26, 2016).

²⁶ Office of Federal Student Aid, *PLUS Loans*, <https://studentaid.ed.gov/sa/types/loans/plus#eligibility> (last visited October 26, 2016).

²⁷ Office of Federal Student Aid, *Federal Student Loan Programs*, <https://studentaid.ed.gov/sa/sites/default/files/federal-loan-programs.pdf> (October 2015).

history.²⁸ In taking into account all the different types of loans, interest rates, and the loans' respective sources, college or graduate school can quickly become expensive.

B. *The Reason for the Student Loan Surge*

The spike in student loans over the past 30 years illustrates the need for allowing student loans to be classified as nonconsumer debt in certain circumstances. The spike is not merely due to the ordinary inflation rate of money. "Since 1985, the overall Consumer Price Index ["CPI"] has risen 115% while the college education inflation rate has risen nearly 500%."²⁹ "If the cost of college tuition was \$10,000 in 1986, it would [in 2007] cost the same student over \$21,500 if education had increased as much as the average inflation rate[,] but instead education is \$59,800[,] or over 2 ½ times the inflation rate."³⁰

The sharp increase in student loans is due to several culprits, the first being increased university labor costs and spending, largely made up of administrative costs,³¹ student amenities,³² and construction costs for new buildings.³³ "Between 1993 and 2007, total university expenses rose 35%. [A]dministration expenses rose a whopping 61% and instruction

²⁸ Office of Federal Student Aid, *Federal Versus Private Loans*, <https://studentaid.ed.gov/sa/types/loans/federal-vs-private> (last visited October 26, 2016).

²⁹ Steve Odland, *College Costs Out Of Control*, FORBES (Mar. 24, 2012, 5:20 PM), <http://www.forbes.com/sites/steveodland/2012/03/24/college-costs-are-soaring/#3b920a5c641b>.

³⁰ Gordon H Wadsworth, *THE COLLEGE TRAP: WEB-BASED FINANCIAL GUIDE FOR STUDENTS AND PARENTS* (2007).

³¹ ODLAND, *supra* note 29.

³² Cara Newlon, *The College Amenities Arms Race*, FORBES (July 31, 2014, 12:49 PM), <http://www.forbes.com/sites/caranewlon/2014/07/31/the-college-amenities-arms-race/#441f995e1f3c>.

³³ ODLAND, *supra* note 29.

expenses rose 39%.”³⁴ In 2015 alone, schools spent more than \$11 billion on construction.³⁵

While some universities have been increasing costs, many jurisdictions have been deeply cutting their funding for higher education since the 2008 recession, causing many universities to make up for lost income by increasing prices. “Compared with the 2007-08 school year, when the recession hit, adjusted for inflation . . . [e]very state except Alaska, North Dakota, and Wyoming has cut per-student funding,” while “[s]tate spending on higher education nationwide is down an average of . . . 20.3 percent.”³⁶ Most states have reversed that trend, but many other states, including Tennessee, continued to cut funding into the 2014-15 school year.³⁷

An accelerating demand for higher education has also caused prices to rise, causing students to take out more loans. “College-enrollment [has risen] by 138% over the past 40 years.”³⁸ Because higher education is perceived to be a necessity, the education services industry is not cyclical, resulting in “demand . . . remain[ing] strong [despite shifts in] the economy.”³⁹ This perceived necessity drives students to “tolerate

³⁴ Steve Odland, FORBES, *College Costs Out Of Control*, <http://www.forbes.com/sites/steveodland/2012/03/24/college-costs-are-soaring/#3b920a5c641b> (Mar. 24, 2012).

³⁵ COLLEGE PLANNING AND MANAGEMENT, *CAMPUS CONSTRUCTION 2015*, [HTTPS://WEBCPM.COM/RESEARCH/2016/02/CAMPUS-CONSTRUCTION.ASPX?TC=PAGE0](https://webcpm.com/research/2016/02/campus-construction.aspx?TC=PAGE0) (FEB 1, 2016).

³⁶ Michael Mitchell & Michael Leachman, *Years of Cuts Threaten to Put College Out of Reach for More Students*, CENTER ON BUDGET AND POLICY PRIORITIES (May 13, 2015), <http://www.cbpp.org/research/state-budget-and-tax/years-of-cuts-threaten-to-put-college-out-of-reach-for-more-students>; see also *Last Week Tonight with John Oliver: Student Debt* (HBO television broadcast Sept. 7, 2014), <https://www.youtube.com/watch?v=P8pjd1QEA0c>.

³⁷ MITCHELL & LEACHMAN, *supra* note 36.

³⁸ ODLAND, *supra* note 29.

³⁹ Jay Berman & Janet Pfleeger, *Which industries are sensitive to business cycles?*, Feb. 1997 MONTHLY LAB. REV. 19, 24 (noting that educational services industry employment is among the least correlated with business cycle fluctuations).

[] increased costs and allow [] universities to raise prices uninhibited by normal economic forces.”⁴⁰

Further, the student loan surge can also be attributed to access to credit. As far as public credit options go, unsubsidized loans may especially drive the increase in loan volume, because they do not have a “financial need” requirement.⁴¹ Private loans marketed through numerous banks and universities fill the void, often with higher interest rates than public loans where public options are not available or max out. So long as a student loan applicant has a cosigner, “[v]irtually everyone who applies is approved for almost unlimited student loans, regardless of how likely they are to be able to pay them back.”⁴² Lenders are not worried, “because student loans cannot be discharged in bankruptcy,” and lenders know that “they’ll get their money back one way or another.”⁴³

With these factors taken together, educational prices will continue to rise. Since the 1970s, “colleges and universities [have depended] on the loan programs to maintain their enrollments.”⁴⁴ “Without private lenders pumping limitless amounts of loans into the education market . . . , universities would be forced to limit their tuition hikes with too high of prices turning away students who cannot attend.”⁴⁵ However, colleges have no incentive to keep tuition low, because students will find a way to pay the bill whether they can afford it

⁴⁰ ODLAND, *supra* note 29.

⁴¹ Postsecondary National Policy Institute, *Federal Student Aid: A Background Primer*, NEW AMERICA (Mar. 16, 2015), <https://www.newamerica.org/postsecondary-national-policy-institute/federal-student-aid-2/>.

⁴² Kayla Webley, *Is Forgiving Student Loan Debt a Good Idea?*, TIME MAG. (Apr. 20, 2012) <http://business.time.com/2012/04/20/is-forgiving-student-loan-debt-a-good-idea/>.

⁴³ *Id.*

⁴⁴ Seth J. Gerson, *Separate Classification of Student Loans in Chapter 13*, 73 WASH. U. L. Q. 269, 280 (1995) (citing Caspar W. Weinberger, *Reflection on the Seventies*, 8 J.C. & U.L. 451, 452 (1981)).

⁴⁵ Mueller, Preston, Comment, *Comment: The Non-Dischargeability of Private Student Loans: A Looming Financial Crisis?*, 32 EMORY BANKR. DEV. J. 229, 244 (2015) (referencing *Gross Profit Margin and Markup*, ENTREPRENEUR (Aug. 23, 2000), <http://www.entrepreneur.com/article/21936> [hereinafter ENTREPRENEUR]).

or not.⁴⁶ With demand for education and a growing population, educational institutions and banks “have capitalized on the trend of unlimited lending to students.”⁴⁷ “Because of [] lenders’ policies [allowing easy access to credit], universities can continue to raise tuition without seeing a significantly large drop in the number of enrolled students, allowing tuition prices to rise well above the actual value of the education.”⁴⁸

III. BANKRUPTCY BASICS

A. *Mechanics of Chapter 7 and Chapter 13 Bankruptcy*

Bankruptcy was a tool designed to give the debtor a new beginning, or a “fresh start.”⁴⁹ Bankruptcy law allows for a “fresh start”⁵⁰ for consumer debtors in two flavors: Chapter 7 and Chapter 13. Chapter 7 involves liquidation. Generally, debtors who voluntarily file under Chapter 7 or are involuntarily forced into bankruptcy must relinquish all nonexempt assets to a bankruptcy estate.⁵¹ A Chapter 7 Trustee is appointed by the U.S. Trustee (a branch of the U.S. Department of Justice) to liquidate the debtor’s nonexempt property in the bankruptcy estate, manage the funds from the estate, and to pay outstanding expenses, and distribute the amount owed to creditors.⁵²

⁴⁶ Kayla Webley, *Is Forgiving Student Loan Debt a Good Idea?*, TIME MAG. (Apr. 20, 2012) <http://business.time.com/2012/04/20/is-forgiving-student-loan-debt-a-good-idea/>.

⁴⁷ PRESTON, *supra* note 45 (citing WEBLEY, *supra* note 42).

⁴⁸ *Id.* (citing ENTREPRENEUR, *supra* note 458).

⁴⁹ Elizabeth Warren & Jay L. Westbrook, *THE LAW OF DEBTORS AND CREDITORS* 199 (2d ed. 1991).

⁵⁰ *Id.*

⁵¹ See 11 U.S.C. § 704(a) (2010). Nonexempt assets are broadly defined, but generally include “all legal or equitable interests of the debtor in [any] property” claimed by the debtor at the commencement of a bankruptcy case. 11 U.S.C. § 541 (a)(1) (2010). This includes items like proceeds, rents, and profits from property. *Id.* § 541 (a)(6).

⁵² *Id.* § 704(a)(1).

Generally, a case lasts between three to six months, after which debtors usually receive a discharge of dischargeable debts, the Trustee reports that nonexempt assets have been administered to pay creditors, and a final decree is entered.⁵³

Chapter 13, sometimes referred to as the “wage earner’s plan,” involves a debt-repayment plan created as an alternative to Chapter 7 liquidation.⁵⁴ Generally, debtors who voluntarily file under Chapter 13 are forced to retain their assets, and the Bankruptcy Court in the debtor’s district assigns a three to five year payment plan (the “applicable commitment period”) depending on the income of the debtor.⁵⁵ The U.S. Trustee or another disinterested party administers the Chapter 13 estate by accounting for debtors’ property, disbursing plan payments to creditors, and filing an account of the estate’s administration with the court.⁵⁶ If and when debtors finish making payments to creditors under their payment plans, the debtors receive a discharge of their debts,⁵⁷ property in the estate is re-vested to the debtor,⁵⁸ and a final decree is entered.

A general advantage of a Chapter 13 plan is that debtors are able to catch up on mortgages and other consumer loans while retaining possession of their residence and other property.⁵⁹ However, a disadvantage is that Chapter 13 bankruptcy estates must include much of the property otherwise exempted in Chapter 7 cases, like property stated under Section 541 and all future earnings and future property gained by debtors.⁶⁰

⁵³ *Discharge in Bankruptcy – Bankruptcy Basics*, ADMIN. OFFICE OF THE U.S. COURTS, <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/discharge-bankruptcy-bankruptcy-basics> (last visited April 26, 2016).

⁵⁴ Commission on the Bankruptcy Laws of the United States, *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong., 1st Sess., pt. 1, at 157-59 (1973).

⁵⁵ 11 U.S.C. § 1325(b)(4) (2010).

⁵⁶ *See id.* § 1302(a)-(b).

⁵⁷ *See id.* § 1328.

⁵⁸ *Id.* § 1327(b).

⁵⁹ *Id.* § 1306(b).

⁶⁰ *Id.* § 1306(a).

Another disadvantage is that the statistics of completing a Chapter 13 repayment plan are dismal at best. Completion rates of Chapter 13 “hover nationally at about one-third of confirmed plans.”⁶¹ However, that average varies greatly across different regions of the country, districts, and individual courtrooms.⁶² Regardless, the statistics are troubling, and unlike a Chapter 7 plan, Chapter 13 debtors, with minor exceptions, cannot receive a discharge until they complete their court-approved repayment plans.⁶³

If debtors do not complete the plan, they do not receive a Chapter 13 discharge, and their case is converted into a Chapter 7 liquidation or dismissed (in which case creditors can simply begin collection actions against them)⁶⁴ and they will have lost the income paid into the Chapter 13 Trustee over the life of the case, rather than having received the Chapter 7 discharge within approximately 3 to 6 months of filing their petition.⁶⁵ Further, since postgraduate debtors are likely in default under their student loans when they file under Chapter 13, their student loan balances balloon with the accrual of default interest, penalties, and attorneys’ fees.⁶⁶

⁶¹ Gordon Bermant & Ed Flynn, EXEC. OFFICE FOR UNITED STATES TRUSTEES, *Bankruptcy by the Numbers: Measuring Performance in Chapter 13: Comparisons Across States*, https://www.justice.gov/ust/bankruptcy-numbers-measuring-performance-chapter-13-comparison-across-states#N_1_ (updated May 7, 2015).

⁶² *Id.*

⁶³ 11 U.S.C. § 1328(b) (2010); *see also* 9 AM. JUR. 2D *Bankruptcy* §72 (2001).

⁶⁴ 11 U.S.C. § 1307(c) (2010).

⁶⁵ *Id.* § 349(b)(3).

⁶⁶ Interest accrues on federal unsubsidized loans from the day they are disbursed, while interest on subsidized loans begins to accrue after a six month grace period. *See* NAVIENT CORP., *How Student Loan Interest Works*, <https://www.navient.com/loan-customers/interest-and-taxes/how-student-loan-interest-works/> (last visited Sept. 6, 2016) (Navient Corporation is a publicly-traded company that services student loans on behalf of the U.S. Department of Education).

B. A Brief History of Student Loan Debt in Bankruptcy

Initially, when subsidized student loans were created in the 1950s, Congress was not concerned about bankruptcy abuse by student loan discharges. “Congress assumed that student borrowers would repay their loans from future earnings attributable to their advanced education.”⁶⁷ “The repayments of current student borrowers would help refinance the program for future student borrowers.”⁶⁸

Just before 1976, all student loans were dischargeable. However, as more loan options became available and the demand for education increased, “the dollar amount of yearly federal loan expenditures increased into the hundreds of millions, [and] concerns developed about the possibility for abuse of the programs.”⁶⁹ In 1970, Congress “appointed the Commission on Bankruptcy Laws of the United States [(the “Commission”)], an independent group of judges and private citizens, to evaluate the bankruptcy system and make suggestions for reform.”⁷⁰

In 1973, the Commission examined possible “loopholes” that student debtors could take advantage of by discharging their student debt. The Commission found no statistical evidence of a problem with discharged loans.⁷¹ “However, the Commission was concerned that even a small percentage of discharges would create a negative public image

⁶⁷ GERSON, *supra* note 44 (citing WEINBERGER, *supra* note 44, at 455).

⁶⁸ *Id.* (citing *Garmerian v. Rhode Island Higher Educ. Assistance Auth.*, 81 B.R. 4, 5-6 (Bankr. D.R.I. 1987) (citing 125 CONG. REC. S.9160 (daily ed. July 11, 1979) (statement of Sen.DeConcini))).

⁶⁹ *Id.* (citing Weinberger, *supra* note 44, at 452-55).

⁷⁰ *Id.* at 274 n.40 (citing the COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, REPORT OF THE COMMISSION OF THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 137, 93d Cong., 1st Sess., pt. 1, at 157-59 (1973) [hereinafter BANKRUPTCY COMMISSION REPORT]).

⁷¹ BANKRUPTCY COMMISSION REPORT, *supra* note 70. In addition, the Commission cited statistical data from a Department of Health, Education & Welfare report, which showed that the bankruptcy rate within the Guaranteed Student Loan (“GSL”) Program was only 0.23% of the total amount of such loans. *Id.* at 178-79 n.5; *see also id.* n.23 for an explanation of the GSL Program.

that would discredit . . . student loan programs”⁷² and that such a discharge would allow debtors to evade their student loans simply by filing for bankruptcy. Thus, the Commission proposed a discharge limitation for federal student loans.⁷³ Congress agreed with these public policies and determined that federal student loans should be excluded from general discharge.⁷⁴

With the Education Amendments of 1976, Congress limited the dischargeability of federal student loan debt in bankruptcy during the five-year period following commencement of repayment.⁷⁵ Two years later, Congress addressed the issue again with the Bankruptcy Reform Act in 1978.⁷⁶ The Bankruptcy Reform Act instituted the current Bankruptcy Code,⁷⁷ containing Section 523(a)(8),⁷⁸ even further limiting

⁷² GERSON, *supra* note 44, at 281 (citing BANKRUPTCY COMMISSION REPORT, *supra* note 53, at 170) (citation omitted) (“[S]uch abuses discredit the system and cause disrespect for the law and those charged with its administration.”).

⁷³ *Id.* (citing BANKRUPTCY COMMISSION REPORT, *supra* note 70, at 140) (The Commission noted “[A] loan or other credit extended to finance higher education that enables a person to earn substantially greater income over his working life should not as a matter of policy be dischargeable before he has demonstrated that for any reason he is unable to earn sufficient income to maintain himself and his dependents and to repay the educational debt.”).

⁷⁴ Congress passed the Education Amendments of 1976 just three years after the Commission made its recommendation. *See id.* at 281.

⁷⁵ Education Amendments of 1976, Pub. L. No. 94-482, § 439A, 90 Stat. 2081, 2141 (codified at 20 U.S.C. § 1087-93 (1976) (repealed 1978)).

⁷⁶ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549. (1978).

⁷⁷ *See* 11 U.S.C. §§ 101-1330 (2010) (as amended).

⁷⁸ *Id.* § 523 states in part:

- (a) A discharge . . . does not discharge an individual debtor from any debt—

. . . .

- (8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor’s dependents, for

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(A)

the dischargeability of federal student loans by creating a presumption against student loan discharge unless the debtor and the debtor’s dependents face an “undue hardship.”

After 1978, student debtors still had another “loophole” for discharging federal student loans under a Chapter 13 bankruptcy plan – the so-called Chapter 13 “super discharge.” Section 523(a)(8) did not apply to bankruptcy under Chapter 13 at that time and, by choosing to repay at least a portion of their debts over time, Chapter 13 debtors could discharge their student debts. However, in 1990, Congress closed the Chapter 13 “loophole” by amending Section 1328(a)(2),⁷⁹ including federal student loans as nondischargeable debts under a Chapter 13 bankruptcy.⁸⁰

Private student loans were not subject to the same federal student loans discharge limitations until 2005, when Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).⁸¹ BAPCPA’s language broadened the non-dischargeability provisions to not only include federal student loans, but also any

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- (i) 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
 - (ii) an obligation to repay funds received as an educational benefit . . .

⁷⁹ *Id.* § 1328 states in part:

- (a) [A]s soon as practicable after completion by the debtor of all payments under the plan . . . unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter . . . , the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title . . . , except any debt—

. . . .

(2) of the kind specified in . . . paragraph . . . (5)[or] (8) of section 523(a)”

⁸⁰ *See* Student Loan Default Prevention Initiative Act of 1990, Pub. L. No. 101-508, § 3007, 104 Stat. 1388-25, 1388-28 (1990) (codified at 20 U.S.C. § 1085). Section 1328(a)(2) now provides that educational loan debts will not be discharged in a Chapter 13 proceeding. 11 U.S.C. § 1328(a)(2).

⁸¹ Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), Pub. L. No. 109-8, 119 Stat. 23 (2005).

“obligation to repay funds received as an educational benefit” or “any other educational loan that is a qualified education loan,” thereby extending the Section 523(a)(8) presumption to both federal and private student loans.⁸² All discharge claims for educational loans are presumed to be subject to abuse.

C. Policy for Chapter 13 and the Reason for Barriers to Chapter 7

Congress began its quest to eliminate the possibility of student loan discharge in bankruptcy in the 1980s, but prior to 1984, debtors of all incomes could generally choose whatever choice of bankruptcy best suited their situation, whether Chapter 7 or Chapter 13.⁸³ For instance, the 1978 Bankruptcy Reform Act created Chapter 13 as a preferred alternative to Chapter 7 for consumer debtors.⁸⁴ Further, “[t]he Commission concluded that Chapter 13 bankruptcy should be encouraged as an alternative to Chapter 7.”⁸⁵

The reasons that Congress intended Chapter 13 to be the chapter of choice for debtors were the “historically meager return to unsecured creditors in Chapter 7 liquidations”⁸⁶ and Chapter 13’s emphasis on payment, rather than discharge, of unsecured debts.⁸⁷ Congress and many bankruptcy courts did not force any debtors prior to 1984 to use Chapter 13, but provided incentives like Section 1306(b) to encourage

⁸² *Id.*

⁸³ See Irving A. Breitowitz, *New Developments in Consumer Bankruptcies: Chapter 7 Dismissal on the Basis of “Substantial Abuse,”* 59 AM. BANKR. L.J. 327, 330 (1985) (discussing the first time a bankruptcy court could dismiss on its own motion a Chapter 7 petition filed by a debtor whose debts are “primarily consumer” debts).

⁸⁴ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

⁸⁵ GERSON, *supra* note 44, at 275 n.40 (citing BANKRUPTCY COMMISSION REPORT, *supra* note 53, at 157-59); see also *id.* at 282 n.98.

⁸⁶ *Id.* at 274.

⁸⁷ See S. REP. NO. 65, 98th Cong., 1st Sess. 22 (1983) (describing Chapter 13 relief as contemplating “a substantial effort by the debtor to pay his debts”).

debtors to use Chapter 13 over Chapter 7,⁸⁸ which allowed debtors to retain their possessions upon filing.

However, by the 1990s, Congress and creditor lobbies long realized that the “generous” provisions of Chapter 7 and the “no-questions-asked” policy of debt forgiveness under Chapter 7 were being abused.⁸⁹ For instance, “‘high-income’ debtors [who] could actually afford to repay [debts], instead, would file for bankruptcy, discharge most if not all of their unsecured debts, and continue to enjoy their income unencumbered by [such debt].”⁹⁰ Evidently, Congress enforced its preference for Chapter 13 and curbed abuse of Chapter 7 with the passage of these amendments; most notably, the 1984 Bankruptcy Amendments and Federal Judgeship Act (the “1984 Amendments”) and BAPCPA in 2005.

The 1984 Amendments granted bankruptcy courts the power to dismiss, on their own motion, Chapter 7 petitions filed by individual debtors for debts that are primarily consumer debts.⁹¹ Pre-BAPCPA, Section 707(b)(1) stated that bankruptcy courts or U.S. Trustees “may dismiss a case filed by an individual debtor [. . .] whose debts are primarily consumer debts [. . .] if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter.”⁹²

BAPCPA, in addition to instituting a presumption of abuse for discharge of student loans, broadened the meaning of “abuse,” instituted the means test,⁹³ and allowed bankruptcy courts to make a possible determination of a Chapter 7 filing made in “bad faith.”⁹⁴ BAPCPA expanded the meaning of “abuse” under Section 707(b) while continuing

⁸⁸ 11 U.S.C. § 1306(b).

⁸⁹ S. REP. NO. 106-49, at 2-3 (1999).

⁹⁰ Roma Perez, *Not “Special” Enough for Chapter 7: An Analysis of the Special Circumstances Provision of the Bankruptcy Code*, 61 CLEV. SREET L. REV. 983, 989 (2013).

⁹¹ See BREITOWITZ, *supra* note 83.

⁹² 11 U.S.C. § 707(b)(1) (2004).

⁹³ *Id.* § 707(b)(2).

⁹⁴ Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), Pub. L. No. 109-8, 119 Stat. 23 (“means test” and “bad faith” codified as amended in 11 U.S.C. § 707(b)(2) and (b)(3) (2010)).

the previous restriction to individual debtors whose debts are primarily consumer debts. Currently, Section 707(b)(1) states that bankruptcy courts or U.S. Trustees “may dismiss a case filed by an individual debtor [...] whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under [Chapter 13] if it finds that the granting of relief would be an abuse of the provisions of this chapter.”⁹⁵ Simple “abuse” is a much lower threshold.

The means test analyzes a debtor's eligibility for Chapter 7 bankruptcy relief, providing that if the combined income of the debtor and his or her spouse is equal to or less than the corresponding median income, then no party may move for dismissal of the debtor's case.⁹⁶ Median income is measured by the median income in the state where the debtor resides for a family of the same or smaller size as reported by the most recent Census Bureau.⁹⁷ The median income is generally not high. For example, in Tennessee, the median income for a family of four is \$67,518.⁹⁸ Many postgraduate debtors and their spouses will have a greater income because many postgraduate salaries are now above what postgraduates owe in student debt.⁹⁹ However, some sources indicate that students graduating in 2016 will break the record for student loan debt.¹⁰⁰ If debtors fail the means test, then courts will force them into a Chapter 13 repayment plan or face a presumption of abuse.

In addition, BAPCPA added Section 707(b)(3) to the Bankruptcy Code as another way for a court to find “abuse” and dismiss a Chapter 7

⁹⁵ 11 U.S.C. § 707(b)(1) (2004).

⁹⁶ *See Id.* § 707(b)(7).

⁹⁷ *Id.* § 101(39A)(A) (2010).

⁹⁸ *See* United States Census Bureau, *Median Household Income by State*, https://www.justice.gov/ust/eo/bapcpa/20160501/bci_data/median_income_table.htm (last visited October 25, 2016).

⁹⁹ *See* Josh Mitchell, *Student Debt Is About to Set Another Record, But the Picture Isn't All Bad*, THE WALL STREET JOURNAL (May 2, 2016, 2:41 PM), <http://blogs.wsj.com/economics/2016/05/02/student-debt-is-about-to-set-another-record-but-the-picture-isnt-all-bad/?mod=e2tw#:LxoXdamCw6aCXA>.

¹⁰⁰ *Id.*

case. Pursuant to Section 707(b)(3), the court may dismiss or convert a Chapter 7 case if it finds that a Chapter 7 petition was filed in “bad faith,” based on the totality of circumstances.¹⁰¹

D. The Meaning of “Primarily Consumer Debt”

If the court finds that the debtor’s debts are primarily consumer, then the court can easily suspect abuse or apply the means test; both can dismiss a debtor’s Chapter 7 petition altogether or switch the debtor upon consent to a Chapter 13 case. If postgraduate debtors could avoid having their educational loans characterized as “primarily consumer debts,” then they could altogether avoid the suspicion of abuse or the means test.¹⁰² The words “primarily consumer debt” within the context of student loans can be broken down into two distinct parts: the meaning of “primarily” and the meaning of “consumer debt.”

“Primarily” in the context of “consumer debt” is not statutorily defined in the Bankruptcy Code. In layman’s terms, “primarily” means “for the most part.”¹⁰³ That definition is vague for the purposes of Section 707(b)(1). Such a definition of “primarily” has different interpretations:

(1) Compare the total dollar amount of consumer debt to the [...] amount of non-consumer debt, and if the total consumer debt is greater, then there is consumer debt; (2) look to the total number of debts, rather than total dollar amount, and, if more than half the debts were consumer obligations, then that would constitute primarily consumer debts¹⁰⁴

The majority of bankruptcy courts take the approach in (1) that “a debtor’s liabilities are primarily consumer debts [as used in 11 USCS § 707(b)(2)] if the aggregate dollar amount of such debts exceeds 50% of the debtor’s total liabilities.”¹⁰⁵ Otherwise, Section 707(b)(2) does not

¹⁰¹ 11 U.S.C. § 707(b)(3) (2010).

¹⁰² *See id.* § 707(b)(1).

¹⁰³ Webster’s Eleventh New Collegiate Dictionary (2003).

¹⁰⁴ Wayne R. Wells and Janell M. Kurtz, *A Critical Analysis of Bankruptcy Code Section 707(b)*, 36 CLEV. STREET L. REV. 385, 404 (1988).

¹⁰⁵ *In re Hlavin*, 394 B.R. 441, 446 (Bankr. S.D. Ohio 2007).

apply. The minority of bankruptcy courts take the approach in (2) or a combination of (1) and (2).¹⁰⁶

“Consumer debt” is statutorily defined as “debt incurred by an individual primarily for a personal, family, or household purpose.”¹⁰⁷ This is the same definition that is used by Section 707(b)(1) analyses in Chapter 7 cases involving student loans.¹⁰⁸ However, “legislative history . . . indicates that [this language] was adapted from the definition used in various consumer protection laws, and the courts have turned to [case law] to determine [the definition of debt].”¹⁰⁹ Thus, case law is especially relevant for distinguishing between consumer and nonconsumer debt.

IV. CASE EXAMPLES

Generally, student loan debt is classified as a “consumer debt[.]”¹¹⁰ However, some courts have split opinions as to whether student loan debt is consumer debt or nonconsumer debt. Bankruptcy courts tend to follow one of two schemes to determine the debt associate with student loans: either (1) the “profit motive test,” or (2) defining student loan debt according to its purpose.

In *In re De Cuna*, the Southern District of Texas bankruptcy court analyzed a student debtor under the profit motive test, stating that the profit motive test excludes a debt from being a consumer debt if it “was incurred with an eye toward profit.”¹¹¹ Janus De Cuna, the debtor, obtained a series of student loans to fund his doctorate degree

¹⁰⁶ *In re Johnson*, 115 B.R. 159, 162 (Bankr. S.D. Ill. 1990) (holding that the question of whether debtors have primarily consumer debts should be evaluated in terms of both the dollar amount and number of consumer debts).

¹⁰⁷ 11 U.S.C. § 101(8) (2010).

¹⁰⁸ *See, e.g., In re Rucker*, 454 B.R. 554, 555 (Bankr. M.D. Ga. 2011).

¹⁰⁹ *In re Palmer*, 542 B.R. 289, 292 (Bankr. D. Co. 2015).

¹¹⁰ *See generally* 11 U.S.C. § 101(8) (2010).

¹¹¹ *In re De Cuna*, No. 12-37424, 2013 Bankr. LEXIS 5128, at *6 (S.D. Tex. Dec. 6, 2013) (citing *In re Booth*, 858 F.2d 1051, 1055 (5th Cir. 1988)).

from the New York University School of Dentistry.¹¹² He received his degree in 1997, but after initial success, he experienced several hardships in both his personal and professional life, resulting in the end of his practice.¹¹³ The debtor suffered from severe debt, totaling \$251,058 by the time he filed for bankruptcy in 2012.¹¹⁴ Of that amount, \$30,126 was for student living expenses, which the parties agreed was consumer debt.¹¹⁵ The other \$220,931 was borrowed to cover tuition, fees, costs for books, and for other associated school materials.¹¹⁶

The parties disputed whether the debtor's student loans for tuition, fees, and costs for books were consumer debt.¹¹⁷ The debtor attempted to file a voluntary Chapter 7 petition.¹¹⁸ However, the U.S. Trustee filed a motion to dismiss his Chapter 7 petition under Section 707(b)(1),¹¹⁹ arguing that his obligations were "primarily consumer debts" and the case should be dismissed accordingly or converted to a Chapter 13 proceeding.¹²⁰

The *De Cuna* court began by considering whether the debtor's obligations were "primarily consumer debts."¹²¹ If his obligations were found to be primarily consumer in nature, then the court would also inquire whether allowing him to continue under Chapter 7 would constitute an abuse.¹²² In considering the Bankruptcy Code definition, the court used the "profit motive" test from the Fifth Circuit to

¹¹² *Id.* at *1.

¹¹³ *Id.* at *1-2. De Cuna could no longer practice full-time due to a divorce, his business failing, and his suffering a stroke. *Id.*

¹¹⁴ *Id.* at *2.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.* at *3.

¹¹⁹ *See generally* 11 U.S.C. § 707(b) (2010).

¹²⁰ *De Cuna*, 2013 Bankr. LEXIS 5128, at *3.

¹²¹ *Id.* at *5.

¹²² *Id.*

determine whether a debt should be classified as consumer debt.¹²³ The profit motive test in the Fifth Circuit excludes a debt from being a consumer debt if it “was incurred with an eye toward profit.”¹²⁴ Under this approach, a court should look at the “entirety of the transaction to determine the true purpose for the extension of the credit,” and such an analysis determines whether there was a motive for profit.¹²⁵

The *De Cuna* court stated that applying such a test for student loans is difficult where the debt is “not directly related to the purchase of a tangible good or an investment in a commercial business venture.”¹²⁶ The court recognized persuasive authority to demonstrate the complexities of classifying student debt, noting a Tenth Circuit case, *In re Stewart*, discussed below.¹²⁷ The *Stewart* court rejected the profit motive test and arrived at a different conclusion.¹²⁸ Instead, *Stewart* focused on how the loan proceeds were actually utilized.¹²⁹ However, the *De Cuna* court thought that the *Stewart* analysis comported with the profit motive test.¹³⁰

The *De Cuna* court concluded that the debtor’s dentist school student loan obligations for tuition, school fees, and books were nonconsumer debts.¹³¹ However, the court affirmed that the student living expenses were consumer debts because those proceeds were used

¹²³ *Id.* at *6 (citing *In re Booth*, 858 F.2d 1051, 1055 (5th Cir. 1988) (where the court used the profit motive test to determine whether a debtor’s obligations were “primarily consumer” in nature)).

¹²⁴ *De Cuna*, 2013 Bankr. LEXIS 5128, at *6 (citing *Booth*, 858 F.2d at 1055).

¹²⁵ *Id.*

¹²⁶ *Id.* at *6-7.

¹²⁷ *Id.* at *7. See also *In re Stewart*, 175 F.3d 796 (10th Cir. 1999).

¹²⁸ *De Cuna*, 2013 Bankr. LEXIS 5128, at *7 (citing *Stewart*, 175 F.3d at 806-07) (the court found that the debtor’s obligations were ultimately consumer debts because the proceeds were used for family expenses and to maintain a certain lifestyle).

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.* at *10.

to pay living expenses.¹³² In so concluding, the *De Cunae* court held that “student loan proceeds that are used for direct educational expenses with the intent that the education received will enhance the borrower’s ability to earn a future living are not consumer debts.”¹³³ The debtor testified that he went to dental school to become a business owner and hoped to earn a high income to support his family, but that he had no interest in self-satisfaction or impressing others; rather, he was interested in educating himself to become a dentist.¹³⁴ The court could “think of no better example of incurring a debt with an eye toward profit.”¹³⁵

The U.S. Trustee argued that the debtor’s obligations were consumer debts because his education benefitted him personally.¹³⁶ However, because the debts were made “with an eye toward profit,” established by the profit motive test, the debtor’s tuition, fees, and book costs were deemed to be nonconsumer debts. With this conclusion, the debtor’s debt ratios were 42.37% consumer¹³⁷ and 57.63% nonconsumer.¹³⁸

Because the total nonconsumer debt was greater than his consumer debt, the debtor did not have “primarily consumer debts,” and thus was able to file for Chapter 7 bankruptcy without having to pass the means test or be subject to suspicions of abuse.

However, in *In re Rucker*, the Middle District of Georgia bankruptcy court impliedly disapproved of the profit motive test, citing two cases, *In re Stewart* (“*Stewart P*”) and *In re Millikan*, which both specifically rejected the profit motive test.¹³⁹ Instead, the *Rucker* court

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.* at *8-9.

¹³⁵ *Id.* at *9.

¹³⁶ *Id.*

¹³⁷ *Id.* at *8 n.4. (calculated by the court to be: (\$266,784.16 + \$84,654.87 + \$30,126.96) / \$900,615.82).

¹³⁸ *Id.* at *8 n.5. (calculated by the court to be: (\$9,700 + \$288,418.79 + \$220,931.04) / \$900,615.82).

¹³⁹ *In re Rucker*, 454 B.R. 554, 555-56 (Bankr. M.D. Ga. 2011) (citing *In re Stewart*, 201 B.R. 996, 1004-05 (Bankr. N.D. Oka. 1996); *In re Millikan*, No. 07-01759-AJM-7, 2007 Bankr. LEXIS 4696, at *10 (Bankr. S.D. Ind. Sept. 4, 2007)).

stated that each student loan “must be evaluated according to its purpose,”¹⁴⁰ and the court must therefore analyze “all facts relevant to purpose when the characterization of student loans is in dispute,”¹⁴¹ not just the profit motive.

The debtors in *Rucker* filed a voluntary Chapter 7 petition indicating that their obligations were primarily nonconsumer debts.¹⁴² The U.S. Trustee filed a motion to dismiss the Debtors’ Chapter 7 petition under Section 707(b)(1), arguing that the Debtors’ obligations, of which \$189,960 was student loan debt for a medical degree, were “primarily consumer debts.”¹⁴³ In addition, the U.S. Trustee argued that the court should treat student loans as *per se* consumer debt because all education is inherently personal.¹⁴⁴ Education “is instilled in a person’s mind; it can never be separated from the person.”¹⁴⁵ The Debtors argued just the opposite, analogizing student loans with income tax debt, which they contended should always be categorized as nonconsumer debt in bankruptcy.¹⁴⁶

Unlike *De Cunae*, the *Rucker* court did not apply the profit motive test to determine whether the Debtors’ obligations were consumer debts as defined in the Bankruptcy Code. Instead, the *Rucker* court discussed *Millikan* and *Stewart*, which the U.S. Trustee cited in support of his argument for student loans to be treated as *per se* consumer debt.¹⁴⁷

In short, *Stewart I* concerned a debtor who voluntarily filed for Chapter 7 bankruptcy with significant student debt from attending an undergraduate university and medical school, in addition to other

¹⁴⁰ *Rucker*, 454 B.R. at 555.

¹⁴¹ *Id.* at 558.

¹⁴² *Id.* at 554.

¹⁴³ *Id.* at 554-55.

¹⁴⁴ *Id.* at 555.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *See id.* at 555-57.

personal debts.¹⁴⁸ The debtor argued that these loans were nonconsumer debts by citing *In re Gentry*,¹⁴⁹ which held that “consumer debt” is completely defined by Section 101(8).¹⁵⁰ The U.S. Trustee disagreed, moving to dismiss Stewart’s Chapter 7 case as a “substantial abuse” under Section 707(b).¹⁵¹

The court disagreed with the debtor’s argument that his medical education debt was nonconsumer in nature, reasoning that Congress’ intent behind Section 707(b) was to keep “an individual debtor who voluntarily [...] takes advantage of modern easy-credit practices to accumulate debts, for the immediate purpose of satisfying his private appetites and maintaining or enhancing his personal qualities and lifestyle.”¹⁵² The court stated that easy-credit practices include student loans.¹⁵³

The court explicitly rejected the profit motive test. The “[p]rofit motive is relevant but not necessarily decisive, for several reasons.”¹⁵⁴ “No one forces a debtor to incur student loans; such debts are incurred on debtor’s own initiative, at his option, in hopes of enhancing those most personal of qualities.”¹⁵⁵ “[S]tudent loans enable a debtor to receive and retain a benefit (education) that ‘cannot be conserved as security for payment of the debt.’”¹⁵⁶ Thus, the court dismissed the case under Section 707(b), holding that “student loans in general should be

¹⁴⁸ *In re Stewart*, 201 B.R. 996, 997 (Bankr. N.D. Okla. 1996).

¹⁴⁹ *Id.* at 1003. See generally *In re Gentry*, 185 B.R. 368, 372 (Bankr. M.D. Fla. 1995) (stating that “[11 U.S.C. § 101(8)] clearly defines consumer debt, and where the statute is clear the court need not and should not look beyond the statute unless the result is demonstrably at odds with the intentions of the drafters.”).

¹⁵⁰ *Gentry*, 185 B.R. at 372.

¹⁵¹ *Stewart*, 201 B.R. at 1002.

¹⁵² *Id.* at 1004.

¹⁵³ *Id.*

¹⁵⁴ *Id.* at 1004-05.

¹⁵⁵ *Id.* at 1004.

¹⁵⁶ *Id.*

treated as ‘consumer debt,’ . . . absent unusual facts or factors of which this Court is not presently aware.”¹⁵⁷

In re Millikan concerned a debtor who filed for Chapter 7 bankruptcy with student loan debt, arguing that the loans were nonconsumer debts.¹⁵⁸ Having similar facts, “[t]he court in *Millikan* relied heavily on the bankruptcy court opinion in *Stewart*, quoting it extensively.”¹⁵⁹ The *Millikan* court rejected the ‘profit motive’ test¹⁶⁰ and agreed with the *Stewart I* court, holding that “few human activities are entirely innocent of a profit motive.”¹⁶¹ Further, the court stated that “education is personal in nature; it resides only within the person who . . . earns the degree. Education is a non-transferrable asset that can only be used by the individual.”¹⁶² Because of the inherent personal nature of education, the court implied that it generally should be considered a consumer debt and not based on profit.

The *Rucker* court agreed with the courts in *Millikan* and *Stewart I* in rejecting the profit motive theory, extensively quoting the two courts and employing their rationale. The *Rucker* court opined that if substantial student loans were to be treated as nonconsumer debts under the profit motive test, then most student debtors could easily “avoid dismissal or conversion to Chapter 13 even though their high salaries put them in a better position to repay creditors.”¹⁶³ However, the *Rucker* court rejected the U.S. Trustee’s argument that *Millikan* and *Stewart I* support the proposition that student loans are *per se* consumer debt.¹⁶⁴

¹⁵⁷ *Id.* at 1005, 1008.

¹⁵⁸ *In re Millikan*, No. 07-01759-AJM-7, 2007 Bankr. LEXIS 4696, at *12-13 (Bankr. S.D. Ind., Sept. 4, 2007).

¹⁵⁹ *Rucker*, 454 B.R. at 555.

¹⁶⁰ *Millikan*, 2007 Bankr. LEXIS 4696, at *13.

¹⁶¹ *Id.* (quoting *Stewart*, 201 B.R. at 1996).

¹⁶² *Millikan*, 2007 Bankr. LEXIS 4696, at *13.

¹⁶³ *Rucker*, 454 B.R. at 556.

¹⁶⁴ *Id.* at 558.

The court rejected the “conclu[sion] that [personal benefit] is always the motivating factor for incurring [a student] loan.”¹⁶⁵

Instead, the *Rucker* court impliedly rejected the profit motive test and held that all debt, including student loan debt, “must be evaluated according to its purpose”¹⁶⁶ and “all facts relevant to purpose when the characterization of student loans is in dispute,”¹⁶⁷ because such an inquiry is more consistent with Section 101(8). With this holding, the *Rucker* court did not make a ruling for either the Debtors or the Trustee; rather, the court stated that a separate trial would need to be held to consider the Trustee’s motion to dismiss.¹⁶⁸

In *In re Palmer*, the court followed a similar approach to the one in *Rucker*. *Palmer* is especially relevant, because it considers *Stewart*, *Millikan*, *Rucker*, and *De Cunae* together. While rejecting a pure profit motive test like the one used in *De Cunae*, the *Palmer* court also rejected *Rucker*’s approach in considering all facts relevant to the purpose of the student loan because that “would require courts to proceed into a quagmire of evidentiary and factual determinations.”¹⁶⁹ Rather, the *Palmer* court held that the profit motive test may be considered with surrounding factors, but only to a limited extent; the debtor “must demonstrate a tangible benefit to an existing business, or show some requirement for advancement or greater compensation in a current job or organization” to show that “a student loan was incurred with a for-profit motive.”¹⁷⁰

The debtor in *Palmer* had a number of debts incurred for personal reasons, including \$91,312 in student loans, most of which he took out to pay for a doctorate degree in business administration from Argosy University (“Argosy”), which he began in 2009.¹⁷¹ The debtor

¹⁶⁵ *Id.* at 557.

¹⁶⁶ *Id.* at 555.

¹⁶⁷ *Id.* at 558.

¹⁶⁸ *Id.*

¹⁶⁹ *In re Palmer*, 542 B.R. 289, 295 (Bankr. Colo. 2015).

¹⁷⁰ *Id.* at 297.

¹⁷¹ *Id.* at 290-91.

testified that after he and his wife took a vacation to Oregon in 2009, where they visited a number of wineries, he became interested in the alcoholic beverage industry.¹⁷² The debtor ended up writing a dissertation on the Oregon wine industry, and in 2011, he and his wife purchased a bar.¹⁷³ The bar ultimately closed in 2014, and he filed for bankruptcy.¹⁷⁴

The debtor argued that he took out the student loans from Argosy with the intention of becoming a business owner; thus, the debts were incurred with a profit motive, making them nonconsumer debts.¹⁷⁵ The Trustee argued that the profit motive test is unworkable as the primary test to distinguish consumer and nonconsumer debt, citing *Stewart and Millikan*.¹⁷⁶ The court agreed with the Trustee.¹⁷⁷ The *Palmer* court heavily relied on *Stewart's* rationale and other Tenth Circuit cases citing *Stewart* as a starting point. “[W]here student loans result in tangible benefits that are assimilated to the debtor’s person, thereby enhancing the debtor’s personal qualities, the Court concludes that the loans are properly characterized as consumer debts.”¹⁷⁸

The debtor *in Palmer* attempted to contrast his case from *Stewart*, saying that in *Stewart*, the debtor pursued a medical degree; the *Palmer* debtor pursued a business administration degree, which clearly had a profit motive.¹⁷⁹ The court responded to this argument by holding that it could not conclude that any time a debtor sets out “on a course of action to obtain a skill that would improve his ability to earn future

¹⁷² *Id.* at 291.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 298.

¹⁷⁸ *Id.* at 293 (quoting *In re Grenardo*, 2012 Bankr. LEXIS 6302, *29 (Bankr. D. Colo., May 2, 2012) (relying on *In re Stewart*, 175 F.3d 796 (10th Cir. 1999))).

¹⁷⁹ *In re Palmer*, 542 B.R. 289, 294 (Bankr. Colo. 2015).

income” that he incurs a nonconsumer debt.¹⁸⁰ “This is a slippery slope . . . [considering that a] student may incur debt in a certain area of study with the hope that he or she will eventually succeed in that area, but for various reasons this may or may not occur.”¹⁸¹ The court then stated specific difficulties with using the profit motive test:

[T]he difficulty with the profit motive test is that it places in the hands of the debtor the means to characterize the debt. If a debtor testified that he or she had attended school for humanitarian reasons or . . . personal satisfaction of learning, the student loan could be considered a consumer debt. If the debtor testified that he or she had attended school primarily to earn a large income, the same loan could now become a nonconsumer debt.¹⁸²

Further, the *Palmer* court struggled with how to determine where a personal purpose to get an education ends and where a profit motive begins, writing that a court should not decide that the “compassionate doctor or teacher who obtains an education with altruistic motives [differs] from those of someone determined to be an investment banker or business owner for pure profit motives”¹⁸³

The *Palmer* debtor also argued that in *Stewart* the student loan money was partly used for living expenses, while in his case, the Argosy loans were used directly to pay for tuition and book expenses.¹⁸⁴ However, the *Palmer* court stated that these distinctions are not pivotal; rather, this distinction would be problematic.¹⁸⁵ For example, other students may not be able to live at home and are required to use student

¹⁸⁰ *Id.* at 295 (quoting *In re De Cuna*, No. 12-37424, 2013 Bankr. LEXIS 5128, at *6 (S.D. Tex. Dec. 6, 2013)).

¹⁸¹ *Palmer*, 542 B.R. at 295.

¹⁸² *Id.* at 294-95 (quoting *In re Millikan*, No. 07-01759-AJM-7, 2007 Bankr. LEXIS 4696, at *6 (Bankr. S.D. Ind., Sept. 4, 2007)).

¹⁸³ *Palmer*, 542 B.R. at 295.

¹⁸⁴ *Id.* at 294.

¹⁸⁵ *Id.*

loan proceeds for living expenses.¹⁸⁶ Thus, the *Palmer* court did not believe that primarily focusing on tuition and housing expenses produced a fair result.

However, the *Palmer* court did not rule out the profit motive test entirely. While the court agreed with sister courts that student loans “must be evaluated according to its purpose,”¹⁸⁷ student loans should not be evaluated to the same extent as in *Rucker*. The *Palmer* court stated that evaluating a loan’s purpose based on all relevant facts would burden courts with the plethora of factual and evidentiary determinations.¹⁸⁸

Rather, debtors must demonstrate a tangible benefit to an existing business or show some requirement for advancement or greater compensation in a current job or organization in order to show that a student loan was incurred with a for-profit motive.¹⁸⁹ However, “[i]f the profit motive is not interpreted narrowly, it can be applied to virtually all student loans.”¹⁹⁰ Based on this holding and the testimony and evidence presented, the court found that Palmer could not demonstrate that his student loan was incurred purely or primarily for a profit motive.¹⁹¹ Rather, the court held that Palmer “pursued his doctorate for the ‘personal purpose of fulfilling a lifelong goal.’”¹⁹²

V. PROPOSAL

Student loan debt should be considered nonconsumer debt when the debt is needed for postgraduate or professional degrees that are meant to qualify for a job, profession, or business. With this proposal, postgraduate debtors in bankruptcy would have a better chance to

¹⁸⁶ *Id.*

¹⁸⁷ *In re Rucker*, 454 B.R. 554, 555 (Bankr. M.D. Ga. 2011).

¹⁸⁸ *Palmer*, 542 B.R. at 295.

¹⁸⁹ *Id.* at 297.

¹⁹⁰ *Id.* at 296.

¹⁹¹ *Id.* at 297-98.

¹⁹² *Id.* at 298 (quoting *In re Stewart*, 201 B.R. 996, 1004 (10th Cir. 1999)).

qualify for Chapter 7 liquidation. Such debtors would not be subject to the means test or other allegations of abuse under Section 707(b) that would either force them into Chapter 13, or force them to forego bankruptcy relief altogether. The following points illustrate immediate and long-term benefits from this proposition.

A. Immediate Practical Benefits

The case law is not uniform, and this issue has yet to be addressed by federal appellate courts. Because of the split decisions among the district courts, the issue of student debt in bankruptcy is in limbo. As illustrated above, some courts hold that student loans are consumer debts, while others hold to the contrary. There is plenty of room for interpretation of Sections 101(8) and 707(b); any of the three following alternatives could be argued: (1) a profit motive approach; (2) the totality of the circumstances approach; or (3) a combination of the two. Clarifying the circumstances that student loans are nonconsumer debt would give courts, practitioners, and clients a clearer, more administrable standard.

Secondly, it is important to note that Chapter 13 plans have a low completion rate – “about one-third of confirmed plans.”¹⁹³ If student loans are treated as consumer debt that require student debtors to file Chapter 13, then postgraduate debtors are not likely to complete the plan. Although that average varies greatly across different regions of the country, districts, and individual courtrooms,¹⁹⁴ the statistic is troubling. Just a couple of decades ago, about half of all debtors who initially filed for Chapter 13 had their cases dismissed after defaulting on their plans with no resolution of their financial problems and no discharge, even though they had devoted many months of payments of their “disposable income” to payments under these plans.¹⁹⁵

¹⁹³ Gordon Bermant & Ed Flynn, Executive Office for United States Trustees, *Bankruptcy by the Numbers: Measuring Performance in Chapter 13: Comparisons Across States*, https://www.justice.gov/ust/bankruptcy-numbers-measuring-performance-chapter-13-comparison-across-states#N_1_ (updated May 7, 2015).

¹⁹⁴ *Id.*

¹⁹⁵ Michael Bork & Susan D. Tuck, Administrative Office of the U.S. Courts, *Bankruptcy Statistical Trends; Chapter 13; Dispositions (Working Paper 2)* (October 1994) (studying termination data for Chapter 13 cases filed between 1980 and 1988).

Further, nondischargeable student loans continue to accrue fees and interest while student debtors are in the Chapter 13 repayment plan. Post-petition charges do not have to be paid during the bankruptcy; however, once the bankruptcy is over, or if the debtor fails to complete the plan, the debtor becomes liable once again for all the charges accrued on the student loan while the case was active. The *Palmer* court recognized this as a practical effect of its holding:

[A] debtor's debt burden could actually increase over the life of a [C]hapter 13 plan, since, unless the plan will pay 100% to creditors, nondischargeable student loans will continue to accrue fees and interest during the three to five year span of the plan. It may be better policy for a debtor with substantial student loans to obtain a discharge in a shorter amount of time in chapter 7, thus theoretically freeing up income to pay the student loans after discharge of other debts.¹⁹⁶

However, the bankruptcy courts can only work with the hand that they have been dealt by Congress and higher courts; a bankruptcy court has a "duty . . . to apply the Bankruptcy Code provisions, taking into account the language as it has been interpreted in case law."¹⁹⁷ A court's ability to set policy is limited without aid from a legislature.

Most importantly, the essence of bankruptcy is to provide debtors with a "fresh start," and if the bankruptcy system denies honest but unfortunate postgraduate debtors that opportunity, then the system fails. Many students in bankruptcy, and especially graduate students with more than six figures of student debt, are likely to fail Section 707(b)(1) because their student debts are often considered primarily consumer in nature. As a result, when graduate students fall into bankruptcy, either they will fail the means test, or the U.S. Trustee will dismiss the case for abuse reasons, subjecting those graduate students to the more strenuous

¹⁹⁶ *In re Palmer*, 542 B.R. 289, 298 (Bankr. D. Colo. 2015) (footnote omitted).

¹⁹⁷ *Id.*

Chapter 13 plan. During the three to five-year repayment plan period, debtors pay off their past instead of investing in their future, if they finish the plan at all.

B. The Shift in Risk is a Benefit

Federal and private creditors would experience more risk under this proposal. However, by shifting more risk to lenders, the incentives would be aligned at the outset to all parties involved in the student loan transaction. Creditors, in considering that some students may be able to treat their student loans as nonconsumer debt by filing under Chapter 7, would evaluate risk more carefully before lending to students, pushing student loans to resemble risked-based business loans.¹⁹⁸

“Risk-based credit pricing involves adjusting the interest rate on loans so that the interest rate compensates the lender not only for the time value of money, but also for the risk that borrowers will default on their debts and cause the lender to incur losses.”¹⁹⁹ Currently, the student loan market is not risk-based, but rather based on uniform pricing.

Uniform pricing subsidizes the riskiest borrowers while profiting from the safest borrowers. In the student loan context, uniform credit pricing is a subsidy to students who are studying fields with the lowest value in the labor market and a tax on students who are studying fields with the highest value in the labor market and the best employment prospects.²⁰⁰

Thus, currently, “[a] successful medical student with virtually no risk of becoming unemployed or defaulting on her debts would pay the graduate student rate between [5.84% and 6.8%] – while a struggling art history major with rather less secure employment prospects would pay the undergraduate rate of [4.29%].”²⁰¹ However, a more “risk-based

¹⁹⁸ A complete theoretical discussion regarding risk-based student loans is outside the scope of this paper. For more information, see the cited sources.

¹⁹⁹ Michael Simkovic, *Risk-Based Student Loans*, 70 WASH. & LEE L. REV. 527, 589 (2013) (footnote omitted).

²⁰⁰ *Id.* at 590.

²⁰¹ *Id.* at 566 (interest rates based on current 2015-16 federal loan rates).

pricing [approach] in federal student loans would advance the interests and values that Congress articulated when it first established federal support for higher education.”²⁰²

With creditors bearing more risk, the question would not be “simply how much students borrow each year,”²⁰³ rather, creditors would also ask “whether students’ incomes at graduation and beyond will be sufficient to repay their debts over the next ten to thirty years.”²⁰⁴ Creditors should then make appropriate changes to the loan and its terms. Such loan changes might be printing a minimum payment warning or a repayment chart on student loan agreements, similar to the required minimum payment warning on credit card statements.²⁰⁵ Alternatively, creditors could adjust private student loan interest rates to account for changes in risk.

A risk-based approach would benefit the economy and students, who should consider their own risk more before taking out student loans. When creditors bear risk and communicate those risks to student borrowers, students may reconsider taking out loans to pursue a degree that results in lower employment prospects, where otherwise the “[s]tudents . . . may not have accurate information about post-graduation employment prospects and wages in their [concentration].”²⁰⁶ Theoretically, a scheme that allows for risk-based loan pricing would channel students into “schools and academic majors with better employment prospects due to the lower interest rates that are attached to those universities and majors”²⁰⁷ and would force “student

²⁰² *Id.* at 530.

²⁰³ *Id.* at 565.

²⁰⁴ *Id.*

²⁰⁵ Credit Card Accountability Responsibility and Disclosure (“CARD”) Act of 2009, Pub. L. 111-24, 123 Stat. 1734 (2009) (codified as amended in scattered sections of 15 U.S.C.) (“minimum payment warning” codified in 15 U.S.C. § 1637(b)(11)).

²⁰⁶ SIMKOVIC, *supra* note 199, at 583.

²⁰⁷ Alexander Yi, *Reforming the Student Debt Market: Income-Related Repayment Plans or Risk-Based Loans?*, 21:3 VA. J. SOC. POL’Y & L. 511, 536 (2014).

borrowers to internalize the risks created by their own decisions.”²⁰⁸ Conversely, “students would be discouraged from those schools and concentrations with lower employment prospects because of the higher financing costs attached to them.”²⁰⁹

C. Creditors Will Have Protections

Protections can and should exist to insulate creditors. Not all postgraduate debtors who take out student loans to get a professional degree should qualify for the benefit of this proposal. Without protections, the benefit proposed here would be unfair to creditors, who expect bankruptcy abuse protections to be in place. This proposal is not a call for student loans to be discharged, for the elimination or reduction of the “undue hardship” burden, or to automatically allow student debtors to choose between Chapter 7 or 13. Indeed, if protections did not exist, some postgraduate debtors would attempt to abuse Chapter 7 to wipe out their obligations, and such cases should be converted to Chapter 13. *Palmer* arguably serves as such an example, considering that the debtor pursued a doctorate degree in business administration that his employer did not pay for nor require.²¹⁰ However, the current law considers most student loans as consumer debt, leaving postgraduate debtors with Chapter 13 as their only bankruptcy option. This proposal calls for balance.

We can balance the need for Chapter 7 abuse protections and the need for this proposal with the following two protections: (1) a legislative clarification codified in the Bankruptcy Code; and (2) a judicial test that guides courts as to what is a nonconsumer debt and that requires the postgraduate debtor to demonstrate that a degree was a business or nonconsumer expense.

Bankruptcy courts would have a clearer definition of consumer versus nonconsumer debt in the context of student loans if the

²⁰⁸ SIMKOVIC, *supra* note 199, at 590.

²⁰⁹ *Id.*

²¹⁰ *In re Palmer*, 542 B.R. 289, 291 (Bankr. Colo. 2015).

Bankruptcy Code were amended with explicit language in the definition for “consumer debt.”²¹¹ Such language might read:

Section 101(8)(A): A loan acquired for the purpose of obtaining a professional degree from an institution of higher education of any kind, public or private, is not consumer debt when that loan is (1) required and necessary to practice in that job, profession, or business; or (2) directly related to the purchase of a tangible good or an investment in a commercial business venture. The loans must have been used for school tuition, school textbooks, and other directly related educational expenses.²¹²

Section 101(8)(B): When considering whether a loan acquired under this section is a consumer or nonconsumer debt, the court must consider the purpose for the loan, the material facts surrounding the loan, and whether the loan was mainly taken out to profit from the education that the loan paid for, or whether a profit motive was involved.

Such a legislative clarification would work in coordination with a judicial test that would guide courts as to what is a business or nonconsumer expense. Such a test cannot be a bright-line rule; rather, it must distinguish between the dilettante who uses a loan for an art history degree out of pure enjoyment and the postgraduate who pursues an education to secure employment, start a business, or become a professional, such as a doctor, dentist, or attorney.

I propose a seven-point balancing test, comprised of the following factors: (1) what the postgraduate debtor originally intended to study; (2) the duration of time to earn a degree; (3) whether the postgraduate debtor worked part-time or had another career during school; (4) whether society generally expects the postgraduate debtor to have the particular degree to secure particular employment; (5) whether

²¹¹ See generally 11 U.S.C. § 101(8) (2010).

²¹² See Tami Wells Thomas, *Student Loan Debts as Non-Consumer Debts – or Not*, American Bankruptcy Institute Journal 34.10, 28-29, 81 (Oct. 2015).

the postgraduate debtor had (or would have reasonably had) the job, profession, or business that expected or required his degree; (6) whether there was any “profit motive” in obtaining the degree, as discussed in *Palmer*; and (7) any other factors that the court may find material to the case. Such a test should be more qualitative than quantitative, because each of those factors may measure differently depending on the particular case at hand. Further, postgraduate debtors should have the burden of proof to demonstrate these factors as the debtors who pursued the degree.

The *Rucker* court’s main concern was that if “substantial student loans were treated as nonconsumer debts under a profit-motive test, [then most student debtors could easily] avoid dismissal or conversion to Chapter 13 even though their high salaries put them in a better position to repay creditors.”²¹³ While the *Rucker* court had a valid point, a judicial inquiry within the proposed seven-point framework would relieve those concerns, as well as the concerns of the *Palmer* court. The profit motive test would be qualitatively analyzed with the other factors and only to a limited extent. Additionally, courts like the *Rucker* court would not have to decide for the most part whether “the portion of student loans used to pay for elective classes unrelated to the student’s major were incurred with a profit motive.”²¹⁴ The seven-point framework goes to the crux of *Rucker* and *Palmer* – student loan debt “must be evaluated according to its purpose.”²¹⁵

Another point that the judicial framework should consider is school housing; a debt that is nearly always considered a consumer debt. Student housing should also be considered a nonconsumer debt if a postgraduate degree is found to be a nonconsumer debt and such housing costs were incurred to obtain the degree. While a valid issue, this is a slippery slope. Certainly, with the same reasoning, a court could set up frameworks for school meal plans, food, and school transportation. Thus, an inquiry into school housing should be very limited, and such a framework should be applicable if and only if a

²¹³ *In re Rucker*, 454 B.R. 554, 556 (Bankr. M.D. Ga. 2011).

²¹⁴ *Id.*

²¹⁵ *Id.* at 555.

postgraduate debtor's tuition and book debts are also found to be nonconsumer debts.

Such a balancing test for student housing would consider: (1) whether the postgraduate debtor's residence prior to obtaining the degree was within a reasonable distance from the school; (2) the relative cost of housing in the area; (3) the general cost of student housing; (4) the cost of the postgraduate debtor's student housing compared to other housing in the area; (5) whether the educational institution requires students to live on campus; (6) whether the student reasonably needed to live near the school; and (7) any other factors that the court may find material to the case. No other nonconsumer debt should be found outside tuition, books, school fees, and school housing.

VI. CONCLUSION

The law currently punishes our professionals by preventing them from pursuing an education and investing in their future. However, treating student debt as nonconsumer debt for certain unfortunate and honest postgraduate debtors would allow our bankruptcy system to balance the interest of the future of our students and professionals with potential abuses in the system. Otherwise, many of our professionals will continue to wallow in the debts of their past, holding back the full potential of their futures, and thereby holding back our economy.