

The Upside-down Education

Is Bankruptcy an Alternative for Relief from Student Loans?

By L. ALEXANDRA HOGAN

A college education should increase a person's earning capacity over a lifetime. Unfortunately, many graduates are finding that the value of their education is outweighed by heavy student-loan debt. This may be the reason that the delinquency rate on student loans has surpassed that of other types of consumer loans, such as credit cards and car loans.

The New York Fed reports that student-loan debt has exceeded \$956 billion and estimates that 21% of these loans are in default.

Financial blows caused by events like loss of employment, medical issues, or divorce are catalysts for personal bankruptcy filings. Bankruptcy is meant to give a fresh start to honest debtors by providing a mechanism of relief from most types of debt, such as credit cards, personal loans, medical bills, and foreclosure deficiencies. Although it is not impossible to discharge student loans in bankruptcy, it is difficult to do, and just recently got even harder. Although seemingly harsh, this law is meant to protect the solvency of the educational-loan system and to prevent people from abusing the system by receiving a free education.

Relief from student-loan debt is not generally available in bankruptcy, unless failure to discharge the debt would lead to an "undue hardship" on the debtor, under §523(a)(8) of the Bankruptcy Code. Courts use different tests to determine what constitutes an undue hardship. In Massachusetts, bankruptcy courts generally evaluate undue hardship on a case-by-case basis by considering (1) a debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and their dependents' reasonable necessary living expenses; and (3) any other relevant facts and circumstances.

Some examples of debtors' circumstances that led to findings of undue hardship include the following: student loans exacerbated by the debtor's mental illness; the debtors reaching their maximum earning capacity in worthwhile, but low-paying, teaching jobs;



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the debtor being homeless and unemployed; the debtor being unable to complete her doctorate degree program and suffering from depression; and the debtor suffering from a variety of medical illnesses, making employment almost impossible. The takeaway is that circumstances must be dire to obtain relief.

A recent court case closed a loophole in the law, making discharge even more unlikely. Typically, a general unsecured loan like a line of credit is dischargeable in bankruptcy. The case of *In re Belforte*, decided on Oct. 1, 2012 in the U.S. Bankruptcy Court for the District of Massachusetts, Eastern Division, held that the debtor's line of credit could not be discharged. The debtor made a handwritten note seeking an increase in her line of credit to pay for her children's tuition and expenses. Liberty Bay Credit Union increased and rewrote the debtor's line of credit under a new unsecured loan agreement — not through Liberty Bay's educational-lending program.

Liberty Bay neither inquired from the debtor what the loan would be used for, nor did it exercise oversight as to how the debtor utilized the loan proceeds, as a traditional student lender would. Notwithstanding this, the court construed the bankruptcy statute broadly and ruled that, since the loan was used for an 'educational benefit,' it was not dischargeable. Under this ruling, it is now clear that an individual with a regular per-

sonal loan used for an educational benefit must establish undue hardship as well.

Those with unusually difficult situations should consult with a bankruptcy attorney to determine whether their circumstances would qualify as an undue hardship. But otherwise, where does this leave the average person struggling with high student-loan debt and low or non-existent income?

Avoid the potentially harsh consequences of defaulting on student loans, including wage garnishment, tarnished credit, and offset tax refunds. There are options to avoid defaulting on federal student loans. Deferment, forbearance, and repayment plans may be available. The U.S. Department of Education has announced a new option that may greatly benefit newer graduates, called "Pay as You Earn."

This plan may apply to those with partial financial hardship who have certain types of federal direct student loans. Under this plan, 10% of a person's annual discretionary income is paid, and after 20 years of participation, the loan is forgiven. To learn more about Pay as You Earn, visit www.studentaid.ed.gov. ■

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