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Preston Mueller

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THE NON-DISCHARGEABILITY OF PRIVATE STUDENT LOANS: A LOOMING FINANCIAL CRISIS?

ABSTRACT

In 2005, Congress altered 11 U.S.C. § 523(a)(8) to exclude private student loans from discharge in bankruptcy. The change was a line-item in a larger bankruptcy bill, but it has had massive effects on the higher education market in the United States.

This Comment will show how granting private student loans the privileged status of being non-dischargeable in bankruptcy skews lenders' incentives. Because private student lenders know that their debts cannot be discharged, they have no incentive to consider a student borrower's ability to repay. As a result, most students are granted a nearly unlimited line of credit without lenders worrying about those students' ability to repay. This Comment argues that this phenomenon has thus led to skyrocketing university tuition rates in the past decade, which in turn has created the need for students to borrow even more. This troubling cycle is creating a bubble in the higher education market, which will have disastrous effects if left unaddressed.

This Comment will also propose a solution to this problem. By allowing students to discharge private student loans in bankruptcy, Congress could create a self-sustaining mechanism in the private student loan market by restoring lenders' incentives to gauge students' ability to repay. If Congress changes the Bankruptcy Code to allow private student loans to be discharged in bankruptcy, lenders will only grant loans proportionately to a student's ability to pay. This Comment ultimately argues that this small change will have far-reaching and highly beneficial results for the nation's economy.

INTRODUCTION

In the fall of 2015, roughly 20.2 million students were expected to attend colleges and universities across the United States, constituting over 4.9 million more students than in the fall of 2000.¹ Between 2002 and 2012 alone, college enrollment in the United States increased by 24%.² Not only are more students attending college, but they are paying a higher price for this education than ever before.³ Controlled for inflation, the average four-year private university tuition in 1974 was \$10,273, measured in 2014 dollars.⁴ By 2014, this average figure had risen to \$31,231, an increase of roughly 204%.⁵

The historical increases in college enrollment and tuition rates have made financing higher education big business in the United States.⁶ Student loans are the second-highest form of consumer debt facing our nation behind mortgages, accounting for \$1.2 trillion of debt.⁷ The average student graduating in 2012 owed \$29,400, which is over \$10,000 more than the average student debt just ten years ago.⁸ Legislatures have taken notice of this explosive rise in debt and are proposing legislation to help distressed student loan debtors find a way out of their predicaments.⁹

Of special interest to this Comment are the changes to the Higher Education Act proposed by Senator Tom Harkin, one of which would allow

¹ *Back to School Statistics*, NAT'L CTR. FOR EDUC. STATISTICS, <http://nces.ed.gov/fastfacts/display.asp?id=372> (last visited Dec. 29, 2015).

² *Enrollment*, NAT'L CTR. FOR EDUC. STATISTICS, <http://nces.ed.gov/fastfacts/display.asp?id=98> (last visited Dec. 29, 2015).

³ See Doug Short, *A Depressing Look at Income Growth Compared to Health Care and College Costs*, BUS. INSIDER (Mar. 9, 2011, 5:29 AM), <http://www.businessinsider.com/college-and-health-cost-versus-income-2011-3>.

⁴ *Trends in College Pricing*, COLL. BD. (2015), <http://trends.collegeboard.org/college-pricing/figures-tables/tuition-fees-room-board-time-1974-75-2014-15-selected-years>.

⁵ See *id.*

⁶ See CONSUMER FIN. PROT. BUREAU, *PRIVATE STUDENT LOANS* 17 fig.4 (2012), http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf (showing that the private student loan industry alone was worth over \$10 billion by 2008).

⁷ 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-is-crippling-students-parents-and-the-economy/>.

⁸ Tyler Kingkade, *Average Student Debt Climbs to \$29,400, up 63 Percent in Less than a Decade: Study*, HUFFINGTON POST (Dec. 4, 2013, 3:08 PM), http://www.huffingtonpost.com/2013/12/04/average-student-debt-2012_n_4380946.html.

⁹ See Reyna Gobel, *Dems Rush to Propose Student Loan Legislation in Election Year*, FORBES (July 2, 2014, 11:57 AM), <http://www.forbes.com/sites/reynagobel/2014/07/02/dems-rush-to-defend-student-borrowers-in-election-year/>.

debtors to discharge all private student loan debts in bankruptcy.¹⁰ Under the current system, discharging any student loan is difficult and can only be done in rare instances where the debtor can show that keeping the debt will cause an “undue hardship.”¹¹ Because student loan debts are so rarely discharged in bankruptcy, private lenders have less incentive to worry about the ability of borrowers to repay and will grant students nearly infinite lines of credit for higher education.¹² This effect can be seen in the number of outstanding private student loans over time.¹³ Until the 2005 amendments, private student loans were dischargeable under the Bankruptcy Code (the “Code”).¹⁴ In 2005, when private student loans were first exempted from discharge, \$6.6 billion in private student loans were granted by lenders.¹⁵ This number jumped to \$7.8 billion the next year, and was above \$10 billion by 2008.¹⁶

The fact that the private student loan industry saw a 50% increase in the years immediately following a change in the Code pertaining to private student loans is likely no coincidence. Thus, it seems that the exemption of private student loans from discharge is at least partially to blame for the spiraling cost of college tuition and the ballooning level of student loan debt seen in the United States. In order to fight the negative effects of this amendment, Congress should follow Senator Harkin’s suggestion and allow private student debts to be discharged in bankruptcy as they were before the 2005 amendments to the Code.¹⁷

¹⁰ See *id.*

¹¹ See Andrew M. Campbell, Annotation, *Bankruptcy Discharge of Student Loan on Ground of Undue Hardship Under § 523(a)(8)(B) of Bankruptcy Code of 1978*, 144 A.L.R. Fed. 1 (1998).

¹² Kayla Webley, *Is Forgiving Student Loan Debt a Good Idea?*, TIME BUS. (Apr. 20, 2012), <http://business.time.com/2012/04/20/is-forgiving-student-loan-debt-a-good-idea/> (“Virtually everyone who applies is approved for almost unlimited student loans, regardless of how likely they are to be able to pay them back. But lenders aren’t really concerned about that because student loans cannot be discharged in bankruptcy. They know they’ll get their money back one way or another.”).

¹³ See Diana Jean Schemo, *Private Loans Deepen a Crisis in Student Debt*, N.Y. TIMES (June 10, 2007), http://www.nytimes.com/2007/06/10/us/10loans.html?pagewanted=all&_r=1& (“[P]rivate loans have become the fastest-growing sector of the student finance market, more than tripling over five years to \$17.3 billion in the 2005-06 school year . . .”).

¹⁴ See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59.

¹⁵ CONSUMER FIN. PROT. BUREAU, PRIVATE STUDENT LOANS, *supra* note 6.

¹⁶ *Id.*

¹⁷ Higher Education Affordability Act, S. 2954, 113th Cong. § 1031 (2014).

I. BACKGROUND

A. Statutory Background

Student loans were not always exempt from discharge in bankruptcy.¹⁸ In fact, prior to 1976, all student loans were eligible for discharge in bankruptcy.¹⁹ In 1976, Congress changed this policy by enacting § 439(A) of the Higher Education Act of 1965.²⁰ This Act mandated that student loans would be exempt from discharge in bankruptcy unless: 1) they became due more than five years before the date of filing, or 2) exempting the discharge would cause an “undue hardship” on the debtor and his dependents.²¹ The reasoning behind Congress’s decision to exempt federal loans was largely due to a desire to protect the solvency of the federal student loan program from the perceived abuses of bankruptcy discharge.²² Congress’s fear of rampant student loan debt abuse was largely based on anecdotal evidence.²³ At the time, there were stories circulating about students getting “free” educations by discharging their student debts upon graduation without trying to make any repayments or showing extenuating circumstances.²⁴ Despite Congress’s fear, empirical studies conducted recently have found that when the Higher Education Act was enacted, less than 1% of all federal student loans were discharged in bankruptcy.²⁵ Clearly, Congress’s fears were unfounded, and the abuse of student loan discharge was too minor to threaten the federal student loan program in any way.²⁶ Yet, over time, more and more forms of student debts have become exempted from discharge under this same guise of preventing abuse.²⁷

¹⁸ See 11 U.S.C. § 35(a) (1976) (providing a list of debts that cannot be discharged, with loans for educational purposes not on the list).

¹⁹ See Rafael Pardo & Michelle R. Lacey, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation*, 83 AM. BANKR. L.J. 179, 180 (2009).

²⁰ See Campbell, *supra* note 11.

²¹ See *id.*

²² See Pardo & Lacey, *supra* note 19, at 181.

²³ See *supra* note 19, at 180–81 (“Congress took this action on the basis of perceived abuses. . . . relying on a few stories of recent graduates who had obtained discharges of their student loans without any attempted repayment and in the absence of extenuating circumstances.”).

²⁴ See *id.*

²⁵ *Id.* at 181.

²⁶ *Id.*

²⁷ See *id.*

The original Bankruptcy Code enacted in 1978 officially codified the student loan exemption from the Higher Education Act at § 523(a)(8).²⁸ Section 523(a)(8) exempted the discharge of any debt “to a governmental unit, or a nonprofit institution of higher education, for an educational loan,” unless the loan first became due five years before filing for bankruptcy, or excepting the debt from discharge would impose an “undue hardship” on the debtor and the debtor’s dependents.²⁹ In 1979, this language was amended to exempt from discharge any “educational loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or a nonprofit institution of higher education.”³⁰ Yet another round of amendments in 1984 removed the wording “of higher education,” effectively exempting from discharge all non-profit student loans, regardless of who made the loan.³¹ The time frame after which an individual could discharge student loans under § 523(a)(8) increased from five to seven years in 1990.³² Then in 1998, Congress changed the wording once again to abolish the discharge after seven years exemption, leaving the “undue hardship” exception as the only way to discharge student loans covered by § 523(a)(8).³³

Perhaps the largest change to the Code came recently in 2005, when Congress added § 523(a)(8)(B) which exempts private student loans from discharge.³⁴ These 2005 amendments were the most recent change to § 523(a)(8) and resulted in the current statute.³⁵ Under the current provisions, unless there is a showing of “undue hardship,” discharge does not apply to:

[A]n educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or an obligation to repay funds received as an educational benefit, scholarship, or stipend; or any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the

²⁸ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 523(a)(8), 92 Stat. 2549, 2591 (codified as amended at 11 U.S.C. § 523(a)(8) (2012)).

²⁹ *Id.*

³⁰ *Id.*

³¹ See Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 454, 98 Stat. 333, 376.

³² See Crime Control Act of 1990, Pub. L. No. 101-647, § 3621, 104 Stat. 4789, 4965.

³³ See Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971, 112 Stat. 1581, 1837.

³⁴ See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59.

³⁵ See Pardo & Lacey, *supra* note 19, at 181.

Internal Revenue Code of 1986, incurred by a debtor who is an individual.³⁶

Under this wording, all forms of student debt, public or private, are exempt from discharge in bankruptcy, absent a showing of “undue hardship.”³⁷ The reasons given by Congress for the 2005 amendments to the Code were to ensure that “the system is fair for both debtors and creditors” and to “respond to many of the factors contributing to the increase in consumer bankruptcy filings . . . to eliminate abuse in the system.”³⁸ Although the goal of the amendment was to eliminate abuse, many critics, including Senator Richard Durbin, argued no evidence existed to suggest that private student loan debts would be subject to abuse at a rate higher than any other consumer debt.³⁹ Not only is there scarce evidence of student loan abuse, but the private student loan industry had been growing before the 2005 amendments, making it hard to believe that abuse was threatening the industry.⁴⁰

The change exempting private student loans from discharge instead seems to be the result of a “sweetheart deal” between Congress and the private student loan industry.⁴¹ Critics believe that the facts surrounding the passage of the 2005 amendments support the conclusion that this amendment was snuck into a larger education reform bill.⁴² Specifically, the section which proposed the change to § 523(a)(8) was just seven lines amidst a vast multi-hundred-page bill.⁴³ In addition, in all of the dissenting opinions given in response to the proposed 2005 changes, there was not a single mention of the change to § 523(a)(8).⁴⁴ This lack of concern is especially peculiar because there were multiple House members who expressed their dissenting opinions on the non-dischargeability of private student loan debts in the House Judiciary

³⁶ 11 U.S.C. § 523(a)(8) (2012).

³⁷ See Kayla Webley, *Why Can't You Discharge Student Loans in Bankruptcy?*, TIME BUS. (Feb. 9, 2012), <http://business.time.com/2012/02/09/why-cant-you-discharge-student-loans-in-bankruptcy/>.

³⁸ H.R. REP. NO. 109-31, at 2 (2005).

³⁹ Larry Levinson & Denise Cariello, *Senator Durbin Introduces Two Student Lending Bills*, EDUC. INDUSTRY REP. (Feb. 4, 2013), <http://www.educationindustryreporter.com/2013/02/senator-durbin-introduces-two-student-lending-bills/>.

⁴⁰ *Id.* (“In fact, the private student loan market had been growing—even before this measure was enacted into law.”).

⁴¹ *Id.*

⁴² See *id.*; see also Pardo & Lacey, *supra* note 19, at 181 (“This change did not meet with any objections from lawmakers, even from the House members who expressed dissenting views to accompany the House Judiciary Committee’s report on the 2005 amendments.”).

⁴³ See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59.

⁴⁴ See Pardo & Lacey, *supra* note 19, at 181.

Committee's report on the amendments.⁴⁵ Thus, it is clear that Congress has failed to act consciously and constructively on student loan exemption since the act's passage in 1976. This Comment will argue that this failure to address the student loan exemption has negatively impacted the American economy and needs to be addressed.

B. Case Law Background

Currently under the Code, private student loan debts cannot be discharged unless the debtor can show that the exemption from discharge would create an "undue hardship" on the debtor or his dependents.⁴⁶ Courts have differed in their approach to interpreting what constitutes an "undue hardship" for a debtor under § 523(a)(8) over time.⁴⁷

In 1979, the bankruptcy court for the Eastern District of Pennsylvania attempted to define "undue hardship" in *In re Johnson*.⁴⁸ The court outlined a three-part test for establishing an "undue hardship."⁴⁹ The first prong of the test asked if the income of the debtor was sufficient to allow the debtor to repay the loans and also support himself and any dependents at a "subsistence or poverty standard of living."⁵⁰ The second prong was a good faith test, and the third was a policy consideration, determining if allowing the discharge of the student debt would conflict with the purpose of Congress in specifically exempting these debts from discharge under § 523(a)(8).⁵¹ The Pennsylvania bankruptcy court re-visited and clarified this test in 1987 in *In re Bryant*.⁵² In *Bryant*, the court elaborated on the first prong of the test from *Johnson* so that courts would now use data on the federal poverty level in the debtor's area to establish the "subsistence or poverty standard of living" standard.⁵³

Federal Circuit Courts took on the task of establishing an "undue hardship" test in the 1987 case *Brunner v. New York State Higher Education Services Corp.*⁵⁴ In *Brunner*, the Second Circuit established a new three-prong test for

⁴⁵ *See id.*

⁴⁶ *See Webley, Why Can't You Discharge Student Loans in Bankruptcy?*, *supra* note 37.

⁴⁷ Campbell, *supra* note 11.

⁴⁸ *See* No. 77-2033 TT, 1979 U.S. Dist. LEXIS 11428, at *59–62 (E.D. Pa. June 27, 1979).

⁴⁹ *See id.*

⁵⁰ *Id.* at *60.

⁵¹ *See id.* at *60–61.

⁵² *See* Campbell, *supra* note 11.

⁵³ *See In re Bryant*, 72 B.R. 913, 916 (Bankr. E.D. Pa. 1987).

⁵⁴ *See* 831 F.2d 395 (2d Cir. 1987).

determining “undue hardship.”⁵⁵ The *Brunner* Test specifies that an “undue hardship” exists when it is found that: 1) the debtor’s current financial circumstances would not allow the debtor to subsist and repay his student loan; 2) additional circumstances exist that would make it likely that the financial distress of the debtor would continue for a majority of the repayment period; and 3) the debtor has acted in good faith while trying to repay the loan.⁵⁶ The *Brunner* Test was later adopted by many federal district courts and bankruptcy courts⁵⁷ as well as the Seventh Circuit,⁵⁸ the Sixth Circuit,⁵⁹ and the Third Circuit Court of Appeals.⁶⁰

Regardless of the name of the test used, when deciding if an “undue hardship” exists, courts look primarily to the economic prospects of the debtor and whether any conduct of the debtor would disqualify him from discharging the student loan.⁶¹ Even though the current bankruptcy scheme technically allows for the discharge of student loans in certain situations, the burden that a debtor must meet to prove an “undue hardship” under any test is extremely high and therefore rarely applies.⁶² Also, because the Code never actually defines “undue hardship,” many scholars have argued that cases involving the discharge of student loans often produce unfair and inconsistent results because judges do not have an objective standard to rely on.⁶³ This lack of a clear and cohesive standard, in addition to Congressional tightening of rules and standards in the Code, has created an untenable situation for those individuals in desperate need of relief from student loan debt.

II. ANALYSIS

Even if the “undue hardship” standard was applied evenly, it still places such a large burden on debtors that student loans are rarely discharged.⁶⁴ The

⁵⁵ See Campbell, *supra* note 11.

⁵⁶ See *Brunner*, 831 F.2d at 396.

⁵⁷ See Campbell, *supra* note 11.

⁵⁸ See *In re Roberson*, 999 F.2d 1132, 1135 (7th Cir. 1993).

⁵⁹ See *Cheesman v. Tenn. Student Assistance Corp. (In re Cheesman)*, 25 F.3d 356, 359 (6th Cir. 1994).

⁶⁰ See *Pa. Higher Educ. Assistance Agency v. Faish (In re Faish)*, 72 F.3d 298, 305–06 (3d Cir. 1995).

⁶¹ See Campbell, *supra* note 11.

⁶² See Gobel, *supra* note 9 (“It is incredibly hard to get student loans discharged in bankruptcy . . .”).

⁶³ See, e.g., Edward Paul Canterbury, *The Discharge of Student Loans in Bankruptcy: A Debtor’s Guide to Obtaining Relief*, 32 OHIO N.U. L. REV. 149, 149 (2006) (“[The undue hardship standard] has produced unpredictable and unfair results due to Congress’ failure to adequately define the contours of the standard.”).

⁶⁴ See Josh Mitchell, *Harkin Opens Door to Bankruptcy Options for Student Loans*, WALL ST. J. (June 25, 2014, 12:01 AM), <http://blogs.wsj.com/economics/2014/06/25/harkin-opens-door-to-bankruptcy-option-for-student-loans/>.

result is that many debtors are unable to achieve the “fresh start,” which is one of the primary goals of the American bankruptcy system.⁶⁵ In addition to preventing individuals from realizing a fresh start, this student loan exemption from discharge skews the incentives of private lenders, allowing them to lend near infinite amounts without worrying about a borrower’s ability to repay.⁶⁶ In other words, this Comment will argue that the Code’s exemption of private student loans from discharge creates artificial incentives for private lenders to lend beyond the socially optimum level. Some of these negative effects may be arguably worth tolerating if there were an overriding policy consideration requiring private student debts to be non-dischargeable, yet no such evidence seems to exist. Thus, in order to improve the efficiency of our bankruptcy system and economy, § 523(a)(8) of the Code should be changed back to its pre-2005 form where private student loans were not exempt from discharge.

A. *Why Not All Student Loans?*

Before going further, it is worth exploring why only private student loans should be allowed to be discharged in bankruptcy. That is, why not allow for the discharge of federal student loans? After all, the 1976 Bankruptcy Code amendment exempting federal student loans from discharge, like the 2005 amendments, passed despite a lack of evidence of any real policy threats.⁶⁷

This question has many answers, but perhaps the most important is that allowing full discharge of all federal student loans would prevent the government from collecting roughly one trillion dollars in a time of high national debt levels.⁶⁸ Legislators are concerned that, in today’s uncertain economic climate, allowing federal student loan holders to discharge their debts could cause the educational financial aid program to become insolvent, effectively ending necessary federal student loans.⁶⁹

⁶⁵ See Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 MICH. L. REV. 2234, 2268 (1997) (“[B]ankruptcy does have certain normative policy objectives distinct from those of state collection law. Not the least of these, in a consumer bankruptcy case, is the fresh start for a financially beleaguered debtor.”).

⁶⁶ See Webley, *Is Forgiving Student Loan Debt a Good Idea?*, *supra* note 12.

⁶⁷ See Pardo & Lacey, *supra* note 19, at 181.

⁶⁸ See Denhart, *supra* note 7 (explaining that in addition to maintaining the solvency of the federal loan program, federal student loans have lending caps and protections built into them that allow debtors other avenues of relief besides declaring bankruptcy).

⁶⁹ See Webley, *Why Can’t You Discharge Student Loans in Bankruptcy?*, *supra* note 37 (“The government is the backer on those loans (and therefore would be out of cash).”); see also Josh O’Connor, *Make Student Loan Debt Dischargeable in Bankruptcy . . . Again*, NAT’L BANKR. FORUM (Feb. 28, 2014),

In addition to preventing the federal loan program from becoming insolvent, federal student loans have lending caps per student, while private student loans do not.⁷⁰ With no lending limits, students who take private loans are able to pay whatever price a university may set for tuition, as opposed to borrowers with federal loans who cannot borrow more than \$57,500 for their undergraduate education.⁷¹ If students were only able to access federal loans, the federal loan cap would help limit tuition costs because schools could not raise tuition beyond that \$57,500 level without facing major opposition from students receiving federal loans. As a result, universities would be forced to keep tuition fairly affordable. However, these limitless student loans from private third parties reduce opposition over tuition hikes because students with private loans are able to pay whatever rate a school sets.⁷² This results in universities being able to easily raise their tuitions year after year without significant pushback, as demonstrated by the astonishing rate of tuition increases since the 2005 amendments.⁷³

Finally, federal student loans have regulations and protections built into them that private student loans do not.⁷⁴ Unlike with private student loans, debtors with federal student loans have options other than discharge to alleviate themselves of their student debt.⁷⁵ For example, debtors with federal student loans can choose an Income Based Repayment plan, in which they are required to make monthly payments of only 10% of their monthly discretionary income.⁷⁶ After twenty-five years of such payments, regardless of if the debtor has paid off the full balance, the remainder of the debtor's student loan debts are forgiven.⁷⁷ Private student loans, however, are largely

<http://www.natlbankruptcy.com/make-student-loan-debt-dischargeable-in-bankruptcyagain/> (“[P]roponents of reform [paint] bleak scenarios about federal educational aid drying up if the discharge status quo carried the day.”).

⁷⁰ See Schemo, *supra* note 13.

⁷¹ *How Much Can I Borrow?*, OFF. FED. STUDENT AID, <https://studentaid.ed.gov/types/loans/subsidized-unsubsidized#how-much> (last visited Dec. 30, 2015).

⁷² See Ivar Berg, *The Effects of Inflation on and in Higher Education*, 456 ANNALS AM. ACAD. POL. & SOC. SCI. 99, 108–09 (1981) (“[T]hese ‘off-budget’ programs are indeed inflationary, a prospect that did not phase academics who breathed a sigh of relief when they raised tuition rates in confidence that students’ and parents’ opposition to rate increases would be reduced in proportion to the growing availability of low interest loans.”).

⁷³ See *Trends in College Pricing*, *supra* note 4.

⁷⁴ See Webley, *Why Can’t You Discharge Student Loans in Bankruptcy?*, *supra* note 37.

⁷⁵ See *id.* (“Federal loans have a lot of options for repayment such as Income Based Repayment and loan forgiveness programs that give borrowers more realistic options for repayment and a way out.”).

⁷⁶ See *Income-Based Repayment (IBR)*, IBRINFO, <http://www.ibrinfo.org/what.vp.html#IBR> (last visited Dec. 30, 2015).

⁷⁷ *Id.*

unregulated and have no such requirement for an Income Based Repayment plan.⁷⁸ Those with private student loans, however, often have no way to manage their debt besides full repayment on the creditor's terms, and thus, need discharge as an alternative form of relief.⁷⁹

B. *Guaranteeing a Fresh Start*

The lack of options available to debtors with private student loans not only seems unfair on a personal level, but actually undermines the goals of the United States' bankruptcy system.⁸⁰ One of the bankruptcy system's main goals is to ensure that debtors are able to be economically productive again after declaring bankruptcy, or in other words, to give debtors an economic "fresh start."⁸¹ In the landmark case *Local Loan Co. v. Hunt*, the Supreme Court designated the fresh start as a fundamental policy of bankruptcy, reasoning that if no fresh start were guaranteed, then debtors who go through the bankruptcy process would have reduced incentives to work after exiting bankruptcy. Specifically they stated:

From the viewpoint of the wage earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either The new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.⁸²

In other words, a wage earner who still has his pre-bankruptcy debts has no incentive to work versus doing nothing, because both choices will result in zero new income to that individual (assuming that the individual must devote

⁷⁸ See Schemo, *supra* note 13.

⁷⁹ See Webley, *Why Can't You Discharge Student Loans in Bankruptcy?*, *supra* note 37 ("Basically, the only option with private loans is to repay them—and to repay them on the lender's timetable.").

⁸⁰ See, e.g., Ponoroff & Knippenberg, *supra* note 65 ("[B]ankruptcy does have certain normative policy objectives distinct from those of state collection law. Not the least of these, in a consumer bankruptcy case, is the fresh start for a financially beleaguered debtor.").

⁸¹ See, e.g., Nicholas L. Georgakopoulos, *Bankruptcy Law for Productivity*, 37 WAKE FOREST L. REV. 51, 53 (2002) ("The fresh start policy prevents pauperism and idleness. . . . The fresh start policy and the existence of the reorganization process . . . are the major examples of bankruptcy law provisions that revive productivity.").

⁸² *Id.* at 58.

all of his income to paying his debts).⁸³ Even if the individual does not have to devote all of his income to paying off his debts, the payments he must make to creditors will in effect act as a wage reduction, which leads to a reduction in that individual's supply of labor under normal assumptions.⁸⁴ As a result, debtors who are not given a real fresh start after going through the bankruptcy process can be expected to be less productive, and thus prevent our economy from reaching its maximum efficiency.⁸⁵

In addition to the economic argument for why private student loan debtors should be given a fresh start, there is also a public policy concern. Specifically, it is the goal of any legal system to aim for equitable application of the law to ensure predictability of outcomes.⁸⁶ In its current state, the Code does not seem to give equitable treatment to similar forms of consumer debt.⁸⁷ Even though multiple types of consumer debts are dischargeable under bankruptcy law, student loans for some reason are not. One author lamented about student loan debt that, "[i]t's actually worse than a bad mortgage."⁸⁸ Many people think that student loans function like any other type of loan in bankruptcy, only to end up "stuck in purgatory their entire life, just because they made a mistake and borrowed too much money."⁸⁹ The long-term consequences of over-borrowing for higher education seem to be completely out of sync with the consequences of other consumer debts which can be discharged in bankruptcy, despite the debtors in both situations engaging in virtually the same behavior. In fact, a student who borrowed to pay tuition and improve her life seems less culpable than someone who, say, ran up charges on his or her credit card, though the Code exempts the former from discharge rather than the latter.⁹⁰ Thus, the

⁸³ See *id.*

⁸⁴ See Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARVARD L. REV. 1393 (1985); Albert Rees, *An Overview of the Labor-Supply Results*, 9 J. HUM. RESOURCES 158, 159 fig.1 (1974).

⁸⁵ See Jackson, *supra* note 84.

⁸⁶ See *Hanna v. Plumer*, 380 U.S. 460, 474 (1965) (Harlan, J., concurring) ("[S]uch alternative governing authority must necessarily give rise to a debilitating uncertainty in the planning of everyday affairs.").

⁸⁷ See Webley, *Why Can't You Discharge Student Loans in Bankruptcy?*, *supra* note 37 ("[I]t would offer an option for students to get rid of debt that, at its core, is not really any different from other types of debt that the government does allow borrowers to discharge.").

⁸⁸ Sarah Lacey, *Peter Thiel: We're in a Bubble and It's Not the Internet. It's Higher Education.*, TECH CRUNCH (Apr. 10, 2011) (quotation marks omitted), <http://techcrunch.com/2011/04/10/peter-thiel-were-in-a-bubble-and-its-not-the-internet-its-higher-education/>.

⁸⁹ Webley, *Why Can't You Discharge Student Loans in Bankruptcy?*, *supra* note 37.

⁹⁰ See Tyler Kingkade, *Private Student Loan Bankruptcy Rule Traps Graduates with Debt Amid Calls for Reform*, HUFFINGTON POST (Aug. 15, 2012, 9:51 AM), http://www.huffingtonpost.com/2012/08/14/private-student-loans-bankruptcy-law_n_1753462.html ("There's no reason why private student loans should be treated differently than gambling debt, when it comes to bankruptcy eligibility.").

incongruence between the treatments of these similar forms of debt not only harms the individual debtor with student loans, but deteriorates the equality and predictability of our bankruptcy system.

C. Economic Benefits of Allowing Discharge

Allowing the discharge of private student loan debts in bankruptcy would have much broader effects than simply giving debtors a fresh start after bankruptcy proceedings. Specifically, allowing discharge of private student loans in bankruptcy would address both the problem of the higher education degree bubble as well as the nation's rising student debt.

1. The Higher Education Degree Bubble

When people talk about financial or economic bubbles, they are typically referring to a rapid increase in price of some sort of financial asset, such as stocks, commodities, or real estate.⁹¹ The term “bubble” more generally refers to a rapid increase in price for any asset “to levels significantly above the fundamental value of that asset.”⁹² In other words, a bubble occurs when the perceived value of a good increases beyond its real value, regardless of what that good is.⁹³ Since 1985, the Consumer Price Index (“CPI”) has risen 115%, while the cost of college education has increased 500%.⁹⁴ To put this into perspective, a \$10,000 tuition in 1986 would now cost the same student over \$21,500, if tuition increased at the same rate of inflation; instead, it would actually cost that student \$59,800 for tuition today because of inflation.⁹⁵ The cost of tuition has increased so quickly that between 2003 and 2013 the CPI for tuition rose 79.5%, while necessities such as housing increased only 22.8%, and men's and women's clothing increased 6.9% and 5.6%, respectively.⁹⁶

Even though tuition has been increasing at astonishing rates, a bubble does not occur until the price increases significantly beyond the fundamental value

⁹¹ See *Economic Bubble Definition*, NASDAQ GLOSSARY, <http://www.nasdaq.com/investing/glossary/e/economic-bubble> (last visited Dec. 29, 2015) (“A market phenomenon characterized by surges in asset prices to levels significantly above the fundamental value of that asset.”).

⁹² *Id.*

⁹³ See *id.*

⁹⁴ 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/>.

⁹⁵ *Id.*

⁹⁶ Danielle Kurtzleben, *CHARTS: Just How Fast Has College Tuition Grown?*, U.S. NEWS & WORLD REPORT (Oct. 23, 2013, 3:56 PM), <http://www.usnews.com/news/articles/2013/10/23/charts-just-how-fast-has-college-tuition-grown>.

of the good.⁹⁷ This brings into question then the fundamental value of a college degree. What benefits do individuals gain by obtaining a college diploma? Although people may argue that various immeasurable mental and emotional benefits are derived from higher education, from an economic perspective, a rational individual would only choose to attend college if he or she believed that the future benefits were greater than the costs incurred by attending.⁹⁸ This economic reasoning is just another way to state the traditional “American dream” ideal that students attend college to get better jobs in hopes of earning more money over their lifetime than if they had not attended. Thus, if the net amount of money that college graduates earn is increasing compared to those who do not attend college, then the rapid increase in college tuition seen in the past years could arguably be justified. Unfortunately, the question of whether college actually increases one’s lifetime earnings is a difficult one to answer.

Whether college is a profitable investment for an individual depends on many factors.⁹⁹ College major plays a large role in how much a college degree returns on investment.¹⁰⁰ One study conducted by the research firm PayScale gathered data from over 900 colleges and universities in order to determine the twenty-year return of different college degrees.¹⁰¹ The study found that after taking the cost of education into account, an engineering degree from University of California Berkley would make a student on average \$1.1 million better off over a twenty-year span as compared to a high school diploma.¹⁰² Even the least profitable university engineering degree would be expected to have a twenty-year return of near \$500,000 over the average high school diploma alone.¹⁰³ Economics and Computer Science degrees similarly averaged a twenty-year ROI between \$362,600 to \$1.109 million and \$304,000 to \$1.6 million, respectively.¹⁰⁴ Thus, for certain fields of study it seems that continuing education past high school is almost always a sound investment, even with rising tuition rates.

⁹⁷ See *Economic Bubble Definition*, *supra* note 91.

⁹⁸ See *Rational Choice Theory Definition*, INVESTOPEDIA DICTIONARY, <http://www.investopedia.com/terms/r/rational-choice-theory.asp> (last visited Dec. 30, 2015).

⁹⁹ See, e.g., *Is College Worth It?*, ECONOMIST (Apr. 5, 2014), <http://www.economist.com/news/usa/21600131-too-many-degrees-are-waste-money-return-higher-education-would-be-much-better>.

¹⁰⁰ See *id.*

¹⁰¹ *Id.*

¹⁰² See *id.*

¹⁰³ See *id.*

¹⁰⁴ *Best Value Colleges for Economics Majors*, PAYSACLE, <http://www.payscale.com/college-roi/major/economics> (last visited Dec. 29, 2015); *Best Value Colleges for Computer Science Majors*, PAYSACLE, <http://www.payscale.com/college-roi/major/computer-science> (last visited Dec. 30, 2015).

The picture becomes much less clear when discussing majors such as Humanities and English, Education, or the Arts though. For example, the PayScale study reports that a “Humanities” major from University of California Berkeley can expect a twenty year ROI of \$463,100 for an in-state student, which is clearly a substantial return on one’s investment.¹⁰⁵ On the other end of the spectrum, however, Humanities majors from Bowling Green State University on average actually realize a negative twenty year return on investment of \$207,100 for in-state students after paying off the expenses for their education.¹⁰⁶ The large gap seen between the return on investment for graduates within the same majors shows the second variable affecting the value of a college education: quality of the school. No matter the major, students attending one of the highest-rated universities can expect a return on investment in the hundreds of thousands of dollars according to this study.¹⁰⁷ Though as the numbers show, our society’s vision of college as a guaranteed way to improve your lifetime earnings is not true for all students.¹⁰⁸

The result of this frequent exaggeration of a college education’s financial benefits is that people end up taking on significant debt based on the societal promise of a large payday, only to find that there is no such guarantee.¹⁰⁹ Deemed “a million-dollar misunderstanding”¹¹⁰ by some, these estimates have driven this higher education bubble, inducing students to attend college despite skyrocketing tuition costs and graduate salaries staying stagnant for most of the past decade.¹¹¹ The result is many individuals are prevented from economically-productive activities, such as buying houses, starting businesses, or investing their money, which in turn harms the overall economy.¹¹²

2. *Over Access to Credit Driving Up Tuition*

To correct this bubble and the harmful effects that it brings, the price of education needs to be returned to the actual value of a college education.¹¹³

¹⁰⁵ See *Best Value Colleges for Humanities Majors*, PAYSACLE, <http://www.payscale.com/college-roi/major/humanities/> (last visited Dec. 29, 2015).

¹⁰⁶ See *id.*

¹⁰⁷ See *id.*

¹⁰⁸ See *id.*

¹⁰⁹ See Mary Pilon, *What’s a Degree Really Worth?*, WALL ST. J. (Feb. 2, 2010, 12:01 AM), <http://online.wsj.com/articles/SB10001424052748703822404575019082819966538>.

¹¹⁰ *Id.* (calling the perception that college is exponentially beneficial “a million-dollar misunderstanding”) (quotation marks omitted).

¹¹¹ See *Is College Worth It?*, *supra* note 99.

¹¹² See *id.*

¹¹³ See *Economic Bubble Definition*, *supra* note 91.

One culpable mechanism for driving up tuition costs is private lenders who grant students easy access to borrowing, and in doing so, remove the incentive for universities to keep tuition down.¹¹⁴ Section 523(a)(8) of the Code gives private educational lenders the same protection from discharge as non-profit lenders, even though private companies have no limit on the amount they can lend.¹¹⁵ The combination of these two circumstances creates a situation where private lenders need not worry about whether a borrower's education is going to be sufficiently valuable to pay off the loan because the debt cannot be discharged if the borrower files for bankruptcy.¹¹⁶ As a result, lenders have an incentive to give vast sums of money to students because the Code requires that these debts must be repaid.¹¹⁷

Universities have capitalized on the trend of unlimited lending to students.¹¹⁸ Without private lenders pumping limitless amounts of loans into the education market, as with any other good, universities would be forced to limit their tuition hikes with too high of prices turning away students who cannot attend.¹¹⁹ Private student lenders who are willing and able to lend any amount that a university may charge reduce this threat of students not attending because of an inability to pay.¹²⁰ Because of these lenders' policies, 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.¹²¹

¹¹⁴ See Webley, *Is Forgiving Student Loan Debt a Good Idea?*, *supra* note 12.

¹¹⁵ See Pardo & Lacey, *supra* note 19, at 181 ("By virtue of [the] legislation, *for-profit* lenders have been extended the special treatment that had been traditionally reserved for educational and nonprofit institutions. . . . Without limits on the amount students can borrow, without programs to reduce or defer payments, and without caps on interest rates, students can quickly find themselves deeply mired in debt.").

¹¹⁶ See Webley, *Is Forgiving Student Loan Debt a Good Idea?*, *supra* note 12 ("Virtually everyone who applies is approved for almost unlimited student loans, regardless of how likely they are to be able to pay them back.").

¹¹⁷ See *id.* ("But lenders aren't really concerned about [students' ability to repay] because student loans cannot be discharged in bankruptcy. [Lenders] know they'll get their money back one way or another.").

¹¹⁸ See *id.*

¹¹⁹ See *Gross Profit Margin and Markup*, ENTREPRENEUR (Aug. 23, 2000), <http://www.entrepreneur.com/article/21936>.

¹²⁰ See Webley, *Is Forgiving Student Loan Debt a Good Idea?*, *supra* note 12 ("And further, colleges have no incentive to keep tuition low . . . because whether they can afford it or not, students will find a way to pay the bill.").

¹²¹ See *id.*

The climbing trend can be seen in tuition rates over the past few decades, with private lenders contributing to the skyrocketing rates of tuition.¹²² Some increases in prices are expected for goods over time due to inflation, but tuition has been increasing at rates far ahead of almost any other good.¹²³ Since 1985, tuition rates in the United States have increased roughly 500%, while the Consumer Price Index (“CPI”) has increased only 115%.¹²⁴ Clearly factors besides simple inflation are accounting for the increased tuition rates with the over-availability of third party funds being a probable cause.¹²⁵

A similar phenomenon has been seen in medical care costs, which have increased 43.1% between 2003 and 2013, nearly doubling the growth of the CPI over that period.¹²⁶ Like with private student loans contributing to rising tuition, observers have pointed to the easy availability of third and fourth-party insurance funds as the cause of the rising health care costs.¹²⁷ Because so many individuals do not pay for their health care directly, they are not as responsive to the cost and value of the care that they receive.¹²⁸ If people were forced to pay healthcare costs out of pocket, instead of a third party paying for them, people may be “quite willing to accept health care from the ‘second-tier,’ but reputable, hospital if it meant that [they] could save 30 percent on [their] premiums.”¹²⁹ Overpriced hospitals would eventually notice this price signal and realize that individuals are not willing to pay such high prices for medical treatment, and in turn, they would lower their prices, as has been seen in other industries.¹³⁰

¹²² See *Rising Cost of College Tuition and the Effectiveness of Government Financial Aid: Hearing Before the S. Comm. on Gov’t Affairs*, 106th Cong. 28 (2000) (statement of David W. Breneman, Dean, Curry School of Education, University of Virginia) (“Federal loan programs are capped, but you have a multitude of private loan programs . . . and it is hard for me to believe, frankly, that somehow this has not played into some aspect of tuition increases.”).

¹²³ See Kurtzleben, *supra* note 96.

¹²⁴ Odland, *supra* note 94.

¹²⁵ See *Rising Cost of College Tuition*, *supra* note 122 (“Federal loan programs are capped, but you have a multitude of private loan programs . . . and it is hard for me to believe, frankly, that somehow this has not played into some aspect of tuition increases.”).

¹²⁶ Kurtzleben, *supra* note 96.

¹²⁷ See Avik Roy, *How Employer-Sponsored Insurance Drives Up Health Costs*, FORBES (May 12, 2012, 12:05 PM), <http://www.forbes.com/sites/aroy/2012/05/12/how-employer-sponsored-insurance-drives-up-health-costs/>.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ See *id.* (“[A]irlines consistently find that consumers prefer lower fares to cost-inefficient, and tasteless, airplane food. No such price signal exists in the employer-sponsored insurance market.”).

This same basic reasoning can be applied to students paying for college with private student loans. Because they are not paying the cost of tuition out of pocket, and instead are borrowing from private lenders with near limitless amounts of funds, individuals have less incentive to fight against rising tuition by “voting with their feet” and attending other institutions.¹³¹ As with hospital choice, people would likely be “quite willing” to attend a slightly less reputable university with a much lower price tag if they had to pay out of pocket. As it stands now, however, because private lenders are willing to lend whatever a university may charge, students do not have to make this decision, and therefore, universities do not receive the signal that their services are overpriced.

At least with third party insurance, the rising costs in medical care can be justified by the benefits given to individuals. The benefit to third party insurance is that individuals are able to receive more coverage than they would if they had to purchase insurance themselves.¹³² Thus, the benefits gained from the third party insurance program could arguably justify the increased medical costs that they cause. As discussed in the Background section, there is no corresponding policy interest for the passage of the 2005 amendments to the Code that can justify the negative results of this law.¹³³ Instead, the exemption of private student loans from discharge seems to be the result of a “sweetheart deal” that has had disastrous effects and needs to be repealed.¹³⁴

D. Protections Against Abuse

One of the most common reasons legislators give for excluding student loans from discharge is the need to prevent abuse of the bankruptcy system.¹³⁵

¹³¹ See *id.* (describing how borrowing money from a third party causes many individuals to become insensitive to price changes) (“If you bought insurance for yourself, you might be quite willing to accept health care from the ‘second-tier,’ but reputable, hospital if it meant that you could save 30 percent on your premiums.”).

¹³² See *id.* (“[A] worker who pays federal and state income taxes at a combined rate of 30% will receive \$7,000 for every \$10,000 his employer provides in gross salary. But the same employee will receive \$10,000 in benefits for every \$10,000 his employer spends on health insurance—a 43% improvement.”).

¹³³ See Pardo & Lacey, *supra* note 19, at 181.

¹³⁴ Levinson & Cariello, *supra* note 39.

¹³⁵ See Pardo & Lacey, *supra* note 19, at 180–81 (“Congress took this action [of exempting student loans from discharge] on the basis of perceived abuses of the bankruptcy system by student-loan debtors . . .”); Kingkade, *Private Student Loan Bankruptcy*, *supra* note 90 (“This harsh treatment of students in the bankruptcy system was built on the false premise that students were more likely to ‘abuse’ the bankruptcy system . . .”); Campbell, *supra* note 11 (“The legislation was a response to a rapid increase in the number of bankruptcies filed by recent graduates of college or professional schools who were not in financial distress generally and who filed for bankruptcy in order to discharge their student loans shortly after graduating.”).

The 1976 Bankruptcy Code included a five-year waiting period before student debts could be discharged because lawmakers were skeptical of new graduates discharging their debts while they still had few assets and then going on to more lucrative careers.¹³⁶ As stated earlier though, this fear of post-graduate abuse was baseless when the provisions were put into effect because, even then, student debt abuses accounted for less than 1% of all filings, and this fear remains baseless today.¹³⁷ Even if abuse of the bankruptcy system posed as large a threat as legislatures believe, existing anti-abuse measures can sufficiently curb abuse without having to resort to the harsh measure of exempting private student loans from discharge.¹³⁸

Currently, the Code has independent abuse provisions, most notably the means test in § 707(b), which sets an objective and straightforward standard for a judge to detect and prevent abuse of the system.¹³⁹ Also, even if an individual's filing passes the means test, a court can still dismiss the case if it finds that the filing was made in "bad faith," or if "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse."¹⁴⁰ In addition, many student loans by private lenders today require a co-signing party to help ensure that the bank is secured in the event of abuse.¹⁴¹ Together these protections effectively safeguard against abuse in the bankruptcy system, which this Comment will argue makes the exemption of student loans unnecessary.

I. The Code's Anti-Abuse Provisions

Section 707 of the Code states that after notice and hearing, a court may dismiss a chapter 7 case, or convert it to a chapter 11 or 13 case, if it finds that

¹³⁶ See *Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1306 (10th Cir. 2004) ("Upon graduation, the typical student has little or no non-exempt property that can be distributed to creditors, but may have substantial future earning potential. Section 523(a)(8) was designed to remove the temptation of recent graduates to use the bankruptcy system as a low-cost method of unencumbering future earnings.").

¹³⁷ See Pardo & Lacey, *supra* note 19, at 181 ("Simply put, the discharge of student loans in bankruptcy was too minor to threaten the economic viability of the student-loan program.").

¹³⁸ See 11 U.S.C. § 707(b)(3) (2012).

¹³⁹ See 11 U.S.C. § 707(b).

¹⁴⁰ Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 AM. BANKR. INST. L. REV. 665, 666 (2005) (quotation marks omitted).

¹⁴¹ See Susan Tompor, *Cosigning a Student Loan Risky for Parents*, USA TODAY (Aug. 24, 2014, 7:01 AM), <http://www.usatoday.com/story/money/columnist/tompor/2014/08/24/susan-tompor-cosigning-a-student-loan-risky-for-parents/14501901/> ("About 90% of private student loans . . . were cosigned in 2011, according to the Consumer Financial Protection Bureau.").

the granting of relief would be an abuse of the Code.¹⁴² Courts usually do not convert individual chapter 7 filings to chapter 11; so, where courts find a filing has abused the system, the court will often use a § 707 action to dismiss the case or convert it to a chapter 13.¹⁴³ From an anti-abuse standpoint, chapter 13 bankruptcies are preferable to chapter 7 for can-pay debtors because chapter 13 requires that a debtor stick to a three- to five-year payment plan to pay off his debts, whereas chapter 7 discharges his debts.¹⁴⁴

One way that a court determines whether a filing constitutes an abuse is by applying the means test articulated in § 707(b)(2).¹⁴⁵ Section 707(b)(2)(A)(i) explains that there is a presumption of abuse when a debtor's monthly income multiplied by sixty is greater than or equal to: (1) the larger of \$7475 or 25% of the debtor's nonpriority unsecured claims in the case, or (2) \$12,475.¹⁴⁶ Calculating a debtor's monthly income under § 707(b)(2) is done by averaging the debtor's monthly income for the six month period preceding the petition date.¹⁴⁷ Once the debtor's monthly average income is determined, the court compares it to the monthly average income for individuals of the same household size in the state in which the debtor resides.¹⁴⁸ If the debtor's monthly average income is found to be above median (that is, if the debtor fails the means test), then § 707(b)(2)(A)(ii) states that the debtor may deduct monthly allowable expenses from his or her monthly average income to see if she can meet the standards of the means test.¹⁴⁹ Deductions are allowed for obligations such as health and disability insurance,¹⁵⁰ the cost to care for a chronically ill household member,¹⁵¹ and allowances for housing and

¹⁴² 11 U.S.C. § 707(b)(1).

¹⁴³ See ADMIN. OFFICE OF THE U.S. COURTS, BANKRUPTCY BASICS, (2011), <http://www.uscourts.gov/uscourts/FederalCourts/BankruptcyResources/bankbasics.pdf> ("Unless the debtor overcomes the presumption of abuse, the case will generally be converted to chapter 13 (with the debtor's consent) or will be dismissed.").

¹⁴⁴ See 11 U.S.C. § 1322(a) ("The plan— [] shall provide for the submission of all or such portion of future earnings or other future income of the debtor . . .").

¹⁴⁵ See 11 U.S.C. § 707(b).

¹⁴⁶ 11 U.S.C. § 707(b)(2)(A)(i).

¹⁴⁷ See Culhane & White, *supra* note 140, at 673.

¹⁴⁸ See *id.* at 674.

¹⁴⁹ See *id.* at 675.

¹⁵⁰ 11 U.S.C. § 707(b)(2)(A)(ii)(I) ("Such expenses shall include reasonably necessary health insurance, disability insurance . . .").

¹⁵¹ 11 U.S.C. § 707(b)(2)(A)(ii)(II) ("In addition, the debtor's monthly expenses may include, if applicable, the continuation of actual expenses paid by the debtor that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family . . .").

utilities.¹⁵² These expenses are not to include any payments for debts.¹⁵³ Thus, the means test is a way to ensure that the wealthiest debtors do not abuse the system without depriving individuals of their basic needs. If a debtor still fails the means test after all of the allowed deductions, then he can still rebut the presumption of abuse by making a showing of special circumstances.¹⁵⁴

Although the means test weeds out the worst cases of abuse, very few debtors actually fail the test.¹⁵⁵ Only about 6–15% of individuals filing under chapter 7 are above-median debtors, and even some above-median debtors are able to do pre-bankruptcy restructuring to pass the means test.¹⁵⁶ Thus, recent graduates with few assets at the time of filing attempting to discharge their student debts in an abusive way will almost always pass the means test; so, another mechanism must be applied as well.¹⁵⁷

To combat this potential problem of abusive debtors passing the means test, courts have another mechanism for preventing abuse.¹⁵⁸ If a debtor passes the means test, a court may still dismiss a chapter 7 bankruptcy or convert it to chapter 11 or 13 “if ‘the debtor filed the petition ‘in bad faith,’” or “‘the totality of the circumstances . . . of the debtor’s financial situation demonstrates abuse.’”¹⁵⁹ This provision giving courts discretion to dismiss a filing for abuse is especially important for preventing student loan abuse because new graduates are likely to have very few assets, and thus will qualify as below-median debtors.¹⁶⁰

¹⁵² 11 U.S.C. § 707(b)(2)(A)(ii)(V) (“[T]he debtor’s monthly expenses may include an allowance for housing and utilities.”).

¹⁵³ 11 U.S.C. § 707(b)(2)(A)(ii)(I) (“[T]he monthly expenses of the debtor shall not include any payments for debts.”).

¹⁵⁴ See 11 U.S.C. § 707(b)(2)(B)(i) (citing examples including “serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative”).

¹⁵⁵ See Culhane & White, *supra* note 140, at 665 (“Since 1999, however, Congress has had reason to expect more than 95% of chapter 7 filers to pass the [means] test.”).

¹⁵⁶ See *id.* at 674 (“Debtors could possibly manipulate outcomes by reducing income, moving to a higher-median state, or increasing household size.”).

¹⁵⁷ See 11 U.S.C. § 707(b).

¹⁵⁸ See Culhane & White, *supra* note 140, at 665–66 (“Debtors who pass the means test still face judicial scrutiny and dismissal for ‘abuse of the provisions of [chapter 7]’”) (alteration in original) (quoting Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 102(a), 119 Stat. 23, 27–32 (codified at 11 U.S.C. § 707(b)(3) (2012))).

¹⁵⁹ *Id.* at 666.

¹⁶⁰ See *Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1306 (10th Cir. 2004) (“Upon graduation, the typical student has little or no non-exempt property that can be distributed to creditors, but may have substantial future earning potential. Section 523(a)(8) was designed to remove the temptation of recent graduates to use the bankruptcy system as a low-cost method of unencumbering future earnings.”).

The “good faith” requirement is typically used to limit abusive actions such as repeat filings and blatant non-cooperation by debtors, although its scope could potentially be widened to prevent abuse by student loan debtors.¹⁶¹ The Sixth Circuit showed how the “good faith” requirement can encompass student loan abuses in *In re Cheesman*.¹⁶² The court found that the debtors did not violate the “good faith” requirement because they did not file for bankruptcy immediately before their debts becoming due, had been making payments on their loans for years, and held “worthwhile jobs.”¹⁶³ Most importantly, the court found “[t]here [was] no indication that they were attempting to abuse the student loan system by having their loans forgiven before embarking on lucrative careers”¹⁶⁴

The Tenth Circuit gave another explanation of “bad faith” filings in *Educ. Credit Mgmt. Corp. v. Polleys*, holding that when determining whether a debtor filed in good faith, the inquiry should focus on “the legitimacy of the basis for seeking a discharge.”¹⁶⁵

Under either explanation given by the courts, the “good faith” requirement would prevent a debtor from trying to discharge student loan debts upon graduation simply to unencumber future earnings. Under the Tenth Circuit’s definition focusing on legitimacy, one can assume that a student filing for bankruptcy simply to increase his or her future earnings would be dismissed or converted quite easily for a showing of “bad faith.”¹⁶⁶ The Sixth Circuit’s definition explicitly mentions that graduates attempting to discharge their loans before heading off on a lucrative career will be dismissed for bad faith, showing that courts are able to prevent student loan abuse without having to exempt all private student loans from discharge.¹⁶⁷

¹⁶¹ See Culhane & White, *supra* note 140, at 668.

¹⁶² See 25 F.3d 356, 359–60 (6th Cir. 1994).

¹⁶³ *Id.* at 360 (“The Cheesmans made minimal payments on their loans several years after their loans became due and at least a year before filing for bankruptcy. Furthermore, the Cheesmans chose to work in worthwhile, albeit low-paying, professions.”).

¹⁶⁴ *Id.*

¹⁶⁵ 356 F.3d at 1310 (“For instance, a debtor who willfully contrives a hardship in order to discharge student loans should be deemed to be acting in bad faith. Good faith, however, should not be used as a means for courts to impose their own values on a debtor’s life choices.”).

¹⁶⁶ See, e.g., *Stewart v. U.S. Trustee (In re Stewart)*, 175 F.3d 796 (10th Cir. 1999) (discussing a doctor being sued and going through an expensive divorce who filed for bankruptcy in bad faith).

¹⁶⁷ See *Cheesman*, 25 F.3d at 360 (“There is no indication that they were attempting to abuse the student loan system by having their loans forgiven before embarking on lucrative careers in the private sector.”).

Another tool used by courts to help prevent abuse of the bankruptcy system is a broader test found in § 707(b)(3)(B) that allows a judge to dismiss a chapter 7 case if the “the totality of the circumstances . . . of the debtor’s financial situation demonstrates abuse.”¹⁶⁸ This test is broader than the means test because it takes into account the debtor’s current ability to repay, as well as his projected disposable income.¹⁶⁹ The Tenth Circuit laid out a list of factors in *In re Mondragon*, which it used to weigh the totality of the circumstances when looking for abuse.¹⁷⁰ These factors are:

(1) [T]he debtor’s ability to repay his or her debts; (2) whether the debtor has a stable source of future income; (3) whether the debtor’s expenses can be reduced without depriving the debtor of adequate food, clothing, shelter and other necessities; (4) whether the debtor has suffered a sudden illness or calamity; (5) whether the debtor has obtained cash advances and consumer purchases far in excess of the debtor’s ability to repay; (6) whether the debtor has excessive expenses; (7) whether the debtor has provided accurate and complete information on his or her statements and schedules; and (8) whether the debtor has acted in good faith.¹⁷¹

Although not all courts follow this exact set of criteria, it shows that bankruptcy courts are concerned about the debtor’s projected ability to repay.¹⁷² Thus, students graduating and trying to discharge their student loan debts before moving on to a profitable job would almost certainly have their cases dismissed or converted to a chapter 13 case under both the totality of the circumstances test and the good faith test.

2. *Student Loan Cosigners*

The provisions in the Code that prevent abuse are not the only protection that lenders have against students walking away from educational loans.¹⁷³ The recent trend in the private student loan market requiring cosigners for student

¹⁶⁸ 11 U.S.C. § 707(b)(3)(B) (2012); *see also* Culhane & White, *supra* note 140, at 668 (“Totality of the circumstances has a broader scope . . .”).

¹⁶⁹ *See In re Mondragon*, No. 7-06-10665 MR, 2007 Bankr. LEXIS 2894, at *9–11 (Bankr. D.N.M. Aug. 24, 2007); *see also In re Henebury*, 361 B.R. 595, 612 (Bankr. S.D. Fla. 2007).

¹⁷⁰ *See* 2007 Bankr. LEXIS 2894, at *5.

¹⁷¹ *Id.*

¹⁷² *See Henebury*, 361 B.R. at 609 (“Post-BAPCPA, other bankruptcy courts have held that abuse determinations pursuant to the totality of the circumstances of the debtors financial situation requires analysis of a debtor’s actual ability to pay and therefore post-petition events are properly considered under § 707(b)(3)(B).”).

¹⁷³ *See Tompor*, *supra* note 141 (stating that most private student loans issued require a cosigner).

loans provides extra assurance for lenders that they will be repaid.¹⁷⁴ Together, the cosignors and bankruptcy provisions provide sufficient protection to creditors such that exempting private student loans from discharge is unnecessary.

Cosigners on private student loans have increased in recent years, with about 90% of the private student loans issued in 2011 having a cosigner.¹⁷⁵ This figure is up from just 67% in 2008.¹⁷⁶ When an individual cosigns a student loan, he assumes the responsibility to repay the student's debt in the event that the student defaults on the loan.¹⁷⁷ This means that even if the student tries to walk away from payment, the lender can still go after the cosigner as if he or she held the debt.¹⁷⁸ Many times lenders will have requirements about a cosigner's creditworthiness in order for a borrower to qualify to ensure that there is adequate ability to pay in the event of a default by the student.¹⁷⁹ The fact that nearly all private student loan debts are cosigned gives lenders sufficient protection in the event that a student defaults.¹⁸⁰

In addition to protecting lenders when a student defaults, having a cosigner also protects the lender if the student borrower declares bankruptcy.¹⁸¹ Even if both the cosigner and the student declare bankruptcy, and the student is able to discharge the debt, most courts which ruled on this issue have refused to release the cosigner from their obligation.¹⁸² Many cases have addressed the dischargeability of cosigners' student loan debt, yet "[n]o reported case appears to have held that § 523(a)(8) does not apply to an educational loan where . . . only the parent is liable."¹⁸³ Not only can the cosigner be held solely liable if the student stops paying, but lenders can also hold the cosigner liable

¹⁷⁴ See *id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ See *id.*

¹⁷⁸ See *id.* ("That cosigned loan is treated as if it were the parent's loan.")

¹⁷⁹ *How Do I Find Student Loans if I Don't Have a Creditworthy Cosigner?*, EDVISORS (last visited Dec. 20, 2015), <https://www.edvisors.com/ask/faq/student-loans-no-cosigner/>.

¹⁸⁰ See Tompor, *supra* note 141 (stating that roughly 90% of the private student loans issued in 2011 required a cosigner).

¹⁸¹ See *id.* (stating that even a cosigner cannot typically achieve a discharge of the student loan debt in the event of a bankruptcy filing).

¹⁸² See Patricia Somers & James M. Hollis, *Student Loan Discharge Through Bankruptcy*, 4 AM. BANKR. INST. L. REV. 457, 467 (1996).

¹⁸³ *Uterhark v. Great Lakes Higher Educ. Corp. (In re Uterhark)*, 185 B.R. 39, 41 (Bankr. N.D. Ohio 1995) (citations omitted).

in a whole range of circumstances, including if the cosigner enters bankruptcy or if the student dies.¹⁸⁴ The reasoning given varies from case to case, but the underlying motivation for holding cosigners liable, even though they did not actually receive an educational benefit, is that lenders are similarly harmed when the student or cosigner discharges the loan.¹⁸⁵ Essentially, having a cosigner on a loan gives lenders an assurance that they will be able to extract payment in almost any situation, making it very difficult for students to abuse private student loans.

E. Effects of a Bubble

1. Avoiding a Bubble Burst

The 2008 subprime mortgage crisis shocked the global economy and resulted in years of economic hardship known as the “Great Recession.”¹⁸⁶ The major cause of the subprime mortgage crisis was lenient lending standards that allowed individuals to purchase more of a home without putting any actual equity into the investment.¹⁸⁷ It was believed for a long time that homes were an extremely reliable investment, and people, therefore, were willing to borrow huge sums of money to buy houses they could not afford.¹⁸⁸ In many people’s minds, the worst-case scenario if they could not afford the payment would be to sell the house at a small cost, or maybe even for a profit.¹⁸⁹ This belief that the particular asset was always a sound investment caused people to buy more, thus driving up the prices of homes without actually improving the real value

¹⁸⁴ See Daniel A. Austin, *The Indentured Generation: Bankruptcy and Student Loan Debt*, 53 SANTA CLARA L. REV. 329, 350–51 (2013) (“Private student loan lenders are not required to forgive the cosigner, and while some may do so, other lenders demand payment even if the student borrower has died.”); Somers & Hollis, *supra* note 182, at 466–67 (noting that one court has allowed discharge to a cosigner debtor but that most courts do not allow such a discharge).

¹⁸⁵ Somers & Hollis, *supra* note 182, at 467; see also *Palmer v. Student Loan Fin. Corp.*, 153 B.R. 888, 895 (Bankr. D.S.D. 1993) (finding liability because of a focus on the type of debt, instead of on the debtor).

¹⁸⁶ See, e.g., Jamie P. Hopkins & Katherine A. Pustizzi, *A Blast from the Past: Are the Robo-Signing Issues That Plagued the Mortgage Crisis Set to Engulf the Student Loan Industry?*, 45 U. TOL. L. REV. 239, 242 (2014).

¹⁸⁷ See *id.* (“These trends continued, with people refinancing more, buying more, owning less, and having bigger interest payments.”).

¹⁸⁸ See, e.g., *id.* at 241 (“[H]omeownership is widely recognized as a stable investment.”).

¹⁸⁹ See Jeff Holt, *A Summary of the Primary Causes of the Housing Bubble and the Resulting Credit Crisis: A Non-Technical Paper*, 8 J. BUS. INQUIRY 120, 125–26 (2009) (“Irrational exuberance played a key role in the housing bubble, as with all bubbles, when all parties involved in creating the housing bubble became convinced that home prices would continue to rise. . . . Home buyers continued to purchase homes (often for speculative purposes) even though the monthly payments would eventually prove unmanageable. They assumed that they would be able to ‘flip’ the home for a profit . . .”).

of the asset.¹⁹⁰ Eventually the prices of homes became so far out of sync with the actual value of the real estate that the market collapsed, and people found themselves underwater on their mortgages.¹⁹¹

As a result of the loose lending standards that allowed individuals to purchase expensive homes with little equity, the 2007 drop in housing prices “spread the flame of contagion and crisis.”¹⁹² By 2010, more than 25% of all U.S. mortgage holders owed more on their mortgages than their homes were worth.¹⁹³ The reduction in the price of an asset as important as a house led to many people losing one of their largest investments, and thus, a large chunk of their overall wealth.¹⁹⁴ The reduced housing prices alone would have created quite a large financial shock, but because many individuals owed more on their homes than they were worth, foreclosures and mortgage defaults greatly increased.¹⁹⁵ As more and more people began foreclosing and defaulting, banks and lenders began to realize that lending was riskier than they had originally anticipated and responded by freezing lines of credit across the nation.¹⁹⁶

This freezing of credit lines at a time when individuals’ wealth had been largely wiped out led to a serious reduction in real productivity.¹⁹⁷ When an individual experiences a reduction in wealth, typically he can rely on credit to continue to make purchases until his wealth builds up enough to pay off the credit charges, ensuring that individual has a constant level of consumption through economic hardship.¹⁹⁸ Freezing lines of credit concurrently with a drop

¹⁹⁰ See Hopkins & Pustizzi, *supra* note 186, at 241–42 (“[H]omeownership is widely recognized as a stable investment These trends continued, with people refinancing more, buying more, owning less, and having bigger interest payments.”).

¹⁹¹ See *id.* at 243 (“However, when housing prices fall, many people end up owing more money to their lender than they have in either the house or their personal savings.”).

¹⁹² *Id.* at 242.

¹⁹³ *Id.* at 243.

¹⁹⁴ See Paul Solman & Elizabeth Shell, *Latest U.S. Home Prices Show Your Largest Asset May be Withering Away*, PBS (Apr. 24, 2012, 2:11 PM), <http://www.pbs.org/newshour/making-sense/latest-us-home-prices-show-you-1/> (“If you’re a homeowner, you’re watching the value of one of your largest assets—if not your very *largest* asset—wither away.”).

¹⁹⁵ See Hopkins & Pustizzi, *supra* note 186, at 241–42 (“[W]hen housing prices decrease, foreclosure and mortgage defaults increase.”).

¹⁹⁶ See Peter J. Montiel, *On Macroeconomic Reforms and Macroeconomic Resiliency: Lessons from the Great Recession*, 2 MODERN ECON. 528, 531 (2011) (“The financial panic was followed by a collapse of real activity as the result of reduced asset values and the freezing up of credit flows.”).

¹⁹⁷ See Hopkins & Pustizzi, *supra* note 186, at 241.

¹⁹⁸ See Jonathan Morduch, *Income Smoothing and Consumption Smoothing*, 9 J. ECON. PERSP. 103, 104 (1995) (“Second, households can smooth consumption by borrowing and saving, depleting and accumulating

in an individual's wealth renders him unable to make purchases (or can only make a limited number of purchases), and when this phenomenon occurs for many individuals across a nation, overall economic activity declines.¹⁹⁹ This is exactly what happened in the wake of the 2008 housing crash, resulting in a GDP reduction of roughly 3.7%, and unemployment rates doubled, reaching over 10%.²⁰⁰ Because of the initial housing collapse, and the ensuing crisis, more than \$11 trillion in household wealth disappeared, and millions of Americans lost their homes.²⁰¹

The similarities between the subprime mortgage crisis and the student debt bubble are striking.²⁰² Both situations involve over-lenient lending standards, allowing individuals to purchase assets (education and housing) while putting less and less equity into the investment.²⁰³ These lending standards make funds readily available, encouraging people to spend more money than they would under normal lending standards, which in turn causes the price of the asset to increase at astonishing rates.²⁰⁴ In both the pre-2008 housing and the current student loan market, the price of the assets increased at a rate much faster than their real value, creating a bubble.²⁰⁵ It follows then, that like in the subprime mortgage crisis, when the price of the asset falls back in line with its real value, it may spark a national and potentially worldwide crisis.

Because loose credit standards inflated both the housing and student loan bubbles, it seems that the fallout from the student debt bubble bursting would cause many of the same effects as the housing market crash of 2008. In both

nonfinancial assets, adjusting labor supply, and employing formal and informal insurance arrangements. These mechanisms take force after shocks occur and help insulate consumption patterns from income variability.”).

¹⁹⁹ See John Irons, *Economic Scarring: The Long-Term Impacts of the Recession*, ECONOMIC POLICY INSTITUTE, (Sept. 30, 2009), <http://www.epi.org/publication/bp243/>.

²⁰⁰ Hopkins & Pustizzi, *supra* note 186, at 241.

²⁰¹ *Id.*

²⁰² See Michael B. Fishbein, *9 Striking Similarities Between the Housing Bubble and The Higher Education Bubble*, HUFFINGTON POST (Mar. 31, 2014, 5:59 AM), http://www.huffingtonpost.com/michael-b-fishbein/9-striking-similarities-b_b_5062840.html.

²⁰³ See Hopkins & Pustizzi, *supra* note 186, at 242 (“In general, these kinds of loan structures permit new homeowners to purchase a home with less capital and lower initial payments. In turn, these borrowers have less equity in the home’ These trends continued, with people refinancing more, buying more, owning less, and having bigger interest payments.”). See generally CONSUMER FIN. PROT. BUREAU, PRIVATE STUDENT LOANS, *supra* note 6.

²⁰⁴ See Hopkins & Pustizzi, *supra* note 186, at 241–42 (“[h]omeownership is widely recognized as a stable investment”); *Trends in College Pricing*, *supra* note 4 (explaining that the price of higher education has skyrocketed in this country in the past forty years, with the average cost of tuition rising approximately 204% from 1974 to 2014).

²⁰⁵ See Holt, *supra* note 189, at 120; Lacey, *supra* note 88.

events, the value of the borrower's asset (i.e., the home and the college education) decreases substantially, leaving the borrower underwater on his or her investment.²⁰⁶ Since he cannot pay off this large debt, the debtor must discharge the money by entering into either foreclosure or bankruptcy. Both situations give the debtor an ability to discharge the debt, but they force the debtor to forfeit future wages or other assets and severely harm his credit score.²⁰⁷ Not only will a bubble burst drastically reduce many individuals' credit scores, but it will also lead to an increase in the amount of bankruptcy and foreclosure filings. This increase will in turn cause borrowers to tighten lines of credit, further limiting debtors' ability to make purchases in their time of reduced wages. As a result, economic activity will stall, and without credit to jumpstart new projects and investments, recovery will be slow.²⁰⁸ This threat is especially pronounced when it comes to student loan debt because recent projections suggest that student debt default rates are expected to be "significantly higher" than those in the pre-2008 housing industry were.²⁰⁹

Students, therefore, need to be able to discharge their student loan debts to prevent the bubble from inflating to bursting levels. Hopefully, allowing students to discharge their private student loan debt will result in a gradual tightening of lending standards. Like with all other types of lending, if private student loans are dischargeable in bankruptcy, lenders will have an incentive to only grant credit to the amount that would be profitable instead of being willing to lend infinite amounts because repayment will be guaranteed. Thus, students will no longer have access to infinite sums of money to attend school

²⁰⁶ See Phil Rosenthal, *Students Finding Out What It Means to Be Underwater*, CHI. TRIB. (Aug. 29, 2012), http://articles.chicagotribune.com/2012-08-29/business/ct-biz-0829-phil-20120829_1_loan-debt-student-loans-rohit-chopra ("It's bad enough millions of U.S. homes are underwater, worth less money on the real estate market than needed to pay off the outstanding mortgage balance. The prospect of millions of Americans dragged under by massive student loans their pricey college educations might not be able to recoup in a weak job market could further challenge the U.S. economy.").

²⁰⁷ See Hopkins & Pustizzi, *supra* note 186, at 243 ("Traditional mortgage foreclosure resulted in three problems for a homeowner: (1) the loss of his or her home; (2) the loss of future wages or other assets; and (3) a decrease in credit score."); Stephen J. Dunn, *Many Consumer Bankruptcies Do More Harm than Good*, FORBES (June 3, 2011, 8:33 PM), <http://www.forbes.com/sites/stephendunn/2011/06/03/consumer-bankruptcies-do-more-harm-than-good/> ("[T]he filing of a bankruptcy case can remain on the debtor's credit report for ten years.").

²⁰⁸ See Hopkins & Pustizzi, *supra* note 186, at 241 ("The financial panic was followed by a collapse of real activity as the result of reduced asset values and the freezing up of credit flows' . . . from which it took the U.S. markets almost five years to fully recover."); see also Phil Rosenthal, *supra* note 206 ("The growing student loan debt crisis (is seen by many) as the next potential threat to our country's financial stability.") (quotation marks omitted).

²⁰⁹ Hopkins & Pustizzi, *supra* note 186, at 240 ("[S]tudent debt default rates [are] projected to be significantly higher than those witnessed in the housing industry.").

and will instead be forced to perform a cost-benefit analysis to determine which university is the best fit for them instead of choosing what they might consider a slightly “better” school at a higher cost. The reduction in the amount of money lent to students will in turn signal to universities that they cannot keep their prices at such exorbitant levels. As a result, the amount of student debt should eventually level off, and the education system should become more sustainable.

2. *The Issue of “Robo-Filings”*

When an individual owes more on her home than it is worth, she is forced to make a cost-benefit analysis to determine whether it is better to foreclose on the home or to continue to make payments.²¹⁰ Although foreclosing may cause a debtor to forfeit assets and harm her credit score, the lower that housing prices drop, the more appealing foreclosure becomes because it allows the debtor to discharge her mortgage.²¹¹ Thus, as housing prices decrease, foreclosure and mortgage rates tend to increase.²¹²

As foreclosures increased following the 2007 housing price drop, banks became swamped with foreclosure proceedings.²¹³ Due to the complicated set of laws surrounding bringing a foreclosure proceeding, properly filing the documents can take a very long time.²¹⁴ Depending on varying state laws, a foreclosure proceeding can potentially require that multiple affidavits and certifications are signed by someone with personal knowledge of the bank’s status to ensure that the bank has proper standing to proceed with the foreclosure.²¹⁵ Specifically, these documents are intended to verify facts about the home, such as whether there are liens on the property, whether the bank owned a mortgage on the house, or if the bank had authority to foreclose on the property.²¹⁶

²¹⁰ *See id.* at 243 (“This tremendous drop in home values placed a high percentage of Americans ‘underwater,’ forcing a strategic decision: Is it better to foreclose on a home if you owe more than it is worth?”).

²¹¹ *See id.*

²¹² *Id.*

²¹³ *See id.* at 239 (“To combat the flood of paperwork required to proceed with the record number of foreclosure filings nationwide, banks, law firms, and other institutions resorted to a process known as ‘robo-signing’ . . .”).

²¹⁴ *See id.* at 244 (“The foreclosure process can be very complicated given the legal requirements to properly effectuate a foreclosure proceeding and the variety of parties involved.”).

²¹⁵ *See id.* at 248–49.

²¹⁶ *See “Robo-Signing” of Mortgages Still a Problem*, CBS NEWS (July 18, 2011, 8:54 PM), <http://www.cbsnews.com/news/robo-signing-of-mortgages-still-a-problem/> (“Banks and their partner firms file mortgage

Because millions of foreclosures were filed in such a short period of time after the housing bubble burst, lenders began using a process called “robo-signing” (sometimes called “robo-filing”) where a lender’s employee would sign hundreds, or thousands, of affidavits and certifications for the lender stating that the employee had personal knowledge of the facts of the foreclosure.²¹⁷ In reality, however, these employees had little or no knowledge of what they were signing.²¹⁸ One report stated that one “robo-signer” for Nationwide Title Clearing Inc., signed his name on an average of five thousand mortgage documents per day for companies like Citigroup and JPMorgan Chase.²¹⁹ In addition to the five thousand documents that this robo-signer executed daily, Nationwide Title Clearing also employed a computer system that automatically applied the signer’s signature to documents that he never saw.²²⁰ These deceptive filings betray a history of strong property ownership recordkeeping, which has been the basis of American property ownership for more than three hundred years.²²¹ As Ohio Attorney General Richard Cordray stated, “[Lenders] can’t pretend this is a fourth-grade student not quite filling in the oval on a test. This is fraud.”²²²

Not only did robo-filing disgrace the history of American property ownership, but it also vastly slowed recovery from the bubble’s burst.²²³ Mortgage and foreclosure filings are not the only area where robo-filing is a cause for concern. With the growing level of student debt in the United States, some scholars worry that if a large amount of student borrowers default on

documents with county deeds offices to prove that there are no liens on a property, that the bank owns a mortgage or that a bank filing for foreclosure has the authority to do so.”)

²¹⁷ See Hopkins & Pustizzi, *supra* note 186, at 249.

²¹⁸ See *id.* at 249–50.

²¹⁹ Prashant Gopal, *No Breaks for Robo-signing Computer Stamping Files*, BLOOMBERG (Nov. 15, 2010, 3:30 PM), <http://www.bloomberg.com/news/2010-11-15/no-coffee-break-for-this-robo-signer-as-computer-stamps-mortgage-documents.html>.

²²⁰ *Id.*

²²¹ “*Robo-Signing*” of Mortgages Still a Problem, *supra* note 216. (“The paper trail ensures a legal chain of title on a property and has been the backbone of U.S. property ownership for more than 300 years.”).

²²² Ariana Eunjung Cha & Dina Elboghady, *50 State Attorneys General Announce Foreclosure Probe*, WASH. POST BUS. (Oct. 13, 2010, 12:50 PM) (quotation marks omitted), <http://www.washingtonpost.com/wp-dyn/content/article/2010/10/12/AR2010101205604.html>.

²²³ See Ray Brescia, *Robo-Sign Scandal Gives State Attorneys General Opportunity to Move Towards a Resolution of the Foreclosure Crisis*, HUFFINGTON POST (Dec. 17, 2010, 3:21 PM), http://www.huffingtonpost.com/ray-brescia/leverage-the-robo-sign-sc_b_798396.html (“[T]he prospect of substantial civil penalties and punitive damages, as well as injunctions preventing foreclosures from going ahead when tainted by robo-sign practices, is considerable.”).

their loans in a short period, then lenders may begin using this fraudulent practice to resolve student debt cases on a large scale.²²⁴

Multiple factors make private student loan debt more likely to result in default than federal student loans.²²⁵ Specifically, private student loans typically impose higher interest rates than federal loans and are subject to less regulation.²²⁶ In addition, federal student loans typically have more lenient default provisions than private loans.²²⁷ Federal loans usually allow borrowers a period of nine months after a missed payment before going into default.²²⁸ The default provisions of private loans vary between contracts, but due to a lack of government regulation, some contracts consider a borrower to be in default as soon as a single payment is missed.²²⁹ For example, an estimated \$8.1 billion in private student loans were in default in 2013 alone.²³⁰ This figure represents more than 850,000 different loans.²³¹ This high rate of defaults suggests that it is only a matter of time before robo-filing becomes prevalent in the private student loan industry.

Although private student loans have a higher risk of default, the threat of a large-scale default is not contained only to private student loans. Between the general rising cost of tuition and a sluggish job market, even federal loans that are typically offered at below-market rates carry a major risk of default.²³² According to statistics published by the Department of Education, payments

²²⁴ See Hopkins & Pustizzi, *supra* note 186, at 253 (“While robo-signing has been addressed, at least in part, with respect to foreclosures, another potential debt collection flood could be on its way: student loans.”).

²²⁵ See *id.* at 255–56.

²²⁶ See *id.* at 255 (“However, these [private] loans . . . are often more expensive than federal student loans. While federal student loans are strictly regulated, private lenders may charge higher variable interest rates, may vary the interest rate based on the borrower’s credit score, or may charge prepayment penalty fees.”).

²²⁷ See *id.* (stating that federal loans generally allow a nine month cushion to borrowers after missing a payment before entering default); Webley, *Why Can’t You Discharge Student Loans in Bankruptcy?*, *supra* note 37 (“Basically, the only option with private loans is to repay them—and to repay them on the lender’s timetable.”).

²²⁸ Hopkins & Pustizzi, *supra* note 186, at 255.

²²⁹ See *id.* at 255–56.

²³⁰ *Id.* at 259.

²³¹ *Id.*

²³² See Andrew Martin & Andrew L. Lehren, *A Generation Hobbled by the Soaring Cost of College*, N.Y. TIMES (May 12, 2012), <http://www.nytimes.com/2012/05/13/business/student-loans-weighing-down-a-generation-with-heavy-debt.html>? (“[I]n 2007, Congress made sure the interest rates on many of those [federal] loans were well below commercial rates . . .”); Hopkins & Pustizzi, *supra* note 186, at 259 (“With an increasing number of students borrowing, and borrowing greater sums in a currently weak economy, complete with decreased job prospects, the reality is that some students borrow more than they can reasonably expect to repay.”).

are only being made on 38% of the balance of federal student loan debt, down from just 46% five years ago.²³³

In addition to the threat of mass default filings, there are similarities between the subprime mortgage market in the period leading up to the 2008 crisis and the current student loan market which increase the likelihood that robo-filings will eventually cause problems for student borrowers. One of these similarities was pointed out by the National Consumer Law Center (the “NCLC”), which stated that both the subprime mortgage market and the private student lending market were “push markets” where products are offered not only to fulfill consumer need, but also to satisfy investor demand.²³⁴ Both markets also have incentives to increase the number of individuals approved for a loan by reducing the required minimum credit score to qualify.²³⁵ In short, the NCLC stated that “during the boom, [private student] lenders made a high percentage of loans to weaker credits,” which is precisely the behavior that led to the subprime mortgage crisis.²³⁶

Due to the similarities between the two markets, it logically follows that the robo-signing, which was a problem in the wake of the 2008 financial crisis, could be a hazardous consequence of allowing the student loan debt bubble to continue to swell.²³⁷ Like in the subprime mortgage market, the confusion of sorting out these fraudulent filings would impede any recovery effort, prolonging the financial downturn that would occur if the student loan debt bubble bursts. The best way to avoid this prolonged recession is to ensure that the student loan debt bubble does not reach its bursting point by allowing private student loans to be discharged in bankruptcy.

²³³ Martin & Lehen, *supra* note 232.

²³⁴ See *Private Student Loans: Providing Flexibility and Opportunity to Borrowers?: Hearing Before the S. Banking Subcomm. on Fin. Insts. and Consumer Prot.*, 112th Cong. 8 (2012) (statement of Deanne Loonin, Attorney, National Consumer Law Center).

²³⁵ See *id.*

²³⁶ *Id.*

²³⁷ See *Written Testimony of Rohit Chopra Before the S. Comm. on Banking, Hous., and Urban Affairs*, 113th Cong. (2013) (statement of Rohit Chopra, Assistant Director & Student Loan Ombudsman, Consumer Financial Protection Bureau) (“[I]t is clear that many of you are keenly interested in finding solutions for some of the troubling trends in the student loan market.”); Hopkins & Pustizzi, *supra* note 186, at 261 (“Given the similarities between collection practices in the [student debt and subprime mortgage] markets, we can expect to see similar collection tactics employed as more and more borrowers default and fall further into student loan debt.”).

CONCLUSION

Congress erred when it exempted private student loans from discharge in the 2005 amendments to the Code. As a result of this provision, the level of private student loan debt has surged in the United States, which has in turn contributed to the skyrocketing cost of tuition.²³⁸ Congress thus needs to repeal this change and should return § 523(a)(8) of the Code to its pre-2005 state.

A significant benefit of allowing private student loans to be discharged in bankruptcy is that it would free up roughly 15% of the \$1.2 trillion student loan debt for more economically productive uses.²³⁹ And perhaps more importantly, allowing discharge of private student debts would also remove the false incentives of private lenders to over-lend to college students. If private student loans could be discharged in bankruptcy, private lenders would begin to treat student loans like all other types of credit and lend only when they could be sure that borrowers would be able to re-pay. Consequently, the number of student loans made per year would drop, perhaps even to their pre-2005 levels.²⁴⁰

Over time, universities would be forced to take notice of this change because some students would choose less costly institutions in the absence of being able to obtain a near infinite private student loan. The risk of losing students in response to a tuition increase will prevent universities from increasing their tuition rates at the astounding rates seen in recent history. Hopefully, over time, slowing the rise of tuition rates would have a secondary effect of slowing the growth of student loan debts.

From examining the 2008 subprime mortgage crisis, scholars were able to learn certain lessons which must now be applied to the student loan market.²⁴¹ The similarities between the two markets are quite pronounced—excessively loose credit standards underlie and fuel both.²⁴² These lax standards allow individuals to borrow more than they are able to repay, causing them to enter foreclosure or bankruptcy (depending on their type of debt). Thus, the result is an increase in the number of default filings. This increase in turn causes

²³⁸ See Webley, *Is Forgiving Student Loan Debt a Good Idea?*, *supra* note 12.

²³⁹ See Denhart, *supra* note 7; Kingkade, *Private Student Loan Bankruptcy*, *supra* note 90 (“Today, 2.9 million Americans have private student loan debt, owing about \$150 billion and representing 15 percent of all student debt.”).

²⁴⁰ CONSUMER FIN. PROT. BUREAU, *PRIVATE STUDENT LOANS*, *supra* note 6.

²⁴¹ See, e.g., Hopkins & Pustizzi, *supra* note 186, at 257–60.

²⁴² See, e.g., *id.*

lenders to tighten lending standards at a time when individuals have a reduced level of wealth, leading to a severe reduction in the amount of economic activity overall in the country.²⁴³ Therefore, to prevent a large surge of defaults, and the economic slowdown that they bring, lending standards need to be gradually tightened to help deflate the growing student debt bubble. As previously emphasized, allowing private debts to be discharged in bankruptcy is one way to deflate this bubble.

Not only did the 2008 financial crisis teach America about the effects of a bursting credit bubble, but it also warned scholars of the possible dangers of large-scale defaults. Specifically, when lenders become overwhelmed by the number of borrowers defaulting on their loans and must enact collection actions against them, there is a huge amount of paperwork involved.²⁴⁴ In the context of foreclosures, an employee of the lender must read and verify the facts surrounding each particular mortgage to decide whether the bank had proper standing to proceed with a foreclosure.²⁴⁵ Because there were so many defaults, lenders were unable to effectively evaluate each filing, and therefore began robo-signing the required documents.²⁴⁶ Individual employees would testify to signing thousands of affidavits and certifications a day, each one verifying that the employee had studied and was familiar with the information contained within.²⁴⁷ To respond to this scandal, State Attorney Generals imposed substantial civil and punitive damages, in addition to issuing injunctions.²⁴⁸ This process prolonged the recovery period after the 2008 financial crisis and monopolized legal resources at an already strenuous time. Due to the similarities of the student loan and subprime mortgage markets, many scholars are now afraid that robo-signing could be an issue if student borrowers begin defaulting on their loans en masse.²⁴⁹ This fear gives extra weight to the argument that the student debt bubble needs to be deflated before it pops.

Finally, although the exemption of student loans from discharge in bankruptcy was passed under the guise of preventing abuse, there are other

²⁴³ *Id.* at 241.

²⁴⁴ *See id.* at 248–50.

²⁴⁵ *See id.*

²⁴⁶ *See id.* at 249–50.

²⁴⁷ *See id.*

²⁴⁸ *See* Ray Brescia, *supra* note 223 (“[T]he prospect of substantial civil penalties and punitive damages, as well as injunctions preventing foreclosures from going ahead when tainted by robo-sign practices, is considerable.”).

²⁴⁹ *See* Hopkins & Pustizzi, *supra* note 186, at 263–64.

mechanisms preventing borrowers from abusing the student loan system, rendering the § 523(a)(8) exemption unnecessary. One of these protections is § 707(b) of the Code, which includes multiple defenses to bankruptcy abuses.²⁵⁰ This provision includes a means test that prevents above-median debtors from abusing the system and instead channels them into a chapter 11 or 13 case, or dismisses the filing altogether.²⁵¹ Students and recent graduates who have not yet built up assets or have little to no monthly income are especially likely to pass the means test,²⁵² so courts consequently have designed another way to prevent against abuse: Section 707(b)(3) allows a court to dismiss a bankruptcy proceeding if it believes that the petition was filed in “bad faith” or if the “totality of the circumstances . . . demonstrate abuse.”²⁵³

Along with these abuse-prevention mechanisms in the Code, almost all private student loans today require a creditworthy cosigner in order to be approved.²⁵⁴ Therefore, even if a student defaults on his payments and has no real tangible assets for the lender to seize, another adult is on the hook for payment of the full balance of the debts. Many lenders have requirements about cosigners’ financial abilities, ensuring that some collateral will be available to repay the lender if the student defaults.²⁵⁵

In conclusion, it seems that the 2005 amendment to § 523(a)(8) of the Code was a line-item snuck into a larger bill that serves no meaningful function to protect against abuse. The consequences of this seemingly “small” provision, however, have been exceedingly dangerous and substantial, leading to spiraling tuition and student debt levels in the past nine years. If left unaltered, the exemption of private student loans from discharge could cause the student

²⁵⁰ See 11 U.S.C. § 707(b) (2012) (containing the means test and totality of the circumstances test).

²⁵¹ See 11 U.S.C. § 707(b)(2).

²⁵² See *id.*

²⁵³ 11 U.S.C. § 707(b)(3).

²⁵⁴ See Tompor, *supra* note 141 (stating that roughly 90% of the private student loans issued in 2011 required a cosigner).

²⁵⁵ See *Private Student Loans*, FIN. AID, <http://www.finaid.org/loans/privatestudentloans.phtml> (last visited Dec. 29, 2015) (“Unfortunately, these rates often will be available only to borrowers with great credit who also have a creditworthy cosigner.”).

loan debt bubble to burst, and, in turn, a rippling economic effect similar to that in 2008 from which the nation is still struggling to recover.

PRESTON MUELLER*

* Notes and Comments Editor, *Emory Bankruptcy Developments Journal* (2015-16); J.D. Candidate, Emory University School of Law (2016); B.A., Economics, the University of Michigan (2013). First I would like to thank Professor Sue Payne for her guidance and editing throughout the writing process. I also would like to thank the *Emory Bankruptcy Developments Journal* staff, especially Armie Lewis, for their time spent on my Comment. Finally, I am so grateful for the support of my friends and family, particularly my parents Gene and Nancy Mueller for all of their support.