



Business Litigation Update

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Tenth Circuit Limits Bankruptcy Protections for Private Student Loans

Millions of Americans are grappling with student debt on top of the challenges posed by the coronavirus pandemic and the economic recession. Unlike other categories of personal debt, most student loans are nondischargeable absent a showing that the debtor is experiencing an “undue hardship.” Of the over \$1.6 trillion in student loan debt, over \$50 billion is comprised of private loans. On August 31, 2020, in *McDaniel v. Navient Solutions, LLC*, the Tenth Circuit joined the Fifth Circuit in narrowing the circumstances under which private student loans are nondischargeable under the Bankruptcy Code, a decision that could have a huge impact on student lenders with portfolios of private loans.

Background

The Bankruptcy Code makes student loans nondischargeable if they fall into one of three categories: (1) qualified education loans; (2) a loan made, insured, or guaranteed by a governmental unit, or funded by a governmental unit or nonprofit institution; or (3) “an obligation to repay funds received as an educational benefit, scholarship or stipend.” If a student loan falls into one of those three categories, then the borrower must show “undue hardship” before the student loan debt can be discharged.

Private student lenders who issue loans that do not constitute “qualified education loan[s]” (which are loans issued to borrowers taking at least six credits per semester at certain accredited schools the amount of which do not

exceed the cost of attendance) or are not guaranteed by the federal government or a nonprofit have argued that these private loans are nevertheless nondischargeable because they were for an “educational benefit.” The Tenth Circuit joined the Fifth Circuit in taking a narrow approach in defining the “educational benefit” exception to nondischargeability.

The *McDaniel* Decision

In *McDaniel*, a husband and wife sought Chapter 13 bankruptcy relief in Denver with more than \$200,000 in student loans. Roughly half of that amount was used to finance tuition and was nondischargeable under the Bankruptcy Code as “qualified education loans.” The other \$107,000 was made up of “tuition answer loans” that were used to pay the debtors’ living expenses while attending college. The debtors filed an adversary complaint seeking a declaration that the tuition answer loans were dischargeable.

The lender conceded that these loans were not made or guaranteed by a governmental unit or nonprofit institution, nor were they qualified education loans. Instead, the lender argued, in relevant part, that the loans fell into the third category of nondischargeable student loan debt: “an obligation to repay funds received as an educational benefit, scholarship or stipend.”

The bankruptcy court ruled that the tuition answer loans were dischargeable because they were not for an

“educational benefit” under the plain language of the Bankruptcy Code. The lender appealed, and the Tenth Circuit upheld the bankruptcy court’s decision.

In large part, the Tenth Circuit followed a 2019 decision from the Fifth Circuit, which held that an “obligation to repay funds received as an educational benefit” does not include student loans. The court concluded that “Congress presumably did not intend” the third subsection “to also cover” loans. The statutory terms “obligation to repay funds received as an educational benefit” and “educational loan” are not the same. For a “normal English speaker,” the court wrote, an “educational benefit” refers “to things like a health benefit, unemployment benefit, or retirement benefit.” In other words, a benefit “implies a ‘payment,’ ‘gift,’ or ‘service’ that ordinarily does not need to be repaid.” For example, the educational benefits provided by the GI Bill—not applying for private student loans. The court also supported this conclusion by finding that interpreting “educational benefit” to include “loans” would render the other provisions of the statute superfluous.

Conclusion

The Fifth and Tenth Circuit’s recent decisions will make it significantly more difficult for student lenders to argue that private student loans are nondischargeable when the loans are not qualified education loans and are not guaranteed by the federal government or a nonprofit. However, the recent decisions have done nothing to impede a lender’s ability to argue that a loan is nondischargeable because it is a “qualified education loan” or a loan made, insured, or guaranteed by a governmental unit, or funded by a governmental unit or nonprofit institution. If courts continue to ease certain borrowers’ path to discharge of their student loans, the volume of private student loan debt in the market, coupled with an economic recession, could have a dramatic financial impact on private student lenders.

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