

STUDENT LOAN BANKRUPTCIES

I. INTRODUCTION

The number of student loans discharged in bankruptcy has grown rapidly in the past few years. In 1975 alone there were 4,559 claims, representing a 59.9% increase over the number of claims filed in 1974.¹ By the end of 1975 the federal government and guaranty agencies had reimbursed lenders for \$20.9 million of guaranteed student loans discharged in bankruptcy.² Of the \$18.5 million paid by the federal government, \$14.1 million was paid from January 1974 through June 1976.³

These figures have provoked several recent judicial⁴ and legislative responses.⁵ A provision of the Education Amendments of 1976⁶ prohibits the discharge of a guaranteed student loan in the first five years of its repayment period unless the debtor can prove undue hardship. Bills currently before Congress,⁷ however, would repeal this provision and allow guaranteed student loans to be freely dischargeable again. This Note, in suggesting an appropriate solution to the problem, examines: (1) possible legislative solutions to the problem of student loan bankruptcies, (2) the policies behind the educational loan programs and the Bankruptcy Act, (3) the available statistics on student loans and defaults, (4) the congressional hearings and reports, and (5) the judicial responses. It concludes that all guaranteed student loans and National Direct Students Loans should be excepted by statute from discharge during the first five years of the repayment period if the creditor

1. *Bankruptcy Act Revision: Hearings on H.R.31 and 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 1st & 2d Sess. 1065, 1076 (1975-1976) (statement of Edward T. York, Jr.) [hereinafter cited as *Bankruptcy Act Hearings*].

2. *Id.*

3. *Id.*

4. *Girardier v. Webster College*, 563 F.2d 1267 (8th Cir. 1977); *Handsome v. Rutgers Univ.*, 445 F. Supp. 1362 (D.N.J. 1978); *State v. Wilkes*, 41 N.Y.2d 655, 363 N.E.2d 555, 394 N.Y.S.2d 849 (1977).

5. Education Amendments of 1976, § 127(a), 20 U.S.C. § 1087-3 (1976); H.R. 8457, 95th Cong., 1st Sess. (1977); H.R. 8200, 95th Cong., 1st Sess. (1977); H.R. 31 & 32, 94th Cong., 2d Sess. § 4-506(a)(8) (1976).

6. 20 U.S.C. § 1087-3 (1976).

7. H.R. 8457, 95th Cong., 1st Sess. (1977); H.R. 8200, 95th Cong., 1st Sess. (1977).

can prove that the debtor will not suffer undue hardship if required to repay the loan. A proviso to the statute should prohibit educational institutions from engaging in coercive repayment practices after a student loan is discharged in bankruptcy.

II. LEGISLATIVE BACKGROUND

Two major loan programs currently provide funds to students for educational expenses. The National Defense Education Act established a program in 1958 to provide National Defense Student Loans (NDSL) to students in institutions of higher learning.⁸ Under this program a student borrows directly from an institution's loan fund, which is supported by federal and institutional contributions.⁹

In 1965 Congress provided a federal guaranteed student loan program (GSL) and enacted provisions encouraging state and private guaranteed student loan programs.¹⁰ Under a GSL program a student borrows money from a bank, corporation, college, or any other qualifying lender. The guaranty agency, which could be the federal government, a state agency, or a private nonprofit organization, endorses the loan.¹¹ There are state or nonprofit guarantors in twenty-six states; most are reinsured by the Commissioner of Education.¹²

Both programs provide for the cancellation of loans upon the death or disability of the borrower.¹³ In addition, a specified percentage of

8. National Defense Education Act, § 201, 20 U.S.C. § 421 (1976). Congress continued the basic program under § 461(a) of the Education Amendment of 1972, 20 U.S.C. § 1087aa (1976), but changed the name of the loans to National Direct Student Loans.

9. The Commissioner of Education apportions the funds authorized for student loans among the states; each institution applies to the Commissioner for a portion of the funds allocated to the state in which it is located. The institution then sets up a fund to which it contributes one dollar for every nine dollars the federal government contributes. 20 U.S.C. §§ 1087bb-cc (1976).

10. Higher Education Act of 1965, § 421, 20 U.S.C. § 1071 (1976).

11. The guaranty agency promises repayment of the principal and interest to the lender. The lender also receives a special allowance of up to three percent interest from the federal government to encourage participation. S. REP. NO. 882, 94th Cong., 2d Sess., reprinted in [1976] U.S. CODE CONG. & AD. NEWS 4713, 4730; see UNITED STUDENT AID FUNDS, INC., INFORMATION AND INSTRUCTIONS FOR STUDENT LOAN APPLICANTS (June 1977).

United Student Aid Funds, Inc. is presently the only nonprofit student loan organization operating nationwide. *Review of Higher Education Programs, 1975: Hearings on Examination into the High Default Rate and the New Policy of the Department of Health, Education, and Welfare in Regard to Refunds Due Students Attending Schools and How Those Refunds Affect the Amount of Federal Guarantee Before the Subcomm. on Education of the Senate Comm. on Labor and Public Welfare, 94th Cong., 1st Sess. 1, 188 (1975) (statement of Charles Meares) [hereinafter cited as Higher Education Hearings].*

12. See *Bankruptcy Act Hearings*, supra note 1, at 1076.

13. 20 U.S.C. §§ 1087(a), 1087dd(c)(1)(F) (1976). When an NDSL is cancelled the institu-

an NDSL may be cancelled for each year that a student performs certain public services such as full-time teaching of handicapped children in a public elementary school.¹⁴ If a student defaults on a loan or is discharged in bankruptcy, the loss falls primarily on the federal government.¹⁵

The purposes of the student loan programs are: (1) to ensure a sufficient supply of well-trained, competent professional and technical personnel;¹⁶ and (2) to allow every person the fullest possible educational opportunity by making loans available to those who could not otherwise obtain a loan because of their age and lack of collateral or borrow-

tion bears 10% of the loss and the federal government bears the remainder. When a GSL is cancelled, the Commissioner pays the outstanding balance to the lender; the federal government, therefore, bears the entire loss. 45 C.F.R. § 177.5 (1977).

14. 20 U.S.C. § 1087ee (1976). The Commissioner repays the entire amount cancelled to the institution's loan fund.

15. When an NDSL has been in default for at least two years, the institution may assign its rights without recompense to the United States. 20 U.S.C. § 1087cc(a)(5) (1976). The institution loses 10% of the amount of the loan, while the federal government loses 90%. Any portion of the loan collected after assignment is assigned to the general Treasury fund. *Id.* The purpose of this provision is to allow the institutions and the Office of Education to clear their books of uncollectible loans. H.R. REP. NO. 554, 92d Cong., 2d Sess., reprinted in [1972] U.S. CODE CONG. & AD. NEWS 2462, 2493.

When a student borrower defaults on a GSL the guarantor repays the lender. If the loan is federally guaranteed, the Commissioner, upon notification by the lender, will repay the "amount of the loss." 20 U.S.C. § 1080(a) (1976). The "amount of the loss" will be 100% of the unpaid principal plus interest, unless more than 5% of the loans made by the lender that were in repayment at the end of the preceding fiscal year are in default. In that case the lender is entitled to only 90% of the loss on those loans in excess of 5% of the total loans and 80% of the loss on those loans in excess of 9% of the total loans. 20 U.S.C. § 1075(b)(1)(A) (1976). The statute also provides that if a student loan is discharged in bankruptcy, the Commissioner will repay the outstanding balance. 20 U.S.C. § 1087(b) (1976). If the defaulted loan is insured by a state or nonprofit guaranty organization and the organization is reinsured by the federal government, the organization pays the lender its loss and is then reimbursed by the federal government. It will be reimbursed in full if the organization's total default rate is less than or equal to 5%. If more than 5% of the agency's loans are in default, the agency will be reimbursed for 90% of the excess loans and, if more than 9% of the agency's loans are in default, the agency will be reimbursed for 80% of the excess. 20 U.S.C. § 1078(c)(1)(B) (1976). These reimbursement provisions also apply when a student loan is discharged in bankruptcy. After the federal government pays a claim or reimburses a guaranty organization, the Office of Education has the responsibility to attempt to collect from the student. *Bankruptcy Act Hearings, supra* note 1, at 1076.

16. 20 U.S.C. § 401 (1976); 45 C.F.R. § 144.1 (1977). "If there is any one thing upon which all commentators in the field agree it is that the explanation for the enactment of NDEA can be summed up in one word, Sputnik." Garsaud, *The National Defense Education Act, Title II—Student Loan Program—Moving Toward the End of the First Decade*, 14 LOY. L. REV. 79, 82 (1967). It was also a factor leading to the enactment of the guaranteed student loan programs. See S. REP. NO. 673, 89th Cong., 1st Sess., reprinted in [1965] U.S. CODE CONG. & AD. NEWS 4027, 4053.

ing history.¹⁷

The present Bankruptcy Act represents a fusion of two contradictory notions: retaliation and cooperative action.¹⁸ The retaliatory notion—that “persons who fail to pay their debts ought to be punished”—comes from Roman law.¹⁹ Every state now bans imprisonment for debt,²⁰ however the correspondence received by the Commission on Bankruptcy Laws of the United States “suggests that the attitudes that animated the builders of debtors’ prison still survive.”²¹

The premise of cooperative action is that society should maximize both the return to creditors and the rehabilitation of debtors. The original emphasis was on the equitable adjustment of creditors’ claims.²² As society recognized the social costs of permanent financial distress, a concern evolved for the welfare of debtors.²³ Today the primary purpose of bankruptcy is the discharge of indebtedness and the “fresh start” that follows.²⁴

Discharge is a privilege available to the “honest but unfortunate debtor” to give him a “fresh start, . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.”²⁵ A debtor is considered honest if he has

17. See S. REP. NO. 673, *supra* note 16, at 4060; *Higher Education Hearings*, *supra* note 11, at 182 (statement of B.B. Elkins).

18. H.R. DOC. NO. 137, Part I, 93d Cong., 1st Sess. 61, 63 (1973).

19. Kennedy, *Reflections on the Bankruptcy Laws of the United States: The Debtor's Fresh Start*, 76 W. VA. L. REV. 427, 428 (1974). The first federal Bankruptcy Act of 1800, ch. 19, 6th Cong., 1st Sess., 2 Stat. 19, followed English bankruptcy practice, which had its origins in Roman law. See Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226, 228 (1976).

20. See Kennedy, *supra* note 19, at 431.

21. *Id.* at 431-32.

22. See 1A COLLIER ON BANKRUPTCY ¶ 14.01 (14th ed. 1978); Note, *Section 14f(2) of the Bankruptcy Act: Half a Loaf to the Bankrupt*, 14 HOUS. L. REV. 486, 487-88 (1977). See also *In re Leslie*, 119 F. 406 (N.D.N.Y. 1903).

23. See Note, *Bankruptcy Exemptions: State Law or Federal Policy?*, 35 U. PITT. L. REV. 630 (1974). “[A] discharge provides him with the incentive to use his skills and talents, and thereby contribute to society even after financial disaster.” 1A COLLIER ON BANKRUPTCY ¶ 14.01 (14th ed. 1978).

24. See 1A COLLIER ON BANKRUPTCY ¶ 14.01 (14th ed. 1978). From fiscal year 1946 through fiscal year 1967 approximately 90% of bankruptcy cases involved nonbusiness debtors. See Countryman, *supra* note 19, at 231. Of these, about 85% were no-asset cases, in which no dividends were distributed to creditors; yet in over 95% of the cases courts granted a discharge. See Kennedy, *supra* note 19, at 435-36. The emphasis on discharge is also apparent in judicial decisions. See, e.g., *Lines v. Frederick*, 400 U.S. 18, 19-20 (1971); *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 514 (1938); *Freshman v. Atkins*, 269 U.S. 121, 122-23 (1925).

25. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 (1934).

not committed any of the acts listed in section 14(c) of the Bankruptcy Act,²⁶ which a creditor can use as the basis for an objection to a discharge.²⁷

Although the fresh start doctrine is recognized by many courts²⁸ and by Congress,²⁹ some cases limit it. For example, in *Wetmore v.*

26. The court shall grant the discharge unless satisfied that the bankrupt has (1) committed an offense punishable by imprisonment as provided under section 152 of title 18; or (2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of account or records, from which his financial condition and business transactions might be ascertained, unless the court deems such acts or failure to have been justified under all the circumstances of the case; or (3) while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation; or (4) at any time subsequent to the first day of the twelve months immediately preceding the filing of the petition in bankruptcy, transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed, any of his property with intent to hinder, delay, or defraud his creditors; or (5) in a proceeding under this title commenced within six years prior to the date of the filing of the petition in bankruptcy has been granted a discharge, or had a composition or an arrangement by way of composition or a wage earner's plan by way of composition confirmed under this title; or (6) in the course of a proceeding under this title refused to obey any lawful order of, or to answer any material question approved by, the court; or (7) has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities; or (8) has failed to pay the filing fees required to be paid by this title in full: *Provided*, That if, upon the hearing of an objection to a discharge, the objector shall show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this subdivision, would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt.

11 U.S.C. § 32(c) (1976).

27. See generally 1A COLLIER ON BANKRUPTCY ¶ 14.02(1) (14th ed. 1978); Schuchman, *An Attempt at a "Philosophy of Bankruptcy,"* 21 U.C.L.A. L. REV. 403, 449-50 (1973). The Bankruptcy Act of 1898 read in pertinent part: "The judge shall . . . investigate the merits of the application and discharge the applicant unless he has [committed objectionable acts]." Ch. 541, § 14, 30 Stat. 550 (1898) (current version at 11 U.S.C. § 32 (1976)). Section 14(c) of the Bankruptcy Act now provides in pertinent part: "The court shall grant the discharge unless satisfied that the bankrupt has [committed objectionable acts]." The merits of the application, therefore, are not to be investigated any further than the eight statutory grounds of objection. 1A COLLIER ON BANKRUPTCY ¶ 14.02(1) (14th ed. 1978).

28. See, e.g., *Lines v. Frederick*, 400 U.S. 18 (1970), in which the Court stated that the "most important consideration limiting the breadth of the definition of 'property' lies in the basic purpose of the Bankruptcy Act to give the debtor a 'new opportunity in life and a clear field for future effort,'" and held therefore that a bankrupt wage earner's vacation pay did not pass to the trustee in bankruptcy as "property." *Accord, In re Schmelzer*, 480 F.2d 1074 (6th Cir. 1973); *In re Aveni*, 458 F.2d 972 (6th Cir. 1972).

29. The 1966 amendments to § 17(a)(1) of the Bankruptcy Act, Pub. L. No. 89-496, § 2, 80 Stat. 220 (current version at 11 U.S.C. § 35 (1976)), made debts for taxes, which became legally due and owing more than three years preceding bankruptcy, dischargeable. The House Report explaining the amendment reflects Congress' concern for the "honest but financially unfortunate debtor" unable to make a fresh start due to "an overwhelming liability for accumulated taxes."

Markoe,³⁰ the Supreme Court refused to allow the debtor's need for a fresh start to override his moral and legal obligation to support his wife and children. And in *In re Kokoszka*, the Second Circuit held that "permitting a bankrupt to retain his tax refund would not be giving him a 'fresh start' to accumulate new wealth, but [rather] a 'head start' over others who had no such refund."³¹

III. THE PROBLEM AND THE LEGISLATIVE RESPONSES

The federal government extends loans to students with neither collateral nor a cosignor.³² If a student defaults on his loan or declares bankruptcy, the government has no property or guarantor to look to for satisfaction of the indebtedness. Because of the Bankruptcy Act's definition of insolvency,³³ any student whose total liabilities exceed his total assets may declare bankruptcy and thereby relieve himself of his student loan obligation. Until recently, however, students used the Bankruptcy Act too infrequently to arouse concern. From 1966, when the GSL program began, through 1970, there were only 348 GSL bankruptcy claims, totaling \$0.4 million.³⁴ By the end of 1975 the federal government and guaranty agencies had paid approximately \$21 million in bankruptcy claims.³⁵ From 1970 through 1975 approximately \$9 million in NDSLs were discharged in bankruptcy.³⁶ In fiscal year 1975

S. REP. NO. 1158, 89th Cong., 2d Sess. 3, reprinted in [1966] U.S. CODE CONG. & AD. NEWS 2468, 2469.

30. 196 U.S. 68 (1904). Despite the Court's refusal to relieve this debtor of his obligation, *Wetmore* was one of the first cases to recognize the fresh start doctrine. *Id.* at 77.

31. 479 F.2d 990, 995 (2d Cir. 1973), *aff'd sub nom. Kokoszka v. Belford*, 417 U.S. 642 (1974). *Accord*, *Richardson v. United States*, 552 F.2d 291 (9th Cir. 1977).

32. 20 U.S.C. §§ 1077(a)(2)(A), 1087(c)(1)(E) (1976).

33. A person shall be deemed insolvent within the provisions of this title whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts

11 U.S.C. § 1(19) (1970).

34. *See Bankruptcy Act Hearings*, *supra* note 1, at 1076.

35. *See id.* Other figures show that approximately \$18 million of bankruptcy claims were paid by the end of 1975. *Id.* at 1085. Of this approximately \$11 million was paid under the federally insured loan program and \$7 million under state and private guaranty agency programs. *Id.* at 1084. Bankruptcies represent 4% of the total loss under the entire GSL program (loss results from default, bankruptcy, death, or disability) and 0.5% of the cumulative matured amount of GSLs. *Id.* at 1085.

36. Letter from Robert Coates, Office of Education, Department of Health, Education, and Welfare, Washington, D.C. (Dec. 1977) (statistics on NDSL program (available on request from the *Law Quarterly*)). By 1975 the GSL program had disbursed almost three times the dollar amount of loans disbursed under the NDSL program. From 1970 through 1975 both programs

alone \$6.8 million in GSLs³⁷ and \$3.3 million in NDSLs³⁸ were discharged in bankruptcy. The incidence of GSL bankruptcies has grown at a much greater rate than individual or nonbusiness bankruptcies³⁹ and is expected to continue to increase as a result of the more aggressive collection activities recently initiated by the federal government.⁴⁰

To explore the increased use of the bankruptcy process by former students, two congressional hearings were held in 1975 and early 1976.⁴¹ Unfortunately, no documented studies of the reasons for the increase were submitted to either hearing.⁴² Instead, most of the statements assumed that the increase was attributable to abuse of the bankruptcy process.⁴³ The term "abuse" refers to situations where a student has income or a strong possibility of receiving income, but files for bankruptcy to avoid repayment of his student loan.⁴⁴ Witnesses

experienced approximately the same rate of loss on loans discharged in bankruptcy. *Id.*; *Bankruptcy Act Hearings*, *supra* note 1, at 1085.

37. Letter from Robert Coates, *supra* note 36. From fiscal 1966 through fiscal 1972 the number of federally insured student loan bankruptcies totaled 2,146 for \$2.4 million; in February 1975 the cumulative total reached 8,969 for \$11.3 million. *Higher Education Hearings*, *supra* note 11, at 6 (statement of T.H. Bell).

38. Letter from Robert Coates, *supra* note 36.

39. "From fiscal year 1973 to fiscal year 1974 the number of guaranteed student bankruptcies increased 29.2%. The national average of the number of individual bankruptcies increased 8.4% during the same period. . . . From fiscal year 1974 to fiscal year 1975 the number of student loan bankruptcies jumped 59.9% while the national average of the number of bankruptcies moved upward 32.9%." *Bankruptcy Act Hearings*, *supra* note 1, at 1078. From 1973 to 1974 the dollar amount of discharged NDSLs increased 14.3% and from 1974 to 1975 there was an increase of 82.1%. Letter from Robert Coates, *supra* note 36.

40. *Bankruptcy Act Hearings*, *supra* note 1, at 1069, 1077. By 1975 GSLs in default totaled \$401 million. *Id.* at 1085. As collection efforts are increased, it is likely that many debtors whose loans are in default will seek a bankruptcy discharge. September 1975 statistics showed that the 25% rate of bankruptcy losses in Wisconsin was much higher than other states. A witness suggested this was attributable to the "vigorous pursuit of defaulters" in Wisconsin. *Id.* at 1091 (statement of John N. Erlenborn).

41. *Higher Education Hearings*, *supra* note 11; *Bankruptcy Act Hearings*, *supra* note 1.

42. See *Higher Education Hearings*, *supra* note 11; *Bankruptcy Act Hearings*, *supra* note 1.

43. There were only two attempts during the hearings to statistically substantiate this assumption. Charles Meares, president of United Student Aid Funds, Inc., said that 85% of USAF defaulters who declare bankruptcy do so within three years of leaving school and that in many cases student loans represented 90% of a bankrupt's liabilities (60% to 70% being commonplace). *Higher Education Hearings*, *supra* note 11, at 189. In addition, another witness testified that the results of a 1975 survey under the New Jersey state guarantee program revealed the average time between the receipt of the last loan and the filing of bankruptcy was two and a half years, while a survey conducted in 1972 showed four and a half years as the average. Furthermore, the occupations of those borrowers who had declared bankruptcy included an assistant dean of students, a vice principal, a teacher, and a pharmacist. *Bankruptcy Act Hearings*, *supra* note 1, at 1079 (statement of Edward T. York, Jr.).

44. See, e.g., *United States v. Martin*, 561 F.2d 135 (8th Cir. 1977) (married defendants with a combined salary of \$20,000 and outstanding student loans of \$18,300 filed for bankruptcy).

suggested other reasons for the increase in student loan bankruptcies: (1) students leaving college today are entering the worst economic situation since the Depression and are finding work unavailable or available only at subsistence wages,⁴⁵ and (2) bankruptcy is merely "symptomatic of the general permissiveness" of the GSL program.⁴⁶

The period from 1975 through most of 1977 was marked by public alarm over the increasing number of student loan bankruptcies and by the assumption that the increase was attributable to abuse of the bankruptcy process.⁴⁷ In response, Congress enacted section 127(a) of the Education Amendments of 1976, which reads:

A debt which is a loan insured or guaranteed under the authority of this part may be released by a discharge in bankruptcy under the Bankruptcy Act only if such discharge is granted after the five-year period (exclusive of any applicable suspension of the repayment period) beginning on the date of commencement of the repayment period of such loan, except that prior to the expiration of that five-year period, such loan may be released only if the court in which the proceeding is pending determines that payment from future income or other wealth will impose an undue hardship on the debtor or his dependents.⁴⁸

Also in 1976 the Commission on the Bankruptcy Laws of the United States proposed an amendment to the Bankruptcy Act that would have

One witness questioned the validity of this assumption:

I would like to point out that none of the witnesses has given us a documentation to support the allegations made that there is a general attitude of "I am not going to pay my bills, and I am going to take advantage of the bankruptcy laws." We had an increase of bankruptcy in this country generally, that is very large in the last few years. A lot of it has to do with recession and a lot with inflation and all kinds of different things.

Bankruptcy Act Hearings, *supra* note 1, at 1096 (statement of Rep. Edwards).

45. *Bankruptcy Act Hearings*, *supra* note 1, at 1083, 1129 (statements of Rep. Edwards, Clarissa Gilbert).

46. *Higher Education Hearings*, *supra* note 11, at 64. The Consumer Bankers Association asserted that "[w]ith more explicit instructions to students, better defined eligibility requirements, and stronger collection effort, perhaps we could restore enough discipline in this program to avoid the question of providing the U.S. Government with an additional priority." *Id.* The high default rate and total amount of unpaid GSLs indicate the ineffectiveness of the program's collection system. The default rate on federally insured student loans is approximately 18-22%, on state guaranteed loans, approximately 7.6%, and on USAF loans, about 6%. The national average default rate on unsecured revolving consumer credit is about 5.4%. *See Higher Education Hearings*, *supra* note 11, at 51, 188 (statements of Charles M. Meares, Robert E. Tobey); *Bankruptcy Act Hearings*, *supra* note 1, at 1090 (statement of John N. Erlenborn).

47. *See Higher Education Hearings*, *supra* note 11, at 187-90; *Bankruptcy Act Hearings*, *supra* note 1, at 1066, 1078-79, 1091, 1093, 1101-03, 1121-22.

48. Education Amendments of 1976, § 127(a), 20 U.S.C. § 1087-3(a) (1976) (amending Higher Education Act of 1965, § 439(a), 20 U.S.C. 1087-3 (1976)). Subsection (b) provides that subsection (a) is effective "with respect to any proceedings begun under the Bankruptcy Act on or before September 30, 1977." *Id.*

"[T]his part" refers to "Part B. Federal, State, and Private Programs of Low-Interest Insured

excepted from discharge "any educational debt if the first payment of any installment thereof was due on a date less than five years prior to the date of the petition and if its payment from future income or other wealth will not impose an undue hardship on the debtor and his dependents."⁴⁹ There are two major differences between these responses. First, section 127(a) of the Education Amendments of 1976 applies only to GSLs,⁵⁰ whereas the proposed Bankruptcy Act amendment would have excepted from discharge both GSLs and NDSLs. Second, under the Education Amendment the burden of proving the existence of undue hardship rests on the debtor,⁵¹ whereas the Bankruptcy Commission's proposed amendment would have required the creditor to prove that a denial of discharge would not result in undue hardship.⁵²

Loans to Students in Institutions of Higher Education," which is a section of the Higher Education Act of 1965, 20 U.S.C. § 1071-87-4 (1976). As a result, this section limits only the discharge of GSLs and not NDSLs.

The Senate Report indicates that Congress enacted the nondischarge provision because of the rapid increase in the number and amount of guaranteed student loans discharged in bankruptcy. S. REP. NO. 882, 94th Cong., 2d Sess. 1, 32-33, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 4713, 4713, 4744. The belief that the increase was due to abuse cases and that it threatened to destroy the entire guaranteed loan system pervaded both congressional hearings. *See, e.g., Higher Education Hearings, supra* note 11, at 6, 191; *Bankruptcy Act Hearings, supra* note 1, at 1067-68, 1078-79, 1090.

49. H.R. 31, 94th Cong., 2d Sess. § 4-506(a)(8) (1976), *reprinted in Bankruptcy Act Hearings, supra* note 1, app. 156-57. The Commission made the same proposal in 1973. H.R. 6, 93d Cong., 1st Sess. § 4-506(a)(8) (1973). The National Conference of Bankruptcy Judges proposed similar amendments in 1973 and 1976. H.R. 32, 94th Cong., 2d Sess. § 4-506(a)(8) (1976); H.R. 7, 93d Cong., 1st Sess. § 4-506(a)(8) (1973).

50. During both the *Bankruptcy Act Hearings, supra* note 1, and the *Higher Education Hearings, supra* note 11, witnesses showed concern only for the GSL program. For example:

I would not be uncomfortable if the definition of educational debt were to be limited to Federal and Federal insured or guaranteed student loans. This construction would cover the major Federal student loan effort and secure, I believe, the concerns of the overwhelming majority of those actively involved with the problem.

Bankruptcy Act Hearings, supra note 1, at 1091-92 (statement of John N. Erlenborn). The GSL program is the largest single form of student aid authorized by the Committee on Education and Welfare. *Id.* at 1090. As of June 30, 1976, the cumulative number of GSLs was 8,210,000 and cumulative loan volume was \$8.2 billion. S. REP. NO. 882, *supra* note 48, at 4730-31.

51. To prevent discharge of the loan, the creditor must prove that the loan is a GSL and that the first five years of the repayment period have not expired. To secure discharge of the loan, the debtor must show that he will suffer undue hardship if forced to repay the loan. *Compare* Education Amendments of 1976, § 127(a), 20 U.S.C. § 1087-3(a) (1976), *with* Bankruptcy Act, § 17(a)(3), 11 U.S.C. § 35(a)(3) (1976). The Supreme Court interpreted § 17(a)(3) as requiring a creditor, in order to prevent discharge of his claim, to prove that the debt owed him was not "duly scheduled in time for proof and allowance," and requiring a debtor, in order to secure discharge of the debt, to prove that the creditor "had notice or actual knowledge of the proceedings in bankruptcy." *Hill v. Smith*, 260 U.S. 592, 595 (1923).

52. To prevent discharge of the loan, the creditor must show that the loan is an "educational

In 1977 a General Accounting Office (GAO) study⁵³ revealed the presence of abuse in approximately twenty percent of the prior year's bankruptcy cases involving GSLs. This study⁵⁴ and a reevaluation of the default and bankruptcy figures convinced many that excepting educational loans from discharge was not justified by need or sound policy.⁵⁵

In July 1977 a bill⁵⁶ was introduced in the House that would make all student loans dischargeable in bankruptcy. In 1978 the House passed Bankruptcy Act amendments⁵⁷ that would not include educational debts among the exceptions from discharge and would provide for repeal of the Education Amendment provision that now limits the discharge of guaranteed student loans.⁵⁸

IV. JUDICIAL RESPONSES TO THE DISCHARGE OF STUDENT LOANS

There have been three recent judicial responses to the increasing numbers of student loan bankruptcies. In *State v. Wilkes*,⁵⁹ the New York Court of Appeals failed to recognize or discuss abuse, although its clear presence may have influenced the decision. The court's holding—NDSLs were too contingent to be dischargeable in bank-

debt," that the first five years of the repayment period have not expired prior to the date of the debtor's petition, and that repayment of the debt will not impose an undue hardship on the debtor. H.R. 31, 94th Cong., 1st Sess. § 4-506(a)(8) (1975), reprinted in *Bankruptcy Act Hearings, supra* note 1, app. 157.

53. See H.R. REP. NO. 595, 95th Cong., 1st Sess. 140-44 (1977). The study revealed 72% of the sample individuals, including teachers, housewives, students, mechanics, attorneys, carpenters, and truck drivers, were employed at the time of filing their bankruptcy petitions. In the year prior to filing for bankruptcy, 20% of the sample individuals had incomes in excess of \$10,000, and another 39% had incomes of \$5,001 to \$10,000. Educational debts accounted for 60% or more of all nonpriority, unsecured indebtedness in 35% of the sample cases, and in 8% of the cases educational debts were the only debts listed. *Id.*

54. *Id.* at 133, 154-55, 161-62.

55. *Id.* at 132-64. The former Chairman of the Post-Secondary Education Subcommittee, stated: "[T]o assert that a practice involving less than one student borrower out of two hundred is a 'large and growing scandal' seems a little disproportionate." *Id.* at 148 (statement of James O'Hara). Some witnesses asserted that improvement of the administration of the loan programs is a better solution, *id.* at 133, 151, 154, 160, and that the discharge exception "is a punitive measure which unfairly discriminates against every student who relies on loans to help pay the costs of education." *Id.* at 149, 153, 160.

56. H.R. 8547, 95th Cong., 1st Sess. (1977).

57. H.R. 8200, 95th Cong., 1st Sess. (1977).

58. *Id.* Education Amendments of 1976, § 127(a), 20 U.S.C. § 1087-3(a) (1976). See note 48 *supra* and accompanying text.

59. 41 N.Y.2d 655, 363 N.E.2d 555, 394 N.Y.S.2d 849 (1977), rev'g 52 App. Div. 2d 454, 384 N.Y.S.2d 530 (1976). See note 75-77 *infra* and accompanying text.

ruptcy—will prevent all bankrupts, even those in real need of relief, from obtaining a discharge of their NDSLs. In *Girardier v. Webster College*,⁶⁰ the Eighth Circuit held that the Bankruptcy Act did not prohibit coercive post-discharge debt collection attempts by a *private* college. But a federal district court, in *Handsome v. Rutgers University*,⁶¹ held that a *state* university may not withhold transcripts or deny registration to a former student whose student loans had been discharged.⁶²

When defendant in *Wilkes* filed for bankruptcy⁶³ he was earning an annual salary of \$9,000⁶⁴ and owed \$3,900 for NDSLs,⁶⁵ \$3,000 for loans guaranteed by the New York State Higher Education Assistance Corporation,⁶⁶ and \$160 for various charge accounts.⁶⁷ His petition was granted, and when plaintiff brought an action to recover the amount of the NDSL debt, Special Term granted summary judgment to defendant on the basis of his former discharge.⁶⁸ The Appellate Division affirmed,⁶⁹ but the New York Court of Appeals reversed and held that an NDSL is a contingent debt not capable of reasonable estimation and therefore not a provable debt dischargeable in bank-

60. 563 F.2d 1267 (8th Cir. 1977).

61. 445 F. Supp. 1362 (D.N.J. 1978).

62. Although *Rutgers* was decided after the GAO study, the court still found there was "widespread abuse of the bankruptcy laws on the part of students." *Id.* at 1363. Plaintiff, however, appears to have been in legitimate need of a discharge. She was compelled to leave school because of medical problems and her NDSLs constituted only 20% of the liabilities she discharged in bankruptcy. *Id.* at 1363-64.

63. 41 N.Y.2d at 657, 363 N.E.2d at 557, 394 N.Y.S.2d at 850.

64. *Id.*

65. 52 App. Div. 2d at 455, 384 N.Y.S.2d at 531.

66. *Id.*

67. 41 N.Y.2d at 657, 363 N.E.2d at 557, 394 N.Y.S.2d at 850.

68. *Id.* at 656, 363 N.E.2d at 567, 394 N.Y.S.2d at 850.

69. 52 App. Div. 2d at 454, 384 N.Y.S.2d at 530. The Appellate Division ruled that NDSLs were provable in bankruptcy. *Id.* at 457, 384 N.Y.S.2d at 532. After examining §§ 63(a) and 57(d) of the Bankruptcy Act and pertinent law (*Maynard v. Elliott*, 283 U.S. 273 (1931), and *In re Crisp*, 521 F.2d 172 (2d Cir. 1975)), the court was "constrained to conclude that the liability on the debts in question was fixed and existed at the time defendant filed his petition in bankruptcy." *Id.* at 457, 384 N.Y.S.2d at 532.

70. 41 N.Y.2d at 658, 363 N.E.2d at 558, 394 N.Y.S.2d at 851. The New York Court of Appeals reasoned as follows: (1) only provable debts are dischargeable, Bankruptcy Act, § 17(a), 11 U.S.C. § 35(a) (1976); (2) in general, contingent debts may be proved and allowed, *id.* § 63(a)(8), 11 U.S.C. § 103(a)(8) (1976); (3) if, however, a contingent claim is "not capable . . . of reasonable estimation," it shall not be allowed, *id.* § 57(d), 11 U.S.C. § 93(d) (1976); and (4) a contingent claim that has been proved, but that has not been allowed "is deemed to be not provable." *Id.* § 63(d), 11 U.S.C. § 103(d) (1976). The court stated that because the claim was not susceptible of "reasonable estimation," it would not have been allowed if the state had filed a proof of claim and, therefore, it was not dischargeable when the court granted defendant's bankruptcy petition. 41 N.Y.2d at 657-58, 363 N.E.2d at 558, 394 N.Y.S.2d at 851.

ruptcy.⁷⁰ When Wilkes received his NDSL it was subject to several conditions: cancellation in the event of the maker's total and permanent disability or death; reduction of ten percent of the unpaid balance for each year of service as a full-time public school teacher, up to a maximum of fifty percent; and reduction of fifteen percent for each year of teaching in specified low-income areas or of teaching the handicapped.⁷¹ The court reasoned that these conditions, taken together, made the ultimate amount of liability impossible to ascertain or approximate.⁷² It further asserted that the vague provisions of the Bankruptcy Act dealing with contingent claims⁷³ should be construed to achieve the Act's basic purpose, which was, according to the court, "to relieve honest debtors of the crushing burdens of heavy debt," and not to allow student borrowers to frustrate the purposes of the national student loan program.⁷⁴

The court's refusal to find NDSLs capable of reasonable estimation is not supported by existing case law and the limited conditions placed on these loans. The Bankruptcy Act provides that contingent debts may be proved and allowed.⁷⁵ An exception to this general rule arises when any contingent debt is not allowed under section 57(d) of the Bankruptcy Act⁷⁶ because it is not capable of reasonable estimation. The claim is then deemed unprovable.⁷⁷

Congress designed section 57(d) "to codify the judicially declared state of the law prior to its enactment."⁷⁸ Thus to determine the scope

71. 41 N.Y.2d at 656-57, 363 N.E.2d at 557, 394 N.Y.S.2d at 850.

72. *Id.* at 658, 363 N.E.2d at 558, 394 N.Y.S.2d at 851. The court also reasoned that the loan was not a commercial transaction in which the state had weighed the benefits of having the student borrower teach against the costs of nonrepayment. Consequently, "any attempt at valuing the teaching obligation by reference to the amount of the loan is unavailing." *Id.* at 659, 363 N.E.2d at 558, 394 N.Y.S.2d at 851-52.

73. Bankruptcy Act, §§ 57(d), 63(a)(8), 63(d), 11 U.S.C. §§ 93(d), 103(a)(8), 103(d) (1976).

74. 41 N.Y.2d at 660, 363 N.E.2d at 558-59, 394 N.Y.S.2d at 852.

75. "Debts of the bankrupt may be proved and allowed against his estate which are founded upon . . . contingent debts and contingent contractual liabilities . . ." Bankruptcy Act, § 63(a)(8), 11 U.S.C. § 103(a)(8) (1976).

76. 11 U.S.C. § 93(d) (1976) provides:

Claims which have been duly proved shall be allowed upon receipt by or upon presentation to the court . . . : *Provided, however,* That an unliquidated or contingent claim shall not be allowed unless liquidated or the amount thereof estimated in the manner and within the time directed by the court; and such claim shall not be allowed if the court shall determine that it is not capable of liquidation or of reasonable estimation or that such liquidation or estimation would unduly delay the administration of the estate or any proceeding under this title.

77. *Id.* § 63(d), 11 U.S.C. § 103(d) (1976).

78. *Thompson v. England*, 226 F.2d 488, 490 (9th Cir. 1955).

of "contingent debts" capable of reasonable estimation, it is necessary to determine the state of the law in 1938. In *Dunbar v. Dunbar*,⁷⁹ the Supreme Court held that a husband's written contractual obligation to pay his wife a specified sum annually "during her life or so long as she remained unmarried" was incapable of valuation and therefore not provable under the Bankruptcy Act.⁸⁰ The Court recognized that an annuity terminating at death could easily be valued by reference to life expectancy tables, but found the contingency of "continued widowhood" impossible to calculate.⁸¹

In *Maynard v. Elliott*,⁸² considered the leading case in this area,⁸³ the Supreme Court held that a claim against an indorser of unmatured commercial paper was provable.⁸⁴ The Court noted that the contingent nature of an obligation rendered a claim upon it incapable of proof when it is "beyond the control of the creditor, and dependent upon an event so fortuitous as to make it uncertain liability will ever attach. . . . [o]r the contingency may be such as to make any valuation of the claim impossible, even though liability has attached."⁸⁵

79. 190 U.S. 340 (1903).

80. *Id.* at 351.

81. *Id.* at 345.

82. 283 U.S. 273 (1931).

83. *See, e.g.*, *Thompson v. England*, 226 F.2d 488, 490 (9th Cir. 1955); *State v. Wilkes*, 41 N.Y.2d 655, 658, 363 N.E.2d 555, 558, 394 N.Y.S.2d 849, 851 (1977).

84. 283 U.S. at 275-76. The Court compared the claim against an indorser of commercial paper to a claim on contracts of suretyship or on a guaranty of payment of a debt not due until after bankruptcy. *Id.*

85. *Id.* at 278. Since *Maynard*, courts have viewed the question of estimation liberally to afford the bankrupt a fresh start by including all his debts within the scope of the discharge. *See, e.g.*, *Brown v. O'Keefe*, 300 U.S. 598 (1937); *In re Crisp*, 521 F.2d 172 (2d Cir. 1975); *Schaefer v. Smith*, 469 F.2d 1256 (10th Cir. 1972); *Chevron Oil Co. v. Dobie*, 40 N.Y.2d 712, 358 N.E.2d 502, 389 N.Y.S.2d 819 (1976); *Edwards Co. v. Long Island Trust Co.*, 75 Misc. 2d 739, 347 N.Y.S.2d 898 (1973).

Where claimant loaned her husband, the bankrupt, \$12,000 to be repaid from the proceeds of his business "as soon as said business is in a sound, financial position," the claim was held to be contingent on an event so "fortuitous as to make it uncertain liability will ever attach" and therefore not allowable. *Thompson v. England*, 226 F.2d 488, 490 (9th Cir. 1955) (quoting *Maynard v. Elliott*, 283 U.S. 273, 278 (1931)). The claims of two persons who had purchased stock from a bankrupt, under an agreement that the bankrupt would repurchase the stock for \$5,500 if they had not received a \$5,000 return on the stock prior to specified dates in 1972, were allowable under the bankrupt's petition filed in 1971. The court said that the amounts of both claims were fixed, \$5,500 each, therefore, no estimation was necessary and that the contingency was not dependent on an event so fortuitous as to make it uncertain liability would ever attach. *Schaefer v. Smith*, 469 F.2d 1256, 1258 (10th Cir. 1972) (quoting *Maynard v. Elliott*, 283 U.S. 273, 278 (1931)). A state's claim against the bankrupt for hospitalization costs was capable of reasonable estimation under § 57(d), though the debt was subject to possible increase in the future. *In re Crisp*, 521 F.2d 172, 176-77 (2d Cir. 1975). The bankrupt's liability already existed; therefore only the amount of

The Court pointed to *Dunbar*⁸⁶ as an example of the latter class.⁸⁷ In 1937 the Supreme Court added its last thoughts on this subject: "What infusion of contingency will vitiate a claim is at best a question of degree, . . . though there is a leaning toward allowance in aid of the purpose of the statute to relieve the honest debtor."⁸⁸

Section 57(d) of the Bankruptcy Act⁸⁹ expressly provides that estimation need only be reasonable and recognizes that estimation should be based on all the pertinent facts ascertainable at the time of liquidation.⁹⁰ For example, in the case of a guaranty, which becomes operative only upon the occurrence of an indefinite event such as the default of the principal debtor, the financial status of the principal debtor "should be carefully examined and his probable future revenue and expenditure appraised as accurately as feasible, before determining whether, and if so, to what extent the bankrupt guarantor may be called upon to redeem his promise. This determination, however, calls for an estimate."⁹¹ If the claim against a guarantor⁹² or an indorser of commercial paper⁹³ is capable of reasonable estimation, the claim against the principal debtor can also be estimated. Liability turns primarily on the same factors: the financial status of the principal debtor and his ability to repay.

Under the cancellation provisions of an NDSL, the student is the principal debtor and the United States is the guarantor. The contingency, however, is not the ability of the principal debtor to repay, but rather the possibility that he will die, become disabled, or decide to teach in specified schools or to specified students.⁹⁴ *Wilkes* recognized

the obligation was contingent. *Id.* at 176. "However, at any particular time the amount of the debt is known. . . . Thus, the claim is liquidated when a bill is rendered, even if it is subject to increase. This is not a mere 'arbitrary' estimate . . . , but rather an accurate statement of the debt at that time." *Id.* (citation omitted). The court explained that the amount at which the bankruptcy court would liquidate the debt (at the cost already fixed, the maximum amount possible, or at an intermediate amount) would depend on the evidence before it indicating the possibility of an increase such as "the source of any possible windfall [or] the Commissioner's practice if the bankrupt's wages merely increase." *Id.* at 177.

86. See notes 79-81 *supra* and accompanying text.

87. 283 U.S. at 278.

88. *Brown v. O'Keefe*, 300 U.S. 598, 606 (1937) (citation omitted).

89. 11 U.S.C. § 93(d) (1978).

90. 3 COLLIER ON BANKRUPTCY ¶ 57.15 (14th ed. 1976).

91. *Id.*

92. See *Chevron Oil Co. v. Dobie*, 40 N.Y.2d 712, 358 N.E.2d 502, 389 N.Y.S.2d 819 (1976).

93. *Maynard v. Elliott*, 283 U.S. at 278.

94. The conditions under which liability on NDSLs may be reduced or cancelled are extremely limited. See 20 U.S.C. § 1087ee(a) (1976). NDSLs granted since 1972 no longer allow a

that the contingency of death or disability can be reasonably estimated.⁹⁵ Unfortunately, the court failed to recognize that it could also estimate the likelihood that a student borrower may become a teacher within several years after the bankruptcy hearing. The court could have based this estimate on a review of all the pertinent facts, *e.g.*, the kind of college degree the bankrupt held, his employment status, the likelihood of his returning to school to obtain a teaching degree, and his future plans.⁹⁶ *Wilkes* affects not only those NDSL borrowers⁹⁷ with the ability to repay but also those in real need of relief. This result is not warranted by prior law and is inconsistent with the Bankruptcy Act's basic purpose to provide a fresh start.⁹⁸

In any event, in all states except New York there are currently no *direct* limitations on the discharge of NDSLs.⁹⁹ Any person who has liabilities exceeding assets may obtain a discharge. In *Girardier v. Webster College*,¹⁰⁰ however, the Eighth Circuit placed an *indirect* limitation on the use of bankruptcy to discharge an educational debt. By allowing *private* colleges to undertake coercive post-discharge collection efforts, the court limited the utility of a discharge. But a federal district court, in *Handsome v. Rutgers University*,¹⁰¹ prohibited *state* colleges from engaging in such post-discharge conduct.

10% reduction for each year the debtor teaches in a public elementary or secondary school. *Id.* They are still cancelled in the event of total disability or death. *Id.* § 1087dd(c)(1)(f). A percentage of the loan is cancellable for each year of service as: (1) a full-time teacher in a public elementary school that is eligible for assistance pursuant to Title I of the Elementary and Secondary Education Act of 1964, *id.* § 241, (2) a full-time staff member in a preschool program carried on under § 222(a)(1) of the Economic Opportunity Act, 42 U.S.C. § 2809(a)(1) (1976), (3) a full-time teacher of handicapped children in a public or other nonprofit elementary or secondary school, and (4) a member of the United States Armed Forces for service that qualifies for special pay under 37 U.S.C. § 310 (1976). 20 U.S.C. § 1087ee(a) (1976).

95. 41 N.Y.2d at 658, 363 N.E.2d at 558, 394 N.Y.S.2d at 851. *Accord*, *Dunbar v. Dunbar*, 190 U.S. 340, 345 (1903); *Reid v. Karoley*, 232 Ark. 261, 264, 337 S.W.2d 648, 650 (1960).

96. The probability of the occurrence of other conditions under which part of an NDSL may be cancelled, *supra* note 94, are also capable of estimation at the time of the bankruptcy hearing by considering similar factors.

97. *See* 20 U.S.C. § 1087ee(a) (1976). *Wilkes* will not affect bankrupts holding GSLs because the only contingency attached to GSLs is cancellation in the event of death or disability, *id.* § 1087(a), and the court acknowledged that this contingency can be reasonably estimated. 41 N.Y.2d at 658, 363 N.E.2d at 558, 394 N.Y.S.2d at 851.

98. *See* note 24 *supra* and accompanying text.

99. Section 127(a) of the Education Amendments of 1976, 20 U.S.C. § 1087-3(a) (1976), places limitations only on the discharge of GSLs. *See* note 48 *supra* and accompanying text.

100. 563 F.2d 1267 (8th Cir. 1977).

101. 445 F. Supp. 1362 (D.N.J. 1978).

After receiving bachelors degrees from Webster College, both plaintiffs in *Girardier* obtained bankruptcy discharges of their NDSL indebtedness to defendant. The college refused plaintiffs' subsequent request for transcripts because they had not repaid their NDSLs.¹⁰² The Eighth Circuit, while recognizing that the Bankruptcy Act imposes some limits on creditors' actions, held the Act did not prohibit a private college from withholding the transcripts of former students whose loans had been discharged in bankruptcy.¹⁰³ Section 14(f)(2) of the Bankruptcy Act,¹⁰⁴ said the court, prohibited only legal means of debt collection and did not prevent creditors from using informal, extralegal means of inducing the bankrupt to pay his debt.¹⁰⁵ In *Perez v. Campbell*,¹⁰⁶ the Supreme Court prohibited state action that had the effect of creating "a powerful weapon for collection of a debt."¹⁰⁷ *Girardier*, however, interpreted *Perez* as not precluding the same kinds of actions by private creditors.¹⁰⁸ Although one of the fundamental policies of the Bankruptcy Act is to provide the debtor with a fresh start, the majority found that it "does not necessarily mean every conceivable mechanism for furthering this goal has been written into the Act so as to become law."¹⁰⁹

Plaintiff in *Handsome v. Rutgers University*¹¹⁰ attended Rutgers,

102. 563 F.2d at 1269. Plaintiff Girardier owed \$1,500 and plaintiff Luzkow owed \$1,900.

103. *Id.* at 1276. The court also held that the "Buckley/Pell Amendment," 20 U.S.C. § 1232(g) (1976), granting students a right to review educational records, did not prohibit Webster College's refusal. *Id.* at 1276-77.

104. 11 U.S.C. § 32 (1976).

105. 563 F.2d at 1272-73. The court found that the legislative history did not indicate a congressional intent to include informal means of debt collection within the proscription of § 14(f)(2) and that the word "process" as used within § 14(f)(2) implied court action only. *Id.*

106. 402 U.S. 637 (1971).

107. *Id.* at 650 (quoting *Kesler v. Department of Pub. Safety*, 369 U.S. 153, 183 (1962)).

108. *Id.* at 1273-74. See Note, *Supremacy of the Bankruptcy Act: The New Standard of Perez v. Campbell*, 40 GEO. WASH. L. REV. 764, 771-73 (1972). The court cited cases decided after *Perez* involving state or local laws that specifically recognized the private action versus state action distinction. 563 F.2d at 1273-74. See *Rutledge v. City of Shreveport*, 387 F. Supp. 1277 (W.D. La. 1975); *Grimes v. Hoschler*, 12 Cal. 3d 305, 525 P.2d 65, 115 Cal. Rptr. 625 (1974); *In re Lofkin*, 327 So. 2d 543 (La. Ct. App. 1976). The concurring judge in *Girardier* asserted the private action versus state action distinction was not warranted by *Perez* and said that inconsistent results may follow from its use. 563 F.2d at 1277 (Bright, J., concurring).

109. 563 F.2d at 1274-75. The court referred to two sections of the proposed Bankruptcy Act amendments: § 4-508, which would protect a bankrupt from discriminatory treatment, and § 4-507, which would prohibit the revival or reaffirmation of a debt extinguished by discharge, H.R. 31 & 32, 94th Cong., 2d Sess. §§ 4-507, 4-508 (1976), to illustrate the present Bankruptcy Act's failure to fully implement the fresh start policy. 563 F.2d at 1275-76.

110. 445 F. Supp. 1362 (D.N.J. 1978).

which is the New Jersey state university, from 1968 until her poor physical condition forced her to withdraw in 1975.¹¹¹ Because of her medical expenses, she was unable to repay her \$4,600 NDSL and, therefore, in April 1977 filed a petition for bankruptcy, which was granted in June of that year.¹¹² Thereafter, she applied for readmission,¹¹³ but the university refused to allow her to register and refused to supply a copy of her transcript.¹¹⁴ The court held that "such thinly-veiled coercion on the part of a state university to compel repayment of loans duly discharged under the federal bankruptcy laws violates the Supremacy Clause and plaintiff's right to equal protection as guaranteed by the Fourteenth Amendment."¹¹⁵ Because Rutgers, a *state* creditor, "transgressed upon the 'fresh start' policies of the Bankruptcy Act" by withholding plaintiff's transcripts and refusing to allow her to register, its action violated the supremacy clause.¹¹⁶ In addition, the court found that the state had no legitimate interest in securing the repayment of loans discharged in bankruptcy and that defendant's action violated plaintiff's fourteenth amendment equal protection rights.¹¹⁷

The result in *Girardier*, although it appears unjust to the plaintiffs in light of *Rutgers*, is a correct application of the Bankruptcy Act. In the 1970 amendments, Congress specified the means to prevent abuse of the discharge process by creditors.¹¹⁸ Section 14(f)(2)¹¹⁹ provides that the order of discharge shall "enjoin all creditors whose debts are discharged from thereafter instituting or continuing any action or employing any process to collect such debts as personal liabilities of the bankrupt." The *Girardier* court's holding—that this section prohibits only legal means of post-discharge debt collection—is supported by the legislative history of the amendment,¹²⁰ by *Rutgers*,¹²¹ and by a

111. *Id.* at 1363-64.

112. *Id.*

113. *Id.* at 1364.

114. *Id.* The university's refusal to supply a transcript also thwarted her efforts to apply for admission to a vocational training program. *Id.*

115. *Id.* at 1363.

116. *Id.* at 1367.

117. *Id.*

118. Bankruptcy Act, § 14(f), 11 U.S.C. § 32(f) (1976). "[T]he major purpose of the proposed legislation is to effectuate more fully the discharge in bankruptcy by rendering it less subject to abuse by harassing creditors." H.R. REP. NO. 1502, 91st Cong., 2d Sess. 1, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 4156, 4156.

119. 11 U.S.C. § 32(f)(2) (1976).

120. *See* H.R. REP. NO. 1502, *supra* note 118; *Explanatory Memorandum to Accompany S. 4247*, 116 CONG. REC. 34818, 34819 (1970).

recent federal district court opinion,¹²² which found that a creditor who made threats and undertook extralegal collection activities could not be held in contempt of a Bankruptcy Court's discharge order.¹²³

In *Perez v. Campbell*,¹²⁴ the Supreme Court held that an Arizona motor vehicle safety act had the purpose and effect of frustrating the Bankruptcy Act and was therefore invalid under the supremacy clause.¹²⁵ The Arizona statute effectively withheld driving privileges until a motorist satisfied any automobile accident judgment rendered against him, even if the debt had been discharged in bankruptcy.¹²⁶ The Court found that the "plain and inevitable effect" of this statute was "to create a powerful weapon for collection of a debt from which [the] bankrupt [had] been released,"¹²⁷ and that the statute, therefore, frustrated the basic purpose of the Bankruptcy Act, to give debtors "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."¹²⁸ In short, the court held that the supremacy clause prohibits coercive state action to induce payment of a discharged debt.¹²⁹

The *Rutgers* court recognized that a college's refusal to grant transcripts to former students whose NDSLs have been discharged in bankruptcy imposes severe consequences upon the student.¹³⁰ Unless students repay their discharged NDSLs, they will be foreclosed from advancement in education or in livelihoods that require an academic transcript. This frustrates the fresh start policy of the Bankruptcy Act. Therefore, if Webster were a state college, its action would certainly have been prohibited under the supremacy clause.¹³¹ Since Webster is

121. The New Jersey District Court found that the sole purpose of § 14(f)(2) "is to prevent creditors from taking legal actions against debtors." 445 F. Supp. at 1368 (emphasis in original).

122. *In re Thompson*, 416 F. Supp. 991 (S.D. Tex. 1976).

123. *Id.* at 996. Although the plaintiffs in *Girardier* did not so argue, Webster College's assertion of the plaintiffs' failure to pay their NDSLs in *defense* to plaintiffs' claims could be interpreted as a use of "process" under § 14(f)(2) of the Bankruptcy Act. Courts would probably be unwilling to accept this argument, however, since it would be an indirect method of using § 14(f)(2) to prevent extralegal actions by creditors, which was not the intended purpose of this section. See note 120 *supra* and accompanying text.

124. 402 U.S. 637 (1971).

125. *Id.* at 652-54.

126. *Id.* at 639-43.

127. *Id.* at 649 (quoting *Kesler v. Department of Pub. Safety*, 369 U.S. 153, 183 (1962)).

128. *Id.* at 648-49 (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)).

129. *Id.* at 656.

130. 445 F. Supp. at 1363.

131. See *id.* at 1367.

a private college, the *Girardier* result is not inconsistent with *Rutgers*. This conclusion, however, is not forced by precedent; no court has previously held that extralegal actions taken by private creditors against bankrupts are valid.¹³² It is instead supported by existing constitutional and statutory law. The Bankruptcy Act does not expressly prohibit discriminatory action by private creditors against bankrupts, and there is no constitutional or statutory provision that provides a remedy against a private creditor whose actions violate the purpose of the Bankruptcy Act.¹³³

There are two possible arguments that plaintiffs could have used to circumvent the conclusion reached in *Girardier*. First, plaintiffs could have argued that the National Defense Education Act¹³⁴ directed Webster College to collect NDSLs for the federal government.¹³⁵ This

132. Although the majority opinion in *Girardier* quoted from a commentary that indicated there are two cases, *Carter v. Sutton*, 147 Ga. 496, 94 S.E. 760 (1917), and *McClendon v. Kenin*, 235 Ore. 588, 590-92, 385 P.2d 615, 616-17 (1963), so holding, neither case, in fact, decided this. 563 F.2d at 1273 (quoting Note, *supra* note 108, at 722). In *Carter*, the court upheld the eviction of a tenant for nonpayment of rent, even though the rent obligation had been discharged in bankruptcy, solely on the basis of a state statute. Further, *Carter* involved the validity of state action rather than private action. In *McClendon*, the court held that a labor organization's suspension of a member whose debts had been discharged in bankruptcy did not conflict with the purpose of the Bankruptcy Act. "We have here, instead of an exercise of state police power, an exercise of the right of private persons to contract and associate." 235 Ore. at 591, 385 P.2d at 616. It proceeded to hold that if state financial responsibility laws do not subvert the purpose of the bankruptcy law, then the labor organization's action would not subvert it. *Id.* at 591-92, 385 P.2d at 616. The court applied the same principles to private and state action to determine whether the action was prohibited by the Bankruptcy Act. Because *Kesler v. Department of Pub. Safety*, 369 U.S. 153 (1962), the state action case upon which *McClendon* relied, has been overruled by *Perez v. Campbell*, 402 U.S. 637 (1971), a court now considering the same kind of action by a labor organization would have to apply the test set out in *Perez*, *id.* at 648-50, to determine if the action is prohibited.

Since 1971, when *Perez* was decided, only one court has discussed whether extralegal action by private parties against a bankrupt is contrary to the purposes of the Bankruptcy Act. *McLellan v. Mississippi Power & Light Co.*, 545 F.2d 919 (5th Cir. 1977) (en banc). The court's statement that the Bankruptcy Act does not shield a bankrupt from actions taken by private individuals, *id.* at 929-30, is dictum. *Id.* at 934.

133. Although the *Rutgers* court disagreed with the result reached in *Girardier* and suggested that "a student has some sort of a property interest in his transcripts, which reflect time, money and hard work," the court indicated no constitutional provision or statute under which the plaintiffs in *Girardier* could have enforced this property right. 445 F. Supp. at 1366 n.6. Indeed, the *Rutgers* court acknowledged that "it is the state—and not private parties—which is limited by the Supremacy Clause," and that the fourteenth amendment applies only to state actions. *Id.* at 1367.

134. 20 U.S.C. §§ 1087cc(a)(2)(C), 1087cc(a)(2)(D), 1087cc(a)(3)(D), 1087cc(a)(5), 1087dd(c)(1)(H) (1976).

135. See 45 C.F.R. § 144.11(c) (1976), which reads in pertinent part:

Each institution at which a Fund is established shall accept responsibility for and use due diligence in effecting collection of all amounts due and payable to the Fund in con-

would establish a conflict between two federal statutes, the Bankruptcy Act and the National Defense Education Act. In *Zwick v. Freeman*¹³⁶ and *Marvin Tragash Co. v. United States Department of Agriculture*,¹³⁷ courts were faced with similar situations. In these cases the conflict was between section 2 of the Perishable Agricultural Commodities Act,¹³⁸ which imposes penalties upon members of the industry for flagrant and repeated failure to pay debts, and the Bankruptcy Act. Although both courts upheld the penalty provision of the Commodities Act,¹³⁹ the decisions set forth the applicable test when two federal statutes conflict: If the extent of the encroachment of one federal statute upon the goals of the other is "unconscionable, excessive, or irreconcilable,"¹⁴⁰ the encroaching provision is invalid. To use this argument successfully a plaintiff would have to prove that the goal of the collection provision of the National Defense Education Act is to require schools to coerce payment of a discharged NDSL and that this goal unconscionably or irreconcilably conflicts with the fresh start purpose of the Bankruptcy Act.¹⁴¹

The plaintiffs also could have argued that Webster College violated section 1985(3)¹⁴² by withholding transcripts. Although the Supreme

nection with loan transactions of the Fund. The institution shall use such collection practices as are generally accepted among institutions of higher education and which are at least as extensive and forceful as those used in the collection of other student loan accounts due the institution. In the exercise of due diligence, the institution shall: . . . (4) Establish such further collection procedures as the institution may consider appropriate to effect prompt and regular repayments.

136. 373 F.2d 110 (2d Cir.), cert. denied, 389 U.S. 835 (1967).

137. 524 F.2d 1255 (5th Cir. 1975).

138. 7 U.S.C. § 499(b) (1976).

139. 524 F.2d at 1256; 373 F.2d at 117. The *Zwick* court explained:

The measures which petitioners object to in the Commodities Act . . . prevent petitioners from shortly making a fresh debt-free start in the industry in which they had been earning their livelihood, although they are entirely free, as far as the challenged statute is concerned, to enter any other occupation or business which appeals to them. Nevertheless, in the light of the purposes of the Commodities Act . . . to have financially responsible persons as licensees or employees of licensees under that Act, the extent of encroachment of the Commodities Act upon the goals of the Bankruptcy Act cannot be regarded as unconscionable or excessive.

373 F.2d at 116-17.

140. 524 F.2d at 1258; 373 F.2d at 116-17.

141. 20 U.S.C. § 425(b) & (c) (1976). See notes 128-29 *supra* and accompanying text. The *Zwick* court noted that the Commodities Act provision does not prevent persons from making a fresh start in any occupation other than the perishable agricultural commodities industry, see note 139 *supra*, whereas the collection provision of the National Defense Education Act in effect prevents persons from making a fresh start in any business that requires further education or a transcript in order to obtain a job.

142. 42 U.S.C. § 1985(3) (1970), which provides:

If two or more persons in any State or Territory conspire . . . for the purpose of depriv-

Court held in *Griffin v. Breckenridge*¹⁴³ that section 1985(3) applies to a purely private conspiracy that deprives plaintiffs of their thirteenth amendment rights, lower courts have taken inconsistent positions on whether it reaches private conspiracies that deprive plaintiffs of fourteenth amendment rights.¹⁴⁴ If plaintiff is in a jurisdiction that has held section 1985(3) prohibits the deprivation of fourteenth amendment rights by private conspiracies, he must allege that the purpose of the conspiracy was to deprive him of equal protection of the laws or equal privileges and immunities under the laws, that racial or class-based discrimination motivated the conspirators, and that he suffered injury to his person or property or was deprived of his constitutional rights.¹⁴⁵ Although the third element was present in *Girardier*, it would be difficult to argue the presence of the first two.

Several lower courts have held that a university cannot conspire with itself.¹⁴⁶ “[I]f the challenged conduct is essentially a single act of discrimination by a single business entity, the fact that two or more agents participated in the decision or in the act itself will normally not constitute the conspiracy contemplated by [section 1985(3)].”¹⁴⁷ It is possible to argue, however, that this single entity rule is inapposite in bank-

ing, either directly or indirectly, any person or class of persons of the equal protection of the laws, or of equal privileges and immunities under the laws; [and] in any case of conspiracy set forth in this section, if one or more persons engaged therein do, or cause to be done, any act in furtherance of the object of such conspiracy, whereby another is injured in his person or property, or deprived of having and exercising any right or privilege of a citizen of the United States, the party so injured or deprived may have an action for the recovery of damages, occasioned by such injury or deprivation, against any one or more of the conspirators.

143. 403 U.S. 88 (1971).

144. See Note, *Section 1985(3): A Viable Alternative to Title VII for Sex-Based Employment Discrimination*, 1978 WASH. U.L.Q. 367. Alternatively, a plaintiff could argue that because a private university receives federal funding and helps to meet federal policy goals through its participation in the student loan programs, its private collection efforts are state action.

145. See Note, *supra* note 144, at 383-86. *Accord*, *Griffin v. Breckenridge*, 403 U.S. 88, 102-03 (1971).

146. *Keddie v. Pennsylvania State Univ.*, 412 F. Supp. 1264, 1276 (M.D. Pa. 1976). *Accord*, *Rubenstein v. University of Wis. Bd. of Regents*, 422 F. Supp. 61, 64 (E.D. Wis. 1976); *Cole v. University of Hartford*, 391 F. Supp. 888, 894 (D. Conn. 1975). An exception to this rule is found in *Rackin v. University of Pa.*, 386 F. Supp. 992, 1005-06 (E.D. Pa. 1974), where the court recognized a conspiracy among the university, its officers, and certain tenured faculty members because of continuing and varied instances of discrimination and harassment. *Accord*, *Weise v. Syracuse Univ.*, 522 F.2d 397, 408 (2d Cir. 1975).

147. *Dombrowski v. Dowling*, 459 F.2d 190, 196 (7th Cir. 1972). *Accord*, *Girard v. 94th St. & Fifth Ave. Corp.*, 530 F.2d 66, 70 (2d Cir. 1976); *Keddie v. Pennsylvania State Univ.*, 412 F. Supp. 1264, 1276 (M.D. Pa. 1976); *Lattimore v. Loews Theatres, Inc.*, 410 F. Supp. 1397, 1402 (M.D.N.C. 1975); *Cole v. University of Hartford*, 391 F. Supp. 888, 892-93 (D. Conn. 1975); *Rackin v. University of Pa.*, 386 F. Supp. 992, 1005-06 (E.D. Pa. 1974).

ruptcy discrimination cases.¹⁴⁸

If the burden of proving a conspiracy between two or more persons is met, the only remaining problem is to prove the second element: intent to deprive a person of equal protection or equal privileges and immunities. This element is satisfied by proving "some racial, or perhaps otherwise class-based, invidiously discriminatory animus behind the conspirators' action."¹⁴⁹ Plaintiffs must allege, therefore, that they belong to a class consisting of student borrowers seeking to obtain the shelter of the bankruptcy laws and that the private college's actions were directed at plaintiffs because of their membership in this class rather than because of their individual traits. Then plaintiffs must prove that their class is one of those protected by section 1985(3). The Fifth Circuit sitting en banc in *McLellan v. Mississippi Power & Light Co.*¹⁵⁰ recently held that because no statutory protection against discriminatory treatment has ever been afforded bankrupts and because the Supreme Court has decided the right to file in bankruptcy is not a fundamental right,¹⁵¹ section 1985(3) does not protect bankrupts as a class.¹⁵² However, the Court has not held the right to be free from discrimination on the basis of sex to be a fundamental right; yet several lower courts have held that sex discrimination activates section

148. See Note, *supra* note 144, at 386-89 (arguing the single entity rule should be confined to antitrust cases and is inapposite in sex-based employment discrimination cases).

149. Griffin v. Breckenridge, 403 U.S. 88, 102 (1971). *Accord*, *McLellan v. Mississippi Power & Light Co.*, 545 F.2d 919 (5th Cir. 1977) (en banc), *vacating* 526 F.2d 870 (5th Cir. 1976); *Westberry v. Gilman Paper Co.*, 507 F.2d 206, 210 (5th Cir. 1975) (participation in environmental activities raised a sufficient inference of "class-based, invidiously discriminatory animus behind the alleged actions of the conspirators' to evidence subject matter jurisdiction . . . under § 1985(3)"); *Cameron v. Brock*, 473 F.2d 608 (6th Cir. 1973) (§ 1985(3)'s "protection reaches clearly defined classes such as supporters of a political candidate"); *Action v. Gannon*, 450 F.2d 1227 (8th Cir. 1971) (upholding a § 1985(3) claim by white church members alleging deprivation of first amendment rights); *Grillo v. Seilaff*, 414 F. Supp. 272 (N.D. Ill. 1976); *Reichardt v. Payne*, 396 F. Supp. 1010 (N.D. Cal. 1975) (private conspiracy motivated by invidious discriminatory intent based upon sex is sufficiently class-based); *Pendrell v. Chatham College*, 370 F. Supp. 494 (W.D. Pa. 1974) (plaintiff who alleged "she was discriminated against for her advocacy of women's rights . . . has satisfied the class-based animus requirement").

150. 545 F.2d 919 (5th Cir. 1977) (en banc), *vacating* 526 F.2d 870 (5th Cir. 1976). *McLellan* involved an employee who was discharged from private employment solely because he filed a petition in voluntary bankruptcy. *Id.* at 922. The employee alleged a conspiracy between his employer and his union, which had refused to assist him in seeking reinstatement. *Id.*

151. *United States v. Kras*, 409 U.S. 434 (1973).

152. 545 F.2d at 932-33. The court devoted much of its opinion to elaborating the theory that to establish liability under § 1985(3) one must show the conspirators' intentional conduct to be independently violative of state law. *Id.* at 924-27, 929-31. The court resolved the case, however, by holding that the plaintiff did not satisfy the class-based animus requirement. The enunciation of its independent illegality test was therefore dictum.

1985(3).¹⁵³ As the dissenting judge in *McLellan* said: "[T]he problem . . . involves ascertaining the strength and scope of the federal policy of solicitude for bankrupts or potential bankrupts."¹⁵⁴ The panel opinion, which had held that bankrupts were a protected class under section 1985(3),¹⁵⁵ based its decision on "[t]he legislative intent to assist economically troubled individuals and the long line of federal cases reaffirming that goal."¹⁵⁶ The determination of the class status of bankrupts is complex and should be presented for further consideration by other courts.

The judicial responses to the increasing number of student loan bankruptcies, at worst, make irrational distinctions and, at best, offer only a partial solution to the problem. The decision in *State v. Wilkes*¹⁵⁷ was erroneous; the court's construction of section 57(d) of the Bankruptcy Act¹⁵⁸ was inconsistent with both the prior case law and the fresh start purpose of the Bankruptcy Act. The result of the *Girardier*¹⁵⁹ and *Rutgers*¹⁶⁰ decisions is that bankrupts who have obtained a discharge of student loans will be treated differently depending on whether they attended a state or private university. *Wilkes*, even if followed by other courts, would only prevent the discharge of NDSLs. It would not prohibit the discharge of GSLs. The *Girardier* holding will have a deterrent effect only on those students who have attended private universities and foresee a need for future services from the university. Unfortunately, both decisions treat students who are abusing the bankruptcy process in the same manner as those students in real need of a discharge.

V. EVALUATION OF THE LEGISLATIVE ALTERNATIVES

There are several possible legislative responses to the problem of student loan bankruptcies. First, Congress could tighten the operation of the loan programs, especially the eligibility requirements and the collection mechanism, while leaving student loans freely dischargeable in

153. *E.g.*, *Beamon v. W.B. Saunders Co.*, 413 F. Supp. 1167 (E.D. Pa. 1976); *Reichart v. Payne*, 396 F. Supp. 1010 (N.D. Cal. 1975).

154. 545 F.2d at 939.

155. 526 F.2d at 877-78.

156. *Id.* at 878.

157. 41 N.Y.2d 655, 363 N.E.2d 555, 394 N.Y.S.2d 849 (1977).

158. 11 U.S.C. § 93(d) (1976).

159. 563 F.2d 1267 (8th Cir. 1977).

160. 445 F. Supp. 1362 (D.N.J. 1978).

bankruptcy.¹⁶¹ Second, Congress could prohibit the discharge of all student loans in the first five years of the repayment period unless the debtor could prove undue hardship.¹⁶² Third, Congress could prohibit the discharge of all educational loans only during the first five years of the repayment period, provided the creditor can prove the debtor will not suffer undue hardship.¹⁶³ Finally, discharge of educational debts could be prohibited entirely.¹⁶⁴

To date, there have been four legislative responses. The first two, however, conflict with the last two. The Education Amendments of 1976¹⁶⁵ and the Commission on the Bankruptcy Laws' 1976 proposed amendments¹⁶⁶ both placed limits on the dischargeability of educational loans. The latter two responses,¹⁶⁷ both made in 1977, would repeal the Education Amendments provision and allow all educational debts to be freely dischargeable.

The House Report accompanying H.R. 8200¹⁶⁸ included several arguments favoring the repeal of the Education Amendments of 1976. Several witnesses argued that section 127(a) deprives students of "a right which every other citizen has available to him if he needs it,"¹⁶⁹ and by its presumption of abuse treats all students as though they were suspected felons.¹⁷⁰ This section is "grossly unfair to the solid majority of honest and good faith debtors,"¹⁷¹ because it requires them to prove "undue hardship," which may be a difficult standard to meet.¹⁷² Moreover, this is not justified by need or policy.¹⁷³ Statistics reveal that only one-half to three-fourths of one percent of all matured loans

161. See H.R. 8457, 95th Cong., 1st Sess. (1977); H.R. 8200, 95th Cong., 1st Sess. (1977); notes 56-58 *supra* and accompanying text.

162. This response is similar to § 127(a) of the Education Amendments of 1976, but it includes all student loans. 20 U.S.C. § 1087-3(a) (1976). See note 48 *supra* and accompanying text.

163. The Commission on the Bankruptcy Laws of the United States made this proposal. See note 49 *supra* and accompanying text.

164. This response was proposed in H.R. 6428, 95th Cong., 1st Sess. (1977).

165. Education Amendments of 1976, § 127(a), 20 U.S.C. § 1087-3(a) (1976). See note 48 *supra* and accompanying text.

166. H.R. 31, 94th Cong., 2d Sess. § 4-506(a)(8) (1976), reprinted in *Bankruptcy Act Hearings*, *supra* note 1, app. 156-57. See note 49 *supra* and accompanying text.

167. H.R. 8457, 95th Cong., 1st Sess. (1977); H.R. 8200, 95th Cong., 1st Sess. (1977). See notes 56-58 *supra* and accompanying text.

168. H.R. REP. No. 595, 95th Cong., 1st Sess. (1977).

169. *Id.* at 149, 154.

170. *Id.* at 149, 151, 154, 161.

171. *Id.* at 155.

172. *Id.* at 154-55.

173. *Id.* at 134, 152, 154, 155, 160.

are discharged in bankruptcy¹⁷⁴ and that only a small portion, perhaps twenty percent, of these bankruptcy cases involved abuse.¹⁷⁵ Rather than limiting the bankruptcy process, the loan program, especially the eligibility requirements and collection efforts, could be tightened,¹⁷⁶ or, if that alternative is unacceptable, the losses incurred by the loan programs should be viewed as the cost of necessary social legislation.¹⁷⁷ In addition, section 127(a) is contrary to the purposes of the Bankruptcy Act to provide a fresh start to debtors¹⁷⁸ and to provide equal treatment for all creditors.¹⁷⁹

Those who propose limiting the discharge of educational loans rely on the following justifications. Although student loans represent only a small percentage of all matured loans, the number of bankruptcies and the dollar amount of loss is significant in absolute terms.¹⁸⁰ From 1970 through 1975 approximately \$30 million of student loans were discharged in bankruptcy.¹⁸¹ Further, as efforts to collect all the student loans in default¹⁸² are increased,¹⁸³ there will probably be a greater increase in the number of bankruptcies.¹⁸⁴ Even if the increase in student loan bankruptcies is not due solely to increased abuse and is not threatening to destroy the loan system, policy reasons dictate limiting whatever abuse exists. Educational loans, in contrast to consumer loans, are extended on a good faith, nonprofit basis¹⁸⁵ at low interest

174. *Id.* at 133, 148, 152. This percentage does not appear to represent any threat to the loan program. *Id.* at 151. "Student bankruptcy is only growing at a larger percentage rate than other bankruptcy because it has only been in the past several years that there has been any substantial number of educational loans coming into maturity." *Id.* at 149.

175. *Id.* at 133, 154-55, 161-62. The 20% figure is derived from the GAO study, *see* notes 53-54 *supra* and accompanying text, which found that in 20% of the bankruptcy cases involving guaranteed student loans, over 80% of the debtor's total indebtedness arose from educational loans. *Id.* at 133. If a debtor's student loans were less than 80% of his total debts, it is likely he "encountered financial difficulty after school, and that the bankruptcy is a result of a true need for bankruptcy relief rather than an abuse of the bankruptcy system." *Id.*

176. *Id.* at 134, 154, 160.

177. *Id.* at 134.

178. *Id.* at 133-34, 152-53. The report notes that a student loan is not "a fundamentally different type of obligation from that involving loans for 'material' reasons." *Id.* at 153.

179. *Id.* at 134, 151-52, 155, 162.

180. *Higher Education Hearings, supra* note 11, at 6 (statement of T.H. Bell).

181. *Bankruptcy Act Hearings, supra* note 1, at 1076 (statement of Edward T. York, Jr.); Letter from Robert Coates, *supra* note 36.

182. The default rate on guaranteed student loans is approximately 18-22%. *Bankruptcy Act Hearings, supra* note 1, at 1090 (statement of John N. Erlenborn).

183. *See* St. Louis Globe-Democrat, Oct. 26, 1977, at 9A, col. 4.

184. *See* note 40 *supra* and accompanying text.

185. *See* notes 16-17 *supra* and accompanying text.

rates to borrowers who have neither collateral nor co-signors.¹⁸⁶ A student loan is also distinguishable from medical bills and other debts incurred as a result of accident or misfortune because the discharge of a student loan not only puts the student back on his feet but in many cases also gives him a head start. Finally, allowing discharge of the loans of students who have the ability to repay is contrary to the policy behind the student loan programs not to provide outright grants to students seeking higher education.¹⁸⁷

The best legislative response to the problem would be to enact a law prohibiting discharge of any GSLs or NDSLs in the first five years of its repayment period if the creditor can prove the debtor would not suffer undue hardship.¹⁸⁸ Congress should also prohibit educational institutions from engaging in any discriminatory conduct that has the effect of coercing repayment of discharged loans. The statute should also include a method to determine whether a denial of discharge would impose an undue hardship on a debtor. The Commission on the Bankruptcy Laws proposed the following test:

[T]he rate and amount of his future resources should be estimated reasonably in terms of ability to obtain, retain, and continue employment and the rate of pay that can be expected. Any unearned income or other wealth which the debtor can be expected to receive should also be taken into account. The total amount of income, its reliability, and the periodicity of its receipt should be adequate to maintain the debtor and his dependents, at a minimal standard of living within their management capability, as well as to pay their educational debt.¹⁸⁹

This test would prevent discharge of student loans in the two situations where the debtor does not need a fresh start: (1) where the student cur-

Consider the immediate moral response to the situation in which a loan is made by a friend as against the loan taken from a bank with assets of hundreds of million dollars. . . . [W]hat are the salient differences that seem to create similar legal obligations but of different morality?

. . . Is it not that one creditor is in the business of making loans for profit, and that there is nothing philanthropic about the obligation? Do we not take into account that the debt was created as part of a calculated impersonal undertaking involving large numbers of similar "investments" all made for profit?

Schuchman, *supra* note 27, at 428-29.

186. See *Higher Education Hearings*, *supra* note 11, at 190-91 (statement of Charles Meares); *Bankruptcy Act Hearings*, *supra* note 1, at 1068 (statement of Ray Thornton).

187. If Congress had intended to relieve students of responsibility for the costs of higher education, it could have done so. Instead, this alternative was expressly rejected in favor of providing loans on a good faith basis to students. S. REP. NO. 673, *supra* note 16, at 4060.

188. See notes 161-64 *supra* and accompanying text.

189. H.R. Doc. No. 137, *supra* note 18, Part II, at 140-41. This proposal was contained in the notes to H.R. 31, *supra* note 49, § 4-506, but was not included in the amendment.

rently has the ability to repay his debt;¹⁹⁰ and (2) where the student has received such benefits from his higher education that a discharge of his debt would give him a head start.¹⁹¹

Congress has the constitutional power to enact such a statute. The only possible constitutional challenge might be that the statute violates the equal protection guarantee by setting up a special class of student borrowers.¹⁹² Because bankruptcy is not a fundamental right, the statute, to withstand this challenge, must have a rational justification¹⁹³ such as prevention of abuse.

The statistics indicate that some limitation should be placed on the dischargeability of student loans in order to minimize abuse. Although the GAO study indicates that approximately twenty percent of student loan bankruptcies are attributable to persons abusing the bankruptcy process,¹⁹⁴ in absolute terms this represents a significant loss. As collection efforts increase, many debtors whose loans are now in default will seek a bankruptcy discharge,¹⁹⁵ thereby increasing the losses in both loan programs. Because both programs suffer approximately the same percentage of loss from loans discharged in bankruptcy,¹⁹⁶ the same limitations should apply to each.

Limiting the discharge of student loans when there is abuse¹⁹⁷ is consistent with the fresh start purpose of the Bankruptcy Act. When an individual has acquired skills from his education that have value in the marketplace there is no need for his loan to be cancelled. The liability

190. This situation arises when a former student petitions for bankruptcy while his assets are less than his liabilities, but he has sufficient income to make periodic payments on his loan.

191. This category includes former students who, as a result of their educational loan, have obtained a skill or trade that is beneficial to them in the marketplace. A student is in the first category but not in the second category if his income resulted from some factor other than his education, *e.g.*, an unexpected inheritance. A person would be included in the second category and not in the first when he had no income actually coming in at the time he filed for bankruptcy, but as a result of his education his prospects for obtaining sufficient future income were strong, *e.g.*, the social work major who graduates at a time when there is a strong demand for social workers, but files for bankruptcy before he obtains a job.

192. *Bolling v. Sharpe*, 347 U.S. 497, 500 (1954), was the first case to recognize that the equal protection guarantee is part of the due process assurance of the fifth amendment.

193. *United States v. Kras*, 409 U.S. 434, 446 (1973). The Court held that bankruptcy is not a fundamental right and that it does not touch upon any suspect criteria. *Id.* at 446. "Instead, bankruptcy legislation is in the area of economics and social welfare. . . . This being so, the applicable standard, in measuring the propriety of Congress' classification, is that of rational justification." *Id.*

194. See note 175 *supra* and accompanying text.

195. See notes 182-84 *supra* and accompanying text.

196. See note 36 *supra* and accompanying text.

197. See note 191 *supra* and accompanying text.

for his educational debt is offset by the asset he has acquired. If, however, the debt were to be cancelled, the former student would retain a valuable asset giving him a head start over those who do not have a similar education.¹⁹⁸

Limiting the dischargeability of educational loans is also consistent with the purposes of the student loan programs. Congress intended that the program ensure a supply of competent professional and technical personnel¹⁹⁹ and provide financial aid to students otherwise unable to pursue an education.²⁰⁰ Congress chose to achieve these goals by implementing an accessible and massive loan system, not by furnishing outright grants to students.²⁰¹ To allow students who could repay their debt if they so desired to discharge their loans in bankruptcy is contrary to the federal government's intention to extend loans on a good faith, nonprofit basis.²⁰²

The need for legislative action in this area is underscored by the irrational and incomplete solution provided by the courts.²⁰³ Given the GAO study, which indicates that a minority of student loan bankruptcies are due to abuse,²⁰⁴ there is no reason for a blanket prohibition of the discharge of NDSLs.²⁰⁵ If Congress were to enact a provision limiting discharge to those student debtors truly in need of a fresh start, there would be no justification for permitting private universities to undertake coercive actions.²⁰⁶ These practices frustrate the fresh start policy of the Bankruptcy Act,²⁰⁷ and irrationally prohibit only state universities from engaging in this conduct.

Placing the burden on creditors to prove that the debtor will not suffer undue hardship eliminates several objections²⁰⁸ to section 127(a).²⁰⁹ The suggested statute presumes the good faith rather than the dishon-

198. The debtor would also have a head start over those with a similar education who have an accompanying liability for a student loan. Congress did not intend the Bankruptcy Act to provide a head start. See *Richardson v. United States*, 552 F.2d 291 (9th Cir. 1977); *In re Kokoszka*, 479 F.2d 990 (2d Cir. 1973), *aff'd sub. nom. Kokoszka v. Belford*, 417 U.S. 642 (1974).

199. See note 16 *supra* and accompanying text.

200. See note 17 *supra* and accompanying text.

201. See note 187 *supra*.

202. Note that most of the loss from student loan bankruptcies is borne by the federal government. See note 15 *supra* and accompanying text.

203. See notes 157-60 *supra* and accompanying text.

204. See notes 53-54, & 194 *supra* and accompanying text.

205. *State v. Wilkes*, 41 N.Y.2d 655, 363 N.E.2d 555, 394 N.Y.S.2d 849 (1977).

206. *Girardier v. Webster College*, 563 F.2d 1267 (8th Cir. 1977).

207. See notes 129-31 *supra* and accompanying text.

208. See notes 169-72 *supra* and accompanying text.

209. 20 U.S.C. § 1087-3(a) (1976).

esty of the student debtor.²¹⁰ By treating an educational loan as prima facie dischargeable and by placing the burden on the creditor to prove the loan is excepted from discharge, the statute treats student loans in the same manner as other debts.²¹¹ Moreover, this allocation of the burden of proof avoids creating "an undue hardship for good faith bankrupts."²¹² Good faith student bankrupts will also be protected by bankruptcy courts, which tend to construe reasonable exceptions to discharge in favor of the bankrupt.²¹³

VI. CONCLUSION

The best alternative is to impose some limitations on the discharge of educational loans rather than merely tightening the programs and leaving student loans freely dischargeable. Reducing eligibility by requiring cosignors or collateral is contrary to the purposes of the loan programs, and increasing collection efforts on loans in default will lead to an increase in bankruptcies, thereby further increasing the need for limitations on discharge. The large volume of student loan bankruptcies and the Bankruptcy Act's policies justify the exception, in certain circumstances, of these loans from discharge. The courts have not rationally delineated the appropriate circumstances; therefore the solution lies with Congress.

Mala Gusman Bridwell

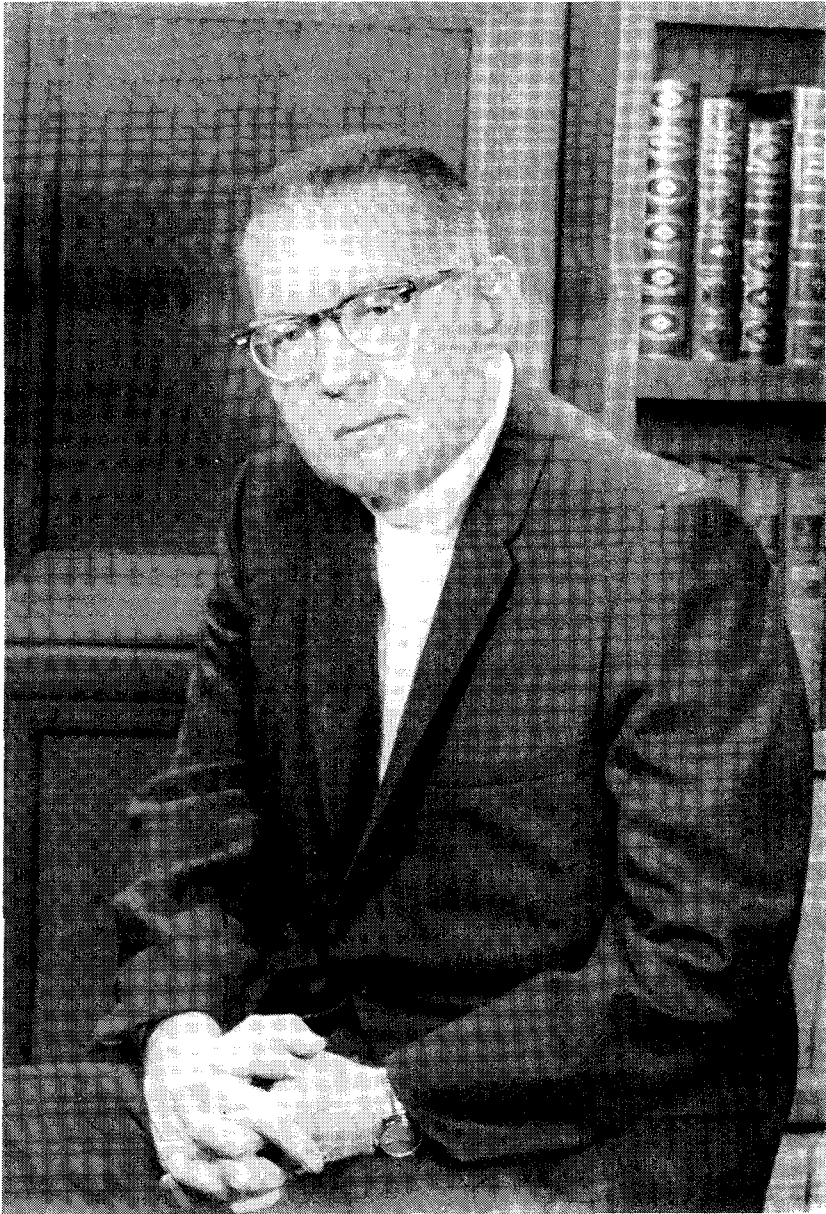
As this Note went to press, Congress repealed section 127 of the Education Amendments of 1976 and added educational loans to the list of exceptions from discharge.

210. This is consistent with the GAO study, which indicates that only a minority of bankruptcies involving educational loans are due to abuse. See notes 53-54, 175, & 194 *supra*.

211. Courts have consistently held that all provable debts are prima facie dischargeable and that the creditor has the burden of proving a debt is within the exceptions to discharge listed in § 17(a) of the Bankruptcy Act, 11 U.S.C. § 35(a) (1976). See, e.g., *Hill v. Smith*, 260 U.S. 592, 595 (1923); *In re Knight*, 421 F. Supp. 1387 (M.D. La. 1976), *aff'd*, 551 F.2d 862 (5th Cir. 1977); *In re Dolnick*, 374 F. Supp. 84 (N.D. Ill. 1974); *Sweet v. Ritter Fin. Co.*, 263 F. Supp. 540 (W.D. Va. 1967); *Anderson v. Sundstrom*, 307 Minn. 439, 241 N.W. 2d 82 (1976); *Aetna Cas. & Sur. Co. v. Lauerman*, 12 Wis. 2d 387, 107 N.W.2d 605 (1961).

212. H.R. REP. No. 595, *supra* note 53, at 135. Although it may be difficult for a creditor to prove that the debtor will not suffer undue hardship if forced to repay his loan, it is unfair to place the burden on the debtor when the GAO study indicates that only a minority of student loan bankruptcies involve abuse. In any event, it often will not be a difficult burden for the creditor. The debtor's schedule of assets and debts and a sworn statement from the debtor about his current income, future job prospects, and expected future income may be sufficient to prove the debtor has the ability to repay without suffering undue hardship.

213. See *Gross v. Fidelity & Deposit Co.*, 302 F.2d 338 (8th Cir. 1962); *In re Fuhrman*, 385 F. Supp. 1185 (W.D.N.Y. 1973); *In re Soika*, 365 F. Supp. 555 (W.D.N.Y. 1973).



Upon the occasion of his retirement from the faculty of the Washington University School of Law, the Editorial Board of the Law Quarterly and the authors of the works contained herein respectfully dedicate this issue to Arno Cumming Becht—teacher, scholar, and friend.