Playing the "Get Out of College Free" Card: Dischargeability of Educational Debts in Chapter 7 Bankruptcy

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Playing The “Get Out of College Free” Card: Dischargeability of Educational Debts in Chapter 7 Bankruptcy

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I. INTRODUCTION

A fundamental principle of bankruptcy law is that certain debts are excluded from discharge in a bankruptcy proceeding. Since the inception of the Bankruptcy Code in 1978, certain educational debts are nondischargeable in Chapter 7 bankruptcy. The policy underlying the nondischargeability provision of § 523(a)(8) of the Bankruptcy Code is to keep educational loan and scholarship programs intact for future students by prohibiting students who have received funds under these programs from discharging their educational debts in bankruptcy.

Recently, however, colleges and universities have faced the specter of students who, if they play their cards right, may discharge tuition, room and board, and other debts with impunity. Controversy has flared regarding exactly what educational debts fall within the scope of § 523(a)(8), and courts have reached converse holdings on substantially similar facts. Currently, whether or not an educational debt is dis-

1. A discharge releases the debtor from personal liability for pre-bankruptcy debts and limits a creditor’s recovery to the funds received in the bankruptcy process. See 1 DAVID G. EPSTEIN ET AL., BANKRUPTCY 12-13 (1992).
4. See 11 U.S.C. § 523(a)(8); infra notes 14-15. A bankruptcy petition filed under Chapter 7 of the Bankruptcy Code is a “liquidation” form of bankruptcy in which a trustee will collect all nonexempt property of the debtor, convert it to cash, and then distribute the cash to the creditors. See 1 EPSTEIN ET AL., supra note 1, at 9-10. In contrast, a petition filed under Chapter 13 of the Bankruptcy Code is a “rehabilitation” form of bankruptcy in which the debtor retains her property and creditors are paid from the debtor’s post-petition earnings under a court-approved plan. See id. at 9, 13-14. This Comment will address educational debts in Chapter 7 bankruptcy only. For a discussion of educational debts in Chapter 13 bankruptcy, see Seth J. Gerson, Note, Separate Classification of Student Loans in Chapter 13, 73 WASH. U. L.Q. 269 (1995).
charged in Chapter 7 bankruptcy may depend solely upon in which jurisdiction the university is fortunate, or unfortunate, enough to find itself in.

This Comment surveys the case law interpreting the dischargeability of educational debts under § 523(a)(8). Part II sets forth the cases that construed the "educational loan" language of § 523(a)(8) prior to 1990. Part III.A discusses the 1990 amendment to § 523(a)(8), which added the terms "benefit overpayment" to the statute. Part III.B then examines the cases that have interpreted the language of § 523(a)(8) subsequent to the 1990 amendment. Finally, Part IV proposes a strategy whereby colleges and universities may navigate the Kafkaesque quagmire of judicial holdings under § 523(a)(8) and attempt to stem the flow of student-debtors who deplete endowment resources by discharging educational debts owing to the schools.

II. DISCHARGEABILITY OF EDUCATIONAL DEBTS PRIOR TO 1990

Until the mid-1970s, no prohibition on discharging educational debts existed, and a debtor could discharge student loans in bankruptcy.

8. This Comment addresses the issue of dischargeability exclusively with respect to debts where the student is the sole debtor. The student, however, is not always the sole debtor; often the student's parent or spouse will cosign or guarantee the debt. See Peter B. Barlow, Nondischargeability of Educational Debts Under Section 523(a)(8) of the Bankruptcy Code: Equitable Treatment of Cosigners and Guarantors?, 11 BANK. DEV. J. 481, 482 n.4 (1994/1995). Two distinct lines of cases regarding the applicability of § 523(a)(8) to cosigners and guarantors have emerged. See id. at 482. One line of cases allows discharge for cosigners and guarantors of educational loans, the other line of cases does not. See id. This Comment, however, will only address the dischargeability of educational debts in Chapter 7 where the student is the sole debtor.

10. See infra text accompanying notes 79-92.
11. See infra text accompanying notes 93-187.
12. See infra text accompanying notes 188-211.
13. See Lee v. Board of Higher Educ., 1 B.R. 781, 783 (S.D.N.Y. 1979); Darrell Dun-
As part of the Bankruptcy Reform Act of 1978, however, Congress enacted § 523(a)(8),\textsuperscript{14} denying debtors in Chapter 7 bankruptcy a discharge for any educational loan to a governmental unit or nonprofit institution of higher education.\textsuperscript{15} Congress gradually broadened the scope of § 523(a)(8),\textsuperscript{16} and by 1990, § 523(a)(8) read as follows:

\textbf{§ 523. Exceptions to discharge.}

\begin{itemize}
  \item[(a)] A discharge under section 727, 1141, 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
  \begin{itemize}
    \item[(8)] for an educational loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or a nonprofit institution . . . .
  \end{itemize}
\end{itemize}

During the twelve years following the enactment of § 523(a)(8), courts were frequently called upon to see whether certain debts were "educational loans" within the meaning of § 523(a)(8).\textsuperscript{18} Although some loans,
such as Guaranteed Student Loans, it was unclear to what extent an extension of funds, such as a scholarship award, living stipend, work study advance, or credit extension qualified as an educational loan for purposes of nondischargeability under § 523(a)(8). The courts formulated two different tests for determining whether a debt constituted an educational loan within the meaning of § 523(a)(8). The first test, the “educational purposes” test, looked to see whether the funds were for educational purposes. The second test, however, looked to see whether the extension of funds was a “loan.”


20. But see Ealy v. First Nat'l Bank (In re Ealy), 78 B.R. 897, 898 (Bankr. C.D. Ill. 1987) (holding a Guaranteed Student Loan was not an educational loan because the creditor-assignor failed to establish whether the student used the proceeds for educational purposes).


23. See Shipman v. Department of Mental Health (In re Shipman), 33 B.R. 80, 81 (Bankr. W.D. Mo. 1983); infra text accompanying notes 30-34 (discussing Shipman).


25. Cf. Dunham & Buch, supra note 13, at 689-91 (suggesting that two approaches existed under pre-1990 case law for determining whether a debt constituted an educational loan for purposes of § 523(a)(8) but citing a case where the debtor was the cosigner, not the student).

26. See Vretis, 56 B.R. at 157; Shipman, 33 B.R. at 82.

A. Educational Purposes Test

Under the educational purposes test, “the central issue in determining dischargeability [under § 523(a)(8)] is whether the funds were for educational purposes, not whether the funds constituted a loan.” Two different approaches of evaluating whether or not the funds were for educational purposes existed: the Shipman approach of whether the proceeds were used for educational purposes and the Vretis approach of whether the funds were awarded for educational purposes.

The first approach, employed by the Bankruptcy Court for the Western District of Missouri in Shipman v. Department of Mental Health (In re Shipman), looked to see if the debtor used the proceeds for educational purposes. In Shipman, the student entered into a contractual relationship with the Missouri Department of Mental Health whereby the department advanced the student a “salary” in exchange for her promise to work for the Department of Mental Health upon graduation. The student resigned after six months and signed a note for $10,865.97 in lieu of repayment by work but ultimately filed for Chapter 7 bankruptcy. The court held that the financial obligation was not an educational loan because the debtor spent the funds on rent and living expenses and “not directly for an educational purpose.” Thus, under the Shipman approach...

28. Shipman, 33 B.R. at 82.
30. Shipman, 33 B.R. at 80.
31. See id. at 82. The Shipman court traced the history of § 523(a)(8) back to the nondischargeability provision under the Higher Education Act of 1965 and concluded that the “direct link [of § 523(a)(8)] to the federal education statute is an excellent indication” that the purpose of the funds controls. See id.; see also supra note 14 (setting forth the legislative history of section 439A). But see Joyner, 171 B.R. at 763 (stating that the Shipman “court’s discussion focused on what constituted a ‘loan’ for purposes of § 523(a)(8)”).
32. See Shipman, 33 B.R. at 81.
33. See id.
34. See id. at 82; see also Ealy v. First Nat’l Bank (In re Ealy), 78 B.R. 897, 898 (Bankr. C.D. Ill. 1987) (holding the Guaranteed Student Loan was not an educational loan because the creditor-assignor failed to establish whether the debtor used the proceeds for educational purposes). The Shipman court, relying upon Commonwealth of Virginia v. Ziglar (In re Ziglar), 19 B.R. 298 (Bankr. E.D. Va. 1982), also predicated its holding on the facts that the note the student signed in lieu of repayment by work was in return for money already advanced and that she did not return to school after executing the note. See Shipman, 33 B.R. at 82. In Ziglar, a married couple defaulted on seven Guaranteed Student Loans. See Ziglar, 19 B.R. at 299. Although the Commonwealth obtained judgments and the couple executed a note in release of the judgments, the couple later defaulted on the note. See id. The court held that the note was not an educational loan but an agreement to release the two...
proach, an extension of funds to a student could never constitute a nondischargeable educational loan where the student used those funds for living expenses.

The second approach, however, looked to see if the funds were awarded for educational purposes. In United States Department of Health and Human Services v. Vretis (In re Vretis),35 the student received financial assistance in the form of a living expense stipend and a tuition and fee award for osteopathic school.36 The student received the funds under the Public Health and National Health Service Corps Scholarship Training Program in return for a promise to serve on active duty in the National Health Service Corps for at least two years.37 When the student ultimately defaulted on his service obligation, the Department of Health and Human Services sought reimbursement.38 Distinguishing Shipman on the facts as involving a salary advance rather than a living expense stipend, the Vretis court held that the financial assistance provided to the student was a nondischargeable educational loan under § 523(a)(8), notwithstanding the fact that the debtor may have used the proceeds for rent and living expenses, because “the initial characterization of the loan is what controls.”39

judgments because the couple did not receive money in exchange for the note and they did not return to school. See id. at 300. But see Nicolay v. Georgia Higher Educ. Assistance Corp., 370 S.E.2d 660, 660 (Ga. 1988) (holding that the consolidation of seven promissory notes for student loans into one installment note which established a schedule for payment of the first seven notes was directly for educational purposes).

36. See id. at 156.
37. See id. Under the Public Health Service Scholarship Program, the Department of Health and Human Services made grants to students who agreed to serve in the commissioned Corps of the Public Health Service or as a civilian member of the National Health Service Corps after graduation. See 42 U.S.C. § 234, repealed by Act of Oct. 12, 1976, Pub. L. No. 94-484, § 408(b)(1), 90 Stat. 2281.
Thus, the courts developed two different approaches for evaluating whether or not a debt was for educational purposes. The *Shipman* approach looked at the purpose for which the funds were used, while the *Vretis* approach looked at the purpose for which the funds were awarded. In neither instance did the courts look to see whether the transaction was a loan.

**B. Loan Test**

Other courts, however, eschewed the educational purposes test and made a threshold inquiry into whether the funds constituted a loan in determining dischargeability under § 523(a)(8). In *University of New Hampshire v. Hill (In re Hill)*, the university provided a student with short term credit until the student received his loan proceeds. The student, however, was suspended for poor grades before he received the loan proceeds, failed to pay his outstanding balance with the university, and ultimately filed for Chapter 7 bankruptcy. At trial, the university argued that the extension of credit was a loan for purposes of § 523(a)(8). The court agreed with the university and held the debt nondischargeable under § 523(a)(8), saying that the distinction between an extension of credit and a loan is "a distinction without a defense." The court relied upon the definition of a loan as "a sum of money due to a person" and the debtor's acknowledgment that he owed the university tuition.

One year later, in *United States Department of Health and Human Services v. Avila (In re Avila)*, the Bankruptcy Court for the Western District of New York provided a more comprehensive analysis of the term "loan" under § 523(a)(8). In *Avila*, the student received $22,007.34 under the Public Health Service Scholarship Program to finance his medi-

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nondischargeable and saying that "[i]f a student were to take out a guaranteed student loan and spend it on a car or vacation, the student . . . would still fall within the scope of section 523(a)(8)". *But cf.* United States Dep't of Health and Human Servs. v. Avila (*In re Avila*), 53 B.R. 933, 936-37 (Bankr. W.D.N.Y. 1985) (applying the loan test rather than the educational purposes test on substantially the same facts); *infra* text accompanying notes 47-57 (discussing *Avila*).

41. See id. at 646.
42. See id.
43. See id. at 646-47.
44. See id. at 647.
45. Id. (quoting AMERICAN COLLEGE DICTIONARY (1970)).
46. See id.
48. See id. at 936.
cal education at the University of Puerto Rico. In return for the funds, the student had to serve on active duty as a commissioned officer in the Public Health Service or as a civilian member of the National Health Service Corp. The student never served in either organization, and the Department of Health and Human Services sought reimbursement.

The court first noted that, although § 523(a)(8) prohibits the discharge of an educational loan, Congress "did not elaborate on exactly what constituted an educational loan." The court declined to apply the educational purposes test, without any reference to Shipman, saying "the funds provided were for educational or educationally related purposes... what is encompassed by the term loan is determinative." Next, the court surveyed the definition of loan in other contexts. The court started with the "classic" definition of a loan:

'We define a loan as follows: In order to constitute a loan there must be a contract whereby, in substance one party transfers to the other a sum of money which that other agrees to repay absolutely, together with such additional sums as may be agreed upon for its use. If such be the intent of the parties, the transaction will be considered a loan without regard to its form.'

The court then looked at whether the transaction must assume a specific form to constitute a loan and concluded that "whether or not [a] transaction constitutes a loan, is to be determined from the surrounding facts in the particular case." Finally, the court held that "[w]hether the agreement was called a scholarship, award, grant or loan is immaterial. The intent of both parties was to create an obligation which would require repayment. This was a loan."
Thus, for some courts, whether or not a debt was a loan determined nondischargeability under § 523(a)(8). These courts looked at the substance of the transaction, rather than the labels used by the parties. Under the loan test, the threshold inquiry was not the purpose for which the funds were used, but the intent of the schools and the student. If the intent to lend or borrow funds existed, then the transaction was an educational loan for purposes of § 523(a)(8).

C. Andrews University v. Merchant

Although the courts interpreting the pre-1990 statutory language of § 523(a)(8) conceived two distinct tests, the educational purposes test and the loan test, for ascertaining whether a debt constituted a nondischargeable educational loan, one of the last cases decided under the pre-1990 statutory language attempted to reconcile the two tests. In Andrews University v. Merchant (In re Merchant), a bank made a loan to the student in connection with a student loan program, whereby the university guaranteed the loan in the event of student default. In addition to the loan guaranty, the university also extended credit to the

807 F.2d 122, 127 (8th Cir. 1986) (relying upon Avila and holding that when a student received funds under the Physician Shortage Area Scholarship Program but never fulfilled the service obligation to practice in a physician shortage area, the funds were an educational loan for purposes of § 523(a)(8)); United States v. Dillingham (In re Dillingham), 104 B.R. 505, 509 (Bankr. N.D. Ga. 1989) (citing Avila and holding that a scholarship award under the Public Health Service Scholarship Program "has been determined to constitute an 'educational loan' within the meaning of § 523(a)(8)")); Rural Ky. Med. Scholarship Fund, Inc. v. Lipps (In re Lipps), 79 B.R. 67, 70 (Bankr. M.D. Fla. 1987) (citing Avila and holding that, when a student received a loan at a reduced interest rate under the Rural Kentucky Medical Scholarship program but never fulfilled the service obligation, the extra interest was an educational loan for purposes of § 523(a)(8)). But cf. United States Dep't of Health and Human Servs. v. Brown (In re Brown), 59 B.R. 40, 41-43 (Bankr. W.D. La. 1986) (following the Shipman rationale with respect to funds received under the Public Health Service Scholarship Program without any citation to Avila and holding that the government must show "what part of the stipend was used directly for educational purposes, i.e., books, supplies and equipment and what part was used for non-educational purposes, such as rent and living expenses").

58. See Andrews Univ. v. Merchant (In re Merchant), 958 F.2d 738 (6th Cir. 1992). Although Merchant was decided in 1992, the court applied the pre-1990 language of § 523(a)(8) because the debtor filed her Chapter 7 petition before November 29, 1990. See id. at 739 n.1; see also Crime Control Act of 1990, Pub. L. No. 101-647, § 3631, 104 Stat. 4789, 4966 (declaring effective date of amended § 523(a)(8) as 180 days after passage of the Act). The court did, however, find support for its holding in the post-1990 language of § 523(a)(8), commenting that the new statutory language "does strengthen the court's interpretation of Congress' [sic] intent." Merchant, 958 F.2d at 739 n.1.

59. See Merchant, 958 F.2d at 739.
student for educational expenses in return for notes evidencing her indebtedness.\footnote{See id. at 739-41. The student signed the promissory notes in favor of the university before she registered for class. See id. at 741.} Thus, two distinct transactions existed, (1) the bank loan guaranteed by the university, and (2) the credit extensions evidenced by promissory notes payable to the university.

After graduation, however, the student defaulted on both the loan to the bank and the promissory notes to the university.\footnote{See id. at 739.} The university, according to the terms of the guaranty agreement, reimbursed the bank and brought suit against the student in satisfaction of both the guaranteed bank loan and the promissory notes.\footnote{See id. at 739.} The District Court for the Western District of Michigan held that both the guaranteed bank loan and the credit extensions were dischargeable under § 523(a)(8).\footnote{See id. at 739.}

The Sixth Circuit, however, reversed.\footnote{See id. at 740.} The first argument advanced by the student was that the bank loan guaranteed by the university was not an educational loan, under the second clause of § 523(a)(8), because it was not "funded in whole or in part by a nonprofit institution."\footnote{See id. at 740.} The court rejected this argument and declined to adopt the district court's reasoning that because the university did not purchase every bank loan it guaranteed, just the loans in default, the university did not fund the bank loans.\footnote{See id. at 740-41.} The circuit court, looking at the legislative history of § 523(a)(8), construed the statutory language of "funded in whole or in part" more broadly, reasoning that the fact the bank had full recourse against the university in the event of default "was crucial to [the debtor] receiving money to fund a portion of her education."\footnote{See id.}

Next, the court considered the issue of whether the credit extensions evidenced by promissory notes were educational loans within the meaning of § 523(a)(8).\footnote{See id. at 740-41. The court addressed the second prong of § 523(a)(8), that the loan be "made under any program funded in whole or in part by a . . . nonprofit institution," only with respect to the loan guaranty. See id. The court did not discuss whether the second transaction, the credit extension, was made under a program funded by the university. See id.} The court first set forth the "classic" definition of
loan, which was the same definition used by the Avila court. The court then stated that, although the lower courts rejected the reasoning of Hill, they found the Hill analysis persuasive. The Sixth Circuit summarized Hill as finding that a credit extension is a loan for purposes of § 523(a)(8) "when the following factors are present: (1) the student was aware of the credit extension and acknowledges the money owed; (2) the amount owed was liquidated; and (3) the extended credit was defined as 'a sum of money due to a person.'" The court then held that, under Hill, because the student was aware of the credit extensions, acknowledged the money owed as evidenced by the promissory note, and received her education by agreeing to pay these sums of money after graduation, the credit extensions were educational loans for purposes of § 523(a)(8).

Following the Merchant reasoning, therefore, the extent to which an extension of funds, such as a scholarship award, living stipend, work study advance, or credit extension qualifies as an educational loan for purposes of nondischargeability under § 523(a)(8) can be resolved by answering one simple question: did the student acknowledge the obligation and did the student receive her education by agreeing to repay the obligation? By examining whether the student acknowledged the obligation, the Merchant court focused on the student's intent to borrow funds, thereby adopting the loan test. By examining whether the student received her education by agreeing to repay the obligation, the Merchant court focused on the purpose for which the funds were used. Thus, the Merchant decision not only appears to reconcile the educational purposes test with the loan test but also formulates a bright line rule for educational debts under § 523(a)(8).

69. See id. at 741.
70. See United States Dep't of Health and Human Servs. v. Avila (In re Avila), 53 B.R. 933, 936 (Bankr. W.D.N.Y. 1985); see supra note 55 and accompanying text (reviewing the Avila court's definition of loan).
72. See Merchant, 958 F.2d at 741.
73. Id. (quoting Hill).
75. See Merchant, 958 F.2d at 741.
76. The court also stated, in dicta, that the Hill analysis "is further supported by In re Shipman . . . which held that the 'central issue in determining dischargeability is whether the funds were for educational purposes, not whether the funds constituted a loan.'" Id. at 741 n.2 (citation omitted) (quoting Shipman v. Department of Mental Health (In re Shipman), 33 B.R. 80, 82 (Bankr. W.D. Mo. 1983)).
III. DISCHARGEABILITY OF EDUCATIONAL DEBTS SUBSEQUENT TO 1990

By the time the Sixth Circuit formulated its bright line rule in *Merchant*, Congress had already turned its attention to the issue of what constituted an educational loan for purposes of § 523(a)(8). In 1990, Congress expanded the scope of § 523(a)(8) to include "educational benefit overpayment." Unfortunately, Congress did not define the term educational benefit overpayment and failed to provide any clarification with respect to its intention in enacting the new language. In the face of this Congressional silence, courts have turned their attention to interpreting the amended language of § 523(a)(8). The resulting morass of contradictory holdings annuls whatever small degree of certainty existed under the earlier version of § 523(a)(8). Presently, whether or not an educational debt will be discharged in Chapter 7 bankruptcy may depend solely upon what court hears the case.

A. The 1990 Amendment

In 1990, § 523(a)(8) was amended to read as follows:

§ 523. Exceptions to discharge.

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

... (8) for an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship or stipend. ...

Very little legislative history exists, however, to shed light on Congress's intent in enacting the new language. The educational benefit overpayment language first appeared in the Fair Debt Collection Procedures Act of 1988. The Act, as Senate Bill 1961, was reported out of the Senate...
Judiciary Committee without hearings or a written report. Thus, no commentary concerning the original impetus for the language survives.

Although Senate Bill 1961 passed the Senate, no further action was taken. A similar act, with the same language regarding § 523(a)(8), was proposed in the next Congress as Senate Bill 84, but that too was reported out of the Judiciary Committee without hearings or a written report. The House Committee on the Judiciary then picked up the legislation, under the aegis of House Bill 5640, and issued a report. In that report, the Committee commented that the bill “expands [§] 523(a)(8) to apply to educational benefit overpayments, such as those resulting from a default on performance of an obligation on which an educational scholarship was conditioned.” The Committee Report, however, provided no further explanation.

Ultimately, the House passed House Bill 5640, incorporated Senate Bill 84 into House Bill 5640, and enacted the educational benefit overpayment language as part of the Federal Debt Collection Procedures Act of 1990. The only further explanation proffered in support of the benefit overpayment language was a statement made on the House floor by the Chairman of the House Committee on the Judiciary that the legislation “extends the Bankruptcy Code’s nondischargeability of student loans to debts which are similar in nature to student loans.”

Thus, the plain language and legislative history of the 1990 amendment resolved clearly the dischargeability of scholarship awards contingent upon service obligations, putting an end to the Public Health Service Scholarship litigation. The new statutory language did not succeed, how-

90. See id. at 8255.
ever, in drawing a bright line as to which educational debts will be nondischargeable as educational benefits overpayments. The coast was clear for confusion.

B. Subsequent Case Law

The courts that have interpreted § 523(a)(8) since its amendment in 1990 are divided over whether a student's educational debt is an educational benefit overpayment or loan for purposes of § 523(a)(8). Although less than a dozen reported cases address the post-1990 language, three different approaches have emerged. Depending upon the jurisdiction, educational debts are (1) partially/fully nondischargeable, (2) fully nondischargeable when the student has executed a promissory note in favor of the university, or (3) fully dischargeable.

1. Partially/Fully Nondischargeable

a. Najafi v. Cabrini College

The first court to consider educational debts under the 1990 amendment was Najafi v. Cabrini College (In re Najafi). In Najafi, the student, after dropping out of Cabrini College, became a compulsive gam-

93. Compare Stone v. Vanderbilt Univ. (In re Stone), 180 B.R. 499, 500, 502 (Bankr. M.D. Tenn. 1995) (holding tuition debt is an educational benefit overpayment or loan when student has signed promissory note evidencing indebtedness), and Najafi v. Cabrini College (In re Najafi), 154 B.R. 185, 191 (Bankr. E.D. Pa. 1993) (holding tuition debt is an educational benefit overpayment or loan when student attended classes for a few weeks), with Dakota Wesleyan Univ. v. Nelson (In re Nelson), 188 B.R. 32, 34 (Bankr. D.S.D. 1995) (holding tuition debt is not an educational benefit overpayment or loan even when student signed promissory note evidencing indebtedness), and Seton Hall Univ. v. Van Ess (In re Van Ess), 186 B.R. 375, 380-81 (Bankr. D.N.J. 1994) (holding tuition debt is not an educational benefit overpayment or loan when student attended classes for a few weeks).

94. See Stevens Inst. of Tech. v. Joyner (In re Joyner), 171 B.R. 762, 765 (Bankr. E.D. Pa. 1994) (finding that the portion of debtor's loan attributable to room and board was an "educational benefit"); Najafi, 154 B.R. at 191 (finding that debtor was liable only to the extent of the benefit actually received); infra Part III.B.1 (discussing Najafi and Joyner).


bler in Atlantic City and won over $100,000 playing blackjack. Subsequent to his newly-found wealth, the student reapplied for admission at Cabrini. The college allowed the student to register and attend classes without making a tuition payment. The student attended classes for only two weeks but did not provide the college with an official or written notice of withdrawal. At the end of the semester, the college billed the student $4430, the full tuition for the semester. The student then filed for Chapter 7 bankruptcy.

The Bankruptcy Court for the Eastern District of Pennsylvania first looked at some of the pre-1990 amendment cases that interpreted the term educational loan under § 523(a)(8). After reviewing four pre-1990 amendment authorities, the Najafi court held that Cabrini's advancement of credit to the student was an educational loan under the previous version of § 523(a)(8), and therefore nondischargeable. It is unclear, however, whether the court relied upon the educational purposes test, the loan test, or the Merchant approach of combining the two tests. On the one hand, by determining that the advancement of credit constituted a loan, the court appears to have adopted the approaches of

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98. See id. at 187-88.  
99. See id. at 188.  
100. See id. Officially, Cabrini prohibited students from registering and attending class before they paid their tuition. See id. The student-debtor first testified that he believed that Cabrini intended to waive his tuition obligations "due to his newly-acquired 'celebrity' status," but later admitted that the college had never made any statements to him concerning such a waiver. See id. Although it is unclear from the record, Cabrini appears to have taken the position that although the college was willing to give the student some flexibility, it "expected the [d]ebtor to pay the tuition bill as soon as possible." See id.  
101. See id.  
102. See id.  
103. See id. at 187.  
104. See id. at 189. The Najafi court stated that "[f]our cases have been located which interpreted the term 'educational loan' . . . . " Id. But see supra Part II (discussing five cases that interpret the term educational loan).  
105. The four cases that the Najafi court identified were Shipman v. Department of Mental Health (In re Shipman), 33 B.R. 80 (Bankr. W.D. Mo. 1983), University of New Hampshire v. Hill (In re Hill), 44 B.R. 645 (Bankr. D. Mass. 1984), In re Ellenburg, 89 B.R. 258 (Bankr. N.D. Ga. 1988), and Andrews University v. Merchant (In re Merchant), 958 F.2d 738 (6th Cir. 1992). See Najafi, 154 B.R. at 189. In Ellenburg, the student attended classes under the mistaken impression that her mother was paying her tuition. See Ellenburg, 89 B.R. at 258. When the student learned that her mother was not paying tuition, she withdrew. See id. The student testified that she never borrowed any money and never signed any document agreeing to repay money or interest. See id. For a discussion of the three other cases identified by the Najafi court, see supra Part II.  
106. See id. at 189-90.
the \textit{Hill} and \textit{Avila} courts, focusing on whether the funds comprised a loan rather than exploring the purpose for which the funds were used. On the other hand, all of the extensions of credit were used to satisfy the student's tuition debt so the court may have adopted the educational purposes test. The court's sole rationale for concluding that the extension of credit was an educational loan under the pre-1990 version of § 523(a)(8) was that "[t]he weight of [the] authority support[ed] the conclusion ... ."

The court then went on to construe the 1990 amendment. The court recognized that "the absence of commas in the phrase 'educational benefit overpayment or loan' makes this phrase difficult to interpret." The court determined, however, that "the terms 'benefit,' 'overpayment,' and 'loan' should be construed as a series of nouns, all modified by the adjective 'educational.'" Thus, the court reasoned, the receipt of an educational benefit falls within the scope of § 523(a)(8) and is excepted from discharge.

\begin{footnotesize}
110. \textit{See} \textit{Najafi}, 154 B.R. at 189-90. After reaching this conclusion, however, the court said "[w]e agree with the [d]ebtor that it is difficult to characterize the instant as 'an obligation to repay funds.' No funds were received by the [d]ebtor from either Cabrini or any lending institution during the pertinent period." \textit{Id.} at 190. It is impossible to ascertain why the court made this statement after specifically citing to the \textit{Merchant} decision. In \textit{Merchant}, the Sixth Circuit expressly held that an extension of credit by the university to the student was an obligation to repay funds even though the student never received the funds physically. \textit{See} \textit{Merchant}, 958 F.2d at 741. The \textit{Najafi} court could have distinguished \textit{Merchant} on whether the student was aware of the credit extension and acknowledged the money owed. \textit{See supra} note 74 and accompanying text. The \textit{Merchant} debtor acknowledged the money owed, as evidenced by the promissory note. \textit{See id.} The \textit{Najafi} debtor, however, testified that he believed that Cabrini intended to waive his tuition obligation. \textit{See} \textit{Najafi}, 154 B.R. at 188. The \textit{Najafi} court, however, did not make this distinction. \textit{See id.} at 189-90. Instead, the court appeared to say that a credit extension is not an obligation to repay funds, a finding which runs directly contrary to the \textit{Merchant} opinion. \textit{See generally} \textit{supra} text accompanying notes 58-76 (discussing the \textit{Merchant} court's decision).
113. \textit{Id.}
114. \textit{See id.}
After determining that the receipt of an educational benefit is nondischargeable, the court abruptly stated that the student received an educational benefit from Cabrini.\textsuperscript{115} Although, presumably, the court predicated its finding on the two weeks of classes that the student attended, it did not specify what sort of educational benefit the student received, relying instead upon a bare assertion of fact.\textsuperscript{116} The court did, however, measure the value of the benefit according to the number of weeks of classes that the student attended.\textsuperscript{117} The court found that the debtor attended classes for one-seventh of the semester and limited the nondischargeable debt to one-seventh of the tuition bill ($633) plus an allowance for administrative actions ($750).\textsuperscript{118} Thus, $3680 of the student's $4430 tuition debt was dischargeable.\textsuperscript{119}

b. Joyner v. Stevens Institute of Technology

Two years later, in Joyner v. Stevens Institute of Technology (In re Joyner),\textsuperscript{120} the Bankruptcy Court for the Eastern District of Pennsylvania revisited the educational benefit overpayment or loan language of § 523(a)(8). Although the court purported to elucidate and reaffirm its holding in Najafi,\textsuperscript{121} the Joyner decision succeeded only in further clouding the § 523(a)(8) debate.

\textsuperscript{115} See id.

\textsuperscript{116} See id. The Najafi court did not address the requirement that the educational benefit be made under a program funded in whole or in part by a nonprofit institution. See id at 189-91. But see Santa Fe Med. Servs. v. Segal (In re Segal), 57 F.3d 342, 348 (3rd Cir. 1995) (holding a loan made by employer to employee so that employee could pay off her student loan nondischargeable and rejecting Najafi's reasoning as inconsistent with § 523(a)(8) to the extent Najafi could be interpreted as not requiring a program); Seton Hall Univ. v. Van Ess (In re Van Ess), 186 B.R. 375, 380 (Bankr. D.N.J. 1994) (finding that the Najafi debtor was not participating in a program funded by the college when he attended classes but failed to pay tuition); infra notes 151-54 and accompanying text (setting forth the Van Ess court's discussion that an educational benefit overpayment or loan must be made under a program funded in whole or in part by a nonprofit institution).

\textsuperscript{117} See Najafi, 154 B.R. at 190.

\textsuperscript{118} See id. The college argued that the student should be held liable for the full semester's tuition, pointing to its policy that a student must officially withdraw before a refund would be honored. See id. at 191. The court rejected the college's argument and refused to apply the policy because the college did not adhere to its own policies in accepting the student without payment of tuition. See id.; supra note 100 (discussing the college's policies).

\textsuperscript{119} See Najafi, 154 B.R. at 191.

\textsuperscript{120} 171 B.R. 762 (Bankr. E.D. Pa. 1994).

\textsuperscript{121} Judge David A. Scholl authored both the Najafi and the Joyner decisions. See Joyner, 171 B.R. at 763; Najafi, 154 B.R. at 187. At the time of the Joyner decision, Judge Scholl was Chief Bankruptcy Judge. See Joyner, 171 B.R. at 763.
In *Joyner*, the court considered the dischargeability of “that portion of the loan used to pay room and board,” an issue it had expressly reserved in an earlier order.¹²² Neither the order nor the opinion set forth the nature of the indebtedness, whether it was a loan made under the Stafford loan program or an outstanding balance on the student’s account. Arguably, however, the labeling of the debt as a loan without further discussion by the court suggests that the indebtedness was a bona fide loan rather than an extension of credit or outstanding balance for unpaid charges.

Inexplicably, however, the *Joyner* court did not analyze whether the portion of the loan used to pay room and board was an educational loan.¹²³ Instead, the court looked only at whether the room and board portion of the loan was nondischargeable under the second clause of § 523(a)(8) as “an obligation to repay funds received as an educational benefit, scholarship or stipend.”¹²⁴ Citing the *Najafi* opinion, the court held that the room and board portion of the loan was an educational benefit within the meaning of § 523(a)(8) and thereby nondischargeable.¹²⁵

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¹²² See *Joyner*, 171 B.R. at 763. In the earlier order, the court summarily declared the “balance presently owed by the [debtor] nondischargeable to the extent that it was attributable to tuition. See id. at 760-62.

¹²³ It is unclear why the court failed to pursue this line of reasoning. The court could have applied the loan test, as articulated in *University of New Hampshire v. Hill* (In re *Hill*), 44 B.R. 645, 647 (Bankr. D. Mass. 1984), and held the loan nondischargeable without any difficulty, especially if this was a bona fide loan. Likewise, the court could have applied either the *Shipman* or *Vretis* approach of the educational purposes test. See supra Part II.A. (discussing *Shipman* and *Vretis*). Under the *Shipman* approach, the loan would have been dischargeable because the funds were not used for educational expense but for living expenses. See *Shipman* v. Department of Mental Health (In re *Shipman*), 33 B.R. 80, 82 (Bankr. W.D. Mo. 1983). Under the *Vretis* approach, the loan would have been nondischargeable, even though used for room and board, because, presumably, it was awarded for educational purposes. See United States Dep’t of Health and Human Servs. v. Vretis (In re *Vretis*), 56 B.R. 156, 157 (Bankr. M.D. Fla. 1985). Thus, the court never needed to reach whether the student received an educational benefit. Although the court does discuss the *Shipman* and *Vretis* cases, it does so only to bolster its educational benefit finding. See *Joyner*, 171 B.R. at 763-65; infra text accompanying notes 125-28 (applying the educational purposes test).

¹²⁴ See *Joyner*, 171 B.R. at 763.

¹²⁵ See id. The *Najafi* decision discussed only the educational benefit overpayment or loan language of the first clause of § 523(a)(8). See *Najafi*, 154 B.R. at 190. The *Joyner* court, however, was looking to see if the loan was nondischargeable under
Next, the court looked at the pre-1990 educational purposes test cases to support its finding of an educational benefit. The court concluded that its earlier reasoning in Najafi supported the Vretis approach of the educational purposes test: whether the funds were awarded for educational purposes. The court reasoned:

[If the inquiry is upon whether the student receives an “educational benefit” from a loan, it should not matter whether the money is used for tuition or other living expenses. Both are part of the “educational benefit” sought by the student. Under the guaranteed student loan program, for example, the loan proceeds may apparently be used by the student to pay for tuition, room and board, books, student fees, or any other expenses incidental to education. All of these expenses serve the student’s “educational benefit,” and lenders and the government do not make distinctions between the uses of proceeds when awarding such loans.]

The court, therefore, held that the room and board portion of the loan was an “obligation to repay funds received as an educational benefit” because the receipt of the funds conferred an educational benefit on the debtor.

Under Joyner, therefore, a credit extension for a room and board debt is an educational benefit overpayment or loan for purposes of § 523(a)(8). Under Najafi, a credit extension for a tuition debt is an educational benefit overpayment or loan for purposes of § 523(a)(8). Thus, a college or university that is lucky enough to find itself in the Eastern District of Pennsylvania may rest easy because educational debts are either partially or fully nondischargeable in that jurisdiction.

2. Fully Nondischargeable When Student Has Executed a Promissory Note: Stone v. Vanderbilt University

The Bankruptcy Court for the Middle District of Tennessee articulated a second approach to educational debts under the 1990 amendment in Stone v. Vanderbilt University (In re Stone). In Stone, the student

the second clause of § 523(a)(8) as “an obligation to repay funds received as an educational benefit, scholarship or stipend.” See Joyner, 171 B.R. at 763. Thus, the Joyner court collapsed two distinct clauses of the statute into one educational benefit rubric. Cf. Alibatya v. New York Univ. (In re Alibatya), 178 B.R. 335, 338 (Bankr. E.D.N.Y. 1995) (commenting that the defendant-university “blurs distinctions between such excepted categories, blending them under one overarching rubric, namely, educational benefit”); infra note 169.

127. See id. at 764. But see supra text accompanying note 107 (commenting that Najafi, by determining that the credit extension was a loan, may have adopted the loan test).
129. See id. at 765.
had an outstanding balance of $5145 with Vanderbilt, representing tuition, nurse malpractice insurance, and other administrative fees, when he withdrew from school.  

Vanderbilt refused to release a transcript unless the student "signed a promissory note for the balance on his account." The student executed a note in favor of Vanderbilt, defaulted on the note, and then filed for Chapter 7 bankruptcy.  

On summary judgment, the Stone court found the note nondischargeable. The court first set forth, in great detail, the Sixth Circuit's reasoning in Merchant. Applying this reasoning, the court then held that the promissory note for the outstanding balance was an educational loan because the debtor did not deny the indebtedness, "the amount claimed was liquidated, and the terms of the note prove[d] an 'amount due' Vanderbilt." The court, however, did not stop there; it also found that "[a]n 'educational benefit' undoubtedly was conferred upon [the] debtor at the expense of Vanderbilt." In support of this finding, the court noted that the debtor attended classes, participated as a student, and was covered by nursing malpractice insurance. The court, therefore,
held the note nondischargeable\(^{139}\) because it was either a loan or an educational benefit for purposes of § 523(a)(8).\(^{140}\)

Under *Stone*, therefore, a credit extension evidenced by a promissory note is an educational benefit overpayment or loan for purposes of § 523(a)(8). Thus, a college or university that finds itself in the Middle District of Tennessee may rest easy because educational debts are fully nondischargeable in that jurisdiction when the student has executed a promissory note in favor of the university.

3. Fully Dischargeable

a. Seton Hall University v. Van Ess

Yet a third approach to the statutory educational benefit overpayment or loan language emerged in the bankruptcy courts of the Second Circuit. In 1994, one year after the *Najafi* court’s decision, the Bankruptcy Court for the District of New Jersey considered the same issue on substantially the same facts in *Seton Hall University v. Van Ess (In re Van Ess)*.\(^{141}\) In *Van Ess*, the student registered for the fall semester at the university’s law school, attended some classes, but did not pay tuition.\(^{142}\) The student subsequently filed for Chapter 7 bankruptcy.\(^{143}\)

The university, relying on *Merchant* and *Hill*, argued that the student’s failure to pay tuition created an extension of credit to the student by the university and that such an extension of credit was a nondischargeable educational loan.\(^{144}\) Alternatively, relying on *Najafi*, the university argued that the student’s attendance at class and non-payment of tuition resulted in an educational benefit under § 523(a)(8).\(^{145}\)

\(139\) *But see* Virginia v. Ziglar (*In re Ziglar*), 19 B.R. 298, 300 (Bankr. E.D. Va. 1982) (holding that a note executed to satisfy judgments on defaulted student loans was not an educational loan for purposes of § 523(a)(8)); *supra* note 34 (discussing *Ziglar*). Under the *Ziglar* reasoning, the *Stone* court would have reached the opposite result because the *Stone* debtor neither received any money in exchange for the note, nor returned to school after the execution of the note. *See Stone*, 180 B.R. at 500; *Ziglar*, 19 B.R. at 300.

\(140\) *See Stone*, 180 B.R. at 502. Although the *Stone* court delivered its opinion subsequent to the decisions in *Seton Hall University v. Van Ess (In re Van Ess)*, 186 B.R. 375 (Bankr. D.N.J. 1994), and *Alibatya v. New York University (In re Alibatya)*, 178 B.R. 335 (Bankr. E.D.N.Y. 1995), the court made no reference to this line of cases. *See infra* Part III.B.3.a.-b. (discussing *Van Ess* and *Alibatya*).


\(142\) *See id.* at 376.

\(143\) *See id.*

\(144\) *See id.* at 377.

\(145\) *See id.*
The court, however, rejected both of the university's arguments.\textsuperscript{146} The court began its discussion with a review of the legislative history of § 523(a)(8).\textsuperscript{147} The court then looked at the "plain meaning" and the underlying policies of § 523(a)(8)\textsuperscript{148} and concluded both weighed in favor of discharge:

There is no overriding policy that warrants treating \textit{SHU} differently from any other creditor. Indeed, given the ready availability of student grants and loans, one might very well conclude that \textit{SHU} is particularly well situated to avoid defaults on tuition obligations. Students who need financial aid may avail themselves of various government programs or university sponsored programs, and \textit{SHU} need not permit students to attend class unless the tuition is paid.\textsuperscript{149}

Next, the court turned its attention to the university's entreatment that, under the reasoning of \textit{Najafi}, the debtor received an educational benefit.\textsuperscript{150} The \textit{Van Ess} court, however, refused to adopt \textit{Najafi}'s "strained reasoning," pointing out that the \textit{Najafi} opinion ignored the requirement that the educational benefit overpayment or loan must be made under a program funded in whole or part by a "governmental unit or nonprofit institution."\textsuperscript{151} The \textit{Van Ess} court, looking at the facts of \textit{Najafi}, did not find that the \textit{Najafi} debtor was "participating in a program funded by the college" when he attended classes but failed to pay tuition.\textsuperscript{152} Likewise, the court found that the debtor in the case at bar did not participate in a funded program when he attended law school classes without paying tuition.\textsuperscript{153} Simply put, the court, with tongue in cheek, did not find that either debtor participated in a "funded program which permitted attendance at school without payment of tuition."\textsuperscript{154}

\textsuperscript{146} See \textit{id.} at 378-81.
\textsuperscript{147} See \textit{id.} at 378.
\textsuperscript{148} See \textit{id.; see also Barlow, supra note 8, at 489-93 (discussing the "plain meaning" approach to statutory interpretation of § 523(a)(8) in the context of cosigners and guarantors).}
\textsuperscript{149} \textit{Van Ess}, 186 B.R. at 379. The \textit{Van Ess} court did not mention Representative Brooks's statement on the House floor that the amended language of § 523(a)(8) "extends the Bankruptcy Code's nondischargeability of student loans to debts which are similar in nature to student loans." \textit{See} 136 \textit{CONG. REC.} 13,288 (1990); see \textit{also supra text accompanying note 92 (discussing the statement of Representative Brooks).}
\textsuperscript{150} See \textit{Van Ess}, 186 B.R. at 379-80.
\textsuperscript{151} See \textit{id.} at 380; \textit{supra note 116 (discussing the requirement that the educational benefits or loan be made under a program).}
\textsuperscript{152} See \textit{Van Ess}, 186 B.R. at 380.
\textsuperscript{153} See \textit{id.}
\textsuperscript{154} \textit{Id; see also Santa Fe Med. Servs., Inc. v. Segal (In re Segal), 57 F.3d 342, 348 (3rd Cir. 1995). In Segal, the employer, Santa Fe Medical Services, made a loan to an
The court also refused to construe the student's failure to pay as an extension of credit, rejecting the university's Merchant and Hill argument that a student's failure to pay tuition creates an extension of credit and that such an extension of credit is a nondischargeable educational loan. The Van Ess court distinguished Merchant and Hill as "extensions of credit in connection with loan programs." With respect to Merchant, the court distinguished the credit extension as part of the student loan program between the bank and the university. With respect to Hill, the court distinguished the credit extension as a temporary measure made in reliance on the debtor's application for a guaranteed student loan and with the expectation that the debtor would pay the credit as soon as he received the student loan proceeds.

Finally, the Van Ess court concluded its opinion by analogizing the university's debt to a debt due to a family dentist. According to the court, both creditors involuntarily extended credit to the debtor by virtue

employee so that the employee could pay off her National Health Scholarship obligation. See id. at 344; see also supra note 38 (discussing the National Health Scholarship Program). The Third Circuit held that the loan was not made under a program funded in whole or in part by a nonprofit institution or governmental unit. See Segal, 57 F.3d at 347-50. The court found that Santa Fe, a nonprofit institution, did not have a practice of making such loans to employees and did not have any procedures in place, saying "[a]s far as we can tell, this was a unique, unprecedented arrangement created specifically to facilitate the acquisition of [the debtor] as a staff physician." See id. at 347.

155. See Van Ess, 186 B.R. at 380.

156. See id.

157. See id. The court, however, appears to have misread the facts of Merchant. In Merchant, two distinct transactions existed: (1) the bank loan guaranteed by the university, and (2) the credit extensions evidenced by promissory notes payable to the university. See Andrews Univ. v. Merchant (In re Merchant), 958 F.2d 738, 739 (6th Cir. 1992); supra text accompanying notes 59-60 (discussing Merchant). Although the Merchant court did find that the loan guaranty was a program funded in part by the university, the Merchant court considered the credit extension independently of the loan guaranty; in fact, the Merchant court explicitly failed to address whether the credit extension was made under a program funded by the university. See Merchant, 958 F.2d at 740-41. Thus, no basis exists for concluding that the Merchant court considered the credit extension part of the loan program. In fact, the very structure of the Merchant opinion, where the loan guaranty and the credit extension are discussed in discrete sections, argues against such a conclusion. See id.

158. See Van Ess, 186 B.R. at 380. The Hill opinion, however, does not appear to base its holding on the university's reliance on the guaranteed student loan or the short term nature of the credit extension. See University of New Hampshire v. Hill (In re Hill), 44 B.R. 645, 647 (Bankr. D. Mass. 1984). Instead, the Hill opinion appears to rely solely upon the facts that the amount was certain and the debtor acknowledged that he owed the university tuition. See id.; supra text accompanying notes 40-46 (discussing Hill).

159. See Van Ess, 186 B.R. at 381.
of the debtor's failure to pay, and the university should have no greater remedy than other general service providers for nonpayment of a bill. The court made very clear its stance on the dischargeability of educational debts, stating that "if Congress had intended the scope of § 523(a)(8) to include the simple nonpayment of tuition or any and all extensions of credit whether within or apart from an educational loan program, we assume that it would have so stated."

b. Alibatya v. New York University

The Second Circuit's hard line approach towards the post-1990 language further solidified when the Eastern District of New York, in Alibatya v. New York University (In re Alibatya), adopted the New Jersey bankruptcy court's construction of educational benefit overpayment and loan. In Alibatya, a student entered into a one year housing license agreement with NYU while attending graduate school. Under the license agreement, the fee was payable in three equal installments on or before August 1, December 1, and April 1. In May 1989, three months prior to the expiration of the one year period, the student termi-
nated the license and vacated the apartment. At the time the student terminated the license, the student owed NYU $2550.50 under the terms of the license. Subsequently, the student filed for Chapter 7 bankruptcy.

The court began the opinion by attempting to clarify the university's arguments for nondischargeability. The court concluded that the main thrust of the university's argument was that the university's failure to exercise its right to terminate the lease when the student did not make the third rental installment constituted an extension of credit. The court, however, found no extension of credit and hence no loan because no intent to make a loan, on the part of the university, and no intent to borrow funds, on the part of the student, existed. The court determined that the parties intended to form a lessor/lessee relationship and not a lender/borrower relationship. The court stated:

Defendant makes no showing or even plausible explanation as to how its forbearance under the express provisions of the housing license agreement, and not exercising its right to terminate, transmutes a rental obligation into a loan . . . . And there is no indication that Plaintiff ever considered himself anything other than a lessee of housing facilities.

Thus, the court held that student room and board charges of an educational institution, standing alone, do not constitute a dischargeable debt under § 523(a)(8).

166. See id.
167. See id.
168. See id. at 336.
169. See id. at 338. The court noted:

The underlying basis for Defendant's nondischargeability position is somewhat enigmatic and therefore escapes precise analysis. At one point or another, either in papers filed or at oral argument, Defendant has sought to place Plaintiff's student housing obligation within virtually every category of excepted educational debt identified in 11 U.S.C. § 523(a)(8). Remarkably, at the same time, Defendant blurs distinctions between such excepted categories, blending them under one overarching rubric, namely, educational benefit.

Id. at 338; see also Stevens Inst. of Tech. v. Joyner, (In re Joyner), 171 B.R. 763, 765 (Bankr. E.D. Pa. 1994) (collapsing two distinct clauses of § 523(a)(8) and holding that loan was an "obligation to repay funds received as an educational benefit" because the receipt of the funds conferred an "educational benefit" on the debtor); supra note 125.

170. See Alibatiya, 178 B.R. at 338. The university refers to this as a "constructive loan." See id.
171. See id. at 339.
172. See id.
173. Id.
174. See id. at 340.
Under *Alibatya*, therefore, a credit extension for a room and board debt is not an educational benefit overpayment or loan for purposes of § 523(a)(8). Likewise, under *Van Ess*, a credit extension for a tuition debt is not an educational benefit overpayment or loan either. Thus, a college or university that finds itself in the bankruptcy courts of the Second Circuit faces the distinct possibility that it will not recover from a delinquent student.

c. Dakota Wesleyan University v. Nelson

The most recent case interpreting nondischargeability under § 523(a)(8) starts where the Second Circuit left off. Although the Middle District of Tennessee had held that educational debts are fully nondischargeable when the student has executed a promissory note to the university evidencing such indebtedness, the South Dakota District Court reached a contrary conclusion on the same facts in *Dakota Wesleyan University v. Nelson (In re Nelson)*. In *Nelson*, the student owed the university $3057 for tuition, room and board, course fees, and books and supplies at the end of the 1990 fall semester. The student enrolled for the 1991 spring semester and attended classes but did not complete her 1990-91 financial aid application until the end of the semester. The university, learning that no financial aid would be forthcoming because of the student’s dilatory application, did not permit her to take final exams and did not charge her for the spring semester. The student signed a promissory note to the university but made only four payments on the note before filing for Chapter 7 bankruptcy. The bankruptcy court declared the note dischargeable and the district court affirmed.

175. See *Van Ess*, 186 B.R. 375, 380-81 (Bankr. D.N.J. 1994); *supra* text accompanying notes 141-61 (discussing *Van Ess*).
178. See *id.* at 33.
179. See *id.*
180. See *id.*
181. See *id.*
182. See *id.* at 34. The university appealed the bankruptcy court’s unpublished opinion to the district court, which had jurisdiction to hear the appeal under 28 U.S.C. § 158(a) (1994). See *Nelson*, 188 B.R. at 33. The district court reviewed the bankruptcy court’s factual findings and conclusions of law de novo. See *id.*; see also Wegner
The district court first held that no educational benefit overpayment or loan existed because "the [u]niversity's choice to allow [the student] to continue to attend classes without signing a note or making payment cannot amount to a loan or an educational benefit overpayment." Next, the court determined that even if the student did receive an educational benefit, neither a nonprofit institution nor a governmental unit funded the benefit by providing the student with funds.

v. Grunewaldt, 821 F.2d 1317, 1320 (8th Cir. 1987) (stating that "the district court may review the bankruptcy court's legal conclusions de novo").

183. See Nelson, 188 B.R. at 33. The court cited four cases, Alibatya v. New York University (In re Alibatya), 178 B.R. 335, 338-40 (Bankr. E.D.N.Y. 1995), Peller v. Syracuse University (In re Peller), 184 B.R. 663, 669 (Bankr. D.N.J. 1994), In re Ellenburg, 89 B.R. 258, 262-63 (Bankr. N.D. Ga. 1988), and Department of Mental Health v. Shipman (In re Shipman), 33 B.R. 80, 81 (Bankr. W.D. Mo. 1983), in support of this holding. See id. None of these cases, however, appear directly on point. In Alibatya, the court determined that a straight-forward lessor/lessee relationship existed. See Alibatya, 178 B.R. at 338; supra text accompanying notes 172-73 (discussing Alibatya). In Peller, the student's parents were the debtors while in Nelson the debtor was the student herself. See Peller, 184 B.R. at 665; supra note 161 (discussing Peller). Unlike Ellenburg, the Nelson debtor was not attending classes under the mistaken impression that her mother was paying her tuition. See Ellenburg, 89 B.R. at 262; supra note 105 (discussing Ellenburg). Also, the Ellenburg student withdrew once she learned that her tuition was not being paid and never signed any document agreeing to repay money or interest. See Ellenburg, 89 B.R. at 262; supra note 105 (discussing Ellenburg). Finally, it is unclear why the Nelson court cites Shipman in support of its decision. Applying the educational purposes test of Shipman, the Nelson debtor's note would clearly be an educational loan for purposes of § 523(a)(8) because the extensions of credit were used for educational purposes like tuition and course fees. See Nelson, 188 B.R. at 33. The Nelson court appears to have overlooked the main tenet of Shipman: "the central issue in determining dischargeability [under § 523(a)(8)] is whether the funds were for educational purposes, not whether the funds constituted a loan." Shipman, 33 B.R. at 82; see supra text accompanying notes 30-34 (discussing Shipman).

Also, the Nelson court did not mention University of New Hampshire v. Hill (In re Hill), 44 B.R. 645 (Bankr. D. Mass. 1984). See supra text accompanying notes 40-46 (discussing Hill). In Hill, the court held that an educational loan existed where the university extended short term credit pending receipt of the student's loan proceeds. See Hill, 44 B.R. at 646-47. Arguably, the university in Nelson also supplied short term credit until the student received her financial aid proceeds. The Nelson court, however, did not make any attempt to distinguish Hill from the case at bar.

184. See Nelson, 188 B.R. at 33. It is unclear what the court meant by this statement. If the university extended credit to the student, then that extension of credit was funded by the university. The proper inquiry is whether this credit extension was a program within the meaning of § 523(a)(8). See supra text accompanying notes 151-54 (setting forth the Van Ess court's discussion that the educational benefit overpayment or loan must be made under a program funded in whole or in part by a governmental unit or nonprofit institution).
Finally, the court distinguished the case at bar from Andrews University v. Merchant (In re Merchant), \(^{185}\) characterizing Merchant as a loan made by a commercial lender and then guaranteed by the educational institution. \(^{186}\) The court then held, in dictum, that the promissory note itself was not a loan or educational benefit under § 523(a)(8), expressly declining to follow Stone v. Vanderbilt University (In re Stone). \(^{187}\)

Under Nelson, therefore, a credit extension with a promissory note acknowledging the obligation is not an educational benefit overpayment or loan for purposes of § 523(a)(8). Thus, a college or university that finds itself in the District of South Dakota confronts the very real possibility that it will not recover from a delinquent student because educational debts are fully dischargeable in that jurisdiction even when the student has executed a promissory note in favor of the university evidencing her indebtedness.

IV. PROPOSAL

In light of the contradictory authorities, the course that universities and colleges must follow to ensure that courts will not discharge educational debts in Chapter 7 bankruptcy is anything but clear. Reliance on

\(^{185}\) 958 F.2d 738 (6th Cir. 1992); see supra text accompanying notes 58-74 (discussing Merchant).

\(^{186}\) See Nelson, 188 B.R. at 34. The Nelson court, however, just like the Van Ess court, misread the facts of Merchant. See supra note 157 (discussing the Van Ess court's interpretation of Merchant). In Merchant, two distinct transactions existed: (1) the bank loan guaranteed by the university, and (2) the credit extensions evidenced by promissory notes payable to the university. See Merchant, 958 F.2d at 739; supra text accompanying notes 59-60 (discussing Merchant). The Nelson court construed Merchant as a case where the "debtor's obligation to the bank on the promissory notes was funded, in part, by the university." Nelson, 188 B.R. at 34. The Merchant promissory notes were in favor of the university, however, not the bank. See Merchant, 958 F.2d at 740-41. The Merchant promissory notes evidenced the credit extension by the university and were completely independent of the bank loan guaranty. See id.

the guidance set forth in prior decisions does not guarantee that the college or university will succeed in having its debt declared nondischargeable under § 523(a)(8). For example, in Nelson, Dakota Wesleyan University appears to have followed, to no avail, the Van Ess court's admonitions of requiring students to rely on government or school sponsored financial aid programs and prohibiting students from attending classes. The Nelson student was late in filing her financial aid application late and did not receive any financial aid. When the University realized this, it prevented the student from taking final exams. The South Dakota bankruptcy court, however, still found the debt dischargeable under the rationale of Van Ess.

The Van Ess and Nelson decisions contemplate blind adherence to a strict policy of not allowing delinquent students to attend classes. This practice, however, may very well result in punishing an innocent student for circumstances beyond her control and a public relations nightmare for the school. For example, what course of action should a school pursue when a student's parent incurs large medical bills for an unexpected surgery before the semester's tuition is paid, the parent's insurance company contests coverage for some of these expenses, and the parent cannot make the tuition payment until the matter is resolved? According to the Nelson and Van Ess courts, the school should immediately prevent the student from attending classes or run the risk of having the tuition obligation discharged. The Van Ess and Nelson decisions, therefore, force schools to choose between the Scylla of having an educational debt owed by a delinquent student discharged in a Chapter 7 proceeding and the Charybdis of inflexibility with respect to family calamities that create temporary financial hardships.

In addition, many schools have monthly installment tuition payment plans in order to accommodate middle-income families that do not have the cash flow to make two large lump-sum payments. How can schools distinguish a trustworthy student (who will pay tuition over a ten-month period) from a nontrustworthy student (who ultimately will not pay and will file for bankruptcy)? Under the Van Ess and Nelson

188. See supra text accompanying notes 177-87 (discussing Nelson).
190. See Nelson, 188 B.R. at 33.
191. See id.
192. See id. at 34.
193. See Toddi Gutner, Paying for the Kid's Sheepskin, Bus. Wk., Nov. 11, 1996, at 134 (discussing prevalence of installment tuition plans for families "who can pay tuition out of cash flow but don't have thousands of dollars tucked away").

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decisions, a school may have to choose between installment tuition payment plans or protecting itself from getting stuck with an unpaid tuition bill. Discontinuing such tuition payment plans, however, may put an education at the student's choice of schools beyond the reach of many families who simply cannot pay $10,000 in September and January, but who can afford to pay $1,500 every month.

Unfortunately, the courts that have considered the educational benefit overpayment or loan language of § 523(a)(8) have failed to address such difficult issues, leaving university counsel with little guidance. Colleges and universities that are unlucky enough to find themselves in South Dakota, New York, or New Jersey forums may not have much leeway to argue their position. Most jurisdictions, however, have yet to consider the issue. Thus, what strategy should schools follow to ensure that its educational debts will not be discharged in Chapter 7 bankruptcy?

The first hurdle that every court must clear before addressing whether the debt is an educational benefit overpayment under the post-1990 language of § 523(a)(8) is whether the debt is an educational loan. Nonetheless, courts interpreting § 523(a)(8) subsequent to the 1990 amendment have disingenuously distinguished and, in effect, overruled the prior case law of Andrews University v. Merchant (In re Merchant), which held that a credit extension is a loan for purposes of § 523(a)(8). Such a result, however, is wholly untenable. First, nothing in the legislative history indicates that Congress disapproved of the holding in University of New Hampshire v. Hill (In re Hill), the analytical precursor to Merchant. Moreover, Representative Brooks's statement that the amended § 523(a)(8) "extends the Bankruptcy Code's nondischargeability of student loans to debts which are similar in nature to student loans" supports the conclusion that the 1990 amendment expanded, not limited, the reach of § 523(a)(8).

195. 958 F.2d 738, 741 (6th Cir. 1992); see supra text accompanying notes 58-74 (discussing Merchant).
197. See supra notes 71-74 (discussing the Merchant court's adherence to Hill). The Merchant decision, although rendered subsequent to the 1990 amendment, applied pre-1990 law. See Merchant, 958 F.2d at 739 n.1; supra note 58 (stating that Merchant was decided under pre-1990 statutory language).
198. See 136 CONG. REC. 13,288 (1990); see also Merchant, 958 F.2d at 739 n.1
Most importantly, however, the courts, in surreptitiously overruling the

*Merchant* holding that a credit extension is a loan for purposes of

§ 523(a)(8), have misread the facts of *Merchant*. In both *Van Ess* and

*Nelson*, the courts failed to recognize that, in *Merchant*, two distinct
transactions existed, (1) the bank loan guaranteed by the university, and

(2) the credit extensions evidenced by promissory notes payable to the

university. The proper reading of *Merchant* is that an extension of

credit by a university to a student will constitute a loan for purposes of

§ 523(a)(8) “when the following factors are present: (1) the student was

aware of the credit extension and acknowledges the money owed; (2) the

amount owed was liquidated; and (3) the extended credit was defined as

‘a sum of money due to a person.’

Thus, *Merchant*, if read correctly, is still good law and provides a

bright line rule that can be applied consistently both by courts and

schools. Under *Merchant*, a college or university that extends credit to a

student makes a loan for purposes of § 523(a)(8) when the student is

aware of the credit extensions, acknowledges the money owed as evi-
denced by promissory notes, and receives her education by agreeing to

pay these sums of money after graduation. Furthermore, those courts

that have adopted the *Merchant* holding are equally willing to find an

educational benefit. Thus, an extension of credit should be an educa-
tional benefit overpayment or loan under § 523(a)(8).

Even when a school successfully convinces a court that *Merchant*

remains good law, however, the dischargeability battle is only half won.
The key to avoiding dischargeable debts is the adoption and implementa-
tion of a program for extending credit. According to the language of

§ 523(a)(8), the educational benefit overpayment or loan must be made

under a “program funded in whole or in part by a governmental unit or

nonprofit institution.”

(commenting that the new statutory language “does strengthen the court’s interpreta-
tion of Congress’ [sic] intent”).

199. See supra notes 157, 186 (discussing the treatment of *Merchant*). Confusion
regarding the facts of *Merchant* runs rampant and is not limited to the courts. See
Patricia Somers & James M. Hollis, *Student Loan Discharge Through Bankruptcy*, 4
AM. BANKR. INST. L. REV. 457, 466 n.88 (1996) (characterizing the *Merchant* court as
“refusing to give debtor discharge where credit extension by university to student
was for purpose of acquiring loan”).

200. See *Merchant*, 958 F.2d at 740-41; supra notes 157, 186 (discussing the treat-
ment of *Merchant*).

201. See *Merchant*, 958 F.2d at 741 (quoting *Hill*, 44 B.R. at 647).

Tenn. 1995); Stevens Inst. of Tech. v. Joyner (*In re* Joyner), 171 B.R. 762, 765
(Bankr. E.D. Pa. 1994); Najafi v. Cabrini College (*In re* Najafi), 154 B.R. 185, 191
(Bankr. E.D. Pa. 1993); supra Parts III.B.1-2 (discussing *Stone, Joyner, and Najafi*).

gram needs to be, it must be more than a post facto attempt to explain why the school failed to collect monies from the student. As the Van Ess court commented, it is difficult to believe that a university has a funded program which permits attendance at school without payment of tuition.204

Arguably, the Van Ess decision should not be a bar to establishing that an extension of credit by the school to a student is a program funded by the university. In Van Ess, the court distinguished the Merchant holding that a credit extension evidenced by promissory notes is an educational loan for purposes of § 523(a)(8), stating that the credit extension was part of an established student loan program whereby the university guaranteed bank loans.205 Once again, however, the Van Ess court misread the facts of Merchant.206 In Merchant, the Sixth Circuit considered the credit extension independent of the loan guaranty and appears not to have questioned that the credit extension was made under a program funded by the university.207 Thus, under a correct reading of Merchant, seeking a promissory note evidencing indebtedness from each student who has not paid in full by the second week of class should qualify as a program.

In addition, it is very important that once a school has a program for extending credit in place, it follow the program scrupulously. In Najafi, the school had an official policy of prohibiting students from registering and attending classes before they paid tuition.208 Although the court declared a portion of the debt nondischargeable, the court rejected the college's argument that the student be liable for the full semester's tuition because the college, by accepting the student without payment of tuition, did not adhere to its own policies.209

Unfortunately, the pro-discharge stance of the Van Ess, Alibatya, and Nelson decisions ensure that students will litigate, with great fervor, the

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204. See Seton Hall Univ. v. Van Ess (In re Van Ess), 186 B.R. 375, 380 (Bankr. D.N.J. 1994); supra notes 151-54 (discussing the Van Ess court's finding that the debtor did not participate in a funded program).
205. See Van Ess, 186 B.R. at 380.
206. See supra note 157 (discussing the Van Ess interpretation of Merchant).
209. See id. at 191.
dischargeability of educational debts in Chapter 7 bankruptcy. When the school inevitably finds itself in court, however, it should avoid lobbying for the adoption of the Pennsylvania bankruptcy court’s approach in Najafi and Joyner.210 Although the Najafi and Joyner decisions appear to be the most sympathetic approaches to nondischargeability under § 523(a)(8) for a university or college, this luster is only superficial.211 A college or university’s best bet for avoiding dischargeability of educational debts under § 523(a)(8) is to urge the court to adopt the Sixth Circuit’s holding in Merchant.

V. CONCLUSION

Recent decisions regarding the scope of § 523(a)(8) have spawned uncertainty as to the dischargeability of educational debts in Chapter 7 bankruptcy. On substantially similar facts, courts have reached converse holdings as to whether a credit extension by the school to the student for tuition and room and board charges constitutes an educational benefit overpayment or loan for purposes of § 523(a)(8). Some courts allow students to discharge these educational debts, some courts do not. Currently, whether or not an educational debt will be discharged in Chapter 7 bankruptcy may depend solely upon the jurisdictions in which universities and colleges are fortunate, or unfortunate, enough to find themselves.

Courts interpreting § 523(a)(8) since the 1990 amendment have, in effect, overruled prior case law, which held that a credit extension is a loan for purposes of § 523(a)(8). Colleges and universities, when faced with the predicament of litigating the dischargeability of an outstanding balance on a student’s account, should petition the court for a correct reading of the case law interpreting educational loans under § 523(a)(8). Specifically, the school should contend that courts holding that a credit extension is not an educational benefit overpayment or loan have misread the facts of the prior case law and that a credit extension is an educational loan for purposes of § 523(a)(8) when the student is aware

211. Analytically, both the Najafi and the Joyner opinions are inferior. The crux of the court’s analysis in Najafi is the absence of commas in the statutory language. See Najafi, 154 B.R. at 190. Moreover, the Najafi court inexplicably refutes the reasoning of Merchant immediately after adopting it. See id. at 190; supra note 110 (discussing Najafi). Joyner confuses the two phrases of § 523(a)(8) and creates a hybrid creature of an obligation to repay funds received as an educational benefit because the receipt of the funds conferred an educational benefit on the student. See Joyner, 171 B.R. at 763-65; supra note 125 (discussing Joyner). Moreover, Merchant is an appellate decision, in fact, the only appellate decision in this area.
of the credit extension, acknowledges the money owed as evidenced by promissory notes, and receives her education by agreeing to pay these sums of money after graduation. Moreover, the school must be prepared to show that it did not just permit class attendance without payment of tuition, but that it has a funded program in place for extending credit. Hopefully, this strategy will permit colleges and universities to stem the flow of student-debtors who discharge educational debts in Chapter 7 bankruptcy, thereby protecting endowment resources for future generations of students.

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