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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
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I. INTRODUCTION

A fundamental principle of bankruptcy law is that certain debts are excluded from discharge¹ in a bankruptcy proceeding.² Since the inception of the Bankruptcy Code in 1978,³ certain educational debts are nondischargeable in Chapter 7 bankruptcy.⁴ 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.⁵

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.⁶ 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.⁷ 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).

2. See *Grogan v. Garner*, 498 U.S. 279, 287 (1991). A primary purpose of the Bankruptcy Code is "to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh." *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915). By enacting the nondischargeability provisions of 11 U.S.C. § 523(a), "Congress evidently concluded that the creditors' interest in recovering full payment of debts in these categories outweighed the debtors' interest in a complete fresh start." *Grogan*, 498 U.S. at 287; see 11 U.S.C. § 523(a) (1994) (setting forth sixteen categories of nondischargeable debts).

3. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101-1330 (1994)).

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).

5. See 124 CONG. REC. 1,791 (1978) (statement of Rep. Ertel).

6. See, e.g., *Dakota Wesleyan Univ. v. Nelson* (*In re Nelson*), 188 B.R. 32, 33-34 (Bankr. D.S.D. 1995) (allowing full discharge of \$3057 tuition debt); *Alibatya v. New York Univ.* (*In re Alibatya*), 178 B.R. 335, 340 (Bankr. E.D.N.Y. 1995) (allowing full discharge of \$2550 housing debt); *Seton Hall Univ. v. Van Ess* (*In re Van Ess*), 186 B.R. 375, 376, 381 (Bankr. D.N.J. 1994) (allowing full discharge of \$5774 tuition debt); *infra* Part III.B.3 (discussing cases finding educational debts fully dischargeable).

7. Compare *Stone v. Vanderbilt Univ.* (*In re Stone*), 180 B.R. 499, 502 (Bankr.

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).⁸ Part II sets forth the cases that construed the "educational loan" language of § 523(a)(8) prior to 1990.⁹ Part III.A. discusses the 1990 amendment to § 523(a)(8), which added the terms "benefit overpayment" to the statute.¹⁰ Part III.B. then examines the cases that have interpreted the language of § 523(a)(8) subsequent to the 1990 amendment.¹¹ 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.¹²

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.¹³

M.D. Tenn. 1995) (holding tuition debt fully nondischargeable 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 partially nondischargeable when student attended classes for a few weeks), with *Nelson*, 188 B.R. at 34 (holding tuition debt fully dischargeable even when student signed promissory note evidencing indebtedness), and *Van Ess*, 186 B.R. at 380-81 (holding tuition debt fully dischargeable when student attended classes for a few weeks).

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.

9. See *infra* text accompanying notes 13-74.

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),¹⁴ denying debtors in Chapter 7 bankruptcy a discharge for any educational loan to a governmental unit or nonprofit institution of higher education.¹⁵ Congress gradually broadened the scope of § 523(a)(8),¹⁶ and by 1990, § 523(a)(8) read as follows:

§ 523. Exceptions to discharge.

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

(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 institution¹⁷

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).¹⁸ Although some loans,

ham & Ronald A. Buch, *Educational Debts Under the Bankruptcy Code*, 22 MEM. ST. U. L. REV. 679, 680 (1992); Barlow, *supra* note 8, at 487-88.

14. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101, 92 Stat. 2549, 2591 (codified as amended at 11 U.S.C. § 523(a)(8) (1994)). Although § 523(a)(8) did not come into being until 1978, Congress actually enacted the first prohibition against the discharge of student loans two years earlier as section 439A of the Higher Education Act of 1965. *See* Education Amendments of 1976, Pub. L. No. 94-482, § 127(a), 90 Stat. 2081, 2141 (codified at 20 U.S.C. § 1087-3 (1976) (repealed 1978)). Section 317 of the Bankruptcy Act of 1978 repealed section 439A. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 317, 92 Stat. 2549, 2678 (1978).

15. Although the original Senate bill, S. 2266, 95th Cong. (1977) (enacted), contained the nondischargeability provision of section 439A of the Higher Education Act of 1965, the House bill, H.R. 8200, 95th Cong. (1977), did not prohibit discharge of educational loans. *See* Thad Collins, Note, *Forging Middle Ground: Revision of Student Loan Debts in Bankruptcy as an Impetus to Amend 11 U.S.C. § 523(a)(8)*, 75 IOWA L. REV. 733, 743 (1990). Ultimately, however, Congress adopted the Senate bill. *See id.* For an exhaustive discussion of the legislative history to § 523(a)(8), see Palmer v. Student Loan Fin. Corp. (*In re* Palmer), 153 B.R. 888, 892-94 (Bankr. D.S.D. 1993).

16. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 454, 98 Stat. 333, 375-76 (removing requirement that nonprofit institution must be one “of higher education”); Act of Aug. 14, 1979, Pub. L. No. 96-56, § 3, 93 Stat. 387 (including all federal, state, and college financial assistance programs funded in whole or in part by a governmental unit or a nonprofit institution of higher education); *see also* Barlow, *supra* note 8, at 488 (setting forth legislative changes to § 523(a)(8) from 1978 to 1994).

17. 11 U.S.C. § 523(a)(8) (1988), amended by Crime Control Act of 1990, Pub. L. No. 101-647, tit. XXXVI, § 3621, 104 Stat. 4789, 4964-65.

18. *See, e.g.*, United States Dep’t of Health and Human Servs. v. Avila (*In re* Avila), 53 B.R. 933, 937 (Bankr. W.D.N.Y. 1985) (holding that an educational loan existed where a debtor received funds under a scholarship program); University of New Hampshire v. Hill (*In re* Hill), 44 B.R. 645, 647 (Bankr. D. Mass 1984) (concluding that a university’s extension of credit qualified as a loan); Shipman v. Dep’t of Mental

such as Guaranteed Student Loans,¹⁹ obviously fell within the ambit of § 523(a)(8),²⁰ it was unclear to what extent an extension of funds, such as a scholarship award,²¹ living stipend,²² work study advance,²³ or credit extension²⁴ 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).²⁵ The first test, the "educational purposes" test, looked to see whether the funds were for educational purposes.²⁶ The second test, however, looked to see whether the extension of funds was a "loan."²⁷

Health (*In re Shipman*), 33 B.R. 80, 82 (Bankr. W.D. Mo. 1983) (holding that a "salary" in exchange for a promise to work for the Department of Mental Health upon graduation was not an educational loan). *But see* 2 EPSTEIN ET AL., *supra* note 1, at 395 (commenting that cases questioning what is and what is not an educational loan "have not seen any significant action in the courts").

19. Guaranteed Student Loans were first prohibited from discharge in 1976 under section 439A of the Higher Education Act of 1965. *See* Collins, *supra* note 15, at 743 n.92; *supra* note 14 (setting forth legislative history of section 439A). Congress renamed the Guaranteed Student Loan program the Robert T. Stafford Student Loan Program in 1988. *See* Act of April 28, 1988, Pub. L. No. 100-297, § 2601(a), 102 Stat. 330 (codified as amended at 20 U.S.C. § 1071(c) (1994)). Stafford loans are made by private and governmental lenders but guaranteed by the Department of Education. *See* Gerson, *supra* note 4, at 279-80 n.78.

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).

21. *See* United States Dep't of Health and Human Servs. v. Avila (*In re Avila*), 53 B.R. 933, 934 (Bankr. W.D.N.Y. 1985); *infra* text accompanying notes 47-57 (discussing *Avila*).

22. *See* United States Dep't of Health and Human Servs. v. Vretis (*In re Vretis*), 56 B.R. 156, 156 (Bankr. M.D. Fla. 1985); *infra* text accompanying notes 35-39 (discussing *Vretis*).

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*).

24. *See* University of New Hampshire v. Hill (*In re Hill*), 44 B.R. 645, 646 (Bankr. D. Mass. 1984); *infra* text accompanying notes 40-46 (discussing *Hill*).

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.

27. *See* 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); *Hill*, 44 B.R. at 647.

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.”²⁸ Two different approaches of evaluating whether or not the funds were for educational purposes existed:²⁹ 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)*,³⁰ looked to see if the debtor *used* the proceeds for educational purposes.³¹ 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.³² 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.³³ 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.”³⁴ Thus, under the *Shipman* ap-

28. *Shipman*, 33 B.R. at 82.

29. See *Stevens Inst. of Tech. v. Joyner (In re Joyner)*, 171 B.R. 762, 764 (Bankr. E.D. Pa. 1994).

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).

35. 56 B.R. 156 (Bankr. M.D. Fla. 1985).

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.

38. *See Vretis*, 56 B.R. at 157. If a recipient failed to perform the required service obligation, he was "liable for the payment of an amount equal to the cost of tuition and other education expenses, and scholarship payments . . . plus interest at the maximum legal prevailing rate." 42 U.S.C. § 234(f)(1), *repealed by* Act of Oct. 12, 1976, Pub. L. No. 94-484, § 408(b)(1), 90 Stat. 2281.

39. *See Vretis*, 56 B.R. at 157; *cf. Stevens Inst. of Tech. v. Joyner (In re Joyner)*, 171 B.R. 762, 764 (Bankr. E.D. Pa. 1994) (holding, under post-1990 law, that "it should not matter whether the money is used for tuition or other living expenses"); *Barth v. Wisconsin Higher Educ. Corp. (In re Barth)*, 86 B.R. 146, 148 (Bankr. W.D. Wis. 1988) (holding, with respect to a parent guarantor, a Guaranteed Student Loan

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)*,⁴⁰ the university provided a student with short term credit until the student received his loan proceeds.⁴¹ 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.⁴² At trial, the university argued that the extension of credit was a loan for purposes of § 523(a)(8).⁴³ 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.”⁴⁴ The court relied upon the definition of a loan as “a sum of money due to a person”⁴⁵ and the debtor’s acknowledgment that he owed the university tuition.⁴⁶

One year later, in *United States Department of Health and Human Services v. Avila (In re Avila)*,⁴⁷ the Bankruptcy Court for the Western District of New York provided a more comprehensive analysis of the term “loan” under § 523(a)(8).⁴⁸ In *Avila*, the student received \$22,007.34 under the Public Health Service Scholarship Program to finance his medi-

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*).

40. 44 B.R. 645 (Bankr. D. Mass. 1984).

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.*

47. 53 B.R. 933 (Bankr. W.D.N.Y. 1985).

48. *See id.* at 936.

cal education at the University of Puerto Rico.⁴⁹ 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.⁵⁰ The student never served in either organization, and the Department of Health and Human Services sought reimbursement.⁵¹

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."⁵² 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."⁵³ Next, the court surveyed the definition of loan in other contexts.⁵⁴ The court started with the "classic" definition of a loan:

'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.'⁵⁵

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."⁵⁶ 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."⁵⁷

49. See *id.* at 934.

50. See *id.*; *supra* note 37 (discussing the Public Health Service Scholarship Program).

51. See *Avila*, 53 B.R. at 934. At the time the debtor in *Avila* filed his Chapter 7 petition, the United States was entitled to recover \$31,146.30. See *id.*; *supra* note 38 (setting forth the United States' statutory right to reimbursement if the debtor fails to perform the required service obligation).

52. See *Avila*, 53 B.R. at 936.

53. See *id.*; *cf.* United States Dep't of Health and Human Servs. v. Vretis (*In re Vretis*), 56 B.R. 156, 157 (Bankr. M.D. Fla. 1985) (applying the educational purposes test rather than the loan test on substantially the same facts); *supra* text accompanying notes 35-39 (discussing *Vretis*). *Avila* was decided two months prior to the *Vretis* decision. See *Vretis*, 56 B.R. at 156; *Avila*, 53 B.R. at 933.

54. See *Avila*, 53 B.R. at 936-37.

55. *Id.* at 936 (quoting *In re Grand Union Co.*, 219 F. 353, 356 (2d Cir. 1914)).

56. See *id.* (quoting *Stolze v. Bank of Minn.*, 69 N.W. 813, 814 (Minn. 1897)).

57. *Id.* at 937; see also United States Dep't of Health and Human Servs. v. Smith,

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.⁵⁸ 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.⁵⁹ 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.⁶⁰ 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.⁶¹ 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.⁶² 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).⁶³

The Sixth Circuit, however, reversed.⁶⁴ 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."⁶⁵ 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.⁶⁶ 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."⁶⁷

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).⁶⁸ The court first set forth the "classic" definition of

60. *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.

61. *See id.* at 739.

62. *See id.*

63. *See id.* at 738-39.

64. *See id.* at 739.

65. *See id.* at 740.

66. *See id.*

67. *See id.*

68. *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.*

loan,⁶⁹ which was the same definition used by the *Avila* court.⁷⁰ The court then stated that, although the lower courts rejected the reasoning of *Hill*,⁷¹ they found the *Hill* analysis persuasive.⁷² 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.’”⁷³ 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).⁷⁴

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.⁷⁵ 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.⁷⁶ 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).

71. *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*).

72. See *Merchant*, 958 F.2d at 741.

73. *Id.* (quoting *Hill*).

74. See *id.* But cf. *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*).

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).⁷⁷ In 1990, Congress expanded the scope of § 523(a)(8) to include "educational benefit overpayment."⁷⁸ 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.* . . .⁷⁹

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 1988.⁸⁰ The Act, as Senate Bill 1961,⁸¹ was reported out of the Senate

77. See Crime Control Act of 1990, Pub. L. No. 101-647, tit. XXXVI, § 3621, 104 Stat. 4789, 4964-65 (codified at 11 U.S.C. § 523(a)(8) (1994)).

78. See *id.*

79. 11 U.S.C. § 523(a)(8) (1994) (emphasis added to indicate changes); see *supra* text accompanying note 17 (setting forth pre-1990 statutory language).

80. 134 CONG. REC. 16,282 (daily ed. Oct. 14, 1988). Although the original Federal Debt Collection Act legislation was drafted by the Department of Justice in 1987, it is unclear if this draft legislation included the educational benefit overpayment language. See H.R. REP. NO. 101-736, at 26 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6630, 6634.

81. S. 1961, 100th Cong. (1988).

Judiciary Committee without hearings or a written report.⁸² Thus, no commentary concerning the original impetus for the language survives.

Although Senate Bill 1961 passed the Senate, no further action was taken.⁸³ A similar act, with the same language regarding § 523(a)(8), was proposed in the next Congress as Senate Bill 84,⁸⁴ but that too was reported out of the Judiciary Committee without hearings or a written report.⁸⁵ The House Committee on the Judiciary then picked up the legislation, under the aegis of House Bill 5640,⁸⁶ and issued a report.⁸⁷ 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.”⁸⁸ The Committee Report, however, provided no further explanation.

Ultimately, the House passed House Bill 5640,⁸⁹ incorporated Senate Bill 84 into House Bill 5640,⁹⁰ and enacted the educational benefit overpayment language as part of the Federal Debt Collection Procedures Act of 1990.⁹¹ 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.”⁹²

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-

82. See H.R. REP. NO. 101-736, at 26, *reprinted in* 1990 U.S.C.C.A.N., at 6634. The “benefit overpayment” language first appears in the Act as it was reported out of Committee. See 134 CONG. REC. S16,282 (daily ed. Oct. 14, 1988).

83. See H.R. REP. NO. 101-736, at 26, *reprinted in* 1990 U.S.C.C.A.N., at 6634.

84. S. 84, 101st Cong. (1989).

85. See H.R. REP. NO. 101-736, at 26, *reprinted in* 1990 U.S.C.C.A.N., at 6634.

86. H.R. 5640, 101st Cong. (1990).

87. See H.R. REP. NO. 101-736 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6630.

88. H.R. REP. NO. 101-736, at 33-34, *reprinted in* 1990 U.S.C.C.A.N., at 6641-42. Presumably, this was to put an end to the scholarship litigation in cases like *United States Department of Health and Human Services v. Avila (In re Avila)*, 53 B.R. 933 (Bankr. W.D.N.Y. 1985), and *United States Department of Health and Human Services v. Vretis (In re Vretis)*, 56 B.R. 156 (Bankr. M.D. Fla. 1985). See *supra* note 57 (setting forth cases considering the applicability of § 523(a)(8) to funds received under scholarship programs).

89. See 136 CONG. REC. 8241 (1990).

90. See *id.* at 8255.

91. Crime Control Act of 1990, Pub. L. No. 101-647, tit. XXXVI, § 3621, 104 Stat. 4789, 4964-65 (codified at 11 U.S.C. § 523(a)(8) (1988)).

92. See 136 CONG. REC. 13,288 (1990) (statement of Rep. Jack Brooks).

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).⁹³ 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,⁹⁴ (2) fully nondischargeable when the student has executed a promissory note in favor of the university,⁹⁵ or (3) fully dischargeable.⁹⁶

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)*.⁹⁷ 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*).

95. See *Stone*, 180 B.R. at 502; *infra* Part III.B.2 (discussing *Stone*).

96. See *Nelson*, 188 B.R. at 34; *Alibatya v. New York Univ. (In re Alibatya)*, 178 B.R. 335, 340 (Bankr. E.D.N.Y. 1995); *Van Ess*, 186 B.R. at 380; *infra* Part III.B.3.

97. 154 B.R. 185 (Bankr. E.D. Pa. 1993).

bler in Atlantic City and won over \$100,000 playing blackjack.⁹⁸ Subsequent to his newly-found wealth, the student reapplied for admission at Cabrini.⁹⁹ The college allowed the student to register and attend classes without making a tuition payment.¹⁰⁰ The student attended classes for only two weeks but did not provide the college with an official or written notice of withdrawal.¹⁰¹ At the end of the semester, the college billed the student \$4430, the full tuition for the semester.¹⁰² The student then filed for Chapter 7 bankruptcy.¹⁰³

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).¹⁰⁴ After reviewing four pre-1990 amendment authorities,¹⁰⁵ 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.¹⁰⁶ 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

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 262. 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 *Hill* and *Avila* courts,¹⁰⁷ focusing on whether the funds comprised a loan rather than exploring the purpose for which the funds were used.¹⁰⁸ 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.¹⁰⁹ 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"¹¹⁰

The court then went on to construe the 1990 amendment.¹¹¹ The court recognized that "the absence of commas in the phrase 'educational benefit overpayment or loan' makes this phrase difficult to interpret."¹¹² 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.'"¹¹³ Thus, the court reasoned, the receipt of an educational benefit falls within the scope of § 523(a)(8) and is excepted from discharge.¹¹⁴

107. *But see* Stevens Inst. of Tech. v. Joyner (*In re Joyner*), 171 B.R. 762, 764 (Bankr. E.D. Pa. 1994) (commenting that "[o]ur reasoning in *Najafi* . . . supports the reasoning of the *Vretis* court").

108. *See Najafi*, 154 B.R. at 189-90.

109. *See Joyner*, 171 B.R. at 764.

110. *See 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." *Id.* at 190. It is impossible to ascertain why the court made this statement after specifically citing to the *Merchant* decision. In *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. *See Merchant*, 958 F.2d at 741. The *Najafi* court could have distinguished *Merchant* on whether the student was aware of the credit extension and acknowledged the money owed. *See supra* note 74 and accompanying text. The *Merchant* debtor acknowledged the money owed, as evidenced by the promissory note. *See id.* The *Najafi* debtor, however, testified that he believed that Cabrini intended to waive his tuition obligation. *See Najafi*, 154 B.R. at 188. The *Najafi* court, however, did not make this distinction. *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 *Merchant* opinion. *See generally supra* text accompanying notes 58-76 (discussing the *Merchant* court's decision).

111. *See Najafi*, 154 B.R. at 190.

112. *Id.* (quoting 11 U.S.C. § 523(a)(8) (1994)).

113. *Id.*

114. *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.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.¹¹⁶ The court did, however, measure the value of the benefit according to the number of weeks of classes that the student attended.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).¹¹⁸ Thus, \$3680 of the student's \$4430 tuition debt was dischargeable.¹¹⁹

b. Joyner v. Stevens Institute of Technology

Two years later, in *Joyner v. Stevens Institute of Technology (In re Joyner)*,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*,¹²¹ the *Joyner* decision succeeded only in further clouding the § 523(a)(8) debate.

115. *See id.*

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).

117. *See Najafi*, 154 B.R. at 190.

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).

119. *See Najafi*, 154 B.R. at 191.

120. 171 B.R. 762 (Bankr. E.D. Pa. 1994).

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

122. See *Joyner*, 171 B.R. at 763. In the earlier order, the court summarily declared the "balance presently owed by the [d]ebtor" 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 126-28 (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.¹²⁶ 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.¹²⁷ The court reasoned:

[I]f 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.¹²⁸

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.¹²⁹

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)*.¹³⁰ 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.

126. See *Joyner*, 171 B.R. at 763-65.

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).

128. *Joyner*, 171 B.R. at 764-65.

129. See *id.* at 765.

130. 180 B.R. 499 (Bankr. M.D. Tenn. 1995).

had an outstanding balance of \$5145 with Vanderbilt, representing tuition, nurse malpractice insurance, and other administrative fees, when he withdrew from school.¹³¹ Vanderbilt refused to release a transcript unless the student "signed a promissory note for the balance on his account."¹³² The student executed a note in favor of Vanderbilt, defaulted on the note, and then filed for Chapter 7 bankruptcy.¹³³

On summary judgment, the *Stone* court found the note nondischargeable.¹³⁴ The court first set forth, in great detail, the Sixth Circuit's reasoning in *Merchant*.¹³⁵ 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."¹³⁶ 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."¹³⁷ In support of this finding, the court noted that the debtor attended classes, participated as a student, and was covered by nursing malpractice insurance.¹³⁸ The court, therefore,

131. *See id.* at 500.

132. *See id.*

133. *See id.*

134. *See id.* at 502.

135. *See id.* at 501; *see also* *Andrews Univ. v. Merchant (In re Merchant)*, 958 F.2d 738, 740-41 (6th Cir. 1992); *supra* text accompanying notes 58-74 (discussing *Merchant*).

136. *See Stone*, 180 B.R. at 501-02. The Bankruptcy Court for the Middle District of Tennessee, which falls within the Sixth Circuit, rendered the *Stone* decision. *See* 28 U.S.C. § 41 (1994) (stating that Tennessee falls within the Sixth Circuit). The *Stone* court, however, did not state explicitly that it felt constrained by *stare decisis* to follow *Merchant*. *But cf.* *Timnreck v. United States*, 577 F.2d 372, 374 n.6 (6th Cir. 1978) (saying "[t]he district courts in this circuit are, of course, bound by pertinent decisions of this Court").

137. *Stone*, 180 B.R. at 502.

138. *See id.* Although the court did cite *Najafi* in a footnote, the court's finding of an educational benefit did not rely upon the *Najafi* reasoning. *See id.* at 501 n.5. *But see* *Dakota Wesleyan Univ. v. Nelson (In re Nelson)*, 188 B.R. 32, 34 (Bankr. D.S.D. 1995) (stating "Stone adopts the flawed and unsupportable construction of § 523(a)(8) set out in *Najafi*"). It is unclear, however, exactly what rationale the court applied to find an educational benefit apart from listing the debtor's activities at the school. *See Stone*, 180 B.R. at 502. This was the court's sole explanation for why an educational benefit was "undoubtedly conferred." *See id.*

held the note nondischargeable¹³⁹ 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*).

141. 186 B.R. 375, 380 (Bankr. D.N.J. 1994).

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.¹⁴⁶ The court began its discussion with a review of the legislative history of § 523(a)(8).¹⁴⁷ The court then looked at the "plain meaning" and the underlying policies of § 523(a)(8)¹⁴⁸ and concluded both weighed in favor of discharge:

There is no overriding policy that warrants treating SHU differently from any other creditor. Indeed, given the ready availability of student grants and loans, one might very well conclude that 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 SHU need not permit students to attend class unless the tuition is paid.¹⁴⁹

Next, the court turned its attention to the university's entreatment that, under the reasoning of *Najafi*, the debtor received an educational benefit.¹⁵⁰ The *Van Ess* court, however, refused to adopt *Najafi*'s "strained reasoning," pointing out that the *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."¹⁵¹ The *Van Ess* court, looking at the facts of *Najafi*, did not find that the *Najafi* debtor was "participating in a program funded by the college" when he attended classes but failed to pay tuition.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.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."¹⁵⁴

146. *See id.* at 378-81.

147. *See id.* at 378.

148. *See 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).

149. *Van Ess*, 186 B.R. at 379. The *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." *See* 136 CONG. REC. 13,288 (1990); *see also supra* text accompanying note 92 (discussing the statement of Representative Brooks).

150. *See Van Ess*, 186 B.R. at 379-80.

151. *See id.* at 380; *supra* note 116 (discussing the requirement that the educational benefits or loan be made under a program).

152. *See Van Ess*, 186 B.R. at 380.

153. *See id.*

154. *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.¹⁵⁵ The *Van Ess* court distinguished *Merchant* and *Hill* as "extensions of credit in connection with loan programs."¹⁵⁶ With respect to *Merchant*, the court distinguished the credit extension as part of the student loan program between the bank and the university.¹⁵⁷ 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.¹⁵⁸

Finally, the *Van Ess* court concluded its opinion by analogizing the university's debt to a debt due to a family dentist.¹⁵⁹ 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.¹⁶⁰ 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."¹⁶¹

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)*,¹⁶² adopted the New Jersey bankruptcy court's construction of educational benefit overpayment and loan.¹⁶³ In *Alibatya*, a student entered into a one year housing license agreement with NYU while attending graduate school.¹⁶⁴ Under the license agreement, the fee was payable in three equal installments on or before August 1, December 1, and April 1.¹⁶⁵ In May 1989, three months prior to the expiration of the one year period, the student termi-

160. *See id.*

161. *Id.* at 380. *But see* *Peller v. Syracuse Univ. (In re Peller)*, 184 B.R. 663, 669 (Bankr. D.N.J. 1994) (stating that § 523(a)(8) "does not provide for the nondischargeability of any type of higher institution's services, but is limited to the extension of credit or a loan") (emphasis added); 136 CONG. REC. 13,288 (1990) (statement of Representative Jack Brooks) (commenting that the 1990 amendment to § 523(a)(8) "extends the Bankruptcy Code's nondischargeability of student loans to debts which are similar in nature to student loans"). *Cf.* *Albernaz v. United States*, 450 U.S. 333, 341 (1981) (cautioning against reading "much into nothing. Congress cannot be expected to specifically address each issue of statutory construction which may arise").

In *Peller*, decided three months after *Van Ess*, the New Jersey bankruptcy court once again found an outstanding balance owed to a university fully dischargeable. *See Peller*, 184 B.R. at 669. Although the debtors in *Peller* were the student's parents, rather than the student, the court discussed the *Hill*, *Merchant*, and *Najafi* decisions and did not cite to either line of cases under § 523(a)(8) dealing with parent cosigners. *See id.* at 667-69; *see also* Barlow, *supra* note 8 (discussing two distinct lines of cases regarding the applicability of § 523(a)(8) to cosigners and guarantors).

162. 178 B.R. 335 (Bankr. E.D.N.Y. 1995).

163. *See id.* at 340.

164. *See id.* at 336-37.

165. *See id.* at 337.

nated the license and vacated the apartment.¹⁶⁶ At the time the student terminated the license, the student owed NYU \$2550.50 under the terms of the license.¹⁶⁷ Subsequently, the student filed for Chapter 7 bankruptcy.¹⁶⁸

The court began the opinion by attempting to clarify the university's arguments for nondischargeability.¹⁶⁹ 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.¹⁷⁰ 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.¹⁷¹ The court determined that the parties intended to form a lessor/lessee relationship and not a lender/borrower relationship.¹⁷² 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.¹⁷³

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).¹⁷⁴

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 Alibatya*, 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.¹⁷⁶ 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,¹⁷⁶ the South Dakota District Court reached a contrary conclusion on the same facts in *Dakota Wesleyan University v. Nelson (In re Nelson)*.¹⁷⁷ 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.¹⁷⁸ 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.¹⁷⁹ 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.¹⁸⁰ The student signed a promissory note to the university but made only four payments on the note before filing for Chapter 7 bankruptcy.¹⁸¹ The bankruptcy court declared the note dischargeable and the district court affirmed.¹⁸²

175. See *Van Ess*, 186 B.R. 375, 380-81 (Bankr. D.N.J. 1994); *supra* text accompanying notes 141-61 (discussing *Van Ess*).

176. See *Stone v. Vanderbilt Univ. (In re Stone)*, 180 B.R. 499, 502 (Bankr. M.D. Tenn. 1995); *supra* Part III.B.2. (discussing *Stone*).

177. 188 B.R. 32, 34 (Bankr. D.S.D. 1995).

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.”¹⁸³ 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.¹⁸⁴

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, 262-263 (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 339; *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 payed 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.*

187. See *Nelson*, 188 B.R. at 34; cf. *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*). The *Nelson* court stated that it would not follow *Stone* because "Stone adopts the flawed and unsupportable construction of § 523(a)(8) set out in *Najafi*." *Nelson*, 188 B.R. at 34. The *Stone* decision, however, did not adopt the *Najafi* reasoning. See *Stone v. Vanderbilt Univ. (In re Stone)*, 180 B.R. 499, 501 (Bankr. M.D. Tenn. 1995); *supra* note 138 (discussing *Stone*).

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*,¹⁸⁸ 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.¹⁸⁹ The *Nelson* student was late in filing her financial aid application late and did not receive any financial aid.¹⁹⁰ When the University realized this, it prevented the student from taking final exams.¹⁹¹ The South Dakota bankruptcy court, however, still found the debt dischargeable under the rationale of *Van Ess*.¹⁹²

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.¹⁹³ 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*).

189. See *Nelson*, 188 B.R. at 33-34; *Seton Hall Univ. v. Van Ess (In re Van Ess)*, 186 B.R. 375, 379 (Bankr. D.N.J. 1994); *supra* text accompanying note 149 (discussing *Van Ess*).

190. See *Nelson*, 188 B.R. at 33.

191. See *id.*

192. See *id.* at 34.

193. See Todd 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").

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 amendment¹⁹⁴ have disingenuously distinguished and, in effect, overruled the prior case law of *Andrews University v. Merchant (In re Merchant)*,¹⁹⁵ 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)*,¹⁹⁶ the analytical precursor to *Merchant*.¹⁹⁷ 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).¹⁹⁸

194. See *Nelson*, 188 B.R. at 33; *Van Ess*, 186 B.R. at 380; *infra* Part III.B.3 (discussing *Van Ess*, *Alibatya*, and *Nelson*).

195. 958 F.2d 738, 741 (6th Cir. 1992); see *supra* text accompanying notes 58-74 (discussing *Merchant*).

196. 44 B.R. 645, 647 (Bankr. D. Mass. 1984); see *supra* text accompanying notes 40-46 (discussing *Hill*).

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*.¹⁹⁹ 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.²⁰⁰ 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.’”²⁰¹

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 evidenced 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.²⁰² Thus, an extension of credit should be an educational 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 implementation 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.”²⁰³ Although it is unclear how formal such a pro-

(commenting that the new statutory language “does strengthen the court’s interpretation 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 treatment of *Merchant*).

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

202. See *Stone v. Vanderbilt Univ.* (*In re Stone*), 180 B.R. 499, 502 (Bankr. M.D. 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*).

203. See 11 U.S.C. § 523(a)(8) (1994); *supra* text accompanying note 79 (discussing

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

the 1990 amendment to § 523(a)(8)).

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*).

207. See *Andrews Univ. v. Merchant (In re Merchant)*, 958 F.2d 738, 740-41 (6th Cir. 1992).

208. See *Najafi v. Cabrini College (In re Najafi)*, 154 B.R. 185, 188 (Bankr. E.D. Pa. 1993).

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

210. *Joyner v. Stevens Inst. of Tech. (In re Joyner)*, 171 B.R. 762 (Bankr. E.D. Pa. 1994); see *supra* notes 120-29 (discussing *Joyner*).

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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