



Practice Section Tip of the Month – July 2013

Both the 9th Circuit BAP and the 9th Circuit have recently weighed in on the 3rd prong of the "Brunner Test" with regard to discharging student loans. The 1st prong is that the debtor cannot maintain a minimal standard of living if required to pay student loans in full; the 2nd prong is that "additional circumstances" indicate that the inability to pay would persist into the future; the 3rd prong is that the debtor made good faith efforts to repay the loans. The 3rd prong is where most litigation arises. What one court giveth, the other court taketh away.

The BAP, in a decision filed 4/16/13 under BAP No. AZ-11-1233, Bk. No. 09-00317, Adv. No. 10-0764 (I got this off the BAP's website so I do not have the actual citation), *Janet Rose Roth v. Educational Credit Management Corporation*, did two significant things:

1. Reversed the bankruptcy court's decision not to discharge debtor's student loans under the 3rd Brunner prong. There is a laundry list in the case law of how to determine good faith, or lack thereof, including but not limited to whether any payments have been made, deferments sought, timing of the request for discharge vis-a-vis when the debt became due, attempts to negotiate a lower payment, etc. The bankruptcy court in *Roth* said that this debtor failed due to her lack of voluntary payments, lack of efforts to renegotiate, obtain a forbearance or obtain a disability discharge. For a number of reasons, the BAP felt that the bankruptcy court was over-cautious. A must-read is Judge Pappas's concurrence, wherein he said, "...respectfully, the Brunner test for determining undue hardship is truly a relic of times long gone." Admittedly, this was a close case and the debtor had many sympathetic factors in her favor. But it opened the door to better treatment of a debtor whose circumstances don't seem to fit into what is required to discharge student loans under existing case law even though in reality it would be a terrible burden to continue to pay those loans.
2. Ruled that the standard of review on questions relating to the 3rd Brunner test prong is *de novo*, in which the appellate court weighs the bankruptcy court's factual findings and its own findings in coming to a decision. The other standard, which they rejected with regard to the 3rd prong is whether the bankruptcy court committed clear error. Had the BAP chosen the clear error path, it would not have been able to reverse the lower court.

BUT THEN....

The 9th Circuit, in *Michael Eric Hedlund vs. The Educational Resources Institute, Inc.*; and *Pennsylvania Higher Education Assistance Agency*, No. 12-35258, D.C. No. 6:11-cv-6281-AA (from the 9th Circuit's website), in an opinion filed May 22, 2013, held that the district court erred by reviewing the bankruptcy court's good faith finding *de novo*, thereby reinstating the clear error standard of review. In this case, it was to the debtor's advantage for the circuit to apply clear error. The bankruptcy court had granted a partial discharge, but the district court reversed under the 3rd prong. The circuit stated that it "...consistently reviewed the good faith prong for clear error."

Both appellate courts ruled in ways that were favorable to the debtor. Although the standard of review is now set as clear error, both of these cases give some very good hints about how to argue good faith at the bankruptcy court level.

Submitted by Katie Dullea