

# The College as Creditor

Bankruptcy Basics  
and Student Debt Collection Practices  
for  
College Business Officers

AAG Alan Smith

January 25, 2018

# Purposes and Types of Bankruptcy

- Purposes of Bankruptcy Code are to provide (1) a “fresh start” for honest debtors and (2) equitable treatment of creditors.
- Types of Bankruptcy
  - Chapter 7 (Liquidation)
  - Chapter 11 (Reorganization)
  - Chapter 13 (Adjustment of Debts)

## Chapter 7 Liquidation

- Classic bankruptcy liquidating debtor's nonexempt assets and distributing to creditors (most are "no asset" cases).
- General discharge operates as permanent injunction against collection of all dischargeable pre-petition debts.
- Some student debts are dischargeable, others not.

# Chapter 13

## Adjustment of Debts

- Debtor retains control of assets while repaying creditors under court-confirmed “wage earner’s plan.”
- Applies only to individuals with regular income.
- Discharge of all scheduled debts upon completion of repayment plan (3-5 years).
- Important to confirm that repayment plan does not include nondischargeable student debt.

# Student Debt Exception

## Section 523(a)(8)

- Students debts not dischargeable unless requiring repayment would impose “undue hardship” on debtor and dependents.
- Same rule applies under Chapter 7 or 13, but only certain student debts are nondischargeable.
- Student debtor must file separate “undue hardship” proceeding (no general discharge).

## What Debts Are Excepted?

- An educational benefit overpayment or loan made, insured, or guaranteed by a government agency or made under any program funded by a government or nonprofit agency.
- An obligation to repay funds received as an educational benefit, scholarship, or stipend.
- A “qualified education loan” under the Internal Revenue Code.

## 'Educational Benefit Overpayment'

- Any amount overpaid, such as payment of educational benefits for period in which student is not enrolled.
- Examples: GI Bill benefits, tuition waivers, grant or work study overpayments.
- Could also include benefits funded by a nonprofit (e.g., a college foundation).

## 'Educational Loan'

- Advancement of funds, credit, or financial accommodations under a contemporaneous, mutual understanding of future repayment.
- Must quantify and create an obligation to repay value of educational benefit actually received, whether or not funds are in fact advanced to the student.



# 'Educational Benefit'

'

- Any funds received as an educational benefit, including a scholarship or stipend, regardless of funding source.
- Requires (1) an obligation to repay funds (2) that are actually received (3) for an educational purpose.
- Example: Obligation to refund a scholarship upon early academic withdrawal.

# 'Qualified Education Loan'

'

- Debt incurred solely to pay “qualified higher education expenses” for taxpayer or taxpayer’s spouse or dependent.
- Qualified expenses means cost of attendance at Title IV eligible institution.
- Covers “alternative” or “supplemental” loans, regardless of funding source.

# Dischargeable Student Debts

- Unpaid tuition account
- Housing and dining charges
- Mandatory student fees
- Child care fees
- Parking fees
- Bookstore charges

# Undue Hardship

- Nondischargeable student debt can only be discharged based on “undue hardship.”
- Debtor must file separate adversary proceeding (requires summons and complaint).
- Parents incurring nondischargeable debt for student’s education can also claim undue hardship.
- Parents filing for bankruptcy may claim “clawback” of “preferential” tuition payments.

## Three-Part 'Brunner' Test

- Can debtor maintain a “minimal standard of living” if required to repay the loan?
- Do “additional circumstances” indicate that debtor’s situation is likely to persist over the life of the loan?
- Has debtor made “good faith efforts” to repay the loan?

# 1. Minimal Standard of Living

- Requires more than tight finances.
- Can debtor increase current income or reduce expenses to repay the loan?
- No “self-imposed” hardship or voluntary underemployment.
- Minimal standard of living is not current or desired standard.

## 2. Additional Circumstances

- Additional circumstances must show why debtor's situation is unlikely to change over life of the loan.
- Debtor must show insurmountable barriers to financial recovery.
- Focus is on debtor's current and future circumstances, not past choices or preexisting conditions.

### 3. Good Faith Efforts

- Debtor's efforts to maximize income and minimize expenses.
- Debtor's efforts to repay, take advantage of loan consolidation programs, and/or negotiate repayment terms.



## Partial Hardship Discharge

- Bankruptcy court can grant partial discharge of student debt based on undue hardship.
- Debtor must meet all three “Brunner” tests as to amount of debt to be discharged.

## Debtor Protections

- Automatic Stay – Section 362(a)
- Discharge Injunction – Section 524
- “Fresh Start” Provisions – Section 525  
(Anti-Discrimination)

# Automatic Stay

## Section 362(a)

- Prohibits any action to collect pre-petition debt once bankruptcy petition is filed.
- Penalties for willful violation include actual damages, attorney fees, punitive damages. Violation “willful” if creditor knew of stay. Formal notice not required.
- Applies to all student debt until court determines debt to be nondischargeable.
- Does not apply after bankruptcy case closed (up to 5 years in Chapter 13 case).

# Co-Debtor Stay

- Creditor in Chapter 7 case may proceed against a co-debtor (co-signer) without violating the automatic stay.
- Chapter 13 “co-debtor stay” prohibits any efforts to collect a consumer debt from a co-debtor.
- Consumer debt is debt incurred for a personal, family, or household purpose (including educational loans).

# Discharge Injunction

## Section 524

- Discharge operates as permanent injunction prohibiting any action to collect a debt that has been discharged in bankruptcy.
- Does not apply if bankruptcy case is closed without discharge of student debt.

# Discrimination ('Fresh Start') Provisions

## Section 525

A government agency cannot—

- Deny a license, permit, or similar grant,
  - Discriminate in employment, or
  - Deny a student grant or loan—
- 
- “solely because” a person has been in bankruptcy or has not paid a debt that is dischargeable in bankruptcy.
- 
- § 525 violated if discrimination would not have occurred “but for” the bankruptcy or nonpayment.

# Regulated Creditor Actions

- Coercive payment demands
- Wage garnishments
- Withholding grades or transcripts
- Refusing registration or graduation
- Denying student grants or loans

## When Prohibited

- While bankruptcy case is pending.
- After student debt is discharged or determined to be dischargeable.
- Whenever student grants or loans are denied “solely because” of bankruptcy or nonpayment of dischargeable debt.



## When Permitted

- After student debt is determined to be nondischargeable or bankruptcy case is closed without a discharge of student debt.
- Whenever student grants or loans are denied for reasons other than student's bankruptcy or nonpayment of dischargeable debt.
- May consider post-bankruptcy credit history as evidence of future ability to pay. May impose non-discriminatory requirements (e.g., requiring all students to pay in advance).

# Federal Program Rules— Student Eligibility

- Student is not eligible for Title IV loan, grant, or work study award if in default on any Title IV loan or grant overpayment.

(34 CFR 668.32)

- No default or overpayment liability if debt has been discharged or qualifies for discharge under bankruptcy law.

(34 CFR 668.35)

# Federal Program Rules— Bankruptcy Procedures

- College receiving notice of bankruptcy must stop all collection efforts (including efforts against a Chapter 13 co-debtor).
- Must file proof of claim except in Chapter 7 “no asset” case.
- Must use “due diligence” to oppose hardship discharge.  
(34 CFR 674.49)

# Federal Program Rules— Opposing Hardship Discharge

- College must determine whether repayment under current or any adjusted payment plan would impose undue hardship.
- If not, will cost of opposing discharge exceed one-third of entire amount owed?
- If not, college must oppose discharge and obtain any default judgment.
- College may compromise debt in order to obtain judgment.

# Federal Program Rules— Chapter 13 Procedures

- No response required if proposed payment plan will repay entire student debt or makes no provision for the debt.
- If plan is to pay less than full amount and discharge the rest, (1) will college receive at least as much as under Chapter 7, and (2) is debtor using all income not needed for support of self and dependents?
- If not, college must object to confirmation of plan, unless cost of objecting exceeds one-third of amount to be discharged.

## Federal Program Rules— Chapter 13 Procedures (Con't)

- College must monitor confirmed repayment plan.
- Must move to dismiss or convert to Chapter 7 if debtor fails to make plan payments.
- Must oppose unjustified request for hardship discharge.
- No action required if cost exceeds one-third of amount to be discharged.

# Debt Collection Issues

- Interest Charges & Late Fees
- Collection Agency Contracts
- Fair Debt Collection Practices Act
- Student Financial Responsibility Agreements

# Interest Charges & Late Fees

- Interest at rate of 1% a month shall accrue on debts owed to the state, starting on the date the debts become past due. RCW 43.17.240.
- Each institution of higher education may, in the control and collection of any debt, impose reasonable financing and late charges, as well as reasonable costs and expenses incurred in the collection of such debts, if provided for in the note or agreement signed by the debtor. RCW 28B.10.293.



# Collection Agency Contracts— RCW 19.16.500

- Public agencies may by written contract retain licensed debt collection agencies and may add to the debt a “reasonable” collection agency fee.
- A “reasonable fee” is a contingent fee up to 50% of the first \$100,000 of debt and up to 35% of the remainder.
- A reasonable “minimum fee” is the full amount of the debt up to \$100 per account.
- Any fee agreement entered into by a public agency is “presumptively reasonable.”

# Collection Agency Contracts— Higher Education

- Federal student loan regulations limit collection agency fees for first collection efforts to 30% of amounts collected and 40% for subsequent collection efforts, plus court costs. 34 CFR § 674.47.
- Each institution of higher education may, in the control and collection of any debt, impose reasonable financing and late charges, as well as reasonable costs and expenses incurred in the collection of such debts, if provided for in the note or agreement signed by the debtor. RCW 28B.10.293.

# Fair Debt Collection Practices Act— 15 USC § 1692(f)

- FDCPA prohibits unfair debt collection practices.
- Cannot collect any amounts for interest or collection costs except as (1) expressly authorized by debtor agreement or (2) permitted by law.
- Interest charges permitted by RCW 43.17.240, collection costs by RCW 19.16.500.
- But for higher education, RCW 28B.10.293 permits interest charges and collection costs only if provided for in a signed debtor agreement.

# Bradley v. Franklin Collection Service

739 F.3d 606 (11<sup>th</sup> Circuit 2014)

- *Bradley* involved two (non-student) debtors named Bradley and Calma. Both signed agreements to pay collection costs.
- Calma's agreement stated: *I agree to pay all costs of collection including reasonable collection agency fees.* Bradley's agreement stated: *I agree to pay all costs of collection.*
- Calma's agreement was enforceable under FDCPA, but Bradley's was not. Calma expressly agreed to pay "collection agency fees." Bradley's agreement to pay "all costs of collection" was held to mean all actual costs of collection, not a percentage-based contingent fee.

## But, but, but . . .

- Collection agencies after *Bradley* began refusing to collect student debts without a signed debtor agreement to pay collection agency fees.
- But aren't collection costs enforceable under the FDCPA if (1) authorized by debtor agreement or (2) permitted by law?
- And aren't collection agency fees expressly permitted under RCW 19.16.500?
- Yes, and yes, but for higher education, RCW 28B.10.293 requires a signed debtor agreement.

# Student Financial Responsibility Agreements—Key Provisions

- 1. Payment of Fees / Promise to Pay
- 2. Delinquent Account / Collection
- 3. Communication / Billing Methods
- 4. Debtor's Signature

# 1. Payment of Fees / Promise to Pay

- I agree that any amounts charged to my Student Account that are not paid by the due date shall constitute a nondischargeable student debt under § 523(a)(8) of the U.S. Bankruptcy Code that I am obligated to repay.
- Any overpayment of financial aid or other educational benefit that I receive for any period when I am not enrolled shall also constitute a nondischargeable student debt that I am obligated to repay.
- All such student debt shall also include any late fees, finance charges, and collection fees and costs as described in Section 2 below.

## 2. Delinquent Account / Collection

- **Late Payment Charges.** I understand and agree that if I fail to pay my student account balance by the scheduled due date, the College will assess a finance charge at the rate of 1% a month on the past due portion of my student account. Such finance charge is in addition to late payment fees (see [www.college.edu/registrar/latefees](http://www.college.edu/registrar/latefees)).
- **Collection Agency Fees.** If I fail to pay my student account balance by the due date, and fail to make acceptable payment arrangements, the College may refer my delinquent account to a collection agency. I understand that I am responsible for paying the collection agency fee of up to 30% of the amounts collected for first collection efforts (and up to 40% for subsequent collection efforts), plus court costs.



### 3. Communication / Billing Method

- I understand that the College uses electronic billing and my student email address to communicate with me about my student account and that it is my responsibility to review College emails on a timely basis.
- I understand that I may request paper billing statements and mailed communications by submitting a request to Student [Accounts@College.edu](mailto:Accounts@College.edu).
- I understand and agree that I am responsible for keeping College records up to date with my current mailing address and contact information.

## 4. Debtor's Signature

- Student debtor must sign and date the agreement.
- "I agree by signing this agreement that I will be bound by its terms."
- If using electronic signature or click-through "I agree" button, College must be able to retain and authenticate the agreement including signature and date.

# Questions?

AAG Alan Smith

[alans@atg.wa.gov](mailto:alans@atg.wa.gov)