Life After Espinosa: Is Student Loan Debt Dischargeable in Bankruptcy?

By Camille Iurillo and J'Aimee Crockett

On March 23, 2010, the Supreme Court handed down its third opinion this term construing the Bankruptcy Code in the case of United Student Aid Funds, Inc. v. Espinosa.[1] When presented with the question "Is student loan debt dischargeable in bankruptcy without a finding of undue hardship?" the Supreme Court narrowly, but unanimously, said "yes."

In 1992, Francisco J. Espinosa, trade-school graduate, filed for bankruptcy. Espinosa's Chapter 13 bankruptcy petition listed his outstanding student loan balance of $13,250 as his only debt. Further, Espinosa proposed to pay only the principal balance in his Chapter 13 Plan. In response, United Student Aid Funds, Inc. ("United"), the holder of Espinosa's student loans, filed a proof of claim in the bankruptcy case for $17,832.15, which represented the principal amount of $13,250 plus the accrued interest on Espinosa's student loans. The bankruptcy court, however, eventually entered its confirmation order approving Espinosa's Chapter 13 Plan as originally submitted, thus requiring him to repay only the principal. Problematically, the bankruptcy court also failed to make an undue hardship finding as required by the Bankruptcy Code.[2]

Five years later, after Espinosa completed all of the payments required by the Chapter 13 Plan, the bankruptcy court entered Espinoza's discharge order enjoining his creditors from attempting to collect on his student loan debt. Three years after the discharge order was entered United tried to garnish Espinosa's federal income tax refunds. Espinosa reopened his bankruptcy case seeking an order prohibiting United from collecting. In opposition, United sought to have the original confirmation order held void, arguing that it had been entered in violation of the Bankruptcy Code and Rules.

After the case made its way through the Ninth Circuit, the Supreme Court granted certiorari on June, 15, 2009. The broad issue before the Supreme Court was whether an order discharging student loan debt absent an adversary hearing and a finding of undue hardship—which is in clear contravention of the Bankruptcy Code—is void. While the Court unanimously agreed that the bankruptcy court erred, the Court ultimately upheld the validity of the discharge order.

Justice Thomas, writing for the Supreme Court, emphasized that the case was capable of unanimous resolution on narrow procedural grounds. So, despite the fact that the bankruptcy court was required to make an undue hardship determination before discharging student loan debt, its failure to do so was not sufficient grounds for a jurisdictional attack under Federal Rule of Civil Procedure 60(b)(4).[3] Concurrently, the Supreme Court found that United suffered no due process violation because it received actual notice of the discharge—even if the discharge was entered in error.

With a strictly procedural disposition to Espinosa, there was no consensus regarding the merits of the case. The Justices may have been inclined toward a procedural resolution simply

[1] United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010).

[2] Nor did Espinosa initiate an adversary proceeding as required by the Rules.

[3] Noting that a motion under Rule 60(b)(4) is not a substitute for a timely appeal.

because United failed to seek relief from the discharge order until six years after it was entered by the bankruptcy court. In fact, Justice Thomas commented "the order remains enforceable and binding on United because United had notice of the error and failed to object or timely appeal."

In sum, Espinosa does not live up to the pre-opinion hype, as it does not "open the floodgates" to debtors seeking discharge of student loan debt. Debtors still have an obligation to prove undue hardship, bankruptcy courts still have an obligation to review Chapter 13 Plans prior to approval, and creditors, like United, still have an obligation to timely object to dischargeability of a debt and to provisions that do not comply with their rights under the Code. As such, Espinosa's holding is consistent with both Taylor v. Freeland & Kronz[4] and Travelers Indemnity Co. v. Bailey,[5] in which the Supreme Court held that untimely attacks on orders will not be allowed merely because the orders were unwise or unwarranted.

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[4] 112 S. Ct. 1644 (1992).
[5] 129 S. Ct. 2195 (2009).