

# Third Circuit: Tuition Debt is Dischargeable

By Henry M. Karwowski, ECBA Debtor/Creditor Committee Co-Chair

**A** little over a year ago, in a *Chronicle* article entitled "Discharging Student Loan Debt – Mission Impossible?", the author examined the dischargeability of student loan debt in a bankruptcy case. The conclusion: a debtor cannot, in the absence of truly compelling evidence signifying undue hardship, expect to discharge such debt.

In this article, the author examines a separate, but related, issue: whether bankruptcy can serve as a means of eliminating tuition debt. In a recent case, the United States Court of Appeals for the Third Circuit held that a debtor could indeed discharge in bankruptcy his outstanding tuition balance owed to a university.

## Applicable Statute/Historical Application

The United States Bankruptcy Code does not allow an individual debtor to discharge the following debt:

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, unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

11 U.S.C. § 523(a)(8).

Historically, New Jersey bankruptcy courts have found that a tuition obligation does not qualify as this type of debt, and hence, that such an obligation is dischargeable. For instance, in *Seton Hall Univ. v. Van Ess (In re Van Ess)*, 186 B.R. 375, 381 (Bankr. D.N.J. 1994), the Honorable Novalyn L. Winfield dismissed a complaint pursuant to which Seton Hall University sought to except from discharge the debtor's obligation arising from a failure to pay a full semester's tuition at its law school. Likewise, in *Peller v. Syracuse Univ. (In re Peller)*, 184 B.R. 663, 669 (Bankr. D.N.J. 1994), the Honorable Rosemary Gambardella determined that the debtor's unpaid tuition and housing debt, owed to Syracuse University and incurred over the

course of a year, constituted dischargeable debt.

## Mehta Decision

The Third Circuit recently examined the same issue in *Boston Univ. v. Mehta (In re Mehta)*, 310 F.3d 308 (3d Cir. 2002). In that case, the debtor sought to discharge over \$13,000 in tuition and fees owed to Boston University. Judge Winfield rejected the university's argument that the delinquency constituted either a "loan" or a debt for an "educational benefit" within the meaning of section 523(a)(8). *Mehta*, 310 F.3d at 310.

The Third Circuit affirmed. First, it found nothing in the record indicating that the university and the student had intended a "loan." It noted that the university had apparently never made an inquiry into the debtor's credit worthiness, and had apparently never required the debtor to execute any kind of promissory note or loan agreement. *Id.* at 314. Contrary to the university's suggestion, the court found that a Student Accounting Services Department handbook, in particular, did not amount to a loan agreement; the document contained nothing more than generalized information about fees, financial obligations, payments plans, refund procedures, meal cards, and medical insurance. *Id.*

Further, the Third Circuit noted that courts have generally held that nonpayment of tuition qualifies as an educational loan under section 523(a)(8) in only two (2) classes of cases: (1) where funds have changed hands; or (2) where the parties have executed an agreement whereby the college extends credit. *Id.*

Second, the court concluded that the tuition failed to qualify as a debt for an "educational benefit." It observed that this exemption applies only in cases in which overpayment for an educational benefit program, such as the GI bill, has been made. *Id.* at 316. Moreover, it found that, because the parties had not exchanged any funds, the debt did not fall within section 523(a)(8)'s exclusion of obligations for "funds received as an educational benefit." *Id.* at 316-17.

Accordingly, the Third Circuit found the debt dischargeable.

## Conclusion

Unless the educational institution to which he or she is indebted has advanced funds or

credit, or has required the execution of a promissory note or loan agreement, a debtor will likely succeed in establishing dischargeability of tuition. □

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