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Second Circuit Court of Appeals Rules Non-Qualified Private Student Loans Are Dischargeable

By Benjamin Mintz and Brendan M. Gibbons*

The authors discuss a decision by the U.S. Court of Appeals for the Second Circuit involving the dischargeability of a student loan in the absence of the undue hardship requirement.

The U.S. Court of Appeals for the Second Circuit, in *Homadian v. Sallie Mae, Inc.*,[1] has ruled in favor of a private student loan borrower and found that his loans were discharged without his meeting the undue hardship requirement usually applied to student loans.

The court found that the borrower's loans were not an "obligation to repay funds received as an educational benefit" and were therefore subject to discharge. In reaching that conclusion, the court held that private education loans that were not "qualified" within the meaning of the Bankruptcy Code were generally subject to discharge, without regard to the undue hardship standard. The opinion noted that applying the "educational benefit" prong to a loan would make every student loan an educational benefit and improperly broaden the statute's scope, which separately excepts from discharge "qualified private educational loans."

Navient Corp., the successor to Sallie Mae, the loan's initial servicer, did not argue that the borrower's loans were qualified private educational loans, likely because the loans were issued directly to the student and used for living expenses rather than tuition.

This decision puts the Second Circuit in agreement with the U.S. Courts of Appeals for the Fifth and Tenth Circuits, which recently have reached similar conclusions.[2]

THE *HOMAIDAN* CASE

Hilal K. Homaidan received two direct-to-consumer "tuition answer loans" from Sallie Mae totaling more than $12,000. The funds went directly to

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[1] *Homadian v. Sallie Mae, Inc.*, 3 F.4th 595 (2d Cir. 2021).

[2] *See McDaniel v. Navient Sols. LLC (In re McDaniel)*, 973 F.3d 1083 (10th Cir. 2020); *Crocker v. Navient Sols. LLC (In re Crocker)*, 941 F.3d 206 (5th Cir. 2019).

Homaidan's bank account and, according to him, were not used for educational expenses. In 2009, after declaring bankruptcy under Chapter 7, Homaidan obtained a discharge order from the U.S. Bankruptcy Court for the Eastern District of New York, however, the order did not specify which debts were discharged and noted that "debts for most student loans are not dischargeable in a Chapter 7 proceeding."

According to Homaidan, Navient then "pester[ed]" him to pay back his loans, causing him "to assume that the loans had not been discharged." He paid back his loans in full.

In 2017, Homaidan reopened his bankruptcy case and commenced a putative class action adversary proceeding against Navient, alleging that Navient "employed a scheme of issuing dischargeable loans to unsophisticated student borrowers and then demanding repayment even after those loans are discharged in bankruptcy." Navient argued that Homaidan's loans were not discharged.

Section 523(a)(8) typically prevents most educational loans from being discharged. The court, acknowledging that Section 523(a)(8)'s language is "dense," interpreted the statute to mean "that three categories of educational debt cannot be discharged in bankruptcy (absent a showing of hardship): (1) loans and benefit overpayments backed by the government or a nonprofit; (2) obligations to repay funds received as an educational benefit, scholarship, or stipend; and (3) 'qualified private educational loans.' "

Navient conceded that its loans were not qualified private education loans and instead argued that they fall into the second bucket: an obligation to repay funds received as an educational benefit.

First, Navient attempted to read "loan" into the text of the second category, Section 523(a)(8)(A)(ii), but the court found that "when Congress includes particular language in one section . . . but omits it in another . . . it is generally presumed that Congress acts intentionally. . . ."

Second, Navient argued that the term "obligation to repay" refers to a loan in other statutes. But the court focused on the statute at hand and found that "Congress used the word 'loan' several times in 523(a)(8) but left it out of 523(a)(8)(A)(ii), signaling that the omission was intentional."

The court finally noted that Navient's interpretation of the statute was untenable because it "would draw virtually all student loans within the scope" and would "swallow[] up" the other subsections of the statute. Indeed, the court agreed with Homaidan's "narrower interpretation," which "reserves a role for each" subsection of the statute: "§ 523(a)(8)(A)(i) covers government and nonprofit-backed loans and educational benefit overpayments; § 523(a)(8)(A)(ii)

covers scholarships, stipends, and conditional education grants; and § 523(a)(8)(B) covers private loans made to individuals attending eligible schools for certain qualified expenses."[3]

Therefore, the court ruled that Navient's loans did not fit into any of those categories and were discharged through the bankruptcy court's original discharge order.

QUALIFIED EDUCATIONAL LOANS

Navient did not argue that the loans in question were overpayments backed by the government or a nonprofit (the first category), or a qualified private educational loan (the third category). "For a loan to be 'qualified' under § 523(a)(8)(B), the student must attend an eligible educational institution and the loan must fund only qualified higher education expenses." Homaidan alleged that the loans "were made outside the financial aid office and were not made for qualified education expenses."

He also noted "that Internal Revenue Code Section 6050S requires lenders to issue 1098-E tax forms to all customers with qualified education loans, and [Navient] never issued a 1098-E tax form to him."

The question of whether his loans were actually "qualified" was not before the court, however, based on the allegations, it appears that they were not qualified.

CONCLUSION

Although student loans are typically not dischargeable absent a showing of hardship, the Second Circuit's decision establishes that there is a subclass of non-qualified private student loans that are indeed dischargeable. Lenders and other investors in private student loan debt will need to evaluate whether the private student loan debt at issue is qualified or else risk potential discharge of unqualified private student loans should the borrower file for bankruptcy.

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[3] According to research cited by Bloomberg Law, the type of private "educational benefit" loan the Second Circuit addressed likely amounts to about $30 to $50 billion of outstanding student loan debt, a small fraction of the $1.7 trillion total outstanding student loan debt.