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Eastern District of New York Goes Its Own Way on Dischargeability of Bar Review Loan

A court's recent ruling that a portion of a law school graduate's loans could be discharged breaks new ground and could result in banks changing the way they lend money. The Honorable Carla Craig of the United States Bankruptcy Court for the Eastern District of New York ruled that a law graduate, Lesley Campbell, could discharge in bankruptcy a loan she received from Citibank while studying for the bar exam in 2009. Judge Craig's very thorough opinion disagreed with other federal court decisions from around the country on the same issue and could result in a shift in when and how banks lend to students and graduates.

In the case before Judge Craig, Ms. Campbell sought to discharge a bar review loan she received from Citibank. This loan allowed Ms. Campbell to pay for her living expenses while she studied for the bar exam. Traditionally, lenders loan money to law and medical graduates, among others, after graduation to allow these individuals to study for their licensing exams or to relocate. Lenders view these loans as low-risk because the borrower has already graduated, received their degree, and is only waiting to pass their licensing requirements. In Ms. Campbell's case, however, after failing the bar exam, she could not afford the payments on her nearly \$300,000 of student loans. As a result, she filed for bankruptcy protection under chapter 7 of the bankruptcy code and sought to discharge the Citibank loan on the basis that it did not fall within the "educational benefit" exemption. Under the bankruptcy laws, loans used as an "educational benefit," which is specifically defined in the bankruptcy code, cannot be discharged in bankruptcy.

Despite the opposing decisions on the issue, Judge Craig held that the discharge exemption for "educational benefits" applied only to federal and federally banked lenders. Judge Craig stated that merely because Citibank required Ms. Campbell to be a law student to qualify for the loan did not turn an "arm's length consumer credit transaction into a 'benefit' that would make it eligible for the exemption." In effect, Judge Craig ruled that the bar expenses loan had the same characteristics as an ordinary consumer loan, regardless of whether Ms. Campbell used it to facilitate studying for the bar exam. Judge Craig also ruled that the opposing decisions on the issues cited by Citibank were not persuasive because none of those cases interpreted how the term "educational benefit" was defined in the bankruptcy code. Judge Craig further stated that the legislative history and purpose of the relevant bankruptcy code section supported her decision because the impetus for including an exception to discharge for education loans made by the government was the concern that if students were allowed to discharge such loans, the solvency of government education loan programs would be undermined, which may discriminate against future students, because there will be no funds available for them to get an education. As a result of this reasoning, Judge Craig ruled that Ms. Campbell was allowed to discharge the Citibank loan as part of her bankruptcy plan.

It's no secret that the cost of higher education is rising at an astounding rate. According to the White House, nearly 70 percent of bachelor's degree recipients leave college with debt and reports calculate the current aggregate of student loan debt outstanding to approximate \$1.2 trillion. Up until now, this amount has been completely protected from the discharge exemptions of the bankruptcy laws. Now that a court has allowed some of this money to be dischargeable in bankruptcy, lenders may shift how they deal with these types of loans. For example, they may require an applicant to obtain a co-signer or may only offer such loans to applicants with the highest credit scores. Alternatively, lenders may make less money available for these types of loans, may change the terms on which these loans are offered or may do away with such loans altogether. In light of this groundbreaking ruling, lenders should consider their options and students seeking loans should anticipate changes.

—Catherine Pastrikos Kelly, Meyner and Landis LLP. Ms. Pastrikos Kelly was counsel to Ms. Campbell in the above discussed proceeding.