CHASING THE STUDENT DEBTOR: DOES A BANKRUPTCY DISCHARGE PRIVATE STUDENT LOANS?

Jason Wadden
Matt Rossetti
Goodmans LLP[1]

I. INTRODUCTION

With rising tuition costs, an increasing number of private education institutes, and a greater number of Canadians studying abroad, students are graduating with debt loads at levels never seen before. At the same time, students are facing an increasingly difficult jobs market, where finding stable and viable long-term employment is becoming more challenging. The result is an environment where more graduates may look to bankruptcy as the best alternative for getting their financial affairs in order.

Student loans, however, are treated differently in bankruptcy than other unsecured debts and, depending on their particular circumstances, bankrupts might not be able to have their student loans discharged in a bankruptcy. Since 1974, Courts have held that both government-backed and private student loans invoke a "higher moral standard" that impacts on the decision of whether or not to grant a discharge, and if so, on what terms. Eventually, section 178(1)(g) was added to the *Bankruptcy and Insolvency Act* (the "**BIA**") to provide that student loans granted or guaranteed by the federal or provincial governments cannot be discharged until some point in time after the debtor ceased being a full-time student. Despite the fact that section 178(1)(g) only applies to government-backed loans, Courts have continued to treat student loans granted by private entities or individuals ("**Private Student Loans**") as invoking a "higher moral standard" and have continued to often place conditions on the bankrupt's discharge that require all or a substantial portion of the student loans to be repaid. This provides an opportunity for private lenders to

---

[1] Jason Wadden is a partner in the Litigation and Insolvency & Restructuring Departments of Goodmans LLP. Matt Rossetti is a student-at-law with the firm.

achieve greater recoveries in a bankruptcy than what might otherwise be available with regular unsecured claims.

II. THE EMERGENCE OF SPECIAL POLICY CONSIDERATIONS

Historically, the BIA did not provide any special treatment for student loans in a bankruptcy proceeding. As a result, a bankrupt could have his student debts discharged absolutely like any other unsecured debt.[2] However, over time, Courts began to view student loans as engaging unique policy considerations:

(a) Student loans provided by or guaranteed by the government ("**Government Student Loans**") are provided on a needs basis, and are offered to students regardless of their credit-worthiness, thereby burdening taxpayers (who are involuntary creditors) with the risk of default.

(b) Student loans, whether government-issued or otherwise, provide debtors with a lifelong asset of "higher education." That "asset" cannot be realized by the Trustee in Bankruptcy for the benefit of the debtor's creditors. This is considered to be inequitable since, despite the bankruptcy, it is presumed that the asset of higher education will allow the bankrupt to enjoy a higher standard of living.

These concerns lead Courts to treat student loans as invoking a "higher moral standard", requiring that stricter conditions be imposed on discharges where the bankrupt's debts included student loans.[3]

This stringent standard of discharge first arose in Canada in the 1974 Saskatchewan Queen's Bench decision of *Re Provost*,[4] which involved a Government Student Loan. In 1974, there was no distinction between student loans and regular unsecured debt in bankruptcy proceedings. In *Provost,* Justice Bayda explained his dissatisfaction with simply providing an absolute discharge for student loans:

> It strikes me as being grossly unfair for a person to be able to go to a financial institution and say "I have no assets but take a chance on me anyway and lend me some money for my education; when I have my new professional status (my new 'asset') I will pay you back out of earnings" and then on getting his education says to his creditor, with impunity, "I am not making as much money

---

[2] *Re Cunningham,*1986 CarswellBC 503, [1987] 1 WWR 31.

[3] *Re Manning,* 2011 CarswellAlta 2290 at para 27, 2011 ABQB 566 (*Manning)*.

[4] *Re Provost*, 1974 CarswellSask 7, [1974] 2 WWR 611 (*Provost*).

> as I expected and I am not able to comfortably pay you now, so, I am asking you to forego the debt and if you do not, I will make an assignment in bankruptcy and cancel it out". Judicial approbation of such an attitude could result in a serious undermining of the current system of student loans.[5]

The Court reasoned that unlike tangible assets that can be seized by creditors, an education is a "life-long" intangible asset that cannot be confiscated from the debtor and, therefore, the "asset" of the education should involve long-term payments:

> The bankrupt's education is a long-term or capital asset. The acquisition of any long-term asset (such as, for example, a home) can be expected to involve long-term payments. The asset is used while it is being paid for. This reasoning should apply to a person's education. The recipient may expect to pay for it over the years. But his education is providing the income from which payment is to be made. In that sense the education pays for itself.[6]

The reasoning in *Provost* thereafter became the basis on which Canadian Courts dealt with discharges of bankrupts who held student loans.

Unlike a government student loan, a Private Student Loan is issued by private persons or entities in consideration of their financial or other interests. Typically, private entities take on the financial risk associated with their risk tolerance and business plans, and can provide loans only to those they consider to be a viable credit-risk or investment. Nonetheless, Courts have applied the same "higher moral standard" to a range of debt products that a student might obtain from private lenders, including loans issued to students by private individuals[7], loans issued to students by private credit companies[8], and student lines of credit issued to students by banks.[9]

---

[5] *Provost* at para 25.

[6] *Re Umpherville,* 1995 CarswellSask 503 at para 6.

[7] *Manning*.

[8] *Re Boyle,* 2005 CarswellOnt 3518, [2005] OJ No. 3372 (*Boyle*).

[9] *Re Insley*, 2007 CarswellSask 620, 2007 SKQB 556 (*Insley*).

III. BIA AMENDED TO ADDRESS GOVERNMENT STUDENT LOANS

A. Canadian Government Student Loans Cannot Be Discharged

In 1997, Parliament introduced section 178(1)(g) into the BIA, which today provides that any debt arising under "the *Canada Student Loans Act*, the *Canada Student Financial Assistance Act* or any enactment of a province that provides for loans or guarantees of loans to students seven-years post study period are not discharged by a discharge of bankruptcy."[10] In extraordinary circumstances of hardship, the seven-year no-discharge period for student loans may be reduced to five years.[11]

In *Conexus Credit Union v. Schneider Estate* ("Conexus"), the Saskatchewan Queen's Bench explained that the purpose of section 178(1)(g) is to provide added protection to the government issuing the student loan, so that the recovered funds can be re-lent to other students.[12] Furthermore, in *Re Mortimer,* the New Brunswick Queen's Bench emphasized the need to strike a balance between allowing individual debtors to "start fresh" by freeing them from their debts, and responsibility toward Canadian taxpayers who have helped finance their education. In *Mortimer,* the Court held that it would be unfair for the bankrupt's discharged debts to fall on the shoulders of Canadian taxpayers, as it was the bankrupt individual who received the benefit of an education, with no benefit going towards the taxpayer.[13]

---

[10] *Bankruptcy and Insolvency Act*, RSC 1985, c. B-3, s. 178(1).: Section 178(1)(g) originally provided for a two year period following full-time studies in which a discharge could not be granted. The provision was amended in 1998 to extend this period to ten years, and amended again in 2007 to the current period of seven years.

[11] *BIA,* s. 178 (1.1); *Re Hankinson,* 2009 CarswellNS 381.: Under this section, an applicant can bring a hardship application to apply to have their government student debts discharged within 5 years after ceasing to be a full-time student. Some factors to be considered on a s. 178(1.1) application are: whether the money was used for the purposes loaned; whether the applicant completed the education; whether the applicant derived economic benefit from the education; and whether the applicant made reasonable efforts to pay the debt.

[12] *Conexus Credit Union v. Schneider Estate (Trustee of),* 2003 CarswellSask 548 at para 17, 2003 SKQB 335 (*Conexus*).

[13] *Re Mortimer,* 2012 CarswellNB 171 at para 23, 2012 NBQB 109.

B. Section 178(1)(g) Does Not Apply To Private or Foreign Government Student Loans

Courts that have considered section 178(1)(g) have held that Private Student Loans are not captured by this section, nor are student loans that are provided or guaranteed by foreign governments. Thus, in contrast with Government Student Loans, Private Student Loans may be extinguished in bankruptcy at any time subject to any conditions that the Court might impose.

Conexus was one of the first cases to address section 178(1)(g) as it relates to Private Student Loans. Justice Klebuc, applying basic principles of statutory interpretation, concluded that section 178(1)(g) has no application to non-government student loans:

> Section 178(1) specifically provides that the "[7]-year rule" applies to government student loans and makes no mention whatsoever of non-government student loans. Under the doctrine of *expressio unius est exclusio alterius*, "Where a provision specifically mentions one or more items but is silent with respect to other items that are comparable, it is presumed that the silence is deliberate and reflects an intention to exclude the items that are not mentioned"…Parliament's silence in s. 178(1) on the matter of non-government student loans indicates an intention on its part not to extend the benefits of the [7]-year rule to non-government student loans and, as a consequence, to treat government student loans differently from non-government loans.[14]

Justice Klebuc went on to suggest that applying section 178(1) to non-government loans would amount to "judicial legislating" by the Court, since on a plain reading of the section, section 178(1)(g) does not apply to non-government student loans. The Court subsequently granted the bankrupt a conditional discharge from his debts.

In *Re Boyle*,[15] the debtor was a chiropractor whose debts were comprised substantially of student loans issued by a private U.S. company. Following graduation from a Canadian chiropractic college, Boyle attended a chiropractic school in the United States, which lost accreditation midway through his studies, rendering him unable to complete this further training. In determining whether or not the Private Student

---

[14] *Conexus* at para 11.

[15] *Boyle.*

Loan could be discharged, the Court considered the policy rationale behind the special treatment of student loans, distinguishing the features of public and Private Student Loans:

> Government loans are made in application to a Program that is available to all students who meet the established criteria without reference to credit or to any capacity to reimburse. They are of public interest. Abuses reflect on the integrity of the Student Loan Program. Non-government student loans are business decisions made according to the policy and at the discretion of some particular granters; they are made to borrowers who can establish that they will be able to reimburse. These loans are of private interest. Abuses reflect on the integrity of the insolvency system.[16]

It is also clear that section 178(1)(g) does not apply to individual creditors, just as it does not apply to for-profit lenders. In *Re Manning*, the Alberta Queen's Bench held that a debt owed to an individual who lent money to a student to pay for tuition is not protected by section 178(1)(g) of the BIA.[17]

Canadian Courts have also held that while Canadian Government Student Loans are subject to section 178(1)(g), American government-backed loans are not, and are therefore dischargeable in bankruptcy. Registrar Sharp in *Re Kanovsky* noted that "the wording of the present section 178(1)(g) is very clear. The reference is specifically to *Canadian* student loans…*American* student loans do not fall within the ambit of this section."[18]

IV. SPECIAL CONSIDERATIONS FOR PRIVATE STUDENT LOANS

Although Parliament decided not to add protections in the BIA for lenders of Private Student Loans, Courts have nonetheless continued to apply the "higher moral standard" at discharge hearings where a bankrupt has Private Student Loans. This provides lenders of Private Student Loans with an opportunity to push for greater recoveries in a bankruptcy than what they otherwise would be entitled to if the loans were other types of unsecured claims.

---

[16] *Boyle.*

[17] *Re Manning*.

[18] *Re Kanovsky,* 2000 CarswellMan 598 at para 28, 2000 MBQB 206 (*Kanovsky*).

A. Types of Conditions Typically Imposed

The Court is given wide discretion under s. 172 of the BIA to determine whether or not any conditions will be placed on the discharge of the bankrupt:[19]

> 172. (1) On the hearing of an application of a bankrupt for a discharge, other than [bankrupt personal income tax debtors] the court may
>
> (a) grant or refuse an absolute order of discharge;
>
> (b) suspend the operation of an absolute order of discharge for a specified time; or
>
> (c) grant an order of discharge subject to any terms or conditions with respect to any earnings or income that may afterwards become due to the bankrupt or with respect to the bankrupt's after-acquired property.

As discussed below, lenders of Private Student Loans have been successful in obtaining conditions on the discharge of student debtors. Those conditions have included the setting of minimum payments to be made, and requiring the bankrupt to consent to a judgment in favour of the Trustee up to the full amount owing under the Private Student Loan. These remedies can have the practical consequence of the creditor's claim surviving discharge of the student loan. However, as the amounts to be paid will be issued to the Trustee in Bankruptcy, there will be some dilution in the recoveries.

B. The Four *Van Steenes* Factors

Courts determine the type and extent of conditions placed on a discharge having regard to four factors first enunciated in the 1992 British Columbia Superior Court case *Re Van Steenes*:[20]

(i) prejudice to a single, significant creditor;

(ii) public interest in upholding the programs;

(iii) failure to make reasonable efforts to pay; and

(iv) present and future capacity to pay.

---

[19] *BIA* at s. 172(1).

[20] *Re Van Steenes,* 1992 CarswellBC 500, [1992] 5 WWR 611 (*Van Steenes*).

(i) Prejudice to a Single, Significant Creditor

The Court must first consider whether an absolute release of student debts would result in prejudice to a single, significant, creditor. The Court must determine whether the bankrupt has any other indebtedness beyond the student loans. If the indebtedness of the bankrupt is made up almost entirely of student loans, and it appears as though the debtor's assignment into bankruptcy is merely a "convenient" way to shed student loan obligations, the Court will likely impose harsher discharge conditions.[21] In *Re Insley,* the Saskatchewan Queen's Bench held that "the bankrupt's assignment was made to evade or ameliorate payments to one significant creditor – the RBC."[22] This factor played a major role in the Registrar's eventual decision to impose a conditional discharge on the bankrupt, contingent upon her entering into a judgment with the Trustee for $193,000, equivalent to the entire amount owed on her student line of credit.

(ii) Public Interest in Upholding the Programs

In addition to determining whether there has been prejudice to a single creditor, the Court must also analyze whether discharging the student loan would be contrary to the public interest. Where a student loan results in the bankrupt acquiring an asset that will generate significant income in the future, the integrity of the bankruptcy and insolvency system would be undermined if the bankrupt were to retain the entire benefit of the asset without the creditors receiving a share, which could jeopardize the provision of such programs. This was the case in *Re Korenic,* where the Ontario Superior Court of Justice held that it would be inappropriate to allow a bankrupt to attain a chiropractic degree without any realization on it for the benefit of creditors, and to provide an absolute discharge would undermine public confidence in the

---

[21] *Van Steenes* at para 23.

[22] *Insley* at para 43.

insolvency system.[23] Ultimately, the bankrupt was discharged conditionally, contingent on her payment of a portion of her student debt to the Trustee.[24]

(iii) Failure to Make Reasonable Efforts to Pay

Before granting a discharge, the Court will consider whether the bankrupt has made reasonable efforts to pay back her outstanding debts. The Court in *Van Steenes* held that "[w]here there is an ability to pay from after-acquired income, coupled with a persistent ignoring of the obligation, some consequences should flow insofar as the right to an absolute discharge is concerned."[25] Conversely, Courts will consider a prudent attempt by the bankrupt to pay their outstanding debts throughout the bankruptcy process as a mitigating factor. In *Boyle,* the bankrupt had a second loan under the Canada Student Loans Program, which he was currently paying off to the best of his ability. The Court determined that the bankrupt had made reasonable efforts in good faith to pay off his loans, and granted him an absolute discharge from his Private Student Loan.[26]

(iv) Present and Future Capacity to Pay

Arguably the most important factor in determining the type and extent of discharge is the bankrupt's present and future capacity to pay his or her outstanding debts. The "present and future capacity to pay" factor is largely determined by examining whether the debtor has obtained a post-secondary degree through the student loan, and if so, the specific degree attained. As a general rule, if little or no benefit will be derived from the bankrupt's education, the Court will be more likely to grant the bankrupt an absolute discharge. However, if the degree attained through the Private Student Loan allowed the bankrupt to derive a long term benefit, then the Court will likely impose much stricter discharge conditions, including ordering the bankrupt to repay the amount in full.

---

[23] *Re Korenic,* 2005 CarswellOnt 3523 at para 14, [2005] OJ No 3377 (*Korenic*).

[24] *Korenic* at para 15.

[25] *Van Steenes* at para 28.

[26] *Boyle* at para 26.

In *Re Goreil,* the bankrupt took out a Private Student Loan to enroll in an accounting course. Having encountered great difficulty with the material, the bankrupt declined to write the exams as it was obvious that she would not pass. Her subsequent employment was unrelated to her education and she had no ability to repay her loan. In granting an absolute discharge, the Court reasoned that where a bankrupt receives no apparent benefit from the education financed by the student loan program, and where there are no other extenuating circumstances, student loans should not be treated any differently than any other indebtedness or obligation of the bankrupt.[27] Similarly, in *Conexus,* the bankrupt took out a student line of credit to attend university, and withdrew from his university studies after two years. The Court reasoned that because the bankrupt did not attain a long term asset, his student line of credit should be treated the same way as any other unsecured debt.[28]

In contrast with the cases mentioned above, Courts are least forgiving in situations where an individual has, or is expected to, complete a degree with high earnings potential. Students of professional programs, such as medicine, have received particular scrutiny by the Courts.

Medical school graduates that have subsequently become bankrupt have been dealt with particularly sternly. In *Re Dolgetta,* the bankrupt had just completed a joint medical and doctorate degree. During this period, she accumulated over $150,000 in debt on her student line of credit. Although debts resulting from a student line of credit are private debts by nature, the Court rejected the argument that the line of credit could be discharged absolutely:

> She chose to go to medical school and she chose to undertake two degrees concurrently, a Herculean task which would tax the dedication and energy of the strongest student…She is obtaining the education she bargained for, albeit on a slower time frame than she had hoped for when she commenced the joint degree program.[29]

---

[27] *Re Goreil,* 1992 CarswellBC 518, (1992) 15 CBR (3d) 88.

[28] *Conexus* at para 21.

[29] *Re Dolgetta,* 2008 CarswellAlta 1206 at para 38, 2008 ABQB 556.

As a result, the bankrupt's discharge was conditional on consenting to a judgment in favour of the trustee for the full amount outstanding to the bank. The Court reached a similar conclusion in *Re Insley*, where a medical school graduate assigned herself into bankruptcy:

> This bankrupt is an intelligent, well-educated woman who can expect a bright and promising career… I am satisfied that hard work and effort by the bankrupt will result in a comfortable life for her. She acquired exactly what she bargained for — financial support for purposes of acquiring a long term, durable asset — and did so, in her own words, in the relative comfort that easy credit affords.[30]

The bankrupt was granted a conditional discharge, contingent upon consent to a judgment against her in favour of the trustee for an amount equal to her entire student line of credit.

Chiropractors have generally been held to a lower standard of discharge than medical school graduates. In *Re Kanovsky,* the bankrupt obtained a student loan from an American private lender. Because the bankrupt qualified as a chiropractor, and as such, was "a professional with the prospect of a positive future earning capacity,"[31] an absolute discharge would not be granted by the Court. However, the Court only ordered a small part of the debt be paid to the trustee, as the bankrupt had extenuating personal circumstances, and his current income was insufficient to service the debt. In *Korenic,* another case involving a bankrupt chiropractor, the Court reached a similar conclusion. The fact that the bankrupt had high income-earning potential as a chiropractor was mitigated by other factors, such as the amount of time that it would take for the bankrupt to become profitable, and the recent delisting of chiropractic services from OHIP.[32] As a result, the bankrupt was forced to only pay approximately 10% of her total student indebtedness to the trustee as a condition of discharge.

---

[30] *Insley* at para 46.

[31] *Kanovsky*.

[32] *Korenic.*

(v) Other Factors

In addition to the factors listed in *Van Steenes*, Courts have considered other mitigating and aggravating factors in deciding what conditions, if any, should be imposed as part of a discharge.

The Court will take extenuating circumstances beyond the bankrupt's control into account in deciding what conditions of discharge to impose, if any. This was precisely the case in *Re Shin,* where a bankrupt medical student was involved in a serious motorcycle crash shortly before commencing her residency, and was found unfit to complete her medical training. The Court held that the bankrupt's $134,000 student loan owed to the bank could be discharged absolutely due to the fact that the debtor's bankruptcy was caused by "misfortune" rather than "misconduct."[33]

Another case involving extenuating circumstances was *Re Boyle*. As noted above, Boyle, a Canadian chiropractor, accumulated significant student debt while attempting to attain a second degree in the United States. The Court determined that the "uncompleted studies for a second degree" did not represent an asset to the debtor, nor did they enhance the debtor's livelihood. Despite the fact that Boyle was already a chiropractor, because his uncompleted studies were a result of the school losing accreditation and therefore not his own fault, the Court granted Boyle an absolute discharge from his debts.[34]

A factor that does not appear to have been considered in the context of Private Student Loans, yet is likely to be a factor considered by the Court, is the length of time since the debtor ceased full-time studies. As noted above, section 178(1)(g) provides that Government Student Loans may be discharged seven (7) years after the debtor ceased full-time studies. In the face of that policy decision by Parliament, it is foreseeable that Courts will find that conditions should not be imposed on a bankrupt's discharge if the bankruptcy occurred more than seven years after the bankrupt ceased full-time studies. This is particularly the case with Private Student Loans where lenders are not required to provide loans on a

---

[33] *Re Shin,* 2009 CarswellOnt 3109, 177 ACWS (3d) 876.

[34] *Boyle*.

needs basis, but instead typically make profit-seeking business decisions based on their tolerance for and assessment of credit risk.

C. Private Student Loans in Consumer Proposals

It appears that Courts have not yet considered how Private Student Loans are to be treated in consumer proposals under the BIA. Given the unique treatment afforded to Private Student Loans in bankruptcy, it is arguable that these types of loans may be dealt with differently from other unsecured claims in a consumer proposal.

V. CONCLUSION

Bankruptcy does not necessarily spell the end of the enforcement process for collecting on Private Student Loans, but instead opens one last opportunity for recovery. Creditors of Private Student Loans may ask for conditions to be placed on the bankrupt's discharge to ensure that some recovery is made in respect of the Private Student Loans. Given that the test for imposing such conditions is not a bright-line, and the Court's analysis will be highly fact-specific, creditors and counsel should consider requesting conditions be imposed on the bankrupt's discharge. In making such a request, the creditor and counsel should have regard to the nature of studies undertaken, whether or not the studies were completed, reasons why studies were discontinued, the bankrupt's income potential having regard to current and expected market conditions for someone with their particular qualifications, and any extenuating circumstances that led to the bankruptcy.