

Bankruptcy and Student Loan Debts: An Ongoing Problem

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Cases Considered:

[Mainstreet Hair Salon 1992 Ltd. v. Schumaker, 2008 ABQB 363](#)

Many individuals would be unable to undertake post-secondary education without assistance in the form of student loans for tuition payments and living expenses. Last year, about 350,000 college and university students relied on federal student loans worth \$1.9 billion (K. Pinchin, "Government Accused of Milking Student Loan Plan," *Globe and Mail*, July 22, 2007). The fact remains, however, that many students are unable to repay the loan upon graduation, and even an assignment in bankruptcy fails to discharge the debt. This comment discusses the difficulty surrounding the student loan and bankruptcy issue and determines that an answer satisfactory to all sides has yet to be reached.

In *Mainstreet Hair Salon 1992 Ltd. v. Schumaker*, the bankrupt, Schumaker, had taken an aesthetics course while working at Mainstreet Hair Salon. Her employer paid for the course, on condition that Schumaker would repay the cost if she left her employer within 3 years of completing the course. Schumaker decided to leave within that time period, maintaining that her employer "changed their policies to an extent that I was not able to continue working there". Her employer brought an action against Schumaker for the cost of the course and on June 7, 2007, judgment was granted in favour of the employer, holding Schumaker liable to repay her employer an amount totalling approximately \$6,380. After judgment was entered on June 26, 2007, Schumaker and her employer, the judgment creditor, entered into negotiations concerning her plan for repayment. Schumaker proposed to pay \$150 per month, her employer countered with a proposal for her to pay \$200 per month, and shortly thereafter, on July 12, 2007, Schumaker assigned herself into bankruptcy.

In March 2008, Schumaker applied for a discharge from bankruptcy. Her trustee opposed the discharge based on the fact that, of the \$1,720 Schumaker had agreed to pay the trustee, \$670 remained unpaid. On May 1, 2008, the Registrar ordered that Schumaker be discharged from bankruptcy on the condition that she pay the Trustee the remaining \$670 owing, at a rate of \$150 per month. The Registrar did not require payments to be made to Schumaker's only creditor, her previous employer. The employer appealed the Registrar's order discharging Schumaker from bankruptcy.

Madam Justice Joanne Veit first determined the standard of review. An appeal of a Registrar's order will be allowed where it has been demonstrated that the Registrar "erred in principle or in law or failed to take into account a proper factor or took into account an improper factor, which led to a wrong conclusion": *Re Impact Tool & Mould Inc. (Trustee of) v. Impact Tool & Mould Inc. (Receiver of)*, [2006] O.J. No. 958 (ONCA). After considering the relevant case law and the circumstances of the bankrupt, Justice Veit concluded that Schumaker's discharge should include an additional condition, namely, that she pay ninety percent of the debt owed to her employer.

The court reached that conclusion on two grounds. First, in situations involving a single judgment creditor, courts have tended to be reluctant to discharge a bankrupt who "files in the face of a judgment." Second, while the purpose of a discharge is to give an "honest but unfortunate debtor" another chance, there is an additional consideration when the debt is in the form of a student loan. Schumaker was found to be young, healthy, without dependents, and without other debt. Given those circumstances, as well as the fact that she obtained a life time advantage from the debt she incurred, Justice Veit found that she should not be relieved of her entire debt. The qualification - the fact that Schumaker had to pay ninety percent of the debt as opposed to the full amount - was due to the price she had already paid in filing for bankruptcy: the additional debt she incurred to the trustee, and the liabilities she had acquired as a bankrupt (para. 20).

In reaching this conclusion, Justice Veit focused on the policy choice made by the legislature in deciding that a bankrupt should not be relieved of student loan debt on the basis that the debtor has become enriched by the education received. While this particular case deals with a private student loan, it brings to light some of the issues surrounding government student loan programs. The focus of this comment will therefore be on government student loans and the consequent debt shouldered by students who have attended university or college.

As the law currently stands in Canada, a first time bankrupt will obtain an automatic discharge within nine months of filing an assignment for bankruptcy unless the discharge is contested. Student loans are, however, non-dischargeable debt, meaning that if a debtor applies for bankruptcy within seven years of having been a student, the debtor must still pay any student loan debt for which he or she was liable before the assignment in bankruptcy: Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 178(1)(g)(ii) (BIA). Once five years have passed since they were a student, a bankrupt can apply to the court to have the remaining debt discharged. The court will make a determination based on whether the person acted in good faith in connection with the debt and if he or she can still show evidence of financial difficulty (ss.178(1.1)(a), (b) BIA).

The time periods that former students must wait after ceasing to be a full or part-time student have recently been changed. The period of non-discharge of debt or obligation obtained as a loan under the *Canada Student Loans Act*, the *Canada Student Financial Assistance Act*, or any provincial enactment that provides or guarantees loans to students, is currently seven years instead of the ten years it was formerly, and the period for an application to the court is now five years instead of ten.

The law with regard to student loan debt and bankruptcy in Canada has been amended several times within the last 10 years. In 1997, amendments to the BIA prevented individual bankrupts from discharging their student loans if they were still in school, or within two years after they left school. The reason for the amendments was to counteract the losses of the Canada Student Loan Program, which had increased from \$40.1 million to \$91.1 million between 1990 and 1996 (HRDC, Canada Student Loan Program Claims Legacy Files). In 1998, further amendments were made to the BIA. In order to reflect the benefits conferred on students in the 1998 Budget, the amendments extended the period of time for non-discharge to ten years (Industry Canada, Report on the Operation and Administration of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*, Group 3, last updated Nov. 17, 2004).

The continuous benefits of gaining an education cannot be overstated. Education confers a lifelong advantage, an advantage that cannot be taken away from a debtor, namely increased employment opportunities and the ability to earn more income. Therefore, incurring debt to obtain an education is an investment in the future, and a student debtor should not be able to discharge that debt while continuing to benefit from that investment. A student loan program is mandatory in any country that aims to build an educated workforce. However, there is another aspect to student loan debt, a less beneficial aspect, to which the legislature should turn its mind. If a person stands to benefit from a student loan, does that mean the government should dole them out, without hesitation, to anyone who applies? Or should the government shoulder some responsibility for the consequent student loan burden that graduates must bear for years after they graduate, dispensed with minimal regard for whether their future income will provide them with the ability to repay the loan.

While the benefits cannot be questioned, there are some facts on the other side that need to be considered. Students graduating with degrees in the arts and social sciences, as opposed to professional programs such as engineering, tend to face financial difficulties in repaying their student loans because the remuneration they receive after graduation tends to be modest. A national graduates' survey on student debt, published in 2004, reported that in the class of 2000, on average, college graduates owed \$12,600 upon graduation and university graduates with bachelor degrees owed \$19,500 ([Statistics Canada, The Daily, Apr. 26, 2004](#)). Those statistics are significant, especially when considering that the interest rates charged by the Canadian government, and most provinces, is prime plus 2.5%, a rate among the highest in the G8 countries, and a rate most banks are willing to beat. Alberta and Nova Scotia have recently announced plans to lower their interest rates to either prime, or below but some measures introduced by the government to help debtors struggling with paying their student loans are, in fact, making many situations more difficult. Students who take advantage of the Revision of Terms under the Canada Student Loans Program get a short term reduction in their monthly payments and more time to pay their loans, but in so doing, they are required to pay more interest. The Coalition for Student Loan Fairness maintains that the number of students who pay a long term penalty for the short term benefit has risen about 77% since 2002.

The point of this comment is to make clear that the situation is rife with complex issues. It is apparent that the government must continue granting student loans, and it is also apparent that many debtors are struggling with the debt burden after graduation, their career aspirations not having materialized as planned, or having materialized with less remuneration than expected. The solution is not as simple as calling for a reduction in interest rates, as the government must also be compensated for having provided an interest-free loan for the duration of the students' studies. Rather, questions need to be posed with regard to whether it would be feasible, or even desirable, to set loan rates to correspond with the remuneration provided in the various fields. This comment does not purport to provide a solution to this dilemma but simply maintains that it is an issue that must continue to be discussed.