An Education in Debt:
Student Loans and Bankruptcy

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INTRODUCTION

Students often require significant financial assistance in order to attend school and complete their studies. In some cases, borrowing as a student can result in a nearly insurmountable debt upon graduation. In decades past, tuition rates were manageable and students had available to them more programs offering "free" money in the form of grants, scholarships and bursaries. While some of those programs remain available today, their availability is more limited and with the skyrocketing tuition fees, students are increasingly reliant on borrowing by way of lines of credit, credit cards, private loans and student loans.

Government student loans are unique to other forms of financing because they are not dependent upon a good credit history. The program is designed to permit students from low income families to obtain a post-secondary education. Students are eligible for these loans based on need and a lack of income. Another unique feature of government student loans is that they are not automatically released on a discharge from bankruptcy, due to section 178(1)(g) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA").

Individuals, institutions and governments lend money to students to fund their education on the expectation that those who attend post-secondary education are acquiring skills and knowledge that are likely to result in higher-than-average income levels in the future from which they can repay the loans. This expectation is the underlying policy reason for disallowing the release of student loan debts on bankruptcy. Students are becoming more and more reliant upon the government to finance post-secondary education, which is becoming more and more unaffordable to the average student. So the amount of post-graduation debt is rising, yet students are not permitted to enjoy the "fresh start" that the bankruptcy system is designed to provide.

Between 1992 and 1997, the BIA did not make any specific provisions with regard to the release of student loan debts, and they were treated as any other consumer debt that is released on a

discharge from bankruptcy.[1] Since 1997, there have been several amendments to the BIA relating to student loans, and there are currently proposals to make further amendments to the relevant provisions. Some have speculated that these changes might have been made in response to a rising number of students defaulting on student loan payments beginning in the early 1990s, resulting in losses to the government and to taxpayers.[2]

Just as there have been amendments to the treatment of student loans in the bankruptcy system over the last 10 years, the student loan program itself has seen many changes over the last 15 to 20 years. Traditionally, student loans were granted through a federal-provincial partnership so that students held two separate loans: one provincially-funded and one federally-funded through the Canada Student Loan Program ("CSLP").

There are now several provinces that have integrated their provincial student financial assistance programs with the CSLP (including Ontario, Saskatchewan, New Brunswick and Newfoundland). This makes the application, distribution and repayment processes much more streamlined, as there is only one application for all financial assistance and once studies are completed, there is only one monthly payment to make. In addition, the bodies responsible for administering student loan programs have changed, which is relevant in terms of who students deal with when negotiating the repayment terms of their student loans.

It is helpful to understand the statutory framework governing student loans and how such loans are administered when considering how these loans are dealt with in the bankruptcy system. A recent study was prepared for the Office of the Superintendent in Bankruptcy, and used a comparative approach to review the treatment of government student loans in bankruptcy.[3] This paper attempts to provide a broader context for dealing with student loan debts in bankruptcy proceedings and for appreciating how courts have treated student loan debts in bankruptcy.

[1] Prior to 1992, student loan debts were designated as preferred debts (as Crown debts) under the BIA.
[2] Canada, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Report of the Standing Senate Committee on Banking, Trade and Commerce, November 2003) at 48.
[3] Office of the Superintendent in Bankruptcy, *Government Student Loans, Government Debts and Bankruptcy: A Comparative Study* by Stephanie Ben-Ishai (presented at the Insolvency Research Symposium in January 2006), online: Office of the Superintendent in Bankruptcy < http://strategis.ic.gc.ca/epic/site/bsf-osb.nsf/en/h_br01667e.html>.

STUDENT LOAN PROGRAMS

History of Administration of Student Loans

The CSLP was started in 1964 pursuant to the *Canada Student Loans Act*, R.S.C. 1985, c. S-23. At its inception and continuing to 1995, the CSLP was administered through financial institutions whereby students, who the government approved to receive financial assistance, would obtain a loan from a financial institution. The provincial-federal partnership then in place provided for provincial student assistance offices responsible for reviewing loan applications, confirming eligibility, assessing financial need, and determining the amount of funding that would be provided. The financial institutions would advance the loan and administer the repayment process once the student completed his or her studies. These are referred to as "guaranteed loans", as the Government of Canada guaranteed each loan that was issued under the CSLP and would reimburse the financial institution for the amount of any loan that went into default. A similar agreement was in place for that portion of the loan that was provincially-funded.

All federal student loans that were issued prior to August 1, 1995 are subject to the *Canada Student Loans Act*. On June 23, 1994, the *Canada Student Financial Assistance Act*, S.C. 1994, c. 28 received Royal Assent, and changed the administration of the CSLP and the relationship between the Government of Canada and financial institutions with respect to the program. Under the *Canada Student Financial Assistance Act*, the Government established a "risk-shared" agreement with certain financial institutions. Under this new agreement, the financial institutions would assume the risk of student loans going into default, with the Government contributing only a fixed payment in such situations.

As of July 31, 2000, the risk-sharing agreement came to an end and the Government of Canada assumed responsibility for financing all student loans directly. Financial institutions are no longer involved in any of the administration of the CSLP, and while the provincial offices continue their role in the application and acceptance process, the administration of the loans program is now the responsibility of the National Student Loans Service Centre. The National Student Loans Service Centre processes the loan documents, arranges for the loan funds to be

deposited in the recipient's bank account, keeps track of the amount of the loan and the amount to be repaid, sets up the loan repayment schedule, and administers repayment programs such as Interest Relief and Debt Reduction in Repayment.

There are similar provincially-designated bodies to administer the provincially-funded portion of student loans. For example, in British Columbia, the relevant body is the British Columbia Student Loan Service Bureau. These bodies also administer programs such as Interest Relief and Debt Reduction in Repayment.

Interest Relief

The interest payable on student loans is a significant factor when it comes time to start repaying the loans. The CanLearn website (www.canlearn.ca), the government website that provides information about the CSLP, suggests that when negotiating repayment plans, a borrower may choose either a fixed rate of interest or a floating rate. The website indicates that the current fixed rate of interest is prime + 5%, which would be in place for the duration of the repayment period (which can be up to 10 years). The floating rate is reported as prime + 2.5%.

As of 1998, borrowers who are paying back student loans are eligible to claim most of the interest they pay on student loans as a deduction on their income tax.

Student loans are interest-free during the period that the borrower is still attending school pursuant to section 7 of the *Canada Student Financial Assistance Act*, and section 8 provides for a 6-month grace period following the end-of-study date, where payments of principal and interest are not required:

> 7. (1) Subject to the regulations, no interest is payable by a borrower on a student loan prescribed by regulations made under paragraph 15(j) in respect of any period of studies during which the borrower is a full-time student, or in respect of any subsequent period ending on the last day of the month in which the borrower ceases to be a full-time student.
>
> (2) No fee of any kind may be charged to a borrower on a student loan in respect of any period of studies, or a subsequent period, referred to in subsection (1).

> 8. Subject to the regulations, no amount on account of principal or interest in respect of a student lean prescribed by regulations made under paragraph 15(j) that is made to a full-time student is required to be paid by the borrower until the last day of the seventh month after the month in which the borrower ceases to be a full-time student.

However, while borrowers are not required to make any payments on either the principal or interest of their loans during the grace period, interest does begin accrue. Borrowers have the option of either paying the accumulated interest in a lump sum when they begin payments on their loan, or having the interest capitalized and added to the principal of their loan.

Borrowers are required to start making payments on their loans on the first day of the seventh month after they have stopped attending full-time studies. The relevant Loans Centre will automatically send the borrower a Consolidation Agreement which shows the details of the outstanding loan balance, the monthly payment (calculated based on the amount of the loan), when the monthly payments are due, how long the repayment term is, and the interest being charged. The lowest possible monthly payment is generally $25, including interest.

Once the initial 6-month grace period has expired, recipients of student loans, both through the CSLP and provincially-funded programs, who continue to have a low income, are entitled to apply for the Interest Relief program pursuant to the *Canada Student Financial Assistance Regulations*, SOR/95-329, s. 19. The eligibility criteria to qualify for this program provides that the applicant must:

1. reside in Canada;

2. have a student loan that is not currently in default (though if the borrower filed for bankruptcy on or after May 11, 2004, he or she may still qualify for Interest Relief even if the loan is in default);

3. have signed a Consolidation Agreement; and

4. have a gross family income (before deductions) that falls within the maximum income guidelines (according to Schedule 1 of the *Regulations*).

The Interest Relief program is such that if a borrower meets the eligibility criteria and is approved, the borrower does not have to make any payments on interest or principal for the period of interest relief, usually granted for a period of six-months.

Additional applications for Interest Relief are accepted for periods of six months at a time, provided the applicant continues to meet eligibility requirements, generally to a maximum of 30 months throughout the lifetime of the loan. However, Extended Interest Relief is also provided for in section 20 of the *Regulations*, after 30 months of interest-free status and under certain conditions, for up to an additional 24 months.

Debt Reduction in Repayment Program

The Debt Reduction in Repayment Program is provided for in the *Canada Student Financial Assistance Regulations*, SOR/95-329, s. 42.1, and arrived in its current form through amendments to the *Regulations* in 2004 and 2005. This program allows borrowers who have ceased being students for at least five years and continue to have difficulty repaying student loans, to apply to have the loan principal reduced.

To qualify for this program, the borrower must have previously been granted all possible interest-free periods under the Interest Relief program. Further, the borrower's loans must be in good standing (not more than two months in arrears) and the loan payments must exceed a given percentage of the borrower's income provided for in the *Regulations*.

If the initial application is approved, the borrower is eligible for a reduction of principal up to $10,000 (the amount to be determined according to a formula in s. 42(2)). If the borrower continues to experience financial hardship in paying back the student loan, he or she may apply a second and third time for additional reductions in the loan principal for amounts of up to $10,000 and $6,000 respectively.

BANKRUPTCY AND STUDENT LOANS

The BIA

Section 178 of the *Bankruptcy and Insolvency Act* provides for several specific types of debts that will not be released when a bankrupt person is discharged:

> 178 (1) An order of discharge does not release the bankrupt from
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> > (a) any fine, penalty, restitution order or other order similar in nature to a fine, penalty or restitution order, imposed by a court in respect of an offence, or any debt arising out of a recognizance or bail;
> >
> > (a.1) any award of damages by a court in civil proceedings in respect of
> >
> > > (i) bodily harm intentionally inflicted, or sexual assault, or
> > >
> > > (ii) wrongful death resulting therefrom;
> >
> > (b) any debt or liability for alimony or alimentary pension;
> >
> > (c) any debt or liability arising under a judicial decision establishing affiliation or respecting support or maintenance, or under an agreement for maintenance and support of a spouse, former spouse, former common-law partner or child living apart from the bankrupt;
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> > (d) any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity or, in the Province of Quebec, as a trustee or administrator of the property of others;
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> > (e) any debt or liability resulting from obtaining property or services by false pretences or fraudulent misrepresentation, other than a debt or liability that arises from an equity claim;
> >
> > (f) liability for the dividend that a creditor would have been entitled to receive on any provable claim not disclosed to the trustee, unless the creditor had notice or knowledge of the bankruptcy and failed to take reasonable action to prove his claim;

> **(g) any debt or obligation in respect of a loan made 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 where the date of bankruptcy of the bankrupt occurred**
>
> > **(i) before the date on which the bankrupt ceased to be a full- or part-time student, as the case may be, under the applicable Act or enactment, or**
> >
> > **(ii) within seven years after the date on which the bankrupt ceased to be a full- or part-time student**; or
>
> (h) any debt for interest owed in relation to an amount referred to in any of paragraphs (a) to (g).

The majority of these debts are not released by bankruptcy for social policy reasons: someone who has incurred a debt arising through the commission of a fraud, a failure to pay child or spousal support, failure to pay a fine or restitution order or because the debtor is required to pay an award of damages for assault should not be permitted to avoid those debts through bankruptcy.

One rationale[4] for preventing debtors from using the bankruptcy process to discharge student loan debts is the belief that students attending post-secondary education may be temporarily insolvent upon graduation but will be able to repay their loans from future income earned as a result of their education. It has also been noted that both the Government of Canada and provincial governments lent significantly more money for student loans beginning in the 1990s and are attempting to recoup as much from those loans as possible. Further, former students have other forms of debt relief available to them, as noted above, with respect to the Interest Relief and Debt Reduction in Repayment programs.

It is not surprising that the law does not permit relief through the bankruptcy process for debtors who have defrauded creditors, failed to pay fines, child or spousal support or judgments for

[4] The Superintendent of Bankruptcy created the Personal Insolvency Task Force in 2000 for the purpose of suggesting ways to reform the personal bankruptcy provisions in the Act. In its Final Report, released in August 2002, the Task Force discussed these rationales for including student loan debts in those that are not released on discharge (see pp.13-17).

assault. However, it seems anomalous that recent graduates with student loan debts should be given the same harsh treatment.

Perhaps in recognition of these concerns, the Act does provide for an application for release of student loan debts under certain conditions:

> 178 (1.1) At any time after five years after a bankrupt who has a debt referred to in paragraph (1)(g) ceases to be a full- or part-time student, as the case may be, under the applicable Act or enactment, the court may, on application, order that subsection (1) does not apply to the debt if the court is satisfied that
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> > (a) the bankrupt has acted in good faith in connection with the bankrupt's liabilities under the debt; and
> >
> > (b) the bankrupt has and will continue to experience financial difficulty to such an extent that the bankrupt will be unable to pay the debt.

These provisions, both section 178(1)(g) and section 178(1.1), originally provided for a period of only two years to pass before a declaration of bankruptcy would release the student loan debt or before a bankrupt could make an application that paragraph 178(1)(g) does not apply. They were originally included in the Act by way of *An Act to Amend the Bankruptcy and Insolvency Act*, S.C. 1997, c. 12, s. 105(2) and (3). Prior to that time, debts from student loans were fully released upon a bankrupt being discharged. Amendments came into force on June 18, 1998 (through the *Budget Implementation Act, 1998*, S.C. 1998, c. 21, s. 103), changing the time in both sections to ten years. However, the most recent amendment, which came into force on July 7, 2008 (through SI 2008-78), provides for a term of 7 years in the case of s.178(1)(g) and 5 years in the case of s.178(1.1).

The length of time a student is required to wait before a student loan debt is discharged in bankruptcy or before an application can be made to discharge the debt has been the subject of impassioned debate. Bill C-55, *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, 1st Sess., 38th Parl., 2005, (assented to 25 November 2005), S.C. 2005, c. 47 s. 107) ("Bill C-55"), which came into force on July 7, 2008, changed the time frame for a third time. Currently section 178(1)(g)(ii) provides that a student

loan debt is eligible for discharge in bankruptcy after seven years, rather than ten years, and an application under section 178(1.1) to expunge a student loan debt can be brought five years after ceasing to be a student, rather than ten years. There is a senate bill, Bill S-201, *An Act to amend the Bankruptcy and Insolvency Act (student loans)*, 1st Sess,. 40th Parl., 2008 ("Bill S-201"), which has been introduced several times, and received first reading on November 20, 2008. Bill S-201 proposes an amendment to the Act providing that an order of discharge would release a student loan debt if the bankruptcy occurred within five years after the bankrupt ceased to be a student. The Senate Bill would also allow a bankrupt to apply at any time for an order releasing all or part of the student loan debt. Furthermore, Bill S-201 would have the BIA amended so that it lists factors the court must consider on such an application:

> (a) the extent to which the bankrupt has sought relief under debt reduction or repayment assistance programs available under the applicable Act or enactment referred to in paragraph 1(g);
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> (b) any efforts that the bankrupt has already made to pay the loan;
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> (c) the bankrupt'' future earning capacity, including long-term employment prospects and expected increases in income; and
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> (d) the bankrupt's current and future obligations, including obligations to the bankrupt's family.

Prior to the coming into force of Bill C-55, the state of the law was set out succinctly in *Re Kelly* (2000), 20 C.B.R. (4th) 251, [2000] O.J. No. 4373 (S.C.J., Registrar Sproat):

> [T]here are now three relevant time periods, insofar as student loan obligations are concerned. They are:
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> 1. if the date of bankruptcy was after December, 1992 but before September 30, 1997, debts or obligations in respect of student loans were released by an order of discharge;
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> 2. if the date of bankruptcy was on or after September 30, 1997 but before June 18, 1998, the bankrupt's student loans were not released by an order of discharge and the bankrupt

was obligated to wait 2 years from the time the bankrupt ceased being a full or part-time student before applying to the court for an order that the student loans be released; and

3. if the date of bankruptcy was on or after June 18, 1998, the bankrupt's student loans were not released and the bankrupt was obligated to wait 10 years from the time the bankrupt ceased being a full or part-time student before applying the court for an order that the student loans be released.

To that explanation we can add a fourth relevant time period: if the date of the bankrupt's discharge is on or after July 7, 2008 the bankrupt's student loan debt may be discharged if he or she ceased to be a student 7 years prior to their filing. Further, the bankrupt may make an application that s.178(1) does not apply after 5 years of having ceased to be a student.

Currently, there is no discretion for a Registrar to reduce the amount of student loans payable. A Registrar may only determine that paragraph 178(1)(g) does not apply and release the entire debt, or he or she may deny the application altogether.

Applications For Discharge From Bankruptcy

The case of *Re Van Steenes* (1992), 13 C.B.R. (3d) 131, 69 B.C.L.R. (2d) 124 (S.C., Macdonald J.), is an example of how courts treated student loan debts during the period when they were released on discharge. The bankrupt applied for an absolute discharge from bankruptcy, having student loan debts in the amount of $14,240.47, and other unsecured debts in the amount of $3,500.00. Macdonald J. found that while a student loan debt does not survive bankruptcy, the Court is not "prevented from considering the special circumstances in which student loans arise, the particular of purpose for which they are designed, the understood terms of repayment and the public policy considerations involved in supporting the program when considering a discharge application". In considering all of the circumstances involved in the student loan debt, Macdonald J. determined the following relevant factors:

(1) Prejudice to a single, significant creditor;

(2) Public interest in upholding the programs;

(3) Failure to make reasonable efforts to pay;

(4) Present and future capacity to pay.

In this case, the bankrupt had accrued his student loans during the first three years of attending a Bachelor of Arts program at UBC. The bankrupt then left school and moved to Toronto for three years, where he worked only intermittently before returning to Vancouver and completing his degree with independent financing. Several months after he graduated, the bankrupt obtained steady employment with Canada Customs, however, he had not commenced repayment of his student loans, even after obtaining this employment, and he subsequently made an assignment in bankruptcy. As a result, the Court ordered a conditional discharge of the bankrupt, conditional upon payment to the Trustee of $3,000.00 at a minimum rate of $100.00 per month.

Thus, it appears that the amendments to the BIA to disallow the release of student loan debts was in some respect a codification of the common law.

In *Re Brunt*, 2006 NSSC 237, 24 C.B.R. (5th) 51 (Registrar Cregan), the applicant made an assignment in bankruptcy and the Attorney General of Canada opposed the applicant's absolute discharge because of outstanding Canada Student Loans, which comprised the majority of her debt. The applicant had accrued her student loan debt in pursuit of a Bachelor of Education, and had made her assignment in bankruptcy 10 years and seven days after she ceased to be a full or part time student. The amount of her Canada Student Loan debt was approximately $24,000.00.

The applicant had some work in her field for the first three years after completing her studies. However, she then became pregnant and was unable to work due to medical difficulties. She was unable to return to work after her pregnancy as her children require significant care (her son is autistic). While the Attorney General of Canada argued for a conditional discharge, Registrar Cregan found that it could be "six or more years before she could be expected to be free enough to have a good income to enable her to have surplus income or assets sufficient to justify her having to make payments into her estate".

Registrar Cregan suggested that the principles from *Re Van Steenes, supra*, had essentially been replaced by the amendments to the *Act* in 1997 regarding student loans, in favour of delaying discharge of them for at least 10 years after completion of studies. At that point, the concern

about the convenience of using the bankruptcy system to avoid paying student loans is essentially eliminated.

Perhaps in an attempt to alleviate the harshness of the current Act, the Court has interpreted the meaning of "ceased to be a full or part time student" in section 178(1)(g) so that it does not include time that a bankrupt is enrolled in studies but not relying on government student loans. In *Re Ledoux*, 2005 SKQB 75, 8 C.B.R. (5th) 225, Registrar Herauf[5] considered an application for discharge by a bankrupt who had student loan debts. The bankrupt was a full-time student from 1986 until 1989. She made no payments on her loan after finishing her program and Canada Student Loans obtained judgment in 1989. The bankrupt returned to school between 1992 and 2000 but did not receive any student loan funding. Canada Student Loans took the position that the bankrupt finished her studies in 2000. The Court found that she had finished her studies in 1989 for the purposes of the student loan and hence the loan was beyond the 10 year time period and dischargeable. The bankrupt received a conditional order of $6,000 at $200 per month based on surplus income.

In *Re Cochran*, 2006 NSSC 242, 24 C.B.R. (5th) 130 (Registrar Cregan), the applicant made an assignment in bankruptcy in September 2005, after graduating in 1995 and having financed his education with student loans. The applicant's student loan debt accounted for about 45% of his liabilities, with the remainder being comprised of business-related debt. At the time of his application, the applicant was employed in the United States in a position that made use of his education. The applicant did have some surplus income, though he made no voluntary payments on his student loans. The Attorney General objected to the discharge, being the creditor of a total of principal and interest on student loans in the amount of $28,062.55, representing approximately 1/3 of the total liabilities of the applicant. Registrar Cregan granted the applicant a conditional discharge, which required him to pay $4,500.00 to the estate over a 12-month period.

In *Re Ament* (2006), 24 C.B.R. (5th) 284, [2006] O.J. No. 3538 (S.C.J., Registrar Nettie) the applicant applied for a discharge from bankruptcy, having made his assignment on August 16,

[5] Now the Honourable Mr. Justice Herauf of the Court of Queen's Bench of Saskatchewan. As the Registrar in Bankruptcy in Saskatchewan for several years, many of his decisions are referred to in this paper.

2005. The bankrupt was in medical school at the time of his application, entering his fourth and final year at a university in the United States. He had financed his education with student lines of credit, which had reached $150,000.00, as well as tuition loans from a US-based lender in the amount of $130,000.00. He also had outstanding credit card debts in the amount of $17,000.00. The bankrupt admitted to increasing the amount of debt that would have otherwise been owed as a result of online gambling and lavish spending while attending school. As the loans were not Canada Student Loans per s.178, the creditor must prove a fact under s.173 in order to prevent the bankrupt from being unconditionally discharged. Having found two facts under section 173(1) of the *Act*, the Court found as follows:

> In determining the appropriate disposition, I must bear in mind what have become the three touchstones of any discharge Court – the need of an honest but unfortunate debtor for a fresh start, freed from the crushing burdens of her debt; the *prima facie* right of the creditors to be repaid; and the need for the public to have confidence in the insolvency system and to view the disposition in a way consistent with the integrity of that system.

The Court then referred to the decisions in *Re Coffey*, 2004 NLSCTD 22, 2 C.B.R. (5th) 121 and *Re Korenic*, [2005] O.J. No. 3377 (S.C.J.), and stated as follows:

> The case at bar also presents the issue, … of the bankrupt that has obtained a long term enduring asset, which by law vests in the trustee, but which cannot easily be realized upon except by the bankrupt – an education. How best can such an asset be realized upon for the benefit of the creditors, especially in cases where the bulk of the creditors are the very parties who financed its acquisition? After all, the fact that such an asset would be acquired and would have future value is precisely what enticed both RBC and the US lender to lend in the first place. It would be offensive to commercial morality and, in my view, call the integrity of the insolvency system into question if this asset were not realized upon for the benefit of the creditors.
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> The only way to effect such a realization is to impose as a condition of discharge the repayment of an amount which reflects this value. In the case at bar, that would seem to be the amount owed to the opposing creditor, RBC, on its student credit line. While I have considered a reduction of this amount equal to some portion of the amounts gambled and spent lavishly, I am not convinced that to do so would not impugn the integrity of the insolvency system. Gambling in a hopeless attempt to restore one's financial footing and spending in a lavish manner on personal wants with creditors' money are not activities to be rewarded or condoned by a discharge Court. Accordingly, I do not find it appropriate to

> find other than that all amounts owing to RBC ought to be the subject of a conditional discharge order herein… I find that the principle to be enunciated here is that the Bankrupt ought to pay what he bargained to pay, which is the amount owed to the opposing creditor, RBC…

The Court discharged the Bankrupt on the condition that he pay the sum of $150,000.00 to the Trustee, that repayment start as soon as possible after his graduation, and that the minimum monthly payments be in the amount of $200.00, with interest on default.

The decision in *Re Ament* appears to acknowledge that there are, today, many options available to students to finance educational pursuits, but that only government student loans are subject to the statutory prohibition from automatic release of the debt prior to the expiry of 10 years from the time the bankrupt ceases to be a student. The Registrar relied on the same principles and policies underlying section 178(1)(g) to conclude that the bankrupt could not escape this debt that had been incurred to generate an enduring asset.

Finally, and most recently, *Re Dolgetta*, 2008 ABQB 556, [2008] A.J. No. 1001 (Registrar Hanebury) dealt again with the situation of a bankrupt medical student. The bankrupt was enrolled in a joint M.D. / Ph.D. program at the University of Calgary and had accumulated a debt of over $150,000 owing to the Royal Bank of Canada. The bankrupt had ended an abusive relationship during her studies, and took a year off of her M.D. studies although she remained enrolled in the Ph.D. program. She suffered from anxiety and depression, as well as large weight gain, and was seeking counselling and otherwise dealing with those issues. The bankrupt was to start her year of clerkship in the same month the reasons were delivered. She testified it would be at least three years, and more likely six years, until she finished her residency and would be in a position to begin to repay her loans.

RBC opposed the discharge and sought to prove a fact under s.173 of the BIA in order to have conditions imposed on the bankrupt's discharge. RBC argued that the bankrupt had engaged in irresponsible spending, her personal spending being almost $800 per month on average. Registrar Hanebury reviewed the law including *Re Ament* and *Re Insley*, 2007 SKQB 383, [2007] S.J. No. 561 which were particularly helpful as they also involved medical students.

Registrar Hanebury held that the debts could not be discharged unconditionally since RBC proved a fact under s.173(a). There was no material change to the expectations of the debtor or creditor. The bankrupt had already postponed her M.D. when she applied for the line of credit at the Royal Bank, she knew that reaching her ultimate goal would take her longer than she had originally planned. The court noted that her career prospects remained bright and that when a debtor receives a life asset it is reasonable to expect that it may take a significant portion of a person's life to pay the debt in relation to that asset. The Registrar held that the creditor had the right to be paid, and that an unconditional discharge would bring the integrity of the insolvency system into disrepute. It would not be fair for the bankrupt to graduate with a clean slate while her peers "will be shouldering heavy debt loads as they commence their medical careers" (at para. 47).

Applications for Release of Student Loan Debts

Good Faith and Continuing Hardship

Re Minto (1999), 191 Sask.R. 1, [1999] S.J. No. 798 (Q.B., Registrar Herauf) is one of the leading decisions on applications for an order that section 178(1)(g) does not apply to student loan debt. In this case, the bankrupt had obtained student loans but was required to discontinue his program in the spring of 1996. He was unable to make any payments on his loans on account of a low income and he applied for Interest Relief. However, on expiry of his Interest Relief, the bankrupt made an assignment in bankruptcy, less than two years after he had ceased being a student, in December 1997. He received his discharge in November 1998.

First, Registrar Herauf engaged in an exercise of statutory interpretation to conclude that the term "bankrupt" in section 178(1.1) includes both discharged and undischarged bankrupts. Then, after concluding that the applicant in this case was no longer a student (though in an apprenticeship program), Registrar Herauf considered what factors were relevant in determining whether to grant relief pursuant to section 178(1.1). He started by making the following observations (at paras. 55-59):

> The onus is on the applicant to convince the court that both requirements are satisfied in order to obtain the relief sought. Before a court can grant such an

> order it must be satisfied, on a balance of probabilities, that the bankrupt has "acted in good faith" in connection with his or her student loans, and that the bankrupt "has and will continue to have" such financial difficulty that he or she will be unable to satisfy the loans.
>
> Since making an order under subsection 178(1.1) involves exercising a discretion the court is not obligated to grant the relief even if the applicant has satisfied the court on the two points in question.
>
> The final matter to deal with before considering the merits of the application is the powers of the court in dealing with an application under subsection 178(1.1). It is obvious that the court has the power to "order that subsection (1) does not apply to the debt," or to refuse to make such an order. The court could also adjourn the application.
>
> However, I cannot agree with the submission of the applicant that the court could make an order that subsection (1) does not apply to only one of the student loan debts of an applicant with more than one debt. Nor can I agree with the applicant's submission that the court could grant an order that subsection (1) does not apply to a portion of the student loan debt of an applicant.
>
> I have read the subsection over many times and cannot come to the conclusion that Parliament intended the court to read such things as "one debt" or "partial debt" into the word "the debt."

With respect to the relevant factors on such an application, Registrar Herauf cited the following:

1. whether the money was used for the purpose loaned;

2. whether the applicant completed the education;

3. whether the applicant derived economic benefit from the education (ie: is the applicant employed in an area directly related to the education);

4. whether the applicant has made reasonable efforts to pay the debts; and

5. whether the applicant has made use of available options such as interest relief, remission, etc.

In the circumstances of that case, Registrar Herauf granted the application on the basis that he was satisfied that the bankrupt had acted in good faith in connection with his student loan debt and that he would continue to experience financial difficulty.

An example of a case dealing with the former limitation period of ten years under section 178(1.1) is *Re Kelly* (2000), 20 C.B.R. (4th) 251, [2000] O.J. No. 4373 (S.C.J., Registrar Sproat) wherein the bankrupt made an assignment in bankruptcy on October 6, 1997 and obtained her discharge in May 2000. In September 2000, the bankrupt brought an application under subsection 178(1.1) for release of the student loan debts that had not been discharged because it had been less then ten years since she had been a student at the time she made her assignment. The applicant had accumulated over $23,000 in federal and provincial student loan debts. The Registrar noted that the 1997 amendments preventing the automatic release of student loan debts upon an Order of Discharge "were motivated by the recognition that a bankrupt had and would continue to have the benefit from the education he or she obtained with the assistance of the student loans and to address a perceived abuse of the bankruptcy process".

The Registrar went on to apply the test set out in subsection 178(1.1), noting that the test is conjunctive and that the bankrupt has the onus of establishing on a balance of probabilities both that she acted in good faith and that she will continue to experience financial difficulty to the extent that she will be unable to pay her student loan liabilities. With respect to the requirement to act in good faith, Registrar Sproat followed the decision of Registrar Herauf in *Re Minto*, as to the factors relevant to the determination of the issue of "good faith".

Registrar Sproat also found that, in addition to those factors from *Re Minto*, the timing of the bankruptcy and whether the student loans formed a significant part of the bankrupt's overall indebtedness at the date of bankruptcy were factors to be considered.

With respect to the second part of the test, that the bankrupt continue to experience financial difficulty, Registrar Sproat noted that there is no guidance for courts as to the appropriate duration of time that the bankrupt must experience financial difficulty going into the future. It is, therefore, dependent upon the facts of each particular case.

In *Re Kelly*, Registrar Sproat found that because the bankrupt had been steadily employed on a full-time basis for approximately three years, had been making RRSP contributions, could demonstrate some excess income over her stated expenses, had enjoyed tax refunds of over $1,000.00 yearly, and had received bonuses from her employer each year, she had not

experienced financial difficulty to such an extent that she was unable to pay her student loans. The application was dismissed.

The factors to be considered in determining whether an applicant has acted in good faith in connection with his or her student loans, as expressed in *Re Minto* and *Re Kelly*, were applied in *Re Fines* (2005), 17 C.B.R. (5th) 155, [2005] O.J. No. 4463 (S.C.J., Registrar Nettie) and *Re Power* (2006), 18 C.B.R. (5th) 265, [2006] O.J. No. 8 (S.C.J., Registrar Nettie). In *Re Power*, Registrar Nettie dismissed the application based on an inference that the applicant had made her assignment in bankruptcy purely to avoid paying her student loan debts and at the time of the application, the applicant had excess income and, therefore, the ability to contribute to her debt.

In *Re Fines*, a discharged bankrupt applied for an order that section 178 of the BIA did not apply to his student loan. The bankrupt had mental and physical disabilities and was unemployable. He had survived on social assistance since leaving school. He had not completed his educational program and had gained no financial benefit from the loan.

The Court found that while the bankrupt made an assignment as soon as he could wipe out the student loans, given the circumstances, any sanctions against the bankrupt would be purely academic.

In *Re Westwood*, 2005 BCSC 1575, 16 C.B.R. (5th) 306, a discharged bankrupt applied for an order that section 178 did not apply to her student loan. The student loan was approximately $2,500. The bankrupt ceased being a student nine years and eleven months prior to her assignment. She did not complete her educational program due to her husband's illness and had gained no financial benefit from the loan. The Court allowed the application, finding that she had no practical means to repay the debt and would continue to suffer financially if the loan was not discharged.

The relevant factors for determining whether a bankrupt had exercised good faith with respect to his student loans were expressed somewhat differently in *Re Cook* (2006), 20 C.B.R. (5^{th}) 192, [2006] O.J. No. 493 (S.C.J., Platana J.). Platana J. followed factors outlined in the decision of *Re Lee*, [2003] O.J. No. 5325 (S.C.J., Power J.), as follows:

a. Whether the borrower obtained the loan pursuant to misrepresentations;

b. Whether the loan proceeds were used for a purpose other than the intended one;

c. Whether the applicant misrepresented, or withheld, relevant information to or from the Court;

d. Whether the applicant has given a preference to the payment of other liabilities over the student loan liabilities;

e. What efforts, if any, the applicant has made to repay the loan. This includes consideration of various financing options and whether the applicant availed herself of any Interest Relief Programs available through the Student Loans Program;

f. Whether the applicant made any effort to avoid repayment when it was possible to pay; and

g. Whether there has been any unreasonable denial of liability.

With respect to the test for whether the applicant would continue to experience financial difficulty, the Court followed the decision in *Re Kelly*, *supra*, and referred to *Re Swann*, 2001 BCSC 1175, 92 B.C.L.R. (3d) 130 (Master McCallum), in which the nature of the applicant's skills, the likely demand for those skills and the probability of the applicant being able to apply her education to earn an income sufficient to allow repayment, were noted to be relevant factors in this test.

Platana J. dismissed the application, finding that the bankrupt had acted in good faith in attempting to pay off his student loan debt prior to making an assignment in bankruptcy, but had not satisfied the Court that he would suffer financial difficulty in the future if the student loan was not discharged. The bankrupt had been promoted in his job, had acquired assets and leased a new car since his discharge.

Consumer Proposals and Section 178(1.1)

Where *Re Minto, supra* confirmed that both discharged and undischarged bankrupts could make an application pursuant to section 178(1.1), the case of *Canada (Attorney General) v. Snopko* (2004), 48 C.B.R. (4th) 41, [2004] O.J. No. 562 (S.C.J., Sills J.) considered whether a person who had not made an assignment in bankruptcy could make such an application. This case involved an individual who filed a consumer proposal, rather than making an assignment in bankruptcy. The Court determined that section 178(1)(g) "has no application to an insolvent consumer debtor who makes a consumer proposal, and applies only to a 'bankrupt'".

Further, Section 66.28(2) of the *Act* provides that having a consumer proposal accepted by the creditors is binding in respect of all unsecured claims, but that it does not release the consumer debtor from the debts and liabilities referred to in section 178 unless the creditor has agreed. In *Snopko*, the Attorney General had objected to the proposal and, therefore, was at liberty to pursue the consumer debtor for the balance owing to it upon the successful completion of the proposal and discharge of the administrator. Accordingly, the Court held that the consumer debtor does not have available the remedy under section 178(1.1) unless he or she first makes an assignment in bankruptcy.

In *Re Cardwell,* 2006 SKQB 164, 20 C.B.R. (5th) 175 (Registrar Herauf), two debtors made Consumer Proposals, and each had outstanding student loans. The student loan creditors consented to the Proposals by voting for their acceptance. Both applicants completed their proposals and received Certificates of Completion. However, one of the student loan creditors that had consented to the proposals recommenced pursuing the debtors for payment. Both debtors then applied for declarations that the debts of their student loan creditors were discharged by section 66.28(2) of the *Act*. Following the decision of Master Bolton in *Re Slaney*, 2004 BCSC 388, 4 C.B.R. (5th) 95, Registrar Herauf held that creditors of student loan debts must not only assent to the Proposal, but also to the release of the debt upon completion of the Proposal for section 66.82(2) to apply.

Further, one of the debtors applied pursuant to section 178(1.1) for his student loan debts to be discharged, arguing that the decision in *Canada v. Snopko, supra,* was wrongly decided. Registrar Herauf agreed with this submission, holding as follows:

> The parties argue that it is clear subsections 62(2) and 66.28(2) of the *Act* contain specific references to subsection 178(1) and therefore, that section applies to Proposals and Consumer Proposals as well as bankruptcies. Student loan debts were included in subsection 178(1) only on the understanding that relief against such debts would eventually be available in cases of hardship. It was expected that if student loan debts were not released upon a discharge from bankruptcy, debtors with student loans would be encouraged to make Consumer Proposals, thus paying a portion of their debts, rather than going into bankruptcy. In these circumstances, there is no reason that subsection 178(1.1) should not apply to Proposals and Consumer Proposals as well as bankruptcies. To hold otherwise, would be to deny any recourse to persons who have made an effort to pay their debts in good faith. They would be in a worse position than persons who went into bankruptcy. Their only options in cases of hardship would be to make another Consumer Proposal or Proposal, go into bankruptcy or make a Proposal for the Orderly Payment of Debts. Subsection 178(1.1) should simply be interpreted to include debtors who have made Proposals or Consumer Proposals under Division I or II of the *Act*.

Having determined that section 178(1.1) applied to consumer debtors, the Court denied the application because the applicant had made no effort to make any payments on his student loan debts until he was compelled do to so, he did not take advantage of interest relief programs and he was gainfully employed in the area for which he had obtained a student loan funded education.

CONCLUSION

From the review of these cases, it is clear that the concern remains that students may use the bankruptcy system to avoid paying student loans that helped them accrue an enduring asset, unless appropriate limits are imposed. Yet, courts also seem willing to acknowledge that student loans have the potential to create a unique set of problems for those who are unable to utilize their education to provide an income to repay these loans. Prior to 1997, student loans were discharged on bankruptcy, and Registrars across the country were capable of discerning whether an individual was abusing the system, taking into account the factors from *Re Van Steenes*. The imposition of a two-year and, shortly after, a ten-year waiting period before student loan debts

can be discharged simply removes any discretion that a Registrar may have had to forgive debts of those who are truly “honest but unfortunate debtors”.

Bill C-55 has changed the waiting period for a third time, so that section 178(1)(g)(ii) provides that student loan debt is eligible for discharge in bankruptcy after seven years of ceasing to be a student, and so that an application under section 178(1.1) to expunge a student loan debt can be brought five years after ceasing to be a student, rather than ten years.

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