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## DEBTS, DIVORCE, AND STUDENT LOANS

Case Update on Division of Student Loans and Claims for Equitable Reimbursement

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Increasingly, family lawyers are encountering property division cases involving the equitable distribution of student loans or claims seeking equitable reimbursement for funds spent on higher education during the marriage.

The statistics regarding tuition increases are staggering. According to the College Board's most recent annual survey on trends in college pricing ([www.collegeboard.com](http://www.collegeboard.com)), for private colleges, the average cost of a 4-year program, including room and board, is \$78,840. The average figure for in-state public universities is \$18,776.

Young couples who borrow money for school after they are married are finding it difficult to save for future goals, such as retirement, due to the debt service on their student loans. However, because interest rates on federal student loans are relatively low, married couples may have more flexibility in managing this debt service, even allocating their disposable income toward other payments, such as high-interest credit card debt.

Over the past 18 months, courts in Kentucky, Nebraska, Wisconsin and Tennessee have decided cases involving the equitable distribution of student loans as part of an overall property division. The cases involve marriages of various durations. A major factor in the adjudication of these disputes is whether the enhanced education of the student-spouse inures solely to his or her benefit. Another is whether the degree earned substantially contributes to the student-spouse's earning capacity.

## Case Review

In *Thompson v. Thompson*, 2003 WL 21713987 (July 25, 2003), the Kentucky Court of Appeals reviewed a case where the husband argued that it was error to assign him 100% of the student loan debt. In affirming the lower court's decision, the court cited appellate case law, holding that loans obtained to get an educational degree are considered non-marital debts. Because the husband reaped the benefit of the education, he was responsible for bearing the repayment of the student debt incurred in obtaining his degree. The husband argued unsuccessfully that the student loans facilitated the acquisition of marital property and further argued that incurring this debt was necessary for the support and maintenance of the family. Based on the imputed earning capacity to the husband of \$43,000 a year (compared with that of the wife at almost \$11,000 a year), the lower court reasoned that the husband was also in a better financial position to assume 100% of the obligation to repay the student loans.

In *Schmid v. Schmid*, 2003 WL 21397862 (June 17, 2003), the Nebraska Court of Appeals confronted a different fact pattern. Unlike *Thompson*, where the parties had been married for less than 6 years, the couple in *Schmid* had been married for 26 years at the time of trial. The wife took out student loans over a 4-year period as she worked toward completing her bachelor's degree. She testified that when she decided to get a degree in education, it was because she thought that teaching was her special calling and that she felt it would financially benefit the family. Because the student loans were incurred prior to separation -- and because they were incurred for the joint benefit of the parties -- the lower court classified the debt as marital, and directed each party to pay one-half of the outstanding loans. The appellate court affirmed this ruling, deeming it to be fair and reasonable based on the facts. Because each party was awarded approximately 50% of the marital assets, the court held that it was reasonable for the trial court to divide the student loans using the same percentage.

In *McLaren v. McLaren*, 665 N.W.2d 405 (Wis. Ct. App. May 14, 2003), the Wisconsin Court of Appeals reviewed a case involving a 10-year marriage where the wife's student loans totaled approximately \$26,000. The husband argued that the bulk of the wife's student loans were premarital and that he received no benefit from them, and that because he derived no benefit from the wife's education, the lower court erred by including all of the student loans in the marital estate and by failing to order the wife to be solely responsible for their repayment.

The lower court had found that the couple did not distinguish the premarital student loans from the marital. Holding that the premarital student loans were transmuted into the marital student loans, the lower court included the entire student loan obligation in the marital estate and ordered the husband to pay a separate marital consolidation loan to equalize the wife's payment of her student loans. On appeal, the court affirmed the lower court's finding that the couple made certain decisions during the marriage that resulted in the student loans not being paid down, and that it was equitable under the circumstances to assign the husband non-student loan debt to equalize the wife's payment of the transmuted student loans incurred both before and during the marriage.

In *Varner v. Varner*, 2002 WL 3118327 (September 25, 2002), the Tennessee Court of Appeals confronted a very short-term marriage of less than 2 years. In that case, both the husband and wife had substantial student loans, and each was ordered to pay his or her own student debt. The wife was responsible for paying back her student loans in excess of \$11,000, while the husband was assigned responsibility for the student loans he incurred in excess of \$16,000. On appeal, the court affirmed this division of marital debt under an abuse of discretion standard.

In a recent case out of California on the issue of equitable reimbursement, the California Court of Appeals, Fourth District, reviewed a lower court's decision denying a wife's requested reimbursement to the community for funds spent on the husband's legal education. In *Graham v. Graham*, 109 Cal. App. 4th 1321, 135 Cal. Rptr.2d 685 (May 21, 2003), the parties married in 1992. During the marriage, the husband enrolled in law school, and the couple spent over \$12,000 for tuition and related expenses. The husband also took out a student loan to aid in the payment of these law school expenses, but at the time of the trial, he accepted sole responsibility for the repayment of these loans as non-marital debts.

At the time the divorce action was filed, the couple had been married for approximately 7 years. When the case was tried, the husband had one remaining semester in law school, but did not plan on taking the California bar exam. His GPA was a mediocre 2.2. While in law school, the husband worked as a police officer, earning approximately \$4400 a month. The wife argued for reimbursement of the money spent on the husband's law school tuition and related expenses during the marriage. She argued that the husband would have a substantially

enhanced earning capacity as a result of his higher education. In rejecting the wife's claim, the lower court found that the husband did not necessarily have any plans to become a lawyer. He went to law school to make up for a less-than-stellar collegiate career, not necessarily for the purpose of financial gain. The husband argued that his earning potential might well be greater if he remained on the police force, rather than pursuing a legal career.

The lower court reasoned as follows: "It's too speculative ... to try to figure out whether [the husband] is going to make more money in the future, and he may or he may not. He may or may not pass the bar. He may or may not do anything with the law degree. He may decide that he wants to stay in the police department and go for a higher position ... He might find that what he can make there looks pretty good compared with trying to scratch out a living in the legal field. A law degree is not a ticket to prosperity. Some people are very good at it and make money, and other people become disillusioned and they don't make any money. So, ... it's all on the outcome. It may happen, it may not ..."

On appeal, the court affirmed, agreeing with the lower court's conclusion that the wife did not meet her burden of proving that the husband's law degree would result in a substantial enhancement of his earning capacity as a matter of law.

#### How It Affects Your Practice

From a practice standpoint, family lawyers facing equitable reimbursement claims must determine whether the education or training for which reimbursement is sought substantially enhances the student-spouse's earning capacity. In a weak legal economy -- with law school graduates finding it more and more difficult to secure jobs in both the private and public sectors upon graduation -- the wife in Graham could not prove that her husband's earning capacity would be substantially enhanced. Would the husband's law degree help him advance through the ranks of the police department, thereby resulting in an increase of his salary? Perhaps a vocational expert might have assisted the wife in making this claim. However, the expense of retaining such an expert must be weighed as part of an overall case-management strategy.

Was the husband in Graham left with a residual financial advantage because of his newly earned law degree? The lower court didn't think so, but the timing of the filing of the divorce action lends some sympathy to the wife's position. The husband filed for divorce in June 1999, and at the time of the trial -- some 15 months after the action was commenced -- the husband needed to complete only one semester to earn his degree. Graham was not a case where the parties remained married many years after the student-spouse completed his or her degree, where an assessment might have been made to see if both parties enjoyed the benefits of the student-spouse's enhanced earning capacity.

#### Conclusion

Although there are more and more cases involving student loans as marital debt, the outcome of a claim for reimbursement is not clear, and such a claim is not an easy one on which to prevail.

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