STUDENT LOAN DEBT – CAN ANYONE FIX THE PROBLEM?

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It is undeniable that student loan debt has increasingly become one of the most significant impediments to Americans struggling to make ends meet. Student loan debt in the U.S. has reached an estimated $1.75 trillion for more than 46 million borrowers - about 1 out of every 7 Americans. Approximately $1.62 trillion of that debt is tied to federal student loans, while $131 billion is made up of private student loans.[1] Student loan debt now overwhelmingly exceeds credit card ($89 billion) and auto loan debt ($1.5 trillion).[2]

There are many factors to point to the skyrocketing increase in student loan debt over the last ten years. Some argue that the colleges and universities are at fault for increasing tuition rates, while others would say the government is at fault for not providing more subsidies for education. The high cost of a college education combined with college graduates' inability to obtain employment with wages and salaries sufficient to meet their household and student loan obligations has caused an enormous default rate in student loans.

THE EVOLUTION OF SECTION 523(A)(8)

Over the last 45 years, the Bankruptcy Code has gone through a number of changes that have affected the dischargeability of student loans. Prior to 1976, student loans were no different than any other unsecured debt and were routinely discharged in bankruptcy proceedings. Due in part to concerns that student loan borrowers were abusing the bankruptcy process by discharging student loans, in 1976, Congress enacted the Education Amendments of 1976. The Amendment added Section 439A to the Higher Education Act of 1976 which permitted discharge under the Bankruptcy Act of an educational loan if the beginning of the repayment period, excluding any deferments, was more than five years before the date of discharge or sooner if the court determined that payment from future income or other wealth would cause an under hardship on the debtor or the debtor's dependents.

Section 439A was adopted in part in the Bankruptcy Reform Act of 1978 as Bankruptcy Code Section 523(a)(8). The Section made the discharge applicable to debts due to governmental units or nonprofit institutions of higher education for educational loans. Also, the scope of undue hardship was narrowed to imposing an undue hardship on the debtor ***and*** the debtor's dependents as opposed to the debtor ***or*** the debtor's dependents. Two other changes included a superdischarge of student loan debt provided for in a Chapter 13 plan and changing calculation of the five year period to the date the loan first became due, without regard to any tolling events.

In 1984, legislation was passed to drop "of higher education" from the Code, thus expanding the scope of dischargeability to private loans backed by the government and nonprofit institutions.

In 1990, Congress enlarged the five-year period in Section 523(a)(8) to seven-years and student loans were removed from the Chapter 13 superdischarge.

Equally effecting student loans, in 1991, the Higher Education Technical Amendments eliminated the six-year statute of limitations on collection of defaulted student loan debt.

The biggest blow to dischargeability of student loan debt came in 1998 with the elimination of the seven-year period and subjecting the discharge of student loans solely to a determination of undue hardship.

As a result of amendments to Section 523(a)(8) under the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), essentially all student loans, including private loans, became nondischargeable, barring a determination of undue hardship.

HOW THE COURTS HAVE INTERPRETED AND APPLIED UNDUE HARDSHIP

Section 523(a)(8) now currently provides that a discharge does not discharge an individual debtor from any debt –

> unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for--
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> **(A)(i)** an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or
>
> > **(ii)** an obligation to repay funds received as an educational benefit, scholarship, or stipend; or
>
> **(B)** any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;

Most bankruptcy courts around the country utilize the Brunner test to determine undue hardship, set forth in *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987). In fact, every circuit but two has adopted the Brunner test, which provides that in order to establish "undue hardship", a debtor must show:

1. That the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans;

2. That additional circumstances exist indicating that this state of affairs is likely to persist for a

1 https://www.nerdwallet.com/article/loans/student-loans/student-loan-debt https://www.forbes.com/advisor/student-loans/average-student-loan-statistics/ https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/24/fact-sheet-president-biden-announces-student-loan-relief-for-borrowers-who-need-it-most/

2 As of 2nd Quarter 2022. https://www.newyorkfed.org/newsevents/news/research/2022/20220802

significant portion of the repayment period of the student loans; and

3. That the debtor has made good faith efforts to repay the loans.

The *Brunner* test has been widely criticized by debtors as being overly strict and unfair. At the time it was decided, the original language of Section 523(a)(8) was in effect, meaning that student loans that were more than five years into the repayment period could still be discharged. Although the temporal-based discharge of student loans was removed in 1998, the Brunner test remained (and still remains) the majority test for undue hardship. The *Brunner* test has also been criticized as being too vague. For example, what is a "minimal" standard of living? What does "significant portion" mean exactly? What is the applicable "repayment period"? What does a "good faith effort" mean?

Some courts have ruled that a "minimal" standard of living lies somewhere between poverty and mere difficulty, and requires more than a showing of tight finances. *See In re Acosta-Conniff*, 632 B.R. 322, 340 (Bankr. M.D. Ala. 2021). However, there is no uniform definition of a "minimal" standard of living among the Circuits.

In addition, with the advent of income-based repayment plans, which can stretch from 20 to 25 years with the possibility of a zero monthly payment, the U.S. Department of Education has argued that the availability of these plans and subsequent forgiveness of the remaining balance results in a debtor being unable to satisfy the second prong of the *Brunner* test. Although courts have begun to reject this argument, the *Brunner* test remains arduous.

DISCHARGEABILITY OF PRIVATE STUDENT LOANS

There has also been evolving case law regarding whether a private student loan falls under the classification set forth in Section 523(a)(8). In particular, for a private student loan to be "qualified" under Section 523(a)(8)(B), the student must attend an eligible educational institution and the loan must fund only "qualified higher education expenses", as that term is defined in the Internal Revenue Code. Those expenses are generally the cost of attendance, reduced by certain deductions. Students who utilize their student loans to pay for items other than tuition, such as housing and other expenses, have challenged the assertion that their loans fall under Section 523(a)(8)(B).

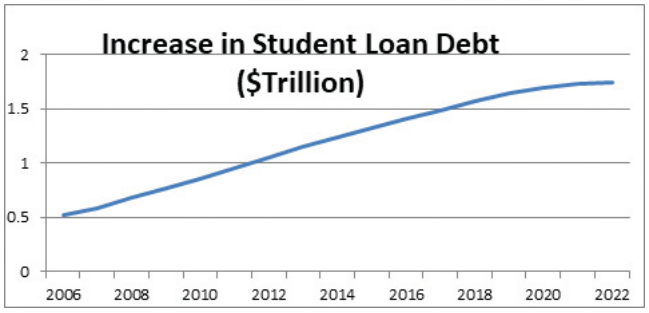
Essentially, if a private student loan is not a "qualified education loan", then lenders look to Section 523(a)(8)(A)(ii) to assert that the loan is non-dischargeable. However, the issue there is that the word "loan" does not appear in Section 523(a)(8)(A)(ii). Courts have increasingly held that a private student loan is not "an obligation to repay funds received as an educational benefit, scholarship, or stipend."

One case of note is *Homaidan v. Sallie Mae, Inc.*, 3 F.4th 595 (2nd Cir. 2021). In that case, the debtor obtained a student loan directly, and the proceeds went straight to the debtor's bank account, and the loan proceeds exceeded the cost of tuition. Therefore, the loan was not a qualified education loan, and further was not made, insured or guaranteed by a governmental unit. The court ruled that Section 523(a)(8)(A)(ii) covers scholarships, stipends and conditional education grants, and not "loans" such as the one at issue.

While not a panacea for all private student loan borrowers, these cases provide an opportunity to those borrowers whose loans exceed the cost of tuition to assert that they are outside the gambit of Section 523(a)(8) and therefore dischargeable.

LEGISLATIVE ATTEMPTS TO COMBAT EVER INCREASING STUDENT LOAN DEBT

As illustrated in the below chart, since the passage of BAPCPA in 2005, student loan debt has more than tripled from $500 billion in 2006 to over $1.75 trillion in 2022. Although legislators have proposed a number of bills seeking to remedy the ever increasing student loan debt, no bankruptcy related laws have come close to passing.



Source: Data Download: Consumer Credit Outstanding - All, The Federal Reserve.

To some extent, as discussed above, expansion and contraction of the nebulous application of "undue hardship" has been solely limited to case law. Unfortunately, there seems to be little consistency in applying the standard among the bankruptcy courts and courts of appeal, mostly because each decision is based on a case by case analysis of somewhat unique facts. There is a great need to create a more bright line definition of undue hardship. The following is a chronological survey of some more recent examples of failed legislative attempts to return dischargeability of student loan debt to a more accessible tool.

In each of the last seven Congresses (111th – 117th), Rep. Steven Cohen (D-TN) has introduced the Private Student Loan Bankruptcy Fairness Act.[3] The bill

3 H.R.5043 introduced 4/15/2010; H.R.2028 introduced 5/26/2011; H.R.532 introduced 2/6/2013; H.R.1674 introduced 3/26/15; H.R.2527 introduced 5/18/2017; H.R.885 introduced 1/30/2019; H.R.4907 introduced 8/3/2021. The Higher Ed Act, introduced 9/28/2016.

amends Section 523(a)(8) to allow the discharge of all private education loans regardless of whether any undue hardship has been demonstrated. Although each introduction of the bill has been supported by up to 46 cosponsors, the bill has never made it out of committee.

In a much more sweeping approach, Rep. John Delaney (D-MD) introduced H.R.449 (1/21/2015) (the Discharge Student Loan in Bankruptcy Act of 2015). The bill completely deletes Section 523(a)(8), making all student loans freely dischargeable, without any limitation. The language of the bill was duplicated in H.R.6239[4] and in H.R.3451[5] . Rep. Delaney reintroduced the bill on May 4, 2017 (H.R.2366) and Glenn Grothman (R-WI) introduced identical bills in 2020 and 2021[6]. None of these bills, however, have received any traction.

In 2019, Sen. Elizabeth Warren introduced the Student Loan Debt Relief Act of 2019 (S.2235). Along with striking Section 523(a)(8) in its entirety, the bill also included a comprehensive program establishing limitations on collection of defaulted student loans; forbearance; refinancing; and up to $50,000.00 of forgiveness of student loans. Although this bill never made it to committee, Senators Warren, Chuck Schumer and others have continued to fight for the $50,000.00 forgiveness.

In December of 2020, both the Senate and the House introduced the companion Consumer Bankruptcy Reform Act of 2020.[7] The bill was a complete overhaul of Chapter 7 and created a new Chapter 10. With respect to student loans, the Act recites findings that:

> (6) student loan debt burdens are creating distortions in the labor and housing market;
>
> (7) the nondischargeability of private student loan debt has not resulted in lower financing costs for student loan borrowers.[8]

One of the purposes identified in the Act is "allowing the discharge of student loan debt on equal terms with most other types of debt".[9] In doing so, the Act eliminates in its entirety Section 523(a)(8). The Act was introduced in the midst of the COVID-19 pandemic and at the end of the 116th Congress, and partially as a result, did not get much attention. There have been some rumors that the bill will be reintroduced in the 117th Congress, but so far, it has not.

There appear to be at least two recurring themes in all of the aforementioned legislation – a desire to eliminate any exception to dischargeability of student loans, or at the very least to allow discharge of private student loans. Notwithstanding the persistent attempts, neither solution has received sufficient support in Congress.

In an effort to turn the clock back on dischargeability of student loans, on August 4, 2021, Senators Durbin and Cornyn introduced S.2598, the "Fostering Responsible Education Starts with Helping Students Through Accountability, Relief, and Taxpayer Protection Through Bankruptcy Act of 2021" which is more commonly known by the clever acronym of the "FRESH START Through Bankruptcy Act". Although the bill maintains, but does not seek to further define the undue hardship exception, it amends Section 523(a)(8) to include dischargeability of federal student loan debt where the first loan payment was due ten years prior to the filing of a borrower's bankruptcy case. It also provides that institutions of higher education where at least one-third of their students receive federal student loans must repay to the Department of Education a percentage[10] of the discharged student loan. This bill has no additional sponsors and has not made it to any committee.

PRESIDENTIAL USE OF EXECUTIVE POWERS TO PROVIDE STUDENT LOAN DEBT RELIEF

During the pandemic, the President, through either his Executive Powers or the Department of Education, has attempted to relieve the pressure on student borrowers by forbearing interest and any payments on student loans, which relief has now been extended through the end of 2022. One of President Biden's platform issues was to provide a forgiveness of student loans. There has been an extended debate on the amount of forgiveness. Over the last two years, the President has approved the forgiveness of student loan debt in varying amounts to specific groups of student loan borrowers, however, until just recently, no global relief had been offered.

On August 24, 2022, President Biden announced a three-part plan to provide student loan debt relief. As part of this plan, borrowers whose annual income is less than $125,000 are eligible to have up to $20,000 of debt cancellation for Pell Grant recipients with loans held by the U.S. Department of Education, and up to $10,000 of debt cancelation for non-Pell Grant recipients. In addition, the pause on federal student loan repayment will be extended one final time, through December 31, 2022.

In addition, the U.S. Department of Education is also working with the Justice Department in revising its bankruptcy policy regarding federal student loans.

THE CLLA PROPOSES A COMPROMISE

Whether by executive or legislative action, more clarity is needed regarding the appropriate standard to

4 The Higher Ed Act, introduced 9/28/2016.

5 Student Loan Bankruptcy Parity Act of 2015, introduced 9/8/2015.

6 H.R.5899, introduced 2/13/2020 and H.R.4563, introduced 7/20/2021.

7 H.R.8902 by Rep. Jerry Nadler and S.4991 by Senators Warren, Durbin and Whitehouse.

8 S.4991, Sec. 101(a)(6) and (7).

9 S.4991. Sec. 101(b)(8).

10 The repayment percentage will be either 50%, 30% or 20% of the amount of the loan discharged in bankruptcy as determined by a formula taking into consideration the three-year average cohort default rate of the institution from the time the loan was first due.

establish undue hardship and more flexibility is needed regarding the overall discharge of student loans. The Commercial Law League of America (CLLA) is a 127 year old organization whose members include creditors' rights and bankruptcy attorneys. Although the goals, objectives and legal positions of CLLA members may differ from time to time, the League has always promoted and supported the fair, equitable, and efficient administration of collection and bankruptcy laws for all parties-in-interest.

In 2019, recognizing a need to address the ever-inflating student loan bubble, the CLLA empowered a committee to study and formulate a more definitive and reasonable standard for dischargeability of student loans. The bankruptcy and collections professionals that were appointed to the committee reached agreement on the following proposed amendment to Section 523(a)(8) that have been adopted by the CLLA:

> A discharge does not discharge an individual debtor from any debt . . . unless excepting such debt from discharge under this paragraph would impose a substantial hardship on the debtor and the debtor's dependents, for—
>
> **(A)(i)** an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, incurred for the debtor's own education; or
>
> **(ii)** an obligation to repay funds received as an educational benefit, scholarship, or stipend, for the debtor's own education; or
>
> **(B)** any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual for the debtor's own education;
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> **(C)** for purposes of this subsection the term "substantial hardship" shall mean that (i) at least ten years has passed since the debt first became payable; and (ii) based on the debtor's current income and expenses, the debtor cannot maintain an adequate standard of living for the debtor and the debtor's dependents if required to pay such debts; and (iii) this state of affairs is likely to persist for at least five years. A substantial hardship shall be presumed if any one of the following conditions is present:
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> **(i)** the borrower:
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> **(a)** is receiving disability benefits under the Social Security Act,
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> **(b)** the borrower has either a 100% disability rating or has a determination of individual unemployability under the disability compensation program of the Department of Veterans Affairs,
>
> **(ii)** in the seven years before bankruptcy, the borrower's household income averaged less than 175% of the federal poverty guidelines, or
>
> **(iii)** at the time of bankruptcy, the borrower's household income is less than 200% of the federal poverty guidelines and
>
> **(a)** the borrower's only source of income is from Social Security benefits or a retirement fund; or
>
> **(b)** the borrower provides support for an elderly, chronically ill, or disabled household member or member of the borrower's immediate family.

In addition, and significantly, under the Sub-Committee's proposal, a Chapter 11, 12 or 13 discharge would discharge any student loan if the debtor has paid at least 10% of the outstanding principal owing as of the petition date under the plan.

Coincidentally, around the same time CLLA adopted its proposed changes to Section 523(a)(8), the American Bankruptcy Institute (ABI) Commission on Consumer Bankruptcy published its Final Report on proposed changes to the Bankruptcy Code. The ABI Report includes proposed changes to Section 523(a)(8) that are similar in many respects to those suggested by the CLLA.

The Sub-Committee's proposal provides a fair and balanced method of discharging student loans, compared to many of the other legislative and executive measures currently proposed. For example:

1. It relaxes the standard from an "undue" hardship to a "substantial" hardship.
2. It allows for a discharge to debtors who have guaranteed other individuals' student loans.
3. It provides for an objective and concrete method for determining "substantial" hardship, while allowing a debtor to overcome the burden of establishing these objective standards if circumstances are warranted.
4. It includes a temporal requirement as part of the presumption of substantial hardship.
5. It allows for a discharge of student loans in Chapter 11, 12 or 13 cases if the debtor commits to paying 10% of the outstanding principal owing on the loan.

While other proposals focus on either eliminating Section 523(a)(8) altogether or limiting dischargeability to only private loans, the CLLA's proposal was reached through a compromise between its Bankruptcy and Creditors' Rights Sections and achieves the CLLA's key mission of fairness and equality. We believe that the CLLA proposal is a balanced, reasonable and definitive approach to addressing the student loan dilemma and one that should strongly be considered by Congress. ■