Written Testimony of John Rao

Attorney,
National Consumer Law Center

Before the House Judiciary Subcommittee on Antitrust, Commercial, and Administrative Law

Oversight of Bankruptcy Law and Legislative Proposals

June 19, 2019

Chairman Cicilline, Ranking Member Sensenbrenner, and members of the Subcommittee:

Thank you for holding this hearing on the Oversight of Bankruptcy Law and Legislative Proposals and for inviting me to testify today. I testify here today on behalf of the low-income clients of the National Consumer Law Center (NCLC).[1] A broad range of families and households are affected by consumer bankruptcy legislation, and in particular by the proposed bills that would make student loans dischargeable in bankruptcy.

In my work as an attorney at NCLC, I provide training and technical assistance to attorneys across the country who represent consumers in bankruptcy cases. I am the author and

[1] The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of twenty-one practice treatises and annual supplements on consumer credit laws, including *Consumer Bankruptcy Law and Practice* (11th ed. 2016). NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws.

editor of various publications on bankruptcy. I often speak at educational programs for bankruptcy attorneys, trustees, and judges, and I have served as a member of the federal Judicial Conference Advisory Committee on Bankruptcy Rules. My testimony is based on this work and my experience representing consumers in debt collection, bankruptcy and foreclosure defense matters.

The gravity of the student loan debt problem cannot be overstated. Americans now owe more in student loan debt than they do for auto loans, credit cards, or any other non-mortgage debt.[2] Student loan debt has become a key factor for many people who are considering when or whether to start small businesses, buy homes, or start families.[3] Student loan debt is a factor not only for people who are entering the workforce for the first time, but also for those who are seeking to enter retirement.[4]

For the many reasons stated below, we support passage of the Student Borrower Bankruptcy Relief Act, H.R. 2648 (and its companion bill, S. 1414).

Current bankruptcy policy on student loans was based on false assumptions.

We have long encouraged individuals of all ages to pursue higher education as a path to success. They are told that incurring student loan debt will give them a better chance at achieving their goals. Similarly we encourage individuals to start businesses and to take chances in other entrepreneurial endeavors. In both cases we know that some individuals will fail. However, our bankruptcy laws treat student borrowers much more harshly – the business

---

[2] Fed. Reserve Bank of N.Y., Household Debt and Credit Report: Q1 2019 (May 2019).
[3] William Elliott & IlSung Nam, Is Student Debt Jeopardizing the Short-Term Financial Health of U.S. Households?, Federal Reserve Bank of St. Louis Review, Sept./Oct. 2013. Vol. 95, Issue 5 at 405-24; *see also* Springer, Is Student Debt Keeping Americans Away from Marriage? Research Shows That Modern Couples Are Choosing to Cohabit and Pay Off Debts Before Marriage." ScienceDaily (Sept. 26, 2018).
[4] Lori A. Trawinski, Susanna Montezemolo & Alicia Williams, The Student Loan Debt Threat: An Intergenerational Problem, AARP Public Policy Institute (May 2019).

entrepreneur is given an opportunity for a fresh start while the student borrower is given no margin of error and is effectively denied the right to a bankruptcy discharge. In fact our bankruptcy laws currently treat student loan borrowers in the same manner as individuals who fail to pay child support and criminal fines, and those who incur debts by fraud or maliciously injur others.

This harsh treatment of student borrowers in financial distress in the bankruptcy system was not the result of careful analysis and thoughtful policy debate. Instead it was based on the false premise that student borrowers were more likely to abuse the bankruptcy system, even compared to other consumers with debts owed to the government. No evidence to support this premise existed when the law was first changed to limit student loan dischargeabilty or at the time of subsequent amendments.

Student loans were initially dischargeable like other unsecured debt, as no provision of the Bankruptcy Act or the Higher Education Act prohibited the discharge of student loans. In 1976, an amendment to limit student loan dischargeabilty was considered in connection with the Higher Education Act. While the House Judiciary committee initially raised a jurisdictional objection, the bankruptcy amendment passed subject to a delay in its effective date and a joint request from the chairs of the relevant Judiciary and Education subcommittees for a Government Accountability Office (GAO) study on the subject. The amendment provided that loans insured or guaranteed under the Higher Education Act were dischargeable in bankruptcy only after the loan had been subject to repayment for a period of five years or if the bankruptcy court determined that "payment from future income or other wealth will impose an undue hardship on the debtor or his dependents."[5]

[5] Education Amendments of 1976, Pub.L. No. 94–482, § 439A(a), 90 Stat. 2081, 2141 (codified at 20 U.S.C. § 1087–3 (1976) (repealed 1978)).

Reviewing data from the period when student loans were dischargeable without limitation, the GAO concluded that most consumers did not elect to discharge student loans in bankruptcy. The GAO study found that only a fraction of one percent of all matured student loans had been discharged in bankruptcy. A House Report summarized the GAO's findings:

> First, the general default rate on educational loans is approximately 18%. Of that 18%, approximately 3-4% of the amounts involved are discharged in bankruptcy cases. Thus, approximately ½ to ¾ of 1% of all matured educational loans are discharged in bankruptcy. This compares favorably with the consumer finance industry.[6]

The GAO study also found that debtors who discharged student loans in bankruptcy had other significant indebtedness, suggesting that the filings of some debtors were based on other financial problems and not motivated by an attempt to discharge student loans.

This evidence led to an effort to repeal the Higher Education Act amendment as Congress considered adoption of the 1978 Bankruptcy Code. Don Edwards, Chairman of the House Subcommittee on Civil and Constitutional Rights, stated that any student loan exception to discharge "must be justified by the strongest showing of need and of sound policy."[7] Referring to the GAO study and other data, he concluded: "The need does not appear to be present here, nor does policy suggest that an exception is appropriate."[8]

William D. Ford, chairman of the Subcommittee on Postsecondary Education, wrote to the Judiciary Committee to express his strong support for repeal of the Higher Education Act nondischargeability amendment:

> I have seen no evidence which convinces me of the need for a remedy as discriminatory and as inappropriate as section 439a of the Higher Education Act. I do not believe that bankruptcies involving student loans are increasing at such a rate as to require a provision this drastic, nor am I convinced that young debtors are declaring bankruptcy for the main purpose of 'ripping off' the government by not paying back their student loans.[9]

---

[6] H.R. Rep. 95-595, 1st Sess. 1977, 1978, 1978 U.S.C.C.A.N. 5963, 6094, 1977 WL 9628.
[7] H.R. Rep. 95-595, 152, 1978 U.S.C.C.A.N. 5963, 6113.
[8] *Id*.
[9] H.Rep. 95-595, 160, 1978 U.S.C.C.A.N. 5963, 6121.

Even representatives of the banking industry supported the repeal. The Judiciary committee heard the following from Walter W. Vaughan, of the American Bankers Association and Consumer Bankers Association task forces on bankruptcy:

> While we recognize that the idea of a student receiving a valuable education and then irresponsibly refusing to repay the loans which made this education possible is reprehensible, we are nonetheless opposed to this exception. This section is contrary to the Bankruptcy Act policy of providing the bankrupt with a fresh start and we suspect that the damage done to the many 'poor but honest debtors' will far exceed any possible benefit. We are not persuaded that the 'hardship' exception will be that meaningful due to its vagueness. Secondly, this exception, in effect, gives the government agencies (which are the guarantors of many student loans) and educational institutions privileged treatment that is not warranted. If the social utility of what is exchanged for the debt is to be determinative of dischargeability then the question can be raised of whether it is proper to discharge medical bills, food bills, etc. This proposed change simply suggests that if sufficient political pressure can be generated, a special interest group can obtain special treatment under the bankruptcy law. We believe that this section runs counter to the general policy of limiting exceptions to discharge and grounds for objecting to discharge and should be eliminated.[10]

After consideration of the GAO study and other compelling evidence that student borrowers were not abusing the bankruptcy system and that student loan debt should not be treated differently, the House Judiciary committee voted in favor of the repeal and rejected an amendment that would have made educational loans nondischargeable. Despite all the evidence that the stories of abuse were perception rather than reality,[11] however, in 1978 Congress ultimately incorporated the general framework of the earlier Higher Education Act amendment, providing for discharge after a five year waiting period or upon proof of undue hardship, into the Bankruptcy Code. This limited exception to discharge may have been acceptable to some

---

[10] H.R. Rep. 95-595, 150, 1978 U.S.C.C.A.N. 5963, 6111.

[11] *Compare* Hearings on H.R. Rep. No. 95-595, 95th Cong. 159 (1977) (statement of Ronald J. Iverson, Executive Director, Vt. Student Assistance Corp. reporting on several cases where student loans comprised majority of debt discharged in bankruptcy), *with* Kurt Wiese, *Discharging Student Loans in Bankruptcy: The Bankruptcy Court Tests of 'Undue Hardship*,' 26 ARIZ. L. REV. 445, 449 (1984) (alleged student loan discharge problem was created by media).

members of Congress because it still permitted the unconditional discharge of student loans that had been in repayment for at least five years.

Subsequent amendments further eroded the discharge rights – in 1990 the waiting period for an unconditional discharge was extended from five to seven years.[12] Also in 1990 the undue hardship test and the seven-year waiting period were made applicable in Chapter 13 cases.[13] In 1998, Congress totally eliminated the waiting period option for dischargeability, leaving only discharge upon proof of undue hardship.[14] The final blow came in 2005 when most private student loans were made nondischargeable by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

These changes were again made without any evidence that the limited and quickly eroding discharge rights were being abused. No GAO studies were commissioned to update the earlier study to determine if debtors were discharging student loans in unusual amounts under the five- and seven-year periods or that educational debt discharged in bankruptcy was having any significant fiscal impact on the student loan program. The most drastic change, the total elimination of the right to an unconditional discharge after a waiting period, was not made in bankruptcy legislation originating in the House or Senate Judiciary committees but rather through the Higher Education Amendments of 1998. No mention of bankruptcy abuse or other problems with the bankruptcy discharge, or of any hearings conducted concerning the provision, is contained in the Conference Report for that legislation.[15]

---

[12] Federal Debt Collection Procedures Act of 1990, Pub.L. No. 101–647, § 3621(2), 104 Stat. 4933.
[13] Student Loan Default Prevention Initiative Act of 1990, Pub.L. No. 101–508, § 3007(b), 104 Stat. 1388–28.
[14] Higher Education Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1837 (1998).
[15] The Conference Report gives the following explanation for the change: "The conferees, in the effort to ensure the budget neutrality of this bill, adopted a provision eliminating the current bankruptcy discharge for student borrowers after they have been in repayment for seven years." *See* H. Rept. 105-750 (Conference Report for H.R. 6), p. 408, Sept. 25, 1998.

Bills introduced in this Congress give this Subcommittee the opportunity to reconsider these earlier decisions. While the availability of bankruptcy relief is not the sole solution to the current student loan debt crisis, there are many sound policy reasons why it should be restored as a safety net for those borrowers who have no ability to repay their student loans.

Concerns about abusive filings are less compelling now because of substantial changes to the Bankruptcy Code.

Opponents of bankruptcy relief will say that even if there was no earlier evidence of abuse by student borrowers, the amount of student loan debt is much higher now than it was in the 1970s and therefore many borrowers will seek bankruptcy relief if given the option rather than repay their loans. This falsely assumes that student borrowers are somehow different than other consumers and will abusively file bankruptcy rather than pursue repayment options.

The words of former Chairman James O'Hara of the post-secondary education subcommittee resonate today as they did in 1977. In response to news stories about isolated examples of abusive filings, he stated:

> … stories would have us believe that students (and the other bankrupts those stories almost never mention) can go through bankruptcy without a serious second thought; that it is an easy process by which they can painlessly transfer their obligations to the taxpayer. The fact is, of course, that bankruptcy is a serious step, that it involves the distribution of the bankrupt's assets and much of his income among his creditors, and that it is basically damaging to the credit and personal reputation of those forced to go through it. It can be entered into a last resort; it can, and sometimes is, entered into imprudently and without sufficient thought to its consequences, but it is not and has never been designed to be an 'easy way out' for the bankrupt. Bankruptcy, for most of those who enter into it, carries its own deleterious consequences.[16]

The concerns that Congress had in the 1970s about potential abuse, whether based on false perceptions or reality, are even less compelling now because of other substantial changes that have been made to the Bankruptcy Code. In 2005, Congress added a number of new

[16] H.R. REP. 95-595, 149-50, 1978 U.S.C.C.A.N. 5963, 6110-11.

provisions drastically impacting personal bankruptcy filings, such as a means test, enhanced document and filing requirements, exemption limitations, and counseling requirements. These changes have made it more difficult for all consumers to file bankruptcy, especially those who have assets and higher incomes to pay their debts.

To be eligible for bankruptcy relief, individuals and families must have monthly income that is less than the limited monthly living expenses allowable under the means test. Even Chapter 13 filers must abide by the strict expense guidelines established by Chapter 13 and IRS rules for the life of the plan, which is generally five years, with all income above these minimum provisions being dedicated to repaying debts. In addition, declaring bankruptcy creates an unwanted stigma and harms an individual's credit, making access to credit less available or more expensive. As a result, those who can afford to pay their student loans are very unlikely to take advantage of any change in law permitting discharge of student loans.

Consumers do not file bankruptcy if there are manageable ways for them to deal with their debt burden. Other consumers who face financial distress and would benefit from bankruptcy often do not file because of the cost of filing bankruptcy. These factors are best shown by considering the bankruptcy filing rates at the height of the Great Recession. A RAND study of American families during the Great Recession found that by April 2010, 39 percent of households had experienced financial distress.[17] However, less than 1.4 percent of the 116.7 million American households filed bankruptcy in 2010. There remained a steady decline in bankruptcy filings after 2010, despite the continuation of challenging economic times for a number of years.

---

[17] RAND Labor and Population, Effects of the Financial Crisis and Great Recession on American Households, Michael Hurd and Susann Rohwedder, Nov. 2010. The study measured financial distress by considering the following factors: if the respondent and/or spouse is unemployed, or if the household is more than two months behind on mortgage payments (or in foreclosure), or if the value of the house is less than the amount of the mortgage.

The media reports of well-paid doctors[18] and other professionals who sought bankruptcy relief soon after completing their education, which apparently motivated the original exception to discharge, simply cannot occur under our current bankruptcy law. If debtors with large amounts of educational loans, few other debts, and well-paying jobs were to file bankruptcy now, their bankruptcy cases will be dismissed without a discharge. Any issues related to the debtor's good faith in filing bankruptcy can be addressed by the bankruptcy court under Bankruptcy Code sections 707(b) or 1325(a)(7). Other options under the Code to punish bad debtors are also available. For example, a debtor who has fraudulently transferred property, concealed or falsified information, or made false oaths related to the bankruptcy case will be denied a discharge under Code section 727(a), and could be prosecuted for a federal crime.

In addition to Bankruptcy Code changes, the government has been provided extraordinary collection tools that did not exist when the 1978 nondischargeability provision was first enacted. In 1991, the Higher Education Act was amended to permit a borrower's wages to be garnished to collect defaulted student loans in an administrative proceeding, without obtaining a court judgment.[19] A Department of Treasury procedure also can be used to collect student loans through the offset of tax refunds.[20] The Debt Collection Improvement Act of 1996 expanded these collection efforts by permitting the offset of Social Security of other government benefits.[21] In 1991, the then-existing six-year statute of limitations for filing collection actions against borrowers, and all other limitation periods for student loan collection, were eliminated.[22]

---

[18] It should be noted that H.R. 2648 and S. 1414 do not amend or repeal 42 U.S.C. § 292f(g), so the current nondischargeability provisions for Health Education Assistance Loans (HEAL) would remain in effect.
[19] 20 U.S.C. § 1095a.
[20] 31 U.S.C. § 3720A.
[21] Pub. L. No. 104-134, 110 Stat. 1321 (1996); 31 U.S.C. § 3716.
[22] See Pub. L. No. 102-26, 105 Stat. 123 (Apr. 9, 1991), amending 20 U.S.C. § 1091a.

Collection lawsuits, tax intercepts, wage garnishments, and government benefit offsets may be done at any time. The only end point is that collection must cease when a borrower dies.[23]

The initial exception to discharge for student loans reflected a concern by Congress about the financial stability of loan programs when a bankruptcy discharge might be sought before the government had an opportunity to collect on the debt. The possibility of debtors avoiding collection during periods when they have an ability to repay their student loans, before seeking a bankruptcy discharge, is another factor not relevant today.

The availability of bankruptcy relief will encourage more responsible behavior by student loan servicers.

Nearly a quarter of the more than 43 million federal student loan borrowers are in distress on their loans.[24] Many of these borrowers could benefit from the Department of Education's income-driven repayment (IDR) options. However, borrowers too often are denied access to these programs because of serious problems in the student loan servicing industry. The four largest servicers of federal student loans have a documented history of "widespread servicing failures" that "create obstacles to repayment, raise costs, cause distress and "driv[e] borrowers to default."[25]

Financial incentives for servicers are not aligned with the best interests of student loan borrowers.[26] Compared with other options, enrolling borrowers into IDR plans is time-intensive and expensive for servicers. As a result, servicers fail to dedicate necessary resources in ensuring that borrowers understand and successfully access affordable and sustainable IDR

---

[23] 20 U.S.C. § 1091(a)(d).

[24] U.S. Dep't of Educ., Federal Student Aid, Data Center, Federal Student Loan Portfolio; *see also* Consumer Fin. Prot. Bureau, Student Loan Servicing: Analysis of Public Input and Recommendations for Reform (Sept. 2015).

[25] Consumer Fin. Prot. Bureau, CFPB Concerned About Widespread Servicing Failures Reported by Student Loan Borrowers (Sept. 29, 2015).

[26] U.S. Gov't Accountability Office, Federal Student Loans: Education Could Improve Direct Loan Program Customer Service and Oversight: Highlights, Report No. GAO-16-523 (May 16, 2016).

plans. Instead, servicers steer many borrowers into forbearances and deferments, which are costly to the borrower and profitable for the servicer because they are easier to administer. Some servicers have misrepresented that borrowers have no other repayment options.

An NCLC client had this experience as she struggled to afford her student loan payments after completing a medical assistant program at a for-profit school in Massachusetts.[27] For the first five years after she graduated from her program, she dutifully contacted her servicer and submitted documentation of her financial hardship. Nevertheless, despite clear eligibility for a zero dollar IDR payment, she was never enrolled in an IDR plan. When this borrower came to NCLC, she had never even heard of IDR options. Instead, each year when she called her servicer to discuss her financial situation and options, she was directed into a number of forbearances.

Though she remained in good standing on her loan during that time, she would have been better off in an IDR plan, getting credit toward eventual loan forgiveness. She will have to stay in repayment for five additional years because of the time wasted in forbearances. Further, because the interest that accrued on her loans during her forbearances was capitalized (meaning it was rolled into the principal balance of the loan and is now factored into future computations of interest), the loan balance has grown and will continue to increase a faster rate.

Servicer problems also have a significant negative impact on borrowers and the student loan program when borrowers file bankruptcy for reasons unrelated to their student loans. A Department of Education regulation places student loans in forbearance while they are in an active bankruptcy case. This prevents borrowers from staying on IDR plans and getting the benefit of payments towards loan forgiveness during their bankruptcy cases. Student loans are

[27] This client story was discussed by my colleague, Joanna K. Darcus, in her testimony to the House Subcommittee on Oversight and Investigations, Committee on Financial Services, regarding “An Examination of State Efforts to Oversee the $1.5 Trillion Student Loan Servicing Market” on June 11, 2019.

effectively "put on a shelf" during the case, even for the three to five years that a debtor may be in a Chapter 13 case. Even worse, borrowers can emerge from Chapter 13 further in debt because interest continues to accrue on their loans during the bankruptcy, and this interest is capitalized when the case concludes.

While the Department has not adopted a regulation or formal guidance permitting borrowers to stay on IDR plans during bankruptcy, it has approved an informal template that may be used by debtors to seek approval during the Chapter 13 plan confirmation process to stay on IDRs.[28] However, student loan servicers in some cases have resisted implementing the debtor's confirmed Chapter 13 plans or related bankruptcy court orders and continue to place borrowers in forbearance.[29]

The Department's policies on bankruptcy, capitalization of interest, and penalty collection fees have resulted in some consumers paying much more that the original amount of their loans and still owing substantial sums. For example, in *In re Martish*,[30] the consumer had a federal consolidation student loan in the amount of $11,202.95, with a 9% interest rate. This was her only student loan debt. In 1998, she filed a Chapter 7 case, which was later converted to a Chapter 13 case and concluded in 2001. Still unable to manage her growing student loan debt despite significant payments, the consumer filed a second Chapter 13 case in 2014. By the time this second case was filed, the consumer had made approximately $39,835 in payments on the student loan. The student loan holder, ECMC, filed a proof of claim in this case asserting that the debtor still owed $27,021.57. Included in the alleged amount due was the assessment of a

---

[28] Amanda L. Anderson, Mark A. Redmiles, "Federal Student Loan Debt in Bankruptcy: Recent Movement Towards Income-Driven Repayment Plans in Chapter 13," United States Attorneys' Bulletin, March, 2018.
[29] *See, e.g., In re* Berry, 582 B.R. 886 (Bankr. D.S.C. 2018), aff'd, 2019 WL 1034484 (D.S.C. Mar. 5, 2019).
[30] 2015 WL 167154 (Bankr. E.D. N.C. Jan 12, 2015).

lump-sum charge for collection costs in the amount of $5,289.57. This penalty for collection costs represented 25% of the principal amount owed at that time.

Making bankruptcy relief available to consumers is one way to compel better behavior by servicers. Rather than take the easy and financially rewarding route of steering consumers into forbearances, servicers would need to be concerned that their failure to enroll borrowers in sustainable repayment plans might result in the loss of the account (and related servicer revenue) to a bankruptcy discharge. While few consumers will pursue bankruptcy, particularly if servicers act more responsibly, the potential threat of bankruptcy will encourage servicers to properly implement IDR programs.

The current undue hardship method of discharge denies student borrowers bankruptcy relief.

The current undue hardship method of discharge is random, arbitrary and unfair.[31] The phrase "undue hardship" has been construed by courts to require a showing of exceptional circumstances and a "certainty of hopelessness." Debtors are faced with an impossible burden of proof – "They must somehow prove that their future is as hopeless as their present."[32]

Overly aggressive litigation tactics that have been used in undue hardship cases by student loan creditors have imposed far greater barriers to justice on debtors than those facing litigants in other civil litigation. While data on undue hardship cases is scarce, one study has

---

[31] Rafael I Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 U. Cin. L. Rev. 405 (Winter 2005). From an evaluation of hundreds of published undue-hardship decisions applying the *Brunner* standard, the authors conclude that *Brunner* is not effective as a predictable and reliable legal standard. Debtors similarly situated by demographics and financial circumstances are typically not treated the same when different courts apply the standard. The authors conclude that "those debtors granted a discharge and those denied a discharge predominantly resemble one another and that there are few statistically significant differences in the factual circumstances of the two groups." *Id*.

[32] Testimony of Deanne Loonin, Hearing on the Private Student Loan Bankruptcy Fairness Act of 2010, before the U.S. House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, April 22, 2010.

shown that student loan creditors are far less likely to resolve litigation through settlement than other civil litigants.[33] This study reveals that only 36 percent of the debtors' cases in the study were settled or had other pre-trial dispositions. Generally about 97 percent of all cases in state and federal courts are resolved by means other than by trial.[34]

A far greater percentage of debtors who seek discharges due to undue hardship are forced to go to trial to get a verdict than are other civil litigants. Yet bankruptcy debtors are far less likely to be able to afford the expense of a multi-day trial than other civil litigants. Almost 20 percent of the undue hardship discharge cases in the study ended in a trial verdict. By contrast, statistics compiled by the Administrative Office of the U.S. Courts show that of the federal court civil cases concluded in the period when the study was conducted (FY 2011), overall only 1.1 percent were concluded by a trial verdict.[35]

Student borrowers are required to litigate undue hardship in a separate adversary proceeding. This requires filing a complaint, often responding to extensive discovery by student loan creditors, and preparing and offering evidence for trial. In some cases, debtors are expected to retain and offer testimony of expert witnesses.

Under one prong of the undue hardship test used by most courts, the consumer debtor must prove an inability to repay the student loans and at the same time meet necessary living expenses. In the vast majority of cases decided by bankruptcy courts, debtors satisfy this requirement because their financial circumstances are so dire. However, this comes only after costly and unnecessary litigation, including extensive pre-trial discovery about the debtor's

---

[33] Iuliano, Jason, "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard," 86 American Bankruptcy Law Journal 495 (2012).

[34] Court Review: The Journal of the American Judges Association Volume 42, Issue 3-4 - A Profile of Settlement, Dec. 1 2006.

[35] Table C-4, Annual Report of the Director: Judicial Business of the United States Courts.

expenses.[36] This is because the Department of Education and Educational Credit Management Corporation (ECMC), a contractor hired by the Department to handle litigation for guaranty agencies, typically refuse to stipulate to the obvious.

Far more troubling, it has become common practice for the Department and ECMC to argue in court cases that certain "discretionary" or "non-essential" expenses, such as restaurant meals, cable television, and Internet access, are avoidable and could free up income to pay the student loan debt. Certain individual expenses are highlighted without consideration of the debtor's overall budget or attempts to reduce expenses, in order to portray the debtor as irresponsible. This is done even in cases in which the debtor's income may be below the poverty level and the expense in question would have no impact on the debtor's student loan repayment ability.

The story of Karen Lynn Schaffer, as reported in a New York Times article, is an example that is unfortunately not unique.[37] Ms. Schaffer, age 54, took out a student loan for her son to attend college at a time when her husband was employed. Her husband later could not work due to severe medical problems from hepatitis C, diabetes and liver cancer. Ms. Schaffer took a number of steps to reduce expenses. She also became employed in a full-time job in a security position, waking up at 4:00am every morning to care for her husband before leaving for work. ECMC argued that Ms. Schaffer was spending too much on food by eating at restaurants. This turned out to be the $12 she was spending at McDonald's, where Ms. Schaffer and her husband normally split a "value meal." Ms. Schaffer said: "I was taking care of Ron and working a full-time job, so lots of times I didn't have time to fix dinner, or I was just too darn tired."

---

[36] As an example of the extensive discovery requested by the Department, *see In re* Dorsey, 2015 WL 4873123 (Bankr. E.D. La. Aug. 13, 2015).

[37] Natalie Kitroeff, "Loan Monitor Is Accused of Ruthless Tactics on Student Debt," New York Times, Jan. 1, 2014.

Under the undue hardship test used by most courts, the debtor must show a good faith attempt to repay the student loans. While initially somewhat narrow in scope, the Department and ECMC have urged courts in litigation to inappropriately extend the good faith inquiry to matters beyond payment efforts. It has been used by loan holders as a morality test in which the debtor's life choices and past conduct are called into question. ECMC in particular has forced debtors to respond to extensive discovery that has probed into intimate details of their personal lives. ECMC then attempts to exploit these details in order to discredit debtors' testimony about hardship, regardless of how irrelevant the matters may be to an undue hardship determination.

For example, in one case ECMC questioned the debtor about why she had five children (a daughter and two sets of twin boys) after obtaining her student loans. In finding this inquiry and the related argument to be "audacious" and "beyond the pale," the bankruptcy court described ECMC's tactics as follows:

> ECMC brought out one other circumstance oriented toward the Debtor's past acts and conduct, but only late in the process. In cross-examining the Debtor, its counsel got her to acknowledge that she had borne all of her children "after [she] took out the student loans," and that she had understood at those times that she owed the associated debt. He then asked her if her children had been "planned"; to which she responded, curtly, that she was of the Roman Catholic faith. Counsel then dropped the subject until closing argument. At that time, referring to "her religious choice," ECMC's counsel abjured that "you have to make the decision to have a family in light of what you can afford ..."[38]

Debtors in other cases have been forced to refute arguments by the Department or ECMC that in order to repay their student loans they should not have taken prescription drugs to counteract the side effects of mental health medication,[39] should not have taken custody of two

[38] *In re* Walker, 406 B.R. 840, 863 (Bankr. D. Minn. 2009), *aff'd*, 427 B.R. 471 (B.A.P. 8th Cir. 2010), *aff'd*, 650 F.3d 1227 (8th Cir. 2011).
[39] *In re* Renville, 2006 Bankr. LEXIS 3211 (Bankr. D. Mont. Jan. 5, 2006).

grandchildren, one of whom was a victim of physical abuse,[40] or should not have ended their studies without getting a degree so as to care for elderly parents.[41]

Many consumer debtors cannot afford the costs needed to file the underlying bankruptcy case,[42] even without considering the additional costs for the undue hardship discharge proceeding. Given the highly aggressive litigation tactics of ECMC and other creditors, and the fact that these cases are more likely to be tried rather than settled, most hardship discharge cases require substantial time to properly litigate, ranging anywhere from 40 to 100 hours, or more. If attorneys charge for this time even at a discounted hourly rate, fees can easily mount in the thousands and tens of thousands of dollars. Most debtors who are successful in hardship cases have incomes that are near the poverty level, and certainly cannot afford to pay these fees.[43] To make matters worse, ECMC and other creditors almost always appeal court decisions that are favorable to debtors. Appeals are extremely costly.

It is not surprising that these proof requirements and litigation burdens have meant that virtually no consumer debtors in the bankruptcy system seek a discharge of their student loans. Barely 0.1 percent of debtors in bankruptcy with student loan debt sought an undue hardship discharge in the above-noted 2007 study.[44] The many barriers to obtaining an undue hardship discharge have effectively eviscerated the Bankruptcy Code's fresh start potential for borrowers burdened by student loan debt.

---

[40] *In re* Mitcham, 293 B.R. 138 (Bankr. N.D. Ohio 2003).
[41] *In re* Bene, 474 B.R. 56 (Bankr. W.D. N.Y. 2012).
[42] United States Government Accountability Office, "Bankruptcy Reform: Dollar Costs Associated with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," p. 22, June 2008 (finding that the average attorney fee in chapter 7 consumer bankruptcy cases had increased by 51 percent after the 2005 Act).
[43] There are few alternatives for debtors who cannot afford to hire an attorney to litigate a hardship case. Most pro bono bankruptcy programs do not provide representation in hardship discharge cases.
[44] Iuliano, Jason, "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard," 86 American Bankruptcy Law Journal 495 (2012).

The potential for loan cancelation upon completion of an IDR is not a substitute for a bankruptcy discharge.

The Department and ECMC often oppose an undue hardship discharge for a consumer who could make minimal IDR payments even when there is no likelihood that the consumer's financial situation will improve or that there will be any meaningful repayment of the student loans. Even when faced with clear evidence that the consumer's situation is not likely to change, the Department's position has been that the consumer should wait twenty or twenty-five years in the future to obtain loan forgiveness through the IDR program rather than a seek bankruptcy discharge. This position is fiscally irresponsible as it fails to consider the administrative costs to the Federal government and ultimately taxpayers in keeping the consumer on an IDR plan when there is no anticipated loan repayment.

This is illustrated by the Department's actions in *In re West*.[45] The debtor is 60 years old and unemployed. His only income is $194 per month in Supplemental Nutrition Assistance Program ("SNAP") benefits, and he lives with an aunt who does not charge him rent. The bankruptcy court found the debtor's testimony to be credible that his criminal background, combined with his age and race, have made it impossible for him to find work. Despite this bleak future, the Department argued that the debtor should not receive a bankruptcy discharge and instead should enroll in an IDR with a $0 payment.

Simply put, the Department's policy amounts to throwing good money after bad. The fact that the debtor's IDR payment is $0 or some minimal dollar amount is confirmation that the debt is not recoverable. Efforts to keep the debtor on an IDR for twenty or twenty-five years, including the administrative costs of annual recertifications and collection costs if the debtor re-defaults, impose a real cost on the student loan system and taxpayers that is not offset by future recoveries. Neither the government nor the debtor benefits from this outcome. When it comes to

[45] *In re* West, 2018 WL 846539 (Bankr. W.D. Tenn. Feb. 6, 2018). The Department appealed the decision in this case granting a discharge to the debtor.

collection of debts, the federal government should adopt the reasoning of all other creditors and recognize the point at which a debt is no longer recoverable.

Moreover, the apparent purpose of making student loans nondischargeable in bankruptcy has been to protect the financial integrity of the student loan program by ensuring that student loans are repaid. Denying a debtor such as Mr. West a bankruptcy discharge and forcing him to stay on a $0 payment IDR until he is age 85 does not further this purpose. Far worse, it imposes additional non-recoverable administrative costs on the student loan system.

Income-driven repayment plans provide important options for many borrowers dealing with student loan debt. However, the possibility of forgiveness of debt after twenty or twenty-five years on an IDR plan for borrowers who lack repayment ability does not remotely resemble a discharge under the Bankruptcy Code.[46]

Rather than removing a debt burden, IDR plans almost invariably increase the burden for low-income borrowers. Unlike a loan modification involving a permanent and immediate restructuring of the debt with a reduced payment amount, a borrower under an IDR remains legally obligated for the full student loan debt based on the contractual terms until the loan is forgiven, if at all, after twenty or twenty-five years. For a debtor with a $0 or nominal IDR payment, doubling, tripling, or quadrupling of the loan indebtedness is all but certain as unpaid interest continues to accrue and is capitalized. This is the opposite of a "fresh start."[47]

[46] Barrett v. Educ. Credit Mgmt. Corp. (*In re* Barrett), 487 F.3d 353, 364 (6th Cir. 2007) ("requiring enrollment in the ICRP runs counter to the Bankruptcy Code's aim in providing debtors a 'fresh start.'"); *In re* Booth, 410 B.R. 672, 676 (Bankr. E.D. Wash. 2009).

[47] *In re* Dufresne, 341 B.R. 391 (Bankr. D. Mass. 2006) (rejecting ICRP alternative and noting that lender ignored "the indefinite and perhaps decades-long duration of the forbearance, the ongoing accruals of interest added to current debt, the public credit reporting of a large and growing debt in a perpetual default status, the tax consequences of a debt forgiven many years hence"); *In re* Brooks, 406 B.R. 382, 393 (Bankr. D Minn. 2009).

Decades of mounting student loan indebtedness can have a drastic impact on an individual's future access to credit, employment opportunities, and housing.[48] It can impose a substantial emotional burden on the debtor as well.[49]

While a bankruptcy discharge provides clear relief from this burden, the IDR plans offer no certainty of relief. Borrowers only obtain forgiveness of debt if they adhere rigorously to all program requirements for the full twenty to twenty-five year duration. Borrowers who default while in a program lose eligibility.[50]

Borrowers may also lose eligibility due to paperwork problems and servicer errors that can (and often do) occur during the decades of annual recertifications required to maintain participation.[51] Data released by the Department in 2015 indicates that many borrowers miss the deadline to recertify and thus may experience payment amount changes and further capitalization of accrued interest. The Department reported that nearly 57% of borrowers whose income-driven plan recertification was due in a twelve-month period ending in late 2014 did not recertify on time.[52]

---

[48] *In re* Jolie, 2014 WL 929703, at *9 (Bankr. D. Mont. Mar. 10, 2014)("The evidence is uncontroverted, and it shows that [debtor's] student loan debt prevents her, because of its effect on her credit score, from increasing her income, and this predicament will persist while the student loan debt remains."); *In re* Mathieu, 495 B.R. 882 (Bankr. D. Minn. 2013) (47-year-old debtor would continue paying under ICRP until age 72 and never have access to reasonable credit); *In re* Strand, 298 B.R. 367 (Bankr. D. Minn. 2003) (interest accruing over twenty-five-year period under ICRP will leave debtor "hamstrung into poverty for the rest of his life" and prevent him from obtaining credit or approval of rental applications).

[49] *In re* Barrett, 337 B.R. 896, 903-904 (B.A.P. 6th Cir. 2006) (lender's emphasis on ICRP "fails to take account of the additional worry and anxiety that the Debtor is likely to suffer if he is compelled to watch his debt steadily increase knowing that he does not have the ability to repay it for reasons beyond his control"), *aff'd* 487 F.3d 353 (6th Cir. 2007); *In re* Marshall, 430 B.R. 809, 815 (Bankr. S.D. Ohio 2010).

[50] 34 C.F.R. §§ 685.221(a)(2), 685.209(a)(ii), 682.215(a)(2).

[51] 34 C.F.R. §§ 685.209(a)(5)(iii), 685.221(e)(3).

[52] These data were released in materials for the Department's March 2015 negotiated rulemaking. U.S. Dep't of Educ., Sample Data on IDR Recertification Rates for ED-Held Loans, available at www.ed.gov.

When borrowers are required to make even small IDR payments, re-defaults can occur because the income driven plans do not take expenses into account. The formulas that set payments based solely on income do not look at medical expenses, high housing costs, or expenses for any short-term emergency the borrower may encounter. For twenty to twenty-five years a borrower is one sickness or accident away from permanently losing the "discharge" ostensibly available under a long-term repayment plan.

Once in default under a plan, the borrower can lose eligibility to participate in another income-driven plan. Defaults under plans can be irreparable because the options for removing a loan from default (consolidation, rehabilitation) may be one-time only or (like rehabilitation) burdensome.[53] Getting out of default through rehabilitation also does not ensure that the borrower will avoid financial troubles. In fact, the Consumer Financial Protection Bureau recently reported that "nearly one in three borrowers who exited default through rehabilitation defaulted for a second time within 24 months, and over 40 percent of borrowers re-defaulted within three years."[54]

Discharge of a debt in bankruptcy is not a taxable event. However, forgiveness of a student loan debt at the end of an IDR may result in cancellation of indebtedness income that is taxable.[55] Therefore, successful completion of a long-term plan may simply see the Internal Revenue Service replace the Department as the powerful creditor pursuing the borrower for several more decades.[56]

---

[53] *See, e.g.* 34 C.F.R. § 685.220(d) (if all the borrower's direct loans have been consolidated, the borrower cannot re-consolidate the same loans to get out of default).
[54] Consumer Financial Protection Bureau, "Update from the CFPB Student Loan Ombudsman," May 16, 2017.
[55] 26 U.S.C. § 61(a)(12).
[56] *In re* Barrett, 487 F. 3d 353, 364 (6th Cir. 2007); *In re* Durrani, 311 B.R. 496, 508 (Bankr. N.D. Ill. 2005), *aff'd* 320 B.R. 357 (N.D. Ill. 2005).

The policy goals of the student loan program do not outweigh the fresh start objective of the Bankruptcy Code.

Opponents of bankruptcy relief argue that student loans are inherently different and are entitled to special treatment. The government operates or financially supports a number of loan programs with laudable goals similar to the student loan program, such as programs for veterans, farmers, small business owners, and first-time home buyers. Many of these programs, like the student loan program, have less stringent underwriting requirements than comparable loan products in the private market. However, unlike the student loan program, these other government sponsored loans are dischargeable in bankruptcy.

In a 1997 letter explaining his opposition to making student loans nondischargeable, Don Edwards, former chairman of the Subcommittee on Civil and Constitutional Rights, stated:

> I understand that the grant of educational loans under the GSL and FISL programs is different from the grant of other loans in some respects. That, however, does not provide sufficient justification for an exception to discharge. In establishing the loan programs, Congress made a determination that it was in the public interest to finance college educations, and to pledge the support of the Federal Treasury in that effort. Accordingly, Congress required less investigation of credit standing, prohibited co-signers in many cases, and prohibited security interests in the student's property. The program was conceived as a social welfare program, both for the students involved and for the nation as a whole. It would be inconsistent with that objective to treat the program as strictly a business proposition when the time for repayment arrives.[57]

We urge Subcommittee members to consider the thoughtful comments of Chairman Edwards as you evaluate the Student Borrower Bankruptcy Relief Act, H.R. 2648 (also S. 1414).

Other bankruptcy proposals and bills under consideration.

We are pleased that the subcommittee is considering a number of bankruptcy bills at the same time. While all of these bills would make considerable improvements to the bankruptcy system, we wish to highlight the following:

---

[57] H.R. Rep. 95-595, 154, 1978 U.S.C.C.A.N. 5963, 6115.

- Honoring American Veterans in Extreme Need Act of 2019, H.R. 2938, S. 679. The HAVEN Act would exclude veteran's disability benefits from the definition of "current monthly income" for purposes of the means test. We support this legislation and urge Congress to expand the bill to include retirement benefits for veterans, as well as pension and disability benefits under other programs that serve the same function as Social Security benefits, which are currently excluded.
- Family Farmer Relief Act of 2019, H.R. 2336 & S.897. This bipartisan bill would increase the debt limit for family farmers in Chapter 12. For the reasons stated in the report of the ABI Commission on Consumer Bankruptcy, we urge Congress to similarly consider doubling the debt limits for consumers in Chapter 13 cases.

Finally we urge the Subcommittee to consider proposals that would reduce the costs of bankruptcy filing for consumers. Several of these proposals, such as eliminating the credit counseling requirement and reducing the paperwork requirements for low-income debtors to prove safe-harbor status from the means test, are discussed in my testimony at an earlier Subcommittee hearing[58] and in the report of the ABI Commission on Consumer Bankruptcy.

---

[58] Hearing on H.R. 3553: "Bankruptcy Administration Improvement Act of 2017," September 26, 2018.