


PREPARING TO MANAGE Student Loan Debt in Bankruptcy

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Ranking as the second highest source of consumer debt in the U.S.¹, student loans have been making headlines. For the last three-plus years, the federal government, which controls more than 90% of total student loan debt, placed a payment and interest pause on all federally held student loans. While this provided temporary relief to borrowers, it did little to address the underlying and inevitable issue—how will struggling borrowers ever be able to repay these loans in a financially sustainable manner?

NEW FEDERAL PROGRAMS FOR STUDENT LOANS

To address this question, the federal government introduced two key student loan initiatives. The first, known as the Biden One-Time Forgiveness plan, provides for the discharge of up to \$20,000 of federal student loans for borrowers below certain income thresholds. And, while this program has received much fanfare, it barely makes a dent for the millions of borrowers who owe tens (and even hundreds) of thousands of dollars. Moreover, and perhaps more importantly, this plan was challenged and as of this writing, is before the Supreme Court facing an uncertain future.

The second plan introduced by the federal government barely made news headlines but stands to be a far more realistic opportunity for borrowers to meaningfully address their student loans. On November 17, 2022, the Department of Education (DOE) together with the Department of Justice (DOJ) announced new guidance for discharging federal student loans in bankruptcy (the “Guidance”). The Guidance did not change existing bankruptcy statutes or case law. Debtors are still required to prove “undue hardship.”

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However, instead of forcing each debtor to engage in a costly and uncertain adversary proceeding, the Guidance provides a streamlined path to a stipulated discharge. At the end of the process, if debtors can check off the boxes that DOJ and DOE have laid out, these departments will stipulate that an “undue hardship” exists, and debtors will be entitled to a discharge of all or some of their outstanding federal student loans without unnecessary litigation. The Guidance completely flips the script on discharging student loans in bankruptcy. What once was considered nearly impossible should now become more accessible to millions of distressed student loan debtors.⁷

COURT-BASED PROGRAMS CAN STREAMLINE BANKRUPTCY DISCHARGES

While the Guidance represents one of the biggest shifts and opportunities in bankruptcy practice in the last several years, it does present implementation challenges. First, a detailed assessment of the debtors past, present, and future financial circumstances is required. Second, the policy calls for an extensive exchange of documentation between the DOJ and the debtor. Third, the process will likely require an ongoing dialogue between the debtor’s attorney and the DOJ. An inefficient process could prove costly and time-consuming to all parties involved.

With the flood of requests that are expected, the DOJ and DOE will have their hands full trying to manage and staff this brand-new approach. Because the DOJ and DOE are already short-staffed, implementing the Guidance is likely to pose some challenges. (Think of the challenges mortgage modifications faced around 2010).

At the epicenter of where student loan discharges are set to unfold, bankruptcy courts have an opportunity to get ahead of these issues and pave the way for an orderly and streamlined process for both debtors and the DOJ/DOE. By implementing court-based programs that define procedures

and use readily available technology to guide and connect debtors and creditors, bankruptcy courts can make the discharge process efficient and cost-effective. Action from bankruptcy courts could help borrowers avoid several frustrating Catch-22s. For example, in many districts, a bankruptcy petition results in an automatic bankruptcy forbearance for the student loan borrower. However, the DOJ Guidance specifies that enrollment in an income-driven repayment (IDR) plan is evidence of good faith from the debtor. Debtors trapped in an automated bankruptcy forbearance may find themselves unable to enroll in an IDR plan. Worse yet, should the debtor’s student loans not get discharged, the debtor will have lost valuable time on IDR that could have counted as progress towards IDR forgiveness. Absent judicial intervention, many student loan debtors may find themselves worse off because they attempted to secure a fresh start.

As new developments unfold in the deployment of federal government plans to address student loan debt, bankruptcy courts and professionals should be prepared to take advantage of the opportunities they now have to discharge student loans in bankruptcy. Just as many bankruptcy courts already have proven, court-based programs for mortgage modifications and student loan management, creating similar programs for student loan discharges can provide a solution that would not require much effort and would pay great dividends to all those involved. ■

FOOTNOTES

1. Hanson, Melanie, “Student Loan Debt Statistics” EducationData.org, July 29, 2022, <https://educationdata.org/student-loan-debt-statistics>.
2. Prior to the new guidance, of the nearly 250,000 student loan debtors that file for bankruptcy in an average year, only about 300 would successfully discharge their student debt. <https://scholarship.law.duke.edu/cql/viewcontent.cgi?article=4046&context=dj>.