

Bankruptcy Must Be On The Table As A Student Loan Solution

By **Jonathan Carson and Eric Kurtzman** (December 7, 2023, 4:02 PM EST)

As the political dialogue regarding student loan forgiveness continues, one option for distressed student loan borrowers warrants far more attention than it's receiving: student loan discharge in bankruptcy.

On Nov. 17, 2022, the U.S. Department of Justice and the U.S. Department of Education announced new guidance regarding how and when the federal government will agree to discharge federal student loans in bankruptcy.

Without a deeper understanding of how this guidance has transformed the student loan landscape, millions of federal student loan borrowers — including a high percentage of minority and socioeconomically disadvantaged former students — will miss a life-changing opportunity currently available to regain control over their financial condition.

Student loan discharge in bankruptcy is not an entirely new concept. For the past few decades, however, debtors have generally viewed it as generally unavailable through the bankruptcy process.

In 1998, Congress amended Section 523 of the U.S. Bankruptcy Code to remove the previous seven-year aging requirement on student loans to be discharged and replaced it with an undue hardship test. Congress, however, did not define "undue hardship."

As a result, courts have had to try to provide some guidance. The most commonly used test to assess undue hardship is the Brunner Test, named after the 1987 U.S. Court of Appeals for the Second Circuit case *Brunner v. New York State Higher Education Services Corp.*

This test, employed in many jurisdictions, requires debtors to demonstrate three key elements to qualify for discharge:

1. Present inability to repay the student loans;
2. Financial hardship that is likely to persist into the future such that the debtor is unlikely to repay the student loans in the future; and
3. Past good-faith efforts to try to repay the student loans.



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In addition to the Brunner Test, some jurisdictions use the totality of circumstances test. This test looks to:

- The debtor's past, present and reasonably reliable future financial resources;
- A calculation of the debtor's and their dependents' reasonably necessary living expenses; and
- Any other relevant facts and circumstances surrounding each particular bankruptcy case.

This broader approach provides more flexibility for debtors to present a comprehensive picture of their financial situation and argue for the discharge of their student loans.

Both standards require the filing of an adversary proceeding — a lengthy, unpredictable and costly legal process within the bankruptcy filing — to pursue the discharge of student loan debt. The historical result: Very few adversaries were ever filed.

In an effort to address this challenge, the DOJ and DOE introduced new guidance. The guidance provides objective standards under which all undue hardship cases are to be reviewed.

Under the guidance, the attorney still files an adversary proceeding, but in lieu of engaging in full litigation, the attorney completes a new attestation form that includes critical information designed to allow the DOJ and DOE to determine if the debtor meets the guidance's objective standards for the undue hardship test.

This critical improvement process results in the increased likelihood for discharge of the student loan debt that has been a financial burden carried by many for far too long. The guidance simplifies the process and promotes predictability with the predictable result that attorneys — and borrowers — should feel much more confident when filing for student loan discharge.

To clarify, the statute that requires an undue hardship in order to discharge federal student loans has not changed. Neither has the case law. Brunner remains the majority standard of review, as well as the totality of circumstances test.

While these standards remain the same, the guidance has made significant modifications to how to assess the standards by providing easily referenced benchmark data that clearly defines whether the student loan debtor faces undue hardship in repaying their loan. That may sound simple, and it should, because it is.

The problem student loan borrowers faced prior to these modifications was proving undue hardship when the definition of "undue hardship" depended on the subjective determination of individual judges and, accordingly, varied from court to court, case to case.

With the guidance, the DOJ and DOE have provided greater transparency than ever into how its attorneys — assistant U.S. attorneys — will evaluate each case and relevant financial information to make that determination.

In practice, many attorneys have found that the attestation form offers a new opportunity to provide a full picture of the client's financial situation and allows them to present the debtor's situation in a compelling manner.

In addition to providing hard financial data, it allows the attorney to elaborate on the client's circumstances that led them to their current situation and to provide context for why their student loan debt should be eligible for discharge within bankruptcy.

Student loan borrowers should not take filing for bankruptcy lightly. But for borrowers who take the bankruptcy path, there now remains no reason that the second-largest consumer debt, student loans, should be left unremediated.

Bankruptcy may very well be a struggling borrower's best option by providing a fresh start financially and relief from the stress associated with managing lenders and debt collectors. While it is true that bankruptcy may temporarily affect one's credit, missed debt payments and excessive credit utilization have similar negative impacts.

And without an inflection point like bankruptcy, for a large percentage of debtors, the debt keeps mounting with accrued interest. With conscious effort and financial planning, individuals can rebuild their credit relatively quickly after a bankruptcy discharge.

As consumer debtor attorneys have tested the waters in filing adversary proceedings on behalf of their clients since the guidance was put in place, they have been met with success, and the initial results indicate they have been effective.

According to a November press release from the DOJ, a full or partial discharge has been recommended by the government and agreed to by the court in 99% of cases in which courts have entered judgments or orders to date.[1] There remains a significant potential for greater success as attorneys become familiar with the process and what it offers their clients.

Filing for bankruptcy to address student loan debt requires a significant shift in thinking about the bankruptcy process. Bankruptcy is often misunderstood or misrepresented, but needs to be on the table as a real solution to the student loan debt crisis.

The legal community now has an opportunity to educate distressed student loan borrowers about their expanded horizons, and has the option of discharging student loan debt in bankruptcy if it's the right choice for them.

Bankruptcy can provide relief from the seemingly insurmountable debt facing millions, and a fresh start that so many student loan borrowers seek without the uncertainty of elusive promises of student loan forgiveness that remain at the center of political debate.

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[1] <https://www.justice.gov/opa/pr/justice-department-and-department-education-announce-successful-first-year-new-student-loan>.