COMMERCIAL LAW LEAGUE OF AMERICA
EXPERTISE • INSIGHT • RESULTS

CLLA HILL DAY

March 3, 2025

THE STUDENT LOAN CRISIS

1. EVOLUTION OF DISCHARGEABILITY OF STUDENT LOANS

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 debtors 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, provided the court determined that payment from future income or other wealth would cause an under hardship on the debtor or the debtor's dependents.

The Bankruptcy Act of 1978 added Section 523(a)(8) which adopted a modified version of the provisions in the Higher Education Act which included dischargeability of student loan debt in the Chapter 13 superdischarge. In 1990, the 5-year period was enlarged to 7 years and student loans were removed from the Chapter 13 superdischarge. In 1998, the 7-year exception was eliminated and a student loan could only be discharged upon a showing 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. Since the enactment of BAPCPA, many legislators have attempted to address the ever-increasing student loan debt by proposing bills that range from eliminating § 523(a)(8) in its entirety, to re-imposing provisions for a 5, 7 or 10 year unqualified discharge of student loans, to eliminating provisions making private student loans nondischargeable.

During this evolution, the courts have also struggled with the various amendments to § 523(a)(8) and the interpretation of "undue hardship", which is not defined in the Bankruptcy Code. In 1987, the Second Circuit in *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987), devised a three-prong test to determine whether a debtor qualifies for an undue hardship exception. The test has been adopted by most of the Circuits and provides that a student loan may be discharged if:

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

2. Additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loan(s); and

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

2. THE PROBLEM

Since the passage of BAPCPA in 2005, student loan debt has more than tripled from $500 Billion in 2006 to over $1.77 Trillion as of September 2024.[1] Although legislators have proposed a number of bills seeking to remedy this student loan crisis, no bankruptcy related laws have come close to passing. President Biden had attempted to provide a universal $10,000.00 in student loan forgiveness, but the Supreme Court struck that down. According to ED, the Biden administration has approved a total of $188.8 billion in student loan forgiveness for 5.3 million borrowers since taking office,[2] the vast majority of that forgiven debt has been given to individuals who have been permanently disabled or have been paying on Income Driven Repayment and Public Service Loan Forgiveness programs for more than 20 years. While the forgiveness programs have helped some, they do not address the need to fine tune and better define "undue hardship" in § 523(a)(8) in order to create a more objective test to permit discharge of student loans in bankruptcy.

The *Brunner* test is dated, subjective, has been widely criticized by debtors as being overly strict and unfair, and imposes an enormous burden on debtors to prove its elements. More predictability is necessary in the area of student loan dischargeability.

In the Fall of 2022, the Department of Education and Department of Justice introduced guidelines to help define "undue hardship" in the context of § 523(a)(8). The guidelines include a financial attestation form to be completed by debtors in bankruptcy seeking to discharge student loans, which are reviewed by governmental officials who analyze the data and make a determination whether the debtor has met the undue hardship burden. If so, then the DOJ does not oppose the debtor's adversary proceeding seeking the discharge. While initial data seems to suggest that the program has been successful, only a fraction of debtors have taken advantage of the program.[3]

While the DOJ guidance program has promise, it is not law and could be modified or withdrawn at any time. There is a strong need to codify a clear definition of "undue hardship"

---

[1] https://www.federalreserve.gov/releases/g19/current/default.htm

[2] https://www.nasfaa.org/news-item/35444/Biden_Administration_Announces_Final_Student_Loan_Debt_Relief_Approvals

[3] So far, "632 cases were filed in the first ten months of the new process (November 2022 through September 2023)," said the Education Department. . . . Still, this is a tiny fraction of nearly 40 million federal student loan debtors. https://www.forbes.com/sites/adamminsky/2023/11/16/student-loan-discharges-approved-in-99-of-cases-under-new-bankruptcy-policy-says-biden-administration/?sh=6df170c613d0

to eliminate any uncertainty for both those seeking and opposing discharge of student loan debt.

3. THE SOLUTION

In 2019, a subcommittee comprised of CLLA Bankruptcy Section and Creditors' Rights Section members adopted a proposed amendment to § 523(a)(8) which more clearly defines the hardship required to be proven in order to discharge a student loan in bankruptcy. The CLLA proposal implements a standard of "substantial hardship", which is met if:

1. The student loan obligation, first became due ten years prior to the filing of the bankruptcy case;
2. The debtor's monthly disposable income would be less than 80% of the amount calculated on line 39c of Official Form B 22A-2 if the debtor has filed a case under chapter 7 or line 45 of Official Form B 22C-2 if the debtor has filed a case under chapter 13; and
3. Such state of affairs is likely to persist for at least five years.

Further, substantial hardship is presumed if any of the following conditions are present:

1. The debtor:
   (a) is receiving disability benefits under the Social Security Act,
   (b) the debtor has either a 100% disability rating or has a determination of individual unemployability under the disability compensation program of the Department of Veterans Affairs,
2. In the seven years before bankruptcy, the debtor's household income averaged less than 175% of the federal poverty guidelines, or
3. At the time of bankruptcy, the debtor's household income is less than 200% of the federal poverty guidelines and
   (a) the debtor's only source of income is from Social Security benefits or a retirement fund; or
   (b) the debtor provides support for an elderly, chronically ill, or disabled household member or member of the debtor's immediate family.

The CLLA proposal also 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 as of the petition date.

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.