Student Borrower Bankruptcy Relief Act: Proposed Legislation

NCHER Private Loan Committee Meeting
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Student Borrower Bankruptcy Relief Act

Historical Context

Case Law Update

Questions
Student Borrower Bankruptcy Relief Act
Currently, Para. 8 of under 11 U.S.C. § 523(a) provides:

(8) unless excepting such debt from discharge under this paragraph would impose an undue 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; 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
H.R. 2648- Student Borrower Bankruptcy Relief Act

- Proposes that federal & private student loans would be discharged
  - Introduced in 2019
  - House Judiciary Committee recently voted to advance H.R. 2648; unlikely to have votes to pass in Senate in current form
  - Removes undue hardship requirement
  - No waiting period for borrowers, would be effective immediately
Timeline of Student Loan BK Developments

1976 - Education Amendments
- Discharge available only if:
  - From certain financial institutions (i.e. bank, state agency, higher ed. institution or vocational school)
  - Insured by federal gov’t, state gov’t, or nonprofit private institutions; and
  - 5 years passed since beginning of repayment period (not counting any suspension)
  - Unless showed “undue hardship” to debtor or debtor’s dependents

1978 - Bankruptcy Code Amendments
- Undue hardship standard on debtor and his dependents
- 5 year period ran from date loan “first became due”, did not toll running of period during any suspension
- Dischargeable in Ch. 13 if loan was provided for in plan

1987 - Brunner Standard for “undue hardship”

1990 - Bankruptcy Code Amendments
- Increased time period from 5 to 7 years for loans to become freely dischargeable
- Removed ability to obtain early discharge if loan was included in Ch. 13 plan

1998 - Bankruptcy Code Amendments
- Eliminated time period for loans to become freely dischargeable, unless there was showing of undue hardship

2005 - Bankruptcy Code Amendments - For the first time, some private educational loans became non-dischargeable
Case Law Updates
Foundation for the Hardship Discharge: The Brunner Test

- Debtor cannot maintain, based on current income and expenses, a minimal standard of living if forced to repay the loans
- Additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the loans
- Debtor has made good faith efforts to repay the loans
  - Case predated the current version of the Bankruptcy Code, making its current-day application somewhat incompatible
  - Litigation on hardship discharge is expensive and time-consuming
Challenge to Brunner

- **Rosenberg v. New York State Higher Education Services Corp.** (January 2020)
- Brunner has been MISINTERPRETED
- “quasi-standard of mythic proportions”
- Discharged $220,000 in student loan debt
  - Based on means test calculations made in connection with BK filing, debtor had negative income, therefore could not maintain minimum standard of living
  - Court did not have to find that state of affairs was going to persist forever. Only for a significant portion of the repayment period.
  - Good faith effort to repay looks to past behavior, not reasons for the BK filing, the amount of the debt or whether repayment options were rejected. Debtor made payments in various amounts, paid under income-based repayment plan, made payments even when they were not due. Plenty of evidence of good faith effort over the past 20 years
Evaluating “Educational Benefit”

  - Court found that specific language in 523(a)(8)(A)(ii) excludes “loans” such that “educational benefit” only includes scholarships and stipends
  - Practical effect of this finding is that a private loan (i.e., a loan that is not made, insured or guaranteed by government units, or under programs funded by government units of nonprofit institutions) can be discharged notwithstanding Section 523(a)(8) of the Bankruptcy Code
  - Affirmed recently by the 10th Circuit Court of Appeals last month (2020)
Collateral Attack

- Student Loan Payments as Fraudulent Transfers: *Sterman* (Bankr. S.D.N.Y. 2018)
  - Court found that payments made by debtor parents for daughters’ college tuition and fees constituted constructive fraudulent transfers that could be recovered by the Chapter 7 bankruptcy trustee
  - Holding was limited to transfers made on behalf of daughter when, at the time of the transfer, daughter was older than 21
  - Parents did not receive “reasonably equivalent value” for such transfers
Closing Thoughts

- What’s on deck for 2021?
  - Potential alternatives – waiting period, some hardship
  - Reading the tea leaves from recent case law

- Reminder: 2019 ABI Commission Report recommended availability of discharge for private student loans