New DOJ Guidelines May Facilitate Student Loan Discharge

By **Michael Myers and Elanor Mulhern** (December 13, 2022)

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In conjunction with court-stalled efforts to forgive federal student debt for certain borrowers, President Joe Biden's U.S. Department of Justice recently **announced** a new set of guidelines for its attorneys to use when deciding whether to recommend that a bankruptcy judge discharge an individual's federal student loans.

The purpose of the guidelines is to streamline the process of discharging federal student debt which, unlike other consumer debt, such as credit cards, medical bills, etc., is not automatically discharged through bankruptcy.

Rather, under the U.S. Bankruptcy Code, a debtor seeking to discharge such loans has to prove undue hardship absent discharge, in separate action before the bankruptcy court. These complicated procedural steps, along with the stringent test adopted by most circuit courts for determining undue hardship, have long been criticized by consumer advocates as a significant barrier to those seeking discharge of their student debt.

As an initial matter, the process of bringing an adversary proceeding, a separate filing from the initial bankruptcy proceeding, is seen as an impediment to many borrowers. Indeed, a 2020 study revealed that, of a quarter million annual bankruptcy filings wherein the debtor has student loans, less than 300 obtain discharge of their student debt.[1]

Oftentimes, an individual debtor's bankruptcy attorney will exclude any representation of the debtor in an adversary proceeding from their scope of work, as the proceeding often entails significantly more work and additional costs. Debtors then are frequently forced to choose either to pay more money for an attorney to represent them in the adversary proceeding, or bring the lawsuit themselves without representation, thereby significantly reducing the chance of success.

Further impeding successful discharge, the standard established by the courts in determining what constitutes an undue hardship is often described as too vague and too high a bar to clear for most debtors.

Because the Bankruptcy Code does not define undue hardship, courts have been left to formulate their own test. Most circuit courts of appeals have adopted the three-factor Brunner test, under which the bankruptcy judge considers (1) whether the debtor can maintain a minimal standard of living, (2) whether the debtor's current financial situation is unlikely to change, and (3) whether the debtor has made a good faith effort to repay the loans.[2]

Other courts — the minority — have adopted an alternative, known as the totality-of-the-circumstances test. This version requires courts to consider: (1) the debtor's past, present and reasonably reliable future financial resources; (2) a calculation of the debtor's and any dependent's reasonable necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case.[3]

While the totality-of-the-circumstances test is presumably a lower bar than the Brunner test, debtors in jurisdictions looking at the totality of the circumstances have not been significantly more successful in obtaining discharge. Failure to satisfy the applicable test results in student debt carrying on for the debtor even after bankruptcy.

The perceived difficulty of bringing an adversary proceeding and succeeding under these standards has led to the noted miniscule number of debtors receiving a bankruptcy discharge of federal student loans and the small number of debtors even making the attempt. However, when debtors do bring an adversary proceeding, their success rate is notable.[4]

Notwithstanding the low usage rate, and criticism of both the process and the difficult standards established by the courts, the U.S. Supreme Court last year declined to review the standards for determining undue hardship, and Congress is not poised to implement changes to the Bankruptcy Code at this time.

Thus, with the Brunner test and totality-of-the-circumstances test likely to continue as the law of the land, the newly announced guidelines represent the DOJ's attempt to bring clarity and uniformity to the process for its attorneys, the courts and debtors.

The guidelines are the product of a coordinated effort between the DOJ and U.S. Department of Education that was announced nearly a year ago. At that time, the DOJ had also stated that it would stay any pending bankruptcy proceeding, at the borrower's request, pending the announcement of the new guidelines.

Under the DOJ's new guidelines, debtors will complete an attestation form from which DOJ attorneys will determine whether to recommend either full or partial discharge, though partial discharge is not an option specifically addressed by the guidelines, if certain criteria are met — such as having expenses that exceed income and having made a good faith effort toward repayment.

Having a consistent set of defined criteria nationwide is intended to provide more clarity and consistency in the application of the legal tests for determining undue hardship.

Having a recommendation from the DOJ should prove a useful tool for both individual debtors and the Department of Education, as the defendant in adversary proceedings, as well as the bankruptcy judges making the ultimate decision on whether to grant a discharge.

Further, the increased uniformity could encourage more of the millions of debtors with federal student loan debt to bring adversary proceedings and seek discharge, as they would potentially have a better understanding of the requirements for discharge and the likelihood of success.

However, some have raised concerns that the good faith effort prong in the new guidelines is itself too vague, and could cause confusion in the discharge process if the reviewing DOJ attorneys have divergent views on what constitutes a good faith effort toward repayment.

It also remains to be seen whether bankruptcy judges will simply adopt these recommendations or whether they will consider themselves compelled to make independent assessments based on the standards for determining undue hardship adopted by their respective circuit courts, notwithstanding the recommendation, particularly in cases where

the debtor is also seeking to discharge private student debt.

Now that the guidelines have been announced, the aforementioned stays implemented by the DOJ are being lifted. Soon, observers will be able to determine the effect of those guidelines in bankruptcies, including how bankruptcy courts implement the guidelines and whether student loan discharge rates increase.

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[1] Jason Iuliano, The Student Loan Bankruptcy Gap, 70 Duke Law J. 101, 102 (2020).

[2] Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395, 396 (2d Cir. 1987).

[3] See, e.g., In re Long, 322 F.3d 549, 553-54 (8th Cir. 2003).

[4] 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, 479 (2005) (noting that 57% of discharge determinations led to at least some relief from educational debt).