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May 21, 2018

Office of Postsecondary Education
U.S. Department of Education
Washington, D.C.

**Re: Docket ID ED-2017-OPE-0085, Request for Information on
Evaluating Undue Hardship Claims in Adversary Actions
Seeking Student Loan Discharge in Bankruptcy Proceedings**

On behalf of the American Bankruptcy Institute's Commission on Consumer Bankruptcy, we submit the attached comments in response to the Department of Education's request for information (RFI) on the evaluation of undue hardship claims in bankruptcy.

The American Bankruptcy Institute (ABI) is the world's largest association of insolvency professionals, made up of over 11,000 members in multi-disciplinary roles, including attorneys, bankers, judges, lenders, professors, turnaround specialists, accountants and others. These members represent debtor, creditor and other stakeholder interests. Founded in 1982, ABI is non-profit and non-partisan and organized under Internal Revenue Code section 501(c)(3). ABI also plays a leading role in providing congressional leaders and the general public with unbiased reporting and analysis of bankruptcy regulations, laws and trends. ABI is often called on to testify before Congress, analyze proposed bills, and conduct periodic briefings for congressional committees, legislative staff, other government regulators and the media.

In December 2016, the ABI's board of directors passed a resolution creating the Commission on Consumer Bankruptcy and charging the Commission with "researching and recommending improvements to the consumer bankruptcy system that can be implemented within its existing structure." The Commission and its three advisory committees are composed of fifty-two bankruptcy professionals. The commissioners and committee members represent all stakeholders in the bankruptcy system, including attorneys who primarily represent debtors and attorneys who primarily represent creditors as well as chapter 7 trustees, chapter 13 trustees, retired bankruptcy judges, government officials, and academics. As of the date of this letter, the Commission and its committees have conducted seven public meetings in which we have heard from seventy-eight witnesses. We have received 131 written comments. The Commission and its committees have

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held fifty-seven private meetings to debate possible reforms. More information, including the membership of the Commission and its committees, is available at our web site: <https://consumercommission.abi.org/>.

Many of the witnesses at our public meetings and the persons who sent us written comments urged the Commission to address the treatment of student loans in bankruptcy. The Commission has placed student loans on its publicly available list of topics to be studied.

We will release the Commission's final report in the coming year. The final report will set out comprehensive recommendations on student loans in bankruptcy, including recommendations for legislative changes about how student loans are treated in both chapter 7 and chapter 13 bankruptcies.

We had not intended to release any of the Commission's recommendations until the final report. However, in light of the Department of Education's request for information and the importance of the student-loan issue, the Commission agreed to release several recommendations that directly respond to the RFI. These recommendations focus on the regulatory reforms that are the subject of the RFI and should not be understood as the Commission's recommendations for possible legislative changes or any other reforms.

The Commission has debated and approved the attached recommendations, which state the conclusions of the Commission as a deliberative law reform group. As such, they do not necessarily reflect the views of any individual associated with the Commission. The Commission also has two non-voting, ex officio members as representatives of the U.S. Trustee Program and Internal Revenue Service. These two ex officio members provided technical assistance and institutional perspectives but took no position on proposals made by the Commission.

We hope that you find these comments helpful as you consider changes to the "Dear Colleague" letter mentioned in the RFI. The Department of Education plays an important role in the administration of the student-loan system. Action at the regulatory level could have a major effect in alleviating the growing burdens of student debt on everyday Americans and the overall economy. If the Commission can provide other helpful information or be of further assistance, please do not hesitate to reach out to us.

Sincerely,



William H. Brown
U.S. Bankruptcy Judge (retired), Western District of Tennessee
co-chair, ABI Commission on Consumer Bankruptcy



Elizabeth L. Perris
U.S. Bankruptcy Judge (retired), District of Oregon
co-chair, ABI Commission on Consumer Bankruptcy

American Bankruptcy Institute's Commission on Consumer Bankruptcy

Recommendations to the Department of Education: Evaluating Undue Hardship Claims in Adversary Actions Seeking Student Loan Discharge in Bankruptcy Proceedings

I. Promulgation and Interpretation of Regulations

Through regulations or interpretive guidance, the Department of Education should provide the following with respect to governmental student loans:

(a) *Bright-line Rules.* Creditors should not oppose discharge proceedings where the borrower meets any of a set of the criteria below. These criteria should be set out in federal guidelines that indicate household financial distress and therefore undue hardship:

(1) *Disability-based guidelines.* The borrower (i) is receiving disability benefits under the Social Security Act or (ii) 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) *Poverty-based guidelines.*

(A) In the seven years before bankruptcy, the borrower's household income averaged less than 175% of the federal poverty guidelines.

(B) At the time of bankruptcy, the borrower's household income is less than 200% of the federal poverty guidelines and (i) the borrower's only source of income is from Social Security benefits or a retirement fund or (ii) the borrower provides support for an elderly, chronically ill, or disabled household member or member of the borrower's immediate family.

(b) *Avoiding Unnecessary Costs.* Creditors should accept from the borrower proof of undue hardship based on the above criteria without engaging in formal discovery.

(c) *Alternative Payment Plans.* Payment of the loans in bankruptcy should be effective (i) to satisfy any period of forgiveness or cancellation of the loans under an income driven repayment plan, (ii) to rehabilitate a loan in default, and (iii) in chapter 13 cases, to prevent the imposition of collection costs and penalties.

II. Best Interpretation of 11 U.S.C. § 523(a)(8)

(a) *Brunner Test*. The three-factor *Brunner* test should be understood to require the debtor to establish only that

(1) the debtor cannot pay the student loan sought to be discharged according to its standard ten-year contractual schedule while maintaining a reasonable standard of living,

(2) the debtor will not be able to pay the loan in full within its initial contractual payment period (10 years is the standard repayment period) during the balance of the contractual term, while maintaining a reasonable standard of living, and

(3) the debtor has not acted in bad faith in failing to pay the loan prior to the bankruptcy filing.

(b) *Standard of Proof*. Each of these factors should be understood to require proof by a preponderance of the evidence.

(c) *Appellate Review*. The determination of the bankruptcy court as to each of the factors should be recognized as a finding of fact subject to deference in appellate review and in the consideration of appeal by the Department of Education, any guaranty agency, eligible lender, or holder of a federal student loan, and any agent of these parties.

Discussion & Explanation

Student loan debt is one of the most significant economic problems facing the United States. According to Federal Reserve data, outstanding student loan debt has tripled since 2006, from under \$500 billion to over \$1.5 trillion.¹ In 2003, both credit card and auto loan indebtedness were several times the amount of student loan debt, but now student loan debt greatly exceeds them both.² Among all types of household debt, student loans have the highest delinquency rate.³ As a percentage of the balance, the most recent data show 11.0% of student loans as 90+ days delinquent as compared to 7.6% for credit card debt, 4.1% for auto loans, and 1.3% for home mortgages.⁴

Student loan overindebtedness causes overall economic activity to decline and constrains the post-college options that students have. Academic studies have associated student debt with

¹ These figures are from the Federal Reserve's G.19 release on consumer credit, available at <https://www.federalreserve.gov/releases/g19/current/default.htm>.

² See Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit (2017:Q4), at 3 (Feb. 2018) https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2017Q4.pdf.

³ See *id.* at 12-14.

⁴ *Id.* at 12.

(1) lower earnings of college graduates,⁵ (2) lower levels of homeownership,⁶ (3) lower automobile purchases,⁷ (4) increases in household financial distress,⁸ (5) lower probability of students to choose public-service careers,⁹ (6) poorer psychological functioning,¹⁰ (7) delayed marriage,¹¹ and (8) lower probability of continuing education through graduate school.¹² Student loans thus affect not only those who owe the loans but also have consequences that ripple through our communities and our nation. Because of its regulatory and oversight powers, the Department of Education can make substantial inroads in alleviating the student debt problem that will improve the lives of all Americans.

Repayment of federal student loans is in the best financial interest of the federal government. To further this purpose, the Department of Education has sensibly adopted programs that promote the responsible repayment of student loans. At the same time, federal bankruptcy law recognizes that highly distressed student loan borrowers may not be able to repay their loans even with these options. Those bankrupt debtors who can show “undue hardship” can have their student loans discharged in bankruptcy.¹³ Our comments seek to balance these competing interests.

Bright-line rules

The current options used by the Department of Education have not always proven to be the most sensible, cost-effective manner of addressing collection processes for student loan borrowers who have filed for bankruptcy. Costly and inefficient litigation both causes the federal

⁵ See Justin Weidner, “Does Student Debt Reduce Earnings” (Nov. 11, 2016) (unpublished manuscript) https://scholar.princeton.edu/sites/default/files/jweidner/files/Weidner_JMP.pdf.

⁶ See Alvaro A. Mezza, Daniel R. Ringo, Shane M. Sherlund & Kamilia Sommer, “Student Loans and Homeownership” (June 2017); Rajashri Chakrabarti, Nicole Gorton & Wilbert van der Klaauw, “Diplomas to Doorsteps: Education, Student Debt, and Homeownership,” Liberty Street Economics blog (Apr. 3, 2017) <http://libertystreeteconomics.newyorkfed.org/2017/04/diplomas-to-doorsteps-education-student-debt-and-homeownership.html>.

⁷ See Meta Brown & Sydnee Caldwell, “Young Student Loan Borrowers Retreat from Housing and Auto Markets,” Liberty Street Economics blog (Apr. 17, 2013) <http://libertystreeteconomics.newyorkfed.org/2013/04/young-student-loan-borrowers-retreat-from-housing-and-auto-markets.html>.

⁸ See Jesse Bricker & Jeffrey Thompson, *Does Education Loan Debt Influence Household Financial Distress? An Assessment Using the 2007-2009 Survey of Consumer Finances Panel*, 34 CONTEMP. ECON. POL’Y. 660 (2016).

⁹ See Erica Field, *Educational Debt Burden and Career Choice: Evidence from a Financial Aid Experiment at NYU Law School*, 1 AM. ECON. J.: APPLIED ECON. 1 (2009); Jesse Rothstein & Cecilia Elena Rouse, *Constrained After College: Student Loans and Early-Career Occupational Choices*, 95 J. PUB. ECON. 149 (2011).

¹⁰ See Katrina M. Walsemann, Gilbert C. Gee & Danielle Gentile, *Sick of Our Loans: Student Borrowing and the Mental Health of Young Adults in the United States*, 124 SOCIAL SCI. & MED. 85 (2015).

¹¹ See Dora Gicheva, *Student Loans or Marriage? A Look at the Highly Educated*, 53 ECON. EDUC. REV. 207 (2016).

¹² See Vyacheslav Fos, Andres Liberman & Constantine Yannelis, “Debt and Human Capital: Evidence from Student Loans” (Apr. 2017) (unpublished manuscript) <https://ssrn.com/abstract=2901631>.

¹³ 11 U.S.C. § 523(a)(8).

government to incur substantial costs in the bankruptcy collection process with little recovery and leaves bankrupt borrowers without effective relief. It is in the interest of the federal government and borrowers that the government uses a more cost-effective approach for collection from student loan borrowers who have filed bankruptcy cases. Having clear, objective bright-line rules would reduce the costs of undue hardship litigation for the borrowers, the creditors, and the courts, while encouraging the debtors who genuinely need bankruptcy relief (and their attorneys) to seek it.

Our recommendations suggest two sets of bright-line rules,¹⁴ one built around federal Social Security and veterans disability benefits and the other based on the federal poverty guidelines. Both require the borrower to have undergone eligibility screening by a federal administrative agency. More importantly, both indicate borrowers highly likely to be in severe financial distress and therefore highly likely to be incurring undue hardship.

To be eligible for disability benefits under the Social Security Act, an individual must have an “inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.”¹⁵ Veterans disability benefits require either a 100% disability rating or a showing that includes the inability to hold “substantial gainful employment,” a threshold interpreted to mean an inability to earn more than the federal poverty guideline.¹⁶

Our second set of guidelines are built around the federal poverty guidelines. The most recently revised federal poverty guidelines are:¹⁷

Household Size	Poverty Guideline
1	\$12,140
2	\$16,460
3	\$20,780
4	\$25,100

We suggest two thresholds. First, any borrower whose household income averages less than 175% of the national poverty guidelines – currently \$21,245 for a household of one – for the seven years before a bankruptcy filing be considered to have undue hardship. We recommend increasing the figure to 200% of the national poverty guidelines at the time of a bankruptcy filing for two

¹⁴ Our recommendations for bright-line rules and cost-savings draw upon a 2014 letter from seven members of Congress. See Press Release, “Cohen, 6 Members of Congress Urge Education Secretary to Bring More Fairness to Struggling Students” (May 16, 2014) <https://cohen.house.gov/press-release/cohen-6-members-congress-urge-education-secretary-bring-more-fairness-struggling>.

¹⁵ 42 U.S.C. § 423(d)(1).

¹⁶ See, e.g., *Faust v. West*, 13 Vet. App. 342, 356 (Vet. App. 2000).

¹⁷ See Annual Update of the HHS Poverty Guidelines, 83 Fed. Reg. 2642 (Jan. 18, 2018) <https://www.federalregister.gov/documents/2018/01/18/2018-00814/annual-update-of-the-hhs-poverty-guidelines>.

situations to account for personal circumstances: retirees on fixed incomes and persons providing support for an elderly, chronically ill, or disabled household or family member.

The Department of Education's "Dear Colleague" letter, dated July 7, 2015, refers to certain factors, including determinations of disability by the Department of Veterans Affairs and Social Security Administration as "negat[ing] the need for discharge of their student loans in bankruptcy." A borrower may have reasons for filing bankruptcy that include but are not limited to student loan debt. A judicial remedy also sometimes can help solve problems that an administrative remedy might not, such as tax liability from the discharged debt. As the "Dear Colleague" letter notes, the administrative and judicial remedies can be "equally effective." Just as there is no reason for the Department's guidelines to deprive a borrower of an administrative remedy when an equally effective judicial remedy is available, there is no reason to deprive the borrower of the judicial remedy because an administrative remedy is available, especially when the judicial remedy can address other debt and legal issues the borrower might be facing. The "Dear Colleague" letter should respect the choice the borrower makes in addressing debt problems.

Avoiding Unnecessary Costs

Current regulations require a determination of whether "the expected costs of opposing the discharge petition would exceed one-third of the total amount owed."¹⁸ If so, the discharge petition should not be opposed. Despite the direction in the regulation, it is the sense of the Commission that student loan collectors have often vigorously litigated student loan discharge proceedings regardless of the cost/benefit of the litigation.

Student loan creditors should accept and evaluate the borrower's evidence without reference to formal guidelines such as court discovery rules. We are not recommending that the student loan creditor simply accept any evidence on blind faith. Rather, the creditor should exercise good judgment and discretion about the reliability of the borrower's evidence. Using informal processes will lower costs for both creditor and borrower. Formal litigation discovery processes should be the last, not the first resort. If the borrower submits satisfactory evidence of undue hardship outside the litigation process, the student loan creditor should agree that the debtor is entitled to discharge of the student loan debt.

Alternative Repayment Plans

Regulations also should be considered to address how chapter 13 bankruptcy interacts with the student-loan repayment programs. The Department of Education already is authorized to accept alternative minimum payments for borrowers under "exceptional circumstances."¹⁹ The safeguards built into the confirmation of a chapter 13 plan set out statutory requirements more stringent than the Department's income-driven repayment plans, including a liquidation analysis

¹⁸ 34 C.F.R. § 682.402(i)(1)(iii).

¹⁹ *Id.* § 685.208(l)(1).

that is not otherwise considered by the Department. These safeguards should suffice for determining the amount necessary for an alternative repayment.

Also, outside of bankruptcy, borrowers can generally only cure a default on a student loan either through consolidation of their loans or rehabilitation.²⁰ 11 U.S.C. § 1322(b)(5), however, allows a chapter 13 plan to “provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim on which the last payment is due after the date on which the final payment under the plan is due.” Section 1322(b)(5) should be interpreted to apply to the cure and maintenance of student loan payments, and the Department of Education should accept this treatment under chapter 13 plans, both to increase student loan payments and avoid unnecessary collection costs.

These observations lead to the following specific proposals for reform. Pursuant to 20 U.S.C. § 1087e(d)(4), the regulations regarding alternative repayment plans at 34 C.F.R. § 685.208(l) should be amended to provide (1) that the payments under a confirmed chapter 13 plan constitute an “exceptional circumstance” sufficient for the Department of Education to accept any disbursements from a chapter 13 plan as an alternative repayment and (2) that, notwithstanding, the provisions of 34 C.F.R. § 685.219(c)(iv) and 34 C.F.R. § 685.221(f)(1), such payments apply towards any period of forgiveness or cancellation of the student loans under the applicable income driven repayment plan.

The Department of Education also should amend 34 C.F.R. § 685.211(f)(1) to provide that the amount “of a borrower’s reasonable and affordable payment based on the borrower’s financial circumstances” includes amounts paid through a borrower’s chapter 13 plan to “cure and maintain” payments under 11 U.S.C. §1322(b)(5). The Department also should amend 34 C.F.R. § 30.62 to provide that, if student loan payments are made through a chapter 13 plan, the Department of Education will forego administrative costs under 34 C.F.R. § 30.60 and penalties assessed under 34 C.F.R. § 30.61.

Best Interpretation of 11 U.S.C. § 523(a)(8)

As the Request for Information notes, many courts have interpreted the undue hardship standard using a three-factor test known as the *Brunner* test. This test provides that undue hardship exists only if—

- (1) the debtor cannot maintain, based on current income and expenses, a “minimal” standard of living for herself and 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 loans; and
- (3) the debtor has made good faith efforts to repay the loans.²¹

²⁰ *Id.* §§ 685.211(f), 685.220.

²¹ *Brunner v. New York State Higher Education Services*, 831 F.2d 395, 396 (2d Cir. 1987). As the Request for Information also notes, the Eighth Circuit uses a “totality of the circumstances” test. *See Long*

The second of these factors has often been described as requiring the debtor to establish a “certainty of hopelessness” regarding payment of the student loan sought to be discharged.²² With this strict judicial case law in place, very few debtors have sought to discharge student loans in bankruptcy.²³

The Commission believes the widely accepted *Brunner* test can be an appropriate standard for determining undue hardship, balancing consideration of the debtor’s present ability to pay student loan indebtedness, the debtor’s future ability to make the loan payments, and the debtor’s good faith in connection with the loan. However, as pointed out by the Seventh Circuit, the “glosses” that some decisions have added to the *Brunner* test do not always track the language of the statute itself.

The district judge did not doubt that [the debtor] has paid as much as she could during the 11 years since receiving the educational loans. Instead the judge concluded that good faith entails commitment to future efforts to repay. Yet, if this is so, no educational loan ever could be discharged, because it is always possible to pay in the future should prospects improve. Section 523(a)(8) does not forbid discharge, however; an unpaid educational loan is not treated the same as a debt incurred through crime or fraud. The statutory language is that a discharge is possible when payment would cause an “undue hardship”. It is important not to allow judicial glosses, such as the language in . . . *Brunner*, to supersede the statute itself.²⁴

We believe the best interpretation of the *Brunner* test will hew closely to the statute. In particular, we believe the Department should adopt the following interpretations:

(a) Courts and the Department should determine the degree of hardship based on the contractual terms of the loan itself, rather than alternatives offered by the creditor, such as federal income-based repayment plans.²⁵

v. Educational Credit Mgmt. Corp., 322 F.3d 549 (8th Cir. 2003). The Commission’s recommendations apply to whichever judicial test is used.

²²See, e.g., Educational Credit Mgmt. Corp. v. Frushour (In re Frushour), 433 F.3d 393, 401 (4th Cir. 2005); Olyer v. Educational Credit Mgmt. (In re Olyer), 397 F.3d 382, 386 (6th Cir. 2005).

²³ See Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard*, 86 AM. BANKR. L.J. 495, 499 (2012) (“[B]arely 0.1 percent of student loan debtors in bankruptcy sought to discharge their educational debts.”).

²⁴ Krieger v. Educational Credit Mgmt. Corp., 713 F.3d 882, 884 (7th Cir. 2013)

²⁵ See In re Engen, 561 B.R. 523, 548 (Bankr. D. Kan. 2016) (pointing out difficulties with these repayment plans).

(b) Undue hardship should be found if repayment of the loan according to its terms would prevent the debtor from paying reasonable living expenses, rather than requiring living at a poverty level.²⁶

(c) The factual determinations required by *Brunner* should be subject to the ordinary evidentiary burden, preponderance of the evidence. The debtor should not be required to prove that future repayment of the student loan is certain to be hopeless.²⁷

(d) The fact-findings of a bankruptcy court on the *Brunner* factors should be recognized as entitled to deference on appeal, and reversible only for clear error.²⁸

Our recommendations for regulatory reforms and the best interpretation of the *Brunner* test are presented as complementary parts of a more effective treatment of student loan debt. If the Department were not to adopt those regulatory reforms, we would advocate that those reforms – including the adoption of bright-line rules – be incorporated into decisions applying § 523(a)(8) case law.

²⁶ See *Ivory v. United States (In re Ivory)*, 269 B.R. 890, 899 (Bankr. N.D. Ala. 2001) (listing items necessary to maintain a minimal standard of living).

²⁷ See *Price v. DeVos (In re Price)*, 573 B.R. 579, 601 (Bankr. E.D. Pa. 2017) (“[T]he phrase ‘certainty of hopelessness’ carries a connotation that vastly overstates the debtor’s evidentiary burden under § 523(a)(8). . . . It is time to retire its use.”), *rev’d on other grounds* 2018 WL 558464 (E.D. Pa. 2018).

²⁸ See *ECMC v. Acosta-Conniff (In re Acosta-Conniff)*, 686 F. App’x 647, 649 (11th Cir. 2017) (“A bankruptcy court’s findings as to each of the three prongs of the Brunner test are factual findings that should be reviewed by the district court for clear error; not under a de novo standard of review.”).