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Student Loan Discharge: Where Are We Headed?

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The discharge and forgiveness of student loan debt has long[1] been a contentious topic, both inside and outside of bankruptcy circles. With escalating student loan debt levels[2] a focus of national attention, critics have called for a change to the legal landscape governing the dischargeability of student loan debt in bankruptcy. Courts considering the issue are bound to apply decades-old tests. Nonetheless, there are indications that change might be on the horizon, even as a new administration takes office.

Discharge of student loan debt[3] in bankruptcy is governed by 11 U.S.C. § 523(a)(8). The provision requires a debtor to demonstrate that repaying the loan(s) at issue would impose "an undue hardship on the debtor and the debtor's dependents."[4] The Bankruptcy Code does not define "undue hardship," so its meaning has been left to the courts. Several decades of case law have resulted in the emergence of two tests to determine the dischargeability of student loans: the majority *Brunner* test, and the totality-of-the-circumstances test.

In *Brunner v. New York State Higher Educ. Servs. Corp.*,[5] the U.S. Court of Appeals for the Second Circuit adopted a three-pronged test that a debtor must satisfy to obtain a discharge of student loan debt. The test requires a debtor to demonstrate that (1) he or she is unable, at his or her current level of income and expenses, to maintain a "minimal" standard of living if required to repay the loans; (2) additional circumstances exist indicating that his or her current state of affairs is likely to persist for a significant portion of the repayment period; and (3) he or she has made good faith efforts to repay the loan.[6] Significantly,[7] the court observed that § 523(a)(8) indicates a "clear congressional intent to make the discharge of student loans more difficult than that of nonexcepted debt."[8]

The *Brunner* test has since been adopted by the U.S. Courts of Appeals for the Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth and Eleventh Circuits.[9] The Eighth Circuit[10] and the majority of lower courts in the First Circuit[11] apply the so-called totality-of-the-circumstances test, under which courts consider a debtor's "past, present, and reasonably reliable future financial resources, reasonable and necessary living expenses, and any other relevant facts and circumstances."[12] Despite this distinct nomenclature, the differences between the totality-of-the-circumstances test and the *Brunner* test are "modest, with many overlapping considerations."[13] Courts universally recognize the heavy burden of establishing undue hardship to obtain a discharge of student loan debt.[14]

Student loan borrowings account for roughly 9 percent of total U.S. household debt.[15] Studies regarding the effect of increasing student debt levels on the broader economy abound. For example, according to one Federal Reserve Board study, a $1,000 increase in student loan debt caused a decrease of approximately 1.5 percent in the home ownership rate among the study's control group of borrowers[16]

1 *See* Report of the Comm'n on the Bankr. Laws of the United States, H.R. Doc. No. 93-137, 93 Cong., 1st Sess. Pt. II (1973), reprinted in *Collier on Bankruptcy*, App. Pt. 4(c) at 4-710 (16th ed. 2024) (explaining that exception to discharge for student loan debt "responds to the rising incidence of consumer bankruptcies of former students motivated primarily to avoid payment of educational loan debt").

2 *See* Federal Reserve Bank of New York Center for Microeconomic Data, Quarterly Report on Household Debt and Credit (November 2024) (reporting $1.61 trillion in outstanding student loan debt in U.S. as of end of third fiscal quarter of 2024).

3 In *Homaidan v. Sallie Mae Inc.*, 3 F.4th 595 (2d Cir. 2021), the U.S. Court of Appeals for the Second Circuit found that § 523(a)(8) does not apply to certain direct-to-consumer private loans that exceed the cost of attendance because they do not comprise "an obligation to repay the funds received as an educational benefit." *Id.* at 601 (quoting 11 U.S.C. § 523(a)(8)(A)(ii) (internal quotation marks omitted)). Recognizing that § 523(a)(8)(B) excepts from discharge any loan that is a "qualified education loan" as defined in the Internal Revenue Code, the Second Circuit explained that "for a loan to be 'qualified' … the student must attend an eligible educational institution and the loan must fund only higher education expenses." *Id.* at 601, n.3 (citations omitted).

4 11 U.S.C. § 523(a)(8).

5 831 F.2d 395 (2d Cir. 1987).

6 *Id.* at 396.

7 Given the "fresh start policy" embodied in the Bankruptcy Code, *Grogan v. Garner*, 498 U.S. 279, 826-87 (1991), courts considering the dischargeability of other types of debt strictly construe exceptions to discharge against the creditor. *See, e.g., Pazdzierz v. First Am. Title Ins. Co. (In re Pazdzierz)*, 718 F.3d 582, 586 (6th Cir. 2013) (citation omitted); *Okla. Dep't of Sec. ex rel. Faught v. Wilcox*, 691 F.3d 1171, 1174 (10th Cir. 2012) (internal quotation marks and citation omitted); *In re Crosswhite*, 148 F.3d 879, 881 (7th Cir. 1998) (citation omitted); *In re Cohn*, 54 F.3d 1108, 1120 (3d Cir. 1995).

8 *Id.*

9 *See In re Frushour*, 433 F.3d 393, 400 (4th Cir. 2005); *In re Oyler*, 397 F.3d 382, 385 (6th Cir. 2005); *Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1309 (10th Cir. 2004); *In re Gerhardt*, 348 F.3d 89 (5th Cir. 2003); *In re Cox*, 338 F.3d 1238, 1239 (11th Cir. 2004); *In re Pena*, 155 F.3d 1108, 1112 (9th Cir. 1998); *In re Faish*, 72 F.3d 298,306 (3d Cir. 1995); *In re Roberson*, 999 F.2d 1132, 1135 (7th Cir. 1993).

10 *See Long v. Educ. Credit Mgmt. Corp.*, 322 F.3d 549 (8th Cir. 2003).

11 *See Nash v. Conn. Student Loan Found. (In re Nash)*, 446 F.3d 188, 190 (1st Cir. 2006) (declining to "pronounce our views of a preferred method of identifying a case of 'undue hardship'").

12 *Educ. Credit Mgmt. Corp. v. Jesperson (In re Jesperson)*, 571 F.3d 775, 779 (8th Cir. 2009).

13 *Bronsdon v. Educ. Credit Mgmt. Corp. (In re Bronsdon)*, 435 B.R. 791, 798 and n.12 (B.A.P. 1st Cir. 2010) (adopting totality-of-circumstances test and recognizing that "only practical difference between the two tests is that under *Brunner*, the debtor must establish that she made a good faith effort to repay the loans") (citing *Educ. Credit Mgmt. Corp. v. Kelly (In re Kelly)*, 312 B.R. 200, 206 (B.A.P. 1st Cir. 2004)); *see also Nash*, 446 F.3d at 190 (noting that bankruptcy court had applied totality-of-circumstances test "but was of the view that courts essentially looked at the same factors under either test").

(this is equivalent to an average delay of 2.5 months in home ownership[17]). Other studies have attributed student loan debt to a reduction in the likelihood of entrepreneurship[18] and a reduction in the likelihood of stock ownership.[19]

Citing these factors and others as its bases, in 2022 the Biden administration commenced efforts to relieve student loan debt. In a June 2023 decision, the U.S. Supreme Court found that the comprehensive student loan forgiveness program established by the Secretary of Education was not authorized under the Higher Education Relief Opportunities for Students (HEROES) Act of 2003 — a bipartisan 2003 law addressing national emergencies invoked by the Secretary to carry out the program.[20] The program would have resulted in up to $20,000 in debt relief to Pell Grant recipients and up to $10,000 in debt relief to other qualified borrowers, in each case subject to income and other requirements and qualifications. Revised efforts, most of which met with varying degrees of opposition in the federal courts,[21] followed.

Separately, the Department of Justice (DOJ) announced a revised process developed in coordination with the Department of Education (DOE) for handling cases in which borrowers seek to discharge federal student loan debt in bankruptcy.[22] The process is set forth in a guidance memo provided to DOJ attorneys for reference in connection with the representation of the government in adversary proceedings filed by debtors seeking a discharge of student loan debt.[23] It advises that the government should stipulate to facts supporting undue-hardship claims and recommend discharge to the bankruptcy court where the debtor, based on information provided in a government-developed attestation form, satisfies three stated conditions that effectively mirror the *Brunner* test (*i.e.*, "(1) the debtor presently lacks an ability to repay the loan; (2) the debtor's inability to pay the loan is likely to persist in the future; and (3) the debtor has acted in good faith in the past in attempting to repay the loan"[24]).

According to the guidance memo, the procedures are intended to ensure that "discharges are sought and received when warranted by the facts and law."[25] The memo also provides that DOJ attorneys should consult with the DOE to evaluate the specific circumstances of each case.[26] According to the results of a survey of all 94 U.S. Attorneys' Offices conducted after the first year of implementation of the revised process, borrowers have reaped myriad intended benefits, including an increased number of court judgments providing full or partial discharge.[27]

It remains to be seen whether the new administration will alter, roll back or leave the revised process in place. Notably, in 2018 the DOE under the prior Trump administration published a request for public comment on factors to be considered in evaluating undue-hardship claims in connection with its reconsideration of its then-current policy regarding the discharge of student loan debt in bankruptcy.[28]

Regardless of the view eventually espoused by the new administration, the government's position with respect to discharge is not binding on the bankruptcy court. Similar to the described actions of the Executive Branch, recent jurisprudence may indicate a trend toward flexibility in the determination of whether a debtor has demonstrated undue hardship. Circuit and other courts have questioned the stringency of the *Brunner* requirements.[29]

Congress also is tuned in to the issue of dischargeability in bankruptcy. In August 2021, Sens. Dick Durbin (D-Ill.), John Cornyn (R-Texas) and Josh Hawley (R-Mo.) introduced a bipartisan bill amending § 523(a).[30] A key provision of the bill would allow for the discharge of student loan debt 10 years after the first loan payment is due while retaining the current concept of dischargeability at any time in cases of undue hardship.[31] A separate provision would require institutions of higher education that have at least one-third of their students receiving federal student loans to partially repay a discharged loan to the DOE, with the repayment amount dependent on the institution's average rates of student loan default and repayment.[32] While the bill died in committee after no action was taken, the measure bears watching, as it is common for legislative text to be reintroduced in subsequent sessions of Congress.[33]

14 *See, e.g., Jesperson*, 571 F.3d at 779 (8th Cir. 2009) ("The debtor has the burden of proving undue hardship … [and] [t]he burden is rigorous."); *Nash*, 446 F.3d at 191 (recognizing debtor's "formidable task" in establishing undue hardship because "Congress has made the judgment that the general purpose of the Bankruptcy Code to give honest debtors a fresh start does not automatically apply to student loan debtors"); *Frushour*, 433 F.3d at 401 ("The second [*Brunner*] factor is … a demanding requirement"); *Educ. Credit Mgmt. Corp. v. Curiston*, 351 B.R. 22, 29 (D. Conn. 2006) ("[T]he additional circumstances element [of the *Brunner* test] sets a high standard of proof."); *Williams v. N.Y. State Higher Educ. Serv. Corp. (In re Williams)*, 296 B.R. 298, 302 (S.D.N.Y. 2003) ("A debtor carries a heavy burden when she seeks to establish an undue hardship under section 523(a)(8)."), *aff'd*, 84 Fed. App'x 158 (2d Cir. 2004); *In re Kelly*, 351 B.R. 45, 52 (Bankr. E.D.N.Y. 2006) ("Establishing undue hardship is a 'heavy burden' for any debtor.") (footnote and citation omitted); *see also, e.g., Traversa v. Educ. Credit Mgmt. Corp.*, 2010 U.S. Dist. LEXIS 117559, at *9 (D. Conn. Nov. 5, 2010), *aff'd*, 444 Fed. App'x 472 (2d Cir. 2011); *Bridgeforth v. United States Dep't of Educ. (In re Bridgeforth)*, 2022 Bankr. LEXIS 209, at *3 (Bankr. M.D. Pa. Jan. 26, 2022); *Magsino v. United States Dep't of Educ. (In re Magsino)*, 2014 Bankr. LEXIS 1365, at *13 (Bankr. W.D.N.C April 4, 2014); *Duval v. IRS (In re Duval)*, 2012 Bankr. LEXIS 1391, at *12 (Bankr. S.D.N.Y. April 3, 2012).

15 *See* Federal Reserve Bank of New York Quarterly Report on Household Debt and Credit (November 2024).

16 Alvaro A. Mezza, Daniel R. Ringo, Shane M. Sherlund & Kamila Sommer, "Student Loans and Homeownership," Washington: Bd. of Governors of the Fed. Reserve Sys. 3 (2017), doi.org/10.17016/FEDS.2016.010r1 (unless otherwise specified, all links in this article were last visited on Dec. 27, 2024).

17 *Id*.

18 *See* Thomas Korankeye, "Student Loan Debt and U.S. Married Households' Stock Investment Decisions," *Econ. Analysis Letters* 2(4) 13-18 (2023); Karthik Krishnan & Pinshuo Wang, "The Cost of Financing Education: Can Student Debt Hinder Entrepreneurship?," *Mgmt. Sci.* 65(10): 4522-4554 (2018).

19 *See* Jordan Coakley & Meng Li, "Impact of Student Loan Debt on Stock Ownership: An Analysis Based on the Survey of Consumer Finances," 20(6) *J. Accounting & Fin.* 31 (2020).

20 *See Biden v. Nebraska*, 600 U.S. 477 (2023).

21 *See* Katie Lobosco, "Federal Appeals Court Could Rule Soon on Biden's Student Loan Repayment Plan. Here's What Borrowers Need to Know," CNN (Oct. 24, 2024), cnn.com/2024/10/24/politics/student-loans-save-plan-court/index.html.

22 *See* "Justice Department and Department of Education Announce a Fairer and More Accessible Bankruptcy Discharge Process for Student Loan Borrowers," U.S. Dep't of Justice Office of Public Affairs (Nov. 17, 2022), justice.gov/opa/pr/justice-department-and-department-education-announce-fairer-and-more-accessible-bankruptcy.

23 "Student Loan Guidance," U.S. Dep't of Justice (2022), justice.gov/ust/student-loan-guidance.

24 *Id*. at 1.

25 *Id*. at 2.

26 *See id*.

27 *See* "Justice Department and Department of Education Announce Continuing Success of Student-Loan Bankruptcy Discharge Process," U.S. Dep't of Justice Office of Public Affairs (July 17, 2024), justice.gov/opa/pr/justice-department-and-department-education-announce-continuing-success-student-loan.

28 *See* United States Department of Education, Request for Information on Evaluating Undue Hardship Claims in Adversary Actions Seeking Student Loan Discharge in Bankruptcy Proceedings, 83 *Fed. Reg.* 7460 (Feb. 21, 2018).

29 *See, e.g., Krieger v. Educ. Credit Mgmt. Corp.*, 713 F.3d 882 (7th Cir. 2013) ("The statutory language is that a discharge is possible when payment would cause an 'undue hardship.' It is important not to allow judicial glosses … to supersede the statute itself.").

30 *See* Fostering Responsible Education Starts with Helping Students Through Accountability, Relief and Taxpayer Protection (FRESH START) S. 2598, 117th Cong. (2021) (referred to committee on judiciary).

31 *See id*.

32 *See id*.

33 *See* S. 2598, 117th Congress: FRESH START Through Bankruptcy Act, govtrack.us/congress/bills/117/s2598.

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Conclusion

It is impossible to predict executive or legislative action or court decisions on any topic, but the fact that issues regarding dischargeability and forgiveness of student loan debt will persist as long as students continue to borrow is a sure bet. As judicial precedent continues to evolve and policymakers continue to respond to the challenges posed by mounting student debt levels, outcomes will continue to significantly impact borrowers and, arguably, the entire economic landscape. The issue warrants close attention. abi