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OVERSIGHT OF BANKRUPTCY LAW AND LEGISLATIVE PROPOSALS

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTEENTH CONGRESS

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OVERSIGHT OF BANKRUPTCY LAW AND LEGISLATIVE PROPOSALS

Tuesday, June 25, 2019

HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON ANTITRUST, COMMERCIAL AND ADMINISTRATIVE LAW

COMMITTEE ON THE JUDICIARY
Washington, DC

The Subcommittee met, pursuant to call, at 10:01 a.m., in Room 2141, Rayburn Office Building, Hon. David Cicilline [Chair of the Subcommittee] presiding.

Present: Representatives Cicilline, Nadler, Neguse, Johnson of Georgia, Jayapal, Scanlon, McBath, Sensenbrenner, Collins, Buck, Armstrong, and Steube.

Staff present: David Greengrass, Senior Counsel; John Doty, Senior Advisor; Lisette Morton, Director of Policy, Planning, and Member Services; Madeline Strasser, Chief Clerk; Moh Sharma, Member Services and Outreach Advisor; Susan Jensen, Parliamentarian/Senior Counsel; Julian Gerson, Staff Assistant; Joseph Van Wye, Professional Staff Member, ACAL Subcommittee; Slade Bond, Chief Counsel, ACAL Subcommittee; Daniel Flores, Minority Chief Counsel; and Andrea Woodard, Minority Professional Staff Member.

Mr. CICILLINE. The Subcommittee will come to order. Without objection, the Chair is authorized to declare recess of the Committee at any time.

We welcome everyone to our hearing on Oversight of Bankruptcy Law and Legislative Proposals. I now recognize myself for an opening statement.

The overriding principle of the bankruptcy system is to give people who are overwhelmed with unimaginable debt a fresh start through meaningful relief from their debt. The system is supposed to work for everyone, from consumer debtors and small business owners to family farmers, serviceMembers, and veterans, and give them a new pathway to economic prosperity. But as the witnesses at today's hearing will document, the bankruptcy system is not working.

For example, as my colleague and friend, Senator Durbin, will attest, far too many student loan borrowers have been unable to succeed financially due to overwhelming student loan debt. The amount of outstanding student loan debt has skyrocketed to $1.5 billion. According to the Federal Reserve, this amount has tripled since 2006 and is expected to grow to $2 billion by 2022.

In addition to undermining the quality of life and the earning of borrowers, the crisis has also severely affected the economy overall. The American Bankruptcy Institute reports that student loan debt has undermined homeownership, automobile ownership, and has also resulted in a decline in students choosing public service careers over the private sector. As this report notes, and I quote, "student loan debt thus affects not only those who owe the loans, but also has consequences that ripple through our communities and our nation."

Worse still, 20 states have passed laws to suspend or revoke occupational and driver's licenses for people in default for student loan debt. According to a 2017 report by the *New York Times* there have been at least 8,700 cases of at-risk or revoked professional licenses for student loan default. In one example, the 10nessee Board of Nursing, a State with nursing shortages, suspended the license of a nurse who defaulted on her student loan because she was unable to work for a period due to severe epileptic seizures. To reinstate her license, the state required her to pay more than $1,500, which she could not afford without a job, effectively ending her career as a nurse. This grotesque outcome is due to amendments to the bankruptcy code that have made educational debt virtually non-dischargeable.

Under current law, student borrowers cannot discharge this debt unless they demonstrate that they would face an undue hardship if the debt were not discharged. While Congress intended that provision to provide relief for hard-hit borrowers, in practice it is an extremely high bar to relief for those with crushing debt. As an original co-sponsor of H.R. 2648, the Student Borrow Bankruptcy Relief Act of 2019, legislation introduced by Chair Nadler and Senator Durbin to repeal the undue hardship requirement, I look forward to hearing testimony from our witnesses on ending this crisis.

Today's hearing is also an opportunity to examine other potential improvements to the bankruptcy system. These include several commonsense bills that would ease burdens, streamline the bankruptcy process, or expand eligibility for service Members, veterans, small businesses, and family farmers. Additionally, this hearing is an opportunity to consider heightened disclosure requirements for bankruptcy professionals retained by the board established by Congress to oversee the budget and fiscal plans of Puerto Rico's instrumentalities.

I welcome each of our esteemed colleagues to offer testimony in support of these thoughtful measures. At this time, I now recognize the gentleman from Wisconsin, the Ranking Member of this subcommittee, Mr. Sensenbrenner, for his opening statement.

Mr. SENSENBRENNER. I thank the Chair. The bankruptcy system is an essential element of the U.S. economy. Rooted in the bankruptcy clause of the Constitution, it has, since the founding of our republic, provided the United States with the most stable lending environment in the world. I am pleased that with today's hearing, we can begin our examination of ways that we can make our bankruptcy system even better.

The Subcommittee is considering a wide range of legislative proposals today. I am an original co-sponsor of one of them, the Family Farmer Relief Act of 2019. This bill would raise the level of debt that may be taken into a family farm bankruptcy under Chapter 12. It is important that we consider this bill as it modernizes Chapter 12 to account for the higher levels of investment needed to farm in today's family farming setting.

We will also examine the Small Business Reorganization Act. This bill offers a way to make Chapter 11 bankruptcy more accessible to small businesses. That will make it easier for small businesses to reorganize their debts rather than liquidate when they fall on hard times. Modeled on the Chapter 12 small farm bankruptcy provisions that have proven successful, the Small Business Reorganization Act is a genuine promise to help the bankruptcy code better serve American business in the 21st century. Two other bills we will consider offer more flexibility in bankruptcy for serviceMembers and their families, and the third would require more transparency from firms helping to resolve Puerto Rico's insolvency under the 2016 PROMESA legislation. I am glad we are considering these bills as well.

Finally, we will look at Chair Nadler's proposed legislation to make all student loans dischargeable in bankruptcy. The amount of student debt has reached crisis-level proportions for large numbers of young Americans who are the future our country. I am willing to consider that bankruptcy reform should allow them an easier chance to deal with substantial debt, but I must emphasize that since the great majority of new student loans are Federal loans, we must do everything we can to make sure that innocent taxpayers are not forced to pick up the tab for unpaid student loans. Further, Congress would be remiss in steering college students to bankruptcy court as the only help that we are willing to give. Regardless of this bill, we must address the skyrocketing costs of higher education.

It is my hope my colleagues are willing to work across the aisle to achieve this goal, and I yield back the balance of my time.

Mr. CICILLINE. Thank you, Ranking Member Sensenbrenner. The Chair now recognizes Chair of the Full Committee, the gentleman from New York, Mr. Nadler, for his opening statement.

Mr. NADLER. Thank you, Mr. Chair. I thank the Chair for holding today's hearing, the first hearing in the 116th Congress on the very important subject of bankruptcy reform.

The Bankruptcy Code either directly or indirectly affects millions of Americans and all types of businesses, from the largest to the smallest. When it works properly, it offers a second chance to individuals and businesses in financial distress. Various reforms are necessary to ensure that it reaches its full potential.

We are fortunate today to be joined by four Members who have introduced legislation to address certain deficiencies and unfairness in the Code. I am pleased that this undertaking is largely bipartisan, which I hope will help facilitate enactment of these needed reforms. I am especially appreciative that Senator Durbin is here today to share his thoughts on legislation that both he and I introduced earlier this year, the Student Borrower Bankruptcy Relief Act.

Our legislation would address head on the manifest unfairness that student loans, unlike every other unsecured debt, such as credit cards or auto loans, are effectively non-dischargeable in bankruptcy. This Subcommittee last considered such relief more than 10 years ago, and unfortunately the problem of crushing student loans has only worsened. Currently 45 million Americans owe student loan debt estimated at a total of $1½ trillion, an amount that exceeds outstanding credit card and auto loan debt combined.

Some of this debt is attributable to for-profit education mills that promise much but deliver little. Some of this debt is also the result of predatory lending practices that target young Americans desperate to improve their lives and contribute to society, but who do not fully understand the terms of the loans they take on. Some of this debt is disparately borne by minorities who, on average, own more than their White counterparts, and who are more often the targets of such predatory lending practices.

There is no reason that this one category of debt should be singled out for special treatment that makes relief under the Bankruptcy Code virtually impossible. I thank Senator Durbin for joining me in attempting to put an end to this injustice. The problem of student loan debt is just one of the many issues we must address. As today's witnesses will explain, we also need to address two important provisions affecting those who serve our country in the military. According to a 2018 Lifestyle Survey of Service Members and Veterans, financial issues were the top lifestyle stressor, and unfortunately bankruptcy is sometimes the best answer for those in financial distress.

Under current law, National Guard Members and reservists who serve on active duty are, like other active service Members, exempt from the Bankruptcy Code means test, which determines whether a debtor's income is too high to have all his or her debts erased in bankruptcy. This critical protection for National Guard Members and reservists must be extended before it expires at the end of the year.

In addition, although Social Security benefits are not treated as income for purposes of the means test, veterans' disability benefits do constitute income under this test. Fortunately, bipartisan legislation addressing this inequity has been introduced in both the House and the Senate. We must also ensure that family farmers in financial distress are eligible for Chapter 12 of the Bankruptcy Code, the specialized form of bankruptcy relief specifically intended for family farmers. I am pleased that the gentleman from New York, Mr. Delgado, is here today to discuss his bipartisan legislation that will accomplish this vital goal.

In addition to these concerns, further reforms are necessary to better effectuate the financial reorganization of small businesses debtors. Experiences since the enactment of the 2005 amendments to the Bankruptcy Code show that provisions intended to streamline the bankruptcy process for these debtors fail to address certain fundamental concerns, such as the ability to cram down dissenting creditors who object to a debtor's reorganization plan. I thank the gentleman from Virginia, Mr. Cline, for his leadership on this issue.

Finally, Congress should consider the need to promote greater transparency and integrity with respect to the ongoing financial reorganization of Puerto Rico. In response to dire fiscal issues facing Puerto Rico at the time, Congress passed the Puerto Rico Oversight Management and Economic Stability Act, or PROMESA, in 2016. That legislation established the Financial Oversight and Management Board with control over Puerto Rico's budget, laws, financial plans, and regulations, and the authority to retain professionals to assist the Board in executing its responsibilities.

Although largely patterned on Chapter 11 of the Bankruptcy Code, PROMESA did not incorporate all facets of Chapter 11 into other relevant provisions of the Code, including, for example, the Code's mandatory disclosure requirements regarding actual or potential conflicts of interest that professional persons seeking to be retained in a bankruptcy case must make to the court prior to their retention. Fortunately, our colleague from New York, Ms. Velázquez, is with us today to discuss her legislation that addresses this shortcoming in PROMESA.

In addition to our colleagues who will be testifying, we have a distinguished panel of other witnesses who will share their perspectives on the important issues under consideration today. Accordingly, I look forward to hearing from all of today's witnesses, and I yield back the balance of my time.

Mr. CICILLINE. I thank the gentleman. I am now pleased to recognize the Ranking Member of the full committee, the gentleman from Georgia, Mr. Collins, for his opening statement.

Mr. COLLINS. Thank you, Chair Cicilline and Ranking Member Sensenbrenner. I am glad that we are having this hearing today, and it is good to be on something that we can all discuss and hopefully move forward on. It is good to see the senator and the rest of our Members here as well.

The bankruptcy system is a critical component of the economy. It provides for an important safety net for entrepreneurs and households when they need a fresh start. It also stabilizes and encourages lending because it is a tried-and-true way for creditors to recover as much as feasible when things go wrong for borrowers. I particularly applaud this Subcommittee for considering today the Small Business Reorganization Act. This important bill, recently introduced by Representative Cline and Subcommittee Chair Cicilline, offers long-term and long-needed reform to Chapter 11 of the Bankruptcy Code to help small businesses.

Chapter 11 has for many years been the key to survival for firms that need to reorganize their debt so they can continue in business. Reorganization preserves jobs, investments, and valuable contributions to our economy. For just as many years, Chapter 11's terms have been poorly suited to allow small businesses and their creditors to take full advantage of the relief it promises. To solve this problem, this bill takes up as a model for small business the provisions of Chapter 12 that help small family farmers to reorganize their farming enterprises when needed. Chapter 12 has long worked well for family farmers. Weaving models based on it into Chapter 11 for general use in small business cases is a terrific idea.

I was proud to have introduced the Small Business Reorganization Act last term with the Subcommittee Chair Cicilline, and I am proud to be an original co-sponsor this term. This bill promises to finally make Chapter 11 work for the entrepreneurs whose small businesses form the backbone of job creation in communities across our Nation.

We also consider today several other bills. Respectively, they offer more flexibility in bankruptcy for service Members and their families, an increase in the amount of debt that can be reorganized in Chapter 12 bankruptcies, and increased transparency concerning firms helping to resolve Puerto Rico's insolvency under the 114th Congress' PROMESA legislation. I am glad that we have the chance to examine these bills today.

We are also, though, here to consider Chair Nadler's proposed legislation to expand the amount of student loan debts that can be discharged in bankruptcy, and I also recognize the senator's work on that as well. However, like many Members, I am deeply touched by the skyrocketing cost of higher education and the massive amounts of debt students are taking on to shoulder these costs. To be the best help, Congress must find ways to stop the explosion of costs. Congress' answer to students should not be, sorry, we are unwilling to drive down costs, but we want to make it easier for you to end up in bankruptcy court. The answer needs to be about the costs themselves and the institutions with a firm look at the total picture. As someone who just came from, you know, a few years ago on the state level, this is one of the biggest issues we have, and I am glad we are discussing it. We need to find an answer to this, but I think we cannot also discharge the cost aspect of university and college systems as we go forward.

Also, since the vast majority of students loans are now Federal loans, our answer to taxpayers shouldn't be that in response to unbearable student loan levels, all Congress can do is to increase the ways in which taxpayers get left holding the bag. That is exactly what happens when Federal student loans are discharged in bankruptcy cases. I really want to help Chair with his proposal and the senator as well and would ask all my colleagues to join in a real search for real solutions that we can find a total picture of this problem we have.

It is something that needs to be fixed, but simply in life, sometimes the best answer is not free. It is how do we get in and dig and find our important answer. With that, I yield back.

Mr. CICILLINE. I thank the gentleman. We have two panels of witnesses today. It is now my pleasure to introduce today's first panel.

Our first witness is Senator Dick Durbin. Senator Durbin is the 47th United States senator from the State of Illinois and is the state senior senator. He serves as the Senate Democratic Whip. Currently he sits on the Senate Judiciary, Appropriations, Agriculture, and Rules Committees. Senator Durbin is the author of S. 1414, the Student Borrower Bankruptcy Relief Act of 2019, which is identical to H.R. 2648, a bill introduced by Chair Nadler earlier this year.

Our second witness, Congresswoman Nydia Velázquez, is the representative for New York's 7th Congressional District in the 116th Congress. She is the Chair of the House Small Business Committee, a senior member of the Financial Services Committee, and a member of the House Committee on Natural Resources. She is currently serving her 14th term as a member of Congress. She is also the author of H.R. 683, which would impose disclosure requirements for professional persons employed by the Financial Oversight and Management Board for Puerto Rico.

Our third witness on the panel is Representative Ben Cline of Virginia's 6th Congressional District. He is a member of both the House Judiciary Committee and the Education and Labor Committee. He previously served as a member of the Virginia House of Delegates from 2002 to 2018. Representative Cline is the author of H.R. 3311, the Small Business Reorganization Act of 2019.

Our fourth witness on the first panel is Congressman Antonio Delgado, the first-term representative from New York's 19th District. He is a member of the Agriculture, Small Business, and Transportation and Infrastructure Committees. Additionally, he is the author of H.R. 2336, the Family Farmer Relief Act of 2019.

We welcome all our distinguished witnesses on our first panel and thank them for participating in today's hearing. Please note that each of your written statements will be entered into the record in its entirety. Accordingly, I ask that you summarize your testimony in 5 minutes. As you know, to help you stay within this time, there is a timing light on your table. When the light switches from green to yellow, you have 1 minute to conclude your testimony. When the light turns red, it signals your 5 minutes have expired. We will, of course, try to afford you every courtesy we can.

We will begin, of course, with Senator Durbin. You may begin.

STATEMENT OF THE HON. RICHARD DURBIN

Senator DURBIN. Chair Cicilline, thank you for the introduction. Chair Nadler, good to see you again. My friend, Congressman Sensenbrenner, it is great to be here with you, and Congressman Collins who left earlier, we have worked together. I am going to submit my statement for the record. I would like to just make three or four points if I can.

Number one, I recently had a conversation with a member of the Federal Reserve—I won't name the person—and I asked about the issue of student loans. This person said to me, this noted economist said to me, I don't get it. Why is it that no matter what you borrow money for, whether it is essential or frivolous, under our bankruptcy system, you can be discharged from that decision to borrow that money under certain economic circumstances, but not student loans. Student loans trail you to the grave. This is a decision you are making that is going to be with you to the bitter end because you cannot discharge it in bankruptcy.

Now, think of the people most affected by it. They are the people in America least experienced when it comes to debt: 19–20-year-old college students? What does $30,000 mean to that student? What does $50,000 mean to that student? Probably nothing because they don't have a life experience to measure it against as to what they are likely to earn and what they are likely to be able to pay back. That is the largest class of people who are affected by this decision which says we will not allow you to discharge your decision, even if it's a bad one, in bankruptcy except in the most extreme circumstances.

I also would like to make a point that the *Wall Street Journal* a look at how many people qualify to be discharged in bankruptcy for student debt because of undue hardship. The *Wall Street Journal* found in the year 2017, despite the fact, as Chair Nadler said, we have tens of millions of people in debt with student loans, four—exactly four—in the entire United States of America could prove undue hardship.

The Department of Education enforces the collection of most of these student loans. I have asked them to consider the possibility that if you are a quadriplegic disabled veteran saying it is an undue hardship to pay back your student loan, you just might be credible. Well, I haven't been able to convince them of that, but it shows you the extreme circumstances we have here. The only debt you cannot discharge in bankruptcy is incurred by people with little life experience and virtually no way to escape it by the current law requiring undue hardship to be proven.

The other point I want to make to you is a point well taken. We need to address not only student debt, but the increasing cost of education. It has gone through the roof, and it is out of control. First stop, let me suggest to you, I will give you two numbers, and these two numbers are going to be on the final, so you might want to write them down: 9 and 35. Nine percent of high school graduates in America go to for-profit colleges and universities, 9 percent. Thirty-five percent of all student loan defaults are students from for-profit colleges and universities. What does that tell us? They are over-charging and under-educating. They are not preparing the people with this debt to move forward in a life that can pay of that debt. So, 35 percent of all the student loan defaults can be addressed by addressing the outrages involved in the for-profit college and university industry.

Secondly, I happen to believe that when it gets right down to it that there is going to be a restructuring within higher education. Jack Reed, well known to Chair, has a provision which says to a school you are going to have skin in the game. If you drag this student into a debt that is unimaginable, unpayable, your institution is going to be on the line, too. Why is that such an outrageous idea? They are borrowing money through the Federal government and, in some cases, in the for-profit cases, running all the way to the bank. Why shouldn't they have some skin in the game when it comes to defaults on student loans? They might think twice about the loan. They might think twice about the cost of tuition in higher education.

We have got to get them in sync with the reality that unless we do something, they have got a perfect world. They can use Federal taxpayers' dollars, make the profit off them, and leave the responsibility to those kids, their families, and future generations. Let's start with this. Let's do this change in bankruptcy. It wasn't that long ago that people could discharge loans in bankruptcy. Let's return to that. It will give not only these young people a second chance, but it will be a dramatic boost to the economy.

Thank you, Mr. Chair.

[The statement of Senator Durbin follows:]

Statement of Senator Dick Durbin
Hearing before the House Judiciary Committee Subcommittee on Antitrust, Commercial and Administrative Law on
"Oversight of Bankruptcy Law and Legislative Proposals"
June 25, 2019

Chairmen Nadler and Cicilline, Ranking Members Collins and Sensenbrenner, and members of the Subcommittee, thank you for holding this hearing. And thank you for inviting me to speak about the need to reform the way student loans are treated by the bankruptcy code.

It's long past time for Washington to get serious about student debt.

Over 44 million Americans hold more than $1.5 trillion in student loans. Student loan debt is the second largest type of household debt after mortgages. It is also the fastest growing household debt, increasing by 157 percent since 2007.

The average college student owes about $30,000 upon graduation. Two-and-a-half million student borrowers owe more than $100,000.

Student debt is limiting young people's lives and life choices. Americans are putting off buying a home and starting a family because of this debt.

And it's not just young people who are affected. In 2017, there were 8.4 million Americans over age 50 who had student loan debt.

Student borrowers try to repay their loans in a timely manner. But many struggle to do so—often because of unforeseen circumstances like medical issues, or perhaps they were misled into attending a for-profit college that did not prepare them for the job market, or the servicer of their loan didn't provide them with accurate information.

Last year, over 11 percent of student loan debt was in default or seriously delinquent. That's the highest delinquency rate among types of consumer loans tracked by the New York Fed.

And Federal Reserve Chairman Jerome Powell has said that student debt absolutely could hold back economic growth.

This is a crisis. And it's time to do something about it.

Chairman Nadler, Chairman Cicilline and Representative Katko have introduced the bipartisan Student Borrower Bankruptcy Relief Act, which is before this committee. I am the lead sponsor of this bill in the Senate.

The premise of our bill is simple: it's time to restore the availability of meaningful bankruptcy relief for student loan borrowers.

The bankruptcy process has been around since the founding of our nation. Filing for bankruptcy should be a last resort, but for some Americans it is a necessary one.

It can give people a chance to get back on their feet and on a path to a productive financial future.

Americans can seek a fresh start from most types of debt in bankruptcy. If a person overextends himself on his credit card or goes into debt buying a house, a boat, a car, or luxury items, he can address those debts in bankruptcy.

But the bankruptcy code provides no meaningful relief for student loan debt. Student borrowers who find themselves unable to repay their loans are saddled with this debt for life.

Very few types of debts have been given an exemption from discharge in the bankruptcy code—only things like child support payments, alimony, overdue taxes, and criminal fines.

But in 1998 Congress put federal student loans in this nondischargeable category, and in 2005 it included private student loans as well.

Right now the only way a student borrower can get bankruptcy relief for student loans is if she can demonstrate "undue hardship." This standard has proven nearly impossible to meet. A *Wall Street Journal* report found only four cases in 2017 where a bankruptcy judge discharged student loan debt for undue hardship.

It didn't used to be this way. Prior to 1976, student loans were fully dischargeable in bankruptcy, and up until 2005 many student loans were still dischargeable with certain conditions.

We've had more than enough time to see how this experiment with student loan nondischargeability works. And it's clear that we need reform.

The American Bankruptcy Institute's blue-ribbon Commission on Consumer Bankruptcy recently issued a report that said, "Student loan debt significantly depresses U.S. economic activity, and current bankruptcy law ineffectively addresses it." I agree.

Our bill would restore dischargeability for private and federal student loans. This bill is supported by many student and consumer groups.

Remember, filing for bankruptcy is not a step that student borrowers would take lightly. It's not a free pass out of debt. It's a painful process.

And because Congress in 2005 created a strict means test for bankruptcy filings, those who have the funds to repay their student loans could not simply liquidate them in bankruptcy under our bill. There are safeguards in the process to prevent abuse.

The bottom line is, we need to give options to student borrowers who have no realistic path to pay back their crushing student debt burden. Bankruptcy should be a meaningful last resort to help them get back on their feet.

I urge this Committee to move forward with student loan bankruptcy reform.

Mr. CICILLINE. Thank you, Senator Durbin. The Chair now recognizes Representative Velázquez for 5 minutes.

STATEMENT OF THE HON. NYDIA VELÁZQUEZ

Ms. VELÁZQUEZ. Chair Cicilline, Chair Nadler, Ranking Member Sensenbrenner, and Members of this subcommittee, thank you for the opportunity to testify today on my legislation, the Puerto Rico Recovery Accuracy in Disclosures Act. This important bill will close a loophole in the Island's debt restructuring process, improve transparency, and restore confidence and integrity in the process.

Before Hurricane Maria devastated Puerto Rico in late 2017, the Island was already in a deep recession brought on in part by trying to pay down over $120 billion in government debt. In response, Congress passed the Puerto Rico Oversight Management and Economic Stability Act, known as PROMESA, in 2016 to set up an orderly bankruptcy process to restructure this debt, stimulate economic development, and put the Island on a path to financial recovery. While we can have a difference of opinion on how well the Oversight Board is carrying out its mission, one thing should be clear: the Island and her people are entitled to the same rights and protections as any debtor on the mainland.

As the Committee is aware, the trust the American people have placed in our bankruptcy system is based on a fair, efficient, and transparent process. Transparency, as required by section 327 of the Code and Rule 2014, applies to every corporate bankruptcy, and ensures any conflicts of interest or even the perception of a conflict between those working on the bankruptcy and the debtor are disclosed. However, PROMESA does not have a similar requirement.

My bill will address this oversight and apply a robust disclosure requirement to all PROMESA title III proceedings, eliminating the double standard the people of Puerto Rico are facing. Puerto Ricans should be confident that the Board's bankruptcy advisors do not have their thumb on the scale to favor certain debts where they have a self-interest and ensure integrity in the PROMESA process.

The need for PRRADA was recently articulated when the Board-appointed law firm investigated potential conflicts in Puerto Rico's bankruptcy. One of the main recommendations in the law firm's report was that vendors should disclose affiliate relationships and found that trading in Puerto Rico's public debt is particularly problematic as it gives rise to the appearance of conflict. This is exactly what the PRRADA bill requires vendors to do and why the bill should become law. PRRADA will guarantee to the people of Puerto Rico the same transparency and disclosure practices required by law in U.S. mainland bankruptcies.

In the interest of fairness for Puerto Rico's people and for the impartiality in restructuring and thereby securing Puerto Rico's future, we must pass H.R. 683 and close this loophole. I am proud to say this is bipartisan legislation with co-sponsors from both sides of the aisle, including Members of this Committee and Members of the Natural Resources Committee, which, as you may know, has been deeply involved in Puerto Rico policy.

I kindly ask that the Judiciary Committee look favorably on this bill, and I thank you again for the opportunity to be here today and to bring fairness to the people of Puerto Rico. Thank you.

[The statement of Ms. Velázquez follows:]

Nydia Velazquez Testimony on H.R. 683, the Puerto Rico Recovery Accuracy in Disclosures Act
Judiciary Committee hearing
June 19, 2019, 2:00 p.m.

Chairman Cicilline, Ranking Member Sensenbrenner, and Members of the Subcommittee, thank you for the opportunity to testify today on my legislation, the Puerto Rico Recovery Accuracy in Disclosures Act. This important bill will close a loophole in the Island's debt restructuring process.

Before Hurricane Maria devastated Puerto Rico in late 2017, the island was already in a deep recession brought on, in part, by trying to pay down over $120 billion in government debt.

In response, in 2016, Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act – or PROMESA - to set up an orderly bankruptcy process to restructure this debt, stimulate economic development, and put the Island on a path to financial recovery.

While we can have a difference of opinion on how well the Oversight Board is carrying out its mission, one thing should be clear - the island and her people are entitled to the same rights and protections as any debtor on the mainland.

As the committee is aware, the trust the American people have placed in our Bankruptcy system is based on a fair, efficient, and transparent process. Transparency, as required by section 327 of the Code and Rule 2014, applies to every corporate bankruptcy and ensures any conflicts of interest - *or even the perception of a conflict* - between those working on the bankruptcy and the debtor are disclosed. However, PROMESA does not have a similar requirement.

My bill would address this oversight and apply a robust disclosure requirement to all PROMESA Title III proceedings, eliminating the double standard that the People of Puerto Rico are facing. Puerto Ricans should be confident that the Board's bankruptcy advisors don't have their "thumb on the scale" to favor certain debts where they have a self-interest and ensure integrity in the PROMESA process.

The need for PRRADA was recently articulated when a board-appointed law firm investigated potential conflicts in Puerto Rico's bankruptcy. One of the main recommendations in the "Luskin Report" was that vendors should disclose affiliate relationships and found that trading in Puerto Rico public debt is particularly problematic, as it gives rise to the appearance of conflict. This is exactly what the PRRADA bill requires vendors to do -- and why the bill should become law.

PRRADA will guarantee to the people of Puerto Rico the same transparency and disclosure practices required by law in U.S. mainland bankruptcies. In the interest of fairness for Puerto Rico's people and for impartiality in restructuring – and thereby securing – Puerto Rico's future we must pass H.R. 683 and close this loophole.

I'm proud to say this is bipartisan legislation with cosponsors from both sides of the aisle – including Members of this Committee – and Members of the Natural Resources Committee, which, as you know, has been deeply involved in Puerto Rico policy. I kindly ask that the Judiciary Committee look favorably on this bill – and I thank you again for the opportunity to be here today.

Mr. CICILLINE. Thank you, Chairwoman Velázquez. The Chair now recognizes Representative Cline for his opening statement.

STATEMENT OF THE HON. BEN CLINE

Mr. CLINE. Thank you, Mr. Chair, Ranking Member Sensenbrenner, and Chair Nadler for holding this hearing today and for the opportunity to appear before you to discuss the Small Business Reorganization Act, which I am proud to introduce alongside Chair and Ranking Member Collins.

In 2010, the National Bankruptcy Conference Small Business Working Group identified a problem regarding small businesses in the current bankruptcy law and presented to Congress a report which recommended amendments to the Bankruptcy Code to add a new Chapter for small business reorganizations. Chapter 11 of the Bankruptcy Code was primarily designed to allow a business to restructure its debt obligations while maintaining operations with the underlying principle being that a business in its entirety is more valuable than assets valued independently.

The point of Chapter 11 is that preservation of the business benefits both the creditor, who should receive a higher recovery because of the debtor's restructuring than they would otherwise obtain through a liquidator, and the debtor, who can remain in business. Unfortunately, the current Bankruptcy Code makes it difficult for small businesses to reorganize and forces them to use alternatives that often lead to liquidation. When the choice is between a process that is time consuming and needlessly expensive or the simpler route of negotiating with creditors for liquidation under State law, many small businesses overwhelmed by their situation choose the latter.

Our legislation intends to fix this problem by allowing small businesses with less than $2.5 million in debt to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business. This not only benefits the owners, but employees, suppliers, customers, and others who rely on that business. Under our legislation, small business owners could retain a stake in the company if the reorganization doesn't discriminate unfairly and is fair and equitable with respect to each class of claims or interests. Bankruptcy courts couldn't approve the plan unless all of the small business' disposal income, excluding amounts necessary for the payment of ordinary operating expenses, is applied to the plan over a 3–5-year period.

Mr. Chair, as you well know, our districts depend on their small businesses. They are convenience stores, restaurants, and pharmacies. Those who endeavor to open and run a small business are proud of their work and their standing in our communities. Unfortunately, they also take on sometimes insurmountable financial burden. When they are forced to close, it has a great impact on the community. I am proud to join you, Mr. Chair, in introducing the Small Business Reorganization Act to provide an important avenue of relief to the people in our communities who employ countless individuals and who drive our local economies.

With that, thank you, Mr. Chair.

[The statement of Mr. Cline follows:]

Congressman Cline Testimony
Committee on the Judiciary Hearing/Antitrust, Commercial and Administrative Law Subcommittee
"Oversight of Bankruptcy Law and Legislative Proposals"
Tuesday, June 25, 2019

Thank you to the subcommittee and to Chairman Cicilline and Ranking Member Sensenbrenner for the opportunity to appear before you today to discuss the Small Business Reorganization Act.

As you know, Article I, Section 8 of the United States Constitution grants Congress the ability to enact "uniform laws on the subject of Bankruptcies." And since the signing of our Constitution, Congress, in various forms, has done just that. The Bankruptcy Code that exists today was enacted in 1978 and has undergone several significant amendments – in 1984, 1994, and 2005. It is due for another with legislation I have introduced with Chairman Cicilline, the Small Business Reorganization Act.

In 2010, the National Bankruptcy Conference Small Business Working group identified a problem regarding small businesses in the current bankruptcy law and presented to Congress a report which recommended amendments to the Bankruptcy Code to add a new chapter for small business reorganizations.

Chapter 11 of the Bankruptcy Code was primarily designed to allow a business to restructure its debt obligations while maintaining operations, with the underlying principle being that a business in its entirety is more valuable than assets valued independently. The point of Chapter 11 is that preservation of the business benefits both the creditor, who should receive a higher recovery because of the debtor's restructuring than they would otherwise obtain through a liquidation, and the debtor, who can remain in business.

Unfortunately, the current Bankruptcy Code makes it difficult for small businesses to reorganize and forces them to use alternatives that often lead to liquidation. When the choice is between a process that is time consuming and needlessly expensive, or the "simpler" route of negotiating with creditors or liquidation under state law, many small businesses, overwhelmed by their situation, choose the latter.

Our legislation intends to fix this problem by allowing small businesses with less than $2.5 million in debt to file bankruptcy in a timelier and cost-effective manner, and hopefully allows them to remain in business. This not only benefits the owners, but employees, suppliers, customers, and others who rely on that business.

Under our legislation, small business owners could retain a stake in the company if the reorganization plan doesn't discriminate unfairly and is fair and equitable with respect to each class of claims or interests. A bankruptcy court couldn't approve the plan unless all of the small business's disposable income, excluding amounts necessary for the payment of ordinary operating expenses, is applied to the plan over a three-to-five-year period.

Mr. Chairman, our districts depend on their small businesses. They are convenience stores, restaurants, and pharmacies. Those who endeavor to open and run a small business are proud of their work and their standing in our communities. Unfortunately, they also take on a sometimes-insurmountable financial burden. When they are forced to close, it has a great impact on the rest of us.

I am proud to introduce the Small Business Reorganization Act, along with Chairman Cicilline, to provide an important avenue of relief to the people in our communities who employ countless individuals and drive our local economies.

Mr. CICILLINE. Thank you, Representative Cline. Representative Delgado is now recognized for 5 minutes.

STATEMENT OF THE HON. ANTONIO DELGADO

Mr. DELGADO. Thank you, Chair Cicilline. I also want to thank Ranking Member Sensenbrenner as well as Chair Nadler, Ranking Member Collins, and the entire Subcommittee for the invitation. I appreciate you holding this hearing to make sure our nation's bankruptcy laws reflect today's economy and represent the experiences of our nation's farmers.

I am proud to represent New York 19th Congressional District, which stretches nearly 8,000 square miles. It is made up of 11 counties and includes the beautiful Hudson Valley and Catskill Mountains. My district is the 8th most rural in the country and the 3rd most rural represented by a Democrat. It is home to more than 500 farms, 8,000 farm operators, and 5,000 farmers. Today I am here to speak on behalf of family farmers across my district, who, along with farmers across the country, are facing alarming rates of foreclosure during this down-farm economy.

I would like to take this opportunity to articulate for the Committee exactly what a down-farm economy looks like. Farmers are currently facing a 5th year of declining net farm income. Prices are low, inputs are high, and current trade policies make the future unknown. The year 2018 marked the 4th consecutive year of rising bankruptcy rates as a proportion of the farm population. In addition, at the 2018 Agriculture Economic Outlook Foreign Trade Forum, the USDA chief economist said net farm income is expected to remain flat over the next 10 years, and, when accounting for inflation, to fall in real terms.

This is a down-farm economy, and this story is not unique to New York 19 or upstate New York. This is an urgent national issue for our farmers. According to the National Farm Bureau, last year just 498 farms filed for Chapter 12 bankruptcy compared to nearly 766,000 consumer filings through Chapter 7 and 13. Over the last 10 years, Chapter 7 and Chapter 13 have seen 10 million total filings compared to just 5,039 Chapter 12 filings. It is clear the current debt cap has rendered Chapter 12 inaccessible for today's farm families.

This farm economy is exacerbated by an outdated filing cap that leaves farmers without options to restructure or repay their debt. This is why I introduced the Family Farm Relief Act, along with the Ranking Member, Mr. Sensenbrenner, and our colleagues on both sides of the aisle. H.R. 2336 is a bipartisan step to give these family farmers long-overdue relief through Chapter 12. Chapter 12 debt relief was, in fact, originally written for family farmers experiencing a down-farm economy. The rules as written allow for a seasonal repayment as farmers' incomes shift with the seasons.

Our legislation modifies Chapter 12 bankruptcy rules to increase the debt cap for eligibility from $3,237,000 to $10 million. These changes reflect the increase in land values as well as the growth over time and the average size of U.S. farming operations. These changes will provide farmers additional options to manage the current farm economy. Lifting the cap will allow farmers to retain assets and continue farm operation.

The Family Farm Relief Act, which also has a bipartisan Senate counterpart, has the support of important voices in the farming community, including the American Farm Bureau Federation and the National Farmers Union. Upon introduction, the American Farm Bureau said this legislation will help to align bankruptcy law with the scale and credit needs of U.S. agriculture. The National Farmers Union also joined in endorsing the Family Farm Relief Act saying that it will help more family farmers avoid liquidation or foreclosure, allowing them to stay in operation. This legislation aims to do just that: Keep farmers operational.

Allowing farmers increased flexibility is critical to the health and wellness of our family farmers in the upstate economy at large. I encourage the Committee to mark up this legislation and bring it to the House floor so we can give our farmers and growers the flexibility they need to continue operations.

Thank you all again for the opportunity to testify today to address how we can aid our farmers in this difficult farm economy. I look forward to working with you all to advance the Family Farm Relief Act. Thank you.

[The statement of Mr. Delgado follows:]

Family Farmer Relief Act Testimony

Testimony before House Judiciary Committee, Subcommittee on Antitrust, Commercial and Administrative Law

Rep. Antonio Delgado (NY-19)

Good morning, thank you all for having me. I appreciate you holding this hearing to make sure our nation's bankruptcy laws reflect today's economy and represent the experiences of our nation's farmers.

I'm proud to represent New York's 19th Congressional District, which stretches nearly 8,000 square miles, is made up of 11 counties, and includes the beautiful Hudson Valley and Catskill Mountains. My district is the eighth most rural in the country, and the third most rural represented by a Democrat. **It is** home to more than 5,000 farms and 8,000 farm operators.

Today, I am here to speak on behalf of family farmers across my district who, along with farmers across the country, are facing alarming rates of foreclosure during this down farm economy.

I would like to take this opportunity to articulate for the committee exactly what a down farm economy looks like:

- Farmers are currently facing a fifth year of declining net farm income. Prices are low, inputs are high, and current trade policies make the future unknown.

- 2018 marked the fourth consecutive year of rising bankruptcy rates as a proportion of the farm population.

In addition, at the 2018 Agricultural Economic and Outlook Foreign Trade Forum, USDA Chief Economist Robert Johansson said, "net farm income is expected to remain flat over the next ten years, and when accounting for inflation, to fall in real terms."

This is a down farm economy—and this story is not unique to NY-19, or Upstate New York. This is an urgent, national issue for our farmers.

According to the National Farm Bureau, last year, just 498 farms filed for Chapter 12 bankruptcy, compared to nearly 766,000 consumer filings through chapters 7 and 13. Over the last ten years, Chapter 7 and Chapter 13 have seen 10 million total filings compared to just 5,039 Chapter 12 filings. It's clear the current debt cap has rendered Chapter 12 an inaccessible tool for today's farm families.

This farm economy is exacerbated by an outdated filing cap that leaves farmers without options to restructure or repay their debt.

This is why I introduced the Family Farmer Relief Act, along with the Ranking Member, Mr. Sensenbrenner and our colleagues on both sides of the aisle.

H.R.2336 is a bipartisan step to give these family farmers long overdue relief through Chapter 12.

Chapter 12 debt relief was in fact originally written for family farmers experiencing a down farm economy. The rules, as written, allow for a seasonal repayment, as farmer's incomes shift with the seasons.

Our legislation modifies Chapter 12 bankruptcy rules to increase the debt cap for eligibility from $3,237,000 to $10,000,000.

These changes reflect the increase in land values, as well as the growth over time in the average size of U.S. farming operations. These charges will provide farmers additional options to manage the current farm economy. Lifting the cap will allow farmers to retain assets and continue farm operation.

The Family Farmer Relief Act, which also has a bipartisan Senate counterpart, has the support of important voices in the farming community including the American Farm Bureau Federation and the National Farmers Union.

Upon introduction, the American Farm Bureau said this legislation, "will help to align bankruptcy law with the scale and credit needs of U.S. agriculture."

The National Farmers Union also joined in endorsing this the Family Farmer Relief Act saying that it, "will help more family farmers avoid liquidation or foreclosure, allowing them to stay in operation."

This legislation aims to do just that: keep farmers operational.

Allowing farmers increased flexibility is critical to the health and wellness of our family farmers and the Upstate economy at large. I encourage the committee to mark up this legislation and bring it to the House Floor, so we can give our farmers and growers the flexibility they need to continue operations.

Thank you all again for the opportunity to testify today to address how we can aid our farmers in this difficult farm economy. I look forward to working with you all to advance the Family Farmer Relief Act.

Mr. CICILLINE. Thank you, Representative Delgado. In keeping with our committee's practice, the witnesses are at this point excused. We thank you very much for coming here today to share your thoughts about these various pieces of legislation and thank you for your leadership on this very important issue. This was very informative to the Committee and will certainly guide us as we consider these legislative proposals. Thank you again.

The witnesses for the second panel will please take your seats after our staff have made the administrative arrangements, which is code for placing your name cards on the table.

Thank you and welcome to our witnesses.

Our first witness on our second panel is Hollister Petraeus. Ms. Petraeus retired from the Consumer Financial Protection Bureau in 2017 after spending 6 years as the director of the Office of Servicemember Affairs where she worked to strengthen consumer protection measures for the military, veterans, and their families. Prior to joining the CFPB, Ms. Petraeus served as the director of BBB Military Line, a program with the Council of Better Bureaus that fosters outreach between local better business bureaus and military communities. She currently sits on the board of directors of the Children of Fallen Patriots Foundation and the Board of Governors of the National Military Family Association. Ms. Petraeus received her bachelor's degree from Dickinson College and is the recipient of the Department of Defense Medal for Distinguished Public Service. Welcome.

The second witness on our panel is Robert Keach, who appears on behalf of the American Bankruptcy Institute. He is a shareholder at Bernstein, Shur, Sawyer, & Nelson, and focuses on bankruptcy reorganization and out-of-court workouts. He has appeared before bankruptcy courts in seven districts across New England, New York, and California. He has been a panelist for national bankruptcy, lender liability, and creditors' rights programs. Mr. Keach served as the President of the ABI from 2009 to 2010 and is currently an adjunct professor teaching cross-border insolvency and business bankruptcy at Boston College Law School. He received his B.A. from the University of Vermont and his J.D. from the University of Maine School of Law.

Our next witness is Edward Boltz, representing the National Association for Consumer Bankruptcy Attorneys. Mr. Boltz currently serves as an attorney and managing partner at the Law Offices of John Orcutt. There he represents consumers across a broad spectrum of financial matters, including Chapter 7 and 13 bankruptcies, mortgage issues, and student loan legislation. Mr. Boltz is also the vice President of NICBA, a position he has held since 2007. At various points he has served as the NICBA's director, president, and co-chair of the Legislative Committee as well. Mr. Boltz received his B.A. from Washington University in St. Louis and his J.D. from George Washington University Law School.

Our third witness is John Rao, who appears on behalf of the National Consumer Law Center. Mr. Rao has been a staff attorney at NCLC since 1996 focusing on consumer credit, mortgage servicing, and bankruptcy issues. He provides testimony to Congress and Federal regulatory agencies on issues affecting low-income consumers and has filed amicus briefs in cases before the Supreme

Court and various courts of appeal. Before joining NCLC, he was a managing attorney at the Providence office of Rhode Island Legal Services, heading the program's consumer unit. He received his B.A. from Boston University and his J.D. from the University of California Hastings Collee of Law. A special welcome to you, Mr. Rao.

Our fifth witness is Professor Jiménez, a professor at the University of California Irvine School of Law. Professor Jiménez's research focus is on bankruptcy, consumer financial distress, and financial product regulation and their intersection with consumer protection and access to justice. She was a founding staffer with the Consumer Financial Protection Bureau where she worked on debt relief, credit reporting, and student loan issues. She received her M.S. from the Massachusetts Institute of Technology and her J.D. from Harvard Law School where she won the Outstanding Bankruptcy Student Award from the American Bankruptcy Institute. Welcome.

Our last witness today is Judge Thomas Small, who is representing the National Bankruptcy Conference. Judge Small served as a bankruptcy judge for the Eastern District of North Carolina from 1982 to 2007, and as chief judge from 1992 to 1999, and again from 2006 to 2007. From 2000 to 2001, he served as President of the National Conference of Bankruptcy Judges and chaired the U.S. Judicial Conference Advisory Committee on Bankruptcy Rules from 2000–2004. Additionally, since 2007, Judge Small has sat on the Board of Editors of the *Collier on Bankruptcy Treatise*. He received his B.A. from Duke University and his J.D. from the Wake Forest University School of Law.

We welcome all our very distinguished witnesses on the second panel and thank you for participating in today's hearing. Now if you would please rise, I will begin by swearing you in. Please raise your right hand.

Do you swear or affirm under penalty of perjury that the testimony you are about to give is true and correct to the best of your knowledge, information, and belief, so help you God?

[A chorus of ayes.]

Mr. CICILLINE. Let the record show the witnesses answered in the affirmative. You may be seated. Thank you.

Please note that each of your written statements will be entered into the record in its entirety. Accordingly, I ask that you summarize your testimony in 5 minutes. To help you stay within that time, there is a timing light on your table. When the light switches from green to yellow, you have 1 minute to conclude your testimony. When the light turns red, it signals that your 5 minutes have expired.

Ms. Petraeus, we will begin with you. You are recognized for 5 minutes.

TESTIMONY OF HOLLISTER K. PETRAEUS

Ms. PETRAEUS. Chair Cicilline, Ranking Member Sensenbrenner, Chair Nadler, and distinguished Members of the subcommittee, thank you for the opportunity to speak to you today, most notably on the HAVEN Act, which was recently introduced by Representatives McBath and Steube.

Let me say up front that I'm not a bankruptcy expert nor a lawyer, but I do have a long history of advocacy for the military on consumer financial matters. I'm the daughter, wife, and mother of Army officers. As I've lived a life of constant moves and, more recently, combat deployments, I saw the impact those events had on the finances of military personnel and their families.

During the first year of the Iraq War, my husband's division went to war. I saw the families' financial challenges firsthand during that year, not just those of the active-duty troops, but also families of the Guard and Reserve who came to our family assistance center for help. I did what I could to help raise awareness with our Federal and State legislators who visited. I also worked with local business leaders to include the Better Business Bureau, which led to the job that I held there for 6 years.

Running the BBB Military Line was an education for me on the fact that many scammers specifically target the military for their steady paycheck, which is often coupled with youth and financial inexperience. While I was at the BBB, we developed a number of free financial readiness workshops to provide in-person financial education for serviceMembers and their families. But while education is important, the sad truth is that in many cases, serviceMembers' finances are impacted by events that they cannot control: Deployments, shoddy loan servicing, inaccurate credit reporting, and the flouting of important consumer financial laws.

So, when I was offered the opportunity to head up the Office of Servicemember Affairs at the newly-formed Consumer Financial Protection Bureau, I jumped at the chance. I knew that the Bureau had the power to enforce consumer financial laws, and that to me was a vital part of protecting military families' hard-earned money. I ran that office for 6 years, and in that time, we saw over $120 million returned to serviceMembers.

Last year, I was asked to join an American Bankruptcy Institute Task Force on Veterans and Service Members. One of its most immediate missions was to correct a glaring error in the Bankruptcy Code of 2005, language that effectively denied disabled veterans the protections it provided to all other disabled Americans. Under the 2005 law, judges could no longer decide the debtor's disposable income but had to include virtually all income that the debtor received, except for three things: Benefits received under the Social Security Act, payments to victims of war crimes, and payments to victims of terrorism.

That first item is the problem. Civilians receive disability benefits from the Social Security Administration, but disabled Service Members and Veterans do not. They get their disability benefits from the VA and from the Department of Defense. So, by using specific language referencing the Social Security Act, Congress effectively denied those who had become disabled in the service of their country the rights given to others who had not served, and that is obviously not right.

I cannot imagine that Congress intended this, but with their disability pensions counted, veterans may fail the means test and not qualify for Chapter 7 bankruptcy which allows for a quick, fresh start. Instead, they must file for Chapter 13 with a 3- to 5-year payment plan that they must fund from their current monthly income, including their military disability pension. Surely Congress never intended that a military disability benefit should go into the pockets of creditors. The HAVEN Act will fix that problem.

Let me also mention one other item you are considering for National Guard and Reserve Members. Combat deployment, while a source of extra pay, could have a catastrophic impact on their civilian small business. If they opted for bankruptcy, the means test counted their military special pay and allowances, even though they were no longer receiving them. That could make their income too high for bankruptcy. The National Guard and Reservists Debt Relief Act of 2008 fixed that issue, and today you are looking to extend it for another 4 years, an action I support. Our citizen soldiers who put on the uniform of our country should not be financially penalized for doing so.

Ideally, no one should need to declare bankruptcy, but it happens and at a higher rate for veterans. Many of them have disabilities that make it hard to earn a living wage, and that may limit their caregiver spouse, too. No veteran should face the added stress of pledging their disability benefits to creditors. You can eliminate the roadblocks and make it harder for them to discharge their debts, and I commend you—excuse me—for your efforts today. Thank you.

[The statement of Ms. Petraeus follows:]

Chairman Cicilline, Ranking Member Sensenbrenner, and other distinguished Members of the Subcommittee, I'd like to thank you for the opportunity to speak to you today about some of the military-related bills you are considering in this meeting, most notably the HAVEN Act, H.R. 2938. The HAVEN Act, otherwise known as the Honoring Veterans in Extreme Need Act, was recently introduced by Representatives McBath and Steube of the Judiciary Committee, and I thank them for that and I also thank all of you for taking up this bill so quickly.

Let me start with a little about me and my qualifications to speak to you today. I will say up front that I am not a bankruptcy expert! Also, unlike many people in this room, I am not a lawyer. However, I do have a long history of advocating for the military on consumer financial matters, a history that grew out of my lifetime experience as a military family member. I am the daughter and wife of career Army officers, and also the mother of an Afghanistan veteran. As I lived a life of constant moves and, more recently, frequent combat deployments, I saw the impact those events had on the finances of military personnel and their families, and was moved to do something about it.

During the first year of the Iraq War, in 2003, my husband was Commanding General of the 101st Airborne Division (Air Assault) whose 20,000 Soldiers went to war from their home base of Fort Campbell, Kentucky. I saw the families' financial challenges first-hand during that year of deployment – not just those of the active-duty troops, but also those of the Guard and Reserve families whose Soldiers deployed from Fort Campbell, and who came to our Family Assistance Center for help. I did what I could during that year to help raise awareness about their issues with the many legislators, both Federal and state, who came to visit the Fort Campbell families during that year. I also worked with local business leaders, to include the CEO of the area's Better Business Bureau, and that informal advocacy led to my being offered in 2004 the job of running a national military outreach effort for the Council of Better Business Bureaus: BBB Military Line®.[1]

I did that job for 6 years, and it was quite an education for me on the fact that many scammers specifically target the military for their steady paycheck, which is often coupled with youth and financial inexperience. And that is a continuing trend, as a BBB Scam Tracker Annual Risk Report for 2017 found that servicemembers, veterans and their families are more likely to be targeted for scams, and lose an average of 27% more money than other consumer to scams.[2] At the BBB we developed a number of financial readiness workshops to provide in-person financial education for servicemembers and their families concerning a number of topics such as day-to-day financial management, scams and planning for retirement. BBBs across the United States taught many sessions of the free workshops, and continue to do so to this day.

But, while I feel that education is an important part of financial well-being, the sad truth is that in many cases servicemembers' finances are impacted by events they cannot control: deployments, shoddy loan servicing, inaccurate credit reporting, and the flouting of important consumer financial laws. So when I was offered the opportunity in 2011 to head up the Office of Servicemember Affairs at the newly

[1] https://www.bbbmarketplacetrust.org/military-and-veterans-initiative
[2] https://www.bbb.org/globalassets/local-bbbs/council-113/media/scam-tracker/risk-report/bbbscamtrackerannualreport-final-2017.pdf

formed Consumer Financial Protection Bureau[3], I jumped at the chance. I knew that the Bureau had the power to enforce approximately 20 consumer financial laws, and to me that was a vital part of protecting military families' hard-earned money. I ran that office for 6 years, and I'm proud to say in that time we saw over $120 million returned to servicemembers, veterans and their families from financial service providers who broke the law in their dealings with them. We were also able shine a spotlight on shoddy loan servicing and, through the use of our public complaint database, motivate companies to put more emphasis on customer service than they had ever done before.

The military bankruptcy bill that you're looking at in which I take a particular interest is, of course, the HAVEN Act. I first heard about the issue it addresses when I was approached last year by Ted Gavin, then-President of the American Bankruptcy Institute[4], who asked me to join a Task Force on Veterans & Servicemembers that he was setting up. The ABI, as you may know, is a non-profit association of bankruptcy professionals, including attorneys, auctioneers, bankers, judges, lenders, professors, turnaround specialists, accountants and others – and I should note that you have another past president of the ABI testifying today: Bob Keach. As Mr. Gavin related it to me, one of the most immediate missions of the task force was to foster legislation that would correct what they saw as a glaring error in the bankruptcy code that was harming disabled veterans. And he hoped that my work on consumer financial matters impacting servicemembers and veterans would provide the task force with insights that might be helpful, both for their legislative and educational efforts.

I must confess that I had no particular knowledge of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)[5] or its specific provisions, but I was shocked to discover that there was language in the code that was effectively denying disabled veterans the protections it provided to all other disabled Americans. To give you my layman's summary, after BAPCPA was signed into law, bankruptcy judges no longer were permitted to decide what would constitute "disposable income" in a debtor's case. Instead they had to adhere to a broad definition of "current monthly income" that included virtually all income the debtor received. There were only three sources of income excluded from "current monthly income": (1) benefits received under the Social Security Act; (2) payments to victims of war crimes; and (3) payments to victims of terrorism.[6]

That first item, "benefits received under the Social Security Act," is the problem. Disabled American civilians receive disability benefits from the Social Security Administration, but disabled servicemembers and veterans do not. They get their disability benefits from the Veterans Administration or, in some cases, from the Department of Defense. So, by using specific language referencing the Social Security Act, Congress effectively denied those who had become disabled in the service of their country the rights given to other disabled Americans who did not serve. To paint a picture, if you compare two people who are both receiving Federal disability benefits – one a civilian who was hurt in a car wreck and gets Social Security disability benefits, the other a veteran who receives VA disability benefits for a similar injury sustained in an IED attack in Iraq – only the civilian gets to exclude his disability benefits from "current monthly income" calculations in bankruptcy. And that is obviously just not right.

[3] https://www.consumerfinance.gov/practitioner-resources/servicemembers/
[4] https://www.abi.org/about-us
[5] https://www.congress.gov/109/plaws/publ8/PLAW-109publ8.pdf
[6] 11 U.S.C. Section 101(10A)

I cannot imagine that anyone in Congress who worked on the bankruptcy code in 2005 specifically intended to slam the door in the face of veterans in this way, forcing their disability pensions to be pledged to creditors, and denying them the fresh start" that the Bankruptcy Code makes available to every US citizen.[7] But that is the effect that the BAPCPA language has had. With their disability pensions counted as "current monthly income," veterans may be told that they fail the bankruptcy "means test" and make too much money to qualify for Chapter 7 bankruptcy, which would allow for a quick disposal of their assets and an immediate fresh start thereafter. Instead, they must file for Chapter 13 bankruptcy, which requires a three-to-five-year payment plan that they have to fund with the bulk of their current monthly income – including their military disability pension. Certainly it is my sense that Congress never intended that a military disability benefit should go into the pockets of creditors, but rather should go to support the daily needs of the disabled veteran. But what appears to be a simple oversight from 2005 has led to a dramatic and inequitable outcome that systemically discriminates against our country's disabled veterans.

So what is the scope of this problem? It's hard to find military-specific data on bankruptcies because filers are not required to identify veteran status, but there are some indicators that veterans are over-represented in the bankruptcy population. A study[8] by Jonathan Fisher found that approximately 125,000 veterans filed for bankruptcy in 2017. And he stated that while veterans comprise 10.3 percent of the national population, they comprise 14.7 percent of chapter 7 filers and 15.0 percent of chapter 13 filers. Fisher thinks that veteran's over-representation in bankruptcy could potentially be explained by lower earnings, higher debt, and lower net worth. And he states something very pertinent to this hearing, which is that "25-26 percent of bankruptcy filers report some kind of disability, which is more than 10 percentage points higher than the national average."[9]

I must commend the bankruptcy attorneys who first raised awareness about this disparity in the bankruptcy code, after seeing at least five bankruptcy court rulings against disabled veterans on this issue[10]. In some cases the judges specifically noted that the bankruptcy code left them with no discretion to rule in favor of the disabled veteran. The bankruptcy professionals – led by the tireless efforts of Jay Bender of Birmingham, Alabama – have dedicated significant time and effort to trying to right this wrong. There is no financial benefit to them in doing so – by my observation they are doing this for the best of motives.

I'd also like to thank the Congressional staff in both the Senate and the House who worked on the HAVEN Act, and crafted language that would fix the disparity in the statute. It's certainly my hope that every single member of Congress will see the logic of a speedy passage of this law. There are veterans anxiously waiting to see that outcome. The spouse of one recently emailed a colleague: "We…had to file

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[7] Of note, under Federal law and most states' law, these disability payments are exempt from the reach of creditors outside of bankruptcy. 38 U.S.C. § 5301(a)(1) generally prohibits garnishment of VA disability benefits. Because their disability payments are protected outside of bankruptcy, some veterans have been coached to suffer through a foreclosure or other creditor harassment and avoid a bankruptcy filing so they may protect their disability benefits.

[8] https://www2.census.gov/ces/wp/2017/CES-WP-17-54.pdf

[9] Id.

[10] https://www.bradley.com/-/media/files/insights/publications/2018/11/defending-our-veterans.pdf?la=en

Ch. 13… in early March and were shocked to find out that his Veterans Disability would be subject to the means test and used to pay back creditors….We have set every alert, on every website, in order to get updates on [the HAVEN Act] as it moves along….This will not only help us, but the many men and women that fight for our country and live the rest of their lives re-adjusting to life outside the military."

Before I close, let me mention another issue that I first learned about during my time at the BBB: the fact that, for many National Guard and Reserve members who are small business owners, combat deployment, while a source of extra pay and allowances, can have a catastrophic impact on their civilian small business back at home. Without the ability to do the work or directly supervise day-to-day operations, many have seen their businesses languish and ended up in the position of having no option but to shut down and declare bankruptcy when they got home. But at that point they ran afoul of the bankruptcy "means test," which calculated their income over a several-year period and included all their military income in that calculation. With the inclusion of deployment's special pay and allowances, even though the servicemember was no longer eligible for nor receiving them when filing for bankruptcy, the servicemember's income was often declared to be too high for bankruptcy eligibility, denying them the ability to make a fresh start.

Congress fixed that issue with the National Guard and Reservists Debt Relief Act of 2008[11], providing exemptions from the means test for certain qualifying Guard and Reserve members. In 2015, when those protections were due to expire, they were extended until December of 2019[12]. Today this subcommittee is looking at a bill to extend the protections once again, for another 4 years, and I'd like to express my support for that effort, as the Reserve Component continues to be an operational force around the world. Our citizen Soldiers who leave their civilian jobs to put on the uniform and serve our country should not be financially penalized for doing so.

To close, I'd like to thank the subcommittee for considering two important bills today designed to protect in bankruptcy those who have served our country. Ideally, no one should need to declare bankruptcy, but the truth is that it happens, and it happens at a higher rate for veterans than for the general population. Their financial situation is not improved by the fact that many of them leave the service with disabilities that make it difficult to earn a living wage, and may limit the wage-earning capabilities of their spouse, who serves as a caregiver for them. Given the recent high levels of veteran suicide and mental health issues, no veteran should face the added stress of pledging their disability benefits to creditors or suffering under a cloud of financial distress outside of bankruptcy. It surely is the right thing to do to eliminate roadblocks that make it harder for them to discharge their debts and get a fresh start, and I commend those who realized that and set these bills in motion.

Thank you.

[11] https://www.congress.gov/110/plaws/publ438/PLAW-110publ438.pdf
[12] https://www.govinfo.gov/content/pkg/BILLS-114hr4246enr/pdf/BILLS-114hr4246enr.pdf

Mr. CICILLINE. Thank you, Ms. Petraeus. Mr. Keach is now recognized for 5 minutes.

TESTIMONY OF ROBERT KEACH

Mr. KEACH. Mr. Chair—

Mr. CICILLINE. Would you please turn on your microphone?

Mr. KEACH. Thank you.

Mr. CICILLINE. Thank you.

Mr. KEACH. Chair Cicilline, Ranking Member Sensenbrenner, and Chair Nadler, distinguished Members of the subcommittee, thank you for inviting me to present the views of the American Bankruptcy Institute in support of the several bipartisan bankruptcy measures now pending before the subcommittee. ABI is the world's largest association of professionals practicing in appropriately structuring in personal bankruptcy with nearly 11,000 Members worldwide.

I was honored to serve as the co-chair of the ABI's Commission to Study the Reform of Chapter 11. The 400-page report of the Chapter 11 Commission was the product of more than 3 years of study on how best to improve and modernize the Bankruptcy Code with input from all sectors and viewpoints. The report has been an influential resource for stakeholders and cited by numerous Federal courts, including the Supreme Court, and inspires reform efforts like the bipartisan, bicameral items on today's agenda.

Others will speak on some of these bills, but let me focus on two: The Family Farmer Relief and the Small Business Reorganization Act.

The ABI endorses and urges passage of the Family Farmer Relief Act. This bipartisan and bicameral legislation would increase the debt limits for the filing of Chapter 12 cases from the existing limits, now about $4.1 million, to $10 million. Since its enactment in the midst of the severe farm crisis in 1986, Chapter 12 has been a useful and durable support for the cyclical and economic challenges faced in American agriculture. The original debt limit for Chapter 12 eligibility was $1.5 million. That was set in 1986. However, today's farming operations are larger. Farming has become much more expensive due to the need to access technology. Accordingly, debt loads are much larger given the capital requirements for farmland, equipment, and inputs.

As a result, the liability cap under Chapter 12, which has been increased for cost of living and other factors over the years, does not align with the modern credit and risk environment associated with family farming. This bill would increase that cap to $10 million, which we think is long overdue. A crisis in this sector is already unfolding. Uncertainties in both the trade and commodities markets as well as the impact of natural disasters makes this an ideal time to reset Chapter 12 before a larger crisis arrives.

I would also, Mr. Chair, move to admit a letter from the American College of Bankruptcy in support of the Chapter 12 reform.

Mr. CICILLINE. Without objection, so ordered.

[The information follows:]

MR. KEACH FOR THE RECORD

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June 14, 2019

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Washington, D.C. 20515

Hon. F. James Sensenbrenner
Ranking Member
Subcommittee on Antitrust, Commercial
and Administrative Law
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Cicilline and Ranking Member Sensenbrenner:

The American College of Bankruptcy is an honorary association of almost 900 bankruptcy and insolvency professionals. The College plays an important role in sustaining professional excellence in the bankruptcy field. College Fellows include commercial and consumer bankruptcy attorneys, judges, insolvency accountants, turnaround and workout specialists, law professors, government officials and others in the bankruptcy and insolvency community. Its Fellows share a commitment to the administration and improvement of the Bankruptcy Code.

Please accept this letter as the ACB's endorsement of

1. H.R. 2336, the "Family Farmer Relief Act of 2019," which would increase the debt limits for the filing of chapter 12 cases from their existing limits ($4,153,150 for farmers, and $1,924,550 for fishermen) to $10 million; and

2. the "Small Business Reorganization Act" (which as of the time of this writing has not yet been assigned a bill number in the House, but which we understand will be identical or substantially identical to S. 1091, its counterpart in the Senate), which would provide for a new subchapter V to chapter 11 that establishes a streamlined and much more cost-effective means to reorganize small businesses.

Chapter 12 addresses the needs and concerns of family farmers and fisherman, and while it is an important tool for them, it has not been updated to address the much higher levels of debt they have faced in recent years. If chapter 12 is to accomplish the salutary purposes for which it was enacted, it should be amended to increase the monetary limit for eligibility to invoke it.

Chapter 11 has long been of great value in preserving jobs, enhancing going concern value, and maximizing creditor recoveries for many businesses. But the present chapter 11 does not work efficiently for businesses of smaller size, which constitute the great bulk of business entities in financial distress. For small businesses, the present chapter 11 is seldom effective in achieving a reorganization due to extensive reporting requirements, complicated procedures, broad participation from groups of creditors at the debtor's expense, high costs, and stringent plan confirmation requirements that most small business owners likely cannot meet. Thus, seeking chapter 11 relief often is a path to liquidation rather than to a

P.O. Box 249, Stanardsville, VA [illegible]
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restructuring. Accordingly, many small businesses (as well as many bankruptcy professionals) do not consider chapter 11 in its present form to be a viable option.

The streamlined processes built into the Small Business Reorganization Act would go far in addressing the failure of current chapter 11 to address the foregoing issues, and would make chapter 11 available for the very large community of small businesses, and their creditors, who are so often effectively foreclosed from benefitting from chapter 11. In that regard, the Small Business Reorganization Act would be even more effective in accomplishing its goals if the monetary debt cap for filing a small business chapter 11 case were amended to make it $10 million – the same amount as the cap under a revised chapter 12.

In each case, the American College of Bankruptcy fully supports Congressional efforts to improve the utility of the bankruptcy system through the passage of the Family Farmer Relief Act and the Small Business Reorganization Act. You are welcome to publicly cite the College's support of each of these bills as you deem appropriate to secure the bills' passage.

We note that the views expressed in this statement are those of the American College of Bankruptcy, on whose behalf this statement is issued, and do not necessarily reflect the personal views, if any, of any judge or other Fellow of the College (or any firm or educational institution with which one or more Fellows may be affiliated).

On behalf of the College, we thank you and the co-sponsors of these bills for your service to the country, and, particularly for your work to help farmers, fishermen and small businesses in financial distress, as well as the creditors to whom they are indebted, to obtain the relief they need through our bankruptcy system.

We would be grateful if you would keep us abreast of developments with respect to these bills, and if you would let us know if there is anything more the College can do to support this legislation.

Sincerely,

Marc A. Levinson, Chair

Mark D. Bloom, President

cc: All Subcommittee Members, by electronic delivery

Mr. KEACH. Thank you. Let me speak also briefly about the Small Business Reorganization Act. Chapter 11 of the Bankruptcy Code has long been of great value in preserving going concern value jobs and maximizing creditor recoveries from any businesses. Small businesses are the entities that drive job creation in a dynamic economy, but they are also most likely to experience financial distress. As Congress looks to find ways to help small businesses enter the marketplace and create jobs, it should also focus on helping existing businesses succeed and save jobs that otherwise would be lost if those businesses closed their doors.

The Small Business Reorganization Act of 2019 is a good start, and we thank Representative Cline and Chair Cicilline for sponsoring it in the House. This is the jobs bill that has already been paid for. It costs us nothing to make the bankruptcy system work better for small business. With some tweaking, it can be an even more effective remedy.

The testimony before the ABI Commission strongly established that the Chapter 11 process simply does not work for small- and medium-sized businesses. Witnesses testified consistently that small businesses were running away from Chapter 11, and those that filed were filing, frankly, merely to facilitate a quick liquidation. Only 27 percent of small businesses that file Chapter 11 confirm plans.

Why is Chapter 11 in its existing form not working? It's simply too complex and too costly for these businesses. More importantly, current doctrines that apply in Chapter 11 means that it is a virtual certainty that the existing owners of the business will not get to retain their ownership interest in reorganizing under Chapter 11. The Small Business Reorganization Act fixes those problems. However, like the Chapter 12 bill, we think its debt limit is somewhat too low at $2.6 million. ABI would encourage that the same change be made to this bill in increasing the debt limit to $10 million for small businesses. The data studied by the ABI Commission seem to establish that as the right level to encompass the businesses that need help.

Here, too, I would like to introduce letters from the American College of Bankruptcy and the National Conference of Bankruptcy Judges in support of this legislation.

Mr. CICILLINE. Without objection, so ordered.

[The information follows:]

MR. KEACH FOR THE RECORD

American College of Bankruptcy

June 14, 2019

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Ranking Member
Subcommittee on Antitrust, Commercial
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U.S. House of Representatives
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On behalf of the College, we thank you and the co-sponsors of these bills for your service to the country, and, particularly for your work to help farmers, fishermen and small businesses in financial distress, as well as the creditors to whom they are indebted, to obtain the relief they need through our bankruptcy system.

We would be grateful if you would keep us abreast of developments with respect to these bills, and if you would let us know if there is anything more the College can do to support this legislation.

Sincerely,

Marc A. Levinson, Chair

Mark D. Bloom, President

cc: All Subcommittee Members, by electronic delivery

NCBJ | National Conference of Bankruptcy Judges

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June 21, 2019

The Honorable Jerrold Nadler, Chair
House Judiciary Committee
2132 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Doug Collins, Ranking Member
House Judiciary Committee
1504 Longworth House Office Building
Washington D.C. 20515

Re: Small Business Reorganization Act of 2019 (S.1091)

Dear Chairman Nadler and Ranking Member Collins:

The National Conference of Bankruptcy Judges ("NCBJ") is an association of the Bankruptcy Judges of the United States which has several purposes: to provide continuing legal education to judges, lawyers and other involved professionals, to promote cooperation among the Bankruptcy Judges, to secure a greater degree of quality and uniformity in the administration of the bankruptcy system and to improve the practice of law in the United States Bankruptcy Courts. In accord with its approved legislative action guidelines, the NCBJ submits this letter in support of the Small Business Reorganization Act of 2019 (S.1091) (the "SBRA").

The provisions of the SBRA aim to reduce the time, resources, and costs expended by small business debtors in their efforts to reorganize under chapter 11 of the Bankruptcy Code. In addition, the SBRA allows an independent trustee to provide oversight in cases where creditors typically lack the ability or wherewithal to actively monitor the proceeding. The NCBJ supports these efforts to enhance the viability of small business reorganizations while balancing the rights of debtors, creditors, and other constituencies.

The views expressed in this letter represent those of the NCBJ as an organization, on whose behalf this statement is issued, and do not necessarily reflect the personal views of any sitting bankruptcy judge.

Please do not hesitate to contact me if you have any questions.

With kindest regards, I am

Respectfully yours,

John E. Waites

Honorable John E. Waites
President,
National Conference of Bankruptcy Judges

cc: Susan Jensen
Committee on the Judiciary
Susan.Jensen@mail.house.gov

Mr. KEACH. My time is about up, but I would just take my last statement to also note that the ABI supports the HAVEN Act, and like to submit a letter from the American College of Bankruptcy in support of the HAVEN Act as well.

[The information follows:]

MR. KEACH FOR THE RECORD

American College of Bankruptcy

June 11, 2019

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Hon. Doug Collins
Ranking Member, Committee on Judiciary
United States House of Representatives
1504 Longworth House Office Building
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Please accept this letter as the ACB's endorsement of the Honoring American Veterans in Extreme Need (HAVEN) Act, introduced in the House of Representatives as H.R. 2938, and also introduced (with the same text) in the Senate as S. 679. There is no reasonable basis for the Bankruptcy Code's inequitable treatment of veterans' disability benefits, and the ACB fully supports Congressional efforts to rectify this problem through the passage of the HAVEN Act. You are welcome to publicly cite the ACB's support of the HAVEN Act as you deem appropriate to secure the bill's passage.

We note that the views expressed in this statement are those of the American College of Bankruptcy, on whose behalf this statement is issued, and do not necessarily reflect the personal views, if any, of any judge or other Fellow of the College (or any firm or educational institution with which one or more Fellows may be affiliated).

On behalf of the ACB, we thank you and the co-sponsors of the HAVEN Act for your service to the Country, and, particularly for your work to help disabled veterans in financial distress obtain the relief they need through our bankruptcy system.

We would be grateful if you would keep us abreast of developments with respect to the HAVEN Act, and if you would let us know if there is anything more the ACB can do to support this important piece of legislation.

Sincerely,

Marc A. Levinson, Chair

Mark D. Bloom, President

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AMERICAN BANKRUPTCY INSTITUTE www.abi.org

HEARING ON OVERSIGHT OF BANKRUPTCY LAW & LEGISLATIVE PROPOSALS

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMMERCIAL AND ADMINISTRATIVE LAW

HOUSE COMMITTEE ON THE JUDICIARY

JUNE 19, 2019

TESTIMONY OF AMERICAN BANKRUPTCY INSTITUTE

BY ROBERT J. KEACH, ESQ.

BERNSTEIN SHUR; PORTLAND, MAINE

ABI PAST PRESIDENT AND CO-CHAIR, COMMISSION TO STUDY THE REFORM OF CHAPTER 11

Chairman Cicilline and Ranking Member Sensenbrenner,

Thank you for inviting me to present the views of the American Bankruptcy Institute (ABI) in support of several bipartisan bankruptcy measures now pending before the subcommittee. ABI is the world's largest association of professionals practicing in the area of corporate restructuring and personal bankruptcy, with nearly 11,000 members worldwide. ABI is non-profit and non-partisan, and was founded in 1982 in part to provide unbiased analyses to Congress, administrative agencies and the public. Our website, ABI.ORG, contains a wealth of news, information, case law, analysis and scholarly research, updated each day.

I served as President of ABI from 2009-10 and later as Co-chair of ABI's Commission to Study the Reform of Chapter 11 (Chapter 11 Commission). My full bio is attached to these remarks. I was also retained, prior to the commencement of the Title III cases under PROMESA, to serve as a fee examiner with respect to certain professionals retained by the Financial Management and Oversight Board for Puerto Rico (FOMB), and, following the appointment by the court of a fee examiner for the Title III cases, Brady Williamson, I have continued to advise the FOMB with respect to the review of fees and expenses of professionals retained by the board with respect to fees and expenses incurred in connection with non-Title III services. In my testimony with respect to PRRADA below, I do not testify on behalf of the FOMB, but only as a representative of the ABI, and my statements do not reflect the views of the FOMB or any member thereof.

The 400-page report of the Chapter 11 Commission was the product of three years of study by two dozen thought leaders in the community on how best to improve and modernize a U.S. Bankruptcy Code that was nearly 40 years old at the time. Since its issuance in 2014, the Chapter 11 Commission report has been an influential resource for stakeholders and cited by numerous federal courts, including the U.S. Supreme Court. The Chapter 11 Commission continues to inspire legislative reform, including at least one of the bipartisan, bicameral items on today's agenda, which ABI is pleased to support.

Today I will address four bipartisan measures: the "Family Farmer Relief Act of 2019", the "Small Business Reorganization Act of 2019", the "Honoring American Veterans in Extreme Need Act of 2019", and briefly, the "Puerto Rico Recovery Accuracy in Disclosures Act of 2019". I will also offer for the record with your permission, supporting letters from the American College of Bankruptcy on several of these items.

We also understand the Subcommittee has an interest in the important interface between the Bankruptcy Code and student loan debt. This significant economic problem is the subject of the first set of reform recommendations contained in the Final Report of the ABI Commission on Consumer Bankruptcy (Consumer Commission) issued on April 11 of this year, and we are pleased to be able to share those recommendations today, as part of my written statement.

Family Farmer Relief Act of 2019 (H.R. 2236; S. 897)

This bipartisan and bicameral legislation would increase the debt limits for the filing of Chapter 12 cases from the existing limits (now $4,153,150 for farmers) to $10 million.

Since its enactment in the midst of the severe farm crisis in 1986, Chapter 12 has been a useful and durable support for the cyclical economic challenges faced in American agriculture, roiled by fluctuating land values, swings in commodity prices, weather calamities and adverse trade policies made by government. In 2005 Chapter 12 was made a permanent part of the Bankruptcy Code's protections and expanded to include family fishermen. Chapter 12 has not only assisted family farmers in their efforts to successfully reorganize debts in bankruptcy court, it has perhaps more significantly provided a framework that encouraged stakeholders to reach agreement on debt restructuring outside the expense of the formal bankruptcy process.

Farming is not just a job; it is a way of life in farming communities that exist in nearly every Congressional district in the country. There is great value for rural communities who are able to retain entrepreneurs involved in family farming.

At the outset in 1986, Congress established a debt limit of $1,500,000 for eligibility. Since then, the debt limits have been adjusted upward, but limited to changes in the Consumer Price Index. In 1986 the vast majority of farms were owned and operated by members of a single or extended family. That remains true, as today's farms are owned and operated by the later generations of those families who managed to survive cycles of severe economic stress, with the help of Chapter 12. However, today's farming operations are much larger and operated by fewer families than in the 1980s. Farming has progressed from intense labor with small equipment in the 1980s to limited labor but much more expensive technology, including computers using expensive GPS capability. Debt amounts are much larger today, given capital requirements for farm land, equipment and inputs.

Relative to 1986, and in nominal dollars, production expenses in agriculture have increased by 198 percent and farm debt has increased by 182 percent, while net cash income has experienced only half of that growth, according to the American Farm Bureau. As a result, the liability cap under Chapter 12 does not align with the modern credit and risk environment associated with family farming.

Rep. Delgado's bill (H.R. 2336), which now has 23 bipartisan cosponsors, is a needed improvement if Chapter 12 is to continue to serve its salutary proposes for family farmers and Main Street businesses who work in concert in rural communities.

The Family Farmer Relief Act of 2019 would allow more family farmers to seek relief under the program by raising the Chapter 12 operating debt cap to $10 million. Lifting the liability cap and giving more farmers an opportunity to qualify for Chapter 12 bankruptcy provides the restructuring and seasonal repayment flexibility that many farmers need in today's lagging farm economy and will help to align bankruptcy law with the scale and credit needs of U.S. agriculture.

Farmers and ranchers have experienced what turbulent economic headwinds do to the livelihoods of families and our rural communities. No region of the country is unaffected: in the last 10 years, more than 200 Chapter 12 cases have been filed in New York, Texas, Michigan, Puerto Rico and Florida. More than 300 have been filed in Wisconsin and Georgia, and more than 400 in California.

This commonsense, bipartisan legislation will give more family farms an opportunity to reorganize their business while avoiding critical disruptions in our national agriculture supply chain that can affect every American. To be sure, while there certainly have been years where farmers faced greater immediate financial challenges than 2019, uncertainties in both the trade and commodities markets make this an ideal time to reset Chapter 12 before a crisis arrives. ABI supports this legislation and urges its enactment in this Congress.

Small Business Reorganization Act of 2019 (H.R. ; S.1091)

Chapter 11 of the Bankruptcy Code has long been of great value in preserving going concern value, jobs, and maximizing creditor recoveries for many businesses. But as the Chapter 11 Commission found, the law no longer works well for businesses of smaller size.

Small businesses are the entities that produce job creation and a dynamic economy, but are also most likely to experience financial distress.

As Congress looks to find ways to help small businesses enter the marketplace and create new jobs, it also should focus on helping existing businesses succeed and save jobs that otherwise would be lost if those businesses closed their doors. The "Small Business Reorganization Act of 2019" (SBRA) is a good start and we thank Rep. Cline and Rep. Cicilline for sponsoring it in the House. With modest improvement, it can be even more effective in service to the nation's economic backbone.

The deficiencies in existing U.S. bankruptcy laws were highlighted and examined extensively during a three-year study process undertaken by the American Bankruptcy Institute's Chapter 11 Commission. The Commission was made up of 22 of the country's most respected and experienced bankruptcy professionals, and the Commission process involved approximately 150 bankruptcy professionals working on advisory committees and almost 90 witnesses who testified at 17 public hearings. The Commission endeavored to include all perspectives and stakeholders in the conversation, including businesses of all sizes, secured lenders, bondholders, unsecured trade creditors, and employees. Consequently, the Commission's findings and recommendations are the result of a holistic study that seeks to improve the U.S. bankruptcy system for all stakeholders.

The Commission's study concluded that Chapter 11 no longer works efficiently or effectively for many financially distressed companies or their creditors. Although the identified issues permeate chapter 11 bankruptcies, the testimony before the Commission suggested that the chapter 11 process simply does not work at all for small- and medium-sized businesses. Witnesses testified how small- and medium-sized businesses no longer use chapter 11 to try to save their businesses; rather, for the most part, these companies file bankruptcy knowing the business will not survive. And the numbers support this testimony. For example, for Fiscal Years 2008-2015, over 18,000 small businesses filed a chapter 11 case; only about 27% of those companies confirmed a reorganization plan. Notably, these numbers do not account for the small businesses that are struggling but do not even try to reorganize under chapter 11 because the Bankruptcy Code is seen as broken and unworkable for those kinds of businesses[1].

Chapter 11 doesn't work for small and medium-sized businesses because the Bankruptcy Code (a) places unrealistic and artificial deadlines on small- and medium-sized businesses, which do not give these companies an opportunity to restructure; (b) imposes substantial and costly disclosure and reporting requirements on these companies; (c) does not provide any tools that can help small businesses—whose owners may be unsophisticated in finance, business plans, or restructuring issues—create and implement an effective

[1] Indeed, in FY 2018, there were only 1,335 small business chapter 11 cases filed nationwide. The number of cases filed under the current small business chapter 11 has declined for eight consecutive years. Source: Federal Judicial Center Integrated Data Base.

reorganization plan; and (d) makes it difficult for a small business owner to maintain an ownership interest in the business under the current Chapter 11.

Providing a small- or medium-sized debtor with the time and the tools to reorganize under the Bankruptcy Code allows individuals to retain businesses they have worked hard to build, while preserving the value of secured creditors' collateral. It keeps that business operating and acting as a customer or supplier to other small businesses, and it saves jobs. It also encourages owners of struggling businesses to seek the help they need or to enter into financing and other arrangements that may mitigate short-term problems, rather than deepening the company's longer-term financial or operational difficulties through delay. It also protects the rights of creditors in terms of notice, due process and fair and equitable treatment -- rights not present in potential state law alternatives

The SBRA could address many of the difficulties experienced by small business debtors, in large measure by applying the terms found in Chapter 12. However, the SBRA as currently proposed would apply to cases where a debtor has aggregate liabilities that do not exceed $2,566,050 (excluding debt owed to one or more affiliates or insiders). This debt limit, borrowed from the current definition of "small business debtor" in Section 101(51D) of the Code, is simply too low to provide meaningful help for small and medium-sized companies.

As in the case of family farms, most small businesses will have more than $2.7 million in total debt (secured, priority and unsecured). For example, in times of distress, a business will actually increase borrowings secured by the business assets in an attempt to remain afloat. Or one underinsured judgment in a products liability case, for example, could make a business ineligible for relief, when that relief is most needed. Accordingly, we think the debt limit proposed for a remodeled Chapter 12 ($10 million, as found in H.R. 2336) should be adopted as part of SBRA.

The ABI Chapter 11 Commission considered several analyses and empirical studies of Chapter 11 debtors' assets and liabilities found in the schedules of filed cases. The data revealed a natural breaking point at a $10 million threshold. The Commission then examined the types of businesses that might be captured by a definition that included companies with $10 million or less in assets or liabilities. They considered this question based on industry and geographic region, methodically walking through the different companies that could be captured by such a definition.

The Commission agreed that while public companies should be excluded from small business treatment no matter the size, that otherwise entities with $10 million or less in assets or liabilities corresponded most closely with businesses not well served by current U.S. bankruptcy law. We support this change to the SBRA.

Honoring American Veterans in Extreme Need Act of 2019 (H.R. 2938; S. 679)

The objective of the [Honoring American Veterans in Extreme Need (HAVEN) Act of 2019] is to secure the economic well-being of veterans and dependents who rely on disability compensation and may be experiencing financial hardship.

The problem is that under current bankruptcy law, disability benefits paid by the Department of Veterans Affairs [VA] and the Department of Defense [DoD] are included in the calculation of a debtor's disposable income, which increases the portion of the debtor's income that is subject to the reach of creditors. By contrast, current bankruptcy law explicitly exempts Social Security disability benefits from this disposable-income calculation. This disparate and unexplained treatment of veterans results from an apparent drafting error in the 2005 bankruptcy amendments. Unfortunately, it has resulted in significant financial hardship to some disabled veterans who have been forced to use benefits to fund repayment plans in Chapter 13 while being denied access to Chapter 7.

When a disabled veteran who has served his country has his or her VA disability benefits included in current monthly income (CMI) for purposes of the Chapter 7 means test, the likely result is that the veteran will "fail" the means test, while an identically disabled person receiving Social Security benefits can exclude the income and remain eligible for relief. This disparate treatment discriminates against veterans and should be fixed.

To eliminate this unequal treatment of disability benefits, the HAVEN Act would exclude VA and DoD disability payments made to veterans or their dependent survivors from the monthly income calculation used for bankruptcy means testing. Disabled veterans have earned their disability-related benefits in defense of our nation, and these benefits honor their service and the sacrifices that they have made. Forcing debtor beneficiaries to dip into these funds to pay off creditors not only dishonors their service and sacrifice, but also puts taxpayers at risk by increasing the likelihood that the beneficiary and his or her dependents will require public assistance. The HAVEN Act also complements recent congressional efforts to combat service member and veteran mental health issues, addiction, suicide, poverty, and homelessness — all of which are exacerbated by financial hardship.

The HAVEN Act has also been endorsed by a wide array of stakeholder groups, including the ABI. *Final Report of the ABI Commission on Consumer Bankruptcy, p 135-36 (2019).* Others include the American College of Bankruptcy, the Boston Bar Association, The American Legion, Veterans of Foreign Wars, Disabled American Veterans, Paralyzed Veterans of America, Iraq and Afghanistan Veterans of America, Wounded Warrior Project, Association of the United States Army, Association of the United States Navy, Retired Enlisted Association, Society of Military Widows, Veterans for Common Sense, and the U.S Army Warrant Officers Association.

We commend Rep. McBath and Rep. Steube for their recent introduction the HAVEN Act in the House. With the committee's permission, I would offer for the record letters in support of the HAVEN Act from the American College of Bankruptcy, as well as two recent articles published in the American Bankruptcy Institute *Journal*.

Puerto Rico Recovery Accuracy in Disclosures Act (PRRADA) of 2019 (H.R. 683; S. 1675)

This bill, introduced by Rep. Velazquez on behalf of a group of bipartisan cosponsors, would impose certain requirements on the payment of compensation to professional persons employed in cases commenced under Title III of the Puerto Rico Oversight Management and Economic Stability Act (commonly known as "PROMESA"). A similar bill in the Senate also enjoys bipartisan support.

Congress passed PROMESA in 2016 to set up a process to restructure the island's debts, pay off creditors, ensure efficient permitting of critical infrastructure projects, provide for fiscal responsibility and put the island on the path to financial recovery.

However, Congress failed to include one essential check in PROMESA: the requirement that the professionals compensated under PROMESA disclose any connections to the various creditors or other key stakeholders. This transparency requirement applies to every corporate bankruptcy under the Bankruptcy Code and Rules.

Under the bill, in a case commenced under section 304 of PROMESA, no attorneys, accountants, appraisers, auctioneers, agents, consultants, or other professional persons shall be compensated under section 316 of PROMESA (48 U.S.C. 2176) unless prior to making a request for compensation, such a professional person has submitted a verified statement conforming to the disclosure requirements of rule 2014(a) of the Federal Rules of Bankruptcy Procedure setting forth the professional person's connections with the debtor, creditors, any other parties in interest, their respective attorneys and accountants, the Oversight Board, and any person employed by the Oversight Board. Such statement shall include information on the identity of each entity or person with whom such professional person has a connection. Such professional person shall be required (1) to supplement such verified statement as additional relevant information becomes known to such person; and (2) to file annually a notice confirming the accuracy of such statement.

PRRADA should provide, in future proceedings, the same transparency and disclosure practices required by law in U.S. mainland bankruptcies. To the extent that it is consistent with current Bankruptcy Code requirements, it is a welcome change. However, because the PROMESA proceedings have been in place for some time, and the disinterestedness and other standards of the Bankruptcy Code were not requirements for retention of professionals at the outset of any of the Title III cases, the remedy provisions of PRRADA will have to be carefully considered, and likely amended, to prevent the inadvertent disqualification or necessary resignation of professional firms, including many local firms, that fairly and properly met the standards of retention when the Title III cases were commenced. Such an event could be highly disruptive of the current proceedings and the considerable progress made in those cases. Calibration of the application of the Bankruptcy Code standards going forward, when such standards did not previously govern, is essential to avoid interfering with that progress.

Student Loan Debt Treatment in Bankruptcy

U.S. student loan debt has ballooned from less than $400 billion in 2004 to over $1.5 trillion today, far surpassing credit card or auto debt. It is projected to swell to $2 trillion by 2022 and experts say a large portion of it is unlikely to ever be repaid. More than a quarter of borrowers are in delinquency or default. Student over-indebtedness has significant adverse consequences for the national economy as well. High levels of post-secondary education debt correlates with lower earnings, lower rates of home ownership, fewer automobile purchases, higher household financial distress, and delayed marriage and family formation among other ripple effects.

In the 1970s, policy makers were concerned that students would take out numerous loans and then seek to discharge them in bankruptcy after graduation. As a result, lawmakers added a stipulation that student loan borrowers would have to wait at least five years after they began repayment before they could be discharged in bankruptcy. In 1990, that waiting period was increased to seven years. Almost a decade later, the rules changed again, and now people with federal or private student loans can discharge their debt in bankruptcy only if they can prove their loans pose an "undue hardship." But what one bankruptcy judge finds to be an undue hardship may not be to a judge across the country, or in the same circuit, or even in the same court house.

Congress has never spelled out what that term means, and lawyers and advocates say this uncertainty leads to unfairness in the courts and a reluctance by financially distressed borrowers to even consider bankruptcy as an option. A number of voices in Congress have joined law scholars in calling on the U.S. Department of Education to establish clear rules around when borrowers are eligible to discharge their student debt in bankruptcy.

The ABI's Consumer Commission studied this issue as well from 2017-19 and unanimously recommended a series of statutory amendments to Sections 523(a)(8) and 1322, as well as calling for the Department of Education to promulgate bright line rules in cases of disability, poverty and the allowance of alternative repayment plans. The Consumer Commission further recommended that the *Brunner* test on "undue hardship" be clarified, and that student loan debt be permitted to be separately classified in Chapter 13 plans.

Significantly, the Consumer Commission weighed the rationale for student loan dischargeability against the current and projected student debt landscape. "The Commission considered but rejected the notion of making student loans freely dischargeable like any other debt, concluding that the rationales supporting nondischargeability remain valid". *Final Report of the ABI Commission on Consumer Bankruptcy*, p. 6 (2019). Instead, "[T]he Commission's recommendations are intended as a package and represent a practical, middle ground approach that will provide meaningful changes while respecting the traditional protections for student loans".

Thank you for the opportunity to appear before the Committee today. The ABI is ready to assist the Committee and staff on these important bankruptcy proposals.

Mr. CICILLINE. Thank you, Mr. Keach. The Chair now recognizes Mr. Boltz for 5 minutes.

TESTIMONY OF ED BOLTZ

Mr. BOLTZ. On behalf of NACBA, I want to thank Chair Nadler, Ranking Member Collins of the Judiciary Committee, and Chair Cicilline and Ranking Member Sensenbrenner of this Subcommittee for the opportunity to offer our views on the State of consumer bankruptcy and pending legislative proposals. While there are many issues related to consumer bankruptcy in play in both the courts and throughout the economy as a whole, I will limit my remarks to some currently-pending legislation directly related to bankruptcy as well as several other topics to which proposed legislation may serve as effective vehicles for essential change.

First, we would talk about restoring the bankruptcy discharge for student loans. NACBA through its Members and, more importantly, its clients are often the first to see economic troubles affecting Americans. In 2007, NACBA, with the Center for Responsible Lending and the Consumer Federation of America, released a survey finding that there was a sharp rise in subprime mortgage-related problems. Shortly thereafter, we hit the great recession caused by the housing crash. In 2012, again NACBA first forecast the coming student debt bomb. Since then, student debt has skyrocketed to over $1.5 trillion, and the amount of student loan debt now surpasses all other consumer debt except for mortgage debt.

In response to this unabated growth of the student loan crisis and greater questions about higher education, there have been numerous proposals, both large and small. While the Department of Justice, after consultation with NACBA, among others, has given guidelines about allowing Chapter 13 debtors to participate in various income-driven repayment plans during their bankruptcies, such plans have often faced resistance from bankruptcy courts as purportedly constituting unfair discrimination.

Additionally, in February 2018, the Department of Education issued a request for information regarding its application of the undue hardship standard currently under the Bankruptcy Code. Despite more than 400 responses highlighting the harsh effects of this standard submitted more than a year ago, there have been no results, let alone any changes, in the practices by the Department of Education in this regard. Additional congressional oversight of the Department of Education would be welcome.

These minimum efforts, however, show the inadequacy of piecemeal, non-comprehensive changes that stop short of restoring the general dischargeability of student loans in bankruptcy. Furthermore, while government loan programs generally lend to borrowers without regard to creditworthiness, private student loans are largely underwritten on the same basis as other consumer debts with lending risk reflected in the interest rates charged as well as requiring co-signers, often parents or elderly grandparents, and other demands for security. Research indicates that the non-dischargeability of private student loans made in 2005 by BAPCPA did not result in the lowering of interest rates by student borrowers, in large part because there is no showing of strategic default by borrowers prior to BAPCPA or since.

Restoration of the discharge of bankruptcy for student loans and private student loans would help restore the most debt-burdened and make them economically functional again. For these reasons, we support Senator Durbin and the House bill, H.R. 2648, that would restore the complete discharge. We also would support as a smaller step H.R. 885, which would restore the dischargeability of private student loans.

Regarding the HAVEN Act, the Bankruptcy Code uses a means test to determine the projected disposable income a debtor has to pay to unsecured creditors. These tests are based currently on monthly income, which excludes the debtor's Social Security Act, while Social Security and disability retirement benefits are excluded based on the protections outside of bankruptcy from collection by any creditors, with the sole exception largely being student loans.

Debtors receiving veterans' disability benefits as well as veterans retirement benefits have these same protections outside of bankruptcy as do other forms of public retirement benefits, such as railroad workers and certain public school workers. As written in an article published earlier today, many of these people are worse off in bankruptcy than they would be outside of bankruptcy.

For these reasons, NACBA supports the HAVEN Act, but would encourage this Subcommittee to look at expanding such to cover not just disability benefits, but also veterans' retirement benefits. We do recognize that should be capped, however, at the maximum amount of Social Security so as to not provide a windfall for retirees with substantial benefits otherwise.

I thank you for your time.

[The statement of Mr. Boltz follows:]

Written Testimony of Edward C. Boltz
National Association of Consumer Bankruptcy Attorneys

Before the Subcommittee on Antitrust, Commercial and Administrative Law
Judiciary Committee
U.S. House of Representatives

Subject: Oversight of Bankruptcy Law and Legislative Proposals

June 19, 2019

Introduction

Chairman Cicilline, Ranking Member Sensenbrenner and Members of the Subcommittee:

My name is Edward Boltz and I am a consumer bankruptcy attorney, practicing in North Carolina. I am appearing on behalf of the National Association of Consumer Bankruptcy Attorneys (NACBA), where I currently serve as its vice president of and co-chair of its legislative committee. I have also previously served as the president of this same association. NACBA is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. Formed in 1992, NACBA has nearly 3,000 members located in all 50 states and Puerto Rico. NACBA's members represent a large percentage of the American consumers who file bankruptcy cases in the United States Bankruptcy Courts.

On behalf of NACBA, I want to thank Chairman Nadler and Ranking Member Collins of the Judiciary Committee and Chairman Cicilline and Ranking Member Sensenbrenner of this Sub-Committee for the opportunity to offer our views on the state of consumer bankruptcy and also pending legislative proposals. Over the past 25 years NACBA members have greatly appreciated the bi-partisan interest and support of Congress. While there are many issues relating to consumer bankruptcy currently in play both in the courts and throughout the economy as a whole, I will limit my remarks to currently pending legislation directly related to bankruptcy, as well as several other important topics as to which other proposed legislation may serve as effective vehicles for essential change.

1. **Restore Bankruptcy Discharge for Student Loans**[1]

   NACBA, through its members and their clients, is often the first to see economic trouble affecting Americans. In 2007, NACBA released with the Consumer Federation of America

[1] All statutory references are to Title 11 of the United States Code, unless otherwise specified.

and the Center for Responsible Lending a national survey find a sharp rise in subprime mortgage related problems.[2] In 2012,[3] NACBA first forecast the coming "Student Loan Debt Bomb."[4] Since then student loan debt has skyrocketed to over $1.5 trillion.[5] The amount of student loan debt now surpasses all other types of consumer debt, with the sole exception of mortgage debt.[6] Student loans have the highest delinquency rate of any other type of household debt.[7] A significant number of borrowers have fallen into default[8] and are unable to make meaningful payments.[9] Growing evidence indicates that student loan debts not only severely restrict borrowers' futures, but also are choking economic productivity.[10]

The history of student loans in the context of bankruptcy is one of ever-increasing restrictions on discharge through legislation often unrelated to bankruptcy, passed with little direct oversight or hearings by this Subcommittee or even Congress more generally. Originally, under the Bankruptcy Code enacted in 1978, student loans were dischargeable after five years in Chapter 7, sooner upon a showing of undue hardship,[11] and without a waiting period in Chapter 13. But then, in 1990, through separate legislation not directly related to bankruptcy and subject to scant legislative inquiry, the waiting period in Chapter 7 was extended from five to seven years[12] and later made applicable in Chapter 13.[13] The waiting period was then completely eliminated in 1998, making covered student loans

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2 *See* https://consumerfed.org/pdfs/Bankruptcy_Press_Release041207.pdf

3 *See* https://www.nacba.org/wp-content/uploads/2015/06/020712-NACBA-student-loan-debt-report.pdf

4 For regular updates regarding the Student Loan crisis, *see* https://www.studentdebtbomb.com/

5 From the Federal Reserve's G.19 release on consumer credit, available at: https://www.federalreserve.gov/releases/g19/current/default.htm.

6 See Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit (2018:Q2), at 3 (Aug. 2018) https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/ pdf/HHDC_2018Q2.pdf.

7 See *id.* at 12-14.

8 In the context of student loans, "default" means there have been no payments for more than 270 days, whereas a student loan is "delinquent" if there has not been a payment within 30 days.

9 *See* Kristen Blagg, "Underwater on Student Debt," (Aug. 2018), https://www.urban.org/research/publication/underwater-student-debt/view/full_report; Ben Miller, "Getting Repayment Rates Right," Center for American Progress (July 10, 2018), https://www.americanprogress.org/issues/education-postsecondary/reports/2018/07/10/453199/getting-repayment-rates-right/; Judith Scott-Clayton, "The Looming Student Debt Crisis Is Worse Than We Thought," Economic Studies at Brookings (Jan. 10, 2018), https://www.brookings.edu/wp-content/uploads/2018/01/scott-clayton-report.pdf.

10 The negative impacts of student loans have been found to include: (1) lower earnings of college graduates; (2) lower levels of homeownership; (3) fewer automobile purchases; (4) higher household financial distress; (5) lower probability of students choosing public-service careers; (6) poorer psychological functioning; (7) delayed marriage; and (8) lower probability of continuing education through graduate school. For a survey of these findings, see Lawless, Robert M., "Final Report of the ABI Commission on Consumer Bankruptcy" (2019), at 3, fns. 6-13.

11 It was under these statutory provisions that the test for discharge of student loans in the majority of jurisdictions was developed in *Brunner v. New York State Higher Educ. Serv. Corp. (In re Brunner)*, 46 B.R. 752 (S.D.N.Y. 1985), aff'd, 831 F.2d 395 (2d. Cir. 1987). Ms. Bruner, the debtor in the case, was forced to seek the discharge of her student loans less than a year after her college graduation. **As interpreted by the courts based on that decision, the undue hardship provision has proved to be a nearly insurmountable barrier to the discharge of student loans in bankruptcy.**

12 *See* Crime Control Act of 1990, Pub L. No. 101-647, § 3621, 104 Stat. 4789, 4965.

13 *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 3007(b)(1), 104 Stat. 1388, 1388-28.

nondischargeable in all cases absent a showing of undue hardship.[14] Most recently, in 2005, the student loan nondischargeability provisions were extended to include private student loans.[15]

In response to the unabated growth of the student loan crisis and the greater questions about higher education, there have been numerous proposals large and small. While the Department of Justice, after consultation with NACBA, among others, has published guidelines for allowing Chapter 13 debtors to participate in the various Income Driven Repayment ("IDR") plans during their bankruptcy,[16] such plans have often faced resistance from bankruptcy courts as purportedly constituting "unfair discrimination."[17] Additionally, in February 2018, the Department of Education issued a Request for Information regarding its application of the undue hardship standard.[18] Despite the more than 400 responses highlighting the harsh effects of this standard,[19] submitted over a year ago, no results, let alone actual changes in procedures, by the Department of Education have been forthcoming. (Additional congressional oversight of the Department of Education in this regard would be welcome.[20]) These minimal efforts show the inadequacy of piecemeal, non-comprehensive changes that stop short of restoring the general dischargeability of student loans in bankruptcy.

Furthermore, while government student loan programs generally lend to borrowers without regard to credit worthiness, private student loans are underwritten largely on the same basis as other unsecured consumer loans, with lending risks reflected in the interest rate offered, as well as requirements for co-signers (usually parents or even elderly grandparents), among other demands for security. Research indicates that the nondischargeability of private loans made under BAPCPA did not, however, result in lower interest rates for

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[14] *See* Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971(a), 112 Stat. 1581, 1837. This Act also eliminated the previous ten year Statute of Limitations for collection of government student loans, making them perhaps the only debt without any such limitation.

[15] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59. This preclusion of dischargeability, currently codified at § 523(a)(8)(B), refers to any educational loan that is a "qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986," a category that includes educational loans made by private entities regardless of whether they have a governmental or nonprofit insurance guaranty.

[16] *See* Anderson, Amanda L. and Redmiles, Mark A., Federal Student Loan Debt in Bankruptcy: Recent Movement Towards Income-Driven Repayment Plans in Chapter 13, United States Attorneys' Bulletin, Vol. 66, Number 2, pp. 53-71 (March 2018), available at https://www.justice.gov/usao/page/file/1046201/download

[17] For a survey of cases related to the separate classification of student loans and the more persuasive reasons that such plans should be allowed, see *In re Engen*, 561 B.R. 523 (Bankr. D. Kan. 2016).

[18] *See* https://www.federalregister.gov/documents/2018/02/21/2018-03537/request-for-information-on-evaluating-undue-hardship-claims-in-adversary-actions-seeking-student

[19] The comments submitted by NACBA can be found at https://www.regulations.gov/document?D=ED-2017-OPE-0085-0366

[20] The February 2018 RFI may have been a delayed response to the 2014 letter from, among others, several members of this Committee. *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.

student borrowers,[21] in large part because there is a lack of evidence showing strategic default by borrowers prior to the enactment of BAPCPA.[22]

Restoration of the discharge in bankruptcy for government and private student loans would help the most debt-burdened borrowers of these loans economically functional once again. At the same time, bankruptcy is a serious financial step, which subjects debtors to strict scrutiny of not only their income, but also their assets.[23] Further, bankruptcy not only carries a severe social and moral stigma, but also has a dramatic and lasting effect on debtor's credit score for as long as 10 years. These impacts ensure that any release from student loan indebtedness is not without severe cost, avoiding the moral hazard concerns potentially present under other forgiveness plans.

For these reasons, NACBA supports the following:

- **Student Borrower Bankruptcy Relief Act**, H.R. 2648 & S. 1414: This bipartisan bill would return discharge rights to debtors for student loans.
- **Private Student Loan Bankruptcy Fairness Act of 2019**, H.R. 885: This bill would restore discharge rights for debtors for non-governmental student loan.
- Continued and expanded oversight of the Department of Education and its handling of undue hardship under current law.
- To the extent that student loans remain nondischargeable, expressly affirm that Chapter 13 plans may separately classify student loans to allow maintenance of payments for borrowers in income-driven repayment plans.

2. Treat Veterans' Benefits the Same as Social Security Benefits by Excluding Them From Current Monthly Income

The Bankruptcy Code uses a "means test" in chapter 7 and a "projected disposable income test" in chapter 13 a measure of the debtor's ability to pay creditors. Both tests are based on "current monthly income,"[24] which excludes benefits received under the Social Security Act. Both Social Security disability and retirement benefits[25] are excluded based upon the protection that such benefits have from seizure or assignment for creditors.[26] Debtors

[21] Alexei Alexandrov & Dalie Jiménez, Lessons from Bankruptcy Reform in the Private Student Loan Market, 11 HARV. L. & POL'Y REV. 175 (2017).

[22] *See* Rajeev Darolia & Dubravka Ritter, *Strategic Default Among Private Student Loan Debtors: Evidence from Bankruptcy Reform* (2017), https://ssrn.com/abstract=3064662.

[23] Unlike the various IDR plans, which look solely to a borrower's income without regard to assets, a bankruptcy filing only allows debtors to retain exempt assets without paying claims, including those for student loans, for such nonexempt assets.

[24] 11 U.S.C. § 101(10A) (B)

[25] Other benefits provided under the Social Security Act include: Medicaid, 42 U.S.C. § 1396b; programs in Guam, Puerto Rico, and the Virgin Islands providing old age benefits, *id.* at §§ 301-306; the Stephanie Tubbs Jones Child Welfare Services Program, *id.* at §§ 620-628; programs for family support, family preservation, family reunification, and adoption support services, *id.* at §§ 629-629i; foster care and adoption assistance, *id.* at §§ 670-679c; and aid to the blind in Puerto Rico, Guam, and the Virgin Islands, *id.* at §§ 1201-1206.

[26] 42 U.S.C. § 407(a).

receiving Social Security benefits are protected from being worse off in bankruptcy than outside of it.[27] Veteran's retirement and disability benefits, however, are not excluded, despite having virtually identical purposes, functions and protections outside of bankruptcy.[28] Congress should extend the same protections to disabled and retired veterans as civilians currently have. (Indeed, depending on the type of employment, some civilians may not even be eligible to participate in the Social Security and must instead rely upon other sources of retirement and/or disability benefits that also have virtually identical purposes, functions and protections outside of bankruptcy.[29]) Because the amount of a veteran's retirement is based on the service member's final rank and can potentially be substantial, this exclusion should not exceed the maximum available Social Security benefit.[30]

For these reasons, NACBA supports the following:

- **Honoring American Veterans in Extreme Need Act of 2019** or the **HAVEN Act**, H.R. 2938 and S. 679: As currently proposed, the HAVEN Act would exclude "any monthly compensation, pension, pay, annuity, or allowance paid under title 10, 37 or 38 [of the United States Code] in connection with a disability, combat related injury or disability, or death of a member of the uniformed services except that retired pay excluded under this subclause shall include retired pay under chapter 61 of title 10 only to the extent that such retired pay exceeds the amount of retired pay to which the debtor would otherwise be entitled if retired under any provision of title 10 other than chapter 61 of that title." This legislation would exclude only veteran's disability benefits, but is a modest improvement over current law.
- NACBA strongly supports expanding the proposed protections under the HAVEN Act to exclude "any monthly compensation, pension, pay, annuity, or allowance paid under title 10, 37 or 38 in connection with a disability, combat related injury or disability, **retirement** or death of a member of the uniformed services except that retired pay excluded under this subclause shall include retired pay under chapter 61 of title 10 only to the extent that such retired pay exceeds the **maximum Social Security retirement benefit** ~~amount of retired pay to which the debtor would otherwise be entitled if retired under any provision of title 10 other than chapter 61 of that title~~." This version would best promote and implement the goals of the proposed legislation by providing retired veterans the full scope of the same protections afforded civilians, and no more.

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27 See the remarks of Senator Edward Kennedy, 145 CONG. REC. 29,929 (1999).

28 *See* 38 U.S.C. §§ 1101-1163 (service-connected military disability benefits); *id.* at §§ 1501-1543 (nonservice-connected disability benefits).

29 See, for example, 3 See 5 U.S.C. § 8346 (exempting civil service retirement benefits from legal process); 22 U.S.C. § 4060(c) (exempting foreign service retirement and disability payments from attachment); 33 U.S.C. § 916 (exempting longshoremen's and harbor workers' pensions from assignment and legal process); 38 U.S.C. § 1562 (exempting Congressional Medal of Honor pension from legal process); 38 U.S.C. § 5301(a)(1) (exempting veterans benefits from assignment and legal process); 45 U.S.C. § 231m (exempting railroad retirement benefits from assignment).

30 This amount is currently $2,788.00 a month or $33,456.00 a year.

- For the same reasons, these protections should be extended to the other pension and disability benefits discussed herein that have virtually identical purposes, functions and protections outside of bankruptcy as Social Security benefits.

3. **Reduce Paperwork and Pre-Bankruptcy Counseling Requirements That Needlessly Increase Costs and Unfairly Inhibit Access to Bankruptcy**

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 created many new wasteful requirements for debtors in need of bankruptcy relief, which act as barriers to the courts and restrict access to justice for lower income debtors who cannot afford the increased costs that they have caused. Prominent among these is the requirement that individual debtors obtain credit counseling prior to filing bankruptcy.[31] Particularly for debtors facing exigent circumstances, such as a pending foreclosure, wage garnishment, or vehicle repossession, this credit counseling requirement, aimed at providing alternatives related solely to unsecured debts, provides little, if any, benefit.[32] Further, as at least 85-90% of debtors that complete an approved credit counseling course ultimately do file bankruptcy,[33] the utility of this requirement is negligible, particularly as the cost of credit counseling can be a deterrent for debtors with below median income.

For these reasons, NACBA recommends the following:

- **Credit Counseling:**
  - **Exception for Exigent Circumstances:** A waiver of the pre-bankruptcy credit counseling requirement should be made available in cases where the counseling offers no real benefit or where any potential benefit is outweighed by the need to permit filing without such counseling in order to preserve the ability to obtain the fundamental benefit of a fresh start, such as in cases involving pending foreclosures, wage garnishments, and vehicle repossessions.
  - **Elimination for Debtors with Below Median Income**: As debtors with family income below the median are presumed to be entitled to bankruptcy relief and not subject to Means Testing, they should similarly not be required to undergo credit counseling.

4. **Exclude Earned Income Tax Credits (EITC) Exclusion From Disposable Income and Property of the Estate**

Congress intended the EITC to be available to low income working families who need those funds for basic necessities of life. However, many states' exemption laws do not

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31 11 U.S.C. § 109(h).

32 *See* Michael D. Sousa, Just Punch My Ticket: A Qualitative Study of Mandatory Debtor Financial Education, 97 MARQ. L.REV. 391, 463 (2013).

33 *See* U.S. TRUSTEE PROGRAM, DIRECTOR ADDRESSES THE 52ND ANNUAL SEMINAR OF CHAPTER 13 TRUSTEES (July 31, 2017), https://www.justice.gov/ust/speeches-testimony/director-addresses-52nd-annual- seminar-national-association-chapter-13-trustees

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protect EITC funds, which often means they can be seized by bankruptcy trustees. This results in lower income families losing this valuable resource at the time they need it most in filing for bankruptcy relief. The EITC should be treated the same as Social Security benefits and protected in bankruptcy.

For these reasons, NACBA supports the following:

- **Working Families Tax Relief Act of 2019**, H.R. 3157 and S. 1138:[34] Bankruptcy protections for the EITC should be added with an amendment to this proposal.

5. Adjust Chapter 13 Debt Limits

Many urban areas have experienced enormous increases in home prices in the past several years, far in excess of the index used to adjust dollar amounts in the Bankruptcy Code. In some of these areas, the resulting home mortgage debt necessary for families to buy a home disqualifies them from eligibility for Chapter 13 relief because of the secured debt eligibility limit in 11 U.S.C. § 109(e).[35] Despite being adjusted for inflation every three years,[36] to maintain Chapter 13 eligibility for homeowners, the secured debt limit needs to be adjusted accordingly.

In a similar vein, student loan debt has also, as mentioned previously, skyrocketed in the last several years. Particularly since there is no longer a statute of limitations on federal student loans, many loans have continued to accumulate interest and collection costs over decades. The balances owed on these loans can easily prevent individual student borrowers from qualifying for Chapter 13 under the § 109(e) debt limits and thus present a further basis for adjusting the debt limit to ensure meaningful access to bankruptcy relief.

For these reasons, NACBA recommends the following:

- **Family Farmer Relief Act of 2019,** H.R. 2336 & S.897: This bipartisan bill would increase the debt limit for family farmers in Chapter 12 from $4.2 million to $10 million. This bill should be amended to similarly double, or substantially increase, the debt limit for consumer debtors in Chapter 13.

6. Clarify That Late-Filed Tax Returns are Considered Returns in Bankruptcy

The Bankruptcy Code has long permitted debtors to discharge certain tax debts not incurred by fraud. [37] More specifically, tax debts based on late-filed returns have been dischargeable

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34 The latter entitled "A bill to amend the Internal Revenue Code of 1986 to expand the earned income and child tax credits, and for other purposes."

35 Currently, the debt limit for noncontingent, liquidated unsecured debt is $419,275.00 and for noncontingent, liquidated secured debt it is $1,257,850.00

36 11 U.S.C. § 104(a).

37 *See United States v. Hindenlang (In re Hindenlang)*, 164 F.3d 1029 (6th Cir. 1999), which established a four-part test to determine if a filing is a "return" if it (1) purports to be a return, (2) is executed under penalty of perjury,

in carefully articulated circumstances. In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), added a confusing and unnumbered paragraph to the Code[38] which several circuit courts[39] have interpreted as preventing the discharge of *any* tax debt pursuant to a late-filed return. Under this "one-day late" rule, a tax debt based on a return filed even a single day late is no longer dischargeable under any circumstances. Because other Code language was not amended and still indicates that tax debt based late-filed returns may be discharged, it is likely that the unnumbered, hanging paragraph was the result of an unintentional drafting error. The IRS continues to allow the discharge of certain tax debt related to late-filed returns, but some state authorities have taken a more aggressive view.[40] When strictly applied, the effect of the "one-day late" rule renders all such debt nondischargeable forever. The American Bar Association,[41] the American Bankruptcy Institute,[42] and the National Bankruptcy Conference[43] have corrective proposals to clarify the law.

For these reasons, NACBA recommends the following:

- **Taxpayer First Act of 2019,** H.R.1957: This bill could be a vehicle for amending 11 U.S.C. § 523(a)* to include the following taken from the American Bar Association:

  "For purposes of this subsection, the term 'return' means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements **other than timeliness**)." (Additional language in bold.)

Conclusion

On behalf of the National Association of Consumer Bankruptcy Attorneys, our members, and our clients, I thank you for this opportunity to testify before the Subcommittee on Courts, Commercial and Administrative Law of the Judiciary Committee, regarding your oversight of bankruptcy law and pending legislative proposals. NACBA stands ready to continue to work with this Subcommittee and other interested parties in devising effective solutions regarding Student Loan discharge, the equitable treatment of Veteran's retirement and disability benefits in bankruptcy, the lowering of barriers to filing bankruptcy, the protection of the Earned Income Tax Credit, the

(3) contains sufficient data to allow calculation of tax, and (4) represents an honest and reasonable attempt to satisfy the requirements of the tax law. In that case, where the debtor did not file any document until after the IRS had completed its assessment with a Substitute for Return ("SFR"), such document was not considered a return.

38 Commonly referred to as either 11 U.S.C. § 523(a)* or the 523(a) Hanging Paragraph.

39 See *McCoy v. Mississippi State Tax Comm'n,* 666 F.3d 924 (5th Cir. 2012), *Mallo v. IRS (In re Mallo)*, 774 F.3d 1313 (10th Cir. 2014), and *Fahey v. Mass. Dep't of Revenue (In re Fahey)*, 779 F.3d 1 (1st Cir. 2015).

40 *See Giacchi v. IRS (In re Giacchi)*, 856 F.3d 244, 247 (3d Cir. 2017) ("The government notes that this approach, called the 'one-day-late rule,' fails to harmonize provisions of § 523 that contemplate some late-filed forms are "returns.").

41 See https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/072914letter.pdf

42 See Lawless, Robert M., "Final Report of the ABI Commission on Consumer Bankruptcy" (2019), at 21-25.

43 See http://nbconf.org/wp-content/uploads/2015/07/NBC-Ltr-S-Jensen-re-ABA-Taxation-Proposal-523a.pdf

increase of Chapter 13 debt limits, and clarifications of the definitions of tax returns, as well as any other important bankruptcy issues affecting consumer debtors.

Speaker:
Edward Charles Boltz
Vice President, NACBA

Mr. CICILLINE. Thank you. Thank you, Mr. Boltz. The Chair now recognizes Mr. Rao for 5 minutes.

TESTIMONY OF JOHN RAO

Mr. RAO. Chair Cicilline, Ranking Member Sensenbrenner—

Mr. CICILLINE. Please put on your microphone. Thanks.

Mr. RAO. Chair Cicilline, Ranking Member Sensenbrenner, and Chair Nadler, Members of the subcommittee, thank you for inviting me to testify today. While there are a number of bills and proposals before this Committee that are worthy of consideration, including those in the report of the ABI's Commission on Consumer Bankruptcy, I wish to voice my strong support for Chair Nadler's Student Borrower Bankruptcy Relief Act, and will focus on that bill.

When the bankruptcy discharge for student loans was eliminated in the Higher Education Reauthorization Act in 1998, the conference report stated that some protections still remain for borrowers in the form of undue hardship. While this was a questionable premise even then, we now know with certainty that undue hardship is effectively a non-existent right. It is virtually never used. One study has found that only one-tenth of 1 percent of bankruptcy filers with student loans seek an undue hardship discharge. The barriers to getting an undue hardship discharge are enormous and deny access to those most needing relief.

Some will suggest more borrowers would try for undue hardship if Congress defined it in a way that would allow courts to apply a more lenient standard. No matter how defined, the undue hardship method of discharge will be random and arbitrary. In the two circuits where a less stringent test is currently used, student borrowers fare no better in the outcomes of their cases, and no more cases are brought in those circuits. Even with a less strict standard, the burden is on the student borrower to bring a court action and prove that their loan should be discharged. Any system that requires the poorest and most in need to come up with thousands, even tens of thousands, of dollars to fund contested litigation will not work. This economic reality alone explains why no cases are brought now and why none will be brought under a redefined standard.

Another reason given in 1998 for changing the law was that borrowers in financial distress could rely upon the Department of Education's income-driven repayment plans. We now know after many years of experience that these programs are fraught with problems and their reach is limited. Many eligible borrowers are not enrolled in these plans despite clear potential benefits. Instead, borrowers are steered by servicers into forbearances and deferments, which causes their balances to grow as interest continues to accrue and is capitalized. Services do this because it is more profitable for them as it is much easier to put someone on forbearance than to enroll them in an income-driven repayment plan.

Making bankruptcy dischargeable or making bankruptcy discharge available to borrowers would incentivize servicers to Act more responsibly. Even if servicer problems were fixed, it makes no sense to keep borrowers who might otherwise seek bankruptcy relief on an IDR for 20 years, especially those who don't have repayment ability to be paying nothing or some minimal amount. The administrative costs of annual recertifications and collection costs if the debtor re-defaults are a waste of taxpayer funds and further drains the student loan program.

As each of the bankruptcy discharges for student loans was eliminated over the period 1977 to 2005, there was no evidence of abuse by consumer borrowers. The debate was moved by perception rather than reality. Still, any concern about the potential abuse is even less compelling now because of the substantial changes that were made in the Bankruptcy Code in 2005, including a means test, document requirements, and exemption limitations.

The question remains, why student loans are treated differently? The government financially supports a number of loan programs with laudable goals similar to student loans, such as loan programs for veterans, farmers, small business owners, and homebuyers. While many of these programs also have less strict underwriting, somehow, we treat them differently and make them non-dischargeable. Some argue that this is because student loans help borrowers obtain a college degree, which is an asset that will guarantee future income. This ignores the many student borrowers who are struggling with large amount of debt never completed their schooling or obtained a degree. Even those borrowers who obtain a degree run into unexpected life traumas or other circumstances that prevent them from having sufficient incomes to repay their loans.

In conclusion, it is time to directly confront the myths about student loans dischargeability and rebut the rationales for treating student loans differently in bankruptcy. Congress should reverse this policy and Act immediately to ensure that student loans are not exempted from discharge. Thank you, Chair.

[The statement of Mr. Rao follows:]

Written Testimony of John Rao

Attorney,
National Consumer Law Center

Before the House Judiciary Subcommittee on Antitrust, Commercial, and Administrative Law

Oversight of Bankruptcy Law and Legislative Proposals

June 19, 2019

Chairman Cicilline, Ranking Member Sensenbrenner, and members of the Subcommittee:

Thank you for holding this hearing on the Oversight of Bankruptcy Law and Legislative Proposals and for inviting me to testify today. I testify here today on behalf of the low-income clients of the National Consumer Law Center (NCLC).[1] A broad range of families and households are affected by consumer bankruptcy legislation, and in particular by the proposed bills that would make student loans dischargeable in bankruptcy.

In my work as an attorney at NCLC, I provide training and technical assistance to attorneys across the country who represent consumers in bankruptcy cases. I am the author and

[1] The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of twenty-one practice treatises and annual supplements on consumer credit laws, including *Consumer Bankruptcy Law and Practice* (11^{th} ed. 2016). NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws.

editor of various publications on bankruptcy. I often speak at educational programs for bankruptcy attorneys, trustees, and judges, and I have served as a member of the federal Judicial Conference Advisory Committee on Bankruptcy Rules. My testimony is based on this work and my experience representing consumers in debt collection, bankruptcy and foreclosure defense matters.

The gravity of the student loan debt problem cannot be overstated. Americans now owe more in student loan debt than they do for auto loans, credit cards, or any other non-mortgage debt.[2] Student loan debt has become a key factor for many people who are considering when or whether to start small businesses, buy homes, or start families.[3] Student loan debt is a factor not only for people who are entering the workforce for the first time, but also for those who are seeking to enter retirement.[4]

For the many reasons stated below, we support passage of the Student Borrower Bankruptcy Relief Act, H.R. 2648 (and its companion bill, S. 1414).

Current bankruptcy policy on student loans was based on false assumptions.

We have long encouraged individuals of all ages to pursue higher education as a path to success. They are told that incurring student loan debt will give them a better chance at achieving their goals. Similarly we encourage individuals to start businesses and to take chances in other entrepreneurial endeavors. In both cases we know that some individuals will fail. However, our bankruptcy laws treat student borrowers much more harshly – the business

[2] Fed. Reserve Bank of N.Y., Household Debt and Credit Report: Q1 2019 (May 2019).
[3] William Elliott & IlSung Nam, Is Student Debt Jeopardizing the Short-Term Financial Health of U.S. Households?, Federal Reserve Bank of St. Louis Review, Sept./Oct. 2013. Vol. 95, Issue 5 at 405-24; *see also* Springer, Is Student Debt Keeping Americans Away from Marriage? Research Shows That Modern Couples Are Choosing to Cohabit and Pay Off Debts Before Marriage." ScienceDaily (Sept. 26, 2018).
[4] Lori A. Trawinski, Susanna Montezemolo & Alicia Williams, The Student Loan Debt Threat: An Intergenerational Problem, AARP Public Policy Institute (May 2019).

entrepreneur is given an opportunity for a fresh start while the student borrower is given no margin of error and is effectively denied the right to a bankruptcy discharge. In fact our bankruptcy laws currently treat student loan borrowers in the same manner as individuals who fail to pay child support and criminal fines, and those who incur debts by fraud or maliciously injur others.

This harsh treatment of student borrowers in financial distress in the bankruptcy system was not the result of careful analysis and thoughtful policy debate. Instead it was based on the false premise that student borrowers were more likely to abuse the bankruptcy system, even compared to other consumers with debts owed to the government. No evidence to support this premise existed when the law was first changed to limit student loan dischargeabilty or at the time of subsequent amendments.

Student loans were initially dischargeable like other unsecured debt, as no provision of the Bankruptcy Act or the Higher Education Act prohibited the discharge of student loans. In 1976, an amendment to limit student loan dischargeabilty was considered in connection with the Higher Education Act. While the House Judiciary committee initially raised a jurisdictional objection, the bankruptcy amendment passed subject to a delay in its effective date and a joint request from the chairs of the relevant Judiciary and Education subcommittees for a Government Accountability Office (GAO) study on the subject. The amendment provided that loans insured or guaranteed under the Higher Education Act were dischargeabable in bankruptcy only after the loan had been subject to repayment for a period of five years or if the bankruptcy court determined that "payment from future income or other wealth will impose an undue hardship on the debtor or his dependents."[5]

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[5] Education Amendments of 1976, Pub.L. No. 94–482, § 439A(a), 90 Stat. 2081, 2141 (codified at 20 U.S.C. § 1087–3 (1976) (repealed 1978)).

Reviewing data from the period when student loans were dischargeable without limitation, the GAO concluded that most consumers did not elect to discharge student loans in bankruptcy. The GAO study found that only a fraction of one percent of all matured student loans had been discharged in bankruptcy. A House Report summarized the GAO's findings:

> First, the general default rate on educational loans is approximately 18%. Of that 18%, approximately 3-4% of the amounts involved are discharged in bankruptcy cases. Thus, approximately ½ to ¾ of 1% of all matured educational loans are discharged in bankruptcy. This compares favorably with the consumer finance industry.[6]

The GAO study also found that debtors who discharged student loans in bankruptcy had other significant indebtedness, suggesting that the filings of some debtors were based on other financial problems and not motivated by an attempt to discharge student loans.

This evidence led to an effort to repeal the Higher Education Act amendment as Congress considered adoption of the 1978 Bankruptcy Code. Don Edwards, Chairman of the House Subcommittee on Civil and Constitutional Rights, stated that any student loan exception to discharge "must be justified by the strongest showing of need and of sound policy."[7] Referring to the GAO study and other data, he concluded: "The need does not appear to be present here, nor does policy suggest that an exception is appropriate."[8]

William D. Ford, chairman of the Subcommittee on Postsecondary Education, wrote to the Judiciary Committee to express his strong support for repeal of the Higher Education Act nondischargeability amendment:

> I have seen no evidence which convinces me of the need for a remedy as discriminatory and as inappropriate as section 439a of the Higher Education Act. I do not believe that bankruptcies involving student loans are increasing at such a rate as to require a provision this drastic, nor am I convinced that young debtors are declaring bankruptcy for the main purpose of 'ripping off' the government by not paying back their student loans.[9]

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[6] H.R. Rep. 95-595, 1st Sess. 1977, 1978, 1978 U.S.C.C.A.N. 5963, 6094, 1977 WL 9628.
[7] H.R. Rep. 95-595, 152, 1978 U.S.C.C.A.N. 5963, 6113.
[8] *Id.*
[9] H.Rep. 95-595, 160, 1978 U.S.C.C.A.N. 5963, 6121.

Even representatives of the banking industry supported the repeal. The Judiciary committee heard the following from Walter W. Vaughan, of the American Bankers Association and Consumer Bankers Association task forces on bankruptcy:

> While we recognize that the idea of a student receiving a valuable education and then irresponsibly refusing to repay the loans which made this education possible is reprehensible, we are nonetheless opposed to this exception. This section is contrary to the Bankruptcy Act policy of providing the bankrupt with a fresh start and we suspect that the damage done to the many 'poor but honest debtors' will far exceed any possible benefit. We are not persuaded that the 'hardship' exception will be that meaningful due to its vagueness. Secondly, this exception, in effect, gives the government agencies (which are the guarantors of many student loans) and educational institutions privileged treatment that is not warranted. If the social utility of what is exchanged for the debt is to be determinative of dischargeability then the question can be raised of whether it is proper to discharge medical bills, food bills, etc. This proposed change simply suggests that if sufficient political pressure can be generated, a special interest group can obtain special treatment under the bankruptcy law. We believe that this section runs counter to the general policy of limiting exceptions to discharge and grounds for objecting to discharge and should be eliminated.[10]

After consideration of the GAO study and other compelling evidence that student borrowers were not abusing the bankruptcy system and that student loan debt should not be treated differently, the House Judiciary committee voted in favor of the repeal and rejected an amendment that would have made educational loans nondischargeable. Despite all the evidence that the stories of abuse were perception rather than reality,[11] however, in 1978 Congress ultimately incorporated the general framework of the earlier Higher Education Act amendment, providing for discharge after a five year waiting period or upon proof of undue hardship, into the Bankruptcy Code. This limited exception to discharge may have been acceptable to some

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[10] H.R. Rep. 95-595, 150, 1978 U.S.C.C.A.N. 5963, 6111.

[11] *Compare* Hearings on H.R. Rep. No. 95-595, 95th Cong. 159 (1977) (statement of Ronald J. Iverson, Executive Director, Vt. Student Assistance Corp. reporting on several cases where student loans comprised majority of debt discharged in bankruptcy), *with* Kurt Wiese, *Discharging Student Loans in Bankruptcy: The Bankruptcy Court Tests of 'Undue Hardship*,' 26 ARIZ. L. REV. 445, 449 (1984) (alleged student loan discharge problem was created by media).

members of Congress because it still permitted the unconditional discharge of student loans that had been in repayment for at least five years.

Subsequent amendments further eroded the discharge rights – in 1990 the waiting period for an unconditional discharge was extended from five to seven years.[12] Also in 1990 the undue hardship test and the seven-year waiting period were made applicable in Chapter 13 cases.[13] In 1998, Congress totally eliminated the waiting period option for dischargeability, leaving only discharge upon proof of undue hardship.[14] The final blow came in 2005 when most private student loans were made nondischargeable by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

These changes were again made without any evidence that the limited and quickly eroding discharge rights were being abused. No GAO studies were commissioned to update the earlier study to determine if debtors were discharging student loans in unusual amounts under the five- and seven-year periods or that educational debt discharged in bankruptcy was having any significant fiscal impact on the student loan program. The most drastic change, the total elimination of the right to an unconditional discharge after a waiting period, was not made in bankruptcy legislation originating in the House or Senate Judiciary committees but rather through the Higher Education Amendments of 1998. No mention of bankruptcy abuse or other problems with the bankruptcy discharge, or of any hearings conducted concerning the provision, is contained in the Conference Report for that legislation.[15]

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[12] Federal Debt Collection Procedures Act of 1990, Pub.L. No. 101–647, § 3621(2), 104 Stat. 4933.

[13] Student Loan Default Prevention Initiative Act of 1990, Pub.L. No. 101–508, § 3007(b), 104 Stat. 1388–28.

[14] Higher Education Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1837 (1998).

[15] The Conference Report gives the following explanation for the change: "The conferees, in the effort to ensure the budget neutrality of this bill, adopted a provision eliminating the current bankruptcy discharge for student borrowers after they have been in repayment for seven years." *See* H. Rept. 105-750 (Conference Report for H.R. 6), p. 408, Sept. 25, 1998.

Bills introduced in this Congress give this Subcommittee the opportunity to reconsider these earlier decisions. While the availability of bankruptcy relief is not the sole solution to the current student loan debt crisis, there are many sound policy reasons why it should be restored as a safety net for those borrowers who have no ability to repay their student loans.

Concerns about abusive filings are less compelling now because of substantial changes to the Bankruptcy Code.

Opponents of bankruptcy relief will say that even if there was no earlier evidence of abuse by student borrowers, the amount of student loan debt is much higher now than it was in the 1970s and therefore many borrowers will seek bankruptcy relief if given the option rather than repay their loans. This falsely assumes that student borrowers are somehow different than other consumers and will abusively file bankruptcy rather than pursue repayment options.

The words of former Chairman James O'Hara of the post-secondary education subcommittee resonate today as they did in 1977. In response to news stories about isolated examples of abusive filings, he stated:

> … stories would have us believe that students (and the other bankrupts those stories almost never mention) can go through bankruptcy without a serious second thought; that it is an easy process by which they can painlessly transfer their obligations to the taxpayer. The fact is, of course, that bankruptcy is a serious step, that it involves the distribution of the bankrupt's assets and much of his income among his creditors, and that it is basically damaging to the credit and personal reputation of those forced to go through it. It can be entered into a last resort; it can, and sometimes is, entered into imprudently and without sufficient thought to its consequences, but it is not and has never been designed to be an 'easy way out' for the bankrupt. Bankruptcy, for most of those who enter into it, carries its own deleterious consequences.[16]

The concerns that Congress had in the 1970s about potential abuse, whether based on false perceptions or reality, are even less compelling now because of other substantial changes that have been made to the Bankruptcy Code. In 2005, Congress added a number of new

[16] H.R. REP. 95-595, 149-50, 1978 U.S.C.C.A.N. 5963, 6110-11.

provisions drastically impacting personal bankruptcy filings, such as a means test, enhanced document and filing requirements, exemption limitations, and counseling requirements. These changes have made it more difficult for all consumers to file bankruptcy, especially those who have assets and higher incomes to pay their debts.

To be eligible for bankruptcy relief, individuals and families must have monthly income that is less than the limited monthly living expenses allowable under the means test. Even Chapter 13 filers must abide by the strict expense guidelines established by Chapter 13 and IRS rules for the life of the plan, which is generally five years, with all income above these minimum provisions being dedicated to repaying debts. In addition, declaring bankruptcy creates an unwanted stigma and harms an individual's credit, making access to credit less available or more expensive. As a result, those who can afford to pay their student loans are very unlikely to take advantage of any change in law permitting discharge of student loans.

Consumers do not file bankruptcy if there are manageable ways for them to deal with their debt burden. Other consumers who face financial distress and would benefit from bankruptcy often do not file because of the cost of filing bankruptcy. These factors are best shown by considering the bankruptcy filing rates at the height of the Great Recession. A RAND study of American families during the Great Recession found that by April 2010, 39 percent of households had experienced financial distress.[17] However, less than 1.4 percent of the 116.7 million American households filed bankruptcy in 2010. There remained a steady decline in bankruptcy filings after 2010, despite the continuation of challenging economic times for a number of years.

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[17] RAND Labor and Population, Effects of the Financial Crisis and Great Recession on American Households, Michael Hurd and Susann Rohwedder, Nov. 2010. The study measured financial distress by considering the following factors: if the respondent and/or spouse is unemployed, or if the household is more than two months behind on mortgage payments (or in foreclosure), or if the value of the house is less than the amount of the mortgage.

The media reports of well-paid doctors[18] and other professionals who sought bankruptcy relief soon after completing their education, which apparently motivated the original exception to discharge, simply cannot occur under our current bankruptcy law. If debtors with large amounts of educational loans, few other debts, and well-paying jobs were to file bankruptcy now, their bankruptcy cases will be dismissed without a discharge. Any issues related to the debtor's good faith in filing bankruptcy can be addressed by the bankruptcy court under Bankruptcy Code sections 707(b) or 1325(a)(7). Other options under the Code to punish bad debtors are also available. For example, a debtor who has fraudulently transferred property, concealed or falsified information, or made false oaths related to the bankruptcy case will be denied a discharge under Code section 727(a), and could be prosecuted for a federal crime.

In addition to Bankruptcy Code changes, the government has been provided extraordinary collection tools that did not exist when the 1978 nondischargeability provision was first enacted. In 1991, the Higher Education Act was amended to permit a borrower's wages to be garnished to collect defaulted student loans in an administrative proceeding, without obtaining a court judgment.[19] A Department of Treasury procedure also can be used to collect student loans through the offset of tax refunds.[20] The Debt Collection Improvement Act of 1996 expanded these collection efforts by permitting the offset of Social Security of other government benefits.[21] In 1991, the then-existing six-year statute of limitations for filing collection actions against borrowers, and all other limitation periods for student loan collection, were eliminated.[22]

[18] It should be noted that H.R. 2648 and S. 1414 do not amend or repeal 42 U.S.C. § 292f(g), so the current nondischargeability provisions for Health Education Assistance Loans (HEAL) would remain in effect.
[19] 20 U.S.C. § 1095a.
[20] 31 U.S.C. § 3720A.
[21] Pub. L. No. 104-134, 110 Stat. 1321 (1996); 31 U.S.C. § 3716.
[22] See Pub. L. No. 102-26, 105 Stat. 123 (Apr. 9, 1991), amending 20 U.S.C. § 1091a.

Collection lawsuits, tax intercepts, wage garnishments, and government benefit offsets may be done at any time. The only end point is that collection must cease when a borrower dies.[23]

The initial exception to discharge for student loans reflected a concern by Congress about the financial stability of loan programs when a bankruptcy discharge might be sought before the government had an opportunity to collect on the debt. The possibility of debtors avoiding collection during periods when they have an ability to repay their student loans, before seeking a bankruptcy discharge, is another factor not relevant today.

The availability of bankruptcy relief will encourage more responsible behavior by student loan servicers.

Nearly a quarter of the more than 43 million federal student loan borrowers are in distress on their loans.[24] Many of these borrowers could benefit from the Department of Education's income-driven repayment (IDR) options. However, borrowers too often are denied access to these programs because of serious problems in the student loan servicing industry. The four largest servicers of federal student loans have a documented history of "widespread servicing failures" that "create obstacles to repayment, raise costs, cause distress and "driv[e] borrowers to default."[25]

Financial incentives for servicers are not aligned with the best interests of student loan borrowers.[26] Compared with other options, enrolling borrowers into IDR plans is time-intensive and expensive for servicers. As a result, servicers fail to dedicate necessary resources in ensuring that borrowers understand and successfully access affordable and sustainable IDR

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[23] 20 U.S.C. § 1091(a)(d).
[24] U.S. Dep't of Educ., Federal Student Aid, Data Center, Federal Student Loan Portfolio; *see also* Consumer Fin. Prot. Bureau, Student Loan Servicing: Analysis of Public Input and Recommendations for Reform (Sept. 2015).
[25] Consumer Fin. Prot. Bureau, CFPB Concerned About Widespread Servicing Failures Reported by Student Loan Borrowers (Sept. 29, 2015).
[26] U.S. Gov't Accountability Office, Federal Student Loans: Education Could Improve Direct Loan Program Customer Service and Oversight: Highlights, Report No. GAO-16-523 (May 16, 2016).

plans. Instead, servicers steer many borrowers into forbearances and deferments, which are costly to the borrower and profitable for the servicer because they are easier to administer. Some servicers have misrepresented that borrowers have no other repayment options.

An NCLC client had this experience as she struggled to afford her student loan payments after completing a medical assistant program at a for-profit school in Massachusetts.[27] For the first five years after she graduated from her program, she dutifully contacted her servicer and submitted documentation of her financial hardship. Nevertheless, despite clear eligibility for a zero dollar IDR payment, she was never enrolled in an IDR plan. When this borrower came to NCLC, she had never even heard of IDR options. Instead, each year when she called her servicer to discuss her financial situation and options, she was directed into a number of forbearances.

Though she remained in good standing on her loan during that time, she would have been better off in an IDR plan, getting credit toward eventual loan forgiveness. She will have to stay in repayment for five additional years because of the time wasted in forbearances. Further, because the interest that accrued on her loans during her forbearances was capitalized (meaning it was rolled into the principal balance of the loan and is now factored into future computations of interest), the loan balance has grown and will continue to increase a faster rate.

Servicer problems also have a significant negative impact on borrowers and the student loan program when borrowers file bankruptcy for reasons unrelated to their student loans. A Department of Education regulation places student loans in forbearance while they are in an active bankruptcy case. This prevents borrowers from staying on IDR plans and getting the benefit of payments towards loan forgiveness during their bankruptcy cases. Student loans are

[27] This client story was discussed by my colleague, Joanna K. Darcus, in her testimony to the House Subcommittee on Oversight and Investigations, Committee on Financial Services, regarding "An Examination of State Efforts to Oversee the $1.5 Trillion Student Loan Servicing Market" on June 11, 2019.

effectively "put on a shelf" during the case, even for the three to five years that a debtor may be in a Chapter 13 case. Even worse, borrowers can emerge from Chapter 13 further in debt because interest continues to accrue on their loans during the bankruptcy, and this interest is capitalized when the case concludes.

While the Department has not adopted a regulation or formal guidance permitting borrowers to stay on IDR plans during bankruptcy, it has approved an informal template that may be used by debtors to seek approval during the Chapter 13 plan confirmation process to stay on IDRs.[28] However, student loan servicers in some cases have resisted implementing the debtor's confirmed Chapter 13 plans or related bankruptcy court orders and continue to place borrowers in forbearance.[29]

The Department's policies on bankruptcy, capitalization of interest, and penalty collection fees have resulted in some consumers paying much more that the original amount of their loans and still owing substantial sums. For example, in *In re Martish*,[30] the consumer had a federal consolidation student loan in the amount of $11,202.95, with a 9% interest rate. This was her only student loan debt. In 1998, she filed a Chapter 7 case, which was later converted to a Chapter 13 case and concluded in 2001. Still unable to manage her growing student loan debt despite significant payments, the consumer filed a second Chapter 13 case in 2014. By the time this second case was filed, the consumer had made approximately $39,835 in payments on the student loan. The student loan holder, ECMC, filed a proof of claim in this case asserting that the debtor still owed $27,021.57. Included in the alleged amount due was the assessment of a

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[28] Amanda L. Anderson, Mark A. Redmiles, "Federal Student Loan Debt in Bankruptcy: Recent Movement Towards Income-Driven Repayment Plans in Chapter 13," United States Attorneys' Bulletin, March, 2018.
[29] *See, e.g., In re* Berry, 582 B.R. 886 (Bankr. D.S.C. 2018), aff'd, 2019 WL 1034484 (D.S.C. Mar. 5, 2019).
[30] 2015 WL 167154 (Bankr. E.D. N.C. Jan 12, 2015).

lump-sum charge for collection costs in the amount of $5,289.57. This penalty for collection costs represented 25% of the principal amount owed at that time.

Making bankruptcy relief available to consumers is one way to compel better behavior by servicers. Rather than take the easy and financially rewarding route of steering consumers into forbearances, servicers would need to be concerned that their failure to enroll borrowers in sustainable repayment plans might result in the loss of the account (and related servicer revenue) to a bankruptcy discharge. While few consumers will pursue bankruptcy, particularly if servicers act more responsibly, the potential threat of bankruptcy will encourage servicers to properly implement IDR programs.

The current undue hardship method of discharge denies student borrowers bankruptcy relief.

The current undue hardship method of discharge is random, arbitrary and unfair.[31] The phrase "undue hardship" has been construed by courts to require a showing of exceptional circumstances and a "certainty of hopelessness." Debtors are faced with an impossible burden of proof – "They must somehow prove that their future is as hopeless as their present."[32]

Overly aggressive litigation tactics that have been used in undue hardship cases by student loan creditors have imposed far greater barriers to justice on debtors than those facing litigants in other civil litigation. While data on undue hardship cases is scarce, one study has

[31] 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 (Winter 2005). From an evaluation of hundreds of published undue-hardship decisions applying the *Brunner* standard, the authors conclude that *Brunner* is not effective as a predictable and reliable legal standard. Debtors similarly situated by demographics and financial circumstances are typically not treated the same when different courts apply the standard. The authors conclude that "those debtors granted a discharge and those denied a discharge predominantly resemble one another and that there are few statistically significant differences in the factual circumstances of the two groups." *Id.*

[32] Testimony of Deanne Loonin, Hearing on the Private Student Loan Bankruptcy Fairness Act of 2010, before the U.S. House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, April 22, 2010.

shown that student loan creditors are far less likely to resolve litigation through settlement than other civil litigants.[33] This study reveals that only 36 percent of the debtors' cases in the study were settled or had other pre-trial dispositions. Generally about 97 percent of all cases in state and federal courts are resolved by means other than by trial.[34]

A far greater percentage of debtors who seek discharges due to undue hardship are forced to go to trial to get a verdict than are other civil litigants. Yet bankruptcy debtors are far less likely to be able to afford the expense of a multi-day trial than other civil litigants. Almost 20 percent of the undue hardship discharge cases in the study ended in a trial verdict. By contrast, statistics compiled by the Administrative Office of the U.S. Courts show that of the federal court civil cases concluded in the period when the study was conducted (FY 2011), overall only 1.1 percent were concluded by a trial verdict.[35]

Student borrowers are required to litigate undue hardship in a separate adversary proceeding. This requires filing a complaint, often responding to extensive discovery by student loan creditors, and preparing and offering evidence for trial. In some cases, debtors are expected to retain and offer testimony of expert witnesses.

Under one prong of the undue hardship test used by most courts, the consumer debtor must prove an inability to repay the student loans and at the same time meet necessary living expenses. In the vast majority of cases decided by bankruptcy courts, debtors satisfy this requirement because their financial circumstances are so dire. However, this comes only after costly and unnecessary litigation, including extensive pre-trial discovery about the debtor's

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[33] Iuliano, Jason, "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard," 86 American Bankruptcy Law Journal 495 (2012).
[34] Court Review: The Journal of the American Judges Association Volume 42, Issue 3-4 - A Profile of Settlement, Dec. 1 2006.
[35] Table C-4, Annual Report of the Director: Judicial Business of the United States Courts.

expenses.[36] This is because the Department of Education and Educational Credit Management Corporation (ECMC), a contractor hired by the Department to handle litigation for guaranty agencies, typically refuse to stipulate to the obvious.

Far more troubling, it has become common practice for the Department and ECMC to argue in court cases that certain "discretionary" or "non-essential" expenses, such as restaurant meals, cable television, and Internet access, are avoidable and could free up income to pay the student loan debt. Certain individual expenses are highlighted without consideration of the debtor's overall budget or attempts to reduce expenses, in order to portray the debtor as irresponsible. This is done even in cases in which the debtor's income may be below the poverty level and the expense in question would have no impact on the debtor's student loan repayment ability.

The story of Karen Lynn Schaffer, as reported in a New York Times article, is an example that is unfortunately not unique.[37] Ms. Schaffer, age 54, took out a student loan for her son to attend college at a time when her husband was employed. Her husband later could not work due to severe medical problems from hepatitis C, diabetes and liver cancer. Ms. Schaffer took a number of steps to reduce expenses. She also became employed in a full-time job in a security position, waking up at 4:00am every morning to care for her husband before leaving for work. ECMC argued that Ms. Schaffer was spending too much on food by eating at restaurants. This turned out to be the $12 she was spending at McDonald's, where Ms. Schaffer and her husband normally split a "value meal." Ms. Schaffer said: "I was taking care of Ron and working a full-time job, so lots of times I didn't have time to fix dinner, or I was just too darn tired."

[36] As an example of the extensive discovery requested by the Department, *see In re* Dorsey, 2015 WL 4873123 (Bankr. E.D. La. Aug. 13, 2015).
[37] Natalie Kitroeff, "Loan Monitor Is Accused of Ruthless Tactics on Student Debt," New York Times, Jan. 1, 2014.

Under the undue hardship test used by most courts, the debtor must show a good faith attempt to repay the student loans. While initially somewhat narrow in scope, the Department and ECMC have urged courts in litigation to inappropriately extend the good faith inquiry to matters beyond payment efforts. It has been used by loan holders as a morality test in which the debtor's life choices and past conduct are called into question. ECMC in particular has forced debtors to respond to extensive discovery that has probed into intimate details of their personal lives. ECMC then attempts to exploit these details in order to discredit debtors' testimony about hardship, regardless of how irrelevant the matters may be to an undue hardship determination.

For example, in one case ECMC questioned the debtor about why she had five children (a daughter and two sets of twin boys) after obtaining her student loans. In finding this inquiry and the related argument to be "audacious" and "beyond the pale," the bankruptcy court described ECMC's tactics as follows:

> ECMC brought out one other circumstance oriented toward the Debtor's past acts and conduct, but only late in the process. In cross-examining the Debtor, its counsel got her to acknowledge that she had borne all of her children "after [she] took out the student loans," and that she had understood at those times that she owed the associated debt. He then asked her if her children had been "planned"; to which she responded, curtly, that she was of the Roman Catholic faith. Counsel then dropped the subject until closing argument. At that time, referring to "her religious choice," ECMC's counsel abjured that "you have to make the decision to have a family in light of what you can afford ..."[38]

Debtors in other cases have been forced to refute arguments by the Department or ECMC that in order to repay their student loans they should not have taken prescription drugs to counteract the side effects of mental health medication,[39] should not have taken custody of two

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[38] *In re* Walker, 406 B.R. 840, 863 (Bankr. D. Minn. 2009), *aff'd*, 427 B.R. 471 (B.A.P. 8th Cir. 2010), *aff'd*, 650 F.3d 1227 (8th Cir. 2011).
[39] *In re* Renville, 2006 Bankr. LEXIS 3211 (Bankr. D. Mont. Jan. 5, 2006).

grandchildren, one of whom was a victim of physical abuse,[40] or should not have ended their studies without getting a degree so as to care for elderly parents.[41]

Many consumer debtors cannot afford the costs needed to file the underlying bankruptcy case,[42] even without considering the additional costs for the undue hardship discharge proceeding. Given the highly aggressive litigation tactics of ECMC and other creditors, and the fact that these cases are more likely to be tried rather than settled, most hardship discharge cases require substantial time to properly litigate, ranging anywhere from 40 to 100 hours, or more. If attorneys charge for this time even at a discounted hourly rate, fees can easily mount in the thousands and tens of thousands of dollars. Most debtors who are successful in hardship cases have incomes that are near the poverty level, and certainly cannot afford to pay these fees.[43] To make matters worse, ECMC and other creditors almost always appeal court decisions that are favorable to debtors. Appeals are extremely costly.

It is not surprising that these proof requirements and litigation burdens have meant that virtually no consumer debtors in the bankruptcy system seek a discharge of their student loans. Barely 0.1 percent of debtors in bankruptcy with student loan debt sought an undue hardship discharge in the above-noted 2007 study.[44] The many barriers to obtaining an undue hardship discharge have effectively eviscerated the Bankruptcy Code's fresh start potential for borrowers burdened by student loan debt.

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[40] *In re* Mitcham, 293 B.R. 138 (Bankr. N.D. Ohio 2003).
[41] *In re* Bene, 474 B.R. 56 (Bankr. W.D. N.Y. 2012).
[42] United States Government Accountability Office, "Bankruptcy Reform: Dollar Costs Associated with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," p. 22, June 2008 (finding that the average attorney fee in chapter 7 consumer bankruptcy cases had increased by 51 percent after the 2005 Act).
[43] There are few alternatives for debtors who cannot afford to hire an attorney to litigate a hardship case. Most pro bono bankruptcy programs do not provide representation in hardship discharge cases.
[44] Iuliano, Jason, "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard," 86 American Bankruptcy Law Journal 495 (2012).

The potential for loan cancelation upon completion of an IDR is not a substitute for a bankruptcy discharge.

The Department and ECMC often oppose an undue hardship discharge for a consumer who could make minimal IDR payments even when there is no likelihood that the consumer's financial situation will improve or that there will be any meaningful repayment of the student loans. Even when faced with clear evidence that the consumer's situation is not likely to change, the Department's position has been that the consumer should wait twenty or twenty-five years in the future to obtain loan forgiveness through the IDR program rather than a seek bankruptcy discharge. This position is fiscally irresponsible as it fails to consider the administrative costs to the Federal government and ultimately taxpayers in keeping the consumer on an IDR plan when there is no anticipated loan repayment.

This is illustrated by the Department's actions in *In re West*.[45] The debtor is 60 years old and unemployed. His only income is $194 per month in Supplemental Nutrition Assistance Program ("SNAP") benefits, and he lives with an aunt who does not charge him rent. The bankruptcy court found the debtor's testimony to be credible that his criminal background, combined with his age and race, have made it impossible for him to find work. Despite this bleak future, the Department argued that the debtor should not receive a bankruptcy discharge and instead should enroll in an IDR with a $0 payment.

Simply put, the Department's policy amounts to throwing good money after bad. The fact that the debtor's IDR payment is $0 or some minimal dollar amount is confirmation that the debt is not recoverable. Efforts to keep the debtor on an IDR for twenty or twenty-five years, including the administrative costs of annual recertifications and collection costs if the debtor re-defaults, impose a real cost on the student loan system and taxpayers that is not offset by future recoveries. Neither the government nor the debtor benefits from this outcome. When it comes to

[45] *In re* West, 2018 WL 846539 (Bankr. W.D. Tenn. Feb. 6, 2018). The Department appealed the decision in this case granting a discharge to the debtor.

collection of debts, the federal government should adopt the reasoning of all other creditors and recognize the point at which a debt is no longer recoverable.

Moreover, the apparent purpose of making student loans nondischargeable in bankruptcy has been to protect the financial integrity of the student loan program by ensuring that student loans are repaid. Denying a debtor such as Mr. West a bankruptcy discharge and forcing him to stay on a $0 payment IDR until he is age 85 does not further this purpose. Far worse, it imposes additional non-recoverable administrative costs on the student loan system.

Income-driven repayment plans provide important options for many borrowers dealing with student loan debt. However, the possibility of forgiveness of debt after twenty or twenty-five years on an IDR plan for borrowers who lack repayment ability does not remotely resemble a discharge under the Bankruptcy Code.[46]

Rather than removing a debt burden, IDR plans almost invariably increase the burden for low-income borrowers. Unlike a loan modification involving a permanent and immediate restructuring of the debt with a reduced payment amount, a borrower under an IDR remains legally obligated for the full student loan debt based on the contractual terms until the loan is forgiven, if at all, after twenty or twenty-five years. For a debtor with a $0 or nominal IDR payment, doubling, tripling, or quadrupling of the loan indebtedness is all but certain as unpaid interest continues to accrue and is capitalized. This is the opposite of a "fresh start."[47]

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[46] Barrett v. Educ. Credit Mgmt. Corp. (*In re* Barrett), 487 F.3d 353, 364 (6th Cir. 2007) ("requiring enrollment in the ICRP runs counter to the Bankruptcy Code's aim in providing debtors a 'fresh start.'"); *In re* Booth, 410 B.R. 672, 676 (Bankr. E.D. Wash. 2009).

[47] *In re* Dufresne, 341 B.R. 391 (Bankr. D. Mass. 2006) (rejecting ICRP alternative and noting that lender ignored "the indefinite and perhaps decades-long duration of the forbearance, the ongoing accruals of interest added to current debt, the public credit reporting of a large and growing debt in a perpetual default status, the tax consequences of a debt forgiven many years hence"); *In re* Brooks, 406 B.R. 382, 393 (Bankr. D Minn. 2009).

Decades of mounting student loan indebtedness can have a drastic impact on an individual's future access to credit, employment opportunities, and housing.[48] It can impose a substantial emotional burden on the debtor as well.[49]

While a bankruptcy discharge provides clear relief from this burden, the IDR plans offer no certainty of relief. Borrowers only obtain forgiveness of debt if they adhere rigorously to all program requirements for the full twenty to twenty-five year duration. Borrowers who default while in a program lose eligibility.[50]

Borrowers may also lose eligibility due to paperwork problems and servicer errors that can (and often do) occur during the decades of annual recertifications required to maintain participation.[51] Data released by the Department in 2015 indicates that many borrowers miss the deadline to recertify and thus may experience payment amount changes and further capitalization of accrued interest. The Department reported that nearly 57% of borrowers whose income-driven plan recertification was due in a twelve-month period ending in late 2014 did not recertify on time.[52]

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[48] *In re* Jolie, 2014 WL 929703, at *9 (Bankr. D. Mont. Mar. 10, 2014)("The evidence is uncontroverted, and it shows that [debtor's] student loan debt prevents her, because of its effect on her credit score, from increasing her income, and this predicament will persist while the student loan debt remains."); *In re* Mathieu, 495 B.R. 882 (Bankr. D. Minn. 2013) (47-year-old debtor would continue paying under ICRP until age 72 and never have access to reasonable credit); *In re* Strand, 298 B.R. 367 (Bankr. D. Minn. 2003) (interest accruing over twenty-five-year period under ICRP will leave debtor "hamstrung into poverty for the rest of his life" and prevent him from obtaining credit or approval of rental applications).

[49] *In re* Barrett, 337 B.R. 896, 903-904 (B.A.P. 6th Cir. 2006) (lender's emphasis on ICRP "fails to take account of the additional worry and anxiety that the Debtor is likely to suffer if he is compelled to watch his debt steadily increase knowing that he does not have the ability to repay it for reasons beyond his control"), *aff'd* 487 F.3d 353 (6th Cir. 2007); *In re* Marshall, 430 B.R. 809, 815 (Bankr. S.D. Ohio 2010).

[50] 34 C.F.R. §§ 685.221(a)(2), 685.209(a)(ii), 682.215(a)(2).

[51] 34 C.F.R. §§ 685.209(a)(5)(iii), 685.221(e)(3).

[52] These data were released in materials for the Department's March 2015 negotiated rulemaking. U.S. Dep't of Educ., Sample Data on IDR Recertification Rates for ED-Held Loans, available at www.ed.gov.

When borrowers are required to make even small IDR payments, re-defaults can occur because the income driven plans do not take expenses into account. The formulas that set payments based solely on income do not look at medical expenses, high housing costs, or expenses for any short-term emergency the borrower may encounter. For twenty to twenty-five years a borrower is one sickness or accident away from permanently losing the "discharge" ostensibly available under a long-term repayment plan.

Once in default under a plan, the borrower can lose eligibility to participate in another income-driven plan. Defaults under plans can be irreparable because the options for removing a loan from default (consolidation, rehabilitation) may be one-time only or (like rehabilitation) burdensome.[53] Getting out of default through rehabilitation also does not ensure that the borrower will avoid financial troubles. In fact, the Consumer Financial Protection Bureau recently reported that "nearly one in three borrowers who exited default through rehabilitation defaulted for a second time within 24 months, and over 40 percent of borrowers re-defaulted within three years."[54]

Discharge of a debt in bankruptcy is not a taxable event. However, forgiveness of a student loan debt at the end of an IDR may result in cancellation of indebtedness income that is taxable.[55] Therefore, successful completion of a long-term plan may simply see the Internal Revenue Service replace the Department as the powerful creditor pursuing the borrower for several more decades.[56]

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[53] *See, e.g.* 34 C.F.R. § 685.220(d) (if all the borrower's direct loans have been consolidated, the borrower cannot re-consolidate the same loans to get out of default).
[54] Consumer Financial Protection Bureau, "Update from the CFPB Student Loan Ombudsman," May 16, 2017.
[55] 26 U.S.C. § 61(a)(12).
[56] *In re* Barrett, 487 F. 3d 353, 364 (6th Cir. 2007); *In re* Durrani, 311 B.R. 496, 508 (Bankr. N.D. Ill. 2005), *aff'd* 320 B.R. 357 (N.D. Ill. 2005).

The policy goals of the student loan program do not outweigh the fresh start objective of the Bankruptcy Code.

Opponents of bankruptcy relief argue that student loans are inherently different and are entitled to special treatment. The government operates or financially supports a number of loan programs with laudable goals similar to the student loan program, such as programs for veterans, farmers, small business owners, and first-time home buyers. Many of these programs, like the student loan program, have less stringent underwriting requirements than comparable loan products in the private market. However, unlike the student loan program, these other government sponsored loans are dischargeable in bankruptcy.

In a 1997 letter explaining his opposition to making student loans nondischargeable, Don Edwards, former chairman of the Subcommittee on Civil and Constitutional Rights, stated:

> I understand that the grant of educational loans under the GSL and FISL programs is different from the grant of other loans in some respects. That, however, does not provide sufficient justification for an exception to discharge. In establishing the loan programs, Congress made a determination that it was in the public interest to finance college educations, and to pledge the support of the Federal Treasury in that effort. Accordingly, Congress required less investigation of credit standing, prohibited co-signers in many cases, and prohibited security interests in the student's property. The program was conceived as a social welfare program, both for the students involved and for the nation as a whole. It would be inconsistent with that objective to treat the program as strictly a business proposition when the time for repayment arrives.[57]

We urge Subcommittee members to consider the thoughtful comments of Chairman Edwards as you evaluate the Student Borrower Bankruptcy Relief Act, H.R. 2648 (also S. 1414).

Other bankruptcy proposals and bills under consideration.

We are pleased that the subcommittee is considering a number of bankruptcy bills at the same time. While all of these bills would make considerable improvements to the bankruptcy system, we wish to highlight the following:

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[57] H.R. Rep. 95-595, 154, 1978 U.S.C.C.A.N. 5963, 6115.

- Honoring American Veterans in Extreme Need Act of 2019, H.R. 2938, S. 679. The HAVEN Act would exclude veteran's disability benefits from the definition of "current monthly income" for purposes of the means test. We support this legislation and urge Congress to expand the bill to include retirement benefits for veterans, as well as pension and disability benefits under other programs that serve the same function as Social Security benefits, which are currently excluded.
- Family Farmer Relief Act of 2019, H.R. 2336 & S.897. This bipartisan bill would increase the debt limit for family farmers in Chapter 12. For the reasons stated in the report of the ABI Commission on Consumer Bankruptcy, we urge Congress to similarly consider doubling the debt limits for consumers in Chapter 13 cases.

Finally we urge the Subcommittee to consider proposals that would reduce the costs of bankruptcy filing for consumers. Several of these proposals, such as eliminating the credit counseling requirement and reducing the paperwork requirements for low-income debtors to prove safe-harbor status from the means test, are discussed in my testimony at an earlier Subcommittee hearing[58] and in the report of the ABI Commission on Consumer Bankruptcy.

[58] Hearing on H.R. 3553: "Bankruptcy Administration Improvement Act of 2017," September 26, 2018.

Mr. CICILLINE. Thank you, Mr. Rao. The Chair now recognizes Professor Jiménez for 5 minutes.

TESTIMONY OF DALIE JIMÉNEZ

Ms. JIMÉNEZ. Chair Cicilline, Ranking Member Sensenbrenner, and Members of the subcommittee, thank you for the opportunity to express my views to you today. In the few minutes before you, I want to urge the Subcommittee to approve bills that would make the bankruptcy discharge available to all student loan borrowers.

The $1.5 trillion in outstanding student loans and the rising defaults are symptoms of structural problems that bankruptcy cannot solve. Bankruptcy, however, is well suited to bring relief to individuals who are today suffering greatly under the weight of this crushing system. I want to make the case for dischargeability of private student loans first and then focus on rebutting objections to the dischargeability of Federal loans.

In 2005, owners of private student loan debt received a tremendous gift. With the stroke of a pen, the $56 billion of outstanding private loans that were originated at a time when those loans were immediately dischargeable in bankruptcy suddenly became practically nondischargeable. There was no economic justification for doing this. None.

What did the American people get from this? A few studies examined the effect of the 2005 amendments on the private student loan market, including two studies that I coauthored. To summarize them, basically, making private student loans presumptively nondischargeable harmed students. It increased the cost of the loans. It did not translate into savings for subprime borrowers, and it was done despite any evidence of opportunistic behavior by private student loan borrowers.

Since 2005, private lenders have increased their requirements for co-borrowers by 1.5 times. In 2005, it was 60 percent of under budget loans had a co-borrower. Now it is over 90 percent.

What does the market look like today? Well, interest rates range from 0 to 20 percent, and defaults are quite low, similar to credit cards, around 2 percent. This is very different from Federal student loans that have about 11 percent default.

Less than 2 percent is the only data we have from 2005 to 2011, less than 2 percent of private student loans are included in a bankruptcy filing. The special treatment of private student loans in bankruptcy is utterly indefensible, and I urge you to end it.

I now want to address some of the arguments against discharging Federal loans—Federal student loans in bankruptcy. A typical one is the student benefited from the education at the expense of the creditor, and thus, they ought to be obligated to repay. That is an argument against bankruptcy discharge generally, and it ignores in this context the public benefits of a well-educated citizenry.

Another common objection is that students will get loans, graduate, and file bankruptcy as quickly as possible. But there has never been any empirical evidence of any widespread abuse. In fact, the individual anecdotes that people point to are of cases in which the bankruptcy judge denied a discharge.

That objection also ignores the moral hazard consequences of the current system on creditors and servicers. These players yield tremendous power by virtue of their treatment in bankruptcy and lack, therefore, market incentives to improve their treatment of students.

Theorized objections to changing the system ignore the real-life consequences of bankruptcy. Filing bankruptcy is expensive. It affects the cost and availability of important products, like obtaining credit, insurance, living arrangements, and job prospects for years to come. These arguments also ignore the many tools the bankruptcy system already have to control abuse—means testing, good faith requirements, limit on how often someone can obtain a bankruptcy discharge, among others.

Another argument for the status quo is that making these loans dischargeable would compromise the viability of the student loan program. That argument assumes that making a discharge available for Federal borrowers would precipitate massive numbers of the 45 million student loan borrowers to file bankruptcy. This would require astronomical growth in bankruptcy filings, which at their height saw about 2 million people filing. The numbers just don't add up.

Second, this argument assumes that the availability of Federal student loans depends on repayment. The funding of the Federal student loan program is a political question. It does not depend on the fiscal solvency of the program itself. The real question is where do American people think their government should invest?

I would argue that higher education is one such place, although we do not necessarily need to do it through loans. Changing the bankruptcy treatment of these students' loans would allow us to focus on the people who are suffering the most. I urge you to report these bills positively out of the Subcommittee and to amend the Bankruptcy Code immediately to make all student loans dischargeable.

Thank you.

[The statement of Ms. Jiménez follows:]

UCI University of California, Irvine

Dalié Jiménez
Professor of Law

Written Testimony of

Dalié Jiménez
Professor of Law
University of California, Irvine School of Law

Before the:

House Judiciary Subcommittee on

Antitrust, Commercial, and Administrative Law

June 25, 2019

10 a.m.

Rayburn House Office Building, Washington, D.C.

Witness Background Statement

Dalié Jiménez is a Professor of Law at the UC Irvine School of Law where she teaches courses on bankruptcy, consumer financial regulation, and contracts.

Professor Jiménez is one of three principal investigators in the Financial Distress Research Project, a large-scale, longitudinal, randomized control trial evaluating the effectiveness of legal and counseling interventions to help individuals in financial distress. The project has received generous financial support from the National Science Foundation, the American Bankruptcy Institute, the National Conference of Bankruptcy Judges, and the Arnold Foundation, among others.

A member of the American Bankruptcy Institute's Consumer Bankruptcy Commission, Professor Jiménez has published half a dozen articles examining the bankruptcy system, student loans, and student loans in bankruptcy. She also co-leads the Student Loan Law Initiative at UCI Law, a partnership with the Student Borrower Protection Center aimed at spurring more academic research on the issue of student debt.

Professor Jiménez spent a year as part of the founding staff of the Consumer Financial Protection Bureau working on debt collection, debt relief, credit reporting, and student loan issues. Prior to her academic career, she clerked for the Honorable Juan R. Torruella of the United States Court of Appeals for the First Circuit, was a litigation associate at Ropes & Gray in Boston, and managed consumer protection issues for a Massachusetts state senator.

A *cum laude* graduate of Harvard Law School, Professor Jiménez also holds dual B.S. degrees in electrical engineering/computer science and political science from the Massachusetts Institute of Technology.

Chairman Cicilline, Ranking Member Sensenbrenner, and members of the Subcommittee:

Thank you for the opportunity to speak to you today.

My name is Dalié Jiménez. I am a tenured professor at the University of California, Irvine School of Law, where I teach courses in bankruptcy, consumer financial protection, and contracts. I also co-lead the Student Loan Law Initiative at UCI Law, a project aimed at spurring more academic research on the issue of student debt. The views I express here are my own, however.

Student debt is in the news far more often than any other consumer financial product. And deservedly so. Today, roughly 1 in 5 adults have a student loan.[1]The Federal Reserve Bank of New York estimates that roughly 20%[2] of the outstanding dollars of student loans are delinquent, a proportion that's higher than all other types of consumer credit in the same quarter. The growth in numbers and amount of debt has also been staggering.

We have copious evidence that this debt is dragging down the economy and that people are suffering. Studies link student debt to lower levels of homeownership and car purchases, higher household financial distress, delayed marriage, and lower probability of going to graduate school.[3]

Finally, there is abundant evidence that student debt is increasing gender and racial disparities in this country.[4] Women make up half of the population but owe two-thirds

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[1] There are 44.7 million student loan borrowers. The Census Bureau estimates the total US population as 327,167,434 (as of July 1, 2018). Roughly 77.6% of the US population is over 18. Zack Friedman, STUDENT LOAN DEBT STATISTICS IN 2019: A $1.5 TRILLION CRISIS FORBES, https://www.forbes.com/sites/zackfriedman/2019/02/25/student-loan-debt-statistics-2019/ (last visited Jun 23, 2019). U.S. Census Bureau QuickFacts: United States, , https://www.census.gov/quickfacts/fact/table/US/PST045218 (last visited Jun 23, 2019)

[2] The rate reported in the FRBNY charts is 10.9% for the first quarter of 2019. However, they note that "[a]s explained in a 2012 report, delinquency rates for student loans are likely to understate effective delinquency rates because about half of these loans are currently in deferment, in grace periods or in forbearance and therefore temporarily not in the repayment cycle. This implies that among loans in the repayment cycle delinquency rates are roughly twice as high." NEW YORK FEDERAL RESERVE, CENTER FOR MICROECONOMIC DATA, QUARTERLY REPORT ON HOUSEHOLD DEBT & CREDIT (Q1 2019), at 2, https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/hhdc_2019q1.pdf.

[3] *See* AMERICAN BANKRUPTCY INSTITUTE, FINAL REPORT OF THE ABI COMMISSION ON CONSUMER BANKRUPTCY 3 (2018)(collecting studies). *See also* AMERICAN STUDENT ASSISTANCE, LIFE DELAYED: THE IMPACT OF STUDENT DEBT ON THE DAILY LIVES OF YOUNG AMERICANS (2015), https://www.asa.org/site/assets/files/4646/life_delayed_12-2015.pdf; IRENE LEW, HARVARD UNIVERSITY JOINT CTR. FOR HOUSING STUDIES, STUDENT LOAN DEBT AND THE HOUSING DECISIONS OF YOUNG HOUSEHOLDS (2015), https://www.jchs.harvard.edu/sites/default/files/lew_research_brief_student_loan_11_2015.pdf.

[4] Judith Scott-Clayton, *What accounts for gaps in student loan default, and what happens after*, BROOKINGS (2018), https://www.brookings.edu/research/what-accounts-for-gaps-in-student-loan-default-and-what-happens-after/; Jason N. Houle & Fenaba R. Addo, *Racial Disparities in Student Debt and the Reproduction of the Fragile Black Middle Class*, SOCIOLOGY OF RACE AND ETHNICITY 2332649218790989 (2018), https://doi.org/10.1177/2332649218790989; Susan Adams, WHITE HIGH SCHOOL DROP-OUTS ARE AS LIKELY

of outstanding student loan debt.[5] Department of Education data shows that twelve years after they entered college, the median white borrower had paid down 35% of their original loan balance.[6] In contrast, the median African American's loan balance had grown 113%.[7]

I want to make four main points in my testimony:

(1) student debt is a civil rights issue and is exacerbating inequality;
(2) federal student loans should be dischargeable in bankruptcy;
(3) private student loans do not deserve special treatment in bankruptcy; and
(4) the "moral hazard" arguments against these proposals have no empirical basis.

I. Student Debt is a Civil Rights Issue[8]

Student debt is a civil rights issue. Students of color, especially African American students, disproportionately borrow,[9] borrow larger amounts,[10] do so to attend schools associated with lower graduation rates[11] and worse career outcomes,[12] and default at

To LAND JOBS AS BLACK COLLEGE STUDENTS FORBES, https://www.forbes.com/sites/susanadams/2014/06/27/white-high-school-drop-outs-are-as-likely-to-land-jobs-as-black-college-students/ (last visited May 24, 2019).

[5] Women's Student Debt Crisis in the United States: AAUW, https://www.aauw.org/research/deeper-in-debt/ (last visited Jun 14, 2019).

[6] Ben Miller, NEW FEDERAL DATA SHOW A STUDENT LOAN CRISIS FOR AFRICAN AMERICAN BORROWERS, CENTER FOR AMERICAN PROGRESS (2017), https://www.americanprogress.org/issues/education-postsecondary/news/2017/10/16/440711/new-federal-data-show-student-loan-crisis-african-american-borrowers/.

[7] *Id.*

[8] Portions of this section are borrowed from a draft essay with Jonathan Glater, currently titled "The Civil Rights Case for Student Debt Reform," forthcoming in volume 55.1 of the Harvard Civil Rights-Civil Liberties Journal.

[9] Brandon A. Jackson and John R. Reynolds, *The Price of Opportunity: Race, Student Loan Debt, and College Achievement*, 83 SOCIOLOGICAL INQUIRY 335, 351 (2013).

[10] *Id.* [Jackson & Reynolds @ 351]

[11] This is so because these students disproportionately attend for-profit providers of postsecondary education. Sandra Staklis, Vera Bersudskaya, and Laura Horn, Department of Education National Center for Education Statistics, STUDENTS ATTENDING FOR-PROFIT POSTSECONDARY INSTITUTIONS: DEMOGRAPHICS, ENROLLMENT CHARACTERISTICS, AND SIX-YEAR OUTCOMES 6 (tbl. 1) (2011), https://nces.ed.gov/pubs2012/2012173.pdf. The worse outcomes at for-profit institutions are well documented; *see, e.g.*, David J. Deming, Claudia Golden, and Lawrence F. Katz, *The For-Profit Postsecondary School Sector: Nimble Critters or Agile Predators?*, 26 J. Econ. Perspectives 139, 152-160 (2012) (analyzing higher student loan default rates at for-profit institutions, the lower likelihood of achieving a bachelor's degree at such schools, and the heavier debt burdens borne by students who attend them).

[12] Stephanie Riegg Cellini and Latika Chaudhary, The Labor Market Returns to a For-Profit College Education, National Bureau of Economic Research, Working Paper No. 18343, at 4-5 (2012), at www.nber.org/papers/w18343.pdf (finding that returns to for-profit postsecondary education lag those estimated for students of other types of postsecondary institutions).

higher rates,[13] and have higher unemployment.[14] The decision to make loans a primary way of funding education has had a disparate, negative impact on students who belong to racial and ethnic groups historically subject to explicit, *de jure* and more recently *de facto* discrimination.

Student debt may not have been proposed or developed as a tool of oppression, racial, socioeconomic, or otherwise, but it serves to reinforce preexisting inequality along lines of race and class in at least three ways:

(1) graduates encumbered by debt do not have the same opportunities as their classmates who are not,[15]
(2) students who do not graduate but did borrow confront significantly greater challenges than students who fail to complete but who did not borrow,[16] and
(3) some potential students are so fazed by the prospect of indebtedness that they choose to forego higher education entirely.[17]

Student debt is exacerbating the racial wealth gap.[18] The vast differences persist even among White and African American households with higher education credentials. "White households with a bachelor's degree or post-graduate education (such as with a Ph.D., MD, and JD) are *more than three times* as wealthy as black households with the same degree attainment."[19] What's worse,

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[13] J. Fredericks Volkwein, Bruce P. Szelest, Alberto F. Cabrera, and Michelle R. Napierski-Prancl, *Factors Associated with Student Loan Default among Different Racial and Ethnic Groups*, 69 J. HIGHER EDUC. 206, 215 (1998).
[14] BLACK UNEMPLOYMENT IS RISING AGAIN, AND TRUMPISM COULD BE PLAYING A ROLE FORBES, https://www.forbes.com/sites/pedrodacosta/2019/05/17/black-unemployment-is-rising-again-and-trumpism-could-be-playing-a-role/ (last visited May 21, 2019).
[15] Jonathan D. Glater, *Student Debt and Higher Education Risk*, 103 CAL. L. REV. 1561, 1582 (2015).
[16] This is so because the student borrower who drops out may not enjoy an income boost that would have been associated with completion of a program of study but will still face a repayment obligation.
[17] Some scholars have found that students from some ethnic groups, such as Latinx students and Asian American students, express an aversion to taking on debt to pay for higher education. ALISA F. CUNNINGHAM AND DEBORAH A. SANTIAGO, STUDENT AVERSION TO BORROWING: WHO BORROWS AND WHO DOESN'T 18 (2008), http://files.eric.ed.gov/fulltext/ED503684.pdf, *accord* Pamela Burdman, *The Student Debt Dilemma: Debt Aversion As A Barrier To College Access* 9, Center for Studies in Higher Education, University of California, Berkeley (2005), https://cshe.berkeley.edu/sites/default/files/publications/rop.burdman.13.05.pdf (describing lower rates of borrowing by students of Mexican descent).
[18] LAURA SULLIVAN ET AL., THE RACIAL WEALTH GAP (Demos) (2015), https://www.demos.org/sites/default/files/publications/RacialWealthGap_1.pdf; THOMAS SHAPIRO ET AL., THE ROOTS OF THE WIDENING RACIAL WEALTH GAP: EXPLAINING THE BLACK-WHITE ECONOMIC DIVIDE (Institute on Assets and Social Policy) (2013); WILLIAM DARITY JR ET AL., WHAT WE GET WRONG ABOUT CLOSING THE RACIAL WEALTH GAP (Samuel DuBois Cook Center on Social Equity) (2018); THE ASSET VALUE OF WHITENESS: UNDERSTANDING THE RACIAL WEALTH GAP DEMOS, https://www.demos.org/research/asset-value-whiteness-understanding-racial-wealth-gap (last visited May 18, 2019); Louise Seamster, *Black Debt, White Debt*, 18 CONTEXTS 30–35 (2019).
[19] (emphasis added). William Darity Jr et al., WHAT WE GET WRONG ABOUT CLOSING THE RACIAL WEALTH GAP (Samuel DuBois Cook Center on Social Equity) (2018).

> on average, **a black household with a college-educated head has less wealth than a white family whose head did not even obtain a high school diploma**. It takes a post-graduate education for a black family to have comparable levels of wealth to a white household with *some* college education or an associate's degree.[20]

It is no surprise then that "[twelve] years after entering college, the typical African American student who started in the 2003-04 school year and took on debt for their undergraduate education owed more on their federal student loans than they originally borrowed."[21] And not just a little more: the median African American student owed 13% *more* than what they originally borrowed *twelve years earlier*.[22]

Education is not "the great equalizer" for students of color.[23] A bachelor's degree hardly insulates African American students from loan default: 23% of those in the 2003-04 cohort defaulted in their loans, as compared to 6% of White students and a 9% overall default rate for completers.[24] In fact, African American student borrowers default on their federal student loans at *more than twice* the rate as their white counterparts, irrespective of whether they obtained a bachelor's, associate, or no degree.[25]Professor Abbye Atkinson's bankruptcy research supports these findings. She finds that African Americans with a college degree are just as likely to file for bankruptcy as African Americans without one.[26] The same is not true for White students. She concludes that "while a college diploma may help to insulate college graduates in general and White graduates specifically from financial challenges as represented by bankruptcy filings, for African Americans, a college diploma provides little economic insulation from bankruptcy."[27]

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[20] (emphasis added). William Darity Jr et al., WHAT WE GET WRONG ABOUT CLOSING THE RACIAL WEALTH GAP (Samuel DuBois Cook Center on Social Equity) (2018).
[21] Miller, *New Federal Data*, *supra* note 6.
[22] One thought might be that this is due to a larger percentage of dropouts. But one would be wrong: "[r]egardless of whether they graduated or dropped out, the median African American student owed more than they originally borrowed." *Id.* By comparison, African American borrowers who started college in 1995-96 and owed 101 percent a dozen years later." *Id.*
[23] THE DECLINE OF THE "GREAT EQUALIZER" THE ATLANTIC, https://www.theatlantic.com/business/archive/2012/12/the-decline-of-the-great-equalizer/266455/ (last visited May 21, 2019); Louise Seamster & Raphaël Charron-Chénier, *Predatory Inclusion and Education Debt: Rethinking the Racial Wealth Gap*, 4 SOCIAL CURRENTS 199, 200 (2017) ("Student loans, in other words, may allow an increasing number of black students to pursue a college education, but available evidence suggests that this occurs in a context where differential returns yield much lower returns than those experienced by whites.").
[24] *Id; see also* Miller, *New Federal Data*, *supra* note 6.
[25] Forty-nine percent of African American students and 21% of White students who entered college in 2003-04 and took out federal loans defaulted on them. NEW FEDERAL DATA SHOW A STUDENT LOAN CRISIS FOR AFRICAN AMERICAN BORROWERS CENTER FOR AMERICAN PROGRESS, https://www.americanprogress.org/issues/education-postsecondary/news/2017/10/16/440711/new-federal-data-show-student-loan-crisis-african-american-borrowers/ (last visited May 18, 2019) (Table 4).
[26] Abbye Atkinson, *Race, Educational Loans & Bankruptcy*, 16 MICHIGAN JOURNAL OF RACE & LAW 1, 12 (2010).
[27] Abbye Atkinson, *Race, Educational Loans & Bankruptcy*, 16 MICHIGAN JOURNAL OF RACE & LAW 1, 12 (2010).

Given these disparities, it is not surprising that we have abundant evidence of large—and rapidly growing—racial disparities in who has student debt and how much they owe.[28] "By the time they are in their fourth year of study, 90% of African American and 72% of LatinX undergraduate students have acquired student loan debt, as compared to 66% of white students.[29] Four years after earning a bachelor's degree, black graduates in the 2008 cohort held $24,720 more student loan debt than white graduates ($52,726 versus $28,006), on average."[30]

There is also growing evidence that students of color are treated differently while in repayment. The National Consumer Law Center has found that student loan servicers chose to sue defaulted borrowers at higher rates in communities that have a higher density of people of color.[31] Over 60% of these cases result in a default judgment.[32] Given that communities with higher numbers of people of color generally have less wealth, the higher rate of lawsuits in those communities make little economic sense. The Consumer Financial Protection Bureau has reported the difficulties that many students encounter when attempting to enroll in IDR,[33] and now we also have evidence that borrowers of color enroll in IDR at much lower rates that White borrowers (about half for African American borrowers and one quarter for Latinx borrowers).[34]

Student debt disproportionally and adversely affects communities of color and we must view reforms through a civil rights lens. There are many things Congress could do to reverse this effect, but today I will only speak to the two major reforms being considered by this subcommittee: making all student loans (private and federal) dischargeable in bankruptcy.

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[28] JUDITH SCOTT-CLAYTON & JING LI, BLACK-WHITE DISPARITY IN STUDENT LOAN DEBT MORE THAN TRIPLES AFTER GRADUATION (Brookings) (2016), https://www.brookings.edu/research/black-white-disparity-in-student-loan-debt-more-than-triples-after-graduation/

[29] https://www.consumerfinance.gov/about-us/blog/significant-impact-student-debt-communities-color/. These numbers were based on 2011-12 NPSAS data, which undercounted the total debt load. Department of Education, *2015-16 National Postsecondary Student Aid Study (NPSAS:16) Student Financial Aid Estimates for 2015-16 First Look* at B-29 (2018).

[30] JUDITH SCOTT-CLAYTON & JING LI, BLACK-WHITE DISPARITY IN STUDENT LOAN DEBT MORE THAN TRIPLES AFTER GRADUATION (Brookings) (2016), https://www.brookings.edu/research/black-white-disparity-in-student-loan-debt-more-than-triples-after-graduation/

[31] MARGARET MATTES & YU, PERSIS, INEQUITABLE JUDGMENTS: EXAMINING RACE AND FEDERAL STUDENT LOAN COLLECTION LAWSUITS (2019), https://www.nclc.org/images/pdf/student_loans/report-inequitable-judgments-april2019.pdf.

[32] *Id.*

[33] SETH FROTMAN, UPDATE FROM THE CFPB STUDENT LOAN OMBUDSMAN: TRANSITIONING FROM DEFAULT TO AN INCOME-DRIVEN REPAYMENT PLAN (MAY 17, 2017), https://www.consumerfinance.gov/data-research/research-reports/update-cfpb-student-loan-ombudsman-transitioning-default-income-driven-repayment-plan/; SETH FROTMAN, CONSUMER FIN. PROT. BUREAU: ANNUAL REPORT OF THE STUDENT LOAN OMBUDSMAN (2015), https://files.consumerfinance.gov/f/201510_cfpb_annual-report-of-the-cfpb-student-loan-ombudsman.pdf.

[34] Kristin Blagg, THE DEMOGRAPHICS OF INCOME-DRIVEN STUDENT LOAN REPAYMENT URBAN INSTITUTE (2018), https://www.urban.org/urban-wire/demographics-income-driven-student-loan-repayment (last visited May 30, 2019).

II. Federal Student Loans Should Be Dischargeable in Bankruptcy

Our $1.56 trillion in outstanding student loans and rising defaults are symptoms of much larger problems. To wit, the way we fund higher education is broken and we are perhaps harming more than we are helping those who need it the most. Those are structural problems that bankruptcy cannot solve. Bankruptcy, however, is well suited to bring relief to *individuals* suffering greatly under the weight of this system. **I urge this Subcommittee to act to move legislation forward that would make the bankruptcy discharge available to student loan borrowers.**

It is hard to find *anyone* who's happy with the current state of the law around student loan discharges,[35] but I will not rehash the history of how we got here.[36] Instead I want to focus on the problems with the arguments against discharge, how we are failing our student borrowers,[37] and how the bills you are considering today would put us in the right path going forward.

A. Arguments Against Discharge

There are a few arguments against discharging federal student loans in bankruptcy. A typical one posits that the student has benefited from the education at the expense of the creditor and thus they ought to be obligated to repay despite bankruptcy.[38] That argument is specious both because it ignores the public good aspects of education and because it is indistinguishable from an argument against discharging any other kind of government debt in bankruptcy.[39]

Another category of arguments can be described as worries over opportunism, fraud, or moral hazard. In Part IV of this testimony, I show why those arguments are overstated. It

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[35] Katy Stech Ferek, *Judges Wouldn't Consider Forgiving Crippling Student Loans—Until Now*, Wall St. J. (June 14, 2018), https://www.wsj.com/articles/judges-wouldnt-consider-forgiving-crippling-student-loans-until-now-1528974001. *But see* Jason Iuliano, *Student Loans and Surmountable Access-to-Justice Barriers*, 68 Florida Law Review 377, 379 (2016) ("the widespread pessimism regarding the current undue hardship standard should be tempered.") for a minority view.

[36] The American Bankruptcy Institute Consumer Commission Report has a brief history, as do a number of scholarly articles. AMERICAN BANKRUPTCY INSTITUTE, FINAL REPORT OF THE ABI COMMISSION ON CONSUMER BANKRUPTCY 3-9 (2018) [hereinafter ABI COMMISSION REPORT]; Rafael I. Pardo, *The Undue Hardship Thicket: On Access to Justice, Procedural Noncompliance, and Pollutive Litigation in Bankruptcy*, 66 FLORIDA LAW REVIEW (2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2426744 (last visited Oct 14, 2014).

[37] For further discussion of issues with the judicial interpretations of "undue hardship" see Matthew Bruckner, Brook E. Gotberg, Dalié Jiménez, and Chrystin Ondersma, *A No-Contest Discharge for Uncollectible Student Loans*, forthcoming in the Colorado Law Review (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3366707 (proposing that the Department of Education use their powers to acquiesce to undue hardship discharge under certain limited circumstances).

[38] *Accord* John AE Pottow, *The Nondischargeability of Student Loans in Personal Bankruptcy Proceedings: The Search for a Theory*, 44 CAN. BUS. LJ 245, 256 (2006).

[39] Bear in mind that we discharge federal and state tax debts after a 3-4 year period, and federally-guaranteed mortgage debt immediately. 11 U.S.C. § 523(a)(1).

should be noted here that these moral hazard-type arguments are applicable to most other debts dischargeable in bankruptcy.

The most sensible justification for treating federal student loans differently in bankruptcy than say, mortgages or personal loans, is that making these loans dischargeable would compromise the viability of the student loan program.[40] But even then, I do not think this argument holds much water. Its viability requires at least two assumptions: (1) that making any kind of discharge available for federal student loans would precipitate mass bankruptcies that would discharge sizable portions of student loan debt; (2) that the funding of the federal student loan program depends on its solvency.

These are both faulty assumptions. First, even at the height of bankruptcy filings, less than 1.5 million people filed annually; these days it is around 750,000.[41] Compare this to the almost 45 million people who currently have a student loan.[42] The numbers don't add up. If we expected a rush to bankruptcy the likes of which have never been seen,[43] we could design the discharge to slow down that rush by, for example, making loans dischargeable only after some period of time. The second assumption is also flawed. The funding of the federal student loan program is a political question. It does not depend on the fiscal solvency of the program itself, anymore than the funding of the Social Security Trust Fund.[44] The real question (and it's a difficult one) is where do the American people (through their elected representatives) think it is worthwhile to put our dollars. I would argue that higher education is one such place, although we do not necessarily need to do it through loans.

[40] *Accord* Pottow, *supra* note 38.
[41] In 2018, there were 751,186 nonbusiness bankruptcies. Report F-5A.U.S. Bankruptcy Courts—Business and Nonbusiness Bankruptcy Cases Commenced, by County and Chapter of the Bankruptcy Code,During the 12-Month Period Ending December 31, 2018, https://www.uscourts.gov/sites/default/files/data_tables/bf_f5a_1231.2018.pdf.
[42] *See supra* note 1.
[43] See Part IV for reasons why this is unlikely.
[44] Jim Kavanaugh, *Behind the Money Curtain: A Left Take on Taxes, Spending and Modern Monetary Theory, Counter Punch* (Jan. 22, 2018), https://www.counterpunch.org/2018/01/22/behind-the-money-curtain-a-left-take-on-taxes-spending-and-modern-monetary-theory/; Sean Williams, FACT OR FICTION: SOCIAL SECURITY IS RUNNING OUT OF MONEY? - THE MOTLEY FOOL (2018), https://www.fool.com/retirement/2018/06/15/fact-or-fiction-social-security-is-running-out-of.aspx; Sean Williams, FACT OR FICTION: SOCIAL SECURITY IS RUNNING OUT OF MONEY? THE MOTLEY FOOL (2018), https://www.fool.com/retirement/2018/06/15/fact-or-fiction-social-security-is-running-out-of.aspx.

B. Bankruptcy as the Last Safety Net

In many ways, bankruptcy functions as the last social safety net in a shrinking field of available alternatives.[45] All the evidence points to it being inadequate,[46] and yet even this last resort is unavailable to most student loan debtors.[47] The current system creates almost insurmountable barriers to justice for any but the "luckiest" of student loan debtors.[48] In significant part, this is due an access problem.[49] Few lawyers do this work. Fewer still are willing to take it on without an upfront fee, a challenge for debtors for whom it is an undue hardship to repay the loans. The debtors who most deserve this relief are those least likely to get it.[50]

The plethora of *ex post* schemes that Congress has approved in the last decade are meant to ameliorate the social and economic costs to an individual who lost the educational "bet" when borrowing for education.[51] In theory, they should be working splendidly. Indeed, given that practically all federal student loan borrowers are eligible for some form of IDR, we should have very low levels of defaults. In practice, these interventions are a disaster and we are seeing record levels of preventable defaults.[52] Fixing these issues should be a priority, but it will take time. In the meantime, students who could find relief in bankruptcy are suffering.

I also want to highlight a forgotten but serious deficiency with our courts' current interpretations of the statutory standard. Each of the judicial glosses interpreting "undue

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[45] Jean Braucher, *Consumer Banktuptcy as Part of the Social Safety Net: Fresh Start or Treadmill*, 44 Santa Clara Law Review 29 (2004); Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129 (2005).

[46] Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 CORNELL LAW REVIEW 63 (2006).

[47] The numbers are hard to come by, but one study estimates that thirty-two percent of consumers filing for Chapter 7 bankruptcy do so with student loan debt. Mike Brown, EVEN AFTER BANKRUPTCY, STUDENT DEBT STILL REMAINS FOR MANY, LENDEDU (June 11, 2019), https://lendedu.com/blog/student-loans-bankruptcy.

[48] In *A No-Contest Discharge*, we recount the story of Mr. Mosley, a homeless veteran who attempted to discharge his student loans. His discharge was ultimately granted, but only after three years of fighting the Educational Credit Management Corporation, representing the Department of Education. *A No-Contest Discharge, supra* note 37, at 2-4. He is one of the "lucky" ones.

[49] Rafael I. Pardo, *The Undue Hardship Thicket: On Access to Justice, Procedural Noncompliance, and Pollutive Litigation in Bankruptcy*, 66 FLORIDA LAW REVIEW (2014).

[50] Rafael I. Pardo, *Taking Bankruptcy Rights Seriously*, 91 WASHINGTON LAW REVIEW 1115 (2016)(noting that "prior research suggests that individuals who have attained at least an undergraduate degree constitute a greater percentage of bankruptcy debtors who seek to discharge their educational debt than of debtors in the general bankruptcy population.").

[51] Income-Driven Plans, FEDERAL STUDENT AID (2018), /repay-loans/understand/plans/income-driven (last visited Jun 24, 2019); Forgiveness, Cancellation, and Discharge | Federal Student Aid, , https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation; Deferment and Forbearance | Federal Student Aid, , https://studentaid.ed.gov/sa/repay-loans/deferment-forbearance.

[52] CONSUMER FINANCIAL PROTECTION BUREAU, STUDENT LOAN SERVICING 10 (2015), https://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf; CONSUMER FINANCIAL PROTECTION BUREAU, STUDENT LOAN SERVICING: ANALYSIS OF PUBLIC INPUT AND RECOMMENDATIONS FOR REFORM (2015), at 10, https://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf.

hardship" focuses on the student and their ability to repay the debt. But this focus on the individual ignores systemic issues that would make repayment *undue*. Students with winning fraud, misrepresentation, or consumer protection claims against their school are not able to use undue hardship to repay their loan because the current framework does not fit that situation. Those students should not be saddled forever with this debt,[53] but as it stands the fact that they were mistreated by a school that accreditors and the Department of Education thought was worthy leaves many with little recourse.[54]

Some of those students may have borrower defense arguments that they can make to the Department of Education, but many will not find relief with that avenue. The Department's borrower defense rule may not cover their situation.[55] Or worse, they may face a Department unwilling to follow its own rules.[56] Under their current authority, the Department of Education could help student loan borrowers who file bankruptcy by deciding not to fight against students who want to discharge their loans in certain situations. Several members of Congress, academics, and the ABI Consumer Commission report have argued that it should do so in certain circumstances.[57]

C. Bills before the Subcommittee and Possible Alternatives

The subcommittee has two bills before it that would remove all student loans from the list of exceptions to bankruptcy discharge, H.R. 2648 and H.R. 770. The Senate is considering a similar bill, S. 1414. These bills are simple and get at the heart of the problem. They treat federal student debt in the same way that we treat mortgages

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[53] As effectively can happen with federal loans given that they do not have a statute of limitations. *See* PUB. L. NO. 102-26, 105 Stat. 123 (Apr. 9, 1991), amending 20 U.S.C. § 1091a. *See also* Dalié Jiménez, *Ending Perpetual Debts*, 55 HOUSTON LAW REVIEW 609 (2017).

[54] Suing the school or officials who committed the fraud is theoretically an option, but one unlikely to yield monetary relief even if successful.

[55] Improved Borrower Defense Discharge Process Will Aid Defrauded Borrowers, Protect Taxpayers | U.S. Department of Education, , https://www.ed.gov/news/press-releases/improved-borrower-defense-discharge-process-will-aid-defrauded-borrowers-protect-taxpayers.; *but see Partial Borrower Defense Denials Violate Due Process, Privacy Act: Injunction Sought Against DeVos, Department of Education*, HARVARD PROJECT ON PREDATORY STUDENT LENDING (2018), http://www.legalservicescenter.org/partial-borrower-defense-denials-violate-due-process-privacy-act-injunction-sought-against-devos-department-of-education/.

[56] Data Show No Action on Borrower-Defense Claims | Inside Higher Ed (Apr. 1, 2019), https://www.insidehighered.com/quicktakes/2019/04/01/data-show-no-action-borrower-defense-claims; *Review of Federal Student Aid's Borrower Defense to Repayment Loan Discharge Process* | Oversight.gov (Dec. 8, 2017), https://www.oversight.gov/report/ed/review-federal-student-aids-borrower-defense-repayment-loan-discharge-process; Steven Chung, THE DEPARTMENT OF EDUCATION APPROVED A SHOCKINGLY LOW NUMBER OF FEDERAL STUDENT LOAN FORGIVENESS APPLICATIONS ABOVE THE LAW, https://abovethelaw.com/2018/09/the-department-of-education-approved-a-shockingly-low-number-of-federal-student-loan-forgiveness-applications/.

[57] *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.; ABI Commission on Consumer Bankruptcy Response, https://www.regulations.gov/document?D=ED-2017-OPE-0085-0378; *A No-Contest Discharge*, *supra* note 37.

backed by the Federal Housing Administration or Veterans' Affairs. These bills recognize that for the vast majority of individuals, declaring bankruptcy is declaring failure, and that they do not do this lightly.

I imagine that some members of Congress may be reluctant to vote for such a sweeping change. In that case, I want to comment briefly about a possible compromise. I was a member of the American Bankruptcy Institute Commission on Consumer Bankruptcy. This seventeen-member group was comprised of a diverse group of bankruptcy experts ranging from academics like myself to consumer advocates, judges, trustees, and a fair number of creditor lawyers.[58] The student loan issue was one of the first ones we took up and a supermajority of this group agreed on a set of recommendations.[59] Among other relevant proposals, the Commission recommended limiting the scope of 523(a)(8).[60] Specifically, the recommendations would limit the exception to bankruptcy discharge to educational loans that meet three criteria:

(1) They were made, insured, or guaranteed by a governmental unit (such as a state or the federal government),
(2) They were incurred for the debtor's own education, AND
(3) They first became due less than seven years before the bankruptcy case was filed, regardless of any suspension of payments.

All other "student" loans would be treated like most other debt is treated in bankruptcy—dischargeable if the debtor gets a discharge. A student that obtained a governmental loan could not discharge that loan within seven years of the beginning of repayment unless they could meet the undue hardship standard.

Three major things to highlight to bring the recommendation home: (1) private student loans would be treated like credit cards (as I urge this Committee to do in the next Part of this testimony); (2) parent PLUS loans would be automatically dischargeable, and (3) we would return to the pre-1998 version of this section which made them immediately dischargeable if the loans had been outstanding for 7 years (70% of the typical period of repayment).

I want to note that the ABI Commission proposal would not fix the problems with the undue hardship standard.[61] In particular, it would not fix the issues affecting students who were lied to and fraudulently induced to take out federal loans by their schools. I

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[58] Members, American Bankruptcy Institute Commission on Consumer Bankruptcy, https://consumercommission.abi.org/commission-members.
[59] Two-thirds affirmative votes from members were required before a proposal would make it into the Commission Report.
[60] I do not have time to discuss the other statutory proposals and regulatory proposals but I do believe that they work best as a package (in particular the statutory proposals (1)-(4)). *See* . AMERICAN BANKRUPTCY INSTITUTE COMMISSION ON CONSUMER BANKRUPTCY REPORT, *supra* note 36 at 3-5.
[61] To ameliorate some of that, the Commission report had another set of recommendations aimed at judges but that could also be implemented through statute or regulation. AMERICAN BANKRUPTCY INSTITUTE COMMISSION ON CONSUMER BANKRUPTCY REPORT, *supra* note 36 at 2.

view this as a significant problem and so my preference is for one of the aforementioned bills before the committee.

III. Private Student Loans Do Not Deserve Special Treatment

I now turn to the utterly indefensible treatment of private student loans in bankruptcy.[62] Enacting any of the proposals discussed above would also solve the private student loan problem, but it is important to discuss it separately. In 2005, holders of private student loan (PSL) debt received a tremendous gift: the roughly $55.9 billion of student loans originated under a Bankruptcy Code that allowed immediate discharge of those loans suddenly became presumptively nondischargeable.[63] There was no economic justification for this. None.

The only common feature between private and federal student loans is that they are extensions of credit for educational purposes.[64] Unlike with federal loans, private lenders pick and choose their borrowers, adjusting the loan price to the individual borrower.[65] This often results in private loans charging two and three times the federal loan interest rate. In addition, private loan borrowers lack the statutory protections afforded to federal student loan borrowers, posing an even higher risk to their financial well-being.

Since the 2005 amendments to the Bankruptcy Code, private student loan rates have ranged from 0% to almost 20%, depending on perceived borrower risk.[66] Due in large part this risk-based underwriting, private student loans have enjoyed a low default rate over the last decade. The latest PSL default rate is 2.19%.[67] This is far more similar to

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[62] Note that most of the arguments in Part II (particularly II.A and II.B) apply to private loans since they are not treated any differently from federal loans in bankruptcy.
[63] CONSUMER FINANCIAL PROTECTION BUREAU, PRIVATE STUDENT LOANS REPORT Appendix Figure 4, at 17 (2012), https://www.consumerfinance.gov/data-research/research-reports/private-student-loans-report/.
[64] Note that PSL lenders have sought a very broad reading of 523(a)(8), arguing, despite the statutory language to the contrary, that "'educational benefit' should be read to include any funds that the borrower purports to use to pay educational expenses." Brief of Bankruptcy Scholars as Amici Curiae in Support of Appellees and Affirmance, McDaniel v. Navient Solutions (*In re* McDaniel), No. 18-01445 (10th Cir. Apr. 18, 2019).
[65] The Consumer Banker's Association, a lender member group, attributes the success of private student loans to "... careful underwriting, which is arguably the best consumer protection of all." CBA Statement on Department of Education Student Loan Bankruptcy Request for Information | Consumer Bankers Association (Feb. 21, 2018), https://www.consumerbankers.com/cba-media-center/media-releases/cba-statement-department-education-student-loan-bankruptcy-request (last visited Jun 15, 2019).
[66] CFPB PRIVATE STUDENT LOANS REPORT, *supra note* 63, Appendix Figure 2, at 97 (2012), https://www.consumerfinance.gov/data-research/research-reports/private-student-loans-report/. These were rates at origination, most private student loans are variable-rate, offloading interest rate risk on the borrower. *Id.*
[67] Federal and private loans do not have equivalent definitions of default. I am using here the charge-off rate reported for a large proportion outstanding private student loans as of the third quarter of 2018. *See* DAN FESHBACH ET AL., MEASUREONE: PRIVATE STUDENT LOAN REPORT Q3 2018, at 4 (Dec. 20, 2018), https://docs.wixstatic.com/ugd/0aaff0_0026dfd2506049cb9089731813e32e8f.pdf.; CBA Statement on

credit cards (default rate of 2.5% in the same time period)[68] than to student loans issued by the federal government (10.8% default in a similar time period).[69] Between 2005 and 2011, the nine largest private student lenders reported that only 0.2-1.1% had a borrower or co-borrower who filed bankruptcy.[70]

A few studies have examined the effect of the 2005 bankruptcy amendments on the private student loan market. I describe them below. The top-line summary is clear, **making private student loans nondischargeable *harmed* students.** PSLs are just like any other consumer debt and should be treated accordingly.

In one paper, Xiaoling Ang and I examined loans made just before the 2005 amendments and just after. We found that the immediate effects of making PSLs nondischargeable (comparing the quarter before the law went into effect to the same quarter a year later) was that (1) the average borrower's credit score decreased slightly,[71] (2) loan volumes increased temporarily,[72] and (3) **the costs of the loans increased by an average of 0.35%.**[73]

In a second paper, Alexei Alexandrov and I once again examined the 2005 bankruptcy changes and found that **subprime students "saw little to no savings from the**

Dept. of Education Student Loan Report | Consumer Bankers Association, , https://www.consumerbankers.com/cba-media-center/media-releases/cba-statement-dept-education-student-loan-report (last visited Jun 15, 2019).

[68] The number quoted is from the third quarter of 2018. FRB: Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks, , https://www.federalreserve.gov/releases/Chargeoff/delallsa.htm (last visited Jun 16, 2019).

[69] National Student Loan Cohort Default Rate Falls | U.S. Department of Education, , https://www.ed.gov/news/press-releases/national-student-loan-cohort-default-rate-falls (last visited Jun 15, 2019).

[70] CFPB PRIVATE STUDENT LOANS REPORT, *supra note* 63.

[71] This indicates a slight expansion in the kinds of borrowers who received credit post-BAPCPA but note "that in terms of less-than-prime borrowers, the credit expansion we observe[d] was modest: the effect on the average credit score was the same as applying for multiple credit cards within a short period." Xiaoling Ang & Jimenez, Dalie, *Private Student Loans and Bankruptcy: Did Four-Year Undergraduates Benefit from the Increased Collectability of Student Loans?*, *in* STUDENT LOANS AND THE DYNAMICS OF DEBT 211 (2015). Additionally, as Darolia and Ritter note in a study of the same time period, "The increased prevalence of cosigners might be one reason that lenders were willing to extend more credit to less creditworthy borrowers even though dischargeability itself does not appear to affect borrower behavior relative to the behavior of borrowers with only federal student loans." Rajeev Darolia & Dubravka Ritter, *Strategic Default Among Private Student Loan Debtors: Evidence from Bankruptcy Reform*, EDUCATION FINANCE AND POLICY 24 (2019), https://www.mitpressjournals.org/doix/abs/10.1162/edfp_a_00285 (last visited Jun 16, 2019).

[72] PSL originations increased after 2005 from 6.6 billion to 7.8 billion in 2006 and a height of 10.1 billion in 2008. After the recession, volumes leveled out at pre-2005 levels (5.6 and 5.7 billion in 2010 and 2011, respectively). See Figure 4 in CFPB PRIVATE STUDENT LOAN REPORT, *supra note* 63 at17.

[73] This is the average increase comparing 2005 v. 2006 (right around the law change). The costs increase even further—to an additional 0.50%—when one compares Q1 2006 and Q1 2007. Xiaoling Ang & Jimenez, Dalie, *Private Student Loans and Bankruptcy: Did Four-Year Undergraduates Benefit from the Increased Collectability of Student Loans?*, *in* STUDENT LOANS AND THE DYNAMICS OF DEBT 179, 208 (2015).

reduction in bankruptcy protections" in 2005.[74] We also explored the question of whether students would have been more likely to borrow private loans if prices *had decreased* after 2005. We found that students around the prime/subprime cutoff are not sensitive to price and that "even if BAPCPA had lowered interest rates for students with subprime co-borrowers, even by as much as three percentage points, this interest rate decrease would not have resulted in additional students entering the market due to their inelastic demand."[75]

It is important to note that another change after 2005 is that the proportion of private loans with a co-borrower has increased dramatically. PSL co-borrowers can be a parent, spouse, or friend. In co-signing for a loan, they become liable for the full amount, should the main borrower (the student) fail to repay. A cosigner multiplies the possibility of recovery for the lender. In 2005, just over 60% of private loans made for a student to attend an undergraduate institution had a co-borrower. By 2010, that number was over 80%.[76] Today, that number is over 90%.[77] In other words: **when private student loans were dischargeable in bankruptcy, lenders required *fewer* undergraduates get a co-borrower than they do now.** Today, when lenders have the added protection of presumptive nondischargeability, they require almost all loans to have a co-borrower.

The last study examining the 2005 changes looked at "whether private student loan borrowers distinctly adjusted their Chapter 7 bankruptcy filing behavior in response" to the 2005 changes.[78] In other words: The authors note that they could not find evidence of "widespread opportunistic behavior by PSL borrowers" before BAPCPA.[79] They go on to say that they "interpret these findings as a lack of evidence that the moral hazard associated with PSL dischargeability pre-BAPCPA appreciably affected the behavior of student loan borrowers systematically."[80]

It is past time for Congress to end the special treatment for private student lenders. H.R. 885 would do just that and I urge this Committee to report this bill favorably.

IV. The Moral Hazard Arguments Against Discharge Are Grossly Overstated

A common objection to proposals that would make some or all student loans dischargeable in bankruptcy is that they will encourage consumers to 'game' the system.

[74] Alexei Alexandrov & Dalié Jiménez, *Lessons from Bankruptcy Reform in the Private Student Loan Market*, 11 HARV. L. & POL'Y REV. 175, 179 (2017).
[75] *Id.* at 201.
[76] CFPB PRIVATE STUDENT LOANS REPORT, *supra note* 63, at 27.
[77] DAN FESHBACH ET AL., MEASUREONE: PRIVATE STUDENT LOAN REPORT Q3 2018 39 (2018), https://docs.wixstatic.com/ugd/0aaff0_0026dfd2506049cb9089731813e32e8f.pdf.
[78] Rajeev Darolia & Dubravka Ritter, *Strategic Default Among Private Student Loan Debtors: Evidence from Bankruptcy Reform*, EDUCATION FINANCE & POLICY 1 (2019), https://doi.org/10.1162/edfp_a_00285.
[79] *Id.* at 28.
[80] *Id.*

That is, won't people just load up on loans, graduate, and file bankruptcy as quickly as possible? This argument is enticing, but it simply doesn't have empirical support.

This objection is rooted in theoretical speculation and "anecdata"—anecdotal evidence passed as representative facts. These stories of individuals behaving badly are shocking but come with no evidence of anything like widespread abuse. There will always be examples of a minority of individuals who do something extreme, or outside the norm.[81] Those outlandish tales make for good stories, but they make terrible policy fodder. I have yet to see anyone produce evidence that these concerns have played out in bankruptcy in any significant numbers. To the contrary, from the very beginning of the student loan discharge exception, there have been little more than anecdotes from those pushing for them and significant evidence that these were not at all representative of the facts.[82]

Instead, we have abundant evidence that the overwhelming majority of individuals file bankruptcy reluctantly and only have all options have failed.[83] As detailed in Part II, we also do not have evidence that the private student loan borrowers acted opportunistically in attempting to discharge their private student loans before the law was changed.[84]

Second, these arguments assume that the only moral hazard we need be concerned with is that of individual borrowers. But we cannot ignore the other players in the system: student loan issuers/creditors and servicers. In the current system, these players yield tremendous power and thus lack market incentives to improve their processes vis-à-vis students.[85] This is especially true of the federal government, which has no statute of limitations on collection, can garnish not only bank accounts but social security, disability, and earned income tax credit income.[86]

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[81] Lulu Garcia-Navarro, Alligators, Drugs And Theft, Oh My! New List Shows Top 10 'Florida Man' Stories, NPR (Mar. 3, 2019), https://www.npr.org/2019/03/03/699832548/alligators-drugs-and-theft-oh-my-new-list-shows-top-10-florida-man-stories.

[82] At the same time that the 94th Congress put up the first barrier to dischargeability of student loans, it asked the Government Accountability Office (GAO) to undertake a study of what was actually happening with student loan discharge. The aim was to find abuses, but in fact "The results of the GAO report indicated that less than one percent of all federally insured and guaranteed educational loans were discharged in bankruptcy." Rafael L Pardo & Michelle R Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 UNIVERSITY OF CINCINNATI LAW REVIEW 405, 422-24 (2005) (recounting the history).

[83] *See, e.g.*, Pamela Foohey, Robert M. Lawless, Katherine M. Porter and Deborah Thorne, *Life in the Sweatbox*, 94 NOTRE DAME LAW REVIEW 219 (2018); Ronald J. Mann & Katherine Porter, *Saving Up for Bankruptcy*, 98 GEORGETOWN LAW JOURNAL 289, 314–15 (2010).

[84] Rajeev Darolia & Dubravka Ritter, *Strategic Default Among Private Student Loan Debtors: Evidence from Bankruptcy Reform*, EDUCATION FINANCE AND POLICY 24 (2019), https://www.mitpressjournals.org/doix/abs/10.1162/edfp_a_00285.

[85] Katherine Porter, *Bankrupt Profits: The Credit Industry's Business Model for Postbankruptcy Lending*, 93 IOWA LAW REVIEW 1369, 1399 (2008)

[86] Dalié Jiménez, *Ending Perpetual Debts*, 55 HOUSTON LAW REVIEW 609 (2017).

Third, filing bankruptcy is a significant event and not something most people do lightly. It is expensive,[87] wreaks havoc on a person's credit report which in turn affects the cost and availability of important products like obtaining credit, insurance, living arrangements, and job prospects.[88] It can even affect a person's dating life.[89] These disruptions will impair a credit report for 7-10 years. And of course, the Bankruptcy Code limits how often someone can obtain a bankruptcy discharge.[90] Hypothetical explanations of what might happen if student loans became dischargeable in some fashion typically ignore the real-life consequences of filing bankruptcy.

Finally, the bankruptcy system already has significant tools to curb potential abuses. Since 2005 access to Chapter 7 is limited to those who can pass the means test.[91] Anyone who makes above the median for their household size in their state receives additional scrutiny.[92] In addition, the Bankruptcy Code provides robust tools aimed precisely at ferreting out the opportunistic debtor.[93] It is instructive to note that the overwhelming number of "anecdata" accounts of opportunistic debtors come from bankruptcy court decisions denying those debtor's the bankruptcy discharge.

Arguments about debtor opportunism are convenient rhetorical devices that obfuscate the issues. We should reject hypothetical theories and cherry-picked examples that lump and demonize hardworking people. We've listened to those voices before and they help get us here. Now let's listen to the people.

V. Why Congress Should Take Action Now

The likely consequences of enacting one or more of the proposals I've discussed, or something like the ABI proposal—is a temporary uptick in bankruptcy filings, an increase in social welfare, increased economic activity, and more students going to college.

A temporary uptick in bankruptcy filings is only natural: after all, the main reason we are here is that *people are suffering*.

Private loan borrowers often have trouble negotiating workouts with their creditors. In the last decade, almost half of private loan borrowers are actually co-signers: parents,

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87 Lois R. Lupica, *The Consumer Bankruptcy Fee Study*, American Bankruptcy Institute Law Review (2012).
88 Lea Krivinskas Sheppard, *Toward a Stronger Financial History Anti-Discrimination Norm*, 52 Boston College Law Review (2012).
89 Jodi Helmer, *Looking for Mr. FICO: Singles Using Credit Score to Filter Dates*, CreditCards.com (June 26, 2013), https://www.creditcards.com/credit-card-news/singles-dating-credit score-1270.php.
90 11 U.S.C. §§ 727(a)(8),(9).
91 Charles J. Tabb and Jillian K. McClelland, *Living with the Means Test*, 31 SOUTHERN ILLINOIS L. J. 463 (2006).
92 *Id.*
93 *See, e.g.*, 11 U.S.C. §§ 707(b), 1325(a)(7), 727(a).

grandparents, friends of students. Those borrowers would likely very much welcome relief.

There are over 8 million federal student loan borrowers in default.[94] Many of them do not need to be there, because there is some income-driven repayment or other forgiveness option theoretically available to them under federal law. But laws on the book are not the same as how people experience law and all of the evidence we have is that the Department of Education is failing financially distressed borrowers.

Another (all-but-certain) consequence of enacting one or more of these proposals is an increase in social welfare. It is clear that this issue cuts across parties, age, gender, and even economic status.

Economic activity is also likely to increase. The income freed by a bankruptcy discharge will translate into more spending in the economy. But we are also likely to see indirect effects: as new graduates feel more able to take employment and other risks knowing that—should they need it—there is a safety net available if these risks do not work out. For the same reason we will likely see increased postsecondary enrollment.

We should welcome these outcomes. So long as the Department of Education appropriately manages the schools that receive federal funds,[95] all we would be doing is increasing entrepreneurship and calculated risk-taking. That is in fact one of the lauded functions of our Bankruptcy Code.[96]

Congress should amend the Bankruptcy Code immediately to allow student loans to be treated like credit cards and medical debt—automatically discharged in bankruptcy—and allow bankruptcy judges to use the statutory tools they already have to prevent bad faith filings.

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[94] It's important to remember that 'default' in federal student loans means that a borrower has failed to make payments over a 270-day period.

[95] There is certainly room for improvement on that front. *See, e.g.*, FOR-PROFIT COLLEGE KAPLAN TO REFUND FEDERAL FINANCIAL AID UNDER SETTLEMENT WITH UNITED STATES, https://www.justice.gov/usao-wdtx/pr/profit-college-kaplan-refund-federal-financial-aid-under-settlement-united-states (last visited May 28, 2019); SCHOOL OWNER PLEADS GUILTY TO $2 MILLION BRIBERY SCHEME INVOLVING VA PROGRAM FOR DISABLED MILITARY VETERANS, https://www.justice.gov/opa/pr/school-owner-pleads-guilty-2-million-bribery-scheme-involving-va-program-disabled-military (last visited May 28, 2019); ATTORNEY GENERAL XAVIER BECERRA SUES FOR-PROFIT ASHFORD UNIVERSITY FOR DEFRAUDING AND DECEIVING STUDENTS STATE OF CALIFORNIA - DEPARTMENT OF JUSTICE - OFFICE OF THE ATTORNEY GENERAL, https://oag.ca.gov/news/press-releases/attorney-general-xavier-becerra-sues-profit-ashford-university-defrauding-and (last visited May 28, 2019).

[96] K. Ayotte, *Bankruptcy and Entrepreneurship: The Value of a Fresh Start*, 23 JOURNAL OF LAW, ECONOMICS, AND ORGANIZATION 161–185 (2006).

Mr. CICILLINE. Thank you very much, Professor Jiménez.

I now recognize Judge Small for 5 minutes.

TESTIMONY OF HON. THOMAS SMALL

Judge SMALL. Thank you, Mr. Chair, Mr. Sensenbrenner, Committee Members.

The National Bankruptcy Conference is grateful for the opportunity to participate at this hearing this morning to present its views with respect to small business reorganizations.

As a bankruptcy judge, I saw this problem firsthand and have known for over 30 years that Chapter 11 doesn't work well for small businesses. Chapter 11 is too expensive. Confirmation requirements are too onerous. Creditors have too much control of the process.

House bill 3311, which incorporates the essential aspects of the National Bankruptcy Conference's proposal, would remedy all these problems and provide incentives and procedures for debtors and creditors to arrive at consensual plans. There would be a new voluntary subchapter, Chapter 11, subchapter V, that small business enterprises could use to reorganize.

The debtor would be a debtor in possession, but in every case, there would be a standing trustee, much like in Chapter 11—or Chapter 12. Only the debtor could file a plan, and the plan must be filed quickly, within 90 days. There would not be a creditors Committee in most cases. There would be no disclosure statement unless the court ordered otherwise. Even without a disclosure statement, the debtor would have to provide a lot of information, including all of the information and periodic reports that small business debtors now provide under Chapter 11.

A confirmed plan under subchapter V may be either consensual or nonconsensual. If the plan meets most of the current Chapter 11 requirements, including the high voting requirements, the plan would be confirmed, and the case would proceed as if it were a regular Chapter 11 case. The trustee would disappear, and the debtor would receive a discharge upon substantial consummation.

If the debtor cannot meet the requirements for a consensual plan, the plan can still be confirmed if it meets subchapter V's "crammed down" requirements, the most important of which is that the plan must provide that all the debtor's projected disposable income be received in a 3- to 5-year period, as determined by the court, and be applied to make payments under the plan.

If the court confirms a nonconsensual plan, the trustee remains in place and monitors compliance with the plan, and the debtor's discharge would be delayed until all plan payments are made.

Now the National Bankruptcy Conference tried really hard to make this a balanced proposal that would benefit both debtors and creditors. Obviously, reorganization will be more feasible for small businesses, but there are benefits for creditors as well.

For one thing, every subchapter V case has an impartial, independent standing trustee who provides oversight of the debtor's operations. Every case will move fast. Debtors will not be allowed to languish in Chapter 11, and the plan may provide for specific remedies, including liquidation, that can be executed by the trustee if the debtor fails to meet its obligations under the plan. Most importantly, reorganizations would avoid liquidations, and asset values would be preserved.

Now in 1985, I had the privilege of testifying before—with my late colleague, bankruptcy judge Thomas Moore before two Senate Judiciary Committee subcommittees looking into bankruptcy and the farm crisis. Our message in 1985 was that Chapter 11 did not work well for family farmers, and what was needed was a new Chapter to deal with their specific problems.

Today, my message with respect to small businesses is similar. Chapter 11 does not work well for small businesses, and legislation is needed. Chapter 12 saved thousands of family farms for the benefit of family farmers and their creditors, and I strongly believe that today, House bill 3311 would save thousands of small businesses for the benefit of their owners, their creditors, their suppliers, their customers, their employees, and the economy as a whole.

I would be glad to answer any questions you may have.

[The statement of Judge Small follows:]

Testimony of

A. Thomas Small
U.S. Bankruptcy Judge EDNC (Retired)

on behalf of

National Bankruptcy Conference

before the

House Judiciary Committee's Subcommittee on Antitrust, Commercial and Administrative Law

for hearings on

Oversight of Bankruptcy Law and Legislative Proposals

June 19, 2019

Bankruptcy professionals have known for decades that chapter 11 does not work well for small business debtors, and in 2009 the National Bankruptcy Conference formed a working group to see if there were a better way to reorganize financially troubled small businesses. In 2010 the Conference, a voluntary, non-partisan, not-for-profit organization composed of about 60 of the nation's leading bankruptcy judges, professors and practitioners, proposed that Congress enact a new subchapter (subchapter V) of chapter 11 exclusively for small businesses. In 2018, a second Conference working group reviewed the 2010 proposal and the Conference still believes strongly that the proposal would form a solid basis for legislation to solve the small business reorganization problem. A copy of the Conference's proposal is attached.

> [Chapter 11] was designed for large corporations with extensive operations and complex capital structures, not small enterprises that depend critically on the skills of a single owner-manager and family members. The model for Chapter 11 was the publicly-traded manufacturer, not the local diner. As a result, many distressed small businesses are forced to wind down using antiquated state-law procedures instead of chapter 11. If they do enter chapter 11, their cases are often dismissed or converted to liquidation.

Report prepared in 2010 by the Small Business Working Group of the National Bankruptcy Conference (the report can be found at the NBC website at www.nationalbankruptcyconference.org,).

The NBC report in 2010 concluded that chapter 11 often does not work well for smaller businesses for a number of reasons including that chapter 11 gives secured creditors excessive influence over the process, chapter 11 generates exorbitant administrative costs, and chapter 11 includes requirements such as a high voting threshold and elaborate disclosures. Furthermore, specific "small business debtor" and "individual debtor" obstacles added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 present roadblocks to reorganization.

Subchapter V remedies all of those problems, and provides incentives and procedures to encourage small business debtors and their creditors to arrive at consensual plans. A bill introduced in the Senate, the "Small Business Reorganization Act of 2019" (S. 1901), incorporates the important aspects of the Conference proposal, and the National Bankruptcy Conference enthusiastically supports that pending legislation. References in this testimony to sections of subchapter V are to sections of the attached Conference proposal and not to sections of pending legislation.

Summary of Subchapter V

The Conference proposal would create a new subchapter of chapter 11 for the reorganization of a "small business enterprise debtor" [defined as a debtor "(A) that is engaged in commercial or business activities, and (B) that has aggregate noncontingent, liquidated, secured, and unsecured debts as of the date of the order for relief -- (i) in an amount equal to not more that $7,500,000 (excluding debts owed to 1 or more affiliates or insiders), and (ii) not less that 50 percent of which arose from the commercial or business activities of the debtor." § 1183(1)]

The subchapter is voluntary, and the election procedure is left to the Bankruptcy Rules. § 1181.

There will be a standing trustee in every subchapter V case who will perform duties similar to those performed by a chapter 12 or chapter 13 trustee. § 1184. The small business enterprise debtor will be a debtor in possession. §§ 1183(2) and 1185. A debtor in possession could be removed "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor." § 1186.

Only the small business enterprise debtor may file a plan, and the case will be on a fast track. § 1189. The debtor must file a plan within 90 days after the order for relief, but that time may be extended. §1189(b). A status conference is required in every subchapter V case. § 1192.

Unless the court for cause orders otherwise, there will be no creditors' committee and no disclosure statement. § 1182(b). Although there will not be a disclosure statement in most subchapter V cases, each subchapter V plan must include "a brief history of the business operations of the small business enterprise debtor, a liquidation analysis, and projections with respect to the ability of the small business enterprise debtor to make payments under the proposed plan of reorganization." § 1190.

A small business enterprise debtor is required to make the same disclosures that a "small business debtor" is required to make under § 1116. § 1188(a) and (b). Additionally, a small business enterprise debtor must file the periodic reports that a "small business debtor" is required to file under § 308. § 1188(b).

There are two ways to have a plan confirmed under subchapter V - consensually under § 1193(a) or nonconsensually under § 1193(b).

To have a consensual plan under § 1193(a), all the requirements of § 1129(a), other than § 1129(a)(15) [special disposable income requirements for individual chapter 11 debtors], must be met. A consensual plan must meet the high voting requirements of § 1126, but in a subchapter V case "a holder of a claim or interest shall be deemed to have accepted a plan, if the holder fails to file a timely ballot after being notified by the small business enterprise debtor of (1) the treatment that such holder will receive under the proposed plan; and (2) the consequence under this section of the failure by the holder to file a timely ballot." § 1191.

If a consensual plan is confirmed under §1193(a), the trustee's service is terminated upon "substantial consummation." § 1184(c). Also, if a consensual plan is confirmed under §1193(a), the small business enterprise debtor receives a discharge at confirmation under § 1141(d).

If a consensual plan is not confirmed under § 1193(a), the small business enterprise debtor may seek a nonconsensual confirmation under § 1193(b). Confirmation under § 1193(b) requires that all of the requirements of § 1129(a) be met other than § 1129(a)(8), (10) and (15). Additionally, the plan must "not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and had not accepted the plan." §1193(b). The condition that a plan be fair and equitable with respect to a class of secured claims means that the requirements of §1129(b)(2)(A) be met. § 1193(c)(1). The condition that a plan be fair and equitable with respect to each class of claims or interests means "as of the effective date of the plan -- (A) the plan provides that all of the debtor's projected disposable income to be received in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or (B) the value of the property to be distributed under the plan in the 3-year period, or longer period not to exceed 5 years as the court may fix, beginning on the date on which the first distribution is due under the plan is not less than the projected disposable income of the debtor." § 1193(c)(2).

Finally, to be confirmable under § 1193(b), the court must find that the small business enterprise debtor "will be able to make all payments under the plan, or there is a reasonable likelihood that the small business enterprise debtor will be able to make all payments under the plan, and the plan provides appropriate remedies, that may include the liquidation of nonexempt assets, to protect the holders of claims or interests in the event that the payments are not made." §1193(c)(3).

For purposes of §1193(b), "disposable income" means "the income which is received by the small business enterprise debtor and which is not reasonably necessary to be expended -- (1) for the maintenance or support of the debtor or a dependent of the debtor or for a domestic support obligation that first becomes payable after the date of the filing of the petition; or (2) for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor." § 1193(d).

A plan confirmable under § 1193(b), may, notwithstanding §1129(a)(9)(A), provide for payment through the plan of a claim of a kind specified in § 507(a)(2) or (3). § 1193(e).

If a plan is confirmed under § 1193(b) the trustee remains in place until the plan is completed, and the small business enterprise debtor does not receive a discharge until completion of all payments due within the first three years of the plan, or such other longer period not to exceed five years as the court may fix. § 1194. The debts that are discharged when a plan is confirmed under § 1193(b) are the debts provided for in § 1141(d)(1)(A) and all other debts allowed under § 503 except "any debt -- (1) on which the last payment is due after the first 3 years of the plan, or such other time not to exceed 5 years fixed by the court; or (2) the kind specified in section 523(a) of this title." § 1194.

Plan modifications are allowed, but a plan confirmed under §1193(a) may not be modified after "substantial consummation." § 1195(a) and (b). A plan confirmed under § 1193(b) may be modified by the small business enterprise debtor at any time within 3 years, or such longer time not to exceed 5 years as fixed by the court. § 1195(c).

Section 1197 provides that "[n]otwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title, by a small business enterprise debtor solely because such person holds a claim of less than $5,000 that arose prior to commencement of the case." § 1197.

The annual compensation of the subchapter V standing trustee and the percentage fee charged would be determined by the United States trustee pursuant to 28 U.S.C. § 586(e). If a plan is confirmed under § 1193(a) and the services of the trustee are terminated upon "substantial consummation," the court shall award compensation to the trustee "consistent with services performed" and subject to the limits established under 28 U.S.C. § 586(e)(1). The quarterly fees provided in 28 U.S.C. § 1930(a)(6) shall not apply in a subchapter V case.

Incentives for Consensual Plans

Subchapter V provides a number of incentives and procedures for debtors and creditors to arrive at consensual plans. Small business enterprise debtors will want to attain confirmation through a consensual plan to avoid 3 to 5 years of trustee supervision and to receive a discharge upon confirmation. Secured creditors will want to arrive at a consensual plan to avoid the possibility of a nonconsensual plan under § 1193(b). One of the standing trustee's duties is to "facilitate the development of a consensual plan of reorganization," and one function of the mandatory status conference is "to encourage and facilitate the attainment of a consensual plan of reorganization." § 1184(b)(7) and § 1192. Status conferences work well in chapter 12 cases and chapter 12 trustees frequently assist family farmers and their creditors in reaching consensual plans.

How is Subchapter V Advantageous to Creditors?

Subchapter V has a number of advantages for creditors. One important advantage is that there will be an impartial independent trustee in every subchapter V case who provides oversight of the debtor's operations, examines the debtor's affairs, makes recommendations concerning confirmation of the plan, mediates disputes, facilitates a consensual plan, and, if a plan is confirmed under § 1193(b), monitor's compliance.

Subchapter V cases will move fast and debtors will not languish in chapter 11. Small business enterprise debtors with no prospect of reorganization will be identified early, and their cases will be converted or dismissed. Plans that are confirmed under § 1193(b) may contain remedies, such as the liquidation of nonexempt assets, if the small business enterprise defaults in payments under the plan. Consensual plans confirmed under § 1193(a) may contain provisions for a standby trustee or for a third party to monitor a debtor's compliance with the plan. Also, the small business enterprise debtor is required to file the same information and periodic reports required of a small business debtor.

Subchapter V gives the debtor a fair and better chance to reorganize, and by preserving the going concern value of the debtor's assets the value of secured creditors' collateral is maintained. Reorganization also provides unsecured creditors a better chance of receiving distributions on their claims.

Some creditors contend that the proposal does away with the absolute priority rule, but that is not correct. Secured claims are subject to exactly the same absolute priority rule in subchapter V as they are in current chapter 11. A nonconsensual plan can be "crammed down" over the dissent of secured lenders only if the plan satisfies 1129(b)(2)(A), which is precisely the same standard applied in current chapter 11 cases.

It is true that subchapter V modifies the absolute priority rule in § 1129 with respect to unsecured claims, but does not do away with the rule. Subchapter V instead adopts the alternative absolute priority currently applied in chapter 12, chapter 13, and individual chapter 11 cases. In all of these cases, unsecured creditors are entitled to be paid from the debtor's disposable income over a period of time.

Subchapter V Advantages for Small Businesses

A subchapter V case will move fast and that alone will reduce costs. Furthermore, the case will be less expensive because there will most likely be no disclosure statement and no creditors' committee. Small business enterprise debtors will also be able to pay costs of administration through the plan rather than in full at confirmation.

Several confirmation obstacles are also removed. Creditors will have the ability to vote for or against a plan, but the debtor's problem of creditor apathy is solved by providing that a creditor's failure to file a timely ballot is counted as an acceptance. Also, an alternate absolute priority rule will apply with respect to unsecured creditors, and the owners of the small business enterprise debtor will be able to retain their ownership interests.

Some small business debtors may not be able to file a plan within 90 days, but a small business enterprise debtor that cannot meet the 90-day plan filing requirement can request an extension. The standard for granting an extension under § 1189(b) ("if the need for an extension is attributable to circumstances for which the small business enterprise should not justly be held accountable"), is the same as the standard in § 1221 in chapter 12 cases, and is a less onerous standard than "small business debtors" must meet under § 1121(e) ("preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time") in chapter 11.

Subchapter V is a voluntary chapter, and if a debtor does not believe it can be reorganized on the fast track, or doesn't want the scrutiny of a trustee, the debtor is not compelled to elect to be a small business enterprise debtor under subchapter V.

Conclusion

The National Bankruptcy Conference's subchapter V proposal retains most of chapter 11's requirements and provisions, but also incorporates some of the features of chapter 12 that have worked so well for family farmers and fisherman. A working group of the Conference recently reviewed the 2010 proposal and, as previously stated, the National Bankruptcy Conference strongly supports the 2010 subchapter V proposal and believes that it could be the foundation of legislation that would provide much needed relief for financially distressed small businesses.

SUBCHAPTER V -- REORGANIZATION OF A SMALL BUSINESS ENTERPRISE DEBTOR.

§ 1181. Applicability of Subchapter.

This subchapter shall only apply in those chapter 11 cases in which a small business enterprise debtor elects that this subchapter applies.

§ 1182. Inapplicability of Other Sections.

(a) Sections 105(d), 1101(1), 1104, 1105, 1106, 1107, 1108, 1115, 1116, 1121, 1123(a)(8), 1123(c), 1127, 1129(a)(15), 1129(b), 1129(c), 1129(e) and 1141(d)(5) of this title do not apply in a case under this subchapter.

(b) Unless the court for cause orders otherwise, sections 1102, 1103, 1125 of this title do not apply in a case under this subchapter.

(c) If a plan is confirmed under section 1193(b), section 1141(d) of this title shall not apply, except as provided in section 1194.

§ 1183. Definitions.

In this subchapter,

(a) the term "small business enterprise debtor" means a debtor

(1) engaged in commercial or business activities; and

(2) that has aggregate noncontingent, liquidated, secured, and unsecured debts as of the date of the order for relief

(A) in an amount not more than $7,500,000 (excluding debts owed to 1 or more affiliates or insiders); and
(B) not less than 50% of which arose from the commercial or business activities of the debtor.

(b) the term "debtor in possession" means the small business enterprise debtor unless removed as debtor in possession under section 1186(a).

§ 1184. Trustee

(a) IN GENERAL.—If the United States trustee has appointed an individual under section 586(b) of title 28 to serve as standing trustee in cases under this subchapter and if such individual qualifies as a trustee under section 322, then such individual shall serve as trustee in any case under this subchapter. Otherwise, the United States trustee shall appoint one disinterested person to serve as trustee in the case or the United States trustee may serve as trustee in the case if necessary.

(b) DUTIES.—The trustee shall—

(1) perform the duties specified in paragraphs (2), (5), (6), (7), and (9) of section 704(a) of this title;

(2) perform the duties specified in paragraphs (3), (4) and (7) of section 1106(a) if the court, for cause and on request of a party in interest, the trustee, or the United States trustee, so orders;

(3) appear and be heard at any hearing that concerns—

(A) the value of property subject to a lien;

(B) confirmation of a plan filed under this subchapter;

(C) modification of the plan after confirmation; or

(D) the sale of property of the estate;

(4) ensure that the small business enterprise debtor commences making timely payments required by a plan confirmed under this subchapter;

(5) if the small business enterprise debtor ceases to be a debtor in possession, perform the duties specified in section 704(a)(8), paragraphs (1), (2) and (6) of section 1106(a) of this title, including operating the small business enterprise debtor's business; and

(6) if there is a claim for a domestic support obligation with respect to the small business enterprise debtor, perform the duties specified in section

704(c).

(7)facilitate the development of a consensual plan of reorganization.

(c) If the small business enterprise debtor's plan is confirmed under section 1193(a), the trustee's service in the case shall terminate when the plan has been substantially consummated.

§ 1185. Rights and powers of a debtor in possession.

Subject to such limitations or conditions as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all functions and duties, except the duties specified in paragraphs (2), (3), (4) and (6) of section 1106(a) of this title, of a trustee serving in a case under chapter 11, including operating the small business enterprise debtor's business.

§ 1186. Removal of debtor in possession.

(a)On request of a party in interest, and after noticed and a hearing, the court shall order that the debtor shall not be a debtor in possession for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the commencement of the case, or for failure to perform the debtor's obligations under a confirmed plan.

(b)On request of a party in interest, and after notice and a hearing, the court may reinstate the debtor in possession.

§ 1187. Property of the Estate.

(a) If a plan is confirmed under section 1193(b) of this title, property of the estate includes, in addition to the property specified in section 541 of this title --

(1)all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 of this title, whichever occurs first; and
(2)earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 of this title, whichever occurs first.

(b) Except as provided in section 1186 of this title, a confirmed plan, or an order confirming a plan, the small business enterprise debtor shall remain in possession of all property of the estate.

§ 1188. Duties and Reporting Requirements of Small Business Enterprise Debtor.

(a)Upon electing to be a debtor under this subchapter, the small business enterprise debtor shall file the documents required by section 1116(1)(A) and (B) of this title whether or not such debtor is a small business debtor.

(b)A small business enterprise debtor, in addition to the duties provided in this title and as otherwise required by law, shall comply with the requirements of sections 308 and 1116(2), (3), (4), (5), (6), and (7) of this title, whether or not such debtor is a small business debtor.

(c)If the court orders under section 1182(b) that section 1125 of this title applies, section 1125(f) of this title shall apply whether or not such debtor is a small business debtor.

§ 1189. Filing of the plan.

(a) WHO MAY FILE A PLAN.—Only the small business enterprise debtor may file a plan under this subchapter.

(b) DEADLINE.—The small business enterprise debtor shall file a plan not later than 90 days after the order for relief under this chapter, except that the court may extend the period if the need for an extension is attributable to circumstances for which the small business enterprise debtor should not justly be held accountable.

§ 1190. Contents of Plan

A plan filed under this subchapter —

(a) shall include a brief history of the business operations of the small business enterprise debtor, a liquidation analysis, and projections with respect to the ability of the small business enterprise debtor to make payments under the proposed plan of reorganization; and

(b) notwithstanding section 1123(b)(5) of this title, may modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was (A) not used primarily to acquire such property, and (B) was used primarily in connection with the small business enterprise.

§ 1191. Deemed Acceptance of Plan.

For purposes of section 1126(c) or (d) of this title, a holder of a claim or interest shall be deemed to have accepted a plan if the holder fails to file a timely ballot after being notified by the small business enterprise debtor of

(a)the treatment that such holder will receive under the proposed plan, and

(b) the consequence under this section of the failure by the holder to file a timely ballot.

§ 1192. Status Conference.

The court shall hold a status conference to further the expeditious and economical resolution of the case, and to encourage and facilitate the attainment of a consensual plan of reorganization.

§ 1193. Confirmation of Plan

(a) The court shall confirm a plan only if all of the requirements of section 1129(a), other than section 1129(a)(15), of this title are met.

(b) Notwithstanding section 510(a) of this title, if all of the applicable requirements of section 1129(a), other than paragraphs (8), (10) and (15), of this title are met with respect to a plan, the court, on request of the small business enterprise debtor, shall confirm the plan notwithstanding the requirements of such paragraphs if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(c) For purposes of this subsection, the condition that a plan be fair and equitable with respect to each class of claims or interests includes the following requirements:

(1) With respect to a class of secured claims, the plan meets the requirements of section 1129(b)(2)(A);

(2) As of the effective date of the plan --

(A) the plan provides that all of the debtor's projected disposable income to be received in the three-year period, or such longer period not to exceed five years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or

(B) the value of the property to be distributed under the plan in the three-year period, or longer period not to exceed five years as the court may fix, beginning on the date that the first distribution is due under the plan is not less than the debtor's projected disposable income; and

(3) The small business enterprise debtor will be able to make all payments under the plan, or there is a reasonable likelihood that the small business enterprise debtor will be able to make all payments under the plan, and the plan provides appropriate remedies, that may include the liquidation of nonexempt assets, to protect the holders of claims or interests in the event that the payments are not made.

(d) For purposes of this subsection, "disposable income" means the income which is received by the small business enterprise debtor and which is not reasonably necessary to be expended --

(1) for the maintenance or support of the debtor or a dependent of the debtor or for a domestic support obligation that first becomes payable after the date of the filing of the petition; or

(2) for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business.

(e) Notwithstanding section 1129(a)(9)(A) of this title, a plan that provides for the payment through the plan of a claim of a kind specified in section 507(a)(2) or 507(a)(3) of this title may be confirmed under section 1193(b) of this title.

§ 1194. Discharge.

If the small business enterprise debtor's plan is confirmed under section 1193(b) of this title, as soon as practicable after completion by the debtor of all payments due within the first three years of the plan, or such longer period not to exceed five years as the court may fix, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the small business enterprise debtor a discharge of all debts provided in section 1141(d)(1)(A) of this title, and all other debts allowed under section 503 of this title and provided for in the plan, except any debt -

(1) on which the last payment is due after the first three years of the plan or such other time not to exceed five years fixed by the court; or
(2) of the kind specified in section 523(a) of this title.

§ 1195. Modification of Plan.

(a) The small business enterprise debtor may modify a plan at any time before confirmation, but may not modify such plan so that such plan as modified fails to meet the requirements of section 1122 and, with the exception of 1123(a)(8), section 1123 of this title. After the modification is filed with the court, the plan as modified becomes the plan.

(b) If a plan has been confirmed under section 1193(a), the small business enterprise debtor may modify such plan at any time after confirmation of such plan and before substantial consummation of such plan, but may not modify such plan so that such plan as modified fails to meet the requirements of section 1122 and, with the exception of 1123(a)(8), section 1123 of this title. Such plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified under section 1193(a) of this title.

(c)If a plan has been confirmed under section 1193(b), the small business enterprise debtor may modify such plan at any time within three years, or such longer time not to exceed five years fixed by the court, but may not modify such plan so that such plan as modified fails to meet the requirements of section 1193(b) of this title. Such plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified under section 1193(b) of this title.

(d)If a plan has been confirmed under section 1193(a), any holder of a claim or interest that has accepted or rejected such plan is deemed to have accepted or rejected, as the case may be, such plan as modified, unless, within the time fixed by the court, such holder changes such holder's previous acceptance or rejection.

§ 1196. Payments.

(a)Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the small business enterprise debtor after deducting --

(1)any unpaid claim allowed under section 503(b) of this title;

(2)any payment made for the purpose of providing adequate protection of an interest in property due to the holder of a secured claim; and
(3)any fee owing to the trustee.

(b)If a plan is confirmed under section 1193(b) of this title, except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.

(c)Prior to confirmation of a plan, the court, after notice and a hearing, may authorize the trustee to make payments to the holder of a secured claim for the purpose of providing adequate protection of an interest in property.

§ 1197. Transactions with Professionals.

Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title, by a small business enterprise debtor solely because such person holds a claim of less than $5,000 that arose prior to commencement of the case.

END OF SUBCHAPTER V

There will need to be amendments to other sections of titles 11 and 28

Title 11

103(i) Subchapter V of chapter 11 of this title applies only in a case under chapter 11 concerning a Small Business Enterprise Debtor in which such debtor elects that Subchapter V shall apply.

322(a) add trustee selected under 1184

326(a) add chapter 11 other than a case under subchapter V.

326(b) add subchapter V of chapter 11

347 (a) and (b) add chapter 11, subchapter V and 1196

363(c)(1) add 1184 and 1185

364(a) add 1184 and 1185

523(a) add 1194

524(a), (c)(1) and (d) add 1194

557(d)(3) add 1184

1146(a) add 1193

Title 28

586(a)(3) add Subchapter V

586(b) add Subchapter V

586(d)(1) add Subchapter V

586(e)(1) and (2) add Subchapter V - also add a provision that “in the event that the trustee’s services are terminated upon substantial consummation under section 1184(c), the court shall award compensation to the trustee consistent with services performed by the trustee and the limits on the trustee’s compensation established pursuant to section 586(e)(1) of title 28.”

589b(a)(1) add Subchapter V

589b(d) and (d)(8) add Subchapter V

1930(a)(6) except Subchapter V from chapter 11 quarterly fees

Mr. CICILLINE. Thank you, Judge Small.

Thank you to all the witnesses for your opening statements.

We will now proceed under the 5-minute rule with questions, and I will begin by recognizing the gentleman from Georgia, Mr. Johnson, for 5 minutes.

Mr. JOHNSON of Georgia. I thank Chair for holding this important hearing.

Bankruptcy reform for vulnerable groups has gone overlooked for too long and gathering the experts we have before us today is an important step towards passing meaningful legislation and fixing the problems that they have testified about.

Make no mistake. We are here because the rich are getting richer, and the poor are getting poorer. After decades of adding pro Wall Street laws to the books, we have settled into a system with loopholes that stack the deck against fairness for people in bankruptcy proceedings.

The so-called Bankruptcy Abuse Protection—or excuse me, Bankruptcy Abuse Prevention and Consumer Protection Act, passed in 2005, made student loan debt nondischargeable in bankruptcy. This legislation should have been called the Bankruptcy Protection for Private Lenders for For-Profit Colleges and Universities Act because the private lenders were the ones who benefited the most from making student loans nondischargeable in bankruptcy.

Ms. Jiménez, you say that it was $56 billion on the books at the time the 2005 legislation passed. That was a gift, a panacea for the private loan industry. These so-called schools that they left money for student loans too often had humongous advertising budgets. They swept in a bunch of unqualified students. They accepted everybody, regardless of whether you could read, and when you finished matriculating, the diploma that you received was not worth the paper that it was written on. Graduates had degrees but couldn't find a job.

As a result of this change in Federal law, people are stuck paying back these student loans for the rest of their lives. Even gambling debt is dischargeable, but student loan debt is not dischargeable. Even timeshare debt is dischargeable in bankruptcy, but student loan debt is not.

I am proud to be a cosponsor of Chair Nadler's bill. It is H.R. 2648, the Student Borrower Protection—excuse me, Student Borrower Bankruptcy Relief Act of 2019. I am proud to be cosponsor of that bill, and I hope that it will pass. It is time to take steps to ensure that groups such as these students are protected, and I am looking forward to hearing about the solutions that we are testifying about today.

Ms. Jiménez—well, actually, Mr. Boltz, in your testimony, you discussed the development of bankruptcy law in the realm of student loans, commenting about Congress having made it increasingly difficult to discharge student loans. Why do you think that was the case? Why did Congress do that, Mr. Boltz? If you are—

Mr. CICILLINE. Could you put on your microphone?

Mr. BOLTZ. Mr. Johnson, as best I know, most of the changes that made student loans dischargeable were made in bills that were not even through the Judiciary Committee. They were often in a higher education act. Some of the changes were made in crime bills.

Mr. JOHNSON of Georgia. Why was this change made, though?

Mr. BOLTZ. It was often made as part of a deal to increase the amount of lending that was available on the idea that the poorest people who were unable to pay, if we kept them on the books, that somehow that would increase the liquidity of the student loan programs. As Ms. Jiménez has testified, that is really not the case.

Mr. JOHNSON of Georgia. Well, what do you say about it, Ms. Jiménez? Why did they do it?

Ms. JIMÉNEZ. I think it is partly as we opened, talking about Federal loans first or Government-guaranteed loans, is we opened up more and more Federal loans available to students and asked—didn't ask about their ability to repay, then it was basically the bogeyman story that people were going to come in and start filing bankruptcy—start going to school, graduate, file bankruptcy—

Mr. JOHNSON of Georgia. Do you think it was—let me ask you? Do you think it was to protect the lenders more than to protect borrowers and shore up the system? What do you think the real motivation was for passing the legislation?

Looks to me like it was to protect those who were giving the campaign contributions to those who were passing the laws, but I will move on.

Mr. Rao, according to a recent study, Black men and women who take out loans to finance their education are forced to take out more money than their White peers. What is the reason for this disparate impact on minority populations, and how can we in Congress work to stop it?

Mr. CICILLINE. The gentleman's time has expired, but the witness may answer the question.

Mr. RAO. Yes, Mr. Johnson. I would say that, actually, Professor Jiménez has done a lot of research on this, and there has been a lot of evidence that minority families lack the same amount of resources that some White families have and will often be required to incur additional debt. They are also going often to private schools, which charge more. There are actually a number of reasons that Professor Jiménez has outlined in her research.

So, thank you.

Mr. JOHNSON of Georgia. Thank you. I yield back. I thank Chair.

Mr. CICILLINE. Thank you.

The Chair now recognizes the Ranking Member of the subcommittee, Mr. Sensenbrenner, for 5 minutes.

Mr. SENSENBRENNER. Thank you very much.

I have been on this Committee since I was first elected to Congress in 1978. Before I was elected to Congress, there was a major redo of the Bankruptcy Code that was passed in '78, and that made student loans nondischargeable. I believe in '82 or '83, this committee, which was still heavily run by Democrats, made the loans nondischargeable. Now at that time, there was very little Federal lending, and most of the lending were guaranteed student loans through the private banking sector.

I remember the debate when that happened that said that there were a lot of graduates, particularly those with advanced degrees, that were filing for bankruptcy to discharge their student loans even before the ink was dry on the diplomas they got for getting an advanced degree.

I think most of us agree that a college education is a way to have increased income, and an advanced degree is a way to have even better advanced incomes. I think with the exception of you, Ms. Petraeus, everybody here has a law degree on that. That might have been the motivation a while ago when you decided to go to law school.

Now my question is, yes, there is a problem with student loans, defaulted student loans. If we make them nondischargeable, how do we prevent people who have a diploma that will get them having six-figure incomes in their practices from gaming the system and getting a major part of their debt discharged, when that debt ended up giving them the opportunity for significantly increased income if they did not have those degrees?

So, who would likely to be first?

[Laughter.]

Mr. SENSENBRENNER. Because we cannot repeat that mistake. If we repeat that mistake the American taxpayers will rise up, saying the Federal Government lent them money, and they had no intention of paying it back because the bankruptcy court was across the street.

Mr. RAO. Ranking Member Sensenbrenner, that problem that you address, even though I don't acknowledge that it did exist, was fixed in 2005 by the amendments that Mr. Johnson referred to. While many of them have made bankruptcy filing much more difficult, they absolutely address the issue you are talking about, someone coming right out of college with—the doctor with the six-income figures, that person would never be able to get a discharge under our current bankruptcy law. The means test would preclude that person. Forgetting whether it is student loan or any other debt, they would never be able to get a discharge.

The reports of abuse—and Ranking Member Sensenbrenner, you refer to 1978. This Judiciary Committee asked for a GAO study to be done to look at how much student loan was being discharged in bankruptcy when it was dischargeable, and that study showed that there was virtually no abuse and that the same amount of—

Mr. SENSENBRENNER. Then why did the Judiciary Committee turn around and make it nondischargeable?

Mr. RAO. Actually, it didn't. This Committee did not vote in favor of it. Eventually, it was included as a compromise with the GAO study, and then all the other changes were not done by this committee. They were done by the higher education committees. This—

Mr. SENSENBRENNER. This doesn't answer my question. If we make student loans dischargeable again, how do we prevent a gaming of the system?

Now, if you look at a means test on this, you walk out of med school or you walk out of law school, you don't have bags of money unless you have got a trust fund sitting around. So, most people will be able to qualify under a means test because their income is not very much, and their assets are probably negative.

So, how do we do that? Because the key to getting this passed is to figure out how to prevent people from gaming the system. If we just say, well, nobody ever did that in the past, sir, you are in denial, and you are having this proposal, which I think has got some merit to it if it is properly done, leading it down to defeat.

Now, somebody else in my remaining 24 seconds? Yes, Ms. Jiménez?

Ms. JIMÉNEZ. Could I answer? So, I want to talk about both the idea that this is something that will happen, and even if it did, that we cannot stop it. The means test didn't just create barriers based on income, as you were just referring to, Ranking Member Sensenbrenner. It also added bad faith and dismissal for cause provisions to the code under both Chapter 7, 13, and 11 that allow a bankruptcy judge to take into account exactly the circumstances that you are afraid of, the person who graduates and then doesn't currently have a job, so has no income, but has very good prospects.

In that situation, and there are a few other things in the Bankruptcy Code, the judge can dismiss those cases or deny a discharge in general or a discharge of that particular debt.

Mr. SENSENBRENNER. Yes, my time is up, but I am a skeptic. You have got to convince me.

Thank you.

Mr. CICILLINE. Thank you, Mr. Sensenbrenner.

The Chair now recognizes the Chair of the Full Committee, Chair Nadler, for 5 minutes.

Mr. NADLER. Thank you, Mr. Chair.

Before I ask my question, I want to note for the record that Professor Jiménez interrupted her stay with her family in Germany to fly back yesterday so she could participate in today's hearing, which was rescheduled from last week. I think all of us very much appreciate your significant efforts, and we are glad you are with us today.

Now my question. Among the staggering statistics you cite in your prepared testimony are the following. One in five adults have student loans, and approximately 20 percent of the outstanding amount of these loans are in default. What impact do these factors have on our nation's economy?

Ms. JIMÉNEZ. Thank you for the question, Representative Nadler.

There is abundant evidence that the number of defaults and the amount of student debt that people are holding are delaying marriage, purchasing of homes, not—people are choosing not to go into public service careers. They are choosing to delay all sorts of purchases, including cars.

We live in a consumption economy, and we need consumers to actually participate, and this is stopping that participation.

Mr. NADLER. Thank you.

As a result of your research, you have observed the disparate impact of student loan debt with respect to gender and race. Could you explain what those disparate impacts are and the principal factors causing them?

Ms. JIMÉNEZ. Absolutely. So, basically, this is just reproducing the racial gaps and the racial differences that we have in our society. The racial wealth gap, in general, is widening and is wide, and that means that, say, Black borrowers are forced to borrow student loans at higher rates than White borrowers because they don't have family wealth to support them, and they also tend to attend for-profit schools, which are schools that are actually marketing themselves more towards blacks, Latinos, women, and working people. They have much worse outcomes in terms of graduation rates, employment rates, repayment rates, basically everything—everything that would matter.

So, the higher education is sold as some kind of panacea out of poverty or lower middle class, and that works for some people, but it doesn't work for everyone. It is basically a bet that the student is taking, and sometimes that bet fails. It happens to fail more often for Black and Latinos.

Mr. NADLER. Thank you.

Mr. Rao, what are some of the so-called reforms enacted by the 2005 amendments to the Bankruptcy Code that make it more difficult for all consumers, let alone those with overwhelming student debt, to file for and obtain bankruptcy relief?

Mr. RAO. Yes, Chair Nadler. The major change, of course, was the means test. There were also—and so that means test requires all filers to calculate their current monthly income. There are additional filing and document requirements. If you are above the median income in your state, you are subjected to the full means test, which does remove those who have an ability to repay. It creates a presumption of abuse and would ultimately deny those folks a discharge.

There were also changes for exemptions so that particularly higher-income consumers couldn't move to States with unlimited homesteads and high assets in that way. There were also counseling requirements that were imposed that haven't actually proven to have done much in terms of really making bankruptcy relief having exposed those individual debtors to other options.

Mr. NADLER. As a result of these reforms, if student loan obligations were made fully dischargeable, would the argument that such legislation would invite abuse be even less compelling?

Mr. RAO. Yes, absolutely. It would address that problem, which even though I would say that it didn't exist, it certainly would address the problem of bankruptcy filers.

Mr. NADLER. Thank you. Finally—thank you.

Finally, Judge Small, you were a bankruptcy judge for many years. Based on that experience, what are your thoughts about the current law with respect to the dischargeability of student loans?

Judge SMALL. It is almost impossible to discharge a student loan in most circuits under the Brunner undue hardship test. If you are not going to repeal 23(a)(8), you should at least do something to make the standard of the Brunner test easier so that a debt could be discharged for hardship, maybe not undue hardship.

Mr. NADLER. Thank you very much. My time is 4 seconds from expiring. I yield back.

Mr. CICILLINE. Thank you, Mr. Chair.

I recognize the gentleman from North Dakota, Mr. Armstrong.

Mr. ARMSTRONG. Thank you.

So, I am a sponsor of H.R. 236, the Family Farmer Relief Act, and it is important because over the last 20 years, the increase in production from our farmers all across the country has gone up significantly. These are some of the best scientists and producers in any industry in the world. At the same time, the decline in farm income, combined with trade fluctuations, has created a really difficult time for farmers.

I think one of the reasons we don't notice the farm crisis that is actually going on right now, and partially because of the farm crisis in the '80s, is because there are less family farmers than there were 20 years ago. Some of that is because of prior farm crises. Some of it is just based on economies of scale, which is where we get to a revamp of Chapter 12.

According to the USDA, debt-service ratios are projected to reach all-time highs very shortly, with the 5-year 50 percent collapse in farm income, it is imperative that producers have adequate safety nets to rely upon should they need to make the extraordinarily difficult decisions for their farm.

In both 2017 and 2018, approximately 500 farms filed each year under Chapter 12 bankruptcy. The Upper Midwest has witnessed a 19 percent increase in Chapter 12 filings since 2017, and that statistic does not include the effects of droughts, floods, and recent trade disputes.

Just like any good business, our egg producers need updated and flexible tools to reorganize their debt. Chapter 12 bankruptcy is an important and unique provision that allows farmers to restructure their debt while maintaining their farming operations and uniquely recognizes some of those challenges that are based on a farm business income.

Unfortunately, the current debt cap from Chapter 12, it is $4.1 million, it unnecessarily excludes farmers' most desperate need of reorganization. Just to be quite frank, it doesn't recognize what the current family farm looks like. By increasing the debt cap from Chapter 12 bankruptcy from $4 million to $10 million, this bill will keep more farmers in fields and farms and in the family.

I always am on a continuing quest to educate people about North Dakota, and one thing that is great, we do not have corporate farming. So, every farm in North Dakota is a family farm. I will note this bill is particularly beneficial to my State because we only have family farms.

Yet the effect of this bill won't just be felt by farmers, but it is felt by the rural communities who rely on them as an economic driver. Strong farms support strong rural communities. So, we need to give them the tools that meet their needs in the current economy.

Family farms are more than just a business. They are a commitment to a tradition passed down from generation to generation. We owe it to our farmers to make this simple change and stand with them when we need to make the most difficult decisions.

I would just note that this bill was in desperate need of introduction prior to what is going on in the farm community right now, and whether it is floods that are going on all across the country, droughts that some people are experiencing, and obviously, the uncertain trade situation that everybody faces.

Last, but not least is we have gone from a scenario where the family farmer can work on a $120,000 piece of equipment to a $1 million piece of equipment that is more computer than mechanical at this point, and inputs continue to rise, whether it is transportation, anhydrous, all these things. So, the number of acres you need to do to produce and have a valid family farm is going up every day. They provide not only my region, my State, but every State across the country with food and actually, quite frankly, feed the world.

So, I am proud to be a part of that bill. I will just say one thing that on this student loan debt, and I think it is something that we have to address. That is that college tuition is increasing at an unsustainable rate. There has been a 213 percent in tuition from 1987 to 2017, and we have great colleges in North Dakota. We have great colleges all across the country. I am not sure they are getting 217 percent better education than those people who got in 1987 did.

There really are no market forces that drive down college tuition, but there are plenty of market forces that benefit schools increasing, whether it is a local chamber of commerce, State education. We continue to grow these campuses.

Oftentimes, employment is going up at not quite 213 percent, but a very high rate. The employment that is on college campuses isn't academic. It is more administrators, more deals with those.

So, when we deal with these student loan issues, we also have to figure out how to put some kind of federally backed student loan. We have an incentive to keep local college tuition costs down, and that has to be a part of this conversation. Otherwise, I worry that we open the flood gates to an ever-increasing tuition cost where we get into a situation where not only are we increasing college tuition everywhere, but we are not necessarily preparing our students for a 21st century workforce.

So, I yield my time without asking a single question, and I don't think I have done that before.

Mr. CICILLINE. Very thoughtful comments. Thank you.

The gentleman yields back. I now recognize the gentlelady from Washington, Ms. Jayapal, for 5 minutes.

Ms. JAYAPAL. Thank you so much, Chair Cicilline, for holding this hearing, and thank you to all of you for your comments.

I am confused by the comments earlier about people gaming the system because I feel like the student loan system is a giant trap. We say to people you have to get an education. K–12 used to be enough to get a good job. It isn't anymore. We all know that.

We say to people go get a trade or a vocational skill or do something, get a 4-year degree. Then they do that, but they come out with an average of $40,000 to $50,000 in debt, $1.5 trillion in student loan debt in this country.

When I think about gaming the system, I think about the fact that, actually, the Federal Government right now is charging so much on interest, so much more than we actually pay for that money, that many of these borrowers—I got a whole bunch of tweets yesterday because we introduced our "College for All" bill. A whole bunch of these borrowers were telling me they are paying $700 a month for their principal payments, trying to pay off their student loans, and $4, $5 is actually going to principal.

The rest of it is going to interest because we are charging these enormous interest rates for these students. So, they are never going to be able to get out of debt.

When I think about, again, gaming the system, I wonder how it is that we can bail out Wall Street firms because they are supposedly too big to fail, but these student borrowers, 44 million people with student loan debt in this country today, are too small to fail. They can have their entire lives destroyed, no future, and yet somehow there is this different standard.

So, let me ask you, when big businesses fall on hard times—you have all talked about this—they can take advantage of the relief that bankruptcy offers. When students have the same problem, they cannot.

That means an organization like the Trump Administration, for example—the Trump organization, excuse me, can declare bankruptcy with taxpayer costs. Any big organization, I am not picking on Trump. Any of them can declare bankruptcy, and somehow, they are not gaming the system. Tet students are. So, why aren't we worried about the gaming of the system with those big organizations or, to the counter, why don't we say, look, to these students, we can give you the same benefit?

So, Mr. Boltz, in your written testimony, you described this ever-increasing set of restrictions on how and when ordinary people can discharge their loans. What is any logical reason—I will take any single logical reason for why clients with student debt should face this heavier, higher burden to discharge their student loans than major corporations?

Your mike.

Mr. BOLTZ. Thank you, Ms. Jayapal.

Particularly, in regard to the private student loans, there is absolutely no basis for this whatsoever. When it comes to the Federal loans, there is the argument that has been made and is not terribly solid that because the Government is on the hook for these amounts that it affects the liquidity of making future loans.

One of the things that is important to consider, however, of the $1.5 trillion in student loans, 11 percent of the borrowers, of the 44 million people, they are in default, which is a technical term under—in student loan law, which means they are more than 9 months without a payment. More than a third of people are delinquent on their student loan.

So, part of what that means is that of the $1.5 trillion, the Government is not going to ever see all of that. So, there is a large fallacy that this is somehow going to undermine the ability to continue to make loans for students.

Ms. JAYAPAL. In fact, if we are really concerned about the State of the economy, there are reports that say that if we were to cancel all $1.5 trillion in student loan debt, we would bring $1 trillion over the next 10 years into our economy. Even the Federal Reserve has said people are putting off major decisions like buying homes or investing in a car or whatever else they need, even getting married or having kids, because of their student debt.

Mr. Rao, you are an attorney at the National Consumer Law Center, and you pointed out that currently in bankruptcy law, the business entrepreneur is given an opportunity for a fresh start, while the student borrower is given no margin of error. Do student borrowers present some very special risk to the bankruptcy system that I am missing?

Mr. RAO. No, I don't believe they do. In fact, they probably present less risk than particularly some of the business filers or, you know? There was one point in 1978 when, as a member of this Committee had said, that it was inappropriate to really view the student loan programs as a social program when we are granting the loans, but then to treat them as business, strictly as business when you are trying to collect the debt.

I would say it is even worse than that because, as you have pointed out, we allow the business entrepreneur to get a discharge, but we don't allow the student loan borrower.

Ms. JAYAPAL. Thank you, Mr. Rao.

Thank you, Ms. Jiménez, for making the trip back.

I had one more question, but I am out of time. I would just say before I yield back, Mr. Chair, that yesterday, I introduced with Senator Sanders and Representative Omar a bold package to cancel $1.5 trillion in student loan debt and to ensure that we can actually invest in the future of our young people by making college tuition free and debt free. I look forward to the day when we can make that kind of investment for our future.

Thank you.

Mr. CICILLINE. I thank the gentlelady.

I now recognize the gentlelady Pennsylvania, Ms. Scanlon, for 5 minutes.

Ms. SCANLON. Thank you very much.

The issue of student loan debt is one that comes up at every town hall and every constituent conversation that I have. Pennsylvania has the highest student debt levels in the country, 1.8 million people have some amount of student loan debt in Pennsylvania, and the average of $36,000 per person is about 20 percent higher than the rest of the country. So, it is a huge issue in my community.

What has really been striking to me is the intergenerational impact that we are seeing now. So, last August I met a woman who had just dropped her daughter off at college, and she was emotional. It wasn't because her daughter was going to college. It was because her daughter was going to her second-choice college. Mom and Dad were still paying off their student debt, so the daughter couldn't go to her first-choice college.

Then there is Nate and Natalie, who attend church with me. Young parents, they have boys ages 4 and 6. They can't start saving for their kids' education because they are still paying their student loans.

These are responsible people. They are paying their taxes. They are paying their loans. They are doing what they are supposed to do.

My own kids' friends, my three have just graduated from college, and I am hearing how people aren't buying cars, and they are not buying houses. They are not getting married and they are delaying having children. So, clearly, there is an emotional drag on the system.

I just saw an article a couple days ago from Adweek about targeting millennial customers, millennial consumers. Our corporations are having to adjust their marketing tactics because the metrics that held true for previous generations aren't working because the millennials have such a debt load, they don't have the discretionary income. So, this whole drag on our economy is really something I am pleased that we are having this hearing to start chipping away.

Obviously, amending the Bankruptcy Code does not solve the whole problem. We have to go after the predatory private colleges and the predatory loans and revamp the system for how people pay for it. I do think that this bankruptcy piece is so important. The piece that really is striking to me is that student loans were dischargeable. That there was this chipping away at it, and now we are treating student loans differently than credit card debt. It is kind of astounding to me.

So, I guess maybe Ms. Jiménez, am I correct that the amendment suggested here would not create special rules for student loan debt, like favored treatment for student loan debt, but would lump it in with the general category of debt. Is that right?

Ms. JIMÉNEZ. That is right. Absolutely correct. The student loan debt special treatment is the rare event, and so the Representative Nadler's bill and Senator Durbin's bill would just take that special treatment away.

Ms. SCANLON. Okay. Mr. Rao, so when we are treating student loans like other debt, that doesn't mean that someone is going to be able to walk in and say I just don't feel like paying, kind of like I just don't feel like paying my credit cards, does it?

Mr. RAO. Right. Again, the Bankruptcy Code does screen for consumers who would really have an ability to repay their debt based on their income. So, if they do have that, they would be presumed to be abusive and they would not get a discharge.

Ms. SCANLON. Okay. So, we still have the courts and the rest of the Bankruptcy Code to Act as a stopgap against abuses?

Mr. RAO. Yes.

Ms. SCANLON. Okay. Ms. Jiménez, your statement talked a little bit about the difference in student loan debt and defaults with communities of color and that we have got some disparity there. Can you explain that a little?

Ms. JIMÉNEZ. Absolutely. The fact that we have chosen to support the higher education system through loans means that we have created or re-created and exacerbated the wealth gap in this country because we are making people who already come from families who don't have as much wealth as others, we are making them borrow. They already don't have—there is already disparities in education, in job prospects based on implicit bias and just outright racism, and we are making those people take out loans.

Then there is actually evidence that we are suing them more often and that they are not receiving the same benefits as others in income during the repayments.

Ms. SCANLON. The thing that really surprised me when I started looking into this was the statistic that women actually hold more student loan debt. Two-thirds of all student loan debt is women, despite the fact that they have less wealth with which to repay. Can you comment on that?

Ms. JIMÉNEZ. Exactly. A lot of that is actually working women, single parents, who are preyed upon by for-profit colleges. They mostly take out private loans. The for-profit college's business model is really around Federal loans. So there, even if we made private student loans nondischargeable, that wouldn't really solve that problem.

Ms. SCANLON. Okay. So, that is kind of an intersection of the two problems?

Ms. JIMÉNEZ. That is right.

Ms. SCANLON. Okay, thank you. I yield back.

Mr. CICILLINE. I thank the gentlelady.

The Chair now recognizes the gentleman from Colorado, Mr. Neguse, for 5 minutes.

Mr. NEGUSE. Thank you, Mr. Chair, and thank you for holding this important hearing. I appreciate the witnesses and their testimony.

I want to focus in on an issue that many of my colleagues have talked about already at great length, which is, of course, the student loan debt that is harming so many people across our country and really drastically impacting the lives of nearly 45 million people, and the crippling effect of student loans on our nation's financial health is, of course, well known to this Committee and, I believe, to the witnesses as well.

Just to give you some sense of context, I represent the great State of Colorado. In Colorado, student loan debt, as of January 2019, is $26 billion and impacts 700,000 Coloradans, and more than 20,000 rural Colorado residents are severely delinquent. So, this is an issue that we must address with the urgency that it requires, which is why I am proud to be one of the co-lead and lead sponsors of the Student Borrower Bankruptcy Relief Act of 2019, with Chair Nadler and Senator Durbin, to ensure ultimately the Bankruptcy Code is fair to all.

I want to have a question for you, Mr. Keach. I reviewed your written testimony. I guess I am trying to better understand the rationale for the exception as it was enacted in the early 1970s. Then, obviously, over time it was changed, right?

So, in your written testimony, you offer that the Consumer Commission, which is the commission of the ABI, weighed the rationale—I am quoting from your written testimony—for student loan dischargeability against the current and projected student debt landscape. Then I will just give you a quote. "The commission considered, but rejected the notion of making student loans freely dischargeable," which is a misnomer in terms of the word "freely," but I understand that this is from the commission, "freely dischargeable like any other debt, concluding that the rationale supporting nondischargeability remained valid."

So, could you explain what was going on in the minds of policymakers 40 years ago as to why they came up with this exception in the first place?

Mr. KEACH. Sure, I can try. I think my colleagues to the left, all three of which are Members of the ABI Consumer Commission—and I thank them for their service—in that respect, could probably speak to this.

The historical antecedents that have been talked about are largely accurate, and that is that there were beliefs about moral hazard. That has been addressed. The bigger concern was probably for the solvency of the Federal student loan program or at least for the liquidity and solvency of the program.

The ABI Consumer Commission recommendation actually is somewhat of a midpoint between those people who are concerned about that and complete discharge and, in fact, would discharge private loans. It would also allow for the discharge of federally provided, guaranteed, or insured loans that were more than 7 years old at the time of the bankruptcy.

It would also allow for discharge of loan obligations of people other than the students themselves. Would also materially reform the so-called Brunner hardship test to make that test meaningful and allow for people to actually get discharged under that test. As Judge Small said, that doesn't happen today.

It doesn't allow for full dischargeability of federally funded, guaranteed, or insured student debt other than under the hardship test.

Mr. NEGUSE. So, on that precise point, notwithstanding the undue hardship test and, obviously, the recognition that that test has not been—with the lack of any real discernible standards makes it largely toothless. I guess I am trying to better understand why adhere to this purported rationale that was adopted 50 years ago if the underlying presuppositions of that rationale have not come to pass?

Mr. KEACH. Sure. I don't want to speak for the full ABI Consumer Commission, but that I don't think there is any support in that commission or in the commission recommendation with a rationale about moral hazard. That has gone out the window. I don't think anybody is making that argument anymore.

To the extent that there is balance built into the ABI Consumer Commission report, which is probably somewhere near where Ranking Member Sensenbrenner was and the Nadler bill, is really about a concern for continued solvency and funding of the Federal system. It doesn't at all try to protect the private lending system.

Mr. NEGUSE. To that point, do we have—thank you for your answer—do we have any empirical data that suggests that that concern is substantiated? I guess that is my point. Because with a wide variety of other common loan structures, right, I am thinking home mortgages by way of example. We certainly—those are dischargeable in bankruptcy, and we don't have wide concerns about the security of that program.

I guess that is what I am trying to get at, and I—

Mr. KEACH. Well, interestingly enough, actually, residential mortgages that are within the various Federal programs actually do have more protection under the Bankruptcy Code than regular private loans. So, there is actually a pretty direct parallel here.

Mr. NEGUSE. They are dischargeable.

Mr. KEACH. Well, they are not fully modifiable or fully dischargeable, right?

Mr. NEGUSE. Sure. They are in part dischargeable. Certainly, far more dischargeable than a student loan.

Anyway, I see my time has expired, but—

Mr. KEACH. Well, to the extent there is a deficiency, that is true. You can't actually modify materially in Chapter 13, for example, a first mortgage because of the Federal mortgage insurance program. So, there are some parallels to that.

Mr. NEGUSE. Thank you, Mr. Chair.

Mr. CICILLINE. The Chair now recognizes the gentlelady from Georgia, Ms. McBath, for 5 minutes.

Ms. MCBATH. Thank you, Mr. Chair.

I am so glad for each of you spending a few moments with us this morning. I am very excited to be the cosponsor of the bipartisan HAVEN Act of 2019, along with my Republican colleague Mr. Steube. This measure has also been endorsed not only by Ms. Petraeus and Mr. Keach, but also endorsed by the Veterans of Foreign Affairs, the American Legion, Disabled American Veterans, among others.

I appreciate this opportunity to discuss ways in which we can reform our bankruptcy system to better serve people and small businesses that are facing financial hardship. No one wants to turn to bankruptcy, and we should ensure that these systems effectively help people rescue their financial lives.

I am especially pleased to have the opportunity to discuss my bill, the HAVEN Act, which I introduced, as I said once before, with my Republican colleague Congressman Steube. This bill would help veterans qualify for bankruptcy relief by excluding their VA and Department of Defense benefits from the calculation of their income, as it is already done with Social Security disability payments.

This small change will help veterans who are most in need, and no one should ever be penalized for the payments they receive for their injuries resulting from their brave service to our country. I am proud to support this bipartisan bill and to discuss it with you today.

Mr. Keach, I will turn to you, if you will. Can you think of any reason why Social Security benefits should be treated differently than VA or Department of Defense benefits for bankruptcy income calculations?

Mr. KEACH. The ABI can't think of any reason why that should be true. We fully support the HAVEN Act. We, frankly, are of a belief that the inclusion of these benefits for our veterans in disposable income calculation was an error, and that error should be corrected. This bill would do that.

Ms. MCBATH. Thank you very much.

Ms. Petraeus, in your written testimony today, you cite a study indicating that 125,000 veterans filed for bankruptcy in 2017. The study also found that although veterans comprise only 10.3 percent of the population, they make up 14.7 percent of Chapter 7 debtors and 15 percent of Chapter 13 debtors.

Why is it important for veterans to be able to access Chapter 7 bankruptcy rather than counting their benefits as income and potentially making only Chapter 13 bankruptcy relief available for themselves?

Ms. PETRAEUS. Thank you for the question.

I must say this has been an education for me on bankruptcy. Chapter 7 is the equivalent of a fire sale. Everything must go. You dispose of your assets, and then you walk away, freed of your obligations.

Chapter 13 is a whole other thing, where you end up paying for 3 to 5 years. You have to set up a payment plan. Frankly, for many of these veterans, they don't have a whole lot of money to start with. If they end up having to even take their disability pension and apply it to their payment plan, they have got almost nothing left.

The military leads a very mobile lifestyle. I, myself, moved 24 times in 37 years while my husband was on active duty. The spouse unemployment is a very significant issue for the military, which means they have not had a spouse who has had the opportunity to build a career or to have a very significant income. When you add in disability, that spouse may now be a full-time caregiver as well.

So, they just don't have a lot of money, frankly, and to, again, take away their pension and apply it to a payment plan is just punitive. I can't imagine that that was really intended.

Ms. MCBATH. Thank you. One more question.

Based on your many years of experience working with service Members and veterans dealing with financial challenges, why do you think so many veterans are seeking bankruptcy relief?

Ms. PETRAEUS. Again, some of it is just a part of the life they have led. The military is not a place where you get rich. It is very meaningful service. I was lucky enough to live in that community my whole life. They do it for the best of reasons. But, they tend to have lower income as a group.

A significant number of them do have issues after serving that may impact their ability to get or to keep a job. I will also say they are not exempt from the student loan crisis. Even though they have the GI bill, a surprising number of veterans have significant student loans, in many cases because they have been targeted by unscrupulous for-profit colleges that have marketed to them.

They have spent not only their GI bill, but then taken out private student loans to fund what in many cases is a fairly worthless education. So, they have a lot of the same issues. They have a mobile lifestyle, and they don't have a good income to start with. So, when they get out of the military, that may put them in a very shaky financial situation.

Ms. MCBATH. Thank you so much for your service, and thank you so much for your testimony.

Ms. PETRAEUS. Thank you.

Ms. MCBATH. I am out of time.

Mr. CICILLINE. I thank the gentlelady for yielding back.

I now recognize myself for 5 minutes. Thank you again to our witnesses that have participated in today's hearing.

Ms. Petraeus, thank you for your work and the passion with which you bring to this important work. We all recognize the current system that creates or provides or exempts, I should say, Social Security benefits from the law's current definition of current monthly income for purposes of determining eligibility for consumer bankruptcy relief.

While at the same time disability benefits from the Veterans Administration and the Defense Department are not, seems to make very little sense to anyone. I am just wondering if any of the witnesses on the panel today can think of any good reason for this disparate treatment?

[No response.]

Mr. CICILLINE. Okay. The record should reflect that no witness saw them. I thank you again for your advocacy for this important bill.

I want to just turn now to the student loan bankruptcy. I misspoke in my opening statement when I indicated that student loan debt is at $1.5 trillion and will be at $2 trillion by 2022. I think I said billion by mistake.

For me, sort of in line with what Ms. Jayapal said earlier, when we talk about this gaming the system, it is fair to say the system is gaming young people. That the system right now forces young people to go into tremendous debt with really no ability to get out, and the consequences for that on the individual borrower, as well as our economy broadly, is enormously significant.

I want to just respond to a question that was raised earlier about how do we make sure young people aren't just gaming the system? There was—Mr. Rao, made references to this report. The GAO study found that only a fraction—in fact, I'll summarize the GAO findings.

First, the general default rate on educational loans is approximately 18 percent. Of that 18 percent, 3 to 4 percent of the amounts involved are discharged in bankruptcy cases. Thus, approximately 0.5 to 0.25 of 1 percent—0.5 of 0.25 of 1 percent of all matured education loans are discharged in bankruptcy. This compares favorably with the consumer finance industry.

So, there wasn't a problem of young people gaming the system. It was 0.5 or 0.25 of 1 percent. You must wonder what resulted in the creation of this undue hardship standard. In addition to there being no evidence that it is necessary, Mr. Rao, why has this standard been difficult to administer, and why has this undue hardship application kind of varied from case to case? What does that mean for kind of this system overall?

Mr. RAO. Yes, Chair Cicilline. As I mentioned in my statement, it is just not a viable way to approach the student loan problem. The cost alone—so there is the issue of the vagueness of the standard and the fact that judges apply it in different ways and the fact that it has been interpreted by the circuit courts to apply a very strict standard.

Even putting that aside for the moment, the system requires that there be a litigation. We are talking about the consumers who would be most eligible for an undue hardship could barely pay for the cost to file the underlying bankruptcy case, let alone tens of thousands of dollars to fund contested litigation.

The Department of Education fights these cases very hard, as well as the contractor that is hired by them, ECMC. So, it is just not happening. People aren't getting undue hardship discharges.

Mr. CICILLINE. Many of my colleagues in this hearing have referenced our additional responsibility to figure out how we make the cost of higher education affordable and accessible, and we are dealing today with some of the symptoms of a system that is broken, where people are accumulating enormous debt and are unable to pay it.

We have to do both. We have to address this question, but we also have to deal with kind of the source of the problem in a different Committee with different legislation.

I really want to thank you because this is a very serious issue. We hear about it all the time from young people and from families. I hear about it every day from my sister, who has two children who just finished school and are saddled with enormous student loan debt. We hear this wherever we go. So, these are important bills that we intend to move.

The last issue I want to just raise is a slightly different issue, and that relates to Chapter 7 bankruptcies. Trustees Act as a fiduciary appointed by the Justice Department to ensure that debtors comply with various requirements, including filing documents with the court and surrendering their nonexempt assets for liquidation, along with other essential responsibilities.

The fee for trustees is paid by debtors, and in addition to paying for legal representation and compulsory debt counseling, debtors must also pay a $335 fee to file for Chapter 7 bankruptcy. The Chapter 7 trustees receive just $60 of this filing fee, a compensation level that has not been adjusted in 25 years and the only method of compensation in more than 90 percent of Chapter 7 cases. So, this is a significant problem.

It is an understatement that increasing Chapter 7 trustees' compensation is long overdue. Everyone recognizes that.

Mr. Rao, you previously testified in favor of adjusting this problem to resource the funds outside of steep increases in consumer debtor filing fees. What are some of those sources, and what are some other ways to reduce consumer debtors' burdens in bankruptcy while also addressing this sort of unfairness of the $60 fee, which has been unchanged for 25 years?

Mr. RAO. Yes, Chair Cicilline. Trustees are also compensated by the assets which are sold in a bankruptcy case, and there is a certain percentage that are in the Bankruptcy Code as to how much of a percentage of the asset that they are able to receive as a commission.

Our proposal would be to adjust those cutoffs so that they would receive higher amounts in those asset cases through the commission on the sale of assets.

The other way to approach the problem, the opposition that we have had to the bills that have been introduced is that they focus solely on having debtors pay for the increased compensation through filing fees. The other possibility is to make it possible so that there are savings for consumers in reducing some of the filing requirements so that there is less burden on them in filing the case, and then possibly there may be that they could share some of the costs through an increase in filing fee, but only if there is a compensating reduction in their cost of access to the bankruptcy system.

Mr. CICILLINE. Thank you.

With that, I think there are—no, sorry. I just want to make sure I properly close the hearing.

First, I want to say thank you to the witnesses for this incredibly useful testimony. It will inform and guide our work.

I ask unanimous consent to include a number of letters and statements in the record regarding proposed measures to address issues in our Bankruptcy Code—two statements from the American College of Bankruptcy, one endorsing the Family Farmer Relief Act and the Small Business Reorganization Act, one supporting the HAVEN Act, and a statement from the Association of Young Americans endorsing the Student Borrower Bankruptcy Relief Act.

Without objection.

[The information follows:]

CICILLINE FOR THE RECORD

American College of Bankruptcy

June 14, 2019

Hon. David N. Cicilline
Chairman
Subcommittee on Antitrust, Commercial and Administrative Law
U.S. House of Representatives
Washington, D.C. 20515

Hon. F. James Sensenbrenner
Ranking Member
Subcommittee on Antitrust, Commercial and Administrative Law
U.S. House of Representatives
Washington, D.C. 20515

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Prof. Ingrid Michelsen Hillinger
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Hon. Jeffery P. Hopkins
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Dear Chairman Cicilline and Ranking Member Sensenbrenner:

The American College of Bankruptcy is an honorary association of almost 900 bankruptcy and insolvency professionals. The College plays an important role in sustaining professional excellence in the bankruptcy field. College Fellows include commercial and consumer bankruptcy attorneys, judges, insolvency accountants, turnaround and workout specialists, law professors, government officials and others in the bankruptcy and insolvency community. Its Fellows share a commitment to the administration and improvement of the Bankruptcy Code.

Please accept this letter as the ACB's endorsement of

1. H.R. 2336, the "Family Farmer Relief Act of 2019," which would increase the debt limits for the filing of chapter 12 cases from their existing limits ($4,153,150 for farmers, and $1,924,550 for fishermen) to $10 million; and

2. the "Small Business Reorganization Act" (which as of the time of this writing has not yet been assigned a bill number in the House, but which we understand will be identical or substantially identical to S. 1091, its counterpart in the Senate), which would provide for a new subchapter V to chapter 11 that establishes a streamlined and much more cost-effective means to reorganize small businesses.

Chapter 12 addresses the needs and concerns of family farmers and fisherman, and while it is an important tool for them, it has not been updated to address the much higher levels of debt they have faced in recent years. If chapter 12 is to accomplish the salutary purposes for which it was enacted, it should be amended to increase the monetary limit for eligibility to invoke it.

Chapter 11 has long been of great value in preserving jobs, enhancing going concern value, and maximizing creditor recoveries for many businesses. But the present chapter 11 does not work efficiently for businesses of smaller size, which constitute the great bulk of business entities in financial distress. For small businesses, the present chapter 11 is seldom effective in achieving a reorganization due to extensive reporting requirements, complicated procedures, broad participation from groups of creditors at the debtor's expense, high costs, and stringent plan confirmation requirements that most small business owners likely cannot meet. Thus, seeking chapter 11 relief often is a path to liquidation rather than to a

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restructuring. Accordingly, many small businesses (as well as many bankruptcy professionals) do not consider chapter 11 in its present form to be a viable option.

The streamlined processes built into the Small Business Reorganization Act would go far in addressing the failure of current chapter 11 to address the foregoing issues, and would make chapter 11 available for the very large community of small businesses, and their creditors, who are so often effectively foreclosed from benefitting from chapter 11. In that regard, the Small Business Reorganization Act would be even more effective in accomplishing its goals if the monetary debt cap for filing a small business chapter 11 case were amended to make it $10 million – the same amount as the cap under a revised chapter 12.

In each case, the American College of Bankruptcy fully supports Congressional efforts to improve the utility of the bankruptcy system through the passage of the Family Farmer Relief Act and the Small Business Reorganization Act. You are welcome to publicly cite the College's support of each of these bills as you deem appropriate to secure the bills' passage.

We note that the views expressed in this statement are those of the American College of Bankruptcy, on whose behalf this statement is issued, and do not necessarily reflect the personal views, if any, of any judge or other Fellow of the College (or any firm or educational institution with which one or more Fellows may be affiliated).

On behalf of the College, we thank you and the co-sponsors of these bills for your service to the country, and, particularly for your work to help farmers, fishermen and small businesses in financial distress, as well as the creditors to whom they are indebted, to obtain the relief they need through our bankruptcy system.

We would be grateful if you would keep us abreast of developments with respect to these bills, and if you would let us know if there is anything more the College can do to support this legislation.

Sincerely,

Marc A. Levinson, Chair

Mark D. Bloom, President

cc: All Subcommittee Members, by electronic delivery

American College of Bankruptcy

June 11, 2019

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Hon. Jerrold Nadler
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United States House of Representatives
2132 Rayburn House Office Building
Washington, DC 20515

Hon. Doug Collins
Ranking Member, Committee on Judiciary
United States House of Representatives
1504 Longworth House Office Building
Washington, DC 20515

Dear Chairman Nadler and Ranking Member Collins:

The American College of Bankruptcy is an honorary association of almost 900 bankruptcy and insolvency professionals. The College plays an important role in sustaining professional excellence in the bankruptcy field. College Fellows include commercial and consumer bankruptcy attorneys, judges, insolvency accountants, turnaround and workout specialists, law professors, government officials and others in the bankruptcy and insolvency community. Its Fellows share a commitment to the bankruptcy system's administration and improvement.

Please accept this letter as the ACB's endorsement of the Honoring American Veterans in Extreme Need (HAVEN) Act, introduced in the House of Representatives as H.R. 2938, and also introduced (with the same text) in the Senate as S. 679. There is no reasonable basis for the Bankruptcy Code's inequitable treatment of veterans' disability benefits, and the ACB fully supports Congressional efforts to rectify this problem through the passage of the HAVEN Act. You are welcome to publicly cite the ACB's support of the HAVEN Act as you deem appropriate to secure the bill's passage.

We note that the views expressed in this statement are those of the American College of Bankruptcy, on whose behalf this statement is issued, and do not necessarily reflect the personal views, if any, of any judge or other Fellow of the College (or any firm or educational institution with which one or more Fellows may be affiliated).

On behalf of the ACB, we thank you and the co-sponsors of the HAVEN Act for your service to the Country, and, particularly for your work to help disabled veterans in financial distress obtain the relief they need through our bankruptcy system.

We would be grateful if you would keep us abreast of developments with respect to the HAVEN Act, and if you would let us know if there is anything more the ACB can do to support this important piece of legislation.

Sincerely,

Marc A. Levinson, Chair

Mark D. Bloom, President

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ASSOCIATION of YOUNG AMERICANS

House Judiciary Committee
Hearing: Oversight of Bankruptcy Law and Legislative Proposals
AYA Statement for the Record

June 25, 2019

Dear Chairman Nadler and Ranking Member Collins:

On behalf of our 17,000 members, most of whom are between the ages of 18-35 and are saddled with insurmountable student debt, the Association of Young Americans (AYA) strongly supports the Student Borrower Bankruptcy Relief Act of 2019 (H.R. 2648). This legislation would eliminate the section of the bankruptcy code (11 U.S.C. 523(a)(8)) that makes student loans non-dischargeable and would treat student loans like most dischargeable forms of consumer debt.

Founded in 2016, AYA is a nonpartisan membership organization dedicated to getting more young Americans involved in politics and advocating for the policies that will affect their future. As thousands of our members are facing the crushing burden of paying off student loans and are among the 44 million Americans holding onto $1.5 trillion in loan debt, it is imperative that Congress enact laws that alleviate this burden when necessary, including in bankruptcy. Since 1980, the cost of college has increased eight times faster than wage growth—2.6% annually compared to 0.3% annually. According to a recent Forbes analysis, "the cost of a four-year degree exploded to $104,480, real median wages only went from $54,042 to $59,039 between 1989 and 2016." Behind mortgage payments, student debt is now the second largest category of consumer debt and has caused young Americans to delay starting families, left them unable to buy homes, and prevented them from starting their own businesses–crippling their abilities to meaningfully participate in the economy.

Despite the sacrifices many borrowers make to pay their student loans in a timely manner, some borrowers face unexpected extreme hardships—like medical emergencies, death of a family member, underemployment and job loss—often times making bankruptcy the only viable, last resort option for financial recovery. Current law only allows for the discharge of student loans in bankruptcy if a borrower is able to meet the extremely strict standard of proving undue hardship. However, the undue hardship standard is so difficult to meet and leaves too many student borrowers in financial hardship even after other debts have been discharged through bankruptcy. The Wall Street Journal has reported that many bankruptcy judges are beginning to look for creative ways to help alleviate the burden due to the rigid nature of the law. AYA believes it is unnecessarily cruel to require a borrower that has already met the strict standards for declaring bankruptcy to then further prove that paying their student debt would cause undue hardship and does not think Congress has any justifiable reasons to retain this senseless policy.

Congress did not always exclude student loans from discharge in bankruptcy. Prior to 1976 student loans were treated like all unsecured loans and were dischargeable. In 1978, Congress feared, without a base of knowledge or proof to make this prediction, that people would fail to repay student loans and undermine public support for educational loans. Between 1978 and 1990, Congress enacted a 5, and then 7, year waiting period to ensure people could not easily discharge their loans before being adequately employed. Unfortunately, without any meaningful justifications, Congress between 1998 and 2005 made all student loans from the government, public, and private institutions non-dischargeable but for a showing of undue hardship. According to resources from the National Association of Consumer Bankruptcy Attorney's, "there was never any evidence of significant abuse of bankruptcy by student loan borrowers, and evidence that future student-loan borrowers would strategically flock to bankruptcy protection remains weak." Further, the analysis on the issue highlights:

> A study conducted in 1977 by GAO analyzed the bankruptcy filings of borrowers whose student loans were discharged found that the student loans themselves were generally not the cause. In a random study of bankruptcy discharges of student loans prior to the reforms of the late 1970s, only eight percent of bankruptcy filers with student loans had no other outstanding debts. Most borrowers had significant unsecured debts other than student loans: On average, student loans were only 29 percent of all debts reported by these bankruptcy filers. Most consumers file for bankruptcy because of unexpected emergencies or traumas in their lives.

At a time where millions of Americans are unable to help grow the economy because of an unreasonable crushing student debt burden, Congress should not make it harder for borrowers to obtain relief in times of economic crisis. No young American who has worked tirelessly towards paying off their student debt and worked to make ends meet wants to file for bankruptcy. However, in cases where they have met the strict standards for qualification, they should not then be forced to spend the little remaining means they have post-bankruptcy paying back student loans, which often have high interest rates and account for a large debt to income ratio.

For all of these reasons, AYA believes that student borrowers who meet the strict standards for bankruptcy should be allowed to discharge their student loans and we strongly urge Congress to pass the Student Borrower Bankruptcy Relief Act of 2019 (H.R. 2648).

Sincerely,
Ben Brown
Founder, AYA

Mr. CICILLINE. This concludes today's hearing. Thank you again to our distinguished witnesses.

Without objection, all Members will have 5 legislative days to submit additional written testimony—sorry, additional written questions for the witnesses or additional materials for the record.

Without objection, this hearing is adjourned.

[Whereupon, at 12:03 p.m., the Subcommittee was adjourned.]

APPENDIX

I. EFFECTUATING THE FRESH START

A. Discharge and Dischargeability

§ 1.01 Student Loans

(a) Bankruptcy Code Amendments.

(1) Section 523(a)(8) should except from discharge only student loans that

(A) were made, insured, or guaranteed by a governmental unit,

(B) were incurred for the debtor's own education, and

(C) absent a showing of undue hardship, first became payable less than seven years before the bankruptcy case was filed, regardless of any suspension of payments.

(2) Section 507(a) should have a new, eleventh priority for claims excepted from discharge under § 523(a)(8).

(3) Section 1322(a) should allow the plan to provide for less than full payment of all amounts owed for a claim entitled to the student loan priority only if the plan provides that all of the debtor's projected disposable income for a five-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(4) Section 1322(b)(10) should provide that it does not apply to priority unsecured debts.

(b) Promulgation and Interpretation of Regulations. Through regulations or interpretive guidance, the Department of Education should provide the following with respect to governmental student loans:

(1) 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:

(A) 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.

(B) Poverty-based guidelines.

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

(ii) 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.

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

(3) 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.

(c) Best Interpretation of Current Law.

(1) Standard for Dischargeability.

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

(i) 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,

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

(iii) 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 whether to appeal by the Department of Education, any guaranty agency, eligible lender, or holder of a federal student loan, and any agent of these parties.

(2) Treatment of Nondischargeable Student Loans in Chapter 13.

(A) Section 1322(b)(1) should be interpreted to allow separate classification and payment of nondischargeable student loans at a higher dividend than other general unsecured claims as long as the other unsecured claims are paid at least as much as is required under the best interest test of § 1325(a)(4), including cases where the best interest test would not require any payment.

(B) If precedent requires rejection of the recommendation in subparagraph (A) and a higher payment of nondischargeable student loans is held not to be generally available under § 1322(b)(1), courts should use the following best interpretations:

(i) If another person is liable for payment of a nondischargeable student loan, § 1322(b)(1) should be interpreted to allow a plan to provide for its payment at a higher rate than other general unsecured claims, as long as the other unsecured claims are paid at least as much as is required under the best interest test of § 1325(a)(4), including cases where the best interest test would not require any payment;

(ii) Section 1322(b)(5), providing for the cure and maintenance of long-term unsecured claims, should be interpreted to apply to student loans; and

(iii) Section 1322(b)(10), disallowing payment of interest on nondischargeable debts, should be interpreted as not applying to claims being treated under § 1322(b)(5).

Scope of the Problem. 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 today.[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 both.[2] Among all types of household debt, student loans have the highest delinquency rate.[3] The most recent data show 10.9% of student loans as 90+ days delinquent,[4] and various reports suggest that the true default rate is higher because government figures look only at defaults in the first three years after graduation.[5]

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) lower earnings of college graduates,[6] (2) lower levels of homeownership,[7] (3) lower automobile purchases,[8] (4) higher household financial distress,[9] (5) lower probability of students choosing public-service careers,[10] (6) poorer psychological functioning,[11] (7) delayed marriage,[12] and (8) lower probability of continuing education through graduate school.[13] Student loan debt thus affects not only those who owe the loans but also has consequences that ripple through our communities and our nation.

1 These figures are from calculations based on 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 (2018:Q2), at 3 (Aug. 2018) https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2018Q2.pdf.

3 *See id.* at 12-14.

4 *Id.* at 1.

5 *See* Kristen Blagg, "Underwater on Student Debt," (Aug. 2018) (https://www.urban.org/research/publication/underwater-student-debt/view/full_report); Ben Miller, "Getting Repayment Rates Right," Center for American Progress (July 10, 2018) https://www.americanprogress.org/issues/education-postsecondary/reports/2018/07/10/453199/getting-repayment-rates-right/; Judith Scott-Clayton, "The Looming Student Debt Crisis Is Worse Than We Thought," Economic Studies at Brookings (Jan. 10, 2018), https://www.brookings.edu/wp-content/uploads/2018/01/scott-clayton-report.pdf.

6 *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.

7 *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.

8 *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.

9 *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).

10 *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).

11 *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).

12 *See* Dora Gicheva, *Student Loans or Marriage? A Look at the Highly Educated*, 53 Econ. Educ. Rev. 207 (2016).

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

History. Congress first excepted student loans from the bankruptcy discharge in the Education Amendments of 1976.[14] A debtor in bankruptcy could discharge a student loan after five years had passed since the beginning of the repayment period, not counting any period during which repayment had been suspended. Before the end of the five-year period, a debtor could discharge a student loan only upon a showing of undue hardship to the debtor or the debtor's dependents. To be excepted from the discharge, the student loan had to be (1) from certain financial institutions like a bank, a state agency, an institution of higher education, or a vocational school, and (2) insured by the federal government, a state government, or a nonprofit private institution. This amendment went into effect on September 30, 1977.[15]

When Congress enacted the Bankruptcy Code in 1978, section 523(a)(8) retained the basic rule that a student loan was freely dischargeable after five years and dischargeable before that time upon a showing of undue hardship.[16] There were a few changes. The nondischargeability provision applied to any debt to a "governmental unit, or a nonprofit institution of higher education, for an educational loan." Gone was the requirement that the loan be insured, although because at the time most every student loan was insured, the change made little practical difference. The Bankruptcy Code framed the undue-hardship standard as whether there was an undue hardship on the debtor *and* the debtor's dependents, arguably a change from the previous rule that required a showing of undue hardship either as to the debtor *or* the debtor's dependents. The Bankruptcy Code now measured the running of the five-year period as beginning when the student loan "first became due" and did not toll the running of the period during any time payment was suspended. Finally, and most importantly, student loans were dischargeable in chapter 13 through its "superdischarge" (presuming the loan was "provided for by the plan").[17]

The next major legal development happened not through a legislative enactment but through decisional law. Marie Brunner graduated in 1982 with a master's degree in social work and $9,000 in student loans. Less than a year later, she filed bankruptcy. The bankruptcy court allowed a discharge, finding undue hardship in Ms. Brunner's "shaky finances and her unsuccessful efforts to find work following her graduation."[18] The Second Circuit rejected Ms. Brunner's attempt to get an early discharge of her student debt. In doing so, the Second Circuit announced what has become the widely accepted *Brunner* test to define undue hardship:

> (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

14 Pub. L. No. 94-482, § 127, 90 Stat. 2081, 2141 (adding section 439A to the Higher Education Act of 1965).

15 *See* Alan M. Ahart, *Discharging Student Loans in Bankruptcy*, 52 Am. Bankr. L.J. 201, 202-03 (1978).

16 Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 109(e), 92 Stat. 2549, 2591.

17 *See id.* § 1328(a)(2) (discharging all debts provided for by a chapter 13 plan except for debts specified in § 523(a)(5)).

18 Brunner v. New York State Higher Educ. Serv. Corp. *(In re* Brunner*)*, 46 B.R. 752 (S.D.N.Y. 1985), *aff'd*, 831 F.2d 395 (2d Cir. 1987).

(3) the debtor has made good faith efforts to repay the loans.[19]

The Second Circuit noted that there was no evidence that Ms. Brunner's "current inability to find any work will extend for a significant portion of the loan repayment period. She is not disabled, nor elderly. . . . No evidence was presented indicating a total foreclosure of job prospects in her area of training."[20] With the congressional judgment at the time of *Brunner* that a debtor could freely get a discharge for student loans after five years, a strict "undue hardship" standard was understandable.

Congress next acted in 1990, lengthening the period before a student loan became freely dischargeable from five years to seven years after it first became due.[21] In a separate statute, Congress also removed student loans from chapter 13's "superdischarge," meaning debtors now could not freely obtain an early discharge of a student loan in either chapter 7 or chapter 13.[22]

The most significant development for the treatment of student loans in bankruptcy occurred in 1998 when Congress eliminated the time period after which student loans became freely dischargeable.[23] The rule now became that student loans were nondischargeable at any time unless the debtor made a showing of undue hardship. By this time, however, a substantial body of case law had developed, primarily using the *Brunner* test, that defined what a debtor must show to establish undue hardship. The courts had developed this case law under the prior statutory structure but now began applying it in the different context of nondischargeability without a time limit.

In 2005, Congress again added to the definition of student debt that could not be discharged in bankruptcy. For the first time, even private educational loans became nondischargeable in bankruptcy.[24]

Underlying the legal developments has been a belief that student loans have different characteristics from other types of debts that merit exception from the bankruptcy discharge. First, educational lending often enables increased earning power and supposes graduates will use that earning power to repay the loan. Having a procedure that allows graduates to walk away from that debt, especially soon after graduation, particularly increases the moral hazard risk from nonpayment in ways that are not present for other types of debt. Second and relatedly, it offends a sense of fairness to allow nonpayment of a debt

19 Brunner v. New York State Higher Educ. Serv. Corp. *(In re* Brunner), 831 F.2d 395 (2d Cir. 1987).

20 *Id.* at 396-97.

21 *See* Crime Control Act of 1990, Pub L. No. 101-647, § 3621, 104 Stat. 4789, 4965. Congress also added "an educational benefit overpayment" and "an obligation to repay funds received as an educational benefit, scholarship or stipend" to the types of student loan debts excepted from the bankruptcy discharge. *Id.* 4964-65.

22 *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 3007(b)(1), 104 Stat. 1388, 1388-28. This provision was originally set to expire in 1996, *id.* § 3008, 104 Stat. at 1388-29, but was made permanent in 1994, *see* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 501(d)(38)(A), 108 Stat. 4106, 4147.

23 *See* Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971(a), 112 Stat. 1581, 1837.

24 *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59. The definition, codified at § 523(a)(8)(B), refers to any educational loan that is a "qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986," a category that includes educational loans made by private entities regardless of whether they have a governmental or nonprofit insurance guaranty.

that enabled a higher income.[25] Third, nondischargeability of student loans may be important to protect the solvency of the governmental student loan program.[26]

Retention of Nondischargeability. The Commission weighed the reasons for student loan nondischargeability against the problems that massive amounts of student loan debt are creating for American households today. The Commission considered but rejected the notion of making student loans freely dischargeable like any other debt, concluding that the rationales supporting nondischargeability remain valid. Funding of sources for educational lending is essential to the system of higher education, and increased earnings resulting from higher education will often allow a student to repay loans that are initially quite large. If reasonably applied,[27] *Brunner's* three-factor undue-hardship standard can allow appropriate bankruptcy relief during a period when discharge of student loans is not otherwise available. The Commission's recommendations are intended as a package and represent a practical, middle-ground approach that will provide meaningful changes while respecting the traditional protections for student loans.

Statutory Amendments — Return to the Seven-year Rule. The centerpiece of the Commission's recommendation is to return to the pre-1998 rule that allowed student loans to be discharged after seven years from the time they first became payable. Before seven years, student loans would be dischargeable only upon a finding of undue hardship. The rationales for nondischargeability lose their force after a student loan has been outstanding for a significant time. If a debtor cannot obtain sufficiently lucrative employment to repay a student loan that has long been outstanding, it is unlikely the debtor's circumstances will change to allow significant repayment of the student loan. For loans that have been long outstanding and have become delinquent, it is more likely that the overhang of substantial student loan debt will prevent the debtor from engaging in productive economic activity, diminishing the debtor's contribution to the community, such as by establishing a household and supporting the tax base.

The Commission considered different time periods after which a student loan could be freely discharged. Some commissioners thought five years or less might be appropriate, while others believed much longer time periods were appropriate. Drawing on the experience from the pre-1998 law, the Commission decided a seven-year period best balanced the need for payment and the need to encourage economic activity by the debtor. A seven-year period is 70% of the initial ten-year repayment period for a student loan.

Statutory Amendments — No Protection for Nongovernmental Loans. The Commission recommends that only student loans made, insured, or guaranteed by a governmental unit receive any protection from discharge. Governmental student loan programs advance the public policy of making higher education widely available and generally must make their loans available to anyone who qualifies, without regard to underwriting criteria. When making student loans, the government cannot choose only the most creditworthy borrowers. Failure to repay these loans can threaten the viability of government student loan programs.

25 *See, e.g.*, T.I. Federal Credit Union v. DelBonis, 72 F.3d 921, 936 (1st Cir. 1995) ("It is undisputed that Section 523(a)(8) was enacted to prevent abuses in student loan programs."); *In re* Pelkowski, 990 F.2d 737, 742-43 (3d Cir. 1993) (citing House floor statements).

26 *See, e.g., Pelkowski*, 990 F.2d at 743 (citing House floor statements).

27 *See infra* notes 43-53 and accompanying text.

In contrast, private student loans are underwritten in a similar fashion to other unsecured debt, and the interest rates charged on the loans can reflect the risk of loss associated with these obligations. As with any participant in a consumer lending market, private student lenders may require co-signers and security to protect their loans. BAPCPA added private student lenders to those protected from discharge. Academic research, however, suggests that this change did not lead to lower interest rates for student borrowers[28] and was not necessary given the lack of strategic default in the private student loan market before BAPCPA.[29] The Commission therefore recommends that Congress should return section 523 to its pre-2005 state where private student loans did not receive any dischargeability exception.

Statutory Amendments — Protecting Nonstudent Debtors. The Commission also recommends that section 523(a)(8) should limit nondischargeability to student loans owed by the student who benefitted from the loan, rather than by third parties. Third parties — guarantors or suppliers of collateral — would not have benefitted from the loans, and if they are otherwise in need of bankruptcy relief, they should not have their discharge impaired by their support of the student who did benefit.

Statutory Amendments — Priority for Student Loan Debt and Treatment in Chapter 13. Loans that are excepted from discharge should be a priority claim under section 507, specifically a new eleventh priority, which would be the lowest bankruptcy priority. Thus, student loans excepted from discharge would be paid after all other priority claims but before general unsecured creditors.

The Commission recommends this priority for two reasons. The first is to further the goal of obtaining payment of governmental student loans, allowing for distribution of a greater share of the estate in a chapter 7 case where there are distributions to creditors.

Second, and more importantly, giving nondischargeable student loans a priority will improve their treatment in a chapter 13 plan. Student loans are general unsecured debts. Although a chapter 13 plan may designate separate classes of unsecured claims, the plan may not "discriminate unfairly" against any class.[30] Some chapter 13 debtors have separately classified their student loan debt to provide for greater payments on the student loan debt as compared to other unsecured debts. Although as discussed below the Commission believes the better interpretation of existing law is that such separate treatment is not "unfair," some courts have found otherwise.[31]

But regardless of whether student loans can be classified separately as nonpriority claims, a plan can separately classify a priority claim. As *Collier* explains, "there can be no doubt that a plan may separately classify priority claims."[32] A priority reflects a congressional judgment that the type of claim merits

28 Alexei Alexandrov & Dalié Jiménez, *Lessons from Bankruptcy Reform in the Private Student Loan Market*, 11 Harv. L. & Pol'y Rev. 175 (2017).

29 *See* Rajeev Darolia & Dubravka Ritter, *Strategic Default Among Private Student Loan Debtors: Evidence from Bankruptcy Reform* (2017), https://ssrn.com/abstract=3064662.

30 11 U.S.C. § 1322(b)(1).

31 *See infra* notes 54-58 and accompanying text.

32 8 Collier on Bankruptcy ¶ 1322.05 (16th ed. Richard Levin & Henry Sommer eds.).

payment before other general unsecured claims. Carrying through that priority into the chapter 13 plan not only furthers the policy goal of repayment of federally backed student loans but also helps further the debtor's fresh start by reducing the amount of nondischargeable debt that will remain after the chapter 13 case ends.

Section 1322(a)(2) requires that any priority debt be paid in full through the chapter 13 plan. Section 1322(a)(4) excepts domestic support obligations owed to a governmental unit from the payment-in-full requirement because many debtors might owe a large enough amount of domestic support debt to a government unit that it would be impossible to pay the debt in full during the three- to five-year life of a chapter 13 plan.[33] Nondischargeable student debt similarly can be large, and in conjunction with giving student loan debt a priority, the Commission recommends a coordinating amendment to section 1322(a)(4) to except priority student loan debt from the payment-in-full requirement.

Finally, section 1322(b)(10) prohibits payment of interest on nondischargeable unsecured claims unless all claims are paid in full. This rule conflicts with section 1322(b)(5), which allows for curing and maintaining current payments on loans for which the last payment is due after the end of the plan. To maintain the current payment requires payment of the interest on it, meaning a debtor cannot comply with both section 1322(b)(5) and (b)(10) in regard to interest payments on long-term nondischargeable debts where the last payment is scheduled for after the plan completion date (like student loans). Congress should make conforming amendments to section 1322(b)(10), which would mean eliminating the exception clause (i.e., all the language that currently appears in 1322(b)(10) after the phrase "except that").

Regulatory Changes — Bright-Line Rules.[34] 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.

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 has both caused the federal government to incur substantial costs in the bankruptcy collection process with little recovery and has left bankrupt borrowers without effective relief. It is in the interest of the federal government and borrowers that the government use 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.

33 *Id.* ¶ 1322.05[5].

34 The Commission released its recommendations on regulatory changes for student loan debt in a letter that responded to 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). The Commission's letter can be found at https://www.regulations.gov/document?D=ED-2017-OPE-0085-0378.

Our recommendations suggest two sets of bright-line rules,[35] 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. The Commission recommends that the Department of Education through regulations or interpretive guidance provide that student loan creditors should not oppose the dischargeability of student loans of persons (i) who are eligible for Social Security or veterans disability benefits or (ii) who fall below certain poverty-level thresholds.

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."[36] 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 guidelines.[37]

Our second set of guidelines are built around the federal poverty guidelines. The most recently revised federal poverty guidelines are:[38]

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 in two situations: retirees on fixed incomes, and persons providing support for an elderly, chronically ill, or disabled household or family member.

35 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.

36 42 U.S.C. § 423(d)(1).

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

38 *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.

Determinations of disability by the Department of Veterans Affairs or the Social Security Administration can serve as grounds for an administrative forgiveness of student loan debt,[39] but that does not eliminate the need for judicial alternatives 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. The administrative and judicial remedies can be equally effective. Just as there is no reason for the Department of Education'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 Department of Education should respect the choice the borrower makes in addressing debt problems.

Regulatory Changes — 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."[40] If so, the discharge petition should not be opposed. Despite the regulation's directive, it is the sense of the Commission that student loan collectors have often vigorously litigated student loan discharge proceedings regardless of the costs and benefits 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 resort, not the first. 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 a discharge of the student loan debt.

Regulatory Changes — 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 from borrowers under "exceptional circumstances."[41] The safeguards built into the confirmation of a chapter 13 plan set out statutory requirements more stringent than the Department of Education's income-driven repayment plans, including a liquidation analysis that is not otherwise considered by the Department of Education. 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.[42] Section 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

39 *See* 34 C.F.R. §§ 685.212(b), 685.213.

40 *Id.* § 682.402(i)(1)(iii).

41 *Id.* § 685.208(l)(1).

42 *Id.* §§ 685.211(f), 685.220.

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 toward 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). Finally, the Department of Education 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 forgo administrative costs under 34 C.F.R. § 30.60 and penalties assessed under 34 C.F.R. § 30.61.

Best Interpretation — Section 523(a)(8). As discussed above,[43] many courts have interpreted the undue-hardship standard using a three-factor test known as the *Brunner* test.[44] 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.[45]

43 *See supra* notes 18-20 and accompanying text.

44 The Eighth Circuit uses a "totality of the circumstances" test. *See* Long v. Educational Credit Mgmt. Corp., 322 F.3d 549 (8th Cir. 2003). The Commission's recommendations apply to whichever judicial test is used.

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

For example, the second of these *Brunner* 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.[46]

Because of the *Brunner* test's strictness, seemingly dire financial circumstances sometimes are not enough to constitute "undue hardship." For example, in *In re Oyler,* a pastor who was married with three dependent children claimed that repayment of his $40,000 in student loans would be an undue hardship. The pastor suffered from a medical condition that had caused four retinal detachments, but the family had no health insurance.[47] Although his annual income was less than $10,000 and well below the poverty line for a family of five, the court of appeals ruled the student loan could not be discharged because the debtor had not sought the highest paid possible work for which he was qualified.[48] With such strict judicial case law, few debtors have sought to discharge student loans in bankruptcy.[49]

The Commission recommends that courts properly understand the *Brunner* test by hewing closely to the statute, as appropriate judicial interpretive techniques require. Section 523(a)(8) directs the court to consider "the debt" and not some different contract the debtor and creditor might have made under different circumstances. Thus, the court should consider whether the debtor can repay within the contractual term of the loan, which is typically ten years. The statutory language suggests other interpretive guideposts for what constitutes "undue hardship" under section 523(a)(8):

> (a) Courts 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.[50]
>
> (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.[51]
>
> (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.[52]

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

47 *Oyler*, 397 F.3d at 384.

48 *Id.* at 386.

49 *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.").

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

51 *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).

52 *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).

> (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.[53]

Because the open-ended nature of the *Brunner* inquiry cannot account for all situations that might arise, the Commission recommends a best interpretation of the third *Brunner* factor that incorporates the concept of bad faith. The court should deny discharge to a student loan only where the debtor has acted in bad faith in failing to make loan payments before filing bankruptcy.

Best Interpretation — Section 1322 and Chapter 13 Plans. As discussed above, the Commission has recommended a statutory amendment to give nondischargeable student loans a priority in bankruptcy. With a priority, nondischargeable student loans clearly could be classified separately from other unsecured debt and treated differently under the chapter 13 plan.[54] Although such treatment might discriminate among classes, it would not run afoul of section 1322(b)(1)'s prohibition against *unfair* discrimination, as the priority would itself be a reason for the separate classification.

If Congress does not amend the Bankruptcy Code to give nondischargeable student loans a priority, the Commission believes the best interpretation of section 1322(b)(1) still allows separate classification of student loans. Unsecured creditors always are protected by section 1325(a)(4)'s best-interest test, which ensures they receive at least as much under the chapter 13 plan as they would have received had the debtor filed under chapter 7.

Like priorities, nondischargeability represents a congressional judgment that a debt merits special treatment. In the context of student loans, the nondischargeability provision also furthers the protection of the public fisc and the solvency of student loan programs. Allowing separate classification promotes repayment of student loans and indeed directly furthers the congressional reasons behind nondischargeability. It is not unreasonable to prefer a student loan in the chapter 13 plan. Allowing separate classification also lets the debtor pay down a nondischargeable debt and promotes the debtor's fresh start.

Only the most wooden interpretive methods ignore the context of their times. The Commission found persuasive Judge Berger's explanation in *In re Engen*[55] of why the context of student loans is different today than it was when the nondischargeability rules first came into effect:

> Student loans are different because unlike other nondischargeable debts, it is not the debtor's misconduct in acquiring the loans that supports nondischargeability. . . . [T]he idea that student loans are nondischargeable to avoid fraud and a free ride is inaccurate.

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53 *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.").

54 *See supra* note 32 and accompanying text. Section 1322(a)(3) requires the same treatment of claims within a class. Therefore, if a debtor wishes to provide a different payment for student loans, a separate classification would be necessary.

55 561 B.R. 523 (Bankr. D. Kan. 2016).

History. Congress first excepted student loans from the bankruptcy discharge in the Education Amendments of 1976.[14] A debtor in bankruptcy could discharge a student loan after five years had passed since the beginning of the repayment period, not counting any period during which repayment had been suspended. Before the end of the five-year period, a debtor could discharge a student loan only upon a showing of undue hardship to the debtor or the debtor's dependents. To be excepted from the discharge, the student loan had to be (1) from certain financial institutions like a bank, a state agency, an institution of higher education, or a vocational school, and (2) insured by the federal government, a state government, or a nonprofit private institution. This amendment went into effect on September 30, 1977.[15]

When Congress enacted the Bankruptcy Code in 1978, section 523(a)(8) retained the basic rule that a student loan was freely dischargeable after five years and dischargeable before that time upon a showing of undue hardship.[16] There were a few changes. The nondischargeability provision applied to any debt to a "governmental unit, or a nonprofit institution of higher education, for an educational loan." Gone was the requirement that the loan be insured, although because at the time most every student loan was insured, the change made little practical difference. The Bankruptcy Code framed the undue-hardship standard as whether there was an undue hardship on the debtor *and* the debtor's dependents, arguably a change from the previous rule that required a showing of undue hardship either as to the debtor *or* the debtor's dependents. The Bankruptcy Code now measured the running of the five-year period as beginning when the student loan "first became due" and did not toll the running of the period during any time payment was suspended. Finally, and most importantly, student loans were dischargeable in chapter 13 through its "superdischarge" (presuming the loan was "provided for by the plan").[17]

The next major legal development happened not through a legislative enactment but through decisional law. Marie Brunner graduated in 1982 with a master's degree in social work and $9,000 in student loans. Less than a year later, she filed bankruptcy. The bankruptcy court allowed a discharge, finding undue hardship in Ms. Brunner's "shaky finances and her unsuccessful efforts to find work following her graduation."[18] The Second Circuit rejected Ms. Brunner's attempt to get an early discharge of her student debt. In doing so, the Second Circuit announced what has become the widely accepted *Brunner* test to define undue hardship:

> (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

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14 Pub. L. No. 94-482, § 127, 90 Stat. 2081, 2141 (adding section 439A to the Higher Education Act of 1965).

15 *See* Alan M. Ahart, *Discharging Student Loans in Bankruptcy*, 52 Am. Bankr. L.J. 201, 202-03 (1978).

16 Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 109(e), 92 Stat. 2549, 2591.

17 *See id.* § 1328(a)(2) (discharging all debts provided for by a chapter 13 plan except for debts specified in § 523(a)(5)).

18 Brunner v. New York State Higher Educ. Serv. Corp. *(In re* Brunner*)*, 46 B.R. 752 (S.D.N.Y. 1985), *aff'd*, 831 F.2d 395 (2d Cir. 1987).

2. Where the last payment on an unsecured claim is due after the date on which the final payment under the plan is due, section 1322(b)(5) allows a chapter 13 plan to cure any default in payments of the claim and maintain current payments. This provision should be interpreted as fully applicable to student loans.[58]

Because section 1322(b)(10), by prohibiting payment of interest on nondischargeable unsecured claims in the absence of full payment of all claims, conflicts with § 1322(b)(5), it should be held inapplicable to student loan claims being treated through cure and maintenance.[59]

58 *See In re* Truss, 404 B.R. 329, 332 (Bankr. E.D. Wis. 2009).

59 *See In re* Brown, 500 B.R. 255, 269 (Bankr. S.D. Ga. 2013).

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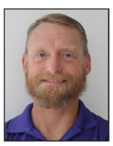
Feature

By Jonathan S. Glover, J.D. CPT, Army (ret.)

The Bankruptcy Code's Disservice to Those Who Served



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Jonathan Glover is a retired captain from the U.S. Army and serves as an Equal Justice Works Fellow. Stetson University College of Law, Veterans Law Institute is the host site for his fellowship, sponsored by Greenberg Traurig, LLP and the Florida Bar Foundation.

Editor's Note: *ABI conducted its Eleventh Annual Bankruptcy Law Student Writing Competition during the first semester of 2019. Law students from around the nation submitted papers that focused on such topics as bankruptcy fraud exception, livestock in bankruptcy and applying undue hardship to aging debtors. All papers were judged by a panel of bankruptcy experts on style, substance and relevance.* ***Jonathan S. Glover****, a retired Army captain and a student at Stetson University College of Law, won second place in the competition. He received a $1,250 cash prize (sponsored by Wolcott Rivers Gates), a one-year ABI membership and publication of the paper in the* ABI Journal.

In addition, ABI's Task Force on Veterans and Servicemembers Affairs has a primary mission to "remediate and prevent adverse debt concerns and impacts on veterans and servicemembers to ensure that we financially strengthen those that strengthen us with the respect and dignity they deserve." To that end, the Task Force has focused much of its initial attention on the Bankruptcy Code's perplexing and inequitable treatment of veterans' benefits in consumer bankruptcy cases. For more information, please contact Task Force Chair ***John W. Ames*** *(Bingham Greenebaum Doll LLP; Louisville, Ky.) at james@bgdlegal.com or visit veterans.abi.org.*

> *"Most disturbing, [the] Debtor's original attorneys ... do not even now recognize that they put [the] Debtor into a chapter 13 case when she qualified for a chapter 7 discharge. The lawyers ... failed to recognize the rights of an active duty military person in bankruptcy."*[1]

1 *In re Love*, 461 B.R. 29, 32 (Bankr. N.D. Ill. 2011).

The federal government provides a tax exemption to disabled persons, which allows such income to be excluded from gross income for tax purposes. The statutes are clear that all disability compensation should receive the maximum protection under the law. This article compares Veterans Administration (VA) disability to Social Security Disability Insurance (SSDI) compensation, how the Internal Revenue Code (IRC) treats each for tax purposes, and the exclusion of VA disability compensation in chapter 7 versus inclusion in chapter 13.

Veterans compensation is complex, and knowledge of that compensation system is needed to properly evaluate veterans for possible bankruptcy filings. An attorney who is not experienced in this type of compensation could advise a veteran to file under the wrong chapter. It is important to remember that disabled veterans either volunteered to serve their country or were drafted.[2] According to the 2000 census, 12.7 percent of the population were veterans, and these veterans face unique challenges.[3] Sometimes, the only consistency for a veteran is the monthly disability compensation, and the attorney plays a key role in helping the veteran protect rights in that compensation.[4]

The amount of veterans' compensation varies based on several factors. Bankruptcy attorneys may not be aware of statutory considerations that could impact the case. The rules of professional conduct require that a lawyer provide competent representation to a client,[5] and the quote at the beginning of

2 "In Harm's Way ... How Many Real Vietnam Vets Are Alive Today?," American War Library (2007), *available at* americanwarlibrary.com/personnel/vietvet.htm (there are approximately 850,000 Vietnam Veterans still alive) (unless otherwise specified, all links in this article were last visited on May 31, 2019).

3 "Military Service," U.S. Census Bureau, *available at* census.gov/population/www/cen2000/censusatlas/pdf/12_Military-Service.pdf.

4 "VA Form 21-8764, Disability Compensation Award Attachment Important Information," U.S. Department of Veteran's Affairs (2009), *available at* vba.va.gov/pubs/forms/VBA-21-8764-ARE.pdf.

5 *See* Rule 4-1 of the Florida Rules of Professional Conduct (2018), *available at* www-media.floridabar.org/uploads/2019/05/2019_09-MAR-RRTFB-3-29-19.pdf.

this article is a reminder of the consequences of failing to know the compensation system.

Attorneys who decide to represent veterans should understand veterans benefits, because a disabled veteran might need more help besides bankruptcy. For example, a veteran rated at 70 percent disabled might be individually unemployable, meaning that the veteran cannot work and is compensated at the 100 percent rate. This same veteran might not be aware of the option to apply for SSDI, which could result in an award with retroactive pay and a new source of income. Attorneys should take extra time to get a veteran's background and history so that no stone is left unturned. Proper representation for veterans will give them the best opportunity for success and might avoid bankruptcy altogether.

VA Disability: Background and Purpose

The U.S. Department of Veterans Affairs was established in 1930, and title 38 was enacted on Sept. 2, 1958, to administer the laws and provide benefits to veterans and their families.[6] Veterans file claims for VA disability compensation either prior to, or immediately following, discharge from military service, but there is no statute of limitations for filing a claim. After review, a disability percentage is determined correlating to the compensation received.[7]

Veterans are released from active duty for many different reasons.[8] As long as the veteran leaves service with a discharge that is not under dishonorable conditions, the veteran is eligible to file a claim for benefits. A disabled veteran is defined as someone who is entitled to compensation for a disability rated at 30 percent or more and receives compensation commensurate with the level of disability.[9] Final ratings decisions by the VA could impact the veteran's employability, and the wrong rating will impact a disabled veteran who cannot work.[10] The exhibit lists the different rating percentages and employability determinations that affect the amount of compensation.

A veteran with a spouse and child rated with a disability rating of 70 percent due to post-traumatic stress disorder receives compensation of $1,566.48 per month. This veteran is permitted to work. However, if this veteran cannot work and was properly labeled as individually unemployable, then the payment to the veteran would be $3,261.10 per month.[11] The proper classification results in additional compensation of $1,694.62 per month. This is important because other disability-compensation programs such as SSDI can be impacted or stopped if the individual works.

6 38 U.S.C. § 301(b) (2012); "VA History in Brief," U.S. Department of Veteran's Affairs, *available at* va.gov/opa/publications/archives/docs/history_in_brief.pdf; "Title 38: Veterans' Benefits," Government Publishing Office, *available at* gpo.gov/fdsys/pkg/USCODE-2011-title38/html/USCODE-2011-title38.htm (passed in 1958 with numerous amendments since its passing).

7 *See* "How to File a VA Disability Claim," U.S. Department of Veterans Affairs (2018), *available at* benefits.va.gov/compensation/process.asp (there is an eight-step process for filing claim, and VA does not provide timeline for making its determinations; rather, VA states that nature and type of claim can impact length of the process, and this is assuming that there are no rejections of filed claims requiring appeal that can take much longer).

8 Soldiers can be discharged for administrative reasons, discipline reasons and for injuries incurred while not on duty that resulted in an inability to carry on service. All of the discharges can have a different impact on the ability and amount of success in filing a claim for VA benefits.

9 38 U.S.C. § 3741(1) (2012); "Compensation and Benefit Rates," U.S. Department of Veterans Affairs (2017), *available at* benefits.va.gov/compensation/rates-index.asp.

10 A veteran who is rated with an individual unemployability rating is rated at less than 100 percent and is paid at 100 percent, but is prevented from working if the veteran wants to receive the 100 percent payout. On the other hand, a disabled veteran who is unable to work, but does not receive the full 100 percent rating or the individual unemployability signifier, receives compensation at the percentage rated by the VA.

11 "Veterans Compensation Benefits Rate Tables — Effective 12/1/18," U.S. Department of Veterans Affairs, *available at* benefits.va.gov/compensation/resources_comp01.asp.

SSDI

In 1938, Congress recognized that individuals who were permanently and totally disabled were in a desperate economic situation.[12] SSDI was created to provide financial assistance to workers who paid long enough into Social Security who, due to a disability, cannot work.[13] According to the Social Security Act, a disabled person is someone with a medically determinable physical or mental impairment that will either result in death or last longer than 12 months, and prevents any substantial gainful activity."[14]

Individuals who apply for SSDI go through a similar process as veterans applying for VA disability compensation, but veterans are not automatically entitled to SSDI.[15] Someone receiving SSDI can work, but the amount of income being earned is heavily regulated.[16] For a disabled veteran, VA disability compensation is not affected by receipt of SSDI.[17] SSDI awards are reviewed periodically based on the classification of the disability, and the review could result in a loss of benefits.[18]

IRS Application to VA Disability and SSDI

The IRC defines "gross income" as all income regardless of the source, with caveats and exceptions.[19] For veterans, the IRC excludes amounts received for personal injuries resulting from active service in the armed forces, as well as disability income resulting from injuries incurred directly from military action.[20] The IRC also protects VA disability compensation from tax levy or garnishments.[21]

12 "Social Security," Committee Staff Report on the Disability Insurance Program (1974), *available at* ssa.gov/history/pdf/dibreport.pdf (SSDI, as it is known today, was developed to provide protection against lost income during period of either temporary or permanent disability).

13 "Benefits for People with Disabilities," Social Security, *available at* ssa.gov/disability.

14 42 U.S.C. § 416(i)(1) (2012).

15 "Veterans Who Have a VA Compensation Rating of 100 Percent Permanent and Total," Social Security, *available at* ssa.gov/people/veterans/100pt.html (veterans rated at 100 percent permanent and total can receive expedited processing of their applications).

16 "Working While Disabled: How We Can Help," Social Security Administration (2018), *available at* ssa.gov/pubs/EN-05-10095.pdf (worker generally can earn up to $1,180 per month and still receive Social Security disability benefits).

17 "Expedited Processing of Veteran's 100 Percent Disability Claims," Social Security Administration (2017), *available at* ssa.gov/pubs/EN-05-10565.pdf.

18 "What You Need to Know When You Get Social Security Disability Benefits," Social Security (2017), *available at* ssa.gov/pubs/EN-05-10153.pdf (when medical improvement is expected, condition is reviewed every six to 18 months; when improvement is possible, condition is reviewed about every three years; when improvement is not expected, condition is reviewed every five to seven years).

19 26 U.S.C. § 61(a) (2012); "Information for Veterans," Internal Revenue Service (2017), *available at* irs.gov/individuals/information-for-veterans (IRS has numerous credits, tax considerations and exceptions for veterans that fall into variety of different categories).

20 26 U.S.C. § 104(a)(4)(5) (2012).

21 26 U.S.C. § 6334(10) (there shall be exempt from levy any amount payable to individual as service-connected disability benefit under title 38).

Employability and Compensation Levels

Rating	Employability	Compensation Level	Allowed to Work?
100%	Employable	100%	Yes
100%	Unemployable	100%	No
60%*	Employable	60%	Yes
60%*	Unemployable	100%	No
70%**	Employable	70%	Yes
70%**	Unemployable	100%	No

** 60 percent rating requires a single condition rated at 60 percent; otherwise, to qualify for individual unemployability, the combined rating must be 70 percent.*

*** 70 percent combined rating must include one disability rated at 40 percent or more.*

The IRC provides exclusions for gross income from SSDI, but they are not as broad.[22] Veteran-disability compensation is completely excluded, whereas SSDI is exempt based on a formula.[23] The reduced taxation protection of SSDI compared to VA disability is probative of the legislative intent of protecting veterans compensation.

Exemptions overlap between VA disability and SSDI where the statute for compensation for injuries or sickness states that "gross income does not include ... amounts received by an individual as disability income attributable to injuries incurred as a direct result of ... military action."[24] This exception connects VA compensation and SSDI because an individual who receives compensation from both sources, if the cause of the disability is military action, can exclude all of the veteran compensation from gross income. This furthers the legislative intent that disabled veteran compensation remains with the veteran.

Inequities in Application of Acts of Congress and Potential Impacts

Chronological History and Comparison of the Acts of Congress

The Social Security Act was enacted on Aug. 14, 1935.[25] Title 38, Veterans Benefits, was enacted on Sept. 2, 1958.[26] The IRC's exemption of veterans' benefits from gross income was originally amended in 1960.[27] The major reform of the Bankruptcy Code, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), was not passed until 2005.[28]

The Social Security Act was the baseline of how to compensate disabled persons. Veterans-benefit legislation was enacted next and incorporated many of the concepts from the Social Security Act.[29] However, the VA provides additional benefits.[30] The IRC's definition of "gross income" excludes VA disability compensation.[31] Thus, as of the 1960 changes to the IRC, the acts passed by Congress created a system whereby veterans' benefits received the same, and sometimes even more, protection as disability benefits.

With BAPCPA's enactment,[32] SSDI and VA disability compensation are excluded from income under the means test in chapter 7.[33] Unfortunately, in chapter 13, SSDI is excluded unless voluntarily included by the debtor, while VA disability compensation is not.[34]

When there are contradictions and inconsistencies in congressional acts, courts look to legislative intent, but that is not always dispositive.[35] When Congress creates legislation, it often builds on previous legislation. An example is veterans-disability compensation, because it uses the framework of the Social Security Act but has numerous exceptions and application differences.[36] The Bankruptcy Code deviates from this by providing fewer protections to veterans than persons receiving SSDI in chapter 13.[37]

Why Veterans Are Afforded So Many Protections in Other Areas of the Law, but Not in the Application of Chapter 7 vs. Chapter 13

VA disability compensation is exempted from classification as gross income. It is not subjected to means testing for under chapter 7, but is included in the disposable-income calculation in chapter 13.[38] The compensation is the same, the purpose is the same and the legislative intent of the compensation is the same regardless of the chapter of bankruptcy. Therefore, the compensation should be exempted from both chapters.

In chapter 7, the purpose and policy behind exempting VA disability compensation is to ensure that the debtor does not end up destitute.[39] In chapter 13, the assumption is that the procedure for determining disposable income accounted for enough financial resources for the debtor to survive, leaving the remainder to be put toward the paying of creditors.[40] A debtor who files for chapter 7 must satisfy the means test or face conversion to chapter 13 or dismissal for abuse.[41] A veteran faces this same situation despite VA disability compensation being exempted, and, based on the totality of the circumstances, a judge can either convert or dismiss the case.[42] There is little dispute that anyone with the means to repay a debt should not be allowed bankruptcy protection.

In *Brah*, the court ruled that a debtor's decision to pursue chapter 13 relief is voluntary, so the debtor must include VA benefits in the disposable-income calculations. The justification that the debtor is filing voluntarily — or has their basic financial security resolved through the disposable-income calculation to avoid being destitute — cuts against the legislative intent behind veteran-disability compensation.[43] Congress expressly stated that VA disability compensation is exempt from tax levy or creditor garnishment.[44]

Congress also clearly intended the maximum protection of veteran disability compensation because it made it exempt from gross income, protects it from garnishment or levy, and prevents its use in the means test.[45] Inclusion of this compensation in chapter 13's disposable-income calculation is an outlier that contradicts legislative intent.

There is a good example of exclusion of VA disability compensation coupled with the court's authority to dismiss

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22 26 U.S.C. § 86(c).

23 26 U.S.C. § 104(a); 26 U.S.C. § 86(c) (2012) (tax exemptions are based on total household gross income, and those amounts are based on party's filing status).

24 26 U.S.C. § 104(a)(5).

25 "Historical Background and Development of Social Security," Social Security Administration, *available at* ssa.gov/history/briefhistory3.html.

26 "Title 38 — Veterans' Benefits," Government Publishing Office, *available at* gpo.gov/fdsys/pkg/USCODE-2011-title38/html/USCODE-2011-title38.htm (passed in 1958, with numerous amendments since its passing).

27 "26 U.S.C. § 104: Compensation for Injuries or Sickness," Government Publishing Office, *available at* gpo.gov/fdsys/pkg/USCODE-2010-title26/html/USCODE-2010-title26-subtitleA-chap1-subchapB-partIII-sec104.htm.

28 "S.256 — Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," Congress.gov, *available at* congress.gov/bill/109th-congress/senate-bill/256/text (current Bankruptcy Code was enacted in 1978, but did not include means test).

29 38 U.S.C. § 301(b) (2012); "VA History in Brief," *supra* n.6.

30 "How to File a VA Disability Claim," *supra* n.7.

31 26 U.S.C. § 104(a).

32 Laura B. Bartell, "Very Special Circumstances: The Almost Irrebuttable Presumption of Abuse Under Section 707(b)(2)," 91 *Am. Bankr. L.J.* 393 (2017).

33 11 U.S.C. § 707(b)(4)(D) (2012).

34 *In re Danny Ray Buren, Annie Laura Jones, Marian Frances Henderson, Bob Dwaine Penovich, Anetricia Katherine Woods, Guy T. and Maybelle Adelia Drake and Wallace Hornal, Debtors-Appellees, Henry E. Hildebrand III, Standing Trustee, Chapter XIII v. The Social Security Administration*, 725 F.2d 1080, 1081 and 1088 (1984); *In re Brah*, 562 B.R. at 925-26.

35 *Pension Benefit Guar. Corp. v. LTV Corp.*, 496 U.S. 633, 650 (1990) (court looked at congressional intent and statutory construct regarding restoration of pension plan of chapter 11 debtor and held that subsequent legislative history is hazardous basis for inferring intent of earlier Congress, and equally tenable inferences might be drawn from language being omitted, including legislation that incorporated change).

36 "Historical Background and Development of Social Security," *supra* n.25; "Title 38 — Veterans' Benefits," *supra* n.26.

37 11 U.S.C. § 101(10A) (2012); *In re Brah*, 562 B.R. at 924 (VA benefits are current monthly income, but Social Security benefits are excluded; distinction is that the two legislative acts are codified under different titles, despite fact that benefits have similar purposes).

38 26 U.S.C. § 104(a); 11 U.S.C. § 707(b)(4)(D); 11 U.S.C. § 1325(b)(2).

39 *In re Brah*, 562 B.R. at 925.

40 *Id.*

41 11 U.S.C. § 707.

42 *In re Thomas R. Rowell and Natasha Rowell*, 536 B.R. 245 (E.D. Wis. 2015).

43 *In re Brah*, 562 B.R. at 925.

44 38 U.S.C. § 5301; 42 U.S.C. § 407.

45 26 U.S.C. § 104(a); 26 U.S.C. § 6334(10); 38 U.S.C. § 5301; 11 U.S.C. § 707(b)(4)(D).

the case for abuse. *Rowell* was a chapter 7 case in which the trustee moved for dismissal despite the debtor being exempted from the means test because of military service.[46] The debtors were educated professionals who lived a lavish lifestyle with a combined annual income of $443,332.[47] The court dismissed the case for abuse, holding that the debtors were not needy and lived lavishly with unreasonable expenses.[48] There was no reason VA disability compensation cannot be excluded by chapter 13, and a totality-of-the-circumstances test be used to determine when a case should be dismissed or a debtor's disposable income adjusted to allow for additional payments to creditors under a chapter 13 plan.

Why Is SSDI Afforded More Protection in the Bankruptcy Code than VA Disability Compensation?

Congress intended for VA disability compensation to have broader protections and exemptions than SSDI.[49] Unfortunately, this protection of VA disability compensation stops at the gates of chapter 13.[50] On the other hand, SSDI is provided protection.[51]

In *Buren*, seven individuals who received Social Security benefits filed for chapter 13 protection, and they included their Social Security benefits as part of their regular income.[52] The court ordered the Social Security Administration to send the benefits to the trustee. On appeal, the court held that the Bankruptcy Code precluded this order, and bankruptcy courts cannot compel the government to pay a debtor's Social Security benefits to the trustee.[53]

The court took the opposite approach in *Brah*. In this case, the trustee objected to a plan based on the debtor's withholding VA disability compensation from the plan.[54] The debtors compared VA disability compensation to SSDI, arguing that Congress intended for VA disability compensation to be protected.[55]

The court disagreed and held that there is a similarity between them, but that no exception for VA disability exists.[56] The court never evaluated the legislative intent in drawing its conclusion.[57] The nonassignability and exempt-status-of-benefits section of the VA Act expressly states that the benefits are exempt from any claim of creditors.[58] Therefore, the protection already exists and should preclude VA disability benefits calculated as part of disposable income.

Desired End-State and Takeaways

Veterans receive disability compensation because of permanent disabilities received while serving.[59] This money is paid to the veteran for life and is tax-exempt, exempt from gross-income calculations and virtually free from garnishment or levy.[60] The compensation is intended to ensure financial security for the veteran, yet in a chapter 13, the veteran must include it to pay creditors. The courts have ruled that this is required under the Bankruptcy Code because the debtor voluntarily files for chapter 13 protection, and inconsistency in the statutes is legislature's responsibility to correct.[61]

The argument that a debtor with multiple sources of compensation will only be required to pay an amount determined after calculation of disposable income is a strong argument.[62] However, other legislation is equally clear that these funds are intended to remain out of creditors' reach.[63] The problem with including VA disability compensation in a chapter 13 disposable-income calculation is that if the debtor has the case dismissed or converted to chapter 7, or never files for bankruptcy protection, the VA disability compensation cannot be attached or garnished by creditors. This inconsistency highlights the irrationality of requiring only chapter 13 debtors to include veterans benefits as income payable to creditors.

Attorneys who work with disabled veterans facing financial hardship should take the time to understand the client's entire picture, because financial hardship might be a symptom of a larger problem. Attorneys should use caution when a disabled veteran seeks assistance, because the rules of professional conduct require competent legal representation.

The number of veterans is large, and many face financial and physical challenges in their personal and professional lives.[64] It is important to remember that these heroes raised their right hand and volunteered to run into places from which most people would run away. They saw and did things that, quite honestly, are unimaginable, and they served in conditions that are deplorable.

These soldiers, sailors, airmen and Marines suffered physical and mental injuries and anguish resulting in permanent trauma to their person physically and mentally. Congress enacted legislation with safeguards to provide for this group and protect them out of recognition for what they endured.[65] It is our duty as legal scholars, practitioners and professionals to continue the fight, take note of inequities and do whatever it takes to protect those who have protected us. abi

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The American Bankruptcy Institute is a multi-disciplinary, nonpartisan organization devoted to bankruptcy issues. ABI has more than 12,000 members, representing all facets of the insolvency field. For more information, visit abi.org.

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46 *Id.*
47 *Id.*
48 *Id.* at 254.
49 "Social Security," *supra* n.12 (SSDI as it is known today was developed to provide protection against lost income during period of either temporary or permanent disability); 38 U.S.C. § 301(b) (2012); "VA History in Brief," *supra* n.6.
50 *In re Brah*, 562 B.R. at 925-26.
51 *In re Buren*, 725 B.R. at 1081.
52 *Id.*
53 *Id.* at 1087.
54 *In re Brah*, 562 B.R. at 923.
55 38 U.S.C. § 5301
56 *In re Brah* at 925.
57 *Id.*
58 38 U.S.C. § 5301(a)(1) (2012).
59 8 U.S.C. § 3741(1).
60 *Rose v. Rose*, 481 U.S. 619 (1987) (federal pre-emption does not preclude state from issuing garnishment order allowing garnishment of VA disability compensation to satisfy state support order); "How to File a VA Disability Claim," *supra* n.7.
61 *In re Brah*, 562 B.R. at 925-26.
62 *Id.* at 923.
63 38 U.S.C. § 5301; 26 U.S.C. § 104.
64 "Military Service," *supra* n.3.
65 38 U.S.C. § 3741.

AMERICAN BANKRUPTCY INSTITUTE
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Feature

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Defending Our Veterans

Excluding Veterans' Benefits from Current Monthly Income

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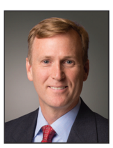

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Part of the mission of ABI's newly formed Task Force for Veterans and Servicemembers Affairs is to "remediate and prevent adverse debt concerns and impacts on veterans and servicemembers to ensure that we financially strengthen those that strengthen us with the respect and dignity they deserve." To that end, the Task Force has focused much of its initial attention on the Bankruptcy Code's perplexing and inequitable treatment of veterans' benefits in consumer bankruptcy cases.

While the Code excludes benefits received by individuals under the Social Security Act from the definition of "current monthly income" and thus from an individual's "disposable income," the Code inexplicably provides no comparable exclusions for benefits received through the U.S. Department of Veterans Affairs or otherwise on account of a veteran's service. The disparate treatment of veterans' benefits presents significant hardship to some veterans, compelling them to devote these benefits — including their disability benefits — to the funding of their chapter 13 plans and restricting their ability to seek relief under chapter 7 rather than under chapter 13.

Overview: Veterans' Benefits Pre- and Post-BAPCPA

For years, there was little (if any) debate about whether veterans' benefits paid through the Department of Veterans Affairs should be included in the debtor's "disposable income." Prior to 2005, the Bankruptcy Code allowed bankruptcy judges to exercise their discretion, based on the facts of each case, in determining what constituted a debtor's disposable income. Under the pre-2005 Code, "disposable income" was defined in 11 U.S.C. § 1325(b)(2) as:

> [I]ncome which is received by the debtor and which is not reasonably necessary to be expended —
>
> > (A) for the maintenance or support of the debtor or a dependent of the debtor, including charitable contributions....
> >
> > (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

Under this definition, it was accepted that veterans' benefits should not be considered part of a chapter 13 debtor's "disposable income." No published opinions interpreting the pre-2005 "disposable income" definition even considered that possibility, no less ruled that veterans benefits affirmatively constituted disposable income.

All that changed with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[2] Through BAPCPA, Congress divested bankruptcy judges of the discretion they previously had to decide what would — and would not — constitute "disposable income" in a debtor's case. Congress did so by revising § 1325(b)(2) to make "current monthly income" the starting point for calculating a debtor's disposable income. A new phrase to the Bankruptcy Code, "current monthly income" was generally defined by Congress to mean the average monthly income from all sources that the debtor receives,

1 The opinions expressed herein are provided as a result of Ms. Gunn's own experiences and not as a representative of the Attorney General or the Division of Child Support Enforcement. She is also an honoree of ABI's 2017 "40 Under 40" class. In addition, Mr. Thompson served as a captain and helicopter pilot in the U.S. Army before earning his law degree.

2 Pub. L. 109-8, 119 Stat. 23.

as well as any other amount paid by an entity other than the debtor for the household expenses of the debtor or the debtor's dependents.[3]

From this broad definition, Congress specifically excluded three sources of income: (1) benefits received under the Social Security Act; (2) payments to victims of war crimes or crimes against humanity on account of their status as victims of such crimes; and (3) payments to victims of terrorism on account of their status as victims of such terrorism.[4] For reasons that are not clear,[5] veterans' benefits provided through the Department of Veterans Affairs were not excluded from the Bankruptcy Code's "current monthly income" definition.

Post-BAPCPA Case Law

Following BAPCPA, at least five courts have addressed whether a debtor's disposable income includes veterans' benefits.[6] In each of these cases, the bankruptcy court held that because veterans' benefits are not specifically excluded from the Bankruptcy Code's definition of "current monthly income," these benefits must be counted as part of a debtor's disposable income. As a result, the bankruptcy judge denied confirmation of the debtor's proposed chapter 13 plan in each of these cases because the plan failed to commit all of the debtor's disposable income to funding the plan as required by 11 U.S.C. § 1325(b)(1)(B).

Jay Bender is a partner with Bradley Arant Boult Cummings LLP. Elizabeth Gunn is the bankruptcy specialist for Virginia's Division of Child Support Enforcement. John Thompson is a partner with McGuireWoods LLP.

The most recent of those opinions is illustrative of these cases. In *In re Brah*, the chapter 13 trustee objected to a husband and wife's joint chapter 13 plan, arguing that it was unconfirmable because the debtors failed to include their veterans' disability benefits in their disposable income calculation upon which the plan was based.[7] The debtors countered that because their veterans' benefits were not assignable nor subject to levy, seizure or attachment under applicable nonbankruptcy law,[8] they were not obligated to dedicate those benefits toward funding their plan.

The *Brah* court sided with the trustee, finding §§ 101(10A) and 1325(b)(2) to mandate unambiguously that the debtors include their veterans' disability benefits in their current monthly income. The court surmised that had Congress intended to exclude otherwise-exempt assets from the disposable-income calculation, it could have done so by expressly excluding such assets from the definition of "current monthly income" in § 101(10A).[9]

In reaching its holding, the *Brah* court noted and addressed the puzzling discrepancy between the treatment of Social Security benefits and veterans' benefits in chapter 13 cases:

> Although the exclusion of Social Security benefits from current monthly income suggests that [Department of Veterans Affairs] Benefits also should be excluded, the statutory exception applies only to "benefits received under the Social Security Act."... [T]he Court understands why the Debtors seek the same exclusion for their veterans' disability benefits as afforded to recipients of Social Security disability benefits. But creating this exception is a job for Congress, not the Court. The Debtors' ability to exempt these benefits does not remove the [Department of Veterans Affairs] Benefits from the Bankruptcy Code definition of current monthly income. And the fact that the benefits are not subject to attachment, garnishment or other legal process does not render the benefits immune from the disposable income calculation in a voluntary Chapter 13 plan. Accordingly, the Trustee's objection is sustained and the [Department of Veterans Affairs] Benefits should be included in the Debtors' disposable income.[10]

Brah and the four cases preceding it all analyzed whether veterans' benefits were a part of a debtor's disposable income in the context of considering confirmation of a proposed chapter 13 plan. However, the issue has wider implications, extending to the threshold question of the chapters of the Bankruptcy Code under which a veteran can seek relief.

As part of BAPCPA, Congress enacted its "means test" for determining an individual consumer debtor's eligibility to file for chapter 7 relief. Codified in § 707(b) of the Bankruptcy Code, the means test evaluates whether an individual's chapter 7 filing might be abusive by, in part, looking at the amount of his/her current monthly income.[11] Under that test, the greater a debtor's current monthly income, the greater the likelihood that the debtor's chapter 7 filing will be presumed abusive. Including veterans' benefits in a veteran's current monthly income calculation might decrease the availability of chapter 7 relief to veterans.

The negative impact of means testing on veterans is tempered to some extent by 11 U.S.C. § 707(b)(2)(D), which provides that a court may not dismiss or convert a chapter 7 case filed by an individual for abuse, based on any form of means-testing, if that individual falls within a limited category of veterans.[12] However, that exclusion is narrow, offering no protection for a veteran whose service ended more than 540 days before his/her bankruptcy filing and whose debts arose primarily after his/her service concluded.

3 11 U.S.C. § 101(10A).
4 *Id.*
5 BAPCPA's legislative history does not address why veterans' benefits were not excluded from the "currently monthly income" definition.
6 *In re Brah*, 562 B.R. 922 (Bankr. E.D. Wis. 2017); *In re Hedge*, 394 B.R. 463 (Bankr. S.D. Ind. 2008); *In re Waters*, 384 B.R. 432 (Bankr. N.D. W.Va. 2008); *In re Wyatt*, 2008 WL 4572506 (Bankr. E.D. Va. Oct. 10, 2008); *In re Redmond*, 2008 WL 1752133 (Bankr. S.D. Tex. April 14, 2008). For a discussion of these cases, *see* Jay Bender, "The Unequal Treatment of Veterans and Veterans' Disability Benefits Under the Bankruptcy Code," *Norton Bankruptcy Law Adviser*, v. 2017, issue 6 (June 2017).
7 562 B.R. at 923.
8 38 U.S.C. § 5301(a)(1).
9 562 B.R. at 923.

10 *Id.* at 924, 925-26.
11 11 U.S.C. § 707(b)(2)(A).

Correcting the Code

There is no sensible basis for the Bankruptcy Code treating benefits paid to veterans through the Department of Veterans Affairs differently than benefits received by individuals from the Social Security Administration. The disparate treatment results in systematic discrimination against veterans, even if wholly unintentional. Consistent with its mission, ABI's Task Force on Veterans and Servicemembers Affairs plans on bringing increased attention to this issue in the hope that veterans will soon be relieved of the adverse effects of the Bankruptcy Code's problematic "current monthly income" definition.

At least one piece of legislation has been drafted to provide veterans with such relief. Written with input from veterans organizations and bankruptcy professionals, the Honoring American Veterans in Extreme Need Act (HAVEN Act)[13] proposes to amend the Bankruptcy Code's definition of "current monthly income" to specifically exclude from that definition veterans' disability benefits and a wide range of other veterans' benefits.[14] Earlier this year, Sen. Tammy Baldwin (D-Wis.) proposed the HAVEN Act as an amendment[15] to the John S. McCain National Defense Authorization Act for Fiscal Year 2019 (the "NDAA Act"); however, her amendment was not adopted prior to passage of the NDAA Act.

Correcting the Bankruptcy Code's unfair treatment of veterans' benefits is overdue, and the ABI Task Force for Veterans and Servicemembers Affairs is optimistic that the HAVEN Act will soon be passed with the bipartisan support that it deserves. Meanwhile, the ABI Task Force will continue to look for additional ways to improve the bankruptcy process to better meet the needs of financially distressed veterans and servicemembers. We encourage all ABI members to help the Task Force's mission and share your ideas about where such improvements can be made. abi

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12 Section 707(b)(2)(D) provides specifically that the court may not dismiss or convert a case based on any form of means testing (1) if the debtor is a disabled veteran and the debtor's indebtedness occurred primarily during a period during which the veteran was (a) on active duty or (b) performing a homeland defense activity; or (2) with respect to the debtor, while the debtor is (a) on, and during the 540-day period beginning immediately after the debtor is released from, a period of active duty of not less than 90 days, or (b) performing, and during the 540-day period beginning after the debtor is no longer performing, a homeland defense activity performed for a period of not less than 90 days; if after Sept. 11, 2001, the debtor, while a member of a reserve component of the Armed Forces or a member of the National Guard, was called to such active duty or performed such homeland defense activity.

13 For the complete text of the HAVEN Act, *see* 164 Cong. Rec. S3633 (daily ed. June 11, 2018) (proposed Senate Amendment 2643 to Senate Amendment 2282 to H.R. 5515).

14 In addition to the existing exclusions under 11 U.S.C. § 101(10A), the HAVEN Act proposes to exclude from "current monthly income" (1) compensation under chapter 11 of title 38; (2) compensation under chapter 13 of title 38; (3) pensions under chapter 15 of title 38; (4) retired pay payable to members of the Armed Forces retired under § 1201 or 1204 of title 10; (5) retired pay payable to members of the Armed Forces placed on the temporary disability retired list under § 1202 or 1205 of title 10; (6) disability severance pay payable under § 1212 of title 10 to members separated from the Armed Forces under § 1203 or 1206 of that title; (7) retired pay payable in accordance with § 1201 or 1202 of title 10, or disability severance pay payable in accordance with § 1203 of that title, to members of the Armed Forces eligible for such pay by reason of § 1207a of that title; (8) combat-related special compensation payable under § 1413a of title 10; (9) any monthly annuity payable under the Survivor Benefit Plan under subchapter II of chapter 73 of title 10 if the participant in the plan with respect to whom the annuity is payable was retired for physical disability under chapter 61 of that title; (10) the special survivor indemnity allowance payable under § 1450(m) of title 10; and (11) any monthly special compensation payable to members of the uniformed services with catastrophic injuries or illnesses under § 439 of title 37.

15 164 Cong. Rec. S3633 (daily ed. June 11, 2018).

CONSUMER BANKERS ASSOCIATION

June 25, 2019

The Honorable David Cicilline
Chairman, Subcommittee on Antitrust,
Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515

The Honorable Jim Sensenbrenner
Ranking Member, Subcommittee on Antitrust,
Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Cicilline and Ranking Member Sensenbrenner,

On behalf of the Consumer Bankers Association[1] ("CBA") I would like to submit the following comments for the June 25 hearing, Oversight of Bankruptcy Law and Legislative Proposals. Our comments today are related to legislation that would remove the requirement that filers show that repaying an education loan would cause undue hardship to themselves or their dependents in order to discharge the loan in bankruptcy. CBA is the voice of the retail banking industry whose products and services provide access to credit for consumers and small businesses in all 50 states.

CBA's perspective is based on years of working with student loan borrowers to ensure a successful outcome to their financing of higher education. CBA member institutions make approximately 65 percent of all private education loans. The ability of a borrower to use their education to successfully repay their education loans is the benchmark for a successful higher education experience. As such, CBA member banks carefully consider the ability to repay before offering a loan. Underwriting for the ability to repay is arguably the strongest consumer protection available. However, access to education should not equate with over-borrowing or borrowing to attend programs that are not of sufficient quality to permit the student to repay their education loans.

In a student loan market dominated by the federal government, private loans make up less than 8 percent of the nearly $1.6 trillion in outstanding student loan debt. In addition, the Department of Education disburses about 90 percent of new loans per year through the Direct Stafford and PLUS loan programs, with private lending accounting for only 10 percent.

[1] CBA is the voice of the retail banking industry whose products and services provide access to credit to millions of consumers and small businesses. Our members operate in all 50 states, serve more than 150 million Americans and collectively hold two-thirds of the country's total depository assets. In addition, CBA membership includes private sector lenders who make the majority of private student loans to help families finance a college education.

Publicly available data show that most private student loan borrowers are successfully keeping up with their payments. According to the most recent survey by the independent research firm Measure One, the default rate for private student loans made by CBA members is 1.85 percent.[2] Only about 2 percent of private loans are seriously delinquent (90 days) and less than 3 percent are in the early stages of delinquency (30-89 days). Performance continues to improve due to robust underwriting practices.

Congress decided to restrict the ability of education loan borrowers to discharge their loans in bankruptcy for good reasons. CBA members – and the federal government -- make loans in good faith with the expectation that they will be repaid. A majority of loans are made without collateral to students who have little income, limited employment history, and haven't established credit, yet wish to borrow tens of thousands of dollars while making no payments for several years. It is only reasonable that borrowers should make a good faith attempt to repay their loans and make education loan payment a priority.

Both the federal government and private loan lenders work with borrowers who are having trouble with loan payments to give them time to get on their feet. The government offers income based repayment options while private lenders can modify loans and payment plans for distressed borrowers to help them get back on track.

Still, CBA members recognize there are cases where a borrower's overall financial situation has deteriorated to the point where the borrower decides to file for bankruptcy protection from creditors. Federal loans have had restrictions on dischargeability since 1977, with current rules in the Bankruptcy Code in place for federal loans since 1998, and, for private loans, since 2005. Contrary to popular belief, upwards of 40 percent of filers who try are able to demonstrate to a judge that they should have their education loans discharged. However, only 0.1 percent of student loan debtors who have filed for bankruptcy attempt to discharge their student loans, probably due to the incorrect belief that they are not dischargeable.[3]

The decision by Congress to create the undue hardship standard and apply it to all education loans was carefully considered before the law was changed in 2005 as part of the bi-partisan Bankruptcy Reform Act. Versions of the bankruptcy reform legislation that were introduced in the seven years preceding passage of the final bill included the undue hardship requirement for both federal and private education loans. In fact, nearly identical legislative language was passed at least seven times by either the House or the Senate before the final passage took place on April 14, 2005.

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[2] MeasureOne Private Student Loan Report, March 31, 2019 -- www.measureone.com

[3] An empirical Assessment of Student Loan Discharges and the Undue Hardship Standard, rev. Sept 25, 2014 -- https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1894445

As noted above, education loans are dischargeable in bankruptcy if the filer can show that repaying the loan would cause undue hardship. Because undue hardship is not defined in the law, the courts have over the decades settled on tests that judges use to determine undue hardship. The widely used "Brunner" test is the standard most often followed, although there is no requirement that a judge do so. The more recent, similar, "Totality of Circumstances" test is now used in some circuits, leading to somewhat different standards in different parts of the country.

CBA agrees with the policy allowing education loans being discharged in bankruptcy when undue hardship is proven by the borrower. However, making it relatively easy to walk away from education loans in bankruptcy would significantly increase the cost to taxpayers of the federal loan programs, and the increased risk of losses would force private lenders to raise the cost of loans to borrowers while reducing access to credit.

We do believe it could be useful for the courts to follow one standard in the interest of equal treatment of borrowers rather than have different standards available in different parts of the country. A single standard would benefit borrowers, and allow loan holders to more efficiently determine whether or not to assume an adversary position in a bankruptcy proceeding.

CBA looks forward to working with Congress on the topic of reforming the student loan system and we thank you for the opportunity to submit this letter.

Sincerely,

Richard Hunt
President and CEO
Consumer Bankers Association

NCBJ | National Conference of Bankruptcy Judges

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May 31, 2019

The Honorable Jerrold Nadler, Chair
House Judiciary Committee
2132 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Doug Collins, Ranking Member
House Judiciary Committee
1504 Longworth House Office Building
Washington D.C. 20515

Re: Honoring American Veterans in Extreme Need (HAVEN) Act (S.679).

Dear Chairman Nadler and Ranking Member Collins:

The National Conference of Bankruptcy Judges ("NCBJ") is an association of the Bankruptcy Judges of the United States which has several purposes: to provide continuing legal education to judges, lawyers and other involved professionals, to promote cooperation among the Bankruptcy Judges, to secure a greater degree of quality and uniformity in the administration of the Bankruptcy system and to improve the practice of law in the Bankruptcy Courts of the United States. In accord with its approved legislative action guidelines, the NCBJ submits this letter in support of the Honoring American Veterans in Extreme Need (HAVEN) Act (S.679).

Currently, the Bankruptcy Code excludes benefits received under the Social Security Act from the definition of "current monthly income." 11 U.S.C. § 101((10A). Veterans disability benefits, on the other hand, are included in current monthly income. The HAVEN Act brings veteran's benefits into parity with social security benefits under the definition of "current monthly income," and will remedy an imbalance in the Bankruptcy Code that disproportionately steers veterans receiving such benefits into Chapter 13 cases because they often fail the Chapter 7 means test.

The views expressed in this letter are those of the NCBJ as an organization, on whose behalf this statement is issued, and do not necessarily reflect the personal views of any sitting bankruptcy judge.

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Please do not hesitate to contact me if you have any questions.

With kindest regards, I am

Respectfully yours,

John E. Waites
2018-2019 President
National Conference of Bankruptcy Judges

cc: Susan Jensen (by email)
Committee on the Judiciary