VBA BANKRUPTCY LAW SECTION
BENCH-BAR BROWN BAG LUNCH MEETING
with Hon. Colleen A. Brown, U.S. Bankruptcy Judge

United States Bankruptcy Court, Rutland
Friday, June 8, 2018 ~ 12:00 - 1:00 PM
Dial-in number: (888) 398-2342. Access code: 846 68 72#
If you dial into the meeting, please use your "mute" function, unless speaking.

AGENDA

1. FORM 113: CHALLENGES & CROWD SOURCE TIPS — ATTENDEES
   - Open discussion: what's working? what's not?

2. INFO ABOUT DEBTORS ANONYMOUS — JUDGE BROWN
   Visit http://debtorsanonymous.org/getting_started/index.php/find/findameeting
   Brochures available at the meeting.

3. USTP DEBTOR AUDIT 2017 ANNUAL REPORT — LISA PENPRAZE
   (Attachment)

4. SURVEY OF BANKRUPTCY COURTS USING PROOF OF IDENTITY PROTOCOL IN *PRO SE* CASES (Attachment) — JUDGE BROWN/ LISA PENPRAZE

5. PRO BONO PANEL FOR STUDENT LOAN DISCHARGEABILITY APS: — JUDGE BROWN
   4 firms have offered to represent debtors, *pro bono*, in student loan dischargeability APs (*once Law Lines has verified the Ds are eligible*):
   - Downs Rachlin & Martin (contact is Andre Bouffard)
   - Facey Goss & McPhee (contact is Heather Cooper)
   - Gravel & Shea (contact is Robert Hemley)
   - Paul Frank + Collins (contact is Robert DiPalma)

6. ABI COMMISSION RECOMMENDATIONS RE STUDENT LOAN DEBT: — JUDGE BROWN
   (Attachment)

7. LEASE ASSUMPTION/ REAFFIRMATION ISSUES: — HEATHER COOPER

8. ABI'S "40 UNDER 40" PROGRAM
   Visit www.abi40uder40.org.for info on how to apply or nominate a colleague. — JUDGE BROWN
   Nominations are due June 30, 2018.

9. CLERK'S OFFICE UPDATES: — JEFF EATON / JODY KENNEDY
   - Introducing our new CA, Julie Frank (hired to replace Emerson Howe)
     - Julie will have what was previously Emerson's telephone number (657-6414).
   - Best way to contact the Clerk's Office
     - Call the main line (657-6400) for all inquiries
     - Please do not email a CA directly.
   - Reminder: it is important attorneys keep their email addresses up to date in the CM/ECF system.
     - Do this at: Utilities - maintain user accounts - enter name - submit - email information

3 Attachments

These Bench-Bar lunch meetings are coordinated by the Bankruptcy Court. They are free and no pre-registration is required. Contact Maria Dionne @ 802-657-6432 or maria_dionne@vtb.uscourts.gov with any questions.

United States Department of Justice
Executive Office for United States Trustees

Public Report:

Debtor Audits by the United States Trustee Program Fiscal Year 2017

(As required by Section 603(a)(2)(D) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8)

March 2018

TABLE OF CONTENTS

EXECUTIVE SUMMARY 1

INTRODUCTION 1

I. CASE DESIGNATION PROCESS AND TERMINOLOGY 3

II. OUTCOMES 4

Aggregate Audit Outcomes 4

Outcomes By Judicial District 6

CONCLUSION 9

EXECUTIVE SUMMARY

The United States Trustee Program (USTP) is authorized to audit individual chapter 7 and chapter 13 bankruptcy cases under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005) (BAPCPA). Section 603(a)(2)(D) of the BAPCPA states that the Attorney General must:[1/]

> (D) Establish procedures for providing, not less frequently than annually, public information concerning the aggregate results of such audits including the percentage of cases, by district, in which a material misstatement of income or expenditures is reported.

In Fiscal Year 2017, the USTP designated 1,013 cases for audit. Of the cases designated for audit, 30 were dismissed before the case was assigned to an audit firm. In addition, audits of 10 cases from the District of Puerto Rico were suspended and not completed following Hurricanes Irma and Maria. Of the remaining 973 cases, 485 were random audits and 488 were exception audits (audits of cases with income or expenditures above a statistical norm). Reports of Audit were filed in 920 of the completed audits, and at least one material misstatement was reported in 23 percent of these cases. There were 53 Reports of No Audit filed. A Report of No Audit is filed when a case selected for audit is closed without completion either because the debtor failed to provide sufficient information to complete the audit or the case was dismissed while the audit was in process.

INTRODUCTION

The United States Trustee Program is the component of the Department of Justice whose mission is to promote the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders – debtors, creditors, and the public. The USTP consists of 21 regions with 92 field office locations nationwide and an Executive Office in Washington, DC. Each field office is

[1/] Authority to implement provisions of the BAPCPA was delegated from the Attorney General to the Director of the Executive Office for United States Trustees (Attorney General Order No. 2785-2005 dated October 14, 2005).

responsible for carrying out numerous administrative, regulatory, and litigation responsibilities under title 11 (the Bankruptcy Code) and title 28 of the United States Code.[2/]

The USTP is authorized to contract with independent firms to perform audits of individual chapter 7 and chapter 13 cases designated by the USTP. The purpose of the audit is to determine the accuracy, veracity, and completeness of petitions, schedules, and other information required to be provided by the debtor under sections 521 and 1322 of title 11. The audits are designed to provide baseline data to gauge the magnitude of fraud, abuse, and error in the bankruptcy system; to assist the USTP in identifying cases of fraud, abuse, and error; and to enhance deterrence.

The USTP selects independent audit firms through a competitive procurement process to perform the audits using certified public accountants or independent licensed public accountants.[3/] The debtor audits are conducted in accordance with audit standards promulgated by the USTP and published in the *Federal Register*.[4/]

The USTP is authorized to randomly designate for audit 1 out of every 250 consumer bankruptcy cases per federal judicial district and to designate cases for exception audit in which the income or expenditures of a debtor deviate from the statistical norm of the district in which the case was filed. Due to budgetary constraints, the designation of audits was suspended on April 13, 2016, and did not resume until June 7, 2017. The USTP designated cases for random audit at the rate of approximately one out of every 440 consumer cases filed during the remainder of Fiscal Year 2017.

[2/] The USTP has jurisdiction in all federal judicial districts except those in Alabama and North Carolina.

[3/] BAPCPA Section 603(a)(2).

[4/] BAPCPA Section 603(a)(1); *Federal Register*, Vol. 71, No. 190 (October 2, 2006).

I. CASE DESIGNATION PROCESS AND TERMINOLOGY

Random audits are selected randomly from all consumer bankruptcy cases within a federal judicial district. In contrast, cases designated for exception audit must meet specific criteria established by the USTP. These criteria are based on income or expenditures greater than a statistical norm for the district where the case was filed, as specified under uncodified section 603(a)(2)(C) of the BAPCPA.

An audit consists of a comparison between selected items on a debtor's originally filed bankruptcy papers and documents produced by the debtor at the request of the audit firm. Audit firms also conduct at least two searches using commercially and publicly available database services to look for unreported assets and to verify the market value of assets.

After an audit has been completed, a Report of Audit is filed with the court by the audit firm and a copy is transmitted to the United States Trustee. The Report of Audit identifies any material misstatement that is reported by the audit firm. The report is not a legal determination and the legal effect of the audit firm's finding of a material misstatement, if any, is a question for the court. Prior to filing a Report of Audit with the court noting a material misstatement, the audit firm contacts the debtor, through counsel if represented, to provide the debtor an opportunity to offer an explanation or supply additional information that may negate the finding. A material misstatement indicates the audit produced information that challenged the accuracy, veracity, or completeness of a debtor's petition, schedules, or other filed bankruptcy documentation. Inaccurate or incomplete information deprives the court, the United States Trustee, the private trustee, and creditors of adequate information to decide whether to conduct further investigation, recover assets, or seek relief against the debtor.

While specific criteria for reporting a material misstatement are not released to the public to preserve the integrity of the audit process, in general, material misstatements relate to the understatement or omission of the debtor's assets, income, or pre-petition transfer of property. If a material misstatement is identified in a Report of Audit, the bankruptcy court gives notice to all creditors in the case. In addition, the United States Trustee determines what action is appropriate

based on the material misstatement(s) and may pursue a variety of actions depending on the circumstances of the case, including seeking denial or revocation of discharge, or reporting the material misstatement to the United States Attorney.[5/] In many instances, the United States Trustee may take no action on a material misstatement identified in a Report of Audit based on a number of factors, including whether the debtor corrected the error (e.g., filed amended schedules) or whether the material misstatement was intentional.

If the audit firm cannot complete the audit because the debtor did not produce documents requested in connection with the audit or because the case was dismissed while the audit was in process, a Report of No Audit is filed with the court by the audit firm and a copy is transmitted to the United States Trustee. The United States Trustee may take appropriate enforcement action when a Report of No Audit is filed, including seeking revocation of discharge, if the debtor fails to satisfactorily explain the failure to make available the documentation requested for the audit.[6/]

II. OUTCOMES

Outcomes are presented in this report both as aggregate national numbers from all judicial districts within the jurisdiction of the USTP, as well as separately by judicial district.

Aggregate Audit Outcomes

Table 1 shows the total number of cases designated for audit, broken down between cases with no report (i.e., cases that were dismissed prior to assignment to an audit firm) and cases where either a Report of Audit or a Report of No Audit was filed with the court. For Reports of Audit filed with the court, the table also identifies the number of cases with at least one material misstatement and the number of cases with no material misstatements. Further, for all cases designated for audit, the table shows the distribution between random audits and exception audits.

[5/] *See* 11 U.S.C. §§ 707, 727(a), 727(d)(4)(A).

[6/] *See* 11 U.S.C. § 727(d)(4)(B).

In Fiscal Year 2017, the USTP designated 1,013 cases for audit. Of the cases designated for audit, 30 were dismissed before the case was assigned to an audit firm. In addition, audits of 10 cases from the District of Puerto Rico were suspended and not completed in the aftermath of Hurricanes Irma and Maria. Of the remaining 973 cases, 485 were random audits and 488 were exception audits. Reports of Audit were filed in 920 of the completed audits, and at least one material misstatement was reported in 23 percent of these cases. Twenty-eight percent of exception audits identified at least one material misstatement, compared to 19 percent of random audits. There were 53 Reports of No Audit filed.

Table 1: USTP Debtor Audits for Fiscal Year 2017 (Nationwide Aggregate)

	Total	Random	Exception	% of Cases Designated
Cases Designated for Audit	1,013	519	494	
Cases with No Report	40	34	6	4%
Cases with Report	973	485	488	96%
Report of Audit Filed	920	458	462	91%
No Material Misstatements	704	370	334	
% of Reports of Audit	77%	81%	72%	
At Least One Material Misstatement	216	88	128	
% of Reports of Audit	23%	19%	28%	
Report of No Audit Filed	53	27	26	5%

* Percentages are rounded.

More than one material misstatement may be reported in a single case. For Fiscal Year 2017, income related material misstatements were reported in more than two-thirds of the cases with material misstatements, while around half of the cases with material misstatements had asset or transfer-related material misstatements.

Outcomes by Judicial District

Table 2 shows the distribution of cases by judicial district in which either a Report of Audit or a Report of No Audit was filed. For cases with a Report of Audit, a breakdown of the number and percentage of cases with at least one material misstatement is provided. This table combines information from both random and exception audits. Due to differences in the number of case filings per judicial district, there is wide variation among districts in the number of Reports of Audit; districts with fewer filings will have fewer reports. For districts with 10 or more Reports of Audit, the percentage of audits with material misstatements ranged from 0 percent to 40 percent.

Table 2: Outcomes by Judicial District for Fiscal Year 2017

District	Reports of No Audit	Reports of Audit	At Least One Material Misstatement	
			# of Cases	% of Reports of Audit
Alaska	0	2	1	50%
Arizona	0	20	3	15%
Arkansas Eastern	1	9	2	22%
Arkansas Western	0	4	1	25%
California Central	5	42	13	31%
California Eastern	2	17	4	24%
California Northern	0	11	1	9%
California Southern	0	10	3	30%
Colorado	2	13	3	23%
Connecticut	1	6	2	33%
DC	1	1	0	0%
Delaware	0	4	1	25%
Florida Middle	3	26	6	23%
Florida Northern	1	3	1	33%
Florida Southern	0	18	2	11%
Georgia Middle	0	12	2	17%
Georgia Northern	6	36	7	19%
Georgia Southern	1	8	1	13%
Guam	0	0	0	N/A
Hawaii	2	0	0	N/A

* Percentages are rounded.

Table 2 (continued): Outcomes by Judicial District for Fiscal Year 2017				
District	**Reports of No Audit**	**Reports of Audit**	**At Least One Material Misstatement**	
			# of Cases	**% of Reports of Audit**
Idaho	0	5	3	60%
Illinois Central	0	8	2	25%
Illinois Northern	5	50	20	40%
Illinois Southern	0	5	0	0%
Indiana Northern	0	13	4	31%
Indiana Southern	0	20	5	25%
Iowa Northern	0	2	1	50%
Iowa Southern	0	4	0	0%
Kansas	0	10	3	30%
Kentucky Eastern	0	12	3	25%
Kentucky Western	0	10	3	30%
Louisiana Eastern	0	4	1	25%
Louisiana Middle	0	2	1	50%
Louisiana Western	0	12	3	25%
Maine	0	2	0	0%
Maryland	1	23	7	30%
Massachusetts	2	10	1	10%
Michigan Eastern	0	32	7	22%
Michigan Western	0	9	2	22%
Minnesota	0	13	3	23%
Mississippi Northern	1	5	0	0%
Mississippi Southern	0	10	1	10%
Missouri Eastern	0	15	0	0%
Missouri Western	0	11	1	9%
Montana	0	2	1	50%
Nebraska	0	6	1	17%
Nevada	1	11	4	36%
New Hampshire	0	2	0	0%
New Jersey	2	32	6	19%
New Mexico	0	4	1	25%
New York Eastern	3	16	3	19%
New York Northern	0	8	3	38%
New York Southern	1	7	2	29%
New York Western	1	5	2	40%
North Dakota	0	2	1	50%

Table 2 (continued): Outcomes by Judicial District for Fiscal Year 2017				
District	**Reports of No Audit**	**Reports of Audit**	**At Least One Material Misstatement**	
			# of Cases	**% of Reports of Audit**
Northern Mariana Islands	0	0	0	N/A
Ohio Northern	1	27	5	19%
Ohio Southern	1	23	5	22%
Oklahoma Eastern	0	2	1	50%
Oklahoma Northern	1	3	1	33%
Oklahoma Western	0	7	2	29%
Oregon	0	10	4	40%
Pennsylvania Eastern	1	11	3	27%
Pennsylvania Middle	0	8	1	13%
Pennsylvania Western	1	9	2	22%
Puerto Rico	0	1	0	0%
Rhode Island	0	2	1	50%
South Carolina	0	10	4	40%
South Dakota	0	2	0	0%
Tennessee Eastern	0	17	4	24%
Tennessee Middle	0	13	3	23%
Tennessee Western	2	18	1	6%
Texas Eastern	0	6	1	17%
Texas Northern	1	14	1	7%
Texas Southern	0	11	2	18%
Texas Western	0	10	2	20%
Utah	0	16	5	31%
Vermont	0	2	0	0%
Virgin Islands	0	0	0	N/A
Virginia Eastern	2	20	3	15%
Virginia Western	0	8	1	13%
Washington Eastern	0	6	3	50%
Washington Western	0	13	5	38%
West Virginia Northern	0	2	0	0%
West Virginia Southern	0	2	1	50%
Wisconsin Eastern	1	16	4	25%
Wisconsin Western	0	5	3	60%
Wyoming	0	2	0	0%
TOTAL	**53**	**920**	**216**	**23%**

CONCLUSION

In Fiscal Year 2017, the United States Trustee Program continued to administer audits of individual chapter 7 and chapter 13 bankruptcy cases. Out of 920 Reports of Audit, a material misstatement was reported in 19 percent of the random audits and in 28 percent of the exception audits. This resulted in an overall material misstatement rate of 23 percent.

Survey of Bankruptcy Courts Using Proof of Identity Protocol in *Pro Se* Cases

Requiring proof of identity from those filing *pro se* cases provides bankruptcy judges and courts with relevant information. It is also an effective mechanism to deter unscrupulous individuals from using the bankruptcy system as part of their schemes to defraud those in financial difficulties or to engage in some form of identity theft. Approximately twenty-seven districts have implemented such requirements. While the scope and requirements vary amongst districts, in each they provide a first line of defense against those who abuse the bankruptcy system and serve as important consumer protection tools. Although Federal Rule of Bankruptcy Procedure 4002(b)(1) requires a picture identification of every individual debtor at the meeting of creditors under § 341, there is no statute or national rule specifically requiring proof of identity at the filing of a case.

Through the intake process, systemic schemes and their perpetrators can be detected and appropriate civil inquiries and actions pursued. Retaining the proof of identity facilitates the detection of those schemes and provides the evidence necessary to pursue enforcement actions.

Foreclosure or loan modification scheme perpetrators and unscrupulous bankruptcy petition preparers are just a few examples of those who abuse the bankruptcy system to defraud individuals in financial distress. In general, rescuers require a set monthly fee and falsely promise homeowners that they will assist them when a home is in foreclosure or when they need to negotiate a loan modification. They often direct the homeowners to stop making their mortgage payments or ask homeowners to sign blank deeds transferring fractional interests in their property and other documents which may include bankruptcy petitions. In order to induce

their victims to continue payment for alleged services, the perpetrators must produce results to convince the homeowners that their false promises are true.

One of the easiest and least expensive ways to accomplish this goal is for the perpetrators to file incomplete bankruptcy petitions in the names of their victims. All too often such a filing is seen as free from risk by the scammers. The filing of the petition immediately stops the foreclosure or eviction action, and, depending on the district, it can be done without paying the filing fee by either requesting IFP status or an installment fee payment plan. Depending on the scheme, the homeowner is not told that a case has been filed in his or her name or, if the homeowner has authorized one filing, the homeowner is not aware that the perpetrators have filed multiple cases in the homeowner's name. For the perpetrators, the risk of detection is slight given the volume of bankruptcy cases that are filed and the ease of filing cases without need, in most districts, to provide any proof of identity. In many instances, the victims eventually lose their homes along with the money they paid to the perpetrators.

Some bankruptcy petition preparers (BPPs) make similar false promises and statements concerning the services they provide, the benefits the debtor will receive by using those services, and the total amount of fees charged. They, like the scammers, usually will file the cases over the counter.

Without the proof of identity requirement at intake, the likelihood of detecting the scheme or the perpetrators is remote. The proof of identity required at the first meeting does not safeguard against "automatic stay" filing schemes or undisclosed BBPs. Perpetrators of rescue schemes file bankruptcy cases to invoke the automatic stay to stop collection actions with no intent of complying with Bankruptcy Code requirements. These "bare-bones" filings generally

are dismissed well before the first meeting of creditors, and, if they are not, the debtors rarely attend the meetings. Cases filed by undisclosed BPPs are also difficult to detect at the first meeting because it is not uncommon for the BPPs to direct debtors to deny that they were assisted.

A recent example from the Southern District of California illustrates the value of a proof of identity protocol.

A disbarred attorney filed two bankruptcy cases as a BPP. He gave a false name and used a false social security number for his BPP disclosures. He was identified as the actual BPP based on a copy of the photo identification the Court Clerk's office docketed. In one of the bankruptcy cases, the debtor testified at the meeting of creditors that he thought the BPP was a properly licensed attorney, the BPP drafted all bankruptcy paperwork, the BPP advised the debtor not to disclose certain assets, and certain documents with the debtor's signatures were not the debtor's actual signatures.

The U.S. Trustee's office filed a complaint against the BPP under 11 U.S.C. § 110~~,~~ to disgorge fees, to impose various fines, and to enjoin him permanently from acting as BPP. A default judgment was entered fining the BPP $500 per violation for 24 violations of 11 U.S.C. § 110 and tripling the fines. The Court permanently enjoined the BPP from acting as a BPP and ordered him to refund the $600 fee to the debtor and pay $4,000 in damages and fines to the debtor. The Court also ordered the BPP to pay $37,000 in fines and $11,445 in attorney's fees to the U.S. Trustee. Based on a referral made by the U.S. Trustee's office to the U.S. Attorney's office, the BPP entered into a plea agreement admitting to using a false social security number and was sentenced to four years of probation and a special assessment of $100.00.

Likewise, a proof of identity requirement also helps to protect individuals from identity theft or misuse of their social security numbers. Such requirements are commonplace in a variety of settings today, and any perceived burden on the filer is more than outweighed by ensuring that the filing is authorized. Retaining a copy of the proof of identity also provides a source of evidence for a victim to use in showing that the filing was unauthorized.

For example, an individual discovered that a bankruptcy case had been filed in her name in the District of Massachusetts when she applied for a loan. Several years earlier, the debtor moved from Massachusetts to a different state leaving a house she owned with her estranged husband who had also relocated. The house remained occupied by her husband's relatives. In her absence, the relatives filed several chapter 13 bankruptcy cases in her name to stop the foreclosure on the Massachusetts residence.

Upon learning of the cases, the victim filed an identity fraud report and retained a lawyer to assist her. The lawyer contacted the U.S. Trustee about the unauthorized filings. After conducting an inquiry, the U.S. Trustee filed a motion to expunge the fraudulently filed cases. Included as part of the evidence at the hearing on the motion were the drivers licenses the relatives provided the Clerk at the time they filed the cases. The bankruptcy judge expunged the cases and entered an order sanctioning both of the relatives involved in the scheme.

Bankruptcy judges also use the proof of identification information. In the Southern District of California, judges review the filing information to see if the *pro se* debtor or a third party presented the case for filing. This information is often relevant when a judge decides a request for waiver of the filing fee or credit counseling.

Approximately a third of the judicial districts have a proof of identification procedure in place for *pro se* filers. An informal survey of the procedures used in these districts is attached. This information may be useful to districts with high or rising levels of *pro se* filers to help deter identity theft, rescue schemes, criminal schemes, and other abuses to the bankruptcy system.

Procedures among Districts vary; we do not endorse any particular practice or procedure.

AMERICAN BANKRUPTCY INSTITUTE

www.abi.org

May 21, 2018

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

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

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

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

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

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

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

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

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

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

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

Sincerely,

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

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

American Bankruptcy Institute's Commission on Consumer Bankruptcy

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

I. Promulgation and Interpretation of Regulations

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

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

(1) *Disability-based guidelines.* The borrower (i) is receiving disability benefits under the Social Security Act or (ii) has either a 100% disability rating or has a determination of individual unemployability under the disability compensation program of the Department of Veterans Affairs.

(2) *Poverty-based guidelines.*

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

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

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

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

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

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

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

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

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

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

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

Discussion & Explanation

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

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

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

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

[3] *See id.* at 12-14.

[4] *Id*. at 12.

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

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

Bright-line rules

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

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

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

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

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

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

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

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

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

[13] 11 U.S.C. § 523(a)(8).

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

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

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

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

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

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

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

[15] 42 U.S.C. § 423(d)(1).

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

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

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

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

Avoiding Unnecessary Costs

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

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

Alternative Repayment Plans

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

[18] 34 C.F.R. § 682.402(i)(1)(iii).

[19] *Id.* § 685.208(l)(1).

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

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

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

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

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

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

> (1) the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans;
>
> (2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and
>
> (3) the debtor has made good faith efforts to repay the loans.[21]

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[20] *Id.* §§ 685.211(f), 685.220.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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