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THE TRUTH ABOUT STUDENT LOANS AND THE UNDUE HARDSHIP DISCHARGE

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An article published late last year in the American Bankruptcy Law Journal *("An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard,"* by Jason Iuliano)[1] may leave readers with the false impression that it is not so difficult for consumers to discharge student loans in bankruptcy. This document highlights the shortcomings of the Iuliano study and sets the record straight on undue hardship in bankruptcy.

The central point raised by the Iuliano study is not in dispute: few consumers who file for bankruptcy try to have a bankruptcy judge decide if their student loans can be discharged. However, the study's conclusions beyond this point are not supported by the empirical data and ignore the plain realities facing student loan borrowers.

In reality:

- **A consumer's prospects of winning a student loan discharge case are slim and worse than in typical civil litigation.**
- **Student loan holders and their agents, including the Educational Credit Management Company (ECMC), very aggressively fight discharge cases and are far less likely to settle out of court than in typical civil litigation.**
- **Most consumer debtors need representation by an attorney to bring a hardship discharge adversary proceeding.**
  The contrary conclusion in Iuliano's article is derived from such a small sample size that no reliable conclusions can be reached as to outcomes.
- **Most consumer debtors, particularly those most in need of a discharge, cannot afford the litigation costs needed to bring a hardship discharge adversary proceeding.**

Analysis

A consumer's prospects of winning a student loan discharge case are slim and worse than in typical civil litigation.

- The Iuliano study suggests that the consumer debtors in the sample who did file a hardship discharge case were "relatively successful." In fact, only **25 percent** of the debtors received a full discharge of their loans. Although another **14 percent** received a partial discharge, the study provides no analysis of whether these partial discharges provided any significant benefit to the debtors or helped them solve their financial

[1] Jason Iuliano, "An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard", 86 AMBKRLJ 495 (Summer 2012).

problems. For example, discharging even half of a debtor's $150,000 in student loans will still leave the debtor hopelessly in debt.

- The study offers no comparison to other civil litigation. Only **27 percent** of the debtors in the study received a full or partial discharge by settlement.[2] By comparison, a study of federal court civil litigation found that **67 percent** of the cases in the districts surveyed resulted in a successful settlement for the party who brought the case.[3]

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- Fewer hardship discharge cases are resolved out of court than in other civil litigation. 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.[4]

- A far greater percentage of debtors need to go to trial to get a verdict in their hardship cases as compared to other civil litigation. Almost **20 percent** of the debtors in the study had trial verdicts. Statistics compiled by the Administrative Office of the U.S. Courts show that of the federal court civil cases concluded in FY 2011, only **1.1 percent** were by a trial verdict.[5]

Most consumer debtors need representation by an attorney to bring a hardship discharge adversary proceeding.

- The Iuliano study irresponsibly suggests that debtors do "not need to hire an attorney to be successful" in hardship discharge cases. This conclusion is based on the study's finding that debtors without attorneys were just as likely to receive a hardship discharge as those with attorneys. However, this finding is derived from such a small sample size that no reliable conclusions can be reached as to outcomes. In fact, the study fails to disclose data that is needed for this analysis, such as the precise number of *pro se* debtors in the dataset that received discharges, their financial characteristics, or whether their discharges were obtained by settlement or after trial.

- To bring a hardship discharge adversary proceeding, the debtor must first have a bankruptcy case that is properly filed with the court. Assembling and preparing all the required documents in a bankruptcy case is a difficult process. Individuals who file *pro se* are much more likely to have their bankruptcy cases dismissed than those who are

[2] The study sample contained 90 dismissals, 4 default judgments, 4 summary judgments, 67 settlements, and 40 trial verdicts. Of the cases that were settled, 56 received a full or partial discharge.
[3] Eisenberg, Theodore and Lanvers, Charlotte, What is the Settlement Rate and Why Should We Care?, Cornell Legal Studies Research Paper No. 08-30, November 21, 2008.
[4] Court Review: The Journal of the American Judges Association Volume 42, Issue 3-4 - A Profile of Settlement, Dec. 1 2006.
[5] Table C-4, Annual Report of the Director: Judicial Business of the United States Courts.

represented by counsel.[6] This is not addressed in the Iuliano study.

- A student loan hardship discharge must be brought as a separate "adversary proceeding" within the bankruptcy case. The Iuliano study fails to mention that this is a formal proceeding that operates exactly like a lawsuit in federal court, and is subject to the civil procedural rules dealing with the filing of a complaint and service of process, pre-trial discovery, motion practice, and evidentiary requirements. If the student borrower is not one of the few fortunate debtors that are immediately offered a settlement, ECMC and other student loan creditors (who are represented by counsel) will conduct a deposition of the debtor, require responses to formal discovery requests, and challenge the debtor if expert testimony is not provided. It is absurd to suggest that many debtors without representation could properly litigate a hardship case and avoid dismissal.

- The hardship discharge standard applied by most courts involves a multi-part test that is extremely fact specific, requiring that proper proof be offered at trial on each element. Most *pro se* debtors do not know what proof is required or how to present it in court under the evidence rules.

Most consumer debtors, particularly those most in need of a discharge, cannot afford the litigation costs needed to bring a hardship discharge adversary proceeding.

- Many consumer debtors cannot even afford the costs needed to file the underlying bankruptcy case, even without considering the additional costs for the hardship discharge proceeding. A recent consumer bankruptcy fee study has shown that there has been a 51 percent increase in the total costs of filing bankruptcy, which include filing fees, credit counseling fees, and attorney's fees, for discharged chapter 7 no-asset cases filed after the enactment of BAPCPA in 2005.[7] In dollar amounts, the national mean total costs increased from $868 pre-BAPCPA to $1,309 post-BAPCPA. In some parts of the country, these costs can be higher, between $1,500 to $2,000.

- Most consumer debtors simply cannot pay the additional costs to litigate a hardship adversary 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. To make matters worse, ECMC and other creditors almost always appeal court decisions that are favorable to debtors. Appeals are extremely costly.

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[6] The Do-It-Yourself Mirage: Complexity in the Bankruptcy System, in Broke: How Debt Bankrupts the Middle Class at 157 (Katherine Porter, ed., Stanford: Stanford University Press, 2012).

[7] *See* Lupica, Lois R., The Consumer Bankruptcy Fee Study: Final Report, Amer. Bankruptcy Instit. Law Review, Vol. 20, No. 1 (Spring, 2012).

- There are few alternatives for debtors who cannot afford to hire an attorney to litigate a hardship case and are unable to handle the case on their own. Most *pro bono* bankruptcy programs do not provide representation in hardship discharge cases.

The methodology used in the Iuliano study calls into question some of its key conclusions.

- The Iuliano study claims that barely 0.1 percent of student loan debtors in bankruptcy sought a hardship discharge, based on the 217 adversary proceedings found in 2007. The methodology used to find these cases was to conduct a PACER search for cases in which the ten largest education loan holders, plus ECMC, were listed as a party. However, a search on Westlaw of court decisions rendered in hardship adversary proceedings filed in 2007 suggests that this methodology failed to locate all such cases. For example, the Iuliano study did not search for cases bought against the United States Department of Education (DOE), perhaps because of its role as a loan insurer. A number of cases not represented in Iuliano's sample, though, were brought solely against DOE and have only DOE listed as the party in the PACER system.[8] The loans in these cases may have been held by one of the ten largest holders before DOE took over collection, and therefore the 217 figure undercounts the actual proceedings filed with respect to loans originated by these creditors. Similarly, the PACER search may not have picked up cases brought against different corporate entities of the same lender. For example, the study searched PACER for "Citi Student Loans" as one of the ten largest creditors, but one of the court decisions on Westlaw in 2007 involved an adversary proceeding brought against "Citibank NA."[9]

- More importantly, the failure to search on PACER for adversary proceedings filed against DOE is a significant limitation of the study. Many student loans were made in the period before 2007 directly from DOE to the student under the Student Loan Reform Act of 1993. Lenders and guaranty agencies did not participate in the making of these Direct Loans. Although the study claims to have obtained data from a broad nationwide sample of hardship discharge cases filed in 2007, it curiously does not explain why DOE was not included as one of the party name search fields on the PACER system. Including DOE surely would have provided a more robust and representative dataset.

- The Iuliano study claims that many more debtors would get student loan discharges if they simply sought them. This finding is based on a comparison of the financial characteristics of the 213 debtors in the sample with those of the assumed 169,557 debtors having student loans with one of the ten largest lenders who filed bankruptcy cases in 2007 and did not seek a discharge (the "non-discharge seekers"). The 169,557 figure was not derived by conducting a similar PACER search of all bankruptcy cases filed in 2007 in which one of the ten largest lenders is listed as a creditor. Instead it was assumed that 71.2 percent of debtors with student loans in 2007 bankruptcy cases (based the Consumer Bankruptcy Project data) had loans with the ten largest lenders because

[8] *E.g., In re* Lustig, 2008 WL 5831708 (Bankr.D.Or. Dec 11, 2008) (ADV 07-03267-RLD, BKR 07-32533-RLD7)*; In re* Lavy, 2008 WL 4964721 (Bankr.W.D.Wash. Nov 14, 2008) (No. 07-41399, ADV 07-4120); Lee v. Spellings (In re Lee), 387 B.R. 1 (Bankr. N.D. Iowa April 16, 2008)(No. 01-00456, Adv. 07-09031).
[9] *In re* Groves, 398 B.R. 673 (Bankr.W.D.Mo. Nov 21, 2008) (NO. 07-60283, ADV 07-6032).

that represents these creditors market share. This is a questionable assumption not based on sound statistical methodology. It is quite conceivable that debtors with student loans held by these creditors do not file bankruptcy with the same frequency as debtors having loans with other, smaller creditors. In fact, some lower-income debtors with student loans for attendance at for-profit schools may have been more likely to have filed bankruptcy for reasons not related to the student loans, and their loans may not have been held by one of the ten largest lenders.

- A further problem with this methodology is that the dataset of adversary proceedings filed in a given year is different than the dataset of bankruptcy cases filed in the same year. An adversary proceeding can be filed months after the underlying bankruptcy is filed. Thus, for example, a debtor may file a bankruptcy case in November, 2007 but not file a hardship discharge adversary proceeding until January, 2008. There is no deadline in the Bankruptcy Rules for when a hardship discharge adversary proceeding must be filed. For example, in one of the hardship discharge adversary proceedings filed in 2007 that was found using a Westlaw search, the debtor's underlying bankruptcy case had been filed many years earlier in 2001 and was reopened in 2007 to file the adversary proceeding.[10]

- This discrepancy in the datasets that were compared may have had a significant impact on the results because of the year chosen in the study, which was shortly after the effective date of BAPCPA on October 17, 2005. BAPCPA caused a dramatic reduction in bankruptcy filings in the years shortly after it went into effect: 597,965 non-business bankruptcy cases were filed in 2006, 822,590 in 2007, 1,074,225 in 2008, and 1,412,838 in 2009. The financial characteristics of the debtors who filed bankruptcy cases in 2007 may not be representative of the debtors who filed adversary proceedings in 2008, and certainly are not likely to be representative of the bankruptcy cases filed today.

- Even if the study's methodology were sound, the data do not support the study's conclusion that non-discharge seekers would get discharges if they just tried. Not surprisingly the study found that of the debtors who did seek a discharge, those who were successful were less likely to be employed, more likely to have a medical hardship, and more likely to be poor. Significantly, the study also found when comparing discharge seekers to non-discharge seekers, that discharge seekers are worse off financially. Discharge seekers make less money, own fewer assets, and have more debts, including student loans. In fact, discharge seekers in the study had mean student loan debt of $80,746 as compared to $20,538 for non-discharge seekers. This data suggest a conclusion contrary to that of the study. Non-discharge seekers may have reasons for not seeking a discharge different than those of discharge seekers and the outcomes in their cases if brought would be different than discharge seekers.

[10] Lee v. Spellings (In re Lee), 387 B.R. 1 (Bankr. N.D. Iowa April 16, 2008)(No. 01-00456, Adv. 07-09031).