

THE DEVELOPMENT OF FEDERAL STUDENT LOAN BANKRUPTCY POLICY

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Abstract

Perhaps 200,000 to 250,000 student loan borrowers enter bankruptcy every year, and the large majority of student loans are issued under federal programs administered by the Department of Education (“Department”). Thus, the Department’s rules about when student-loan holders should consent to bankruptcy discharge are critically important. Nevertheless, they have received little attention compared to judicial doctrine relating to student loan bankruptcy.

This Article presents the first detailed history of the Department’s student loan bankruptcy policy. It first describes the current rules, under which loan holders are to oppose discharge unless the repayment would cause “undue hardship” — the standard for discharge under the Bankruptcy Code—or opposing discharge would cost more than one third the outstanding loan balance. These rules call for consent to discharge only where the borrower would be able to prevail against the holder in court by showing undue hardship or where consent would make the holder financially better off.

The Article identifies the source of the Department’s analytical framework in rules adopted under Secretary William Bennett in 1987. The Article traces the history from that point, identifying where gaps and ambiguities have crept in and where the Department has increased holders’ discretion without explanation. It shows that the Department has never adopted regulations to govern consent to discharge of loans it holds itself, a formerly small category that now accounts for the majority of student loans outstanding.

The Article concludes with recommendations for improving the Department’s rules. First, it should consider amending the regulations to cure the gaps and ambiguities they contain. Second, it should cabin the tremendous discretion holders enjoy by adopting bright-line rules providing for consent to discharge under certain objectively defined circumstances. Third, recognizing that an overly strict policy undermines the purposes of the student loan programs, it should liberalize its policy, for example by permitting discharge when student loans have turned out to be harmful to the borrower.

INTRODUCTION

Student loan bankruptcy is a critical subject: one million borrowers default on student loans every year,¹ and there are perhaps 200,000 to 250,000 bankruptcies each year in which the debtor has student loans.² Because most student loans are

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1 See U.S. Dep’t of Educ., *New Direct Loan Defaults*, FEDERAL STUDENT AID, <https://studentaid.ed.gov/sa/about/data-center/student/default> (reporting 1.08 million defaults on federal student loans in 2018). The one million figure includes only defaults on student loans issued under federal programs and thus understates the total.

2 The only estimate of this number of which the author is aware is 238,446, posited by

issued under federal programs that the Department of Education (“Department”) administers,³ understanding the Department’s bankruptcy rules is critical. This Article traces the history of those rules, identifies themes that emerge from that history, and makes recommendations for how the rules could be improved.

As explained in Part I, the Department’s rules require holders to consider the borrower’s hardship and the cost-effectiveness of fighting discharge in deciding whether to consent to bankruptcy discharge of student loan debt. If repayment would cause the borrower undue hardship or opposing discharge is estimated to cost more than one-third of the amount owing, a federal student loan holder is to consent to discharge. Otherwise, the holder is to oppose discharge.

Part II traces the evolution of the Department’s regulations in this area.⁴ The Department adopted the basic structure of its policy with little explanation in 1987 under Secretary William Bennett. The policy was embodied in rules for the smallest major federal student loan program, the Federal Perkins Loan Program (“Perkins” program). The Department has subsequently applied the same without explanation to the much larger Federal Family Education Loan Program (“FFELP” or “FFEL” program) and William D. Ford Federal Direct Loan Program (“Ford” program).

The most important developments since the 1980s have been in tension with one another. One series of changes appears to grant ever-increasing discretion to holders. By contrast, a poorly worded change adopted in 1999 added language that could be read to reduce discretion by requiring holders to adopt an extremely draconian policy.

Part III evaluates the regulations and makes suggestions for improvement.⁵ The Department apparently has spent little effort over the years considering its bankruptcy-discharge policies. The resulting regulations are incomplete and ambiguous and require holders to perform an analysis that is not transparent to borrowers. An interpretive letter the Department issued in July 2015 addresses some (but not all) of these issues. The letter, however, is only a guidance document, and is not as authoritative as revised regulations would be.

As for the substantive content of the regulations, the factors the rules direct holders to consider—borrower hardship and the cost-effectiveness of opposing

Jason Iuliano for bankruptcy filings in 2007. See Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard*, 86 AM. BANKR. L.J. 495, 504 (2012). Although the number of bankruptcy filings varies greatly from year to year as a general matter, the total number of consumer bankruptcy filings was similar in 2007 (822,596) and 2018 (773,418), suggesting that Iuliano’s estimate may still be in the ballpark. See *id.* (2007 figure); Ed Flynn, *How Long Will the Era of Bankruptcy Stability Last?*, ABI J., Aug. 2019, at 38 (2018 figure).

3 See THE COLLEGE BOARD, TRENDS IN STUDENT AID 2018, Fig. 6 (indicating that nonfederal loans have varied between 7% and 26% of student loans issued each academic year between 1997-98 and 2017-18).

4 A companion paper also discusses the history of these regulations, but in much less detail. See John Patrick Hunt, *Consent to Student-Loan Bankruptcy Discharge*, 95 IND. L.J. (forthcoming 2020).

5 The evaluation and suggestions in Part III draw on two companion papers. See Hunt, *supra* note 4; John Patrick Hunt, *Tempering Bankruptcy Nondischargeability to Promote the Purposes of Student Loans*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3399987&dgcid=ejournal_html_email_consumer:law:ejournal_abstractlink.

discharge—are certainly reasonable. However, the specific analysis the Department requires is unnecessarily borrower-unfriendly, is not transparent to borrowers, and is based on an incomplete understanding of what the Department’s goals in borrower bankruptcy should be. The Article concludes that the Department should adopt clear rules calling for consent to discharge when certain objectively hardship-related circumstances are met and should liberalize its discharge policy in other respects to better serve the purposes of the student loan programs.

I. Background

A. Student-Loan Bankruptcy

Most debts—credit-card debts, medical debts, home mortgages, auto loans—can be discharged in bankruptcy.⁶ That means that after the bankruptcy, the creditor may not sue the debtor to collect the loan or otherwise try to get the debtor to pay it.⁷ Some debts, by contrast, are not dischargeable at all in bankruptcy. These include criminal fines,⁸ debts arising out of willful or malicious injury to another,⁹ and recent tax debts.¹⁰ Creditors on these types of loans may pursue the debtor after the bankruptcy is complete.

Student loans occupy a unique middle ground. They can be discharged, but only if the borrower starts an action against the creditor, known as an “adversary proceeding,”¹¹ and proves that repaying the student loans would cause “undue hardship” to the borrower or the borrower’s dependents.¹² Few bankrupt debtors start such a proceeding (0.2%, according to a study of 2007 bankruptcies),¹³ and student loans are therefore rarely discharged in bankruptcy.

The adversary proceeding for discharge is a form of litigation and can be settled: the creditor, if it so chooses, can consent to the borrower’s discharge.¹⁴ For

6 See 11 U.S.C. § 727(a) (2019) (with exceptions, “the court shall grant the debtor a discharge” in Chapter 7 bankruptcy); *id.* § 523(a) (specifying nondischargeable debts).

7 See 11 U.S.C. § 524(a)(2) (2019) (“A discharge ... operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any [discharged] debt as a personal liability of the debtor,”). The creditor does still have the right to foreclose on any collateral, such as a house securing a home mortgage. See 4 COLLIER ON BANKRUPTCY ¶ 524.02[2][d] (16th ed. 2019). That right is generally irrelevant to student loans, which usually are not secured by collateral.

8 See 11 U.S.C. § 523(a)(7) (2019).

9 See *id.* § 523(a)(6) (2019).

10 See *id.* §§ 523(a)(1), 507(a)(8).

11 See Fed. R. Bankr. P. 7001(6) (designating “a proceeding to determine the dischargeability of a debt” as an adversary proceeding).

12 See 11 U.S.C. § 523(a)(8) (2019).

13 The referenced data come from Iuliano, *supra* note 2, at 504-05. For details on the 0.2% calculation, which reflects changes Iuliano made to his numbers after criticism, see Hunt, *supra* note 4, at 15 n.108.

14 See Letter from Lynn Mahaffie, Deputy Assistant Secretary for Policy, Planning, and Innovation, Office of Postsecondary Education, Department of Education to “Dear Colleague” (July 7, 2015), DCL ID: GEN-15-13, at 1 [hereinafter “2015 Dear Colleague Letter”] (discussing federal student loan holders’ ability to “consent or not object to a borrower’s claim of undue hardship”).

loans issued under federal programs, which are the large majority of student loans, the decision to consent or not is governed by rules issued by the Department.

B. The Department's Current Policies: the 2015 Dear Colleague Letter

The Department set forth its discharge consent policies in a so-called “Dear Colleague Letter” dated July 7, 2015.¹⁵ The letter instructs loan holders to use a two-step framework in deciding whether to consent to discharge.

In the first step, the holder is to determine whether the borrower will endure “undue hardship” unless the loan is discharged.¹⁶ The letter indicates that the holder is to define “undue hardship” the same way the term is used in the Bankruptcy Code, as interpreted by courts.¹⁷ If undue hardship is present, the letter probably directs the holder to consent to discharge.¹⁸ However, the letter is not totally free of ambiguity and may provide that the holder has discretion to decide whether to consent.¹⁹

In the second step, undertaken if undue hardship is absent, the holder determines whether opposing discharge will cost more than one-third the amount the borrower owes on the loan.²⁰ If costs exceed the one-third threshold, indicating that opposing discharge would not be cost effective, the holder “may” consent to discharge.²¹ Conversely, if costs fall below the one-third threshold, the holder “must” oppose discharge.²²

The letter is the most recent statement of the Department’s discharge policy. It is based on, and interprets, two separate sets of regulations: one for the Perkins Loan program and one for the Federal Family Education Loan Program.²³ It applies its interpretation to the William D. Ford Federal Direct Loan program, which does not have its own regulations on the subject of borrower bankruptcy²⁴ despite being the largest federal student loan program.²⁵ The Article now examines each of the programs in turn, summarizing the current regulations for the program before describing the regulations’ history.

15 *Id.*

16 *Id.* at 1-2.

17 *Id.* at 3 (holder’s decision about undue hardship “would necessarily be made according to the legal standards set by the Federal courts.”).

18 *See id.* at 10-11 (if holder concludes undue hardship is absent, “the holder should consent to, or not oppose discharge”).

19 *See id.* at 2 (holder “can” consent to discharge if undue hardship is present. A companion paper discusses the ambiguity in the letter and why it should be resolved in favor of requiring consent to discharge when undue hardship is present. *See Hunt, supra* note 4, at 10.

20 *See* 2015 Dear Colleague Letter, *supra* note 14, at 3.

21 *Id.* at 3-4.

22 *Id.* at 11.

23 *See id.* at 1.

24 *See id.*

25 *See* discussion *infra* Part II.C.1.

II. History of the Student Loan Bankruptcy Discharge Consent Rules

This Part discusses in turn the three major federal student loan programs: the Perkins program, the FFEL program, and the Ford program. For each program, Part II gives a brief description, surveys the current rules, and traces the history.

A. The Federal Perkins Loan Program

The Perkins Loan program, which Congress allowed to expire in September 2017,²⁶ was the oldest federal student loan program. It had roots in the 1958 National Defense Education Act,²⁷ which provided for direct loans to students in higher education.²⁸ The program has had three names: it was known as the National Defense Student Loan Program until 1972,²⁹ as the National Direct Student Loan Program from 1972 to 1986,³⁰ and as the Perkins Loan Program starting in 1986.³¹

The Perkins program is not just the oldest but also the smallest of the three major federal student loan programs, with \$6.6 billion in loans outstanding as of the middle of 2019.³² Despite its small size, it is important because the current rules governing objection to bankruptcy discharge originated in rules the Department adopted for the Perkins program in 1987.

Under the Perkins program, higher education institutions entered into agreements with the federal government under which the institution and the government each contributed to a revolving loan fund, which the higher education institution used to make loans to students.³³ The lion's share of the funds used to make Perkins loans came from the government,³⁴ but the institution itself was the lender (and, for Perkins loans still outstanding, usually is still the lender).

26 See *Congress Fails to Reauthorize Federal Perkins Loan Program*, NH JOURNAL, Oct. 2, 2017, <https://www.insidesources.com/congress-fails-reauthorize-federal-perkins-loan-program-heres-impact-students/>.

27 Pub. L. 85-864, 72 Stat. 1580 (Sept. 2, 1958).

28 See *id.* §§ 201-09, 72 Stat. at 1583-87.

29 See National Direct Student Loan Program, 40 Fed. Reg. 48,252, 48,252 (Oct. 14, 1975) [hereinafter "1975 NDSL NPRM"] (Section 137 of the Education Amendments of 1972 ... established the National Direct Student Loan Program... The National Direct Student Loan Program is deemed to be a continuation of the National Defense Student Loan Program").

30 *Id.*

31 See Perkins Loan Program, 52 Fed. Reg. 45,552, 45,552 (Nov. 30, 1987) [hereinafter "1987 Perkins Rules"] ("The Higher Education Amendments of 1986 (Pub. L. 99-498) changed the name of the National Direct Student Loan Program to the Perkins Loan Program.").

32 U.S. DEP'T OF EDUC., FEDERAL STUDENT AID PORTFOLIO SUMMARY, <https://studentaid.ed.gov/sa/about/data-center/student/portfolio> (last visited Aug. 8, 2019).

33 See Nat'l Ass'n of College & Univ. Bus. Officers, NACUBO ADVISORY GUIDANCE 18-03: PERKINS PROGRAM CLOSE-OUT (2018), <https://www.nacubo.org/-/media/Nacubo/Documents/AdvisoryGuidance182PerkinsLoanProgramwinddown81618.ashx?la=en&hash=6090553A8E2D44FBCAC24FD0CF50A25E62743847>, at 3 [hereinafter NACUBO Guidance].

34 *Id.* at 3.

The higher education institution is also typically the holder of the loan at the time of borrower bankruptcy and therefore is typically charged with deciding whether to oppose a borrower's petition for discharge.³⁵ The Department regulations discussed in the next section govern the institution's decision, but the institution often retains significant discretion. The structure of the Perkins program affects the incentives facing the institution when it exercises that discretion and decides whether to oppose discharge.

When the Perkins program was operating, the institution's Perkins loan fund was used to finance future Perkins loans.³⁶ Thus, the discharge of otherwise collectible loans harmed the institution, because the loss reduced the institution's ability to make Perkins loans going forward. Moreover, because some of the Perkins loan fund's capital came from the institution, part of the fund (the "institutional share") belonged in a sense to the institution, even though in another sense the money did not belong to the institution because it was committed to Perkins loans and not available for unrestricted use. Depending on one's perspective, some of the institution's "own money" could be seen as having been at risk in a bankruptcy. For these reasons, the institution had an incentive to contest the discharge of loans that could be collected if not discharged.

Now that the Perkins program is being wound down, it appears that the institution can make unrestricted use of the institutional share of Perkins repayments that it collects.³⁷ Institutions' incentives to contest discharge of loans that can be collected if discharge is denied are now even clearer, because they no longer have to use monies collected to make new Perkins loans. It is clearer that the institution's own money is at risk in a Perkins loan bankruptcy.

The Perkins regulations make opposing discharge even more attractive by authorizing the institution to recover funds laid out to oppose discharge. The regulations permit the institution to recover the costs of opposing discharge from the borrower.³⁸ If the borrower does not pay, the institution is permitted to charge its Perkins fund for expenses it incurs in opposing discharge, as long as the institution's actions are "required or authorized" under the regulations.³⁹

35 See 2015 Dear Colleague Letter, *supra* note 14, at 1-2 (institution as holder decides whether to oppose discharge). Although the Dear Colleague letter treats the institution's holding the loan in borrower bankruptcy as the typical case, it appears that the Department may become the loan holder if the institution is unable to collect. See 34 C.F.R. § 674.50(a)(1) (2019) (providing for assignment of defaulted note to United States); *id.* § 674.50(f)(1) (providing that United States acquires all "rights, title, and interest in" the loan upon assignment); *id.* § 674.50(c)(12) (providing that assigning institution must cooperate with Secretary to "enforce the loan or loans.").

36 NACUBO Guidance, *supra* note 33, at 3.

37 U.S. DEP'T OF EDUC., ANNOUNCEMENT, PERKINS LOAN PROGRAM—FEDERAL PERKINS LOAN REVOLVING FUND DISTRIBUTION OF ASSETS AND TIMELINES FOR 2018-19 (July 11, 2018), <https://ifap.ed.gov/eannouncements/071118CBPerkinsLoanRevolFundDistributionOfAssets1819.html>. ("Institutions must return to the Department the federal share and return to the institution the institutional share of an institution's Perkins Fund."). Institutions may decide not to continue collecting their Perkins loans. They have the option of assigning the loans to the Department of Education for collection, forfeiting the institutional share but avoiding the costs of continuing to administer the loans. See NACUBO Guidance, *supra* note 33, at 4.

38 See 34 C.F.R. § 674.47(b)(1) (2019).

39 See *id.* §§ 674.47(b)(2); 674.47(e)(6)(ii). Even if the institution's actions are not "required or

Thus, the institution has significant incentives to oppose borrower discharge. As will be seen, under the regulations it has significant discretion to do so.

1. Current Perkins Program Regulations

The Perkins regulations govern the institution's decision whether to oppose discharge.⁴⁰ As the 2015 Dear Colleague Letter suggests, the regulations set up a two-step process that involves assessing undue hardship and the cost of collection. In the first step, the institution "must determine on the basis of reasonably available information, whether repayment of the loan under either the current repayment schedule or any adjusted schedule authorized under subpart B or D of this part would impose an undue hardship on the borrower or his or her dependents."⁴¹ The reference to "Subpart B or D" indicates Perkins-specific provisions for deferment of payments (Subpart B)⁴² and for cancellation based on criteria such as service in the military or as a Head Start teacher (Subpart D).⁴³ The reference is not to the more familiar income-driven repayment programs or to Public Service Loan Forgiveness. Neither IDR nor PSLF is available for Perkins loans unless they are consolidated.⁴⁴

In the second step, taken "[i]f the institution concludes that repayment would not impose an undue hardship,"⁴⁵ the institution evaluates the cost-effectiveness of opposing discharge. The institution is to "determine whether the costs reasonably expected to be incurred to oppose discharge will exceed one-third of the total amount owed on the loan, including principal, interest, late charges, and collection costs."⁴⁶ If the expected costs of opposing discharge are one third or less of "the total amount owed on the loan," the institution "shall oppose the borrower's request for a determination of dischargeability"⁴⁷ and, if the borrower is in default, "seek a judgment for the amount owed on the loan."⁴⁸

authorized," the institution is nevertheless allowed to charge the fund for bankruptcy costs up to 40 percent of any judgment received. *See id.* § 674.47(e)(6)(iii).

40 *See id.* § 674.49(c).

41 *Id.* § 674.49(c)(3). Special rules govern bankruptcies commenced before October 7, 1998. *See id.* § 674.49(c)(2).

42 *See* 34 C.F.R. Subt. B, Ch. VI, Pt. 674, Subpart B (34 C.F.R. §§ 674.31-674.40) (2019) ("Terms of Loans") (providing for deferments in certain circumstances).

43 *See* 34 C.F.R. Subt. B, Ch. VI, Pt. 674, Subpart D (34 C.F.R. §§ 674.51-674.64) ("Loan Cancellation") (2019); *id.* § 674.59 (military service); *id.* § 674.58 (service as a full-time staff member in a Head Start program).

44 Public Service Loan Forgiveness and income-driven repayment are not available for Perkins loans (unless they are consolidated into direct loans), *see Income-Driven Plans*, U.S. DEP'T OF EDUC., <https://studentaid.ed.gov/sa/repay-loans/understand/plans/income-driven#eligible-loans> (last visited Aug. 14, 2019). Subparts B or D of the Perkins regulations do not provide for PSLF or IDR. *See* 34 C.F.R. §§ 674.31-674.40 (2019) (Subpart B); *id.* §§ 674.51-674.64 (Subpart D).

45 34 C.F.R. § 674.49(c)(4) (2019).

46 *Id.* § 674.49(c)(4).

47 *Id.* § 674.49(c)(5)(i).

48 *Id.* § 674.49(c)(5)(ii).

The regulations have notable gaps. They do not specify what the institution is to do if the costs of opposing discharge exceed the one-third limit.⁴⁹ Nor do they expressly provide what the institution is to do if it determines that repayment would result in undue hardship. The fact that the analysis proceeds to a second step if undue hardship is absent suggests that the institution either may or must not oppose discharge if undue hardship would result from repayment. There is no indication, however, whether the operative verb is “may” or “must.”

The regulations also are ambiguous. They contain provisions of uncertain scope that could be read to require the institution to oppose discharge in all circumstances. Specifically, they open by stating that the institution “must use due diligence and may assert any defense consistent with its status under applicable law to avoid discharge of the loan”⁵⁰ and that “the institution must follow the procedures in this paragraph to respond to a complaint for dischargeability ... unless discharge would be more effectively opposed by avoiding that action.”⁵¹ These provisions are not expressly qualified and thus arguably require the institution always to oppose discharge. However, given that the regulation provides for a specific process to decide whether to oppose discharge, the quoted provisions are probably better understood as instructing the institution on how to proceed once it has decided not to consent to discharge. In any event, the provisions are unclear.

2. Perkins Program Regulatory History

The first mention of borrower bankruptcy in the regulatory history of the Perkins program and its predecessors came in 1975 with a notice of proposed rulemaking (NPRM)⁵² issued by the Office of Education of the Department of Health, Education, and Welfare, the predecessor to the Department of Education. The 1975 NPRM led to an interim rule in 1976,⁵³ an interim final rule in 1978,⁵⁴ and a final rule in 1979.⁵⁵ These rules did not address opposition to borrower discharge

49 The FFEL regulations provide more guidance for this situation. They state that the agency “may, but is not required to” oppose discharge in this circumstance. *Id.* § 682.402(i)(1)(iii).

50 *Id.* § 674.49(c)(1).

51 *Id.*

52 1975 NDSL NPRM, *supra* note 29, at 48,262 (proposing regulations to be codified at 45 C.F.R. § 144.32).

53 See Title 45 – Public Welfare, Chapter I – Office of Education, Department of Health, Education, and Welfare, Part 144 – National Direct Student Loans, Part 176 – Supplemental Educational Opportunity Grants, 41 Fed. Reg. 51,946, 51,969 (Nov. 24, 1976) [hereinafter 1976 NDSL Interim Rules] (adopting interim regulations to be codified at 45 C.F.R. § 144.49).

54 See Title 45 – Public Welfare, Chapter I – Office of Education, Department of Health, Education, and Welfare, Part 144 – National Direct Student Loans, Part 175 – College Work-Study Program, Part 176 – Supplemental Educational Opportunity Grants, 43 Fed. Reg. 37,896, 37,920 (Aug. 24, 1978) (adopting interim final regulations to be codified at 45 C.F.R. § 144.50). The 1978 action made changes to the interim rule; all the changes appear to be directed to making the regulation more readable rather than changing the substance.

55 See National Direct Student Loan Program; College Work-Study Program; and Supplemental Educational Opportunity Grant, 44 Fed. Reg. 47,444, 47,471 (Aug. 13, 1979) [hereinafter 1979 NDSL Rules] (to be codified at 45 C.F.R. § 174.50). The 1979 action also made changes to the rule; they consist of breaking the rule into three subsections and further simplifying the wording. *Id.*

in bankruptcy; instead, they governed when an institution was to stop collection efforts due to borrower bankruptcy⁵⁶ and when an institution was permitted to write off NDSL loans, as they were then called.⁵⁷

a. The 1985 NPRM and 1987 Rules: Origin of the Two-Step Test

In 1985, the Department, under Secretary William Bennett, proposed the first regulations for the NDSL program governing opposition to borrower discharge.⁵⁸ The proposed rules provided that the institution was to oppose discharge unless the borrower had “clearly proven” that repayment would entail undue hardship⁵⁹ or that the debt had been in repayment for five or more years.⁶⁰ The five-year exception dovetailed with the bankruptcy law of the time, which provided that student loans that had been in repayment for five years or more were nondischargeable without a showing of undue hardship.⁶¹

In the first example of what would become a pattern, the Department explained the proposal in only a cursory way. The entire explanation was, “Provisions regarding collection from debtors in bankruptcy have been substantially expanded to reflect changes in bankruptcy law that have become effective since this Subpart was last revised.”⁶² Given the new reference to undue hardship in the 1985 NPRM,⁶³ the changes to which the Department was referring presumably included

56 The 1975 NDSL NPRM proposed a prohibition on collection activity against a borrower “who has been adjudicated a bankrupt.” 1975 NDSL NPRM, *supra* note 29, at 48,262 (proposing regulations to be codified at 45 C.F.R. § 144.32). The 1976 interim rule added the condition that “such loan has been discharged.” 1976 NDSL Interim Rules, *supra* note 53, at 51,969. *See also id.* at 51,955-56 (discussing changes from proposed to interim rules). The Office noted, that although it supported legislation to restrict bankruptcy dischargeability in the first five years of repayment and such legislation had been introduced, no such legislation had been enacted. *Id.*

57 The 1975 NDSL NPRM proposed that an institution be able to write off loans because of borrower bankruptcy after “an official notice of the adjudication has been received by the institution.” 1975 NDSL NPRM, *supra* note 29, at 48,262 (to be codified at 45 C.F.R. § 144.32). The advantage of writing off a loan presumably was that doing so terminated the institution’s duty to “exercise due diligence” in collection of that loan, although the proposed rules apparently did not specify this. *See* 1975 NDSL NPRM, *supra* note 29, at 48,261 (to be codified at 45 C.F.R. § 144.31).

58 *See* National Direct Student Loan Program, 50 Fed. Reg. 7872, 7878 (Feb. 26, 1985) [hereinafter 1985 NDSL/Perkins NPRM] (to be codified at 34 C.F.R. § 674.49).

59 *Id.* (to be codified at 34 C.F.R. § 674.49(c)(1)(i)). In evaluating whether the borrower had “clearly proven” the allegation of undue hardship, the institution was to “consider all possible payment plans that are acceptable to the institution and that are allowed by law.” *Id.* (to be codified at 34 C.F.R. § 674.49(c)(1)(ii))

60 *See id.* at 7878 (to be codified at 34 C.F.R. § 674.49(c)(2) (if borrower sought discharge on ground debt had been in repayment for five or more years, institution was to “oppose that request ... unless it determines that the borrower has clearly proven that allegation.”).

61 *See* Bankruptcy Reform Act, Pub. L. No. 95-598, § 523, 92 Stat. 2549, 2590–91 (1978) (requiring a showing of undue hardship for discharge only if loan has been in repayment for less than five years.

62 1985 NDSL/Perkins NPRM, *supra* note 58, at 7873.

63 *See* 1979 NDSL Rules, *supra* note 55 (not mentioning “undue hardship”).

Congress's adoption of the undue-hardship requirement in 1976.⁶⁴ Although that requirement had been in place when the interim, interim final, and final rules were adopted in 1976, 1978, and 1979 respectively, the Department apparently had not previously updated the regulations to reflect it.

In 1987, the Department adopted a rule on opposition to bankruptcy discharge⁶⁵ that departed from the 1985 NPRM and adopted the two-step test in effect today. The 1987 rules dropped the requirement that the borrower "clearly prove[]" the allegation of hardship.⁶⁶ Instead, the institution was to assess undue hardship.⁶⁷ If undue hardship was absent, the institution was to compare one third of the loan balance to expected litigation costs⁶⁸ and oppose discharge if expected costs fell below the one-third threshold.⁶⁹ Each of these requirements was phrased in language identical to that used in the regulations today.

Thus, the 1987 Perkins rule appears to be the origin of the requirements to evaluate undue hardship and compare the costs of opposing discharge to one third of the outstanding loan balance that apply to all three major programs today. The Department adopted these requirements for the much larger Federal Family Education Loan program in 1992,⁷⁰ and the 2015 Dear Colleague Letter applies them to the Direct Loan program.⁷¹

The Department explained the changes from the 1985 proposed rules to the 1987 rules. It stated, "Based on comments received, this section has been revised to present more clearly the actions required to protect the Fund's interest in the event of borrower recourse to bankruptcy."⁷² The Department went on:

It is not the purpose of these regulations to attempt to set forth each provision of bankruptcy law that applies to student loan collection, and institutions must expect to retain counsel to handle student loan accounts in bankruptcy. However ... the Secretary considers it appropriate to explain

64 See John Patrick Hunt, *Help or Hardship? Income-Driven Repayment in Student-Loan Bankruptcies*, 108 GEO. L.J. 1287, 1302-03 (2018) (describing adoption of nondischargeability in 1976).

65 See 1987 Perkins Rules, *supra* note 31.

66 The 1987 rules also deleted the requirement that the borrower "clearly prove[]" an allegation that the student loan had been in repayment for five or more years. See *id.* at 45,560 (codified at 34 C.F.R. § 674.49(b)(2)).

67 *Id.* at 45,560 (to be codified at 34 C.F.R. § 674.49(c)(3)) ("determine, on the basis of reasonably available information, whether repayment of the loan under either the current repayment schedule or any adjusted schedule authorized under Subpart B or D of this part would impose an undue hardship on the borrower and his or her dependents.").

68 *Id.* at 45,560 (to be codified at 34 C.F.R. § 674.49(c)(4)).

69 *Id.* at 45,560 (to be codified at 34 C.F.R. § 674.49(c)(5)) (institution "shall oppose" discharge request).

70 See discussion *infra* Part II.B.2.b.

71 See discussion *supra* Part I.B. The 1987 rule also retained the provision forbidding the institution from opposing discharge if the borrower's loan had been in repayment for more than five years. 1987 Perkins Rules, *supra* note 31, at 45,555; see discussion *supra* note 60 and accompanying text.

72 1987 Perkins Rules, *supra* note 31, at 45,555.

here those enforcement steps which institutions should be prepared to take in bankruptcy proceedings, the information they should consider in choosing whether or not to contest a bankruptcy, and the weight to be given to the cost of litigation.⁷³

The explanation also indicated the Department's interest in protecting the government from inefficient collection efforts: "[B]ecause the regulations now permit institutions to charge to the Fund the costs of the litigation required in bankruptcy, it is appropriate to prescribe here the circumstances in which particular activities are reasonable and cost-effective."⁷⁴ As discussed earlier, the amounts in Perkins funds come primarily from the federal government,⁷⁵ so the federal investment is at risk in litigation that such funds pay for.

The sentences just quoted make up the fullest explanation of the Department's policy on opposition to bankruptcy discharge to be found anywhere in the regulations for any of the federal student loan programs. They focus less on the substance of the regulation than the decision to regulate. The only substantive purpose they embrace is that of protecting the federal FISC from cost-ineffective collection efforts.⁷⁶ The rule was designed to protect federal financial interests, rather than to advance the overall purposes of the student-loan programs. Somewhat surprisingly, the only federal pecuniary interest it mentioned was that in not wasting money on cost-ineffective discharge opposition, rather than that in collecting money from student borrowers.

The statutory basis for these crucial regulations seems surprisingly weak. The critical 1987 rules cited as authority 20 U.S.C. Section 424 and 20 U.S.C. Section 1087cc.⁷⁷ Section 424 requires that "an agreement with any institution of higher education under this title" have particular characteristics.⁷⁸ Section 1087cc provides that "[a]n

73 *Id.*

74 *Id.*

75 *See* discussion *supra* Part II.A.

76 It is not clear that the rules accomplished that purpose. The provision that authorized institutions to recover bankruptcy-related costs from Perkins loan funds allowed (and allows) institutions to charge the Perkins fund for the cost of bankruptcy-related action "required or authorized under" the bankruptcy provisions. *See* 1987 Perkins Rules, *supra* note 31, at 45,559 (codified at 34 C.F.R. §§ 674.47(e)(5)(i)), 674.47(e)(6)(ii) (2019). Given that the rules did not explicitly forbid the institution from opposing discharge, with a possible exception for loans that were over five years old, *see* 1987 Perkins Rules, *supra* note 31, at 45,560 (codified at 34 C.F.R. § 674.49(c)(2)), institutions may well have been able to recover the costs of opposing bankruptcy discharge even if they determined that repayment would entail undue hardship or that litigation costs would exceed one-third of the loan balance.

77 *Id.* at 45,561.

78 *See* National Defense Education Act, Pub. L. 85-864, § 204, 72 Stat. 1580, 1584, (1958). Section 204 of the NDEA was codified at 20 U.S.C. § 424. *See* Pub. L. 88-665, § 204, 78 Stat. 1100, 1101, (1964) (indicating codification of NDEA § 204 at 20 U.S.C. § 424). The provision of Section 424 most relevant to this Article appears to be Section 424(a)(5), which provides that the agreements referenced in the section must "include such other provisions as may be necessary to protect the financial interest of the United States and promote the purposes of this title and as are agreed to by the Commissioner and the institution." Although Section 204 has been amended several times since 1958, none of the amendments affects subsection (a)(5). *See* Pub. L. 88-665, § 204(a), 78 Stat. 1101 (1964); Pub. L. 89-329, §§ 462, 466(b), 79 Stat. 1252, 1254, (1965); Pub. L. 90-575, §§ 172, 175, 82 Stat. 1030, 1034, 1035, (Oct. 16, 1968).

agreement with any institution of higher education for capital contributions under this part shall” contain certain provisions.⁷⁹ Moreover, the vitality of Section 424, which was enacted as part of the 1958 National Defense Education Act⁸⁰ may be in doubt. It is now omitted from the U.S. Code; the reporter’s note states that “this subchapter has not been funded since fiscal year 1975.”⁸¹ Thus, neither cited provision clearly confers the authority to regulate and one of them may be defunct. Although other provisions of the Education Code probably grant the Secretary the authority to issue the regulations,⁸² it is not clear the Secretary could rely on statutory provisions not cited in the administrative record if the present rules were challenged.⁸³

b. Post-1987 Developments: Introducing Ambiguity

Changes to the Perkins bankruptcy discharge opposition regulations since 1987 appear to have been minor. The Department amended the regulations to react to the contraction (in 1990)⁸⁴ and elimination (in 1998)⁸⁵ of the borrower’s ability to get a discharge of older student loans without showing undue hardship.

In 1999, the Department added a provision, parallel to one for the FFELP adopted a few days later,⁸⁶ that “[t]he institution must use due diligence and may assert

79 See 20 U.S.C. § 1087cc(a) (2019).

80 See *supra* note 78; see also 20 U.S.C. ch. 17 (“National Defense Education Act”) (containing 20 U.S.C. §§ 401-602).

81 See 20 U.S.C. §§ 421-25, uscode.house.gov (last visited Feb. 5, 2019). Presumably this has to do with the replacement of the National Defense Student Loan Program with the National Direct Student Loan Program and then the Perkins Loan Program. The Department did continue to rely on the NDEA provisions as authority for the Perkins regulations in the 1999 Perkins rules. Federal Perkins Loan Program, 64 Fed. Reg. 58,298, 58,308 (Oct. 28, 1999) [hereinafter 1999 Perkins Rules] (citing 20 U.S.C. §§ 421-29 as authority).

82 See 20 U.S.C. § 1221e-3 (2019) (conferring on Secretary the authority to make “rules and regulations” “in order to carry out functions otherwise vested in the Secretary”); *id.* § 3474 (granting Secretary authority to make “rules and regulations” “as the Secretary deems necessary or appropriate to administer and manage the functions of the Secretary or the Department.”).

83 See *Global Van Lines v. ICC*, 714 F.2d 1290, 1297 (5th Cir. 1983) (refusing to allow agency to rely on provision not mentioned in NPRM as statutory basis for its authority to issue regulation) (citing *SEC v. Chenery Corp.*, 318 U.S. 80, 87 (1943)). However, the *Chenery* doctrine would not prevent the Department from using these provisions as the statutory basis for new regulations.

84 See Crime Control Act of 1990, Pub. L. No. 101-647, § 3621(2), 104 Stat. 4789, 4965 (extending undue-hardship requirement, which had previously applied to loans that had been in repayment up to five years, to loans that had been in repayment up to seven years); Perkins Loan Program, College Work-Study Program, and Supplemental Educational Opportunity Grant Program, 57 Fed. Reg. 32,342, 32,346 (July 1, 1992) (providing that institution may not oppose petition for discharge if loan has been in repayment for seven or more years) (to be codified at 34 C.F.R. § 674.49(c)(2)); see also *id.* at 32,343 (stating that regulations are being amended to reflect Crime Control Act of 1990).

85 See Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971(a), 112 Stat. 1581, 1837 (requiring undue hardship for all student-loan discharges in bankruptcy); 1999 Perkins Rules. *supra* note 81, at 58,313 (amending rules to forbid institution from opposing discharge based on the length of time the loan has been in repayment only when the loan has been in repayment for seven or more years at filing of petition and the petition is filed before October 8, 1998) (to be codified at 34 C.F.R. § 674.49(c)(2)).

86 See discussion *infra* Part II.B.2.c.

any defense consistent with its status under applicable law to avoid discharge of the loan.”⁸⁷ The due-diligence requirement seems at least arguably superfluous because institutions were already required to “exercise due diligence in collecting loans.”⁸⁸ Neither the NPRM nor the final rule explained what the added due diligence requirement was supposed to accomplish or why it was being adopted. As explained, the added sentence introduces ambiguity into the regulations.⁸⁹ As for the assert-any-defense language, the Department explained that the change clarified that the regulations did not bar state-related institutions from relying on sovereign immunity.⁹⁰ These changes went into effect on July 1, 2000,⁹¹ and the regulations have not changed since.

c. Treatment of Federally Held Perkins Loans

The regulations are directed to institutions, the parties that normally decide whether to oppose a borrower’s petition for discharge. It appears that the Secretary can become responsible for handling a borrower bankruptcy. For example, the institution may assign the loan to the Secretary if the institution has been unable to collect after following prescribed procedures.⁹² In such a situation the Secretary apparently would be responsible for collection, including handling the borrower’s bankruptcy. However, the regulations do not contain, and apparently have never contained, any rules governing the Secretary’s conduct in borrower bankruptcies. The Secretary’s unwillingness to be bound by regulations for the Perkins programs seems to presage the complete absence of borrower-bankruptcy regulation for the Ford program, where the federal government is the lender.⁹³

B. The Federal Family Education Loan Program

Congress created the Guaranteed Student Loan (GSL) program, predecessor to the Federal Family Education Loan (FFEL) program, in the Higher Education Act of 1965.⁹⁴ Congress renamed the GSL program the FFEL program in the Higher Education Amendments of 1992.⁹⁵ The Health Care and Education Reconciliation Act of 2010 terminated the FFEL program and no new loans have been made under

87 1999 Perkins Rules, *supra* note 81, at 58,313 (to be codified at 34 C.F.R. § 674.49(c)(1)).

88 34 C.F.R. § 674.41(a) (in effect as of January 1, 1999). Nevertheless, the Department described the due-diligence language as “amend[ing] the regulations.” Federal Perkins Loan Program, Notice of Proposed Rulemaking, 64 Fed. Reg. 41,232, 41,238 (July 29, 1999).

89 See discussion *supra* notes 50-51 and accompanying text.

90 1999 Perkins Rules, *supra* note 81, at 58,307.

91 *Id.* at 58,298 (establishing July 1, 2000 effective date).

92 See 34 C.F.R. Part 34 (2019).

93 See *infra* Part II.C.1.

94 See U.S. DEP’T OF EDUC., FEDERAL STUDENT LOAN PROGRAMS DATA BOOK, FY 1997 – FY 2000, <https://www2.ed.gov/finaid/prof/resources/data/fslpdata97-01/edlite-intro.html> (last visited Feb. 5, 2019).

95 See *id.*

the program since June 30, 2010.⁹⁶ Congress repeatedly changed the GSL and FFEL programs over their 45-year life.⁹⁷

The amount of debt outstanding under the FFEL program was \$517 billion in 2010.⁹⁸ That amount has dwindled to \$272 billion as of the middle of 2019, but the FFEL program is still the second-largest program by amount of loans outstanding.⁹⁹

To understand how FFEL creditors are to respond to a borrower's bankruptcy, it is helpful to understand how the various entities in the program interact. Under the FFELP, private lenders made loans to students. "Guaranty agencies,"¹⁰⁰ which could be state government or nonprofit organizations, guaranteed FFELP loans (and continue to guarantee loans that are still outstanding).¹⁰¹ Under the guarantee arrangements, the guaranty agency reimburses the lender for losses arising from certain events, such as default.¹⁰² The Department in turn reinsures the guaranty agencies.¹⁰³ That is, the Department reimburses the guaranty agency for its payments to the private lender upon the occurrence of certain conditions.¹⁰⁴

Guaranty agencies did not guarantee all GSL program and FFELP loans. The Department has guaranteed some student loans directly, without the intermediary of a guaranty agency. These "federal GSL programs"¹⁰⁵ were to operate as a backup to the guaranty agency program in states where guaranty agencies did not operate or did not serve all eligible students.¹⁰⁶ Although such programs earlier received significant regulatory attention,¹⁰⁷ the Department withdrew regulations governing the programs in 2013 and the 2015 Dear Colleague Letter does not mention them.¹⁰⁸

96 See Pub. L. 111-152, §§ 2201-2208, 124 Stat. 1029, 1074-1077 (2010).

97 See ANGELICA CERVANTES ET AL., *OPENING THE DOORS TO HIGHER EDUCATION: PERSPECTIVES ON THE HIGHER EDUCATION ACT 40 YEARS LATER* (2005), at 29-42 (summarizing history of Higher Education Act from 1965 to 2005 and describing changes to the GSL and FFEL programs).

98 U.S. DEP'T OF EDUC., *supra* note 32.

99 *Id.*

100 See 34 C.F.R. § 682.401(b)(5) (2019) (specifying what percentage of loan balance the guaranty agency is to guarantee).

101 See *id.* § 682.200, "Guaranty Agency."

102 See *id.* § 682.100(b)(1) (with exception for loans guaranteed directly by government, "a guaranty agency guarantees a lender against losses due to default by the borrower on a FFEL loan").

103 See *id.* § 682.404 (providing for Secretary's entering into reinsurance agreements with guaranty agencies).

104 See *id.* § 682.404(a) (specifying that government will pay guaranty agency 95 to 100 percent of the agency's default claim losses on FFEL loans, depending on when loan was made).

105 See *id.* § 682.100(b)(2)(i)-(ii) (listing types of loans, under the "Federal GSL Programs" that the federal government has guaranteed directly).

106 See *id.* § 682.100(b)(2)(iii).

107 See, e.g., *Guaranteed Student Loan Program*, 44 Fed. Reg. 53,866, 53,884 (Sept. 17, 1979) [hereinafter 1979 GSL Final Rule] (codified at 45 C.F.R. § 177.503(a)(2) (describing basic structure of federally insured student loan program contract)).

108 See Student Assistance General Provisions, Federal Perkins Loan Program, Federal Family

The FFELP regulations establish a process for claims and payments in the event of the borrower's Chapter 7 bankruptcy. If the borrower begins an action to have the loan obligation determined to be dischargeable on the grounds of undue hardship, the lender is to file a claim with the guaranty agency.¹⁰⁹ Upon timely¹¹⁰ presentation of proper documentation,¹¹¹ the guaranty agency is "promptly"¹¹² to pay the lender "the unpaid balance of principal and interest"¹¹³ and the lender assigns the loan to the guaranty agency.¹¹⁴ Apparently the government then pays the agency on a reinsurance claim as though the borrower had defaulted.¹¹⁵ This amount is apparently 95 percent of the amount the agency paid the lender, at least for loans disbursed since October 1998.¹¹⁶

If the bankruptcy court declares the student loan dischargeable¹¹⁷ and certain additional conditions are met,¹¹⁸ the Secretary "reimburses the guaranty agency

Education Loan Program, and William D. Ford Federal Direct Loan Program, 78 Fed. Reg. 65,768, 65,820 (Nov. 1, 2013) (removing and reserving subpart E of 34 C.F.R. Part 682, which had governed guaranteed loans guaranteed directly by the federal government without the involvement of a guaranty agency). The author has been unable to locate information about outstanding balances under the program.

109 See 34 C.F.R. § 682.402(f)(5)(i)(C) (2019). If the borrower does not seek to have the loan discharged on the ground of undue hardship, the lender continues to hold the loan and, after the bankruptcy is completed, treats the loan as though it had been in forbearance for the duration of the proceeding. See *id.* § 682.402(f)(5)(ii). Different rules apply to bankruptcies started before October 8, 1998. See *id.* § 682.402(f)(5)(i)(B).

110 See *id.* § 682.402(g)(2)(v) (setting forth deadlines for submission of bankruptcy-based claim to guaranty agency).

111 See *id.* § 682.402(g)(1) (detailing required documentation supporting lender's bankruptcy-based claim on guaranty agency). Proper documentation includes the promissory note or a copy, *id.* § 682.402(g)(1)(i), an assignment of the proof of claim filed in the bankruptcy, *id.* § 682.402(g)(1)(v)(A), and a statement of any facts of which the lender is aware that may form the basis for an objection to discharge. *Id.* § 682.402(g)(1)(v)(B).

112 *Id.* § 682.402(h)(1)(i).

113 *Id.* § 682.402(h)(2)(i)(B).

114 See *id.* § 682.401(b)(8)(i)(B) (providing for assignment of loans to guaranty agency in event borrower files a bankruptcy petition).

115 See *id.* § 682.402(k)(2) ("The Secretary pays a ... bankruptcy ... claim ... on a loan held by a guaranty agency after the agency has paid a default claim to the lender thereon and received payment under its reinsurance agreement.").

116 See *id.* § 682.404(a)(1). Higher reimbursements are available for loans disbursed before October 1998. *Id.*

117 See *id.* § 682.402(k)(1)(i)(A). Under earlier rules, the government paid out when the borrower was "adjudicated a bankrupt," 1979 GSL Final Rule, *supra* note 107, at 53,878 (codified at 34 C.F.R. § 177.402(b)(1)-(2)) subject to the guaranty agency's obligation to the government for a portion of the claim if the loan was not actually discharged. *Id.* (codified at § 177.402(f)(3)). The Department adopted the current rule that the government pays out on the bankruptcy claim only after the debt is discharged, in 1986. See Guaranteed Student Loan and PLUS Programs, 51 Fed. Reg. 40,886, 40,905 (Nov. 10, 1986) [hereinafter 1986 GSL PLUS Final Regulations] (codified at 34 C.F.R. § 682.402(h)(1)(i)).

118 See 34 C.F.R. § 682.402(k)(2)(i)-(v) (2019) (listing conditions for Secretary's payment of bankruptcy claim to guaranty agency).

for its losses” on the bankruptcy claim.¹¹⁹ The conditions that must be met for the agency to be paid at this step include the agency’s exercise of due diligence up until discharge.¹²⁰ If the loan is declared nondischargeable, the lender must repurchase the loan from the guaranty agency¹²¹ and the agency reimburses the government for the reinsurance payment it previously received.¹²²

Scholars have posited that guaranty agencies have a financial incentive to oppose discharge.¹²³ It is difficult to discern the guaranty agency’s incentives from the regulations because it is not clear what the guaranty agency receives if the discharge is granted or what it receives if discharge is denied. If discharge is granted, the Department pays the agency “a percentage of the outstanding principal and interest that is equal to the complement of the reinsurance percentage paid on the loan,”¹²⁴ but the percentage is not clearly specified.¹²⁵ If discharge is denied, the lender “repurchases” the loan from the guaranty agency¹²⁶ and the agency reimburses the government for the reinsurance payment it previously received.¹²⁷ However, the regulations do not appear to specify how the repurchase price is calculated or whether it includes bankruptcy litigation costs.¹²⁸

119 *Id.* § 682.402(k)(1)(i)(A).

120 *See id.* § 682.402(k)(2)(v).

121 *Id.* § 682.402(j)(1)(i) (providing for lender repurchase of loan in event of denial of borrower discharge, unless guaranty agency sells loan to another lender).

122 *See id.* § 682.402(k)(1)(ii).

123 *See* Dalié Jiménez, Matthew Bruckner, Pamela Foohey, Brook Gotberg, & Chrystin Ondersma, *Comments of Bankruptcy Scholars on Evaluating Undue Hardship Claims in Bankruptcy*, 21 J. CONS. & COM. L. 114, 119 (2018).

124 *Id.* § 682.402(k)(5). It thus appears that the Secretary pays 100% of the principal and interest on loans that are discharged in bankruptcy, subject to the rule that interest accrues for only 60 days after the bankruptcy petition. *See id.* § 682.402(k)(5)(i).

125 The regulations do not appear to specify what “the complement” is. They also do not explicitly define the “reinsurance percentage,” although that term presumably refers to the 95 percent of the default payment to the lender for which the agency already has been reimbursed. Although it is not clear, the “complement” could be the other five percent. If so, the guaranty agency might not recover its bankruptcy litigation costs, as its default payment to the lender is calculated without reference to such costs. *See id.* § 682.402(h)(2)(i)(B) (guaranty agency to pay “unpaid principal and interest” to lender in event of bankruptcy). However, that is only conjecture.

126 *See id.* § 682.402(j)(1)(i).

127 *See id.* § 682.402(k)(1)(ii).

128 A manual that guaranty agencies prepared for FFELP lenders suggests that the repurchasing lender does reimburse the guaranty agency for collection costs incurred unless the agency waives reimbursement. Thus, there is some evidence that the guaranty agency recovers its bankruptcy litigation costs if it defeats discharge, but this is not entirely clear. *See* COMMON MANUAL GOVERNING BOARD, 2018 COMMON MANUAL: UNIFIED STUDENT LOAN POLICY § 13.5, at 13 (2018), <http://commonmanual.org/wp-content/uploads/2018/07/ECM2018.pdf>. Notably, a guaranty agency is to charge the borrower for costs it incurs in collecting a loan on which it has paid a bankruptcy claim, including attorney’ fees and court costs. *See* 34 C.F.R. 682.410(b)(2) (2019). Chargeable collection costs are subject to limitations in the promissory note. *Id.* They also are capped at the amount the Department would collect if it held the loan. *Id.* § 682.410(b)(2)(ii). Finally, they cannot exceed an amount given by a formula that accounts for commissions the Department pays to collection agencies. *Id.* § 682.410(b)(2)(i).

A complete analysis of a given guaranty agency's incentives in deciding whether to resist borrower discharge probably entails reviewing agreements specific to that agency. The author has not been able to locate a readily, publicly available set of such documents, so a firm conclusion about guaranty-agency incentives must await further research.¹²⁹

1. Current FFELP Regulations

If a debtor in bankruptcy seeks to discharge FFELP loans, the regulations provide that the guaranty agency decides whether to oppose the discharge request.¹³⁰ The regulations set forth rules for the guaranty agency's decision.¹³¹ The regulations are emphatic; they declare that the guaranty agency "shall immediately take" whatever action the rules require upon receipt of the claim from the lender.¹³²

Following the Perkins regulations, the FFEL regulations set up a two-step structure for deciding whether to oppose discharge.¹³³ First, the guaranty agency "must determine whether repayment under either the current repayment schedule or any adjusted schedule authorized under this part would impose an undue hardship on the borrower and his or her dependents."¹³⁴ The reference to "this Part" means Part 682, the FFEL regulations. These provide for eligibility for one IDR program, income-based repayment (IBR), so presumably the agency is to consider IBR as a way of repaying the loans.¹³⁵ The FFEL regulations do not

129 The relevant contracts could include guarantee and reinsurance agreements, as well as contracts with additional parties such as Educational Credit Management Corporation, *see infra* note 130, and loan servicers.

130 The Department has delegated control of much FFELP student-loan bankruptcy litigation by contract to third parties, most notably Educational Credit Management Corporation (ECMC). *See* Rafael I. Pardo, *The Undue Hardship Thicket: On Access to Justice, Procedural Noncompliance, and Pollutive Litigation in Bankruptcy*, 66 FLA. L. REV. 2101, 2143-44 (2014). A 2006 contract between the Department and ECMC provides, "ECMC is authorized to accept assignment of all FFELP loans on which the borrower has filed a petition for relief under the U.S. Bankruptcy Code" and that "ECMC shall fulfill all remaining guaranty agency responsibilities for any loan in this category." Letter from Gary D. Whitman, Reg'l Inspector Gen. for Audit Servs., U.S. Dep't of Educ., to Richard Boyle, Chief Exec. Officer, ECMC Grp., Inc., at 19 (Mar. 3, 2011) (contract attached to letter). The 2006 contract appears to have no expiration term, and ECMC continues to be a substantial presence in student loan bankruptcy even as FFELP balances diminish: A Westlaw search indicates that ECMC was listed as a party in 13 student loan undue-hardship decisions in 2018. Nevertheless, the regulations and the 2015 Dear Colleague letter are addressed to guaranty agencies, so this Article focuses on them.

131 *See* 34 C.F.R. § 682.402(i) (2019) (setting forth rules for guaranty agency's participation in bankruptcy proceedings).

132 *See id.* § 682.402(h)(1)(ii).

133 *See id.* § 682.402(i)(1)(ii)-(iii).

134 34 C.F.R. § 682.402(i)(1)(ii) (2019) (FFEL). An additional exception applies to bankruptcies (1) filed before October 8, 1998 and (2) in which the first payment on the loan was due more than seven years before the bankruptcy. In such cases, the guaranty agency apparently is not to oppose discharge. *See id.* § 682.402(i)(1)(i).

135 *See id.* § 682.215 (providing for IBR). The Department of Education confirms that unconsolidated FFEL loans are eligible for IBR but not for other IDR programs. *See Income-Driven Plans*, U.S. DEP'T OF EDUC., <https://studentaid.ed.gov/sa/repay-loans/understand/plans/income-driven#eligible-loans> (last visited Feb. 5, 2019).

provide for other IDR programs or PSLF,¹³⁶ so presumably these programs do not affect the agency's undue-hardship analysis.

Then, "[i]f the guaranty agency determines that repayment would not constitute an undue hardship," the agency must evaluate the cost-effectiveness of opposing discharge. It "must determine whether the expected costs of opposing the discharge petition would exceed one-third of the total amount owed on the loan, including principal, interest, late charges, and collection costs."¹³⁷ If the "expected costs of opposing the discharge petition" do exceed the one-third threshold, then the agency "may, but is not required to, engage in the activities described in paragraph (i)(1)(iv) of this section"¹³⁸ oppose discharge.

The referenced "paragraph (i)(1)(iv)" provides guidance for how to oppose discharge:

The guaranty agency must use diligence and may assert any defense consistent with its status under applicable law to avoid discharge of the loan. Unless discharge would be more effectively opposed by not taking the following actions, the agency must – (A) Oppose the borrower's petition for a determination of dischargeability; and (B) If the borrower is in default on the loan, seek a judgment for the amount owed on the loan.¹³⁹

Like the Perkins regulations, the FFEL regulations contain gaps. They do not say what the guaranty agency is to do if undue hardship is present, nor what to do if undue hardship is absent and expected litigation costs fall below the one-third threshold. The FFEL regulations also contain an ambiguity comparable to that in the Perkins regulations: the "must use due diligence ... to avoid discharge" provision quoted above is of unclear scope and could be read to conflict with the two-part test by imposing an unqualified duty to oppose discharge.

The regulations confer a great deal of discretion on holders. In the case where undue hardship is absent and opposing discharge is not cost-effective, they affirmatively grant holders discretion: the holder "may, but is not required to" oppose discharge.¹⁴⁰ In other cases, the regulations do not clearly instruct the holder to do or not do anything in particular. As discussed below, the regulations evolved from 1986 to 2001 to give holders more and more discretion.¹⁴¹

136 See 34 C.F.R. § 685.219 (2019) (providing for PSLF for direct loans). The FFEL regulations have no comparable provision, and the Department of Education confirms that FFEL loans must be consolidated to be eligible for PSLF. See *Public Service Loan Forgiveness*, U.S. DEP'T OF EDUC., <https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/public-service#eligible-loans> (last visited Feb. 5, 2019). Arguably, the guaranty agency could consider the borrower's ability to become eligible for PSLF or other IDR programs by consolidating. The regulations and 2015 Dear Colleague Letter provide no guidance on this point.

137 34 C.F.R. § 682.402(i)(1)(iii).

138 *Id.* § 682.402(i)(1)(iii).

139 *Id.* § 682.402(i)(1)(iv).

140 *Id.* § 682.402(i)(1)(iii).

141 See discussion *infra* Part II.B.2.c.

2. FFELP Regulation History

It appears that the first FFEL /GSL program rulemaking document to mention bankruptcy is an NPRM for the GSL program dated November 5, 1976.¹⁴² This NPRM, which did not lead to final rules, did not describe any substantive standards for holders' opposition to discharge.¹⁴³ This is unsurprising because student loans were fully dischargeable when the NPRM was drafted so there would have been little reason to oppose discharge.¹⁴⁴

However, a new NPRM issued in 1978¹⁴⁵ and the resulting final rules promulgated in 1979¹⁴⁶ also omitted any mention of the question when to oppose borrower discharge, as did a 1981 NPRM¹⁴⁷ and 1982 final rule¹⁴⁸ for the new PLUS program, under which the federal government guaranteed loans parents took out for their children's education.¹⁴⁹ This was so even though the 1979 rules recognized the possibility that the loans might not be discharged.¹⁵⁰

a. 1985 NPRM and 1986 Rules: "Shall Diligently Contest" Discharge

The Department of Education proposed its first substantive standards for guaranty agencies' conduct in the case of borrower bankruptcy in a 1985 NPRM¹⁵¹ and the Department adopted final rules based on the NPRM in 1986.¹⁵² For the

142 See Guaranteed Student Loan Program, Notice of Proposed Rulemaking, 41 Fed. Reg. 48,862 (Nov. 5, 1976) [hereinafter 1976 GSL NPRM].

143 Most significantly, it provided that for loans insured directly by the federal government without the intermediary of a guaranty agency, a lender who had filed a default claim with the government was not permitted to file a proof of claim in the borrower's bankruptcy, but was instead required to forward relevant information to the Office of Education so that it could file a claim on behalf of the government. *Id.* at 48,871.

144 See Hunt, *supra* note 64, at 1302-04 (describing enactment of nondischargeability in 1976); 1976 GSL NPRM, *supra* note 142, at 48,862 (NPRM drafted before nondischargeability enacted).

145 Guaranteed Student Loan Program, Proposed Rulemaking, 43 Fed. Reg. 14,376 (April 5, 1978) [hereinafter 1978 GSL NPRM].

146 1979 GSL Final Rule, *supra* note 107, at 53,875-83 (codified at 45 C.F.R. §§ 177.400-177.408) (establishing regulations for guaranty program without providing guidance as to when guaranty agency should oppose borrower's bankruptcy discharge).

147 See Parent Loans for Undergraduate Students (PLUS) Program, Notice of Proposed Rulemaking, 46 Fed. Reg. 4956 (Jan. 19, 1981).

148 See PLUS Program, 47 Fed. Reg. 17,200, 17200 (April 21, 1982) [hereinafter 1982 PLUS Final Rules].

149 The only difference between the PLUS program and existing GSL program bankruptcy rules related to continuing collection against a spouse in the event of a co-borrower spouse's discharge. See *id.* at 17,200 (PLUS loans have "same terms, conditions, and benefits" as GSL loans); *id.* at 17,216 (codified at 34 C.F.R. § 683.32(a) (co-borrower discharge for guaranty agency PLUS loans); *id.* at 17,227 (codified at 34 C.F.R. § 683.63(c)(1) (co-borrower discharge for federally insured PLUS loans)).

150 1979 GSL Final Rule, *supra* note 107, at 53,878 (codified at 45 C.F.R. § 117.402(f)(3)) (providing for treatment of loans for which the Commissioner pays a bankruptcy claim but that are not actually discharged in bankruptcy).

151 Guaranteed Student Loan Program and PLUS Program, 50 Fed. Reg. 35,964, 35,964 (Sept. 4, 1985) [hereinafter 1985 GSL PLUS NPRM]

152 See 1986 GSL PLUS Final Regulations, *supra* note 117.

first time, guaranty agencies were told what to do in case of borrower bankruptcy. The Department issued the 1985 FFEL NPRM several months after the bankruptcy rules it had proposed for the Perkins program,¹⁵³ and it took a different tack. Rather than requiring the holder to evaluate whether the borrower had clearly proven the allegation of undue hardship, as the Perkins proposal directed, the FFEL regulations provided that the guaranty agency “shall diligently contest the discharge of the loan by the bankruptcy court.”¹⁵⁴ The guaranty agency’s exercise of due diligence through discharge was a condition of the federal reimbursement otherwise available to the guaranty agency upon borrower discharge.¹⁵⁵

The Department has said even less to justify the GSL and FFEL rules than it has to justify the Perkins rules. The 1985 GSL NPRM offered only the vaguest of explanations. It announced that the overall purpose of the rules, including the bankruptcy discharge opposition standards, was to “incorporate recent statutory changes.”¹⁵⁶ The NPRM also stated that the rules were intended to “implement various policy initiatives intended to prevent student loan defaults and to effect repayment of loans once default has occurred.”¹⁵⁷ The latter justification probably did not literally cover the bankruptcy discharge opposition rules, because bankruptcy apparently is not an event of default for FFELP loans.¹⁵⁸ The NPRM

153 See *supra* Part II.A.2.a.

154 See 1986 GSL PLUS Final Regulations, *supra* note 117, at 40,905 (codified at 34 C.F.R. § 682.402(g)(1)); 1985 GSL PLUS NPRM, *supra* note 151, at 35,981 (to be codified at 34 C.F.R. § 682.402(d)(1) (same)). Previously, a guaranty agency’s requirement apparently had ceased at an earlier stage of the case, when the debtor was “adjudicated a bankrupt.” See 1979 GSL Final Rule, *supra* note 107, at 53,878 (codified at 45 C.F.R. § 117.402(f)(1)(iii)) (establishing as prerequisite for government payment on guaranty agency’s borrower bankruptcy claim that “[t]he guarantee agency exercised due diligence in the collection of the loan until the borrower ... was adjudicated a bankrupt.”). The 1978 Bankruptcy Reform Act eliminated the concept of “adjudication as a bankrupt.” See 4 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 68.12[2] (Richard Levin & Henry J. Sommer eds., 2018).

155 See 1986 GSL PLUS Final Regulations, *supra* note 117, at 40,905 (codified at 34 C.F.R. §§ 682.402(g)(1)(i), (g)(2)) (reimbursement of guaranty agency on discharge, provided certain conditions met); *id.* (to be codified at 34 C.F.R. § 682.402(h)(1)(iv)) (conditions include guaranty agency’s due diligence through discharge). If the discharge was not granted, the guaranty agency could choose either to require the lender to repurchase the loan or to sell the loan to another lender. See *id.* at 40,905 (codified at 34 C.F.R. § 682.402(g)(1)(ii)).

156 1985 GSL PLUS NPRM, *supra* note 151, at 35,964.

157 *Id.*

158 The FFELP regulations define default as “[t]he failure of a borrower to make an installment payment when due, or to meet other terms of the promissory note, the Act, or regulations as applicable,” provided the failure has persisted for 270 days for loans repayable in monthly installments (330 days for a loan repayable in less frequent installments) and “the Secretary or guaranty agency finds it reasonable to conclude that the borrower ... no longer intend[s] to honor the obligation to repay.” 34 C.F.R. § 682.200. The author has located no provision of the Act or regulations making borrower bankruptcy a default, and the only basis the Department of Education’s indicates for default on FFELP or Ford program loans is nonpayment for 270 days. *How to Repay Your Loans: Understanding Delinquency and Default*, U.S. DEP’T OF EDUC., <https://studentaid.ed.gov/sa/repay-loans/default#default> (last visited Feb. 5, 2019). The FFELP master promissory note does not define bankruptcy as an event of default, although it defines default and indicates that the loan can be discharged in bankruptcy only on a showing of undue hardship. See FFELP Federal Stafford Loan

did not offer any specific rationale for the proposed rules governing guaranty agencies' response to bankruptcy. The rules apparently attracted no comment from the public,¹⁵⁹ and the Department adopted them without change in the 1986 regulations.¹⁶⁰

b. The 1990 NPRM and 1992 Rules: Adopting the Two-Step Test

The Department proposed further revisions to the rules governing guaranty agencies' response to borrower petitions for bankruptcy discharge in 1990¹⁶¹ and adopted the revision in 1992.¹⁶² The 1992 rules relaxed the previously unqualified duty to oppose discharge. They paralleled the regulations the Department had adopted for the Perkins program in 1987,¹⁶³ and were substantially similar to the regulations in effect today.

Under the 1992 rules, the guaranty agency was to take action "immediately" upon receipt of a claim from the lender.¹⁶⁴ It was to determine whether repayment would impose an undue hardship.¹⁶⁵ If the guaranty agency determined that repayment "would not constitute an undue hardship," it was to determine whether opposing discharge would cost more than one third the outstanding balance on the loan.¹⁶⁶ If the guaranty agency determined that opposing discharge would cost less than one-third of the amount owed, it was to oppose discharge.¹⁶⁷

Master Promissory Note, <https://ifap.ed.gov/dpccletters/attachments/FP0608StaffApp2008.pdf> (last visited Feb. 5, 2019). The FFELP regulations treat default and bankruptcy claims as separate categories. *See, e.g.*, 34 C.F.R. Part 682 App. D, Part I.E (2019) (setting out different rules for lender cure of violations relating to "default claims" and "bankruptcy claims"); *id.* § 682.402(i)(1)(iv)(B) (requiring guaranty agency to seek a judgment in borrower's bankruptcy discharge proceeding "if the borrower is in default on the loan").

159 *See* 1986 GSL PLUS Final Regulations, *supra* note 117, at 40,941 (discussing public comments to proposed 34 C.F.R. § 682.402 and not mentioning rules for guaranty agencies' opposition to discharge).

160 *Compare* 1985 GSL PLUS NPRM, *supra* note 151, at 35,981 (to be codified at 34 C.F.R. § 682.402(d)(1) (guaranty agency "shall diligently contest the discharge of the loan by the bankruptcy court")) *with* 1986 GSL PLUS Final Regulations, *supra* note 117, at 40,905 (codified at 34 C.F.R. § 682.402(g)(1)) (same).

161 Guaranteed Student Loan Programs, Proposed Rules, 55 Fed. Reg. 48,324, 48,332 (Nov. 20, 1990) [hereinafter 1990 GSL NPRM] (explaining proposed new rules "regarding the actions required of guaranty agencies in bankruptcy proceedings").

162 *See* Federal Family Educational Loan Programs, Rules and Regulations, 57 Fed. Reg. 60,280 (Dec. 18, 1992) [hereinafter 1992 FFEL Rules].

163 *See* discussion *supra* Part II.A.2.a

164 1992 FFEL Rules, *supra* note 162, at 60,349 (codified at 34 C.F.R. § 682.402(f)(1)(ii)).

165 *See id.* at 60,349 (codified at 34 C.F.R. § 682.402(g)(1)(i)(B)). The agency was also to determine whether the loans had been in repayment for seven or more years. *Id.* (to be codified at 34 C.F.R. § 682.402(g)(1)(A)). Presumably, the guaranty agency was not generally expected to fight discharge if the loans had been in repayment for seven years, because student-loan dischargeability did not at that time cover loans of that vintage. *See* Hunt, *supra* note 64, at 1300-12 (explaining evolution of student-loan nondischargeability).

166 1992 FFEL Rules, *supra* note 162, at 60,349 (codified at 34 C.F.R. § 682.402(g)(1)(ii)).

167 *Id.* at 60,349 (codified at 34 C.F.R. § 682.402(g)(iii)).

For justification, the 1990 NPRM that gave rise to the 1992 rules again cited “various policy initiatives designed to reduce defaults and increase collections on loans that do go into default.”¹⁶⁸ The NPRM’s specific discussion of the new bankruptcy rule simply summarized the rule and did not offer a justification.¹⁶⁹ The proposed rules on consent to discharge again apparently attracted no public comment, and the Department adopted them without change from the NPRM and without offering further justification.¹⁷⁰

c. Post-1992 Developments: Ambiguity and Increased Holder Discretion

The changes to the rules since 1992 have not altered the core requirements to evaluate undue hardship and estimate litigation costs. A 1999 rule added an explicit statement that the agency “must use diligence and may assert any defense consistent with its status under applicable law to avoid discharge of the loan”¹⁷¹ and “must ... oppose the borrower’s petition,” “[u]nless discharge would be more effectively opposed” by not doing so.¹⁷² This paralleled a rule the Department had adopted just a few days earlier for the Perkins program.¹⁷³ As with the Perkins rule, the scope of this duty is unclear. According to an analysis paralleling that of the Perkins rules, the duty seems likely to have governed the agency’s conduct once it had decided to oppose discharge.¹⁷⁴

The 1999 rule also removed the requirement that the guaranty agency “shall” oppose discharge if litigation costs were expected to fall below the one-third threshold and did not replace it. That had been the only provision directing the guaranty agency to take or not take particular action based on the two-step analysis. Thus, after the change, guaranty agencies were still told to carry out the two-step analysis, but had no explicit instructions about what to do with the results.¹⁷⁵ The

168 1990 GSLNPRM, *supra* note 161, at 48,324. Although some rules in the NPRM were to “implement new statutes,” as opposed to policy initiatives, *id.* at 48,324, the statute-implementing rules did not include the discharge consent provisions. *See id.* at 48,324-27. *See also id.* at 48,332 (discharge consent provisions are “Other Regulatory Changes”).

169 *See id.* at 48,332 (summarizing proposed changes to 34 C.F.R. 682.402(g) without providing justification).

170 *See* 1992 FFEL Rules, *supra* note 162, at 60,285-322 (describing Department responses to comments and changes from NPRM to final rule without mentioning 34 C.F.R. § 682.402(g)).

171 *See* Federal Family Education Loan Program and William D. Ford Federal Direct Loan Program, 64 Fed. Reg. 58,938, 58,960 (Nov. 1, 1999) [hereinafter 1999 FFEL Ford Final Rules] (codified at 34 C.F.R. § 682.402(i)(1)(iv)). The codification of the bankruptcy rules at 34 C.F.R. § 682.402(i) indicates that they had been renumbered since the 1992 rulemaking. A comparison of historical versions of the Code of Federal Regulations on LEXIS/NEXIS indicates that the renumbering took place in 1993. The author has been unable to find more information on the renumbering.

172 *Id.* at 58,938 ((codified at 34 C.F.R. § 682.402(i)(1)(iv)).

173 *See* discussion *supra* Part II.A.2.b.

174 *See* discussion *supra* Part II.A.2.b.

175 It is possible that 34 C.F.R. § 682.402(i)(1)(iv) governed the decision whether to oppose discharge. If so, the agency would have been under an unqualified duty to use due diligence, or to use due diligence to avoid discharge. As explained above for the parallel Perkins rules, *supra* notes 50-51 and accompanying text, such a reading is probably incorrect.

Department described the 1999 changes as amendments to “filing procedures” and did not further explain them.¹⁷⁶

The Department restored some guidance in 2001. In that year, it added a sentence expressly stating that the guaranty agency “may, but need not” oppose discharge if it determines that doing so would cost more than one third the amount owed on the loan.¹⁷⁷ Thus, from 1986 to 2001, the rules evolved from providing that the holder “shall diligently contest” discharge in all cases to silence in most possible cases, coupled with an affirmative grant of discretion in the case where undue hardship is absent and opposing discharge would be cost-ineffective.

By addressing that one case, the change provided some clarity that had been lacking. But even after the change, the regulations did not specify what was supposed to happen if the guaranty agency found that repayment would entail undue hardship or if it expected that opposing discharge would cost less than one third of the balance. The 2001 amendment was the last change to date to the FFELP bankruptcy discharge opposition rules.

The Department did not explain its reasoning in 2001. It described the change as one of a series of “needed technical corrections and other clarifying changes to the FFEL and Direct Loan program regulations” that did “not affect the substantive rights or obligations of any affected parties.”¹⁷⁸

d. Treatment of Federally Held FFELP Loans

During the history of the GSL/FFEL program, the Department would litigate some GSL/FFEL bankruptcies itself. The most common situation in which this occurred seems to have been the bankruptcy of a borrower of a loan that was directly insured by the federal government rather than by a guaranty agency.¹⁷⁹

176 1999 FFEL Ford Final Rules, *supra* note 171, at 58,938; Federal Family Education Loan Program and William D. Ford Federal Direct Loan Program, Notice of Proposed Rulemaking, 64 Fed. Reg. 43,428, 43,432 (Aug. 10, 1999). The 1999 rules also contained a change to reflect the elimination of any exception to nondischargeability for older student loans. *See id.* at 58,960 (codified at 34 C.F.R. § 682.402(i)(1)(i)-(ii)) (providing that inquiry into whether loans are seven or more years old applies only to bankruptcies filed before October 8, 1998).

177 Federal Family Education Loan Program and William D. Ford Federal Direct Loan Program, 66 Fed. Reg. 34,762, 34,763 (June 29, 2001) [hereinafter 2001 FFEL Ford Final Rules] (codified at 34 C.F.R. § 682.402(i)(1)(iii)).

178 2001 FFEL Ford Final Rules, *supra* note 177, at 34,762.

179 Under the 1978 proposed rules for federally insured loans, upon the government’s payment of a bankruptcy claim to the lender, the lender assigned the note and a proof of claim, accompanied by a statement of grounds for an objection to discharge, to the federal government. *See* 1978 GSL NPRM, *supra* note 145, at 14,412 (proposing 45 C.F.R. § 177.64(b), “[p]ayment of a claim shall be contingent upon receipt of an assignment” of the note and any proof of claim); *id.* (proposing 45 C.F.R. § 177.64(a), claim to include “a statement as to any objections to the discharge in bankruptcy of which the holder may be aware.”). The 1979 rules adopted the assignment and statement-of-basis provisions. *See* 1979 GSL Final Rule, *supra* note 107, at 53,891 (codified at 45 C.F.R. § 177.516(a)(4) & (a)(4)(ii)); *id.* at 53,892 (codified at 45 C.F.R. § 177.516(e)(4)(iv)). The holder was not required to note the undue-hardship provision as a basis for objection, but was expected to provide notice of the fact that “the debtor has assets available to pay the debt,” if that was known to be true. *Id.* at 53,915-16. The Commissioner of the Office of Education, and not the lender, was responsible for fighting discharge

The Department has never set any rules governing its decision whether to oppose bankruptcy discharge.¹⁸⁰ The 1976 and 1978 NPRMs did not mention the United States' decision whether to oppose discharge at all, and the 1979 rules indicated only that, "[t]he Commissioner [of the Office of Education, Department of Health, Education, and Welfare (HEW)] will contest the bankruptcy discharge if the case warrants such action."¹⁸¹ Indeed, in a response to a comment HEW suggested that the fact the government would handle the bankruptcy was precisely why a regulation was unneeded.¹⁸²

The 1985 NPRM and ensuing 1986 rules also said nothing about what the government would do in the case of borrower bankruptcy.¹⁸³ Presumably, this absence reflected the Secretary's intention, declared in the 1985 NPRM, to "exercise the full discretion accorded by 20 U.S.C. 1082(a)(5) and (a)(6) to decide, on a case-by-case basis, whether the interests of the United States are served by refraining from collection on all or part of a defaulted loan."¹⁸⁴ Subsequent bankruptcy rules, including the landmark 1992 rules, did not adopt any policy governing the Secretary's behavior.

C. The William D. Ford Federal Direct Loan Program

Under the Ford program, the federal government makes loans to students. Ford is the largest federal loan program, with a balance of \$1.198 trillion outstanding as

of federally insured loans, where there was no guaranty agency. See 1979 GSL Final Rule, *supra* note 107, at 53,915 (explaining that the time necessary "to expedite the Commissioner's objection to a discharge in bankruptcy" was a consideration in setting the deadline for submission of bankruptcy claims); *id.*, at 53,914 (after lender files proof of claim, it has "no other responsibilities for contesting the discharge in bankruptcy). The 1986 rules for bankruptcies involving federally guaranteed loans were similar to the 1979 rules. The government would pay the lender and take an assignment of the note upon the borrower's filing a bankruptcy petition. See 1986 GSL PLUS Final Regulations, *supra* note 117, at 40,917 (codified at 34 C.F.R. § 682.511(a)(1)(iii) & 682.511(c)).

180 The Department has issued regulations governing its own conduct with respect to other aspects of the FFELP. See, e.g., 34 C.F.R. § 682.300(a) (2019) ("The Secretary pays a lender, on behalf of a borrower" certain interest payments).

181 1979 GSL Final Rule, *supra* note 107, at 53,914.

182 *Id.* ("Several commenters asked how the provision in the Education Amendments of 1976 ... limiting discharges in bankruptcy during the first five years after leaving school would affect these regulations. *Response:* Since the 5-year nondischargeability provision affects the loan after the lender assigns to [the Office of Education], the provision has no effect on the payment of claims or on the lender's responsibilities."). The conduct of the bankruptcy after assignment to the federal government was outside the scope of the regulation.

183 See 1986 GSL PLUS Final Regulations, *supra* note 117, at 40,913-19 (codified at 34 C.F.R. §§ 682.500-682.515) (providing rules for federally insured GSL and PLUS loans and not addressing whether government would oppose borrower's petition for discharge).

184 1985 GSL PLUS NPRM, *supra* note 151, at 35,966. 20 U.S.C. §§ 1082(a)(5) and (a)(6) provide that the Secretary "may" "(5) enforce, pay, or compromise, any claim on, or arising because of, any such insurance or any guaranty agreement under section 1078(c) of this title; and (6) enforce, pay, compromise, waive, or release any right, title, claim, lien, or demand, however acquired, including any equity or any right of redemption." Section 1078(c) covers guaranty agency programs. 20 U.S.C. § 1078(c) (2019).

of the middle of 2019.¹⁸⁵ It is also, after expiration of the Perkins loan program in September 2017,¹⁸⁶ the only major generally available federal student loan program under which loans are made.¹⁸⁷

Because the federal government is the lender in the Ford program, the analysis of involved entities and incentives is less complex than for the Perkins or FFEL programs. The Department apparently conceives its goals in deciding whether to consent to discharge as “balanc[ing] its obligation to collect debts with judging whether the repayment of loans would constitute an undue hardship to borrowers.”¹⁸⁸ In the Department’s view, whether undue hardship exists is to be determined according to tests developed by the federal courts.¹⁸⁹

1. Ford Program Current Rules

The Department’s regulations collected under the heading “William D. Ford Federal Direct Loan Program” do not address whether or when the Department will oppose bankruptcy discharge of direct loans.¹⁹⁰ The 2015 Dear Colleague Letter applies to all three programs, and insofar as it is based on the FFEL and Perkins regulations, it applies those regulations to the Ford program.¹⁹¹ As discussed,¹⁹² the Department has not adopted discharge consent regulations governing loans it holds under the Perkins and FFEL programs, so perhaps it is unsurprising that there are no regulations governing discharge consent for government-held loans under the Ford program.

185 U.S. DEP’T OF EDUC., *supra* note 32.

186 See, e.g., Madeline St. Amour, *Perkins Loan Program Expires Despite Attempts to Save It*, PORTLAND MORNING SENTINEL (Oct. 14, 2017) <https://www.pressherald.com/2017/10/14/perkins-loan-program-expires-despite-attempts-to-save-it/> (reporting that Perkins program expired Sept. 30, 2017).

187 TEACH grants, which are aimed at teacher education, convert to loans if the recipient does not complete a service obligation. See *Federal Student Aid*, U.S. DEP’T OF EDUC., <https://studentaid.ed.gov/sa/types/grants-scholarships/teach> (last visited Feb 5, 2019).

188 2015 Dear Colleague Letter, *supra* note 14, at 1.

189 *Id.* at 3.

190 See William D. Ford Federal Direct Loan Program, 34 C.F.R. Part 685 (2019) (not addressing opposition or consent to discharge). The regulations do provide for administrative forbearance pending the bankruptcy. See *id.* § 685.205(b)(4). They also explicitly provide that the Secretary will not require any further payments on a loan discharged in bankruptcy. *Id.* § 685.212(c). This provision may be unnecessary because the Bankruptcy Code forbids actions to collect a discharged debt. See 11 U.S.C. § 524(a)(2) (2019).

191 The regulations governing guaranty agencies’ opposition to FFEL loan discharge arguably apply, through incorporation by reference, to the Department’s decision to oppose discharge of a Ford loan. The Higher Education Act provides that direct loans “shall have the same terms, conditions, and benefits ... as loans made to borrowers, and first disbursed on June 30, 2010 under sections 1078, 1078-2, 1078-3, and 1078-8”. 20 U.S.C. § 1087e(a)(1) (2019). The enumerated provisions govern various types of FFEL loans. Thus, if the rules governing a guaranty agency’s response to a borrower’s petition for discharge are “terms, conditions [or] benefits” of the loan, rules borrowed from these other provisions might govern the Department’s conduct. This argument would have to contend with the fact that the FFEL rules govern guaranty agencies, not the Department, so that they cannot literally govern the Department’s conduct when the borrower seeks to discharge a direct loan. However, discharge policies might appear to be “terms, conditions, or benefits” from the borrower’s perspective, whether implemented by the guaranty agency or the Department.

192 See discussion *supra* Parts II.A.2.c, II.B.2.d.

2. Ford Program Rules History

The only statement of Department policy relating to the Direct Loan Program appears to be the 2015 Dear Colleague Letter. The author has been unable to locate any materials bearing directly on the history of the letter or of Department policy for direct-loan bankruptcies more generally. According to the letter, the substantive standards for deciding whether to oppose direct-loan discharge are identical to those for deciding whether to oppose discharge of direct loans under the FFEL and Perkins programs, suggesting that those programs' regulations are the source for the direct-loan bankruptcy policy.

D. The 2015 Dear Colleague Letter in Light of the Regulations

The 2015 Dear Colleague Letter interprets the regulations just described. In so doing, it purports to fill the gaps and resolves the ambiguities identified above. Unlike the Perkins and FFEL regulations, the letter probably tells holders what to do when repayment would cause undue hardship: they are to consent to discharge.¹⁹³ It resolves the scope of the awkward 1999 amendments that potentially instruct holders to oppose discharge under any and all circumstances¹⁹⁴ by not discussing them, thus essentially reading them out of the rules. Unlike the regulations,¹⁹⁵ the letter provides clear guidance about what to do if undue hardship is absent and the holder applies the one-third-of-balance test.¹⁹⁶ Most importantly, the letter sets out borrower-bankruptcy rules for the largest federal loan program, the William D. Ford Direct Loan program.¹⁹⁷ That is important because there are no regulations governing borrower bankruptcies under this program.¹⁹⁸

The letter is clearly a step toward addressing the technical issues with the regulations. However, the letter is a guidance document.¹⁹⁹ Such documents cannot contradict the regulations and therefore cannot fix their more fundamental problems.

II. Evaluating the Student Loan Bankruptcy Discharge Rules in Light of Their History

This Part identifies three problems with the Department's regulations that are apparent from the historical review and proposes approaches to mitigating them. They are presented in ascending order of generality.

193 See Hunt, *supra* note 4, at 10, for discussion of the letter's ambiguity on this point and how that ambiguity should be resolved.

194 See discussion *supra* Parts II.A.2.c, II.B.2.d.

195 See discussion *supra* Parts II.A.1, II.B.1.

196 See discussion *supra* Part I.B.

197 See discussion *supra* Part I.B.

198 See discussion *supra* Part II.C.1.

199 See 2015 Dear Colleague Letter, *supra* note 14, at 1.

First, the history reveals that the Department's regulations have been ambiguous and incomplete since the 1980s,²⁰⁰ and that the Department introduced more ambiguity in 1999.²⁰¹ The Department should consider clarifying the language in the regulations themselves, not just in an interpretive letter. It should revise the unclear language added in 1999 to the Perkins and FFELP program regulations to make clear that there is no unqualified requirement to oppose discharge. The Department should also make clear that when undue hardship is present, the holder is to consent to discharge.²⁰²

Second, our review has shown that holders have tremendous discretion under the regulations and that how they decide to exercise that discretion is not transparent to borrowers. We have seen how discretion for FFEL program holders steadily expanded from 1986 to 2001.²⁰³ We have also seen that the Department never adopted any formal rules governing the government's consent to discharge of loans it holds – now by far the largest category of loans outstanding.²⁰⁴

The Department should adopt bright-line rules that at least create a presumption in favor of discharge when certain objectively defined conditions are met, such as when the borrower has income at or near the poverty line and is recognized by a federal agency as disabled. Such rules would alleviate borrower uncertainty and constrain the very broad discretion holders currently enjoy.²⁰⁵ Professors Matthew Bruckner, Pamela Foohey, Brook Gotberg, Dalié Jiménez, and Chrystin Ondersma have presented a detailed proposal along these lines.²⁰⁶

Third, the Department has devised its policy using an unduly cramped frame of reference that takes into account only legal constraints and cost-effectiveness. This was apparent in the explanation of the original 1987 Perkins program rules, where the only expressed substantive value was protecting federal finances. The situation has not improved since then. Nothing requires the Department to use the undue-hardship standard from the Bankruptcy Code in deciding whether holders should consent to discharge.²⁰⁷

Instead, the Department should be guided by the overall purposes of the student-loan programs in crafting its discharge policy.²⁰⁸ The Department should

200 See discussion *supra* Parts II.A.1, II.A.2.a, II.B.1, II.B.2.a.

201 See discussion *supra* Parts II.A.2.b, II.B.2.c.

202 See Hunt, *supra* note 4, at 17-22, for more detail.

203 See discussion *supra* Part II.B.2.c.

204 See discussion *supra* Parts II.A.2.c, II.B.2.d, II.C.1.

205 See Hunt, *supra* note 4, at 22-29, for more detail.

206 See Matthew Bruckner, Brook Gotberg, Dalié Jiménez & Chrystin Ondersma, *A No-Contest Discharge for Uncollectable Student Loans*, COLO. L. REV. (forthcoming 2020) (manuscript at 6-7), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3366707 (describing nine objectively defined sets of circumstances in which the authors argue that the Department should consent to student-loan discharge in bankruptcy); Jiménez et al., *supra* note 123, at 115 (2018) (presenting earlier version of proposal).

207 The companion paper *Consent to Student-Loan Bankruptcy Discharge* develops this argument in more detail. See Hunt, *supra* note 4, at 29-30, 43-56.

208 See Hunt, *supra* note 4, at 30-34, for more detail.

recognize that overly strict policies interfere with underlying goals of student loans such as providing access to education, giving the country the benefit of an educated population, and not allowing loans to interfere unduly with career choice.²⁰⁹ As an executive agency, the Department is better situated than the courts to devise a bankruptcy policy that balances monetary recovery and combating borrower bad faith against avoiding borrower suffering and achieving the overarching education-related goals of the loan programs.

Concretely, the Department should abandon its policy of opposing discharge whenever undue hardship is absent and the cost of opposing discharge falls below the one-third threshold. It should craft a more generous policy, one that takes account of the overarching goals of the student loan programs it administers. Such a policy could include consenting to discharge where the borrower is successful in a low-paying field for which the borrower was trained, allowing a high debt-to-income ratio to create a rebuttable presumption that discharge should be allowed, and developing rules providing for consent to discharge when student loans have turned out to be harmful to the borrower.²¹⁰

209 See Hunt, *supra* note 5, at 5-40, for more detail.

210 See Hunt, *supra* note 5, at 49-62, for more detail.