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JUDGES WOULDN'T CONSIDER FORGIVING CRIPPLING STUDENT LOANS – UNTIL NOW

For decades, college debt was immune from the bankruptcy process. Judges are actively seeking ways help to debtors

By Katy Stech Ferek
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For decades, bankruptcy judges refused to consider reducing student loans. That is now changing, and some judges are throwing lifelines to people struggling to repay their debt.

In interviews with the Wall Street Journal, more than 50 current and former bankruptcy judges, frustrated at seeing borrowers leave federal courtrooms with six-figure debts, say they or their colleagues are more open to chipping away at the decades-old guidelines that determine how such debt is treated.

"If the law's not going to be improved by Congress, we have to help these young people who are drowning in student loan debt," said U.S. Bankruptcy Court Judge John Waites in South Carolina.

Outright cancellations remain rare, but judges said they have other tools at their disposal, including encouraging lawyers to represent borrowers for nothing. The lawsuits can cost \$3,000 to \$10,000 and take years.

Other judges are embracing debt-relief techniques that don't fully erase student loans but make repayment more affordable by, for instance, canceling future related tax bills. The popularity of these relief strategies could get a boost from a panel of professors, judges and advocates who are studying failures in consumer bankruptcy law and plan to release a report next year.

Nearly 45 million people carry student debt in the U.S. – the total amount has more than doubled over the past decade to \$1.4 trillion – most backed by the federal government. It has eclipsed credit cards as the largest source of consumer debt after mortgages. Almost every other type can be extinguished in bankruptcy, but legal standards made college debt largely untouchable. Borrowers typically must repay student loans over their lifetime, even those facing extreme financial hardship.

In March, Federal Reserve chairman Jerome Powell said he would be "at a loss to explain" why student loans can't be cancelled like other debt. The Trump administration is considering whether to fight cancellation requests less aggressively.

Consumer bankruptcy lawyers are starting to notice that judges are being more flexible. One Las Vegas law firm recently filed the first cancellation request in its 14-year history after hearing a judge at a conference voice concern over student loans. Other lawyers said growing sympathy among judges is making lenders more willing to reach resolutions out of court.

"I'm getting really good results with settlements these days," said Chicago lawyer David Leibowitz. "I'm not the only one."

Rules governing how student debt is handled in bankruptcy are made by Congress and by judges who issue influential rulings. Several bills in Congress that would erase student-loan debt in bankruptcy have stalled in recent years.

Last year in Philadelphia, U.S. Bankruptcy Court Judge Eric Frank cancelled a single mother's \$30,000 in student loans. Opposing lawyers from the U.S. Department of Education said the borrower needed to prove her hardship would persist 25 years, the length of some repayment plans. Judge Frank ruled that the relevant window was five years.

An appeals court overturned his ruling, but his decision inspired Judge Mary Jo Heston in Tacoma, Wash., in December to cancel a portion of another borrower's loans.

Such rulings are rare because few troubled borrowers attempt to cancel their student loans, because of the historically slim chances of victory. Last year, only 473 people of the millions repaying student loans sought relief using bankruptcy, according to a Wall Street Journal analysis.

No one tracks outcomes of student-loan cancellation cases, and only a handful advance to the point where a judge rules. In one examination of cases in 2017, judges ruled on student-loan debt 16 times, according to lawyer Austin Smith who analyzed WestLaw's database of key decisions.

In those decisions, judges preserved student-loan debt in 12 cases, and canceled it in three. One borrower got partial relief.

Some bankruptcy judges criticize their colleagues for re-interpreting well-settled law on student loans. "My view is, if the law is clear, follow it," said retired California judge Peter Bowie.

The push to rethink the legal standard on student-loan debt is bipartisan. Judges interviewed by the Wall Street Journal were appointed during both Republican and Democratic administrations, though bankruptcy judges are appointed by appeals court judges, not the president.

Disagreements among judges on student-loan debt expose philosophical differences, said Cornell Law School professor Jeffrey Rachlinski. Some judges want to maintain predictability by sticking to past law. Others see their roles as fixing flaws in the legal system, he said. "There are people who like to change the institution in which they work."

Before 1976, laws allowed borrowers to do away with student-loan debt in bankruptcy. Congress, out of concern that new graduates would take too much advantage of that option, made a new rule: Borrowers could cancel student loan debt after only five years of payments. Judges could grant exceptions if borrowers showed that repaying would cause "undue hardship."

Congress didn't define "undue hardship" so the task of doing so fell to federal judges. When Marie Brunner, a 1982 graduate of a master's program in social work, tried to cancel her loans in bankruptcy, a New York judge in 1985 said she had to show three things: she

struggled financially, her struggles would continue and that she had made a good faith effort to repay. She lost.

That list still serves as a baseline for hardship in circuit courts that control the rules in most states. Some appeals courts set even higher benchmarks, with one, for instance, saying borrowers must face a "certainty of hopelessness."

In 1998 Congress said any borrower trying to cancel any federal student loans must prove "undue hardship," like Ms. Brunner. Congress gave private student loans the same protection in 2005.

Some of the country's bankruptcy judges are starting to argue that the prevailing legal standard is unintentionally harsh and wasn't meant for adults still on the hook for student-loan debt years after college.

Judge Frank Bailey in Boston made that argument in an April ruling wiping out \$50,000 in student loans for a 39-year-old man whose health ailments prevent him from working.

Frustrated judges are more likely to "look for wiggle room and try to find solutions that will allow them to sleep at night," said Terry Maroney, a Vanderbilt Law School professor who studies judicial decision-making.

Some judges, including U.S. Bankruptcy Court Judge Michael Kaplan in Trenton, N.J., said they are looking for ways to be more forgiving after seeing their own adult children borrow heavily for their education. Other judges grew concerned after talking to their law clerks. The typical law-school student takes out \$119,000 in loans, according to the legal-education watchdog group Law School Transparency.

Two judges said they regret their rulings against borrowers more than a decade ago. One Florida judge said that if the case was filed today, the borrower would win.

Kansas judge Dale Somers said he worked particularly hard to justify the reasoning in a December 2016 ruling that cancelled more than \$230,000 in interest that built up on a couple's student loans from the 1980s. They left bankruptcy owing the original amount: \$78,000.

Alabama judge William Sawyer declared that student loans had become "a life sentence" in a 2015 decision cancelling a \$112,000 student loan debt for high school science teacher Alexandra Conniff, a single mother of two teen boys whose yearly income is \$59,400.

She took out loans for several degrees, including a Ph.D. in special education, a discipline she also taught. Repaying them over 15 years would cost \$843 a month.

Ms. Conniff testified she has been unable to land higher-paying jobs and keeps costs down. Federally contracted lawyers argued she could cut retirement savings, life insurance payments and \$100 in monthly landline-phone costs. The case is under appeal and was sent back to Judge Sawyer to re-rule.