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Committee on the Judiciary

Subcommittee on the Administrative State, Regulatory Reform, and Antitrust

Hearing on Bankruptcy Law: Overview and Legislative Reforms

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The charge of this hearing is to "examine whether bankruptcy law is continuing to strike the correct balance between the rights of creditors and debtors or whether narrowly tailored updates are necessary to maintain the viability of the bankruptcy system for small businesses, consumers, and creditors." In this statement, I first discuss two narrowly tailored proposals with bipartisan support that warrant swift enactment. Then I address two challenging topics that have prompted calls for reform.

Before diving into the details, let us reflect on the broader context: Article 1 Section 8 of the United States Constitution expressly authorizes national bankruptcy laws. While I favor a relatively narrow interpretation of this authority, the main topics for the hearing fall squarely into this category. Effective and fair bankruptcy relief is of critical importance to the economy and to maintaining the legitimacy of the legal system.

Promoting Fair and Effective Small Business Reorganization: Restoring Broader Eligibility for Subchapter V of Chapter 11

In 1978, a bipartisan group of law makers enacted major reforms to American bankruptcy law, including a reimagining of corporate reorganization. The new Chapter 11 was meant to preserve and enhance a company's economic value and keep alive viable businesses for the benefit of creditors of various kinds, workers, and other stakeholders.

For small businesses, often described as the backbone of the economy, these aspirations applied well but Chapter 11 itself did not. For decades, experts have recognized that Chapter 11 was too costly and cumbersome for smaller businesses and their creditors. Fifteen years ago, Judge A. Thomas Small (Bankruptcy E.D.N.C.), former in-house bank counsel with deep expertise in small business and farm bankruptcies, testified that Chapter 11 continued to fall short on its objectives in small business cases, and that the 2005 amendments to the Bankruptcy Code made small business reorganization even less feasible.[1] That's why the Small Business

[1] Testimony of A. Thomas Small on behalf of the National Bankruptcy Conference before the Senate Judiciary Committee's Subcommittee on Administrative Oversight and the Courts, Hearing on Could Bankruptcy Reform Help Preserve Small Business Jobs, March 17, 2010.

Reorganization Act, signed into law by President Trump in 2019, was such an important development.

SubChapter V, the small business reorganization track created by that law, became effective in February 2020. Very shortly thereafter, the Coronavirus Aid, Relief, and Economic Security Act expanded eligibility for SubChapter V. That expanded eligibility has since expired, reducing accessibility of this important law for small businesses and their creditors.

At issue is a simple proposal: permanent restoration of the $7.5 million debt cap (indexed for inflation) for SubChapter V cases. My initial ambivalence about broader eligibility has been overcome based on the research, published case law, and hearing the experiences of judges and lawyers around the country. The track record makes clear that this simple amendment is among the most important steps Congress could take to ensure bankruptcy plays its crucial economic and legal role, and I fully support it. There is no reason to stay anchored to the eligibility limit to which the statute has reverted (approximately $3 million).

It is often noted that SubChapter V lacks some of the requirements that traditional Chapter 11 contains. That is true, particularly in the plan confirmation process. But the drafters filled any gaps with powerful, and arguably more effective and well targeted, protections for creditors and other stakeholders. For example, trustees are appointed in SubChapter V cases, a significant monitor rarely seen in traditional Chapter 11. Moreover, the provisions of SubChapter V do not exist in a vacuum – an array of oversight mechanisms and requirements built into the architecture of the bankruptcy system more generally apply here as well.

As the research of other hearing witnesses illustrates, the justifications for restoring broader eligibility for SubChapter V are independent of a pandemic or other such crisis. SubChapter V could be valuable in response to future crises, but I know of no justification for deferring restoration.

Funding Congressional Mandates: Updating Base Compensation for Chapter 7 Trustees

As suggested above, operation and oversight of the bankruptcy system depends on a mixture of public and private institutions and actors. The private parties who agree to serve as trustees, with government oversight, play a central role. The list of duties for trustees in the most common type of case, Chapter 7, is long and has grown over time. Among other roles, trustees help ensure that creditors' claims are valid under applicable nonbankruptcy law, a matter that is important to all participants in a bankruptcy case and to the system as a whole.

To date, Congress has expanded Chapter 7 trustee responsibilities without adjusting their base compensation, not even for inflation.[2] Importantly, H.R. 3867, the Bankruptcy

[2] A temporary measure for supplemental compensation (currently section 330(e) of the Bankruptcy Code), is by design not a reliable source of payment and is set to expire in 2026.

Administration Improvement Act of 2025, provides this much-needed update without raising the fees for financially distressed families to access Chapter 7 filing.

The Treatment of Student Loans of Financially Distressed Bankruptcy Filers

Although federal bankruptcy law provides relief from many kinds of obligations, there have always been exceptions. The section of the Bankruptcy Code governing student loans, section 523(a)(8), has been amended so many times that it operates almost completely differently from its original terms.[3] Several details should be kept in mind when considering reform.

Scope: The classic justification for restricting discharge of student loans is to protect the public fisc, particularly public funds dedicated to educational advancement. But since 2005, section 523(a)(8) protects for-profit lenders making completely private educational loans. As researchers have explored, private student loans are an entirely different type of financial product, with a different origination process, from traditional student loans.[4] One approach to rationalizing this provision is to amend section 523(a)(8) to exclude private student loans and focus on government- made, insured, or guaranteed educational loans.[5]

Criteria and procedure for relief from student loans in bankruptcy: Even when the scope of protected student loans was narrower, there was a time when American bankruptcy law provided three paths to student loan discharge.

- Path One related to the age of the student loan. For example, starting in the 1970s, bankruptcy law provided that if the loan was first subject to repayment at least five years before the bankruptcy filing, it could be discharged. Congress later extended that time period to seven years and then eliminated Path One. It would have been particularly relevant to many older Americans carrying student loan debt today.[6]
- Only if a loan was more recent would Path Two become relevant: bring a lawsuit alleging that the student loan imposed an "undue hardship" on the debtor and dependents.

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[3] Student loans are one example of how costly and complex personal bankruptcy has become without evidence of corresponding benefits. For an analysis by economists of the system's needless complexity, and a proposal for simplification supported by historical practices, see Richard M. Hynes & Nathaniel Pattison, A Modern Poor Debtor's Oath, 108 Va. L. Rev. 915 (2022).

[4] Xiaoling Ang & Dalié Jiménez. 2015. "Private Student Loans and Bankruptcy: Did Four-Year Undergraduates Benefit from the Increased Collectability of Student Loans?" In Student Loans and the Dynamics of Debt, Brad Hershbein and Kevin M. Hollenbeck, eds. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, pp. 175-234. See generally Melissa B. Jacoby, A Dose of Common Sense in the Treatment of Private Loans in Bankruptcy, New America Higher Ed Watch, May 19, 2010.

[5] E.g., H.R. 423, Private Student Loan Bankruptcy Fairness Act of 2025.

[6] E.g., Tia Caldwell & Sarah Sattelmeyer, Why Do So Many Older Americans Owe Student Loans, New America, May 31, 2023 (using credit bureau, GAO, Department of Education, and Federal Reserve Bank of Philadelphia data, among other sources).

- Path Three involved initiating and completing a Chapter 13 repayment plan, to which section 523(a)(8) did not apply (today it does apply to Chapter 13).

In other words, earlier iterations of bankruptcy law offered some financially distressed individuals relief from student loans without filing and winning an undue hardship lawsuit. Notably, key case law narrowly interpreting the term undue hardship developed during this time when there were other paths to discharge.

M. Caldwell Butler, Republican Congressman from Roanoke Virginia, a principal co-sponsor of the Bankruptcy Reform Act of 1978, ultimately found even this more forgiving approach to student loans difficult to justify. After returning to private practice, Congressman Butler, a member of the National Bankruptcy Review Commission in the 1990s, led a majority of that commission to propose the complete repeal of section 523(a)(8).[7]

The procedure underlying section 523(a)(8), the provision governing student loan nondischargeability, also bears emphasis. To effectuate some other exceptions to discharge in the Bankruptcy Code, the *creditor* must initiate a lawsuit and prove that the exception is met. Under section 523(a)(8), the *debtor* must file (and win or settle) an undue hardship lawsuit.[8] Even if a financially distressed individual has struggled to stay current on a student loan and lives in a circuit with a slightly more flexible undue hardship standard, there's a good chance a court will never even get the chance to consider undue hardship because the debtor cannot afford to hire a lawyer to bring the lawsuit, which is separate from the fee for preparing the bankruptcy filing.

Broader personal bankruptcy context: The student loan exception to discharge and the undue hardship standard long precede the 2005 amendments that imposed many new requirements on all individuals and families who file for bankruptcy – including a means test in Chapter 7 that is also used in some Chapter 13 cases to determine payment plans. All personal bankruptcy filers are subject to scrutiny and submit documentation of their financial distress.

Customer Data Privacy and the Role of Applicable Nonbankruptcy Law

Although this hearing is largely focused on the most common types of bankruptcy (personal bankruptcy and small business), the bankruptcy filing of 23andMe, a direct-to-consumer genetic testing company, has generated legislative interest.[9] 23andMe's bankruptcy attracted attention not only because its database includes the genetic and personal information of millions of customers, and not only because it recently experienced a major cybersecurity breach, but because it entered bankruptcy with the stated intention to sell itself on a fast track and

[7] Report of the National Bankruptcy Review Commission Proposal 1.4.5, October 20, 1997. See also Student Borrower Relief Act of 2024 H.R. 9931 (118th Cong. Oct. 4, 2024).
[8] The procedures by which the Department of Justice and Department of Education may be willing to settle these lawsuits are provided here.
[9] See, e.g., S. 1916, Don't Sell My DNA Act, introduced May 22, 2025.

has taken some positions on the (in)applicability of data privacy laws of concern to state attorneys general and others.

To the extent Congress adds more robust customer data privacy protections to federal law, as some privacy experts endorse, those protections should apply whether or not bankruptcy is the forum for the transaction.[10] I would be glad to field questions on this topic, along with the others that fall more squarely in the intended scope of the hearing.

[10] Sara Gerke, Melissa B. Jacoby, & I. Glenn Cohen, Bankruptcy, Genetic Information, and Privacy, 392 New England Journal of Medicine 937-939 (March 6, 2025); Sara Gerke, Melissa B. Jacoby, & I. Glenn Cohen, 23andMe's Bankruptcy Raises Concerns About Privacy in the Era of Big Data, 389 British Medical Journal 1071 (May 27, 2025).