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Legal Sidebar

Student Loan Cancellation Reaches the Supreme Court

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Nearly all litigants who successfully petition the Supreme Court to hear their claims do so after losing appeals in another court, such as in a state supreme court or a federal circuit court of appeals. There is, however, a category of federal appeals of "such imperative public importance as to justify deviation from normal appellate practice and to require immediate determination" in the nation's highest court. Statute and the Supreme Court's rules thus authorize a process, called *certiorari before judgment*, under which the Court agrees to hear cases on their merits before the lower federal courts finally dispose of them. The Court has exercised this authority to decide some of its most seminal modern cases.

Student loan cancellation has prompted further use of this process. In December 2022, the Supreme Court twice exercised this extraordinary authority, without recorded dissent, in litigation challenging the Biden Administration's one-time student loan cancellation policy. On December 1, the Court granted certiorari before judgment in litigation brought by six states, which was then pending in the U.S. Court of Appeals for the Eighth Circuit (Eighth Circuit). On December 12, the Court used the same procedure to accept jurisdiction over litigation brought by two student loan borrowers who were defending a favorable district court judgment in the U.S. Court of Appeals for the Fifth Circuit (Fifth Circuit). The Court's orders state that the Court will hear both cases during its February 2023 argument session.

This Sidebar provides a first look at the two cases now before the Court. The Sidebar summarizes the cancellation policy targeted by the plaintiffs' claims. Next, the Sidebar introduces and describes the standing and merits questions presented by these two appeals. The Sidebar ends with a summary of next steps, which will inform a more extensive review of the litigation and considerations for Congress.

The Cancellation Policy

On August 24, 2022, the Biden Administration announced that the Secretary of Education (Secretary) would exercise asserted statutory authority under the Higher Education Relief Opportunities for Students Act of 2003 (HEROES Act) to cancel certain federal student loan debt. The statute authorizes the Secretary to "waive or modify any statutory or regulatory provision applicable to the student financial assistance programs" under Title IV of the Higher Education Act (HEA) (which authorizes the primary federal student loan programs) "as the Secretary deems necessary" for a variety of purposes. For example,

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waivers or modifications may be used to ensure that individuals affected by a national emergency "are not placed in a worse position financially" in relation to that assistance because of the emergency. The Secretary is to publish any waivers or modifications "by notice" in the *Federal Register.*

Eligibility under the cancellation policy turns on (1) a borrower's income; (2) whether the borrower received a Pell Grant (a type of Title IV student financial assistance for individuals who show financial need); and (3) the type of federal student loan(s) the borrower owes.

To qualify, a borrower's 2020 or 2021 adjusted gross income (AGI) must have been less than $125,000 (for individuals or married borrowers who file separately) or $250,000 (for married couples filing jointly, among others). The policy allows certain borrowers to qualify based on one or both parent's AGI.

For borrowers who meet this income rule, their history as Pell Grant recipients will determine the amount of cancellation benefits they will receive. All eligible borrowers will see up to $10,000 in cancellation benefits. In addition, eligible borrowers who received a federal Pell Grant at any point will receive up to an additional $10,000, for up to $20,000, in benefits.

Finally, not all federal student loans are eligible for cancellation. Federal Direct Loans are eligible. These loans are by far the largest share of the federal student loan portfolio, exceeding $1.4 trillion in outstanding principal and interest as of September 30, 2022. The Department of Education (ED) issues and holds Direct Loans but contracts with servicers to handle billing and other account services.

Loans issued under the Federal Family Education Loan (FFEL) program are also potentially eligible for cancellation. The FFEL program helped students finance higher education until 2010, when authority to issue new loans terminated. Non-federal lenders originated FFEL program loans using their own funds, but the federal government guaranteed those loans against loss in some cases, such as borrower default. More than $200 billion in principal and interest was outstanding on these loans as of September 30, 2022.

Some of these FFEL program loans are held today by the federal government or a guaranty agency (GA), which are state or nonprofit entities that help administer the FFEL program. Other loans remain with other non-federal holders, for which they may be revenue-generating assets. Some non-federal holders have also used FFEL program loans to issue Student Loan Asset Backed Securities (SLABS), which are bonds payable solely from collections on a pool of non-federally held FFEL program loans. SLABS provide issuers with access to credit markets and investors with interest income.

From the policy's inception, only FFEL program loans held by the federal government or a GA were eligible for cancellation. Until September 29, 2022, though, most borrowers with non-federally held FFEL program loans that were not directly eligible could gain cancellation eligibility by consolidating into the Direct Loan program. That is, most such FFEL program borrowers could apply for and receive a new federal student loan (i.e., a new federal Direct Consolidation Loan) to repay an existing loan (i.e., an existing FFEL program loan), thus ending potential future revenue for non-federal holders. ED would then apply cancellation benefits to the new Direct Consolidation Loan. When ED first unveiled the policy, it did not impose a particular deadline for borrowers with non-federally held FFEL program loans to apply for cancellation. On September 29, ED announced that Direct Consolidation Loans consolidating non-federally held FFEL program loans would not be eligible for cancellation if the applications for those Direct Consolidation Loans were filed on or after on or after that date.

Litigation Background

Within weeks of the Biden Administration's announcement, lawsuits challenging the policy were filed in federal district courts across the country. The Supreme Court's recent grants of certiorari before judgment concern two of these cases, filed in federal courts in Missouri and Texas. As a result of these two lawsuits, the Eighth Circuit and a federal district court in Texas have, respectively, enjoined and vacated the cancellation policy. The earliest of these decisions issued on October 21, 2022, before any cancellation had yet occurred under the policy. In both cases, the Administration sought relief in the Supreme Court, which granted certiorari on the questions of whether the plaintiffs have standing to challenge the cancellation policy and whether the cancellation policy is substantively and procedurally lawful.

Standing is a jurisdictional requirement for federal courts arising from Article III of the Constitution, which extends the judicial power of the United States to "cases" and "controversies." Plaintiffs must show that they have suffered an "injury-in-fact" that is fairly traceable to the defendant's allegedly unlawful conduct, and that is likely to be redressed by the remedy sought from the court. As explored more fully below, the litigants in these cases claim standing to challenge the policy using arguments that differ on their specific circumstances.

In contrast, the litigants' arguments about ED's authority to implement this cancellation policy are generally similar across the different cases. The Biden Administration argues that the language of the HEROES Act expressly authorizes the waiver and modifications of borrowers' repayment obligations to lessen loan delinquencies and defaults that ED expects would otherwise occur once it lifts the pandemic-related pause on loan repayment, interest accrual, and involuntary collections (payment pause). Plaintiffs, on the other hand, invoke the major questions doctrine to argue that the HEROES Act is not specific enough to support a program of such major economic and political significance.

Missouri Litigation (*Biden v. Nebraska*)

The state plaintiffs in the Missouri litigation (Arkansas, Iowa, Kansas, Missouri, Nebraska, and South Carolina) argue that the HEROES Act does not authorize the cancellation policy and that the broad-based cancellation of student loans under the policy would result in concrete injury to the states. The district court initially dismissed the suit, holding that none of the plaintiffs had established Article III standing. However, on appeal, the Eighth Circuit concluded that Missouri had shown a probable concrete and particularized injury likely to provide it standing to challenge the cancellation policy.

The injury to Missouri arises from the impact that cancellation would have on the Higher Education Loan Authority of the State of Missouri (MOHELA), an entity created by the Missouri legislature, which acts as a servicer of federal student loans made under the Direct Loan program. As a servicer, MOHELA receives revenue based on the loan accounts that it services, and the Eighth Circuit noted that MOHELA's revenue would decline if the cancellation policy ultimately renders many borrower accounts inactive. Missouri argued that this financial harm to MOHELA should be attributed to the state, because MOHELA is an "arm of the state." While the Eighth Circuit indicated that this arm-of-the-state theory may be correct, the Eighth Circuit placed more reliance on the fact that MOHELA is required to make payments to a fund in the Missouri state treasury to support capital projects at public universities and colleges. The loss of revenue to MOHELA from the policy's effect on serviceable Direct Loan accounts would, according to the Eighth Circuit, hinder MOHELA's treasury payments, resulting in an injury to the state.

In a filing to the Supreme Court before its grant of certiorari, the state plaintiffs continue to press as their primary argument for standing Missouri's injuries from the loss of revenue to MOHELA, both as an arm of the state and as a payer into the state treasury. The Biden Administration argues that MOHELA should not be considered an arm of the state and that the connection between the loss of revenue and MOHELA's inability to make payments to the state treasury is too speculative. The plaintiffs also restate a number of alternative standing claims rejected by the district court, including:

- The loss of state tax revenue resulting from the fact that several states' income tax laws mirror the federal income tax treatment of discharged debt, which was modified in the American Rescue Plan Act of 2021 to exclude student loan discharges before 2026 from federal income taxation; and

- Negative effects that consolidation of FFEL program loans prompted by the cancellation policy will have on states that (1) hold FFEL program loans, (2) use such loans to issue SLABs, or (3) invest in SLABS issued by others.

In addition to the question of standing, the Court also granted certiorari in the Missouri litigation on whether the cancellation policy exceeds ED's authority under the HEROES Act or is arbitrary and capricious. With respect to ED's authority, the state plaintiffs argue that the HEROES Act cannot be fairly read to authorize a program of this scope. Alternatively, the plaintiffs argue that the cancellation policy conflicts with specific elements of the HEROES Act. They argue that ED has not sufficiently causally connected cancellation to the COVID-19 emergency and would impermissibly place borrowers in a *better* position than they were in before the emergency. The state plaintiffs also argue that the program is arbitrary and capricious based on a number of procedural objections to the cancellation policy, claiming that ED did not consider reasonable alternatives to loan cancellation; used the emergency as a pretext for cancellation; failed to justify the parameters of the program; ignored reliance interests of states, lenders, and servicers; and reversed its position of consolidation of FFEL program loans. Because the Court granted certiorari before judgment, the Court will consider these questions without the benefit of the lower courts' final ruling on the issues involved in these statutory questions.

Texas Litigation (*Department of Education v. Brown*)

The plaintiffs in the Texas litigation are two borrowers with federal student loans who assert that ED used improper procedures to adopt the cancellation policy. The Texas plaintiffs point to two statutes that they say govern development of such a policy. First, the HEA states that "regulations pertaining to" its Title IV provisions must generally "be subject to a negotiated rulemaking." Second, the Administrative Procedure Act (APA) generally requires agencies to adopt "rules" using notice-and-comment rulemaking. The Texas plaintiffs argue that the policy qualifies as a "regulation" or "rule" under these statutes because it is a statement of general applicability, with future effect, that determines the right of certain borrowers to cancellation benefits and fixes obligations on ED to provide those benefits. ED did not adopt the cancellation policy after negotiated or notice-and-comment rulemaking. The Texas plaintiffs therefore assert a single claim under the APA, urging the Court to "hold unlawful and set aside" the cancellation policy for failing to observe "procedure required by law."

The Texas plaintiffs join a theory of procedural injury to this APA claim. In a procedural injury case, a plaintiff claims that Congress gave them a "procedural right to protect" their "concrete interests." The plaintiff suffers an "injury," for Article III standing purposes, when the agency denies the plaintiff a procedural right in a way that harms a concrete interest. As with standing more generally, a plaintiff alleging procedural injury must show that the relief she seeks will redress the harm suffered, but "normal standards for redressability" do not apply. The plaintiff must show is that there is "some possibility" that requiring the agency to honor the procedural right will cause the agency to reconsider the harmful action.

In the Texas litigation, the claimed procedural injury is ED's failure to observe allegedly applicable HEA and APA rulemaking requirements. The concrete interest that this failure allegedly affects is the Texas plaintiffs' ability either to qualify for cancellation benefits (in the case of the plaintiff whose FFEL program loans are not held by ED nor a GA) or to qualify for more benefits (in the case of the plaintiff who only qualifies for $10,000 in cancellation benefits because he did not receive a Pell Grant). The Texas plaintiffs argue that, based on press accounts, there is some possibility that if federal courts vacated the policy, ED would reconsider the policy with public comment and adopt a more generous policy.

Whether the HEROES Act authorizes the cancellation policy is bound up with the Texas plaintiffs' ability to show standing and to prevail on the merits of their APA procedural claim. Waivers or modifications made under the HEROES Act do not need to undergo negotiated rulemaking under the HEA or notice-and-comment rulemaking under the APA. ED argues that this exemption defeats the Texas plaintiffs' standing and the merits of their claims because the HEROES Act authorizes the policy. Alternatively, ED contends that if in fact the HEROES Act does not authorize the cancellation policy, then a judgment to that effect would not remedy the plaintiffs' alleged injuries but rather ensure that neither plaintiff "receives any debt relief at all." The Texas plaintiffs respond to this last point by arguing that ED has "repeatedly claimed" that it has "significant authority" to "forgive debts" using statutory authority provided in the HEA rather than in the HEROES Act, meaning that there could be other authority to adopt a more generous cancellation policy if ED were to reconsider the policy under the rulemaking procedures that these plaintiffs argue apply to the policy.

On November 10, a Texas district court entered judgment for the Texas plaintiffs, declaring the policy unlawful and vacating it. The district court reasoned that the plaintiffs had sufficiently alleged standing based on their procedural injury theory. The district court then considered the APA claim in two respects. The district court first examined the APA's "procedural requirements," concluding the policy did not need to undergo notice-and-comment procedures because ED stated it had issued the policy under the HEROES Act. The district court then considered the APA's "substantive requirements." In contrast to its procedural-requirements discussion, the district court held that by issuing the cancellation policy under the HEROES Act, the Secretary exceeded his statutory authority. This was because the policy resolved a question of vast economic and political significance (i.e., broad cancellation) without clear congressional authorization to do so. The Supreme Court has granted certiorari in this case on both standing and whether the cancellation policy exceeds ED's statutory authority.

Next Steps

Although the Court has granted the Biden Administration's requests for review of questions about standing and statutory authority, the Court held in abeyance the federal government's request to stay either of the lower court decisions blocking the policy. Therefore, cancellation will occur, if at all, only after the Supreme Court renders a decision in favor of the Biden Administration in these appeals.

Relatedly, when ED unveiled the cancellation policy, it stated that the existing payment pause would end on December 31, 2022. ED has since extended the pause through August 2023, at the latest, to "give the Supreme Court an opportunity" to resolve the student loan litigation appeals during its current Term.

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