



# NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT

In re: ) BAP No. OR-04-1103-KMaMo  
MICHAEL ERIC HEDLUND and )  
STEPHANIE RAE HEDLUND, ) Bk. No. 03-63788 AER-7  
Debtors. ) Adv. No. 03-06231

PENNSYLVANIA HIGHER EDUCATION )  
ASSISTANCE AGENCY, )

Appellant, )

v. )

MICHAEL ERIC HEDLUND, )

Appellee. )

**FILED**

AUG - 6 2004

MEMORANDUM<sup>1</sup>

NANCY B. DICKERSON, CLERK  
U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT

Argued by Video Conference and Submitted on July 29, 2004  
at Pasadena, California

Filed - August 6, 2004

Appeal from the United States Bankruptcy Court  
for the District of Oregon

Honorable Albert E. Radcliffe, Chief Bankruptcy Judge, Presiding

Before: KLEIN, MARLAR, and MONTALI, Bankruptcy Judges.

<sup>1</sup>This disposition is not appropriate for publication and may not be cited except when relevant under the doctrines of law of the case, res judicata, or collateral estoppel. See 9th Cir. BAP Rule 8013-1.

1 Appellant, Pennsylvania Higher Education Assistance Agency,  
2 appeals the bankruptcy court's order that the student loan  
3 obligation of appellee is dischargeable, in part, under 11 U.S.C.  
4 § 523(a)(8). We REVERSE.

5  
6 FACTS

7 Appellee obtained a law degree from Willamette University  
8 College of Law in Salem, Oregon, in 1997, and a bachelor of  
9 science degree in business administration from the University of  
10 Oregon in 1992. He financed his law school education by  
11 executing six federal Stafford student loans that were guaranteed  
12 by appellant. The loans are based on three promissory notes  
13 totaling \$85,245.87. Interest continues to accrue on the loans  
14 at a rate of 4.22 percent per annum.

15 Following law school graduation, appellee twice failed the  
16 Oregon bar exam. On the morning of his third scheduled bar exam,  
17 he stopped for coffee, locked his keys in his car, and missed the  
18 test. Appellee has no plans or desire to retake the test again.

19 During appellee's summer breaks from law school, he worked  
20 in Klamath Falls, Oregon, as a law clerk for his father's law  
21 firm and for the Klamath County District Attorney's Office  
22 ("D.A.'s Office"). After law school graduation, appellee was  
23 employed with the D.A.'s Office for approximately one year.  
24 Appellee planned on working as an assistant district attorney for  
25 a couple of years, then working for his father's law firm in  
26 Klamath Falls. Because appellee did not pass the bar exam, he  
27 abandoned his plan to practice law.

28 Appellee is thirty-three years old, married and has a two-

1 year old daughter. He is healthy with no physical or mental  
2 disabilities, is not on medication and has no addictions.

3 Appellee is currently employed as a juvenile counselor at  
4 the Klamath County Juvenile Department ("Juvenile Department")  
5 and has held that position since 1999. Appellee's current  
6 household income is approximately \$40,320 per year (\$3,360 per  
7 month), which represents appellee's salary of \$3,200 per month  
8 and his spouse's salary of \$160 per month. Appellee's salary is  
9 higher than the average wage in Oregon and is considered  
10 excellent for the Klamath Falls area.

11 There are three employment positions in appellee's  
12 department that are more highly compensated. Vacancies for those  
13 positions are not expected in the foreseeable future and the  
14 court found that appellee had no possibility for advancement in  
15 his current position barring unforeseen circumstances. Appellee  
16 testified that he would apply for other employment that would  
17 benefit him financially even though he is satisfied with his  
18 current job.

19 Appellee's spouse is employed at a flower shop only one day  
20 a week and takes care of their daughter the remainder of the  
21 time. Appellee testified that his spouse has the potential to  
22 work more than one day a week, and the bankruptcy court found  
23 that appellee's monthly household income could be increased by  
24 \$320 if appellee's spouse were to work three days a week. The  
25 court also found that if appellee's spouse were to work more  
26 hours, it would impose little or no expense for day care because  
27 both appellee's and his spouse's parents live nearby and there  
28 was testimony that they would be "excited and delighted to help

1 take care of their granddaughter."

2 In Schedule I of his bankruptcy schedules, appellee listed  
3 current monthly expenses of \$2,450. Significant monthly expenses  
4 include: \$375 for rent; \$95 for cable/internet; \$75 on cell  
5 phones; \$150 on transportation (not including car payments); \$25  
6 on charitable contributions; \$35 on a gym membership; and \$125 on  
7 clothing. Appellee drives and owns outright a 1990 Chevrolet  
8 Blazer and appellee's spouse drives a 2002 Honda Accord leased  
9 for \$354 per month.

10 After law school graduation, appellee filed for and received  
11 several extensions on his loan obligation. His reasons for  
12 requesting extensions were that he did not pass the bar exam.  
13 When appellee's extensions expired, he became delinquent in his  
14 payments and requested that his loans be consolidated. His  
15 request was denied due to his delinquent payments, and eventually  
16 appellee's wages were garnished.

17 The court found that appellee's monthly payments on the  
18 loans would be approximately \$800 per month. The parties  
19 stipulated that appellee made one voluntary payment on his loans  
20 of \$954.72, which came from part of an inheritance he received  
21 when his grandmother died, and thirty-three involuntary semi-  
22 monthly payments (\$258 per month) totaling \$4,272.52 that were  
23 obtained through occupational wage garnishment.

24 Appellee testified that he could afford the \$258 per month  
25 that was being garnished. The court found that appellee's  
26 household income and expenses could be adjusted to allow for  
27 payments of \$225 per month.

28 The parties stipulated that appellant offered appellee three

1 different repayment options designed to lower his monthly  
2 payments to pay the loan over a thirty-year amortized period of  
3 time.<sup>2</sup> Appellee did not apply for the William D. Ford Income  
4 Contingent Repayment Program ("ICRP") despite having been  
5 informed by appellant of that option, because he believed he  
6 would not qualify for the program.

7 The court did not consider the reamortization offer to be  
8 the equivalent of the ICRP.

9 The bankruptcy court issued an oral ruling on December 15,  
10 2003, and found that appellee met the three-part test under  
11 Brunner v. New York State Higher Educ. Servs. Corp. (In re  
12 Brunner), 46 B.R. 752, 756 (S.D.N.Y. 1985) aff'd 831 F.2d 395 (2d  
13 Cir. 1987), which has been adopted by the Ninth Circuit in United  
14 States Student Aid Funds, Inc. v. Pena (In re Pena), 155 F.3d  
15 1108, 1112 (9th Cir. 1998).

16 The court found that any debt above \$30,000 would be an  
17 "undue hardship" on appellee and ordered the debt partially  
18 discharged. The court ruled that appellee's loan obligation of  
19 \$30,000 would not create an "undue hardship" and denied discharge  
20 of that amount pursuant to 11 U.S.C. § 523(a)(8).<sup>3</sup>

21 This appeal ensued.  
22  
23

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24 <sup>2</sup>Option 1: \$417.67 for 359 months; 1 payment of \$414.79.  
25 Option 2: \$307.43 for 24 months; 335 payments of \$432.56; 1  
26 Option 3: \$307.43 for 24 months; \$374.11 for 36 months;  
\$446.11 for 299 months; \$444.31 for 1 month.

27 <sup>3</sup>At the conclusion of trial, appellee proposed to the  
28 bankruptcy court that \$28,000 of his student loan obligations to  
appellant be declared non-dischargeable.

1 JURISDICTION

2 The bankruptcy court had jurisdiction via 28 U.S.C. §§ 1334  
3 and 157(b)(1). We have jurisdiction under 28 U.S.C. § 158(a)(1).  
4

5 ISSUE

6 Whether the bankruptcy court erred in finding appellee met  
7 his burden of showing that repayment of his student loans would  
8 impose an undue hardship on him or his family.  
9

10 STANDARD OF REVIEW

11 The bankruptcy court's findings of fact are reviewed for  
12 clear error, and the application of the legal standard in  
13 determining whether a student loan debt is dischargeable as an  
14 undue hardship is reviewed de novo as implicating a mixed  
15 question of law and fact. Rifino v. United States (In re  
16 Rifino), 245 F.3d 1083, 1088 (9th Cir. 2001); Pa. Higher Educ.  
17 Assistance Agency v. Birrane (In re Birrane), 287 B.R. 490, 494  
18 (9th Cir. BAP 2002); United Student Aid Funds, Inc. v. Nascimento  
19 (In re Nascimento), 241 B.R. 440, 444 (9th Cir. BAP 1999).  
20

21 DISCUSSION

22 Appellant argues that the court erred when it ruled that a  
23 healthy thirty-three year old male making approximately \$40,000  
24 per year, married with one child, with an undergraduate degree in  
25 business administration and a law degree, with no physical or  
26 mental disabilities, and with the potential to add additional  
27 household income is entitled to discharge \$55,245.87 of his  
28 \$85,245.87 in student loans as an undue hardship under

1 § 523(a)(8).

2 A government guaranteed student loan is nondischargeable  
3 "unless excepting such debt from discharge . . . will impose an  
4 undue hardship on the debtor and the debtor's dependants[.]" 11  
5 U.S.C. § 523(a)(8). The debtor carries the burden to prove by a  
6 preponderance of the evidence that he or she is entitled to a  
7 discharge of the student loan. Nys v. Educ. Credit Mgmt. Corp.  
8 (In re Nys), 308 B.R. 436, 441 (9th Cir. BAP 2004).

9 Undue hardship is not defined in the Bankruptcy Code, but it  
10 involves more than a "garden variety hardship." Id. Only in  
11 cases where the debtor proves real and sustained hardship may the  
12 court grant a discharge. Id.

13 Whether a student loan is dischargeable under § 523(a)(8)  
14 entails the application of the three-part Brunner test. Pena,  
15 155 F.3d at 1111-14. Under that test, the debtor must prove:

16 (1) that he cannot maintain, based on current income and  
17 expenses, a "minimal" standard of living for himself and his  
18 dependents if forced to repay the loans;

19 (2) that additional circumstances exist indicating that this  
20 state of affairs is likely to persist for a significant portion  
21 of the repayment period of the student loans;

22 (3) that the debtor has made good faith efforts to repay the  
23 loans. Id.

24 The bankruptcy court found that appellee met his burden of  
25 proving all three prongs. We will review each prong in turn and,  
26 for those issues subject to de novo review, are entitled to  
27 substitute our judgment for that of the trial judge.

28



1 1. Minimal Standard of Living

2 The first prong of the Brunner test requires a debtor to  
3 prove more than simply tight finances. Nascimento, 241 B.R. at  
4 445. "The proper inquiry is whether it would be 'unconscionable'  
5 to require the debtor to take steps to earn more income or reduce  
6 her expenses." Id. Courts require more than temporary financial  
7 adversity, typically stopping short of utter hopelessness. Id.

8 In analyzing this element, the bankruptcy court did not  
9 focus upon unconscionability, but rather applied a "disposable  
10 income test" generally used to confirm chapter 13 plans.

11 The court stated that the standard the District of Oregon  
12 follows under the first Brunner element is the chapter 13  
13 disposable income test. Sequeira v. Sallie Mae Servicing Corp.  
14 (In re Sequeira), 278 B.R. 861 (Bankr. D. Or. 2001). In applying  
15 that test, the court found that monthly payments on the debt are  
16 approximately \$800, and that even though appellee's "expenses  
17 could be reduced without imposing an undue hardship," they "could  
18 not be reduced to any number that would be even close to allowing  
19 an \$800-per-month loan payment." Id. at 16. The court then  
20 concluded, without making any findings regarding appellee's  
21 current income or expenses, that he met his burden of proving  
22 this first Brunner prong. Id.

23 Appellant argues that the court's use of the disposable  
24 income test was erroneous because the inquiry should be on  
25 determining if repayment of his loans would put him below the  
26 minimum amount necessary to support his family.

27 Appellee's schedules show net monthly income of \$2,449, and  
28 monthly expenses of \$2,450, leaving no disposable income.

1 Appellant argues that an examination of appellee's expenses show  
2 that repayment of the loan would not cause him to slip below a  
3 minimal standard of living because his budget contains  
4 unnecessary items such as cable television, internet services,  
5 cell phones, a gym membership, charitable contributions, a new  
6 car, and \$150 a month on transportation costs when both appellee  
7 and his spouse live and work in Klamath Falls.

8 Appellee testified that the cable, internet, cell phones,  
9 and new car expenses were all obtained during and after the time  
10 that appellee's wages were being garnished at a rate of \$258 per  
11 month. Such expenses have led other courts to decline to  
12 discharge student loan debt. See, e.g., Rifino, 245 F.3d at  
13 1088.

14 While the chapter 13 disposable income test informs the  
15 analysis (and would be controlling for the life of a chapter 13  
16 plan), the fact that student loans are not dischargeable in  
17 chapter 13 cases without proof of undue hardship means that the  
18 ultimate standard is more stringent than the disposable income  
19 test. Thus, we have looked to whether it would be unconscionable  
20 for debtors to take steps to reduce expenses or earn more income.  
21 Nascimento, 241 B.R. at 445.

22 When we reexamine de novo appellee's monthly income minus  
23 expenses, we reach a different conclusion than the trial court.

24 Appellee's cable, internet, cell phones, gym membership, and  
25 new car payment all warrant adjustment, as a debtor who would  
26 show "undue hardship" must "adjust [his] lifestyle to allow [him]  
27 to make the payments on [his] student loan." Nascimento, 241  
28 B.R. at 446.

1 In our view, it would not be unconscionable for appellee to  
2 eliminate those expenses, totaling approximately \$559, from his  
3 monthly budget. Furthermore, the court found, and we agree, that  
4 appellee's spouse could work more than one day a week.  
5 Increasing appellee's spouse's work schedule would not cause  
6 significant child care expenses because both sets of grandparents  
7 are "excited and delighted" to help watch their granddaughter.  
8 The court found that an increase in appellee's spouse's hours  
9 could bring an additional \$320 to their monthly budget.

10 Trimming \$559 and adding \$320 per month would provide  
11 monthly income of approximately \$2,769, and monthly expenses of  
12 \$1,891, leaving an extra \$878.

13 To be sure, adding a student loan payment to those expenses  
14 would cause "tight finances," but it would not be unconscionable.

15 Thus, in our de novo review we conclude that appellee did  
16 not carry his burden of meeting the first Brunner prong.

17

## 18 2. Additional Circumstances

19 The second prong of the Brunner test requires a debtor to  
20 prove that "additional circumstances exist indicating that this  
21 state of affairs is likely to persist for a significant portion  
22 of the repayment period of the student loans." Brunner, 831 F.2d  
23 at 396. This prong is intended to effect congressional intent to  
24 make the discharge of student loans more difficult than that of  
25 other nonexcepted debt. Rifino, 245 F.3d at 1088-89; Birrane,  
26 287 B.R. at 497.

27 We recently held in Nys (after the bankruptcy court had  
28 decided this case) that:

1 'additional circumstances' under the second prong  
2 of the Brunner test must be indicia of a debtor's  
3 inability to repay the loan in the future. Such  
4 circumstances need not be 'exceptional,' except in  
5 the sense that they are tenacious and demonstrate  
6 insurmountable barriers to the debtor's financial  
7 recovery and ability to pay for a significant  
8 portion of the repayment period. This approach  
9 gives the courts the appropriate flexibility to do  
10 justice in each unique case.

11 Nys, 308 B.R. at 446.

12 We then set forth the following nonexhaustive list of  
13 matters for a court to consider when determining what constitutes  
14 "additional factors":

- 15 1. Serious mental or physical disability of the debtor or  
16 the debtor's dependents which prevents employment or  
17 advancement;
- 18 2. The debtor's obligations to care for dependents;
- 19 3. Lack of, or severely limited education;
- 20 4. Poor quality of education;
- 21 5. Lack of usable or marketable job skills;
- 22 6. Underemployment;
- 23 7. Maximized income potential in the chosen educational  
24 field, and no other more lucrative job skills;
- 25 8. Limited number of years remaining in work life to allow  
26 payment of the loan;
- 27 9. Age or other factors that prevent retraining or  
28 relocation as a means for payment of the loan;
10. Lack of assets, whether or not exempt, which could be  
used to pay the loan;
11. Potentially increasing expenses that outweigh any  
potential appreciation in the value of the debtor's assets

1 and/or likely increases in the debtor's income;

2 12. Lack of better financial options elsewhere.

3 Nys, 308 B.R. at 446-47.

4 Applying the facts as found by the bankruptcy court to the  
5 Nys considerations leads us to conclude that appellee's  
6 circumstances do not rise to the level necessary to satisfy the  
7 second Brunner prong.

8 Neither appellee nor his spouse suffer from a serious mental  
9 or physical disability, nor does their daughter; appellee's  
10 spouse cares for their daughter, and both appellee's and his  
11 spouse's parents are able and willing to watch her as well;  
12 appellee is well educated, having both a business degree and a  
13 law degree; appellee received a good quality education; appellee  
14 has usable and marketable job skills; he is employed full-time,  
15 from 9:00 a.m. to 5:00 p.m. with weekends off, and has the  
16 ability to seek additional part-time work, plus his spouse is  
17 capable of working more than one day a week. Furthermore,  
18 although the court found that appellee will soon meet his  
19 "maximized income potential" in his current job, appellee still  
20 has the ability to retake the bar exam again, which, if he  
21 passed, would allow him to seek higher paying employment in his  
22 "chosen educational field." Moreover, appellee is only thirty-  
23 three years old and has many more productive years ahead of him  
24 to work and pay off his educational loans.

25 To be sure, appellee and his spouse own no significant  
26 assets. They rent a two-bedroom duplex from appellee's parents  
27 on favorable terms. Further, appellee testified that he and his  
28 spouse plan on having more children and will need a larger

1 residence. Finally, appellee testified, and the court found,  
2 that even though appellee could apply for higher paying jobs in  
3 other counties, they would encounter a higher cost of living and  
4 doing so would impose child care costs because neither set of  
5 grandparents would be nearby.

6 The present lack of assets that could be used to pay back  
7 the loan, the potential for increased expenses, and the lack of  
8 better financial options elsewhere are not of a magnitude  
9 sufficient to support a conclusion that "additional  
10 circumstances" warrant a finding of undue hardship under the  
11 second Brunner prong. To the contrary, we are persuaded that  
12 appellee has a potential for a bright future.

13  
14 3. Good faith effort

15 The third prong of the Brunner test requires that a debtor  
16 demonstrate a good faith effort to repay the loans. Nys, 308  
17 B.R. at 447. In evaluating good faith we consider: (1) the  
18 debtor's effort to obtain employment, maximize income and  
19 minimize expenses, and (2) debtor's efforts to negotiate a  
20 payment plan. Birrane, 287 B.R. at 499.

21 The bankruptcy court found this third prong to be the most  
22 troublesome, calling it a "close case." The bankruptcy court  
23 considered appellee's repayment record, whether his failure to  
24 repay the loans was due to factors beyond his reasonable control,  
25 whether appellee had realistically used efforts to maximize his  
26 financial potential and minimize expenses, the length of time  
27 after appellee's loan obligation went into repayment mode that he  
28 filed for bankruptcy, the percentage of his student loan debt in

1 relation to his other debts, and whether appellee obtained any  
2 tangible benefit from the student loan obligations.

3 The court found that even though appellee only made one  
4 voluntary payment on his loans, he attempted to negotiate for  
5 lower monthly payments and offered to pay \$5000 good faith money,  
6 which he was going to receive from his parents, but was turned  
7 down. The court then noted:

8 [a]s to whether or not the hardship is beyond his  
9 reasonable control, this debtor may not be as  
10 sympathetic as some who have come before the Court in  
11 the sense that he does not have physical or mental  
12 disabilities, he's not handicapped in any fashion.  
13 Here, I guess, the hardship of disability would have to  
14 be referred to as the failure to pass the bar exam.  
15 While there's no guarantee that he would be making more  
16 money even if he had passed the bar exam, I do note  
17 that the debtor attempted to take the bar exam twice,  
18 failed the exam twice. I'm willing to infer that he  
19 did not intend to fail the exam. Hence, it would  
20 appear that his hardship, to the extent it exists, is  
21 caused by factors beyond his reasonable control.

22 The court also found that appellee has attempted to maximize  
23 his financial potential and that he can minimize expenses to make  
24 room in the family's budget for some loan payments, especially if  
25 appellee's spouse were to work more hours a week. Furthermore,  
26 the court found that appellee waited four and a half years after  
27 his repayment period commenced before filing bankruptcy, and that  
28 he received a tangible benefit from the student loan obligations.

Regarding appellant's offered payment plan options, the  
court found:

[i]t was represented to the Court that [the amortized  
repayment plan] is a replacement for ICRP. The Court  
respectfully disagrees, . . . [The plan] is simply a  
proposal to amortize the loan over 30 years. So, first  
of all, it lasts five years longer [than the ICRP] and  
involves full payment of the obligation. Secondly, the  
[ICRP] involves, as I understand it, an analysis of the

1 debtor's income each and every year to determine what  
2 the monthly payments will be that year. There is no  
3 such evaluation under [this plan]. There are several  
4 different options that can be selected, and once  
5 selected the monthly payments are fixed.

6 So, the Court disagrees and would not conclude  
7 that [the plan] is a replacement for ICRP in any event;  
8 and further, as will become apparent, the Court  
9 concludes that the debtor could not make the payments  
10 under [the plan] without undue hardship because the  
11 debtor does not have sufficient funds available to make  
12 the upwards of \$300 per month payments required.

13 Based on a review of all the above factors, the court  
14 concluded that appellee made a good faith effort to repay the  
15 loan and therefore satisfied all three Brunner prongs. That  
16 being the case, the court concluded that appellee has room in his  
17 budget, with his spouse working more hours, for \$225 a month to  
18 go towards his student loan payments. The court then discharged  
19 all but \$30,000 of appellee's student loan debt.

20 Appellant argues that appellee exhibited a lack of good  
21 faith by not negotiating a repayment plan that provided for only  
22 \$49.43 more than what he testified that he could afford.  
23 Specifically, appellee testified that he could afford to pay \$258  
24 a month, and two of the three monthly payment options that  
25 appellant offered to appellee started as low as \$307.43, leaving  
26 a difference of \$49.43. Appellant contends that the court erred  
27 in finding good faith especially when the court found that  
28 appellee's budget provided for excess income if appellee's spouse  
were to work more than one day a week.

Appellant also argues that the court erred when it found  
that appellee's failure to pass the bar exam was a hardship  
beyond his reasonable control, especially in light of the third  
episode.



1 We agree with appellant that the bankruptcy court was too  
2 charitable. As previously discussed, appellee and his spouse  
3 have taken no steps to maximize their income, nor minimize their  
4 expenses. If they were to eliminate from their budget luxury  
5 items such as cable television, internet and cell phone services,  
6 the gym membership, the new car payment, and recreation expenses,  
7 they would have room in their budget for loan payments of  
8 \$307.43. That is even more of a possibility if appellee's spouse  
9 worked more hours and appellee got a part-time job.

10 We agree with the bankruptcy court that the fact that  
11 appellee only made one voluntary payment on his loan obligation  
12 is not dispositive. Birrane, 287 B.R. at 499. Nevertheless,  
13 appellee's circumstances did not satisfy the Brunner test in a  
14 manner sufficient to justify partially discharging the student  
15 loan debt.

16  
17 CONCLUSION

18 Concluding that appellee satisfied none of the three  
19 essential elements of the Brunner test, the partial discharge of  
20 appellee's student loan debt was not adequately supported.  
21 REVERSED.

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