

1 Student Loan Hardship Discharge
2 Partial discharge

3 Sequeira v. Sallie Mae Svc'g Corp. et al. 99-6239-fra
4 In re Karen Sequeira 692-63217-fra13

5 1/31/01 FRA Published

6 Plaintiff/Debtor is a 55 year old veterinarian with
7 disposable income of \$176/month after payment of reasonable
8 living expenses. She has made payments on her student loans in
9 excess of \$10,000 over the years, but still owes approximately
10 \$40,000 to the U.S. Department of Education. Debtor has carpal
11 tunnel syndrome and a strained back. It was established by
12 testimony, including that of a rehabilitation counselor, that the
13 Debtor could expect to work another seven years.

14 The Court concluded that the Debtor met the three
15 requirements of the Brunner test, given her age and physical
16 difficulties, and that repayment of the entire balance of the
17 Debtor's student loans would constitute an undue hardship under §
18 523(a)(8). However, given the Ninth Circuit's recent opinion in
19 In re Myrvang, 232 F.3d 1116 (9th Cir. 2000), the Court held that
20 where a Debtor meets the requirements of Brunner with respect to
21 the entire balance of student loans, but has the ability to pay
22 part of the debt without an undue hardship, the Debtor will be
23 required to repay that part of the student loan debt which does
24 not create an undue hardship, and the remainder will be
25 discharged.

26 The Court determined the present value of the student loan
debt which Debtor can repay without creating an undue hardship,
using Debtor's disposable income over the period in which that
income will continue to be earned. The amount of the student
loan debt in excess of \$13,047 will be discharged.

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF OREGON

IN RE)	
)	
KAREN E. SEQUEIRA,)	Case No. 692-63217-fra13
)	
_____ Debtor.)	
)	
KAREN E. SEQUEIRA,)	Adv. Proc. No. 99-6239-fra
)	
Plaintiff,)	
)	
v.)	
)	
SALLIE MAE SERVICING CORP.,)	
WASH. STATE UNIV., ORE. STATE)	
UNIV., U.S. DEPT. OF EDUCATION,)	
EDUCATIONAL CREDIT MANAGEMENT)	
CORP.,)	MEMORANDUM OPINION
_____ Defendants.))	

Plaintiff seeks a judgment declaring that her obligation to repay student loans should not be excepted from discharge. 11 U.S.C. § 523(a)(8). The case was tried on October 19, 2000 against the lone remaining defendant, U.S. Department of Education, and the record supplemented thereafter by consent. After consideration of the evidence presented, and post-trial arguments of the parties, I hold that payment of the entire debt

1 would impose an undue hardship on the Plaintiff, and that the
2 debt should be discharged to the extent it exceeds \$13,047. My
3 reasons follow.

4 **I. BACKGROUND**

5 Plaintiff is a 55-year-old veterinarian. She began her
6 training for her career late in life, and, as a result, is
7 carrying a substantial student loan debt at an older age than
8 most. She currently earns \$45,500 per year. An accountant
9 testified that her after-tax annual income would be \$30,193, or
10 \$2,516 per month, based on an earlier gross wage of \$43,306.
11 From this I calculate her present monthly net income to be
12 \$2,615. Plaintiff's monthly budget requires expenditures of
13 \$2,439. Projected monthly expenses include modest rent (\$600 a
14 month) and utilities (\$300 per month). The utilities charges
15 include \$100 per month in phone charges, which the Plaintiff
16 justifies by noting that she has several children and
17 grandchildren spread over considerable distances. She spends
18 \$600 a month on food and household items such as paper products,
19 cleaning materials, and toiletries. She pays \$120 a month in
20 professional expenses, which includes the cost of mandatory
21 continuing education involving attendance at seminars,
22 occasionally at remote locations.

23 Finally, Plaintiff estimates \$200 per month expense for the
24 care of her 83 year old mother, which obligation she shares with
25 a sister.

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1 A rehabilitation counselor testified that the work
2 expectancy of a 55 year Caucasian female was 7.4 years.
3 Plaintiff's colleague and employer testified that retirement in
4 one's early 60's is not unusual for a veterinarian.

5 The employer indicated that the Plaintiff had recently cut
6 her work schedule from five to four days a week. The record is
7 unclear as to whether this will affect her present income of
8 \$45,500 per annum.¹ Salaries are recalculated at the end of
9 every year, taking the business' income into account. Testimony
10 of both the counselor and the employer indicate that the
11 Plaintiff's physical difficulties, including carpal tunnel
12 syndrome and strained back, have an adverse, but not critical
13 effect on her work. Her employer indicated that Plaintiff does
14 good work, but occasionally needs help in lifting patients, etc.

15 Generally, the Plaintiff leads a frugal lifestyle. While
16 some expenses may be questioned, her overall budget is not
17 unreasonable. She has, since the student loans were incurred,
18 paid a total of \$10,309.72, to various lending entities. She is
19 currently indebted to the United States Department of Education
20 for approximately \$40,000. She investigated a workout by way of
21 a Ford loan², but saw no prospect of success, given her

22
23 ¹This is the gross income shown in Plaintiff's latest tax
return.

24 ²A Ford loan usually involves consolidation of student loan
25 debts, and amortization over 20 years. When the borrower reaches
26 retirement age, the balance of the debt is forgiven. One problem
with such loans is that the extent to which the debt is forgiven
is taxable, resulting in tax liability without cash from which to

1 (relatively) advanced age and the minimum \$300 per month
2 payment.

3 **II. DISCUSSION**

4 Bankruptcy Code § 523(a)(8) excepts from discharge debts
5 incurred

6 for an educational benefit overpayment or loan made,
7 insured or guaranteed by a governmental unit or
8 nonprofit institution, or for an obligation to repay
9 funds received as an educational benefit, scholarship,
or stipend, unless-

9 * * *

10 (B) excepting such debt from discharge will impose
11 an undue hardship on the debtor and the debtor's
dependents...

12 Courts in the Ninth Circuit have applied a three-part test
13 to determine whether excepting a student loan debt from discharge
14 will impose an undue hardship. The circumstances to be
15 considered are:

16 1. The debtor's level of income at the time of trial, and
17 whether the debtor can maintain a minimal standard of living if
18 required to repay the loan;

19 2. Whether the circumstances contributing to the hardship
20 are likely to persist for a significant period of time; and

21 3. Whether the debtor has made a good faith effort to pay
22 the debt.

23 Brunner v. New York State Higher Education Services Corp., 831
24 F.2d 395 (2d Cir. 1987), accord In re Pena 155 F.3d 1108 (9th

25 _____
26 pay it.

1 Cir. 1998).

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3 The question then arises whether, in applying the Brunner
4 standard, the bankruptcy court must discharge all, or none, of
5 the student loan debt, or may discharge only a portion of it.
6 The power of a bankruptcy court to enter a "partial discharge"
7 has been a matter of some controversy. Prior to 1998, bankruptcy
8 courts in this District uniformly followed In re Littell, 6 B.R.
9 85 (Bankr. D. Or. 1980). Littell held that the court had the
10 equitable power to discharge a student loan to the extent that
11 denial of discharge would cause undue hardship; that the part of
12 the debt that could be paid without such hardship had to be paid.
13 The Bankruptcy Appellate Panel disavowed partial discharge in In
14 re Taylor, 223 B.R. 747 (BAP 9th Cir. 1998). The BAP reasoned
15 that the reference to "such debt" in the exception portion of
16 §523(a)(8) (as opposed to explicit language allowing for partial
17 discharge, such as: "to the extent failure to do so constitutes
18 an undue hardship") meant that Congress required an all-or-
19 nothing approach.

20 The issue appears to have been resolved in the Circuit by a
21 recent case, In re Myrvang, 232 F.3d 1116 (9th Cir. 2000).
22 Myrvang involves discharge of a debt arising out of a dissolution
23 of marriage. 11 U.S.C. § 523(a)(15).³ The trial court, over

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25 ³ 11 U.S.C. § 523(a)(15) provides:
26 (a) A discharge under section 727, 1141, 1228(a), 1228(b), or
1328(b) of this title does not discharge an individual debtor
from any debt -

1 debtor's objection, held that discharge of a marital debt (other
2 than for support) was not limited to an all-or-nothing approach.
3 The Court of Appeals agreed with the bankruptcy court, relying on
4 Tennessee Student Assistance Corp. v. Hornsby (In re Hornsby),
5 144 F.3d 433 (6th Cir. 1998). In Hornsby, the Court of Appeals
6 for the Sixth Circuit held that Code §105⁴ authorizes bankruptcy
7 courts to enter partial discharges in student loan cases. The
8 Court reversed the bankruptcy court's decision to discharge the
9 entire loan obligation of a couple which, while "financially
10 burdened" were still able to pay some of the debt.

11 Although the Bankruptcy Court should not have
12 discharged the Hornsbys' entire student loans, we
13 believe it had the power to take action short of total

14 * * *

15 (15) not of the kind described in paragraph (5)
16 that is incurred by the debtor in the course of a
17 divorce or separation or in connection with a
18 separation agreement, divorce decree or other order of
19 a court of record, a determination made in accordance
20 with State or territorial law by a governmental unit
21 unless -

22 (A) the debtor does not have the ability to pay
23 *such debt* from income or property of the debtor not
24 reasonably necessary to be expended for the
25 maintenance or support of the debtor or a dependent of
26 the debtor and, if the debtor is engaged in a
business, for the payment of expenditures necessary for
the continuation, preservation, and operation of such
business; or

(B) discharging *such debt* would result in a
benefit to the debtor that outweighs the detrimental
consequences to a spouse, former spouse, or child of
the debtor; [emphasis added]

⁴ Code §105(a):

"The court may issue any order, process, or judgment
that is necessary or appropriate to carry out the
provisions of this title...."

1 discharge. We find this authority in 11 U.S.C. §
2 105(a) [footnote omitted] which permits the bankruptcy
3 court to 'issue any order, process or judgment that is
4 necessary or appropriate to carry out the provisions of
5 this title,' so long as such action is consistent with
6 the Bankruptcy Act. [citation omitted].... In a student
7 loan case where undue hardship does not exist, but
8 where facts and circumstances require intervention in
9 the financial burden on the debtor, and all-or-nothing
10 treatment thwarts the purpose of the Bankruptcy Act.

11 In re Hornsby, 144 F.3d at 438-439.

12 The Myrvang court agreed with the Sixth Circuit's reasoning
13 in Hornsby, stating that "Its analysis applies with equal force
14 to dischargeability proceedings under § 523(a) (15)." Myrvang at
15 1123-1124. The court goes on to note that

16 construing the words 'such debt' to preclude
17 partial discharge would run counter to the
18 bankruptcy court's equitable powers under
19 11 U.S.C. § 105(a). Therefore, we hold that
20 a bankruptcy court has the discretion to
21 order a partial discharge of a separate debt
22 arising out of the terms of a divorce decree.

23 In re Myrvang, 232 F.3d at 1124.

24 It is incontrovertible that the Court of Appeals deems
25 partial discharge of student loan debts to be permissible when
26 undue hardship would result if none of the debt is discharged,
but the debtor has the ability to pay part of the debt. What
remains is to reconcile this development with Brunner and Pena.
The first element of the Brunner test has been said to require a
finding that the debtor cannot maintain a "minimal" standard of
living if forced to pay the debt. In re Rosen, 179 B.R. 935, 940
(Bankr. D.Or. 1995). Construing Brunner to require that a debtor

1 have no disposable income at all necessarily dictates an all or
2 nothing approach: if there is no money available after necessary
3 expenses, the debt is discharged in full. If there is, Brunner
4 is not satisfied, and none of the debt is discharged.

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7 In light of Myrvang, the first element of the Brunner test
8 should be read to require that the debtor be unable to pay any
9 part of the debt from remaining assets, or available post-
10 petition income. If she cannot, and the other elements are
11 satisfied, the entire debt is discharged. If she can pay part of
12 the debt from disposable income, and the other elements are
13 satisfied, the debt should be discharged, but only to the extent
14 she is unable to pay.

15 Whether income is available for this purpose requires the
16 same analysis required to determine "disposable income" in
17 Chapter 13 cases⁵. The Chapter 13 disposable income standard was
18 developed to determine the amount a reorganizing debtor should be
19 allowed to retain for his, and his dependents', support and
20 maintenance. There is no reason to believe that Congress

21
22 ⁵ 11 U.S.C. § 1325(b)(2) defines "disposable income" as:

23 income which is received by the debtor and which is not
24 reasonably necessary to be expended -

25 (A) for the maintenance or support of the debtor,
including charitable contributions.... and

26 (B) if the debtor is engaged in business, for the
payment of expenditures necessary for the continuation,
preservation and operation of such business.

1 intended a harsher standard in discharge analysis. A number of
2 courts look to the disposable income concept to determine the
3 amount to be paid in partial discharge cases. See, e.g., In re
4 Grine, 254 B.R. 191 (Bankr. N.D. Ohio 2000) (Student loans), In re
5 Raimondo, 183 B.R. 677 (W.D. N.Y. 1995) (Student Loans), In re
6 Crosswhite, 148 F.3d 879 (7th Cir. 1998) (Marital settlement under
7 § 523(a)(15)), In re Metzger, 232 B.R. 658 (Bankr. E.D. Va. 1999)
8 (§ 523(a)(15)). In these cases the debtor is, effectively,
9 relieved of debts to the extent the debt exceeds the disposable
10 income available to pay it. In other words, repayment
11 requirements constitute an undue hardship to the extent they
12 exceed income available after payment of necessary expenses for
13 maintenance and support.

14 Plaintiff is presently able to make payments of \$176.00 per
15 month, the amount her after tax income exceeds her expenses.
16 However, she will not be able to sustain that income for more
17 than another seven and a half years, given her age and current
18 medical difficulties. After that, the income from her
19 professional practice will end, and her income available for loan
20 payments will disappear as well.⁶ In short, it may not work a
21 hardship on the debtor to require loan payments today, but it
22 undoubtedly will in the not too distant future.

23 The debtor's age has been held to be a factor in student
24 loan cases. Brown v. Union Financial Svcs. Inc. (In re Brown),

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26 ⁶While expenses attributable to her work will end, the net
gain is far outweighed by the loss in income.

1 249 B.R. 525 (Bankr. W.D. Mo. 2000). In that case the court held
2 that requiring a 61-year old debtor to pay a student loan debt
3 would work an undue hardship, given the approaching end of the
4 debtor's earning capacity. While the Eighth Circuit has not
5 adopted the Brunner approach, consideration of the debtor's
6 prospective earning capacity is consistent with the requirement
7 that the Court take into account the long term effect of debtor's
8 current financial condition. If courts are to consider, for
9 example, whether a current disability is persistent enough to
10 justify discharge, there is no reason why disability sure to
11 manifest itself in the foreseeable future should not be
12 considered as well. The combination of Debtor's age and medical
13 difficulties satisfies the first two parts of the Brunner test,
14 or at least demonstrates that the time will come when the test
15 will be met.⁷

16 What remains is a determination of the amount of the student
17 loan claim, if any, to be excepted from discharge. As noted, a
18 number of courts authorizing partial discharge have applied the
19 "disposable income" concept found in Chapter 13 of the Code to
20 determine the amount a debtor can pay without undue hardship.
21 This approach brings to bear a coherent body of law developed in
22 chapter 13 cases used to determine the debtor's income and
23 reasonable and necessary living expenses, in order to determine

25 ⁷ Debtor has made over \$10,000 in payments on student loans
26 over the life of her Chapter 13 reorganization. There is no
dispute that the third Brunner element has been satisfied.

1 the amount the debtor can devote to payment of claims. Once the
2 extent of a debtor's ability to pay is ascertained, and the time
3 over which payments can be made, the court can calculate a
4 present value of the projected payments. To the extent the claim
5 exceeds that present value, it should be discharged under the
6 undue hardship provisions.

7 Courts allowing partial discharge have taken a number of
8 different approaches, such as:

9 1. Discharging separate notes, while not discharging
10 others, In re Hinkle, 200 B.R. 690 (Bankr. W.D. Wash. 1996), or
11 discharging part of all loans, on a pro rata basis, In re
12 Raimundo, 183 B.R. 677 (Bankr. W.D. N.Y. 1995).

13 2. Discharging accrued interest or fees, Griffin v.
14 Eduserv, 197 B.R. 144, 147 (Bankr. E.D. Okla. 1996), or post-
15 petition interest, In re Miller, 254 B.R. 200 (Bankr. N.D. Ohio
16 2000).

17 3. Providing for graduated payments, Berthiaume v. PHEAA,
18 138 B.R. 516 (Bankr. W.D. Ky 1992), set payments for a fixed
19 period, with default provisions, In re Kapinos, 253 B.R. 709
20 (Bankr. W.D. Va. 2000).

21 Since the court's authority to allow partial discharge is
22 premised on its equitable powers, the method may depend on the
23 equities of each case. Here, there is only one loan -- and only
24 one lender -- involved. The Court's task under § 523(a)(8) is to
25 determine the extent, if any, that denial of discharge of the
26 student loan debt will constitute an undue hardship. This

1 requires determination of the amount which can be paid. The
2 court should, when possible, leave it to the parties to determine
3 the ultimate terms of repayment, either by looking to the terms
4 of the contract, or by negotiation.

5 In this case the Debtor's budget does not include any
6 expenditures "not reasonably necessary" for her own maintenance.
7 She does help provide for her mother, who appears to depend on
8 her for part of her own support. Under §1325(b)(2), a dependent,
9 for whom the cost of providing support is a necessary and
10 reasonable expense in calculating disposable income available to
11 make plan payments, has been defined as "a person who reasonably
12 relies on the debtor for support and whom the debtor has reason
13 to and does support financially." Leslie Womac Real Estate, Inc.
14 v. Dunbar (In re Dunbar), 99 B.R. 320 (Bankr. M.D. Louisiana
15 1989). See also In re Rigdon, 133 B.R. 460 (Bankr. S.D. Ill.
16 1991); In re Collopy, 99 B.R. 384 (Bankr. S.D. Ohio 1989); In re
17 Gonzales, 157 B.R. 604 (Bankr. E.D. Mich. 1993). The same logic
18 applies in this context. After deducting her reasonable
19 expenses (\$2,439/month) from her current after-tax income
20 (\$2,615/month), \$176 per month remains. Her current income is
21 expected to continue for 89 months, calculated from the date of
22 trial. Applying a discount rate of 5% (the interest charged by
23 the government for these loans) the present value of the cash
24 flow Debtor can sustain is \$13,047. To the extent her student
25 loan obligation exceeds this amount, it should be discharged.

26 **III. CONCLUSION**

