United States Bankruptcy Court
District of New Mexico

Document Verification

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Case Number: **99-01021**
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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
BERNAGENE MARIE SHAY,
Debtor. No. 7-98-16805 SA

BERNAGENE MARIE SHAY,
Plaintiff,
v. Adv. No. 99-1021 S

NM EDUCATIONAL
ASSISTANCE FOUNDATION,
Defendant.

MEMORANDUM OPINION

This matter came before the Court for trial on the merits of a complaint to determine dischargeability of defendant's student loan debt. Plaintiff appeared through her attorney George Moore. Defendant appeared through its attorney Reginald Storment. Having heard the testimony and arguments presented, and being otherwise informed and advised, the Court enters this Memorandum Opinion. This opinion constitutes the Court's Findings of Fact and Conclusions of Law pursuant to Bankruptcy Rule 7052. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I).

FACTS

Plaintiff obtained a Bachelors of University Studies degree and a legal assistant certificate. Plaintiff had four student loans associated with this education, and has paid three in full. The fourth loan, which is the subject of this lawsuit, was in the original amount of $16,000 and had a remaining balance of $10,362 as of May, 1999, and accrues interest at $71 per month.

Plaintiff works as an administrative assistant at the All Faiths Receiving Home in Albuquerque, New Mexico, which is a home for abused children. She uses some of her legal training skills in this position, having to deal with the Children's Code, probation, and juvenile court. She has been in this position for about five years, and believes she is at the "outer edge" of what the job can pay. Therefore she expects only cost of living raises in the future. Her job has a flexible schedule, and good benefits. The Court also finds that she is using her education fully in this job, and has maximized her earning potential.

Plaintiff's gross income is $2,378 per month. Payroll taxes of $360 per month, health insurance at $360 per month, and a medical "cafeteria plan" of $100 per month are deducted, leaving a net take home pay of $1,566 per month. Plaintiff's payroll taxes are based on three deductions, so she does not expect to receive any tax refunds.

Prior to working at the All Faiths Receiving Home, plaintiff worked as a paralegal at various Albuquerque law firms. She has investigated returning to paralegal work, determined that she could probably earn $3,000 more per year, but also determined that the cost of this $3,000 would be many hours of overtime and loss of flexibility in her schedule. She also interviewed with a local private school for an administrative job, but found out

that this would result in an actual decrease in income of $3,000 annually.

Plaintiff has been in a living arrangement with Carol Brown ("Brown") for about ten years. Brown was a debtor in another chapter 7 case filed in this jurisdiction in January, 1999. Brown is a telemarketer for MCI Worldcom and has a gross income of $1,132 per month and a net take home of $777 per month. Brown's payroll taxes are based on nine deductions, so she does not expect any tax refunds. As a benefit, Brown receives free health insurance for herself and very inexpensive dental and vision insurance. Brown has a background in computer programming, but has been out of the field for ten years. She would need extensive training if she were to return to employment in that field.

Trial Exhibit 3A is a hypothetical Schedule I, Current income, for their combined income. Brown testified that her MCI paycheck goes directly into the household account. Therefore, Exhibit 3A is a good representation of the actual cash flow for the couple, at a total net income of $2,344.

The couple are the parents[1] of a set of twins, aged 3. Brown works an evening shift from 5:00 p.m. to 10:00 p.m. that complements plaintiff's 8:00 to 4:30 schedule. This allows the

[1]Plaintiff is the birth mother; Brown formally adopted the twins.

couple to keep the children at home, avoiding the cost of day care. Both Brown and plaintiff have investigated the cost of day care, and found it would be approximately $800 per month for both children for full time care.

Trial Exhibit 3B is a hypothetical Schedule J, Current expenditures, for Plaintiff and Brown. The major expenditures are: $714 for housing, $600 for food, $300 for a car payment, $309 for utilities (although Plaintiff testified that the $49 telephone bill included in this total was somewhat less at the time of trial), $150 insurance, and $110 for the installment purchase of a carpet (which would continue for two more years.) These total $2183. Miscellaneous expenses, including $60 per month in prescriptions, $125 gasoline, $30 budgeted for home repairs, $50 for clothing, total another $352, and all appear reasonable for a family of four. The total expenditures of $2535 exceeds income by $192. The budget does not include any expenses for vacations, travel, car repairs, replacement of vehicles, or major repairs on the house.

The $714 housing expense is for a real estate contract for a house that Plaintiff and Brown purchased post-petition. Plaintiff had been renting a house from relatives, but had to move when the rent was raised to $900 per month. The house they purchased is in need of repairs. The carpet loan reflected in their expenditures is for carpeting purchased to fix up the

house. The purchase price of the house was $86,000. Plaintiff and Brown paid $6,700 as a down payment, which came from: $3,947 tax return (plaintiff's), $1,055 tax return (Brown's), and $3,000 loan against Plaintiff's exempt 401k plan. When questioned why she bought a house instead of paying her student loan, Plaintiff responded that her first priority was to have a safe home for her children, in a neighborhood with good schools, and that in the long run the purchase of this house made economic sense because the $714 contract payment is less than comparable rents. Defendant's counsel conceded the wisdom of the purchase, but nevertheless questioned the choice of investing in the future instead of paying her student loan. In addition, the Court finds that the amounts budgeted are all reasonable, not excessive, and that the budget overall demonstrates a modest life style. The Court assumes that the expenses listed above will, for the most part, increase as the cost of living increases. Therefore, even if Plaintiff receives cost of living raises, they will be offset by the actual increased cost of living. Debtor testified that the expenses listed above also do not include costs that will be associated with her children growing older such as school uniforms, sports, or entertainment.

As noted above, Plaintiff paid off three of her four student loans. Her uncontraverted testimony was that she was never late on any student loan payment until she got a forbearance when her

children were born. Since then, she has been unable to make ends meet or make the student loan payments. Defendant conceded that Plaintiff has acted in good faith. The Court also finds good faith, as demonstrated by her paying 3 of the 4 student loans, and making all payments on the fourth loan until she was unable to due to the birth of her children. Furthermore, she sought and obtained a deferment, but was unable to even pay the interest accrual after that time.

The United States Department of Health and Human Services 1999 Poverty Guidelines sets $16,700 as the "Poverty Guideline" for a family of four. This works out to about $1,400 per month. Plaintiff's monthly net income is $1,566, and the household's net monthly income is $2,344.

CONCLUSIONS

Section 523(a)(8) provides that a discharge does not discharge an individual for any debt –

> for an educational ... loan made, insured or guaranteed by a government unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship or stipend, unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

In Woodcock v. Chemical Bank, NYSHESC (In re: Woodcock), 45 F.3d 363, 367-68 (10th Cir.), cert. denied 116 S.Ct. 97 (1995), the Court of Appeals for the Tenth Circuit affirmed (with little

discussion) the Bankruptcy and District Courts' application of three tests for a determination of undue hardship under section 523(a)(8). Those tests were the "mechanical test", as set forth in Craig v. Pennsylvania Higher Educ. Assistance Agency (In re Craig), 64 B.R. 854, 856 (Bankr. W.D. Pa.) *appeal dismissed* 64 B.R. 857 (W.D. Pa. 1986); the "good faith and policy test", as set forth in North Dakota State Bd. of Higher Educ. v. Frech (In re Frech), 62 B.R. 235, 241, 244 n.9 (Bankr. D. Mn. 1986); and the "objective test", as set forth in In re Bryant, 72 B.R. 913, 915-16 (Bankr. E.D. Pa. 1987). In Woodcock, the debtor was found not to meet the tests for discharge of his student loans. Woodcock, 45 F.3d at 367-68. The Tenth Circuit did not, however, address the issue of whether meeting all three tests was necessary, or whether satisfaction of one test would allow discharge.[2]

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[2]Nor did the Tenth Circuit expressly limit future decisions to these three tests.

See e.g., Brunner v. New York State Higher Education Services Corp. (In re Brunner), 831 F.2d 395, 396 (2nd Cir. 1987):

> "Undue hardship" requir[es] a three part showing: (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.

Given the facts in this case, Plaintiff would also prevail under the Brunner test.

In Frech, 62 B.R. at 240, the Minnesota Bankruptcy Court applied all three tests, and explained "The Debtor bears the burden of proof on each test; if the Court finds against the Debtor at any particular stage, its inquiry ends and the debt will not be dischargeable in bankruptcy." Therefore, the Court will review the facts of this case in light of all three tests stated above.

A. Mechanical Test.

In Craig, 64 B.R. at 857, the Court set forth the mechanical test as:

> Will the Debtor's future financial resources for the longest foreseeable period of time allowed for repayment of the loan, be sufficient to support the Debtor and her dependent at a subsistence or poverty standard of living, as well as to fund repayment of the student loan?

(Citing In re Johnson, 5 B.C.D. 532 (E.D. Pa. 1979)).

The Court finds that the debtor's current budget reflects a modest subsistence level of living. There is nothing lavish; indeed, the budget reflects mostly the basics of life: housing, food, transportation, health and auto insurance. The Court has also found that debtor is using her education and has attained

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See also In re Johnson, 5 B.C.D. 532 (E.D. Pa. 1979)(Court used 3 tests: "undue hardship", "mechanical" and "good faith" tests.)

Judge Rose has cited the Brunner, Bryant, and Johnson tests as the three leading tests for determining §523(a)(8) issues. Garcia v. New Mexico Student Loan Guarantee Fund, Adv. No. 96-1317R (Bankr. D. N.M. Aug. 9, 1999).

the maximum level of employment for her education, and will not receive future increases other than cost of living. Her budget does not allow for repayment of the loan at this time, and the Court cannot envision it will at any point in the future. The debtor meets the Mechanical Test.

B. Good Faith and Policy Test.

The Frech Court, cited by the Tenth Circuit in Woodcock, described the good faith and policy test as two separate tests. First, it described the "good faith test" as a showing by the debtor that he is actively minimizing current household living expenses and maximizing his personal and professional resources. 62 B.R. at 241. Then, if so, the "policy test" would apply:

> The Court must determine whether allowing discharge of a given educational loan would constitute the abuse of bankruptcy remedies with which Congress was concerned. Basically, the Court must determine the relative magnitude of the debtor's educational loan obligations as a component of his or her total debt structure, and in conjunction must consider the personal, professional, and financial benefit which the debtor has derived and will derive from the education financed by the loans in question.

Id.

The Court finds that the Debtor meets the "good faith" test for essentially the same reasons set forth above under the "mechanical test."

Debtor's bankruptcy schedules show $30,689 of unsecured debt, of which $9,412 is the student loan. Debtor also shows

secured debt, her vehicle loan, in the amount of $9,522. The Court finds that the bankruptcy was not filed simply to discharge a student loan. The filing was not an abuse of bankruptcy remedies; the Court also notes that debtor had repaid three of four student loans before she filed her bankruptcy. Furthermore, the Court has considered the benefits which the debtor has derived from her student loans, and has found that she is using her education, but has advanced as far as she likely can in her profession. In sum, the debtor meets the "good faith and policy test".

C. The Objective Test.

In Bryant, the United States Bankruptcy Court for the Eastern District of Pennsylvania constructed an "objective test" for determining dischargeability of student loan obligations. 72 B.R. at 913. This test is "objective" because it is tied to federal poverty guidelines:

> "Undue hardship" exists (1) Where the debtor has net income which is not substantially greater than federal poverty guidelines, because a debtor so living perforce is unable to maintain a minimal standard of living and make payments on student loans; or (2) Where the debtor has income substantially above the aforesaid poverty guidelines, but there is a presence of "unique" or "extraordinary" circumstances which render it unlikely that the debtor will be able to repay his or her student loan obligations.

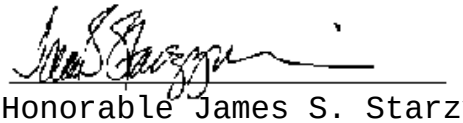
Id.

In this case, the Plaintiff herself has net income of $1,567 per month, slightly above the poverty guidelines. Plaintiff's

household has income of $2,344. On one hand, Plaintiff's partner is not liable on the student loan debt, but on the other, she does contribute significantly to the support of the household, both monetarily and in terms of allowing a savings in child care expense. The Court finds that Plaintiff's income is at approximately the poverty level, and consequently she is unable to service the student loan. The Court also finds that even though the total household income is above the poverty level by almost $900 per month, the budget, which the Court finds reasonable, does not allow for payment of even the interest on the student loan, and that it should be discharged.

Summary

The Court finds that under all three of the tests acknowledged in Woodcock v. Chemical Bank, NYSHESC (In re: Woodcock), 45 F.3d 363, 367-68 (10th Cir. 1995) the Plaintiff's student loan should be discharged. The Court will enter judgment for the plaintiff.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that, on the date file stamped above, a true and correct copy of the foregoing was either electronically transmitted, faxed, mailed, or delivered to the listed counsel and parties.

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