

In the United States Bankruptcy Court

for the Northern District of Iowa

WILLIAM P. NEUBAUER
PAMELA R. NEUBAUER

Bankruptcy No. 99-01897-C

Debtor(s).

Chapter 7

WILLIAM P. NEUBAUER
PAMELA R. NEUBAUER

Adversary No. 99-9180-C

Plaintiff(s)

vs.

IOWA COLLEGE STUDENT AID
COMMISSION and EDUCATIONAL
CREDIT MANAGEMENT CORPORATION

Defendant(s)

ORDER RE: DISCHARGE OF STUDENT LOAN DEBT

This matter came before the undersigned on September 21, 2000 on Debtors' Complaint to Determine Dischargeability of Student Loans. Debtors William P. and Pamela R. Neubauer appeared pro se as Plaintiffs. Christopher C. Foy represented Defendant Educational Credit Management Corporation (ECMC). The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I).

STATEMENT OF THE CASE

Debtors filed a voluntary Chapter 7 petition on July 19, 1999. Educational Credit Management Corporation is a creditor. Each Debtor owes ECMC for separate student loans. Debtors assert that this debt is dischargeable based on "undue hardship" under §523(a)(8). ECMC argues the student loan debt should be excepted from discharge.

FINDINGS OF FACT

Debtors incurred the debt they seek to discharge between 1982 and 1989 as student loans. Mr. Neubauer accrued total student loans with an original principal balance of \$28,324.30 to fund both an undergraduate degree and a Juris Doctorate. On April 16, 1990, Mr. Neubauer consolidated this debt with a loan from the Student Loan Marketing Association (SLMA) of \$28,340.30. With interest and penalties this amount has increased to \$63,300.14 as of September 21, 2000.

Mrs. Neubauer accrued a debt with an original principal balance of \$15,901.11 to fund her B.A. in history. On February 19, 1988, Mrs. Neubauer received a loan from SLMA to consolidate these student loans. With interest and penalties, the total balance has increased to \$46,054.58 as of September 21, 2000. ECMC is the current owner and holder of both of Debtors' consolidated notes as the successor in interest to SLMA. Debtors have made only minimal payments toward their student loan debt over the past decade.

After Mr. Neubauer graduated from law school, he worked for three employers and as a sole practitioner for about eight years before leaving the practice of law and working in the insurance industry. Mr. Neubauer worked for Geico Direct as an insurance agent before transferring to Life Investors, his current employer. Mrs. Neubauer is also currently employed at Life Investors. Debtors have two children, ages 1 and 6 at the time of the petition, and are expecting another child in January.

Debtors' gross household income for 1999 was approximately \$47,250.00, and their anticipated gross income for 2000 is \$55,000.00. Their student loans total \$109,354.72 as of September 21, 2000. This amount accrues interest at 9% per annum.

UNDUE HARDSHIP

Loans for an educational benefit from a governmental agency are not discharged in bankruptcy unless repayment will impose an undue hardship on the debtor and the debtor's dependents. 11 U.S.C. § 523(a)(8). The 1998 amendment to § 523(a)(8) deleted a paragraph enabling student loan debtors to discharge student loans that first became due more than seven years prior to filing. Higher Education Amendments of 1998, Pub. L. No. 105-244, §971, 112 Stat. 1581, 1837 (1998). The critical point of this amendment is that Congress made undue hardship the exclusive basis for discharging student loans. 11 U.S.C. § 523(a)(8).

The Bankruptcy Code does not define what constitutes "undue hardship." 11 U.S.C. § 101. The Eighth Circuit Bankruptcy Appellate Panel provides guidance for determining undue hardship in In re Andresen, 232 B.R. 127, 140 (B.A.P. 8th Cir. 1999). To determine undue hardship, the Eighth Circuit Court of Appeals considered the totality of the circumstances in In re Andrews, 661 F.2d 702, 704 (8th Cir. 1981). In Andresen, the B.A.P. stated:

We interpret Andrews to require a totality of the circumstances inquiry with special attention to the debtor's current and future financial resources, the [] necessary reasonable living expenses for the debtor and the debtor's dependents, and any other circumstances unique to the particular bankruptcy case.

Andresen, 232 B.R. at 140.

The Northern District of Iowa has applied the Brunner test to determine undue hardship. In re Hawkins, 187 B.R. 294, 298 (Bankr. N.D. Iowa 1995). Under the Brunner test, the debtor must show:

(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.

Brunner v. New York State Higher Educ. Serv. Corp., 831 F.2d 395, 396 (2d Cir. 1987).

This test does not consider the financial benefits or the marketability of the skills gained through the education financed through the loans Debtors seek to discharge. Hawkins, 187 B.R. at 298. This is relevant because Mr. Neubauer has a law degree that is, arguably, highly marketable in the current market. The actual value of that degree to Debtors, however, is diminished because Mr. Neubauer does not practice law or work in the legal field. Applying Brunner, the Court will not consider the value of Mr. Neubauer's legal education.

PARTIAL DISCHARGE AND SEPARATE DISCHARGEABILITY

There is some debate regarding the partial dischargeability of student loans; courts are split between an all or nothing approach and partial discharge. See, e.g., Andresen, 232 B.R. at 129-37. A partial discharge would enable a debtor to repay only that portion of the student loan the debtor is capable of repaying without suffering undue hardship. Id. at 132-33. The all or nothing approach enables a debtor facing undue hardship to discharge the entire debt while the debtor who fails to make a showing of undue hardship must repay the totality of the loan. Id. at 133.

Section 523(a)(8) provides an exception to discharge:

for an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, or any 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;

11 U.S.C. § 523(a)(8). This section neither specifically allows partial discharge of student loan debt nor precludes it.

While the Eighth Circuit Court of Appeals has not ruled on partial dischargeability, the Eighth Circuit Bankruptcy Appellate Panel has adopted the all or nothing approach. Andresen, 232 B.R. at 136-37. In Andresen, the B.A.P. held that § 523(a)(8) must be applied to each loan separately. Id. at 137. This distinction provides the Court with some discretion in cases where debtors owe on more than one student loan. The Court may determine that repaying one or both of Debtors' student loans presents an undue hardship. In Andresen, the court ruled that excepting two of the debtor's student loans from discharge presented an undue hardship while excepting a third loan did not. Id. at 141.

CURRENT AND FUTURE FINANCIAL RESOURCES

Debtors' current combined gross income is approximately \$55,000.00. This income, however, is expected to change in the near future for several reasons. Mr. Neubauer's income has increased substantially over the past few years. His current position, however, is in a relatively new division at Life Investors. Its prospects for the future are expected to effect his income. Mr. Neubauer's past pay increases have been realized in large part because he found new employment with better compensation. The record suggests that Mr. Neubauer intends to remain in the employ of Life Investors for the foreseeable future. He testified that his employment contains performance incentives based on the future success of his division. He currently contributes approximately 60 per cent of Debtors' combined income.

Mrs. Neubauer is pregnant with Debtors' third child and expecting in January. She expects to take maternity leave and her future employment and income is uncertain for the foreseeable future.

Debtors have indicated that Mrs. Neubauer may opt to remain at home to provide child care. While this would reduce the cost of child care as an expense, Debtors' total income will be reduced by approximately 40 per cent.

REASONABLY NECESSARY LIVING EXPENSES

The Court examines Debtors' current income and expenses to determine if they live in a manner more extravagant than a "minimal" standard of living. Debtors' monthly net income is approximately \$3,500.00. Debtors' current expenses total \$3,390.00. Debtors' monthly expenses are used for food, shelter, and utilities for the most part, and with few exceptions, are reasonably necessary.

A minimal standard of living does not require that debtors income is below the poverty level; it does however preclude luxuries or frivolous expenses. Hoyle v. Pennsylvania Higher Educ. Assistance Agency, 199 B.R. 518, 521-23 (Bankr. E.D. Pa. 1996). "While Debtor's gross income level may be higher than the poverty level, she is living a frugal lifestyle. If forced to repay her student loan, she would not even be able to do that." Id. at 523.

Debtors do not fail the minimal lifestyle test solely because their income exceeds the poverty level. Debtors anticipate expenses will change in the foreseeable future due to changes in child care arrangements, a recent automobile accident, and expenses related to their expected child. [\(1\)](#)

IMPACT OF REPAYING LOANS

Debtors' monthly expenses listed in Schedule J do not include payments on their student loans. The impact of repaying both loans would be dramatic. The annual interest on these loans is currently over \$9,840.00. To merely cover accrual of interest, Debtors must pay ECMC over \$820.00 per month. If they are unable to pay that much, the loans will continue to grow.

Currently, Debtors show an ability to pay less than half of that amount. To pay an amount that would enable Debtors to pay some portion of principal, Debtors would be unable to maintain what is already a frugal lifestyle. If Debtors do not have the resources to pay any principal, this debt will never be repaid, and debtors will face a situation analogous to indentured servitude, where they work their entire lives to pay a debt that keeps growing.

Considering the loans separately, repayment of Mr. Neubauer's student loan obligation would require payments of approximately \$500.00 per month to pay some of the principal. A \$500.00 monthly payment would pay down principal by approximately \$150.00 per year on the \$63,300 debt. Debtors currently cannot afford to pay \$500.00 per month toward this debt without eliminating expenses that this Court finds reasonably necessary. Moreover, the Court does not anticipate Debtors will have ability to pay that amount in the reasonably foreseeable future.

Repayment of Mrs. Neubauer's student loan obligation of \$46,054.58 would require a monthly payment in excess of \$345.41 to pay any principal. This amount is within Debtors' ability to pay without eliminating any reasonably necessary expenses.

ADDITIONAL CIRCUMSTANCES

While Mr. Neubauer has earned a law degree, he is not currently employed in a capacity where he is rewarded for that training with an increased salary. Mr. Neubauer tried for almost a decade to utilize his legal training, and his efforts were met with little success.

Some questions are raised by Debtors' ten-year failure to attempt repayment of their loans. It is important to note that the original indebtedness was \$44,225.41. Of Debtors' current student loan obligation, \$65,129.31 is interest that accrued during the ten years that Debtors did not make payments on their loans. This however, does not necessarily demonstrate a lack of good faith on the part of the debtor. Hawkins, 187 B.R. at 299.

In Hawkins, the debtor failed to make even a minimal payment on her loans. Id. The court found that this did not preclude a finding of good faith. Id. "A debtor's good faith is measured by her 'efforts to obtain employment, maximize income and minimize expenses,' and by inquiring whether debtor is culpable for causing her own poor financial condition." Id. In determining whether Debtors are culpable for causing their own financial condition, the court should look to whether they "lived the high life, t[ook] the easy road or made [] irresponsible decision[s] affecting [their] ability to repay [their] loan[s]." Hoyle, 199 B.R. at 524.

Debtors have worked throughout the period following graduation, they have not lived an extravagant lifestyle, and they have not taken the easy road or made irresponsible decisions. There is nothing to suggest that Debtors are taking advantage of the system in this case. Their inability to make payments in the past was the result of insufficient income to make payments. While Debtors' failure to repay raises questions, it does not preclude a finding of good faith where the circumstances suggest that Debtors minimized expenses and maximized income.

Additional circumstances that may be considered is the impact of these debts on Debtors in the absence of a discharge. If ECMC obtains a judgment against Debtors for these debts, Debtors' home, as a post-acquisition debt will be subject to a lien that may be foreclosed despite the homestead exemption. Iowa Code § 561.21(1) (1999). Thus, Debtors would face potential foreclosure on their home.

The garnishment limits against future earnings preclude collection amounts sufficient to repay ECMC. The maximum amount that ECMC can garnish from Mr. Neubauer annually, based on his expected income, is \$1,500.00. Iowa Code § 642.21(1)(c). The Iowa garnishment statute would allow a maximum annual garnishment of \$800.00 from Mrs. Neubauer based on her expected income. Iowa Code § 642.21(1)(b). If garnishment becomes the means for collecting these debts, they will increase in size annually. In the first year alone, the debt would increase over \$7,500.00.

CONCLUSION

If Debtors are forced to repay their loans, they would not be able to maintain a minimal standard of living. There is no evidence to suggest that Debtors' income will increase sufficiently in the foreseeable future to allow them to repay these loans. Debtors' have lived frugally, and circumstances beyond their control rendered them unable to make payments on their loans. Thus, they have shown a good faith effort to repay these loans.

Repaying the total of Debtors' student loan obligations presents an undue hardship because it requires that debtors pay an amount that would not leave sufficient income to provide for reasonably necessary expenses. By the same standard, Debtors' income is not sufficient to enable Debtors to make payments on Mr. Neubauer's debt. The Court finds, however, that Debtors have sufficient resources to

afford reasonably necessary expenses and make payments on Mrs. Neubauer's student loan obligation. The Court will therefore discharge Mr. Neubauer's student loan obligation. Mrs. Neubauer's student loan obligation is excepted from discharge under §523(a)(8).

WHEREFORE, Debtors' motion to discharge student loan obligation for undue hardship is GRANTED in part and DENIED in part.

FURTHER, the Court finds that repayment of Debtors' entire student loan obligation presents an undue hardship.

FURTHER, the Court finds that repayment of Mr. Neubauer's student loan obligation presents an undue hardship. Debtor William Neubauer's student loan debt is therefore discharged.

FURTHER, the Court finds that repayment of Mrs. Neubauer's student loan obligation does not present an undue hardship. Debtor Pamela Neubauer's student loan debt is therefore excepted from discharge.

SO ORDERED this 18th day of October, 2000.

Paul J. Kilburg
Chief Bankruptcy Judge

1. The court does not consider evidence not presented at trial in calculating Debtors' expenses. Thus, ECMC's objection to post-trial statements of Debtors is moot.