

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

EDWARD R. FRANKLIN & CHERYL
L. FRANKLIN, DBA FRANKLIN
PRODUCTIONS GROUP,

BKY 4-93-6489

Debtors.

EDWARD R. FRANKLIN,

Plaintiff,

vs.

NATIONAL CITY BANK; PORTLAND
STATE UNIVERSITY; OREGON STATE
SCHOLARSHIP COMMISSION; SALLIE
MAE a/k/a LOAN SERVICING
CENTER; UNITED STATES
DEPARTMENT OF EDUCATION;
& UNITED STUDENT AID FUNDS, INC.,

ADV. 4-95-032

FINDINGS OF FACT,
CONCLUSIONS OF LAW AND
ORDER FOR JUDGMENT

Defendants.

At Minneapolis, Minnesota, September 8, 1995.

The above-entitled matter came on for trial on August 22, 1995. Appearances were as noted on the record. The Court, having heard the arguments of counsel and the evidence and being duly advised in the premises, makes the following:

FINDINGS OF FACT

1. Edward R. Franklin ("Edward") is thirty-one years old, married, and has three dependent children ages six, three, and one. Edward's wife, Cheryl L. Franklin ("Cheryl"), is thirty-four years old and currently pregnant. The couple were married in 1988.

2. Edward, Cheryl, and their children are all in good health.

3. Although Cheryl has been actively engaged as a homemaker for the last six to seven years, she has not been employed outside the home in the last nine years.

Apparently, she has not attempted
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Patrick G. De Wane, Clerk, By <u>PK</u>

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to seek employment outside the home due to the ages of the children and the importance the role of family unity plays in the couple's lives. Cheryl does not have a high school diploma.

4. Between 1984 and 1993, Edward attended college, sometimes intermittently, at various educational institutions in Oregon, California, and New York. Although he completed course work in general studies, his emphasis was in theater. Edward hoped to be an actor.

5. In order to finance his education as well as meet living expenses, Edward was forced to work during school and obtain funds through various grant programs. The primary source for his educational financing, however, was derived from different student loan programs.

6. On or about September 14, 1990, Edward executed a promissory note payable to the order of National City Bank ("NCB") in connection with the consolidation of several different loans in the principal amount of \$21,391.53, which bears interest at the rate of 10% per annum. The note was assigned to the defendant in this case, United Student Aid Funds, Inc. ("USAF"), on or about December 2, 1994, and has an unpaid principal and accrued interest balance as of August 22, 1995, of \$33,304.12.

7. On or about September 23, 1991, Edward executed a promissory note payable to the order of First Interstate Bank, in the principal amount of \$3,000.00 (although only \$2,370.00 was disbursed), which bears interest at a variable rate currently at 8.53%. That note was assigned to and is guaranteed by the defendant in this case, the Oregon State Scholarship Commission ("OSSC"). The unpaid principal and accrued interest balance under

this note as of August 22, 1995, is \$3,122.25.

8. On or about October 28, 1991, Edward executed a promissory note payable to the order of First Interstate Bank, in the principal amount of \$2,625.00, which bears interest at the rate of 8% per annum for the first four years and 10% per annum thereafter. That note was also assigned to the OSSC. The unpaid principal and accrued interest balance under this note as of August 22, 1995, is \$3,217.84.

9. The USAF note and the two OSSC notes both require Edward to pay the holder reasonable attorneys' fees and costs of collection.

10. Edward is also indebted to Portland State University ("PSU") in the approximate amount of \$428.77 for tuition charges and/or other expenses associated with his enrollment at PSU.

11. At some point between 1984 and 1993, Edward decided to go into business for himself and opened a theater group. The business venture failed and left him saddled with extensive financial obligations.

12. Edward's financial condition began to markedly deteriorate. After paying approximately \$1,000.00 toward the reduction of his scholastic indebtedness, he defaulted on his student loan payments. Although he indicated that he "applied for forbearance," there was really no lucid testimony presented with regard to what, if any, steps he actually took to work things out with the lending agencies or what, if any, avenues still remain available.

13. On November 15, 1993, Edward and Cheryl filed a joint petition for relief under Chapter 7 of the United States Bankruptcy

Code. The discharge provisions of the Code have enabled Edward and Cheryl to rid themselves of a significant amount of unsecured debt and have ostensibly served as the catalyst for being able to compromise a nondischargeable tax claim with the Internal Revenue Service ("IRS"). Nevertheless, Edward and Cheryl remain obligated to the IRS and the Oregon Department of Revenue, despite the benefit of the bankruptcy discharge.

14. Edward and Cheryl have always tried to minimize their expenditures by, for example, purchasing food at the food shelter and buying used clothing. It was the advent of bankruptcy, however, which has ostensibly forced them to actually put pen to paper and prepare a formal budget.

15. Edward and Cheryl own two vehicles. One of the vehicles was purchased for approximately \$5,100.00 and was paid for by the use of a secured credit card. The security for the credit card consists of a cash savings account in the amount of \$3,000.00.

16. Edward has extensive work experience in the hospitality industry, primarily as a waiter. He worked for Marriott in various geographic locations for a number of years as well as other restaurants. Edward testified that he was working close to seventy hours a week and was rarely at home with his family. In 1994, Edward was able to earn \$34,741.00.¹ He further testified that the grueling hours and importance of family in his life made him look for a management position in the food and beverage industry despite the concomitant cut in pay. Edward found such a position and

¹Edward's approximate gross income in previous years is as follows: 1990--\$24,500.00; 1991--\$28,796.00; 1992--\$18,600; 1993--\$26,000. During some of this time, however, Edward was enrolled in college.

recently completed a training program with Cracker Barrel Old Country Store, Inc., and has moved into an entry level management position with the company in one of their restaurants based in Georgia. He expects his annual base income to be approximately \$24,000.00. There is a good possibility for a bonus, however, and he indicated that he hopes to earn around \$26,000.00 in his first year. Although certainly not guaranteed, Edward anticipates that annual performance-based raises will garner a five to six percent increase in salary.

17. The debtors' budget reflects that after a deduction for taxes, Edward's current monthly take home pay, estimated at an annual rate of \$26,000.00, amounts to \$1,690.00. Estimated monthly expenses, however, are \$2,234.88, leaving an estimated budgetary shortfall of approximately \$544.88. It is noted, however, that the estimated budget contains at least \$235.00 worth of expenditures which can fairly be regarded as payments on short-term obligations.

18. This action arises by Complaint filed by debtor on February 7, 1995, which seeks to discharge the student loans owing the various defendants pursuant to 11 U.S.C. § 523(a)(8)(B). The Complaint alleges that an inability to discharge the educational indebtedness would constitute an undue hardship and effectively preclude the debtors and their family from maintaining an adequate standard of living.

19. USAF and OSSC have counterclaimed and seek to have the outstanding educational indebtedness, comprised of the principal together with accrued interest declared nondischargeable. Additionally, USAF and OSSC, pointing to the terms of the promissory notes executed by Edward, further seek to recover

reasonable attorney's fees and costs of collection.

20. PSU was duly served with a Summons and Complaint in a timely manner in accordance with the Bankruptcy Rules but has not answered the Complaint or otherwise appeared in this action. Although Sallie Mae, a/k/a Loan Servicing Center, and the Department of Education have not interposed an answer to the Complaint, the plaintiff has conceded that he is not indebted to either of those entities.

CONCLUSIONS OF LAW

1. Bankruptcy law is grounded upon the public policy of freeing the honest, but unfortunate debtor, from the financial burdens of prepetition indebtedness and thereby allowing the debtor to make an unencumbered fresh start. United States Dept. of Health & Human Servs. v. Smith, 807 F.2d 122, 123 (8th Cir. 1986) (citing Kikoszka v. Belford, 417 U.S. 642, 645-46 (1974)). See S. Rep. No. 95-989, 95th Cong., 2d Sess. 7, reprinted in 1978 U.S.C.C.A.N. 5787, 5793 (indicating that at the very heart of the fresh start provisions of the Bankruptcy Code, lies the § 727 discharge). Accord Local Loan Co. v. Hunt, 292 U.S. 234, 244, 54 S. Ct. 695, 699, 78 L. Ed. 1233 (1934); Williams v. United States Fidelity & Guar. Co., 236 U.S. 549, 554-55, 35 S. Ct. 289, 290, 59 L. Ed. 713 (1915).

2. However, bankruptcy law limits a debtor's ability to discharge certain obligations which arose prior to the commencement of the case by statutorily excepting certain categories of debts from the bankruptcy discharge. The exceptions from discharge are set forth at § 523 of the Bankruptcy Code and are essentially the product of countervailing policy considerations in which the scales

of justice tip in favor of certain creditors by allowing enumerated categories of obligations to remain virtually unscathed by the bankruptcy discharge. Generally speaking, educational loans granted or insured by the government fall into this category.

3. The resolution of this adversary proceeding is governed by § 523(a)(8)(B) which provides in pertinent part that:

A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt--

(8) 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 or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship, or stipend, unless--

(B) 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)(B) (emphasis added). In short, student loan obligations may be discharged in bankruptcy under this provision only if the debtor demonstrates by a fair preponderance of the evidence that requiring the repayment of the loan would impose an "undue hardship" on the debtor and his dependents. See O'Brien v. Household Bank FSB (In re O'Brien), 165 B.R. 456, 458 (Bankr. W.D. Mo. 1994) (citing In re Roberson, 999 F.2d 1132, 1136 (7th Cir. 1993)).

4. The Code does not define the phrase "undue hardship" because limiting these terms of art to an exacting and inflexible definition would thwart a searching inquiry into the facts of a particular case and the concomitant determination of whether they warrant a finding of dischargeability.

5. It is clear, however, that Congress intended to safeguard

the integrity of the student loan program by permitting the discharge of student loans only in what can be fairly regarded as unique or "exceptional circumstances." Shoberg v. Minnesota Higher Ed. Coord. Council, 41 B.R. 684, 687 (Bankr. D. Minn. 1984). The courts are therefore resoundingly unanimous in concluding that there must be more than a mere hardship or present financial adversity, the hardship must be undue and generally evidence a persisting problem that will have a long-term impact upon the debtor's prospects for the future:

"mere financial adversity will not do . . . the point is that Congress meant the extinguishment of student loans to be an available remedy to those severely disadvantaged economically as a result of unique factors which are so much a part of the [debtor's] life, present and foreseeable future, that the expectation of repayment is virtually non-existent unless by the effort the [debtor] strips himself of all that makes life worth living."

North Dakota State Bd. of Higher Ed. v. Frech (In re Frech), 62 B.R. 235, 241 (Bankr. D. Minn. 1986) (quoting In re Briscoe, 16 B.R. 128, 131 (Bankr. S.D.N.Y. 1979)). As such,

[a] debtor does not establish undue hardship by proof that continuing responsibility for student loans would bring about "an unpleasantness," or a "garden-variety hardship." The hardship which would result from nondischargeability must be long-term. The Court must find "the certainty of hopelessness [or repayment], not simply a present inability to fulfill financial commitment."

Id. (citations omitted). See Phelps v. Hemar Ins. Corp. (In re Phelps), 180 B.R. 27, 28 (Bankr. D.R.I. 1995) (requiring a permanent hardship).

6. The inquiry for undue hardship progresses along a tripartite or three-pronged analysis, termed the "mechanical," the "good faith" and the "policy" tests. In re Frech, 62 B.R. at 240. The inquiry ends, and the debt will be found to be nondischargeable

in bankruptcy, if the debtor fails to carry the burden of proof with respect to any one of the tests. Id.

7. The "mechanical test" is the threshold requirement that requires a bankruptcy court to reasonably assess a debtor's vocational profile by estimating a number of factors including the rate and amount of a debtor's future resources in terms of ability to obtain and retain adequate employment, the total amount of available income, its reliability, the periodicity of its receipt, future employment and income prospects, family support responsibilities, education and skills, aptitude, marketability, health, as well as balance sheet factors such as the debtor's current and future household expenditures and their reasonableness in kind and amount. Andrews v. South Dakota Student Loan Assistance Corp. (In re Andrews), 661 F.2d 702, 703 (8th Cir. 1981); Schoberg v. Minnesota Higher Ed. Coord. Council, 41 B.R. 684, 687 (Bankr. D. Minn. 1981); Cossette v. Higher Ed. Assistance Found., 41 B.R. 689, 691 (Bankr. D. Minn. 1984). Fundamentally, the court must be satisfied under this test that the debtor's income and other financial resources will not be sufficient to maintain a minimal or "poverty level" standard of living, not only presently, but in the foreseeable future if the debtor were under a continuing obligation to make some payment on the student loan debt. In re Frech, 62 B.R. at 241.

8. Careful consideration of the evidence in this case leads to the conclusion that Edward has failed to meet his burden of proof under the mechanical test. The hardship Edward and his family will be forced to face will not be "undue" within meaning of § 523(a)(8)(B). Edward is a healthy young man, who is bright,

extremely articulate, and motivated. He is reasonably well educated, has a good work ethic, and exhibits a deep commitment to family values. He has a long work history in the hospitality industry and has a promising future in his new employment.

9. The bankruptcy laws have enabled the debtors in this case to free themselves from a substantial portion of their prepetition indebtedness. Although the Court does not doubt that the debtors' monthly budgetary shortfall is very real and that they are making efforts to minimize expenses, a number of the budgeted items such as the \$120.00 per month tax obligation are not continuing obligations. Moreover, the Court is not convinced that the debtors have been doing all that they can to maximize available resources. While not meaning to denigrate the importance of her position as a homemaker, Cheryl, who did not testify at this proceeding, has not been employed outside the home for approximately nine years. She is young, healthy, and apparently capable of generating at least some income in order to relieve the family's current plight. Debtor did not provide evidence to demonstrate that, even with young children, she could not contribute anything to the family income. There is no reason to believe that the hardship with which the debtors are currently faced will be permanent or in any real sense unique to that which exists, at least to some degree, in every Chapter 7 case.

10. Debtor has failed to meet the mechanical test. There is no need to determine, therefore, whether debtor meets the good faith or public policy tests.

ORDER FOR JUDGMENT

Accordingly, and for reasons stated, IT IS HEREBY ADJUDGED:


1. That judgment be entered in favor of the defendant-creditor, United Student Aid Funds, Inc., and against plaintiff-debtor, Edward R. Franklin, rendering the educational indebtedness of the unpaid principal and accrued interest nondischargeable in bankruptcy.

2. That judgment be entered in favor of the defendant-creditor, Oregon State Scholarship Commission, and against the plaintiff-debtor, Edward R. Franklin, rendering the educational indebtedness of the unpaid principal and accrued interest nondischargeable in bankruptcy.

3. That judgment be entered in favor of the plaintiff-creditor, Edward R. Franklin, and against the defendant-creditor, Portland State University, in the amount of \$428.77 together with any accrued interest to date, said sum being dischargeable in bankruptcy pursuant to Rule 7055 of the Federal Rules of Bankruptcy Procedure.

3. That the request for attorneys' fees and costs for collection as set forth in the counterclaims of the United Student Aid Funds, Inc., and the Oregon State Scholarship Commission is in all things DENIED.

LET JUDGMENT BE ENTERED ACCORDINGLY.


Nancy C. Dreher
United States Bankruptcy Judge