

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE

UNITED STATES BANKRUPTCY COURT
WESTERN DIVISION
FILED

SEP 24 1998

IN RE:

JED G. WEINTRAUB
CLERK OF COURT
WESTERN DISTRICT OF TENN.

BARTINA GRADDY,

Case No. 98-2282 1 -B

Debtor.

Chapter 7

BARTINA GRADDY,

Plaintiff,

v

Adversary Proceeding

No. 98-03 17

UNITED STATES,

Defendant.

MEMORANDUM OPINION AND ORDER GRANTING DEFENDANT'S
MOTION FOR SUMMARY JUDGMENT AND DENYING PLAINTIFF'S MOTION

APPEARANCES:

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Before the Court are motions for summary judgment from both parties to this adversary proceeding. The defendant, the United States, filed its motion for summary judgment in response to the debtor's "Complaint to Determine Dischargeability of Debt," and the debtor subsequently filed her motion for summary judgment. At issue is whether the seven year period of nondischargeability of student loans under §523(a)(8)(A) should be measured from the date the original loan became due or instead from the date the consolidated loans first became due. In this case the original loans became due more than seven years before the debtor filed for bankruptcy, but the consolidated loan fell due within the seven-year period. No material issues are in dispute, and the parties present a question of law. The following constitutes findings of fact and conclusions of law pursuant to Fed. R. Bankr P. 7052 and 7056. This is a core proceeding under 28 U.S.C. §157(b)(2)(I).

SUMMARY OF FACTS

The debtor originally filed for bankruptcy under Chapter 7 on February 25, 1998, before converting her case to Chapter 13 on June 25, 1998. On March 19, 1998, the debtor filed this adversary proceeding to obtain a discharge of her student loans. The unsecured claimholder for the balance on the loans is the United States Department of Education. The loans were guaranteed by the United States pursuant to Title IV-B of the Higher Education Act of 1965, 20 U.S.C. §§ 1071 et seq., and the original five loans became due on November 11, 1986. After defaulting on her payments, the debtor on September 6, 1996, executed a promissory note evidencing a consolidation loan in accordance with Title IV-D of the Higher Education Act of 1965, 20 U.S.C. §§ 1087a et seq. In this transaction, the original loans were paid off with the proceeds of the consolidation loan, which became due on or after November 6, 1996.

DISCUSSION AND CONCLUSIONS OF LAW

This case is before the Court on motions for summary judgment. Federal Rule of Bankruptcy Procedure 7056 states that Federal Rule of Civil Procedure 56 applies in adversary proceedings under the Bankruptcy Code. Rule 56 provides that summary judgment is available if “the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to a judgment as a matter of law.” Fed. R. Civ. P. 56(c). See Celotex Corp. v. Catrett, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). The Court has examined the pleadings in the file and has determined that no genuine issues of material fact exist and that summary judgment is appropriate.

This case presents the question of whether a consolidated student loan can be discharged if the original loans became due more than seven years before the debtor’s bankruptcy filing but the consolidation loan becomes due within seven years of the filing. That question requires a determination of two narrower issues: whether the consolidation loan is a new loan and whether the original loans have been extinguished. The Court concludes that the consolidation loan is a new loan which extinguished the original loans.

11 U.S.C. §523(a)(8) controls the dischargeability of educational loans guaranteed or insured by the government:

(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—

(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 unit or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship, or stipend, unless—

(A) such loan, benefit, scholarship, or stipend overpayment first became due before more than 7 years (exclusive of any applicable suspension of the

repayment period) before the date of the filing of the petition; or
(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents

The debtor asserts § 523(a)(S)(A) as her basis for discharge. Acknowledging that the original loans would be discharged under § 523(a)(S)(A) if the loans had not been consolidated, the government argues that the consolidation loan discharged the original loan, and the consolidation loan is the only loan in existence to provide the relevant date for dischargeability.

The consolidation of educational loans is governed by the Higher Education Act, which was amended to allow students to consolidate loans. The Act, in section 1078-3(e) states in part: "Loans made under this section which are insured by the Secretary shall be considered to be new loans made to students for the purpose of section 424(a) [20 U.S.C. § 1074(a)] of this title." 20 U.S.C. §1078-3(e). 20 U.S.C. § 1074(a), establishes a maximum total principal amount that the government can expend on new loans and installments to students covered by federal loan insurance. The Act further provides that any lender making a consolidation loan to an eligible borrower "shall enter into an agreement with the Secretary or a guaranty agency which provides- .(D) that the proceeds of each consolidation loan will be paid by the lender to the holder or holders of the loans so selected to discharge the liability on such loans." 20 U.S.C. § 107%3(b)(1)(D).

The plain language of section 1078-3 of the Higher Education Act alerts borrowers and lenders that upon consolidation of loans governed by the Act, the original loans are discharged. This discharge occurs as the original loans are paid off with the proceeds of the consolidation loans. Thus, just as The Higher Education Act considers the consolidated loans new loans for purposes of the Secretary's expenditures under the Act, the majority of courts addressing the issue have held that the

consolidated loan is a new loan for purposes of section 523(a)(8)(A). See, e.g., In re McKinney, 1992 WL 265992 (N.D. Ohio, May 12, 1992), rev'g In re McKinney, 120 B.R. 416 (Bankr. ND. Ohio 1990); In re Hesselgrave 177 B.R. 68 1 (Bankr. D. Ore. 1995); In re Menendez, 15 1 B.R. 972, 974 (Bankr. M.D. Fla. 1993)(stating that the plain reading of § 523(a)(8)(A) shows that “such loan” “must refer to the loan which is sought to be discharged, which in the present instance is represented by the consolidation note”).

Congress allowed the consolidation of student loans in order achieve its purpose of “reduc[ing] defaults by making repayment terms sensitive to the borrower’s financial situation.” In re Martin, 137 B.R. 770,774 (Bankr. W.D. Mo. 1992) (holding that the consolidated loan was a new loan which first became due under the terms of the consolidated loan). Avoiding repayment first by consolidating the loan and then by filing bankruptcy would oppose the legislative intent behind the Higher Education Act and the Bankruptcy Code. Id. at 775. Another court notes that “[i]t would be inequitable to allow the debtor to do away with the troublesome features of the original loans and accept the benefits of consolidation and then still be able to use the favorable repayment dates for bankruptcy purpose.” In re Cobb, 196 B.R. 34, 38 (Bankr. E.D. Va. 1996)(finding that the consolidation loan was a new loan and therefore not dischargeable). Congress enacted § 523(a)(8)(A) to curb the abuse of students tiling for bankruptcy soon after graduation and only minimal efforts at repayment, e.g., In re Hiatt, 36 F.3 d 2 1, 24 (7th Cir. 1994), and a strong public policy for repayment of student loans is evidenced by Congress’ extending the five-year period of nondischargeability to seven years. In re McKinney, 1992 WL 265992; In re Saburah, 136 B.R. 246 (Bankr. C.D. Cal. 1992); In re Cobb, 196 B.R. 34, 37. As the Hiatt Court noted, finding that the consolidation loan determines when the loan first becomes due “[f]urtheres the Congressional policy

by ensuring that a consolidation loan, which is in fact a second government guaranteed student loan debt, is collectible for a least five years [now seven years] before it is dischargeable.” In re Hiatt, 36 F.3d at 24.

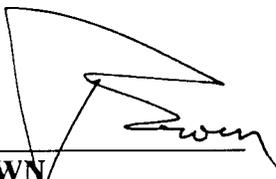
The debtor cites no cases supporting her argument, for the cases she cites involve debtors seeking discharge of suspended loans or taxes. The Court distinguishes or rejects the few cases holding that the original loan terms control repayment of consolidation loans under section 523(a)(S)(A). The first court to decide the issue held that the consolidated loans were dischargeable because they first became due when the original loans became due. In re Brown, 4 B.R. 745 (Bankr. E.D. Va. 1980). In re Brown is distinguishable, because the creditor for the consolidation loan was the same entity as the creditor for the original loan, In re Hesselrave, 177 B.R. at 683, and Ms. Graddy’s consolidation loan contains different lenders and different terms from the old notes. Although two cases from Brown’s district, In re Ziglar, 19 B.R. 298 (Bankr. E.D. Va. 1982) and In re Washington, 41 B.R. 211 (Bankr. E.D. Va. 1984), followed Brown, they received much criticism and rejection from other courts, and they are no longer considered controlling in that judicial district. In re Cobb, 196 B.R. 34, 36-37.

The Brown Court’s decision was sparked by its fear of effecting an extension of the nondischargeability period from five to fifteen years. See In re Brown, 4 B.R. 745. A later court from Brown’s district rejected Brown and its rationale and stated that the extension to fifteen years “does not conflict with the Congressional intent to curtail abuse and promote the viability of the student loan program.” In re Cobb, 196 B.R. at 37. Notably, 20 U.S.C. § 1078-3(a)(3)(B) provides for consolidation of eligible student loans only once. In re Martin, 137 B.R. 770,774. Other courts regard Brown’s effect as “benefit[ing] the student with money during school, then burden[ing] the

taxpayer with funding such a loan which was hardly repaid. Such a result was not intended by Congress.” In re Hesselgrave, 177 B.R. at 683.

Concluding that the consolidation loan is a new loan and that the original loans are no longer in existence, the Court agrees with the government that the debtor’s student loans will first become due when the consolidation loan becomes due. This date being within seven years of the debtor’s bankruptcy filing, the Court grants defendant’s motion for summary judgment and denies plaintiffs motion for summary judgment.

WHEREFORE, IT IS ORDERED that the student loan represented by the consolidation loan remains nondischargeable under section 523(a)(A).



WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

DATE: Sept. 24, 1998