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JUL - 3 2002

BANKRUPTCY COURT
OAKLAND, CALIFORNIA

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

No. 00-42039 J7

Adv. No. 02-4017 AJ

JANNY CASTILLO,

Debtor. /

JANNY CASTILLO,

Plaintiff,

vs.

ED FUND and EDUCATIONAL
CREDIT MANAGEMENT CORPORATION,

Defendants. /

DECISION AFTER TRIAL

By this adversary proceeding, plaintiff Janny Castillo, the above debtor ("Castillo"), seeks to discharge an educational loan pursuant to Bankruptcy Code § 523(a)(8). Defendant Educational Credit Management Corporation ("ECMC") is the current holder of the loan. The court will grant Castillo the requested relief.

A. Facts

The relevant facts are basically undisputed. Castillo is a 40-year old woman, generally in good health, and is the sole provider

1 for her four minor children, who live with her. The children are
2 ages 9, 13, 15, and 16. Castillo has a high school diploma.

3 Castillo took out the loan at issue (the "Loan") in 1993 to
4 consolidate two loans that helped fund Castillo's expenses in
5 obtaining a certificate from Dickinson Warren Business College,
6 where she studied word processing and related skills. The original
7 amount of the Loan was in the sum of \$9,759. Because of Castillo's
8 inability to make payments, the current balance of the Loan is now
9 in the approximate sum of \$22,700.

10 After 1993, Castillo faced some difficult challenges. Over the
11 following six-year period, she was homeless or living in a homeless
12 shelter with four children, and dependent on AFDC.

13 Thereafter, with the assistance of a United Way agency and a
14 Section 8 voucher, Castillo was able to rent living space. She also
15 started providing volunteer services at the Oakland, California
16 public school that her children attended. After Castillo performed
17 volunteer work for three years, the school offered her a position as
18 a salaried instructional assistant, the position that she now holds.
19 Castillo currently earns a gross monthly salary of \$1,544 at the
20 school. With anticipated overtime, Castillo estimates that her
21 gross monthly income will be approximately \$1,720, and that her
22 monthly take-home pay will be \$1,470. Castillo's monthly expenses
23 total approximately \$1,760, which is \$290 in excess of her monthly
24 take-home pay. The amount and reasonableness of Castillo's expenses
25 are not in dispute.

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1 B. Discussion

2 Bankruptcy Code § 523(a)(8), as in effect for bankruptcy cases
3 filed on or after October 7, 1998, provides:

4 (a) A discharge under section 727 . . . of this title does not
discharge an individual debtor from any debt—

5 (8) for an educational benefit overpayment or loan made,
6 insured or guaranteed by a governmental unit, or made under any
7 program funded in whole or in part by a governmental unit or
8 non-profit institution, or for an obligation to repay funds
9 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.

10 Although the Bankruptcy Code does not define "undue hardship,"
11 the meaning of the term is governed by the Ninth Circuit's decision
12 in In re Pena, 155 F.3d 1108 (9th Cir. 1998). Pena adopted the
13 three-part test articulated in In re Brunner, 46 B.R. 752, 753
14 (S.D.N.Y. 1985), aff'd, 831 F.2d 395 (2d Cir. 1987). Pena, 155 F.3d
15 at 1114. Under this test, the debtor must first establish that she:

16 cannot maintain, based on current income and expenses, a
17 'minimal' standard of living for herself and her
dependents if forced to repay the loans.

18 Pena, 155 F.3d at 1111 (quoting Brunner, 831 F.2d at 396).

19 Next, she must show that "additional circumstances exist
20 indicating that this state of affairs is likely to persist for a
21 significant portion of the repayment period of the student loans."
22 Id. Finally, she must have made "good faith efforts to repay the
23 loans." Id.

24 The first issue, then, is whether Castillo could maintain a
25 minimal standard of living if she were forced to repay the loan.
26

1 Here, the court's answer is in the negative.

2 ECMC has not challenged the accuracy or reasonableness of
3 Castillo's budget, which has no room for any payments on the loan.¹
4 Rather, ECMC argues that the first prong of the Pena test is not met
5 because Castillo is eligible for one or more forbearance programs
6 currently in effect. In this regard, ECMC references the Ford
7 Program described at 34 C.F.R. § 685, which includes an Income
8 Contingent Repayment Program, described at 34 C.F.R. § 685.208(f).
9 ECMC calculates that based on her current circumstances, Castillo's
10 monthly payments under the Income Contingent Repayment Program would
11 be "\$0.00," and notes that the debt remaining after 25 years of
12 participation in the program would be cancelled.

13 The court rejects ECMC's argument for several reasons. First,
14 and most significantly, it begs the question raised by the first
15 prong of the Pena test, which is not whether the debtor will or will
16 not be forced to repay the loans. Rather, the relevant
17 consideration is whether the debtor and the debtor's dependents
18 could maintain a minimal living standard, assuming that the debtor
19 is, in fact, "forced to repay the loans." Here, there is no
20 question that if Castillo is forced to repay, she could not maintain
21 a minimal standard of living for herself and her dependent children.

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23
24 ¹The court recognizes that because of the Ninth Circuit's
25 decision in In re Myrvang, 232 F.3d 1116 (9th Cir. 2000), partial
26 discharge of a student loan debt is probably permissible
notwithstanding the BAP's prior decision to the contrary in In re
Taylor, 223 B.R. 747 (9th Cir. BAP 1998).

1 Indeed, carrying ECMC's argument to its logical conclusion, it
2 would follow that the mere availability of exemption laws to protect
3 a debtor from forced repayment may preclude satisfaction of the
4 first Pena prong.

5 This conclusion is reenforced by the facts of Pena, wherein the
6 bankruptcy court found, as is the case here, that the debtors' net
7 monthly income was less than their monthly expenses. In applying
8 the first prong to this circumstance, the Pena court stated, quite
9 simply

10 Subtracting the Penas' average monthly expenses . . . from
11 their net monthly income . . . the Penas faced a deficit
12 of \$41. Clearly, in these circumstances the Penas could
13 not maintain a minimal standard of living and pay off the
14 student loans.

15 Pena, 155 F.3d at 1112. Thus, the court's relevant focus was the
16 impact, rather than the likelihood, of the debtor being forced to
17 repay. (The court also notes that in Pena, the debtors met the
18 first prong of the test when their monthly expenses exceeded their
19 net monthly income by only \$41, whereas here, the amount of the
20 excess is \$290.)

21 Moreover, under ECMC's interpretation of the first Pena prong,
22 the dischargeability of an educational loan would be within the
23 discretion of the lender, whether or not in the view of the court,
24 nondischargeability would result in an undue hardship. All that
25 lender would have to do to render an educational loan
26 nondischargeable would be to agree to forbear from collection,
conditionally based on the debtor's inability to repay, or
unconditionally for some meaningful period of time. And in any case

1 where that agreement is enforceable under applicable nonbankruptcy
2 law, it would follow, according to ECMC's argument, that an
3 educational debt cannot be discharged because nondischargeability
4 would not result in any diminution of the debtor's standard of
5 living.

6 Such a reading of Bankruptcy Code § 523(a)(8) would clearly be
7 contrary to the Congressional intent. Had Congress wanted to
8 empower creditors to render otherwise dischargeable educational
9 debts nondischargeable merely by agreeing to forbear from
10 collection, or by enacting regulations adopting rules for
11 forbearance, it could have said so. It did not.

12 The court holds that Castillo has satisfied the first Pena
13 prong.

14 The next issue is whether "additional circumstances exist
15 indicating that this state of affairs is likely to persist for a
16 significant portion of the repayment period of the student loans."
17 The court answers in the affirmative.

18 In In re Rifino, 245 F.3d 1083 (9th Cir. 2001), the Ninth
19 Circuit noted with reference to this prong that discharge of student
20 loan debts should be "more difficult than that of other nonexcepted
21 debt." Id. at 1088-89 (internal citation and quotes omitted). In
22 Rifino, the debtor was a social worker with a Masters degree who
23 worked at a child care center. Expert testimony established that
24 social workers such as the debtor often enjoy the opportunity for a
25 significant income increase by moving into administrative positions
26 or private practice, and that the debtor's Masters degree offered

1 her "numerous opportunities for advancement." Id. at 1089.

2 Here, the evidence showed that Castillo has no advanced degree,
3 just a high school diploma. Although Castillo testified that she
4 has some basic computer skills that she uses to help the children at
5 her school, ECMC presented no expert testimony or other evidence to
6 suggest that Castillo's high school diploma or basic computer skills
7 would likely result in any future measurable net income increase
8 that would enable her to make any payments of relevance on the Loan.
9 It is true, as ECMC argues, that all of Castillo's children will
10 have reached 18 years of age in nine more years, at which point
11 Castillo will no longer be responsible to care for and support them.
12 This fact alone, however, does not negate the fact that Castillo's
13 financial condition is likely to persist for a significant portion
14 of the repayment period.²

15 The court holds that Castillo has satisfied the second Pena
16 prong.

17 The final issue is whether Castillo made a good faith effort to
18 repay the Loan. A debtor's failure to make payment when the debtor
19 is unable to do so, does not, by itself, preclude a finding that the
20 debtor has made a good faith effort. See In re Brown, 239 B.R. 204,
21 209 (S.D. Cal. 1999).

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24 ²An exhibit submitted by ECMC shows that for Castillo's
25 loan, the repayment period for a "standard" repayment plan would
26 be 120 months, and that the repayment period for an "extended" or
a "graduated" repayment plan would be 240 months.

1 Here, the evidence showed that Castillo was never financially
2 able to make any repayments. Nor did ECMC present any evidence
3 suggesting that Castillo's inability to pay resulted from any
4 factors beyond her reasonable control, see In re Roberson, 999 F.2d
5 1132, 1136 (7th Cir. 1993), or any improper attempts to manipulate
6 the Bankruptcy Code.

7 Some courts have stated that a debtor's refusal to negotiate
8 repayment terms might indicate a lack of good faith, see, e.g.,
9 Brunner, 831 F.2d at 397, especially given the availability of
10 forbearance programs such as the Ford Program mentioned above. See,
11 e.g., In re Wallace, 259 B.R. 170, 183-84 (C.D. Cal. 2000). Here,
12 ECMC concedes that Castillo cannot make any payments and was never
13 in a position to make any payments since the inception of the Loan.
14 Moreover, the court has found that the debtor has no reasonable
15 prospects in the future for being able to make payments. Under
16 these circumstances, Castillo's failure to make payments or to enter
17 into an agreement under which the Loan cannot be discharged for up
18 to 25 years (pursuant to the Income Contingent Repayment Program)
19 does not evidence lack of good faith on her part.

20 A contrary holding would be tantamount to a holding that the
21 mere availability to a bankruptcy debtor of a forbearance program
22 precludes a debtor from satisfying the third Pena prong, either
23 because the debtor has elected to enter into the program and thereby
24 forego potential relief under Bankruptcy Code § 523(a)(8) or has
25 refused to enter into the program, thereby precluding a finding of
26 good faith.

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The court holds that Castillo has satisfied the third Pena prong.

C. Conclusion

Castillo is entitled to a judgment that the Loan is dischargeable herein, and the court will issue its judgment so providing.

Dated: July 3, 2002

Edward P. Jellen
United States Bankruptcy Judge

