UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION

IN RE:	)	
	)	
DAVID and CRYSTAL SMITH,	)	Case No. 00-51738C 7W
	)	
Debtors.	)	
	)	
DAVID and CRYSTAL SMITH,	)	
	)	
Plaintiff,	)	
	)	Adv. Pro. No. 01-6013
v.	)	
	)	
TEXAS GUARANTEED STUDENT LOAN CORP.,	)	
	)	
Defendant.	)	

ORDER

This matter came on for trial before the undersigned Bankruptcy Judge on April 17, 2002 in Winston-Salem, North Carolina, after due and proper notice, upon the Complaint for Hardship Discharge filed by David and Crystal Smith (the "Debtors") against Defendant, Texas Guaranteed Student Loan Corp. ("TGSLC"). Appearing before the Court was Amy S. Davis, on behalf of the Debtors, and Franklin Drake, on behalf of the Defendant. The issue before the Court is whether Crystal Smith's student loan debt imposes an undue hardship that would render the debt dischargeable pursuant to 11 U.S.C. § 523(a)(8). Having reviewed the file and considered the arguments of counsel and the testimony of witnesses, the Court makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

David and Crystal Smith filed their petition under Chapter 7 of the Bankruptcy Code on September 1, 2000. On Schedule F, the Debtors listed a debt in the amount of $12,411.31 for a student loan. On February 14, 1994, the Debtors jointly executed and delivered to the Student Loan Marketing Association ("Sallie Mae") a Federal Consolidation Loan Application and Promissory Note to consolidate several smaller student loans David Smith had obtained in 1982 and 1983. As a result, Crystal Smith became jointly and severally liable to Sallie Mae for all amounts borrowed by David Smith. In May 1999, Sallie Mae assigned all its rights and interest to TGSLC.

In 1997, Mr. Smith sustained an injury arising out of and in the course and scope of his employment with Carolina Handling. Mr. Smith is now disabled and unable to work, and will not be able to return to work. He is medicated from an infusion pump which delivers morphine to his spine via a catheter. He also has other serious mental and emotional issues. Prior to the petition date, Mr. Smith attempted suicide and set the family home on fire. He ultimately plead guilty to attempted burning of a dwelling. From February 14, 1994 until Mr. Smith's injury, the Debtors made approximately 29 monthly payments on the student loan. They have requested and been allowed at least one forebearance for a period of time due to Mr. Smith's injury. Since the filing of this adversary proceeding, TGSLC has granted Mr. Smith individually a permanent and complete cancellation of his own liability to TGSLC for the student loan debt pursuant to his completion and submission of a "Total and Permanent Disability Cancellation Request Form OMB 1845-0015." Mrs. Smith remains liable to TGSLC for all sums borrowed by David Smith. The parties have stipulated that the balance due and owing to TGSLC is $12,745.89 as of September 1, 2000 plus interest for an approximate payoff at the time of trial of $14,600.00.

Subsequent to the bankruptcy filing, in July 2001, Mr. Smith, Carolina Handling and Carolina Handling's insurance carrier, Federal Insurance Group, entered into a settlement agreement and release, whereby Carolina Handling agreed to settle all matters by payment of $205,000.00 in one lump sum and the payment of $60,191.85 in medical expenses. The release provides that Carolina Handling shall not be responsible for any further medical benefits. This settlement was approved by the North Carolina Industrial Commission. After the deduction of attorney's fees, Mr. Smith received approximately $150,000.00 from the settlement. He spent $27,000.00 on a Dodge Caravan and used $101,000.00 as a down payment on a house with a purchase price of $199,000.00 in Wilmington, N.C. The house and mortgage are in Mrs. Smith's father's name.[1] The remainder of the funds was used to catch up on bills that had accrued post-petition while awaiting the settlement, to replace furniture which was burned in the fire, to pay for moving expenses from Concord, N.C. to Wilmington, N.C. and to supplement living expenses for approximately six months. [2]

Mrs. Smith has an associates degree from Brevard College. She is presently self-employed as a Mary Kay Cosmetics Consultant. Her salary is based upon commissions from sales, therefore her income varies considerably. She testified that during her most productive year, she made approximately $28,000 gross. As a result of her success, she received a Mary

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[1] Crystal Smith testified that the home was purchased by her father because her father was able to obtain financing with much more favorable terms than the Debtors could obtain due to their bankruptcy.

[2]While the Court may question the wisdom of Mr. Smith's decision to spend the settlement funds on a house and car, those funds belonged entirely to Mr. Smith. Since Mr. Smith has been relieved of his own liability to TGSLC for the student loan debt because of his disability, he was under no obligation to use those funds to pay TGSLC. Mrs. Smith had no interest in those funds and could not require her husband to use those funds to pay TGSLC.

Kay company car. However, in the last six months, she had a gross income of $3,316.00, expenses of $2,782.39 and ultimately realized a profit of $534.33 from this work. Due to this drop in sales, Mary Kay has notified her that she will lose the company car within the next two months. Mrs. Smith attributed this drop in income to her recent move from Concord, N.C. to Wilmington, N.C., resulting from a loss in business from her old client base, and to the fact that one of the junior sales representatives in her group was promoted, causing her Mary Kay group to split into two groups. Mrs. Smith anticipates that during the next several years, she will rebuild her business in the Wilmington area and that her income will return to previous levels.

Mrs. Smith testified that it is not feasible for her to look for a more traditional, 40 hour per week job due to her responsibilities at home. Mr. Smith's condition varies from day to day. Mrs. Smith testified that on good days, he may be able to walk about the house and engage in some limited driving. On bad days, her husband is unable to get out of bed and needs help caring for his basic needs. Mr. Smith is unable to work, and will remain unable to work in the foreseeable future. Mrs. Smith frequently must provide basic care for her husband and transportation to various medical appointments.[3] In addition, the Debtors have three children, ages eight, ten and fifteen. The Debtors' oldest child suffers from social anxiety disorder and depression, and is unable to attend a traditional school; therefore, she is currently homeschooled. Mrs. Smith's schedule and responsibilities necessitate that she have a job with flexible hours and that allows her to work out of her home so she can be available to care for her husband and children.

[3] Mr. Smith does not presently see doctors on a weekly basis. He is not currently receiving any physical therapy and has recently begun to drive a vehicle on days in which he is able.

At this time, the Debtors' combined income is approximately $1,500.00 per month. This income is comprised of Mr. Smith's social security payment in the amount of $920.00 per month, as well as the social security payment that Mrs. Smith and each of the three children receive in the amount of $121.00 per month and Mrs. Smith's profit from her Mary Kay business. The Debtors' expenses are approximately $2,345.00 per month. Their expenses include a mortgage payment in the amount of $843.40 for their four bedroom home. The Debtors were able to obtain this low mortgage payment by using the bulk of Mr. Smith's settlement on the down payment. Their expenses also include $165.00 for power, $12.50 for trash, $38.21 for water and sewer, $45.00 for life insurance, $10.00 for haircuts, $42.88 for basic cable, $79.00 for car insurance, $80.00 for gas, $43.00 for a cell phone, $165.00 for telephone, and $600.00 for food. Some of the telephone expenses are related to Mrs. Smith's business.

The Debtors have not been able to afford health insurance. Mrs. Smith recently obtained a quote for a policy which cost $325.00 per month with a $500.00 deductible. Additionally, at the time of the hearing, the Debtors could not afford to set aside any money for clothing, vacations, extracurricular activities for the children, recreation, and prescription medications for their daughter's allergies and social anxiety disorder and for Mrs. Smith's depression. In an effort to trim back on expenses, the children no longer participate in ballet, karate or even the school band. The Debtors could no longer afford the monthly rental on the band instrument. The Debtors are unable to afford glasses to correct their son's vision. The Debtors basic living expenses currently exceed their income by about $845.00. As a result, the Debtors have entirely exhausted Mr. Smith's settlement funds. The Debtors are behind on some of their bills, including power and cable.

DISCUSSION

Section 523(a)(8) of the Bankruptcy Code provides as follows:

> (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 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). The issue in this case is whether excepting Mrs. Smith's student loan debt from discharge will impose an undue hardship on Mrs. Smith and her dependants. Courts most frequently use the three prong test set forth in Brunner v. New York State Higher Education Services Corp., 831 F.2d 395 (2d Cir. 1987), when determining whether a student loan obligation should be discharged because it will create an undue hardship. Although the Fourth Circuit has not explicitly adopted the Brunner test, courts in this Circuit have utilized that standard in determining whether an undue hardship exists. see, e.g., In re Ammirati, 187 B.R. 902 (D.S.C.1995); Commonwealth of Virginia State Educ. Assistance Authority v. Dillon, 189 B.R. 382 (W.D.Va.1995); Kapinos v. Graduate Loan Center, 243 B.R. 271 (W.D.Va.2000); and In re Walcott, 185 B.R. 721 (Bankr. E.D.N.C. 1995). See also, In re Kasey, 187 F.3d 630 (table), 1999 WL 476462 (4th Cir.1999) (using the Brunner standard in unpublished decision).

Under the Brunner test, the court must consider (1) debtor's current level of income and expenses and whether a minimal standard of living can be maintained by the debtor and dependants if the debtor must repay student loans; (2) additional circumstances that might suggest that debtor's current financial condition would likely continue for a significant portion of

the repayment period; and (3) whether the debtor has made a good faith attempt to repay the student loans. If one of the prongs of this test is not satisfied, the inquiry ends and the student loans cannot be discharged. In re Brightful, 267 F.3d 324 (3rd Cir. 2001).

In this case, based upon Mrs. Smith's current level of income and expenses, Mrs. Smith is unable to maintain a minimal standard of living for herself and her family. The Debtors' budget is not excessive. A monthly housing payment of $843.40 per month is not unreasonable for a family of five. The budget does not include funds for recreation, clothing, lessons for the children or therapy for the oldest child. Mrs. Smith and her children cannot afford health insurance and cannot always afford to fill prescriptions for medication when needed. Mrs. Smith's income is very low. The social security payments that the family receives are minimal. Without making any student loan payment at all, Mrs. Smith is unable to maintain a minimal standard of living based on the family's income and expenses. The Court concludes that she has satisfied the first prong of the Brunner analysis.

The second prong of the Brunner test requires some additional circumstances suggesting a "certainty of hopelessness." In re Roberson, 999 F.2d 1132, 1136 (7th Cir. 1993) (citations omitted). Presently, Mrs. Smith's income is minimal; however, she testified that she expects her income will return to previous levels in time. TGSLC argues that Mrs. Smith could obtain other employment which provides a more steady income and benefits. TGSLC further argues that the Debtor's 15 year old child is available to provide childcare to her siblings while Mrs. Smith works. TGSLC's argument lacks merit for several reasons. Mrs. Smith provided ample evidence that she needs flexible work hours to care for her disabled husband and children. Her oldest child is unable to lift Mr. Smith, and cannot provide adequate care for him. In addition, this child suffers from social anxiety disorder and depression, is unable to attend school and

requires her own care. Mrs. Smith does not have a college degree or any useful vocational training. She has been employed by Mary Kay since June 1991. Her prospects for employment that would provide her with a salary sufficient to hire someone to care for her husband and children while she works are very dim.

If, in time, Mrs. Smith's income returns to its previous high of $28,000 gross, the family may reach a point when their expenses to maintain a minimal standard of living no longer exceed their income such that the Debtors may obtain medical insurance and prescription medications, therapy for their eldest child and other basic necessities. Mrs. Smith has the sole responsibility for three children and a disabled husband. Mr. Smith is permanently disabled and will require care for the foreseeable future. He is only 38 years old. The settlement and release that he executed does not provide for the payment of any further medical expenses from his former employer. No one anticipates that Mr. Smith will have any future income other than his social security income. These additional circumstances are sufficient to create a certainty of hopelessness for the future and suggest that Debtors' current financial condition will likely continue indefinitely into the future.

According to counsel for TGSLC, the repayment period for the loan, which is not stated in the Note and depended entirely upon the amount borrowed, was 114 monthly payments. Consequently, according to counsel for TGSLC, the full amount of the loan is now due. The repayment period is over. TGSLC admits that the Debtor has no present ability to pay, but contends that if payments were deferred for two or three years, the Debtor could commence a repayment plan. TGSLC did not present evidence as to any kind of repayment plan that it might consider. The Court finds that Mrs. Smith has satisfied the second prong of the Brunner analysis.

The third prong of the Brunner analysis requires the debtor to show a good faith effort to

repay the loans. The evidence shows that the Debtors made approximately 29 monthly payments. The Debtors made every effort to repay these loans prior to the petition date. When they were unable to make payments, they sought a forbearance. The Court finds that Mrs. Smith has shown that she made a good faith effort to repay the loans. Accordingly, the Court finds that Mrs. Smith is entitled to a discharge of the student loan on the basis of undue hardship.

CONCLUSION

For the foregoing reasons, IT IS ORDERED, ADJUDGED AND DECREED that the Debtors are discharged from their obligation to Texas Guaranteed Student Loan Corp. on the basis of undue hardship pursuant to 11 U.S.C. § 523(a)(8).

This the 3 day of May 2002.

CATHARINE R. CARRUTHERS

Catharine R. Carruthers
United States Bankruptcy Judge