UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE: Malcolm Charles Burton and Patricia Davis Burton, Debtors.	C/A No. 96-74861-W Adv. Pro. No. 96-8269-W
Navy Federal Credit Union, Plaintiff, v. Malcolm Charles Burton and Patricia Davis Burton, Defendants.	**JUDGMENT** Chapter 7

ENTERED
JUL 7 1997
K. R. D.

Based upon the Findings of Fact and Conclusions of Law as recited in the attached Order of the Court, the debt to the Navy Federal Credit Union is discharged and judgment shall be entered in favor of the Debtors with each side to bear their own costs and attorney's fees.

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
July 3, 1997.

12

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE: Malcolm Charles Burton and Patricia Davis Burton, Debtors.	C/A No. 96-71861-W Adv. Pro. No. 96-8269-W
Navy Federal Credit Union, Plaintiff, v. Malcolm Charles Burton and Patricia Davis Burton, Defendants.	**ORDER** Chapter 7

ENTERED
JUL 7 1997
K. R. D.

THIS MATTER comes before the Court upon a Complaint filed by the Navy Federal Credit Union ("NFCU") seeking the non-dischargeability of alleged student loan indebtedness in the amount of $52,900.00 pursuant to 11 U.S.C. § 523(a)(8).[1]

In this action, NFCU takes the position that it is a federally chartered nonprofit credit union and the loans were made to the Debtors for educational purposes and therefore the loans should be determined to be non-dischargeable. The Debtors dispute that NFCU is a nonprofit institution and additionally allege that any loans for educational purposes were consolidated with other loans made by NFCU to the Debtors for non-educational purposes and that this "commingling" of the loans takes them out of the protection of §523(a)(8).

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[1] Further references to the Bankruptcy Code, 11 U.S.C. § 101, *et seq.*, shall be by section number only.

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11

After consideration of the evidence; consisting of the Joint Stipulations of Fact [2], with exhibits, filed by the parties, the Court makes the following Statement of Facts and Conclusions of Law pursuant to Rule 52 of the Federal Rules of Civil Procedure, made applicable by Rule 7052 of the Federal Rules of Bankruptcy Procedure.[3]

STATEMENT OF FACTS (BY STIPULATION OF THE PARTIES)

1. NFCU is a federally chartered credit union under the Federal Credit Union Act, 12 U.S.C. §1751, et seq.

2. NFCU has approximately one million shareholders.

3. NFCU issues dividends on savings accounts on a three month basis.

4. On the dates listed below, NFCU made loans to the Debtors for educational purposes:

DATE	AMOUNT
07/12/91	$ 8,500.00
01/03/92	$ 3,500.00
08/21/92	$ 3,500.00
10/06/92	$10,000.00
05/05/93	$20,000.00
08/02/94	$ 7,400.00
TOTAL	$54,900.00

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[2] Based upon this stipulation, the parties asked and the Court agreed, to make its decision solely upon a Stipulation of Facts with the attached exhibits, which was filed on March 9, 1997 and incorporated herein fully, and proposed orders from the parties. The parties did not raise any other issues related to § 523(a)(8) including the hardship discharge provisions codified in § 523(a)(8)(B) and the Court will not address them here except to make the initial finding that apart from the issues stipulated to be in controversy, all other issues related to § 523(a)(8) have been waived.

[3] The court notes that to the extent any of the following Findings of Fact constitute Conclusions of Law, they are adopted as such, and to the extent any Conclusions of Law constitute Findings of Fact, they are so adopted.

On the dates listed below, NFCU also made the following loans to the Debtors:

DATE	AMOUNT	LABELED PURPOSE
04/08/91	$3,499.00	Home Improvement
01/03/92	$8,500.00	Home Improvement
04/07/92	$4,658.00	Home Furnishings
11/17/94	$4,200.00	Vehicle Repair
01/06/95	$5,000.00	Moving
TOTAL	$25,857.00	

5. The telephone loan application corresponding to the loan issued on August 21, 1992 describes the purpose of the loan as educational and home improvement; the note; however, describes the note as being for educational purposes.

6. On March 17, 1995, another promissory note was executed by the Debtor with the stated purpose of consolidation. There was no cash advanced to the Debtor and the amount financed was $65,619.81 The March 17, 1995 consolidation loan consolidated loans labeled as being for educational purposes and loans labeled for other purposes.

7. At the time the Debtors obtained the loans labeled as being for educational purposes, NFCU had the capability to issue student loans which were guaranteed or funded under the Guaranteed Student Loan Program or similar governmental program.

8. None of the loans issued to the Debtors by NFCU were guaranteed or funded under the Guaranteed Student Loan Program or similar governmental program.

9. NFCU did not issue the loan proceeds to an educational institution but instead issued the loan proceeds directly to the Debtors.

10. NFCU did not require any documentation from an educational institution prior to issuing to Debtors loans labeled as being for educational purposes.

11. NFCU did not require the Debtors to provide proof of enrollment at an educational institution.

12. NFCU did not require the Debtors to provide an estimate of their tuition, books, or living expenses in support of the loan applications.

13. NFCU issued the loans labeled as being for educational purposes based upon telephone loan applications by the Debtors.

14. The loans issued by NFCU labeled as being for educational purposes did not have a deferment period of repayment in which no payments were required on the outstanding principal and interest for so long as the Debtors remained enrolled in an educational institution.

15. The initial payments on the loans issued by NFCU labeled as being for educational purposes became due within at least sixty days after the respective loans were issued.

16. The interest rate on the loans issued by NFCU Labeled as being for educational purposes ranged from 11.9% to 12.9%.

17. The interest rates on the loans labeled as being for educational purposes and issued by NFCU were a higher interest rate than would have applied to Guaranteed Student Loans issued at the same time.

CONCLUSIONS OF LAW

For purposes of this adversary proceeding, § 523(a)(8) excepts from discharge an educational benefit loan insured or guaranteed by a governmental unit or a non-profit institution. Section 523(a)(8) provides in full 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-

(A) such loan, benefit, scholarship, or stipend overpayment first became due 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.

11 U.S.C. § 523(a)(8).

As a threshold inquiry, the Court must determine if this debt to NFCU is for an educational benefit. The Debtors assert that when the educational loans were consolidated with loans for non-educational purposes, the loans fell out of the non-dischargeable province of § 523(a)(8) because the original educational loans have been satisfied by payoff from the proceeds of the new consolidated loans.

Many of the reported decisions which consider the effect of consolidation of educational loan debts focus upon the time limits of § 523(a)(8)(A), i.e. the beginning of the seven year due date of the loan, and involve the consolidation of several previous educational loans into a new educational loan, rather than the consolidation of educational loans with loans for non-educational purposes. However, a review of these opinions does provide helpful guidance.

The Seventh Circuit has concluded that a loan consolidation extinguished the original loan and replaced it with a new loan and therefore determined that the seven year period pursuant

to § 523(a)(8)(A) commences on the date the consolidated loan became due. In its decision, the Court stressed the statutory language of the term "such loan" in § 523(a)(8)(A).

> Although one bankruptcy court case cited by [the debtor] does provide direct support for her position, see McKinney I, 120 B.R. at 420-21, we are not persuaded by that court's reasoning, nor was the district court that reviewed the decision. See McKinney II, 1992 WL 265992, at *2-3; 1992 U.S.Dist. LEXIS 14796, at *6-*7, rev'g McKinney I, 120 B.R. at 420-21. The McKinney I bankruptcy court failed to consider that, when a borrower undertakes a consolidation loan, the original loan is repaid in full and the debt is discharged, and also that section 523(a)(8)(A) provides for discharge of a debt only if the loan relating to that debt "first became due" more than five years prior to the bankruptcy filing.

Hiatt v. Indiana State Student Assistance Program, 36 F.3d 21 (7th Cir. 1994).

While the Fourth Circuit has not issued an opinion directly on the issue before the Court, the Fourth Circuit has affirmed in an unpublished order, a District of Maryland opinion that found that a student loan first became due on the date of the first installment payment of a consolidated loan rather than the original loan.

> As in Saburah, defendant's consolidation loan was made by Sallie Mae and the creditors associated with the earlier educational loans were paid off at the time of the consolidation loan. In addition, the payment terms provided to defendant were more generous than those of the earlier loans. Herein defendant seeks only to have the consolidation loan discharged noting that the earlier loans no longer exist.

U.S. v. McGrath, 143 B.R. 820 (D.Md. 1992), aff'd U.S. v. McGrath, 8 F.3d 821 (4th Cir. (Md.)). While these cases relied upon a strict construction of § 523(a)(8) resulting in fewer discharged student loans, their emphasis on the creation of a new loan and the extinction of the previous loan during consolidation leads this Court to conclude that a consolidation of

educational loans with loans for non-educational purposes extinguishes the education loan characteristics upon consolidation. A recent decision from the Bankruptcy Court for the Eastern District of Virginia following the Hiatt and McGrath reasoning also lends support to this conclusion.

> In the case before this Court, an entirely new lender is involved and the consolidated loan is not a continuation of the original loan, but rather a completely new loan. Saburah, 136 B.R. at 252. Most importantly, the debt sought to be discharged is the consolidated loan and the original loans no longer exist. Id. at 252. Entering into a new loan obligation and paying off the earlier notes serves to extinguish the dates that the old loans first became due for the purposes of section 523(a)(8)(A). Martin, 137 B.R. at 774.

In re Cobb, 196 B.R. 34 (Bkrtcy.E.D.Va. 1996). In Cobb, the debtor attempted to argue that upon consolidation of his educational loans, the consolidated loan did not have educational characteristics because the debtor was no longer attending school. Judge Adams however found that the "essential purpose of the consolidation was the repayment and restructuring of a debt incurred to pay the costs of higher education." In re Cobb, 196 B.R. at 38. In the facts within, the consolidation was not solely a restructuring of a debt to pay the costs of higher education but was a consolidation of several loans including loans for home improvement, home furnishings, vehicle repair and moving expenses.

Additionally, the consolidated loans in the above cited cases were made pursuant to the consolidated loan program codified at 20 U.S.C. § 1078-3, which is part of the Higher Education Act. There was no evidence presented by NFCU that any of the loans and certainly the March 17, 1995 consolidation loan were made pursuant to 20 U.S.C. § 1078-3.

Ultimately the Court must consider whether the creditor has met its burden to establish

the existence of the debt and, in the case of a non-dischargeability complaint pursuant to § 523(a)(8), to establish that the debt is for an "educational benefit."

> The party challenging the dischargeability of a debt bears the burden of proof. Robb v. Robb (In re Robb), 23 F.3d 895 (4th Cir. 1994)(§523(a)(5)); Stone v. Stone (In re Stone), 11 B.R. 209, 211 (Bankr. D.S.C. 1981)(§523(a)(2)); Green v. Green (In re Green), 5 B.R. 247, 2 C.B.C.2d 905 (Bankr. N.D.Ga. 1980)...
> The standard of proof in a dischargeability complaint is preponderance of evidence: Grogan v. Garner, U.S. 111 S.Ct. 654 (1991) Combs v. Richardson, 838 F.2d 112, 18 C.B.C.2d 487 (4th Cir. 1988); Whitson v. Middleton (In re Middleton) 898 F.2d 950 (4th Cir. 1990)...

Butler, Bankruptcy Handbook, ¶ 16.9 at p. 16-5, ¶ 16.10 at p. 16-5 (1996). "The [creditor] must first establish the existence of the [educational benefit] debt, that the debt is owed to or insured or guaranteed by a governmental agency or nonprofit institution of higher learning..." In re Raymond, 169 B.R. 67,69 (Bkrtcy. W.D.Wash. 1994). In this case, it is the finding of the Court that NFCU has not met this burden.

The loans specifically labeled as "educational" by the creditor in the loan documents were made on July 21, 1991, January 3, 1992, August 21, 1992, October 6, 1992, May 5, 1993 and August 2, 1994. The loans for non-educational purposes were made on April 8, 1991, January 3, 1992, April 7, 1992, November 17, 1994 and January 6, 1995. Pursuant to the loan documents, each new subsequent loan would pay off (and in effect consolidate) the previous indebtedness. There has been no showing that the balance of debt subject to this action was either completely used for or intended for an educational benefit. From the evidence presented, the Court is left without a method to trace the loans or determine an amount that solely represents "educational" debts.

In this case, the parties have stipulated that the loans in question were later consolidated with loans which were not made for educational purposes. Before claiming that the full balance of such a consolidated loan qualifies as an educational loan, the creditor must demonstrate the actual use or intention to use the loan or an exact portion thereof for an educational benefit. If the consolidation loan was a pure consolidation of educational loans, the Court would be more open to the argument that the consolidated loan retained its original educational characteristics.

Having determined that the creditor has filed to meet its burden of proof to establish that the current debt is for an educational benefit, the Court need not address whether the loans were 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. It is therefore the finding of this Court that the debt to the Navy Federal Credit Union is discharged and judgment shall be entered in favor of the Debtors with each side to bear their own costs and attorney's fees.

AND IT IS SO ORDERED.

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
July 3, 1997.

JV-9 -