

**DEC 05 2006**

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U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT**

**UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT**

6	In re:	)	BAP No.	AZ-05-1495-DKPa
		)		
7	BETTY A. McBURNEY,	)	Bk. No.	99-09453-RTB
		)		
8	Debtor.	)	Adv. No.	04-00669-RTB
		)		
9	_____	)		
		)		
10	EDUCATIONAL CREDIT	)		
	MANAGEMENT CORPORATION,	)		
		)		
11	Appellant,	)		
		)		
12	v.	)	<b>O P I N I O N</b>	
		)		
13	BETTY A. McBURNEY,	)		
		)		
14	Appellee.	)		
		)		
15	_____	)		

Argued and Submitted on October 19, 2006  
at Phoenix, Arizona

Filed - December 5, 2006

Appeal from the United States Bankruptcy Court  
for the District of Arizona

Hon. Redfield T. Baum, Sr., Chief Bankruptcy Judge, Presiding.

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Before: DUNN, KLEIN, and PAPPAS, Bankruptcy Judges.

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1 DUNN, Bankruptcy Judge:  
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3 This is an interlocutory appeal in which a student loan  
4 creditor appeals from an order denying its motion to dismiss an  
5 adversary proceeding brought by the debtor, seeking a  
6 determination that her student loan debts were dischargeable in  
7 her 1999 chapter 7<sup>1</sup> bankruptcy case. Because we conclude that  
8 the consolidation loan made postpetition extinguished the  
9 debtor's liability on prepetition student loans and is not  
10 vulnerable to "undue hardship" attack under § 523(a)(8) in a pre-  
11 consolidation bankruptcy case, we REVERSE.  
12

13 FACTS

14 The debtor, Betty A. McBurney, acting pro se, filed her  
15 chapter 7 bankruptcy case on August 9, 1999. Ms. McBurney  
16 received her chapter 7 discharge on December 6, 1999, and her  
17 case was closed on January 24, 2000.

18 On March 14, 2000, at Ms. McBurney's request, Sallie Mae  
19 Servicing Corporation ("Sallie Mae"), on behalf of guarantor  
20 United Student Aid Funds, disbursed funds (the "Consolidation  
21 Loan") totaling \$32,390.59 to consolidate three prepetition  
22 student loans ("Student Loans") owed by Ms. McBurney. Of this  
23 amount, \$2,846.62 was paid to "DEVRY," and \$29,543.67 was paid to  
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25 <sup>1</sup>Unless otherwise indicated, all chapter, section and rule  
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330,  
27 and to the Federal Rules of Bankruptcy Procedure, Rules 1001-  
28 9036, as enacted and promulgated prior to the effective date  
(October 17, 2005) of most of the provisions of the Bankruptcy  
Abuse Prevention and Consumer Protection Act of 2005, Pub. L.  
109-8, April 20, 2005, 119 Stat. 23 ("BAPCPA").

1 "SALLIE MAE - UNIPAC." No funds were disbursed to Ms. McBurney  
2 from the Consolidation Loan proceeds.

3 Ms. McBurney reopened her 1999 chapter 7 case and commenced  
4 an adversary proceeding against the United States Department of  
5 Education on April 8, 2004, seeking a hardship discharge of the  
6 Consolidation Loan pursuant to § 523(a)(8). Sallie Mae was  
7 substituted as the defendant on June 10, 2005, and moved to  
8 dismiss the adversary proceeding pursuant to Rule 7012 on the  
9 basis that the Consolidation Loan was not a prepetition debt, and  
10 that the complaint therefore failed to state a claim as to which  
11 relief could be granted. Educational Credit Management  
12 Corporation ("ECMC") was substituted as the defendant in place of  
13 Sallie Mae on September 21, 2005. By Minute Order dated November  
14 28, 2005, the bankruptcy court denied the motion to dismiss.<sup>2</sup>

15 On December 9, 2005, ECMC filed its Notice of Appeal. We  
16 granted leave to appeal the bankruptcy court's interlocutory  
17 order.

#### 18 19 JURISDICTION

20 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.  
21 §§ 1334 and 157(b)(2)(I). We have jurisdiction over this  
22 interlocutory appeal pursuant to 28 U.S.C. § 158(a)(3).  
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#### 24 ISSUES

25 Whether the Consolidation Loan is a postpetition debt to  
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27 <sup>2</sup>The bankruptcy court entered a separate order denying the  
28 motion to dismiss on January 4, 2006.

1 which § 523(a) (8) does not apply.

2 Whether the bankruptcy court erred in denying ECMC's motion  
3 to dismiss the adversary proceeding for failure to state a claim.

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5 STANDARD OF REVIEW

6 We review a bankruptcy court's conclusions of law de novo.  
7 Fireman's Fund Ins. Co. v. Grover (In re Woodson Co.), 813 F.2d  
8 266, 270 (9th Cir. 1987).

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10 DISCUSSION

11 I. The Consolidation Loan is a Postpetition Debt.

12 Subchapter IV, Part B of the Higher Education Act of 1965<sup>3</sup>  
13 facilitates the availability of federally insured student loans  
14 to eligible borrowers. Eligible borrowers may consolidate their  
15 student loan obligations. 20 U.S.C. § 1078-3. The issue as to  
16 whether a consolidation student loan is dischargeable in  
17 bankruptcy arose with some frequency under the version of  
18 § 523(a) (8) in effect for cases filed prior to October 7, 1998.  
19 As a condition precedent to discharge without a showing of undue  
20 hardship, under former § 523(a) (8) (A), a student loan must have  
21 come due more than seven years prior to the petition date (the  
22 "Nondischargeability Period").<sup>4</sup>

23 The majority of reported decisions were consistent with  
24 Hiatt v. Ind. State Student Assistance Comm'n, 36 F.3d 21 (7th

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26 <sup>3</sup>20 U.S.C. § 1071, et seq.

27 <sup>4</sup>The seven-year minimum repayment period applied to  
28 bankruptcy cases filed after November 15, 1990; prior to that  
date, the minimum repayment period was five years.

1 Cir. 1994), which held that a consolidation student loan  
2 represented a new, distinct debt, the proceeds of which were used  
3 to cancel the original student loan notes and to pay the  
4 underlying debt. In the reported decisions consistent with the  
5 Hiatt holding, courts determined that the Nondischargeability  
6 Period was governed by the date a consolidation student loan  
7 first became due, even if the original student loan had first  
8 become due at an earlier date, and even where a debtor had been  
9 paying on the student loan debt from that earlier date. We cited  
10 Hiatt with approval in Drysdale v. Educ. Credit Mgmt. Corp. (In  
11 re Drysdale), 248 B.R. 386, 390-91 (9th Cir. BAP 2000), aff'd, 2  
12 Fed. Appx. 776, 777 (9th Cir. 2001).

13 ECMC contends that our decision in Drysdale regarding the  
14 nature of a consolidation student loan remains applicable  
15 notwithstanding the change to § 523(a)(8),<sup>5</sup> which eliminated the  
16 Nondischargeability Period and left undue hardship as the only  
17 cause for discharging a student loan debt. As a result, ECMC  
18 asserts the student loan debt Ms. McBurney owed when she filed  
19 her adversary complaint is the Consolidation Loan, a postpetition  
20 debt, not the Student Loans, which existed as prepetition debts  
21 until satisfied by the proceeds of the Consolidation Loan.

22 In Drysdale, we explicitly adopted the interpretation of  
23 § 523(a)(8)(A) set forth both in Hiatt and in Rudnicki v. So.  
24 Coll. of Optometry (In re Rudnicki), 228 B.R. 179, 181 (6th Cir.  
25 BAP 1999). In doing so, we implicitly adopted the underlying

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27 <sup>5</sup>This amendment to § 523(a)(8) was effective for cases filed  
28 on or after October 7, 1998, and is applicable in Ms. McBurney's  
chapter 7 case filed in 1999.

1 premise in Hiatt and in Rudnicki that a consolidation student  
2 loan is a new, distinct loan, the proceeds of which are applied  
3 to extinguish the original student loan debt. Since it is based  
4 on an interpretation of relevant provisions of the Higher  
5 Education Act of 1965, which remain applicable, that premise  
6 holds true notwithstanding that § 523(a)(8)(A) no longer exists.<sup>6</sup>

7 For example, a consolidation student loan lender is  
8 obligated to pay the proceeds of the consolidation student loan  
9 to holders of the loans being consolidated to "discharge the  
10 liability on such loans." 20 U.S.C. § 1078-3(b)(1)(D). Also,  
11 the commencement of the repayment obligation for a consolidation  
12 student loan is set relative to the time when the holders of the  
13 loans being consolidated have "discharged the liability of the  
14 borrower" on those loans. 20 U.S.C. § 1078-3(c)(4).  
15 Additionally, Congress expressly provided that a consolidation  
16 student loan is a new loan for purposes of 20 U.S.C. § 1074,  
17 which sets the limitation on the annual amount of student loans  
18 covered by federal insurance. 20 U.S.C. § 1078-3(e).

19 From the record it is clear that the proceeds of the  
20 Consolidation Loan were disbursed to the holders of the Student  
21 Loans on March 14, 2000, postpetition. Ms. McBurney's liability  
22 on the Student Loans was extinguished by the disbursements. She  
23 incurred a new liability in its place, i.e., the Consolidation  
24 Loan.

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26 <sup>6</sup>While BAPCPA reintroduced a subsection (A) to § 523(a)(8),  
27 the BAPCPA version of § 523(a)(8) does not revive the passage of  
28 a minimum repayment period as a basis to allow discharge of a  
student loan debt in cases filed on or after October 17, 2005.

1 II. Rule 12 Requires Dismissal of the Adversary Proceeding.

2 As provided by § 101(12), "'debt' means liability on a  
3 claim." As provided by § 101(5), "claim," as applicable for our  
4 purposes, means "right to payment."

5 At the time she filed her chapter 7 petition in 1999, Ms.  
6 McBurney was liable for the Student Loans. Had she not entered  
7 into the Consolidation Loan, her liability for the prepetition  
8 Student Loans would have continued to exist and would properly be  
9 the subject of an adversary proceeding filed in her reopened  
10 chapter 7 case to determine her ability to discharge the Student  
11 Loans based on alleged undue hardship, whenever brought. See  
12 Rule 4007. However, once her liability on the Student Loans was  
13 extinguished on March 14, 2000, the Student Loans were no longer  
14 debts.

15 As we have stated, the Consolidation Loan is a postpetition  
16 debt. Generally speaking, a chapter 7 debtor can discharge only  
17 debts that arose before the date of the order for relief. See  
18 § 727(b).

19 ECMC moved to dismiss the adversary complaint for failure to  
20 state a claim upon which relief can be granted. Rule 7012(b)  
21 (incorporating FED. R. CIV. P. 12(b)(6) in adversary proceedings  
22 in bankruptcy). In considering ECMC's Rule 7012 motion, we take  
23 as true all allegations of material fact made in Ms. McBurney's  
24 adversary complaint and construe those facts in the light most  
25 favorable to Ms. McBurney. See Cervantes v. United States, 330  
26 F.3d 1186, 1187 (9th Cir. 2003). The complaint should not be  
27 dismissed unless it appears beyond doubt that Ms. McBurney can  
28 prove no set of facts in support of her claim that would entitle

1 her to relief. See No. 84 Employer-Teamster Joint Council  
2 Pension Trust Fund v. Am. W. Holding Corp., 320 F.3d 920, 931  
3 (9th Cir. 2003); Zimmer v. PSB Lending Corp. (In re Zimmer), 313  
4 F.3d 1220, 1222 (9th Cir. 2002).

5 As is evident from the discussion above, at the time Ms.  
6 McBurney filed her adversary complaint, the Student Loans were  
7 not debts, and the Consolidation Loan was a postpetition debt not  
8 eligible for discharge under any circumstances in her 1999  
9 chapter 7 case.<sup>7</sup> Accordingly, under no circumstances can Ms.  
10 McBurney demonstrate that she is entitled to relief under  
11 § 523(a)(8) in her pending adversary proceeding. See generally  
12 Clarke v. Paige (In re Clarke), 266 B.R. 301 (Bankr. E.D. Pa.  
13 2001).

14 On that basis, the Bankruptcy Court erred in denying the  
15 Rule 7012 motion.

#### 17 CONCLUSION

18 Ms. McBurney's liability on the Student Loans was  
19 extinguished when the proceeds of the Consolidation Loan were  
20 disbursed. Ms. McBurney's Consolidation Loan is a postpetition  
21 debt not subject to discharge in her 1999 chapter 7 case. The  
22 bankruptcy court erred in denying ECMC's motion to dismiss the  
23 complaint for failure to state a claim upon which relief can be  
24 granted. We REVERSE and REMAND with instructions to enter an

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26 <sup>7</sup>We are deciding only that the Consolidation Loan is not  
27 dischargeable under § 523(a)(8) in Ms. McBurney's 1999 chapter 7  
28 case. The dischargeability of the Consolidation Loan in any  
future bankruptcy case Ms. McBurney might file is not an issue  
before us.



1 order dismissing the adversary proceeding.

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