UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

TOMMY L. HUNTER, Case No. 96-11390-MAM-13

Debtor.

TOMMY L. HUNTER,

Plaintiff,

v. Adv. No. 03-01079

STUDENT LOAN GUARANTEE FOUNDATION OF ARKANSAS, SALLIE MAE SERVICING, L.P., and ARCTECH, INC.

Defendants.

ORDER GRANTING DEFENDANTS' MOTIONS TO DISMISS

Larson D. Edge, Jr. and Angela M. Cooper, Mobile, Alabama, Attorneys for Tommy L. Hunter
Lawrence B. Voit, Mobile, Alabama, Attorney for Sallie Mae Servicing, L.P., and Artech, Inc.
Connie M. Meskimen, Little Rock, Arkansas, Attorney for Student Loan Guarantee Foundation of Arkansas

This matter is before the Court on the defendants' motions to dismiss Tommy L. Hunter's adversary proceeding. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2) and the Court has authority to enter a final order. For the reasons indicated below, the Court finds that the motions to dismiss filed by the Student Loan Guarantee Foundation of Arkansas, Sallie Mae Servicing, L.P., and Arctech, Inc. are due to be granted and Tommy L. Hunter's adversary proceeding is due to be dismissed with prejudice.

FACTS

Tommy L. Hunter filed a chapter 13 bankruptcy case in this Court on April 16, 1996. Sallie Mae Servicing, L.P. filed a $3,671.14 proof of claim for Mr. Hunter's student loan. The proof of claim included only principal and prepetition interest. The chapter 13 trustee paid the claim in full and this Court entered an order discharging Mr. Hunter on September 28, 2000.

After Mr. Hunter received his discharge, the defendants pursued collection efforts against him for the remaining principal balance and interest due on his student loan. Mr. Hunter did not remit any additional payments to the defendants for his student loan because he believed that he paid the entire principal balance in his bankruptcy case. The defendants asserted that their entire claim was not paid during Mr. Hunter's bankruptcy case because postpetition interest on his student loan continued to accrue during the course of his case. The defendants further asserted that they were required by law to apply Mr. Hunter's plan payments first to interest (including both prepetition and postpetition interest) and then to principal.

Mr. Hunter filed an adversary proceeding complaint against the defendants on April 8, 2003. The Court held a hearing on his complaint on June 10, 2003. Mr. Hunter argues that he paid the entire principal balance on his student loan debt in his bankruptcy case and the amount the defendants claim he still owes is a result of improper application of his plan payments. The defendants argue that this Court lacks subject matter jurisdiction over Mr. Hunter's adversary proceeding because it does not "relate to" his bankruptcy case. Alternatively, the defendants argue that if this Court does have subject matter jurisdiction, part of Mr. Hunter's principal balance on his student loan debt survived his bankruptcy case because his plan payments were properly applied first to interest that continued to accrue on his principal balance and then to the principal balance itself.

LAW

The defendants have filed motions to dismiss Mr. Hunter's adversary proceeding under Fed. R. Bank. P. 7012(b)(6).[1] "Under Fed. R. Civ. P. 12(b)(6), dismissal of a complaint is appropriate 'only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations.'" *Corner v. First USA Bank, N.A. (In re Corner)*, Case No. 02-13156, Adv. No. 03-01034 (Bankr. S.D. Ala., July 3, 2003) (citing to *Blackston v. Alabama*, 30 F. 3d 117, 120 (11th Cir. 1994) (quoting *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984). "On a motion to dismiss the court must accept as true all facts alleged and draw all inferences therefrom in the light most favorable to the plaintiffs." *Id*. (quoting *Hornfeld v. City of North Miami Beach*, 29 F. Supp. 2d 1357, 1361 (S.D. Fla. 1998). A very low sufficiency threshold is necessary for a complaint to survive a motion to dismiss. *Id*. The Court will address the defendants' two arguments for dismissing Mr. Hunter's adversary proceeding under this framework.

A.

"The jurisdiction of the district courts (from which the bankruptcy court's jurisdiction is derivative) over bankruptcy matters is established in 28 U.S.C. §1334." *Noletto v. NationsBanc Mortgage Corp. (In re Noletto)*, Case No. 98-13813, Adv No. 99-01120 (Bankr. S.D. Ala. February 15, 2000) (citing to *Continental Nat. Bank of Miami v. Sanchez (In re Toledo)*, 170 F.3d 1340, 1344 (11th Cir. 1999)). Section 1334(b) states in relevant part that "the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." "Generally, '[a]rising under' proceedings are matters invoking a substantive right created by the Bankruptcy Code," *Id*. (citing to *In re Toledo*

[1] Federal Rule of Bankruptcy Procedure 7012(b)(6) is identical to Federal Rule of Civil Procedure 12(b)(6).

at 1345), and "'arising in' proceedings involve administrative-type matters, or . . . matters that could arise only in bankruptcy." *Id.* This Court has held that the "plain meaning of the words used in [28 U.S.C. §1334(b)] gives a district court jurisdiction over suits . . . in which the issues relate only to federally created bankruptcy law." *Id.* (citing to *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) for the proposition that the plain meaning of legislation is conclusive except in rare cases).

The defendants argue that this Court lacks subject matter jurisdiction over Mr. Hunter's adversary proceeding complaint. They state that Mr. Hunter's complaint does not "arise under" title 11 or "relate to" a case under title 11. However, the defendants only cite to cases involving the latter type of jurisdiction. *Community Bank of Homestead v. Boone (In re Boone)*, 52 F.3d 958 (11th Cir. 1995) (finding that debtor's claim against a bank fell outside of "related to" jurisdiction); *Miller v. Kemira, Inc. (In re Lempco Gypsum, Inc.)*, 910 F.2d 784 (11th Cir. 1990) (considering whether a civil proceeding is sufficiently "related to" bankruptcy to confer jurisdiction on the district court); *In re McAllister*, 216 B.R. 957 (Bankr. N.D. Ala. 1998) (finding that the creditor's garnishment action did not endow the court with jurisdiction under 28 U.S.C. §157(c)(1), which gives bankruptcy courts "related to" jurisdiction).

To the extent that the defendants argue that this Court does not have subject matter jurisdiction over Mr. Hunter's complaint because it is not 'related to' his bankruptcy case, "they ignore the language 'arising under' or 'arising in' a case under title 11." *In re Noletto*. Case law plainly holds that "[t]he Bankruptcy Code exclusively governs the determination of whether a debt is nondischargeable . . . ." *In re McFarland*, 84 F.3d 943, 946 (7th Cir. 1996) (citing to *Brown v. Felsen*, 442 U.S. 127, 129-30 (1979)). Moreover, Mr. Hunter's complaint to determine the dischargeability of his student loan debt "clearly fit[s] within the plain language of the

'arising under' or 'arising in' jurisdictional categories," *Id.*, because a dischargeability determination is listed as a core proceeding (one arising under or in a case under title 11) in 28 U.S.C. §157(b)(2)(I). The defendants' motions to dismiss Mr. Hunter's adversary proceeding for lack of subject matter jurisdiction denied.

B.

Under 11 U.S.C. §523(a)(8), "government-guaranteed student loans are nondischargeable in bankruptcy proceedings absent a showing of undue hardship." *Kielisch v. Educational Credit Management Corporation (In re Kielisch)*, 258 F.3d 315, 319 (4th Cir. 2001). Mr. Hunter did not argue for an undue hardship determination during his bankruptcy case, nor does he argue for one now. Mr. Hunter agrees with the defendants that his student loan debt, including the postpetition interest that accrued during his bankruptcy, was nondischargeable and that he remained personally liable for any amount of his student loan debt that was not paid during his bankruptcy. He disagrees, however, with the manner in which the defendants applied his bankruptcy plan payments toward his student loan debt.

Section 682.404(f) of Title 34 of the Code of Federal Regulations "directs creditors on a defaulted student loan debt to apply payments received first toward accrued interest and then to the principal balance." *Banks v. Sallie Mae Servicing Corp.*, 299 F.3d 296, 300 (4th Cir. 2002). The defendants argue that their application of Mr. Hunter's bankruptcy plan payments was in accord with 34 C.F.R. §682.404(f). They filed a $3,671.14 proof of claim for Mr. Hunter's student loan that included only principal and prepetition interest. Subsequently, the defendants applied Mr. Hunter's bankruptcy plan payments first to postpetition interest that accrued during his bankruptcy case and then to principal, rather than applying his plan payments exclusively to their $3,671.14 proof of claim. Mr. Hunter argues that the defendants' application of his plan

payments in this manner violated 11 U.S.C. §502(b)(2).

Section 502(b)(2) of the Bankruptcy Code provides that creditors may file claims in a debtor's bankruptcy case "only for prepetition interest and principal and not for unmatured, postpetition interest." *Kielisch* at 321. "The purpose of this provision is to protect other creditors, as well as to avoid administrative inconvenience, by ensuring that it is 'possible to calculate the amount of claims easily and . . . that creditors at the bottom rungs of the priority ladder are not prejudiced by the delays inherent in liquidation and distribution of the estate.'" *Id*. (quoting *In re Hanna*, 872 F.2d 829, 830 (8th Cir. 1989)). The defendants do not dispute that "based on 502, that [they] could file claims with the Debtor['s] estate[] only for prepetition interest and principal and not for unmatured, postpetition interest." *Id*. The defendants argue that although §502(b)(2) prohibited them from filing a claim in Mr. Hunter's bankruptcy case for postpetition interest, nothing in the Bankruptcy Code prohibited them from applying the plan payments they received to postpetition interest before applying them to principal.

The 4th Circuit Court of Appeals directly addressed this issue in *Kielisch v. Educational Credit Management Corporation (In re Kielisch)*, 258 F.3d 315 (4th Cir. 2001). In *Kielisch*, the Court of Appeals held that even though the creditor was prohibited from filing a proof of claim for postpetition interest, it could apply the debtors' bankruptcy plan payments first to postpetition interest and then to principal. 258 F.3d at 323-24. The Court of Appeals disagreed with the debtors' position that application of their plan payments to postpetition interest violated §502(b)(2). *Id*. It explained that "adopting the Debtors' position would, in essence, permit them partially to discharge the interest on their nondischargeable student loan debts without a showing of undue hardship . . . because allowing their estates to pay off loan principal without first permitting the application of the payment by the estate to satisfy postpetition interest would

reduce the overall amount that the Debtors would have to pay as a result of their debts and would also prevent the accumulation of interest that would have accrued but for their bankruptcies." *Id.* "This would place the Debtors in a far more favorable position than other student loan debtors solely by virtue of their Chapter 13 bankruptcies, thus allowing the Debtors to accomplish indirectly what they could not accomplish directly under the plain language of § 523(a)(8), i.e., a partial discharge of the interest on their student loan debts without a showing of undue hardship." *Id.*

The 4th Circuit Court of Appeals in *Kielisch* acknowledged that two other courts of appeal previously held that §502(b)(2) generally prohibits creditors from collecting postpetition interest from bankruptcy plan payments. *See United States v. Victor*, 121 F.3d 1383, 1387 (10th Cir. 1997) (holding that "[s]ection 502(b) does not simply prohibit certain creditors from filing a proof of claim for post-petition interest; it prohibits those creditors from collecting the interest from the bankruptcy estate"); *In re Hanna*, 872 F.2d 829, 830 (8th Cir. 1989) (holding that §502(b)(2) sets forth a "general rule 'disallowing' the payment of unmatured interest out of the assets of the bankruptcy estate"). However, the *Kielisch* court disagreed with those holdings on the basis "that both of [those] cases simply assume, with little analysis, that §502's prohibition on the allowance of claims for postpetition interest from the estate also bars the application of estate payments to postpetition interest." 258 F.3d at 325 n.7.

This Court agrees with the *Kielisch* court's analysis of the interaction between 34 C.F.R. §682.404(f) and the Bankruptcy Code. The 4th Circuit Court of Appeals explained in *Kielisch* that "the basic reasons for the rule denying post-petition interest as a claim against the bankruptcy estate are the avoidance of unfairness as between competing creditors and the avoidance of administrative inconvenience . . . ." 258 F.3d at 324-25 (quoting *Bruning v. United*

States, 376 U.S. 358, 362 (1964)). These reasons are inapplicable to a nondischargeable student loan debt for which a creditor may only file a proof of claim for principal and prepetition interest. In such a case, "the amount claimed from the estate remains the same no matter how [the creditor] applies the payments;" therefore, the creditor's "method of application simply has no effect on the rights of other creditors." *Kielisch* at 325. Additionally, the creditor's application of the plan payments to postpetition interest does not inconvenience the administration of the debtor's case because "no matter how long the proceedings take, [the creditor] still receives only the amount that it sought in its proofs of claim . . . ." *Id.*

The relevant facts in this case mirror those in *Kielisch*. Mr. Hunter's student loan was a nondischargeable debt. He remained personally responsible for any amount of his debt that he did not pay during his bankruptcy case, including postpetition interest. The defendants filed a proof of claim for Mr. Hunter's student loan that included only principal and prepetition interest. The chapter 13 trustee paid the defendants' claim in full but the defendants asserted that Mr. Hunter still owed them money because they applied his payments first to postpetition interest and then to principal.

The defendants' application of Mr. Hunter's plan payments was proper under 34 C.F.R. §682.404(f), which specifically provides that payments are applied first to interest and then to principal. Additionally, §502(b)(2) of the Bankruptcy Code does not prohibit the defendants from applying Mr. Hunter's payments in this manner. It only prohibits them from filing a claim for postpetition interest, which they did not do. Finally, the defendants' application of Mr. Hunter's plan payments does not contravene the policy behind §502(b)(2)'s disallowance of filing claims for postpetition interest because it will not affect the rights of other creditors or inconvenience the administration of Mr. Hunter's bankruptcy estate.

CONCLUSION

For all of the reasons indicated above, the Court finds that it is clear that no relief could be granted to Mr. Hunter under any set of facts that could be proved consistent with his allegations in this adversary proceeding. The Court is GRANTING the motions to dismiss filed by the Student Loan Guarantee Foundation of Arkansas, Sallie Mae Servicing, L.P., and Arctech, Inc. Tommy L. Hunter's adversary proceeding is DISMISSED with prejudice.

Dated: July 22, 2003

/s/ Margaret A. Mahoney
MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE