

**TUITION CLAWBACKS\***

By Ashley S. Whyman

A recent and emerging trend in Chapter 7 bankruptcy cases is lawsuits brought by Chapter 7 trustees to recover from colleges and universities pre-petition tuition payments made by Chapter 7 debtors for their adult children's post-secondary education. While many of these cases have settled, thus not resulting in reported decisions, there are four written decisions to date on this subject.<sup>1</sup> This article discusses the legal theory behind these avoidance actions and explores the universe of case law.

**I. Chapter 7 Trustee's Fiduciary Duty**

While proponents for colleges and universities and some legal commentators opine that these tuition claw back lawsuits by Chapter 7 trustees are distasteful, a Chapter 7 trustee has a fiduciary duty to recover and collect money for the bankruptcy estate for ultimate distribution to creditors of that bankruptcy estate. See 11 U.S.C. §§ 704, 726. A Chapter 7 trustee has a duty to investigate all pre-petition transfers that may lead to a recovery for creditors, including transfers to educational institutions.

**II. The Legal Theory – Fraudulent Transfer**

The trustee's legal theory is grounded in both state fraudulent transfer law, which the trustee may utilize pursuant to the Bankruptcy Code, and on the fraudulent transfer provisions of the Bankruptcy Code.

**A. State Law Fraudulent Transfer Provisions – 11 U.S.C. § 544(b)**

Pursuant to 11 U.S.C. § 544(b), a Chapter 7 trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is avoidable under state law. See 11 U.S.C. § 544(b). In the case of tuition claw backs, the Chapter 7 trustee must look to the law of the state in which the alleged fraudulent transfer was made.

All states have fraudulent transfer statutes. These statutes may differ slightly from state to state. Generally, the biggest difference between jurisdictions is the statute of limitations, or the period of time during which a creditor (or in this case, a Chapter 7 trustee) can look back to recover the alleged fraudulent transfers. Under Massachusetts law and under most state fraudulent transfer statutes, the statute of limitations on fraudulent transfers is four years, prior to the commencement of the debtors' bankruptcy case, meaning the Chapter 7 trustee can seek to recover four years' worth of college tuition payments under state law. See M.G.L.A. c. 109A, §10; Uniform Fraudulent Transfer Act (UFTA), § 9. While state fraudulent transfer statutes

If you have any questions about the issues addressed here, or any other matters involving Bankruptcy and Creditors' Rights issues, please feel free to contact:

Andrew P. Barsom

Meredith C. Burns

Daniel C. Cohn

Michael P. Connolly

Mark G. DeGiacomo

Taruna Garg

Olga L. Gordon

Robert E. Kaelin

Ryan M. MacDonald

Eric B. Miller

Kari L. Olson

Monica P. Snyder

Thomas S. Vangel

Robert A. White

Ashley S. Whyman

Kevin F. Yetman

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<sup>1</sup>There are also reported cases on Chapter 7 trustee's attempts to recover tuition payments paid by debtor-parents for their minor children's grammar school private education. Courts have found that parents have a legal duty to educate their minor children, and have universally denied a Chapter 7 trustee's right to avoid and recover these payments. See *In re Akanmu*, 502 B.R. 124 (Bankr. E.D.N.Y. 2013) and *In re Karolak*, Adv. P. No. 13-04394 (PJS), 2013 WL 4786861 (Bankr. E.D. Mich. Sept. 6, 2013).

typically closely resemble the Bankruptcy Code's fraudulent transfer provisions, the Chapter 7 trustee should assert causes of action under the state court fraudulent transfer statute, as well as under the Bankruptcy Code, where appropriate, since the statute of limitations on avoidance actions under the Bankruptcy Code is limited to two years prior to the commencement of the debtors' bankruptcy case. See 11 U.S.C. § 546(a)(1).

## **B. Bankruptcy Code Fraudulent Transfer Provision – 11 U.S.C. § 548(a)(1)(B)**

The vast majority of tuition claw back actions are brought under a “constructive” fraudulent transfer theory, as opposed to an “actual” fraudulent transfer theory (which would require the trustee to prove that the debtor-parents made the transfer with the actual intent to hinder, delay or defraud their creditors).<sup>2</sup> The basis of the Chapter 7 trustee's “constructive” fraud action is that while the matriculating student may receive value in the form of an education from the debtor-parents tuition payments, the payee-debtor-parents, who made such payments to the college or university while insolvent, receive nothing (or, in legal terms, received no “reasonably equivalent value”).

Section 548(a)(1)(B) of the Bankruptcy Code authorizes a trustee to avoid a transfer of property under a “constructive” fraud theory. Section 548(a)(1)(B) provides, in relevant part, as follows:

The Trustee may avoid any transfer ... of an interest of the debtor in property, or any obligation ... incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily-

(B)(i) received less than reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfers to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

See 11 U.S.C. § 548(a)(1)(B).

### **i. Reasonably Equivalent Value**

The Bankruptcy Code does not define “reasonably equivalent value.” “Value,” however, is defined in the Bankruptcy Code as “property, or satisfaction or securing a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or a relative of the debtor.” 11 U.S.C. § 548(d)(2)(A). Value can be in the form of either a direct or indirect economic benefit to the debtor. See *In re Wilkinson*, 196 F. App'x 337, 342 (6th Cir. 2006) (“Value can be in the form of either a direct economic benefit or an indirect economic benefit.”); *In re Kelsey*, 270 B.R. 776, 781 (9th Cir. BAP 2001) (“value is limited to economic or monetary consideration”); *In re Treadwell*, 699 F.2d 1050, 1051 (11th Cir. 1982) (holding that “love and affection” in exchange for monetary transfers was not reasonably equivalent value); *In re Green*, 268 B.R. 628, 651 (Bankr. M.D. Fla. 2001) (debtor's moral or family obligation to pay for their daughter's wedding is not reasonably equivalent value); see also 3 Alan N. Resnick & Henry J. Sommer, *Collier Bankruptcy Manual* 548.05[1][b] (Matthew Bender) (“In order to determine if fair economic exchange has occurred [to constitute reasonably equivalent value], the court must analyze all the circumstances surrounding the transfer in question.”).

## **III. A Split in Authority**

As stated *supra*, there are four reported decisions to date on a Chapter 7 trustee's ability to avoid and recover pre-petition tuition payments made by debtor-parents for their adult children's post-secondary education. There is a split of authority on the issue, with two decisions denying the Chapter 7 trustee any right to recovery and two favoring the Chapter 7 trustee. There are no appellate decisions on the issue.

<sup>2</sup>Note, however, that where a debtor was engaged in a Ponzi scheme, the actual intent of the debtor can be established as a matter of law and, in such case, a cause of action for actual fraud under 11 U.S.C. § 548(a)(1)(A) is warranted. See *In re AFI Holding, Inc.*, 525 F.3d 700, 704 (9th Cir. 2008).

## i. Cases Against Avoidance and Recovery of Tuition Payments

In In re Cohen, No. 05-38135 (JAD), 2012 WL 5460956 (Bankr. W.D. Pa. October 31, 2012), the Chapter 7 trustee challenged \$102,573.00 in payments made by the debtors pre-petition for their son and daughter's post-secondary education. Id. at \*9. While the court acknowledged that Pennsylvania law did not require parents to pay for their children's post-secondary education, the court held that payments were "reasonable and necessary for the maintenance of the Debtor's family for purposes of the fraudulent transfer statutes only," and thus unavoidable. Id. at \*10.

In the other Pennsylvania case, In re Oberdick, 490 B.R. 687 (Bankr. W.D. Pa. 2013), the Chapter 7 trustee challenged \$82,536.22 in payments made by the debtors pre-petition for their children's undergraduate education at the University of Chicago and Robert Morris University. In following the reasoning of the Cohen court, the court found that although the debtors did not have any legal obligation to pay for their children's undergraduate education, the payments "were made out of a reasonable sense of parental obligation" and that "there is something of a societal expectation that parents will assist with such expense if they are able to do so." Id. at 712.

Neither of these decisions discuss or reference the definition of "value" set forth in Section 548 of the Bankruptcy Code (with respect to the college tuition payment issue) and neither find that the debtors received any economic value for the college tuition payments.

## ii. Cases Favoring Avoidance and Recovery of Tuition Payments

In In re Leonard, 454 B.R. 444 (E.D. Mich. 2011), the Chapter 7 trustee sought to avoid and recover, as fraudulent transfers, tuition payments totaling more than \$21,000 made by the debtor-parents to Marquette University for their 18-year-old son's education. Id. at 445-446. The trustee and the University filed cross-motions for summary judgment on the trustee's constructive fraudulent transfer claims. The issue hinged on the debtor-parents' receipt of "reasonably equivalent value" for the transfers. The University argued that the debtors received reasonably equivalent value for the tuition payments in the form of peace of mind in knowing that their son was receiving a good education and the expectation that their son would become financially independent as a result of his education. Id. at 454-455. In ruling in the trustee's favor, the court reasoned that any indirect benefit received by the debtors could only be considered "value" if it were an economic benefit that was "concrete" and "quantifiable." Id. at 457. The court determined that the debtor-parents did not receive any value in exchange for the tuition payments because the intangible benefits of peace of mind and financial freedom were not "concrete and quantifiable." The court also held that the payment of college tuition did not satisfy any legal duty on the debtors' part (which may constitute equivalent value) since the parents had no legal obligation to provide their adult child with a college education. Id.

Similarly, in In re Lindsay, No. 06-36352 (CGM), 2010 WL 1780065 (Bankr. S.D.N.Y. May 4, 2010), the Chapter 7 trustee sought to avoid and recover, as fraudulent transfers, tuition payments totaling more than \$35,000 made by the debtor-parents to a university for their adult son's education. On the trustee's motion for summary judgment, the court found in favor of the trustee. The court rendered its decision based on the facts that (1) the debtor-parents produced no evidence of a legal obligation to pay their son's tuition, "such as a promissory note in favor of the university or a lender," (2) no law existed obligating a parent to pay for an adult child's education, and (3) the debtors offered no authority to support their argument that they had a "moral obligation" to fund their adult child's education. Id. at \*9.

In an unwritten decision in the Eastern District of Massachusetts dated September 2, 2015 in the adversary proceeding styled Mark G. DeGiacomo, Chapter 7 Trustee of Steven and Lori Palladino v. Sacred Heart University, Adv. Pro. No. 15-1126 (MSH), the Bankruptcy Court for the Eastern District Of Massachusetts denied Sacred Heart's University's motion to dismiss the Chapter 7 trustee's adversary complaint for the avoidance and recovery of pre-petition tuition payments made by the debtors to the university for the benefit of the debtors' adult child. [Doc. No. 24].

## IV. A Move For Legislation

Representative Chris Collins of New York introduced a bill into Congress known as "The PACT (Protecting All College Tuition) Act of 2015." See Congressional Bills 114th Congress H.R. 2267. The bill seeks to amend Section 548 of the Bankruptcy Code to except good faith post-secondary tuition payments made by parents for the benefit of their children. As of the date of this article, Congress has not acted on the proposed bill.

*Ashley S. Whyman is an associate in the Litigation Department of Murtha Cullina and a member of the Firm's Bankruptcy & Creditors' Rights Practice Group. Ms. Whyman can be contacted at 617.457.4085 or [awhyman@murthalaw.com](mailto:awhyman@murthalaw.com).*