Consumer: Post-Secondary Education –
Distressed Schools and Stressed Out Parents

What? My son the doctor's tuition payments didn't give me value? But I'm kvelling with such pride!

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This paper explores the issues that arise when parents who made college tuition payments or guaranteed student loans on behalf of their adult children later file bankruptcy and the trustee tries to avoid those payments / guarantees as fraudulent conveyances under 11 U.S.C. § 548(a), or state fraudulent transfer laws, because, *inter alia*, the parent(s) did not receive "reasonably equivalent value." Because there is limited case law thus far, we summarize recently reported decisions, and will make bold predictions at the conference.

Recall, under § 548(a) a trustee may avoid a transfer if it was "actually" or "constructively" fraudulent. First, as it applies to both types of transfers, the statute provides:

> (a)(1) The trustee may avoid any transfer...of an interest of the debtor in property,...that was made...on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

Next, the statute addresses transfers that are "actually" fraudulent when the Debtor:

> (A) made such transfer or incurred such obligation with ***actual intent*** to hinder, delay, or defraud any entity to which the debtor was … indebted; …

In addition, or in the alternative, a transfer is "constructively" fraudulent when the Debtor:

> (B)(1) ***received less than a reasonably equivalent value*** in exchange for such transfer...; and
>
> (ii)(I) was insolvent on the date that such transfer was made ... or became insolvent as a result of such transfer...

11 U.S.C. §§ 548(a)(1)(A)-(B)(i)-(ii)(I).

In addition to the trustee's powers under § 548, pursuant to § 544(b), the trustee may avail himself of state fraudulent transfer laws, which often have longer look-back periods than § 548, but generally have similar statutory elements.

Here are the reported decisions to date:

***Eisenberg v. Pennsylvania State University (In re Lewis)*, No. 16-0282-REF, 2017 WL 1344622 (Bankr. E.D. Pa. Apr. 7, 2017); Richard E. Fehling, United States Bankruptcy Judge**

Chapter 7 trustee sued Pennsylvania State University ("Penn State"), pursuant to 11 U.S.C. §§ 548(a)(l)(A) and (B), and the Pennsylvania Uniform Fraudulent Transfer Act ("PUFTA") §§ 5104 and 5105, seeking to recover loan proceeds from Parent Plus loans[1] made to Penn State in the name of debtor that paid the tuition and other qualified educational expenses of two of debtor's children. The court granted Penn State's motion to dismiss the complaint, finding that debtor never held an interest in the proceeds of the Parent Plus loans. The trustee conceded that the proceeds from the Parent Plus loans were paid directly to Penn State, bypassing the debtor entirely. Thus, the loans did not and could not have passed through debtor's hands and did not and could not have been used to pay any of debtor's debts, and could not be used for any purpose other than to pay the cost of the children's tuition and other qualified educational expenses at Penn State. The court also noted that if the trustee were to succeed in his attempt to avoid debtor's obligation on the Parent Plus loans, the transfer of the loan proceeds to Penn State would still not be avoided; regardless, the trustee

[1] As noted in the opinion, the "existence of the Parent Plus loan system is dependent upon and limited by the Higher Education Act of 1965 ("Higher Education Act"), and related federal regulations. Parent Plus loans may only be issued 'to pay for the student's cost of attendance ...' at '[c]olleges, universities, graduate and professional schools, vocational schools, and proprietary schools ....' A parent is only eligible to receive a Parent Plus loan if '[t]he parent is borrowing to pay for the educational costs of a dependent undergraduate student....' "

sought to recover the proceeds of the Parent Plus loans, not to avoid debtor's obligation on the loans.

As for whether debtor received reasonably equivalent value in exchange for the transfers, the court stated that a parent's payment of a child's undergraduate college expenses is a reasonable and necessary expense for maintenance of the family and for preparing family members for the future. "The parent therefore receives reasonably equivalent value in exchange for the tuition payment."

DeGiacomo v. Sacred Heart University, Inc. (In re Palladino), 556 B.R. 10 (Bankr. D. Mass. 2016); Melvin S. Hoffman, United States Bankruptcy Judge

On April 1, 2014, the Palladinos filed chapter 7. On July 21, 2014, debtors each pled guilty to charges of investment fraud for operating a Ponzi scheme through their company, Viking Financial Group, Inc. The chapter 7 trustee filed an adversary proceeding against Sacred Heart University ("SHU") pursuant to § 548(a)(1)(A) and (B) and Massachusetts Uniform Fraudulent Transfer Act Chapter 109(a) ("UFTA") to set aside tuition payments of $64,696.22 made directly by the debtors on behalf of their adult child, Nicole, to SHU.

The parties filed cross motions for summary judgment. First, the court granted SHU summary judgment on the trustee's cause of action that the transfers to SHU were actually fraudulent under § 548(a)(1)(A) pursuant to the so-called "Ponzi scheme presumption" in connection with debtors' investment fraud. The court took a limited view of the Ponzi scheme presumption, following the *Madoff* standard that "transfers made in furtherance of that Ponzi scheme are presumed to have been made with fraudulent intent," *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 531 B.R. 439, 471 (Bankr. S.D.N.Y. 2015), and stated that allowing the trustee "to prevail under

an actual fraud theory here would mean ignoring the nature of the transactions engaged in by the [Debtors] in their day to day affairs (morally culpable as they may have been in relation to the scheme itself), like buying groceries, paying medical bills, and supporting their child." *See Kapila v. Phillips Buick–Pontiac–GMC Truck, Inc. (In re ATM Fin. Servs., LLC)*, Adversary No. 6:10–ap–44, 2011 WL 2580763, at *5 (Bankr. M.D. Fla. June 24, 2011).

Next, the court granted SHU summary judgment on the trustee's constructive fraud claim. The only issue before the court was whether debtors received reasonably equivalent value from SHU in exchange for the transfers. The court noted that even though the daughter "was considered an adult under Massachusetts law, she was a dependent student for college financial aid purposes. This meant that whenever Nicole sought financial aid from SHU, the Palladinos were required to submit financial aid forms and other personal financial information as part of the school's evaluation of Nicole's eligibility." The court also noted that under Massachusetts law a parent has no legal obligation to support an adult child and stated that "[e]thereal or emotional rewards, such as love and affection, do not qualify as value for purposes of defeating a constructive fraudulent conveyance claim." However, the court disagreed with the trustee's argument that the transfers failed to provide debtors with any quantifiable value. The court noted that debtors' affidavits stated they believed their payments to SHU would result in a financially self-sufficient daughter, and stated "[a] parent can reasonably assume that paying for a child to obtain an undergraduate degree will enhance the financial well-being of the child which in turn will confer an economic benefit on the parent … [and] constitutes a *quid pro quo* that is reasonable."

***Roach v. Skidmore College (In re Dunston)*, No. 14-41799-EJC, 2017 WL 600473 (Bankr. S.D. Ga. Feb. 7, 2017);**
Edward J. Coleman, United States Bankruptcy Judge

In 2004, debtor had established two qualified tuition savings plans under 26 U.S.C. § 529 (the "529 Plans"). In the fall of 2013, debtor's adult daughter enrolled in Skidmore College ("Skidmore"). Debtor made three tuition payments directly to Skidmore on behalf of her daughter (the "Transfers"). In 2013, she withdrew $71,149.15 from the 529 Plans to reimburse herself for the first two Transfers to Skidmore totaling $57,836 she had previously made from her personal checking account; thus, the amount withdrawn from the 529 Plans exceeded the amount of the first two Transfers. Subsequently, in 2014, debtor withdrew $27,570.72 from the 529 Plans to reimburse herself for part of the third Transfer of $29,971.

After filing, her chapter 7 trustee commenced an adversary proceeding against Skidmore pursuant to § 548(a)(1)(B), seeking to recover the Transfers totaling $87,807.00 made to Skidmore for the debtor's adult daughter's tuition. The Transfers were not made to Skidmore directly from the 529 Plans; rather, debtor paid the tuition from her checking account and reimbursed herself from the 529 Plans.

Skidmore filed a motion for summary judgment asserting the trustee did not meet his burden of proof on each element of whether (1) debtor transferred "an interest of the debtor in property" to Skidmore, (2) debtor "received less than reasonably equivalent value" in exchange for the Transfers, and (3) debtor was insolvent on the date of the Transfers. The court declined to grant summary judgment on (1), whether the use of the 529 funds insulated the tuition payments from § 548 attack; and (2) whether debtor received reasonably equivalent value for the Transfers.

The court first addressed whether debtor had an interest in the Transfers under § 541(b)(6).[2] Skidmore argued that had the Transfers not occurred, the funds would have remained in the 529 Plans and would have been excluded from the debtor's estate. The trustee argued that once the funds were transferred to debtor's checking account, they lost their exclusion from property of the estate. The court held the fact that debtor commingled the funds withdrawn from the 529 Plans with the funds in her checking account was not determinative of whether the funds transferred to Skidmore would have been excluded under § 541(b)(6) had the Transfers not occurred, because neither § 541(b)(6) nor the Internal Revenue Code require qualified tuition expenses to be paid directly from the plan to the institution. Rather, the issue was whether the funds transferred to Skidmore could be traced to the funds withdrawn from debtor's 529 Plans. The court found that Skidmore failed to prove as a matter of law that the Transfers could be traced to debtor's 529 Plan withdrawals.

The court then turned to the issue of whether debtor received reasonably equivalent value for the Transfers. Skidmore argued that the debtor received an

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[2] Section 541(b)(6) of the Bankruptcy Code, which provides, in relevant part:
(b) Property of the estate does not include—
* * *
(6) funds used to purchase a tuition credit or certificate or contributed to an account in accordance with section 529(b)(1)(A) of the Internal Revenue Code of 1986 under a qualified State tuition program (as defined in section 529(b)(1) of such Code) not later than 365 days before the date of the filing of the petition in a case under this title, but—
(A) only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were paid or contributed;
(B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed the total contributions permitted under section 529(b)(7) of such Code with respect to such beneficiary...; and
(C) in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $6,225[.]
11 U.S.C. § 541(b)(6).

indirect, economic benefit by helping her daughter achieve financial independence, thus relieving debtor of the need to financially support her in the future. However, the court found that debtor "did not provide[] any evidence from which the court could quantify [the] value in any manner," nor did she increase her assets in any way that could be used to pay her creditors. Further, the court expressly disagreed with Judge Hoffman's conclusion in *Palladino*, and noted that while debtor may have felt a moral obligation to pay for her daughter's college education, she did not owe any legal obligation under Georgia law to provide that education.

As to solvency, however, the court granted Skidmore summary judgment as there was no material issue of fact regarding debtor's solvency as to the first two Transfers, but denied summary judgment regarding the third Transfer. Thus, the court found a genuine issue of material fact existed as to whether debtor transferred an interest of the debtor in property or used funds excluded from the estate as part of debtor's 529 Plans as to each Transfer, that a debtor does not automatically receive reasonably equivalent value in exchange for the payment of an adult child's college tuition, and that a genuine issue of material fact existed regarding debtor's solvency at the time of the third Transfer.

***Geltzer v. Xaverian High School (In re Akanmu)*, 502 B.R. 124, 127 (Bankr. E.D.N.Y. 2013); Carla E. Craig, Chief United States Bankruptcy Judge**

This decision addresses payments for private school tuition of minor children.

The chapter 7 trustee commenced an adversary proceeding pursuant to § 548(a)(1)(B) and § 273 of the New York Debtor & Creditor Law against two parochial schools seeking to recover tuition payments totaling $46,562 as fraudulent conveyances made by debtors prior to the commencement of the case for the education of their two

minor children. Defendants filed a motion to dismiss asserting as a matter of law that the value provided in the form of an education for the debtors' children constitutes reasonably equivalent value and fair consideration to the debtors. The court granted defendants' motion to dismiss, ruling that debtors received reasonably equivalent value and fair consideration, directly and indirectly, in exchange for the tuition payments, in the form of the education provided to their children.

Under New York law, parents are legally obligated to supply their children with "adequate food, clothing, shelter [and] education ... medical, dental, optometrical [and] surgical care." Fam. Ct. Act § 1012(f)(i)(A) (defining "neglected child"). The court rejected the trustee's argument that New York law did not require debtors to provide parochial or private school education: "[t]he fact that the Debtors chose to educate their children in parochial school rather than public school, arguably exceeding the 'minimum standard of care,' does not change the fact that, by doing so, they satisfied their legal obligation to educate their children, thereby receiving reasonably equivalent value and fair consideration." The court also stated that "[i]t is irrelevant to this determination whether the Debtors could have spent less on the children's education, or, for that matter, on their clothing, food, or shelter." The court also observed that "[i]t is by no means clear that the pre-petition tuition payments on behalf of a college-age child would be recoverable as a constructively fraudulent conveyance."

Other cases finding tuition payments are not avoidable:

McClarty v. University Liggett School (In re Karolak), Case No. 12–61378, Adv. No. 13–04394–PJS, 2013 WL 4786861 (Bankr. E.D. Mich. Sept. 6, 2013). Trustee brought adversary proceeding pursuant to § 548(a)(1)(B) and Mich. Comp. Laws Ann.

§ 566.35(1) to recover debtors' payments to private school on behalf of their minor children. The court held that parents received reasonably equivalent value when they made tuition payments for their minor children's education.

Sikirica v. Cohen (In re Cohen), 2012 WL 5360956 (Bankr. W.D. Pa. 2012) *aff'd in part, vacated in part, remanded on other grounds*, 487 B.R. 615 (W.D. Pa. 2013). Trustee commenced adversary proceeding pursuant to § 548 and PUFTA §§ 5104 and 5105 seeking to recover tuition payments debtors made for children's post-secondary education. In its post-trial decision, in denying the trustee's requested relief, the court stated "[w]hile the Pennsylvania legislature has not yet enacted a statute that requires parents to pay for their children's post-secondary education, this Court holds that such expenses are reasonable and necessary for the maintenance of the Debtor's family..."

Trizechahn Gateway, LLC v. Oberdick (In re Oberdick), 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013). Pre-petition, a creditor sued debtor in state court pursuant to PUFTA §§ 5104 and 5105 to recover deposits debtor made into an entireties account that were later used to pay debtor's children's college tuition; after debtor filed chapter 7, the trustee was substituted as plaintiff. The court held that funds from the entireties account paid for undergraduate college tuition for debtor's children constituted expenditures for necessities that were therefore not avoidable under the Pennsylvania Uniform Fraudulent Transfer Act. However, funds used to pay debtor's child's friend's tuition, debtor's child's high school trip to Italy, and debtor's child's fraternity fees were not necessary expenditures and were avoidable by the trustee.

Other cases finding tuition payments are avoidable:

Gold v. Marquette Univ. (In re Leonard), 454 B.R. 444, 457 (Bankr. E.D. Mich. 2011). Chapter 7 trustee commenced adversary proceeding against Marquette University pursuant to §§ 548(a)(1)(A) & (B) and Mich. Comp. Laws §§ 566.34(1)(a) & 566.37 to recover tuition payments made to Marquette by debtors on behalf of their adult son. The court found that debtors did not receive reasonably equivalent value in exchange for the tuition payments and stated that a parent's moral obligation to help pay for their child's college education may bestow "peace of mind" on a parent, but such a benefit is not economic, concrete or quantifiable.

Banner v. Lindsay (In re Lindsay), No. 06-36352 (CGM), 2010 WL 1780065 (Bankr. S.D.N.Y. May 4, 2010). Trustee commenced adversary proceeding pursuant to NY Debt. & Cred. Law § 273–a seeking to recover from judgment debtor proceeds of a vehicle and trailer that debtor used to pay son's college tuition. The court found that "Defendants do not offer any authority in support of their argument that a judgment debtor's 'moral obligation' to pay for a child's college education is a defense to § 273–a." "The issue is not whether Debtor transferred the vehicles and encumbered the trailer for fair value. The issue is whether he permissibly transferred the money received for these assets to the university as tuition for the son."