

Client Alert

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Tuition Clawback in Bankruptcy Cases

Numerous bankruptcy trustees have attempted to claw back from colleges and universities — and even from private elementary and secondary schools — the tuition payments that parents made on behalf of their children, when the parents subsequently filed for bankruptcy.

At the college level, there are a handful of reported decisions involving tuition clawback, with decisions going both ways, as discussed below. However, the reported cases represent the tip of the iceberg. There have been many instances when trustees pursued tuition payments from colleges and universities in which the matter was resolved short of a reported decision. Often, the amount of the tuition at issue may not be sufficient for the educational institution to choose to devote the resources necessary to oppose clawback.

The reported cases revolve around the fraudulent transfer provisions of the federal Bankruptcy Code, as well as the fraudulent conveyance statutes of the states at issue. Further, some of the courts have looked to state law to determine whether a particular state has articulated a parental obligation to pay for a child's education (and to what extent).

Cases Ordering Tuition Clawback

1. *In re Leonard*,
454 B.R. 444 (Bankr. E.D. Mich. 2011)
 - Court held that more than \$20,000 in tuition payments to Marquette University that parents made on behalf of their 18-year-old son would (if proven to have been made with property of debtor parents) constitute avoidable fraudulent transfers because parents themselves received no economic value in exchange for the payments
 - Marquette argued that debtors received reasonably equivalent value for tuition because of (i) peace of mind knowing son was obtaining good education; and (ii) expectation their son would become financially independent because of such education
 - Marquette claimed the transfers were made with proceeds of student loan that debtor's son obtained from JPMorgan Chase, which father co-signed
 - Marquette asserted — and trustee disputed — that the son endorsed the student loan check and gave it to his mother to deposit in bank with the understanding that funds were to be held in trust for son's educational expenses at Marquette
 - Court noted that debtors had no legal obligation to provide adult child with college education

- Court determined that debtors did not receive any value in exchange for tuition payments because benefit to debtors was not concrete and quantifiable
 - Court noted that Marquette did not attempt to quantify claimed parental value of having child educated
 - Court rejected speculative and unquantifiable claims of psychological benefits

2. *In re Lindsay*,

No. 06-36352 (GCM), 2010 WL 1780065 (Bankr. S.D.N.Y. May 4, 2010)

- Court held tuition payments were avoidable under New York Debtor and Creditor Law § 273-a because debtor did not receive fair consideration
 - Court found transfers made with constructive intent to defraud
 - Court said that, because transfers were made without fair consideration, burden shifted to transferee to demonstrate solvency
 - Defendants did not offer any authority to support their argument about a “moral obligation” to pay for child’s college education

Cases Rejecting Tuition Clawback

1. *In re Cohen*,

No. 05-38135-JAD, 2012 WL 5360956 (Bankr. W.D. Pa. Oct. 31, 2012), rev’d on other grounds, 487 B.R. 615 (W.D. Pa. 2013)

- Rejected Chapter 7 trustee’s attempt to recover payments made by debtors for tuition for children’s undergraduate education
 - Looked at both Pennsylvania law on fraudulent transfer and Bankruptcy Code
 - Trustee failed to prove debtor actually intended to hinder or defraud creditor
 - Allowed trustee to challenge any transfers (including tuition payments) that debtor made within four years preceding date he filed for relief
- Acknowledged that Pennsylvania law did not require parent to pay for child’s post-secondary education
 - Though Pennsylvania had enacted a law previously that required separated, divorced or unmarried parents to provide post-secondary education support to their adult children, state supreme court subsequently declared the statute unconstitutional under equal protection clause (failed to apply to married parents)
- Nonetheless, court held post-secondary education payment to be “reasonable and necessary” for maintenance of debtor’s family “for purposes of the fraudulent transfer statute only.” *In re Cohen*, 2012 WL 5360956, at *10.
- Significantly, court expressly pointed out that holding is limited to payments for undergraduate education: “as such children in graduate school are well into adulthood.”

2. *In re Oberdick*,

490 B.R. 687 (Bankr. W.D. Pa. 2013)

- Held that debtor's \$82,000 in payments for undergraduate tuition for two children were not avoidable under Pennsylvania Uniform Fraudulent Transfer Act
- Court found tuition constituted expenditure for necessities
 - "There is something of a societal expectation that parents will assist with such expenses if they are able to do so."
 - However, "if there were some evidence that Defendants had made the educational expenditures as part of a strategy or with ulterior motive to shield funds from creditors," then the court might view it differently
 - But here, paid tuition out of reasonable sense of parental obligation
 - The student had been denied financial aid because of the expected family contribution

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At this point, it appears that no case on this issue has reached a higher level of the judicial system.

Trustees can be expected to continue to pursue tuition payments for the simple reason that, on a typical list of payments made by a debtor during the look-back period, tuition may often be the largest single number on the list.

What options are available to colleges and universities faced with tuition clawback?

- Settlement
- Fighting the cases individually
- Developing a coordinated strategy
 - Litigation – quantify the financial benefit to debtor parents of getting children off the payroll (anti-boomerang) by obtaining a college education
 - Legislative
 - federal level – Bankruptcy Code
 - state level – obligation to provide education
- Consider/develop policies to address clawback, such as preserving right to collect from student

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