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## COLLEGE TUITION IN JEOPARDY: CLAWBACK OF TUITION PAYMENTS MADE BY PARENTS

On November 12, 2019, the U.S. Court of Appeals for the First Circuit became the first federal appellate court to decide whether insolvent parents are committing a fraudulent transfer when they pay their child's tuition. In a ruling that poses significant concerns for colleges and universities, the Court held that a bankruptcy trustee could "claw back" such payments when the parent later declares bankruptcy, even if the parent paid the tuition years before the bankruptcy proceedings began.

By way of background, bankruptcy trustees in recent years have argued that insolvent parents commit a constructive fraudulent transfer when they pay their adult child's tuition. The trustees argue that parents do not get "reasonably equivalent value" for such payments because they are not legally required to pay for their adult children's college education and the children, not the parents, get the education.

While district courts have split on this issue, the First Circuit came down in favor of the trustee. The trustee had sought to recover tuition payments from a Connecticut institution, Sacred Heart University. The school and its *amici* argued that parents receive real value when they pay their children's tuition,

including the benefit of having a child who is more likely to become financially self-sufficient, and the value of meeting societal expectations that a parent will contribute to their children's college education. The federal government has structured its financial aid system around the presumption that parents will contribute to the costs of a child's education—underscoring the expectation that parents share in the responsibility for their children's college education. An *amicus curiae* brief submitted by the American Council on Education and an array of educational associations supported the University's position. [1]

The district court agreed with the University, but the First Circuit did not. Describing the issue as "straightforward," the Court said the tuition payments "depleted the estate and furnished nothing of direct value to the creditors who are the central concern of the code provisions at issue." Section 548 of the Bankruptcy Code recognizes certain specific types of transactions that "confer value," but tuition payments are not one of them. The Court was unwilling to go beyond those items and examine whether the debtor parents here received "reasonably equivalent value" for the tuition they paid.

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[1] That amicus was authored by Wiggin and Dana attorneys Aaron Bayer and Benjamin Daniels.

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The ruling poses significant challenges to colleges and universities. Educational institutions cannot anticipate parental insolvency, especially when they may receive the tuition payments years before the parents seek bankruptcy protection. Moreover, institutions will have a tough time recovering funds from the students, who likely have other debts and few resources. This will burden institutions, giving them few options other than raising tuition or reducing services. The First Circuit did not address those policy concerns, but left it for Congress to resolve.

Congress has previously considered, but did not pass, legislation to address this problem. Some states, however, have amended their own fraudulent transfer laws to prevent bankruptcy trustees from using those laws—which often have a longer “claw-back” period—to recover tuition payments to colleges and universities. Connecticut, for example, amended its statute in 2017 to provide that college tuition payments made by parents or guardians on behalf of minor or adult children are not voidable. The practical effect of that amendment is that a bankruptcy trustee in Connecticut could only claw back tuition payments

under the federal statute, which is limited to payments made in the two years before the bankruptcy filing, and not under the state statute that otherwise would have permitted recovery of four years of payments.

There are a few steps colleges and universities may be able to take to mitigate the effects of this decision. They could require parents to make payments into an account under the student’s control, and tuition payments could then be made by the student from that account when they are due. That could provide the institution with a defense to a claw-back claim under Bankruptcy Code section 550(b), which protects subsequent transferees who receive transfers for value, in good faith, and without knowledge of the voidability of the transfer. Institutions who litigate claw-back claims should also remember that it is the trustee’s burden to prove that the parents were insolvent when they made the tuition payments.

One thing seems certain—trustees will rely on the First Circuit’s decision to bolster their efforts to claw back tuition payments from educational institutions. It remains to be seen whether other circuits will follow that decision.