

LEGAL UPDATES

PUBLISHED: DECEMBER 16, 2019

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First Circuit Clarifies When College Tuition Can Be Considered a Fraudulent Transfer

Last month the First Circuit Court of Appeals became the first federal appellate court to take up the matter of whether college tuition paid for an adult child by a bankrupt parent constitutes a fraudulent transfer. Chief Circuit Judge Jeffrey R. Howard held in *DeGiacomo v. Sacred Heart University, Inc.* that the payments to the college in the case were constructively fraudulent transfers under Section 548(a)(1)(B) of the U.S. Bankruptcy Code, reversing the finding of the bankruptcy court and remanding the case for further proceedings.

The background

DeGiacomo v. Sacred Heart University, Inc. involved a lawsuit brought by a Chapter 7 bankruptcy trustee against Sacred Heart University attempting to claw back approximately \$65,000 that had been paid by the debtors to the college to fund their adult child's tuition. The litigation was brought under both the U.S. Bankruptcy Code and the Massachusetts Uniform Fraudulent Transfer Act. These payments occurred while the debtors were operating a multimillion-dollar Ponzi scheme through a closely-held company. After both parties filed cross-motions for summary judgment, the United States Bankruptcy Court for the District of Massachusetts granted the university's motion and denied the motion filed by the trustee; the trustee appealed directly to the U.S. Court of Appeals.

At the lower-court level there has been a significant divergence of opinion regarding how tuition payments made by debtors should be viewed within the scope of U.S. bankruptcy law. Judge Howard acknowledged this, writing that “[t]uition payments made by insolvent parents have divided the courts, although the recent cases have mostly ruled for trustees.”

DeGiacomo v. Sacred Heart University, Inc.

The trustee in this case appealed the bankruptcy court's order in favor of Sacred Heart, but did so only on the issue of its constructive fraud claim. On this issue the lower court had reasoned that the debtor parents' belief that a "financially self-sufficient daughter offered them an economic benefit" satisfied the "reasonably equivalent value standard" of § 548(a)(1)(B)(i). This is precisely where the First Circuit took exception.

The circuit court turned that logic upside down, holding that "courts evaluate transfers from the creditors' perspective, measuring value at the time of transfer." With that being the starting point, the court cited § 548(d)(2)(A) as providing a "straightforward" answer to the central question in *DeGiacomo v. Sacred Heart University, Inc.* and ultimately found that the tuition payments "furnished nothing of direct value to the creditors who are the central concern of the code provisions at issue."

What this means to you

If the First Circuit's jurisprudence on this issue is more fully recognized throughout the country, institutions of higher education will have a difficult time holding on to tuition payments made by insolvent parents who pay for their child's tuition and later file for bankruptcy. Additionally, these constructively fraudulent conveyance claw back actions can happen as much as four-years after the payment was made. This issue has had a limited impact over the past decade, as the U.S. economy has experienced a long, if slow, expansion and Chapter 7 consumer bankruptcy filings have declined for eight straight years; however, U.S. consumer debt is approaching \$14 trillion and many metrics used to determine the health of the American consumer display signs of stress. Colleges and universities would do well to evaluate their legal options now, while bankruptcy filings continue to ebb.

Contact us

If you have a question about potential changes in case law relating to tuition payments being categorized as constructively fraudulent transfers, contact Michael Fielding or your Husch Blackwell attorney.