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**Do Parents Receive Reasonably Equivalent Value for Paying College Tuition for their Children Making Such Payments Avoidable**

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**Introduction**

Under section 548 of title 11 of the United States Code (the “Bankruptcy Code”), a trustee may avoid a transfer by a debtor that was an actual or constructive fraud.<sup>1</sup> An actual fraudulent transfer is a transfer made with actual intent to hinder, delay, or defraud creditors.<sup>2</sup> In general, a constructive fraudulent transfer is a transfer or the incurrence of an obligation by a debtor that was made within two years before the date of filing the bankruptcy petition, for less than reasonably equivalent value, at a time when the debtor was insolvent and could not pay its debts and obligations as they became due.<sup>3</sup>

In the context of tuition payments made by a debtor for the benefit of a third party (e.g., their children), the courts appear to be divided on whether such payments may be avoided as fraudulent transfers.<sup>4</sup> This memorandum discusses whether debtor parents receive reasonably equivalent value in exchange for tuition payments thus, making them unavoidable as fraudulent

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<sup>1</sup> See 11 U.S.C. § 548(a)(1)(B)(i)–(ii) (2018).

<sup>2</sup> *Id.*

<sup>3</sup> See *In re Lyondell Chem. Co.*, 567 B.R. 55, 108–09 (Bankr. S.D.N.Y. 2017), *aff'd*, 585 B.R. 41 (S.D.N.Y. 2018); 11 U.S.C. § 548(a)(1)(A)–(B).

<sup>4</sup> See generally *In re Miami Neurological Inst.*, No. 17-10703-BKC-RAM, 2020 WL 3410182, at \*7 (Bankr. S.D. Fla. June 19, 2020) (holding tuition payments made by a debtor on behalf of debtor’s employees gave debtor “reasonably equivalent value”).

transfers. Part I analyzes how case law interprets indirect value received in exchange for a debtor's transfers. Part II examines how case law interprets intangible value received in exchange for a debtor's transfers. Part III addresses the current split in case law regarding whether a trustee for a debtor parent may avoid college tuition payments made on behalf of the debtor's children, as fraudulent transfers.

### **I. Indirect Value May Provide Reasonably Equivalent Value**

Under section 548(d)(2) of the Bankruptcy Code “‘value’ means property, or satisfaction or securing of a present or antecedent debt of the debtor but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor.”<sup>5</sup> Although the statute defines “value,” both the statute and the legislative history fail to define “reasonably equivalent value.”<sup>6</sup> When analyzing whether a debtor received value, “[c]ourts generally construe the term ‘value’ broadly for purposes of the Bankruptcy Code.”<sup>7</sup>

When analyzing whether a debtor received reasonably equivalent value in exchange for a transfer, a court will evaluate whether (1) the debtor received value, and (2) the value received was reasonably equivalent to the value transferred.<sup>8</sup> After a defendant establishes that the debtor has indeed received value, the burden shifts to the trustee to show that the debtor did not receive reasonably equivalent value.<sup>9</sup> In analyzing whether a debtor received “reasonably equivalent value,” courts have used a broad interpretation.<sup>10</sup>

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<sup>5</sup> 11 U.S.C. § 548(d)(2)(a) (2018).

<sup>6</sup> See Andrew Mackenzie, *The Tuition “Claw Back” Phenomenon: Reasonably Equivalent Value and Parental Tuition Payments*, 3 COLUM. BUS. L. REV. 924, 931 (2016).

<sup>7</sup> *In re PSN USA, Inc.*, 615 F. App'x 925, 930 (11th Cir. 2015).

<sup>8</sup> See *In re Miami Neurological Inst.*, 2020 WL 3410182, at \*4.

<sup>9</sup> See *id.* at \*6.

<sup>10</sup> See *id.* at \*7 (holding tuition payments made by a debtor on behalf of debtor's employees gave debtor “reasonably equivalent value”).

Courts have generally held value received by a debtor indirectly, where the initial benefit has gone to a third person, can provide reasonably equivalent value under section 548.<sup>11</sup>

The seminal case on the matter is *Rubin v. Hanover Mfr. Trust*. 661 F.2d 979 (2d Cir. 1981).<sup>12</sup> In *Rubin v. Hanover*, the United States Court of Appeals for the Second Circuit held a debtor could have received value indirectly through the ability to settle its accounts quicker thereby increasing available funds, and by receiving a source of working capital to keep the debtor in business in exchange for loans made by the debtor to third parties.<sup>13</sup> The Second Circuit remanded and directed the lower court to consider the monetary value of these exchanges but noted when calculating value received versus value transferred, the court need not require “a penny-for-penny exchange.”<sup>14</sup> The Bankruptcy Court for the Eastern District of Michigan followed the indirect benefit rule established by *Rubin* but narrowed the applicability to only situations where the value received was (1) an economic benefit, (2) that was concrete, and (3) quantifiable.<sup>15</sup>

## II. Intangible Benefits May Provide Reasonably Equivalent Value

Courts have frequently held that “[e]ven intangible property can confer value on a debtor.”<sup>16</sup> In one case, a court held that educational benefits received by debtor’s employees conferred intangible value to debtor when said employees used that knowledge to implement

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<sup>11</sup> See *In re Jeffrey Bigelow Design Grp.*, 956 F.2d 479, 485 (4th Cir. 1992) (“It is well settled that reasonably equivalent value can come from one other than the recipient of the payments, a rule which has become known as the indirect benefit rule.”); *In re PSN USA, Inc.*, 615 F. App’x at 933 (holding debtor received reasonably equivalent value in exchange for \$3 million in payments made under a contract between debtor’s parent company and a third party satellite service, to which debtor was not a party, because debtor received satellite services under the contract and indirectly benefitted from any benefit to the parent company).

<sup>12</sup> 661 F.2d 979 (2d Cir. 1981).

<sup>13</sup> *Id.* at 993–94.

<sup>14</sup> *Id.* at 994.

<sup>15</sup> See *In re Leonard*, 454 B.R. 444, 457–59 (Bankr. E.D. Mich. 2011) (holding “speculative and unquantifiable claims of psychological benefits,” received by debtor parents in exchange for paying their son’s college tuition, did not provide reasonably equivalent value).

<sup>16</sup> See *In re Miami Neurological Inst.*, No. 17-10703-BKC-RAM, 2020 WL 3410182, at \*4 (Bankr. S.D. Fla. June 19, 2020).

better operational strategies by negotiating for better insurance rates and decreasing collection times on accounts receivable.<sup>17</sup> Another court held debtors received reasonably equivalent value not only through cash received, but through the value in a repurchase option and the debtors' ability to continue to run debtors' business.<sup>18</sup> Courts have even held promises to provide future services to be intangible, reasonably equivalent value transfers, that had an ascertainable economic benefit.<sup>19</sup>

### **III. There is a Split in Case Law on Whether Debtor Parents Receive Indirect, Intangible Value in Exchange for Paying their Children's College Tuition**

There is currently a split in case law on the issue of whether college tuition payments made by a debtor parent on behalf of their children are avoidable under section 548(d)(2)(a) of the Bankruptcy Code.<sup>20</sup> The source behind the different conclusions on the same issue, starts with which circumstances of the issue the court focuses on and how broadly the court interprets the language of section 548.<sup>21</sup>

#### ***A. A Debtor Parent Receives Indirect, Intangible Value in Exchange for Paying Their Children's College Tuition***

The Bankruptcy Court for the Western District of Pennsylvania held payments made by debtor parents for undergraduate tuition were not avoidable as fraudulent transfers under section 548 because they provided reasonably equivalent value in an indirect, intangible form.<sup>22</sup> There, the court disregarded a precedent that held "parents are not responsible for the educational support of their children past high school," and stated "[w]hile the Pennsylvania legislature has

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<sup>17</sup> *Id.* at \*5.

<sup>18</sup> *In re Calvillo*, 263 B.R. 214, 220 (W.D. Tex. 2000).

<sup>19</sup> *See In re Pawlak*, 483 B.R. 169, 185 (Bankr. W.D. Wis. 2012) (holding promise to provide future legal services provided reasonably equivalent value).

<sup>20</sup> *See Derek A. Huish, Clawing Back Tuition Payments in Bankruptcy: Looking to Ancient and Recent History to Define the Future*, 104 IOWA L. REV. 2151, 2182 (2019).

<sup>21</sup> *See id.*

<sup>22</sup> *In re Cohen*, No. ADV 07-02517-JAD, 2012 WL 5360956, at \*10 (Bankr. W.D. Pa. Oct. 31, 2012), *aff'd in part, vacated in part on other grounds, remanded sub nom*, *Cohen v. Sikirica*, 487 B.R. 615 (W.D. Pa. 2013).

not yet enacted a statute that requires parents to pay for their children’s post-secondary education . . . such expenses are reasonable and necessary for the maintenance of the Debtor’s family . . . ” thus, taking a very broad view of “intangible.”<sup>23</sup> Identically, a year later, the same court denied a trustee’s request to avoid tuition payments, holding payments made by debtor parents for their children’s undergraduate tuition were a “necessity” even though there was not a legal obligation for parents to pay their children’s undergraduate tuition.<sup>24</sup> The court acknowledged an intangible, “societal expectation” that obligates parents to do so.<sup>25</sup> Similarly, the Bankruptcy Court for the Eastern District of Pennsylvania held such transfers were not avoidable because they are “reasonable and necessary expense[s] for maintenance of the family and for preparing family members for the future,” thus, taking another broad view that tuition coverage indirectly conveyed intangible, reasonably equivalent value to the debtor parent.<sup>26</sup>

In 2018, the Bankruptcy Court for the Southern District of New York created a split on the issue within their own district by holding such transfers were not avoidable. The bankruptcy court reasoned that in exchange for the tuition payments made for the benefit of debtors’ children, debtors indirectly received reasonably equivalent value through means of satisfaction of an intangible, societal obligation to fund their children’s college education.<sup>27</sup> However, the *Sterman* court drew a line defining this broad view, holding the transfers made for the benefit of the debtors’ children after they turned twenty-one, when they were becoming financially independent, were avoidable under section 548.<sup>28</sup>

***B. A Debtor Parent Does Not Receive Indirect, Intangible Value in Exchange for Paying Their Children’s College Tuition***

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<sup>23</sup> *Id.* at \*9–10.

<sup>24</sup> *In re Oberdick*, 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013).

<sup>25</sup> *Id.*

<sup>26</sup> *In re Lewis*, 574 B.R. 536, 541 (Bankr. E.D. Pa. 2017).

<sup>27</sup> *In re Sterman*, 594 B.R. 229, 238–39 (Bankr. S.D.N.Y. 2018).

<sup>28</sup> *Id.* at 239.

The Bankruptcy Court for the Eastern District of Michigan held tuition payments made by debtor parents for their eighteen-year-old son were avoidable as fraudulent transfers.<sup>29</sup> It was argued that debtors indirectly received the intangible benefits of peace of mind in anticipation that their son would not need their financial support in the future, after he received an education.<sup>30</sup> The court noted the Bankruptcy Code does not define “reasonably equivalent value” and proceeded to analyze precedent following the indirect benefit rule that was established by *Rubin* but interpreted it narrowly, holding any indirect benefit flowing to debtor had to be (1) an economic benefit, (2) that was concrete, and (3) that was quantifiable.<sup>31</sup> The court reasoned satisfactions of moral obligations do not bestow any concrete, economic value on debtors, especially since there is no legal obligation to support adult children, and higher education does not necessarily guarantee financial success for the child.<sup>32</sup> Specifically, the court stated “[s]peculative and unquantifiable claims of psychological benefits cannot meet Marquette’s [the fraudulent transferee’s] burden.”<sup>33</sup>

In *In re Lindsay*, the Bankruptcy Court for the Southern District of New York held tuition payments made by debtor parent were avoidable as fraudulent transfers and actually ordered the debtor to personally pay back the trustee.<sup>34</sup> Similar to *In re Leonard*, the Lindsey court reasoned that there was no law requiring parents to pay for their children’s college education and highlighted the lack of precedent to support the debtor’s argument that satisfaction of an intangible, moral obligation is a defense to section 548.<sup>35</sup>

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<sup>29</sup> *In re Leonard*, 454 B.R. 444, 459 (Bankr. E.D. Mich. 2011).

<sup>30</sup> *Id.* at 454–55.

<sup>31</sup> *See id.* at 456–57.

<sup>32</sup> *Id.* at 457.

<sup>33</sup> *Id.* at 459.

<sup>34</sup> No. 06-36352 (CGM), 2010 WL 1780065, at \*9–10 (Bankr. S.D.N.Y. May 4, 2010).

<sup>35</sup> *See id.*

The First Circuit overruled the Massachusetts Bankruptcy Court’s decision that college tuition payments made on behalf of debtors’ child were not avoidable because they contributed to future self-sufficiency of the child.<sup>36</sup> The lower court had held college tuition payments made on behalf of debtors’ child were not avoidable because they contributed to future self-sufficiency of the child which was “concrete and quantifiable enough.”<sup>37</sup> In overruling the lower court, similarly, to the above case law focusing on concrete, economic, quantifiable value, the First Circuit held none of the five recognized classes of transactions that confer value were present: (1) the exchange of property; (2) the satisfaction of a present debt; (3) the satisfaction of an antecedent debt; (4) the securing or collateralizing of a present debt; and (5) the granting of security for the purpose of securing an antecedent debt, and there was no legal obligation to pay a child’s college tuition, thus providing debtor parents with no reasonably equivalent value.<sup>38</sup>

The Bankruptcy Court for the District of Connecticut also held such payments were avoidable under section 548.<sup>39</sup> The court acknowledged “concerns about familial obligations,” but referred to the intent of Congress in holding such transfers to be avoidable.<sup>40</sup> Specifically, the court stated “it is not for us to speculate, much less act, on whether Congress would have altered its stance” based on the issue in this case.<sup>41</sup> The court also stated that although “such support [was] unquestionably admirable,” there was no legal obligation to pay for debtor’s child’s college education, thus the transfer did not give debtor reasonably equivalent value.<sup>42</sup>

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<sup>36</sup> *In re Palladino*, 942 F.3d 55 (1st Cir. 2019).

<sup>37</sup> *In re Palladino*, 556 B.R. 10, 16 (Bankr. D. Mass. 2016), *rev'd and remanded*, 942 F.3d 55 (1st Cir. 2019).

<sup>38</sup> *In re Palladino*, 942 F.3d at 59.

<sup>39</sup> *In re Knight*, No. 15-21646 (JJT), 2017 WL 4410455, at \*7 (Bankr. D. Conn. Sept. 29, 2017).

<sup>40</sup> *Id.* at \*4.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at \*5.



Likewise, the Bankruptcy Court for the Southern District of Georgia held such tuition payments to be avoidable under section 548.<sup>43</sup> The Georgia bankruptcy court acknowledged that “the debtor may have felt a moral obligation to pay for [their child’s] college education and help her to achieve financial independence,” but held the satisfaction of such intangible, moral obligations did not provide the debtor parent with reasonably equivalent value.<sup>44</sup> The debtor did not receive any form of economic benefit; they did not discharge or satisfy any legal obligations, nor did they increase their assets in any way.<sup>45</sup>

In comparison, when analyzing the issue in another context, a court recently held a debtor indirectly received reasonably equivalent value when the debtor paid its employees’ tuition and an employee used the knowledge gained to negotiate better insurance rates and decrease collection times on accounts receivable for the debtor.<sup>46</sup> Although the court did not explicitly state that value received had to be economic, concrete, and quantifiable, the court did go through an analysis to determine whether the value received roughly equaled the value transferred.<sup>47</sup> Currently, this is the only case that has addressed the issue in the employer-employee context.

## **Conclusion**

There are two starkly different approaches that courts take when it comes to deciding whether a debtor parent receives reasonably equivalent value in exchange for paying their child’s college tuition. Courts seemingly agree that value may include an indirect benefit but appear to disagree on the breadth of latitude with which they interpret “intangible benefits.”<sup>48</sup> Courts

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<sup>43</sup> See *Matter of Dunston*, 566 B.R. 624, 637 (Bankr. S.D. Ga. 2017).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *In re Miami Neurological Inst.*, No. 17-10703-BKC-RAM, 2020 WL 3410182, at \*7 (Bankr. S.D. Fla. June 19, 2020).

<sup>47</sup> *Id.* at \*5.

<sup>48</sup> See *In re Leonard*, 454 B.R. 444, 457 (Bankr. E.D. Mich. 2011); *In re Sterman*, 594 B.R. 229, 238 (Bankr. S.D.N.Y. 2018).

holding debtor parents do not receive reasonably equivalent value focus on whether parents received “concrete, economic, and quantifiable” value which is a more traditional view of the definition of “value” within the Bankruptcy Code.<sup>49</sup> In contrast, courts holding debtor parents receive reasonably equivalent value focus on a broad interpretation of intangible benefits such as satisfaction of “societal obligations” and “necessities” to “maintain the family.”<sup>50</sup>

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<sup>49</sup> See *In re Leonard*, 454 B.R. at 459; *In re Palladino*, 556 B.R. 10, 16 (Bankr. D. Mass. 2016), *rev'd and remanded*, 942 F.3d 55 (1st Cir. 2019).

<sup>50</sup> See *In re Sterman*, 594 B.R. at 238; *In re Oberdick*, 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013).